ICG Goa

Universal Basic Income For India

Feasibility and Desirability

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Universal Basic Income

- Four dimensions
  - Cash transfers (not in-kind, coupons, vouchers etc)
  - Unconditional (unlike Conditional Cash Transfer programmes in Mexico, Brazil that depend on school enrolment & child health)
  - Universal (no socio-economic or demographic criteria)
  - Given to each (adult) individual

Debate

- Most controversial dimensions are
  - Why cash? (gives individuals choices)
  - Why lumpsum & not proportional to income? (least amount distortion, income hard to verify)
  - Why universal and not targeted? (avoids the costs of targeting, & is effectively progressive since it has to be funded through taxes)

Debate

- No serious proposal for UBI advocates curbing spending on health and education – some of the fears here are misguided

- All UBI proposals have to have a funding plan, one that typically would end of being a progressive (negative income tax)

- UBI can only provide relief against hunger and destitution & not a long-term poverty alleviation strategy – for that growth & employment is essential

Renewed Interest Stems from Policy Initiatives

- Being implemented in several developed countries (e.g., Finland , the Netherlands, and the Canadian province of Ontario) & discussed in others (Scotland)
- Some developing countries too, such as Iran, Namibia, MP in India under SEWA, Kenya & is part of several experiments involving unconditional cash transfers (UCTs)
- Banerjee et al WBRO 2017, Bastagli et al 2016, Evans & Popova (2014) provide reviews

Antecedents – Developed world

- Sir Thomas More in *Utopia* (1551) proposed the idea of a guaranteed income, Thomas Paine in *Agrarian Justice* (1795) proposed a citizen’s dividend to all US citizens.
- Other advocates include Fourier, J S Mill, Bertrand Russell
- In more recent times it has received support from economists from both left (Meade, Tobin, Atkinson) and right (Hayek, Friedman)
- Milton Friedman’s negative income tax proposal
- Current trends related to attempts to reform the welfare state

Antecedents – Development Policy

- Three broad categories of development policies
  - Enabling the poor greater access to markets
  - Improving the access of the poor to public services and infrastructure
  - Transfers - explicitly redistributive in nature (conditional, unconditional, in-kind etc)

Arguments in Favour of UBI

- The arguments in favour of the first two features of a UBI – cash transfers and unconditionality - are similar in both country contexts
  - A UBI cuts administrative costs and empowers citizens by giving them choice and control over how to spend the money received as assistance.
  - Standard economic inefficiencies associated with in-kind or conditional transfers, such as distorted resource allocation from both the demand and supply sides, direct bureaucratic costs, and corruption, limit considerably the social returns on public funds.

UBI too requires some infrastructure

- It is not that there are no administrative costs associated with cash transfers or that there is no potential for corruption.
- Also, for cash transfers to be feasible, a well-functioning financial infrastructure is necessary, which is often not the case in developing countries

Will people waste the money & work less?

- A frequent concern that is raised about a UBI is founded on paternalistic grounds – whether having a fixed guaranteed income makes people want to work less and squander the cash on inessential consumption

- However, evidence suggests that this is largely unfounded in developing countries
  - Banerjee et al. (2016) re-analyse the results of seven randomised controlled trials of government-run cash transfer programmes from six countries worldwide to examine their impacts on labour supply.
  - Across the seven programmes, they find no systematic evidence of impact on either the propensity to work or the overall number of hours worked, for either men or women.

- Evans and Popova (2014) review evidence from 19 studies with quantitative evidence on the impact of cash transfers on temptation good expenditure, as well as 11 studies that surveyed whether respondents reported they used transfers to purchase temptation goods supported by data from Latin America, Africa, and Asia.
- They find either no significant impact or a significant negative impact of transfers on expenditures on alcohol and tobacco.

- The third feature of a UBI - that it is universal as opposed to targeted to specific groups – is the most debated.
- On the positive side, it prevents inclusion and exclusion errors associated with contingent or means-tested welfare assistance programmes, including cash transfers.
- A UBI circumvents the challenges of targeting by being a lump-sum transfer, which is independent of the behaviour (as are unconditional cash transfers) and characteristics (income, age, health, or family-status) of the recipient.

