

# Basic Social Security 2030

Paths for reforming  
Finnish basic social  
security in the 2020s

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## Paths for reforming Finnish basic social security in the 2020s

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## Foreword for international readers

This report is an edited version of the Finnish Green Think Tank Visio's report 'Perusturva 2030' (published June 2019) for international readers. The report looks at the problems of the Finnish social security system and – given the context – at times goes into specifics of the current Finnish system. For the same reason, most of the sources are from Finnish research institutes and in Finnish. However, the principles for a better basic social security system are applicable to any so-called developed country, and the concrete stepping stones and microsimulations work as examples on how to find solutions regardless of the current system in a given country. Ultimately, the social security systems of many countries are comprised of similar elements in unique ways and the roadmap from the status quo towards the ideal (even if shared) must be tailored for each country.

The first four chapters examine various aspects and problems of the Finnish social security system together with income taxation, both on a general level and through the complex idiosyncrasies of the Finnish system. Based on these observations, chapter five presents Visio's model for a complete basic social security system, including basic income as a central element. As a first step in transitioning from the status quo towards Visio's model, a combination of a small basic income and streamlined income taxation is introduced, coupled with microsimulation data to evaluate the effects of the reform on public spending and individuals.

From a European Union perspective, the report gives some ideas having to do with the subsidiarity principle. The basic income model proposed in the report is comprised of a national-level element, as well as a local-level element, that takes into account the cost of living in a given local area (municipal or larger regional level). Even though the report is focused on developing the social

security system within one country (Finland), the same principle of subsidiarity can be extended to the European level. This could mean, for example, three levels of basic income divided between the EU, the state and the local level. The amount of basic income given out by each administrative level is determined by the lowest common denominator, i.e. the minimum sum that an individual living anywhere within the region in question would need.

This translation has been realised by the Green European Foundation as part of its transnational project on Basic Income with the support of Visio, with the aim of spreading ideas and research among policy makers across Europe.

Glossary for international readers:

Kela = Short for *Kansaneläkelaitos*, the Social Insurance Institution of Finland. This government institution grants the benefits included in basic social security.

Activation model = A policy initiated in 2018, stipulating that a person's unemployment benefit may be decreased unless they fulfil their activity requirement over a specified period of time.

## Background

The purpose of this report is to survey and compile challenges faced by the Finnish social security system as well as the principles for solving the said challenges and to offer proposals for action for the parliamentary term 2019–2023 and further into the 2020s. The report examines the basic social security of the working-age population and aims to create a balanced, critical perspective for social discourse during a time when political parties often try to stand out from their political rivals or appeal to their reference group by voicing exaggerated opinions on the reform of social security.

Apart from a few observations, the development of the pension system and earnings-related security has been excluded from the report for the benefit of focusing on the development of basic social security for the working-age population. However, the purposefulness and sustainability of the aforementioned systems should also be reviewed in the long term and, moreover, better integrated with basic social security. Actions particularly related to children and families with children are also excluded from the report. Nevertheless, the benefits and services of low-income families are in need of development in order to battle child poverty and restrain the hereditary nature of disadvantage.

Think Tank Visio has produced several publications, articles and estimates on the development of social security and basic income; the 2007 publication *Perustulon aika*<sup>1</sup> was used that same year by the Finnish political party Greens as a basis for their basic income model. In 2014, Think Tank Visio and the Greens cooperated to update the calculations and the model. This report will not dig as deep into the principles of social security or the justifications for basic income; instead, it proposes practical short and medium-term steps towards reaching the objectives.

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<sup>1</sup> Green Think Tank Visio: <https://www.ajatuspajavisio.fi/julkaisut/perustulon-aika/> (in Finnish)

# I. Status quo and objectives

## Prevailing principles of basic social security

Basic social security guarantees a minimum subsistence and basic necessities of human life for a person covered by social security when facing unemployment, for example. It can consist of monetary social security benefits, tending to basic needs through various services, and other support services. The principle behind the market-friendly mixed economy of Finland is that the public sector guarantees the basic necessities but the market provides an efficient way of producing the said necessities. That is why basic social security primarily means ensuring subsistence, whereupon the individual personally obtains their food, housing and other necessities. The question of whether it is more efficient to distribute money or the actual commodity is apt when the market producing the commodity is dysfunctional. Housing is one such challenging question, as growth centres often suffer from a shortage of reasonably priced apartments.

In the prevailing Finnish system, the following benefits can be considered to be part of the basic social security of the working-age population: labour market subsidy, basic unemployment allowance, basic amount of sickness allowance, basic amount of parenthood allowance, rehabilitation allowance, general housing allowance and financial aid for students. In addition, last-resort income support (also known as social assistance) can be considered to be part of basic social security, even

though it is not applied for until basic social security and earnings-related security are found to be insufficient. The amount of basic social security benefits is equal for all recipients and excludes earnings-related benefits. Any changes in basic social security affect all the adult non-pensioners covered by social security in Finland, in other words a total of 3 million people.

Basic social security in Finland consists of various overlapping or alternative elements. The overall basic social security varies according to the individual's labour market status and situation in life. When talking about the level or sufficiency of basic social security, people often refer to benefits based on labour market status (labour market subsidy, basic unemployment allowance, basic amount of sickness allowance and basic amount of parenthood allowance) that are currently equal in amount. However, it would be more meaningful to discuss the overall basic social security that, depending on the recipient, may include both a benefit based on labour market status and other basic social security benefits. This provides a more authentic picture of the sufficiency of the person's subsistence, as the total amount of available income determines whether the person's primary or last-resort security covers the basic necessities of human life. Public discourse often focuses on parts of the overall system, making it harder to assess the need for reform as a whole.

## Objectives of the basic social security reform

The changes sought through the basic social security reform vary between different parties, but generally speaking, the following are considered to be the key issues to be tackled with the reform:

1. The prevailing system does not sufficiently reduce poverty. The level of basic social security is not sufficient in every respect.
2. The prevailing system allows people to fall through the cracks due to not being eligible for benefits or not applying for benefits to avoid excessive bureaucracy. In other words, basic social security does not ensure sufficient coverage.
3. The prevailing system creates a welfare trap among some groups. The balancing of social security and

employment can be difficult. This may invite passivity, impairing the rate of employment and increasing the costs of social security.

- ▶ In an income or unemployment trap, the combined effect of income taxation and the income testing required for benefits (benefits are cut as income increases) means that accepting new work or more hours only results in a marginal increase in earnings, reducing the financial incentive for work.
- ▶ In a bureaucratic trap, accepting new work or earning additional income results in the need to report the said work or income to the authorities and potentially have the grounds for benefits reprocessed, inconveniencing the recipient and,



at worst, delaying the payment of benefits due to processing. As a result, the person may decide to apply for income support when waiting for the primary benefit.

4. The prevailing system is excessively bureaucratic. Pigeonholing people strictly according to labour market status does not account for the diverse situations people may find themselves in or for overlapping activities such as working, being self-employed and studying at the same time. This causes additional work for both benefits officers and the recipients of benefits and may prevent the recipient's access to a needed support service. The complexity also makes the system appear to be unreliable and difficult, thus becoming another stress factor in the recipients' lives. Moreover, the sanctions of cutting the benefits when the recipient does not fulfil various activation conditions increase the uncertainty of finding sufficient income. Sanctioning may be unreasonable if the recipient does not possess the resources or abilities to fulfil the condition.

#### Less poverty, more employment

Reducing poverty decreases human suffering and both social and health-related issues at individual and societal levels. It increases well-being and functional capacity,

thus promoting active and independent individuals. Studies show that poverty creates a mental burden that has a negative impact on cognitive function, making it even harder for the individual to improve their circumstances or fulfil their potential.<sup>2</sup> We can, therefore, conclude that societal investments in the elimination of poverty will lead to cost savings in the future. Restraining the hereditary nature of poverty and reducing child poverty, in particular, have a long-term positive impact. More than 10% of Finnish children still live in low-income families.<sup>3</sup>

When battling poverty, it is important to focus not only on a sufficient level of basic social security but also on the coverage of the said security (preventing exclusion from benefits), the effects on the incentives for work (income or bureaucratic trap) and the psychological impacts (stress caused by a complex system and uncertain subsistence). Reducing unemployment naturally reduces poverty and the need for social security, which is why society must support employment on a long-term basis. Work is also an important social factor in many people's lives, playing a vital role in their well-being. A high rate of employment or, to be more precise, gross domestic product, facilitates the funding of public expenses, such as social security. The system must balance between improving employment and providing sufficient basic social security when these elements result in conflicting pressure to make changes to social security and taxation.

## Conditions of basic social security and principles of basic income

The conditions for receiving benefits vary according to the type of benefit. Some benefits, such as labour market subsidy, may include a requirement for active measures, such as job-seeking. Should the recipient fail to fulfil the said requirements, their benefit may be cut or cancelled. This is called a **conditional** benefit. An **unconditional** benefit does not include an activity requirement. **Need-based** benefits, in turn, are granted for a specific reason, such as a person's situation in life or housing costs. **Universal** benefits are available to anyone covered by social security, regardless of their situation in life. These concepts are subject to interpretation, and their definitions vary. Housing allowance or basic income can be considered to be universal as they are not dependent on the person's situation in life, but on the other hand, they are effectively granted only to people

with a low income. A benefit with low income as the only requirement can, in principle, be considered to be either a need-based or universal benefit. For this reason, it is important not to become excessively fixated on the terminology and definitions in the social security reform.

One of the advantages of need-based benefits is their better allocation to those in need of support, which translates into better support for the individual and smaller cost for society due to the restricted grounds for granting the said benefit. On the other hand, need-based benefits entail increased bureaucracy, as the grounds for granting the benefit must be specified in detail and the fulfilment of the requirements must be assessed and monitored. This increases the workload of social services and the applicant and may result in added uncertainty and a

negative psychological impact on the applicant. Strict definitions for need-based benefits may also prevent some individuals in need of support from receiving the benefit and make it difficult to transition from one type of grounds to another.

In the current Finnish political discourse, people often end up advocating either unconditional or conditional or, on the other hand, either need-based or universal social security, even though these are not mutually exclusive as long as social security is comprised of several parts. As evident from the advantages and disadvantages of the various grounds and requirements discussed above, all of the parts of social security serve a function and play an important role as part of a functional basic social security system.

**Basic income**, an increasingly popular topic of discussion in Finland, has been proposed by various political parties and movements as a solution for the problems faced by social security. The basic income experiment (2017–2018) brought international attention to the idea, making it one of the most highly publicised means of reform.

In addition to distributional and ideological grounds, basic income is thought to improve the financial incentives of work due to consistent taxation or the income testing required for benefits, as well as to cut back on bureaucracy and, therefore, promote the coverage of basic social security. However, improving financial incentives by eliminating the most glaring income traps, in other words high effective marginal tax rates, is not exclusive to basic income; the same can also be achieved with the current need-based benefits. Reducing bureaucracy through a universal approach can, on the other hand, be considered to be one of the advantages of basic income when compared to systems based on strict pigeonholing or means-tested benefits. A real-time incomes register, however, could be used to streamline the integration of current benefits and salaries by automating benefit cuts and calculations (Currently under staggered deployment in Finland, the National Incomes Register will serve as a state-administered incomes register where each individual's key types of income can be directly reported. The information in the register will enable automatic calculation of the amount of income-tested benefit without requiring the recipient to send copies of their payslips, for example.)

Basic income, in turn, can clarify and facilitate the receipt of guaranteed, unconditional basic social security compared to the current unconditional benefits, such as general housing allowance or the basic amount of income support that may be reduced due to refusal to participate in activation measures. Basic income can be used to ensure subsistence or supplement other income for those not in need of other social or employment services, but not

receiving sufficient income for their basic needs. This enables a more efficient allocation of support service resources to those in need. Basic income also promotes the certainty and predictability of subsistence, which is an important factor in general well-being.

Ultimately, a fixed basic income paid to all regardless of their level of income and, correspondingly, unconditional **negative income tax**, are equal when it comes to the end result, in other words the income that the individual takes home. The advantages of a fixed basic income include predictability and clarity, as the individual receives the same amount of benefit each month regardless of their level of income. In addition, a benefit paid to even those with a high income may increase the acceptability of the benefit's universal nature, as well as its social cohesion. On the other hand, the benefit entails a higher nominal marginal tax rate. Moreover, some may question the system due to the "unnecessary" benefit paid to those with a high income.

