

(approved
by Cabinet Order No. _____
_____ 2014)

**Concept paper „Setting of the minimum income level”
(informative part)**

Riga, 2014

Content

Used abbreviations	3
Introduction	4
1. Definition and detailed description of the problem	7
1.1. Minimum income levels/ at-risk-of-poverty thresholds in Latvia for 1991-2013	7
1.1.1. Minimum subsistence level	10
1.1.2. The income level compliant with the status of a needy family (person)	12
1.1.3. The income level compliant with the status of a low-income person.....	14
1.1.4. Guaranteed minimum income level	15
1.1.5. (EU) At-risk-of-poverty threshold	17
1.2. Impact of social transfers upon the reduction of poverty	22
1.3. Income inequality	27
1.4. Minimum income levels in Estonia and Lithuania	34
2. Solutions to the problem	36
3. Assessment of the impact of solutions upon the central and municipal budgets.....	44
4. Further Action.....	49

Used abbreviations

CSB	Central Statistical Bureau of the Republic of Latvia
EU	European Union
EC	European Commission
EUROSTAT	Statistical Office of the European Union
GMI	Guaranteed minimum income
PIT	Personal Income Tax
GDP	Gross Domestic Product
MoW	Ministry of Welfare
CM	Cabinet of Ministers
OECD	Organisation for Economic Co-operation and Development
WB	World Bank
SSIMC	State social insurance mandatory contributions

Introduction

Fighting poverty and social exclusion has been set as a priority goal in the European Union (EU) strategy "Europe 2020". It is stated there that the number of persons in the EU facing poverty and social exclusion should be reduced by at least 20 million until 2020. This is the first time in the EU history when the reduction of poverty is expressed in numbers, which enforces this undertaking, as it asks for more careful data analysis, looking for causal relationships and the most suitable solutions. Each EU Member State sets its quantitative target on the basis of the three indicators defined at the EU level and forming the indicator of the EU target for reduction of poverty: the at-risk-of-poverty rate¹, people living in households with very low work intensity² and severe material deprivation indicator³ or by choosing own national indicator. Latvia's target on the poverty reduction is based on two indicators: at-risk-of poverty rate and/or the people living in households with very low work intensity, defining that until 2020 the risk of poverty and social exclusion should be eliminated for 121 thousand residents of Latvia. Latvia's goals for the reduction of poverty are singled out also in the *National Development Plan (2014 – 2020)*, and are as follows:

- 1) implement measures to raise the standard of living of employed persons by reducing the proportion of employees exposed to the risk of poverty in the 18 to 64 age group from 9.5% in 2010 to 5% in 2020⁴;
- 2) by means of a comprehensive family support system that encourages a reconciliation of work and family life, reduce the at-risk-of-poverty of children from 25% in 2010 to 20% in 2020⁵.

Although there are minimum income schemes in each country, they are not always sufficient for preventing the risk of becoming poor or escaping the poverty. Therefore, the European Parliament in its resolution of 2010⁶ invites the Member States to introduce relevant minimum income schemes and to set the minimum income threshold that would correspond to at least 60% of the national median equivalised disposable income in the relevant country. On 10 December 2013, the government of Latvia approved the informative report "Proposals for improvement of the social security system" where the undertaking to develop a new and common minimum income level is defined as a key required measure. On the same date also the European Economic and Social Committee⁷ adopted an opinion regarding the European minimum income and poverty indicators where is emphasised the necessity to ensure adequate minimum income in the EU, to review the methodologies for the assessment of the poverty levels, to carry out the evaluation of social impact of the measures included in the National reform programs and National social reports, to implement in-depth monitoring of the situation regarding poverty and social exclusion etc. Finally, also the World Bank in its

¹ The at-risk-of-poverty rate is the share (percentage) of residents below the defined at-risk-of-poverty threshold.

² A person is considered to be living in a household with a very low work intensity if the ratio of the months worked during the reporting period by all the members of the household at the working age (18 -59 years) to the total number of months that the household members could theoretically work is below 20%.

³ Severe material deprivation is characteristic of the persons who correspond to at least four criteria of material deprivation: the lack of financial capacity 1) to cover utility payments, rent or to repay a loan; 2) to afford to maintain one's house warm; 3) to cover sudden, unexpected expenses from own resources; 4) to eat meat, poultry or fish every second day; 5) to go for a holiday outside one's home for at least one week every year; 6) to use a car for one's own needs; 7) to possess a washing machine; 8) a colour TV; 9) a telephone.

⁴ National Development Plan of Latvia for 2014-2020, Cross-Sectoral Coordination Centre (2012), p.37.

⁵ Ibid, p. 40.

⁶ European Parliament resolution of 20 October 2010 on the role of minimum income in combating poverty and promoting an inclusive society in Europe (2010/2039(INI)), [OJ C 70E, 8.3.2012., pp. 8–18](#)

⁷ European Economic and Social Committee, SOC/482 „European minimum income and poverty indicators”, 10 December 2013. Available at <http://www.eesc.europa.eu/?i=portal.en.soc-opinions.26780>. Viewed on 08.07.2014.

study of 2013⁸ indicated the necessity to implement a wide debate regarding the adequacy of the minimum income support as well as the mechanisms based upon which the entitlement to receive particular benefits and their amounts is defined, at the same time emphasising the necessity to carefully analyse the incentives for the transition from receiving passive support to the active involvement in the labour market⁹.

Poverty is a multidimensional phenomenon. The causes of poverty may be both low and insufficient income and also obstacles preventing the involvement in employment, for example, insufficient and/or non-compliant knowledge and skills, poor health, discrimination, stereotypes and prejudices. The poverty may also be contributed to by unbalanced economic development of the regions in a country, a high unemployment level outside large cities, insufficiently progressive system of reallocation of taxes, insufficient linkage with the system of benefits and other objective and subjective reasons.

The **overarching goal** for setting the minimum income level is the reduction of poverty and income inequality on the basis of solidarity principles. The **goal** is to define methodologically justified minimum income level compliant with the socioeconomic situation that would serve as a benchmark for the improvement of the support measures defined within the fields of social security system (state social benefits, social insurance, social assistance). At the same time it is important to apply the minimum income level for the improvement of the labour tax system in order not to create the motivation for the passive receipt of the support, but to encourage active involvement in the labour market along with receiving the assistance. Within the context of both the provision of the minimum income level and the promotion of employment, the role of the policy for reducing the shadow economy is particularly important because the share of shadow economy to a great extent impacts the support available to the population that could be received from different fields and systems which are important and indispensable for ensuring a dignified life.

This concept paper provides the evaluation of poverty threshold or minimum income levels currently established in Latvia by identifying their deficiencies, as well as provides the description of the minimum income levels in Estonia and Lithuania. The impact of benefits, pensions and other social transfers¹⁰ upon the income of population and the reduction of their poverty risk has also been evaluated. The concept paper also analyses the income inequality by describing the efficiency of tax and benefit system, as well as provides the evaluation of linking the minimum wage with the minimum income level. Based on the situation assessment, solutions are proposed for defining an adequate, justified and common minimum income level in the country by identifying the necessary links with certain action policies.

The draft concept paper has been presented to several stakeholders and generally positive evaluation and support for further development has been received. In May 2014 it was presented during the annual negotiation round of the Association of Local and Regional Governments and the Ministry of Welfare, as well as at the meeting of the Social Security Sub-Committee. In June and July 2014 the draft concept paper was presented at the advisory institutions established by the Ministry of Welfare: at the meetings of the Social Inclusion

⁸ World Bank study „Latvia: Who is Unemployed, Inactive or Needy?”, p.14. Available at http://www.lm.gov.lv/upload/aktualitates/latvia_compwbs.pdf. Viewed on 08.07.2014.

⁹ *ibid.* p. 20 Viewed on 08.07.2014.

¹⁰ Social transfers: pensions and benefits (paid by state and municipalities), subsistence for children, scholarships, social insurance benefits and compensations, including also from other countries. Website of the Central Statistical Bureau <http://www.csb.gov.lv/statistikas-temas/termini/socialie-transferti-36002.html>. Viewed on 30.05.2014.

Policy Coordination Committee¹¹ and Cooperation Council of Social Work Experts¹². The draft concept paper was also sent to the members of the Social Inclusion Policy Coordination Committee asking for written comments, and in the result, proposals and amendments were received from the representative of Kurzeme Planning Region and these were incorporated in this concept paper accordingly. From 4th to 18th July 2014, the draft paper was published on the website of the Ministry of Welfare for public consultation¹³ and a supporting and positive response was received from the Samaritan Association of Latvia. During the discussions two major questions were raised regarding 1) the proposed equivalence scale for a child, expressing the view that it was too low, and 2) too little emphasis on the activation of individuals and involvement in the solution of one's own situation in order to prevent the possibilities of promoting the passive receipt of support. After having evaluated the views of the stakeholders, the Ministry of Welfare changed the proposed equivalence scale for children by increasing it accordingly, as well as included a broader information about the goal of the equivalence scales, their most widespread kinds and reviewed the major discussion points regarding the calculation of the equivalence scales. In order not to create an impression that it is only planned to provide support to the population without their active involvement in the improvement of their own situation (where possible), the concept paper was supplemented with the relevant information by emphasising that the financial support will be evaluated along with the participation measures by maximising their implementation efficiency.

¹¹ The minutes of the meeting on 18.06.2014 by following the link on the website of MoW <http://www.lm.gov.lv/text/2676>.

¹² The minutes of the meeting on 02.07.2014 by following the link on the website of MoW <http://www.lm.gov.lv/text/1654>.

¹³ The information is available by following the link on the website of MoW <http://www.lm.gov.lv/text/1789>.

1. Definition and detailed description of the problem

A relatively high at-risk-of-poverty has been maintained in Latvia for more than ten years as the minimum income of population from both paid work (taxes, remuneration, etc.) and the social protection system (the guaranteed minimum income level, the state social security benefit, etc.) is not sufficient for securing the reduction of poverty in the country. The poverty situation in Latvia was analysed in the information report "Proposals for improvement of the social security system"¹⁴, therefore this information will not be reiterated in the present concept paper. However, results of the World Bank study will be emphasised once again, where along with the general evaluation of the system the major deficiencies of the social security system are referred to and the problems in the social assistance system, the labour market policy, the state policy of social benefits and taxes are identified and, at the same time, key population risk groups are defined.

The following are defined as the major common problem areas of the social security system in the conclusions drawn within the framework of the World Bank study:

- a lack of clearly defined targets of the support provided by the state and municipalities and the necessity of its improvement regarding the most poorest population;
- the necessity to implement measures that would allow smoother transition from social assistance support to paid employment;
- the necessity to define more accurately the priority target groups to be supported;
- the necessity to improve certain active employment measures.

The key target groups whose support measures need to be improved or for whom new initiatives should be developed are low income families with children, households with low work intensity, elderly population, in particular with addiction issues, chronic diseases or disability.

The subdivisions of this section analyse the historical formation of the minimum income level/at-risk-of-poverty thresholds defined and/or used in Latvia¹⁵ and their calculation methodology, review the international practice regarding the calculation of poverty thresholds, analyses the impact of social transfers upon the reduction of poverty of the population, evaluates the role of taxes within the context of income inequality and reviews the practice of Lithuania and Estonia in defining and applying the minimum income level.

1.1. Minimum income levels/ at-risk-of-poverty thresholds in Latvia for 1991-2013

Five minimum income levels/ at-risk-of-poverty thresholds were calculated or defined in Latvia until 2013. Prior to listing them, it is important to take into account that the goals and the criteria of defining and applying them, as well as the time-frame considerably differs, therefore, on one hand, their comparison and sequential listing is not useful. On the other hand, one should be aware of the importance and the role of these indicators in the development of the action policy and in relation with the views prevailing in the public for more than ten years, at the same time also keeping in mind that the evaluation regarding the existing indicators has not been done so far. Taking into account these considerations, the

¹⁴ Approved by the Cabinet of Ministers on 10 December, 2013 Available at http://www.lm.gov.lv/upload/aktualitates2/lmzino_211113.pdf.

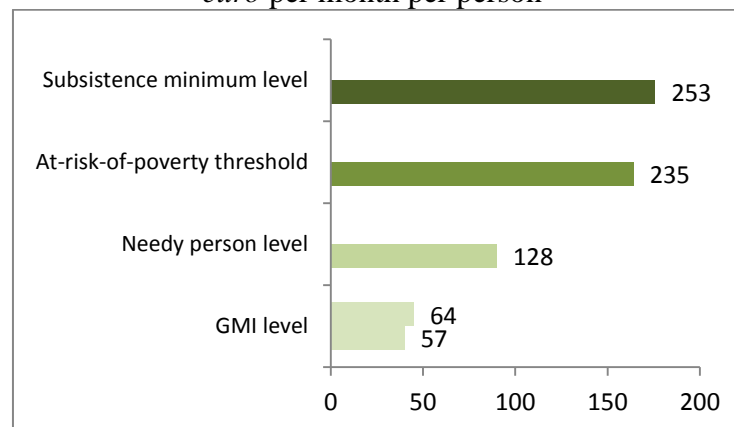
¹⁵ The minimum income level and at-risk-of-poverty threshold should not be viewed as synonyms because they have different goals, different purposes of definition and application.

listing of the minimum income levels/at-risk-of-poverty thresholds is provided below based on their definition and/or validity year/-s:

- (1) (1991-2013) the value of the full minimum subsistence basket of goods and services per person (hereinafter referred to as the “minimum subsistence level”);
- (2) (1993) the income level compliant with the status of a needy person (hereinafter referred to as the “needy person”);
- (3) (1993) the income level compliant with the status of a low-income person (hereinafter referred to as the “low-income person”);
- (4) (2003) the guaranteed minimum income level (hereinafter referred to as the “GMI level”);
- (5) (2004) the at-risk-of-poverty threshold defined at the EU level (hereinafter referred to as the “at-risk-of-poverty threshold”).

It should be added that municipalities have set different levels of income as compliant with the status of a low-income person (from 142 to 356 *euro* per month), therefore these amounts are not listed in Figure 1.

Figure 1.
The amounts of the minimum income levels/ at-risk-of-poverty thresholds in 2012,
euro per month per person¹⁶



Data source: CSB and MoW

* 64 *euro* for a child, 57 *euro* for an adult

As it can be seen from Figure 1, in 2012 the GMI level was the lowest level followed by the income level of a needy person. The minimum subsistence level and the at-risk-of-poverty threshold were considerably higher. In addition to the different amounts of the minimum income/ at-risk-of-poverty threshold, it is important to find out if these are set in regulatory enactments, thus impacting a person's entitlement to apply for a certain support (see Table 1).

Table 1.
Minimum income levels/ at-risk-of-poverty thresholds in Latvia for 2013

Levels/ thresholds	Defined in national regulatory enactments	Calculation methodology
Minimum subsistence level	Not defined	Yes
The income level of a needy person	Defined	None
The income level of a low-income person (differentiated)	Defined	None

¹⁶ The data of 2012 are provided as the at-risk-of-poverty threshold for 2013 will be available in January/ February 2015.

Guaranteed minimum income (GMI) level	Defined	None
At-risk-of-poverty threshold	Not defined	Yes

Source: MoW

At national level the minimum income levels/ the at-risk-of-poverty thresholds as defined in regulatory enactments are not defined on the basis of any particular calculation methodology. They are set depending on the financial possibilities of the state and municipalities at the particular moment. Moreover, there is no clear indexation procedure of these levels. Still, they provide a possibility for persons to qualify for receiving various services and benefits, for example, a benefit for ensuring the GMI level, allowances for needy persons to ensure the accessibility of various services, etc. The minimum subsistence level and the at-risk-of-poverty threshold, which are not defined in regulatory enactments, are calculated on the basis of particular methodology and they are mainly used for statistical purposes and not the provision of assistance and support to the population.

There are several major problems related to the existence of such different minimum income levels/ at-risk-of-poverty thresholds (hereinafter all of them referred to as the minimum income level):

- it is not possible to develop a targeted and measurable policy because resources are not focused for reaching a target. In particular, the minimum income is aimed at ensuring income which is not dependent on contributions and which forms a safety net for persons to whom social insurance benefits and/or state universal social benefits are not available¹⁷. As there are different minimum income levels with different links to regulatory enactments, their role and purpose is not clear and the support provided by them is unbalanced, and their contribution to solving the poverty problem is not compliant;
- different interpretation possibilities. When there are different minimum income levels with different purposes of their use, various indicators are used for reflecting the poverty issue. As a result, every stakeholder (mass media, population, state and municipal institutions, NGO's, etc.) use the indicator which they consider suitable for the particular case, compliant with the current socioeconomic situation, as well as according to their own understanding of the method of calculation of the particular indicator and the purpose of its definition or application. For example, the minimum subsistence level was not set by regulatory enactments at national level, thus the state support was not provided to people with income below the minimum subsistence level. However, various stakeholders regularly used the data of the minimum subsistence level for describing the social situation in the country and the required support for an individual¹⁸;
- due to the lack of the methodology for setting the minimum income level it is not possible to provide arguments regarding their justification and adequacy.

Further subdivisions provide a more comprehensive description of the defined minimum income levels.

¹⁷ European Commission and Social Affairs Commission opinion regarding "Minimum Income in Europe" (own initiative report). Brussels, 10 December 2013. SOC/482. Available at <http://www.eesc.europa.eu/?i=portal.en.soc-opinions.26780>. Viewed on 31.05.2014.