- On the negative side, two frequent criticisms of a UBI are that the direct cost of any universal programme is high, and the fact that the poor and rich will receive the same transfer does not seem very equitable.
- Neither of these criticisms are strong.

- No serious case for UBI comes without a complementary proposal for full or partial offsetting of costs from other direct transfer programmes for the poor, or the garnering of higher taxes.
- Whether taxes are raised or not, under an income-tax scheme with wide coverage, the gross transfers to the rich will be offset by taxes.
- Therefore, in net terms, only those below a certain income level will receive a net transfer (& why a UBI is similar to the negative income tax scheme)

Additional Arguments in favour of UBI

- Only 27% of women in labour force (excluding “unpaid care work”)
- Lowest among BRICS countries
- UBI has potential to empower them in intra-household decision-making
- Also, occupations associated with stigma (such as manual scavenging)
- Potential to shift low-caste groups away from these

Additional Arguments in favour of UBI

- Curbing power of bureaucracy
- Cases of the poor being deprived of benefits that has led to deaths for forced implementation of UID (*aadhaar*) scheme
- Some of the resistance comes from what could be called the political-bureaucratic complex that runs a patronage network for distribution of in-kind benefits
- Induce individuals to be included in the formal system of benefits – will help expand tax net

Additional Arguments in favour of UBI

- Creating a sense of solidarity and unified support behind a government programme
- Targeted programmes are always subject to tussle over budgetary priorities
- Universal programmes (e.g., NHS in the UK) enjoy broad support

UBI - Some Simple Arithmetic

- A UBI can be interpreted as a lump sum transfer b funded by a balanced budget incremental proportional income tax of t, that is

$$y^{net} = b + (1 - t)y^{gross}$$

- y^{gross} is gross income and y^{net} is net income.

- We can think of an existing income tax rate of τ_0 that funds some public services and the cost of running the government and $t = \triangle\tau$ is the additional tax to fund the UBI scheme.

- To keep the notation simple, we set $\tau_0 = 0$.

- There is a critical income level for which the individual is unaffected in net terms with the extra tax and transfer

- It is given by

$$y^{net} = y^{gross} = \hat{y}$$

- We can solve

$$\hat{y} = b + (1 - t)\hat{y}$$

- Or,

$$\hat{y} = \frac{b}{t}$$

- Those above $\hat{y}$ pay more taxes than they receive in transfers and those below it is the other way round

- The requirement of budget balance means that for a target level of b we can determine the needed t
- Conversely, this also allows us to figure out for a feasible level of t, what is the level of b that is possible
- Of course, this assumes linear (proportional) taxes and with progressive taxes, the calculations will be more involved

Case of India

- In India, giving everyone a sum that equals the yearly income corresponding to the poverty line is about 9% of GDP, while the corresponding figure for the US is 20%.

- From our discussion earlier, we can see that this would also be the additional income tax rate that would be needed

- Both these numbers are impractical given the fiscal realities of the respective countries.

Can a Developing Country Like India afford it?

- It is precisely in this dimension where the arguments in favour of UBI differ sharply between developing and developed country settings.
- Given the state capacity of developing countries, only a very small fraction of the population pays income taxes.
- For example, in India a mere 2.3% of the population file tax returns and about 1% pay taxes, rendering the fiscal instruments to reclaim the transfer from the rich severely limited.
- The Economic Survey, an annual report on the state of India’s economy, shows that there are only 7 taxpayers for every 100 voters in the country.
- The corresponding figure for Scandinavian countries is nearly 100 and the figure for most developed countries is in the 60-80 range.

- This renders the scope of a UBI more limited in a developing country setting, as funding is a challenge given the limited tax-base
- Furthermore, the tax base often excludes some affluent sections of society - concerns about fairness.
- It might seem that developed countries can afford any form of extra expenditure better - not only do they have a wider tax-base, they are also richer.
- However, when we compare the country contexts, poverty is relative given differences in the cost of living as well as the subjective definitions of what constitutes poverty.

