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CONCEPTS IN WELFARE PROGRAM DESIGN

A VOLUME OF STUDIES

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
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LETTERS OF TRANSMITTAL

AUGUST 16, 1973.

To the members of the Joint Economic Committee:

Transmitted herewith is Paper No. 9 (pt. 1) in the Series *Studies in Public Welfare,* prepared for the Subcommittee on Fiscal Policy in conjunction with its review of the Nation's public welfare programs. This volume is entitled "Concepts in Welfare Program Design."

The three studies in this volume are the views of the authors only, and do not represent the views of the Joint Economic Committee, the Subcommittee on Fiscal Policy, any individual members thereof, or the staff.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

AUGUST 14, 1973.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a volume, entitled "Concepts in Welfare Program Design," containing three studies prepared for the Subcommittee on Fiscal Policy by outside experts.

In preceding volumes the subcommittee has provided extensive documentation of the many problems in our current set of public welfare programs. We have noted as well that it is far easier to critique these programs than to restructure them in a rational way. But responsible critics must grapple with the serious issues facing us.

In an attempt to provide the Congress with diverse ideas on basic reform strategies, the subcommittee asked several outside experts to think freely and imaginatively on this subject. Three persons—Benjamin A. Okner, Robert H. Haveman, and Arnold H. Packer—whose papers comprise part 1 have done just that, and we are pleased to present their thought-provoking papers. Of course, the papers represent only the views of their authors, and do not represent the views of the Subcommittee on Fiscal Policy, any individual members thereof, or the staff. Part 2, to be published at a later date, will present equally challenging ideas.

This volume was compiled and edited by the subcommittee staff, principally Alair A. Townsend, James R. Storey, Irene Cox, Robert I. Lerman, and Jon H. Goldstein.

MARTHA W. GRIFFITHS,
Chairman, Subcommittee on Fiscal Policy.

CONTENTS

THE ROLE OF DEMOGRANTS AS AN INCOME MAINTENANCE ALTERNATIVE

By BENJAMIN A. OKNER*

SUMMARY

This paper examines four variations of the "demogrant" approach to income maintenance reform. A demogrant is a common grant available to all members of a demographic group without regard to any other condition or criterion.

The paper focuses on the income redistribution each plan would bring about and on the changes in the income tax structure necessary to finance each plan. The pros and cons of demogrant plans as alternatives to current welfare programs are not discussed, nor are the administrative issues associated with such plans.

Some facts about the four demogrants under analysis are summarized in table 1. The most costly plan (plan B) would reduce the number of families in poverty by 80 percent while redistributing about $47 billion of total income. The least expensive plan (plan C) would reduce the number of poor families by 71 percent and redistribute almost $34 billion of income.

INTRODUCTION

In recent months, national attention has been directed toward the idea of instituting a universal demogrant or credit income tax in the United States. While the idea is not a new one, a great deal of interest and controversy was generated by the discussion of a $1,000 per person demogrant during the 1972 presidential campaign. About the time its importance as a campaign issue diminished, a green paper was issued recommending adoption of a credit income tax in Great Britain.[1] Although the British green paper has not yet been widely discussed in this country, there is little doubt that various proposals for using demogrants and tax credits as an income maintenance alternative will be with us for many years.

*The views expressed are the author's and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution. The author is grateful for many helpful comments received on an earlier draft of this paper from Russell Lidman of the Institute for Research on Poverty, University of Wisconsin.

An earlier draft of this paper was presented at the Conference on Integrating Income Maintenance Programs sponsored by the Subcommittee on Fiscal Policy of the Joint Economic Committee and the Institute for Research on Poverty, held at the institute in July 1972.

[1] "Proposals for a Tax Credit System," Cmnd. 5116 (London: Her Majesty's Stationery Office, October 1972).

TABLE 1.—*Summary of data on four alternative demogrant schedules*

	Schedule—			
	A	B	C	D
Annual grant amounts	[1] $1,500	[2] $1,500	[3]	[4]
Annual grant amounts for selected family types:				
Single person	1,500	1,500	1,000	1,250
Married couple	3,000	3,000	2,000	2,500
Couple with 2 children under age 14	3,000	3,600	2,400	4,000
Single person over age 65	1,500	1,500	1,500	1,250
Annual total grant outlays (billions)	194.3	215.4	158.4	200.7
Average effective income tax rate needed (rates for individuals would be lower after demogrants are credited):				
Comprehensive tax reform [5]	39.2	42.2	34.0	40.2
Partial tax reform [5]	42.8	46.1	37.1	43.8
Net redistributional cost (tax increases for "loser" families) (billions):				
"Comprehensive" tax reform	$42.4	$47.0	$33.5	$45.3
"Partial tax" reform	39.4	44.2	30.9	43.3
Percent changes in income after taxes and transfers, by income quintiles:				
Lowest 5th	+31	+33	+28	+27
2d 5th	+20	+22	+15	+19
3d 5th	+8	+10	+5	+10
4th 5th	−1	−1	−2	[6]
Highest 5th	−9	−10	−7	−10
Percent reductions in number of poor families:				
Total	76	80	71	80
By age of head:				
Under 65	66	72	57	75
65 and over	95	96	96	88
By family size:				
1	80	80	72	70
2	83	85	78	86
3 to 5	69	77	64	91
6 or more	58	77	61	85

[1] Each adult.
[2] $1,500 each adult; $300 each child under 18.
[3] Persons aged: 65 and over, $1,500; 55 to 64, $1,200; 18 to 54, $1,000; 14 to 17, $400; and under 14, $200.
[4] Family members: 1st 2, $1,250 each; 2d 2, $750 each; 3d 2, $500 each; and others, $250.
[5] For definitions of comprehensive and partial tax reforms see supplement A.
[6] Less than half of 1 percent.

The purpose of this paper is to examine the nature and magnitude of the income redistribution which would be effected by alternative demogrant plans and the income tax changes needed to finance them. While certain assumptions about the degree of income tax reform and welfare reform which could accompany these demogrant plans are made, an in-depth critique of political, administrative or other problems associated with such reform is beyond the scope of this study. Also, the paper does not deal with the pros and cons of a demogrant as compared with existing welfare programs or with other approaches to welfare reform such as a negative income tax or a wage subsidy plan, and no

attempt is made to examine the variety of ways in which a demogrant could be administered.

Basically, a demogrant is simply a per capita benefit paid to persons regardless of the amount or sources of their other income. The grant amount can be structured in a number of different ways. For example, if paid only to children, the demogrant would be a children's allowance. Alternatively, the benefit could be paid to all persons but with a different amount paid to persons of different ages. Still further modifications could be introduced so that the first two children in a family receive higher benefits than do additional children. These are just a few examples of the many ways in which a demogrant program can be structured. Regardless of what criteria are chosen, the essential feature of a demogrant program remains unchanged; benefits are paid solely on the basis of some demographic feature of persons and once established, payments are made to qualified individuals as a matter of right and without any demonstration of need or means test.

Although the demogrant may seem new and radical to some people, tax provisions which serve in lieu of a demogrant program have existed in the United States since 1913 when the present Federal individual income tax was adopted.[2] Under current law, there is a $750 per capita exemption and a $1,300 to $2,000 standard deduction permitted when computing one's Federal individual income tax liability. For an individual with $3,000 of income, the $2,050 exemption plus deduction reduces his tax liability by $287. Since after-tax income is increased by this amount, the personal exemption and standard deduction are equivalent to an annual $287 demogrant. These implicit "demogrants" in the Federal income tax work in a rather curious manner. For those with no income subject to tax, we now provide no "demogrant." The grant size then increases as income rises because of the progressive tax rate structure. For an individual in the 50 percent tax bracket, the implicit "demogrant" is $1,375 and for a very wealthy individual subject to the 70 percent marginal tax rate, the implicit "demogrant" rises to $1,925.[3]

A universal demogrant-tax credit can be thought of as a means to rationalize and correct the regressive implicit system of grants that now exists. This could be accomplished by replacing the personal income tax exemptions (and possibly deductions) with a payment that does not vary with the size of one's income. However, it would have an additional feature not now in the income tax law: since it would include payments or rebateable tax credits to everyone, those with incomes too low to be liable for federal income taxes would be "blanketed-in" to the existing implicit demogrant system.

A universal demogrant would probably involve taxes and transfers of very large magnitudes. For this reason, most demogrant proposals are accompanied by financing proposals which involve broadening the individual income tax base.[4] Such base-broadening along with a

[2] Actually, the implicit "demogrant" in the individual income tax has an even longer history since it was also a feature of the 1861 income tax imposed to finance the Civil War.

[3] These last two examples are admittedly unrealistic since they assume that such wealthy individuals are still using the maximum standard deduction of $2,000.

[4] For example, see Earl R. Rolph, "A Credit Income Tax," in T. R. Marmor, *Poverty Policy* (Chicago: Aldine-Atherton, 1971), pp. 207–217.

single rate on taxable income could simultaneously provide a minimum income guarantee for the poor, a progressive effective tax on income, and a simpler and more equitable income tax system.

Although it is not imperative that reform and simplification of the income tax and of welfare programs accompany institution of a demogrant-tax credit program, many people (including the author) would consider this approach to be highly desirable. Otherwise, the most logical alternative for raising the revenue needed to finance the grants would come from imposition of a surtax on tax liabilities under existing law. The size of surtax needed varies depending upon the demogrant plan adopted; under plans with fairly generous benefits, the surtax would produce extremely high marginal tax rates. Because tax reform and welfare reform seem to be desirable goals which should be combined with a demogrant system, in our analyses we have followed the practice of others in proposing that the benefits be financed in this way rather than by simply raising tax rates on the existing income tax base.

In the remainder of the paper, we examine the distributional effects of four different demogrant systems, accompanied by partial or comprehensive tax reform. Most of the results pertain to calendar 1970 but in a later section, we make some projections for calendar 1975.[5] For each of the plans, we present estimates of the gross "costs" of the program, the amounts of income redistributed by income level and family size, the resulting effective tax rates, the number of families with increases and decreases in after-tax or benefit income, and the effect of the grants on the poverty population.

The Demogrant and Tax Reform Structures

In an integrated tax and demogrant system, each family's net tax liability is equal to the algebraic sum of its gross tax liability less the amount of its demogrant. Thus, if the gross tax liability for a four-person family were $2,000 and its demogrant were equal to $3,500, it would have a negative net liability and receive a payment of $1,500 ($2,000 less $3,500). With the same grant amount, for a higher income family whose gross tax liability was $7,500, the net tax paid would be $4,000 ($7,500 less $3,500). Thus, the gross tax liability on other

[5] The analysis is for calendar 1970 because that is a recent year for which we have reliable data on population, income, and taxes. All calculations are based on the Brookings MERGE File of 30,000 family units for the year 1966 with incomes and population projected to the 1970 level. The MERGE data file was created by combining financial and demographic data from the 1967 Survey of Economic Opportunity (SEO) with income and tax information from the 1966 Internal Revenue Tax File. For a more detailed description of the file and how it was constructed, see Benjamin A. Okner, "Constructing a New Data Base From Existing Microdata Sets: The 1966 MERGE File," *Annals of Economic and Social Measurement*, Vol. 1, No. 3, July 1972 (Brookings Reprint No. 251). The computer work was performed at the Brookings Social Science Computer Center with the major share of the programing done by Ralph W. Tryon and Andrew D. Pike. Marjorie P. Odle and Stephen W. Kidd were also responsible for part of the computer programing. I gratefully acknowledge the efforts of all these persons.

income will continue to increase as income rises; the demogrant is nontaxable and remains constant regardless of income.[6]

BENEFIT LEVELS

In our analysis, we use four different demogrant schedules. Under schedule A, benefits of $1,500 are paid only to adults (persons age 18 or over) and no allowances are paid to children. Schedule B provides allowances of $1,500 for each adult and $300 for each person under 18 in the family. Schedule C provides differential benefits based on the person's age: each person age 65 or over receives $1,500; each person age 55 to 64 receives $1,200; all other adults (age 18 to 54) receive $1,000; children under age 14 receive $200; and children age 14 to 17 each receive $400. And finally, schedule D provides $1,250 benefits for the first two family members and variable benefits for additional members (regardless of age); the next two persons receive $750 each; the fifth and sixth, $500 each; and all persons after the sixth each receive $250.

The total benefits for selected families of different size and type are shown in table 2. Aged individuals and couples fare equally well under schedules A, B, and C but receive somewhat reduced amounts under schedule D. The amounts paid to nonaged families vary considerably under the different schedules. Thus, for a four-person family (married couple with two young children) headed by a person under age 55, total benefits range from $2,400 under schedule C to $4,000 under schedule D. Of course, total payments do not vary with the number of children under schedule A; for the large six-person family, this results in a $2,000 difference between the $3,000 benefit under schedule A and the $5,000 payment under schedule D.

When measured against their poverty-income thresholds, most types of families fare extremely well under the various demogrant schedules. Aged couples with no children receive payments in excess of their poverty-income level under all schedules. Aged single persons receive about 80 percent of their poverty-income level under all schedules except D.

[6] In this paper, all the calculations assume a nontaxable demogrant. While it is possible to tax the demogrant along with other income, we do not do so since this usually involves an unnecessary complication. Under a flat tax rate, it is always possible to achieve identical distributional results under a taxable or nontaxable demogrant simply by changing the rate (this is not necessarily true under a progressive rate schedule). However, there is one advantage to making the demogrant taxable if one wishes to concentrate the net benefits more heavily among low income families. This would involve a recoupment surtax levied on the grant above some chosen income level. Such a proposal is discussed by Harvey E. Brazer in his article, "Tax Policy and Children's Allowances," in Eveline M. Burns (ed.), *Children's Allowances and the Economic Welfare of Children, a Conference Report* (New York: Citizens Committee for Children of New York, Inc., 1968), p. 140. While Brazer's discussion had to do with concentrating the benefits of children's allowances among the poor, exactly the same scheme could be employed with respect to demogrants.

TABLE 2.—*Illustrative benefit levels for selected types of families under various demogrant schedules*

Family type	Amount of benefit: Schedule—				Benefit as percentage of poverty level.[1]—Schedule—			
	A	B	C	D	A	B	C	D
Nonaged family head:[2]								
Single person	$1,500	$1,500	$1,000	$1,250	74.6	74.6	49.8	62.2
Married couple:								
No children	3,000	3,000	2,000	2,500	114.6	114.6	76.4	95.5
1 child under 14	3,000	3,300	2,200	3,250	96.4	106.0	70.7	104.4
2 children under 14	3,000	3,600	2,400	4,000	75.6	90.7	60.5	100.8
3 children: 2 under 14 and 1 age 15 to 18	3,000	3,900	2,800	4,500	64.1	83.3	59.8	96.1
4 children: 2 under 14 and 2 age 15 to 18	3,000	4,200	3,200	5,000	57.0	79.8	60.8	95.0
Aged family head:[2]								
Single person	1,500	1,500	1,500	1,250	80.6	80.6	80.6	67.2
Married couple, no children	3,000	3,000	3,000	2,500	127.7	127.7	127.7	106.4

[1] Computation based on 1970 poverty-income levels for nonfarm families with male head. See U.S. Bureau of the Census, *Current Population Reports, Consumer Income* (series P-60, No. 77, May 7, 1971), p. 20.

[2] For nonaged families, adults are assumed to be age 18 to 54; for aged families, adults are assumed to be 65 years and over.

For the archetypal nonaged four-person family, payments are equal to 90 percent or more of the poverty-income threshold under schedules B and D. But only under schedule D do benefits stay close to the poverty line as family size increases (payments to nonaged single persons are only equal to about 60 percent of their poverty-income level, however). On the other hand, under schedule A the payments decline relative to the poverty-level income as family size increases because there are no benefits paid to children.

It should be noted that the benefits under programs A, B, and C possess several administrative advantages over the schedule D benefit schedule. Under the former schedules, where the amount of payment depends solely on the person's age, there are no incentives for either forming or dissolving existing family units in order to receive larger payments. While it is impossible to assess its importance, there is the possibility of such changes taking place under a schedule, such as D, where benefits are related to the family size. For example, it is possible that a six-person family consisting of husband, wife, and four children might decide to call itself two three-person units, each containing one of the spouses and two children. As a single unit, it would receive total payments of $5,000 under schedule D. As two units, each "family" would receive $2,750 and together the six persons would get $5,500—$500 more than if they filed as a single unit. This possibility is probably more important theoretically than it would be in practice, but the investigation and enforcement procedures that would undoubtedly accompany such a program would be extremely costly and could be avoided under the age-related benefit schedules.

In addition to avoiding possible family-splitting problems, a constant per capita grant eliminates any advantages that could exist with respect to splitting of income among family members or manipulations to affect the timing of income. A proportional rate would also aid in the administration of a demogrant since tax withholding on all income at its source could be easily implemented. This is essentially the approach outlined for the tax credit proposed for Great Britain in the recent green paper.

HOW MUCH DO THE DEMOGRANT PROGRAMS COST?

In 1970, gross outlays under schedule A would have been about $194 billion; under schedule B they would have been about $215 billion; under C, about $158 billion; and outlays under schedule D would have been about $201 billion. However, it is incorrect to call these sums the cost of the programs; rather they are simply the total amount of the various grants or credits.

Since the programs involve only transfers from one group to another, at least in the first stage, they involve no use or reallocation of economic resources.[7] However, the cost that is of relevance with regard to these programs is the amount by which after-tax income is reduced for "loser families" who will pay higher taxes to finance the grants and which will increase the after-benefit incomes of the "gainer families."

[7] There may be real economic costs in subsequent stages if the programs cause people to change their work and leisure patterns or have other real effects on the quantity or quality of economic resources. Since there is no way to estimate such effects, they are not considered in this analysis.

In other words, the cost of a program is the amount of increased taxes that will have to be paid by some families or the tax cuts they will have to forgo in order to finance the grants or credits.[8]

FINANCING THE GRANTS AND TAX REFORM

It is certainly no secret that a large number of people of diverse political persuasions and in very different economic circumstances feel that the time for tax reform is long overdue. The Federal individual income tax is not the only levy toward which the so-called tax revolt is directed, but it certainly is a major item on the reform agenda.

For the integrated tax reform and demogrant analysis presented here, we have chosen two different levels or kinds of tax reform.[9] The first is a "comprehensive reform" of the individual income tax structure which would eliminate virtually all tax preferences, nonessential deductions, and personal exemptions. This would result in increasing the taxable income base by over 70 percent. Under the comprehensive reform, the tax base would be increased primarily by fully taxing realized capital gains and gains on assets transferred by gift or bequest; by eliminating homeowners' preferences; by taxing net imputed rent on owner-occupied dwellings and eliminating all itemized deductions for property taxes and mortgage interest; by taxing transfer payment receipts; by disallowing itemized personal deductions for medical expenses that are less than 5 percent of income and charitable contributions that do not exceed 3 percent of income; and by removing the percentage standard deduction allowed under current law. This is the tax base suggested by Pechman and Okner in their study for the Joint Economic Committee.[10] Actually, in conjunction with the demogrant program, the Pechman-Okner taxable income base would be increased even more than is suggested in their study since they retained the personal exemptions for taxpayers, spouses, and dependents which would be unnecessary under a demogrant-tax credit system.

The second tax reform plan is less comprehensive but probably more realistic politically; this is called "partial reform." Under partial reform, the tax base would include realized capital gains in full, capital gains transferred at death or by gift (beginning with enactment of the legislation) as well as all the income items now taxable. Itemized personal deductions would be retained for State-local income and property taxes, interest up to the amount of property income reported on the tax return, medical expenses and charitable contributions to the extent that they exceed 3 percent of income, and miscellaneous deductions (child care, alimony, et cetera). Tax credits would replace

[8] We assume that the demogrant plans are to be self-financing through the individual income tax and that Federal expenditures on other programs (with the exception of spending reductions noted below) remain unchanged. Of course, it is possible to finance the grants through increases in other taxes and reductions in other expenditures. However, because the inclusion of such alternatives would greatly complicate the analysis, the self-financing assumption is retained in this paper.

[9] A detailed description of the tax changes and resulting taxable income levels under the reforms is given in the supplement to this paper.

[10] See "Individual Income Tax Erosion by Income Classes," in *The Economics of Federal Subsidy Programs*, a compendium of papers prepared for the use of the Joint Economic Committee, 92d Cong., 2d sess. (1972) (Brookings Reprint No. 230).

the present per capita exemptions and the standard deduction would be reduced to 8 percent of income, up to a maximum of $800 for taxpayers who do not itemize their deductions. The rate advantages of income splitting are eliminated under both reform programs.

While the second package contains much less reform than the comprehensive program, it features a substantial reduction in the standard deduction, complete elimination of the deduction for gasoline taxes and substantial elimination of the deduction for small amounts of charitable contributions.

REDISTRIBUTIONAL COST OF A TAX CREDIT-DEMOGRANT SYSTEM

The calculation of the distributional cost of a tax credit-demogrant program starts with the fact that there must be sufficient revenue to cover the total grant outlays under the program. To this must be added the 1970 yield of the individual income tax (on the assumption that other Government services are maintained). From this can be subtracted the 1970 Federal outlays on cash public assistance, food stamp and other nutrition programs, and the housing assistance programs. The resulting amount is the gross revenue needed to finance the demogrant plus other Government programs remaining after institution of the grants. As shown below, under schedule A, gross tax collections required would be about $271 billion while under credit schedules B, C, and D the totals required would be about $292 billion, $235 billion, and $277 billion, respectively.[11] This compares with $83.8 billion actually collected in 1970.

[In billions of dollars]

	Schedules			
	A	B	C	D
Tax credit outlays	194. 3	215. 4	158. 4	200. 7
1970 income tax yield	83. 8	83. 8	83. 8	83. 8
Less expenditures on:				
Cash public assistance	−4. 7	−4. 7	−4. 7	−4. 7
Food stamps and other nutrition	−2. 2	−2. 2	−2. 2	−2. 2
Housing assistance	−. 6	−. 6	−. 6	−. 6
Gross tax collections required	270. 6	291. 7	234. 7	277. 0

Before proceeding with the cost calculation, it is worth considering how social security, unemployment insurance, and other transfer payments would be treated under a demogrant program. The proper treatment of such receipts presents difficult problems, to which there are no simple answers. In our analysis, we do not want people to end

[11] The calculation implies that the new demogrant-tax credit program would totally supplant the existing Federal categorical public assistance programs, the food stamp program, and housing assistance programs. No saving from the State-local government expenditures on existing public assistance programs is taken into account since in many jurisdictions the demogrants would be less than existing welfare payments and the States would need a substantial portion of the revenue newly available to them to supplement benefits paid under a Federal demogrant program. If State-local public assistance savings are also counted as cost offsets, the gross tax collections needed under each of the schedules would be reduced by about $4 billion.

up worse off financially than they were before the program's inception. Thus, we assume people are given the option of either (1) taking their existing transfers tax free as they now do; or (2) participating in the program, but counting the existing transfers as income subject to tax. The simulation model makes the choice for each household so that disposable income is maximized.[12]

Returning to the redistributional cost calculation, once the amount of gross tax collections required is determined, it is not difficult to compute the average rate on taxable income required under a given tax program. For example, since under schedule A and the comprehensive tax base gross revenue of $271 billion would have to be raised on a tax base of $690 billion, this plan would require an average rate on taxable income of 39.2 percent. The various combinations of schedules, tax bases, and average rates required are shown in table 3. For comparison purposes, it should be noted that the actual effective rate on taxable income in 1970 (including the 2.5 percent surcharge) was 20.9 percent.

[12] An alternative treatment might be to eliminate the welfare-type transfer programs (such as veterans' pensions) and restructure the social insurance programs (such as social security) so that they become strictly contributions-related programs with no welfare elements. This approach should lower the budgetary cost of these programs relative to the assumptions used in this study.

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TABLE 3.—*Effective tax rates and redistributional cost of various demogrants under a proportional tax schedule, 1970*

[Dollar amounts in billions]

Item	Schedule A		Schedule B		Schedule C		Schedule D	
	Comprehensive reform tax base	Partial reform tax base	Comprehensive reform tax base	Partial reform tax base	Comprehensive reform tax base	Partial reform tax base	Comprehensive reform tax base	Partial reform tax base
Gross tax collections	$270.6	$270.6	$291.7	$291.7	$234.7	$234.7	$277.0	$277.0
Taxable income	$689.6	$632.6	$689.6	$632.6	$689.6	$632.6	$689.6	$632.6
Average effective rate on taxable income (percent) [2]	39.2	42.8	42.2	46.1	34.0	37.1	40.2	43.8
Net redistributional cost (tax increases) [1]	$42.4	$39.4	$47.0	$44.2	$33.5	$30.9	$45.3	$43.3

[1] Computed using proportional effective tax rate shown above.
[2] These are the tax rates applied to taxable income which would be required to finance general Government expenditures and the demogrants. Income tax rates for individuals would be lower when the nontaxable demogrants are credited against tax liabilities.

An alternative method for determining the redistributional effect of a demogrant-tax credit program would involve first setting the desired tax rate to be used and then calculating the level of benefits that could be paid under the program. For example, one might set 35 or 40 percent as the desired tax rate. This would then generate a given amount of revenue that could be distributed through a grant program and the benefits would then be scaled to exhaust the sum available. Under the self-financing assumption adopted for this analysis, it is obvious that once a decision is made concerning the benefit levels, the required tax rate is also determined, and vice versa. Since there is no analytically "correct" way to proceed, we started with a given structure and level of benefits that were of interest and let the needed tax rates vary. Obviously, for many purposes it might be more interesting to examine the distributional effects of different benefit structures all of which are financed by the same rate on taxable income.

In the last line of table 3, we show the total redistributional costs of the four demogrant plans as measured by the total increase in taxes for those families who will pay more under the new program (these are all calculated using a proportional tax rate on taxable income). Schedule B benefits of $1,500 for adults and $300 for children are clearly the "most expensive." Benefits under schedule A ($1,500 per person only for adults) and schedule D payments ($1,250 for adults and variable amounts for children) cost roughly the same. The least costly program is that using schedule C benefits (variable amounts depending on the person's age). As can be seen, even a "cheap program" involves redistributional costs in excess of $30 billion, while an expensive one would have cost $44 to $47 billion in 1970.

While the concept of cost associated with a purely redistributive program is elusive, even when it is defined as we have done so here, the amount of the redistribution is influenced greatly by what tax base is used in conjunction with financing the program. As can be seen in table 3, the cost varies depending upon whether a comprehensive or partial tax reform base is used. The costs would be still different from those shown if the programs were financed by progressive rate schedules rather than proportional rates.

Effect of the Demogrants on the Distribution of Income

It is useful to compare the after-tax and grant distributions of income under each of the proposed plans with that resulting under the existing tax and transfer system. The distributions of 1970 income, taxes, transfers, and income after current taxes and transfers distributed by income classes are shown in table 4. Not surprisingly, we find that transfer payments are concentrated among families at the low end of the income scale, while individual income taxes primarily affect those at the high end of the scale.

Our figures indicate that 36.5 percent of families had pretransfer incomes under $5,000 and received 6.4 percent of total income before taxes and transfers. These families received 65.1 percent of all transfer payments, paid 2.6 percent of Federal income taxes, and wound up with 11.8 percent of total income after taxes and transfers.

TABLE 4.—*Distribution of income, current taxes, transfers, and income after current taxes and transfers by income classes, 1970*

[Income classes and families in thousands; money amounts in millions]

Income class [1]	Number of families	Aggregate income before taxes and transfers [1]	Aggregate transfer payments	1970 income tax	Income after taxes and transfers
Under $3	18,017	$16,343	$30,051	$450	$45,945
$3 to $5	6,485	25,918	5,336	1,773	29,481
$5 to $10	16,743	123,844	8,914	11,954	120,805
$10 to $15	11,091	136,612	4,395	15,095	125,912
$15 to $20	6,369	109,833	2,786	12,905	99,714
$20 to $25	3,449	76,602	1,258	9,662	68,198
$25 to $50	3,680	119,883	1,239	17,202	103,920
$50 to $100	547	35,118	99	7,269	27,948
$100 to $500	126	20,366	----------	5,429	14,937
$500 to $1,000	4	2,541	----------	738	1,804
$1,000 and over	2	3,714	----------	1,118	2,596
All classes [2]	67,133	664,419	54,363	83,833	634,949
PERCENTAGE DISTRIBUTION					
Under $3	26.8	2.5	55.3	0.5	7.2
$3 to $5	9.7	3.9	9.8	2.1	4.6
$5 to $10	24.9	18.6	16.4	14.3	19.0
$10 to $15	16.5	20.6	8.1	18.0	19.8
$15 to $20	9.5	16.5	5.1	15.4	15.7
$20 to $25	5.1	11.5	2.3	11.5	10.7
$25 to $50	5.5	18.0	2.3	20.5	16.4
$50 to $100	.8	5.3	.2	8.7	4.4
$100 to $500	.2	3.1	----------	6.5	2.4
$500 to $1,000	(3)	.4	----------	.9	.3
$1,000 and over	(3)	.6	----------	1.3	.4
All classes [2]	100.0	100.0	100.0	100.0	100.0

[1] Money receipts exclusive of transfers and taxes; receipts include total amount of realized capital gains and total gain on assets transfered by gift or bequest.
[2] Includes negative income class not shown separately.
[3] Less than half of 0.1 percent.

At the other end of the income scale, 6.5 percent of families had pretransfer income of $25,000 and above and received 27.4 percent of aggregate income before taxes and transfers. This group received 2.5 percent of all transfer payments, paid 37.9 percent of total income taxes, and retained 23.9 percent of the total after-tax and transfer income.

The existing tax and transfer system does redistribute income from the rich to the poor. However, the degree of redistribution is far less than most people probably believe.

A comparison of the 1970 distribution of income after taxes and transfers with those under the various demogrant schedules and the comprehensive tax reform base, distributed by income classes, is shown in table 5. The same information distributed by families grouped by before-tax and transfer income quintiles is shown in

table 6. As can be seen in the latter table, schedule B effects the largest degree of income redistribution in favor of families in the lowest quintile of before-tax income; their share of income after taxes and transfers increases from 5.3 percent under the present system to 7.0 percent under the tax credits provided by schedule B. The smallest amount of redistribution in favor of those at the bottom of the income scale is provided by schedule D benefits.

TABLE 5.—*Distribution of before-tax and after-tax income under various demogrant schedules, by income classes, 1970*

[Income classes and families in thousands; dollar amounts in millions]

Income class [1]	Number of families	Aggregate before-tax income	Income after tax and transfers	Income after taxes under demogrant schedules			
				A	B	C	D
Under $3	18,017	$16,343	$45,945	$59,836	$60,676	$58,425	$57,974
$3 to $5	6,485	25,918	29,481	35,601	36,232	33,921	35,579
$5 to $10	16,743	123,844	120,805	130,122	131,923	126,947	132,276
$10 to $15	11,091	136,612	125,912	123,660	124,248	123,376	125,193
$15 to $20	6,369	109,833	99,714	92,655	92,140	93,586	92,731
$20 to $25	3,449	76,602	68,198	61,786	61,168	62,923	61,465
$25 to $50	3,680	119,883	103,920	91,890	90,181	94,402	90,642
$50 to $100	547	35,118	27,948	25,208	24,596	26,437	25,098
$100 to $500	126	20,366	14,937	14,094	13,650	14,924	13,999
$500 to $1,000	4	2,541	1,804	1,690	1,625	1,803	1,671
$1,000 and over	2	3,714	2,596	2,403	2,301	2,578	2,373
All classes [2]	67,133	664,419	634,949	633,541	633,483	633,755	633,632
PERCENTAGE DISTRIBUTION							
Under $3	26.8	2.5	7.2	9.4	9.6	9.2	9.1
$3 to $5	9.7	3.9	4.6	5.6	5.7	5.4	5.6
$5 to $10	24.9	18.6	19.0	20.5	20.8	20.0	20.9
$10 to $15	16.5	20.6	19.8	19.5	19.6	19.5	19.8
$15 to $20	9.5	16.5	15.7	14.6	14.5	14.8	14.6
$20 to $25	5.1	11.5	10.7	9.8	9.7	9.9	9.7
$25 to $50	5.5	18.0	16.4	14.5	14.2	14.9	14.3
$50 to $100	.8	5.3	4.4	4.0	3.9	4.2	4.0
$100 to $500	.2	3.1	2.4	2.2	2.2	2.4	2.2
$500 to $1,000	(3)	.4	.3	.3	.3	.3	.3
$1,000 and over	(3)	.6	.4	.4	.4	.4	.4
All classes [2]	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[1] Money receipts exclusive of transfers and taxes; receipts include total amount of realized capital gains and total gain on assets transferred by gift or bequest.

[2] Includes negative income class not shown separately.

[3] Less than half of 0.1 percent.

Note: Figures are rounded and will not necessarily add to totals.

TABLE 6.—*Percentage distribution of before-tax income and income after taxes and transfers, under present law and under various demogrants, by population quintiles, 1970*

Before-tax and transfer population quintile	Before-tax income	Income after taxes and transfers	Income after taxes and transfers under demogrant schedules [1]			
			A	B	C	D
Lowest fifth	1. 80	5. 29	6. 91	7. 01	6. 75	6. 70
Second fifth	6. 82	8. 84	10. 58	10. 76	10. 19	10. 54
Third fifth	14. 67	14. 97	16. 18	16. 41	15. 77	16. 45
Fourth fifth	24. 09	23. 27	22. 98	23. 08	22. 90	23. 24
Highest	52. 62	47. 63	43. 35	42. 74	44. 39	43. 07
Top 5 percent	22. 06	19. 03	17. 13	16. 76	17. 77	16. 95
Top 1 percent	9. 07	7. 27	6. 69	6. 51	7. 05	6. 65
Total	100. 00	100. 00	100. 00	100. 00	100. 00	100. 00

[1] Taxes computed using a proportional tax rate on the comprehensive tax base.

Under each of the schedules, we find that after-tax and grant income increases most for families in the lowest three quintiles; in terms of absolute income, this corresponds roughly to those with less than $10,000. The share received by those in the fourth quintile is reduced only slightly from the 1970 level, while after-tax and transfer income of families in the highest quintile (before-tax incomes of about $15,000 and over) falls substantially. However, the changes in the share of total income received by those at the very top of the income distribution is not very much changed under any of the demogrant schedules examined. Under the most redistributive structure, schedule B, the share of income received by the top 1 percent of families drops from 7.3 to 6.5 percent—0.8 percentage points. This is the greatest proportionate reduction effected under any of the demogrant programs.

EFFECTIVE TAX (BENEFIT) RATES

Another way to view the effect of the demogrants is to examine the effective rates of tax or transfer (that is, tax or transfer divided by total income) at different income levels. As compared with the 1970 tax and transfer system, all the demogrant schedules result in larger average amounts of transfer income for families with incomes below $5,000, and, on the average, changes families from net taxpayers to grant recipients in the $5,000 to $10,000 income class (table 7). For those with higher incomes, the various demogrant schedules have different effects on the average tax and effective tax rates paid. Average taxes for families with incomes of $10,000 to $15,000 are increased least under schedule D while those in this income class experience the largest tax increases under the schedule C tax and grant program. For all families with incomes of $15,000 or above the largest tax increases occur under the schedule B structure while the smallest tax hikes take place under the schedule C program.

TABLE 7.—*Effective tax or benefit rates and average tax or benefit payments under various demogrant schedules, by income classes, 1970*

Income class [1] (in thousands)	1970 tax (+) or transfer (−)		Taxes (+) or benefit payments (−)							
			Schedule A		Schedule B		Schedule C		Schedule D	
	Effective rate	Average amount	Effective rate	Average amount	Effective rate	Average amount	Effective rate	Average amount	Effective rate	Average amount
Under $3	[3] −181.1	[4] −$1,643	[3] −266.1	[4] −$2,414	[3] −271.3	[4] −$2,461	[3] −257.5	[4] −$2,336	[3] −254.7	[4] −$2,311
$3 to $5	−13.8	−549	−37.4	−1,493	−39.8	−1,590	−30.9	−1,234	−37.3	−1,490
$5 to $10	2.4	182	−5.1	−375	−6.5	−482	−2.5	−185	−6.8	−504
$10 to $15	7.8	965	9.5	1,168	9.1	1,115	9.7	1,193	8.4	1,030
$15 to $20	9.2	1,589	15.6	2,697	16.1	2,778	14.8	2,551	15.6	2,685
$20 to $25	11.0	2,437	19.3	4,296	20.1	4,475	17.9	3,996	19.8	4,389
$25 to $50	13.3	4,337	23.4	7,606	24.8	8,070	21.3	6,923	24.4	7,945
$50 to $100	20.4	13,114	28.2	18,124	30.0	19,243	24.7	15,877	28.5	18,326
$100 to $500	26.7	42,949	30.8	49,619	33.0	53,130	26.7	43,048	31.3	50,370
$500 to $1,000	29.0	195,709	33.5	225,915	36.1	243,214	29.0	195,837	34.3	230,956
$1,000 and over	30.1	671,366	35.3	787,371	38.0	848,362	30.6	682,402	36.1	805,526
All classes [2]	4.4	439	4.7	460	4.7	460	4.7	460	4.7	460

[1] Money receipts exclusive of transfers and taxes; receipts include total amount of realized capital gains and total gain on assets transferred by gift or bequest.

[2] Includes negative income class not shown separately.

[3] This minus amount indicates that incomes in this class were raised by the percentage amount shown through transfer payments net of taxes. That is, under the column "1970 tax (+) or transfer (−)," the −181.1 shown indicates that transfer payments raised the income of this class by 181.1 percent.

[4] This minus amount is the average amount by which incomes in this class were raised by income transfer payments.

THE DISTRIBUTION OF BENEFITS BY FAMILY SIZE AND INCOME

Because of the way the various demogrant schedules are structured, the differences in taxes paid or benefits received by families of different sizes is of even greater interest than those found in comparisons displayed only by income class. Such data are summarized in table 8 in which we show the number of families who will experience tax increases and amount of increase and in table 9 in which we present similar information for families whose after-tax and benefit income rises under the various demogrant schedules. In these tables, families are classified by broad income classes within the small, medium, and large size categories in order to summarize the large amount of data involved.

