

TAX-BENEFIT POLICIES IN LATVIA: EQUITY CONSIDERATIONS AND IMPLICATIONS FOR SUSTAINABLE FISCAL POLICY

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Main questions

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- Why inequality in the context of fiscal policy?
- Does the current tax-benefit system provide sufficient protection against poverty and reduce inequality?
- Does the current tax-benefit system “make work pay”?
- What are the policy options to improve protection and promote employment?

Equity, fiscal policy and inclusive growth

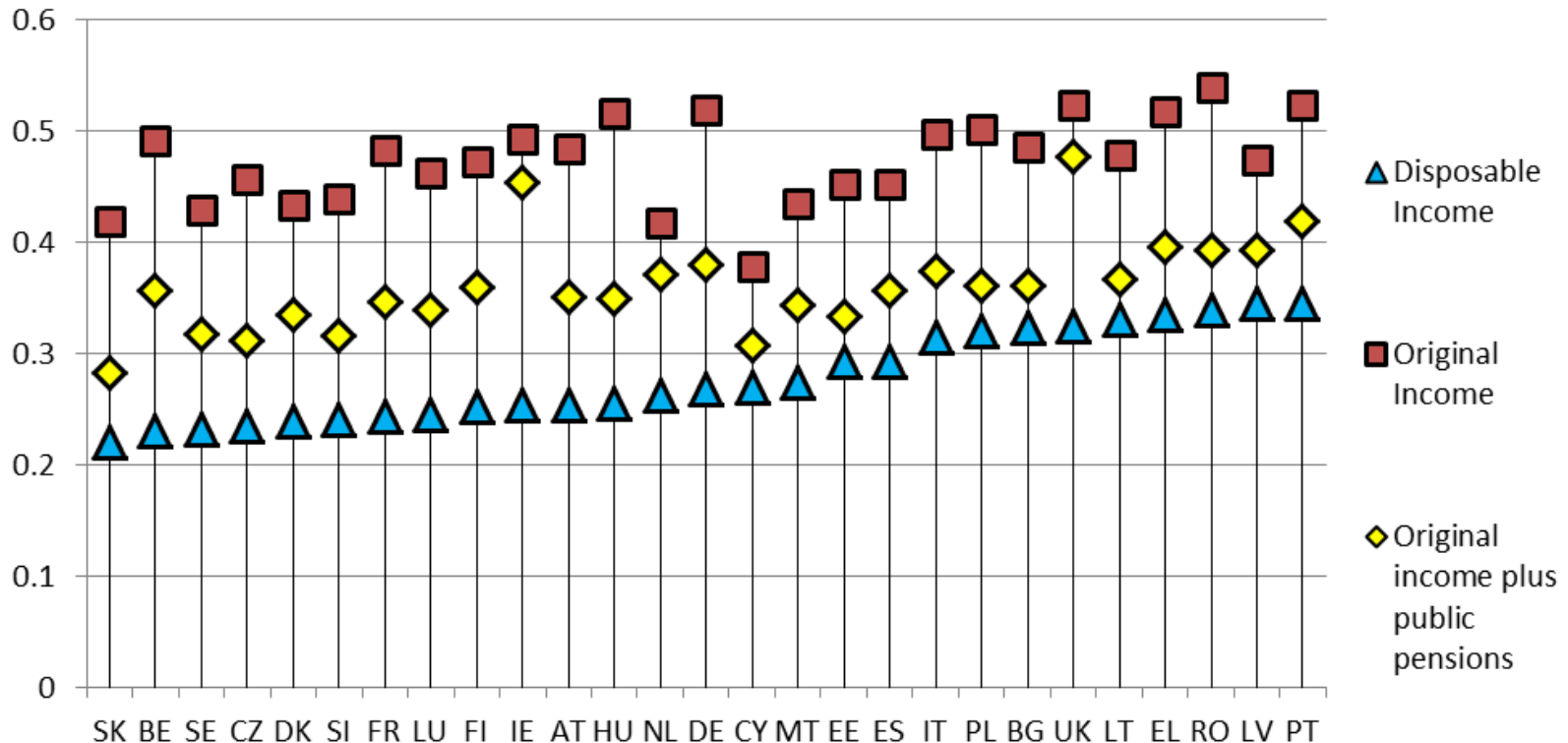
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- Although some inequality is deemed necessary to provide incentives for investment and economic growth (Barro, 2000; Forbes, 2000)...
 - ▣ Lower income inequality is important for achieving greater equality of opportunities
 - ▣ There is also evidence that high inequality may retard growth (Berg and Ostry, 2011)
- Reducing income inequality while boosting economic growth?
 - ▣ “Win-win” policies: better-targeted subsidies/benefits, improvements in economic opportunities for the poor, and active labor market policies that promote employment

The tax and benefit system contributes relatively little to income inequality reduction

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Income inequality (Gini coefficient) before and after taxes and benefits (2010 policies)



Notes: Countries ordered according to the value of the Gini coefficient of disposable income. In the calculation of Gini coefficients negative income has been replaced by zero.

