



The World Bank

Assessing and Measuring Incentives

The Role of Benefits and Taxes
for the Jobless in Eastern Europe

Johannes Koettl and Michael Weber

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Overview

1. **Conceptual framework**
 - ▶ Focus on labor market transitions
2. **Measuring (dis-)incentives for (formal) work**
 - ▶ Using the OECD tax and benefit model
3. **Descriptive analysis of work (dis-)incentives**
 - ▶ Comparing non-ECA OECD, the Balkans, the New EU Member States, and Turkey
4. **Which (dis-)incentives matter?**
 - ▶ Characteristics of labor markets in non-ECA OECD, the New EU Member States, the Balkans, and Turkey
5. **Conclusions**



1. Conceptual framework

Incentive-Compatible Benefits for the Jobless



- ▶ Comprehensive view on active labor market policies (ALMPs)
 - ▶ Support people to look for, find, and keep the *right* job
- ▶ Activation policies are essentially based on the principle of mutual obligations:
 - ▶ Income support (UB, SA, in-work benefits, etc.) conditional on compliance (search job, keep job, train, etc.)
- ▶ Many different labor market transitions where activation policies can help
- ▶ Financial incentives are key for mutual obligations
- ▶ How do financial incentives compare between high-income OECD and ECA countries?
- ▶ In high-income countries, focus is on unemployment benefits (UB), but other benefits are taken into account more and more
 - ▶ Move towards integrated SP systems
- ▶ In ECA, UB coverage is relatively low
 - ▶ But what about other benefits?



Labor market transitions

- ▶ **Between employment**
 - ▶ Between formal and informal
 - ▶ Formal to formal
 - ▶ Informal to informal
- ▶ **Between unemployment and employment**
 - ▶ Employment to unemployment (w/ or w/o benefit)
 - ▶ Unemployment (w/ or w/o benefit) to employment
- ▶ **Between inactivity and (un)employment**
 - ▶ Inactive to active job seeker
 - ▶ Active job seeker to inactive/discouraged
 - ▶ Between inactivity and employment

Measuring incentives between labor market transitions



- ▶ Incentives and disincentives between these various labor market transitions can be measured
 - ▶ Requires analysis of tax and benefit system
- ▶ But: the degree to which these disincentives **matter** will very much depend on country context
- ▶ Largely driven by the characteristics of labor markets
 - ▶ Which transition matter mostly?
- ▶ Focus on transitions from unemployment/inactivity to formal employment
- ▶ Work in progress, preliminary findings



2. Measuring (dis-)incentives for (formal) work

Using the OECD tax and benefit model



Labor market transitions of interest

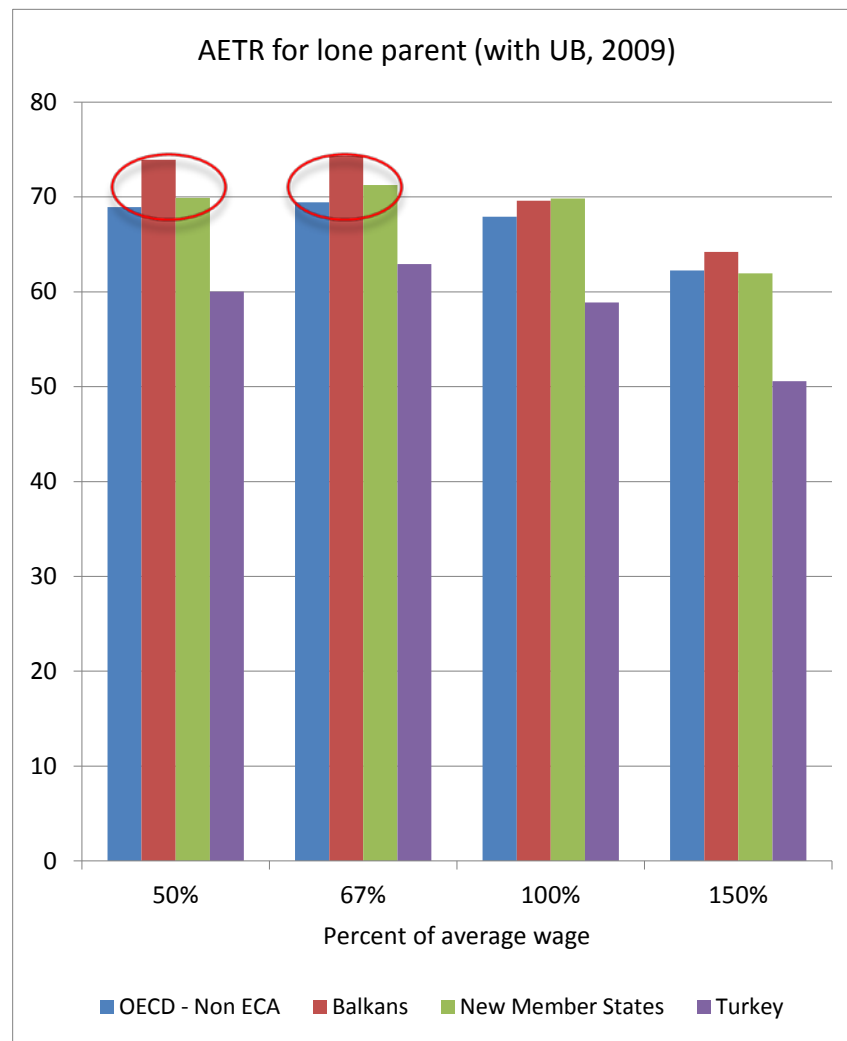
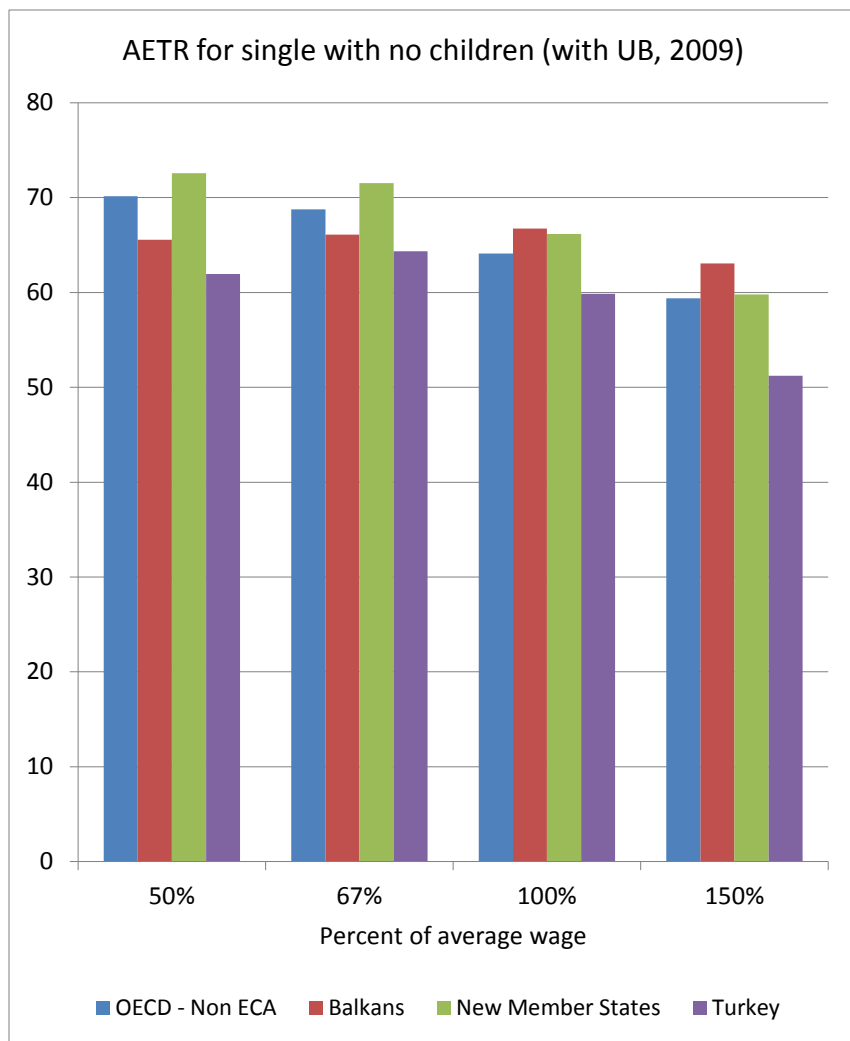
- ▶ Average effective tax rate (AETR): What share of gross income of the accepted formal job—including in-work benefits—is taxed away through personal income tax (PIT), social security contributions (SSCs), **and lost benefits** (UB, SA, family and housing benefits)?
 - ▶ Unemployment to formal job
 - ▶ Inactivity to formal job
- ▶ Net replacement rate (NRR): What share of net income is replaced through benefits when losing/giving up a formal job?
 - ▶ Formal job to unemployment
 - ▶ Formal job to inactivity
- ▶ Marginal effective tax rate (METR): What share of additional gross income is taxed away when expanding work hours?
 - ▶ Full-time to part time
- ▶ Formalization tax rate (FTR): What share of informal income is taxed away through PIT, SSCs (employer and employee), and lost benefits when formalizing at the same wage level?
 - ▶ Informal job to formal job