The number of families that experience tax increases ranges from 26.1 million under schedule A to 28.2 million under schedule D. These loser families represent 38.9 and 42.0 percent of all families in the population, respectively. Thus, regardless of the benefit schedule used, approximately 40 percent of all families will experience tax increases to finance the benefits paid to the gainer families.

TABLE 8.—*Summary of tax increases for loser families [1] under various demogrant schedules, by family size and income classes, 1970*

[Income classes and number of families in thousands; dollar amounts in millions]

Family size and income class [2]	Schedule A		Schedule B		Schedule C		Schedule D	
	Number of families	Tax increase	Number of families	Tax increase	Number of families	Tax increase	Number of families	Tax increase
Small families [3]	10, 881	$12, 374	13, 103	$17, 087	11, 422	$9, 859	15, 361	$18, 720
Under $5	2, 725	1, 847	3, 363	2, 472	2, 325	1, 361	4, 277	3, 156
$5 to $10	2, 770	1, 694	3, 597	2, 524	3, 230	1, 518	4, 378	3, 092
$10 to $15	2, 174	1, 931	2, 833	2, 895	2, 719	1, 789	3, 367	3, 367
$15 to $20	1, 598	2, 036	1, 665	2, 867	1, 597	1, 751	1, 694	3, 036
$20 to $25	792	1, 395	792	1, 893	768	1, 111	803	1, 900
$25 and over	822	3, 471	853	4, 436	783	2, 329	842	4, 169
Medium-sized families [3]	11, 851	21, 976	11, 358	23, 740	12, 760	18, 320	10, 824	21, 570
Under $5	372	745	344	727	407	666	428	673
$5 to $10	831	867	604	739	978	777	541	669
$10 to $15	3, 332	2, 471	2, 790	2, 066	3, 677	2, 166	1, 999	1, 643
$15 to $20	2, 962	4, 498	3, 143	4, 611	3, 260	3, 880	3, 258	3, 850
$20 to $25	1, 799	3, 742	1, 870	4, 182	1, 897	3, 249	1, 984	4, 024
$25 and over	2, 555	9, 653	2, 607	11, 415	2, 541	7, 582	2, 614	10, 711
Large families [3]	3, 383	8, 008	2, 418	6, 191	2, 874	5, 276	2, 023	4, 963
Under $5	103	242	58	159	74	162	42	100
$5 to $10	313	299	72	159	137	171	63	129
$10 to $15	995	987	423	290	694	456	129	119
$15 to $20	710	1, 396	639	904	706	935	507	567
$20 to $25	548	1, 514	519	1, 141	554	1, 026	562	865
$25 and over	714	3, 570	707	3, 538	709	2, 526	719	3, 183
All groups	26, 116	42, 360	26, 880	47, 016	27, 057	33, 455	28, 205	45, 253

[1] All taxes and benefits calculated using a proportional rate on the comprehensive tax base.

[2] Money receipts exclusive of transfers and taxes; receipts include total amount of realized capital gains and total gain on assets transferred by gift or bequest.

[3] 1- and 2-person families are classified as small; 3-, 4-, and 5-person families as medium size; and 6-person or larger families as large.

Note.—Details may not add to totals because of rounding.

TABLE 9.—*Summary of grant payments and tax relief for gainer families,*[1] *by family size and income classes, 1970*

[Income classes and number of families in thousands; dollar amounts in millions]

Family size and income class[2]	Schedule A		Schedule B		Schedule C		Schedule D	
	Number of families	Income increase	Number of families	Income increase	Number of families	Income increase	Number of families	Income increase
Small families[3]	23, 336	$24, 632	21, 113	$22, 212	22, 794	$20, 666	18, 857	$16, 904
Under $5	16, 538	19, 595	15, 900	18, 649	16, 938	17, 273	14, 987	14, 631
$5 to $10	5, 051	4, 025	4, 225	3, 082	4, 591	2, 440	3, 444	1, 911
$10 to $15	1, 523	605	863	235	978	260	330	75
$15 to $20	127	62	60	35	128	30	31	19
$20 to $25	21	14	20	9	44	20	9	4
$25 and over	76	331	45	202	115	643	56	264
Medium-sized families[3]	14, 676	19, 697	15, 168	22, 791	13, 765	14, 654	15, 702	24, 877
Under $5	4, 372	9, 062	4, 399	10, 664	4, 336	7, 336	4, 315	11, 193
$5 to $10	6, 540	7, 459	6, 766	9, 164	6, 392	5, 228	6, 829	10, 410
$10 to $15	2, 627	2, 071	3, 169	2, 205	2, 282	1, 172	3, 960	2, 755
$15 to $20	782	612	601	464	483	272	486	241
$20 to $25	228	174	157	99	130	78	43	34
$25 and over	127	319	76	195	142	568	69	244
Large families[3]	3, 008	5, 063	3, 971	8, 990	3, 518	5, 382	4, 368	10, 594
Under $5	1, 013	2, 404	1, 058	3, 889	1, 042	2, 555	1, 074	4, 484
$5 to $10	1, 238	1, 515	1, 479	3, 118	1, 414	1, 763	1, 488	3, 863
$10 to $15	439	679	1, 011	1, 364	741	660	1, 305	1, 796
$15 to $20	191	246	261	356	195	183	393	259
$20 to $25	62	73	90	100	56	33	48	39
$25 and over	65	146	72	163	70	188	60	153
All groups	41, 017	49, 395	40, 253	53, 992	40, 076	40, 704	38, 928	52, 377

[1] All taxes and benefits calculated using a proportional rate on the comprehensive tax base.

[2] Money receipts exclusive of transfers and taxes; receipts include total amount of realized capital gains and total gain on assets transferred by gift or bequest.

[3] 1- and 2-person families are classified as small; 3-, 4-, and 5-person families as medium size; and 6-person or larger families as large.

Note.—Details may not add to totals because of rounding.

Despite the considerable difference in total costs among the various programs—for example, $34 billion under schedule C versus $47 billion under schedule B—there is not a great deal of variation in the distribution of the tax increases among families of different sizes under the various schedules. Under each program, roughly 50 percent of the total tax increase would be paid by medium-size families containing 3 to 5 persons. The largest difference in the distribution of total cost by family size occurs under schedules A and D, that is, between the $1,500 adult-only grant and the schedule providing near poverty level benefits to families with declining amounts for the third and subsequent children. Only about 29 percent of the small families would pay increased taxes under schedule A while 51 percent of such families would have tax hikes under schedule D. The situation for large families under the two schedules is just the reverse: 19 percent of the 5-person or larger families would pay increased taxes under schedule A while only 11 percent of such families would pay higher taxes under schedule D. This difference is particularly interesting since the total cost of these two plans is fairly close.

As shown in table 9, after-tax and grant income for about 40 million families would increase under all the demogrant tax credit schedules. About 60 percent of the total population would therefore be gainers under the program. Since tax increases and tax relief roughly balance one another,[13] the patterns and amounts of relief are pretty much the complement of the amounts and patterns of tax increases shown in table 8. Small families receive about 50 percent of the total grant and tax relief amount under benefit schedules A and C; under schedule B they receive 41 percent and under schedule D, small families get only 32 percent of the total benefit. In terms of the number of families receiving relief, small families fare best under schedules A and C where about two-thirds receive increases in their after-credit income. Large families fare best under schedule D benefit levels where about 68 percent of the units receive grants or tax relief.

It is also interesting to note the proportions of the gainers that are currently taxable and will pay lower taxes under a demogrant (those with tax relief)[14] and those who are not now subject to tax but will experience an increase in transfer income under the new program. As we have already seen, the total number of gainer families varies only slightly—between 39 and 41 million—under the different grant schedules. We find the same kind of consistency when we examine the number of gainers who receive tax relief under the various schedules. Regardless of the benefit structure, about 24 million families or 60 percent of all gainer families receive tax relief and the remaining 40 percent are currently nontaxable families whose after-credit income rises under the demogrant program.

[13] There are about $7 billion more in grants and tax relief than in tax increases because of the assumed reduction of Federal expenditures for public assistance, food stamps, and housing assistance. Thus, gains shown in the preceding tables are overstated for households benefiting from present welfare programs.

[14] It is possible to further subdivide this group into those who remain net taxpayers under the demogrant and those whose tax credit is sufficiently large to eliminate completely their tax liability and convert them from taxpayers into net grant recipients. We do not present separate data for these two subsets of gainers and classify a family as receiving tax relief if it is taxable under 1970 law and has its net tax liability reduced (even to a negative amount) under the demogrant-tax credit program.

While the total number of gainers with tax relief is fairly constant under the different grant levels, the number and distribution of these families does differ by family size. For example, more than 11 million small families receive tax relief under schedule A while only about 8 million of such families receive relief under schedule D benefit levels (table 10). On the other hand, there are more medium size and large families who receive tax relief under schedule D than under any of the other schedules examined. This is especially interesting since there are fewer total gainer families under this schedule than under any of the others.

TABLE 10.—*Number of gainer families with tax relief and currently nontaxable families under various demogrant schedules, by family size, 1970*

[Number of families in thousands]

Family size [1]	Schedule A		Schedule B		Schedule C		Schedule D	
	Number of families	Average income increase	Number of families	Average income increase	Number of families	Average income increase	Number of families	Average income increase
Gainers with tax relief:								
Small families	11, 368	$844	9, 526	$809	10, 451	$612	7, 941	$684
Medium-size families	11, 737	1, 120	12, 192	1, 229	10, 839	846	12, 755	1, 296
Large families	1, 781	1, 336	2, 643	1, 663	2, 235	1, 094	3, 022	1, 752
Subtotal	24, 887	1, 010	24, 358	1, 112	23, 525	765	23, 719	1, 149
Nontaxable gainer families:								
Small families	11, 967	1, 256	11, 589	1, 252	12, 342	1, 157	10, 914	1, 051
Medium-size families	2, 938	2, 229	2, 976	2, 624	2, 925	1, 876	2, 947	2, 832
Large families	1, 225	2, 193	1, 331	3, 453	1, 282	2, 292	1, 346	3, 938
Subtotal	16, 130	1, 504	15, 895	1, 693	16, 551	1, 371	15, 209	1, 652
All gainer families	41, 017	1, 204	40, 253	1, 341	40, 076	1, 016	38, 928	1, 345

[1] 1- and 2-person families are classified as small; 3-, 4-, and 5-person families as medium size; and 6-person or larger families as large.

In table 10 we also show the average amount by which income increases for the gainer families under the various demogrants.[15] These averages differ because the different payment levels under the various programs result in different amounts of total outlay. While the overall averages under schedules B and D are quite close, the two benefit structures affect the number of gainers with tax relief and nontaxable gainer families quite differently. Not only do more small families receive tax relief under the schedule B program, but their average increase in after-credit income is $125 higher than such families receive under schedule D. This advantage to small families with tax relief is outweighed both by the number of, and benefits paid to, larger families that receive relief under schedule D so that the overall average income increase for families receiving tax relief under schedule D is greater than under schedule B.

Among the nontaxable gainers, the total number of medium-size and large families is about the same under both schedules B and D; however, the average benefits to these families are substantially higher under D than under B. Again, more small families fare better financially under the schedule B benefit program than is the case under schedule D.

The Effect of Demogrants on the Size of the Poverty Population

In the United States, poverty status is conventionally determined by comparing a family's total census money income (which includes all transfer payments but excludes income from capital gains) with the official poverty-income level for families of a given size, composition, and (farm/nonfarm) place of residence. Under this procedure, there is no allowance made for income tax or any other tax payments for which the family is liable.

Using the conventional method, there were an estimated 25.5 million poor persons comprising 10.2 million poor families in 1970.[16] Our estimate of the 1970 poverty population based on the MERGE file projection is 22.8 million persons and 9.0 million families with census incomes below the poverty-income level.[17] While our estimates are somewhat lower than the official figures, we feel that they are sufficiently close to Census Bureau figures to be used in the remainder of this section.

In order to measure the poverty population after institution of a demogrant program, two changes in the conventional procedure must be made. Since it assumed that the demogrant will replace the current Federal public assistance programs, these payments are subtracted from the amount of census income received by a family when compar-

[15] The income increases shown in table 10 differ from the gross benefit levels shown in table 2 because part of the gross benefit received may be reduced by positive tax liability for gainers with tax relief. Also, in the case of nontaxable gainers, the gross benefit may be offset by the elimination of public assistance and the taxation of other transfer payment income.

[16] U.S. Bureau of the Census, *Current Population Reports, Consumer Income* (series P–60, No. 77, May 7, 1971).

[17] Our estimate is lower than the official one both because it is based on a projection from an earlier year (rather than a current-year survey) and because our incomes were projected from the 1966 level after correction for income underreporting in 1966.

ing its income to the appropriate poverty-income level.[18] In lieu of public assistance, the amount of gross benefit received by each family is included in income for determining its poverty status. No account was taken of tax payments that would offset the amount of net benefit to be received in order to keep the data comparable to the present before-tax measure.

Number of poor families under current law and under various demogrant schedules, 1970

[Number of families in millions]

Item	Number of poor families	Poor families as percent of tota
Present law	9. 0	13. 5
Demogrants:		
Schedule A	2. 2	3. 2
Schedule B	1. 8	2. 7
Schedule C	2. 7	4. 0
Schedule D	1. 8	2. 8

As can be seen from the summary table above, all of the demogrants examined would virtually wipe out poverty in this country—as it is currently defined. The extent to which the poverty population is reduced is perfectly correlated with the total outlays under a demogrant tax credit. Under schedule B, which involves gross outlays of $215 billion, the poverty population would shrink to 4.8 million persons comprising 1.8 million families. Under schedule C, which involves gross outlays of $158 billion, there would be another 2.9 million poor persons (a total of 7.7 million) and an additional 876,000 poor families (a total of 2.7 million).

The number of poor families under current law and under each of the various demogrant schedules is shown in table 11. In addition to a family size classification, we have also added an aged/nonaged classification to the data there. Because of the way benefits are structured, it is not surprising that poverty among the aged is, for all intents and purposes, eliminated under all of the schedules. The only families headed by an aged person who remain poor after any of the demogrant programs are the small number of such families with virtually no income or negative income (for example, from farm or business losses).

We can also infer from the table that the poverty-income deficit remaining after schedules A, B, and C demogrants would be quite small. There are no poor families in the two-person group under schedule D where a two-person aged family receives $2,000 ($1,250 for the adult and $750 for the first child). Under schedule A, this

[18] This procedure is not consistent with the earlier assumption that the States would continue to supplement demogrant benefits in many jurisdictions where the new benefits are not as generous as the existing welfare payments. However, it was impossible to adjust for this using our data base. As a result, our poverty estimates will be higher than is likely to be true under a demogrant tax credit program.

family would receive only $1,500 for the adult member; it would receive $1,800 under schedule B ($1,500 for the adult and $300 for the child); and under schedule C, it would receive either $1,700 or $1,900, depending on the age of the child. The $300 difference between schedule A and schedule B benefits is sufficient to remove 6,000 aged families from poverty. And similarly, the additional $100 to $300 in benefits under schedule D as compared with schedule C is large enough to remove the remaining 5,000 aged two-person families from poverty.

TABLE 11.—*Comparison of the number of poor families under current law and under various demogrant schedules, by age of family head and family size, 1970*

[Number of families in thousands]

Age of head and family size	Current law	Schedule A	Schedule B	Schedule C	Schedule D
Nonaged head: [1]					
Single	2,226	737	733	1,068	897
2 persons	962	286	255	386	247
3–5 persons	1,732	580	439	681	164
6 or more persons	962	414	223	384	154
Subtotal	5,881	2,017	1,650	2,520	1,461
Aged head: [1]					
Single	2,109	123	123	123	382
2 persons	821	11	5	5	----
3–5 persons	187	12	2	4	----
6 or more persons	43	9	4	9	----
Subtotal	3,159	156	135	141	382
All ages:					
Single	4,334	861	856	1,192	1,279
2 persons	1,782	298	260	391	247
3–5 persons	1,919	592	441	685	164
6 or more persons	1,005	424	228	393	154
Total	9,041	2,174	1,785	2,661	1,844

[1] "Nonaged" refers to families headed by a person age 64 or under; "aged" refers to families headed by a person age 65 or above.

NOTE.—Details may not add to totals because of rounding.

For families headed by a person under age 65, our findings are consistent with those presented above since anyone removed from poverty under the demogrant-credit income tax must have been classified as a gainer family in the earlier discussion. While there are impressive cuts in the nonaged poverty population under all the benefit schedules, the largest drop occurs under schedule D where the number of poor families is cut by 4.4 million families. This is closely followed by the 4.2 million family reduction under schedule B. The number of poor nonaged families under schedule C drops by the smallest number—"only" 3.4 million.

Nonaged single persons fare best under schedules A and B, and do worst under the low schedule C benefits, where most of them will

receive only $1,000. There are very small differences in the numbers of two-person families removed from poverty under the various demogrants under all programs other than schedule C; there, again, smaller families fare considerably worse than they do under the other schedules.

The 2.7 million poor nonaged families with three or more persons comprise almost half of the 1970 nonaged total. And the 13.9 million persons in these families account for about three-fourths of the nonaged poverty population. These large families fare best under schedule D benefit levels and under this program the number of families in poverty is cut to 318,000, or by about 88 percent. The number of persons residing in such families is reduced to 1.7 million under schedule D benefits. As we have seen before, the schedule A payments are least beneficial to large families. Under this program, the number of large nonaged poor families is reduced to about 994,000 (families of three or more persons) containing about 5.4 million persons. Stated differently, schedule A payment levels will leave about 3.6 million more nonaged persons in large families in the poverty population than would be the case under the schedule D payment schedule.

A Forward Look to 1975

While projections are always hazardous, it is interesting to attempt to predict how a demogrant-credit income tax system might be expected to grow over time. Since the next year after 1970 for which the Bureau of the Census has projected population estimates is 1975, we have chosen that as the nearest year for which we might present another set of demogrant estimates.

Along with the population growth that will take place between 1970 and 1975, there will also be a rise in the price level; in turn, this will influence the poverty-income levels. Using the Brookings assumptions regarding future movements in consumer prices,[19] we estimate that the 1975 benefit for a single person that corresponds to about 75 percent of the poverty-income level will be about $1,750 (schedule A grant for adults). A benefit structure with payments of $1,750 for each adult and $350 for each person under 18 will provide a $4,200 grant for a four-person family. This will amount to about 90 percent of the 1975 poverty-income level for such a family and corresponds to the schedule B structure for 1970.

The lowest Bureau of the Census projected population for 1975 is 216 million persons.[20] Of these, it is estimated that about 147 million persons will be adults and 69 million will be under age 18. A grant of $1,750 per adult in 1975 would thus require gross outlays of about $257 billion (this would correspond to the schedule A benefit levels for 1970). A near poverty-level grant schedule, corresponding to schedule B in 1970, would require gross outlays of about $281 billion in 1975.

The Brookings estimate of Federal individual income tax collections for calendar 1975 (at full employment) under current law is $132 billion. From this we can subtract $17 billion for public assistance and

[19] Charles Schultze and others, *Setting National Priorities: The 1973 Budget* (Brookings Institution, 1972), p. 412.

[20] U.S. Bureau of the Census, *Population Estimates and Projections* (series P-25, No. 476, February 1972), p. 13.

other programs replaced by the demogrants.[21] But there is also projected a $12 billion full-employment deficit for 1975. If we are in fact expecting full employment in 1975 without the stimulus from a deficit, a balanced budget would be appropriate. This requires financing the deficit, presumably with a rise in the personal income tax.[22] Thus, Federal revenue needed for purposes other than the grants will be $127 billion ($132 billion −$17 billion +$12 billion). Adding to this the $257 billion needed for the flat $1,750 per adult grant brings the total collections required in 1975 up to $384 billion. Similarly, total collections needed to finance the near poverty level grants and other Government activities would be $408 billion.

With needed collections of this magnitude, changes in the tax base would be an absolute necessity. That this is so becomes quite obvious when we consider that taxable income in 1975 under current law is expected to be about $660 billion. In order to raise gross revenues of $384 billion on this base would require an average effective tax rate of 58.2 percent; raising $408 billion would require an average effective rate of 61.8 percent.

	1975 projections	
	Equal per-adult benefits	Near poverty-level benefits
Total revenue required (billions)	$384.0	$408.0
Taxable income:		
Partial tax reform	975.0	975.0
Comprehensive tax reform	1,060.0	1,060.0
Effective tax rate on taxable income (percent):		
Partial tax reform	39.4	41.8
Comprehensive tax reform	36.2	38.5

As indicated in the above table, either the per adult or near poverty-level demogrants appear feasible with either a partially reformed tax base or under comprehensive tax reform.[23] Under either of the reformed tax bases, the average effective rate on taxable income could remain around 40 percent.

It is impossible to make for 1975 the same detailed projections of families by size and income level as were presented for 1970. Nevertheless, we can form some general conclusions based on those results. Obviously, any demogrant tax credit program that involves gross outlays of less than about $280 billion in 1975 will be inadequate in terms of insuring a poverty-level minimum income guarantee for all families. Outlays under a per capita benefit schedule only for adults

[21] This includes about $10 billion for Federal public assistance programs, $3 billion of housing assistance, and $4 billion for food stamps and other nutrition programs, all of which would be eliminated under a demogrant program. This assumes a continuation of current trends for existing programs. However, by 1975 there could be major new programs (for example a means-tested scholarship program) which a demogrant could also replace.

[22] Reduction in expenditures and/or increases in other taxes could also finance the deficit.

[23] Taxable income in 1975 under the partial and comprehensive tax reforms are author's estimates. The definitions of the two reform programs are the same as given above.

totaling about $257 billion will still leave a large number of large families with grants well below their poverty income levels. Very few aged families would remain in poverty—as it is currently defined—under either program.

Projecting roughly from our results for 1970 (adjusted to take account of the full employment assumption in the estimates), the poverty income level demogrants would probably involve a redistributional cost of about $40 billion in 1975 (assuming comprehensive tax reform). This would primarily involve a redistribution from higher to lower income families and would avoid the large amount of redistribution in favor of small families inherent in a flat per capita demogrant solely for adults. For purposes of administrative simplicity, it would probably be preferable to make the grants age-related per capita benefits along the lines of schedule C.

Conclusions

There is no question that universal demogrants or tax credits combined with tax reform can effect a significant redistribution of income in the United States. The amount of redistribution actually achieved is a function of how the benefit levels are structured and the degree to which the income tax is altered in order to finance the grants.

Using a proportional rate and comprehensive tax reform it is possible to raise the share of total after-tax and grant income going to the lowest 20 percent of the population from 5.3 percent under the existing tax and transfer system to 7.0 percent under schedule B benefit levels. In terms of the degree of redistribution achieved, schedule D benefit levels would be least effective; under that schedule the share of income received by the lowest one-fifth of all families would rise to 6.7 percent.

Of course, income redistribution of such magnitudes cannot be achieved without cost. In our analysis, the relevant cost was considered to be the redistributional cost of a program; namely, the amount by which taxes would have to be increased (or future tax cuts forgone) by loser families. For benefit schedule B, which effected the greatest amount of income redistribution, we estimate that 26.9 million families (of the 67.1 million total in 1970) would have to pay increased taxes of about $47 billion. For the "cheapest" schedule of benefits, the distributional cost would be about $34 billion in additional taxes paid by 27.1 million families.

All of the programs examined had a sizable impact on the size of the poverty population as it is currently measured. Poverty among the aged is virtually eliminated, regardless of which benefit schedule is adopted. For nonaged families, schedules which continue to pay generous benefits to large families have the greatest poverty-reducing impact.

While it is clear that any of the programs discussed are economically feasible, they have not yet been tested in the political arena. Put most concisely: Do the American people want the degree of income redistribution that would be achieved under a demogrant program, and are the loser families willing to accept the tax increases they would be obliged to pay in order to obtain the amount of tax and welfare reform suggested in this paper?

SUPPLEMENT A

The Comprehensive and Partial Tax Reform Bases

In 1970, adjusted gross income (AGI) of all family units in the United States amounted to $637 billion. Under the comprehensive income tax base AGI would have risen to $730 billion, or by 14.5 percent. Taxable income would have risen from $401 to $690 billion, an increase of $289 billion or 72.1 percent. Under the partial tax reform, AGI would have amounted to $703 billion, an increase of 10.3 percent; and taxable income would have risen $232 billion, or 57.9 percent.

The comprehensive tax base is an attempt to make the income tax base correspond as closely as practical to an economic concept of income, that is, consumption plus tax payments plus (or minus) the net increase (or decrease) in the value of assets during the year. Some modifications, however, are made on the grounds of historical precedent or to take account of administrative considerations. Thus, capital gains would be taxed only when actually realized or constructively realized when transferred to others through gift or bequest rather than on an accrual basis; gifts and inheritances would be excluded from income; all dividends would be included in income, but not undistributed corporate profits; and employer contributions to private health and pension plans would not be considered current income.

Such a tax base would differ greatly from that which now exists in the United States. To achieve the comprehensive reform base, the following changes from present tax law would have to be made: treat as ordinary income all realized gains (and losses) and gains on property transferred by gift or bequest; eliminate the tax exemption for interest on State and local government bonds; limit depletion allowances to cost depletion; limit depreciation to amounts computed under the straight-line method; tax interest on the current-year increment to the cash surrender value of life insurance policies; include net imputed rent in taxable income and eliminate the personal deductions for real property taxes and mortgage interest; tax transfer payments as ordinary income; eliminate most itemized deductions;[24] eliminate the minimum standard deduction (but not the low-income allowance); eliminate the special exemptions for the aged and blind and the retirement income tax credit; and eliminate the dividend exclusion. In addition, the rate advantages (but not the mechanics) of income splitting for married couples and the maximum tax on earned income would be eliminated under the comprehensive reform income tax. For purposes of this paper, personal exemptions and dependents deductions would also be eliminated, as they would be replaced by the demogrants.

The partial reform tax base excludes certain features of the comprehensive tax base which, on political grounds, we feel would be extremely difficult to implement. Under the partial tax reform, the following changes from the comprehensive tax are made: State and local government bond interest remains nontaxable; interest earned on life insurance policies is not taxed; and homeowner preferences, in

[24] The following itemized deductions would be eliminated or modified: medical expenses up to 5 percent of income, charitable contributions up to 3 percent of income, gasoline taxes paid and personal property taxes paid. In addition interest payments would be deductible only up to the level of income received from property.

the form of interest on mortgages and real estate taxes paid, continue to be allowed as itemized personal deductions.[25] In addition only the first 3 percent of medical expenses are nondeductible (as opposed to the first 5 percent under the comprehensive law.)

Under both the comprehensive and partial tax reforms, the increases in AGI, taxable income and tax liability are considerable (see tables S–1 and S–2). In both cases the greatest increases in taxable income and tax liability result from changes in the treatment of exemptions and personal deductions. Under the comprehensive law the elimination of homeowners' preferences, the various other itemized deductions and the inclusion of transfers as taxable income each add between $30 and $40 billion to taxable income. Since transfers are largely distributed to the poor, the revenue effect of taxing transfers is less than that of the other two changes, the benefits of which accrue mainly to the more well-to-do. Thus, the taxation of capital gains adds $19 billion to taxable income, and over $9 billion to revenue, while taxation of transfers increases taxable income by $32 billion, but results in only $7.5 billion additional revenue.

TABLE S–1.—*Comparison between adjusted gross income, taxable income, and tax liability under present law and the comprehensive reform income tax, 1970 income levels*

[In millions of dollars]

Item	Adjusted gross income [1]	Taxable income [1]	Tax liability
Present law	636, 915	400, 614	83, 833
Elimination of rate advantages of income splitting [2]			15, 613
Plus:			
½ realized capital gains	10, 487	9, 709	5, 381
Constructive realization of gain on gifts and bequests	10, 097	9, 362	4, 207
Tax-exempt State and local bond interest	1, 647	1, 616	1, 019
Other preference income [3]	633	555	194
Dividend exclusion	1, 492	1, 342	451
Interest on life insurance policies	10, 461	9, 900	2, 871
Homeowners' preferences [4]	15, 257	39, 132	12, 525
Transfer payments	43, 210	31, 694	7, 543
Personal exemptions [5]		147, 466	42, 669
Personal deductions [6]		38, 230	14, 808
Equals: Comprehensive reform income tax	730, 199	689, 620	191, 114

[1] The increase in taxable income is greater than the change in adjusted gross income because the elimination of certain exemptions and deductions increases taxable income but does not affect adjusted gross income.
[2] Includes revenue effect of eliminating the 50-percent maximum tax on earned income.
[3] Excess of percentage over cost depletion and accelerated over straight-line depreciation.
[4] Includes effects of adding net imputed rent and disallowing itemized deductions for mortgage interest and real estate taxes.
[5] Includes effect of eliminating retirement income credit.
[6] The following itemized deductions are eliminated or modified: charitable contributions up to 3 percent of income, gasoline taxes paid and personal property taxes paid. In addition interest payments are deductible only up to the level of income received from property.

NOTE.—Details may not add to totals because of rounding.

[25] This is subject to the qualification that all interest expenses are deductible only up to the level of income earned from property. This qualification applies to all interest expenses, not just those on home mortgages, and therefore is not borne entirely by homeowners.

TABLE S–2.—*Comparison between adjusted gross income, taxable income, and tax liability under present law and the partial reform income tax, 1970 income levels*

[In millions of dollars]

Item	Adjusted gross income [1]	Taxable income [1]	Tax liability
Present law	$636, 915	$400, 614	$83, 833
Elimination of rate advantage of income splitting [2]			15, 613
Plus:			
½ realized capital gains	10, 487	9, 709	5, 381
Constructive realization of gain on gifts and bequests	10, 097	9, 362	4, 207
Other preference income [3]	633	547	185
Dividend exclusion	1, 492	1, 342	436
Transfer payments	43, 210	30, 051	6, 856
Personal exemptions [4]		145, 820	37, 521
Personal deductions [5]		35, 185	12, 698
Equals: Partial reform income tax	702, 834	632, 630	166, 730

[1] The increase in taxable income is greater than the change in adjusted gross income because the elimination of, certain exemptions and deductions increases taxable income but does not affect adjusted gross income.

[2] Includes revenue effect of eliminating the 50 percent maximum tax on earned income.

[3] Excess of percentage over cost depletion and accelerated over straight-line depreciation.

[4] Includes effect of eliminating retirement income credit.

[5] The following itemized deductions are eliminated or modified: charitable contributions up to 3 percent of income, gasoline taxes paid, and personal property taxes paid. In addition interest payments are deductible only up to the level of income received from property.

NOTE.—Details may not add to totals because of rounding.

If taxed at 1970 rates, the total of all the additions to the base under the comprehensive tax law plus the elimination of the rate advantages of income splitting would increase tax collections by more than $107 billion. Close to 40 percent of this increase is due to the elimination of personal exemptions and deductions. Elimination of income splitting, taxation of all capital gains, and elimination of the homeowners' preferences each account for between 9 and 15 percent of the increase in tax liability. The total of all the other features accounts for roughly one-quarter of the $103 billion revenue increase.

Under the partial tax reform, over three-fifths of the increase in taxable income is due to the elimination of the exemption and personal deductions, roughly 15 percent is due to the elimination of the itemized deductions, another 13 percent reflects the inclusion of transfers in the tax base. The combined effect of the other provisions accounts for about 9 percent of the increase in taxable income.

Again using the 1970 tax rates, the elimination of exemptions and personal deductions accounts for over 45 percent of the increase in tax revenue under the partial tax reform. Elimination of the advantages of income splitting accounts for another 19 percent. The inclusion of transfers and all capital gains in the tax base account for 8 and 12 percent, respectively. And the elimination of the other itemized deductions accounts for almost 15 percent of the increased tax liability.

WORK-CONDITIONED SUBSIDIES AS AN INCOME-MAINTENANCE STRATEGY: ISSUES OF PROGRAM STRUCTURE AND INTEGRATION

By ROBERT H. HAVEMAN*

SUMMARY

This paper analyzes a strategy for aiding low income families in which the aid provided families with able-bodied heads is tied to the level of work effort. Families without an employable head would continue to qualify for welfare. This strategy involves the integration of public employment, wage subsidy, and direct cash transfer programs.

In the first main section of the paper, the Senate Finance Committee version of such a strategy is described and its effect on several categories of low income families is analyzed. This is followed by a detailed critique of the proposal in which its equity and efficiency effects are evaluated, as well as the likely effect of its implementation on the national wage structure and the administrative difficulties which it will encounter. This critique concludes that while the target efficiency of the subsidy to the poor and the nonpoor is rather high, the proposal has other (primarily horizontal) equity effects which are undesirable. Also, while the proposal has labor-supply incentive effects which are more desirable than those of negative-income-tax type plans, it tends to discourage increased earnings stemming from higher wage rates. When the implicit tax rates of other income-conditioned programs are added to this discouragement, it seems likely that there would be little incentive for low income family heads to seek advancement or investment in human capital.

In analyzing the effect of this strategy on the national wage structure, the critique concludes that there would be little if any undermining of that structure. This is due to both the size and character of the program and the nature of labor market rigidities.

A major set of difficulties with the proposal is seen to revolve around the question of administrative feasibility. These difficulties center on the multiplicity of programs within the strategy, the problems inherent in a major public employment program, and the difficulties of implementing a national wage subsidy.

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In the final section, an alternative work-conditioned, income-supplementation program is suggested. This program is built around an earnings subsidy program and strives to avoid many of the difficulties of the Finance Committee proposal. The paper concludes with a discussion of how this form of income-supplementation strategy could be integrated with a number of other cash and in-kind transfer programs without losing its desirable work incentive characteristics. A technique for mitigating the disincentive effects of cumulative tax rates is described. It involves establishing a ceiling on the number of programs from which any family can receive benefits.

I. Introduction

Since the inception of Federal need-related, income-maintenance programs in the United States, the expectation has been that such programs would be both residual and transitional. They would be residual in that they would provide income support to those limited number of households which had little expectation of self-support—female-headed families with children, the aged, the blind, the disabled—and that were not covered by the contributory social-insurance programs. They would be transitional in that they would shrink in size as the social-insurance programs expanded in coverage.

Neither one of these expectations has been fulfilled. The coverage of public-assistance eligibles by social-insurance programs has proceeded slowly. More importantly, as the proportion of the population living in female-headed families rose and as the eligibility for public assistance was broadened, the size of the residual increased rather than decreased.

During the 1960's, especially from 1967 on, the rate of expansion of the AFDC program (the largest of the public-assistance programs) was substantial. Between 1960 and 1971, the number of AFDC recipients tripled and program costs rose sixfold. During this same decade other programs were initiated which also provided assistance to the poor—food stamps, medicaid, public housing, and a plethora of other social services. By 1971, nearly $20 billion per year was being spent on cash and in-kind transfer programs with an antipoverty objective.

During the early 1970's, this "welfare system" came under increased public scrutiny. Viewed as a whole, it had many characteristics which gave it the appearance of unwise—indeed, unproductive—social policy. Because of eligibility standards and benefit levels, some families on welfare had higher total incomes than similar families in which the head worked full time. Because of the benefit schedule and the lack of integration among the many programs, little if any income improvement could be obtained by increased effort to earn income. Because of the restriction of eligibility in the AFDC program to female-headed families [1] together with the increasing number of apparently "able-bodied" women receiving support, the program was viewed by many as unequitable to male-headed poor families, as

[1] Some families with an unemployed or incapacitated male head also receive benefits from AFDC.

"sexist" in its discouragement of labor-force participation by women, and as conducive to family breakup and family instability. Because of the variance in eligibility and benefit levels by State, interstate inequities persist and artificial inducements to mobility are feared. Moreover, even though the system has grown rapidly, the existence of poverty has not been eliminated.[2]

In response to these concerns, many reform proposals have been made—negative-income-tax plans, demogrant schemes, and children's allowances. In all cases, these proposals were aimed at alleviating many of the problems with the existing system. To be seriously considered, a proposed plan had to demonstrate an increase in work incentives, an increase in equity between able-bodied male and female heads (often stated as extending coverage from the deserving to the working poor), the establishment of an acceptable need-related income floor for all families, and administrative feasibility—all of this without any major expansion in roles or costs. Because of the conflicting nature of some of these objectives, proposals traded gains in achieving one objective with costs in achieving the others.

The proposal which has received the most widespread attention is the family assistance plan—later known as H.R. 1—of the Nixon administration. The latest version of this program called for a national minimum income guarantee of $2,400 for a family of four persons, both male- and female-headed. As the earnings of a family increased above $720 per year, the level of the guarantee would have decreased by $0.67 per $1 of earnings—a 66.7 percent tax rate. However, because recipients of cash transfers often receive other income-conditioned benefits—for example, medicaid and public housing—and pay other positive taxes on their earnings, the effective tax rate would have been substantially in excess of 67 percent. For some recipients and over some income ranges the effective rate would have been more than 100 percent. To counteract these offsets to the work incentive implied by the basic tax rate of 67 percent, the proposal incorporated a work requirement for adult benefit recipients who were not ill, incapacitated, elderly, mothers with children under 6, youths between 16 and 22 who are attending school, or needed in the home because of illness.

To assist those required to register for work and training, H.R. 1 would have provided financing for 200,000 public-service jobs, and support for some job training and day care. If an "employable" adult refused employment or training, a penalty of $800 would have been subtracted from family annual benefits.

In addition to these provisions, H.R. 1 would have eliminated the food stamp program, altered the eligibility requirements of medicaid and public housing to eliminate the "notch," encouraged States to supplement Federal benefits so as to minimize the adverse effect of the program on current recipients, and established Federal Government administration of the program. The effect of these changes would have increased the number of recipients from 15 million in 1973 to about 25 million, at a total additional Federal cost of about $2 billion.

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[2] For an analysis of the nature and evolution of the public-assistance system, see Sar A. Levitan, Martin Rein, and David Marwick, *Work and Welfare Go Together* (Baltimore: Johns Hopkins Press, 1972).

While the House of Representatives passed H.R. 1 on two separate occasions, it has not been supported by the Senate Finance Committee. In its place, the committee has put forth an income-maintenance plan of its own. By comparing the provisions of this plan with H.R. 1, the failure of H.R. 1 to gain committee approval appears to be attributable to the lack of effective work incentives implicit in the high, cumulative, marginal tax rate on earned income, the likely ineffectiveness (in employing able-bodied family heads) of a work test which is not accompanied by sufficient employment and training opportunities and day-care support, and the high income guarantee available to an able-bodied family head—male or female—who manages to elude the work test.

