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Abstract

This paper reappraises the Negative Income Tax (NIT) and employment-subsidy approaches to welfare reform. The first section shows that the NIT has become a less attractive alternative, primarily because of its difficulty in avoiding unacceptably high tax rates and its limited and sometimes harmful role in dealing with high unemployment. The second section, which considers whether an employment-subsidy (ES) approach could do better, begins with a list of common objections to ES programs. Then, it describes a specific jobs and income plan (JOIN). The paper concludes by showing how JOIN not only could overcome the common objections to ES programs but also could outperform the NIT in accomplishing many welfare reform objectives.

A Reappraisal of Negative Income Tax and Employment Subsidy Approaches to Reforming Welfare

Robert I. Lerman

The negative income tax (NIT) enjoyed widespread popularity among economists in the mid- and late-1960's, when the economy was operating at full employment and the deficiencies of the welfare system seemed obvious. Employment-subsidy alternatives attracted far less support and interest in the academic community. Since then, unemployment has been persistently high, the income transfer system has grown dramatically in expenditures and complexity, and the political system has rejected both expensive and inexpensive NIT proposals. At the same time, political leaders have been groping for a sensible employment subsidy approach. The effort going into the Humphrey-Hawkins bill is an example of this tendency. Further, there is growing recognition that the American people are more willing to support job guarantee programs than income guarantee programs. In a 1972 national poll, 72 percent of the respondents favored a guaranteed job plan, while only 38 percent favored a guaranteed income plan. All these developments justify a reappraisal of the NIT and employment-subsidy approaches to welfare reform. This paper attempts to contribute to such a reappraisal.

I. A Reappraisal of the NIT

Neither the Ford Administration nor the Congress moved toward the NIT in 1975 and 1976 in spite of developments favorable to its promotion.

The Subcommittee on Fiscal Policy and the Department of Health, Education, and Welfare provided carefully constructed NIT proposals. The small labor supply reductions found in the New Jersey NIT experiments strengthened the hand of NIT advocates, and tax reductions of tens of billions of dollars should have lessened the concern about expenditure levels required by a moderate NIT program. Still, enthusiasm for the NIT declined, partly because of improvements in the existing transfer system.

The income transfer system has grown rapidly. Total government expenditures on the pretransfer poor jumped from $31 billion to $79 billion between Fiscal Years 1965 and 1972. The proportion of pretransfer poor taken out of poverty by all transfers rose from 52 to 72 percent between 1968 and 1972. Lampman [1975b] points out that in the last decade, developments in the income transfer system have accomplished many tasks which the NIT was expected to achieve. The Supplemental Security Income program guaranteed a poverty level income to the elderly, blind, and disabled. The 1967 amendments to the Social Security Act lowered tax rates on earnings faced by AFDC recipients. Most important, the food stamp program raised substantially the benefits available to low income households with a working head and sharply reduced state differentials in combined benefit levels.

Given the political difficulties associated with undertaking grand reforms and the improvements in the current system, some analysts now favor an incrementalist strategy. They argue that relatively small changes in the food stamp and AFDC programs, and adoption of national health insurance, would bring about a reasonable NIT-oriented transfer

system. Opponents of this strategy cite the current system's exorbitant administrative costs, horizontal inequities, and excessive complexity, and continue to press for complete overhaul.

But while the case for a complete overhaul remains strong, the NIT strategy has become questionable. On the plus side, the NIT's largest stumbling block--the fear of significant NIT-induced reductions in labor supply--is today smaller because of the generally optimistic results of the New Jersey experiment. However, the improvement is not dramatic because these results are subject to varying interpretations.

Moreover, there are some new drawbacks. First, the increasing extent of income-conditioning has made the cumulative tax rate problem more serious. It is now clear that the NIT would coexist with other programs or taxes that reduce the marginal return from earnings. Even if food stamps were eliminated, state supplements, Social Security taxes, state and local taxes, subsidized housing, child care, higher education, and national health insurance (or Medicaid) would raise the effective tax rate (see Lampman [1975b]).

