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## Why Cash Violates Neutrality

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**Abstract** – Egalitarian liberal political philosophers have been at pains to show that there is a nonnegligible “place” for liberty within the framework of an egalitarian theory of justice. Thus, many have insisted that, when redistribution is required in order to achieve greater equality, assets should be transferred in the most abstract form possible, ideally through a system of cash transfers. In this article we argue that this strategy has the potential to generate significant violations of neutrality. The problem arises from the fact that individuals with certain rates of time preference often want to use social institutions as self-binding mechanisms and as a result may exhibit a preference for in-kind benefits or other institutional arrangements that are frequently misclassified as paternalistic. We argue that egalitarians who rely on cash transfers as a way of accommodating the demands of liberty do so at the expense of neutrality therefore.

**Keywords** – cash transfers, discount rates, egalitarianism, liberty, neutrality, time preference

Over the past three decades, political philosophers have been powerfully impressed by the argument that modern societies, being characterized by a pluralism of reasonable conceptions of the good, should be governed by political principles that strive to remain neutral with respect to the goals and projects of

their citizens.<sup>1</sup> Any failure to respect neutrality, it is argued, leads to an illegitimate privileging of the values of certain citizens to the detriment of others. This is permissible in voluntary organizations, but because the power of the state is both universal and mandatory within its territory, the government must act as the agent of all its citizens, and this requires that it not take sides in disputes over questions of the good life.

Of course, the fact that the state must remain neutral with respect to questions of value does not mean that it cannot be guided by normative judgments. A number of principles can be used to rank social states, which do not require any commitment one way or the other on controversial questions of value. Three in particular have dominated (implicitly or explicitly) modern debates over the appropriate role of the state. First, there is a Pareto-efficiency principle, which states that if at least one person prefers (from his or her own perspective) some new social state to the status quo and no one prefers the status quo, then that new state is normatively superior (Rawls, 1999). The second major principle is that of equality. Although there is no canonical formulation of this principle, there is a widespread sense that it should be able to be formulated in a way that satisfies neutrality (Heath, 2008b). After all, even though individuals may have incompatible goals and projects, each may be given equal means to pursue them or each may achieve an equal level of satisfaction with respect to them. Finally, there is the principle of liberty. Without judging the value of specific goals that individuals adopt, each individual can be given the freedom of action necessary to pursue them. Thus the state can use its authority in a way that maximizes individual freedom, subject only to some compossibility constraint (Rawls, 1999, p. 220; Steiner, 1994).

The compatibility of these three principles is in serious question, however: in particular, there is a widespread perception that a commitment to equality generates a significant conflict with liberty.<sup>2</sup> Thus, egalitarian liberal political philosophers have been at pains to show that there is a nonnegligible “place” for liberty within the framework of an egalitarian theory of justice (Dworkin, 2000b). Typically, they have chosen to do so by insisting that, when redistribution is required in order to achieve greater equality, assets should be transferred in the most abstract form possible: “iron ore rather than steel, for example, and

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<sup>1</sup> This argument is implicit in John Rawls’s early work (1999, pp. 27–28), where it is formulated in terms of the “priority of the right over the good.” It becomes more central to his later view (1996, pp. 173–176) although he distances himself from the term “neutrality” (p. 191). The term is explicitly associated with Dworkin (e.g., 1985).

<sup>2</sup> Robert Nozick (1975, p. 163) claims that egalitarians must be prepared “to forbid capitalist acts among consenting adults.”

undeveloped land rather than fields of wheat," as Ronald Dworkin (2000b, p. 152) puts it. Ideally, economic justice would be achieved through a system of cash transfers, since this would allow individuals as much choice as possible with respect to the ends pursued. Proposals for large-scale asset redistribution in the form of a capital grant, such as one finds in the work of Bruce Ackermann and Anne Alstott (1999), David Nissan and Julian Le Grand (2000, 2003), or Samuel Bowles and Herbert Gintis (1998) represent the extreme of this tendency. Philip Van Parijs's (1995) proposal for a universal basic income (1995) is motivated by similar considerations, as is the enormous emphasis placed upon "income and wealth" in John Rawls's list of primary goods (Rawls, 1996, 1999).

Capital grant and basic income proposals have frequently met with what Stuart White (2004, p. 62) calls the *exploitation challenge*, which claims that they "allow citizens to establish a morally troubling, parasitical relationship to their fellow citizens...[such that some can] free-ride on the productive efforts of others".<sup>3</sup> A second objection facing proposals of this sort has received less attention, unfortunately. White calls it the *alienation objection*: "the freedom secured by citizen's stake policies is too easily alienated, too easily lost through careless employment of the stake" (White, 2004, p. 63). We are concerned here with this second, underappreciated objection. While cash transfers do promote liberty of a sort, a system of distributive justice based entirely upon such means can generate significant violations of neutrality, because, simply put, cash is not neutral. The problem arises from the role that *time preference* plays in each individual's system of goals, or more specifically, the way that differing rates of discounting across individuals affect their capacity to manage liquidity. Individuals with certain rates of time preference often want to use social institutions as self-binding mechanisms – in much the way that David Hume (1978) described. As a result, they may exhibit a preference for in-kind benefits or other institutional arrangements that are frequently misclassified as paternalistic. In this article, we argue that a state that attempts to meet its redistributive obligations in the form of cash transfers thereby fails to exhibit equal concern for all its citizens, and that egalitarians who propose such transfers as a way of accommodating the demands of liberty within their more general theories of justice do so at the expense of neutrality.

This does not mean that all cash transfers are undesirable. It does, however, provide an argument in support of traditional welfare-state programs, such as socialized medicine, which provide goods to citizens in-kind, or in a way that

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<sup>3</sup> See also Anderson (2000), Galston (2000) and Barry (2000).

imposes certain constraints on fungibility. To the extent, therefore, that basic income programs are intended as a type of *welfare reform* we have no objection to them. But to the extent that plans for a more comprehensive capital grant or basic income are intended to *supplant* traditional forms of state provision (e.g., Murray, 2006), we are skeptical. Our argument proceeds as follows. In Section 1, we trace the origins of the general presumption in favor of cash that has arisen among contemporary egalitarians. In Section 2, we show how cash fails to satisfy the constraints of neutrality, due to the consequences of hyperbolic discounting. In Section 3, we show that these problems should not be relegated to practical difficulties or implementation issues, but should structure the way that we think about basic questions of justice and entitlement. We conclude by briefly sketching the policy implications of this perspective on high-level design features of the welfare state.