¹⁸ Kůla, E. The minimum subsistence level income as a human security factor. Collection "Social human security: development of abilities, cooperation, inclusion" (2013). p. 21, Editor in charge F. Rajevska. ISBN 978-9984-45-609-6.

1.1.1. Minimum subsistence level

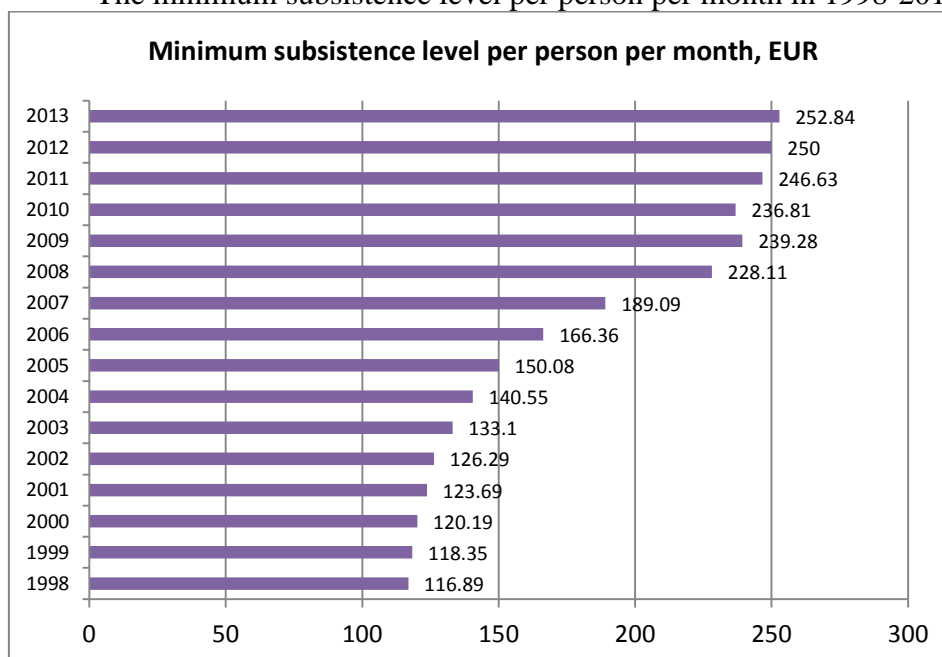
The content of items and consumption standards of the full minimum consumer basket of goods and services (the subsistence minimum) were defined in Resolution of the Cabinet of Ministers No. 95 of 8 April 1991, Annex No. 3. The minimum subsistence level is the first minimum consumption level that was defined following the restoration of the independence in 1991 and it was valid for 23 years as since January 1, 2014 the calculation of the minimum subsistence level has been suspended. However, having regard of its long-term validity and importance in relation to the society's prevailing opinion and understanding of it as a level describing the population income, in this concept paper it will be classified as a minimum income level.

The standards of subsistence minimum basket were developed on the basis of methodology developed by the Ministry of Work and Social Affairs of the USSR in 1991. It is clear that its nomenclature reflected the opinion regarding the minimum consumption needs prevailing at the end of 1980-ies. The subsistence minimum basket applied until now included food items, consumer goods and services the amount of which ensured the minimum subsistence level as accepted in the society at that time, excluding alcohol and tobacco products, luxury items, health care and education services.

The calculations of the value of the full minimum consumer basket of goods and services were done on the basis of the monthly survey of consumer prices. Various venues of trade and provision of paid services most visited by customers all over the territory of Latvia (shops, markets) were surveyed by observing and recording the prices of consumer goods and services. The norms of the goods and services included in the basket were multiplied with the average prices of the relevant month, these multiplications were finally added up, thus obtaining a single value that was published every month on the website of Central Statistical Bureau.

Figure 2.

The minimum subsistence level per person per month in 1998-2013, *euro*



Source: CSB

As it can be seen in Figure 2, the minimum subsistence level has been increasing gradually on an annual basis since 1998, except the deepest crisis period in 2010 when the prices of goods and services in the consumer basket slightly decreased.

When the indicator of minimum subsistence level was linked to the social protection system, it considerably strengthened its importance and applicability. The linking of it with the regulatory enactments *de jure* was terminated in 2003 when the new Regulation of the Cabinet of Ministers on the status of a needy person entered into force¹⁹, however, in practice the minimum subsistence level was not taken into account since 1996 when on 26 March Regulations of the Cabinet of Ministers No. 75 "Regulations on the social assistance benefit to needy families and the evaluation of the material condition of needy families" entered into force. Accordingly, for 18 years the minimum subsistence level has only had an informative role and has been basically used for statistical purposes²⁰, for example, for comparing it to the minimum monthly wage or other minimum income levels. Taking into account the outdated methodology of the minimum subsistence level (an unchanged range of food items and consumer goods for 23 years), the minimum subsistence level has not been calculated since 1 January 2014, i.e., the minimum subsistence level was removed from the State Statistical Information Program annually approved by the Cabinet of Ministers .

Both in regulatory enactments and in individual studies the term "crisis minimum subsistence level" and "the food share of the crisis minimum subsistence level" is used. In regulatory enactments defining the crisis minimum subsistence level and its food share, only their amounts can be found, but there is no explanation behind what it means. Next year following the setting of the minimum subsistence level (1992), the crisis minimum subsistence level²¹ and the food share of the crisis minimum subsistence level²² were defined in regulatory enactments. The Dutch researcher Franciska Gassmann, in her study about the poverty in Latvia, wrote that the food share of the crisis minimum subsistence level was the minimum required for subsistence²³ plus 5% of the total value of goods and services²⁴. The Central Statistical Bureau provides the following general and very brief information regarding the minimum subsistence level in unpublished materials: "In the spring of 1993 the crisis minimum consumer basket was created and existed for just a few years"²⁵.

At present the Baltic International Centre for Economic Policy Studies is involved in an EU pilot project (the project implementation term: January 2014 - February 2015), within the framework of which the common EU methodology for reference budgets²⁶ is being developed for the purpose of evaluation of the social protection systems existing in the EU Member States²⁷. Within the framework of this pilot project the University of Antwerp and the independent research company "Applica" analyses the experience of all the 28 EU Member States in the definition of reference budgets and their application during the last 40 years, and based on the summary of theoretical conclusions and the experience of the Member

¹⁹ Regulations of the CM No. 97 of 25.02.2003 "Procedure for declaring a family or a single person household a needy" /not in force/

²⁰ Gassmann, F. (2000). „On the verge of poverty: welfare and economic transition in Latvia” p. 52, Maastricht University.

²¹ Resolution of the Cabinet of Ministers of the Republic of Latvia No. 188 of 22 May 1992 "Regarding changes in the minimum wage and the amounts of benefits and scholarships".

²² Resolution of the Cabinet of Ministers of the Republic of Latvia No. 550 of 24 December 1992 "Regarding the approval of the crisis minimum subsistence level".

²³ Bread, meat, eggs, milk, fish, sugar, oil and margarine, potatoes, vegetables, fruit and berries.

²⁴ Gassmann, F. (2000). „On the verge of poverty: welfare and economic transition in Latvia” p. 53, Maastricht University.

²⁵ Kūla, E. The minimum subsistence level income as a human security factor. Collection "Social human security: development of abilities, cooperation, inclusion" (2013). p. 21, Editor in charge F. Rajevska. ISBN 978-9984-45-609-6.

²⁶ Reference budget is the basket of goods and services which reflects a certain living standard in the particular country or region; it is analogous to the minimum consumer basket in Latvia.

²⁷ European Commission „Pilot Project for the development of a common methodology on reference budgets in Europe" (2014), p.10.

More information at <http://ec.europa.eu/social/main.jsp?catId=625&langId=en&callId=382&furtherCalls=yes>

States, the methodology for the definition of the consumer basket of goods and services will be developed for several types of households, by estimating the values of the baskets in compliance with the socioeconomic situation of each EU Member State.

The subsistence minimum baskets comply with the approach of measuring the absolute poverty comprising consumer goods and services that are estimated and evaluated in compliance with the minimum monthly or annual costs required for an individual or a family. The application of subsistence minimum baskets is widespread across EU Member States, however, the methodologies of developing these baskets differ, and therefore no comparison among the Member States is possible. Usually the prevailing opinion in the society (also in Latvia) is that the at-risk-of-poverty threshold or the minimum income level should be defined equal to the value of this subsistence minimum basket²⁸. However, there are clearly defined differences between the minimum subsistence level, the poverty threshold and the minimum income. In particular, the baskets of goods and services are developed for the purpose of reflecting a certain living standard. The poverty threshold means the level of economic resources used for identifying who is or is not poor. If the poverty means the necessary minimum economic resources for an individual not to be excluded from the minimum accepted living standard in the society where he/ she lives, it depends on both the individual's needs and circumstances and the social context. The subsistence minimum baskets, in their turn, are developed only for a few types of families or the most typical models of households living in clearly defined conditions. For example, during elaboration of the basket of goods and services, a person with a relatively good health condition serves as a criterion according to which the minimum consumer goods and services to be included in the basket are defined, because it is not possible to develop the minimum consumer basket of goods and services for a person with health issues as there are too many variables and influencing factors (the person's age, diseases, types of medicines and doctors to be seen, accessibility and prices, etc.). Therefore, the subsistence minimum baskets are mainly used for assessing the sufficiency and adequacy of the income set in the country without applying them in the legislation. Though there are also a few exceptions²⁹.

1.1.2. Needy family (person) income level

The term “needy family (person)” was defined in the legislation as early as in 1993 when a family where the income per family member did not exceed 75% of the minimum subsistence level defined by the Cabinet of Ministers³⁰ and amounting to 75% of the crisis minimum subsistence level was classified as a needy family. Over the course of time the linkage of the income level of a needy family (person) to certain indicators of the living standard has changed:

- from 1993 to 2003 the income level of a needy family (person) was defined equal to 75% of the crisis minimum subsistence level per person in the family³¹. It should be noted that the available documentary evidence regarding the amounts of the crisis minimum subsistence level and the amounts of the income of needy family (person) is

²⁸ Kūla, E. The minimum subsistence level income as a human security factor. Collection “Social human security: development of abilities, cooperation, inclusion” (2013). p. 21, Editor in charge F. Rajevska. ISBN 978-9984-45-609-6

²⁹ European Commission „Pilot Project for the development of a common methodology on reference budgets in Europe” (2014), pp. 13-14.

³⁰ Regulations of the CM No. 19 of 18.11.1993 “Procedure for classifying families as needy” and Regulations of the CM No. 75 of 26.03.1996 “Regulations regarding the social assistance benefits to needy families and the evaluation of the material condition of needy families” /not in force/

³¹ Ibid.

scattered and relates to one or two years, therefore this information is not included in the Table 2 below.

- starting from 2003, the income level of a needy family (person) was no longer related to the crisis minimum subsistence level and was linked to the minimum monthly wage by defining that the income level of a needy family (person) per family member does not exceed 50% of the minimum wage in the country valid as on the 1st January of the relevant year during the last three months³²;
- and as from 2011 the income level of a needy family (person) was again no longer linked to the minimum wage and was defined equal to a particular level. Namely, a family (person) shall be declared as needy if its average income per family member does not exceed 128.06 *euro*³³ during the last three months.

Table 2.

Income level of a needy person for 2003-2014

<i>YEAR</i>	<i>EURO per month</i>
2003	50
2004	57
2005	57
2006	64
2007	85
2008	114
2009	128
2010	128
2011	128
2012	128
2013	128
2014	128

Source: MoW (the amounts are rounded)

In the executive summary, which is the report on the assessment of initial impact of each regulatory enactment, where information has to be provided, inter alia, on the justification of the draft legal act, the current situation and problems, the goal and the essence of the legal regulation, etc., no explanation has been provided³⁴ on why the income level on the basis of which a person is declared as needy is changed, which indirectly attests that the resolution was adopted during the economic crisis without justified calculation methodology, on the basis of the agreement reached between stakeholders. Initially this amendment was intended to be in force until the end of 2011, however, later this norm of the crisis period was maintained.

Moreover, the criteria of a needy person, based on the evaluation of material resources, may differ among municipalities, thus placing people in an unequal situation.

³² Regulations of the CM No. 97 of 25.02.2003 "Procedure for declaring a family or a single person household a needy" /not in force/; Regulations of the CM No. 214 of 03.03.2009 "Regulations regarding the declaring of a family or a single person household a needy" /not in force/; Regulations of the CM No. 299 of 30.03.2010 "Regulations regarding the declaring of a family or a single person household a needy" /in force/

³³ Regulations of the CM No. 1140 of 21.12.2010 "Amendments to Regulations of the CM No. 299 of 30. March 2010 "Regulations regarding the declaring of a family or a single person household a needy"".

³⁴ Draft Regulations of the CM "Amendments to Regulations of the CM No. 299 of 30. March 2010 "Regulations regarding the declaring of a family or a single person household a needy" were developed on the basis of the task assigned to the MoW in the meeting of the CM on 19.11.2010 (protocol no. 65, 2§ Clause 48) in relation to the fiscal consolidation measures to be implemented in the central budget of 2011, in particular, the development of amendments to regulatory enactments by defining that the threshold of 90 lats should be applied for the purpose of declaring the status of a needy family (person) for years 2011 and 2012.

The status of a needy person provides an entitlement to certain reliefs defined by the state, for example, the legal assistance provided by the state, the relief from the payment of certain state duties and the patient's fee, a reduced rate of the property tax, etc.

1.1.3. Low-income person income level

Different from the income level of a needy family (person), the income level of a low-income person, as well as different property evaluation criteria can be defined individually by each municipality in its own binding regulations. It is only provided in regulatory enactments³⁵ that the income level of a low-income person shall not be below the income level of a needy family (person), however it can be equal to that, meaning that in 2014 it was 128.06 *euro*. This means that a municipality may define a higher income level of a low-income person and provide for the entitlement to assistance, for example, the housing benefit, a support for health care and mandatory education for more people. Thus, only the minimum social assistance level is defined at national level and municipalities have a legal entitlement to develop social assistance policy which is more favourable to people.

Information regarding the income levels of low-income persons in municipalities is available only from 2010 as the income level of a low-income person was not provided in the state statistical reports until then. The below Table 3 reflects the information regarding the number of municipalities who have set the income levels of low-income persons above the income level of a needy person and the range of the income levels of low-income persons in the relevant year.

Table 3.

	Number of municipalities who have set a higher income level of a low-income person (% of the total number of municipalities)	Range of the income level of the status of a low-income person, <i>euro</i>
2010	50 (42 %)	141 - 369
2011	46 (38 %)	142 - 356
2012	39 (33 %)	142 - 356
2013	73 (61%)	142 - 356

Source: Summary by the MoW based on the data provided by municipalities

As it can be seen, not all the municipalities used their rights to set a higher income level of a low-income person. Moreover, from 2010 to 2012 a number of municipalities who used this entitlement tends to decrease, which could be explained by the decrease of the crisis impact and the improvement of the general situation, as well as the termination of the state co-financing to municipalities for providing the housing benefit after 1 May 2012. In 2013 a considerably higher number of municipalities (61%) set a higher income level of a low-income person, which was possibly related to the planned state support to low-income households (needy and low-income) in the situation of the electricity market liberalisation as the increase of the electricity prices was expected. The fact that not all the municipalities used the right to set a higher income level of a low-income person, as well as the differentiated amounts indicate that the circumstances in municipalities differ and the situation of persons with similar income is distinct in different municipalities. In particular, a person with the same income level in municipalities x and y with different municipal binding regulations will be entitled to a certain support and assistance in municipality x and will not be entitled to the same in municipality y, thus placing people in an unequal situation. The above is also confirmed by the evaluation carried out in 2014 regarding the intended structural reforms in

³⁵ Part Six of Section 14 of the Law "Assistance for solving housing issues" and Part Two of Section 36 prim of the Law "Rent of residential premises".

the field of the social assistance policy³⁶, where it is concluded that "A uniform and centralised mechanism has not been defined [...] regarding the granting of the status of a low-income person, which allows the application of common and specific criteria in various municipalities [...]", and it is proposed to set a common income level of a low-income person in the country.

The status of a low-income person, first, provides the entitlement to apply for a housing benefit which is the second social assistance benefit following the benefit for ensuring the GMI level that has to be provided by municipalities on a mandatory basis. As regards the housing benefit, it should also be emphasised that the above research concluded that "The comparison of the criteria for granting the housing benefit and its amounts as provided for in the binding regulations of the municipalities included in the research, leads to the conclusion that there is a great variety. Moreover, there is no similar or comparable approach depending on the size of the particular municipality, thus the amount of the housing benefit available to people in various municipalities and the criteria for granting it are different causing unequal conditions"³⁷. The status of a low-income person also provides the entitlement to other types of benefits and support provided by the municipality and the state.

1.1.4. Guaranteed minimum income level

The guaranteed minimum income level (GMI) was introduced on 1st January 2003 when the Law on Social Services and Social Assistance entered into force. This is the lowest level of the minimum income/ resources provided for in the legislation. The introduction of the GMI was initiated within the framework of the project on reforms of Latvia's social welfare system implemented by the World Bank since 1995. One of the components of the above project was "Administration of the social assistance system". It was aimed at the simplification of the system of social assistance benefits in municipalities by making it more efficient for persons with the lowest income in order to eliminate the different approaches applied in different municipalities regarding the granting of benefits and to ensure the possibilities to receive municipal support for the poorest population of the municipalities³⁸. Four municipal benefits³⁹ that were provided for by the Law "On Social Assistance" were replaced by a single benefit - the benefit for ensuring the guaranteed minimum income level. Its goal was defined as follows "to provide support to the poorest families by avoiding at the same time the development of the dependence of families on social assistance benefits."

