



OECD ECONOMIC SURVEY OF FINLAND 2018

Improving work incentives while safeguarding inclusiveness

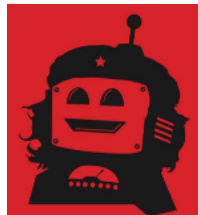


Jon Pareliussen 1 March 2018, Helsinki.



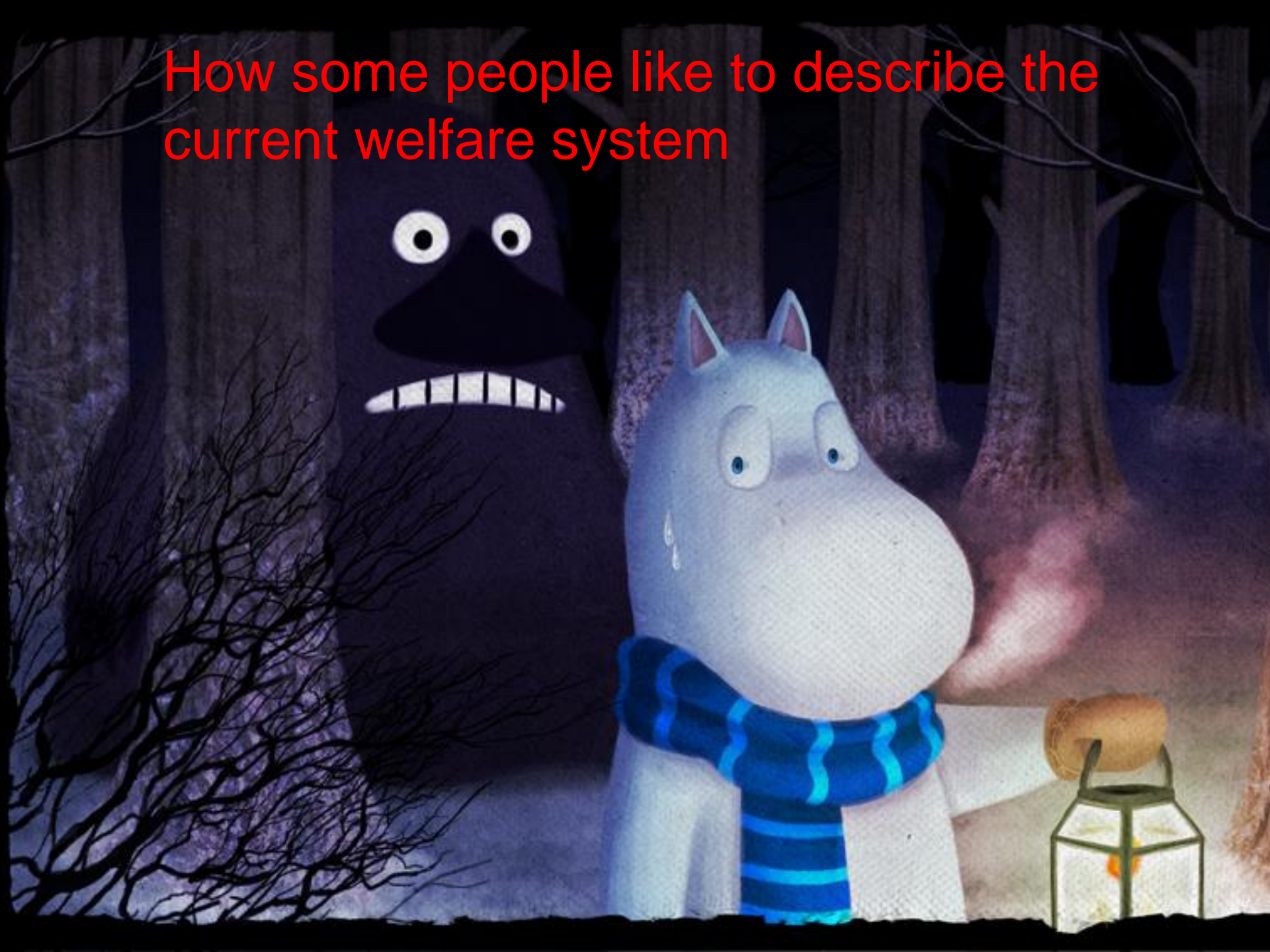
Outline

- Introduction: why reform?
- Benefit reform scenarios to understand current weaknesses and form a vision for the future.
- Findings from the scenarios.
- Survey recommendations.



“If you don't know where you are going, you might wind up someplace else.”
- Yogi Berra

How some people like to describe the current welfare system





Benefit reform scenarios

a uniform benefit

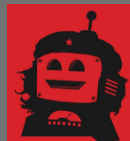
vs

a uniform tapering rule





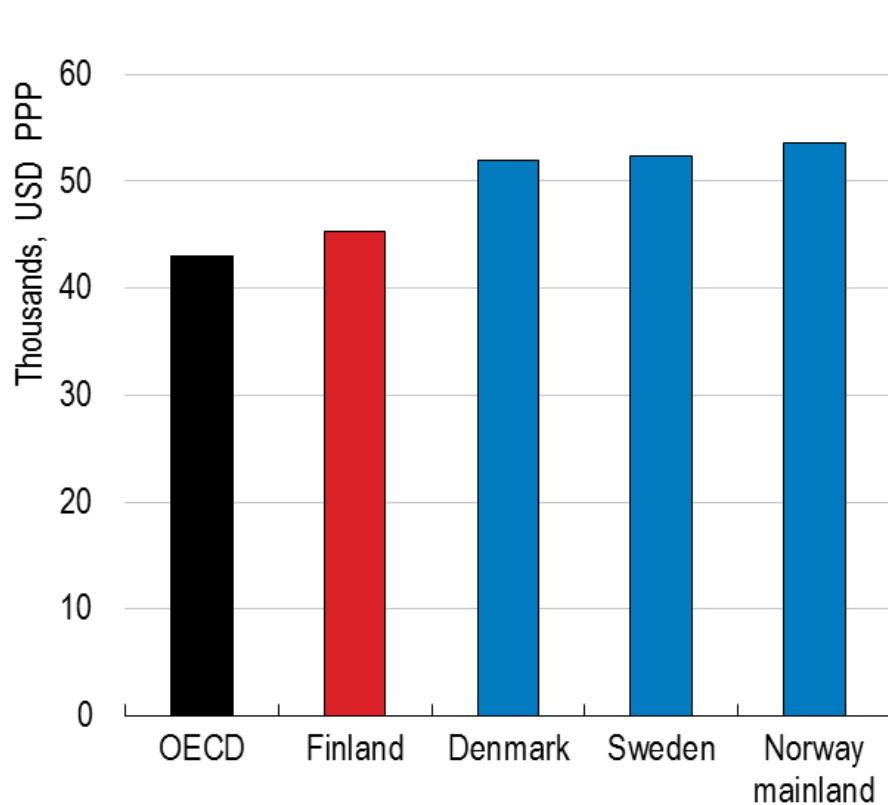
INTRODUCTION: WHY REFORM?



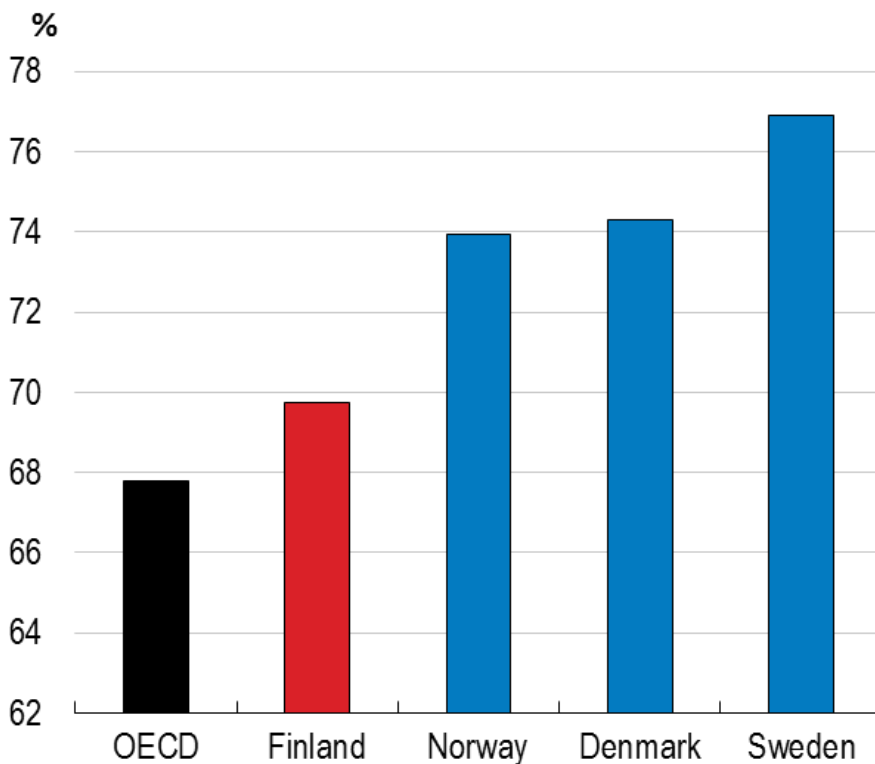


High employment cornerstone in Nordic model, but Finland lags behind other Nordics

