

# Why a Universal Basic Income Is Better Than Subsidies of Low-Wage Work

August 5, 2018 (preliminary version)

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## Executive Summary

In this paper, we compare subsidies of low-wage work, such as the Earned Income Tax Credit (EITC), to unconditional cash transfers—or what is commonly referred to as a universal basic income (UBI).<sup>2</sup> The EITC helps families with *low earnings* but does not provide any support to those *without earnings*. It is an extremely popular policy because it redistributes income to low-earning families while encouraging work. In contrast, a UBI provides unconditional support to everyone and is often combined with a progressive tax on earnings.

In this paper we argue that a UBI would be preferable to subsidies of low-wage work on economic, moral, and political grounds.

The economic arguments for a UBI are twofold:

- First, subsidies of low-wage work, such as an EITC, distort incentives; they cause people to work more than they otherwise would. A UBI would reduce the resulting inefficiency, so that there would be a bigger economic pie to distribute, and more money would go to those who need it.

In this paper, we call this the “magic bucket”: the idea that by moving from a world in which we provide subsidies of low-wage work to one in which we provide universal transfers, we incur societal savings. As we reduce conditional (EITC) payments to support an unconditional (UBI) transfer system, individuals work less, which leads to government savings from fewer and smaller EITC transfers. As a result, you can reduce EITC payments by less than \$1 to pay for \$1 of UBI.

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<sup>2</sup> This paper benefited from feedback by Kendra Bozarth, Arin Dube, Robert French, Zoe Hitzig, Rakeen Mabud, Iona Marinescu, Suresh Naidu, and Marshall Steinbaum.

- Second, subsidies of low-wage work depress wages. By providing incentives for people to work, such subsidies allow employers to pay less, so they are, at least in part, a transfer to employers rather than workers. Replacing subsidies of low-wage work with a UBI would improve workers' bargaining position and wages.

We also argue that there are important moral and political considerations for unconditional transfers, such as a UBI, over conditional ones, such as an EITC:

- First, a UBI would increase individual liberty and would improve fairness. This sort of benefit would allow people in abusive relationships with domestic partners, employers, or government administrators to leave the situation without fear of material destitution. Unconditional benefits would also improve fairness by remunerating unpaid care work (particularly by women), civic engagement, and cultural production.
- Second, a UBI would be politically more sustainable and popular than narrowly targeted transfers. Universal benefits tend to have stronger democratic support than conditional benefits for the poor.

In summary, these arguments suggest that a UBI would give more to those who need it, would promote liberty, and would be politically viable and stable.

If one accepts these arguments, a political case needs to be made for a UBI. Any such case must grapple with and overcome distinctions drawn between the "deserving" and the "undeserving" poor. Such distinctions underpin the popularity of conditional transfers among politicians, but that underpinning has historically often been based on racial discrimination. A case for a UBI also needs to provide alternative narratives of a shared fate and shared interests, of a common defense of liberty, and of the valuable contributions of those working outside paid labor.

## Introduction

### **The Earned Income Tax Credit**

The **Earned Income Tax Credit** (EITC) is the most progressive component of the U.S. income tax code, redistributing income toward families with low (but not without) earnings. The EITC was first introduced in 1975 and was substantially expanded in the 1990s. In order for someone to be eligible to receive EITC payments, they must have paid employment but earn less than a certain amount. Additionally, EITC payments go mostly to households with children. Figure 1 below plots how much someone could receive through the EITC in 2017, depending on how much he or she earns and how many children they have.<sup>3</sup>

Transfers increase in proportion to earnings until a maximum amount is reached (at annual earnings of \$14,040 for households with two or three children). Above this threshold, transfers stay constant for a set range (up to annual earnings of \$18,340 for households with two or three children) and then decrease for higher earnings.

People without earnings do not receive any transfer payments through the EITC. People with very low earnings face “negative marginal taxes.” This means that for every additional \$1 of earnings, take-home pay increases by more than \$1. Conversely, people with earnings above \$18,340 face “positive marginal taxes.” This means that for every additional \$1 of earnings, take-home pay increases by less than \$1.

The combination of two key features makes the EITC a popular program among policymakers. First, the EITC significantly reduces poverty among working families. Second, it also provides a strong incentive for unemployed people to seek work.

