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End of previous Forum article

Hilmar Schneider

Universal Basic Income – Empty Dreams of Paradise

One of the most essential arguments made by proponents of a universal basic income (UBI) is that it will ensure dignity and self-determination. More time could be spent on social engagement if less time had to be spent on securing one's own livelihood.¹ In short, a UBI would not only make us richer, but also happier.

¹ A recent overview of the arguments in favour of a universal basic income and the related empirical evidence can be found in R. Osterkamp: Fünf Streitfragen um das bedingungslose Grundeinkommen – unaufgeregt betrachtet, in: ifo Schnelldienst, Vol. 69, No. 21, 2016, pp. 26-35.

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False happiness promises

To envision this, we first have to stop asking ourselves how this could be financed. We also have to assume that there will be no adjustment reactions – price responses, tax evasion or mass immigration – that could shatter this dream.

This is easy if we pretend that a UBI is like winning the lottery, which is the analogy drawn by some proponents.² However, concluding that a UBI would have the same effects for everybody is the same sort of fallacy that makes people fall for Ponzi schemes. The prospect of winning seems to block critical thinking when it comes to imagining how a lottery in which everyone has a 100% likelihood of winning would

² See, for example, www.mein-grundeinkommen.de.

work.³ If the illusion of arbitrary scalability of individual earnings prevents a significant portion of the population, across all classes, from recognising that this is a scam due to the financing gap, it should not be surprising that people are equally receptive to a UBI's promises of winning. At least there is no reason to assume fraudulent intent. This may explain the widespread sympathy for the UBI concept. For example, during a referendum in June 2016, a fifth of the Swiss electorate voted in favour of introducing a UBI, although it seems likely that only a minority of these supporters would have been able to provide a consistent answer to the financing question.

Whether winning the lottery would actually make people as perpetually happy as they expect is also questionable. Numerous studies prove that the joy of winning is rather short-lived.⁴ In the long run, lottery winners' satisfaction with life is slightly higher than before winning, but much lower than people imagined before winning.⁵ What is known as the "joy of anticipation" is also referred to as impact bias in social psychology, and it constitutes one of the many cognitive distortions of human perception.⁶ The same applies to universal basic income.

False income promises

Undoubtedly, the most important question is how to pay for universal basic income. The answer depends largely on the details of how it will be provided. However, its proponents often prefer to remain silent on such fine points. The Swiss referendum is one of the few exceptions. It posed the question of whether every adult should receive a monthly contribution of 2,500 Swiss francs (€2,300) and every minor 625 Swiss francs

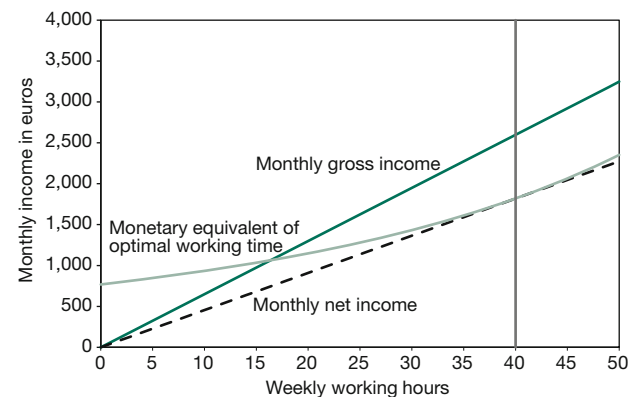
3 These are not isolated instances, and such thinking can essentially trigger mass movements. In 1997 scammers in Albania were able to convince a significant portion of the population to trust them with their money by promising incredible returns. When the bubble burst, massive unrest followed; see Zinsen aus der Kristallkugel, in: Der Spiegel, No. 6, 3 February 1997. The case of investment fraudster Bernie Madoff, whose false promises lured in over 50,000 investors, is also legendary; see e.g. Madoff köderte überwiegend Deutsche und US-Bürger, 14 May 2014, available at <http://www.spiegel.de/wirtschaft/service/bernard-madoff-betrueger-koederte-viele-deutsche-mit-schneeballsystem-a-969268.html>. The popularity of gifting clubs is also interesting to note in this respect; see e.g. C. Grotepass: Kettenbrief und Schenkkreis, available at <http://www.sekten-info-essen.de/texte/schenkkreis.htm>.

