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# Unconditional Basic Income: An Economic Perspective

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# Unconditional basic income: an economic perspective

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A wide range of public figures from the social sciences, politics and business have proposed paying every citizen a fixed amount of income without means testing or work requirement. The idea is fascinating. Most recently, a widely reported [crowd-funding initiative](#) from Berlin collected €12,000 to finance one year's worth of unconditional basic income for a randomly selected individual.

After introduction of a UBI, every citizen would be entitled to a payment of maybe €600 per month, however, there would be no social insurance payments based on unemployment, job-seeking or need. Most basic income proposals include financing through a relatively flat income or consumption tax. Social security contributions would be reduced, with pensions and health insurance paid for by general taxation. Two prominent UBI schemes that have been adapted to the German institutions include those put forward by the mediatic founder of pharmacy chain dm Götz Werner ([Unternimm die Zukunft](#)) and the Solidarisches Bürgergeld proposed by the head of the German economic research institute HWWI Thomas Straubhaar ([Straubhaar 2008](#)). Rather than evaluating specific basic income schemes, this contribution focuses on economic considerations that apply to a range of different schemes. The first part discusses pros and cons of a basic income. The second part highlights economic mechanisms that are often not fully appreciated in discussions on the basic income. The third part presents the resulting welfare analysis - who would benefit from a basic income, who would lose? Taking the distributional effects seriously raises questions of justice. In the final section, the prospects for adoption of a UBI in Germany are considered.

## Advantages and Disadvantages of an Unconditional Basic income

Proponents of the UBI argue that it is more efficient compared to current social insurance systems, whilst at the same time enabling a more just distribution. Additionally, it is intended to provide citizens with opportunities outside the labour market ([Santens 2014](#), [Van Parijs 2013](#)). First, a UBI can address poverty. Under this premise, a recent UNICEF report studied a limited monthly Child Basic Income of €50 per child in all EU countries funded by a flat tax of 0.2% on all EU incomes. Child poverty could be reduced substantially ([Levy et al. 2013](#)). In Germany, child benefits are already paid unconditionally - an exception in the current system. Secondly, a UBI could remove so-called poverty traps inherent in a tax and benefit system in which benefits are rapidly withdrawn on taking up work, thus “reducing unemployment without increasing poverty” ([Lehmann 2003](#)). Thirdly, the current highly complex tax-and benefit system generates large administrative costs, as well as uncertainty, stress and stigma for the benefit recipients (by means-testing,

monitoring work requirements and tracking the family ties). These user costs have raised concerns about the low take-up rates of certain benefits (Atkinson 2011). Welfare consequences can be serious when the conditions attached to welfare payments are breached (as a [recent case](#) in the UK shows). Finally, a UBI is intended to enable individuals to pursue social, artistic or family activities by overcoming material needs of the most basic kind.

The main arguments raised against the UBI concern the financial cost (see e.g. the evaluation of a proposed German UBI scheme by DIW researchers (Meinhardt et al. 1996), or the evaluation of the Althaus scheme ([Opielka and Strengemann-Kuhn, 2007](#))) and perceived lack of fairness ([Hienstorfer 2014](#)). Both issues are linked to behavioural reactions of individuals and firms on the labour market which may be hard to assess in the case of systemic changes - a problem that mars all evaluations of large-scale policy reforms ([Rust 2013](#)), e.g. the assessment of the introduction of a minimum wage. Simple accounting exercises which compare the costs of a UBI with the savings from scrapping various welfare programmes leaving aside any behavioural changes in light of the UBI are not credible (see [Spermann 2007](#) and Atkinson, 1995, ch.7).

### **Basic income: impacts on employment and wages**

Whether people work more or less with a UBI is an important element in judging the economic consequences of introducing a UBI. Most commentators initially reflect on the income effect - i.e. the fact that the additional income provided by the UBI can influence the desired number of working hours. Citizens may prefer to spend their additional income on more leisure (i.e. cut their working hours) rather than continue working the same number of hours and enjoy more leisure. Few empirical studies independently assess the income effect and those that do find fairly small reactions of hours worked to changes in wealth (Henley 2004).

From an economic perspective a second effect is of particular interest - the marginal tax rate effect. Whilst citizens could afford to stay at home more with the UBI, they can gain more consumption for every hour that they do work. This is particularly true for benefit recipients, who must relinquish part of their welfare benefits on taking up employment in the current system. The UBI can help remove the poverty trap since UBI payments are made independent of earned income. The income effect may thus reduce hours worked by employed individuals, whereas the marginal tax rate effect may increase employment levels by helping unemployed individuals back into work.