The keystone of the strategy developed by the Senate Finance Committee is the proposition that both male and female family heads without severe impediments to work should rely on earned income as their primary means of support. There are four corollaries to this proposition: First, a criterion must be established to distinguish employable family heads from those with severe impediments to work. Second, positive work-related incentives—as opposed to work disincentives in the form of implicit tax rates—are important both to induce work effort by employable family heads and to supplement their earned income. Third, a program of guaranteed public jobs is essential to offset the destructive effect of a loose labor market on such an employment-related program. Finally, for those family heads who cannot be expected to work, a more traditional income-support system with little concern for work incentives should be made available.

While such a work-conditioned, income-maintenance strategy has some familiar components, it represents a rather different policy approach than either the current welfare system or H.R. 1. As such, the committee plan leaves many unanswered questions and unresolved problems. In succeeding sections of this paper many of these will be raised and analyzed. In the second section, the specifics of the Senate Finance Committee strategy will be described and its impact on various categories of low-income families analyzed. In the third section, the committee proposal will be critiqued and compared with H.R. 1. This critique will focus on considerations of efficiency, equity, effect on the national wage structure, and administrative feasibility. The fourth section presents an alternative work-conditioned, income-maintenance scheme which corrects a number of the structural problems of the Senate Finance Committee proposals. The integration of this plan with other income-transfer programs is also discussed in this section, and some of its advantages and disadvantages are evaluated.

II. Work-Conditioned Income Supplementation: Senate Finance Committee Style

In June 1972, the Senate Finance Committee announced their version of a welfare reform bill. The "Assistance to Families" provision of this bill emerged after 2 years of committee deliberations as a substitute to H.R. 1 which had been passed by the House. Upon its release, the administration, Senate liberals, and the media denounced the bill as "a $9 billion step backward," as "slavefare," and as "barbaric."

The proposal which drew this response is not a simple and straightforward scheme. While it would reduce the size of the current AFDC program it would not eliminate it. While it would require some current welfare recipients to be employed in order to qualify for income supplementation, it would guarantee success to their efforts to find employment. Moreover, it would provide substantial assistance for child care services to heads of single-parent families who are declared to be "employable." While it would be a less attractive program to some current welfare recipients than the current AFDC program, it would funnel substantial income support to working poor and near-poor families who are now effectively excluded from the Nation's income-maintenance system. In describing their strategy, the committee stated:

> * * * Paying an employable person a benefit based on need, the essence of the welfare approach, has not worked. It has not decreased dependency—it has increased it. It has not encouraged work—it has discouraged it. It has not added to the dignity in the lives of recipients, and it has aroused the indignation of the taxpayers who must pay for it * * *. The only way to meet the economic needs of poor persons while at the same time decreasing rather than increasing their dependency is to reward work directly by increasing its value.

The Structure of the Senate Bill

The primary provisions of the Senate Finance Committee proposal are conveniently described by focusing first on the program of assistance to families without an employable head and then on those with such a head. The program, it should be noted, provides no assistance to single individuals or childless couples.

THE PROGRAM OF ASSISTANCE TO FAMILIES WITHOUT AN EMPLOYABLE HEAD

Under the current welfare system, income support through AFDC is provided for families that are headed by females or by incapacitated fathers and stepfathers and that meet the income and asset tests of State welfare systems—about 3 million families. In addition, in about 25 States families headed by long-term unemployed fathers receive support through AFDC–UF.[3] The committee bill would continue these cash transfer programs only for those single-parent (primarily female-headed) families in which the parent has a child under age 6 or is ill, incapacitated, attending school full time, or residing in a geographically remote region. About 1.8 million families fall into this category, approximately 60 percent of the current AFDC population.

For this residual AFDC population the Senate bill would require that States with high benefit levels not reduce payment levels below $2,400 for a family of four. States with payment levels below this amount could not reduce them at all. In addition, a block grant would be provided States to enable them to raise benefits to this level with no additional cost to them.[4] After disregarding $240 of earnings plus

[3] About 20 percent of all AFDC families are male-headed.

[4] The block grant, however, does not cover costs for benefit levels beyond $2,400 even though the family has more than four members. While this appears to be tantamount to a guarantee level of $2,400 for a four-person family, it should be noted that some States may well not increase benefit levels, even though costless.

earnings to cover another $240 of child support costs, earned income would be taxed at a 100 percent rate.[5]

The committee proposal, like H.R. 1, would not provide Federal matching of the State supplemental payments. Also, like the administration proposal, the food stamp program would be eliminated for families who are eligible for welfare benefits. However, States could choose to supplement the basic Federal program by the amount of the implicit cash value of food stamps to a family (an average of about $800) without incurring additional cost. However, unlike H.R. 1, the Senate proposal does not encourage States to cede administration of the welfare program to the Federal Government.

THE PROGRAM OF ASSISTANCE TO FAMILIES WITH AN EMPLOYABLE HEAD

Under the committee proposal, families with heads who are classified as employable would not be eligible for direct cash transfers unrelated to work. For some of these families—employable female- and male-headed families who are now receiving AFDC or AFDC–UF benefits—this will significantly change their status. Such family heads, however, are guaranteed a minimum income of $2,400 per year (unrelated to family size) provided they participate in the employment program.[6]

The employment program would be administered by a Work Administration (WA) which would be created by the bill. Any eligible family head would be guaranteed a job by the WA. In dealing with registrants in the program the WA would have three options available. First, the participant could be placed by the WA in a regular public- or private-sector job paying $2 per hour or more. Full-time work for a year in a job provided by the WA would yield the worker an income of at least $4,000 per year.

A second option for the WA would be to place the participant in a regular private- or public-sector job that pays less than the national minimum wage[7] but more than three-fourths of it. In this case, the WA would subsidize the applicant's wage rate by three-fourths of the difference between his wage rate and the national minimum wage rate.[8]

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[5] The 100 percent tax rate provision goes into effect only after the employment program (described below) is in operation.

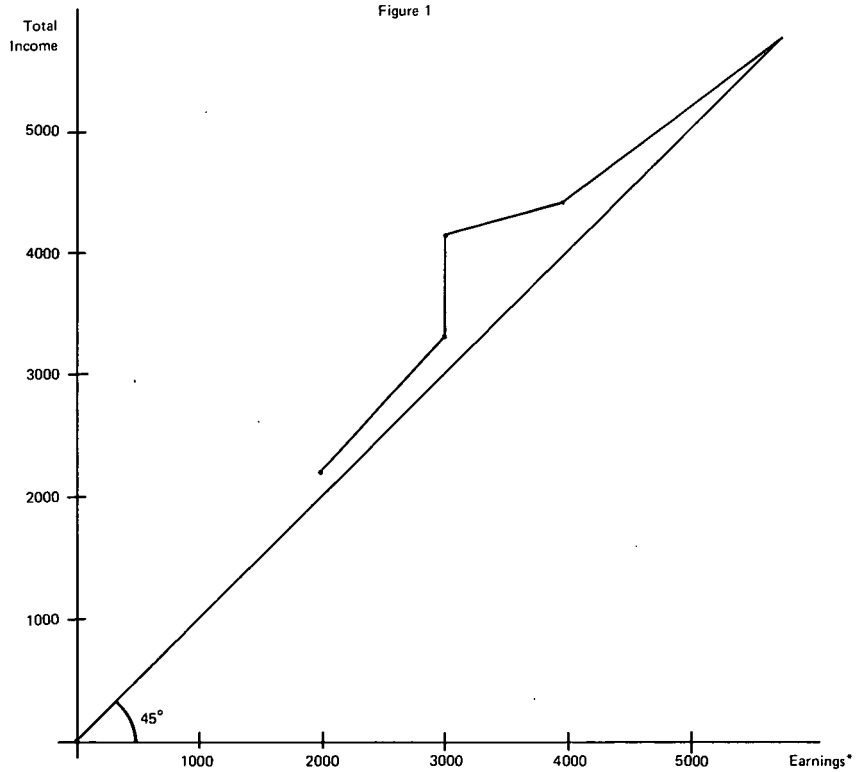
[6] Eligibility for the employment program is limited to the heads of families with less than $300 per month of unearned income or $5,600 of total family income per year.

[7] Currently, the minimum wage is $1.60 per hour. However, passage of at least a $2 minimum wage seems likely. Except where noted, the subsequent discussion of the proposal will assume that the minimum wage is $2 per hour.

[8] The formula for this form of wage rate subsidy is: $S=.75(X-W)$, where S is the per hour subsidy, W is the actual wage rate, and X is the national minimum or target wage rate. To be eligible for the subsidy $.75X<W<X$. For example, if the national minimum wage rate is $2 per hour and if the applicant is placed in a position paying $1.50 ($1.80) per hour, the WA would subsidize the wage rate by $0.375 ($0.15) per hour. From the employee's point of view, his wage rate would be $1.875 ($1.95) per hour, which for full-time work implies an income of $3,750 ($3,900) per year.

For applicants who find themselves in either of these circumstances, there is a supplemental subsidy which would be administered by the WA—an earnings bonus. For every dollar earned in employment by the family head and his wife covered by the social security program,[9] an additional 10 percent bonus would be paid, up to an earnings level of $4,000. Beyond $4,000 of husband's plus wife's earnings, the bonus (which reaches a maximum of $400 at an earnings level of $4,000) would be decreased by $0.25 for each additional dollar of earnings, hence falling to zero at an earnings level of $5,600. The schedule of work-conditioned subsidies related to the earnings of a family head in full-time employment (without a working wife) is shown in figure 1. Total income for such a family is shown in table 1. It should be noted that both the wage-rate subsidy and the earnings bonus would also be payable to low-income family heads who secured regular public or private employment on their own.

Figure 1



*Increased earnings from $3000-$4000 assumed to come from full-time work but at increasing wage *rates*.

[9] A part of the rationale for the earnings bonus is to eliminate the social security payroll tax for low-income workers. The earnings bonus would be administered by the Internal Revenue System.

TABLE 1.—*Earnings, subsidies, bonuses, and total income for participants in employment program working full time in regular employment*

Wage rate	Annual earnings from employer	Wage rate subsidy	Earnings bonus	Total income
$1.50	$3,000	$750	$300	$4,050
$1.75	3,500	375	350	4,225
$2.00	4,000	----------	400	4,400
$2.50	5,000	----------	150	5,150
$2.80	5,600	----------	----------	5,600

The third option available to the WA would be exercised if it failed to place the applicant in regular private- or public-sector employment. In this case, the applicant would be employed in one of the public service activities to be either arranged or operated by the WA. For such employment, the applicant would be paid three-fourths of the national minimum wage and would be guaranteed 32 hours of work per week. Presuming a $2 minimum wage and 32 hours of work per week, this would imply an annual income of $2,400.[10] Neither the wage-rate subsidy nor the earnings bonus would be paid for such employment.

A special arrangement is provided for the low-income family head who is able to secure only part-time regular public or private employment. In such a situation, the employee would receive his wage rate from the regular private- or public-sector job, the wage-rate subsidy (if his wage rate was less than the minimum wage but more than three-fourths of it), and the earnings bonus on the sum of husband's and wife's earnings. In addition, the part-time worker would be eligible for additional employment from the WA to result in a combined total of 40 hours per week. The amount of income (and, hence, employment) which the WA would provide the applicant through some regular part-time employment is shown in table 2.[11]

Of concern is the matter of State income-supplementation programs and their relationship to the work-conditioned subsidies embodied in the committee bill. To eliminate the chance that State supplementation would reduce the work incentives of the plan, the bill requires States which choose to supplement the incomes of participating families to assume that the annual earnings of the family are at least $2,400—implying 32 hours of work at the guaranteed wage rate of $1.50. Moreover, States would be required to disregard annual earnings between $2,400 and $4,500 in computing State supplemental pay-

[10] The limitation of work to 32 hours appears to be based on a desire to keep the guarantee at the $2,400 level, hence making the public service alternative less desirable than full-time private employment. An alternative would be to guarantee full-time employment, which at $1.50 per hour implies an annual income of $3,000. In the remainder of this paper, both alternatives are analyzed.

[11] An interesting question affecting this package of employment options concerns the availability of public service employment to a family head currently holding full-time regular employment at, say, the minimum wage. With a minimum wage of $2, the annual earnings of the worker would be $4,000 to which would be added the earnings bonus of $400. Could this person become eligible for additional public service employment through the WA? The committee has answered this affirmatively, stating that the WA *may* provide the worker up to 20 additional hours of work per week if such employment is available.

ments. This implies a constant additional cash benefit that is not eroded by incremental earnings until earnings equal more than $4,500. As the Finance Committee report states:

> The effect of this requirement would be to give a participant in the work program a strong incentive to work full-time * * *, and it would not interfere with the strong incentives he would have to seek regular employment rather than working for the Government.

In addition to this basic structure of the cash transfer, work-conditioned subsidy, and public service employment programs, there are other important provisions. One such provision concerns the subsidization of child-care services for participants in the employment program. Perhaps more than other proposals for welfare reform, a work-conditioned, income-support program has implications for the public-sector provision or subsidization of day-care services. Because the committee bill would lead to essentially full-time employment for over 1 million mothers of school-age children who are currently receiving AFDC benefits, a major increase in the supply of after-school and full-time summer day-care services is required.

TABLE 2.—*Public service income and employment provided by Work Administration to low-income family head with part-time regular employment* [1]

Number of hours of work and wage rate	Annual income from employer	Income from wage-rate subsidy	Income from earnings bonus	Total income from part-time employment	Additional income and hours per week guaranteed by Work Administration [2]	Total income
10 hours/week:						
$1.20/hour	$600	----	$60	$660	$2,250(30)	$2,810
$1.60/hour	800	$150	80	1,030	2,250(30)	3,280
$2.00/hour	1,000	----	100	1,100	2,250(30)	3,350
$2.40/hour	1,200	----	120	1,320	2,250(30)	3,575
20 hours/week:						
$1.20/hour	1,200	----	120	1,320	1,500(20)	2,820
$1.60/hour	1,600	300	160	2,060	1,500(20)	3,560
$2.00/hour	2,000	----	200	2,200	1,500(20)	3,700
$2.40/hour	2,400	----	240	2,640	1,500(20)	4,140
30 hours/week:						
$1.20/hour	1,800	----	180	1,980	750(10)	2,730
$1.60/hour	2,400	450	240	3,090	750(10)	3,840
$2.00/hour	3,000	----	300	3,300	750(10)	4,050
$2.40/hour	3,600	----	360	3,960	750(10)	4,710

[1] Assumes employee is head of house and that there are no secondary workers in family.
[2] Number in parentheses behind dollar income entitlement is number of hours per week the Work Administration would have to provide in public-service employment.

The Senate bill would establish within the WA a Bureau of Child Care which would have as its central function the provision of child-care services to single-parent family heads participating in the employment program. The Bureau would train persons to provide family day care, contract with existing day-care providers, give technical assistance to organizations wishing to establish facilities, and provide day-care services in its own, to-be-developed facilities, making maximum use of mothers who are participants in the employment

program. [12] While mothers employed in special public-service jobs would apparently receive free day-care services—valued at $800 per child per year—the day-care benefit would be diminished for employable mothers who earn in excess of $2,400. The committee has not specified the rate at which this subsidy is to be reduced as earnings increase above $2,400.

A second important provision enables participants in the employment program to volunteer for training programs to be administered by the WA. However, during the training, participants would be paid $1.30 per hour rather than the $1.50 in the special public service jobs. The cumulated difference between the two wage rates would be paid as a lump sum to those trainees who complete the program.

III. The Senate Finance Committee Proposal: A Policy Evaluation

The Finance Committee proposal represents a major alternative to other proposed welfare reform strategies such as negative income taxation, the credit income tax (demogrant), and H.R. 1. As such, its efficiency and equity characteristics require evaluation as well as the likely effect of its implementation on the national wage structure and the behavioral patterns of recipients. In this section, several of these probable impacts will be analyzed.

Equity Effects

The Finance Committee proposal is likely to cost $12–$15 billion over and above the cost of the existing AFDC, AFDC–UF, and food stamp programs. About 40 percent of this cost is attributable to the public employment program, with the work-conditioned subsidies and the direct transfer components accounting for 20 percent each. Each of these components have equity effects which must be considered.

First, the public employment program. The participants in this program will be those current AFDC and AFDC–UF recipients declared to be employable and those persons who find the public service option superior to their current job. It is apparent that the overwhelming majority of these people are below the poverty line and most of them are substantially below. Government expenditures providing income for these people have a high "target efficiency"—a high proportion of the dollars spent would be received by the poor with little of the cost spilling over to nonpoor recipients.

A second component of this strategy is the work-conditioned subsidy.[13] This subsidy would be paid to workers who are household heads and who are earning a wage rate below the national minimum wage but above three-fourths of it. Because of the low level of this standard, most of these workers would have incomes below the poverty line.

However, it should be noted that some of the family heads holding such low paying jobs may not be poor. Examples would include

[12] The committee would authorize $800 million for the provision of such services.

[13] Because the wage rate form of a work subsidy has been most extensively studied, it will be used here as the basis of the analysis.

individuals with substantial unearned income, family heads holding second jobs, families with two or more full-time earners, and the heads of small families. While evidence on the extent to which this subsidy would spill over to nonpoor recipients is not firm, there is some indication that it would not be trivial.

In a recent study, Michael Barth analyzed the distribution of the benefits of a universal wage-rate subsidy among poor and nonpoor.[14] Because this study displayed the population subgroups which would be recipients of such a universal program it is possible to estimate the distributional effect of a program limited to family heads (as the Senate bill is). Table 3 displays such results for two wage-rate subsidy plans—a $1.60 minimum wage and a $2 minimum wage, with the subsidy equal to 50 percent of the differential between the actual wage and the national minimum.

TABLE 3.—*Distribution of recipients and benefits of wage subsidy plans among poor and nonpoor (based on the 1967 Survey of Economic Opportunity)*

	Poor				Nonpoor			
	Recipients		Benefits		Recipients		Benefits	
	Millions	Percent of the total	Millions of dollars	Percent of the total	Millions	Percent of the total	Millions of dollars	Percent of the total
$1.60 plan	2. 5	62. 5	1. 0	52. 6	1. 5	37. 5	0. 9	47. 5
$2.00 plan	2. 9	41. 4	1. 7	39. 5	4. 1	58. 6	2. 6	60. 5

The table shows that for the smaller plan nearly 65 percent of total recipients are poor and that well over one-half of the benefits go to poor recipients. Comparable figures for the larger plan are 41 and 40 percent. The same study shows that for the smaller plan, 65 percent of poor family heads who work for wages would receive some subsidy while 75 percent of such workers would be subsidized under the larger plan.[15]

[14] Michael C. Barth, "Cost, Coverage, and Antipoverty Effect of a Per Hour Wage Subsidy," Ph. D. dissertation, City University of New York, 1971. Barth estimated that a *universal* wage-rate subsidy plan would target only about 20 percent of its benefits on recipients below the poverty line. See also Michael C. Barth, "Universal Wage Rate Subsidy: Benefits and Effects," in U.S. Congress, Joint Economic Committee, "The Economics of Federal Subsidy Programs," Part 4, August 1972, pp. 497–540.

[15] A number of things should be emphasized regarding the implication of these results for estimating the target efficiency of a work-conditioned, income-supplementation strategy. First, because of the change in wage-rate level between 1966 and 1973, work subsidy based on a $2 wage standard is closer in real terms to the $1.60 plan described in the study. Second, because the plans discussed in the study subsidize 50 percent of the wage-rate differential, they would concentrate a smaller share of the subsidy on those with actual wage rates at the lower end of the wage distribution than would a plan with a higher percentage subsidy. Such plans, however, would concentrate a larger share of the subsidy on very low wage-rate earners than would a plan that subsidized only wage rates above some level, as in the Senate Finance Committee bill. Finally, to the extent that there is nontrivial leakage of benefits, it seems highly likely that the bulk of the leaked benefits would accrue to near-poor family heads.

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While there would be some leakage of benefits to those families who are not classified as being in poverty, it seems safe to claim that three-fourths of the benefits from the work-subsidy component of the strategy would accrue to poor or near-poor families. Moreover, to the extent that a program objective is to insure that work effort by the primary earner is rewarded at some "reasonable" level, the provision of some subsidy to the nonpoor would be warranted.

Similarly, it appears that to integrate the child-care subsidy with work-conditioned-subsidy and public-employment programs would place a high priority on the provision of these services to AFDC-type mothers deemed to be employable. Because such mothers would receive this subsidy if they worked and because most of them would in all likelihood be employed in public-service employment, the target efficiency of this expenditure would also be high. However, to the extent that the expenditure was subsidizing day-care costs of mothers with earnings above the poverty line—as an income-conditioned-subsidy schedule would imply—the target efficiency would be reduced.

Finally, the additional public expenditures required to support a $2,400 benefit level for all families of size four in the non-work-related cash transfer program would have a 100 percent target efficiency. All of the beneficiaries would be single-parent families without an employable head with current benefits below such a national standard.

Although this evaluation is a crude one, it seems clear that the target efficiency of the Finance Committee strategy is very high. For example, it is not unreasonable to assert that at least 75–80 percent of the subsidy provided will be received by families below the poverty line with much of the remainder accruing to the near-poor. This level of target efficiency, it should be emphasized, is higher than that of an equally costly negative-income-tax-type plan. The reason for this is the relatively high breakeven earnings level for moderately large negative tax plans with "reasonable" tax rates. The work-conditioned, income-supplementation strategy is able to avoid some of this leakage of support to the nonpoor by tying subsidies to labor-market performance, hence eliminating the tax rate of negative-income-tax plans required to erode the guarantee.[16]

An equity question related to that of target efficiency concerns the effect of the program on the very poorest of the poor. One way to state this question is to inquire if the bill would establish a minimum income below which no family would fall. While the current welfare system does not provide such an income floor, H.R. 1 would have. The $2,400 minimum income level for a family of four in this proposal would have raised benefits in 22 of the 50 States and would have established this guaranteed minimum income level for 9 million people in working poor families not now covered by public assistance.

In considering the existence of this income floor for the committee bill, its effect on each of the several categories of low-income families

[16] It should, in addition, be noted that nearly 30 percent of the costs of H.R. 1 is earmarked for State and local government savings—a not very "target effective" expenditure if the target is low-income families. See Jodie Allen, "A Funny Thing Happened on the Way to Welfare Reform," Urban Institute Paper 301–14, 1972.

must be evaluated. One primary category consists of the head who would continue to be eligible for cash transfers unrelated to work. The committee bill would enable States to establish an income floor of $2,400 for families of four persons in this category at no additional State cost, plus enabling States to supplement the Federal benefit by "cashing out" food stamps—worth $800 per family—at no additional cost. It seems likely then that the minimum income guarantee would be at least three-fourths of the poverty line for most families in this category.[17]

A second category consists of those families whose head is declared to be employable. For these families, there is also a guarantee. However, access to it requires work effort. In addition to subsidized regular employment, employable family heads would always have the guarantee of public-service employment on which to fall back. Even if this program paid but three-fourths of a national minimum wage of $2 per hour, full-time work would yield an annual income of $3,000. Consistent with such a strategy, single-parent family heads who are employable would be guaranteed after-school and summer day-care subsidies (valued at about $800 per year) for each child. For the group of employables, then, an income floor would also be established.[18]

This is not to say, however, that all of these families would be as well off in terms of spendable income (cash benefits less net child care and other work expenses) in this program as they would be under the current welfare system or H.R. 1. Some clearly would not be. In particular, those mothers now receiving AFDC who are declared employable and who reside in current high benefit States are likely to find themselves with less spendable income under the Finance Committee strategy than under either the current system or H.R. 1. This is especially true if the high benefit States—in the absence of a Federal mandate—reduce their current benefit levels or fail to provide supplemental benefits to public-service employees.

Moreover, for some family heads currently receiving AFDC, the welfare loss induced by requiring work outside the home in lieu of "home work" may be substantial. For others this substitution may yield a welfare gain. In evaluating the existence of a minimum income guarantee for families in this category, the concept of real income should not be ignored and contribution of the welfare loss or gain attributable to the implied substitution of employment outside the home for "home work" should be counted.

However, because of the work subsidy, most of the current working poor would find themselves with substantially more net spendable income than they currently have. Moreover, those families whose heads earn a very low market wage rate, even though they would get a work subsidy, might not have income above that guaranteed by public-service employment provided by the WA. The heads of these families would have every incentive to shift from regular employment to the WA program to take advantage of its guaranteed employment and

[17] However, some of these women both work and draw AFDC benefits. Because the Senate Finance Committee bill erodes benefits in response to earnings at a very high rate, some of these women would be made worse off because of the bill, and existing work effort would be eliminated.

[18] An apparently unresolved question, however, concerns the support provided children in case the family head *refuses* to work.

income.[19] With this option available, no family headed by an employable person who is willing to work should find itself with less spendable income than that guaranteed by special public-service employment programs.

While the Finance Committee strategy appears to both target its support on the poverty population rather effectively and to establish a minimum income floor for all families, it has some additional equity effects which are not so attractive. One of these structural problems is related to the concept of "need" which serves to justify the family-size-conditioned benefit schedules of the current AFDC program, H.R. 1, and other reform proposals. The subsidies provided through the Work Administration depend only upon the wage rate received and the number of hours worked. As a consequence, large size families will be substantially less well off if the head is declared to be employable than under the current welfare system (if eligible) or H.R. 1. However, it should be added that although not included in the legislation, the committee anticipates that State supplementation plans will reinstate family-size-conditioned benefits.[20]

Finally, the committee bill has a number of provisions which create horizontal inequities among program beneficiaries, only some of which appear to be justified. The first is the classification of some people as eligible for cash transfers unrelated to work because of their distance from the nearest WA office. As a result, a family with an otherwise employable head living in a rural area will receive cash assistance without work effort while a similar family in an urban area will achieve an income supplementation only through participating in the work program. This inequity may be justified on efficiency grounds given the transportation costs of bringing a rural family head together with the nearest WA office.

A second provision generating horizontal inequities is a fundamental one. The only way in which a participant who is directly employed by the WA in a public-service job can be distinguished from one placed in regular public or private employment is that the WA was successful in the latter case but not in the former. While the regular employee gains the benefits of a wage which is likely to be at least the national minimum plus both the wage subsidy and the earnings bonus, the public-service employee does not. This inequity is the price required to maintain the incentive for public-service employees to seek regular employment.

The third provision resulting in horizontal inequities is the generous provision of child care to mothers employed directly by the WA in

[19] While the wage rate paid to public service employees—being below the national minimum wage rate—would seem to be in conflict with the notion of a minimum standard, it should be noted that 2.3 million workers in the United States earn less than $1.50—three-fourths of the minimum wage (from surveys conducted in 1970 and 1971 by the Employment Standards Administration of the U.S. Department of Labor). From a special tabulation of the SEO tape (1967), it was estimated that 4 million family heads earned less than $1.60 per hour and 7 million family heads earned less than $2 per hour. Similar figures for *male* heads are 3 and 6 million.

[20] An earlier version of the bill did provide for a children's allowance to be paid to all low income families with more than four members. For the fifth, sixth, and additional members of a family unit, annual grants of $300, $180, and $120 were suggested. The allowance would have been reduced by $1 for every $2 of earnings above $3,600 annually.

public-service jobs. For these participants, provision of child care would be given highest priority and would be fully subsidized. Other working mothers not employed by the WA may have equally low incomes but would apparently be assigned a lower priority for provision of day care services. They would be unlikely to receive full subsidization of such services.

A further provision encouraging horizontal inequity is that which leaves the decision of supplementation open to the States. As a result, those welfare beneficiaries or work-program participants residing in States which legislate generous State supplementation plans would have higher total incomes than equally poor residents in low-supplementation States. However, because the committee bill enables States to raise benefit levels for welfare benefits to $2,400 for a family of four at no additional State cost, this inequity would be reduced from the one existing in the current welfare system.

Finally, because of the heavy emphasis placed on the provision of subsidized day care to single-parent families, inequity between one- and two-parent families is created. While low-income, single-parent families will have some day-care expenses subsidized, they will at some income level be subject to a tax rate on earnings net of day-care payments. Alternatively, if the mother in a two-parent family directly provides child care, there is no implicit tax rate on earnings attributable to day-care provision. By conditioning the day-care subsidy on income and making it available only to single-parent families, a tax-rate-based inequity between some equally situated one- and two-parent families is created.

Efficiency Effects

In addition to equity considerations, a second criterion used to evaluate the effectiveness of a Government expenditure program is the economic efficiency criterion which focuses on the resource allocation effect of a policy change. When this criterion is applied to an income transfer policy, it is the impact on the work-leisure choice which is a primary issue. In this regard, a work-conditioned, income-supplementation strategy embodies a quite different set of incentives than do the current welfare system, H.R. 1, or proposed negative-income-tax or credit-income-tax plans.

For example, as noted in the first section, H.R. 1, when integrated with payroll taxes and State supplements, would have imposed a marginal tax rate of at least 80 percent or more on recipient earnings. The effect of this, together with the guaranteed income obtainable without work, would have been to erode seriously the incentive for work efforts for both current AFDC recipients and the working poor. The committee bill, on the other hand, incorporates three characteristics which induce work effort.

The first characteristic is the requirement that those who are employable must engage in productive employment (not merely be available to work) in order to be eligible for an income supplement. The second is the inducement for work effort implied in the work-subsidy provision. As an example of the difference in work incentives between a negative-income-tax-type plan and a work-conditioned-subsidy scheme, table 4 compares the marginal tax

rates of a few individuals in different circumstances under H.R. 1 and under the committee bill. There it is seen that in all cases the marginal tax rate on earnings is substantially lower in the committee bill than in H.R. 1. In one-half of the cases shown for the committee bill the marginal tax rate is negative, implying that a $1 increase in earnings results in an increase in income of more than $1. The pattern of benefits and marginal tax rates for both schemes are also shown in figures 2 and 3. Figure 2 shows the relationship of total income and earnings when increased earnings result from increased wage rates; figure 3 shows the relationship when increased hours worked account for increased earnings.[21] The dashed line in figure 3 shows the relationship when increased earnings are obtained by full-time work at a wage rate which increases from $1 to $1.50 to $1.80 to $2 per hour.

A third positive work-incentive provision in the committee proposal is that which affords family heads who are working part time in regular employment the opportunity for additional work in public-service employment up to a total of 40 hours per week. By opening up additional opportunities to those seeking income beyond that attainable through part-time employment, it is likely to stimulate additional work effort by at least some workers.

Although these positive inducements for work effort are substantial, the committee bill is not uniform in its labor-supply effects. As noted in figures 2 and 3, the marginal tax rates vary significantly depending on whether incremental earnings are attributable to an increase in hours worked or an increase in wage rates. Because the wage-rate subsidy is based on the differential between the actual wage rate and the national minimum wage rate, the volume of subsidy at a given wage rate is a direct and linear function of the number of hours worked. However, efforts to increase earnings through seeking higher paid employment are not so rewarded. Indeed, increased earnings from higher wage rates erode the per hour subsidy, permitting the worker to retain only a fraction of the increased earnings from the higher paying jobs. As seen in table 4 and figure 3, the implicit marginal tax rate on earnings increases due to wage-rate increases is over 70 percent through some earnings ranges.

Moreover, while the committee wishes to encourage female family heads eligible for cash transfers unrelated to work effort to participate in the employment program on a voluntary basis, it has stipulated a tax rate on earnings for such employment (except for a small disregard) to be 100 percent.

[21] It will be noted in figures 2 and 3 that the guarantee in H.R. 1 includes the cashed out value of food stamps. While the committee proposal enables States to supplement to the equivalent of the food stamp benefits without bearing any cost, this is not included in the schedules shown.

Figure 2*

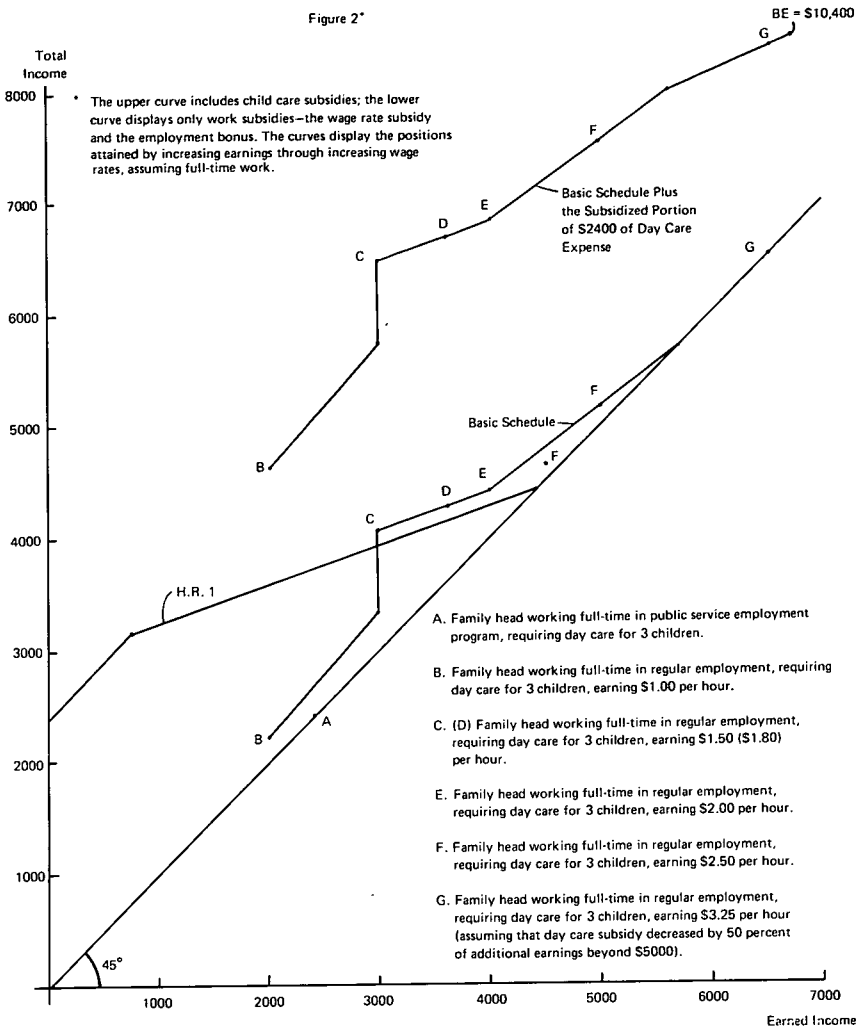
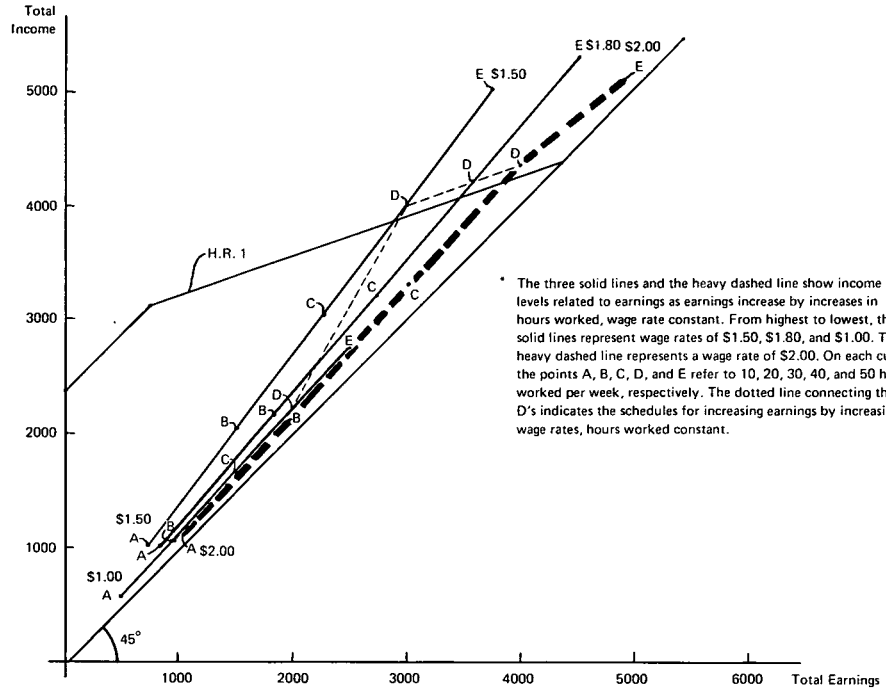

BE = $10,400
Total Income
8000
7000
6000
5000
4000
3000
2000
1000
* The upper curve includes child care subsidies; the lower curve displays only work subsidies—the wage rate subsidy and the employment bonus. The curves display the positions attained by increasing earnings through increasing wage rates, assuming full-time work.
Basic Schedule Plus the Subsidized Portion of $2400 of Day Care Expense
Basic Schedule
H.R. 1
A. Family head working full-time in public service employment program, requiring day care for 3 children.
B. Family head working full-time in regular employment, requiring day care for 3 children, earning $1.00 per hour.
C. (D) Family head working full-time in regular employment, requiring day care for 3 children, earning $1.50 ($1.80) per hour.
E. Family head working full-time in regular employment, requiring day care for 3 children, earning $2.00 per hour.
F. Family head working full-time in regular employment, requiring day care for 3 children, earning $2.50 per hour.
G. Family head working full-time in regular employment, requiring day care for 3 children, earning $3.25 per hour (assuming that day care subsidy decreased by 50 percent of additional earnings beyond $5000).
45°
1000
2000
3000
4000
5000
6000
7000
Earned Income

Figure 3*



* The three solid lines and the heavy dashed line show income levels related to earnings as earnings increase by increases in hours worked, wage rate constant. From highest to lowest, the solid lines represent wage rates of $1.50, $1.80, and $1.00. The heavy dashed line represents a wage rate of $2.00. On each curve the points A, B, C, D, and E refer to 10, 20, 30, 40, and 50 hours worked per week, respectively. The dotted line connecting the D's indicates the schedules for increasing earnings by increasing wage rates, hours worked constant.

