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THE FAMILY ASSISTANCE PLAN: AN ANALYSIS AND EVALUATION

D. Lee Bawden, Glen G. Cain and Leonard J. Hausman

UNIVERSITY OF WISCONSIN ~ MADISON

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by

D. Lee Bawden
Glen G. Cain
Leonard J. Hausman

D. Lee Bawden is an Associate Professor of Economics and Agricultural Economics at the University of Wisconsin; Glen G. Cain is an Associate Professor of Economics at the University of Wisconsin; both are members of the Institute staff. Leonard J. Hausman is Assistant Professor of Economics and Social Policy at Brandies University and is a former Institute staff member. The research reported here was supported by funds granted to the Institute for Research on Poverty at the University of Wisconsin by the Office of Economic Opportunity pursuant to the provisions of the Economic Opportunity Act of 1964. The authors wish to express their gratitude for an unusually large amount of advice and criticism from a number of their colleagues at the Institute for Research on Poverty of the University of Wisconsin and The National Manpower Policy Task Force Associates. Special thanks for background help go to Robinson Hollister, William Klein, Larry Orr and Harold Watts. We are grateful to Robert Lampman for both general information and specific comments on this paper. In an area as complicated as income maintenance and regarding a bill like FAP, no two people are likely to agree on all the points discussed in this paper. We wish, therefore, to absolve all those mentioned, explicitly or implicitly, from responsibility for our conclusions, recommendations, and, of course, for our errors.

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ABSTRACT

The Family Assistance Plan (FAP) is commended for the welfare reforms that it contains: a federally-financed income guarantee, an extension of cash transfers to the working poor, and a movement towards federal administration of public assistance. To fulfill the objectives set for FAP by the Administration, however, a number of changes should be made in the legislation which has been proposed. The recommended changes, which are rationalized in the body of this paper and summarized in its conclusion, are directed towards making a firm and explicit commitment to federal administration of FAP, eliminating extraneous provisions like the work test and child care services, and taxing income from various sources more uniformly. The conversion of the food stamp program into additional cash transfers is another recommended improvement. This change would raise the cash guarantee to roughly $2400, decrease the disincentive to work that the aggregate tax rate of the two separate programs may well create, lessen the administrative complications of income maintenance, and eliminate another stigmatizing and demeaning aspect of rendering assistance to the poor.

THE FAMILY ASSISTANCE PLAN: AN ANALYSIS AND EVALUATION

INTRODUCTION

President Nixon's Family Assistance Plan (FAP) advances major welfare reforms. It provides for a federally financed income guarantee, extends cash transfers to the working poor, and takes major steps towards federal administration of public assistance. For these and other reasons, the proposal is to be commended; but the purpose of this paper is to suggest ways of improving the bill and not to dwell on praising its positive aspects.

The bill has undergone numerous revisions in its travels from the Administration to Congress and back to the Administration, and more changes may be expected in the months to come. Although it is not possible to discuss a final version of the bill, we believe it is useful to analyze the issues that must be dealt with in any bill and to use the versions of the bill that emerged from Congress (HR 16311) and the Administration's counter proposals (dated June 10, 1970 from the Department of Health, Education and Welfare) to illustrate in a concrete way the problems encountered. We seek modifications in these bills which would further enhance the objectives of FAP. Thus constructive recommendations are made which do not necessarily consider political pressures that impinge on the Congress; gauging such pressures and devising appropriate responses to them is not within our competence.

Among students of the field there is widespread acceptance of the following general objectives of FAP:

1. the alleviation of poverty among all poor persons;
2. the reduction of financial disincentives to work;
3. the provision of financial incentives to maintain stable families;
4. the equal treatment of equally poor persons, regardless of residence or source of income; and
5. the development of a single and efficient admiistrative mechanism that promotes the dignity and self-reliance of FAP recipients.

The attainment of these objectives is constrained by a tight budget, and a number of compromises in the bill are the consequence of an attempt to wrest (in the words of Robert Finch, former Secretary of HEW) "revolutionary structural reform in the system."[1] Although there are compelling reasons to increase both the coverage and level of benefits, most of our suggestions are made within the budgetary allocation of $4 billion. Revisions that raise the financial costs will be made clear, as will those that reduce them. We believe our suggested changes, if implemented, would enhance the achievement of the stated objectives within existing budgetary constraints.

The analysis and suggested changes in the bill proceed in a framework provided by the list of objectives, though it should be noted that the objectives are interrelated and that many provisions of the bill affect several objectives.

ALLEVIATION OF POVERTY

The major purpose of FAP is to put money, and thus goods and services, into the hands of the poor. The degree to which the program achieves this

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[1]"Statement of Secretary of Health, Education, and Welfare," Robert H. Finach, in "Explanation of the Family Assistance Act of 1969," Committee on Ways and Means, House of Representatives, 91st Congress, 1st Session, on The Subject of Social Security and Welfare Proposals, Part 1 of 7, p. 50, October 15-16, 1969.

purpose largely depends on the extent of its coverage, income and asset eligibility criteria, and level of benefits.

Coverage

The plan is basically designed to aid poor families with children who are either under 18 years of age or who are 18 to 21 years of age in school.[2] For the first time, therefore, all poor families with children, including families with male heads and families where the head is working, will be given federally-financed assistance in all fifty states. It is noteworthy that almost half the poor people in the United States are members of families with an able-bodied male head less than 65 years of age; that nearly 60 percent of the latter group is poor despite the fact that the breadwinner holds a full-time, year-round job; and that, among most of the remainder, the head works part time the entire year or full time for part of the year.

FAP embodies the principle that the working poor are as deserving of help as are those who are unable to work; it moves us closer to a standard whereby families receive assistance because they <u>are</u> poor and not because of <u>why</u> they are poor. A large step is thereby taken toward removing incentives for an individual or family to engage in behavior to fit into such categories of eligibility as "the fatherless family" or "the family with an unemployed head."

The inclusion of families without children and of unrelated individuals would, of course, enhance the goal of reducing poverty. The costs of such an extension of coverage is estimated to be about $1.5 billion. A large portion of these benefits would supplement incomes of deserted, divorced,

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[2]Separate provisions of the bill to assist all aged, blind, and disabled adults will not be discussed in this paper.

and single women, and much of the remainder would go to young couples, most of whom will eventually become parents. One benefit from this expansion is that the "baby bonus" feature of the existing bill is removed. Childless couples would have no special incentive to alter their plans regarding childbearing, and it would be less likely that children would be transferred from their natural home to that of a childless relative to qualify the latter unit for FAP benefits. Both types of induced behavior are undesirable and would not arise if coverage were universal.

Eligiblity criteria regarding income and assets

A family's income and size principally determine its FAP benefits. The income guarantee is $500 per year for each of the first two family members plus $300 per year for each additional member. This is the amount that would be paid to a family, perhaps in monthly or biweekly installments, if it had less than $720 in annual earnings. For example, a family of four earning $720 or less would receive federal payments of $1600 per year. Each dollar earned in excess of $720 would result in a 50-cent reduction in the FAP benefits.[3] If the family of four has $3920 (or more) in earned income, FAP payments are reduced to zero.[4]

Family income, upon which the size of FAP payments is based, is in general defined more inclusively than under the positive income tax. Income from some sources is excluded, however. Earnings of children in school, the tuition part of scholarships and fellowships, training allowances, the value of food stamps, other public or private charities, and inconsequential or

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[3]Each dollar of some types of income that are declared as "unearned" (see below) would result in a one dollar reduction in FAP benefits. The example assumes all income is "earned."

[4]For "earned" income, the amount of FAP payments for a family of four is given by the formula: FAP payments = $1600 - 1/2 (non-excludable family income - $720).

infrequently earned income are all ignored in computing family income for FAP purposes. Moreover, families are allowed to deduct from their reported income the expenses of child care for a working parent up to some limit of expenses to be decided by the Secretary of HEW.