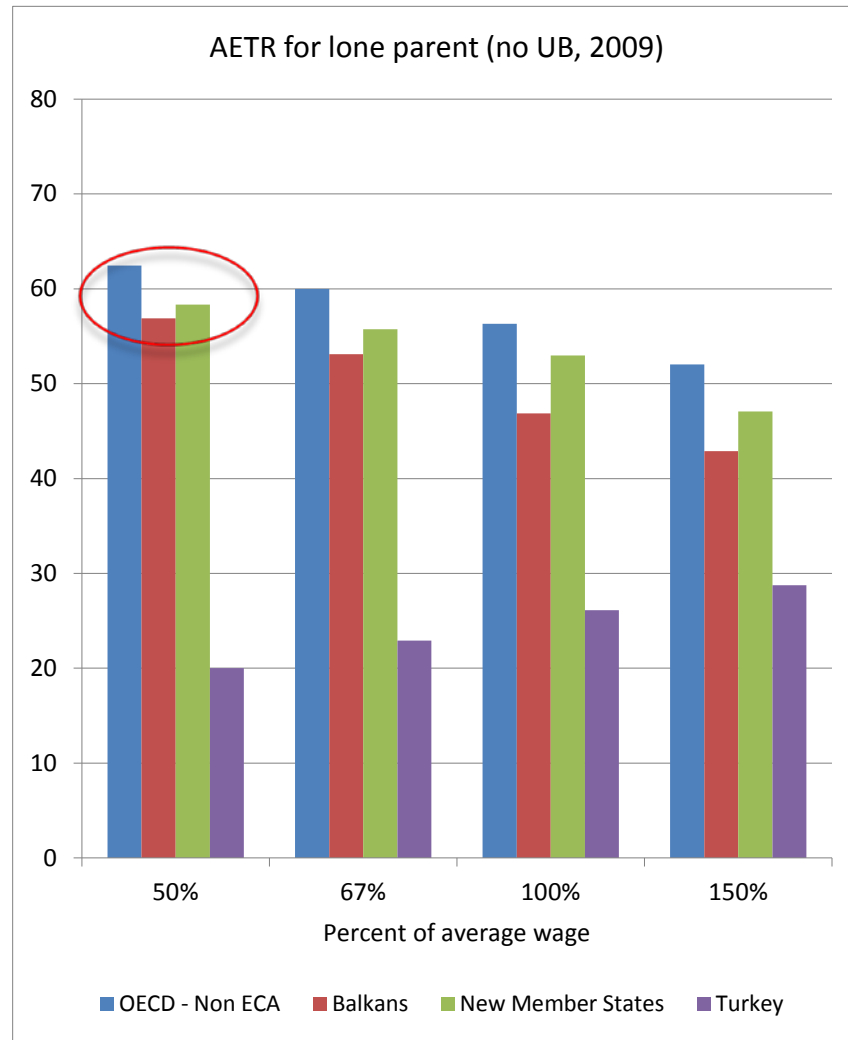
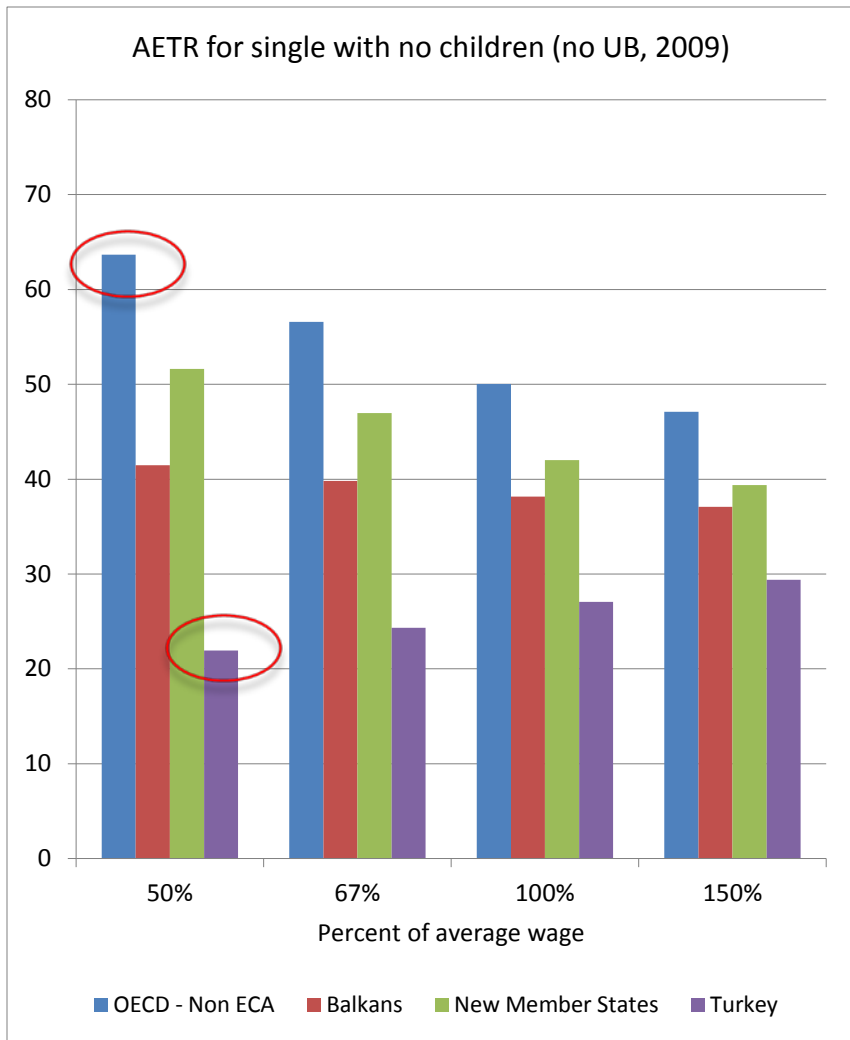
3. Descriptive analysis of work (dis-)incentives

