Are temporary or permanent income payments better placed to boost demand during Covid-19?

Journal Item

Are temporary or permanent income payments better placed to boost demand during Covid-19?

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Abstract

Covid-19 has sparked calls for a universal basic income as a way of coping with a demand shock caused by the pandemic. Temporary income payments have been part of the emergency response to the pandemic. This paper questions the effectiveness of temporary payments as a way to raise demand. Some observers claim that vouchers are better targeted at sectors hit hard by Covid-19 as people may have a tendency to save than spend from temporary payments. There may be a stronger case for permanent rather than temporary payments if the aim is to boost demand in the economy.

Key words: Covid-19; Universal Basic Income; Temporary Income Payments

Introduction

Covid-19 has ushered in an economic crisis. For example, the coronavirus has induced the largest fall in UK national income for over 300 years (Office for Budget Responsibility 2020). The public health steps to contain the spread of the virus has led to the shutting down of large parts of the UK economy. Particular sectors hit hard by lockdown and other restrictions include mass entertainment (such as music or theatres), hospitality and travel (Office for Budget Responsibility 2020). Joyce and Xu (2020) report that certain parts of the population have been disproportionately affected by the shutdowns. Workers aged 25 or under were two and a half times more likely than others to work in sectors closed down by public health measures. Women were one third more likely than men to work in those parts of the economy hit hard by Covid-19 restrictions.

The pandemic has increased economic insecurity (Borquin et al. 2020). This crisis has sparked calls for a universal basic income (Standing 2020; Johnson and Roberto 2020). This idea promises: 'regular, non-means-tested cash transfers to all residents of a political territory on an individual basis, without means-test or work requirement' (Haagh 2019, 243). A petition presented to the UK Parliament demanded a universal basic income as a response to Covid-19. The petition had over 100,000 signatures which meant it had to be debated in Parliament. This proposal was debated at Westminster Hall on 13 October 2020 (Mackley et al*.* 2020). The government declares that it is not in favour of a universal basic income and instead points to other temporary steps that it is making to citizens such as the Coronavirus Job Retention Scheme (UK Government and Parliament 2020). When it was first introduced, the government provided a grant to employers that covered 80% of the wages of employees (up to a cap per employee of £2,500 a month) plus associated employer National Insurance contributions and pension contributions.

Does Covid-19 strengthen the case for a universal basic income? One argument for a universal basic income is as a form of social protection. People may have lost jobs or work in sectors closed down by the pandemic. People and households still need money to buy necessities such as food or electricity. Basic income might provide people with income to meet their needs. Sloman (2019; 2020) says that a basic income here extends a ‘transfer state’. In particular, an important theme of UK social policy since around the First World War involves the state making income payments directly to citizens for social protection. These transfers include policies such as the state pension, Child Benefit and Child Tax Credits. Sloman (2019; 2020) argues that the next logical step for the transfer state is to introduce a universal basic income. He proposed this before the pandemic but says that Covid-19 has made this more urgent.

Although social protection is important, this research note looks at a different but related argument that a universal basic income is needed as a demand stimulus. Standing is a well known supporter of a universal basic income and co-founder of the Basic Income Earth Network (Standing 2011a; 2011b; 2017). Standing (2011a; 2020) maintains that social justice provides the main argument for a universal basic income. But he also claims that a universal basic income is a necessary response to a national economic crisis. Standing writes that the coronavirus pandemic is the: ‘biggest demand shock in modern history. That is where basic income comes into the equation, moving from desirable to essential’ (Standing 2020).

Emergency income payments have been part of the immediate economic response to the crisis. For example, in the US, President Donald Trump signed a Coronavirus

Aid, Relief and Economic Act that gave $2 trillion of federal government help to households and businesses. Among the measures enacted are a set of Economic Impact Payments that amount to $1,200 per person for one year and up to $500 for each child under 16 years of age. The payments are tapered off for those on high incomes, with no payments for those who have an income of more than $99,000 a year (Inland Revenue Service 2020a). A second round of Economic Impact Payments was agreed by the US government and these payments began on December 30 2020. These payments provide up to $600 for individuals or $1,200 for married couples and up to $600 for each married child (Inland Revenue Service 2020b). President Joe Biden ushered in a third round of Economic Impact Payments as part of his $2.1 trillion America Rescue Plan. From March 2021, eligible individuals would receive $1,400 ($2,800 for married couples) and $1,400 for each qualifying dependent (Congressional Budget Office 2021; White House 2021; Inland Revenue Service 2021).

