

# Lecture 12: Reforming the Welfare State

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# Introduction

- **Demographic and economic conditions have changed since 1945**
  - Increase in longevity, increase in old-age dependency rate
  - Changes in family formation
  - Change in the labour market
  - Change in the importance of skills and education
  - Slowdown in growth and productivity
- **Many view the welfare state design from the 1940s as dated**
  - A too conditional WS : universal basic income
  - A too costly WS : cuts to benefits and privatization
  - A too passive WS : activation policies
  - A WS with disincentive effects : individual accounts

# Outline of the lecture

## I. **Universal basic income**

- ① The principles and economics
- ② The empirical evidence
- ③ Participation income

## II. **Social investment strategy**

- ① Child-centered welfare state
- ② Activation policies

# I. Universal basic income

- **An old idea**

- Thomas Paine's Citizen dividend (1776)
- Henry Georges (the value of land should belong equally to all)
- Juliet Rhys-Williams (UK, 1940s) : campaign for basic income

- **More recent reformulation**

- Milton Friedman, *Capitalism and Freedom* (1962)
- James Tobin, "A case for an income guarantee" *The Public Interest* (1966)
- Philippe Van Parijs, Belgian political philosopher, proponent of UBI (Van Parijs, 1992; Van Parijs and Vanderborght, 2017). Founder of the Basic Income European Network (BIEN), see <https://basicincome.org/>

# Universal basic income (UBI)

- **Experimentations of UBI**

- Finland RCT experiment 2017-18
- Ontario Basic Income Pilot (OBIP) in Canada (2018-19)
- Stockton Economic Empowerment Demonstration (SEED), in California  
*<https://www.stocktondemonstration.org/>*

- **Interest by policymakers**

- George McGovern proposed a basic income in the 1972 US election campaign
- Hillary Clinton considered a UBI as part of her 2016 presidential campaign proposals
- Andrew Yang campaigned for UBI in the 2020 Democratic primary in the U.S.
- Benoît Hamon included UBI in its proposal (2017 French presidential election)
- Switzerland had a referendum about introducing a UBI in 2016 (see <https://basicincome-initiative.ch/>)

# What is Universal basic income (UBI) ?

## ① Universal

- All the population of a country is eligible
  - All citizens (including nationals living abroad) ?
  - All residents (including foreigners) ?

## ② Unconditional

- No income means-test
- No conditionality (searching employment, training, caring)

## ③ Cash benefit

- No in-kind benefits, no vouchers

## ④ Individual

- Granted based on individual (not household)

## ⑤ Paid regularly

- Monthly or weekly paiement

# How UBI is different from other proposals ?

- **Other proposals that are not UBI**
  - Basic Endowment : capital endowment at start of life
  - EITC : focuses on working poor (i.e., conditional on working)
  - Guaranteed Employment : a right to work with an income (rather than a right to an income without work)
  - Participation Income (PI) : conditioning on participating into socially useful activities
- **Is UBI similar to Negative income tax ?**
  - NIT could be very close in theory to UBI
  - Main difference is UBI is upfront payment, NIT is a net of tax payment

# The arguments presented for UBI

## ① Enhanced freedom

- “why surfers should be fed” (Van Parijs, 1991)
- “liberal justice consists (...) in maximizing the real freedom to pursue the realization of one’s conception of the good life”

## ② Robots are coming !

- Robots will replace all the jobs and owners of robots will own all wealth : UBI should redistribute income so that people have all the same basic income

## ③ Replace the patchwork of social benefits

- Complex web of benefits, with high marginal tax rates
- UBI can reduce marginal tax rates and provide higher incentives to work

## ④ Means-tested benefits lead to inadequate coverage

- UBI can reduce large non take-up rates, increased coverage of social benefits
- UBI would reduce stigma

# How to fund UBI ?

## ① Rents from natural resources

- Public ownership of natural resources (land, non-renewable resources)  
e.g., oil rent (Alaska, Iran, Kuwait)

## ② Money creation

- Modest or temporary funding through QE

## ③ By replacing totally or in part social spending

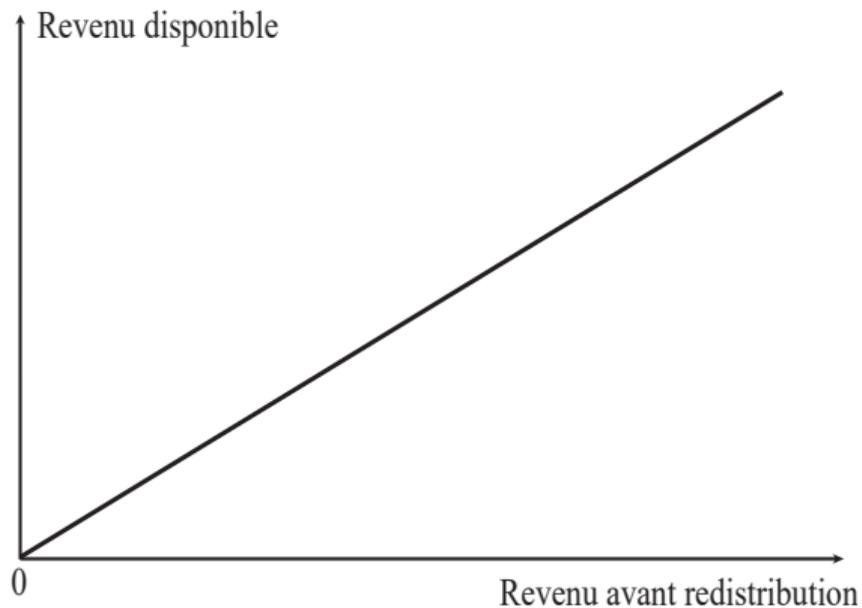
- Large redistribution effects depending on types of social spending replaced

