NEGATIVE OUTLOOK FOR THE NEGATIVE INCOME TAX

Juanita M. Kreps
Professor of Economics
Duke University

> We are convinced that rising productivity has brought this country to the point at last when all citizens may have a decent standard of living at a cost in resources the economy can easily bear. We believe that nearly all should, and wish to, earn their own support, for the dignity and self-respect that comes from earning one's own living can hardly be achieved otherwise. . . . But the war on poverty has made it abundantly clear that the road to satisfying life through work is not open to everyone: not to families without breadwinners, not to those whose productivity is reduced by physical or mental incapacity, not to people too old to work. . . .
>
> The Commission recommends that Congress go beyond a reform of the present structure and examine wholly new approaches to the problem of income maintenance. In particular, we suggest that Congress give serious study to a "minimum income allowance" or "negative income tax" program. Such a program, if found feasible, would be designed to approach by stages the goal of eliminating the need for means test public assistance programs by providing a floor of adequate minimum incomes.[1]

In today's review of possible schemes for maintaining incomes, the negative income tax is but one possible method, and perhaps not the best. Yet it does call attention to the shortcomings of present programs. And it does attempt to provide the one short-run medication—money—for the disease that we have come to diagnose, without consultation, as poverty. All variations on the income theme suffer some disadvantage in addition to the common one of cost.

THE THEME, WITH VARIATIONS

It is generally recognized that the present public assistance program fails to meet the needs of the thirty-five million poor in the United States. Not only are coverage and benefits restricted, but administration of the program leads to interference in the lives of the recipients. Out of this situation and the concept of the social dividend plan—a plan for the redistribution of the wealth of society based on the theory that everyone is entitled by right to a minimum share in

[1] *Technology and the American Economy*, Report of the National Commission on Technology, Automation, and Economic Progress, Washington, D.C., 1966, p. 38.

the goods produced by society—has come the idea of the negative income tax. This is a scheme for transferring by taxation the money necessary to guarantee some minimum annual income. Its advocates argue that the concept of a guaranteed income is already inherent in the public assistance program and that the tax system now transfers income from one segment of the population to another by allowing deductions to families with children.

The negative income tax shares with other guaranteed minimum income plans an essential characteristic: it is a direct transfer of money to the poor, and is thus an attempt to provide sufficient funds to maintain an adequate level of living *now*. It is not intended to supplant efforts to increase the factor income of the poor, but is based on the idea that these efforts are at best long run, and at worst, ineffective in reaching certain groups of persons.

In effect, the negative income tax involves a symmetrizing of the present positive tax system. Administration would be by the Internal Revenue Service, payments being made automatically upon receipt of a statement of income similar to (but simpler than) an ordinary tax form. It is non-categorical in approach. Eligibility (in most plans, based on the family as a unit) would be determined solely by income and family size; consequently, the difficulties of determining eligibility in exclusionary categories would be virtually eliminated.

Although many variations have been suggested, they all require decisions on the base to which the rate is to be applied, the tax rate, the effective minimum, and a break-even point. Two possible *bases* have been under consideration: (1) the unused exemptions and minimum standard deductions of a family with no taxable income and (2) the poverty-income gap, which is the difference between an officially established poverty line for a particular size family and that family's money income. Although the two bases differ substantially only for very small or very large families, the poverty-income gap is considered a better indicator of need. It has the additional advantage of eliminating payments to families with low taxable incomes, but who are not poor in terms of total money income.

As to tax *rate*, one observes that the present public assistance system operates under what amounts to a 100 percent tax—for every dollar earned, the public assistance allotment is reduced by $1.00. This provides a disincentive to work. The negative income tax attempts to provide some work incentive by allowing the poor to keep a percentage of their earnings in addition to the payment. This means a tax rate considerably lower than 100 percent. Not only does a 100 percent rate eliminate the monetary incentive to work; it could re-

sult in a much greater cost to the economy. The poverty-income gap is presently estimated at $11 billion. Although it is impossible to measure the extent of the disincentive effect produced by filling the gap at one fell swoop, guesses of the probable cost range to $24 billion.

The effective *minimum income* can be either a stated floor or simply the amount paid on a particular scale to a family with zero income. The *break-even point* is that point at which a family's tax liability equals its guaranteed income, and thus the payment becomes zero.