### **A Universal Basic Income as an Alternative to the EITC**

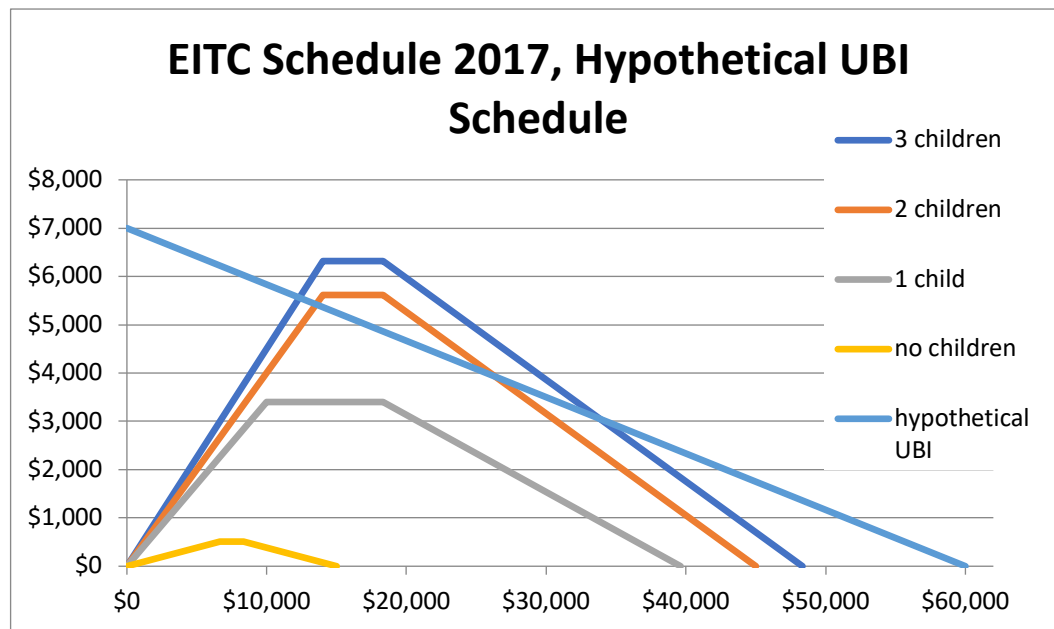
Despite the popularity of the EITC, proposals for an alternative type of transfer system are gaining increasing support from a diverse set of proponents. Such proposals, often discussed under the header of a “**universal basic income**” (UBI), are based on the idea that every eligible adult would be entitled to basic means of subsistence regardless of employment status, family status, or any other conditions. Most proposals for a UBI would offset the cost by instating or increasing progressive income taxes. With such an increase of taxes on higher incomes, only people with lower earnings would actually receive a net transfer under a UBI scheme (after taking taxes into account).

The various proposals for a UBI differ significantly along several dimensions. They differ in the amount of the universal transfer and in the intended progressivity of changes to

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<sup>3</sup> A great overview of the literature on the EITC can be found in Nichols and Rothstein (2015).

the income tax code needed to pay for it. They also differ in terms of changes to related policy initiatives. As is our perspective in this paper, some proposals consider the UBI as an addition and complement to other public transfers and programs, such as unemployment insurance or the public provision of education, health care, or housing. Other proposals consider it as a replacement for other public programs, which we do not advocate.



### **Comparing the EITC and a UBI**

The key feature that distinguishes subsidies of low-wage work, such as the EITC, from transfer programs, such as a UBI, is the **shape of the effective tax schedule** at the bottom of the income distribution. The EITC provides no income support for people without any earnings. Rather, the EITC subsidizes low-wage work by topping up the wages of low-paid workers with public transfers. By contrast, a universal basic income would provide income support for **everyone** at the bottom of the income distribution. This support would then be taxed away at a positive marginal tax rate as earnings increase. Figure 1 illustrates a hypothetical UBI schedule of this form.

While the EITC is well established and popular, the UBI has ardent opponents as well as proponents. Disagreements about the desirability of a UBI are the result of, at least in part, a lack of clarity about what bundles of policy measures are compared. In this paper, we **compare** subsidies of low-wage work to unconditional transfers that are **equally generous** in the sense that the total outlay of public spending is the same,<sup>4</sup> while leaving

<sup>4</sup> Current total EITC expenditures are around \$65 billion, corresponding to \$2,445 per capita.

the rest of the tax and transfer system the same, including effective taxes on higher incomes and the public provision of goods. Limiting the scope of our argument this way makes it clear what alternatives are compared. However, the limited scope of our argument should *not* be taken as a statement against the desirability of a more progressive general income tax system or against the desirability of public provision of various goods.

In this paper, we make the case that there are several strong arguments for a universal basic income, as opposed to subsidies of low-wage work. Our arguments draw first on the theory of optimal income taxation, and second on the literature on labor market equilibrium effects. We will then briefly discuss questions of justice, fairness, and deservingness. We conclude with some thoughts on the political economy of a UBI. The remainder of this introduction summarizes these arguments; the rest of the paper elaborates in greater detail.

### **Subsidizing Work Is Bad for Both Efficiency and Equity**

The first argument for a UBI relative to subsidies of low-wage work is that **transfers that increase with earnings cause inefficiency**. The standard framework that economists use for analyzing income taxes can be summarized as follows. Redistributive taxation involves a tradeoff between the welfare of different people. Higher incomes are generally taxed at higher rates, because richer individuals have a higher ability to pay, and because there is a desire to compensate for the inequalities generated by society. Unfortunately for a policymaker who seeks to redistribute income, taxable earnings might fall when marginal tax rates are increased. Such a decline might be due to tax evasion or reduced work effort. As a consequence, reducing tax contributions for lower-income individuals by \$1 might require increasing the contributions of richer individuals by more than that. This is sometimes described with the metaphor of a “leaky bucket.” Optimal taxes trade off the desire to redistribute income against the efficiency costs due to this leaky bucket.

