The Negative Income Tax

Three views by

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Schemes for Transferring Income to the Poor

THIS ARTICLE is about various schemes for transferring additional income to poor people: the "negative income tax," modification of public assistance and social insurance, family allowances, and tax credits. Nine particular methods are evaluated and a selection is made by the authors of the one which seems to them to be most hopeful of a good result per dollar of expenditure.[1]

A Description of Negative Income Taxation

Negative income taxation would use the individual income tax system as a vehicle for closing a portion of the poverty-income gap, i.e., the difference between the actual income of poor families and the income they would need in order not to be poor. It would pay money from the federal treasury to families according to a schedule based on actual income received and family size. For example, a family of four persons with an income of $2,000 might be said to have a poverty-income gap of $1,000. That is, their income is $1,000 below a "poverty line" of $3,000. Similarly, it is $1,000 below their total of personal exemptions and minimum standard deductions under the income tax law. Hence, the $1,000 is that family's unused exemptions and deductions and it can be called their "negative taxable income." To this negative base one could apply a tax rate to compute a "negative tax" or allowance. Thus, a 50 per cent tax rate would yield an allowance of $500 in the example given. The scheme described above is one variant of negative income taxation. In this paper it is later referred to as negative rates taxation.

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[1] The work for this article was done while the authors were members of the Institute for Research on Poverty at the University of Wisconsin. Their earlier writings on the topic include Christopher Green, *Transfer by Taxation: One Approach to Improved Income Maintenance* (Ph.D. dissertation, University of Wisconsin, 1966), and Robert J. Lampman, "The American System of Transfers: How Does it Benefit the Poor?" in L. Goodman, editor, *Social Welfare and Economic Progress* (New York: Columbia University Press, 1966).

One could achieve the same result by paying a standard allowance to all families and then taxing pre-allowance income in such a way that the tax is less than the allowance for poor families but more than the allowance for non-poor families. This is illustrative of the guaranteed minimum income[2] or social dividend[3] approach to negative income taxation.

The similarity between social dividend taxation and negative rates taxation can be understood by noting that each employs the same three basic variables. These basic variables are (1) an income guarantee; (2) a tax rate applied against a tax base; and (3) a break-even level of income where the tax liability equals the allowance guarantee. Any two of these three basic variables determine the third. In negative rates taxation, the income guarantee is the level of negative tax allowances that is received when income other than the allowance or guarantee is zero. In social dividend taxation, the guarantee is the level of gross payments or entitlement for which a family or individual is eligible. The tax base in negative rates taxation is the gap between some standard, such as the value of exemptions and deductions allowed a family or the family's poverty line, and the level of family income. In social dividend taxation the tax base is the family's income before allowance.

TABLE 1
NET ALLOWANCE RECEIVED BY A FAMILY OF FOUR UNDER A NEGATIVE RATES PLAN AND A SOCIAL DIVIDEND PLAN

Negative rates plan			Social dividend plan		
(1) Family income before allowance	(2) Poverty-income gap $3,000–(1)	(3) Net allowance based on 50 per cent of poverty gap	(4) Basic allowance guarantee equal to $1,500 (equal to 50 per cent of poverty line)	(5) Tax liability with 50 per cent rate (50% × (1))	(6) Net allowance (4)–(5)
$ 0	$3,000	$1,500	$1,500	$ 0	$1,500
500	2,500	1,250	1,500	250	1,250
1,000	2,000	1,000	1,500	500	1,000
1,500	1,500	750	1,500	750	750
2,000	1,000	500	1,500	1,000	500
3,000	0	0	1,500	1,500	0

Table 1 indicates that a negative rates plan which fills 50 per cent of a family's poverty gap would provide the same level of allowances as a social dividend plan which guarantees a minimum income equal to 50 per cent of a poverty line and, at the same time, taxes family income up to the

[2] See Robert Theobald, *Free Man and Free Markets* (New York: C. N. Potter, 1963), pp. 192–197, and Edward E. Schwartz, "A Way to End the Means Test," *Social Work*, IX (July 9, 1964), 3–12.

[3] See Lady Rhys-Williams, *Something to Look Forward To* (London: MacDonald, 1943), and *Taxation and Incentive* (New York: Oxford University Press, 1953), pp. 121–137.

break-even line at a 50 per cent rate. Columns (3) and (6) show that for any given level of before-allowance income the net allowance (gross allowance minus tax liability) is the same under each type of plan. Therefore, it is useful to think of negative rates and social dividend taxation as two types of what might be called "transfer-by-taxation."

Transfer-by-taxation differs from other modes of income maintenance in that income and family size are the leading factors which condition benefits. Most, if not all, the eligibility considerations which are used in public assistance or social insurance programs—assets, ability to work, relatives' responsibility, age, retirement status, employment record, previous taxes paid, and so forth—are left to one side. Hence, all families with incomes below some specified level—not just certain categories of families—would receive allowances. Moreover, every family would be assured a minimum (this may or may not be a "high minimum") level of income.

Ideally, the administration of transfer-by-taxation would be, like social insurance, so impersonal as to avoid most of the stigma generally associated with being "on relief." It could be administered in connection with the present income tax system and would require only that a beneficiary file tax forms at the beginning and end of a stated accounting period. The set of allowances or negative tax rates can be designed to induce work effort and thrift on the part of actual and prospective beneficiaries. In this regard, transfer-by-taxation may be more constructive than an extension of public assistance to the "working poor," since the latter typically involves a dollar-for-dollar substitution of benefits for other income foregone and vice versa. In other words, public assistance uses a 100 per cent marginal tax rate, but transfer-by-taxation opens up the possibility of using lower tax rates and thereby supplementing low earned incomes without discouraging all work effort by recipients of such supplements.

A Comparison of Negative Income Tax Plans

Transfer-by-taxation is a flexible technique. In designing a plan, one may vary the level of the basic guarantee, the tax rate, and the break-even level of income. By changing the definitions of such key terms as "income" and "family" and by varying eligibility conditions one may alter the specific way in which a plan relates to the concepts and parameters of the present individual income tax system, as well as to public assistance and other social welfare systems.

Before designing and choosing among transfer-by-taxation plans, the following key questions need to be explored.

1. What portion of the poverty-income gap is closed by the plan?
2. Would any of those presently poor be made worse off by adoption of the plan? Are the poor and near-poor treated equitably in the sense that their rankings are the same before and after allowances are paid?
3. What effects will the plan have on work, saving and investment, family size, and family composition?
4. What is the budgetary cost of the plan and who will pay it?
5. How much of the total expenditure under the plan goes to poor families?
6. How would the plan relate to present provisions in taxation, public assistance, and other social welfare programs?

With these key questions in mind, we turn to an outline of five different transfer-by-taxation plans: tax-equity negative rates, social dividend, welfare-oriented negative rates, child's entitlement, and earned income supplement plans.

The Tax-Equity Negative Rates Plan

The simplest negative rates plan would refund to nontaxable income tax filers some percentage of their unused personal exemptions and minimum standard deductions (afterwards referred to as "unused EX + MSD").[4] Such a plan would produce greater equity in the income tax system. The taxpayer with unused EX + MSD is not now getting the full use of these provisions, nor does he benefit from tax rate reductions or increases in personal exemptions and allowable deductions. This results in an inequity whereby families of different size and the same income pay the same tax, namely, a tax of zero dollars. Applying even a modest negative tax rate, say 14 per cent (presently the lowest bracket rate), to unused EX + MSD would allow the poor of differing family sizes to utilize the EX + MSD allowed them under the income tax system. A high tax rate, say 50 per cent, would meet a substantial portion of the needs of the poor.

The cost of the Tax-Equity Negative Rates Plan with a 14 per cent rate would have been about $2.8 billion in 1964; the cost with a 50 per cent rate would have been approximately $10 billion.[5] The appeal of the plan is its simplicity, i.e., the relative ease with which it could be administered alongside the existing (positive) income tax system. The present tax return

[4] For simplicity the minimum standard deduction is used. It is a known amount varying with family size. An income tax filer receives a $200 MSD, and $100 for each dependent (including himself). Thus a family of four has $600 in MSD. Most low income families can be expected to use the MSD unless itemizing heavy medical expenses will increase their deductions.

[5] The cost figures are rough guesses since the aggregate amount of unused EX + MSD, calculated by the tax system's income concept of adjusted gross income, is not readily available. However, the Treasury has estimated that there was $22 billion in unused EX + MSD in 1961. By 1964 this figure can be supposed to have fallen slightly to about $20 billion. Part of this would be offset by savings on public assistance.

indicates whether the filer has unused EX + MSD and whether therefore he would be eligible for, and in what amounts he may receive, negative tax allowances. It would, of course, be necessary to make sure that persons not now filing tax returns (because they are not presently required to do so), but who would be eligible to receive allowances if they did so file, are encouraged to file and are aided in filing an income tax return.

The simplicity of the plan is also its major shortcoming. It ignores the fact that the present definition of income for positive income tax purposes excludes important forms of income such as transfer income. Because of this, some non-poor people would get negative tax allowances. Moreover, it does not take account of the fact that the welfare unit is "the family," whereas the tax unit is any income earner and his "dependents." Some families might have several tax filers under present law.

Another difficulty with the Tax-Equity Negative Rates Plan is that the use of unused EX + MSD as a standard in determining eligibility for allowances has the effect of shortchanging small families. The poverty-line incomes set by the Social Security Administration are well in excess of EX + MSD for families of one, two, or three persons. The problem, however, is offset somewhat by the fact that the aged are presently allowed double EX + MSD. In 1964 over 50 per cent of the one-, two-, and three-member families with money income below the poverty lines were headed by an aged person.[6] On the other hand, very large families are favored by the use of EX + MSD rather than poverty lines as a basis for calculating the negative tax base. Moreover, as Table 2 shows, the use of EX + MSD rather than poverty lines results in major variations in the proportion by which the poverty gap is closed for different families. These variations are associated with differences in family size and income as a percentage of the family's poverty line. This variation in the treatment of poor families may be difficult to justify.

The Social Dividend Plan

The Social Dividend Plan is modeled after plans suggested by Lady Rhys-Williams, Robert Shutz, and D. B. Smith.[7] It would make periodic payments to every citizen (or family) sufficient to guarantee an annual "poverty-free" income. Using currently accepted poverty lines, the total or "gross" cost of such a guaranteed minimum income plan in 1964

[6] Derived from *Current Population Reports*, U.S. Bureau of Census, Series P-60, No. 47 (Washington, D.C.: September, 1965), Tables 3 and 4, pp. 24–25.

[7] Rhys-Williams, *op. cit.;* Robert R. Shutz, *Transfer Payments and Income Inequity* (Ph.D. dissertation, University of California, 1952); D. B. Smith, "A Simplified Approach to Social Welfare," *Canadian Tax Journal*, XII (May–June, 1965), 260–265.

would have been $155 billion. This enormous cost would be financed by a special tax on each family's money income before allowances. The level of the tax rate(s) will determine the plan's "net cost," or the amount of redistribution of income from families with before-allowance income above the break-even level to families with income below that level. In 1964 a single tax rate of 33⅓ per cent applied against $465 billion of family money income would have raised $155 billion and would have redistributed out of that amount about $51 billion. Under such a plan a four-person family

TABLE 2

PERCENTAGE OF POVERTY-INCOME GAP FILLED FOR DIFFERENT SIZE FAMILIES WHEN 50 PER CENT NEGATIVE TAX IS APPLIED TO UNUSED EXEMPTIONS AND DEDUCTIONS

Income before allowance as percentage of poverty-line income	Size of family unit						
	Net allowance as percentage of poverty-income gap						
	1	2	3	4	5	6	7
0	30	40	46	50	53	55	57
10	28	39	45	50	53	55	57
20	25	37	45	50	54	56	58
30	21	36	44	50	54	57	59
40	17	33	43	50	55	58	61
50	10	30	42	50	56	60	63
60	0	25	40	50	57	62	67
70	[a]	17	37	50	59	67	72
80	[a]	0	30	50	64	75	83
90	[a]	[a]	10	50	79	100	116

[a] No unused EX-MSD. Will pay a positive tax if adjusted gross income equals total money income.

with a $3,000 guarantee would have a $9,000 break-even income level. That is, this family would not begin to pay "net" for the cost of the plan until its income before allowances rose above $9,000.

