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End of previous Forum article

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Basic Income in the Finnish Context

The basic income experiment is one of the key projects in the governmental programme of Prime Minister Juha Sipilä's centre-right government. The experiment is being carried out in 2017-2018 and will be followed by an assessment of its results in 2019. The government considers basic income to be a possible policy measure to reform the Finnish social security system in order to better adjust to changes in working life, to make social security more participatory, to diminish disincentives to working, to reduce bureaucracy and to simplify the overly complex tax-benefit system.

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In the autumn of 2015, the Prime Minister's office called for tenders to design the basic income experiment. After an evaluation of the scientific quality and competence of

the participating research groups, the planning of the experiment was entrusted to a consortium led by the Research Department of the Finnish Social Insurance Institution (Kela). The planning group was assigned the following tasks:

- Produce a detailed description of the basic income models suitable for the experiment and determine the appropriate level of basic income for these models (euros per month);
- Propose methods to integrate earnings-related benefits and different types of basic social security benefits into the basic income;
- Determine the taxation for the different models;
- Evaluate the strengths and weaknesses of the different basic income models; and
- Consider Finnish constitutional aspects and EU law.

The government proposed four different general basic income models as a basis for the assignment:

- A full basic income model, wherein most current social benefits would be abolished;
- A partial basic income model, which would leave certain basic social security benefits and earnings-related benefits intact;
- A negative income tax model; and
- Other possible basic income models.

The four options were extensively discussed in the first report our research group delivered to the government on 30 March 2016.[1] On the basis of that report, the government decided that the experiment should focus on partial basic income models. In accordance with this decision, we will limit our analysis to this class of basic income models. In this paper, we use a static microsimulation model to analyse the impact of a partial basic income on income taxes, benefit expenditure, income inequality and work incentives. The structure of the basic income model in the actual pilot experiment (2017-2018) and the experimental setting are also briefly described in Box 1. The legal constraints on the implementation of a basic income – which were extensively discussed in the preliminary report of the working group – are analysed elsewhere.[2]

Box 1
The Finnish basic income experiment (2017-2018) in a nutshell[1]

Goal: To obtain information on the effects of a basic income on employment.

Level of basic income: €560/month, a tax-free benefit. The benefit is deducted from current basic social benefits, which means that there are no changes in the income levels of the unemployed.

There are no changes in the tax system, and the basic income is not affected by work income. Thus, the model significantly increases the disposable income of the employed. However, it would be an expensive model if implemented for the whole population.

Target group: Persons between 25 and 58 years of age living in Finland who received a basic daily allowance or labour market support in November 2016.

Research design: The treatment group is a simple random sample of 2,000 individuals. Participation in the experiment is mandatory. The rest of the target group forms the control group (around 175,000 individuals). Research data are collected mainly from official registers (e.g. tax and benefit registries).

1 https://www.youtube.com/watch?v=8xPAlEkT0kk.

Modelling basic income

The effects of the different basic income models presented in the subsequent sections are analysed using a microsimulation model.[3] In this paper, we will briefly de-

1 See O. Kangas, V.-V. Pulkka: Ideasta kokeiluun? Esiselvitys perustulokokeilun toteuttamisvaihtoehdoista, 2016, available at http://tietokayttoon.fi/documents/10616/2009122/13-2016_Ideasta+kokeiluun.pdf/c758c343-2687-4dea-869e-5dbdb14e888f?version=1.0. For an abridged English-language version, see O. Kangas: From idea to experiment. Report on universal basic income experiment in Finland, Working papers 106, Kela 2016, available at https://helda.helsinki.fi/bitstream/handle/10138/167728/WorkingPapers106.pdf.

2 L. Kalliomaa-Puha, A.-K. Tuovinen, O. Kangas: The Basic Income Experiment in Finland, in: Journal of Social Security Law, Vol. 23, No. 2, 2016, pp. 75-88.

3 The SISU microsimulation model is developed and maintained by Statistics Finland. Here, taxes and benefits are simulated both for hypothetical and observed households (service data of income distribution for the year 2013, based on a sample of around 23,000 persons). For more information, see https://www.stat.fi/tup/mikrosimulointi/index_en.html.

scribe the effects of a basic income on the governmental budget, income distribution and work incentives (participation tax rates). The models are based on the following choices:

- Basic income is paid to all individuals aged 18 and above, but not to pensioners (who will continue to receive old-age pensions and disability pensions);
- Basic income is deducted from taxable insurance-based social benefits (e.g. earnings-related unemployment allowances, basic unemployment allowances, labour market subsidies, sickness allowances, parental allowances, child home care allowances and student benefits);
- The tax system is replaced with a simple flat tax model: earned income and capital income are taxed at the same rate with no tax-exempt dividends; basic income is taxable earned income, but a tax deduction corresponding to basic income will be applied to earned income; and
- Basic income diminishes a person's housing allowance and social assistance.

Our simulations are of a static nature, which means that any behavioural effects of basic income are not modelled. All models are budget-neutral. This is achieved by adjusting the tax rate to a level at which the total consumable income of the population is the same as in the current system. Budget effects are analysed for monthly basic income levels of €450, €550, €650 and €750, but participation tax rates – which describe the proportion of additional market income that is lost because of paid taxes or decreases in benefits – are computed only for the €550 and €750 levels.

