

# INCOME AS A FACTOR OF CONSUMER BEHAVIOUR OF LATVIAN INHABITANTS IN ECONOMICS AND TOURISM

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## **Introduction**

Constructive state policy in the field of consumption plays an important role in sustainable social and economical development of a country. On the level of macroeconomics the state regulates the consumption process by means of fiscal policy, building the socially oriented budget of the country, creating a fair taxation system for the population that stimulates domestic demand and economic activity.

Therefore, the primary task of the modern macroeconomic theory in Latvia is development and sustaining of the socially important state regulation means and methods of consumption and consumer behaviour of the population with consideration of basic factors.

The aim of this article is to detect the peculiarities of the consumer behaviour of the population in Latvia on the ground that the level and dynamics of their income are important factors of such behaviour. In this connection the major tasks of the work are: analysis of income level to the type of the consumer behaviour and social group of the consumers; analysis of the influence of Latvian taxation system on the possibilities of increasing the domestic demand of different population groups; defining the measures intended for increase and growth of domestic demand.

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## **Methods of the research**

The monitoring of consumer confidence and consumer behaviour apart from the *Eurobarometer* is also carried out by *Latvian barometer*. In these investigations the representativeness and periodicity of the sample is observed [8].

An examination of the situation in Latvia is taken. The factor analysis in the period of the lowest consumer confidence was carried out based on the data of *Latvian barometer*. The aim of it was to reveal the types of consumer behaviour of Latvian population depending on income, social group, education and age.

## **Consumer behaviour and its types**

In the current research the term *consumer behaviour* is understood as the aggregate of factors characterizing actions of consumers and their preferences [1, p.80]. Consumer behaviour was analyzed based on three major types of consumer behaviour: active, traditional and tolerant. The active type of consumer behaviour is typical for present day consumer society. It is expressed by the widely spread practice of the “credit consumption” based on the broad and easily accessible system of credits and loans. The traditional type is attributable to societies with traditional value systems. In this type of consumption the expenditure is equal to income and based on the settled norms of the consumer behaviour, that is passively-adaptive demand. The tolerant (or formative) type is typical for peripheral or transitory consumer groups. In this group various types of actively-adaptive demand are predominant.

### **Correlation of income and income level to the type of consumer behaviour**

Income is the definitive factor of consumer behaviour in Latvia. Income is means in monetary and natural value, which a person receives from other people or organizations for covering personal expenditures. These means incorporate wages and other types of income from activity (after the tax payment); including transfers, net income from the business or agricultural activity, property (rent), dividends and other [2, p.275]. This factor of consumer behaviour of the households in economics of Latvia has been examined in details. The factor analysis was based on the data received from the representative survey carried out by the *DnB NORD bank* for December 2009 with the use of programme SPSS 17. The types of consumer behaviour according to the level of income are represented in Table 1. Consumers with monthly income above 200 Ls per person of household are generally classified with the active type of consumer behaviour. They belong to the social group *middle class* (government personnel and specialists, businessmen, managers of enterprises, qualified workers). The social group is understood as the behavioural model (the set of expectations and actions), that is inherent to the particular part of consumers.

Consumers with income below 79 Ls per person are classified with the traditional type of the consumer behaviour. They belong to the social group of *lower class* (low qualification and wage workers, unemployed, pensioners, housewives). The group of consumers with the income between 115 – 149 Ls are classified as the tolerant type of consumer behaviour. They belong to the social group *middle class periphery* (self-employed workers of the production and service sphere, farmers, students, semiskilled wage workers).

According to the results of the factor analysis, it can be understood that the majority of active consumers are in the state sector of Latvia. In the private sector most consumers belong to the tolerant type.

Table 1

**Types of consumer behaviour of population of Latvia according to their income, %**

Average monthly income for each member of the family, Ls	Types of consumer behaviour			Total:
	Active	Tolerant	Traditional	
To 79	18,3	21,4	<b>60,3</b>	100,0
80 – 114	34,0	33,3	32,7	100,0
115 – 149	19,8	<b>52,1</b>	28,1	100,0
150 – 199	33,6	39,5	27,0	100,0
200 and above	<b>57,3</b>	26,2	16,5	100,0
No Answer	32,1	31,7	36,2	100,0
Total:	33,4	33,3	33,2	100,0

Source: author's calculations on the results of the factor analysis of *DnB NORD bank* survey, N = 1004.

