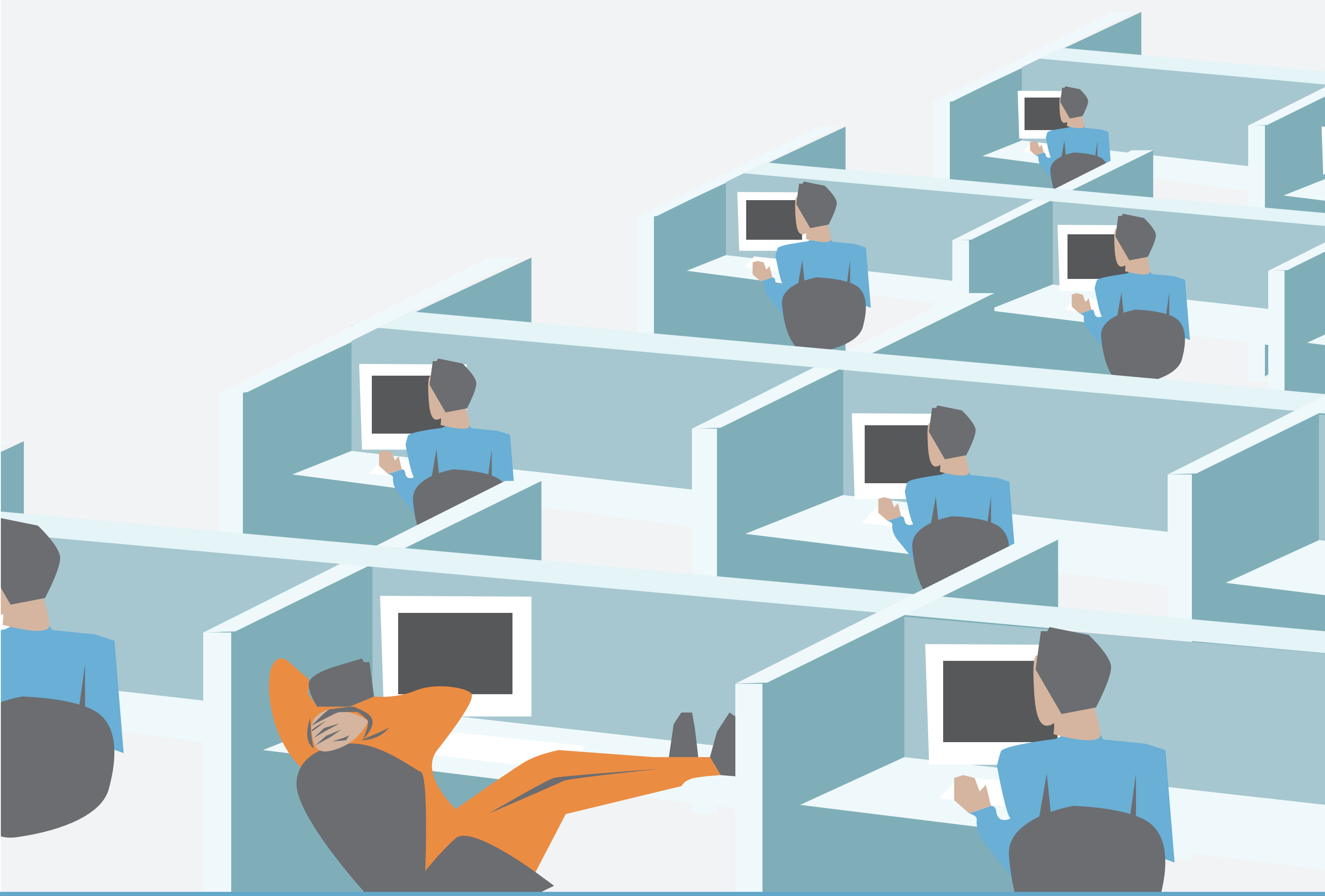
MONEY FOR ALL:

THE WINNERS AND LOSERS FROM A UNIVERSAL BASIC INCOME

JIM ROSE - MARCH 2016



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AUTHOR

Jim Rose is a Research Fellow at the New Zealand Taxpayers' Union and has worked at the Ministry of Business, Innovation and Employment, the Department of Labour, the Ministry of Social Development, and the New Zealand Treasury. In Australia he has worked in Canberra for the Productivity Commission, the Department of Prime Minister and Cabinet, and the Department of Finance.

Jim has Masters degrees in economics and in public policy from the Australian National University and from the National Graduate Institute for Policy Studies in Tokyo respectively. He blogs at www.utopiayouarestandinginit.com.

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Abstract

Any evaluation of a Universal Basic Income must consider how much taxes must increase in order to fund it.

A Universal Basic Income will benefit a large number of people, except those whom the modern welfare state was founded to protect. Substantial increases in taxes on income and investment are required for current beneficiaries and retirees to break even from the introduction of a Universal Basic Income. In order for the most vulnerable in society to be no worse off under a Universal Basic Income, it would need to be at least $15,000 per year – 36% higher than the $11,000 proposed by the Morgan Foundation and the Labour Party.

Any evaluation of a Universal Basic Income must consider how much taxes must increase in order to fund it. In order to pay for a Universal Basic Income at a level where those most vulnerable are no worse off, either a massive new tax on investment and capital is required or the Government would have to introduce a flat rate income tax as high as 50%.

