

**The Social Contract Revisited**

# Guaranteed Income as a Replacement for the Welfare State

**Charles Murray**

The Foundation for Law, Justice and Society

in collaboration with

The Centre for Socio-Legal Studies,  
University of Oxford

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## Executive Summary

- A guaranteed income (GI) that replaces the welfare state is not currently on the political agenda, but it offers the possibility for a grand compromise that could attract a majority political coalition: for the Left, it represents larger government in that it constitutes a state-driven redistribution of wealth, while for the Right, it offers smaller government in terms of the state's power to control people's lives.
- Any large-scale GI cannot be economically feasible in addition to current welfare programmes. Financial constraints in both Western Europe and the United States require that the money for funding a GI comes from the existing Social Security budgets.
- The overarching reason to scrap the apparatus of the welfare state is that the welfare state is self-destructing. After a process that has taken decades, the welfare state has severely degraded the traditions of work, thrift, and neighbourliness which enabled the system to work at the outset. It is now spawning social and economic problems that it is powerless to solve.
- In the United States, a GI of \$10,000 per year for all adults aged twenty-one years and older will cost no more than the projected cost of the current system as of 2011. By 2028, it will cost more than a trillion dollars less per year than the projected costs of the current system.
- Using conservative assumptions, the proposed GI is demonstrably superior to the current system in enabling the elderly to accumulate comfortable retirement incomes. Furthermore, the proposed GI effectively ends involuntary poverty, even assuming minimum-wage jobs and high unemployment.
- The work disincentive effects of the proposed GI are diminished by a high payback point that begins at US\$25,000 of earned income. The disincentive effects that may result are likely to be concentrated in hours worked rather than the decision to stay in employment.
- The proposed GI may be expected to bring about a substantial reduction in extramarital births, and to increase, to an uncertain extent, labour force participation among young males currently outside of the labour force.

# Guaranteed Income as a Replacement for the Welfare State

## *Introduction*

Professor Amitai Etzioni's policy brief presents a cogent case for a guaranteed income (GI). Like other advocates, he sees the GI as a moral imperative – in his case, it is an expression of a moral obligation we have to one another as human beings, rather than as a policy justified by a basic human right. He shares with many other advocates of a GI the view that it should be given to individuals, not families, and that it should supplement, not replace, means-tested programmes that provide additional services to the poor and other disadvantaged groups. He distinguishes his approach from many others by invoking the 'communitarian differential', arguing that it is appropriate both ethically and practically to pay more attention to the people in one's immediate community than to people one has never met.

This policy brief also advocates a GI, but from a different political perspective and with different priorities.

## *Moral obligation or expediency?*

While a GI is not on the current policy agenda of any government, it has unique potential in the years to come as the basis for a coalition of supporters from Left and Right. A GI is already attractive on ethical grounds for most people on the Left. Those on the Right of the political spectrum, including many on the libertarian Right, are already reluctantly convinced that large-scale transfer payments are here to stay, and are consequently receptive to ways of spending the money that does not involve extensive bureaucracies and social engineering. In view of this convergence of views on GI, a grand compromise is potentially available: for the Left, it represents larger government in that it constitutes a state-driven redistribution of wealth, while for the Right, it offers smaller government in terms of the state's power to control people's lives.

## *Replace or augment?*

From a practical standpoint, Professor Etzioni's arguments for a GI in addition to the existing benefit system are moot. No matter how theoretically persuasive those arguments might be, no Western nation can afford to add a significant GI to its existing commitments. On the contrary, all Western nations need to restructure their existing benefit systems to avoid bankruptcy. If a GI is to be financially feasible, it must replace existing programmes rather than augment them.

I regard this practical necessity as serendipitous. The real reason to scrap the advanced welfare state is that its apparatus is outmoded, ineffectual, and often counterproductive. Because this view is so central to the Right's potential support for a GI, some explanation of it is in order.

The European and American welfare states evolved under the twin assumptions that resources were scarce and that government could allocate them effectively. The first assumption was true during the first half of the twentieth century, in the sense that no country had ever been so rich that its wealth, divided evenly among everyone, would provide everyone with a comfortable living. After World War II, in a few countries, wealth increased so much that, for the first time, there was enough money to go around. It was technically possible for no one to be poor. Much of the energy behind the social turmoil of the 1960s was fuelled by this revolutionary change.

Now let us consider the second of the assumptions: that governments could allocate resources effectively. During the early decades of the welfare state, it seemed simple. The indigent elderly depend on charity, so let the government provide everyone with a guaranteed pension. The unemployed husband and

father cannot find a job, so let the government give him some useful work to do. Those who are sick cannot afford to go to a private physician, so let the government pay for health care.

