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PAPERS AND COMMENTS

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UNIVERSITY OF WISCONSIN - MADISON

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ABSTRACT

The papers and discussions which follow were presented at the December 1973 meetings of the Allied Social Science Associations in New York City. They provide a stimulating review and perspective on the state of policy and reform possibilities in income maintenance and the welfare system.

Harold W. Watts, session chairman

THE ROLE OF INCOME-CONDITIONING  
IN THE AMERICAN SYSTEM OF TRANSFERS

Robert J. Lampman

Between 1960 and 1973 social welfare expenditures under federal, state and local government programs increased from \$52 billion to \$215 billion. They were equal to 11.8 percent of gross national product (GNP) in 1960 and 17.6 percent in 1973. The three leading classifications of these expenditures are social insurance (\$86 billion), education (\$65 billion), and public aid (\$28 billion). Lesser amounts are listed under health and medical programs, veterans programs, "other social welfare," and housing. In addition to these public expenditures, there is a growing set of private transfers to persons in the form of such things as pensions, health insurance benefits, scholarships and charitable grants. This battery of public and private transfers, in cash and in-kind, is financed by taxes, which, in some cases, are designed to further certain transfer purposes, and by private contributions. The public and private components of this American system of transfers now take in and pay out an amount equal to almost one-fourth of GNP. And that share seems destined to grow.

The scope and scale of this system have grown particularly rapidly since 1964, starting with the introduction of medicare and medicaid and federal aid to elementary and secondary education, and continuing in more recent years with other innovations as well as with the expansion of existing programs. I will, in this paper, point to a few of the more remarkable changes of recent years. The changes selected for discussion were all designed to concentrate their benefits on families in relatively

low-income status. They all have to do with the income-conditioning of benefits, a practice which is now surprisingly popular.

### Three Recent Changes

Supplemental Security Income (SSI), which goes into effect January 1, 1974, is our first nation-wide negative income tax. Perhaps it is the second such plan in the world, following the British Family Income Supplement of 1971. It covers only the aged, blind, and disabled, but it does establish near-poverty-line guarantees (\$2500 for a couple) in all states and it sets uniform rules for determining eligibility and benefits. It will be administered by the Social Security Administration and financed out of general revenues. States must contribute enough to maintain present guarantees for current beneficiaries and are encouraged to add to SSI levels for new recipients. The guarantee is reduced dollar for dollar by all but the first \$20 per month of non-earned income (including social security benefits) and by 50 percent of earnings after the first \$65. In other words, after certain set-asides, the implicit tax rates are 100 percent on non-earned income and 50 percent on earnings. This will produce break-even points in the neighborhood of \$6000 for a year for those couples with earnings. There is no work test and no relative responsibility test, but there is a resources test.

SSI will add about \$3 billion of cash income to low-income families and individuals in its target categories. This will fill a substantial part of the poverty-income gap which was about \$10 billion in 1972 and is probably less in 1973. However, this effect is somewhat muted by the withdrawal of eligibility for foodstamps on the part of those claiming SSI.

A second notable change is the liberalization of Aid to Families with Dependent Children (AFDC). The 1967 Amendments specified that the tax rate on earnings cannot exceed 67 percent. Researchers find that because of the set-aside of \$30 a month indicated by federal law, and because of the practice in some states of ignoring earnings that bring total income up to stated standards, and because of deductibility of work expenses (a favorable ruling requires deduction after the 67 percent tax rate is applied to earnings), and because of variability of rent allowances, the tax rate is rarely as high as 67 percent. This means, of course, that break-even incomes are substantially higher than guarantees. AFDC has also been liberalized by court rulings outlawing rateable reductions in benefits to extend a fixed-sum appropriation through a benefit period, state residence requirements, and state rules on the issues of "a man in the house" and the non-adoptive step-father, as well as the earlier practice in some states of counting "expected" but not actually received contributions from relatives. All of these changes, plus a less harsh stance by administrators and, perhaps, a decline of stigma associated with receiving AFDC benefits, have contributed to a close to 100 percent take-up by eligibles, if we are to believe Census reports of numbers and income of broken families. This remains true in spite of the Talmadge Amendment of 1972, which mandated a work test for mothers whose youngest child is six years of age or older.

AFDC guarantee levels have varied widely from state to state, with the highest-paying states' guarantees running six times above those in the lowest. However, the advent of the foodstamp program has served to reduce this variation. AFDC cash plus foodstamp bonus values now

yield guarantee levels for a family of four of \$2316 in Mississippi and \$5046 in Hawaii, i.e., a difference of only about two to one. Similarly, the availability of foodstamps for working poor families diminishes the gap between what a low-wage earner can provide for his family and what they would get if he deserted and let them go on AFDC.

The third remarkable change in our system of transfers is the evolution of foodstamps into a major program. The foodstamp schedule which goes into effect on January 1, 1974 has a guarantee of \$1704 for a family of four, a set-aside of \$360 as well as deductibility of taxes paid and of certain working expenses, and a tax rate of 30 percent, leading to a notch where \$288 worth of benefits are lost, down to a break-even point of \$5676. This schedule is to be operational in all areas of the country by next July. This year, about 12.5 million people have benefited from the program, but the higher benefit schedule and the mandating of it nation-wide, will make more than 30 million people eligible, in spite of the fact that most SSI recipients are not eligible. Hence it is a second nation-wide negative income tax, but, in this case, one with benefits in kind. It can be argued that some part of the \$5 billion to \$10 billion of foodstamp bonuses of the expanded program should be counted as reducing the poverty-income-gap.

