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The Life Account

REFORMING THE NORDIC SOCIAL SECURITY MODEL TO ENCOURAGE WORK, EMPLOYMENT AND SAVING

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Content

Foreword

This report reviews the historical background and the current crisis situation of the Finnish welfare system. It outlines a concrete solution for reform: the Life Account. The Life Account transforms the conventional welfare system based on tax-transfers to a system based on individual welfare accounts, widely researched around the globe and partly implemented in some countries. A comprehensive literature review at the end of the report sets forth the academic frame of the concept.

The Life Account is a personal welfare account, which records the charges paid and benefits received over one's lifetime. Benefits are debited to one's own account and if the balance is not sufficient to cover the cost, the state will lend the missing amount. The Life Account employs mandatory and voluntary contributions rather than taxes to finance social transfers to people of working age.

If the account balance is positive at the end of the account lifecycle, the account holder will keep the amount. Any negative balance will be written off. The account balance has no effect on the financial credit standing of the account holder.

The account encourages saving and employment by allowing to transfer part of one's income into the account before income taxes are deducted. The account holder can choose to invest the money and income taxes won't be paid until when the money is withdrawn from the Life Account. The system further allows for transferring money between Life Accounts before income taxes are paid. Mandatory employer contributions to the current pension and insurance systems are executed automatically on behalf of the account holders when a transfer takes place. This makes employment effortless and reduces the tax wedge for services, resulting in an increased demand for labour.

The purpose of the report is to initiate a discussion on reform of the Nordic welfare model, which was designed in the 1960s for the needs of a then closed economy largely based on rapid industrialisation, rising education levels and a favourable population pyramid. The Life Account is designed for an open service economy, with a large dependency on global trade, whose population is both educated and ageing. The Life Account is a concrete model for transforming the Welfare State to a Welfare Society supported by sound financials.

Helsinki, December 2013

Elina Lepomäki
Research Director, Libera Foundation

Why should the existing structures be changed?

PAUL LILLRANK

With the depression beginning in 2007 and its accompanying Lehman shock and euro crisis, an era that could be described as the 'Old Normal' came to an end. Because the current crisis is structural by nature, structural changes are called for.

1.1 Causes of the crisis

The economic crisis is both grave and protracted because it combines a number of elements. First, speculation in the housing market led to a bubble that burst. The transformation of euphoria into panic is a well-known development. Speculative bubbles have emerged since the 18th century at a rate of about one per decade[1]. People learn the hard way. Then a new generation comes along who are able – at least for a while – to entertain the illusion that this time things are otherwise[2].

Second, the developments are affected by the normal business cycle with its troughs and peaks. Keynesian economics teaches us to cushion dips and put a damper on booms. In a downswing, the government borrows money to stimulate the economy. In an upswing, it holds back and repays debts. While everybody is eager to do the former, the latter is often overlooked because in politics you always need something more to distribute.

Third, we have reached a turning point of an extended techno-economic cycle. At one time, the railway, combustion engine and electricity upset the existing equilibrium of the forces and relations of production causing turbulence. Since the 1990s, the Internet and globalisation have enabled supply networks and complex financing arrangements on an unprecedented scale. Their multiplier effects are not easy to predict. Regulation, practices and morals have failed to keep up with technological advancements.

Fourth, as a result of the fall of the iron and bamboo curtains, over one billion keen new workers have entered the global labour market. As the level of domestic saving is high in the developing countries, there is an oversupply of both capital and labour. Part of routine work will relocate to areas with lower labour costs. Because the price of money remains low, low interest rates fail to stimulate in the same way as in the past. Since supply-side surpluses are enor-

1 Kindleberger, Charles & Robert Aliber: Manias, Panics, and Crashes: A History of Financial Crises. Wiley, New York 2005.

2 Reinhart, Carmen & Kenneth Rogoff: This Time Is Different: Eight Centuries of Financial Folly. Princeton University Press, 2011.

mous, it will take years for the word economy to find a new equilibrium[3]. At the same time, the labour markets in affluent economies will become polarised. The elite that benefits from the global economy gets richer whereas the middle class shrinks as a result of the fall in the number of traditional industrial jobs, and a class of precarious workers is created in the service industries remaining outside word trade[4].

A fifth category consists of a number of themes exploring more long-term developments and underlying causes. Common to all of them is that the mechanisms of society and the economy have changed. The world does not work as it used to – we are heading for a 'New Normal'.

The years 1870–1970, particularly the decades following the Second World War, represented the Old Normal – a period of unique growth[5] that broke down the class society of the pre-modern era. Scientific breakthroughs spawned new technologies and applications such as sewage and the water closet; the refrigerator and the temperature-controlled food supply chain; the combustion engine and road transport; electricity and lighting; and electronics and computers. Manufacturing and distribution created a large number of well-paid jobs.

At the time when the baby-boomers entered the labour market, the dependency ratio was excellent: few children and old people, and a lot of working-age citizens. With women's increased employment and better access to education, the size of the workforce swelled and its standard of quality improved. However, these types of growth drivers are of a one-off nature. Women can be liberated from domestic chores for the labour market only once. The refrigerator revolutionised households and food production. Once accomplished, it can only be improved by small steps. While non-recurring growth drivers are useful as productive factors and in maintaining prosperity, they no longer serve as engines of growth in developed countries. From this follows that economic growth, if any, remains modest. Societal problems cannot be solved by increasing resources; instead, the existing ones need to be put to more efficient use.

Arguably, the combined intellectual capacity brought together by the global network economy will, in the long term, generate new breakthroughs and growth drivers. However, it may take a couple of decades before their economic impact is felt.

3 Alpert, Daniel: The Age of Oversupply. Penguin Books, 2013.
4 Standing, Guy: The Precariat: The New Dangerous Class. Bloomsbury Academic, New York 2011.
5 Cowen, Tyler: The Great Stagnation. Penguin Books, 2011.

1.2 The Old Normal and the Welfare State 1.0

The Old Normal triggered profound changes in traditional social relations. For the first time in world history, the majority of population in the developed countries became wealthy enough in the 1950s to stop worrying about biological survival on a daily basis. Public safety nets made it possible to subsist without individual effort. The notions of morality, work and human relations that evolved over thousands of years in conditions of scarcity were deeply shaken[6]. When affluent enough, people are not compelled to tolerate quarrelsome and loveless marriages, succumb to the employer's arbitrary rule, respect authority or maintain personal social safety nets. Once a basic standard of living is secured, leisure becomes increasingly attractive and many feel no need for excessive effort. At the same time as major health and economic risks have diminished, addiction to security [7] extends to ever smaller risks. Avoidance of risks reduces innovative enterprise.

General affluence has decreased the inter-dependency between people. The individualism advocated by classical liberalism sought to free people from the constraints imposed by the state, religion, class, birth, race and gender to form voluntary alliances – the civil society. However, the state-driven individualism of the Nordic welfare model led to atomisation, making individuals as independent of one another as possible. Now the individual is a vessel into which welfare is poured by a benevolent state.

Many of the Welfare State 1.0 institutions – such as social welfare and health care, education and taxation – were established during the Old Normal and on its terms. In reliance on unending economic growth, it made sense to establish more or less perpetual expenditures and believe that social problems can be solved through an infusion of money and a flood of government services. Faced with conditions created by the New Normal, the old systems plunged into an acute crisis. Version 2.0 needs to be built on different premises.

1.3 Welfare Society 2.0

Individualism – the liberation of the individual – has triggered a megatrend from a mechanistic to a behaviouristic view of the world. According to the mechanistic thinking born in the 19th century, man was primarily a member of some collective. His needs could be objectively determined through the inherent

6 Offer, Avner: The Challenge of Affluence: Self-Control and Well-Being in the United States and Britain since 1950. Oxford University Press 2006. Fukuyama, Francis: The Great Disruption. Penguin Books, 1999.

7 Eberhart, D., I trygghetsnarkomanernas land – Sverige och det nationella paniksyndromet. Månpocket 2007.

characteristics of that collective and problems could be addressed top-down. If a person is a member of the collective of the hungry, give him bread. If another person is one of the sick, steps are taken to treat him. If a third person is ignorant, he is sent to school to listen to experts. Personal choices are assumed to be of little significance. Actually, they are not even needed because it is the system that ensures welfare, equality and justice.

In neo-classical economics, man is understood as a rational actor (Homo Economicus) pursuing his own interests, and companies as machines seeking to maximise profits. In contrast, behavioural economics disputes the notion of any general rationality and explores the ways in which people actually behave when faced with a choice. Rationality is limited and often just an attempt to justify emotionally motivated decisions. Most people do not seek to maximise their own benefits; instead, they are content with a satisfactory outcome and take account of the social implications of their actions. Behavioural medicine argues that people create their own health, possibly with the assistance of experts. The behavioural megatrend perceives man as a responsible actor.

Free and affluent individuals brought together by the social media cannot be bullied and bossed around like people in the past. Since people are different and make choices in different ways, social policy measures addressing all individuals as a whole cease to be effective.

1.4 Stimulation and austerity

Perceptions of society, crisis and the future affect the way in which we respond to the New Normal, stagnating economic growth, demographic change and the deterioration of the dependency ratio. One or some of the suggested interpretations must be selected.

If the speculative bubble is felt to be enough by way of an explanation, let's nick the villains, let the speculators absorb their losses, fine-tune the regulatory framework and forge ahead just a little wiser.

If the crisis is caused by the business cycle, the remedy is aggressive stimulation. Growing sovereign debt is not a problem as such if stimulation increases economic activity and we get back on the growth track, and commit to lightening the debt burden when things improve. If the underlying cause is something else, stimulation through government borrowing will prove dangerous. If the economy fails to recover, the debt burden will become heavy and lead to pauperisation. Consequently, those with a more cautious mindset prefer to apply the brakes and resort to a policy of austerity to cut public spending and reduce indebtedness in an attempt to restore confidence in the future.

Austerity hurts and wreaks havoc[8]. Spending cuts and even a freeze on expenditure have an adverse impact on the vested interests of one party or another. Austerity in an economic downswing is at variance with textbook Keynesian theory. The downturn gets deeper when demand dwindles. Stimulation would be easier if it could only be done.

Stimulation may be used for the purpose of increasing consumer demand or investing in select areas thought to offer high leverage. One euro spent on stimulating the economy may yield, say, five euros in return. Indisputably, there are many countries with areas where the leverage effect is high. Research, education, health care and the transport infrastructure are typically cited as examples. In the emerging economies, investments in these areas usually yield a return that is easy to measure. When the mortality and morbidity rates fall, the size of the workforce available for the economy increases – a necessary (though not sufficient) prerequisite for any growth.

However, it is a well-known fact in health economics that when health costs exceed USD 1,500 per capita, improvements in public health level off. In the developed countries, most health care spending is used for extending the life of people of extremely advanced age by a few months. While this may increase demand for the services, it does not have any stimulating multiplier effects. At best, the leverage ratio is one.

Investing in education is necessary in countries in which a shortage of skilled labour is an impediment to growth. Increased supply of labour improves the employment rate. Yet the training resources are already in full use in the leading countries of education, such as Finland and South Korea. All additional resources go to reducing class sizes, raising pay levels and funding other comfort zone schemes; however, no research is available showing how these efforts contribute to economic activity and if so, how long it takes for the effects to be felt. Prolonging and extending studies leads to the inflation of education. Those with PhDs take the positions previously held by holders of Masters' degrees who, in turn, take the jobs of polytechnic graduates who, in turn, take the jobs of those with upper secondary education with a growing number of marginalised people left at the bottom of the pyramid.

Many governments fail to target the stimulating policies to areas with a high leverage effect. From 2003 to 2007, the appropriations to the British National Health Service increased by 50%, yet this had no discernible impact in terms of the availability of services or public health. In a developing country like India, investments to improve the transport infrastructure reduce distances, decrease logistics costs and expand the markets. But Japan has been mixing

8 Stuckler, David & Sanjay Basu: Body Economic – Why austerity kills. Penguin Books, 2013.

concrete and laying asphalt for decades. A bridge leading nowhere creates employment in the construction industry for a while, and then nothing.

It is difficult to show whether targeted stimulation packages are effective or not. Politics fail to address results. Whatever effects have been achieved, they are preferably not advertised. In a pluralistic democratic society, the latitude for the exercise of coercion by the state is limited to narrow sectors. Consequently, politics is more like pushing with a string: persuasion and the creation of opportunities[9]. Instead of pushing, the structures should encourage and gently nudge [10] people in the preferred direction.

1.5 What change?

There is a reluctance to change things when the going is good. Old structures need to be pulled down to make room for the new. A crisis offers an opportunity for change. An advocate for change must be able to answer the following questions:

- Why can't we go on with the existing structures?
- What structures must be changed?
- What is expected from this change?
- How will the change be made?
- How will the effects of the change be measured?
- What to do if the foreseen effects are not achieved with the change?

More probably than not, the necessity of structural changes is obvious to most. The deterioration of the dependency ratio, deficits in public finances, overspending, and decreasing economic activity should be reason enough to think so.

It is necessary to change those structures that affect the level of economic activity, particularly innovative entrepreneurship, the growth of public expenditure, employment and participation in society.