According to DHEW's NIT plan [U.S. Department of Health, Education, and Welfare, 1976], the combination of state supplements and Social Security taxes alone could jack up the tax rate from 50 to 66 percent. For the almost 10 percent of the nation's poor in housing programs, the cumulative tax rate would rise to over 70 percent. Programs offering income-conditioned child care, health insurance, and higher education benefits would extend the high cumulative tax rates to a much wider segment of the recipient population. In addition, smooth integration of the NIT

and the personal income tax would require a substantial rise in the marginal tax rates faced by taxpayers whose incomes are somewhat above the NIT breakeven income. Otherwise, families moving out of the NIT benefit range would find their tax liability rising suddenly from zero to several hundred dollars. To some extent, the NIT plan of the Subcommittee on Fiscal Policy [1974] does more to minimize these effects, but it cannot prevent the cumulative tax rate on NIT recipients from rising to 60 percent. Work expenses would further reduce the return from added earnings. One could lessen the problem of escalating tax rates by lowering the NIT tax rate and raising budget costs. However, the need for these changes is often brushed aside, thereby making the NIT appear more favorable than it actually would be.

Other difficulties are associated with the interaction between the NIT and high unemployment rates. A generous NIT with a 50 percent or higher tax rate might raise unemployment by worsening the inflation-unemployment tradeoff in a manner similar to the effects of Unemployment Insurance. Increasing the extent to which income transfers shield low income workers from unemployment-induced losses is likely to lengthen the time they spend out of a job. In terms of Hall's [1974] wage inflation model, the NIT gives certain workers increased incentives to refuse (temporarily) jobs whose wages are lower than what they expect; this can reduce worker quality at each scale wage, and thus cause higher effective wages for a given unemployment rate.

Conversely, very high unemployment rates limit the NIT's effectiveness in eliminating poverty. Most NIT plans take for granted the ability of family heads to earn a large share of the family's needed resources.

However, very high unemployment rates impose a special burden on low income families. Gramlich [1974] estimated that a one-point rise in the unemployment rate lowered the average income of poor, two-parent families by only 3 to 4 percent; however, among those who experienced unemployment, the average loss in pretransfer income was about 8 percent. Moreover, the economy is no longer immune from very high unemployment. A rise from a 5 to a 7.5 percent unemployment rate would probably cause an average income reduction of at least 20 percent for all low income unemployed, and much larger reductions for many. An NIT could compensate for half or slightly more of these income losses, but it would leave many low income families with inadequate incomes and bearing more than their share of the unemployment burden.

Even the NIT's equity features are now seen as having drawbacks (see Lampman [1975a]). To consider only income and family size in determining benefits, however consistent with horizontal equity principles, is often not a sensible transfer policy. One should also take account of income-generating capacity. Consider two examples. Universal NIT programs would offer full benefits to nonworking students. To most people, this is unfair since these students have reasonable earnings opportunities and their low income status results from a voluntary choice to trade current income for leisure or future income. Garfinkel and Haveman [1975] found 40 percent of single young students to be poor on a current income basis, but virtually zero were poor by an earnings capacity measure. It would be difficult to exclude young people with low incomes and high capacities, judging by Supreme Court decisions striking down rules limiting food stamp eligibility.

Quantitatively more significant is the inequity of according similar treatment to one- and two-parent families. Although government poverty thresholds show equal income needs for one- and two-parent families of the same size, the income-generating capacity of two-parent families is generally much higher. Nevertheless, planned NIT income guarantees are typically set as high or higher for two-parent families, partly because planners oppose providing incentives for family-splitting.

Reactions against specific NIT proposals illustrate the difficulty of using a single program to resolve different problems. Hechlo [1975] reports objections to the British NIT proposal on the grounds that too little money would be provided to the poorest groups, those that should be entitled to preferential treatment. Similar objections have been heard in the United States. Finally, the NIT does not appeal to the many who see jobs, not cash, as the appropriate way to help able workers.

