



ISSN 2443-8030 (online)

# The Effect of Taxes & Benefits Reforms on Poverty & Inequality in Latvia

By Viginta Ivaškaitė-Tamošiūnė,  
Virginia Maestri, Janis Malzubris,  
Aurélien Poissonnier  
and Anneleen Vandeplass

ECONOMIC BRIEF 039 | OCTOBER 2018

EUROPEAN ECONOMY

*Economic and  
Financial Affairs*



**European Economy Economic Briefs** are written by the staff of the European Commission's Directorate-General for Economic and Financial Affairs to inform discussion on economic policy and to stimulate debate.

The views expressed in this document are solely those of the author(s) and do not necessarily represent the official views of the European Commission.

Authorised for publication by Servaas Deroose, Deputy Director-General for Economic and Financial Affairs.

## LEGAL NOTICE

Neither the European Commission nor any person acting on behalf of the European Commission is responsible for the use that might be made of the information contained in this publication.

This paper exists in English only and can be downloaded from [https://ec.europa.eu/info/publications/economic-and-financial-affairs-publications\\_en](https://ec.europa.eu/info/publications/economic-and-financial-affairs-publications_en).

Luxembourg: Publications Office of the European Union, 2018

PDF ISBN 978-92-79-77368-6 ISSN 2443-8030 doi:10.2765/830917 KC-BE-18-007-EN-N

---

© European Union, 2018

Non-commercial reproduction is authorised provided the source is acknowledged. For any use or reproduction of material that is not under the EU copyright, permission must be sought directly from the copyright holders.

# The Effect of Taxes and Benefits Reforms on Poverty and Inequality in Latvia

By Vīginta Ivaškaitė-Tamošiūnė, Virginia Maestri, Janis Malzubris, Aurélien Poissonnier,  
and Anneleen Vandeplas

## Summary

Despite its steady reduction since 2011, the share of people at risk of poverty or social exclusion in Latvia remains high compared to other EU Member States. A large labour tax reform, including a move towards progressive tax rate schedule, a reduction of the standard personal income tax rate and an increase of the basic (tax-free) allowance, was adopted in the summer 2017. A reform of the social assistance scheme has been under discussion for several years. Simulations based on the EUROMOD and the OECD Tax-Benefit model are used to assess the impact of these taxes and benefits reforms on poverty, inequality, and incentives to work over the horizon 2016-2020.

Overall, the results indicate that the tax reform will benefit households in all income deciles, albeit at a sizeable budgetary cost and with a relatively limited impact on poverty and inequality. If pursued, the reform of the social assistance scheme offers an opportunity to support the income of the poorest households and bring inequality and poverty in Latvia more in line with the EU average. Through adjustments in the design of the benefits scheme, the negative impact of raising the adequacy of benefits on incentives to take up work can be mitigated.

**Acknowledgements:** Most of the analysis in this brief was carried out when Virginia Maestri was still in unit B2 of the Joint Research Centre, Aurélien Poissonnier in unit F4 of DG ECFIN and Anneleen Vandeplas in unit A3 of DG Employment, Social Affairs and Inclusion. The note benefited from comments by Krzysztof Bandasz, Anca Dragu, Matteo Duiella, Jorge Duran, Christine Frayne, Iveta Gravite, Heinz Jansen, Athena Kalyva, Barbara Kauffmann, Giedrius Sidlauskas, Mary Veronica Tovsak Pleterski, Anne Van Bruggen, Kristine Van Herck, Irene Vlachaki, and other participants to ECFIN's country focus seminar.

**Contact:** Janis Malzubris, European Commission, Directorate-General for Economic and Financial Affairs, Economies of the Member States Estonia, Latvia, Lithuania, Netherlands, [janis.malzubris@ec.europa.eu](mailto:janis.malzubris@ec.europa.eu).

## Introduction

**Despite its steady reduction since 2011, the share of people at risk of poverty or social exclusion (AROPE) in Latvia remains relatively high compared to other EU Member States.** The decline in the AROPE has been supported by significant increases in employment rates and real wages. Poverty is high, in particular, for the elderly, single-person households and the unemployed.<sup>1</sup> The relatively high poverty rate in Latvia can partly be attributed to the low redistributive power of the tax-benefit system (see e.g. European Commission, 2017a), and its recent rise suggests that lower deciles of the income distribution are growing more slowly than median income and hence the poverty threshold (European Commission, 2018a).<sup>2</sup> At 12% of GDP in 2016, social protection spending in Latvia remains low as compared to the EU28 average of 19.1% (European Commission, 2018b).

**These issues are also reflected in the high level of inequality in Latvia.** In 2016, the S80/S20 ratio for incomes stood at 6.2 and the Gini coefficient at 34.5% (Table 1, Graph 1, see definitions in Annex 1), substantially above the respective EU average figures of 5.1 and 31%. Since 2011, both inequality indicators have remained relatively stable, but there are signs of a slight improvement in 2016.<sup>3</sup> Net wealth<sup>4</sup> inequality is more pronounced than income inequality in the Euro Area (EA) and even more so in Latvia (Table 1). In Latvia, around half of the wealth reflects ownership of the main residence; a quarter reflects ownership of other real estate. This is similar to the EA average. While Latvian households tend to hold a smaller share of their wealth as financial assets, the distribution of those assets is broadly similar to elsewhere in the EA. Income inequality is a topic of increasing policy concern, as it can have a negative impact on (sustainable) growth (see e.g. European Commission, 2016).

**As part of the Europe 2020 strategy, Latvia has committed to fighting poverty.** Latvia's national target implied reducing by 121,000 the number of persons living in households at risk of poverty and/or in households with very low work intensity over the period 2010-2020.<sup>5</sup> This target was reached in 2016, mostly on the back of rising employment rates (Eurostat, 2017a). The proportion of the population living in households with low work intensity and/or experiencing severe material deprivation has declined since 2011, but relative

poverty (AROP) is increasing and currently stands above its 2010 level. Fighting poverty and inequality also features high on the policy agenda in the context of the European Pillar of Social Rights, endorsed by EU Member States in 2017.

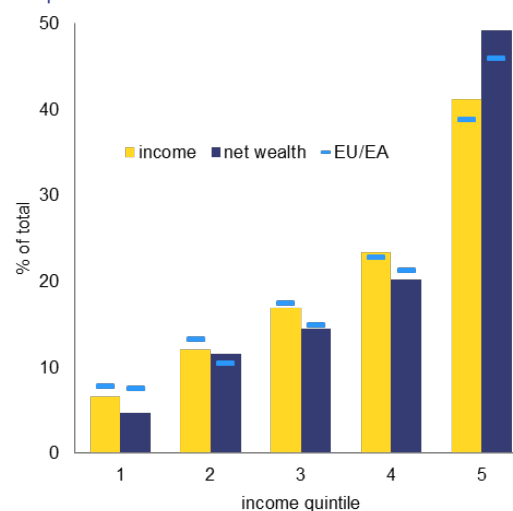
**Table 1: Comparison of inequality and poverty indicators**

	Income			Wealth
	Gini	S80/S20	AROP	Gini
Latvia	34.5	6.2	21.8	78.5
Estonia	32.7	5.6	21.7	69.1
Lithuania	37.0	7.1	21.9	n/a
EU min	24.3	3.5	9.7	49.2*
EU avg	31.0	5.1	17.3	68.5*
EU max	38.3	7.9	25.3	78.5*

Note: Definitions of the indicators are presented in Annex 1. Data on wealth inequality are not available for Lithuania. \* Aggregate wealth indicators are for the EA instead of EU because of data availability.

Source: EU SILC (Eurostat, 2017) and HFCN (2016)

**Graph 1: Distribution of income and net wealth**



Note: The latest and most comprehensive data available are used: net wealth refers to 2014 data for the EA and Latvia; income refers to 2015 data for the EU and 2016 for Latvia.

Source: EU SILC (Eurostat, 2017b) and HFCN (2016)

**Since 2012, the European Commission has been encouraging Latvia to address poverty in the context of the European Semester.** Latvia has received Country Specific Recommendations to "reduce the tax wedge for low-income earners" and to "improve the adequacy of social assistance benefits". Similar recommendations have been made *inter alia* by the OECD (2015) and by the IMF

(2016). Latvia has responded by initiating discussions on a reform of the minimum income scheme<sup>6</sup> in 2014 and by adopting various tax measures in recent years, among which a major tax reform in 2017.

