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Summary Findings and Policy Options

Ministry of Welfare, Riga, May 15, 2013

The World Bank



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- Context For Study
- Who Are Those Who Have Experienced Persistent Labor Market Difficulties?
- Is there evidence of benefit dependency? What options are there for the tax and benefit system to increase protection and work incentives?
- How are ALMP programs performing and what lessons can be drawn for future policy directions?

I.

Context for the Study



Why do a study on unemployment and the tax-benefit system?

Motivation for Study

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- Labor market has recovered since the crisis, but unemployment still high and participation lower than pre-crisis
 - Concern on long-term unemployment and benefit dependency
 - Growth issue—particularly given aging demographics—need to maximize labor market participation and labor productivity
- Aim to increase living standards (given high poverty and inequality)
 - Strategy of shared prosperity and to support families
 - Government expanded safety net during the crisis and increased spending:
What policies moving on from crisis measures (emergency social safety net)?

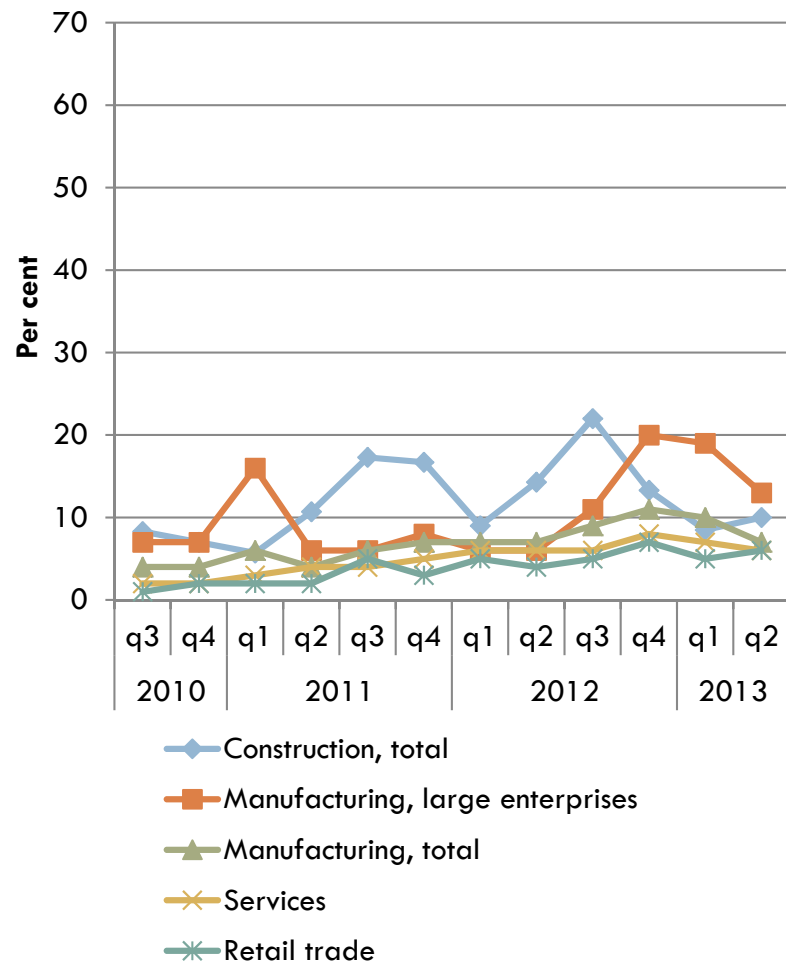
Motivation for Study

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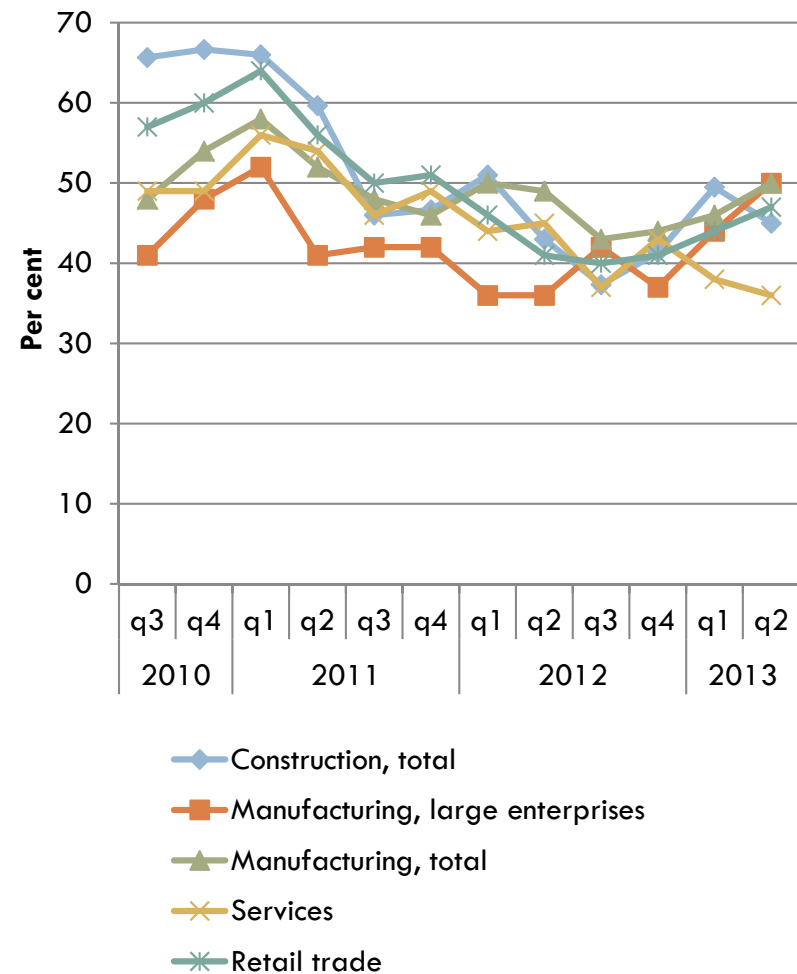
- In collaboration with World Bank, Government of Latvia embarked on study to look at long-term unemployment
 - Objective is to have background analysis to inform tax, benefit and ALMP Design
 - Evidence-based policy marking
 - Build on approach of Government-supported evaluation of crisis measures (emergency public works program)
 - Government of Latvia invested significant effort in producing a detailed database on benefits and employment-unemployment spells
 - Latvia joins the U.K., the Netherlands and Nordic countries in using administrative data for evidence-based policy analysis

Enterprises report insufficient demand rather than a shortage of labor as limiting factor in Latvia, 2010-2013