There are two categories of nonexcludable income--earned and unearned. Wages, salaries, and income from self-employment are considered earned, and this income is taxed at a 50 percent rate. (That is, the FAP benefit is reduced by 50 cents for each dollar of earned income.) Unearned income consists of rents, dividends, interest payments, veterans' pensions, unemployment compensation, farm subsidies, and the like--anything that is not the direct product of labor. Income from these sources is taxed at a 100 percent rate--FAP benefits are reduced on a dollar-for-dollar basis as unearned income is received.

The list of income sources to be taxed at a 100 percent rate was greatly expanded by the House Ways and Means Committee. The intention was to save FAP funds, but it may have the opposite effect. If a FAP beneficiary knows, for example, that his receipt of unemployment compensation cannot benefit him at all (because of the 100 percent FAP tax rate and the low level of his unemployment benefits), he is unlikely to bother applying for them. However, if the tax rate on unearned income were below 100 percent, it would pay him to apply and, at a 75 percent rate for example, the government would save three FAP dollars for every four unemployment compensation dollars. This same argument can be advanced for many of the income sources taxes at the 100 percent rate--pensions (which can be delayed), farm subsidies (which require an outlay of cost on the part of the recipient and raise the effective total "tax" on the subsidy above 100 percent), etc. Similarly, the 100 percent tax provides an incentive to convert income-earning assets to alternatives which substitute rising valuation or deferred income for current income.

The treatment of infrequently earned, small amounts of income may be a necessary simplification for administrative reasons. However, the deduction of all earnings of children who attend school seems excessively generous and may allow some nonpoor families to receive scarce FAP dollars--some high school and college students earn substantial incomes during the summer. Moreover, an incentive is created to substitute children's labor (which is untaxed) for that of an adult, whose earnings are taxed at a 50 percent rate.[5] Greater equity could be achieved with an explicit ceiling, as is hinted at in the bill, of perhaps $600 or less per working child per year, with amounts over this treated as regular income and thus taxed at the applicable rate.

Aid from public programs and private charities is not counted in family income for purposes of determining FAP benefits. One disadvantage of this is that the principle of horizontal equity is violated: a family receiving aid or charity of a given amount will get more FAP payments than a family which has earnings of the same amount, because the second family loses some FAP payments while the first loses none. Another disadvantage is that incentives are created for people to "categorize" themselves to become eligible for such aid. Thus it is more consistent with the objective of equity and of a desired incentive system to count as income all of this aid in excess of some nominal amount and not including nominal gifts for special occasions. This procedure is not without some difficulties. One is the problem of placing a dollar value on in-kind income such as housing or clothing. Another is that the charitable agency may already be taxing income in some way, and thus

[5] Or, as is common among farmers under the positive income tax, to transfer some of the adult's earnings to the children in the guise of wages.

the added FAP tax will increase the effective tax rate facing the FAP recipient. Finally, some charitable agencies may object to handing out "50-cent dollars" and may withdraw their aid to FAP recipients.

The treatment of Medicaid has received special attention. Under both the original Administration and the House versions of the bill, the benefits of Medicaid were exempt from the income category as defined for FAP payments. Although it is reasonable to view Medicaid less as income than as payments to cover unforeseen expenses of ill health or injury, some categories of poor are not eligible to receive Medicaid. The restricted coverage creates an inequity and there is, moreover, an undesirable incentive for the recipient to stay "on welfare" to maintain his Medicaid benefits. A useful reform in these earlier versions is provided by the latest Administration bill which replaces Medicaid by a national health insurance plan for all poor families with children. Premiums to pay for the insurance are to be scaled according to the income of the family. This is a preferable way of providing health services despite the fact that the method of paying premiums creates, in effect, a tax on income that is added on to the tax implicit in the reduction of FAP payments as income rises. We deal with the problems involved in the accumulation of tax rates below.

There is also an asset limit for determining eligibility; a family with nonexcludable assets in excess of $1500 cannot receive FAP payments. Since the value of an owner-occupied home, all household goods and personal effects, and business assets of the self-employed are excluded, it would not be too difficult for a family to exchange its includable assets--like personal savings or the cash value of an insurance policy--for excludable ones, to meet the $1500 limit. We doubt that this conversion of assets should be encouraged. The problem of keeping "nonpoor" families from receiving scarce funds can be much more equitably handled by including as taxable income some fraction, say 10 percent, of estimated net worth above some specified exclusion levels. An equity of $10,000 in a home and $20,000 in business assets might be excluded for imputation purposes. (However, the income from a business would be included and taxed at the applicable rate.)

Benefit levels

The maximum FAP benefit of $1600 for a family of four is only 45 percent of the current poverty threshold of $3720. Forty-two states are currently guaranteeing more than $1600 per year to four-person families who qualify for Aid to Families with Dependent Children (AFDC). By itself FAP is woefully inadequate, whether judged by the absolute poverty standard or by the standards revealed by current state operations. It is appropriate, however, to take into account supplementary payments which states may be required to offer and the food stamp program. First, regarding the supplementary payments, the bill clearly indicates that a state must supplement FAP benefits for all female-headed FAP recipients, if the benefit levels of the state's program of AFDC exceeds the FAP guarantee level. There are 42 states which will be required, under this provision, to add cash payments to raise FAP benefits up to the levels of AFDC benefits prevailing in January 1970. In addition, the bill suggests that the federal government should develop regulations which will eventually prevent states from holding welfare payments to levels below what the states themselves define as minimum family needs. These extensions of AFDC benefits may mean that the total budgetary cost of the bill will rise above the anticipated $4 billion level, since the bill provides for federal contributions to state treasuries to compensate the state for added costs of supplementation.

The budgetary costs to both federal and state governments will also depend on the amount of payments going to current AFDC-UF families (UF stands for unemployed father). Twenty-three states now have an AFDC-UF program. The initial Administration and the House versions of the bill required, in all 42 states where AFDC benefits exceed FAP benefits, the extension of state supplements to male-headed families where the male head meets the eligibility criterion on employment currently used in the AFDC-UF program. The latest Administration version of the bill not only does not extend AFDC-UF coverage but eliminates any federal aid to the program and, thereby, virtually eliminates the program. Many of the 90,000 families now receiving benefits under AFDC-UF will face substantial cuts in benefits as a result of the shift to FAP coverage. Both proposals dealing with AFDC-UF involve difficulties which we will discuss below.

Second, the Administration proposes a food stamp program that will provide a sizeable supplement to FAP. The food stamp program is very similar to the FAP program, except that recipients are constrained to use their supplements to purchase food. For individuals and families not covered by FAP, the basic guarantee (at zero earnings) of the food stamp program was $1200 under the original version of the Administration and House bills and $1272 under the most recent version of the Administration bill. (We use the $1272 amount throughout this paper.) Since FAP payments are included as income for purposes of determining the food stamp allowance, the amount of food stamps going to a zero-earnings family covered by FAP would be between \$840 and \$900, depending on the formula used to determine benefits.[6] Taken together, these two programs will guarantee a family of four a minimum income of \$2500 per year, about two-thirds of the present poverty level. Families of four with earnings of around \$3000 or more will, with payments from both programs, be raised above the \$3720 level. The estimated cost of the food stamp program, if FAP becomes law, is \$1.5 billion per year, slightly less than the estimate of the net cost of FAP payments, (net of current welfare payments).

The question remains whether such a sizeable amount of money could not be better spent by expanding the coverage of FAP, increasing the cash guarantee, lowering the implicit tax rate on earned income, or some combination of the three. Professor Harold Watts, Director of the Institute for Research on Poverty at the University of Wisconsin, has argued against the inclusion of food stamps in the following terms:

> The first issue here is whether, aside from the public passion for feeding the poor, there is any lasting reason for dealing with food separately from the general and varied needs of people with low incomes. There is ample empirical evidence that people spend a substantial part of any increase in income on food. This is particularly true for the poor. If by a combination of food stamps and cash benefits we do not coerce people into spending more on food than they would have with an all-cash benefit of equal value, we shall simply have gone needlessly to substantial nuisance and expense. If on the other hand, we try to make people spend substantially more on food (and correspondingly less on clothing, housing, transportation, education, etc.) than they would with an all-cash benefit, we shall be facing a serious enforcement problem in preventing families from reselling the stamps or food. Such an enforcement nightmare could largely nullify (by its cost) the rather dubious advantage of altering their expenditure patterns. In either case food stamps seem to be a bad bargain in comparison to general cash benefits.[7]

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[6] The original Administration and House versions of FAP calculated the food stamp allowance with a 30 percent tax on the sum of earnings plus FAP benefits minus \$360. The new version calls for a 31.8 percent tax on earnings plus FAP benefits minus \$240.

