AN EVALUATION OF THE EFFICACY OF THE
NEGATIVE INCOME TAX PROPOSAL

by
Sue Parrish

Chancellor's Scholar Program
April 1983
# Table of Contents

**Introduction**

**History of the Antipoverty Movement**
- Social Insurance  
- Public Assistance (Welfare)  
- War on Poverty

**Causes of Welfare Problems**
- Lack of Coordination
- Cost
- Fraud, Error and Abuse
- Disincentives
- Welfare Problems in Review
- A Guaranteed Income

**The Negative Income Tax**
- History of the Negative Income Tax Concept
- Negative Income Tax Structure
- Variations of a Negative Income Tax Plan
- A More Feasible Alternative
- An Evaluation of a Negative Income Tax Plan

**Conclusion**

**Footnotes**

**A Selected Bibliography**

**Exhibits:**
- I
- II
- III
- IV
- V
- VI

<table>
<thead>
<tr>
<th>Exhibit</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>2</td>
</tr>
<tr>
<td>II</td>
<td>15</td>
</tr>
<tr>
<td>III</td>
<td>17</td>
</tr>
<tr>
<td>IV</td>
<td>20</td>
</tr>
<tr>
<td>V</td>
<td>21</td>
</tr>
<tr>
<td>VI</td>
<td>24</td>
</tr>
</tbody>
</table>
AN EVALUATION OF THE EFFICACY OF THE
NEGATIVE INCOME TAX PROPOSAL

Introduction
For the past 20 years, the cost of attempting to redistribute the income of Americans in order to reduce or eliminate poverty through our current system of public assistance has steadily increased. Exhibit I illustrates the increase in social welfare expenditures by both the federal government and state and local governments for the period 1960 to 1979. Total welfare expenditures increased from $52.3 billion in 1960 to $428.4 billion in 1979, an increase of 719 percent. Federal spending for the same period rose from $25 billion to $264.2 billion, an increase of 956.8 percent.1 This high cost is partially the result of inefficiency and a lack of coordination and control among the various public assistance programs at the federal and state levels.

The present system also provides little or no incentives to work. This lack of work incentives contributes to the phenomenon of the cycle of poverty, whereby the reliance on public assistance is passed on from generation to generation.

A review of the current system of social welfare, including a brief history of the antipoverty movement, provides insight into the problems which exist in this system of relief. This analysis strongly emphasizes the need for change. A Negative Income Tax plan is an approach to such a change which utilizes the federal tax system as a means of reducing or eliminating poverty. It consists of a negative
Social Welfare Expenditures Under Public Programs, 1960-1979
tax or subsidy paid to households whose incomes fall below a certain level. This subsidy is reduced as income is earned by a rate of less than 100 percent, thereby providing an incentive to work. Such a plan is designed to replace the traditional system of categorical monetary and in-kind income transfer programs.

History of the Antipoverty Movement

Poverty has always been a serious problem in America's society. How could a country so rich explain its vast number of poor? Since explanations consisted mainly of laziness and ignorance, these people were generally ignored, and the problems of the poor were swept neatly under the Congressional carpets. Strong lobbying, however, brought about the enactment of worker's compensation in 1908 and veterans' disability compensation in 1917. Although these programs were designed to provide recompense to employees and veterans for injuries sustained in the line of duty rather than to combat poverty, they represent the beginning of an era characteristic of social responsibility.

The need for public assistance peaked in 1929. Almost 50 percent of the United States population was thrust into poverty because of severely depressed economic conditions. However, it was not until 1933 that President Franklin Roosevelt, in his New Deal, recognized the government's responsibility to improve the standard of living of all U.S. citizens. During this time of reconstruction, more than 35 government agencies and policies were established to provide relief to the unemployed, to promote economic recovery, and to administer programs for political, economic and social reforms. Some of these policies and
agencies included: the Fair Labor Standards Act of 1938 (which provided for a minimum wage for employees), the Agriculture Adjustment Administration, the Federal Deposit Insurance Corporation, the Farm Security Administration, the Federal Emergency Relief Administration, the Federal Security Agency (now the Department of Health and Human Services), the National Labor Relations Board, the Railroad Retirement Board, the Public Works Administration, the Resettlement Administration, the Social Security Board, the Tennessee Valley Authority, and the Works Progress Administration. Although most of these agencies were abolished by 1940, they demonstrate a clear change in political attitudes toward the poor and helpless.