6 Shortage of labor



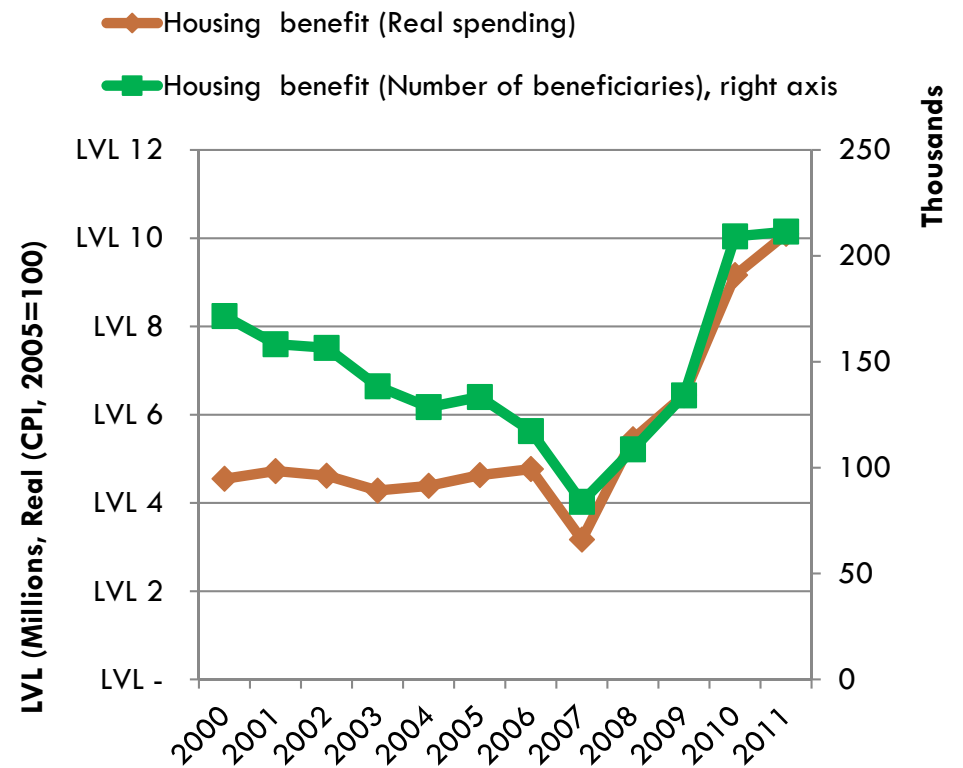
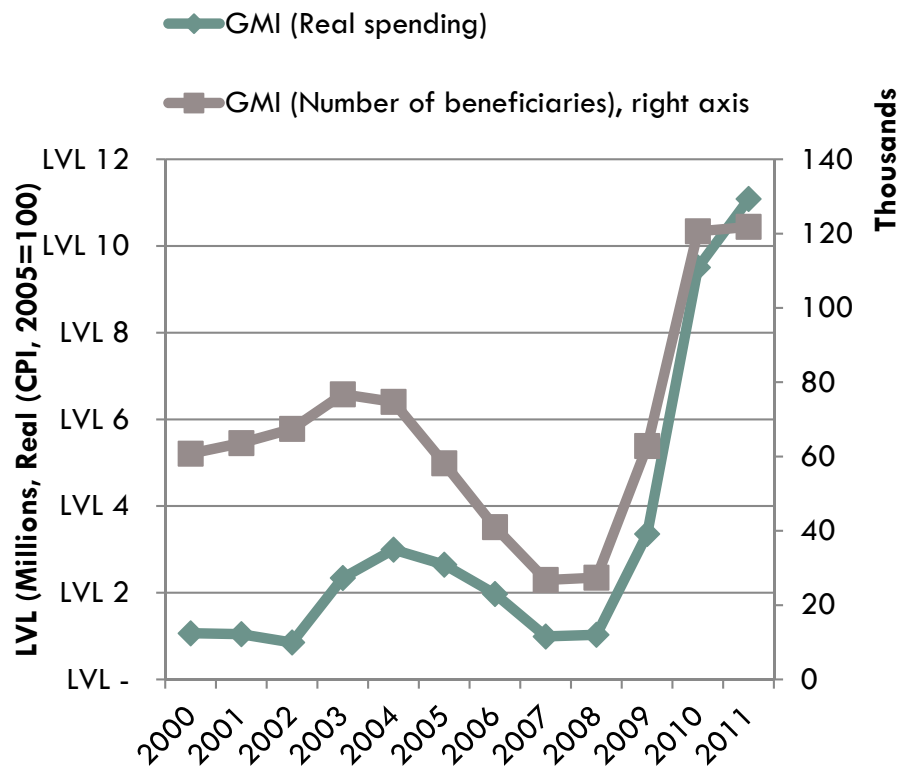
Insufficient demand



Source: Business Tendencies (Economic Sentiment) survey, CSB

Unlike In Some Other Countries With Large Austerity Programs, the Safety Net in Latvia Did Expand During the Crisis

...but policy adjustments were needed



Source: Administrative data.

II.

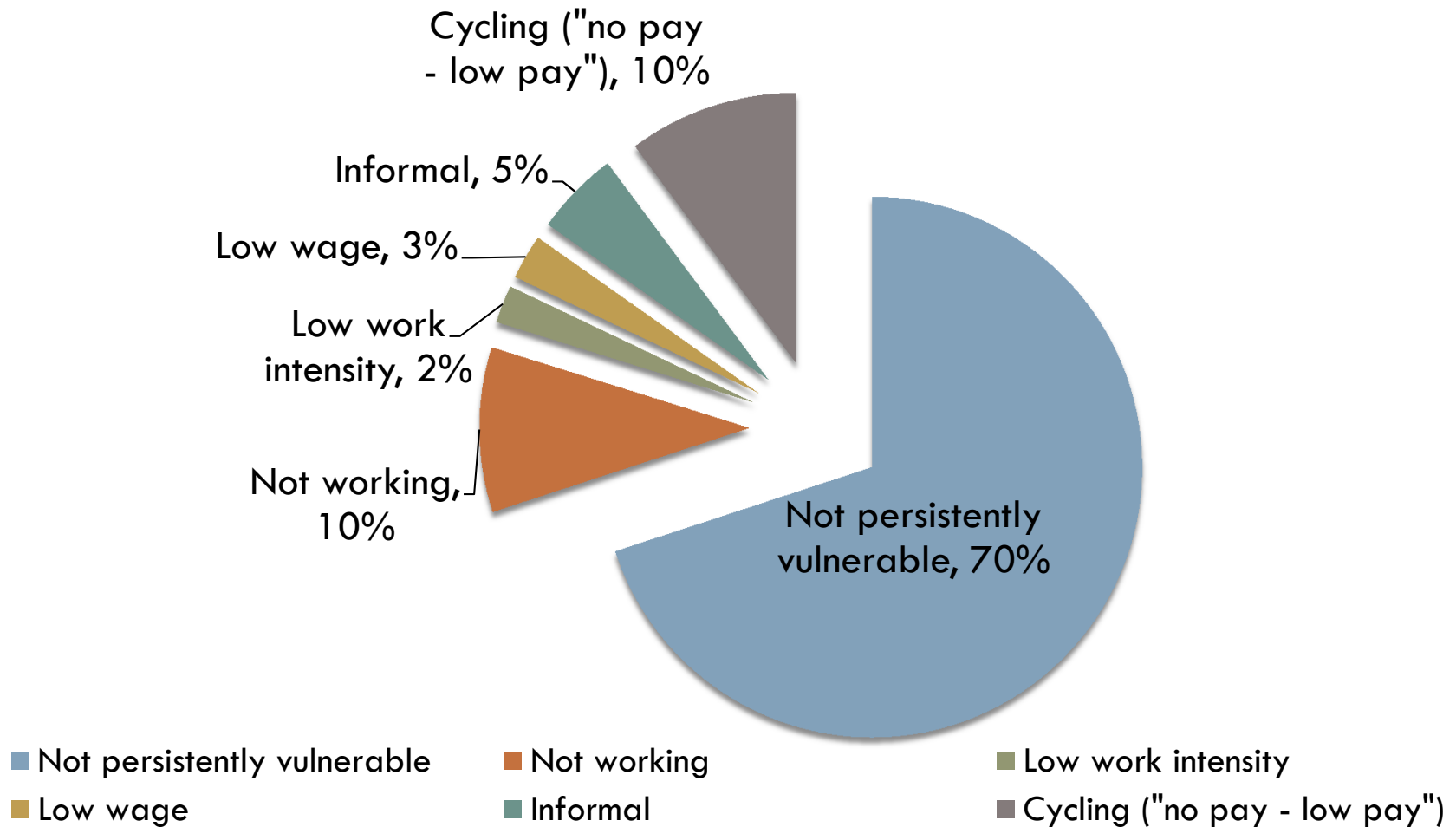
Profiling Those with Persistent Labor Market Difficulties



Which groups are suffering from no or unstable work?