[7] Testimony of Harold Watts before the Committee on Ways and Means, House of Representatives, 91st Congress, 1st Session on The Subject of Social Security and Welfare Proposals, Part 7 of 7, pp. 2456-2467, November 13, 1969.

Another issue, the manner in which the food stamp program would aggravate the problem of high tax rates on earned income and thereby reduce incentives to work, is taken up in the next section.

INCENTIVES TO WORK

In the reform of welfare assistance, one issue which has received much attention is the need to alter the features of existing legislation which discourage work. This is not only because of the importance attached to work in its own right, but because the costs of the program are directly related to the amount of work and earnings by the eligible population. The provisions of the bill that affect work behavior are principally those involving the level of the guarantee, the tax rates on earnings, the ease or difficulty in shifting on and off FAP rolls, the treatment of expenses of work and child care, and the use of a "work test." A discussion of these provisions follows.

The guarantee level

Higher guarantee levels and the associated higher amounts of income supplements are expected to create greater disincentives to work. There is widespread agreement with this proposition on the basis of "common sense" and "intuition" or economic theory,[8] depending on one's approach to the issue, but there is little hard evidence from any source by which to measure the extent of disincentives in the face of higher levels of transfer payments. We would add no more to this qualitative judgment except to mention that "informed opinion" also holds that the extent of disincentive is probably

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[8] See, "Income Redistribution and the Labor Supply: A Symposium," with an introduction by H. Watts and articles by C. Green, R. Perlman, P. Albin and B. Stein, J. Leuthold, and J. Conlisk, Journal of Human Resources, v. 3, no. 3, Summer 1968.

minor, and that the guarantee level is much less important a factor than the tax rates on earned income.

The tax rate on earned income

The FAP proposal follows the 1967 public assistance amendments in attempting to keep the implicit tax rate on earnings below 100 percent. The implicit tax rate on earnings of 50 percent specified in FAP should lessen the disincentive to work among the approximately 2 million families receiving AFDC assistance payments, but a 50 percent rate will likely create some disincentive to work for the many families not previously on welfare. Under FAP a family will be allowed to earn up to $720 annually with no loss of FAP benefits. Larger amounts of income could be received without loss of FAP benefits, if the income is excludable or if it can be offset by the allowable deduction for child care. Otherwise, amounts of "earned" income in excess of $720 result in a loss of 50 cents in FAP benefits for each dollar earned--a 50 percent tax rate on earnings--until annual income reaches the "breakeven level" where FAP benefits are reduced to zero. (Recall that the breakeven level for a family of four is $3920 if all income is "earned.")

There are, however, additional implicit tax rates from other segments of the welfare package that will affect low-income families. In the 42 states where AFDC payments are higher than the basic FAP levels, an increase of $1.00 in a family's income will bring about a reduction in total FAP and state payments of 66 2/3 cents for those families eligible to receive both types of payments. Moreover, in all 50 states the food stamp program will provide another type of benefit that will be reduced as family income is increased--another source of increase in the aggregate tax rates. There are social security taxes to be added and, above a certain level of income, positive income taxes. Finally, the Administration has recently proposed adding a health insurance plan for which premiums will increase as income rises.

The compounding of tax rates that results from direct taxes on earnings and losses in program benefits associated with earnings is illustrated in Tables 1-5. Families of four receiving FAP benefits in the eight low-payment states will face the tax schedule shown in Table 1 based on the original Administration and House versions of FAP. Different tax rates take effect at different levels of earnings. Between 0 and $720 of earnings, only the social security and food stamp taxes apply. Thus, for example, a man earning $720 loses 5.2 percent of $720 (or $37) in social security taxes; and then the food stamp authorities will reduce the family's food stamp bonus by $205 because take-home pay has increased by $683 (30% x $683 = $205). (Because the food stamp program taxes the net earnings of $683 rather than the gross of $720 at a 30 percent rate, the effective marginal tax rate on the $720 of increased earnings if less than 35.2 percent [5.2 + 30.0]; it is 33.64 percent.) At $720 of annual earnings, the 50 percent FAP tax takes effect and the total effective tax rate on earnings rises to 68.64 percent, which exceeds the highest tax rate in the positive income tax system (65 percent). When the 14 percent positive income tax rate takes effect, the aggregate rate climbs to 78 percent. (We have assumed a positive income tax after $3800 based on the tax reform act of 1969 and our interpretation of how the new law would apply in 1972. No state taxes are included.) Note that these high rates apply over the broad range of earnings ($720 - $3920) in which most working recipients will find themselves. Thus the actual tax rate on earnings in the eight low-payment

TABLE 1

Direct Taxes on Earnings and Losses in Benefits that Result from Compounding of Tax Rates in Low-benefit States (Original Administration and House Version of FAP)

(A) Gross Earnings	(B) Social Security Tax [5.2% of A]	(C) Positive Income Tax[a]	(D) Take-home Pay [A-(B+C)]	(E) FAP Payment [1600 - 1/2(A-720)]	(F) Food Stamps [1272 - .3(D+E-360)]	(G) Total Income [D+E+F]	(H) Change in Earnings [change in col. A]	(I) Change in Total Income [change in col. G]	(J) Marginal Tax Rate Over Interval of Earnings.[b]
			dollars						%
0	0	0	0	1600	900	2500	720	478	33.64
720	37	0	683	1600	695	2978	3080	965	68.64
3800	198	0	3602	60	281	3943	120	26	78.44
3920	204	17	3699	0	270	3969	880	498	43.44
4800	250	140	4410	0	57	4467	236	132	44.14
5036	262	175	4599	0	0	4599			

See footnotes on following page.

Footnotes for Table 1.

[a]The \$3800 level is where the head of a family of four will begin to pay positive income taxes, assuming that a family head may claim a \$700 exemption for each family member, and a \$1000 standard deduction. (These assumptions approximate how the new tax law amendments will affect low-income families.) The tax amounts are 14% on the first \$1000 in excess of \$3800; \$140 plus 15% of the first \$1000 in excess of \$4800; and \$290 plus 16% of the first \$1000 in excess of \$5800.

[b]The marginal tax rate on earnings is not assumed to be the simple sum of the various tax rates which apply to earnings. For example, if the social security tax rate is 5.2% and the food stamp tax is 30%, then the (total) marginal tax rate on earnings is not 35.2% (5.2% + 30%), since the food stamp authorities tax the take-home (or net) earnings. The amount of the tax over the bracketed income range is given by the following formula:

$$\text{tax on } [0\text{-}\ 720] = 5.2\%A + 30\%(A-5.2\%A)$$

where A=gross earnings. The tax rate formulas become more complicated as positive income rates and FAP tax rates are added, and these formulas are listed below:

$$\text{tax on } [720\text{-}3800] = 5.2\%A + 50\%(A-720) + 30\%[A-50\%(A-720)-5.2\%A]$$

$$\text{tax on } [3800\text{-}3920] = 5.2\%A + 14\%(A-3800) + 50\%(A-720)+30\%[A-50\%(A-720) - 5.2\%A-14\%(A-3500)]$$

$$\text{tax on } [3920\text{-}4800] = 5.2\%A + 14\%(A-3800) + 30\%[A-5.2\%A-14\%(A-3800)]$$

$$\text{tax on } [4800\text{-}5036] = 5.2\%A + 15\%(A-4800) + 30\%[A-5.2\%A-15\%(A-4800)]$$

The given tax rates apply to all earnings within a particular interval. There are "kinks" or discontinuities in the schedule of tax rates because different rates come into effect at different points. For example, federal income taxes don't take effect until the \$3800 level.

states should be thought of as being in the 68 to 78 percent range, not at the widely discussed 50 percent level.