It turned out not to be simple after all. The act of giving pensions increased the probability that people reached old age needing them. Governments struggled to find useful work for unemployed people and were ineffectual employers even when they did. The demand for medical care outstripped the supply. But, despite the complications, these are the easy tasks. Scandinavia and the Netherlands – small, ethnically homogeneous societies, with traditions of work, thrift, neighbourliness, and social consensus – do them best.

Traditions decay when the reality facing the new generation changes. The habit of thrift decays if there is no penalty for not saving. The work ethic decays if there is no penalty for not working. Neighbourliness decays when neighbours are no longer needed. Social consensus decays with immigration. Even the easy tasks become hard as time goes on.

In the United States during the second half of the twentieth century, the welfare state confronted accelerating increases in the number of people who were not just poor, but who behaved in destructive ways that ensured they would remain poor, sometimes living off their fellow citizens, sometimes preying on them: the underclass. As the years passed, poor young men increasingly reached adulthood unprepared to work even when jobs were available. They were more disposed to commit crimes. Poor young women more often bore children without a husband. Poor children more often were born to parents who were incompetent to nurture them. When it came to solving these problems, it was obvious by the 1980s that government had failed. The growing evidence was that government had exacerbated the problems it was trying to solve. As the Americans were making these discoveries, an underclass also began to emerge in the British and Continental welfare states.

That the apparently straightforward tasks of the welfare state have become complex and underclasses are growing throughout the Western world are neither coincidences nor inevitable by-products of modernity. Over a process that takes decades to play out, the welfare state self-destructs. First, it degrades the traditions of work, thrift, and neighbourliness that enabled the system to work at the outset; then it spawns social and economic problems that it is powerless to solve. Devising an effective replacement for the welfare state is not only a budgetary necessity but also a social imperative.

### *A specific plan for the United States*

To frame the discussion, it is useful to think in terms of a specific proposal. The one I have proposed in a book entitled *In Our Hands* converts all transfer payments to a single cash payment for everyone aged twenty-one and older (Murray 2006). It would require an amendment to the American Constitution that I am not competent to frame in legal language, but its sense is easy to express: 'Henceforth, federal, state, and local governments shall make no law nor establish any program that provides benefits to some citizens but not to others. All programs currently providing such benefits are to be terminated. The funds formerly allocated to them are to be used instead to provide every citizen with a cash grant beginning at age twenty-one and continuing until death. The annual value of the cash grant at the program's outset is to be US\$10,000.'

This version of a GI, does not involve much bureaucracy, besides the administration of a national identity card attesting to citizenship, establishing eligibility for the GI. The grant itself would be electronically deposited in monthly instalments into a bank account established by the recipient (no bank account, no grant). Earned income has no effect on the grant until it reaches US\$25,000. From US\$25,000 to US\$50,000, surtax is levied that reimburses the grant up to a maximum of US\$5000. The surtax is 20 per cent of incremental earned income. The grant is administered for individuals without regard to earned income from other members of the household.

The GI eliminates programmes that are unambiguously transfers – Social Security, Medicare, Medicaid, welfare programmes, social service programmes, agricultural subsidies, and corporate welfare. It does not apply a strict libertarian definition of *transfer*, leaving activities such as state-funded education, and funding for transportation infrastructure and the Post Office in place. Services that are required for the operation of the courts and criminal justice system are also retained. For example, the enforcement of child-abuse laws sometimes means that children must be taken from their parents. Doing so requires that the government provide for the well-being of that child through facilities and services.

### ***The financial feasibility of an adequate guaranteed income***

Once benefits replacement is used as the basis for financing a GI, the money problem becomes manageable. By about 2011, the GI will be cheaper than maintaining the system the United States has in place, and the cost savings will increase geometrically in the years to come. The cost of the GI will increase as the population increases and ages, at about one per cent per year in total spending (expressed as the compound average growth rate [CAGR], not the arithmetic average). But total government spending on the programmes the GI replaces will rise much faster. From 1980 to 2000, the annual real increase in the costs of the programmes to be replaced averaged 2.9 per cent, almost three times the rate of increase for the GI. Those increases are about to get larger, as the ageing Baby Boomers generate increases in Social Security and Medicare far larger than those we saw in 1980–2000. Using conservative assumptions, the GI would cost US\$549 billion less than a continuation of the current system by 2020. By 2028, the cost differential would be US\$1 trillion per year. This statement does not take transition costs into account, a complex issue that I set aside here except to note that a system that costs a trillion dollars less per year than the current system by 2028 provides options for dealing with transition costs.