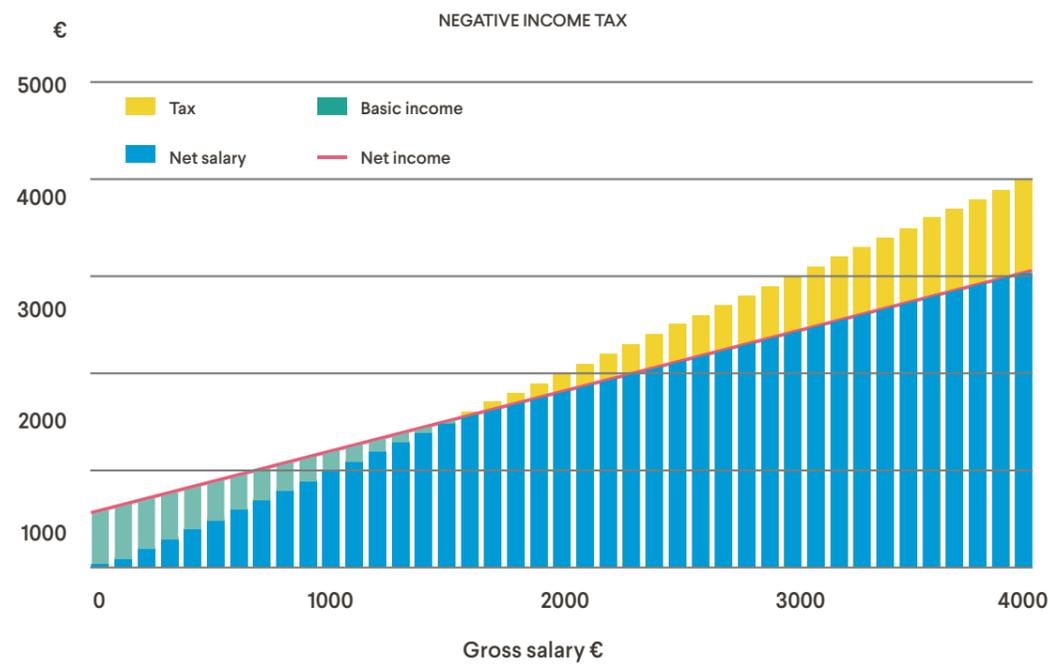
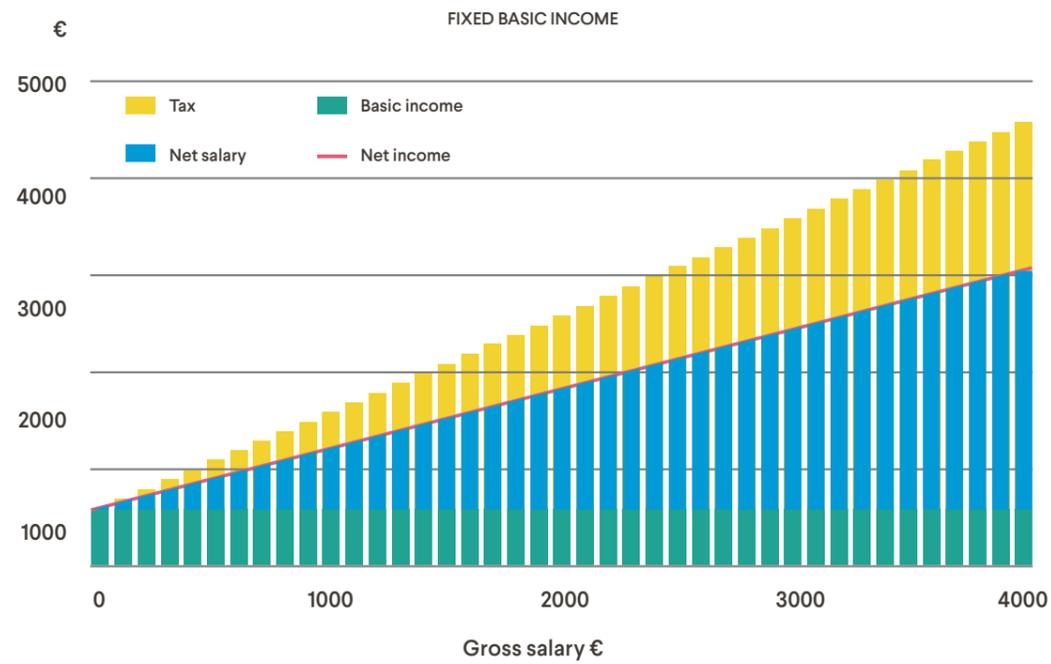
One of the strengths of a negative income tax is that it is automatically targeted at those with a low income, as the income of each month (or other interval) affects the amount of basic income paid the next month. This eliminates an unnecessary back-and-forth transfer of funds, keeping the nominal marginal tax rates reasonable and potentially increasing the legitimacy of the system, as the benefit is only paid to those with a low income, thus creating significantly smaller social expenses when compared to fixed basic income. One of the drawbacks of a negative income tax is that income testing may delay the payment of benefits due to the fact that basic income granted on the basis of a zero-income month is not paid until the next month. In addition, the fluctuation of the sum might be quite impractical to those struggling with their financial situation.

Integrating a monthly negative income tax with an annual taxation system requires some further consideration. One solution might be to address income transfers after the tax year, as part of tax refunds or back taxes, whereupon the effective tax rate determined according to income level is not affected by the distribution of the income within the year. Moreover, adjusting the amount of negative income tax or the withholding tax rate during the tax year could narrow down the difference between withholding tax and the final tax, thus cutting back on surprising back taxes.

The Finnish basic income experiment (2017–2018) features a EUR 560 basic income that was not cut if the recipient found employment. Preliminary results indicate that the basic income did not increase or decrease employment or working when compared to the same size group who received labour market subsidy.

<sup>2</sup> Science: [https://scholar.harvard.edu/files/sendhil/files/976.full\\_.pdf](https://scholar.harvard.edu/files/sendhil/files/976.full_.pdf)

<sup>3</sup> Statistics Finland: <https://findikaattori.fi/en/103>



The end result, meaning the net income, is the same.

Meanwhile, the basic income test group reported higher levels of well-being in the questionnaire survey.<sup>4</sup> A possible interpretation is that a person's marginal tax rate is not the largest obstacle in finding employment and that a low, unconditional benefit promotes no more passivity than a conditional benefit. Reducing uncertainty over income and cutting down on bureaucracy, on the other hand, may increase well-being. However, the experiment was extremely limited in terms of its scope, duration and sample group, in addition to which only a small share of the test subjects responded to the preliminary questionnaire. Moreover, the experiment did not include taxation, even though it would be part of a realistic basic income model. Therefore, the results of the experiment do not yield particularly comprehensive conclusions either for or against basic income.

<sup>4</sup> Kela: [https://www.kela.fi/ajankohtaista-henkiloasiakkaat/-/asset\\_publisher/kg5xtoqDw6Wf/content/perustulokokeilun-alustavat-tulokset-hyvinvointi-koettiin-paremmaksi-ensimmaisena-vuonna-ei-tyollisyysvaikutuksia?utm\\_source= uutiskirje&utm\\_medium=email&utm\\_campaign=Perustulokokeilu+-+F%C3%B6rs%C3%B6k+med+basinkomst](https://www.kela.fi/ajankohtaista-henkiloasiakkaat/-/asset_publisher/kg5xtoqDw6Wf/content/perustulokokeilun-alustavat-tulokset-hyvinvointi-koettiin-paremmaksi-ensimmaisena-vuonna-ei-tyollisyysvaikutuksia?utm_source= uutiskirje&utm_medium=email&utm_campaign=Perustulokokeilu+-+F%C3%B6rs%C3%B6k+med+basinkomst) (in Finnish)

# II. Targets for development in basic social security

In the following section, we shall examine basic social security from various angles, discuss some of the issues in the status quo and propose stepping stones for de-

velopment. Many of the objectives can be promoted side by side.

## Level and coverage of basic social security

The sufficiency and coverage of Finnish basic social security can be examined by, for example, investigating the need for last-resort income support.

- ▶ 37% of labour market subsidy recipients need basic income support to supplement their income.<sup>5</sup>
- ▶ 30% of households receiving basic income support lack primary benefits.<sup>6</sup>
- ▶ More than 7% of Finns receive basic income support.<sup>5</sup> (cf. Sweden 4%)

Based on these statistics, it is evident that the level of primary basic social security is insufficient for preventing the need for income support. From 2015 to 2019, the level of basic social security has been particularly weakened due to index cuts and benefit cuts due to the activation model, which manifests itself as increased demand for income support.<sup>7</sup> In addition, the primary basic social security does not ensure sufficient coverage as the conditions for receiving the said security and the complexity of the system exclude or alienate a large number of potential recipients from the primary benefit, which is why they end up having to rely on last-resort income support. Income support was not meant to be an extensive or long-term means of basic social security and it is bureaucratic by nature, as well as, at its worst, a passivating means of security. Considerably reducing the need for income support must be one of the objectives of the social security reform.

Other observations:

- ▶ **Recipients in urban municipalities, especially in the Helsinki metropolitan area, receive basic income support in larger amounts and in longer stints.**<sup>8</sup> This is partially explained by the higher housing costs. The metropolitan area

also has more households lacking any taxable income compared to the rest of the country.

- ▶ **Even though the level of student grants is considerably weaker than that of labour market subsidy, only 3.6% of student grant recipients receive basic income support.**<sup>5</sup> This is partially explained by the fact that the right to a student loan is considered to be income in the basic income support calculations, excluding most students from receiving the benefit. In addition, despite the low level of basic social security, students' circumstances are better suited for a tight budget as they have access to student housing, subsidised meals and other student discounts. Moreover, it is more profitable to accept new work when receiving a student grant compared to labour market subsidy, as, despite the income limits specified in the conditions of student grants, student grant recipients take home a larger share of their earnings than labour market subsidy recipients who are bound by the strict income testing. Young people are also more likely to share an apartment, which also keeps housing costs down.
- ▶ **In nearly 50% of households lacking primary benefits and earned income, the applicant is under the age of 25.**<sup>6</sup> Young people under the age of 25 are rarely entitled to a primary minimum benefit, as, without vocational education or studies, they are not entitled to labour market subsidy. In addition, unlike other population groups, those under the age of 25 must comply with a five-month qualifying period.

The sufficiency of basic social security can also be assessed by comparing it to a **reasonable minimum consumption budget** which is used to determine the minimum costs of living that the income should cover.

<sup>5</sup> Kela: <http://tutkimusblogi.kela.fi/arkisto/4755> (in Finnish)

<sup>6</sup> Kela: <https://www.kela.fi/documents/10180/0/T+Korpela+-+esitys+060318/4ffc5f31-837e-458e-8459-fd617337f06b?version=1.0> (in Finnish)

<sup>7</sup> Finnish Institute for Health and Welfare: [http://www.julkari.fi/bitstream/handle/10024/137711/URN\\_ISBN\\_978-952-343-296-3.pdf?sequence=1&isAllowed=y](http://www.julkari.fi/bitstream/handle/10024/137711/URN_ISBN_978-952-343-296-3.pdf?sequence=1&isAllowed=y) (in Finnish, with abstract in English)

<sup>8</sup> Kela: [https://helda.helsinki.fi/bitstream/handle/10138/231747/Perustoimeentulotuen\\_tarve\\_suurinta\\_paakaupunkiseudulla.pdf?sequence=1&isAllowed=y](https://helda.helsinki.fi/bitstream/handle/10138/231747/Perustoimeentulotuen_tarve_suurinta_paakaupunkiseudulla.pdf?sequence=1&isAllowed=y) (in Finnish)

Even though specifying a minimum budget is not without its complications and some people might even survive on a smaller budget, at least temporarily, such estimates provide a vital benchmark for the level of basic social security. The Finnish Institute for Health and Welfare (THL) has estimated that basic social security covers **73–94%** of the reasonable minimum consumption of a person living alone in a rental apartment.<sup>9</sup>

Raising the level and purposefully allocating basic social security is necessary in order to ensure sufficient income for the recipients and reduce the need for last-resort income support. In addition, the coverage of basic social security must be improved by developing and expanding the conditions on which it is granted to ensure that no one is excluded from receiving primary basic social security benefits.

Basic income is one of the potential solutions for preventing people from falling through the cracks in the system, promoting the coverage of social security and considering the individuals who do not meet the standards or fulfil the conditions of the system at the moment. Even a small form of guaranteed, regular support would reduce uncertainty in the lives of the disadvantaged. Basic income could alleviate the pressure to use other forms of social security and services in situations where the person only needs some minor financial added support in order to cope.

In actual fact, the unconditional nature of basic income would not constitute a major change compared to the prevailing system as reduced basic income support is already available, even if the recipient refuses all requirements. The general housing allowance does not entail any activity requirements either.

The final report of the working group appointed to address inequality issues (Saari et al.)<sup>10</sup>, the Promoting youth inclusion report (Hiilamo et al.)<sup>11</sup> and the participation income model (Hiilamo et al.)<sup>12</sup> propose a low basic amount or basic level that would be granted even if the person refuses all activation measures – although only for a temporary period of time in the former. The proposed level in the former is EUR 616 per month and in the latter EUR 280–490 per month. An unconditional basic level can be considered to be an implementation of basic income, although a more bureaucratic version.

### Remark on pensioners

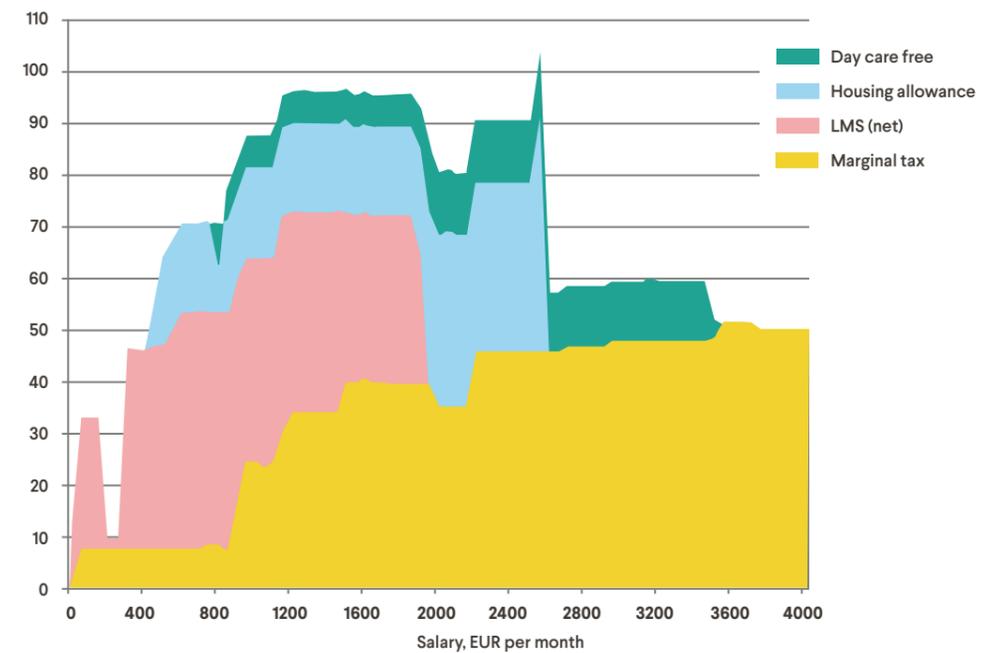
As pensioners cannot be expected to supplement their basic social security by working, their need for income support must be reduced by increasing the level of guarantee pension, but also by cutting back on medication and travel costs in particular, as well as social and health care service fees, as pensioners who are ill are more likely to suffer from income-related issues. The copayments and upper limits of these costs should be decreased, and a common upper limit would prevent the accumulation of the costs. The objective should be to completely eliminate customer fees in health care. Targeting the measures towards those who are ill or frequent users of the services is a more effective means of preventing poverty among pensioners.

In addition, solutions should be considered for promoting purposeful housing for the elderly in order to cut back on their housing costs and generally improve housing efficiency. However, it is hard to avoid a situation in which a widow or a widower is living alone, and a pensioner may find it more difficult to adjust to shared housing, compared to young or working-age people. As with the working-age population, the basic social security should cover the subsistence of those living alone as well. Therefore, it is important to review the type of legislation that renders it difficult for people to move and sell their apartment, such as transfer tax, and the development of reverse mortgages. The objectives could also be promoted through counselling and personal assistance.

### Proposed measures:

- ▶ Increasing the overall level of basic social security by EUR 100–200
- ▶ Harmonising or combining the current need-based minimum benefits and extending the grounds for granting benefits
- ▶ Implementing an unconditional and universal basic social security benefit (basic income) that would partly replace the current basic social security
- ▶ Eliminating the five-month qualifying period of people under the age of 25 in labour market subsidy

SINGLE PARENT'S EFFECTIVE MARGINAL TAX RATE IN 2015, %  
Job-seeker on labour market subsidy (LMS). One child (2 yrs). Rent EUR 660 per month.