The important cost figure is the plan's net rather than its gross cost, because the former indicates the amount of income actually redistributed from those with above to those with below break-even incomes. For families with income above the break-even level of income, the guarantee would be a credit against the taxes they must pay to finance the plan. Families with expected income above the break-even level might sensibly forego receiving "allowances" and paying "social dividend taxes" on that portion of their income which equals their break-even income levels.

Still, a net cost of $51 billion reduces the attractiveness of the plan—at least to those who have to pay for it. Moreover, many families obviously not in any real need for income maintenance would receive allowances. In 1964, 68 per cent of all families and unrelated individuals would have been eligible to receive net allowances under the plan just described. In that year, only 19 per cent were adjudged to have been poor. Of the $51 billion paid out in net allowances, $28 billion would have gone to non-poor families. (However, some of the $28 billion would be income in excess of poverty-line income received by families who were poor before allowances.)

An alternative set of tax rates could reduce the net cost of the Social Dividend Plan and the percentage of families eligible for net allowances. If the tax rate on income before allowance was 50 per cent rather than 33⅓ per cent up to the break-even level of income—i.e., now twice the guarantee—the net cost of the plan in 1964 would have been about $30 billion.[8] This $30 billion "net cost" could have been financed by a 14 per cent tax on all income (not only presently taxable income) above the break-even levels. There is a major reduction in the tax rate on "net" taxpayers from 33⅓ per cent, when a single rate on all income is used, to 14 per cent, when a 50 per cent rate is applied to income below the break-even level. This is due to (1) limiting the number of families eligible for net allowances and hence increasing the income base out of which the net cost of the plan is financed, and (2) a more rapid reduction in net allowances for each dollar of pre-allowance income received by a family.

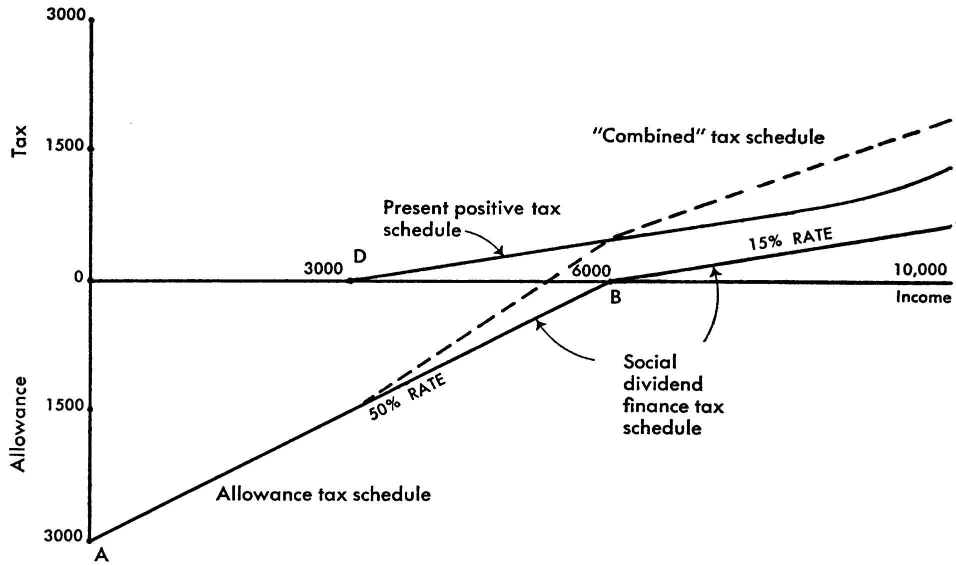
The advantage of the Social Dividend Plan is that it guarantees a poverty-free minimum income. In other words, it would completely fill the poverty-income gap. It would make possible the elimination of public assistance, except in unusual cases, and perhaps reductions in some other social welfare programs. Aside from the heavy cost of the plan and its "inefficiency" (in the sense that most of the net allowances go to non-poor families), the plan has another disadvantage in that it fails to fit neatly into the existing income tax framework. This failure is due to two factors: (1) break-even levels of income are far in excess of the value of EX-MSD presently allowed a taxpayer, and (2) the definition of "income" would need to differ from that for general tax purposes. High break-even levels mean that many "positive" taxpayers will be net allowance recipients.

Figure 1 illustrates the relationship between the different tax schedules. Schedule ABC is the social dividend tax schedule and DE is the present positive tax schedule. The "combined" tax schedule shows the allowance received or tax paid when both tax schedules are taken into consideration. Note that the combined schedule assumes that similar definitions of income are used for positive and social dividend tax purposes. The heavy cost of the plan will necessitate a broad definition of income for social dividend purposes—a definition of taxable income quite different from the present "taxable income" tax base.

[8] The $30 billion is based on no adjustment for under-reporting of income in the Census survey. It assumes that no social welfare programs are reduced in scale. If public assistance were cut, the $30 billion figure would rise by half the amount of the cut. It also assumes no one does any less work because of the tax.

FIGURE 1

A SOCIAL DIVIDEND PLAN
(Family of four)



Welfare-Oriented Negative Rates Plan

This plan is a refinement of the Tax-Equity Negative Rates Plan discussed above. It would recognize the following:

1. A family's poverty-income gap is a better guide to eligibility for allowances than is unused EX-MSD. Therefore, poverty lines are substituted for the value of EX-MSD used in the Tax-Equity Negative Rates Plan.
2. The present income tax unit often is not the same as the family unit which pools its income in order to meet its major items of expense. Thus the Welfare-Oriented Plan adopts a "basic" family tax unit consisting of spouses, all children under 19 years of age, and students under 22 years of age. The present income tax rules establishing dependency status would apply to persons outside the basic family unit.
3. The present definition of income for income tax purposes is an inadequate guide to a family's welfare. Therefore, as a step in the direction of a more complete evaluation of a family's economic position, family money income would replace adjusted gross income in determining eligibility for allowances.

The Welfare-Oriented Negative Rates Plan presumes that social insurance programs are to be continued and that the money income from these programs is to be included in the definition of income for negative tax purposes. Thus the negative rates allowances are designed to supplement the earnings and social insurance income of poor families. Public asistance would be treated otherwise. That is to say, public assistance (P.A.) would be excluded from the definition of income for the purposes of determining eligibility for and the level of negative rates allowances. There are two reasons for this differential treatment of public assistance. One is that P.A., unlike social insurance benefits, is conditioned upon a family's present resources—of which income is an important component. Thus the level of public assistance would depend, in part, upon the level of negative tax allowances a family received. But if P.A. were included in the definition of income, negative tax allowances would depend, in part, on the level of P.A. It would be very difficult for welfare officials to determine what P.A. payments to make if the level of negative tax allowances depended on the level of P.A., and vice versa.

There is a second reason for excluding P.A. from the definition of income for negative tax purposes. The objectives of transfer-by-taxation are to provide an income floor for all, to pay allowances to families only according to the family's income and size, to reduce the disincentives created by 100 per cent tax rates, and to eliminate the stigma presently associated with being on relief. The objectives would be enhanced if P.A. were reduced to supplemental payments after negative tax allowances have been calculated. This would maximize the negative allowances paid to a family on P.A. and minimize its P.A. receipts.

The cost to the federal government of the Welfare-Oriented Plan, using the definitions stated above and a 50 per cent tax rate, would have been $6.3 billion in 1964. This figure is a combination of $8 billion in negative tax allowances and an estimated $1.7 billion reduction in federally financed public assistance payments.

This plan, like the others, has some shortcomings. It does not tie neatly into the existing individual income tax system because at several points the plan departs from concepts used by the positive system. For example, the use of poverty lines rather than EX-MSD as break-even levels of income means that some small families (less than four members) would be both taxable and eligible for allowances. Moreover, the broader definition of income and the "basic" family tax unit utilized by the plan mean that there would be two different definitions of income and tax unit within the individual income tax system. These might create administrative problems.

One disappointing feature of the Welfare-Oriented Negative Rates Plan is that it would require some supplementation by public assistance if none of the present poor are to be made worse off. If the tax rates to be paid by the working poor are to be kept at low levels, then, given the low break-even level of income, the guaranteed minimum income would be lower than the benefits public assistance provides in some of the states.

The Incentives Question

It will be apparent to the reader that the tax rate used in a plan is critical to its outcome. Given a low break-even point, a tax rate lower than 50 per cent would not do much to fill the poverty-income gap. But why not apply a higher than 50 per cent rate to the pre-allowance incomes of the poor? Indeed, why not apply a 100 per cent rate? The basis for not doing so is that such a high rate would have undesirable side effects. It seems reasonable to assume that a 100 per cent tax rate would reduce the supply of work effort at given wage rates, although it must be admitted that there is not an overwhelming amount of empirical evidence leading to this conclusion. On the other hand, we are not aware of evidence to the contrary.

Today the only instance of a 100 per cent tax rate is found in relief programs. The retirement test in Old Age, Survivors, and Disability Insurance has effective rates of 50 per cent, followed by 100 per cent, over a short range of earnings. The rate at which unemployment compensation benefits are reduced is generally lower than 50 per cent of added wages. Reducing the rewards for extra work effort by more than 50 per cent of wages is relatively rare. A few very high income earners are currently earning enough to fall into a 50 per cent or higher tax bracket on part of their earnings. Studies of such earners have shown that high marginal rates appear to have a negligible effect on the amount of work effort supplied.[9] However, what is true of highly paid executives and professionals may not be true of very low income, generally unskilled, workers. Status, power, and the demands of business associates and clients may be as important as net compensation rates in determining the amount of work effort an executive or professional supplies. This is not so likely to be the case in occupations providing low pay.

High tax rates within a given income range might not be the only factor to dampen work incentives. Another factor could be the guaranteed minimum income itself.[10] Some of the poor might find that the guaranteed

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[9] Thomas Sanders, *Effects of Taxation on Executives* (Boston: Graduate School of Business Administration, Harvard University, 1951); George F. Break, "Income Taxes and Incentives to Work: An Empirical Study," *American Economic Review*, XLVII (September, 1957), 529–549; James N. Morgan, Robin Barlow, and Harvey E. Brazer, "A Survey of Investment Management and Working Behavior Among High Income Individuals," American Economic Association, *Papers and Proceedings*, LV (May, 1965), 252–264.

[10] See the study by C. T. Brehm and T. R. Saving on "The Demand for General Assistance Payments," *American Economic Review*, LIV (December, 1964), 1017–18.

minimum is as high or higher than their present earnings. While it is not likely that many poor families are satisfied with their present income level, it is possible that some (probably only a few) families might be content to stop work and simply substitute the guarantee for present earnings. A similarly unknowable number of persons might, because of the guarantee, be less pressured to seek an end to unemployment or to undertake an arduous training or retraining program. Moreover, a negative tax rate would tend to reduce the dollar value of training allowances; a 100 per cent tax rate would, in many cases, reduce it to zero.

What about disincentives to work, save, and invest resulting from higher taxes on the non-poor, who would, of course, have to bear the net cost of the several plans reviewed above? Only the Social Dividend Plan would require a notable increase in tax rates for the non-poor. As Figure 1 suggests, a 14 per cent social dividend tax on all income above the break-even level combined with the present income tax rates would make for relatively high marginal rates on taxable income for upper income families. Under such a plan, 50 per cent tax rates would apply at the lowest and the upper income levels. Persons subject to such a rate would find not only wages but also property incomes, social security benefits, and private pensions significantly altered.

Would transfer-by-taxation provide an inducement to have more children? An additional child in a poor family means a $500 increase in the poverty gap and a $700 increase in unused EX-MSD. With a 50 per cent negative tax rate an additional child could mean as much as $250 to $350 more in net allowance. A higher tax rate would, of course, mean higher allowances. The possible effect on the incentive to have children is even less clear than in the case of the incentive to work. Additional children in an already poor family only increase the family's poverty. The negative tax allowances do not fully offset this increase in poverty if the tax rate is less than 100 per cent.