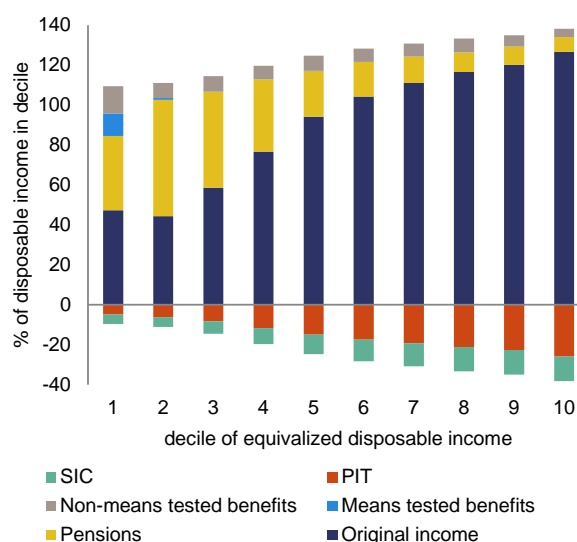
**Inequalities are also reflected in non-financial aspects such as access to health care and education.** EU SILC data show that in 2015, 1% of individuals among the richest 20% reported unmet healthcare needs as a result of a high cost of care in Latvia, a rate twice as high as the EU28 average. For individuals among the poorest 20%, this incidence was 15.5%, compared to only 4.1% in the EU28. Similarly, results from the 2012 PISA survey suggest that, while the impact of the socio-economic background on student performance is not markedly stronger than in other countries, the gap in performance between urban and rural pupils is much larger in Latvia than in most OECD countries (OECD 2016). Unequal access to healthcare and education is widely considered as an important channel through which inequality affects productivity and economic growth (Dabla-Norris et al. 2015; Stiglitz 2012).

**Taxes and benefits can play a crucial role in reducing poverty and inequalities** (Graph 2). In advanced economies, benefits typically account for around 75% of the reduction in inequality between market and disposable income, while taxes account for the remaining 25% (Brys et al., 2016). In Latvia, the share of disposable income that is levied in employees' social insurance contributions (SIC) and personal income tax (PIT) is gradually increasing with income, from less than 10% for the poorest households to more than 40% for the richest (Graph 2). This difference is however to a large extent attributable to differences in tax liabilities (in other words, having taxable earnings or not) and not to differences in tax rates. Benefits, and in particular the means-tested ones, favour the poorest, but account for a relatively small share of income. In 2014, taxes and benefits brought the Gini coefficient down by 16 pp in Latvia against 20 pp on average in the EU.<sup>7</sup> The relatively weak impact on income inequality is due to both the limited adequacy of social protection system and the limited progressivity of the tax system.

**The tax wedge on low income earners in Latvia is relatively high** (see definitions in Annex 1). This weighs on household's disposable income and contributes to poverty and inequality. In 2016, the tax wedge at 50% of the average wage stood at 41%,

the third highest level in the EU and 8 pp above the average (Graph 3). Likewise, the tax wedge at 67% of the average wage was the 6<sup>th</sup> highest in the EU and 5 pp above the average in 2016. Moreover, the difference between the tax wedge on low and high income earners is small compared to the EU average, pointing at a low degree of progressivity of income taxation and hence a weak capacity for income distribution through labour taxation (see also Graph 7). A high tax wedge can also generate disincentives to hire and to work, particularly at the bottom of the income distribution, where labour supply and demand are the most sensitive to monetary incentives.

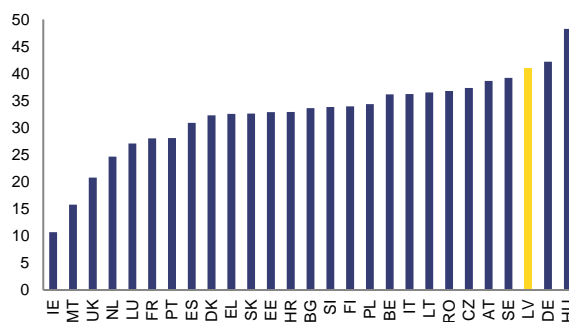
**Graph 2: Breakdown of equivalised disposable income by deciles in 2016**



Note: for definitions of deciles and equivalised disposable income, see Annex 1

Source: EC calculations based on the EUROMOD model

**Graph 3: Tax wedge on low income earners (2016)**



Note: Low income earners are defined as single persons earning 50% of the average wage.

Source: OECD-EC Tax and Benefits indicators

**This note discusses the effect on inequality, poverty and work incentives of various labour tax and means-tested benefit reforms** based on results from the EUROMOD and OECD tax-benefit simulation models (Box 1 and 2). We discuss the reforms that have been adopted by the Latvian authorities, as well as some alternative reforms that have been proposed in previous policy discussions. In a first section, we consider labour taxation reforms. In a second section, we consider reforms of the social assistance system.

## Making income taxes more progressive

### Income taxes in Latvia over the recent past

**The tax revenue share in GDP is low compared to the EU average:** 31% of GDP in 2016 compared to an EU28 average of almost 39%. Latvia's tax system relies more heavily on indirect taxation than on direct taxation. Nevertheless, the tax burden on labour is relatively high, especially for low-income earners. The tax revenue share in GDP is limited by tax non-compliance, given the large shadow economy, including underreported wages.

**Until the end of 2017, Latvia had a flat personal income tax (PIT) rate for income above a basic (tax-free) allowance.** The flat tax rate was introduced in 1997 at the rate of 25%, as it was believed that a flat tax would contribute to economic growth, given its simplicity of administration, transparency and potential to reduce tax distortions and inefficiencies (see e.g. Hall & Rabushka, 1983). More recent literature has casted doubt on these beneficial effects (Saavedra et al., 2007; ECB, 2007; Keen et al., 2006). The tax rate was reduced to 23% in 2009, then briefly increased to 26% in 2010 because of the crisis, and then gradually went down to 23% again in 2015.

**The basic allowance introduces some degree of progressivity in the personal income tax.** As it represents a larger share of net income for low income earners, it has a stronger impact on the tax wedge on low incomes than on high incomes. The basic allowance was cut from around EUR 1,500 per year in 2009 to around EUR 600 in 2010 (for reasons of fiscal consolidation). In combination with the increase in the PIT rate, this resulted in an increase of the tax wedge on low income earners (at 50% of the average wage) from 37% in 2009 to 43% in 2010 (OECD-EC, 2018). From 2016, the size of

the basic allowance is differentiated by income level: it is raised to EUR 1,200 per year for annual incomes up to EUR 4,560 and linearly declining to a lower bound of EUR 900 per year for annual incomes above EUR 12,000. Further gradual reinforcements of this differentiation until 2020 were also legislated in 2015.

**At the same time, the differentiation of the basic allowance is to some extent increasing the complexity of administration of personal income taxation in Latvia.** It is not compulsory for taxpayers in Latvia to submit their annual income declaration, unless they want to benefit from tax reliefs. The basic allowance reduction for low-income earners is also administered as a tax relief: taxpayers must submit their income declaration to benefit from it.<sup>8</sup> From 2018, the basic allowance during the year is applied based on the projected level of income, thus minimising the size of tax repayments at the end of the year, but increasing administrative complexity.

**The tax allowance for dependents has been steadily raised over the past ten years, reflecting a strengthening family-friendly orientation of tax policies.** The tax allowance for dependents grew from EUR 1,076 per year in 2009 to EUR 1,980 per year in 2014. In 2016, it was further raised to EUR 2,100, but only for young people (under 24) and for specific groups such as pensioners and disabled persons. For able-bodied adults, it was abolished.

**In 2016, a *solidarity tax* was introduced.** The contribution rate for compulsory social insurance is 34.09% of gross salary, out of which 23.59 pp is paid by the employer and 10.50 pp by the employee. In 2015, a cap on social contributions was applied: no social contributions were due (and consequently no social rights were earned) on income exceeding EUR 48,600 per year.<sup>9</sup> The introduction of a *solidarity tax* in 2016, which levied an additional tax on incomes above EUR 48,600 (similar in size to the social contribution rate, but without accruing additional benefit rights), has helped to redress this element of regressivity.

### The 2017 tax reform

**Income taxation is being overhauled by measures adopted in the summer of 2017.** Both the personal and corporate income tax rates are reduced, partly financed by higher excise duties and improvements in VAT collection. The majority of measures are

effective from 2018 with some transitional provisions in place until 2020. The following analysis focuses on the changes in labour taxation.

