'Basic Income' or 'Bait and Switch'?

The idea of a 'Basic Income' is said to be attractive to both ends of the political spectrum. But this apparent agreement may be deceptive: Is one name being used to describe two different programs?

Others have asked the same question: "The support from thinkers of both the left and the right might portend broad social agreement on a GAI [Guaranteed Annual Income – a more generic name for a type of Basic Income as discussed below]. I worry instead that the breadth of support is an indicator of a policy that hasn't been specified in enough detail, allowing the policy to be all things to all people" [Milligan 2010].

The archetypical vision on the Right is of a Basic Income that is a small, unconditional payment financed by replacing all other income security programs and many social services. In the United States, libertarian advocates of a Basic Income see it replacing even Medicare for the poor and the young. Supposedly, there would also be savings by cutting the administrative cost of running current programs, made possible due to the hypothesized greater simplicity of an unconditional payment. However, current administrative costs are exaggerated and unconditional payments are not so simple – as we discuss later in this paper – so these savings would be largely illusory. In the Right's vision, the amount of the benefit has to be small because the constraint on the size of the income guarantee is the amount that can be saved. The whole enterprise must at least turn out fiscally neutral or, even better, reduce government expenditure.

But the Right's Basic Income plan actually would reduce income for many low-income households – for example, recipients of Employment Insurance and contributory pension plans such as the Canada Pension Plan. Cuts in public services would hurt most those who can least afford to purchase private substitute services. With no change in the tax system, this vision would see redistribution – from the near-poor to the very-poor, while leaving upper income groups unaffected. It would increase income inequality. From a progressive point of view, it would be a 'bad' Basic Income plan.

On the other side of the spectrum, the archetypical Left vision is of a Basic Income program offering an unconditional benefit large enough to lift almost everyone out of poverty. While social assistance (or 'welfare' as it is usually called in Canada) would be replaced, most other major income security programs – social insurance plans, income supports for the working poor, and child and elderly benefits – would remain intact. Social services would be unaffected.

If the Basic Income guarantee is large enough to eliminate poverty, taxes would have to rise to cover the costs. Although there would be a steep increase in taxes, overall the money would just flow in and out of government, so this plan would also be fiscally neutral. And the increased tax could have the added benefit of decreasing inequality. This is the 'good' Basic Income plan.

For those looking for progressive change that can meaningfully reduce poverty and inequality, the search is on for a practical way to implement a 'good' Basic Income. But is this a chimera? Are progressives advocating for a 'good' Basic Income actually playing into the hands of a regressive agenda? If we get a sweeping reform of income security in the name of Basic Income, will we actually end up with something much closer to the evil twin – the 'bad' Basic Income?

NEGATIVE INCOME TAX

Before the term 'Basic Income' came into vogue, policy wonks spoke generally about a 'Guaranteed Annual Income', usually known by its acronym GAI. A GAI could be implemented through many different mechanisms, but the original idea was to deliver a GAI via a 'negative income tax' [Friedman 1962]. In a negative income tax system, when income reported for tax purposes falls below a certain level, the tax-filer gets a payment *from* government rather than paying money *to* the government. The amount of the benefit only decreases gradually – for example, by 50 cents on each dollar of income. It all sounds so simple – that is, until you think about the kind of 'details' noted by Milligan.

In Canada, income tax is filed retrospectively on the previous year's income, with consequent benefit adjustments in July. July is about a half-year after the end of the tax year, so the income used to calculate the amount of benefit might be as much as a year-and-a-half out of date. This would not work. Poor people need help right away or they cannot feed their children (or themselves) or pay their rent. Income has to be reported at least monthly and benefits adjusted according to current income.

Our annualized retrospective income tax system will not function as a stand-alone delivery vehicle for a negative income tax. Canada would have to move from its present tax system relying on annual reconciliation to a pay-as-you-earn income tax system (as in the United Kingdom), wherein taxes are assessed and deductions adjusted at least monthly. This is neither simple nor less expensive administratively. (For a discussion of the problem of 'responsiveness' and different country's approaches) [Mendelson, Whiteford and Millar 2003].

But in addition to these administrative issues, there are even more serious implications of a negative income tax in respect of the question of *who* pays.