Budget effects

In the partial basic income model, the level of benefits is rather low, and the aim is not to replace the other transfers entirely. However, in the ideal case, basic transfer schemes such as basic unemployment allowance, minimum sickness and rehabilitation benefits, and social assistance would be replaced by a partial basic income. In the models used in this paper, the degree of replacement depends on the level of the basic income. For monthly basic income levels from €450 to €750, a large proportion of the social benefits, such as earnings-related benefits and housing allowances, would not be replaced by the basic income, and as such they would continue to provide individuals with additional income security.

Table 1

Impact of different basic income levels on other social expenditure items

in millions of euros

	Current legislation	BI €450	BI €550	BI €650	BI €750
Unemployment expenditure	3,928	1,740	1,546	1,357	1,184
Health insurance	1,402	989	898	815	741
General housing allowance	603	547	513	482	407
Social assistance	586	373	238	147	92
Basic income		15,757	19,259	22,760	26,262
Additional financing requirement		12,018	15,066	18,169	21,294
Flat tax		37,459	40,123	43,243	46,870
Other taxes	32,638	5,981	5,981	5,981	5,981

Source: Author's elaboration based on SISU microsimulation model.

Table 1 shows that, for example, in a basic income model of €550 per month, the unemployment allowances paid by the state would decrease from €3.9 billion to €1.5 billion annually, and the allowances paid under Finland's Sickness Insurance Act would decrease from €1.4 billion to €0.9 billion. Furthermore, annual social assistance expenditure would decrease from about €590 million to about €240 million. With a monthly basic income of €750, social assistance expenditure would decrease much further, to about €90 million. Total sums of disability benefits, child benefits, child maintenance allowances, students' housing supplements and pensions paid by Kela would remain unchanged, as the models do not call for any changes to these programmes. The total sum of child home care allowances would decrease from €420 million to €70 million, and practically the only study grants left would be those paid to recipients under the age of 18.

Table 2 shows budget-neutral flat tax rates for partial basic income levels. In the models, the reported tax rates are applied to all earned and capital income. For basic income levels from €450 to €750, the tax rate ranges from 40% to 50.5%. Excluding the population aged 18 to 24 from the basic income would reduce the cost-neutral tax rate by about one or two percentage points (based on monthly basic incomes of €550 and €750, respectively).

Distributional effects

It is also interesting to know how basic income would affect income distribution and who the winners and the losers in these models would be. The effects of lower basic income models are quite modest, because a low basic

Table 2
Simulated basic income expenditure and budget-neutral flat tax for different levels of monthly basic income and as applied to different target populations

	Adults (excl. pensioners)		Individuals aged 24 and over (excl. pensioners)	
Basic income (euros/month)	Basic income expenditure (million euros/year)	Tax rate (%)	Basic income expenditure (million euros/year)	Tax rate (%)
450	15,757	40.0	13,317	39.0
550	19,259	43.0	16,276	42.0
650	22,760	46.5	19,236	45.0
750	26,262	50.5	22,195	48.5

Source: Author's elaboration based on SISU microsimulation model.

income does not increase the level of social security and because the current Finnish social security system already covers a large proportion of the population with low or no market income. At the monthly basic income levels of €550 and €750, the Gini coefficient would decrease from the current value of 0.264 to 0.261 and 0.242, respectively. A basic income of €750 would reduce child poverty (from 13.2% to 11.7%), whereas a basic income of €550 would cause a slight increase in child poverty (from 13.2% to 14.0%).

A basic income of €550 would improve the disposable income of students, housewives and low-income wage earners, whereas, somewhat surprisingly, individuals with unemployment benefits would be the largest group of losers. For them, the basic income would only partially replace their existing benefits, and the taxes on their remaining unemployment security benefits (such as various supplements and earnings-related components) and on their market income would be higher than under the current system.

Work incentives

One of the main goals of the Finnish experiment is to ascertain whether basic income is an efficient tool to combat various work disincentives built into the present system. One way to analyse the effects of basic income models on monetary work incentives is to compare participation tax rates in the current system and in different basic income models for different types of households.

Table 3 describes the participation tax rates for one-adult households in two different scenarios. In the first scenario, the individual does not receive any insurance-based benefits (i.e. they are eligible only for a housing allowance and social assistance). In the second scenario, the individual receives basic unemployment benefits that are adjusted for part-time work.

Table 3
Impact of basic income on participation tax rates
in %

Change in wages, in euros	Current legislation	Basic income €550 a month	Basic income €750 a month
	Progressive tax	Flat tax	Flat tax
No social insurance benefits			
0 → 500	80.0	50.2	63.9
0 → 1,000	65.1	63.6	74.0
0 → 2,000	65.2	60.8	66.2
1,000 → 2,000	65.3	58.0	58.3
Adjusted basic unemployment allowance			
0 → 500	36.9	50.2	63.9
0 → 1,000	51.7	63.6	74.0
0 → 2,000	66.3	60.8	66.2
1,000 → 2,000	80.9	58.0	58.3

Note: The estimates are for a wage earner living alone, and they include a simulated housing allowance and social assistance.

