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ABSTRACT

In this paper, the equity assumptions implicit in categorical assistance and certain in-kind programs are contrasted with those of the negative income tax. How these two different viewpoints were expressed in legislative proposals and enactments during the past decade is shown. This history reveals growing awareness of the complexity of the equity issues involved and a pragmatic tendency to blend the two viewpoints and the programs they inspire.

CONCEPTS OF EQUITY IN THE DESIGN OF SCHEMES FOR INCOME REDISTRIBUTION

Equity issues arise at almost every stage in the design and redesign of schemes to redistribute income. Such schemes, by definition, take from somebody and give to somebody else. Both those taken from and those given to are concerned that the taking and the giving be fair or just or equitable. However, it seems that equity, like beauty, is in the eye of the beholder. One famous economist said that in matters of tax equity we are at sea without rudder or compass. Another concluded that equity is the mother of confusion. Still others have reasoned that economists could play a part in resolving distributional questions only if noneconomists provided them with a social welfare function. Some texts represent horizontal equity--equal treatment of people in equal positions--as being of a different order from vertical equity--unequal treatment of people in unequal positions--and hence, more amenable to consideration by the skilled economist.[1]

Despite all these caveats, academic economists have been active in the design and review of income redistribution schemes, and I propose to discuss some of the equity issues that have arisen in the last ten years of debate over the negative income tax (NIT). In particular, I plan to contrast the equity assumptions implicit in categorical assistance and in certain in-kind programs with those of the NIT, and to show how these two different viewpoints were expressed in legislative proposals and enactments during the past decade. This history reveals growing awarness of the complexity of the equity issues involved and a pragmatic tendency to blend the two points of view and the programs they inspire.

The controversies stirred up by academic economists have been aired in the halls of Congress and in presidential campaigns. Recent proposals put forward by Secretary Caspar Weinberger of Health, Education, and Welfare and by a subcommittee of the Joint Economic Committee of Congress (JEC) chaired by Representative Martha Griffiths assure us that these controversies are still alive.[2] During this same period, numerous measures of tax reform and provision of cash in-kind benefits have been adopted, including Medicare and Medicaid, tax deductions and welfare deductions for child care expense, a nationwide food stamp program, Supplemental Security Income, and emergency public service employment.

I. The Negative Income Tax as Part of a War on Poverty

President Johnson's declaration of a war on poverty in 1964 opened up the question of who are the people below some arbitrarily set income-poverty lines. These lines were set in terms of annual money income adjusted for family size and, hence, reflected some concern for vertical and horizontal equity issues. It was not long before questions were raised about what American income-maintenance institutions were doing to reduce income poverty and how they could be redesigned to do more in pursuit of that goal.[3]

One incongruity that stood out from the data on the poor was that most of those who were poor did not receive cash income-maintenance benefits. This was because eligibility was set in categorical terms. Yet, most poor people were not in families headed by aged, blind, or disabled persons nor were they in families broken by death or desertion. On the contrary, most were unattached individuals or were in intact families headed by non-aged, nondisabled men. Much of the cash benefits, which then totalled $35 billion, went to people who were not poor prior to receipt of benefits. Obviously the system was not targeted efficiently on those in income poverty.

Public assistance was the most target-efficient part of the system and had a much higher score in this regard than the social insurances (particularly, Unemployment Compensation) or the status programs (e.g., veterans' benefits). Nonetheless, economists singled out public assistance, particularly Aid to Families with Dependent Children (AFDC), as the devil in the piece, and proceeded to advocate as a substitute for it "welfare reform" in the shape of a negative income tax. An equally plausible response to the exclusion of the noncategorical poor would have been to add a new program specifically for the excluded group and to improve AFDC and other categorical benefits in the lowest paying states. Some so argued. What formed the powerful movement for negative income taxation, however, was the vision of a universal scheme to replace all the categorical assistances at one blow. This movement challenged the concept of equity in public assistance on the grounds of reasonable classification, asserting that income poverty was a basis for discrimination more relevant to the public interest than the traditional categories.[4] It also challenged assistance on the grounds that its 100 percent implicit tax rates, or benefit-loss rates, were both unfair and inefficient.

The NIT movement picked up momentum and gathered new equity issues as it went, challenging existing practice in virtually every corner of the income-maintenance field and eventually going so far as to suggest revising the whole structure and rate schedule of the individual income tax. It was rather like a new religion sweeping out of the desert to set right inequities perpetrated in pursuit of false gods that had dominated earlier efforts against poverty, insecurity, and inequality.