Social Insurance. Plans to provide social insurance were established during the Great Depression of 1929-1938. For example, the Old Age, Survivor's and Disability Insurance program, more commonly known as Social Security, was enacted in 1935. The OASDI program was not designed to provide benefits to those in need, but to those who had contributed financially to it and who met certain eligibility requirements.

Other categorical programs, such as unemployment insurance (1935), railroad retirement plans (1937), and black lung benefits (1969), have been added to the list of social insurance programs which provide direct monetary benefits. In 1965, the Social Security System was expanded to include Medicare, which is a basic medical plan that provides hospitalization, nursing-home care, home nursing visits, and out-patient tests and diagnoses to those 65 and older. All elderly persons, regardless of financial need, are eligible for these benefits.
dependent upon the covered worker's contributions. Benefits under Medicare are termed "in-kind" benefits, because no cash transfers are made. They are services which are provided by the government through both public and private health care facilities.

Public Assistance (Welfare). During this era of the Great Depression, the federal government also recognized a responsibility to help those citizens whose income, if any, was so low they were unable to contribute to social insurance programs. Welfare, or public assistance, programs were established to help those who were ineligible for social insurance. Unlike social insurance programs, the focus of the public assistance programs was directed to those people in need. Categorical assistance programs, which provide cash payments to the poor, include veterans' pensions (1933) and Aid to Families with Dependent Children (1935). The 1972 amendment to the Social Security Act provided cash benefits through Supplemental Security Income, which incorporated prior programs for old age assistance, aid to the blind, and aid to the permanent and totally disabled.

Public assistance is also provided on an in-kind basis. The Food Stamp Program, under the Department of Agriculture, began in 1964. Food stamps are issued to qualified individuals in the form of vouchers with which to purchase food. Public housing assistance, which first began in 1937, is a program whereby local governments receive federal subsidies to acquire housing projects which are then rented to low-income families. These tenants pay approximately 25 percent of their income for rent and the federal government assumes
the remainder of the rental price. Medical services are provided to low-income individuals through Medicaid, established in 1965. Benefits under Medicaid are similar to those under the Medicare program; however, Medicaid services are provided on the sole basis of need rather than on the recipient's prior contributions.

The War on Poverty. The 1950s was a decade of unprecedented economic growth for the United States. For the first time, many Americans realized a surplus of income. Sales of durable goods and luxuries were at a peak. However, this growth in the nation's Gross National Product did very little to provide relief for the millions of other Americans who were not a part of the labor force. A renewed interest in the poverty problem gained the attention of President John Kennedy. Just a month prior to his assassination in 1963, he was presented with a document entitled "Program for a Concerted Assault on Poverty." A few months later in his 1964 State of the Union Address, President Lyndon Johnson declared a war on poverty. Within eight months, the President signed into law the Economic Opportunity Act and established the Office of Economic Opportunity to administer a number of programs designed to eliminate poverty entirely.

The OEO, later reorganized and renamed the Community Services Administration, provided funding for administrative expenses involved with the operation of locally community action agencies. State, local and private contributions, a portion of which were in-kind services, covered the remainder of the agencies' costs. The OEO established community action agencies to serve as umbrella agencies for a number
of antipoverty programs, such as neighborhood health services, legal services, lunch programs and home weatherization. CAA's frequently service Head Start Programs which are under the direction of the Department of Health and Human Services. Head Start provides just what its name implies: an opportunity for preschool aged children of poor families to get a head start by preparing them for public school through emphasis on academic activities.

After World War II the federal and state governments created or reestablished programs to provide training and vocational counseling for the poor. Many states revived their employment agencies during the 1950s and 1960s. The Job Corps prepared 16 to 21 year old high school drop-outs from very poor families for employment. The Neighborhood Youth Corps, under the direction of the Department of Labor, also provided training and part-time job opportunities for disadvantaged school drop-outs to age 21. Congress passed the Emergency Employment Act of 1971 seeking to create new jobs within communities for the unemployed. This program was later incorporated into the Comprehensive Employment and Training Act of 1973 (CETA), which operated through revenue sharing, where state and local governments match the funds provided by the federal government.