New Zealand already has a guaranteed minimum family income for the working poor. The minimum family tax credit ensures that family incomes do not fall below $23,036 per year after tax. This guaranteed minimum family income is twice as generous as the proposals of the Morgan Foundation and the Labour Party.

Similarly, New Zealand already has a Universal Basic Income for those over the age of 65 by way of New Zealand Superannuation. Variation of the eligibility age of New Zealand Superannuation down to 60 and back to 65 suggests that a Universal Basic Income would have a large labour supply effect. According to a Treasury estimate, a Universal Basic Income would result in as much as a 20% reduction in labour supply for workers aged 60 to 64.

As expressed to varying degrees by nearly all political parties represented in Parliament, New Zealand is already struggling to fund current superannuation entitlement for retirees. Raising taxes to fund payments to people who are not deemed in need by the current wel-fare system is a fundamental shift in terms of priorities in social insurance. It is also inconsistent with the very concerns those promoting a Universal Basic Income have publicly expressed about the age of entitlement of New Zealand Superannuation.

A fiscal crisis is looming for both the eligibility age of New Zealand Superannuation and health spending because of an ageing society and the retirement of the baby boomers. It appears a Universal Basic Income would not be the highest priority for spending even if there is a political appetite for higher taxes to fund such a large additional social spend.

1. Introduction

The Labour Party is the first major political party to express an interest in a Universal Basic Income. A background paper (Harris and Bierema 2016) has been released as part of the Party's *Future of Work* project.

The Morgan Foundation[1] has published considerable material including a book setting out in detail the case for a Universal Basic Income and how it could be funded with higher taxes. The Foundation even has an online tool that allows users to design their own Universal Basic Income and work out its costs and how to fund it with new or higher taxes.[2] There is growing interest in a Universal Basic Income abroad including a referendum later this year in Switzerland.

This paper explores the implications and merits of a Universal Basic Income and responds to the Labour Party's paper and Morgan Foundation's modeling. The purpose is to outline the implications from the perspective of the taxpayers who would have to pay new or increased taxes.

We do not see any plausible scenario where the introduction of a Universal Basic Income would not require substantial increases in taxes. The purpose of a guaranteed minimum income is to replace existing welfare benefits. To fund those on welfare benefits even at the basic level as well as extend a Universal Basic Income to those who don't currently qualify for welfare payments would require much more than is currently spent by the Government on income support.

A Universal Basic Income is unlikely to offer value for money for taxpayers. While many will gain, those left worse off are the very people most in need of government assistance. It appears that the implications of much higher taxes on economic growth, living standards and reduced after-tax incomes have not been considered in the proposals put forward. If the political support is there for a great big new tax, is a Universal Basic Income first cab off the rank for that new revenue stream? We are doubtful.

A Universal Basic Income is unlikely to offer value for money for the taxpayers.

1 Morgan Foundation, *The Big Kahuna - Tax and Welfare* at http://www.bigkahuna.org.nz/
2 Morgan Foundation, *The Big Kahuna - Tax and Welfare* at http://www.bigkahuna.org.nz/calculator/finance-minister.aspx

2. What is a Universal Basic Income?

THE CASE FOR THE NEGATIVE INCOME TAX IS THAT IT IMPROVES WORK INCENTIVES, REDUCES BUREAUCRACY, ELIMINATES A MULTIPLICITY OF OVERLAPPING PROGRAMS AND TARGETS BENEFITS ON THE POOR.

2.1 Negative income taxes

The idea of a guaranteed minimum income has a long history. Generally, it involves applying a higher marginal tax rate, or surcharge, paid until the 'guaranteed minimum income' is fully abated against any income. It results in very high marginal tax rates for low income earners, in order to avoid the middle class from benefiting from the income support and the enormous expense this might involve.

In 1946 George Stigler proposed a negative income tax as an alternative to increasing the minimum wage to address poverty. Friedrich Hayek supported the idea in the *Constitution of Liberty* (1960). Milton Friedman championed the idea in *Capitalism and Freedom* (1962). The negative income tax replaces existing welfare benefits with a payment that is abated at a rate of 50% when income is earned.

President Nixon proposed a guaranteed minimum family income plan in 1969 to replace the Aid to Families with Dependent Children (AIDC) scheme at the behest of future Senator Daniel Patrick Moynihan. This was based on the negative income tax proposals of Friedman and Stigler. Nixon's plan passed in the US House of Representatives but not the Senate after 3 years of political infighting.

In 1987, then New Zealand Labour Finance Minister Roger Douglas announced a Guaranteed Minimum Family Income Scheme to accompany a new 22% flat income tax. The idea did not go ahead due to the subsequent conflict within that Government.

The original support for negative income taxes from Friedman and Stigler was born of the notion that bureaucracies are poor at adequately screening, categorising and tagging welfare claimants. The case for the negative income tax is that it improves work incentives, reduces bureaucracy, eliminates a multiplicity of overlapping programs and targets benefits on the poor.

The existing system of benefits for those out of work, single mothers, the sick or invalid are all examples of screening, categorising and tagging of welfare claimants. The tagging is based on relatively coarse screening devices such as job loss, sole parenthood and medical grounds. Akerlof (1978) noted that the truly needy—those with low job skills who have extreme difficulty in becoming employed—can be partly identified by some measurable, observable characteristic, which he called "tagging the poor". Some combination of indications of poor health, low levels of education and spotty employment histories might be indicators of low job skills. Depending on whether the welfare tag is job loss, sole parenthood, sickness or invalidity, different abatement regimes, benefit levels and work tests apply. ACC is another example of tagging with the screening based on accidental injury.

