Outgrowing Capitalism to Fund Universal Basic Income

By Marco Dondi

Abstract

*The benefits of UBI are being more broadly acknowledged but funding UBI through taxes dissatisfies most conservatives. It also raises concerns even among some progressives that a UBI would substitute some of the welfare programs more targeted to the poor. This paper explores the option of funding a UBI through new money creation without creating inflation. In fact, for centuries, commercial banks have been growing the money supply as they give more loans, with central banks only creating money in exceptional cases such as war finance. From 1980, the money supply (M2) has grown at a rate of over 5% per year, mostly through the increase in electronic deposits by banks. In response to Covid-19, central banks increased the money supply by up to 25% in a single year, or 4 trillion dollars in the United States. This paper argues that the market mechanism of money creation and allocation through commercial lending is inadequate, and central banks’ interventions sub-optimal if measured by their effectiveness in tackling social challenges such as poverty and climate change. By recognizing the limits of capitalism, with its market fundamentalism responsible for shaping our monetary system, we can take money creation away from private banks and put it at the direct service of people, thus using money creation to fund Universal Basic Income.*

Introduction

At a global level, societies are progressing in a relatively constant pace towards increasing prosperity, with emerging markets reducing the numbers of people living in absolute poverty. Nonetheless, most people in the richest countries in the world spend most of their time working to make ends meet, living paycheck by paycheck, and never really having the chance to pause and think about how to find fulfillment. In North America especially, people work among the longest hours among OECD countries[[1]](#footnote-1) and retire the latest in life[[2]](#footnote-2). In the United states, depending on the year and the survey, 30 to 40 percent of people have essentially no savings and up to 60% have less than 1000 USD in savings[[3]](#footnote-3). All these people, as well as those doing only marginally better, have less chances of being satisfied with their jobs[[4]](#footnote-4) and are more likely to divorce or be stuck in unhappy marriages[[5]](#footnote-5). They have little chances of crafting their own path to finding fulfillment and spend most of their energy on taking care of their family through hard work. Sadly, many regret focusing too much on work later in life[[6]](#footnote-6).

At the same time, research has shown that income ceases to be a driver for happiness and only weakly correlates to life satisfaction beyond a certain level[[7]](#footnote-7). This is true at individual level but also at country level, where countries with GDP per capita above a certain threshold no longer show any correlation between well-being metrics and GDP per capita, whereas such correlation exist between well-being metrics and inequality[[8]](#footnote-8).

There seems to be a *comfort threshold* of income below which individuals and countries struggle to thrive but above which additional income becomes increasingly less important to different dimensions of well-being. For life-fulfilment in particular, money and income have nothing to do with it[[9]](#footnote-9). Unfortunately, most OECD countries have been on a 40-year trend towards more inequality where those who have beyond what they need for well-being are getting more and the vast majority that are looking up at the comfort threshold see it moving farther away[[10]](#footnote-10). In France, one of the countries with the highest redistribution of market outcomes, poverty is contained to 10% of the population, compared to 40% without taxes and transfers[[11]](#footnote-11). Correcting market outcomes seems indispensable to creating an inclusive Capitalism. But is 10% of French people in poverty satisfactory for a modern society? Could we not aspire to propel civilization to a society where everyone is by definition above the comfort threshold? Universal Basic Income provides that solution, but how can we sustainably fund it?

In this paper I take the perspective that countries can take either of two roads to sustainably fund a UBI program. The first is to fund it through the conventional tax system. The cost of UBI proposals are typically in the range of 20-40% of GDP, but the net costs – assuming that those people with sufficiently high market incomes would pay a slightly higher tax rate than today to counterbalance the UBI transfer they receive – is more in the range of 2-6% of GDP. Such a scheme is often converted into a negative income tax program, where instead of paying a UBI transfer to everyone and then increasing the income tax rates for those with higher incomes, it only adds a negative tax rate for those below a certain income threshold. A net cost of 2-6% of GDP is relatively affordable and could be funded by a combination of new taxes, be that a carbon tax, wealth taxes, or higher VAT on luxury products. Any non-regressive tax scheme would work. The challenge of pursuing this funding pathway is political, given the UBI would be seen as a redistribution program, and history has shown that most tax increases have been reversed. Even in France, the country of liberté, egalité, and fraternité has reversed wealth taxes[[12]](#footnote-12), going in the opposite direction of French most renowned economist Thomas Piketty, who proposed taxing those with very high wealth to avoid perpetual wealth concentration[[13]](#footnote-13).