Should such income payments be temporary or permanent? This research note suggests that there are at least two issues with temporary payments as a demand stimulus during Covid-19. First, there are alternative policies such as vouchers that might be better targeted policies at those sectors hit hard by the pandemic. Second, evidence suggests that people used emergency payments to save or pay down debt rather than spend during the pandemic. Arguably, there is a stronger case for making income payments permanent rather than temporary.

This research note is organised as follows. The first part outlines the nature of the demand shock under Covid-19. The second part considers the interest in temporary income payments as a stimulus to demand. The third section asks if temporary income payments will be effective as a demand stimulus. This section also considers vouchers as an alternative to temporary income payments. The final part suggests that permanent rather than temporary income payments may be better placed to act as a demand stimulus.

A demand shock

Both businesses and individuals need support with coping with the fall-out from Covid-19. For example, those businesses that are told to shut down are likely to need financial support to survive the pandemic. This will probably involve some mix of tax relief, government grants and business loans. Emergency income payments to individuals cannot therefore address all of the challenges facing the economy. This means that a policy such as universal basic income ought to be seen as part of a wider package of support.

This research note now looks at the claim that a universal basic income is needed to address a demand shock wrought by Covid-19. Two points might be made about this demand shock. First, arguably drops in demand have occurred from a suppression of demand by government rather than a sudden change in consumer preferences. Governments have responded to the pandemic by requiring that many 'non-essential' retailers such as beauty salons or bookshops close and issuing stay at home orders. One possibility is that demand rebounds quickly once restrictions are lifted. Any demand shock then may be temporary. In the UK, there have been discussions that a 'roaring 20s' might succeed the pandemic with a successful rollout of a vaccine programme and the easing of restrictions (Bell et al. 2020). The thought is that demand that has been pent up during the pandemic will lead to high consumer spending once restrictions are eased. A Bank of England (2021) report suggests that consumer spending might help fuel economic recovery after the pandemic subsides.

Second, the demand shock is uneven across the economy. Certain sectors hit hard by the public health steps to contain the virus include hospitality and travel (Office for Budget Responsibility 2020).

The uneven nature of the demand shock raises a question of whether it is better to target measures particularly at those sectors badly affected by Covid-19 rather than providing general support across the economy. One obvious policy idea here would be for government to distribute vouchers for those sectors that have been hit hard by the pandemic. This research note will examine this further below.

Temporary income payments

Temporary income payments or stimulus payments are an influential idea for boosting demand in an economy. Different economic traditions have shown interest in this proposal (Friedman 1969; Coppola 2019; Sahm 2019). One rationale for this can be found in proposals for 'helicopter money' outlined in neoclassical theory (Mercinger 2017). Friedman (1969) argued that there may be an exceptional situation in which an economy may be facing a recession but there is little scope for using traditional monetary tools to raise consumption and demand. For example, interest rates might already be at very low levels. Faced with these conditions, Friedman (1969) outlined a famous thought experiment in which the government could drop $1,000 bills from the sky to boost consumption.

This ‘helicopter money’ idea has prompted discussion in central bank circles. Former Chair of the US Federal Reserve Ben Bernanke (2016) declared that Friedman’s idea was a respectable proposal as an exceptional response to stimulate demand in an economy in which interest rates are very low and there is a threat of deflation. He notes that helicopter money is in effect a fiscal stimulus as it involves an increase in public spending that is financed by a rise in the stock of money. Similarly, Buiter (2016) argues that helicopter money is a cogent idea for encouraging consumption.