## ④ By taxation (income, wealth, VAT)

- VAT increase to fund UBI
- Progressive income tax increases

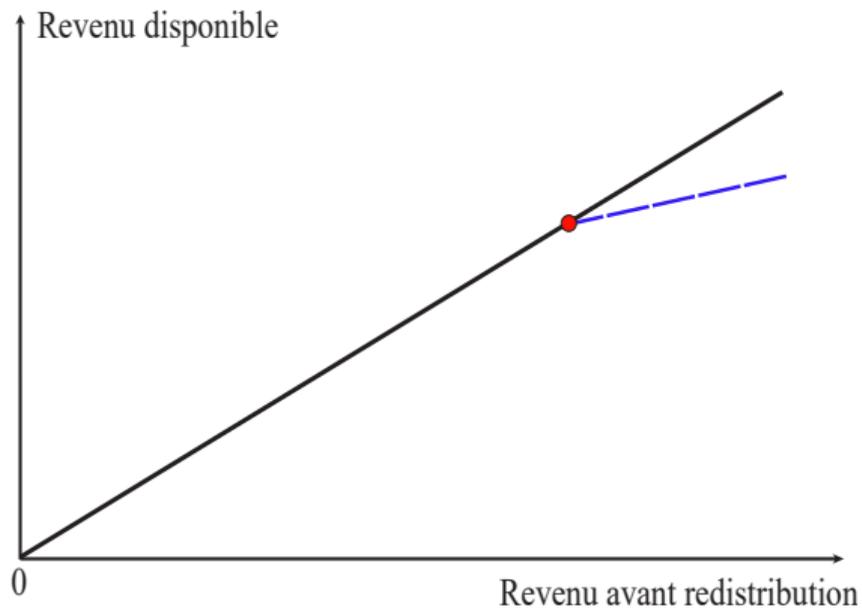
# How to model a funded UBI ?

Figure 1 – Income before UBI and taxation



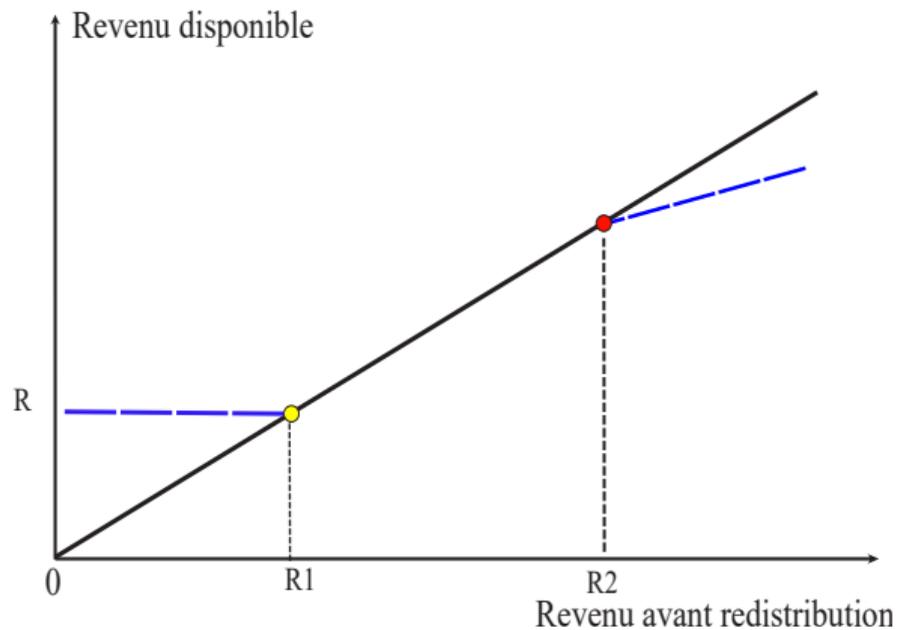
# How to model a funded UBI?

Figure 2 – Progressive income taxation



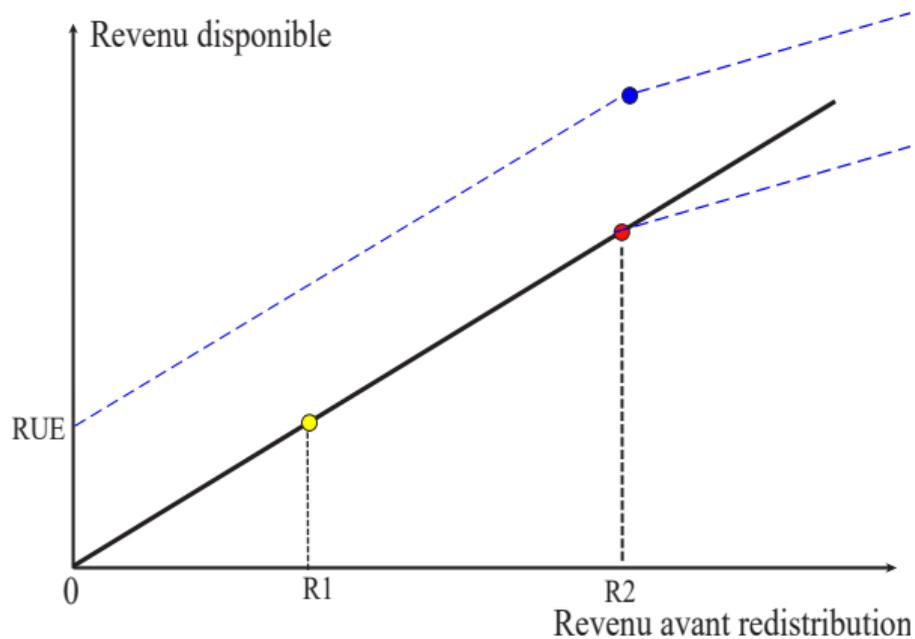
# How to model a funded UBI?

