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# A NEGATIVE INCOME TAX AND LOW INCOME FARM FAMILIES\*

A. H. CHISHOLM

*Australian National University*

**An efficient procedure is proposed for making welfare payments to low income farm families. This is a negative income tax. It uses the income tax system for linking directly transfer payments to income needs, without unduly adverse effects on resource allocation. The negative income tax proposal is considered in relation to rural adjustment and reconstruction.**

In Australia over recent years, low farm incomes have generated considerable adjustment pressures in the rural sector. Concomitant with the deterioration in economic conditions in the rural sector, total Commonwealth financial grants to the sector have increased from \$160m. in 1966-67 to an estimated \$380m. in 1971-72.<sup>1</sup> Although traditional subsidies on farm outputs and inputs have maintained their relative importance, the introduction of a general rural reconstruction programme in 1971, marked a significant shift in Commonwealth Government rural policy. It seems likely that downward pressures on farm income will be maintained, and that rural adjustment and reconstruction will be a major feature of rural policy during the 1970s.<sup>2</sup>

At present, Commonwealth financial grants to the rural sector are not linked directly to the income needs of farm families. Rather, their incidence is usually the reverse. The focus of this paper is on a procedure for making income transfers to farm families whose income needs are greatest from a welfare viewpoint. Negative income tax (NIT) uses the income tax system as a vehicle for making income-conditioned transfers to low income families. Already a form of NIT has been suggested by Schapper [22]. However, no attempt has been made to consider alternative forms of NIT, problems of designing a NIT suitable for farm operators, and the general place of NIT in the continuing process of rural adjustment.

The relevance of this paper to the Australian rural sector rests on the untested hypothesis that there are a significant number of low income farm families.<sup>3</sup> It is argued that many of these are at present 'trapped'

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<sup>1</sup> Derived from [1, Table No. 12, p. 22]. Income tax concessions are excluded.

<sup>2</sup> It is estimated [1, p. 9] that aggregate real farm income in 1970-71 was the lowest since 1944-45. Although some increase in farm income is anticipated for 1971-72, downward pressures on income are expected to continue [1, p. 26], especially for producers in the wheat, dairy, sugar and horticultural industries, who will be affected by the entry of the U.K. into the E.E.C.

<sup>3</sup> The data necessary to test this hypothesis—the pooled income of individual farm family units, including income derived from off-farm sources—is unavailable. However, McKay [17] has estimated that, in the early 1960s, approximately one

in agriculture, in the sense that their welfare would be permanently lower if they left their farms immediately. For most of these farm families NIT would provide temporary relief until they attained adequate income in farming, or in an alternative occupation. For those with no opportunities to attain adequate income, transfer payments would be permanent.<sup>4</sup>

### *NIT and Rural Adjustment*

For the purpose of relating NIT to rural adjustment,<sup>5</sup> three groups of low income farmers may be distinguished. Those who are without prospect of earning an adequate income either in farming or in an alternative occupation, given their physical and mental capacity, managerial and other skills, and net worth. Those who are without prospect of earning an adequate income in farming, but who consider they have occupational alternatives. And those who consider they can eventually achieve an adequate income in farming, by methods such as debt reconstruction, acquisition of more land, change of farm activities, and supplementary income acquired through part-time off-farm work. These low income groups will henceforth be referred to as groups one, two and three, respectively.

In the process of rural adjustment, farmers are continually moving into and out of these low income groups. They eventually leave their farm,<sup>6</sup> reattain an adequate income, or become 'permanent' low income farmers. At any time, many farmers will be uncertain to which low income group they belong, due to deficiencies in information. Uncertainty will be particularly high when a rapid deterioration of economic conditions occurs.<sup>7</sup> In these circumstances, a period of several years may be required for a farm family to decide and implement its best course of action. Time is required to search for information and to evaluate it with regard to the profitability of alternative farm activities, opportunities for debt reconstruction and acquisition of more land. If these prospects are bleak, more time is required to seek information regarding occupational alternatives, job retraining opportunities, and the general con-

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third (80,000) of Australian farms regularly earned less than \$2,000 per annum, for their owner's labour, management and capital. Given the recent trends in aggregate net farm income and the number of farm operators, the number of farms with incomes below \$2,000 would have since increased [1, pp. 9-11], unless a very marked change in the income distribution pattern has occurred. See also Davidson [6].

