Basic Income Flat Tax and Public Property Rights

paper by
Keith Rankin
Dept of Accounting and Finance
Unitec Institute of Technology

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> "The IRD is either a distributor of wealth or a legalised thief of private property."
>
> Deborah Coddington (2011)

Introduction

Taxation policy in New Zealand and elsewhere has become an arcane political art rather than a principled social science. Other than following in general terms the vertical equity principle[1] of progressivity – meaning that average personal tax rates rise as incomes rise – the setting of income tax rates and thresholds is essentially an exercise in distributive politics.

This paper sets out the argument for a Basic Income Flat Tax (BIFT) approach to taxation and welfare, and the policy implications of a formal adoption of such an approach. An important part of the argument presented is that, in New Zealand at least, a *de facto* BIFT tax-benefit regime already exists, and that therefore there need be no significant transitional redistributions arising from a formal adoption of a Basic Income Flat Tax structure.

Taxation as Principled Theft?

The classical notion, that taxation is a necessary evil which should be minimised, is rarely disputed. In the mindset of classical liberalism, all income as initially distributed is private – be it in the form of wages, profits, rent, or interest – with the "kleptocratic state" (Charap and Harm 1999 p.4) being tantamount to a warlord or bandit (McGuire and Olson 1996) who takes a share of that income, for purchases or, if altruistic, for redistribution.[2] Whereas in history much tax revenue was used to purchase military services for defence from foreign invasion, force could be applied also to those subjects who attempted to avoid their requirement to concede goods and services (or their cash equivalent) to the state. Classical liberals accept that thief with reluctance, knowing that the alternative to government is the anarchy from which kleptocracies emerged.

The two fiscal principles classical liberalism are that taxes should be low, and should be levied proportionally, according to the rule of horizontal equity; equal treatment for all. An overarching principle is that taxation should be efficient,[3] meaning that economic choices should be minimally influenced by opportunities for tax avoidance (which includes income avoidance practices such as working less) and that the administrative costs of tax collection and allocation should be as low as

possible (Mirrlees 2010b, p.1). It is thus widely assumed, as a part of this concept of efficiency, that a taxation regime should do nothing to lower labour force participation rates. Creedy (2010) uses high labour force participation as a central criterion of the efficiency of the "tax-and-transfer" system.[4] Likewise, Mirrlees (2010b, p.3) notes a trade-off between "work incentives" and "redistribution", implying that increased work disincentives always represent an adverse outcome. Henry (2009, p.xx) seeks a "work supportive transfer system".

While there is widespread acceptance that taxation and cash benefits are parts of a single whole, there is very little public discussion about the difference – if any – between explicit cash transfer payments, tax credits, tax concessions, and subsidies.[5] Yet in statistical presentations, such as the claim by Prime Minister John Key, following the 2011 Budget Statement, that "51% of all personal taxes in this country was paid by 13% of taxpayers" (Hansard), the differences are critical.[6] Creedy (2010, pp.109-110) introduces Basic Income Flat Tax as a "tax and transfer structure". While his Figure 2 depicts a proportional income tax with an explicit universal "transfer", his Figure 3 shows a progressive tax structure that includes negative tax rates. Creedy's "transfer" has morphed into a concession, which, because the concession may exceed a person's tax liability, may also be called a "refundable tax credit" (Atkinson 1995, p.3).

This paper suggests a workable definition for the tax-benefit interface, by adopting a "landlord" rather than a "warlord" view of taxation. The paper goes on to make an important distinction between the "Crown" (or sovereign) and the "government", and to demonstrate how such a distinction can enable improvements to future policymaking.

The Public Property Rights "Distributor of Wealth" Argument

The first "economists", the French physiocrats, argued that the land conferred a net surplus which was appropriately available for the support of the "political class" who provided what today would be called public goods (Einaudi 1933, p.135). Ideas developed in pre-democratic times are easily adaptable to democracies, however, with what Einaudi describes as the physiocratic "national dividend" able to be distributed to an enlarged universally enfranchised political class.

Classical economists, in the Ricardian tradition, tended to see both the "state" – a conflation of "sovereign" and "government" – and the landlords as the bad guys. They argued strongly for policies – for example, removal of agricultural protection – that would reduce landlords' rents. However, they accepted that, in a world constrained by scarcity, landlords' income shares would inevitably rise as economies grew over the long run. Their concept of diminishing returns meant

that inequality would rise, profits would fall, and poverty would be the dismal lot of all but the lucky few. The model pointed to economic rent, as a pure surplus, as an ideal fund from which government revenue might be drawn. For the classical economists, a good outcome was for that long run to be protracted, allowing high rates of profits and reinvestment to continue for as long as possible.

For one of them, JS Mill, that protraction of time would be enough to create permanently higher living standard benchmarks. In addition, Mill (1873) and others in the 1870s and 1880s came to believe that land should be leased by a landlord state,[7] rather than having a landlord class with freehold title. One of the strongest advocates in New Zealand of Mill's ideas on land nationalisation was Premier John Ballance (Hamer 1988), who first introduced income tax in New Zealand in 1891 (Rankin 2009) as an addendum to a comprehensive land tax.

Today, the land as such, no longer enjoys the significance that it held in past centuries of economic thought. However it is widely accepted that non-private inputs play a crucial role in enabling developed world living standards.[8] These unowned inputs, those resources that inhabit the public domain,[9] represent the public equity of a society. We may interpret income taxation as the Crown levying a rent (or royalty) on the use of public domain inputs.[10]

In a democratic society, where the Crown is a symbolic representation of the people and their public property rights, such a levy is the equal property of all (or at least all adults, given the differing legal status of minors),[11] and in principle may be distributed equally to all, as a portion of each person's disposable income, as a public equity benefit.[12] Simon (2000) calls each person's share of public income a "patrimony".[13] An important implication of this landlord approach is that, contrary to the warlord view, tax minimisation need no longer be seen as optimal from the viewpoint of the citizenry. The distribution of royalty income represents an alternative non-labour source of income to populations; not the confiscation implicit in the warlord view.[14] Higher rates of tax (by the Crown) need not be associated with the "Leviathan" of bigger government (Micklethwait 2011).

Simon (2000) suggested that, based on comparisons of rich and poor countries today, a flat rate of tax of 70% might accurately reflect the economic contribution of public domain inputs vis-à-vis private inputs. In reality, the resources in the public domain are largely gifted – and the whole point of a gift is that no return is expected. Indeed academic outputs represent one form of such gifts. Thus the rate of tax chosen may be set pragmatically, in accordance with a wider set of public

objectives, including the maintenance of a labour supply that is optimal for the circumstances a society experiences.