Non-ECA OECD, the Balkans, New EU Member States, and
Turkey

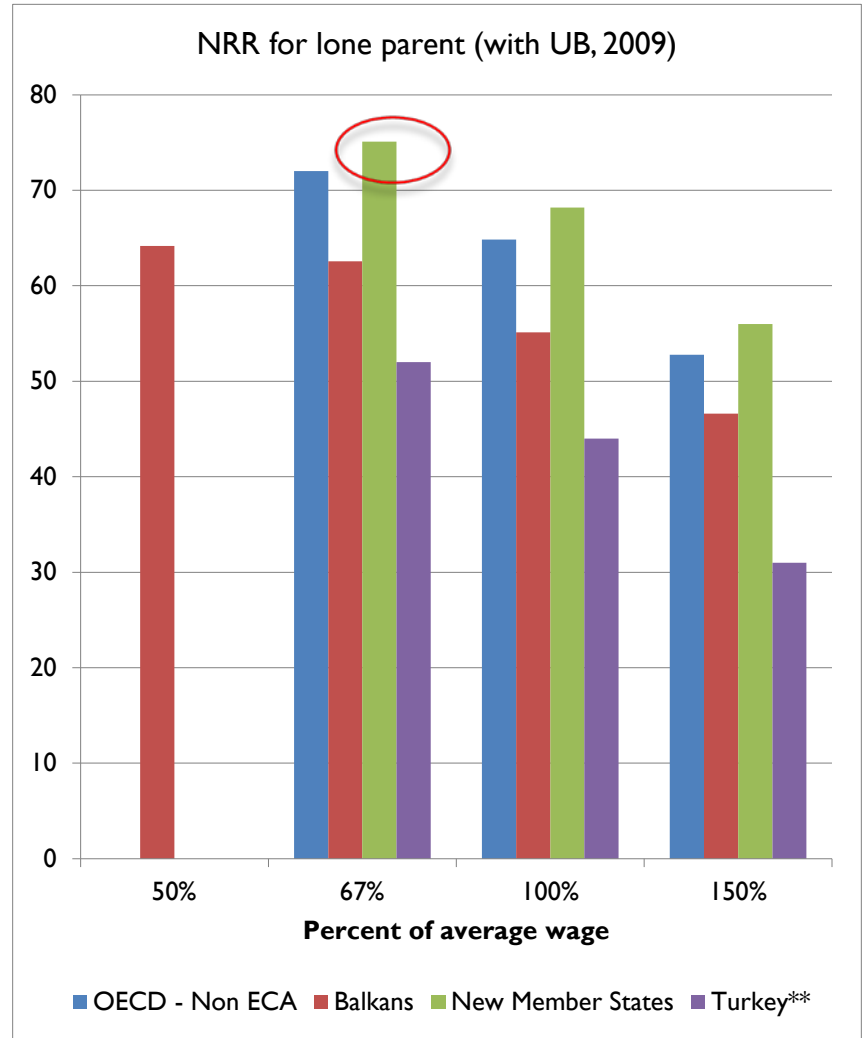
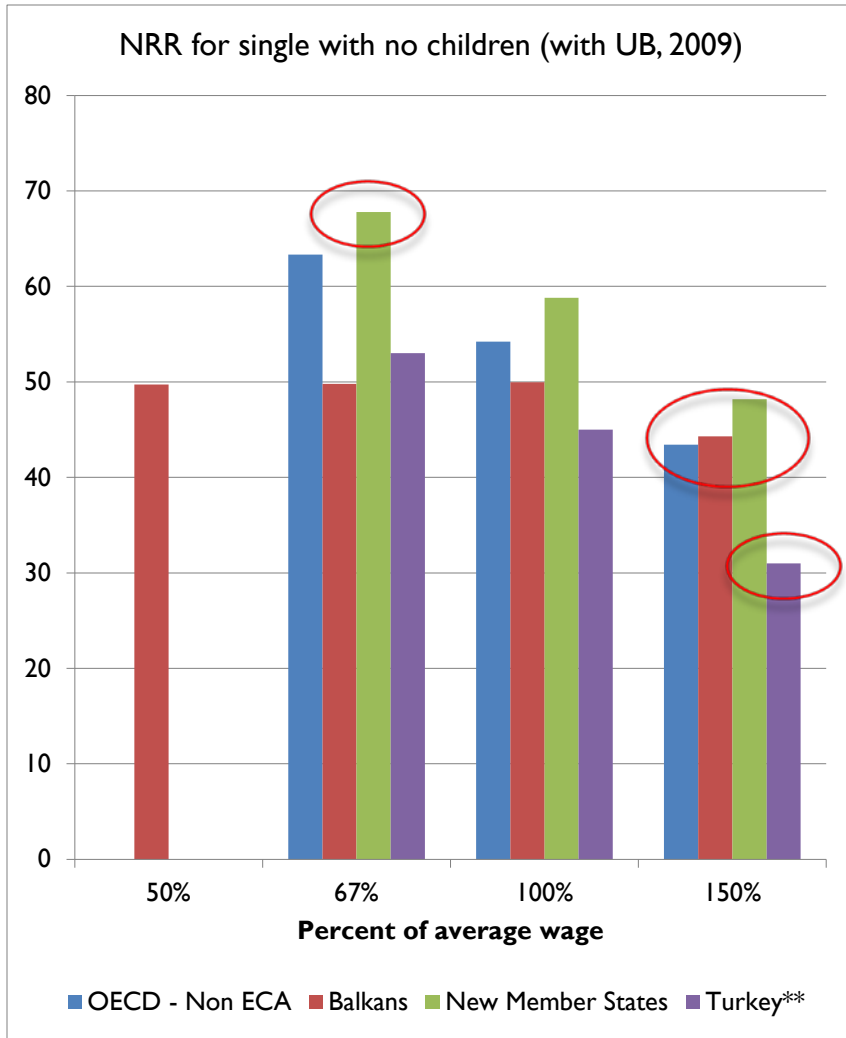
AETR from unemployment to formal job: high and fairly similar across regions; higher in the Balkans for families



AETR from inactivity to formal job: more diverse, highest in OECD, lowest in Turkey; more similar for families (role of family benefits in Balkans and NMS)



NRR: highest in NMS, fairly similar for higher-wage earners (except Turkey)





Summary

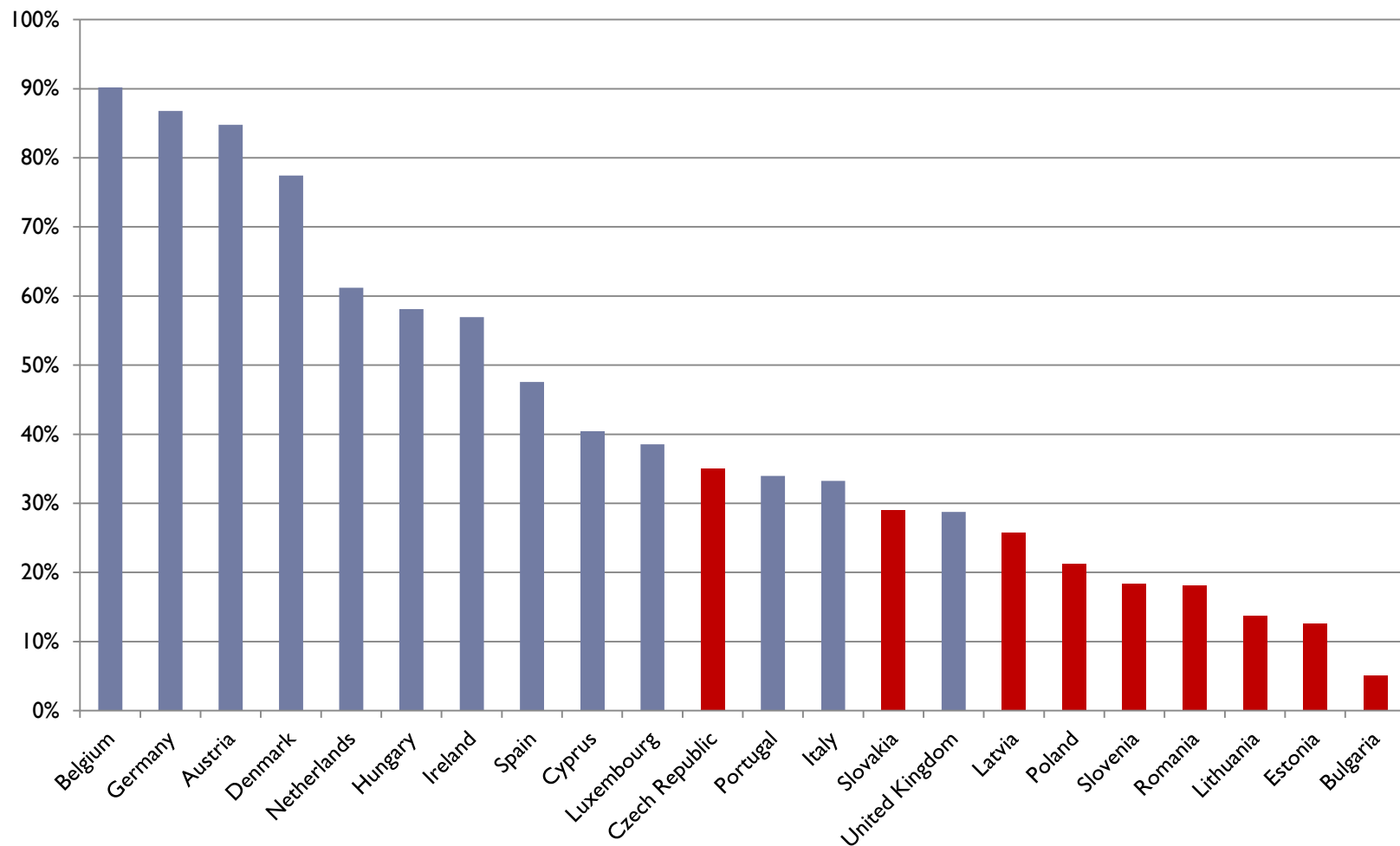
- ▶ Comparative descriptive analysis of work disincentives in OECD, Balkans, NMS, and Turkey
- ▶ From unemployment (with unemployment benefits) into a formal job:
 - ▶ Disincentives are fairly similar across regions
 - ▶ High at 60 to 70 percent average effective taxation
 - ▶ Higher for families, especially in the Balkans (role of family benefits)
- ▶ From inactivity (with means-tested benefits like social assistance, housing, family benefits) into formal job:
 - ▶ Overall, disincentives are lower than with UB
 - ▶ Without children: much more diverse across regions because much lower for Balkans, NMS, and Turkey
 - ▶ With children: fairly similar across regions, but lower for Turkey



