



Inequality, a lack of caring for people and solidarity, but this can be changed!

An evidence-based dream of a more equal Latvia

Facts

With the increase in people's general income, those with the lowest income are not feeling this improvement, as the statutory income level which provides them with the opportunity to qualify for certain support continues to remain low. According to data from the Survey of Income and Living Conditions carried out in 2016 by the Central Statistical Bureau of the Republic of Latvia, of all households with two adults and three or more dependent children, one in four households is at risk of poverty (25.5%). Of the one-parent households with at least one child, one third of households (34.4%) is at risk of poverty. Older people over 65 years of age have the highest risk of poverty with 38.1% at risk. The highest risk of poverty is among older people over 65 years of age - 38.1% are at risk of poverty. If the particular person is living alone, the risk of poverty increases, and so 74% of households with seniors over the age of 65 living alone are exposed to the risk of poverty. The Roma are a group of people who are at risk of poverty. In 40.5% of Roma households, there are no legally employed family members and most of the family are supported through various social benefits and other types of financial help. (Latvian Facts, 2015).

Study

Income and social inequality in Latvia were examined from economic, financial, social, educational and health policy aspects in the unorthodox inter-disciplinary survey. The problems and the hardest hit groups of people were highlighted, as were specific suggestions offered for improving the abovementioned policies in the form of policy planning, as well as in changes to legal regulations.

The Study conducted by the Task Force on Reducing Inequality was undertaken in 2017.

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WHERE ARE WE?

For more than 10 years, there has been a relatively high proportion of people at risk of poverty and a marked level of income inequality in Latvia. Compared to other EU member states, Latvia has a long-standing low level of income redistribution, which is determined by the existing tax-benefit system and long-term high-income inequality.¹ Taking into account the low level of redistribution of the Latvian tax/benefit system, it could be expected that this would be socio-politically balanced by strong labour incentives. However, according to EUROMOD simulation results for EU 28 (BICEPS, 2016), the labour incentives created by the tax/benefit system in Latvia are relatively weak compared to other countries. This means that the Latvian tax relief system is characterised by relatively low efficiency and fairness.² When analysing the processes related to the prevalence of inequality, there is a tendency: those, who are already sufficiently competitive, especially in terms of education, accumulate more (educational) resources: this is referred to as the "Matthew Effect" (Merton 1968), as well as accumulative (cumulative) advantages (DiPrete & Eirich 2006, Elman Rand & O 2004). This differentiating, decisive "accumulation of education" tendency leads to increasing inequality, both in education and in the labour market, furthermore throughout life.

In 2015, 8.4% of the population of Latvia reported unsatisfied health care needs and it was the fourth highest indicator among all the countries of the European Union. Low-income people report most about unsatisfied medical care needs: one in six residents (17.1%) living in a low-income household reported, that due to financial or other reasons they had to avoid visiting a doctor or obtaining treatment, and this proportion is three times higher than the average in the European Union (5.5%). Inequality in health care leads to variations in the health status of the population at the individual and regional level, differences in health status between individuals and groups of the population. Inequality in health can have different causes, for example, social inequality in the health field is related to different living conditions, as well as factors such as income, unemployment and education levels. Important factors affecting health inequalities are age, disability, unemployment, availability and quality of health care services, educational level and living and working conditions (income, purchasing power, etc.). A recent report by the European Commission condemns Latvian policy makers regarding the escalation in inequality, for introducing the Law on Health Care Financing in 2017. Even though the idea is to motivate people to pay taxes, a proportion of people risk losing their current access to health care. This will, most likely, lead to the fact that the level of health of these particular people will deteriorate even further, treatment will be put off and the use of emergency services care will increase.

Excessive inequality is an economic and social problem that, in the long run, worsens a country's economic situation. Measurements of the subjective assessment of happiness³ show that people feel happier living in a more equal society.

Inequality in Latvia is too high and interferes with the nation's sustainable development and with the implementation of the National Development Plan 2014-2020's policy planning framework's concepts about the coordination of social, economic and environmental development.