In this "landlord" view of the public realm, in a democracy the Crown can be regarded as a corporate entity – analogous to a joint-stock company – which draws revenue from the productive assets in its care and distributes that part of that revenue to its shareholders. While it is true that the extent that the Crown pays public equity benefits to its shareholders may influence labour supply, it is not clear why the labour supply issue here is in any way different from the same issue as it affects private equity beneficiaries.

Basic Income Flat Tax defined

As a result of interpreting income taxation as a rent or royalty, and the payment of equity benefits – not transfers – from the ensuing fund, we get the following personal taxation formula:

$$D = (1-t)G + B \qquad\qquad [1]$$

where: D is personal disposable income
G is gross personal income
t is the flat rate of tax (FT)
B is the basic income or "equity" benefit (BI)

A pure flat tax option is simply a subset, with B=$0. Figures 1 and 2 show the structure graphically, with Figure 1 emphasising the basic income equity benefit, and Figure 2 emphasising the flat tax.

If we make allowance for vertical equity transfers – usually granted on the basis of unequal need – then we get, for each tax-resident:

$$D \geq (1-t)G + B \qquad\qquad [2]$$

This is equivalent to:

$$D = (1-t)G + B + V \qquad\qquad [3]$$

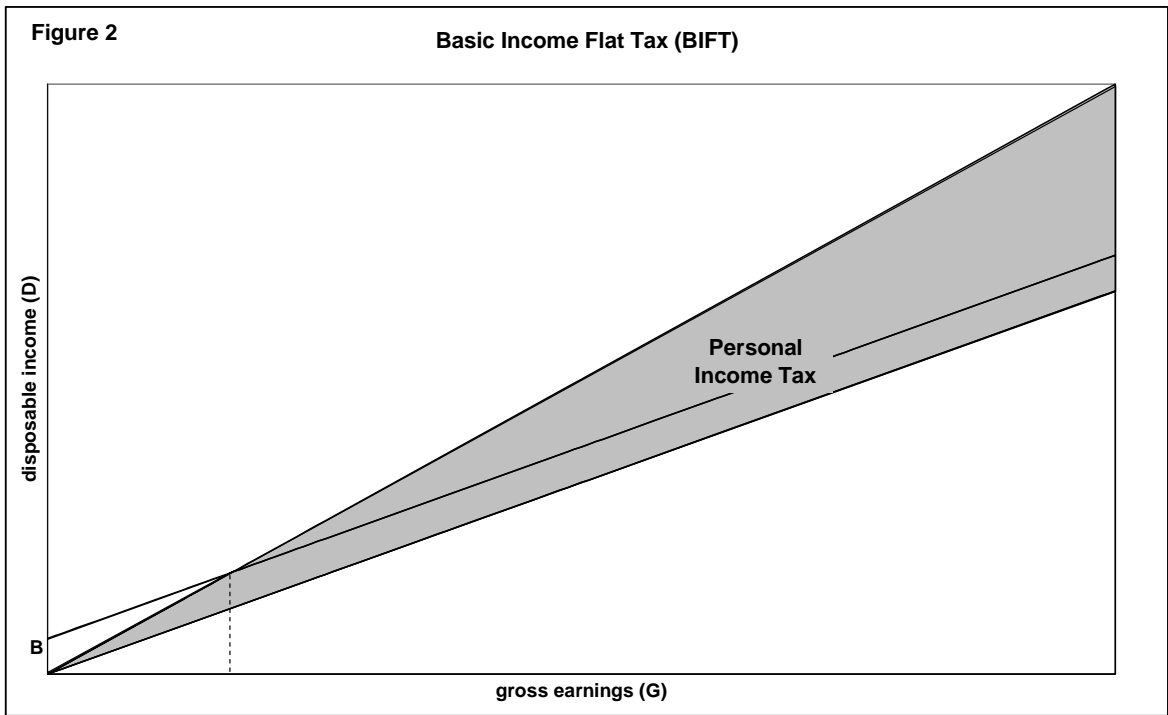where: V is a variable transfer, ≥ 0, reflecting individual vertical equity considerations

Figure 1

Basic Income Flat Tax (BIFT)

disposable income (D)

Equity Benefit

Private Income

B

gross earnings (G)

Figure 2

Basic Income Flat Tax (BIFT)

disposable income (D)

Personal
Income Tax

B

gross earnings (G)
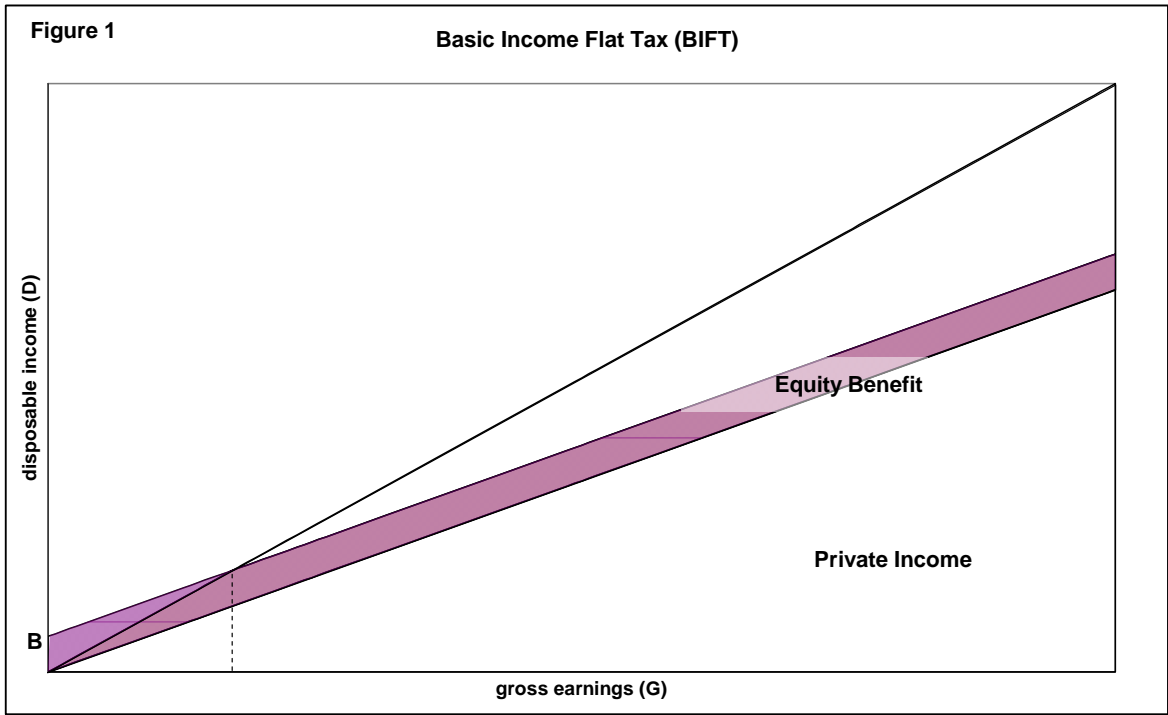
Figure 3 shows an example with likely New Zealand values.