4. Which (dis-)incentives matter?

Characteristics of labor markets in non-ECA OECD, the Balkans, the New EU Member States, and Turkey

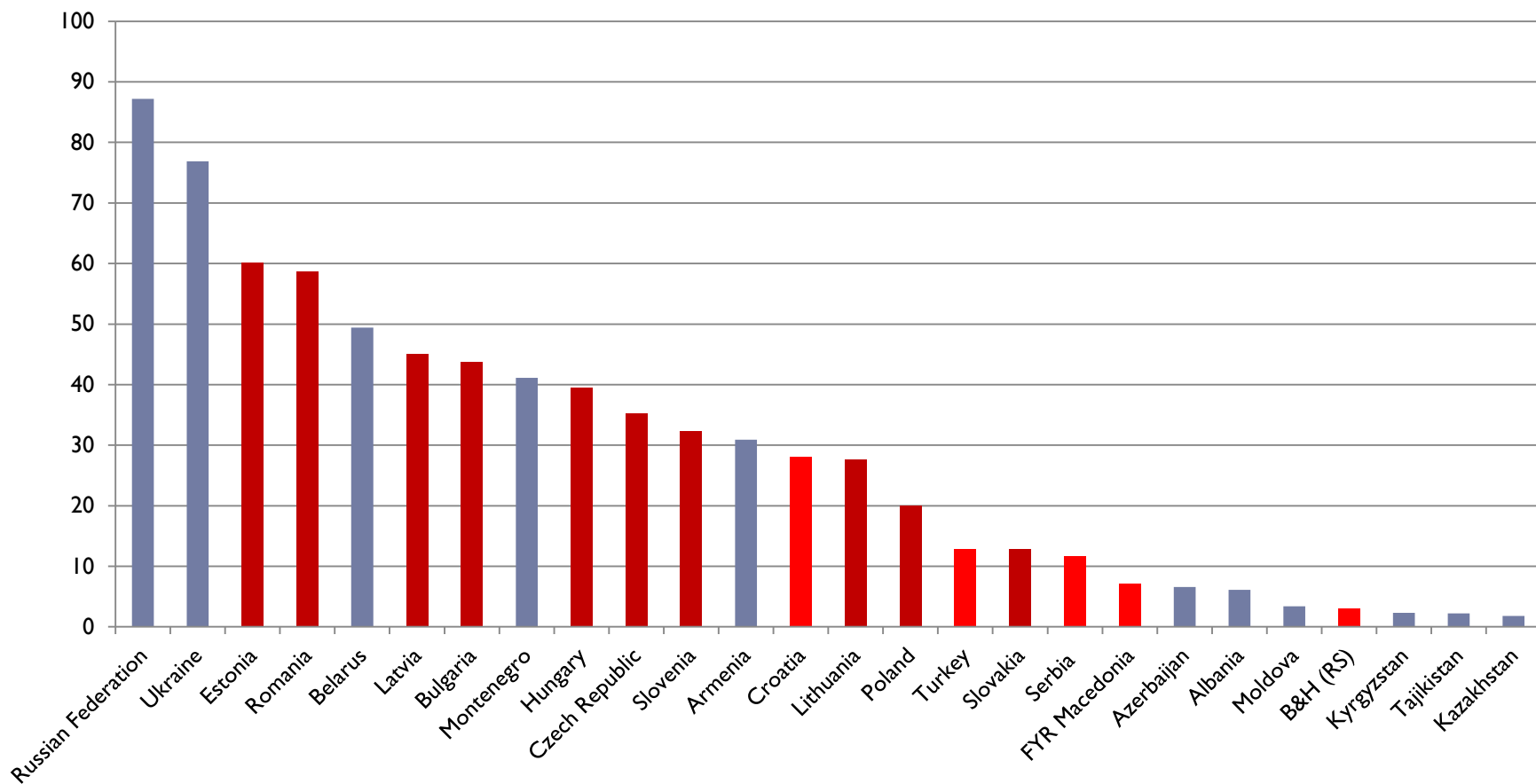
Household survey data: UB coverage (share of unemployed receiving UB) much lower in Eastern Europe



Administrative data: low UB coverage (share of **registered** unemployed receiving UB) in Balkans, Turkey, and most NMS



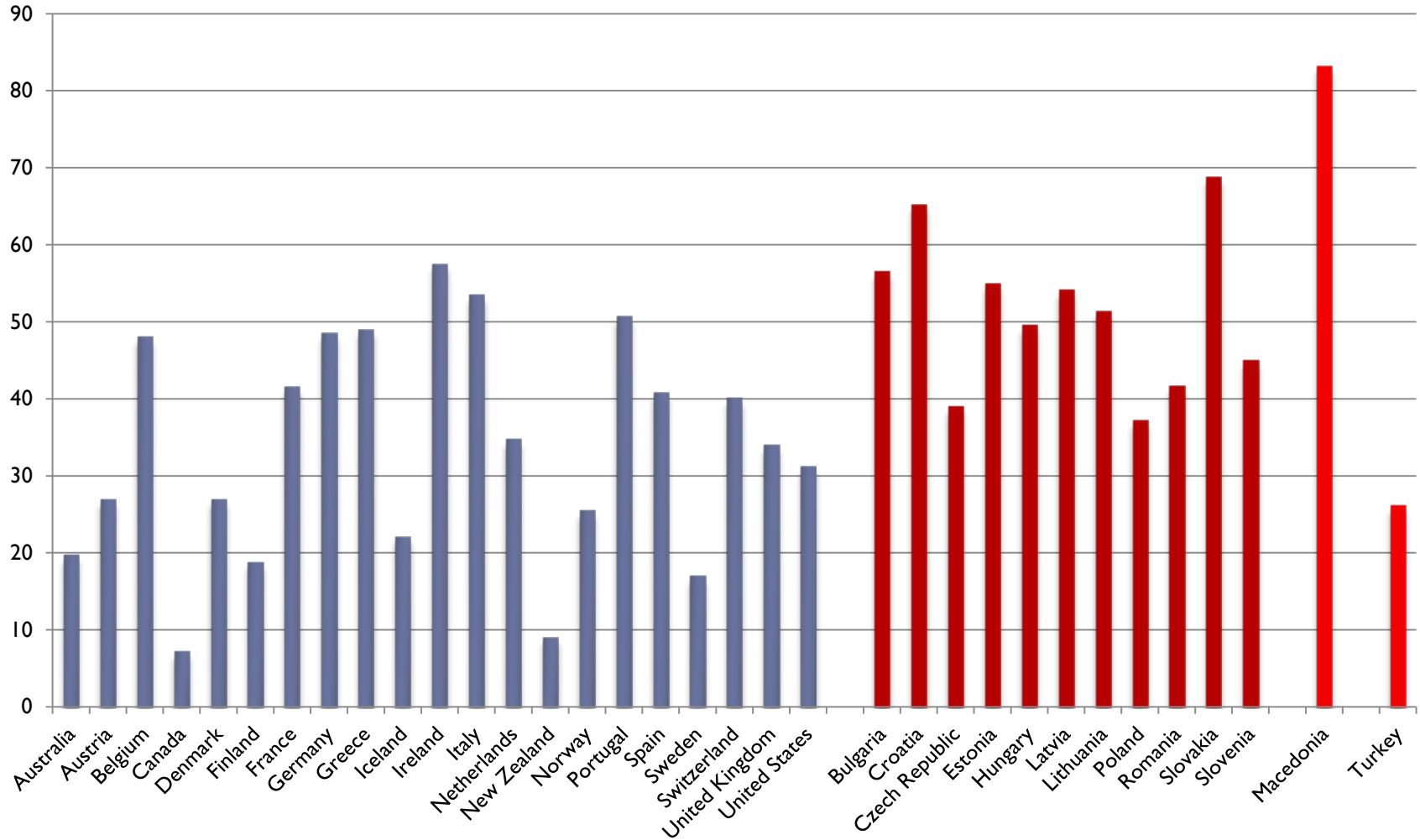
UB recipients as % of registered unemployed (2009)