### ***Immediate effects 1: retirement income***

With regard to the elderly living in retirement, the first and largest advantage of the GI over the current system is that it is truly universal (American Social Security is not), and even in the worst case provides US\$10,000 a year for every elderly person in the country. But the GI does more than give everyone a guaranteed floor income. The GI makes it easy for low-income people to have a comfortable retirement. Summarizing the more detailed discussion in the book, consider someone who puts US\$2000 a year in an index-based stock fund every year from age twenty-one until he retires at sixty-six. If one applies a worst-case scenario, assuming a lower compound average growth rate (4%) than has actually occurred in any forty-five-year period in the history of the American stock market, that person will have about US\$253,000 at age sixty-six, with which they could purchase an annuity worth about US\$20,500 a year, on top of the US\$10,000 continuing grant. What about people who don't save any money or invest it unwisely? Everyone, including the improvident and incompetent who have squandered everything, still have US\$10,000 a year each, US\$20,000 for a couple, no matter what. Six people who have completely squandered everything can pool their resources and have US\$60,000 per year; and so on. If a guaranteed floor is important, the GI does a far better job than the current system.

What about the risks of trusting to the stock market versus the security of a government-backed guarantee? In the specific case of the GI, a guarantee of US\$10,000 a year remains even if the stock market crashes. But there is a larger reality to consider: if stocks do not appreciate in real value by an anaemic average of 4 per cent over the next forty-five years, the economy will have failed to grow enough to enable the government to make good on its promises under the current system.

### ***Immediate effects 2: health care***

The GI requires that every recipient of the grant, beginning at age twenty-one, spends US\$3000 of the US\$10,000 grant on a health care insurance package that includes coverage for high-cost single

events such as surgery and for catastrophic long-term illnesses or disability. The GI also requires that insurance companies treat the entire population as a single risk pool. Given that environment, health insurance companies can offer plans with excellent coverage for somewhere around US\$3000. They can be so inexpensive for the same reason that life insurance companies can sell generous life insurance cheaply if people buy it when they are young.

For the rest of the brief, I assume that US\$3000 of the grant goes to health care from age twenty-one onward. I am not wedded to that precise figure, however. The sense of the proposition is this: determine the cost of a health insurance policy that would pay for extraordinary health care costs, including major surgery, all genetically based diseases, and illnesses involving long-term care or disability. That is the amount of money that I am willing for the government to provide. If it is determined that the number is US\$3800, then the grant should be US\$10,800. The arguments in the rest of the paper assume US\$7000 remains after health care is deducted. As long as this amount remains constant, the amount devoted to health care is irrelevant. The only effect of tweaking the size of the grant would be to alter the crossover year when the GI is no more costly than the current system.

### ***Immediate effects 3: poverty among the working-aged***

By poverty, I mean the lack of resources to provide for basic material needs and comforts. I conceive of poverty along a dimension ranging from purely involuntary to purely voluntary. Involuntary poverty occurs when someone who plays by the rules is still poor. Poverty that I consider voluntary is the product of one's own idleness, fecklessness, or vice.

The immediate effect of the GI is to end involuntary poverty among the working-aged as well as the elderly. In a world where every adult starts with US\$10,000 a year, no one needs to go without decent food, shelter, clothing, and the amenities of life. This statement holds even after taking the expenses of retirement and medical care into account. To summarize the detailed calculations presented in

the book, assuming that US\$3000 of the grant is devoted to health care (by requirement) and US\$2000 is devoted to a retirement fund (voluntarily), leaving US\$5000 per person per year, surpassing the official poverty line under the GI is easy for people in a wide range of living circumstances, even in a bad economy with substantial periods of unemployment, and even assuming jobs at the minimum wage.

### ***Immediate effects 4: the underclass***

The word *underclass* denotes a class of people who exist at the margins of Western societies. They are usually poor, but poverty is a less important indicator than personal behaviour destructive to themselves and to their communities. Three categories of people constitute a large part of the problem: chronic criminals, never-married women with children, and able-bodied young men who are out of the labour force (Murray 1989). How might the GI affect them?

#### ***Criminality***

According to sociological theory that sees crime as a response to economic deprivation, the GI should reduce crime. The GI will provide a nice test of such theories. But the twentieth century provided a nice test, too, and the theories flunked. Poverty fell; crime rose. The GI may indirectly reduce crime through positive effects on family structure, but I will not forecast reduced crime as one of the GI's positive effects. If it happens, it will be a bonus.