Now consider the case of transfers that increase with earnings, such as the EITC. When transfers increase with earnings, there is an **efficiency cost of increased labor supply**. What this implies is that there would be a larger economic pie to distribute if everyone with low enough income got a transfer (as under a UBI), and not just people with positive earnings (as under the EITC).

Why is that? The crucial intuition is that under the EITC, recipients work *too much*. If EITC payments are reduced and recipients continue to work the same amount, the money saved by paying recipients less can be used instead to pay for a UBI. When you do that, some people might decide to stop working or to work fewer hours, since it's not

worth it anymore. But if they stop working, that means they stop receiving the EITC, leaving additional money on the table for the government to redistribute.

Put differently, under the current EITC, we need to take less than \$1 from a person with positive earnings to give \$1 to a person without any income. Starting from the EITC, we have a “**magic bucket**.” If we have a magic bucket, and if we think that those without any income are in need of support—at least to the same extent as those with positive earnings—then transfers increasing with earnings are not optimal. As a matter of economic efficiency, a universal basic income is thus preferred to subsidies of low-wage work.

### **The Magic Bucket**

One of the arguments for a universal basic income in this paper is based on the “magic bucket.” According to this argument, the government would have to raise taxes by *less* than \$1 on someone who has little income to make a \$1 transfer to someone with no income. The following example helps to clarify this argument.

Imagine an economy with three people: Katy, Jess, and Eric. Katy and Jess are eligible for Earned Income Tax Credit payments, and Eric is unemployed and is therefore earning no income. Katy and Jess receive \$7.50 per week under the current EITC program, while Eric gets nothing.

The government now decides to introduce a UBI, reducing the EITC to pay for it. Suppose that a UBI of \$1 per week is introduced, and the EITC is reduced to \$7 per week. Eric therefore gets \$1 more, and Katy and Jess get 50 cents less.

Under the new scheme, Jess decides to drop out of the labor force (maybe he has some elderly family member to take care off). Everything else equal, this choice makes Jess better off, otherwise she would not make this choice. In addition, the government now no longer has to pay the EITC to Jess—she just receives the UBI. Thus, the government saves \$6. The \$6 are then added to the pot for the UBI and distributed among Jess and Eric—ultimately raising the UBI to \$4 per week.

That’s the magic bucket: By redistributing money toward the unemployed (Eric, and then Jess, in our example), the government gets additional money “for free.”

### **Subsidizing Work Depresses Wages and Is a Transfer to Employers**

The second argument for a universal basic income is that **subsidizing increased labor supply hurts other workers**. Workers compete with each other for jobs in the labor market, and wages are affected by this competition. As the EITC was expanded in the 1990s, low-wage workers' labor supply increased. It appears that due to this increase in labor supply, the wages of other workers competing for the same jobs were depressed. As a result of depressed wages, employers' profits increased. Because of this depression of wages, **the EITC is, at least in part, a transfer not to low-wage workers but rather to the employers of these workers.**

The effect of a hypothetical UBI would be quite different. It does not distort the incentives to seek paid employment by subsidizing low-wage work; instead, a universal basic income actually **strengthens** the bargaining position of job seekers—and more so the larger the UBI. If workers have the outside option of receiving the UBI, they don't need to accept work under whatever conditions employers care to offer. As a consequence, wages would not be depressed by such a UBI; instead, they would likely be increased, and both the unemployed and low-wage employed workers could be better off for the same total amount of spending by the government.

A related argument concerns involuntary unemployment. Especially during recessions, but also during other phases of the business cycle, it might be difficult and costly (in terms of time and effort) to find a job. When competition among workers increases, it becomes more difficult to find a job. As a consequence, even if subsidies of work increase the labor force participation of the subsidized workers, these workers might end up taking someone else's job. Increasing the labor supply of some workers therefore makes other workers worse off. Total employment does not necessarily increase even if the labor force participation of individual subsidized workers rises.

### **A Universal Basic Income Would Further Individual Liberty and Fairness**

The previous arguments drew on established economic theory and empirical research, but the political debate regarding cash transfers to the poor is, however, also rife with arguments about fairness, justice, and deservingness—in addition to arguments about tradeoffs and empirical responses. The third argument for a UBI is that **it provides a baseline of safety and dignity for all and serves as a source of personal liberty**. By providing a guaranteed **outside option**, a UBI reduces personal dependency on exploitative employers, overbearing welfare administrators, and domestic partners, and guarantees that no one is completely left behind and excluded from society. Being able to count on a UBI gives people **the power to say no**. A UBI also serves as a means for society to reward the activities that are socially valuable but do not generate market revenue, which are often done by those without paid employment. In particular, this socially valuable work includes care for children, the elderly and sick (care work still done

predominantly by women), but also artistic and cultural contributions, political and community participation, and more.