While these tax rates are high, even steeper ones confront female heads of households in the 42 states with AFDC benefits which are higher than FAP benefits. This point is illustrated in Tables 2 and 3 using a hypothetical (but plausible) guarantee of $3720 for a family of four. Table 2 applies to the original Administration and House versions of the bill, and this differs in several important respects from the second Administration proposal. A major difference is that the maximum implicit tax rate on the state supplement contribution is 66 2/3 percent in the new new version and was 80 percent in the old version. Another important change in the new version of the bill is the exclusion of male-headed families from federally supported state supplemental payments. Thus, the rates and payment schedule in Table 2 applies to families with female heads to families with male heads who meet the employment criterion for AFDC-UF coverage. In Table 3 the schedules apply only to female-headed families. Other changes in the new version of the Administration's FAP proposal will be noted below when Table 3 is discussed.

In Table 2, we see that between $720 and $2761 of earnings, the total marginal tax rate on earnings is 80 percent; this is because social security taxes are being paid and FAP payments, state supplementary payments, and food stamps are all being reduced (as specified in the formulas shown in Table 2). The tax rate drops to 72 percent in the income range between $2761 and $3800. The reason for the decline is that the food stamp bonus (and its associated implicit tax) disappears at $2761, and the positive income tax does not take effect until earnings reach $3800. In the relatively broad earnings bracket from $3920 to $5432, the

TABLE 2

Direct Taxes on Earnings and Losses in Benefits that Result from Compounding of Tax Rates in High-benefit States
(Original Administration and House Version of FAP)

(A) Gross Earnings	(B) Social Security Tax [5.2% of A]	(C) Positive Income Tax[a]	(D) Take-home Pay [A-(B+C)]	(E) FAP Payment [1600 - 1/2(A - 720)]	(F) State Supplement Payment[b] 360)]	(G) Food Stamps [1272 - 13(D+E+F-	(H) Total Income [D+E+F+G]	(I) Change in Earnings [change in col. A]	(J) Change in Total Inc. [change in col. H]	(K) Marginal Tax Rate over Interval of Earnings.[c]
dollars										%
0	0	0	0	1600	1743	377	3720			
								720	478	33.64
720	37	0	638	1600	1743	172	4198			
								2041	403	80.31
2761	143	0	2618	580	1403	0	4601			
								1039	291	71.87
3800	198	0	3602	60	1230	0	4892			
								120	16	85.87
3920	204	17	3699	0	1209	0	4908			
								880	8	99.2
4800	250	140	4410	0	506	0	4916			
								32	-1	100.2
5432	282	235	4915	0	0	0	4915			

See footnotes on following page.

Footnotes to Table 2.

[a]See Table 1, footnote a.

[b]The state supplement (F) is assumed to be \$1743, an amount selected to provide a total supplement of \$3720 to a family of four earning no income. The formula for computing F is shown most simply in three expressions. The state supplement tax rate is 0 up to 720 and 1/6 up to \$3920 (the point at which FAP benefits end) and is set at 80 percent on income in excess of \$3920.

$$A < 720, \; F = 1743$$

$$720 < A < 3920, \; F = 1743 - 1/3[1/2(A-720)] = 1863 - 1/6A$$

$$A > 3920, \; F = 1743 - .8(A-3920)-1/3(1/2)(3920=-720)$$

$$= 4346 - .8A$$

[c]See Table 1, footnote b, in conjunction with the following formulas which apply to Table 2 above:

$$\text{tax on } [0-720] = \left.5.2\%A + 30\%(A-5.2\%A)\right\} = 33.64\%A$$

$$\text{tax on } [720-2761] = \left.\begin{array}{l} 5.2\%A + 50\%(A-729) + \\ 33.3\%[50\%(A-720)] + \\ 30\% \;\; A-50\%(A-720) - \\ 33.3\%[50\%(A-720)] - \\ 5.2\%A \end{array}\right\} = \begin{array}{l} 80.03\%A + \\ \text{(a constant)} \end{array}$$

$$\text{tax on } [2761-3800] = \left.\begin{array}{l} 5.2\%A + 50\%(A-720) + \\ 33.3\%(50\%A-720) \end{array}\right\} = \begin{array}{l} 71.8\%A + \\ \text{(a constant)} \end{array}$$

$$\text{tax on } [3800-3920] = \left.\begin{array}{l} 5.2\%A + 50A(A-720) + \\ 33.3\%(50\%A-720) + \\ 14\%(A-3800) \end{array}\right\} = \begin{array}{l} 85.87\%A + \\ \text{(a constant)} \end{array}$$

$$\text{tax on } [3920-4800] = \left.\begin{array}{l} 5.2\%A + 50\% \; (A-3920) \\ + \; 14\%(A-3800) \end{array}\right\} = \begin{array}{l} 99.2\%A + \\ \text{(a constant)} \end{array}$$

$$\text{tax on } [4800-5432] = \left.\begin{array}{l} 5.2\%A + 80\%(A-3920) + \\ 15\%(A-4800) \end{array}\right\} = \begin{array}{l} 100.2\%A + \\ \text{(a constant)} \end{array}$$

tax rate is at the confiscatory level of 99 to 100 percent. This means that a worker earning $2.50 per hour will increase his total income at a rate of from zero to 2 cents per hour worked! For persons receiving income-conditioned rent supplements and public housing subsidies, or paying state and local income taxes, the combined tax rate will be even higher.

High tax rates were a major reason the Senate Finance Committee requested on May 1970 that the Administration revise the first version of the bill. The proposals made by the Administration in June 1970 lower the tax rates in four ways: (1) FAP and state supplementary payments are calculated on earnings after deducting federal income taxes; (2) the maximum tax rate on state supplements was lowered from 80 percent to 66 2/3 percent; (3) Medicaid was replaced with a health insurance plan, which substitutes lower graduated taxes for the higher tax rate implicit in a categorical program;[9] and (4) all male-headed families were dropped from coverage of AFDC-UF and thus no longer face the 66 2/3 percent tax on state supplements. The new rates and payment amounts for difference levels of incomes are shown in Tables 3 and 4. Note that the food stamp allowance (which here has a 31.8 percent tax and a $240 set-aside) and the health insurance allowance are calculated on the basis of the sum of gross or pre-tax earnings plus the payments from FAP and the state supplements.

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[9] The Administration also proposes to make rent payments income-conditioned for families living in public housing. Like the reform in providing health insurance, an income-conditioned payment avoids the sharp break at the amount of family income when the family becomes ineligible to receive the subsidy. The implicit tax rate at that income amount is likely to be astronomically high. For example, some nominal amount of additional earnings (theoretically, one more dollar), which lifts the family's income over the cut-off point for receiving aid, might entail the loss of, say, $1600 worth of housing subsidies. Graduated taxes substitute tax rates over the entire range of income, but this is preferable to a categorical means test. We do not include the treatment of housing subsidies in our paper, since only about 6 percent of all FAP families will be receiving these subsidies.

TABLE 3

Direct Taxes on Earnings and Losses in Benefits: High-benefit States for Female-headed Families (New Administration Version of FAP)[a]

(A) Gross Earnings	(B) Social Security Tax [5.2% of A]	(C) Positive Federal Income Tax[b]	(D) Take-home Pay [A-(B+C)]	(E) FAP payment[c] [1600 - 1/2(adj. A-720)]	(F) State Supplement Payment[d]
dollars					
0	0	0	0	1600	1878
720	37	0	683	1600	1878
846	44	0	800	1537	1857
1626	85	0	1541	1147	1727
3800	198	0	3602	60	1365
3940	205	20	3715	0	1344
4726	246	130	4350	0	894
4800	250	140	4410	0	852
5800	302	290	5208	0	285
6309	328	371	5610	0	0

Footnotes

[a]The example below applies to a state guaranteeing $3720 for a family of four, not including health benefits.