**The progressivity of personal income taxation is strengthened.** The reform differentiates PIT rates according to three income brackets. The standard PIT rate of 23% is reduced to 20% for incomes up to EUR 1,667 per month and a second tax rate of 23% is applied to incomes between EUR 1,667 and EUR 4,583 per month. Beyond this income, the upper PIT rate is set at 31.4% and compensated by the employee's share of the solidarity tax applying to the same tax payers. The social contribution and the solidarity tax will be raised by 1 pp (shared equally among employers' and employees' contributions), with the ensuing additional revenues earmarked for healthcare financing. The differentiation of the basic allowance is further reinforced, envisaging an upper bound of EUR 3,000 by 2020 for the lowest incomes and a lower bound of EUR 0 for the highest incomes. The tax reform also raises the basic allowance for pensioners and (non-work-able) dependents (from EUR 2100 to 3000 annually), with a view to addressing elderly and child poverty.

**This tax reform carries a large budgetary cost.** The combination of the different measures with regard to the PIT, social security contributions, the solidarity tax and basic allowances is expected to cost 1.1% of GDP by 2020 (Table 2).<sup>10</sup>

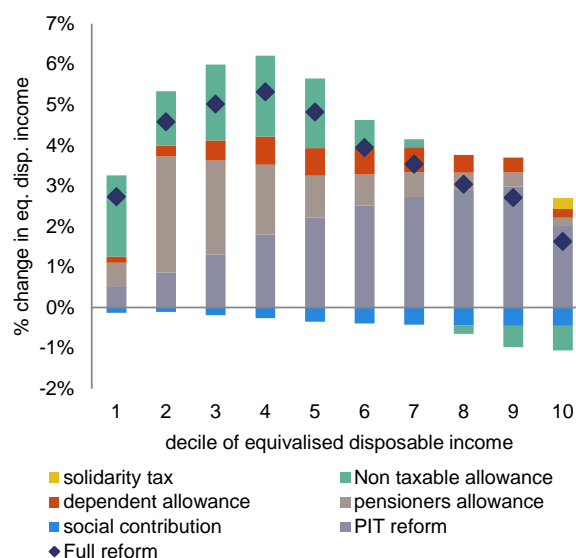
**The lowest income households are not well targeted by this reform.** Whereas more than 90% of households benefit financially from the combined effect of the different reform components, only 40% of the poorest decile does, given that most of people in this category had no or a very low tax liability previously. The effect on their income is therefore limited (+2.7%, Graph 4). The reform is the most beneficial to the middle of the income distribution (+5.3% for the fourth decile) but also benefits the richest decile (+1.6%). Since the reform is relatively more beneficial to the second to fifth decile, it improves inequality and poverty indicators: -0.5 pp for the Gini coefficient and -1.8 pp for the relative poverty rate by 2020.<sup>11</sup>

### Individual impacts of the reform elements

**While the reform package slightly reduces inequality, the move to progressive PIT rates is costly and benefits higher income households the most.** All tax payers benefit from the reduction of

the standard PIT rate from 23% to 20% for incomes up to 170% of average wage. The adopted thresholds for the progressive tax rates are so high that the 23% and 31.4% rates only apply to a small number of very high income earners. As the highest PIT rate reflects merely a reshuffling of the solidarity and income tax, the effective tax burden on the highest share of income does not change. The benefits of the adopted changes in the PIT rates and brackets increase with rising incomes (except for the top decile) (Graph 5). The reform costs 0.8% of GDP, of which 60% goes to the richest 30%. As a result, the Gini coefficient is actually expected to increase by 0.2 pp due to the adopted PIT reform and the relative poverty rate is expected to decline by 0.3 pp only by 2020.

Graph 4: Effect of the tax reform on equivalised disposable income by decile (2020)

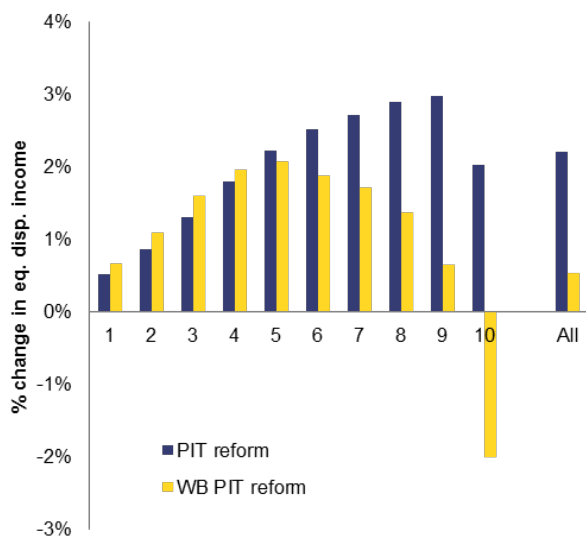


Source: EC calculations based on the EUROMOD model

**An alternative progressive PIT system proposed earlier by the World Bank would have been less costly and more efficient in reducing poverty and inequality.** In 2016, Latvia commissioned the World Bank to review its tax system with a particular focus on efficiency and equity. In response, the World Bank recommended the adoption of a progressive PIT scheme, applying a low tax rate (19%) up to the minimum wage (EUR 360 per month in 2016), a rate of 23% for monthly incomes between EUR 360 and EUR 1,300; and a tax rate of 29% for any income above that threshold (World Bank, 2017). The reform proposed by the World Bank would have

been less costly (0.2% of GDP rather than 0.8% in the case of the adopted PIT reform). Moreover, it would have mainly benefited the middle of the income distribution, negatively affecting only the 10% richest (Graph 5). As a result, it would have lowered the Gini coefficient by 0.6 pp and the relative poverty rate by 0.5 pp by 2020.

Graph 5: Effect of PIT rate reform on income distribution



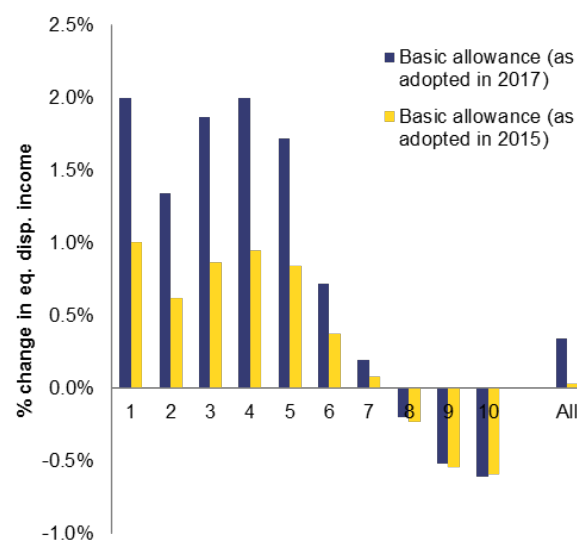
Source: EC calculations based on the EUROMOD model

**The reinforced differentiation of the basic allowance comes at a small fiscal cost and largely benefits the bottom half of the income distribution.** Being redistributive, the effect of the newly adopted reform of the basic allowance on the government budget is limited (0.1% of GDP). Households' average annual equivalised disposable income is positively impacted (+0.3%). On the contrary, disposable income for the top deciles is expected to decrease (Graph 6). As a result of the reform, the Gini coefficient and the relative poverty rate are expected to be respectively 0.5 pp and 0.8 pp lower by 2020.<sup>12</sup>

**Compared to those adopted in 2015, the changes in the basic allowance adopted in 2017 are more generous for households in the lowest deciles, but are also more costly.** The legislative amendments that were adopted in 2015 intended to raise the basic allowance from EUR 1,200 to EUR 1,920 for low-income earners by 2020. The 2017 reform takes this increase a step further, to EUR 3,000 by 2020. Both configurations target the first half of the income distribution, but the latter is more generous (Graph

6). At the same time, the losses for higher income earners would have been similar. While the 2017 amendment comes at a cost of 0.1% GDP (see above), the implementation of the initial (2015) reform would have been largely budget-neutral. In terms of inequality and poverty, the reform adopted in 2015 would have reduced the Gini coefficient by 0.3 pp (instead of 0.5) and the AROP by 0.3 pp (instead of 0.8).

Graph 6: Effect of the basic allowance reforms on income distribution



Source: EC calculations based on the EUROMOD model

**The increase in the allowance for dependants benefits middle income groups more.** Households in the first decile of income distribution are little impacted by the reform. A large share of their taxable income was already covered by tax-free allowances before the reform and only 11% of households with dependent children in the first decile gain from the reform (Pluta and Zasova, 2017). The reach of the measure increases towards the middle income groups, which gain the most relative to their disposable incomes. The measure has little impact on inequality.

