

# How can we reduce inequality?

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## Summary

**Our current systems of taxation and benefits are hugely complicated and not fit for purpose - either now or for the future.** Without systemic change, things keep getting worse. This article shows that if we replace the notion of lower income taxes on lower incomes with a fixed payment plus a fixed Income tax rate for all incomes, then we simplify our tax and benefit systems with a reduction in our levels of inequality and poverty. Tax reform leads naturally to consideration of Universal Basic Incomes (UBIs).

It is concluded that an adult UBI of \$11,000 per year could be paid for by taxing ALL income at 33% (with no reduction of the rate for lower incomes) and an Asset Tax of 0.5% levied on improved values of property and collected with local body rates.

There are many other alternatives mentioned.

## Introduction

It will become obvious that this is a hugely complex issue. The most outstanding fact is that collectively, we must first decide that we want to reduce inequality. In order to marshal the political will to do it we need to show people how any Implementation of some measures to move in the right direction will actually function. That is the purpose of this paper. But whatever is done, there is no way of escaping the fact that if some people are to have more money or more services, they must be paid for.

Insecurity of employment, inadequate education, poverty and the rise of social media are beginning to lead to increasing concern about inequality, not just of income but of wealth. In 2014, the International Monetary Fund published its conclusion that income inequality “*tends to reduce the pace and durability of economic growth.*” Hardly surprising, since if the poor have no money, they cannot buy things. Pope Francis has spoken of the evils and economic damage of inequality. So, unusually, some who worship God and some who worship money point in the same way. Others fear that inequality will spell the end of democracy. Witness the various political upheavals of recent times.

Thinkers for many years have suggested that what is known as a Universal Basic Income (UBI) would help with these problems. The proposals have had many names and various forms. **Correcting a subtle defect in our Income Tax system leads naturally to the need for different Universal Basic Incomes for different ages.**

### **The nature of UBIs**

To understand what a UBI is consider the simplicity of New Zealand's Superannuation. It is paid to everyone over the age of 65 regardless of wealth, income, health or anything else except (astonishingly in this age) different amounts depending on marital or living arrangements. Superannuation has been a wonderfully successful "trial" of the UBI concept. It has largely solved the poverty problem for the aged since 1938. And one of its great merits is that it suggests the idea of having different UBIs, possibly even different taxes, for different age groups. Some obvious groupings are for children and teenagers (0 to 17), Adults (18 to 65) and Superannuitants (65 and up).

One cannot easily put a value on the many benefits from a UBI – some of which depend on the actual sizes of the UBIs. A list of the benefits to be expected include, reduction of child poverty; empowerment of women and care-givers; a stop to "beneficiary bashing"; removal of "the poverty trap," reduced cost of Government administration; easy collection of fines and child maintenance; reduced student loan and ACC problems; improved social cohesion; reduced stress; improved health and school attendance as well as many others.

**We already have a UBI for Superannuitants, and for the sake of simplicity in this article, I will take it that their payments and taxes will remain completely unchanged. I will also leave aside consideration of the necessary UBI for children.**

Because of our social issues as well as the real and present threat from new technologies for many who have previously felt secure in their ability to work and "pay their way" the Labour Party's Commission on the Future of Work recommended further study of Universal Basic Incomes and this is ongoing.

There are two problems. Superannuation funding is often said to be a problem, so **how can we also afford more UBIs? Secondly, how does one make the transition from the present system to the new one?** I will not address the transition problems here either.

## Our present Income Tax system

**A cynic might well say that our Income Tax system is an enduring con-trick whereby the poor think they are benefiting from having lower tax rates on lower incomes. But the wealthy benefit more.**

National, have demonstrated this with their new tax-reduction policy, which (surprise, surprise) would actually increase inequality. They proposed that the income tax thresholds would increase “to give tax cuts to low and middle New Zealand.” The 10.5% tax threshold would apply up to \$22,000 per year instead of only up to \$14,000 per year. The 17.5% rate would apply up to \$52,000 per year instead of only to \$48,000 per year. The effect would be that those with no income or less than \$14,000 per year would get no tax cut but everyone earning more than \$52,000 per year would get a tax cut of \$1060 per year. Everyone, even if they earn millions per year. Inequality increases.

A fairer alternative would have been to use the same \$2 billion to make the first \$5270 per year of income tax-free. Then all those with an income above that figure would benefit by \$553 per year. But tax cuts do not benefit those with no income. So, even this alternative for using the tax cut money would not do much for inequality. Fortunately, with the change of Government, the tax cuts will not be made.

The continuing position is that people will pay 33% Income Tax on their income over \$70,000 . But they will pay \$9080 less than if they paid 33% on **ALL** of their income. This is because they get the advantage of all the lower rates on the first \$70,000. In other words, they get a “discount” from the 33% rate of \$9080. If you have an income of \$48,000 per year, the discount from 33% is \$8420 and on an income of \$14,000 per year, it is only \$3,150 per year. **Is this fair?** The more you earn, the greater the discount you get.