Example of a high effective marginal tax rate in 2015. The net income of the person does not substantially increase even if their earnings rise from a monthly salary of EUR 900 to EUR 2,600. The person is in an income trap and, from a purely financial standpoint, working is not profitable. Image data: VATT Institute for Economic Research

## Work and welfare traps

In addition to the level and coverage of basic social security, its functionality also depends on its quality. The psychological impacts, bureaucracy and financial incentive effects of the social security system affect the recipient's well-being and the dynamic impacts related to their employment, in other words, the circumstances around combining earning with social security and finding work in the first place.

In the prevailing basic social security system, work-related bureaucracy and uncertainty and, in some cases, high effective marginal tax rates, act as obstacles to finding work and accepting more working hours.

### Bureaucratic trap

In the social security system of Finland, the expression 'bureaucratic trap' has usually been used as a reference to

delays in the payment of adjusted labour market subsidies due to earned income. When a person receiving benefit payments took on an odd job, for example, they had to report the said job to Kela, after which the authorities would sometimes delay the payment of the benefit until the person received the remuneration for the work and delivered the payslip to Kela. This often resulted in an inconstant and unpredictable income.

However, the situation was amended in the spring of 2019<sup>13</sup> as the adjustment of labour market subsidy is now based on payment; in other words, earned income only affects the benefit of the month in which the person receives the remuneration. Moreover, Kela no longer primarily requires recipients to deliver their payslips, as the information is supplied by the national incomes register.

<sup>9</sup> Finnish Institute for Health and Welfare: [https://www.julkari.fi/bitstream/handle/10024/135425/Suomensosiaalinentila\\_4\\_2017\\_final2\\_kor-%20jattu.pdf?sequence=1](https://www.julkari.fi/bitstream/handle/10024/135425/Suomensosiaalinentila_4_2017_final2_kor-%20jattu.pdf?sequence=1) (in Finnish)

<sup>10</sup> Prime Minister's Office: [http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160706/01\\_2018\\_Eriarvoisuutta%20kasittelevan%20tryn%20oppuraportti\\_kansilla\\_netii.pdf](http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160706/01_2018_Eriarvoisuutta%20kasittelevan%20tryn%20oppuraportti_kansilla_netii.pdf) (in Finnish, with abstract in English)

<sup>11</sup> Diaconia University of Applied Sciences: [https://www.theseus.fi/bitstream/handle/10024/133266/Puheenvuoro\\_11\\_978-952-493-298-1.pdf](https://www.theseus.fi/bitstream/handle/10024/133266/Puheenvuoro_11_978-952-493-298-1.pdf) (in Finnish, with abstract in English)

<sup>12</sup> Prime Minister's Office: [https://tietokayttoon.fi/documents/10616/3866814/18\\_2017\\_Nelj%C3%A4+osallistavan+sosiaaliturvan+mallia.pdf/4e31990f-5e94-4b64-b73a-a72784c91f85?version=1.0](https://tietokayttoon.fi/documents/10616/3866814/18_2017_Nelj%C3%A4+osallistavan+sosiaaliturvan+mallia.pdf/4e31990f-5e94-4b64-b73a-a72784c91f85?version=1.0) (in Finnish, with abstract in English)

<sup>13</sup> Kela: [https://www.kela.fi/ajankohtaista/-/asset\\_publisher/mHBZ5fHNro4S/content/osa-aikatyota-tekeva-ei-joudu-ena-odottamaan-tyottomysetuutta](https://www.kela.fi/ajankohtaista/-/asset_publisher/mHBZ5fHNro4S/content/osa-aikatyota-tekeva-ei-joudu-ena-odottamaan-tyottomysetuutta) (in Finnish)

The complexity of social security and taxation hinder individuals' abilities to estimate the impact of additional earnings on the income they can take home. Various forms of protected income, fluctuating concepts of income and the grounds for granting benefits make the system hard to grasp and navigate.

### Income and unemployment trap

In an income trap, the extra income from accepting more work results in such a marginal increase in earnings that it is not financially profitable to accept more work. In this situation, the **marginal tax rate** is high; each newly earned euro is heavily taxed. An **effective marginal tax rate**, in turn, takes both income taxation and income-related social security cuts into consideration – in other words, the actual income remaining after it has been cut down by both taxation and benefit cuts. An unemployment trap means that an unemployed person is unable to substantially increase their actual income, even if they find employment. This is impacted by an effective marginal tax rate on a more extensive income interval; in other words, an extensive marginal tax rate. The definition of an income or unemployment trap is vague, but it usually concerns effective marginal tax rates exceeding 70–80%.<sup>14</sup>

Each individual income test related to a benefit causes the possibility of several benefits being simultaneously cut by a certain percentage of earned income. These effects accumulate and, at their worst, can result in a close to 100% effective marginal tax rate within certain income intervals. The issue does not apply to all recipients of benefits, but the most marginal cases should be corrected.

### Protected income and income testing

Both minimum daily allowances and the general housing allowance comply with the EUR 300 protected income; the benefit is not cut back by earned income under the said sum. The housing allowance also uses a formula for a basic copayment that, in practice, increases the protected income by about EUR 600. The purpose of these types of protected income is to make it easier to earn some extra income without creating a high effective marginal tax rate within the limitations of the protected income. The idea is that minor work during unemployment enables the person to maintain their capacity for work and the employer to assess the worker's aptitude for the work. The impact of protected income on full-time employment, however, seems to be

weak, but this requires some additional research.<sup>15</sup> Instead, protected income shifts incentive issues to higher income levels corresponding to half-day and full-time employment and increases social security costs as people with a higher income can then also be granted the benefits in question. Correspondingly, income testing after protected income is strict in order to ensure that the benefit is not transferred to average wage earners.

The unemployed already enjoy excellent financial incentives for work; however, problems arise from overlapping means-tested benefits that, when combined, may result in a high effective marginal tax rate, even over a long income interval, thus creating an income trap. Income support, in particular, impairs financial incentives.<sup>14</sup> The income testing of the general housing allowance already accounts for simultaneous labour market subsidy by halving the taper rate of the housing allowance. The protected income in the general housing allowance (earned income allowance) has increased the costs of the system, but has not allocated additional funds to zero-income households, the upsurge of which explains the majority of the increased use of the general housing allowance.<sup>16</sup>

Instead of protected income, therefore, it might be wiser to make income testing more moderate, but also more uniform over a longer income interval, thus preventing high, intense effective marginal tax rates, even if this may increase the participation tax rate starting from minor earned income. Alternatively, equally strict income testing would better allocate the support towards those with a low income as its tapering start at a lower income.

If a benefit is intended to be comprehensive and potentially long-term, it should also encourage people to accept work while receiving the benefit. Better integrating work with social security is one of the key objectives for the basic social security reform. Cumulative income testing can be alleviated:

- ▶ by reducing the taper rates of separate benefits
- ▶ by reducing the number of separate benefits
- ▶ by eliminating other factors that increase the effective tax rate (day care fee)
- ▶ by combining the taper rates of several benefits into one, thus setting a fixed maximum limit (e.g. 65%)
- ▶ by eliminating protected income, thus alleviating income testing by spreading it over a more extensive income interval.

### Proposed measures:

- ▶ Alleviating the worst income traps by lightening the income testing of primary benefits or combining the income testing of overlapping benefits
- ▶ Ensuring that the extensive (employment) and intensive (added income) effective marginal tax rates remain within reasonable limits
- ▶ Creating a minor unconditional and universal basic social security benefit (basic income) that would partly replace the current basic social security and, thus the amount of benefits under strict income testing
- ▶ Continuing to expand the incomes register and the automation of payments
- ▶ Eliminating day care fees in early childhood education

## Functional and customer-oriented service path

In addition to income transfers, social security also heavily relies on support services used to help the customer find employment or rehabilitation, for example. These two elements are also connected through the fact that those in need of services also often receive income transfers. A better integration of income transfers and services, therefore, enables the development of a more efficient service path. On the other hand, a faulty, rigid integration of the two elements may also make it more difficult to receive the correct service if the service is bound to the incorrect type of benefit.

In addition to the labour market situations, the major obstacles for finding employment do not lie in the financial welfare traps of taxation and social security, but in shortcomings such as irrelevant competence, inadequate life management skills or poor health. That is why developing the services and providing the correct type of assistance are the most important means of reducing long-term unemployment.

It has been suggested that the current unemployment services are not always genuinely useful, but focus more on measuring the activity levels of the unemployed or even punishing people for being unemployed. In addition, there has been criticism towards the quality and sufficient supply of services. A support service meeting the activity requirements of the activation model has not always been available, resulting in a situation where an unemployed person may have been sanctioned as if it was their own fault.

The support services for unemployment, illness, etc. should meet the needs of each customer. As people's

circumstances may vary a great deal, the services should be made more individual and customer-oriented.

Implemented in six Finnish municipalities, the 2018–2019 municipal experiment for inclusive social security studied face-to-face assistance and support provided by social workers and social advisors, as well as communal peer groups with promising results. During the experiment, it was also observed that the individuals referred to social work to have their need for social security assessed were more likely to arrive at the meeting than those referred to social work as a result of cutting back on their basic amount of income support.<sup>17</sup> In other words, making participation obligatory by threatening to cut social security may not be an effective means of activating the unemployed. Instead, meeting the customer's needs without a connection to their benefits may prove to be more effective. The customer may be designated a personal coach who works with them to prepare a plan for navigating through their situation in life. If necessary, services can also be targeted, without requirements, directly to those applying for need-based support or those with a long-term situation of zero earned income by, for example, inviting them to prepare a personal plan. Various local programmes, such as outreach youth work, are vitally important targeted services in need of development in municipalities.

Initiated in 2018, the activation model stipulates that a person's unemployment benefit may be decreased unless they fulfil their activity requirement over a specified period of time. Cutting a primary type of basic social security

<sup>14</sup> VATT Institute for Economic Research: [https://vatt.fi/documents/2956369/3012213/muistio\\_50.pdf](https://vatt.fi/documents/2956369/3012213/muistio_50.pdf) (in Finnish)

<sup>15</sup> Prime Minister's Office: <http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160959/45-2018-Tyottomyysturvan%20suojaosa%20ja%20tyottomyyden%20aikainen%20tyoskentely.pdf> (in Finnish, with abstract in English)

<sup>16</sup> Kela: <https://helda.helsinki.fi/bitstream/handle/10138/299806/Tutkimuksia155.pdf> (in Finnish, with abstract in English)

<sup>17</sup> Ministry of Social Affairs and Health: [https://stm.fi/documents/1271139/6184550/Osallistavan+sosiaaliturvan+kuntakokeilu\\_tutkimuksesta+tiivisti+31\\_lokakuu+2018.pdf](https://stm.fi/documents/1271139/6184550/Osallistavan+sosiaaliturvan+kuntakokeilu_tutkimuksesta+tiivisti+31_lokakuu+2018.pdf) (in Finnish)

has hindered many people's financial situation and, at the same time, the weakened basic social security has been compensated for by solutions such as income support, whereupon the incentive effect of the activation model is nonexistent for those earning a low income.<sup>18</sup>

Pigeonholed, need-based social security may create situations where, in order to receive a specific service, the person must switch from one benefit to another, potentially weakening the level of their security or causing an interruption in their benefits. That is why need-based minimum security should be harmonised to ensure that the level of support and the grounds for determining the benefit remain unchanged regardless of the types of services that the customer is receiving. This was also proposed by the working group appointed to address inequality issues.<sup>19</sup> A person may need support in both rehabilitation and applying for studies. The customer will not care whether this officially constitutes one type of benefit or two separate, need-based yet consistent benefits, as long as receiving the correct benefit does not result in any additional bureaucracy for them.

The role of the Public Employment and Business Services (employment agencies acting locally under the Ministry of Employment and the Economy) as a provider of statements on labour force policy should be discontinued and they should be considered a social service alongside healthcare, education counselling, etc. The right to support should also be fulfilled if the person accepts a place in an educational institution but has not started their studies (also if a person has postponed their studies due to military service or alternative civilian service and is waiting for the studies to commence after completing their service).

### **Basic income support should be discontinued**

Income support (also known as social assistance) consists of the basic amount and the supplementary and preventive amount. In 2017, the granting process of basic income support was transferred from the municipalities to Kela. The transfer made it easier for some individuals to apply for the benefit and harmonised the principles of granting the benefit, which has increased the use of basic income support and reduced its underuse.<sup>20</sup>

On the other hand, the transfer resulted in a situation in which the means testing of income support is conducted by two separate parties: Kela and the municipalities. Even though applying for preventive and supplementary income support and the link to social work is in the municipalities, meaning close to the customer as it should be, municipalities have to spend a great deal of time applying for the basic amount from Kela with the customer. Information also travels poorly between these two parties, especially from municipalities to Kela. Kela has an extensive database and a

wealth of customer data that should be accessible to both of these parties. Basic income support granted by Kela is quite computational and standardised, whereas municipalities conduct more social work. It would be clearer that only the preventive and supplementary amount linked to social work (potentially combined as one benefit) would remain in income support and that only one party, the municipalities, would provide the related social work. In that case, the calculations, testing and the assessment of reasonable rent included in the current basic amount would become part of municipalities' preventive and supplementary income support. That, however, would require the state to guarantee some type of minimum security, for example, in the form of basic income or a more comprehensive, need-based basic social security. At the moment, the minimum basic income support is EUR 300 per month (reduced level).

By discontinuing basic income support, we can also avoid the situation where, in order to receive income support for medication from municipalities, pensioners would first need to apply for basic income support from Kela but could not be granted it due to a pension that exceeds the income limit.

One of the problems of municipal social work is that some municipalities are too small to provide sufficiently diverse services for various needs or to ensure the funding required by income transfers. In that sense, a region ('province', 'county') would provide a more realistic scale for local government, particularly if it corresponds better with people's commuting distances. In any case, the state must monitor the sufficiency and functionality of social security at a local level.

### **Proposed measures:**

- ▶ Discontinuing activity-based sanctions in social security and making the services more appealing and accessible
- ▶ Increasing individual counselling based on a personal customer relationship in the services
- ▶ Piloting new services in municipalities
- ▶ Harmonising or combining need-based minimum security to ensure that the type of benefit does not restrict the necessary service
- ▶ Discontinuing basic income support by replacing it with basic income and focusing the resources of active social service at a local level

## Role of housing allowance in social security

As housing is a basic necessity of life, it must be taken into consideration in social security. Those on low income spend the majority of their income on housing. However, some might ask why there is a separate form of support for housing as it is only one of many necessary items of expenditure. There is no separate food allowance with a specified level, for example. The need for housing allowance can be justified by the fact that housing costs vary both geographically and within the same area, unlike food that costs more or less the same across the country. Therefore, the housing allowance can be used to compensate for a situation where a person on low income is unable to find reasonably priced housing due to the rental market or other circumstances. It can also be used to even out differences between renting and owning an apartment, the latter of which has a more advantageous position in terms of taxation.

