

## SPECIAL

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for Improved  
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# Unconditional Basic Income

Thomas Straubhaar

## Universal Basic Income – New Answers to New Questions for the German Welfare State in the 21st Century

The universal basic income (UBI) is a new answer to the main challenges for the welfare state in the 21st century. Even if long term forecasts have become more difficult to make than ever before due to the disruptive processes that structurally deform economies and societies, some long-term trends are highly predictable:

- Globalisation, digitisation and individualization will fundamentally change how and with whom people will spend their life time, and how and where they want to live, work and earn their living.
- Additionally, increasing geographical, professional and social mobility and flexibility and (ab)use of big data will completely transform the relationship between public policies and individual responsibilities to protect people against uncertainty and insecurity. This also applies to topics that are so important for individual economic success and social status like health and education. Lifelong education will become indispensable. But investments in personal health and (further) education require both free time and available (personal) financial resources.
- Furthermore, traditional security nets – like family bonds – will become looser. Marriages and parental partnerships may no longer last a lifetime and will leave a higher number of single parents, who are particularly affected by poverty – especially in times of higher age.
- Finally, relatively low fertility rates and increasing life expectancy will lead to further demographically aging societies with rising financial pressure on the pay-as-you-go pension system whereby active workers have to pay for retired pensioners.

Openness and the global integration of markets, international division of labour and competition may well improve efficiency and stimulate economic growth. New technologies will offer new opportunities for a better life and greater prosperity for all. But globalisation and digitisation also carry the risks of increasing inequality.<sup>1</sup> The gap between higher and lower-paid work and richer and poorer people could increase.<sup>2</sup> Moreover, growing polarisation will make it more difficult to achieve political stability and social cohesion within and between countries and their societies (Bertola 2018).

A welfare state that has its foundations in the circumstances of the late 19th century may prove unable to keep pace with the mass of structural changes in economics, politics and society in the future. Globalisation and digitisation are highly disruptive processes. Disruption occurs precisely because the consequences of new technologies and new political developments are so flexible and pervasive. Consequently, adopting today's welfare state to the circumstances of the future is one reaction, but adapting is another one (Mühleisen 2018). Therefore, two basic strategies could be followed to answer the challenges of the future: either politics wants to change the world to adapt it to an old social welfare system, or societies find a new welfare system that fits well to the disruptive processes of the world in the 21st century. The UBI follows the second option.

### LIMITS OF THE BISMARCKIAN WELFARE STATE MODEL

Today's German welfare state was established by its Iron Chancellor Otto von Bismarck during the heydays of industrialization at the end of the 19th century. At that time, workers were moving in masses from an agrarian subsistence economy to heavy industry and manufacturing factories. They worked hard and died young. While in middle age a farmer had to work some 1,500 hours a year to make a living, at the end of the

<sup>1</sup> It is a hotly debated question whether globalization or digitization is (more heavily) responsible for an increase in inequality. Analysis by IMF staff suggests that technological progress has contributed the most to widening income inequality in recent decades (see Obstfeld 2016).

<sup>2</sup> Income inequality has increased in nearly all world regions in recent decades, but at different speeds (World Inequality Report 2018).



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19th century a factory worker had to put more than twice those hours simply to survive (see Bregman 2017). Average annual working time in 1885 was about 3,660 hours; nowadays it is about 1,350 hours per year.<sup>3</sup> And while today's life expectancy at birth is 78.3 years for boys and 83.2 years for girls, it was 35.6 years for boys and 38.5 years for girls in the late 19th century when Bismarck's 'carrot-and-stick policy' was the midwife of the first pension system in Germany.<sup>4</sup>

In the aftermath of the Second World War, the German welfare state had to be re-established from scratch. It still relied on the Bismarckian ideas of a dual system with a pay-as-you go scheme financed by labour wage fees on the one hand, and a tax-financed general redistribution system on the other. Under the disastrous post war circumstances, the Bismarckian type of social welfare state was the right decision because it was fast and relatively easy to establish.<sup>5</sup> And in times of a 'German economic miracle' with rising prosperity for large swathes of the society, a baby boom leading to a growing population, and labour-intensive industrial manufacturing, the welfare state was expanded step by step.

According to the economic, social and demographic conditions of post-war circumstances, today's 'Bismarckian' German welfare state is based *demographically* on the classical population pyramid with many young people following their ancestors; *socially* on the traditional family model with a – mostly male sole earner and a mother who cares at home for the education of common children and a marriage that lasts the whole life long; *economically* on a fast-growing economy, which provides the financial background for a steadily wider range of distribution; and *ideologically* on a (Protestant) work ethic, that understands work as the main task of humans.

None of the pillars of the Bismarckian social welfare state of the post-war period will correspond to the future (for data and details, see Straubhaar (2016)): *demographically*, the population pyramid has been turned on its head - fewer and fewer young people will be confronted by more and more elderly people; *socially*, private and professional breaks of relationships have become the rule and the traditional family understanding has been replaced by new forms of living together in 'patchwork' relationships; *economically*, growth rates have slowed, public debt has risen, and globalisation and digitisation are changing the value-added processes, narrowing the room for distribution and calling into question the so-called 'intergenerational contract'; and *ideologically*, more and more people are searching for a more balanced

work-life allocation of their life time, searching for options to work less and spend more time on leisure.

It comes as no surprise that the increasing discrepancy between reality and (Bismarckian) ideology has already led to severe problems in the German welfare state in recent decades. The principle of equivalence has been ignored in the social welfare system for a while. The payoffs by far outweigh payments into the system. A balance is only struck thanks to an increasing inflow of additional public money stemming from taxes (and not from contributions, as supposed in the Bismarckian concept). The tax-financed portion reaches about one-third of total payoffs – see Federal Ministry of Labour and Social Affairs (2017). The further ageing of the population in particular will increase the financing problems of the welfare state. Pension contributions will rise, and the pension level will fall. These are not positive prospects for future generations.

### **BASIC GOALS OF A WELFARE STATE MODEL FOR THE 21ST CENTURY**

A welfare state in the 21st century has to correspond to the circumstances that will shape the daily living conditions of the masses in the future. It should switch from "safety net policies – which protect those subject to job loss, for example, through unemployment benefits – to trampoline policies that offer a springboard to new jobs" (Obstfeld 2016, 15).

An appropriate welfare state of the future has to offer answers to the questions of how human work in the 'second age of the machine' (Brynjolfsson and McAfee 2014) can offset robots with artificial intelligence (AI) substituting or replacing the human labour force. It is not so much the fear that the future will lead to a jobless economy and that there will be no need for workers anymore that should be the concern of a welfare state in the future. It is rather the question of increasing the quality of jobs and respecting the growing desire of more and more people for a more balanced division of time between work and life. It could be a quite reasonable goal for a welfare policy to further lower weekly or annual working time, to allow more people to take longer time-outs and sabbaticals (that they could use for further qualification and lifelong further education).<sup>6</sup> Why should a future welfare state not judge 'unemployment' as a political success rather than a failure?

Globalisation and digitisation are provoking growing concerns over the future of employment, and the consequences of new technologies eliminating low-skilled work, depriving parts of the population of the prospect of employment and welfare. New technologies and increasing mobility of factors of

<sup>3</sup> Data are provided for the 19th century by Statista (2018) and for the present by OECD (2018).

<sup>4</sup> Data stems from Statistisches Bundesamt (2018). Actually, life expectancy for 60 year-old men was 12.1 years in 1871 and is 21.6 years today, while for 60 year-old women it was 12.7 years in 1871 versus 25.3 years today.

<sup>5</sup> For the distinction between the 'Bismarckian' and the 'Beveridge' type of social welfare state in the context of a UBI, see Kay (2017).

<sup>6</sup> Average working time has further decreased in Germany in the last hundred years from about 3,300 annual hours worked per worker in 1913 (Statista 2018) to 1,450 hours in 2000 and 1,350 hours in 2017 (OECD 2018), in fact the lowest working time of all countries analysed.

production (especially labour) might challenge the viability of social welfare and the financial stability of pay-as-you-go social security systems financed by fees on labour income. But at the same, tax systems that rely on labour income might come under pressure, because robots do not pay taxes (and do not pay contributions to social security systems either). Finally, technological change may result in increased inequality within a society and a stronger polarisation between capital owners and the labour force, and especially lower-skilled workers (European Parliament 2017).

If robots and AI are replacing workers and human brains, capital intensity and labour productivity are increasing. “The good news is that output per person rises. The bad news is that inequality worsens, for several reasons. First, robots increase the supply of total effective (workers plus robots) labor, which drives down wages in a market-driven economy. Second, because it is now profitable to invest in robots, there is a shift away from investment in traditional capital, such as buildings and conventional machinery. This further lowers the demand for those who work with that traditional capital” (Berg *et al.* 2016, 11). This may lead to growing inequality among societies and between economies (World Inequality Report 2018).

Even if the question of whether or not increasing income and wealth polarization is ‘fact or fake’ is highly controversial; and it is hotly debated whether and to what degree politics and welfare states are bridging the gap, more and more people think and believe that globalisation and digitisation are a negative danger rather than a positive opportunity (see Obstfeld 2016). Moreover, as behavioural economics shows convincingly (see the seminal work by Nobel prize laureates Daniel Kahneman or Thaler), feelings are sometimes more important than facts when people are judging the impact of public (social) policies. That makes the search for a robust and ‘fair’ welfare system for the 21st century so indispensable.

### **BASIC IDEAS OF THE BASIC INCOME CONCEPT**

The idea of a UBI is nothing new (for a survey on the moral philosophical roots of the UBI, see Van Parijs (1992) and more recently Van Parijs and Vanderborght (2017)): the idea of a minimum income first appeared at the beginning of the 16th century. The idea of an unconditional one-off grant first appeared at the end of the 18th century. And the two were combined for the first time to form the idea of an unconditional basic income near the middle of the 19th century (BIEN 2018).

Among the best-known advocates of a UBI in the 20th century were the British economist and politician Juliet Rhys-Williams, as well as the US economists and Nobel laureates Milton Friedman and James Tobin. As early as 1943, Lady Rhys-Williams made the socially-motivated proposal of a social security transfer that should cover the minimum subsistence level. For Lady Rhys-Williams, the abolition of a degrading ‘petition’

and a distrustful control by state authorities was the decisive advantage of a state’s livelihood without pre-conditions or considerations: “the State owes precisely the same benefits to all of its citizens, and should in no circumstances pay more to one than to another of the same sex and age, except in return for services rendered” (Rhys-Williams 1943, 138).

In the 1960s, Milton Friedman (1962) developed the concept of negative income tax as a coupling of income tax and social transfers.<sup>7</sup> James Tobin supported the concept of ‘an income guarantee’ that was based on the negative income tax (Tobin 1966). “In the US presidential election of 1972, Nobel Laureate James Tobin urged Democratic candidate George McGovern to propose basic income policies, while fellow Laureate Milton Friedman advocated a negative income tax to Republican candidate Richard Nixon” (Kay 2017, 70).

The ideas of Friedman and Tobin were then taken up by Philippe van Parijs, who brought forward the concept of a UBI and founded the (European) Basic Income Earth Network (BIEN) in 1986. This network provides alternative arguments about, proposals for, and problems concerning UBI as idea, institution, and public policy practice (BIEN 2018).

Nowadays, many scholars, such as Nobel laureate Christopher Pissarides (2016), believe it is important to search for more clever strategies to cope with the challenges of the 21st century: “we need to develop a new system of redistributions, new policies that will redistribute inevitably from those that the market would have rewarded in favour of those that the market would have left behind. Now, having a universal minimum income is one of those ways, in fact, it is one I am very much in favour of, as long as we know how to apply it without taking away incentive to work at the lower end of the market”.

Anthony Atkinson (2013) was also looking for ‘new forms of social security’. Of these, perhaps the most discussed is the idea of a ‘citizen’s income’ or a ‘basic income’, whereby a universal benefit is paid individually to all citizens. If the EU is to go down the basic income route, then a natural starting point is with an EU basic income for children. In his very last book, Atkinson (2015, 303) went a step further by proposing that “there should be a capital endowment (minimum inheritance) paid to all at adulthood” – an idea that closely resembles the UBI (with the difference that it is

<sup>7</sup> For Friedman, the question remained open ‘to what extent’ and ‘in what form’ state support should be granted to everybody. He stated that the fixing of the minimal income was primarily a political decision (even if the ensuing costs could produce economic distortions): “it would be possible to set a floor below which no man’s net income [...] could fall [...]. The precise floor set would depend on what the community could afford” (Friedman 1962, 158). To be fair, it must be mentioned that Friedman himself did not pursue a UBI concept, but rather a model aimed at employed persons whose own capacity is not strong enough to meet their own needs. This is supported by his statement that “like any other measures to alleviate poverty, it reduces the incentives of those helped to help themselves, but it does not eliminate that incentive entirely, as a system of supplementing incomes up to some fixed minimum would. An extra dollar earned always means more money available for expenditure” (Friedman 1962, 158).

not paid as a regular periodic (i.e. monthly or annual) flow, but rather as a one-off down payment).

Politics has reacted to the increasing demand for new social welfare concepts and the UBI plays a prominent role in these reactions. Switzerland held a referendum on its introduction (and rejected it) – see Schweizerische Eidgenossenschaft (2016). Finland has carried out a basic income experiment in 2017–2018 and will now go through an assessment of its results in 2019 (Kangas *et al.* 2017). India is contemplating replacing the welfare state with a UBI (Economist 2017). And in the United States discussions in favour of a basic income are gaining momentum, and especially arguments that a UBI might be a sane solution to the era's socioeconomic woes (Lowrey 2018; Yang 2018).

### THE BASICS OF BASIC INCOME CONCEPTS

The most popular definition of a UBI stems from the Basic Income Earth Network (BIEN): a basic income is a periodic cash payment unconditionally delivered to all on an individual basis, without means-test or work requirement. That is, basic income has the following five characteristics: (1) periodic: it is paid at regular intervals (for example every month), not as a one-off grant; (2) cash payment: it is paid in an appropriate medium of exchange, allowing those who receive it to decide what they spend it on. It is not, therefore, paid either in kind (such as food or services) or in vouchers dedicated to a specific use; (3) individual: it is paid on an individual basis – and not, for instance, to households; (4) universal: it is paid to all, without means test; and (5) unconditional: it is paid without a requirement to work or to demonstrate willingness-to-work (BIEN 2018).

A wide variety of UBI concepts and proposals have been presented and discussed in politics, economics and philosophy recently. They differ along many dimensions. There are different views on the amounts of the UBI, the source of funding, as well as the nature and size of reductions in other transfers that might accompany it. Straubhaar (2017) has elaborated a UBI concept that is an unconditional cash payment flowing monthly from the state budget to everybody. It is transferred from public to private accounts a whole life long, from birth to death without any pre-conditions to be fulfilled by the beneficiary. It is supposed to cover the socio-cultural subsistence minimum. However, it is a political and not an economic decision, where exactly the level of subsistence will be fixed.

The UBI is guaranteed to each member of the society as an individual legal claim. Everyone receives the UBI without application, without controls and without preconditions. It flows independent of employment, personal circumstances, relationships or attitudes. No one checks who is living with whom in what kind of relationship or whether there are good or bad reasons for granting a minimum allowance.

Straubhaar (2017) sees the UBI as a complete substitute for all other publicly financed support. The social welfare state would be replaced by one single payment – the UBI. It would be financed by taxes and there will be no further social fees to be paid by workers from their incomes. In its most stringent form, it would be designed as a single universal transfer combining in one single instrument all individual direct taxes and transfers or subsidies flowing from public coffers to individuals.

Finally, according to Straubhaar (2017) the UBI is financed by taxing identically (i.e. a flat tax) the outcome of all economic activity (i.e. the value added). Taxing identically value added at the end of the production process just when value added is leaving the production site and is distributed to the production factors in form of wages for labour, or interests (or dividends) for capital owners, or profits for the shareholders looks like the most promising response of the welfare state to 'digitisation'.<sup>8</sup> As soon as value added reaches people (i.e. workers, capital owners or shareholders) the treasury should tax the benefits of economic activities (and the outcome of a positive interaction between man and robots, human and artificial intelligence).

### UBI AS AN ADAPTION OF SOCIAL MARKET ECONOMY PRINCIPLES

The social market economy concept follows a simple idea: market efficiency and social redistribution are not mutually exclusive – indeed, they are mutually dependent. "The fundamental meaning of the social market economy is to link the principle of freedom in the markets with the principal of social balance" (Müller-Armack 1976, 243). A free market economy based on the principle of free allocation of production factors and prices that reflect supply and demand in competitive markets creates the greatest possible value added. Generating the highest value added possible is the most powerful precondition for socially oriented redistribution from the economically strong to the economically weak.

The UBI is an adequate and effective way to adjust the concept of the social market economy to the age of digitisation, globalisation and the long-term trends that accompany a demographically ageing society. It follows the principle that economic efficiency and social justice are not opposites. They can be harmoniously combined and are mutually complementary. The unconditional basic income unites the social with the liberal: it is liberal because it is unconditional, and social because it is for everyone. It is equal for everyone – and at the same time allows everyone to be different (Häni and Kovce 2015).

<sup>8</sup> Theoretically, it does not matter whether production (i.e. value added) or consumption is taxed with a flat (i.e. constant) rate. In practise, however, different degrees of openness and international mobility for consumers and producers, and the ease of tax avoidance strategies may speak in favour of taxing production rather than consumption.



Like the social market economy, the UBI consistently separates the allocation of income and the distribution of income. The efficiency of market economies should be used to maximize the value added in an economy (as the basis for income of the production factors involved to produce the value added, i.e. wages for labour, interest payments for capital and profits for owners and shareholders). In addition, market interventions aimed at redistributing income (i.e. taxes and transfers) should be applied efficiently, which means that they should distort the market outcomes as little as possible.

The UBI frees the labour market from social-political redistribution tasks. But it also corrects the income allocation effects of the labour market. It takes something away from the better-off to give it to those who earn little or nothing.

### **BASIC (DIS-)INCENTIVES OF A BASIC INCOME**

(Micro-)Economics is the art of setting incentives and sanctions in such a way that efficiency and equality, allocation and distribution, are balanced in a fair and equitable manner. Of course, the fundamental questions arise of what should be the level of a UBI and what would this mean for the tax rate to finance it? However, these questions are not at all specific to the UBI. They have to be answered anyway and independent of the question of whether a society wants to stay with a Bismarckian-type of welfare state or move towards a UBI.

Determining the UBI level is necessarily a political decision. Economists can only argue that a high UBI would require high tax rates (and *vice versa*) in order to finance it. High tax rates normally decrease incentives to work, because they have a negative impact on the available income. And a higher UBI will diminish individual labour supply more strongly than a lower UBI.

It cannot be ruled out that parties could be tempted to promise (unrealistically) high UBIs prior to elections. But this is by no means different from current practices. Competition for the electorate is part of democracy. A population must decide through democratic procedures whether it wants the UBI to be high or low, and whether it is willing to accept the consequences of this decision – including the high (or low) tax rates required to fund the UBI.

The German government regularly presents a ‘report on the amount of the minimum subsistence level of adults and children to be tax-exempt’, i.e. the minimum subsistence rate (Federal Ministry of Finance 2016 and 2018). Therefore, the political determination of the subsistence minimum in the context of a UBI would not be new, but rather the continuation of long-established political procedures.

There is no doubt that every intervention into the free interplay of supply and demand of production factors will have a greater or lesser impact on

incentives to work. These trade-offs are immanent to every welfare system that taxes income and subsidises people – independent whether it is a Bismarckian welfare system or a UBI. Therefore, the consequences of a UBI must be judged in relation to the (dis)incentives of today’s welfare state.

While the extent of redistribution requires a (normative) political discussion, the (positive) economic analysis can convincingly demonstrate that a ‘blind’ social policy is the most effective, most efficient and thus the most equitable social policy. An efficient social policy should support people, and not specific factors of production or regional or sectoral industries. Furthermore, it should refrain from paternalistic behaviour and simply flow unconditionally. The fundamental aim should be to redistribute some degree of purchasing power from people with higher incomes to those with lower incomes. Not more, not less. Direct individual payments to economically weaker people are more targeted, less expensive and more effective than indirect measures, which require the fulfilment of specific criteria, particular pre-conditions or certain behaviours, for example, the requirement of being employed or at least searching for employment, or the attainment of a specific age.

The UBI replaces the activating, controlling and thus paternalistic social policy of indirect aid with unconditional direct cash payments. However, this also explains why social bureaucracy and trade unions might oppose a UBI. They would lose influence and power in this new construction of the welfare state. The minimum wage would be replaced by a state-guaranteed minimum income, and the state would no longer have to worry about job creation or unemployment. Active public labour policies would become superfluous, which would save administrative costs.

Direct aid is more economically sensible and socially equitable than indirect actions, which are always associated with leakage in the form of bureaucracy and false incentives. Indirect interventions in the labour, education, health, insurance or housing markets are comparatively more expensive, imprecise and unjust.

### **UNIVERSAL BASIC INCOME – EMPTY DREAMS OF PARADISE OR UTOPIA FOR REALISTS?**

In spite of the radical rhetoric that some proponents use, the UBI is nothing but a fundamental tax reform. It unites all personal government transfers (or subsidies) and direct taxes as a universal payment in a single instrument. The UBI follows the concept of a negative income tax and enables a politically determined redistribution goal to be achieved much more precisely than with today’s principle of a tax system combined with a social insurance system. The UBI, in the form of a negative income tax, solves the allocation-distribution-

puzzle with one simple and transparent instrument in an efficient and effective way.