Only few people are able to, or have the courage, or can hope to succeed as an innovative entrepreneur. No extension of education or increase in TEKES funding will turn the majority of Finnish youth into international high-flyers who would be able to secure an adequate standard of living for others. A sustainable level of consumption calls for more work – all types of work – not just something that gives maximum yield. What should be done to nudge the labour market in this direction?

9 Ringen, Stein: A Nation of Devils. Democratic Leadership and the Problem of Obedience. Yale University Press 2013

10 Thaler, Richard & Cas Sunstein: Nudge: Improving decisions on health, wealth and happiness. Penguin Books 2009.

Welfare Society 2.0

MARKO HAMILO

The October issue of Tuima.fi, the online publication of the journalism students at the Haaga Helia University of Applied Sciences, ran a story about Tatu, a 26-year-old young man who was not interested in either working or studying. "According to Tatu, all you have to do to qualify for full social assistance is to register as unemployed. Why would Tatu change his lifestyle, if he's doing well enough as it is," the article asks.

Living in a bed-sitter in Punavuori, Helsinki, Tatu claims social assistance from Helsinki City and a housing allowance from Kela, the Social Insurance Institution of Finland, in the total amount of almost EUR 1,100 per month.

According to the publication, he had never taken part in any training organised by the social services, nor accepted any work offered to him by the employment office. Yet he did not lose any of the benefits.

"It's enough that you do something to earn the benefits. Once you sign on a course, people in the social services are satisfied that you've registered and no cuts are made to your benefit. Then you just never show up for the course."

At times, Tatu registers as an unemployed jobseeker but then turns every job down. If his benefits were to be radically reduced, he would not consider work as the first option.

"I'd just try to cope with the situation somehow, just as I've done in the past."

2 The failure of the welfare state

How is it possible for the Finnish welfare state to have evolved over the decades into this kind of automatic teller machine that can be abused with impunity by work-shy people like Tatu? How long can the system be sustained simply thanks to the majority of those young people in Finland who are still committed to the Protestant work ethic?

Luckily, the number of dodgers like Tatu remains low in our society. Over the years, the welfare state has assumed a number of other strange characteristics, most likely not intended by any of the people involved in creating the system.

While most people approve the redistribution of income – at least to some extent – through taxation and income transfers, the financial aid for students remains a form of support mostly paid by workers to the children of well-earning families who themselves often become highly paid earners upon graduation.

In contrast, a victim of crime claiming social assistance often loses all the damages awarded because they reduce the amount of social assistance provided.

To understand what has gone wrong with the welfare state, we have to examine the root causes. A proposal for improvement will be presented towards the end of this article. Here, we will limit ourselves to looking at income transfers. Publicly funded welfare services are in a class by themselves and are not addressed in this report.

2.1 From the social policies of the 1960s up to the present day

As early as 1928, Per Albin Hansson, the long-term prime minister and chairman of Sweden's Social Democratic Party, redefined the concept of 'folkhemmet' (the people's home) – originally used by the conservatives – as meaning a welfare society that requires a social policy, such as general sickness insurance, child allowances, an employment pension system and popular education.

The Finnish counterpart to this type of programme declaration for the welfare state was the pamphlet 60-luvun sosiaalipolitiikka[1] (Social Policy for the Sixties) published in 1961 by Pekka Kuusi, the General Director of the Finnish alcohol monopoly Alko. "Where to find a new Pekka Kuusi?" was the question put by Marko Junkkari, the head of the politics desk at the leading Finnish daily Helsingin Sanomat[2].

According to Junkkari, the key message of Kuusi's pamphlet was a "new perception of the relationship between social policy and the economy. Until then, social policy had been viewed mostly as an economic burden. Kuusi argued the opposite saying that the welfare state contributed to economic growth."

The Libera Foundation accepts the challenge posed by Junkkari and updates the social income transfers for the 2010s using the model presented in this report. The line of thinking is very much the same as that used by Kuusi 52 years ago. First, it is necessary to carry out an analysis of society and then define the measures to pursue the selected policy.

At the heart of Kuusi's analysis lay the argument that Finland was wasting its resources on low-productivity work and sunset industries. "If we do not wish to remain a grazing ground squeezed between a rich Sweden and a rising Soviet Union offering cheap labour and raw materials, we have to concentrate all our resources on accelerating economic growth." (p. 91)

According to Kuusi, it was possible to speed up economic growth and promote welfare by increasing work productivity. The key to growth was industrialisation. There were 350,000 surplus workers in agriculture and forestry, for whom new jobs had to be found in industry and services.

Kuusi knew that such structural changes would cause unemployment, at least intermittently. To deal with this, unemployment insurance was required. "If...society guarantees a sizeable part of the income of citizens left without work, employment and investment policies can be put to really effective use to steer the national economy in attaining the overall development goals." (p. 128)

Similarly, an education policy was required to improve work productivity and a housing policy to direct labour to the areas where work was available. The sixties social policy outlined in the pamphlet was implemented and worked fairly well up until the financial crisis of the early 1990s.

2.2 Shortage of low-paying jobs

In his book Hyvinvointivaltion eloonjäämisoppi [3] (Survival Guide for the Welfare State), economist Osmo Soininvaara of the Greens of Finland analyses a welfare state whose structures no longer promoted economic growth; instead, they maintained unemployment.

Where Kuusi thought that only industrialisation can create economic growth, Soininvaara finds that only services can give work. Of course, industry will continue to be needed, but in the age of industrial robots it no longer offers the job opportunities it used to. While a growing sector of private services has evolved to fill the gap left by industry in many countries, Finland has remained underdeveloped in terms of the service culture.

Private services face stiff competition from people doing things themselves. Does it make sense to buy cleaning services or clean yourself? Should we eat out or cook our own meals?

A point of view: Tax wedge kills private services

How many extra hours does a middle-class person have to work to be able to buy one hour's worth of a work performance from a service provider?

For example, physicians are often in a position to work extra at medical centres in addition to their main employment, and many find this more meaningful than domestic chores. From the standpoint of the economy, it would be more efficient if highly trained individuals like doctors did what they knew best.

Let us assume that the service provider earns an income slightly below the average, and so his income tax rate is 30 per cent. To earn EUR 100 in cash, he needs to be paid EUR 143. The employer's non-wage payroll costs are 23 per cent, or EUR 33, and the labour costs of the service firm EUR 176. In addition to the cost of labour, the entrepreneur needs to charge value added tax at the rate of 24 per cent. Consequently, the price of the service inclusive of VAT is EUR 218.

For the doctor to get EUR 218 in cash, he needs to earn nearly twice as much. In 2013, the tax rate for extra work in the higher middle-class income bracket of EUR 3,440 to EUR 6,000 was 49.3%. Consequently, the doctor would need a gross income of EUR 430 in order to pay the hired person EUR 100 in cash. A wage earner with an average income of EUR 2,720 to EUR 3,360 would have to earn EUR 401 at the marginal tax rate of 45.6%.[11]

If the income level of the person to be hired is modest, say less than EUR 2,000 per month, and the hirer only ears an average income of EUR 3,440, the required gross pay is close to EUR 350.

Known as the 'tax wedge', this system makes private services highly unprofitable, especially in Finland where differences in pay are small. Even if the hourly pay of the doctor buying the service were twice as high as that of the cleaner or child-minder to be hired, the doctor would have to work two hours at the medical centre to be able to engage a cleaner or child minder for one hour. The outcome is that either nobody is hired or the job is done but not reported.

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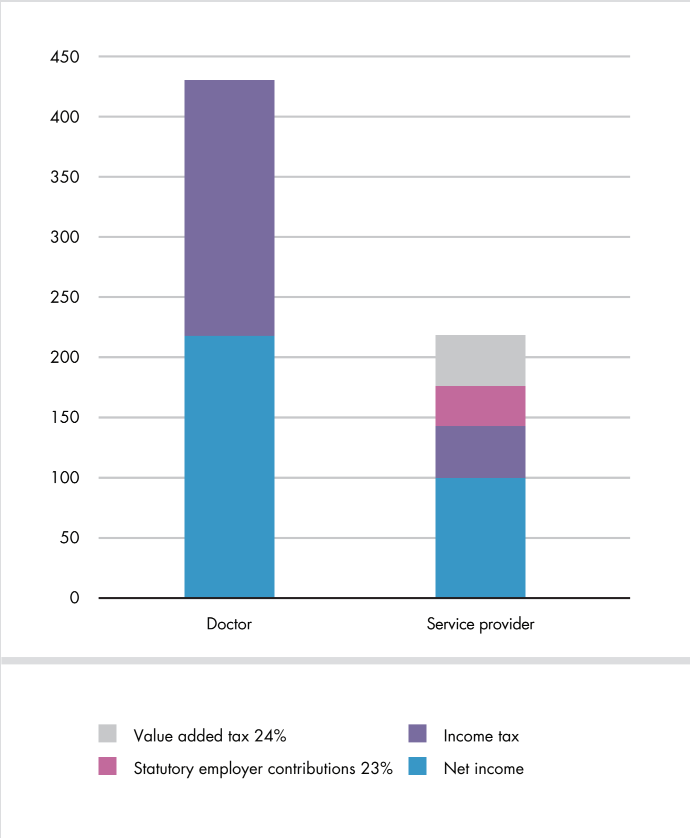
11 http://www.veronmaksajat.fi/fi-FI/tutkimuksetjatilastot/tuloverotus/palkansaajanveroprosentit2013/
The marginal tax rate calculation includes state income tax, average municipal tax, church tax, YLE broadcast tax, employment pension premiums of a wage-earner under 53, unemployment pension insurance premium, sickness insurance daily allowance contribution, sickness insurance medical care contribution as well as the deductions to be made by the tax authorities as a matter of routine. These include basic deduction in municipal taxation, deduction on earned income, and the standard deduction of work-related expenses. Annual income is calculated by multiplying the monthly salary by 12.5 (inclusive of holiday bonus).

PICTURE 1: EXAMPLE ON THE TAX WEDGE: A DOCTOR NEEDS A 430 EURO GROSS EARNING IN ORDER TO BE ABLE TO PAY 100 EUROS IN NET TO A SERVICE PROVIDER



Many of the inherent structures of the welfare state encourage people to do things themselves instead of buying services. A high tax rate widens the tax wedge between the taxable price of services and take-home wages. If a person with academic training earns an extra EUR 100 by doing overtime, he or she will be left with EUR 50 after taxes. If this amount is used to purchase, say, cleaning services, the hirer will additionally have to pay VAT to the state and withhold income tax as well as the employer's and employee's pension premiums from the cleaner's wages.

The final outcome is a service that is so expensive that it makes sense for the academic person to clean the house him- or herself. Alternatively, the cleaner should be paid so low hourly wages as to prevent hiring under the provisions of the applicable collective agreement. As an entrepreneur, the cleaner could sell his or her services at any price, but why bother when the same income level can be achieved through social benefits by doing nothing?

It is no coincidence that the structures of the welfare state discriminate against low-productivity work and price it out of the market. After all, it was Pekka Kuusi's intention. The goal of his social policy was to generate economic growth by moving people from less productive work to more productive industrial jobs. This was achieved – with a vengeance.

According to researcher Pekka Myrskylä's article in the Tieto & trendit magazine of Statistics Finland[4], the number of jobs requiring only primary education has tumbled compared to the late 1980s. However, the total number of jobs in the economy has not diminished relative to the end of the 1980s. Jobs requiring upper secondary qualifications have increased by 200,000 and tertiary level jobs doubled.

"Over half a million jobs requiring only primary education have vanished. There is no lack of job-seekers: over one million applicants compete for the little more than 300,000 jobs available.

There are half a million working-age Finns with just comprehensive school education while these jobs are also sought by 340,000 students and people currently otherwise employed as well as 250,000 immigrants and 60,000 to 70,000 foreigners staying in Finland on a temporary basis."

If the problem could be solved simply by expanding education, it would have already been done. But all the people are not equally trainable. The comprehensive school and improved access to university education have already exploited the talent potential, much of which was still unharnessed at the time when Pekka Kuusi addressed the issue.

As it is, it is easy to subscribe to the view that Soininvaara arrived at almost 20 years ago. Differences in productivity have increased in the workforce and there is a constant over-supply in the labour market of those with low skills.

Even a modest work input is worth utilising, which the price of work should adapt to.

In the United States, the unemployment rate is low, but poor people may, at worst, be compelled to hold several low-paying jobs and still have to struggle to make ends meet. In the welfare state, in contrast, low-paying jobs have been made impossible for employers through minimum wages and other regulations, or they are unprofitable for workers because social security guarantees the same income level without any effort. In the European model, those who are unable to earn their living by working are supported by society which foots the whole bill.

Additionally, the existing rigid bargaining system has created a market for temping agencies through which at least some degree of the necessary flexibility has been achieved in the labour market. In reality, it means redistribution of income from the lower middle class to the temping agencies.

3 "Wages to live on"?

What if people could earn their living partly from work and partly from social security? Such mixed solutions failed to work when Soininvaara tried to salvage the welfare state in the midst of the depression and they will not work now, either. Soininvaara thought that the system needed an overhaul and Libera thinks that it still does.

However, the defenders of the Nordic welfare model often invoke the principle that "you need to earn enough to live on your wages".

Of course it is possible – in the name of the welfare state and the wage-earners' interests – to conclude collective agreements with erga omnes applicability and pass minimum wage legislation that makes it impossible for workers to agree with employers on wages below the level deemed by the legislators to ensure a decent standard of living. Yet no one can force an employer to hire an employee whose work input is worth less to the employer than the cost of the minimum wage. The end result is unemployment.