Recommended solutions

We consider that to encourage the sustainable development of Latvian society, social inequality and its consequences (poverty of those employed or receiving benefits, social exclusion, health problems or a lack of education) needs to

¹ Inequality of income earned in Latvia is one of the highest in the EU - only Ireland, Greece and Portugal are above Latvia. At the same time, Latvia has one of the lowest levels of income redistribution in the EU, that is provided by tax/benefit systems. This is measured by the difference between the Gini coefficient for earned income and the Gini coefficient for disposable income (**Available net income** - cash income from paid employment; converted to cash earnings per employee from using a company or service car for private needs; income or loss from self-employment; received pensions and benefits; regular cash assistance from other households; earnings from interest on deposits; dividends and shares; income received by children under 16 years of age; income from rental of property; amount received from the State Revenue Service (SRS) due to overpayment of income tax (for the pursuit of economic activity, eligible expenses - education, medical treatment etc.). As a result, income inequality in Latvia is one of the highest in the EU (BICEPS, 2017)

² See Pluta, A., Zasova, A. Latvia Stumbling Towards Progressive Income Taxation:

Episode II: http://www.biceps.org/assets/docs/neregulara-rakstura/Occasional_paper_10.pdf, Page 14

³ For example see the newest World Happiness report: <http://worldhappiness.report/ed/2017/>

be reduced in the medium term. This can be achieved by the coordinated transformation of societal policy instruments and offering new instruments, as well as their implementation in the areas of employment, social benefits, social services, education and health.

Further, we will look at policy actions and tactics that can be implemented in different sectors, to help move towards a more equal society. They are **effective corrections of redistribution mechanisms** for taxes and benefits, **the quality of institutions (state and local authorities and agencies in the fields of planning and implementation of public policies, especially in employment, social services, education, health), and investments in human capital**. In the process of modelling the solutions, we have found that it is efficient to look at the last two groups of inequality reduction opportunities in correlation: the quality of the institutions is directly related to the competencies of the persons working there, including the competence to plan and implement public investment in the target groups of society, which are in conditions of social exclusion - that is, already suffer from the consequences of inequality.

Adjustments to the redistribution mechanism

Income inequality can be affected by tax policy. A regressive tax system can increase inequality, but a progressive tax system can reduce it. Tax policy alone is not an instrument that can reduce the gap of inequality sustainably and in the long term.

The reforms of tax and minimal livelihoods (ML) currently implemented in Latvia have some common goals: both reforms are intended to increase the level of income redistribution, which is provided by the Latvian tax-benefit system. The ML reform aims to do this by increasing the income of the poorest people. The tax reform aims to achieve this by increasing PIT relief for low-wage recipients and introducing a progressive PIT rate. In accordance with the results of our analysis, both reforms will help to achieve a small reduction in income inequality. At the same time, none of the reforms offers effective solutions for the weak stimulus for low wage earners to work and the high tax burden problem.

Policy recommendations:

- Income tested benefits. To improve the stimulus for low wage earners to work, reform of income tested benefits (GMI and lodging benefit) is necessary in order to avoid a 100% effective tax rate, to which the income of low wage earners is currently subject. This type of situation develops because with an increase in the income of income tested benefit recipients, for example, by one euro, the size of the benefit is decreased by one euro. This creates poor incentives to increase labour income and poses a risk of a poverty trap. *The policy recommendation is to reform the conditions on the basis of which the level of benefit is based – the offer is not to reduce the benefits by the same amount as the income of the benefit recipient is increased, but to reduce this gradually.*
- Personal income tax levels. Given the limited budgetary resources, it is desirable to reduce the tax burden, which would be more directly targeted to the low-wage recipients. For example, according to our estimates, if the lowest PIT rate were to be reduced to 15% rather than 20%, the tax breach for low-wage recipients would decrease by 3 percentage points in 2020, which would allow Latvia to approach the average tax gap index in the OECD countries. Undeclared budget revenues could partly be offset by lowering the income threshold for a higher PIT rate.
- PIN untaxed minimum. In accordance with our calculations, reform of the untaxed minimum by 2020 is an effective way to reduce the tax burden for low income earners. Accordingly, our recommendation is to continue to increase the maximum annual untaxed minimum after 2020 as well.