A. GDP per capita (2017Q3 or latest)



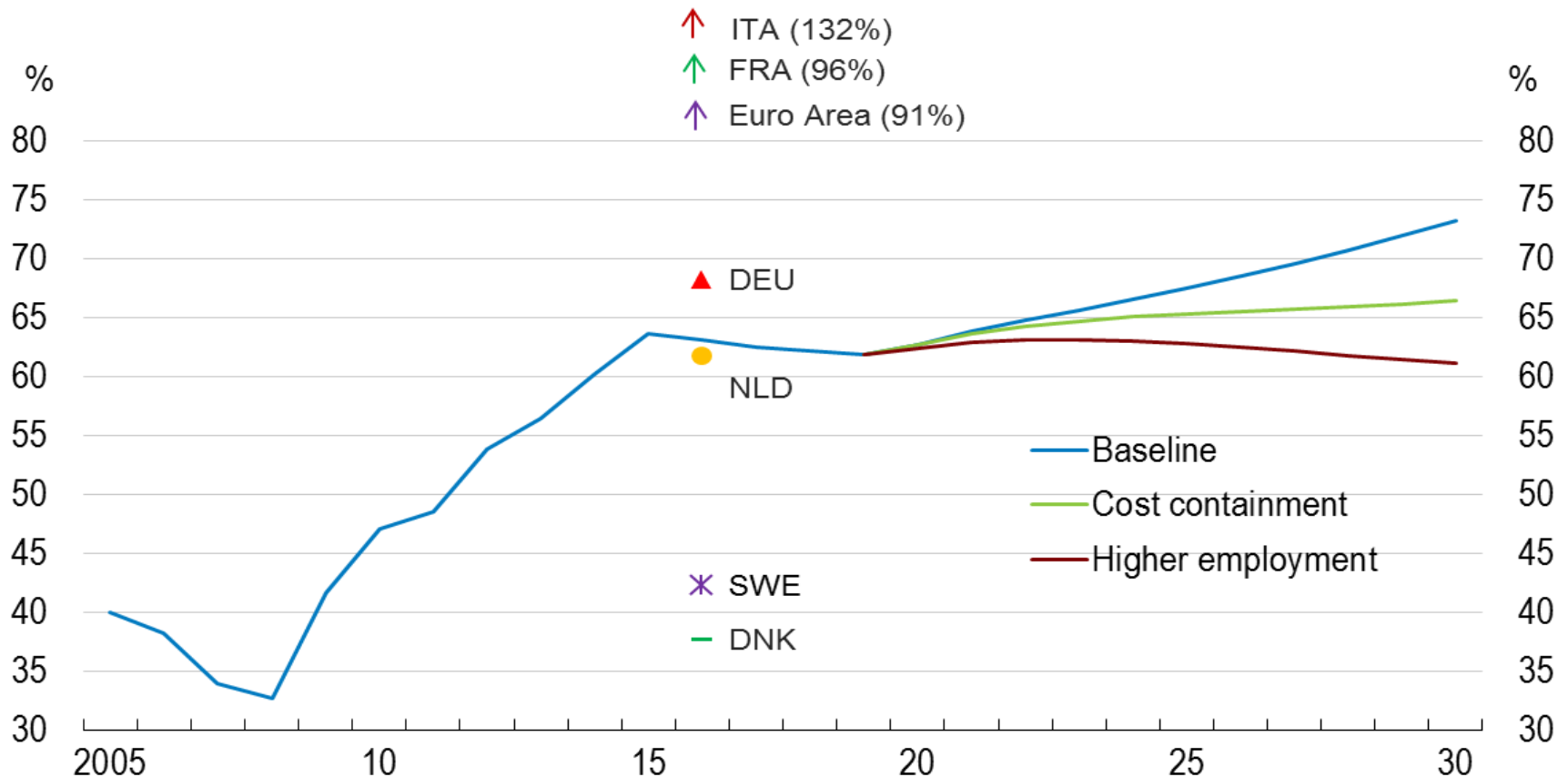
B. Employment rate, aged 15-64 (2017Q3)



Source: OECD Economic Outlook database; and OECD Labour Force Statistics database.



Higher employment important to meet demographic challenge



Note: The cost containment scenario assumes that reforms to the provision of health care and social services reduce growth in related spending by half. The higher employment scenario assumes cost containment in age-related spending and a higher employment rate of the population aged 15-64, which rises to 74% in 2030.

Source: OECD Economic Outlook database and OECD calculations.



The government and social partners have done a lot lately

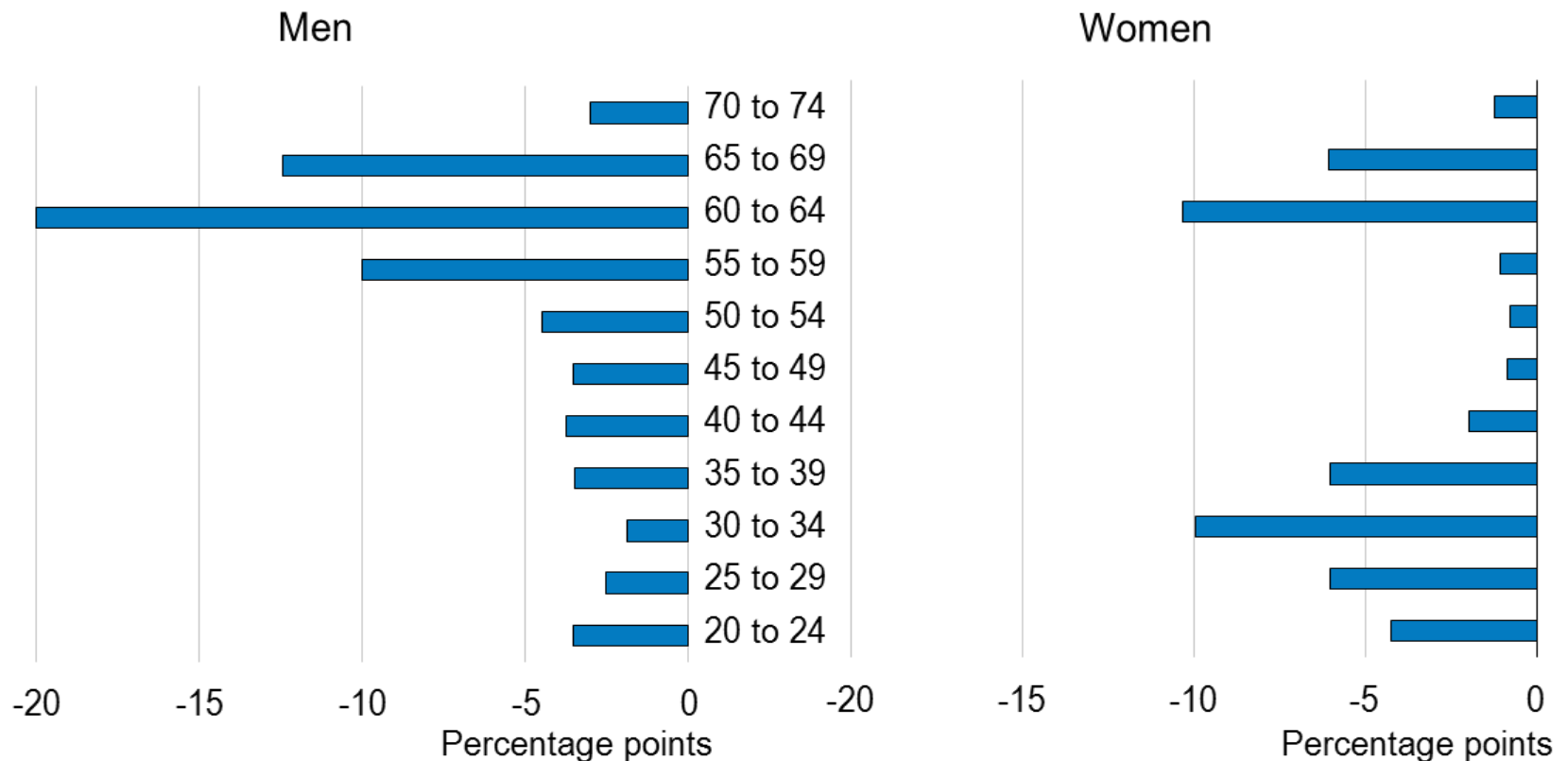
- New wage bargaining model.
- Reducing unemployment insurance duration.
- Job search requirement and new activation model
- Extended trial period for new hires.
- Education reform.





But incentives, complexity and the future of work calls for further benefit reform

Employment gap to Nordics (2016)¹



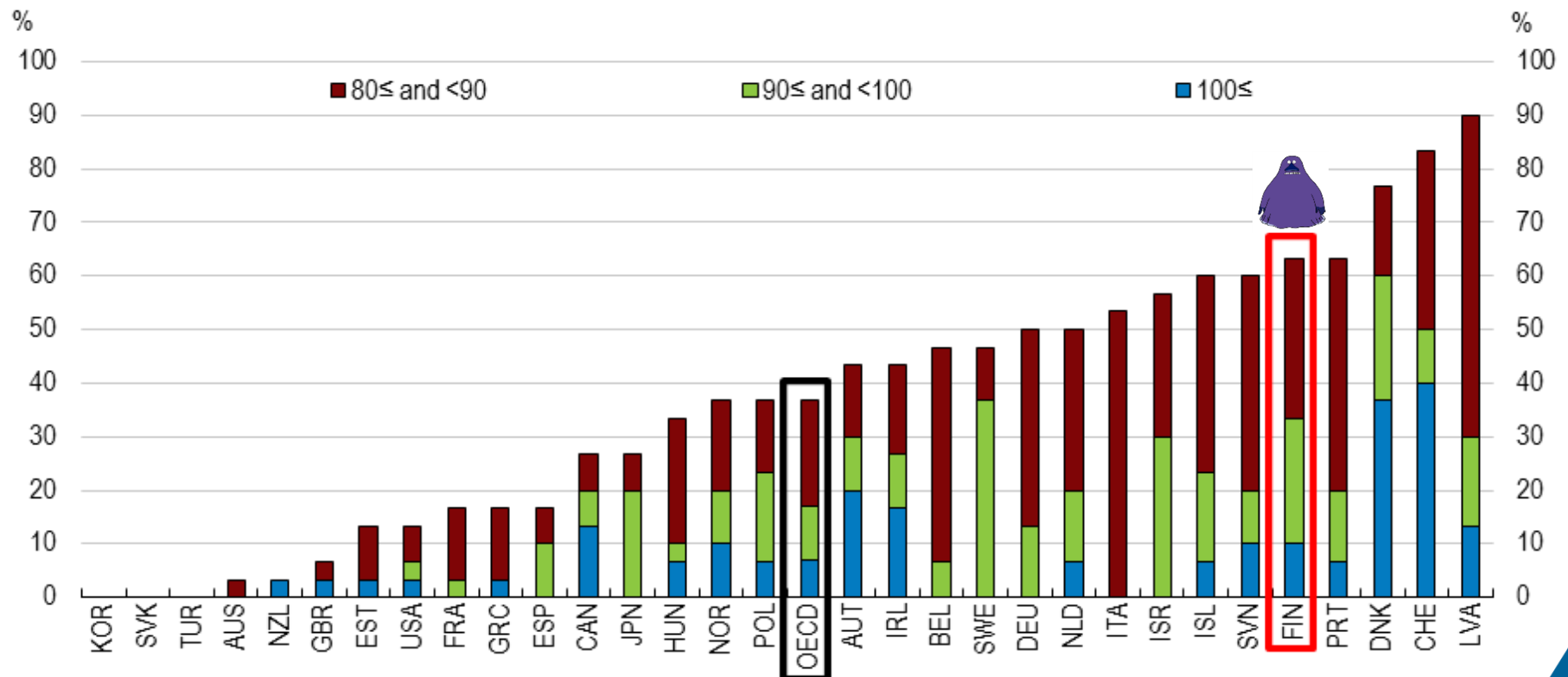
1. Difference in employment rates between Finland and the Nordic average (Denmark, Norway, and Sweden), within each age-gender sub-group.