Labour market reforms in several countries have introduced schemes similar to the negative income tax (Moffitt 2003). A negative income tax subsidizes incomes below some threshold and taxes individuals only above the threshold. In Germany this is done via "Aufstocken" of ALG II, similar systems operate in the UK and US with the Working Families Tax Credit and the Earned Income Tax Credit). Participants in these programmes will be less subject to the marginal tax rate effect. The main difference is that UBI payments are not means-tested and are not restricted to labour market participants. Compared to these schemes, the UBI could further reduce the fraction of benefits that are withdrawn from extra labour earnings of

unemployed on taking up a job. Contrasting to the income effect, the empirical relevance of the marginal tax rate effect is well documented: The decision whether or not to start working - for married women in particular - appear sensitive to policies in this area. Several studies thus predict positive employment effects of introducing a UBI ([Bonin and Schneider 2007](#), [Van der Linden 2004](#), [Van der Linden 2002](#), [Lehmann 2003](#)).

A large-scale reform of labour market taxes and benefits such as the UBI will not only influence individuals' decision to work but also wage levels. Modern expositions of the labour market assume firms and workers bargain over wage levels (on an individual, firm or industry level). In these models, bargaining power is a function of workers' and firms' outside option, i.e. what they could do in the absence of an agreement ([Chéron 2002](#), [Van der Linden 2002](#)). Unemployment benefits increase the attractiveness of the outside option. By contrast, the unconditional nature of the UBI makes the outside option less attractive vis-à-vis employment than with unemployment benefits. This effect of the UBI can be expected to reduce negotiated wages, an effect which may further increase employment.

Whilst the specific assumptions of the scientific studies on UBI differ, the most likely effects appear to include a reduction of unemployment, an exit from the labour market of individuals with poor labour market perspectives, a reduction in hours worked and a reduction in the bargained wage.

### **Welfare effects - Who gains from a UBI?**

The three effects jointly generate winners and losers of a UBI depending on individuals' current employment situation. The unemployed can more easily increase their earnings, workers in bad jobs may quit the labour market more easily, whilst employees with good labour market perspectives will lose their wage-related welfare benefit payments. Very few studies claim that all citizens may benefit from a UBI ([Chéron 2002](#) finds such a so-called Pareto improvement under very specific conditions). [Lehmann \(2003\)](#) differentiates the distributional impact according to level of education. He finds that more qualified individuals do not benefit from the UBI, that less qualified benefit from lower unemployment and that some individuals with low levels of qualifications leave the labour market.

Furthermore it can be noted that whilst current systems of welfare provisions focus on the household, the UBI would be paid to the individual. Family members who take over domestic work and caring would then receive their own payment. Since this work is still predominantly largely shunned by men, women would benefit over-proportionally from a UBI ([Atkinson 2011](#)).

An economic analysis of the welfare effects of the UBI should take into account two further dimensions of individual circumstances: First, the type of current employment and, second, individuals' alternatives outside of the labour market.

Introduction of a UBI can be expected to affect different jobs differently since the income effect may reduce the importance of the extrinsic (monetary) compensation relative to intrinsic motivation ([Pech 2010](#)). Whilst there is also some evidence that income effects change the valuation of non-monetary aspects in practice ([Haywood 2014](#)). Employers could react to this in a variety of ways: Employment in less

intrinsically attractive posts may suffer. Firms may be forced to provide better non-monetary working conditions. Wages levels could adapt, rising for less intrinsically attractive jobs and falling for attractive jobs. Firms could also try to substitute capital for labour, thereby increasing wages but reducing employment. A full assessment needs to estimate the costs of providing workers with intrinsically attractive jobs (see e.g. Dey and Flinn 2005).

The alternatives individuals have outside the labour market play an important role in assessing the employment effects of a UBI. A UBI could encourage individuals to leave the labour market to care for family members or to pursue artistic and social activities. The welfare effects of these transitions will depend importantly on the extent to which these activities are socially or merely individually beneficial. Unfortunately, there is apparently no empirical work evaluating this important issue. To ensure that only socially productive activities benefit from publicly provided income, [Atkinson \(2011\)](#) and [Van der Linden \(2004\)](#) prefer an Active Citizen's Income paid conditionally on participating in the labour market or performing other useful duties. This however requires a monitoring of these conditions with ensuing costs.

### Funding and fairness of a UBI scheme

The idea of an Active Citizen's Income can also be interpreted in terms of desert: individuals should deserve the resources they are provided with. Most obviously, it is alleged that if workers pay the taxes that finance UBI recipients who do not work, the latter exploit the former ([Hienstorfer 2014](#)). However, individuals who take up work can also be said to deserve a significant proportion of their earnings - an argument against high marginal tax rates. We have noted that the UBI reduce these ([Atkinson, 1995, ch.4](#)). Moreover, the view that workers paying taxes are the sole contributors to national income supposes a labour-centric view of production ([Widerquist 1999](#)). Other factors (e.g. land, knowledge, security) also importantly influence productivity as evidenced by empirical studies that find very important "country effects" when comparing levels of productivity across countries. To the extent that political stability for example does not only depend on employed workers, it can be argued that part of national income can be shared amongst all citizens as a social dividend. This would be akin to the dividends that Alaska pays its citizens from its sovereign wealth fund (funded by royalties on oil extraction).