The second road I propose is to fund most of UBI transfers with newly printed money. There would be no redistribution, but rather a change in the way new money is created and allocated today to prioritize a UBI program over other uses of money.

Money creation and allocation by the free market

Since the invention of banking, banks were implicitly allowed to create money. Depositor would deposit gold or whatever metal was recognized as money, and banks would give a paper recognizing that the depositor had a right to withdraw. As those papers circulated instead of the metal, they became as good as gold or any other metal. Banks would also lend money, either in gold or in paper and as banks created more paper than they had gold, they multiplied the amount of money in circulation. And each bank could issue their own paper notes with their name, having multiple parallel currencies circulating, one for each bank. A good simplification to create a parallel to today would be to call gold M1 and the sum of gold and paper as M2, two of the most used money aggregates.

The issue with this system was the unregulated way in which banks could create paper. When too much paper was created and loans given out with poor diligence, gold flew out of the banks because depositors wanted gold instead of paper - no longer a reliable substitute for gold. Central banks were created to stabilize this system and only have one type of paper money that only the central bank could print and maintain control over the quantity of that paper compared to gold. Nonetheless, given a bank only needs to keep a small percentage of gold or paper compared to the amount of loans they give, their lending activities can multiple the money supply, by a factor of 10 if reserve requirements are 10%. The monetary economist Allyn Young estimated back in 1924 that 85% of money in the US came from bank loans[[14]](#footnote-14).

With the fall of the gold standard, the independence of central banks from governments, and the emergence of electronic money, the role of banks in money creation and allocation has significantly increased. Most of what people are saving is in the form of electronic money in some digital banks account. Most payments happen with a transfer of digits between two bank accounts in the same or in different banks. And most new money creation happens when banks create a new electronic deposit whenever an individual or company is approved a new loan. And this money creation is indispensable to enable economic growth: a higher number and value of transactions to enable a bigger economy would be impossible without new money creation. With the velocity of circulation of money (M2) rather constant (except for a fall in times of crisis), not growing the money supply would make it impossible to grow an economy.

When inflation increased in double digits in the 1970s, the prevalent narrative was one where anything government-led was branded as communist and the market mechanism was presented as perfect and rational. As a result, the role of central banks was curtailed, from one of enabling government priorities and economic development to one more focused on constraining the money supply through the use of reserve requirements (initially) and interest rates (ultimately). And the creation and allocation of new money was left to commercial banks through their lending activities. The theory was the following: if a bank is willing to lend to a borrower for a certain interest rate, and a borrower is willing to pay the interest rate, this is the highest assurance that new money would be put to use to generate higher value to afford the repayment of the principal and interests and therefore justify the need for more money in circulation. Tying money creation with a free-market credit-debt agreement was seen as the best solution to ensure money creation leads to the production of something of higher value.

This theory, as most of the neoliberal economic theories of the 1970s, clashed with real world data, that instead showed several issues with this free-market model of money creation. First, the majority of bank lending, up to 85% in some estimates[[15]](#footnote-15), ended up being used to purchase existing assets, inflating their prices. The availability of a collateral was the best assurance for banks to get their money back. Housing represents 15% of the typical consumption basket, up to 50% for some segments of the population. With real returns on housing of around 7% per year and approximating house inflation to also be around 7% per year[[16]](#footnote-16), house prices alone are responsible for 1 to 3.5 percentage points of yearly inflation. This does not even include the impact that higher costs of rent has for all the other products and services where rent is a big cost component. Second, commercial banks are also prone to cognitive biases and greed, leading them to create too much money in good times, causing financial crisis including the 2008 great recession, and too little in bad times, forcing central banks to intervene with money creation of their own to help the economy slowly recover. Third, any increase of the money supply by banks is associated with an increase in debt. And the more the distribution of income is unequal, the more the new money created ends up in the bank accounts of those with no debts to repay, while the majority of people increase their stock of debt, be that a mortgage, credit card, student loan, car loan, etc. Private and public debt levels have now exceeded 300% of GDP and continue to rise[[17]](#footnote-17). Lastly, much of this new money created by bank does not go towards solving the biggest challenges society is trying to tackle. With climate change for example, most of the decarbonization projects are funded by governments, NGOs, or private investors. Banks fund established companies that typically produce fossil fuels or are powered by them. Only post Covid-19, with much pressure from NGOs, some European central banks have pledged to consider climate change when creating and allocating money as part of their monetary policy operations. And these monetary policy operations are growing in size by the decade, suggesting that maybe society needs to rethink the conventional free-market mechanism for creating and allocating money.