However, there is a growing understanding in Finland that we need ways of employing people whose productivity at work falls short of the cost level defined as a minimum in the collective agreements.

Arto Satonen and Outi Mäkelä, both vice chairs of the National Coalition Party's parliamentary group, said in the Talouselämä [5] magazine in September that this "can be achieved by reconciling social security with earned income".

"A case in point is the recent government resolution on priority income guaranteeing an unemployed person EUR 300 in protected earnings." It means the amount of money that may be earned by the unemployed without losing the unemployment benefit.

Even if the blessings of combining social security with earned income to both the individual and society at large are finally dawning on people and becoming politically acceptable – two decades after the issue should have been tackled – there is not even the slightest consensus on the measures to be adopted.

3.1 Unconditional basic income

Satonen's and Mäkelä's comments are from a Talouselämä story discussing the idea of unconditional basic income raised by Björn Wahlroos in September. Mäkelä and Satonen rejected the idea because it "would give a wrong signal in terms of social morals".

According to them, Finland's success has been built on the Lutheran work ethic saying that everyone has a duty to assume responsibility for themselves and others by working.

"Society steps in to help when a person is unable to do so, for example because of illness, old age or unemployment. A changeover from needs-based social security to unconditional basic income would make it acceptable to live on welfare without a compelling reason to do so."

The basic income proposed by Wahlroos was also part of Soininvaara's toolkit in his welfare state survival guide. The idea is simple enough. In the past, the small difference between unemployed benefits and pay was not a major problem because the labour exchange always had some work to offer that the unemployed jobseeker was obliged to accept. Now the obligation to accept work has ceased to apply in reality and the unemployment benefit has, for all intents and purposes, become an unconditional basic income.

Originally, the idea of basic income – or the equivalent negative income tax – was introduced by Milton Friedman, a well-known proponent of classical liberalism. It defines a floor for taxable income. If you earn more, you pay tax in the same way as now. If your income falls short of this limit, you automatically receive social assistance, or 'negative tax', from the state which is not needs-based. In other words, to be eligible for such support, you do not have to be available for the labour market and ready to accept a job assigned by the employment office.

Mathematically, basic income is identical with negative income tax except that it means that every person of age is automatically paid a certain amount of money – basic income – each month without any special basis for such support. All earnings exceeding this amount would be taxable at the same flat income tax rate. For most people, net income would not change much as a result of the reform. For low-income earners, it would be a powerful incentive to earn extra money.

In the 1980s, basic income was known as citizen's pay. It was the pet project of the green-left movement, which was looking for alternatives to the western lifestyle amidst the prosperity created by the economic boom, although the idea was more to free people from the drudgery of paid work rather than encourage individuals to accept low-paying jobs.

The model of partial basic income proposed by Soininvaara in the face of the economic crisis and mass employment argued that under-employment would be better than complete unemployment for the unemployed whose income could be supplemented by basic income. The basic income would have been so low that it would have been necessary to retain both the needs-based social assistance system and the conventional unemployment benefit.

In fact, basic income models have attracted at least some degree of interest among all political parties, particularly the Green, probably because the idea stems from a correct diagnosis. It should be possible to combine earned income with social support in such a way that it always makes sense to accept employment. However, the reason why the idea of basic income has failed to win widespread support is that it is the wrong remedy for the ailment. It is easy to see when we try to determine the level of basic income so as to make it both sufficiently incentive yet not too expensive.

If the basic income is very low, anybody even remotely fit for work would seek to earn extra money on top of it; however, for those unable to find any work, the system would be too harsh. If, by contrast, the basic income were sufficiently generous to allow even the less fortunate to lead a decent life, it would provide work-shy people with a comfortable standard of living all paid by society.

In particular, if the basic income were to be paid automatically to the bank account without the claimant even having to show up at a social services, employment or Kela office, it would be possible to live nicely in, say, Estonia, Spain or Thailand on even a low basic income – as long as Finland remained the nominal registered place of residence.

3.2 Loan instead of money

Soininvaara's Survival Guide for the Welfare State proposes yet another revolutionary innovation. He admitted himself that it would not necessarily be politically realistic – and he was right. Instead of developing the idea further in his subsequent book Täystyöllisyyteen ilman köyhyyttä (Towards Full Employment without Poverty), Soininvaara abandoned it with little fanfare.

Soininvaara's revolutionary proposal was that instead of claiming an earnings-related unemployment benefit, an unemployed person could receive a low-interest or interest-free loan. If he or she were re-employed or received other income, the loan would be repaid in connection with taxation. Then the personal tax rate would be a few percentage points higher than normal as long as any part of the loan remained unpaid.

If any unemployment debt were left at the time of death, it could be claimed, with moderation, from the deceased's estate – children would be guaranteed a certain legal portion of the assets and the widow or widower would not be evicted from home. As a result, even the state would incur some credit losses in case the assets were not enough for full repayment.

Soininvaara thinks that the system would offer a number of advantages. The unemployment loan would be large enough to ensure that nobody would be driven to bread lines. It would always make sense for an unemployed person to accept work, even if low-paid: although the net income would not increase, no more debt would be incurred.

For taxpayers, this would be much more affordable than the current system because expenses would only be incurred for interests and credit losses. Additionally, the need to monitor the unemployment security system for fraud would diminish because a loan is not much of a benefit. Instead, control measures could target those whose debt balances threaten to reach levels where repayment proves unlikely.

The authors of this report believe that the time is finally ripe for a system where unemployment security and many other needs-based income transfers should be granted in the form of loans instead of 'free money'. Among such forms of support are at least social assistance and financial aid for students. The present report proposes a model in which pensions would also be integrated into the same system, albeit over a long transition period. Each citizen would have a personal account from which withdrawals could be made when necessary, and in which money could also be saved for old age.

Instead of the technical details of the various models, it is more important to understand the principles of loan-type social security based on personal accounts. Of course, the model will only assume its final form through a long political process, but it might be a good idea to start with student financial aid in an effort to initiate the shift towards an income redistribution system conducive to work and entrepreneurship.

3.3 Student financial aid

Over the past few decades, student financial aid has been developed into the wrong direction. The share of the non-repayable study grant has increased at the expense of the student loan. Many students are suspicious of the state-guaranteed student loan available at market rates and prefer to go to work instead of studying on a student loan on a full-time basis.

Understandably, they are worried about whether they will be able to earn a salary high enough to repay the loan after graduation. However, a new student loan model could be based on an arrangement, under which the personal tax rate would not increase and repayment of the loan to society would not commence until a certain index-tied threshold pay is exceeded. For example, if a humanist fails to achieve this income level, he or she would not have to repay the loan. If so, the situation would be identical to the current system with study grants.

3.4 Redistribution of income

Many may find a loan-type social security system an extremely right-wing proposition. After all, redistribution of income decreases when income transfers are replaced by loans.

Many people share the illusion that the existing social security state would be a sort of institutionalised Robin Hood who takes from the rich and gives to the poor. A case in point is the financial aid paid to university students. It is financed by all wage-earners, including low-income workers, in the form of taxes while most of the claimants are children of well-to-do families who will, in all probability, find themselves in the highest income brackets after graduation.

Aside from these 'reversed Robin Hood income transfers', much of the existing social security system is about re-distributing money between the members of the middle class depending on the phase of life they happen to be in. At some points of life, they are net payers; at others, net recipients. Even though the members of the middle class financing the welfare state seldom need to resort to social assistance or labour market support, they claim, from time to time, earnings-related unemployment benefits and receive child allowances.

"When we talk about the distribution of income, we often focus on the annual earnings of citizens or households," writes Niku Määttänen, Research Supervisor at the Research Institute of the Finnish Economy.

"For example, the commonly used poverty indicator shows the number of households with annual disposable income of less than 60 per cent of the median annual earnings. Similarly, the impacts of various tax and social security reforms are frequently assessed just in terms of annual income.

More often than not, however, people's annual earnings vary greatly over their lifetime and they can respond to this variation by saving, borrowing or selling off assets. Consequently, Määttänen thinks that an analysis based on annual income fails to give a complete picture of the distribution of economic wellbeing.

"More likely, economic wellbeing is based on lifetime earnings, i.e., the income earned by people over their entire lifecycle. That is why income distribution issues should be considered more from the lifecycle perspective."

Economic models can be used to evaluate how the distribution of income over one's lifetime would change if the rules governing taxation and social security were revised.

"A typical outcome of such models is that, on the whole, taxes and income transfers tend to level lifecycle earnings much less than annual incomes," writes Määttänen.

Consequently, the conversion of income transfers into loans would not, in all cases, decrease the redistribution of income at all. However, the reform would give a greater incentive to work, entrepreneurship, studies, and saving because the individual knows that the money received by way of support would have to be repaid from one's personal account at a later date.

Naturally, redistribution of income takes place both within and between lifecycles, an effect produced by progressive and flat-rate taxation alike. The unconditional basic income works this way. Forms of support that redistribute income from high-income earners to low-income earners in a lifetime context may well be preserved if redistribution of income is established as a generally accepted goal.

For all practical purposes, child allowances partly amount to the recirculation of money from typical two-child families to other two-child families. Partly, child allowances constitute income transfers within lifecycles: they are financed by the recipients during childless years through taxation. Only part of child allowances are income transfers from those without children to families with children.

This report does not propose that child allowances should be discarded or converted into loans. The purpose of the example is just to draw the reader's attention to our tendency to regard the welfare state as a sort of safety net when it returns to a family with children the same EUR 100 it had just taken away in the form of taxes. When formulating his social policy for the sixties, Kuusi hardly had this type of arcade game in mind.

3.5 Social assistance

One form of social security with an exceptionally distortive effect is the social assistance granted by the municipality. The incentive effect of unemployment benefits has been increased by the introduction of what is known as adjusted daily allowance, which guarantees that an unemployed person gets to keep at least something for every extra euro earned. By contrast, the needs-based social assistance intended as an aid of last resort kills the last remnants of any interest in working. The amount of support is calculated according to the customer's necessary expenses and paid to the extent his or her eligible-for-support expenses exceed the income and assets available.

For one thing, if social assistance payments were transformed into a loan, it would be consistent with the original ideal of this form of support: it helps you get over the worst. To discourage individuals to accept social assistance too easily, it should be given as a loan.

In reality, social assistance today constitutes the basic form of security for many long-term unemployed. If you are entitled to social assistance, it does not make sense to accept low-paid work or short-term employment. If a long-term unemployed person were to take out social-assistance loans over an extended period of time, it is clear that, with time, the loan principle would grow so high that the borrower would be unable to repay it. For this reason, it is important to make the labour market work in a way that allows the combination of benefits and earned income.

When decisions on granting social assistance are made, those of the applicant's assets that are easily convertible into cash are also taken into account. However, a permanent residence is not considered an asset in this sense. This is discriminatory against those whose savings are invested in instruments other than a home. With the social assistance loan, the requirement to liquidate assets would not have to be as strict as this, nor would it be necessary to treat tenants and home-owners differently.

One of the most perverse aspects of the logic applied in connection with social assistance is that any damages awarded to a victim of a crime reduces social assistance with the result that such a person receives practically nothing by way of compensation. With the social-assistance loan, this problem would not exist. All that a recipient of damages would lose is a low-interest loan, nothing more.

4 Entrepreneurs and the intermittently employed

Under the present system, entrepreneurs have weaker social security than employees. It is true that an entrepreneur may be eligible to the daily allowance paid to the unemployed provided that all entrepreneurial activity has verifiably ceased as a result of bankruptcy or the liquidation of the company's or entrepreneur's assets. However, the increasingly common self-employment is a type of entrepreneurship that differs greatly from what our current unemployment security system was created for. For freelancers completing one-off assignments or those in short-term employment, the existing social security system is disastrous. Yet a combination of a low basic income and complementary loan security would help maintain a decent standard of living during the months when no orders are coming in, while at the same time encouraging people to seek work whenever possible.

4.1 Progressive control

Many liberals find that the welfare state has developed into a prying 'nanny state' that knows better than its citizens what is good for them. Accordingly, one of the arguments for unconditional basic income is that it relies on the individual's own efforts to assume responsibility for his or her economy, rather than on the state. Some, perhaps Utopian basic income models argue that unemployment security and social assistance could be completely discarded and so the employment authorities and social workers would not have to be constantly monitoring and needs-assessing to determine whether the claimant is truly available for the labour market or in need of social assistance.

However, a basic income of such generosity would make it possible to live at society's expense. And it is hardly control in the narrow sense of the term if society restricts the freedom of the individual in disposing of money that is provided by society, not earned by the beneficiary.

Consequently, the best solution would be the idea of progressive control put forward, among others, by Henri Heikkinen and Antti Vesala in their book Elämää Hyvinvointivaltiossa [7] (Living in a Welfare State) suggesting that the state intervene only when it appears that the individual fails to assume responsibility for his or her own affairs.

For example, basic income could be devised so as to make it impossible to live on it indefinitely. After all, the idea with basic income is to support those unable to live on their earnings, not to enable a passive lifestyle. In final taxation, the basic income received during the year could be partly recognised as a loan from society if the claimant fails to earn any other income at all.