TABLE 4.—*Some illustrations of benefits and marginal tax rates for H.R. 1 and the Senate Finance Committee bill*

	H.R. 1 [1]		Senate Finance proposal [1]				
						MTR (percent) [2]	
	Earnings	Total income	MTR (percent) [2]	Earnings	Total income	Hours [3] variable	Wage rate [3] variable
Case 1: Family with head employed at $1.40 per hour	$2,800	≈$3,500	+72.2	$2,800	$3,080	−4.8	−4.8
Case 2: Family with head employed at $1.60 per hour	3,200	≈3,850	+72.2	3,200	4,120	−23.8	+70.2
Case 3: Family with head employed at $2.50 per hour	4,500	≈4,000	+86.2 [4] (+119.2)	4,500	4,775	+30.2	+30.2

[1] For both H.R. 1 and the Senate Finance Committee bill, the cases shown assume that the family head is the only working family member and that he or she is employed in a regular public or private job. The benefits implied in the data exclude any public service employment income, State supplemental benefits, child care subsidies, or any other benefits in addition to the basic program.

[2] The estimate of the marginal tax rate on earnings cumulates the payroll tax rate and the marginal tax rate implicit in the plan for both H.R. 1 and the Senate Finance Committee bill. Those tax rates shown with a plus sign in the table are tax rates in the conventional sense; those with a minus sign are negative marginal tax rates or marginal subsidy rates. In the latter case, a $1 increase in earnings results in an increase of after-tax income which is greater than $1.

[3] For the Senate Finance Committee proposal, 2 marginal tax rates are shown. In the first case, it is assumed that the increase in earnings is generated by an increase in *hours* worked, wage rate constant. In the second case, it is assumed that the increase in earnings is generated by an increase in the *wage rate*, hours worked held constant.

[4] This extreme tax rate is due to the provision in H.R. 1 that beyond the Federal break-even States may impose 100 percent tax rates on earnings. This figure assumes that States exercise this option.

Moreover, because of likely differentials in State supplementation between welfare recipients and participants in the employment program, mothers who do volunteer may be subject to an implicit tax on earnings in excess of 100 percent. Only if such volunteering mothers could achieve earnings in excess of $2,400 per year would such confiscatory tax rates be avoided.

Finally, the committee bill contains two provisions which would discourage participants in the employment program from engaging in job training programs. As described above, while the proposal permits participants in public-service employment to opt for training rather than work, it places those who choose to do so at a financial disadvantage by delaying the time at which some income is received. Further, because the wage-rate subsidy imposes high marginal tax rates on increased earnings from higher wage rates, the incentive to upgrade one's skills and wage-rate potential is weakened.

This problem of high marginal tax rates on increased earnings from higher wage rates is further exacerbated by the failure of the committee to deal explicitly with the other income-conditioned programs from which work subsidy recipients can draw benefits. While the medicaid program would be modified by the committee to eliminate the notch, the income-conditioned nature of the benefits would persist. In addition, public housing, higher education subsidies, and the positive income and social security taxes would all add their tax rates on earned incomes to the cumulation. When all of these are considered, some work subsidy recipients would be no better off in terms of net spendable income by accepting a higher paying position. Moreover, the positive incentives for increases in earnings through increases in hours worked would be reduced by this cumulative tax rate problem.

In addition to the effects of the proposal on the labor-leisure choice, there are other important economic efficiency effects of the proposal. One of the most significant of these is the effect on real output from diverting mothers from the production of "home services" to the employment program. Clearly, a net social gain from this diversion exists if the marginal product of such a worker (as indicated by her market wage) is in excess of the value of her home services (perhaps as indicated by the costs of hiring a housekeeper in her place) plus the consumption value she places on being at home. While it is difficult to ascertain reliable estimates of these values, it is not obvious that a female family head with low skills and marginal employability will produce more in, say, a public-employment program than she would have by remaining a homemaker. Given the stated intent of the Senate committee to employ former AFDC mothers in day-care centers sponsored by the WA, it is not unrealistic to view a portion of the program as one in which mothers care for each other's children. Their activity would be called public-service employment and they would receive a pay check rather than a welfare check.

That such an arrangement will automatically increase real national output is not obvious. In sum, while the net increase in work effort outside the home (in either private or public-service employment) surely represents a gross increment to social output, it must be

compared with the value of home services forgone (including the consumption value of home work) in ascertaining the net efficiency effect of required employment outside the home.

A further efficiency effect concerns the impact of the wage-rate subsidy on factor input combinations. Viewing that subsidy as an artificial alteration in the market price of workers receiving the subsidy, employers are likely to substitute labor subject to the subsidy for both capital and labor which is not subsidized. To the extent that this artificial alteration in effective wage rates induces inefficient input substitutions—as standard economic theory would suggest—a real welfare loss must be attributed to the policy. Again, the magnitude of this efficiency effect is unknown and, in all likelihood, unknowable.

In summary, the committee bill would, in all likelihood, increase the amount of work effort by low-income family heads. It would do so by requiring employable family heads to work in order to qualify for subsidization, by raising their effective wage rates by direct subsidization, and by guaranteeing employment to those seeking work. However, the bill provides substantially greater incentives for a family head to increase earnings by increasing the number of hours worked rather than increasing his or her rate of pay. By failing to integrate the full program with other income-conditioned subsidies, the bill would confront some recipients with tax rates of nearly 100 percent on increments to earnings from improved skill levels, promotions, or job changes. Further, the bill almost completely discourages work efforts by families eligible for direct cash transfer and may generate reductions in real social output through inducing inefficient substitution of employment outside the home for home work and inefficient substitution of subsidized low-wage inputs for unsubsidized labor and capital.

Effects on the National Wage Structure

According to standard economic analysis, a wage-rate subsidy, by itself, would tend to erode the structure of wages in any given labor market. The logic is as follows: As viewed by low-wage workers, the effect of a wage-rate subsidy is to increase the effective price at which they can sell their labor. With a labor-supply curve of positive elasticity, workers will respond to the higher effective price by making available an increased supply of labor. The labor market, in turn, will respond to this shift in supply by establishing a lower observed price or wage rate. At this lower market wage rate, those workers whose wage rates are subsidized will still be better off than before the subsidy—assuming that the decrease in the market wage rate is not equal to the subsidy.

However, because of this artificially induced reduction in the market wage rate for low-wage workers covered by the subsidy, employers will have incentive to substitute such labor for higher wage, noncovered (and presumably higher skilled) workers and for capital. The effect of this substitution would be a reduction in the demand for both higher skilled labor and capital inputs, which the market would

transform into lower wage rates for higher skilled workers and a lower return on capital.[22]

Those employers able to make such substitutions would experience a reduction in production costs which, if they sold their goods in a competitive market, would result in some reduction in the price of their output. Through this mechanism some of the wage subsidy paid to low-wage workers would be passed along to consumers in the form of lower prices.

To some extent, these decreases in observed wage rates in both high- and low-skill markets will be offset by an output effect. Because of the net increase in labor supply induced by the subsidy, real output in the economy will rise. This in turn will increase the demand for labor in both high- and low-skill markets, providing some offset to the first-round wage-rate decreases. In the absence of rigidities, however, observed wage rates are likely to show some net reduction.[23]

Under some combinations of labor market circumstances, then, one might perceive the following adverse effects from a wage subsidy: [24]

(1) A reduction in the market wage rate for both low-wage workers covered by the subsidy and those who are not.

(2) Under certain extreme labor market conditions, a reduction in the market wage rate for low-skill labor sufficient to override the subsidy, leaving the low-wage worker worse off than before.

(3) A reduction in the demand for—and wage rates paid to—higher skill, higher wage labor.

(4) Under certain labor market conditions, more competition between higher and lower skilled workers in the lower skilled labor market and/or increased unemployment for low-skilled workers.

Given the current state of knowledge, it is impossible to discern which, if any, of these impacts might accompany the institution of a wage subsidy for low-wage workers. The net effect depends upon the nature of labor market imperfections, the elasticities of the supply and demand for both higher and lower skilled workers, the elasticity of substitution of high- and low-skill workers within firms and industries, and the nature of supply, demand, and cross elasticities in product markets. Simultaneous determination of the interacting effects of all of these relationships is required to answer the question with any certainty. Currently, neither the data nor the general equilibrium models are available for such estimation.[25]

This is not to imply, however, that nothing can be said about the likelihood of any of these effects developing from any specific legisla-

[22] If for some reason, the market price for these inputs (higher skilled labor) was inflexible downward, the effect of the wage subsidy would be to move some of the higher skilled labor into the lower skill labor market, further increasing the labor supply in that market and further decreasing the market wage rate in that market. Under these circumstances, it is possible that the wage rate in this market would fall to such an extent that low-wage workers receiving the subsidy might be worse off than before the subsidy was put into effect.

[23] It should be noted that if the wage rate in the market for low-wage workers was inflexible downward, the increase in labor supply induced by the wage subsidy would force some low-wage workers into unemployment. However, a possible offset to this could occur if some family heads leave private-sector jobs for public service employment, thus opening up low-wage slots for nonheads of families.

[24] Again, offsetting these adverse effects is the real output effect which would tend to increase the demand for both high- and low-skilled labor.

[25] Neil Weiner, Robert D. Lamson, and Henry M. Peskin, "Report on the Feasibility of Estimating the Effects of a National Wage Bill Subsidy," Institute for Defense Analysis, paper HQ 69–10725, September 1969.

tive proposal incorporating a wage subsidy. Consider a wage subsidy targeted on low-wage workers (say those with wage rates below the national minimum) consistent with a Finance Committee type work-conditioned, income-supplementation strategy. Presume the existence of two separate labor markets: that covered by minimum wage legislation and that not covered by the minimum wage law. Assume also a public-service-employment guarantee for any family head whose regular employment alternatives are less desirable than the guaranteed public employment. Finally, assume that minimum wage legislation constrains most employers from substituting workers not covered by the minimum wage law for workers who are.

In this context, it seems unlikely that the demand for higher skill workers and the prevailing wage paid them would be greatly undermined by the wage-subsidy provision of the program. This erosion can occur only if employers can easily substitute low- for high-skill workers in response to a change in relative prices.[26] Such substitution is difficult given the influence of labor organizations and the industrial coverage of minimum wage legislation.[27]

Without this erosion in the market for higher skill labor it seems unlikely that substantial additional competition between high and low skill would be induced. As a result, it is most unlikely that workers newly covered by the subsidy could receive lower net wages after the institution of the subsidy than before.

However, if by some set of circumstance—perhaps, wage inflexibility again—some workers in the low-skill (covered) labor markets are forced into unemployment because of the increase in labor supply induced by the subsidy, real costs could occur. It is with respect to such occurrences that the strategy provides the guarantee of public-service employment. With the guarantee, low-wage workers experiencing unemployment or wage-rate reduction are presented with an alternative which may be superior to their situation prior to the effects of the wage-rate subsidy, let alone after the possible adverse effects of the subsidy have occurred.

On the basis of these considerations, it appears that, especially in the face of existing labor market inflexibilities caused by minimum wage laws and labor organizations, the work-conditioned, income-supplementation strategy offers protection against many of the possible adverse effects of a wage-rate subsidy on workers in most skill and wage-rate categories. Due to industry coverage of the minimum wage, the subsidization of low-wage workers, and the guarantee of public service employment, few workers are likely to be adversely affected by potential wage rate erosion induced by the wage subsidy.[28]

Finally, the small size of the subsidy relative to the market for low-wage workers should be noted. In 1966, approximately 32 million workers had wage rates below $2 per hour according to the Survey of Economic Opportunity. This group of workers earned in excess of $50 billion. It seems highly unlikely that a $2 to $3 billion wage-rate subsidy targeted on this group of workers would seriously erode the wage structure of the labor markets in which they operate.

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[26] It should be noted, however, that some substitution of this sort will occur as a matter of course if the price of goods produced by low-skill-intensive industries falls relative to the price of goods produced by high-skill-intensive industries.

[27] Again, recall the real output offset to the reduced demand for both high- and low-skill labor.

[28] Most of those adversely affected will be nonheads, who are not eligible for wage subsidization or public service employment.

Questions of Administrative Feasibility

It seems to be an axiom that issues of administration pose serious questions of feasibility for all proposed modifications of the public-assistance system. Issues of administrative discretion regarding categorization, reporting, eligibility and benefit determination, termination, and social service provision have plagued the current welfare system for many years. Neither H.R. 1 nor the Finance Committee proposal avoids these problems. In fact, because the committee proposal (and to a lesser extent, H.R. 1) involve the integration of public employment and additional in-kind benefit and service programs with cash transfers, the problem of discretion is likely to be exacerbated. Moreover, the difficulties inherent in implementing programs requiring interagency coordination are expanded severalfold in both of these proposals. For example, the Finance Committee proposal would not only establish several new programs, it also imposes administrative responsibilities on three separate agencies. Any person covered by legislation could receive benefits and services from three to four different programs and from as many different offices.

Some sense of the extensiveness of these administrative difficulties can be gained by an enumeration of the primary new administrative tasks implied by the committee proposal. One of the most basic new responsibilities is the separation of the population of current welfare recipients into employables and welfare eligibles. While the basic rules for distinguishing the status of different recipients have been suggested, numerous special situations are inevitable and unspecified in the rules. With such special situations the basic difficulty of categorization becomes even more severe and the opportunity for horizontal inequities through administrative discretion becomes enormous.[29]

A second major set of administrative responsibilities and difficulties is associated with the development of the Work Administration. As described in the proposal, the WA will have a number of options in dealing with an employable family head who is guaranteed public-service employment but who does not already have a job:

(1) The WA can work with private-sector employers to secure regular employment for applicants. In this case, the applicant, once placed in a job, would deal directly with the employer in negotiating the terms of employment.

(2) It can work with public-sector employers in much the same way to gain regular employment for applicants.

(3) It can provide special public-service employment to applicants who cannot be placed in regular public or private employment. This requires the WA to either create an enterprise employing labor and producing outputs or services for "the betterment of the community," or to hire out employees to private or regular public employers on a temporary basis.[30]

All of these activities imply enormous new responsibilities in the areas of job development and job placement.[31] To accomplish them

[29] It should be noted that H.R. 1 also required a separation of those families with and without an employable head and was thus subject to these same difficulties.

[30] In the latter case the payment would be made directly from the employer to the WA and wages would be paid by the WA to the workers.

[31] As noted above, the development of a large scale day care program and the employment of participants in the employment program in it is also envisioned to be one of the primary responsibilities of the WA.

with creativity, efficiency, and equity is a major new and difficult undertaking. Consider, for example: How does the WA deal with a worker who refuses to accept private-sector employment to which he is referred? How does the WA determine if a private-sector job is appropriate for regular placement of an applicant or if the job is a temporary one which the employer should contract out to the WA? On what basis does the WA declare that a rural applicant is too remote from a WA office to require public-service employment in order to be eligible for benefits? How is the danger of "dead-end" jobs to be avoided as the WA seeks to create jobs for "the betterment of the community?" How does the WA deal with recalcitrant employees in the special public service part of the program? What is the maximum length of time that a person can remain in special public-service employment? What can the WA offer to employers to induce them to deal with it rather than fill job openings in the open market? The alternatives open to the WA in all of these areas imply the necessity to exercise enormous administrative discretion.

As the proposal is now structured, a person could be in several different programs over the course of a year. For example, a person could be in special public-service employment and, hence, ineligible for the wage-rate subsidy or earnings bonus, in regular employment in the private sector and either eligible or ineligible for both the subsidy and the bonus, or in the residual AFDC program. In each of these situations, the individual would be eligible for packages of benefits of one type or another. The recordkeeping effort required to account for these changing situations for, say, 10 million families is mind-boggling. Moreover, depending on the accounting periods used for determining payments and the mode of payment, these basic difficulties could be compounded.

A further administrative difficulty stems from the dependence of the wage-rate subsidy on the reported wage rate. Because of this dependence, an incentive is created for both the subsidized worker and his employer to collude in reporting a lower than actual wage rate and a larger number of hours than actually worked for any given earnings level. In this way the subsidy payment would be increased over its appropriate level and both employer and employee could gain. The enforcement of prohibitions against this practice would be a difficult undertaking. Moreover, because the standard employee paycheck shows only total earnings, it fails to yield the information required to determine eligibility for the subsidy and the amount of subsidy to be paid. As a consequence, special documentation would be required for determination of the appropriate subsidy to be paid.

In addition to these administrative difficulties, a number of additional problems inhibit the implementation of the special public service employment program. The first of these is the inevitable competition of special public service employees with regular public employees if the WA negotiates such special positions within Government agencies. A second problem is that of locating appropriate work for a population which is primarily female when most tasks in the public sector are thought of by many as "male jobs." [32] Finally, it appears that many State governments would be reluctant to partici-

[32] This point was emphasized by several State Governors who responded to questions of the Senate Finance Committee regarding the potentiality of such a program.

pate in such a program if the Federal Government paid only the salary of special public-service employees. State governments have emphasized the need for the Federal Government to cover other associated costs of the program—supervisory, equipment, space, and supply costs—if they were to be induced to accept special public-service employees.

IV. An Alternative Work-Conditioned, Income-Supplementation Program—the Earnings Subsidy

While the Senate Finance Committee bill has a number of equity, efficiency, and administrative problems, it represents an income-maintenance strategy with work incentive and income support characteristics which are attractive to many. In this section, the dimensions of an alternative program of work-conditioned subsidies is described and critiqued. The objective is to retain some of the desirable characteristics of the committee bill while correcting several of its structural problems. This alternative incorporates all three of the attributes essential to a work-conditioned, income-supplementation strategy—direct cash transfers for those not expected to work, work subsidies for low-income family heads with jobs, and guaranteed employment for poor families with employable heads unable to secure a job. Its major provisions would include:

1. An employability criterion.—This proposal, like that of the Finance Committee and H.R. 1, would require the categorization of low-income family heads into two groups: those who are employable and those who, because of disability or severe child care responsibilities, are not expected to work. While the criterion proposed by the Senate Committee recognizes a number of the determinants of "employability," a more comprehensive criterion is required. This criterion should perhaps consider the number of children as well as the age of the youngest child. If the program is to be integrated with day-care subsidies, the determination of employability on the basis of number of children can be justified on efficiency grounds. It should also incorporate comprehensive standards for determining the seriousness of partial disabilities.

2. A cash transfer program.—Both male and female single-parent families without an employable head would be eligible for direct cash benefits unrelated to work effort. A Federal minimum of $3,000 for a family of four would be guaranteed, with States remaining free to supplement incomes above the Federal minimum but with no added Federal funding. The guarantee would be reduced by $2 for every $3 of other income—earned and unearned. The Federal Government would administer the program.

3. A public-service-employment program.—All family heads found to be employable would be guaranteed a special public service job paying three-fourths of the national minimum wage. Assuming the national minimum wage to be $2 per hour, this implies a public-service wage rate of $1.50. Work for up to 40 hours per week would be offered, implying an income guarantee of $3,000 per year.

4. An earnings subsidy.—All families would be eligible for a subsidy on their earnings from regular public- or private-sector jobs. Moreover, low-income family heads could add special public-service-employment income to subsidized earnings up to a total income level of $3,000 per year without facing a positive marginal tax rate.

The earnings subsidy would be paid at a 50 percent rate on regular family (sum of husband's and wife's) earnings up to $2,000. Hence, a family head working one-half time at the minimum wage rate of $2 per hour (hence earning $2,000) would receive a subsidy of $1,000, yielding a total income of $3,000. Beyond earnings of $2,000, the worker would fall on a schedule implying a positive marginal tax rate of 33 percent. The breakeven point would occur at $5,000. Table 6 illustrates the earnings subsidy schedule applicable for low-income families who engage only in regular private- or public-sector employment.

In addition to being in either the special public-service-employment program (without the earnings subsidy but guaranteeing an income level of $3,000) or employed in a regular private or public job, a worker could combine both. For a worker with some regular earnings, the special public-service program could be used to supplement private matched earnings up to a total of $3,000 without an erosion of marginal earnings through the implicit tax rate. Beyond $3,000, incremental public-service-program earnings would be subject to the 33 percent tax rate. Similarly, a worker with some special public-service earnings could use regular (subsidized) earnings to supplement public earnings up to the $3,000 level without an erosion of marginal earnings. Again, total earnings in excess of $3,000, but below the breakeven point, would be subject to the implicit 33 percent tax rate. Table 7 illustrates the total income pattern for low-income workers who engage in either regular public- or private-sector employment or special public-service employment or who combine these alternatives in various proportions.

TABLE 6.—*Net allowances from the earnings subsidy for a family with regular employment income*

Family income before allowance	Net allowance	Income after allowance	Marginal tax rate
0	0	0	
$500	$250	$750	−50
$1,000	500	1,500	−50
$1,500	750	2,250	−50
$2,000	1,000	3,000	−50
$2,500	883	3,337	+33
$3,000	666	3,666	+33
$3,500	500	4,000	+33
$4,000	333	4,333	+33
$4,500	167	4,667	+33
$5,000		5,000	+33

In the table, several patterns are of special interest. First, the very large incentive for increased regular employment (provided by the 50 percent subsidy on private earned income up to $2,000) is seen in the first column. As regular earned income increases from $500 to $1,000 to $1,500 to $2,000, total income increases from $750 to $1,500 to $2,250 to $3,000. This incentive for increased regular employment is also seen by reading across the rows. For any level of earned income up to $4,000, the level of total income is inversely related to the proportion of it which is earned in the special public-service employment.

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Second, the effect of the 33 percent tax rate on income over $3,000 is seen by reading down any of the columns. This tax rate—which assures that the breakeven income level will not exceed approximately $5,000—has yet another impact which is observable in the table. While individuals who have some income from regular employment would be eligible for a total of $3,000 of special public-service income, any such income earned after a total income level of $3,000 has been attained would be subject to the 33 percent tax rate. In effect, such earnings would entail employment at 67 percent of the hourly wage rate paid for special public-service employment—or about $1 per hour. Few would be expected to make themselves available for the public program at this hourly rate. Consequently, this provision assures that excessive use of the public program will be minimal.

Finally, it should be emphasized that in all cases in the table showing total income of less than $3,000, family heads could obtain additional tax-free income by taking advantage of the special public-service employment guarantee. (These cases are denoted by footnote reference 1, table 7.) As shown in the table, then, these cases represent individuals who choose not to avail themselves of the $3,000 public-service guarantee which is open to them.

Several of the combinations implicit in table 7 are shown in figure 4.

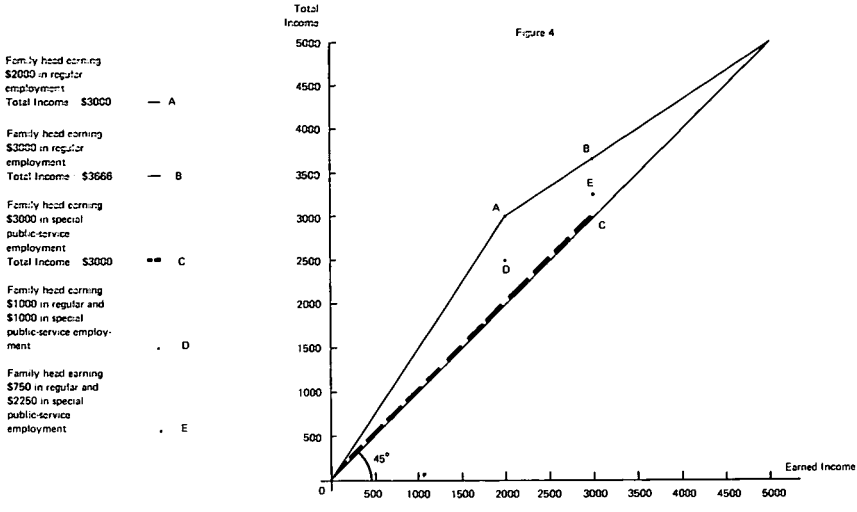
5. A children's allowance.—A notable characteristic of the earnings subsidy and public-service employment programs is the absence of differential subsidization based on family size. To condition employment-based subsidies on family size would entail the payment of a variety of wage rates for the same work effort, hence violating the principle of "equal pay for equal work."

To provide some family-size-conditioned subsidy differential, the structure of low-income subsidies described in points 2 and 4 would be supplemented by the payment of a children's allowance for families in excess of four members. In order to recognize the economies of scale in family size, grants of, say, $300, $180, and $120 would be provided for the fifth, sixth, and additional members of a family unit.

TABLE 7.—*Total income by earned income level and by the regular employment, public-service-employment division of earned income for a family head*

Earned income	100 percent private	75 percent private, 25 percent public	50 percent private, 50 percent public	25 percent private, 75 percent public	100 percent public
$500	[1] $750	[1] $687	[1] $625	[1] $562	[1] $500
$1,000	[1] 1,500	[1] 1,375	[1] 1,250	[1] 1,125	[1] 1,000
$1,500	[1] 2,250	[1] 2,063	[1] 1,875	[1] 1,687	[1] 1,500
$2,000	3,000	[1] 2,750	[1] 2,500	[1] 2,250	[1] 2,000
$2,500	3,337	3,293	3,125	[1] 2,812	[1] 2,500
$3,000	3,666	3,666	3,500	3,250	3,000
$3,500	4,000	4,000	3,912	3,625	[2]
$4,000	4,333	4,333	4,333	4,000	[2]
$4,500	4,667	4,667	4,667	[2]	[2]
$5,000	5,000	5,000	5,000	[2]	[2]

[1] Any individual with total income below $3,000 is eligible for additional public-sector earnings equal to the difference between the total income figure shown and $3,000 without an erosion of marginal earnings.
[2] Not applicable, in that public-sector earnings cannot exceed $3,000 per worker.



Such family-size-conditioned subsidies are most important for large families with very low incomes. At higher income levels not only is the ability to support large families greater but, in addition, through the personal exemption provision of the Federal income tax, large families which pay Federal taxes receive substantial implicit family-size-conditioned subsidies. To accommodate the goal of targeting the family-size-conditioned benefit on those with very low incomes:

(*a*) The total children's allowance benefit would be reduced by $0.10 for every dollar earned in special public-service employment.[33]

(*b*) The total children's allowance benefit would be reduced by $0.15 for every dollar earned that was subject to the earnings subsidy.[34]

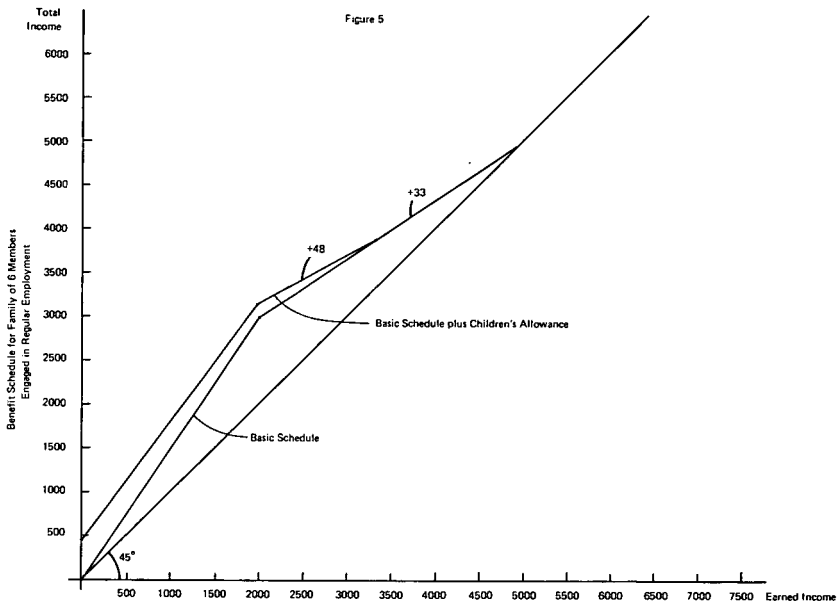
The total benefit schedule for a family of six members with earnings only from regular employment is shown in figure 5.

6. Integration with child care subsidies.—Substituting a work-conditioned, income-supplementation strategy for the current welfare system would require additional work effort from numerous female heads with school-age children and from long-term unemployed male family heads. Hence, subsidization of after school and full-time summer day care would appear to be an essential part of such a policy shift.

There are two standard means of integrating a program of child care support with an income-supplementation program. The first is through a system of child care expense deductions from gross earnings. The second is through either direct governmental provision of child care services or direct Government payment of child care expenses privately purchased.

[33] Hence, the head of a five-member family working full time in special public-service employment would receive no net children's allowance. If the family had six members, children's allowance benefits would be $180.

[34] The head of a family of five (six) with only regular employment earnings would experience a breakeven earnings level on children's allowance benefits of $2,000 ($3,200). It should be noted that the differential marginal tax rate modestly reduces the relative incentive to seek regular employment as opposed to special public service employment.



In the first case—deductibility of child care expenses from gross income—the implicit marginal tax rate on earnings determines the portion of child care costs which are borne by the Government and the portion borne by the family. Hence, if the marginal tax rate is 0.5, child care expenses will be shared equally by the program and the family; if the marginal tax rate is 0.67, the Government will bear two-thirds of the cost of child care.

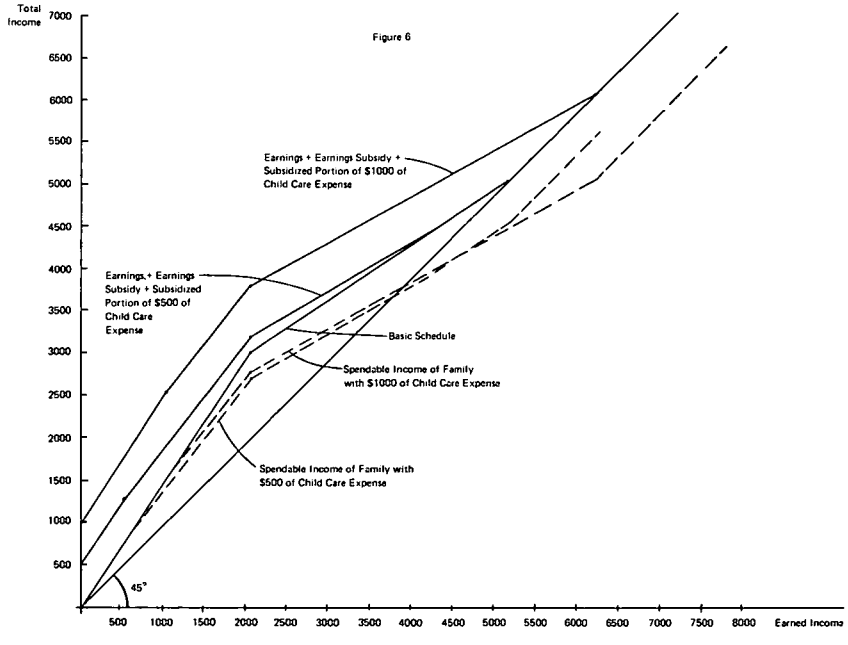
Subsidization of child care through deductibility is impossible to integrate with an income-supplementation program in which there are negative marginal tax rates on earnings, as in both the earnings and wage-rate subsidy plans. A standard deductible arrangement here would entail the family's bearing of more than 100 percent of the cost of child care.

The alternative in such a situation would be for either direct Government provision of services or reimbursement for services purchased privately. If this form of subsidization is to be targeted on the poor, the subsidy must be income conditioned. Three difficulties are encountered with this form of subsidization. First, for large single-parent families—say, three or more children requiring child care—this may entail Federal subsidies in excess of the earnings of the parent. Some would regard such public expenditures as inefficient when the alternative is for the parent to stay at home, produce his or her own child care services, and support the family from direct cash transfers. Second, because such income-conditioned child care subsidies cause the breakeven income level to be extended beyond that implied by cash subsidies, the budgetary costs of the program become very large. The target efficiency of the program becomes simultaneously reduced. The third difficulty is the standard one of cumulative tax rates. Given the substantial costs of child care services, the implicit tax rate required to achieve an acceptable breakeven level

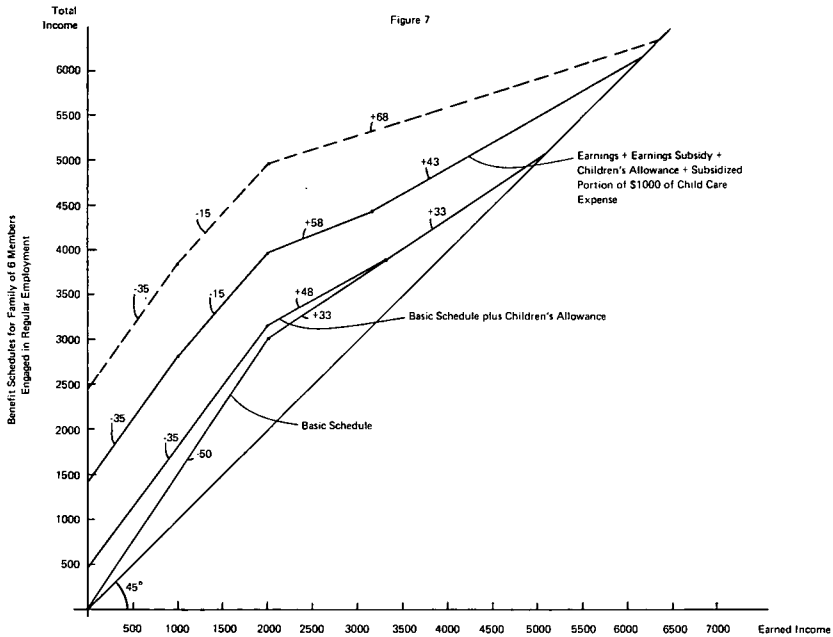
may be very high. When this tax rate is combined with the tax rate on income-conditioned cash subsidies, the cumulative tax rate may be prohibitive.

The first of these problems can be mitigated by including the number of children requiring child care subsidization in the criterion of "employability." Hence, a mother with, say, six children from ages 6 to 12 would be eligible for direct cash transfers unrelated to work plus the children's allowance.

One possible way of alleviating the second and third problems for families receiving the 50 percent earnings subsidy is to require the family to begin sharing the costs of child care in the income range at which the subsidy is still in effect. This would reduce the need for a high implicit marginal tax rate through the income range where tax rate cumulation is a problem. Such an arrangement is shown in figure 6 for child care expenses of $500 and $1,000. In this situation, the full cost of child care would be borne by the Government while family earnings were less than or equal to child care costs. From that earnings level to $2,000 of earnings—at which level the 50 percent earnings subsidy is replaced by a 33 percent tax rate—an implicit tax rate of 20 percent would be imposed on earnings in order to reduce gross child care subsidy. This would effectively reduce the earnings subsidy from 50 to 30 percent through this range. Beyond $2,000 of earnings (implying at least $3,000 of total income for workers in regular employment), the child care subsidy would be taxed at a rate of 10 percent. This implies a cumulative tax rate of 43 percent from $2,000 to either the new higher breakeven point or the earnings level beyond which no child care subsidy is provided.



In figure 7, the integrated benefit schedule is shown for a family of six with earnings from regular employment, children's allowances of $480 at zero earnings, and $1,000 of child care expense. The upper solid line shows that the cumulative tax rate varies from −35 percent to +58 percent. The high tax rate of 58 percent is the result of the implicit tax rates on the earnings subsidy (33 percent), the children's allowance (15 percent), and the day-care subsidy (10 percent). The breakeven earnings level for such a family is about $6,200.



7. Integration with State supplementation.—States would be permitted to supplement the incomes of families whose heads are employed in special public-service jobs or whose earnings from regular employment are subsidized. However, such supplementation programs would be constrained in the following ways:

(*a*) State supplemental benefits would be based on the assumption that total income (including Federal subsidies) is at least $3,000 even if it is less than $3,000.

(*b*) Where children's allowance subsidies do not extend above earnings levels of $2,000 (families of less than six members), the supplementation program would be limited to a marginal tax rate of 25 percent. This tax rate would apply to earned income from $2,000 to $5,000. For incomes above $5,000, the program would be limited to a tax rate equal to the sum of the tax rate on the supplemental program (25 percent) and the tax rate on the Federal earnings subsidy (33 percent). This implies a maximum combined tax rate from Federal and State income supplementation programs of 58 percent. Including child care subsidies, the maximum marginal tax rate would be 68 percent.

(*c*) Where children's allowance subsidies do extend above earnings levels of $2,000 (families of six or more), the supplementation program would be limited to a tax rate of 10 percent over the earnings range through which children's allowance subsidies are paid. For earnings ranges above that amount, the provisions of (*b*) would apply.

The benefit schedule for a family of six with $1,000 of child care expense and with State supplemental benefits of $1,000 is shown as the dashed line in figure 7. This schedule incorporates the provision for adjusted tax rates for families with children's allowance subsidies which extend above earnings levels of $2,000.

8. Refund of payroll taxes.—Families with earnings from special public-service employment or those receiving the earnings subsidy would receive a refund of social security taxes paid on earnings.

9. A ceiling on the number of programs in which a family may participate.—As the preceding analysis has shown, marginal tax rates march up to a significant level when a family participates in the earnings subsidy program, the children's allowance program, the child care subsidy program, and the program of State benefit supplementation. These programs by no means exhaust the list of Federal in-kind and cash transfer programs with benefit levels which are income conditioned. Consider, for example, existing medical care programs, public housing programs and other housing subsidies, higher education subsidy programs, veteran's benefit programs, unemployment compensation benefits, and social security survivor benefits. Moreover, recent proposals for subsidized health care have high benefit levels and implicit marginal tax rates of 25 percent or more on earnings. Participation in several of these programs implies marginal tax rates well in excess of 100 percent and a total elimination of work incentives.

A number of techniques exist for reducing this cumulative tax rate problem including the taxation of the benefits of one program in the benefits of another, the sequencing of programs, and the use of the deductibility procedure.[35] While each of these techniques can reduce the cumulative tax rate below the simple sum of component program tax rates and below 100 percent, none keep the cumulative tax rate from closely approaching the 100 percent level. An alternative to these techniques which could restrain the cumulative tax would be to establish a ceiling on the number of programs from which a family can receive benefits. Having established the ceiling, families could choose among that set of available program benefits which best fit their needs and tastes.