Thus, the GMI level is defined in a centralised manner at national level, and the decision regarding the granting of the benefit for ensuring the GMI level, on the basis of the evaluation of the material resources (income and properties) of a family (person), and the calculation of the benefit is adopted by each individual municipality, in particular, the municipal social service office. The municipality is authorised to define a higher GMI level for various groups of population, however, it shall not exceed the income level set for declaring a family or a single person as needy (128.06 *euro* per person per month in 2014). The GMI level is reviewed on an annual basis in compliance with the negotiations between the Ministry of Welfare and the Latvian Association of Local and Regional Governments in

³⁶ "Evaluation of the initial impact (ex-ante) regarding the planned structural reforms in the field of the social assistance policy" (2014), SIA „KPMG Baltics“. "Final report on the best solution versions for changes in the social assistance system and the required support measures from other systems and the evaluation of the impact of proposed versions upon the central and municipal budgets", p. 6. Available on the website of the MoW by following this link <http://www.lm.gov.lv/text/2744>.

³⁷ Ibid. p. 7

³⁸ Ministry of Welfare (1998). "White paper. Latvia: Project of the reforms of the social welfare system", p.2, Administration of the social assistance system. Riga.

³⁹ 1) the social assistance benefit to needy families; 2) the housing benefit; 3) the benefit for care; 4) the funeral benefit. /Law "On Social Assistance", not in force since 01.01.2003./

relation to the annual draft central budget. Thus, the GMI level is not justified on the basis of accurate calculations or set indicators, it is provided for in regulatory enactments based on the prior political agreement between the heads of the Ministry of Welfare and the Latvian Association of Local and Regional Governments. As it can be seen in Table 4, the GMI level has been gradually increasing since 2004, and in 2013 the above authorities agreed to reduce the GMI level to the level of 2008/2009.

Table 4.

GMI level per person in 2003-2014 (*euro* per month)

YEAR	<i>euro</i>
2003	21
2004	26
2005	30
2006	34
2007	38
2008	38
2009 (until 30.09.2009)	53
2009 (from 01.10.2009)	57 and 64*
2010	57 and 64
2011	57 and 64
2012	57 and 64
2013	50
2014	50

Source: MoW (the amounts are rounded);

* 57 *euro* for an adult, 64 *euro* for a child

The families or single persons who have been declared as needy are entitled to benefit for ensuring the GMI level for the time period for which the compliance with the status of a needy family (person) is established (3 to 6 months). However, not all the persons recognized as needy are entitled to this benefit taking into account the low GMI level. In particular, the persons whose income exceeds the GMI level and is below the income level of a needy person (from 49.80 *euro* to 128.06 *euro*) are not entitled to the GMI benefit. By means of the GMI benefit the GMI level set by the state or the municipality is provided for each family member. The GMI benefit is calculated as the difference between the GMI level set by the Cabinet of Ministers or the municipality (49.80 *euro* per month set by the state in 2014) per family member and the total income of the needy family (person)⁴⁰.

Municipalities are authorised to set a higher GMI level⁴¹ than set by the state in order to ensure more protection to the population with the lowest income. In the below Table 5 it can be seen whether and how many municipalities use this option provided for by the law and what is the set GMI level if they do.

Table 5.

The GMI level set by municipalities in 2010-2012

	For adult with disability	For person of retirement age	For a minor (children)
2010			
<i>Number of municipalities</i>	11	10	4
<i>euro</i>	57-128	57-128	57-128
2011			
<i>Number of</i>	11	9	3

⁴⁰ Regulations of the CM No. 550 of 17.06.2009 "Procedure for calculating, granting and paying of the benefit for ensuring the guaranteed minimum income level and signing the agreement for participation".

⁴¹ Clause 2 of Regulations of the CM of 18.12.2012 "Regulations regarding the minimum income level".

<i>municipalities</i>			
<i>euro</i>	85-128	85-128	57-71
2012			
<i>Number of municipalities</i>	5	6	1
<i>euro</i>	107-128	107-128	57

Source: The summary by the MoW based on the survey of municipal social service offices of⁴².

Different from the income levels of a low-income person which are set by municipalities, an option of setting a GMI level above that set by the state is used by comparatively very few municipalities, although the GMI benefit is the last possible support from public resources to people with the lowest income or no income at all. In the evaluation regarding the planned structural reforms in the field of social assistance policy⁴³ it is concluded that „[...] the GMI benefit cannot provide for the basic needs” and “the base GMI amount justified on the basis of economic calculations is required because the amount set by the state is regularly changed which does not indicate on the targeted social policy from the socioeconomic point of view”.

So far there is no analysis made regarding the possible causes behind this trend, therefore this will be among the issues to be solved in the course of the evaluation of the required changes in the social assistance system.

1.1.5. (EU) At-risk-of-poverty threshold

Application of at-risk-of-poverty threshold indicator defined at the EU level was started when Latvia was preparing for joining the EU, i.e. in 2003 when the pre-accession document *Joint Memorandum on Social Inclusion of Latvia* was developed. Along with the development of the above document, Latvia started to use the so called ‘open method of coordination’. The open method of coordination⁴⁴ includes the policy areas which are not regulated by the EU legislation, in particular (1) social inclusion, (2) pensions and (3) health care and long-term care. By using this method, the mechanisms, which may impact the relevant policies are used, for example, common goals and indicators are defined, mutual learning and the best practice exchange is encouraged.

The open method of coordination includes common indicators that consist of 18 overarching or primary indicators and context indicators⁴⁵. One indicator, i.e. the at-risk-of-poverty threshold will be viewed in this concept paper.

The at-risk-of-poverty threshold is expressed as 60% of national median equivalised disposable income⁴⁶. Thus, the population whose disposable income is below 60% of the national median income are deemed to be exposed to the at-risk-of-poverty.

⁴² The survey of 119 municipal social service offices regarding the GMI level set by the municipality council for various groups of population in 2012 and 2013 was carried out from 24 January to 4 February 2013. Achieved response 100%. The survey results are available at the website of the MoW by following this link http://www.lm.gov.lv/upload/invaliditate/gmi_aptauja_feb07102013.pdf.

⁴³ "Evaluation of the initial impact (ex-ante) regarding the planned structural reforms in the field of the social assistance policy" (2014), SIA „KPMG Baltics”; "Final report on the best solution versions for changes in the social assistance system and the required support measures from other systems and the evaluation of the impact of proposed versions upon the central and municipal budgets", p. 6; Available on the website of the MoW by following this link <http://www.lm.gov.lv/text/2744>.

⁴⁴ *Open method of coordination*. More information is available at http://ec.europa.eu/invest-in-research/coordination/coordination01_en.htm.

⁴⁵ Information about the EU social inclusion indicators is available here <http://ec.europa.eu/social/main.jsp?catId=756&langId=en>

⁴⁶ CSB website <http://www.csb.gov.lv/statistikas-temas/metodologija/nabadzibas-ienakumu-nevienlidziba-36833.html?order=title&sort=asc>. Viewed on 30.05.2014.

Median is a statistical indicator describing the centre value (the middle point of distribution) of the observations grouped from the lowest value to the highest value⁴⁷. Thus, the income median means the middle point of the income grouped from the lowest to the highest value (and not the mean income).

Equivalent income is the disposable income of households divided by the number of household members, i.e. by assigning an individual (different) equivalent weight to each household member⁴⁸. The needs of households increase as do the number of household members due to a higher consumption, however, the consumption does not increase in proportion to the number of persons, e.g., the needs for the living space, electricity, etc. do not triple if a household consists of three persons. Therefore equivalence scales are used in order to assign a value to each household member in proportion to their needs in compliance with the number of persons in a household. In assigning these values, usually two factors are taken into account, i.e. the size of a household (the number of family members) and the age of household members (children and adults of working age and older)⁴⁹.

Choice of certain equivalence scales depends on the assumptions regarding how much consumption is saved with every next adult and child, as well as the values of the chosen scales for various individuals. It should be noted that the major discussions regarding equivalence scales have been and still are in relation to the expenses incurred due to the satisfaction of children's needs. For example, what is the child's consumption for electricity, water compared to an adult, or how larger income is needed for a family with a child/ children to attain a certain living standard that would be equal to that of a family without any children, etc. However, in all these cases the consumption by children was set below the consumption of a first person or an adult. At the same time, it is important to emphasise that the values of the selected scales impact the result, i.e. at-risk-of-poverty rate for elderly persons will be lower (and it will be higher for children) if the scales according to which the consumption value of every next household member increases are selected.

The following 3 most widespread scales are distinguished in practice⁵⁰:

- 1) the equivalence scale of the Organisation for Economic Co-operation and Development (OECD), also referred to as Oxford scale according to which value 1 is assigned to the first adult, a value 0.7 to household members above the age of 14 (consumption equals 70% of consumption of the first household member) and 0.5 to children up to age of 14 (consumption equals 50% of consumption of the first household member);
- 2) the OECD modified equivalence scale which was adopted at the end of the 1990-ies by the EU Statistical Bureau EUROSTAT⁵¹, stating that the equivalent weight of a first adult in a household is 1, of the second and each next household member aged above 14 years it is 0.5 and of children aged below 14 it is 0.3;
- 3) the square root scale - the income of households is divided by the square root of the size of a household, assuming that, for example, the needs of a family with 4 members are double a single person household, defining that the equivalent weight of the first adult in a household is 1, of the second and each next household member aged above 14 years it is 0.4 and of children aged below 14 it is 0.3.

⁴⁷ CSB website <http://www.csb.gov.lv/statistikas-temas/termini/mediana-39000.html>. Viewed on 30.05.2014.

⁴⁸ Besharov J., Couch A., Besharov J., Couch A., (2012). Counting the Poor: New Thinking About European Poverty Measures and Lessons for the United States" http://books.google.lv/books?id=sEr3ipZZ7yIC&hl=lv&source=gbs_navlinks_s. page 7

⁴⁹ OECD note „What are equivalence scales?“. Viewed on 30.05.2014.

⁵⁰ Ibid.

⁵¹ EUROSTAT has modified the equivalence scale by assigning lower values to household members aged above and below 14 years.

Table 6.

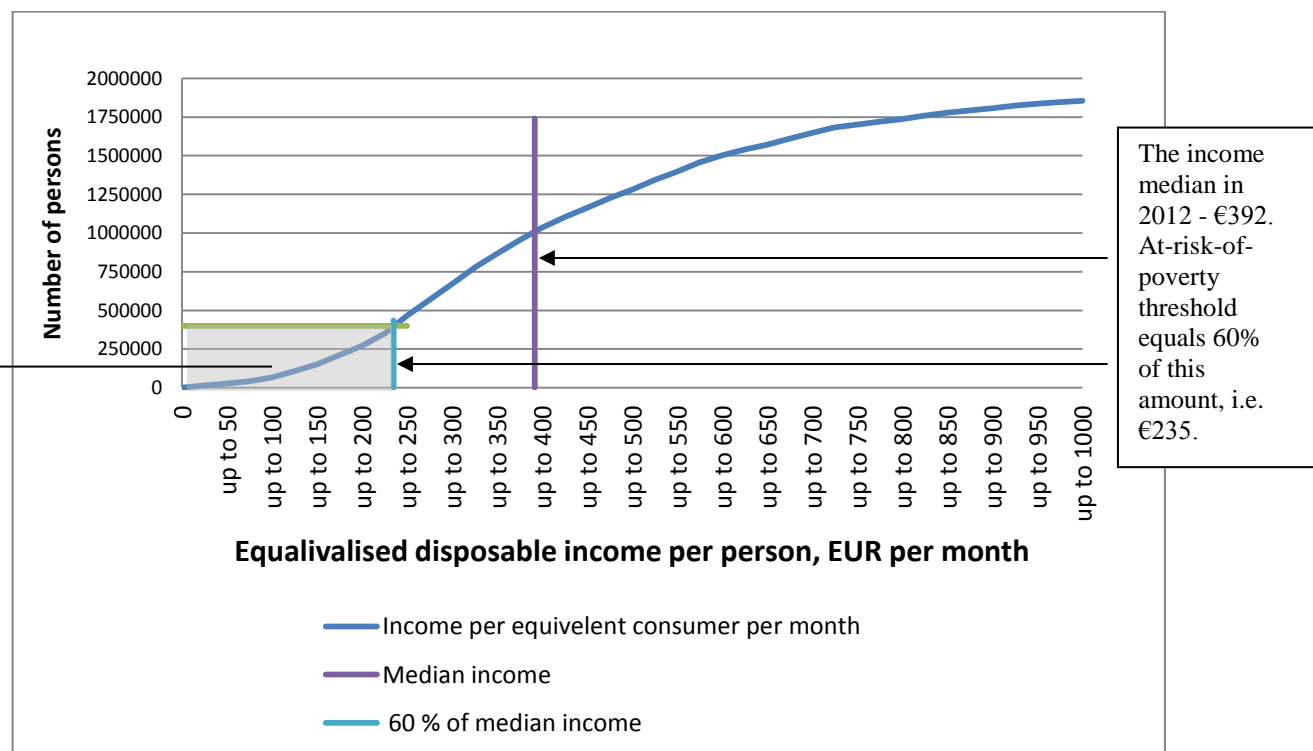
	Latvia's approach ⁵²	OECD equivalence scale	OECD modified equivalence scale ⁵³	Square root scale
1 adult	1	1	1	1
2 adults	2	1.7	1.5	1.4
2 adults, 1 child	3	2.2	1.8	1.7
2 adults, 2 children	4	2.7	2.1	2.0
2 adults, 3 children	5	3.2	12.4	2.2

Source: MoW on the basis of OECD

In Latvia, for the purpose of defining the GMI, the income levels of a needy and a low-income person, the equivalence scales are not applied, i.e. irrespective of the number of persons in a household and their age, the value 1 is assigned to all household members, including children. According to the OECD equivalent scale, the weight for a child until the age of 14 is 0.5, which means that a child consumes 50% or a half of the consumption of a first adult. In case of a modified OECD scale which is applied at the EU, a child's consumption amounts only to 30% of the consumption of the adult. Therefore, in the course of analysing the disposable income of members of households, it is important to know whether the equivalence scales are applied to the persons in a household. If such scales are applied, their value depending on the number and the age of persons in a household has to be known.

In the Figure 1, at-risk-of-poverty threshold of Latvia and at-risk-of-poverty rate (the share of the population below at-risk-of-poverty threshold) in Latvia is reflected on the basis of EU calculation methodology, i.e. 60% of national median equivalised disposable income, by applying the equivalence scale of 1, 0.5 and 0.3.

Figure 1.



Data source: CSB, the Figure made by MoW. 19.4% of the population were exposed to at-risk-of-poverty in Latvia in 2012 or their income was up to 235 euro per month.

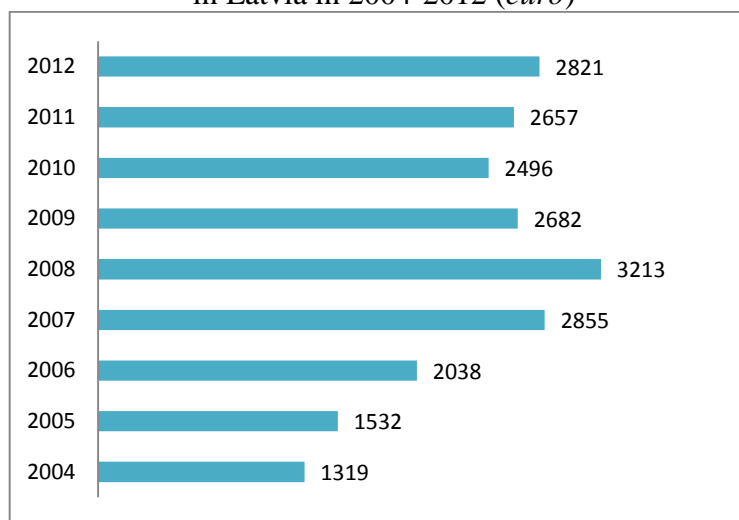
⁵² See sections 1.1.2, 1.1.3, 1.1.4.

⁵³ The scale applied at the EU for the calculation of at-risk-of-poverty threshold.

At-risk-of-poverty threshold is calculated by the statistical offices of Member States based on a common methodology⁵⁴. This indicator and other social inclusion indicators are compared in order to analyse and to evaluate the poverty and social exclusion situation in the EU Member States.

Figure 3.

At-risk-of-poverty threshold for a single person household per year in Latvia in 2004-2012 (*euro*)



Data source: CSB

As seen in Figure 3, at-risk-of-poverty threshold was gradually increasing till 2008, decreased in 2009-2010 due to the crisis impact and has been characterised by the increasing trend since 2011. As at-risk-of-poverty threshold is calculated on the basis of income of population, it is natural that the at-risk-of-poverty threshold was growing up to 2009 because the income of population was continuously increasing year by year, however, during crisis when the income of population rapidly decreased, also the at-risk-of-poverty threshold lowered.