Figure 3 – Means-tested benefit



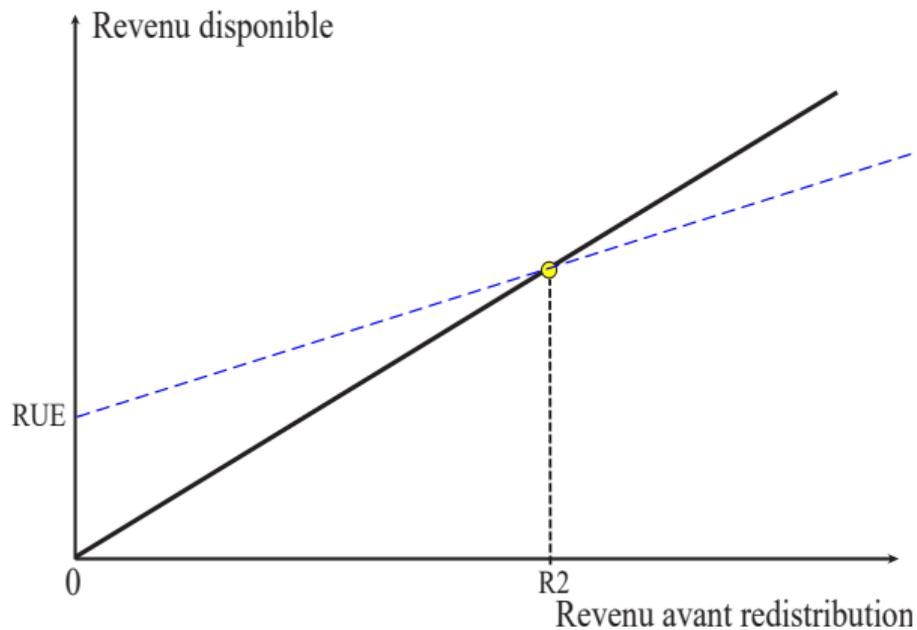
# How to model a funded UBI?

Figure 4 – An unfunded UBI



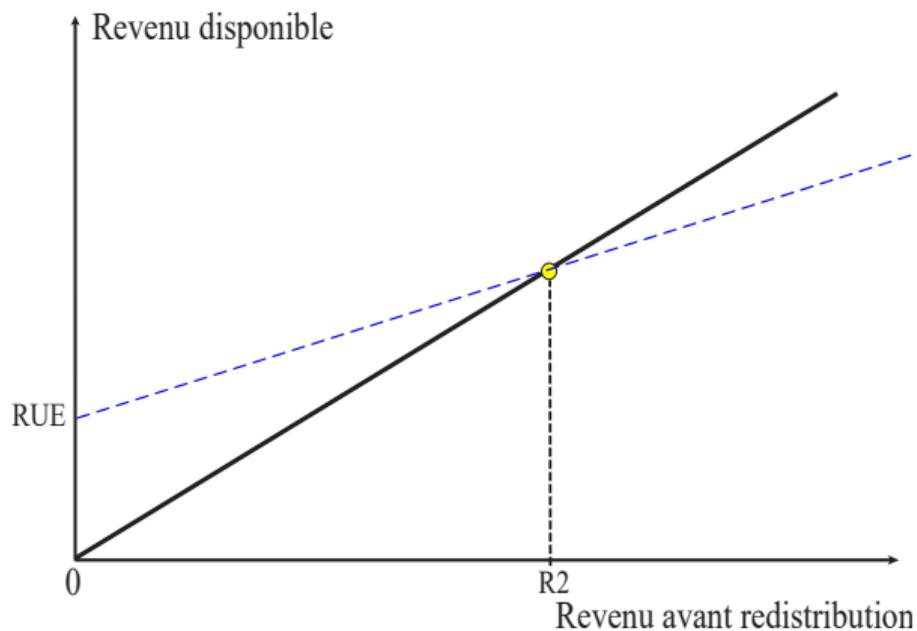
# How to model a funded UBI?

Figure 5 – UBI funded by flat-rate tax



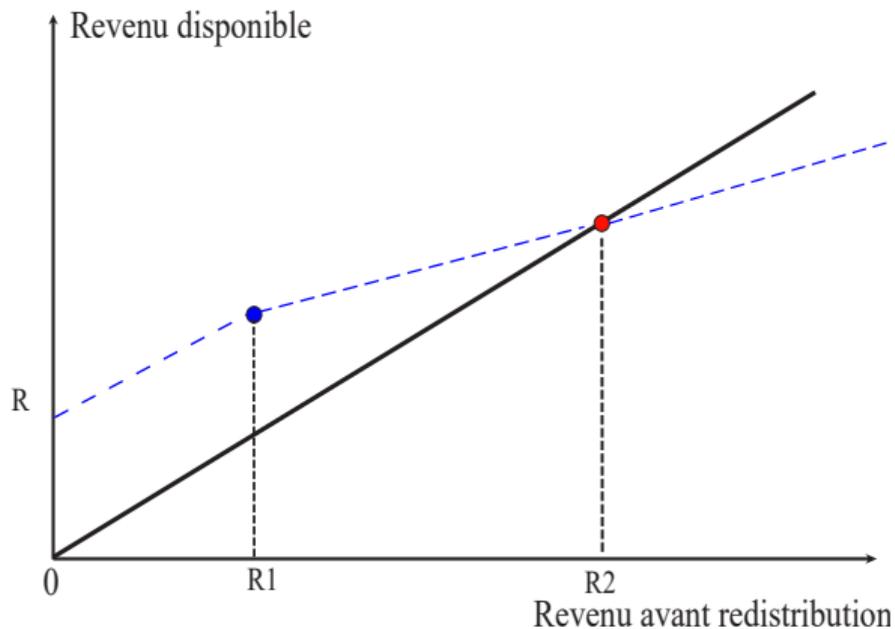
# How to model a funded UBI?