This problem would have been even more acute under the National Government’s proposal. People were still to pay 33% Income Tax on their income over \$70,000. In this case their “discount” would have been \$10,140. Someone on \$52,000 would get a discount of \$9,600 from the 33% rate; on \$22,000 their discount would only be \$4290 and on \$14,000 the discount would have remained at \$1470.

To be fair to everyone the principle should be that whatever benefit is given by Government (at all levels) should be given equally to everyone in the same measure. Thus free education, healthcare, parks, libraries, transport and the like should be available to all on the same basis. This leavening effect for quality services does much to reduce inequality and can do a great deal more.

**A new approach is required. Make it simple. Pay all adults the same amount such that most current benefits can be abandoned. And, to pay for this, take away from everyone the same percentage of what they have, both in terms of other income and wealth.**

This leads to the concept of giving all adults \$9080 per year (a UBI) and taxing all income at 33%. Consider that if we went a little further and made the UBI high enough to completely replace benefits like Job Seeker, etc, there would be considerable savings to be made in administration, bureaucracy, and surveillance. Unless we made the UBIs unrealistically high, we would still need some hardship and disability allowances, etc., but only a small part of the current bureaucracy. So let us work on an adult (18 to 64) tax-free rate of, say, \$11,000 per year for the moment.

The security of knowing that the UBI is always paid regardless of whether one is sick, in or out of work or training, etc., would relieve a lot of stress for those who currently have to struggle or may be thrown into that position.

There would be no steps or conditions which must be met for adults to be given their UBI and which must be adhered to or their payment would be withdrawn. There would be no need for bureaucracy to judge whether a person meets the specifications to “deserve” the payment or not.

There would be no need for surveillance, which sometimes becomes harassment and causes great stress for those already stressed by their poverty or disability. Vote Social Development for 2016/17 had *“a total of over \$49 million on services for investigation of overpayments, fraudulent payments and collection of overpayments”*. IRD currently budget over \$300 million for all of their investigations some of which concern social payments that they administer. Desperation makes ordinarily honest people into liars.

Nor would there be stand-down periods or “claw-back” if more than a certain amount was earned - the “poverty trap” would disappear.

However, the cost of the adult UBIs is then (2015 figures)  $11,000 \times 2,816,960 =$  \$30,986,560million. Say, 31 billion. Ouch!

The Income Tax take from Adults only (excluding the Income Tax from Superannuitants) will increase with a uniform 33% rate by roughly \$18billion. Remember that, apart from recovery from those on less than \$70,000 per year, all those on or over \$70,000 per year will be paying an additional tax of \$9080 per year on their salary up to \$70,000. (I will deal below with the difference from their receipt of an \$11,000 UBI)

We are then looking at a difference of \$13 billion between the adult UBI costs and the increased Income Tax. The savings from removing other benefits which pay less than around \$11,000 per year and reducing the administration costs may be something like 6 billion per year. Many decisions are needed before the latter figure can be accurately determined. Will ACC payments be reduced by the UBI? Will the Child UBI and the Adult UBI make DPB redundant? What about Working for Families etc. And where will the extra \$7 billion come from?

There are many alternative funding methods possible either separately or in combination - financial transaction tax, what is known as Positive Money, Capital Gains Tax, GST, Carbon Tax, Asset Tax, increased Company Tax, Stamp Duty, and many others. The problem with some is that they bear proportionately more heavily on the poorest. And new taxes must cost some of the population more than they receive so that the reverse is true for others. A good target would, possibly, be to have 70% of the population with a net benefit from the combination of tax and UBI.

### **Positive Money**

The Positive Money approach, supported by Modern Monetary Theory is a very exciting possibility but with many conceivable transition problems including opposition from the world-wide financial industry. However, if we funded Kiwi Bank properly we could build it up to at least the same level as the old Bank of New Zealand which was Government owned and had 45% of the NZ banking market. We were once 45% of the way to the Positive Money ideal of having Government issue debt and receive the interest instead of the Banks.

### **Using Income Tax only to pay for Adult UBI**

Consider just increasing Income Tax. As noted above I have suggested the adult UBI be \$1920/year higher than the top "tax discount" so that many benefits can be discontinued. This extra \$1920/ year advantages all those on incomes above \$70,000 as well as those below that figure. We could eliminate this advantage by increasing the Uniform Income Tax rate to 35.6%.

**This would still leave those with no other income better off by \$11,000 per year tapering off to no net benefit from the UBI for those on \$70,000 per year and a net cost for those on higher incomes.**

All of the income above 70,000 as well as below 70,000 is subject to the higher tax. It brings in an extra \$4billion! Which still leaves us \$3billion more to find.