The values of at-risk-of-poverty threshold vary in different countries as the income of population differs, therefore usually these values are not compared, as the income depends on numerous factors, i.e. the taxation system, mechanisms for formation of wages, social protection systems, etc. However, if the situation in Latvia is compared to that in the other EU Member States (see Figure 4), it can be seen that in 2011⁵⁵ the at-risk-of-poverty threshold in Latvia was the fourth lowest behind Romania, Bulgaria and Lithuania. In Latvia a person is exposed to the at-risk-of-poverty if his/her monthly income is up to 221 *euro* for the first member of a household, and, for example, in Belgium this amount is 1002 *euro* per month, in United Kingdom it is 950 *euro*, in Greece – 476 *euro*, in Estonia – 299 *euro*, in Poland – 253 *euro*, in Lithuania – 217 *euro*, in Romania – 106 *euro*. At the same time, it should be noted that the correlation between at-risk-of-poverty threshold and national welfare level cannot be denied, and as seen in Figure 5, the GDP per capita also attests that the poorer a country is, the lower is at-risk-of-poverty threshold.

⁵⁴ Survey “European Union Statistics on Income and Living Conditions” (EU-SILC). The annual income of households, i.e. their composition and amount, is one of the key survey objects.

⁵⁵ Different from the CSB of Latvia, the EUROSTAT publishes the EU-SILC data with a reference to the year of the survey conduct and not the income review period, therefore data of 2012 reflect the situation in 2011 (with the exception of a few countries).

Figure 4.
At-risk-of-poverty threshold in EU-28 for
single person household, 2012 (euro)

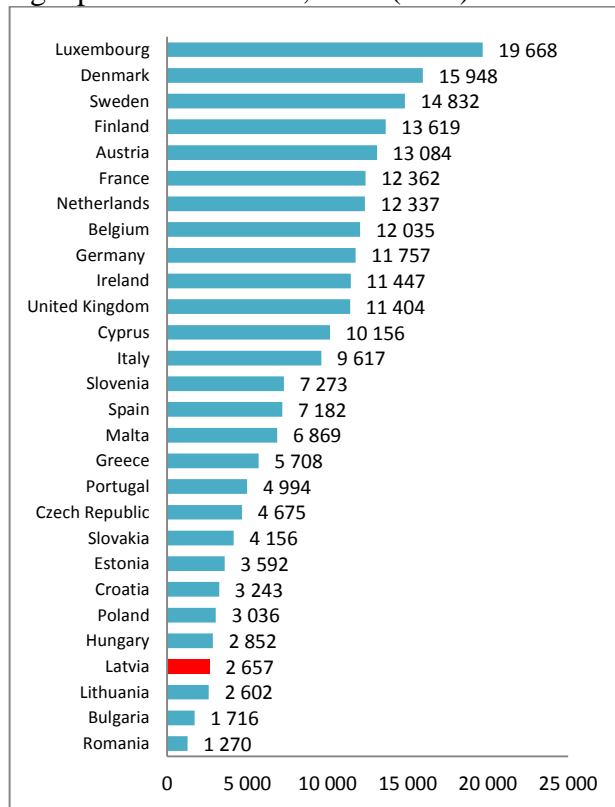
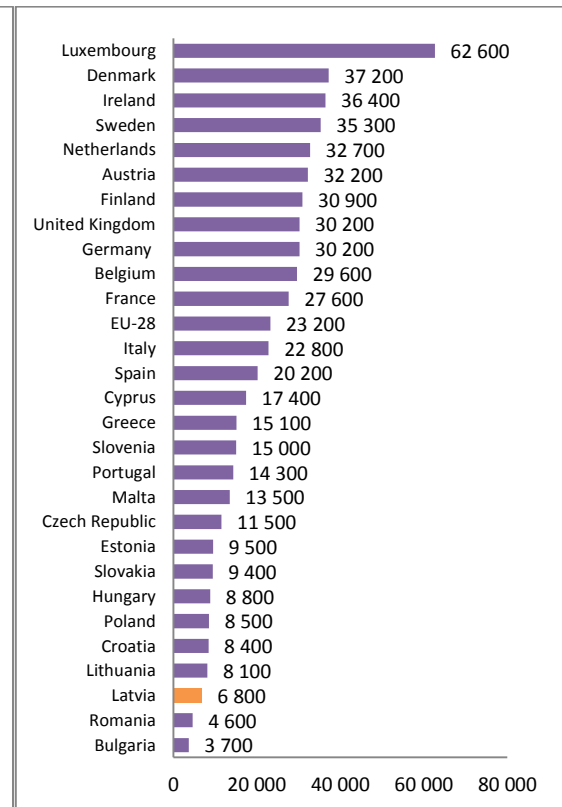


Figure 5.
GDP per capita in EU-28, 2012 (euro)



Data source: Eurostat

A brief historical overview of the process of the adoption of decisions and the justification is provided below in order to clarify why the EU at-risk-of-poverty threshold was set at the level of 60%.

Before 2000 the EU Statistical Office EUROSTAT set the poverty line at 50% of the mean disposable income of households. In the same year, the EUROSTAT changed the method of the poverty assessment in line with the recommendation of the Task force on poverty and social exclusion established by the EUROSTAT in 1998⁵⁶ to define the at-risk-of-poverty in future as follows:

- 1) not taking into account the mean income of households, but the median income instead,
- 2) at the level of 60% of national median equivalised disposable income and not 50% of the mean income of households as it was done before.

Thus, the approach of the poverty measurement was improved in the EU in 2001. The decision to change the calculation methodology for the at-risk-of-poverty threshold by basing it on the median income instead of the mean income is explained by referring to the features characteristic of the distribution of income (asymmetry, etc.), in particular, the median income is less impacted by extreme values of the income distribution and it does not change due to change of selections as much as the mean income. The choice regarding 60% (and not 40%, 50% or 70%) of the median income is not justified from the scientific point of view, as this was the agreement on the lowest income level providing a “normal life” in the EU taking into

⁵⁶ EUROSTAT Task force on poverty and social exclusion (1998).

account that this threshold was equal to the poverty level defined in most EU Member States⁵⁷.

It should be noted that at-risk-of-poverty threshold and also the other EU common indicators are mainly used for statistics purposes, in particular, for comparing situations in other EU Member States, and it does not mean that material support is provided to the people if they are exposed to the risk of poverty. In the EU Member States the support is usually provided to the population if the income of people is up to 30% of national median equivalised disposable income⁵⁸. The EU at-risk-of-poverty threshold is not defined in the regulatory enactments of Latvia either and it is used much more rarely than data regarding needy persons or the minimum subsistence income, still during the crisis and post-crisis period the focus was on these indicators and there could be several explanations behind it:

- 1) The EU development strategy "Europe 2020" for the next 10 years was adopted in 2010 and it includes the quantitative target of poverty reduction;
- 2) crisis and post-crisis period has caused very serious consequences on social situation of people, by exposing a large part of population to the at-risk-of-poverty and social exclusion, therefore the society, including mass media, politicians and scientists, as well as other stakeholders, are increasingly interested in the issues of poverty and inequality and the measurements related to it;
- 3) crisis situations urge countries assess the efficiency of social policy in order to identify deficiencies and faults, therefore policy makers focus more and in details on the analysis of indicators and publicity⁵⁹.

1.2. Impact of social transfers upon the reduction of poverty

In order to identify how efficient the current social security system is, whether it protects against the risk of becoming poor after the receipt of social transfers⁶⁰, the used financing for the state social insurance, state social benefits and municipal social benefits and the at-risk-of-poverty prior to receive of these social transfers is reflected below.

⁵⁷ Besharov J., Couch A., Besharov J., Couch A., (2012). Counting the Poor: New Thinking About European Poverty Measures and Lessons for the United States" http://books.google.lv/books?id=sEr3ipZZ7yIC&hl=lv&source=gbs_navlinks_s. 21 lpp.

⁵⁷ OECD note „What are equivalence scales?”. Viewed on 30.05.2014.

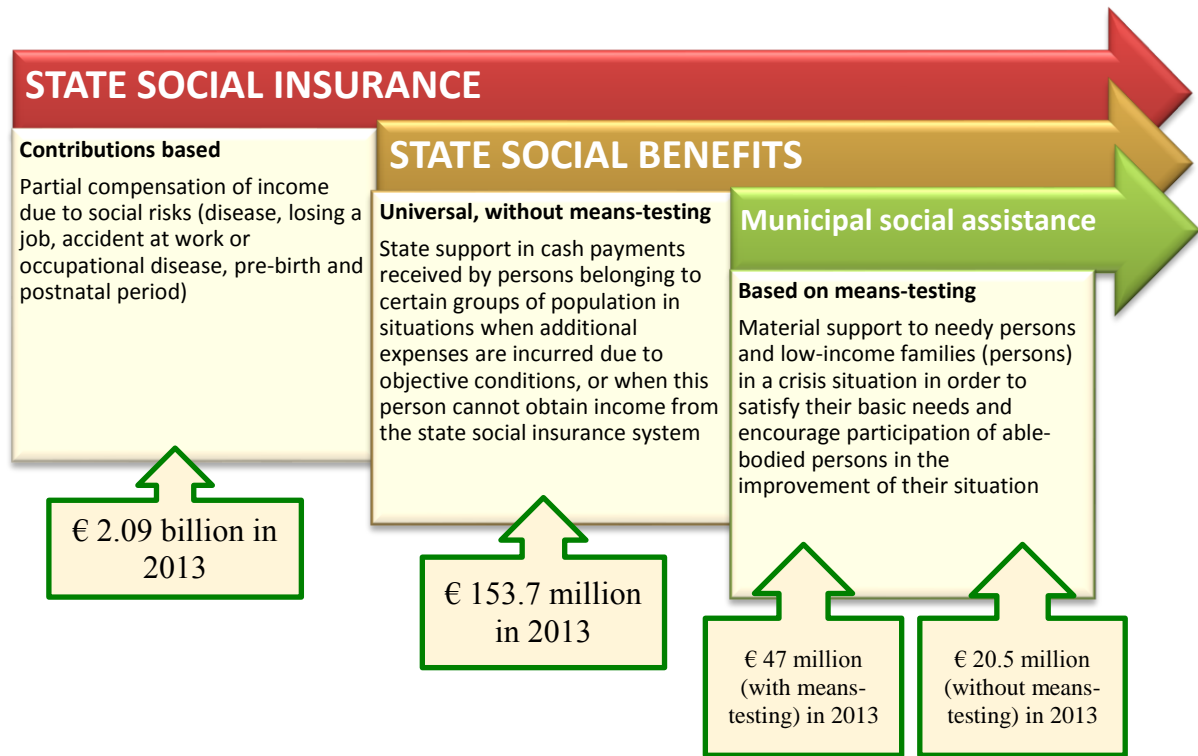
⁵⁸ The research of the World Bank, „Latvia: Who is Unemployed, Inactive or Needy?”, p.14. Available at http://www.lm.gov.lv/upload/aktualitates/latvia_compwbs.pdf. Viewed on 08.07.2014.

⁵⁹ Estivils, citation from Lāce T., (2012). "Social exclusion in Latvia: description of the situation and the policy analysis. Monograph Riga: Zinātne”, p. 16.

⁶⁰ Social transfers: pensions and benefits (paid by the state and municipalities), subsistence for children, scholarships, social insurance benefits and compensations, including also from other countries. The website of the Central Statistics Bureau <http://www.csb.gov.lv/statistikas-temas/termini/socialie-transferti-36002.html>. Viewed on 30.05.2014.

Figure 2.

Social security system of Latvia and its financing



Source: MoW

The total amount spent for pensions and benefits that are paid from the state social insurance budget⁶¹ equals to 2.094 billion *euro* in 2013. The amount spent for state social benefits⁶² that are granted without the evaluation of the person's income equals to 154 million *euro* in 2013. Municipalities, in their turn, in 2013 spent 67.5 million *euro* for social benefits⁶³, of which 47 million *euro* were paid on the basis of the assessment of person's income and 20.5 million *euro* were paid without income assessment. The total amount spent

⁶¹ Old age pensions, disability pensions, pensions for the loss of supporter, sickness benefits, funeral benefits, compensation of damage caused at work, unemployment benefit, maternity benefit, paternity benefit, parents' benefit, compensation for the loss of working ability, compensation for the loss of supporter, other benefits, including the following: a benefit to the surviving spouse in case of the death of pension beneficiary, pensions of Supreme Council deputies, pensions in compliance with special resolutions, service pensions, compensation of damage to persons who have suffered due to accident of Chernobyl NPS.

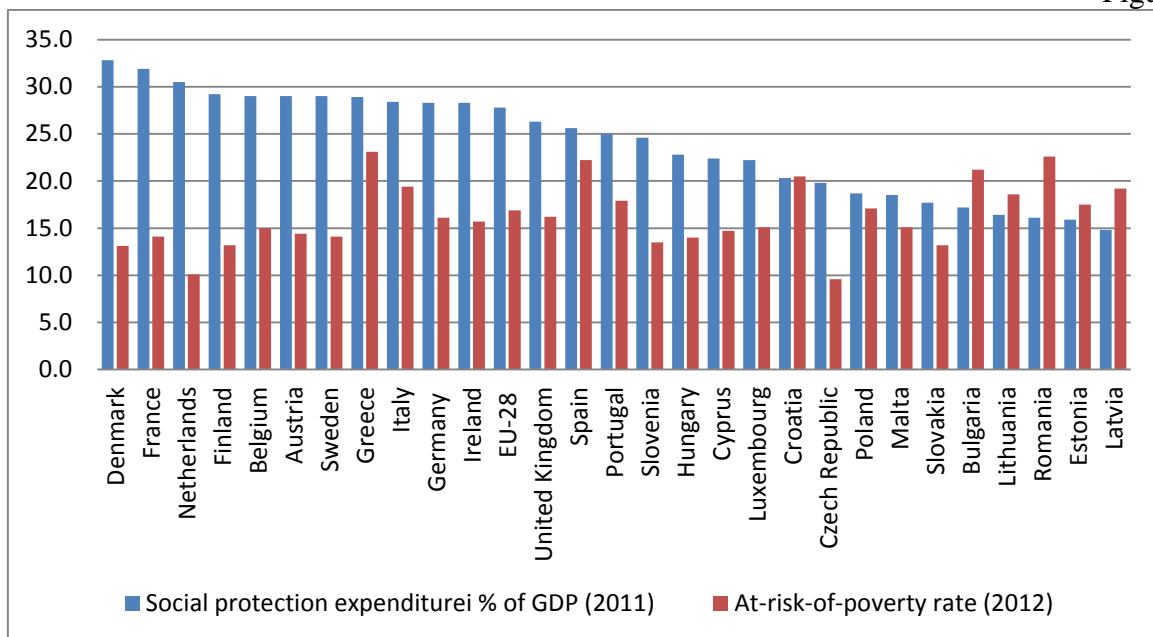
⁶² A child care benefit (including the benefit for the care of a disabled child), the state family benefit, a supplement to the state benefit for a disabled child, a child birth benefit, the state social security benefit, a benefit and a compensation to a guardian and a foster family (*including*: a benefit for a guardian for the child's maintenance, a compensation for performing the guardian's duties, a compensation for performing the foster family's duties), a benefit to a disabled person requiring special care, other benefits and compensations, *including the following*: the state social benefit to the participants of the elimination of the consequences of the accident of Chernobyl NPS and the families of the diseased participants of the elimination of the consequences of the accident of Chernobyl NPS, a benefit for the compensation of the transport expenses to disabled persons with movement difficulties, the state special benefit to the children of the persons who died during the process of the regaining of the independence of Latvia, a support to children suffering from celiakia, a funeral benefit, a compensation for adoption, a compensation for the care of a child to be adopted

⁶³ Social assistance benefits that have been paid on the basis of the assessment of the person's income: a benefit for ensuring the GMI level, a housing benefit, other social assistance benefits for ensuring the fundamental needs of a family (person) as provided for in the binding regulations of municipalities (for food, clothing, health care, mandatory education). A single benefit in an emergency and other benefits paid by municipalities without the evaluation of income: a benefit to an orphan and a child left without the parental care after the expire of the out-of-family care (a single benefit for starting an independent life, a single benefit for the purchase of household items, for covering the monthly rent of housing, coverage of monthly expenses when a person continues the studies, psycho social and material support for the integration of a child after reaching the age of 18 in the society, a benefit for a foster family, a monthly benefit for a child's subsistence), other support measures and compensations to the population.

for state and municipal benefits on the basis of the income assessment and without it not depending on the person's contributions equals to 221.2 million *euro* in 2013.

The evaluation of total social protection expenditure as a share of GDP reveals that the smallest percentage share of GDP is allocated in Latvia if compare to other EU-28 Member States (see Figure 6). However, the ratio between expenses for social protection and the share of population exposed to the at-risk-of-poverty is different. There are countries where the expenditure for social protection as a share of the GDP is comparatively high, still at-risk-of-poverty rate is also relatively high, like in Spain and Greece. It is important to understand that the poverty problem cannot be solved by the social protection system only. The tax system and redistribution of tax revenues in the country plays an equally important role.