Negative income taxes were proposed as an administratively simple welfare reform to give adequate income support to the low paid, out of work and unable to work, while still providing reasonable work incentives. The negative income tax was intended to replace existing welfare benefits. A Universal Basic Income has the same goal: replacing existing welfare benefits.

2.2 Family in-work tax credits

The modern incarnations of negative income taxes manifest as in-work family tax credits to reduce poverty among the working poor. *Working for Families* payments are contingent on working a minimum number of hours per week with the credits abated quickly (at low income thresholds) depending on the recipient's family size.

In-work tax credits were introduced in many countries including New Zealand to encourage movement into employment by breadwinners. By linking a large payment with full-time and semi-full-time work, the rewards for working are increased for single parents and families.

2.3 A Universal Basic Income

A Universal Basic Income is fundamentally different from a negative income tax and its progeny such as the *Working for Families* in-work tax credit. There is no means test to phase out the guaranteed minimum income. Under a negative income tax, recipients face a very a high marginal tax rate (often 50% or more) to quickly reduce the payment once income is earned.

Under a Universal Basic Income, there is no abatement if the recipient earns income. They pay the same taxes as everybody else, which under the Morgan Foundation's proposal is a flat tax on incomes of 30%. An important rationale for this absence of any abatement of the Universal Basic Income on income earned is that this income testing stigmatises recipients. By giving the guaranteed minimum income to everyone, rich or poor, free of any conditions, there is supposed to be less stigma on the poor from relying upon government for income support.

In a nutshell, a Universal Basic Income is not *Working for Families* on a larger scale. *Working for Families* is contingent on working and is heavily income tested. A Universal Basic Income is the opposite of that. A Universal Basic Income is paid to any member of society, be they unemployed, invalid, a single mother, a married mother living with a primary earner, part-time workers, students, a retiree, anyone. The unconditional nature of the payment to every adult in society is why it is so expensive.

There is no escaping the need for a large tax increase to fund a Universal Basic Income. Any serious discussion of a Universal Basic Income must be upfront about that. The Morgan Foundation deserves acknowledgement for its frankness about this. The Foundation has an online tool which allows the public to know exactly how much it costs and what new taxes are required. The Labour Party refers to the Morgan Foundation costings in its own background paper, but does not replicate any of the figures.

There is no escaping the need for a large tax increase to fund a Universal Basic Income.

2.4 The minimum family tax credit

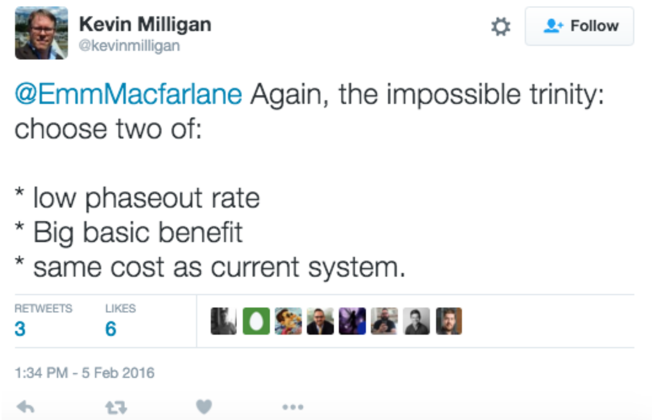
The other consideration in proposing a Universal Basic Income is New Zealand already has a guaranteed minimum family income. The minimum family tax credit ensures that a family's income after tax does not fall below $23,036 a year ($443 per week). To qualify for this part of *Working for Families*, a parent must work at least 30 hours each week as a couple, or 20 hours per week as a single parent (IRD 2015).

This guaranteed minimum family income is twice as generous as the proposals by the Morgan Foundation and the ideas being promoted for discussion by the Labour Party. A Universal Basic Income would replace this minimum family tax credit to the working poor and would be vastly more expensive.

3 Who gains and who loses?

3.1 Milligan's Impossible Trinity

The Canadian economist Kevin Milligan summarised the policy dilemmas surrounding a Universal Basic Income in a single Tweet:



It is impossible to design a generous basic income with a low phase out rate that does not increase poverty among beneficiaries and the retired without a large amount of new revenue – either drastic cuts to other areas of government spending or substantially higher taxes.

3.2 The Morgan Foundation Universal Basic Income

The Morgan Foundation proposes a Universal Basic Income of $11,000 per year for every adult and replacing all other benefits including New Zealand Superannuation. It proposes that this be funded by a flat income tax rate of 30% on all income (personal income and company taxes).

To fill in the funding gap of a Universal Basic Income of about $10 billion, the Morgan Foundation proposes a new comprehensive capital tax. This would tax capital (excluding financial assets) equal to the income tax that would apply if the capital earned a constant rate of return of 6%. That is the Morgan Foundation's great big new tax – the sting in the tail to pay for the Universal Basic Income.

The proposal of the Morgan Foundation opts for a low phase-out rate and a big basic benefit. The proposal would cost $10 billion more than the current welfare system.