Figure 6 – A negative income tax (NIT)



# How to model a funded UBI?

Figure 7 – UBI funded by progressive income tax



# Simple arithmetic of UBI

- **Gross cost of UBI**

- James Tobin : UBI of  $x\%$  of average income, implies  $x\%$  tax rate  
e.g., in France, RSA 607 euros = 24% of av. disp. inc.  
gross UBI = 68 m.  $\times$  607  $\times$  12 = 495 bn euros (19% GDP)

- **How much can be saved by reducing social benefits ?**

- In France, total social spending is 21% of GDP (excluding health care but with pensions)
- Spending on poverty (35 bn), on housing (16 bn), ie. 2% GDP

- **Redistributive effects if UBI is funded by social spending**

- From low income to middle income
- From elderly to middle aged
- From households with kids to childless individuals
- From disabled to non-disabled

# Empirical evidence on UBI

- **Open questions**

- What are the labor supply effects of UBI?
- Key question is more the impact the funding of UBI (rather UBI itself)
- What are long term effects in terms of health, dignity, satisfaction, innovation?

- **Experimental research on UBI**

- Never really a test of UBI (and its funding)
- Nevertheless interesting to provide evidence

- **Two case studies**

- ① Alaska Permanent Fund
- ② Finland RCT

# Evidence from Alaska Permanent Fund

- **Alaska Permanent Fund**

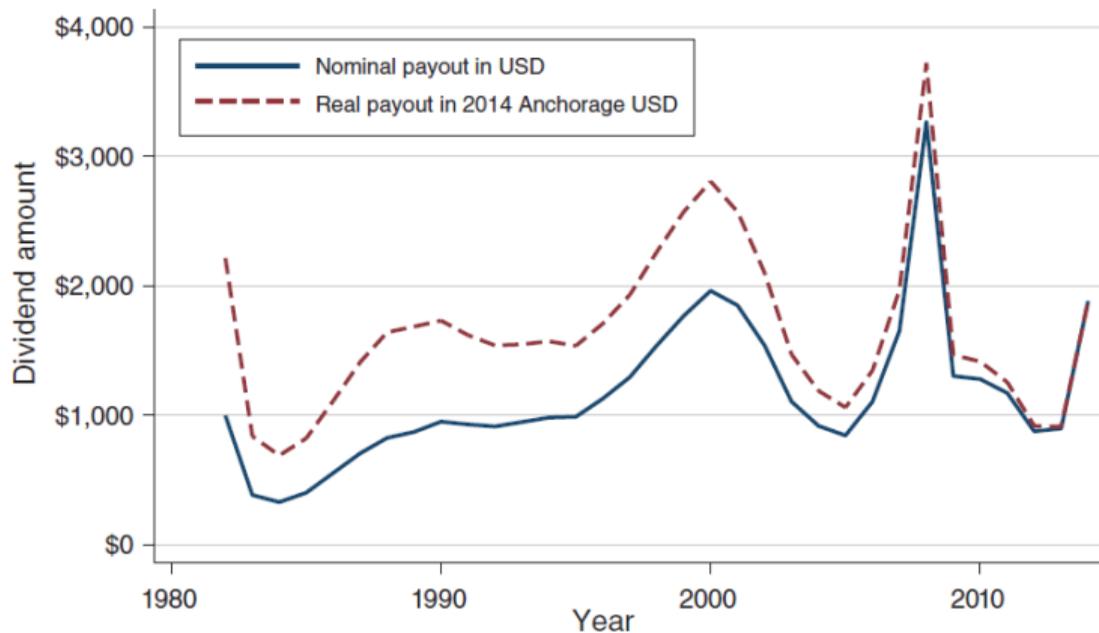
- 1970s oil discovery in Alaska, royalties accruing to the State
- Creation of Alaska Permanent Fund to invest and diversify the royalties (value in 2022, \$65 bn)
- Since 1982, payment of a dividend to citizens of Alaska (around \$1000-\$2000 p.a.)

- **Jones and Marinescu (AEJ-EP, 2022)**

- Data : CPS survey data
- Method : Synthetic control method (i.e., chooses a weighted average of control states to best match Alaska)
- Results : no effect on employment, and increased part-time employment by 1.8 ppt
- Interpretation : the null employment effect could be explained a by positive general equilibrium response offsetting a negative income effect

# Labor market impact of Alaska permanent fund

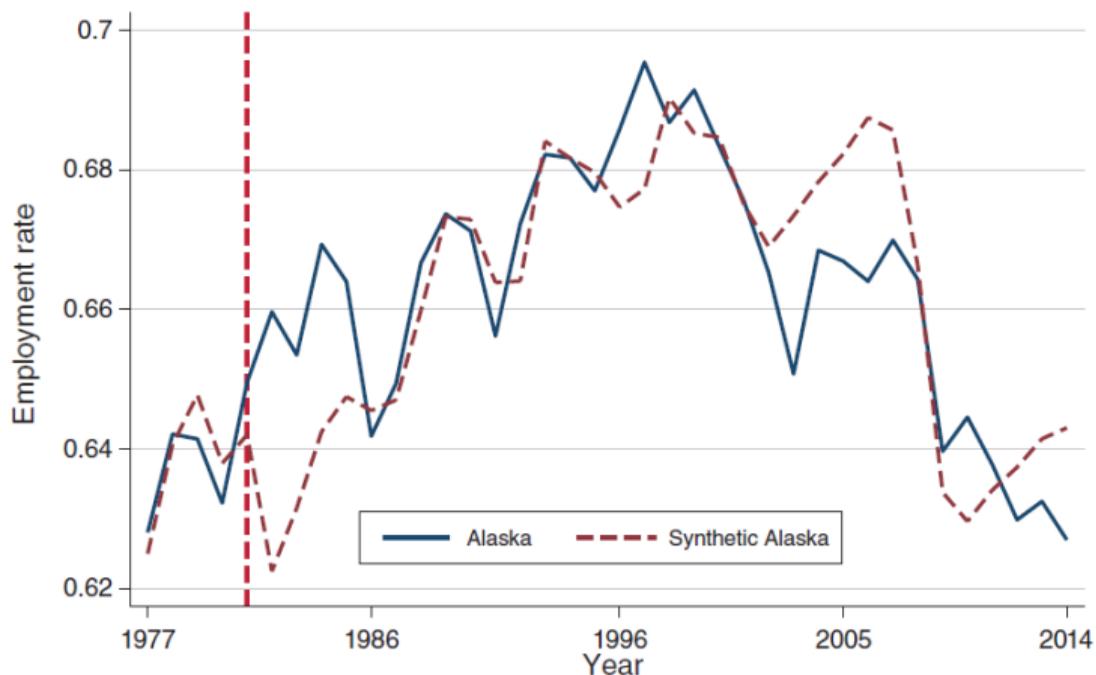
Figure 8 – Alaska permanent fund dividend : real and nominal amount