## 1. The Argument for Cash

According to Rawls (1999, p. 54), the social primary goods are the appropriate *equalisandum* for his theory of justice because they are items “that every rational man is presumed to want” whatever else he wants and “normally have a use whatever a person’s rational plan of life.” The principles Rawls selects to govern the distribution of these items mandate the equal distribution of liberty and opportunity and permit inequalities in wealth and income only insofar as these are beneficial to the least advantaged members of society. The institutional implications he derives from these principles include a constitution to guarantee and protect the fundamental liberties, a public education system to foster equal opportunity, and a *social minimum* to maximize the wealth and income of the least advantaged. This social minimum is to be paid either in the form of “family allowances and special payments for sickness or unemployment, or more systematically by such devices as a graded income supplement” (1999, p. 243).

The social minimum must be paid as a cash grant because it is intended to maximize income, which – in the *Theory of Justice* formulation – is a primary good in virtue of being something that “a rational man wants whatever else he wants” (1999, p. 79). Maximizing the income of the worst-off individual is necessary, moreover, because doing so increases the worth of his liberty. The constitution ensures equal formal freedom, but “the worth of liberty is not the same for everyone. Some have greater...wealth, and therefore greater means to achieve their aims” (1999, p. 179). It is, therefore, the purpose of the *difference principle* to compensate for the lesser worth of liberty by increasing the wealth of the least

advantaged through the social minimum. "Taking the two principles together, the basic structure is to be arranged to maximize the worth to the least advantaged of the complete scheme of equal liberty shared by all" (1999, p. 180). For Rawls, the social minimum is thus intended to increase the worth of freedom to the least advantaged, and it must be paid in the form of an income supplement because cash is something all rational individuals are presumed to want, thus cash does not favor one conception of the good over another.

Ronald Dworkin (1985, p. 125) argues that the principle of equality requires governments to treat all citizens with an equal concern and respect. Almost everyone is an egalitarian of one form or another, in Dworkin's view. What makes *liberal* egalitarianism distinctive is the further commitment to neutrality with respect to conceptions of the good. "The [liberal] theory of equality supposes that political decisions must be, so far as possible, independent of any particular conception of the good life, or of what gives value to life. Since the citizens of a society differ in their conceptions, the government does not treat them as equals if it prefers one conception to another" (1985, p. 127). It follows that if the liberal state is truly committed to treating its citizens equally, it must ensure against more of society's available resources being spent on satisfying the ambitions of some than of others (Dworkin, 2000a, p. 65). The only way it can achieve this, Dworkin (2000a, p. 67) argues, is by distributing resources in such a way that no one prefers the bundle of goods received by another, otherwise known as an "envy-free allocation".

Using *envy freeness* as a criterion of equality is subject to some well-known difficulties, however. The most salient in this context is the possibility of intuitively *unjust* distributions resulting from the specific nature of the goods being distributed. Giving the Gentile a dozen pork chops and the Jew a single chicken thigh may result in an envy-free division of the "mixed grill platter", but it fails to satisfy anyone's intuitive sense of equality. Dworkin regards both of these problems (perhaps counterintuitively) as issues of liberty. The problem is not with the principle of distribution, he claims; the problem is that the specificity of the commodities in question acts as a constraint on the preferences of the parties in an objectionable way. To deal with this, Dworkin (2000b, p. 147) introduces what he calls the "principle of abstraction," which requires that people's choices be made as authentically as possible against a background of freedom.

The principle of abstraction "insists that an ideal distribution is possible only when people are legally free to act as they wish except so far as constraints on their freedom are necessary to protect security of person and property, or to

correct certain imperfections in the market” (2000b, p. 148). This principle requires that resources be redistributed in the most abstract form possible, usually as a cash transfer. This ensures liberty because the fungible nature of cash allows people to choose how they will use what they receive; it offers “more discriminating choices and is thus more sensitive to the discrete plans and preferences people in fact have” (2000b, p. 151). Thus liberty is the background against which authentic choices can be made, yet it can only be truly secured, Dworkin maintains, when the resources with which these choices are made exhibit the maximum degree of fungibility.

A serious problem with Dworkin’s view is that while he insists that inequalities generated by a lack of natural talent be redressed, he suggests that inequalities generated through foolish venture be allowed to stand. As a result, while the freedom of those entitled to redistribution is more or less assured, those rendered destitute through foolish venture cannot make authentic choices of any kind, since they lack the means to execute their particular projects. Philippe Van Parijs (1995, p. 21) argues that a state truly committed to equality must guarantee the equitable distribution of what he calls “real freedom.” While formal rights and liberties are necessary for real freedom, they are not sufficient, because doing or choosing anything whatsoever requires the control of external objects, which formal rights alone cannot guarantee. Thus Van Parijs (1995, p. 33) claims, “one is really free as opposed to just formally free to the extent that one possesses the means, not just the right, to do whatever one might want to do.” Real freedom requires not only a protected scheme of fundamental liberties, but an unconditional guarantee of external resources with which all individuals, as opposed to simply the worst off, may choose not only what to consume but, more importantly, what kind of life to lead.

The best institutional expression of real freedom, according to Van Parijs (1995, p. 33), is realized by the provision of an unconditional basic income. The state must raise the lowest income as much as is compatible with a ban on forced labor, and it must provide this income unconditionally to all citizens. Owing to its unconditional nature, the basic income is “something on which a person can count, a material foundation on which a life can firmly rest, and to which any other income, whether in cash or in kind, from work or savings, can legitimately be added” (1995, p. 35). Van Parijs is also adamant that the basic income be distributed in the form of a cash grant. In his view, the obvious explanation for this is that “with a market economy in place, a concern with maximum individual freedom generates a presumption in favor of cash” (1995, p. 31). In

simple terms, cash allows for the satisfaction of the greatest number of diverse preferences.

Van Parijs does acknowledge that certain social goods would have to be provided for prior to the distribution of the grant based on their salutary effects on security, productivity and opportunity: a police force, a legal system, an education system and some general infrastructure. But he insists that the basic income itself must be issued in the form of a cash grant with which its recipients would be expected to satisfy their own specific needs and wants. According to Van Parijs, even the goods and services that all individuals could presumably be said to want, such as food, shelter and health care, must be purchased by individuals out of their grant. These are items, he claims, "of which it is plausible to assume that no one in her right mind would not want to buy them out of her basic income were she given the whole of it in cash," and which cannot be provided in-kind because individuals desire them to differing degrees and in differing proportions (1995, p. 44).

