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**Article**

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End of previous Forum article

Heiner Flassbeck

## Universal Basic Income Financing and Income Distribution – The Questions Left Unanswered by Proponents

Recently, more and more voices have spoken up in favour of the introduction of a Universal Basic Income (UBI). In Germany the CEO of Deutsche Telekom came out in sup-

port of the idea,<sup>1</sup> and Yanis Varoufakis is touring Europe propagating a UBI. The argument for a UBI is that the current technological evolution is destroying so many jobs that there is no longer any other choice but to decouple

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<sup>1</sup> See Telekom-Chef Höttges für bedingungsloses Grundeinkommen, in: Zeit Online, 29 December 2015, available at <http://www.zeit.de/wirtschaft/2015-12/digitale-revolution-telekom-timotheus-hoettges-interview>.

income from work. This argument is absurd for many reasons, but mainly because productivity nowadays is rising much more slowly than it was several decades ago.<sup>2</sup> If, one day, productivity were to increase substantially again, it would be both possible and necessary to increase wages. Working time could be reduced in small incremental steps, and problems associated with demand could be solved accordingly.<sup>3</sup> This means, however, that there is no basis for such a major step as the implementation of a UBI.

Even the euro crisis is being used as an argument by the proponents of a UBI. The case is being made that Germany drove the countries in the south against the wall with its high productivity, and that we are therefore now in need of a fundamental change. However, it was not German productivity that caused the crisis in Europe, but solely German wage moderation.

Even if these arguments are nonsensical, the UBI obviously fascinates many. Like many similarly radical ideas, it seems to solve at once many serious problems in the confusing world in which we now live. A UBI leads to a welfare state without the endless bureaucracy and without the attacks on the human dignity of benefit claimants. It would not be means-tested. It would create space for individuals to better contribute to society according to their own intrinsic abilities. As a consequence, people would be more motivated. In a word, a UBI would lead to a more humane society. The problem is, however, that the proponents of these ideas exaggerate the positive effects of their proposals and by and large ignore the negative ones. Criticism from economists is often dismissed as overly “technical”, as a mere counter-argument that can be dealt with anytime if the political will is present.

This is more than just problematic. If our criticism deals with a central point that cannot be easily surmounted politically, one should not ignore it. The refusal to take note of valid arguments leads to the formation of discussion and activist groups that are disconnected from the real world. They support “solutions” that have great appeal to masses of poorly informed people, and they raise hopes that remain unrealisable. We hope to make a contribution to this debate by explaining why a UBI cannot work. In-

<sup>2</sup> Analysed in detail in H. Flassbeck: Der Roboter als Jobkiller? – 3, Makroskop, 13 January 2016, available at <https://makroskop.eu/2016/01/der-roboter-als-jobkiller-teil-3-050-e/>.

<sup>3</sup> Friederike Spiecker and I have shown this in several contributions. See e.g. H. Flassbeck, F. Spiecker: Professor Bontrup und ein ziemlich alter Trugschluss, Makroskop, 16 September 2014, available at <https://makroskop.eu/2014/09/professor-bontrup-und-ein-ziemlich-alter-trugschluss/>.

deed, there are much better ways to help people than by introducing a UBI.

### Income and production cannot be divorced

What is the problem in concrete terms? Most of us earn an income because we sell our labour on the labour market in the form of a contribution to the production of goods and services. Others receive an income from the state, because they – for whatever reason – are unable to earn an income on the market. *Tertium non datur*: a third way does not exist. All payments and all transfers derive from either market exchange or redistribution. Interest paid to investors for loans are also earned through the production of goods and services, at least if the investment proved successful. If there is insufficient investment, as is the case nowadays, interest also disappears.

Income and production cannot be separated or divorced. One cannot, in the longer term, have the one but not the other. Even if the state were to create money out of thin air in order to overcome the stagnation in the development of income, the fact remains that incomes that will be paid after the recession recedes must be covered by increases in production. It is for this very good reason that production (that is, the origin of wealth) is on one side in the national accounts and the distribution (that is, the social allocation of the results of production) and the use of income (the demand side) are on the other side. They are intrinsically two sides of the same coin. As a rule, nominal income growth that is not associated with higher productivity, i.e. which does not have an equivalent on the production side, leads to price increases (i.e. inflation), so that real income growth matches the pace of increases of production.

Setting aside these basic and real relationships, many nonetheless support the cause for an unconditional basic income. There is little question that their motives are generally honourable. But the best intentions cannot override fundamental relationships.

It is, in fact, quite amazing how these simple truths are being ignored in debates over the UBI. A recent discussion featured two advocates of the UBI (Ronald Blaschke and Daniel Häni), but it broke off exactly at the moment when the question came up of how the basic income should be financed – this is nothing else but the question of how to put together production and income.<sup>4</sup> Häni, who had

<sup>4</sup> J. Wellbrock: Chaos-Podcast: Desaster um das „Bedingungslose Grundeinkommen“ #BGE, 27 July 2016, available at <http://www.spiegelfechter.com/wordpress/133528/chaos-podcast-desaster-um-das-bedingungslose-grundeinkommen-bge>.

already declared that he would not discuss “certain UBI models”, remained completely silent when the question of financing came up.

### Everyone already has a basic income – but it is not unconditional

Häni argued that virtually everyone already has some sort of a basic income; now it is just a question of making it “unconditional”. But that is precisely the separation of production and income which cannot be successful over the longer term. If a portion of income which was previously linked to contributions to production and which could only be paid for by successful (i.e. profit-making) productivity becomes unconditional, how is the level of production going to increase to make this economically possible?