Causes of Welfare Problems

Lack of coordination. Only a handful of federal assistance programs designed to eliminate poverty or at least to alleviate its effects has been mentioned. A complete list of income transfer or support programs would prove to be too lengthy to write and too monotonous to read. A study by the Institute for Socioeconomic Studies revealed
that 182 categorical federal income support programs were in existence during the fiscal year 1977.¹¹

A major problem with our current system of providing assistance on a categorical basis is that it is often difficult to fit people into categories. Each program pays benefits to individuals or families who meet certain eligibility requirements, and because of the lack of coordination among the programs, requirements often overlap allowing individuals to qualify for several different programs and to receive more gross income than was intended. An example of such a situation was the discovery of a woman with three children who received, in addition to her monthly earnings, benefits from AFDC, public housing, surplus commodities, child care, school lunch assistance and Medicaid. Her total income was $678 per month. At that time, a working woman receiving no benefits would have had to earn more than $800 a month to receive the same net income, and the average salary for a woman was only $500 per month.¹²

Requirements for these categorical programs can, and very often do, conflict with each other, and people in need must give up benefits from one program in order to qualify for another. A 56 year old man receiving Social Security payments was given a $14 per month increase in benefits. That small increase caused him to lose his eligibility for Medicaid, caused the cost of his food stamps and the cost of his subsidized housing to rise, and resulted in a reduction in the payments he received from his veterans' pension. In the end, the man lost far more per month than the $14 increase in Social Security benefits.¹³
The inability of the different programs to coordinate their efforts with each other also leads to waste. A young girl had acquired a rare and incurable illness in which her throat muscles became paralyzed. She was unable to speak and could survive only on a special diet of liquid food which cost $4 a day. Her mother received Social Security survivors' benefits, and the government's assistance of $4 per day for treatment would cause the family's income to increase to the point where the daughter could not collect her monthly allotment. Because the family could not afford to lose this income, the solution was for the girl to remain in the hospital. Therefore, it cost the government $135 per day for $4 worth of food.\textsuperscript{14}

Cost. The complexity of our categorical welfare system and the lack of coordination has led to increased inefficiency and exhorbitant costs of administering the myriad public assistance programs. The cost to taxpayers for employing hundreds of thousands of people to help determine eligibility, ensure the receipt of proper benefits, and to check against fraud was almost $2 billion in 1977 just for AFDC, food stamps, Medicaid and CETA. These administrative costs are, of course, in addition to the benefits paid to recipients. The total cost of administering the 182 different categorical income transfer programs and the delivery of benefits was approximately $248 billion for fiscal year 1977, or 69 percent of the federal tax receipts. About $35 billion of this amount was in the form of tax relief which is a form of income support to specific groups and, therefore, a cost or loss of revenue to the government. In addition to the federal assistance, state and local governments spent an additional $50 billion on support services and payments during this same year.\textsuperscript{15}
Fraud, error and abuse. A further result of the complexity and inefficient administration of our current system is the amount of money lost each year to fraud, error and abuse. In 1978, Joseph Califano, Jr., the Secretary of Health, Education and Welfare, estimated this loss to be approximately 10 percent per year of the two largest programs administered by HEW, AFDC and Medicaid. This amounts to well over $1 billion for each program.\(^{16}\) A large portion of this cost is a result of errors on the part of local welfare offices in the processing of claims. Their failure to detect false statements from recipients or their inability to follow up on the information given has led to payments to applicants who are not eligible and to overpayments to qualified individuals.

In addition to false claims by recipients, the current method by which our Medicaid system is administered is an open invitation to abuse and fraudulent claims by physicians and pharmacists. Mr. Califano reported that physicians have "claimed to have performed more than one appendectomy on the same person, or ... six tonsillectomies on the same individual in a year. Other cases involve women who have supposedly given birth three times in the same year, or doctors who list 70 house calls to the same address in a year."\(^{17}\) It has also been found that pharmacists can easily bill Medicaid for false or nonexistent prescriptions.\(^{18}\)

The program reported to have more incidents of fraud and abuse than any other area of public assistance is the Food Stamp Program. In a recent telephone conversation with a representative of the Food and Nutrition Service of the Department of Agriculture, the administering
agency of the Food Stamp Program, he admitted that fraud, abuse and errors do exist and are problem areas. However, he supplied no accurate data. The agency strongly feels that the publicized reports concerning fraudulent misuse and counterfeiting of food stamp coupons are greatly "sensationalized." Because accurate data is unavailable on the subject of welfare fraud, it cannot be determined whether this issue has been overstated by media reports or whether the administering agencies are understating the extent of the dollars lost or both.

