The Macroeconomics of Basic Income Grants*

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In a time of short or no historical memory, it is easy to believe that some ideas are completely novel and innovative. So it is with the idea of the "Universal Basic Income", which is getting much exposure in both developed and developing countries as a fundamentally new policy to deal with contemporary inequalities and the increasing uncertainty around employment generation. I have already considered some of the advantages and concerns with this idea, specifically in the Indian context, in a previous column (http://www.frontline.in/columns/Jayati_Ghosh/a-universal-basic-income-in-india/article9511636.ece). But it is worth looking in more detail at the history of this idea, and some of its previous critiques.

In the Indian tradition, some elements of the "grand design" ofthe basic income approach can be found as early as in Kautilya'sArthashastra, which was apparently composed by several authors over the 4th to 2nd centuries before the Christian Era. This sagacious text noted that widespread general impoverishment relating to inadequate food and access to minimum money to meet survival needs can destroy society and must be avoided by the ruler at all costs. Other types of impoverishment, however, could be addressed with grants of grain and money to the poor, regardless of whether they were to be seen as "deserving".

In Europe from the 16th century onwards, this idea of providing some cash grants to ensure basic survival of all members of a society was expressed at different times. It was a central feature of Thomas More's Utopia and explicitly championed in Belgium by Johannes LudovicusVives, whose ideas were implemented by the Flemish municipality of Ypres in the late 16th century and became one of the principles determining the Poor Laws established in England. But these were schemes essentially targeted to the poor, and they in turn were required to "deserve" this transfer by indicating their willingness to work.

In modern times, some of the most interesting discussion around these ideas occurred in the mid-20th century in the United States, when Milton Friedman proposed "a negative income tax" as part of a linear system that would fully integrate all personal income and transfer systems. In such a system, a minimum level of income would be defined such that people earning at that level would pay no taxes; those earning more would pay a proportion of their income above that level; and those earning less would receive a payment to cover the shortfall between their income and the prescribed level.

Interestingly, this was quite consistent with Friedman's views on "economic freedom" and reducing the role of the state in interfering with markets. In effect, he saw this is a substitute for the "ragbag" of other government social assistance and welfare programmes, and indeed even removing the need for a legislated minimum wage. He saw this as leading to the elimination of food stamps, disability benefits and other welfare programmes, social security programmes and other government assistance programmes. This in turn would reduce administrative costs and the associated bureaucracy to "a fraction" of the previous spending on all these programmes combined. In addition, it would reduce the "perverse incentives" created by overlapping programmes, for example when a low-wage worker would lose benefits if she took on additional work. He also felt that – unlike minimum wage laws that according to him created sticky wages that led to unemployment – a negative income tax (kept sufficiently low, of course) would increase the availability of cheap labour, thereby benefiting businesses.

This view from the Right of the political spectrum was met with confirmation from the liberal Left, as economists like John Kenneth Galbraith also started arguing for the state providing a guaranteed minimum income that would be more general and generous, and at the same time less dependency-creating, than existing social assistance programmes.

This confluence of right and left economic thinking on the idea of a basic income has remarkable contemporary resonance. That is why it is instructive to consider more closely an important – though unfortunately not as influential – critique of the idea in macroeconomic terms. The economist Hyman P. Minsky is today best known for his work on financial markets, which is now sufficiently recognised in the mainstream for the media to refer to a financial panic, such as that following the September 2008 Lehmann Brothers collapse, as a "Minsky Moment". But he was also the author of some very important work on macroeconomic processes and policies, in which he brought out very clearly the macroeconomic significance of employment programmes as a major policy tool for full employment.

Some of this work has been brought together in a volume (Ending Poverty: Jobs, Not Welfare", edited by Dimitri B. Papadimitriou, L. Randall Wray and Jan Kregel, Levy Institute of Bard College 2013). In one of the articles in this book, first published in 1969, Minsky takes up the macroeconomics of a negative income tax, which is in essentials similar to the basic income idea (though more sophisticated and therefore complicated to implement than a simple basic income). This is a critique at a different level from that often offered in terms of the concerns related to elimination of in-kind transfers and public social services.

Minsky begins by noting that for such a scheme to have the effect of reducing poverty, it must first deliver to the poor and near poor a larger money income than existing welfare schemes. (We ignore here all the problems of identification of the beneficiaries and assume that they are targeted correctly and accurately.) This further requires benefits that are deliveredby right (not means test) and are responsive to changing circumstances.

Minsky analyses such a scheme in terms of an income-expenditure model that explicitly incorporates uncertainty, in which such a scheme would inevitably have effects on consumption, supply of labour, investment and portfolio behaviour. Without going into the analytical details, his conclusion on this matter is worth quoting:"A negative income tax is expansionary or inflationary, even if budgets are balanced. Monetary and fiscal constraint can offset this inflationary pressure, but at a cost in measured gross national product and rate of growth."

In other words, even if the proposed transfers simply substitute for the previous social and welfare schemes with no additional fiscal implications, the effect will either cause output to expand (in the absence of supply constraints) or cause inflation (if there are supply constraints, for example in agriculture). Since a negative income tax raises the floor for real income for all families below the defined level, this would raise the ratio of consumption to income for those families and therefore also in the aggregate. Similarly, an improvement in welfare and therefore consumption would tend to raise investment, inducing an inflationary expansion. As this becomes apparent, speculative shifts in the investment and liquidity preference functions will occur.

Therefore, according to Minsky, “there exists a price level at which the real value of the negative income tax equals the real value of the previous welfare schemes. If the distributional effects are ignored, at this price level the pre-negative income tax equilibrium is re-established.”

However, the point is that the distributional effects cannot be ignored, especially given the stated purpose of poverty reduction. If the negative income tax induces inflation, there will be an upward shift in money incomes, causing some families that earlier fell below the defined threshold level to rise above it. “Families which initially were net beneficiaries would cross the breakeven line in dollar terms and experience a decline in their real income. Simultaneously, the rise in prices will erode the value of the benefits to the poor. The end result will be an equilibrium which delivers less in real terms than promised to the poor, while biting more deeply than anticipated into the real income of the not-poor, but not very well-off, population.”

Therefore this type of intervention, which effectively ignores distributional effects even while ostensibly purporting to deal with unequal income distribution, may fail in terms of its intended outcome of reducing or doing away with poverty. This argument makes the case in terms of macroeconomic analysis, for considering the system-wide and ripple effects of such a programme, in addition to the direct effects.

These are the reasons why Minsky emphasises the importance of direct job creation programmes, stressing the “employer of last resort” function of the government. While recognising that transfer-based programmes could be a measure of the compassion of a society, they must fail as stand-alone poverty reduction strategies. “Job-based strategies”, on the other hand, not only affirm the dignity of labour in various forms (and especially if they recognised various forms of work including care work) but they also become the primary tool for making full employment a permanent feature of the economy.

This is obviously Utopian to the extent that such a strategy is likely to be incompatible with the other features of capitalism, especially global capitalism in its current virulent form. But it is certainly a more hard-headed approach than one that blithely assumes that cash transfers will in themselves generate more equal economies and societies.

* **This article was originally published in the Frontline Print edition: July 21, 2017.**