If such loans accrue over a longer period of time, the amount to be withdrawn each month could be gradually decreased and at some point the social services or employment authorities would have to step in to initiate activation measures.

4.2 Other needs-based social security

All in all, the income transfers discussed above amount to EUR 4 billion. Municipalities spend over EUR 500 million on social assistance every year. Unemployment benefits cost EUR 2.4 billion, of which earnings-related daily allowances account for EUR 1.1 billion. Student financial aid including housing benefits amounts to EUR 850 million.

Consequently, major savings could be made in public finances if some of these income transfers were to be converted into loans. Of even greater significance would be the positive impact of the reform on attitudes and behaviour.

Many other forms of needs-based social security could be left as they are because they do not involve similar incentive problems as, say, unemployment benefits. A person incapacitated by illness or injury needs his or her disability pension and cannot be magically healed by any economic incentive.

4.3 Left-wing or right-wing?

Would the reform outlined above be politically feasible? What values is it based on? Is it left-wing or right-wing?

Above all, it is a question of updating the welfare state to the 2010s. The existing structures are a legacy of the 1960s when social policy objectives were subordinated to a policy aiming at industrialisation and economic growth. The old structures do not work any longer in a society where industry employs a decreasing and services an increasing number of people.

If the ideas for the reform of the social state outlined in this report are anchored in a specific value basis, it could be crystallised in that working, employing, enterprising, studying and saving should always be more gainful than passivity.

Just like basic income, loan-type social security could be fine-tuned through various adjustments to make it as left-wing or right-wing as desired. If it includes a basic income that need not be repaid, the model is all the more left-wing the higher the basic income and tax rate are. In its extreme left-wing version, the income tax would be progressive to boot. To make the loan-based model as left-wing as possible, the ceiling for the amounts to be withdrawn monthly could be set high, the loan terms soft, and the threshold for eligibility for loans low. In its extreme right-wing version, the reform would specify a low flat-rate tax with no basic income at all.

Continuity to the Nordic model would, however, be provided by the principle of the universality of rights. Universality means that everybody has a subjective right to support from society if they are unable to support themselves. It is not a question of the American-type system where society only helps those who cannot be helped by employment-related social insurance, the family or charitable organisations, such as the church.

4.4 Psychological incentive

If man were a fully rational Homo economicus, even income looming far in the future would affect motivation at any given moment. In reality, however, future income and expenses are discounted into current cash, often rather carelessly. In a loan-type social security system, if a person uses a lot of social benefits when a young adult, the consequences may not be felt until the old age in the form of a slightly reduced pension. Can social policies be planned based on the assumption that all people are rational and forward-looking?

Here, too, the principle of progressive control applies. Most people want both to secure a decent standard of living in old age for themselves and leave something to their children. However, some people will always have problems in seeing beyond the next calendar month because of depression, substance use or other gaps in life management skills. Such people are quick to accept all the benefits available here and now, even if it means a financial burden at some point in the distant future.

The psychological effectiveness of incentive mechanisms could be enhanced, for example by reducing monthly benefits relative to the amount of debt incurred. When repayments are made, the amount of monthly benefit due to unemployment or other reasons would start rising again.

Another tool for increasing psychological effectiveness would be provided by account statements sent regularly by e-mail or otherwise showing the current amount of debt to society and the amounts of the benefits the recipient would be entitled to if the applicable criteria were met.

5. Options

What options does Finland have?

Fine-tuning the current model: So far, all attempts to amplify the incentive effect have only shifted the problem to some other part of the fragmented patchwork system. For example, while the adjusted daily allowance did something to alleviate the incentive problems with unemployment security, the dilemma was only moved to social assistance, which has become the main source of income for the long-term unemployed. Provision of compulsory training courses for the unemployed has proved to be a futile humiliating exercise that fails to help them get back to work. The system needs to be re-built from scratch.

Basic income is the only comprehensive alternative to seriously challenge the existing regime. But it is at variance with the generally accepted Protestant work ethic still prevailing in Finland. In the red-green Utopias of the 1980s, citizen's pay was intended to enable alternative ecological lifestyles. In contrast, the more realistic models of the 1990s sought to create a social security system that provided more incentives than the existing one. A low basic income can be incorporated into the loan model.

Civil work or 'participatory social security'. In her book Hyvinvointivaltion peruskorjaus [8] (Renovation of the Welfare State) from 1997, Kati Peltola, former Head of the Helsinki City Social Services Centre and member of the Left Alliance, proposed that unemployment benefits only be paid for the first four months of unemployment. After that, the unemployed person would have to accept 'civil work' assigned by the municipality.

This autumn, Paula Risikko of the National Coalition Party and Minister for Social Affairs and Health, introduced the concept of participatory social security where some form of activity would be assigned to the long-term unemployed in order to prevent social exclusion. It is unclear what sort of duties would be given to social security claimants, but according to Risikko they could not consist of work for which employees would otherwise be hired. Consequently, the purpose of participation is to serve as a stick and deterrent. In October, Centre Party Chairman Juha Sipilä also expressed support for such participation, but only for those under 25.

The question arises whether a person fit for work would be able to earn a wage equal to the amount of social security if he or she were able to compete for work at a price of labour below the minimum wage. At best, participatory social security could serve as a complementary element for those of lowest employability. In the life account model, the participatory model could be applied when a claimant has exhausted, or is about to exhaust, his or her social security account balance.

The life account is the first comprehensive proposal for a complete overhaul of the system of social income transfers for over 15 years. Hopefully, general awareness of the sustainability gap is keen enough to ensure that the proposal is not torpedoed off-hand without thorough scrutiny.

This introduction has provided a general outline of the underlying principles. The following chapter will present one model embodying this principle, which can be implemented in a variety of ways. The foregoing text provided a description of an approach in which the individual becomes indebted to society. The same principle is at work when the individual is called upon to save up for a rainy day - from his or her earnings - in a fund which the starting capital has already been contributed by society.

The Life account

ELINA LEPOMÄKI

6 Key objectives of the life account

The life account foresees a comprehensive reform of the social security system in order to promote enterprise, employment and saving. Unlike the basic income and social account models based on the supply of labour, the life account also addresses the demand for labour. It will make employing simpler, less costly and more flexible. Additionally, the life account seeks to promote saving and the formation of private capital.

The life account foresees a loan-based social security system, in which records are kept of the charges paid and benefits received over one's lifetime. Benefits are debited to one's own account and if the balance is not sufficient to cover the cost, the state will lend the missing amount. If the account balance is positive at the end of the account lifecycle, the account holder will keep the amount. Any negative balance will be written off.

The life account permits more flexible planning of personal economy in the various phases of life and the withdrawal of benefits when necessary. Needs assessment will be increasingly assumed by individuals themselves and the state will step in only when assistance is required. At present, a significant part of income transfers take place within the lifecycle of the one and the same person instead of between the lifecycles of different people. With the life account, some of the bureaucracy resulting from this unnecessary shuffling of money will be avoided.

The life account provides greater incentives in many ways. For one thing, when withdrawing benefits from one's own account, the claimant understands the cost of these benefits. Yet the system provides the same flexibility as unconditional basic income: temporary support can be claimed free from any external needs assessment even if the claimant earned income from other sources at the same time. All work will always pay.

This chapter gives a presentation of the central principles underlying the life account model. All the money amounts are indicative only and intended as examples. The final chapter provides an analysis of the impact of changes to these euro limits on the operation of the model. Essentially, the life account model can be adopted with only minor yet clear adjustments to the existing social security and tax system and subsequently extended to a broader range of the unemployment and social security benefits enjoyed by the citizens, while at the same time enabling a wide variety of employment opportunities for oneself and others. Although the model does not call for any changes to taxation or the regulation of the labour market, the report discusses in more detail how a few major reforms would improve its operation.

6.1 Incentive social security

The life account is a form of social security that encourages every person fit for work to assume control of their personal economy. The life account only applies to able-bodied citizens of age without any impact on the lives of those who are unfit for work, disabled or under guardianship. Instead of questioning, ascribing blame for or reclaiming anything, the life account offers a basic livelihood for all Finnish citizens in need. Assistance can also be claimed if earnings are not enough to cover the cost of living.

The life account provides a better response to the challenges of today's working life and entrepreneurship because the economic situation of an individual may change significantly from month to month, irrespective of one's own planning. A person can be repeatedly unemployed or under-employed. The life account offers extra income flexibly when necessary. Unlike the present earnings-related unemployment security system, the life account does not encourage claimants to live on benefits for their full term since the balance of the life account is reduced by every withdrawal.

6.2 Incentive to work

The life account gives an incentive to work because it is always possible to earn more and then some, irrespective of the amount withdrawn from the account. All the payments made into the life account are credited to the person involved. The amount available for withdrawal from the account will not be lost no matter what other income is earned or received at the same time. Unlike in the basic income system, withdrawals from the life account are earmarked, and it is in the interest of each individual to work in order to keep the account balance positive.

Additionally, the life account can be used for making tax-efficient investments and hire domestic help flexibly. With the life account, a self-employed person can accept work assignments flexibly. In the life account context, it is not necessary to establish a firm in order to employ oneself, irrespective of whether the activity is carried on a part-time, full-time or continuous basis, or as an experiment.

6.3 Incentive to employ

Transfers from the life account to other accounts are easy. Statutory employer contributions are debited automatically to the account. The life account encourages people to hire help because the account holder is free to use the non-restricted funds in the account for purchasing services, i.e., employing others, up to an annual limit of EUR 20,000.

Compensation for the services rendered by others is paid before the payment of one's own taxes. This is similar to the combined effect of the current domestic help credit and the employment subsidies, such as the private care subsidy granted to households, except that hiring another person does not involve any of the extra bureaucracy household-employers now have to deal with. This makes it easier to employ people and it also reduces the tax wedge.

6.4 Accrual of capital and saving

The life account gives an incentive to plan one's economy and save for the future. It promotes popular capitalism. The capital accruing in the life account always inures to the benefit of the account holder, who can use the unrestricted funds in the account flexibly over his or her lifetime and its various phases. With the life account, investments can be made before the payment of income tax, which does not become payable until funds are withdrawn from the account for personal use. As a result, the life account gives the citizen a tax-effective tool for saving in other asset classes besides the home.

6.5 Progressive control

The life account draws upon the thinking that an individual is free to make any choices when spending his or her own money, whereas the use of society's funds involves a degree of control. The life account gives flexible access to support in various life situations, but the availability and amount of such support are governed by increasingly stringent restrictions as the funds in the life account dwindle.

The life account deficit means a shortfall of funds, or a situation in which withdrawals of society money by the individual involved exceeds the payments made. If the control exercised by society in the form of activation measures does not come into being until the need for such control arises – i.e., the entire initial capital of the life account has been exhausted or it is quickly dwindling – the extent of bureaucracy required is greatly reduced compared to the present system.

The life account does not take any stand on the currently applied activation measures more generally; instead, its starts from the premise that, on the labour market, people are primarily motivated by their own will – driven by the need to get by or professional ambition – not by any contrived employment measures. Activation measures applied as a condition for unemployment benefits have a limited impact on employment, especially when unemployment has lasted for a long period.

A survey by the Ministry of Employment and the Economy found that intensified activation measures – or an impending threat of such measures – failed to motivate the long-term unemployed to seek jobs in the private sector. Rather, they served as a tool for preventing social exclusion. In contrast, the activation measures did have an impact on the employable workforce, especially through the threat effect. [10]

7 Life account instead of basic income

The purpose of the life account model is to get people who are well-off in terms of lifetime earnings to pay for their own unemployment security, and to direct social income transfers primarily to those with low earnings. The thinking is based on the fact that the existing income redistribution system consists mainly of shuffling money back and forth within the lifecycle of a single individual instead of between the lifecycles of different people.

A Swedish study suggests that transfers within a single lifecycle accounts for 68 per cent of all redistribution of income. Only 32 per cent is transferred from one person to another.[12] While no comparable studies have been conducted in Finland, it is safe to assume that the order of magnitude is more or less the same as in other countries offering extensive social security (such as Sweden).

Primarily, the life account model addresses the biggest portion of the income transfers – the benefits paid by people to themselves in their lifetime. As such, the model is no more no less caring than the existing social security system, but it helps alleviate the complexity of the present system and reduce the unnecessary work required to maintain it.

7.1 How does the life account relate to social security?

The publicly financed social security system seeks to guarantee all citizens a reasonable standard of living and livelihood in respect of certain social risks and needs. The benefits available under the system consist of cash or services.

The life account affects the social security of people fit for work provided in the form of cash throughout their lifetime. It takes no stand on the social security provided in the form of services. The life account is not intended as the primary source of social security for the disabled or those unfit for work, irre-

12 Bilaga till långtidsutredningen 2003, Regeringen Sverige. http://www.regeringen.se/content/1/c4/15/41/9e3e0bf3.pdf

spective of the point of time during one's lifetime at which the unemployment diagnosis is made. Instead, the life account offers social security for those who are in a position to influence their standard of living through their own actions.

The adoption of the life account will not have any impact on the existing forms of needs-based social security related to sickness and health, or the sources of livelihood of last resort. The life account addresses the members of the active workforce and people fit for work who are temporarily unavailable for employment because of specific circumstances, such as working at home in the family.