What we see in the work of Rawls, Dworkin and Van Parijs are three different strategies for incorporating a concern for individual liberty into a broadly egalitarian theory of justice. Yet while each one has a different "place for liberty" within the overall theoretical framework, each also relies at a crucial point upon the use of cash transfers as a way of meeting egalitarian objectives without compromising individual liberty. The assumption being made, in all three cases, is that cash payments are neutral (since the money can be spent on anything that the recipient chooses) and that they thereby promote liberty (since they avoid any of the paternalistic constraints associated with in-kind transfers). In other words, egalitarians opt for cash transfers as a way of accommodating liberty, precisely because cash is assumed to be neutral. Yet is this assumption correct?

## **2. Understanding Improvidence**

Most of us know from everyday experience that not everyone is equally good at handling cash. For example, we speak of people with money "burning a hole in their pockets." Even those who are sophisticated at managing their finances usually take specific measures aimed at reducing the liquidity of their own assets: by purchasing real estate, locked-in retirement savings plans, dedicated education savings funds, back-loaded mutual funds, etc. Furthermore, the creation of such illiquid assets is strongly encouraged by the tax system. Yet despite this, the majority of the population fails to take advantage of these

opportunities and, perhaps unsurprisingly, fails to accumulate any wealth or savings.<sup>4</sup>

One may be tempted to regard this sort of improvidence as a consequence of irrationality, not of reasonable value pluralism. For instance, philosophers have been inclined to categorize the failure to save (or the tendency to overspend) as an instance of weakness of the will or *akrasia*, which is typically regarded as a form of irrationality (e.g., Mele, 1992). As a result, improvidence is not regarded as something that must be taken into consideration from the standpoint of a theory of justice. The state need not remain neutral with respect to the concerns of the provident and the improvident, simply because the latter are (by definition according to many) irrational. The possibility of irrational behavior is a problem that may arise at the level of institutional design or implementation, but it is not an issue that arises in the formulation of normative theory. Typically, individuals may not appeal to their own irrationality as an argument against a particular state policy.<sup>5</sup> For example, the fact that some people can anticipate being overwhelmed by the temptation to break a particular law is not really an objection to that law in cases where everyone approves of the basic principle underlying the legislation.

Yet the problem with this diagnosis of improvidence as irrationality is that it rests upon a failure to appreciate just how ubiquitous so-called weakness of the will is. If this sort of improvidence is irrational, then much of the human race would stand convicted of acting irrationally much of the time (Ainslie, 2001, p. 64). A more charitable approach would be to analyze improvidence in terms of the time preference that individuals bring to bear upon the satisfaction of their own first-order preferences. Economists typically represent this by saying that people *discount* future satisfaction. A discount rate ( $\rho$ ) can be defined as the extra fraction of a payoff needed to make an agent indifferent between satisfying some desire now and satisfying it one time period in the future<sup>6</sup> (The analogy here is to interest rates – which represent the amount that an agent must be paid in order to defer consumption.) From the discount rate, one can define a discount factor  $\delta = 1/(1+\rho)$  as the value in present payoffs of one unit of payoffs to be received one period in the future. It indicates the present value of future satisfaction

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<sup>4</sup> Recall, in this context, that the poor have exactly the same incentive to save as do the rich, and thus their failure to do so is something that demands explanation (Frank, 1999, pp. 98–100).

<sup>5</sup> Note the assumption that the relevant sort of neutrality is *justificatory* neutrality (Kymlicka, 1989), not neutrality with respect to consequences. Were it the latter, then the issue of improvidence would constitute a much more obvious (and unproblematic) challenge to the neutrality of liberty.

<sup>6</sup> The discount rate is typically taken to represent a number of factors, including uncertainty, but also an element of pure time preference. Here we assume that time preference is all that is at issue.

(Rasmusen, 1989, p. 108). Thus, if  $u_t(a)$  represents the expected payoff at time  $t$  from some action  $a$ , the value of some stream of future payoffs is worth the following in the present:

$$(1) \quad u(a) = u_1(a) + \delta^1 u_2(a) + \delta^2 u_3(a) \dots + \delta^{t-1} u_t(a)$$

Because the discount imposed at any given time period is an exponential function of the discount factor, this is referred to as an “exponential” discount function. Thus the discount is subject to the same sort of compounding over time as is interest on savings.

This analysis seems intuitively compelling – primarily because of the analogy to the interest rate. As a result, it took a long time before anyone recognized that this representation of the agent’s discount function was based upon a number of substantive psychological assumptions. Most importantly, it presupposes that a particular lapse of time has the same significance to the agent regardless of how far removed it is from the present. Thus if some future event  $p$  is preferred to some future event  $q$  at time  $t$ , then  $p$  must also be preferred to  $q$  at any other time period. But as psychologist George Ainslie and others have shown, individual preferences often reveal a different pattern. For example, given a choice between a cheque for \$100 that can be cashed right away, and a cheque for \$200 that can be cashed in three years, many people will choose the former. But many of these same people, when given a choice between a cheque for \$100 that can be cashed in six years, and a cheque for \$200 that can be cashed in nine years, will take the \$200 (Ainslie, 1992, p. 78). The three-year wait that must be endured in order to secure the extra \$100 seems to loom larger in the short run than it does in the long run. Ainslie (2001, p. 65) describes this as a “warp” in the way that we evaluate the future.