Source: OECD Labour Force Statistics Database.



Incentives can be weak in the current system


% of modelled households facing high average effective tax rates when transitioning from unemployment to full-time work (synthetic indicator).



Note: Average effective tax rates are modelled in the OECD TaxBen model for six stylized household types and for five income levels: 33%, 50%, 67%, 100% and 150% of national average wage. Households with children are assumed to have two children aged four and six.



A complex welfare system reflects complex individual situations

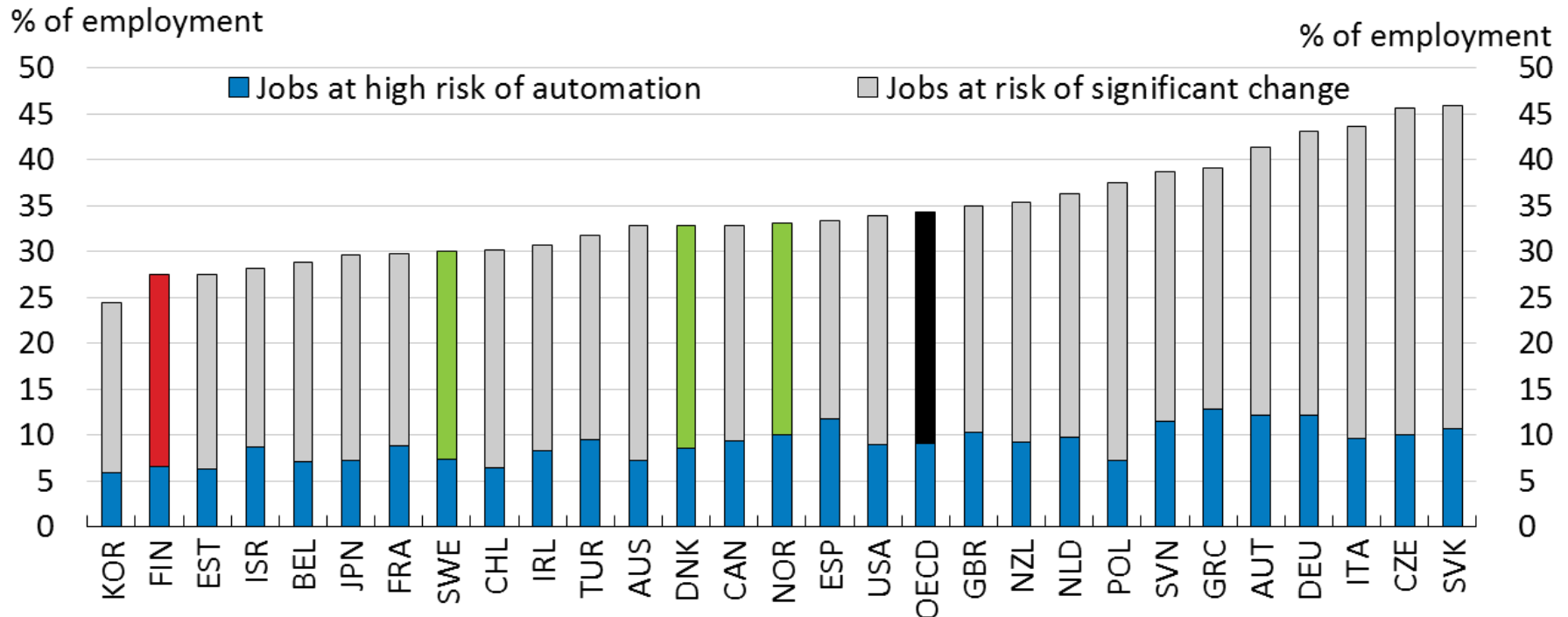
Current system		
Benefit / fee	Programme description	
Family benefit	Child and lone parent (lump-sum)	Lone parent child maintenance allowance
		Lone-parent supplement to child benefit
		Child benefit
	Childcare benefit	Homecare allowance
		Homecare supplement
		Municipal homecare supplement
Unemployment benefit	Labour market subsidy	
	Basic unemployment insurance	
	Income-related unemployment insurance	
Social assistance	Basic and household related amount	
	Housing supplement	
Housing benefit	Housing allowance	
Childcare fee	Income related	
	Floor and ceiling	

- Each benefit has a tapering rule reducing the incentive to work.
- These rules interact in complex ways, compounding disincentives.
- May also cause “bureaucratic traps”.



A changing world of work calls for more streamlined and flexible solutions

The risk of automation in OECD countries

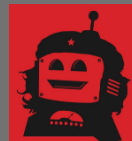


Note: Based on the analysis of the task content of individual jobs using the OECD Adult Skills Survey (PIAAC). Jobs are at high risk of automation if the likelihood of being automated is at least 70%. Jobs at risk of significant change are those with the likelihood of being automated estimated at between 50 and 70%. For more details, see OECD Employment Outlook 2017.

Source: OECD Labour Force Statistics database; and OECD Employment Outlook 2017, OECD Publishing, Paris.



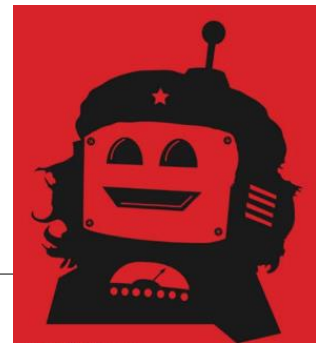
BENEFIT REFORM SCENARIOS: UNDERSTAND THE PRESENT TO PLAN FOR THE FUTURE





Basic income


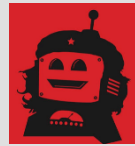


– a universal benefit for all



- Basic income high on the agenda, a limited trial is ongoing in Finland.
- Already OECD work on the subject.
- Consistency problems unmasked with microsimulations:
 - Social welfare trilemma between incentives, inclusiveness and fiscal cost.
 - Can a basic income both fix incentives and be inclusive when taking cost into account?



Summary of the scenarios

Current system			Basic income scenario	Universal credit scenario		
Benefit / fee	Programme description					
Family benefit 	Child and lone parent (lump-sum)	Lone parent child maintenance allowance	Family benefit (lump-sum)	Family benefit (lump-sum)		
		Lone-parent supplement to child benefit	 Basic income + increased income taxation		 Universal credit	
		Child benefit				
	Childcare benefit	Homecare allowance				
		Homecare supplement				
		Municipal homecare supplement				
Unemployment benefit	Labour market subsidy			 Universal credit		
	Basic unemployment insurance					
	Income-related unemployment insurance					
Social assistance	Basic and household related amount →					Social assistance
	Housing supplement					
Housing benefit	Housing allowance		Housing benefit			
Childcare fee	Income related		Childcare fee		Childcare fee (lump-sum)	
	Floor and ceiling					



Universal Credit

-a universal tapering rule

Make
work pay!




Welfare
that works!



- Merge benefits into one and withdraw them at one single and moderate rate.
 - Removes benefit interactions.
 - Increases transparency.
 - Improves incentives.
 - Keeps targeting (and hence income distribution) as in the current system.
 - Limited fiscal cost.
- Technically more demanding than a basic income.

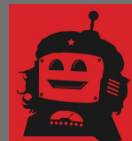


Summary of the scenarios

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Family benefit 	Child and lone parent (lump-sum)	Lone parent child maintenance allowance	Family benefit (lump-sum)	Family benefit (lump-sum)		
		Lone-parent supplement to child benefit	 Basic income			
		Child benefit				
	Childcare benefit	Homecare allowance		Basic income		
		Homecare supplement				
		Municipal homecare supplement				
Unemployment benefit	Labour market subsidy					
	Basic unemployment insurance					
	Income-related unemployment insurance					
Social assistance	Basic and household related amount		Social assistance	Taper rate 65% of earnings after tax		
	Housing supplement					
Housing benefit	Housing allowance		Housing benefit			
Childcare fee	Income related	Childcare fee	Childcare fee (lump-sum)			
	Floor and ceiling					