**The pensioners' allowance reform has a marked impact on average disposable income in the second to fourth deciles (Graph 4).** Those are deciles with a large share of pension incomes (Graph 2). The impact of the measure on incomes in the first decile is limited, as already one-third of pensions were below the allowance in 2016 and this share is set to increase.<sup>13</sup> Nevertheless, the reform has a positive redistributive effect and should markedly



bring down the at-risk-of-poverty rate for the single elderly, albeit to a level that remains more than three times as high as for the overall population.

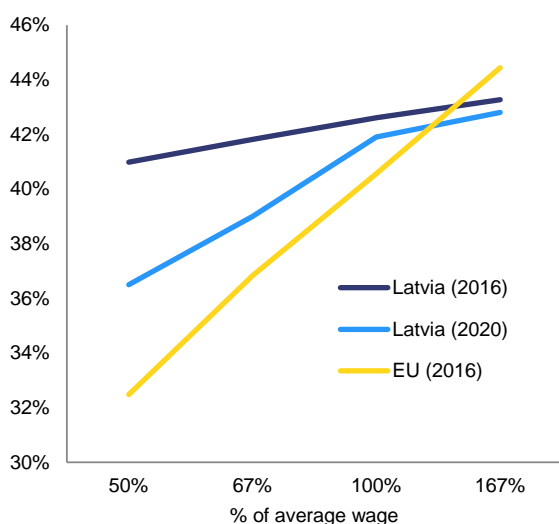
**The impact of the *solidarity tax* reform is small.**<sup>14</sup>

Since the crisis, repeated changes have been made to the ceiling on social contributions, generating lively debates. The number of affected taxpayers is, however, quite small (less than 6 thousand households within the top decile, i.e. 0.7% of the taxpayers). Therefore, the impact on poverty, inequality and the government budget of modifications to the solidarity tax is negligible (Table 2).

**The additional social contribution rate to finance health should bring in 0.3% of GDP in fiscal revenues.**

It directly adds to the tax wedge for all employees, but it will weigh slightly more on richer households' incomes (Graph 4), given lower work intensity in the lower income groups. The impact on poverty and inequality is negligible (Table 2). However, it may have a positive impact on access to and/or quality of healthcare.

Graph 7: Tax wedge for a single earner



Source: OECD-EC (2018) and EC calculations based on OECD Tax-Benefit model

**The tax wedge on low income earners remains high after the measures.**

The tax wedge on a single person earning 50% of the average wage is estimated to be reduced to 36.5% in 2020,<sup>15</sup> down from 41% in 2016, but still above the EU average of 32% (Graph 7). The difference in the tax wedge on

low and high income earners widens, but remains flatter than on average in the EU.

## Raising the adequacy of social assistance benefits

### The guaranteed minimum income and housing benefits: two means-tested benefits

**The social assistance system in Latvia provides for the basic needs of the poorest residents.**

The main support measures are a mean-tested benefit for ensuring the guaranteed minimum income level (GMI) and a housing benefit to cover housing-related costs. Additional support can be made available to cover other costs (education, healthcare, social rehabilitation) for eligible households. Municipalities are responsible for the payment of these benefits.

**The GMI ensures a minimum level of income to Latvian households.**

Introduced in 2003, the GMI provides benefits as a top-up of household income to reach a certain minimum threshold set by the Cabinet of Ministers. Since 2013, it has stood at EUR 49.80 per month, with a minimal increase in 2018 to EUR 53 per month (European Commission, 2018b), but municipalities can increase the rate up to EUR 128 – or differentiate the rate for specific target groups (such as children, pensioners or disabled persons).<sup>16</sup>

**The housing benefit is intended to cover basic housing expenses.**

The level of the housing benefit depends on the household's composition, its income level<sup>17</sup> and on the municipality of residence. Jaunzeme (2017) reports an average housing benefit of less than EUR 15 per person per month. The eligibility for both the GMI and the housing benefit is reassessed every three months.

**The GMI and the housing benefits are closely intertwined and complement each other.**

The GMI received is calculated as the difference between the GMI threshold and all relevant net income. The housing benefit is provided as a top-up of household income (including, where applicable, the received GMI benefits) to reach the GMI threshold augmented with actual housing expenses up to a ceiling.

**The adequacy of the GMI is low, particularly for single people.**

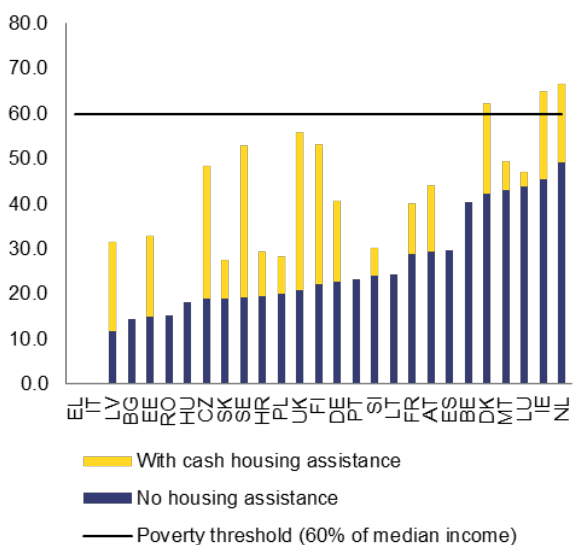
In 2015, the monthly budget required for a healthy diet in Riga, where one-third of the Latvian population lives, was estimated at EUR 153

for a single person and EUR 574 for a household with two adults and two children.<sup>18</sup> This means that even if the GMI is raised to the maximum allowed level, it hardly suffices to cover food costs (let alone other basic necessities). On average in the EU, minimum income schemes provide beneficiaries with around 25% of the national median household income. In Latvia, however, the level of the GMI is just over 10% of median household income (Graph 8). Benefits are relatively more generous once cash housing benefits (cf. *infra*) are considered as well; and for households with children. In 2016, some measures were introduced to reduce child poverty such as the increase in family state benefits for the fourth (and any subsequent) child;<sup>19</sup> and the exclusion of family benefits from the means-test for social assistance.<sup>20</sup>

**The inactivity trap: a design flaw**

**The design of the GMI and housing benefits system risks generating an inactivity trap.** The means tested benefits, first the GMI and then the housing benefits, are lowered 1-for-1 with increased earnings, until earnings exceed the benefits entitlement, beyond which no benefits are received. The 1-for-1 withdrawal of both benefits limits the incentives to take up work as long as expected earnings do not (sizably) exceed the benefits threshold.

**Graph 8: Income levels provided by cash minimum-income benefits (net income for single persons as % median income, 2015)**

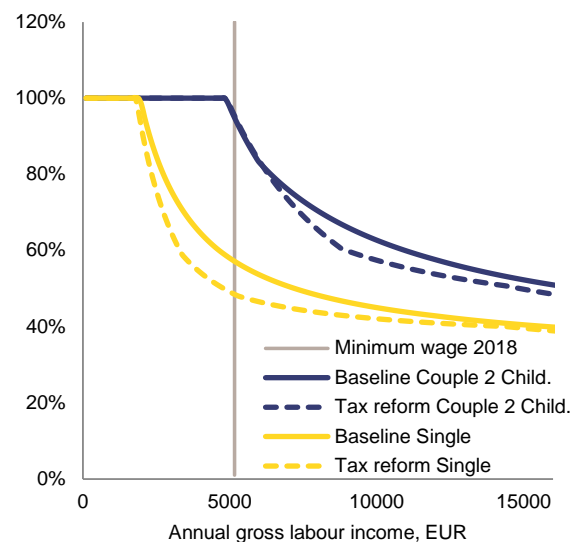


Source: OECD-EC (2018)

**Disincentives to take up a low-wage job are reflected in the high participation tax rates, particularly for families with children.** In our baseline scenario,<sup>21</sup> a single person taking up a full-time job at the level of the minimum wage (at EUR 430 in 2018)<sup>22</sup> faces a participation tax rate (PTR, see Annex) of 62% (Graph 9), implying that the increase in net income (after taxes and lost benefits) equals 38% of gross labour earnings. This is not so different from policy settings in other countries in the EU. The first earner in a household with two parents and two children, however, faces a PTR of 100%, implying that there is hardly any financial gain from taking up work at the minimum wage.<sup>23</sup> While the participation tax rate for single earners at 50% of the average wage is in line with the EU average, for single-earner families consisting of two adults and two children it is among the highest in the EU.