It is not really a surprise that the UBI gets a lot of headwinds and criticisms. Some opponents judge it simply as an ‘empty dream of paradise’ and decry it as ‘false happiness promises’ (Schneider 2017). Others see the UBI as a ‘Trojan Horse’ that fulfils the cynical plan, namely to destroy the old Bismarckian welfare state. They call it a *Stilllegungsprämie*, a public payment for deprived people to be silent and accept the severe consequences of structural change calmly and peacefully.

In a very balanced overview of the most hotly debated controversial arguments, Osterkamp (2016) examines the pros and cons, and also demonstrates (as far as available) some existing empirical evidence. It becomes obvious that the fiscal and labour market impacts of a UBI most heavily depend on the amount of the UBI. However, most, if not all, empirical analysis suffers from the disruption that the UBI would provoke. A simple extrapolation of existing correlations or causalities is misleading. The Lucas-critique applies “that any change in policy will systematically alter the structure of econometric models” (Lucas 1976, 41).<sup>9</sup>

The most controversial critique of a UBI is probably the expectation that people might lower their labour supply and will refuse to accept badly-paid, monotonous work offers; or jobs that are dangerous, harmful to health or violate human dignity. Yes, this may indeed prove the case, but may this turn out to be a positive goal: to avoid work that leads to physical injury and psychic pressure or mental illness?

The UBI wants to create the best possible (pre-) conditions for people willing to work. If as many people as possible are employed in (well-paid) jobs, there are also more funds available to support the economically weak. That is why everything must be done to enable people to work and earn their own incomes. The UBI empowers people, irrespective of gender, age and preconditions. It makes it easier for people to live according to their own ideas, wishes and norms. Not everyone will take advantage of these opportunities, but at least the options are open to everybody.

The UBI would empower people to more readily take on some risks of daily life.<sup>10</sup> If people are assured

that a failure will not lead to a bottomless case of destitution and poverty, and that their subsistence minimum is secured, they will assess future challenges as opportunities rather than threats. This applies to all people, and not just to those who behave in accordance with social norms and traditional values or behaviours. On the contrary, non-conformists often help to see the world through different eyes and from novel perspectives. New ideas and innovative solutions can emerge from the new thinking of outsiders.

Although the UBI is neither perfect, nor easy or even costless to introduce, it is worth analysing its implications in-depth and comparing them with those of alternative welfare state systems now more than ever. The UBI fulfils the economic law of satisfying a political goal at minimal economic cost better than any other concept for a future welfare state. So although a UBI may still seem utopian to many opponents: sometimes the long-term risks of radical changes cause lower costs than the risks associated with continuing the system already in place. A UBI is risky, but no UBI might be even riskier!

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and taking more risks also contains sound economic reasons for a state social policy, which serves the purpose of securing the subsistence minimum for everybody.

<sup>9</sup> The structural breaks that genuinely accompany the UBI also limit the insights of OECD (2017)-research into the impact of a UBI, because the OECD-simulations were restricted to the four countries Finland, France, Italy and Britain and derived their results from the rather unrealistic assumption of excluding any short-term or long-term behavioural responses to the introduction of a UBI. The OECD concludes that “realistically, and in view of the immediate fiscal and distributional consequences of a fully comprehensive UBI, reforms towards more universal income support would need to be introduced in stages, requiring a parallel debate on how to finance a more equal sharing of the benefits of economic growth” (OECD 2017, 1). These might indeed be wise suggestions to implement the UBI in practice.

<sup>10</sup> The economics of insurance behaviour convincingly show that insured people are willing to accept more risks (Sinn 1986). And a larger share of risk-takers within the total population correlates positively with the macroeconomic performance of a society. This empirical observation is the justification for compulsory insurance, for example motor vehicle liability insurance or health and accident insurance. However, the positive correlation between being insured

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## Some Lessons from the Recent UK Debate about Universal Basic Income<sup>1</sup>

### EVENTS

Rather than attempt to relate the whole of the recent history of the UBI debate in Britain – impossible in a short article – I shall concentrate on a series of events from which I shall draw some lessons that might have broader relevance.

### The Importance of Microsimulation Research<sup>4</sup>

In March 2014, at its Spring Conference, the UK's Green Party voted to include a UBI in its manifesto for the forthcoming General Election. The details had not been published, but what was known was that the Party intended a UBI of £72 per week for every adult (less for children and young people, and more for elderly people), and that it intended to pay for it by abolishing means-tested benefits and income tax personal allowances.

This scheme might have been similar to the Citizen Basic Income Trust's illustrative scheme that the House of Commons Work and Pensions Select Committee published as evidence in 2007, and that the Trust subsequently published in 2007 and updated in 2013. There was no problem with affording this scheme, as the abolition of personal tax allowances, the abolition of means-tested benefits, and the restriction of pension contribution tax relief to the basic rate of income tax, would have saved enough money to pay for the whole of the UK population's UBIs, but there was a problem. For some low-income households their UBIs would have more than replaced the value of their lost personal tax allowances, but they would not have replaced the whole of their abolished in-work means-tested benefits. Because the UBIs would never be withdrawn, additional earnings would have produced more additional disposable income than additional earnings could produce in the context of means-tested benefits, so households suffering small losses at the point of implementation of a UBI would have been able to make them up quite easily by earning a little more. This, however, was clearly not a total solution, so more work was required.

In 2012 I used the Euromod microsimulation software maintained by the Institute for Social and Economic Research at the University of Essex to quantify the losses that low-income households would have experienced; and during the summer of 2014 we studied a number of schemes similar to our illustrative scheme, and found that we could reduce the losses, but not eliminate them. So the search began for alternative methods of implementation: and work that I carried out using Euromod during the autumn of 2014 showed that a revenue neutral UBI scheme would not impose losses on low income households at the point of implementation if means-

### A GROWING DEBATE

Nearly thirty-five years ago, following a brief period of parliamentary interest in Universal Basic Income (UBI), a heterogeneous group of people gathered to discuss how we might promote debate on UBI (often called a Citizen's Income, or a Citizen's Basic Income): an unconditional and non-withdrawable income for every individual. The group became the Basic Income Research Group, and then the Citizen's Income Trust, and now the Citizen's Basic Income Trust: and although the name has changed, the purpose has remained the same: to promote debate on the desirability and feasibility of a UBI. For over thirty years the organisation has published the *Citizen's Income Newsletter*, maintained a library and a website, held meetings and conferences, and responded to requests for information. For most of that period, interest among policymakers, academics and the general public, was fairly limited, but around 2014 the debate started to take off. Articles in the press have multiplied, think-tanks have researched UBI and published reports, policymakers and academics have engaged with the issue and public interest is rising.<sup>2</sup>

The extent of an idea's influence is difficult to gauge, and the contribution that any particular factor has made to that influence is even more difficult to evaluate. The most likely explanation for the increasing depth and extent of the debate in Britain is that a variety of factors have reinforced each other: debate and activities in other countries (such as the pilot projects in Namibia and India, the current experiment in Finland, and the Swiss referendum); the Citizen's Basic Income Trust's history of meetings, conferences, publications, and conversations with groups and individuals; and the availability of books about the subject.<sup>3</sup>

<sup>1</sup> The author writes here in a personal capacity, and the views expressed are not necessarily those of the Citizen's Basic Income Trust or of the Basic Income Earth Network (BIEN).

<sup>2</sup> <http://citizensincome.org/news/a-new-european-survey-reveals-significant-public-support-for-citizens-basic-income/>.

<sup>3</sup> At a seminar at the London School of Economics in November 2017 Professor David Piachaud credited this author's books with having had an influence on the debate in Britain, and it is possible that the appearance of the first book-length general introduction since 1990 – *Money for Everyone* (2013) – did have a limited effect. What is certainly true is that the now considerable body of literature in English has increased both the extent and the intelligence of the debate in Britain.

<sup>4</sup> See Torry (2015a).



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tested benefits were left in place and households' UBI were taken into account as income when their means-tested benefits were calculated. The 2012 and 2014 results were published together in an Institute for Social and Economic Research working paper (Torry 2014), and were republished in the Citizen's Income Newsletter.

The trouble for the Green Party started with a television interview with Natalie Bennett, the party's leader, during which she was unable to explain the detail of the party's UBI policy. *The Guardian's* political editor, Patrick Wintour, then consulted the Citizen's Basic Income Trust's website, telephoned me for a discussion, and wrote an article claiming that the Trust had said that the Green Party's UBI scheme would impose losses on low income families. We had not said that – in fact, we had never commented on the Green Party's scheme, except to note that they intended to develop one for their manifesto. However, by highlighting the similarities between our illustrative scheme and what the Green Party had said to date about theirs, Wintour had drawn his own perfectly correct conclusion and had published it as if it was ours. What he did not emphasise, which he might have done, was that we had proved that it is perfectly possible to implement a genuine UBI without imposing losses on low income households if means-tested benefits are retained and households' UBI are taken into account when their means-tested benefits are calculated.

What this incident showed was that the current state of the UBI debate requires high-quality research if objections are to be answered; and that in order to prove that UBI is feasible it is essential to publish illustrative schemes that cannot be criticised on the grounds of financial infeasibility. The constraints that I now impose on my research are therefore as follows: illustrative schemes should be strictly revenue neutral (that is, they should be paid for by rearranging current benefits and income tax systems, and should not require additional public expenditure); income tax rates should rise by no more than 3 percent; no low income households should suffer significant losses in disposable income at the point of implementation; no households should suffer unsustainable losses at the point of implementation; and both poverty and inequality should be reduced by the scheme. Of course, it would be nice to be able to propose new forms of taxation that would enable a higher level of UBI to be paid and means-tested benefits to be abolished: but in the short to medium term it is essential to publish illustrative schemes that are immediately feasible, and not ones that would rely on public revenue not currently available.

A corollary of these requirements is that microsimulation is the only adequate research method for evaluating illustrative UBI schemes.

Microsimulation employs a computer programme into which a country's tax and benefits systems is coded, and through which financial data obtained from a substantial proportion of the country's population is run (in Britain, the Family Resources Survey sample is 0.1 percent of the population). A UBI can be written into the programme, and existing taxes and benefits can be changed, meaning that the programme can compare a variety of UBI schemes to the current tax and benefits scheme. Importantly, this is the only research method that enables us to leave means-tested benefits in place and discover how many households would be taken off them by their UBIs; and it is the only method that can tell us how household disposable incomes would change at the point of implementation of a UBI scheme. Research using the Euromod microsimulation programme continues.<sup>5</sup>

### What to Publish, and How<sup>6</sup>

On Wednesday 14 September 2016, Members of Parliament debated UBI. The debate was fair and well-informed, with two exceptions: a Member of Parliament suggested that the Citizen's Basic Income Trust had said that an income tax rate of 48 percent would be required; and another suggested that the Trust had said that a UBI scheme would generate considerable losses for low-income families. Both of these statements related to one of three schemes researched in Torry (2015b). The paper recognised that one particular scheme would be infeasible, and that a similar scheme would be infeasible too, as it would also have generated considerable losses for low-income households. However, another scheme outlined in that working paper would have required only a small increase in income tax rates, would not have generated unsustainable losses in household disposable income, and would have generated almost no losses among low-income households.

Subsequent to the parliamentary debate, the trustees of the Citizen's Basic Income Trust decided that the Trust would no longer publish research results on infeasible illustrative UBI schemes. This is clearly far from desirable in terms of the academic integrity of the Trust's research output, but it is difficult to see what else can be done if Members of Parliament are intent on quoting results related to infeasible schemes as if they applied to any and every illustrative scheme, and if they are going to choose not to quote research results related to feasible schemes.

Soon after the parliamentary debate, on 12 January 2017, the House of Commons Work and Pensions Committee held an evidence session on

<sup>5</sup> For the most recent microsimulation research, see Torry (2018a).

<sup>6</sup> <http://citizensincome.org/news/members-of-parliament-debate-citizens-income/>.



UBI.<sup>7</sup> A notice had been circulated inviting researchers and other interested parties to apply to attend and give evidence. Three researchers who had undertaken microsimulation research on illustrative UBI schemes applied to attend, but none of us were invited. A researcher who had published illustrative schemes that would require infeasibly high tax rate rises, and who employed a research method that could not determine household losses for illustrative schemes that retained mean-tested benefits, nor discover how many households would no longer receive means-tested benefits, had not applied to attend, but was invited. It was no surprise that when the committee's report was published, the Chair of the committee, Frank Field MP, said this: a universal Citizen's Income would either require unthinkable tax rises or fail to deliver its objectives of simplification and a guaranteed standard of living. There are problems in the welfare system, but Citizen's Income is not the solution to them. Rather it is a distraction from finding workable solutions.<sup>8</sup>

Nobody had been present who could point out that at least one revenue neutral illustrative UBI scheme was available that would take a significant number of households off means-tested benefits, and thus provide them with a far simpler system; that would maintain standards of living, particularly for low income households; and that would require only a 3-percent rise in income tax rates.

It is difficult to know what can be done about parliamentary enquiries that choose to ignore relevant evidence. The only response available is to disseminate relevant evidence as widely as possible.

### UBI and UBI Illustrative Schemes<sup>9</sup>

Some recent exchanges in online and print journals have revealed the importance of clear definitions and clear distinctions. On 23 November 2017, the website *Social Europe* published an article<sup>10</sup> by Bo Rothstein entitled '*UBI: A Bad Idea for the Welfare State*'. It set out from a definition of 'Unconditional Universal Basic Income' (UUBI) as 'every citizen will be entitled to a basic income that frees them from the necessity of having a paid job'; and it added the details that the level of UBI would be £800 per month, and that 'all means-tested programs for those who cannot support themselves through paid work can be abolished'.

The definition of UBI offered by BIEN (the Basic Income Earth Network) is this: 'a basic income is a periodic cash payment unconditionally delivered

to all on an individual basis, without means-test or work requirement';<sup>11</sup> while the UK's Citizen's Basic Income Trust defines it as: 'an unconditional and non-withdrawable income paid to every individual'.<sup>12</sup> The consensus – and, after all, consensus is what definitions are all about – is that a UBI is an unconditional income paid to every individual. The definition implies neither a particular amount, nor that means-tested benefits would be abolished, and it does not imply that the UBI would free people from paid employment.

The illustrative UBI scheme proposed by Rothstein would be financially infeasible, and it would, as he suggests, endanger the reciprocity on which our society is based. Rather than incentivising employment and self-employment by lowering marginal deduction rates (the rates at which additional earnings are reduced by income tax, national insurance contributions, and the withdrawal of means-tested benefits), the very large UBIs would generate disincentivising effects that would overwhelm the incentivizing effect of reduced marginal deduction rates. Neither of these problems would result from the kind of illustrative UBI scheme already discussed in this article – see also Torry (2018a).

Distinctions matter. A UBI is always an unconditional income paid to every individual, without a means test and without a work test. A UBI scheme specifies the rate at which the UBI would be paid for each age group, and the funding mechanism. There are many possible UBI schemes. As Rothstein correctly suggests, his chosen scheme would have many disadvantages. As I have shown, an alternative scheme would exhibit none of those disadvantages, and would offer many additional advantages.

The increasingly mainstream UBI debate is important. It is therefore vital that the debate should be rational. Rationality requires attention to definitions and details, and particular to the distinctions between UBI and UBI schemes.

### UBI and Minimum Income Guarantee<sup>13</sup>

In the final edition of *Renewal* for 2017, Frederick Pitts, Lorena Lombardozi and Neil Warner (Pitts *et al.* 2017) suggest that the experience of the Speenhamland reforms of 1795 were 'an experiment in a kind of basic income'. They were not. These reforms represented a Minimum Income Guarantee. The supplements paid out guaranteed a net income and were definitely not a 'Basic Income'. This difference really matters. A Minimum Income Guarantee is constituted by a minimum income level below which a household's income is not allowed to fall, and the payment made is designed to bring a

<sup>7</sup> <http://citizensincome.org/news/new-royal-society-of-arts-podcast-and-a-report-from-the-work-and-pensions-committee/>.

<sup>8</sup> <https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2015/citizens-income-report-published-16-17/>.

<sup>9</sup> <https://www.socialeurope.eu/universal-basic-income-definitions-details>.

<sup>10</sup> <https://www.socialeurope.eu/ubi-bad-idea-welfare-state>.

<sup>11</sup> <https://basicincome.org/>.

<sup>12</sup> <http://citizensincome.org/>.

<sup>13</sup> See also Torry (2018b).

household's net income up to the specified level. The modern equivalents in Britain are Working Tax Credits and so-called Universal Credit. In Speenhamland, the supplement paid out was designed to fill the gap between the worker's earnings and a specified minimum income that was related to family size and the price of bread. The supplement was a means-tested benefit.

A UBI is entirely different. It is an equal payment to every individual of the same age. The difference is clear. The Speenhamland payments fell if earnings rose, and rose if earnings fell. A Basic Income remains the same whatever the individual's earnings. This means that the effects would be different. The Speenhamland supplement functioned as a dynamic subsidy. It rose if wages fell, so employers who cut wages knew that the supplement would make up for the wage cut. A UBI would be a static subsidy: that is, it would not rise if wages fell, so both employers and employees would know that if wages fell then employees' families would be worse off. Both collective bargaining and the National Living Wage would be even more important than they are now, and the effort to maintain them would intensify.

Another difference relates to employment incentive. With a Minimum Income Guarantee, there can be little financial advantage to seeking increased wages, a better-paying job, or additional skills. Increased wages would mean a lower supplement. But because a UBI would never change, anyone currently on means-tested benefits whose UBI enabled them to come off them would immediately experience increased incentives to seek higher wages or additional skills. An increase in wages would no longer result in a loss of benefits, so an increase in earned income would result in a far greater increase in net income.

As Pitts *et al.* (2017) suggest, there are criticisms to be made of the Speenhamland approach. But those criticisms would not apply to a UBI. A UBI would never compromise 'the bargaining power of labour', and so would not contribute to "falling or stagnating wages and deteriorating employment prospects" (Pitts *et al.* 2019, 151). Indeed, by providing a secure financial platform on which individuals and households could build, a UBI would increase workers' ability to start their own businesses, to turn down badly-paid jobs, and to argue for wage increases.

It is worth reiterating that rational debate requires careful definition and attention to detail. A UBI is an unconditional and non-withdrawable income paid to each individual. The Speenhamland supplements constituted a Minimum Income Guarantee. That is not the same thing. What the current debate requires is not erroneous comparisons, but detailed definitions, careful distinctions, high-quality research, and flawless logic.

## CONCLUSION

The lessons to be drawn from this brief list of events during the recent UK debate about UBI might be as follows:

- Microsimulation research on illustrative UBI schemes is essential.
- It is crucial to publish illustrative UBI schemes that are cost-neutral, that do not impose any significant losses on low income households; that impose no unsustainable losses on any households, that do not increase tax rates by more than politically feasible amounts, and that reduce both poverty and inequality.
- If policymakers choose to quote research results on infeasible illustrative UBI schemes as if those results applied to any and every illustrative scheme, and if they choose not to quote research results related to feasible schemes, then a decision might have to be taken to only publish results related to immediately feasible illustrative schemes.
- If important evidence is ignored, then wide dissemination of relevant research results is the only response available.
- It is essential to distinguish between UBI as an unconditional income for every individual, and illustrative UBI schemes that specify funding mechanisms and the levels at which UBIs will be paid. Objections to a particular UBI scheme are not necessarily objections to UBI.
- It is essential to distinguish between UBI and other very different mechanisms, such as a Minimum Income Guarantee.

Needless to say, a further lesson to be learnt is that the UBI debate is different in every country, that the debates in other countries will have lessons to contribute to the debate in Britain, and that the UK debate might have lessons to contribute to debate elsewhere. Projects such as the one that gave rise to this article are essential to this process.

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## The Rise (and Fall) of the Basic Income Experiment in Finland

### INTRODUCTION

In 2015 the newly-elected Finnish Prime Minister Juha Sipilä committed his centre-right coalition government to launching a basic income experiment. Outlined in the Government Programme in just a single line, the Finnish coalition government followed through on its initial commitment by first commissioning a research consortium (led by the research department of Kela, the Finnish Social Insurance Institution) to prepare experimental design options, followed by the drafting and rushing through Parliament of the necessary legislation (Finlex 1528/2016). A two-year randomised controlled trial (RCT) started in January 2017. It will be concluded by the end of 2018 and subsequently evaluated by Kela's research department and its results presented to the Finnish Parliament sometime in 2019.<sup>1</sup>

Finland was initially hailed as spearheading a new paradigm shift in European welfare policy, with advocates and decision-makers around the world watching closely to see how the Finnish experiment would develop. Several countries have since embarked on similar projects, drawing lessons from the Finnish experience (De Wispelaere 2016a). However, as more details emerged, and in particular as key limitations in the Finnish experimental design and implementation became apparent, initial enthusiasm amongst basic income advocates and interested parties rapidly turned into overt criticism. Influential Finnish basic income proponents such as former Green League MP and minister Osmo Soininvaara, have criticised the model being experimented upon as fiscally unrealistic (Soininvaara 2017). Others challenge the sample restriction to the unemployed, the limited duration or the low amount of the pilot scheme. The recent refusal by the Finnish government to expand the trial or extend it beyond 2018 sparked further consternation.