In August 2013, there were about four million people aged 15 to 72 in Finland, of whom 2.6 million were in the active workforce and 1.4 million outside of it. Being outside of the workforce refers to people who are neither employed nor unemployed.[13]

7.2 Lifecycle of earnings and expenses

One's annual income varies depending on the phase of life. People respond to the variations in earnings by saving, borrowing or selling their assets. To a great extent, economic wellbeing is based on lifetime earnings instead of the annual income generated in any given year. [6]

The hypotheses of lifetime earnings used in economics are based on the assumption that people are rational in their thinking. An individual makes a choice whether to consume now or later. It is assumed in these theories that individuals even out consumption over their lifetime, for example by taking out a mortgage when young, saving when middle-aged and spending when retired. [13]

The life account model argues that while most people are able to act rationally, its underlying principle operates in accordance with the existing social security system, even when this assumption breaks down. The life account permits people capable of planning ahead to harvest the advantages deriving from their own decisions primarily for their own benefit, which supports rational choices. Even so, the life account model will not leave people incapable of such planning to their own devices.

7.3 Latitude for a variety of life paths

There is no single model for lifetime consumption. It is increasingly rare for anybody to acquire an education for a given profession as a young adult and then pursue the same career for the following 40 years. As a result of techno-

13 Statistics Finland 2013 workforce survey http://tilastokeskus.fi/til/tyti/2013/08/tyti_2013_08_2013-09-24_tie_001_fi.html

logical advancements, old fields of activity are replaced by new, and there is a continuous need for training. Many people of working age take – or have to take – time-outs, during which they do not work at all or only on a part-time basis. The life account encourages people to save when there is an opportunity to do so, while at the same time offering flexibility when costs exceed earnings.

Usually, people do not save much when young because they study, hold relatively low-paying jobs or are on family leaves. Another reason for low saving activity may be that the individual does not set great store by future consumption and wants to spend everything now. Naturally, while the life account model will do nothing to eradicate such human short-sightedness, [13] it still gives a greater incentive than the existing social security model to exercise far-sightedness by offering people the opportunity to reap the fruits of their own industry, thrift and the ability to plan ahead.

Aside from short-sightedness, people can also be myopic [13] in the sense that they cannot plan their consumption over time despite obvious incentives to do so - even if they could, they are unable to stick to the plan due to a lack of self-discipline or hardships in life. As far as this human characteristic is concerned, the life account – much less than the existing social security systems – has no solution to offer, except that it is advisable to take better care of people, especially when they are unable to do so themselves. The life account rests on the idea of progressive control: whenever possible, people are given latitude to manage their own affairs. But if action on the part of the social services is required, all resources should be put into play.

Nor is there any single model for consumption in old age, either. An individual does not necessarily use all of his or her savings when retired because they want to leave part of their assets to their offspring, or simply do not want to spend, or wish to have a buffer for a rainy day. Some consumers continue to save even after retirement. Also, spreading the savings over the remaining years of one's life is difficult because it is hard to estimate the time left to live. [13] The life account recognises this fact and therefore the remaining principal in the life account behaves like any other property and is inheritable.

7.4 The entrepreneur's lifecycle

Of the total of about 230,000 companies in Finland, close to 140,000 (61 per cent) are one-man businesses.[14] Most self-employed people operate as private traders under a trade name. As a rule, they are engaged in the service industries and the added value generated by the business is labour-intensive. Most self-

14 Oulun Yrittäjät. Yksinyrittäjäohjelma (Oulu Region Entrepreneurs). http://www.yrittajat.fi/fi-FI/pohjois-pohjanmaanyrittajat/oulu/yleista/yksinyrittajat/

employed people have no intention of expanding their operations beyond self-employment. According to a survey carried out by the Federation of Finnish Enterprises in 2010, nearly 55 per cent of the respondents had been working as entrepreneurs for over five years. For many, it was a permanent arrangement. Close to 90 per cent were engaged in their line of business on a full-time basis.[15]

Almost without exception, all new businesses are initially established as one-man operations, even if they were aiming at growth. An innovation-based business model calls for testing, and more often than not, the entrepreneur either lacks the resources or has no reason to hire anybody before the model has proven itself. According to the Federation of Finnish Enterprises survey, 75 per cent of self-employed people use less than EUR 5,000 per year to purchase services from other entrepreneurs or companies. [15]

In 2011, the entrepreneurs' average earnings were EUR 45,061. Of this, earned income accounted for 72 per cent and capital income for 28 per cent. When all taxable income, corporate tax and statutory contributions are taken into account, the average entrepreneurial income is equivalent to gross corporate revenues of EUR 51,370.[16] Two-thirds of the entrepreneurs earned less than the average pay per year. Slightly over one-fifth had an income of less than EUR 15,000 in 2011. Some of them ran the business on a part-time basis or the side.

The life account is designed to make self-employment more flexible and rewarding without the need to establish or run a company for the purpose of small-scale business. It does away with some of the administrative duties associated with managing a business. Additionally, in the life account model, some of the tax reliefs available to businesses can be utilised by private individuals.

7.5 Liability to pay value added tax

In its survey published in 2002, the Government Institute for Economic Research found that the threshold for the liability to pay value added tax (currently EUR 8,500) hampered business growth and encouraged people to slice the operations into smaller units or run the business off the books. The conclusions drawn in the study suggest that the limit should be tripled to cover the administrative and social costs of VAT taxation. [9]

According to the study, the VAT threshold had major effects on business behaviour. In particular, a sizeable number of private traders operate below said limit. It does not make sense for them to increase turnover even if they could do so because after crossing the threshold for VAT liability they would have to pay

15 Suomen Yrittäjät Yksinyrittäjäkysely (Federation of Finnish Enterprises. Self-Employed Survey) http://www.yrittajat.fi/File/709dc35b-c318-41e3-8a03-3a631c53d98e/SY_yksinyrittajakysely_2010.pdf

16 Yrittäjien tulot ja verot 2013 (Entrepreneurs' Earnings and Taxes 2013) http://www.yrittajat.fi/fi-FI/suomenyrittajat/tutkimus/yrittajien_tulot_verot2013/

tax on all sales. To compensate for this difference, sales would have to be increased substantially.

The report goes on to say that the threshold for VAT liability in Finland is exceptionally low by European standards. In the UK, for example, the limit for self-employed people is almost ten times higher than in this country. [11] In summer 2013, small entrepreneurs filed a citizen's initiative to raise the threshold for VAT liability to EUR 50,000.[17]

7.6 Households as employers

In a market economy, specialisation leads to improved efficiency.[18] When people are engaged in a line of work consistent with their individual fields of expertise as extensively as possible, the consumption potential of the economy grows. However, the taxes on work and value added tax increase the tax wedge, with the result that it makes sense for most people to do the household chores themselves, even if they were, relatively speaking, 'better qualified' to carry out their regular work they are paid for. As a result of the tax regime, some of the work that could be carried out on the labour market is done by households.

Other factors affecting this choice include the availability of services, the opportunities to employ an external person for the selected job and individual preferences regarding household chores as well as the extent to which free time is valued. [14] Generally speaking, services help save time that can be used for doing one's regular salaried work.

The life account lowers the barriers to hiring by reducing the tax wedge and automating statutory employer payments in a situation where a private person or household directly engages another person to perform work. It is safe to assume that this will have a positive impact on employment, especially in the case of people with little education, where the supply of labour is usually more flexible. [14] However, the willingness of people with limited education to accept employment is also affected by the level of social security benefits available. In the life account model, acceptance of work makes sense because basic social security is not lost even if the claimant had other earnings.

At present, household services are used extensively, with and without the domestic help credit. According to the survey by the Government Institute for Economic Research (VATT), the domestic help credit is used most widely by those over 75, home-owners, entrepreneurs, families with two breadwinners and two children, and those with a researcher education. Most of the costs eligible

17 Pienyrittäjien kansalaisaloite ALV:n alarajan nostamisesta (Small Entrepreneurs' citizens' initiative to raise the Lower Limit for VAT Liability) http://www.pienyrittajat.fi/kansalaisaloite-alv-n-alarajan-n/

18 David Ricardo (1816), Principles of Political Economy and Taxation

for the domestic help credit are related to house repair services (81 per cent), which is partly due to the scope of such work and the fact that the domestic help credit is restricted to the performance of certain types of services. According to the study, the propensity for making use of the domestic help credit increases with the income bracket, but the differences between average tax deductions made within the brackets remain small. [14]

8 Operation of the life account

The life account is a personal form of social security for every citizen of working age and fit for work. Its intended use is implied by its name: the life account (in Finnish perustili, literally 'basic account') offers a subsistence-level income in all life situations and enables flexible acceptance of employment and an uncomplicated way of hiring others. It provides a safety net at times when one is underemployed or unemployed. The life account can replace earnings-related unemployment security. With the life account model, needs assessment is left to individuals themselves where possible.

8.1 Scope

In cash terms, the basic support that can be withdrawn from the life account is equivalent to the current minimum benefits. In its simplest form, it replaces the following forms of social support and benefits: student grants, the basic daily allowance for the unemployed, and labour market support. It may also replace other needs-based benefits, such as allowances related to parenting and home care services. As a result of the positive employment effect of the life account, it may, for example, render the private care allowance paid to families with children unnecessary.

The income to be withdrawn from the life account should primarily be compared to the labour market support currently paid to the long-term unemployed, rather than social assistance. Social assistance (just like the housing allowance) is to be retained as a needs-based form of support complementary to the life account, even though it would be advisable to eliminate the disincentives associated with these aids before proceeding to the life account environment. In the long-term, the life account could also replace social assistance and earnings-related unemployment benefits, in part or in full.

The opportunity for tax-free employment provided by the life account is equivalent to the domestic help credit and replaces, due to its wide scope of applicability, the allowances for private child home care as well as other employment subsidies available to households.

8.1.1 The individual and the life account

The life account responds to people's needs in the present-day labour market: it would no longer be necessary to devote unreasonable lengths of time in applying for basic support, and it would always make sense, financially speaking, to accept even small occasional jobs. The amount available for withdrawal from the account will not be lost even if the account holder earned income from other sources at the same time. Additionally, the life account would make it possible for households to make use of services flexibly without the bureaucracy that employers are currently burdened with. The life account permits transfers to other accounts, and when such a transfer is made for consideration, part of the funds are allocated to the statutory insurance premiums related to employment relationships. Moreover, the life account would reduce the employment-related tax wedge, which would, for its own part, increase demand for services and labour-intensive work performances in particular.

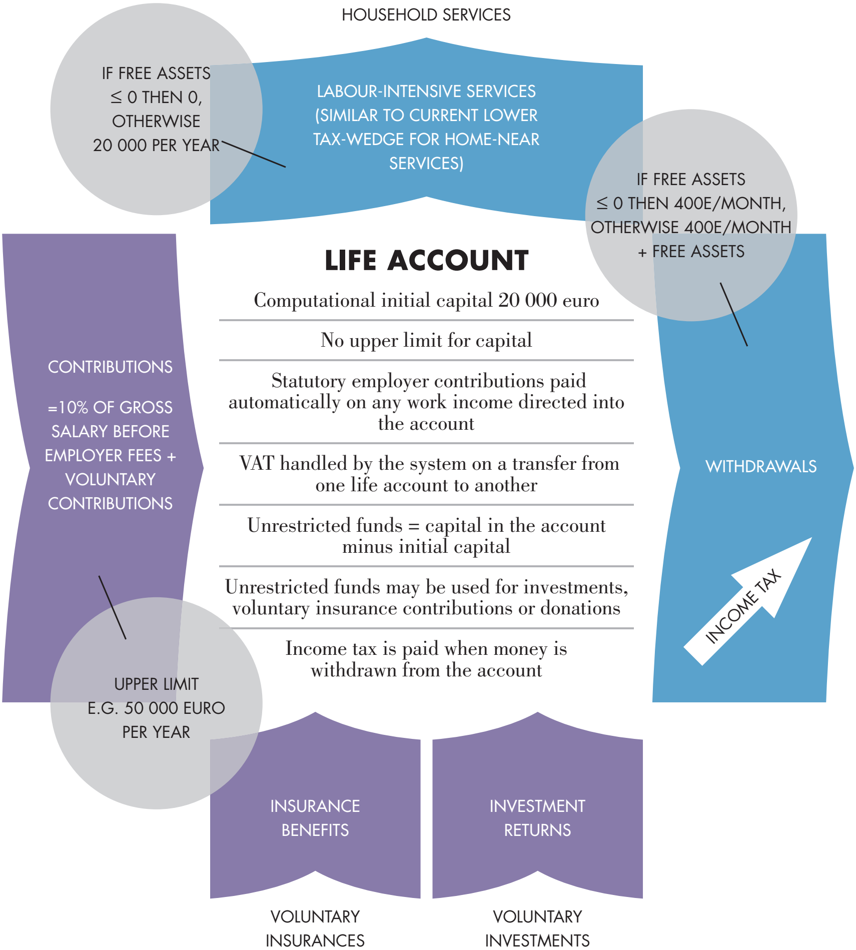
The life account will put an end to the artificial classification of people as employed and unemployed. In reality, people's employment status varies substantially from part-time to full-time positions over their lifetime. Additionally, the life account makes it easier to become an entrepreneur: thanks to the financial support provided by the account, the business concept can be perfected at least on a part-time basis and even a quick return to the labour market would not result in the loss of benefits. A private individual interested in entrepreneurship can test his or her business idea, relying on the financial security provided by the life account without having to register as an unemployed jobseeker.