Divergent notions of fairness might also help understand some of the motivations behind transfers, such as the EITC, which exclude those without earnings. In public discourse, a distinction is often made between the “deserving” and the “undeserving” poor. Those without paid work are considered morally undeserving. The distinction between the deserving and the undeserving is often made with implicit or explicit racist overtones (e.g., the common reference to so-called “welfare queens”). A case for a UBI needs to confront such notions head-on.

#### **A Universal Basic Income Would Be Popular and Politically Sustainable**

The fourth argument for a UBI is that **universal benefits have greater potential for broad and sustained political support**. Industrialized countries differ in the width of their social safety nets. Some countries traditionally provide narrowly targeted benefits (income transfers, housing, etc.) for the poor, without providing much in terms of transfers or public services to those slightly further up the income distribution. The consequence of such narrowly targeted programs is that only a small group of people benefits from the transfers and services. In general, those who benefit comprise a group of people with little political leverage, and benefit recipients are often socially stigmatized. This marginalization of beneficiaries increases the political ease with which policymakers may further dismantle the already narrowly targeted benefits.

By contrast, countries with broad-based social safety nets and broad public provision of goods tend to see broader support for their social spending programs. Broad-based programs—this would include Medicare and Social Security in the U.S.—garner broad support and are much harder to undo politically. It stands to reason, then, that a universal basic income could be a democratically popular and stable policy that can provide a strong social safety net for the long run.



## The Distorting Effects of Subsidizing Work

The economics literature on optimal income taxation builds on the model first formulated by Mirrlees (1971). Saez (2001) revisited this model, and a review of the literature on optimal taxation can be found in Chetty (2009).

In this section, we review the key assumptions behind the Mirrlees model, a framework designed to measure optimal taxation. We then discuss how this model captures a tradeoff between 1) the desire to redistribute income toward those who need it more and 2) the desire to not distort incentives too much. The balance between these objectives determines the progressivity of an optimal tax system. A more progressive system redistributes more income toward those who need it more, but it also potentially distorts incentives to work or creates incentives to evade taxes.

In particular, this logic can be applied to the design of transfers and taxes at the bottom of the income distribution. The key point that we will argue here is that *subsidizing* earnings (negative marginal tax rates) is as distortionary as *taxing* earnings (positive marginal tax rates). **Subsidizing earnings—as opposed to making payments to those with zero earnings—is bad for redistribution *but also* because it distorts incentives.** To the extent that people without any earnings are in even greater need of income than those with low-wage jobs, an unconditional basic income is therefore better policy on both efficiency and equity grounds than a subsidy of low-wage work, as provided by the EITC.

In the Mirrlees tradition, there are key assumptions of models of income taxation, which we sketch below. In these models, every worker's taxable income depends both on individual choices (e.g., how much and how hard to work or whether to evade taxes) and on factors beyond the individual worker's control (e.g., what wage they can command in the labor market). Workers make their choices based on the wages they face, as well as some schedule of taxes on their income. Therefore, they make choices that are optimal for themselves, subject to these constraints.

Let us now take the perspective of a policymaker who wishes to design an optimal income tax schedule. The policymaker thinks that an additional dollar given to a poorer worker is worth more than an additional dollar for a richer worker, all else equal. But the policymaker also has to consider the fact that workers will likely respond to changes in the tax system. For instance, a worker who faces high taxes may respond by evading taxes or by working less, while a worker whose earnings are subsidized might respond by working more.

In order to figure out what optimal taxes look like, we need to understand what happens when we make small changes to the tax schedule. If a tax schedule is truly optimal, there are no small changes that would improve overall welfare. Throughout, we take welfare to be a weighted sum of individual welfare, where the weights determine how much we care about a marginal dollar for each individual.

For any given tax schedule, what happens if we make that tax schedule a bit more progressive? If we took \$1 from a rich person and gave \$1 to a poor person, that would be improving welfare, all else equal, since \$1 is worth more to the poor person. However, by redistributing in this way we change the marginal tax rate. If the tax rate gets high, rich individuals might start hiding their money in tax havens or hire lawyers to figure out other methods to reduce their tax contributions. Actions such as these reduce the tax revenue available for redistribution.

We aim to compare the welfare consequences of tax schedules that generate the same amount of public revenues when trying to design an optimal schedule. Holding revenues constant, we can effectively only reduce taxes on poor people by a bit less than \$1 for every \$1 increase of tax contributions by rich people. Taxes are thus like a “leaky bucket,” which society can use to “carry” income from those who have more to those who have less. Optimal taxes equate two magnitudes: First, how much more valuable is income to the poor, relative to the rich? Second, how much more do we need to increase taxes on the rich in order to lower taxes on the poor, holding government revenues constant? The latter of these two questions—how “leaky” the “bucket” is—is an empirical matter. The empirical literature to date suggests that individuals higher up the income distribution don’t respond very much to changes in their marginal taxes. Furthermore, top incomes are very unequally distributed. Together, these two facts suggest that top tax rates should be much higher than present actual tax rates, as argued by Saez (2001).

An important assumption underpinning this argument is that people act in their own self-interest. This assumption implies that if we increase the taxes on rich people, and they respond by hiding some of their income, their decision to do so reduces public revenues but has no negative consequences for their own welfare.