Figure 3

Basic Income Flat Tax (BIFT) with Vertical Equity Transfers

OEP	Income Tax
OPZ	Private Income
OBDP	Equity Benefit
VBC	Transfer
OVCDZ	Disposable Income
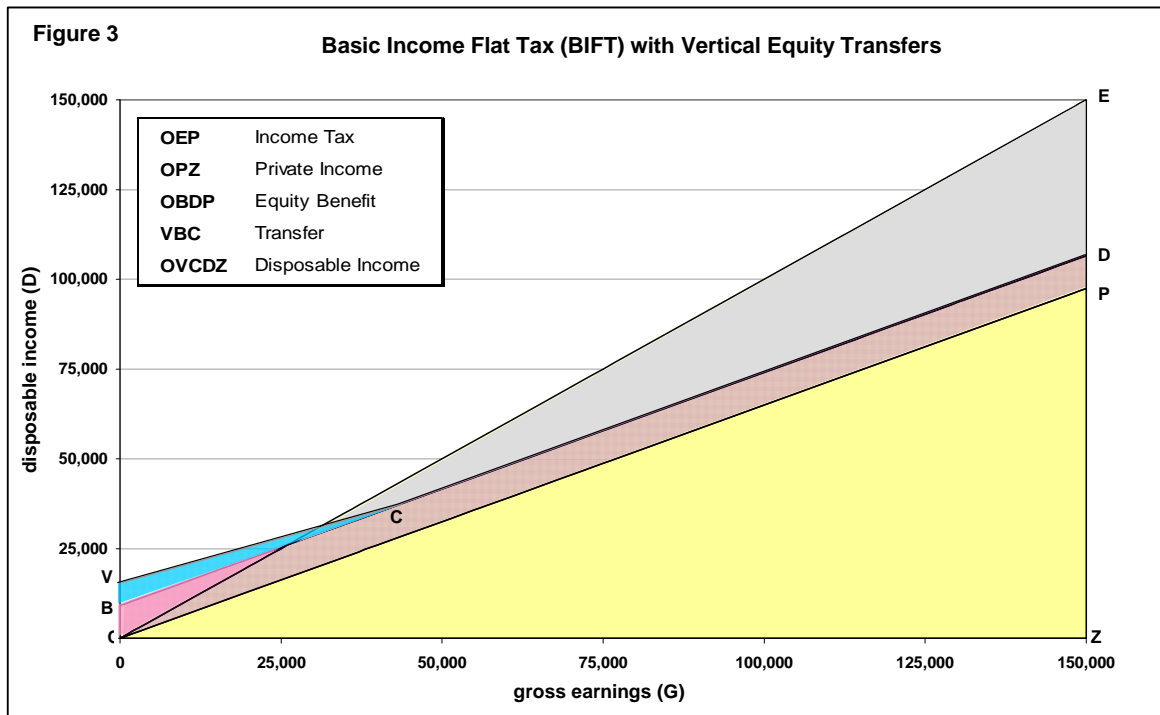
It is important to note that BIFT differs substantially from the Guaranteed Minimum Income Flat Tax (GMIFT) structure (Creedy 2010, Figure 5, p.111), proposed for families by Roger Douglas in 1987 (Goldsmith 2008 pp.301-4, Mydans 1988) and still advocated by him (Douglas 2009). Such a structure pays a transfer only, with no equity benefit. A GMI incurs an effective marginal tax rate (EMTR) of 100%. In Figure 3, under a GMIFT, B=0 and VC is horizontal. New Zealand retains a remnant GMI for low-waged families ("Minimum Family Tax Credit") that shows up in Figure 5 below.

New Zealand's 2011/12 personal tax scale from a BIFT perspective

Salaried persons in New Zealand in income ranges $70,000 to $111,669, and with no other income source, presently conform exactly to [1] with these parameters:[15]

$$D = (1-0.3504)G + \$9,080 \qquad [4]$$
$$0.6496\,G + \$9,080$$

For example,[16] such a person with a $100,000 salary has, in 2011/12, a disposable income of:

$$D = 0.6496(100,000) + \$9,080 \qquad [5]$$
$$= \$74,040$$

Such a person with an $80,000 salary has a disposable income of:

$$D = 0.6496(80,000) + \$9,080$$
$$= \$61,048$$

All persons with incomes above $70,000 satisfy inequality [2], using the parameters given in [4]. The BIFT parameter "t" (otherwise represented as FT) is simply the top personal rate[17] of 33% combined with the present 2.04% ACC earners levy (Inland Revenue).

The Basic Income parameter "B" (or BI) can be determined as the some of all tax concessions arising from the statutory rates applying to the first $70,000 of a person's income.

Table 1: Calculating Ordinary Tax Concessions New Zealand 2011/12				
income threshold $	statutory rate %	concession		
		rate %	amount $	cumulative $
0				0
	10.5%	22.5%	3,150	
14,000				3,150
	17.5%	15.5%	5,270	
48,000				8,420
	30.0%	3.0%	660	
70,000				9,080
	33.0%	0.0%	0	

Most New Zealand tax residents in all income ranges conform with [2], given the wide array of transfers presently available. Most of the remainder come close to conforming with [2]. Given, however, that some persons fall short of conforming with [2], we can re-specify [3] as:

$$D = (1-t)G + B + R \qquad [6]$$

where: R is a residual $\geq -((1-t)G + B)$

The majority of persons for whom R<0 are employed childless persons with gross incomes below $70,000. Most of those most affected qualify for housing subsidies (Accommodation Supplements paid by Work and Income) and the "Independent Earner Tax Credit". Through combining these cash allowances with the tax concessions implicit in the lower statutory tax rates that they pay, most such persons experience an income residual (R) that's close to zero, albeit below zero.