The reference point in the quest for equity was the federal individual income tax, which was seen as embodying the ideals, if not the practice, of vertical and horizontal equity.[5] Public assistance, with its multijurisdictional administration and with discretion in the hands of the case-worker, was pictured--in sorry contrast--as intolerably unfair and self-defeating. Few were willing to stand up and defend the old-time religion of public assistance[6] and prophets of NIT found themselves in a complex political alliance of "welfare-reformers," not all of whom pursued the same goals although they did share a lack of appreciation for public assistance.

The pure negative income tax idea was to achieve vertical and horizontal equity by simply turning the income tax upside down. While that might be acceptable as a way to distribute a relatively small amount of money, as would follow from a 14 percent negative tax rate against unused exemptions and deductions, it would not be acceptable if the guarantee were set near public assistance levels and the negative tax rate were set near 50 percent. The latter course would require new decisions about the <u>definition of income</u> (what about transfer income and other tax-exempt income?), the <u>family unit</u> (what about members of a nonpoor family filing separate returns?), the <u>income accounting period</u> (what about the reasons why public assistance uses a one-month period?), and the <u>method of paying benefits</u> (should tax with-holding have a symmetrical counterpart in prepayment of benefits and reconciliation of the account at the end of the year?). The concern for symmetry led some to advocate changes in the income tax. They asked, if it is fair to insist on, say, compulsory joint filing for NIT people, why not insist on it for positive taxpayers? It is doubtless because of this preoccupation with symmetry that few early writers had anything to say about child care and other work expenses and most assumed a single tax rate for all types of income of 50 percent or less. Few discussed a work test.

II. The 1967 AFDC Amendments and New In-kind Benefits

While designs were being drawn for noncategorical schemes of NIT, interesting things were happening to public assistance. The 1967 amendments to AFDC carried a clear signal that Congress was changing its expectations about work by women who head families. This was revealed by, among other things, lowering the nominal tax rate on earnings from 100 to 67 percent and, simultaneously, mandating that work expenses were to be deducted from countable income in calculating benefits. It was consistent to say that if women are to be urged to work, then their expenses of working must not unduly diminish their stay-at-home income. However, these and other changes raised breakeven levels of income and thereby contributed to the explosion of the welfare rolls.

Contemporary NIT literature reflected little awareness of these amendments and of their uneven implementation. I suppose it is fair to say that few contributors to that literature had much detailed knowledge of how public assistance actually worked. However, later writings show concern about a new "inequity" arising, in part, out of these amendments, in the form of relatively high total incomes (including reimbursements for child care) of people on welfare.[7] NIT was advocated as a way to bring these "excesses" under control.

Other significant developments on the income redistribution front in the 1960s include the introduction of Medicaid (1965), legal services for the poor (1965), direct provision of federally supported child care (1965), and major changes in the food stamp program (1967 and 1969). Medicaid eligibility, in some states, was noncategorical but benefits were income conditioned. The same thing was true of legal services, child care, and food stamps. Some of these new in-kind programs, following the tradition of public housing, had remarkable high guarantees and high breakeven points, often restrained only by highly inequitable notches in the benefit schedules. A pattern often followed is to set guarantee levels equal to "need" as the latter is envisioned by experts in health care or legal services or housing or child care and to follow with breakeven points well beyond poverty lines. This generous pattern is then offset by an appropriation that will fund--or a method of administration that will enroll--only a small percentage of all those nominally eligible. By NIT standards this is highly inequitable, but in-kind defenders say it is better to do "enough" for one than to do a trivial amount for a score. Do the best you can for a select few--that's fair if the cause is just--as opposed to doing an inadequate and ineffective job for a thankless mass. These few words are, perhaps, enough to indicate that some in-kind promoters start from a concept of equity quite opposed to that of NIT. We shall refer to this concept later when discussing public service employment.

Again, it was quite awhile before NIT advocates caught on to the significance of in-kind programs and to the need to confront their competing ethic.