McKay's estimates do not account for income derived from 'off-farm' sources, and the comparison of farm with non-farm incomes is fraught with difficulties. It may be noted, however, that the age pension for a married couple with two dependants (i.e. equivalent to a family of four) effectively guarantees their annual income will not be less than \$2,000; and that the minimum annual wage equivalent for a male adult in N.S.W. is approximately \$2,700.

<sup>4</sup> It is outside the scope of this paper to justify a Government policy providing a minimum income guarantee to a particular group in society, suffice to note that all employees have such a guarantee in the form of minimum wage legislation and unemployment benefits. For a discussion of policies to redistribute losses caused by 'economic progress' see Schultz [23].

<sup>5</sup> Here, knowledge of the general process of rural adjustment is assumed. See, for instance, Heady [15].

<sup>6</sup> The best indicator available, of the decline in number of farm operators, is for male owners, lessees or sharefarmers working permanently on rural holdings [3, p. 27]. These have decreased by 12.7 per cent over the period 1967 to 1971.

<sup>7</sup> For example, the 1970-71 drop in wool prices.

sequences of what could be a major change in occupation and family location. Search for information on job alternatives will probably require more time when, as at present, unemployment is high. Finally, if a decision to leave farming is made, it may then take several years to negotiate a sale, or to lease the property.

Consider the introduction of a NIT with the following features. A NIT transfer would be made to farmers in group one until they were eligible for an age pension, or moved out of the group. For farmers at present in groups two and three, NIT would be temporary, and must be known to be temporary, so that adequate pressures to adjust are maintained. For instance, a possible condition is that no farmer would be entitled to more than three annual NIT transfers, unless in the opinion of the authority there were exceptional circumstances. This would ensure that NIT would not encourage low income farm families to remain in agriculture indefinitely.

#### *NIT and Resource Allocation*

NIT may affect work-leisure choices, risk-taking, the rate that farmers enter and leave the low farm income category, and the occupational choices of those leaving farming. The former effect is discussed separately, and the other influences are considered here.

NIT may influence decisions made by families not at present in the low farm income category. Both for potential entrants to farming, and for farmers at present with adequate incomes, NIT would change the after-tax probability distribution of expected future income from farming.<sup>8</sup> By increasing the mean and reducing the variance of expected farm income, it may encourage potential low income families to enter agriculture, and discourage farmers, who at present have adequate income but have some probability of becoming low income farmers, from leaving agriculture. For the first category, it could be stated that no family entering agriculture, subsequent to the introduction of NIT, would be eligible for transfers unless Government approval for entry had been obtained. For farmers in the second category, the effect would be unlikely to be very marked, because they would not anticipate receiving more than three NIT transfers.

For farmers in groups one and three, the significant resource allocative effect of NIT would be its influence on the work-leisure choice. For group two farmers, however, NIT may also influence the rate at which they would leave their farms and their choice of occupations. Consider first the situation where NIT delays the exit of farmers from farming, but does not alter the 'post-adjustment' resource allocation. Assume also, that there are no divergences between private and social returns from alternative resource allocations, before NIT. The economic cost to society of the delay in adjustment caused by NIT would be equal to the present value of the difference between the actual returns on farmers' labour, land, and capital for the period of delay, and that which would have obtained in the absence of NIT.