Why low coverage?

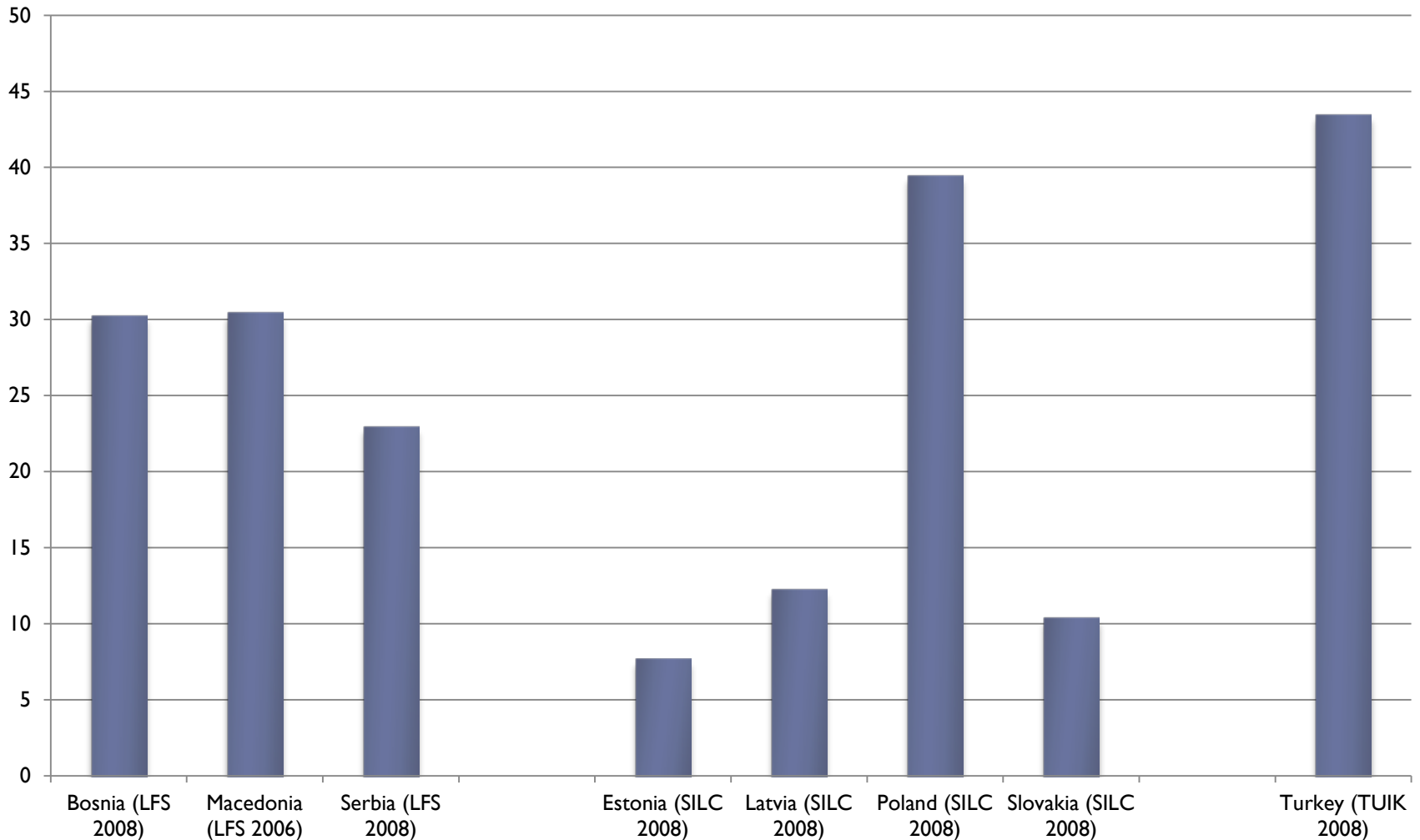
Long-term unemployment is higher in ECA



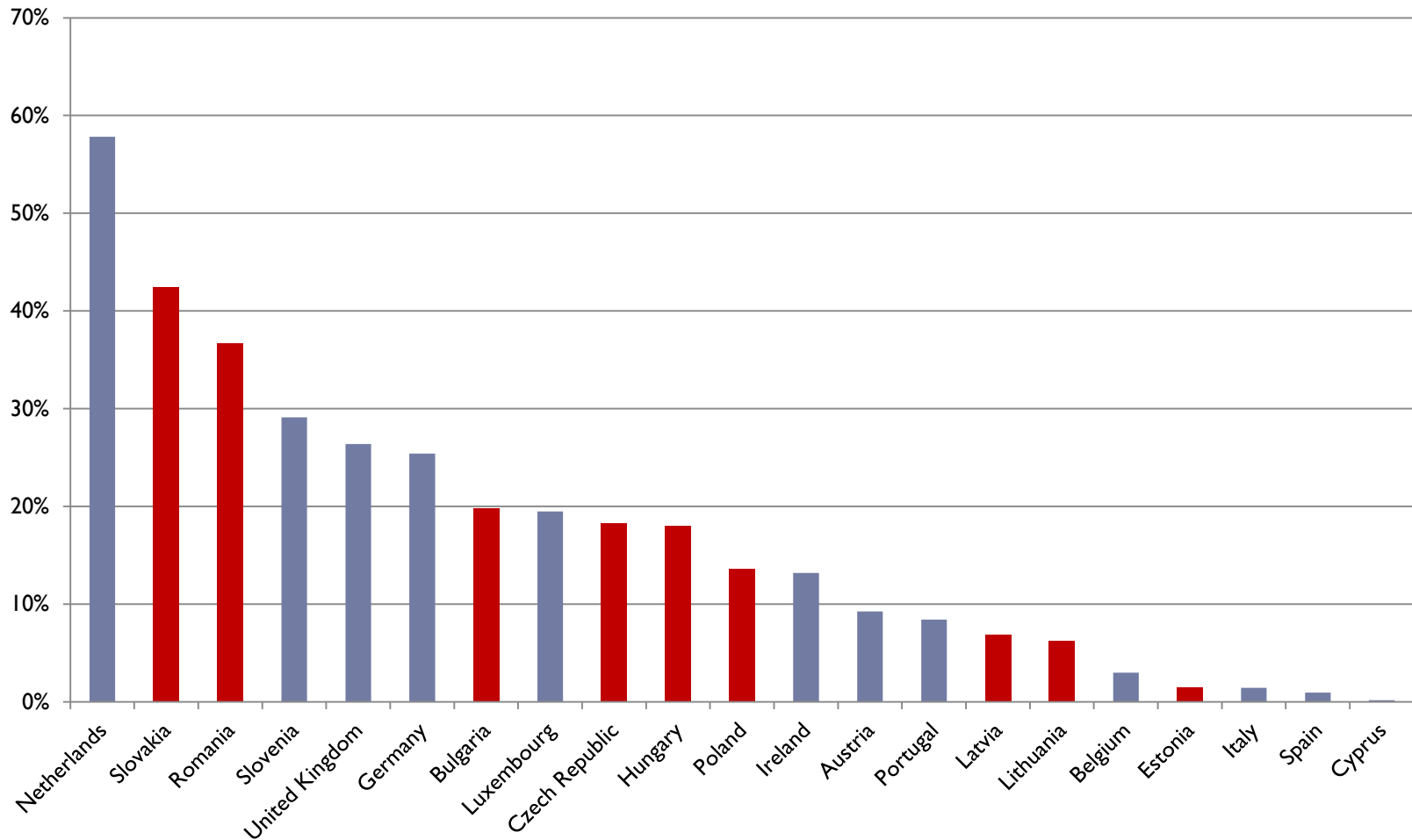


Why low coverage?

