



Fondacija za razvoj ekonomske nauke

Foundation for the Advancement of Economics

POLICY Brief

Making Work Pay for Western Balkan Countries: the case of Serbia and Macedonia

Context – Tax and Benefit System in Serbia and Macedonia: Why Work at Low Wage Levels Does Not Pay?

Serbia and Macedonia are countries with a troubled labour market situation. The employment rates of 45.8% for Serbia and 40.7% for Macedonia are far below the EU average, while the unemployment rates of 25% and 28.8%, respectively, are among the highest in the region and considerably higher than the EU-27 average (10.9 %).

Lower employment and increasing unemployment rates point to high flows from activity to inactivity, especially for women, young people and workers at the fringe of the labour market (Table 1). Inactivity and informality is prevalent among low-educated individuals and those without or some working experience. Low educational attainment coupled with a negligible work experience generates low earnings capacity in the labour market. When earnings or potential earnings are low, incentives to seek employment or stay in employment are usually limited.

Table 1: Inactivity and unemployment rates by level of education and gender, Serbia and Macedonia (%)

Level of education	Inactivity				Unemployment			
	Serbia		Macedonia		Serbia		Macedonia	
	Men	Women	Men	Women	Men	Women	Men	Women
Primary	32.4	64.4	14.3	68.9	21.5	25.1	38.2	34.8
Secondary	24.5	40.9	12.7	25.6	22.4	26.5	31.6	31.8
Tertiary	18.0	22.4	10.6	9.4	15.5	14.2	23.0	26.3

Source: Serbia: LFS, 2011, Macedonia: Eurostat

Disincentives for looking for a job are further aggravated by high tax burdens on labour income for low-wage workers and by a sudden withdrawal of social benefits once a person due to formalization.

Therefore, the so-called mini-jobs and midi-jobs (mainly part-time jobs) are not economically attractive for low-wage earners and they opt for inactivity or informality.

Aim of the research

This research examines employment, poverty and income inequality effects of introducing making work pay (MWP) policies for two Western Balkan countries: Serbia and Macedonia. MWP policies are means-tested transfers given to individuals conditional on their employment status. They intend to enhance the incentives to accept work and to redistribute resources to low income groups.

Making work pay policies: a brief history....

The introduction and expansion of MWP policies in European countries has been inspired by the Earned Income Tax Credit, introduced for the first time in the United States, and the Working Family Tax Credit (WFTC) in the United Kingdom. The main motivation for the introduction of these policies in Europe and North America during the early 1990s, were the low levels of employment, experienced by certain specific demographic groups of working age. For example, one central stimulus for the WFTC in the UK was the stubbornly low levels of labour market attachment of single mothers and women with low educational attainment; at a time when for other women labour force attachment was on an increasing path. Another distinguishing characteristic of the UK labour market over this period was a growth in workless couples with children.

...design

At the moment, 16 out of 30 OECD countries have one form or another of employment-conditional benefit schemes and several other countries are actively considering their introduction, including Austria and OECD accession countries (Chile and Israel). Even though there are differences among countries in the design of the MWP policies, all employment-conditional measures use at least one of the following criteria to assess eligibility and determine the amount of benefit:

- having children,
- working minimum number of hours, and
- receiving income from work or entering/switching employment.

Most of these benefits are proportional to gross income up to a maximum amount and are – after a threshold – gradually withdrawn. In other words, they are characterized by the gradual phase-in and phase-out brackets as a mean of targeting individuals with specific earnings levels or working hours.

A more important aspect in the design is the choice of the unit used to assess income. In some countries eligibility for benefits is assessed at the

household level while in other countries it is focused on individuals. Family benefits, such as the EITC and the WFTC, depend on the household size and are mean-tested on the family income.

...and effects in other countries

Previous applications of benefits that are means-tested on family income show that they are introduced when distributional objectives are of particular importance. However, while the benefits assessed at the household level encourage the participation of single individuals, it often discourages the participation of second-earners in couples, most of them being women. Yet, in certain cases, family benefits can have both redistributive and incentive effects. This is the case for lone parents that constitute a large group of poor households.