2008 and Covid-19: Central Banks Opening the Pandora Box

In response to the 2008 crisis, central banks printed trillions of dollars to compensate for commercial banks’ credit crunch as well as to bail-out ailing financial institutions. The response to Covid-19 was even larger: The Fed increased its balance sheet by three trillion USD between March and May 2020, three times as big as the injection immediately after September 2008. On the other side of the Atlantic, the ECB increased its balance sheet by two trillion euro between March and September 2020. These are signs that the market process of creating and allocating money is often insufficient. It is also a sign that money printing operations do not necessarily lead to inflation, given inflation has only started to budge due to supply-related shocks post Covid-19.

It is natural to ask a few questions: could central banks’ money printing be directed to solve society’s biggest challenges, be that climate change or poverty? Could central banks start acting preemptively with money creation and use that to avoid foreseeable crisis? Even more fundamentally, could central banks or any other institution for that matter, allocate new money creation more effectively than how commercial banks are?

The answer to the first question is that central banks are relatively constrained in what they can do with new money creation. Today they mostly buy existing assets and lend cheaply to banks, hoping that commercial banks would then lend cheaply and in larger amounts to their customers. While this approach has shown to have better economic outcomes than not creating money at all – think of the 1929 crisis – it also has several limitations. It is not very fast to restart growth. For example, much of this money often ends up in commercial bank accounts at the central bank as excess reserves. It also leads to appreciation of asset prices, to the advantage of those owning assets and less so of those renting. And there is no way of influencing where that money ends up. The fact that 95% of income growth after the 2008 crisis has gone to the richest 1%[[18]](#footnote-18) in the Unites States suggests that quantitative easing does not reduce income inequality. Why would central banks not just give money to people instead? Isn’t this a more fair way to inject money in society? Technically, central banks cannot grant money, although they could get the government to issue perpetual bonds at 0% interest rate, buy those bonds, and with that money the government could fund a UBI program. One could argue that when central banks buy government bonds at very low interest rates as part of quantitative easing operations, the process is not much dissimilar. Both the Trump and the Biden administration benefitted from this process to increase public debts and distribute money straight to people. But central banks could revert this policy whenever inflation changes direction, and therefore this way of funding a UBI would not be sustainable. The second question becomes therefore relevant: is it time for central banks to become more involved in tackling some of the biggest social challenges? Could governments for example change the mandate of central banks, and include climate changes and funding a UBI as part of the mandate, while having to still keep inflation in check? One might argue this is just a prevention of foreseeable crisis. Poverty and increasing inequality will just lead to a new debt crisis. Debts are piling on top of households while wages and incomes are stagnating for most of the population, so a new debt crisis would only be a matter of time. A UBI funded with central banks’ money could instead help people to pay back some of their loans and reduce debt in society. Debt repayments would actually reduce banks’ money. If well-managed, central banks funding a UBI program with a parallel increase in the cost of banks to give loans – whether through interest rates or reserve requirements – could keep the money supply unchanged but reduce the dependency of the economy and society from debt and from banks. A similar argument would hold for central banks funding and expediting the green transition. But any of these proposals are challenging the effectiveness of the money markets in creating and allocating money to the best uses. This is a fundamental challenge to the degree to which capitalism’s relatively unbridled markets are good enough to cope with 21st century challenges. Or from a more inspirational view-point, could society pursue an evolution of capitalism that includes central banks funding a UBI and bringing 100% of people above the comfort threshold? Is this opportunity within grasp?

Outgrowing Capitalism

While capitalism has been a driver of prosperity for several centuries, is it possible that some of its constraints –particularly the predominant role of private banks in expanding and allocating the money supply– is now an unnecessary limitation to further prosperity?

Capitalism more in general has been designed for maximizing production, with the foundational assumption from Jean Baptiste Say that as suppliers invest to produce more, they employ more workers and their wages enables the increasing consumption that justify further investments. This conceptual model describes a supply-driven economy where all that matters is the capital to allow workers to become more productive. Full employment is the natural state and higher productivity translates in higher wages, consumption and therefore welfare. Most economic models are still based on these assumptions from the 1800s. But some of these assumptions are becoming increasingly difficult to accept given real world data, where the unequal distribution of income is actually the weak link preventing further growth. There is an emerging consensus, backed by 40 years of data across several OECD countries[[19]](#footnote-19), that employment and especially wages no longer grow with productivity, making income and wealth more concentrated. Those with high income and wealth have a lower propensity to consume as a share of their income and wealth, and with weak private consumption companies are investing less and slowing down growth in what is often referred to as secular stagnation. There is an emerging consensus on some version of this phenomenon among economists and institutions, including the IMF[[20]](#footnote-20), the OECD[[21]](#footnote-21), the Economic Policy Institute[[22]](#footnote-22), The Brooking Institutions[[23]](#footnote-23), and the list goes on. To this average situation, one needs to consider the recessions that a credit-based monetary system facilitates. Increasing inequality with money supply only growing together with credit-debts agreements leads all debt to cumulate amongst those that can’t afford to repay it. The periodic recessions have been show to decrease the long term potential of our economy, as companies invest and innovate less during times of crisis[[24]](#footnote-24).