The Labour Party simply floats a series of proposals ranging from the Morgan Foundation proposal (which it regards as insufficient because it will increase poverty among beneficiaries and retirees) to a Universal Basic Income which is in addition to any benefits received from the existing welfare schemes.

The Labour Party background paper neither discusses in any detail what extra taxes might be imposed nor their implications for labour supply, investment, entrepreneurship and growth. Taxpayers need to know those implications in any consideration of a Universal Basic Income. Without understanding those costs, the Labour Party's *Future of Work* project risks becoming a wish-list exercise, rather than a serious discussion of what public policy ideas are best for New Zealand's future economy.

The Morgan proposal would cost $10 billion more than the current welfare system.

3.3 Who gains?

The Morgan Foundation's Universal Basic Income of $11,000 for adults makes most better off by about a hundred dollars per week, except those for whom the modern welfare state was established to protect. The Morgan Foundation[3] is upfront about beneficiaries being worse off:

> *With an unconditional basic income, most beneficiaries would be no better off than they are now (in fact sole parents would almost certainly receive a lower benefit).*
>
> *However, they would no longer face the poverty trap, and would be rewarded for returning to work – no matter how much they did. No longer would they lose the benefit when they started earning income. They would be able to keep every dollar they earn, paying only the same tax rate as everyone else.*
>
> *Also beneficiaries would no longer face eligibility criteria that depended on their life choices. Who they live with, how many children they have – would all be up to their personal choice, not the government.*[4]

Single parents are $150 a week worse off and retirees are $50 worse off per week if their current income support was replaced by a Universal Basic Income of $11,000 per adult. Both are entitled to much more under the current welfare benefit system and New Zealand Superannuation respectively. Unemployment, sickness and invalid beneficiaries are about 5% better off under a Universal Basic Income. Labour's background paper described a Universal Basic Income of $11,000 as not enough.

3 Simmons (2015) – available at http://morganfoundation.org.nz/ten-types-of-people-who-would-be-better-off-with-an-unconditional-basic-income/.
4 ibid

3.4 Treasury modelling of a guaranteed minimum income

The New Zealand Treasury (2010) modelled the cost of a guaranteed minimum income (GMI) for the Welfare Working Group. Table 1 shows that a guaranteed minimum income of $300 per week – the mean benefit income among those on benefits – would cost $44.5 billion or $52.6 billion if a Universal Basic Income replaced New Zealand Superannuation. The former could be covered by a flat personal income tax rate of 45.4%; the latter, 48.6%[5]. Full fiscal neutrality[6] requires tax rates of 50.6% and 54.4%.

Table 1: Fiscal Cost and Tax Rates under Treasury Modelling

Fiscal Cost ($m)	GMI $15,000 with status quo settings for New Zealand Superannuation retained	GMI $15,000 and no New Zealand Superannuation	GMI $15,000, no New Zealand Superannuation but Working for Families replaced with a payment of $86 per child per week
GMI Cost	$44,463	$52,638	$52,638
Total Social Transfers	$55,537	$55,458	$57,054
Personal Tax Rates Required			
Cost-neutral Tax Rate	45.4%	48.6%	50%
Fiscally-neutral Tax Rate	50.6%	54.3%	55.7%

Source: New Zealand Treasury (2010).

Most parents receive *Working for Families*. Table 1 shows that compensating families for their loss of *Working for Families* tax credit with a $86 per child per week payment raises the fiscal cost of a guaranteed minimum income to $57.1 billion, with a personal tax rate of 50% (or 55.7% for fiscal neutrality). Treasury noted that many beneficiaries (including the disabled, carers and sole parents) currently receive more than $300 per week and would be made financially worse off under a Universal Basic Income scheme even as high as $15,000 per year.

It was necessary for the Morgan Foundation to propose a new comprehensive tax on income from capital to keep its flat rate income tax within acceptable levels (they chose 30%). That is still near double the marginal tax rate that the majority of New Zealanders face, which is 17.5%. The Morgan Foundation's comprehensive capital tax does not exempt the family home, including those of cash-flow poor retirees.

5 These are based on cost neutrality - where social assistance payments are fully funded by personal tax revenue.
6 Where Government revenue is increased by the same amount as the increased expenditure.

3.5 Who loses?

Whatever the benefits of a Universal Basic Income might be, it is not an answer to family poverty.

The Universal Basic Income and a new comprehensive capital tax would cause great upheaval but struggles to make the most vulnerable groups in society even break-even. Brian Easton (2015) put it well when he said:

> *Many advocates put the UMI forward without doing the sums. Those who do, find that the required tax rates are horrendous or the minimum income is so low that it is not a viable means of eliminating poverty. Among the latter are New Zealanders Douglas, Gareth Morgan and Keith Rankin.*

Easton (2015) summarised who loses from a Universal Basic Income that is anything less than extraordinarily expensive: the poor and those down on their luck. These are the very people for whom the modern welfare state was founded. Whatever the benefits of a Universal Basic Income might be, it is not an answer to family poverty.

3.6 Why pilot a bad idea?

The Labour Party suggested that one way of going forward with a Universal Basic Income is having a trial in a small town of New Zealand. What would this adventure with taxpayers' money tell us that we do not already know from randomised trials of negative income taxes in the USA?

The Labour Party's own background paper accurately summarises these overseas experiments with negative income taxes. Men reduce their working hours by an average of 7% and women by 17%.