This paper focuses on taxes and transfers at the bottom of the income distribution, and we aim to determine whether EITC or UBI is preferable. Currently, the EITC implies that marginal taxes are negative for low earnings; the government subsidizes every additional dollar of earnings. Low-income households with three children, for example, get an additional 45 cents of transfers for every dollar of earnings. Under the standard “leaky bucket”—Mirrlees scenario of positive marginal tax rates—increasing labor supply by taxpayers increases government revenue. By contrast, negative marginal

taxes imply that public revenues are *decreased* when workers increase their labor supply.

Now suppose that we start from the current structure of the EITC, and want to give \$1 to individuals without any income, compensating by reducing subsidies for low-wage workers by \$1. As a consequence, some workers might decide to drop out of the labor force. But if some of these workers drop out of the labor force, government revenues are *increased* since a low-wage worker who dropped out wouldn't receive subsidies anymore. What this implies is that we can give more than \$1 to those without income. In other words, we have a "***magic bucket***," where the amount of tax revenue available increases as we "carry" it to those without any income.

If we care about providing an additional dollar to those without any income, at least as much as we do for anyone else, we should always use a magic bucket—if we have one. This would require lowering the EITC while raising income transfers to those out of work. This logic suggests that we should introduce a UBI—a magic bucket—as long as there are negative marginal taxes. In other words, replacing the EITC with a UBI is justified on both efficiency and equity grounds.<sup>5</sup>

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<sup>5</sup> The preceding argument is complicated somewhat by the presence of so-called extensive margin responses of labor supply. Saez (2002) considers the following hypothetical scenario: Suppose workers cannot decide how much to work, they can only decide whether or not to drop out of the labor force. Suppose further that low-wage workers are going to work no matter what the tax schedule looks like, but that some high-wage workers drop out when we introduce a UBI. If that were to be the case, we would not have an actual "magic bucket"; high-earning individuals would drop out in the presence of a UBI and thus reduce tax revenues. Such a response might then, in principle, rationalize a tax schedule, such as the EITC, since it implies that transfers to low-wage workers are less costly than transfers to those without any income. This is certainly a theoretical possibility, but it requires very unrealistic responses of workers; in order for this logic to go through, high-income workers must be much more likely to drop out than their low-wage counterparts. Jacquet et al. (2010) in particular revisit this argument of Saez (2002) in the context of a model that allows for both extensive and intensive margin responses of labor supply to changes in tax rates. They show that for the range of empirically plausible magnitudes of responses, negative marginal taxes are never optimal.

## Competition in the Labor Market and the Equilibrium Effects of Subsidizing Work

The model of optimal taxation we have discussed in the previous section relies on an unspoken assumption, which might not hold in practice: that changes in worker behavior, induced by changes in taxation, do not affect other workers. Models of labor demand, in which different workers are perfectly substitutable, capital is internationally mobile, and the labor market is frictionless, can justify this assumption. In practice, however, this assumption might not hold.

As a general methodological issue for policy evaluations and optimal policy theory, we next discuss this point in abstract terms. We then discuss two particular channels that matter for a comparison of the EITC and a UBI: 1) the impact of equilibrium on wages and 2) the impact of equilibrium on involuntary unemployment and job-search costs of other workers.

Consider a change of labor market policy, such as unemployment benefits or some training program. Empirical policy evaluations are generally leveraging some source of random variation—whether the variation is intentional, as in an experiment, or an ancillary outcome to the way a policy is implemented or administered, as in a so-called “natural experiment”—to determine the impact of such a policy change on workers. Using data from an experiment where eligibility for training was randomly assigned, a policy evaluation might, for example, compare the unemployment rate of workers who received some training program to the unemployment rate of workers who didn’t. If we observe lower unemployment rates of those with training, the policy evaluation might then conclude that the program is effective. This conclusion might be taken to imply that the program should be scaled up and made available to all workers. This conclusion would be warranted if the labor market success of each worker depended only on their own training status but did not depend on whether other workers participated in the program. This assumption is known as the “Stable Unit Treatment Value” assumption in the policy evaluation literature.

Consider now the opposite extreme case, in which there is a fixed number of jobs available in a given city. Employers prefer to hire those with training, so in this case, any worker who gets a job because of training is crowding out another worker. By randomly varying eligibility for job search assistance, both across cities and across young workers within cities, Crépon et al. (2017) empirically demonstrate the crowd out that occurs in training programs.

If such spillovers (violations of the Stable Unit Treatment Value assumption) do happen, then this affects the welfare evaluation of policy changes. Economists traditionally distinguish between two types of spillovers. First, spillovers might happen through changes of prices and wages. Increased labor supply of some workers, due to the EITC for instance, might depress wages. This depression of wages affects the *incidence* of taxes and transfers (i.e., it affects who effectively benefits from a policy change). Spillovers might also happen through non-price channels; in this case, they are called *externalities*. Increased labor supply might, for instance, make it harder for other workers to find a job. The theory of Pigouvian taxes says that behavior that negatively affects others (i.e., creates negative externalities) should be appropriately taxed to align incentives—rather than subsidized, as in the case of the EITC.