### **Problems of general housing allowance**

The current general housing allowance in Finland is not efficient in evening out the differences in housing costs or the taxation of rented and owned housing. In Helsinki, for example, the general housing allowance covers 80% of the housing costs of a low-income, one-person household up to EUR 516, in other words EUR 412.80. However, it is extremely difficult to find studio apartments for less than EUR 600 in Helsinki (in 2018, the median rent of a studio apartment in Helsinki was EUR 790 per month<sup>21</sup>), which would mean that, in practice, most applicants would be entitled to the full amount of benefit when only examining the housing costs. The benefit is targeted at those on low income through cutting the benefit as income increases. Therefore, in practice, the general housing allowance can be considered to be a regional basic income that is cut in the same manner as negative income tax, although with a slightly more complex formula and bureaucracy. This comparison is also supported by the fact that the housing allowance is not conditional and does not entail activity requirements, unlike unemployment benefits. Compared to individual basic income, the only difference is its allocation to households instead of individuals, therefore allocating the benefit relatively more to those living alone. If the maximum housing costs, in turn, would be raised to a level where they would genuinely even out the housing costs in the current rental market, there is a risk that the 80% compensation of the support would encourage people to live too expensively. In this case as well, the benefit could be allocated by using income testing.

The relative taxation-related advantage of owning over renting has not been taken into consideration in the general housing allowance in Finland, as the housing allowance of a homeowner only addresses direct housing costs but not the tax privilege. Support is also available for the housing cooperative's charge for financial costs, which, in practice, translates into mortgage repayments but, technically speaking, the debtor is not the person but the housing cooperative. In other words, the general housing allowance can be used to accrue personal housing assets, which is a questionable means of using social security.

As the stock of supported rental apartments, such as ARA housing (publicly subsidised rental apartments) or student housing, is insufficient to cover the needs of all low-income households, social security cannot be scaled according to such housing; market-priced housing must also be taken into consideration. This means that those

living in a supported apartment receive double support, as it were, compared to those on low income living in market-priced apartments. The housing allowance could address the benefit of supported rental housing as a factor decreasing the benefit, similarly to homeowners, which would promote the equality of those living in non-supported housing, but this would then dissolve the purpose of supported rental housing when examining only the cost of housing.

There are two alternative paths for developing housing allowance: a benefit that would genuinely even out the housing costs (and the taxation of renting and owning an apartment) or a more simplified benefit in the vein of basic income with a regionally varying amount and allocation conducted through either taxation or cuts.

### **Equal treatment of owning and renting an apartment**

When compared to renting an apartment, ownership entails taxation-related advantages, such as the interest deduction right of mortgages (that has been decreased in recent years) and the tax exemption of imputed rent. Imputed rent refers to the computational benefit that comes from deducting the actual costs, such as maintenance charge and the mortgage interest, from the computational gross rent.<sup>22</sup> Capital gains tax is collected from the rent of a rental apartment but not from homeowners. In order

<sup>18</sup> Finnish Institute for Health and Welfare: <https://blogi.thl.fi/aktiivimalli-lisaa-toimeentulotuen-tarvetta-mutta-ai-juuri-kasvata-pienituloisten-maaraa/> (in Finnish)

<sup>19</sup> Prime Minister's Office: [http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160706/01\\_2018\\_Eriarvoisuutta%20kasittelevan%20tryn%20loppuraportti\\_kansilla\\_nettili.pdf?sequence=1&isAllowed=y](http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160706/01_2018_Eriarvoisuutta%20kasittelevan%20tryn%20loppuraportti_kansilla_nettili.pdf?sequence=1&isAllowed=y) (in Finnish, with abstract in English)

<sup>20</sup> Finnish Institute for Health and Welfare: <https://thl.fi/en/-/perustoimeentulotuen-siirto-kelaan-kasvatti-odotetusti-toimeentulotuen-saajien-maaraa> (in Finnish)

<sup>21</sup> Helsingin Sanomat: <https://www.hs.fi/koti/art-2000005964778.html> (in Finnish)

<sup>22</sup> Statistics Finland: [http://www.stat.fi/meta/kas/asuntotulo\\_en.html](http://www.stat.fi/meta/kas/asuntotulo_en.html)

to ensure that social security and taxation do not use public funds to accrue the wealth of homeowners, this advantage must be taken into account in either social benefits or taxation. In both cases, the computational benefit must be assessed first by comparing the actual costs of the apartment with the market rent of a similar apartment. This taxation-related advantage is negated by acknowledging it as either a factor decreasing the homeowner's housing allowance or directly as tax on imputed rent, regardless of the benefits applied for by the owner. Considering imputed rent as part of social security is easier from a political perspective as it is not taxed directly; it simply reduces the housing allowance to which the person would otherwise be entitled. Moreover, the person would not be required to report their housing costs unless they are applying for a benefit. However, the problem in this model is that the effective taxation of imputed rent is only targeted at the individuals who might otherwise receive housing allowance, meaning that the tax base of imputed rent is narrower. Because of this, a direct tax on imputed rent would be more neutral and equal as it would be collected from all homeowners. This would also enable the development of housing allowance so that actualised housing costs would not need to be taken into consideration. Consequently, social security independent of actualised housing costs requires the Finnish tax system to reintroduce tax on imputed rent. As an optional or interlinking path, imputed rent could only be taken into consideration in social security.

### Regional differences in housing costs

In Finland, housing costs vary between regions. The Helsinki metropolitan area is the most expensive region in terms of housing, and the supply of apartments does not meet the demand. In the general housing allowance, these differences have been addressed by dividing the municipalities into four groups determining the maximum amount of housing allowance. Regional staggering is possible, both in need-based housing allowance taking actualised housing costs into account and in fixed, regional social security. The difference between the lowest rents in an expensive and inexpensive municipality is about EUR 200. At the moment, however, the difference between the maximum amounts of housing allowance in the most expensive and the least expensive municipal group is only EUR 134. On the other hand, housing costs other than rent, such as transportation, may be elevated when living outside growth centres.

Consequently, housing costs can be seen as regional costs of living that surpass mere rental expenses. The rent for

an apartment in a city centre, for example, may be more expensive than in the surrounding municipalities, but transportation costs may be correspondingly higher if the person has to use a car or buy a more expensive public transport pass in order to commute to their workplace downtown. In this sense, an equal level of support, such as basic income in a commuter zone larger than a municipality, would not distort this choice or promote the optimisation of only one item of expenditure.

As growth centres and their insufficient production of housing cause high housing allowance costs, it would be reasonable for the growth centres to cover a share of the costs. This would also create an incentive for the regional government to address and correct the housing shortage that is raising rental prices and housing allowance costs.

The clearest solution would be to specify a maximum level of regional benefits for each level of government participating in the payment of the benefits. In the status quo, municipalities may be part of the same commuter zone, whereupon the differences in benefit levels cannot be very substantial without distorting housing preferences. Should Finland implement the planned regional government reform, a region ('province', 'county') could prove a convenient size for a housing cost area.

Sufficient production of housing in growth centres and resource-efficient urban structure are the only real solutions for decreasing housing costs.

### Impact of housing allowance on rental level

It has been proposed that the general housing allowance systematically increases the level of rents due to the fact that the 80% compensation up to the maximum housing costs makes Kela almost fully responsible for better apartments and their higher rents, thus encouraging benefit recipients to pay higher rents. Logically, this would be a genuine risk; however, the current limits for maximum housing costs are so low that most rents exceed the limit in any case, negating any potential rent-increasing impact. A recent study also shows that, in its current form, the general housing allowance does not increase rents.<sup>23</sup>

However, it is possible that the rent-increasing impact might become a reality if the maximum housing costs would be brought closer to the typical rental level, retaining the 80% compensation rate, particularly as the use of the general housing allowance has increased in Finland and, thus, an increasing share of tenants are covered by the benefit.

Income support has also been suggested to increase rents<sup>24</sup>, but there is no strong evidence to support the claim<sup>25</sup>. Basic income support paid according to housing costs only accounts for 2–5% of the size of the non-subsidised rental market, which may explain the minor impact on rent levels. The potential impact may increase, however, if the use of income support keeps growing. Correspondingly, the potential impact decreases as the need for and use of income support is reduced.

### Allocation of housing allowance and impact on choice of housing

Similarly to other social security, housing allowance is targeted at those on low income by cutting the allowance as the income increases.

Housing allowance is not generally used to compensate for high rents, as both low and high rents usually exceed the maximum housing cost limit set for the general housing allowance. This begs the question whether housing allowance should be expressly paid to those with a high rent, inevitably creating an additional incentive to obtain an expensive apartment. Inversely, housing allowance could be used to encourage people to opt for less expensive and more efficient housing by rewarding inexpensive housing decisions, but this would eliminate the purpose of the benefit as a leveller of high housing costs. It would also be possible to balance between the two by adopting a flexible or staggered compensation share, where the share of compensation is reduced as the housing costs increase, whereupon the incentive to save housing costs grows and no fixed limit is created to which the rents would automatically increase. However, this would still provide the most support, relatively speaking, to those who manage to find an inexpensive apartment in the first place. Targeting the benefit at the most expensive rents could then be promoted by adding a 100% copayment to the first EUR 100–200 housing costs.

The current general housing allowance is affected by the income of the person's common-law partner or a flatmate considered to be part of their household. As a result, one of the individuals may become liable to provide maintenance, even if there is no legal agreement, such as marriage. In practice, the income of a partner or a flatmate may prevent a person from receiving housing allowance. This makes it difficult to find efficient housing solutions and may discourage people from moving in together. This policy puts partners and various relation-

ships in an unequal position and creates an imbalance of power between partners. In addition, it forces Kela to make assumptions on people's private lives.

Because housing allowance is granted for households instead of individuals, it provides relatively less support for those sharing a home when compared to those living alone. Of course, the housing costs per person of those sharing a home are usually lower and, therefore, they need less support, but the policy also encourages people to live alone, which does not promote efficient use of the housing stock or eco-friendly perspectives. Especially after the transition to the general housing allowance, more and more students have decided to live alone.<sup>26</sup>

Housing is also supported in the form of less expensive apartments. Support for housing production and rents should be reviewed critically due to their uneven allocation, but social housing production and renting must also be provided moving forward in order to prevent social segregation and ensure housing for those unable to find a suitable apartment on the free market.

### From housing allowance to housing supplement

Due to the aforementioned, sometimes contradictory objectives, we recommend considering a solution where housing costs would be supported simply by taking into account regional price differences and the taxation of renting vs. owning a home as part of the individual's basic social security. A fixed form of support similar to basic income that would reflect the regional price level has been outlined in the cost-of-living bonus model<sup>27</sup>, where a regionally staggered benefit is added to basic income. This type of addition to basic income could be called a housing supplement, regional supplement or the housing amount of basic income.

As other basic social security is already individual, housing should also be considered to be individual support that does not cause extra bureaucracy or negative incentive effects. However, this does increase the costs of social security and transfers some of the support from those living alone to those sharing a home, especially couples. Therefore, a systematic, gradual change is in order.

23 VATT Institute for Economic Research: <https://vatt.fi/documents/2956369/4541479/wp88.pdf/e5a42951-b75f-4c78-80f7-60e6283a86db/wp88.pdf>

24 Akava Confederation of Unions for Professional and Managerial Staff in Finland: [https://akavaworks.fi/wp-content/uploads/sites/2/2019/06/Asumistuki\\_asuntopolitiikan\\_valineena\\_Soininvaara\\_AkavaWorks\\_raportti\\_20181.pdf](https://akavaworks.fi/wp-content/uploads/sites/2/2019/06/Asumistuki_asuntopolitiikan_valineena_Soininvaara_AkavaWorks_raportti_20181.pdf) (in Finnish)

25 Prime Minister's Office: [http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/161459/28\\_2019\\_Toimeentulotuen%20saajien%20elamantilanne%20asuminen%20ja%20tyonteko.pdf](http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/161459/28_2019_Toimeentulotuen%20saajien%20elamantilanne%20asuminen%20ja%20tyonteko.pdf) (in Finnish, with abstract in English)

26 Kaleva: <https://www.kaleva.fi/uutiset/kotimaa/uusi-asumistuki-on-lisannyt-nuorten-yksin-asumista-yksin-asuminen-yleistyy-nopeasti-kaikilla-suomalaisilla/816967/> (in Finnish)

27 Basic Income Hack: <http://perustulohack.fi/elinkustannuslisa/> (in Finnish)

On the other hand, targeting social security at those on low income can ensure sufficient support for those living alone. Moving forward, basic social security must enable people to live alone, as sharing a home is not always suited for everyone and every circumstance. Neutral support could, on the other hand, promote the development of various, flexible housing solutions.

Personal support utilising household-specific maximum housing costs might be a functional intermediate step in the process. In this case, the system would consider the person's individual income and divide the household's housing costs by the number of adults. The maximum costs of the household divided by the number of adults would be used as the personal maximum costs, with the exception of single parents whose maximum costs would be increased by the number of children as in the prevailing system. However, this mode would also considerably increase the costs and is not a priority in terms of reducing poverty. The key issue in making housing allowance individual is to neutralise the tax advantage of owning a home.

#### **Proposed measures:**

- ▶ Making the general housing allowance individual, instead of household-specific
  - ▶ Correcting the maximum housing costs of municipality groups to better correspond with the differences in housing costs and reassessing their purposeful index. Reviewing the number and size of areas determining maximum housing costs to correspond with the commuter zone or region, for example.
  - ▶ Eliminating the earned income allowance from the general housing allowance and alleviating income testing so that the benefit is cut off at the current income level
  - ▶ Eliminating the deduction right of mortgages
  - ▶ Eliminating charge for financial costs from acceptable housing costs
  - ▶ Increasing housing production in growth centres
  - ▶ Better addressing of the tax advantage of homeowners when calculating housing allowance
  - ▶ Developing housing allowance as part of individual basic social security and improving the integration of housing allowance and earned income
- ▶ Not combining the general housing allowance with the pensioner's housing allowance (separate allowance) in order to develop the general housing allowance as part of the working-age population's social security and taxation without connections to pensioners' social security



# III. Simplifying personal income taxation

Finland uses progressive personal income taxation; the marginal tax rate, in other words the amount of tax paid for additional income, increases alongside the income. As a result, high-income earners pay relatively more taxes than low-income earners, which is considered to be appropriate and fair in the income distribution of a welfare state. Proportional taxation, in other words flat-rate taxation, would mean that the marginal tax rate would be the same for all income brackets, resulting in the same tax rate for everyone. High-income earners also pay more income taxes in this system, however only absolutely.