Plenty is known about the labour supply effects of windfalls in income. There have been studies of everything from lottery winners to changes in the generosity and availability of welfare benefits, old-age pensions, and in-work family tax credits (Cahuc and Zylberberg 2006; Van Ours and Boeri 2013).

In addition, paying a Universal Basic Income to a particular geographical area, without the corresponding changes to the tax system, would result in an enormous and unjustified cross-subsidisation from the general taxpayer into the particular area.

3.7 The labour supply effects of a Universal Basic Income

One of the many drawbacks of the Universal Basic Income is it will induce the recipients to cut back on their labour supply. There are studies of this labour supply effect, known as the income effect, through the study of what happens when people win the lottery. These studies of lottery winners speak to the labour supply effects of a Universal Basic Income because they review windfall increases in income of a diverse range of people. There are no special tax or abatement if the lottery winner earns more income.

A recent study on the labour supply effects of winning the Swedish lottery had a sample of several million lottery winners over 5 to 10 years. Cesarini et al (2016) found that in common with a previous study of the labour supply of lottery winners, after their win there were *"modest reductions in labour earnings suggesting every dollar of universal basic income would reduce labour earnings by roughly $0.11."*

This new research also found productivity losses of $1.40 for every hundred dollars of lottery winnings and that the partners of lottery winners cut back on their labour supplies as well. Taking all these labour supply effects into account, Cesarini et al (2016) concluded that:

> *...every dollar won in a lottery reduces lifetime after-tax labour earnings of winners by $0.10-$0.20.*

There is an example of what happens when a Universal Basic Income is introduced in New Zealand when the eligibility age for New Zealand Superannuation was lowered to the age of 60 in 1977 and slowly increased back to the age of 65 from 1992. The amount paid in New Zealand Superannuation to workers between the age of 60 and 65 is similar to the current proposals for a Universal Basic Income.

The whole point of Sir Robert Muldoon's fist full of superannuation dollars in the 1975 general election was to buy votes by promising an earlier retirement at the taxpayers' expense. There were large changes in the supply of labour of older workers when the eligibility age was lower and raised:

> *...in 1991 NZS eligibility was set at age 60. This model suggests that if the eligibility age had in fact been 65 at that time, the labour force participation rates of 60-64 year old males and females in 1991 would each have been about 21 percentage points higher (Hurnard 2005).*

A leading rationale for increasing the eligibility age of old age pensions in New Zealand and abroad is a significant number of older people will stay in the workforce. Any suggestions by the Labour Party that a Universal Basic Income will increase labour supply rather than reduce it contradicts its recently discarded policy to increase the eligibility age for New Zealand Superannuation. Such policies are premised on a significant labour supply effect.

A Universal Basic Income would push the New Zealand economy into recession off the back of the reduced labour supply from the windfall increase in incomes alone.

3.8 Large tax rises cause recessions and stagnation

A Universal Basic Income would push the New Zealand economy into recession off the back of the reduced labour supply from the windfall increase in incomes alone. Labour supply would be reduced further among lower paid workers because of an increase of their marginal tax rate from 17.5% to 30% (based on the Morgan Foundation model). As an example of the power of higher income taxes to depress an economy, Americans aged 15 to 64 currently work 50% more than do the French (Prescott 2002, 2004; Rogerson 2010). In 1974, the French worked more hours than Americans. Over the next decades, France raised taxes on income from labour by a 1/3rd so French labour supply dropped by 1/3rd (Prescott 2002, 2004). In consequence, in the 1980s French per capita GDP stopped catching up with GDP per capita in the USA.

That recession from the incentive effects of a Universal Basic Income on labour supply would be in addition to the negative productivity shock pushing the economy down further from a huge increase in the taxes on capital — one of the most inefficient forms of taxation. As an example of the damaging effect of capital taxes, Britain, but not the USA, repaid much of its war expenses through immediately raising taxes on capital. This is rather than issuing debt and repaying smoothly over a much longer time as was the case in the USA. These much higher taxes on capital and investment were an important factor behind Britain's poorer economic performance after the Second World War (Cooley and Ohanian 1997).

3.9 Is the optimal rate of tax on income from capital 30%?

The most prominent new result from dynamic models of optimal taxation is taxes on capital income should be avoided (Mankiw, Weinzierl and Yagan 2009, Auerbach and Hassett 2015; Piketty and Saez 2012). That an optimal tax system imposes much lower taxes on capital income than wages builds on the undisputed finding that who pays a tax is not necessarily the writer of the cheque to IRD. Any tax that changes prices and outputs shifts part of the tax to buyers and/or suppliers including workers.

The main effect of a higher tax on income from capital is that investment is likely to be much less. This would almost certainly result in lower wages because New Zealand workers would have less capital and technology to work with, and thus be less productive. This warning against new taxes on income from capital because it will reduce future investment applies especially in a globalised economy.

Investors move their capital and production away from those countries that impose high company taxes to places with lower corporate income tax rates. A meta-analysis of the literature by De Mooij and Ederveen (2008) suggests that a 10 percentage-point reduction in a country's effective average company tax rate increases its stock of foreign direct investment by 30%. Investors respond to lower taxes.