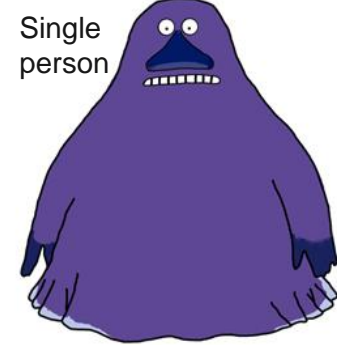


FINDINGS FROM THE SCENARIOS



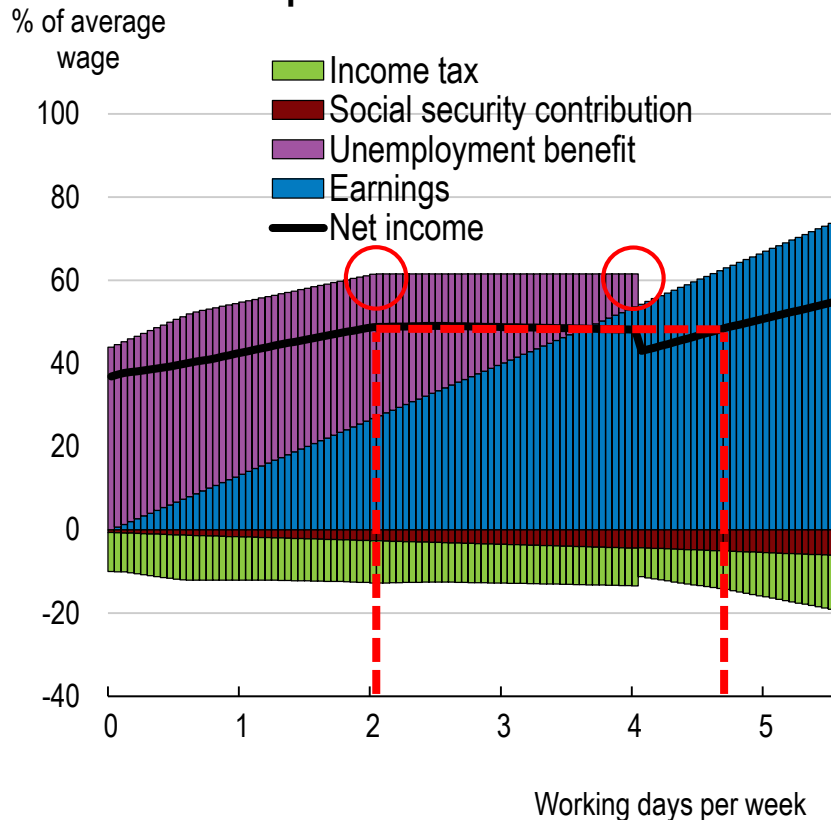


Unemployment insurance rules create disincentives

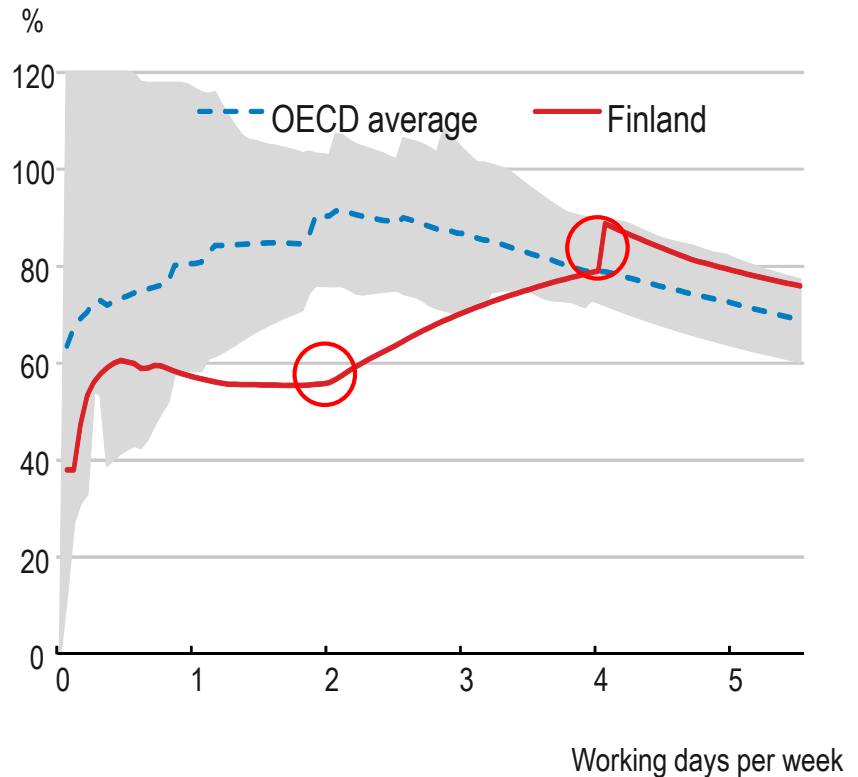


- 100% cap (unemployment insurance and earnings combined).
- Cliff-edge loss of unemployment benefits when working more than 80%.

Decomposition of net income



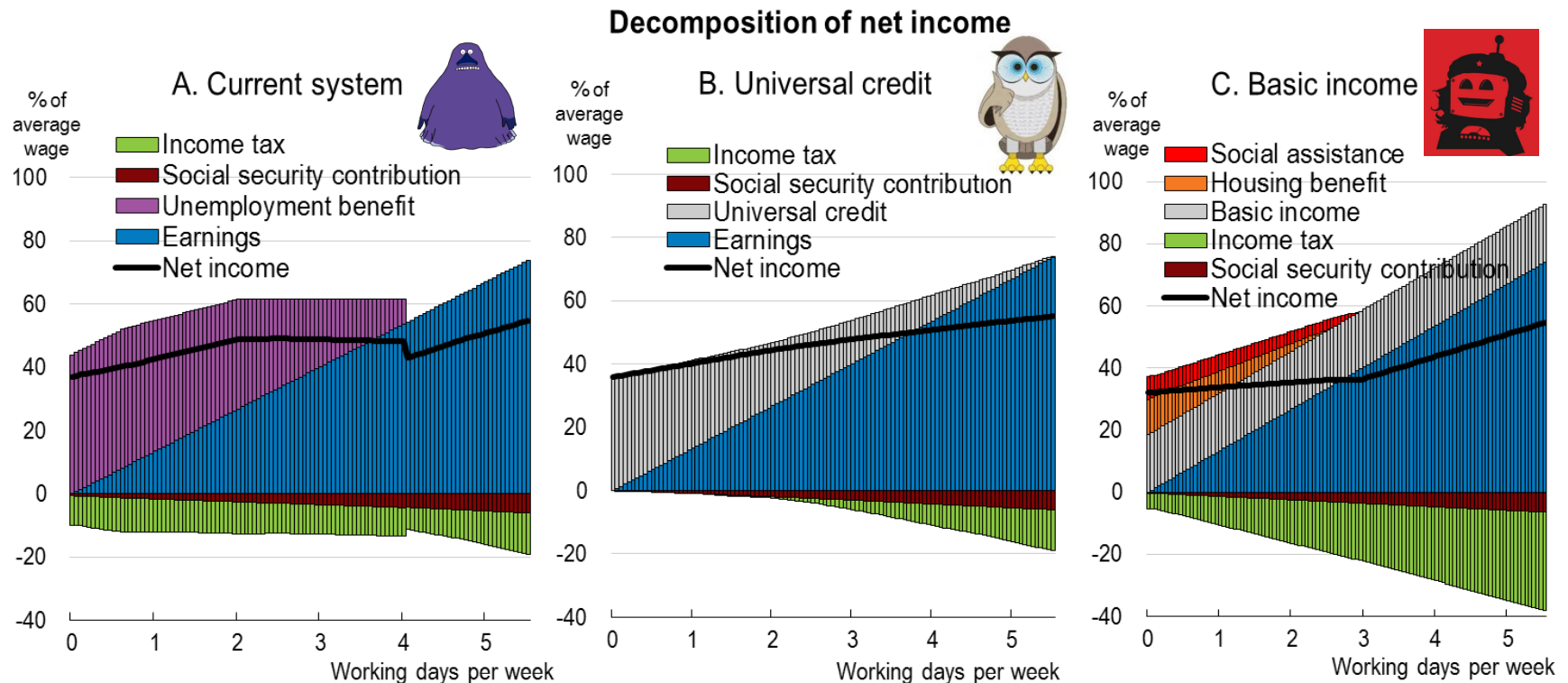
Average effective tax rate



Note: Simulations based on the OECD TaxBen model. The shaded area denotes the range between the 25th and the 75th percentile in the OECD area. A single person entitled to unemployment insurance. Extreme negative and positive rates have been capped at -20% and 120%.



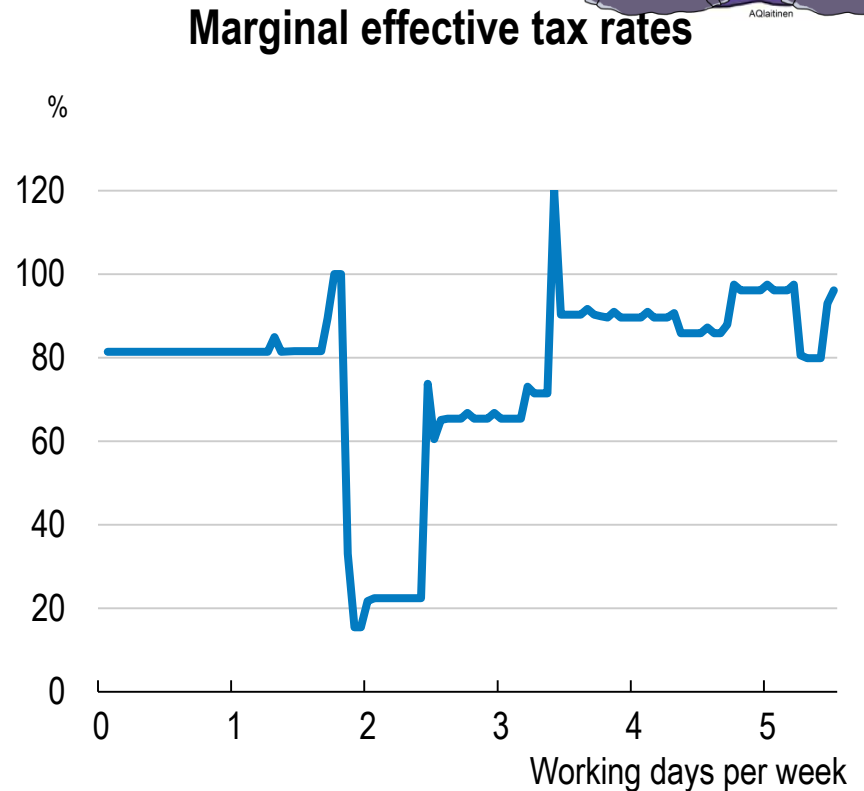
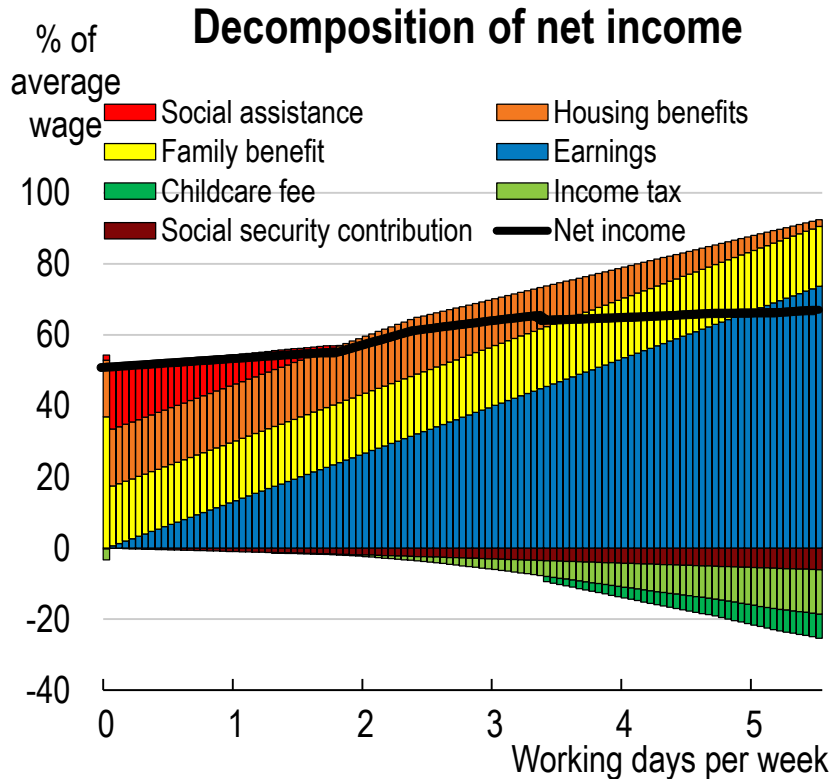
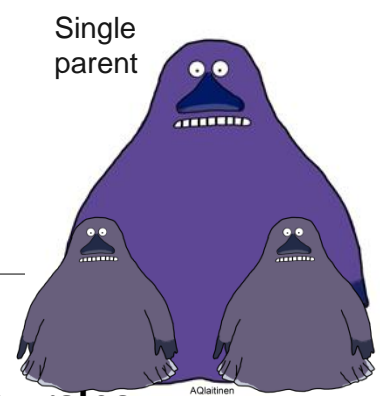
Unemployment insurance rules create disincentives - solutions