It was suggested previously that a period of several years may be required by some farmers to make and implement a decision to leave

<sup>8</sup> NIT may similarly affect the choice of farm activities, when the probability distribution of expected returns from alternative activity combinations intersects the NIT range.

their farm. If a farmer is not given this time due to foreclosure by his creditors, his welfare may be permanently lowered; either because the realized value of farm assets would be less under conditions of forced sale, or because his new occupation would be inferior to the one he would have chosen, given more time.<sup>9</sup>

For both of these situations the farmer may be prepared to borrow more credit to buy time to negotiate more favourable terms of sale, or to select his 'best' future occupation. If, however, the only collateral he could offer for credit is his own human capital, embodying the expected capitalized value of his prospective earnings outside agriculture, he will usually be unable to obtain a loan. There is, here, a case of market failure similar to that for persons with negligible net worth, apart from their human capital, who seek to invest in retraining themselves for a new occupation. The market failure is that commercial lenders will not usually accept human capital as collateral for a loan, and society would probably not permit it. Yet from society's viewpoint, the risk of these prospective earnings outside agriculture being unrealized is negligible.

### *NIT and Rural Reconstruction*

NIT could be made independent of the existing rural reconstruction programme:<sup>10</sup> or it could be linked to the programme. For instance, NIT transfers to farmers in groups one and two could be made conditional upon agreement to have their property purchased for amalgamation, under conditions previously agreed to by government and farmer. A farmer in group one, at the discretion of the authority, could be given the opportunity to retain his home and a few acres.

With respect to group two farmers, a government may permit a NIT to operate for a period after they leave their farm. This action may be taken to encourage persons who are not eligible for the Commonwealth retraining scheme to train for a new occupation while working part-time. Alternatively, it may be considered that some farmers view migration as being a high risk, while the risk from society's viewpoint is negligible.

Finally, the Commonwealth Government, having embarked on a programme of rural reconstruction, may begin gradually to dismantle the existing high levels of protection to some rural industries,<sup>11</sup> on the grounds that it induces an inefficient resource allocation and has a regressive incidence. This action, however, would increase adjustment pressures. NIT would ameliorate these pressures for marginal producers, who would have to make the most substantial adjustment.

### *Form of a NIT*

The different forms of NIT, and their likely economic effects, have

<sup>9</sup> See also, in this regard, the BAE statement that some farmers who may have benefited from rural reconstruction may be forced to take irrevocable action because of immediate pressures [2].

<sup>10</sup> I do not discuss the principles of a general rural reconstruction programme. See Edwards [8], Harris [13], and Mauldon and Schapper [18].

<sup>11</sup> Even when the most generous allowance is made for 'second-best' arguments of the type advanced by Gruen [12], it is clear that the existing level of protection to some rural industries causes an inefficient allocation of resources. For instance, the dairying industry.

been a subject of discussion in the economic literature over recent years.<sup>12</sup> All NIT plans contain three basic elements: a guaranteed minimum income paid by government; a negative tax schedule relating the size of the NIT transfer to the earned income of the tax unit; and a break-even income at which NIT ceases.

Assuming a proportional negative tax rate,  $t$ , specifying the rate of decline of the NIT transfer as income from other sources,  $Y_s$ , rises; a guaranteed minimum income,  $Y_g$ ; and a break-even income,  $Y_b$ , the NIT transfer is given as:

$$(1) \quad \text{NIT} = Y_g - tY_s.$$

The break-even income at which NIT transfer ceases is

$$(2) \quad Y_b = \frac{Y_g}{t}.$$

Thus a low income family would receive a direct income grant from government. This grant would be reduced as earned income increases, but usually by less than the full amount of the increase. The reduction in the grant represents a tax on earned income. A limiting case of NIT, commonly referred to as an income maintenance or poverty gap plan, sets a minimum guaranteed income to the tax unit. If earned income is below this guaranteed level, the difference would be made up by transfer. The effective marginal tax rate on additional earnings below the guaranteed level would be 100 per cent, and the income gain from the surrender of leisure would be zero. Such an expropriatory tax rate is likely to induce considerable leisure-work substitution effects.<sup>13</sup>

All income transfer schemes have these adverse substitution effects to some degree; unless transfers are independent of income status, and thus correspond to lump-sum taxes. One such lump-sum transfer procedure would be to give all families—including high income families—a grant equal in size to the guaranteed minimum income. The budget cost of this scheme would, however, be prohibitive. The marginal tax rate that is set for a NIT thus reflects a trade-off between the magnitude of the adverse leisure-work substitution effects and the budget cost of the programme.