The mounting disappointment with the Finnish experiment both inside Finland and abroad has left basic income aficionados wondering what went wrong. What, if anything, explains how such a promising project could derail in such a short space of time? And what sort

of lessons can we draw from the Finnish experience for other planned and ongoing experiments?<sup>2</sup> In this article we argue that this question puts the proverbial cart before the horse. The story of Finnish decision-makers embracing the basic income idea after 30 odd years of public and political debate and enthusiastically embarking on a project to systematically examine the evidence of what impact a basic income might have on Finnish society is incomplete at best. A proper understanding of the context in which the basic income experiment emerged reveals that the phenomenon to be explained is that the experiment happened in the first place. Conversely, key political decisions related to the experiment's limited goals and design, or interim policy developments pushing for an activation agenda counter to basic income are better understood as reverting back to the *status quo ante*. This analysis suggests that far from having opened a window of opportunity, recent interest in basic income experimentation may amount to little more than a glitch in a remarkably stable policy landscape focused on labour market activation.

### THE FINNISH BASIC INCOME EXPERIMENT: A PRIMER

We start by briefly outlining the key features of the basic income experiment.<sup>3</sup> In a nutshell, the Finnish basic income experiment consists of a nation-wide RCT with a treatment group of 2,000 unemployed subjects between the age of 25–58 who were receiving basic unemployment benefits or labour market subsidy in November 2016. Another 178,000 unemployed individuals who keep receiving basic unemployment benefits serve as the control group for the duration of the experiment. The sample population focuses entirely on unemployed people who are ineligible for earnings-related unemployment benefits.

Subjects in the treatment group are receiving a monthly unconditional basic income of 560 euros instead of conditional basic unemployment benefits;

<sup>2</sup> As this article is being written, the newly-elected provincial government in Ontario (Canada) has just announced that the Ontario basic income pilot, which started a few months ago, would be discontinued.

<sup>3</sup> For a more developed discussion – see De Wispelaere *et al.* (2019); Kalliomaa-Puha *et al.* (2016); Kangas and Pulkka (2016); and Kangas *et al.* (2017).



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<sup>1</sup> This strict (and short!) timeline was primarily driven by political considerations, with a clear eye on the next national elections in 2019, and went against the recommendations of the Kela-led research consortium (De Wispelaere *et al.* 2019).

the basic income allowance is non-withdrawable and can be combined with income from work, as well as other benefits, including housing allowance or social assistance. A complication in the experimental design is the tax treatment of the experimental group: for practical, but mainly political reasons, the 560-euro basic income ends up being excluded from the assessment of subjects' tax liability, which means the model experimented with is not suitable for rolling out as policy without incurring an estimated budget deficit of 11 billion euros (Kangas and Pulkka 2016). In addition, the different tax treatment of subjects in the treatment and control groups introduces distortions that affect the internal validity of the experiment.

While the aim of the experiment is mainly to "identify ways to align the social security system with changes in the nature of work, to create greater work incentives within the system, to reduce bureaucracy" (Kangas and Pulkka 2016, 4), the evaluation is expected to include broader dimensions of objective and subjective wellbeing such as the health impact of basic income. The evaluation will primarily make use of extensive administrative data, complemented with survey evidence of those receiving a basic income and a sample of 2,000 individuals from the larger control group.

The decision of these design parameters was driven by a combination of budgetary, legal, institutional and political reasons. Budget restrictions made it necessary to restrict the trial to a relatively small and focused sample population.<sup>4</sup> Legal considerations pertaining to the Finnish Constitution imposed further restrictions on sampling, while EU legislation limited the type of social policies that could be altered without running afoul of EU competences (Kalliomaa-Puha *et al.* 2016). Institutionally, the specific design of basic unemployment security (combining basic unemployment benefit and labour market subsidy) affected both the selection of the treatment sample and the restriction of the basic income payment to 560 euros per month (Halmetoja *et al.* 2018). These practicalities aside, political considerations had a major role to play in framing the broader remit – e.g. the strong focus on assessing labour market effects – as well as determining specific constraints such as the budget or the strict time frame (to fit the electoral cycle). In fact, politics is arguably the main determinant for understanding the rise (and fall) of basic income experiments in Finland and elsewhere.

### THE POLITICAL DETERMINANTS OF THE FINNISH BASIC INCOME DEBATE

Finland has a long-standing and comparatively sophisticated public engagement with the basic income proposal (Ikkala 2012; Perkiö and Koistinen 2014;

Halmetoja *et al.* 2018; Perkiö, forthcoming). From the early 1990s onwards, discussions of the basic income idea have become more focused on unemployment and from the mid-2000s general discussions gave way to competing detailed and costed proposals such as those put forward by the Greens and the Left Alliance. While policy attention to basic income wax and waned over the decades, two important trends stand out.

The first is that both support for and resistance to basic income amongst Finnish basic income parties appears robust over time. Parties' views on basic income have not changed all that much over the past three decades. Estimating the main parties' relative support for basic income across election cycles since 1979, Lindsay Stirton and colleagues find that Finnish political parties maintain their relative positions to each other, with the Green League, the Left Alliance and (to a lesser degree) the Centre Party taking a favourable view in contrast to the other parties (Stirton *et al.* 2018). In fact, they find political support diverges slightly over time, rather than converging, with polarisation sharpening since 2015. A plausible explanation is that increased political focus on the basic income experiment forces political parties to get off the proverbial fence and declare themselves more firmly for or against. With political positions becoming more entrenched, the basic income experiment did not broaden support amongst political parties, even if polls of individual politicians and the general public suggest otherwise (Pulkka 2018).

A critical feature of the Finnish political landscape is that the current coalition government features only one party that is in favour (Prime Minister Juha Sipilä's Centre Party), with the two partners being moderately sceptical (Finns Party, recently renamed Blue Reform) or even overtly antagonistic (National Coalition Party).<sup>5</sup> Add to this the fact that each of the three ministries involved in setting up and rolling out the basic income experiment – Prime Minister's office, Ministry for Social Affairs and Health and Ministry of Finance – are headed by a different party and the probability of friction or even deadlock increases considerably. Hence, we witness important limitations and constraints creep into development of the basic income experiment at the preparation, design and rollout phases. Importantly, we should expect resistance amongst Finns and National Coalition Party to feature prominently once the experiment is evaluated and the results enter political deliberation.<sup>6</sup> Conversely, the leading defenders of basic income in Finland (Green League and Left Alliance) find themselves in the paradoxical position of either having to oppose the policy they have advocated for decades (issue ownership); or else

<sup>5</sup> The Finns Party split in June 2017 following a contested leadership election, with 19 MPs currently making up the Blue Reform party that continues to take part in the Sipilä government. The Finns split had no impact on the basic income experiment.

<sup>6</sup> On the politics of evidence-based policy-making more generally, see e.g. Cairney (2016) and Parkhurst (2016).

4 <http://tutkimusblogi.kela.fi/arkisto/3316>.

lend support to an experimental design that they have strong reservations about.<sup>7</sup> The coalition dynamics of basic income support are complicated, to say the least.

A second trend when analysing the basic income debate in Finland over time is a major shift in the dominant narrative. Johanna Perkiö (forthcoming) examines political documents from the early 1980s and finds that from the early 1990s onwards the activation frame dominates alternative perspectives within the basic income debate.<sup>8</sup> The study finds that 49 percent of all documents in this period contain the ‘activity’ frame, closely competing with alternatives frames such as ‘subsistence’ (42 percent) or ‘system reform’ (41 percent).<sup>9</sup> Interestingly, traditional basic income arguments score low as frames in the Finnish debate: ‘rights’, for instance, scores a mere 24 percent and ‘transformation work’ an even lower 18 percent. Perkiö (forthcoming) also shows how the ‘activity’ frame starts dominating the debate over time, literally crowding out alternative perspectives. This means that far from being viewed in opposition to labour market activation, basic income is now largely perceived as a tool to promote labour market reintegration in Finland.<sup>10</sup> In view of this, the strict focus on analysing labour market behaviour in the Finnish basic income experiment is hardly a surprise. When critics lament that the Finnish basic income represents a missed opportunity, they fail to appreciate the distinct political context in which the experiment is embedded.

The same context unfortunately also offers a plausible explanation for why recent reforms of unemployment security are going down a route that appears contrary to the principles underlying the basic income proposal. The government of Juha Sipilä recently introduced a new regime for the unemployed consisting of trimonthly interviews, a longer waiting period, substantial cuts in the eligibility periods for unemployment benefits, topped by a so-called ‘active model’ that requires jobseekers to either work on a part-time basis or intensively participate in activation measures or face a 4.65-percent benefit cut (Varjonen 2018). The present government does not appear to see the contradiction in simultaneously rolling out an unconditional basic income experiment and introducing a newsanctions regime for the unemployed. The reason for this is that a firm belief in labour market activation as a primary goal for basic unemployment benefits underlies both approaches. This perspective has been dominant for several decades in Finnish social

policy and has informed policy development since at least the mid-1990s (Kananen 2012).

### **BASIC INCOME IN FINLAND — A NARRATIVE IN NEED OF CORRECTION**

Taking the political determinants of the basic income debate in Finland into account suggests that we need to revise the recent narrative according to which the basic income experiment constitutes a genuine window of opportunity. In this narrative the surprise announcement of the government’s plans to experiment with basic income represents the culmination of decades of Finnish social policy innovation (Koistinen and Perkiö 2014). In Kingdon’s multiple stream framework, Juha Sipilä performed the role of a policy entrepreneur linking the problem, policy and political streams (Kingdon 1984).

The result was not a major shift towards policy implementation, but something far less involved – a commitment to gather and evaluate evidence through an experiment.<sup>11</sup> In terms of a political commitment to the case for basic income, a two-year experiment is a relatively ‘cheap’ form of support (De Wispelaere 2016b). Two years is a long time, politically speaking, and much can happen between the experiment starting and the evidence being evaluated by the powers that be. Moreover, as outlined, the commitment to experimentation must be understood within the constraints of the activation paradigm and the comparatively limited perspective of the main political actors in Finnish social policy, including Sipilä and his Centre Party.

International media and advocacy networks ignored both of these critical limitations and jumped on the announcement of Finland’s experiment with basic income with little regard for (or, indeed, knowledge of) the local context.<sup>12</sup> This gave birth to the narrative that Finland would be the first country to implement a basic income, framing the experiment in a way that inevitably carves out a path to (perceived) policy failure. Ignoring the political context and its constraints from the outset means the dominant narrative set expectations sufficiently high to ensure that the experiment was doomed to fail as soon as it entered the design phase. Enter numerous disappointed and frustrated critics lamenting the Finnish government’s failure to understand or, worse still, deliberately intent on sabotaging basic income policy development. This narrative is in urgent need of correction. Far from constituting a watershed moment with potential spill-over effects across Europe, the Finnish basic income experiment is more plausibly

<sup>7</sup> The model experimented with is very similar to that proposed by the Green League in 2007.

<sup>8</sup> This shift fits with what some scholars have identified as a more recent ideational shift from universalism to selectivism in Finnish anti-poverty policy (Kuivalainen and Niemelä 2010).

<sup>9</sup> Political documents can contain more than one frame (Perkiö forthcoming).

<sup>10</sup> This dynamic is always co-present in leading basic income discussions (e.g. Van Parijs and Vanderborcht 2017), but in Finland has become the dominant frame (Perkiö forthcoming).

<sup>11</sup> The role of experimental evidence in policy development is an impotent variable in explaining why Finland was spearheading the current wave of basic income experimentation (De Wispelaere *et al.* 2019).

<sup>12</sup> It is not unreasonable to think that in the absence of the persistent international media attention the Finnish basic income experiment would have led a very quiet life — and perhaps even died a quiet death. But this, of course, is historical speculation at best.

regarded as being thoroughly constrained from the outset within the parameters of a relatively unchanging policy landscape. Taken in their appropriate context, key decisions taken by policymakers during the preparation and design phases, as well as ongoing policy development during the roll-out phase, appear to conform to a stable policy paradigm that goes back several decades at the very least.

What is to be made of the sudden spike in policy attention that led to the experiment? Punctuated equilibrium theory offers various arguments to explain sudden shifts in policy attention, such as those giving rise to the current interest in basic income experiments. Such arguments run the whole gamut of bounded rationality, framing, cumulative build-up of problems, institutional shift (or even drift), and exogenous shocks opening up a window of opportunity for policy entrepreneurs (Baumgartner and Jones 1993; Jones and Baumgartner 2005). These arguments contribute to understanding why Finland suddenly embarked on conducting the first-ever nationwide RCT trial of basic income. Importantly, this is indeed the phenomenon to be explained: *why* did Finland take up basic income experimentation, and *why now*? Identifying the unique constellation of determinants that led Finland to adopt this route first, subsequently influencing similar debates and actions elsewhere (in Ontario, Scotland, for example), is a task that is yet to be undertaken in a systematic manner.<sup>13</sup>

The Finnish basic income experiment is a good example of stick-slip dynamics, with an increase in social forces or tension slowly building up over time giving rise to a sudden outburst of policy attention (Jones and Baumgartner 2005). In punctuated equilibrium, policy attention does not take the form of a normal, but rather a leptokurtic distribution, with many cases residing in the tails. This combination of small discussion ‘bubbles’ interspersed with a few spikes of policy attention can be clearly seen over three decades of Finnish basic income discussion (Perkiö forthcoming). It is in line with punctuated equilibrium theory to expect the current policy attention spike to subside, and in fact current Finnish politics is arguably already experiencing an important attention shift refocusing on more conditional unemployment security reform, and even an interest in the Universal Credit policy implemented in Britain.

The important insight gleaned from punctuated equilibrium theory, namely that attention shifts must predate policy change, masks another equally important reality: most attention shifts do not, in fact, lead to changes in policy. “Punctuations in attention can arise without significant changes in the substantive content of policy and vice versa” (Dowding *et al.* 2016, 14). Dowding and collaborators correctly insist that punctuations in attention without related policy change should not be regarded as significant policy

events. This too is an important corrective for the dominant narrative, which has viewed the experiment as evidence not merely of increased policy attention, but of something akin to a policy window opening up. While there are certainly reasons to think that the ‘policyscape’ of Finland may be comparatively conducive to implementing a (partial) basic income (Halmetoja *et al.* 2018), at the moment, we have little reason to be overly optimistic that this avenue will be taken in the short run by the current constellation of political decision-makers. Whether the basic income experiment will prove to be a lever for basic income policy development, or a distraction while Finland covertly continues to develop its activation model, still remains to be seen.

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<sup>13</sup> De Wispelaere *et al.* (2019) offer some preliminary arguments.

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## Ugo Colombino and Nizamul Islam Basic Income and Flat Tax: The Italian Scenario<sup>1</sup>



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### INTRODUCTION

The design of a nationwide policy of minimum income or basic income in Italy, comparable to the policies implemented in most European countries, is still a working enterprise. A first proposal to fill the gap was formulated by the ‘Commissione Onofri’ (Onofri 1997) appointed by a Centre-Left Government. The proposal was tested in a sample of local areas during the following two years. However, the test was stopped when a Centre-Right Government came to power, which also transferred the competence of income support policies to the regions, which had effectively been responsible for implementing basic income policies in the previous two decades. More recently, a national basic income scheme, ‘Reddito di Inclusione’ (RdI) was implemented in 2018. It addresses the population in absolute poverty. To put this into perspective, it is meant to be universal, although the funds to date are sufficient to cover about half of the target population. After the last political elections of March 4, the new government is a coalition between Lega and Movimento 5 Stelle (M5S). Lega proposes a flat tax (FT). M5S proposes a basic income guarantee, ‘Reddito di Cittadinanza’ (RdC) that should cover all the population below the relative poverty threshold. While it appears unlikely that the two proposals will be implemented, if ever, with the announced design and figures, their combination is interesting since it has its roots in public economics and in policy debates involving different, but sometimes converging, sides of the ideological spectrum. The think tank ‘Istituto Bruno Leoni’ has also recently proposed a comprehensive fiscal policy reform that includes a basic income guarantee and a flat tax.

The purpose of this paper is to evaluate and compare the fiscal and behavioural effects of (simplified or modified versions of) the M5S+Lega

<sup>1</sup> The preparation of the datasets used in this paper was done by running EUROMOD version [G3.0+]. EUROMOD is maintained, developed and managed by the Institute for Social and Economic Research (ISER) at the University of Essex, in collaboration with national teams from the EU member states. We are indebted to the many people who have contributed to the development of EUROMOD. The process of extending and updating EUROMOD is financially supported by the European Union Programme for Employment and Social Innovation ‘Easi’ (2014-2020). We make use of microdata from the EU Statistics on Incomes and Living Conditions (EU-SILC) made available by Eurostat (59/2013-EU-SILC-LFS). The results and their interpretation are the authors’ responsibility.

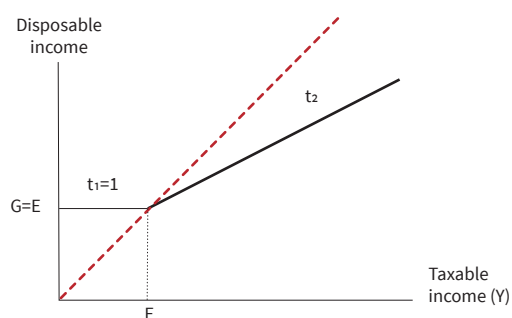
package, the RdI and the proposal by Istituto Bruno Leoni. Moreover, we will show an exercise in identifying optimal (i.e. social welfare maximizing) packages that combine basic income and flat tax. Strictly speaking, these policies do not explicitly envisage an unconditional basic income. However, they belong to the class of the ‘negative income tax’ mechanisms and as such, as we explain in the following section, they can also be interpreted as versions of unconditional basic income.

### BASIC INCOME GUARANTEE VS. UNCONDITIONAL BASIC INCOME VS. NEGATIVE INCOME TAX: A CLARIFICATION

A common illustration of the difference between Basic Income Guarantee (BIG) and Unconditional Basic Income (UBI) is that the former consists of means-tested transfers, while the latter consists of a non means-tested unconditional transfer. As a matter of fact, these definitions conventionally assume a specific implementation of the two policies. Figures 1 and 2 represent standard forms of BIG and UBI. E is the exemption level. The  $t_1$  and  $t_2$  on the two segments of the taxable income–disposable income line represent the two marginal tax rates applied to the two corresponding ranges of values of Y.

The typical interpretation of Figure 1 goes as follows: if your own taxable income Y is below the exemption level E you receive a transfer equal to  $E - Y$ , so that you get a disposable income equal to  $G (= E)$ . If your taxable income is greater than E you pay a tax on  $(Y - E)$  according to a certain rule (for simplicity’s sake, Figure 1 assumes a FT, i.e. a fixed marginal tax rate =  $t_2$ ). However, the scenario can be interpreted in a different way. You get an unconditional transfer equal to G. Then every euro of your taxable income up to E is taxed according to a marginal tax rate  $t_1 = 100\%$ , so that your disposable income is always G, as long your own income Y is below E. Conversely, Figure 2 is typically read as saying that you receive an unconditional transfer G. Then every euro of your own taxable income (both below and above E) is taxed according to a marginal tax rate = t. However,

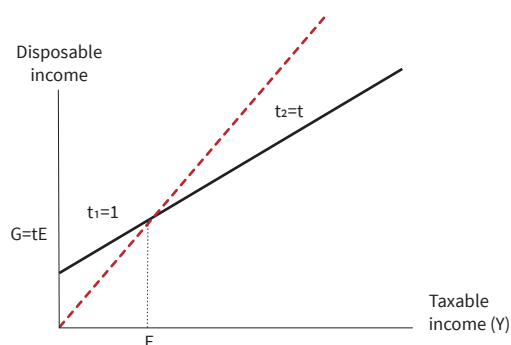
Figure 1  
Basic Income Guarantee



Source: Authors’ own conception.

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Figure 2  
Unconditional Basic Income



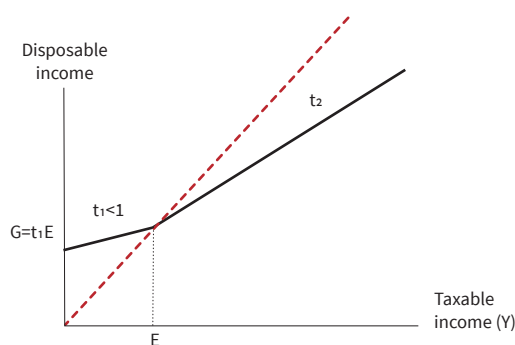
Source: Authors' own conception.

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we may alternatively interpret Figure 2 as follows. Please note that  $t_1 = t_2 = t$  and  $E = G/t$ . If your taxable income  $Y$  is below  $E$ , you receive a transfer equal to  $t(E - Y)$ . If  $Y$  is greater than  $E$  instead, you pay taxes equal to  $t(Y - E)$ . Both mechanisms can be interpreted (and implemented) either in terms of means-tested transfers, or in terms of an unconditional transfer plus means-tested taxes. The difference is only in the slopes of the two segments below and above  $E$ . Moreover, it turns out that both BIG and UBI are special cases of the general mechanism of Figure 3. This is the usual representation of the Negative Income Tax (NIT), but at this point it should be clear that it identifies a general class of which BIG and UBI are special cases. The crucial difference of the case represented in Figures 2 and 3 with respect to the case represented in Figure 1 is the following: while with the latter the guaranteed income is always  $G$  (as long as your own taxable income  $Y$  is below the exemption level  $E$ ), with the former your disposable income below  $E$  is  $Y + t_1(E - Y)$ , i.e. it is 'updated' depending on  $Y$ . Conversely, the key difference between Figure 2 and Figure 3 is that, with the former (UBI),  $t_1 = t_2$ , while with the latter  $t_1 \neq t_2$ .<sup>2</sup> The marginal rate  $t_1$  is also called Benefit Reduction Rate (BRR). Although both BIG and UBI can be seen as special limit cases of NIT, we reserve the label NIT for the case of Figure 3. Please

<sup>2</sup> The standard representation has  $t_1 > t_2$ , but nothing prevents the opposite case.