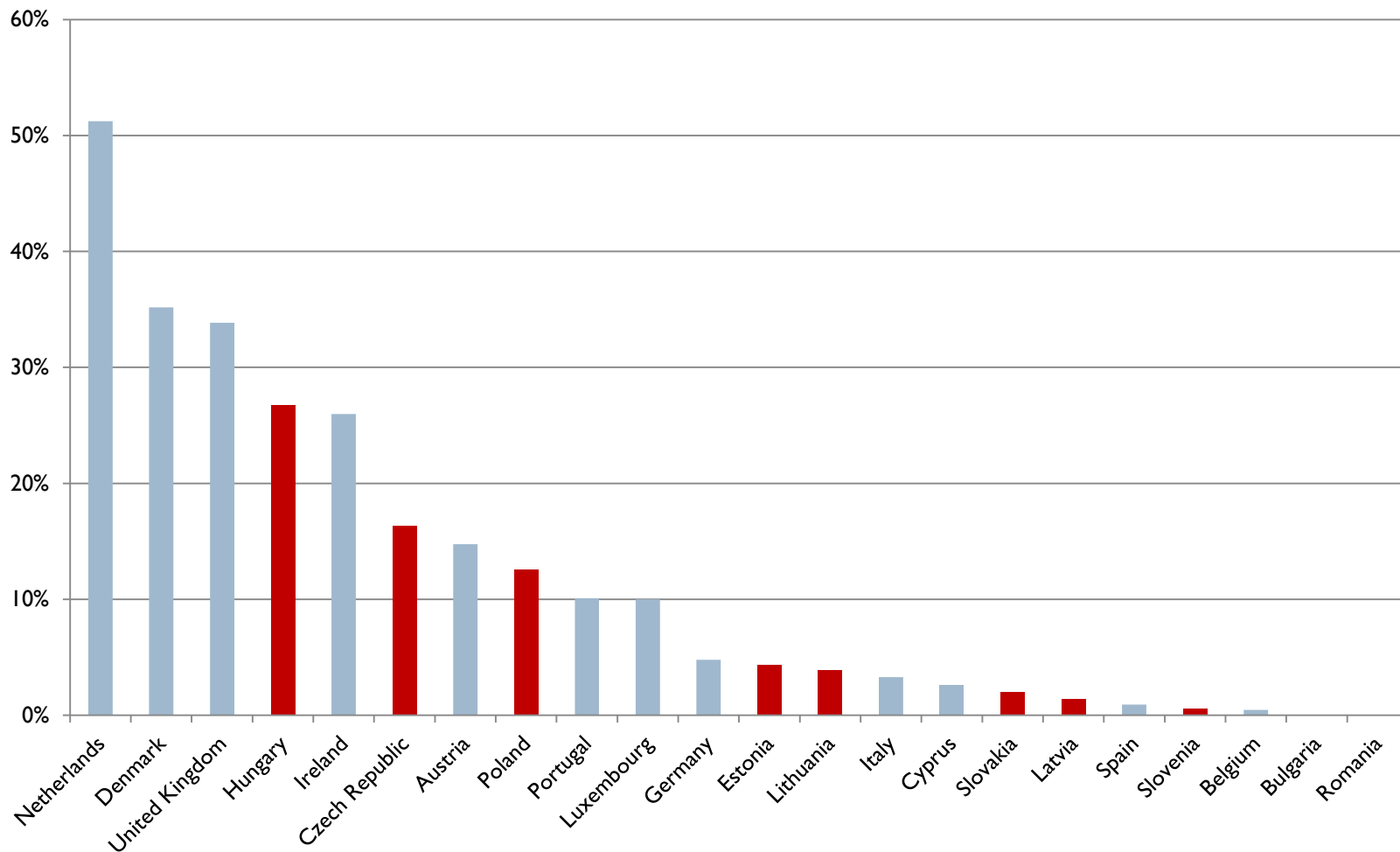
High informality rates in ECA



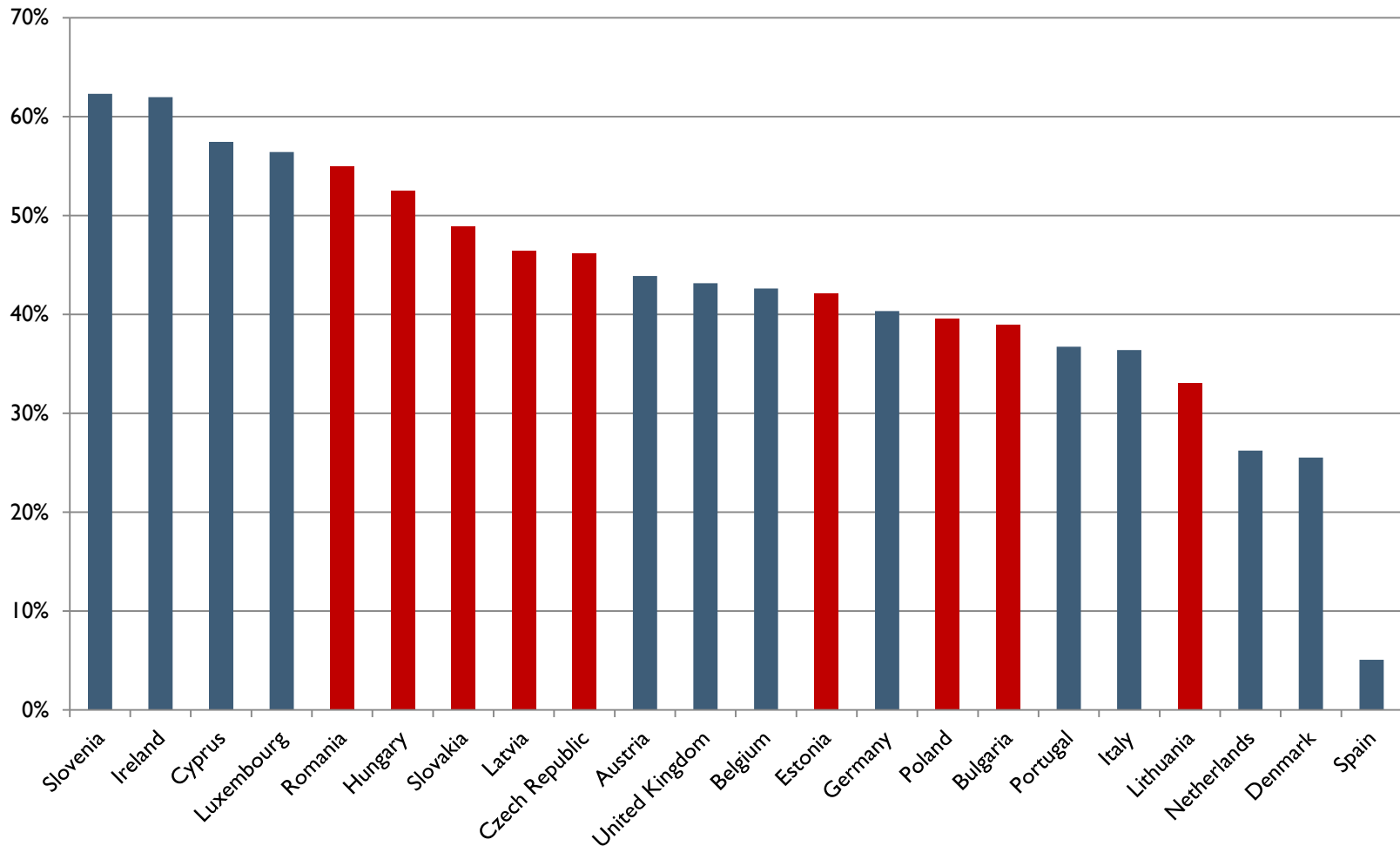
Coverage of social assistance benefits (as share of unemployed)