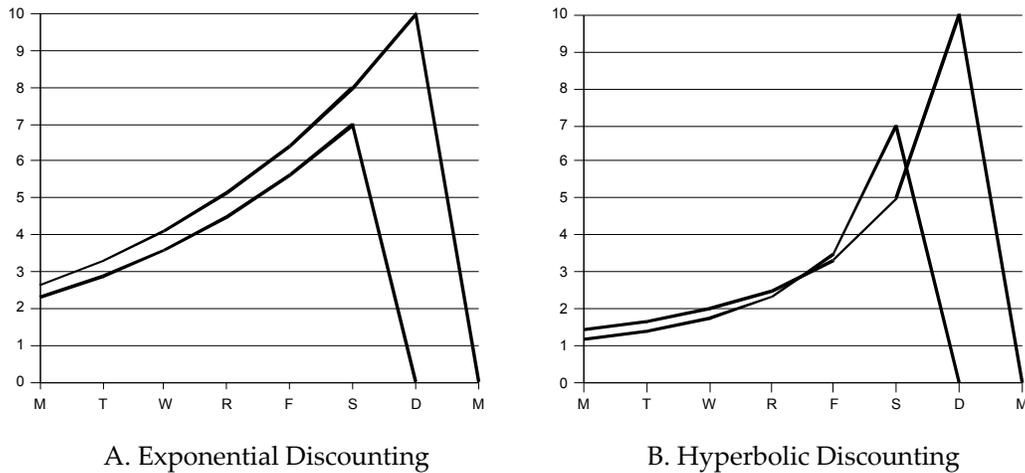
Qualitative descriptions of this warp have been around for a long time – a clear instance is in Hume’s (1978) *Treatise of Human Nature*. The significance of this warp has been largely overlooked, however. The most important consequence is that it generates dynamic instability in the agent’s first-order preferences. The individual who would choose the cheque for \$200 in nine years, but would choose the cheque for \$100 now, would undergo a preference reversal about the first choice at some point in the subsequent six years. Ainslie’s primary contribution is to have realized that these preference reversals can be explained as a simple consequence of agents discounting satisfaction more sharply in the short run than in the long run. He refers to this sort of discounting as “hyperbolic,” because the rate of discount is highly exaggerated in the short run.

Suppose, for the sake of argument, that the agent discounts the future in the following way:

$$(2) \quad u(a) = u_1(a) + \frac{u_2(a)}{2} + \frac{u_3(a)}{3} \dots + \frac{u_t(a)}{t}$$

Such a discount rate will generate temporary preference inversions. This is illustrated in Figure 1. Both charts show the utility that the agent assigns to events: one worth 10 and one worth 7, where the latter is scheduled to occur one period sooner than the former. For example, suppose a person of limited means has to choose between spending money on a movie on Saturday evening or spending money for dinner on Sunday. Eating dinner on Sunday is worth more than seeing the movie. The two graphs show the expected utility for these two outcomes on each day of the preceding week, starting on Monday. On the left, one can see an agent with an exponential discount function ( $\delta = 0.8$  per day of delay), while the right shows an agent with a hyperbolic discount rate (utility divided by “number of days delay plus one”). Both individuals can see clearly that having money for dinner on Sunday represents the greater good. They also both start out, on Monday, with a preference for the greater good. The central difference is that, for the hyperbolic discounter, that preference gets reversed on Friday, remains inverted throughout the day on Saturday, and then switches back again on Sunday. So, left to his own devices, this person will resolve to save the money for dinner on Sunday, but then will have a change of mind and go to the movie when the opportunity presents itself.

Here we recognize a common feature of human psychology. We can decide in advance that  $p$  is better than  $q$ , but then find that when the time comes to choose between the two, we prefer  $q$ . The interesting feature of Ainslie’s analysis is that it goes a long way toward dispelling the aura of irrationality that surrounds this sort of temptation. *Given* the agent’s discount rate and the agent’s preferences, it may be rational for the agent to choose the “lesser good” in this example – at least in the sense that it does not involve intentional counterpreferential choice (Heath, 2008a, p. 227). It is also perfectly rational for the agent, at the point where the events are still a long way off, to take actions to prevent making this choice when the time comes.



**Figure 1. Dynamic preference inconsistency**

Thus hyperbolic discounting provides a rationalizing explanation, not just for temporary preference reversals, but also for the phenomenon of precommitment. An agent who is *merely* short-sighted may pass up the opportunity to receive \$200 after three years, in exchange for \$100 right away and may even regret this decision three years hence. But this regret is *empty*, since at no prior point would this agent have preferred any other option (given that the agent would also have chosen \$100 in six years over \$200 in nine years). A hyperbolic discounter, on the other hand, prefers the \$200 both before and after the point at which the events are proximate. The temporary preference change is due to heightened impatience in the short run. Such an agent, unlike the exponential discounter, has an incentive to make arrangements in advance that will prevent her from choosing the \$100 when the time comes. She also has a preference structure that leads her to endorse this commitment after the time has passed.

This is why the phenomenon of hyperbolic discounting creates problems for the assumption that cash transfers promote liberty in virtue of being neutral. Individuals often rely on *other people* to help them carry out precommitment strategies. More specifically, they often use institutional arrangements to help them carry out such strategies. The locked-in retirement savings account provides a clear example. Yet from the standpoint of liberty, these precommitment arrangements often appear paternalistic. Thus an undifferentiated commitment to maximizing liberty can easily interfere with or even preclude such arrangements. This violates neutrality insofar as it results in

arrangements that are more detrimental to the interests of those who happen to have discount rates that are more exaggerated in the short run.

Philosophers and economists have tended to regard exponential discount functions as *more rational* than hyperbolic ones. Many have gone even further, arguing that any time preference is irrational – after we have factored in risk, we should be completely neutral with respect to present and future satisfaction (Pigou, 1920; Broome, 1994). They are tempted by the thought that because \$100 is \$100 regardless of when we get it, we should be indifferent between getting it today and getting it (with certainty) tomorrow. Yet this is equivalent to saying that people are irrational for experiencing impatience. We may have good reason to want not to feel impatient – just as we may have good reason to want not to feel frustration, or nervousness, or dread – but given that we feel that way, we can hardly be declared irrational for wanting to accommodate it by, for example, accelerating our schedule of gratifications.

Yet if we grant that discounting is not itself irrational, then it is difficult to show that exponential discounting is “more rational” than hyperbolic. Both can be defended under subjectivity of preference: *de gustibus non est disputandum*. The mere fact that hyperbolic discount rates generate dynamic inconsistency is neither here nor there. People change their more substantive preferences all the time, without thereby standing convicted of irrationality. I may like coffee on Monday morning, but not on Sunday; that doesn’t make me irrational. Philosophers sometimes impose, as a rationality constraint on *preference*, the impossibility of a constructing a “money pump” against the agent (i.e., a proposed sequence of trades that the agent will accept, but which guarantees a loss). It is certainly easy to construct a *diachronic* money pump against those who discount the future hyperbolically, but this is hardly decisive, since it is easy to exploit anyone whose preferences are subject to change in a foreseeable manner.<sup>7</sup>

Of course, while hyperbolic discounting may not be irrational, it is certainly something that individuals have good reason to avoid, since it generates a wide range of self-defeating behavior, ranging from addiction, compulsive behavior, to simple bad habits. The important point is that individuals often rely, not just upon their own will power, but also on the help of other people, in order to avoid these pitfalls. In particular, they rely on a wide range of social institutions – including various state institutions – in order to execute these self-control

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<sup>7</sup> In this context, note that liberal political philosophers typically bend over backwards to accommodate the preferences of those whose conception of the good is organized around belief in a supernatural deity. This sets the bar pretty low in terms of what counts as rational.

strategies (Heath and Anderson, 2010). Many of these institutions are in danger of being dismantled in the name of increasing individual liberty, however.