Figure 3  
Negative Income Tax



Source: Authors' own conception.

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note that  $t_1$  is the marginal tax rate applied to  $Y$  as long as  $Y < E$ , but it can also be interpreted as the marginal tax rate applied to the transfer  $G$  while  $Y$  goes from 0 to  $E$ . According to this last interpretation, it is commonly called BRR.

Summing up, we can always think of (and implement) any member of the NIT class as consisting of means-tested transfers or – alternatively – as consisting of one unconditional transfer plus means-tested taxes. This perspective has important implications in view of the policy implementation: the relative appeal of the two alternatives might also depend on the relative administrative costs of means-tested transfers versus means-tested taxes.

Since the income support policies of European countries are largely implemented as means-tested transfers, and (according to what we have seen above) they can also be interpreted in terms of an unconditional transfer, does this mean that the current income support policies are already a form of UBI or NIT? Not really, for two reasons. Firstly, the current proposals of UBI or NIT, as an alternative to traditional policies, insist on the appeal of a simpler and universal system; by contrast, current income support policies are complicated; they might require the fulfilment of various additional eligibility criteria; they may require some activity or willingness to participate in some activity; they might be limited to certain occupational or demographic groups; they may be conditional to the realization of specific events – this being the most common case for insurance based policies. Secondly, the equivalence between the two interpretations/implementations explained above, strictly speaking, holds only in a static scenario. If we allow for the intertemporal dimension, there may be differences. For example, it might make a significant difference to receive an up-front unconditional transfer  $G$  at the beginning of the year or receive means-tested transfers during (or at the end of) the year instead, unless the unconditional transfer is relatively small and/or the credit market is easily accessible and/or uncertainty upon own incomes during the year is not too large.

Keeping the above caveats in mind, this paper will interpret the policies or proposals mentioned in the introduction as based on an unconditional transfer plus means-tested taxes. Moreover, we will ignore other eligibility criteria that might introduce a stricter form of conditionality or limit the universality of the policies. The motivation is that we want to focus on the economic implications of the different mechanisms illustrated in Figures 1 to 3.

## POLICIES IMPLEMENTED OR IN THE PIPELINE

Italy's current government proposes RdC together with a FT. The scheme is the one illustrated in Figure 1. The RdC originally proposed by Movimento 5 Stelle, is a BIG with  $E = G =$  monthly 780 euros, which was the

Italian relative poverty threshold when the policy was first proposed in 2013. Here and in what follows, the indicated amounts of G and E are meant for a single person. The amounts for a household of several persons are scaled according to the OECD equivalence rule. The proposal is not defined in great detail as yet. For example, it is not clear what its interaction would be with other current income support policies like unemployment insurance or REI.

The FT, originally proposed by Lega, envisages a fixed marginal tax rate of around 15–20 percent. Even with this proposal, many details are not defined yet. Recently, a variant with two rates, 15 percent and 20 percent, was presented. It is unclear whether the FT would be applied to all personal incomes or just earnings, although the first hypothesis is more likely.<sup>3</sup> In our analysis, we simulate the effect of the 780-euro BIG with a 20-percent flat tax applied to all personal incomes. Since, as we will see, the package largely violates the public budget constraint and the government has not indicated how the deficit would be covered to date, we also simulate two (very) different fiscally neutral versions of the BIG+FT package.

Recently, the Istituto Bruno Leoni (Rossi 2018) proposed a comprehensive reform whose cornerstone is a BIG (Figure 1) around 500–600 euros (locally differentiated) with a 25-percent flat tax on all personal incomes. This package also implies a deficit, but the proposal includes a list of interventions in public spending and in the design of markets such as insurance and health that are meant to re-establish fiscal equilibrium.<sup>4</sup> We are not able to account for these compensatory interventions in our model, so we simulate a fiscally neutral version of the proposal.

At the beginning of 2018, the previous government implemented a partial version of Rdl. Baldini *et al.* (2018) provide a detailed presentation. It is noteworthy that it adopts the NIT mechanism represented in Figure 3, with  $E = 251$  (for one person),  $G = 188$  and  $MRR = 0.75$ . We will simulate a simplified, fiscally neutral, version of REI with FT.

The packages ‘BIG + FT’ or ‘UBI + FT’ or ‘NIT + FT’ have roots in a broad spectrum of ideological or methodological positions. Milton Friedman (1962) is prominent among the libertarian supporters of NIT and FT. Tony Atkinson (1996) – close to the social-democratic side – devotes a book to the package UBI + FT. In Italy, Rizzi and Rossi (1996) proposed an analogous system. The same idea is updated and articulated in the more general reform designed by the Istituto Bruno Leoni (Rossi 2018). Islam and Colombino (2018) illustrate and evaluate

various NIT+FT packages applied to eight European countries. In principle, a BIG would aim to bring Italian social policy closer to European standards – an objective formulated at least since the report by Commissione Onofri (Onofri 1997). At the same time, the FT would aim to simplify the tax system and introduce better incentives for labour supply and tax compliance (Stevanato 2017). The promise would be an improvement in both efficiency and equity. Unfortunately, as we will see, the government package – as formulated so far – falls way short of these aims. However, there are different designs of the package that show interesting results. In what follows, we simulate and evaluate:

- The original BIG+FT government package
- Two fiscally neutral versions of the government package
- A fiscally neutral version of the reform proposed by the Istituto Bruno Leoni
- A fiscally neutral and universal version of the Reddito di Inclusione with a FT
- Three optimal NIT + FT reforms.

All of the above simulations consider simplified versions of the various reforms, although the simplification should not have an important effect as far as the comparative evaluation is concerned. Moreover, we always assume a FT applied to all personal household incomes (comprehensive and household based taxation). We observe that even the current progressive tax rule, when considering all personal incomes, *ex-post* turns out to be not very far from a flat tax.<sup>5</sup> This suggests that an explicit FT imposed on all personal income might essentially represent a rationalization of the current system. The simulated reforms replace the whole current tax-benefit system. It is a simplifying extreme assumption. Realistically, it is unlikely that any implementation of a reform would cancel out all the current policies. Therefore, the results of our simulation should be taken as benchmark cases.

## SIMULATIONS

We evaluate the policies described above with the model and the methodology developed and explained in Islam and Colombino (2018). The basic tool is a microeconomic model of household labour supply, developed according to the RURO approach (Aaberge and Colombino 2014 and 2018). It is a version of a discrete choice model that includes a representation of demand constraints. It runs on a dataset built with

<sup>3</sup> Lega’s political speakers have mentioned that Alvin Rabushka suggested for Italy a 15-percent FT. This is approximately the FT that we also get as fiscally neutral when it is applied to all the personal income.

<sup>4</sup> The proposal by Istituto Bruno Leoni seems close to a libertarian perspective, where the reduction of some public expenditures is expected to be compensated by a generous BIG and more efficient markets.

<sup>5</sup> This primarily happens for three reasons. Firstly, tax deductions favour high incomes. Secondly, there are personal incomes (e.g. income from capital or financial wealth) that are taxed according to a separate, and on average more favourable rule: since the proportion of those incomes is larger among high income households, the effect is a moderation of progressivity. Thirdly, in high income couples, both partners are likely to work and they have more opportunities to gain from the individual progressive taxation of earnings.



EUROMOD on the basis of EU-SILC Italy 2010.<sup>6</sup> It covers all couples and singles in the 18–65 age bracket. The model assumes a quadratic utility function with household income and household members' labour supply as main arguments and parameters expressed as a function of personal characteristics. Given the model estimates, one can impute a new household budget constraint induced by a reform and then simulate the new choices made by the households and all the implications for incomes, taxes, poverty etc. Our simulations are performed under the fiscal neutrality constraint, i.e. the total of tax revenue minus transfers plus social security contributions under the reform must be equal to the total under the current system. We also compute household-specific money-metric welfare indices, which can then be aggregated into a social welfare index, which offer a synthetic metric to compare policies. We adopt the Kolm social welfare index, which is computationally convenient in our case. The Kolm social welfare index is defined as follows:

$$W = \bar{\mu} - \frac{1}{k} \ln \left[ \sum_i \frac{\exp\{-k(\mu_i - \bar{\mu})\}}{N} \right]$$

where  $\mu_i$  is the money-metric welfare index of the  $i$ -th household,  $\bar{\mu} = \frac{1}{N} \sum_i \mu_i$ ,  $N$  is the number of households, and  $k$  is an index of social preference for equality.<sup>7</sup> The first term on the right-hand side of the expression for  $W$  can be interpreted as a measure of efficiency, while the second term is the Kolm index of inequality.

We will also present an example where we identify fiscally neutral optimal (i.e. social welfare maximizing) policies. The maximization of the social welfare index makes it necessary to embed the microsimulation of the reforms into an iterative optimization subject to the public budget constraint. In general, different values of  $k$  lead to different solutions. As far as the determination of the parameters  $E$ ,  $G$ ,  $FT$  and  $BRR$  is concerned, this is only relevant for the optimal taxation exercise, where we use three different values,  $k = 0.05, 0.10$  and  $0.125$ . For the other simulations, we just have one free parameter and it turns out that there is only one value of that parameter that attains fiscal neutrality whatever the value of  $k$  (at least in the range  $[0, 0.50]$ ). Nonetheless, even for these simulations, the welfare evaluation (i.e. the computation of  $W$ ) depends on  $k$ . We report the evaluation obtained with  $k = 0.10$ .

In addition to the social welfare function, there are, of course, many dimensions – such as the effects on income, labour supply and poverty – along which the reforms can be compared to the current systems and among themselves. One of the dimensions that we highlight in our simulations is the percentage of winners (either in terms of income or in terms of welfare) and its distribution across the population. This is interesting

both as a measure of the benefits received by the population and as an indication of political support for the reform. The main results of our analysis are presented in Table 1 and illustrated by Figures 4 to 13.

A further clarification is in order, before presenting the results. The methodology that we adopt actually compares not the point positions of households, but rather the opportunity sets or the optimal expected choices before and after the reform. This explains, for example, why even currently affluent households are affected by some reforms that only appear to be aimed at the poorest households. The point is that each household faces a whole opportunity set and takes into account the possibility of ending up occupying any position in the opportunity set (with different probabilities, of course).

### The Government Package and Two Variants

We simulate a simplified version<sup>8</sup> of the package with  $E = 780$ ,  $G = 780$ ,  $FT = 20$  percent and  $BRR = 100$  percent. The implementation of this project would generate a 90-billion-euro public budget deficit. This result is in line with other estimates.<sup>9</sup> It is somewhat higher since – unlike other analyses to date – we take into account the households' labour supply responses. Although the  $FT$  has some positive effect on labour supply,<sup>10</sup> it is more than offset by the negative effect of  $G$  and by the 100-percent  $BRR$ . We do not show detailed results in Table 1, since the evaluation could only make sense by making some hypothesis on how the deficit would be covered. So far the government has not given any specific indications, apart from the expectation that the positive labour supply effects should guarantee the self-financing of the package. However, this expectation is definitely not supported by the simulations, including our own. We will then analyse two alternatives whereby the government package is modified in order to attain fiscal neutrality. The first one asks what  $FT$  guarantees the fiscal neutrality – given  $E = G = 780$ ? Conversely, with the second exercise we ask, given a  $FT = 20$  percent, what value of  $G$  is compatible with fiscal neutrality?

*A fiscally sustainable FT with a BIG = 780.* With  $E = G = 780$  and  $BRR = 100$  percent, the  $FT$  that supports fiscal neutrality is 54 percent. The high value of both  $G$  and  $FT$  discourages labour supply: overall the change is around –7.3 percent, with a negative peak of –13.8 percent for single women. Single women on average have lower potential earnings and the very high  $BIG$  represents a strong incentive to leave, or not enter, the labour market. The overall

<sup>8</sup> The government package includes some additional eligibility conditions, which are unlikely to be relevant as far as the comparative evaluation is concerned.

<sup>9</sup> See, for example, Baldini and Daveri (2018), <http://www.lavoce.info/archives/50516/reddito-cittadinanza-m5s-perche-costa-29-miliardi-non-149/>; and Baldini and Rizzo (2018), <http://www.lavoce.info/archives/50668/con-la-flat-tax-conti-pubblici-a-rischio/>.

<sup>10</sup> A pure fiscally neutral  $FT$  leads to a 3.24-percent increase in labour supply.

<sup>6</sup> The fiscal system and the main economic variables that might be relevant for our comparative analysis did not witness significant changes since 2010.

<sup>7</sup> For an interpretation of the different values of  $k$  – see Islam and Colombino (2018).

Table 1  
Behavioural, Fiscal and Welfare Effects of Different Policies

	A fiscally sustainable BIG=780	A fiscally sustainable FT=20%	A fiscally sustainable FT=25% (Bruno Leoni)	A fiscally sustainable Reddito di Inclusione	An optimal NIT+FT k=0.05	An optimal NIT+FT k=0.10	An optimal NIT+FT k=0.10
E	780	330	453	251	767	870	769
G	780	330	453	188	186	287	469
% BRR	100	100	100	75	24	33	61
% FT	54	20	25	17	29	35	39
$\Delta\%$ income	- 11.7	0.1	- 2.0	0.1	- 0.6	- 2.9	- 5.1
$\Delta\%$ welfare	- 4.3	0.8	0.8	0.5	1.0	0.9	1.1
$\Delta\%$ winners							
Income	27	52	59	57	73	61	55
Welfare	38	63	59	64	74	72	71
$\Delta\%$ Headcount poverty index							
All	23.8	24.0	26.7	20.7	- 4.5	1.6	- 2.6
Couples	- 92.0	18.3	3.6	18.3	6.3	- 24.5	15.9
Single women	32.0	23.0	26.6	18.8	- 23.0	8.2	- 31.1
Single men	7.3	19.5	20.1	18.1	1.8	- 3.5	4.2
$\Delta\%$ poverty gap index							
All	- 94.5	- 4.2	- 20.5	- 4.2	- 10.3	- 25.9	- 45.3
Couples	- 92.0	18.3	3.6	18.3	- 6.7	- 24.5	- 39.8
Single women	- 95.1	- 9.2	- 26.0	- 9.2	- 8.9	- 22.8	- 43.4
Single men	- 95.9	- 16.6	- 33.6	- 16.6	- 14.8	- 30.4	- 51.9
$\Delta\%$ labour supply							
All	- 7.3	- 0.7	- 2.0	- 0.7	- 0.7	- 1.9	- 3.4
Married women	- 12.2	0.7	- 1.4	2.2	- 1.2	- 3.3	- 5.3
Married men	- 4.38	- 0.8	- 1.5	- 0.2	- 0.5	- 1.1	- 2.0
Single women	- 13.8	- 5.0	- 7.3	- 2.4	- 2.0	- 3.9	- 7.5
Single men	- 2.0	- 0.7	- 1.0	- 0.4	- 0.3	- 0.5	- 1.0

Notes: Headcount poverty index (HPI) = proportion of households below the relative poverty threshold; poverty gap index (PGI) = HPI  $\times$  income gap, where income gap = average relative distance from the poverty threshold among the poor households; labour supply = monthly expected hours of work (including 0 hours).

Source: Authors' own calculation.

implication is that both disposable income (- 11.7 percent) and social welfare (- 4.3) fall. There is also a clear evidence of 'welfare trap' since the Headcount poverty index (HPI), i.e. the proportion of poor household, increases. However, the poverty gap index (PGI) decreases by almost 100 percent. Since the PGI is equal to the HPI times the income gap, this means that there is a very important decrease in the income gap.<sup>11</sup> In Figure 4 we show the proportion of income winners by decile of initial disposable income and by type of household. A household is defined as a winner if, according to the new budget induced by the reformed tax-benefit rule, the household's new available income increases, given the same pre-reform hours of work.<sup>12</sup> Therefore, this illustration shows the pure budget effect of the reform, without accounting for the household's behavioural response. There is a large majority of winners among the first three deciles of the couples and among the first four

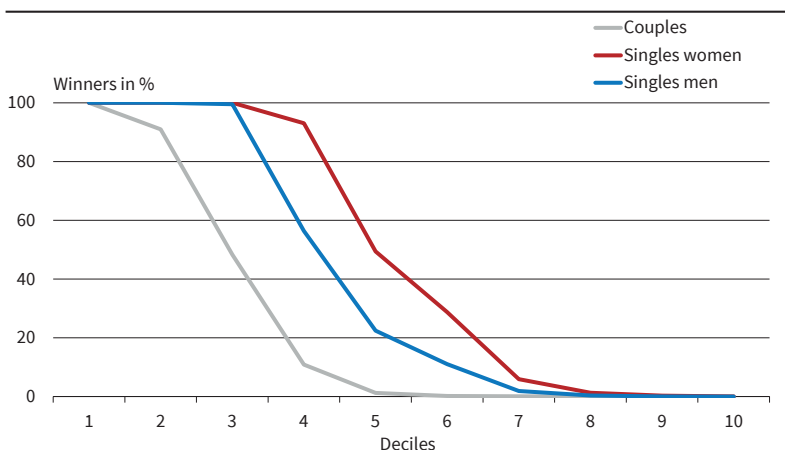
deciles of both single women and single men. In all the other deciles losers prevail. The package leads to a massive redistribution of income, the most evident price of it being the reduction of average disposable income. Figure 5, instead, shows the proportion of welfare winners by initial welfare decile and type of household. In this case we account for the new choices made by the households. This is appropriate, since the model assumes that households maximise their own welfare (or utility), not their income.

*A fiscally sustainable BIG with a 20-percent FT.* A 20-percent FT turns out to be able to support a BIG = 330. Overall, the scenario looks better than the previous one. Disposable income is stable and social welfare increases. Labour supply only suffers a significant negative change for single women (- 5.0 percent). The pattern of effects on poverty is similar to what we have seen with the previous case, although it is more moderate. The striking differences with respect to the '780 + 54 percent package' concern the distribution of winners (Figures 6 and 7). This time the losers are to be found mostly in the middle-low deciles. The distribution of winners is very imbalanced

<sup>11</sup> See the note to Table 1 for definitions of Headcount poverty index, poverty gap index and income gap.

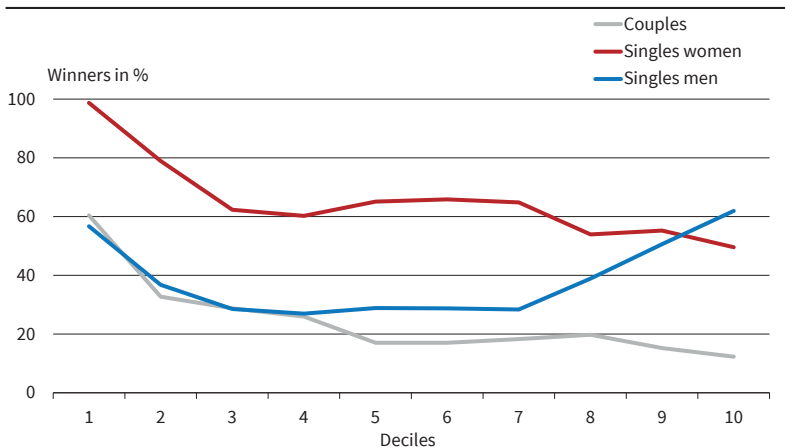
<sup>12</sup> The percentage of households who maintain the same level of income is typically less than 1 percent.

**Figure 4**  
**Income Winners with the '780+54% Basic Income Guarantee + Flat Tax' Package**



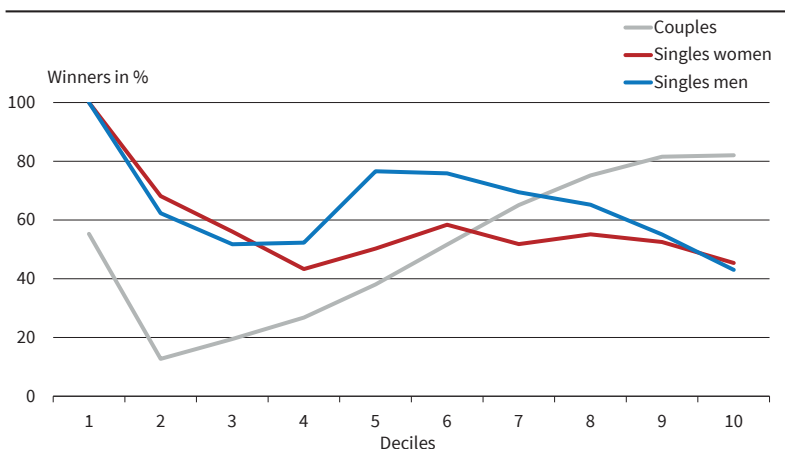
Source: EUROMOD; authors' own calculation. © ifo Institute

**Figure 5**  
**Welfare Winners with the '780+54% Basic Income Guarantee + Flat Tax' Package**



Source: EUROMOD; authors' own calculation. © ifo Institute

**Figure 6**  
**Income Winners with the '330+20% Basic Income Guarantee + Flat Tax' Package**



Source: EUROMOD; authors' own calculation. © ifo Institute

between deciles, household types and genders. As is common in this type of analysis, the distribution of

the eligibility economic conditions. Given the set policy parameters  $G = 188$ ,  $E = 251$  and  $BRR = 75$

welfare winners (Figure 7) is smoother than the distribution of income winners.