### *NIT and Work Effort*

The decision-making unit's response to a tax induced change in its earned income is usually analysed in terms of substitution and income effects. The positive marginal rates of ordinary income taxation reduce the opportunity cost of a unit of leisure time, and thus produce a substitution effect adverse to income-producing effort. Positive average rates, however, reduce the aggregate net return for such efforts, causing an income effect which operates in the opposite direction. Therefore, it is impossible *a priori* to say whether the imposition of an income tax, or

<sup>12</sup> A good introduction to NIT is given in Green [10]. The effects of a general and permanent NIT on farm operators have been discussed by Meyer and Saupe [19]. In a recently published paper, Bawden [4] discusses some interesting preliminary results of a rural experiment with NIT in the United States. For a discussion of various aspects of NIT see [5, 7, 9, 16, 21, 24, 26].

<sup>13</sup> The present tapered means test for age pensions has the essential features of a NIT. For the pension transfer itself, the effective marginal tax rate is 50 per cent. However, when this is combined with the age allowance income tax schedule, the 'true' marginal tax rate can be as high as 100 per cent. Tax induced disincentives to work are much less significant for the aged.

an increase in the rates of an existing income tax, will increase or decrease work effort.<sup>14</sup>

The NIT under discussion is negative only in terms of the direction of the aggregate income transfer. Although the average rate is negative, a positive marginal tax rate is applied to earned income. With NIT then, both income and substitution effects would operate towards reducing income-producing effort. Farmers have more opportunities than most to vary their income-producing effort. It is expected, therefore, that a NIT having a very high marginal tax rate could substantially reduce work effort in low income families.<sup>15</sup> NIT would influence the on-farm work of the owner operator and other family members, and also lessen the effort made to find part-time off-farm work.

The impact of NIT on work effort is important in two respects. First, the substitution effect, arising from the change in the relative prices for leisure and earned income is allocatively distorting, assuming that there is a Pareto optimal resource allocation before NIT. It is likely that some farm families who would be eligible for a NIT transfer are paying income tax. However, the marginal tax rate, and hence the substitution effect, would be much less than with NIT. A second consideration is the effect of lowered income-producing effort on earned income, and the aggregate NIT transfer made to low income families. The lower the earned family incomes resulting from reduced work effort, the higher the budget cost of maintaining a given guaranteed family income. Alternatively, if the budget cost of NIT is held constant, the lower the minimum family income guarantee.

### *Tax Unit*

In this proposal, the tax unit for NIT is the farm family which would be eligible for a NIT transfer when its pooled income is less than the break-even income.

Adoption of a family tax unit raises the problem of definition. Here, a family consists of an adult nucleus, plus any other persons claimed as members by the adult nucleus. For the purpose of qualifying for NIT, the adult nucleus could be any married couple, or any person over the age of 21 years.<sup>16</sup> Persons who are not eligible to form part of the adult nucleus may be claimed as members of the family unit, providing they receive more than one half of their support from the adult nucleus. These members need not necessarily reside on the farm to be included in the family unit for NIT.

No person could be a member of more than one family unit, nor could any adult qualify as a separate unit and receive NIT while remaining economically a part of a unit with adequate income. Also, no person for whom an exemption is claimed on an ordinary income tax return could be included as a member of a family unit claiming a NIT transfer.

<sup>14</sup> For an analysis of the effects of ordinary income tax on work effort see Musgrave [20].