Since there is a gradual reduction in negative income tax benefits as income increases, the benefits do not fully run out until income multiplied by the tax rate equals the amount of the benefit. For those who do not remember their grade school math: If benefits decrease by 50 cents for every dollar of income (i.e., a 50 percent tax back rate), benefits do not end until income is twice the amount of the guarantee. In Ontario, a household of two adults and two children needs about $40,000 a year after tax to be out of poverty. So if there were a guaranteed income for that household at the poverty line, a 50 percent tax back rate means that household benefits would not be cut off until its income exceeded $80,000. For single adults, the implication is that cut-off income is $40,000 since the poverty line is approximately $20,000.

Since poverty lines more or less equal half of median income (give or take a few percentage points depending on the particular poverty line), these income cut-off levels more or less equal median income. While roughly 10 percent of Canadian households are below poverty lines, 50 percent of households are below median income (by definition). So another 40 percent of Canadian households would be entitled to some guaranteed income benefit, beyond the 10 percent of households below the poverty line. A GAI would therefore cost much more than the price tag just for filling the gap between low incomes and the poverty line. For example, if the average amount of benefit for each household above the poverty line but below median income was one-quarter of the amount going to each household below the poverty line, the total cost of the GAI would double.

But an even more significant implication of a 50 percent tax back rate and guaranteed income at the poverty line is that only households with greater than median income would pay *any* net income tax at all. If there were any income tax at all on a household before its income was high enough to eliminate all its guaranteed income benefits, then the household's rate of tax on income would not be 50 percent; rather, its tax rate would be 50 percent *plus* whatever income tax rate applies. Consequently, all income tax would now have to be paid only by above median income households. Above median income, households would therefore need to absorb the cost of all the income tax currently paid by below-median households as well as the cost of the new Guaranteed Income plan.

UNIVERSAL BASIC INCOME

The negative income tax type of income-related program is one way to design a GAI. In the last several years, a different way of delivering a GAI has come to the forefront: the Universal Basic Income. A Universal Basic Income is just what the name implies: It pays an unconditional, flat amount to every adult and child regardless of income. This seemingly saves all the trouble and complexity of the negative income tax type of model. But does this apparent simplicity stand up when we look at the 'details'?

The Universal Basic Income is a mirror reflection of the negative income tax design. With the negative income tax approach, first you report your income and then the amount of benefit you get is reduced accordingly. In the Universal Basic Income, first you get the universal benefit and then your *net* benefit is reduced by some percent (the tax rate) of other income you have. Consequently, the mathematics is exactly the same in the Universal Basic Income as in the negative income style design, albeit not as self-evident. Say the Universal Basic Income is $20,000 for an adult. The amount paid by the Universal Basic Income cannot itself be taxed. If it were taxed, at say 50 percent, then the Universal Basic Income for someone with no other income would actually be $10,000, not $20,000. So if income tax is 50 percent on any income other than the Universal Benefit, the taxpayer would need to have $40,000 taxable income before paying any net income tax at all.

If this result seems the same as for the negative income tax type of program, that's because it is the same. As with the negative income tax, if the Universal Basic Income level equals the poverty rate and if the revenue to pay for the program is raised through income tax, households with more than median income would need to absorb the cost of all the income tax currently paid by households below median income *plus* all of the net added cost of the new Universal Basic Income plan.

Similarly, if the Universal Basic Income is financed by income tax, that does not solve the problem of timeliness of benefit payment. Say, for example, the Universal Basic Income was set at a poverty level of $20,000 for an individual. If that person had a high income in the previous tax year, he or she would have to pay tax on that income in the subsequent year. But what if income has in that subsequent year fallen to zero (due to illness or family break-up or other possible reasons)? The only income the individual would have in that subsequent year is the Universal Basic Income, supposedly to prevent him or her from falling into poverty.

Whether a negative income tax or a Universal Basic Income, if the income accounting period is out of whack with the benefit payment period, either of the programs will be inadequate to prevent extreme hardship when income fluctuates.

Poverty is a here and now experience, not something averaged over a number of years. Thinking through the administrative requirements of the Universal Basic Income drives us to a pay-as-you-earn income tax system with all its inherent complexity, just as with the negative income tax style of design. In fact, if there were a pay-as-you-earn tax system in place and financing via income tax, it is not clear that there actually is any difference at all between the two supposedly alternative ways of delivering a GAI.

Note as well that for both negative income tax and the Universal Basic Income types of design, the significant administrative cost (for recipients) of having to report income on a current basis and the administrative cost (for government) of having to calculate benefits on a timely basis remains. The only administrative saving is in not having to test applicants for their willingness to work. This will not be a huge administrative saving.