Personal income tax is collected by two bodies in Finland: the state and municipalities. The municipal tax rate is a flat-rate tax, whereas the state's income tax scale is progressively staggered, starting from zero. As municipalities do not offer a lower tax bracket for low-income earners, various deductions have been implemented over the years, resulting in a situation where the tax for low-income earners is zero up to monthly earnings or about EUR 1,200 (excl. social insurance contributions). Due to the deductions, the personal income tax scale is not as clear or consistently progressive as one might think. However, taxation does not start from zero, as, regardless of the income bracket, each wage earner pays an average of 8.25% in social insurance contributions comparable to a tax. In addition, the employer pays a larger share of social insurance contributions, including most of the pension contribution.

The complex and mutually dependent system of tax deductions makes it difficult to target new tax reliefs or social benefit increases to specific income levels.

The high level of personal income taxation is criticised, as it weakens incentives for work. Better forms of taxation include environmental protection tax, consumption tax and real estate or land tax.<sup>28</sup> In social discourse, there has been increasing attention on the idea of using lighter labour taxation as compensation for the increments of environmental protection taxes required to prevent climate change; the increments also target low-income earners, as the price of necessary commodities, such as heating, food and transport, rises. The current personal income tax scale, however, yields little opportunity for alleviating the taxation of those with the lowest income (under 1,200 per month), as their taxation (with the exception of social insurance contributions) is already at zero.

Tax rates are also impacted by psychological and principled justifications that are, ultimately, a matter of value judgement. Should the marginal tax rate of a person on median income be less than 50%, and what is the highest acceptable marginal tax rate? According to some estimates, the highest marginal tax rate in Finland could be slightly higher than the current level<sup>29</sup>, but this may not serve the principle of alleviating labour taxation.

The question is made harder by the fact that a significant share of labour taxation is hidden from the employee in the form of social insurance contributions paid by the employer. For those earning less than the median income, these are even higher than the actual income tax they are nominally paying and the social insurance contribution.

If a universal share of basic social security, in other words basic income, is adopted, personal income taxation must be reviewed in connection with the said income. The funding of basic income creates high cost pressure which is compensated for in most basic income models with higher income taxes. In that case, it is possible that the nominal tax rate will be higher but the effective tax rate (with basic income taken into account) lower than the current level. In such a system, it is also possible to actually decrease the tax rate of low-income earners, thus increasing their available income. However, the system requires a balance between the nominal and effective tax rate in order to keep them from diverging too far as an excessively high nominal tax rate and, correspondingly, effective marginal tax rate may weaken the incentives for work.

An effectively progressive tax scale enables lighter taxation for low-income earners, potentially helping them find employment. On the other hand, low tax brackets complicate the funding of the system and result in a situation in which even relatively high-income earners may receive social benefits. With a low income, even strictly taxed additional income increases the available funds relatively more than with a high income, which proves that the incentive effects of working are not as straightforward as one might think when simply examining the progression. For this reason, even a relatively high participation tax rate does not hinder functional integration of taxation and social security.

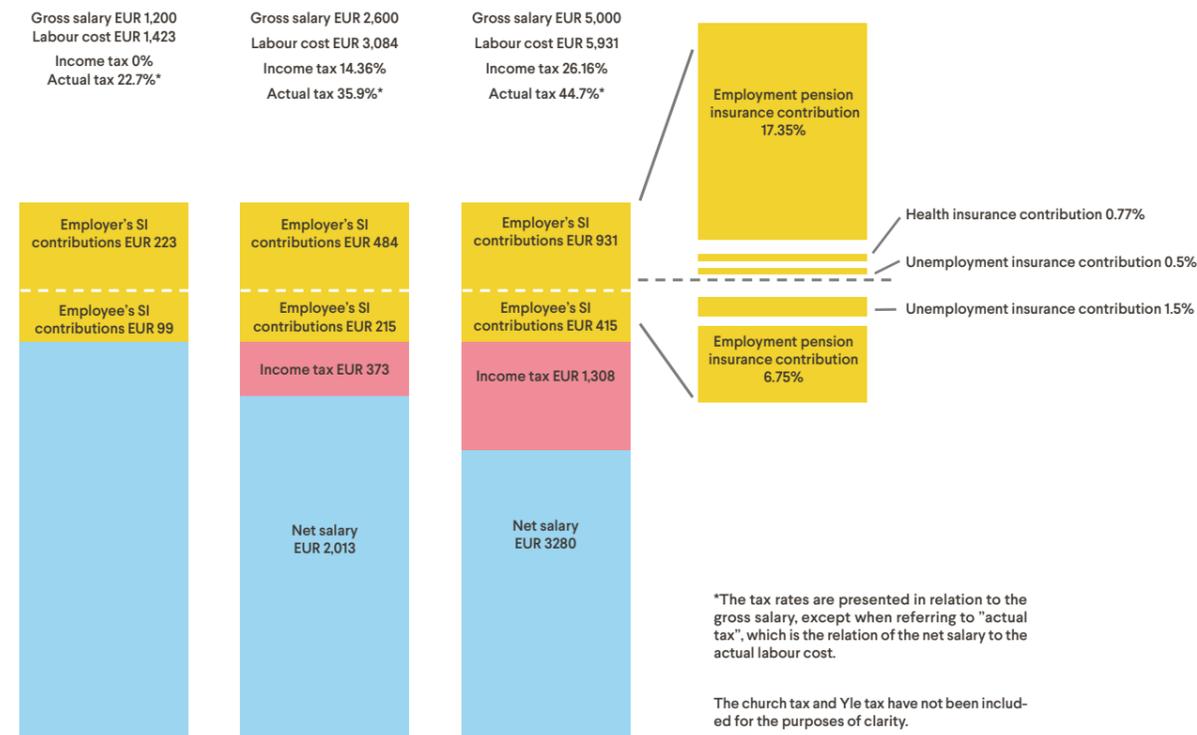
Simplifying personal income taxation would make it easier to integrate it with social security. It may not be important for taxpayers to be able to calculate their own tax rates, but the system and tax progression should be consistent nevertheless. At the present time, the marginal tax rate may fluctuate due to various deductions.

## **Social insurance contributions as part of taxation**

The figure below illustrates how the tax wedge of the Finnish taxpayer consists of both income tax and charges comparable to tax. The actual tax rate is always higher than the nominal income tax. At low income levels, most of the taxes and charges are flat-rate taxes not covered by progression. Therefore, the taxation of a wage earner actually starts at slightly over 20%.

<sup>28</sup> IFS: <https://www.ifs.org.uk/docs/taxbydesign.pdf>

<sup>29</sup> VATT Institute for Economic Research: [https://vatt.fi/artikkeli/-/asset\\_publisher/pitaako-ylinta-tulovero-positiivista-laskea](https://vatt.fi/artikkeli/-/asset_publisher/pitaako-ylinta-tulovero-positiivista-laskea): (in Finnish)



Nominal and actual tax wedge of an employer in different salary brackets

A considerable share of social insurance contributions is paid by the employer. In reality, it does not ultimately matter which party pays the contributions as the funds come from the same pool, increasing the tax wedge of the work. If all the contributions were paid by the employee, the gross salary should similarly be higher while the net salary would remain unchanged. The policy also means that the wage earner is not aware of their actual tax rate. This can be considered to be problematic in terms of the principle of transparent taxation. On the other hand, as some of the taxes are "hidden", it is easier to maintain a high tax rate as there would be great public pressure to significantly drop the tax rate if it was visible. This can also be considered to be an objective, depending on who you ask. To promote transparency in taxation, it would be meaningful to consider recording all the insurance contributions in the wage earner's payslip.

Separate social insurance contributions funding certain parts of social security (employment pension, unemployment security and sickness allowances) complicate taxation and restrict progression. Should social insurance contributions rise, the taxable income is reduced, decreasing the income tax accrual or, correspondingly, creating the need to raise the personal income tax rate.

The payments stem from historical development that has led to the benefits in question being financed through funds. The existence of insurance contributions has been justified on the grounds that only the users of the benefit

in question participate in the contributions. On the other hand, this is a question of social security that is practically under joint and several liability and funded by taxes, whereupon the funding of the benefits is comparable to any other service financed by the welfare state by using tax funds. Moreover, the amount of the said insurance-based benefits does not directly correlate with the paid contributions, as the system is not fully fund-based. The state also pays a fluctuating share of the fund costs. This highlights the system's tax-like nature. In addition, it does not matter whether the contributions are paid by the employer or employee, as stated above.

Social insurance contributions, such as flat-rate tax, make it difficult to extend progression to the lowest income brackets but, on the other hand, this can also be fully compensated for by using basic income. That is why reforming the funding of insurance-based social security is not a priority and, due to its diverse connections to corporations and the distribution of liabilities between the state and municipalities, the reform would be extremely time-consuming. In terms of employment pensions, in particular, the reform would require the reassessment of the entire system's principles, which has been excluded from the scope of this report.

However, there is need to investigate the transfer of the other remaining social insurance contributions as part of the wage earner's personal income tax rate. The national pension contribution was discontinued in 1996,

after which national pensions have been paid from the National Pension Insurance Fund managed by Kela but fully funded by the state. Recent years have featured a similar trend where the responsibility to pay insurance contributions has been transferred to the employee and, finally, to the state. The nursing charge in health insurances is not almost fully funded by the state<sup>30</sup>, and the daily allowance contribution in health insurances has mostly been included in the employee's tax rate.

Eliminating the unemployment insurance contribution would require changes to the funding of the earnings-related unemployment allowance, which would necessitate the reassessment of the principles of the earnings-related system in the direction of the general earnings-related model where any wage earner paying the unemployment insurance contribution would be entitled to earnings-related security, instead of simply those covered by unemployment funds.<sup>31</sup> The current unemployment insurance contribution also contains the risk of falling into the cycle in the event of a recession as the increasing unemployment also increases the pressure to raise the contribution, thus weakening the incentives for work.

Eliminating the insurance contributions would also require an investigation into the status of entrepreneurs in relation to unemployment and health insurance. If the said insurances are voluntary and included in the entrepreneurial risk, there must be a way to either pay or not pay the contributions. This is closely related to the implementation of a combined insurance, where the objective is to facilitate the integration of the wage earner's and entrepreneur's unemployment security. The same applies to the taxation of foreign workforce. However, transferring the responsibility of paying insurance contributions from the employer to the employee does not constitute a problem, even from this perspective.

### Proposed measures:

- ▶ Eliminating the standard deduction for work-related expenses, earned income allowance, labour income tax relief and low-income allowance. Compensating for the change through redefining the tax rates and implementing basic income.
- ▶ Developing personal income taxation alongside social security by reviewing the effective marginal tax rate
- ▶ Recording the employer's social insurance contributions in the employee's payslip
- ▶ Combining social insurance contributions and eliminating them, when possible

<sup>30</sup> Expert consulted: Kela's Chief Actuary Pertti Pykäälä

<sup>31</sup> Ministry of Social Affairs and Health: [http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/161187/Rap\\_47\\_18\\_Kohti%20vakuuttavampaa%20ansioturvaa-netti.pdf?sequence=4&isAllowed=y](http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/161187/Rap_47_18_Kohti%20vakuuttavampaa%20ansioturvaa-netti.pdf?sequence=4&isAllowed=y) (in Finnish, with abstract in English)

# IV. Distribution of liabilities in funding and granting social security

When the party granting a benefit is also the payer of the benefit, the incentive remains to review the functionality of the benefit and aims to reduce the need for the said benefit. At the moment, the benefits in Finnish public administration are granted by the state (Kela) and municipalities. Benefit costs can also be distributed between the two parties with a specified percentage, even if only one party makes the decision on granting the benefit, leaving the “tab open” towards the other party, so to speak.

Due to incentive effects, it is important to assess which level of public administration has the incentive-related opportunity to reduce benefit costs and whether this incentive effect could be increased. Such circumstance-related benefits include need-based social benefits. In practice, the question is, which services and tasks are the responsibility of the state, and which are the responsibility of the municipality or another party more local than the state.

The general housing allowance or the housing supplement in basic income compensates for regionally high housing costs that the area in question can impact, using policies such as zoning and supported housing. Employment policy can also be practised at a local level, as the municipality or the Centre for Economic Development, Transport and the Environment usually manages employment and other social services.

At the moment, municipalities fund some of the Kela-granted labour market subsidy (about 31% in 2017), encouraging the municipalities to promote employment. Moreover, municipalities also fund half of the Kela-granted basic income support (excluding state-funded basic income support for returning migrants and refugees).<sup>32</sup> The other basic social security benefits corresponding to the level of labour market subsidy are not funded by municipalities. This is problematic, as it sets benefits in a mutually unequal position, whereupon the municipality has the incentive to reduce the use of labour market subsidy but not, for example, the costs of sickness allowances. This prevents the harmonisation of the benefits and a fluent, customer-oriented integration of the services. At the moment, municipalities do not participate in the costs of the general housing allowance either.

Many of the current municipalities are too small to manage a larger share of social security costs. In addition, having the state grant (and pay) the benefit helps ensure equal treatment throughout the country.

In terms of managing both housing and employment, as well as social work, a region larger than municipalities but more local than the state would be a natural choice. Commuter zones often consist of several municipalities, and there cannot be excessive variation in the level of

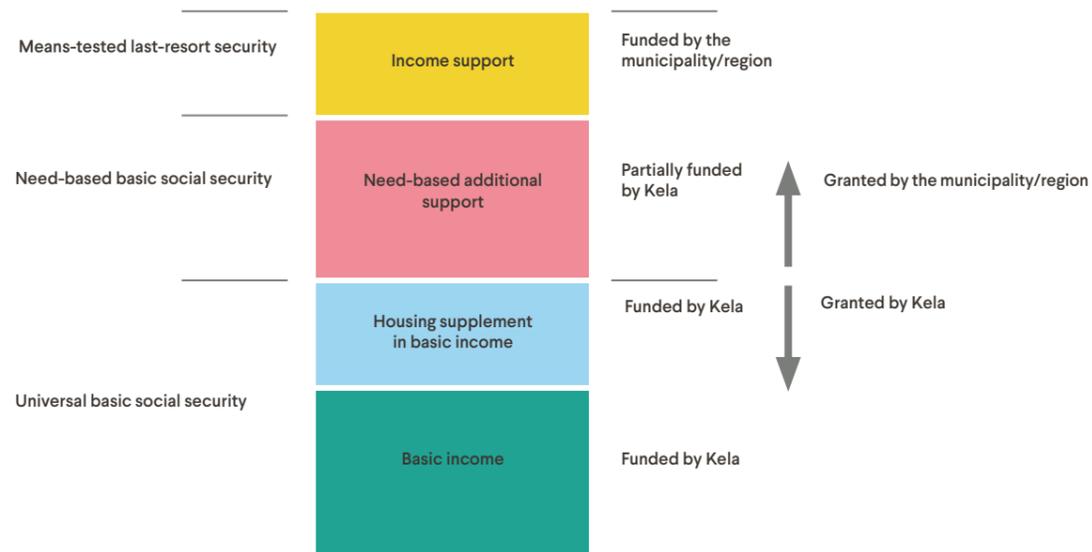
housing allowance within a small area. In addition, such a region would possess a sufficiently large and stable financing base to manage benefit costs and a diverse service system due to its larger population. However, the question of the role of regions in the future is heavily dependent on the planned social welfare and healthcare reform. If a regional government reform is implemented in Finland, creating regional governments with the power to levy taxes, it would be important to assess the extent to which the regions would assume responsibility over the social security system.