Coverage of housing benefits (as share of unemployed)



Coverage of family benefits (as share of unemployed)





Summary

- ▶ Labor market context in ECA countries differs from high-income OECD countries
 - ▶ High informality
 - ▶ Coverage of UB benefits in ECA countries is low when compared to high-income OECD countries
 - ⇒ How shall activation policies work if the income support component of the mutual obligation is irrelevant?

- ▶ But: when taking into account the consumption other benefits (SA, housing, and especially family benefits) among the unemployed, maybe there is potential to exploit the financial incentives for activation policies
 - ▶ Coverage of SA, housing and family benefits among the unemployed is considerably higher than coverage of UB
 - ⇒ Considerable potential for aligning incentive structure across benefits in line with activation principles
 - ⇒ Move toward integrated SP systems



5. Conclusions



Conclusions

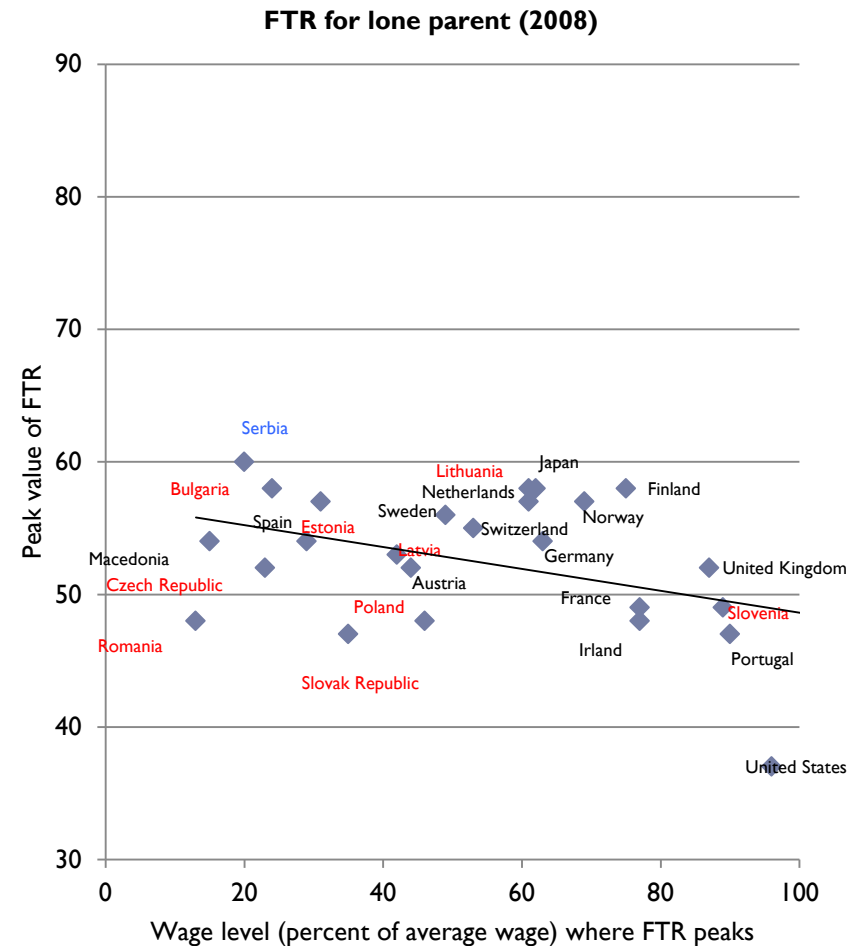
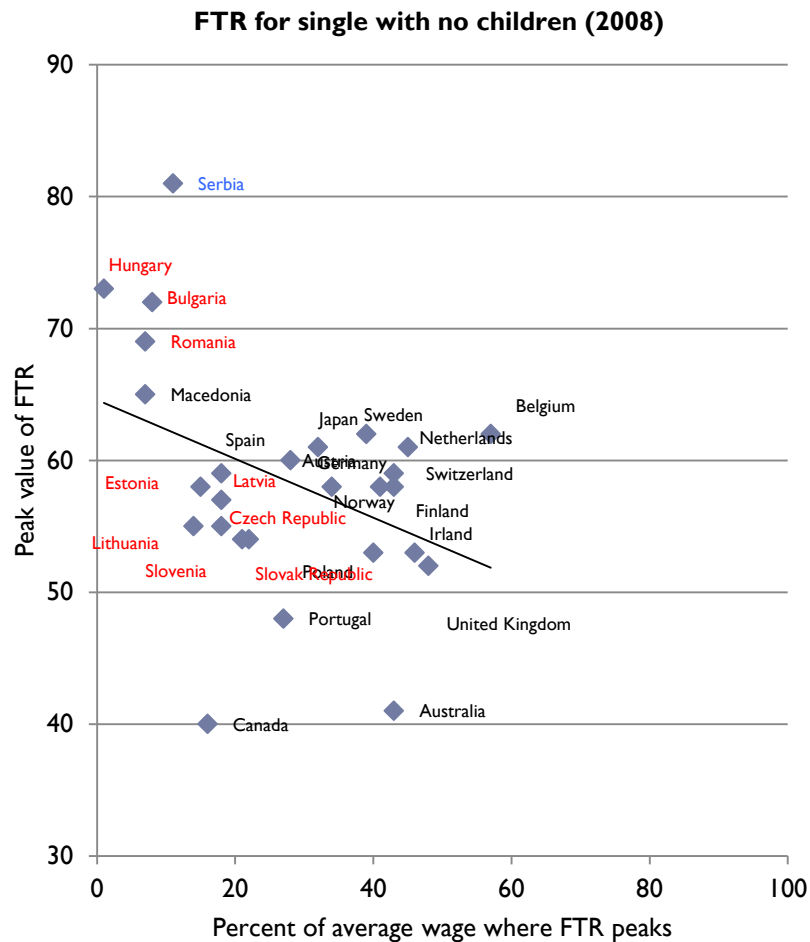
- ▶ Financial incentives are important for the activation agenda
 - ▶ In particular conditionality and eligibility rules building upon UB are key for incentivizing the unemployed
- ▶ Disincentives stemming from the design of unemployment benefits and related benefits and taxes are overall fairly similar in ECA countries when compared to OECD countries
 - ▶ Indicates room for activation conditionalities
 - ▶ Only for inactive households without children AETR and NRR seem considerably lower in ECA (less generous SA)
 - ▶ Family benefits seem to play an important role
- ▶ **But: labor market contexts are very different**
 - ▶ High informality and long-term unemployment
 - ▶ Low UB coverage
- ▶ Potential for better designed, incentive-compatible and integrated SP systems (including UB, but also other benefits) that set the incentives for transitioning to the *right* job and complement/support ALMPs
 - ▶ Integrated SP systems not only require aligned incentive structure, but also capacities to monitor and enforce mutual obligations (enhanced role of public employment services)



Annex



FTR: In NMS and Serbia, opportunity costs of formal work tend to be highest at lower wage levels