If R = -((1-t)G + B), then D=0, the situation of persons receiving no personal income but not eligible for any transfer payment on account of their age (under 65) and the high earnings of their partners. Many such persons will be parents, who would come close to conforming with [2] if Revenue Minister Peter Dunne's "income splitting" proposal (Trevett 2010) is enacted. Others will be students who do not qualify for student allowances.[18]

Whereas [6] is an accounting expression, [3] represents the condition required to qualify New Zealand's personal tax-benefit structure as a real world example of Basic Income Flat Tax. R becomes V, and must not be negative.

Negative Income Tax

Basic Income Flat Tax can be regarded as equivalent to many proposals to integrate the tax and benefit systems through a Negative Income Tax (NIT), in the sense that both may yield the same disposable income for a given gross income. Indeed, because of the Flat Tax requirement, BIFT can be understood as a subset of all possible Negative Income Tax proposals.

Here though, emphasis is placed on the way the Basic Income is accounted for. For example, under NIT accounting, a person grossing $100,000 pays $25,960 in tax. Under BIFT, however, following [4], a person grossing $100,000 pays $35,040 in tax, and receives an equity benefit of $9,080, leaving a disposable income of $74,040. If [5] was to apply universally, then every adult would pay income tax at a marginal and average rate of 35.04%, and every adult would receive an equity benefit of $9,080. By the BIFT accounting convention advocated here, the distribution of income tax is equal to the distribution of taxable income. This is not true if basic incomes are deducted from a person's flat tax liability to yield a net tax liability. Unlike NIT, BIFT conceptually separates the benefit from the tax.

A useful example of the accounting difference is as follows. If in 2012 we make the first $5,000 of earnings non-taxable, without a BIFT framework we would understand that policy to be an annual tax cut of $525 reducing the public share of national income. Within a BIFT framework, however, the taxed share of GDP would be unchanged. What would change, instead, is that the annual BI would rise from $9,080 to $9,605. To employ the company analogy, such a policy would be to distribute additional dividends from profits, rather than to reduce profits.

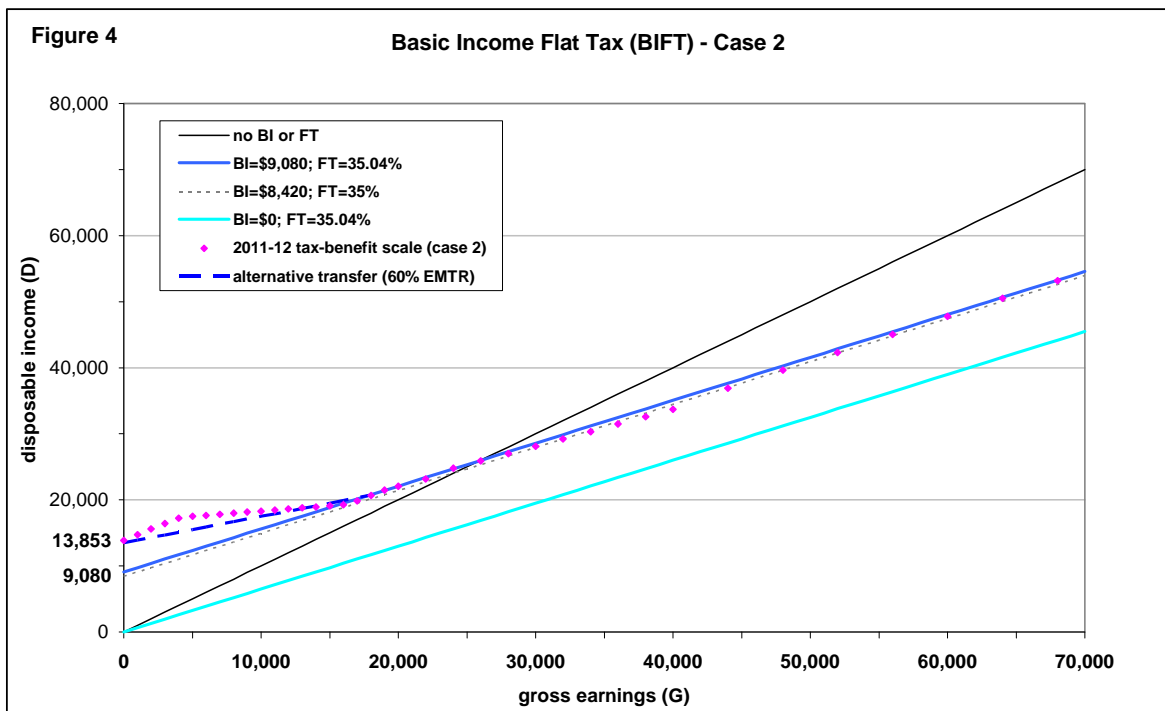## BIFT Examples for New Zealand

We investigate [6] through the use of five examples. In each case, whether under BIFT accounting or present statutory accounting, only salaries are included as taxable income.

1. a single person earning $78,000 ($1,500 pw)

Table 2

Case 1 **Single person with a salary of $78,000 and no other income.**

	BIFT Accounting				**Statutory Accounting**		
	annual $	pw $			annual $	pw $	
Salary	78,000.00	1500.00			78,000.00	1500.00	
tax/acc	27,331.20	525.60	35.04%		18,251.20	350.98	23.40%
untaxed	50,668.80	974.40	64.96%		59,748.80	1149.02	76.60%
benefit	9,080.00	174.62	*		0.00	0.00	
disposable	59,748.80	1149.02			59,748.80	1149.02	

*	annual equity benefit	=	**9,080.00**	plus residual **0.00**

2. a single person in Wellington earning $39,000 ($750 pw) with a mortgage of $250 per week;
   in Figure 4 the earnings are varied from $0 to $70,000

Table 3

Case 2 Single person in Wellington earning $39,000, with weekly mortgage of $250

	BIFT Accounting				**Statutory Accounting**		
	annual $	pw $			annual $	pw $	
Salary	39,000.00	750.00			39,000.00	750.00	
tax/acc	13,665.60	262.80	35.04%		6,640.60	127.70	17.03%
untaxed	25,334.40	487.20	64.96%		32,359.40	622.30	82.97%
benefit	7,779.00	149.60	*		754.00	14.50	§
disposable	33,113.40	636.80			33,113.40	636.80	

*	annual equity benefit	=	**9,080.00**	plus residual **-1,301.00**
§	Accommodation Supplement plus Independent Earner Tax Credit			