Policies conditioned on individual earnings have greater incentive effect than family based alternatives

Measures that are conditioned on individual earnings only are usually of smaller amounts and targeted at a larger number of recipients. Research shows that these policies have greater incentive effects than the family-based alternatives since they do not discourage the participation of second-earners in a couple.

MWP policies in UK contributed to decline in child poverty....

Bell (2005) attributed a decline in child poverty between the fiscal years of 2002 and 2003 and 2003 and 2004 to the introduction of the WFTC programme. Brewer (2006) also noted that the programme reduced the number of families in poverty. St Martin and Whiteford (2003) estimated that the WFTC programme produced about 100,000 new jobs, while the cost of this policy was about 1% of GDP.

... and produced 100,000 new jobs

If introduced in Italy MWP policies would increase labour supply of women by 5 percentage points...

Positive evidence of redistributive effects and social inclusion of low skilled workers in the Anglo-Saxon welfare systems encouraged other countries to study the feasibility of implementing of such policies. Several papers emerged focusing on a country like Italy which is characterized by low labour market participation of less educated and unskilled women, high in work poverty, lack of employment support programs, high marginal tax rates on earned incomes, and a widespread cultural tradition of married couples with male breadwinner (Colonna and Marcassa (2011), Figari (2011), De Lucca, Rossetti and Vuri (2012)). Figari (2011) finds that family in-work benefits lead to an average increase of female labour supply of 3 percentage points. The individual in-work benefit has even stronger incentive effects for women in couples who see their labour supply rising by 5 percentage points. Most of the labour supply reactions induced by the in-work benefits take place among the poorest individuals with important redistributive effects. Similar results, especially for couples with children and at the bottom of the disposable household income distribution are found in De Lucca, Rossetti and Vuri (2012). Colonna and Marcassa (2011) show that the working tax credit boost the participation rate, with the effects being concentrated on unskilled and low educated women.

...with the effects being concentrated on unskilled and low educated women and those at the bottom of the income distribution

Empirical analysis for Serbia and Macedonia

This research combines the tax and benefit micro-simulation model with a structural discrete choice labour supply model. The tax and benefit micro-simulation model is used to reproduce the budget constraint for each household, i.e., the latent set of working hours and household disposable income alternatives, while the labour supply model rationalizes observed behaviour.

The tax&ben model for Serbia (SRMOD) uses is based on the Living Standards Measurement Survey (LSMS) from 2007 which contain detailed socio-economic information for 17,375 individuals living in 5,575 households. The similar model for Macedonia (MAKMOD) is based on the Survey of Income and Living Conditions from 2011 (4.000 hh/13.800 individuals).

Design of the policies

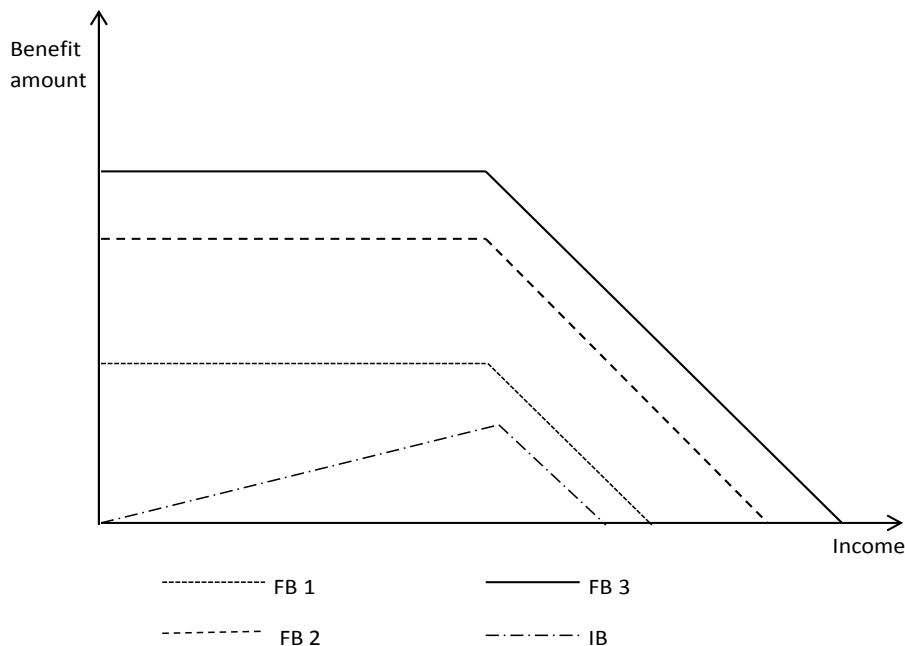
MWP policies for both countries are designed following British Working Family Tax Credit as a role model because this one is the most commonly analyzed and discussed. Additionally, British scheme is showed to be particularly efficient in countries with high inactivity and unemployment among women, which is also the case in Serbia and Macedonia.