Some account must also be taken of the possible effects a transfer-by-taxation plan would have on marriage and separation rates. Simply for getting married to a person with no income, a single person who earned a break-even or lower level of income would receive a $250 increase in income if the tax rate were 50 per cent or $500 if the rate were 100 per cent. A more significant social problem might derive from the tax penalty which would be placed on a marriage between two single persons with disparate incomes. In some cases their combined incomes and negative tax allowances after marriage would be much lower than before. Fathers with above break-even levels of income might find that a negative rates plan so well defends their families' financial well-being that they are more likely because of the plan to desert their families.

All these possible incentive effects are no doubt enhanced by a higher tax rate. Moreover, there are a number of equity problems, e.g., the urban-rural comparison, which are intensified by a higher rate. The effects are hard to appraise, but they restrain us from going beyond a 50 per cent rate. In addition to provoking socially undesirable behavior, a 100 per cent rate would materially alter the cost estimates. We calculate that the Welfare-Oriented Negative Rates Plan would cost $6.3 billion with a 50 per cent rate and about $25 billion with a 100 per cent rate.

The three plans discussed so far are designed to cover all the population. However, it would be possible to restrict benefits to some selected parts of the population. Two such categorically limited plans are discussed below.

The Child's Entitlement Plan

The Welfare-Oriented Negative Rates Plan could be modified to confine eligibility for negative tax allowances to a specific demographic group, namely, families with children. This approach could be rationalized on the basis that the present income maintenance system does less for children than other groups among the poor, that 60 per cent of the members of poor families are children,[11] and that income channeled in the direction of children would represent an investment in the future. The cost of the child's entitlement, using 50 per cent rates, would have been $3.5 billion in 1964.

This plan would have all the shortcomings of the welfare-oriented plan. In addition, a problem of equity between the poor with and without children would be created. Using the poverty lines and tax rates discussed above, a family's maximum allowance would jump from zero with no children, to $1,250 with one child, to $1,500 with two children. Clearly, a new schedule of allowances would be called for, and it would, unfortunately, have to be one which filled less of the poverty-income gap for families with one or two children.

The Earned-Income Supplement Plan

Public assistance, as presently designed and administered, is generally not available to families headed by an able-bodied male. Why not, then, tailor transfer-by-taxation to cover only the "working poor," who,

[11] Mollie Orshansky, "Who's Who Among the Poor: A Demographic View of Poverty," *Social Security Bulletin*, XXVIII (July, 1965), 14. "Families" exclude unrelated individuals.

with their families, were 24 million of the nation's 32 million poor persons in 1964 and leave the "categorical poor" to public assistance? A plan for this group would, presumably, need to pay careful attention to the problem of incentives and not so much attention to the level of the guarantee since the idea is to supplement earnings. Hence, the plan tailored for this group would provide a family of four with an allowance of $750 so long as its income was less than $1,500. In other words, a zero tax rate would apply for non-assistance income levels up to $1,500. Once the family's pre-allowance income goes above $1,500, a 50 per cent rate would apply, i.e., the allowance would be reduced 50 cents for each extra dollar earned and would fall to zero net allowance when the family's pre-allowance income reaches $3,000. Eligibility for earned-income supplements would be confined to those who are not receiving P.A. In 1964, the plan would have cost about $4 billion.

The shortcomings of this plan are associated with its categorical nature. Equally poor families may be treated differently by P.A. and by the earned-income supplement. Some of the present poor might be poorer after the plan is adopted if state and local P.A. policymakers modified their eligibility requirements because of the new plan.

Alternatives to Transfer-By-Taxation

What alternatives, short of negative taxation, are there that would provide substantially improved income maintenance for the poor? On the one hand, there is expansion of and changes in the present public assistance and social insurance programs. On the other hand, new programs could be adopted, such as family allowances and a cash tax credit.

Public assistance. Public assistance programs are designed to meet partially the needs of certain categories of the poor.[12] Although the number of families receiving P.A. has grown, only about a third of poor families and a quarter of poor persons received P.A. in 1965. Many of the poor do not receive P.A. because they fail to pass the means test (which compares a budget plan of expenditures with potential resources), fail to meet residence qualifications, do not know of their possible eligibility, or are frightened off by the stigma they feel is attached to receipt of relief payments. But many more of the poor receive no P.A. simply because they do not fall into any one of the prescribed categories.

There are two general ways to increase payments to the poor by public

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[12] Old Age Assistance, Aid to the Permanently and Totally Disabled, Aid to the Blind, and Aid to Families with Dependent Children. In addition, there is the General Assistance program. At any one time about eight million persons are receiving P.A.

assistance. One is to improve benefits for the established categories. The other is to open up new categories. It is not hard to imagine constructive use of $3 billion of federal funds to raise minimum benefits, make them uniform in all states, and get rid of residence requirements. It takes considerably more imagination to see how the opening of new categories would work, since one confronts the problem of what to do with the working poor. For reasons reviewed above, the reduction of benefits by an amount equal to each increment of earnings cannot lightly be extended to the working poor. Hence, it would be desirable to introduce a category of P.A. recipients for whom a lower than 100 per cent tax rate is applied. This would not produce equity in the sense that equally poor families before assistance are equally poor after assistance. The equity problem can only be handled by putting all categories under one plan. Pursuit of an incentive system would lead to an earned-income supplement, and a search for equity would lead to the welfare-oriented negative rates plan.

If P.A. programs were reformed along the lines suggested above, it would be difficult to distinguish the reformed P.A. program from transfer-by-taxation. True, the administration of the programs might differ somewhat, but the fundamentals would be the same. Eligibility for payments would be income-conditioned and payments more or less standardized throughout the country. An income floor would be provided for the poor and additions to earnings would not be wholly offset by reduction in P.A. payments. This suggests that reform of P.A. may be one way of achieving the goals that a negative tax plan is designed to achieve. However, it may not be the best or shortest route and would necessitate a major break with P.A. traditions.

Social insurance. Although coverage by our social insurance programs is broad, eligibility for receiving benefits is restricted to those who are aged, disabled, survivors of insured workers, or unemployed. This means that only a fraction of the poor (and the non-poor) are eligible at any given time to receive income from the social insurance programs. This is not to underestimate the importance of the social insurances, which in 1961 were responsible for keeping nearly four million families out of poverty. But, like public assistance, the present social insurance approach is categorical in nature and thus of limited usefulness as a measure to reduce poverty *further*. It is, of course, possible to add new categories of insured. For example, society could insure children against the possibility of being born into a poor family. However, it is difficult to insure against all the eventualities that may lead to poverty.

Some steps toward reducing the number of poor persons and families could be taken without adding to the number of present social insurance programs. For example, the level of OASDI and unemployment compensation (U.C.) payments could be raised, all aged persons and survivors could be "blanketed in," U.C. could be extended to all workers, and the period during which an unemployed person is eligible for benefits could be extended. These efforts could bring as many as seven million persons out of poverty.[13] The difficulty with this approach is that it would be extremely costly. The benefits paid could not be confined to the poor. Raising benefit levels would mean raising them for all or most OASDI and U.C. beneficiaries. It would have cost, in 1964, $11 billion in the form of a 50 per cent increase in OASDI benefits to get 2.5 million aged persons out of poverty. Only about $3 billion of that amount would have been received by the poor. Thus the social insurance approach must be termed rather inefficient.

Family allowances. Some thirty nations, mostly European, have adopted systems of family allowances or payments to families with children, the purpose of which is to promote the welfare of dependent children. The rationale for family allowances is that the modern industrial system fails to accommodate for differences in family size.[14] The difficulty with the family allowance as an antipoverty weapon is similar to the difficulty with the social insurance approach. It is inefficient because payments would be made to both the poor and non-poor. The poverty gap of families with children is estimated to have been $7 billion in 1964; the gap per poor child was $470.[15] However, if all children under 18 (not just poor children) had received $235 a year, the cost of the family allowance plan would have been $16.1 billion, only $3.5 billion of which would have gone to those who were poor.[16]

Family allowances could be income-conditioned, as they are in Denmark. That is, the level of family allowance payments could be varied both with number of children and with family income, reaching zero at some specified level of family income. If such an approach were adopted it is hard to see how it would differ in substance from the Child's Entitlement Plan discussed above.

Tax credit. Suppose, instead of concentrating on transfers, we were to refund the taxes, direct and indirect, that the poor pay. Some analysts have

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[13] In 1963, there were 5.2 million aged poor and 1.9 million poor persons living in families headed by an unemployed worker. Orshansky, *op. cit.*, pp. 12–13, 28.

[14] James Vadakin, *Family Allowances* (Miami: University of Miami Press, 1958), pp. 1–4.

[15] $7 billion divided by 14.8 million poor children. This means filling the poverty gap of the parents as well as that of the children.

[16] In 1964 there were approximately 69 million children under 18 years of age.

estimated that the poor pay nearly 30 per cent of their income in taxes of one form or another.[17] If the poor, in 1961, received cash payments equal to 30 per cent of their incomes, 3.3 million families would have been lifted out of poverty at a total cost of $4.5 billion.[18]

The difficulty with such a tax credit plan is that it is perverse in the sense that the level of payments varies directly rather than inversely with the level of the family's pre-tax credit income. The tax credit does most for the "best-off" poor and least for the "worst-off" poor. This is so because the tax credit is a percentage of the family's income. The cash tax credit also creates a "notch" problem. If only families with income below their poverty line are eligible to receive a credit, families with income just above the poverty line could increase their money income by reducing their before tax credit income to a level which made them eligible to receive a tax credit.

If the tax credit were revised to avoid perversity and to get away from the notch problem, it would be a negative rates tax plan.

Conclusion

We have reviewed nine different schemes for adding to the incomes of the poor. On close examination, the number shrinks to six which are really different from one another. The tax equity and tax credit plans are only crude variants of the welfare-oriented plan; and the family allowance, if it is income-conditioned, is similar to the child's entitlement plan.

Which of the six would make "best" use of the nation's resources depends on the priority one accords each of several questions. If one asks, Which scheme will close the poverty-income gap at the least cost? then the answer is, the social dividend plan at a cost of $30 billion. If, on the other hand, one asks, Which plan does the most to close the gap per dollar spent? then the answer is not the social dividend (which pays only $12 out of $30 billion to the poor), but an expanded, still categorical P.A. or any one of three negative rates plans. Note that social insurance falls out of the running on both counts.

If we give priority to the second question, the choice is cut down to one noncategorical plan—the welfare-oriented plan—and three categorical plans, namely, improvements in P.A. which exclude the working poor, the

[17] Richard Musgrave, "The Incidence of the Tax Structure and Its Effects on Consumption," in *Federal Tax Policy for Economic Growth and Stability,* Joint Economic Committee, Subcommittee on Tax Policy, 84th Cong., 1st sess. (Washington, D.C.: 1956), Table 2, p. 98.

[18] The estimates are derived by the authors from Subproject B of a special tabulation of the Bureau of Labor Statistics' *Survey of Consumer Expenditure, 1960–61,* made for the U.S. Treasury Department, Office of Tax Analysis.

earned-income supplement, and the child's entitlement. The non-categorical plan would cost about $6 billion and each of the others would cost between $3 and $4 billion. The choice is not necessarily an exclusive one. For example, P.A. improvements could be combined with the earned-income supplement.

A way to make the choice as set out is to ask the question, Which of the four plans causes the least deviation from an equity standard? To that question the answer is clear; it is the welfare-oriented negative rates plan. Therefore, while there is a case to be made for each of the several plans reviewed, we conclude that the strongest case is that for the noncategorical plan which would fill half the remaining poverty-income gap. The adoption of this plan, along with evolutionary improvements in existing public and private transfer programs, would constitute one important aspect of a broad-ranging war on poverty.