No Minister of Finance welcomes cuts in the company tax of rival investment destinations. Ireland was relentlessly pressured by the European Union because its 12.5% company tax was attracting more investment. The many attempts at tax harmonisation by the European Union were motivated by the fear of large capital flows into lower tax jurisdictions such as Ireland. Corporate tax rate cuts have become a major issue in USA because of capital flight, corporate inversions and the retention of profits offshore.

Fehr et. al. (2013) estimated that the real wages of American workers would rise by 12% if its corporate income tax was eliminated. The capital stock would increase by one-fourth, with most of the added investment from capital inflows. Reducing the 35% U.S corporate tax to 9% instead by eliminating existing loopholes would increase wages by 6% in the short run and 9% in the long run. The U.S. capital stock would increase 17% in the short run and 30% by 2040.

The large tax increases on income from capital required to fund a Universal Basic Income, such as that proposed by the Morgan Foundation, disregard both these lessons of dynamic optimal tax theory and the constitutional political economy of efficient taxes and the size of the public sector.

3.10 Efficient taxes and the size of government

Efficient taxes gather more revenue and are capable of funding a larger public sector with less political resistance from the groups who are net taxpayers. A switch to more efficient taxes through tax reforms allows governments to raise the same, or larger, amounts of revenue for the same level of political resistance from taxpayers. Less revenue and output is wasted by discouraging labour supply, investment, savings and investment with high marginal rates of tax on a narrower tax base. Everyone gains from converging on more efficient modes of redistribution. The tax reforms of the 1980s saved the welfare state by putting it on a revenue raising structure that provoked less political resistance.

3.11 The Nordic welfare states survive through optimal taxation of labour and capital

The Nordic countries have been conscious of optimal tax theory when expanding the size of their welfare states. The Nordics have high but flat taxes on labour income, low taxes on business income and a high, broad-based consumption tax. Business taxes are a less reliable source of revenue because of capital flight and disincentives to invest. Thus, the Nordics do not place above-average tax burdens on capital income, and focus taxation on labour and consumption. The Morgan Foundation proposes increasing the company tax to 30% making New Zealand's one of the highest in the world.

Company taxes are relatively low in Scandinavian countries as compared to the USA so that businesses do not flee to other jurisdictions. Top marginal tax rates on dividends and capital gains are not above average in the Nordic states but their taxes on less mobile tax bases, such as from labour and consumption, are much higher. A large welfare state, such as those in the Nordic countries, requires a significant amount of revenue, so the tax base in these countries must be broad. This also means higher taxes on consumption through the VAT or GST and higher taxes on middle-income taxpayers.

3.12 Is a Universal Basic Income worth the upheaval?

Neither the Labour Party nor Morgan Foundation can escape Milligan's trinity. A Universal Basic Income that no more than breaks-even for those currently relying on the benefit system or New Zealand Superannuation would require a tax increase much larger than anything previously seen in New Zealand. That is just to ensure the less fortunate break-even on replacing a targeted welfare state with a Universal Basic Income. The less fortunate will then live in New Zealand where labour supply, investment, entrepreneurship and wages growth are stifled but they receive no more from government.

A Universal Basic Income that no more than breaks-even for those currently relying on the benefit system or New Zealand Superannuation would require a tax increase much larger than anything previously seen in New Zealand.

4 Why a great big new tax?

4.1 When is tax reform popular with a swinging voter?

Proposals for a Universal Basic Income funded by comprehensive capital tax make much less sense than the proposal by the Green Party, which is to give the in-work family tax credit of $60 per week to those on a welfare benefit. It appears that the Morgan Foundation's solution to child poverty is to give billions of dollars to those not in poverty and leave those on the benefit no better off. It is obvious which is more likely to attract political support and provoke resistance that political parties will court.

Government spending grew in many countries in the mid twentieth century because of demographic shifts, more efficient taxes, more efficient spending, a shift in the political power from those taxed to those subsidised (especially the elderly), shifts in political power among taxed groups, and shifts in political power among subsidised groups. Sam Peltzman argues that:

> *governments grow where groups which share a common interest in that growth and can perceive and articulate that interest become more numerous.*

Governments grew in the developed countries after the Second World War because of an emergence of a middle-class big enough and rich enough to articulate a demand for social insurance at the ballot box.

The median (or swing) voter, who was a middle-class voter, was sensitive to the power of incentives and to not killing the goose that laid the golden egg. After 1980, the taxed, regulated and subsidised groups had an increased incentive to converge on new lower cost modes of redistribution. More efficient taxes, more efficient spending, light handed regulation, and a more efficient state sector reduced the burden of taxes on the taxed groups, many of whom were also the middle-class. Most subsidised groups benefited as well because their needs were met in ways that provoked less political opposition from taxpayers.

Becker and Mulligan (2003) concluded that flatter and broader taxes encourage bigger governments. This is because taxpayers offer less resistance to increases in flat tax rates than to more onerous and less efficient forms of taxation. A switch to more efficient taxes through tax reforms allows governments to raise the same, or larger, amount of revenue for the same level of political resistance from taxpayers. This is because less revenue and output is wasted by discouraging labour supply, savings and investment in capital with high marginal rates of tax on narrower tax basis.

From 1950 to 1980 the size of government doubled in the developed world and then stopped growing. This great restraint on the growth of government happened everywhere. It was not just Thatcher's Britain or Reagan's America. It was everywhere, in France, Germany, and even Scandinavia.