Although administering agencies of public assistance are aware of the loss each year due to fraud, error and abuse, the unwieldy size of the welfare bureaucracy renders it almost impossible to control fraud at the federal level. However, a concerted effort has been made by state and local governments to bring offenders to justice. Authorities in Los Angeles discovered that a woman had received $240,000 in welfare payments by claiming 66 nonexistent children for more than six years. A graduate student in Chicago was found to have collected $150,000 in illegal payments from 1972 to 1978. A Cook County (Chicago) special task force prosecuted in only two years 335 cases of welfare fraud which involved a total of more than $3 million.

Disincentives. Our current system of providing assistance to the poor is also plagued with massive economic costs resulting from the system's built-in work disincentives. As money is earned, welfare payments are reduced and often eliminated. For example, a family who earns $1,000 in income may see its food subsidy reduced by $200,
its AFDC payments decreased by $450, and its public housing assistance reduced by $250. The net effect of the $1,000 in earnings is only $100 of additional income. It hardly seems worth the effort to seek work and be productive when one can stay home and be almost as well off. Often the implicit tax, or the sum of the benefits lost for each additional dollar of income earned, is greater than 100 percent. Therefore, working would make the individuals actually worse off financially than if they did not work and continued to live on government subsidies.

In addition to providing disincentives to work, our current system also contributes to social disincentives. Most assistance programs provide benefits based upon the number of dependents in the family. It is sometimes, therefore, beneficial to have more children as a means to receive additional assistance. The traditional system of public assistance also relies on the categorization of recipients into specific groups. People will often alter—or pretend to alter—their situations to fit into the categories. According to the Congressional Research Service of the Library of Congress, AFDC discriminates against fully employed fathers. They are ineligible for aid regardless of their income level. Such discrimination provides a potential financial incentive for families to break up.21

Welfare problems in review. The preceding examples and statistics are not intended to imply that our current public assistance programs have been completely ineffective. The number of families who live below the poverty line has decreased from almost 50 percent in 1929 to 22 percent in 1960 to 11 percent in 1980.22
The economic and social costs of bureaucratic inefficiencies, however, have increased at alarming rates. For the past two decades, members of the labor force who work to support these programs with their tax dollars have criticized the welfare system and have demanded reform. Several methods of restructure have been proposed which attempt to achieve three objectives: to eliminate poverty; to preserve work incentives as much as possible; and to maintain equity by allowing for a greater total income for those who earn higher incomes through work effort.23

A guaranteed income. A conflict exists, however, in attempting to achieve these three goals, regardless of the method employed. To equitably remove or mitigate poverty requires the adoption of a direct government guaranteed minimum income. Theoretically, such a plan would raise the income of all poor families to an income set at the poverty level at a cost of less than one percent of the Gross National Product, substantially less than the cost of our current welfare programs.24 However, a trade-off between the equity and the efficiency of a guaranteed minimum income arises because of the adverse incentives built into such a plan for both those taxpayers who pay the subsidy and those at the bottom of the income ladder who receive the subsidy. Such adverse incentives lead to economic waste, and they could increase the cost of such a program to the unacceptable level of over $500 billion.25

For example, the establishment of a guaranteed income would undoubtedly require a higher tax rate to be levied on the labor force whose earnings are above this minimum level in order to finance the plan.
Although this increase in taxes will make working less attractive by reducing the net income, it will also make working more necessary in order for the family to maintain its spending level. Such high taxes do, however, encourage the search for additional tax loopholes, or socially unproductive methods to reduce the tax liability. According to economist Arthur Okun, "High tax rates are followed by attempts of ingenious men to beat them, as surely as snow is followed by little boys on sleds." 26

The greatest amount of inefficiency or waste of such a plan is perhaps due to the adverse incentives to work for those families whose income is below the poverty level. Exhibit II graphically illustrates the effects on the labor supply at a guaranteed minimum income level of $7,000. Family X, shown on the vertical line OA, would receive the full amount of the subsidy of $7,000. Family Y whose income is $5,000 would receive a subsidy of $2,000 which would bring it up to the guaranteed minimum income level. Why, then, should this family work and earn $5,000 when it can receive the full amount of $7,000 with no work effort at all? The implicit tax rate (the amount by which the subsidy is reduced for each additional dollar of earned income) for this type of assistance plan is 100 percent. In this manner, a guaranteed minimum income plan fails to reach the goals of providing work incentives and of maintaining equity. 27

