AN UPDATE OF THE POVERTY PICTURE PLUS A NEW LOOK AT RELATIVE TAX BURDENS

by
Harold Watts and Felicity Skidmore

Many government programs alter the incomes of individuals and families and/or their command over goods and services in a very direct way. The following list comprises the major federal and state tax and transfer programs that take money directly from or transfer cash or in-kind benefits directly to the population:

Social Insurance Cash Transfers
- Social Security and Railroad Retirement
- Government Employee Pensions
- Unemployment Insurance
- Worker's Compensation
- Veteran's Benefits (non-income-conditioned)

Cash Assistance
- Veteran's Pensions (income-conditioned)
- Supplemental Security Income (SSI)
- Aid to Families with Dependent Children (AFDC)

In-Kind Transfers
- Food Stamps
- Child Nutrition
- Housing Assistance
- Medicare
- Medicaid

Income and Payroll Taxes
- Federal Individual Income Tax
- Federal Social Security Tax (employee share)
- State Individual Income Taxes

Clearly, only a small number of these would usually be referred to as welfare.

To get a proper picture of the amount of redistribution currently done by government, the appropriate procedure is to take into account the effect of all these programs. This inclusive assessment also provides the necessary framework within which to identify the gainers and losers from the current system and to judge who needs help from tax-and-transfer reform (of which "welfare" reform, as usually discussed, is only a small part).

Impact on Poverty

The impact of government on reducing poverty when the effects of all these programs are taken into account is substantial—and substantially greater than is shown by the government's own poverty measure, which only counts the effect of the cash transfer programs. Table 1 shows the before and after picture estimated for 1976. The poverty count is seen to be much reduced by the tax-and-transfer system.

Cash transfers as counted in the official poverty figures almost halve the overall poverty count compared with pretransfer poverty (reducing it from 21 percent of all persons to 11.4 percent). When taxes and in-kind transfers are included, the poverty count is again almost halved (going from 11.4 percent to 6.5 percent). The poverty-reducing effect of the programs taken together as a system is substantially greater than the effect of cash transfers alone for all age, regional and demographic groups.

But the relative effects of the system do differ by group. These effects are not shown in the tables but are worth noting. Before taxes and transfers, for instance, 27 percent of the poor are aged. Only 7.5 percent of the poor are aged when all program effects are taken into account. Other groups, in contrast, become more prominent in the after-tax-and-transfer statistics. Of the pretransfer poor, 43 percent are under 25; the proportion under 25 rises to 55 percent when all programs have been taken into account. The South has 33 percent of the national population, 41 percent of the preprogram poor, and 56 percent of the poverty after all programs have been accounted for. One out of eight Americans is nonwhite, but one out of four of the poor is nonwhite—both before and after the impact of public policy.

Changes in Income Shares

Obviously, redistributive public policy has dramatic effects on the income of many poor persons. This redistribution, of course, is at someone's expense. Without also including in our calculations the sources of the money to be redistributed, we do not get a picture of the overall effect of government redistributive policy. Table 2 shows, for

<table>
<thead>
<tr>
<th>Number of Persons (millions)</th>
<th>Percentage Poor Before Programs</th>
<th>After Cash Transfers</th>
<th>After All Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age groups</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Persons under 25 years</td>
<td>95.8</td>
<td>20.4</td>
<td>14.6</td>
</tr>
<tr>
<td>Persons 25-64 years</td>
<td>98.3</td>
<td>14.1</td>
<td>8.1</td>
</tr>
<tr>
<td>Persons 65 years and older</td>
<td>22.9</td>
<td>54.1</td>
<td>12.8</td>
</tr>
<tr>
<td>All persons</td>
<td>217.0</td>
<td>21.1</td>
<td>11.4</td>
</tr>
<tr>
<td>Poverty-prone groups</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mothers with children</td>
<td>19.0</td>
<td>58.4</td>
<td>41.8</td>
</tr>
<tr>
<td>Families with aged head</td>
<td>27.2</td>
<td>53.7</td>
<td>13.5</td>
</tr>
<tr>
<td>Nonwhite units</td>
<td>27.6</td>
<td>40.8</td>
<td>27.6</td>
</tr>
<tr>
<td>Units in South</td>
<td>71.4</td>
<td>26.5</td>
<td>16.6</td>
</tr>
<tr>
<td>Single persons</td>
<td>21.6</td>
<td>47.8</td>
<td>25.0</td>
</tr>
</tbody>
</table>

Note: The age groups taken together are exhaustive. The poverty-prone groups as shown in this table are overlapping categories.