Jones and Marinescu (2022), Fig. 1, p. 320.

# Labor market impact of Alaska permanent fund

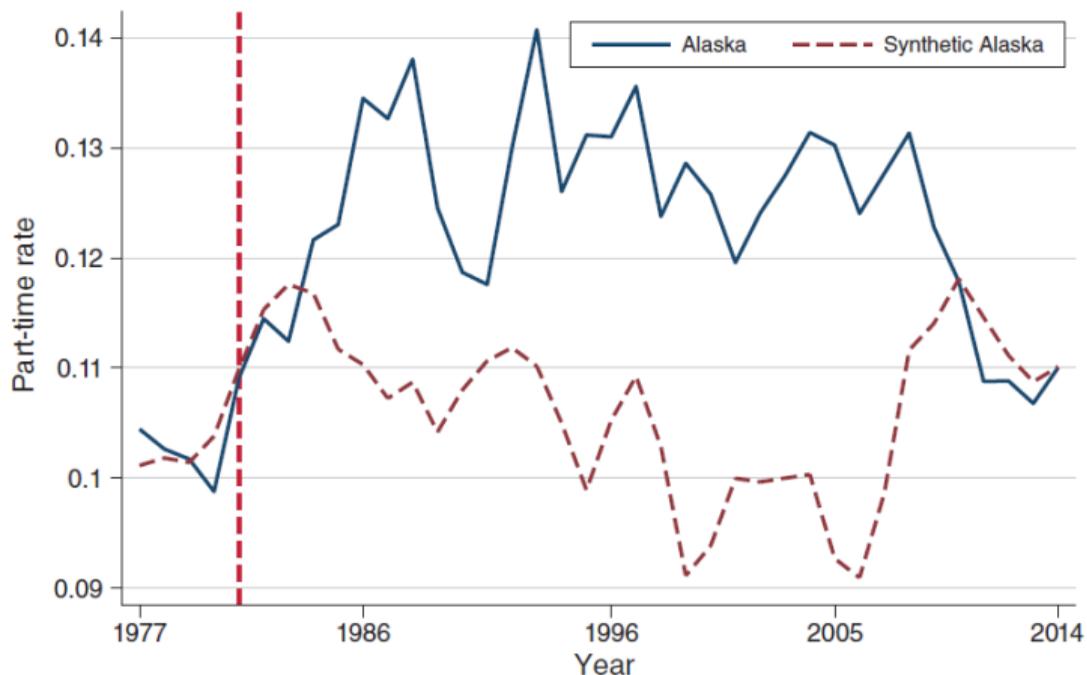
Figure 9 – Employment rate : Alaska versus synthetic Alaska



Jones and Marinescu (2022), Fig. 2.A, p. 326.

# Labor market impact of Alaska permanent fund

Figure 10 – Part-time rate : Alaska versus synthetic Alaska



Jones and Marinescu (2022), Fig. 3.A, p. 328.

# Evidence from Alaska Permanent Fund

- **What do we learn ?**
  - Unconditional cash transfer does not lead to major negative employment effects
  - But amount is small compared to canonic UBI (\$83 p.m.)
  - By using natural resource income, no impact of additional taxation

# Evidence from Finland basic income RCT

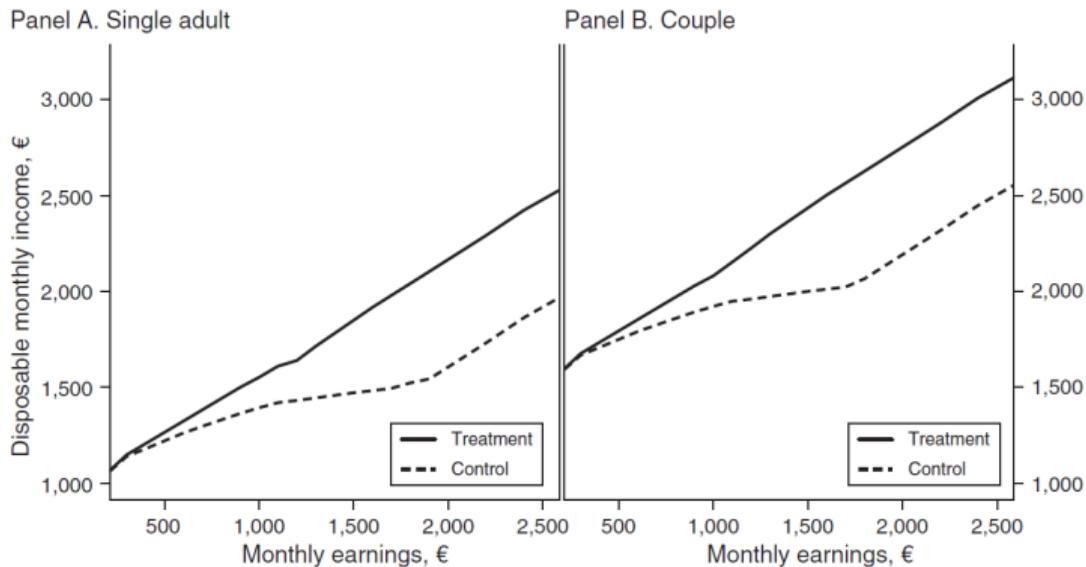
- **Finland basic income RCT**

- Individuals 25-58, received UI allowances
- 2000 treated received 560 euros p.m. in 2017-18
- 3000 controls followed
- Treated individuals could receive other benefits, but then the UBI amount would be deducted
- Large drop in participation tax rate (increased work incentives)
- Participation in the experiment was mandatory, and it removed all obligations for job searching set by the public employment services

