

Global Development Network / CERGE-EI Regional Research Competition

No. RRC12+27: Labour Supply and Inequality Effects of In-Work Benefits: Empirical Evidence from Serbia

Non-technical summary

This paper analyzes employment and distributional effect of in-work benefits in Serbia. In-work benefits (IWB) are means-tested transfers given to individuals conditional on their employment status. These policies are designed to create a significant gap between the incomes of people in and out of work, therefore encouraging the entry into the labour market, but also ensuring a higher living standard particularly for low-income individuals.

This kind of policies could be of interest for Serbia given the high informal employment rates and inactivity rates especially among low-educated individuals and those without work experience. Low-education attainment coupled with a lack of 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. Incentive problems are aggravated when there is a high tax burden on low labour income as well as a sudden withdrawal of social benefits once a person has any formal income on his/her record. In sum, those taking up low-paid employment often see that a large part of their gross earnings is consumed by income taxes, social contributions and/or reduced social benefits. That is why they need incentives to make work pay.

In order to evaluate employment and distributional effects of the in-work benefits in Serbia, the paper combines the tax and benefit micro-simulation model for Serbia (SRMOD) with the so-called structural model of individual and family labour supply. Two benefit schemes are simulated: the first one is means-tested on the household income while the second one is individual-oriented policy.

The findings indicate that the IWB assessed at the household level encourage the participation of single individuals, while benefit that is conditioned on individual earnings would have greater incentive effects for families since it does not discourage the participation of second-earners in a couple. Most of the labour supply changes take place among the poorest individuals.

From a policy perspective, a few concluding remarks arise from the analysis presented in this paper:

- In-work benefits show their potential in supporting labour participation of individuals at the bottom end of the income distribution in Serbia. Even if the increase in labour supply does not lead to substantial changes in the overall poverty rates, it is important to consider the social externalities of increased labour market participation.
- In a period of economic downturn, the in-work benefits can help protect the income of the families affected by the crisis, particularly when the breadwinner loses her/his job.

Keywords: In-work benefits, labour market, Serbia