From the perspective of the social security recipient, the clearest solution would be to receive the benefits and services from the same place, especially in terms of need-based benefits involving bureaucracy. In this sense, the system will become simpler if the basic amount of income support paid by Kela is replaced with basic income and the remaining system is a supplementary and preventive income support fully managed by municipalities. The clearest solution would be to ensure that social work and employment services were provided by one organ, in other words the municipality or region, as it would be able to better integrate the services with benefit processing and it would have the incentive to find savings in benefit costs. For this reason, the employment services of Public Employment and Business Services should be integrated with the social work of municipalities or the potential new regional governments. In that case, the statements on labour force policy, determining the right to benefits, would not be provided by a third party.

Universal and unconditional benefits covering the entire country should continue to be granted and paid by Kela. The housing supplement in basic income may be granted by Kela in connection with the basic income, even if it is paid partly or in full by the municipality or region, as receiving the supplement does not require a visit to the social welfare office. Need-based benefits requiring means testing and participation and last-resort income support should, in turn, be substantially granted and paid by the municipality or region. The benefit processing and support services or referral to them should be at the same level in order to make the services as accessible as possible. As the management of unemployment is important for the entire country's economy, the responsibility to pay need-based benefits may be divided between the state and the local level. It is important to ensure that both the housing supplement and unemployment and sickness benefits contain some form of local-level payment to increase the incentives to prevent the need for support. On the other hand, the local level does not need to participate in the payment of parenthood benefits as parenthood is not a disadvantage to be prevented through local services.

<sup>32</sup> Expert consulted: Kela's Chief Actuary Pertti Pykälä

### THREE STEPS OF BASIC SOCIAL SECURITY AND THE DISTRIBUTION OF LIABILITIES BETWEEN THE STATE AND LOCAL GOVERNMENT



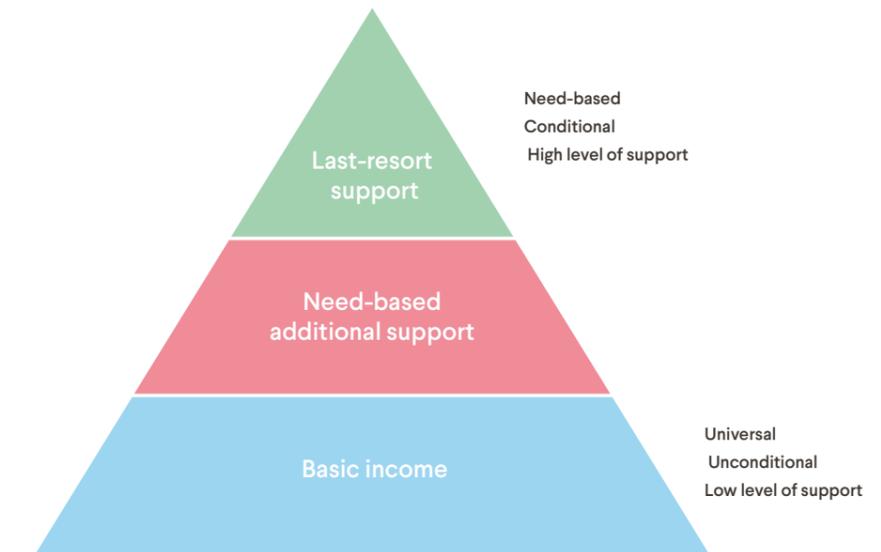
The changes in funding responsibility between the state and municipalities and the reform of income taxation require taking these into consideration in the general transfers to local government.

Should the tax deductions of earned income be eliminated, the state would no longer need to compensate for the accrual of municipal tax lost by the municipalities due to the deductions. On the other hand, the negative income tax model behaves similarly to a deduction, whereupon the state compensates the municipalities for the lost tax revenues. A greater responsibility over paying for social security causes additional costs in the municipalities' economy. However, this is a relatively straightforward calculation as the objective is to ensure that the end result in terms of municipal economy remains unchanged from the current situation. Should the regional government reform and the regions' power to levy taxes be realised, this will cause changes in the distribution of funds between various administrative levels in any case. No matter what happens, the organ granting the benefit or deduction compensates the other parties for the lost tax revenues; in practice, the state pays central government transfers to the municipality or region.

# V. Visio's Basic Social Security 2030 model

Based on the objectives and solutions presented in this report, Green Think Tank Visio proposes a basic social security model as an objective for developing Finnish basic social security in the 2020s. The model is simpler and more comprehensive than the current system and, similarly to the current system, consists of various building blocks. It is a combination of universal and need-based support. The justifications and details of the solutions in the model were discussed in the previous chapters.

Visio's Basic Social Security 2030 model increases the overall level of basic social security from the current situation, considers the diversity of people's circumstances more extensively and makes it easier to integrate social security with earned income. It reduces poverty and the need for income support. Long-term unemployment is managed through comprehensive support services.



### Three levels of social security

The Basic Social Security Model is based on unconditional and universal basic income including a regionally varying housing supplement. If necessary, the basic income provides very modest subsistence, but in practice, most people would need to obtain additional income to cover their expenses in the long term. In other words, unlike high basic income, the model is not predicted to passivate people.

Granted to individuals instead of households, the housing supplement is an unconditional addition to the basic income and its amount varies geographically. Imputed rent cuts back on the housing supplement. The supplement is not paid to young people living with their parents. The housing supplement of families with children is elevated, and co-parenting families, where children alternate between households, are also granted the supplement.

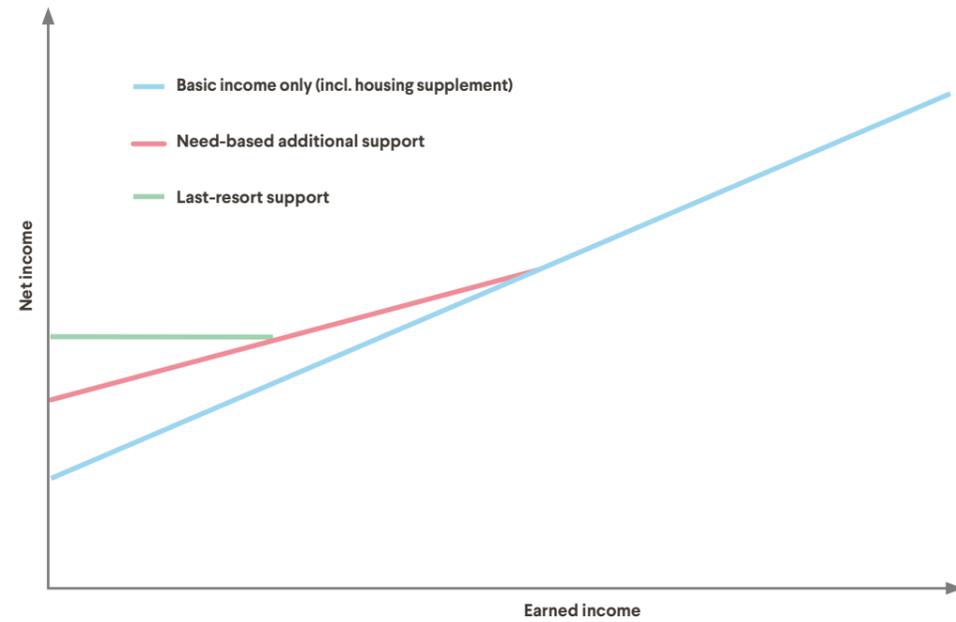
In this model, we propose EUR 400 per month as the basic income level and EUR 100–300 per month as the housing supplement, depending on the area. The basic

income (including housing supplement) can be implemented with the help of a negative income tax. The basic income is integrated with income taxation, whereupon it does not entail separate, strict income testing and the take-home income increases consistently and predictably alongside earned income.

Need-based, conditional additional security is built on top of the basic income when the person becomes unemployed or ill or takes a parental leave. The additional security entails its own income testing which results in the security being discontinued as the income increases. EUR 400 per month could be an appropriate level for the need-based additional security. The earnings-related amount is built on top of this similarly to the current system, for example, earnings-related unemployment allowance on top of basic unemployment allowance.

In addition, last-resort means-tested income support ensures subsistence even in the most difficult and surprising situations in life. Basic income support is replaced with unconditional basic income, whereupon the income support granted by municipalities remains in force.





The figure illustrates the income adjustment of benefits paid on top of basic income.

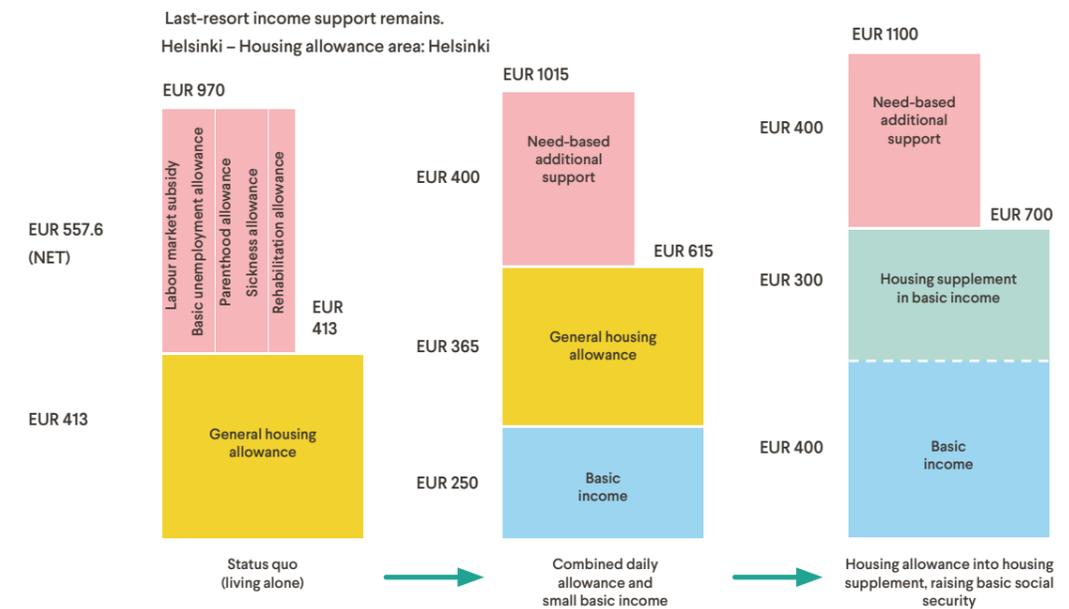
### Customer-oriented services

Compared to the current system, the unemployment support services are more accessible and customer-oriented, regardless of the customer's labour market situation. The necessary services are available regardless of the benefit that the person receiving or whether they are receiving any benefits in addition to basic income. The objective is to comprehensively meet the individual's needs through the services, whether the needs are related to job-seeking, applying for rehabilitation, social rehabilitation, substance abuse treatment, rehabilitation after illness or another reason for unemployment. Participation in services can be added as grounds for receiving need-based security, although this is not an essential part of the model. Services are actively provided to those receiving a need-based benefit, as well as those living on mere basic income in the long term.

### Medium-term model

Visio's Basic Social Security 2030 can be accomplished by adjusting the current Finnish social security and taxation in steps over the next decade. After this, basic social security can be developed towards a more comprehensive basic income-based model, for example, according to the experiences of the reforms and experiments implemented by 2030 and the economical situation at that time. Moving forward, basic social security should be better adjusted to co-function with earnings-related security and the pensions system through the same principles: sustainability, clarity and fairness.

### GRADUAL DEVELOPMENT OF BASIC SOCIAL SECURITY BENEFITS



## First major step: small basic income and streamlined taxation

The calculations in this section were made in cooperation with Mauri Kotamäki, Chief Economist at Finland Chamber of Commerce, according to Visio's outline.

The major changes across various administrative sectors described in Visio's Basic Social Security 2030 model take a great deal of time and preparations and are dependent on economic realities over a long period of time. That is why it would be advisable to implement the reform of social security in manageable pieces that enable future development but can also be considered to be positive accomplishments in and of themselves.

In order to move towards simpler, mutually compatible social security and taxation systems, we must first use the current system to create the necessary structures. The costs of each step to the public economy must also be reasonable in order to be politically viable.

The first structural steps in the development of basic social security:

- ▶ harmonising the current need-based basic social security benefits and making income testing more equitable

- ▶ low basic income that replaces its share of the current basic social security
- ▶ simplifying personal income taxation and integrating it with low basic income
- ▶ increasing the overall level of basic social security

As described in this report, personal income taxation in Finland is complicated and the income available to those on the lowest levels of income cannot be increased by cutting back on the nominal income tax rate. A straightforward solution would be to adopt an income transfer seamlessly functioning with earned income – in other words, basic income. On the other hand, simplifying taxation would result in the elimination of certain tax deductions from the Finnish tax system, which would considerably increase the actual tax rate of those currently paying only the mandatory social insurance contributions. In practice, these factors set a lower limit to the basic income level in order to ensure that the income available to those on low income is not reduced. The attached calculations show that this sum amounts to EUR 250 per month.



A low basic income enables cost-efficient simplification of the tax system and provides a structure for controlled development towards higher basic income. However, a low basic income is already a positive reform in and of itself, as even a low basic income offers additional security for entrepreneurs and the individuals falling through the cracks of the current social security system. It also improves the financial status of employed individuals on low income. The structure of low basic income offers an easy, straightforward solution for reimbursing taxpayers for the rising environmental and consumption taxes. This reimbursement is also known as an environmental tax refund. Moreover, insufficient for subsistence on its own, low basic income is, by its nature, similar to People's Quantitative Easing.

A low basic income might be the easiest solution for experimenting the implementation of a real-time incomes register for automatic income transfers. In that case, the experiment would not cover the entire social security system but a restricted part of the system, thus not disrupting other benefit payments.

The current need-based minimum benefits should be harmonised quickly, especially as a low basic income requires a review of the said benefits in any case. Labour market subsidy, basic unemployment allowance, sickness allowance, parenthood allowance and rehabilitation allowance are to be harmonised in terms of concepts (concepts of income and family) and payment dates. The benefits remain liable to taxation but the determination according to varying benefit dates is replaced with a consistent and clear monthly benefit level.