**The tax reform described above improves incentives to work for singles, but not so much for families with children.** For singles taking up a job around the minimum wage, the participation tax rate is reduced by around 10 pp compared to the baseline scenario. For single-earner families with two children, however, work incentives are hardly affected (Graph 9).

**Graph 9: Participation tax rates (PTR) before and after the 2017 tax reform**



Source: EC calculations based on OECD Tax- Benefit model

**From 2016, taking up work is incentivised to some extent by a temporary income disregard under the GMI scheme.** During the first three months after taking up work, employment earnings

up to the minimum wage are disregarded from the social assistance means-test. This provides financial incentives to work in the short term (3 months) and has low administrative and budgetary costs. However, it is less clear whether this measure can have any long-lasting employment effect.

### Policy options: simulation results

**In 2014, the Latvian government started up discussions on a new methodology for determining of the minimum income level.** The discussions aimed at establishing, in a transparent way, a minimum income level that would serve as a reference point for a wide range of social security benefits, and help raising their adequacy. In 2014, a concept paper was approved by the government setting the "socio-economically adequate" minimum income level at 40% of median household disposable income, currently around EUR 188 per adult per month (Jaunzeme, 2017).<sup>24</sup> The implementation was planned from 2017, but has been postponed without defining an alternative plan (see also European Commission, 2018b). Initial discussions considered raising the GMI to this minimum income level, while more recently the option of setting the GMI threshold at 50% of this level for work-able household members is being considered.

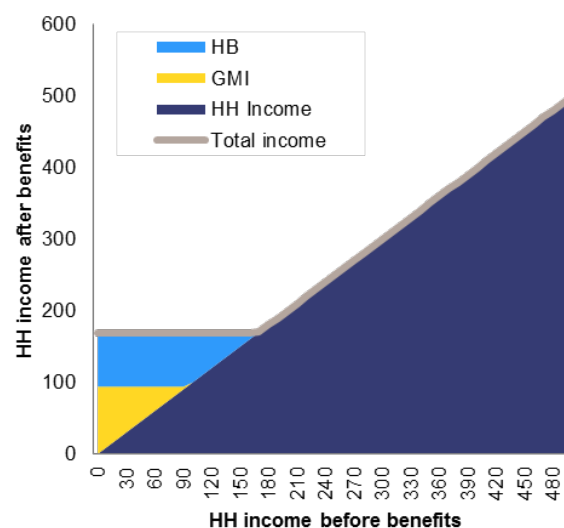
**To add to the ongoing policy discussions, the impacts of different reform scenarios on household income, incentives to work and the government budget are assessed.** Along the lines of the envisaged reform, we consider an increase of the GMI up to 40% of the median household disposable income (EUR 188 per month per equivalent household member),<sup>25</sup> albeit at one half of this level hence EUR 94) for work-able adult recipients (Graph 10, a). Given that this increase in the GMI level and the current 1-for-1 benefit withdrawal risk affecting incentives to work at low wages, we also simulate an alternative reform scenario in which benefits are tapered off with additional earnings (i.e. reduced more gradually). Notably, for every euro of additional income the benefit is reduced by 70 cents instead of one euro, improving the incentives to work (Graph 10, b).

**Increasing the levels of the means-tested benefits has a significant impact on the lowest income earners** (Graph 11). Incomes are significantly improved especially in the first decile of the income distribution, but also somewhat in the second decile. If benefits are tapered off gradually with additional

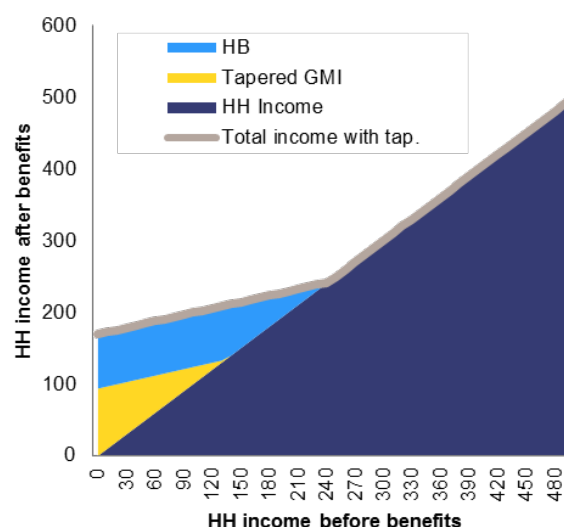
earnings, income gains are significantly strengthened in the first and second decile, and extend to the third and fourth decile as well.

Graph 10: Means tested benefits for a single (work able) person

a) without tapering off



b) with tapering off



Note: A single work able person without any other source of income is entitled to half the new level of the GMI (EUR 188/2) and a housing benefit of EUR 76.<sup>26</sup>

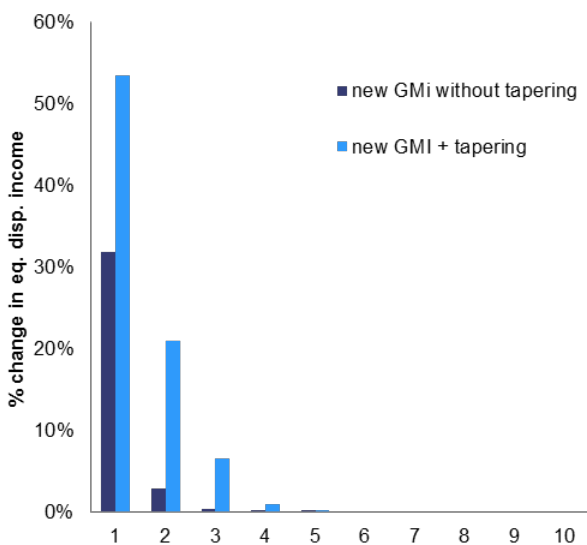
Source: EC calculations

**According to EUROMOD simulations, the budgetary cost of the considered reforms stands at between 0.4 and 1.1% of GDP.** Raising the GMI to 40% of the median income (and half this level for work-able adults) would imply a budgetary cost of 0.4% of GDP. Tapering off the benefits increases the

cost substantially (1.1% of GDP) as more benefits are distributed (Table 2).<sup>27</sup>

**Because the means-tested benefits are targeted to the lowest income households, the reform can have a sizeable effect on poverty and inequality.** With the reform including tapering off, the Gini coefficient would be lower by 2.9 pp and the relative poverty rate by 8.9 pp. As Latvia's Gini coefficient and its relative poverty rate are at present around 3.5 pp and 4.5 pp higher than the respective EU figures, this would allow Latvia to more or less close its gap with the EU average.

Graph 11: Effect of GMI reforms on equivalised disposable income by decile



Source: EC calculations based on the EUROMOD model

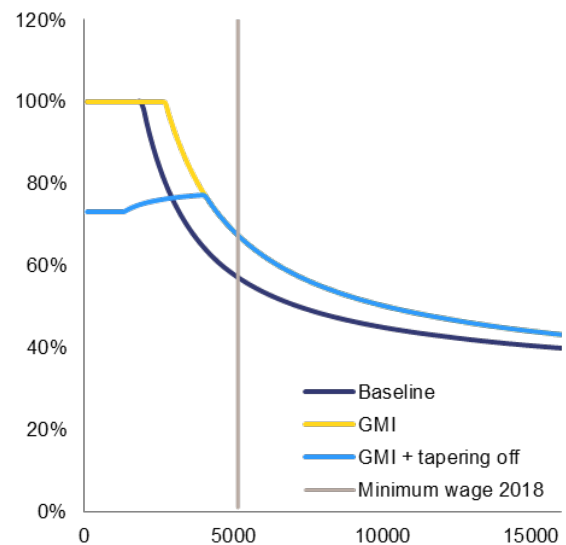
**Tapering off the means-tested benefits can mitigate the negative impact of increased benefit generosity on incentives to work.** By raising the GMI level, the participation tax rate remains at 100% for a wider range of incomes, and this effect is particularly strong for couples with children (Graph 12). In contrast, tapering off the benefits by 70% lowers the PTR for low-income earners by up to 27 pp, which considerably improves their incentives to take up work.