All the bonus values going to those with money income below poverty lines would be relevant to this consideration if one could affirm that foodstamps are as good as money, which they are when people would spend at least as much on food as they can claim in foodstamps. This is roughly the case at poverty-line incomes (the poverty-line for a family of four is now \$4300) and above. The monthly foodstamp allotment for a family of

four is \$142. If such a family has a money income of \$375, their foodstamp bonus is \$38, which yields a total income of \$413. At that level of income they are likely to spend \$142, or one-third of income, on food. On the other hand, at very low levels of cash income this is not likely to be the case. For example, at \$100 of cash income the full foodstamp allotment of \$142 would cost the family \$25. A family in that situation is unlikely to want to devote \$142 out of their full income of \$217 (\$100 cash plus \$117 of foodstamp bonus), that is, two-thirds of their income, to food. Hence, they are likely to bootleg part of their stamps or food and to lose something in the process, or to buy something less than their full allotment of coupons. The fact that these calculations are based on monthly rather than annual income means that foodstamp benefits are worth more to a family with income that varies from month to month than to one with a stable income.

Even with those limitations, foodstamps will serve as a useful supplement to income for many working-poor families. The low guarantee (relative to the average AFDC guarantee) is partly justified on the ground that intact families (unlike single-parent families) have the option of taking income in the form of home-produced child care at the same time that they get income from the market. As we noted, foodstamps also serve well to narrow the interstate variation of AFDC benefits. However, they heighten the disincentive problem for those on AFDC. Since the foodstamp formula takes account of AFDC benefits, the 30 percent tax rate implicit in the foodstamp schedule does not simply add to the 67 percent rate in AFDC, but it does produce a combined rate of about 77 percent on earnings. Even though, as we noted above, the actual rates of tax in AFDC are below the nominal rates,



it is unreasonable to expect that large numbers of welfare mothers are going to work voluntarily in this situation, especially if they have any unreimbursed work expenses. Even deductibility of child care cost will leave some part of that cost as a tax on earnings. Hence, a woman will have to earn a considerable amount before her "disposable income," net of payment for child care, is equal to the guarantee at zero earnings, in which situation she consumes her own home-produced child care.

There are intriguing questions of equity here. Some single-parent families with earnings below AFDC break-even levels (which range up to \$8000 and above in some states) are ineligible for AFDC help because their earnings are above the guarantee level. (The H.R.1 Family Assistance Plan would have corrected this anomaly.) This produces understandable claims by those excluded from AFDC for help in meeting their child care costs and Congress has responded by liberalizing income tax deductions for child care and by pushing for direct government provision of day care on a sliding scale of benefits, with partial subsidy extending above median family income levels. Currently, federal support of day care runs to about \$2 billion a year, with added amounts via welfare deductibility and tax deductibility of day care cost, paid by families.

#### Cumulation of Tax Rates

However, to return to the incentive issue, the fact is that AFDC, foodstamps, and the unreimbursed portion of work expenses, leave many welfare mothers, who are now the majority of women heading families with children, living under a regime of 100 percent implicit tax rates. This is without taking account of medicaid, which varies considerably from state to state, but which has inequitable and disincentive features

in it. The Nixon Administration, according to newspaper reports, is going to propose again what they did in 1971, namely, the nationalization of medicaid and a more orderly income-conditioning of its benefits without regard to welfare status. However, a family would lose eligibility if the head is regularly employed fulltime, in which case they would have the lesser protection of compulsory private insurance contracted for by the employer. Apparently, the medicaid guarantee for a family of four would be on the order of \$1000 in insurance terms. This would be accompanied by a zero tax rate on incomes up to a certain low level, with co-payments functioning as an implicit tax rate beyond that. So this solution to the "medicaid mess" would still leave medicaid with a share in the cumulative tax rate burden.

The Administration is also considering another variant of a negative income tax in the form of an income-conditioned housing allowance, in which the guarantee would vary by family size and also by locational difference in the cost of decent housing. Moreover, the Administration has pushed for, and the Congress has authorized but not yet funded, a negative income tax in the form of Basic Opportunity Grants (BOG) for college students. The guarantee is equal to one-half the cost, including living costs, of attending a college, up to \$1400. Beyond certain set-asides, the tax rate is 20 percent if the student is a family dependent for income tax purposes, and 75 percent if he is independent. The break-even income level for a family of four with a dependent student is above \$10,000; it is \$2300 if the student is independent.

Let us assume that the proposed revision of medicaid, the housing allowance, and the BOG program all come into being and take their place

alongside income-conditioned child day care, foodstamps, AFDC, and SSI. Some beneficiaries of some of these benefits will at the same time be paying payroll and income taxes and will be bearing unreimbursed work expenses. As we indicated before, AFDC recipients will typically confront cumulative tax rates of 100 percent or so in certain income ranges, even without reference to medicaid, housing allowance or BOG. But what about low-income people who are not on AFDC or SSI? They will face the 30 percent tax rate in foodstamps; a tax rate of, say, 20 percent in the housing allowance; possibly, depending upon employment status, a 20 percent rate in medicaid; and, depending on circumstances, some combination of tax rates from among the following: child care benefits, BOG, unreimbursed work expenses, payroll taxes, and income taxes. Hence, it would appear that many working poor and near-poor family heads will face cumulative tax rates well above 50 percent in certain income ranges and at certain stages in the life cycle. Thus, we would seem to be on a collision course with the expectation that most people should have strong monetary incentive to work.