Note: Simulations based on the OECD TaxBen model. A single person entitled to unemployment insurance.



Complexity compounds disincentives



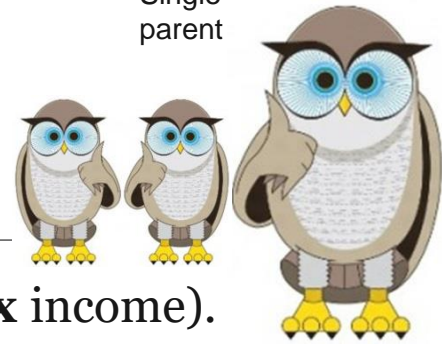
Complex interactions between different benefits and income taxation create incentive traps.

Note: Simulations based on the OECD TaxBen model. A lone parent not entitled to unemployment insurance. The different benefits apply different income definitions and different tapering rules. Social assistance is tapered at a rate of 80% of net income up to a threshold. The housing benefit has relatively complex tapering rules translating to a taper rate of approximately 34% of gross household income. The childcare fee is calculated on the basis of household income.

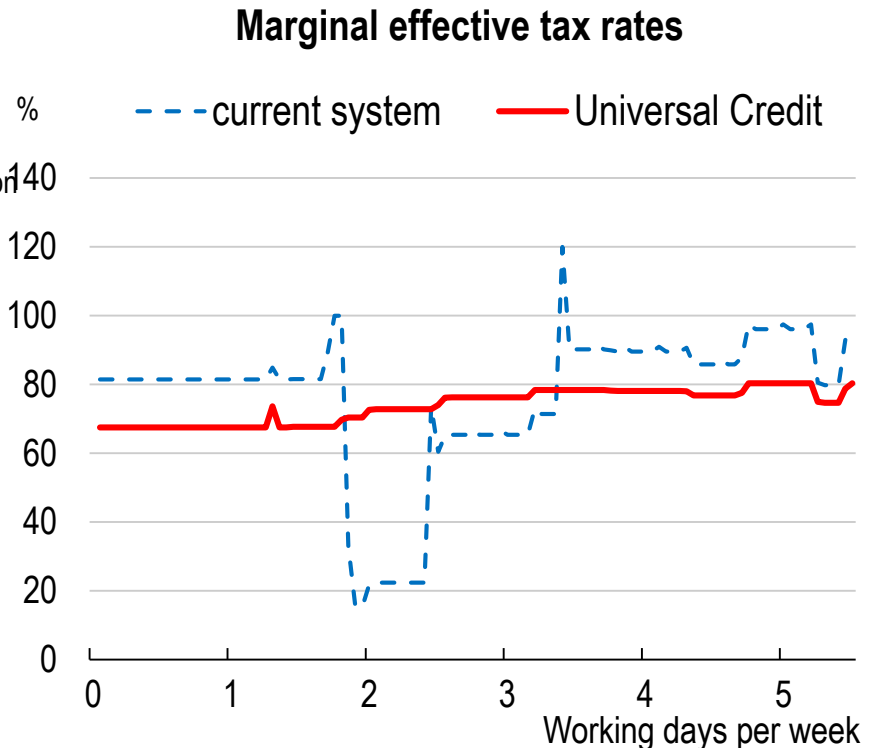
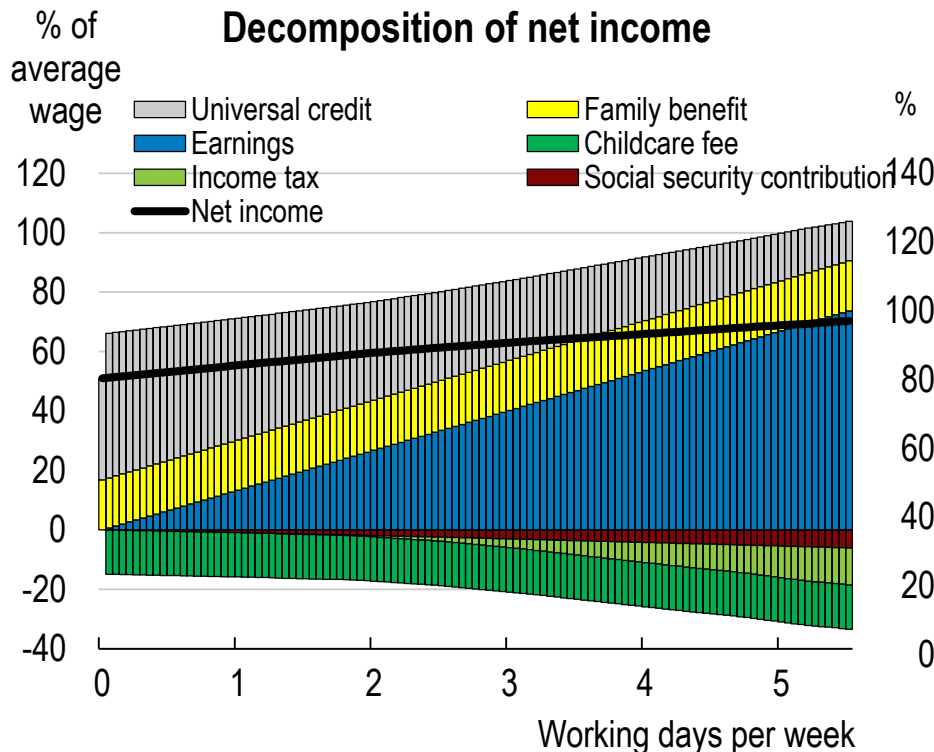


Complexity compounds disincentives - solution

Single parent



- Only one tapering rule in the universal credit (65% of **after-tax** income).




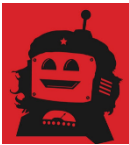




In other words, the net gain from working will be 35 cents of each euro earned after tax. Tapering on after-tax income secures by design that the marginal effective tax rate never exceeds 100%.

Note: Simulations based on the OECD TaxBen model. A lone parent not entitled to unemployment insurance. Extreme positive rates have been capped at 120%.



Both scenarios enhance incentives, universal credit more consistently (1)

Comparative average effective tax rates – unemployment insurance


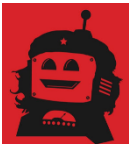


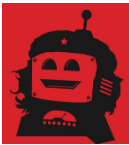

	Going back to work full time with 100% of previous earnings			Going back to work full time with 80% of previous earnings		
Scenarios Household type						
Single	79.1	72.0	73.4	89.4	78.3	72.2
Single parent	97.7	86.2	73.4	99.5	91.4	72.2
Single earner in childless couple	86.5	68.2	73.4	90.3	73.6	72.2
Single earner in couple with children	88.3	74.4	73.4	93.8	81.3	72.2
Second earner in childless couple	74.6	43.9	64.8	83.7	43.2	71.5
Second earner in couple with children	102.0	66.1	73.4	118.0	71.0	72.2

Note: Simulations based on the OECD TaxBen model. Previous earnings 67% of national average wage. Households with children are assumed to have two children aged two and five.



Both scenarios enhance incentives, universal credit more consistently (2)

Comparative average effective tax rates – no unemployment insurance

	Going into half-time work			Going into full-time work		
Scenarios Household type						
Single	87.6	87.9	69.1	72.0	72.0	72.0
Single parent	67.6	92.5	69.1	77.1	86.2	73.4
Single earner in childless couple	87.6	87.9	69.1	86.5	68.2	73.4
Single earner in couple with children	87.6	87.9	69.1	80.6	74.4	73.4
Second earner in childless couple	11.6	41.9	11.6	24.0	43.9	24.0
Second earner in couple with children	89.4	86.3	56.0	66.6	66.1	46.3

Note: Simulations based on the OECD TaxBen model. Potential earnings 67% of national average wage. Households with children are assumed to have two children aged two and five.