#### ***Births to single women***

The GI will plausibly produce a large reduction in births that occur to single women, for the simplest of reasons: it introduces new penalties for nonmarital births for everyone involved. The GI obviously increases the economic penalty of having a baby for a single woman under twenty-one, who no longer has access to any of the existing welfare programmes for single mothers. The GI also increases the economic penalty on the parents of a teenaged mother who is still living at home, thereby also increasing their incentives to pressure the daughter to avoid pregnancy or to have an abortion. Under the GI, having a baby no longer triggers a benefits stream to defray their costs.

The GI radically increases the economic penalties for fathers who are unemployed or working off the books. Under the current system, a child support law is meaningless because they have no visible income. Under the GI, every man aged twenty-one or older has a known income stream deposited to a known bank account every month that can be tapped by a court order. For teenaged fathers who are not yet old enough to be eligible for the grant, their obligation would accumulate until they turn twenty-one, whereupon the child support law would force them to start paying it back.

For low-income single women aged twenty-one and older, the major effect of the GI is to create a cost of having a baby, since the baby would have to be looked after out of the existing US\$10,000 the woman already receives, which contrasts with the current system, where the birth of a baby brings resources that would not be offered if the baby did not exist.

### *Young males not in the labour market*

The third category of people who embody the underclass consists of able-bodied young men in low-income neighbourhoods who do not work or even look for work, and have no excuse for not working (e.g., they are not attending school). In the United States, even in tight labour markets, these young men account for about 8 per cent of white males and 22 per cent of black males.

The GI complicates their lives by forcing them to have an income that other people know about. Without the GI, large numbers of young men who live with parents or girlfriends have an active incentive not to work at a low-paying job. Such a job would not pay enough to get a nice place of their own, but any regular income would put them under pressure to help parents or girlfriends pay for food and rent. With the GI being deposited to their bank account every month, they would no longer have the option of avoiding that pressure. But with the grant as a supplement, the income from a low-paying job now makes it feasible to get places of their own. All those men who would prefer to be independent

have gone from a situation in which they had little incentive to work to a situation in which they have substantial incentives to work.

### *Empowering the individual*

I cannot leave the discussion of effects on the underclass without alluding to a broader effect of the GI that may be the most important of all. A persuasive critique of the current system is that the people who make up the underclass have no reason to think they can be anything else. They are poorly educated, without job skills, and living in neighbourhoods where prospects are bleak. The quest for dignity and self-respect takes the form of trying to beat the system, whether *the system* means the criminal code or the rules that surround the distribution of welfare. The more fortunate members of society may see such people as obstinately refusing to take advantage of the opportunities that exist. Seen from the perspective of the man who has never held a job or the woman who wants to have an infant to love, those opportunities look fraudulent.

The GI does not exhort the young man to go out and get a job. It does not urge the young woman to delay childbearing. It does not do anything that tries to stage-manage their lives. The GI simply provides money. The money is not charity, since everyone in the country turning twenty-one is getting the same thing. Seven thousand dollars of it consists of cash to be used as they wish, not little bundles of benefits to be allocated as the welfare bureaucracy sees fit. The money is deposited monthly into that most middle-class of institutions, a bank account. The GI says just one thing to people who have never had reason to believe it before: 'Your future is in your hands'. And it is the truth.

### *Immediate effects 5: work disincentives*

The most serious practical objection to the GI is its potential effect on work. For years, economists have found through rigorous quantitative analysis what common sense predicts: make it easier not to work, and people work less. How might labour force participation and work effort be expected to change

under the GI? The discussion in *In Our Hands* works through a variety of scenarios, reaching the following conclusions:

- Most of those who remain out of the labour force will be the same people who are out of the labour force under the current system.
- Most of the reductions in work effort will involve fewer hours worked, not fewer people working.
- Most of the people who leave the labour force will be college graduates who take time off between graduation and a permanent job or graduate school.
- The net decrease in work effort will be acceptable.

The key feature of the GI that supports these conclusions is the high income level at which the grant begins to be paid back through the surtax (US\$25,000 of earned income). Past attempts to put a floor on income have foundered on high marginal tax rates for people who take low-paying jobs. Setting the start of the payback of the grant at US\$25,000 lures people into working until they are making too much money to quit. The fact that people start paying a few hundred dollars in surtax when they first get past US\$25,000 in earned income has no meaningful effect on their calculations about whether to continue working, since at US\$25,000 of earned income, they are choosing between a net of US\$35,000 versus a net of US\$10,000. A work disincentive may well be observed, but it will be concentrated in number of hours worked, not in the choice to work at all.

