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# Influence of the public finance on labor force migration in transitional economies


## Abstract

Human resources development is closely related to migration problems that are caused by the public finance management in the EU member states. Dynamics of Lithuania's National budget structure is also shortly discussed in this paper. Finally we make an example of personal tax burden versus an official statistical figure representing country's tax burden. Moreover, we discuss a personal income tax burden as a specific indicator for the migration changes in the less developed EU states.


**Keywords:** tax burden, migration, public finance, Lithuania.
**JEL Classification:** H61.

## 1. Tax burden and the labor force migration

There exists an expectation that increasing integration will contribute to a major convergence among the European economies. The main problem concerning this process is that the countries started with different economic conditions. It is difficult to design a common economic policy because they all have had different growth, inflation and unemployment rates. It was expected that the integration process in the EU would lead to a faster average growth. This means that less developed countries would grow more rapidly than the more developed nations, reducing the gap in terms of per capita income. Therefore, the convergence analysis has enjoyed great relevance in the literature and it has become important to show the elements that could affect such convergence.

On the other hand, it was necessary to introduce some rules or objectives to be achieved by the countries in order to reduce problems. Fiscal convergence is necessary to postpone market and political pressures. In addition, an inflation rate convergence may be needed as well. This is the main reason why the Maastricht convergence criteria on inflation rate, interest rate, public deficit and public debt ratios have been approved. From this perspective, it is necessary to add that the fiscal convergence also has a special relevance in the integration process, because the countries have traditionally designed counter cyclical policies to eliminate their economic problems. Fiscal variables played an important role in those policies. With the convergence criteria this was more difficult to do. The EU countries have been forced to reduce their public expenditure. However, reducing the welfare state is very difficult and time consuming. In this case it was necessary to reduce other public expenditures that could improve physical capital or human capital, which affect growth negatively. The alternative was to increase the tax burden.

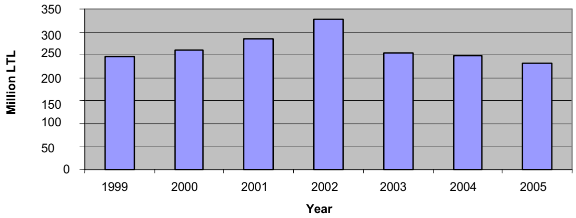
Structure of National and State Budgets reflects changes in the country's public finance policy and the tax burden variations. Revenues of Lithuania's National budget are composed of the income of State and Municipal budgets. According to sources of revenue, the National budget's revenue is divided into two parts: the tax income and the revenue from non-taxable sources. Due to change of Lithuania's economical and political standing as well as laws, amount and structure of national budget's revenue vary as well. Thus, the goal of this short paper is to overview variation and tendency of National budget's revenue in Lithuania and the European Union member states. There is an overview of Lithuania's National budget's revenue variations in several groups.

We try to analyze variations of Lithuania's National budget revenue segments and to characterize their transformation reasons. Moreover, our goal is to describe tendency of the mentioned revenue groups in the future. Summarizing we compare structure of Lithuania's National budget's revenue with such structure of National budgets of the European Union member States. The structure of budget's source of revenue reflects in some way an allocation of the tax burden.

Revenue of Lithuania's National budget is divided into four groups: the revenue from profit and income taxes, the revenue from turnover taxes, the income from property taxes and finally the non-tax revenue. Completed analysis showed that revenue from turnover taxes composed the main part of the national budget's income (i.e. 47-56 percent in different years). The revenue from profit and revenue's taxes is on the second place (18-33 percent in different years). Non-tax revenues composed 8-20 percent and the income from property taxes – 2-3 percent from the total National budget's revenue.

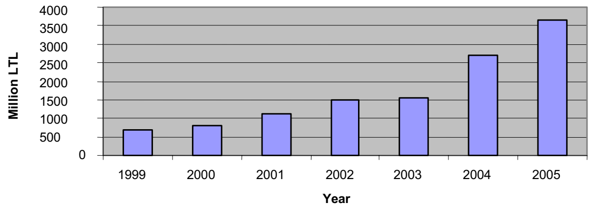
## 2. Dynamics of the National budget's revenue in Lithuania

There are transformations in National budget's revenue sources in Lithuania during the last six years. Quite noticeable is an increase in non-taxable revenues that could be related to the EU structural funds and other activities correlated to the integration of Lithuania's economy into the EU system. Nevertheless the tax burden from the income tax and indirect turnover taxes is increasing gradually.