GEORGE H. HILDEBRAND*

Second Thoughts on the Negative Income Tax

I READILY admit to finding the negative income tax a highly attractive idea. It offers a method of doing something prompt and substantial about poverty, while taking a long step toward tax equality at the same time. Nonetheless, the more I reflect on the practical implications of the scheme, the more skeptical I become. In my judgment, these emerging doubts are serious, not fanciful or trivial. Unless they can be resolved by the proponents of the plan, I hold that we should concentrate our attention on less ambitious ways to improve the present system of income maintenance and supplementation.

Variants of the Tax

By "negative income tax" I mean any form of income maintenance and supplementation based on the mechanism of the personal income tax. In essence this requires the introduction of Treasury subsidies, payable to low income households, as the counterpart of taxes paid to the Treasury by households that are better off. Technically, these subsidies are a form of transfer from government to persons. On the same definition, taxes paid are a negative transfer, as Lampman has pointed out.

The logic of the idea is unassailable and is one of the main reasons for its attractiveness. By means of exemptions, deductions, and excludable forms of income now allowed at law, Congress in effect has established a structure of minimum earned incomes, geared to family size and composition, that are exempt from income tax. However, the income must be earned by the household in the first place—from its labor and its property holdings. Above this no-tax limit—presently $3,000 for a family of four, with both parents under 65 and not blind—the Treasury now claims the right to share in household income, by levying taxes.[1] But as the law now stands, the Treas-

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[1] Each member of the reporting unit now has a $600 exemption. The person filing gets a $200 minimum deduction, plus $100 additional for his own exemption and a $100 deduction for

ury has no collateral obligation to supplement incomes below the line, that is, to share its revenues by payment of subsidies. Thus, the system is both incomplete and inconsistent. The negative income tax, or better, supplementation through subsidy based on the income tax, would cure these defects. At the same time, it would reduce the present inequality of incomes among persons by using subsidies to alter distribution at the lower end, just as taxes now result in altered income distribution at the middle and upper levels.

Among the proposals now in circulation, there are two main alternative methods for determining income deficiency, both to be self-administered by the reporting family or unit.[2] One of them, originally suggested by Milton Friedman, is to find the amount by which the total value of exemptions and deductions exceeds income and then to fix the subsidy at some percentage of this excess, after deducting 50 per cent of income. The other method—proposed by Lampman, Tobin, Schwartz, and Theobald—is to assign every reporting unit an initial fixed allowance or credit (varied by family size and perhaps composition), to reduce the initial value of the credit by some percentage applied to income received, and then to pay out the net value (if any) as subsidy.[3] In essence, this technique substitutes an allowance for the present exemptions and deductions.

Distinction must also be made between full and fractional guaranteed income plans. With a full guarantee, if there is no other income, the subsidy is fixed at 100 per cent of the designated upper limit to the range of poverty incomes, i.e., any short-fall of income relative to those limits is wholly made up. For a family of four, this amounts to $3,000 in Schwartz's proposal and $3,200 in Theobald's. By contrast, in a fractional guarantee, again assuming no other income, only part of the deficiency is covered by subsidy. For Friedman, the minimum for this size of family is set at $1,500.

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each additional exemption. For those who are 65 and over or who are blind, double exemptions are awarded.

[2] Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press and Phoenix Books, 1963), pp. 190–192; Robert J. Lampman, *Negative Rates Income Taxation*, prepared for the Office of Economic Opportunity (unpublished, 1965), and *The Guaranteed Minimum Income: Is It Worth What It Would Cost?* delivered at a Conference on the Guaranteed Minimum Income, University of Chicago (unpublished, 1966); James Tobin, *Memorandum on Basic Income Allowances* (unpublished), and "On Improving the Economic Status of the Negro," *Daedalus* (Fall, 1965), pp. 878–898; Edward E. Schwartz, "A Way to End the Means Test," *Social Work*, IX (July, 1964), 3–12, 97; and Robert Theobald, *Free Men and Free Markets* (New York: Potter, 1963), pp. 165–201.

[3] The allowance approach was initiated by Lady Rhys-Williams in England in her pamphlet, *Something to Look Forward To* (London: MacDonald, 1942). As originally formulated, her scheme proposed a weekly national dividend in cash for everyone except those unemployed who refused suitable employment. See also, Lady Rhys-Williams, *Taxation and Incentive* (New York: Oxford University Press, 1953), pp. 120–149.

For Lampman, it ranges from $420 to $2,000, according to the particular variant. Tobin's minimum is fixed at $1,600.[4] Table 1 presents a systematic comparison of these proposed minimum guarantees.

It must be conceded that any version of the negative income tax involves a fiscal innovation of the first magnitude, simply because it proposes to pay out transfers in cash as an integral part of the income tax itself, rather than as social insurance benefits, public assistance payments, or subsidies of a

TABLE 1

GUARANTEED MINIMUM INCOMES PAYABLE TO A FOUR-PERSON HOUSEHOLD UNDER VARIOUS NEGATIVE INCOME TAX PLANS[a]

Type of plan	Total subsidy payable	Per capita subsidy
Full guarantee:		
Schwartz	$3,000	$750
Theobald	3,200	800
Fractional guarantee:		
Friedman	1,500	375
Lampman[b]		
I	420	105
II-A	1,500	375
II-B	1,500	375
II-C	750	188
II-D	2,000	500
Tobin[c]	1,600	400

SOURCES: Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press and Phoenix Books, 1963), pp. 190–192; Robert J. Lampman, *Negative Rates Income Taxation*, prepared for the Office of Economic Opportunity (unpublished, 1965), *The Guaranteed Minimum Income: Is It Worth What It Would Cost?* delivered at a conference on the Guaranteed Minimum Income, University of Chicago (unpublished, 1965); James Tobin, *Memorandum on Basic Income Allowances* (unpublished), and "On Improving the Economic Status of the Negro," *Daedalus* (Fall, 1965), pp 878–898; Edward E. Schwartz, "A Way to End the Means Test," *Social Work*, IX (July, 1964), 3–12, 97; and Robert Theobald, *Free Men and Free Markets* (New York: Potter, 1963), pp. 165–201.

Editor's note: Green and Lampman's article in the present symposium classifies plans somewhat differently from the method of classification used in papers cited by Hildebrand. The "tax equity negative rates plan" described by Green and Lampman in the present symposium is equivalent to Plan I in Hildebrand's table. Plans II-A to II-D are all versions of "welfare-oriented negative rates plans," while the "social dividend plan" does not correspond to any of the plans discussed in Hildebrand's paper.

[a] Assumes no other income received and that family files as a unit.

[b] Version I is based on 14 per cent of excess of total exemptions and deductions over other income (none in this case). II-A through II-D are based on fractional allowances rather than deductions and exemptions.

[c] Based on $400 allowance for each member of reporting unit.

less obvious kind (low-rent public housing, farm price supports, and so on). But from the standpoint of American socio-economic thought and policy, what is really revolutionary about the proposal are its broader implications: namely, that government should now guarantee minimum incomes and that this guarantee should be available to all poor households filing a tax return, regardless of the reasons for their poverty.

To undertake such a guarantee and to make it universally available would require a decisive break with some deeply ingrained traditions: first, because at these low levels it would effect a divorce of the receipt of income from the correlative performance of labor or ownership of property;

[4] Lampman also considers a full guarantee at $3,000 or $3,130, but has objections to going this far.

and, second, because it would make the guarantee dependent solely on the fact of income deficiency, regardless of cause. This latter element represents an innovation of singular importance. No longer would the right to assistance depend on a showing of handicaps to earning a living—such as old age, disability, or a broken home—the so-called "categorical" approach now followed, under which the able-bodied adult poor and their families are largely excluded from income maintenance.

But there is more to the formal side of the negative income tax. Any version of the idea must face up to the double nemesis of disincentive to work and total fiscal cost. What shall be done about the other income of most poor families? Shall it be offset against the guarantee, as all plans except Lady Rhys-Williams' propose? If so, what should be the rate of offset? If there is to be one, shall benefits from OASDHI or unemployment compensation, or payments from public assistance, be included within other income? And if the guarantee is to be based on existing exemptions and deductions, shall the double exemption privilege for certain persons be retained or dropped?

Any minimum income guarantee must accommodate three mutually interdependent elements: the level of guarantee itself, the rate at which income is to be offset against the initial guarantee, and the total cost of the plan. With a full guarantee, the rate of offset must be made extremely high. Otherwise leakages to those who are not poor will be substantial, and the already huge cost of the plan will become truly astronomical. To constrain cost, Schwartz adopts an average rate of offset of 70 per cent of the first $3,000 of earned income, while Theobald actually proposes a 90 per cent rate. But to get around awkward problems in the income range immediately above $3,000, Schwartz chooses to exempt from tax all incomes up to $4,500. In other words, to avoid resort to an even higher rate of offset, he must open up an extensive array of non-poor incomes to leakages.

Furthermore, what these inordinately high offset rates would actually mean is punitive "taxes" on the labor of the some seven million who make up the working poor. In turn, this would invoke a serious disincentive effect: they would be encouraged to get out or to stay out of the labor market because the terms of trade between income from work and income from the subsidy have been made so unfavorable to remunerative labor. To the extent that these workers withdraw from the labor market, other income falls and the cost of the plan is inflated all the more.

By contrast, a fractional guarantee offers considerable relief from these difficulties, but only at the expense of providing a much smaller contribution to raising poverty incomes. The rate of offset can be made lower—for example, 50 per cent of other income for Friedman, 33⅓ per cent for Tobin, and variable rates of between 25 and 75 per cent, according to the particular variant, for Lampman.[5] In turn, these much more modest rates of "tax" on the labor of the poor would involve much smaller disincentive effects. For this reason, as well as the much lower level of basic guarantee, the total cost of the plan can be sharply reduced. Instead of the roughly $25–30 billion required for Schwartz's or Theobald's 100 per cent plan, Tobin's fractional guarantee would cost around $14 billion, Friedman's about $10 billion, if double exemptions are retained, and Lampman's various versions somewhere between $2 billion and $11 billion as estimated on the basis of 1963 data.[6]

A final consideration concerns the "step" or discontinuity problem, which emerges in the income range where transition occurs from supplementation to taxes payable. To illustrate, suppose that Friedman's plan were adopted: a family of four without other income could establish an income deficit of $3,000, against which $1,500 could be claimed as subsidy on a 50 per cent basis. If, instead, the head earned $1,500, the subsidy falls to $750, and final disposable income becomes $2,250. By reason of a 50 per cent rate of offset, a 2:1 relationship holds right up to $3,000 of other income, at which no net transfer is payable. Below $3,000, then, earnings from work are "taxed" at 50 per cent. By contrast, each added dollar of income earned within the $3–$4,000 bracket is subject to direct income tax at 14 per cent. From the standpoint of equity, therefore, the poorer worker pays a much stiffer rate of "tax" than the one who is somewhat better off. For the same reason, the disincentive effect would be greater in the low income group.

The situation might be corrected by fixing the offset rate at 14 per cent, which would greatly curtail the contribution of the subsidies to poverty incomes. Or the positive tax rate in the first bracket could be raised to the punitive level of 50 per cent, with unacceptable consequences for incentive for those who are self-supporting and not poor. Alternatively, the offset rate could be graduated downward as income rises, to reach 14 per cent on the last increment of income, or the lower end of the present tax schedule could be abolished. But descending graduation reduces the value of the transfers, while raising the level of minimum income subject to tax would

[5] Lampman's Plan II-A calls for a 50 per cent rate; II-B, for 75, 50, and 25 per cent on successive increments of $1,000 of other income; II-C, for a zero rate on first $1,500 and 50 per cent on second $1,500; and II-D for 75 per cent on first $1,500 and 33 per cent on next $1,500. The high initial rates in II-B and II-D are intended to discourage small amounts of work by the very poor and their children, while much lower rates in the higher brackets are aimed at encouraging incentive among the adult working poor who are already partially or fully self-supporting.