- **Verho, Hämäläinen and Kanninen (AEJ-EP, 2022)**

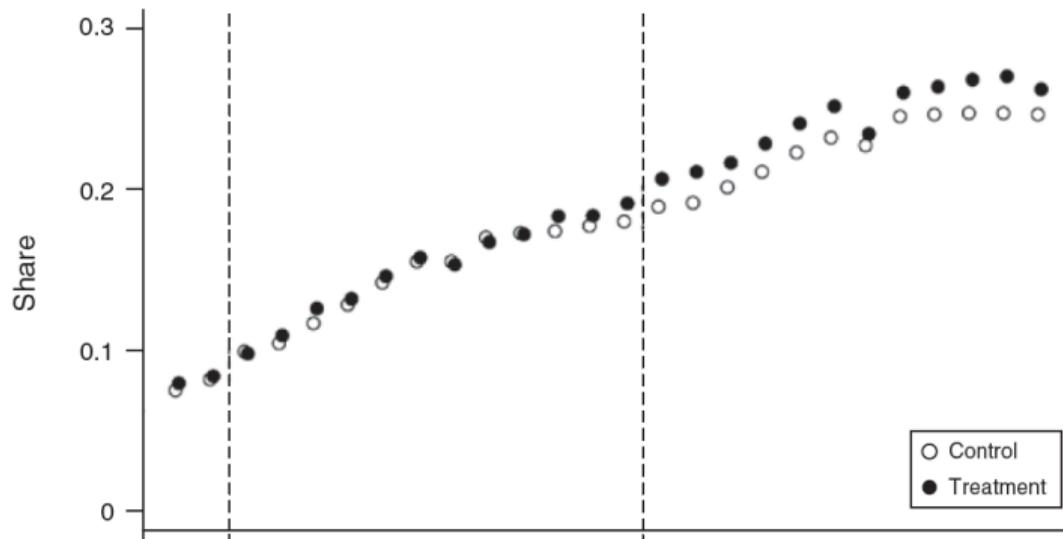
- Very little impact on employment given large drop in participation tax rate
- Treated group reluctant to leave unemployment services

Figure 11 – Change in the work incentives for stylised households



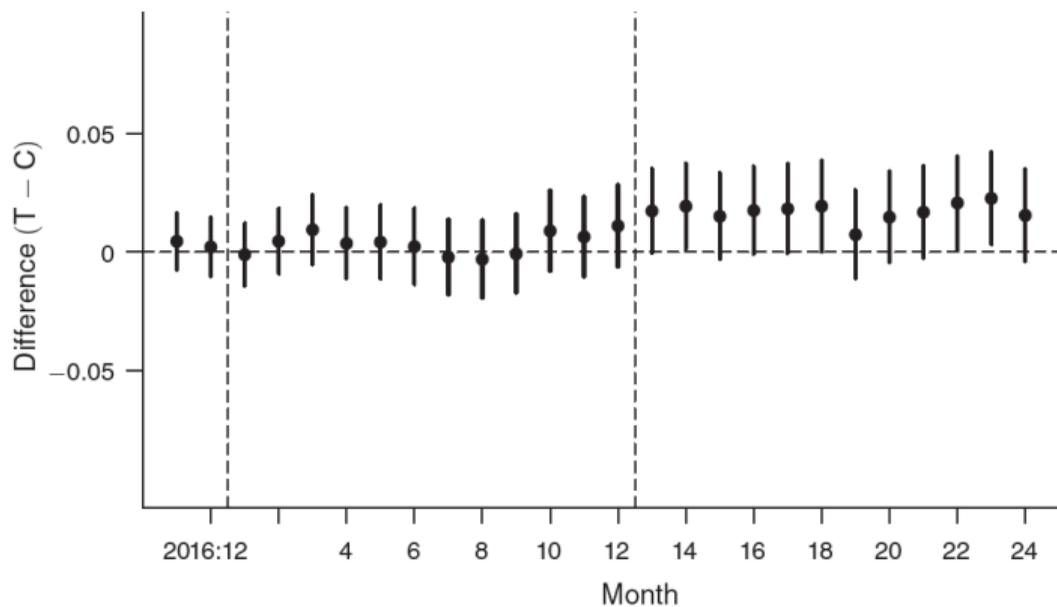
Verho, Hämäläinen and Kanninen (AEJ-EP, 2022), Fig. 1, p. 506.