2007-2010: Broad Categories of No/Unstable Work

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NO/UNSTABLE WORK: DETAILED GROUPINGS

“single older unemployed/disabled”

- . Old/Middle-aged 45-61 y.o.
 - . Single
 - . 10+ yrs. experience
 - . Low education
 - . Many disabled/unemployed
 - . Chronic illness
- 22%

“stay-at-home mums with small child”

- . Younger women 25-39 y.o.
 - . Married/union
 - . Higher education
 - . Child < 6 y.o.
 - . Rural
 - . Working partner
- 11%

“disabled older women with working partner”

- . Older women 50+
 - . Married
 - . Lower education
 - . 10+ yrs. experience
 - . High disability (most in sample), inactive
 - . Chronic illness
 - . Working partner
- 6%

“single young males with low education”

- . Young 20-29 y.o.
 - . Men
 - . Never married
 - . Very low education
 - . Unemployed
 - . No children
 - . Rural
- 18%

“poorly educated, rural male breadwinner”

- . 30-39 y.o. men
 - . Married/union
 - . Very Low education
 - . 10+ yrs. experience
 - . Child < 6 y.o.
 - . Rural
 - . Partner not working
- 11%

“highly educated stay-at-home mums”

- . 30-39 y.o. women
 - . Married
 - . Higher education (most)
 - . 10+ yrs. experience
 - . Children
 - . Urban
 - . Working partner
- 6%

“older unemployed, fit for work”

- . Older 50+
 - . Married
 - . 10+ yrs. experience
 - . Low education
 - . Unemployed/Low earnings /Infrequent work
- 14%

“self-employed older men”

- . Older men 40-54 y.o.
 - . Married
 - . 10+ yrs. experience
 - . Self-employed
 - . No child in household
 - . Informal
- 9%

“disabled older women, partner not working”

- . Older women 50+
 - . Married
 - . Lower education
 - . 10+ yrs. experience
 - . Unfit for work, inactive
 - . Large share retired early
 - . Chronic illness
 - . Partner not working
- 4%

Group size

Policy Options

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- Desirable targeting mechanism: combined strategy that aims at tackling those at risk of persistent labor market difficulties and economic hardship
 - ▣ Hardest to activate: Older and/or disabled pre-retirement age group; and large group of young, less educated unemployed
 - ▣ Easier to activate?: the more educated self-employed population and well-educated stay-at-home moms
- Use **the link between benefits and activation policies** as an instrument to bridge unemployed to employment services
- Implement an activation strategy to target each of the identified groups

III.

Benefit dependency: Is there a benefits trap?



Is there evidence of widespread benefit dependency? Do those on benefits stay on them for long? Does the tax and benefit system provide people with incentives to take jobs?

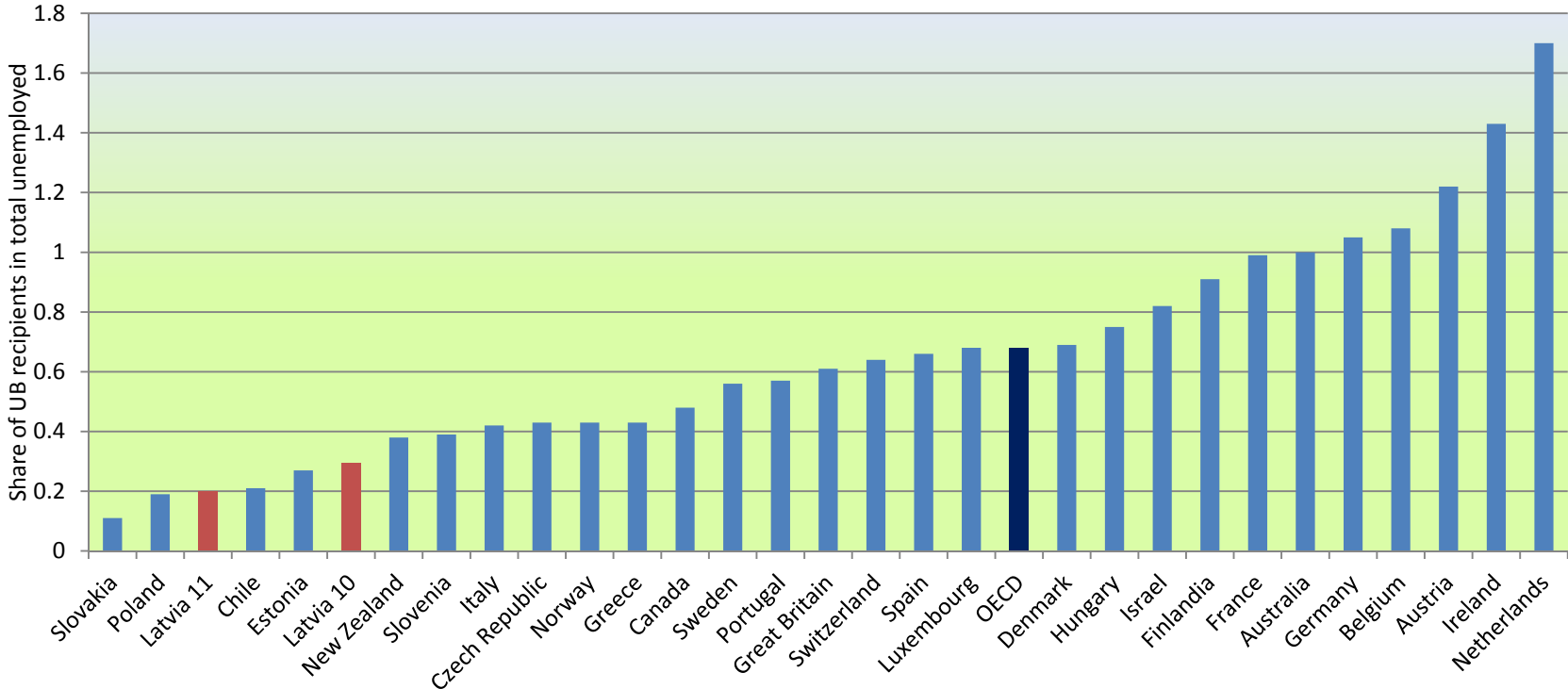
Does the Current Tax-Benefit System “Make Work Pay”?