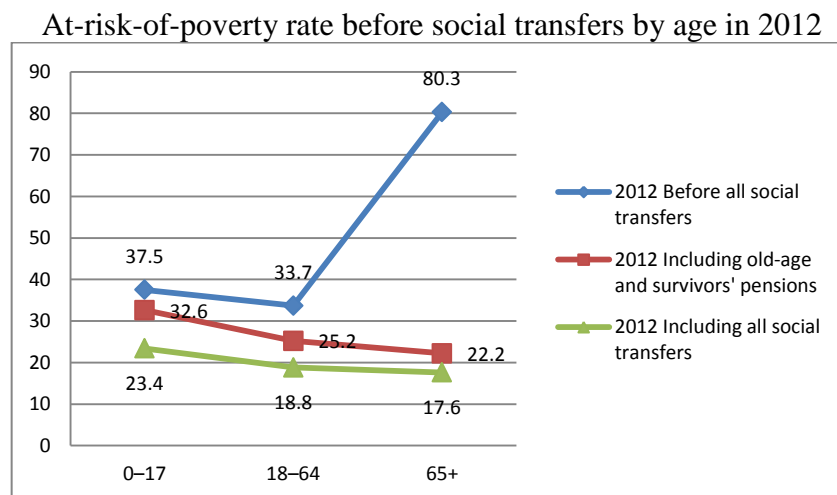
Figure 6.



Data source: EUROSTAT

In order to assess whether social transfers, i.e. pensions and benefits, prevent the risk of being exposed to poverty for a person, the at-risk-of-poverty rate before and after social transfers is reflected in the below Figure as regards children (0-17 years), people of working age (18-64 years) and retired persons (above the age of 65).

Figure 7.



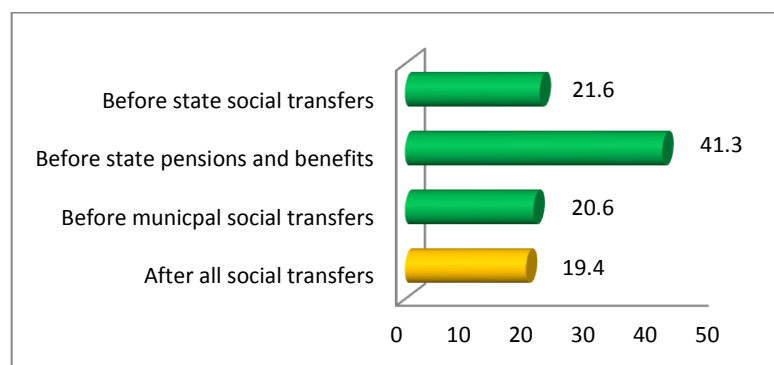
Data source: CSB

Social transfers for children reduce at-risk-of-poverty rate by 14 percentage points, i.e., 37.5% of children would be exposed to the at-risk-of-poverty without benefits and pensions. The situation is similar regarding people at working age, after the receipt of all social transfers the at-risk-of-poverty for population aged 18-64 years decreased by 14.9 percentage points. As regards population at the retirement age (above 65 years), the role of social transfers (mainly the pension) is most essential, as 80.3% of the pensioners would be exposed to the at-risk-of-poverty without social transfers.

In order to find out the contribution by each component of the social security system upon the reduction of at-risk-of-poverty, the Figure 8 presents at-risk-of-poverty rate for population irrespective of their income, before and after receiving the state and municipal social transfers (pensions and benefits).

Figure 8.

At-risk-of-poverty rate **for total population**
before and after receiving the state and municipal social transfers in 2012, %



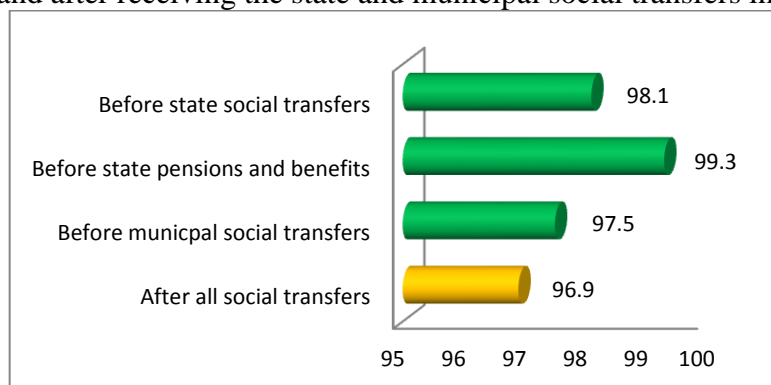
Data source: CSB

The state pensions provide the highest contribution to the reduction of poverty risk, i.e. the at-risk-of-poverty is reduced by approximately 20 percentage points. However, the state and municipal benefits generally provide a small impact upon the reduction of at-risk-of-poverty. If 19.4% of population is exposed to the risk of poverty after receiving all social transfers, the state social benefits reduce the poverty risk by 2.2 percentage points and the municipal benefits reduce it by 1.2 percentage points.

Analysis of the situation of poorest population (1st quintile) leads to a conclusion that the impact of social transfers upon the reduction of poverty risk and poverty depth is considerably lower than in the society as a whole. For example, in case of 1st quintile (average monthly income 112 *euro*) at-risk-of-poverty rate after all social transfers remains at 96.9%.

Figure 9.

At-risk-of-poverty rate **for 1st quintile (the poorest population)**
before and after receiving the state and municipal social transfers in 2012, %



Data source: CSB

This proves that neither state, nor municipal social transfers are sufficiently targeted in order to prevent poverty risk and poverty depth for the poorest population. It would not be a surprise if this trend referred to the state social benefits which are granted to people without assessing their income (universal benefits). However, the municipal social assistance is (should be) targeted at the poorest people in the country⁶⁴. Unfortunately, the above data attest that the municipal social assistance does not reduce the poverty depth for poor people. A study on the planned reforms in the social assistance system confirmed that “Many of the benefits granted by municipalities within the framework of free initiatives, which are targeted basically at satisfying the basic needs, cannot be considered as social assistance benefits as often they are granted without assessing the beneficiary's income level”. In order to solve the above problem, it is proposed “to define a comprehensive and correct reporting system regarding the free initiatives of municipalities and to consider the necessity of supplementing the regulation provided by the Law on Social Services and Social Assistance by clearly defining the forms and the thresholds of such benefits within the framework of their amount and the payment period⁶⁵”.

As seen in Table 7, 1/5 of the population of Latvia with the lowest income belong to the 1st quintile. The evaluation of different minimum income levels (the GMI level of 49.80 euro, the income level of a needy person of 128.06 euro, the income levels of a low-income person of 142-356 euro per month) leads to a conclusion that the support is received by a sufficiently large share of Latvian population, although the proportional share of the GDP allocated for social protection is low.

Table 7.

Monthly disposable income per household member, <i>euro</i> in 2012 (EU – SILC data of 2013)				
		mean	bottom margin	top margin
Latvia		319.90		
Quintiles ⁶⁶	1	111.88		to 171.27
	2	208.63	171.29	241.94
	3	272.10	242.02	309.31
	4	371.99	309.40	459.82
	5	701.33	from 459.9	

Source: CSB

The minimum income levels provided for by regulatory enactments currently are applicable to population belonging to the 1st quintile. People belonging to the 1st quintile are entitled to receive both the GMI benefit and the support and assistance for a needy family (person), however, not all the persons have this entitlement. In particular, not all the persons whose income does not exceed 171 *euro* per month are entitled to assistance. According to the WB study, the GMI or housing benefit is only received by 12.5% of the population belonging

⁶⁴ In compliance with the Law on Social Services and Social Assistance, the social assistance is a benefit in cash or in kind the granting of which is based on the evaluation of the material resources of persons (families) who lack the means to satisfy basic needs (Para 17 of Section 1).

⁶⁵ "Evaluation of the initial impact (ex-ante) regarding the planned structural reforms in the field of the social assistance policy" (2014), SIA „KPMG Baltics“, "Final report on the best solution versions for changes in the social assistance system and the required support measures from other systems and the evaluation of the impact of proposed versions upon the central and municipal budgets", p. 8. Available on the website of the MoW by following this link <http://www.lm.gov.lv/text/2744>.

⁶⁶ Quintile (EU-SILC research) is one fifth (20%) of the number of surveyed households groups in an ascending order based on the disposable income per household member.

to the 1st quintile⁶⁷. Moreover, the existing social benefits are too little (in 2013 the average GMI benefit per person per month was 30.5 *euro*, average housing benefit per person per month was 12.2 *euro*) to ensure that people of the 1st quintile could escape the depth of poverty. This implies that there exists inefficiency of municipal social transfers as regards the reduction of poverty because the existing social benefits are too low for ensuring that the persons belonging to the 1st quintile could escape the poverty trap. In this case a certain contradiction and also a regularity is created by the income levels of a low-income person because low-income persons who receive certain support from the municipality belong to both the 1st quintile, the 2nd, the 3rd and even to the 4th quintile. It means that the municipal support is also received by relatively better-off people if the comparison versus the income in the 1st quintile is made. It confirms also the WB study where it is estimated that Latvia takes a leading position, in particular, the 4th place among the EU Member States who provides social assistance to better-off people, i.e. approximately 50% of well-off people receive a certain social assistance benefit⁶⁸. If the situation is evaluated from the point of view of income inequality, the minimum income should be first of all increased and targeted to the population in the 1st quintile for reaching an actual impact upon the reduction of the income differences.

Also the WB study confirmed that although 91% of the beneficiaries of GMI benefit belonged to the 1st quintile, which implies a good targeting, still the GMI coverage (a number of persons who were entitled to receive the GMI benefit) was very low. From January 2006 to July 2012 the GMI benefit for at least one month had been only received by 6.9% of the population. The WB study also revealed that slightly more than 40% of all the beneficiaries of GMI benefit during this period of time received it only for one period and in most cases this period was not exceeding 3 months. Therefore it was concluded that it would be necessary to broaden the coverage of GMI or the group of the GMI beneficiaries (i.e. the amount of GMI level) and to extend the actual length of GMI benefit receipt to improve the attempts to reduce poverty and income inequality, at the same time reviewing the conditions of the receipt of GMI benefit as regards specific target groups⁶⁹. As regards the comparison of total GDP expenditure, the WB study also confirmed that Latvia has allocated more financial resources to universal benefits programs (state social benefits) than to means-testing programs. It means that in-depth evaluation is required on efficiency of allocated municipal social assistance and state social benefits to identify deficiencies in these systems and find the best solution for reducing poverty, at the same time prevent the poverty risk for population and maintain the motivation to be employed. In addition, it has to be emphasised that if the amounts of benefits, their accessibility and targeting are increased, this may not improve the situation of the poorest persons if the compensating or redistribution mechanisms in the tax system are not applied at the same time⁶⁹.

1.3. Income inequality

For the purpose of poverty reduction, the system of benefits cannot be analysed and evaluated in isolation from other systems making the population income, where the tax system established in the country and redistribution of tax revenue play an important role and cause an essential impact. In order not to create or to develop a situation when along with the increase of amounts of various benefits people lose motivation to work in less paid jobs, the efficiency of labour tax system in relation to the means-tested social benefits` system needs to be assessed.

⁶⁷ The research of the World Bank, „Latvia: Who is Unemployed, Inactive or Needy?”, p.11. Available at http://www.lm.gov.lv/upload/aktualitates/latvia_compwbs.pdf. Viewed on 08.07.2014.

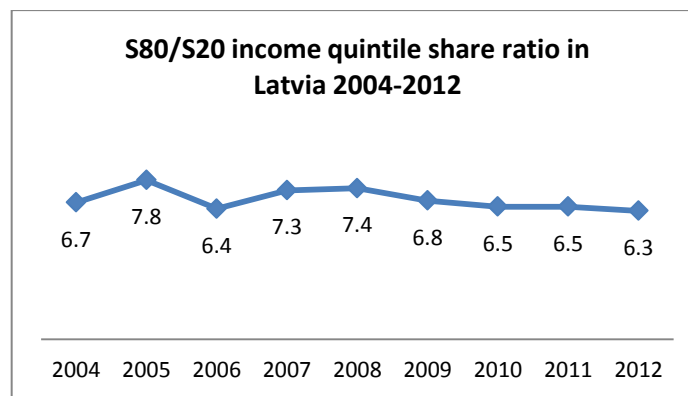
⁶⁸ Ibid. p. 109

⁶⁹ Ibid. p. 15

Income inequality is among the major causes for the at-risk-of-poverty in Latvia and this has been a long-lasting problem for a number of years. The fact that poverty is caused by, inter alia, unequal redistribution of income has been proven by several researchers⁷⁰. Two main indicators that characterize income inequality are Gini coefficient⁷¹ and S80/S20 indicator. Gini coefficient has been constantly high in Latvia during nine years varying between 35% and 39%. S80/S20 income quintile ratio indicator is the indicator that demonstrates the ratio between the amount of disposable income of individuals received by 20% of the population with the highest income (the 5th quintile) and the amount of income received by 20% of the population with the lowest income (the 1st quintile), thus describing the income inequality in the country.

In Latvia, the difference between income of well-off and poor population has been very visible for several years, as the income of poor population is 6-7 times lower than the income of the richest one. The information presented in Figure 10 demonstrates that since 2008 the income difference has been gradually decreasing, still the difference should be considered as high.

Figure 10.



Data source: CSB

Yet the challenge in Latvia in the reduction of poverty is not only restricted to the very low income of the 1st quintile where the difference from the 5th quintile is six fold, but also includes the relatively low income in the 2nd to 4th quintiles. The mean income per quintiles presented in Table 7 demonstrates that the income ratios between the 1st to 4th quintiles are quite compact. According to conclusion drawn by the Dutch researcher Franciska Gassmann during the study of poverty in Latvia in 2002⁷², „[...] there is no middle class in Latvia because the distribution of other 80% of the population is very compact from the point of view of both the income and the expenses”.

„[...] **poverty trap** [...], which is often referred by using the term “low wage trap” in literature and compilations of statistical data „[...] refers to a situation when the increase in gross income does not change into the increase of net income seen by an individual [...]”⁷³. The poverty trap sometimes means that when an individual starts to work the amount of

⁷⁰ Hoeller, P. *et al.* (2012), “Less Income Inequality and More Growth – Are They Compatible? Part 1. Mapping Income Inequality Across the OECD”, *OECD Economics Department Working Papers*, No. 924, OECD Publishing. Available at <http://dx.doi.org/10.1787/5k9h297wxbnr-en>

⁷¹ Gini coefficient describes the inequality of income varying from 0 to 100. Gini coefficient equals 0 in case of absolute equality of income (i.e. all the people have the same income), and the closer to 100 it is the higher the inequality of income. CSB <http://www.csb.gov.lv/statistikas-temas/metodologija/materiala-nendrosinatiba-37053.html>. Viewed on 14.01.2013

⁷² Gassmann, F. (2002). Social reality of the 10 years of transition periods. Series of the social policy studies “Reform of the welfare system today and in future”. pp. 55-65, Ministry of Welfare of the Republic of Latvia and the United Nations Development Program, Riga.

⁷³ Ringold, Kasek & Rydvalova, 2007: 36, the above reference from *Mareks Niklass, Doctoral Thesis „Inclusion of young people with low education on the labour market”*, p. 44.

assigned benefits is reduced (or they are suspended at all) and the income tax is imposed upon the income, thus deterring him/ her from searching for job and accepting of job offers. As an indicator of the poverty trap, the marginal tax rate is used in statistics and research and it is expressed either as a tax rate imposed upon additional income part or its increase (percentage), or as a tax rate for each additional income unit (*euro*). In studies on poverty it is calculated as a percentage of income for each next earned money unit withheld as a tax or reduced by paying lower taxes. The marginal tax rate of 60% is supposed to be a relevant level when an individual may be exposed to a considerable risk of “poverty trap”⁷⁴.

The WB study confirmed that the marginal tax rate for beneficiaries of social assistance in Latvia was very high which considerably impacted the motivation of social assistance beneficiaries to take up a paid job⁷⁵. The marginal tax rate of GMI and housing benefit equals 100%, i.e. even one additionally earned *euro* above the set income level reduces the monetary assistance by one *euro* accordingly or deprives the individual of entitlement to apply for the support. The average efficient tax rate when a person starts a paid job following the receipt of social assistance amounts to 33%. Thus, a person is not motivated to start a paid job because all additionally earned income is subject to income tax and means-tested benefits are reduced or suspended at all, as a result the net amount received is less than if a person did not work. The above is also confirmed by the evaluation of social assistance⁷⁶ and BICEPS study⁷⁷ where it is proved that “in Latvia and in the other Baltic countries people with high METR⁷⁸ are concentrated in the lowest deciles of the distribution of the disposable income. This is very different from many EU countries where the distribution of persons with high METR is either more balanced across deciles or tends to be within the top part of income distribution. Actually, in Latvia and Estonia, all people with high METR belong to the first two deciles of equivalent disposable income.

Initiatives that are usually introduced to make work pay (for example, labour tax credit), are only efficient if the proportional share of shadow economy is relatively low.

Shadow economy has a negative impact not only upon economic and budget policy measures, but it also creates unfavourable social situation regarding income of population, including the minimum income. In the society, the amounts of pensions and benefits in Latvia are often compared to the amounts of social transfers in other EU Member States, mainly in the countries where they are considerably higher. Also in this respect the shadow economy creates an essential obstacle to the attempts to reduce poverty and to increase the income of population because not enough resources are received to the central budget for more adequate financing of the social security systems. The below table presents at-risk-of-poverty rate and share of shadow economy of the GDP in the EU Member States.

⁷⁴ Ibid, Turton, 2001: 289

⁷⁵ The research of the World Bank „Latvia: Who is Unemployed, Inactive or Needy?”, p.50. Available at http://www.lm.gov.lv/upload/aktualitates/latvia_compwbs.pdf. Viewed on 08.07.2014.