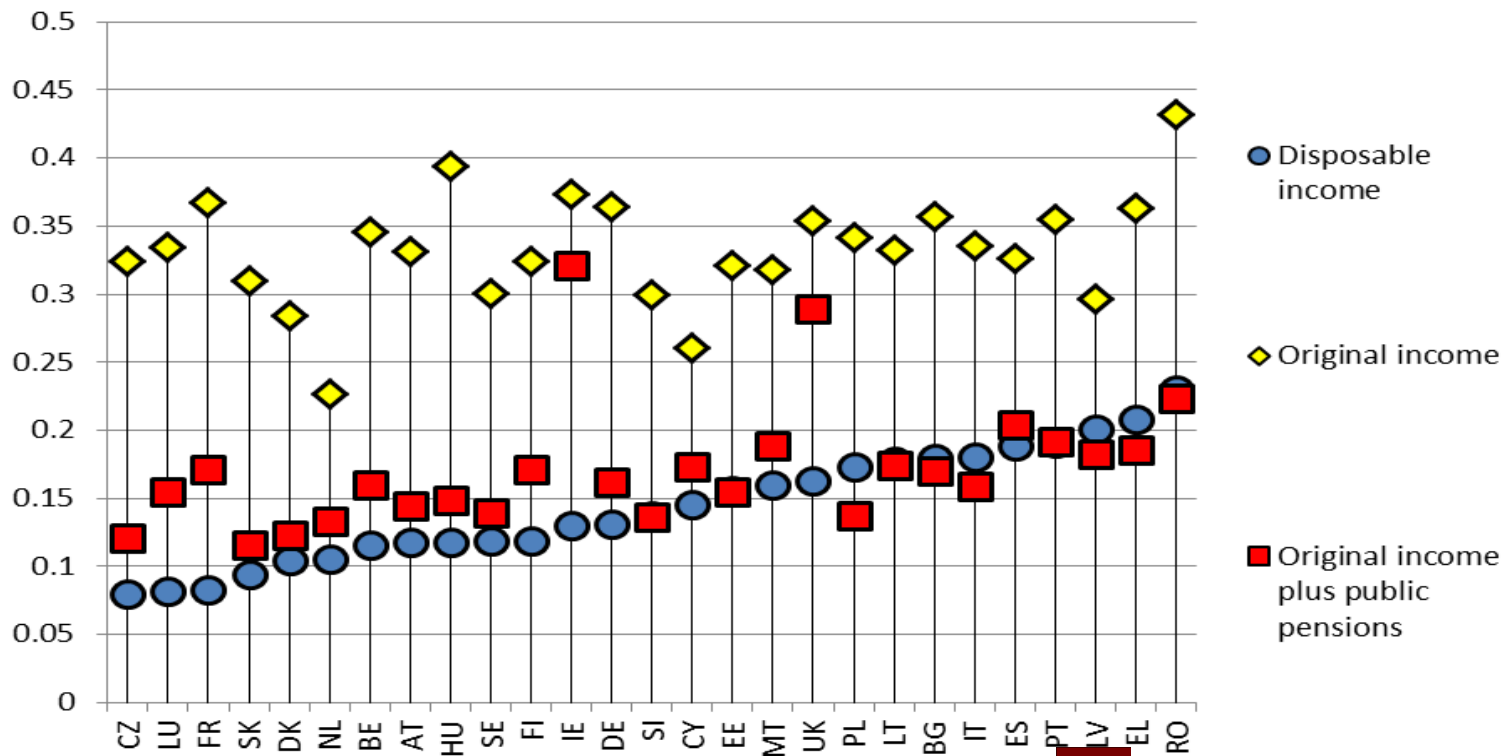
Source: EUROMOD version F6.0. See Background information for details of data sources.