### **Long-term effects**

I have focused on the GI's immediate effects on widely accepted economic and social goals. The more important purpose of the GI probably lies in its long-term effects on family and community. My expectations of them arise from a particular philosophical viewpoint.

Among the peoples in the advanced welfare states of Western Europe – usually secular, often childless, often unmarried – it seems as if a new cultural consensus has been reached: that the purpose of life is to while away the time between birth and death as pleasantly as possible, and the purpose of

government is to make that process as easy as possible. I disagree, holding that to live a satisfying human life requires being enmeshed in the stuff of life. By *stuff of life* I mean the elemental events of birth, death, growing up, raising children, comforting the bereaved, celebrating success, dealing with adversity, applauding the good, scorning the bad, making a marriage, making a living; in short, coping with life as it exists around us in all its richness, which in turn means coping with difficulties, challenges, and defeats. The chief defect of the welfare state from this perspective is not that it is inefficient in dealing with social needs (though it is), nor that it is ineffectual in dealing with them (though it is), nor even that it often exacerbates the very problems it is supposed to solve (as it does). The welfare state drains too much of the life from life. Specifically, it does so by stripping the institutions of family and community of many of their functions and responsibilities.

The GI returns those functions and responsibilities to family and community. In this sense, the importance of the GI on human relationships and the vitality of communities is not that each adult has US\$10,000 a year, but that the government has withdrawn all the ways in which the apparatus of the welfare state tries to take the trouble out of people's lives, and by that withdrawal has made it easier for people to behave in ways that lead to satisfying lives.

Regarding marriage, the GI leaves everyone with the option of remaining single and moving in and out of short-term relationships. But most people want something deeper and more lasting than that, something that looks like marriage traditionally defined. Without the apparatus of the welfare state, marriage once again becomes the locus within which a man and woman can make a future together, laden with responsibilities and obligations that cannot be put aside.

Regarding the community, a GI that has replaced the welfare state makes the community once again the locus within which human needs must be met, and the effects could be profound. It is not necessary for

everyone to become a volunteer social worker to find satisfaction in life, but it is important that human needs of those in trouble are dealt with in a way that is an integral part of everyone's life. In a society where the responsibility for dealing with human needs is consigned to bureaucracies, a disconnect develops between the recognition of suffering and the ordinary citizen's obligations to deal with it. That disconnect is reflected in everything from the way we teach (or fail to teach) virtue to our children, to the way we allocate our time among the competing needs of family, community, and personal pleasure. The GI removes that disconnect.

But the effects of the GI on communities are likely to go far beyond the human needs that the welfare state seeks to address. When the government assumes the core functions of community, it removes the means by which vital communities establish their value. It also cuts off nourishment to secondary and tertiary behaviours that have nothing to do with social work. According to the logic of the social

engineer, there is no causal connection between such apparently disparate events as the establishment of a welfare bureaucracy and the erosion of community spirit. According to the logic I am using, there is a causal connection of great importance.

This has been the barest summary of my reasons for thinking that the effects of the GI on civic life will be transforming. At least with regard to the United States, history gives us good reason to think that those reasons are not grounded in wishful thinking, but in the way that families and communities actually behaved. Nothing stands in the way of the restoration of communities and families that behave appropriately and generously, and that actually solve human problems, except the will to put the responsibility for those problems back in their hands.

### **References**

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### **The Foundation**

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**Charles Murray** is the R.H. Brady scholar at the American Enterprise Institute for Public Policy Research in Washington, DC. He holds a BA in history from Harvard and a Ph.D. in political science from the Massachusetts Institute of Technology. He first came to national attention in the United States in 1984 with the publication of *Losing Ground: American Social Policy 1950–1980*. His other books include *The Bell Curve: Intelligence and Class Structure in American Life* (with Richard J. Herrnstein, 1994), *Human Accomplishment: The Pursuit of Excellence in the Arts and Sciences, 800 B.C. to 1950* (2003), and *In Our Hands: A Plan to Replace the Welfare State* (2006). In the United Kingdom, Dr Murray is best known for a series of extended *Sunday Times* articles, beginning in 1989, about the emergence of a British underclass.

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our website at [www.fljs.org](http://www.fljs.org)  
or contact us at:

The Foundation for **Law, Justice and Society**

Wolfson College  
Linton Road  
Oxford OX2 6UD  
T · +44 (0)1865 284433  
F · +44 (0)1865 284434  
E · [info@fljs.org](mailto:info@fljs.org)  
W · [www.fljs.org](http://www.fljs.org)