Quality of Institutions and Investing in People I: Structural Issues

A more complex structure for the economy

The development of more complex sectors within the economy is the only way to reduce inequality in Latvia in all of its various forms and expressions in a stable and sustainable manner. This should be done by increasing the participation of both the public and the private sector in national development.

The first step would be to develop and implement this type of national development strategy.

The next step is to stimulate innovation. The creation and maintenance of a complex economy is not just the result of the required competencies for a single economic sector, production technology or some specific product's production. It can be achieved by creating a stable supportive environment in society and a continually growing range of people who display an ability to create new productive combinations, processes and products, while driving innovative processes.

The third step is to focus all state-controlled resources, including European funds, for convergence and structural development, in order to develop sectors with high economic complexity.

Fourthly, the state needs to set up loan programmes together with commercial banks in order to guarantee, that new companies and companies in very complex sectors receive sufficient funding at low interest rates.

Fifthly, all necessary reforms must be undertaken in order to attract foreign investors who want to establish manufacturing plants and research facilities in Latvia. Fiscal policy measures and other incentives in the field of banking and transit are often not the best support for the development of highly complex sectors.

Sixthly, in cooperation with the private sector, it is necessary to start retraining programmes for businesses, employees and officials.

Seventhly, there is a need for programmes to reduce social inequality (flexicurity solutions, retraining support and subsidies for people etc.) while this development process takes place.

Quality of Institutions and Investing in People I: Services available to everyone

To sustainably reduce and prevent inequality, it is necessary to develop the supply of services which support the diversity of the people in Latvia, is non-discriminatory and corresponds to the social, healthcare and educational needs of users.

Medium-term priorities include the adaptation of social services to the social needs of clients, already envisaging the flexible adaptation of services/social needs in the regulatory framework. Such social services, including social rehabilitation for people with addictions and those affected by violence, long-term care for people with limited social functionality, active employment measures appropriate to a person's resources and similar, involves the consistent tracking of funding for the needs of the individual and the termination of the service, when the person is able to solve his/her problems himself/herself and is able to function fully within society, both as an employee and a member of a household.

From a service provision aspect, this also means a sensitive approach to the client's culture, which has not yet been achieved for Roma clients or for homosexuals and transgender people. This recommendation is related to that already highlighted in the report from the President's Expert Group on Social Cohesion Policy, late in 2016, on the introduction of diversity management in public administration.⁴ From the aspect of reducing social inequality, in order to help clients overcome the constraints set by their social status,⁵ it is essential to introduce an integrated approach to the differentiation of clients in the development of the education and the professional development of social service

⁴ See Report of the President's Expert Group on Social Cohesion Policy, available at https://www.president.lv/storage/items/PDF/201611_Sabiedr%C4%ABbas_salied%C4%93t%C4%ABbas_zi%C5%86ojums.pdf, especially Page 16

⁵ See the definition of social inequality, Page 3

providers, as well as in the day-to-day work of social service providers in social institutions, mainly in municipal social services, but also in NGOs.

Education as a powerful "social mobility lift"

If the inequality of income for families with children can be potentially reduced by pre-school and interest education services subsidised by state and local government, such as subsidised and accessible, diverse extracurricular activities and the availability of kindergartens for all families, then the growing social inequality in the field of adult education (AE) can be reduced by expanding and diversifying educational services, bringing their content closer to the competences required in the local labour market - in all planning regions in Latvia.

Planning the outcomes of adult education management in the future, the Swedish approach of "one step higher" from 1999 is usable and adaptable as a useful reference point and measurable goal for adult education planning, setting the provision of a certain percentage of people with basic education with secondary education opportunities, as a goal in the adult education annual plan.

For all target groups, especially for the low-income rural population, women over 40 years of age with low primary education and basic skills, and Roma people, there is a need to have a flexible timetable for educational activities, combining this with the possibility of working at least in temporary work as well, plus childcare and the reimbursement of transport costs. Example: Programme No.1 – comprehensive learning of basic skills, including the acquisition of the national language/ Programme No. 2, which follows successively: learning of specific competences required for the performance of the profession practised at the enterprise and supervised by the employer.