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- Evidence does not support widespread benefit dependency:
 - ▣ Coverage of both the unemployment insurance and the GMI program remains low
 - ▣ After unemployment benefits run out, many of those that collect GMI beneficiaries do so as a temporary stop-gap
 - ▣ There is scope for improving adequacy of benefit provision
- Work disincentives are unlikely to be the main employment barrier after a deep recession, however:
 - ▣ Those on means-tested benefit recipients face high marginal effective tax rates (for every LVL1 earned, a LVL1 of benefits is withdrawn)
 - ▣ Financial incentives to take up employment can be improved for low-wage earners

Unemployment Benefit Still Covers Few

Ratio of unemployment benefit recipients to the number of unemployed (2010)

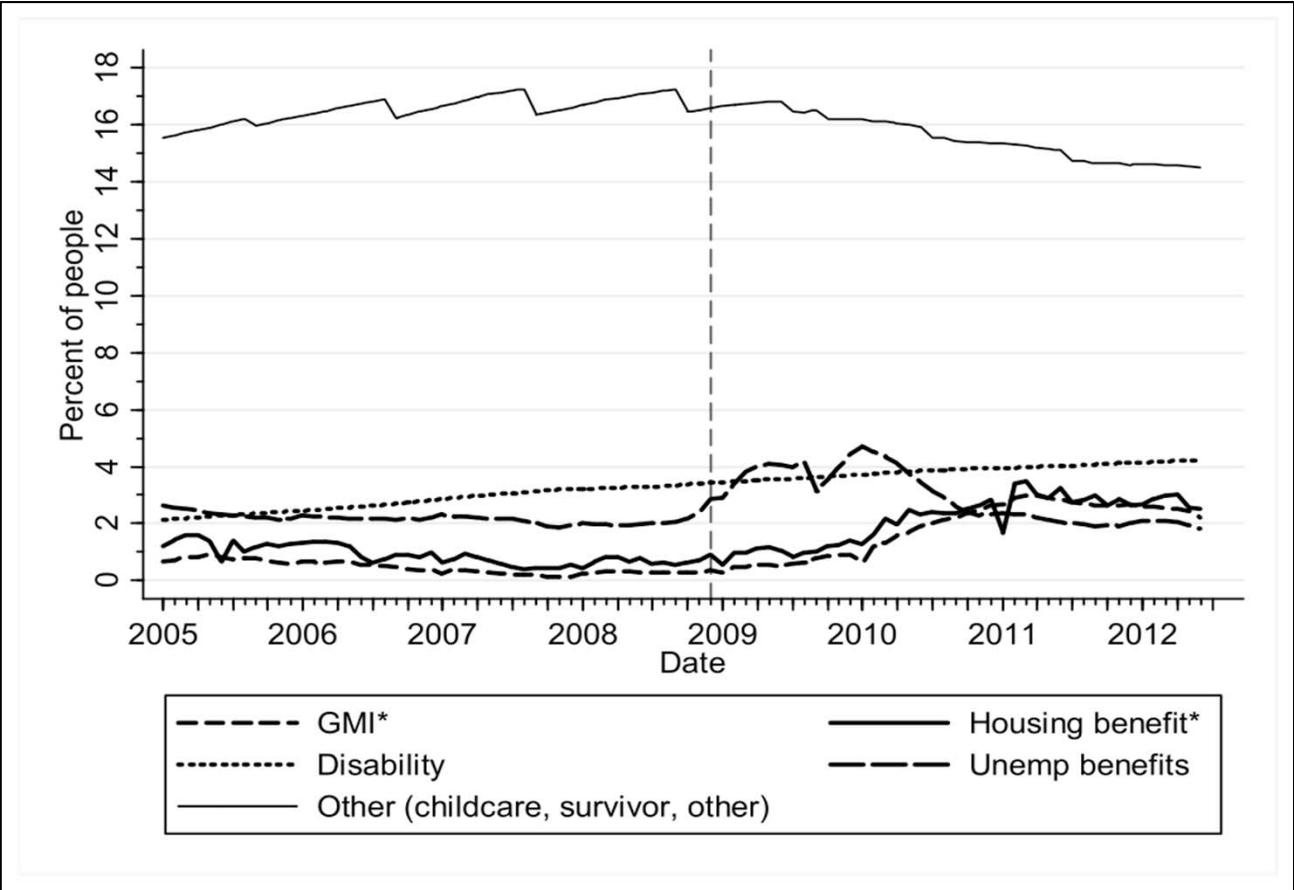


Sources: Eurostat for Latvia, OECD Employment and Labour Market Statistics for all other countries.

Preliminary for Discussion; Please do not Cite

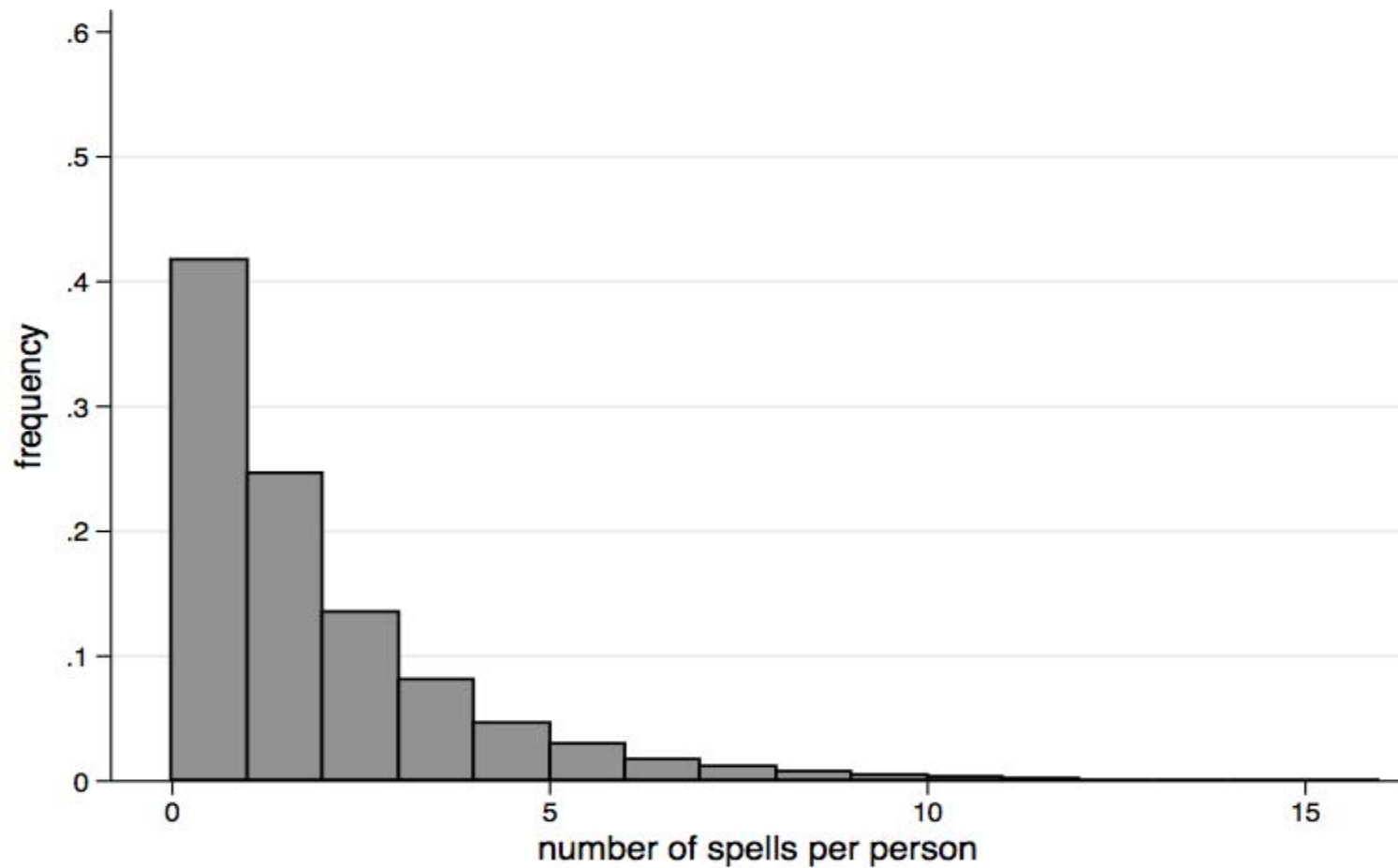
GMI has Grown Since 2010; But a Maximum of 4 Percent Have Participated at Any One Time ...