<sup>15</sup> The underlying assumption is that leisure is a normal good. It is conceivable that leisure, for some individuals, may be an inferior good. For instance, a NIT transfer may change an individual's 'life-style' in such a way so as to increase their 'taste' for income relative to leisure, causing less leisure to be consumed. See Green [11].

<sup>16</sup> In exceptional circumstances a person under 21 may be granted adult status for NIT, e.g. an orphan farm operator.

The income of all members, from all sources—except intra-family unit transfers—would be aggregated to determine the size of NIT transfer.

Another problem is to specify the absolute level of the guaranteed minimum income, and its relationship to family size and composition. Although in the following section a specific NIT schedule is given, it is only illustrative. From a welfare and equity viewpoint, guaranteed minimum incomes should be neutral among families of different size. For instance, a family of four should be given just enough more than a family of three to maintain an equivalent standard of living. This would require the guaranteed minimum income to rise with family size, although not proportionately, as there are economies of scale in family consumption.

#### *Illustrative NIT Schedule*

Attempts to avoid adverse substitution effects of a NIT give rise to unavoidable trade-off conflicts. As already shown, all NIT plans contain three basic variables; a guaranteed minimum income, a NIT rate schedule, and a break-even income. The conflicts arise because any two of the three basic variables determine the third. Thus the objective of a high guaranteed minimum income, combined with a NIT rate that keeps low the disincentives to work, is not compatible with a low break-even income. The high break-even income resulting from such a plan means that NIT transfers would be made to many non-low income families, and that the budget cost of the programme would be high. In the illustrative NIT plan outlined below, an attempt is made to achieve balance between these trade-offs, and to link the NIT schedule with the ordinary income tax schedule.<sup>17</sup>

A guaranteed minimum income of \$600 for a single adult is arbitrarily chosen. For larger family units, the guaranteed minimum income is determined by adding to this amount the tax deductions for dependants allowed under the ordinary income tax. Table 1 summarizes the situation for a family of four, assuming a 50 per cent proportional NIT rate, and a minimum guaranteed income of \$1,276. The NIT plan is illustrated in Figure 1. Y is the total family income before tax and DY is the total disposable income after tax. The line OED shows the relationship be-

TABLE 1  
*Effects of a NIT for a Family of Four*

Before Tax Family Income (Dollars)	Positive Tax Liability (Dollars)	NIT Transfer (Dollars)	After Tax Family Income (Dollars)	Average Tax Rate (Per cent)	Marginal Tax Rate (Per cent)
0	0	1,276	1,276	—∞	50·0
500	0	1,026	1,526	—205·2	50·0
1,000	0	776	1,796	—77·6	50·0
1,500	0	526	2,026	—35·1	50·0
2,000	0	276	2,276	—13·8	50·0
2,500	0	26	2,526	—1·0	50·0
2,552	0	0	2,552	0	50·0
3,000	224	0	2,776	+7·5	50·0
3,128	228	0	2,940	+9·2	22·6
3,500	373	0	3,127	+10·7	25·0

<sup>17</sup> This NIT system is similar to that proposed by Tobin *et al.* [24].