For example, a standard integrated income-supplementation program for the Nation's families could be defined to be the earnings subsidy, children's allowance, child care, and State supplementation programs, the integrated benefit schedule of which is shown in figure 7.[36] Any family which desired to draw benefits from a program not

[35] These techniques have been analyzed in Henry Aaron, "Why Is It So Hard to Reform Welfare?", Brookings Institution, 1973, and Thad Mirer, "Alternative Approaches to Integrating Income Transfer Programs," U.S. Congress Joint Economic Committee, Subcommittee on Fiscal Policy, *Studies in Public Welfare* No. 4 (Washington, D.C.: U.S. Government Printing Office, December 1972).

[36] One might also wish to include the national health care program covering poor families.

included in this set (say, public housing or veteran's benefits) would have to agree to cede benefits from any one of the included programs (say, State supplements) at its own choosing. Participation in two nonincluded programs would require the ceding of benefits from any two included programs. This provision would be combined with a maximum implicit tax rate on any nonincluded program of, say, 10 to 15 percent. This sort of ceiling could restrain the cumulated tax rate from ever exceeding approximately 70 percent.

Such a ceiling on participation would require coordination among the various programs to insure that benefits were not being received from an excessive number of programs by any given family. While such a ceiling on program participation restricts the extensiveness of program participation in order to place an effective maximum on the cumulated tax rate, it does provide substantial choice among beneficiaries concerning program participation.

The alternative program of work-conditioned income supplementation described by these provisions (points 1 to 9) was designed to correct some of the structural problems in the Senate Finance Committee proposal, while retaining its desirable work-incentive characteristics. In addition, it was designed to highlight the difficulties of integrating the several components of income support inherent in the strategy (and in all other welfare reform proposals) with the plethora of other income-conditioned subsidy programs. In considering the problem of program integration, it was concluded that the devices of program sequencing and deductibility would not keep the cumulative tax rate from approaching 90 percent or more. The proposed ceiling on the number of programs from which a family could draw benefits could constrain the cumulative tax rate to below 70 percent.

The major difference between the alternative proposal and that of the Senate Committee is the substitution of the earnings subsidy for the wage-rate subsidy and earnings bonus. In addition to increasing the negative marginal tax rate on earnings to give additional work incentive and subsidization to low-income families, the earnings subsidy simplifies administration of the program by replacing two work-related programs by one. Further, it eliminates both the incentive for beneficiary fraud implicit in a subsidy focused on the wage rate and the comparative disincentive for seeking job training, advancement, and new positions with higher wage rates as opposed to working more hours which is also implicit in the wage-rate subsidy. Finally, the important incentives to seek regular employment rather than accept special public-service employment are strengthened in the alternative proposal.

However, because it would also lead to an increase in the supply of low-wage workers, the alternative proposal would have much the same sort of effect on market wages and the combination of low-wage workers, high-wage workers, and capital inputs employed in the economy. However, as indicated above, while the direction of the effects of these changes is known, their size is not likely to be substantial.

Because this alternative combines the basic components of the committee bill, it too would have a high target efficiency (or anti-poverty effectiveness). The larger earnings subsidy which it provides to families earning very low wage rates or working part time—likely

characteristics of current welfare recipients who would be declared employable—would tend to increase the target efficiency of the program.

By incorporating a children's allowance, the alternative eliminates the lack of family-size-conditioned subsidies inherent in the Senate bill. Because many of the poorest families are the very large families, this provision would also have a high target efficiency. While these are attractive equity effects of the alternative, it does very little to remove the several horizontal inequities of the Finance Committee bill.

Finally, by eliminating one incentive for fraud, the alternative eliminates a major administrative problem with the Senate bill. However, most of the other administrative difficulties inherent in that bill are also present in the alternative proposal. These include the difficult—and perhaps insoluble—administrative problems in implementing a major public-service employment program and the leeway for substantial discretion in applying a criterion for categorizing the poor.

In conclusion, then, the alternative proposal remedies many of the maladies of the Finance Committee bill and moves toward integration of a work-conditioned, income-supplementation strategy with other income-conditioned programs. However, it does not eliminate other difficulties of such an income-maintenance strategy. Because of its emphasis on the employment of the heads of single-parent families, the proposal is still subject to the criticisms levied against any "workfare" proposal. It, however, strives to avoid the epithet of "slavefare." While requiring work effort, the proposal not only guarantees employment but provides sizable financial supplements to earnings. At a minimum, the alternative proposal should enable the work-conditioned, income-supplementation strategy to be considered without the unnecessary difficulties of the Finance Committee proposal.

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CATEGORICAL PUBLIC EMPLOYMENT GUARANTEES: A PROPOSED SOLUTION TO THE POVERTY PROBLEM

By ARNOLD H. PACKER*

I. INTRODUCTION AND SUMMARY

The problems of poverty and income distribution will probably be the most important domestic issue facing the United States in the coming decade. The problem is especially complex because the issues require judgments on nonscientific questions of equity as well as on matters of economics and sociology.

This paper describes an approach that is somewhat different from those that have been seriously considered during the last decade. It is an attempt to resolve the dilemma of providing adequate incomes to the needy and substantially more to those who work. On the one hand, it is hard to believe that a family of four can be decently supported at this time on much less than $5,000. On the other hand, the large number of workers whose take-home pay is barely over $5,000 cannot be expected to accept a system in which $5,000 is given to welfare families that make no constructive contribution in return.

The solution suggested in this paper is a system of guaranteed public employment and income transfers that would provide each family or individual with an income equal to a specified fraction of the median income. Heads of families with children would be offered full-time jobs providing take-home pay equal to half the median family income (for those with two children), which would have been $5,000 in 1970. Single heads of families with children would be able to choose either these full-time positions, or half-time positions providing take-home pay equal to three-eights the median, or $3,750 in 1970. Families in certain circumstances would be able to choose among either of these employment opportunities or a transfer payment equal to one-quarter the median income ($2,500 in 1970). Somewhat different choices would be made available to couples without children and to unmarried individuals.

Any proposal in this field rests on an evaluation of the current situation, assumptions about human behavior, and value judgments about equity. A major burden of this paper will be to make explicit the

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Thanks also go to the Bureau of the Census for making available certain unpublished data. The views expressed are the author's own and do not necessarily reflect the opinions of any of the above mentioned readers nor of anyone associated with any organization with which he is, or has been, associated.

assumptions and judgments upon which this proposal rests so that the reader can judge for himself. This is unlikely to be wholly successful; unfortunately, some assumptions will remain implicit.

The component parts of the suggested program cannot be evaluated piecemeal but must be considered as a complete system because the issues involved are generally interdependent. Therefore, individual subjects could not be treated in a neat sequential manner, examined once, and disposed. Instead, many points are treated briefly, dropped, and then discussed more fully at a later point. Interdependencies are especially important in considering the benefits available to different categories of individuals (for example, family heads, heads of single-parent families, unmarrieds). The proposed benefits and job opportunities have been designed to make the economic incentives as neutral as possible with respect to decisions concerning family structure. Changing the benefits available to only one group may destroy the desired neutrality; thus, the proposals must be considered simultaneously.

The danger of creating adverse incentives with regard to family structure is the reason why approaches that do not discriminate by family status are generally preferred over categorical approaches such as that described here. However, the desire to limit the total cost of the proposal as well as the difficulty in designing a practical noncategorical approach that does not create as many incentive problems as are avoided led to the proposed system of categorical public employment guarantees.

The proposal is the product of a three-step procedure: A choice of an analytical methodology; a set of behavioral assumptions (only some of which are empirically supportable); and the derived conclusions. Each of these steps is subject to error. This methodology may be incorrect; crucial questions may have been ignored or it may not be necessary to resolve the issues raised before proceeding to a solution. Even if the approach is correct it is quite possible that the assumptions are incorrect. Or, finally, it is possible that the analysis and assumptions are correct but they lead to a different set of policies than those described. In sum, this paper is not intended as a set of final recommendations but rather as exploration of this complicated and important problem. Finally, many important issues that are relevant to the subject of this paper are either ignored or disposed of in a sentence or footnote. However, many of these would require papers of their own and this paper is already longer and more complicated than desirable.

A. Alternative Approaches

The defeat of the administration's welfare reform legislation and the adverse reaction to Senator McGovern's original proposal to provide a "demo-grant" of $1,000 to every individual makes it clear that the country is still a long way from finding a solution to poverty in the United States. It is also clear that the problem cannot be solved without considering the distribution of incomes or, at least, the relative positions of the poor and middle classes. A proliferation of programs, legislation, and court decisions intending to affect income distribution has already taken place. Controversy over tax reform,

income policies, minimum wage rates, medicaid, property taxes, per pupil expenditures, and aid to higher education is, in a basic sense, controversy over the distribution of income. Yet, there has been little discussion—in either public or academic arenas—of what constitutes either an appropriate distribution of income or a fair structure of rewards for contributions made or effort put forth within the American socioeconomic framework. The result has been a multitude of overlapping and sometimes conflicting programs, a tax system characterized as riddled with loopholes, a transfer system referred to as a "welfare mess," and an income distribution that has remained essentially unchanged for the last 20 years.

There are three major ways in which the Government has tried to eliminate poverty and directly influence the income distribution; they are:

(*a*) *The tax-and-transfer approach* in which the Government attempts to change the distribution directly by taxing the nonpoor and transfering the money to the poor.

(*b*) *The human capital approach* in which the Government attempts to equalize opportunities and abilities to earn income by fair employment laws, and by education and manpower training programs.

(*c*) *The market-structure approach* in which the Government attempts to modify labor markets so that earned income will become more equal. Minimum wage legislation and, in a more complicated way, high-employment policies, are examples of this approach.

The point-of-view underlying this paper is that the market-structure approach offers a significant and, as yet, unexploited potential for alleviating the poverty problem. A great deal of the paper is addressed to outlining programmatically one way in which this could be accomplished.

B. An Overview

Section II is an attempt to define the fundamental issues of equity and efficiency in order to state the general objectives of any program designed to maintain adequate incomes. The conclusions are that equitable solutions to the poverty problem must consider at least part of the broader question of income distribution and define "poverty" in relative terms. Therefore, the paper does not focus only on those below the official poverty line but, instead, examines the distribution of income among all quintiles of the population, dealing primarily with the lowest two quintiles. The discussion in section II suggests that, for the two lower quintiles, the normative problem of determining the proper distribution is not primarily a problem of reconciling efficiency and equity objectives because, in many respects, these objectives are complementary.

The proposal is outlined in section III. The keystone is a guarantee of a full-time job at half the median family income for each head of a family that contains children. A half-time job paying three-eighths the median income would also be available to heads of single-parent families. Different options are provided to unmarried individuals and families without children. Transfer payments equal to one-quarter of

the median are made available to single-parent families with preschool children and to families headed by aged or disabled persons. The proposed system would replace current welfare programs, including medicaid and most payments in kind, and remove the rationale for minimum wage laws. Social security would also be transformed on a gradual basis so that it would become a needs-tested income maintenance system with an optional annuity. The income maintenance system would guarantee an income equal to one-quarter of the median income ($2,500 in 1970) to all aged (or disabled) families. The benefit would decline, however, as income from other sources increased so that aged families in the top half of the income distribution would receive only the proceeds of their optional annuity.

This concludes the first half of the paper; the second half—sections IV and V—is more technical. The first part of section IV is an empirical examination of the current (1970) income distribution. The approach is to disaggregate the family income data so that three demographic groups can be separately examined. The three are: Two-parent families headed by a nonaged adult; families with children headed by a single parent; and families headed by an aged person. The analysis finds that transfer payments, property income, and other unearned income, taken together, have had little effect on the distribution of income among quintiles. The interquintile differences in income is a result of differences in earnings per worker and, to a lesser extent, workers per family. Next, the definitions and objectives of section II are used to examine the current income maintenance programs. An across-the-board analysis finds that objectives of current programs are often contradictory and that, in general, the programs are neither equitable nor efficient. These findings and the analysis of section II support the conclusion that the most successful solution to the problem will require changing the distribution of earned income rather than directly transferring income among quintiles. Section IV concludes with a brief review of recent investigations that cast doubt on the belief that equality in earned income can be achieved by traditional education or manpower training programs or other means of equalizing investment in human capital.

Thus, section IV looks retrospectively at the existing situation and the effect of earnings and programs on the shape of the income distribution; section V projects, in a very rough way, the effects of the proposal described earlier.

The proposal is designed to alter the income distribution and, in particular, to truncate the "obscene" tail to the left of some standard of decency in a way that is fair to the remainder of the population. Adequately paid guaranteed employment for family heads, along with the removal of minimum wage laws, would modify the income distribution; projection of the changed income distribution is provided in section V. The income share received by the lowest quintile is estimated to increase by two percentage points (from 5.5 percent to 7.5 percent of the total) at the expense of the three highest quintiles. Section V also contains a rough estimate of the proposal's annual cost—$15 billion if it were in effect in 1970. The effect on the income distribution of alternative methods of financing the $15 billion is also considered.

The proposal outline presented in section III is not a complete and detailed description of a fully developed plan. Many important but subordinate issues would have to be resolved before the description would be complete. Similarly, the cost estimate presented in section V is quite rough and depends on many untested assumptions about the response of individuals, firms, and governments to the guarantee. However, it is hoped that the proposal outline is sufficiently detailed and the cost estimate is sufficiently accurate that a tentative decision on the value of the proposal can be made by the reader. If it were decided that the solution to the poverty problem should include the features outlined in this paper it would then be necessary to complete the specification and the analysis.

To recapitulate, the remaining four sections will approach the problem in the following way: Section II discusses the concepts of equity and efficiency; section III presents the proposal; section IV analyzes the current situation; and section V projects the estimated change in the income distribution that is anticipated from the proposal as well as its estimated cost.

II. Efficiency and Equity: Conflicting or Complementary Objectives?

Every society must continually solve the fundamental and perpetual problem of reconciling efficiency and equity. The distribution of income among its population is the empirical result of the solution. The problem may be described in the following oversimplified way. A society that is so inhumane as to be concerned only with efficiency would let those without the ability to earn a living starve—and this includes the children of the unemployed. On the other hand, a society that is so muddleheaded that it passes out all financial rewards equally and without regard to productivity will soon find that everyone is equally poor. Therefore, we must seek a compromise that is both humane and productive. It is the thesis of this section that, for at least the lower half of the income distribution, the objectives of efficiency and equity are not necessarily in conflict and, in fact, are complementary in many ways.

At present, the vocabulary for describing income distribution objectives is rather sparse and imprecise. The two most frequently used words—equity and efficiency—need to be further defined and their various shades of meaning distinguished if objectives are to be stated with some specificity. The following is an attempt to extend this vocabulary. Though there may be some straining to apply these definitions too broadly in what follows it is hoped that, on balance, the defined terms will make it easier to discuss the issues in a logical and systematic manner.

Efficiency is the easier of the two terms to define; it is "the ability to provide the desired effect with the least amount of effort." The term has been applied to a number of aspects of the income distribution problem and it may be well to distinguish three among them: economic efficiency; program efficiency; and budget efficiency.

Maximum *economic efficiency* can be most generally defined as a state in which resources are most productively employed. Economic inefficiency would then occur whenever anyone—because of institu-

tions, incentives, or lack of information—engages in an activity other than the one at which he may most completely utilize his capacities. This is somewhat different from defining economic efficiency as the ratio of the economy's total output to the input of resources. With the latter definition there may be some ambiguity as to the labor component of the denominator of this ratio—whether it is actual hours worked or potential hours worked. Potential hours are implicitly used as the denominator in many discussions of the equity-efficiency problem. For example, potential hours is the implicit denominator in statement that "income equality causes economic inefficiency because it reduces work effort or hours of work desired." Potential hours is incorrect as the denominator because the choice between more goods and leisure is part of an efficient system; inefficiencies only arise when incentives are created that are not neutral with respect to this choice. Whether or not in our complicated society of contracts, law, income taxes, and other public institutions a state of pure neutrality can be imagined is another question.

There are, of course, ways in which income equality will reduce economic output without necessarily reducing input. For example, to the extent that risk capital is privately supplied, efficiency may require social institutions and a tax structure that permits substantial inheritances. In general, if the promise of unequal income leads to additional efficient investment in human and physical capital then it is true that preventing inequality may lead to less efficiency. Guaranteed employment is unlikely to cause inefficiency in this way because it only eliminates the left-hand, low-income tail of the distribution and leaves the right-hand tail substantially intact.[1] In fact, it is quite possible that the additional employment may increase the total investment in human capital.

Some may argue, however, that guaranteed public employment will cause inefficiency because it changes the competitively determined wage structure. This criticism would be valid if we operated in a perfectly competitive system within which workers receive wages equal to their contribution or marginal product. However, the competitive model may be irrelevant because it clearly does not describe the U.S. economy and, in particular, the labor market. Perfect information about alternative employment, equal access to education and employment, and the absence of racial and sexual discrimination are implicitly in the simple competitive model and clearly missing from the empirical situation.

Marginal productivities and wages are not always equal in the real world. If the two were always equal there would be neither involuntary unemployment nor cyclical variations in earnings. Certainly, the millions of individuals who lost their jobs between the end of 1969 and the end of 1970 did not do so because their productive capabilities were suddenly reduced. In our economy there are a large number of potential activities of which involuntary unemployment is the least productive.[2]

[1] Except for the financing of the required public expenditure. As indicated later, however, the financing is relatively small compared to the income received by the upper quintiles.

[2] I wish to thank Jack Gould of the University of Chicago for this formulation. Some economists have suggested that unemployment is not necessarily unproductive if the time is spent searching for a better job; in this case, however, the unemployment would not generally be involuntary.

Therefore, any efficiency loss that occurs from changing the labor market has to be compared with the gain obtained from employing the otherwise unemployed.

However, even if labor markets are not purely competitive it could be argued that further distortions, like discrimination, minimum wage laws, or excessive union power only increases the inefficiency. Therefore, the proposals must be further justified. Externalities are the classical justification for disturbing market-determined prices, wages, or production processes. For example, Government regulation of industrial pollution is a response to a production process which places a cost on society that is otherwise external to the product. Most economists recommend a pollution tax, rather than regulation, as a solution to the pollution problem. In this way the external costs are made internal to the process of producing the product. Each producer now has an incentive to use a less-polluting process to minimize his tax. To the extent that the producer incurs cost in reducing pollution or has to pay the tax he will pass these costs on to the consumer; the consumer will now have a price incentive to use products whose manufacture or disposal are less polluting.

An analogy can be drawn between the industries that, in the absence of intervention, create pollution and those where wages or working conditions are socially undesirable. In both cases, the external costs are not borne by the producers or consumers of the commodity. This analogy holds only if the concept of socially undersirable wages and working conditions is valid; however, the presence of laws that establish minimum wages, proscribe safety and health standards, and regulate child labor suggests that it is.

Thus, a fundamental value judgment of this paper is that it is socially undesirable if the head of a family cannot find employment that provides an adequate income and can be performed in decent working conditions. A more objective argument is that this can be accomplished more efficiently by guaranteeing such employment while removing minimum wage legislation than by regulation, training, or macroeconomic policies. The pollution analogy may be helpful with this latter argument. Effluent taxes are more efficient than direct regulation of pollution because firms can make their production process less polluting and, in many cases, can do so at relatively low cost. Similarly, many firms may find it relatively easy to change their production process or personnel policies so that a family head can, in fact, earn an "adequate" wage; moreover, they will make these changes if family heads are guaranteed public employment.

Consider the situation in which there is some small amount of involuntary unemployment. Assume, for this discussion, that there is only one additional job available and two involuntarily unemployed persons. Let one of these be a father of five and let the other be a teenage member of a high income family who is living at home (or any other secondary worker). Assume further that the teenager is slightly more productive. From society's point-of-view it would be better if the father gets the last remaining job; yet the employer seeking to maximize profits will make the offer to the teenager. The proposed policies are intended to create a situation in which primary family members are guaranteed those jobs that provide adequate wages.

Guaranteed employment will change the structure of labor markets. The transition for those industries that are privately efficient but socially inefficient is a problem of substantial magnitude. It should be noted that the presumed inability of firms to adjust to newly perceived social needs is an argument that has been frequently used to deter labor legislation. It was used in 19th century England to argue against child labor laws and in 20th century America against worker safety legislation. And the analogous argument has been made about a presumed trade-off between concern for the environment and employment opportunities. This is not to say that the adjustment problem should be ignored and it is considered again later in the paper.

Program efficiency is economic efficiency applied to public administration. For this subject, program efficiency is related to the administration of public assistance and poverty programs of all sorts. The desired "effect" of these programs is the transformation of the able-bodied welfare clientele into productive workers. The input is the governmental bureaucracy required to bring about the transformation. Many of the calls for welfare reform are responses to administrative inefficiency. Some are concerned with the wasted effort of social workers whose primary activity is the unproductive one of checking on welfare recipients. Others believe the loss of dignity associated with welfare retards the desired transformation. Generally, the cost-benefit performance of expenditures for social services has been discouraging.

The difficulty of achieving program efficiency is, perhaps, the major reservation about a program of guaranteed public employment; admittedly, administration will be extremely difficult. However, evaluation of the program's efficiency should be made in a context that is broader than the work situation. The appropriate comparison is between a working family head receiving administrative and other support on the job and being generally responsible for his family versus a family receiving welfare payments and social services. A choice between the two must consider the significance of work in providing identification, self-respect, and emotional well-being, and the relationship between earnings and family stability.[3] Thus, despite the inevitable administrative difficulties that will accompany guaranteed public employment (and these will be briefly considered later in the paper), the total program efficiency may be greater under the proposal than under any feasible alternative. In fact, it could be argued that employment is the only way of achieving the desired social outcome—an outcome that provides dignity to those who are not poor and a reduction in what is generally considered antisocial behavior.

Thus, program efficiency is in one sense narrower than economic efficiency because it concentrates only on public resources; yet, in a different sense, it is the broader concept because social concerns are included. Maximum economic efficiency was defined as a state in which resources are most productively employed. However, it is well to keep in mind that the fundamental objective of public policy is something which may be called maximum social efficiency—

[3] See Special Task Force Report to the Secretary of Health, Education, and Welfare, *Work in America*, the MIT Press, Cambridge, Mass., Feb. 1, 1973.

a state in which human potential—in individual and social, as well as economic activities—is most fully realized.

The third definition—*budget efficiency*—is a much narrower concept. In general it measures results per dollar of Government expenditures or, in the case of income maintenance programs, poverty reduction per dollar. Transfer programs that pay benefits only to those in need—say, below the poverty line—are efficient in this sense; conversely, a grant given to every individual, for example, would be budget inefficient. While not as meaningful in an economic sense as the other two concepts, budget efficiency is an important part of the political dimension.[4]

The problem of helping the working poor through welfare reform illustrates the trade-off between budget efficiency and economic efficiency. A low marginal tax rate [5] is desired because it maintains a work incentive and, therefore, leads to more employment and greater economic efficiency. If a minimum support level (guarantee) is set at, say $2,400, a tax rate of 50 percent on the welfare payment brings the breakeven point to $4,800. A breakeven point at that level means that many more people are covered than would be the case with a 67 percent tax rate (and a $3,600 breakeven) and that many more of the recipients will be above the poverty line. Thus, the budget cost of maintaining the work incentive is quite large and economic and budget efficiency objectives will be in conflict.

Budget efficiency may also conflict with program efficiency. For example, a large auditing function may be required to eliminate payments to ineligible families above the poverty line. Yet, it may be more program efficient to use the public resources in a different fashion. More often, however, the public will desire an auditing function because of equity objectives even if the auditing function is economically inefficient.

Because equity is more complex than efficiency and extends beyond economics it has received little attention in the economics literature. Economists are in agreement on the concept of horizontal equity—individuals in equivalent circumstances should be treated equally. The lack of horizontal equity in our current welfare system is one of the strong arguments for reform on the basis of national standards. For example, the canons of horizontal equity state that it is inequitable for a family of four (with no other income) to receive welfare benefits of $60 a month in Mississippi and $347 a month in New Jersey. Though it is difficult to make equivalencies when there are regional differences in living costs or to determine the equitable variation with respect to family size, structure, or circumstances (for example, unequal medical expenses) the desirability of horizontal equity is well accepted.

The more difficult problem is the question of vertical equity, or determining the ethical income differentials where some difference is

[4] As demonstrated by the political discussions of the McGovern-Tobin $1,000 demogrant plan.

[5] The marginal tax rate is the relative difference between the wage rate and the take-home pay net of taxes, work expenses, reductions in welfare payments, et cetera, for the unit of work being considered; that is, the hours of overtime, or the day of work, or the week, or whatever time unit is relevant for the worker in question.

appropriate.[6] Some people are willing to accept the proposition that incomes are demonstrably too unequal and, therefore, more equality means more equity.[7] But this proposition does not indicate how much inequality is appropriate or on how income differentials should be evaluated. What income distribution or system of rewards seems dominant in our society? There is still much acceptance of the work ethic. Tawney's introduction to an edition of Weber's classic work describes the Protestant work ethic as follows:

> Labor is not merely an economic means: it is a spiritual end. Covetousness, if a danger to the soul, is a less formidable menace than sloth. So far from poverty being meritorious, it is a duty to choose the more profitable occupation.[8]

This paper is not addressed to the question of the validity of work as an end in itself but to the connection between work and income or other rewards. Attitudes here are also mixed. "A fair day's pay for a fair day's work" seems to be a generally accepted ethic. Unemployment by chance is acceptable, unemployment by choice is not. Our society appears to be willing to distribute income, and rewards in general, on the basis of effort and talent (or marginal productivity). Moreover, the body politic seems willing to offset misfortune—widowhood, disability, or cyclical unemployment—and it also seems willing to offset, to some degree, unequal endowments of talent or parental support.

What the society seems unwilling to do is provide equal rewards to those who put forth unequal efforts.[9] Work incentives are acceptable to many (noneconomists) not because incentives create efficiency but because it is generally thought equitable that those who wish to work should be able to retain some portion of their earnings.

Thus, equity and efficiency are not necessarily in conflict. Appropriate incentives coupled with adequate opportunities may bring forth more effort (more efficiency) as well as providing more income to the poor while maintaining an acceptable relationship between income and work (more equity). Equality leads to inefficiency if it convinces those who would be willing to put forth more effort to produce only as much as the least conscientious. Equality also leads to inequity if differences in the willingness to work are not reflected in income.

It might be well to define two equity concepts: *reward-equity* (those who sow shall reap) and *support-equity* (for the widows and children). It is possible that the trade-off, in welfare reform, between marginal

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[6] The subject of vertical equity is more a matter of ethics than economics and, thus, has generally been ignored by economists except as described in the tax literature. There, the concept is implemented in the progressive income tax where it only moderates unequal income. The disinclination to make interpersonal comparisons is fundamental to the "new" welfare economics. For a discussion of the relationship between the welfare function as described by Lerner and Bergon and economic policy see Arnold H. Packer, *Models of Economic Systems*, The MIT Press, Cambridge, Mass., 1972, pp. 53–75.

[7] The concept of diminishing marginal utility of income has been used by some writers to support the idea that more equality provides greater total staisfaction. To the extent that this concept is correct, equality and efficiency are not in conflict.

[8] R. H. Tawney, "Foreword" to Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, Charles Scribner's Sons, New York, 1958, p. 3. Though attitudes seem to have changed recently, it may be that it is work content and not attitudes toward work that have changed. That is, it is not work but meaningless or irrelevant work that is held in ill repute.

[9] This is, perhaps, the most difficult problem for public employment of last-resort or unearned wage supplements in general.

tax rates and minimum support levels is more a conflict between these two equity objectives than it is between equity, defined as adequacy, and efficiency, meaning work incentives. It is also possible that the concept of reward-equity is the source of much of the working-class antagonism toward welfare. This is especially so when the limiting case of reward-equity, *rank-equity*, is disturbed. For example, a strong feeling of injustice is likely to be elicited when transfer payments reverse, rather than narrow, relative positions and provide the welfare family with more income than that received by the working poor.

The Employment Act of 1946 stated the Government's responsibility to provide employment opportunities and minimum wage laws declare inadequate wage rates illegal. What remains, however, is to provide guaranteed employment at adequate wages. Though such action may upset the theoretical equality between wages and marginal product it can be both an efficient and equitable way to change income distribution because neither equity nor efficiency are fully achieved in an economic reality that contains involuntary unemployment and underemployment. Moreover, private employment decisions based solely on marginal productivity and ignoring family needs can lay no claim to optimality because of the social cost of unemployed or underpaid family heads.

The program described in the next section follows from the value judgments defined in this one. It is an attempt to create an equitable distribution of income that provides adequate support but relates financial rewards to work effort while, at the same time, retaining an efficient economy in which resources are used most productively.

III. Policies for a More Equitable Income Distribution

This section describes the proposed program. The alternatives are summarized in the following paragraphs and in table 1. Further description and the rationale for the alternatives provided to each of the four demographic groups is presented in sections B through E of this chapter. As indicated previously, the intent is to present a program outline, not a detailed proposal; many unanswered questions remain. A few of these are briefly examined in the concluding subsection F. Hopefully, the description presented in this section contains sufficient detail for evaluating the thrust of the proposal.

A. A Summary of the Proposal

The fundamental variable for calculating the wages paid under the guaranteed employment program or the benefits available for those who do not work is the median family income—an amount equal to approximately $10,000 in 1970.[10]

Every family that contains two able-bodied nonaged (under 65) adults and one or more children would be entitled to one full-time job paying one-half the median family income ($5,000 in 1970). The guarantee would be voided if any single family member earned

[10] The median family income was $9,867 in 1970 and $10,285 in 1971. Over the last 20 years median income grew at an average rate of approximately 5½ percent.

more than that amount or if the family's total unearned income (that is, from pensions, alimony, property) exceeded that amount. No other options would be available to these complete families.[11] The same guarantee under the same rules would also apply to single-parent families; however, these (primarily female-headed) families would have alternative options (see table 1).

TABLE 1.—*Proposed options and fractions of median family income* [1] *available to specified demographic groups*

	Guaranteed employment		Nonearned benefit
	Full-time	Half-time	
Families with children: [2] [3]			
2 able-bodied, nonaged adults	½	(4)	(4)
Single-parent families:			
Without preschool children	½	⅜	(4)
With preschool children	½	⅜	¼
Families without children:			
Aged or disabled [3]	(4)	(4)	[5] ¼
Not aged or disabled [2]	⅜	(4)	(4)
Unrelated individuals:			
Aged or disabled [3]	(4)	(4)	[5] 3/16
Not aged or disabled	¼	(4)	(4)

[1] The median income was slightly less than $10,000 in 1970 and is projected to increase at a rate of approximately 6 percent annually.
[2] Guarantee is exhausted when any family member obtains employment providing income equal to or exceeding guaranteed wage or when unearned income exceeds this amount.
[3] Persons legally designated as disabled (permanent or temporary) could elect to take the applicable employment option.
[4] Not available.
[5] Until total money income reaches ½ the median after which the benefit decreases linearly until it would be eliminated for those whose income exceeds the national median income.

The head of a family that contains children and only one able-bodied nonaged adult would also be guaranteed a half-time job paying three-eighths the median family income. Both half- and full-time job guarantees would be considered fulfilled under the same conditions—when the earnings of some one family member or the sum of unearned income received by the family exceeded one-half the median income. (Relatively few nonadult family members are likely to earn one-half the median income.) These two options—full-time or half-time employment—would be the only alternatives open to single-parent families unless they contained pre-school children (except as noted in footnote 2).

Single-parent families with pre-school children could choose to forego both work options and elect to receive a transfer payment equal to one-quarter the median income. Families receiving this transfer payment would be permitted to retain income from other sources, earned or unearned, until the amount exceeded one-eighth the median (that is, on a 1970 base there would be a $1,250 disregard). The next eighth ($1,250) of income would be taxed at a 50 percent rate after which the transfer payment would be reduced on a dollar-for-dollar basis (that is, the breakeven would be $4,375).

[11] Alternatively a very low transfer payment option, say $2,000 annually, could be provided. It is doubtful whether this option would ever be exercised.

This paper does not fully address the important question of whether or how these amounts should vary with family size. The cost estimates in the final section are based on the assumption that the transfer payment would be only $1,500 for a family consisting of one parent and one child and would increase by $500 for each additional child to a maximum of $3,000 for a family of five or more. Thus the nominal figure of $2,500 applies to a family of four.

Some, but perhaps lesser, variation is intended for those engaged in the public employment. The suggestion is that the wage for a family of four provide income, net of taxes and retirement contributions, equal to one-half the median. For a family of five or more the income might also be net of health insurance premiums. For families of two (one adult and one child) or three the gross might be equal to half the median, that is, taxes, including social security or other retirement contribution, would be subtracted.

Families without children and unrelated individuals would also be entitled to a guarantee of a full-time job. However, the wage would be less—three-eights the median for families without children and one-quarter the median for single individuals.

The plan also envisages some restructuring of social security and aid to aged, blind, and disabled. It would provide a minimum of one-quarter the median income to families headed by such persons and three-sixteenths of the median family income to single individuals.

Before discussing these individual proposals in greater detail we can briefly note two judgments that apply to the complete program.

One value judgment underlying these proposals is that support and reward-equity objectives are achieved if the guaranteed job provides a family of four one-half the median income and the welfare program provides a nonworking family one-quarter the median income. This judgment can be compared to the results of Gallup polls which investigated popular opinion on what constitutes an adequate income. The respondents to polls taken in 1967–71 thought that a nonfarm family of four (husband, wife, and two children) required about two-thirds the median to "get along" (that is, the weekly amount quoted was $101, $120, $126, and $127 in the 4 years). Their response to a similar question in 1947 and 1957 worked out to about three-quarters of the median, suggesting an elasticity of slightly less than one (that is, the perceived requirement increased slightly less rapidly than did median income).[12]

Efficiency considerations were kept in mind when the proposals were framed. However, this paper does not really examine the population within the upper half of the income distribution nor does it consider taxes except in a very limited fashion. As a result many important questions of economic efficiency are ignored. Budget and program efficiency, as well as economic efficiency, were considered for the lower half of the distribution (even if they are not treated adequately in the following discussion). A public-sector job program of the size proposed could become an administrative nightmare;[13]

[12] Christopher Jencks refers to findings indicating that the public thinks half the median family income is required for an adequate standard of living. *Inequality*, Basic Books, Inc., New York, 1972.

[13] For a description of the current nightmare see Sharon Galm, *Issues in Welfare Administration: Welfare—An Administrative Nightmare*, Studies in Public Welfare, Paper No. 5, pt. 1, prepared for the Subcommittee on Fiscal Policy, Joint Economic Committee, U.S. Government Printing Office, Washington, D.C.: 1972.

however, this risk must be weighed against the importance of changing the distribution of income and the difficulty of creating this change by other means. Careful and imaginative planning can mitigate the administrative problems. Phased implementation, beginning with a limited number of jobs and expanding the number until a virtual guarantee is established, can provide the insight that only experience will bring. However, it should be kept in mind that it is the poor who are kept waiting while the administrative problems are solved.

B. The Program for the Working Poor

The working poor have to be included in any workable reform of the welfare system. Economists have long pointed out, and the body politic has recognized, that some financial incentive should be provided to encourage individuals to work. Welfare programs that effectively apply a 100 percent tax rate on earned income provide strong incentives to avoid work (or to fail to report earned income). Yet, the arithmetic of simultaneously achieving work incentives, a decent minimum income, and budget efficiency is not reassuring. If the program provided $3,000 to a family with no other income and reduced payments by 50 cents for each dollar earned the resulting breakeven point of $6,000 of other income would have included 17.5 percent of working family heads and about one-fourth of all families in 1970. Though the administration's revised proposal of a $2,400 minimum, 67 percent tax rate [14] (above a $720 disregard) and, thus, a $4,320 breakeven point is substantially less generous, this breakeven point included almost 10 percent of those families whose head worked sometime during 1970. The Senate Finance Committee found even this proposal unacceptable, apparently on the basis of the social ethic which holds that those who work should not be obliged to support those who choose not to work. The legislative debate over welfare reform strongly suggests that it is necessary to consider the reciprocal responsibilities of the working poor and the rest of society before stating income-distribution objectives.

The Nation's reward ethic will not accept an income maintenance system that provides factory workers little or no more take-home pay than the welfare recipient who either cannot or will not work. On the other hand, it is consistent with both the reward and support ethic to provide adequate income to a family head who wants to, and does, work all year at a full-time job. Thus, the reciprocal responsibilities between the working poor and the remainder of society are:

Any able-bodied family head should be willing to work full time all year if the family contains another adult able to care of the children.

The society should guarantee each family head the opportunity of full-time employment at adequate wages.[15]

[14] The administration's original proposal had a 50 percent rate; this was changed to 67 percent and then, depending on other applicable taxes, rose to 72 and 86 percent, and in some cases 119 percent. See Jodie T. Allen, "A Funny Thing Happened on the Way to Welfare Reform," Urban Institute Paper 301–14, Washington, D.C., January 1972.

[15] It is unrealistic to ask, at this time, that the job be "meaningful" as well as adequately paid. Meaningful jobs are, unfortunately, not that abundant.

If these premises are accepted then it is possible to state income-distribution objectives toward able-bodied, two-parent families:

Full-time employment for the family head that allows him to earn an adequate income.

Minimum discouragement of extra earnings by the family head or by secondary workers in the family.

A distribution of earned income that reflects adequate reward for effort as well as individual ability or marginal productivity.

The elimination of welfare regulations that provide financial incentives for family dissolution.

An "equitable" relationship between minimum earnings and welfare payments to nonworking families.

If reward-equity requires that the income of each family with a full-time worker be double the income of the nonworking welfare family, and if support-equity establishes the welfare payment at one-quarter of the median (as suggested by President Nixon's original proposal to establish a $2,400 minimum for a family of four), then each able-bodied, two-parent family with children should be guaranteed one job that provides take-home pay equal to one-half the median income. In 1970, this guarantee would have meant take-home pay of almost $5,000 and money income close to the top of the lowest income quintile; equivalently, it is a guarantee of 2,000 hours of employment per year at a wage of $2.50 per hour.[16] If the second parent or some other secondary worker is gainfully employed, or if the family head "moonlights," this would not change his income from this guaranteed job.[17] However, if any family member had regular employment paying more than $1,250 per quarter-year (excluding overtime), then the job guarantee would not be available to any family member during that quarter. That is, each two-parent family would be guaranteed at least one job at half the median income in either the private or public sector.