Among the directors there are 94% of active consumers. 91% of the specialists and officials represent the active type of consumer behaviour. The workers are divided between active and tolerant types of consumer behaviour, respectively 40% and 60%.

The majority of the self-employed and farmers are tolerant consumers. Among the pensioners there are 62% of tolerant type and 38% of traditional type consumers. Most of the unemployed represent the traditional type of consumer behaviour. There are no active consumers among the unemployed. Generally, housewives and the unemployed live on transfers and belong to the traditional type of consumers.

Among the people with basic education there are 50% traditional type consumers. Among the consumers with secondary education there are about 43% of traditional type consumers. In the group of consumers with specialized secondary education there are more representatives of the tolerant consumer type, but active and traditional types make up 30% combined. Consumers with incomplete higher education (students) almost do not differ from consumers with secondary education in their consumer behaviour. The majority of active consumers are the consumers with higher education – 63%.

The most active consumers (51%) belong to 35 – 44 years old age group. The majority of tolerant consumers are in the preretirement age group 55 – 74 year olds, but of the traditional type (55%) in the age group of 18 – 24 year olds.

Consumer confidence is the second most important factor of consumer behaviour in Latvia. The higher the income, the higher consumer confidence of the population, and other vice versa.

Generally the income of the population of Latvian regions had the tendency to grow due to various reasons in the time period of between 2004 and 2008 (inflation, economic revival after country had joined EU). See Table 2. In the period of income growth (20 – 40% annually) between the years of 2004 and 2008, households spent more than they earned. Consumers acquired debt and did not save. It was provoked by the high inflation rate and profitable investing into real estate. Many households are used to spend their entire income and for this reason their consumption entirely depends on their income [7, p.55].

Riga became the leading region with the highest income per person of household in 2008 (Riga and Pieriga average amount of – 305 Ls) [5]. In the Zemgale region, the average income per person was 29% lower than in the Riga region (217 Ls). In the Kurzeme region, the average was 25% lower (229 Ls), 37% lower (191 Ls) in the Vidzeme region than in the Riga region. In Latgale the average income per person of household 43% lower (175 Ls) than in the Riga region.

Table 2

**Dynamics of income per person per month in regions of Latvia in 2004 – 2008, Ls**

<b>Region</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Riga	135	175	201	285	309
Pieriga	102	110	162	268	301
Vidzeme	77	92	122	176	191
Kurzeme	83	106	140	170	229
Zemgale	82	99	134	196	217
Latgale	73	80	99	152	175

Source: calculations by author based on data [5].

In other regions of Latvia the index is also lower than in the Riga region. The same state of affairs remains.

The Ministry of Economics of the Republic of Latvia in 2009 carried out an analysis of subjective self-assessment by the households of their material situation.

Table 3 shows that the most of the households assess their level of material situation as the medium. It can be noted, that the style of consumer behaviour and awareness of such households, as habituation to poverty, which is conformist. Such consumer behaviour can be partially attributed to the tolerant type and partially to the traditional. Predominance of such style and mentioned types of consumer behaviour of the households in Latvian regions can become a definite subjective obstacle for overcoming the recession in economics of Latvia during the time period 2011 – 2013.

Meanwhile the consumer behaviour is always conditioned by different economical and non-economical factors.

Table 3

**Self-assessment of economic situation by the households in 2009 by regions, %**

<b>Self-assessment</b>	<b>Riga</b>	<b>Pieriga</b>	<b>Vidzeme</b>	<b>Kurzeme</b>	<b>Zemgale</b>	<b>Latgale</b>
We are not rich, but we manage to live well	11,1	6,5	7,0	11,3	8,6	5,5
We are neither rich, nor poor	58,6	60,0	58,3	60,4	61,2	53,5
We are not poor, but on the verge of poverty	25,6	28,7	31,4	23,7	22,0	33,1
We are poor	4,8	4,8	3,3	4,6	8,1	7,9

**Source:** calculations based on data [9].

**The influence of Latvian taxation system to the possibilities of intensification of domestic demand**

The variables, which influence the income of consumers (basket of goods, minimal wages, exemption limit, personal income tax) have been analyzed.

Every country has its own understanding of minimal and maximal consumption for the households depending on the level of social and economical development of the society.

Therefore the state itself forms norms of consumption that are based on the basket of goods, minimal allowance level, minimal wages, etc. The value of the basket of goods and services of minimal allowance level since April 1991, when this statistical index was factored in, has increased significantly. The approximate exchange rate of the national currency of Latvia is 1 Euro = 0,7 Ls.