### 3. The Problem With Cash

This analysis of hyperbolic discounting allows us to state with greater precision the central problem with the egalitarian strategy of using cash transfers to achieve distributive justice. In their own private choices, people often opt for in-kind benefits rather than cash. For instance, employees may choose to take a fraction of their compensation in the form of benefits rather than cash. This is puzzling until it becomes clear that this is a way of forcing themselves to spend a fraction of their income on salutary goods. Yet if people make such choices individually, there is no reason in principle that they should not be able to make them collectively. Many people would find that being given the freedom to opt out with compensation from the public health insurance or pension system would be quite unwelcome. Acquiring the ability to take the money and spend it on something else represents, for many, not a gain in freedom but simply the removal of an institutional crutch that is used to exercise self-control.

To illustrate, consider how Alaskan citizens have chosen to treat revenues earned by the state from oil and gas royalties (Anderson, 2002). In 1976, they voted in a referendum to establish the Alaska Permanent Fund. Every year, 25 percent of royalties must be transferred into the Fund, which in turn invests the capital and pays a dividend to each state resident.<sup>8</sup> Subsequent proposals to dissolve the fund and transfer the principal to residents, for them to invest as they see fit, have all been rejected. Alaskan residents have exhibited a strong preference to keep the principal *locked away*, not just from politicians, but also from themselves. They prefer to receive the income stream than to hold the assets as individuals. Those who seek to dissolve the fund argue that this is paternalistic. If individuals are regarded instead as hyperbolic discounters it may be seen as a rational self-binding strategy, carried out with the assistance of the state.

The unwillingness to recognize the importance of these sorts of self-binding strategies for the success of the welfare state (or the tendency to classify them as objectionable forms of paternalism) has wide-ranging effects in political philosophy. The most problematic effect is that it leads many theorists to exclude

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<sup>8</sup> There is currently around US\$34 billion in the Fund, and the yearly dividend payment typically ranges from US\$1000 to \$2000 per person.

any discussion of individual intemperance from the *normative* component of their theory. If they do consider these issues, they usually treat these as an implementation problem or as a concession to political or sociological realism. In other words, it is assumed that in an ideal world of rational citizens, there would be no need for any constraints on self-regarding individual choice. It is only in the empirical world, in which people lack education and opportunities, that we must worry about such things. There is no recognition of the fact that, even at the level of ideal theory, rational citizens might use the organizational resources of the state to implement precommitment mechanisms in order to prevent themselves from acting on the basis of temporary preference reversals. Furthermore, there is a failure to recognize that certain individuals may be deeply disadvantaged by social arrangements that impose too much of a burden of self-control upon them.

Because paternalism is regarded as normatively indefensible, except as a concession to “realism”, social reformers and utopian planners have had a tendency to promote schemes that, if implemented, could easily generate tragic results for much of the population.<sup>9</sup> Consider, for example, the distribution of financial wealth (excluding owner-occupied housing) in the United States. In 1995, 93 percent of the financial wealth was held by the wealthiest 20 percent, 6.9 percent by the next quintile, 1.4 percent by the middle, while the bottom two quintiles held -1.3 percent (Wolff, 1998, p. 135). This distribution obviously reflects, not just inequality in income distribution, but also a systematic failure to save on the part of large segments of the population (including many who are quite rich, not just by global standards, but even by relative United States standards). Yet few egalitarians have been willing to address the underlying cause of this wealth inequality.

Consider, for example, the proposal made in *The Stakeholder Society* by Bruce Ackerman and Anne Alstott (1999) for redressing wealth inequality. They suggest that inheritance taxes be increased, in order to finance a cash transfer to each new generation of United States citizens – US\$80,000 per person, to be received between the ages of 18 and 25. They suggest that this money might be used for a variety of projects: including college tuition, start-up funds for a small business, and payment of large medical bills (Ackerman and Alstott, 1999). Thus their proposal is clearly intended as a substitute for several of the in-kind benefits provided by the conventional welfare state (such as health insurance). It is also presented as a serious legislative proposal, complete with calculations of

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<sup>9</sup> The sort of “libertarian paternalism” recommended by Thaler and Sunstein (2008) is no exception, insofar as the authors balk at the thought of having the state implement precommitment strategies.

how much it would cost, how the financing could be arranged through taxation, and so on. Of course, Ackerman and Alstott recognize that their plan may give rise to some serious problems involving improvident use of the funds. Yet they treat this primarily as an educational challenge, one that may be overcome through public education initiatives, combined with the counsel of teachers and parents.

At present, most teenagers have little reason to prepare themselves for the responsibilities of managing eighty thousand dollars. This will change over time as parents, teachers, and friends spend endless hours telling them of the perils of blowing their stakes. We believe that, after hearing years of such talk, most young Americans will surprise the skeptics and make responsible use of their new-found freedom (Ackerman and Alstott, 1999, p. 63).

Yet what reason is there for such optimism? The suggestion that “endless hours” of lecturing from parents and teachers represents a *solution* to the problem of irresponsible conduct among teenagers falls somewhere between the comical and the culpably naïve. Furthermore, looking at how adults in the United States manage their own money offers no grounds for encouragement. They are currently carrying close to \$900 billion in *revolving* debt, much of it on credit cards at punitively high interest rates.<sup>10</sup> Adults are exposed to countless advertisements from debt consolidation and refinancing companies, telling them of the perils of such debts, yet they persist in abusing the “new-found freedom” of consumer credit.