Further, Family Z, a nonpoor family earning $8,000 per year, will also leave the workforce and reduce its income only slightly ($1,000, less the required amount of income taxes). A guaranteed minimum income plan would therefore be equitable and efficient only if people continue to work as much after the subsidy as they worked previously. 28
Guaranteed Minimum Income Plan

Exhibit II

Income Before Tax or Subsidy ($) vs. Income After Tax or Subsidy ($) Graph:

- Positive Tax (50%)
- Negative Tax

Points:
- A (7,000)
- B (7,000)
- X (5,000)
- Y (7,000)
- Z (8,000)

45° Line:

0 5,000 10,000 15,000

INCOME BEORE TAX OR SUBSIDY ($)
Another approach to the redistribution of income is the negative income tax plan. The proposal is a modification of the guaranteed minimum income plan into which work incentives are provided.

The Negative Income Tax Plan

History of the negative income tax concept. The process of negative income taxation is not a new concept. It was first debated in England in the 1930s and later discussed informally by members of the U.S. Treasury Department's Tax Research Division in the mid 1940s. Conservative economist Milton Friedman presented a formal proposal of a negative income tax plan in a lecture in 1956. He later expanded his views in Capitalism and Freedom in 1962.29

Negative income tax structure. Like the guaranteed minimum income plan, the principle of a negative income tax is to extend the income tax rates beyond zero to a negative level in order to provide assistance to low income families. In other words, families whose income falls below a given level receive a subsidy or negative tax rather than paying a positive income tax and receiving welfare payments simultaneously. Exhibit III illustrates a hypothetical model of such a system of taxation.

The 45 degree line, OBD, represents net income if no taxes are paid and no subsidy is received. On this line, a family who earns a gross income of $5,000 will have a net or take-home income of $5,000. The basic elements of a negative income tax plan are: a guaranteed minimum income level; a marginal tax rate; and a "critical income level."
Exhibit III

Negative Income Tax Plan

with a guaranteed minimum income of $7,500 and a marginal tax rate of 33 1/3 percent and a break-even point of $22,500.

Who pays?
The guaranteed minimum level is the amount of income every family is guaranteed, whether or not a household member is employed. This level is set at $7,500 in Exhibit III.30

A marginal tax rate is the amount of tax that is paid on each additional dollar of income. In reference to a negative income tax plan, this tax rate may also be called the "take-back" rate, because it represents the amount by which the negative tax or subsidy is reduced for each additional dollar of earned income. Such a tax rate determines the slope of the "income after negative income tax" line, ABC. The marginal tax rate in the example in Exhibit III is 33 1/3 percent. For every $300 of income earned, the negative tax is reduced by only $100, allowing the family to keep $200. Obviously, the more a family earns by working, the more income it will keep.

The third element of a negative income tax plan is the "critical income level." It is the level of income at which no tax is paid nor subsidy received. This income level is also referred to as the break-even point. The model in Exhibit III establishes the break-even point at an income level of $22,500.

In Exhibit III, a family of four with no earned income would receive the maximum subsidy or negative tax of $7,500, such as Family X. Moving to the right on the earned income before tax or subsidy axis, a family which enters the workforce and earns $6,000 would receive, after the subsidy of $5,500 (a reduction of $1,000 for each $3,000 earned), a total income of $11,500. Family Y, which has an earned income of $15,000, would still receive a negative tax
of $2,500 for an income-after-tax of $17,500. An earned income of $22,500 would provide no subsidy, and any income above $22,500 would produce a positive tax, as is characteristic of our current system of taxation. For example, employing a one-third marginal tax rate, Family Z with an earned income of $30,000 would be required to pay a positive tax of $2,500 (one-third of the difference between the break-even level of $22,500 and the earned income of $30,000).

Exhibit IV presents a table showing subsidy and tax amounts at various income levels.

Variations of a negative income tax plan. The plan shown in Exhibit III would be modified to reduce its cost by simply changing either the minimum income level or the marginal tax rate, or both. For example, Exhibit V illustrates a plan with the same $7,500 minimum income level, but the marginal tax rate has been increased to 50 percent. In this model, the break-even or critical income level is now $15,000. It is important for the reader to understand that any increase in the marginal tax rate would reduce the incentive to work. A 50 percent marginal tax rate, as depicted in Exhibit V, would mean that, for each dollar earned, the negative tax would be reduced by 50 cents, as opposed to the 33 cents reduction in Exhibit III. In addition to creating more work disincentives, a 50 percent implicit tax rate on incomes less than $15,000 would require a regular tax of 50 percent on incomes above $15,000, if a proportional tax structure is maintained as illustrated in Exhibits III and V.