Figure 12 – Employment in the analysis groups



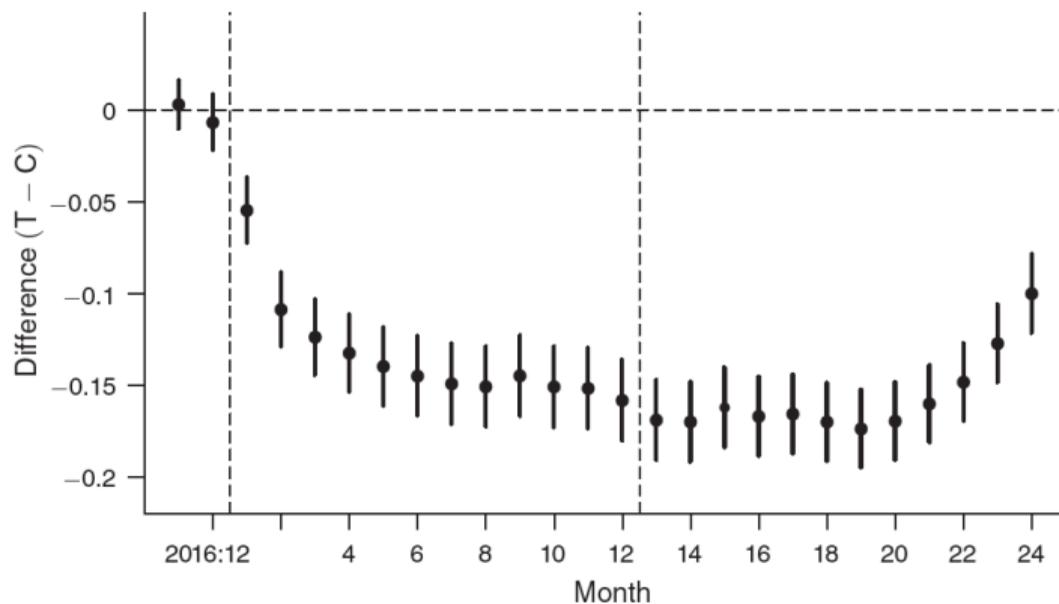
Verho, Hämäläinen and Kanninen (AEJ-EP, 2022), Fig. 2.A, p. 512.

Figure 13 – Difference in employment in the analysis groups



Verho, Hämäläinen and Kanninen (AEJ-EP, 2022), Fig. 2.B, p. 512.

Figure 14 – Difference in the use of unemployment benefits



Verho, Hämäläinen and Kanninen (AEJ-EP, 2022), Fig. 3.B, p. 513.

# Participation income (PI)

- **A proposal by Anthony Atkinson**
  - British economist, specialist of inequality
  - Proposal of participation income (PI) in Atkinson (1996, 2015)
- **A critique of UBI**
  - UBI is never quite universal
  - UBI is too costly to be set at high enough level to reduce poverty
  - UBI is wrong to want to subsidise surfers

# Participation income (PI)

- **A conditional basic income**

- Agreement that means-tested benefit are inadequate, and create high non take-up
- Atkinson in favor of more generous social insurance
- Participation income is income support conditional on participating in socially useful activities (e.g., education, caring, employment)
- “I agree with John Rawls who said that those who surf all day off Malibu must find a way to support themselves” (Atkinson, 2015, p. 221)

- **How to implement ?**

- Administrative cost of assessing eligibility, but only category decision (not income test)
- As a complement to other social insurance/benefits

# Child Benefit : BI for children

- **Advocacy by Anthony Atkinson (2015)**
  - Key role of child benefit to reduce poverty rate
  - Should be universal including for rich families, but taxable
  - “child should count” in determining cash support
- **Rationale**
  - Reducing means-testing
  - Reducing marginal tax rates on low income
  - Redistribution towards children vs households wo children

## II. Social investment strategy

- **Reforming the Welfare state**
  - Activation of welfare spending
  - Focus on public services (child care, education, training, etc.) rather than cash
  - Social investment : spending with positive returns for society
- **Child-centered welfare spending**
  - Evidence that early childhood interventions have long-term beneficial effects : high positive returns of public spending
  - Evidence that welfare state has developed in favor of elderly : more spending on pensions than on children

# Child-centered welfare spending

- **Importance of cognitive development of children**

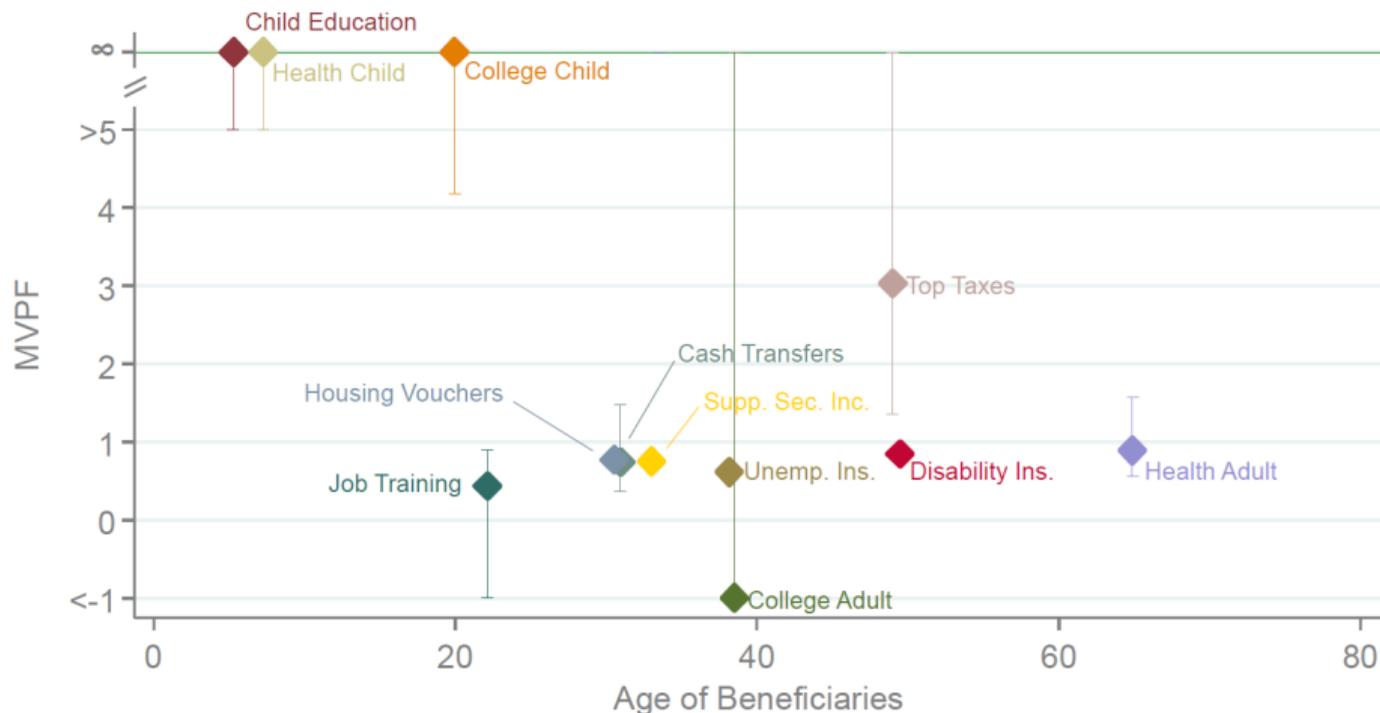
- Large impact of early childhood interventions (Heckman and Lochner, 2000)  
e.g., Perry Pre-school intervention (1961)
- Much higher returns than interventions on adults later in life