It appears that governments of developed nations hit a brick wall in terms of their ability to raise further tax revenues. Political parties of the left and right recognised this new reality. The rising deadweight losses of taxes, transfers and regulation all limited the political value of inefficient redistributive policies. Tax and regulatory policies that significantly cut the total wealth available for redistribution by governments are chosen relative to the germane counter-factuals, which are other even costlier modes of redistribution.

The post-1980 reforms of Thatcher, Reagan, Clinton, Hawke and Keating, Lange and Douglas and others saved the modern welfare state. Their moves towards more efficient taxes and better targeted social spending reduced growth in government spending, but also prevented even larger cuts to social spending since 1980 at the behest of the increasingly restive taxpayer. Social spending growth did temper after 1980, but the level of spending was larger than it had been. This was because more efficient taxes raised extra revenue. These more efficient taxes provoked less political opposition.

Peltzman notes that at the start of the 20th century, the United States government was about 8% of GDP. The two largest programs were education and highways. The post office was as big as the military. Government is about five times that now with defence, health, education and income security accounting for 70% of this total. Peltzman (2012) makes the point that:

> *There is no new program in the political horizon that seems capable of attaining anything like the size of any of these four.*

For the time being the future government rests on the extent of existing mega programs. Health and income security account for 55% of total government spending in the OECD. It is in these two programs where the future of the growth of government lies. The pressure for that growth in government will come from the elderly. Governments will have to choose between high taxes on the young to fund these health and income programs for the elderly, or find other options that include cutbacks.

4.2 The political illogic of a Universal Basic Income

These political lessons behind why government grew in the 20th century, and how the modern welfare state was saved by the 1980s reforms, appear to be ignored by those who are advocating a Universal Basic Income. Billions of extra dollars in revenue must be raised and political resistance, in whichever tax measure is used to fund a Universal Basic Income for those who are not poor, overcome.

4.3 A Universal Basic Income is no answer to technological unemployment

The current bout of technology anxieties about robots replacing low-skilled and manual jobs on a mass scale does not justify the introduction of a Universal Basic Income. Even if the fairs of automation prove true, the Morgan Foundation's Universal Basic Income does not make the unemployed better off. Indeed, by re-moving the targeting of income support, beneficiar-ies generally are made worse off.

Child poverty is not reduced by a Universal Basic Income because single parents receive no more income support than before.

5 There are better solutions to family poverty that require no new taxes

5.1 What reduces child poverty?

If the aim is to reduce family poverty or welfare dependency, a Universal Basic Income is a very poor public policy tool. Child poverty is not reduced by a Universal Basic Income because single parents on the benefit receive no more income support than before.

The only major success in reducing welfare beneficiary numbers anywhere has been time limits in the USA introduced under President Clinton in 1996. Time limits on welfare for single parents reduced caseloads by two thirds; 90% in some states.

The declines in welfare dependency and gains in employment after the 1996 US federal welfare reforms were largest among the single mothers considered most disadvantaged (Doar 2014; Rector and Fagan 2003; Moffitt 2008, Haskins 2015). These mothers were young (ages 18-29), mothers with children who were aged under seven, mothers who were high school drop-outs, and black and Hispanic mothers (Rector and Fagan 2003). Prior to the 1996 US federal welfare reforms, these low-skilled single mothers were thought to face the greatest barriers to employment. Blank (2002) said in a survey article in the Journal of Economic Literature that:

> *At the same time as major changes in program structure occurred during the 1990s, there were also stunning changes in behaviour. Strong adjectives are appropriate to describe these behavioural changes. Nobody of any political persuasion-predicted or would have believed possible the magnitude of change that occurred in the behaviour of low-income single-parent families over this decade.*

Employment of never married mothers increased by 50% after the 1996 US reforms; employment of single-mothers with less than a high school education increased by two thirds; employment of single mothers aged 18 to 24 increased by nearly 100%. (Kim and Rector 2006). Black child poverty fell by more than a quarter to 30% by 2001 (Rector and Fagan 2003; Haskins 2015).

Over a six-year period after the 1996 welfare reforms, 1.2 million black children were lifted out of poverty (Rector and Fagan 2003; Kim and Rector 2006). In 2001, despite a recession, the poverty rate for black children was at the lowest point in US history (Rector and Fagan 2003; Kim and Rector 2006).

Previous attempts to solve child poverty with more money have failed. For example, Prime Minister Bob Hawke promised in the 1987 Australian General Election that no child need live in poverty by 1990. Raising the family allowance to $1 above the family poverty line did not fix child poverty in Australia. That promise was the one Hawke later said he regretted most in his public life.

5.2 Welfare reform and the Samaritan's dilemma

The US federal welfare reforms emphasised helping those who helped themselves, which is the classic Samaritan's dilemma. The Samaritan's dilemma as identified by Buchanan (1972) is a potential aid recipient may not be as cautious as he could against the risk of being in need because he knows that a benevolent government will provide relief. This safety net can increase in the amount of need. No dilemma arises as long as the condition of being in need is beyond the control of potential recipients.

Any welfare system that classifies individuals and provides differential benefits creates an incentive for individuals to attempt to change their characteristics to qualify for more benefits. Different benefits are subject to different work expectations, abatement regimes and degrees of medical scrutiny.