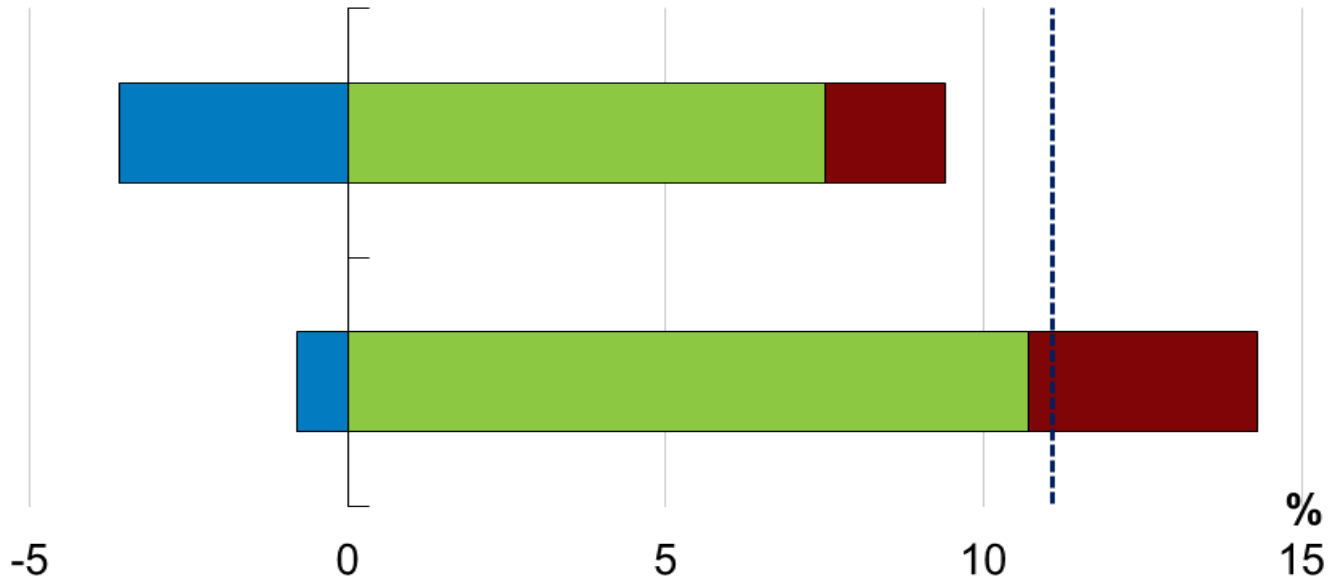
Basic income increases poverty while universal credit reduces it (1)

Inflows to and outflows from poverty

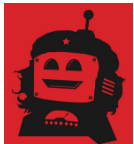
■ Poor before and after
■ Moving out of poverty
■ Moving into poverty
--- Current poverty rate



Universal credit



Basic income



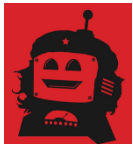
1. Percentage change compared to pre-reform disposable income within each income decile.
2. Share of individuals in working-age households.

Source: Simulations with the TUJA model.



Basic income increases poverty while universal credit reduces it (2)

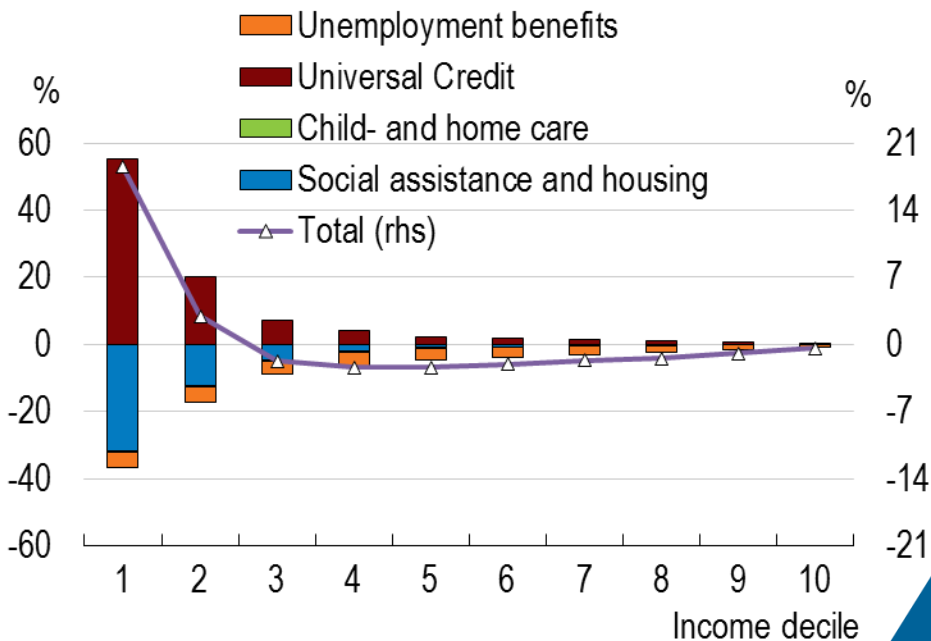
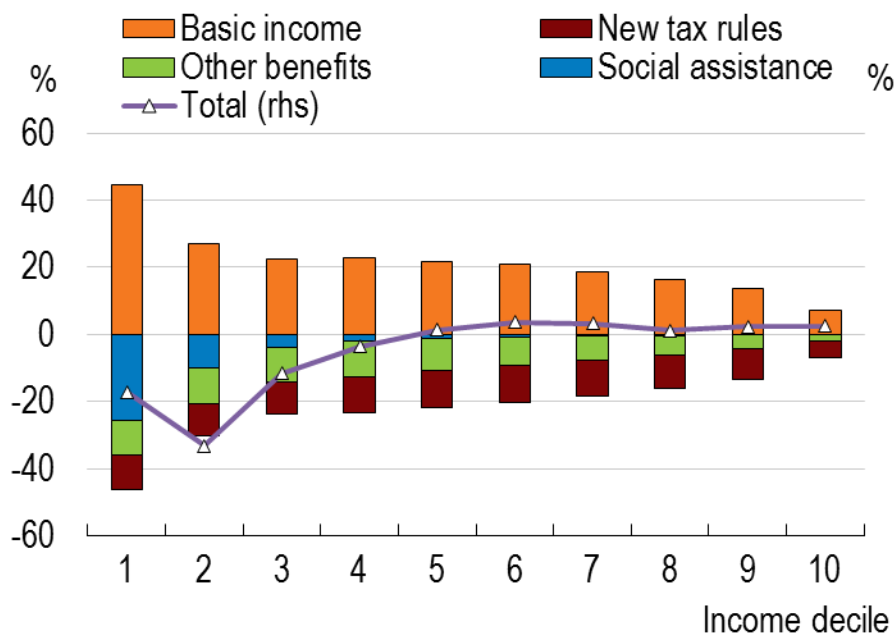
Changing disposable incomes under benefit reform scenarios¹



A. Basic income



B. Universal credit



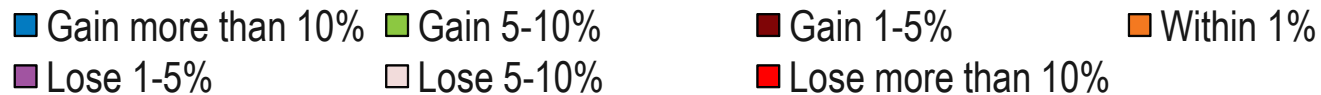
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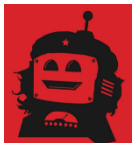
Basic income leads to profound redistribution of income

Gainers and losers

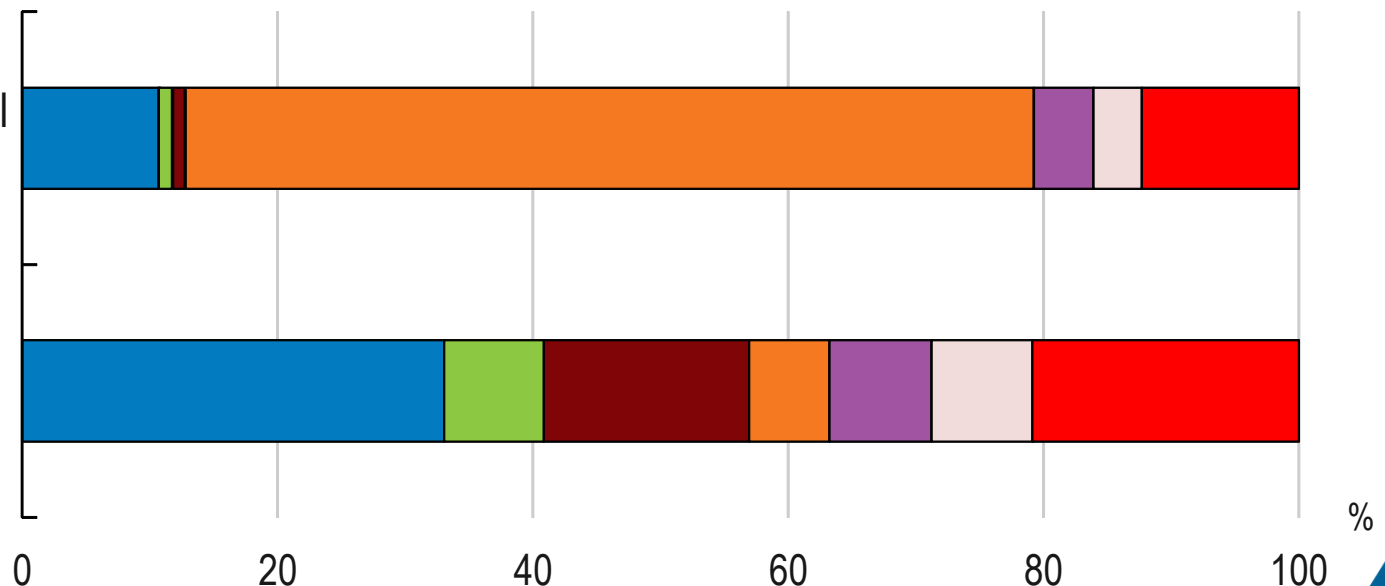
Share of individuals in working-age households



Universal credit

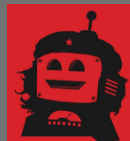


Basic income





RECOMMENDATIONS





Direction/vision for reform: Harmonise benefits and coordinate their tapering

- Universal credit improves on the current system, and outperforms basic income along all dimensions.
 - Assuming that current benefit targeting / distribution of income reflects social preferences.
 - Builds on current system, so transition can be step-wise.