Let me re-state what the cumulative tax rate problem is. If the same earnings are taxed twice by, say, a payroll tax and an income tax, the two tax rates are added together to determine the combined tax rate. But here we are also talking about implicit tax rates, that is, the rates of reduction of a cash or in-kind guarantee. If there are two such guarantees, both subject to a 50 percent tax rate, and if the break-even points are the same, the combined implicit tax rate is 100 percent. As we have seen, the combining of positive tax rates and implicit tax rates, the latter associated with negative income taxes or income-conditioned

benefits, has gone some distance. There are only two basic ways to back off from the prospect of high cumulative tax rates. One way is to reduce the combined guarantee and the other is to extend the break-even points of some or all of the benefits. Neither is likely to be happily received by everybody. The first means reducing benefits for poor people; the second means raising taxes.

#### Ways to Reduce Combined Tax Rates

Ways to limit the combined guarantee include the following. Legislation can require that the benefit from one program be subtracted from the guarantee of another. Thus, social security benefits must be subtracted from the guarantee of SSI. Another rather clever way to limit the combined guarantee is to consolidate two programs by folding the current budget of an as-yet-undeveloped program into the proposed budget of another and producing a new combined guarantee which is actually less than the formulas would dictate. This seems to be how foodstamps were "cashed out" for SSI recipients. A different way is to count the benefits of one program as "income" in computing the benefits of the next. Thus, AFDC benefits are "countable income" for foodstamps. Another technique is to design benefits to avoid simultaneous receipts. Legislation could specify, for example, that anyone claiming foodstamps is ineligible for a housing allowance, or, legislators could simply anticipate that few families will claim income-conditioned pre-school and college aid at the same time.

The other basic tactic for avoiding high cumulative tax rates is to extend break-even points of one or more of the benefits. Set-asides, disregards, and deductibles will accomplish this. Another way is to simply not income-condition the benefit at all and to let the break-even

point be determined by the tax system. The model here is public education. Perhaps the next best candidate for this kind of treatment is medical care benefits. A way to at least confuse the break-evens is to use a different income accounting period for each benefit. Some may use a month, some a quarter, some a year. BOG would use the income of the prior year as the base for the current year's benefit. The British Family Income Supplement uses an estimate of future earnings as the base. Still a different way to extend a break-even is to allow considerable flexibility in the definition of the "family" whose income is to be counted. Congress tried to confine college students applying for food-stamps to the families who claimed them as income tax dependents, only to have the Supreme Court find such a restriction in violation of Constitutional due process. (See U.S. Department of Agriculture v. Murry, 41 LW 5099, U.S. Sup. Ct. No. 72-848, June 23, 1973.) It would seem likely that this same reasoning would apply to the income tax dependency test in the BOG scheme. If it were, many college students from affluent families would go "independent" and claim the maximum grant. This would only be an extension of a profound trend in welfare law toward narrowing family responsibility. SSI cuts the few remaining legal ties between children and their aged parents. Note that in the cases cited, guarantees and nominal tax rates are unchanged, but people behave in such a way as to increase the number of beneficiaries and the cost to the treasury. High cumulative tax rates will encourage such behavior.

The set of in-kind income-conditioned benefits now in place and on the horizon seem to leave little room for a cash benefit for the non-categorical or working poor. Even a plan with an implicit tax rate of about one-third--like the McGovern plan or the proposed British tax

credit scheme, which, incidentally has no guarantee for those earning less than one-fourth the average wage--would appear to be rivalrous with foodstamps, medicaid, a housing allowance, and other benefits and positive rates we have mentioned. Some have advocated an earnings subsidy as a way out of this problem. Thus, the Senate recently passed a bill to refund to workers the social security tax (both that paid by the employer and the employee) on earnings up to \$4000 (at that point the refund would equal \$400) and to diminish the refund to zero at \$6000 of earnings. This would offset to a minimal degree the cumulated tax rates listed above with respect to earnings below \$4000, but would introduce a new implicit tax rate of 20 percent between \$4000 and \$6000 of earnings. Another "way out" is a wage rate subsidy, but that is not easy to confine to poor families, it sets up disincentives to taking jobs at higher wages, and it is difficult to administer. Both an earnings subsidy and a wage rate subsidy are antithetical to deductibility of child care expense. The alternatives of subsidizing private employers or public agencies to create jobs for the poor have at least as many problems as earnings and wage rate subsidies.

#### A Concluding Comment

The recent moves toward more income-conditioning of benefits mean, it seems to me, that advocates of a simple, straight-forward negative income tax with a moderate tax rate in it are caught between a rock and a hard place. They may wriggle out of the difficulty by designing a negative income tax with very low tax rates or by shifting over to an earnings subsidy (which means negative rates). Or, they may try to cancel out or consolidate guarantees or extend the break-evens of some of the non-cash

income-conditioned benefits. Stating the alternatives this way is to indicate my belief that we are approaching the outer limits of income-conditioning.

The practice of confining benefits to low-income families is based upon what might be called the doctrine of minimum provision. As we have seen, it seems to have its own internal dynamic. If minimum provision is assured for education, why is it not also for health care, food, housing, pre-school child care, higher education, legal services, and yet other goods and services? The level of minimum provision is often set well above the level that families with median income will voluntarily consume, e.g., federal standards for child care. The only restraints on this dynamic appear to be unwillingness to tax the non-beneficiaries in order to fully fund the high standards for all eligibles, and concern for high cumulative tax rates on beneficiaries.