Of particular relevance is the fact that all trends fueling lower private consumption and the instability that leads to recessions are either unavoidable demographic shifts or intrinsic to capitalism, and therefore we cannot just consider them a temporary “shock.” These trends include:

1) Population aging, leading to an increased need for saving for old age, a permanent trend unless we allow our governments to be unprepared for epidemics or allow free markets to make health care unaffordable to most.

2) The shift from a growing to a declining population, also a permanent trend in high-income countries that will extend globally. Global population is expected to plateau and start declining in the second half of this century.

3) The dependence of our economy on debt causing its instability is intrinsic to capitalism and the tie between debt, credit and money. Any other way of creating and allocating money would be outside the market mechanism.

4) The inequality in wealth and income is also intrinsic to capitalism as Piketty showed[[25]](#footnote-25), and taxes – which capitalism tolerates – are insufficient to bring inequality under control.

5) Automation, globalization, weak labor unions, and unequal access to quality education are often considered the root causes of income inequality. And aside from automation, the others are intrinsic to capitalism’s ideology of the efficiency of free markets.

Many of these trends were not present in the early 1800s, nor in 1950 but they are now. And if overall consumption now pulls investments and production in high-income countries, we face a problem: Capitalism does nothing to ensure a distribution of purchasing power that increases overall consumption, or even maintains it. As Nick Hanauer, creator of the campaign for a $15 US minimum wage, put it, “In a capitalist system, rising inequality creates a death spiral of falling demand that ultimately takes everyone down.”[[26]](#footnote-26)

With more automation and artificial intelligence, one can only see these trends accelerate, with less demand for labor, less consumption, defaults on debts and crisis, and central banks having to intervene or governments picking up the tabs and taking debts on their own balance-sheets.

Could we not then imagine a system where we break the nexus between labor wages and income with a UBI program with increasing transfer amount as automation and productive grow even faster? Could we get central banks to create money and ensure all people can afford a modest level of consumption and thus sustain economic growth independently from their market wages? Could we create this evolution of capitalism that gives every human being the right to a life in dignity while reducing debts levels and stabilizing – even increasing growth in the process?

Monetism

The forthcoming book *Outgrowing Capitalism: Rethinking Money to Reshape Society and Pursue Purpose”* describes an alternative, or an evolution, of capitalism that starts from the premises above. In high-income countries well-being is no longer correlated to average incomes or GDP per capita, due to both the high level of the average but also to the inequal distribution of incomes. The core goal of society today should therefore be closer to well-being: Neither maximizing GDP, nor keeping as many people employed for as long as possible are conducive to that. The freedom of choosing how to spend one’s own time is instead one important determinant of happiness and life satisfaction[[27]](#footnote-27). Given these considerations, a model of society where we maximize the time people are employed and make access to purchasing power tied to wages and employment seems sub-optimal, especially as advanced algorithms and artificial intelligence enable robots to take over more of the work. Monetism is therefore a future-looking alternative to capitalism where new money creation funds a UBI program, the cornerstone of the future social contract. Banks and individuals would be free to lend and borrow, but central banks would create the new money needed to sustain growth year over year, funding a UBI with this new money. Central banks would likely increase interest rates and/or banks’ reserve requirements as a consequence, so that less money is created by banks and less credit ends up inflating the price of assets and of goods and services[[28]](#footnote-28). Such approach is not dissimilar from the proposal of a private debt jubilee funded by central banks such as that of Steve Keen[[29]](#footnote-29). The main difference is that Keen suggests a once-off debt jubilee that helps recipients and society but cannot fund a continuous program such as UBI. A UBI program would have the added benefit of changing the social contract, giving comfort to people of having their basic needs met with all the well-being and economic benefits that come with it. A systemic funding of UBI with central banks’ money creation can be the first step of an evolution beyond capitalism.