A look at some of the plans which have been suggested indicates the different combinations of these variables. One of the earlier proponents of the negative income tax was Milton Friedman, who in *Capitalism and Freedom* proposed a simple negative income tax plan to replace the present proliferation of public assistance and government welfare programs. Friedman's plan would apply a tax rate of, say, 50 percent to a family's unused exemptions and minimum standard deductions. If the exemptions and minimum standard deductions of a family of five were $3,700, and their income $2,000, unused exemptions and deductions would be $1,700. Fifty percent of this would be $850, so the total income for this family would be $2,850. The unstated but effective minimum income in this case would be the maximum payment of $1,850 to a family with no other income. Friedman hopes to eliminate all other forms of government intervention in the economy, including such welfare services as public clinics, in order to maximize freedom of consumer choice.[2]

Most other plans use the poverty-income gap, rather than unused exemptions and deductions as their base; otherwise, they operate in much the same manner as that proposed by Friedman. To use the same example, if the poverty line for this family were $3,500, their poverty-income gap would be $1,500, and payment (at a 50 percent rate), $750.

Robert Lampman has suggested several more elaborate plans, which demonstrate some of the variations possible.[3] All of his plans are based on the poverty-income gap and restrict payments to those whose incomes are below the poverty line. The break-even point for a family of four would be their poverty line of $3,000. For this family, one plan calls for an effective minimum of $1,500, and then a varying

[2]Christopher Green, "Negative Income Taxes, Improved Public Assistance and Poverty," paper delivered at Conference on Welfare Problems and Public Policy, Clark College, Atlanta, Georgia, April 19-21, 1966, p. 3; and Sar A. Levitan, "The Pitfalls of Guaranteed Income," *The Reporter*, 36, No. 10 (May 18, 1967), p. 13.

[3]Robert J. Lampman, "Negative Rates Income Taxation," paper prepared for the Office of Economic Opportunity, August 1965.

tax rate with high marginal rates for the lower income brackets. If the family's income is $500, their poverty-income gap is then $2,500, and payment at 45 percent of the poverty-income gap would be $1,125, bringing their total income up to $1,625. For a family with a $2,000 income, payment at 25 percent of the poverty-income gap would be $250. This plan concentrates its benefits on the poorest of the poor, but like all negative income tax plans, would reach many of those people who are working and not on relief, yet whose incomes are considered insufficient by today's standards.

Another of Lampman's plans would provide a $750 allowance for families with incomes from $0 to $1,500, with a reduction of 50 percent in the allowance for any income over $1,500. Here, more of the benefits are concentrated on those who have some income, and who are probably not on relief. It also provides a work incentive, especially for those with incomes below $1,500. Since the benefits are clearly inadequate for those with the lowest incomes, the plan relies on public assistance to supplement the allowance.

James Tobin would have an income guarantee high enough to raise those families with no other income out of poverty, and a tax rate low enough to provide incentives for those who can work. For example, if the guarantee were to equal the $3,000 poverty line for a family of four, and the tax rate were set at 50 percent, a family with an income of $2,000 would receive $2,000 ($3,000 less 50 percent of their previous income), making their total income $4,000. He points out that if the income guarantee is to be sufficient to support a family, and yet provide an incentive to work, it is impossible to avoid making payments to families who are above the poverty line. (In the example given above, the break-even point would be an income of $6,000.)[4]

This can be avoided in any plan which provides a reasonable income floor and less than a 100 percent rate, but only at the cost of producing what has been called the "notch" effect. If a minimum of $3,000, for instance, is specified, with a tax rate of 50 percent, and families with incomes over $3,000 are excluded, a family with a $2,000 income would receive $2,000 ($3,000 less 50 percent of $2,000), making their total income $4,000. This would be more than that of a family whose own earnings of $3,500 prohibited them from receiving any assistance. The logical thing for the second family

[4]James Tobin, "It Can Be Done: Conquering Poverty in the U.S. by 1976," *New Republic*, 156, No. 22 (June 3, 1967), pp. 14-18; also "Negative Income Tax," excerpt from an article entitled "Improving the Economic Status of the Negro," *Daedalus*, Fall 1965, pp. 891-93.

to do would be to curtail its earnings until they dropped below the $3,000 level.