The next phase in the development of the American system of transfers may see a greater emphasis on two other doctrines that power the growth of the system. These are the doctrine of sharing income loss and the doctrine of sharing in extraordinary expenditures. The recent emphasis on income-conditioning may turn out to be only a chapter in a longer book.

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## REFLECTIONS ON RECENT HISTORY

James Tobin

When I first became interested in the negative income tax (NIT) in 1964, I had some hope of seeing it adopted but not very much. The Johnson Administration was divided, but generally unfriendly. H.E.W. was committed to gradual improvement of social insurance and existing programs of categorical assistance. The "war on poverty" was supposedly attacking the educational, economic, and social causes of poverty. The Council of Economic Advisers and Budget Bureau could not have found the money for a negative income tax even if they had been thoroughly convinced of its merits.

Nevertheless there were signs that it was an idea whose time was coming. As the press, the public, the Congress worried more and more about welfare reform, the NIT inevitably came to their attention. Although the NIT is naturally an economists' idea, it began to appeal to some professional social workers disillusioned with categorical public assistance. Two or three Congressmen actually introduced NIT bills.

President Johnson postponed decision, and presumably stilled the disagreements of his advisers, by the customary device of appointing a Commission. Chaired by Ben Heineman, the President's Commission on Income Maintenance Programs diligently studied poverty and public assistance in the United States and came out for a negative income tax. The report is excellent in all respects, but President Johnson was not on hand to receive it and his successor was not greatly interested in the findings of a lame duck commission.

President Nixon was getting advice elsewhere, notably from Patrick Moynihan, his first counselor on domestic affairs. In the debate during the previous four years, Moynihan had advocated universal children's allowances and had not been deterred when I and others pointed out how costly and wasteful it was to give money indiscriminately to rich children and poor. Now in the White House, face to face with budgetary realities, he designed and sold the Family Assistance Plan, a reform of the welfare system based on some of the principles of NIT.

There were many objectionable features of FAP in its several incarnations: income guarantees inadequate, marginal tax rates too high, childless couples and single adults excluded, rules and administration not integrated with income tax, excessive power left to states. The work-ethic rhetoric which the Administration used as a smokescreen to conceal the fact that it was advocating guaranteed income was disingenuous and often disgusting.

Nonetheless I would have voted for FAP as a step forward, hoping it would not be the last step. I don't know whose fault it is that FAP never got through the Senate. Probably there is blame enough for everyone, both the liberals whom Moynihan scolds and the conservatives whom the White House often appeased but never delivered. It is quite evident that with Moynihan in Cambridge or New Delhi and the lessons of the 1972 campaign learned, the Administration was only too happy to drop the whole matter.

Now, in 1973, the negative income tax no longer seems like an idea whose time is coming. Maybe its time is past, its tide in the affairs of men ebbed. In the United States, that is. Meanwhile the Conservative government in the U. K. is about to implement a system of cashable

tax credits, against the opposition of the Labour party. Here in the United States the Presidential campaign of 1972 was, of course, a dreadful setback.

What lessons can we learn from the dismal legislative and political history of tax and welfare reform in recent years?

First, Presidential candidates, especially those challenging an incumbent, cannot write tax legislation during campaigns and should not try. They should confine themselves to critique of the status quo and to general principles of reform. Specific proposals are terribly vulnerable, and the arithmetic of taxes and redistribution is hopelessly confused in campaign rhetoric. Senator McGovern's famous thousand dollar demogrant was originally advanced in the spring of 1973 simply as one of a number of interesting possibilities. Little attention was paid to it until Senator Humphrey made it an issue in the California primary. McGovern then put himself on the defensive by embracing the idea and the specific number much more tightly than he ever had before. Unfortunately his defenses were thin. His staff had developed his ideas on tax and welfare reform with minimal technical assistance, and they improvised confusing and erroneous answers to the many specific and arithmetic questions which arose in the California campaign.

Only afterwards was serious work undertaken to design proposals to carry out the candidate's intent and to demonstrate that his basic proposal was financially feasible--though not, of course, just by closing upper-income tax loopholes, as he and his staff sometimes seemed to be saying. The serious designs were too late to undo the political damage, which may have been compounded by the candidate's eventual inglorious

withdrawal from the whole issue. In the process, lasting damage was done to the cause which was so inexpertly championed. It will take time and patient persuasive effort to convince people that income guarantees, demogrants, cashable tax credits, negative income taxes, and all that are not crackpot ideas.

Second, I fear one must conclude that the probabilities are against enacting in one magnificent stroke a comprehensive package of tax and welfare reform. The rhythm of American politics seems to provide legislative majorities for sweeping change and redistribution no more often than once a generation. Consider the periods of drought between the first Wilson administration and the New Deal, and between the New Deal and Johnson's Great Society Congress, whose promise was tragically ended by the escalation of the war in Vietnam.

Proponents of tax reform, discouraged by reversals suffered in the horse-trading negotiations of piecemeal reform, often dream of starting over again from zero. They observe that less than half of national personal income is federally taxable, one obvious reason why tax rates are high. Let everyone toss in his privileges, exclusions, exemptions, deductions, and take his chances on a simple tax on a comprehensive base, with cashable credits for all adults and children. In theory there is a latent majority coalition for a new social financial contract of this kind; winners would be much more numerous than losers. But in practice that coalition has yet to be mobilized. It is too easily splintered by internal conflicts of interest: families versus single individuals, small families versus large; renters versus homeowners; young versus old; poor versus near-poor, and so on.