4 B.S. Frey, A. Stutzer: The Economics of Happiness – How the Economy and Institutions Affect Well-Being, Princeton 2010, Princeton University Press; and C. Lau, L. Kramer: Die Relativitätstheorie des Glücks: Über das Leben von Lottomillionären, Herbolzheim 2010, Centaurus Verlag und Media.

5 J. Gardner, A.J. Oswald: Money and Mental Wellbeing: A Longitudinal Study of Medium-Sized Lottery Wins, IZA DP No. 2233, July 2006.

6 T.D. Wilson, D. Gilbert: Affective Forecasting – Knowing What to Want, in: Current Directions in Psychological Science, Vol. 14, No. 3, 2005, pp. 131-134.

Figure 1
Status quo of working hours and income



Source: Author's depiction.

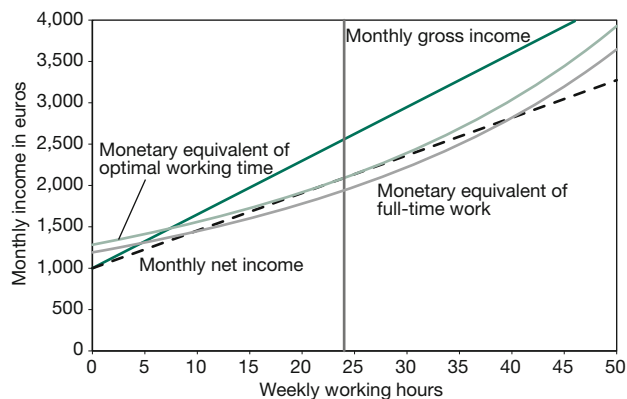
(€575).⁷ Even for wealthy Switzerland, financing such a programme would be a challenge that could only be met through drastic tax increases. Proponents therefore resorted to a euphemistic trick. They calculated that most Swiss citizens were already at this income level or above. Instead of raising income taxes and in return providing taxpayers with a UBI, they just decided that part of one's earnings would be reclassified as universal basic income.⁸ Income subject to the demanding conditions of actually working for it would thereby become UBI by declaration. Those affected can therefore hope to increase their subjective well-being by simply changing the label of their income.

One could also say that the pretention of increasing individual wealth was used in order to sell the introduction of a negative income tax. For the vast majority of the population, this would not produce any net gains, since the increased tax burden would more or less cancel out basic income. Top-level earners would witness drastic net income declines, since their tax burdens would be greater than their claims to basic income. The only beneficiaries would be low-income earners and welfare recipients. Their incomes would automatically be raised to the basic income level. Welfare recipients able to work would also no longer have to prove that they are trying to find work in order to maintain their benefit claims.

7 Basic Income Earth Network – Switzerland: Eidgenössische Volksinitiative «Für ein bedingungsloses Grundeinkommen», 10 December 2014, available at http://bien.ch/sites/bien/files/pdf/eidgenoessische_volksinitiative_fuer_ein_bedingungsloses_grundeinkommen_BI-ENch2014.pdf.

8 Ibid., p. 19: "128 billion – transfer from value-creation equal to the basic income of work-related income." (Author's translation) 128 billion Swiss francs make up approximately 2/3 of the entire financing need, and the description "transfer from value-creation equal to the basic income of work-related income" means nothing other than relabeling work-related income as universal basic income.

Figure 2
Income promises of universal basic income



Source: Author's depiction.