Furthermore, modern theories of the labour market suggest that luck partly determines how fast a worker finds a job and, on a job, how fast her career advances. If important determinants of material well-being are a matter of chance, a UBI may partially insure against these hazards. Finally, discrimination on grounds of sex or race may provide a further justification - in the words of Martin Luther King: "dislocations in the market operation of our economy and the prevalence of discrimination thrust people into idleness and bind them in constant or frequent unemployment against their will" (King 1967).

### Prospects for a basic income in Germany

The UBI has found supporters in several parties in Germany. In the CDU, the former prime minister of Thuringia Dieter Althaus promoted the Solidarisches Bürgergeld

scheme which was however found to be underfinanced ([Bonin and Schneider 2007](#), [Opielka and Strengemann-Kuhn 2007](#)). The liberal FDP campaigned for a Bürgergeld (a Citizen's Income with forms of conditionality) after adopting the policy in 2005. Both proposals are based on the idea of reducing labour cost by reducing social security contributions. In the Green party, a federal working group is tasked with advancing a UBI ("Grüne Grundsicherung"), whilst in the socialist party Die Linke, the current party leader Katja Kipping has been a prominent supporter of a UBI. In these two left-leaning parties, the focus has mainly been on using the UBI to increase levels of social provision.

A series of labour market reforms in Germany has sought to mitigate the negative incentive effects of benefit withdrawal by increasing the conditionality of unemployment benefits as well as reducing the withdrawal rates of welfare payments on accepting a job. These measures are generally thought to have been effective in reducing unemployment (although the OECD is critical of a current UK programme aimed at applying a constant withdrawal rate to benefits, see [OECD 2014](#)), whereby the precise contribution of sanctions is contested (see [Launov and Wälde 2013](#) and [Krause and Uhlig 2012](#)). Apart from the welfare cost imposed on unemployed individuals who must comply with additional requirements, a much-debated consequence of these reforms has been the rise of a low-pay sector which a broad political consensus is currently seeking to contain via a national minimum wage. There is thus currently little taste for large-scale labour market reform in Germany. Implementing a wide-ranging reform like UBI would, however, require a large political consensus, in which trade unions and employer organizations are the key players. German trade unions (like most of their European partners, see [Vanderborght 2006](#)) do not support a UBI and have been hostile in the internal debate in the left-wing party Die Linke ([Kipping 2008](#)). First, this may be a result of the threat of losing bargaining power and the potential of a UBI to lower wages (for the reasons outlined above). Second, a UBI has been argued to be a tool to create a more flexible labour market with less employment protection ([Althaus 2007](#)) - a development which unions oppose. Third, unions may be concerned about the loss of centrality of work that the UBI can be seen to encourage ([Vanderborght 2006](#)).

On the employer side, whilst individual business leaders have spoken out in favour of a UBI (e.g. [Götz Werner](#) or, in Belgium, [Roland Duchâtelet](#)), the employer associations oppose a UBI (see [BDA 2012](#)).

Given this political climate it is surprising that the public debate has focused exclusively on country-wide basic income schemes. Alternatives might include a UBI for under-25 year olds or the possibility for every citizen to take a limited amount of sabbatical years with UBI payments. Not all advantages of the UBI could be realized with these schemes, but the risks are also limited and finding majorities appears much easier.

## Conclusion

Next to the psychological and ethical dimension of the UBI, an economic perspective allows an analysis of potential costs and benefits. Next to negative employment effects as a result of the income effect there are also incentives to increase

employment. However, Germany has chosen an alternative path to increase incentives to resume employment - making a key justification for the UBI less relevant. Identifying winners and losers of the UBI depends not only on whether an individual is in employment, but also on the type of job the individual is currently employed at, as well as the alternatives individuals have outside the labour market. The potential for an UBI could be further studied with this in mind, however, in practice, given the limited support by trade unions and employers, advancement of basic income proposals appears a remote prospect in Germany. [Polling evidence from the US](#) and the failure of a [European citizens' initiative](#) also highlight a lack of public support. With this in mind it would be useful to study more limited versions of the UBI (for young people, as a means to finance sabbaticals, etc.). Finally, changes in the career paths and the organization of work may increase the relevance of arguments stressing the potential of a UBI to foster individuals' intrinsic motivation and change public perception of the proposal. The redistributive effects of specific UBI schemes would then need to be analyzed. Questions to be asked include: How would overall hours worked develop and what will those do, who do not work? How large is the welfare benefit for those who no longer feel under pressure to "work for an income?"

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