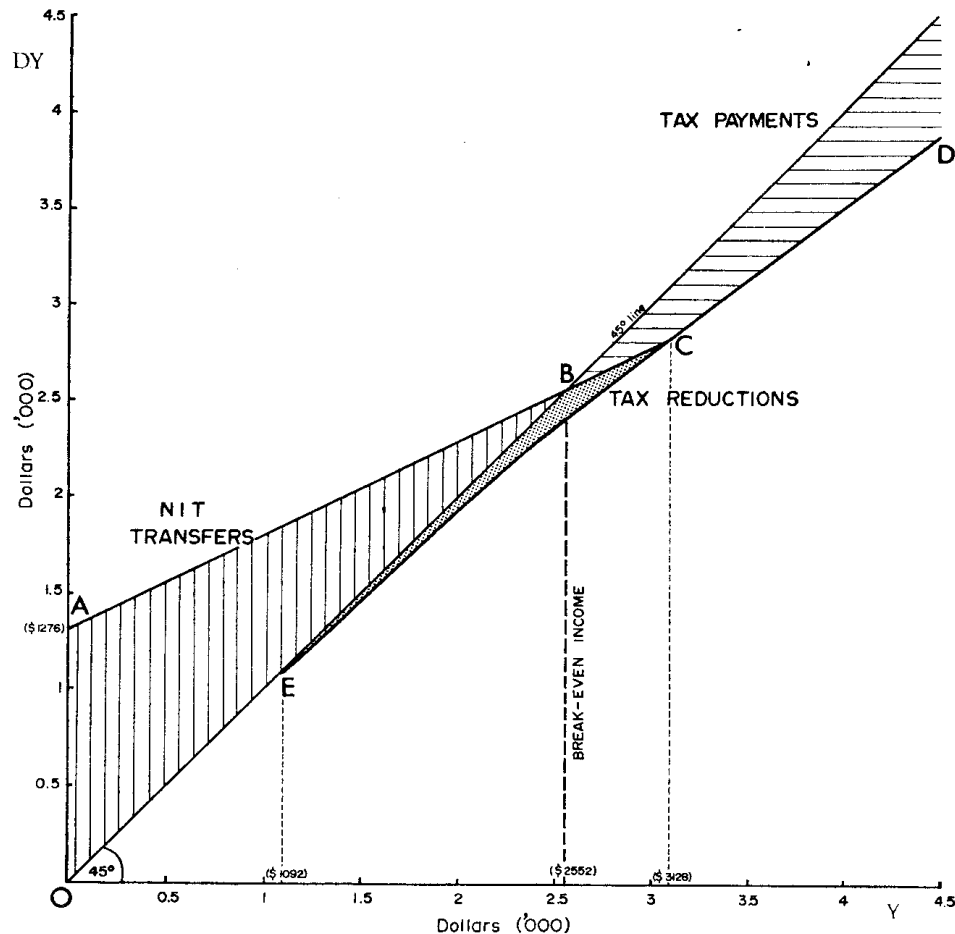


FIG. 1—Negative Income Tax for a family of four.

tween DY and Y under the ordinary income tax, for a married couple with two dependent children, assuming a single tax return in which the wife and children are claimed as full dependants.

The line OED has a slope of 1, for incomes below \$1,092, because the family would pay no tax if its income were below this level. The line then takes on successively lower slopes as income rises and higher progressive tax rates apply. The total tax on any given income is the vertical difference between OED and the 45° line.

With NIT, the relationship ACD is substituted for OED. Families without income receive a NIT transfer of \$1,276. All families with incomes below the break-even income of \$2,552 receive a NIT transfer. Families with incomes between \$2,552 and \$3,128 pay lower tax payments than they would under the ordinary schedule. Families with incomes above \$3,128 are not affected by NIT. It is necessary to include families in the NIT plan with incomes somewhat above the break-even income level to avoid confiscatory marginal tax rates. If the ordinary income tax schedule is applied to all incomes above \$2,552, a family with an income of \$2,553 would pay a tax of \$174 and have a disposable income of \$2,379. The additional dollar of earned income would cost

the family \$173. This is avoided by extending the NIT schedule to where an equivalent tax is paid under it, and under the ordinary income tax schedule.

### *NIT Base*

Administration of a NIT would be simplified if the base used for the ordinary income tax were adopted. However, given the basic welfare aim of NIT, this concept of taxable income is unacceptable. A NIT should be based on economic 'well-being'. This may be broadly thought of as a function of the flow of goods and services over which a family has command. The most important determinant of this flow is current annual income. But this is not a simple and unambiguous concept. Adjustments need to be made to the existing definition of taxable income to provide a more equitable measure of command over a flow of goods and services. These adjustments, and the question of the time period over which income should be measured, are outlined in Appendix I.