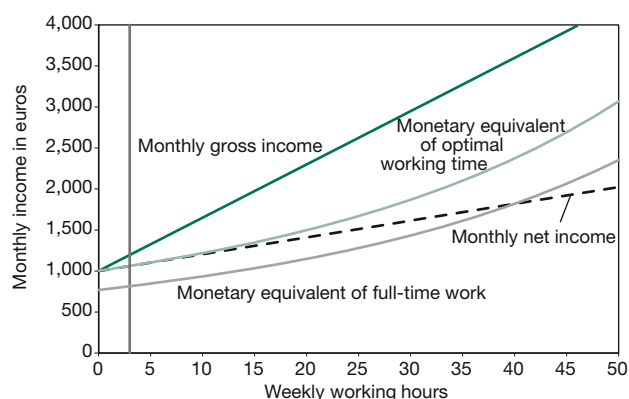
False incentives

The following charts illustrate the effects of a hypothetical monthly basic income of €1,000 in a stylised manner. Figure 1 shows the initial situation. Available net income increases with the number of monthly working hours, assuming an hourly wage of €15 and a tax and contribution rate of 30%. Every combination of income and working hours has a specific utility, though trade-offs should be considered. While additional income from additional hours worked produces positive benefits, the loss of leisure is a negative consequence. Optimal conditions are achieved when benefits through additional income are exactly balanced by the effects of loss of leisure. In Figure 1, this occurs at 40 working hours per week. The curved line is an indifference curve that includes all points that create the same utility for the combination of income and leisure as the optimal working hours.

Figure 2 demonstrates the effects of introducing a UBI of €1,000 per month. The lines for gross and net income shift upwards in parallel, i.e. financing needs are not included. Benefits increase greatly compared to the initial situation. However, optimal working hours shift to the left, i.e. it becomes beneficial to work less than before. This is represented in the figure by the indifference curve for optimal working hours (24 hours per week in the example) lying above the indifference curve for full-time employment. This is due to the so-called income effect that results from the declining marginally added utility of each additional euro as one's income grows. In other words, the more income one already has, the lower the benefits of additional income.

But if we consider the financing needs of UBI – for example, by increasing income taxes – the net income curve flattens dramatically. Figure 3 shows a case that results in the same

Figure 3
Income developments in light of financing needs



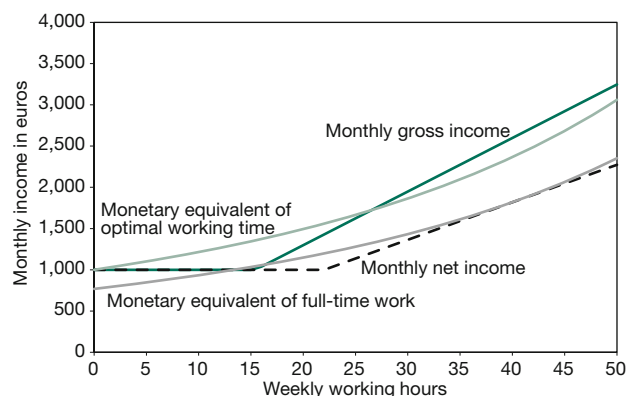
Source: Author's depiction.

net income for a full-time employee as under the status quo, i.e. additional taxes are as high for full-time employment as for UBI. Changes to income would occur anyway through changes to behaviour. This is because the flattening of the net income curve reduces the benefits of additional income in relation to hours worked so strongly that working full-time is no longer beneficial. The optimal number of working hours is now close to zero for income slightly above the UBI level. Financing needs would increase to the same extent to which such behavioural changes would occur, since people who do not work also do not pay taxes.