European Social Situation Observatory – Income distribution and living conditions

Poverty rates remain high after taxes and transfers

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Poverty risk (60% median household disposable income): effects of benefits net of taxes and (employee/self-employed) SICs on all income (2010 policies)



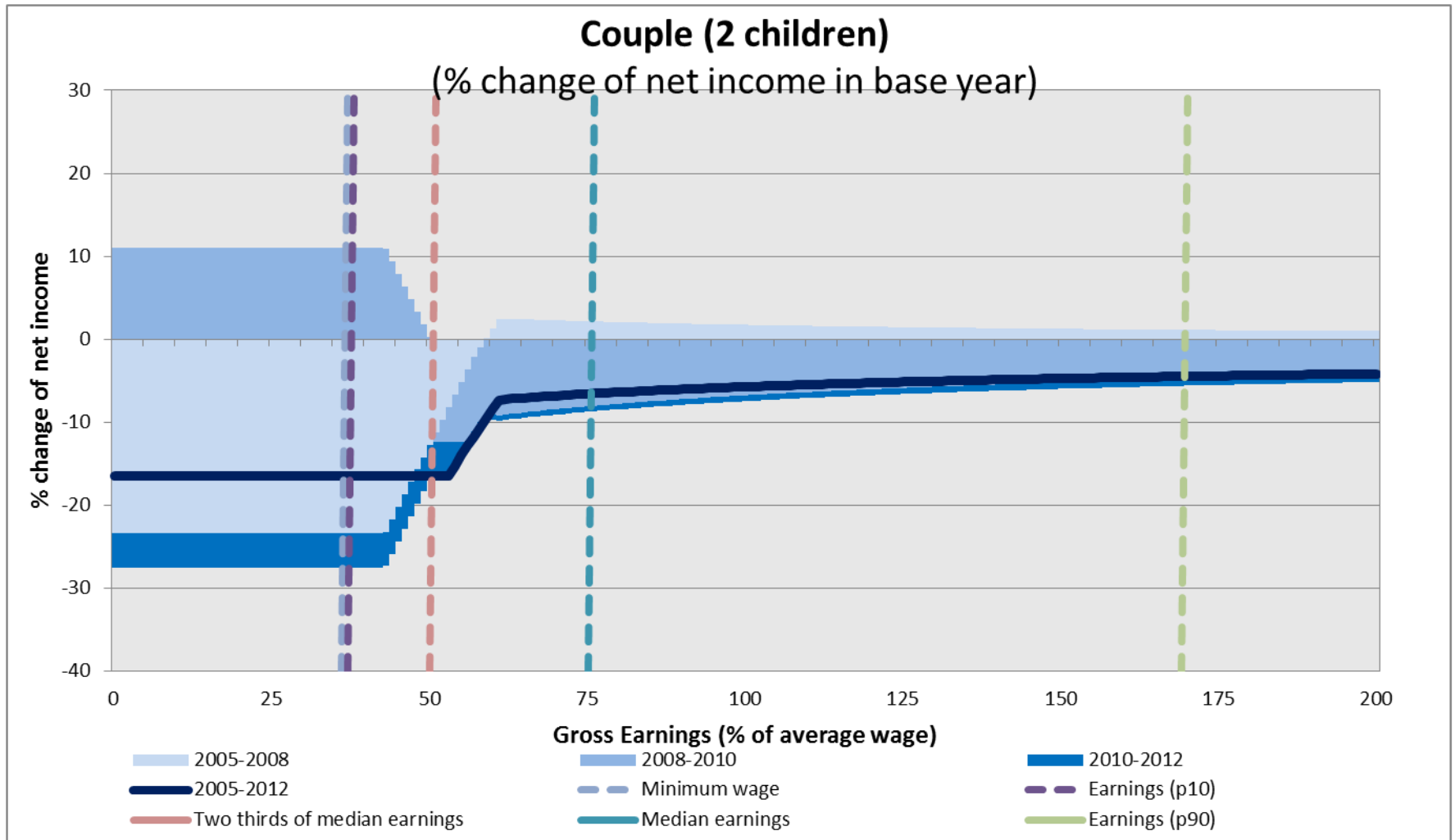
Notes: Poverty risk is the percentage of people in households with equivalised disposable income below the national poverty threshold. The poverty threshold is 60% of the median equivalised disposable income. Countries are ranked by poverty risk using this measure.

Source: EUROMOD version F6.0. See Background information for details of data sources.