[b]See footnote a, Table 1.

[c]FAP payments are based on gross earnings minus the federal income tax. Thus, the breakeven point is $3940 of gross earnings, since at this level of earnings federal income taxes (column C) are $20. "Adj. A" is, therefore, $3920--the point at which FAP payments are zero.

[d]State supplement, F, is assumed to be $1878 at zero earnings, an amount selected to provide a total supplement of $3720 for a family of four, not including the medical insurance. The formulas for computing the state supplement are as follows. "A" is gross earnings.

$0 < A < 720 \quad F = 1878$

$720 < A < 3800 \quad F = 1878 - 1/3[1/2(A-720)] = 1998 - 1/6A$

$3800 < A < 3940 \quad F = 1878 - 1/3[1/2(A-.14\ A-3800\ - 720)] = 1909 - .1434A$

$3940 < A < 4800 \quad F = 1878 - 2/3[A-.14(A-3940)-3940] - 1/3[1/2(3940 - .14\ 3940-3800 - 720)] = 3604 - .5734A$

$4800 < A < 5800 \quad F = 1878 - 2/3[A-.15(A-4800)-4800] - 1026 = 3572 - .5667A$

$5800 < A < 6309 \quad F = 1878 - 2/3[A-.16(A-5800)-5800] - 1593 = 3533 - .56A$

Table 3 continued

(G) Gross Money Income [A+E+F]	(H) Food Stamps [1272 - .318 (A+E+F-240)]	(I) Medical Insurance[e]	(J) Total Income [D+E+F +H+I]	(K) Change in Earnings [change in col. A]	(L) Change in Total Income [change in col. J]	(M) Marginal Tax Over the Interval of Earnings[f]
	dollars					%
3478	242	382	4102	720	382	47.00
4198	13	310	4484	126	16	87.30
4240	0	306	4500	786	195	75.20
4500	0	280	4695	2174	431	80.20
5225	0	99	5126	140	17	87.86
5284	0	84	5143	786	101	87.15
5620	0	0	5244	74	18	76.68
5652	0	0	5262	1000	231	76.97
6085	0	0	5493	509	117	77.00
6309	0	0	5610			

Footnotes

[e]Medical insurance has a basic premium value of \$500. The contribution schedule of the FAP recipient is: 0% of gross income (column G) to \$1600; 5% of G from \$1600 to \$3000; 10% of G from \$3000 to \$4500; and 25% of G from \$4500 to \$5620.

$0 < G < 1600 \quad I = 500 - 0$
$1600 < G < 3000 \quad I = 500 - 5\%(G-1600)$
$3000 < G < 4500 \quad I = 500 - 70 - 10\%(G-3000)$
$4500 < G < 5620 \quad I = 500 - 220 - 25\%(G-4500)$

[f]Tax rates on

[0-720] = 5.2% + 31.8% + 10% = 47%
[720-840] = 5.2% + 31.8% - 15.9% - 5.3% + 50% + 16.67% + 10% - 5% - 1.67% = 87.3%
[840-1626] = 5.2% + 50.0 + 16.67 - 10.0 - 5.0 - 1.67 = 75.2%
[1626-3800] = 5.2% + 50.0 + 16.67 + 25.00 - 12.5 - 4.17 - 80.20
[3800-3940] = 5.2% + 14.0 + 50.0 - 7.0 + 16.67 - 2.33 + 25.00 - 10.75 - 3.59 = 87.86%
[3940-4695] = 5.2% + 14.0 + 66.67 - 9.33 + 25.00 - 14.34 = 87.20%
[4695-4800] = 5.2% + 14.0 + 66.67 - 9.33 = 76.68%
[4800-5800] = 5.2% + 15.0 + 66.67 - 10.00 = 76.97%
[5800-6332] = 5.2% + 16.0 + 66.67 - 10.67 = 77.20%

We see in Table 3 that, for female-headed families in high benefit states, the new tax rates and payment amounts (allowing for Medicaid benefits in the old version) are not very different from those in the old schedules shown in Table 2 for earnings up to \$3920 (or \$3940). Past this level of earnings, the new tax rates are around 75 to 80 percent, whereas the old rates were about 100 percent. Benefits are also more generous in the income ranges above \$3940, and the breakeven level is raised from \$5432 in the old to \$6309 in the new version. The liberality of the newer version will raise budgetary costs somewhat, but this would probably be offset by the exclusion of male-headed families from state supplemental benefits. There is some improvement in work incentives as noted above, but tax rates of 75 to 80 percent are still discouragingly high.

Table 4 shows the tax rates and benefit amounts that would apply to all families with male heads in all fifty states and to female-headed families in the eight low-benefit states. Two points from the table deserve emphasis: (1) the incentive to desertion by the father and (2) the disappointingly high tax rates that are in effect. On the first point, compare the difference in family total benefits in Table 3 (column J) and Table 4 (column I) for the same earnings amounts. At zero earned income, for example, the differences in total benefits between male-headed and female-headed families of the same size in the same state is \$1162. If the male head of the household were to leave his family, the payments would drop by his share of the benefits from FAP, food stamps, and medical insurance, but the remaining family members could receive <u>increased</u> payments because they become eligible for the state supplements. In a state such as that illustrated in Table 3 the total benefits at zero-earned income for a female-headed family of three would be \$3406,[9A] which is \$466 <u>more</u> than the \$2940

[9A] A family of three in a state that guaranteed a poverty level income of \$3120 would be able to receive \$1300 in FAP benefits, \$135 in food stamps, and \$1685 in state supplements. In addition, we have estimated that the medical insurance subsidy would be worth \$286. Thus, the total income of the family of three is \$3406.

TABLE 4

Direct Taxes on Earnings and Losses in Benefits: Male-headed Families in All States and Female-headed Families in Low-Benefit States (New Administration Version of FAP)

(A) Gross Earnings	(B) Social Security Tax [5.2% of A]	(C) Positive Federal Income Tax[a]	(D) Take-home Pay	(E) FAP payment [1600 - 1/2 (adj. A-720)][b]
0	0	0	0	1600
720	37	0	683	1600
2080	108	0	1972	920
3800	198	0	3602	60
3940	205	20	3715	0
4240	220	62	3958	0
4500	234	98	4168	0
4800	250	140	4410	0
5620	292	263	5065	0

Footnotes

[a]See footnote a, Table 1

[b]See footnote c, Table 3

TABLE 4 continued

(F) Gross Money Income (A + E)	(G) Food Stamps [1272 - .318 (F - 240)]	(H) Medical Insurance[c]	(I) Total Income [D+E+G +H]	(J) Change in Earnings [change in A]	(K) Change in Total Income [change in I]	(L) Marginal Tax[d]
1600	840	500	2940	720	420	42.00
2320	611	466	3360	1360	356	73.60
3000	394	430	3716	1720	411	76.10
3860	121	344	4127	140	19	86.03
3940	95	336	4146	300	118	60.67
4240	0	306	4264	260	184	29.23
4500	0	280	4448	300	167	44.20
4800	0	205	4615	820	450	45.20
5620	0	0	5065			

Footnotes

[c] See footnote c, Table 3

[d] Tax rates on [0-720] = 5.2% + 31.8% + 5% = 42%
[720-2080] = 5.2% + 50% + 31.8% - 15.9% + 5% - 2.5% = 73.6%
[2080-3800] = 5.2% + 50% + 31.8% - 31.8% + 10% - 5% = 76.1%
[3800-3940] = 5.2% + 14% + 50% - 7% + 31.8% - 13.67% + 10% - 4.3% = 86.03%
[3940-4239] = 5.2% + 14% + 31.8% + 10% = 61%
[4239-4500] = 5.2% + 14% + 10% = 29.2%
[4500-4800] = 5.2% + 14% + 25% = 44.2%
[4800-5620] = 5.2% + 15% + 25% = 45.2%

available to the male-headed family of four. An amount as high as $466 is not trivial and measure the incentive to family break-ups which FAP had intended to reduce or eliminate. On the second point, the tax rates on earnings are again relatively high--from 74 to 86 percent--over the poverty income range of $720 to $3940. From $3940 to $5620 the rates are lower but still high, 44 to 61 percent, except for a brief interval from $4240 to $4500 when the rate falls to 29 percent.