UBI proponents do take this argument seriously. This is why “experiments” are made that are supposed to demonstrate empirically that people would not or would only insignificantly reduce their working hours after the introduction of a UBI. However, these experiments do not reflect the situation in Figure 3 but rather, at best, the situation in Figure 2. These experiments are financed “externally”, and as such, the incentives for earning more than the UBI remain attractive because there is no necessity for internal financing. Furthermore, these experiments always cover temporary periods. People might therefore not quit their jobs just because they receive greater income temporarily, since they would risk longer unemployment after the experiment ends.

To avoid a counterproductive redistribution requirement, some UBI proponents call for a negative income tax. This is supposed to reduce the financing requirement for the needy and thereby generate only moderate cost increases compared to the status quo. The resulting income curves are shown in Figure 4 which, for simplification, assumes the same tax and contribution rate as under the status quo. However, this scenario also results in strong incentives to stop working. As in the previous example, the benefits of full-time employment are far lower than the benefits of not working. This alter-

Figure 4
Universal basic income in the form of a negative income tax



Source: Author's depiction.

native would therefore create tremendous funding needs due to the state revenue lost through such behavioural changes.

In addition, a negative income tax may not prove very effective with regard to targeting the group of people in need. Not everybody with no or low income is necessarily needy according to welfare considerations, which are typically based on households. For example, from this household point of view, non-employed spouses, students or trainees living in households with incomes above the social minimum must not be regarded as needy. However, the UBI conceptually refers to individuals instead of households. A negative income tax that followed the UBI's logic would also define eligibility with regard to individual income and would therefore inevitably result in additional financing needs. Coupled with the decline in revenue from working less, this would force the monthly net income curve to the right of the kink point in Figure 4 to flatten, which would make the negative behavioural effects even more likely than depicted there.

Simulations confirm the relevance of deficiencies with regard to financing and disincentives. This is also the key argument against a UBI put forward by Colombino.⁹ The German Council of Economic Experts addressed the subject in its 2007-08 annual report and estimated a financial gap of €227 billion for the so-called Althaus model,¹⁰ although this model comes with only a moderate level of basic income.¹¹ Similar estima-

9 U. Colombino: Is unconditional basic income a viable alternative to other social welfare measures?, IZA World of Labor, No. 128, 2015, available at <https://wol.iza.org/articles/is-unconditional-basic-income-viable-alternative-to-other-social-welfare-measures/long>.

10 Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung: Das Erreichte nicht verspielen – Jahresgutachten 2007/08, Wiesbaden 2007.

11 D. Althaus: Das Solidarische Bürgergeld, in: M. Borchard (ed.): Das Solidarische Bürgergeld – Analysen einer Reformidee, Stuttgart 2007, Lucius&Lucius, pp. 2-12.

tions were presented by Bonin and Schneider and Fuest et al.¹² Part of the financial gap results from the fact that the Althaus model also foresees a drastic tax reduction on top of introducing a basic income. However, according to the estimations of Bonin and Schneider, almost half of the overall impact is due to behavioural effects.¹³

In addition to the incentive issues described here, there are more problems which are likely to be expected beyond those considered in the above simulations. For example, price reactions are likely if nobody can be found who is willing to perform low-wage labour. Wages for such work would have to be higher than under the status quo. Although UBI proponents see this development in a positive light, it would actually lead to a worsening of the real income situation of households, since the accompanying wage increases would be reflected in rising consumer prices.

Conversely, if for some reason the wages for these types of jobs did not rise, the UBI would dissuade workers from performing them. Consequently, households would be forced to spend their own time on tasks they would otherwise pay other people to do, such as housework or food preparation. In both cases, these households would be worse off than before, because they would either have to spend additional money or additional time to get what they used to have.

Due to the increased tax burden, the UBI would increase incentives for illegal employment and create even more financing needs. Furthermore, a UBI would destroy incentives for investing in one's education. Not only would it lead to increased unemployment among unskilled workers, but it would also enlarge the group of workers with low qualifications.

Finally, a UBI would serve as a tremendous pull factor for immigration, which would consequently increase financing needs even further.