Because one purpose of the negative income tax plan is to eliminate as many of the current social programs as possible, one must be cautious when reducing the plan's guaranteed minimum income level.
## EXHIBIT IV

<table>
<thead>
<tr>
<th>Earned Income</th>
<th>Tax Paid or (Subsidy Received)</th>
<th>Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>$(7,500)</td>
<td>$ 7,500</td>
</tr>
<tr>
<td>$3,000</td>
<td>(6,500)</td>
<td>9,500</td>
</tr>
<tr>
<td>6,000</td>
<td>(5,500)</td>
<td>11,500</td>
</tr>
<tr>
<td>9,000</td>
<td>(4,500)</td>
<td>13,500</td>
</tr>
<tr>
<td>12,000</td>
<td>(3,500)</td>
<td>15,500</td>
</tr>
<tr>
<td>15,000</td>
<td>(2,500)</td>
<td>17,500</td>
</tr>
<tr>
<td>18,000</td>
<td>(1,500)</td>
<td>19,500</td>
</tr>
<tr>
<td>21,000</td>
<td>(500)</td>
<td>21,500</td>
</tr>
<tr>
<td>*22,500</td>
<td>0</td>
<td>22,500</td>
</tr>
<tr>
<td>24,000</td>
<td>500</td>
<td>23,500</td>
</tr>
<tr>
<td>27,000</td>
<td>1,500</td>
<td>25,500</td>
</tr>
<tr>
<td>30,000</td>
<td>2,500</td>
<td>27,500</td>
</tr>
<tr>
<td>33,000</td>
<td>3,500</td>
<td>29,500</td>
</tr>
</tbody>
</table>

Tax amounts paid and subsidy (negative tax) received at various income levels using a guaranteed minimum income level of $7,500 and a one-third marginal tax rate.

*Break-even point*
Negative Income Tax Plan

with a guaranteed minimum income of $7,500 and a marginal tax rate of 50 percent and a break-even point of $15,000.
to achieve lower costs. If this level is set too low, more assistance programs would undoubtedly have to be re-established, adding greatly to the cost of a negative income tax plan. On the other hand, a guaranteed minimum income level set too high would also produce even greater work disincentives.

In Labor Theory, Richard Perlman describes two alternative negative income tax plans. Rather than maintaining a constant or proportional tax rate, as seen in Exhibits III and V, he studies the effects of both a progressive and regressive tax rate.

When the marginal tax rate is progressive, or increasing, the negative tax received is reduced by greater rates as the family's earned income increases. While this type of negative income tax plan provides for increased income for increased work effort, additional dollars earned are taxed at a higher rate. At this point, when each additional dollar earned is worth less, the worker is motivated to reduce his hours of work. He realizes that he is assured of receiving some income whether he works or not and thereby depresses his supply of labor.31

In another hypothetical model, Perlman discusses a regressive, or decreasing, marginal tax rate. In this plan, the decrease in the negative tax is related to the supply of labor, allowing for greater increases to total income as more labor is supplied. In other words, the plan has stronger work incentives because the negative tax is reduced in smaller increments the more hours of labor supplied. Perlman says of this plan:
On the surface, it appears that this plan might have a regressive quality. It may seem contrary to the purpose of an antipoverty program to grant larger subsidies to higher incomes, as would be the case under this plan. But closer examination reveals that the higher subsidy is not going to workers with higher earnings potential, but as a reward to the same worker for more effort. The maximum attainable subsidy declines with rising full-schedule income, thereby retaining the progressive nature of the tax structure. 32

Although a regressive marginal tax rate would preserve work incentives by making a full work schedule more attractive, such a negative income tax plan would present administrative problems and would prove to be very costly.