Benefit program incidence, 2005-2012

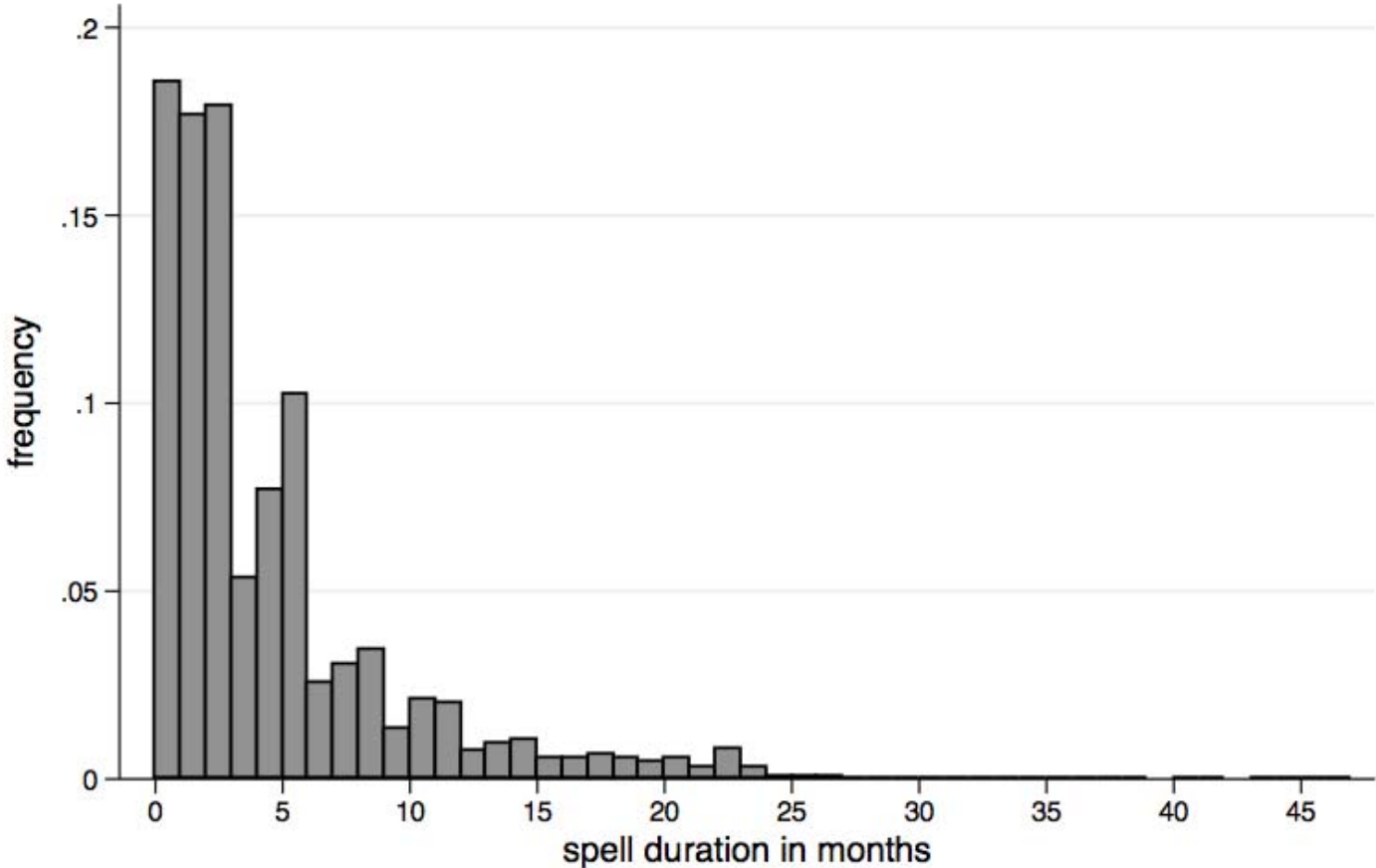


40% of People Have Only One GMI Spell In 2006-2012

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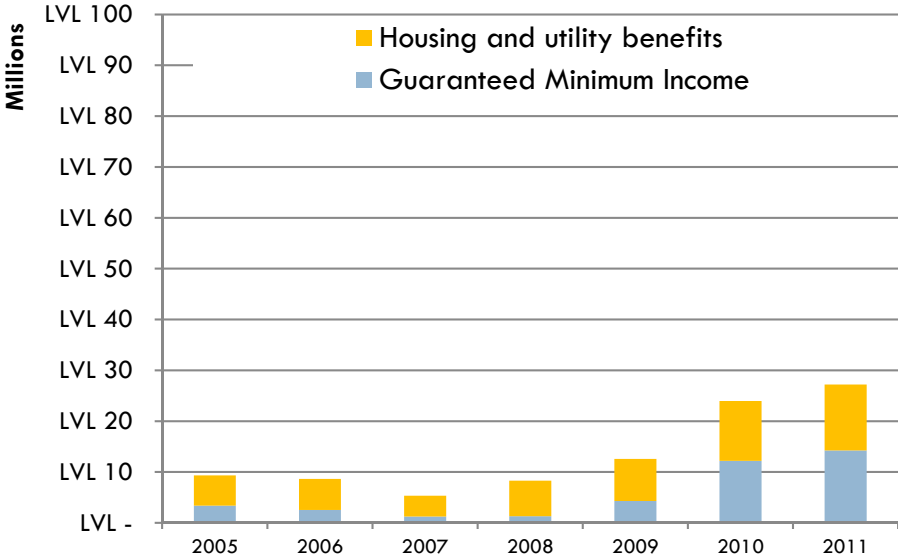
... and Spell Durations Appear to be Short...with A Lot of Spells of One to Three Months



note: 17.3% of spells are censored

Turning to Total Spending, Expenditure on Universal Programs is Larger Than On Means-Tested Programs