Source: The estimates in Tables 1, 3, 4, and 5 are calculated from computer printouts of data prepared for the Congressional Budget Office by Mathematica Policy Research, Inc. The same basic data were used in the CBO's June 1977 Background Paper no. 17, Poverty Status of Families under Alternative Definitions of Income.

The figures in this column are comparable to the government poverty statistics. In calendar year 1975, 12.3 percent of the population were poor by the government definition (analogous to the 11.4 percent figure for 1976 in this table).
fiscal year 1976, the estimated impact of overall govern-
ment redistribution on the relative income shares of
the bottom 20 percent, the top 20 percent, and the three
middle quintiles. The first column shows the shares of
personal income that go to each income group before the
effect of taxes and transfers. As is obvious, these shares are
extremely uneven, with half the total income going to the
richest 20 percent and less than half of one percent to the
bottom 20 percent.

The middle column shows the relative shares that accrue
when the cash transfer programs (social insurance cash
transfers, and cash assistance) are taken into account. This
is the way the government officially defines income. Some
minor lessening of inequality has resulted. Very roughly,
4.5 percent has been taken from the top and added to the
bottom; and 2 percent has been taken from the middle
high income group and given to the middle low one.

When positive taxes and in-kind transfers are also included
(as they are in the third column) we see some additional
equalizing, with another 4.5 percentage points going from
the top group to the bottom two. The middle group’s
share remains remarkably constant throughout. But, when
all is said and done, the top 20 percent are still left with
more than twice “their (proportional) share,” and six
times as much as the poorest group.

Although the changes in income shares appear modest,
large sums are involved in bringing these changes about.
Table 3 presents an accounting of the income shifts among
the different demographic groups. Nearly $142 billion is
collected from higher income individuals and
families—none of which comes net from the aged. Of this, $119
billion is redistributed to the lower income groups, nearly
two-thirds of which goes to the aged.

The aged are revealed to be doing, relatively speaking,
very well indeed. The aged in the higher income groups
have higher average incomes than similar nonaged units,
although they have smaller family sizes and pay almost no
taxes. The aged in the lower income groups are similarly

Table 2
Impact on Income Shares of Households

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Share of Market Income</th>
<th>Share of Income after Cash Transfers</th>
<th>Share of Income after Taxes and All Transfers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest 20%</td>
<td>0.3%</td>
<td>4.5%</td>
<td>7.2%</td>
</tr>
<tr>
<td>Medium Low 20%</td>
<td>7.2%</td>
<td>9.6%</td>
<td>11.5</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>16.3%</td>
<td>16.2%</td>
<td>16.6</td>
</tr>
<tr>
<td>Medium High 20%</td>
<td>26.0%</td>
<td>24.2%</td>
<td>23.4</td>
</tr>
<tr>
<td>Highest 20%</td>
<td>50.2%</td>
<td>45.6%</td>
<td>41.3</td>
</tr>
</tbody>
</table>

*Note: Households include families and unrelated individuals
ranked irrespective of family size. Six out of seven in the lowest
(pre-tax-and-transfer) quintile are either aged households, single
personal units, or female-headed families with children. Nine out of
ten in the top quintile are nonaged, multiperson households.

*Source: Congressional Budget Office, Poverty Status of Families
under Alternative Definitions of Income, Background Paper no.
17, June 1977, p. 24.*

Table 3
Income Changes among Groups
Due to the Tax and Transfer System

<table>
<thead>
<tr>
<th></th>
<th>Number of Persons</th>
<th>Preprogram Income</th>
<th>Postprogram Income</th>
<th>Net Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(millions)</td>
<td>($billions)</td>
<td>($billions)</td>
<td>($billions)</td>
</tr>
<tr>
<td>Lower income familiesa</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aged</td>
<td>15.10</td>
<td>25.5</td>
<td>68.5</td>
<td>+ 43.0</td>
</tr>
<tr>
<td>Nonaged</td>
<td>74.00</td>
<td>156.3</td>
<td>193.7</td>
<td>+ 37.4</td>
</tr>
</tbody>
</table>
| Lower income
  individualsa |                  |                   |                    |            |
| Aged                 | 7.15             | 8.6               | 39.2               | + 30.6     |
| Nonaged              | 8.28             | 23.6              | 31.6               | + 8.0      |
| Total                | 104.53           | 214.0             | 333.0              | + 119.0    |
| Higher income families |                |                   |                    |            |
| Aged                 | 4.14             | 44.2              | 44.2               | 0          |
| Nonaged              | 102.23           | 711.7             | 586.6              | -125.1     |
| Higher income
  individuals |                  |                   |                    |            |
| Aged                 | .79              | 14.3              | 14.3               | 0          |
| Nonaged              | 5.35             | 79.2              | 62.5               | -16.7      |
| Total                | 112.51           | 849.4             | 707.6              | -141.8     |

*aLower income is defined as under $14,000 for family units and
under $7900 for individuals.