The helicopter money proposal contrasts with the quantitative easing conducted after the global financial crisis. Under quantitative easing, the Bank of England made large scale purchases of government bonds to stimulate the economy after 2008-2009. But a problem with this was that quantitative easing was directly mainly at those who held financial assets and this led to inequality as the value of these financial assets rose. The helicopter money idea gives money to people rather than financial institutions and for this reason is sometimes dubbed a people’s quantitative easing (Coppola 2019).

The helicopter money idea though imagines a society in which recipients would be free to spend the $1,000 bills immediately. The situation is more complex under Covid-19 as restrictions mean that consumers may be unable to spend this money in those sectors that have been closed or at least have to wait until these businesses reopen.

Keynesian thought

Emergency income payments have also interested those working within or building on a Keynesian tradition, and this is understood here to cover different strands such as ‘new Keynesian’ and post-Keynesian thought. Keynesian economics has been the main alternative to neoclassical thought. For much of the late twentieth century, Keynesian economics has been used to manage demand in the economy. In particular, public spending encourages further spending in the private sector through a multiplier effect. Mass production provided a key social foundation for mass consumption. This mass production was based around regular employment for (usually male) workers. Regular mass employment provided a stable source of income and this income could be spent on mass consumer goods (Crouch 2008).

Mankiw (2020) proposes temporary income payments as a form of social insurance during Covid-19. This idea suggests sending each person an income payment for a specified number of months. A surtax based on the loss of earnings would then be imposed once the pandemic is over. Those people whose earnings remained the same during the pandemic would pay back the emergency payments in full. Those people who suffered a loss of earnings would pay back part of the payments, depending on how much their earnings had dropped. Those individuals whose earnings dropped to nothing would not pay anything back.

In his contribution to post-Keynesian thought, Standing (2011a; 2011b; 2014; 2017) argues that the social basis of Keynesian economics began to unravel with what he calls a transformation crisis. He writes that a:

> transformation crisis, which could not be resolved by the sort of Keynesian policies that governments had embraced with alacrity. Indeed, by generating those budget deficits they risked making matters even worse. The transformation crisis reflected the growth of economic insecurity and various forms of inequality in the globalisation era. They have generated a global 'precariat', insecure and frustrated, a new dangerous class (Standing 2011a, 9).

Standing (2011a; 2011b; 2014; 2020) developed the concept of the precariat in the aftermath of the global financial crisis of 2008–2009. He claims that the precariat suffers from seven forms of insecurity. First, labour market insecurity which means a lack of opportunities for earning income across the economy. Second, a lack of employment protections against arbitrary dismissal. Third, no opportunity for job security and barriers for promotion. Fourth, no protections if a worker falls ill or sick. Fifth, there is no opportunity to update or gain new skills. Sixth, a lack of a secure and stable income. Seventh, no access to collective voice at the workplace, such as through trade union representation.

The precariat lacks a stable source of income which means that they cannot respond to government spending by higher private spending. In the aftermath of the global financial crisis, Standing (2011a) proposed 'economic stabilisation grants' of £30 per week for the crisis. But, there is also interest in making such income payments permanent. Standing (2020) now calls for a universal basic income as a necessary response to a demand crisis faced by the economy. This contrasts with the temporary nature of the economic stabilisation grant idea.

Will temporary payments be effective?

There is broad interest then in emergency income payments during Covid-19. But, would temporary payments be effective as a demand stimulus? Evidence on the US Economic Impact Payments suggest that this policy has only had a limited impact on increased spending (Armantier et al. 2020; Coibion, Gorodnichenko and Weber 2020). Coibion, Gorodnichenko and Weber (2020) conducted a survey in the US in July 2020 that involved 12,000 respondents. This survey explored daily spending habits and asked questions about the first wave of Economic Impact Payments. These researchers reported that only 15 per cent of the recipients of these payments said they had spent or planned to spend most of this money. A majority stated they had either used it to reduce debt (52 per cent) or saved it (33 per cent). These researchers write that: ‘When asked to provide a quantitative breakdown of how they used their checks, U.S. households report having spent approximately 40 percent of their checks on average, with about 30 percent of the average check being saved and the remaining 30 percent being used to pay down debt’ (Coibion et al. 2020, 2). Lower income households were more likely to spend the payments and higher income individuals were more likely to save rather than pay off debts.