Feasibility

- First is the issue of feasibility - what is the level of basic income that we can afford?
- Calculations based on Rangarajan's poverty line of Rs. 47 and Rs. 32 per adult individual per day in urban and rural areas, respectively, translates to an average amount of about Rs. 1,200 per person per month, or Rs. 1,600 if we allow for inflation adjustments since the Rangarajan figures were based on 2011-12 prices.
- If all Indian adults were given this amount as a lump-sum, which is what a UBI policy would imply, that would be a more than half of total central government expenditure, or a prohibitive 9% of GDP (the corresponding figure for the US is 20%)

- Just to compare:
  - For MGNERGA, the corresponding percentages are 0.32 percent and 2.23 percent
  - For *all* central government direct subsidies, it is 1.7 percent and 12 percent
- 9% of GDP is clearly impractical.
- Can be scaled down – Rs 1000 per person per month gives around 6.5% of GDP
- We can decide on what % of GDP is affordable & work out the amount

Feasibility of UBI in India

- There are ways of cutting some expenditures that are neither efficient nor equitable.
- Total explicit central government subsidies are 1.7% of GDP
- Total central and state budgetary explicit and implicit subsidies amount to 10.6% of GDP and estimates suggest that non-merit subsidies, that is, those that end up going to the non-poor is about 5% of GDP (Mundle & Sikdar, 2018)
- Also, the central government offers a number of tax concessions or incentives on income tax to corporates, individuals and associates of individuals, apart from exemptions on customs and excise duties. These are commonly referred to as ‘revenue forgone’, and estimates suggest that this constitutes 6.5% of GDP.

- Third, another method of funding a UBI would be to have a social welfare tax that is levied on income, wealth, or some forms of consumer expenditure. Given that estimates suggest that the black economy is around two-thirds to three-quarters of the country’s official GDP, the argument for taxing luxury expenditure items is particularly compelling.
- Therefore, for a UBI to be practical, it has to be scaled down from these sums and adapted to the particular country context.
- Since relatively small sums can still have a considerable impact in developing countries, given the differences in the costs of living as well as the abject level of poverty, the case for a UBI is stronger.

Minimum Income Guarantee (MIG)

- This is targeted to the poor while the UBI is universal and not targeted to any group, including the poor.
- It was first floated as a progressive income transfer scheme – those who are poorer will proportionally receive more – if someone's income falls below some threshold level, then the person will get enough to bridge the gap
- It is currently being described as a flat lump-sum amount of Rs 6000 per month per poor family (bottom 20% of the population) that does not depend on the recipient's income level so long as monthly family income falls below Rs 1a progressive income transfer scheme – those who are poorer will proportionally receive more.

Pros & Cons of MIG

- The main advantage relative to UBI is it is cheaper – as opposed to giving to the whole population, it is targeted to the bottom 20%
- Calculations suggest as a fraction of GDP, that is 2.14 percent while as a fraction of government revenue it is 14 percent.
- Just to compare:
  - For MGNERGA, the corresponding percentages are 0.32 percent and 2.23 percent
  - For *all* central government direct subsidies, it is 1.7 percent and 12 percent

Problems with MIG

- It is also politically easier to pitch as it is targeted to the poor and so avoids the "Why should the rich receive a transfer too?" critique.
- But the main problem with this scheme precisely shows what the advantage of UBI is – namely, targeting and incentives to under-report income
- Targeting stems from the difficulty to measure income in an economy like India's where a vast majority of the workforce is employed in the informal sector without any payroll records and a miniscule fraction files income tax
- If you get a flat Rs 6000 if your income falls short of minimum income of Rs 12000 there will be extreme incentives to hide income around the threshold as the money you get will fall from Rs 6000 to 0 if you earn Rs 1 more
- Even if this was made more continuous – make the transfer equal to the gap and not a flat amount, hiding Rs 1 of income will increase transfers by Rs 1

A Proposal - Hybrid Scheme

- One solution could be to integrate a small UBI with MGNREGA.
- Would enable combining workfare with welfare
- UBI is unconditional while under MGNREGA, you get paid only if you work.
- As a result, it is self-targeting — only those who really need the money would be willing to do extra work to earn it.
- On the other hand, it is not ideal for the poor who are unable to do usual manual work, e.g., children, the elderly, the disabled.
- One can think of a transfer policy that combines the two in the following way.