Figure 4 — Basic Income Flat Tax (BIFT) - Case 2

Legend:
- no BI or FT
- BI=$9,080; FT=35.04%
- BI=$8,420; FT=35%
- BI=$0; FT=35.04%
- 2011-12 tax-benefit scale (case 2)
- alternative transfer (60% EMTR)

y-axis: disposable income (D), values 0, 9,080, 13,853, 20,000, 40,000, 60,000, 80,000
x-axis: gross earnings (G), 0 to 70,000

3. an Auckland sole parent earning $7,800 ($150pw), paying $300pw rent, and with one child aged 5; in Figure 5 the earnings are varied from $0 to $70,000

Table 4

Case 3   Sole parent (child age 5), Auckland, earning $7,800 with weekly rent of $300

	BIFT Accounting			Statutory Accounting		
	annual $	pw $		annual $	pw $	
Salary	7,800.00	150.00		7,800.00	150.00	
tax/acc	2,733.12	52.56	35.04%	978.12	18.81	12.54%
untaxed	5,066.88	97.44	64.96%	6,821.88	131.19	87.46%
benefit	27,193.92	522.96	*	25,438.92	489.21	§
disposable	32,260.80	620.40		32,260.80	620.40	

     *   annual equity benefit   =   **9,080.00**   plus residual   **18,113.92**
     §   Domestic Purposes Benefit, Accommodation Supplement plus Family Tax Credit

Figure 5   **Basic Income Flat Tax (BIFT) - Case 3**
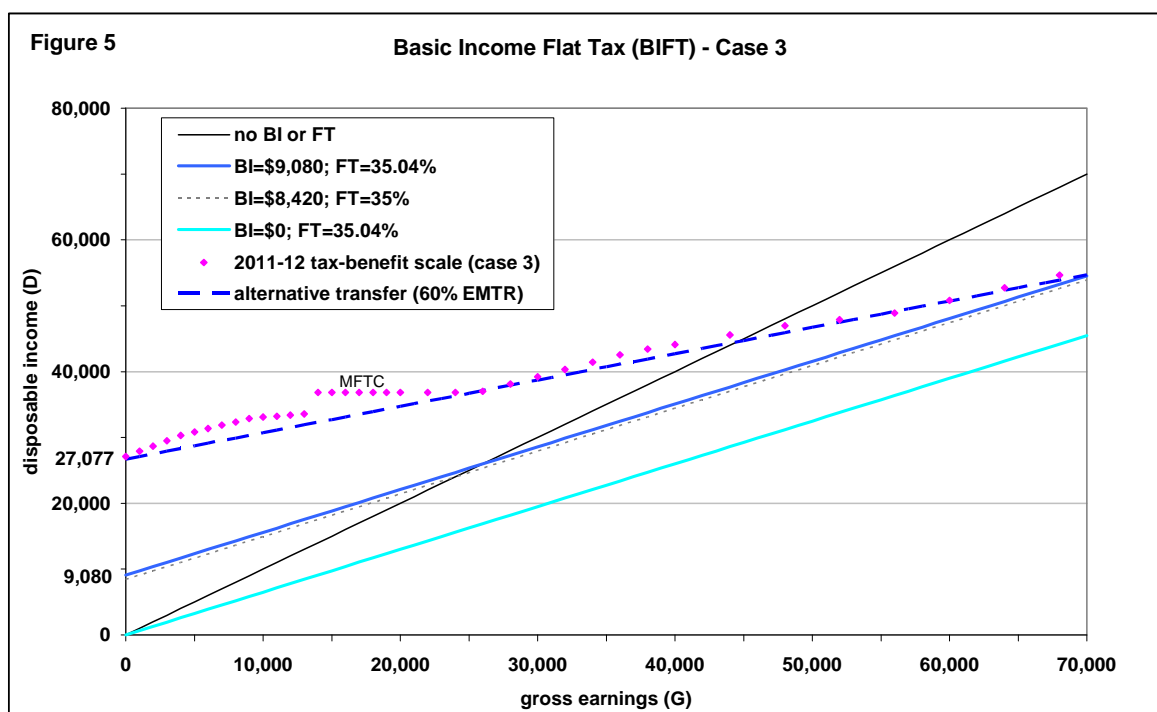
4. a working couple earning $65,000 and $39,000, with three children aged 16, 14 and 12

Table 5a

Case 4a   Couple with salaries of $65,000 and $39,000; children aged 16, 14 and 12

	BIFT Accounting			Statutory Accounting		
	annual $	pw $		annual $	pw $	
Salary	65,000.00	1250.00		65,000.00	1250.00	
tax/acc	22,776.00	438.00	35.04%	13,846.00	266.27	21.30%
untaxed	42,224.00	812.00	64.96%	51,154.00	983.73	78.70%
benefit	8,930.00	171.73	*	0.00	0.00	
disposable	51,154.00	983.73		51,154.00	983.73	

     *   annual equity benefit   =   **9,080.00**   plus residual   **-150.00**

Table 5b

Case 4b   Couple with salaries of $65,000 and $39,000; children aged 16, 14 and 12

	BIFT Accounting			Statutory Accounting		
	annual $	pw $		annual $	pw $	
Salary	39,000.00	750.00		39,000.00	750.00	
tax/acc	13,665.60	262.80	35.04%	6,640.60	127.70	17.03%
untaxed	25,334.40	487.20	64.96%	32,359.40	622.30	82.97%
benefit	8,824.32	169.70	*	1,799.32	34.60	§
disposable	34,158.72	656.90		34,158.72	656.90	

      * annual equity benefit   =   **9,080.00** plus residual **-255.68**
      § In-Work Tax Credit

5. a single income family earning $143,000 with five children

Table 6a

Case 5a   Couple with single income of $143,000; five children aged 9 to 17

	BIFT Accounting			Statutory Accounting		
	annual $	pw $		annual $	pw $	
Salary	143,000.00	2750.00		143,000.00	2750.00	
tax/acc	50,107.20	963.60	35.04%	40,388.05	776.69	28.24%
untaxed	92,892.80	1786.40	64.96%	102,611.95	1973.31	71.76%
benefit	9,719.15	186.91	*‡	0.00	0.00	
disposable	102,611.95	1973.31		102,611.95	1973.31	

      * annual equity benefit   =   **9,080.00** plus residual **639.15**
      ‡ residual due to ACC exemption above $111,669

Table 6b

Case 5b   Couple with single income of $143,000; five children aged 9 to 17

	BIFT Accounting			Statutory Accounting		
	annual $	pw $		annual $	pw $	
Salary	0.00	0.00		0.00	0.00	
tax/acc	0.00	0.00		0.00	0.00	
untaxed	0.00	0.00		0.00	0.00	
benefit	2,370.28	45.58	*	2,370.28	45.58	§
disposable	2,370.28	45.58		2,370.28	45.58	

      * annual equity benefit   =   **9,080.00** plus residual **-6,709.72**
      § In-Work Tax Credit

These examples (except for the comparatively rare Case 5b[19]) all show annual equity benefits close to the $9,080 basic income that all New Zealand tax-residents earning over $70,000 per annum already receive. Figure 4 shows that even a representative single taxpayer receives an annual equity benefit that is always within $1,400 of the $9,080 benefit payable to all higher earners. The negative residuals would reduce even further if the government decided to reduce the present equity benefit

of $9,080 to $8,420 by commencing the top marginal tax rate (35.04% with ACC) at $48,000, thereby removing the second-from-top tax bracket (see Table 1).