European Social Situation Observatory – Income distribution and living conditions

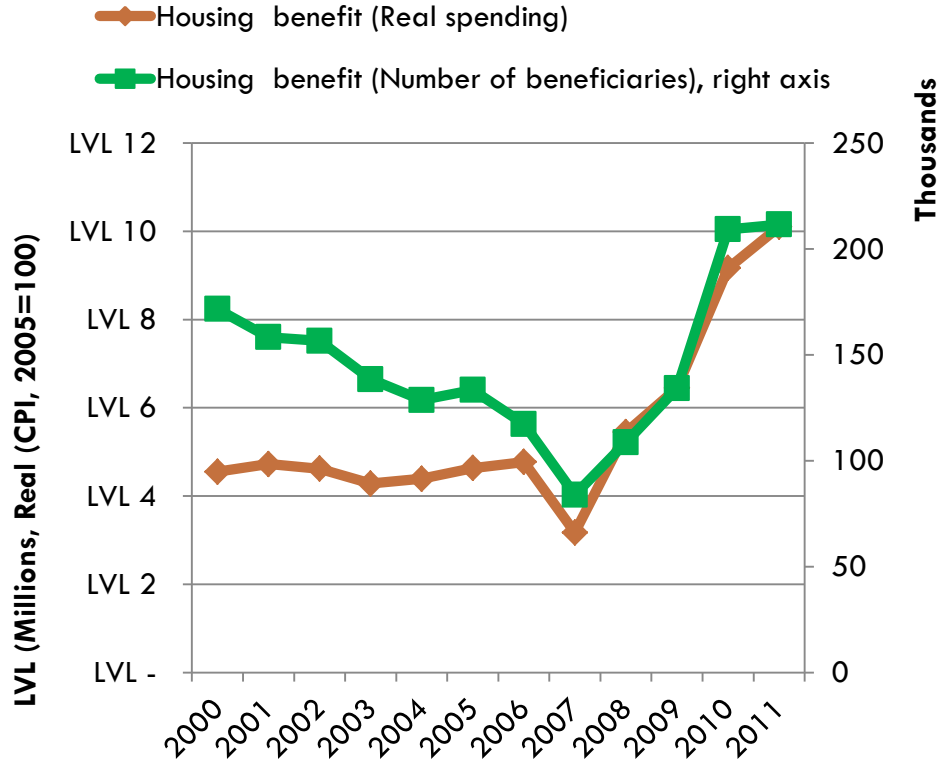
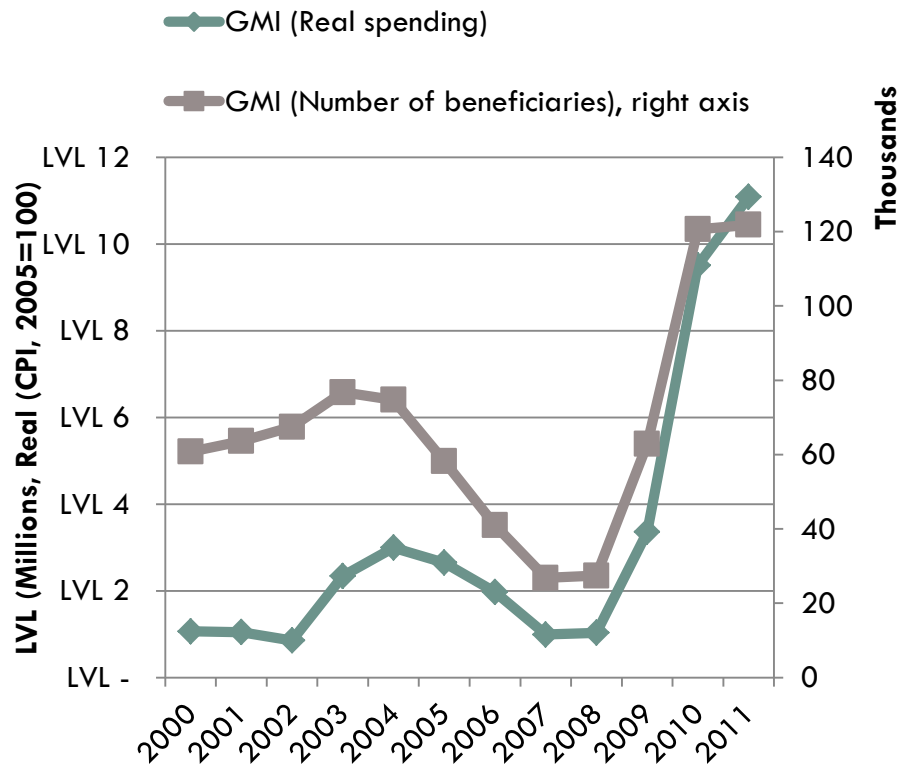
Income changes as a result of tax and benefit policies since 2005