⁷⁶ "Evaluation of the initial impact (ex-ante) regarding the planned structural reforms in the field of the social assistance policy" (2014), SIA „KPMG Baltics“; "Final report on the best solution versions for changes in the social assistance system and the required support measures from other systems and the evaluation of the impact of proposed versions upon the central and municipal budgets", p. 10. Available on the website of the MoW by following this link <http://www.lm.gov.lv/text/2744>.

⁷⁷ The study of the Baltic International Economic Policy Study Centre (BICEPS) “Study regarding the improvement of the tax system” (2014).

⁷⁸ Marginal efficient tax rate (METR). METR measures the proportion of small income increase that is lost due to additional tax payments or not received benefits. Jara & Tumino (2013) define a high METR as the METR exceeding 50% (source: BICEPS study, p. 47).

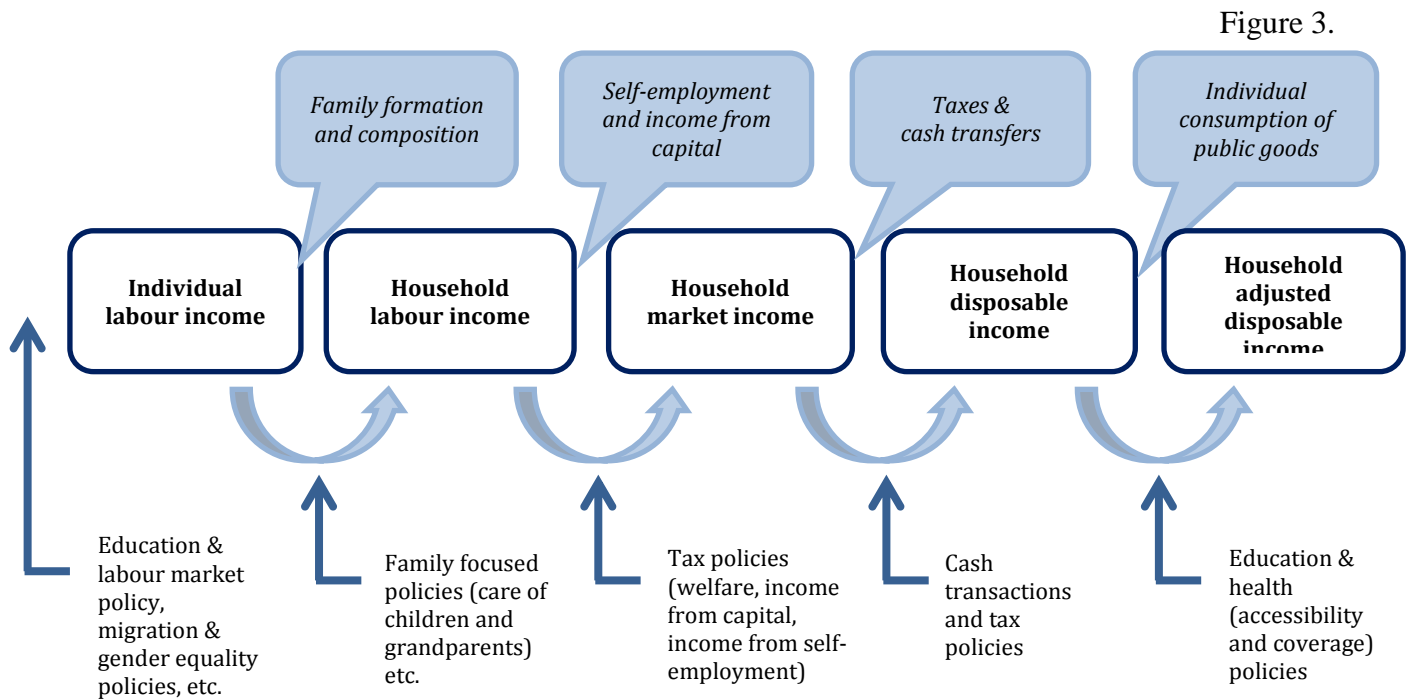
Table 8.

Country	Share of shadow economy as % of the GDP	At-risk-of-poverty rate as % of population
Austria	8	14.4
The Netherlands	9	10.1
France	10	14.1
United Kingdom	10	16.2
Ireland	12	15.7
Denmark	13	13.1
Finland	13	13.2
Germany	13	16.1
Sweden	14	14.0
Slovakia	15	13.2
Czech Republic	16	9.6
Belgium	16	15.0
Portugal	19	17.9
Spain	19	22.2
Italy	21	19.4
Hungary	22	14.0
Slovenia	23	13.5
Poland	24	17.1
Greece	24	23.1
Latvia	26	19.2
Estonia	28	17.5
Lithuania	28	18.6
Croatia	28	20.5
Romania	28	22.6
Bulgaria	31	21.2

Source: Eurostat (at-risk-of-poverty rate) and <http://www.atkearney.com/documents/10192/1743816/FG-The-Shadow-Economy-in-Europe-1.png/2db244cd-9989-447c-8499-ea9043c4d0f3?t=1374166115940>.

As seen in Table 8, there is a certain relation between the share of shadow economy and at-risk-of-poverty rate. In countries where the proportion of shadow economy is low, the at-risk-of-poverty rate is also low and vice versa, in the countries with high proportion of shadow economy, the share of population exposed to poverty risk is also high. Quite often people in Latvia refer to the situation in Scandinavian countries as the desired situation where both the shadow economy and the at-risk-of-poverty rate is low, however, the critical evaluation reveals that the situation in Latvia and its possibilities are much closer to, for example, Greece, Romania or Lithuania. At the same time, it is important to take into account that shadow economy is a broad term and only a part of that should be related to undeclared employment or “envelope wages”. It is also important to take into account that transfers by emigrants have become an important source of income for a certain part of Latvian households.

Within the context of minimum wages and income inequality, it is also important to understand the concept of income and the policy solution required for its solution and compliant with it. The Figure 3 shows how and by what the disposable income of households is formed. It is important because all the listed factors may be different and they impact the income inequality.



Source: the figure adapted from OECD⁷⁹.

- *Individual labour income.* Individual labour income of working age people includes both the wage for full time employees and income from work to other groups of population which also form a part of people of working age (part-time employees, self-employed persons, unemployed, as well as economically inactive persons).
- *Household labour income.* Families consisting of people of working age differ from the point of view of their size and composition and this impacts the total household income from work.
- *Household market income.* This income includes both the income from work and also from capital.
- *Household disposable income.* It includes all households and all income sources after payment of taxes and cash transfers.
- *Household adjusted disposable income.* Household disposable income are adjusted by transfers in kind (for example, public expenditure for health care, education, social housing, etc.).

Thus the income from work impacts the income inequality, on the one hand, and, on the other hand, there are several other influencing factors and conditions that also impact the income inequality at work. For example, in relation to education policy, measures that are aimed at promoting the equality in education indirectly reduce the income inequality. The impact caused by the minimum wage upon the income inequality is comparatively low. The impact of high minimum wage upon the reduction of income inequality can be low, however, in may decrease the employment level of more vulnerable groups, thus increasing the unemployment level and reducing the impact on the GDP per capita⁸⁰.

The minimum income level will be used during setting of the minimum monthly wage for analytical purposes, however, it is not planned to link it to the minimum wage due to the following considerations:

⁷⁹ Economic policy reforms 2012: going for growth © OECD 2012, Part 2, Chapter 5 „Reducing income inequality while boosting economic growth: Can it be done?“, p. 184, available at <http://www.oecd.org/eco/labour/49421421.pdf>. Viewed on 16.07.2014.

⁸⁰ Ibid.

- (1) the minimum wage setting system is common and applies equally to all industries and occupations⁸¹. The minimum wage should apply to employees with lower qualifications by providing for their protection. However, in Latvia the minimum wage is received not only by employees with low qualifications (like, a road sweeper, a person on duty, a loader, a dish washer, etc. in compliance with groups 7-9 of Classification of Occupations corresponding to a low qualification group), but also by qualified employees (for example, medical staff, social cares, etc.) and this may indicate on wage scale compression and, in some cases, also the on “envelope wages”, though, this challenge cannot be solved by means of the minimum wage;
- (2) the minimum income level is calculated on the basis of income, including the received wage. Moreover, the minimum income level is applied to a household comprising not only persons of working age, but also children, adults above the working age and also including persons at working age who, for example, cannot work mainly due to health issues or performing care obligations. As it was presented in Figure 3, the income or the adjusted disposable income of households includes different kinds of income, and the minimum wage is one type of income from paid work received by a particular individual⁸²;
- (3) the existence of social security system is an important precondition for securing the compliance with the minimum wages, because otherwise there are situations when socially not protected persons are ready to accept very low quality jobs within the “shadow economy”, including the agreement to work unpaid overtime (for example, a full time job for a part of the minimum wage), jobs in hazardous conditions, etc. At the same time, in such situations labour taxes are often not paid in a full amount and this has a negative impact upon the accessibility of social security system services. According to the forecasts, the proportion of employees working without any type of a signed job related agreements is low in Latvia⁸³, which means that the presence of job agreements is comparatively efficiently supervised, however, the supervision of the compliance with the provisions regarding the minimum wage is more complicated from the technical point of view, therefore minimum wages are only efficient in the situations when they are set equal to the level compliant with the situation in the national economy and, at the same time, employees can rely upon the protection provided by the social security system. If there is no reliance upon the social security system, the “shadow economy” starts operating as a social safety net⁸⁴, which does not work in risk situations.

Taking into account the said in relation to the poverty and low wage traps, in order to improve the motivation to work, it is necessary to implement changes in the labour tax system simultaneously with improvements in the social assistance.

⁸¹ Ordinance No. 111 of the Cabinet of Ministers of 16.03.2011 „Regarding the Concept paper for the Definition of the Minimum Monthly Wage for the Next Years”, Ministry of Welfare (2011).

⁸² The income from employment includes the wage, single and periodic remuneration, the remuneration for the state service, regular and irregular bonuses and supplements, vacation, termination and other benefits, the compensation for unused vacation in case of termination, sickness leave payment (for the sickness leave A), gifts and prizes, the total value of which exceeds the amount of the minimum wage during the tax year, the employer's scholarships, tuition fees paid by the employer and not required for the performance of the official duties, benefits provided by the employer to employees, including entertainment events, travel and health improvement measures when these can be referred to an individual, other payments made by the employer for the benefit of the employee if they are not directly related with the employer's economic activity or justified by source documents.

⁸³ In from the shadow: integrating Europe's informal labour / Truman Packard, Johannes Koettl, Claudio Montenegro (2012), p. 25. Available at <https://openknowledge.worldbank.org/bitstream/handle/10986/9377/706020PUB0EPI0067902B09780821395493.pdf?sequence=1>

⁸⁴ Ibid. p. 46

Labour taxes⁸⁵ consist of PIT basic rate by applying the non-taxable minimum and tax reliefs for dependent persons, as well as the state social insurance mandatory contributions (SSIMC) which include the employer's and the employee's rate. In compliance with the draft report of the Ministry of Finance (hereinafter referred to as the "draft report")⁸⁶, aimed at proposing a more efficient solution for redistribution of labour taxes that would reduce the income inequality in Latvia, "changes in non-taxable minimum have a relatively higher impact upon the employees with low wages (with a wage below the average level). Thus, this can provide a more targeted impact upon the issues related with the labour market, like unemployment, economic activity, poverty and dependence on benefits. Moreover, by means of non-taxable minimum a more indirect progressivism of income tax system can be ensured". Although non-taxable minimum has been increased from 2009: in 2011 from 49.80 *euro* to 64.03 *euro* per month and as from 1 January 2014 to 75 *euro* per month, this [...] should be deemed inadequately low. The non-taxable minimum in Latvia is almost twice lower than in other Baltic countries. In particular, the current non-taxable minimum in Latvia is *euro* 75 per month, while in Lithuania it is 136 *euro* (it is applied in proportion to the income level), and in Estonia it is 144 *euro* per month."

According to EUROSTAT data, for the employees belonging to the group with low wages (receiving 67% of the average wage, without dependent persons) the tax wedge⁸⁷ was 43.6% in Latvia in 2012 and this is among the highest indicators in the EU just behind Belgium, Hungary, France, Germany, Italy and Austria. In other Baltic countries this indicator was 39.2% which is close to the EU average - 39.9% - or by 4.4 percentage points below that in Latvia.

According to calculations by the Ministry of Finance, reducing the PIT rate from 25% to 24% and increasing the tax relief for dependent persons in 2013, the tax wedge for persons with low wages dropped to 42.9% which is still a high rate among the EU countries. In 2014, taking into account the implemented changes aimed at reduction of labour tax burden, the tax wedge will continue to gradually decrease until it reaches the level of 41.1% in 2016. Still, it will be slightly above the average in the other Baltic countries and EU. Thus, in order to ensure the reduction of tax burden for employees with low wages and without dependants, it would be necessary to implement the gradual increase of non-taxable minimum, taking into account the minimum income level valid in the relevant year. Increasing the non-taxable minimum along with changes in the GMI level and conditions for setting it will be progressive because it will have a direct impact upon people with the lowest income (belonging to the lowest decile)⁸⁸.

⁸⁵ Labour taxes are the set of taxes and fees including both the employer's and the employee's SSIMC and the PIT taking into account the untaxed minimum income and tax reliefs for dependent persons, any additional tax reliefs and certain justified expenses.

⁸⁶ Informative report by the Ministry of Finance „Changes of the labour tax for the reduction of the income inequality - the evaluation of implemented changes and proposals for further action" (the draft of 26.06.2014);

⁸⁷ The tax gap or the tax wedge is the difference between the employer's labour costs and the net wage of an employee. It is calculated as the percentage ratio of the labour taxes (the PIT and the employee's and the employer's SSIMC) and the total labour costs. The total labour costs consists of wages before taxes and the amount of the employer's SSIMC. This indicator describes the difference between the amount earned by the employee and the costs of this labour for the employer.

⁸⁸ The study of the Baltic International Economic Policy Study Centre (BICEPS) "Study regarding the improvement of the tax system" (2014), p. 61.

1.4. Minimum income levels in Estonia and Lithuania

In Estonia, the poverty level is defined⁸⁹ on the basis of absolute poverty threshold, which is calculated on the basis of OECD methodology for poverty measurement, still applying the OECD equivalence scale of 1; 0.7; 0.5 instead of the modified OECD equivalence scale which is applied at the EU (1; 0.5; 0.3). The said absolute poverty threshold is calculated in Estonia on the basis of the minimum household expenses. The absolute poverty threshold is equal to the minimum subsistence level estimated in Estonia in 2005. 4 poverty levels can be distinguished in Estonia:

- (1) The direct poverty which includes the households with the income below the direct poverty threshold (i.e. 80% of the absolute poverty threshold);
- (2) The poverty endangering subsistence which includes the households whose income is between the direct poverty threshold and the absolute poverty threshold (i.e. 80%-100% of the absolute poverty threshold);
- (3) At risk-of-poverty area which includes the households whose income is above the absolute poverty threshold and below the at-risk-of-poverty threshold (i.e. up to 125% of the absolute poverty threshold);
- (4) Poverty-risk-free area which includes the households whose income is above the at-risk-of-poverty threshold (i.e. above 125% of the absolute poverty threshold).

The minimum subsistence level or the absolute poverty threshold in 2014 amounts to 90 *euro* for the first member of a household and 72 *euro* for other members of a household (including children)⁹⁰. The subsistence benefit intended for covering the costs of basic needs, i.e. food, clothing, footwear and other goods and services, except housing expenses, is paid to poor people in Estonia whose income is below the above referred minimum subsistence level, i.e. the income for ensuring the minimum subsistence level are calculated after covering the housing expenses⁹¹. If there are minor children in a household, an additional payment of 15 *euro* is provided. In Estonia there is also a family benefit intended for the provision of support to families with children whose income is below the relative poverty threshold by applying the above referred OECD equivalence scale of 1; 0.7 and 0.5. Accordingly, for the first household member this amount is 299 *euro* per month, for the next household members above the age of 14 years it is 149.50 *euro* per month and for children aged up to 14 years it is 89.70 *euro* per month⁹². The non-taxable minimum and tax relief for dependent children are defined at the same level in Estonia and equal 144 *euro* per month⁹³.

In Lithuania the minimum income level includes social assistance benefit and social support to schoolchildren⁹⁴ which can be received by households or persons whose income is

⁸⁹ Laes, T. (2013). The individual and social nature of poverty. 1/13. Quarterly bulletin of statistics Estonia. Available at www.stat.ee/dokumendid/68625. Viewed on 04.07.2014.

⁹⁰ Estonian Information System Authority https://www.eesti.ee/eng/toetused_ja_sotsiaalabi/toetused_ja_huvitised/toimetulekutoetus. Viewed on 04.07.2014.

⁹¹ OECD Economics Department Working Papers „Reducing Poverty in Estonia Through Activation and Better Targeting (2012)”. Available at: http://www.keepeek.com/Digital-Asset-Management/oecd/economics/reducing-poverty-in-estonia-through-activation-and-better-targeting_5k8xb72v68bx-en#page1

⁹² MISSOC data base. MISSOC (the abbreviation from *Mutual Information System on Social Protection*) is an information system established in the EU where Member States exchange information on social protection. It provides detailed, comparable and regularly updates information on the social protection systems of the countries. More information available at <http://ec.europa.eu/social/main.jsp?langId=lv&catId=815>.