The real time income registry: Make it happen

- Linking benefits to the registry in 2020 can be a game-changer:
 - Allow for real-time coordination of benefits and earnings.
 - Allow for better tools (apps) to evaluate financial consequences of work decisions.
- Technical and legal design and implementation important success factors.

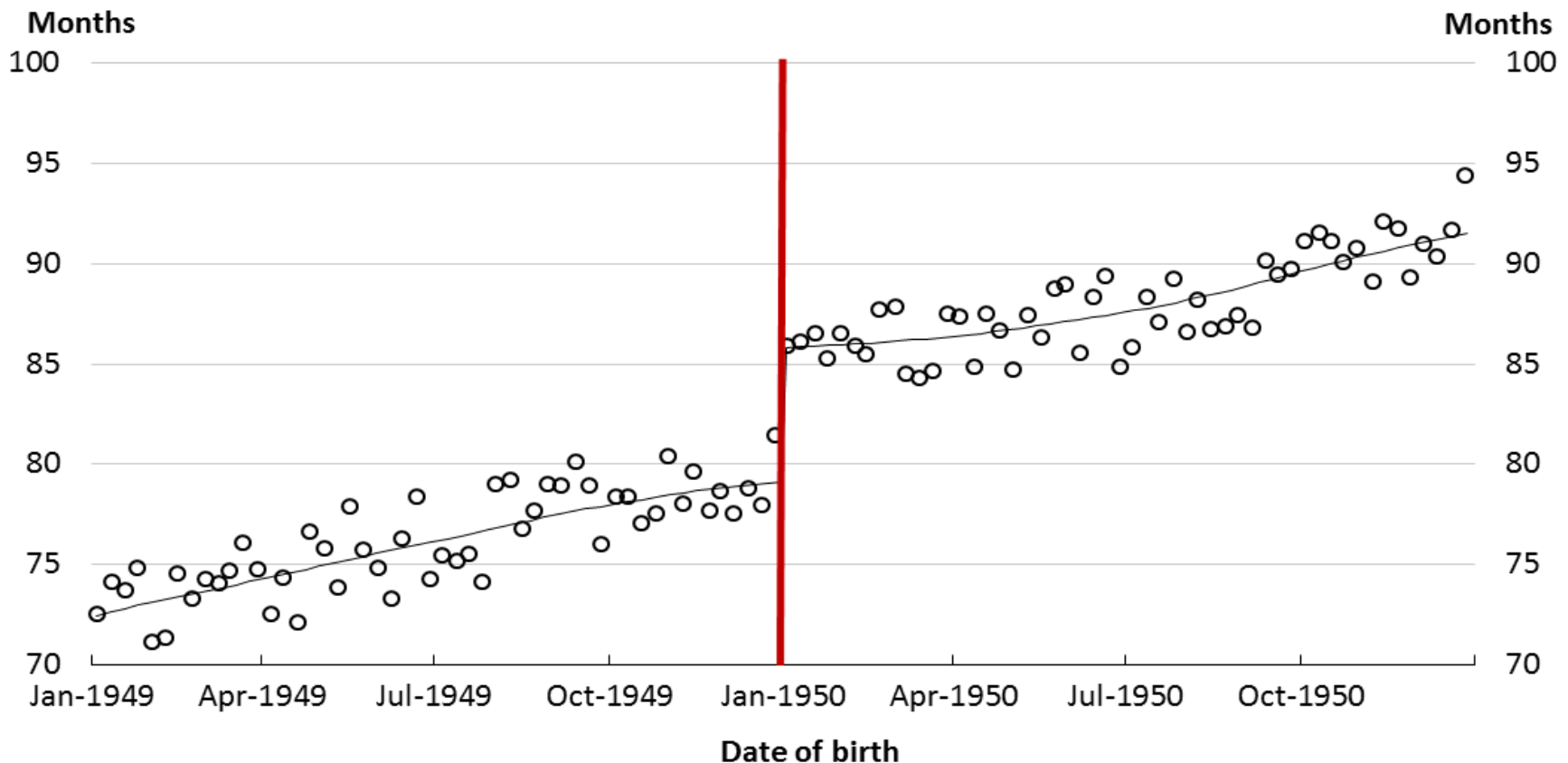


Make work pay for parents (3)

- Restructure the homecare allowance, for example by:
 - Removing the homecare allowance (fix incentives).
 - Increasing the basic parental leave benefit amount (compensate losers).
 - Extending the allowed period to take out parental leave to three years (preserve free choice).
- Individualise the childcare fee (ref. individual income taxation).
- But: these proposals are not fiscally neutral.



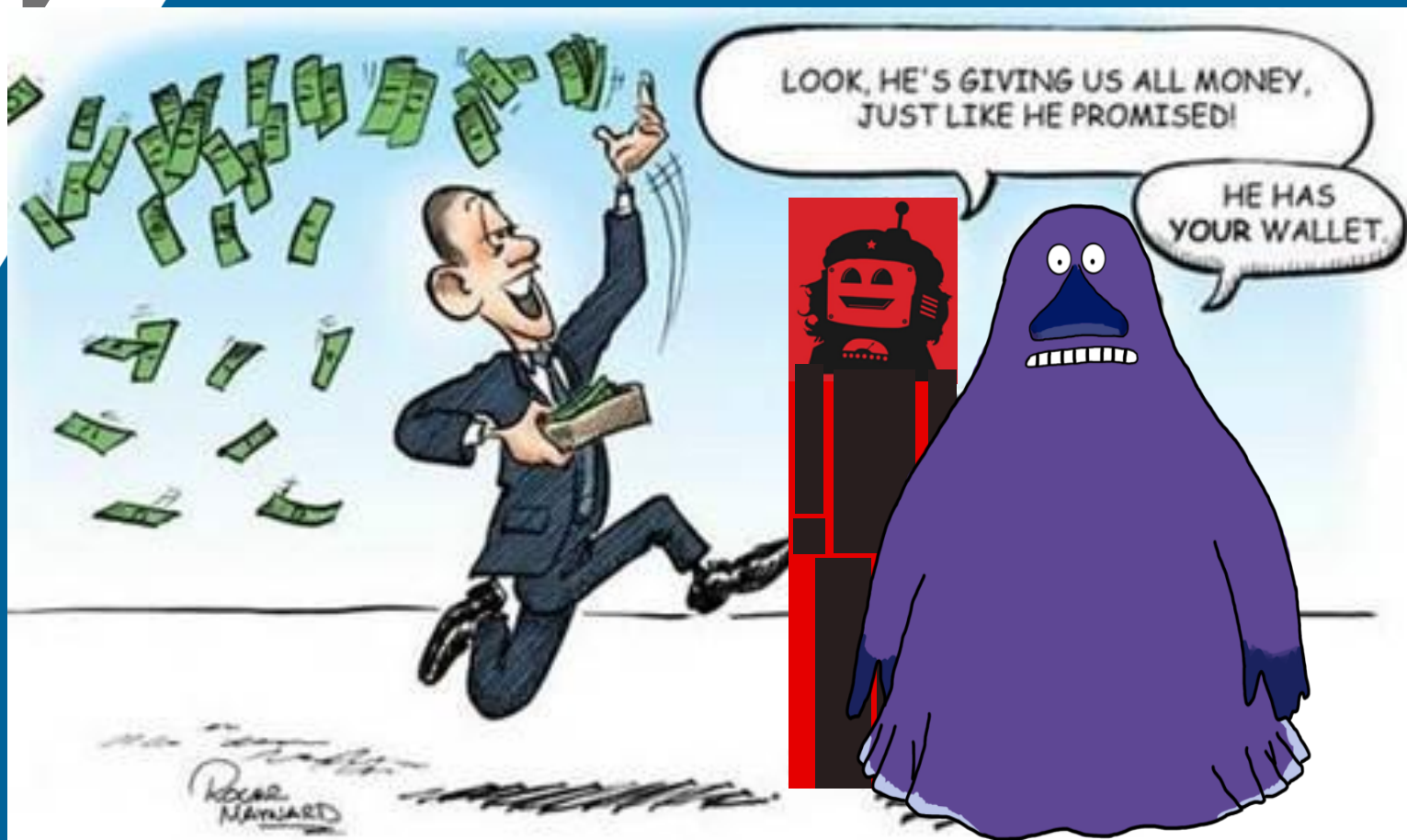
Increase the unemployment tunnel age limit in line with other pensions (at least)



1. The unemployment tunnel age threshold was increased from 55 to 57 years in 2005, only applicable to individuals born after 1949.

Source: Kyrrä and Pesola (2017).

THANK YOU!



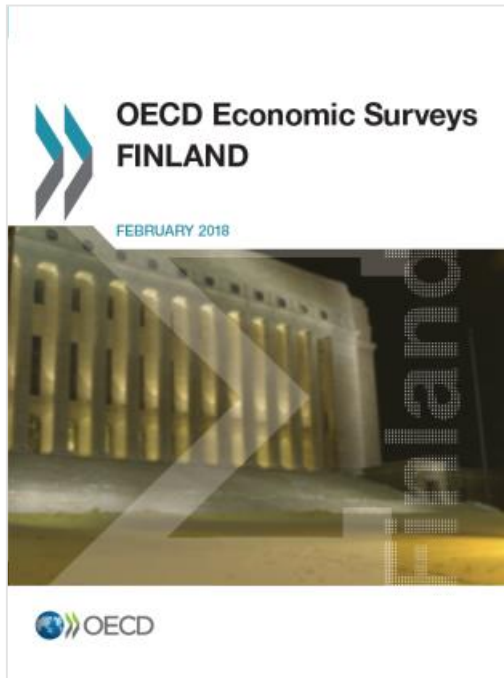


More Information...