If we are to find this \$3bn from income tax alone we have to increase the tax rate to 37.6%. In this case those above \$61,436 of income per year will be worse off than at present but those with no income will still be \$11,000 per year better off. A UBI funded this way could be contemplated but is not likely to be popular.

We could also increase the tax rate for higher incomes. We should avoid re-creating big steps which give more benefit to those on higher incomes. For example take an extra 1% at an income of \$150,000 and a further 1% on every additional \$50,000 but with the higher tax charged on ALL the income. This would yield over \$700 million more in tax. Other percentages could yield more. Moving company tax up to 33% from the present 28% would yield about \$750 million.

**Clearly the choice of the rate of UBI and the switch points in income or wealth which determine winners and losers need careful thought..**

### **The devil in the details. Asset Tax.**

The form and level of tax or taxes chosen to fund UBIs will determine who are the winners and who are the losers compared to the status quo. The details of the application of these taxes will determine the net effect of the combination of tax and UBI for each person and will affect the political acceptability of the changes. So too will the “grand design” or otherwise of the package of measures.

One question is whether to stick with the centuries-old notion of giving benefits only to “the deserving poor”. This implies the “undeserving poor” and the concept of “targeting” determined by political choice - the “nanny state”- with accompanying bureaucracy, surveillance, oppression, administration costs, poverty traps, stand-downs, multiple “hard cases” and “beneficiary bashing”.

Or, alternatively, to have the simple philosophy of “fairness” suggested earlier. With few well-defined and understandable exceptions, giving everyone the same benefits and taking from them the same proportion of whatever they have in either income or wealth. Compare the complexity of Working for Families with Superannuation.

For instance consider the idea of not increasing the Uniform Income Tax rate beyond 33%. Then having Local Bodies collect for Government a levy added to their rates ( as is done for

Regional Authorities) to yield the whole of the extra \$7billion mentioned above. Property is a good proxy for total wealth and a tax on wealth would help to reduce inequality. Local Bodies have always been financed by taxes (rates) on properties. Such a tax would be easy to collect and hard to avoid if it is kept simple.

The total NZ rateable value at March 2017 was \$1,330billion. A 1% tax would yield \$13.3 billion if it is applied to all rateable properties with no exemptions for companies, trusts, family homes or other things. So the missing \$7 billion above would then be covered by around 0.5% as an Asset Tax.

But it is extremely difficult to attempt a calculation about the yield from such a tax if, for example, family homes are exempted. The IRD devote many pages to attempting to define the “family home” for the “bright line” test. The more one reads the more one suspects that with such an exemption then avoidance of this tax will be high. And the reduced tax base will require a higher rate for any fixed level of return. Giving a tax exemption of \$100,000 per year (if it was a 0.5% rate) to the owner of a 20 million dollar “family home” (possibly John Key) is clearly unfair to those whose exemption may be worth only \$10,000. And even worse for those who do not have a home of any sort but have to face the rental increases that will inevitably arise. Their rented homes will be a large proportion of those subject to the higher tax needed from non-family homes. A “family home” exemption would increase inequality and again benefit those who “have” compared to those who “have not”. My view is that there should be no exemptions so that the tax is very simple to understand and collect while being difficult to avoid. Whoever pays the rates pays the tax if there are no exemptions.

Any individual's payment of a new tax will reduce, or reverse, the benefit they get from a UBI regime. To protect the benefit of a UBI for those it is most intended to help, consideration has to be given to some form of compensation for a new tax.

As I have explained above with a tax rate of 33% and an income of \$70,000 or above, an individual with a UBI of \$11,000/yr will be better off by \$1920/yr than they are at present. If the Asset Tax was 0.5 % this \$1920 would pay for the Asset Tax on property with an improved rateable value of \$384,000. And with a couple sharing a house, they would have only one Asset Tax to meet. So built into the \$11,000 UBI, there is probably sufficient compensation for the Asset Tax, and the numbers I have used in my various calculations above remain relevant.

Overseas owners would not get the UBI at all, and those with multiple properties would only have their one UBI but multiple Asset Taxes.

## **Conclusion**

I hope that I have made it clear that there is at least one way of financing a UBI, but that there is a lot of thought required before finalising the UBI amounts and all else, including the transition arrangements. It is not something to be undertaken lightly, and it is understandable that no responsible politician wants to discuss the issues on the hustings before the major detailed work has been done. Nonetheless, **the time for UBIs has come**. They are a natural outcome of the search for better personal tax systems which are fair, reduce inequality and offer some protection for technological change.

There is nothing sacred about any of the numbers that I have used here. There are things to be considered to improve superannuation and to move to a UBI for children and teenagers. I will write about them later, but the case for an adult UBI is the most difficult and the most clear-cut. There is a great deal of work to be done to explore the possibilities, consider the possible side effects and make the decisions.

There has never been a study to consider benefits and taxes at the same time. Unfortunately, the Terms of Reference for the Tax Working Group, which has now been established, do not include consideration of benefits.

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