These high tax rates are inconsistent with a major objective of FAP, the minimizing of financial disincentives to work. The problem illustrates the consequences of the failure to institute a high benefit, single tax rate, universal income maintenance scheme. Table 5, however, embodies a proposal which would be a significant step in this direction. The food stamp program is replaced with additional cash allowances, permitting a total FAP payment of $2400 to a family of four with zero earnings. The $720 set-aside is eliminated here to simplify the illustration and to lower the budgetary costs of the proposal. Most importantly, the tax rate on FAP benefits is 50 percent, and we see the effect of allowing a double deduction from earnings of social security and income taxes. Allowing a deduction of twice the sum of social security and income tax payments from earnings before the earnings are "taxed" by FAP, along with converting food stamps to cash, prevents the tax rates from rising above 50 percent (see column J). This reform would, of course, raise budgetary costs since some social security and income taxes would be foregone by the government and FAP payments would not be reduced to zero until a family receives $6118 in earnings. Note, however, that FAP payments over the earnings range of $4800 to $6118, although positive, would amount to less than the positive income tax.

If the reduced tax rate would result in less work disincentive than the presently proposed bundle of programs, and thus more taxable earnings, the costs of the proposed change may be minimal or nonexistent. Furthermore,

TABLE 5

Direct Taxes on Earnings and Losses in Benefits that Result from Compounding of Tax Rates in Recommended Systems[a]

(A) Gross Earnings	(B) Social Security Tax [5.2% of A]	(C) Positive Income Tax[b]	(D) Take-home Pay [A-(B+C)]	(E) FAP Payment No Deduction [2400-1/2(A)]	(F) FAP Payment Double Deduction [2400-1/2[A-2(B+C)]	(G) Total Income No Deduction [D+E]	(H) Total Income Double Deduction [D+F]	(I) Marginal Tax Rate-No Deduction	(J) Marginal Tax Rate-Double Deduction
dollars								%	%
0	0	0	0	2400	2400	2400	2400	55.2	50.0
3800	198	0	3602	500	698	4102	4300	69.2	50.0
4800	250	140	4410	0	390	4410	4800	20.2	50.0
5800	302	290	5208	0	92	5208	5300	21.1	50.0
6118	318	341	5459	0	0	5459	5459		

Footnotes

[a]The recommended system replaces food stamps with an $800 cash allowance at zero earnings for a family of four; it thus has a basic FAP payment of $2400, contains no set-aside for work-related expenses, and allows a double-deduction for social security and income taxes. (FAP payments and tax rates with no deductions are shown in columns E, G, and I for comparison purposes.)

[b]See Table 1, footnote a.

[c]Note that between $3800 and $4800 of earnings, FAP payments exceed the sum of income and social security taxes, at $4800, they are equal; above $4800, FAP payments are positive but less than tax payments, until earnings reach $6118, when the FAP payments fall to zero.

state supplements would be overridden in many states, thus eliminating the exceedingly high tax rates that arise from them. A problem would remain, of course, in those states that presently guarantee recipients more than $2400 per year. We recommend freezing the rolls of the high benefit state programs--add no new families and allow attrition of existing families--and placing a ceiling on future increases in these plans, except for cost of living adjustments. If the FAP benefits could entail gradual increases over time up to levels of $3500 or so, then FAP would eventually override all state categorical programs.

Getting on and off FAP rolls

One disincentive to employment to current recipients of public assistance is the barrier (real or imagined) a welfare recipient sees as blocking his return to the welfare rolls if the job he gets fails to provide permanent self-sufficiency. FAP should remove this source of dependency. Under FAP the working poor receive benefits, so there can be a smooth transition off and on the FAP rolls as recipients gain and lose employment in jobs paying above poverty levels. (Precisely what accounting period is used in determining the amount of a family's benefit is a closely related and complicated question that will be discussed shortly.)

The transition on and off FAP rolls should be particularly smooth for female-headed families and is a definite improvement over AFDC in this regard. Under the original Administration and House versions of the bill, however, disincentives to work and also some inequities remain for male-headed families in the 42 states granting state supplements for AFDC-UF eligible families. They become eligible for state supplements--and in some states for the substantial benefits of the Medicaid program--only by being "unemployed." The definition of "unemployed" for purposes of eligibility for AFDC-UF varies among states, but the initial FAP legislation required states to continue giving AFDC-UF aid to a man until he works thirty or more hours per week or more than 3/4 of the number of hours considered by the man's industry to be full time for the job, whichever is reached first. The thirtieth hour of work in a week renders the family ineligible for any state supplement and for Medicaid, regardless of the level of his earnings. Thus, the eligibility stipulations for the state supplements create special incentives for male heads to reduce their work effort in order to qualify for the maximum amounts of benefits--an unfortunate feature of the present welfare system which was proposed to be extended to a much larger population under FAP (since an additional 27 states were to institute an AFDC-UF program).

The most recent version of the Administration's bill dispenses with this incentive for male heads to become or to stay less than fully employed by the drastic expedient of eliminating all federal support to the AFDC-UF program. Around 90,000 families now receiving AFDC-UF benefits would suffer financially. This blow could be avoided by the simple device of closing the AFDC-UF rolls to new accretions while permitting current recipients to receive benefits until they are able to leave on their own. The turnover of AFDC-UF beneficiaries is quite high, so the freeze would not be expected to create a permanent category of wards of the state receiving high benefits. The elimination of AFDC-UF also creates, as we noted above, incentives to family split-ups, and we will turn to this problem again below.

Work expenses and child care costs of working parents

On rationale for the deduction of $720 from annual family earnings before calculating FAP payments is that this amount, equal to $60 a month, corresponds roughly with the expenses incurred in earning income. This objective can be met more directly by allowing deductions of up to $50 a month from the earnings of the first adult earner and up to $25 a month for each additional adult earner. Deductions of these amounts would remain within the budget limits implied by the annual deduction of $720 per family, and they would provide more horizontal equity among families with different numbers of adult earners and among families where the earners work different numbers of months per year. Further, the added incentive for secondary earners to work might eventually result in reduced FAP payments.

FAP allows a deduction from income for costs of child care for an employed mother, widowed father, or other guardian. It extends to poor families a subsidy that is now offered only to those female heads of households who earn enough to be in the positive income tax range. If the implicit tax rate on income is 50 percent, then deducting the full costs of child care lessens these costs to the family by 50 percent (if the tax rate is 80 percent, the cost to the family is only 20 percent), with the federal and state governments absorbing the other 50(80) percent in the form of higher FAP and state supplemental benefits. A complete subsidy could be affected by allowing a deduction of the cost divided by the tax rate (e.g., a double deduction with a 50 percent tax rate), with a specified maximum deduction.

For some parents, the FAP legislation goes further in subsidizing child care. At substantial cost, the bill provides for the funding of 450,000 day care slots, at $900 each, which offer educational, health, nutritional, and other services in addition to custodial services. The rationing device by which this sizeable subsidy is to be extended to some mothers but not to others is not clear, but it seems likely that those mothers who have not been working and who are referred to training and employment by local agencies administering FAP will be given the highest priority. It is hard to justify this rationing criterion: the children of these mothers are not necessarily those who would most benefit from an enriched day-care program; nor are these the mothers, necessarily, who should be especially enticed to substitute market work for homework.

