

# INCOME REDISTRIBUTION AND WORK INCENTIVES IN LATVIA AND OTHER EU MEMBER STATES

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# Content

1. Related literature: income redistribution and work incentive in EU
2. The approach / methodology
3. The degree of income redistribution ensured by the tax-benefit systems in EU
4. The work incentives ensured by the tax benefit systems of EU Member States

# Related literature

- **The degree of income redistribution generated by the tax-benefit systems in EU Member States:** Avram et al., 2012;
- **The work incentives generated by the tax benefit systems of EU Member States:** Vork, 2009; Brewer, M. et al., 2010.
  
- **The trade-off between income redistributions and work incentives:**
  - Jara H. X. and Tumino A., 2013; Jara, H.X. et. al., 2012, Mirlees et al, 2010; Brewer, M., et al, 2010; Meghir and Phillips, 2010; Adam S. et al., 2006; Jara, H.X. et. al., 2012,
  
- **People on low incomes, mothers with children and people at pre-retirement age – are most sensitive to the incentive structures implicit in the tax benefit system**
  - Brewer et al 2006; Karabarbounis, 2012; Meghir and Phillips, 3 2009.

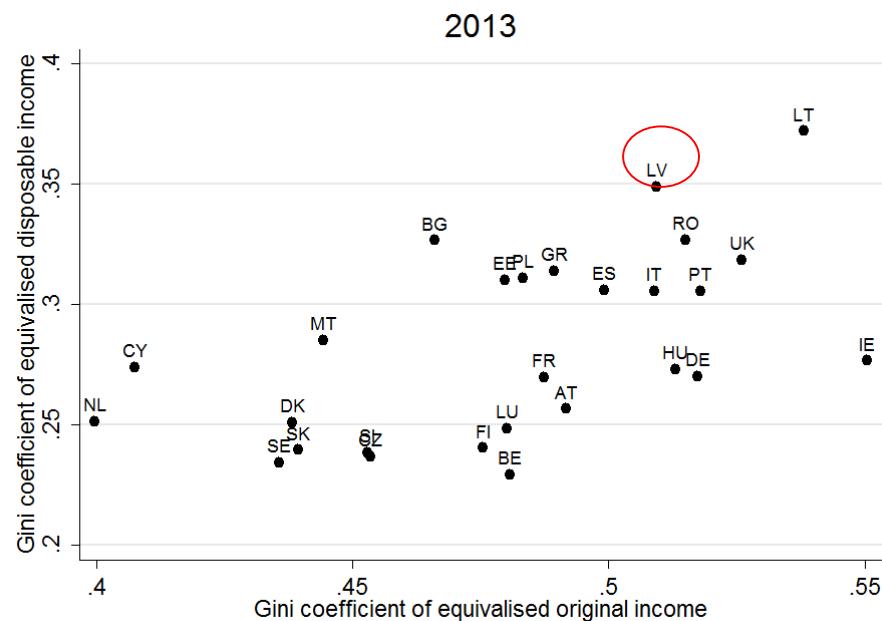
# Related literature (cont.)

- The indicators used to compare the efficiency and equity of tax-benefit systems among the states:
- (Jara H. X. and Tumino A., 2013; Adam S. et al., 2006; Avram et al., 2012)
- A measure of the degree of income redistribution – **reduction in Gini coefficient ensured by direct taxes, benefits and pensions**
- A measure of work incentives – **marginal effective tax rates (METR)** – is defined as the proportion of a small increase in earnings that is lost in tax and withdrawn benefits