The first policy is based on the family level (i.e. it takes into account total family income) and consists of three different schemes (see below for details). The second policy is based on the individual level (i.e. it takes into account only the income of the individual).

The first type of family based policy refers to the case of a single person working full time (FB1, see Figure 1). The second family based scheme (FB2) is related to lone parents and couples working part time (lone parents and couples with children working at least 16 hours per week and couples without children working at least 30 hours per week). The last type of the family benefit (FB3) relates to lone parents and couples working full time (40 hours or more, per week). In each scheme, families are entitled to a full benefit of a certain amount (differs across family types) if their income is below the given threshold (also differing between family types). When income exceeds this ceiling, the benefit is gradually phased out at a rate of 0.37.

In order to have working incentives not only for people with low earnings, but also for people with low hourly wages, an individual based benefit scheme is created. This benefit treats all the workers in the same manner, regardless of their family status. Namely, all individuals working at least 16 hours per week and earning income below a certain amount are entitled to this wage subsidy. Individual benefit is not linear, as in the case of family based benefit, but is being phased in at a rate of 0.36, reaching a maximum amount at a certain income level, when gradually phased out at a 0.37 rate.

Figure 1: Benefit design



Results show that for both countries policies based on family income would have larger labour supply effects for singles persons

In Serbia and Macedonia both individual and family based schemes would trigger a decline in non-participation of single persons, the effects being larger in case of family benefits. In the case of Serbia, family benefits would increase employment of single individuals by 10.2 pp, and in Macedonia by 5.8 pp. On the other hand, policies assessed against individual earnings would reduce inactivity by 6.7 pp in Serbia, and 2.2 pp in Macedonia. Under both schemes the most newly activated individuals would opt for full time employment, while only limited number of them would switch from inactivity to part time employment.

For couples, only policies based on individual earning would reduce non-participation in the labour market

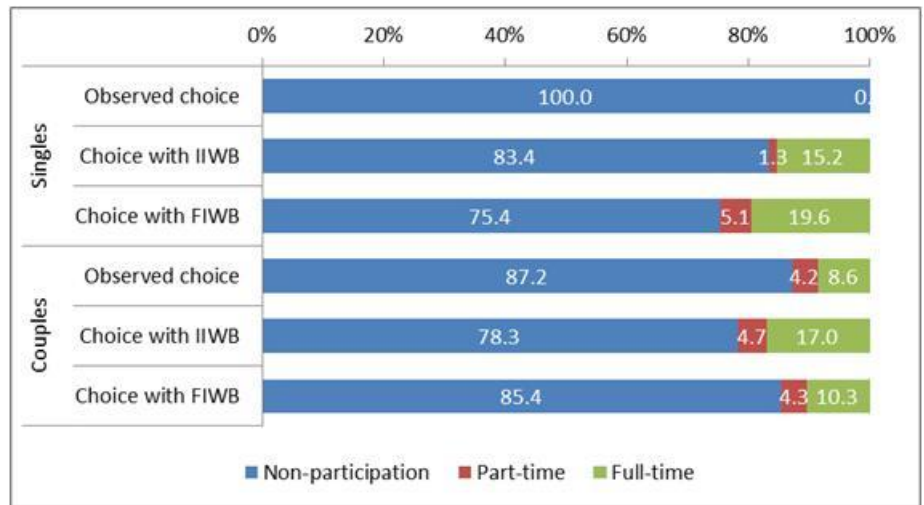
In the case of couples, in both countries only policies assessed against individual earning would increase their desire to work: 2.5 pp in Macedonia and 2.4 pp in Serbia.