The benefit does not determine the offered services. The individual can be referred to the necessary services without having to contact a different service provider. Examples of various service needs include job-seeking, vocational training, social rehabilitation, illness, physical rehabilitation, education and training or entrepreneurial coaching.

### Calculating a low basic income

The SISU microsimulation model maintained by Statistics Finland was used in the calculations for the model to discover the impact of the changes on, for example, income distribution and poverty rate, as well as the model's costs to the public economy. In the model, basic income is simulated as a fixed basic income, but a model implemented as a negative income tax would have identical impacts and costs, which is why there is no need to model the said system separately.

As both the social security system and tax systems are complicated with a great deal of mutual dependency, any step towards reform means balancing between

impacts targeted at various population groups, as well as cooperating to fine-tune different variables. It is also clear that if the objective, in addition to simplification, is to reduce poverty at least to some extent and to maintain reasonable labour taxation (and decrease it in the long term), the change will result in costs to public economy. However, the precise optimisation of the variables in social security and taxation enables us to find a model that would simplify taxation, reduce poverty, make the worst income trap more equitable and create a genuine and realistic basic income in Finland. In the model, we only aimed to change the parameters that have the greatest impact in order to prevent the overall picture from becoming excessively difficult to grasp and control as a stepping stone.

Key variables to adjust include the level of basic income, the level of income tax (tax brackets), the level and adjustment rate of minimum daily allowances and the level and adjustment rate of the general housing allowance. The changes to these variables are not distributed evenly and may lead to varying changes in available income. Even if the initial level of an individual benefit or combination of benefits may increase, the higher effective taxation may result in a zero impact or even a negative impact on the income within certain income intervals. That is why it is important to ensure that the available income does not substantially decrease from the status quo in any wage earner or benefit recipient group. The key cases to be examined are the wage earner, the labour market subsidy recipient and the student and the same cases as with the general housing allowance.

In terms of personal income taxation, the tax authorities automatically make four deductions: the standard deduction for work-related expenses, earned income allowance, labour income tax relief and low-income allowance. Eliminating these simplifies taxation but also makes it considerably stricter for low-income earners who are currently not paying any income tax. This also reduces progression. When municipal taxation remains at the same level (average of 19.88% in 2019), the effective tax rate of a wage earner, including social insurance contribution, settles at 26.49% at the minimum (cf. current 8.25%) in relation to the gross salary. This sets the lower limit of basic income at EUR 250 per month, whereupon the added income created by basic income is negated at the income level of about EUR 1,300 per month due to increased taxation.

As the current actual marginal tax and its staggering at different income levels considerably differs from the tax brackets of the national tax due to deductions, the appropriate figures must be redefined in order to ensure that the actual tax rate in the model closely follows the status quo. The objective in the first stages should only be minor changes for median and average-income earners. The effective tax rate should not rise for those earning

less than the average income but, due to the funding of the model, it might be sensible to collect slightly more taxes from high income. This can also be implemented in the highest tax bracket, which is lower than in the current system. The number of tax brackets can be reduced from the current four brackets (excluding zero-tax bracket) to three. Basic income in itself creates progressiveness in the system, whereupon the progression is not actually reduced, even if the variation range of the nominal income tax is smaller than in the current system.

However, an increase of EUR 250 to the maximum level of overall basic social security would be too high and expensive for the public economy. That is why the minimum amount of basic social security benefits and the general housing allowance should be slightly decreased so that the sum of various combinations of benefits slightly rises from the current level. The amounts of different benefits, their income adjustments and fine-tuning the underlying income tax scale enable a model where the effective tax rate remains close to the status quo. In practice, these should be arranged so that the changes in income are positive or non-existent but not usually negative for low-income earners.

However, certain combinations of benefits in the current system mean that the available income increases irregularly and inconsistently alongside earned income. That is why it is acceptable that the income should decrease due to a steadier accrual of income in some cases where, in the status quo, the person is in a more favourable income bracket in terms of taxation when compared to other recipients of the same benefit. This particularly applies to the general housing allowance. A more even accrual of income means a fairer distribution of income between recipients. By accepting the decrease of available income for some recipients, the costs of the model can be kept more reasonable.

The protected income in labour market subsidy has been retained in the model to maintain a low number of changing parameters and to make the model easier to compare with the status quo.

Although this report does not cover earnings-related unemployment allowance, it must be taken into account in the calculations as any changes to the basic unemployment allowance and increasing basic income are also reflected in the recipients of earnings-related unemployment allowance. Increasing the income of this group is not purposeful in the reform. In order to make the change as neutral as possible in this sense, the accrual rate of the earnings-related unemployment allowance must be adjusted. This has a slight effect in evening out the income between those receiving earnings-related unemployment allowance. Otherwise, the nature of the benefit is not aimed to be substantially changed in the model. However, even the smallest changes in earnings-related benefits are politically challenging and require a long process and strong political will.

## Microsimulation parameters for the EUR 250 basic income model

### 1. Personal income taxation

- ▶ Eliminating the standard deduction for work-related expenses, earned income allowance, labour income tax relief and low-income allowance (with the exception of pensioners).
- ▶ New, three-step state income tax scale:
  - EUR 0–1,399 per month → 0%
  - EUR 1,400–2,299 per month → 11%
  - EUR 2,300–3,699 per month → 20%
  - EUR 3,700 per month → 30%

### 2. Basic income

- ▶ Monthly, tax-exempt basic income of EUR 250 paid to each citizen between the ages of 18 and 64 (excluding pensioners)
- ▶ The basic income is not taken into account in the grounds for day care or the general housing allowance

### 3. Labour market subsidy, basic unemployment allowance, sickness allowance and parenthood allowance

- ▶ Amount EUR 560 per month
- ▶ Unemployment security adjustment à 36%

### 4. Earnings-related unemployment allowance

- ▶ The basic amount of earnings-related benefits follows the amount of basic social security
- ▶ First accrual rate of earnings-related unemployment allowance à 38%
- ▶ First accrual rate of increased earnings-related unemployment allowance à 48%
- ▶ Unemployment security adjustment à same as in labour market subsidy

## 5. Housing allowance

- ▶ Reducing maximum housing costs by EUR 60
- ▶ Co-payment formula coefficient 0.42 à 0.29
- ▶ Eliminating the earned income allowance in housing allowance

The calculation is made by using the SISU microsimulation model. The calculation is static; in other words, it does not account for the behavioural impacts following the reform. The materials come from the year 2016 and the model's parameters were deflated to the 2019 level by using the consumer price index.

### Results of the microsimulation

The cost of the model to the public sector is EUR 542 million. In practice, this would require a revision of central government transfers to local government if wishing to retain the current situation of the municipal economy.

Even though the taxation of pensions is, de facto, separate from the taxation of wage earners, both were derived from the same tax scale. For this reason, the changes in income tax as seen in the model are also reflected as increased pension income tax accrual, which is not the purpose of the model. This sum has been neutralised in the calculation. The

taxation connection between these two forms of income should, therefore, be taken into consideration in the reform, aiming to separate them more clearly.

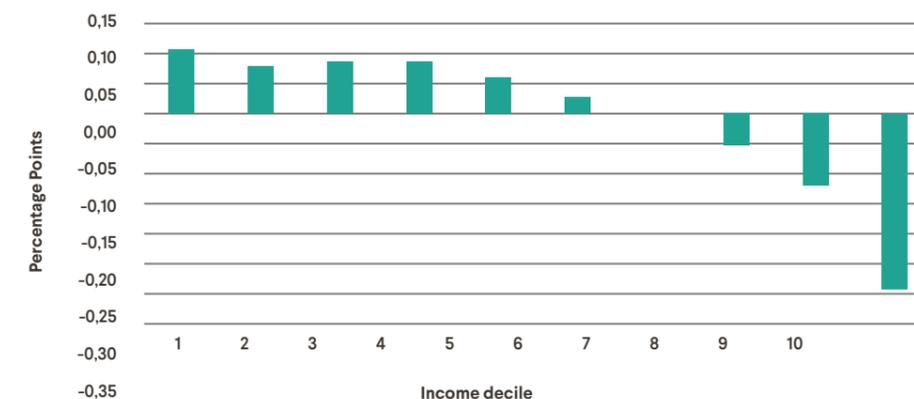
Due to eliminated deductions, the current nominal church tax rates would collect an additional EUR 152 million in taxes. In that case, parishes should decrease their tax rate in order to retain the current level of tax accrual, as the situation would otherwise entail a significant increase in taxes to those liable to pay church tax. However, it is not necessary to include this in the calculation as the church tax is voluntary and the state or municipalities do not decide its amount.

In the model, the Gini coefficient and at-risk-of-poverty rate declined. The number of people with low income (60% of median income) reduced by 23,000. The number of income support recipients was reduced by up to 39%! These are extremely positive results when aiming to battle poverty.

As the social security improvements in the model are targeted at the working-age population instead of children or the elderly, the changes in at-risk-of-poverty rates among these groups seem discouraging. This is partly due to the fact that the median income increases at the overall population level, making the situation relatively worse for these groups, even if the income remains unchanged. Social security targeted at children and the elderly is in need of some changes, but they are not the focus of this report.

TARGET	CHANGE, PERCENTAGE POINTS	CHANGE, INDIVIDUALS
Gini coefficient	-0.6	
Average income	108	
Median income	229	
At-risk-of-poverty rate (60%)	-0.42	-22,950
At-risk-of-poverty rate (50%)	-0.49	-26,895
Child poverty (60%)	0.01	154
Child poverty (50%)	0.46	4,992
Old-age poverty (60%)	0.61	6,978
Old-age poverty (50%)	0.26	3,006
Low-income employed (60%)	-0.51	-11,142
Low-income employed (50%)	-0.36	-7,797
Low-income men (60%)	-0.58	-15,827
Low-income men (50%)	-0.62	-16,786
Low-income women (60%)	-0.26	-7,123
Low-income women (50%)	-0.36	-10,109
Low-income working-age (60%)	-0.92	-30,081
Low-income working-age (50%)	-1.06	-34,893
Income support (households)	-39	-97,527

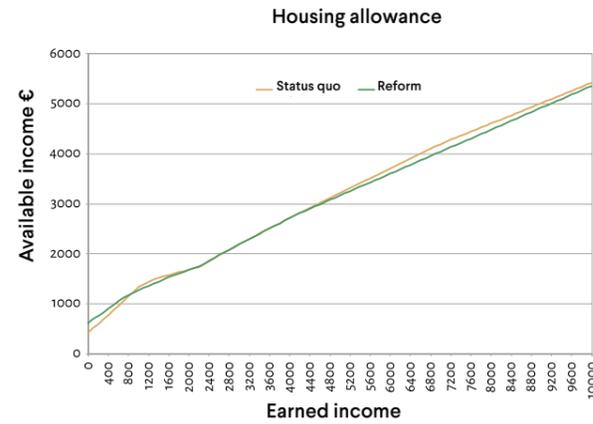
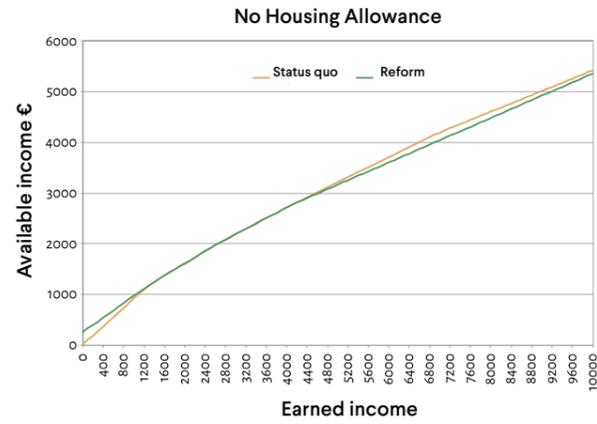
## CHANGE IN SHARE OF INCOME



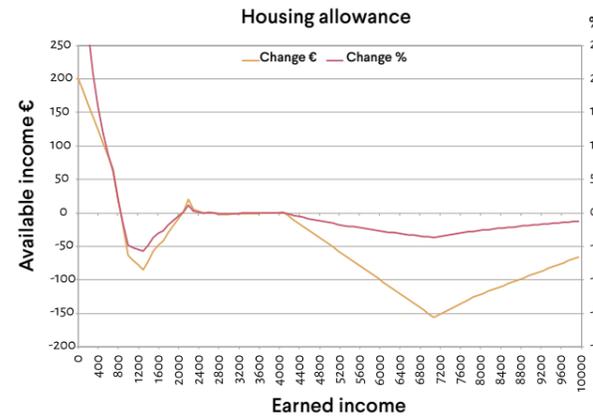
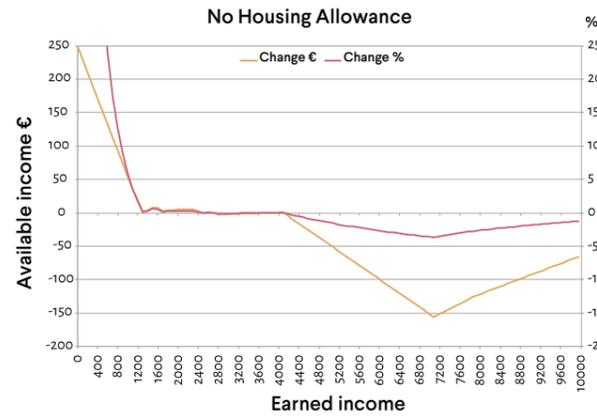
TARGET	COST	
Daily allowances in accordance with the Health Insurance Act total	11	
Unemployment security and educational allowance total	728	
Student grant total	0	
Municipal taxes	-3,088	
Church taxes	-152	
Nursing charges	-31	
State personal income taxes	-3,828	
Capital gains taxes	-9	
Yle tax	0	
Housing allowances total	153	
Day care fees total	2	
Income support	544	
Basic income	-8,707	
Available monetary income, church taxes deducted	-160	
Available monetary income	-312	
Taxes total	7,109	Tax revenues increased
Benefits	739	Benefit cost reduced
Housing allowance, income support, day care fees	699	These costs reduced
Basic income	-8,707	Basic income cost
	-161	Slight margin due to rounding off, etc.
Unemployment security		
Earnings-related unemployment allowance costs, million EUR	-345	Benefit costs reduced
Labour market subsidy costs, million EUR	-313	Benefit costs reduced
Basic unemployment allowance costs, million EUR	-54	Benefit costs reduced
Actual cost (additional pension taxes removed)	-542	