# Approach / Methodology: What is EUROMOD?

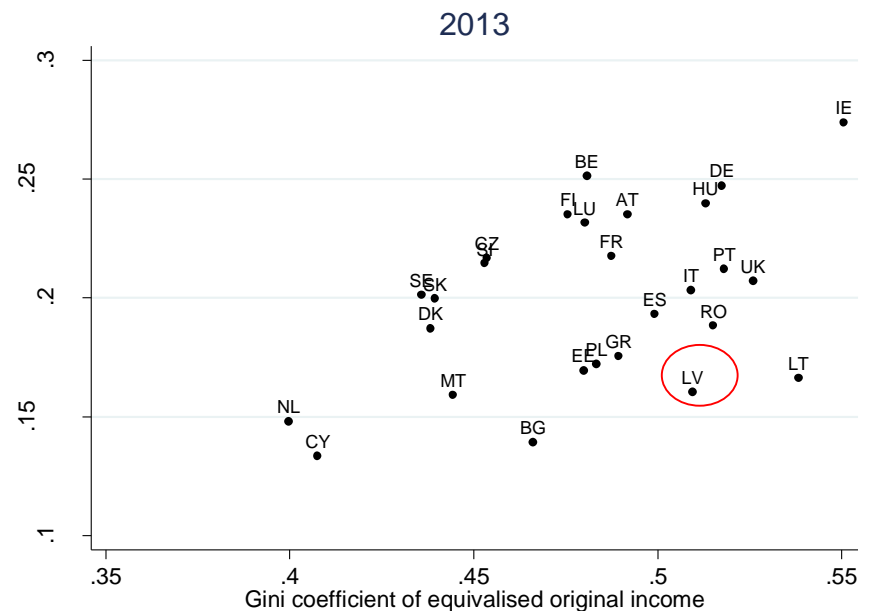
- EUROMOD is a static microsimulation tax-benefit model
  - Deal with income
  - Re-calculate income components (taxes and benefits) under different assumptions (policy reforms, macroeconomic changes)
- A unique model – EUROMOD is built for all EU-27 countries using a unified methodology, which allows for cross-country comparison of the model output (financed by DG-EMPL)
- Based on micro level representative national data
  - ❑ information at the individual level on household demographic, labour market characteristics, gross market income and all the other income sources (i.e. pensions, public transfers and private incomes)
  - ❑ not adjusted for labour market and demographic changes that took place over this period

# Inequality of original income in Latvia corresponds to EU average, inequality of disposable income is one of the highest in EU