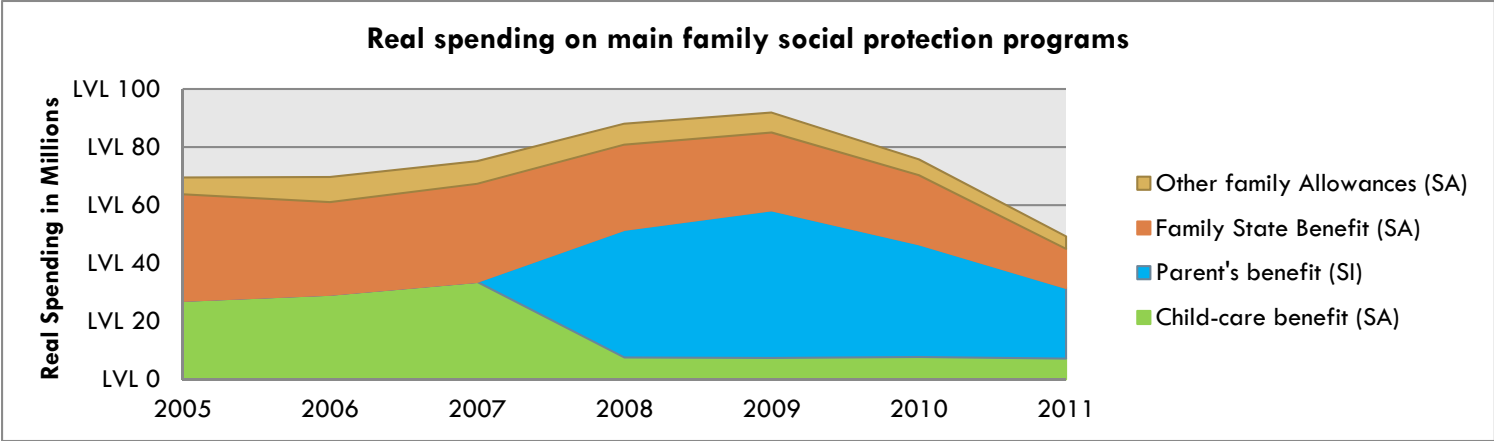
Total spending on means-tested programs



Total spending on non means-tested program

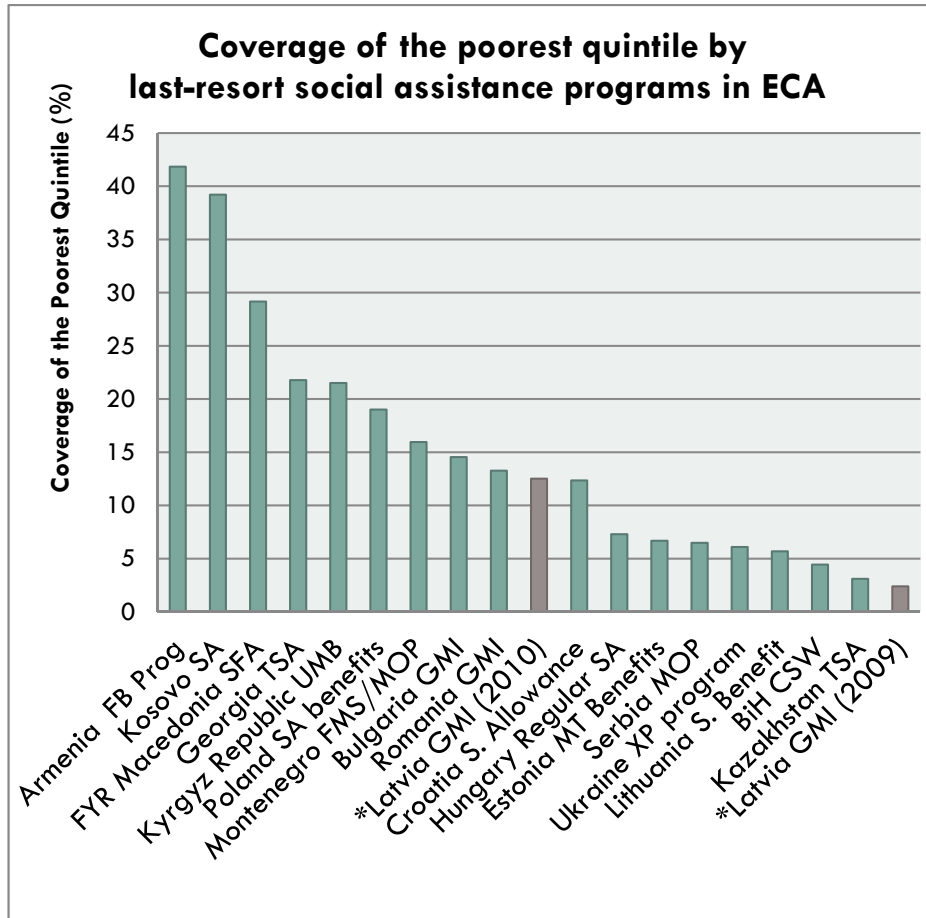


Real spending on main family social protection programs

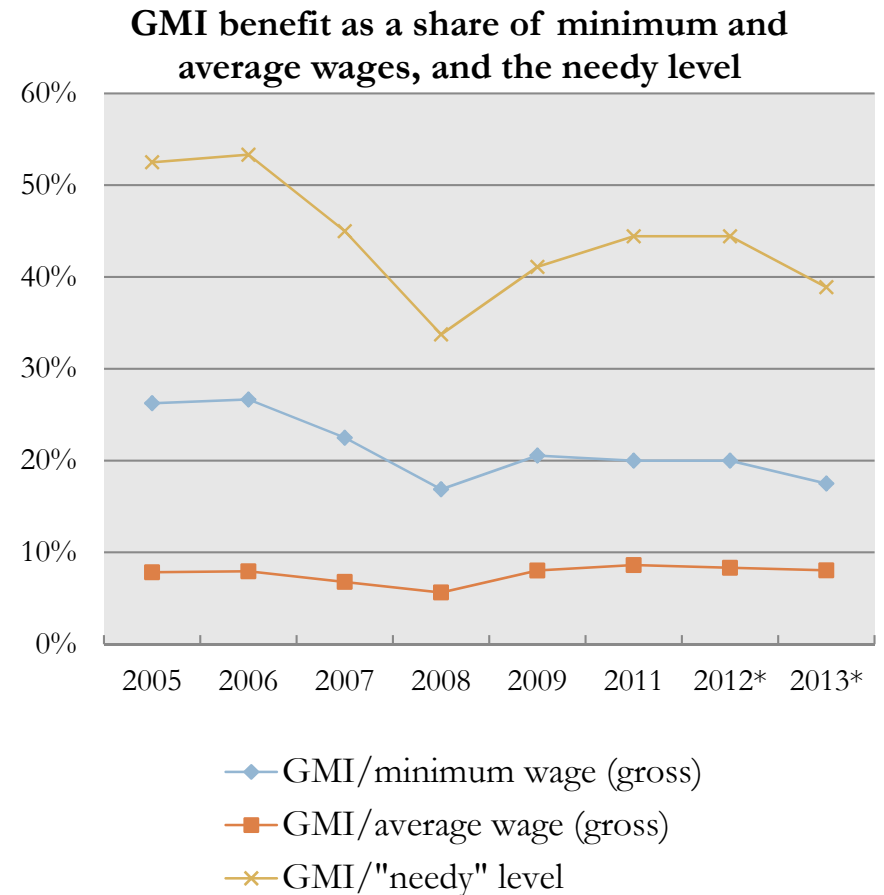


Source: Administrative data, Staff calculations.

GMI is Well-Targeted (91% Goes to the Poorest Quintile), But Coverage and Adequacy Are Low



Note: For Latvia, national consumption aggregate is used while for the rest of countries a standardized welfare aggregate developed by World Bank's ECAPOV team is used. Estimates for the GMI program include housing benefit in cash due to small sample size.
 Source: World Bank staff calculations.