A more feasible alternative. After evaluating several variations of a negative income tax plan, I believe the most feasible alternative is a combination of several plans. Exhibit VI illustrates the dimensions of such a proposal. The guaranteed minimum income level is set at $7,600 for a nonfarm family of four, and the marginal tax rate is established at the proportional rate of 40 percent up to the break-even point of $19,000. This portion of the plan is similar in structure to those shown in Exhibits III and V. However, earnings received after the break-even point would be taxed at progressive or increasing rates. For example, a family whose earnings are $20,000 may be taxed at a rate of 40 percent. Earnings of $30,000 may be subject to a 42 percent marginal tax rate. The tax rate for earnings between $40,000 and $50,000 may be 45 percent, and so on. The increasing tax rates above the break-even point cause the slope of the income after negative income tax to begin decreasing. Net income is still increasing, although it is "increasing at decreasing rates."
Exhibit VI

Negative Income Tax Plan

with a guaranteed minimum income of $7,600 and a 40 percent marginal tax rate to the break-even point of $19,000; thereafter the marginal tax rate is progressive.
At some income level, the marginal tax rate will again become proportional or constant. The current system of taxation in the United States is similar in structure to that of this proposal in its progressive nature.

This negative income tax proposal would replace all of the current welfare programs, with the exception of the social insurance programs, such as Social Security, Medicare, workers' compensation and other retirement and disability plans that require monetary contributions by the recipient. Eventually, at such a time when it is no longer self-supporting, Social Security could be integrated into this system. Until that time, the guaranteed minimum income level would be adjusted downward for households receiving Social Security benefits.

The guaranteed income would also require adjustment based upon geographic locations. For example, a guaranteed minimum income of $7,600 would not provide the same level of assistance for a family in New York City as it would for a family living in rural North Carolina.

The unadjusted cost of this proposal would be approximately $150 billion. The total cost of public assistance and insurance programs would require the addition of the costs of any additional programs which would be maintained, such as Social Security. While the estimated cost figures appear to be high, I believe that a negative income tax plan such as the one proposed in Exhibit VI could be implemented at a total cost of less than the amount currently being spent on social welfare programs, especially if Social Security were to be incorporated into it.
An evaluation of a negative income tax plan. In 1962, Milton Friedman commented on his proposal of a negative income tax plan in *Capitalism and Freedom*:

The advantages of this arrangement are clear! It is directed specifically at the problem of poverty. It gives help in the form most useful to the individual, namely cash. It is general and could be substituted for the host of special measures now in effect. It makes explicit the cost borne by society. It operates outside the market. Like any other measures to alleviate poverty, it reduces the incentives of those helped to help themselves, but it does not eliminate that incentive entirely, as a system of supplementing incomes up to some fixed minimum would. An extra dollar earned always means more money available for expenditure.33

However, like any proposed full-scale change in an established tradition, the negative income tax has received several criticisms, many of which are valid. For example, many fear that a negative income tax would become merely a supplement to the existing social welfare programs rather than a replacement for them. The purpose of a negative income tax plan is to replace all or a major portion of our current assistance programs both equitably and efficiently. As a supplemental program, the negative income tax would create an additional expense for the taxpayer rather than easing his current burden.

Some legislators criticize the negative income tax for providing assistance for the undeserving. They feel it fails to recognize the reasons behind the lack of income, because such a plan would transfer income to all poor families whose income is below a certain level. Many families are poor because of problems with alcoholism, drugs, general self-discipline, family instability and shortsightedness. Cash payments to these individuals may only contribute to these
problems. By transferring money to the so-called undeserving poor, the children, to whom assistance is intended, would not benefit.\(^{34}\) However, many of these problems or conditions are the results of poverty. In these instances, payments of cash benefits may help the victims overcome their problems.

Experiments testing the effects of a negative income tax plan on families were conducted for three and five years in Seattle and Denver, respectively, concluding in 1978. The results of these experiments indicated an unexpected increase in marital dissolutions.\(^{35}\) The reason for these results may be the fact that the guaranteed income would be distributed to households rather than to individuals. Upon the dissolution of a marriage, each household would then be eligible for an independent income. Therefore, it would be unnecessary for a wife to be dependent on the husband or for a husband to remain within the family to provide support.

Another criticism of the negative income tax plan is that the cost would not only include the payments to those families whose income is below the break-even point, but also the loss of tax revenue the government would have received from those families whose incomes are between the poverty level and the established break-even point. As noted previously, the break-even point could be adjusted downward by either increasing the marginal tax rate or reducing the guaranteed minimum income or both.

Despite the drawbacks of a negative income tax plan, some of which are typical of existing programs, the advantages of such a program appear obvious. It would alleviate poverty by equitably
guaranteeing a minimum income to all poor families, rather than to those who are a part of special interest groups, such as farmers, female heads of households, elderly persons, and small businessmen. Such a plan would replace all or a great number of our current income transfer programs at a reduced cost. The negative income tax plan could be administered through a single agency, the Internal Revenue Service, which should reduce administrative costs significantly.