Moreover, credit-card debt is simply the most extreme manifestation of a more general crisis of personal savings in the United States. Although there are a variety of explanations for the decline in savings, economist David Laibson (1997) has argued that innovations in personal banking may share a large part of the blame. The problem, he claims, is that they make it much more difficult to create illiquid assets, and therefore decrease opportunities for self-binding. Whereas customers used to have to give their bank several days notice in order to make a withdrawal from their savings accounts, the difference between savings and checking accounts has now become purely nominal. The introduction of ATMs has meant that everyone has access to their money at all hours: so withdrawing a fixed amount at the beginning of the week can no

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<sup>10</sup> This is down by about \$100 billion, due to the 2008 financial crisis. See U.S. Federal Reserve Statistical Data Consumer Credit for 2009 <http://www.federalreserve.gov/releases/g19/20100108/>

longer be used as a self-control mechanism. Consumer credit has rendered the practice of saving up for a consumer purchase almost obsolete.

More culpably, a lot of recent financial sector *innovation* seems intentionally aimed at discouraging consumers from accumulating any assets or paying off their debts. The 2008 subprime mortgage crisis brought to light a large number of products (including interest-only mortgages, adjustable rate mortgages with so-called teaser rates, and negative amortization loans) that seem to have had little economic or financial rationale for the average consumer but allowed unscrupulous lenders to take advantage of the improvident. Even respectable financial institutions began aggressively pushing consumers to take out home equity lines of credit rather than conventional mortgages. This has the effect of transforming the consumer's home equity into a savings account, with the money accessible at any time from an ATM.

Increased liquidity has not been neutral in its effects, but has rather changed the behavior of consumers in a way that has been highly deleterious to the interests of some. Because of this, it is problematic to treat cash as simply a stand-in for "whatever the individual happens to want," and thus as a neutral way of distributing a "stake" in society. If some individuals discount the future hyperbolically to a greater degree than do others, then the choice to promote equality through large lump-sum cash transfers is hardly neutral. And since excess liquidity is already the source of so much mischief in contemporary American society, could giving young people an enormous cash grant really be such a good idea? All the available evidence suggests that it is not.

Because the central problem is a warp in the way that individuals deal with time, the worst proposals involve large, one-off or infrequent lump-sum payments. Consider, for example, the large "coming-of-age" payments that are common on native reserves with significant oil and gas revenues, such as the Samson Cree reserve in Hobbema, Alberta (which sits on top of a massive oil field that accounted, in its prime, for 10 percent of Canada's national oil output). During the 1980s, the federal government in Canada collected over \$783 million dollars in royalties for the Samson Cree, almost \$200,000 for every individual on the reserve. Half this money was held in trust, the rest was distributed and spent on various projects. At the time, families were collecting nearly \$3,000 in royalties each month and teenagers were given \$100,000 on their 18th birthday. At the same time, Hobbema became the suicide capital of the country. Between 1985 and 1987 the male suicide rate was 83 times the national average (peaking at a rate of 300 per year, in a community of only 6,000) (Laird, 2000, p. 18).

These types of social problems tend to have complex causes, especially in native communities. Yet many tribal elders identified the coming-of-age royalty checks as a major contributing factor. As one avows, "A lot of these kids, they will not listen. They will rebel, simply because of the fact that they have this money coming. It's more of a detriment than anything. Kids will drop out of school. They see it as a career – turning 18. I've seen kids get \$150,000, spend it in two months, then commit suicide" (Gregoire, 2001). Importantly, note that education cannot correct the problem of improvident spending, because the expectation of the cash transfer undermines the incentive to acquire an education. More generally, education cannot solve the problem of hyperbolic discounting, because hyperbolic discounting undermines the individual's motivational structure that individuals require in order to obtain an education. Even if students are forced to attend classes, they cannot be forced to pay attention, much less to learn anything.

Drilling in Hobbema was all but complete by 2000, after which the royalty cheques began to dwindle. By 2005, residents were getting closer to \$30,000 to \$40,000 on their 18th birthday. Even so, Mel Buffalo, a member of the Samson Cree Nation says, "I've seen people spend that in three or four days" (cited in Walton and Campell, 2005). Similar behavior is commonly observed among lottery winners. A national study in the United States suggested that over 70 percent of lotto winners spend it all in the first two years (Karp, 2005). A similar study from New York showed that, on average, winners of one of the 37 state lotteries file for bankruptcy at a rate of about one a month. That works out to an average of a third of all winners. Anecdotal or narrative evidence indicates some of what goes wrong. Evelyn Adams won the New Jersey lottery twice (in 1985 and 1986) to the tune of \$5.4 million. Today the money is gone, largely to Atlantic City slot machines, and she lives in a trailer. William "Bud" Post won \$16.2 million in the Pennsylvania lottery in 1988, but now lives on social security and food stamps. A former girlfriend successfully sued him for a share of his winnings, while siblings pestered him until he agreed to invest in unsuccessful business ventures. Within a year Post was \$1 million in debt, and he eventually declared bankruptcy. Suzanna Mullins won \$4.2 million in the Virginia lottery in 1993, then borrowed an additional \$2 million using her winnings as collateral. She agreed to repay her debt out of her yearly installments, but when the rules changed in Virginia allowing winners to collect in a lump sum, Mullins cashed in the remaining amount but ceased making payments on her loan. Today her winnings are gone, and she owes nearly \$1.8 million. William Hurt of Michigan won \$3.1 million in 1989. A year later he was broke and under indictment for

murder. His lawyer says Hurt spent his fortune on a divorce and on crack cocaine (Cudgeon, 1995).

Not all egalitarians are insensitive to these concerns. The proposals dealt with so far all involve making fairly large payments to individuals. Breaking the lump sum up into a series of smaller payments has the potential to encourage more provident behavior, as does transferring the capital to individuals in a form in which they cannot access the principal, but can only consume the income stream. John Roemer, for example, presents a scheme in which assets would be redistributed as coupons, rather than cash, which in turn could be used only to purchase stock, not consumer goods or services (Roemer, 1994). Dividends would be paid in cash so individuals would be able to live off their investments, but unable to liquidate their stake. They would be forced, in effect, to hold on to their capital – an arrangement that would be further buttressed by regulations prohibiting the formation of investment vehicles whose sole purpose was to liquidate assets (Roemer, 1994, pp. 83–84). Roemer justifies these arrangements in frankly paternalistic terms. Even Van Parijs – for whom freedom is a much more serious preoccupation – when challenged to explain why he envisions a basic income paid in monthly installments, rather than a lump sum transfer, describes it as a response to a “mildly paternalistic concern” for ensuring real freedom over the course of a person’s lifetime.<sup>11</sup>