The Relation between Income and Impact

How does the system affect the various types of families at
different income levels? Table 4 shows, for various aged
and nonaged groups, the average net benefit or tax liability at
different income levels. As can be seen, none of the
aged on average pay positive taxes except the richest 20
percent (that is, those with annual family incomes over
$21,700). Nonaged couples with and without children, in
contrast, on average pay positive taxes when their incomes
reach $7400. The very poorest groups (those with annual
incomes below $1800) all receive on average substantial
positive payments, but here again there are interesting
differences. Aged poor couples (families in which by
definition there are few children) receive a larger average
sum than either poor couples with children or poor
mothers with children.

These are the absolute amounts. Now we can ask: At what
rates do these benefits decline as income rises? Table 5
presents the amounts that are lost in reduced benefits and/or increased taxes per dollar in moving from the
average receipts of one group to the average for the next
highest group—often referred to as marginal tax (or
benefit reduction) rates. (A rate of 40 percent, for
example, means that families which differ by $1000 in
preprogram earnings differ, on average, by only $600 in
postprogram income or command over goods and services.) These rates vary widely. The poorest mothers with
children face a marginal rate of 58 percent, compared with
marginal rates of 22-35 percent for those in the medium
high groups and even lower average rates for the highest
groups.
Table 4
Net Impact Per Unit, by Income Class

<table>
<thead>
<tr>
<th>Income Class</th>
<th>Number of units (millions)</th>
<th>Lowest ($under $1800)</th>
<th>Medium Low ($1801-$7900)</th>
<th>Middle ($7901-$14,000)</th>
<th>Medium High ($14,001-$21,700)</th>
<th>Highest (over $21,700)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aged groups</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Couples</td>
<td>6.10</td>
<td>$7315</td>
<td>$6894</td>
<td>$5049</td>
<td>$3454</td>
<td>$-3911</td>
</tr>
<tr>
<td>Single persons</td>
<td>7.96</td>
<td>4414</td>
<td>3750</td>
<td>2474</td>
<td>440</td>
<td>-6087</td>
</tr>
<tr>
<td>Nonaged groups</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Couples with children</td>
<td>27.24</td>
<td>5144</td>
<td>2595</td>
<td>-244</td>
<td>-2259</td>
<td>-6385</td>
</tr>
<tr>
<td>Couples without children</td>
<td>14.25</td>
<td>5114</td>
<td>2343</td>
<td>-366</td>
<td>-2516</td>
<td>-7260</td>
</tr>
<tr>
<td>Single persons</td>
<td>13.63</td>
<td>2070</td>
<td>135</td>
<td>-1783</td>
<td>-3596</td>
<td>-9400</td>
</tr>
<tr>
<td>Mothers with children</td>
<td>5.22</td>
<td>5565</td>
<td>3047</td>
<td>406</td>
<td>-731</td>
<td>-4655</td>
</tr>
</tbody>
</table>

Note: Tax liability is indicated by (-).

Table 5
Impact Rates, by Income Class

<table>
<thead>
<tr>
<th>Income Class</th>
<th>Lowest ($under $1800)</th>
<th>Medium Low ($1801-$7900)</th>
<th>Middle ($7901-$14,000)</th>
<th>Medium High ($14,001-$21,700)</th>
<th>Highest (over $21,700)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aged groups</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Couples</td>
<td>11%</td>
<td>29%</td>
<td>24%</td>
<td>31%</td>
<td>10%</td>
</tr>
<tr>
<td>Single persons</td>
<td>18</td>
<td>23</td>
<td>30</td>
<td>32</td>
<td>16</td>
</tr>
<tr>
<td>Nonaged groups</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Couples with children</td>
<td>41</td>
<td>48</td>
<td>32</td>
<td>27</td>
<td>19</td>
</tr>
<tr>
<td>Couples without children</td>
<td>52</td>
<td>44</td>
<td>33</td>
<td>29</td>
<td>21</td>
</tr>
<tr>
<td>Single persons</td>
<td>44</td>
<td>33</td>
<td>29</td>
<td>35</td>
<td>28</td>
</tr>
<tr>
<td>Mothers with children</td>
<td>58</td>
<td>46</td>
<td>18</td>
<td>22</td>
<td>13</td>
</tr>
</tbody>
</table>

Note: These are marginal rates (explicit and implicit) for all income classes except the highest (for which, being open-ended, we can only calculate average rates). They are the rates faced by each group as a whole. See Qualification 1 at the end of this article.