Starting Small: 5% of GDP Given in UBI

The money supply has historically equaled about two thirds of GDP[[30]](#footnote-30), increasing beyond four fifth of GDP after the COVID-19 crisis. Let’s say we target a nominal GDP growth of 6%–8% per year, we could inject new central banks’ money for at least 5% of GDP per year and distribute it in a central bank account that each adult citizen is automatically entitled to. Without changing anything else, central banks will then manage interest rates and reserve requirements to achieve their inflation and employment targets.

At a more local level, the same could be done with a voucher system or a local currency managed by the state/city authorities and a state/city bank. The city of Maricà in Brazil is an example of this[[31]](#footnote-31). At the global level the same could be achieved with a global currency issued by the IMF or with newly issued Special Drawing Rights. Five percent of GDP worth of new money, global, national or local/voucher currency, would be distributed to each adult.

At the US level, 5% of GDP would be 430 USD per adult per month, enough to provide some security but insufficient to fully cover basic needs, yet a significant floor that people can rely on, with the only potential – but not certain – cost to society being a slightly higher interest rate on bank loans, should inflation concerns lead the Fed to increase interest rates. In Canada, 5% of GDP would equal to about 310 Canadian dollars per adult per month, and in Mexico 5% of GDP would equal to about 1170 pesos per adult per month.

If this was to be considered at the global level with a global currency created and distributed by the IMF, 5% of GDP in UBI would lead to about 100 international USD a month per adult. In poor countries that is enough to afford basic needs (UBI pilots typically pay less than 50 USD a month). It might cause some local inflation and higher imports, but it could also result in a lot of local economic activity and security. Given recipients would be getting an international currency (or global currency), the impact on the local currency value from higher imports would be limited.

Conclusions

By Breaking Free of Some Obsolete Constraints of Capitalism We Can Fund a UBI Right Now.

Every aspect of today’s society and economy is molded on the assumption that free markets might not be perfect but are as close as we can get. The construct of the monetary system and how new money is created and allocated year after year is of particular importance, given money is the incentive that directs all economic activities: where society invests, what resources are needed, what projects are funded. If we acknowledge that the market failures are becoming increasingly large and the market mechanism increasingly insufficient to tackle 21st century challenges quick enough, then releasing some of capitalism’s constraints might lead to societal leaps. This paper has shown that a priority pathway to channel new money towards a UBI program is a more just, and likely more efficient allocation mechanism than allowing borrowers and banks to freely decide who receives more loans. In fact, based on data from UBI pilots, a UBI would lead to significant increases in well-being, while more credit would mostly go towards purchasing existing assets and increase their inflation. One could propose additional or alternative ways to harness the need to create new money year after year and prioritize solutions to fight climate change. This paper hopes to raise level of ambition of reformers to start seeing capitalism and its rules not as a natural law but rather as a set of norms that can be adapted as societies evolve.

For a complete explanation of monetism, one possible evolution of capitalism, *Outgrowing Capitalism* will be available in the United States on October 26th.

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11. https://www.mckinsey.com/industries/public-and-social-sector/our-insights/inequality-a-persisting-challenge-and-its-implications. [↑](#footnote-ref-11)
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14. http://www.perrymehrling.com/wp-content/uploads/2016/01/Allyn-Young-1x74bxg.pdf. [↑](#footnote-ref-14)
15. “A Conversation with Lord Adair Turner,” Private Debt Project. http://privatedebtproject.org/view-articles.php?An-Interview-With-Lord-Adair-Turner-6. [↑](#footnote-ref-15)
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26. Robb Mandelbaum, “Nick Hanauer Wants You To Know Everything You Know About Economics Is Wrong,” Forbes, January 2018. [↑](#footnote-ref-26)
27. Ed Diener, John F. Helliwell, Daniel Kahneman, “International Differences in Well-Being” Oxford University Press 2010. [↑](#footnote-ref-27)
28. While for moderate amount of UBI transfers this approach of managing inflation would be sufficient, and largely within the current mandate of central banks, monetism proposes more themes requiring priority money creation that require rethinking how central banks manage inflation. This is beyond the scope of this paper. Such system is explained *Outgrowing Capitalism: Rethinking Money to Reshape Society and Pursue Purpose*, forthcoming on October 26th 2021. [↑](#footnote-ref-28)
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30. Money supply defined as M2, compared to nominal yearly GDP. [↑](#footnote-ref-30)
31. https://www.vox.com/future-perfect/2019/10/30/20938236/basic-income-brazil-marica-suplicy-workers-party. [↑](#footnote-ref-31)