Employment measures, which are aimed at the development of competences needed in the labour market, in the short term are more successful in restoring employment, compared to the measures that foresee the development of general skills and competences without direct contact with the labour market.⁶ An example is training with an employer for NEET youth, in the services and sales sectors.

In the field of non-formal education activities, the only measures that are potentially effective are the acquisition of the state language and the English language and the acquisition/improvement of computer skills. Acquiring general skills - foreign language skills and computer skills are important for all target groups. In addition, those with low income and women in rural areas also need to improve communication and other social skills⁷

Opportunities for improving employees' professional qualifications, launched by the state in the autumn of 2017 should be continued, providing special opportunities for certain target groups - pre-retirement employees, people with low qualifications and retraining opportunities for the unemployed and job seekers.

The most important investments are needed to ensure the continuity of education possibilities, by motivating certain target groups (people with a low level of formal education or a low level of basic skills) in advance, and to establish and fund *second-chance education*.

To ensure the quality of adult education, it is necessary to improve the quality of teaching staff by defining the criteria, introducing an effective system and simplifying the mobility of adult educators. Simultaneously, the quality of AE service providers should be controlled and improved - it is important to set criteria for the quality of adult educators and the quality of service provision - the availability of training facilities and childcare facilities, provision of

⁶ See more - Ministry of Finance of the Republic of Latvia (23 December, 2016). The assessment report Evaluation of the impact of unemployed, who are registered in the State Employment Agency, profiling method on getting a job by the unemployed, performer "Ernst&Young Baltic" LTD, available: http://m.esfondi.lv/upload/Petijumi_un_izvertejumi/izvertejuma-zinojums.pdf

⁷ Ibidem, Page 45.

extramural and distance learning opportunities, information, access to career consultations and the flexible organisation of training.

Public health and healthcare

In order to reduce inequality in health care, people's access to high-quality health care services must be provided.

Medium-term priorities include: 1) improvement of health promotion and prevention measures; 2) a review of the location and working model of health care services in order to ensure the availability of adequate health services for all people; 3) ensuring the availability of appropriately qualified medical staff.

Solutions, to reduce inequality in healthcare, are as follows:

- the effect of the Law on Health Care Financing on the evaluation and review of inequality;
- reduction of patient co-payments;
- improved, availability of successive state-funded rehabilitation services;
- the sum for co-payment in the Medicine Compensation System for various diagnoses to be revised;
- improved access to outpatient services for psychiatric patients outside Riga;
- the development of health care services for oncology patients is continued: the availability and quality of organised cancer screening, early diagnosis, treatment, medical rehabilitation and palliative care services;
- improved accessibility at the primary level of basic health care (visiting hours of family doctors, work organisation, etc.);
- the continuous and adequate provision of care for chronic patients (cooperation between health and welfare areas in providing a quality, continuous service);
- a guaranteed number of medical practitioners of the required qualification in the regions;
- a system of motivational remuneration for medical persons is provided.

Recommendations for reducing inequality in Latvia: changes in policy planning documents and the regulatory framework

1. When working on the National Development Plan for the period after 2020, the reduction of inequity should be determined as a development priority in Latvia.
2. To supplement Cabinet of Ministers Regulation No. 19, dated 15th December 2009, "Procedure for Assessing the Initial Impact of a Draft Law", defining that when evaluating a draft law's initial impact, the impact of the draft law on the reduction of inequalities is to be assessed.
3. Adopt an Anti-Discrimination Law that summarises anti-discrimination legislation in the private and public fields, that covers discrimination on a variety of grounds (currently, these rules are found in laws in various areas.)

