Note on distributional impact of personal income tax reforms in Latvia

In September-October 2012, BICEPS performed some background estimations on distributional impact of personal income tax reforms in Latvia for an investigation undertaken by the Baltic Center of Investigative Journalism Re:Baltica. Full version of the article is available on Re:Baltica website: http://www.rebaltica.lv/en/investigations/the_other_side_of_latvias_success_story_/a/799/the_hidden_side_of_latvia%E2%80%99s_%E2%80%98success%E2%80%99_story.html

In this note, we present a brief description of the methodology and results.

Methodology

To estimate the distributional impact of personal income tax reforms, we use the Latvian part of the tax-benefit microsimulation model EUROMOD. EUROMOD is a tax-benefit microsimulation model for the European Union (EU) developed by the core developer team based mainly in ISER, University of Essex, and financially supported by the European Commission DG-EMPL[1]. We use EU-SILC (European Union Statistics on Income and Living Conditions) 2010 data, which contains information on incomes in 2009. EU-SILC data becomes available with a notable lag and in order to assess the impact of reforms on 2012 incomes, we follow a recognized practice of uprating past incomes to the present using updating factors based on aggregate dynamics of the respective income components in national statistics. However, we do not adjust the database to changes in the labour market that happened since 2009. Also, the analysis is limited to the direct impact of the personal income tax reforms, i.e., we do not model secondary effects, such as behavioral responses of agents.

Results

We assess distributional impact of 2012 and 2009 personal income tax reforms:

- 2012 reforms:
  - Reduction in personal income tax rate: from 25% to 24% in 2013 and further to 20% in 2015
  - A proposed but not implemented reform: increase in non-taxable minimum from 45 LVL to 90 LVL and allowances for dependents from 70 LVL to 100 LVL
- 2009 reforms:
  - Reduction in non-taxable minimum from 90 LVL to 35 LVL
  - A proposed but not implemented reform: reduction in non-taxable minimum to 0 LVL (Interview with Gatis Eglītis, "Nebija lētu triku", 2012)

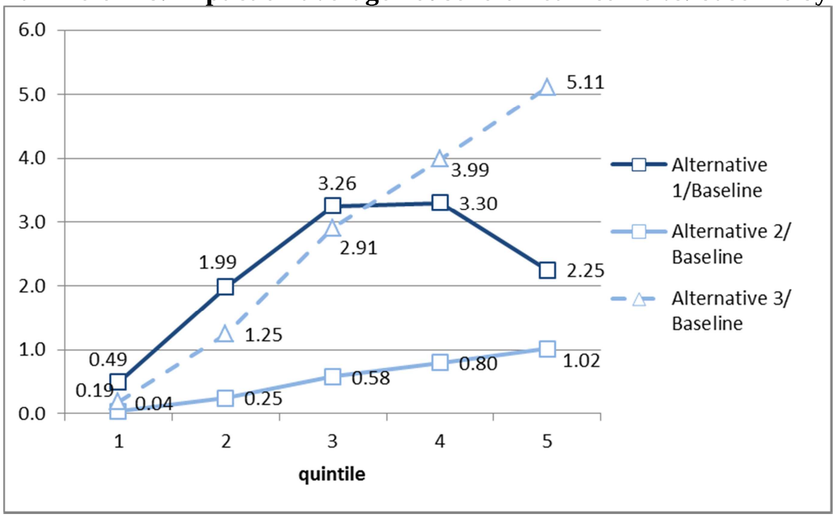
2012 reforms: impact on average household net income vs. baseline by percentiles, %

	Alternative 1	Alternative 2	Alternative 3
Top 10%	1.9	1.1	5.3
Bottom 90%	2.8	0.7	3.3

Alternative 1: Increase in non-taxable minimum (from 45LVL per month to 90 LVL per month) and allowances for dependents (from 70 LVL per month to 100 LVL per month) – proposed, but not implemented
Alternative 2: Reduction in personal income tax rate from 25% to 24% (effective Jan 1, 2013)
Alternative 3: Reduction in personal income tax rate to 20% (effective Jan 1, 2015)