[6] Based on 1962 or 1963 income and poverty data.

mean severe losses of revenue together with substantial direct leakages to those who are not poor by official standards.[7]

Advantages of the Tax

There seems to me to be four basic reasons for the interest that the negative income tax now commands. The most obvious one of them, of course, is the rediscovery of poverty under the impetus of the civil rights movement. Another is that, compared with techniques for demand management and for increasing the productivity of the working poor, the device provides a quick and universal method for raising poverty incomes to any level desired. A third is that it seems to offer a unitary solution to the problem of income maintenance. The tax supposedly would permit us (1) to get rid of categorical public assistance and its means test, and (2) to extend and improve income maintenance, while simplifying and rationalizing it. Finally, as already noted, the proposal carries considerable technical appeal for the economist because it would complete the logical symmetry of the income tax, while achieving greater equity at the same time.

So far as our new-found impatience with large-scale poverty is concerned, it may be remarked that this sentiment began to become manifest early in the sixties, when the growth-gap problem was also paramount. It seemed easy at that time to contemplate a major new program of transfer payments, both as a means for relieving poverty and as a way to combat the depressive effects of fiscal drag on total demand.

Turning to the second factor, there is no doubt that the negative income tax is a speedy and all-inclusive method of getting cash into the hands of those who need it, one that has incidental advantages as a new form of automatic income stabilizer as well. True, a direct and perhaps even universal scheme of children's or family allowances, quite separate from the income tax, would be another method for using the transfer technique in a large way. As for demand management and efforts to improve the earning power of the working poor by vocational preparation and training and by breaking down discriminatory barriers to better jobs, we are dealing here with much slower and much less dramatic methods. But they do go to causes, rather than to the effects of poverty, for they attack one of the roots of the low income problem, that is, low earning power. By contrast, transfer

[7] Tobin's flat allowance with a uniform 33⅓ per cent rate of direct tax on all amounts of other income in the lower and middle brackets is the neatest solution. But observe the consequences: for a family of four, net subsidies would be paid all the way up to $4,800 of other income, and taxes due on the present schedule would be reduced on all incomes between $4,800 and $6,289 by using the allowance as a tax credit. Furthermore, Tobin estimates total leakage to the not-poor at $3.2 billion.

approaches deal primarily with relieving the consequences of poverty. Only indirectly do these techniques promote attainment of the valuable ideal of adequate self-support, i.e., by helping the children of the poor to obtain more education.

But what about the negative income tax as a transfer device? The urge for a unitary solution to the "welfare problem" and perhaps even for all income maintenance is perfectly understandable on the part of those who are impatient with the scope and nature of present arrangements and who are profoundly dissatisfied with the results. The tax helps convert the receipt of public assistance from a matter of stigma to a matter of right and speeds the transition from status to contract.

These motives led Lady Rhys-Williams, a member of the Liberal Party in Britain, to propose universal allowances, financed through the income tax, as a total substitute for the traditional social insurances, with all their apparatus of payroll taxes and complex benefit schedules, and for payments under "national" (public) assistance. For somewhat different reasons, Friedman seems to take a similar view in his suggestion that the subsidies under his plan could replace the whole "rag bag" of existing measures. And even if one stops short of the sweeping Rhys-Williams proposal, as Lampman and Tobin do, surely there is ample room for concern about public assistance today.

For one thing, both in intent and in effect the categorical programs exclude perhaps fifteen million adults and children in families which are mostly headed by the able-bodied working poor.[8] In the main, only the small ADC—Unemployed-Parent program or locally controlled general assistance (G.A.) are available to this large group, and then only in parsimonious amounts.[9] Some grave criticisms have been made of the federal-state Aid to Families with Dependent Children (ADC) program, which covered 3.4 million children and 1.1 million adults in January 1966.[10] Monthly benefits

[8] There are three competing hypotheses to account for the low incomes of the able-bodied poor: (1) by reason of monopsony—monopoly, they do not get their full marginal products; (2) by reason of a network of imperfections in the labor and capital markets, they do not get a fair chance for an education and to compete for better jobs; or (3) they are at the low end of a Gaussian distribution of native endowments. The main explanation probably lies in (2) and (3). If (3) is significant, it follows that increased income maintenance must be the basic approach. For the same reason, unionization and higher minimum wages are irrelevant, as well as downright harmful, to the poor on economic grounds.

[9] Incomplete figures for January 1966 show only 715,000 recipients of G.A., with per capita payments of only $30.36 monthly on the average. Averages by state range from $3.94 monthly in Arkansas to $68.74 in Maryland. *Welfare in Review*, IV (April, 1966), 38.

[10] Many of these charges have been reviewed and appraised by Eveline M. Burns, *Social Security and Public Policy* (New York: McGraw-Hill, 1956), pp. 86–89; Edgar May, *The Wasted Americans: Cost of Our Welfare Dilemma* (New York: Signet, 1965), pp. 47–66; and Maurine McKeany, *The Absent Father and Public Policy in the Program of Aid to Dependent Children* (Berkeley: University of California Press, 1960), I, 32–40.

vary greatly, ranging from $8.36 per recipient in Mississippi to $51.39 in New Jersey (national average: $34.97), mainly because they are determined by the states.[11] In 1961, two-thirds of the cases involved families with an absent father (desertion, divorce, separation, or as what May calls an "itinerant lover"). Precisely because 29 states tie eligibility to absence of the male head, the program does provide incentive to desert, although the scale of this effect is another question.[12] More serious, primitive "suitable home" policies have allowed some administrators to refuse eligibility where illegitimate children are involved—a curious example of punishing the offspring for the sins of the parents. Still worse, strict application of the means test frequently has the effect of imposing a 100 per cent "tax" on earnings from work. As a result, the mother and her older children are given an incentive either not to work or to conceal such income. On another count, there is enormous community pressure to hold down costs, which restricts the admission of eligible families. There is also a legitimate interest in policing the more egregious forms of "chiseling" and outright fraud; this task has so burdened the social workers that little opportunity exists for remedial case work.[13] Clearly, no further demonstration is needed to justify careful consideration of the need to improve existing welfare policies.

Finally, the negative income tax offers some tangible advantages. If it really could be a full substitute for categorical assistance, it could replace the present 100 per cent "tax" on work, although it can do so only with a fractional guarantee. It also could do much to expand badly needed rehabilitative case work. It would involve an approach to income maintenance that would enlarge the freedom of choice of the poor, because the subsidies would be paid in cash and not in kind. If the scheme is carefully designed to preserve the incentive to work, it would represent a market-oriented solution to the welfare problem. This, in turn, would be consonant with the country's traditions. However, because it proposes to make assistance generally available—a real advantage from the standpoint of relieving poverty—the plan must encompass the families of the able-bodied, whether they are employed, unemployed, or idle. At this point, a sharp conflict emerges with the popular and tenaciously held belief that the able-bodied should be required to support themselves.

[11] *Welfare in Review*, IV (April, 1966), 35. ADC now includes a small "unemployed parents segment" and a foster-care program. It began in 1935 as a successor to earlier measures to aid widowed mothers.

[12] Whether the program fosters illegitimacy is also quite another matter. May contends that about 25 per cent of the children involved are illegitimate, but this is not necessarily the effect of the program itself. As he suggests, the begetting of illegitimate children is about the worst example of the profit motive in action in the world, since it "pays" an average rate of return of only $35 a month.

[13] The profession is badly unpaid, overburdened by case loads, and usually not adequately trained—all evidence of its low social esteem.

This conviction comprises a central element of the individualistic system of values by which our work- and property-oriented society has been organized from its very beginnings. It is the basic reason why income maintenance in the United States rests on social insurance arrangements, in which benefits are so largely tied to past earnings and contributions, and on the categorical approach to public assistance. The linkage between earnings, contributions, and benefits is a way of recognizing alike the ideals of self-reliance and payment according to productive contributions. By its very nature, categorical assistance is an indirect means of paying deference to self-reliance, while at the same time giving acknowledgment to our Judao-Christian tradition of charity toward the unfortunate, the handicapped, and the helpless.

Obviously there is a running conflict between these two principles, which is the reason why public assistance is so often characterized by niggardliness, hostile and punitive attitudes, and spasmodic Draconian attempts to cut welfare costs. Thus it has been relatively easy to obtain pensions, tax privileges, and assistance for the aged; they can no longer work and are viewed as having already earned such provisions in the past. It has also been relatively easy to get appropriations for training and retraining projects for poor youngsters and displaced adults; such efforts are directly linked to improving personal earning power. But until the ideal of a deliberate strengthening of family solidarity can gain the same degree of social acceptance as that of self-reliance, any scheme of universal income maintenance and supplementation for the poor—be it children's or family allowances or transfers through the negative income tax—seems likely to be wrecked on the shoals of popular politics.

Disadvantages of the Tax

No feasible version would obviate the need for public assistance. Given the traditional American attitude toward public assistance and the extremely tight fiscal circumstances now prevailing and likely to prevail for some time to come, a 100 per cent guarantee plan is simply out of the question. This is to say nothing of the dubious social wisdom of having the federal government, to paraphrase Lampman, make the following declaration to every poor household: "We will pay you $3,000 a year if you promise not to work; and if you insist on working anyway, we will tax your earnings at a rate even higher than that applied to a multimillionaire." This is not the way to strengthen the position of the father in the family, nor to foster the still socially valuable ideal of self-support. But it is a way to establish politically a large dependent class, readily identifiable, fully subject to stigma, and well isolated from the rest of the community.

We are left, then, with an array of proposals for a fractional guarantee. Would any of them improve on payment levels now available under OASDHI and the categorical programs and serve as a more humane substitute? Table 2 below suggests the answer, and it is largely negative.

With the sole exceptions of a single person or a couple at the minimum under OASDHI, Friedman's plan would do nothing for those now receiving some form of income maintenance and would seriously lower the positions of most of them. Tobin's version would also fall far short of present payments under assistance, except for G.A. Lampman's Version I (see Table 1) would be of real help to those at the OASDHI minima, but otherwise lies well below present levels. If substituted, his Versions II-A through II-D would injure those now on Old Age Assistance, Medical Aid to the Aged, Aid to the Permanently and Totally Disabled, and Aid to the Blind; II-D would distinctly benefit families on Aid to Dependent Children and General Assistance, but II-A through II-C would not. All of these plans would aid poor households now excluded from any public income maintenance and supplementation—clearly a major gain on its own terms.

Assuming that any form of the negative income tax should make no poor household worse off than it is already, two conclusions became obvious. First, none of the plans can serve as an overall substitute for the existing categorical assistance program. And second, none of them would be an overall substitute for the present social insurances. In fact, all but Friedman's plan explicitly assume the retention of OASDHI and unemployment compensation. In consequence, these feasible versions of the negative income tax do not represent a unitary solution to the problem of income maintenance, either as a whole or for public assistance alone. Indeed, both Tobin and Lampman expect assistance to survive in some form. What we actually have proposed here, then, is one more addition to the present pluralistic system, an addition whose basic merit is that it would extend transfer payments at once to many millions now excluded from the system.

It is true that subsidies under these plans would be larger in some states than those now paid under the various assistance programs—in some instances much larger. But in the richer states the converse holds. The primary problem is how to make sure that supplementation by Treasury subsidies would be effective, not just *substitutes* for existing rates of payment under assistance. Since some form of assistance will continue to be needed even if the negative income tax were adopted, it is equally important to reform the old programs.

TABLE 2

PER CAPITA BENEFITS UNDER EXISTING INCOME MAINTENANCE PROGRAMS COMPARED WITH THOSE PAYABLE UNDER VARIOUS FRACTIONAL GUARANTEE PLANS[a]
(ANNUAL VALUE)

Existing programs	Current average per head	Payment per head under negative income tax for those with no other income						
				Lampman[d]				
		Friedman[b]	Tobin[c]	I	II-A	II-B	II-C	II-D
Old Age Assistance (OAA)[e]	$ 941							
		$ 800	$ 400	$ 224	$ 375	$ 375	$ 188	$ 500
Medical Aid to the Aged (MAA)[e]	2,175							
Aid to the Permanently and Totally								
Disabled (APTD)	1,012	450–800	400	126	375	375	188	500
Aid to the Blind (AB)	1,105	450–800	400	126	375	375	188	500
Aid to Families with Dependent Children								
(ADC)	420	375	400	105	375	375	188	500
General Assistance (GA)	364	375	400	105	375	375	188	500
OASDHI:[f]								
Single person, minimum	528	800	528	752	528	528	528	528
Single person, maximum	2,016	800	2,016	2,240	2,016	2,016	2,016	2,016
Couple, minimum	396	750	400	606	396	396	396	396
Couple, maximum	1,512	750	1,542	1,712	1,512	1,512	1,512	1,512

SOURCES: Figures for payments under assistance programs from *Welfare in Review*, U.S. Department of Health, Education, and Welfare, Vol. IV (April, 1966); figures for OASDHI benefits from *Social Security Bulletin, Annual Statistical Supplement*, XXVIII (December, 1964), 25; values for subsidies estimated by the author.