So, in the absence of savings falling from the sky, we are back to the core choice: Set the guarantee level in the Universal Basic Income according to the amount that can be saved by cutting current programs (the 'bad' plan) or set the guarantee level to ensure that no one is in poverty and raise taxes as needed (the 'good' plan).

The *Economist* magazine calculated (for 2015) the amount of Universal Basic Income guarantee that could be paid in each OECD country under various assumptions. In Canada, by replacing all income security programs, but not medicare, we could pay for a universal annual income of $4,400 per person – much less than even current social assistance rates, let alone meeting the poverty line. Taking the second route, and paying a guarantee level at the poverty level of about $20,000 per person would, according to the *Economist*, cost at a very rough approximation an additional 35 to 40 percent of GDP, assuming replacement only of social assistance, child benefits and a few smaller programs. Of course, we do not really face a stark choice of one extreme or the other, but if we

did get an all-encompassing reform of our whole income security system in the name of Universal Basic Income, are we more likely to end up closer to the 'bad' plan or the 'good' plan?

WHAT IS POSSIBLE?

For proponents of the Universal Basic Income, the kind of costing provided above is misleading. The so-called 'cost' of 35 to 40 percent of GDP would not represent extra government spending; rather, it would pass through government and so be fiscally neutral. This observation is correct in theory but not of much practical relevance today. Not to put too fine a point on it: The kind of revenue needed to finance a 'good' GAI – of whatever design – is never going to come through income tax.

There may someday be a way to finance a GAI with guarantee levels high enough to eliminate or substantially reduce poverty – namely by a huge increase in the value-added tax, which in Canada is the GST/HST (Goods and Services Tax/Harmonized Sales Tax). If we are to have extraordinarily large increases in the flow of income through government, and thereby require very large increases in revenue taken in and paid out by government, a value-added tax has many advantages over income tax – in retaining competitiveness, earnings incentives and making it difficult for anyone legally purchasing goods or services in Canada to avoid the tax. Value-added tax is regressive, but would be more than fully offset by the big new GAI for those with low incomes.

A huge value-added tax in Canada would today be impossible, not only politically, but practically since it would drive much of the economy underground. Rumour has it that Sweden and South Korea will be going to a no-cash economy in the 2020s. Canada is already less than half cash. Perhaps if and when cash disappears and all transactions become above-board, it might be possible to revisit the possibility of a poverty-eliminating GAI. In the meantime, the real world of any GAI of whatever kind is this: If we were to create a great big GAI, it will be necessarily fall far below poverty levels, and it would likely entail replacing or at least curtailing many public programs serving those with modest but not necessarily below-poverty levels of income.

SO WHAT SHOULD WE DO WHILE WAITING FOR CASH TO DISAPPEAR?

A non-universal Basic Income for persons with disabilities would be possible right now as a kind of floor guarantee for the Canada Pension Plan Disability benefit, regardless of contributory history. This would necessitate compromise on the issue of non-conditionality because passing the Canada Pension Plan disability test would be required, but it would substantially reduce poverty for those with severe disabilities and thereby provide a highly targeted and efficient way to reduce poverty for some

Canadians with disabilities. Extension of Employment Insurance to a wider group of low-wage unemployed, and more help to the working poor via the Working Income Tax Benefit, could help make a more generous but not open-ended safety net available to working age adults. A provincial housing allowance combined with an aggressive federal commitment to building low-income housing could make shelter more affordable for low-income households. These are just some examples of sensible and doable reforms to combat poverty that could be implemented now for costs that could be accommodated within our present tax structure. (These and other proposals are spelled out in more detail on the Caledon Institute of Social Policy web site *http://www.caledoninst.org*).

A 'good' basic income that might actually achieve the objectives its proponents seek requires a fundamental restructuring of our tax system. Such restructuring is not on any realistic political agenda, at least not for the next few decades. The search for the silver bullet to once and for all eliminate poverty and increase equality in a single great swoop is seductive, but it leads us away from consideration of practical and incremental steps – 'mini-Basic Incomes' – which are nevertheless radical steps with big impacts that move us closer to the objectives of a 'good' basic income.

Perhaps a new experiment or pilot project will give us some useful information. Some attention to issues such as tax integration and administration could be enlightening, as these were ignored in the experiments of the 1970s. But the danger is that good intentions will end in tears. Rather than a Guaranteed Annual Income with benefits approaching poverty levels, we could instead wind up with a Guaranteed Inadequate Income that pleases no one.

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