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RESPONSE TO COLANDER'S ECONOMICS WITH ATTITUDE

The High Costs of UBI are Not Financial: They are Real

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When considering the viability of universal basic income (UBI) and other large-scale federal programs, we would do well to look at the real, rather than financial costs. This shift in perspective is useful because, as the Federal Reserve has reminded us time and again, taxes are not a funding operation for the federal government.

In an important piece titled "Taxes for Revenue are Obsolete," NY Federal Reserve Chairman Beardsley Ruml (1946) stressed that the crucial consideration when imposing taxes is their social and economic consequences, not their funding capacity. While tax revenue ensures the solvency of state and local governments, this is not true for the federal government, whose spending is operationally unconstrained due to the elimination of currency convertibility and advances in Central Bank management (ibid.). Other Federal Reserve papers and statements corroborate this analysis (e.g., Bernanke 2002, 2009; Fawley and Juvenal 2011). The *real* impact of taxes on the economy is their anti-inflationary, income distribution, and incentive effect.

As a practical matter, taxation and spending are two independently determined operations. For example, spending on UBI would vary with changes in demographics if the program were permanent and unconditional. Tax collection would vary with changes in aggregate income and output and other underlying economic conditions, which in turn would be affected by the structure of the tax system, as Colander points out.

Once spending is appropriated through the budgeting process, Federal Reserve and Treasury operations ensure that all payments clear and government checks do not bounce, as is the case with other federal programs. As a practical matter, there is no way of matching tax collection with expenditures. If we attempted to do that via a Trust Fund mechanism, for example (as Roosevelt did with Social Security for political expediency), the fund would act as a recording device, not an actual storage of purchasing power. The inflow of tax revenue into the fund would not be an indicator of the program's solvency. This was well explained by Federal Reserve Chairman Greenspan in a Congressional testimony on Social Security (2005).

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> I wouldn't say that the program is insecure in the sense that there is nothing to prevent the Federal Government from creating as much money as it wants and paying it to somebody. The question is, how do you set up a system, which assures that the *real* assets are created which those benefits are employed to purchase?[1]

Here we confront the key, perhaps fundamental, concern with such large-scale government programs: namely, does the structure of the economy produce the needed *real* goods and services that those UBI benefits are destined to purchase? In other words, even if UBI does not threaten solvency, is the enormous expenditure on the program warranted? What are the real macroeconomic effects of passing UBI and will it ensure a minimum standard of living for all? In my view the answer to these questions is "no" due to some perverse and unintended program effects.

Since collecting taxes is a separate operation from spending, it is appropriate to consider gross (rather than net) expenditures first. I consider the impact of taxes and other reductions in government expenditure below.

If the program is implemented as an "add-on," rather than a replacement for existing government programs, spending on UBI could be as high as 20–35% of GDP annually (Tcherneva 2017). UBI would be an enormous fiscal impulse by any measure. The worry is not that it would compromise the government's budget, but that the expenditure represents vast purchasing power and command over real resources, equivalent to a fifth or more of the US economy. Would the economy produce the needed additional output to satisfy this new demand? If not, how would the resulting real resources be distributed and priced, in order to soak up the additional purchasing power? If output does not adjust sufficiently, the program would prove to be inflationary.

Worse, according to UBI advocates, we should expect a sizable fall in labor supply. One of the presumed benefits of the grant is that it empowers the recipients to refuse poorly paid or otherwise "bad" jobs. If UBI advocates (e.g., Standing 2011) are correct and there is a mass exodus from precarious working arrangements, the inflationary effect of the grant would be exacerbated. Once the value of the grant drops, recipients at the bottom of the income distribution will be once again compelled to work. And if the economy continues to provide poorly paid and precarious work arrangement, they will not be "liberated" from their "bad jobs." Worse still, the grant may accelerate the Uberization of jobs since it represents a large subsidy to firms. Why should an employer offer a living wage, if the government has "promised" to do so via UBI?

If we were to adopt David Colander's proposed tax schema, the negative labor supply effect would be even larger, because (as he points out) households receiving labor income below UBI would pay a marginal tax rate of 100%, effectively earning nothing from working. Many households earning slightly above the UBI grant, according to Colander, would also withdraw from the labor market.

[1] https://www.c-span.org/video/?c3886511/2005-greenspan-ryan-024200.

Suppose, however, that labor supply does not collapse and those at the bottom of the income distribution continue to work in their poorly paid jobs to supplement their UBI grant. Would the UBI recipients be able to acquire the needed real resources to make for a decent living, such as childcare, healthcare, housing, and education (the costliest—and increasingly so—items in a household's budget)? Would the slumlord raise rent and extract some of that basic income in the form of higher prices? Would rising college tuition grind to a halt to allow UBI recipients to access already expensive college education? Would households be able to negotiate cheaper health insurance with insurance companies? All this seems highly unlikely. And would \$20,000/year per person be sufficient to make these basic necessities truly affordable in the face of considerable market power from their providers? Families with decent incomes already have trouble accessing affordable childcare, education, and healthcare. As it is with other income support programs, the issue is not one of inadequate income alone, but also of inadequate provisioning of essential and affordable goods and services that constitute a basic minimum standard of living.

These problems can be made worse if UBI is used to reduce or altogether replace existing welfare programs, such as housing assistance, TANF, Social Security, and Medicare (see Murray 2016, among others)—programs that are carefully targeted to specific dimensions of poverty. This will reduce the provisioning of specific basic necessities, such as affordable food, housing, or healthcare.

Taking into account the likely price pressures that would erode the value of the grant, the under-provisioning of needed goods and services, the threat of replacing existing anti-poverty programs, one could argue that the UBI grant may even unintentionally harm precisely those who need it most—households at the bottom of the income distribution. And if wealthier families deposit their basic income grant into their retirement portfolios, while poorer households spend theirs, UBI may worsen the already skewed distribution of wealth and incomes.

Tax policy could address this problem by increasing the progressivity of taxes, which is the opposite of David Colander's proposal. Taxes can also absorb some of the excess purchasing power, but if the price increases are due to market power and supply side factors, income taxes will not do much to address them.

The best fiscal policy is one that serves as a thermostat for the economy and adjusts spending counter-cyclically. UBI has no such feature (remember the same grant is provided to all year after year, rain or shine).

By contrast, the Job Guarantee (JG), which David Colander (2016) has discussed previously, has a strong macroeconomic stabilizer. As a public option, which provides a basic job at a base wage to anyone who needs work, the JG employs the unemployed in recessions and helps them transition to better-paid private sector jobs in expansions. The JG eliminates involuntary unemployment, by replacing the NAIRU, i.e., the fluctuating pool of unemployed, with a fluctuating pool of employed people in the JG. It also provides a stable minimum wage floor. The countercyclical function of the program and the non-competitive base wage allows it to stabilize output and prices (Tcherneva 2013).

Crucially, the JG addresses another shortcoming of UBI—it produces the very output that is currently underprovided to families experiencing economic insecurity—affordable childcare and housing, free preventative care health clinics, affordable training and education opportunities, and locally sourced food in so-called "food desert" areas. The JG aims to provide a wide range of public services, including urban restoration, fire and flood prevention, stormwater maintenance, and other green projects. In other words, the Job Guarantee provides both the basic income and the output.

As we consider large-scale programs, we would do well to ask, not whether we can pay for them, but whether we are providing the needed output and resources in a manner that addresses economic insecurity, without compromising macroeconomic and price stability. Mailing a check is easy. Guaranteeing that every individual can acquire the needed *real* goods and services for a basic living standard is the hard part.

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