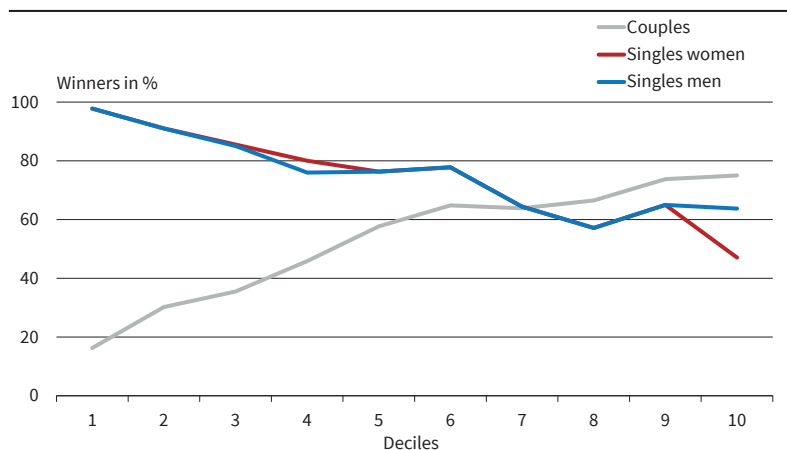
**A Fiscally Neutral Version of the 'Bruno Leoni' Package**

The proposal of Istituto Bruno Leoni (Rossi 2018) envisages a BIG around 500-600 euros, a 25-percent FT and a BRR = 100 percent. There is a deficit in public budget and the proposal includes a detailed plan of public expenditure cuts or restructuring in order to restore fiscal neutrality. The basic idea of the proponents seems to be that the BIG is sufficiently high to compensate (possibly more efficiently) for the cut in public expenditure. We are not able to account for the effects of the cuts in public expenditure. Here we follow the same line as with the government package. Since the prominent element of the proposal seems to be the 25-percent FT, we look for the value of a revenue neutral BIG given  $FT = 25$  percent and  $BRR = 100$  percent. The result is  $G = E = 453$ . Overall, the performance is close enough to the '330 + 20 percent package'. The same applies to the distribution of winners (Figures 8 and 9).

**A Fiscally Neutral and Universal 'Reddito di Inclusionone' + FT**

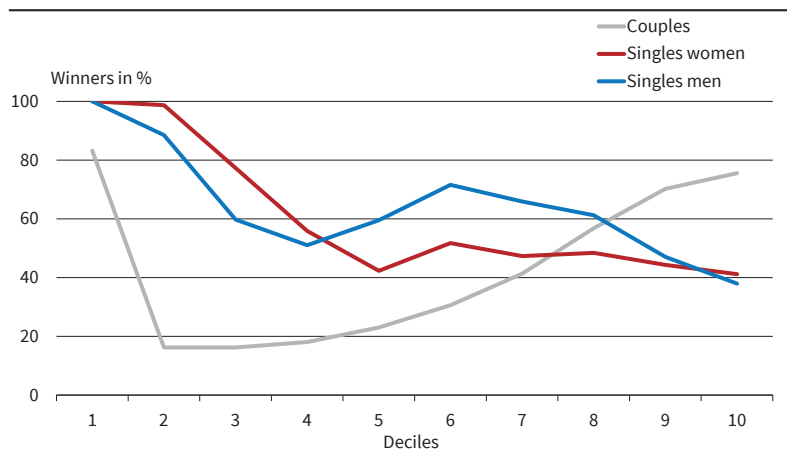
While all of the previous proposals adopt the BIG design of Figure 1, RdI adopts the NIT scheme of Figure 3. While RdC addresses relative poverty, RdI addresses absolute poverty. We assume that the policy is really universal - while at the moment of writing the funds are potentially sufficient to cover approximately half of the population in absolute poverty. Moreover, we simplify

**Figure 7**  
**Welfare Winners with the '330+20% Basic Income Guarantee + Flat Tax' Package**



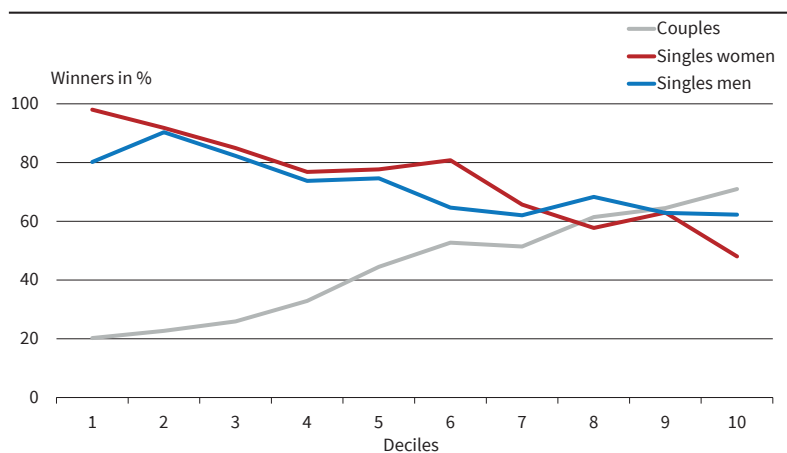
Source: EUROMOD; authors' own calculation. © ifo Institute

**Figure 8**  
**Income Winners with the '452+25% Basic Income Guarantee + Flat Tax' Package**



Source: EUROMOD; authors' own calculation. © ifo Institute

**Figure 9**  
**Welfare Winners with the '425+25% Basic Income Guarantee + Flat Tax' Package**



Source: EUROMOD; authors' own calculation. © ifo Institute

percent we look for the value of FT that attain fiscal neutrality. The result is FT = 17 percent. The overall

of the marginal tax rates and of the public budget constraints. Colombino and Narazani (2013) and Colombino (2015) illustrate previous exercises on Italy.

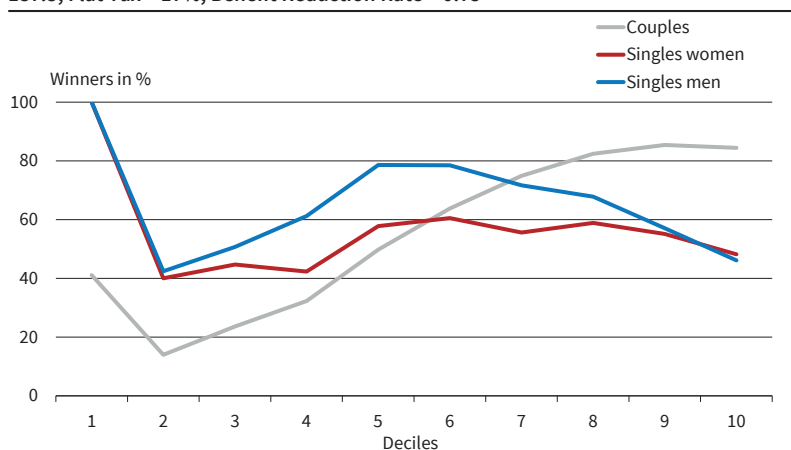
performance (including the distributions of winners of Figures 10 and 11) is again close to that of the previous two policies. In this case, however, we have a positive change in both disposable income (+ 0.1 percent) and social welfare (+0.5 percent). As we have already observed, NIT is a general design that includes BIG and UBI as special cases and, therefore, it generally dominates them. In the next section we illustrate the identification of optimal rules within the NIT class.

**Optimal NIT+FT Packages**

This section documents the results of an exercise in empirical optimal taxation. Namely, we identify the optimal parameters E, G, BRR and FT within the class of NIT mechanisms, subject to the public budget constraint, i.e. the policies are constrained to be fiscally neutral. The optimality criterion is the maximization of the Kolm social welfare index for  $k = 0.05, 0.10$  and  $0.125$ .<sup>13</sup> The NIT mechanism – although a member of the same class – induces radically different incentives when compared to BIG. In the BIG scheme, as long as your own income is in the range  $(0, E)$ , your disposable income is equal to G: your own effort to increase your income has no effect on disposable income. With NIT, by contrast, the effect of your effort is visible. The results of the optimal taxation exercise are reported in the last three columns of Table 1. A higher preference for equality (i.e. a higher value of  $k$ ) entails a higher G and a higher BRR

<sup>13</sup> Islam and Colombino (2018) perform a similar exercise for eight European countries. The exercises reported here address different policies. There are also some differences in the definitions of the public budget constraints. Colombino and Narazani (2013) and Colombino (2015) illustrate previous exercises on Italy.

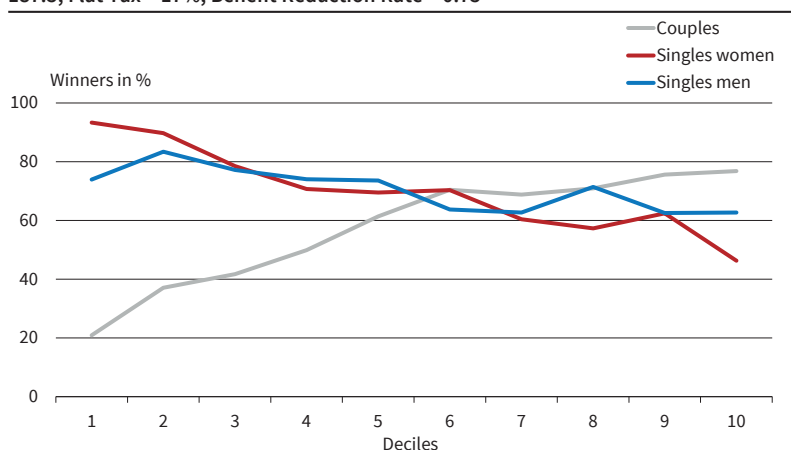
**Figure 10**  
**Income Winners with Tax Exemption Level of Income = 251, Unconditional Transfer = 187.5, Flat Tax = 17%, Benefit Reduction Rate = 0.75**



Source: EUROMOD; authors' own calculation.

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**Figure 11**  
**Welfare Winners with Tax Exemption Level of Income = 251, Unconditional Transfer = 187.5, Flat Tax = 17%, Benefit Reduction Rate = 0.75**



Source: EUROMOD; authors' own calculation.

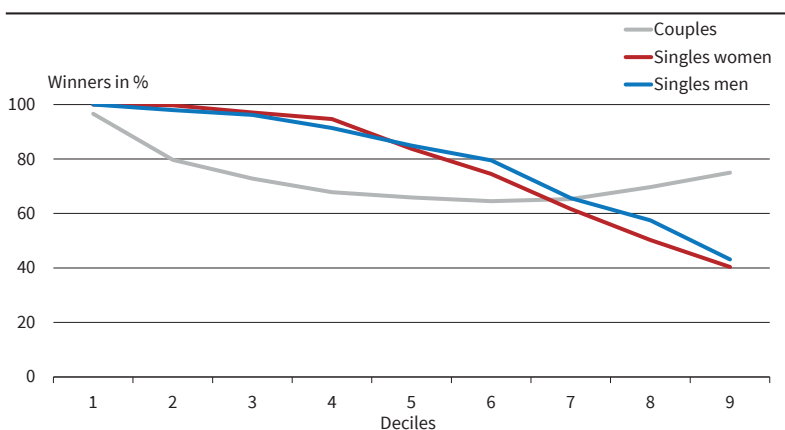
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relative to FT. With a more expensive G, it becomes more convenient to impose higher taxes (higher BRR) on dense segments of the population (i.e. low-average incomes households, those more likely affected by BRR). The three optimal policies show some specific features when compared to the policies of the first three columns of Table 1. Firstly, they perform better in terms of social welfare and poverty gap index. Secondly, they induce a far more equilibrated profile of winners (income-wise and welfare-wise) both across deciles and across types of households. Overall, the (optimal) NIT mechanisms make it possible to obtain a much more balanced distribution of costs and benefits. It is interesting to compare our version of REI with the optimal NIT associated with  $k = 0.05$ . The two policies have essentially the same value of G. The key difference concerns BRR and FT. While REI's BRR is 75 percent, the optimal policy has a much lower value of BRR (24 percent), which implies a much higher value of E ( $= G/BRR = 767$ ) and permits a smoother transition from the subsidised range of incomes (between 0 and

E) to the non-subsidised ones (above E). This also implies a higher FT for the optimal NIT (29 percent instead of 17 percent). It is also worth noting that the optimal BRR and FT are not so far away from each other, so that the system turns out to be rather close to a UBI. It is also instructive to compare the optimal NIT ( $k = 0.05$ ) to our fiscally neutral version of the proposal by Istituto Bruno Leoni. While the latter attains fiscal neutrality with BRR = 100 percent and FT = 25 percent, the former adopts a smoother profile with BRR = 24 percent and FT = 29 percent. The optimal guaranteed income, instead of being kept at 453, is 'updated' from 186 up to 767 depending on the household's own effort. It is interesting to observe that this optimal policy might be considered as an improving modest correction of REI. With this design, the optimal policy shows a better performance in terms of income, welfare, winners and poverty. It is rather striking to compare the graphs related to optimal policy with those showing other policies (government package, Bruno Leoni, REI). The latter tend to generate

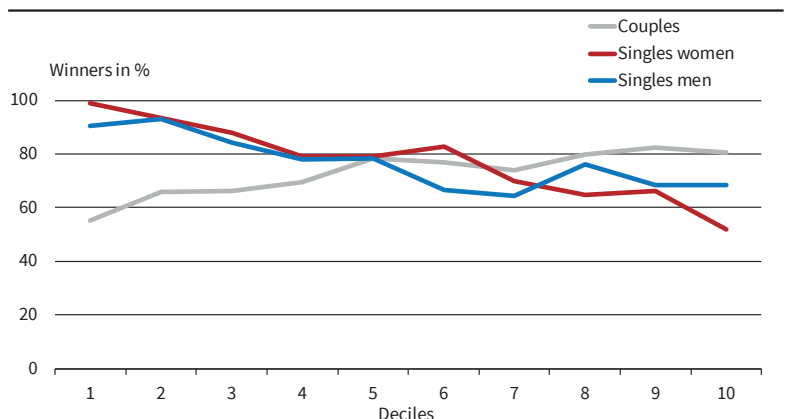
large winners' differences between deciles, between genders and between different household types (couples and singles). The former induces a far more balanced distribution of winners (in terms of both income and welfare). This dimension is important in view of the political support that can be expected for such reforms. If we adopt a more egalitarian criterion such as  $k = 0.10$ , the optimal values turn out to be  $E = 860$ ,  $G = 287$ ,  $FT = 35.7$  percent and  $BRR = 33$  percent. Again, we are not far from the UBI design of Figure 2. If my monthly taxable income is less than 860 euros, I receive a benefit equal to 33 percent of the difference between 860 euros and my income. This disposable income increases with my taxable income (up to 860 euros). As with the  $k = 0.05$ , this mechanism guarantees a good compromise between income support and labour supply incentives. There is a gain in social welfare (+ 1.19 percent). The fall in the poverty gap index is very large. Labour supply grows among couples. The distributions of winners are balanced: Graphs are not reported, but overall they confirm what

**Figure 12**  
Income Winners with the 'Optimal Negative Income Tax + Flat Tax ( $k = 0.05$ )' Package



k: Kolm social welfare index.  
Source: EUROMOD; authors' own calculation. © ifo Institute

**Figure 13**  
Welfare Winners with the 'Optimal Negative Income Tax + Flat Tax ( $k = 0.05$ )' Package



k: Kolm social welfare index.  
Source: EUROMOD; authors' own calculation. © ifo Institute

we see with the  $k = 0.05$  optimal policy (Figures 12–13). In Table 1 we also document the effect of an optimal NIT+FT given  $k = 125$ . Clearly, this policy implies a more generous minimum income support ( $G = 469$ ) and higher taxation ( $FT = 39$  percent). As with the previously commented optimal policies, there are some notable benefits, e.g. a big reduction in the poverty gap index and gains in social welfare. However, there is also a worrying decrease in the labour supply and in income as a result.

**CONCLUSIONS**

Our results show that it is possible to find fiscally neutral packages that combine basic income and flat tax and convey some social and economic benefits. However, the design of the feasible packages is definitely far removed from the current government’s proposals. The ‘preferred’ (most appealing and realistic) proposals seems to be ‘the 330+20 percent package’, ‘the Istituto Bruno Leoni package’ and ‘the optimal ( $k = 0.05$ ) NIT+FT

package’. Even a universal version of REI might represent a starting scenario that could be updated to converge upon one of the three ‘preferred’ policies. The main points in favour of these policies seem to be: the positive effect on both income and welfare of the 330+20 percent package; the generous BIG of (our version of) the proposal by Istituto Bruno Leoni; the large percentage of winners, and their balanced distribution across deciles and household type, of the optimal ( $k = 0.15$ ) NIT+FT. Islam and Colombino (2018) show that there is a significant link between the productivity of the economy and the (optimal) fiscally neutral level of basic income (and of the associated FT). The Italian productivity per hour of work is approximately equal to the average of European countries and the average guaranteed minimum income in Europe is 395 euros. The basic income envisaged by the three most realistic policies ranges between 300-500 euros, depending on the specific policy design: 330 with the 330+20 percent package, 453 with our version of the Istituto Bruno Leoni proposal, 495 (for a single with own

income = 383) with the optimal ( $k = 0.05$ ) NIT + FT policy. The range of basic income values of the three ‘preferred’ reforms is therefore comparatively consistent with the policies currently implemented in European countries when productivity differentials are taken into account.

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Karl Widerquist  
**The Devil's in the Caveats:  
 A Brief Discussion of the  
 Difficulties of Basic Income  
 Experiments**



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 Georgetown  
 University-Qatar

*The devil is in the detail* is a common saying about policy proposals. Perhaps we need a similar saying about policy research, something like *the devil is in the caveats*. No simple list of caveats can bridge the enormous gap in understanding between the specialists who conduct policy research and the citizens and policymakers (including both elected officials and public servants) who are responsible for policy in a democracy, but who often have overblown expectations about what policy research can do.

For example, the headline, 'In 2017, We Will Find Out If a Basic Income Makes Sense', which appeared in *MIT Technology Review* in December 2016 (Condliffe 2016), expressed a common belief about experiments with the Universal Basic Income (UBI) – a policy to put a floor under everyone's income. Although the most laughable inaccuracy of this headline was there were no plans to release findings from any experiments at all in 2017 (nor were any published), the more important inaccuracy was that it reflected the common, but naive belief that UBI experiments are capable of determining whether UBI 'makes sense'. No social science experiment can do any such thing. Social science experiments can produce valuable information, but they cannot answer the big questions that most interest policymakers and voters, such as does UBI work or should we introduce it?

The limited contribution that social science experiments can make to big policy questions like these would not be a problem if everyone understood the experiment's limitations, but unfortunately, the article in *MIT Technology Review* is no anomaly. It is a good example of the misreporting on UBI and related experiments that has gone on for decades (Widerquist 2005) by the publications we count on to get it right. *MIT Technology Review* was founded at the Massachusetts Institute of Technology in 1899. Its website promises "intelligent, lucid, and authoritative [...] journalism [...] by a knowledgeable editorial staff, governed by a policy of accuracy and independence".<sup>1</sup> Although *the Review's* expertise is in technology rather than scientific research, it is the kind of publication that one would expect to be most

able to help non-specialists understand the limits and usefulness of scientific research.

Although there is some overlap between the academics, journalists, policymakers, and citizens involved in policy research and policy discussions, most of the individuals in these groups do not have enough shared background knowledge to understand each other well. Researchers often do not understand what citizens and policymakers expect from research, while citizens and policymakers frequently fail to grasp the inherent difficulties of policy research, or the difference between what research shows and what they most want to know. People who do not understand the limits of experiments also cannot comprehend the value that experiments can contribute to our understanding of an issue.

Specialists usually include a list of caveats covering the limitations of their research, but caveats are incapable of doing the work researchers often rely on them to do. A dense, dull, and lengthy list of caveats cannot provide non-specialists with a firm grasp of what research does and does not imply about the policy at issue. As a result, even the best scientific policy research can leave non-specialists with an oversimplified, or simply wrong impression of its implications for policy. Better written, longer, clearer caveats will not solve the problem either. The communication problem, coupled with the inherent limitations of social science experimentation, call for an entirely different approach to bridging the gap in understanding.

My forthcoming book, *A Critical Analysis of Basic Income Experiments for Researchers, Policymakers, and Citizens: The Devil's in the Caveats*, addresses how these sorts of problems affect Universal Basic Income (UBI) experiments that are underway, planned, or being considered in several countries around the world at present. This article previews and summarises the major findings of that book.

UBI has many complex economic, political, social, and cultural effects that cannot be observed in any small-scale, controlled experiment. Therefore, even the best UBI experiment makes only a small contribution to the body of knowledge on the policy in question and leaves many important questions unanswered. Citizens and policymakers considering introducing UBI are understandably interested in larger issues. They want answers to the big questions like does UBI work as intended; is it cost-effective; should we introduce it on a national level? The gap between what an experiment can show and the answers to these big questions is enormous. Within one field, specialists can often achieve a mutual understanding of this gap with no more than a simple list of caveats, many of which can go without mentioning. Across different fields mutual understanding quickly gets more difficult, and it becomes extremely difficult between groups as diverse as the people involved in the discussion of UBI and UBI experiments.

<sup>1</sup> MIT Technology Review, What We Do, <https://www.technologyreview.com/about/>.