III. Nixon's Welfare Reform Effort of 1969-1972

It seemed to some, in August of 1969, when President Nixon outlined his welfare reform scheme, that he had picked up the NIT flag and would carry it over the top, and with it, the NIT concepts of vertical and horizontal equity. However, by 1972, after two passages through the House and two re-designs by the Senate Finance Committee, the notion that cash benefits should be available to all, with only adjustment by income and family size, was lost in a maze. The product was mostly based upon the principles of AFDC as modified by the 1967 amendments. The House did adopt from NIT advocates the idea of a national minimum, the idea of dropping federal matching grants to the states, and the idea of extending cash benefits to intact families headed by employed persons. However, numerous categorical assistance principles were re-affirmed. For one thing, there were categories--the adult (aged, blind, and disabled) category, the non-eligible category of single persons and childless couples, and the family category. Families with children, whose per capita benefits were to be about one-half those of the adult category, were further divided with regard to expectations to work. A work test was required of all adult members of families except for mothers whose youngest child was under the age of six--or three--years (a provision further strengthened by the Talmadge Amendment of 1971). Failure to meet the work test would be followed by a reduction of the guarantee. Plans were offered to couple the work test with child care, training, and job creation. As the legislation proceeded, more money was to be appropriated for noncash benefits than for cash. The original Family Assistance Plan (FAP) guarantee was raised by $800 via cashing out food stamps. To offset the cost of higher guarantee and to keep the breakevens from going too high, the tax rate was raised from 50 to 67 percent. The particular combination of tax rate and day care expense deductibility yielded less monetary incentive for work by mothers than did AFDC. Some members of the Senate Finance Committee pointed out that the combined guarantees and tax rates of FAP plus Medicaid and public housing and directly provided child care were so high as to leave little pecuniary advantage to work. Income other than earnings was to be taxed at 100 percent, and nonsupporting fathers were to be pursued across state lines and subjected to loss of other federal benefits.

In spring of 1972, Senator McGovern offered a combined welfare and tax reform scheme, which seemed to ignore most of the points raised in Congressional Acts and debates since 1964. He proposed a scheme to replace public assistance and the income tax. It featured a $1,000 guarantee per person, and a flat tax rate of 33 percent against all income with no exclusions, exemptions, or deductions. Three critical equity issues in this loosely sketched plan had to do with the elimination of certain tax preferences, the variation of tax credits with family size, and the amount of tax relief for high salary earners.[8]

The lack of political support for the McGovern plan --and his own denial of it --may have been one of the reasons for the failure of the Congress to pass Nixon's Family Assistance Plan.[9] Just as there were strange political bedfellows in the early days of NIT advocacy, so were there in the shooting down of FAP. The National Welfare Rights Organization opposed it because it cut back benefits for AFDC in the North. Similar difficulties were noted by governors and mayors in high benefit states. There seemed to be little political mileage in adding benefits for men, since such benefits would not give states and local governments relief for their treasuries. What are the lessons there with respect to concepts of equity?[10]

Although FAP failed of enactment, the other big part of Nixon's welfare reform, namely Supplemental Security Income for the aged, blind, and disabled did become law in 1972 and went into effect in 1974. This program contains relatively high guarantees, a 50 percent tax rate on earnings, an end to relative responsibility and to lien laws, a generous assets test, and no work test. Nonearned income is taxed at 100 percent. However, it leaves the way open for supplementing states to vary the guarantee with respect to dependents, essential persons, and living arrangements.

IV. Recent Developments, 1972-1974

Congress has recently made a number of other remarkable departures with respect to income redistribution. These include a liberalization of income tax deductibility of child care and homemaker expense (1972), a doubling of food stamp benefits (1973), and a big break-through in public service employment (1971 and 1974). Also, the "work bonus," pushed by senator Russell long, was incorporated in the tax reform of 1975. These several moves are, of course, each based upon their own concepts of equity. They reflect a concern that was at the forefront of the NIT involvement ten years ago, namely, the exclusion from benefit eligibility of the noncategorical poor. The food stamp program, an in-kind NIT, may be seen as meeting two goals of FAP. First, it raised benefits for AFDC recipients in the low income states, and, second, it extended benefits to those not eligible for AFDC. Public service employment

(PSE) is also addressed to the latter goal, but is subject to complaints of inequity along the lines we noted earlier with respect to certain in-kind programs. It offers a high "benefit" (average pay in PSE in 1975 will average around $8,000), but rations a relatively few jobs among a large number of potentially eligible persons. Neither vertical nor horizontal equity can be carefully observed in the administration of the several billions of dollars appropriated. Clearly, a different standard or concept of equity is involved. A PSE advocate might respond to that line of criticism with the counter-charge: "Any inequality you don't like is an inequity." Here, again, we can identify a "movement" competitive with the NIT movement and informed by a set of unique purposes.