The guarantee would work in the following way. An individual arriving at, say, the Federal Employment Service office in his city and declaring that he or she is a family head living with his children and that neither he nor any other family member is employed at a wage that yields $5,000 annually becomes eligible. (The earning test would be $1,250 in the current quarter if 3 months is the accounting period.) The Service then has a limited period of time (for example, 10 working days in any calendar year) to do the necessary checking and find the applicant a regular job in either the private or public sector paying at least the guaranteed wage. If a regular job could not be found during this period the applicant would become part of the guarantee program and would begin to receive an income of at least $100 per week (at the 1970 median income). The Service would be required to maintain a list of, what we will call, "special" public sector openings so that it would always be able to accommodate any applicant not placed in private or regular public sector jobs. If the individual had one of the special jobs and another family member acquired a job

[16] All the dollar figures are computed on the basis of the approximate 1970 median income of $10,000 and would increase by about 5 to 6 percent each year. It is more convenient to refer to dollars than fractions of median income.

[17] Of course, his income tax would be paid on total family taxable income as it is now.

paying more than one-half the median then the individual would no longer be eligible. Though little attention is paid in this paper to determining the proper accounting period or in devising efficient ways of insuring eligibility it may be useful to suggest some possibilities. The accounting period and the basis for eligibility may be a calendar quarter. Perhaps every individual filing a W–2 (income tax) form might be required to state whether any other family member held or planned to apply for a public sector job. The taxpayer would also be responsible for filing a revision within 30 days if the situation changed and would be liable to penalties for false statements. An indication of an ineligible holder of a special public sector job (the worker earns more than $1,250 in the quarter and states that some other family member is in the program) would be forwarded to the appropriate state office. It should be kept in mind that the whole question of "cheating" in this program is quite different from the general case of welfare cheating. In this instance, the individual may be working at a job that he is not entitled to, something quite unlike receiving unwarranted transfer payments.

It might appear as if the proposal creates a severe "notch" problem; that is, if the second worker in a family earns $4,999 the family's income is $9,999; however, a $2 raise will reduce family income to $5,001. Undoubtedly it would be better if no notch existed; however, there are a number of reasons why this particular notch may not be too serious. The $5,000 paid those workers holding special public sector jobs is not a pure transfer; it is earnings whether or not the market value of the individual's efforts are "worth" $5,000. Moreover, the family would not necessarily be faced with choosing an income of either $5,000 or $10,000. If, having proven himself at the special public sector job, the family head can obtain a regular job the family can keep the entire $10,000 (less taxes). Even if the family head cannot keep his present job he may be able to find work at a wage rate somewhat less than $5,000 so that the combined income need not necessarily fall to $5,001. The fundamental point is that the guaranteed job is not welfare but an opportunity to work. The opportunity is rationed to achieve budget efficiency, but the equity of this notch problem is quite different from the situation involving an income transfer.

Should the family head be eligible for the special job if his family contains a number of secondary workers whose combined income exceeds $5,000 or if there is property or other unearned income? Again, because only an opportunity to work is being offered, the problem is much less severe than it would be with a pure income transfer. It would be reasonable to exclude only those families in which one worker already earns $5,000 or where the family's unearned income exceeds $5,000. We should note again that there is nothing in this program to prevent multiple family members from obtaining regular employment paying $5,000 or $50,000 annually if the family head foregoes the special public service job. The program only provides a guaranteed work opportunity to a restricted group.

A wage of $2.50 per hour exceeded the 1970 minimum wage by more than 50 percent. However, the minimum wage is a compromise between the objective of meeting the minimum needs of a family and the desire to avoid pricing teenagers and other secondary family workers out of the labor market. Establishing eligibility in the manner de-

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scribed above makes it possible to avoid this compromise and eliminates the rationale for minimum wage laws. Without a job guarantee, the absence of minimum wage laws would lead secondary workers to take jobs away from primary workers and, thus, force their wage down. However, secondary workers would not compete with family heads for low-wage jobs if primary workers could be assured of a guaranteed job at a higher wage.

The proposed job guarantee would restructure the labor market; it would formalize a dual labor market but assure that low-wage jobs were restricted to secondary workers. A guarantee would force employers who pay low wages or require that work be performed under unpleasant conditions to either change their production functions or their input mix. This restructuring will undoubtedly have unsettling effects on some industries, especially in some regions of the country. Note that, in 1970, a wage of $2.50 per hour exceeded the average wage in retail trade and was three-fourths of the average manufacturing wage. In April 1970, more than 11 million workers earned less than $2 per hour.[18] However, the labor market effects should not be exaggerated. In 1970, married men living with their wives were less than half of the labor force. Much of the problem could be solved by using secondary workers in low-wage secondary jobs. Moreover, the repeal of the minimum wage laws may offset, to some extent, the adverse effect of the guarantee on marginal industries. In addition, it would be possible to contract the services of those holding special public sector jobs to certain industries whose demand for labor is temporary but whose pay scales (during their season) are adequate.[19]

Certainly some transition costs will remain; however, these costs are unavoidable if our income distribution objectives are to eliminate poverty among the working poor. If it is public policy to have family heads employed at adequate wages then employers who hire family heads to work at low wages are not paying the true social cost for their labor. Changing the labor market structure is likely to be a more efficient way of achieving equity than is minimum-wage regulation or wage subsidies. Obviously, minimum wage laws without job openings have not succeeded. The situation for wage subsidies is more complex and, perhaps, deserves more analysis than is given here. However, provision of a subsidy removes the incentives for employers to change their mix of labor inputs so as to eliminate low-paid work and, in fact, may give such employers an unfair competitive advantage. As noted previously, the argument for changing the job structure is analogous to that favoring pollution taxes in the environmental field. In both cases the recommended solution is superior to regulation or tax subsidies. If this analysis is correct then it is also true that changing the market structure is superior to cash assistance to the working poor. From the employer's point of view such assistance is essentially a wage subsidy. Moreover, some recipients will work less as a result of the assistance and thereby reduce the size of the labor force.

It is difficult to predict how the supply or demand for primary and secondary workers will respond to the introduction of guaranteed

[18] Steven Sternlieb and Alvin Bauman, "Employment Characteristics of Low-Wage Workers," *Monthly Labor Review*, July 1972, p. 11.

[19] Those who work at high wage seasonal employment (for example, construction workers) would not be permitted to use the public sector job as a backup.

employment. Some of the income maintenance experiments suggest that white wives tend to withdraw from the labor force when their family incomes are supplemented. These women may now choose not to work because they find that their net earnings per hour—after the reduction in the income supplement—are quite low. Under the recommended scheme, however, the tax rate on additional earnings would be the normal payroll and income taxes on family incomes in excess of $5,000, a rate much lower than any practical welfare proposal. Unless there is a strong income effect the labor force withdrawals should be substantially fewer under this proposal than it will be under most welfare-type income maintenance proposals.

Some low-paying jobs in the private sector now held by family heads would either disappear or be taken exclusively by secondary workers. The distribution of wages paid to family heads in the private sector will narrow as relative wage increases are granted to those now in the lower part of the wage distribution.[20] Removal of the minimum wage laws will reduce the wage of some secondary workers; however, their unemployment rates are likely to decrease as their relative wage rates decline and because they would not be competing with family heads for many jobs.

The labor market and administrative problems that guaranteed jobs will create will be discussed further at the end of this section. First, however, the proposed benefits and eligibilities available to the remainder of the population will be described.

C. Aid to Dependent Children

Single-parent families present, perhaps, the most difficult problem of reconciling support and reward equity. Though able-bodied, it is frequently difficult for these single parents to work if there are children to be cared for, yet they need financial support to provide for their children.

Because their problems are so complex and differentiated, this group needs a wide set of options. It is suggested that they be permitted to choose among full-time employment, half-time employment or, in some cases, a pure income transfer.

The first option could be made available by permitting the single parent to take advantage of the guaranteed employment described previously. The second option could be provided by guaranteeing, in the same fashion, half-time positions with take-home pay equal to three-eighths of the median income for a family of four. Thus, the single parent could choose, instead of the full-time job at $5,000 annually, to work 25 hours a week for 40 weeks, approximately school hours, and take home—in 1970—about $3,750. (Marginal wage rates are discussed below.)

Though the day-care problem would not be too great for those single-parent families without pre-school children who chose one of the

[20] The narrowing will occur if only because of the elimination of the lower tail of the distribution. Moreover, those now at the $2.50 per hour wage level will tend to seek increases that will maintain their advantage. A general across-the-board wage increase could not preserve the current earning distribution because the proposed guarantee is relative. If everyone received the same relative increase, the median income would increase and so would the guaranteed wage. Even if the same absolute differentials were retained the distribution would narrow.

part-time jobs, the single-parent families with pre-school children present further difficulties. The proposed solution is to provide these families the option of not working at all and receiving one-fourth of the median income (for, say, a family of four). If the female family head chooses to work in the private sector the program might leave her stipend of $2,500 unchanged for the first $1,250 of wages, tax the next $1,250 at a 50 percent rate, and any further income at a 100 percent rate (leaving the breakeven at $4,375). In addition, the single parent with pre-school children could also choose the one-half-time ($3,750) or full-time ($5,000) employment and make her own day-care arrangements. It is also feasible to create 1,000 hour/year employment situations in which the work could be done outside an office and in an environment that would permit the single parent to simultaneously work and tend to her children (for example, typing or other work at home, or working in a park, playground, or day-care center).

It is true that this proposal creates a "notch" that is encountered when the youngest child enters school. However, it is not a money income notch but rather a work requirement notch. For most of these families income will increase from $2,500 to $3,750; but a half-time job will have to be accepted.

The marginal wage rate facing the single parent as she (or he) chooses among her public employment options—no work and $2,500, or part-time work (1,000 hours) and $3,750, or full-time work (2,000 hours) and $5,000—is $1.25 per hour. (Again the wage rate is based on the 1970 median income; she could expect a raise of close to 6 percent in each subsequent year.) The differential between the average and marginal wage rates ($2.50 and $1.25) or, equivalently, the asymmetric nature of the recommended solution—four-eighths of the median income for full-time work, three-eighths for half-time, and two-eighths for no work—is an unavoidable consequence of reconciling support equity and reward equity. As long as some guarantee exists for families without workers the marginal earning rate will be less than the average. This tends to create unwanted incentives for family dissolution; however, the problem is confronted in the proposed program by trying to maintain a neutral balance among the benefits available to different family types. For example, it is possible that a family with two parents and six children would divide into two single-parent, four-person families to be eligible for two grants ($5,000) or two jobs ($10,000). However, the family could stay intact, have one guaranteed job, and allow the other parent to earn up to $5,000 (if the other parent could find employment). To make the split worthwhile the cost and other difficulties of maintaining two households would have to be worth less than the difference between the wage paid by any private sector job available to the secondary worker and the $5,000 she (or he) would receive from the Government position. The more likely alternative may be for the husband to leave, creating one single-parent family and one unmarried individual (a common response to the current welfare system). Therefore, the options available to unmarried individuals (and to couples without children) must be designed to avoid strong incentives to dissolve (or form) families or to have children.

It is appropriate before leaving the subject of single-parent families to make a few remarks about the effect of these proposals on the status

of women. The proposals reflect the judgment that the family is the basic sociological and economic unit. Any such presumption is liable to prejudice the economic rights of the family head's spouse—that is, women in general and wives in particular. Therefore, it is important to examine the situation from the viewpoint of women in various circumstances.

As single women and men are treated equally, we restrict our investigation to wives or female heads of families. (As far as the census is concerned, women can only be family heads if no spouse is present.) As noted before, 29 percent of the families in the lowest quintile are female-headed, according to this definition. The lot of most of these women will be improved by the program and few will be hurt. They are entitled to the same job guarantee as a male household head and, in addition, have the other options described above.

A wife who earns $5,000 or more in the private sector should be unaffected by the program. In fact, her situation may be enhanced because her employer no longer need worry that she is taking a job away from a male breadwinner. Wives earning, say, $7,000 or more in the public sector should also be unaffected. Wives whose husbands designate them the family head will not be adversely affected, either. On the other hand, the earnings of wives whose incomes are protected by the minimum wage laws or wives whose employment in the public sector would be jeopardized by the large-scale public employment of male family heads might be adversely affected. However, the total economic situation for many of these women will be improved because the gains achieved by their husbands will be greater than the losses they incur. Therefore, adverse changes will be primarily restricted to middle- and upper-class wives now in vulnerable, relatively low-paying jobs. Readers must judge for themselves whether the improvement in the condition of other women—especially female family heads—is worth this cost.

Throughout this paper, occasional use is made of the pronoun "she" to refer to heads of single-parent families and of "he" to refer to heads of two-parent families. This usage describes the typical case but should more accurately be read as "he or she." Similarly, the spouse of the family head in two-parent families is referred to as "she" or "wife." For cases where the wife is the family head, the opposite gender should be substituted.

The role of men and women as individuals as well as family members should not be ignored when considering alternative approaches to poverty. It is believed that the proposal is more or less neutral. Again, the reader will have to make his or her own judgment.

D. Nonaged, Unmarried Individuals, and Families Without Children

If only family heads with children were eligible for the guaranteed job then the father would have nothing to gain by leaving the family (unless he took one or more children, thus creating two families). Any attempt to help unrelated individuals will create some incentive for family dissolution. On the other hand, incentives to maintain families are usually incentives to family formation, incentives which may or may not be desirable. The objective is to be reasonably neutral with respect to decisions concerning family size or structure.

Support-equity is the other objective important to the design of the benefits available to nonaged, able-bodied individuals. A balance between these objectives could be provided by guaranteeing unrelated individuals a full-time job but at half pay (that is: one-fourth the median income, or $1.25 per hour in 1970). This amount would guarantee all unmarried individuals an income in excess of the low-income (poverty) line without providing a substantial incentive for family dissolution. There would, unfortunately, be some incentive for illegitimacy; hopefully, it would not be large enough to influence the behavior of many women. For example, a single woman would earn $2,500 for full-time work under the proposed $1.25 per hour wage for unmarried individuals; if she had a child she would be eligible for a part-time position paying $3,750. The question (if one believes that such decisions are made on an economic basis) is whether the time, inconvenience, and expense of raising a child alone has a greater disutility than 1,000 more hours of work and $1,250 less in pay. Moreover, the economic benefit of the illegitimate child is even less if the woman could find a position paying more than $1.25 per hour through her own efforts.

Childless couples also present difficulties in providing equity without, at the same time, creating undesirable incentives for either family formation or parenthood. A full-time job guarantee at a wage of three-eighths the median income ($3,750) might strike an appropriate balance. The financial incentive to become parents would be only $1,250 (that is, $5,000–$3,750), an amount easily offset by the potential earnings of the secondary worker. If both husband and wife were full-time students and neither could accept a position, the family might be made eligible for the full-time position under arrangements whereby the two adults share the position by either alternating semesters of work and school or working 20 hours a week each.

There may be a question of equity (or even legality) about basing pay differentials on family status (for example, paying a family head $5,000 and a single person $2,500 for essentially the same work). There are a number of ways to defend the proposed arrangement; one is historical precedent. To the extent that eligibility is analogous to tax deductions or transfer program eligibility differential treatment based on family status is not an innovation. A better defense may be to admit that the proposed solution is not perfect but that most alternatives appear to be worse. For example, one could ask if it would be more equitable to restrict eligibility to families with children.

In considering the equity of differential pay one should keep in mind the special mixed character of the income earned from the public sector jobs. There is no compulsion; everyone is free to seek employment on his own. The program provides the enrollee with the difference between what he could earn in the private sector and the wage of the public job. The right to this differential is rationed to minimize the budget cost and the rationing scheme and pay differentials reflect the objective of providing support-equity. In some cases, support-equity is achieved at the expense of reward-equity because there is no practical way to completely avoid this trade-off. The next section describes the program for those persons who the society apparently feels need not work.

E. The Program for the Aged and Disabled

In addition to AFDC, current income maintenance programs provide support to what is referred to as the adult categories: those who are old and poor (old age assistance), retired (old age insurance), or disabled (disability insurance, aid to the blind, aid to the permanently and totally disabled, disabled coal miners, and veterans and their families).

Objectives are unclear and overlapping and include support-equity for those in need as well as reward-equity for those who have saved and worked at employment covered by social security. For example, because of the objective of protecting those who have saved and accumulated capital, unearned (property) income does not reduce social security benefits. On the other hand, benefits are reduced (at a 50 percent rate) if annual earned income exceeds $2,100. These sometimes contradictory objectives lead to anomalies such as Government employees with adequate pensions receiving actuarily unearned social security benefits and peculiar overlaps between social security and public assistance.

Despite the contradictions, there are valid reasons for omitting any discussion of the adult categories from this paper. Recent increases in social security benefits, the decision to increase benefits automatically to compensate for inflation, and the legislation (H.R. 1) that increased the earning limit from $1,680 to $2,100 and federalized welfare for the aged and disabled (as of January 1, 1974), perhaps make it unnecessary to change the system of support for these persons. Moreover, the relationship between these adult categories and the groups discussed previously is not as crucial as the relationships among those who can work. That is, while we must be concerned about the incentives concerning family size and structure we need not worry about the incentive to reach the age of 65. Therefore, the program described previously does not depend in any direct way on what is done for the aged and disabled.

On the other hand, considering the aged and disabled simultaneously with the other groups can be helpful. For one thing, the redistribution of income connotes redistributing a fixed amount; what is given to the aged and disabled must be taken from some other group in the society. Though taxes, as such, are only briefly mentioned in this paper, it should be noted that social security financing is highly regressive and falls very heavily on the working poor.[21] Section IV–C contains a discussion of the relationship between "contributions" and "earned" benefits and the general objectives of the current social security system. The only argument being made at this point is that it is desirable to look at income distribution programs comprehensively.

Political judgments also enter this argument. The recommendations described below separate the insurance and welfare aspects of social security. Some suggest that the existing lack of separation is the source of the widespread political support for social security. It is possible, however, that this is also the reason for the lack of support for programs to provide assistance for the needy who are not aged. The fiction

[21] For a complete discussion of this problem see John Brittain, *The Payroll Tax for Social Security*, the Brookings Institution, Washington, D.C., 1972.

that all social security benefits are "earned" (in an actuarial sense) provides the aged with dignity; it also provides them—and their adult children—with a rationale for supporting social security "welfare" (actuarily unearned benefits) while denouncing public assistance welfare.

What would be the essential characteristics of a program for the adult categories if the objective was to provide support for those who are old or disabled and not otherwise well off and, at the same time, provide a fair return for voluntary contributions to a retirement fund?

We continue to assume that support-equity requires that benefits be stated in relative terms. One solution would be to provide each aged or disabled family (with, say, two members) with a payment equal to one-quarter of the median family income or $2,500 in 1970. That is, the stipend provided to each aged couple would be equal to that paid to a family of four with a nonworking, able-bodied single parent. By relating the stipend to the median income the aged and disabled would not only be protected from inflation but, in addition, would receive a share of increased national productivity.

Under this proposal, the payment would not be reduced for other income, irrespective of source, until the family's income, from any source, reached half the median income. Thereafter, the payment would be reduced at a 50 percent rate so that the payment would be eliminated when family income reached the median. If an individual wishes to increase his contribution to more than his required social security tax he could do so and add to his retirement benefit (just as he would purchase a private annuity). The additional payment, however, would be computed on an actuarial basis—earning interests on the voluntary contribution (at, say, the rate on Government bonds) but no inflation or productivity premium.

The proposed program would replace the newly legislated Federal program for the adult categories completely and social security (OASDI) on a partial basis. The replacement would be only partial because those choosing to pay more into the system than required could obtain a Government-guaranteed annuity. That is, the "contribution" for social insurance would be divided into a social security tax and a true contribution. The tax and benefits would thus constitute an explicit redistribution system, transferring income between the working and retired populations.

The transition for OASDI could be accomplished in the following, very gradual, fashion. All social security taxes paid up to the time of the legislation would be considered as providing the taxpayer with vested rights to the current program. The benefits of those with vested rights would not be reduced under the new program. Everyone already retired or who had already had 40 quarters of covered employment would be entitled to choose to receive either the current payment under the current rules (including the provision that benefits be increased to compensate for inflation) or the benefits provided in the proposed new program. On the other hand, those who had not been in covered employment for at least 10 quarters could only receive benefits according to the new rules when they retired (even if it meant reduced benefits).[22] Those whose covered employment was

[22] For example, those who had income from other sources that was greater than the median family income would not receive any benefit payments from the mandatory part of this program.

between 10 and 40 quarters when the legislation was enacted could choose between the new rules or a proportion of existing benefits (for example, if they had 25 covered quarters they could choose to receive one-half the current social security benefits).

It remains to define an equitable relationship (support-equity) between the benefits available to an unrelated individual and an aged couple. If the program provided these persons a benefit equal to 75 percent of that provided couples (that is, a benefit equal to 18.75 percent of the median family income) it would, in 1970, have created an income floor above the official low-income line.[23] If the benefit for individuals were only 60 percent of that provided couples it would coincide with the ratio of average social security benefits paid to these two groups; the ratio for assistance under H.R. 1 is 67 percent. On the other hand, the official low-income levels suggest that a single individual requires 80 percent of the income needed by a couple to maintain the same standard of living. Thus, providing individuals with 75 percent of the benefits provided couples is a compromise between the legislated ratios and the official estimate of need.

F. Summary and Some Unanswered Questions

The proposals outlined in this section are based on the premise that earnings should be the primary determinant of income for able-bodied, two-parent families and able-bodied unmarried individuals; that unearned income should be the primary source for aged or disabled individuals or families and that a choice between these two should be available to single-parent families with emphasis, however, on earned income. Fundamentally, earnings are used to achieve reward-equity and income transfers are used to provide support-equity though in some cases the earnings are modified to accomplish support-equity objectives.

The program creates a large public sector job program and guarantees employment to all able-bodied family heads and unrelated individuals. The program would replace current welfare programs and remove minimum wage laws. Social security as it presently exists would be slowly replaced by a new system of support and voluntary annuities. Public housing and food stamps could be eliminated. Unemployment compensation could be restructured so that it only provided support for a short period during which workers could do some looking for a new position and apply for their guarantee; perhaps 4 to 6 weeks would be adequate. The public sector job would provide each worker with health insurance as well as a wage; thus the medicaid program could be greatly reduced (even though most of the cost would only be shifted). Health coverage for the nonworking population would then be something like medicare for all of the aged, disabled, and nonworking, single-parent families. All of the other families and individuals would be covered by employment-based protection.

These recommendations attempt to reconcile two equity objectives (support- and reward-equity) and three efficiency objectives (economic, program, and budget efficiency) while at the same time avoiding the creation of financial incentives for family dissolution or parenthood.

[23] Beginning in 1974, the new legislation (H.R. 1) provides $195 per month to an aged couple with no other income and $130 per month to a single person. The proposal described above would provide an individual with $155 a month in 1970 or perhaps $190 in 1974.

Each reader will have to make his own value judgment as to whether or not these recommendations are equitable. The question of economic efficiency could, theoretically, be answered objectively because it requires a positive statement about empirical events. Unfortunately, there are no models that will answer this question unequivocally and the reader will have to make his own judgments on the complex, but important, issues discussed below. In addition, thoughtful readers will think of other important questions that were not addressed in the paper—for example, the reaction of public agencies, current public employees, the unions, the procedures for labor contracting, the general labor market responses, and the regional impacts. Certainly all the important issues have not been raised, let alone answered. Perhaps, however, enough is presented so that the reader can make a tentative evaluation of the plan.

One of the most difficult problems will be administering the program. Managing a workable public employment program of this size will not be easy, and a guarantee will make discipline especially difficult to maintain. Supervisors may have to allocate job satisfaction rather than wages to provide rewards for appropriate behavior, a practice that could be abused. It might be advisable to allow supervisors to suspend workers for short periods (after due process). There are some experimental programs with welfare clients in public employment; some success has been reported in New York and some difficulties have been reported elsewhere. The current, relatively large, public employment program has worked reasonably well, but those employed have generally not been welfare recipients.

The discipline problem should not be overstated because the majority of the positions are likely to be filled by family heads who will be responsible workers. Some contracting of these employees to private concerns for temporary or seasonal work may be possible. Imaginative use of these workers, not in leaf raking but in useful work to improve public services or urban and rural landscapes, is also possible. These persons could be used as aides in day-care centers, schools, hospitals, and medical facilities; they can manage traffic and take fares on buses; they may plant trees as well as rake their leaves and they could provide supervision and free entertainment in the parks, and they may help provide some social services more efficiently than is done currently.

As noted previously, a program of this size would have to be implemented in stages; it might take 5 to 10 years before sufficient jobs were created so that a guarantee would not be overly disruptive. It should be borne in mind, however, that while governments will have difficulty coping with a program of this size the poor have difficulty in coping with their poverty.

The size (in 1970) of this program is estimated (in section IV) at approximately 3.6 million full-time and 1 million part-time positions. Almost 13 million individuals were employed by Government, at all levels, in 1970. Much of what these 13 million do might better be accomplished if the poor administered the programs themselves or, at least, were widely employed.

Even with the best of intentions and administration, however, the problems of motivation, maintaining work discipline, and dealing with the welfare clientele in public sector employment will be substantial. They should not be minimized. Finding acceptable work for the low-

skilled in an increasingly complex and bureaucratic economy is among the most difficult problems our society will have to face. But asking those with the fewest skills to solve this most difficult of problems by themselves is likely to be neither equitable nor efficient.

The proposal is directed to the fundamental problem that follows because the poor are often ill equipped to fit most of the available jobs. Current programs are directed to changing the poor so that they become less ill equipped. The provision of wage subsidies or some public employment positions increases the availability but does not change the basic approach of fitting the worker to the job. A guarantee, on the other hand, means that belonging to a demographic category—for example, a family head—provides automatic access to a pay check. Under this arrangement the institutions—that is, firms and governmental units—will be motivated to change the job to fit the worker. Initially the jobs are likely to be make-work (or no-work). But the incentives to find activities that will be useful should be strong and will apply to both employers and jobholders.

Another major problem will be the disruption of the labor markets that would result if guaranteed jobs were available. Part of those costs are the inevitable price of social progress (just as some industries must bear the cost of technological progress). Phased implementation should provide time for the switching process whereby secondary workers (wives, teenagers, unmarrieds) take secondary jobs and primary workers (family heads) are used for jobs paying more than one-half the median. The implementation period would also provide time for employers to change the job structure in their firms so that they could make their job offers as attractive as the public sector jobs. Moreover, not all the changes will be adverse to marginal industries. Most importantly, the removal of minimum wage laws will be beneficial to these firms. As noted previously, married men living with their wives are less than half of the labor force. Also, elimination of disincentives for the aged or secondary workers in welfare families to work may further increase the potential labor pool for these firms. Finally, labor contracting may be of assistance to them. Many of these firms do pay a high enough wage (that is, $2.50 per hour) but their labor demands are sporadic or seasonal. They may be able to purchase labor from the local governments for $2.50 an hour but only for the hours they require.

A nationwide program would undoubtedly have a different impact in the various regions of the country. The labor structure in the South, where many jobs pay $5,000 to $8,000 annually, may require more emphasis on labor contracting than other regions, or perhaps there is a need for regional (or urban-rural) cost-of-living differentials; perhaps by making the guaranteed wage equal half the regional, rather than the national, median income. What such a structural change would do to migration patterns can only be conjectured; however, it might alleviate some of the central city difficulties caused by current wage and income maintenance differentials.

The problems of those who have children without having the mental and/or emotional capacity to care for them will not disappear. What is to be done if a family head refused to work at all? Recent studies [24]

[24] Leonard Goodwin, *Do the Poor Want to Work*, The Brookings Institution, Washington, D.C., 1972.

indicate that the work ethic is sufficiently widespread among all income classes that this is unlikely to be a common occurance. Where it does occur, the husband could convince his wife to be the family head and take the job. What if neither wishes to work? One answer is that in this case society's responsibility is discharged in full and it is not in the child's best interest to leave him in the care of two parents, neither of which is willing to make a minimal effort to earn a living. A less punitive response would provide a minimum stipend, say $2,000, recognizing that very few would choose this in place of a job paying $5,000.

There are no problem-free solutions to poverty, but there are approaches that promise fewer problems than the current situation. In comparing alternatives we should ask whether it is equitable or efficient that those with the fewest skills be left to wrestle with the problems of matching their limited talents to our current employment structure or whether public administrators should be assigned the problems of motivation and discipline. There are certainly going to be problems with those who do not have the discipline to show up for work every day, let alone maintain their work effort. Yet, these may be better problems than unemployed family heads.

In addition to judgments about the complex issues of administration and labor market changes, an evaluation of the proposal requires an estimate of the costs and effects of the proposal on the income distribution. These estimates are provided in section V where it is concluded that the total program would cost approximately $15 billion (as of 1970). However, there are questions that are logically prior to these estimates. What is the current situation and why is change that will cost $15 billion desirable? And why should the change emphasize modifying the structure of the labor market rather than the more traditional approaches of income maintenance programs (or a negative income tax) and investment in human capital? These questions are the subject of the next section.

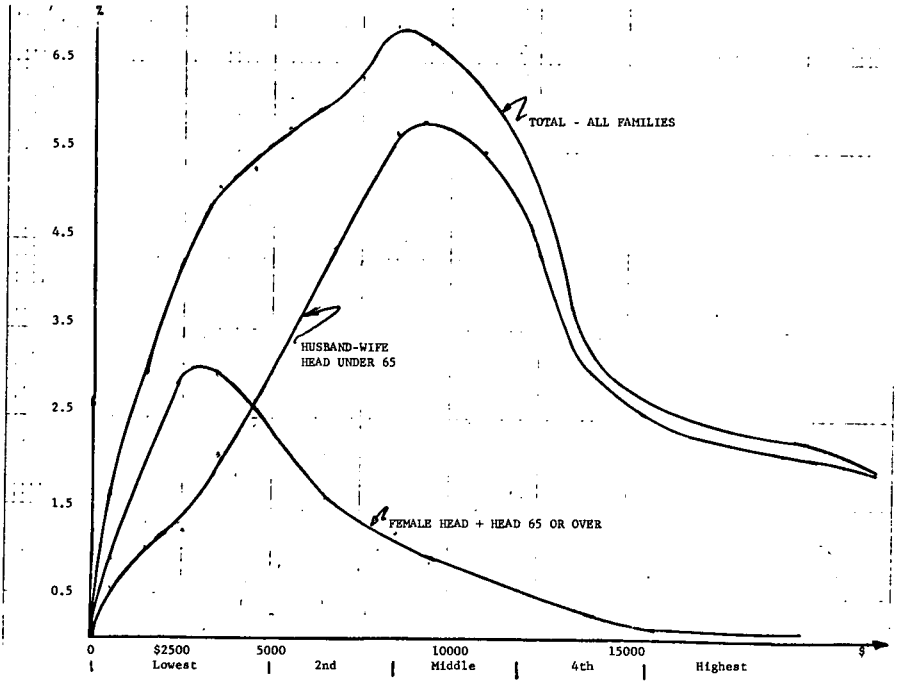
IV. Why the Poor Have Less Money

This section of the paper contains four parts: the first describes the current income distribution; the second partitions the current differences among income quintiles to evaluate the relative importance of unearned income, earnings per worker, and workers per family; the third part examines current and proposed income transfer programs; and the fourth reviews some of the current controversy over the human capital or equality of opportunity approach to equality.

A. A Description of the Current Income Distribution

The 1970 income distribution among U.S. families is shown in figure 1. High-income families, represented by the long tail to the right, cause the median income ($9,867) to be significantly less than the mean ($11,100). The shape of the overall curve can be viewed as determined by the size of the component groups and the distribution of income within each. For example, in figure 1, we see the curve for the 13 million families with aged or female heads beginning to decline while the distribution for the 38 million nonaged, husband-wife families is still rising (giving the overall curve a slight depression in the $4,000 to $5,000 range).

FIGURE 1.—Distribution of Family Income—Total and Subgroups, 1970



One way to examine the income distribution is to look at the share of national income received by each quintile of the population. The ratio of the shares of any pair of quintiles is the ratio of the incomes of the average family in those two quintiles. The ratios for the 1970 income distribution are shown in table 2 below (the shares themselves are shown in the bottom row). For example, the average highest quintile family received 7.6 times as much as the average lowest income quintile family and 1.8 times as much as those in the fourth highest quintile. Those in the second quintile received 2.2 times as much as the average in the low income quintile. There ratios have remained fairly constant for the last 25 years. In 1954 and 1960, the interquintile income ratio of the highest and lowest quintiles was approximately 8.6.[25]

TABLE 2.—*Income ratios by quintile, 1970*

Quintile	Lowest	2d	Middle	4th	Highest
Lowest	1.0	2.2	3.2	4.3	7.6
2d		1.0	1.5	2.0	3.5
Middle			1.0	1.3	2.4
4th				1.0	1.8
Percent total income	5.5	12.0	17.4	23.5	41.6

[25] The 1970 data show somewhat less inequality (the ratio is 7.6). However, more evidence is necessary before it can be assumed that inequality has been permanently reduced.

Projections of the income distribution are presented in section V. Figure 6 and table 12 in that section represent the way figure 1 and table 2 would change if the proposed recommendations were implemented. The projections suggest that the interquintile income ratio between the highest and lowest quintile would drop from 7.6 to 5.4.

Unfortunately, there are no simple measures that describe the income distribution in the way, for example, that unemployment and inflation rates describe the macroeconomic situation. The statistics that summarize the distribution, such as the Gini coefficient [26] (about 0.40 before taxes and 0.37 after), have little intuitive meaning.

The problem is difficult because we are discussing over 200 million people; each is unique and the information about all of them must be condensed into a few paragraphs and numbers. In macroeconomics the information concerning 80 million workers or millions of transaction prices is condensed into one unemployment rate and one or two price indexes with some success. A 4 percent unemployment rate or 3 percent inflation rate does convey a great deal of the overall economic situation. We are beginning, however, to see some of the difficulties of shorthand descriptions now that experts are arguing over the proper price index or insisting that one look beneath the global unemployment rate at the conditions of married men, teenagers, women, and so on.

The income distribution information is more difficult to compress.[27] We are trying to describe income per unit and there is no agreed upon definition of income. Nor is there agreement on the income unit; for example, should it be persons, families, or households? [28] Is it more descriptive to say that 69 percent of persons of low income status were white or that Negroes were 3.4 times more likely than whites to be poor? [29]

The solution to complex data is always aggregation, but aggregation always discards information. We could aggregate by race, or sex of the family head, or age, or educational status, and so on. None of these ways of aggregating the data is necessarily any better (or more truthful) than many others; it depends on what one wants to show.

The choice in this paper is to use families (and unrelated individuals), rather than households or persons as the unit of measurement and to use the Census definition of before-tax money income as the income measure. Income (money income as defined by Census) will be

[26] The Gini coefficient measures the area between a Lorenz (cumulative income versus cumulative population) curve and a 45 degree line that represents an equal distribution of income. The measure is zero for an equal distribution and 1.0 if all income goes to one person in the society.

[27] For some descriptions of the U.S. income distribution see James Morgan, "The Anatomy of Income Distribution," *The Review of Economics and Statistics*, August 1962, pp. 270–283; Herman P. Miller, *Income Distribution in the United States* (A 1960 Census Monograph), U.S. Government Printing Office, Washington, D.C., 1966; and Lee Soltow, *Six Papers on the Size Distribution of Wealth*, National Bureau of Economic Research, New York, 1969. See also, table 7 and fig. 2 of this paper.

[28] The term "families" refers to relationships by blood or marriage, "household" refers to living arrangements; thus, there may be more than one family in a household.

[29] U.S. Bureau of the Census, *Current Population Reports*, Series p–60, No. 81, "Characteristics of the Low Income Population, 1970," U.S. Government Printing Office, Washington, D.C., 1971, table B, p. 3.

categorized by source—essentially earned and unearned income. It is important to note at the outset that unearned (transfer and property) income is seriously underreported and excludes capital gains.

The income distribution situation may be more easily grasped—and perhaps we will be less likely to forget it is individuals and not statistics we are interested in—if we represent the 1970 resident U.S. population of 203 million by a small community of 203 individuals in which each person represents 1 million Americans. Only 15 of these individuals lived alone, the rest being members of 51 families. There were 70 individuals under 18 years old and 20 over 65. The 51 families received $580,000 in before-tax money income (an average of $11,100 per family). If we divide total family income into two halves we find that one-half went to the 14 families whose income was $14,000 or more while the other half had to be shared by the remaining 37 families.[30] Thus, 27 percent of the families received 50 percent of the income. The 14 wealthier families had an average income of $20,600 while the average income of the remaining 37 families was only $7,800.

Income is not the only difference between these two groups. Families whose heads are retired, disabled, cannot find steady employment, or have no spouse tend to be in the lower income group, while those where the husband and wife both work full time are more frequently found in the higher income classes.

Families are traditionally grouped into the five quintiles. The problems of income maintenance are, in most part, the problems of the lowest income quintile. In the lowest quintile, 35 percent of all family heads were aged, 29 percent were female, 45 percent did not work at all, and 22 percent worked full time all year long. (These percentages add up to more than 100 because the cited groups overlap considerably.) If the lowest quintile is thought of as a homogeneous group then the "average" family received about $3,000 (in 1970) split approximately equally between earned and unearned income. But the quintile is not homogeneous; only 40 percent of families received both earned and unearned income, 26 percent worked for every dollar they received, and 35 percent earned none of their income.

It is misleading to view any of the quintiles as homogeneous; moreover, the failure to recognize heterogeneity often leads to mistaken conclusions about the net effect of tax and transfer programs. For example, in 1970 the social security system paid approximately $9 billion in benefits to families in the lowest quintile while collecting less than $2 billion (even assuming, as most economists do, that the employer's share of this tax fell on the wage earner). However, 53 percent of the lowest-quintile families received wages or salaries and paid an average of $240 in social security taxes while 42 percent received social security (and railroad retirement) benefits and collected an average of approximately $2,150 from this source.[31] Obviously,

[30] All the data referred to are for 1970 and were taken from various tables in U.S. Bureau of the Census, *Current Population Reports*, Series P-60, No. 80, "Income in 1970 of Families and Persons in the United States," U.S. Government Printing Office, Washington, D.C., 1971, and *Statistical Abstract of the United States* (92d ed.), Washington, D.C., 1971.