[1] For more information on the EUROMOD, see: https://www.iser.essex.ac.uk/euromod

2012 reforms: impact on average household net income vs. baseline by quintiles, %



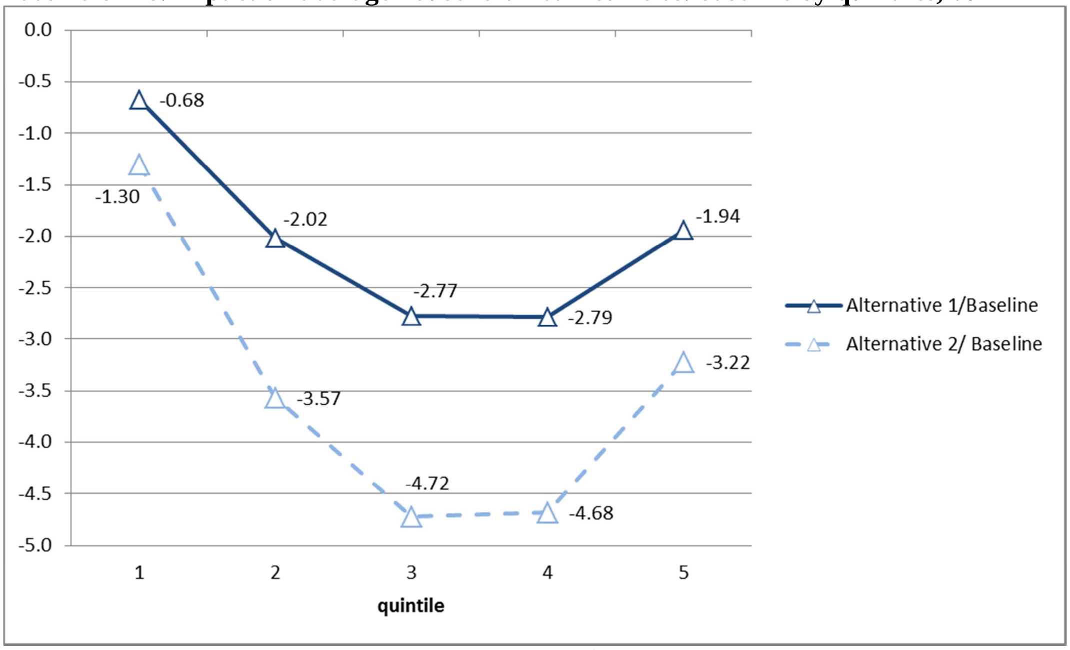
Alternative 1: Increase in non-taxable minimum and allowances for dependents
Alternative 2: Reduction in personal income tax rate from 25% to 24% (effective Jan 1, 2013)
Alternative 3: Reduction in personal income tax rate to 20% (effective Jan 1, 2015)

2009 reforms: impact on average household net income vs. baseline by percentiles, %

	Alternative 1	Alternative 2
Top 10%	-1.7	-2.8
Bottom 90%	-2.4	-4.1

Alternative 1: Reduction in non-taxable minimum income from 90 LVL to 35 LVL per month (effective July 1, 2009)
Alternative 2: Reduction in non-taxable minimum income to 0 LVL per month (proposed, but not implemented)

2009 reforms: impact on average household net income vs. baseline by quintiles, %



<u>Alternative 1</u>: Reduction in non-taxable minimum income from 90 LVL to 35 LVL per month (effective July 1, 2009)
<u>Alternative 2</u>: Reduction in non-taxable minimum income to 0 LVL per month (proposed, but not implemented)

References

Interview with Gatis Eglītis, "Nebija lētu triku", 2012. http://www.ir.lv/2012/4/19/nebija-letu-triku