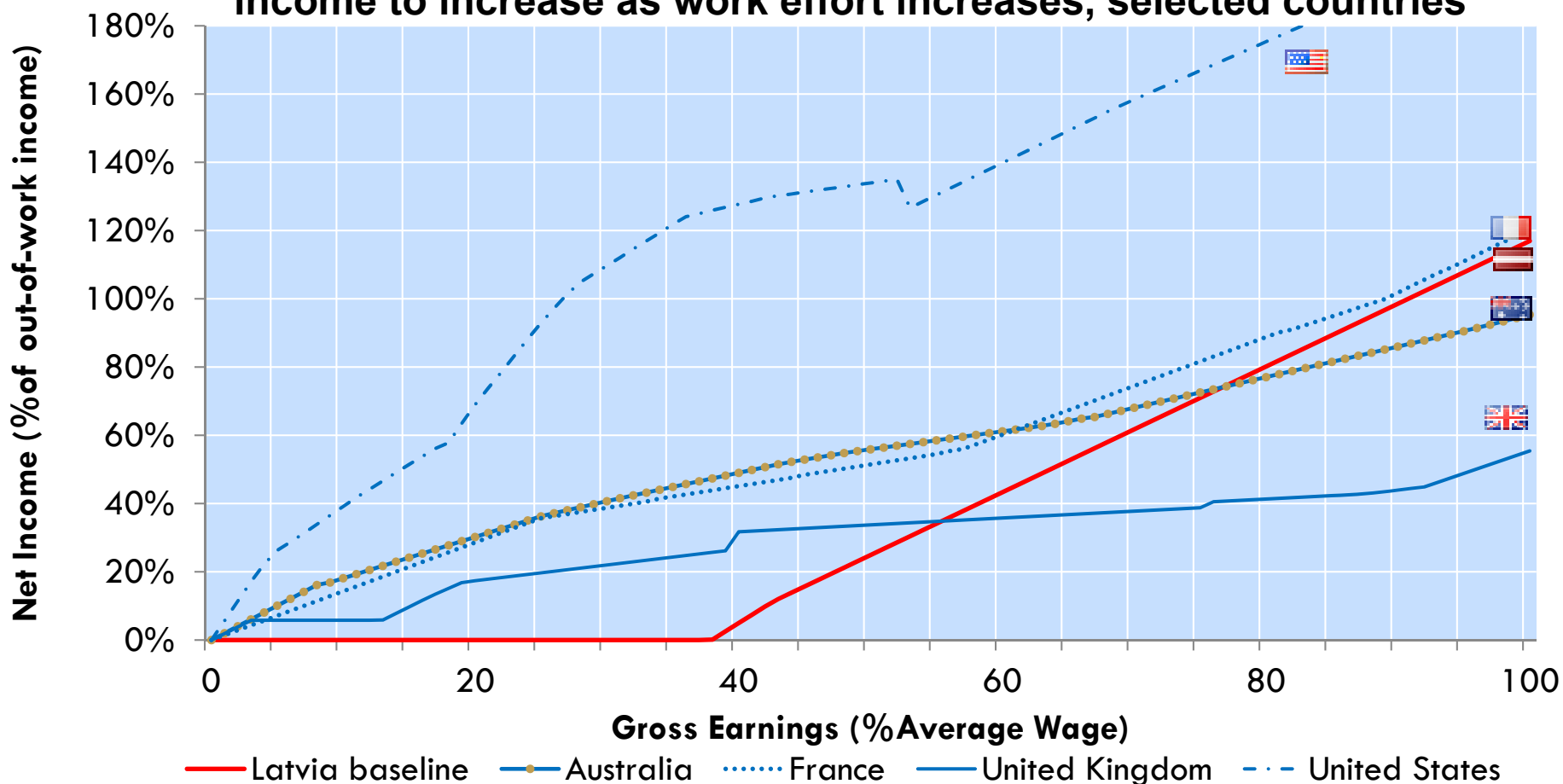


Source: Eurostat, Central Statistical Bureau of Latvia, Ministry of Welfare, World Bank staff calculations.

GMI Recipients Lose All Social Assistance in Moving to a 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.

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, e.g. Earned Income Tax Credits in Korea, United Kingdom, United States or tapered withdrawal of Social Assistance in France, Australia
- Increase of minimum wage and non-taxable minimum
- 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)

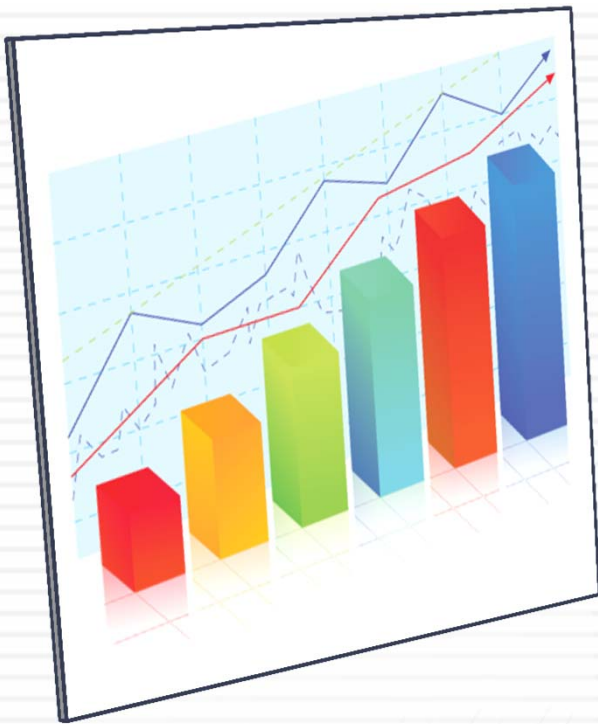
Policy Options to Improve Protection and In-Work Benefits

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- Benefit adequacy could be improved, while simultaneously pay off from work can be increased
 - Increase coverage and generosity of means-tested benefits
- Financial incentives to take up low-wage employment could be enhanced
 - e.g. “back to work” bonuses (for long-term unemployed/GMI beneficiaries, etc.)
 - A permanent in-work benefit scheme can be designed and implemented along with measures aimed at combatting under-reporting
- Tax benefit models allow to simultaneously assess theoretical effect of different measures above
 - Distributional analysis would be needed to assess full impact and costs of any reforms
 - Informality and under-reporting could present a challenge in designing targeted make-work-pay policies

IV.

ALMP Programs



How are ALMP programs performing and what lessons can be drawn for future policy directions?