In the Tax and Benefit Regulation Area:

1. In Section 15 of the Law “On Personal Income Tax”, lower the PIT rate to 15 percent, simultaneously reducing⁸ the income threshold for a higher PIT rate.
2. To amend Cabinet of Ministers Regulation No. 676 dated 14th November 2017 "Regulations on the Calculation of the Untaxed Minimum and Tax Relief for Personal Income Tax" in the following way:
 - to continue raising the maximum annual non-taxable minimum after 2020 as well;
 - to increase the amount of yearly taxable income to which the maximum annual non-taxable minimum applies, to 67 percent of the average wage of an employee.
3. To amend Cabinet of Ministers Regulation No. 550 dated 17th June 2009 "Procedure for the Calculation, Allocation and Payment of Benefits to Ensure a Guaranteed Minimum Income Level and the Agreement on Participation", defining that the benefit is not to be reduced by the same amount by which a recipient's income increases.

In the Economic Policy Area:

1. In working on the National Development Plan for the period after 2020, to consider an innovation-orientated economy as one of the priorities, respectively planning actions to promote entrepreneurship and research and focusing resources on increasing the level of economic complexity.
2. To amend the Law on Aid for Start-up Companies, introducing new forms for the support of new business activities, which are not in conflict with European Union legislation.
3. Review the regulatory enactments issued on the basis of the Law on Financial Institutions for Development in order to facilitate the availability of funding to increase the level of complexity of the economy.

In the Education Policy Area:

1. In working on the European Union Structural Funds and Cohesion Fund management system for the period after 2020, reduce the bureaucratic burden on project executives and participants, at the same time introducing an effective system for project appraisal ex post.
2. In working on the European Union Structural Funds and the Cohesion Fund management system for the period after 2020, to identify targeted groups flexibly, taking into account the potential risks of inequality.

In the Health Care Area:

1. Evaluate the impact of the Law on Health Care Financing on inequality among various social groups and review this to provide effective protection against discrimination.
2. By developing Cabinet of Ministers Regulations on the basis of delegation in the Law on Health Care Financing, to expand the range of state-funded health care services and to reduce patient co-payments.
3. In implementing the Law on Health Care Financing and ensuring sustainable health care financing:
 - to improve the availability of state-funded rehabilitation services;

⁸ Explanation: the income threshold for a higher PIT rate should be reduced, so that a higher rate is applied to a larger number of taxpayers, and it could at least partially compensate the costs associated with lowering the PIT rate.

- to improve access to outpatient services for psychiatric patients outside Riga;
 - to improve access to health care services for cancer and cardiovascular disease patients;
 - to improve access to health care provided by a GP, strengthening primary health care as a basic health care provision, especially for groups of people at risk of social exclusion and poverty;
 - to ensure consistent and adequate care for chronic patients;
 - to ensure a sufficient number of medical practitioners of the required qualification in the regions.
4. To make amendments to the Law on the Compensation of Officials and Employees of State and Local Government Institutions and Cabinet of Ministers Regulation No. 595 dated 29th June 2010 on "Regulations on the Lowest Monthly Salary and Special Allowance for Medical Persons", providing a motivational remuneration system for medical personnel.
5. To amend Cabinet of Ministers Regulation No. 899, dated 31st October 2006 on the "Procedure for Compensation for the Acquisition of Medicines and Medical Devices for Ambulatory Treatment", expanding the range of medicines and reducing the sum of co-payments by patients for various diagnoses.

The Dream Turns Into Reality II: a more equal Latvia in 2025⁹

Latvia is a safe and inclusive society. It is an attractive country for foreigners with an open economy and education. After a decline in February 2018, public opinion polls show a rise in the level of people's trust in state and local government institutions. In the regions, the level of self-help is increasing, and the development of active communities is taking place.

Concern and care for children and families is a recognised societal core value, but this is not set up in opposition to other models of partnership and individual choices. Latvia is a place where having children is a matter of personal parental choice, because the social environment that has been created is such that this decision is a safe choice, without having to be concerned about the economic consequences or social security.

The Latvian nation and its people have accepted as a truism, that by investing purposefully, smartly and generously in education, the state has an opportunity to ensure high competitiveness and balanced, sustainable growth in the long term. The nation's people understand and are conscious of the fact that education is the basis of growth for the state and the economy and is irremediably related to other spheres of life, such as work, health and safety.

In addition to general academic and vocational education, students are provided with high-quality non-formal education aimed at reaching a sustainable lifestyle: the development of emotional intelligence, ecological thinking, and an understanding of the process and how matters are interrelated.