The process that brought about the experiments in most countries is not likely to produce research focused on bridging that gap in understanding. The demand for the current round of experiments seems to be driven more by the desire to have a UBI experiment than by the desire to learn anything specific about UBI from an experiment. An unfocused demand for a test puts researchers in a position to learn whatever an experiment can show, regardless of whether it is closely connected to what citizens and policymakers most want to know. The vast majority of research specialists who conduct experiments are not fools or fakers. They will look for evidence that makes a positive and useful contribution to the body of knowledge about UBI. But the effort to translate that contribution into a better public understanding of the body of evidence about UBI is far more difficult than often recognised. This communications problem has badly affected many past experiments and is in danger of happening again.

To understand the difficulty of the task, imagine a puzzle strewn out over the floor of a large, dark, locked room. A map of the entire puzzle, assembled together, provides an answer to the big questions – does it work, and should we implement it. An experiment shines a light through a window, lighting up some of the puzzle pieces, so that researchers can attempt to map how they might fit together. They can easily map the pieces near the window, but further away their view gets dimmer, the accuracy of their map decreases, and in dark corners of the room, many pieces remain entirely unobserved. Although scientists like to solve entire puzzles when possible, under normal circumstances, they have to settle for something less ambitious. That is why the basic goal of scientific research is to increase the sum of knowledge available to the scientific community – even if that increase is very small. In terms of the example, if a research project can map even one new piece of the puzzle, it succeeds in the basic goal, even if the puzzle as a whole remains unsolved and the map is only readable to other scientists.

As the headline mentioned above illustrates, non-specialists tend to expect something far more definitive from social science experiments, often assuming they have the same goal as high school science tests: to determine whether the subject passes or fails. People often expect that experimental researchers will produce an estimate of whether UBI works or whether the country should introduce it. In terms of the metaphor, they expect researchers to solve the entire puzzle; or at least to provide their best estimate of that solution. If researchers present their findings as social scientists normally do, they present something fundamentally different from what citizens and policymakers are looking for and possibly expecting. The potential for misunderstanding is enormous when research reports say something to the effect of *here are the parts of the puzzle we were*

*able to map* to an audience looking for something to the effect of *here is our best estimate of the solution to the entire puzzle*. Caveats do not and cannot draw the necessary connection: *here is how the parts we were able to map can be used toward a larger effort to find the solution to the entire puzzle and how close or far we remain from it*.

Caveats tend to focus, not on the connection between the two goals, but on trying to help people understand the research on its own terms. In terms of the analogy, caveats tend to focus on the areas that experiments were able to map: how did they map this area; what does it mean to map this area; how accurate is the map of this area, and so on. The relationship between the areas mapped and the solution to the whole puzzle is often covered by one big caveat so seemingly simple that it often goes unstated: obviously the areas we mapped are far from a solution to the entire puzzle. In other words, the information gathered about UBI in an experiment is far from a definitive, overall evaluation of UBI as a policy. As obvious as that caveat might be to researchers, it is not at all obvious to many non-specialists.

Of course, non-specialists know there are some caveats about the reliability of the experiment, but if they overlook or misunderstand that one big caveat they will nevertheless believe that researchers provide their best estimate of whether ‘Basic Income Makes Sense’ (Condliffe 2016) and they will tend to look for that answer in any report on the study. If they get no help doing it, they are likely to overestimate the political implications of the information that experiments find, providing a great opportunity for spin and sensationalism by people willing to seize on small findings that sound positive or negative as proof that the programme has been proven to be a success or a failure. The book and some of my previous work argue that earlier UBI-related experiments have been misunderstood and misused in these ways (Widerquist 2005).

The difficulties above follow on from the complexity of the science involved. Now consider how ethics further complicates the issue. In terms of the analogy, this puzzle is a very special kind: the pieces fit together in different ways depending on one’s moral values. If research definitively proves that a policy does not achieve the goals that its supporters hope it does, research can give a conclusive answer without dealing with ethical controversy. But if a sustainable policy achieves some goal and has some side effects, reasonable people can disagree about how good or bad those goals and side effects are; and how we should evaluate trade-offs between them. Therefore, reasonable people can disagree about whether the evidence indicates that the policy works and should be introduced; or whether that same evidence indicates the policy does not work and should not be introduced. This problem greatly affects the UBI discussion because supporters

and opponents tend to take very different moral positions.

Many people, including many specialists, are less than fully aware of the extent to which their beliefs on policy issues are driven by empirical evidence about a policy's effects; or by a controversial moral evaluation of those effects. For example, mainstream economic methodology incorporates a great deal of utilitarianism, which was the prevailing ethical framework when basic mainstream economic techniques were developed, but has long since lost its prominence in political philosophy and political theory. Many articles in economics journals read as if the author is unaware of the moral judgments incorporated into that methodology. Additionally, not everyone is honest about the extent to which their policy judgments are driven by controversial moral judgments. Some will try to spin the results by hiding the extent to which their evaluation of the evidence is driven by their moral position and portray it as the only objective reality.

Into this ethical morass falls the dense and difficult research report of an experiment's findings with an often tedious and easily ignorable list of caveats about the research's limitations and usually a complete absence of discussion about the moral judgments needed to evaluate the study's implications for policy. Under such circumstances, no one should be surprised that social science experiments easily fall victim to misunderstanding, spin, sensationalism, and oversimplification. Perhaps we should expect these problems to happen more often than not. After all, it is easier to understand an oversimplification than genuine complexity.

Solutions to these problems are difficult and imperfect, but we have to try to address them, if UBI experiments are going to achieve their goal. I presume the overall goal of UBI experiments is (and should be) to enlighten the public discussion by increasing public understanding of evidence on UBI. I do not think that this goal is controversial or new. And I will argue that it should be endorsed by virtually any UBI-related experiment no matter what other goals it might have, such as the basic goal of scientific research (mentioned above), working out technical issues that are important to policymakers, or in some cases, politically promoting UBI. There is nothing inherently wrong with using a study – even a small-scale, less-rigorous study – to promote a policy, as long as the evidence is presented honestly and aimed at improved understanding. In other words, the need to keep the goal of enlightening discussion through good communication and an orientation toward the most important issues is as important to the most political UBI demonstration project as it is to a more rigorous study.

Some past researchers (either conducting or writing about experiments) have failed to appreciate how difficult it is to accomplish this goal,

especially when they focus primarily on the basic goal of scientific research. Increasing the amount of knowledge available to the scientific community does not necessarily or easily translate into improved public understanding of that evidence. The gap in background knowledge has to be addressed because it creates risks that less politically oriented research does not entail, including the vulnerability to misunderstanding, spin, misuse, sensationalism, or oversimplification.

Perhaps the main message of Widerquist (forthcoming 1) is that UBI experiments seldom if ever succeed in enlightening public discussion merely by trying to get non-specialists to understand experimental findings on their own terms. It is not enough to say, *here are the pieces of the puzzle we managed to map*. It is not enough to explain what experimental group is, what a control group is, and what the differences were between the two groups in the study. It is not enough to have a new and improved list of caveats about experimental limitations. Experimental findings should not be presented as a stand-alone piece of research, but as a small part of a larger effort to use all available evidence to answer the big questions about UBI; and to explain the extent to which the big questions remain unanswered. Researchers must attempt to find the information that will be of the most value to the public discussion, and someone – not necessarily the researchers conducting the study – has to attempt the difficult task of communicating those results in a way that people involved in the public discussion of the issue will understand. The difficulty of these tasks is at least half of what the book is about.

Widerquist (forthcoming 1) discusses the difficulty of conducting UBI experiments and communicating their results given both the inherent limits of experimental techniques and the many barriers that make it difficult for researchers, journalists, policymakers, citizens, and anyone else interested in UBI or UBI experiments to understand each other. The book's goals are to improve both the experiments and public understanding of them. Therefore, with the experiments' goal of enlightening public discussion in mind, this book asks two distinct but closely related questions:

1. How do you do a good experiment given the difficulties involved?
2. How can citizens, policymakers, researchers, journalists, and others interested in UBI and UBI experiments communicate in ways that will lead to a better public understanding of the implications of UBI experiments for the public discussion of UBI?

This project is an applied examination of a family of problems *specific* to UBI experiments with no claim that these problems are necessarily *unique* to UBI experiments. Many such difficulties apply to all social

science experiments, and some apply to all policy-related research – see also Deaton and Cartwright (2016); and Teele (2017). To the best of my knowledge, my book will be the first to focus entirely on applying this kind of analysis to UBI experiments, but will not explore whether the kinds of problems discussed for UBI experiments are as bad or worse than problems involved in other social science experiments.

This article and book are written for anyone interested in UBI experiments and UBI as a policy – they are for researchers, journalists, policymakers, citizens, and people who partly belong to one group and partly to another. The danger of misunderstandings exists between everyone involved; and everyone involved can help solve them. No single group can easily clear up such misunderstandings on their own; and hopefully we can all benefit from thinking through the problems examined by this book. Policymakers, journalists, and citizens who understand the place of experiments in the political economy of the UBI discussion will be able to communicate their desire for experiments that are more relevant to that discussion. They will learn more from any experiments that are conducted. And they will be better equipped to counter spin and sensationalism.

Researchers who understand the place of experiments in the political economy of the UBI discussion can obviously communicate their results more effectively. But it is not just about communication. Researchers who understand and respect the public discussion can design better experiments. It would be a mistake to believe researchers conducting experiments can resolve all of these communications issues on their own. Although research specialists are professionals at communicating with other specialists, the vast majority of them are amateurs at communicating with non-specialists – and I am no exception. Scientists are trained to conduct research and communicate it to other scientists, but have no special training in the skills needed to bridge the communications gap. Very often specialists do not know what evidence would be most valuable to citizens or policymakers or how best to help citizens and policymakers understand the value of the evidence researchers are able to find. The ultimate responsibility rests more with the policymakers and donors *commissioning* experiments than with the researchers conducting experiments. They – or whoever they put in charge of hiring the research to conduct experiments – might have the most to gain from understanding the communications gaps involved in UBI experiments.

As more experiments get underway and present their findings, it is important to consider lessons in how to improve the chances that experiments will successfully enlighten the public discussion of UBI. As the book argues, past UBI-related experiments – despite almost always being good science – have a mixed record at increasing the understanding of

evidence among non-specialists. Some succeeded and some failed. No matter what the primary goals of an experiment are, the people commissioning and conducting them ignore the public role of UBI experiments at their peril. The primary goal of a UBI experiment, might simply be to examine a few narrow technical issues that are of particular interest to policymakers commissioning the study or to the research community. There is nothing wrong with the desire to make some goal like this the main focus of a project. But UBI experiments are too closely tied to the political process and their results are too easily misunderstood for researchers to ignore experiments' role in the political economy of the UBI discussion.

Although UBI experiments are scientific endeavors, they are both an outcome of and an input into the political process. The current experiments are – directly or indirectly – a response to the growth of the UBI movement in recent years. It is no coincidence that UBI-related experiments took place in the 1970s and not again (almost anywhere) until the 2010s. These efforts corresponded with waves of support for UBI and related policies (Widerquist forthcoming 2). These enormous undertakings require a great deal of political support. Social science experiments are usually too big to be funded by an everyday grant from a science foundation. The 1970s experiments were commissioned, not by private or public science foundations, but by acts of national legislatures that were seriously considering the policy. The same is true for the new government-funded experiments, such as those in Finland and Canada. Experiments in Namibia, India, Kenya, and two in the United States are all led or funded by private organizations with a strong interest in the UBI debate, although a mix of private and public institutional funding has been involved in some cases (Widerquist forthcoming 1).

Whether researchers like it or not, people on all sides of the UBI discussion all over the world will look to UBI experiments for information about UBI and sometimes for ammunition to use in debate. The experiments will affect the public discussion of UBI. People will seize on findings and say it implies X about whether UBI works or whether we should introduce it. The data will be used this way. The question is whether it will be understood and used appropriately; or misunderstood and abused.

To achieve the goal of enlightening discussion, people commissioning and conducting experiments need to know the local discussion well, but they also need to avoid overconfidence in their belief about how well they know it. Having read a few articles does not make you an expert. Journalists and opinion writers who have platforms to write about UBI are not necessarily experts on the UBI discussion, nor does most of the discussion go on in the pages of major media outlets. People commissioning and conducting experiments should not be tempted to believe that no one in the local discussion is interested in the

big questions that have not been explicitly stressed by prominent writers and speakers involved in the discussion. Ignoring the obvious and rational desire for anyone considering a public policy question to have answers to the big questions about it creates an opportunity for a demagogue to use that lack of information to spin the experiment's findings to their advantage.

To help bridge the communication gaps, the book by Widerquist (forthcoming 1) has to focus extensively on how limited UBI experiments are in answering the big questions about UBI. It also discusses the many communications barriers that make it difficult for researchers to present results in a way that successfully raises the level of understanding of evidence among people involved in the public discussion of UBI. Therefore, the book has a lot of negative things to say that might cause some UBI-supporters to reject experiments altogether. This is not my message; the message instead is how best to conduct a UBI experiment and communicate its results once the decision to conduct an experiment is made. Experiments are happening; it's important to make the best of them.

Widerquist (forthcoming 1) also makes many specific recommendations, including strategies for conducting an effective test and for combatting spin and misunderstanding. Perhaps the best way to sum up my perspective is the following recommendation. Treat experiment(s) as a small part of the effort to answer the questions necessary to evaluate UBI as a policy proposal and to explain which unknown factors remain. This recommendation does not mean that experiments must be conducted in conjunction with many other research efforts to answer all these questions. It means that experiments in isolation cannot be interpreted as saying very much at all about UBI as a policy. The true value of an experiment is making a small contribution to this larger effort. For non-specialists to understand this: additional evidence has to be discussed, and the limits of experimental methods (and the overall effort to research a policy prior to implementation) have to be stressed.

In addition to many more specific suggestions, the book stresses four broad strategies for achieving this goal:

1. Work back and forth from the public discussion to the experiment. Anyone commissioning, conducting, or writing about experiments should respect the national or regional discussion of UBI. Find out what they can about what people most want to know. Design a study to orient as much as possible towards the questions that are important to the local discussion, paying careful attention to the extent to which experiment can and cannot contribute to our understanding of those issues. All reports about experimental

findings should relate the information to the big questions that are important to the local discussion. This strategy involves bringing in non-experimental data and calling attention to all experimental limitations, but it is necessary to help people appreciate the contribution an experiment can make.

2. Focus on the effects rather than the side-effects of UBI. Research projects have a way of focusing attention on the things they can measure at the expense of more difficult questions that might be more important to the policy issue at hand. For example, although the costs of UBI are important and more easily quantifiable, the most important question about UBI is whether it has the many positive effects on people's wellbeing that its supporters claim.
3. Focus on the bottom line. Although the public discussion varies enormously over time and place, the desire for an answer to the big questions is ubiquitous, and so I suggest focusing on what I call the bottom line: an overall evaluation of UBI as a long-term, national policy.<sup>2</sup> Experiments alone cannot provide enough evidence to answer a bottom-line question, but researchers can relate all of their findings to it. Virtually all UBI research has some relevance to that bottom-line evaluation, but citizens and policymakers, often need a great deal of help to understand those implications meaningfully, and even the best journalists are not always able to provide that help.
4. Address the ethical controversy. Researchers cannot resolve the controversy over the moral evaluation of UBI, nor should they try. But they do the public a disservice by ignoring it. They will do better to recognize the controversy and to explain what the findings mean to people who hold different ethical positions that are common in the discussion locally, and perhaps internationally too.

I wish I could say that this strategy will resolve this issue, but no effort to improve experimentation and communication will be perfect. A social science experiment is a very limited tool, and its implications are inherently difficult to understand. The bid to treat experiments as a small and incomplete part of a wider effort to answer all the important empirical issues about UBI will not even eliminate the need for caveats, although it will change the nature of the caveats involved.

There will always be gaps in understanding between the people involved in the discussion of such a complex issue and such complex evidence. If a non-specialist learns everything a specialist knows, they become a specialist. But experimentation and communication can always be improved and I hope

<sup>2</sup> UBI can, of course, be a regional policy.

that this research project makes a small contribution to that effort.

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Michael Clauss and Stefan Remhof

# A Euro Area Finance Ministry – Recipe for Improved Governance?

accepted are likely to be complied with and acted upon. This fact has also been acknowledged by political leaders like French president Macron, who has mobilised popular awareness and support for a comprehensive reform of the euro area, including a common finance ministry (Macron 2017).

The following article aims to examine how the challenge of legitimacy for a euro area finance ministry can be met for the two versions as such; and for a potential transition from the functionalist version to the federalist one. To this end, the article refers to the key principles of governance, namely rule of law and the prevalence of free markets (Juncker 2017). In other words, it explores the extent to which the current proposals for introducing and operating a finance ministry comply with these two principles, which can be regarded as pivotal for democracies and economic efficiency.

## FEDERALIST OR FUNCTIONALIST: OPTIONS TO POSITION A FINANCE MINISTRY FOR THE EURO AREA

In most EU countries finance ministers have become the most prominent figures on the political stage next to government heads. This relates to their role in channelling public funds to reflect the political priorities of their respective governments with respect to the distribution of public goods and economic management (Zimmermann and Henke 1999). Generally fiscal policy is regarded as a domain of national policy, a setting that had been explicitly confirmed in the treaties of Maastricht and Lisbon (TEU, Art. 125). At the European level, involvement in fiscal policy had been confined to loose coordination of national fiscal policies and a small central budget. The bodies in charge, the euro group chair and the ECFIN commissioner, pursue their European roles as a second occupation next to their main responsibility for national policy or EU economics (Wolff 2017).

During the second crisis that centred on Greece in 2015, leaders of the EU institutions initiated an elementary overhaul of this arrangement (Juncker *et al.* 2015). Pivotal to their recommendations was the suggestion to create an institution charged with fiscal coordination, a euro area finance ministry. Further debate centres on two alternative ways of defining this position, which we refer to as functionalist and federalist.

## A Functionally-Defined Finance Ministry to Attune Fiscal Policy Coordination to the Needs of EMU

The rationale for a euro area finance ministry in a functionalist version ('finance ministry light') would be to make the euro area more sustainable or less prone to future crises. It would follow the tradition of political efforts to strengthen coherence and po-

### INTRODUCING A EUROPEAN FINANCE MINISTER – THE DEBATE (RE) GAINS MOMENTUM

After the momentous political decisions on saving the euro area taken between 2010 and 2012, the debate on further reforms was confined to EU bodies and academic circles. It was not until 2017 that the inauguration of a pronouncedly pro-European leadership in France provided the political momentum to reform. Now the debate is focused on reforming euro area fiscal policy to make it more coherent, better synchronised with monetary and banking policies and better legitimized. This debate centres on calls to create a finance ministry for the euro area (Guttenberg and Hemker 2018; Bénassy-Quéré *et al.* 2018). Despite its political reservations against pooling financial resources, even the German government seems on board for some institutional overhaul of the euro area, aimed at strengthening rule-based fiscal coordination – or a 'finance ministry light'.

Rule-based oversight of national fiscal policies vs. pooling financial resources run by a genuine European fiscal capacity can be seen either as alternatives, or as two consecutive stages on the path towards a fully-fledged federal structure. According to the first alternative, which we will call functionalist, a euro area finance ministry's objective would be to help align national fiscal policies, thus enhancing sustainability/reducing the vulnerability of the euro area. According to the second version – that we refer to as federalist – a euro area finance ministry should be one layer within a multi-layered system of fiscal authorities – European, national, local – instead of primarily supervising national budgets (Hinarejos 2014).

One key challenge in establishing a euro area finance ministry will be to address questions of governance such as securing its legitimacy and acceptance between national governments and populations. In an open and democratic society governance can be regarded as pivotal in making any institutions effective, as only rules that are



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litical management of fiscal policy in the euro area, which started with the EFSF in 2010 and continued with the fiscal compact, effective since 2013. In an evolutionary approach a euro area finance ministry would assume the role of the euro group chair (Bénassy-Quéré *et al.* 2018), as well as that of vice president of the EU commission – in some resemblance of the high representative of foreign and security policy (Wolff 2017).