## WAGE EARNER

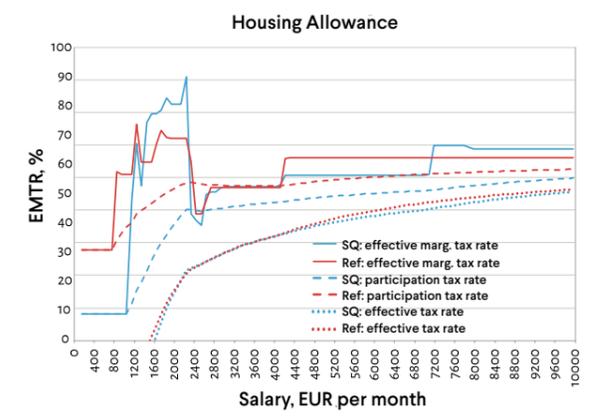
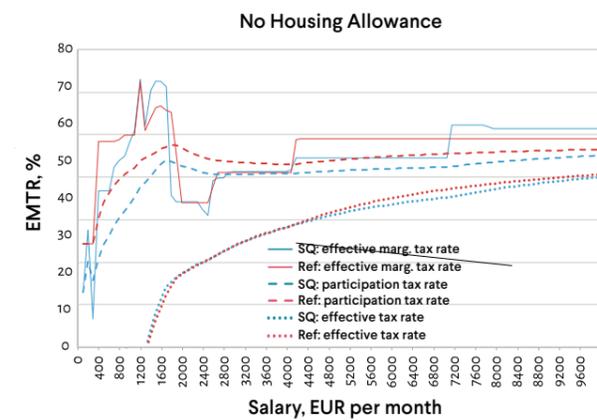
### AVAILABLE INCOME ACCORDING TO SALARY



### CHANGE IN AVAILABLE INCOME

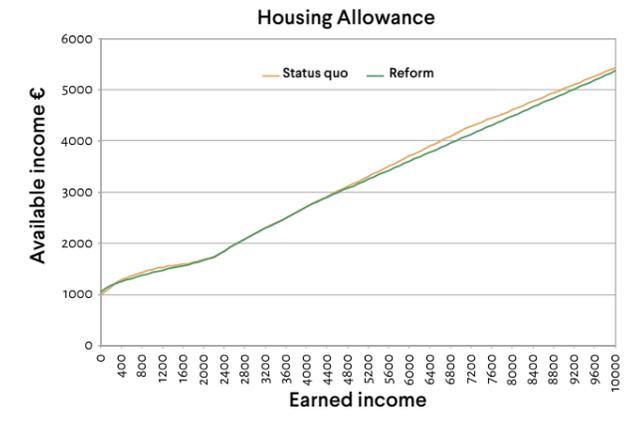
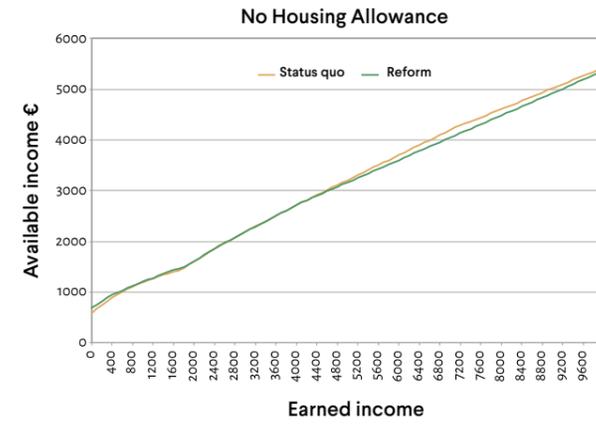


### TAX RATES

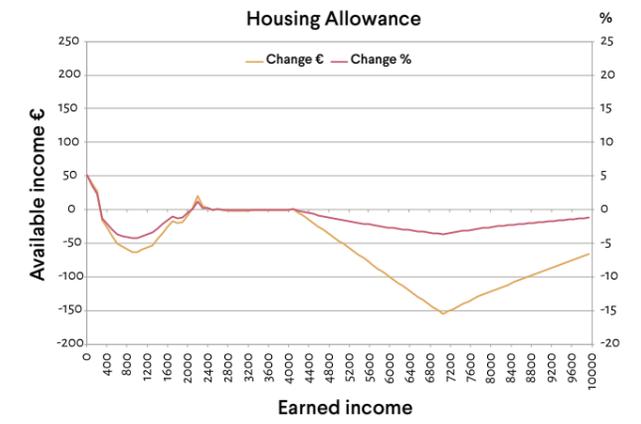
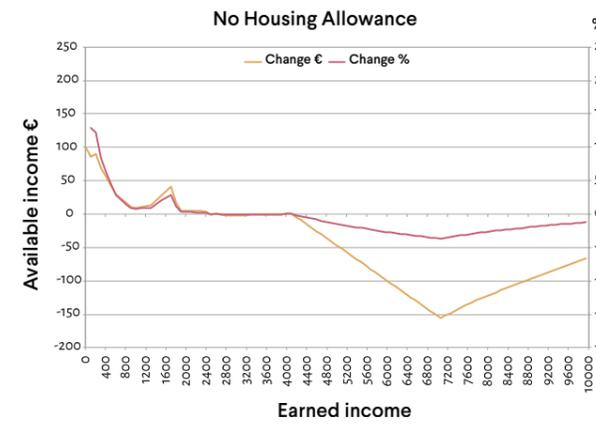


## LABOUR MARKET SUBSIDY RECIPIENT

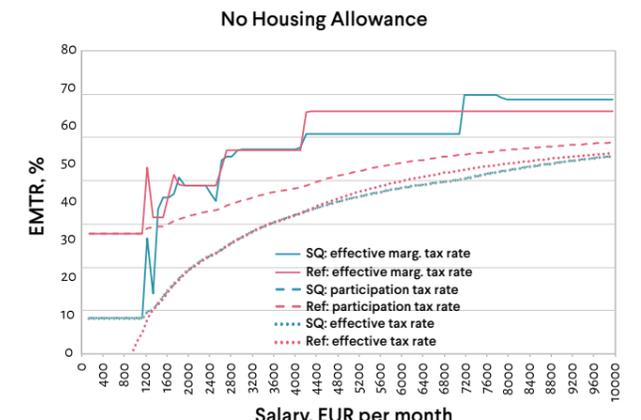
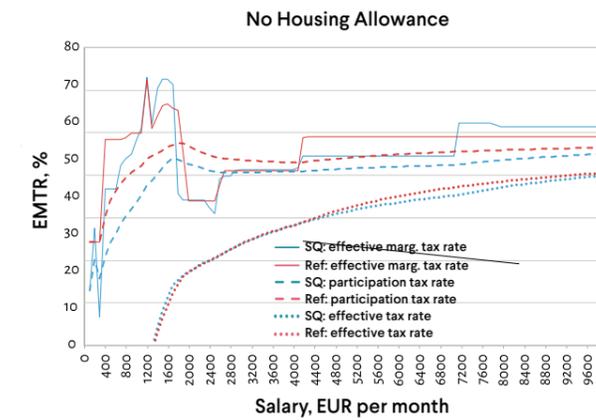
### AVAILABLE INCOME ACCORDING TO SALARY, STUDENT GRANT RECIPIENT



### CHANGE IN AVAILABLE INCOME



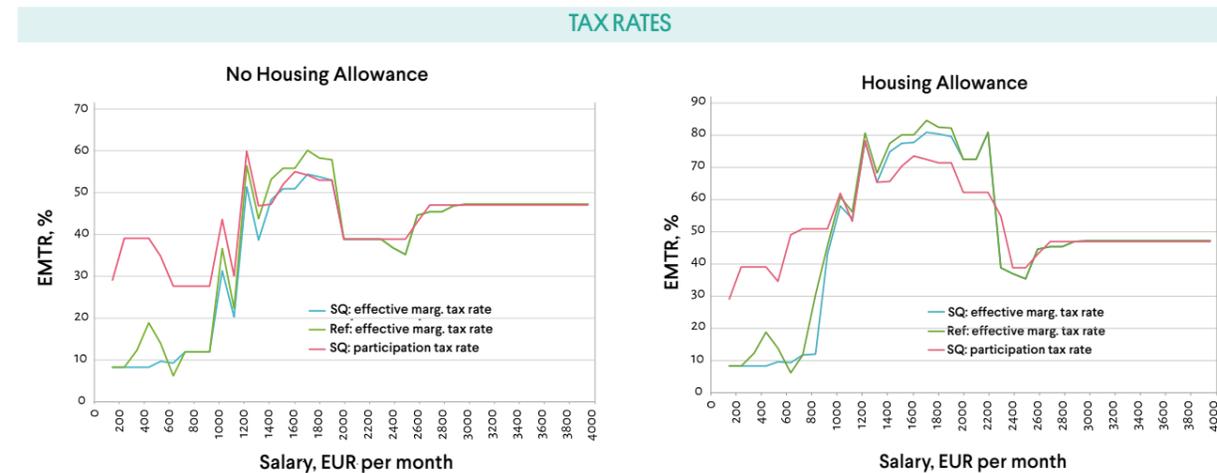
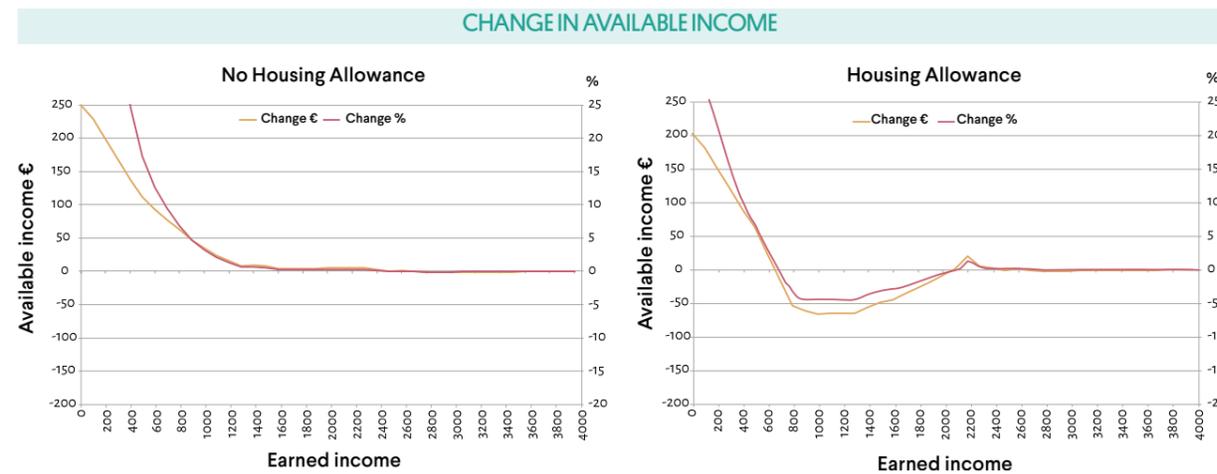
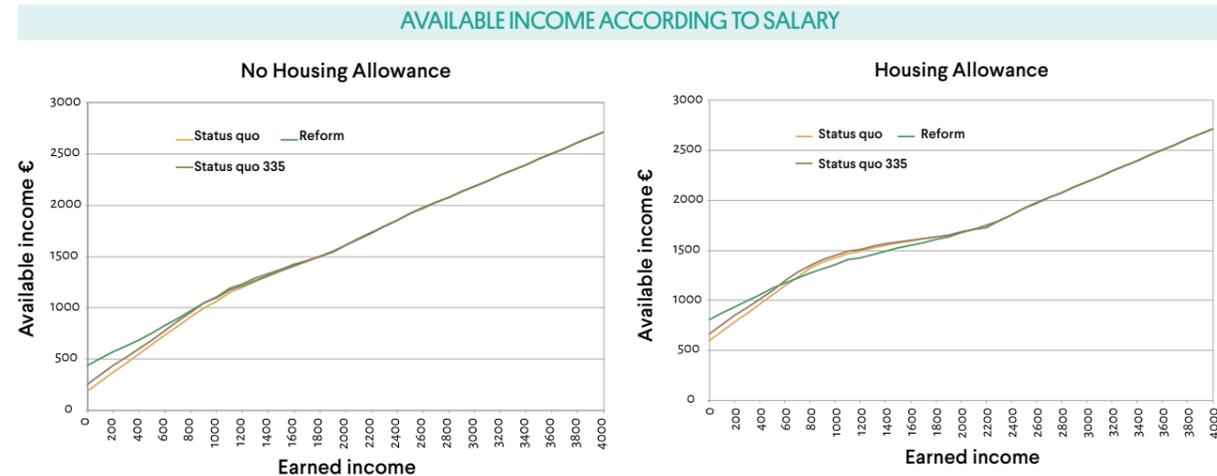
### TAX RATES



## Student

In the simulation, a nine-month student grant corresponding to a typical time spent studying per year was used in the calculations by dividing it across 12 months. For the sake of comparison, in addition to the status quo and the basic income model, we included a version of the status quo with the student grant increased to EUR 335 per month, which has been proposed by various parties in Finland.

Compared to the status quo, low-income students benefit from the system and high-income students lose. In 2017, the median earned income of Helsinki University students was EUR 800 per month.<sup>33</sup>



## Concerning experiments

There has been a great deal of discussion over various experiments, especially in the field of social policy. The concept “experimental culture” describes a new, fresh form of politics. Experiments enable us to test out various innovations and generate research data without committing to specific models. The basic income experiment 2017–2018 is one example of this culture.

possible to create virtual taxation between the test subjects and the tax authorities, whereupon the taxation would be displayed to the test subjects as in the model but the experiment would pay or derive the difference of the tested tax rate and the tax rate required by the tax authorities. Even if such a complicated test setting could be arranged, testing a realistic model would still be challenging due to the reasons stated above and the interpretation of the Constitution.

However, experiments do have some downsides. The Constitution of Finland sets strict restrictions on experiments, whereupon the status of the test group must not grow weaker than that of the rest of the population. Genuine structural reforms in social security mean that there will be winners and losers, even among benefit recipients, meaning that these types of models cannot be tested or the tested model must be made excessively generous (and expensive). Testing a more restricted, technical implementation or services, on the other hand, is possible within the framework of the Constitution. Experiments are also time-consuming. An experiment lasting between 2 and 4 years and the analysing process after the trial period may result in a significant delay in implementing the reform. At the same time, very short or restricted experiments may not yield sufficient information on the dynamic impacts of the reform in the wider scale or the long-term effects.

Therefore, it is important to always consider when experimentation is purposeful and when it would be more advisable to directly pilot or implement the reform in a controlled manner while monitoring its impact. In fact, the majority of decisions in politics is based on advance assessments.

### Low basic income experiment

Implementing the EUR 250 basic income system proposed above requires extensive reforms in the taxation system that are not realistic for mere experimentation. However, it may be possible to test the model by simulating the desired tax model. By testing the model in cooperation with the tax administration, it would be

<sup>33</sup> Student Union of the University of Helsinki: [https://hyy.fi/sites/default/files/avy\\_hyy\\_toimeentulo\\_valmis2018\\_2.pdf](https://hyy.fi/sites/default/files/avy_hyy_toimeentulo_valmis2018_2.pdf)





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