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Unlike in some other countries with large austerity programs, the safety net in Latvia did expand during the crisis

...but policy adjustments were needed and coverage remains low

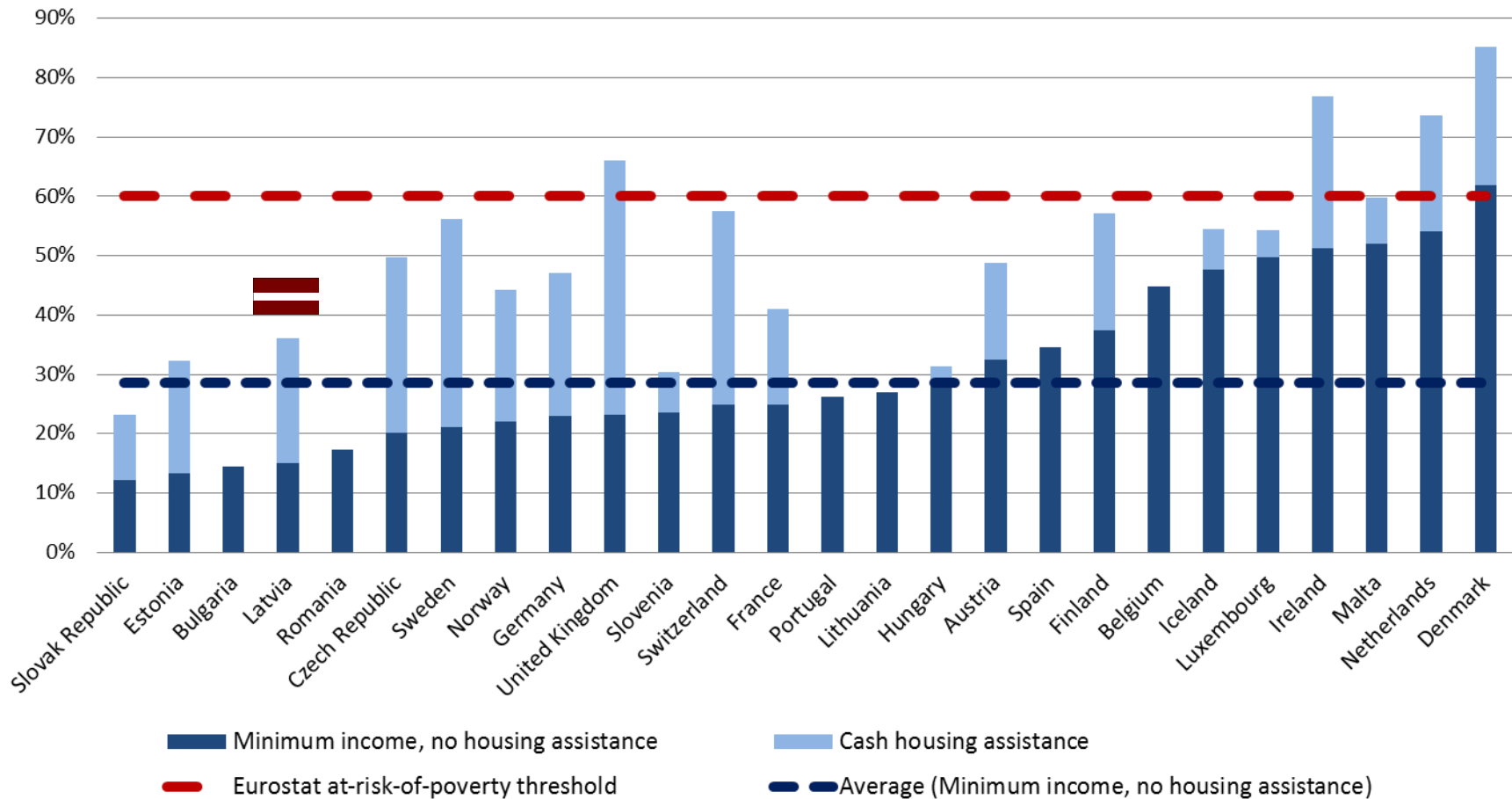


Source: Administrative data from MoW.