[a] For OAA and MAA, subsidy under negative income tax assumes a single-person reporting unit. For ADC and G.A., subsidy is based on a four-person family reporting as a unit. All cases assume no other income besides subsidy, except, where applicable, OASDHI benefits. All assistance figures based on national averages.

[b] Assumes double exemption privilege is retained; OASDHI benefits excluded. Range shown for APTD and A.B. reflects possibility that recipient is under 65 or 65 and over.

[c] Tobin would exempt OASDHI beneficiaries from his plan, save that where such benefits fall below $400 the latter figure would become the minimum.

[d] Lampman would retain all OASDHI benefits; his Plan I retains double exemptions, meaning that subsidies would be added to OASDHI benefits, which are now excluded from other income. For versions II-A through II-D, his figures all apply to a family of four, converted here to per head equivalent.

[e] Present payments under these programs, assuming the same person was a recipient for a full year. Subsidies for both are calculated solely on the basis of income deficit. Actually, under the OAA and MAA programs, there is some possibility of overlap and a recipient may obtain payments from both programs.

[f] Assumes worker retires at 65 and that if there is a spouse, she, too, is 65 or over. Minimum and maximum are based on top and bottom monthly brackets under 1965 amendments, converted to annual values. Figures for couples are on a per capita basis. Figures for Lampman's plans II-A through II-D are for OASDHI benefits only. Subsidies may increase these, but the amounts could not be calculated.

The negative income tax would not displace the means test. There are two reasons for this contention. The first is that public assistance will have to be retained. Since this is so, it will continue to be necessary to audit the income and assets of claimants, both to fix net payment rates according to schedules and to police cases of gross fraud. Local communities would accept no less.[14]

Second, if it could be a full substitute for existing public assistance, the negative income tax would still not displace the means test. Even in this optimal situation the most the device could do would be to introduce a self-administered means test, since every return must require a declaration of income. The returns filed by those claiming the subsidies would have to be checked, sampled, and audited—what else is this but a form of means test? In extreme cases, there would have to be prosecutions for fraud. And if the old principle of taxation still holds, that the higher the tax the greater the frequency of evasion, then surely the higher the prospective subsidy the greater will be the incidence of fraud—another, less welcome aspect of the symmetry concept.

It would be difficult to provide adequate, regular, and frequent assistance. The basic principle of all modern public assistance is that transfer payments should be provided to help fill the unmet needs of poor households. To do this properly the degree of need must somehow be measured; payments must bear a reasonable relationship to need as determined; payments must continue to be made available in adequate amounts so long as the need lasts. How well would the negative income tax meet these criteria?

The use of some set of minimum income standards, with built-in adjustment for family size, is a simple and objective way to measure "need."[15] The difficulties begin when one considers timing. If the subsidy is to be paid after the final return is filed, then the sum forthcoming will reflect "other" income already received and the size of the family at the time of filing. Under present practice, any qualified taxpayer can claim a lump-sum refund at this point. Is the subsidy to be treated in the same way? Is it to be paid

[14] In my judgment the case against the means test has been seriously overdone, identified as the test is with the parsimonious "Overseer of the Poor" of earlier times, and with the British dole under "supplemental allowances" to the permanently unemployed of 1931. In fact, the test can be made no more obnoxious than a credit application. Federal standards could be introduced or improved to insure a more humane use of the test, mainly by reducing the discretion of the investigator and the traditional tie to relatives' responsibility. Granted, it would be ideal if we could eschew the whole distasteful business. But this is just not in the cards until American society is ready to accept some kind of universal allowance system, "as a matter of right."

[15] Except that need depends also on differences in living costs. The Social Security Administration calculated its poverty income minimum at $3,130 for an urban family of four (1964 prices) and at $2,190 for a farm family of the same size. Under the negative income tax, both families would get the same cash grant, given the same amount of other income.

over to the filer (say the male head), perhaps to be dissipated quickly, even though the household's need is a continuing one? If not, on what legal basis can the amount be parcelled out over the next 52 weeks? Suppose, further, that the household's capacity to earn other income or to get assistance payments is reduced in the year ahead, or that it suffers heavy medical expenses or acquires twins or an aged grandmother as new dependents. Any of these events will increase current need under the means test. But if the subsidy has been fixed on an ex post basis, it will have no reasonable relationship to actual need.

Suppose, instead, that income deficiency is calculated on an ex ante basis for the year ahead or, better, by quarterly declarations. I will pass over entirely the question of how to instruct perhaps ten million inexperienced prospective filers in the delicate art of preparing a tax return. I simply say that poor households will be no more able to avoid errors of optimism and pessimism in predicting other income than anyone else. If the family overstates its expected other income, it will receive a lump sum at the end of the period rather than at the time the money was needed. If it understates income, it will have overdrawn the subsidy; it will have to settle up with the Treasury at that point—or accept a lower rate of payment for the next period. In either case, the consequence is the same: the subsidy ceases to bear any relationship to continuing current need. This difficulty seems inherent in any proposal to tie transfer payments to the mechanism of the income tax. I know of no way to get around it.[16]

Double exemptions and excludable income would disrupt the equity of the subsidies. The premise of the negative income tax is that income deficiency is the best way to measure need—a proposition that I accept. As we have seen, there are two ways to calculate the deficiency: (1) fix a flat allowance per capita and set off other income at some rate, as Tobin and Schwartz would do, or (2) gauge deficiency by the value of unused deductions and exemptions (net of other income), as Friedman does and also Lampman in his Plan I. If this second method is used and if the subsidies are actually to reflect need as so measured, a major reconstruction of present tax law becomes necessary, as Lampman recognizes but Friedman does not. Otherwise, the amounts payable will depend on critical variables other than family size, i.e., the age of family members and the type of "other" income received. In other words, it will pay to be 65 years or over and it will pay to have income deriving from OASDHI benefits and tax-exempt bond interest. The reason is that double exemptions are now

[16] On some of these points, see Thomas K. Hitch, "Why The Negative Income Tax Won't Work," *Challenge* (July–August, 1966), pp. 13–15.

awarded to the elderly (and to the blind), while OASDHI benefits (for retirement, widowhood, or disability) and interest on certain securities need not now be counted in adjusted gross income for purposes of taxation.

Consider, for example, a pair of two-person families composed of man and wife. In the first, the couple is under 65; the husband earns $1,570 as an unskilled laborer; there is no other income. Exemptions and deductions total $1,600. Deducting "other" income, their deficiency is $30. Under Friedman's 50 per cent plan, their subsidy is a niggardly $15. Under Lampman's Plan I at 14 per cent, it is a microscopic $4.20.

Now take the second couple, both over 65 and receiving $1,570 from OASDHI, without other income.[17] Double exemptions make their total exemptions and deductions worth $3,000. Retirement benefits need not be included as income. On Friedman's proposal, their subsidy would be $1,500, as against Lampman's $420. On the basis of final disposable income after subsidy, the first couple has only $1,585 under Friedman's plan, while the second gets $3,070, although household size and initial income are the same. The reason is that as the law now stands the subsidy would yield the elderly pair a 100:1 advantage over the working couple. Can it be seriously argued that their actual need is 100 times as great, especially with Medicare and MAA?

Looking at the matter in another way, under present law each child is "worth" $700 in exempt income, if one has the income in the first place, while each elderly person is worth either $1,500 or $1,600, depending on whether he or she files the return. Indeed, through the exclusion privilege, receipt of OASDHI benefits makes the aged person worth considerably more from the tax standpoint.

Justification for this differential treatment is not convincing, but to assault the tax privileges of the aged, many of whom are not poor on any standard, is no easier than an attack on motherhood. Yet, if equitable treatment is to be had under the negative income tax and the subsidies are to conform to the purposes of the proposal, then neither age nor type of other income should influence the size of the transfer. The problem is easily solved in principle. The real difficulty is political. It can be evaded simply by leaving tax privileges intact, as the price to be paid for getting more income into the hands of those poor who are now excluded from public assistance. However, this choice involves other encumbrances: the total cost of the new transfers might rise as much as 40 per cent, there would be substantial leakages to those who are not poor in terms of "all other income," bene-

[17] Average retirement benefit in 1964 for worker and his wife at age 62 or over. *Social Security Bulletin, Annual Statistical Supplement*, XXVIII (December, 1964), 29.

fits would not be geared strictly to number of dependents, and the self-supporting poor would receive grossly inequitable treatment.

Partly for these reasons, Tobin would exclude OASDHI beneficiaries and abolish single or double exemptions for those who are covered by his plan. Lampman, in all versions of his Plan II, would count OASDHI benefits as income and use a flat allowance in place of deductions and double or single exemptions for determining income deficiency. Obviously this is the preferred course if the intent of the negative income tax is to be served with full integrity. But to undertake it is to open up a political hornets' nest, sufficient probably to defeat the proposal itself.

Conclusion

The weaknesses of the negative income tax fall into two classes: those that are technical and those that turn on questions of cost and ideology. Some of the technical problems probably could be overcome. The level of minimum guarantee and the rate of offset could be high enough to replace most forms of public assistance. The means test feature cannot be eliminated and will continue as long as we have public assistance. Problems concerning the timing, adequacy, and frequency of payments will be much harder to resolve. Finally, it is theoretically possible to remove the tax privileges of the aged; to set up new controls to forestall induced splitting up of non-poor reporting units and to redefine the status of dependents; and to achieve a more general reform of the law, which now permits so many non-poor taxpayers to escape so much income taxation.

Questions of cost and ideology are quite another matter. Putting the poverty-income gap at about $12 billion in 1963, a new transfer program of at least $5 billion net would be required to accomplish anything significant, with OASDHI and assistance payments unchanged. Ignoring the question of whether the country can now afford even this much, the basic difficulty is to make sure that an adequate and equitable version could be had within this limit. With removal of double exemptions and excludable income, Friedman's plan would cost roughly $5 billion, *if* there were no disincentive effects.[18] Lampman's II-D, to me his most attractive formulation, implies a minimum guarantee of $500 per head, and could involve a net cost of anything between $2 and $11 billion, depending on the extent of disincentive effects and reductions in public assistance. Thus neither Friedman's

[18] This calculation is for 1963 data, assuming deductions and exemptions of $750 each for 35 million poor people, and accepting Lampman's figure of $4 billion in OASDHI benefits paid to the poor only. Total deductions and exemptions then amount to $26.2 billion; "other income" is $16.4 billion ($12.4 billion in earnings, on Internal Revenue data, plus $4 billion OASDHI); total deficiency is $9.8 billion, and half this becomes subsidy at the 50 per cent rate.

nor Lampman's plan assures a firm cost ceiling. Tobin's scheme is the most carefully drafted of all and has many attractive features. But on his estimate, it would cost at least $14 billion on 1962 data. As for the Schwartz and Theobald proposals, they would involve a net cost of over $25 billion and therefore are out of the question on this count alone.

I submit that the federal budget today cannot supply even $5 billion without substantial curtailment of other forms of expenditure. The one possibility would be to capture the needed revenue by all-out reform of the income tax law, including introduction of an equitable form of the negative income tax. I doubt that the needed reforms can be had, however, because they require the consent of the middle and upper income groups. The plea that the proceeds could be used to finance massive transfers to all of the poor, including the able-bodied, is likely to fall on deaf ears. Assistance by category is still a "categorical" imperative in our system of values. Although I prefer children's or family allowances—on a universal basis as a matter of right—to income maintenance through the income tax, I admit that they too suffer from the same political and fiscal handicaps.

