



## Island

Let us imagine an island with the population of 1000 identical people who, within a year, can produce goods worth 20,000 PLN. These people can work, but they value their leisure and must receive remuneration of at least 5000 PLN annually to compensate for the effort. There is only one employer on the island – in economics we call this situation a **monopsony**.

One day, islanders find a box on the beach with 1 million PLN inside. They consider two options:

**A:** universal basic income – the proposition is to pay out 1000 PLN to each islander (1000 people x 1000 PLN = 1 million PLN).

**B:** unemployment benefit – islanders propose paying 10,000 PLN to those who lose their job. 1 million is enough, because it is believed that in the worst-case scenario the unemployment the unemployment might reach 10% (100 people x 10,000 PLN = 1m).

### How will a monopsonistic employer behave in each of these two scenarios?

Let us begin with the scenario assuming the implementation of the universal basic income. The employer must convince the islanders that working is better than sitting at home. Both working and sitting at home earns each person 1000 PLN, but to convince them to work, the employer must pay them at least 5000 PLN on top of that. When the salary is 5000 PLN, everyone on the island will want to work for the monopsonist. What will their profit be? Each islander produces goods worth 20,000 PLN, but it is sufficient to pay them 5000 PLN, so the profit will amount to  $1000 \times (20,000 - 5000) = 15$  million PLN.

What does it look like in the case of the unemployment benefit? In this situation sitting at home provides an islander with 10,000 PLN, but people do not receive this amount when they are working. So, in order to convince anyone to work, the employer must pay 15,000 PLN! What will their profit be? It still pays off to employ everyone, so  $1000 \times (20,000 - 15,000) = 5$  million PLN.

In summary:

**A:** universal basic income

- islander's income = 6000 PLN (5000 PLN salary + 1000 PLN UBI)
- employer's profit = 15 million PLN
- unemployment = 0%
- social fund exhausted

**B:** unemployment benefit

- islander's income = 15,000 PLN

- employer's profit = 5 million PLN
- unemployment = 0%
- social fund (1 million PLN) remains untouched, because there is no unemployment

Therefore, with universal basic income the salary is 2.5 times lower and employer's profit 3 times higher than in the case of the regular unemployment benefit! Furthermore, in the first case, the social fund disappears entirely. How to explain it?

On a monopsonistic labour market, the entire market power belongs to a single employer, so they can seize a disproportionately large share of the produced income. The introduction of the unemployment benefit reduces the employer's power because society suddenly offers an attractive "plan B" for the workers. It is as if another employer – in the shape of society – suddenly appeared, and offered the opportunity to work for 10,000 PLN. Using the economics jargon, we would say that the benefit increases the **outside option** for the employees. Universal basic income, due to its universal and unconditional nature, does not limit the employer's power since it does not create any "plan B"! Thus, it does not affect the outside option.

Moreover, society does not have to spend a penny for the unemployment benefit. It is enough to promise it to those who would lose their jobs. As long as this 1 million PLN remains in the social fund for the possible coverage of the benefit, the employer will have to pay 15,000 PLN to their employees. Although their profit is smaller, it is still significant, so they will not close the business down. So could society, in this case, introduce the benefit and at the same time spend the money from the fund on basic income? No, because it would lose the argument of being able to pay out potential benefits.

#### **What if there are multiple companies?**

The assumption that there is only one employer is an extreme variant, although the research indicates that monopsonies are becoming increasingly frequent. Let us have a look at the other extreme, the situation where multiple companies compete with one another – in economics we call this model a **perfectly competitive** labour market.

In a perfect competition, employers compete for workers, so in equilibrium the employees will get as much as they produce: 20,000 PLN. No employer can offer less, because immediately another one will appear and seize their employees. This, in turn, results in employers earning nothing. In this case companies have no market power, so they are not capable of seizing any value added created by the islanders. What would be the effects of implementing these two social policies?

#### **A: universal basic income**

- islander's income = 21,000 PLN (20,000 PLN salary + 1,000 PLN UBI)
- employer's profit = 0 PLN
- unemployment = 0%
- social fund exhausted

#### **B: unemployment benefit**

- islander's income = 20,000 PLN
- employer's profit = 0 PLN
- unemployment = 0%
- social fund (1 million PLN) remains untouched, because there is no unemployment

In the world of a perfect competition, the difference between basic income and the unemployment benefit comes down to the question of what we should do with the social fund. In the first case, we distribute it evenly among everyone, and in the second case, we save it for future generations, to be used for instance in the event the competition between the companies disappears, there is an epidemic, or the sea level rises.

### **Lessons**

Although this thought experiment is an enormous simplification of the reality, it does highlight important limitations of the universal basic income model and showcases the significance of the context in which we analyse such solutions. I would like to emphasise the most important lessons:

- The degree of competition on the labour market is crucial for the analysis of social programmes.
- In a monopsonic situation, the unemployment benefit can turn out to be much more profitable to the population than basic income. In the case of a perfect competition, both solutions are comparable.
- Monopsony seems to be an extreme situation, but in fact, many labour markets are heading in that direction. Research in the US and Europe indicates the growing market strength of employers. Even worse, the situation affects women and migrants to a greater extent, since these two demographics have less alternatives on the job market, compared to men or local employees.
- We must ensure the competitiveness of labour markets. As a result of a greater competition among employers, employees receive remuneration adequate to their productivity.



**Paweł Bukowski**

## See also



Curator: Przemysław Wielgosz

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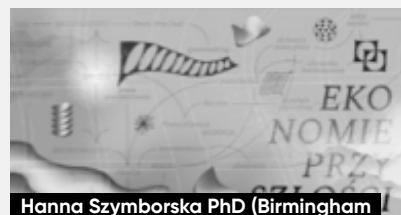
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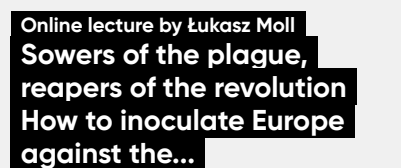
W tytule zacytowałam Olę Tokarczuk, która w swoim felietonie dla „Frankfurter Allgemeine Zeitung” pisze: „siedzimy...”



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