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This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.



Pareliussen, J., H. Viitamäki and H. Hwang (2018), “Basic income or a single tapering rule? Incentives, inclusiveness and affordability compared for the case of Finland”, *OECD Economics Department Working Papers*, forthcoming, OECD Publishing, Paris.



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EXTRA SLIDES

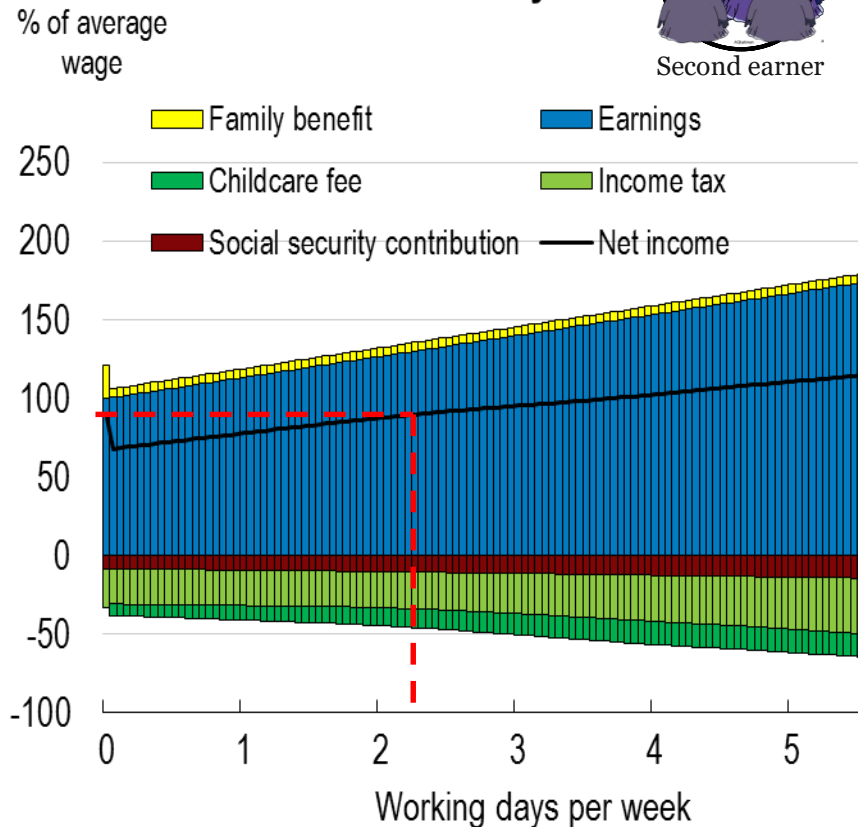


Make work pay for parents (1)

Current system

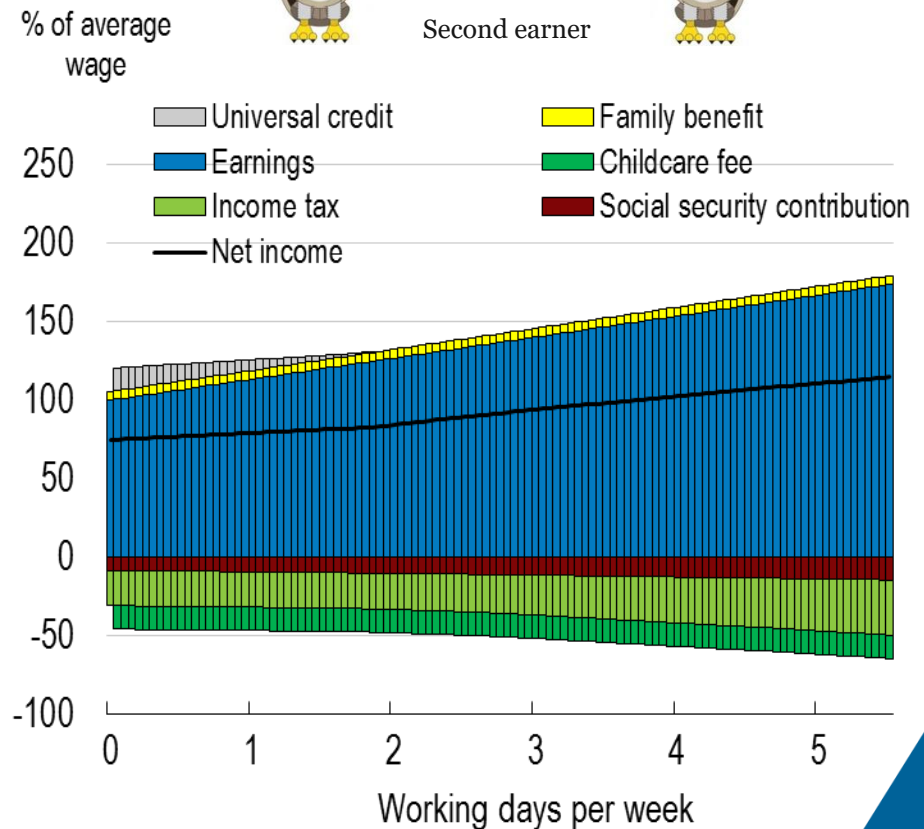


Second earner



Universal credit

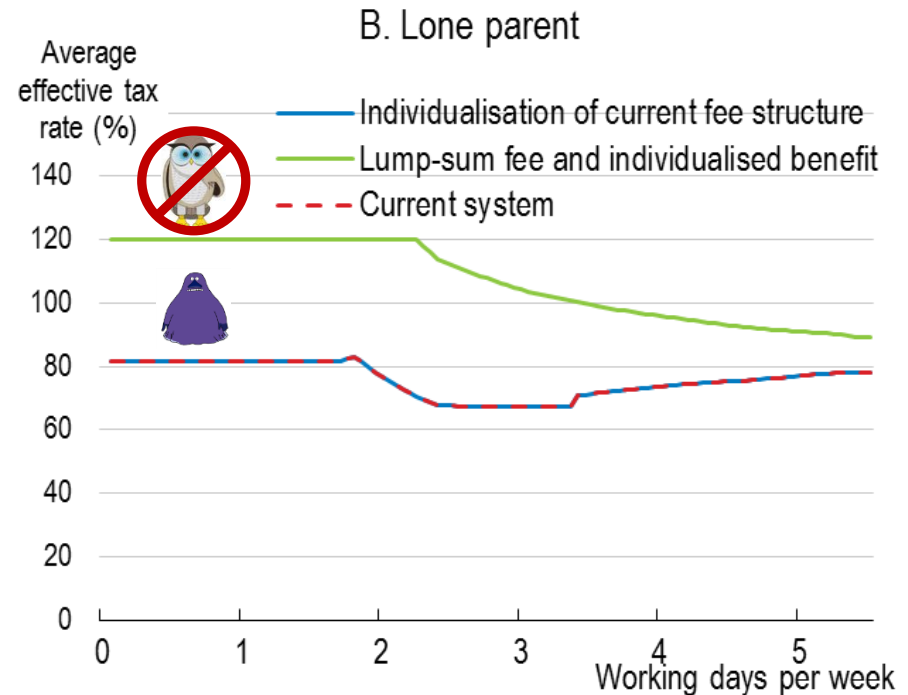
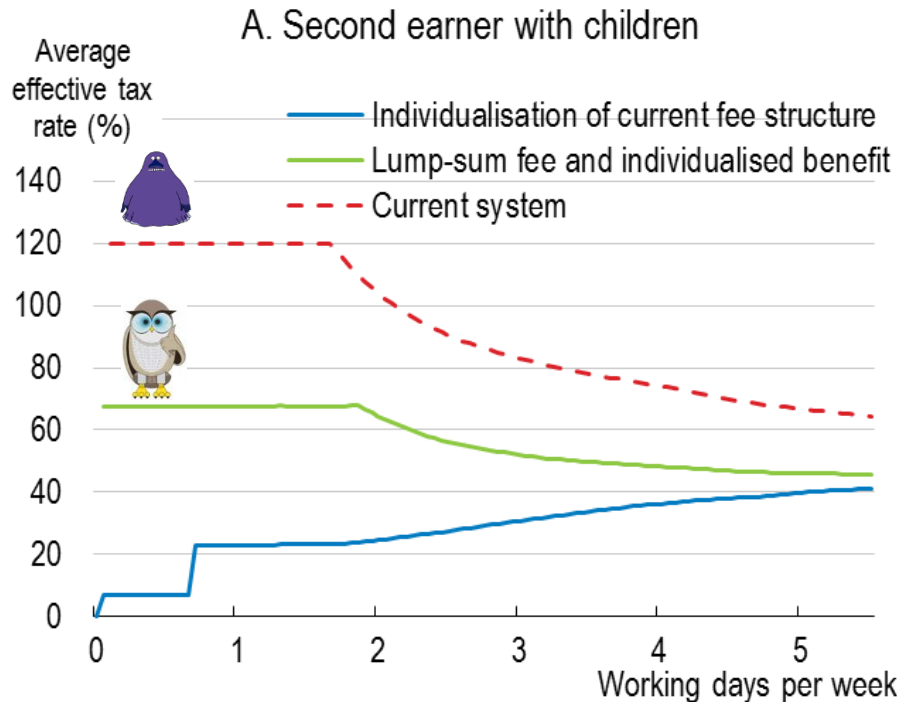
Second earner



Note. For a person going into work with hourly earnings of 67% of the national average wage.
Source: Calculations based on the OECD TaxBen model.



Make work pay for parents (2)



Note: The homecare allowance is abolished in both scenarios. The “lump-sum fee and individualised benefit” scenario replaces the childcare fee structure by a lump-sum fee combined with a childcare benefit tapered off by 65% of after-tax income. Tapering is not coordinated with tapering of other benefits. In couples, the benefit is individualised and tapered against the income of the spouse with the lowest earnings. The “Individualisation of current fee structure” keeps the current childcare fee structure, but the income test to set the level of the childcare fee is applied to the spouse with the lowest earnings. The modelled individual is not entitled to unemployment insurance, and he or she is going into work with hourly earnings of 67% of the national average wage.

Source: Simulations with the OECD TaxBen model, in Pareliussen et al. (2018a).