Considerable larger labour supply effects for those at the bottom of the income distribution

Our research confirms findings from other countries: MWP policies have much larger effects for those at the bottom of the income distribution. Before the introduction of individual type of benefits, in Serbia no single individuals from the bottom quintile have participated at the labor market, while after the introduction 15.2 percent of them would switch from non-participation to full-time employment. In case of a family scheme the labor supply effects on the bottom quintile individuals would be even larger –in the case of full time employment their labour supply would increase by 19.6 pp, and 5.1 pp in the case of part time employment (Figure 2).

In Serbia, non-participation for individuals from the bottom quintile would fall by almost 20 percentage points in the case of family based MWP policy

Figure 2: Labour market participation choices without and with individual MWP policy, Serbia, 1st quintile

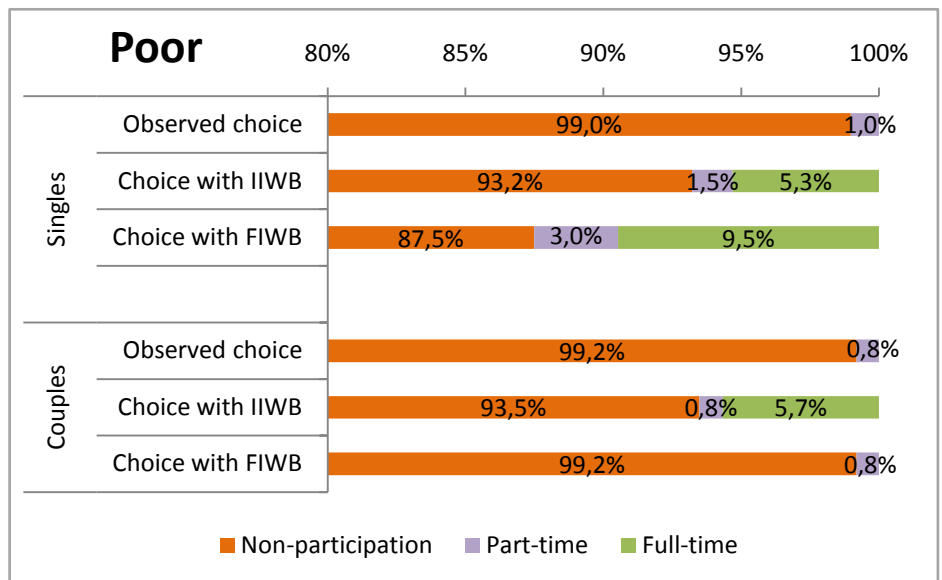


Source: Authors' calculations

In Macedonia, the share of full-time employment increases 5.3 pp in the case of individual policies and 9.5 pp in the case of family based alternatives

In Macedonia, results show that the share of full-time employment increases by 5.3 percentage points in the case of individual policies and by 9.5 pp in the case of family based alternatives. With respect to couples, only the policy assessed against individual earnings reduces inactivity by steering full-time employment to increase by to 5.7 pp (Figure 3).

Figure 3: Labour market participation choices without and with individual MWP policy, Macedonia, poor



Definition of the poor: if the disposable household income is below 60 percent of the median.

Policy recommendations

Employment-conditional cash transfers to individuals facing particular labour-market challenges have been a core element of “make-work-pay” policies for some time and are now in use in more than half of the OECD countries. Labour supply in this rich countries club has been reduced due to generous social assistance schemes. In Serbia and Macedonia, of course, this is not the case. Instead, disincentives for taking up (low-paid) jobs lie in the sudden withdrawal of social assistance benefits once a person has any formal income on his/her record. Thus, the small difference between the income in and out of work prevents social benefit recipients from becoming self-sufficient. Additionally, high labour tax burden on low-paid labour deters employers from looking for these type of workers.

The employment effect of making work pay policies thus depend on both the motivation of individuals to look for a job, but also on the labour market’s capacity to accommodate them. In other words, during times of economic prosperity there will be bigger employment gains after the introduction of MWP policies than during crises. Our results show that there could be considerable labour supply effects after the introduction of MWP policies, and particularly for those at the bottom of the income distribution. Having this in mind, we believe that it is not early to start considering employment-conditional cash transfers so that their full effect can be realized when our economies are on the upward paths.

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