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Can 1 European Country End Poverty Forever?

There's only one way to find out -- and Finland is going to try it.

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Social engineers, on both the right and the left, have made [Social Security too] complex ... Whatever really underlies the 2,728 rules in Social Security's handbook and the tens of thousands of rules ... that "clarify" the 2,728 rules, our Social Security system as currently designed is a travesty.

-- Boston University Economics Professor Larry Kotlikoff

And Social Security is just the beginning of the problem.

From SSA to SSI, SNAP, TANF, WIC, Section 8, and more, America's economic "safety net" comprises a hodgepodge of dozens of federal and state programs, costing us tens of billions of dollars a year to administer, and about \$1 trillion for the benefits they provide. And we're the lucky ones.

With its cradle-to-grave social security system, Europe is the poster child for the modern welfare state. America is just the JV team in this game. In Europe, they play pro ball, with high welfare costs necessitating marginal tax rates of 50% -- and up.

One country is trying to change that.

Haloo, Finland!

Over in Finland (top marginal tax rate: 49.2%), frustration with the cost and bureaucracy of the modern welfare state has hit a peak. But in an attempt to "simplify the social security system," Finland has hit upon a plan to guarantee a basic income sufficient to provide all citizens a subsistence level of living -- at reasonable cost, and with minimal oversight.

They call it the universal basic income, or UBI. Here's how it works.

How UBI works

Globally, UBI goes by many names, including the "basic income guarantee" and "negative income tax." But the essence of the idea is the same: UBI collects a portion of a country's wealth (through taxes), then shares that out equally (as UBI), paying each citizen the minimum level of income sufficient to keep body and soul together.

And UBI aims to do this efficiently, without micromanagement by the nanny-state. Instead of giving the unemployed one benefit ("please provide proof of an ongoing job search"), the retired another ("based on the mean level of your last three pay stubs, divided by π "), and parents of dependent children a third, every UBI recipient receives a lump sum payment to use as he or she sees fit.

Spend it on rent, on food, on private kindergarten -- or live in a box, childless and dining on caviar. It's up to you, and everyone, rich or poor, starts out at the same level.

UBI in Finland

To get the ball rolling, Finland has asked its Kela Social Insurance Institution to develop a pilot project to distribute 20 billion euros over two years (that's about \$22 billion total) in UBI. These payments will be in lieu of ordinary unemployment, pension, child care, and other benefits. ("Free" universal education and healthcare would remain outside of this system.)

Kela will consider several options for implementing UBI, including the unconditional payment to adult citizens of 800 euro (about \$880) per month, every month, for 24 months. With \$22 billion to work with, this would allow for paying up to 1 million Finns \$880 per month for the duration of the project.

Ultimately, Finland may tweak the number of recipients or the size of the payment, substitute UBI for only some, but not all, welfare programs -- or a combination of the above. The precise details should be worked out by November 15, 2016. Finland will then institute UBI at the beginning of 2017 and run it through the end of 2018 -- then assess the results.

(We say "will" because, in contrast to countries such as Switzerland, which holds a referendum on UBI next year, large majorities of all Finnish political parties support the UBI experiment -- from the liberal "Left League" all the way down to the "Conservatives.")

UBI in America?

All of this sounds interesting in an abstract, "Wouldn't it be nice if we lived there?" sense. But believe it or not, the *United States* has tried out UBI, too, albeit on a smaller scale than what Finland proposes. We've tried it several times, in fact, and with encouraging results.

In the 1970s, municipalities in Colorado, Indiana, Iowa, New Jersey, North Carolina, Pennsylvania, and Washington state all set up pilot projects to test out UBI. Alaska even established a Permanent Fund for sharing the state's oil wealth (through annual payments) in 1980, which remains in effect today.

Critics of UBI predicted (and still do predict) that UBI recipients would take the money and sit on their...hands...and just feed from the public trough. That worry echoes the "makers versus takers" arguments of the 2012 presidential election. And yet, experience suggests these worries are exaggerated.

Past UBI experiments in the U.S. show that the vast majority of UBI recipients use UBI as a safety net, but continue working. While UBI recipients worked 9% fewer hours with UBI than they had without it, the greatest reduction in hours worked was seen among mothers with children, who worked 7% to 21% less with UBI than without it. Financial support from UBI allowed them to stay home and raise their children.

As for men, on average, they worked only 6% less with UBI than without it. Men who "dropped out" of the workforce primarily used UBI to pay for education to reenter the workforce, or took more time to conduct a thorough job search before returning to work.

Crucially, "none of the researchers found evidence of people who simply stopped working so that they could live off" a UBI, period.

But is UBI affordable?

Still, one worry that could thwart UBI in Finland, or in the U.S., is cost. Can they -- can *we* -- afford it?

The answer appears to be yes. In the U.S., for example, UBI advocate Allan Sheahen notes that we're already paying for "100 welfare and social programs that would not be needed" under UBI. And according to research by the Heritage Foundation and Cato Institute, the cost of current programs -- approximately \$1 trillion annually -- is enough money to provide twice the poverty level of income to all recipients in need, if the money were more efficiently distributed. (\$1 trillion is also, according to Sheahen, approximately the aggregate cost of all tax "loopholes" in the U.S. tax code.)

As for getting the money to set up UBI, Sheahen suggests that closing such loopholes would be a good first start, and would pay for much of UBI's cost. As for the rest, a system roughly as follows might work.

Every adult in the U.S., resident for five years, receives a \$11,500 UBI. That's the floor income at which everyone starts off -- whether you're a homemaker raising a family, a gainfully employed big-city lawyer, or multibillionaire **Amazon.com** CEO Jeff Bezos. \$11,500 is, incidentally, also roughly equal to the UBI benefit Finland may establish.

UBI benefits are not taxed, but all other income is, such that:

- If you don't have a job, you must live on \$11,500 a year (which is doable, but hardly luxurious).
- If you earn the U.S. average income of \$50,000 a year, you end up with $(65\% \times \$50,000 = \$32,500) + \$11,500 = \$44,000$. (That's equivalent to a 12% effective income tax.)

- Bezos, who earned \$1.68 million from Amazon last year, keeps \$1,092,000 of that, plus his BIG payment of \$11,500 -- so \$1.1 million and change.

Final analysis

Could Finland's UBI idea work in America, too? I honestly don't know. But closing tax loopholes is a pretty popular idea. So is levying a fair tax on the capital gains of hedge fund honchos and private equity billionaires. And of course, we're all in favor of charity here at The Motley Fool.

If we can achieve these three goals, without too big of a tax hit to the middle class (see above -- 12%!), it's just possible that setting up a UBI system is an idea worth looking at here as well as there.

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