The normal rule of tax reform is that almost nobody's taxes can be increased. I say "almost" because some loopholes and privileges are so notorious that they are fair political targets. But the list is pretty short, and the revenue involved pretty small. Any major redistribution through the tax system requires cutting into some widespread tax concessions, not generally perceived as outrageous or even unfair. Examples are the favorable treatment of capital gains, philanthropic contributions, and home ownership. Even if these and other erosions of the tax base could be repaired, a major redistributive tax reform requires higher tax rates, and greater liabilities for many taxpayers. Citizens who might accept higher tax liabilities for war or some other substantive national purpose will resent them deeply when they are being openly redistributed to other citizens.

This is why Senator Humphrey's secretary was so damaging to Senator McGovern's demogrant proposal. In a nationally televised California primary debate, Humphrey pointed out that a single secretary earning \$8000 a year would pay \$567 more in taxes under McGovern's proposal; the higher tax rate would more than offset her \$1000 demogrant.

It was not clear how Humphrey had made this calculation, since no specific McGovern proposal had been set forth. But, although the example may have been exaggerated, it was qualitatively correct. The demogrant proposal did involve a horizontal redistribution from single individuals and couples to large families, along with a vertical redistribution from rich to poor. Never mind that the illustrative secretary was rich as single individuals go--in the upper 17 percent of such persons in 1970. Never mind that she personally would, thanks to salary increases, be better off than in 1970 in after-tax income in 1974 or 1975, whether or

not the McGovern reform was adopted--though of course better off it if was not. The normal growth of after-tax income, with constant tax rates and rules, is not regarded as fair game for additional taxes. The public image was that an ordinary working girl with an income barely in four figures would be unfairly burdened.

Under these political restrictions, the best that a redistributionist can hope for is to claim some share of the annual fiscal dividend--the growth in revenues from existing taxes. This is not easy because of the intense budget competition for those funds. With the fiscal dividend, it is possible to decrease the taxes of the poor and to increase their negative taxes, without explicitly damaging Senator Humphrey's secretary or any other taxpayer. The damage to them in tax reductions foregone is a much smaller political obstacle.

The Moynihan-Nixon Family Assistance Plan is an example of incrementalist strategy. However, it was not a strategy which would lead gradually to a more fundamental reform. Even when we are confined to small steps, we should be following a path that leads somewhere. In particular, I think it is desirable to begin making reforms within the framework of the federal income tax, so that we are not forever stuck with a dual system, welfare for the poor, the income tax code for the rest of us.

In this spirit, I would suggest beginning to convert exemptions and deductions into tax credits, cashable to the extent that they exceed tax liabilities. One step, for example, would be to convert personal exemptions of \$750 into cashable credits of \$375; since almost no one is subject to a marginal tax rate greater than 50 percent, almost no one would lose. The credits for adults could then be gradually increased.

In a similar vein, the standard deduction and homeowners' deductions could gradually be transformed into cashable credits. Cashable credits would gradually take the place of public assistance, and in time an integrated system would evolve. Meanwhile, the working poor and near-poor, who are short-changed by our present welfare and tax systems, would be getting the better breaks they so greatly deserve.

Third, a solution must be found for the pyramiding of actual and implicit income tax rates. Benefits under a host of federal and state programs are scaled to income: public assistance, medical care, rent subsidies, food stamps, educational grants, and more. To the marginal income tax rates implicit in these programs may be added regular income taxes and the ever-increasing social security on earnings. As a result it is easy to display horror cases where the earning of an extra dollar of income costs a family more than a dollar in benefits lost or taxes due. These cases, or less dramatic examples damaging to work incentives, would be more frequent under any welfare reform--whether F.A.P. or N.I.T. or demogrants--which would increase the number of families eligible for income-tested cash assistance along with various in-kind benefits. The Senate Finance Committee's ostentatious discovery of this fact was one of the nails in the coffin of F.A.P. It seemed a miscarriage of justice to place the blame on the cash assistance proposal rather than on the proliferation of uncoordinated in-kind programs. Be that as it may, the problem must be faced more squarely than in the past.

The sweeping solution is to supersede in-kind programs with the cash program. In-kind programs like rent subsidies might continue, but the value of the housing benefits would be subtracted from cash benefits

due, even if the net result was that the family owed tax. A less drastic solution would charge less than 100 percent of in-kind benefits against entitlement under the cash program. If 80 percent of an in-kind program were charged, that program would add only 20 percent of its implicit tax rate to the overall marginal tax. Escalation of disincentive rates can also be mitigated by treating various assistance programs sequentially, including in the income that determines entitlement to the third kind of assistance all the net benefits received from assistance programs numbers one and two.

Fourth, no new system of federal income guarantees can be expected to finance the benefits which some recipients of public assistance receive in the most generous states and localities. Let the best not be the enemy of the good: It is just not economically or fiscally feasible for New York or Connecticut AFDC benefit levels to be universalized across the whole nation to all categories of families. Sometimes a negative income tax is dismissed on this account--if it can't even provide income guarantees equal to the best current welfare benefits, what good is it? The answer, of course, is that the income guarantees would benefit millions throughout the country who are not eligible for those higher welfare benefits.