While both of these moves reflect admirable sensitivity to the real-world issue of how people manage their money, it is unfortunate that both authors perpetuate the idea that there is a straightforward conflict between equality and liberty. Aside from that, one may still have concerns about the proposals and the extent to which they rely upon cash payments. Many lotteries don’t pay out in lump sums, but make monthly payments to winners over several years. This does not necessarily solve all the problems, as the Mullins case shows. First, people are able to contract around this constraint (as Mullins did), by taking out large loans, using the guaranteed income stream as collateral. Second, a certain fraction of the population has serious problems in dealing with cash, even on a timescale of a month or a week.<sup>12</sup> In his book *Working Poor*, David Shipler (2004)

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<sup>11</sup> Although a lump sum would enhance the freedom to invest or engage in a brief period of wild indulgence followed by a lifetime of self-denial, Van Parijs defends installments on the grounds that it is wrong to hold people accountable later in life for foolish decisions they made in their youth. Installments can thus be justified, he claims, by assuming a universal desire of people “in their right minds to protect their real freedom at older ages against weakness of will at younger ages” (Van Parijs, 1995, p. 48).

<sup>12</sup> These considerations suggest that conducting empirical research into Win for Life lotteries, which offer lifelong, unconditioned payments, may indeed yield results with respect to predicting the market behavior of potential basic income recipients, but not likely the kind of positive results hoped for by basic income supporters (Peters and Marx, 2006).

presents a detailed analysis of the monthly budgets of several poor families, which shows clearly why there is sometimes such a large gap between the nominal income of these families and the quality of life they achieve. Part of the problem is a steady stream of small, impulsive purchases.

It is well-known that the poor often wind up paying more for everyday necessities because they are unable to make lump-sum payments that would allow them to reduce their periodic payments. Living in a motel because one is unable to come up with “first and last month’s rent”, as is typically demanded by landlords, is the classic example. Indeed, one of the families that Shipler examined appeared to be in exactly this sort of poverty trap. Their monthly expenditures included \$200 for laundry because the washing machine was broken and another \$200 or so in restaurant bills because they could not cook at home – they owed \$400 to the gas company, as a result of which their service had been disconnected. One might think that this family was in a classic poverty trap, unable to afford the lump-sum payment that would allow them to reduce their monthly expenditures. Yet the household budget also included a surprising number of discretionary expenditures, such as \$161 for tickets to an Ozzy Osbourne concert and \$100 a month to buy packaged lunches for their preschooler. Willie, the father, explained it this way: “I know if we were smart people, we could be well off. Sometimes I bring home \$700 a week. I know I could be well off. But, you know, neither of us can just sit home and say, OK, this is what we’ve got for dinner, and that’s it. If we had \$10 in our pocket and we were sick and tired of sitting in the house, we’d go out and spend \$10 on ice cream and supper” (Shipler, 2004, p. 37).

Indeed, the most striking characteristic of the so-called poverty industry – a term used to refer to the set of businesses that derive most of their profits from the poor – is that they all exploit pathologies of intertemporal choice associated with hyperbolic discounting. This is most obvious in the case of payday loan and cheque-cashing services, pawnshops and rent-to-own stores, but is arguably true of liquor and tobacco stores as well, not to mention the drug trade. Poor financial education is no doubt a factor in some of these cases. But it is wishful thinking to imagine it is the entirety of the problem. If the issue is primarily motivational, rather than informational, then even proponents of basic income need to be careful about the commitment to cash transfers. There is certainly ample room for reasonable disagreement about the use of cash as a tool for achieving greater equality among citizens.

*Conditionality* is a third strategy for dealing with the problem of improvident spending, apart from education and the streaming of payments. David Nissan

and Julian Le Grand advocate a lump-sum, one-time payment to young adults of approximately £10,000, but caution that the payment must be conditioned because “there would be no surer way to lose popular support for a system of capital grants than with a few well-publicized cases of young people blowing their grants on cocaine or wild holidays” (Nissan and Le Grand, 2003, p. 37). They argue that since parents rarely pass along start-up money to their children with no strings attached (and since the start-up grant is supposed to guarantee all young adults the opportunity that inheritance provides to some) neither should the state. In their view, trustees should be appointed who will have to approve an applicant’s spending proposal before the funds are disbursed. Only proposals that include plans to pursue post-secondary education or vocational training, to make a down payment on a first home, or to start a small business should be financed.

Making the grant conditional in this way may well make it more difficult for the recipients to blow it on drugs and travel, but certainly not impossible. And while the approval process may reduce instances of up-front squandering, it cannot prevent recipients from flunking out of school or failing to keep up with regular mortgage payments. What this suggests is that a start-up grant cannot get the state out of the welfare business. Young adults who flunk out of school or lose their homes will require access to the same welfare system that advocates of cash grants find so problematic, which they expect will be made obsolete by their proposed policies (Goodin, 2003, pp. 68–69). More importantly, however, the type of conditionality and oversight that Nissan and Le Grand (2003) envisage undermines what liberal egalitarians have always taken to be the primary rationale for cash grants, which is precisely their fungibility. What is the point of giving people money, but then appointing an oversight committee to tell them how they can spend it? If adolescents are only allowed to spend the money on tuition, residential property, or business start-ups, why not make post-secondary education free, provide decent subsidized housing to youths, and provide interest-free start-up loans for reasonable small business ventures?

Nissan and Le Grand (2003) do identify the central problem with using cash grants to achieve egalitarian ends: trying to increase the wealth of some people by giving them money can be like pouring water into a sieve. The conditions they propose, however, would not only fail to solve what White (2004) calls the “alienation problem,” but would undermine the rationale for cash altogether. Rather than handing out cash, it would be much better to use the money slated for egalitarian redistribution to finance more traditional welfare-state programs (especially in the United States). Furthermore, individuals who discount the

future hyperbolically may have a rational preference for receiving benefits in-kind, rather than through a cash grant. For instance, Ackerman and Alstott (1999) suggest that individuals might like to use their US\$80,000 stake to pay “large medical bills.” Would not a comprehensive state health insurance system be more attractive than asset redistribution? Not only are these sorts of risk-pooling arrangements more efficient than having each individual save privately for a medical emergency, they also deny individuals the option of sacrificing their future health for short-term consumption gains. This provides an aid to self-control that many individuals value (witness the common preference – even setting aside tax treatment – for employer-financed medical benefits over a higher salary). The commitment to neutrality suggests that this preference should be accorded a certain respect. At the very least, the relevant institutional arrangements should not be ruled out based on the grounds that they violate individual liberty or that they are paternalistic.

