

THERE'S NOTHING BASIC ABOUT BASIC INCOME

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In recent years, there has been a lot of talk about basic income. But what exactly is basic income? And what would the economic effects be of such a comprehensive change to the tax-benefit system?

There are many definitions of basic income but in its purest form, basic income is an amount of money (**income**) paid to everyone (why some people use the term *universal* basic income) regardless of circumstances. This can either be enough to live on (**full basic income**), or a smaller amount (**partial basic income**) which is offered in conjunction with the current means-tested system. These two models have different characteristics so it is important to distinguish between them.

A key feature of basic income is its universalism. Everybody would receive basic income regardless of how rich they are. This is likely to reduce the stigma associated with means-tested benefits as well as removing uncertainty over eligibility as circumstances change, both of which limit take-up of means-tested benefits. There are also wider philosophical/sociological reasons why a universalist system might be preferred.¹ It is important to note that these desirable features are far greater with full basic income as many means-tested benefits could be scrapped. With a partial basic income, many people would still rely on existing means-tested benefits to have enough to live on.

There is no set cost of basic income – the cost depends on how generous a particular model of provision is. However, it is clear that full basic income is expensive. Very expensive. How expensive depends on what is deemed “enough” to live on, and decisions about whether the model should be supplemented with other conditional benefits (e.g. for disabilities, childcare, housing costs). Different people have different needs and keeping some degree of differential payments may well be desirable. However, for the sake of simplicity, it is worth stepping away from individual needs and considering how much it would cost to make sure that nobody would be in poverty (giving individuals income so that every household type would receive a combined payment

¹ Garnham A. 2019. The Problem with Means-Testing, CPAG

equal to the 2017/18 poverty threshold before housing costs). This would give, for instance, a couple with two children £480 per week. This particularly high-cost option would cost about £600bn a year, including nearly £500bn to people in households currently above the poverty line, substantially more than the £280bn currently spent on pensions and social security. In order to fund this increased spending, taxes would have to rise dramatically.

Now, this is by no means the only possible full basic income model. If desired, a less generous, less expensive model could be implemented or vice-versa. Similarly, the cost of partial income models depend on how generous the scheme is. A small top-up to existing benefits would cost less and have a smaller impact than a more generous partial basic income scheme.

Whatever the desired scheme (and generosity), it is very likely taxes would have to increase or tax allowances be cut to fund it. However, there is definitely scope to increase taxes in the UK. In 2017, the latest year where we have comparable data across different countries, the UK's tax-to-GDP ratio was 33 per cent, substantially lower than many European countries. If the UK raised an additional £100bn in tax it would still have a lower level of taxation than the Netherlands and an additional £250bn would still be less than Denmark.

How these taxes are raised will have large implications for the economy. Now, you might say if we're giving everyone more money, they won't mind being taxed more. To some extent, this is true. It does seem politically more feasible to increase taxes while giving everyone a substantial income boost. However, it is also the case that taxes are distortionary, i.e. when faced with taxes people change their behaviour. A particularly distorting tax change would be increasing the top rate of income tax. Estimates suggest that increasing the higher rate of income tax would not lead to much additional revenue as people work less or shift their income to other sources such as pensions. Nonetheless, there are many ways to raise tax revenues, including taxes that are targeted at the most well-off in society, that are less distortionary.² The overall effect though is likely to be a reduction in national income.

As well as the distortionary effect of increased taxation, it is important to consider how the introduction of basic income itself will change people's behaviour. One can argue about what qualifies as "basic" but it seems likely that any proposed system would increase out-of-work income. This would have massive benefits for people at the bottom of the income distribution. People would stop worrying about whether they have enough money to last until the end of the month, or what will get taken away if they start work/increase their hours. This could enable them to find a secure and decent job (rather than having to take any work available regardless of insecurity or poor conditions), or spend more time in education, caring for relatives, supporting the community or starting businesses. There is also growing evidence on the long-term benefits of higher social security payments to families in poverty. Studies have shown that there is a causal link between higher benefits in childhood and improved health, education, employment prospects and even life expectancy.³⁴

Nonetheless, in aggregate, the effect of increased out-of-work income is likely to be a reduction in total paid employment as some people would choose not to work or to work less. It is difficult to quantify how large the labour market effect will be. People in favour of full basic income often reference the Alaska Permanent Fund and

² Bradshaw J (ed.) 2019. *Let's Talk About Tax* (ed. J Bradshaw), CPAG

³ Aizer A, Eli S, Ferrie J, Lleras-Muney A. 2016. The long-run impact of cash transfers to poor families. *American Economic Review* 106(4): 935–71