Let us have a look at both logical extremes. Let us assume, first, that most people decide after the implementation of an unconditional basic income (wherever it may come from – see below for more on this) which amounts to, for example, one-third of the average income, to correspondingly reduce their working time by a third. Despite working one-third of the time less, their incomes would remain unchanged. This is nothing but a giant step towards a (voluntary) reduction in working time with full pay – a step that makes even the biggest supporters of a reduction in working hours shudder.

### How do people react?

In this case, hourly income increases by one-third (the basic income is of course included), but the productivity per hour remains unchanged, because lost labour (even if one assumes, unrealistically, that demand for goods and services and production would remain constant overall) cannot be replaced overnight by machines. Unit labour costs are rising and therefore – as we have shown repeatedly – the rate of inflation increases.<sup>5</sup> This means that a significant portion of nominal income growth per working hour is being depreciated – it is lost for consumers because of rising prices. One can see the same phenomenon from the production side: if, realistically, production falls by a third, but total income remains unchanged, it can only be compensated by rising inflation.

The second extreme is that almost all people decide to continue working just as they do today. They would then earn their current salary and receive a basic income on

top. Setting aside the question of where the basic income would come from – who would finance it – it is clear that this miraculous multiplication of income would cause inflation, because earnings would increase while the output of production remained unchanged. Between these two extremes, one can come up with many possible cases, but none of them alter the basic problem: either not enough work will be done or too much will be earned. Furthermore, if some people work less and still earn nominally the same as before, it is easy to imagine that those who continue to work the same amount of hours as before but see their real income decrease because of rising inflation will protest.

### How to finance a UBI

The introduction of a basic income without generating a rise in inflation is hardly imaginable. It would only be possible – and this is an absolutely essential condition – if the implementation of a UBI was the explicit result of state redistribution and if the redistribution measures are widely accepted by all powerful actors in the economy. This is basically unthinkable. For example, if the UBI were financed through higher VAT rates, this would clearly be inflationary, because companies would pass along the bulk of the higher taxes to customers. The consequences for those people relying fully on the UBI would be fatal. Their basic incomes would be insufficient for a decent living. Would the government then be obliged to step in and add conditional aid and social protection to the poorest?

Imagining that one can achieve a massive redistribution of income without triggering adverse reactions through the markets is a dangerous illusion. Picture a monthly UBI of about €1,000 a month for a country like Germany. With a population of about 80 million people, the German government would need roughly €800 billion to finance the UBI. This *additional* revenue is more than the current tax total revenue in Germany, which stands at about €700 billion. Implementing a UBI would thus require a *doubling* of the tax current level.

Some argue that the government would no longer pay social benefits and that the savings could be used to finance a UBI. But this is wrong. The government would indeed no longer be required to pay some €400 billion in social contributions, but it would also no longer receive social security contributions at a similar level. The social security systems in most countries, including Germany, have approximately balanced budgets. Some savings opportunities do exist, as the government normally subsidises pension systems, but the amounts are rather small given the overall burden of a UBI. On the other hand, totally unsolved is the question of health care. Health care contri-

<sup>5</sup> See e.g. H. Flassbeck: Lohn oder Kapital? – Teil 3, in: Makroskop, 14 June 2016, available at <https://makroskop.eu/2016/06/lohn-oder-kapital-teil-3/>.

butions could not be covered by a UBI of €1,000 without pushing those fully dependent on UBI back into poverty. Hence, health care would either remain in the realm of the government, involving expenses of 10-15% of today's GDP (roughly €300 billion), or a monthly UBI of €1,000 would clearly not be sufficient to allow for a decent and independent livelihood.

But even a UBI of €1,000 would destroy the pillars of the system we are used to living in. Doubling government revenue by doubling tax rates would trigger a distributive struggle the likes of which we have never seen before. The ratio of taxes to GDP in most highly developed economies today is close to 25%. To raise the level of taxes and other contributions to 50% would be a revolutionary act. This act, however, would come with the acknowledgement that this is explicitly being done to allow quite a few people to avoid contributing anything tangible to the fabric of our societies anymore. The outcry of those who are expected to contribute as much as or even more than before would be ferocious.

To be unmistakably clear: Given the distribution of power in our societies, it is preposterous to assert that the government would double its tax revenue without powerful groups – entrepreneurs, big companies and rich people – passing on the additional tax burden to customers and the powerless. It is cynical to talk about a UBI without talking about the distribution of power and the many different options available to powerful groups to avoid being taxed for this purpose. And if the powerful are indeed able

to avoid significant extra payments and receive a UBI nevertheless, the overall effects on the distribution of income may be catastrophic.

As said above, the most likely outcome is a spike in inflation, as an increase in the VAT rate will be the only tax measure accepted by the powerful groups. The negative effects of a bout of inflation on the distribution of income would fall on the poor and would immediately bring about a call for special and additional measure by the government to protect the poorest. Once that happens, Pandora's box will be open, and many will ask for conditional measures to correct the dismal outcome of an unconditional basic income on the distribution of income.

Overall, as with most tax law changes seen in recent decades, those with great political and economic power will inevitably gain, and those at the bottom will lose. Ultimately, the rich will find a way to profit from a basic income, to the detriment of the poor, thanks to the distributional effects of different types of state financing. It would be folly to call for a UBI without a detailed and sophisticated calculation of the distributive effects of its financing.

It is essential to have a clear and proper understanding of these issues. It is nothing but hocus pocus to avoid addressing financing issues in a serious manner and to present the UBI as a great remedy for the many ills of society. Those who spread such misinformation and illusions, offering false hope to so many people who will only be disappointed in the end, act irresponsibly.