I referred at the outset of this paper to the current HEW and JEC proposals for "welfare reform." (Incidentally, that term in now disavowed by both groups.) These carefully worked out plans symbolize a kind of winding down of the NIT movement. They reflect an informed concern for recent changes in AFDC, in the several in-kind programs, and in public service employment. Whereas ten years ago NIT schemes could react solely to perceived inequities of categorical assistance cash benefits, now they must react to a much more complex system of cash and in-kind benefits, welfare deductibilities, and payroll and income tax provisions.

Perhaps this point can be illustrated by a quick look at the JEC scheme. It would cover all individuals and families except aged, blind, and disabled adults, who would remain under SSI. It offers a guarantee of $3,600 for a two-adult family of four. This comes in two parts; one is refundable tax credits, which would replace income tax exemptions and minimum standard deductions in the income tax;

the other is a cash benefit called an Allowance for Basic Living Expenses (ABLE). The tax rate is 50 percent on earnings net of Social Security taxes paid and 67 percent on most nonearned income, including imputed income from assets. The tax rate on earnings is slightly reduced by a nonitemized work-expense deduction expressed as a percentage of earnings up to stated maximums. This deduction is markedly less generous than present AFDC and income tax deductions.

This plan would be administered by the Internal Revenue Service. No state would have to supplement any benefit after two years. There would be no work test. Food stamps would be cashed out and housing subsidy income would be taxed in calculating ABLE benefits at 80 percent. Income conditioning is to be restrained in the schedule of benefits in federally supported day care and in Medicaid or any substitute for it. The net cost to the federal government of this program is estimated at $15 billion. Thirty-four million people would be eligible for ABLE benefits, and another 4.8 million would enjoy income tax cuts. In the case of families of four, only those with incomes over $25,000 would pay higher taxes.

This complex package may be characterized as one set out to float against a tide. It would restrain the manifest wish of Congress to be generous to the broken family and to the consumers of publicly supported housing and day care. At the same time it would open the purse without a work test for the working poor and near-poor. It fights to preserve incentives to work, but it has to contend with the drag of unreimbursed work expenses and income-conditioning of in-kind benefits. Cumulative tax rates are likely to be well above 50 percent for many ABLE beneficiaries.

The JEC plan attempts to integrate and systematize much of the tax-transfer system. To do this it must take a stance on a range of interrelated vertical and horizontal equity issues. Each stance is taken in recognition of painful trade-offs. For example, do you want to trade less work-expense deductions for one-parent families in order to gain higher benefits for two-parent families? Highly refined concepts of equity are involved in such trade-offs, and many readers will wonder if the insights into equity questions from the income tax mentality are sufficient to resolve them. The authors of the JEC report are quite aware that efficiency as well as equity considerations are involved and that our knowledge of the ultimate outcomes of social policies is severely limited.[11] They are aware of what Boulding calls the pathologies of grantsmanship and, in particular, what he refers to as the "ignorance trap". A careful reading of the JEC report will make one empathize with the man on Boulding's welfare mountain, whose chief problem is to avoid falling off unmarked precipices.[12]

In this brief paper I have sketchily reviewed only one aspect of the recent history of income-redistribution policy. I have not touched on some of the more flamboyant equity issues in the income-redistribution field having to do with such matters as reducing intrastate variability in educational expenditures, compensatory education, and affirmative action for equal opportunity in employment. None the less, I hope I have indicated a range of concepts of equity and their significance in one corner of the field.

FOOTNOTES

[1]Richard A. Musgrave, in his Theory of Public Finance (New York: McGraw-Hill, 1959) says (p.20) that "...the implementation of distributional considerations raise difficulties of a technical sort. It is by no means obvious how to measure the relative positions that are to be adjusted." He also says (pp. 160 and 164) that an "objective index of equality or inequality" is needed to translate the principle of horizontal equity into a specific tax system, and that "...the choice of the index of equality is a question of social value."