Accounting Implications

The adoption of the accounting reforms suggested – based on equation [6] above – have substantial implications for the ways that we discuss taxation and benefit matters.

- Taxes paid by individuals would be incurred in direct proportion to their gross earnings. This would limit the scope for politicians to make political claims about the percentage of tax that specific groups pay, as in the Prime Minister's post-Budget speech (Hansard).
- Where individuals receive benefits less than or equal to B (ie ≤ $9,080 in New Zealand in 2011/12), then that payment represents an unconditional right; an equity benefit rather than a "hand-out"[20].
- Negative residuals can be regarded as arbitrary "theft", representing a vestigial element of the warlord approach to taxation.
- New Zealand Superannuation (Work and Income) is revealed as a double-patrimony for persons over 65 with substantial private income.
- Company tax at 28% represents a subsidy of 5% of company profits. (Whether such a subsidy facilitates the achievement of a worthwhile economic goal is not addressed here.)
- Adoption of a flat tax of say 35% on all market income means that all private income can be distributed after tax,[21] thereby eliminating the marginal tax incentive problem. Persons who presently earn a salary of $100,000 would come to understand themselves as earning a salary of $65,000. If they get an annual increase of 1%, their salary would simply rise to $65,650. Gross income would no longer become a part of our personal income calculus.

Complete Adoption of BIFT in New Zealand

If BIFT were to be adopted in New Zealand on the basis of equation [3], the required non-accounting reform, which would make a difference to some persons' disposable incomes (D), would be to compensate all persons who have a negative R (residual in [6]). If such compensation could not be immediate, due to a government budget constraint, then the required correction could be made over time, as economic growth permits.

Alternatively, the process could be hastened by reducing the equity benefit (B) to say $8,420 – equivalent to removing the 30% tax bracket on annual earnings between $48,000 and $70,000, as shown in Table 1. That should easily fund all of the required compensation at a cost of reducing the disposable incomes of middle-high earners by a maximum of $660 per year. If we reduced the tax

rate to 35% as well, formally combining the ACC levy with regular taxation, then, instead of [4] we would have, for all qualifying[22] individuals :

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D ≥ (1-0.35)G + $8,420                                    [7]
     0.65 G + $8,420
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Adoption of such a "basic income flat tax" tax-benefit structure in New Zealand not only meets the objective of being "equitable, transparent and simplified" (Henry 2009, p.xix), but also represents a *de jure* version of what, in essence, New Zealand already has in *de facto* form.

Implicit Administrative Reforms

It is in the administration of both taxes and benefits that substantial changes in transaction costs can be made, through increased simplicity,[23] and through Inland Revenue not being required (indeed allowed) to keep information relating to tax-residents' families. Reforms affecting Inland Revenue could include:

- to pay equity benefits to all qualifying individuals through either their pay slips (if they have a Primary tax code) or, as Family Tax Credits are presently paid, directly into their bank accounts

- to reform the transfer system – the vertical equity payments – with the probable object of applying a single rate of abatement (such as the 60% rate shown in Figures 4 and 5) to all transfer beneficiaries

- the ACC earners' levy would be merged into the statutory tax system, as occurred in 1969 when with the 7.5% contributory social security payments were formally merged with general taxation (NZOYB 1969, p.758), with the implication that the trust rate of tax should become the same as parameter FT (ie 35.04% in 2011/12)

- the ACC would draw up to 1% of GDP from normal tax revenues (horizontal equity), while levying businesses in accordance with insurance principles, with premiums based on industry risk and firms' safety records

- to merge New Zealand Superannuation into the overall BIFT structure, converting the excess into an age-related transfer

- to eliminate student allowances and student loan living allowances

- Working for Families to be scaled down, with administration transferred to Work and Income

Implications for Work and Income

Generally, Inland Revenue would deal with the public on a horizontally equitable basis – collecting flat rate taxes while paying equity benefits and corporate subsidies – while Work and Income would deal with the public on a vertically equitable basis, as an income support agency rather than as a job search agency. The impact on Work and Income of BIFT reforms would include:

- the loss of clients whose total benefits are less than or equal to B
- the loss of clients whose benefits exceed B but who prefer a smaller unconditional benefit to a larger benefit with some conditions attached
- would gain new clients only when their transfer entitlements would be non-trivial
- would gain clients currently receiving transfers in the form of Working for Families "Family Tax Credits"
- devolving their job-searching services to the private sector
- taking over the administration of Child Support – an area that requires more personal information than Inland Revenue should ever need

BIFT, Economic Growth and Income Distribution

BIFT has the potential to significantly reduce transaction costs in public administration (Mirrlees 1986),[24] thereby raising economy-wide productivity. Whether higher productivity translates to higher output or to reduced labour force participation will depend on the extent that consumers prefer more consumables vis-à-vis more free time. Certainly the choice of BIFT parameters would be expected influence that choice. How should BI and FT change over time, given the normal processes of exogenous and endogenous growth?

If we accept that growth in the future will be broadly similar to historical growth, then the unowned public domain inputs will continue to expand relative to private inputs. Growth in the past has been made possible through collective learning: improved scientific knowledge, better institutions, better environments; better policies, new ways of harnessing renewable natural resources, increased social capital. If such growth continues, through a larger public domain, then it follows that FT should rise over time, and that BI should rise with it as an increasing share of personal income. If so, then as both marginal tax rates and disposable incomes rise, standard labour market theory suggests that labour force participation rates should fall,[25] enabling productivity gains to be taken in substantial part as incrementally increased leisure.[26]

The question arises though that, as aggregate demand increases with real income growth, we may demand relatively more additional collective goods than private goods, requiring a disproportionate distribution of the growth dividend into government spending, in areas such as health care. The extent that equity benefits should rise over the long term (as a percentage of GDP per person) therefore depends on our relative preferences, at the margin, for collective vis-à-vis private goods.