One can expect a slight reduction in labor supply, because, at the lower income levels, a worker can cut back his hours of work and still have more income than he had prior to the establishment of the negative income tax plan. However, the built-in incentives to work provide that those who do work will be in a position superior to those who choose not to work. Experiments have shown that, while some elect to reduce their work effort, more young adults from poor families graduated from high school, and personal expenditures increased in the areas of housing and medical services. 36

Conclusion

With the continued increase in government spending and the resultant mounting federal deficit, legislators must closely and objectively examine the possible alternatives to eliminate poverty. One alternative would be for the government to divest itself of social responsibilities and accept Darwin's philosophy that the strong will survive. Although this course of action would eliminate billions of dollars in government spending, it would be unacceptable to legislators and the public alike. After decades of providing assistance to the
less fortunate, we could not completely withdraw support. The American conscience would not allow it.

Another alternative to eliminate poverty is to maintain our current methods of income transfer. I have examined the efficiencies and effectiveness of our existing welfare system. Is it providing a cure for the ailment of poverty, or is it merely relieving its symptoms? And how effective is it at relieving these symptoms? Even with the constant increase in spending, the United States is experiencing a slight increase in its number of poor families, and the distribution of income has not changed substantially. Serious problems were detected in our federal assistance programs when Milton Friedman and others proposed a negative income tax over 20 years ago. Since that time, the problems have multiplied with the creation of new programs, many of which overlap with others and produce a waste that taxpayers feel they no longer can nor should bear.

One inherent philosophy of the American people, however, is to help those who will help themselves. Of course, there will always be indigents who are physically or mentally incapable of any type of self support, and society cannot and should not allow them to suffer. No citizen wants to see anyone starve to death because he cannot afford to buy food. It is unacceptable to allow children to suffer from malnutrition and diseases related to inadequate living conditions. No one should have to endure physical pain or die because he cannot bear the cost of medical help. Our welfare programs were designed to provide assistance to people in need; however it has done very little to motivate them to help
themselves. It has encouraged dependence on government aid and has actually contributed to the establishment of a welfare culture, where this dependency is passed on to future generations.

A third alternative and possibly the only viable solution to the problems associated with our current public assistance programs is the development of a new system which would necessitate the dismantling of the existing myriad welfare programs and which would provide a method of equitably and efficiently reducing or eliminating the causes of poverty in the United States. I believe a variation of a negative income tax plan, such as the model proposed in Exhibit VI, may provide for such a system. This proposal would more efficiently and effectively achieve the objectives essential to the success of any plan to provide public assistance. It would eliminate poverty; it would provide for incentives to work; and it would maintain equity by allowing those who work to receive a larger total income than those who rely solely on government support.
Footnotes


3 Ibid., p. 787.

4 Ibid., p. 787.


6 Wonnacott, p. 789.

7 Friedlander, p. 315.

8 Ibid., p. 318.

9 Ibid., p. 324.

10 Ibid., pp. 327-30.


12 Ibid., p. 33.

13 Ibid., p. 35.

14 Ibid., p. 31.

15 Ibid., pp. 24-26.


17 Ibid., p. 41.

18 Ibid., p. 41.


25. This figure is determined by a hypothetical guaranteed minimum income of $5,000 and a total of 10,411,000 families whose incomes were below $5,000 in March 1980, as provided by the Census Bureau of the U.S. Department of Commerce.


27. Wonnacott, p. 793.

28. Ibid., p. 794.


30. The income guarantee should be set below the poverty line in order to provide incentives to work and to keep the cost of the plan at a reasonable level. For example, a $9,200 poverty line for a nonfarm family of four (1982) and a one-third tax rate would establish a break-even point of $27,600 and would bring almost two-thirds of all families into the program. I have selected a $7,500 guaranteed minimum income for illustrative purposes only. A more realistic income guarantee may be closer to $7,000.

31. Perlman, pp. 68-70.

32. Ibid., p. 72.


35. "Some Negative Evidence About the Negative Income Tax," Interview with Daniel P. Moynihan, Fortune, 4 Dec. 1978, pp. 145-46. For further information on the Seattle-Denver experiments, see

A Selected Bibliography


