**THE IMPACT OF THE TAX AND BENEFIT SYSTEM ON THE LABOUR SUPPLY IN LATVIA**

**NODOKĻU UN PABALSTU SISTĒMAS IETEKME UZ DARBASPĒKA PIEDĀVĀJUMA IZMAIŅĀM LATVIJĀ**

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When formulating the tax and benefit policy rules, it is crucial to understand the labour supply behaviour, in particular, the influence of changes in the tax and benefit system on the individual`s decision making to participate in the labour market. The aim of the research is to estimate the impact of the tax and benefit system on the changes in labour supply. The research presents the structural labour supply model that allows estimating the effect of gains to work on the participation probabilities in Latvia, thereby the effect of the recent tax and benefit reforms on the changes of labour supply in Latvia. Gains to work are defined as the difference between net wage and the amount of lost benefits due to taking up a job.

A classical Heckman model is used to impute the hypothetical wage for those actually not working on the basis of the observed employees' wage rates. The amount of benefits out of work are observed only for those who are not working, while the calculation of these measures for working individuals requires the detailed coding of the Latvian tax and benefit system provided by a tax and benefit microsimulation model EUROMOD. Using EUROMOD, individual and household tax liabilities and benefits entitlements are simulated under the existing policy rules in the state.

For the structural order probit equation the author uses the same set of independent variables as in the selection equation of Heckman sample selection model, and, in addition, individual gains to work.

The data used in the empirical analysis is the EU statistics on income and living conditions (EU-SILC), years 2011-2015.

The research results will allow policy makers to determine the tax-benefit reforms should be carried out in order to increase the participation level of the different groups of workers.

 **Key words:** *EUROMOD, microsimulation model, participation level, sample selection, tax and benefit policy rules*