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Universal Basic Income and Negative Income Tax: Two different ways of thinking redistribution

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ABSTRACT

This article examines two redistributive policies: Negative Income Tax and Universal Basic Income. Its aim is to show that, although the two achieve the same distributive outcome through an appropriate tax-benefit system, they are fundamentally different from economic and ethical points of view. The approach integrates positive and normative analysis and explicit attention to ethical issues provides a more complete description of economic aspects. We show that Negative Income Tax scheme is coherent with the libertarian idea of distributive justice, while Basic Income follows egalitarian thought.

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1. Introduction

In recent years, the debate on welfare state reform has seen several proposals for tax-benefit programs, or schemes that integrate social transfer and fiscal withdrawal.

These schemes operate a selective redistribution towards the less affluent and eliminate the problem of categoriality that affects many welfare systems. Moreover, coordination between withdrawal and benefit ensures that the effective marginal tax rate shape does not negatively affect the labour supply. Tax-benefit programs are however open to the criticism that by selecting beneficiaries exclusively according to income parameters and omitting an evaluation of overall wealth, they tend to select target beneficiaries that include many "false positives".

The best known tax-benefit program is Negative Income Tax. This scheme is based on an income baseline: normal tax rates are applied to taxpayers with an income higher than the baseline. For income lower than the baseline, taxpayers receive benefit, or in other words they pay a "negative tax". The term was coined by Friedman (1962). Negative Income Tax has mainly been practiced in the United States in recent decades (See Moffit, 2003).

Universal Basic Income is equally well known as a theoretical construct. It is a lump-sum transfer, universal and unconditional. The combined effect of benefits and the tax system make this scheme universal in theory but selective in practise. In the 20 Century one of the best known proposals for an integrated social security and taxation system was made for all British citizens by Lady Rhys Williams (1943). All citizens were to receive a social dividend, according to the principle that "the state owes the same benefit to all citizens". All the unemployed fit for work were to accept a job if it were offered by the Minister of Work or lose the benefit (Rhys Williams, 1953).

An appropriate system of tax rates and benefits from both Negative Income Tax and Universal Basic Income should lead to the same net income for each level of gross income; poorer sections should receive a benefit, while the more affluent should pay tax. Milton Friedman recently argued (Suplicy, 2000) that the Universal Basic Income could be a way of implementing Negative Income Tax. And Jaquet et al. (2000, p. 78) argue that if a Universal Basic Income cannot be implemented for political reasons, Negative Income Tax could be a minimal alternative way of fulfilling the same aim.[1]

There appears in fact to be a certain amount of confusion between the two types of scheme. Atkinson (1995) calls a program that appears to be a Negative Income Tax associated with a flat rate tax "Basic Income." In the Italian translation of Atkinson's book, the same program is called "minimum guaranteed income". This

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[1] Van Parijs, in the same Suplicy paper, comments on Friedman's point of view and points out that the economic equivalence between the two programs should not hide that the fact that they have different effects on recipients because of the different timing of payments: *ex-ante* in Basic Income, *ex-post* in Negative Income Tax.

term is usually used in economic literature (e.g. Moffit, 2002) for a scheme that ensures, for all individuals with income under a certain threshold, a transfer equal to the gap between the threshold and the income. Minimum guaranteed income therefore appears to be a special case of Negative Income Tax with a marginal tax rate of 100% for all recipients.

The aim of this article is to show that Negative Income Tax and Universal Basic Income are redistributive programs that are very different both from an economic and distributive points of view and from an ethical and distributive justice perspective. Explicit attention to ethical considerations shaping human values and behaviour can furnish a more detailed picture, so our approach integrates positive analysis with normative elements.

The paper is organized as follows.

Section 2 shows how the same distributive result is obtainable with Negative Income Tax and Universal Basic Income, flat rate or progressive, only where Universal Basic Income involves much higher total transfer cost.

In Section 3 we prove that for the same total cost, or the same public expenditure, the distributive effects of the two schemes are quite different.

The difference in terms of redistributive effects can be attributed to different issues in distributive justice. The ethical bases of Negative Income Tax and Universal Basic Income reflect two different concepts of freedom. In Section 4 we focus on the libertarian approach linked to the idea of negative freedom for Negative Income Tax and in Section 5 we focus on the egalitarian view that stress the fundamental role of positive freedom in Universal Basic Income.

The different ideas of distributive justice also come into play on other issues. Section 6 deals with the problem of exploitation of labour. Section 7 discusses how the two ideas of justice differ in their approach to risk. Finally, Section 8 deals with the different views of brute luck in the distribution of personal endowment. Section 9 concludes.