It can be argued that there is in equity an obligation not to reduce the benefits of existing welfare clients. Recognizing this obligation, the federal government should meet the costs. But equity in this sense dictates a grandfather or grandmother clause for individuals, not for categories of individuals or for states and cities. There is no federal obligation to perpetuate existing geographical inequities in welfare



benefits, which are in any case an incentive for uneconomic migration and location. Of course, any state or city can in its own discretion finance its own cash assistance program or negative income tax.

Fifth, the public's fears that their hard-earned tax dollars may support malingerers and loafers must be allayed if any national system of income guarantees is to be acceptable. It is not enough to build work incentives into the system, in the form of income "disregards" and tolerable marginal tax rates. It is not enough to cite the New Jersey experiment and the other voluminous evidence that there are precious few people who enjoy living idly on handouts. It is not enough to point out that the hard pressed middle income taxpayer should direct his outrage to the idle rich who pay less taxes than they should rather than to the idle poor. Public opinion just won't accept a system under which ablebodied adults may loaf at government expense, and there are bound to be a few examples of some who do.

Various devices--e.g., registration for work at a local public employment office--have been suggested and debated. I believe a suggestion by Harold Watts had merit. Let part of the income guarantee (or tax credit) available on account of an adult of working age be contingent on a declaration, under the usual penalties for false statements on tax returns, that he or she was engaged in one or more of the following activities: gainful employment or self-employment, job-seeking, child care and housekeeping, schooling, unpaid volunteer public service. This requirement would not discriminate against the poor; everyone who claims this tax credit, whether he takes it in cash or in reduction of his tax liability, would have to meet the requirement. Nor would a whole

family be penalized for the delinquency of one of its adult members; the benefits or tax credits due to the other adults and children would continue.

Sixth, the general public also resents supporting the children of fathers who have deserted them. Men and women who fulfill their own responsibilities as parents don't wish to be burdened with expenses left behind by parents who have abandoned these responsibilities. Worries on this point have some foundation, as indicated by the continuing growth in the number of dependent female-headed households. Current welfare programs contain provisions for seeking out absent fathers and requiring them to contribute to the support of their deserted children. But these provisions have never been very effective. It is fair to say that they have not been popular with social workers, who have seen them as an authoritarian and punitive attempt to impose bourgeois values on the poor. There is justice in the suspicion, but it is unfortunately no trivial matter if the society ends up supporting millions of deserted mothers and children whose fathers are earning comfortable incomes elsewhere.

A possible answer is to assess an extra tax on the income of an absent father or mother for every child he or she is not supporting--unless of course the obligation has been undertaken by a step-parent or foster parent. To enforce this penalty it would be necessary to assign children social security numbers at birth and to associate them with the numbers of their parents. These social security numbers would also be the basis for claiming NIT benefits, tax credits, or dependents' exemptions on account of children; they would prevent the same child from being claimed as dependent in more than one family.

## DISCUSSION

Alice M. Rivlin

Whoever asked three economists and a social worker to play "historian for a day" was a brave man. Inevitably, he has elicited three very different interpretations of the meaning of recent events for the future of income maintenance and welfare reform.

Professor Tobin, in his new role as current historian, reflects on "the dismal legislative political history of tax and welfare reform in recent years." He is concerned with why there has been so little reform and offers six lessons from history, which are mostly prescriptions for what not to do next time. Professor Lampman is more positive, emphasizing the big changes that have occurred in the last several years. But he sees the changes as raising new problems and sounds anything but optimistic about the future.

History is only "dismal" if one expected more rapid progress. Personally I have been struck with how far we have moved, both intellectually and politically, toward a workable income maintenance system since the problem surfaced in the mid-1960s. Let us go back to 1966, which was after all only eight years ago. Looking around in that year, one would have seen a creaky welfare system, designed thirty years before for very different problems, coming under nearly universal attack. The AFDC program, which had been designed to handle the "temporary" problem of widows and orphans not yet covered by social security, was growing rapidly and unexplainably. Families on welfare were subject to 100 percent tax rates, almost no aid was available for families with a male

head, and the strictness of the welfare categories was maintained by a man-in-the-house searches.

The academic economists had diagnosed the problem and come up with a neat solution. They wanted to replace the whole welfare system with a negative income tax, which would guarantee everyone a minimum income based on family size and preserve incentives to work by reducing the benefit payment substantially less than one dollar for every dollar earned. The negative tax seemed to solve the problem of poverty, work incentives, and family break-up all at once. It was a clean, attractive, utopian scheme and most of us, like Professor Tobin, "had some hope of seeing it adopted, but not very much." We thought there would be plenty of time to design, carry out, and analyze a negative income tax experiment before serious consideration need be given to drafting legislation.

President Johnson was not at all interested in the negative income tax. I don't think he ever explicitly rejected it; he just did not think that anything with so little appeal as welfare reform was worth thinking about. Then came the 1968 election. Those of us who had tried and failed to sell a Democratic Administration the basic idea of welfare reform assumed the jig was up, at least for a while.

But we were wrong. In the next four years events moved much faster than any of us thought possible. A Republican President proposed a basic welfare reform which looked very much like a negative income tax, and the Congress took it seriously. Indeed, considering that it was a new idea stemming from a President of the opposite party the Congress gave the plan a remarkably warm reception. The Family Assistance Plan passed the House of Representatives twice and could have passed the Senate had

an ambivalent President not changed his mind in the middle of a reelection campaign. Perhaps in the heat of the election he realized that Johnson was right: there are no votes in welfare.

Professor Tobin professes not to know "whose fault it is that FAP never got through the Senate." In my opinion, although the arch radicals and the rabid conservatives deserve their share, the blame lies squarely with the Chief Executive for backing away at the crucial moment from the workable compromise worked out by Senator Ribicoff and then Secretary of HEW Elliott Richardson.