2. Could An Employment-Subsidy Approach Do Better?

Before comparing the employment strategy with the NIT, one must ask: what kind of employment subsidy (ES)? The ES strategy may mean wage subsidies, earnings subsidies, or public employment programs. ES proposals which call for very niggardly benefits are seen as attempts to "regulate the poor," while some ES programs have provided jobs for which the wages were nearly as high as the average wage.

In the early 1970's, direct creation of public jobs was viewed as a way of dealing with high unemployment, and was considered to have little relation to welfare reform or poverty. Public employment programs,

such as the Public Employment Program in the United States and the Local Initiatives Program in Canada, did create jobs that were reasonably productive, but the limited number of moderate wage jobs could not improve the unemployment-inflation tradeoff nor relieve the unemployment burden on the lowest income families. Now that there is increasing awareness of the relationship between unemployment and income transfer policies, a sensible ES program has real possibilities. Conservatives and liberals are looking in similar directions. Arthur Burns now advocates a low wage job guarantee program; the Humphrey-Hawkins bill calls on the President to "...make recommendations on how the income maintenance and employment policies can be integrated to insure that employment is substituted for income maintenance to the maximum extent feasible."

What objections would an effective ES program have to overcome? The first is that ES programs channel a low share of benefits to the poor. At any universal public job wage rate or wage subsidy schedule, too high a share of benefits goes to secondary and young single workers. Setting the wage too high makes the program too expensive; setting it too low provides inadequate help for low income families. A second objection is the high administrative costs of public jobs and wage subsidy programs. Third, the demand for low wage labor may be too elastic or too inelastic, depending on the ES program. (We assume that the supply is relatively inelastic.) If demand is highly elastic, a job guarantee program will cut sharply the private demand for low wage workers, making the program an inefficient redistributive tool. If demand is highly inelastic, a wage subsidy will cost more and accomplish

less for low wage workers. A fourth objection is that the ES approach requires a categorization that the universal NIT avoids. Under the ES approach, one must decide who is employable and who is not.

Fortunately, these objections need not force us to abandon the ES stragegy. Elsewhere, I demonstrated how a carefully worked out jobs and income plan (JOIN) could overcome these difficulties [Lerman, 1974]. I shall now briefly describe JOIN and outline its advantages.

Table 1 lays out the JOIN benefit structure. JOIN's job component would offer one special public job or a wage subsidy in another job to every family or single individual. The public job wage (say $2.40) would be slightly above the minimum wage. The wage subsidy would pay half the difference between a target amount (say $3.20) and the worker's wage, for presubsidy wages of at least $2.00. JOIN's income component would go only to one-parent families with children under 14. These families would be eligible for a cash grant in addition to the job subsidy. The grant would be approximately equal to the national average guarantee from combined AFDC and food stamp benefits. (JOIN would fully replace AFDC and food stamps.) All JOIN units would be subject to a surtax of 25 percent on the unit's earnings and of 50 percent on its nonemployment income. But the disregarded amounts of earnings would vary by family type. The disregard for two-parent families with children and one-parent families not eligible for the cash grant would be $6,000; for childless couples, $3,800; and for single individuals and one-parent families receiving the cash grant, zero. The introduction of JOIN would coincide with the often recommended shift from personal deductions to refundable credits.

Table 1

JOIN Benefits and Net Income by Filing Unit Type

Type of Filing Unit	Income Benefits	Job Benefits for All Filing Units	Benefit Reduction (BR) Rules[a]	Net Assured Income[b] (Full-year work)
1. One-parent family with at least one child under 14	Income Guarantee related to family size; $3400 per family of four; tax credit of $250 per person	One public job or wage subsidy per filing unit. Public job wage of $2.40 per hour. Wage subsidy per hour equals 1/2 ($3.20 - worker's wage), if worker's wage is between $2.00 and $3.20 per hour.	BR equals 25% of all earned income (E) including job benefits, plus 50% of all unearned income (U)	$7470
2. One- or two-parent family with at least one child under 18 not included in Type 1.	Tax credit of $250 per person		$BR = \max \begin{cases} .25(E - \$6000) \\ + .50U \\ 0 \end{cases}$	$5114
3. Childless married couple	Tax credit of $250 per person		$BR = \max \begin{cases} .25(E - \$3800) \\ + .50U \\ 0 \end{cases}$	$4450
4. Single individual	Tax credit of $250 per person		$BR = .25E + .50U$	$3365

[a]The $6000 and $3800 figures in the BR formulas for filing types (2) and (3) are earnings disregards. For filing types (1) and (4), the earnings disregards are zero.