Source: Author's elaboration based on SISU microsimulation model.

We see that under the current legislation (i.e. no insurance-based benefits), the participation tax rate for part-time work earnings of €500 is just over 80%. If someone's monthly earned income increases from €0 to €1,000, from €0 to €2,000 or from €1,000 to €2,000, the participation tax rate is about 65%. At the basic income level of €550, however, the participation tax rate is lower than under the current model in all four of these cases. A basic income of €750 produces a participation tax rate that is higher than under the current model for someone whose earnings increase from zero to €1,000 or €2,000. This is the result of a significantly higher tax rate for market income in the basic income model than in the current system for this particular income bracket.

In the example above, the individual is not getting any insurance-based unemployment benefits. Thus, her case is rather "simple". The situation changes when we increase the degree of complexity and examine individuals with a basic unemployment allowance (or labour market subsidy). Under both basic income models discussed above, participation tax rates are higher for part-time work than they are under the current system. When monthly income increases from €0 to €500, the participation tax rate is lower (36.9%) in the current model than in these basic income models (50.2% and 63.9%). However, when an individual moves from unemployment or part-time work (with an income of €1,000) to full-time employment (with an income of €2,000), the participation tax rates of the basic income models are lower than they are in the current

Table 4
Impact of basic income on participation tax rates of single parents
in %

Change in wages, in euros	Current legislation	Basic income €550 a month	Basic income €750 a month
0 → 500	29.3	54.4	60.4
0 → 1,000	42.0	64.7	72.8
0 → 2,000	70.3	81.2	87.8
0 → 3,000	78.4	82.7	87.3
1,000 → 2,000	98.7	97.8	102.9
2,000 → 3,000	94.6	85.6	86.4

Note: The estimates here are for single parents who shift from unemployment to employment, taking into account the adjusted basic allowance, eligibility for housing allowance and social assistance, and day care fees.

Source: Author's elaboration based on SISU microsimulation model.

model (66.3% versus 60.8% and 66.2%, and 80.9% versus 58.0% and 58.3%).

In the Finnish tax-benefit system, single parents usually face the highest participation tax rates and thus the most severe incentive problems. This is because they are eligible for a number of income and means-tested benefits paid on top of each other, and the levels of the benefits vary according to the number of children. Unemployment allowances include child supplements. Housing allowances and housing costs increase as the number of children increases. Social assistance is also adjusted based on the number of children, and single parents are eligible for higher basic levels of social assistance. As a result, paid work is less attractive for single parents than for people who live alone but are otherwise in a similar position. If the children are at a day care age, the problem is further compounded due to earnings-related day care fees.

Table 4 examines participation tax rates for an unemployed single parent ("a difficult case") who is eligible for an earnings-related unemployment allowance. A change from unemployment to part-time or full-time employment is less attractive in the basic income model than in the current tax-benefit model. The reason for lower participation tax rates when changing from part-time work to full-time work and from a lower full-time wage to a higher wage is that basic income models decrease the consumable income of single parents who work part-time.

Conclusions

The Finnish basic income debate has largely been focused on partial basic income models. Basic income is often considered to be an improvement for individuals working in temporary jobs and those with part-time contracts. In partial models, basic income is thought to replace the current insurance-based benefits.

While a partial basic income could offer a solution for bureaucratic traps, gaps and delays in the payment processes of current benefits and perhaps increase the administrative cost-effectiveness of the current system, it would not necessarily increase the monetary incentives for part-time work. The level of basic income, the level and form of taxation, and the manner in which current social benefits are reformed all have a substantial impact on the resulting participation tax rates.

Moreover, if the goal is to decrease poverty or increase the level or coverage of social security, low basic income levels would mean only a slight (if any) improvement. A great deal of bureaucracy would also remain, due to the additional social benefits that would still be required.

If understood as a tool for employment policy, there might be other disadvantages with a basic income. For example, replacing child home care allowances (a cash-for-care system) with basic income raises the question of how it would affect women's employment. The current child home care allowance scheme is already considered to have a negative effect on women's labour market position. If the basic income level was higher than the current home care allowance, the choice to stay home would become economically even more attractive.

An advantage of a basic income model is that it would provide a regular minimum income for people with uncertain or irregular market income flows. If there is a rising number of people to whom this applies, then their livelihood problems will be given more prominence and attention in the social policy discourse. Basic income would also offer possibilities to simplify the current benefit system by merging various basic security benefits paid by the Social Insurance Institution of Finland. Thus, it would make life easier for those low-income people whose income package is composed of different income-tested basic security benefits. First, they would have fewer bureaucracies to deal with, and second, they would no longer need to be afraid of losing their benefits if they accepted job offers. The goal of the Finnish experiment that started this year is to try to get some evidence on how a new social policy instrument mimicking a basic income would work and what kind of behavioural consequences it would have. At this point, there are many strong arguments being made both in favour of and opposed to basic income. Unfortunately, there are not enough facts yet. The Finnish experiment hopes to change that.