Despite these reverses, as Professor Lampman points out, the last several years have seen substantial steps in the direction of a universal income maintenance system which would eliminate poverty without discouraging work. The AFDC program has been liberalized. The Supplemental Security Income Program (SSI) is essentially a negative income tax for the aged. The Food Stamp Program now has universal federal standards and has grown into a kind of negative income tax in-kind, available to the working poor as well as to people in the welfare categories.

My own view of history is somewhat Tolstoyan--great battles won or lost because a single soldier picks up the flag and runs the right (or the wrong) way at the crucial moment. If President Nixon had supported the Richardson-Ribicoff compromise and the Family Assistance Plan had become law, perhaps Professor Tobin would be remarking with surprise on the rapidity of progress.

Perhaps, however, he would not have been optimistic even if FAP had passed, since he saw FAP as incrementalist, "not a strategy which would lead gradually to a more fundamental reform." He believes that

true progress in the income maintenance area must involve reform of the tax system and that both transfers and taxes must be handled under a single system by the Internal Revenue Service.

I disagree. I believe it is possible to have a dignified well-run income maintenance system administered by an agency other than the IRS. The new SSI system, administered by Social Security, does not seem to be obviously inferior to a negative income tax for the aged administered by IRS. The administrative problem of running an income transfer system for low income people is quite different from that of collecting a positive tax. The accounting period had to be shorter, different kinds of information have to be collected, the definition of income may have to be different. Hence, forms and procedures will have to be different for negative than for positive taxpayers even if the same agency administers both programs.

Indeed, I would suggest that recent history may yield a seventh lesson; namely, that the strict tax approach to income maintenance has almost zero political appeal. To be sure, its proponents have not explained it adequately (even to presidential candidates) and should try harder. Nevertheless, it must be recognized that enthusiasm for coupling the positive and negative tax systems remains low, especially in the corridors of the Internal Revenue Service.

But the most important lesson of the recent history seems to me that economists and other policy analysts simply have to work harder on policy problems if they are to come up with practical solutions. Solving the income maintenance problem will require more than coming up with neat sounding proposals. It will be necessary to think these

proposals through carefully, to explore how they would relate to existing programs and how they would be administered. We are all a lot wiser now than we were in 1966. We know a lot about messy things like the problem of cumulative marginal tax rates and the crucial importance of accounting periods. We are all too aware of the equity problems created by the fact that any program which relates "need" to family size results in substantial transfers from small to large families with the same income level.

I am not saying that the policy analysts of 1966 were politically naive--worse than that, we were technically naive. We were like theoretical physicists trying to build a bridge or a bomb. We simply did not understand how complicated practical problems were. Now that we do, perhaps progress will be faster.

## DISCUSSION

Alvin L. Schorr

As members of this panel know, I have long thought the negative income tax an ill wind that no one, no matter how dedicated, would blow good. I was, therefore, from a fairly early point, opposed to the President's welfare reform. But I am heartened by Professor Tobin's and Professor Lampman's papers which forego arguments about "who did what to whom," to extract lessons from the experience of the last few years. And they are, as usual, thoughtful and practical. So we begin to move forward once more.

I would like to point to one lesson that is, it seems to me, implicit in Professor Tobin's paper, although at moments he seems to overlook it himself. That is, none of the income maintenance proposals that has recently been put forward is intrinsically efficient or inefficient. Tax credit, negative income tax, children's allowance, welfare reform: may be efficient or inefficient, depending on design. While he favors a tax credit, Professor Tobin rejects a children's allowance as inefficient. Yet a children's allowance, if it did away with the tax exemption for children, would probably be more efficient than a tax credit at the same payment level. Conversely, many economists have supported the negative income tax because of its presumed efficiency. Yet the Heineman Commission dutifully reported that a negative income tax with a \$3,600 minimum would be only 36 percent efficient.

So one perceives that a scale of incentive payments is one of various approaches to efficiency. Stigma and repressive administration have been a much favored method in practise, if not in conference papers. Trading off a proposed benefit against an existing tax benefit is a method common to the tax credit and children's allowance. Designing a program for a



population group that tends to have a large proportion of poor people is a fourth method and is, as it happens, a principle of social security. (For example, retirement insurance is about 50 percent efficient--in other words, retirement insurance is more efficient than a poverty-level negative income tax.) I am saying, in short, that if we test efficiency by inspection rather than by authority, we shall find a more versatile set of proposals open to us.

That is fortunate, in the light of the lesson that is Professor Lampman's carefully developed main point. That is, we have reached and perhaps exceeded the limits of income-conditioning. With tax rates from one program pyramiding on others, incentive to work in any of them may be quite wiped out. Indeed, other problems arise before the problem of incentives. With the proliferation of regulations that relate one program and benefit level to another, they all become confused. That was the fate, in simpler days, of the AFDC work incentive that Professor Lampman discusses. HEW financed (and suppressed until welfare reform had died anyway) a large-scale study that shows that many recipients did not respond to those work incentives at all. Why not? It seems that neither they nor their income maintenance workers understood the calculation or believed they would really benefit. Nor, some months after researchers had carefully explained the incentives, did they prove more effective. Indeed, I believe that even today investigation would turn up many localities that have never implemented that particular 1967 amendment. They are on an undeclared strike against legislation they fail to understand or regard as hopelessly complex. If even more income-conditioned programs are developed or if we attempt to subordinate the tax rate in one to another, as has been suggested, I suspect that would compound the confusion.

