The EUROPEAN CONSERVATIVE

Another Mediocre Idea From the Left

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March 21, 2023

The European Parliament had barely voted on the idea of a global wealth tax before its attention turned to another staple of 'democratic' socialism: a universal basic income for everyone.

A carefully crafted proposal for a pan-European basic income was put forward by the European Commission in September last year. Formally known as the Council Recommendation on Adequate Minimum Income Ensuring Active Inclusion, the idea was the subject of a parliamentary debate on March 14th.

To be honest, it was not much of a debate. Of the two dozen speakers, Ádám Kósa of Hungary was the only unconditional opponent of the idea. Most of the rest of the speakers offered various iterations of the same argument: there are poor people in Europe, and therefore EU member states must guarantee them an adequate minimum income, AMI. Every adult in Europe would be guaranteed the AMI in lieu of other means for supporting themselves. According to the European Council report, the AMI benefits are

non-contributory and means-tested benefits of last resort to households without sufficient resources, when other sources of income or benefits have been exhausted or are not adequate to ensure a life in dignity.

The report stresses that the AMI is not a version of the universal basic income: it is not supposed to be paid out to people who make more than the AMI threshold. However, this is a moot point: as soon as government declares the AMI, and as soon as it is official that anyone with an income less than the AMI qualifies for support, the AMI *de facto* takes the role of a universal basic income.

America has debated the basic income idea more vigorously than Europe has. The reason is likely to be found in the small differences between welfare states in Europe and their American counterpart: while Europeans in general have strived for comprehensive and economically redistributive benefits coverage, the American welfare state has grown from a selective and more conservative origin. The debate in America has therefore been focused on making the welfare state more comprehensive, yet also simpler.

So far, the outcome of the American conversation has been indecisive, as exemplified by the Cato Institute, a libertarian think tank in Washington. After having analyzed the idea for a few years, Cato left it undecided, but its internal debate is a good introduction to the issue itself.

It looks like the European campaign for a basic/minimum income is more focused on simply creating a new entitlement program with means-tested yet universal accessibility. The reason why Europe seems more determined on moving the AMI from theory to practice is that the right-of-center has basically stayed on the sidelines here. There are almost no determined conservative opponents, but also no dedicated right-of-center voices in favor of the AMI. Therefore, the left seems to be forming a unified front behind the AMI, eliminating meaningful ideological debate over the proposal before it has even started.

At the same time, just because the proponents are ideologically on the same page does not mean that the AMI idea itself is good. On the contrary, as can be seen in the aforementioned debate in the European Parliament, the lack of forceful opposition from conservatives has allowed the AMI proponents to become sloppy—and leave major problems with the AMI unaddressed. These problems run from the concept of poverty that defines the threshold for AMI eligibility to an almost beautiful collision between contradicting economic incentives.

To start with the concept of poverty, the AMI is tied to the prevailing official European definition of poverty. Unlike the straightforward American definition, which simply defines an economic threshold below which a person is poor, the European definition speaks of a threshold below which a person is "at risk of poverty."

Not poverty per se, but "at risk" of poverty.

This is a dubious concept that lacks analytical and statistical stringency. Therefore, it is not suitable as a foundation for any policy making. It does not help that the official definition provided by Eurostat, says that you are at risk of poverty if you have an equivalised disposable income (after social transfer) below … 60% of the national median equivalised disposable income after social transfers.

As if they understand how ridiculous it is to say that someone is “at risk” of poverty, Eurostat provides more stringency in the 2021 edition of Improving the understanding of poverty and exclusion in Europe. Here, they offer various quantitative definitions of poverty itself (Sect. 9.2, p. 156), without the “at risk” prefix. Of all these levels, Eurostat commonly refers to the 60% threshold as the accepted poverty level.

But what, then, is the point with the reference to “at risk of poverty” cited above? That one also offers the 60% level as its quantitative meaning.

Aside from the conceptual confusion, the European poverty concept is relative: it designates a demographic as poor simply because they do not make more than a certain percentage of their neighbor’s income. This definition, which will guide eligibility for a future adequate minimum income in Europe, differs notably from the American definition which ties poverty to the consumer-price index: a household is defined as living in poverty if its income cannot guarantee “a minimum food diet” and other very basic goods and services.

Theoretically, the American poverty definition is absolute in the sense that its quantitative meaning does not change with rising income. In practice, though, it is tied to median income and has been so for 60 years. The poverty threshold is recalculated by the Social Security Administration each year, based on the official consumer price index, CPI. Since median income evolves in close tandem with the CPI, the poverty threshold has been at about 55% of median income since at least the 1980s. In other words, it is in practice a relative definition.