The day-care service could be allocated on the basis of a work test, an income test, and the charging of fees (or some combination of these methods), but a number of difficulties exist with these allocation procedures. One type of fee assessment would be a categorical means test: free child care for the mother who makes less than, say, \$1500 a year, and some positive charge, say \$10 a week or \$520 a year, if she makes more than this amount. The serious defect of this arrangement may be indicated by pointing out that the "cost" of earning the 1500th dollar to a mother is \$519. Another fee arrangement would be a system of graduated charges that rise with the earnings of the mother. The drawback of this scheme is that another tax rate on earnings is piled on top of the existing tax rates.

While there may exist a valid rationale for a system of subsidized day-care programs, we suggest this system not be tied to FAP. The target populations of the two programs, while not mutually exclusive, are not the same. Day care programs are aimed at preschool children, whereas mothers of preschool children are not required to work under FAP.

The work and training test

The bill requires certain family members to register with the local employment service for manpower services, training, and employment. At the discretion of local administrators of the program, FAP benefits may be denied those family members who do not register or who refuse to participate without good cause in suitable manpower services, training, or employment. The registration requirement itself can be useful as a means of bringing a variety of manpower services to the attention of low-income people. What is questionable, however, is the provision which allows for the denial of payments to individuals who refuse to participate in a training program or take a job.

We find the work test objectionable on several grounds. The fist is that it conflicts with the principle--admittedly not universally held--that the receipt of income supplements should be a right and not a privilege. The second objection is the danger that the work test will be subverted by low-wage employers who will veiw FAP recipients as a source of cheap labor. The state employment service may be willing to cooperate in this endeavor in an effort to reduce FAP expenditures--an understandable objective of a governmental agency. The costs of compelling a mother of school-age children to forego "home production" are easy to ignore under these pressures. Indeed, the lack of an explicit recognition of this home production in the work test criteria is another reason we object to the work test as specified in FAP.

The fourth objection is that the administrative complexity of enforcing a work test may be excessive. For example, should a carwasher who is laid off during a rainy spell be required to take a different job? Should a factory worker who is reduced from 40 to 25 hours work per week be required to train for another occupation? What should be done about an ice cream vendor in the winter? What kind of work will be defined as "suitable" for a mother with no previous work experience, and what kind of job will she be required to accept to maintain her portion of FAP benefits? These questions are intended to suggest the difficulty of administering a work test, especially for a population of marginal workers whose work patterns are typically unstable. Finally, there persists the danger that the work test may be administered in a discriminatory manner, e.g., imposed on certain groups (blacks) and not on others (whites) at the whim of local officials.

We see no evidence for the belief that a work test is necessary to maintain work effort, given reasonable implicit tax rates. A current OEO experiment with the negative income tax in New Jersey has shown little, if any, work disincentive.[10] In New York City, a general assistance program has long supplemented the earnings of low-income male-headed families. In spite of the fact that these male heads would have lost nothing by reducing their work effort, the overwhelming majority stayed with their jobs. The commitment to work appears to be a pervasive trait among all income strata. Furthermore, reduced work effort will mean lost income under FAP because the implicit tax rate is less than 100 percent. Finally, most workers are severely restricted in the control they have over their hours of work--they cannot voluntarily step in and out of jobs without paying a high price for such manifest instability.

Although our overall judgment is that the potential savings in FAP funds that result from applying the work test do not offset its shortcomings, we recognize the political pressures for its retention. Many legislators and much of the public demand a work test. We also are aware

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[10] Harold W. Watts, "Adjusted and Extended Preliminary Results from the Urban Graduated Work Incentive Experiment," Discussion Paper Series 69-70, Institute for Research on Poverty, University of Wisconsin, 1970.

that the work test built into AFDC by the 1967 public assistance amendments has not, in general, been harshly enforced. Further, the FAP work test, unlike that in the 1967 law, will not apply to women with children under six. We suggest several additional changes, however: giving training and jobs first to volunteers; requiring mothers of school-age children to work or train only during school hours unless supervised child care is available; carefully stipulating how long a person has to be out of work before he is pursued; and specifying that a person can be assigned only to a job that is comparable in pay and working conditions with his previous employment and that pays no less than 90 percent of the federal minimum wage. Such safeguards should be acceptable to all sides on this issue, but their detail should again illustrate the problems associated with a lack of specificity in the law and a reliance upon local officials to determine when and in what manner they will interfere with the work decisions of individuals.

INCENTIVES TO FAMILY STABILITY

No charge has been more frequently leveled at the AFDC program than that it promotes family break-ups. To date, families headed by destitute males have been able to receive public assistance in less than half the states. This incentive for male heads to desert in order to qualify their families for AFDC is sharply reduced under FAP. Aid will be provided to all families with children whose incomes fall below FAP breakeven levels, as well as to many families whose incomes rise to slightly higher levels in the 42 higher-benefit states.

The state supplement program poses a dilemma: if state supplements are granted widely to male-headed families, as is intended in the first bill's greatly expanded AFDC-UF program, then there arise the disincentives to work and the 30-hour-week inequities described earlier. On the other hand, if the supplements are restricted to female-headed families, as they do now in the main, and as they would in total if the Administration's later proposal to eliminate AFDC-UF is implemented, then most (or all) poor families with male heads would be covered only by FAP. In this case, the gap between FAP benefits and the higher AFDC benefits will continue to offer some incentives for male heads to desert. Again, the way out of this dilemma is to raise the FAP guarantee and break-even level with no increase in implicit tax rates. By doing this, the goals of work incentives, horizontal equity, and family stability incentives can be simultaneously achieved. But the costs of the FAP program would be higher.

There remains one feature in the present bill which will discourage males from assuming the role of the head of a fatherless family. A stepfather is to be held responsible not only for the support of his new wife but also for her children by previous mates. An alternative, that invokes less of a financial penalty on the family for having gained a stepfather, is to reduce the FAP payment by the extent to which the new husband supports his wife and by the extent to which he volunteers support for her children.[11]

EQUITY IN BENEFITS FOR POOR FAMILIES WITHIN AND ACROSS STATES

The Accounting Period

The motivation behind many of the foregoing suggested changes in the bill has been the desire to attain "horizontal equity"—equal benefits to equally poor families. The definition of "equally poor" was shown to have

[11] Moreover, this provision may be unconstitutional. The U.S. Supreme Court recently ruled that a husband is not responsible for support of his stepchildren.

involved family size, net worth, and sources of income, among other considerations. We have not discussed the question of the time period over which the income status of the family is to be measured.

A reasonable length of time is a one-year period, which implies that two families with the same yearly income should receive the same amount of FAP payments for that year. To do otherwise would waste scarce FAP funds by making payments to people whose incomes fluctuate seasonally, but whose annual incomes are above the FAP break-even point. Moreover, if eligibility for FAP benefits were defined over a shorter time period, some families (particularly the self-employed) would be encouraged to concentrate their income in one part of the year.

How best to adjust FAP payments, which probably ought to be made as frequently as every two weeks or at least once a month, to respond to within-year fluctuations in family incomes is a difficult problem and has not been satisfactorily addressed in the proposed FAP legislation. The issues that arise may be brought out by some examples. Consider a system in which the FAP payment for the current month is based on last month's income. If a family has no income in the first month, it would be entitled to a FAP payment (say one-twelfth of its annual entitlement) at the beginning of the second month. But then, if, during the second through the twelfth month, the family's income exceeds the break-even point, it would owe the government the amount it received at the beginning of that second month. Such year-end reconciliations could cause some minor hardships on families that do not plan ahead wisely, and there would be administrative problems in recovering such overpayments.

The need for year-end reconciliations should be avoided, and one way to do so is to use a lagged period of one year for calculating payments.

One alternative is to make all FAP payments in the current year contingent upon the income received last year. The problem with this sytem is clearly that the payments made in the current year may bear no relation to the needs of the family that year. Zero income in the current year, for example, would not produce any FAP payments if last year's income was at or above the break-even point, and the FAP payments forthcoming in the next year might coincide with another year of high earnings. This accounting procedure is undesirable because it makes the system so unresponsible to need.