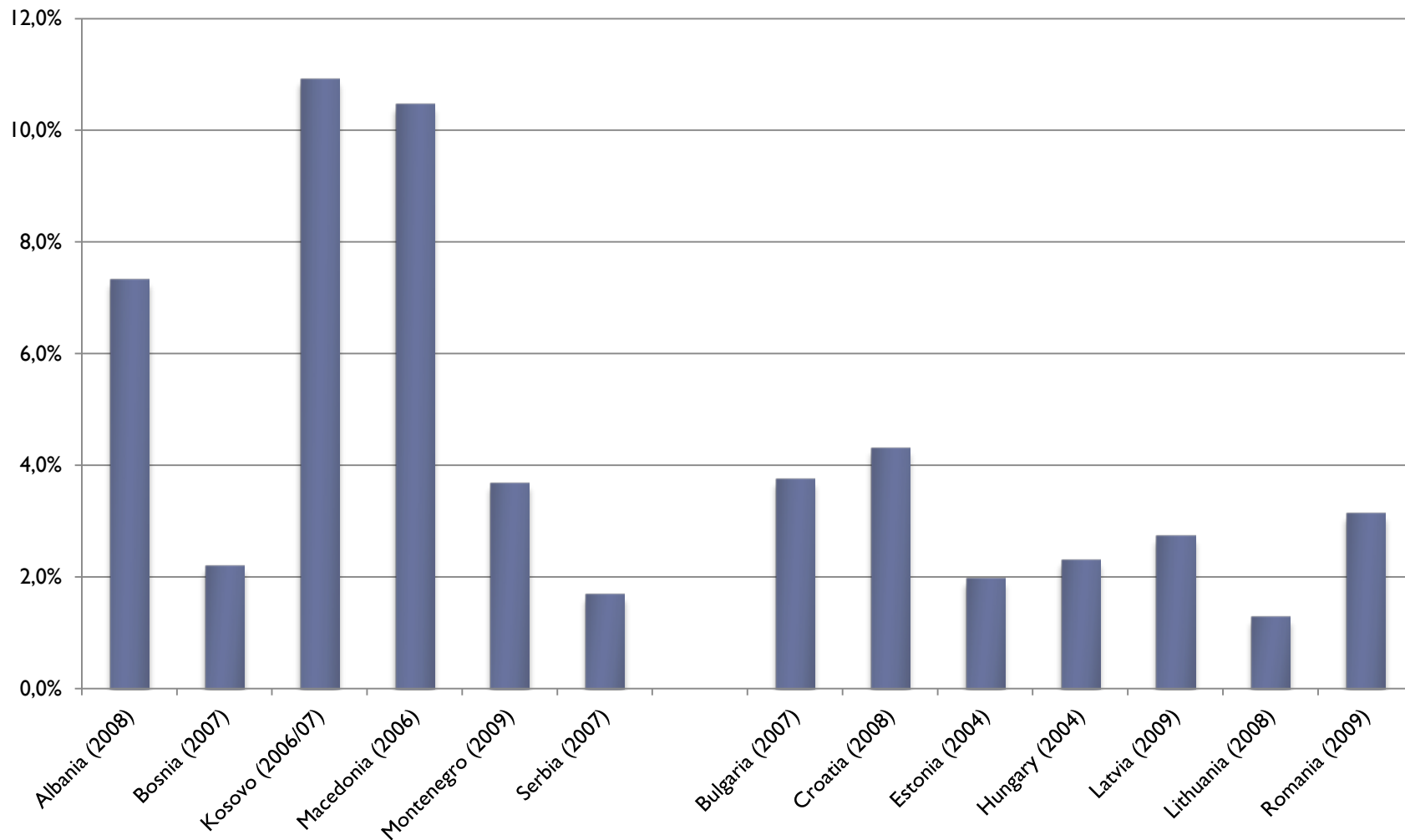


Empirical analysis: do disincentives for formal actually work matter?

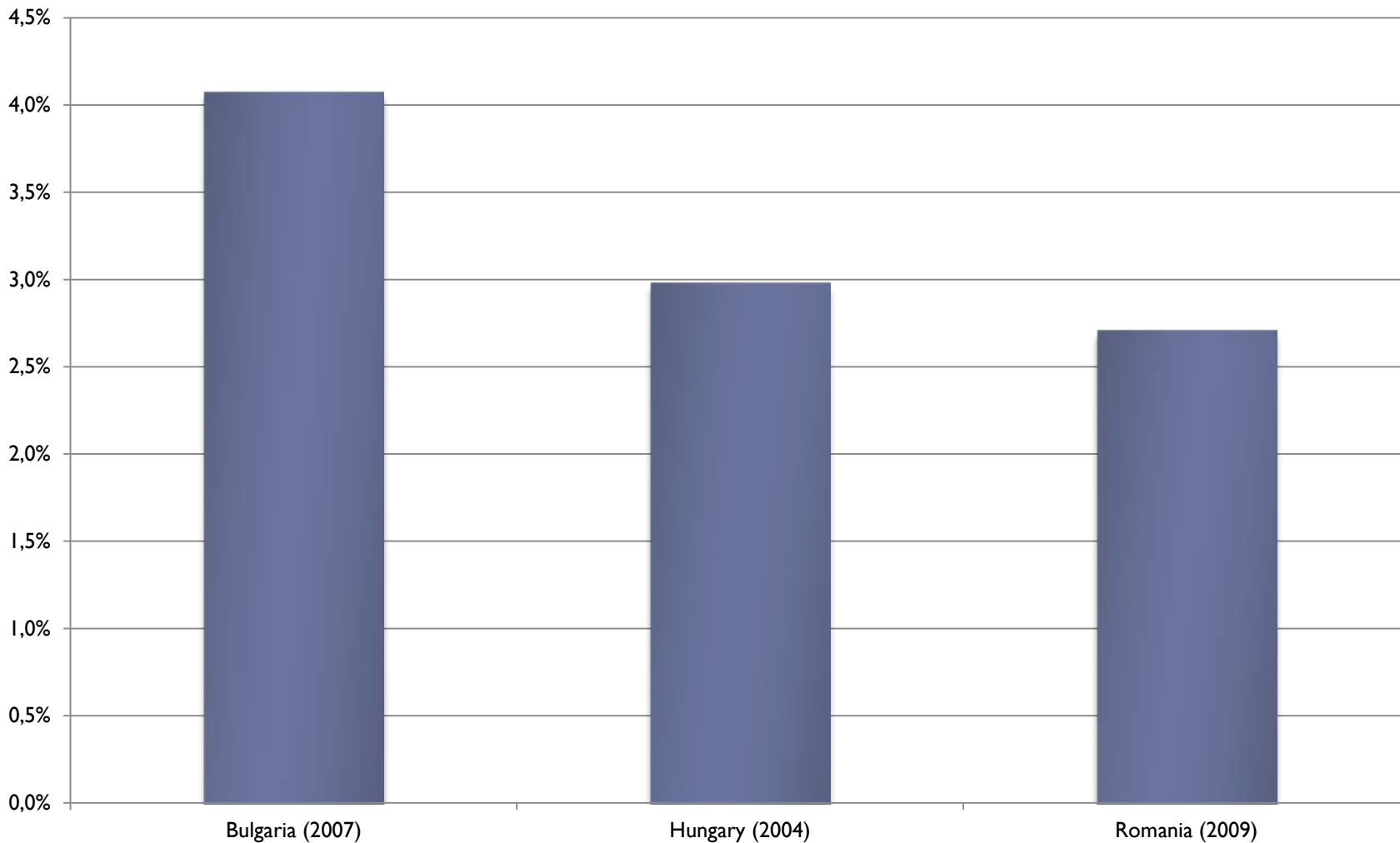


- ▶ Koettl and Weber (2012), using EU-SILC and OECD tax and benefit model for NMS
 - ▶ Matching work disincentives on individual level (FTR, METR, tax wedge)
 - ▶ Find significant positive correlation between FTR/METR and probability of being informal
 - ▶ 1 percentage point increase in FTR (METR) increases probability of being informal by 1.1 (0.8) percentage points
 - ▶ Correlation twice as high for low-wage earners

Coverage of last-resort social assistance benefits (as share of total population)



Coverage of housing benefits (as share of total population)



Coverage of family benefits (as share of total population)