If the above assessment stands up, then those of us who want to raise low incomes will have to settle for more modest immediate gains, deferring larger schemes for later and more appropriate times. This means we should concern ourselves now with reconstruction of public assistance.

Because of limited space, I venture into this subject only briefly, and even then somewhat timorously, because it is so complex. As a starting point, I take it for granted that some form of public assistance will always be needed, to fill out the interstices among the social insurances and also to supplement such benefits where they are too low. For the long term, it seems to me desirable to make need the sole criterion for eligibility, and where need is proved on clear standards, to make provision a matter of right.[19] Incidentally, this is the most that the negative income tax itself would do. Both are simply alternative ways to provide universal transfer payments to the poor.

To put public assistance on these new foundations means that the categories must go and that all the onerous existing restrictions based on age, residence, length of residence, suitable home requirements, unemployability of either parent, total and permanent incapacitation, and relatives' responsibility must eventually be supplanted. It also means a greatly increased role for the federal government in setting standards and providing grants-in-aid.

[19] See *Having the Power, We Have the Duty*, Report of the Advisory Council on Public Welfare to the Secretary, U.S. Department of Health, Education, and Welfare (Washington, D.C.: 1966). See also, Elizabeth Wickenden and Winifred Bell, *Public Welfare: Time For a Change* (New York: New York School of Social Work, Columbia University, 1961).

These changes cannot be accomplished overnight. For one thing, they will cost a great deal of money—out of a population of 34 million poor persons in 1965, only 7.4 million were receiving public assistance, mostly at levels below those now being recommended.[20] For another, these proposals would arouse militant opposition in Congress, whose members are responsible to local constituencies in which the traditional "Poor Law" approach finds expression in these very restrictions. Nonetheless, these objectives seem sound to me as long-term goals.

In the meantime, some practical changes can be made even in a regimen of tight budgets. The 2.1 million aged poor now on OAA might be transferred to OASDHI at corresponding benefit levels. It also may well be possible to drop MAA as Medicare and companion state programs under Title XIX get under way.

The main candidate for practical reform would be ADC, and I do not underrate the obstacles here. I estimate that it would cost about $500 million to raise the *minimum* payment rate per recipient to $50 monthly (the national average is now $35). If new federal standards could be imposed, desertion or divorce as a condition for eligibility could be ended (now imposed in 29 states). It would also be desirable to allow each ADC family to earn some minimum amount of other income—initially, say, $500—without deducting it from assistance payments. Coupling these changes to existing subventions to poor youngsters enrolled in the various job corps and training programs would achieve a substantial advance, at a net added cost of well less than $5 billion.

In counseling caution and delay regarding the negative income tax, I am not saying that it should be rejected out of hand. But I do contend that it is not demonstrably superior to a different kind of allowance system, entirely divorced from the income tax, or even to a major overhaul of public assistance. I also hold that it is a serious mistake to believe that all that the poor really need is a large-scale infusion of new money. They also require far more skilled social work as well as increased provision of other services in kind rather than in cash, for instance, education and vocational training.

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[20] *Having the Power* . . . p. 8. This report provides an eloquent and cogent statement of long-run principles for rebuilding public assistance. However, I can find no estimate of total costs. On a rough estimate, about 15 million out of 34 million poor persons in 1965 received neither public assistance payments nor social insurance benefits, nor both together. To provide this large, excluded group with $500 each in yearly assistance would require $7.5 billion, assuming no disincentive effects and allowing nothing for increased payments to those now on assistance. The omission of cost figures may have been deliberate. To supply them on the basis of an ultimately desired minimum income standard would have crippled the report's practical appeal. To base them on what is feasible for the budget would imply endorsement of a much lower standard, which also would be undesirable.

EARL R. ROLPH*

The Case for a Negative Income Tax Device

THE PERSISTENCE in the United States of millions of people who are poor is a basic reason for the interest in what is often called negative income taxation. In a society which is supposedly the most affluent in the world, the presence of 30 to 35 million people described as poor, depending on one's definition of poverty, scarcely accords with the American dream. In the minds of some, it may raise nagging doubts about both the political structure and the economic system that generates such results. Strong supporters of the American system find it less embarrassing to diagnose poverty as a consequence of some deficiency in poor people, such as laziness, and enjoin them to reform their behavior. But such a diagnosis implies that people are poor out of choice, that they happen to have a strong preference for leisure. Such a diagnosis scarcely fits the evidence.

The reasons why millions of people have low incomes can be enumerated almost indefinitely. People's mental and physical characteristics differ in innumerable ways. Individual talents and inclinations for obtaining gain are subject, as well, to a wide dispersion. The main problem in explaining the income distribution observed in a complex society is not how to explain low incomes. Rather, it is how to explain why the distribution does not have normal statistical properties and in particular why the tail of the low end, including the range of negative incomes, does not have properties similar to those of the upper tail.

Welfare programs in the United States, insofar as they have any rationale, have been based on the theory that the "causes" of low income can be enumerated. Specific measures related to those causes can supposedly provide adequate assistance. Thus there are the categorical aid programs, unemployment insurance, and old age and survivors' insurance. Since the causes are not exhaustive, some cases of distress are inevitably left uncovered by public programs.

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A welfare system aimed at alleviating poverty should adopt the premise that income dispersion, including negative income and small positive income, is normal and will not disappear next year or the year after. Since human productivity varies widely, as do other abilities, there are always some groups whose productivity will be low judged by some standard appropriate for "normal" people. If people of low productivity are to be employed in the absence of special subsidies, employers, to have an incentive to hire them, must be permitted to pay low wage rates. People's incomes from work will leave some of them and their dependents in poverty. To the extent they are denied the choice of working, by the establishment of minimum wages, their incomes will be even lower.

The income distribution as it naturally arises does not guarantee affluence for everyone in an affluent society. Government policy must be consistent with the fact that there are some able-bodied males who are not capable of earning as much as $3,000 a year or even $2,000 a year. Present welfare programs, geared as they are to various presumed causes of personal financial distress, presuppose that people not subject to special difficulties, such as ill health, old age, unemployment, etc., can earn adequate incomes and can bring up children who will develop into effective members of society. The presupposition is scarcely consistent with the facts. Mollie Orshansky found, for example, that 22.3 million people out of 27.9 million defined as poor were in families headed by a male. In addition: "Of the 15 million children counted poor in March 5.7 million were in the family of a worker who had a regular job in 1963 and was not out of work any time during the year."[1] There are poor people who are unemployed or unemployable, but there are others who work and do so regularly. A wage structure that eliminates unemployment and underemployment of people with modest skills cannot be expected to end poverty levels of income, although such a pricing arrangement would result in a vast improvement for many presently disadvantaged groups. There is nothing in economic theory nor in the inherent characteristics of human beings that precludes equilibrium wage rates of one dollar an hour or less for some types of labor services.

If, then, the premise is adopted that the dispersion of income, including low income, is a normal feature of economic affairs, what social measures are appropriate to obtain a socially acceptable level of income for everyone? Negative income tax devices are techniques to solve this problem.

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[1] Mollie Orshansky, "Who's Who Among the Poor: A Demographic View of Poverty," *Social Security Bulletin*, XXVIII (July, 1965), 21, 24.

Poverty Gap Approach to a Negative Income Tax

One approach to the problem is to define poverty as an amount of income less than some standard taken to be reasonably adequate, treat the difference between a person's actual income and the standard as the "poverty gap," calculate the number of dollars required to close the gap, and give each person the difference between his actual income and the standard. Poverty is then "cured" since by definition no one is left below the standard. Only few proponents embrace this position as stated in this bald manner. It is, however, a widely embraced basic premise both in and out of official circles.

Implementation would require legislation to define the standard, to provide for a definition of income as close to a person's total gain as is feasible, and to tax income obtained by the person from his own efforts at a rate of 100 per cent up to the poverty standard. Beyond this point, but not necessarily at it, the federal individual income tax may come into operation. We would then have two individual income taxes, possibly administered by different agencies—one for people with incomes below the standard and another for those above it.

The poverty gap approach to the negative income tax follows the philosophy of public assistance with some important modifications. Public assistance, as administered by states and localities, varies widely in the details of its administration. Common features of public assistance and a pure poverty gap negative income tax are a 100 per cent tax rate and, to a lesser degree, the use of income as the index of a person's or family's economic position. However, in public assistance and relief programs generally, financial aid is given only to those who apply, and then only if the applicants are deemed qualified according to the rules. The amounts of financial support provided typically fall well below the poverty level as defined by the Department of Health, Education, and Welfare.[2]

Thus, a poverty gap negative tax would, if fully implemented at proposed levels, be a complete substitute for public assistance. This type of negative income taxation would differ, however, in the following ways from public assistance: (1) everyone whose income falls below the standard would receive assistance, thereby eliminating the need to make application; (2) reported income of those eligible would presumably be accepted

[2] According to one study, a nonfarm family of two adults and two children requires $3,100 a year to reach the poverty line and $3,980 a year to reach the "low-cost level." Relief payments fall well below such figures. See Mollie Orshansky, "Counting the Poor: Another Look at the Poverty Profile," *Social Security Bulletin*, XXVIII (January, 1965), 70.

as correct, subject to the same type of checking which now applies to income reported for federal income tax purposes; (3) the amount of assistance paid to an eligible family would be greater, in many cases several thousand dollars a year greater, than that under public assistance; and (4) the effective tax rate would not ordinarily exceed 100 per cent; under public assistance the rate for a person who takes a temporary job may be on occasion 200 per cent or even 1,000 per cent, depending on the rules applied to him, the difficulties he has returning to the relief rolls, and loss of free medical care for children. Rates in excess of 100 per cent mean that a person is punished for taking a job.

There are a number of difficulties with the poverty gap approach. A major one is that it is unfinanced. Billions of dollars would need to be disbursed to people with low incomes, and billions of dollars are not now presently lying around in the federal budget. In the happy event that the Viet Nam war is brought to a satisfactory conclusion, the funds used for it might be shifted to closing the poverty gap. Otherwise a major tax increase would be required. Such a tax increase would have to be over and above that presently needed for anti-inflationary purposes. In the absence of clear evidence of "progress" in the Viet Nam war, the poverty gap program may become financially feasible only some years hence, if at all.

The 100 per cent tax rate feature of the poverty gap approach is, of course, unworkable. Apart from other considerations, a 100 per cent tax rate means that people must work for nothing or else conceal their incomes. To enforce such a rate would probably require a return to the relief approach. Then a person who refuses a job may be disciplined by cutting him and his family off the rolls. Recognizing the unworkability of 100 per cent rates, poverty gap advocates have suggested lower rates, such as 80 per cent; few seem willing to go below 50 per cent.

This compromise of principle with practicality requires that the goal of closing the poverty gap be abandoned in favor of a more modest goal and that the non-poor be subsidized. If an income of $3,000 a year for a family of four is taken as the poverty line, and if for reasons of enforceability the tax rate is placed at 50 per cent, the goal of ending poverty would require an allowance of $3,000 a year to ensure that a family with a zero income would achieve a disposable income of $3,000. This technique would mean, however, that a family with an income of $5,000 would get an allowance of $3,000, pay $2,500 in gross tax, and receive a net sum of $500 a year from the Treasury. Thus, people who are defined as non-poor would obtain a net subsidy if the allowance is placed at the poverty line with any tax rate below 100 per cent. To poverty gap thinkers, payments to those above the poverty line are viewed as inefficient or wasteful of public funds.

If, on the other hand, the allowance is placed below the poverty line, the goal of eliminating poverty is partially sacrificed. Instead of a disposable income of $3,000 for a family of four, a smaller allowance must be established. Obviously, the lower the credit, the greater will be the poverty gap remaining. The possible combinations of allowance size and tax rate are indefinitely large, but all would leave the poverty gap more or less unfilled.