A euro area finance ministry would remain distinct from the EU budget commissioner, from the commissioner of financial affairs (charged with surveillance of national budgets) and from the management of the ESM. Essentially such a European fiscal authority would pass judgement on national fiscal policies' compliance with fiscal rules of the euro area. By itself, it seems only an upgrade of the chair of the euro group to a full-time position. However, even such a modest institutional change is likely to have far-reaching consequences by changing the logic of cooperation between national and European fiscal bodies towards more EU involvement and hierarchical decision making (Bénassy-Quéré *et al.* 2018). The current practice of cooperation might change in five ways:

1. In taking decisions on national budgets' compliance with euro area rules 'the euro area finance minister light' will rely on the 'commissioner of economic and financial affairs', who is charged with budget surveillance (Bénassy-Quéré *et al.* 2018).
2. The new practice relies on simplified fiscal rules with as little discretion as possible. This, in turn, is supposed to enhance transparency and protect the fiscal authority from arm twisting on the part of national governments. One option brought forward is to relate fiscal compliance to spending, rather than deficits. According to this proposal put forward in the economists' paper, nominal spending should not grow faster than GDP, until the debt reference level stated in the TFEU (60 percent of GDP) is achieved. High visibility of spending growth will make it a hard constraint, incentivising national treasuries to side with the EU fiscal authority (Bénassy-Quéré *et al.* 2018), thus warding off demands from national spending ministries.
3. The third task relates to the public goods character of money, implying a natural link between the banking system and the public sector. In Europe this is reflected by interdependence between fiscal policy and banking, with government assets accounting for a large share of banks' asset side, linking national fiscal policy decisions *via* their impact on bond prices to banks' balance sheets, hence their lending capacity (ECB 2017). This link is dubbed bank sovereign nexus. The inconsistency between
4. national fiscal policy and area-wide monetary policy could be ironed out by inducing banks to diversify their debt holdings through the so-called ESBies (euro area safe assets) which are derivatives backed by a basket of national government bonds of all the euro area nations (Brunnermeier *et al.* 2011). A euro area fiscal authority could assume the tasks performed by a debt issuing agency, either as arranger or as regulator and surveillance authority. According to the first option it would help create these instruments with reference to underlying government debt and organise interest payments to investors. In this function it would be assisted by legal and financial expert companies. In its alternative role it may be charged with regulating and surveying arranging companies (ESRB 2018). This could be a natural part of its surveillance function (Brunnermeier *et al.* 2011; Bénassy-Quéré *et al.* 2018).
4. The 'finance ministry light' would be compelled to cooperate with the ESM, since its decisions on national budgets will also have an impact on access to ESM funding. Conversely, the ESM assessment of national solvency, which has direct consequences for the governments concerned such as imposing adjustment programmes or debt restructuring, will also impact the finance ministry's judgement in terms of fiscal compliance (Wolff 2017).
5. There might be a link between the 'finance minister light' and the budget commissioner, relating to a newly-created stabilisation fund. This fund, meant to weather asymmetric economic shocks to individual countries, can be released to the countries concerned following the judgement on their abidance by fiscal rules (Juncker *et al.* 2015; Matthes *et al.* 2016).

In essence a euro area 'finance ministry light' means an upgrade of existing control and adjustment mechanisms to national fiscal policies, impersonated by the chair of the euro group. In this capacity it would become the anchor of EU involvement in fiscal policy in general.

### **A Finance Ministry in a Regime of Fiscal Federalism: A Single Fiscal Policy with National Competition**

A European fiscal authority (finance minister) defined in its wide role would correspond to the concept of fiscal federalism. Although key proponents of this version agree that such a role needs to be implemented in various stages, ultimately such a European fiscal authority would be assigned responsibility of running the euro area fiscal policy in its own right along national fiscal policy lines. Insofar that both camps, functionalists and federalists, reach a

consensus, this version of a finance minister would imply a quantum leap compared to the current regime of managing fiscal policy (Priewe 2017; Matthes *et al.* 2016).

In practical terms a fiscal authority defined in this way would function similarly to the treasuries of ‘conventional’ nation states – providing public goods based on a budget funded by revenues decided at the euro area level (Guttenberg and Hemker 2018; Hinarejos 2014). Relative to the *status quo* and to the functionalist version, a fiscal authority defined in the federalist version would imply enhancement in three directions:

- Managing a genuine euro area/EU budget instead of separate funds ultimately funded by national resources
- Vertical division of competences between the EU and national governments, based on subsidiarity, to be defined in more detail below. Current EU competences regarding the single market should be extended to include defence, development aid, asylum policy, corporate taxation and unemployment insurance, but re-allocated to the national level in agriculture (De Vries and Hoffmann 2016)
- Drawing on alternative funding sources including debt and taxing powers instead of

the current system of reserves and national transfers. Candidates for European revenue sources would be proceeds from Emission Certificates, taxes on plastic wrapping, financial transactions or a share in corporate income (Guttenberg and Hemker 2018).

In essence, the European fiscal authority would turn into a political position managing the provision of public goods based on the above mentioned principles of economic and political efficiency. This would make the EU/ euro area a fully-fledged layer in a system of European federal governance (Hinarejos 2014).

## THE ISSUE OF GOVERNANCE IN THE CONTEXT OF A EURO AREA FINANCE MINISTRY

### Governance from a Static and Dynamic Perspective

It is agreed between legal and economic experts that introducing a euro area fiscal authority would demand profound constitutional adjustments legitimated by various national bodies, or even national referendums. At the same time, various past episodes imply that the chances of winning a national referendum with European scope

Table 1

#### Proposals of Euro Area Finance Ministry

	Functionalist version	Federalist version
Supervision	Supervising national budgets as core responsibility	Supervisory aspect of secondary significance
Institutional setting	Part of a network of fiscal policy coordination and adjustment: links to <ul style="list-style-type: none"> <li>• national fiscal authorities on debt strategy and instruments;</li> <li>• ESM on funding debt restructuring, liquidity provision; and</li> <li>• SSM on bank-sovereign-nexus</li> </ul>	Independent body within EU commission, superordinate authority to ESM/EMF re-stabilisation capacity
Monetary policy	Helping to break the bank-sovereign-nexus	Separation from monetary policy, superseding monetary policy in economic stabilisation
Fiscal policy	Coordinating national fiscal policies	Running EU fiscal policy
EU finances	No link to EU finance, national governments determine EU budget size; EU parliament and commission decide on its composition	Running EU budget according to EU (commission) policy decisions
Taxing powers	No taxing powers: taxing power rests exclusively with nation states	Taxing powers included (ultimate version)
Economic stabilisation	Limited fiscal capacity (< 1% GDP)	Significant fiscal capacity (> 1% GDP)
Link to stabilisation funds	Alternative options: separate from finance ministry (EMF) vs. run by finance ministry	Running fiscal capacity as (one) core responsibility of finance ministry
Funding sources (stabilisation)	Funded by reserves	Alternative funding sources
Funding sources (general)	Cross-national-transfers	EU taxes; debt; cross-national-transfers
Rationale for EU expenditure	Funding pooled government duties of nation states	Providing genuine public goods (where EU has economies of scale)
Legitimacy	Primarily by national governments; secondary: EU parliament, national parliaments	By EU parliament

Sources: Bénassy-Quéré *et al.* (2018); Guttenberg and Hemker (2018); Enderlein and Haas (2015); Macron (2017).



decline with the intensity of the changes.<sup>1</sup> Even acknowledging the significance of interfering in national issues like unemployment trends or the general popularity of the respective national government, winning popular endorsement for a 'big leap' finance ministry would appear a high risk option, even under favourable political conditions.

Hence even supporters of a federalist version of a finance ministry acknowledge that this version may only be an ultimate objective (Guttenberg and Hemker 2018). Accounting for this, the following article applies a two-staged approach: its initial focus will be on aspects of governance related to the functionalist version, in a second stage it aims to set (general) requirements for the transition to a federalist version.

Key challenges from a governance point of view are legitimising a euro area finance minister in order to make it work. Only accepted rules will be followed, and hence effective. Further to the introductory remarks, the following analysis of governance will be based on the rule of law and market dominance as guiding principles of open and democratic societies.<sup>2</sup> These principles will be explored in greater detail in the following paragraphs before being applied to the issue of a finance ministry.

### **Economic and Legal Dimension of Governance Interacting in Three Layers**

According to the European Commission, the finance minister aims to pursue the general interest of the euro area economy, also in relation to other economies. In economic terms, the finance minister in the euro area should be endowed with fiscal instruments to propel structural reforms and crisis management (Juncker 2017). Enabling a finance ministry to fulfil its primary assignment of rule-based policy coordination would require certain institutional conditions to be met regarding its design, its powers and its operation. This has even more general consequences for the legal system such as the delineation of public and private spheres in the economy.

The rule of law implies that the legal system – constitution, civil law, public law – governs economic and social behaviour in a consistent manner. This is done by setting boundaries for individuals, in business and in private, within which they are allowed to pursue their objectives and interact to their

mutual benefit. These boundaries must be general in nature, i.e. not pre-set or unduly benefit specific behaviour. Instead, they are meant to secure a sheltered area for individuals, protecting them against intrusion either from other private entities or from the government (Die Denker 2005).

The alternative would be hands-on government planning and intervention determining economic behaviour of individuals and companies as known – in its pure version – by regimes of central planning. But there are many forms of more subtle government intervention regulating certain forms of consumption and production, including setting price ceilings and price floors. Such regulations can be explicit based on legal acts, or implicit, emanating from business cultures, conventions and traditions. Examples of the latter are as diverse as minimum wages, corporate governance, environmental regulations, profit accounting, health and safety rules, building standards and rules governing property uses (Acemoglu and Robinson 2012).

Related to individual freedom and free markets is the aspect of competition, which can be regarded as the prerequisite for the existence of free markets, as well as its outcome. This regards prevalence of market prices in allocating resources and private property, contractual freedom and accountability governing economic behaviour. These principles have been applied in the single market, at least in theory.

### **Rule of Law and Pooling Sovereignty in Europe**

Applying the rule of law to a trans-national context might be less trivial than it would be within national boundaries where there is a reliance on legal traditions and accepted habits, as the latter have evolved in certain national contexts. In the realm of a European fiscal authority – even with respect to a functional definition – legal differences would have a direct bearing on economics as seen in tax collection and the ensuing tax paying morale of different national populations. Other such issues include the different legal positions of recipients of income transfers. It is also worth mentioning the efficiency gaps between states in the provision of public goods such as infrastructures (Matthes *et al.* 2016).

Compared to these issues, the direct economic impact of fiscal integration seems rather manageable. Here the debate relates to the fact that income levels between populations differ significantly, hence funds transferred from richer nations to poorer ones would not be allocated according to the preferences of the providing populations (Läufer and Wambach 2015). This issue may, to some extent, be mitigated in a system of fiscal federalism. At face value the economic line of argument has to be put into the context of income differences within national jurisdictions, e.g. in Germany between east and west, which might exceed

<sup>1</sup> Examples are the initial rejection of the Maastricht treaty in Denmark and the narrow margin of success in France in 1992 and the rejection of the EU constitution in France and in the Netherlands in 2005.

<sup>2</sup> In theory, there might be convergence between systems of more government discretion and systems of strict respect of rule of law. But this would assume that populations are as willing to accept restrictions on their existing liberties as they are willing to accept enhancement of their liberties, which is difficult to reconcile with comparative findings on the working of institutions (Acemoglu and Robinson 2012).

income differences between different national averages.

**GOVERNANCE REQUIREMENTS FOR A EURO AREA FINANCE MINISTRY**

**Status Quo: National Sovereignty with Traits of Debt Mutualisation**

Initially EMU governance had been based on three principles (1) a clear separation between a single monetary policy and national fiscal policies with (2) rule based coordination and (3) exclusion of debt mutualisation. The latter principle was violated by the EFSF arrangement in 2010, reinforced by the enhancements of the ESM in 2012.

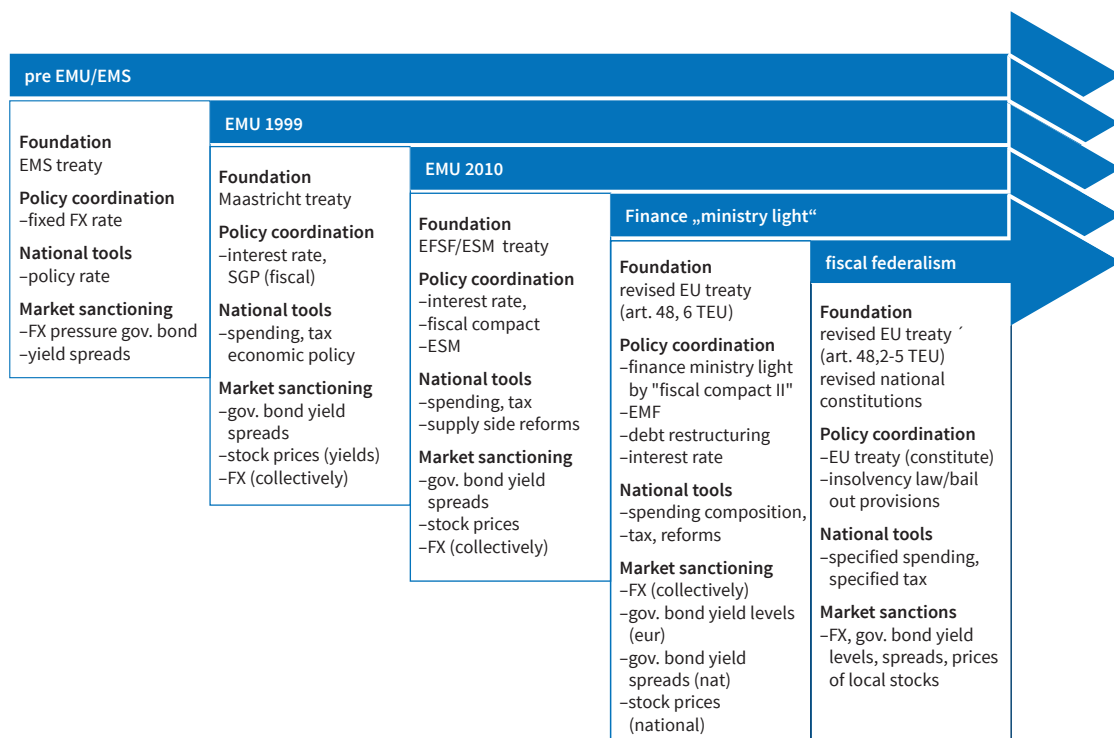
The system of rule-based governance was partially salvaged by two provisions for ESM activity: (1) the requirement of mutual agreement for the majority of ESM decisions; and (2) the strengthening of fiscal rules, its latest outcome being the fiscal compact. Whereas these provisions have successfully confined the debt mutualisation feared by net contributors, experience with various euro area members cast doubt on their impact on fiscal discipline. An obvious example was Spain, where the structural deficit has widened since 2014 in the midst of the economic recovery, but trends in deficits in France and debt in Italy are also disconcerting. By failing to impose financial sanctions, as provided in the SGP and in the fiscal compact, the EU commission set a precedent, boding ill for the future efficacy of rules (cf. France).

**A Functionally Defined Finance Ministry and Governance: Balancing Risk Sharing and Market Discipline**

Recent research on governance in fiscal policy focuses on striking a balance between rules to warrant discipline and discretion to allow flexibility, helping reconcile the interests of creditor countries and of debtor countries (Clauss and Remhof 2016). To this effect transnational research advocates bolstering the current regime of fiscal coordination in two ways: (1) instead of the current euro group setting, where coordination occurs in a consensual way, a euro area finance ministry, chairing the euro group would strengthen the hierarchical element of coordination; and (2) by combining this position with affiliation to the EU commission it would upgrade the EU commissions' role towards national governments.

These two features of governance, hierarchical organisation and EU involvement, are to be accompanied by further institutional and procedural changes: (1) an upgraded ESM with enhanced autonomy on providing temporary liquidity and funding economic reforms with respect to regaining solvency; and (2) accepting of market forces by governments of debtor countries in imposing bail in clauses (CAC) on private investors (Matthes 2017; Bénassy-Quéré *et al.* 2018; Läufer and Wambach 2015). A more far-reaching demand on debt restructuring in the event of government insolvency failed to gain the support of the necessary majority, as did the

Figure 1  
Stages of European Monetary and Fiscal Integration



Source: Proprietary representation based on ECB, EU Commission.

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demand of an exit clause for trespassers (Matthes 2017).

These arrangements can be assessed by their compliance with key principles of governance:

- Enhancing national *fiscal transparency and credibility*: simplifying fiscal rules as demanded in the economists' paper would help reduce a euro area finance ministry's political discretion. In this context the shift from a deficit rule to a rule for spending growth (less than long run nominal GDP growth) might be seen as a quantum leap towards transparency. The credibility of this rule could be amplified by shifting any sanctioning to the markets: excess spending would have to be funded by junior bonds rather than directly by public money from the ESM/EMF (Bénassy-Quéré *et al.* 2018). In this context the finance ministry's verdict would have direct implications for market pricing.
- *Institutional consistency at the euro area level*, disentangling overlapping responsibilities: allocating the functions of budget surveillance and of rule enforcement (currently held by the chair of the euro group) to separate bodies. The euro area finance ministry would decide on the application of fiscal rules, assisted by a plea of the commissioner of economic and financial affairs. This would make the excessive budget procedure more transparent, and hence more credible to investors and potential trespassers. It would in particular make the (remaining) political content of a finance ministry more visible, and hence increase pressure on the ministry to justify its decisions.
- Securing *consistency between fiscal policy, monetary policy and banking*. It is not the bank-sovereign-nexus as such, depicted in the second section, but the fact that the banking sector is torn by its roles of (national) fiscal agent and in (European) monetary policy transmission. This systemic inconsistency was brought to light with the inception of a single supervisory mechanism (SSM). The 'cleaning up' of banks' balance sheets would be necessary, but not sufficient to make them more resilient to national fiscal shocks (ECB 2017). In this context, a finance ministry, by helping banks to diversify their bond holdings through ESBies at various stages of the issuance process, would also help to reconcile the different prerogatives of fiscal and monetary policy.

### **Fiscal Federalism in Europe – A Silver Bullet in Terms of Governance?**

From a governance viewpoint, a European finance ministry in a regime of fiscal federalism seems preferable to the two options mentioned above, as it would comply with the key principle of governance, aligning accountability and responsibility in a transparent, credible and consistent way.

Although from an economic point of view such a regime-shift would have clear merits including economies of scale and enhanced internal and external political clout, it would require consensus on a vertical division of power. Currently such a consensus seems remote, as the public debate on sharing political powers is at best at a nascent stage, as is the public's perception of EU citizenship (Guttenberg and Hemker 2018).

Communicating the potential benefits of fiscal federalism would demand a three-pronged approach:

1. Using the powers of a functionally defined finance ministry to streamline national fiscal policies and to enhance the visibility and acceptance of these efforts; but other than depicted above the functionally-defined finance ministry will serve as a springboard to fiscal federalism
2. Defining the ultimate scope of fiscal federalism in a European context
3. Forging consensus between decision makers and populations of the member states concerned (Priewe 2017; Guttenberg and Hemker 2018; Enderlein and Haas 2015).

### **(a) Making the European Signature Visible in Fiscal Policy**

Whereas fiscal policy to date has been pursued as a national affair, rather than a matter of common European interest; this may change in a functionally defined finance ministry as defined in the previous chapter. It will be the principles of exclusivity, accountability and hierarchical cooperation that will vastly increase the visibility of fiscal policy at the euro area level (Guttenberg and Hemker 2018):

- Exclusivity in pursuing the role of euro group chair means that the incumbent will be perceived in his or her European role of budget surveillance, rather than in a national role.
- Accountability means that defending their decisions to European and national legislators, they have a chance to represent European principles of fiscal policy in public.
- Hierarchical setting strengthens their authority as perceived in a general public.

Any fiscal stabilisation instruments, whether managed by a finance ministry or alternative bodies like the ESM, will add to the visibility of European fiscal policy.

Finally the proponents of this setting emphasise the potential of this role of further enhancement in the context of fiscal federalism. While acknowledging the confinement of this role to 'macroeconomic, financial and fiscal stability' they state the potential for enhancement. "A proper budget could only grow out of political decisions to finance defined common public goods" (Bénassy-Quéré *et al.* 2018, 2).

### **(b) Defining the Scope for European Fiscal Federalism**

Making the European dimension visible to a general public would be a first step towards European fiscal federalism. The next step would be to decide on the substance of this regime, its guiding principles and in the implications of allocating government functions between various levels, i.e. the European, national and local levels (Erlei *et al.* 2008). General functions of fiscal policy can be classified into allocation (i.e. providing public goods), stabilisation (i.e. countering major economic shocks), and distribution (i.e. containing income disparities) – see Zimmermann and Henke (2009).

Fiscal federalism can be defined by the principle of subsidiarity giving priority to lower levels of government, i.e. local and national levels, whereas only those functions will be fulfilled that offer euro area specific efficiency gains at the higher (European) level. In economic terms, efficiency would be defined and measured by the following criteria: spill-over effects, economies of scale, preference heterogeneity, internal market consistency and competition (Berger *et al.* 2017). In political terms the criterion ‘political clout’ might be added (Guttenberg and Hemker 2018).

Key candidates for areas to fall under European competence would be defence, asylum and refugee policy, competition and corporate taxation, unemployment insurance and development aid. Another function often quoted would be environmental protection. Candidates for areas to fall under national competence would be agricultural policy, secondary and tertiary education. Against these findings the current policy setting only seems right in education, whereas a swap in national and European competences would be implied in defence, corporate taxation and agriculture. There may also be policies of shared competences like infrastructure and transport (Berger *et al.* 2017).

An equally pressing concern for a single fiscal policy will be to what extent competition between national governments, as well as between companies, will be accepted or even welcome. Candidates are Swiss-style competitive federalism or German-style cooperative federalism. In terms of private competition, a key focus of fiscal policy is state aid, in particular for the finance sector in the context of bailing out or bailing in. The current debate on enforcing the principle of bailing in reflects also a clash of political cultures with respect to the primacy of markets.

### **(c) Governance under Fiscal Federalism: Stimulating Transnational Political Debate**

Both introducing fiscal federalism and running such a regime in the euro area (or the EU) requires a shift

of focus in the public debate from mere national considerations to a combined national-euro-area-wide focus (Macron 2017). In practical terms this concerns fiscal policy, i.e. the level and composition of revenue and expenditure, as well as the frequency of adjustments (Priewe 2017).

Such a shift in focus is hindered by the language barrier both between the consumers and the providers of political information within Europe. Genuinely European media – whether print, broadcast or electronic – are scarce and a transnational media landscape is virtually non-existent.<sup>3</sup> Although this will be a formidable obstacle in introducing any EU institution such as a finance ministry, it does not seem unsurmountable. It is true that European politicians like Draghi and Juncker trail a long way behind national politicians in terms of their prominence (De Vries and Hoffmann 2016), but they are perceived by their EU functions.