2. Negative Income Tax and Universal Basic Income schemes

Negative Income Tax (NIT) and Universal Basic Income (UBI) can be considered as tax systems associated with tax deduction in the former case, and with a tax detraction, in the latter.

Assuming for simplicity a linear tax system, benefit in NIT is determined according to the equation

$$B = G - t^{\circ}Y \quad \text{if} \quad 0 \le Y \le k \tag{1}$$

$$B = t^{\circ}(k - Y) \quad \text{if} \quad Y \ge k \tag{2}$$

where B is the net benefit (with negative sign) or the tax paid (with positive sign), Y is the gross income, G is the maximum amount of NIT paid to individuals with zero-income, k is the deduction and t° is the tax rate.

In UBI, benefit is calculated according to the equation

$$B = g - t'Y \tag{3}$$

for any value of Y, where t' is the tax rate and g is the fixed and universal level of benefit (detraction).

Observing the post-redistribution disposable incomes, it is possible to see that the two schemes can be similar in terms of redistributive outcomes. For UBI the disposable or post-tax income, Y_d, is

$$Y_d = Y + B = g + (1 - t')Y \tag{4}$$

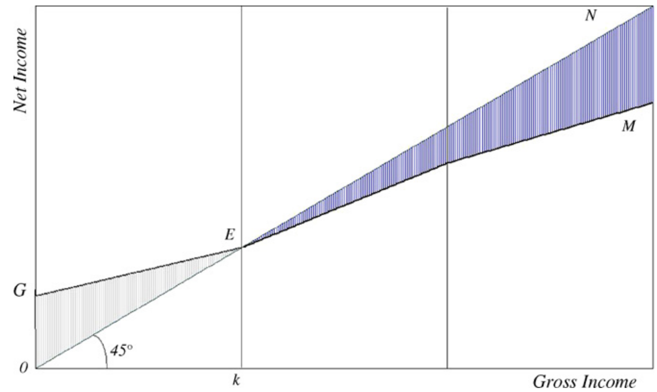

Fig. 1. Scheme of Negative Income Tax.

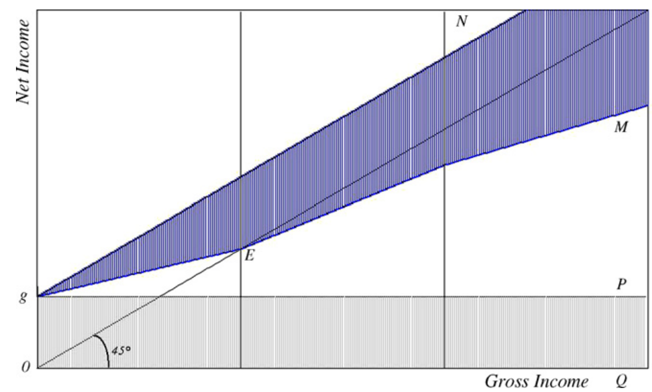

Fig. 2. Scheme of Universal Basic Income.

For NIT it is

$$Y_d = Y + B = (1 - t^{\circ})Y + t^{\circ}k \tag{5}$$

Imposing $t' = t^{\circ}$, the equilibrium between the two programs will be $g = t^{\circ}k$, which is the disposable income equivalence condition between a deduction and a detraction. Using this equivalence, it is possible to design UBI and NIT schemes that give the same disposable income for any level of gross income, and the same marginal and average taxation profile, as observed by Tobin (1965).[2] Even in a more realistic progressive tax system, the same redistributive effect can still be obtained.

For NIT (Fig. 1) a proportional transfer (area *OGE*) can be observed. It decreases with income at a rate $-t$ and it is equal to zero when income Y is equal to the deduction k. Over this threshold, taxpayers pay a positive tax, shown by the area *EMN*, where the corner at the intersection between the 45° line and the disposable income segment shows the tax rate.

In UBI (Fig. 2), the allowance of a universal and unconditioned transfer 0 g to all individuals, shifts the 45° line upwards, and in its new position it shows equality between disposable income and gross income plus UBI. After redistribution, individuals with gross income lower than OE will obtain positive benefit from the difference between the sum of UBI (*Og*) and taxes paid, measured by the vertical distance between the 45° line and the segment *gM*. Taxpayers with an income higher than OE will pay a net tax. The net cost of the UBI program will be equal to the area OKE.

[2] Tobin proposed an allowance of 400 US$ and a first income bracket up to 1200 US$ with a marginal tax rate of 33.3%.

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