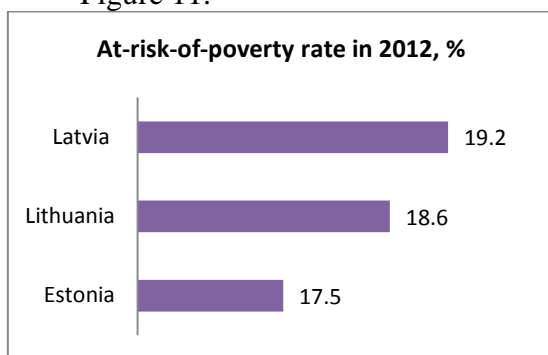
⁹³ Informative report by the Ministry of Finance „Changes of the labour tax for the reduction of the income inequality - the evaluation of implemented changes and proposals for further action" (the draft of 26.06.2014); p.8.

⁹⁴ Lazutka R., Poviliunas A. „Lithuania: Minimum Income Schemes. A Study of National Policies”, European Commission, DG Employment, Social Affairs and Equal Opportunities, 2009, 5.lpp. Available

below the income level provided by the state. The decision regarding the income level provided by the state is adopted by the government, however, there is no methodology for calculating this level. The income level provided by the state in 2014 is 101 euro. Most of the amounts of benefits are set equal to the amount of this income provided by the state or above it, however, their amount may not exceed 20% of the income level provided by the state, i.e. 101 euro. The amounts of benefits are differentiated depending on the number of household members, i.e. 100% amount is paid to the first member of a household, 80% is paid to the second member of a household and 70% is paid to the third and further household members. For example, for a couple with one child the income level provided by the state amounts to 253 euro per month, for a couple with three children it is 395 euro per month and for a parent with one child it is 182 euro per month. It should be noted that these levels and the paid benefits are equal to the minimum income level proposed below in this concept paper for various types of households. Social assistance to schoolchildren consists of two types of support: free meals and items for school. Social pension is also provided for in Lithuania and the groups of the population exposed to higher social risks, i.e. persons of retirement age and persons with disability, are entitled to it. The social pension is granted to persons who do not receive income from the state social insurance system or whose benefits are too low. The amount of social pension depends on the minimum social insurance pension amount, which was 104 euros in 2014 and to which coefficients (from 0.75 to 2) are applied for different groups of beneficiaries⁹⁵. The non-taxable minimum equals 136 euro per month and the tax relief for dependent children equals 58 euro per month⁹⁶.

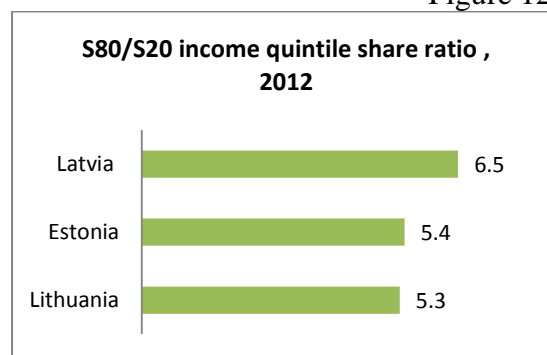
If compare the poverty and income inequality indicators of all three Baltic countries, unfortunately, Latvia is worst-ranked. Both the share of population with the income below the at-risk-of-poverty threshold (Figure 11) and the differences of income between the poorest and well-off households (Figure 12) are higher in Latvia than in Lithuania and Estonia. However, it should be taken into account that these data reflect the situation in 2012, before the implementation of measures for reducing the labour tax burden in Latvia during 2013 and 2014.

Figure 11.



Source: Eurostat

Figure 12.



Source: Eurostat

Taking into account the provided minimum income for the poorest persons in Lithuania and Estonia, it is necessary to implement measures in Latvia in order to improve the situation of the poorest people, at the same time minimising the differences between the neighbouring countries.

at: <http://www.peer-review-social-inclusion.eu/network-of-independent-experts/2009/minimum-income-schemes>.

Viewed on 18.07.2014.

⁹⁵ MISSOC data base.

⁹⁶ Informative report by the Ministry of Finance „Changes of the labour tax for the reduction of the income inequality - the evaluation of implemented changes and proposals for further action" (the draft of 26.06.2014); p.8.

2. Solutions to the problem

Recalling the basic problem, which is insufficiently low income of the poorest people (the 1st quintile) from different systems resulting in the situation when in Latvia there is high income inequality and a high share of population exposed to the at-risk-of-poverty. Therefore, the overarching goal for setting the minimum income level is the reduction of poverty and income inequality on the basis of solidarity principles, and the goal is to define the minimum income level which is based on evidence and compliant with the socioeconomic situation and income from the labour market gained by other persons, in order to increase the income of the poorest people by providing their social protection. At the same time, it should be emphasised that the provision of the minimum income should be considered a supplementary and not a substituting solution. Taking into account the close correlation between the income and the education level in Latvia, it is necessary to continue the implementation of policies that are aimed to reduce the number of drop-outs from schools. Also the competitiveness of the economy needs to be improved in order to provide a possibility for employed persons to receive higher wages. As regards the income from paid work, the policies for reducing the shadow economy play an equally important role taking into account the link between the proportion of the shadow economy and the at-risk-of-poverty rate given before.

Taking into account the above, the Ministry of Welfare proposes three solutions:

1. Set the minimum income level at 40% of national median equivalised disposable income by applying the equivalence scale (1; 0.7; 0.7).
2. In addition to the first solution, develop a new minimum subsistence consumer basket of goods and services for various types of households according to territorial division.
3. Maintain current situation with existing procedure of setting and applying of the minimum income levels.

Solution No. 1: Set the minimum income level at 40% of national median equivalised disposable income by applying the equivalence scale (1; 0.7; 0.7).

This is relative poverty measurement approach and it is basically applied by most EU and OECD countries by defining this as a permanent proportion, which is usually 40%-60% of the median or mean income of households. The OECD at-risk-of-poverty threshold is set equal to 50% of the median equivalised disposable income and the EU at-risk-of-poverty threshold is set equal to 60%. The WB study concludes that in the EU Member States support is usually provided to the population up to 30% of the national median equivalised disposable income⁹⁷. Accordingly, the WB proposes to set the guaranteed minimum income level equal to 106.72 *euro* in Latvia in the situation of 2013⁹⁸. As it is planned to link the proposed minimum income level with the support to be directed to the population, it would not be efficient to propose the minimum income level which would not be applied *de facto* due to its relatively high level, therefore, it is proposed to use the level which is equal to the proposal by the WB (106.72 *euro*) and the current income level of a needy person (128.06 *euro*).

⁹⁷ The research of the World Bank, „Latvia: Who is Unemployed, Inactive or Needy?”, p.44. Available at http://www.lm.gov.lv/upload/aktualitates/latvia_compwbs.pdf. Viewed on 08.07.2014.

⁹⁸ Ibid.

Table 9.

Disposable income for a single person household in 2012,
by applying the OECD equivalence scales, *euro* per months

	OECD modified equivalence scale (1; 0.5; 0.3)	OECD equivalence scale (1; 0.7; 0.5)
30 %	116	97
40 %	157	129
50 %	196	162
60 %	235	194

Data source: CSB




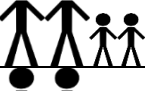






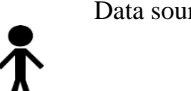
Although, based on the information provided in Table 9, the 30% amount of the OECD modified equivalence scale is closest, still it is proposed to apply the OECD 40% of the national median equivalised disposable income, i.e. 129 *euro*, because the equivalence scales applied in this way are more favourable to families with children (see Table 10).

It should be taken into account that the proposed minimum income level will change on an annual basis based due to changes in the disposable income of households. Therefore, when the support to particular groups of population is defined within relevant systems, it would be necessary to evaluate and to define the percentage decrease or increase based upon which the support will be provided. In particular, if the minimum income level decreases due to the reduction of the household disposable income, it has to be defined whether the support provided to certain groups of population will be reduced accordingly. And if the minimum income level increases due to the increase of disposable income, whether the support provided to certain groups of population will be increased even if the changes are minor and the required investment of administrative resources is disproportionately high.

At the same time, by defining this percentage amount of the income of population and taking into account the demographic situation in Latvia, it is proposed to apply the equivalence scale 1; 0.7; 0.7, which is different from the OECD equivalence scale (1; 0.7; 0.5) and the modified OECD equivalence scale (1; 0.5; 0.5) (see more in Section 1.1.5). The difference between the modified OECD equivalence scale and the OECD equivalence scale is that the consumption value for the next household members is higher in the OECD scale than in the modified OECD scale. The Latvia's choice would be even more favourable for children by applying the equivalence scale equal to that of the second and further adults in a household to them, i.e. 70%. Table 10 presents the minimum income levels for various types of households in the amount of 30% - 60% of the median equivalised disposable income by applying the modified OECD equivalence scale and the OECD equivalence scale.

Table 10.

Minimum income level according to the modified OECD equivalence scale and the OECD equivalence scale
for certain types of households in 2012 (*euro*, according to the data of 2013)

TYPE OF HOUSEHOLD	30%		40%		50%		60%	
	OECD modified equiv. scale	OECD equiv. scale	OECD modified equiv. scale	OECD equiv. scale	OECD modified equiv. scale	OECD equiv. scale	OECD modified equiv. scale	OECD equiv. scale
	116	97	157	129	196	162	235	194
	174	165	235	220	294	275	352	330
	209	213	282	285	353	356	423	427
	244	262	330	349	412	437	493	524
	278	310	377	414	470	517	564	621
	313	359	424	479	529	598	634	718
	348	408	471	543	588	679	705	815
	150	146	204	194	255	243	305	291
	186	194	251	259	314	323	376	388
	336	281	455	374	568	470	681	563
	394	330	534	439	666	551	799	660

Data source: Estimations made by the CSB, MoW



(the first adult and the second adult above the age of 14)



(a child aged up to 14 years).

The proposed method for setting the minimum income level has several major advantages in comparison to the current situation in Latvia and other poverty definition methods⁹⁹:

(1) the minimum income level is assessed upon overall socioeconomic situation in the country, i.e. it is justified and related to the indicators describing the individual's situation - income. This means that there are no possibilities for adopting an arbitrary decision regarding

⁹⁹ Ravallion, M. (2010). Poverty Lines Across the World. World Bank, Policy Research Working Paper No.5284. Washington DC. Available at http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2010/04/27/000158349_20100427143536/Rendered/PDF/WPS5284.pdf. Viewed on 24.05.2013.

the minimum income level because there are clear criteria for defining it, and by means of this method the risk is prevented that if there are different minimum income levels each stakeholder applies the income level which provides advantages to him/ her;

(2) a particular income level is defined that has to be provided by a person by means of a paid job and/ or needs to be provided by means of various systems impacting the income (taxes, benefits);

(3) this minimum income level may serve as an indicator for evaluating the impact of the tax system upon the income inequality and for drawing conclusions whether all the population gains benefit from the macro economic growth which is important in relation to the inclusive employment;

(4) this does not create unnecessary and sensitive discussions regarding what one should be able to buy for this amount of money assuming that within the free market economy an individual can afford as much as he/she can earn from a paid job;

(5) this method is used by quite a few European countries considering it as the most appropriate way by means of which the at-risk-of-poverty threshold is defined envisaging required changes in various line policies impacting the income of population.

It has also certain drawbacks like any other method. If the minimum income level is defined as a constant share of the mean or median income, there can be a situation when both the minimum income level and the share of the population whose income is below this minimum income level increases. For example, within the relevant year the minimum income level has increased from 200 *euro* to 250 *euro* per month, which could indicate that the income of people with low or average income has increased and therefore the share of population with income below this level should have decreased. However, the number of persons whose income is below this level has also increased from 15% to 20%. This attests that the income of a certain category of people has not increased, it has rather decreased¹⁰⁰. This is difficult to accept because it means that the advantages and benefits of the economic growth are not enjoyed by all the population. Therefore the relative poverty measurements are perceived with criticism due to their constant instability because the income of people changes and, as a result, also the relevant at-risk-of-poverty threshold. In order to “compensate” this instability, the anchored at risk of poverty rate is used at EU, i.e. the at-risk-of-poverty threshold of the particular year is defined (for example, in 2012 the at-risk-of-poverty threshold is 235 *euro*), and the share of the population whose income is below this income threshold is calculated for the next years in compliance with the annual income of people, i.e. the threshold remains at the level of 2012 and only the number of people with the income below this threshold changes¹⁰¹. It is also important to take into account whether the population, in particular the target group, understands the essence of this indicator and knows how it works and accepts it as a fair approach.

If this solution is chosen, it should be taken into account that the above data will be obtained, estimated and publicly available with a year's delay. It means that the data of 2012 are available starting from February 2014 and the data of 2014 will be available starting from January or February 2016. However, taking into account the current increase or decrease trends of the at-risk-of-poverty threshold (see Table 11), this will not cause an essential impact upon the situation of people in the course of planning the measures within certain policies fields.

¹⁰⁰ Ibid. p. 17

¹⁰¹ The indicator "at-risk-of-poverty rate", which is linked to a certain time period (*anchored at-risk-of-poverty rate*).

Table 11.

Year	40% of the equivalent (1; 0.7; 0.5) disposable income for a single person household, euro
2009	125
2010	119
2011	124
2012	129

Source: CSB

At the same time it should be taken into account that at present the Central Statistical Bureau estimates and publishes these indicators by applying the modified OECD equivalence scale and a different percentage amount (60%). It means that, first of all, an agreement with the Central Statistical Bureau regarding the estimation and the publication of these data will be required. Second, it will be necessary to plan and implement comprehensive communication measures in order to explain not only the procedure for setting the minimum income level, but also the differences between the at-risk-of-poverty threshold applied in the EU and the methodology chosen by Latvia (see Table 10, 40% of the OECD equivalence scale and 60% of the modified OECD equivalence scale) to the stakeholders, because due to that both the minimum income level or the at-risk-of-poverty threshold will be differentiated and the share of population whose income is below the relevant level or threshold will also differ.

Supporting the above referred methodology on definition the minimum income level the MoW proposes to link it with the:

- 1) **labour taxes**, in order to increase the income for employed persons with low remuneration;
- 2) **social assistance**, in order to increase the support to the poorest population;
- 3) **state social benefits**, in order to provide support to population groups exposed to the highest social risks;
- 4) **minimum state pension**, in order to improve the situation of pensioners with minimum income;
- 5) **unemployment benefit**, in order to provide adequate support to people without a job.

Table 12.

Solutions for certain target groups aimed at increasing their income linking to the minimum income level

Target group:	EMPLOYED PERSONS WITH LOW REMUNERATION
Current situation	Low non-taxable minimum (75 euro per month) creates a poverty trap reducing the motivation to accept a job with a low remuneration.
Solution	The labour tax burden should be reduced for employed persons with low remuneration (with a wage below the average) by increasing the non-taxable minimum.
Target group:	PEOPLE WITH THE LOWEST INCOME
Current situation	The GMI level (50 euro) and the benefit for ensuring this level provides minimum improvement to a person's situation, however, it does not reduce the depth of poverty for poor people.

	The amounts of housing benefit and criteria for granting it differ among various municipalities, placing people in an unequal situation as regards the solution of the issues related to housing expenses ¹⁰² .
Solutions	The GMI level should be increased up to the minimum income level for the first person in a household (0.7 and 0.5 for other persons accordingly) by defining a gradual reduction path of the GMI benefit and lifting the current income levels of a poor and a low-income person.
	The reliefs provided by the state and municipalities to needy and low-income persons should be assessed by evaluating their efficiency and effectiveness.
	The criteria for assessment of material situation should be reviewed in order to prevent a situation when, due to different provisions for assessment of the material position, persons with equal income and material situation in one municipality are entitled to benefits and in another are not. At the same time, it is necessary to evaluate the income which is and is not taken into account when a household applies for a support, by creating more favourable conditions for the households exposed to a high at-risk-of-poverty, for example, single parent families and large families, families with a person with disability.
	Mechanisms for co-participation of the social assistance beneficiaries provided for in the legislation and their application by municipalities should be reviewed in order to encourage and improve the motivation for the current or potential beneficiaries of social assistance to get actively involved in improving their own situation.
	The definition or the content of the housing benefit, the criteria for granting it and the amount or the calculation procedure shall be defined.
Target group:	PENSIONERS WITH MINIMUM PENSIONS
Current situation	At present, the minimum state pension is defined on the basis of the state social security benefit amount (64.03 <i>euro</i>), by applying relevant coefficients to it taking into account a person's insurance length. The pension is the main source of income for pensioners and employment possibilities for retired people are limited resulting in the situation when part of population at the retirement age is exposed to the risk of severe material deprivation due to their low income.
Solution	The minimum amount of the pension or the state social security benefit should be increased up to the defined minimum income level.
Target group:	FAMILIES WITH CHILDREN, INCLUDING CHILDREN WITH DISABILITY AND CELIAKIA, GUARDIANS AND FOSTER FAMILIES, PERSONS WITH DISABILITY, PARTICIPANTS OF THE ELIMINATION OF THE CONSEQUENCES OF THE ACCIDENT AT CHERNOBYL NUCLEAR POWER PLANT OR THEIR FAMILIES, THE CHILDREN OF THE PERSONS WHO DIED WITHIN THE PROCESS OF THE RECOVERY OF THE INDEPENDENCE OF LATVIA
Current situation	State social benefits are granted to these target groups without assessing their income, including to well-off families and individuals. Moreover, a part of municipal social benefits are granted to types of households without assessing their income resulting in the situation when in 96.9% of cases the

¹⁰² "Evaluation of the initial impact (ex-ante) regarding the planned structural reforms in the field of the social assistance policy" (2014), SIA „KPMG Baltics“. "Final report on the best solution versions for changes in the social assistance system and the required support measures from other systems and the evaluation of the impact of proposed versions upon the central and municipal budgets", p. 7. Available on the website of the MoW by following this link <http://www.lm.gov.lv/text/2744>.

	poorest people are still exposed to the poverty risk due to inadequately low and insufficient income support.
Solution	The existing amounts of state social benefits, their goals and efficiency for the defined target groups of the beneficiaries of social support should be evaluated and, where necessary, these should be linked to the minimum income level and envisaged changes in the system of labour taxes and social assistance.
Target group:	UNEMPLOYED PERSONS
Current situation	No bottom or ceiling restriction of the unemployment benefit is defined in Latvia, thus the system affords less protection to the people with low wages which is also confirmed by the high at-risk-of-poverty rate of unemployed persons.
Solution	The possibility to define the bottom or ceiling restriction of the unemployment benefit taking into account the minimum income level shall be evaluated.