False arguments

Prominent UBI proponents, such as the chairman of Siemens, argue that digitalisation will not provide enough jobs for everybody in the future.¹⁴ A significant number of business

12 H. Bonin, H. Schneider: Beschäftigungswirkungen und fiskalische Effekte einer Einführung des Solidarischen Bürgergeldes, Institute of Labor Economics (IZA), 2007, available at www.iza.org/files/IZA-Berechnungen_Althaus-Modell.pdf; and C. Fuest, A. Peichl, T. Schäfer: Beschäftigungs- und Finanzierungswirkungen des Bürgergeldkonzepts von Dieter Althaus, in: ifo Schnelldienst, Vol. 60, No. 10, 2007, pp. 36-40.

13 H. Bonin, H. Schneider, op. cit.

14 M. Hägler: Siemens-Chef plädiert für ein Grundeinkommen, Süddeutsche Zeitung, 20 November 2016, available at <http://www.sueddeutsche.de/wirtschaft/sz-wirtschaftsgipfel-siemens-chef-plaediert-fuer-ein-grundeinkommen-1.3257958>.

representatives at the 2016 World Economic Forum in Davos also supported this view.¹⁵

However, there is no empirical basis for this argument. Technological change has accompanied mankind since well before the introduction of computers and the internet. Although it is true that technological progress has destroyed jobs, it has never led to an overall decrease in employment, but merely to structural changes in employment. Why this should be any different under digitalisation has not been convincingly explained yet. In the long run, any work that can be registered through sensors and that follows processing rules can be performed by machines. However, this does not mean that humans will become superfluous. It only means that people will focus on whatever it is that machines cannot do in the foreseeable future. This especially concerns activities involving creativity or social interaction. Although the proliferation of the terms “artificial intelligence” and “machine learning” suggest that, soon, there will be no place left for human capabilities, this is only because the terms are being used incorrectly. Intelligence, in this sense, means nothing more than increased storage capacity. And machine learning is, likewise, nothing more than a label for purely syntax-bound heuristic applications. This has nothing to do with intelligence or meaningful understanding.

The fallacy of a one-sided focus on jobs lost to technology is based on an asymmetric perception. While the activities that will become superfluous due to technological advances can be stated fairly precisely, human imagination fails when it comes to envisioning the activities and needs that could be

15 P. Krohn: Auf einmal reden alle vom Grundeinkommen, Frankfurter Allgemeine Zeitung, 6 February 2016, available at <http://www.faz.net/aktuell/wirtschaft/wirtschaftspolitik/nach-davos-diskutieren-wieder-alle-ein-bedingungsloses-grundeinkommen-14052661.html>.

created by freeing up resources. The fact that today’s teenagers cannot imagine life without the internet is but one example of such developments. Prior to the introduction of the internet, not even experts were able to predict the revolutionary changes it would bring to consumer and communicative behaviour. For example, the 1995 assessment by Bill Gates that the internet was “just a passing fad” is legendary (though possibly apocryphal).

Conclusion

In conclusion, it can be said that neither the internal nor the external logic for a UBI proves to be convincing. The described unpredictability and the unintended side effects make a UBI an immense risk to society that can only be managed if the costs of such a redistribution remain low. However, this would counteract an essential claim of its proponents. If the UBI is not high enough to replace welfare as it exists, it would not produce enough benefits, such as those that could be achieved through eliminating existing welfare institutions, e.g. pension insurance, unemployment insurance and municipal welfare. If the introduction of a UBI made conditions worse than under the status quo for a significant number of recipients, additional structures would have to be created to administer it without eliminating the existing welfare institutions.

The challenges associated with technological advancement consist of supporting people in actively meeting these changes, not in forcing them to be passive. The wealth of a society is created by allowing people to do what they do best. Achieving optimal resource allocation is one of the greatest challenges of every society. A UBI therefore offers the wrong incentives and tends to promote collective poverty, not only materially but also subjectively.