**There are, however, some limitations to this approach.** The benefits will be extended towards the middle income groups over a relatively wide range of incomes. In the simulated reform, a single-earner couple with two children can receive housing benefits up to a level above the average wage. As a result, means-tested benefits will be less targeted while the budgetary costs will be higher. Moreover,

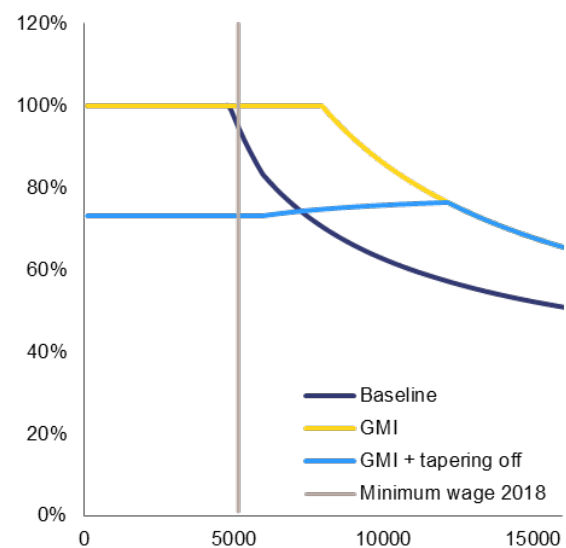
the benefits may influence labour market decisions of (this wider group of) recipients through upward pressure on their marginal effective tax rates. In other words, those who are working will see their pay-off from working additional hours decline to some extent through the gradual withdrawal of benefits. This underscores the importance of carefully adjusting the design of benefits to obtain the best outcomes.<sup>28</sup> In view of this, an interaction of various elements of the Latvia's tax-benefit system on work incentives deserves further analysis.

Graph 12: Effect of GMI reform on PTR

a) single



b) couple with 2 children



Source: EC calculations based on OECD Tax- Benefit model

## Conclusion

**Despite its reduction since 2011, the share of people at risk of poverty or social exclusion in Latvia remains high compared to other EU Member States.** This situation is reflected in the country-specific recommendations issued to Latvia, encouraging the country to raise the adequacy of social benefits and to reduce the labour tax wedge on low-income earners. The tax-benefit system is a powerful instrument to address poverty and inequality, but it remains underused in Latvia relative to other EU countries.

**A tax reform adopted in the summer 2017 will partly address these issues by 2020.** The reform comes at a sizeable budgetary cost (1.1% of GDP by 2020) but has a relatively limited impact on poverty and inequality compared to alternative reform scenarios. While the new PIT tax schedule is

progressive in theory, in practice it is expected to increase inequality. The tax wedge on low income earners is expected to remain high compared to the EU average.

**If pursued, the reform of the minimum income scheme can contribute to addressing poverty and inequality concerns.** Due to their income structure, low income households benefit more, from raising social benefits than from tax cuts. However, simply raising the generosity of the benefits could negatively affect the beneficiaries' incentives to work. At a similar cost as the adopted tax reform, a reform of the minimum income level with more gradual transition from the means-tested benefits to labour income has the potential to close the gap to the EU average in terms of poverty and inequality while improving incentives to work.

Table 2: Comparison of effects of the tax and benefit reforms on inequality, poverty, government budget and household income

	GMI		Tax reform					Alt. Scenarios		
	Raising adequacy, no tapering	Raising adequacy, tapering	2017 Tax reform (all combined)	Solidarity tax	+1 pp of social contribution	2017 reform of basic allowance	Allowance for pensioners and dependents	2017 introduction progressive PIT scheme	World Bank proposal progressive PIT scheme	2015 reform of basic allowance
<b>Income inequalities (Gini)</b>	-1.3 pp	-2.9 pp	-0.5 pp	0.0 pp	0.0 pp	-0.5 pp	-0.3 pp	0.2 pp	-0.6 pp	-0.3 pp
<b>Poverty (AROP)</b>	-1.1 pp	-8.9 pp	-1.8 pp	0.0 pp	0.1 pp	-0.8 pp	-0.9 pp	-0.4 pp	-0.5 pp	-0.3 pp
<b>Gov. budget</b>	-0.4%	-1.1%	-1.1%	-0.1%	0.3%	-0.1%	-0.5%	-0.8%	-0.2%	0.0%
<b>Households eq. disposable income</b>	1.2%	3.5%	3.2%	0.1%	-0.4%	0.3%	1.2%	2.2%	0.5%	0.0%

Note: the budgetary impact of the reform is measured as a % of GDP, other impacts as % change compared to 2016. The different reforms interact with each other, therefore, the full effect of the tax reform, is not exactly equal to the sum of its components effect taken in isolation. The baseline scenario includes 2016 tax and benefits policy settings (for more details see note 24).

Source: EC calculations based on the EUROMOD model

## References

- Brys, B., Perret, S., Thomas, A., O'Reilly, P. (2016), Tax Design for Inclusive Economic Growth, OECD Taxation Working Papers, No. 26, OECD Publishing, Paris. <https://doi.org/10.1787/5jlv74ggk0g7-en>
- Cabinet of Ministers (2014, 30 October) "Setting of the minimum income level", Concept paper Order No. 619, [http://www.lm.gov.lv/upload/sociala\\_ieklausana/conceptet\\_paper\\_en\\_fin.pdf](http://www.lm.gov.lv/upload/sociala_ieklausana/conceptet_paper_en_fin.pdf)
- Callan, T., O'Dea, C., Roantree, B. and Savage, M. (2016) "Financial Incentives to Work: Comparing Ireland and the UK", Budget Perspectives 2017, Paper 2, the Economic and Social Research Institute, Dublin <https://www.esri.ie/publications/financial-incentives-to-work-comparing-ireland-and-the-uk/>
- Dabla-Norris, M.E., Kochhar, M.K., Suphaphiphat, M.N., Ricka, M.F. and Tsounta, E., (2015). "Causes and consequences of income inequality: a global perspective". International Monetary Fund Staff Discussion Note 15/13. <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1513.pdf>
- ECB (2007) Flat Taxes in Central and Eastern Europe. Box 10, ECB Monthly Bulletin, September 2007
- EUROMOD (2017) "Effects of tax-benefit policy changes across the income distributions of the EU-28 countries: 2015-2016", EUROMOD Working Paper 10/17, Institute for Social and Economic Research, University of Essex.
- European Commission (2016) Annual Growth Survey 2017. COM(2016)725 final
- European Commission (2017a), "Country report Latvia 2017", SWD (2017) 79 final. [https://ec.europa.eu/info/strategy/european-semester\\_en](https://ec.europa.eu/info/strategy/european-semester_en).
- European Commission (2017b) Taxation Trends in the European Union. Data for the EU Member States, Iceland and Norway. 2017 Edition. DG Taxation and Customs Union.
- European Commission (2018a) Employment and Social Developments in Europe 2018. DG EMPL.
- European Commission (2018b) "Country report Latvia 2018", SWD(2018) 212 final/2. [https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-latvia-en\\_1.pdf](https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-latvia-en_1.pdf).
- Eurostat (2017a) Smarter, greener, more inclusive? — Indicators to support the Europe 2020 strategy. 2017 edition. Luxembourg: Publications Office of the European Union.
- Eurostat (2017b), "EU statistics on income and living conditions (EU-SILC) methodology", Eurostat online publication; [http://ec.europa.eu/eurostat/statistics-explained/index.php/EU\\_statistics\\_on\\_income\\_and\\_living\\_conditions\\_\(EU-SILC\)\\_methodology](http://ec.europa.eu/eurostat/statistics-explained/index.php/EU_statistics_on_income_and_living_conditions_(EU-SILC)_methodology)
- Hall, R. and Rabushka, A. (1983) "Low Tax, Simple Tax, Flat Tax". New York: McGrawHill.
- Household Finance and Consumption Network (HFCN). (2016). "The Household Finance and Consumption Survey: results from the second wave". European Central Bank Statistics Paper n°18. doi: 10.2866/177251. <https://www.ecb.europa.eu/pub/pdf/scpsps/ecbsp18.en.pdf?d2911394a25c444cd8d3db4b77e8891a>
- International Monetary Fund (IMF) (2016), "2016 article IV consultation – press release; staff report; and statement by the executive directors for the Republic of Latvia", IMF Country Report No. 16/171 <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Republic-of-Latvia-2016-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-43983>
- Jaunzeme, I. (2017) "Minimum income scheme reform in Latvia – Quo vadis?" Presentation at the EC Workshop "Inequality and Structural Reforms: Lessons from Policy", June 19 2017, Brussels.