We now consider the question of whether positive net worth provides a command over goods and services that is not reflected in current income, and whether there should be an offsetting tax on net worth.

### *Offsetting Tax on Net Worth*

Underlying the proposals for reduced NIT transfers to low income families with positive net worth is a presumption that asset holdings provide command over goods and services additional to the annual income. One method of taking this into account is to impute a return to net worth assessed at fair market value. Actual money income from asset holdings is subtracted from imputed income and the difference—if positive—is added to the income base. In effect, this procedure adds to the income base, income arising from such factors as the imputed rental to owner-occupied dwellings, psychic income, and unrealized capital gains.

Apart from difficulties of accurately estimating the market value of farm assets, there is the problem of distinguishing between returns to farm labour and to farm capital. If the return to farm assets is not fully netted out before imputed income is added, there will be double counting of returns to net worth. This difficulty does not appear to justify the use of imputed income to net worth for the purpose of NIT assessment. Also, the main argument for using imputed income, namely that money income provides an underestimate of 'true' income, has been considerably weakened by the proposed adjustments to taxable income.

A separate argument for including net worth in the assessment of a NIT relates to the potential to consume net worth. The implication is that low income families with positive net worth should contribute to their own support through dis-saving some of their wealth. Weisbrod and Hansen [25] have considered problems of measuring the economic 'well-being' of a consumer unit.<sup>18</sup> Although they do not discuss a NIT, their work is relevant. They suggest that the economic 'well-being',  $Yt^*$ , of a consumer unit in time period  $t$ , is the sum of current annual income  $Yt$  (which is net of the yield on net worth),<sup>19</sup> and the annual lifetime

<sup>18</sup> For a good discussion of the problem of measuring the economic 'well-being' of farm families see Hathaway [7].

<sup>19</sup> To avoid double counting of net worth.

annuity value of current net worth  $NW_t.A_n$ ; where  $A_n$  is the value of an  $n$  year annuity whose present value is \$1. Thus,  $Y_t^* = Y_t + NW_t.A_n$ . Economic 'well-being' is the income obtainable in period  $t$  if net worth is converted to yield a lifetime flow. The annuity value will be a function of net worth, life expectancy, and the rate of interest used for the conversion. For any given interest rate, the greater the net worth of the unit, and the shorter its life expectancy, the greater will be the annual annuity.

For the purposes of NIT, any proposal to add the annuity equivalent of net worth to current income would need to show that conversion of net worth to an annuity is both possible and desirable. Possibilities for converting net worth in the form of farm assets into income for consumption, without selling the farm, are extremely limited. The major possibilities are to use farm assets as collateral to borrow from financial institutions, and to reduce farm maintenance expenditure.<sup>20</sup> These limited opportunities, and possible difficulties of estimating market values of farm assets, probably preclude including net worth at the time NIT transfers are made. To avoid the possibility of families with substantial net worth claiming a NIT transfer an upper limit on net worth could be specified, above which NIT transfers would not be made, regardless of the family income.

If it is inappropriate to have an offsetting tax on net worth before sale of the farm, the question arises whether NIT transfers should be refunded at the time of sale. NIT transfers would then be an interest-free loan. Schapper's [22] NIT proposal is restricted to group one low income farmers, and is conditional upon the farmer giving government first refusal of the property in the event of intended sale. The total NIT transfers would be repaid at this time, or eventually from the estate.

There is probably a stronger argument for these farmers to contribute to their own support through dis-saving of net worth, than for other low income farmers. Their life expectancy will tend to be shorter and the lifetime annuity equivalent of their current net worth, for any given net worth, therefore higher. The aggregate NIT transfer they receive will also be greater.