The same applies to political issues. Although even in policy areas under European competence debates are currently primarily conducted at a national level, reflecting national views and interests rather than a European scope, the European angle has become visible. In areas of primary European competence like monetary policy, competition and – recently – asylum policy the European dimension has now reached the general public, even although the debate has mainly been led nationally.

Hence European issues are more likely to be generated by politics, i.e. through re-assigning responsibilities rather than picked up by media. A first significant milestone in fostering public debate in Europe might be cross-referencing the national and European levels of politics. A thoroughly prepared introduction of a finance ministry may stimulate public debate between the providers and beneficiaries of public goods. This would make a euro area finance ministry both an end to enhanced efficiency and a means to broaden the scope of European fiscal policy. Macron’s European conventions conducted in France might be a start for a European debate, which is ultimately necessary to legitimize a regime of fiscal federalism in Europe.

Enhancing the prominence of European themes and personalities, or getting Europe into the headlines of national media should be a next step, while creating a European media landscape may lie further down the road. But given the rapid rise of new media and the proliferation of English as European language, the goal of reaching a transnational audience no longer seems unattainable.<sup>4</sup> Exponential growth in the number of followers of the EU commission in social media bears witness to the Europeanisation of the political debate.

<sup>3</sup> The daily Politico, the French-German TV channel ARTE and the online paper Huffington Post being noteworthy exceptions.

<sup>4</sup> According to numbers published by Instagram.

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Chang Woon Nam\* and Peter Steinhoff\*\*

## The ‘Make in India’ Initiative

‘Make in India’ launched by Prime Minister Narendra Modi in 2014 is a government initiative aimed primarily at stimulating industrial firms to produce in India, since the overall contribution of the country’s manufacturing sector to economic growth has been rather weak and its export share has also continued to gradually shrink (Panagariya 2013; Singh and Ranjan 2015). By implementing numerous reforms in a broad range of government policy fields (like simplification of the tax system, price deregulation and reduction

of foreign firms’ ownership – see Box 1), the Modi administration attempts to attract FDIs from abroad, as well as to enhance the country’s global competitiveness *via* fostering innovation, developing labour skills, providing modern infrastructure, etc.<sup>1</sup>

More precisely, the ‘Make in India’ initiative, which sees the urgent manufacturing revival as the most important prerequisite for guaranteeing the country’s long-term economic development (Singh and Ranjan 2015), is based on the following policy logic. In addition to safeguarding basic production inputs (e.g. power, minerals and water) at competitive prices, the availability of modern transport, logistic and communication infrastructure is required to promote the growth of industry and firms’ accessibility to domestic and international markets. To improve productivity and firms’ R&D activities, well-educated skilled human capital that fully satisfies labour market demands is also required (Singh 2014). Entrepreneurship and the ease of doing business

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<sup>1</sup> See <http://www.makeinindia.com/about>.

### Box 1: The Modi Government’s Reform Programme

The major individual reform measures include, for example:

- Create a unified national tax on goods and services
- End retrospective taxation of cross-border investments
- Deregulate diesel pricing
- Deregulate natural gas pricing
- Deregulate kerosene pricing
- Remove government-mandated minimum prices for agricultural goods
- Use direct benefit transfer to deliver cash subsidies
- Deregulate fertilizer pricing
- Allow more than 50% foreign investment in insurance
- Allow more than 50% foreign investment in defence production firms
- Allow more than 50% foreign investment in railways
- Allow foreign lawyers to practice in India
- Allow foreign investment in more construction projects
- Reduce restrictions on foreign investment in multi-brand retail
- Reduce restrictions on foreign investment in single-brand retail
- Allow more than 50% foreign investment in direct retail e-commerce
- Fully open the coal mining sector to private/foreign investment
- Relax government controls over corporate downsizing
- Stop forcing banks to lend to ‘priority sectors’ including agriculture, small businesses, education and housing
- Extend the expiration date of industrial licenses
- Make it quicker and easier for companies to go through bankruptcy
- Offer one-stop shopping for clearances for new businesses
- Institute a mandatory 30-day ‘notice & comment’ period for proposed regulation
- Allow cities to issue municipal bonds to raise funds
- Raise the ceiling on foreign institutional investment in Indian companies
- Conduct transparent auctions of telecom spectrum

Source: Center for Strategic and International Studies (<http://indiareforms.csis.org/>).



should not only be supported by easier access to venture capital, but should also be strengthened by de-licencing and deregulating the industry during the entire life cycle of a business.<sup>2</sup>

Within this ambitious policy framework the Indian government would like to improve not only the production efficiency of different industries ranging from agricultural commodities to mining and manufacturing goods, but also that of various services (Rajan 2015). To this end, a total of twenty-five economic sectors are identified, which include: (1) automobiles; (2) automobile components; (3) aviation; (4) biotechnology; (5) chemicals; (6) construction; (7) defence manufacturing; (8) electrical machinery; (9) electronic systems; (10) food processing; (11) information technology and business process management; (12) leather; (13) media and entertainment; (14) mining; (15) oil and gas; (16) pharmaceuticals; (17) ports and shipping; (18) railways; (19) renewable energy; (20) roads and highways; (21) space and astronomy; (22) textiles and garments; (23) thermal power; (24) tourism and hospitality; and (25) wellness (see also Nam *et al.* 2017).

Repeatedly the 'Make in India' initiative encompasses heterogeneous promotion measures that are applied not only to traditional, labour and capital-intensive industries, but also to high-tech manufacturing firms and modern services. In addition, this endeavour aims to create favourable business conditions, stimulate direct investment from abroad, firms' innovation and R&D activities, the development of IT and its application, as well as the provision of different transport, logistic and research infrastructure *all at the same time*. Apart from enhancing productivity, which is generally described as the primary engine of economic growth, Modi's policy also appears to exploit other types of positive growth contributions, which are generated by the accumulation and deployment of capital, as well as the more effective use of abundant labour in the country (Jorgenson and Vu 2006).

Against this background, the following crucial questions need to be answered:

- (1) Can India accomplish all these goals at the same time?
- (2) Is there any trade-off or conflict among these different goals?
- (3) Will this Modi reform eventually lead to so-called 'productivity-enhancing structural change' for Indian economy?

At first glance, and particularly from a Western point of view, the 'Make in India' initiative seems to have a rather general character and to be also driven by

redistributive considerations, instead of defining the 'specific' growth promotion priorities more clearly and implementing the better targeted reform policy schemes under adequate consideration of India's economic structure and its competitive strengths in the global market (see also Nam *et al.* 2017).

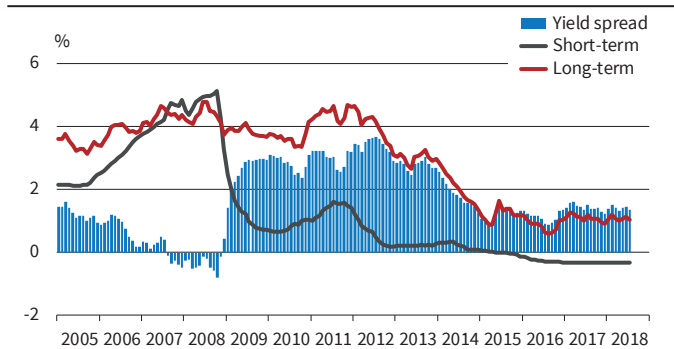
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<sup>2</sup> See [http://www.pmindia.gov.in/en/major\\_initiatives/make-in-india/](http://www.pmindia.gov.in/en/major_initiatives/make-in-india/).

# Financial Conditions in the Euro Area

Nominal Interest Rates<sup>a</sup>

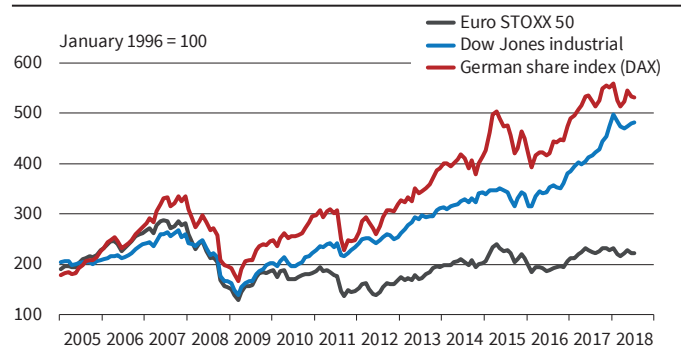


<sup>a</sup> Weighted average (GDP weights).  
Source: European Central Bank.

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In the three-month period from May 2018 to July 2018 short-term interest rates remained stable: the three-month EURIBOR rate amounted to -0.33% in May 2018 and -0.32% in July 2018. In comparison the ten-year bond yields declined from 1.08% in May 2018 to 1.04% in July 2018, whereas the yield spread also decreased from 1.41% to 1.36% in the same period of time.

Stock Market Indices

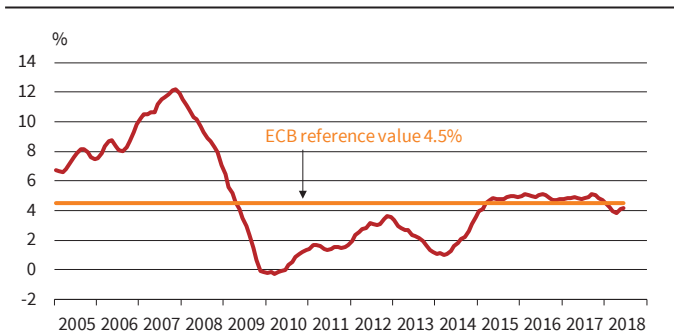


Source: Deutsche Börse; Dow Jones; STOXX.

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The German stock index DAX decreased in July 2018, averaging 12,582 points compared to 12,668 points in June 2018. Yet the Euro STOXX increased from 3,442 to 3,461 in the same period of time. The Dow Jones International also increased, averaging 24,942 points in July 2018, compared to 24,790 points in June 2018.

Change in M3<sup>a</sup>

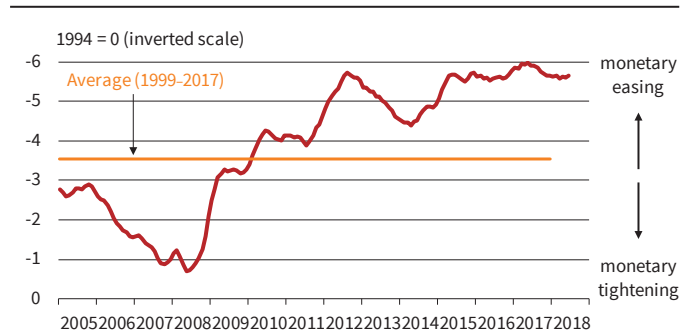


<sup>a</sup> Annual percentage change (3-month moving average).  
Source: European Central Bank.

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The annual growth rate of M3 decreased to 4.0% in July 2018, from 4.5% in June 2018. The three-month average of the annual growth rate of M3 over the period from May 2018 to July 2018 reached 4.2%.

Monetary Conditions Index



Note: MCI index is calculated as a (smoothed) weighted average of real short-term interest rates (nominal rate minus core inflation rate HCPI) and the real effective exchange rate of the euro.  
Source: European Central Bank; calculations by the ifo Institute.

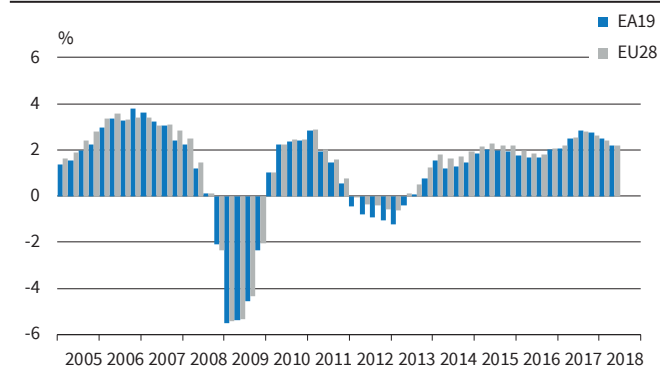
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Between April 2010 and July 2011 the monetary conditions index remained rather stable. This index then continued its fast upward trend since August 2011 and reached its first peak in July 2012, signalling greater monetary easing. In particular, this was the result of decreasing real short-term interest rates. In May 2017 the index reached the highest level in the investigated period since 2004, but its downward trend thereafter stopped in April 2018.

# EU Survey Results

## Gross Domestic Product in Constant 2010 Prices

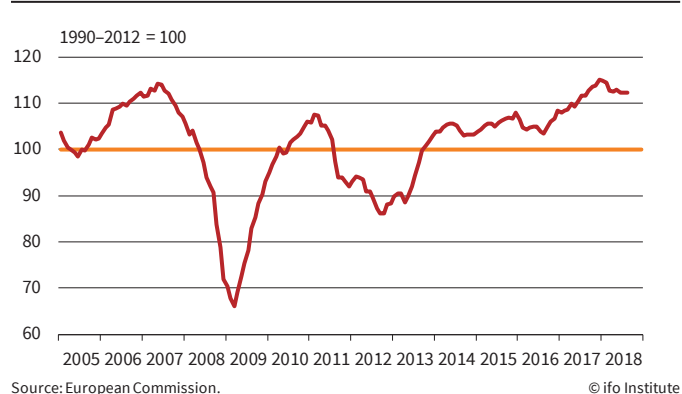
Percentage change over previous year



According to the Eurostat estimates, GDP grew by 0.4% in both the euro area (EA19) and the EU28 during the second quarter of 2018, compared to the previous quarter. In the first quarter of 2018 the GDP had also grown by 0.4% both in the euro area and in the EU28. Compared to the second quarter of 2017, i.e. year over year, seasonally adjusted GDP rose by 2.2% in both the EA19 and the EU28 in the second quarter of 2018.

## EU28 Economic Sentiment Indicator

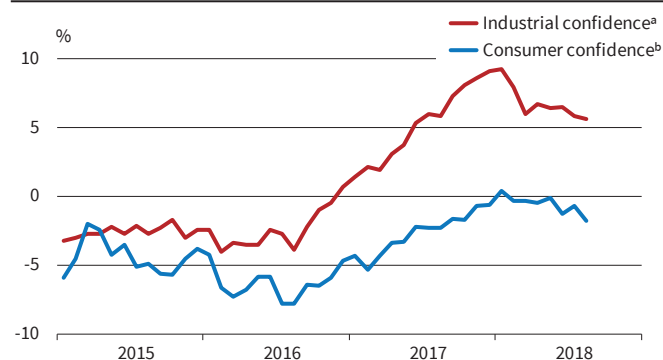
Seasonally adjusted



In August 2018 the Economic Sentiment Indicator (ESI) decreased in the euro area (by 0.5 points to 111.6), while it remained stable in the EU28 (at 112.3). In both zones the ESI stands above its long-term average.

## EU28 Industrial and Consumer Confidence Indicators

Percentage balance, seasonally adjusted

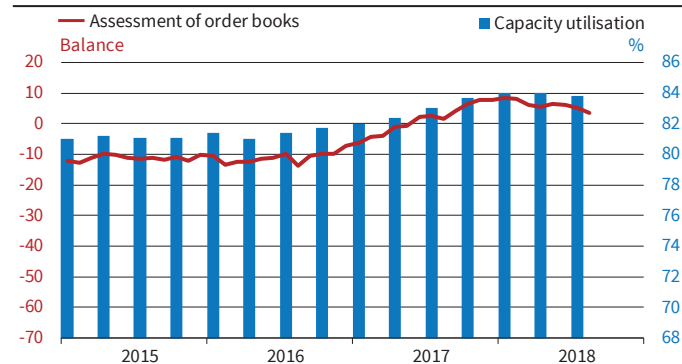


In August 2018, the *industrial confidence indicator* decreased by 0.2 in the EU28 and by 0.3 in the euro area (EA19). The *consumer confidence indicator* also decreased by 1.1 in the EU28 and by 1.4 in the EA19.

<sup>a</sup> The industrial confidence indicator is an average of responses (balances) to the questions on production expectations, order-books and stocks (the latter with inverted sign).

<sup>b</sup> New consumer confidence indicators, calculated as an arithmetic average of the following questions: financial and general economic situation (over the next 12 months), unemployment expectations (over the next 12 months) and savings (over the next 12 months). Seasonally adjusted data.

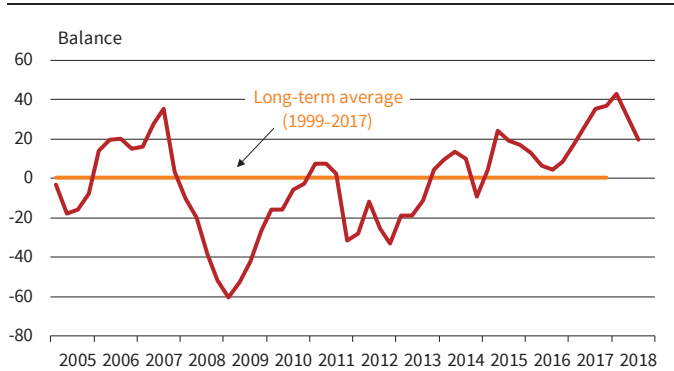
## EU28 Capacity Utilisation and Order Books in the Manufacturing Industry



Managers' assessment of *order books* reached 3.5 in August 2018, compared to 5.0 in July 2018. In May 2018 the indicator had amounted to 6.0. *Capacity utilisation* reached 83.8 in the third quarter of 2018, remained rather stable compared to the second quarter of 2018.

# Euro Area Indicators

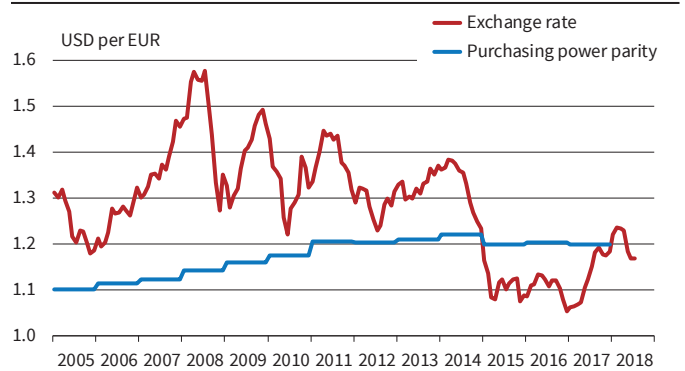
## ifo Economic Climate for the Euro Area



Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

The ifo Economic Climate for the euro area (EA19) fell from 31.1 balance points last quarter to 19.6 balance points in the third quarter of 2018. Although experts' assessments of the current economic situation only deteriorated slightly, their economic expectations clouded over significantly, dropping to their lowest level since the end of 2012. This signals an economic slowdown in the euro area.

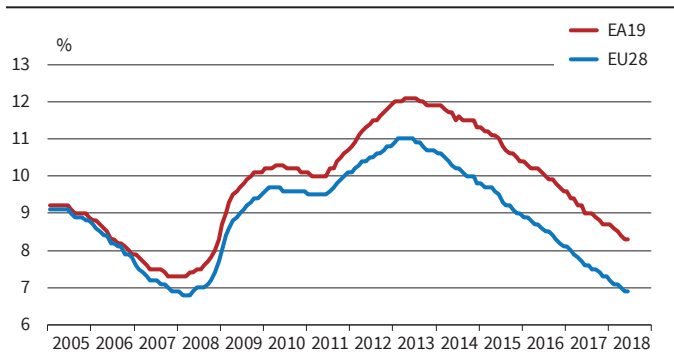
## Exchange Rate of the Euro and Purchasing Power Parity



Source: European Central Bank; OECD; calculations by the ifo Institute. © ifo Institute

The exchange rate of the euro against the US dollar averaged approximately 1.17 \$/€ between May 2018 and July 2018. (In April 2018 the rate had amounted to around 1.23 \$/€.)

## Unemployment Rate

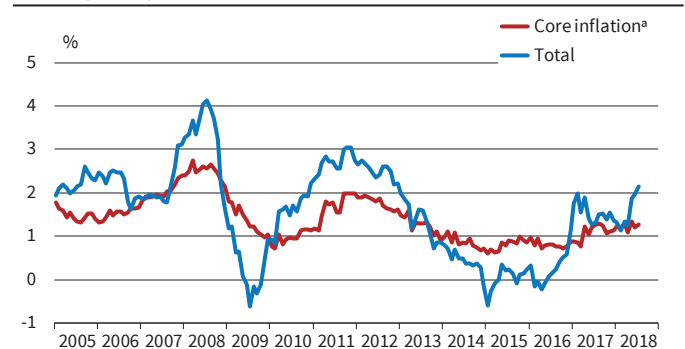


Source: Eurostat. © ifo Institute

Euro area (EA19) unemployment (seasonally adjusted) amounted to 8.3% in June 2018, stable compared to May 2018. EU28 unemployment rate was 6.9% in June 2018, also stable compared to May 2018. In June 2018 the lowest unemployment rate was recorded in the Czech Republic (2.4%) and Germany (3.4%), while the rate was highest in Greece (20.2%) and Spain (15.2%).

## Inflation Rate (HICP)

Percentage change over previous year



<sup>a</sup> Total excl. energy and unprocessed food. Source: Eurostat. © ifo Institute

Euro area annual inflation (HICP) was 2.1% in July 2018, down from 2.0% in June 2018. Year-on-year EA19 core inflation (excluding energy and unprocessed foods) amounted to 1.3% in July 2018, again down from 1.2% in June 2018.