Many welfare reforms are motivated by the Samaritan's dilemma. Reforms put more conditions on benefits to motivate able-bodied recipients to do more to find jobs. People have repeatedly shown an ability to adapt and find jobs when the rewards of working rise and eligibility for benefits tighten (Blank 2002; Cahuc and Zylberberg 2006; Van Ours and Boeri 2013).

One of the strongest empirical results in labour economics is the large spike in exit rates from unemployment near the expiration of benefits (Van Ours and Boeri 2013). These moves into jobs, to other benefits or elsewhere accelerate through more intense job search and a lowering of asking wages.

Empirical studies of sickness, disability and accident insurance also suggest that the impact of incentives on benefit spells, injury durations and labour supply are large (Krueger and Meyer 2002; Cahuc and Zylberberg 2006). For example, before 15 July 1980, employees injured at work in Kentucky were compensated proportional to their wage to a limit of $131 per week. On 15 July 1980, this upper limit was raised to $217 per week. Better paid wage-earners were now much better compensated for accidents. Their periods of convalescence grew 20% longer. The average convalescence period for injured workers unaffected by this rise in the upper limit stayed the same before and after 15 July 1980 (Cahuc and Zylberberg 2006). It is incongruous to suggest that workplace accidents in Kentucky had suddenly become more serious for better paid workers and only for them after 15 July 1980.

A better solution to poverty is to move beneficiaries into a job.

5.3 The relative effectiveness of the carrot and stick in welfare reform

Many studies show that when comparing the carrot and the stick in welfare reform, the stick is more effective in reducing poverty and increasing employment (Cahuc and Zylberberg 2006). Sanctions and indeed just the threat of sanctions and intensive monitoring of job search stimulates higher rates of job finding than do, for example, cash bonuses to find and stay in new jobs (Van Ours and Boeri 2013).

A better solution to poverty is to move beneficiaries into a job (Cahuc and Zylberberg 2006; Van Ours and Boeri 2013). Nichols and Zeckhauser (1982) argued that imposing requirements on welfare recipients, of which work requirements is one example but onerous application procedures and participation requirements are others, both deters the entry of the able-bodied into the welfare benefit system and encourages their quicker return into employment.

A work requirement is a screening device that removes any advantage of moving onto a welfare benefit in terms of more leisure time. These minimum hours in a work requirement can be spent working part time, in study and training, work preparation and job search assistance or volunteering. Linking such requirements with benefits can help deter welfare participation by those able to find a job on their own. The majority of evaluations of mandatory welfare-to-work programs show significant increases in labour supply and reduced welfare dependency (Cahuc and Zylberberg 2006; Van Ours and Boeri 2013).

Requirements as simple as requiring beneficiaries to visit a social security office once a month to sign-on and show proof of job search reduces benefit claims by 5-10% (Cahuc and Zylberberg 2006). New Zealand is one of the few OECD countries with no such rule. Benefit eligibility is reassessed annually.

A requirement to sign-on regularly and show proof of job search is not unfair to healthy adults (including parents who do not have small children). Chapple and Boston (2014) reveal that:

> *Work undertaken at the Department of Labour and based on matching Household Labour Force Survey (HLFS) and administrative welfare records indicated, firstly, that in 2011 about 10 per cent of people whose welfare records showed that they were receiving an unemployment benefit reported to the HLFS that they were actually in full-time employment (i.e., working at least thirty hours a week), and hence were ineligible for the benefit; secondly, that more than one-third of people on an unemployment benefit self-reported as not actively seeking work – and one in five expressed no intention to seek work in the coming year; and, thirdly, that about 10 per cent of people whose welfare records showed that they were receiving a DPB reported being partnered or living as married.*

5.4 The current welfare state makes work pay

Chapple and Boston (2014) are clear that against the background of the New Zealand welfare state and the *Working for Families* tax credit, full-time work earns enough to lift families out of poverty:

> *Sustained full-time employment of sole parents and the fulltime and part-time employment of two parents, even at low wages, are sufficient to pull the majority of children above most poverty lines, given the various existing tax credits and family supports.*

The Chapple and Boston analysis that work pays for both single parents and families follows-on from that of the *Living Wage Movement Aotearoa New Zealand* (King and Waldegrave 2012; Waldegrave 2014). According to their calculations, earning only $19.80 per hour with a second earner working only 20 hours per week affords their two children, including a teenager, a reasonable standard of living that includes Sky TV, pets, international travel, video games and 10 hours of childcare.

6 Conclusions

We conclude that the economic, moral, and political logic of the Universal Basic Income are flawed. John Rawls put forward a very simple test for a just society:

> *A just society is a society that if you knew everything about it, you'd be willing to enter it in a random place.*

Would you prefer to end up as a random member of the current New Zealand with its existing welfare safety net, or a New Zealand that replaced that safety net with the Universal Basic Income? In that alternative New Zealand, it is likely that you would be no better off if you fell on hard times. Average incomes would be lower because of higher taxes stifling labour supply, investment, and lower incentives for entrepreneurship. The choice for the status quo seems obvious.

For a Universal Basic Income to achieve any reduction in poverty levels, or to avoid it costing those in society who most need help, much higher taxes are required. These reduce the incentives to work and economic growth.

The current and future governments of New Zealand have enough of a challenge to work out how to fund a universal old age pension and health spending in an ageing society without giving away billions of dollars to the non-poor through a Universal Basic Income.

We conclude that the economic, moral, and political logic of the Universal Basic Income are flawed.

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