GMI program recipients are at a high risk of poverty

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Single person

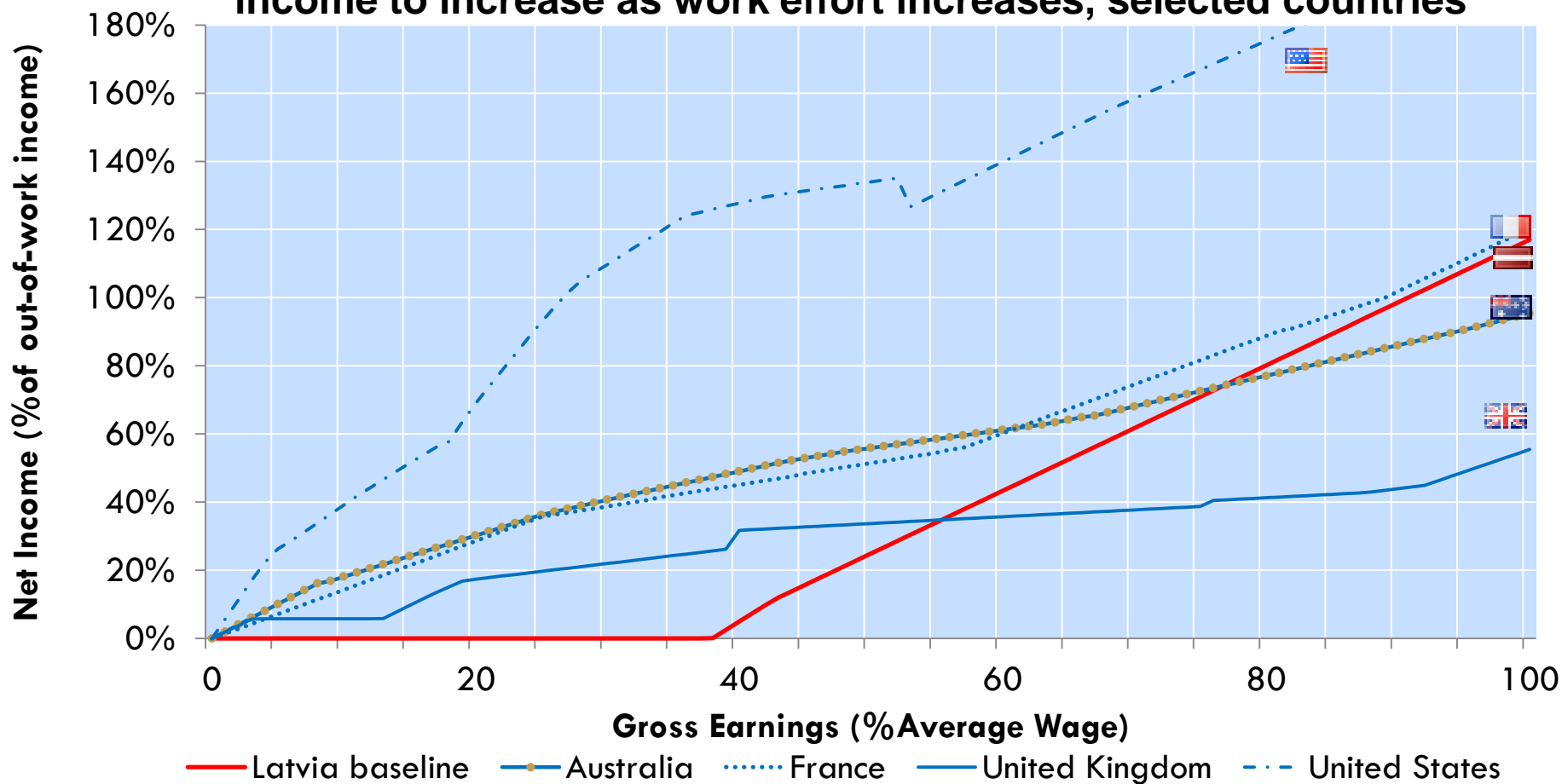


Source: World Bank calculations using OECD, Tax-Benefit Models for single person.