An accounting system that would be slightly more responsive to needs would be one in which the payments <u>this month</u> are based on an average of the previous 12 months' income. A family that was right at the break-even point for the previous 11 months would begin to get some payments after a month of zero income. Even here, however, the amount of FAP payments would only be 1/12 of the monthly guarantee. Not until the family had experienced 12 months of zero income would it receive the full monthly guarantee.

An accounting system which both avoids the year-end reconciliation and is relatively responsive to current needs is one in which a one-month accounting period is combined with an income carry-forward feature. Under this system, a family would "carry forward" the amount of income which exceeded the break-even amount over the previous 12 months, and this carry-forward amount would be assigned to the current month's income if it fell below the break-even point. Since the accounting period is basically the previous 12 months, there is no year-end reconciliation. That this method is more responsive to current need can be illustrated with some examples. If a family was right at the break-even level for 12 months, it would get a full-sized monthly FAP payment if its income fell to zero during the 13th month because it would have had no income to carry forward. If, by contrast, the family's income for the previous 12 months had exceed the break-even amount by \$200 and it earned \$50 in the 13th month, then the FAP payment would be based on a one month's income of \$250 (\$200 carry-forward + \$50 current income). Assume the family had four persons; it then would be eligible for FAP benefits, since \$250 per month for 12 months is \$3000, which is below the break-even amount of \$3920. A FAP payment of slightly more than \$38 would be made for that month, since \$38 is 1/12 of \$460, which is the yearly FAP benefit if the previous 12-month's income is \$3000.[12] If the family's earnings continue to be \$50 the next month, the FAP payment rises to the full amount (1/12 of \$1600, or \$133, since the \$50 is counted in the set-aside).

More details could be added to this brief discussion of the problem of the accounting period, but enough has been said to indicate how its resolution is an important determinant of who gets FAP payments, how much they get, and how responsive to current needs such payments will be. Such an important issue should not be left, as it is now, to the discretion of "the Secretary." The principle of horizontal equity is not effectively upheld in the current FAP bill, which emphasizes quarterly periods and makes no mention of an annual adjustment. Although the bill provides for "the Secretary" to consider income received in other periods, such discretionary power and administrative intervention would be unnecessary if sufficient detail were specified explicitly in the bill.

The bill deals with the problem of making the payments responsive to current needs by providing funds for emergency payments. While such an emergency fund is probably necessary, it should not and need not be

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[12]The annual FAP benefit of \$460 is based on the formula \$1600 - 1/2(\$3000 - \$720).

the sole vehicle to insure responsiveness. The more reliance placed on an emergency fund, the more room for indiscriminante determination of an "emergency" by a case worker, and the larger the administrative expense. This can be minimized if the carry-forward procedure is adopted. It would achieve equity in benefits over a year's accounting period while maintaining a reasonable balance between being responsive to current needs of FAP families and requiring greater self-reliance of these families to plan their receipts and expenditures throughout the year. Finally, the suggested system avoids the need to recover overpayments at the end of a year.

Uniformity across states

In a statement describing the current welfare system, ex-Secretary Finch spoke of its "unjustifiable discrepancies as between regions of the country . . . with no national standards for benefit levels and eligibility practices,"[13] and he argued for corrections of these faults by FAP. The bill goes a long way towards achieving this objective, but sources of interstate discrepancies remain. The principal source, as we have mentioned, is the varying levels of state supplemental benefits. We discuss below two other areas in which improvements could be made: the locus of administrative control, and the amount of discretionary authority to administer the bill.

The bill allows for any one of three administrative set-ups: a state can distribute the basic benefit and its own supplement; it can allow the federal government to do both; or it can share responsibility with the federal government with each distributing its own benefits. Whatever the administrative arrangement, the coverage, eligibility rules, payments procedures, etc., are supposed to be the same for all states. Experience under

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[13]Finch, op. cit. p. 50.

AFDC has demonstrated, however, that uniform federal rules administered by different state and local agencies become quite "un-uniform" in application. What is needed is a sharp break with past practices, and this can be facilitated by turning over the administration of the new welfare system to the federal government.

The bill does encourage movement towards complete federal administration of the basic FAP benefit and the state supplement. First, federal administration of the basic FAP program is presumed, with a provision for the Secretary of HEW to contract with existing, local welfare agencies for administration if he so desires. The time required to establish a federal bureaucracy to administer FAP may make this provision necessary, however. To avoid stigmatizing FAP by associating it with traditional welfare departments, it is desirable to press for the immediate formation of a new federal organization. Failing that, a time limit of two years should be placed on state operation of the FAP program.

Since a constitutional bar to having the federal government tax the states precludes a congressional mandate for federal operation of the state supplements, the bill uses an incentive technique to attain this objective. The federal government will pay all of the administrative costs of distributing the state supplement if a state will relinquish that authority, and one-half the cost if the states administer the supplement.[14] A single administrative organization would presumably be more efficient, and a federal administration increases the chances for uniformity.

Even with a federal administrative structure, the adoption of explicit regulations as substitutes for current discretionary authority on such matters as work tests and accounting periods is also necessary to insure uniformity

[14] If the basic FAP payments were high enough to override all state supplements, then federal administration of the whole program would be assured.

in treatment across geographic boundaries. Suggestions relevant to these areas were made in previous sections of the paper.

CONCLUSION

The provisions of the Family Assistance bill have been discussed in terms of achieving the objectives that the Nixon Administration has set for the plan: the alleviation of poverty, the redirection of incentives, the reduction in the gross disparities among states and families in welfare, and the establishment of efficient and humane adminstration of the program. The last mentioned objective was not discussed separately, since this issue arose frequently in discussing various provisions under the headings of the other objectives of the bill. It was particularly in evidence in discussing the work test and federal-state administration.

The Family Assistance Plan promises major improvements in the nation's welfare system, but the bill can be strengthened in several places. Recommended changes have been suggested throughout the paper. The following list may serve as a summary:

A. Administration

1. The federal government should immediately or very shortly administer the basic FAP payment in all states.
2. Discretionary judgments by administrators of the program should be kept to a minimum by explicit provisions in the law and by regulations.

B. Related Programs

1. The food stamp program should be converted to a cash allowance with a consequent increase in the basic guarantee and in the level of income at which FAP payments are reduced to zero.

2. The direct provision of child-care services should be provided for by other legislation and not tied in with FAP.
3. The work test should either be eliminated or, if its inclusion is a political must, it should provide explicit safeguards against objectionable administration.
4. If AFDC-UF is to be eliminated, as recent Administration proposals advocate, then those families now receiving payments under the program should continue to receive payments as a way of avoiding undue hardship.

C. Taxation of Income

1. Except in the instance of children's earnings and Medicaid, income should be treated and taxed uniformly without regard to its source.
2. In place of the asset test used for determining eligibility, there should be an imputation to income based on net worth
3. To reduce the high implicit tax rate on the earnings of FAP beneficiaries, positive income and social security taxes should be fully compensated for by FAP payments.
4. In place of the $720 annual set-aside per family, each employed FAP beneficiary should be allowed to exclude a specified amount of his (her) earnings.
5. Stepfathers should not be held responsible for the children that their spouses bore in previous marriages.

A final word

A basic concern in the formulation of our recommendations is the elmination of disparities across states and, equally important, disparities within states among poor families who do or do not qualify for the current categorical aid programs. These disparities not only constitute inequities, but they foster behavior by which these very forms of categorical aid are increased. The disparities are reduced by FAP and would be further reduced by adopting many of our recommmendations. Nevertheless, their complete elimination can best be achieved by increasing FAP payment levels--which would take the form of a higher break-even point and lower implicit tax rates on earned income. As more funds become available, increases in FAP payments will permit the replacement of all categorical programs. The long run outlook for welfare reform is bright, despite the difficulties and problems we have discussed in this paper--problems which are attributable to current political and budgetary constraints. If our sights are pointed in the right direction, the future availability of funds from sheer economic growth or from other governmental expenditures will permit the financing of a system of universal income guarantees which can achieve all five objectives initially specified.