[b]Net assured income (full-time work) is the sum of full-year earnings at the public job wage, minus JOIN benefit reductions, Social Security taxes, and personal income taxes, plus the tax credit. For filing type 1, add to this figure the JOIN income guarantee.

To create public jobs, JOIN would use the model employed by LIP. In brief, this would involve soliciting proposals from nonprofit organizations, government agencies, or individuals, using contracts to specify tasks and dates of completion, and giving monitors the responsibility of advising project managers and assuring fulfillment of the contract.

How would JOIN overcome the objections to ES programs cited above? First, it would attain high target efficiency by means of the surtax. The various disregards would allow the net wage for a family head to remain adequate while managing to avoid too large an entry of young single workers into the program. Second, using the LIP model to create jobs would keep costs down. Mukherjee [1974, p.61] reported that LIP administrative costs accounted for only 4 percent of expenditures in 1972-73. Limiting wage subsidy coverage to a minimum wage and to a maximum number of hours should reduce the administrative effort required to deal with misreporting. Third, the combination of wage subsidy and job guarantee would avoid the risks of a large cutback in private employment or of a wage subsidy that gives disproportionate benefits to employers. Fourth, JOIN's categorization is in accord with the public's conception that able people should qualify only for employment help, while unrestricted cash grants should go only to special groups.

In addition, JOIN has important advantages over the NIT in resolving the problems cited in section 1. JOIN's job subsidies and low surtax rate offer much better work incentives than does the NIT. JOIN would generally raise the return to work among low income family members; in contrast, the NIT would subject most workers in low income families to tax rates

of 60 percent or more. With its positive work incentives, JOIN could avoid the danger that tax rates from other benefit programs would push cumulative tax rates to excessive levels. A test of JOIN's labor market effects yielded optimistic results. Using a state labor market simulation model, Lerman, MacRae, and Yezer [1974] found that JOIN would have raised the hours of work and earnings of JOIN participants substantially without causing a decline in the earnings of nonparticipants.

JOIN is clearly a better approach than the NIT or the current income transfer system for relieving the unemployment problem. Under JOIN, transfers would do less to encourage workers to delay accepting jobs. The JOIN subsidy would induce an expansion in private employment without raising the labor costs of employers. More generally, JOIN's stimulus to labor demand would be concentrated on weak labor market sectors, where earnings and employment gains would be least likely to add to inflation. For these reasons, the country could achieve lower unemployment at any inflation rate under JOIN than under the current system or the NIT. But even in times of high aggregate unemployment, JOIN's job guarantee and wage subsidy would outperform the NIT by doing more to shield low wage workers from bearing an excessive share of the unemployment burden.

JOIN also offers a better solution to the equity issues raised above. It would not give income transfers to nonworking students, but would assure all youth the opportunity to escape poverty. Schooling subsidies would require their own justification. JOIN would recognize differences in earnings capacity of one- and two-parent families.

JOIN would guarantee all one- and two-parent families the opportunity to stay out of poverty, but would demand less work effort from one-parent families with young children.

Finally, JOIN would overcome the NIT problem of providing too little to those at the very bottom in order to preserve work incentives and to limit costs. JOIN could assure all units the opportunity to attain a much higher income than the income guaranteed by an NIT with the same net budget costs. For example, the NIT proposed by the Subcommittee on Fiscal Policy could have guaranteed (as of 1975) an income of $3600 to a two-parent family of four at a net Federal budget cost of about $15 billion. JOIN could have offered an assured income opportunity of $4600 to a family of four at a net budget cost of $9 billion.

Perhaps I have painted too rosy a picture of JOIN and its advantages over the NIT. But even if the picture is only half accurate, the JOIN approach warrants serious consideration.

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