UBI + NREGA

- We can have a flat base amount (for example, the Rs 6,000 per month figure that the MIG scheme is referring to) that is given to *all* and then we can allow individuals to claim more if they work under NREGA.
- Those with no income (including none earned via MGNREGA) will receive just the base amount.
- Others will have more, in proportion to the labour they supply.

Advantages of a Hybrid Scheme

- This would make it costly for people to receive additional income beyond the base amount and solve the income-verification problem that is inherent in a MIG scheme.
- Since everyone qualifies for the flat amount, the incentive problem of underreporting is also absent
- Also, registering for the UBI to receive the flat amount would enable tax authorities to bring more people in the informal sector under the tax net

Arguments for UBI in developed vs developing country context

- Turning to the economic arguments behind a UBI in developed and developing countries (as opposed to state capacity) there is a major difference
- In the former, it is the looming threat of unemployment due to globalisation and automation, as well as an increasing consensus on inequality as a policy problem that has renewed earlier debates about what is the best way to carry out economic redistribution.

- We have already noted the problem of state capacity relating to the tax-base as a key constraining factor.
- Some argue that it will deplete funds for other anti-poverty policies.
- Even so, as long as it is posed alongside other poverty alleviation measures, it is worth testing on an affordable scale.
- We should also be clear in recognising that a UBI is only a safety net that provides relief from extreme deprivation relating to goods and services that are available in the marketplace - it is not a substitute for public goods and services.

- In developing countries, it is extreme poverty and a political consensus around poverty alleviation as the main economic policy objective that has driven debates as to what constitutes the best approach to combat poverty.

- There is a case for UBI as a policy response to unemployment (or, more broadly, the rise of the gig economy) as well as poverty in developed countries.

- But it is clearly no alternative to a progressive income or wealth tax if inequality is the main concern. In contrast, the case for a UBI as a policy measure to combat extreme poverty in developing countries is rather compelling.

Notes of caution

- In discussing the merits and demerits of the UBI or any other welfare or development policy, it is important to avoid some standard pitfalls.
- **First**, all policies have some pros and cons, and so just picking a problem with or highlighting a nice feature of a particular policy is not good enough.
- The focus should be on relative costs and benefits of different policies.
- For example, if we compare a UBI scheme with Employment Guarantee schemes the trade-offs are as follows - the latter is self-targeting and so has a lower total cost than a UBI scheme for comparable amounts of per-person benefits.
- However, MNREGA has the disadvantage that some employment opportunities are foregone, a problem the UBI avoids.

- **Second**, one size does not fit all.
- We should be open to the possibility that different policies could work well in different contexts.
- Cash transfers only make sense if you have ready access to markets, which is not true if you live in remote rural areas in which we have to rely on in-kind transfers.

- **Third**, there is no magic pill that will cure all problems.
- A UBI or a cash transfer will provide some relief to the poor, but will not provide a long-term solution to the problem of poverty.
- For that one needs investment in health, education, and skill formation to enable the poor to take advantage of growth opportunities, and investing in infrastructure and regulatory conditions to facilitate private investment for employment generation.
- To give an analogy, giving certain nutritional supplements may help a person who is ill to gain some strength, but it will not cure any disease, nor will it make the person an athlete.

Concluding Thoughts

- My sense is that a lot of opposition to schemes like the UBI from the Left reflects the worry that they will displace other anti-poverty policies.
- On the other hand the Right opposes it as it will divert revenue from policies that enhance growth and also make people welfare-dependent
- Having more cash will help the poor not just with meeting their subsistence needs but also to cope better with risk and relax the borrowing constraints they face. But we should remember that as with any other anti-poverty scheme, in the end, it is jobs, skills, and productivity growth that can reduce poverty in the long run.