The term of minimal wages is directly connected to the minimal consumption budget and budget of minimum subsistence level. In Latvia in 2010 it is defined in the amount of 180 Ls per month. Considering the growth of the personal income tax from 23% to 26% the amount after repayment of tax is 130,31 Ls per month. Taking into consideration that more than 50% of hired workers in Latvia officially make the minimal wages, it means that more than a half of workers of the country are implementing the survival model, but not meeting the definition of wellbeing.

Latvia has become one of a few EU countries that had a growth of personal income tax during the period from 2002 to 2010. In other countries, including Estonia and Lithuania the present rate of this tax is smaller than it was 10 years ago. During the last 10 years the personal income tax in Latvia has been increased and now it is 26%. In Estonia the rate of the similar tax decreased for

5% and now it is 21%. In Lithuania the personal income tax is 21%. The arguments of Latvian officials are the following: existing taxes are justified by the economical situation in the country and they are not too high in the context of the diagram of calculation of tax take, executed in the middle of 2010 by Eurostat [6]. At the present moment in Latvia, 11 types of taxes are in force, but including various state duties their amount comes to 30.

Thereby the comparative analysis of the tax rates in Latvia and other EU countries shows that the Latvian tax rates are in the acceptable range [6].

Table 4

**The part of various taxes in tax payment of each quintile (population group by the income level) in 2010, %**

<b>Quintile</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Social tax	18,25	20,32	20,84	21,58	21,96
Income tax	0	3,01	33,43	41,95	44,65
Property tax	2,43	1,27	0,99	2,36	5,12
Indirect taxes	79,32	75,40	44,74	34,11	28,27

Source: calculations based on data [10].

However because of the unjust taxation system in the part of consumption taxation, the tax burden is much heavier to the low-income population groups, than to the groups with medium and high income levels, which results from the information in table 4.

A person with a minimal net wage receives only 130,31 Ls. This sum is almost for 40 Ls less than officially calculated minimal allowance level (for the end of 2010 it was 169 Ls per month). It means that for the minimal wages the taxes set are too high, as they do not provide the minimal basket of goods and services for the worker. The tax rates have to be either reduced or the level of exemption limit (tax credit) has to be increased.

These measures are able to increase the purchasing capacity of the population, to reduce the amount of wages in envelopes.

**Measures (tools) needed for the intensification and growth of the domestic demand of the population.** Increasing the real earnings of the poor consumers (which includes more than a half of the population of the country) will give the opportunity to activate the domestic demand and it is the factor for the exit of Latvian economics from the recession.

Within the current legislation of Latvia there are three instruments for this: direct reduction of the tax rates, increase of the exemption limit (tax credit), and introduction of the progressive income taxation scale.

Implementation of these instruments as the effective measures will help the population groups with low and medium income levels to activate their consumer demand, and the highly qualified specialists-professionals will be able to reach decent income levels. The use of these three elements can give the positive result: to increase the budget and to increase the real earnings of the low income group of the households.

For example, the decrease in purchasing power of the population reduced the possibilities of export tourist services. More and more firms in Latvia are oriented to the consumers from higher social group and higher income. Citizens of Latvia who work abroad prefer to use the services of the tour operators in the countries they live in.

Along with that the change of traditional values, attitude towards the recreation, young people`s growing mobility, interest in the life styles of other peoples of EU countries, and growth of unemployment has led to the new forms of tourism: work outside of Latvia and Medical Tourism.

On the grounds of present research several **conclusions** can be drawn.

Consumers with respectively high income are characterized by an active type of consumer behaviour, and the consumers with low income are characterized by tolerant or traditional types of consumer behaviour.

In the time period from 2000 to 2008 total income of the households in Latvia had increased from 107 Ls to 252 Ls per person. About 75% out of this amount accounts for salary and about 20% for transfers. The reduction of income and salary happened because of the economic crisis in 2009. The decline of real earnings of the majority of Latvian population has resulted in decreasing the customer demand for many goods and services, for example, on the decrease of the opportunity of territorial mobility of Latvian population within and outside the country for tourism. The real consumer behaviour in Latvia (in short-term period) is caused by a decrease in consumer confidence and attitudes. In the opinion of the author, the reason for the above-mentioned situation is the decrease of income among Latvian households for the last 12 months, as the reflection of the growth of unemployment and structural crisis in the country.

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