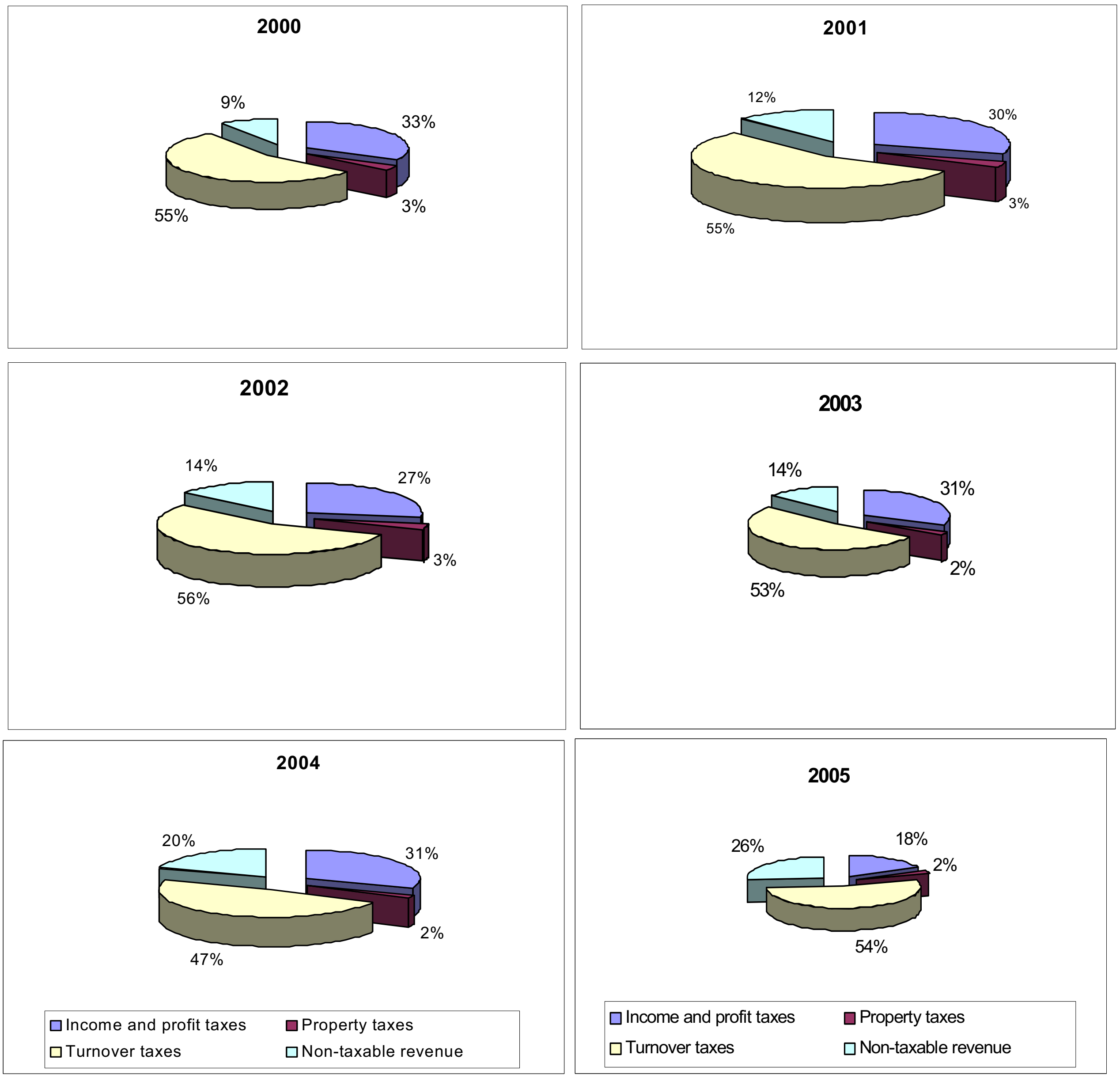

Source: Lithuania's Ministry of Finance, 2006.

**Fig. 1. Lithuania's National budget revenues from property tax in million litas, years 1999-2005**




Source: Lithuania's Ministry of Finance, 2006.

**Fig. 2. Lithuania National budget non-taxable revenues in million litas, 1999-2005**




Source: Lithuania's Ministry of Finance, 2006.