Solution No. 2: In addition to the first solution, develop a new minimum subsistence consumer basket of goods and services for various types of households according to territorial division.

In addition to defining the methodology for the minimum income level and its application proposed under solution No. 1, it is suggested to develop also a new minimum subsistence basket. The necessity of developing the minimum subsistence basket is in particular emphasised by social stakeholders and NGO's. For example, at the meetings of the Social Inclusion Policy Coordination Committee of the Ministry of Welfare,¹⁰³ this question has often been raised by the representative of the Association of Free Trade Unions of Latvia emphasising the importance of the minimum subsistence basket and its necessity, in particular, after suspending its calculation as from 1 January 2014. Taking into account that minimum income levels or at-risk-of-poverty thresholds used until now were not justified and based on particular criteria of establishing them, as well as the planned changes in various policies by linking them with the new minimum income level, it would be useful to evaluate the implemented changes against the indicator that would help to assess their impact and efficiency regarding the income of population and their social situation. Therefore the Ministry of Welfare supports the development of this minimum subsistence basket. Moreover, taking into account that the content of the minimum subsistence basket may differ by age and the number of the persons living in a household and also the place of residence (city or rural area), it is proposed to develop minimum subsistence baskets for different types of households and for different territorial divisions.

At the same time, the advantages and disadvantages for development and application of the minimum subsistence baskets will be emphasised¹⁰⁴.

The advantages of minimum subsistence are as follows:

- Clear understanding and strong normative interpretation. The consumer basket of goods and services and its estimated absolute value is easy to understand contrary to the relative

¹⁰³ See more information on the website of the Ministry of Welfare: <http://www.lm.gov.lv/text/706>

¹⁰⁴ European Commission „Pilot Project for the development of a common methodology on reference budgets in Europe” (2014). More information at <http://ec.europa.eu/social/main.jsp?catId=625&langId=en&callId=382&furtherCalls=yes>

poverty threshold which is defined as the percentage of equivalent income of population in relevant country;

- it allows the assessing of validity of relative poverty threshold. It means that in addition to the relative poverty threshold, its justification can be evaluated by means of the minimum subsistence level;
- it allows assessing the adequacy of the minimum income within social protection framework. In particular, a total value of estimated goods and services allows comparing how adequate and sufficient or inadequate and insufficient the social protection measures are;
- it helps to identify the additional required income support and can provide advice regarding the finance and debts (for example, the planning of financial resources to avoid debts);
- it helps to establish efficient and adequate income support, taking into account an individual's needs and the institutional context.

However, in practice, it is proposed not to apply the minimum subsistence baskets for granting benefits, taking into account the following identified disadvantages:

- a risk of arbitrary (based on a free agreement) definition of various elements in the consumer basket of goods and services (the subjectivity factor), therefore a good theoretical and methodological framework is required;
- this is a time consuming and financially expensive method. The development of minimum subsistence basket is financially expensive and time consuming method of poverty measurement which is not understood and accepted by the public. Moreover, its applicability is only compliant if this consumer basket is regularly reviewed and updated in compliance with the changes in social and economic environment, which, in turn, requires regular additional resources;
- a risk that included goods and services will be presented as the necessary elements for attaining an acceptable living standard and this will be used as a mandatory guideline. As it was referred to in Section 1.1.1, the minimum subsistence baskets are only developed for the most typical models of households living in clearly set conditions. However, the situations of families and individuals are very different, and the minimum subsistence baskets do not include the changing factors that impact an individual's life;
- a risk that the estimated minimum subsistence levels will be “blindly” used as the poverty thresholds, like it was during the period when the previous minimum subsistence was calculated. It relates with the preceding argument regarding different situations of individuals and families, resulting in superficial impression and incomplete understanding of general social situation of people when the minimum subsistence value is used as the poverty threshold without relating it to the context and environment within which a particular individual or family lives and disregarding the description of this situation, thus leading to unproductive and inefficient way of solving the problem;
- a risk that the minimum subsistence level can be subjected to political manipulations, if it is used as a marginal value for development of a policy, because due to that the motivation to work can be reduced. In particular, when the amounts of minimum subsistence baskets are equal to or exceed the minimum wage, incentives and motivation to work decreases considerably.

Having regard of the above said advantages and disadvantages related to the minimum subsistence baskets, when the decision on the necessity to develop such basket is adopted, at the same time it is necessary to prepare a plan of communication measures that are focused on the increase of awareness of all the stakeholders regarding the strengths and weaknesses of estimation and definition of this method.

It is planned to develop a project for preparation of methodology for calculation of the minimum subsistence level starting 2017 after the changes in relevant areas have entered into force, on the basis of the defined minimum income level. Regular calculation of the minimum subsistence level can be forecasted starting 2018.

Solution No. 3: Maintain current situation with existing procedure of setting and applying of the minimum income levels.

Proposed reforms in the minimum income system in Latvia are comprehensive and progressive. Their implementation will require an investment of administrative resources (in particular, by municipalities) and additional financial resources, as well as the necessity to carry out a lot of explanatory work with the society to improve the awareness on the necessity for these changes, their benefits and application conditions. The role of communication is of particular importance because if no understanding of the benefits of this reform is achieved, its practical implementation may be difficult.

If no changes are implemented in the setting and application of current minimum income levels, the existing trends of poverty and income inequality in Latvia will continue progressing. If a number of persons exposed to a relatively high at-risk-of-poverty and insufficiently progressive redistribution of income is maintained, there are the following risks:

- Unchangingly high income inequality and share of population exposed to the at-risk-of-poverty has not only a negative impact upon the quality of life of the population (inability to satisfy one's basic needs, limited access to services, etc.), but it also causes an undesirable impact upon the development of national economy (the amount of produced GDP decreases as the potential of population at the working age is not fully used), the demographic development (emigration of people, a low birth-rate), the safety of individuals;
- difficulties in fulfilling the political commitments by government of Latvia to reduce poverty, thus further deteriorating the trust to *Saeima* /Parliament/, government and state administration;
- non-fulfilment of the recommendations of the Council of Europe regarding poverty reduction;
- criticism from other international institutions (for example, the International Monetary Fund, the Global Competitiveness Index, various international think-tanks, etc.) and researchers about the socioeconomic situation of the country and its impact upon competitiveness resulting in the loss of possibilities to attract investment and exporting.

3. Assessment of the impact of solutions upon the central and municipal budgets

Setting of the minimum income level is a first step for establishing an evidence based, sustainable and progressive social security system and at this stage it does not require additional expenditure from the central or municipal budgets, as long as the minimum income level is not linked to a particular system and its particular element. However, it needs to be taken into account that the use of minimum income level in the improvement of policies is necessary and very important in order to realistically reach the target for reduction of poverty and income inequality, because otherwise it remains a declared commitment without an actual impact upon the situation of people.

It is proposed to implement changes in the particular areas starting from 2017 taking into account the following considerations:

Table 13.

	Desired result	Description of the situation
1.	Changes are implemented together to avoid an adverse undesired result.	The simultaneous implementation of the defined measures is important for avoiding the formation of situation when one system creates considerably more favourable conditions than another, thus creating a situation that is opposite to the planned one regarding both an individual's situation and the central and municipal budgets. For example, if changes are implemented only in social assistance without implementing the necessary measures regarding the reduction of labour taxes, this can cause undesirable encouragement to apply for more social assistance, increasing the proportion of shadow economy and reducing the willingness to work. This cannot be permitted, being aware of the current situation when there are both the labour reserves and the shortage of labour at the same time.
2.	Clear direction of defined policy measures to ensure the timely planning of required financing and action and to understand the goals and the benefits of the planned changes.	Proposals regarding the implementation of changes in the particular fields by linking certain income amounts with the minimum income level are not based upon in-depth evaluation of situation and the relevant systems in overall. Namely, as it was stated above, the in-depth study of situation regarding social assistance, state social benefits, minimum old-age pensions, as well as the bottom and ceiling restrictions of unemployment benefit will be accomplished until December 2015 by proposing solutions to eliminate identified deficiencies. Thus, 2016 is required for development of relevant draft regulatory enactments and providing their approval by all stakeholders. Moreover, this time is needed to ensure that all the stakeholders to whom the above changes will apply (municipalities, population) can plan their action and financial resources in due time. Quick, unconsidered and uncoordinated implementation of the planned changes can produce an adverse result. For example, there are several cases when legal norms provided for by legislation are not applied or are incompletely applied and, of course, there can be various reasons behind it, however, one of them is the lack of understanding about the application of particular provision or about its necessity. As the changes will affect a very broad range of stakeholders, the measures, first, need to be developed in cooperation with all the stakeholders (for example, municipalities) and, second, comprehensive communication activities need to be implemented to ensure that the public and other stakeholders are not just aware of the plans, but also understand the goals and the benefits of the planned changes.
3.	Realistic term of receiving the required financing.	Recommendations of the Council of Europe (2014) to Latvia include both the reduction of poverty and the maintenance of a stable fiscal situation, therefore it is important to balance the implementation of both recommendations. In the course of development of the Law "On framework of medium-term budget for 2014, 2015 and 2016" it was stated that not only the fiscal space of 2014 was divided, but also the fiscal space of 2015 and an essential part of fiscal space of 2016 was

	divided ¹⁰⁵ . Having regard of that, as well as the fact that the implementation of all changes will require considerable financial expenditure on behalf of state and municipalities and/or the restructuring of financial resources, making the support more targeted, it is proposed to implement all the measures starting from 2017, thus creating the timely back-up of the required financial resources for reduction of poverty and income inequality.
--	---

In order to estimate indicative costs caused by implementation of the proposed changes, Table 14 provides information regarding the financing principles of current system by indicating the costs upon the existing conditions, where possible, and provides the estimated amounts of required financial resources from 2017, where possible.

It should be highlighted that **detailed evaluation of the financial impact upon the state and municipal budgets will be made during development of *Plan for implementation of minimum income level*, where the financial impact will be estimated taking into account all the changes in relevant areas. The indicative financial impact upon the particular field is presented in Table 14 without evaluating all the fields in an integrated way.**

Table 14.

Non-taxable minimum	
Current situation	Non-taxable minimum is a share of income of a natural person not subject to the PIT, thus increasing the net income of employed persons. PIT is transferred to the budgets of the state and municipalities according to the following proportion: 20% to the state and 80% to the municipal budget ¹⁰⁶ . Thus, if the amount of the non-taxable minimum is increased, the revenue of both the central and municipal budgets will decrease, however, this will impact most the income of municipalities. Though the reduction in revenues could be compensated by less required support from the social support systems of the state and municipalities.
Proposed solution	Increase the non-taxable minimum from 75 euro to 129 euro.
Current financing and number of beneficiaries	Beneficiaries of non-taxable minimum in 2013 were 752,294 natural persons and the applied amount of non-taxable minimum to these natural entities amounted to 492,859,657.28 euro. Accordingly, the non-received income in 2013 amounted to 118,286,317.17 euro.
Required financial resources (indicative)	If non-taxable minimum is increased from 75 euro to 129 euro, this would reduce income in the central budget of 2017 by 86.6 mill euro (the full year impact equals 94.4 mill euro ¹⁰⁷).
Social assistance	
Current situation	Social assistance is financed from the budgets of municipalities. Benefits that are set by the state as mandatory are the benefit for ensuring the GMI level, housing benefit and single benefit in an emergency situation.
Proposed solution	Increase current GMI level from 50 euro to 129 euro for the first

¹⁰⁵ Informative report by the Ministry of Finance „Changes of the labour tax for the reduction of the income inequality - the evaluation of implemented changes and proposals for further action" (the draft of 26.06.2014); p. 21.

¹⁰⁶ Section 17 of the Law "On Central Budget".

¹⁰⁷ The impact may change depending on the changes made in the result of the updating of input data.

	member of a household and the relevant equivalence scales should be applied to others, at the same time assessing the introduction of the state co-financing for providing the GMI benefit.
Current financing and number of beneficiaries	In 2013 municipalities spent 13.5 mill. <i>euro</i> for payment of the GMI benefit and the GMI benefit was paid to 64,408 persons.
Required financial resources	If GMI level is increased by applying the defined equivalence scales (1; 0.7, 0.7), the expenditure of municipalities would increase by 37.9 mill. <i>euro</i> per year.
Detailed calculation of the financial impact	The impact of changes in the social assistance field upon the central and municipal budgets will be assessed during development of the <i>Plan for implementation of minimum income level</i> .
Minimum pensions	
Current situation	Minimum pensions are financed from the state special insurance budget and they are calculated on the basis of the amount of the insurance contributions paid by the individual and the length of the employment term or the years of employment.
Proposed solution	Increase the minimum pension amount to 129 <i>euro</i> .
Current financing and number of beneficiaries	In June 2014 pensions (old-age, disability, service, loss of the supporter and loss of the working ability) with supplements amounting to below 129 <i>euro</i> were received by 70,511 persons.
Required financial resources	If the amount of minimum pension is increased up to the proposed minimum income level, i.e. 129 <i>euro</i> , additional 35.7 mill. <i>euro</i> per year are required. If the amount of the state social security benefit is increased from 64 <i>euro</i> to 129 <i>euro</i> , resulting in the increase of the amount of both the old-age pensions and also other pensions and benefits ¹⁰⁸ that are based on the above referred benefit, additional 91.3 mill. <i>euro</i> per year are required.
Detailed calculation of the financial impact	The impact of changes in the field of minimum pensions upon the central budget will be assessed during development of the <i>Plan for implementation of minimum income level</i> .
Unemployment benefit	
Current situation	The unemployment benefit is funded from the state special insurance budget and its amount depends on the amount of the insurance contributions made by individual and employment term.
Proposed solution	Set the minimum and maximum restriction for unemployment benefit taking into account the minimum income level.
Current financing and number of beneficiaries	In June 2014 the number of unemployment benefit recipients with the benefit amount up to 129 <i>euro</i> was 7235 and the average amount of the granted benefit was 82.75 <i>euro</i> .
Required financial resources	Before estimate the required financing for increasing the unemployment benefit or linking it to the minimum income level, an in-depth analysis regarding the criteria for defining the unemployment benefit and their impact on the situation of unemployed persons shall be made, where the questions related to the motivation to work and encouragement to pay taxes play a very essential role.

¹⁰⁸ Disability pensions, pensions in case of the loss of the supporter, the insurance compensation for the loss of the supporter, the damage compensation if the damage has been caused at work until 01.01.1997; the insurance compensations for treatment and rehabilitation expenses, funeral benefits.

Detailed calculation of the financial impact	The impact of changes upon the central budget regarding unemployment benefit conditions will be assessed during development of the <i>Plan for implementation of minimum income level</i> .
State social benefits	
Current situation	State social benefits are paid from the central budget.
Proposed solution	Increase, where and if necessary, amounts of the state social benefits taking into account the minimum income level.
Current financing and number of beneficiaries	153.7 mill. <i>euro</i> were spent for state social benefits in 2013. In the first 6 months of 2014 an average number of benefit recipients was 174.6 ths. persons.
Required financial resources	It is not possible to assess the potential impact now as it can only be done after the assessment of all the state social benefits.
Detailed calculation of the financial impact	The impact of changes in the field of state social benefits upon the central budget will be assessed during development of the <i>Plan for implementation of minimum income level</i> .
Provisional expenditure related to the changes in social assistance, labour taxes and state minimum pension	
Total required (indicative) financial resources	In 2017: from <u>160.2 mill. euro</u> to <u>215.8 mill. euro</u> .

Besides to that, it is also proposed to develop a new **minimum subsistence basket**. It is planned to attract the resources within the framework of European Union Investment Fund planning period 2014-2020 starting 2017, therefore, at present it is not possible to estimate the required financial resources for development of the minimum subsistence basket.

4. Further Action

Support the solution No. 2: set the minimum income level at 40% of national median equivalised disposable income by applying the equivalence scale (1; 0.7; 0.7) and develop a new minimum subsistence consumer basket of goods and services for various types of households according to territorial division.

Table 15.

Action and time-table for implementation of proposed solutions

Directions of planned changes	Before drafting the regulatory enactment	Draft regulatory enactment submitted to the CM	Entry into force date
Minimum income level	Concept paper: 17 October 2014	1 July 2015	1 January 2016
Non-taxable minimum			
Social assistance			
Minimum pension	Plan: 1 April 2016	1 October 2016	1 January 2017
Unemployment benefit			
State social benefits			
Minimum subsistence basket	Development and implementation of the project: 31 December 2017	-	1 January 2018

Minister of Welfare

U.Augulis