Implications for Reform

Subject to certain important qualifications (spelled out in the final section), Tables 4 and 5 may be construed as giving us the dimensions of the current tax and transfer system viewed as a universal credit income tax. Table 4 shows the average benefits or taxes of each group in each income category. Table 5 shows the implicit tax rates (the rate at which the average benefit falls as income rises).

The view underlying this way of presenting the facts, of course, is that at present we do, in fact, have a redistribution system with many parts. Any reform should be coordinated among all of them. In other words, don’t redraw a part of the elephant without seeing what it does to the picture as a whole. This, in turn, implies that the appropriate criterion is the combined impact of all parts of the system—whether in fact it is simplified into one program called a credit income tax or whether it is, as now, made up of many different ones. Looked at in this way, several features stand out.

First, the relative treatment of aged and nonaged poor families suggests a need for careful examination of priorities. The older units have higher “guarantees” despite the presence of children in the younger units. Moreover, older units have lower implicit and explicit tax rates, which are hard to justify on incentive grounds. Among the highest income groups, the much lower net tax burden for the aged is startling.

Second, even within the nonaged groups the treatment of couples with children seems comparatively stingy. Such families receive almost no preference relative to childless couples, despite their having twice as many mouths to feed. Relative to single mothers with children, intact families end up with distinctly less at each level of pretransfer income and have generally one more male adult to provide for. These patterns reflect the often noted neglect of the “working poor” in the lower quintiles, but the pattern appears to persist at higher income levels as well.

(continued on page 10)
Update of the poverty picture
(continued from page 7)

Third, the average implicit tax rates in the richest quintile for all the demographic groups (see Table 5) suggest that the burden on those with the highest incomes is far short of "confiscatory," and certainly is smaller than a casual look at tax schedules might suggest. 4

Qualifications

1. These measures are, of course, averages over large groups of households. Different households are affected differently according to the set of programs they are eligible for and according to the subset that they participate in. The schedules shown in Tables 4 and 5 are, thus, much smoother than reality.

2. Social insurance programs are not directly conditioned on income because they are aimed at providing income security against the threat of specific income-reducing events—retirement, disability, death, illness. This consolidation of the social income programs into an accidental "pseudocredit income tax" conditioned strictly on income ignores their original rationale.

3. The consolidation of Medicare as in-kind social insurance and Medicaid as an in-kind, income-tested benefit might be challenged unless the employment-related private subsidies for health insurance are included as well. Such inclusion would probably have the net effect of reducing further the relative burden on the high income groups.

4. However much a consolidated impact schedule might resemble a unified negative income tax or credit income tax schedule, the fact that many programs are involved—each with its own rules, regulations, and personnel—means administrative overhead costs of substantial magnitude. It may be argued that such costs are the inevitable result of the political coalitions needed to achieve any redistribution at all. They should, in any case, be recognized as waste relative to the potential efficiency of a more unified system of income supports.

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Such calculations were released by the Congressional Budget Office in Poverty Status of Families Under Alternative Definitions of Income, Background Paper no. 17, June 1977. The basic methodology used in the paper for including in-kind programs in the income distribution statistics was developed not by the CBO but by Timothy Smeeding in Measuring the Economic Welfare of Low Income Households and the Anti-Poverty Effectiveness of Cash and Non-Cash Transfer Programs, Ph.D. dissertation, University of Wisconsin-Madison, 1975.

Further calculations show that, on a per capita basis, aged households poor on a preprogram basis are raised by the tax and transfer system to income levels more than double those for preprogram poor nonaged families with children ($4500 versus $2000).

Corporate taxes, property taxes, and sales taxes are not included in our calculations. There is no general agreement on the real incidence of these taxes, or how their inclusion would change relative burdens.

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THE TREATMENT OF ASSETS AND INCOME FROM ASSETS IN INCOME-CONDITIONED PROGRAMS

Prepared for the Federal Council on the Aging by the Institute for Research on Poverty

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