⁴ Hoynes H, Schanzenbach DW, Almond D. 2016. Long-run impacts of childhood access to the safety net. *American Economic Review* 106(4): 903–34

American Indian tribe payments as evidence that the labour market effect will be small. However, these studies only provided a small top-up to income and as such it is unsurprising that a significant effect was not found on employment. We can get a sense of the likely size of the effect by scaling up estimates from other tax-benefit reforms. Applying the best possible estimates from the literature, the no-poverty full basic income model could be expected to lead to an approximately 5 per cent reduction in total hours worked.⁵ Any basic income model that boosts out-of-work benefits is likely to reduce employment, although the smaller the increase, the smaller the effect on the labour market. It is also important to think about the household response to basic income. If basic income is introduced without universal childcare, it may be disproportionately women who work less, reducing gender equality.

If there is an increase in out-of-work benefits, it is important that the rest of the tax-benefit system does not disincentivise work, especially at the bottom of the income distribution. Under universal credit, for every £1 earned, 63p of benefits are withdrawn (above the work allowance available to parents and disabled people). This creates a large disincentive to work or to increase earnings. The effect of this high withdrawal rate – possibly the reason for it – is that people stop receiving universal credit at a relatively low level of earnings (and the system overall costs less as it supports fewer people). There is a direct relationship between the withdrawal rate and how far people's income can rise before they stop being eligible for any means-tested support. Lowering the withdrawal rate raises poorer households' income gains from work and improves their work incentives, while also meaning that some higher-earning households continue to be eligible for a certain amount of support but have less of an incentive to increase their earnings (as they are subject to benefit withdrawal as they work/earn more).

Various organisations have proposed removing the personal tax allowance in order to provide a partial basic income, while keeping the rest of the current tax-benefit system largely intact.^{6,7} This would be a highly progressive policy that would substantially redistribute income from the rich to the poor. However, this policy would not address many of the problems of a means-tested system. For people at the bottom of the income distribution, there would still be uncertainty over how much money they would have as their circumstances change, perhaps more so if partial income is included in means-tested benefits calculations. Means-tested benefits could still be stigmatising, if some relatively richer households no longer qualify for means-tested benefits as a result of partial income meaning an even smaller proportion of the population receive means-tested benefits. In addition, people at the bottom of the income distribution would face a very high marginal tax rate as means-tested benefits are withdrawn and income tax is paid on all earnings above the universal credit work allowance (as the models propose abolishing the personal tax allowance).⁸

Now, the importance of the labour market effect depends on what the reason for introducing basic income is. If we are living in a world where robots have reduced the demand for labour, basic income may be necessary to provide a large share of the population the income they need to live off. However, if demand for labour is still high, serious consideration needs to be given to how people will respond to the new tax-benefit system. One could still make the case that the distributional benefits would outweigh the costs, but it is naïve to brush off these concerns completely.

⁵ Author's calculations based on methodology used in Hoynes, H. and Rothstein, J., 2019. Universal basic income in the United States and advanced countries. *Annual Review of Economics*, 11, pp.929-958

⁶ Lansley S, Reed H. 2019. Basic income for all: from desirability to feasibility, Compass

⁷ Stirling A, Arnold S. 2019. Nothing Personal: Replacing the personal tax allowance with a weekly national allowance

⁸ Relatively richer households who leave means-tested benefits will face a lower marginal effective tax rate as they will no longer have benefits withdrawn as they work/earn more.

Another argument made against basic income is that this would lead to the neglect of other publicly provided services. This does not have to be the case. Although basic income could be (partially) funded by cutting government expenditure elsewhere, the vast majority of proposals fund basic income by increasing taxes. One could propose a system where taxes raise by enough to provide basic income and increase spending in other areas. Nonetheless, it is important to always consider the opportunity cost of government spending on a particular area. Spending less on social security means more can be spent on other public services.⁹

Although it may be misleading to pit basic income against public services, it does illustrate a wider point that is important to consider the whole economy at once. Benefits can increase, taxes can rise and public service expenditure can be boosted in a system that doesn't involve giving income to everyone. It is possible to have a far more progressive means-tested (or contributory) system that substantially reduces child poverty. Nonetheless, in order to merit proper discussion, it is vital that any proposal is thorough in its discussion of the large scale economic effects it will have.

⁹ For more on Universal Basic Services see Portes J, Reed H, Percy, H. 2017. Social prosperity for the future: A proposal for Universal Basic Services, UCL Institute for Global Prosperity