[31] Adjusted for underreporting, these data derived from unpublished Bureau of the Census data. Additionally, substantial social security benefits were paid to and collected from unrelated individuals.

social security transfers a significant amount of income between members of this quintile because the taxpayers were generally not the benefit recipients.

As noted above, only 15 of the 203 (million) Americans were not living with another family member in 1970. Census defines these persons as unrelated individuals. Their average (mean) income was $4,560, almost 50 percent greater than the mean per capita income ($3,080) of individuals in families. As was the case for families, however, it is misleading to view this group as homogenous; almost one-third of the unrelated individuals were below the official low-income (poverty) line.[32] Approximately three out of every five unrelated individuals had earnings; the mean income for this group was almost $6,000. In contrast, the mean income for the remaining 40 percent was less than $2,400 and their median income was only $1,700. About one out of every four unrelated individuals was between the ages of 14 and 34 and about half of the remainder were under 65.

The definition of the poverty line recognizes that, while two cannot live as cheaply as one, there are economies of scale in family living. In other words, per capita income is not a measure of well-being because per capita needs vary with family status.[33] This variability makes it difficult to develop an approach to poverty that is neutral with regard to family structure or size. For example, current welfare laws of many States encourage fathers to desert their families. On the other hand, uniform demogrants which do not recognize the scale economies of family living will encourage family formation and fertility.

It is important in evaluating the income distribution to examine the composition of the quintiles. For example, while it is obviously true that there is going to be a lowest quintile in any income distribution, the racial composition of each quintile would be similar (which it is not in the U.S. case) in the absence of any racial differences. Reward-equity may require that income vary with hours worked; in this case those families which do not contain any full-time workers would tend to be in the lowest quintile, while those that contain two or more full-time workers would be more frequently found in the higher quintiles.

In addition to the demographic composition of the quintiles we should also examine the interquintile differences in the amount and composition of income. Support-equity might require that unearned income such as transfer payments (both public transfer and private pensions) be provided to those whom the society feels should not have to work—the retired, the disabled, widows and, up until recently, other female-headed families. These payments, along with property income that the retired might be expected to have, might not change the composition of the quintiles but would diminish the interquintile differences.[34]

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[32] Low income (poverty) as defined by the Social Security Administration (SSA) and revised in 1969. See tables C and pp. 3 and 20 in "Characteristics of the Low Income Population," U.S. Bureau of the Census Series P–60, No. 81, U.S. Government Printing Office, Washington, D.C., 1971.

[33] Benjamin Bridges, Jr., "Family Need Differences and Family Tax Burden Estimates," *National Tax Journal*, December 1971, pp. 423–425.

[34] Public expenditures other than transfers may also diminish the interquintile differences; see W. Irwin Gillespie, "Effect of Public Expenditures on the Distribution of Incomes" in Richard A. Musgrave (ed.) *Essays in Fiscal Federalism*, The Brookings Institution, Washington, D.C., 1965, pp. 122–186.

This general description does not suggest the equitable amount of transfer payments nor the equitable distribution of earned income [35] among workers; nor does it suggest how differences in the number of workers per family should be reflected in quintile differences in income. The following estimates the relative importance of these three facrors (unearned income, earnings per worker, and workers per family) on the 1970 distribution of income among families.

B. The Source of Current Income Differences

Table 3 displays the data on the distribution of unearned (property and transfer) income among U.S. families in 1970. The data in the top half of the table indicate, for each quintile, the proportion of families that are aged and female-headed and the proportion of families that receives each type of unearned income.

Though the percentage of aged and female-headed families diminishes as we move up the quintiles (that is, comparing the second to the lowest, the middle to the second, et cetera) the percentage of families receiving unearned income does not. Almost three-fourths of those in the highest and lowest quintile and more than half of those in the other three quintiles received unearned income.

The number of social security recipients does appear to be related to the number of aged—in each quintile the percent of recipients is 6 percent greater than the percent of aged families. In contrast, the percentage of families receiving property income increases as we move up the quintiles. The percentage receiving pensions is relatively uniform but two-thirds of those receiving welfare are in the lowest quintile.

Just as important as the number of recipients, of course, is the amount each recipient receives. The data for each source of unearned income is shown in the bottom half of table 3. Before discussing these data, some provisos should be noted. The data on unearned income are seriously understated in the Census reports; it is estimated that less than 60 percent of this income is reported. The Census data can, however, be forced to conform to the Bureau of Economic Analysis (BEA) totals by multiplying the dollar amounts by a factor representing the underreporting (for example, since only 38 percent of property income is reported the unadjusted dollar amounts were multiplied by 2.6). The adjusted data are shown in the bottom of table 3. Use of this adjustment procedure assumes that respondents only understated the amount received rather than failing to report any income from that source and that (relative) underreporting does not change with the amount received. Note also that neither adjusted nor unadjusted income includes capital gains nor is the income reduced by the amount of taxes paid.

With these provisos in mind we can analyze the distribution of unearned income among the universe of recipients. That is, the following discussion refers to the 64.7 percent of families that received some unearned income in 1970. The average family receiving some unearned income collected $3,350 [36] in transfers and property income.

[35] For an extremely interesting attempt to arrive at what would be an equitable distribution of earned income, see Ray C. Fair, "The Optimal Distribution of Income," *The Quarterly Journal of Economics*, November 1971, pp. 551–579.

[36] On an adjusted basis, or $1,950 on the basis of unadjusted Census data. The following discussion of unearned income refers to the adjusted data.

TABLE 3.—*Percentage of families receiving unearned income and average amount per recipient family, by source and income quintile in 1970*

	Quintile					
	Lowest	Second	Middle	Fourth	Highest	Total
	Percent of families					
Where family heads are—						
65 years or older	35. 1	15. 1	7. 7	5. 6	5. 6	13. 8
Female	28. 9	13. 8	7. 4	4. 4	2. 7	11. 4
Total	64. 0	28. 9	15. 1	10. 0	8. 3	25. 2
Receiving unearned income from—						
Any source	73. 9	56. 2	57. 1	63. 2	73. 3	64. 7
Social security [1]	42. 0	22. 0	14. 0	11. 0	11. 0	19. 9
Property income [2]	25. 0	31. 0	39. 0	47. 0	64. 0	41. 8
Private pensions [3]	14. 0	11. 0	8. 0	7. 0	8. 0	9. 4
Government pensions [4]	14. 0	19. 0	17. 0	17. 0	15. 0	16. 4
Welfare payments [5]	20. 0	5. 0	3. 0	2. 0	1. 0	6. 0
	Average unearned dollars per recipient family [6]					
Unadjusted unearned income:						
All sources combined	2, 070	2, 040	1, 470	1, 420	2, 600	1, 950
Social security	1, 850	2, 050	1, 850	1, 680	1, 840	1, 870
Property income	630	690	560	670	1, 820	980
Private pensions	1, 080	1, 810	1, 710	1, 680	3, 170	1, 770
Government pensions	1, 030	1, 240	1, 160	1, 510	1, 870	1, 350
Welfare payments	1, 590	1, 530	1, 910	1, 220	980	1, 570
Adjusted unearned income: [7]						
All sources combined	2, 800	3, 210	2, 480	2, 460	5, 530	3, 360
Social security	2, 150	2, 380	2, 150	1, 950	2, 130	2, 170
Property income	1, 640	1, 790	1, 460	1, 740	4, 730	2, 550
Private pensions	1, 930	3, 240	3, 060	3, 010	5, 670	3, 170
Government pensions	1, 185	1, 430	1, 330	1, 740	2, 150	1, 550
Welfare payments	2, 020	1, 940	2, 430	1, 550	1, 250	1, 990

[1] Social security and railroad retirement benefits.
[2] Dividends, interest, net rental income, income from estates or trusts, and royalties.
[3] Private pensions, annuities, alimony, etc.
[4] Government employee pensions, unemployment and workman's compensation, and veterans benefits.
[5] Public assistance and welfare payments.
[6] Dollars from source to quintile/families in quintile receiving income from this source.
[7] Adjustment factor from unpublished census data for 1968.

Source: U.S. Bureau of the Census, Current Population Reports, series P-60, No. 8, "Income in 1970 of Families and Persons in the United States," U.S. Government Printing Office, Washington, D.C., 1971, and unpublished census data. Derived percentages are shown to 2 significant places.

The interquintile variation of the average amount received by recipients in the lowest four quintiles is moderate, $2,850 plus or minus 13 percent. Those in the highest quintile, however, received almost twice this amount from all unearned income sources.

The two most important sources of unearned income are social security and railroad retirement benefits (SS–RR income) and dividends, interest, net rents, and income from estates, trusts, and royalties (property income). In 1970, families (exclusive of unrelated individuals) reported receiving about $20 billion from each of the two sources; on an adjusted basis, however, SS–RR income was approximately $22 billion and property income was $55 billion.

Among those receiving SS–RR income, the average payment per recipient was relatively uniform among quintiles at the mean of slightly less than $2,200 (adjusted). Thus, social security benefits are not progressive [37] with respect to the receiving population; more total dollars go to the bottom quintile only because more old people are poor.

Among those in the lower four income quintiles who received property income the amount received was also relatively uniform at close to $1,600 per receiving family. Among those in the highest quintile who received property income, however, the average family collected $4,700 in interest, dividends, rents, et cetera—three times as much as the average in the lower quintiles.

The average family in the middle three quintiles who received income from private pensions, annuities, or alimony collected $3,200. The average recipient in the lowest quintile, however, received only $1,900, while the average in the highest quintile received three times as much, or $5,700. Among those families receiving Government or veteran's pensions or workman's or unemployment compensation the amount collected was close to $1,200 in the lowest quintile and $2,150 in the highest quintile. Thus, these benefits are also regressive among the universe of recipients (or overall since the percentage of recipients is relatively uniform).

The fact that property income and private and Government pensions tend to exacerbate—not moderate—income inequality has implications for stabilization, as well as income distribution policy.[38] Surprisingly, the average welfare payment seems relatively insensitive to the income quintile in which the recipient may be located. The average recipient in the lowest two quintiles receives close to the overall mean of $2,000, the average payment jumps $400 in the middle quintile, and drops to $1,250 in the highest quintile. Of course, the percentage of recipients drops drastically as we move up the quintiles, from 20 percent in the lowest quintile to 5 percent in the second and 1 percent in the highest.[39]

[37] The word progressive in this document means the expenditures (or tax) tend to diminish income inequality.

[38] Less than full employment has frequently been tolerated in order to reduce the rate of inflation. An equity justification for this policy has been that inflation is especially disadvantageous to the elderly poor who are presumed to be living on fixed pensions or property income. The data indicate that social security benefits are the most important source of unearned income in the lowest quintile. Because these benefits now respond to the consumer price index, the burden of inflation will not be borne primarily by the poorest of the families whose head is 65 years of age or older. Thus, this equity excuse for less than full employment is no longer valid (if it ever was).

[39] Families in the highest quintile may legally receive welfare if, for example, an aged uncle or a niece with a child and no husband live with the primary family.

The data in table 3 describe the interquintile differences in unearned income; the data in table 4 describe the interquintile differences in earned income—the primary determinant of the overall income distribution. Of the families that contained at least one earner, the average (mean) family received $10,800 in earnings in 1970. Of this universe of families, those in the lowest quintile received only $2,200 on average, while the average earned income of those in the highest quintile was $21,400—a ratio of 9 to 1.[40] Some of the interquintile differences in earned income occurs because the wife, in a two-parent family, is willing and able to find employment. On a per-earner basis (rather than per-earning family) the differences moderate. The ratio of earned income between the highest and lowest quintile on a per-earner basis is only 6 to 1 (compared to the 9 to 1 ratio on a per-family basis).

The interquintile variation in total money income may be partitioned among the variables discussed above—the amount of unearned income, the number of earners per family, and the average amount per earner. The results of the partition are shown in table 5 and illustrated in figure 2.

As shown in the top line of table 5, the mean family in the poorest quintile received only 28 percent of the overall mean (not median) income ($3,050/$11,100), while those in the highest quintile received 208 percent of the mean ($23,100/$11,100).[41] For those quintiles in which the average income is less than the mean of $11,100 we can define the difference between the overall mean and the quintile mean as the shortfall; for those in which the average exceeds the mean we can define the negative of this difference as the excess. The remainder of table 5 partitions the shortfall for the lowest three quintiles and the excess for the two highest quintiles among the three causes mentioned above.[42]

The partition of the shortfall for the lowest quintile is shown in the first column in table 5 (or the leftmost bar in fig. 2). The most important reason—69 percent of the total shortfall of $8,050—was a result of lower earnings per worker.[43] Next in importance (34 percent) was the difference between the 0.92 earners in the average family in the lowest quintile and the national average of 1.68. Least important was unearned income.

[40] The earned data are reported fairly accurately and were left unadjusted. More than 95 percent of wage income is reported to the Census and more than 90 percent of nonfarm self-employment income reported to BEA is contained in the Census figures.

[41] The discussion from this point on uses the unadjusted data since this was the basis for forming the quintiles. This procedure understates income inequality.

[42] For example, consider the world as containing only two families. Family A has two earners, each earning $10,000 and unearned income of $4,000 for a total of $24,000. Family B has one earner, earning $7,000 and received $3,000 in unearned income for a total of $10,000. The average family income is $17,000, family A has a $7,000 excess and family B a $7,000 shortfall, the average number of earners per family is 1.5 and the average earnings per earner is $9,000. Of family A's excess (or family B's shortfall in this symmetric world) $500 is a result of the difference in unearned income, $1,500 results from the difference in earnings per earner, and $4,500 is a result of the difference in number of workers. The remaining $500 (the cross product term) is divided equally between numbers of earners and earnings/earner.

[43] That is, the $4,213 difference—between the national mean of $5,863 earnings/earner and the lowest quintile mean of $1,650—times the average number of workers is 59 percent of the lowest quintiles shortfall of $8,050 (including one-half the cross-product term).

TABLE 4.—*Percentage of families receiving earned income and average amount per recipient family by source and income quintile 1970*

	Quintile					Total
	Lowest	Second	Middle	Fourth	Highest	
PERCENT OF FAMILIES						
With nonaged male head [1]	36.0	71.1	84.9	90	91.7	74.8
Receiving earned income:						
From any source	65.2	93.3	98.2	99	99.2	91.0
Wages and salaries	53.0	88.0	94.0	96	95.0	85.8
Self-employed income:						
Nonfarm	10.0	11.0	11.0	12	17.0	12.3
Farm	8.0	6.0	4.0	4	4.0	5.3
AVERAGE EARNED PER RECIPIENT FAMILY						
From all sources	$2,230	$5,920	$8,990	$12,260	$21,370	$10,820
Wages and salaries	2,520	5,730	8,710	11,840	19,480	10,380
Self-employed income:						
Nonfarm	1,160	3,090	4,210	5,410	14,200	6,500
Farm	1,050	2,270	2,920	3,380	6,620	2,710
Note: Earners per family	(0.92)	(1.48)	(1.74)	(2.00)	(2.29)	(1.68)

[1] Total (100 percent) less percentage that have either female heads or heads 65 years or older. The number of disabled family heads is the same order of magnitude as the number of aged-female heads of families. Thus, the percentage shown approximates the nonaged, nondisabled, 2-parent families.

Source: U.S. Bureau of the Census, *Current Population Reports*, Series P-60, No. 8, "Income in 1970 of Families and Persons in the United States," U.S. Government Printing Office, Washington, D.C., 1971, and unpublished Census data. Derived percentages are shown to 2 significant places.

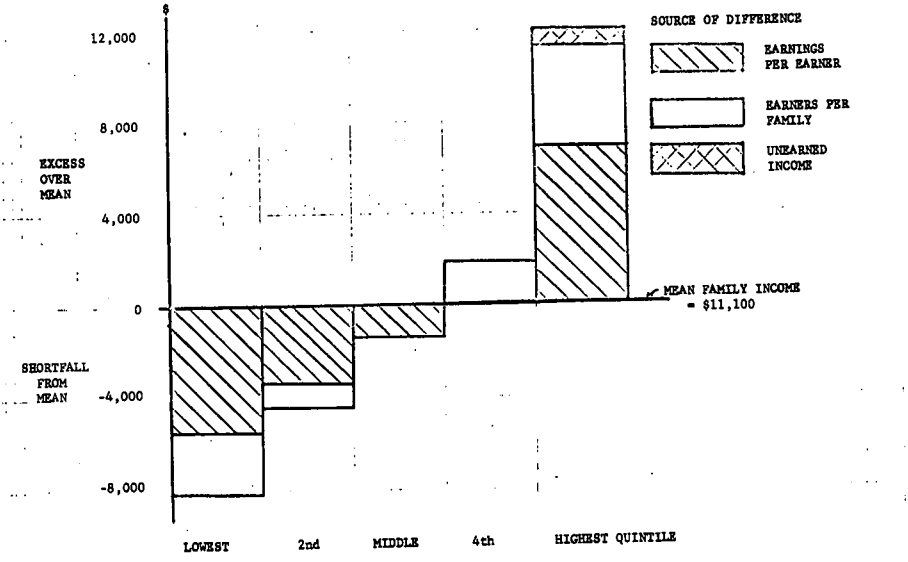
TABLE 5.—*Income differentials by source and quintile* [1]

	Income quintile					National mean
	Lowest	Second	Middle	Fourth	Highest	
Total mean income	3,050	6,650	9,660	13,020	23,100	11,100
Excess or shortfall (−) (from mean)	−8,050	−4,450	−1,440	1,920	12,000	
Unearned income: [2]						
Mean all families	1,530	1,140	840	890	1,900	1,260
Offset (percent)[3]	3	−3	−29	−19	5	
Earned income:						
Earnings per earner	1,650	3,730	5,070	6,070	9,260	5,863
Offset (percent)[4]	−69	−75	−94	20	57	
Earners per family	0.92	1.48	1.74	2.00	2.29	1.68
Offset (percent)[5]	−34	−22	23	99	38	
Addenda: Adjusted unearned income:						
Mean all families	2,070	1,800	1,410	1,550	4,050	2,170
Offset (percent)[3]	−1	−8	−52	−32	16	
Mean recipient families	2,800	3,210	2,480	2,460	5,530	3,360

[1] See fig. 2 for a graphic representation of the data in this table.
[2] Unadjusted.
[3] (National mean-quintile mean unearned income)/quintile excess or shortfall.
[4] Difference in quintile income because of inter-quintile variation in earnings per worker/quintile excess or shortfall.
[5] Difference in quintile income because of inter-quintile variation in number of earners/quintile excess or shortfall.

The last column in table 5 (and the rightmost bar in fig. 2) indicates why families in the highest quintile have more money. More than half (57 percent) of the $12,000 difference (the excess between their average income and the national mean) is a consequence of greater earnings per earner. Almost 40 percent is a result of having, on average, about 0.6 more earners per family. Finally, 5 percent of the excess of their average income over the mean income comes about because families in the highest quintile receive more than the average amount of unearned income (on an unadjusted basis or 17 percent on the adjusted basis).

FIGURE 2.—Partition of Shortfall or Excess in Quintile Income Relative to Mean Income, 1970



The implications of the data are quite clear, as shown below.

TABLE 6.—*Average amount of excess or shortfall for all quintiles*

Source of differences	Amount	Percent
Earnings per earner	$3,464	62
Earners per family	2,002	36
Unearned income	108	2
Average total shortfall or excess	5,574	100

The interquintile difference in average earnings among those who are gainfully employed accounts for more than three-fifths of the interquintile difference in family income; the number of earners per family accounts for another one-third of the difference. Unearned income reduces the inequality in the lowest and fourth quintile, and aggravates the situation for the other three quintiles. On a net basis

unearned income causes a slight amount of the overall inequality (only 2 percent on an unadjusted basis but perhaps 10 percent using the adjusted data in table 3).

The data indicate that historically:

Unearned income, while important to certain subgroups in the population—the aged and disabled, one-parent families, and wealth owners—does not change the overall distribution substantially.

For the majority of the population—families with two able-bodied parents—the most important route to more equitable income distribution is the availability of full-time, full-year employment at adequate wages.[44]

Currently, unearned income does reduce interquintile income differences; it may be because the amount of poverty-reducing transfers is inadequate or because transfers, such as social security, are not targeted. This demonstrated lack of success suggests that it is worthwhile to examine the more important Federal programs for transferring income. The emphasis will be on evaluating them in terms of the objectives defined in section II of this paper.

C. Income Maintenance: Conflicting Objectives and the Welfare Mess

1. WELFARE FOR THE ABLE BODIED

Unclear and conflicting objectives have led to a welfare system that is economically and programmatically inefficient. Current programs do not provide adequate support for those who cannot work, do not create horizontal equity among those on welfare, and do not establish vertical equity between those on welfare and the working poor.

Our current welfare "mess" may reflect the lack of clearly defined objectives or agreement as to what constitutes efficiency and equity. Or, it may be more accurate to place the blame for the mess on an unanticipated change in the clientele and objectives of welfare. Welfare was originally intended to provide support-equity for the unfortunate few who could not work. In the mid-1930's it was assumed that many would require temporary assistance because of society's failure to provide the conditions within which reward-equity could be achieved.[45] These necessary conditions were full employment, to provide opportunities for those who could work, and insurance to provide support for those who could (or should) not. Roosevelt's general economic policies were to provide the former and the Social Security

[44] The data difficulties should be emphasized once again. Joseph Pechman in "Distribution of Federal and State Income Taxes By Income Class," *Journal of Finance*, May 1972, pp. 181–183, estimates that money income was underreported by almost 20 percent in the 1966 census. The underreporting, however, tends to understate the maldistribution of income and would, therefore, tend to support rather than contradict the conclusions presented here.

The policy recommendations made in this paper are based on unadjusted census data. The estimates of the number of individuals affected and program costs suffer from the data problem. However, income understating means that the cost estimates are overstated; on the other hand, the policy proposals are all based on median income which is also understated in the census data. An improvement in the data is a prerequisite to effective income distribution policy.

[45] For a description of the evolution of public assistance see the chapter entitled "From the Poor Laws to the Present" in Bruno Stein, *On Relief*, Basic Books, Inc., New York, 1973.

Act of 1935 was to provide the latter. Thus, welfare would wither away.

Problems arose for a number of reasons—the aid for dependent children (AFDC) caseload changed from widows who were predominately white to unmarried mothers who were frequently black; many middle class mothers went to work and the argument that mothers should be supported so they need not work began to dissolve; and the amount required to provide support at levels that were perceived as adequate increased and outstripped public budgets and insurance benefits. Instead of withering away as anticipated when the Social Security Act of 1935 was passed, the welfare programs became bigger, more complicated and more controversial. But most significantly, a program that was intended to deal with support-equity had to meet objectives for reward-equity.

There still is apparent agreement on providing support (though there is disagreement as to the level) to those who are prevented from working for a "good" reason (the aged, disabled, widows, and children). In addition, our society still seems willing to provide partial or complete subsidies for those (merit) goods—education, health, food, and housing—whose consumption seems especially meritorious. However, concepts of reward-equity have generated resentment against the "loafers" who abuse AFDC and unemployment insurance, and conflicting objectives with regard to single-parent or other able-bodied family heads have led to contradictory programs and regulations. Moreover, the overlapping confusion of programs frequently leaves the family head who tries to meet his responsibilities worse off than those who do not. In addition to discriminating against families with two parents programs create situations and "notches" so that more earnings can result in less income.[46] That is, the multitude of programs create very high effective tax rates on marginal earnings and, at some notches, these rates may exceed 100 percent.

Such a situation is made more likely by the provision of large, means-tested benefits contingent upon welfare status. In New York City, for example, it has been reported that the average AFDC family receives over $1,000 in medicaid benefits.[47] This establishes a strong disincentive to increasing earnings above the point where income is just sufficient to remove this benefit. The same situation arises, to a lesser extent, with regard to food stamps, public housing, and day care.

The magnitude of the problem created by overlapping programs that provide benefits in kind can be seen in the gross figures shown in table 7. It is estimated that medicaid will cost more in fiscal 1973 than AFDC, becoming the largest single income-tested program. In fact, it is estimated that in fiscal 1972, AFDC represented only 27 percent of the total of $24.6 billion spent for income-tested programs while medicaid, public housing, and food (stamps, distribution, and free school lunch) accounted for 40 percent of the total. It is impossible to reform the welfare system by reforming only AFDC while leaving the other programs intact.

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[46] James R. Storey, "Public Income Transfer Programs: The Incidence of Multiple Benefits and the Issues Raised by Their Receipt," *Studies in Public Welfare, Paper No. 1*, prepared for the Subcommittee on Fiscal Policy, Joint Economic Committee, Washington, D.C., March 1972.

[47] Ibid, p. 16.

The growth in the significance of the problem and the shift in emphasis from support to incentives to join the labor force has, in recent years, evoked considerable interest among economists in the problems of poverty, welfare programs, and negative income taxes. These issues have also occupied a place of central importance in public debate, especially since the war on poverty was initiated and President Nixon's family assistance program was introduced.

TABLE 7.—*Benefit outlays under public income transfer programs, fiscal year 1972*

[In billions of dollars]

Program	Benefit outlays, fiscal year 1972			
	Total percent	Total	Federal	State and local
Income-tested programs: [1]				
Aid to families with dependent children	27.2	$6.7	$3.7	$3.0
Old-age assistance	10.2	2.5	1.7	.8
Aid to the blind	.4	.1	.06	.04
Aid to the permanently and totally disabled	6.1	1.5	.8	.7
General assistance	2.8	[2].7	--------	[2].7
Veterans' pensions	10.2	2.5	2.5	--------
National school lunch program (free or reduced-price lunches)	2.0	.5	.5	--------
Food stamps	8.1	2.0	2.0	--------
Food distribution (to individuals and families)	1.2	.3	.3	--------
Public housing	3.3	.8	.8	--------
Medicaid	28.5	7.0	3.9	3.1
Total, income-tested programs	100	24.6	16.3	8.3
Other income transfer programs:				
Old age and survivors insurance	46.0	34.5	34.5	--------
Disability insurance	5.3	4.0	4.0	--------
Railroad retirement	2.8	2.1	2.1	--------
Civil service retirement	4.5	3.4	3.4	--------
Other Federal employee retirement [3]	5.3	4.0	4.0	--------
State and local retirement	4.4	[4]3.3	--------	[4]3.3
Unemployment insurance	8.5	6.4	6.4	--------
Workmen's compensation	4.0	[5]3.0	.2	[5]2.8
Veterans' medical care [6]	2.9	2.2	2.2	--------
Veterans' compensation [7]	4.8	3.6	3.6	--------
Medicare	11.3	8.5	8.5	--------
Total, other programs	100	75.0	68.9	6.1
Total, all programs		99.6	85.2	14.4

[1] These programs base benefits on the current needs of recipients.
[2] Data on general assistance payments are for calendar year 1970.
[3] Military retirement and 6 other retirement programs.
[4] Data on benefits paid by State and local retirement systems are for calendar year 1970.
[5] Data on workmen's compensation benefits under State programs are for calendar year 1970 and include both cash benefits and reimbursements for medical expenses.
[6] The Veterans' Administration medical care program is, in part, an income-tested program since any veteran who signs a "pauper's oath" can get free care in VA hospitals. However, many VA patients are entitled to treatment for reasons related to military service and receive care without regard to their financial resources.
[7] Benefits are income-tested for a small number of parents who are survivors of deceased veterans.

Source: Budget of the U.S. Government, 1973, "Special Analysis L: Federal Income Security Programs." Reprinted from Storey, *op. cit.*

The negative income tax[48] proposals and the coverage of the working poor in the administration's welfare reform bill makes the conflict between the minimum support (guarantee) and incentive objectives explicit. It is clear that the lower the tax on earnings (or more accurately, though equivalently, the smaller the welfare reduction per dollar of additional earnings) the greater the work incentive. If the budget cost of the lower tax rate is offset by dropping the guarantee level (thus applying both the carrot and stick), the total work effort and national income will be increased.[49] The additional economic output will come at the expense of those families with no other income, who will suffer because of the reduction in the guarantee level. Support-equity will be reduced as will budget efficiency, because a larger share of the benefits will now go to those above the poverty line. This result may not appear inequitable to those working poor who are better off at the expense of the nonworking poverty population. Moreover, it is quite possible that the average taxpayer, who would not receive benefits under either arrangement, may find a lower guarantee and a lower marginal tax rate preferable on equity grounds—that is, the reward ethic may be stronger than the support ethic.

The current welfare system is frequently criticized on the basis of program inefficiency. This argument holds that though it may be equitable to help only those who either cannot work or who are already working to the best of their ability, it is administratively inefficient to identify the "slackers." (Some would argue that it is not even possible.) This is perhaps the most significant difference between the negative income tax (NIT) and either the current system or the present welfare reform proposals. Under the NIT proposals:

> Benefits are determined * * * with no attention paid to why a person or family is poor. As a matter of "right" everyone has access to benefits * * * This contrasts especially with the view * * * that * * * society must be protected against the loafer * * *[50]

The recent experience with welfare reform legislation suggests that our society is still very concerned about the loafer. In fact, some claim they are willing to pay for day care rather than provide a welfare check, even if the day-care expenses exceed the welfare check, in order to allow (or force) the welfare mother to work. For those holding this view, the reward-equity consideration is apparently more important than efficiency criteria.

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[48] The essential point of the negative income tax is that it would extend the tax schedule so that those whose income was below the break-even (zero tax) point would pay a "negative" tax; that is, receive money from the Government. Thus, no one would face a confiscatory tax on additional earnings. In particular, the working poor would not find that earnings reduce their welfare benefit, almost dollar-for-dollar, leaving them hardly better off for having earned additional income. For a better description see Bruno Stein, op. cit., pp. 77–97. For an analysis of tax rates see "Income Transfer Programs: How They Tax the Poor," *Studies in Public Welfare, Paper No. 4*, prepared for the Subcommittee on Fiscal Policy, Joint Economic Committee, Washington, D.C.

[49] There is a lower limit to the guarantee level even on economic efficiency grounds. Current standards in some areas are inadequate to maintain the health of recipients and, as a result, the children in these families are unlikely to become self-supporting.

[50] Christopher Green, *Negative Taxes and the Poverty Problem*, The Brookings Institution, Washington, D.C., 1967, p. 7.

The welfare system, despite its other failings, is generally budget efficient; most benefits are paid to those below the poverty line. Budget efficiency, however, is not one of the goals of the social security system; moreover, it is not well integrated with the welfare system (although some provisions of H.R. 1, the social security amendment passed in 1972, moved in this direction) and has its own internal inconsistencies as well.

2. INCOME MAINTENANCE FOR THE AGED AND DISABLED

Federal income maintenance expenditures for the aged and disabled—including cash benefits, in-kind benefits, and tax transfers—were estimated at $75 billion for fiscal 1973.[51] Old age survivors, and disability insurance (OASDI) provides income to those who have worked and paid their payroll taxes while old age assistance (OAA) supports those who are poor and aged. If OASDI provided reward-equity and OAA provided support-equity we would have two program instruments and two reasonably distinct objectives. However, OASDI is far from a Government run annuity and insurance system; reward and support objectives are so hopelessly comingled that it is impossible to sort them out in the current system.

For example, the relationship between social security contributions and benefits is not clear. Perhaps the majority of individuals believe that their benefits have been earned by their contributions to the trust fund; however, many economists argue that there is no relationship. In the economist's view the payroll tax is one way of collecting revenue and retirement benefits is a way of spending and any connection is coincidental or cosmetic. The political and public discussions, however, and more importantly the legislative deliberations, suggest that some[52] connection exists between total contributions and benefits and between individual contributions and benefits.[53] The connection between totals is closer now than it has been in the past because of the recent changes in the actuarial procedures that tend to put the system on a pay-as-you-go basis.

The connection between individual contributions and benefits, however, remains loose in a variety of ways. For example, the minimum benefit exceeds the actuarial value of the corresponding contributions as a reward for having worked (which frequently provides

[51] Office of Management and Budget, *Special Analyses, Fiscal Year 1973*, U.S. Government Printing Office, Washington, D.C., 1972, p. 187.

[52] As an indication of the controversy over this relationship one reviewer suggested replacing the adjective "some" with "close" while another suggested replacing it with "tenuous." The strength of the connection appears, like beauty, to be in the eyes of the beholder. some have suggested that the relationship is an unwritten contract between succeeding generations of workers; each generation agreeing to provide retirement benefits to those who have preceded them in return for similar treatment from the generation that will follow them.

[53] See Milton Friedman, in "Social Security, The Poor Man's Welfare Payment to the Middle Class," *The Washington Monthly*, May 1972, pp. 11–18, for a criticism of the program. He is especially critical of referring to compulsory payroll taxes as "contributions." For both sides of the argument see The American Enterprise Institute, *Social Security: Universal or Selective? Rational Debate Between Milton Friedman and Wilbur J. Cohen*, Washington, D.C., 1972. See also, Brittain, op. cit., pp. 7–13.

a windfall to Civil Service workers or military personnel who retire with their Government pension and then work at a second job long long enough to receive the minimum benefit). Need is also the criterion that provides couples with larger benefits than individuals for the same contribution. On the other hand, the limit on maximum benefits (as well as the minimum number of quarters required to establish eligibility) makes certain "contributions" valueless. Similarly, greater contributions yield larger benefits but not in the same proportion. Contributions may also turn out to bring little benefit for those who receive benefits from OAA and OASDI (because less OASDI would mean more OAA benefits).

Reward equity with regard to the aged is complicated by the issue of saving. Some features of OASDI reward saving as well as having worked, under covered employment, or having been a spouse of a worker. For example, the reward for voluntary saving is reflected in the provisions that permit beneficiaries to receive their full social security benefit irrespective of their property income. However, the reward for forced saving (contributions) is uncertain because OAI benefits will be reduced if a recipient (under the age of 72) earns more than $175 per month.

The earnings limitation is an interesting illustration of conflicting objectives between income maintenance programs. The provision's original, depression-born, intent was to create economic inefficiency by providing the aged with incentives to quit the labor force. (After, of course, they had served their term.) Not only is this in direct contradiction with the avowed aim of welfare reform (that is, we punish the aged for working and the AFDC mother for staying home) it is inconsistent with the support-equity objectives of OASDI itself. That is, we have created a situation in which an individual whose earnings were sufficient to allow him to accrue private savings can supplement inadequate benefits while the individual who never earned enough to save a substantial amount must choose between retirement and benefits under Social Security or continued work.[54]

The attempt to achieve support-equity for the aged through OASI is not completely successful. Because society feels some obligation to provide support for those aged who have not worked at covered employment, social security benefits are supplemented by welfare payments (OAA) when the individual has little other income. But this compromise is not completely satisfactory either. On one hand, OAA benefits carry a welfare stigma; on the other hand, welfare status may bring additional benefits—for example, access to medicaid or food benefits. In this way, it is possible for an increase in social security benefits to be detrimental to some recipients—for example, to someone whose total income from social security and old-age assistance remains essentially unchanged (the increase in the former being offset by the

[54] Recognition of this problem is not new; the justification for continuing the earning limitation has been the budget cost of its removal. Congress seems to be removing the limit in stages. H.R. 1 raised the limit from $140 to $175 a month and the Senate version of that bill would have increased it to $250 a month. If the earning limit cannot be justified on equity or efficiency grounds, one must wonder about its retention on budget grounds during the recent 5-year period when program expenditures approximately doubled.

decrease in the latter) while certain other benefits are lost because the increased social security benefit removes him from the welfare rolls.[55]

What, then, are the adverse results of the lack of clear-cut objectives with regard to the aged? We have a situation in which program overlaps make it extremely difficult for Congress to improve the situation for the poor receiving minimum benefits.[56] In addition, we have a fiction about social security benefits that makes a highly regressive, inequitable tax seem equitable on the basis of the tenuous connection between individual contributions and benefits.

How do the programs for the aged fare as far as the efficiency and equity criteria described in section II? As noted previously, the social security system—the largest, by far, of the income maintenance programs—is designed to be economically inefficient. It is a contradiction to condemn the welfare system on economic efficiency grounds for weakening incentives to work while congratulating the social security system for encouraging retirement.

Because benefits rise with contributions and do not fall with property income, it is certain that the system will not be budget efficient. Less than half of the social security benefits for families go to families in the lowest quintile; yet, more than half of the families whose heads are 65 years or older are in the lowest quintile.

The social security system, however, has generally received high marks for program efficiency. Even this favorable judgment may be incorrect. Though social security taxes may be efficiently collected and benefits effectively dispensed, the discouragement of continued work beyond age 65 may very well lead to undesirable "transformations" within the client group and additional expenditures for nursing homes and geriatric social work.

It is not necessary to argue overlong that current income maintenance programs are, in many ways, inequitable and inefficient. What is important is to determine where income transfers fit in an overall income distribution strategy. Historically, targeted programs (such as welfare) have been used to provide support-equity, and reward-equity programs (such as social security) have not been well targeted. Problems have arisen when the objectives of welfare programs have been broadened to include reward-equity, or when social security has attempted to achieve both equity goals. The negative income tax, welfare reform, and demogrants have been proposed but none of the specific plans have been sufficiently successful in solving the conflict between the two types of equity to be politically acceptable.

We have also seen that, historically, unearned income, in the aggregate, has been essentially neutral with regard to interquintile differences in income. These differences, in 1970 at least, were the

[55] H.R. 1 merged and federalized, as of Jan. 1, 1974, welfare programs for the aged, blind, and disabled. The new law provides $130 per month to an individual and $195 to a couple with no other income but eliminates food stamps. In addition $20 per month of social security payments and $65 per month of earnings are disregarded in computing benefits. Though considerably reduced, some overlaps and inconsistencies remain; for example, why is it equitable to allow a social security recipient to keep $175 a month in earnings and an unlimited amount in unearned income while limiting the earnings of an aged person on welfare to $65 per month?

[56] For example, H.R. 1 permits a welfare aged to keep only a relatively small part of the recent 20 percent social security benefit increase.

result of differences in earnings. Obviously, a large enough and sufficiently well-targeted transfer program could reduce income differentials. And it is also obvious that support-equity for those who cannot or should not work—the aged, disabled, and some single-parent families—will require income transfers. However, the analysis of the efficiency and equity problem and the historical evidence suggest that efficiency, and reward-equity for most of the population, can best be achieved by changing the distribution of earned income. The question remains as to how this may best be accomplished.