There are numerous objections to the establishment of two federal income taxes, one for the poor and one for the non-poor. With two laws, means would have to be found to prevent some members of a family from successfully classifying themselves as poor by splitting off from the family for tax purposes. A large financial incentive would exist to divide the family into zero income units, leaving perhaps only the father to report positive income. The precise gain to a family would depend on the size of the allowance, the tax rate for low incomes, the tax rate for high incomes, and the definition of income. Rules might be devised to minimize family splitting for tax purposes. Effective rules have not, however, been devised for the present federal income tax law for families with property income. It remains feasible to give children assets, the income from which is taxed at lower rates than it would be if left in the names of the parents. The incentive to split income within the family arises from rate graduation under present law.

A further difficulty in a poverty gap design of a negative income tax is the treatment of people who, in a particular year, have a low income but are not poor. A person with assets of, say, $1,000,000, may in a particular year have an income of a negative amount or a small positive amount. He would, however, be classified as poor under a poverty gap system. A young engineer just completing his Ph.D. degree may have an income of $2,000 in one year, and hence be eligible for negative tax treatment, and have an income of $15,000 the following year. Given the fact that the income of some people fluctuates, there are certain to be people who are highly affluent, judged either by their net worth or by their average income over several years, but who have low incomes in particular years.

According to the usually accepted principles of income taxation, there is no objection to paying money to people who normally pay tax, but who, in a given year, happen to have low incomes. Under present law, for example, there are some modest averaging provisions, and persons in business who report negative incomes in a given year may be entitled to take advantage of loss carry-back and carry-forward provisions. In the case of loss carry-backs, people who so qualify are paid by the treasury for the year in which they suffer losses. In this aspect, the present law is a negative income tax. Provisions would be necessary to ascertain a person's negative or positive tax liability in the event he attains less than the poverty level income in a given year. To avoid hopeless confusion, the two income tax laws would have to be made consistent in their treatment of people with fluctuating incomes.

The above difficulties are a small sample of the actual difficulties likely to arise from having two federal individual income taxes. Until and unless the details of the laws are actually drafted, it is impossible to know all the problems that would emerge and what rules would be needed to prevent abuses. The one sure result is even greater complexity than now exists in income taxation in the United States.

Credit Tax Approach

There are many ways of designing a single federal individual income tax and a system of allowances. I shall set forth here a plan described as a credit income tax. The goals of this plan are: (1) to redistribute income systematically in the direction of reducing the present inequality, (2) to minimize incentive problems associated with high marginal rates, and (3) to reduce radically the complexity of the present federal income tax law.

The plan would reduce, and reduce substantially, the incidence of genuine poverty in the United States. However, the complete elimination of poverty would be at best a long-run target. As in other areas of economics, the critical issues are in the nature of more-or-less, rather than all-or-none. Poverty can never be totally eliminated unless society places those who are hopelessly incompetent in managing their own affairs in institutions and denies them their freedom.

The credit income tax suggested here has two main features: a system of flat-sum credits to which all residents of the United States would be entitled, and a general proportional income tax with zero exemptions. A person's or a family's net tax liability, plus or minus, is given by the formula, $T = Yr - Cu$, where T is the net tax liability, Y is taxable income, r is the tax rate, C is the size of the credit (assuming uniform per capita credits), and u is the number of credits for the unit (normally the family).

To illustrate, suppose the credit is \$500 a person a year, and the tax rate is 30 per cent. Table 1 shows the tax liability for a family of four. This combination of tax rate and credit would provide a net payment by the Treasury ranging from \$2,000 for a person or family with an income of zero (ignoring truly negative income) to zero at a level slightly in excess of $6,000 of income.

The higher the credit, given the tax rate, the larger will be the net payments made to people with low incomes. On the other hand, the tax rate depends on the size of the credit. The rate also depends on the desired yield of the tax to the Treasury and the size of the tax base. To calculate the tax rate for the country as a whole, the following formula may be used: $r = \frac{\Sigma C + R}{Y}$, where ΣC is the sum of the credits, R is the desired yield, and Y is total taxable income. Taking the population in round figures to be 200 million, the credit to be $400 per capita, the desired yield to be $50 billion, and total taxable income to be $500 billion, we get:

$$r = \frac{\$80\text{ billion} + 50\text{ billion}}{500\text{ billion}} = 26\text{ per cent.}$$

In recent years, the yield of the federal individual income tax has been in the neighborhood of 9 to 10 per cent of personal income. If personal income were the tax base, a credit of $400 per capita would "cost" about 16 percentage points in the rate. This result does not mean that the average rate of tax would rise from 10 to 26 per cent of personal income. The effective or average rate would remain at 10 per cent. The extra percentage points become the "price" paid for redistribution, including redistribution to one's self.

To implement the credit income tax plan it would be necessary to redraft large parts of the present federal income tax law. It might seem rather drastic to suggest that the federal income tax should be radically changed in order to increase the incomes of people who presently have low incomes. In fact, however, a great part of this task would consist of simplifying the present law. Many of the complexities of the law as it now exists are a direct consequence of graduated rates. As Blum and Calvin have emphasized in this connection, much of the work of lawyers in the tax field arises from the simple fact that the tax rates vary, depending on how much income is reported for tax purposes in a given year.[3] Among other things, all the complexities arising because of incentives that now exist to split income within the family would disappear. In addition, the inequities and the rules designed to deal with these inequities arising from the definition of the tax-paying unit would also disappear. Under a proportional tax, the problem of averaging, a very serious problem under the present law, is solved automatically.

[3] Walter J. Blum and Harry Calvin, *The Uneasy Case for Progressive Taxation* (Chicago: University of Chicago Press, 1953), p. 15.

There are, from the point of view of tax design, large advantages to be gained by eliminating progressive rates. We ordinarily have thought in the past that it was necessary to have increasing rates of tax in order to have progressive taxation. This view turns out to be incorrect. It is possible to have proportional rates and progression by the device of a general credit, as illustrated by Table 1.

TABLE 1

THE CREDIT INCOME TAX[a]

Income	Net tax	Disposable income
0	− 2,000	2,000
1,000	− 1,700	2,700
2,000	− 1,400	3,400
4,000	− 800	4,800
6,000	− 200	6,200
8,000	+ 400	7,600
10,000	+ 1,000	9,000
20,000	+ 4,000	16,000
50,000	+ 13,000	37,000
100,000	+ 28,000	72,000
1,000,000	+298,000	702,000

[a] Assumes a tax rate of 30 per cent and credits of $500 a person for a family of four.

There would be social costs associated with the installation of a general credit income tax. For example, people who presently are not required to file would have to file to be eligible for the credit. This is about 10 per cent of the population. Although the group is relatively small, the compliance task would not be simple. Many of the nonfilers have rather complicated problems. Some are small-scale farmers who are not accustomed to keeping books, some are occasional workers at odd jobs. Hence, an educational task of some magnitude would be in order.

From an economic point of view, however, the social costs of the credit income tax would be negative and would be negative by a large amount. Under the present system, many children are growing up without the advantages of proper food, shelter, clothing, medical care, and education. By increasing the financial means of parents, we would give offspring, on the average, higher levels of living. Society would gain in real terms in the form of greater productivity of the current generation of poor children when they become adults and of greater productivity of contemporary poor adults. Financial means are instrumental in obtaining work, when finding a job requires relocation away from depressed areas, proper dress to impress employers, and meeting living expenses while training. A credit income tax would not, to be sure, provide jobs for people with little skill;

as already indicated, the legal and institutional restrictions on realistic wage rates for such people must be moderated as a necessary condition for achieving substantial progress in this area.

Closely related, and of much greater importance than an increase in the output of goods and services, is the effect of a credit income tax on the problems arising from concentrated pockets of city poverty. Although city poverty has been a feature of American life since the latter part of the nineteenth century, the current-day ghettos differ in two important respects from ethnic ghettos of the past: the hope of significant economic improvement within a generation has all but disappeared, and the city poor are no longer content to be poor.

Systematic redistribution in favor of lower income groups by a technique that carrys no stigma would immediately end the despair of many of the city poor. This change would be a large improvement. It would also improve the finances of cities by removing a substantial portion of the costs of relief from city budgets, permitting cities to finance measures to assist low income groups. Systematic redistribution would also tend to reduce the migration of the rural poor to the cities. These groups, as beneficiaries of a credit income tax, would find their position improved in their own communities and would, presumably, have little or no incentive to migrate. A city slum, however dismal, has held the only hope of improvement for many of the rural poor in the deep South. This is in part due to capricious methods of distributing relief (not limited to the South), including the practice of granting or withholding relief to "discipline" those whose behavior offends the politically dominant group. A credit income tax by contrast would afford no such power to local officials and would automatically give poor rural people greater economic and political security than they now enjoy.

Socially, the process of preparing people for working and living in metropolitan areas can be achieved at a lower cost in the hamlets of Alabama than in the ghettos of New York or Chicago. The large cities must be given the opportunity to take measures to improve the lot of the city poor without being handicapped by large numbers of newcomers out of the rural South.

Concluding Observations

A credit income tax may appear to some to be a radical measure out of keeping with the American political tradition. Those who are inclined to take this view should weigh against it the large and expensive but inefficient programs that transfer goods and money to some groups at the expense of others. More of the same can be expected in the future in the absence of a program of systematic redistribution. With a credit income tax, any possible excuse for continuing agricultural price supports, for example, is removed. Subsidized public housing can be opposed without seeming to be ungenerous; low income groups, bolstered by the credit, may buy their own housing services in the market. From the point of view of high income groups, a credit income tax, if the credit is made modest in size, may be the less expensive alternative.

Those who like big government may find a credit income tax objectionable. No measure, to my knowledge, is a greater threat to the growth of nonmilitary government programs; the credit income tax undermines the most telling argument for many of these programs, namely, financial or real assistance to some group or groups.

A credit income tax can be installed in the near future without waiting for the end of the Viet Nam war. The Treasury and the Congress would need to redraft the Internal Revenue Code to include within the definition of Adjusted Gross Income many of the large classes of income presently fully or partially exempt from taxation, to reduce those deductions presently allowed for purposes other than to provide a more accurate definition of taxable income, and to simplify the code as a consequence of the adoption of a one-rate system. I do not wish to imply that such a change would be easy to achieve.

In the initial phase, the determination of the size of the credit may be accomplished by an estimation of the size of the tax base and the fixing of a rate deemed to be politically acceptable, perhaps 25 per cent, and then fixing the credit at the amount that would exhaust the difference between the potential yield and the desired yield of the income tax at that rate. If such a calculation permitted a credit of only $200 per capita a year in the first year, the automatic increase in the potential yield as income increased would permit the credit to be raised.

Once a credit income tax is established, the size of the credit and of the tax rate can be expected to become a political issue of some importance, with many people with persistent low incomes favoring a larger credit and many people with high incomes favoring a lower rate of tax. The political question of what the income distribution ought to be would then be clearly posed. Whatever the outcome over the years, at least a fundamental feature of economic life would become an explicit political question.

A credit income tax may be looked upon as a direct competitor with the Social Security program. A credit income tax, provided the size of the credit is not a trivial amount, would raise the level of incomes of those with low incomes; and, to the extent the Social Security program does likewise, as in the case of public assistance, aid to dependent children, and medicare, it is in fact competitive. But Social Security, unless the basic philosophy for its main programs—that it is an insurance program—is abandoned, cannot cope with large-scale poverty. An insurance approach implies that participants are "buying" insurance through the device called "contributions," meaning of course taxation, and only those who pay their way get benefits. No one would seriously hold that the radical income inequality found in the United States will be corrected by persuading everyone to acquire insurance against possible disasters. Social Security cannot, except by abandoning the insurance principle altogether, reach the genuine poor; many of these people are in a continuous state of disaster. Public assistance, one of the most unpopular and, for true believers in Social Security, one of the most embarrassing programs in the country, is direct testimony of the failure of the insurance principle. If a credit income tax eliminates public assistance, few tears need be shed. But if a credit income tax is installed and if, in another decade, the credit is made the equivalent of $1,000 a person a year, the entire Social Security program will need to be restudied to ascertain what features remain justified in a society in which poverty has been effectively eliminated as a social problem.

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