- **Early intervention : child care and education**

- Quality child care has impact on cognitive development
- Early schooling has also large returns

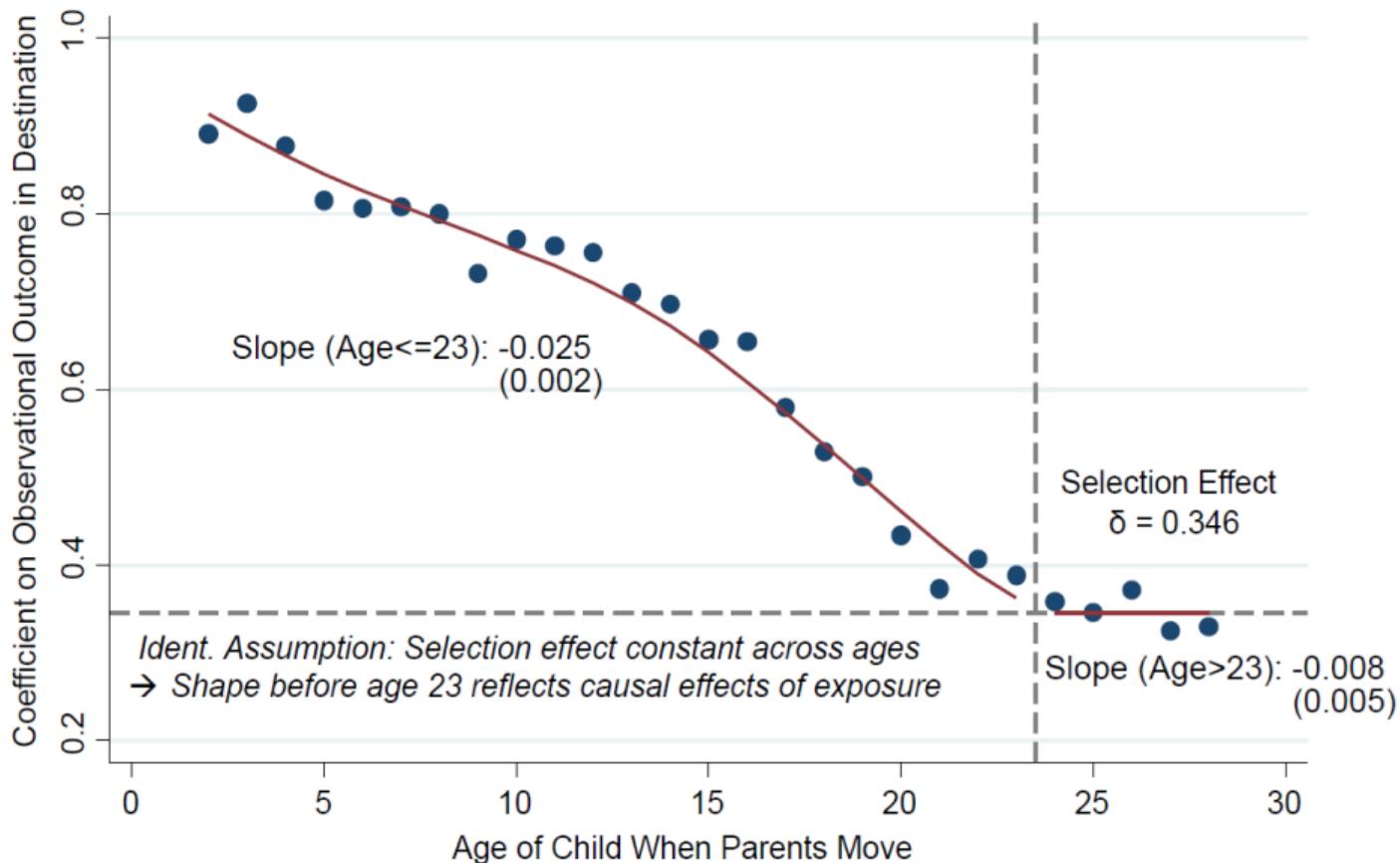


Figure 16 – MVPF Estimates by Age of Policy Beneficiary (Category Averages)



SOURCE : Hendren and Sprung-Keyser (2020), Fig. 4.B, p. 1251.

Figure 17 – Childhood Exposure Effects on Household Income Rank at Age 24



# Child-centered welfare spending

- **Gosta Esping-Andersen**
  - *Why we need a New welfare state* (2002)
  - Reduce child poverty and invest in children through public services
- **Redirecting welfare spending towards families with children**
  - Child benefits : Reduction of child poverty has big long-term effects
  - Reduction/stabilization of old-age spending
  - Increase in child care and early cognitive development

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