As mentioned, Europe relies strictly on a relative poverty concept: it is not based on what a person considered poor actually needs, but on how his standard of living relates to his neighbor’s standard of living.

This has absurd consequences. Suppose John makes €50,000 per year, which also happens to be the median household income. Jack makes €30,000 per year, which is 60% of the median household income. Jack is poor, while John is not.

Over the next year, median income doubles to €100,000 per year, while inflation is zero. Suppose John still makes €50,000 while Jack gets a significant pay hike. He now earns as much as John does.

According to the American definition of poverty, which relies on inflation to change the poverty threshold, neither John nor Jack is now poor. The definition, which applies the 60% threshold, now sets the poverty threshold at €60,000 per year.

This means that both John and Jack are poor, despite the fact that John's real income is unchanged, and Jack got a 67% pay hike.

This is an unrealistic example, of course, where median household income doubles while inflation remains at zero. However, the theoretical point is broadly applicable and points to the core problem of the European definition of poverty: it allows people to improve their standard of living and still receive benefits, in this case, the AMI.

Moving closer to reality, suppose that median income in Europe grows by 5% in one year, and that the income for people classified as poor grows by 3%. Suppose also that inflation is 1%. This means that in real terms, the poor population has gotten a 2% rise in their purchasing power. However, since median income advances more than their income, more people now qualify for AMI.

In other words, the population that gets government help increases, even though the economy is doing better.

The absurdity of the poverty definition notwithstanding, perhaps the greatest problem with the AMI idea is the structure of economic incentives that it comes with. Since the AMI is universal, i.e., is offered to every person with an income below the poverty threshold, it incentivizes people to withdraw from the labor market. This is especially the case with those whose income is at or below the AMI threshold; why work when they can get about the same standard of living while idling?

In other words, the lower-earning segment of the workforce will be discouraged from workforce participation, as well as from climbing the income ladder. This is bad for economic growth, but so is the next incentive created by the AMI: In order to pay for the benefits, AMI proponents will have to raise taxes; it is a safe bet that the higher taxes will only burden the highest-earning households.

Higher taxes on higher incomes are just as work-discouraging as higher taxes on lower incomes, only at the high end of the income spectrum, those taxes are more destructive to the labor market. When small-business owners have to part with more of their incomes in order to pay for an AMI program, they take that money out of their business revenue; with more being lost to taxes, less revenue is used to pay workers.

As revealed in the Council Recommendation paper, AMI proponents are aware of these incentives problems. However, their response is not to propose that the AMI be kept at a bare minimum in order to maintain workforce participation incentives. Their response is to propose more government funding of programs that help people get jobs and grow their workforce skills. But with an AMI that guarantees a dignified standard of living, and—this is the key point—with AMI eligibility set at 60% of median income, it is a safe bet that no spending in the world on workforce improvements will be enough to supersede the incentive to idle.

Last but not least, the AMI idea also comes with a moral problem. By stating that everyone is entitled to the AMI if they lower their income below the 60% threshold, we not only hand out moral entitlements, but also moral obligations. If I have the right to €20,000 per year (or whatever the AMI might be) then someone else must have a duty to make enough income to pay €20,000 in taxes.

Proponents of AMI never address this moral aspect of their idea, yet their idea hinges critically on the existence of that moral duty. It cannot be put into practice before they come clean on who should be shouldered with this duty; judging from the debate in the European Parliament, taking AMI from theory to practice is precisely what the proponents want.

It is not sufficient for the proponents to simply call for more taxes. The responsibility to pay taxes is a general one: we can walk in and out of tax-paying status as much as we want to (and sometimes don't want to). The burden to pay taxes is not morally individualized, which means that anyone who thinks taxes are too high is free to stop paying them by simply dropping out of the workforce—or down to an income where AMI benefits exceed whatever taxes may apply to an income at or below the 60% threshold.

Bluntly speaking, it is perfectly possible for someone who is paying taxes into the AMI system, to simply quit his or her job and live on AMI instead.

Given the economic incentives structure that comes with the AMI, this moral dilemma is more than just a nice theory. If enough people choose to stay eligible for the AMI instead of accepting promotions at work that raise their income, and if enough people choose not to improve their workforce skills, then the cost of the AMI program will rapidly spin out of control.

In short, for the AMI program to work, its proponents must individualize the moral obligation to pay for it. They must simply divide the population into "eligible for benefits" and "obligated to pay taxes." Those fortunate enough to belong in the former category will never have to transition into the latter; those who are designated as "taxpayers" can never be allowed to make themselves "eligible."

A society where this moral stringency is applied to welfare state programs is, of course, openly totalitarian. However, it is difficult to see how the AMI is going to combine generous benefits with fiscal soundness without resorting to totalitarianism.

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