8.1.2 Self-employment and the life account

The life account reduces the bureaucracy associated with small-scale entrepreneurial activity. With the help of the life account, self-employed people can offer their services to various employers, i.e., customers, free from the extensive administrative, accounting and tax-related obligations required of companies (private traders, partnerships or limited liability companies). This would be possible up to a turnover ceiling of EUR 50,000, which would constitute the upper limit of the annual income transferrable to the life account.

A person employing him- or herself under the life account model would be covered by the statutory insurance policies normally associated with regular employment; moreover, the income earned would be taxed at the same rate as applied to wage-earners whenever funds are withdrawn from the life account. The tax deductions enjoyed by businesses will be equally available in the life account environment and may be exercised in personal taxation. Services

PICTURE 2: LIFE ACCOUNT IN ACTION



bought from other self-employed entrepreneurs would be directly tax-deductible in the life account model.

The life account model takes no position on VAT liability as currently applied to various fields of activity or the determination of the tax rate based on turnover. In the life account model, the value added tax payable according to the regular rate for transfers for consideration is earmarked in the payee's account for recognition in a specific VAT fund, the balance of which is credited to the state at the end of the year. Conversely, if people buy services from others within the life account system, the VAT payable for the performance is transferred from the buyer's VAT fund to the service provider's fund. This is similar to the companies' current right to deduct VAT on purchases.[19]

8.2 Life account capital

The life account is personal. It is activated when the person involved reaches the age of 18. A life account will only be assigned to fit-for-work Finnish citizens of age who are permanently domiciled in Finland and covered by the Finnish social security system. A precondition may be imposed for the activation of the account requiring either Finnish birth or a history of naturalisation. The initial capital on the account will be EUR 20,000. This amount will be enough, for example, for drawing a student grant of EUR 400 per month over the following four years without any additional amounts having to be credited to the account.

The principal on the account is theoretical. In other words, the state must not set aside the amount equivalent to the initial capital for every citizen when the account is activated. The procedure follows the financing of the existing labour market support, except that the state pays for the withdrawals without any time limits. Currently, the labour market support payable to a person who has been unemployed for a minimum of 500 days is paid by the state and municipality half and half.

The amounts paid to the account are earmarked and credited to a special fund to be set up for the life account. Insofar as any insurance premiums are paid or investments made from the account, the equivalent capital is allocated out of the earmarked fund to the insurance company or for the payment of the investment. Any deficit accruing in the life account will be covered by the voluntary and statutory payments to be made to the account.

19 Verohallinto, syventävät vero-ohjeet, arvonlisäverotus (Tax Administration, Detailed Tax Guide, VAT taxation). http://www.vero.fi/fi-FI/Syventavat_verohjeet/Arvonlisaverotus/Aloittavan_yrittajan_kysymyksia_arvonlis%2811977%29

8.2.1 Account balance and capital

The initial capital on the account will be EUR 20,000. The capital is equivalent to the account balance. If the capital is exhausted and the account balance is zero or negative, the life account still permits the withdrawal of free social security within the restrictions of the monthly withdrawal limit, just as in the case of social assistance. The account balance may remain negative throughout one's lifetime. When the balance is negative, meaning that the individual involved has accrued debt, a certain percentage of the all the potential wages earned by such an individual will be automatically credited back to the life account.

There is no ceiling for the account balance or capital. Capital may be accumulated in the life account by having wage-earnings or business income credited to the account in accordance with the annual ceiling for such transfers. The account capital is reduced relative to the transfers made from the account. Such transfers may be used for private consumption or made to some other account.

8.2.2 Unrestricted funds

Unrestricted funds refer to the part of the capital in the account that exceeds the initial capital. The unrestricted funds consist of the current balance of the life account less said initial capital of EUR 20,000. If an account holder transfers EUR 5,000 to his or her account and never withdraws any money from it, the amount of unrestricted capital will remain at EUR 5,000 unless any of it is invested.

For example, if the EUR 5,000 accrued in the account was invested in Nokia shares, the amount of the unrestricted capital in the account would be equal to the then-current selling price. If the account holder wishes to withdraw funds for his or her own use, the investment assets will be sold and the money withdrawn taxed at the personal income tax rate.

Any unrestricted capital in the account can be transferred from the account, by the account holder at any time without limitations. Income tax is applied at the moment any funds are transferred from the life account to other uses not covered by the system. Also, the unrestricted funds can be used for buying services by transferring funds to another life account. If there are no transferrable funds available in the account, no transfers to another life account can be made.

8.2.3 Transfers to the life account

Ten per cent (10%) of all the gross income made by each wage earner before statutory employer contributions will be credited to the life account up to a specified annual ceiling (currently EUR 50,000). It only applies to transferrable funds, not the capital in the account. Employers will make payments to the life account comprising not only the gross pay earned by the employee but also the statutory non-wage payroll expense items payable by the employer.

Of the amounts transferred to the life account, a sum equivalent to the statutory employer contributions (employment pension premiums) will be automatically allocated to such insurance. Additional funds may also be credited to the life account over the years on a voluntary basis subject to the annual ceiling. Insurance premiums will be paid in the month during which payment for the work performance is received.

The foreseen statutory transfers to the life account will not mean higher taxes because if the initial capital in the account remains untouched, the account holder is free to withdraw the funds for his or her own use at any time. Even if the account balance is in the red, statutory transfers to the life account will be tantamount to the existing level of taxation because the account holder continues to be able to complement his or her income by drawing additional funds from the life account subject to the monthly ceiling aside from any other earned income. For the periods during which no withdrawals are made, the wage earnings to be credited to the account will be recognised as deductions to the accrued debt.

8.3 Use of the life account

Limitations may be imposed for withdrawing funds from the life account depending on the account balance. The underlying principle is that the account holder may, where possible, do whatever he or she wants with the saved money. Similarly, the initial capital may be used freely subject to certain clearly defined limits without unnecessary bureaucratic interference. Control measures in respect of the life account will not be taken until the account balance starts falling to zero.

If the account balance is equivalent to or higher than the initial capital, a monthly ceiling for withdrawals is applied. Withdrawals can also be made when the account capital is reduced to zero or below. In this case, the account performs like the existing social assistance system where needs-assessment is applied as part of the overall social security to be provided. The unrestricted funds in the account can be used for preferred investments or insurance policies, subject to the applicable regulations.

The life account can be used for self-employment purposes. When a service provider receives a funds transfer to his or her life account from a customer, the statutory VAT portion of this amount is transferred to the payee's VAT account and all the statutory employer contributions allocated to the relevant insurance schemes.

8.3.1 Transfers from the life account for one's own use

Cash may be withdrawn from the life account at any time. If the account balance exceeds the initial capital, unrestricted funds may be withdrawn freely. If the account balance is equivalent to or below the initial capital, withdrawals can be made up to a maximum monthly limit, which in the first version of the life account is EUR 400. Whenever funds are withdrawn from the account, income tax is always payable according to the personal tax rate. Earnings or other income do not affect the amount that can be withdrawn; however, the withdrawal limit may be regulated in accordance with the principle of progressive control when the capital is low or dwindling quickly (see section 10.1 Model adjusting screws).

The funds withdrawn from the account for one's own use will be taxed as income. Deductions can be made in taxation for expenses related to earning the income, such as travel costs and work-related expenses in accordance with the regulations issued by the Tax Administration.[20] With regard to the expenses directly related to earning the income, the right to make tax deductions should be as extensive as that enjoyed by private service providers. While the life account takes no stand on tax deductions as such, the model would work more smoothly if the current income tax and tax relief systems were simplified.

8.3.2 Transfers to another life account

Funds can be transferred from one life account to another subject to the monthly ceiling without any tax consequences. Income tax is not payable until funds are transferred to outside the life account system. No gift or value added tax is payable for the transfers, irrespective of whether the payment is made for consideration or not. When unrestricted funds are transferred to another life account (target account), a portion equivalent to statutory employer contributions is earmarked for statutory insurance premiums.

20 Vähennykset ansiotulosta ja verosta (Deductions on earned income and taxes) http://www.vero.fi/fi-FI/Syventavat_verohjeet/Henkiloasiakkaan_tuloverotus/Vahennykset_ansiotulosta_ja_verosta (Income tax of individual customers/Deductions on earned income and taxes)

Unrestricted funds in the account exceeding the initial capital may be transferred from one life account to another account by paying value added tax and the statutory employer contributions. The system handles the payments automatically in connection with transfers made for consideration. Donations free from employer contributions can be made to foundations, etc. Married spouses or registered partners can transfer funds to each other without any service being provided in exchange and without paying the employer contributions, yet subject to an annual ceiling. This will, among other things, make it possible for spouses to share pension security.

8.3.3 Investment of unrestricted funds

Unrestricted funds in the account exceeding the initial capital can be freely invested in various liquid asset classes. The life account model permits the imposition of special conditions as to the type of investment. When the system is adopted, it is up to the decision-makers to determine whether they prefer individual freedom in investment decisions or favour assets classes promoting domestic employment.

Unrestricted funds in the account exceeding the initial capital may also be used for paying voluntary insurance premiums such as to unemployment funds. Membership fees to various associations cannot be paid out of the life account. Ultimately, the life account model is designed to replace the existing earnings-related unemployment security system in its entirety. No unemployment insurance outside the life account scheme would thus be required; instead, the account itself could be extensively used for making up for lost income in case of unemployment.

Even as it is, membership in an unemployment fund is voluntary, and so it would not mean any major change, conceptually speaking, to ask people to choose whether they wish to voluntarily save in view of potential future unemployment. Just like the current labour market support, the life account also offers minimal basic security, even in the absence of such voluntary saving. But when unrestricted funds have been accumulated in the account, it can also be used for making up for lost income in case of unemployment.

The incentive offered by the life account model would be greater than that offered by the current earnings-related system: nobody would have the opportunity to deliberately exhaust the earnings-related benefit period at the expense of the system before seeking re-employment (until the period of employment required for eligibility to a new earnings-related period is again completed). Instead, when the funds are more clearly earmarked for one's own use, an unemployed person would have an incentive to find work immediately upon the loss of the job.

8.3.4 Release of the capital in the life account

The capital in the life account is released for the free use of the account holder upon reaching the age of 65. If the account balance is negative, the debt is written off. After the release, the ceiling for withdrawals is lifted. Before any funds can be withdrawn from the account, income tax is always paid first, irrespective of whether the funds are taken in instalments or all other once. The capital in the life account is inheritable; it is also inherited if the account holder dies before the account is released (before the age of 65). No negative balance is passed on to the heirs.

9 Transition to the life account environment

Essential to the system is that the life account and its existence are established on a permanent basis. While it can be adopted gradually, it must still be predictable. When the life account model is put in place, some of its properties need to be defined immediately, whereas others can be added little by little. A more detailed description of this is provided in the following chapter. A gradual transition is necessary, especially in order to be able to integrate the model into the existing social security and tax systems as seamlessly as possible.

From the user's point of view, it is important that the key properties of the life account – such as the preservation of capital and earmarking – are not undermined with time. Failing that, the reliability, and thus the use of the account is jeopardised. An individual must be able to rely on the promise that the account constitutes a personally earmarked safety net and that all efforts to expand and consolidate it inure primarily to the benefit of the individuals themselves. The operation of the account must be completely transparent and it must be easy to monitor the account capital.

In principle, the transition to the life account is similar to the process proposed by Heikki Hiilamo[21] for the changeover from the existing social security system towards unconditional basic income:

1. Individualisation of social security.
2. Assurance of equal treatment in the social security context.
3. Combination of benefits.
4. Elimination of bureaucracy.
5. Alleviation of the income-reducing effect.
6. Simplification of taxation.

21 Perustulon avulla eroon köyhyydestä http://perustulo.org/kansalaisaloite-perustulosta/asiantuntijalausuntoja-kansalaisaloitteen-tueksi/heikki-hiilamo-perustulon-avulla-eroon-koyhyydesta/

The transition is discussed in more detail in the following sections. Chapter 10 analyses the various aspects of the model that can be adjusted in order to regulate the extent to which citizens will be required to assume responsibility for their own social security. Additionally, the author will present a number of other more extensive social and structural reforms contributing to the smooth operation of the life account model in the future. While these reforms are not necessary, they would, however, further streamline the life account system and so improve overall economic efficiency.

9.1 Integration into the existing social security system

The life account will replace the existing forms of social security either in part or in full. Integration into the present social security system would be easiest if the labour market support and student grants would be completely discontinued and replaced by the introduction of the life account. An amount more or less equivalent to the level of these benefits could be withdrawn from the life account on a monthly basis irrespective of the account balance. Other needs-based benefits could also be integrated into the model in the long term.

When social assistance or any other discretionary support is claimed, cash could initially be withdrawn from the life account in accordance with the permissible monthly maximum. This would be possible even if the account balance were zero or negative.

Initially, under the life account system, the statutory unemployment insurance premiums would remain unchanged and the earning-related unemployment security would continue to be financed in the same way as today. At present, unemployment funds pay 5.5 per cent of the daily allowance, whereas the earnings-related portion is paid by the Unemployment Insurance Fund and the basic portion by the state.