Productivity growth, *ceteris paribus*, raises inequality, reducing labour's share of income and raising capital's. Raising equity benefits serves as a relatively simple offset, allowing labour to maintain its share of aggregate disposable income, even as the labour share of aggregate income is falling. A stable global economy over the long run requires a predictable distribution of consumer expenditure. The avoidance of increased income inequality may be a better means than increased consumer credit of achieving stable expenditure distributions.[27]

BIFT as a Policy Amenable System

Under a BIFT regime, fiscal stimulus, when required, could be applied either by reducing the FT or by raising the BI, or both. The converse applies to a contractionary fiscal policy.

Reducing the FT carries the implication that public domain inputs are seen as relatively less important, and that private sector inputs are relatively more important to growth. A reduced FT will generally mean more inequality, whereas a raised BI will tend to have an equalising influence. In a time of recession, when fiscal stimulus is required, unemployment also creates more inequality. So a raised BI will normally be a superior policy response compared to a reduced FT.

BIFT parameters may be used as a policy tool to influence labour supply. Thus a policy to raise both BI and FT can be expected to lead to a reduction in the country's labour force participation rate[28], whereas a reduction in both parameters, through income and substitution effects, can be expected to lead to increased participation rates.

We can consider certain periods of history as requiring higher levels of labour supply than might occur through market forces alone; for example periods of war or reconstruction, or periods in which the ratio of working age population to total population is unusually low. A supply elastic economy can be considered one in which both labour and natural resources are held in reserve in normal times, and are released in the kinds of special times noted.

In order to hold a labour reserve in normal times, it is desirable that a degree of leisure preference be encouraged. Higher equity benefits make it possible for some family members to withdraw from the labour force and spend more of their time on unpaid activities. An equivalent option would be the increased incentive that a raised BI would give to individuals to reduce their hours of regular work. This incentive would be accentuated by the higher marginal tax rate that follows from a raised FT.

A policy to raise the BI while reducing government spending represents an option to reduce the size of government without the increases in inequality that usually arise from cutting taxes. This policy would be the equivalent to individual tax-residents keeping a greater proportion of their publicly-sourced incomes, while having to spend more on such items as education and healthcare. While the Crown – as a landlord – would grow (through a rise in FT) in proportion to the growth of public domain inputs, government would grow or shrink (through a change in BI) in accordance with changes in consumers' preferences for individual versus collective goods.

A BIFT approach to fiscal management enables a clear distinction to be made between Crown (as public domain landlord; a passive symbol of publicness) and Government (as policymaker, regulator, adjudicator, and purchaser of collective goods). A society with a big Crown and a small government would be simultaneously egalitarian and libertarian.[29]

Competitiveness issues in a BIFT world.

Some may argue that raising the flat tax rate – whether incrementally in line with productivity growth or as a policy measure – raises production costs in the country concerned, thereby reducing that country's competitiveness in international trade. We should first note that "competitiveness" is a mercantilist[30] concept, and that all countries can produce in accordance with their respective comparative advantages in a world with sufficient aggregate demand relative to aggregate supply.

If either wages or public domain royalties (or exchange rates or environmental standards) are set too low, then a country is open to the accusation of predatory mercantilist competition. Thus, the failure to raise taxes as productivity rises leaves a country open to the charge of predatory trading, and leads to substantial resource misallocation globally. Just as a company tax rate set below the normal rate of income tax is equivalent to a subsidy to companies, a normal rate of income tax that is set lower in one country than in another similar country is equivalent to a subsidy to inefficient producers (and to efficient producers who do not require such a subsidy), and public equity income foregone on the part of that country's residents.

Maintaining artificially low taxes – increasing the gap between actual and appropriate tax rates as GDP increases – is, like most protective tariffs, a form of "beggar-thy-neighbour" policymaking.

BIFT and Global Imbalances

New Zealand is a country indebted to the rest of the world that continues to run current account deficits. Global rebalancing requires that indebted countries run deficits, while creditor countries run deficits. In this context, there is an argument that New Zealand and other highly indebted countries maintain lower tax rates and equity benefits in order to raise competitiveness and labour supply. Such a policy can only be appropriate if the creditor countries agree to do the opposite; to raise their tax rates and equity benefits, with a view to reducing their competitiveness and contracting their labour supplies. Clearly then, while BIFT tax-benefit reform can have benefits for New Zealand, it can have significantly greater benefits for the global economy if adopted in the developed creditor countries as a means to enable substantial falls in their labour force participation rates.[31]

If the creditor countries persist in setting their resource prices too low to facilitate rebalancing – or, worse, to accentuate existing imbalances – then debtor countries find themselves facing an imposed leisure-preference. In this case, the global economy is probably more stable if the debtor countries accept that imposed leisure-preference (by preferring low participation rates to high unemployment rates), rather than fight it by engaging in a futile mercantilist "race to the bottom" with the economically powerful creditor countries. This situation is commonly realised through the familiar mechanism of savings' outflows from the creditor-surplus countries raising the exchange rates of the debtor-deficit countries. While the battleground here lies in monetary rather than fiscal policy – with less expansionary monetary policies in debtor countries unintentionally accentuating their acceptance of leisure preference – relatively generous equity benefits enable a better balance between voluntary and involuntary leisure in the debtor countries.

Conclusion

New Zealand, with its relatively simple tax system and its history of universal benefits, has, in all but name, a "basic income flat tax" tax-benefit structure. New Zealand can reap significant equity gains and reductions in transaction costs by acknowledging this reality, and making the appropriate accounting and administrative reforms. The conceptual separation of "Crown" from "government" makes it possible for a nation to simultaneously have both appropriately high taxes and small government. Further, the BIFT structure gives a policy tool for the management of labour supply.

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Notes

[1] This principle is popularly expressed in the apocryphal statement attributed to Thomas Jefferson: "There is nothing more unequal than the equal treatment of unequal people" (Monticello). Mannan et.al. (2011, p.4) note the resonance between the aphorism attributed to Jefferson and the concept of vertical equity. VUW (2010, p.15) gives a clear definition of vertical equity and contrast it with horizontal equity.