If both group one and two farmers were required to repay NIT transfers, the latter would be discriminated against in relation to groups one and three. Group one is favoured because the present value of repayments, per dollar of NIT transfer, will usually be much lower, due to a longer time lag before repayment, and the third group because they do not sell their farms.

The most equitable alternatives are probably to make NIT a permanent grant for all groups; an interest-free loan for group one, and a grant for groups two and three; or a loan for all groups, with repayment of NIT transfers from farmers' estates.

### *Concluding Comments*

As a welfare programme, NIT has a number of features. It is directed specifically at low income farm families. It provides help in its most useful form, cash. It makes the cost to society explicit. NIT would not

<sup>20</sup> A farmer could also obtain an effective annuity, while maintaining managerial control of the farm, if he sold the farm and leased it back from the purchaser.

discriminate between the various sectors within the rural sector. Although NIT will have some adverse effects on resource allocation, these are likely to be minimal. The NIT would fit into the present income tax system, and it could be administered by the Commonwealth Department of Taxation.

## APPENDIX I

### *Income Base for NIT*

#### *Personal Deductions*

Ordinary income tax allows deductions for dependants and certain personal expenditures. Deductions for dependants would be incorporated into NIT; via the guaranteed minimum incomes for families of varying sizes. The deduction of non-discretionary personal expenditures (e.g. hospital and medical) should continue under NIT because it would allow maximum response to the welfare position of individual families.

#### *Gross Income*

Ideally, the NIT base would include the aggregate money income, income-in-kind, and imputed income, of the family unit. Money income would include earned income, gifts and inheritances received from persons outside the family unit, payments from government, and realized capital gains. Income-in-kind, i.e. farm products grown for home consumption, is recorded in the ordinary tax return. Probably the greatest source of untaxed imputed income is the imputed rental from owner-occupied homes. Exclusion of this item under NIT is unlikely to discriminate significantly between farm families, given the predominance of owner-occupied homes on farms.

#### *Business Expenditures*

Under the ordinary income tax, primary producers may claim a 20 per cent investment allowance on most new plant and equipment, write-off depreciating assets at an accelerated rate, and deduct the full amount of many capital outlays in one year. To prevent farmers with adequate 'real' income from claiming a transfer, the 20 per cent investment allowance would be excluded, and normal depreciation only allowed under NIT. Also, with NIT, a distinction would be made between expenditure required to maintain production, and capital expenditures incurred for improving future earning prospects. The former would be deductible, the latter would not. Thus all developmental expenditures leading to assets, which given moderate maintenance expenditure do not depreciate, would be completely excluded under NIT. With ordinary income tax, these expenditures—for instance most land improvements—can be immediately expensed. Finally to prevent some farmers claiming NIT while accumulating unrealized capital gains through build-up of livestock numbers, these increases would be valued at market prices, and not at a nominal cost price valuation.

#### *Income Averaging*

In direct contrast to an ordinary progressive income tax, families who have annual income that fluctuates in and out of the NIT range would benefit in relation to those with a stable income of the same total size.

Apart from the instability of farm incomes caused by such factors as drought and fluctuating prices, farmers may influence the size of their annual income by adjusting the timing of their sales and expenditures.

To prevent families with high average annual incomes claiming NIT, a cumulative averaging system is proposed. The present averaging procedure for primary producers is unsuitable for NIT, because it responds too slowly to current income. Under the cumulative procedure, the size of the initial NIT transfer would be based on the preceding year's income. At the end of the following year, the average of the two years' income is calculated. The NIT transfer, or tax payment, that would have been received over the two-year period on this average income is then measured. The NIT transfer or tax payment at the end of the second year is the difference between the previously calculated amount and the size of the first NIT transfer. This procedure would then be repeated for an averaging period of not more than five years. Averaging would be compulsory. Negative annual income would be treated as zero in the year incurred, and the losses carried forward and written off against future income. Thus, NIT would not provide a guaranteed minimum annual income when net farm income was negative.

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