The earnings-related daily allowance paid to the unemployed could be replaced by the life account within the framework of the transitional arrangements. The unemployment insurance premiums could remain statutory, but would, in part or in full, be credited to the life account, and the basic and earnings-related portions of the unemployment benefit would also be financed from the life account. The statutory portion payable to the life account out of wage earnings (initially 10 per cent) could be increased in order to secure adequate funding for the life account system. As it would not, strictly speaking, be a parafiscal charge, raising the upper limit would not automatically mean a tax increase. Even if part of the payments made to the life account were to constitute loan repayments in case of a deficit, the social security property of the life account would remain unchanged.

9.2 Integration into the tax system

The life account can be integrated into the existing income tax system without any major modifications. Funds in the life account are not taxed until money is withdrawn for one's own use. Taxes are paid as part of the account holder's personal income taxation. Alternatively, transfers to the life account can be integrated into the existing withholding tax system even if they are not parafiscal charges (see section 8.2.3 Transfers to the life account). The most natural solution would be that the employer simply transfers the statutory 10 per cent portion (or any other amount selected by the wage-earner subject to the upper limit) directly to the employee's life account.

The life account is convenient to self-employed people who currently operate as private traders. The earnings of a self-employed person will be taxed as part of personal income taxation. With regard to the expenses directly related to earning the income, the right to make tax deductions should be as extensive as that enjoyed by entrepreneurs. The life account would offer greater social security for the self-employed and small entrepreneurs than the current system.

9.3 Integration into the labour market

The adoption of the life account will not require changes to the current regulation of the labour market. However, the life account would operate more efficiently if the labour market were to be deregulated and its performance improved. For example, employment at pay levels below the industry-specific minimum wage would be allowed. It would also make sense to give up erga omnes applicability. As a result, people could find employment flexibly according to their individual capabilities and complement their income level with social security withdrawn from the life account.

At present, the rigid regulations of the labour market are circumvented by means of temping agencies and various forms of wage-subsidised employment. Wage-subsidised workforce is used for low-productivity jobs that the long-term unemployed would otherwise be qualified for. The period of time for which wage subsidies are paid determines for how long a long-term unemployed person can actively participate in the labour market. Upon its expiry, a new period of unemployed follows. [10]

Short periods of wage-subsidised employment are neither in the employee's nor the employer's interest: a new person needs to be trained for the job time and again, and the employee has no continuity in the employment relationship. In a free labour market, such jobs would be created on market terms and the individual could complement his or her income through the life account. If so, employment based on apprenticeship could also become more common.

During the period of transition, the life account model can replace both the current earnings-related unemployment security system and the employment pension system. Both are, to a great extent, controlled by the labour market organisations, even though most of the benefits are financed by tax revenues not earmarked for this purpose.

10 Adjustment and additional features of the model

This section provides a brief description of the options that can be used to adjust the life account model in the preferred direction.

10.1 Model adjusting screws

If the life account model is to be less participatory, the monthly withdrawal limit can be raised or the conditions relaxed even when the account balance is in the red. This would constitute a model more closely resembling the conventional basic income system, where the basic income would be an unconditional benefit irrespective of the previous withdrawal history without any needs assessment or earmarking of funds.

A high withdrawal limit implies strong dynamic effects, meaning that the model would substantially increase employment and thus broaden the tax base. It would also call for greater faith in citizens as ‘rational consumers’, which is a point of contention in economics (See section 7.2).

The withdrawal limit for the life account can also be staggered or it may include discretionary elements similar to those in the existing needs-based social security system. If so, the life account could be used to replace the current social security system more extensively, if not completely.

Naturally, the life account withdrawal limit can also be lowered, but this should only apply to funds other than those saved by the account holder him- or herself. Otherwise one of the underlying principles of the life account model would be seriously compromised and the system would not encourage people to save and accumulate capital as effectively as the standard type of account.

The life account withdrawal limit can be lowered and controlled more closely when the account balance is low (less than the initial capital) or negative. Restrictions may also be imposed based on the account holder’s age. For example, this could be done if it is feared that a person who has just reached the age of majority and has been assigned a life account would deplete the account as quickly as possible without studying or working at the same time.

10.1.1 Upper limit for funds transferable to the life account

With the life account, it is possible to defer consumption subject to certain limitations without having to pay income tax on work already completed. Income tax will not become payable until funds are withdrawn from the life account for personal use. If a person starts saving in the account at an early stage and does not withdraw any funds until towards the end of his or her life, this represents a major deferral of consumption – and taxes – which will have obvious fiscal implications, particularly in the early days.

Some of the fiscal losses will be compensated by the services purchased using the funds in the life account as well as by the employment-enhancing effects of the circulation of capital. To put it differently, the public use of funds is partly privatised. If this effect is to be controlled more closely than provided for by the standard life account model, the annual ceiling for the funds transferable to the life account can be lowered from the present EUR 50,000. This may well be justified especially in the introductory phase of the model.

Any lowering of the account transfer ceiling would also mean a lowering of the VAT liability limit because the same ceiling would apply to those who employ themselves by means of the life account. If so, some of the current self-employed people would need to run some form of business in addition to the life account because the volume of business permitted by the account would not be high enough to earn a living. This would happen especially if the ceiling were to be set much lower than EUR 50,000.

10.1.2 Funds transferable from one life account to another

The amount of funds transferable from one life account to another is limited primarily for tax reasons. A person with a higher personal income tax rate may transfer funds from his or her life account to that of another person with a lower income tax rate. While this makes sense to some extent (e.g. in the case of inter-family support between spouses), it also offers obvious opportunities for effectively lowering one's own income tax rate if such funds are circulated via another account back to the original account holder.

This possibility can be primarily limited in four ways by:

1. allowing only transfers for consideration;
2. limiting transfers not for consideration to transactions between married spouses or registered partners;
3. lowering the transfer limit;
4. harmonising income taxation and reducing the progressiveness of income tax.

Of these, the fourth option is the simplest and most sustainable in the long term (see also section 10.2).

Employment through the life account can be limited to certain services, just like the existing domestic help credit. The preparatory report on the effects of the tax deductions for household services issued by the Government Institute for Economic Research (VATT) states that in order to increase the employment effects, the tax credit should primarily target services which take a lot of time when the work is done as domestic chores by people themselves. This would make it possible to achieve time savings that people could use for performing their own work in the labour market. According to the study, lower taxes for services requiring special expertise could be justified if this would have a major impact on moonlighting. [14]

As far as the standard version of the life account is concerned, Libera does not take any stand on whether the permissible uses of the funds transferable from one life account to another should be restricted. Often, complexity adds to inequality and the potential for misuse, but in accordance with the objectives of the life account model, funds should primarily be channelled to creating employment opportunities rather than financing materials purchases. Additional research can be carried out to look into this matter.

10.2 Potential additional features

10.2.1 Simplified and less progressive income taxation

In the life account environment, taxation is simple and predictable. Several social policy experts and the proponents of the contemplated basic income models favour a simple income tax regime with only a few tiers.[22], [23], [24] The levels vary according to the size of basic income, the tax base and the tax-exempt por-

22 Perustulon avulla eroon köyhyydestä (Elimination of Poverty through Basic Income) http://perustulo.org/kansalaisaloite-perustulosta/asiantuntijalausuntoja-kansalaisaloitteen-tueksi/heikki-hiilamo-perustulon-avulla-eroon-koyhyydesta/

23 Vihreiden perustulomalli (The Greens' Basic Income Model) http://www.vihreat.fi/perustulo/malli

tion; a two-tier system is used in the United Kingdom, for example. Simple and predictable taxation facilitates planning in the various phases of life. Equitable taxation without complex deduction rights is also fair and treats the citizens equally.

All the basic income models recently published in Finland propose a single or two-tier flat tax rate to complement the basic income scheme. Flat-rate taxation means relative taxation, in which the tax rate is the same for all (or tiered only once) after a certain tax-exempt portion. Consequently, highly paid people would, in absolute terms, still continue to pay more taxes than low-paid people, but the tax rate itself will not increase with increased earnings.

For example, the basic income model advocated by the Greens of Finland proposes a two-tier income tax: annual income below EUR 60,000 (EUR 5,000 per month) would be taxed at 39 per cent and any earnings beyond that at 49 per cent (the figures are based on a calculation made in 2007 and include both state and municipal tax). In reality, almost everybody's taxes would decrease because all would receive a basic income in addition to wage earnings.

10.2.2 Increasing the limit for value added tax liability

Section 7.5 discussed the significance of the liability to pay value added tax from the small entrepreneur's point of view. The life account model takes no stand on increasing the turnover limit for VAT liability. Most likely, a reduced tax wedge for low turnovers would increase demand for services, but it would place small companies of different sizes in a different position.

The life account model reduces the tax wedge automatically by exempting the purchase of services partly from tax. From the competition point of view, it would be a more neutral way of implementing such a change than any increase in the turnover limit for VAT liability. Another, competition-wise more neutral way of lightening the VAT burden on small entrepreneurs than an increase of the VAT limit would be to raise the basic VAT deduction from the current EUR 22,500 to EUR 50,000. This has been proposed, among others, by the Federation of Finnish Enterprises. While Libera takes a favourable view of these deliberations, any changes to the criteria for the determination of value added tax are not a prerequisite for the operation of the life account.

24 Vasemmiston 750 euron perusturva -keskusteluasiakirja (EUR 750 Basic Security Model of the Left) http://dl.dropbox.com/u/4740043/jaettavia/keskusteluasiakirja_1_2011.pdf

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Literature review: Personal welfare accounts

ELINA LEPOMÄKI

Over the course of the past 40 years, there has been substantial research carried out on personal savings and unemployment accounts, their effect on wealth accumulation, protection in periods of unemployment, the incentives for individuals to work and save, the moral hazard related to insurance systems, as well as the cost of personal welfare accounts in relation to the current unemployment insurance systems. The contribution to research has been substantial by the two world famous economists, Harvard professor and president emeritus of the National Bureau of Economic Research Martin Feldstein as well as Nobel laureate, University of Columbia professor Joseph Stiglitz. The topic has been able to cross ideological boundaries. In this literature review, we will aggregate the main findings of the work carried out by Feldstein and Stiglitz over the years as well as summarise the findings of studies conducted in Europe focusing on adopting welfare accounts in Nordic welfare systems.

In his pioneering research Feldstein showed the effect of Social Security on personal wealth accumulation. (Feldstein, 1974) Using econometric evidence he stated that social security depresses personal saving by a substantial amount (30–50 %). He defines the present value of social benefits as social security wealth, which is not real, but merely an implicit promise that the next generation will tax itself to pay the promised benefits. The amount of social security wealth represents the amount of real wealth that is lost because of the program.

In his 1990s work, Feldstein stated that the pay-as-you-go Social Security system is acting as a drag on economic growth in two ways. First, the payroll tax distorts the supply of labour and the type of compensation sought by workers. These losses are inevitable because of the low return implied by the unfunded Social Security system. Second, the system reduces national savings and investment. Feldstein proposes that transforming the social security system from an unfunded pay-as-you-go system to a system of mandatory private savings accounts, would solve both of those problems and increase economic growth. (Feldstein, 1998)

Feldstein's arguments are consistent with the traditional life-cycle theory of individual consumption-saving behaviour that forms a fundamental part of modern economic theory (Modigliani, 1966; Mankiw, 2012). People attempt to even (or smooth) out their consumption over the course of their adult lives. Borrowing allows people to enjoy some of their future expected income earlier in their life. As people grow older and their incomes rise, they pay off debts and start to save for their retirement years. However, a social security program paying substantial retirement benefits distorts this picture. In systems where people view their social security taxes as an alternative to retirement saving and reduce their saving by the full amount, social security can be argued to cause a loss of private savings.

In his work with Daniel Altman, Feldstein (Feldstein & Altman, 2007) proposed Unemployment Insurance Savings Accounts (UISAs) as an alternative to the traditional Unemployment Insurance (UI) system. UISAs would provide the same protection to the unemployed as the current unemployment insurance system but with less of the adverse incentives. The system would require each individual to save a fraction of his or her wage income in the UISA. If he lost his job and would be eligible for unemployment benefits under the current UI rules, he would withdraw an amount equal to the regular UI benefits from his personal UISA.

In the research, the authors investigated a key empirical question as to whether the concentration of unemployment among a relatively small number of individuals implies that the UISA balances would typically be negative, forcing individuals to rely on government benefits with the same adverse effects that characterize the current UI system.

The authors used the Panel Study on Income Dynamics to simulate the UISA system over a 25-year historic period and found that almost all individuals had positive UISA balances, implying that they would remain sensitive to the cost of unemployment compensation. Even among individuals who experienced unemployment, most had positive account balances at the end of their unemployment spell. They found that the cost to taxpayers of forgiving the negative balances was substantially less than half of the taxpayer cost of the current UI system in the United States.

Joseph Stiglitz (Stiglitz & Yun, 2005) has researched integrating social insurance programs with pension programs through individual accounts. The finding is that such integration is desirable unless the risks are perfectly correlated to each other. The system would allow workers to borrow against their future wage income to finance consumption during an unemployment episode. It would improve search incentives while reducing the risks arising from unemployment.