PROBLEMS AND ALTERNATIVES

Of the many problems involved in the negative income tax perhaps the most important is avoiding payments to the non-poor, if the guarantees are to be adequate and the public assistance characteristic of 100 percent disincentive is to be avoided. Moreover, any of the plans would be very costly, even if restricted to those below the poverty line. Although calculations of cost must take into account the amount of reduction in public assistance expenditures, it is difficult to see how public assistance can be eliminated entirely, without leaving some families worse off than they are at present.

There would also be difficulties in the administration of such a program. If payment were made at the end of a year on the basis of a statement of that year's income, the money would not be available when it was needed. Payment on the basis of estimated income would likely require adjustment at the end of the year, and it might be almost impossible for a poor family to return overpayments. This difficulty could be eased somewhat by quarterly or monthly statements.

Objections have been raised to having such a program administered entirely by the federal government, not only by opponents of "big government," but by those who feel that local workers can do a better job. It is argued that the need is to individualize benefits, not nationalize them, and that the Internal Revenue Service cannot be expected to be more sympathetic to the problems of the poor than present welfare officials.

Finally, criticisms of guaranteed income plans in general are relevant to the negative income tax. There are questions of whether a guaranteed income might lower the already low mobility of the poor, making it even less likely that they will move to sections of the country where jobs are more readily available. Congressman Thomas B. Curtis has suggested that any guaranteed income will lower the incentive to save, raise the propensity to consume, and thus threaten investment.[5]

Several alternatives to the negative income tax have been proposed; revision of the public assistance system is one suggestion. Benefits and coverage should be expanded, additional public services provided, and the means test simplified. The poor are not a homo-

[5]"Income Guarantees: A Spectrum of Opinion," *Monthly Labor Review*, 90 (February 1967), pp. III-IV.

geneous group, the argument runs, and a single program cannot be expected to meet the needs of all. Interestingly enough, the Advisory Council on Public Welfare has suggested a revision of the public assistance system which would turn it into a form of guaranteed income plan. The federal government would establish an income floor and provide the states with all the necessary funds. Eligibility would be determined entirely by need. This plan carries the same disadvantage as the present public assistance system or a negative income tax with a 100 percent rate: it eliminates the monetary incentive to work. Lowering the rate would lead to payments to families above the floor; excluding these families would result in the notch effect.

Daniel Moynihan has suggested a monthly family allotment of $10 per child, regardless of income; 60 percent of all poor families, he points out, have children. However, the objections are raised that this amount is not adequate for the poor, and it also helps families who are not poor and who have 75 percent of the children.[6]

Some economists such as Leon Keyserling feel that while some forms of assistance are necessary and should be expanded for those who are unable or should not work, the emphasis on a guaranteed income is in itself defeatist. They would recommend instead guaranteed full employment, with the government as the "employer of last resort." Keyserling points out that there are more than enough unmet needs in the public sector to avoid the inference of "made work."[7]

In rebuttal, proponents of the negative income tax argue that it would be an effective way of filling the poverty-income gap without discouraging the incentive to work. It would help the *working* poor —there are 17.2 million poor persons in families with a breadwinner —a group largely neglected by present assistance systems. It would eliminate the need for a huge welfare apparatus. It would provide a national assistance minimum, and the present wide state variations in welfare payments would be eliminated. And finally, it would be impersonally and impartially administered, with income and family size being the only criteria.

In conclusion, it should be made perfectly clear that proposals for guaranteeing income are not a substitute for longer-range programs designed to increase labor productivity. As Christopher Green has noted in his excellent analysis of the various income maintenance proposals:

---

[6]Green, *op. cit.*; Lampman, *op. cit.*; and Levitan, *op. cit.*

[7]Leon H. Keyserling, "Guaranteed Annual Incomes," *The New Republic*, 156 (March 18, 1967), pp. 20-23.

> The transfer-by-taxation proposals contrast—but are certainly not incompatible with—the antipoverty programs. . . . The programs under the Economic Opportunity Act are aimed at making the poor more productive future earners; the transfer-by-taxation proposals would give dollars directly to the poor. . . . It is not inconsistent to provide money income for the poor and at the same time make government expeditures for raising the productivity of the poor.[8]

Only in this dual approach can a long-run solution to poverty be found. But both the long-run goal of higher productivity and the short-run guarantee of money income are of course constrained by our current obligations, and by the price pressures generated in a partwar economy.

[8]Christopher Green, *Negative Taxes and the Poverty Problem*, Studies of Government Finance, Brookings Institution, Washington, D.C., 1967, pp. 8-9.