#### **4. Recommendations**

Robert Nozick (1974, pp. 160–164) argued that if egalitarians want to achieve a certain *pattern* of distribution then they would have to place restrictions on the way that individuals can spend their money, and that this reveals an inherent tension between equality and liberty. We suggest that the primary tension is not between equality and liberty, but rather between neutrality and liberty. The problem with maximizing liquidity – removing all constraints on how, when, where and why people can spend their money – is not that it creates outcomes that are unequal, in some sense of the term, but that it is contrary to the rational preferences of individuals who discount the future hyperbolically and who rely upon institutional constraints as part of an extended self-control strategy. Certain segments of the population favor in-kind benefits over cash in a variety of domains. Others do not. Therefore, the just resolution involves a balancing of these conflicting interests; we recommend the following:

1. Lump-sum cash payments of the sort proposed by advocates of large-scale asset redistribution schemes should be precluded. Monthly or weekly payments are unobjectionable, as such, but should be offered as part of a balanced package of in-kind services and transfers. Under no condition should they be allowed to crowd out existing social programs, such as

socialized medicine or public pensions.<sup>13</sup> See recommendations 4 and 5 below.

2. Imposing conditions on periodic payments is not objectionable in principle. Consider the *Oportunidades* program in Mexico or *Bolsa Familia* in Brazil. Essentially, these programs make cash payments conditional on good parenting, such that parents cannot get the grant unless their children have been to school regularly, had their appropriate vaccinations and regular medical checkups, etc. There are no restrictions on the uses to which the cash itself can be put. In other words, the money is not earmarked for health and education, it is intended merely to motivate parents to take advantage of existing state services, which are provided in-kind. The overall program design is aimed, not at discouraging people from wanting certain things, but merely at counteracting the effects of hyperbolic discounting. Most parents don't want their children to be caught in a vicious circle of poverty, and they understand that education and good health dramatically improve their chances of escaping it. Yet when the costs of prevention are upfront and the potential benefits are years away, people face a significant motivational challenge in pursuing these objectives. The *Oportunidades* and *Bolsa Familia* programs diminish the motivational burden by making it in the interest of parents here and now to do the right thing.
3. Vouchers should be taken more seriously, as a middle road between in-kind and cash transfers.<sup>14</sup> In our view, the central problem with vouchers is not that they are paternalistic but that they tend to generate secondary markets, as individuals try to contract around the constraints associated with the voucher. Consider the problems associated with food stamps in the United States. The replacement of paper food stamps by ATM-like plastic cards, replenished monthly with government credit, went some way toward limiting the spread of secondary markets. Nevertheless, the cards can still be used to pay for the groceries of others in exchange for cash. As a result, many states impose fairly draconian penalties for misuse of the cards, including criminal charges and lifetime banishment from the program. This is of serious consequence, given that in the United States, one out of eight adults and one out of four children currently depend in whole or in part on this program (De Parle and Gebeloff, 2009). Thus we suggest that vouchers

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<sup>13</sup> One might be inclined to regard state pensions as simply a cash transfer. Our preference is to regard them instead as in-kind provision of a life annuity, in the style of a defined-benefit pension scheme. A system of genuine cash payments would be like a defined-contribution scheme.

<sup>14</sup> Indeed, one can think of cash as being simply a voucher, one with few constraints on fungibility.

are more attractive in cases where enforcement is less problematic, such as housing and daycare.

4. The in-kind provision of goods and services remains crucially important. This includes such things as education, housing, and health care, as well as many features of the social safety net that are sometimes misclassified as cash transfers, including pensions, disability insurance, and employment insurance. Although these latter benefits take the form of cash transfers, they are better thought of as the in-kind provision of an insurance product, since individuals are unable to opt out with compensation, and since these benefits have a targeted nature intended to respond to the particular need for an income stream when it arises, rather than to social needs in general.
5. We take particular issue with the suggestion that a citizen's grant or basic income could legitimately eliminate the need for a public health care or health insurance system. Ackerman and Alstott (1999) take it to be a virtue of their scheme that recipients could use their grant to pay large medical bills. And Van Parijs (1995, p. 44) claims that, while the state ought to cover public health measures that are necessary to ensure productivity, recipients of a basic income could be presumed to be "sufficiently risk-averse to turn part of their cash grant into an insurance scheme that fully or partly covers a sufficient [range] of services". This seriously underestimates the severity of market failure in the health insurance sector, while dramatically overestimating the foresight and self-control of citizens. Furthermore, even if we assume that rational persons want health insurance, this does not make it paternalistic (or paternalistic in an objectionable way) for the state to provide it. As Stuart White argues,

a given paternalistic intervention is justifiable...if it is a restriction that all citizens would agree to, when in a state of sober reflection on what really conduces to their own individual good, as a way of insuring themselves against individual weakness of rationality and/or will...The intervention is then something that supports people in the pursuit of their goals, rather than an alien imposition on them (White, 2004, p. 71).

Unfortunately, a hypertrophied concern for individual liberty, combined with an aversion to any institutional arrangement that appears paternalistic, has obscured the need for a balanced mixture of welfare-state services by effectively

excluding from consideration the interests of the intemperate. Individuals have long relied not only upon their own will power, but also upon the cooperative assistance of others as a way of avoiding the extremes of intemperance. This means that they have used social institutions as a way of carrying out precommitment strategies. Denying individuals this important crutch, in the name of individual freedom, interferes with the ability of *some* people to effectively pursue their own goals and projects. It is precisely this partiality that constitutes the tension between liberty and neutrality.

## 5. Conclusion

Many political philosophers concerned with identifying a meaningful place for liberty within the framework of an egalitarian theory of justice have insisted that, when equality demands redistribution, assets should be transferred in the most abstract form possible – ideally through a system of cash transfers. In this article, we argue that egalitarians who rely on cash transfers as a way of accommodating the demands of liberty do so at the expense of neutrality, since individuals with certain rates of time preference often want to use social institutions as self-binding mechanisms, and as a result may exhibit a preference for in-kind benefits or other institutional arrangements frequently misclassified as paternalistic. We explore the arguments contemporary egalitarians have offered in favor of cash transfers, and we show each to derive primarily from the liberal commitment to state neutrality. Finally, we show that cash fails to satisfy the constraints of neutrality because of hyperbolic discounting, and we argue that this must inform the way basic questions of justice, distribution and entitlement are approached.

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