Armantier et al. (2020) report similar findings based on results from a New York Fed survey of consumer expectations. This is a nationally representative internet survey of around 1,300 US households. This research found that at the end of June 2020, 29 per cent of stimulus payments were used for consumption, 36 per cent was saved and 35 per cent was used to pay debts. These researchers say their results suggest that a smaller proportion of second round payments would be used for spending. These results suggest that temporary income payments only have limited impact on raising demand.

Crossley et al. (2021) echo the above findings in their research on the likely impact of a hypothetical £500 stimulus payments on UK consumer spending. These researchers draw on data from a wave of the Understanding Society Covid-19 web survey done in July 2020 and the sample size was around 11,000 people. The survey was also conducted as the UK was easing out of its first lockdown and some of the restrictions on the hospitality and other sectors were being loosened. Crossley et al. (2021) found that only 19% of respondents said they would increase spending as a result of a stimulus payment. Only 7% of people reported that they would spend the full amount. Of the 93% who said they would not spend the full £500, 66% of people said they would increase saving and 22% reported that they would cut debts. These researchers also found that a stimulus payment might also crowd out some of the transfers of money that occurs between friends and family. They conclude that: ‘Our estimates of spending responses and MPCs [marginal propensity to consume] suggest that income transfers are not an effective way to stimulate spending’ (Crossley et al. 2021, 14).

Evidence also exists that suggests that better off households have increased saving during the pandemic. It is likely then that any temporary payments will add to the stock of savings for these households. Davenport et al. (2020) chart how spending and saving has changed through the pandemic in the UK. The results draw upon a

Money Dashboard budgeting app data up to the end of September 2020. These researchers found that from July 2020, consumer spending has been around 90 per cent of its pre-pandemic level. Spending on groceries rose during the pandemic but there have been falls in spending on restaurants, pubs, transport and holidays. Davenport et al. (2020) report that the poorest fifth of the population saw an average £170 per month fall in bank balances between March 2020 and September 2020 compared to the same period in 2019. All other quintiles saw an increase in saving (for example, the fourth quintile saw a rise in average saving of over £350 per month between March and September 2020 compared to the same period a year earlier).

Vouchers or temporary payments?

Vouchers are an obvious alternative to temporary income payments as a way to stimulate demand in sectors hit badly by Covid-19. Gardiner et al. (2020) write that a: 'high proportion of any cash transfer is likely to be saved by households, given many households' concerns about their future prospects, especially higher-income ones who have already experienced rising savings through the crisis' (Gardiner et al. 2020, 55).Gardiner et al. (2020) propose High Street Vouchers to protect retailers as the economy came out of lock-down. These would be time limited vouchers of £500 for each adult and £250 for each child. It was suggested that these vouchers could be given out in pre-paid cards, and these payments could be switched off if there is a second wave of infections and a need to close down shops again.

Governments in the UK have shown interest in voucher type schemes for boosting demand. Chancellor Rishi Sunak's Eat Out to Help Out scheme, in which government pays half of the price of any meal or drink out (and capped at £10 per person) on Mondays to Wednesdays during August 2020 overlaps with a voucher scheme. Official figures show that around 100 million meals were claimed in Eat Out to Help Out and the total amount claimed from government was £552 million (HM Revenue & Customs 2020). In November 2020, the Northern Ireland Executive (2020) announced plans for high street vouchers that will be made available through pre-paid cards. The Spend Local pre-paid cards began to be rolled out from October 4 2021. Anyone aged 18 or over could apply for a £100 card to spend on the high street. These cards were valid until November 30 2021 (Department for the Economy 2021).