D. The Need To Change the Structure of the Labor Market

If public policy is to change the distribution of earnings, then it is important to have some agreement as to the fundamental causes for existing distribution. Is it the "system" or is it a lack of effort on the part of the poor? Is the existing distribution of earnings inevitable given the structure of labor markets or can training and education moderate inequality?

In recent years, economists have turned more of their attention to the personal distribution of earnings (as opposed to their more traditional concern for the distribution of income among the factors of production).[57] One approach has been to explain the existing income distribution as determined by noneconomic sociological or biological forces.[58] Another line of thought suggests that earnings differ because individuals invest different amounts in enhancing their own human capital—via formal education or on-the-job training.[59] This human capital approach does not deny ability differentials but contends that education and training can enhance existing skills.[60] The dependence of earnings on human capital is a long established part of folklore and personal behavior. *Poor Richard's Almanack* advises that "An investment in knowledge pays the best interest." Moreover, the acknowledged dependence is the economic rationale for public investment in training and education—an investment that has traditionally been a substantial part of the war on poverty as well as its predecessors.

The human capital hypothesis is fundamentally optimistic; it implies that we can all have more if we are all "worth" more and this can be achieved with more investment in education and training (that is, economic growth is a function of investment in human capital).

[57] For an excellent review of the literature see Jacob Mincer, "The Distribution of Labor Incomes: A survey with Special Reference to the Human Capital Approach," *Journal of Economic Literature*, vol. VIII, No. 1, March 1970, pp. 1–26.

[58] See B. Mandelbrot, "The Pareto-Levy Law and the Distribution of Income," *International Economic Review*, May 1960, and "Paretian Distributions and Income Maximization," *Quarterly Journal of Economics*, February 1962 as referred to in Gary Becker, *Human Capital*, National Bureau of Economic Research, New York, 1964, p. 63.

[59] Ibid.

[60] Becker points out that ability and human capital investment are likely to be highly correlated because such investment pays a higher return for those with more ability. Moreover, such a correlation would explain the observed skewed distribution of earnings even if ability were normally distributed. An alternative explanation of the skewed earnings distribution is an unequal distribution of wealth and all the disadvantages associated with it. Ibid., p. 65.

A substantially different explanation and set of policy prescriptions has been put forth recently. According to what will be called the structural view, the distribution of earnings is not a result of the distribution of abilities—inherent or acquired—but, rather, it is a consequence of the structure of the economy. The structural hypothesis is that the economy, at a given state of development, generates a distribution of employment and earning opportunities.[61] Thus, family position, discrimination of various sorts, and education only determine how the given stock of jobs and wage offers will be distributed.

The structural hypothesis is fundamentally pessimistic; it implies that we are involved in a zero-sum game, in which, for a given economic (and, thus, labor market) structure, the distribution of earnings is given. An end to racial and sexual discrimination will only change the race and sex composition of the quintiles, not the income differences among quintiles.

The thesis of the human capital approach is that the distribution of earnings is determined by the characteristics of labor supply; to the structuralists, the characteristics of labor demand is more important. These alternative theses have vastly different implications for policy.[62] The human capital hypotheses leads to more investment in individuals, while the structural view requires a substantial modification of the economic structure to achieve a more equal distribution.

In summary, there are three basic instruments—each with a multitude of variations—that can be used to modify the distribution of income. One is tax and transfer policies of welfare in any of its forms (for example, the negative income tax, $1,000 grants to all individuals, or even welfare and tax reform); a second is the investment approach of the human capital theorists; the third is structural change in the economy.

The position taken in this paper is that each of the three approaches is necessary because none is sufficient. The major thrust of this paper, however, is structural change. Unions, minimum wage legislation, and full-employment policies are structural techniques that have been used to accomplish income distribution goals; each has merits and faults. The guaranteed employment proposals described in the previous section will affect the earnings structure more directly. The proposal is not put forth as the complete solution but rather as a large and essential component of an income distribution strategy and a component that has not received adequate analytical or policy attention. The next section represents an attempt to project the results of the proposal.

[61] See Lester Thurow and Robert Lucas, *The American Distribution of Income: A Structural Problem*, Joint Economic Committee, Washington, D.C., Mar. 12, 1972. Jacob Mincer and Barry R. Chiswick in "Time-Series Changes in Personal Income Inequality in the United States From 1939 with Projection to 1985," *Journal of Political Economy*, vol. 80, No. 3, pt. II, May–June 1972, pp. S. 34–S. 66, suggest that economic cycles are more important than human capital in influencing inequality. Christopher Jenks and his associates at Harvard's Center for Educational Policy Research also find that educational equality will not lessen income inequality; see *Inequality*, Basic Books, Inc., New York, 1972, p. 8.

[62] For an interesting attempt to distinguish between these two hypotheses see Howard M. Wachtel and Charles Betsey, "Employment at Low Wages," *Review of Economics and Statistics*, vol. LIV, No. 2, May 1972, pp. 121–129.

V. Estimates of the Effect of the Proposals

This final section of the paper presents estimates of what, in a limited sense, are the costs and benefits of the program. The estimated benefit is virtual elimination of poverty and, more generally, the change in the income distribution. No attempt is made to relate this change to the corresponding change in our society or in the quality of American life. The estimated cost is the direct cost to the Federal budget. No estimate is made of the economic costs, the additional public goods that might be produced with the larger work force, or the change in demand for other public or private goods that may result by providing jobs to all family heads.

These estimates of the effects and cost of the proposed program are highly uncertain and are only intended to be indicative of general orders of magnitude. It is difficult to foretell how individuals will react to their options or predict to what extent private firms will modify their production functions and change their labor force inputs. The reaction of the public sector is also uncertain; new employees may be used to increase public services or they may be used as substitutes for other employees (for example, as aides in schools or hospitals) thereby reducing the net cost.

In addition to these uncertainties about fundamental behavior no attempt was made to use the existing computer models (for example, those at the Urban Institute) to analyze the implications of these proposals in detail,[63] even assuming that the basic behavior pattern that existed in 1970 would be maintained. Therefore, the numbers given below are very rough indeed and follow from arbitrary and simple assumptions about very complicated social and economic behavior.

A. The Effect on the Income Distribution of Families

It is difficult to determine precisely how the proposals put forth in this paper would change the income distribution. It is possible, however, to suggest the very general shape of the curves. We assume that the proposals will not significantly affect the before-tax income of those families receiving more than $8,000 in 1970 and, thus, change will be limited to families in the two poorest quintiles.

This part of the 1970 income distribution of the three groups of families—aged families, female-headed families, and husband-wife families—are shown separately in figures 3, 4, and 5.

The solid line represents the income distribution that existed in 1970. The proposals will eliminate some part of each of the three distributions and change the shape of the rest of each of the curves. The dashed line represents the projected income distribution. Those portions of the 1970 income distribution projected to be eliminated by the proposals are shown by the areas designated A, B, and C in figures 3, 4, and 5, respectively.

In some cases individuals will move to the new guarantees (for example, to $2,500, $3,750, and $5,000 in the figures). For illustrative

[63] If these proposals get a sympathetic response, this is the logical next step in the investigation.

purposes only let us assume initially that this is the only change. Then the height of the bar at the guaranteed income level would be increased sufficiently to offset the removed area. For example, 16.8 percent of all aged families received less than $2,500 in 1970, while 7.0 percent received between $2,500 and $3,000; if the incomes of all those receiving less than $2,500 were to be increased to that figure, then the new curve would show 23.8 (16.8+7.0) percent in the $2,500–$3,000 range and no change at higher incomes. The median income would not change but the total income received by the group—and therefore the mean—would increase.

There is nothing necessarily illogical about increasing the income for some families without a corresponding decrease for others. Under current Census procedures income includes transfers and ignores taxes; thus, an increase in Government transfers increases total income. (The subject of the distribution of after-tax income will be briefly discussed later.) In addition, to the extent national product is increased—by increasing total wages earned—there is more income to distribute. Moreover, some of the proposals are likely to lead to some inflation, thereby increasing nominal income. Note, however, that because the guaranteed wage will increase with inflation the process will transfer real income from the higher to the lower end of the income distribution.[64]

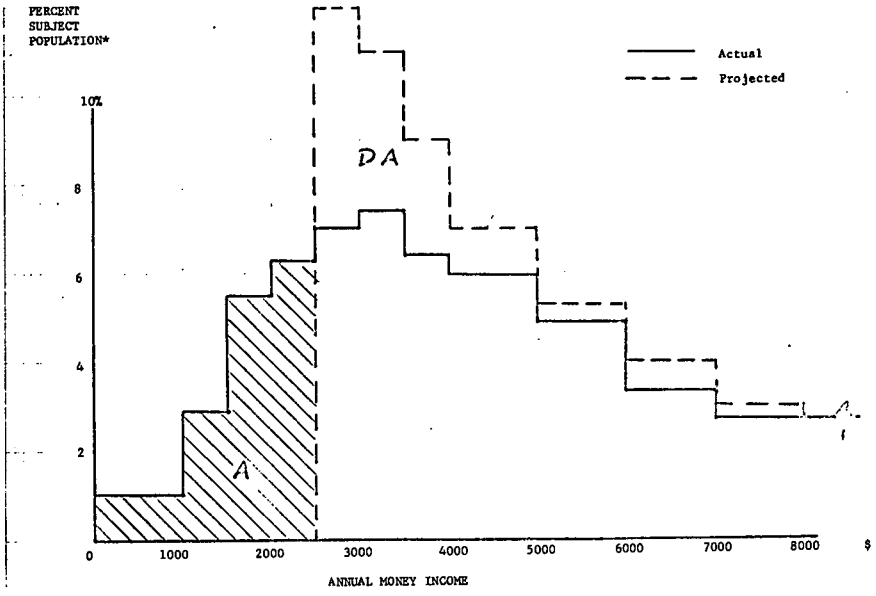
It is quite unlikely, however, that the only effect of the proposal will be to raise the incomes of those below the guarantee to the guaranteed levels. For example, in some husband-wife families the husband will accept one of the $5,000 jobs while the wife is also employed, at a lower annual income, so that total family income may be significantly above the $5,000 level.[65] Moreover, the change in labor markets created by the new job offers will undoubtedly increase the wages of some of those who earn somewhat more than the guarantee and move them to the right in the distribution. It is impossible to predict how widespread these changes will be. We do know, however, that the area of the income distribution curve that is removed by the policy must be added back to the right of the appropriate guarantee line.

Let us first examine the income distribution for families whose heads are over 65, as this is the simplest situation. Because all such families would be guaranteed $2,500 annually under the proposal, those whose 1970 income put them in the crosshatched area A in figure 3 would be moved to a higher income. (These data are shown in tabular form in table 8.) On average, each recipient's benefit would increase by $650 (on the basis of unadjusted Census data). However, only

[64] There would be many macroeconomic changes which have not been discussed. The added income will tend to increase total demand and change its composition. If overall demand is not to be excessive offsetting fiscal or monetary restraints will have to be applied also changing the demand pattern. If wage costs for low-wage industries increase, relative prices might change further. In addition to these changes the economy will tend to be more stable because changes in private demand will, for a great part of the labor force, be reflected in changes in public employment instead of by changes in the number unemployed. Note that because the guarantee is a function of median income the poor would not, in general, suffer from the temporary inflation that is very likely to attend the introduction of the guarantee.

[65] Thus, the income of many families whose incomes were between $5,000 and $8,500 and were in the second quintile in 1970 will be increased. For example, both parents may have been earning $3,000; the guaranteed job would increase one of the parent's earnings, and the family income, by $2,000.

FIGURE 3.—Income Distribution for Families Headed By a Person 65 or Older, Actual 1970 and Projected Under Proposed Program



*Within $500 interval.

TABLE 8.—*Projected and current income distribution for families headed by persons 65 years or older*

Income bracket	Percentage			
	Current (1970)	Projected	Area removed (A) [1]	Area added (DA)
0 to $1,000	2.1	----------	2.1	----------
$1,000 to $1,500	2.9	----------	2.9	----------
$1,500 to $2,000	5.5	----------	5.5	----------
$2,000 to $2,500	6.3	----------	6.3	----------
$2,500 to $3,000	7.0	12.0	----------	5.0
$3,000 to $3,500	7.4	11.0	----------	3.6
$3,500 to $4,000	6.4	9.0	----------	2.6
$4,000 to $5,000	11.9	14.0	----------	2.1
$5,000 to $6,000	8.9	10.5	----------	1.6
$6,000 to $7,000	6.7	8.0	----------	1.3
$7,000 to $8,000	5.4	6.0	----------	.6
$8,000 to $9,000	5.4	5.4	----------	----------
Over $9,000	24.1	24.1	----------	----------
Total	100.0	100.0	16.8	16.8

[1] See fig. 3.

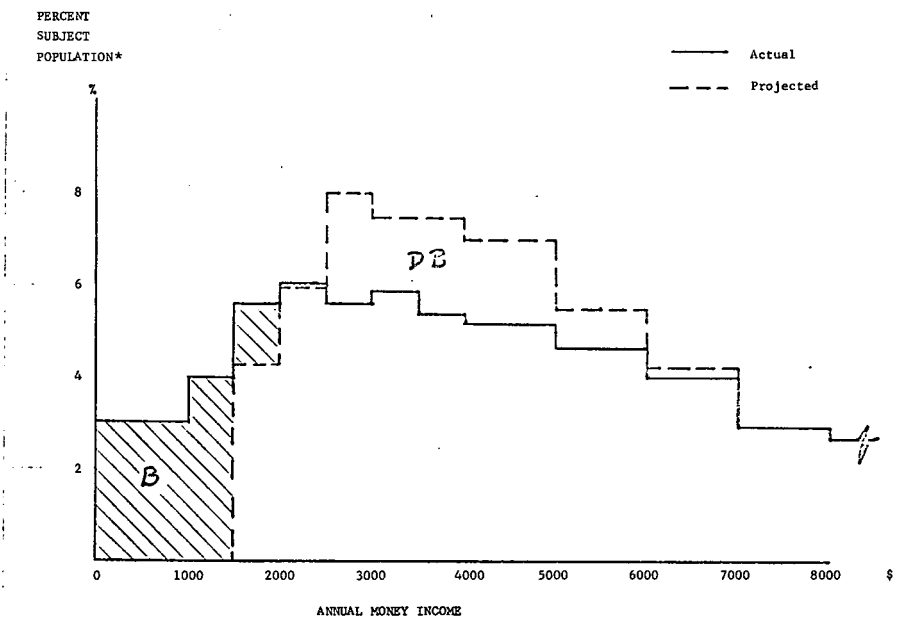
families whose income came solely from social security and/or welfare would move to the $2,500 line; those with other income (earned or unearned) would move further to the right on the chart. In addition, earned income will increase for those social security recipients who are now discouraged from working because of the potential loss of benefits. The increased benefits apply fully to those whose total money

income is less than $5,000 and are reduced at a 50-percent rate for those with incomes above $5,000, reaching zero at $10,000. Thus, the $8,000 line should mark the end of the area of substantial change in the distribution curve.

The dashed line marked "Projected" in figure 3 suggests, in a general way, what the distribution for the aged families might be if the proposals were adopted. The chart was drawn assuming that the proposal will have its greatest effect in the $2,500 to $5,000 range and diminish after that. Area DA, in figure 3, is equal in size to area A; each area represents 16.8 percent of the aged families or about 1.2 million families. In a sense, it is assumed that the program will, on a net basis, move 1.2 aged families from area A to area DA. On a gross basis, however, perhaps 1.9 million aged families will change income brackets. The projected curve suggests that the $2,500–$3,000 range will experience a net increase of 0.5 million families and a gross increase of 1.2 million. The presumption is that 0.7 million who were originally in the $2,500–$3,000 range will move into somewhat higher income brackets (as shown in fig. 3).

Next, we consider female-headed families. One-fourth of the median income, $2,500, was suggested as a welfare stipend for a female-headed family of four with no earners and at least one pre-school child. If we assume that a family of two would receive $1,500 and a family of three would receive $2,000, then the crosshatched area B in

FIGURE 4.—Income Distribution for Female-Headed Families, Actual 1970 and Projected Under Proposed Program



*Within $500 interval.

figure 4 would be removed by the proposal. It is assumed that benefits would increase to $3,000 if the family had more than four members.[66]

TABLE 9.—*Projected and current income distribution for female-headed families*

Income bracket	Percentage			
	Current (1970)	Projected	Area removed (B) [1]	Area added (DB)
0 to $1,000	6.1	----------	6.1	----------
$1,000 to $1,500	4.0	----------	4.0	----------
$1,500 to $2,000	5.6	4.3	1.3	----------
$2,000 to $2,500	6.1	6.0	.1	----------
$2,500 to $3,000	5.6	8.0	----------	2.4
$3,000 to $3,500	5.9	7.5	----------	1.6
$3,500 to $4,000	5.4	7.5	----------	2.1
$4,000 to $5,000	10.5	14.0	----------	3.5
$5,000 to $6,000	9.3	11.0	----------	1.7
$6,000 to $7,000	8.1	8.3	----------	.2
$7,000 to $8,000	5.9	5.9	----------	----------
$8,000 to $9,000	5.7	5.7	----------	----------
Over $9,000	21.8	21.8	----------	----------
Total	100.0	100.0	11.5	11.5

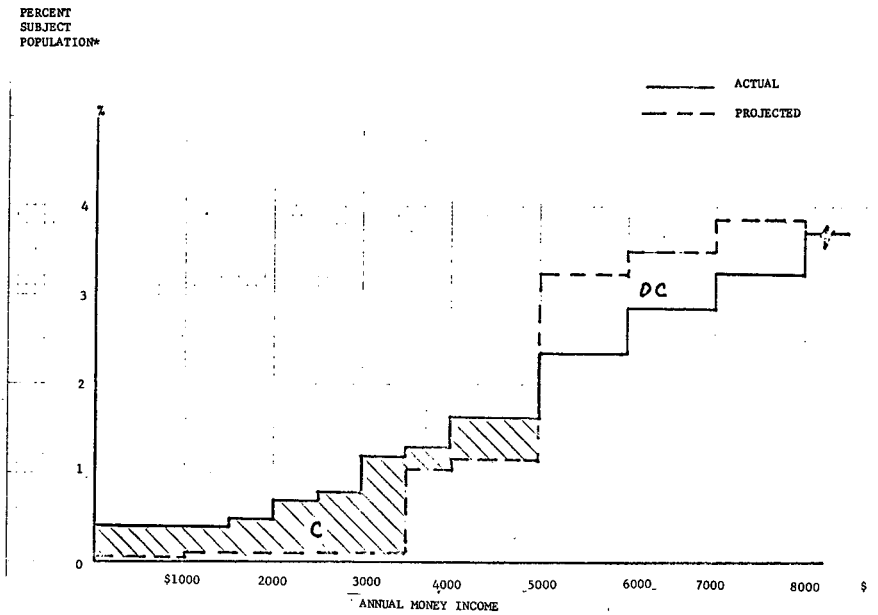
[1] See fig. 4.

Single parents without pre-school children could choose the job guarantees of $3,750 for a 1,000-hour work year or $5,000 for 2,000-hour work year (these options would also be available to a single parent with pre-school children). The wide range of choices should provide a smooth curve outside area B but perhaps with a bunching at $2,500, $3,750, and $5,000 (and at the corresponding points for female-headed families that are less than or more than four in size). Private salaries that are close to the guarantee are likely to increase somewhat and the labor market effect is likely to extend some thousands of dollars beyond $5,000. Fig. 4 (and the data in table 9) suggests, in a general way, what the distribution for female-headed families might be under these circumstances. It was drawn on the assumption that the effects are essentially insignificant at incomes above $7,000. Area DB, in figure 4, is equal to area D, and represents a change in income bracket for 700,000 families on a net basis. Again, the gross change, or total number of families affected should be substantially larger.

The income distribution for husband-wife families under the proposed regime is, perhaps, even less predictable than it was for the other two groups. Let us initially examine the public-sector job guarantee that applies to families with children. Approximately 2.3 million of the 3.8 million nonaged husband-wife families with incomes under $5,000 in 1970 contained children. These 2.3 million families would presumably move up to at least the $5,000 line. Nonstudent, childless couples (except for those families formed during the year) would move to at least the $3,750 line provided by the 3.8 of median-income employment. These changes would eliminate area C, in figure 5. (The data are shown in table 10.)

[66] This is less than some welfare beneficiaries, especially those with larger families, now receive in some cities. The question of supplementation of these Federal benefits is not considered.

FIGURE 5.—Income Distribution for Under-65, Male-Headed Families, Actual 1970 and Projected Under Proposed Program



*Within $500 interval.

TABLE 10.—*Projected and current income distribution for under-65, male-headed families*

Income bracket	Percentage			
	Current (1970)	Projected	Area removed (C)[1]	Area added (DC)
0 to $1,000	0.8	0.2	0.6	----------
$1,000 to $1,500	.4	.2	.2	----------
$1,500 to $2,000	.5	.2	.3	----------
$2,000 to $2,500	.7	.2	.5	----------
$2,500 to $3,000	.8	.2	.6	----------
$3,000 to $3,500	1.2	.2	1.0	----------
$3,500 to $4,000	1.3	1.1	.2	----------
$4,000 to $5,000	3.3	2.4	.9	----------
$5,000 to $6,000	4.7	6.5	----------	1.8
$6,000 to $7,000	5.5	7.0	----------	1.5
$7,000 to $8,000	6.5	7.5	----------	1.0
$8,000 to $9,000	7.4	7.4	----------	----------
Over $9,000	66.9	66.9	----------	----------
Total	100.0	100.2	4.3	4.3

[1] See fig. 5.

Again the impact would carry beyond the guarantee level. For example, if there were multiple earners, family income would be greater than the guaranteed wage. In addition, the change in wage structure would have an important effect on those family heads with children whose earnings were between $5,000 and, say, $7,000. Figure 5 was drawn on the assumption that substantial change would be restricted to incomes less than $8,000. The result for husband-wife families is quite sensitive to this assumption. In the case of the other two groups (aged and female-headed families), less than 30 percent of each group is excluded by ignoring all families with incomes over $8,000; however, three-fourths of husband-wife families had incomes above that figure. The median earnings of all husbands (with earnings) in husband-wife families (including those with no children) was $8,523 and 14 percent of the families were in the $7,000–$9,000 income bracket. It is quite possible, therefore, that the changes in earnings would affect many more families than is indicated in figure 5.

Figure 6 represents the income distribution for all families if figures 3, 4, and 5 correctly represent the distribution for the three component groups (see also table 11). The ratio of interquintile incomes would be as shown in table 12, following. According to these calculations the proposals would increase the average income of families in the lowest quintile by almost $1,200 and that of families in the second quintile by $200. As a result, the highest quintile would receive "only" 5.4 times as much before-tax money income as the lowest quintile, instead of the ratio of 7.6 reported for 1970.

FIGURE 6.—Income Distribution—All Families in Two Lowest Quintiles, Actual 1970 and Projected Under Proposed Program

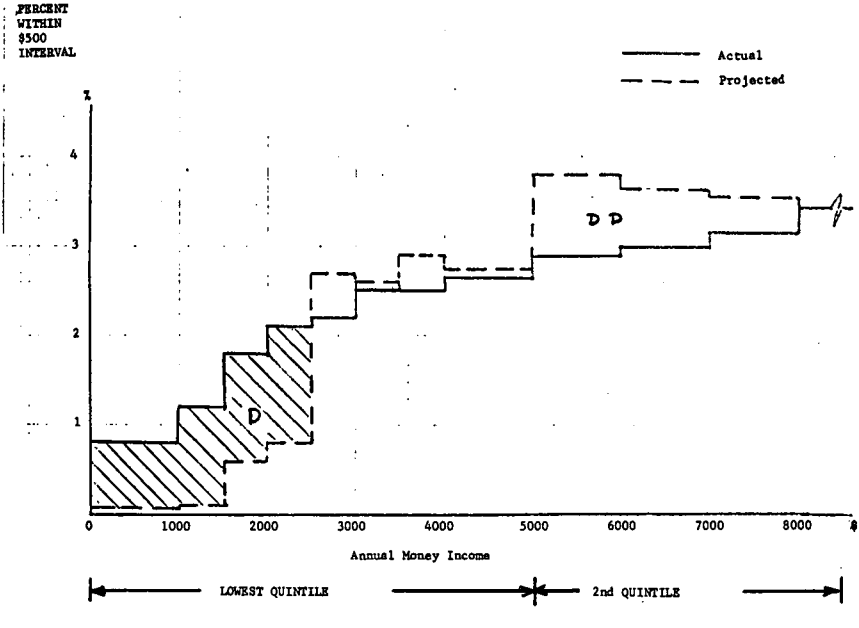


TABLE 11.—*Projected and current income distribution for all families*

Income bracket	Percentage			
	Current (1970)	Projected	Area [1] removed (D)	Area added (DD)
0 to $1,000	1.6	0.1	1.5	
$1,000 to $1,500	1.2	.1	1.1	
$1,500 to $2,000	1.8	.6	1.2	
$2,000 to $2,500	2.1	.8	1.3	
$2,500 to $3,000	2.2	2.7		0.5
$3,000 to $3,500	2.5	2.6		.1
$3,500 to $4,000	2.5	2.9		.4
$4,000 to $5,000	5.3	5.5		.2
$5,000 to $6,000	5.8	7.6		1.8
$6,000 to $7,000	6.0	7.3		1.3
$7,000 to $8,000	6.3	7.1		.8
$8,000 to $9,000	6.9	6.9		
Over $9,000	55.8	55.8		
Total	100.0	100.0	5.1	5.1

[1] See fig. 6.

TABLE 12.—*Income ratio by quintile under proposed strategy*

Quintile	Lowest	2d	Middle	4th	Highest
Lowest	1.0	1.6	2.3	3.1	5.4
2d		1.0	1.4	1.9	3.4
Middle			1.0	1.3	2.4
4th				1.0	1.8
Percent total income	7.5	12.0	17.0	22.9	40.6

Figure 6 (and table 11) indicates that the money incomes of only 1.6 percent of U.S. families would remain under $2,500 in 1970 under the proposed program. The 1.6 percent represents about one-half million female-headed families—those with one or two children who choose not to work—and about one-quarter million childless student couples or newly formed families. If all female family heads elected to accept at least part-time (1,000 hours) employment, then one-half million of the families receiving less than $2,500 and another million single-parent families in the $2,500–$3,500 range would move to the $3,500–$4,000 range. Thus, under these proposals, almost every individual or family would be guaranteed either a stipend or job that would permit them to be above the poverty line; moreover, their real income would increase each year. The next task is to estimate the budget cost of making these changes in the income distribution.

B. Cost Estimate

The following estimates are based on very uncertain assumptions about the effect of the proposal on the demand for labor. If the presence of the guarantee leads to sufficient changes in production functions and sufficient switching of job offers between primary and secondary labor,

then there will be few who will require special public sector employment. On the other hand, if many persons find the newly created positions attractive and leave their present employment to accept a lower wage to work in the public sector then the budget cost will be quite high. The estimates assume that the outcome will fall between these two extremes and that the recommended phased implemenation will provide some control over the budget and allow time for adjustment in the labor market. Separate cost estimates are provided for the public sector job program, for the transfer payments, and for the offsetting savings in current welfare and in-kind (housing and food) programs.

How many husbands would want and be eligible for the guaranteed job? In 1970, 8 million husbands of husband-wife families earned less than $5,000. About three-quarters of a million of these men would not be eligible because their wives earned more than $5,000. Over 1 million of the part-year workers in 1970 were over 65, and another 1½ million were disabled, leaving about 5 million who might take one of the special public sector jobs if the guarantee applied to all families.[67] However, about 1½ million nonaged husband-wife families whose total money income was less than $5,000 in 1970 had no children. Exclusive of childless families the number of husbands who earned less than $5,000 and who would be eligible for this program would be less than 3.5 million.[68]

Workers whose annual income exceeds the guarantee by a modest amount but whose working conditions are dangerous, disagreeable, or otherwise onerous would be tempted to forego some money income to obtain better conditions.[69] I assume, however, that changes in the private and public sector would be sufficient so that those who earned more than $5,000 in 1970 would not switch to the special public service jobs. Moreover, I assume that as a result of changes in labor demand, including private contracting of labor services from the Government, another 1.5 million of the 3.5 million eligibles whose earnings were less than $5,000 will be employed in the private sector. Under these assumptions 2 million husbands in families with children would take a special public sector job at a total cost of $10 billion.

How large is the potential pool of applicants from single-parent families? In 1970, there were approximately 3 million female-headed families in the lowest quintile, but not all of these families contained children. Approximately 2.2 million families were receiving AFDC payments in a typical month. However, the potential pool is larger than the figure for any specific month and the total pool will be assumed to equal 3 million. The gross budget cost, if the 3 million mothers were divided equally among the three options (a $2,500 welfare grant, a $3,750 half-time job, and a $5,000 full-time job), would be $11.3 billion.

The program for unmarried individuals or childless couples, providing wages of only $1.25 and $1.87 per hour, is unlikely to attract many applicants. A $2 billion program would be adequate to support 300,000 applicants in each category.

[67] Simulation with a model similar to that developed at the Urban Institute would provide a much more certain estimate of the figure.

[68] The 3.5 million eligible group is half again as large as the 2.3 million husband-wife families, with children, whose total money income was less than $5,000.

[69] Three million husbands earned between $5,000 and $6,000 in 1970 and another 3.5 million earned between $6,000 and $7,000.

Thus, under these assumptions, the total gross cost for the nonaged, able-bodied families (with and without children) and unrelated individuals is slightly over $23 billion ($10+$11.3+$2). To obtain the net cost,[70] Federal, State, and local expenditures for AFDC ($5 billion); general assistance ($½ billion); food stamps and distribution ($1½ billion); public housing ($½ billion); some significant portion of social services expenditures ($1 billion); and, say, 75 percent of unemployment compensation ($3 billion) should be subtracted from this gross cost. Medicaid expenditures would be transferred to the health insurance provided the newly employed. If 2 percent of all these incomes were deducted as a contribution for health insurance another $0.5 billion could be subtracted. These deductions add up to $11 billion and, thus, the net cost would be, very roughly, $11 billion ($23−$12).

Another $5 billion should be deducted if the basis of comparison is some reasonable version of welfare reform rather than the system that existed in 1970. Another deduction should be made for the public services provided by these approximately 4 million equivalent full-time workers. The net cost of these workers would have been approximately $2,750 per equivalent man-year in the 1970 environment (and only $1,500 if the $5 billion cost of welfare reform is also deducted). The more important benefit, however, would be a more "equitable" distribution of income.

It remains to estimate the cost of the program for the aged and disabled. According to the census data the average family in the lowest income quintile that received social security benefits obtained $1,850 from this source in 1970.[71] Had the proposed plan been in effect their benefit would have increased by approximately $650 (to $2,500). The range of total money income for families in the second quintile, in 1970, was approximately $5,000 to $8,500 or one-half to 85 percent of the median income; the average social security benefit for these families was $2,050. Under the proposal, families with incomes in this range would receive an additional one-half of the difference between their current benefit ($2,050) and $2,500 or, in this case, a benefit increase of $225 (that is, ½ ($2,500−$2,050). For families with higher incomes there would be little change (because they received more than the median family income).

The 1970 gross cost of this proposal for families in the adult category would have been roughly $3.5 billion.[72] In 1970, 5.7 million unrelated individuals received an average social security benefit of $1,270 (unadjusted); almost 3 million received an income of less than $2,000 from all sources. The 1970 cost of bringing the benefits to a $1,870 minimum is roughly $1.5 billion. Thus, the estimated gross program cost for the aged and disabled is approximately $5 billion on the 1970

[70] That is, the net cost for all levels of government.

[71] Unadjusted census data are used throughout. This understated both the current benefits and the median income.

[72] This estimate based on an average benefit increase of $650 in the lowest quintile and $225 in the next to lowest quintile; 10.4 (0.42 × 0.650 + 0.22 × 0.23) = $3.3 billion. The estimate is too high to the extent of extra earnings induced by the change and might also be substantially less on the basis of adjusted income.

base.[73] Old age assistance and aid to the disabled totaled almost $3 billion in 1970. Thus, the net cost of this part of the program will be perhaps only $2 billion and the estimated net cost of the total program is approximately $13 billion. The cost estimates are so rough, however, that it is prudent to add back a couple of billion dollars for unforeseen contingencies and $15 billion will be used as the estimated cost in the following exercise.

C. The Financing Burden

The remaining step in the analysis is to estimate what the financing of this $15 billion cost will do to the income distribution. This is the first instance in this paper on income distribution that an issue has been raised in terms other than income before taxes.

There is merit to the argument that the analysis would have been better served if taxes had been subtracted from income and the focus placed on the distribution of disposable income.[74] This approach, however, also creates a number of complications. Should we deduct only income and employee-paid payroll taxes or should all taxes be deducted from income, including those where the incidence is not obvious (for example, corporate profits taxes, sales taxes, the cost of payroll taxes passed on in the price of goods and services)? Moreover, if we are going to deduct social security contributions why not contributions for private pensions or health insurance, or savings that lead to property income? If these latter deductions from disposable income are voluntary so are some aspects of property taxes (one can purchase a smaller home). Should work expenses or union dues be deducted in computing disposable income? While direct (primarily income) taxes are somewhat progressive and their omission tends to exaggerate inequality, this tendency is likely to be offset by those income items left out of the definition of money income—imputed rent, employer contributions for pensions or other fringe benefits, as well as realized and unrealized capital gains. Thus, the before-tax distribution may be the most appropriate framework as well as the most convenient (because this is the form in which the Census collects and reports the data).

Despite the arguments it may be of interest to project the change in the distribution on an after-tax basis. Unfortunately, the tax data are not arranged in the same fashion, which makes comparability

[73] The benefits available to the aged and disabled in 1974 will be substantially different from the 1970 program. Social security benefits have increased substantially; there was a 15 percent increase in 1970, another of 10 percent in 1971, and one of 20 percent in 1972. Moreover, in 1974, when aid to the adult categories will be federalized and one-quarter of the 1974 median income will be approximately $3,000, the Federal welfare system will guarantee $2,350 to a couple (and some States may supplement the Federal payment).

[74] For a discussion of the impact of taxes on the income distribution, see Lester Thurow, *The Impact of Taxes on the American Economy*, Praeger, New York, 1971; Roger Herriot and Herman Miller, "The Taxes We Pay," *Conference Board Record*, May 1971, pp. 31–40; Joseph A. Pechman and Benjamin A. Okner, "Individual Income Tax Erosion by Income Classes" in *The Economics of Federal Subsidy Programs*, a compendium of papers prepared for the use of the Joint Economic Committee, 92d Cong., 2d sess. (1972).

difficult. It is possible, however, to make some rough estimates of the tax effects of a program of this magnitude at the margin. The total cost of the program was estimated at $15 billion in the 1970 economy. This amount could be obtained by a wide variety of methods. Very approximately, any one of the following could be used to finance the proposal: an extensive individual and corporate income tax reform; or a 12 percent surcharge on individual and corporate income taxes; or a 4.5 percent broad-based, value-added or consumption tax that included a low-income credit. The distributional effects of taxes similar to these have been estimated at the Brookings Institution.[75] The increase in the effective rate and an estimate of the additional tax paid by each quintile are contained in table 13.

TABLE 13.—*Percentage tax increase by quintile to finance a proposal costing $15 billion under 3 tax options*

Quintile	Tax proposal		
	Tax reform (1)	12 percent tax surcharge (2)	Value-added tax (3)
Lowest	0.2	0.1	0.5
Second	.4	.8	1.3
Middle	.6	1.2	2.0
Fourth	.8	1.3	2.4
Highest	2.6	2.0	.8

Note: Percentage of income adjusted for underreporting.

The 1970 income distribution can be subtracted from the projected distribution to determine the projected change in the income distribution exclusive of financing; the data in the appropriate column of table 13 can then be added (weighted by income shares) to estimate the total change in the income distribution for the chosen financing option. The computation is illustrated below. The results suggest that the proposals increase the income of the lowest quintile of families by 2 percent. Exclusive of financing (and also exclusive of the value of the public goods output produced), 1 percent, or half of this increase, comes from the highest quintile, and the other 1 percent from the middle and fourth quintile. If tax reform is chosen as the financing method, then the cost to the highest quintile doubles; they lose more than 2 percent out of their share (their share of money income drops from 41.6 to 39.5 percent). The other three quintiles lose moderate, and progressively diminishing, amounts.

[75] Joseph A. Pechman and Benjamin A. Okner, "Alternative Sources of Federal Revenue" in *Setting National Priorities in the 1973 Budget*, The Brookings Institution, Washington, D.C., 1972, pp. 434, 436, 441. The Brookings computations were based on 1972 income levels and were adjusted to 1970 levels of national income for this purpose.

TABLE 14.—*Total change in the income distribution (percentage points)*

	Lowest	2d	Middle	4th	Highest
1. Projected income shares [1]	7. 5	12	17. 0	22. 9	40. 6
2. Income shares in 1970	5. 5	12	17. 4	23. 5	41. 6
3. Change in shares exclusive of financing [2]	2. 0	0	−. 4	−. 6	−1. 0
4. From $15,000,000,000 tax reform [3]	0	. 05	. 10	. 19	1. 08
5. Total if financed by tax reform [4]	2. 0	−. 1	−. 5	−. 8	−2. 1

[1] Bottom row of table 12.
[2] Bottom row of table 2.
[3] Col. 1 of table 13 weighted by income shares in row 1.
[4] Row 3 sums to zero because, exclusive of financing, the proposal is purely redistributive. Row 4 does not as income is 1.4 percent smaller to accommodate the financing.

There is some mixing of unadjusted income-data "apples" and adjusted data "oranges" in table 14 and the resulting estimates are associated with a great deal of uncertainty. In fact, throughout this paper, the analysis is not refined enought to reach precise conclusions. However, if only the general order of magnitudes is correctly estimated, we can conclude that a program emphasizing categorical employment guarantees can create a humane income distribution that satisfies both equity and efficiency criteria at a price the Nation can afford while remaining relatively neutral with regard to family structure.

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