I do have a suggestion regarding this particular problem. It arises out of the observation that pyramiding is not a function of payment arrangements but only of the effort to recapture earned or "excess" income. In other words, it is not paying out, no matter how many programs are involved, that creates the problem, but taxing back or, as the usually understated British say, claw-back. Suppose we relied solely on the graduated income tax for claw-back, and paid out in as many or as few separate programs as we like--simply taking pains to make all payments taxable? That would be quite workable and a great simplification. The problem, of course, is that public assistance, food stamps, and all the rest have much higher rates of taxation than the income tax at comparable levels. So this complex, probably unworkable system of incentive arrangements and taxation of benefits exists mainly to protect a specially high tax rate for the poor. It is too bad we cannot trifle with that, for otherwise we should have had a solution to this problem.

I have so far offered comments in terms that may interest economists. In this matter of income-conditioning, however, I believe that social issues are far more significant and will have longer term consequences. Our educational system has tended to confine the children of poor people to poverty. In housing and neighborhoods, we separate economic classes more than other industrialized countries. It has lately been argued that we are developing two distinct labor markets. And here, in a transfer system that disposes of almost a fourth of GNP, we also see the deepening of a dual system. It goes without saying that the educational system, residential arrangements, the labor market, and the transfer system interconnect. With all linked and going in the same direction,

we may be developing the permanent underclass of which Gunnar Myrdal once warned--a true duplex society.

A duplex society is not desirable in any country. In the United States, with our ideology of social mobility and with the racial overtones that class divisions carry, it is explosive. Education, housing, and employment are not our subjects here, and their policies may be more difficult to manage. But transfer policy is directly subject to manipulation. There at least we shall turn away from income-conditioning if we want a nation that is at all at peace with itself, as well as for the reasons that Professors Tobin and Lampman have offered.

Before I leave income-conditioning, let me speak directly to Professor Tobin's suggestion of a work declaration. He proposes it, I believe, not so much because it is intrinsically desirable but because he thinks the public thinks it is. The work test he has borrowed from Harold Watts seems so broad as to exclude no one, probably by intention. Who, being otherwise idle, cannot at the least claim to be doing volunteer public service? But the interesting thing is that such a declaration is not required to take a tax exemption under current law, and Professor Tobin understands better than I that an exemption and a credit are the same money. Then what is different? Why, in our heads we understand that we would be giving these \$375 payments to a number of people who are too poor to pay income tax as well as to all the rest.

I will make my point about this in a moment, but should say a word about taxing non-supporting fathers. I have no desire to defend social workers--we must be almost as guilty as economists of having failed the nation in these desperate years--but social workers are not the reason fathers don't support. If some institution must be found responsible,

it may be the courts and prosecutors. One must say in their defense that they don't enforce support because they find it unreasonable to do so. Most separated and divorced men soon remarry and found new families, and few have incomes adequate to the support of both. (I remember the case of a man who was extradited from Maryland to Connecticut and jailed for non-support. The Connecticut prosecutor made a fine showing, and the second wife in Maryland promptly applied for AFDC--and received it.) In general, courts with the facts in hand order less in support than welfare departments, for example, tend to require. You may find that hard to believe, but it is so. I am trying to say that the problem about support--and it is a problem--lies in deep-rooted American patterns of child-bearing and marriage. It will not be dealt with by nuisance taxes or new administrative devices; and proposing them is not a serious way of treating the problem.

I talk about the work declaration and non-support in the context of income-conditioning because it represents a lesson that has, perhaps, not adequately been learned. That is, once we start to design transfer programs to regulate people's lives, we enter on a slick road to "the welfare mess." The President's proposed welfare reform should be an instructive illustration. It was designed by people who intended the simplest sort of income-tax-type administration. In the hands of Congress and lobbyists intent on dealing with the poor--or their idea of the poor--it took on a load of requirements about family relationships, work, training, and child care that could not have been administered at all, let alone simply. I hope you see my point here--that it is precisely the proliferation of these requirements--conceived by the mind-set of income-conditioning--that turns what we call a negative income tax into what we call a welfare mess.

But Professor Tobin's point is--certainly Professor Lampman's point is--that we should move on from income-conditioned programs. If we really grasp what that change means, we don't need all the talk about work and family breakdown that we have had--not to justify transfer program proposals, at any rate. One may think the public will require such discussion. I doubt that. I think the people sitting here lead the public, whether for good or error. In any event, we should give the public the benefit of our best thinking, without supposing that they will think the worst.

Such a view seems to me to be highly compatible with what I take to be the most important lesson that Professors Tobin and Lampman have gleaned. That is that we should keep our eyes on the whole transfer system. We are not, as Tobin says, forever stuck with a dual system. The tax credit he suggests would, at a wild guess, cost \$20 billion net. Yet it is only one element of a series of proposals that one would offer. As has been pointed out, they would have a practical advantage. We have learned that there is small chance of wiping out what we have and writing on a clean slate. If we have a versatile arsenal of measures, each of them calculated to favor people at the bottom of the income distribution, we shall have a better chance of succeeding over a period of time. And we shall have much more to succeed about!

I suppose my underlying point, which I think I take from Professors Tobin and Lampman, is that we are not dealing solely with anti-poverty measures in some simple sense. We are dealing with the distribution of income in the United States, and how it must be altered. It is a difficult, long-term struggle, but that is the struggle.