Rothstein (2010), Leigh (2010), as well as Kasy (2017), among others, have empirically studied the incidence of the EITC, which is driven by endogenous wages. In practice, and in contrast to models in the Mirrlees tradition, different types of workers are not perfectly substitutable. Thus, we cannot arbitrarily increase the supply of some type of workers (say, high school dropouts with few years of work experience) seeking jobs, relative to other workers (say, college graduates with a lot of experience), without affecting their relative wages. If the labor supply of one group of workers is increased, neoclassical models of wage determination, based on the interplay of supply and demand, predict that the wages of the group with increased labor supply will fall.

This dynamic indeed appears to have occurred during the expansion of the EITC in the 1990s. Increased subsidies of low-wage work, as well as cuts to other anti-poverty programs, induced more eligible workers (in particular, single mothers with little education) to seek paid employment. Using variation in EITC top-ups across states and time, Leigh (2010) and Kasy (2017) find that the consequence of the EITC expansion was a significant depression of wages for low-wage female workers—the primary group eligible for the EITC. While the EITC increased the net income for eligible workers who were given wages, depressed wages reduced take-home pay, offsetting a large part of the increase in EITC transfers. Nichols and Rothstein (2015) argue that the estimated depression of wages reported by Leigh (2010) is implausibly large; based on theoretical considerations, they argue that a bit more than a third of all EITC transfers effectively goes to employers. In effect, then, EITC payments appear to be, at least in part, a transfer to employers of low-wage workers rather than to the workers themselves.

Wages are not the only dimension of employment relationships that might be impacted by increased competition in the labor market: Non-wage dimensions, such as hours, flexibility, and workplace safety, might also deteriorate when low-wage labor is subsidized.

There are additional channels through which increased labor supply affects other workers. These additional channels become apparent once we consider models of the labor market that allow for deviations from the neoclassical, frictionless model. Landais et al. (2018) consider optimal unemployment insurance in the context of a model of the labor market with search frictions. With search frictions, both workers and firms have to exert costly effort to find appropriate jobs or employees. When there are a lot of vacancies, it is easy for workers to find a job, but it is hard for firms to find employees. When there are few vacancies but a lot of job seekers, it is the opposite. In recessions, in particular, we might be in a context where there are few vacancies and the number of jobs is almost fixed, independent of worker search effort. Such labor market frictions have two consequences. First, even if subsidizing low-wage work induces individual workers to search hard enough to find a job, it does not increase the aggregate employment rate; they might simply crowd out other workers. This scenario is practically relevant. Lalive et al. (2015) find empirical evidence of this in the context of a temporary large extension of unemployment benefits for a subset of workers in several regions of Austria. Marinescu (2017) finds similar patterns when studying the extension of unemployment benefits during the great recession in the U.S. Second, increased search effort by some workers makes it harder for other workers to find a job, creating a negative externality. Therefore, the aggregate welfare effect of subsidizing earnings needs to consider not only the direct effect on subsidized workers (positive), but also the indirect effect on other workers (negative). As a consequence, once we take into account negative externalities, subsidizing low-wage work appears less desirable, relative to evaluations that ignore these negative externalities.

The recent labor economics literature has also emphasized the role of employer market power.<sup>6</sup> When employers have market power, they reduce their labor demand in order to keep wages low. Thus, the increased labor supply due to the subsidy provided by the EITC increases employer rents not only by increasing relative employer power and therefore decreasing wages, but also through the monopsony rents associated with increased employment.

The incidence of subsidies of low-wage labor, especially in the presence of employer market power, would be significantly altered when there is a minimum wage that is high enough. If the minimum wage were binding, the transfers provided by the EITC would go to the intended recipients, despite increased labor supply—making it illegal for employers to take some of the benefit for themselves.

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<sup>6</sup> See, for instance, Azar et al. (2018) and Steinbaum (2018).

## Fostering Dignity, Safety, and Liberty for All

The arguments discussed in the previous two sections, which focus on economic consequences and tradeoffs, contrast with much of the public and political debate, which often focuses on questions of fairness, deservingness, and justice. There are strong cases to be made for a universal basic income based on visions for a just, fair, and free economy and society. Here, we will emphasize two such arguments. We will also briefly discuss how notions of deservingness might be driving current policy choices. We conclude by revisiting revealed preference arguments, and examining how the choices of rich and poor people are treated differently in discussions about taxation.