[2]The staff background paper for the Hew position is Michael C. Barth, George J. Carcagno, and John L. Palmer, with an overview paper by Irwin Garfinkel, Toward an Effective Income Support System: Problems, Prospects, and Choices (Madison, Wis., Institute for Reseach on Poverty, 1974). The JEC plan is presented in Income Security for Americans: Recommendations of the Public Welfare Study, Report of the Subcommittee on Fiscal Policy of the Joint Economic Committee, Congress of the United States (Washington, D.C.: U.S. Government Printing Office, December 5, 1974). This report follows 19 volumes of staff studies, entitled Studies in Public Welfare.

[3]My first published effort along this line was a paper presented to the National Tax Association in September 1964, in which I suggested that people be refunded 14 percent of their unused income tax exemptions and deductions. I repeated this suggestion, which would have cost about $2 billion, at the American Economic Association in December of that year. Harry G. Johnson was one of the discussants of that paper, and he appeared to be urging a much larger scale negative income tax, on the order of $25 billion. In light of this, I was bemused by his 1973 paper inveighing against "analytically weak or unsupported recommendations for policy, such as remedying inequality by giving large sums, taken from those who currently have high incomes to those who have not." ("Micro-Economic Reflections on Inequality," The Annals of the American Academy of Political and Social Science, No. 409 (September 1973): 55).

[4]This is an interesting example of how a specific income distribution measure appeared to serve as a road map for social intervention. See Lampman, "Measured Inequality of Income: What Does It Mean and What Can it Tell us?" in The Annals (September 1973). For a good brief discussion of the importance of "reasonable classification" to horizontal equity, see Harold M. Groves, Financing Government, Sixth Edition (New York: Holt, 1964). He says (pp. 15-16) that "...a levy that is unimpeachable in its objective is none the less vulnerable if it cannot be defined so that those in essentially similar circumstances contribute alike. Discrimination is the essence of tax wisdom, but it sheds its curse only when it is proved to rest on genuine differences, the recognition of which is required by the public interest."

[5]See Joseph A. Pechman and Benjamin A. Okner, Who Bears the Tax Burden? (Washington, D.C.: Brookings Institution, 1974). Of particular

interest to this discussion is Chapter V, entitled "Variations in Tax Burdens Among Population Subgroups." They find that the overall tax system favors homeowners, rural-farm residents, families with transfers as a major source of income, and large families. It hits hardest at single persons and those families whose major source of income is property or business. (p.82.)

[6]See Michael Mahoney, "The Challenge of Income Maintenance," a paper delivered at the National Conference on Social Welfare, May 12, 1975. He belabors social workers for not defending public assistance in this debate.

[7]Representative Griffiths in her foreword to the JEC report cited in footnote 1, says (p. vi), "We found. ... that the woman on welfare did better in every city than the woman who worked at the median wage. . . the theory of comparing what is given in welfare with what is needed is foolish. 'What is needed' is a phony standard set up by a paternalistic middle class. The real standard is what similar people earn, and how they are treated. Few have ever asked what those who work need."

[8]Russell Lidman, "Cost and Distributional Implication of a Credit Income Tax Plan," Public Policy 20 (Spring 1972)

[9]Two recent and valuable books on the political history of this legislation are Vincent and Vee Burke, Nixon's Good Deed (New York: Columbia University Press, 1974); and M. Kenneth Bowler, The Nixon Guaranteed Income Proposal, (Cambridge, Mass.: Ballinger Publishing Company, 1974.)

[10]This query invites a line of study about indirect beneficiaries of change in income-maintenance arrangements. While shifting and incidence of taxes are much studied, little has been written about incidence of benefits.

[11]Harry G. Johnson spells out his reasons for backing away from large-scale negative income taxation in the Annals article cited in footnote 3. He writes at p. 58, "...ethically-motivated social concern about inequality should focus on inequalities of opportunities and the knowledge and resources to explore them properly. It should not focus on the statistical facts of measured inequalities, which indiscriminately reflect both inequality of original opportunities and rational, voluntary choices among available opportunities intended to maximize individual self-fulfillment. Analysis and remedies that focus on the resultant income distribution--and attempts to correct it by redistributive. . . systems will have (undesirable) side effects." He goes on to detail how such systems may burden those with socially desirable preferences and reward those with undesirable preferences and warns that ". . . in the long run, social institutions and customs adapt to produce the kind of people favored by the fiscal system."

[12]Kenneth E. Boulding, The Economy of Love and Fear, (Belmont, Calif.: Wadsworth, 1973).