Kim and Lee (2020) provide evidence from South Korea on the role of vouchers in boosting demand during Covid-19. They note that in May 2020, the South Korean government provided vouchers to all households that could be used in local shops until August 2020. The size of the voucher depended on number of household members and residence. A three person household on average received vouchers worth US$799. Kim and Lee (2020) draw on results from a survey by the Korean Institute of Public Finance that had 2,000 respondents. The survey found that vouchers increased spending in 36 per cent of households but total spending only rose to a lesser extent (29 per cent). The majority of vouchers were used to buy necessities.

Vouchers have an advantage that they can be targeted at those sectors badly hit by Covid-19. The UK Eat Out to Help Out scheme seemed popular but it is unclear as yet the extent to which it subsidised spending that would have occurred anyway or diverted spending from other days of the week when the offer did not hold. Evidence from South Korea suggests vouchers have a limited effect on spending. Also, vouchers might not necessarily boost demand in these sectors as people might use vouchers to curtail rather than add to the cash they normally spend in these sectors. The effects of vouchers are broadly comparable to the impact on spending from the US Economic Impact Payments. A majority of these payments were used for saving or paying debt rather than spending.

Permanent rather than temporary payments?

Evidence to date on both vouchers and emergency payments suggest that these policies only have a modest role in raising demand. One might still support a universal basic income as a way of guaranteeing social protection or social justice. However, the case for income payments as a demand stimulus might be stronger if these were permanent, as with a universal basic income, rather than temporary. One reason for this is that a universal basic income might perform as an automatic stabiliser to smooth consumption over the economic cycle.

Much of the existing literature on automatic stabilisers does not focus specifically on a universal basic income but rather on other taxes or benefits (Sahm 2019; Maravalle and Rawdanowicz 2020). But, there may be a case for extending automatic stabilisers to cover policies such as a universal basic income. Moffitt and Ziliak (2020) say that there is a patchwork of policies providing social assistance in the US. The most important of these are unemployment insurance (which varies by state) and the Federal Supplemental Nutrition Assistance Program (SNAP) or ‘food stamps’. Moffitt and Ziliak (2020) propose extra Federal cash for low income families with young children as a way to cut income volatility during economic shocks. These researchers do not consider the role of a universal basic income but this might nevertheless act as an automatic stabiliser to smooth demand over the economic cycle.

Sahm (2019) is more explicit about the role of direct stimulus payments as an automatic stabiliser. Her proposal was shaped before the onset of Covid-19 and drew on research on the effects of stimulus payments around the time of the global financial crisis of 2008-2009. Based on her analysis of stimulus payments made after the global financial crisis of 2009-09, she calls for: ‘direct payments to individuals as an automatic stabilizer. The lump-sum annual payments would be made to individuals, regardless of their income level, when the national unemployment rate rises by at least 0.50 percentage points’ (Sahm 2019, 67). Sahm’s idea is not a universal basic income as the trigger for the payments is the unemployment rate. But, this proposal highlights the ways that the discussion of automatic stabilisers could extend to cover income payments besides policies such as unemployment benefit.

A case for permanent over temporary payments need not be tied only to an argument about automatic stabilisers. Other economic traditions also provide an argument for permanent over temporary payments. Friedman’s Permanent Income Hypothesis suggests that people base their consumer spending upon a notion of permanent income that stretches across their lifetime. Theory and empirical tests of the Permanent Income Hypothesis suggest that a change in permanent income will have a bigger effect on consumer spending than a change in temporary income (Friedman 1957; Meghir 2004; Aguiar and Hurst 2008; Lugilde, Bande and Riveiro

2019). A universal basic income would add to a permanent income and so could be expected to have a bigger impact than temporary payments.

Conclusion

The Covid-19 crisis has spurred calls for a universal basic income as a way of addressing a demand shock wrought by the pandemic. This research note has noted that temporary income payments are part of the emergency response to the pandemic. This research note questions whether such payments succeed in boosting demand. Other policies such as vouchers might be targeted better at those sectors hit hard by Covid-19. Doubts can also be raised at the extent to which temporary payments succeed in boosting demand. A more promising route may be to make these payments permanent and a universal basic income would then be an automatic stabiliser.

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