**Fig. 3. Structure of Lithuania's National budget revenues in 2000-2005**

## 3. The tax burden in the EU states

During the last decade tax burden in the EU countries had an obvious growing trend. Those tendencies are clear in different segments of tax revenues, i.e. the tax burden from direct and indirect taxes grew. Moreover, the tax burden of social insurance payments increased as well. Those trends are demonstrated in tables below.

Table 1. Transformations of the tax burden in the EU countries as the percentage from the GDP

| | 1995 | 2002 | 2003 |
|---|---|---|---|
| EU 25 | N/A | 41,3 | 41,5 |
| EU 15 | 42 | 41,6 | 41,8 |

Source: Eurostat, Statistics in Focus, Economy and Finance "Tax Revenue In EU Member States: Trend, Level and Structure 1995-2003".

Table 2. Structure of the tax burden in the EU countries percentage of direct taxes from total tax

| | 2000 | 2003 |
|---|---|---|
| EU 25 | 33,4 | 33,8 |

Source: Eurostat, Statistics in Focus, Economy and Finance "Tax Revenue In EU Member States: Trend, Level And Structure 1995-2003".

Table 3. Structure of the tax burden in the EU countries percentage of indirect taxes from total tax

| | 2000 | 2003 |
|---|---|---|
| EU 25 | 33,4 | 31,6 |

Source: Eurostat, Statistics in Focus, Economy and Finance "Tax Revenue in EU Member States: Trend, Level and Structure 1995-2003".

Table 4. Structure of the tax burden in the EU countries percentage of social insurance from total tax

| | 2000 | 2003 |
|---|---|---|
| EU 25 | 33,2 | 34,5 |

Table 5. Profit tax tariffs in EU member countries, 2004

| Country | Profit tax tariff, percent |
|---|---|
| Austria | 34 |
| Belgium | 34 |
| Denmark | 30 |
| Finland | 29 |
| France | 35 |
| Germany | 38 |
| Greece | 35 |
| Ireland | 12,5 |
| Italy | 33 |
| Luxemburg | 30 |
| Netherlands | 34,5 |
| Portugal | 27,5 |
| Spain | 35 |
| Sweden | 28 |
| UK | 30 |
| Cyprus | 15 |
| Czech Republic | 28 |
| Estonia | 26 |
| Hungary | 16 |
| Latvia | 15 |
| Lithuania | 15 |
| Malta | 35 |
| Poland | 19 |
| Slovakia | 19 |
| Slovenia | 25 |

Source: Eurostat, Statistics in Focus, Economy and Finance "Tax Revenue in EU Member States: Trend, Level and Structure 1995-2003".

## 4. Personal tax burden vs. formal figures

Finalizing this short overview of official tax burden figures and distribution of tax system around 25 EU member countries we try to show an inofficial structure of tax distribution for an ordinary working person in Lithuania. A sample of a personal tax burden living just from the income can be shortly described as follows:

- direct taxes: the income tax flat rate of 27 percent (until July 1, 2006, it was 33 percent); there is a non-taxable wage minimum of 290 litas and a social insurance tax with flat rate of 34 percent (where 31 percent is paid by employer and 3 percent is paid by employee), plus property taxes;
- indirect taxes: VAT 18 percent (flat tax rate), excise duties that consist of approximately half of the total price for excise taxable commodities and plus custom duties.

Therefore, the tax burden for Lithuania's citizen living just from the wage income is quite different from the official figures. In our model we make an essential assumption that the all income would be spent in domestic markets.

Consequently the 1,000 litas monthly income before taxes means 787 litas after direct taxes and approximately 400 litas after the deduction of indirect taxes. Moreover, for the employer labor cost equals 1,310 litas because of the additional 31 percent social insurance payments. Summarizing we can make a conclusion that tax burden is roughly 70 percent from funds allocated to the employee by an employer.

As it was mentioned above an official figure for the tax burden in Lithuania is more or less 34 percent (that is a percentage of the Consolidated National budget from the GDP). According to that number the tax burden is one of the lowest in the EU; in our approach the real tax burden for an average employees approaches 70 percent. Therefore such twofold difference from the official figures can be an explanation for Lithuania's labor force to emigrate. Nevertheless corruption and post soviet structures of public sector management create even bigger pressure for workers and scientists to emigrate. Moreover, last statistical data reveal that more than ten percent of Lithuania's labor force emigrated from the country during the time period of 2000-2006.

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