- Keen, M., Kim, Y., Varsano, R. (2006) "The "Flat Tax(es)": Principles and Evidence". IMF Working Paper WP/06/218. <https://www.imf.org/external/pubs/ft/wp/2006/wp06218.pdf>
- Navickė J., Avram S., Demmou L. (2016) "The effects of reform scenarios for unemployment benefits and social assistance on financial incentives to work and poverty in Lithuania". OECD Economics Department Working Papers No. 1310. OECD Publishing, Paris. <http://dx.doi.org/10.1787/5jlv2jmtmsmr-en>
- Organisation for Economic Co-operation and Development (OECD) (2015), "OECD Economic Surveys: Latvia 2015", OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264228467-en>
- Organisation for Economic Co-operation and Development (OECD) (2016) "Education in Latvia. Reviews of National Policies for Education". OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264250628-en>
- OECD-EC (2018) OECD-EC Tax and Benefits indicators database. Available online at [http://europa.eu/economy\\_finance/db\\_indicators/tab/](http://europa.eu/economy_finance/db_indicators/tab/)
- Pluta, A., Zasova, A., (2017) "Latvia stumbling towards progressive income taxation: episode II", FREE network, Policy brief series, <https://freepolicybriefs.org/2017/10/16/latvia-stumbling-towards-progressive-income-taxation-episode-ii/>
- Saavedra, P., Marcincin, A., Valachy, J. (2007) Flat Income Tax Reforms (Chapter 8). In: Gray, C., Lane, T., Varoudakis, A. (eds.) Fiscal Policy and Economic Growth: Lessons for Eastern Europe and Central Asia (pp. 253-280). Washington, DC: World Bank.
- Stiglitz, J. (2012). The Price of Inequality: How Today's Divided Society Endangers Our Future. New York: W.W. Norton.
- World Bank, (2017). "Latvia Tax Review"  
<http://documents.worldbank.org/curated/en/587291508511990249/pdf/120580-WP-P158470-PUBLIC-117p-WBLatviareportPOP.pdf>
- Xavier Jara, H., Gasior, K., Makovec, M. (2017) Low incentives to work at the extensive and intensive margin in selected EU countries. Research note 4/2016. European Commission.
- Zasova, A., Rastrigina, O., (2017) "Euromod Country Report for Latvia 2014-2016". January 2017. [https://www.euromod.ac.uk/sites/default/files/country-reports/year7/Y7\\_CR\\_LV\\_Final.pdf](https://www.euromod.ac.uk/sites/default/files/country-reports/year7/Y7_CR_LV_Final.pdf)

**Box 1: Euromod microsimulation model**

The EUROMOD microsimulation model<sup>1</sup> is a tax-benefit calculator which covers all the 28 EU Member States in a harmonised way. Based on EU Statistics on Income and Living Conditions survey (EU-SILC) micro-data and encoded national tax and benefit system, the model calculates personal income tax (including allowances, deductions, and tax credits), social insurance contributions, social benefits and overall disposable income and therefore enables researchers to simulate tax and benefit reforms. Importantly, in doing so EUROMOD takes into account individual and household characteristics (demographic, labour market, etc.), various incomes received (from employment, self-employment, property, pensions, incomes from other households and etc.) and captures the interactions of the whole tax and benefit system, the fact that changes in one policy affect the eligibility for others, a feature that is particularly relevant for assessing the budgetary and equity impact of reforms. The present analysis is static i.e., it includes first round fiscal effects only; it does not take into account behavioural impacts on employment.

Simulations for 2020 first assume that between 2016 and 2020, the relative wage distribution (inequalities before taxes and benefits) will remain unchanged. For the simulations on the tax side, we further assume that wages will grow by approximately 5% annually in line with the Commission forecast. This assumption is not made for simulations on the benefit side. These respectively ensure that the most favourable scenarios in terms of fighting inequalities and poverty are presented.

---

<sup>1</sup> <https://www.euromod.ac.uk/> All simulations were done using EUROMOD version G4.0

**Box 2: The OECD Tax-benefit models**

The OECD Tax-Benefit models show how complicated tax and benefit rules can affect the net income of individual families when they are in and out of work. The models are part of the OECD's database on tax-benefit policies, which monitors redistribution policies, income adequacy and benefit generosity for working-age people and their families over time and across countries.<sup>1</sup> They also show how much families gain from employment, accounting for benefits, taxes and other work-related costs, such as for childcare. The model contains information for 34 OECD countries, and 6 EU non-OECD countries, currently for years 2001 to 2015. Benefits covered in the model include Unemployment, Social Assistance, Housing, Family and Employment-conditional benefits. The Tax system covers Personal Income taxes, and both Employee and Employer paid Social Security Contributions. Pensions and VAT are not simulated. Simulations compute changes in the amount of taxes and benefits across years for a set of family types. The characteristics of these family types vary both in terms of family composition and labour circumstances (including wage levels). The advantage of the OECD Tax-Benefit models is that they assess impacts of tax and benefit policies for specific situations (family types and labour circumstances) through intuitive indicators that are easily comparable over time and across countries (with reference to the national average wage). They do not account, however, for the incidence of these family types or labour circumstances in a particular country.

---

<sup>1</sup> <http://www.oecd.org/social/benefits-and-wages.htm> Results obtained from the OECD tax-benefit models, as well as any errors in their use and interpretation, are the sole responsibility of the authors of this note, not of the OECD.



## Annex 1: Definitions<sup>29</sup>

**Disposable income:** refers to the total income of an individual or household, after direct taxes and social security contributions, i.e. the income available for spending or saving.

**Equivalised household disposable income:** defined as the total disposable income of a household adjusted for the household composition by taking into account economies of scale. The standard scale used is the OECD modified equalised scale, assigning a weight of 1 to the household head, 0.5 to other adults (14 year-old or older) and 0.3 to children (younger than 14).

**Deciles/Quintiles:** Income deciles are groups of individuals with equal population size sorted by (equivalised) disposable income. The first decile represents 10% of the population with the lowest income, and the tenth decile represents 10% of the population with the highest income. Quintiles are built on the same logic but using 5 groups representing 20% of the population each.

**At-risk-of-poverty rate (AROP, relative or monetary poverty):** Defined as the proportion of people with an equivalised disposable income below 60% of the national median equivalised disposable income (after social transfers).

**At-risk-of-poverty-or-social-exclusion rate (AROPE):** The at-risk-of-poverty-or-social-exclusion rate is measured as the proportion of person who are either at risk of poverty or severely materially deprived or living in households with very low work intensity. Severely materially deprived persons have living conditions severely constrained by a lack of resources. They experience at least 4 out of 9 following deprivations items: cannot afford i) to pay rent or utility bills, ii) keep home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) a week holiday away from home, vi) a car, vii) a washing machine, viii) a colour TV, or ix) a telephone. People living in households with very low work intensity are those aged 0-59 living in households where the working-age adults (aged 18-59) have worked 20% or less of their total work potential during the past year.

**Gini coefficient:** measures the extent to which the distribution of income or wealth within a country deviates from a perfectly equal distribution. A coefficient of 0 expresses perfect equality where everyone has the same income, while a coefficient of 100 expresses full inequality where only one person has all the income.

**S80/S20 or income quintile share ratio:** measure of the inequality of income distribution. It is calculated as the ratio of total income received by the 20 % of the population with the highest income (the top quintile) to that received by the 20 % of the population with the lowest income (the bottom quintile). The same indicator can be calculated for wealth inequalities.

**Participation tax rate/marginal effective tax rate:** The participation tax rate is an indicator for the financial disincentives to work at the extensive margin. It measures the proportion of gross earnings from work that is "taxed away" in the broad sense when a social assistance recipient takes up a job, both as a result of taxes and social contributions that are charged and as a result of benefits that are lost. This contrasts with the marginal effective tax rate, an indicator for the financial disincentives to work at the intensive margin. The latter measures the proportion of gross earnings "taxed away" when a worker increases the number of hours worked (see e.g. Xavier Jara et al. 2017).

**Tax wedge:** comprises personal income tax and social contributions payable by the employer as well as by the employee; and is expressed as a % of total labour cost to the employer.

---

<sup>1</sup> In most of this paper, the focus will be on relative poverty, given that this is the only poverty indicator that can be reliably assessed with the Euromod model.

<sup>2</sup> The at-risk-of-poverty threshold applied by Eurostat is set at 60% of the national median equivalised disposable income after social transfers.