One justice-oriented case for a UBI can be made based on the notion of individual liberty. We are all entangled in a web of social connections and dependencies, which are often enriching and beneficial. But there are also many ways in which these dependencies can lead to problematic constraints on individual liberty. Such dependencies are often driven by economic outside options: If someone risks having no income if they were to leave a relationship, they are compelled to stay. Consider domestic partnerships in which one partner depends on the other for their material sustenance, shelter, and food, and thus cannot leave. Such a situation might sustain emotional and physical abuse, even forced prostitution in some cases. Consider also employment relationships in which an employee cannot quit, perhaps because unemployment would imply poverty and homelessness for his or her children. The lack of an alternative option for this employee allows the employer to engage in all kinds of exploitative and abusive behavior—both within and beyond the boundaries of the law—from low wages and long hours to sexual harassment. Consider lastly a welfare recipient who is dependent upon a caseworker’s judgment on whether he or she fulfilled various conditions, in order to continue receiving a basic level of material sustenance. Based on the interpersonal power this situation confers to them, caseworkers might engage in various forms of humiliation or discrimination.

Suppose now that everyone were entitled to a basic income that was not conditional. This guaranteed outside option would lower the bar on the quality of relationships that any individual has to accept—whether with domestic partners, employers, or bureaucrats. If a sufficiently generous UBI is introduced, the mere existence of this outside option improves the position of the weaker party in these relationships enough to put an end to many forms of abuse and to many curtailments of personal liberty.

A second justice-oriented case for a UBI can be made based on the notion that it serves as compensation for valuable activities that are not compensated by the market. A functioning society relies on many crucial activities—including care work, looking after the elderly, and bearing children—that are not compensated in the form of wages.

While some of these forms of work can be outsourced to the market or to state institutions, most of them still take place within the household and are carried out predominantly by women. A second category of valuable activities that are not compensated by the market includes various forms of community involvement and political activism. Communities wouldn't work as atomistic assemblies of individuals who engage solely in income-generating market activities. And no democracy could exist without dedicated individuals foregoing market income in order to attempt to right social wrongs through endless hours of committed activism. Third, society benefits from many forms of artistic, musical, or literary production that are not commercially rewarded.

Given how essential these activities are, and given how asymmetrically the burdens of care work, in particular, are distributed, it seems only fair that society should provide some material compensation to those engaging in these activities. Rather than having some bureaucracy decide which of these activities they deem valuable—or which forms of family life or political engagement or artistic expression are rewarded—the most straightforward way to reward those engaging in unpaid but important activities would be to provide a guaranteed universal basic income. Individuals deserve to determine which activities they themselves deem valuable.

Let us next revisit our discussion of optimal taxes from a justice perspective. One of the key ingredients to optimal tax theory is the assumption of revealed preference: people choose whatever is best for them, subject to the constraints they are facing. A consequence of this assumption is the “envelope theorem,” which states that behavior changes induced by (small) policy choices have no direct effect on private welfare, even though they might affect public revenues. This idea drives the notion of efficiency costs of high marginal taxes: If people respond to high taxes by reducing their taxable income, this has no effect on private welfare but has a cost in terms of public revenue (“deadweight loss”).

In our discussion, we applied the same logic to negative marginal taxes, as under the EITC. If people respond to subsidies of low-wage work by working more, that again has no effect on private welfare but does carry “deadweight loss.” Therefore, negative marginal taxes are bad for both efficiency and equity. This argument is not always applied to poor people, however. Instead, many publications on the EITC seem to assume that increasing labor supply is a positive feature of the EITC. Such an assessment implicitly relies on an asymmetric treatment of rich people and poor people: For rich people, whatever they choose is best for them, and thus non-zero marginal taxes induce a distortion; for poor people, it is presumed that they don't know what is best for them and must be induced, using subsidies, to do things they otherwise would choose not to do. Arguments for the EITC thus treat poor people differently from rich people.



Defending personal liberty and rewarding valuable activities are widely shared values. So how is it that political debates focused on questions of fairness have led to the introduction of the EITC rather than some kind of UBI? A leading explanation is the distinction often made between the “deserving” and the “undeserving” poor. The narrative goes roughly as follows. The deserving poor have fallen on bad times, but they are hardworking and moral people who, in due time, will work their way out of poverty, living the American Dream and moving from rags to riches. The undeserving poor, on the other hand, are lazy, caught in a culture of poverty, and are nurtured by a nanny state supporting their immoral lifestyle, which might include the abuse of alcohol and drugs. This construal of the undeserving poor is epitomized by the notion of a “welfare queen.” A good policy, this account contends, should reward moral behavior rather than enabling amoral behavior. Thus, in light of this type of reasoning, it seems only logical that the tax system should help the working (deserving) poor via the EITC rather than serve the out-of-work (undeserving) poor.

Such narratives of deservingness are often supported by racist sentiments. The terms “culture of poverty” and “welfare queen” have clear racial connotations. And the distinction between the deserving and the undeserving poor has obvious strategic benefits for those seeking to dismantle redistributive institutions altogether. The strategy of divide and conquer—pitting the working poor against the unemployed poor, poor white people against poor black people, low-wage native workers against immigrant workers—has a long and successful tradition. Any successful political case for a UBI, and progressive reforms more generally, has to confront this strategy head-on. It must provide alternative narratives of a shared fate and shared interests, of a common defense of liberty, and of the valuable contributions of those working outside of paid labor.