In the past, Stiglitz together with Richard Arnott, has also studied the effect of moral hazard on individuals' activities and incentives. (Arnott & Stiglitz, 1990) Moral hazard arises whenever risk-averse individuals obtain insurance and their accident-avoidance activities cannot be perfectly monitored. In their 1990 paper the authors contend that economies in which moral hazard problems are present contain numerous forms of inefficiencies. Such problems are pervasive in the economy and do not only arise in explicit insurance policies but also in implicit policies such as on the labor market. Whereas the focus of the analysis was to cast doubt on the decentralizability of economies, the same moral hazard problems can be held true also for government controlled insurance programs, such as unemployement benefits and other social security: if individuals do not bear the full consequences of their actions, incentives for accident avoidance tend to be less.

A group of economists have researched the option of adopting welfare accounts in Sweden in the early 2000s. In their research (Fölster;Gidehag;Orszag;& Snower, 2002), they examined a large panel of individual income data and found that the adoption of universal welfare accounts could reduce social insurance expenditure considerably, improve the incentives to work and save, all with relatively small redistributive impact. In Finland, the Research Institute of the Finnish Economy has produced similar findings both in relation to social as well as health accounts. In their work (Lassila & Valkonen, 2008), the authors have called for further studies to simulate the effect of a welfare account policy by using sufficient data panels to analyze effects of income shocks at individual level. They also call for further investigations of dynamic decisions by individuals through a numerical model.

A recent Danish study claims that individual welfare accounts can redistribute lifetime incomes at a lower efficiency cost, compared with a conventional tax–transfer system. (Bovenberg;Hansen;& Sørensen, 2012) The study describes a design for welfare accounts that guarantees a Pareto improvement if behavioural responses to the accounts improve the public budget. It further develops a formula for quantifying the impact of welfare accounts on the government budget and economic efficiency.

One of the few countries to have implemented a personal social security account so far is Chile. Chile was the first country in the western hemisphere to set up a social security system, and the first country in the world to reform it using individual investment accounts. It has again broken new ground by becoming the first country to use individual accounts in an unemployment insurance (UI) system. There has been substantial research and case studies on unemployment accounts in Chile. (Conerly, 2002) (Acevedo;Eskenazi;& Pagés, 2006)

In the past decades, there has also been substantial research in favor of shifting the focus of taxation from capital and income taxes to consumption taxes. Economist Arthur B. Laffer popularized in the mid-1970s the possibility of an inverse relationship between tax rates and government revenue. (Laffer, 2004) The idea behind the formulation was not new, tracing back to Adam Smith (Smith, 1776). The 1980s were largely dominated by supply-side economists, stressing the impact of tax rates on the incentives for people to produce and to use resources efficiently. Whereas marginal tax rates directly affect the incentive of people to work, to save and invest, and to avoid and evade taxes, a consumption tax was argued to have a more neutral effect on economic activity and e.g. no impact on the rate of capital accumulation. (Canto;Joines;Laffer;Miles;& Webb, 1983)

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If this is such a wonderful reform, why has is not been implemented anywhere?

Social security accounts and the other features of the life account have been successfully tested in several countries. Singapore has a social account system allowing citizens to save while working and withdraw funds for health care purposes. Chile uses a system providing unemployment security in the form of loans. In the United Kingdom, there is a soft student loan on which repayments need to be made only at a relatively high income level. Many countries have installed employment pension systems conducive to saving, allowing private individuals to save when permitted by their circumstances and to postpone taxation on savings at a later date. In Sweden, a debate on social accounts has been going on since the late 1990s. Additionally, tax deductions similar to the Finnish domestic help credit are used in a few other countries including Sweden.

Wouldn't such a radical reform wreck the Nordic social security model?

The reform would be radical in terms of its incentive implications – as it is supposed to be; however, it would help maintain the current level of benefits. More than anything else, the existing social security model is being threatened by the erosion of the funding base. If nothing new is invented to replace it, the only option is to cut benefits across the board and tighten the criteria for eligibility.

Should the labour market be deregulated at the same time?

No changes to the labour market are required if social security is converted into debt. If those with little training are to earn even part of their disposable income themselves, it should be possible for them to agree to lower wages than permitted today. It should be pointed out that the employee would be eligible to wage subsidies in the form of basic income.

Would the reform require the introduction of a flat tax rate?

Not necessarily. A basic income independent of earnings is in itself progressive even if all earnings are taxed at the same rate. Most basic income models proposed in Finland would make the income tax less progressive. Moreover, the life account model would work more efficiently if the income tax were less progressive and closer to the capital tax rate.

Should the pension system be overhauled at the same time?

While it is not necessary to reform the pension system at the same time, this would be advisable for a number of reasons. It would be a good idea to have more individual freedom in investing the assets. It would be a simple system where citizens would have a single account from which to withdraw money when a justifiable reason for this exists, for example because of unemployment or studies, and in which to save for old age when permitted by their income level.

Would anybody be bold enough to accept support in the form of a loan, for example if a household already has a big mortgage or the periods of unemployment are long or recurring?

Probably not if it were a question of a market-rate loan. But loan-based social security would offer much softer terms, such as a zero rate of interest. For most people, periods of study and unemployment would only account for a short time of the total work career. As the loan would be repaid little by little over decades of active employment, it would only mean a minor increase of one or two percentage points in the marginal tax rate. The overall tax rate would be reduced when tax revenues would no longer be required to finance conventional social security.

According to Pekka Myrskylä's article in Statistics Finland's Tieto & trendit magazine, those with just primary level education accumulate only 25 years of employment out of a theoretical maximum of 47 years. "Moreover, employment often consists of random jobs because people also accumulate approximately six years of unemployment. Thus, every fifth year is wasted in idleness. This means extremely low lifetime earnings and a low pension later on."

Clearly, this group of people will not be able to repay the benefits received during unemployment through income earned during employment, at least given the present-day labour market. Accordingly, a further objective of the reform is to make it easier to hire low-productivity workers for jobs that now remain undone.

What political parties support the social security reform outlined by Libera?

We hope that all parties examine the report and take a stand. However, our educated guess is that the reform of the social security system towards personal accounts could, in principle, win broad-based support. The principle can be implemented in a 'left-wing' or 'right-wing' framework. To a certain extent, the system incorporates the same features as the proposed income support reforms that have been attractive particularly to the Greens and the parties of the left.

The life account model underlines the individual's possibilities of combining work with social security in a flexible manner.

A similar idea was put forward by the Government in its 2013 budget planning session. The National Coalition-led rainbow Cabinet proposed the introduction of protected earnings (EUR 400 in the case of housing allowance; EUR 300 in the case of unemployment benefits). As a result of the reform, an unemployed person could earn an amount equivalent to the protected income without losing the benefits involved. The idea is to eliminate disincentives. One of the values underlying our proposal is a work ethic emphasising industry and diligence, something that the Finns Party has often underlined.

Aside from the social security reform, the life account model proposes an employment reform for employer-households and self-employed people. For years now, the domestic help credit has been the pet scheme of the National Coalition Party, while the cause of the small entrepreneur has been embraced by several MPs from both extremes of the political sphere. Simplification of taxation, less progressive income tax, and the harmonisation of capital and income taxes have been advocated not only by the traditional right but also by the Greens and the political left. The Centre Party, for its part, announced its alternative in October in response to the Government decisions. Among other things, the policy paper declares as follows: "The Centre Party would reform and simplify the palkka.fi Payment Service for Small Employers to make it easier for households to offer employment opportunities."

Examples

1. Loss of a permanent job

In a small locality, there is only one major employer who decides to wind up operations. As it is, a person losing a permanent position is entitled to an earnings-related daily allowance for a total of 500 days – or almost two years – amounting to about 55 per cent of the regular income of an average wage earner. Under the present system, it does not make sense for the unemployed person to accept any temporary jobs because they would diminish their unemployment benefit.

A more incentive model would be, say, to pay the current type of benefit for 100 days and offer an unemployment loan for the remaining 400 days. This would increase the incentive to accept intermittent employment, retrain for a new profession or move to a locality with better employment opportunities. In these types of cases, the existing insurance-type unemployment security is still reasonably justified.

How would the life account respond to this challenge?

The life account model can be extended to cover earnings-related daily allowance available for the unemployed. With the life account, everybody would always have access to basic social security subject to the limit established for withdrawals, while the unrestricted funds saved in the account would serve as an earnings-related buffer in case of potential unemployment. The individual would always be motivated to accept work – even occasionally during unemployment – because he or she would not lose benefits or access to the funds in the account even if they are not 100 per cent unemployed. Instead, the individual would enjoy greater freedom in deciding how much unemployment support is necessary at any given point. Moreover, while working, he or she would enjoy greater freedom in deciding how much extra money to save in the life account as a buffer for any periods of unemployment or under-employment. A part of all wage earnings would always be saved in the life account under law.

2. An intermittently employed person with an academic degree

Of all people, worst treated under the existing system are freelancers and those with intermittent employment. Self-employed people with occasional assignments have no income security to speak of. However, many intermittently employed people claim unemployment benefits and during the periods they do so, it does not make sense to accept short-term employment because they eat into the benefits. In contrast, a person engaged for slightly longer periods of time can make his or her life fairly comfortable. In order to re-qualify for the 500-day income security, one has to work for a total of 34 weeks over a period of two years. A loan-based social security system would offer greater incentives.

How would the life account respond to this challenge?

The life account model makes no distinction between periods of full-time or part-time employment or unemployment, or equivalent periods of variable duration. Additional income is available whenever needed – and the decision whether to draw such income is very much left to the individuals themselves. With the life account model, nobody needs to pretend to be unemployed if they are not, and all work pays.

The balance of unrestricted funds in the life account is equivalent to earnings-related unemployment security: when withdrawing such unrestricted funds from the account for personal use, the account holder reduces the size of the saved buffer which would otherwise be released in full at a later date, including a potential return on investments. It will not make sense for anybody to withdraw any more unrestricted funds than are really necessary.

With the life account model, provisions for periods of unemployment will not depend solely on voluntary individual efforts. Today, earnings-related unemployment benefits are largely financed out of tax revenues and the compulsory unemployment security premiums payable by all employers and employees. In the life account model, unemployment security would be more extensively based on individual responsibility, even though various types of insurance are conceivable as complementary elements.

3. Student financial aid

Student financial aid represents a transfer of income from the poor to the rich. Discontinuation of the current type of financial aid would not prevent anybody from pursuing full-time studies if repayments on student loans would not begin until a specific income level is achieved. However, the reform would discourage artificial prolongation of studies in order to gain some study-related social benefits.

How would the life account respond to this challenge?

The life account model offers students similar financial support as the current financial aid system, except that this support will not shrink if people work while studying. Nor will the financial aid be directly linked to performance; instead, the amount of and need for support withdrawn from the life account would primarily be based on individual discretion. 'Progressive control measures' would not be applied until the initial capital is seriously depleted.

Similarly, the current student loan can be replaced by extending the life account model. In reality, it would mean increasing the withdrawal limit for the account on a temporary basis (allowing the individual to withdraw more money per month for personal use) and staggering the repayment schedule relative to the income level within the framework imposed by the life account.

4. The less fortunate

When it comes to the employment of poorly educated people, the incentives available to employers to hire people are even more important than the incentives to accept offered work. Wage subsidies provided in the form of basic income would make it possible to employ people at a lower cost. Even so, basic income would have to incorporate features that encourage people to seek employment; for example, part of the basic income received could be recognised as a loan if the claimant fails to participate in working life or training. Similarly, social assistance should consist of a loan, at least partly. If the loan principle grows with time, social services or employment authorities should step in and organise civil work or training for those overly indebted.

How would the life account respond to this challenge?

The life account gives access to additional income on top of wage earnings. The support available in the life account will not be lost on receipt of other earnings. This sort of support would be loan-based, in that part of all wage earnings would always be credited to the life account, the use of which would be restricted when there are no unrestricted funds (exceeding the initial capital) in the account.

The life account makes it possible – in accordance with the principle of 'progressive control' – to impose staggered restrictions on withdrawals from the account if the account balance is low or being quickly exhausted. The restrictions would not mean that the individual would be abandoned or his or her income reduced; rather, they mean that people would be given other assistance beside financial aid when a need for such assistance arises.

While the life account takes no direct stand on the operation of the labour market, amendments to labour legislation or the limitations imposed by collective agreements with regard to pay levels or termination provisions, etc., would make it easier for employers to take the decision to hire somebody. Then, employers would also be able to offer short-term employment other than through temping agencies or hire people on a permanent basis at a pay level below the minimum wage. Most likely, demand for labour would increase, particularly among those with low employability.

More examples and calculations are provided at libera.fi.

How should the Finnish welfare state version 1.0, created in the 1960's, be upgraded? Many institutions of the welfare state, such as social security and healthcare, education and taxation, were built in a time of the Old Normal. Based on the assumption of continuous economic growth, it made sense to create cost machines and to reason that social problems could be solved through heaping money and public services on them. During a time of the New Normal these old systems are facing a crisis.

Libera's Life account is a concrete model for transforming the current welfare state to a new version, 2.0. The life account is a form of a personal welfare account, which improves the incentives to work, employ and save. Compared with a conventional tax-transfer system, it reduces social insurance expenditure. The model allows to combine work income and social benefits, leaving the initial need testing to the individual. It reduces the tax wedge and allows for more flexible employment by households and individuals. The life account also encourages individual saving, financial planning and the accumulation of private wealth.

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