Source: EUROMOD, versija Nr. F6.o++

# The degree of income redistribution in Latvia is relatively low

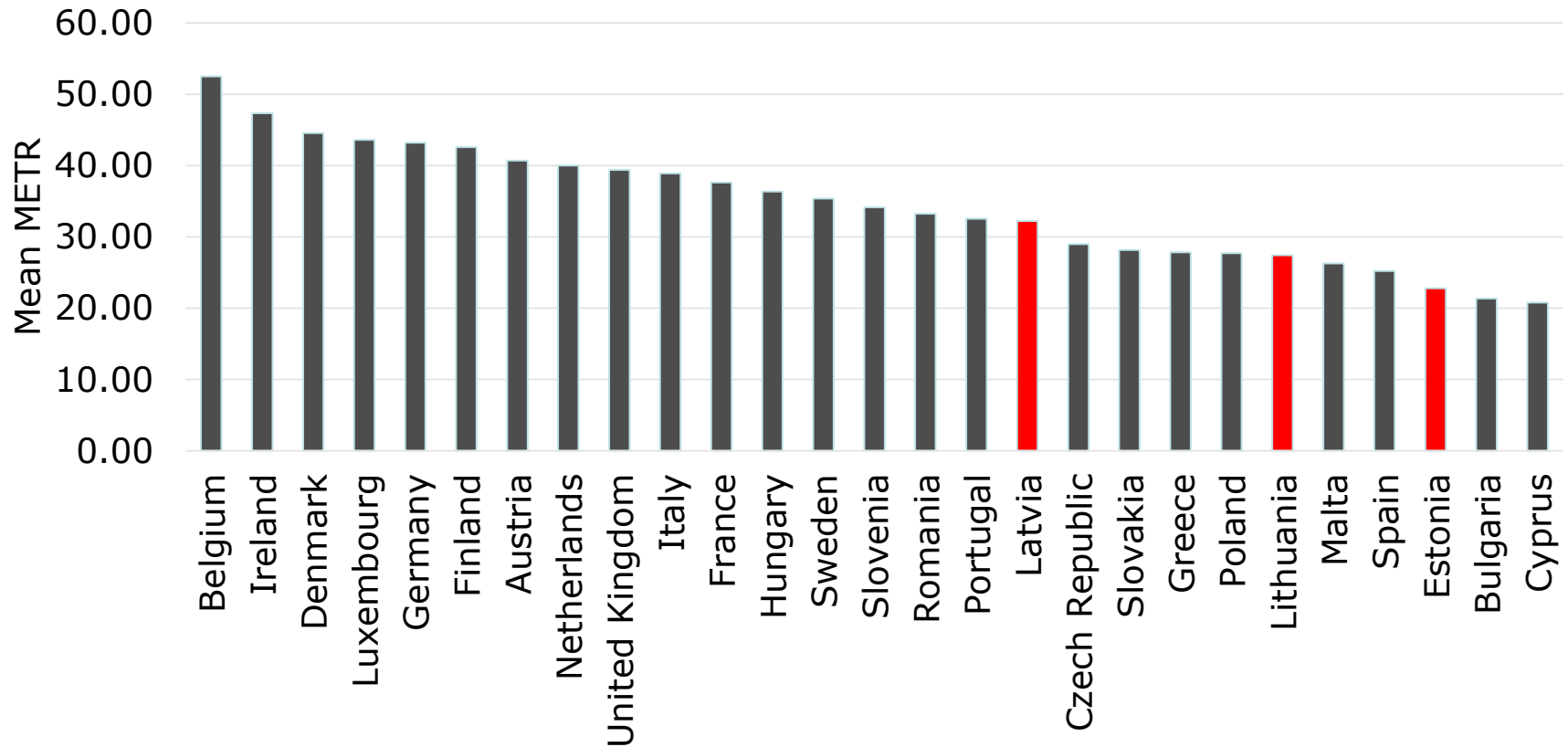


Avots: EUROMOD, versija Nr. F6.o++

During the period from 2008 to 2013, the degree of income redistribution in Latvia increased.

# Average METR in Latvia is relatively high

Distribution of METRs in the EU countries in 2013

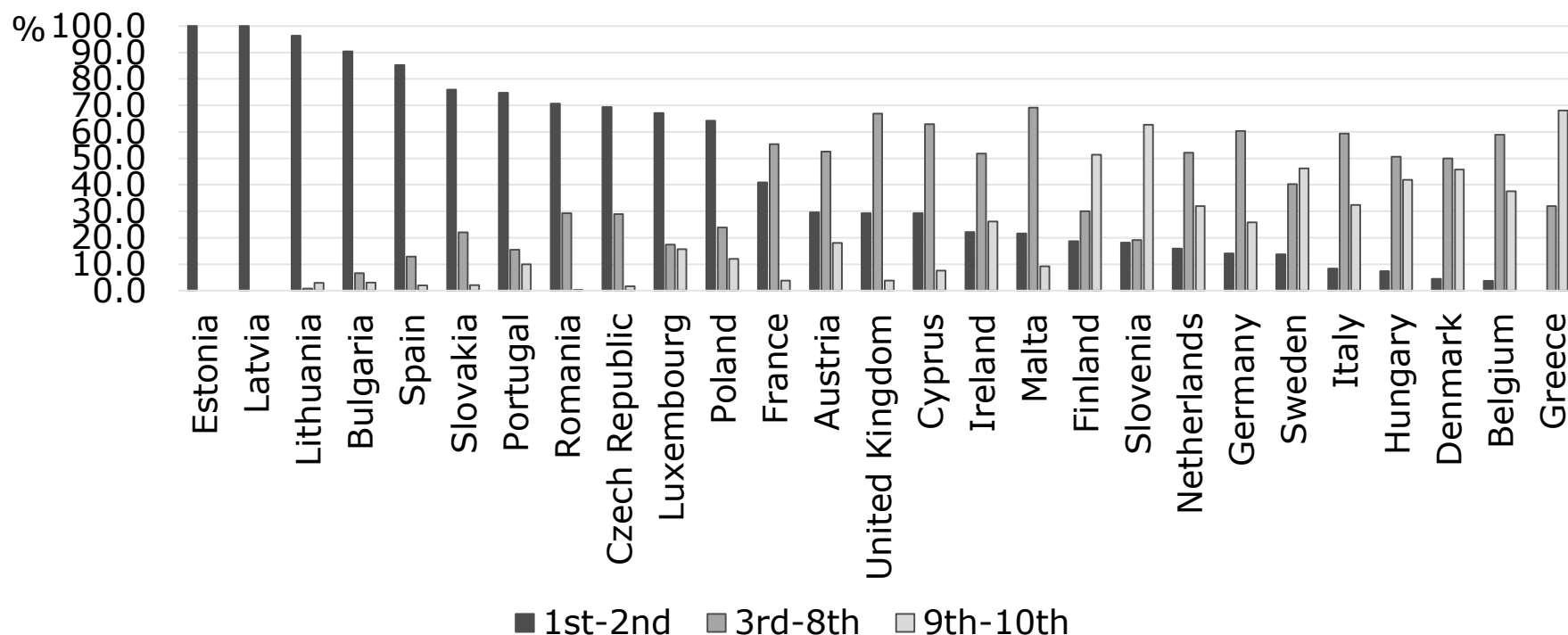


Source: EUROMOD version no. F6.o++



# In Latvia all the people who have a high METR are among the poorest 20%

**Distribution of high METRs (above 50%) (% of total METRs above 50%) by deciles of equivalised disposable income, 2007**



*Note: A high METR is defined as METR above 50%*

*Source: Jara & Tumino, 2013, the authors' calculations*

# Summary

- The degree of redistribution generated by the tax-benefit system in Latvia is one of the lowest in the EU
- Latvian tax-benefit system is characterized by relatively weak incentives to work
- In Latvia all individuals who are faced with high METRs , are among the poorest 20%