# Combating poverty in developing countries with a universal basic income

Articles

Published 17.07.17

**Maitreesh Ghatak**
Professor of Economics and Political Science at the London School of Economics

The pros and cons of a universal basic income in reducing poverty and achieving inclusive economic growth

## Related content

in varying country contexts

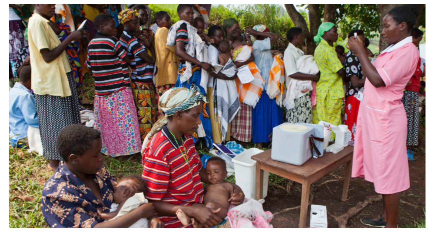
It is relatively rare for the same economic policy to be hotly debated in both developing and developed countries given how different their economic environments are. A universal basic income (UBI) is one such example.

## What is a universal basic income?

A UBI scheme is defined by three features:

1) It is a *cash transfer* scheme as opposed to any specific good or service being provided in-kind, in a subsidised manner, or through coupons or vouchers.

2) It is *non-conditional*, meaning it is not contingent on the recipient satisfying any compliance criteria to receive the assistance. This differentiates it from, for example, conditional cash transfer schemes where families receive an income transfer conditional on their children attending school and family members receiving preventive health care. This approach has been successfully implemented in Latin American countries like Mexico and Brazil. This also distinguishes a UBI from pensions, unemployment and disability benefits in the context of developed countries.



### The future of social assistance in Africa and beyond

Video

Published 21.06.17

### Straw men in the debate on basic income versus targeting

Articles

Published 21.06.17

3) It is *universal*, meaning not targeted to any specific group based on socio-economic or demographic criteria. Targeted assistance caters to those below a certain income level, (e.g., child support or pensions) as opposed to every citizen.

These three dimensions of a UBI – cash transfers, non-conditionality, and universality – can and have been debated. It is useful to think about the respective pros and cons of these different features, and how they apply to developing versus developed country contexts.

## UBI in developing versus developed countries: Pros and cons

The arguments in favour of the first two features of a UBI 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.

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. This is often not the case in developing countries, though mobile banking is making a dent in the problem. Subject to these caveats, unconditional cash transfers are least likely to interfere with the behaviour of the recipients or distort the production or supply side of resource allocation.

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.

Evidence from low- and middle-income countries suggest that, on average, cash transfers to the poor do not cause them to work less or spend their money on inessential consumption. For example, 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. Bastagli et al. (2016) review evidence on the effects of cash transfers on individuals and households through a rigorous literature review from 2000 to 2015, covering 201 studies and report increases in household food expenditure, school attendance, use of health services, dietary diversity, savings, livestock ownership, and purchase of agricultural inputs. A pilot study of UBI in eight Indian villages reports similar findings.

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. These errors are a primary challenge when implementing 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. This is why a UBI is similar to the negative income tax scheme proposed by Milton Friedman.

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. What's more, 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. Therefore unless a UBI is funded through indirect taxes or taxes on capital gains this also raises concerns about fairness. For example, in India, agricultural income is legally tax-free and the informal sector, where most people are employed, is also beyond the reach of the income-tax system.

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. For example, in India, giving everyone a sum that equals the yearly income corresponding to the poverty line is about 10% of GDP, while the corresponding figure for the US is 20%. Both these numbers are impractical given the fiscal realities of the respective countries.

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.

# A cautious case for a universal basic income in developing countries to

# combat poverty

The main economic arguments behind a UBI in developed and developing countries are different. 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.

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.

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.

# Conclusion

A UBI does not in and of itself provide any direct pathway out of poverty. For this to be achieved it must be complemented by skill-formation to allow the poor to be self-sufficient and not dependent on government transfers. A long-term strategy involving investment in human capital is also required, so that the children of poor families can take advantage of growth opportunities. Investing in infrastructure and regulatory conditions to facilitate private investment for employment generation is equally crucial.

In a nutshell, achieving inclusive economic growth is the best long-term approach to poverty alleviation. However, UBI offers a short-term solution by providing an immediate reduction in poverty, and should be used in conjunction with other economic development schemes to achieve a sustainable solution to inequality and poverty.

Photo credit: AMISOM Public Information @ flickr.

# References

Banerjee, A, Hanna, R, Kreindler, G and Olken, B A, (September) "**Debunking the Stereotype of the Lazy Welfare Recipient: Evidence from Cash Transfer Programs**". Department of Economics, Massachusetts Institute of Technology.

Bastagli, F, Hagen-Zanker, J, Harman, L, Barca, V, Sturge, G and Schmidt, T with Pellerano, L (2016), "**Cash transfers: what does the evidence say? A rigorous review of programme impact and of the role of design and implementation features**", the Overseas Development Institute.

Evans, D K and Popova, A (2014), "**Cash Transfers and Temptation Goods A Review of Global Evidence**", The World Bank Africa Region Office of the Chief Economist. Policy Research Working Paper: 6886. Accessible:

Universal basic income

Cash transfers

Poverty

Email Address Send