Conclusions of ALMP Evaluation

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- **All types of professional training and informal education programs for unemployed significantly improve participants' employment rates—both soon after training completion and in the medium term**
- **A substantial variation in terms of various labor market outcomes is found both between types of programs and within each type**
- **Overall, the best performing programs for *men* include:**
 - professional training in manual, as well as service and a sales jobs*
 - employer provided training in non-manual jobs*
 - informal education programs in project management and software*
 - informal education programs for professional drivers of transport and industrial vehicles*
- **For women, the best performing programs include:**
 - employer provided training in manual jobs*
 - professional training in manual jobs*
 - IT (basic skills)*
 - state language (categories 2 & 3) and English (intermediate level)*
 - professional training in manual, as well as service and a sales jobs*

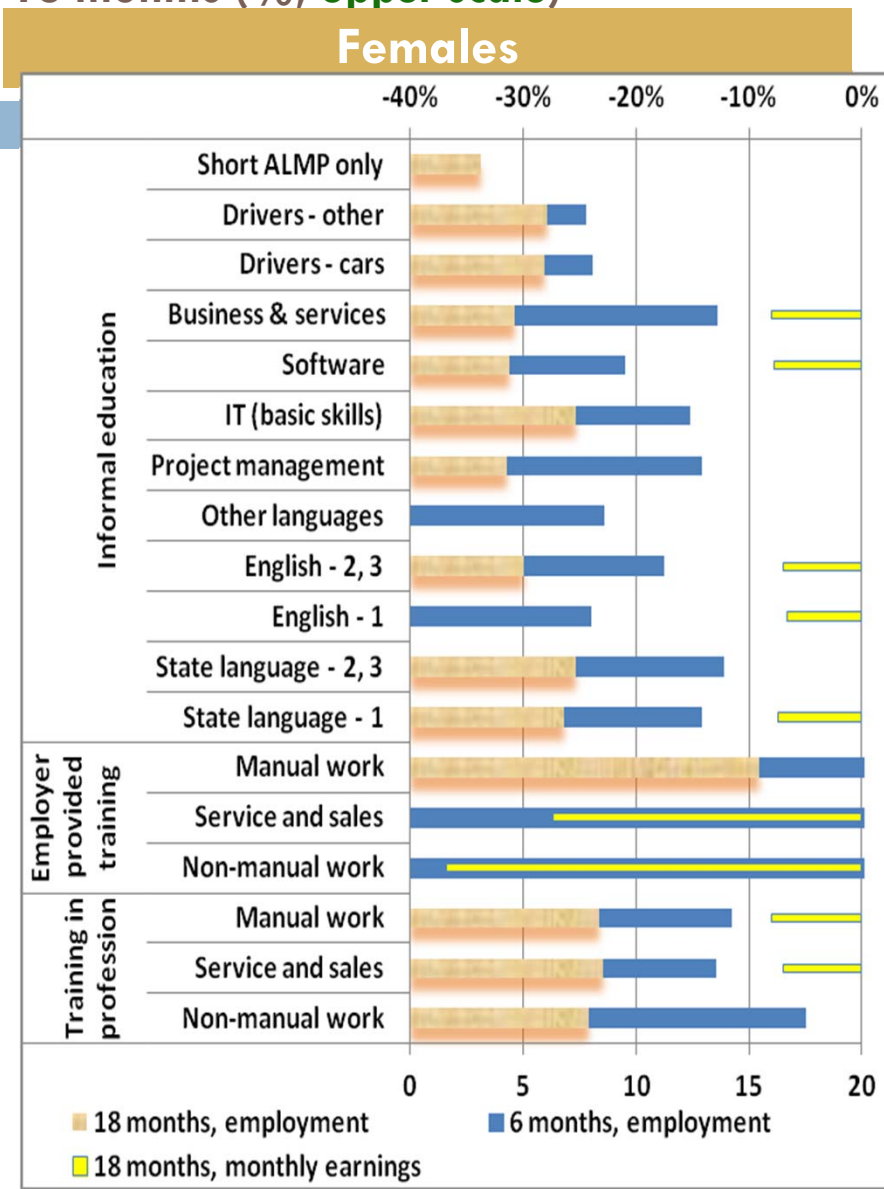
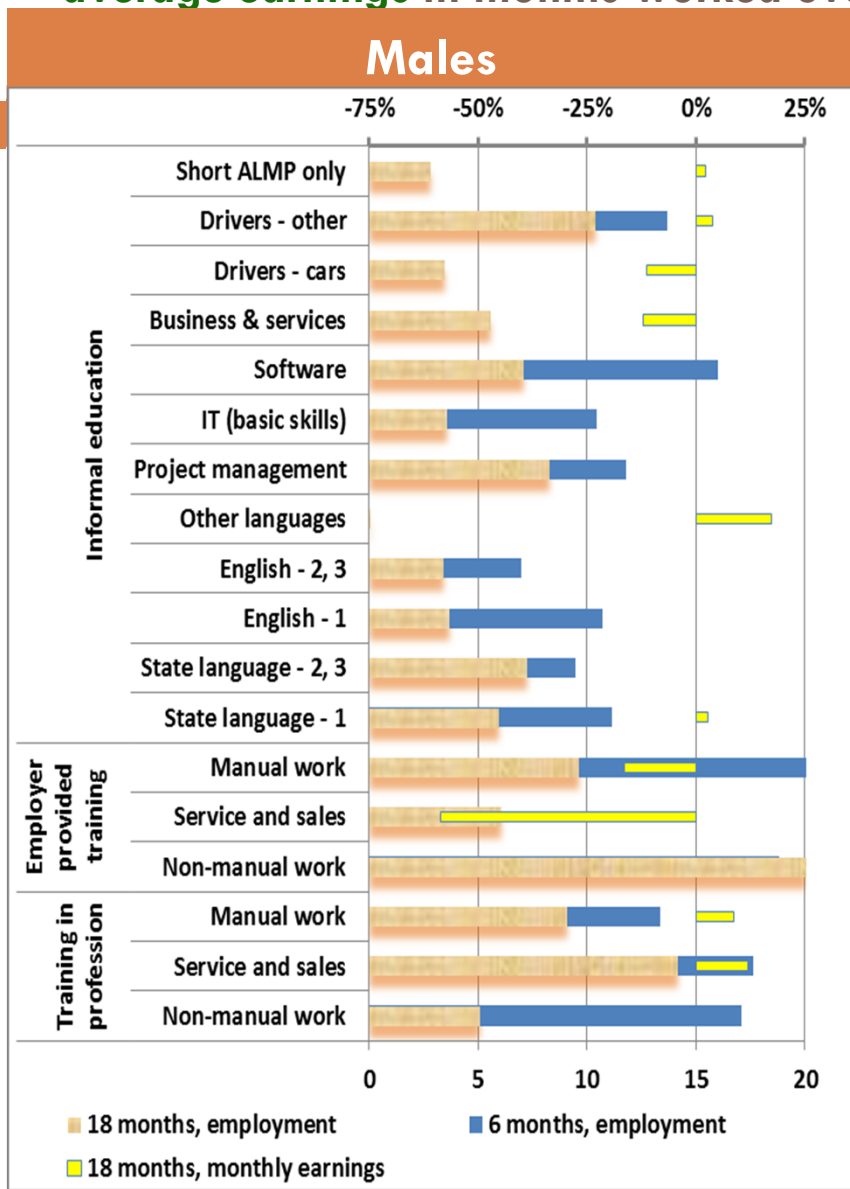
Conclusion of ALMP Evaluation (2)

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- For **most of the employer-provided training programs** (service and sales sector for both genders; manual jobs for men, and non-manual jobs for women), **the participants who keep their jobs have much lower wages than otherwise similar participants of other programs or non-participants**; for females, these programs also do not show a long-term effect on employment
- There is no case for expanding subsidized employer provided training
- While short (non-training) measures to improve competitiveness of the unemployed are useful, they cannot substitute training and education, especially in the medium and longer term
- Evaluation of new ALMP programs using micro-level data should become a normal practice

Estimated ALMP effects on:

- **employment rates 6 and 18 months after training** (% points, **lower scale**)
- **average earnings in months worked over 18 months** (% , **upper scale**)



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Thank you!