<sup>3</sup> Euromod (2017) simulations suggest that the impact on inequality of policy changes in 2015-16 was progressive, with a notable income boost for the 2<sup>nd</sup>-4<sup>th</sup> deciles of the income distribution. This was to a large extent due to increases in public pensions as a result of indexation which is stronger at the bottom, a reduction of social security contributions for self-employed following from a minimum wage raise, the introduction of the solidarity tax, the introduction of a differentiated basic allowance which was felt most strongly by low income earners with (some) taxable income, and an increase in non-means-tested benefits as a result of growth of average earnings.

<sup>4</sup> Difference between total assets and total liabilities.

<sup>5</sup> Note that Latvia's national target differs from the overall EU target on 'risk of poverty or social exclusion' as it refers to the two subindicators 'People living at risk of poverty after social transfers' and 'people living in households with very low work intensity' only.

<sup>6</sup> According to its initial plans, the government envisages to establish a procedure to determine the "minimum income level", which would serve as a reference level for various benefits (such as the minimum unemployment benefits, the minimum income scheme, and minimum pensions).

<sup>7</sup> European Commission calculations based on EU-SILC 2014 data

<sup>8</sup> See e.g. <https://www.vid.gov.lv/en/personal-income-tax>

<sup>9</sup> The compulsory social insurance covers the following types of social insurance: old age state pension insurance (accounting for around 70% of social contributions), unemployment social insurance, insurance against work accidents and occupational diseases, disability social insurance, maternity, parental and sickness social insurance. The size of the social insurance benefits is linked to the contribution wage, which is capped at a certain amount, therefore implicitly limiting the size of social benefits. Additional pension entitlements can be built through the other two pillars – the mandatory individual accounts and the voluntary pension funds.

<sup>10</sup> In addition, the transformation of the corporate income taxation regime is estimated to cost 0.7% of GDP by 2020. Taxes on capital are aligned at a 20% rate and the taxation of corporate income is deferred until the distribution of profits.

<sup>11</sup> Compared to a 3.5 pp distance to the EU average for the Gini coefficient and a 4.5 pp distance for the AROP rate. See also Pluta and Zasova (2017) for a similar assessment of the tax reform.

<sup>12</sup> Compared to a 3.5 pp distance to the EU for the Gini coefficient and a 4.5 pp distance for the AROP rate.

<sup>13</sup> Calculated based on data of the Latvian social insurance agency.

<sup>14</sup> This *solidarity tax* is part of the social security system for tax collection purposes, but no benefit rights are accrued. As it is not linked to the entitlement of benefits, it may be considered as a tax rather than a social contribution.

<sup>15</sup> For this graph, as well as for the EUROMOD simulations, wage growth rates of on average 5.5% per year have been assumed. Assuming higher wage growth would imply a higher tax wedge on low incomes by 2020.

<sup>16</sup> In Riga, the GMI stands at EUR 57 for able-bodied persons; at EUR 64 for children, and at EUR 128 for pensioners and disabled persons in 2017 (<http://www.ld.riga.lv/lv/sociala-palidziba/socialo-pabalstu-veidi-rigas-pasvaldiba-2017-gada.html>).

---

<sup>17</sup> For example, in Riga, the income per household member must not exceed EUR 284.57 per family member per month or EUR 355.72 for a single person.

<sup>18</sup> This estimate resulted from a European Commission-funded project that developed full, cross-nationally comparable food basket budgets for all EU countries, for three types of households, in the capital regions of Member States (for more information, see <http://ec.europa.eu/social/main.jsp?catId=1092&intPagelId=2312&langId=en>).

<sup>19</sup> Family state benefits are non-means-tested monthly allowance for children aged 1-15, and are regulated by the Law on State Social Allowances, which was amended in December 2016.

<sup>20</sup> See Amendment of 12.01.2017 of the Law on Social Services and Social Assistance.

<sup>21</sup> The baseline scenario includes 2016 tax and benefits policy settings, but also two reforms that were introduced in 2017, the exclusion of family benefits from the means test and the increase in family benefits for the fourth child and any subsequent children. Details on the 2016 tax and benefit policy settings are described in Zasova and Rastrigina (2016).

<sup>22</sup> The Latvian monthly minimum wage stood at EUR 360 in 2015, EUR 380 in 2017 and will be raised to EUR 430 in 2018.

<sup>23</sup> PTR above 70% are perceived to be distortive to labour market decisions, see for instance (Callan et al., 2016).

<sup>24</sup> Note that this does not necessarily mean that all benefits would be raised to the "minimum income level", but rather that all benefits would be calculated as a function of this reference level. As such, benefits would also automatically adjust to median income growth.

<sup>25</sup> To compute the benefit paid to a household, the GMI is multiplied by the sum of equivalent number of household members. The equivalence scale (1; 0.7) is applied where the first person in the household receives 100% and the second, and subsequent household members receive 70% of the GMI.

<sup>26</sup> The level of the maximum housing benefit here is based on the assumption made in Euromod for single individuals living in an urban area. In comparison, the OECD Tax-Benefit model assumes a ceiling of EUR 84 for single persons.

<sup>27</sup> Not reducing the GMI for work-able persons would increase the cost of the reform without tapering off to 0.9% of GDP. On the contrary, the budgetary cost with tapering off can be limited to 0.4% of GDP if the GMI is only raised to EUR 132.

<sup>28</sup> In a similar policy discussion on Lithuania, the OECD suggests addressing this problem by lowering the equivalence scale weights for dependent household members, and reinforcing non-means-tested benefits such as child benefits instead (Navické et al., 2016).

<sup>29</sup> For more definitions, see [http://ec.europa.eu/eurostat/statistics-explained/index.php/Category:Living\\_conditions\\_glossary](http://ec.europa.eu/eurostat/statistics-explained/index.php/Category:Living_conditions_glossary)



## **EUROPEAN ECONOMY ECONOMIC BRIEFS**

European Economy Economic Briefs can be accessed and downloaded free of charge from the following address:

[https://ec.europa.eu/info/publications-0/economy-finance-and-euro-publications\\_en?field\\_eurovoc\\_taxonomy\\_target\\_id\\_selective=All&field\\_core\\_nal\\_countries\\_tid\\_selective=All&field\\_core\\_flex\\_publication\\_date\[value\]\[year\]=All&field\\_core\\_tags\\_tid\\_i18n=22614](https://ec.europa.eu/info/publications-0/economy-finance-and-euro-publications_en?field_eurovoc_taxonomy_target_id_selective=All&field_core_nal_countries_tid_selective=All&field_core_flex_publication_date[value][year]=All&field_core_tags_tid_i18n=22614)

Titles published before July 2015 can be accessed and downloaded free of charge from:

- [http://ec.europa.eu/economy\\_finance/publications/economic\\_briefs/index\\_en.htm](http://ec.europa.eu/economy_finance/publications/economic_briefs/index_en.htm)  
(ECFIN Economic Briefs)
- [http://ec.europa.eu/economy\\_finance/publications/country\\_focus/index\\_en.htm](http://ec.europa.eu/economy_finance/publications/country_focus/index_en.htm)  
(ECFIN Country Focus)



## **GETTING IN TOUCH WITH THE EU**

### **In person**

All over the European Union there are hundreds of Europe Direct Information Centres. You can find the address of the centre nearest you at: <http://europa.eu/contact>.

### **On the phone or by e-mail**

Europe Direct is a service that answers your questions about the European Union. You can contact this service:

- by freephone: 00 800 6 7 8 9 10 11 (certain operators may charge for these calls),
- at the following standard number: +32 22999696 or
- by electronic mail via: <http://europa.eu/contact>.

## **FINDING INFORMATION ABOUT THE EU**

### **Online**

Information about the European Union in all the official languages of the EU is available on the Europa website at: <http://europa.eu>.

### **EU Publications**

You can download or order free and priced EU publications from EU Bookshop at: <http://publications.europa.eu/bookshop>. Multiple copies of free publications may be obtained by contacting Europe Direct or your local information centre (see <http://europa.eu/contact>).

### **EU law and related documents**

For access to legal information from the EU, including all EU law since 1951 in all the official language versions, go to EUR-Lex at: <http://eur-lex.europa.eu>.

### **Open data from the EU**

The EU Open Data Portal (<http://data.europa.eu/euodp/en/data>) provides access to datasets from the EU. Data can be downloaded and reused for free, both for commercial and non-commercial purposes.