[2] McGuire and Olson (1996) contrasts a classic warlord ("roving bandit") with the government of a settled nation ("stationary bandit" as a "theft monopolizer"). For a 21st century example or a roving bandit, "Bugti was a local warlord with a penchant for ambushing trains and using his substantial militia to extort taxes from the local peasantry", observes Meros (2011) on his travels in Pakistan. There is a process of evolution from roving warlord, settled autocracy, to democratic government, in which the contract between the taxing authority and the taxpayers evolves. Nevertheless, in the libertarian tradition, governments, by their very nature, remain thieves of sorts. Chakraverti (1999) claimed that the democratic Indian state was "a predator; a kleptocracy".

[3] The advent of Pigovian corrective taxes meant that, within the neoclassical tradition, taxes under some circumstances could be levied to create incentives to persons to behave as if they, of their own accord, internalised external costs and benefits.

[4] Creedy (2003, p.21) uses the expression "*improves* [my emphasis] the labour supply incentives", meaning incentives to raise the labour force participation rate or to work longer hours. A usual neoclassical approach would be to argue that the quantity of labour supplied is optimised when the marginal social benefit of raised output equals the marginal social cost of additional labour (lost free time) and other resources.

[5] Tax concessions on low earnings differ in that they are more likely to be unconditional; received as a right rather than as a result of an application.

[6] English (2011) presents data, from which the Prime Minister's figures were taken, for the distribution of income taxes that uses the definition: "This table includes tax on NZ Superannuation and major Social Welfare benefits, but excludes ACC levies, Working for Families and independent earner tax credits". The ordinary tax concessions that appear as transfers in Creedy's (2010) exposition of Basic Income Flat Tax are arbitrarily treated differently from, for example, the Independent Earner Tax Credit.

[7] See Economictheories.org: "In his Principles of Political Economy, Mill expounded the theory which subsequently became the stated purpose of the Land Tenure Reform Association founded in 1870. The proposal called for the gradual nationalization of land through a tax upon increases in valuation."

[8] Goldsmith (2008) noted that Theodore Gibbs – author of the New Zealand 1951 Gibbs Report on Taxation – "disagreed with Mill's 'unearned increment' argument because 'public property right' arguments for taxation could apply to all types of assets, and not just unimproved land" (Rankin 2009).

[9] The public domain concept can be interpreted at global, national and sub-national levels. National and provincial differences between "social capital that takes primarily [but not only] the form of stored knowledge" play a central role in explaining differences in average incomes and living standards between countries and provinces (Simon 2000).

[10] The term royalty may be better than "rent", so as to avoid confusion between the usage of rent as a hire-fee and the more technical concept of "economic rent". A royalty, analogous to taxes levied on mining companies for their use of countries' natural resources, can be understood as a flat-rate levy on market incomes in return for the free use of public domain inputs.

[11] The appropriate subset of the population will be known here as "tax residents".

[12] In practice, much of this public equity fund may be allocated to all equally, but will be withheld and passed onto government, as the principal source of revenue for the government, being an agent of the Crown, but not itself the Crown. This is analogous to the allocation of company profits into distributed dividends and withheld funds for ongoing company expenditure.

[13] An early advocate of such a return on "*the common property of the human race*" [his emphasis] was Paine (1796).

[14] Indeed, i indirect taxes were sufficient to fund government purchases across the business cycle, then conceivably all royalty receipts could be distributed equally as equity benefits.

[15] The tax rate includes the statutory marginal rate of 33%, plus the 2011 ACC earners' levy of 2.04%. The ACC earners' levy is essentially a flat tax on wages and salaries, although it is not applied, in 2011, on annual earnings above $111,669. The $9,080 represents the sum of the concessions created by having statutory rates of 10.5%, 17.5% and 30% on earnings below $70,000 (see Table 1). This equation disregards Child Support liable parent payments, and Student Loan repayments, both of which are administered by Inland Revenue and may apply to persons in this income range.

[16] Detailed examples are presented in the following section.

[17] This top personal tax rate is the same as the rate of tax applied to family trusts – ie the "trust rate".

[18] These fulltime students depend on combinations of part-time work, transfers from parents, and student loan living allowances.

[19] Dominion Post (2010) suggests that the cost of addressing this remaining hole in the present de facto BIFT system could be less than $3m.

[20] "Hand-out" is a popular expression that can equate to the term "transfer", but not to the term "benefit".

[21] A payslip for a person grossing $100,000 need only show $65,000 taxed earnings, plus a $9,080 equity benefit.

[22] For example, all tax-residents over a given age (eg 17) would qualify.

[23] Gawith (2011) notes the advantages of introducing, along with a flat income tax, a universal basic income that removes "the complexities, incentives, disincentives and unfairness that litters the current benefit system".

[24] "There is little difficulty about paying the same subsidy to every individual in the economy… Uniform positive taxes may be a little more difficult… We can take it that most such taxes use information that is cheaply and publicly available. Not all conceivable public policies have this convenient property."

[25] Both substitution and, for most people, income effects would favour reduced labour supply at the margin.

[26] Increased leisure, worldwide, was possibly the most revolutionary and significant outcome of the century from the 1820s to the 1920s. It was of course accompanied by increased output per person, and increased population. Further, this was market-driven leisure, facilitated however by a policy environment that increasingly regulated working conditions and wage-setting. By way of contrast, from say 1930 to 2010, output growth and population growth have been faster, but have been accompanied by decreased time free from the dictates of market forces. This 1930-2010 pattern would appear to have been driven, in line with the Easterlin hypothesis (Easterlin 1987), by income effects, mostly unrelated to taxation. Substitution effects favouring reduced labour force participation rates, arising from lower income tax thresholds and higher effective marginal tax rates, appear to have been absent over the long run.

[27] Mirrlees (2010b) suggests that we "consider the distribution of expenditure and not just the distribution of income. Lifetime income and lifetime expenditure will be very similar (the main difference being bequests made or received)". In reality, inflation and debt default ensure that income distributions may vary considerably from expenditure distributions.

[28] Strictly, labour force participation rates should be weighted by hours worked. A simple weighting system is to divide the full-time equivalent labour force by the working-age population. That means part-time workers – whether employed or not – count as 0.5.

[29] It is arguable that a country that governs itself as a republic is less able to conceive of this distinction than is a society that has a constitutional (apolitical) monarch as titular head of state.

[30] In essence "mercantilism" represents both the somewhat corrupt political system predominant in early modern Europe (16th to 18th centuries), and the economic theories of the time that emphasised production over consumption as an end in itself, and the desirability of current account surpluses as indicators of national wealth, and the means to national economic power. It is sometimes known as "economic nationalism".

[31] Developed creditor countries' corporations may pursue a strategy of direct investment in debtor countries, enabling the populations of these creditor countries to live increasingly on corporate dividends and public equity benefits.