Business works in partnership with vocational education centres, providing their students with practice and competence development in real factories and laboratories. These centres also offer a change of qualification for middle aged or unemployed people, whose initial professional skills are no longer required on the market.

Employment is not only a means of obtaining a daily living and economic resources, but also a way of facilitating self-realisation for the people of Latvia, creating and maintaining social and civic associations. Short, concentrated and stimulating state support is available to those who have lost their jobs, motivating people to return to the labour market as soon as possible. State aid is aimed at people obtaining and developing new skills and competences, changing qualifications or increasing their skills.

⁹ We offer the reader a vision of changes in the life of the country after the implementation of the solutions we propose.

The state is committed to maintaining a business-friendly environment, attracting investment and effective measures to stimulate employment. The Latvian government is aware that one of the most convincing mechanisms to reduce social, regional and opportunity inequality is moving to an economy that provides a high overall level of employment and is quite complex: based on exports of high value-added goods and services. Therefore, the growth of smart technology and high value-added sectors is at the base of the development of an inclusive, sustainable and competitive economy. With the gradual growth of complexity within the economy, purposeful, continuous and timely retraining of employees is taking place, applying employees' competencies to sustainable economic solutions.

Latvia has achieved the EU 2020 target of employing 73% of the working age population aged 20-64. The basis of the Latvian economy is the efficient, thoughtful and focused use of resources, with the responsible implementation of the state's budget policy. The share of exports in the gross domestic product is being encouraged to grow. Telecommunications and IT solutions are our local resources, as are educated and creative people, biologically clean agriculture, logistics, marketing, design, and tourism. Latvia's export is concentrated on the markets of the European Union, China, India and Latin America. Businesses are encouraged to regularly re-evaluate the efficient use of their resources and their productivity, and Latvia is exporting processed products with an increasing added value. The manufacturing industry is a major backbone of the economy and its share of the overall economic structure will increase to 22% of the total economic contribution by 2025.

Alongside this, investment opportunities corresponding to the demands of future investors are being constantly improved, thus positioning all regions of Latvia as areas for attractive investment in the long term. New and existing businesses in innovative sectors also have access to support tools for the implementation of new projects, which are being provided by *Altum*, the national development financial institution for development programme's close cooperation with private sector partners. *Altum* also supports initiatives for regional and national social entrepreneurship. The government has approved planning for industrial territories, where productive manufacturing and services which are in demand are being focused. Public infrastructure necessary for businesses, in particular production, is being provided in these territories, including high quality plants for all kinds of treatment to reduce the risk of environmental pollution.

Latvia's fiscal policy is being implemented in strict compliance with the principle of progressivity and with the aim of developing manufacturing industry, attracting non-bank foreign investment and significantly enhancing the competitiveness of Latvian exports. As a result, the tax burden is being shifted from the workforce to consumption, financial transactions and real estate, taking the interests of vulnerable groups specially into account. The State Revenue Service (SRS) is effectively combatting the shadow economy, with its internal culture becoming customer-orientated and congenial: a mandatory annual income declaration has been introduced, which is generated by the EDS, and verified and supplemented by customers.

The financial settlement system is connected to the SRS system which guarantees transparency and makes tax evasion an impossibility. Tax evasion is not advantageous, and it is too risky because the SRS has both the information and the resources to fight tax evasion. The Latvian judicial system fully supports the activities of the SRS, and in some cases, people can be arrested for not paying taxes.

Health promotion and prevention measures focusing on a healthy, ecological lifestyle, and alleviating alcoholism, smoking and other harmful behaviours are a top priority for public health. People are well-informed and educated about the impact of various factors on health, the quality of life and life expectancy. As a result, people make balanced and responsible decisions about their health. E-health allows a family doctor to have access to interactive specialist consultations that provide both timely diagnosis and treatment of patients, not only in regional centres, but also in less populated areas. Health care services are available for people. In cases where complex diagnostics and treatment are required, this is done at a regional or national hospital that is equipped with the latest technology and with high-quality medical staff.