GMI recipients lose all social assistance when moving to a low paid job in Latvia

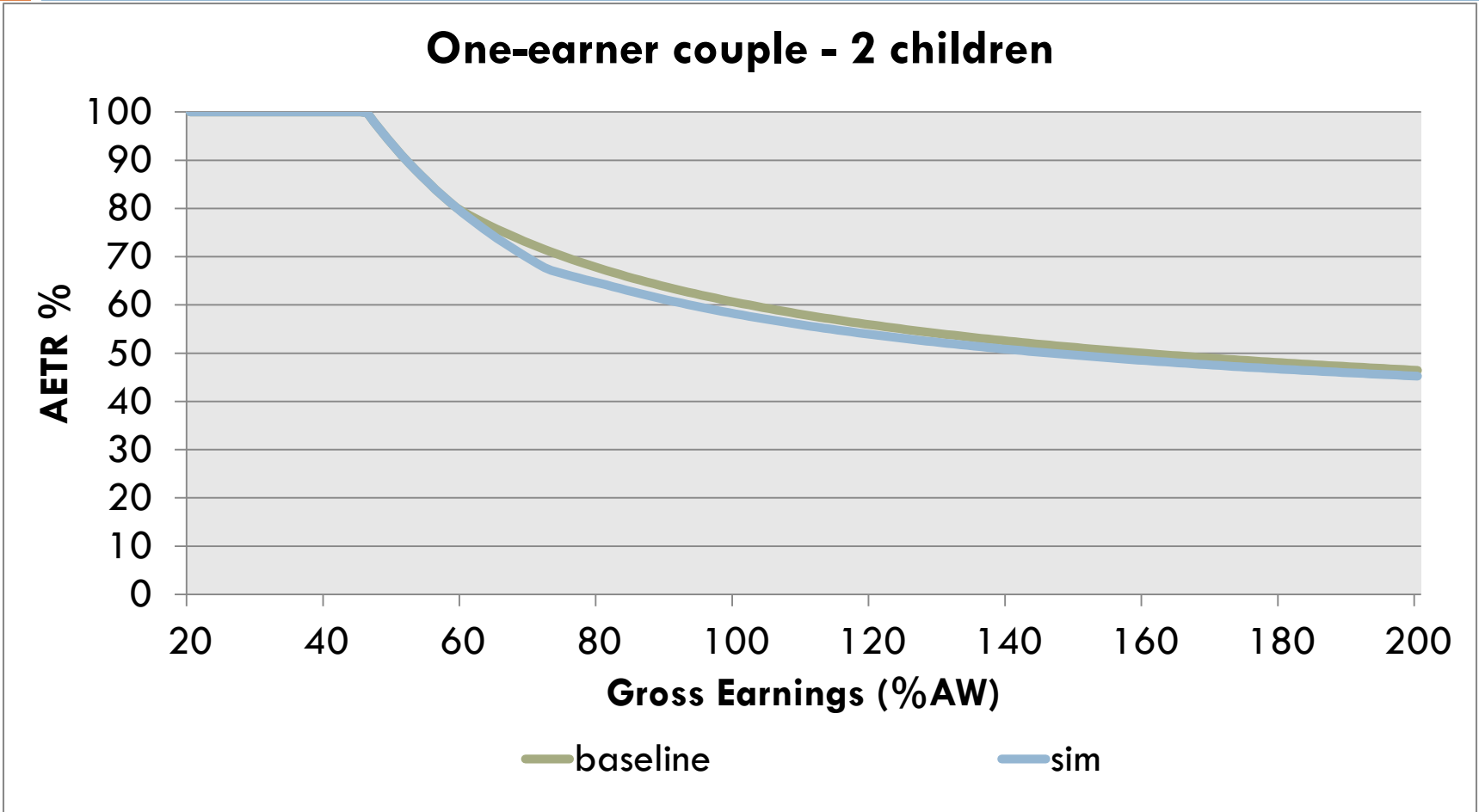
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In-work benefits for low income households allow after-benefit and tax income to increase as work effort increases, selected countries



Source: World Bank calculations using OECD, Tax-Benefit Models for Lone parent with two children.