## The Political Economy of Targeted and Universal Benefits

Thus far, we have considered the desirability of alternative transfer schemes, comparing the EITC to a hypothetical UBI. We reviewed the framework of optimal tax theory, asking how to design a system of taxes and transfers that maximizes some notion of social welfare. This question is in line with the usual approach of economists, taking the point of view of a hypothetical Social Planner. But in a democratic polity with a diverse set of economic interests and political ideologies that are conflicting and vying for power, policies are generally not determined by a Social Planner or “benevolent dictator.” Rather, they are determined by electoral majorities, by lobbying and campaign contributions, by ideological alignments, and by the subjective identities of different people, perceiving themselves as belonging to the same group as other people or not. What does political context imply for the desirability of a universal basic income relative to targeted and conditional benefits, such as the EITC?

Social safety nets and public goods provision in rich countries differ widely in both their scope and their breadth of coverage. Many programs, in particular in continental European countries, both cover a sizable fraction of the population and are generously endowed. These programs include public pensions and health care systems, free public provision of education (including higher education), and free public housing for a majority of the population in some European cities. Examples in the United States include Social Security and Medicare. Such programs tend to be widely popular, enjoy support across the political spectrum, and tend to be stable over alternating governments.

Other programs are more narrowly targeted to the poor. Narrowly targeted programs include traditional welfare systems in the Anglo-Saxon countries and public housing in the United States. Such programs tend to be politically contested, receipt of these benefits is socially stigmatized, and the programs are underfunded. Programs for the poor are often poor programs. Such programs are more easily dismantled, which has happened in the Anglo-Saxon countries, in particular, since the 1980s. A UBI, however, is for everyone.

From a purely economic optimal policy perspective, targeting more narrowly is reasonable. Targeted benefits reach potential beneficiaries who are most in need—and for less budgetary cost than more widely dispersed benefits. But, as argued for instance by Gelbach and Pritchett (2002), this conclusion can change dramatically once we take political constraints into account. Consider a program for which the narrowness of targeting is fixed. Consider then how the generosity of this program is determined in a democratic process. Widely dispersed programs might garner wide support leading to more generous programs. In the end, then, the poor might be better off under less-

targeted programs. Any policymaker interested in improving the well-being of the poor must take these political constraints into account. And it seems that many policymakers indeed do. More conservative policymakers are often in favor of more narrowly targeted programs that redistribute more to the poor (but only because they anticipate the ease of cutting such programs in the future).

This brings us back to a universal basic income: Everybody can perceive themselves as a beneficiary of the UBI, so a cut to such a program might then be as unpopular as a cut to Social Security or to Medicaid. With inherent public support, such a program might create a longer lasting social safety net than existing, more narrowly targeted benefits.

How exactly the politics of a UBI would unfold is of course a complex matter. A key determinant of the political response would be the institutionally available and perceived policy alternatives. That said, once a UBI is introduced, it seems plausible that any political debate about its size would take place largely in isolation from debates about other possible policy changes. Since a majority would have to lose from a reduction of the UBI, considered in isolation, it seems plausible that maintaining or expanding the UBI would have widespread support. This appears to be indeed the case for existing universal transfer programs, such as the Alaska Permanent Fund—which is extremely popular, according to findings of Jones and Marinescu (2018).

## Summary Of Key Arguments

In this paper, we compare two types of transfers: subsidies of low-wage work, like the existing Earned Income Tax Credit (EITC), and unconditional transfers, such as the hypothetical Universal Basic Income (UBI). We discuss several arguments for unconditional transfers.

### **1. Negative marginal tax rates are bad for both efficiency and equity:**

- a. When marginal tax rates are positive, we have to take more than \$1 from someone rich to give \$1 to someone less rich, reflecting a tradeoff between efficiency and equity (“leaky bucket”).
- b. When marginal tax rates are negative, as under the EITC, we have to take less than \$1 from someone with income to give \$1 to someone without any income, by eliminating the distortion to supply too much labor (“magic bucket”).
- c. Going from the EITC toward an equally generous UBI would therefore improve both efficiency and equity.

### **2. Subsidizing increased labor supply hurts other workers:**

- a. Subsidizing low-wage labor supply depresses wages. The subsidy is, at least in part, a transfer to employers rather than to low-income earners.
- b. If there is unemployment, subsidizing low-wage work increases competition for a limited number of jobs and increases search times and search costs for all workers—rather than increasing employment.

### **3. Fairness, justice, liberty:**

- a. A UBI contributes to a society in which everyone is entitled to a basic level of dignity, safety, and liberty, free from material fear and personal dependence on abusive partners, overbearing welfare bureaucrats, or exploitative bosses.
- b. A UBI provides remuneration for the numerous unpaid activities a functioning society relies on—including, for example, care for children and the elderly, political and community involvement, and artistic and cultural production.

### **4. UBI might enjoy more stable support than narrowly targeted transfers:**

- a. Narrowly targeted transfers are often stigmatized and have a limited political constituency to support and defend them.
- b. By contrast, broad-based transfers (e.g., Social Security or Medicare in the U.S.) enjoy stable and broad popular support and experience less political volatility. If appropriately framed, the same might ultimately be true for a UBI.

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