The proposed reform on non-taxable minimum won't have a large enough effect on work incentives

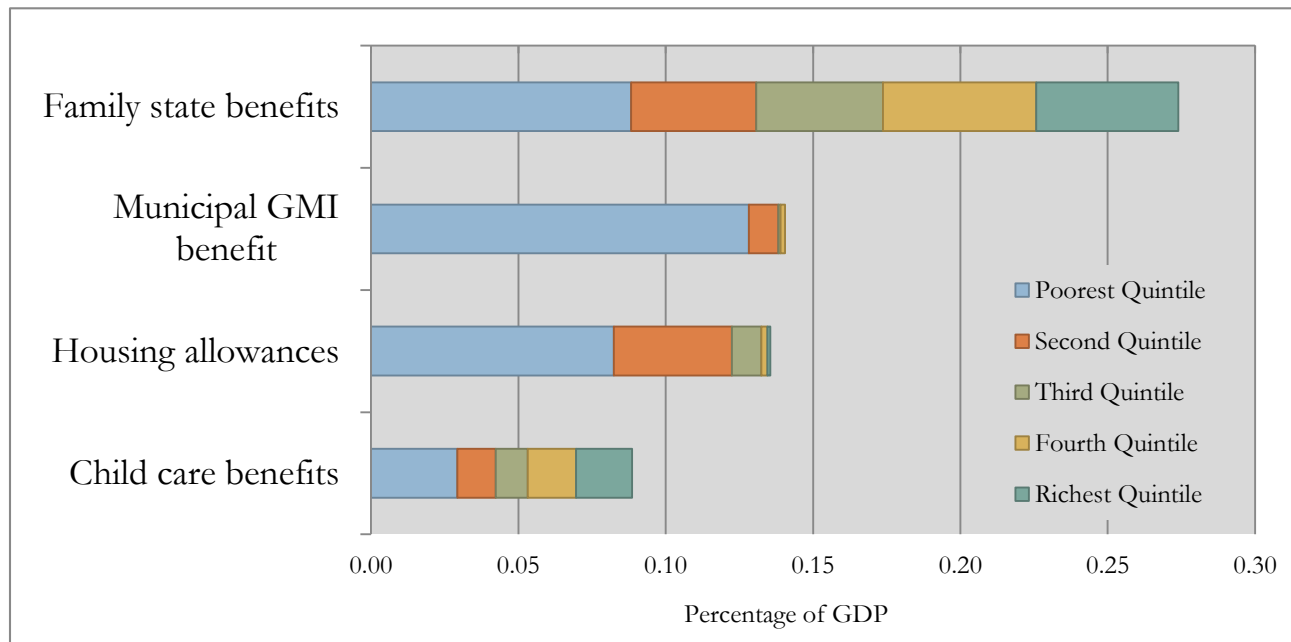


Notes:
baseline scenario - MW = 200 Ls, personal allowance = 45 Ls, dependant allowance = 80 Ls
simulation scenario - MW = 225 Ls, personal allowance = 84 Ls, dependant allowance = 98 Ls

One can do more within the same budget

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- Most of the spending on the GMI program (91 percent) goes to the poorest quintile
- While two thirds of the Family State Benefit goes to the non-poor
- Making the GMI program more adequate (in line with OECD average) would only cost 0.5 percent of GDP



OECD policies to “make work pay”

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- Many countries operate **gradual benefit phase-outs** for individuals who manage to earn only limited amounts
 - Tapered withdrawal of social assistance in France, Universal Credit in the UK
- **Employment-conditional (“in-work”) benefits or tax credits** that support the incomes of workers in non-marginal employment
 - ▣ Reduced social security contributions and/or taxes for low-wage employment
 - ▣ Temporary benefits (“back to work bonuses”)
 - ▣ Permanent benefits (periodic payments via benefit or tax system), e.g. US Earned Income Tax Credit

Policy options to improve protection and promote inclusive growth

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- Benefit adequacy could be improved, while simultaneously pay off from work can be increased
 - ▣ Coverage and generosity of means-tested benefits
 - ▣ Earned income disregards
- Financial incentives to take up low-wage employment could be enhanced
 - ▣ “Back to work” bonuses (for long-term unemployed/GMI beneficiaries, etc.)
 - ▣ A permanent in-work benefit scheme
- Fiscal incidence analysis is needed to comprehensively assess how taxation and public expenditures affect income inequality, poverty, and different socioeconomic groups



THANK YOU!

Tax-Benefit Model

- Based on the 2010 OECD model
 - ▣ Updated with parameters effective in 2012
- ➔ Combined effect of taxation and benefit systems on net income of individuals and other select types of households
 - ▣ single
 - ▣ single parent with two children
 - ▣ one-earner couple without children
 - ▣ one-earner couple with two children
- Taxation and benefits included:
 - ▣ Guaranteed Minimum Income (GMI) program
 - ▣ Housing benefits
 - ▣ Family State Benefit
 - ▣ Income taxes and contributions
- Outputs: net replacement rates, participation tax rates, marginal effective tax rates