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AN EXPERIMENTAL STUDY OF THE
NEGATIVE INCOME TAX

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AN EXPERIMENTAL STUDY OF THE NEGATIVE INCOME TAX

In 1962, in his book, Capitalism and Freedom, Milton Friedman, a noted economist at the University of Chicago, introduced the concept of a negative income tax to the American public. He described it as an extension of the Federal income tax system which would pay out cash — that is, negative taxes — to families at the low end of the income scale, thereby assuring a basic level of income to everyone, strengthening the private market and individual initiative by allowing people to make their own decisions on spending and saving, and cutting back on the large and growing government bureaucracy of social welfare programs.

In six years, the idea has gained national recognition and a wide range of prominent supporters. Melvin Laird, Republican Congressman from Wisconsin, is now drafting negative income tax legislation. Arjay Miller, Vice Chairman of the Ford Motor Company, has made several speeches endorsing the negative tax. Senator Eugene McCarthy has made the guaranteed annual income a presidential campaign issue, and Dr. Ralph Abernathy has made it a primary objective of the Poor People's March on Washington. Many panels and commissions, including several White House Task Forces, have reported favorably on the negative tax and, most recently, Governor Rockefeller's Commission on Welfare in New York State urged its adoption.

And so the debate is widening — but this is largely because the problems are growing worse and because more people are becoming aware of the need for action, not because the details of a solution are becoming clearer. Many of the controversial issues involved in guaranteeing incomes are still far from resolved.

The issues at first were ideological — people claimed that a negative income tax, or any other form of guaranteed annual income, was un-American. It would, of course, be very difficult to test this proposition scientifically. But increasingly people have come to insist that starvation in Mississippi, outhouses in the middle of Manhattan, and a higher infant mortality rate than in most Western industrialized countries are the truly un-American features of our national life.

And so the debate has turned to more pertinent questions. How much will a negative tax cost? How generous a program can we afford? What will be the effect on peoples' work habits — on their decisions to spend, to save, to go into debt? What difference can it make on housing, health care, more and better education, family stability? Does it give people more command over their own lives, greater economic and social opportunity, and a real hope for a future better than the past?

These are questions of fact to which answers can be found. The answers are necessary not only to meet the objections of critics, but also to help advocates determine the features of the best possible program.

Yet, most of the answers cannot be found by analyzing our current set of anti-poverty and manpower programs. These programs just do not offer enough insights into the likely operation of a full-fledged negative income tax. This is not because the negative tax is a particularly radical innovation -- on the contrary, it is just a new way of doing things that this nation set out to do during the Depression. But the techniques of the thirties need updating; and the required changes, as one might guess from the barrage of criticisms now being leveled at welfare, are extensive -- so extensive that drawing firm conclusions about the likely effects of a negative income tax on the basis of current experience with welfare is quite illegitimate. After all, it is because welfare has proved so inadequate over the years that the negative tax has been proposed. It is hard to find fault with a new program on the basis of the drawbacks of its predecessor -- especially drawbacks which the new program is specifically designed to overcome.

In these circumstances, an intelligent approach to policy making requires some sort of pilot project to test out the ideas that the public and lawmakers are already debating, and will soon have to judge. It is a credit to the Federal Government that such a project is being undertaken. The Office of Economic Opportunity, through its research arm, the Institute for Research on Poverty at the University of Wisconsin, has funded an experimental study of the negative income tax, which will take place over the next three years in several urban areas in New Jersey. The study is being conducted by MATHEMATICA, Inc.,

a private research organization in Princeton. Both the Institute and MATHEMATICA are participating in its design and analysis.

From one or more metropolitan areas in the state, a sample of 1200 low-income households with working-age heads will be selected on a random basis. Four hundred of these households will become a control group — they will receive fees for taking part in interviews every three months, but will not get negative tax payments. The other 800 will be enrolled in various negative tax plans. They will receive money in the form of a check by mail twice each month. They will be interviewed four times each year for the full three years and will prepare each month a short tax return stating their income and family size. On the basis of these interviews and reports, plus an audit run by the program itself, the amount of money to be paid each month will be determined.

The calculation will be made in the following way. Depending on its size, each family will be eligible for a basic payment in the event it has no other income. For each dollar of other income which the family does have, its payment will be reduced somewhat, but not dollar for dollar. The dollar for dollar tradeoff — that is, taking away a dollar in benefits for each dollar the family earns — is the way most welfare programs operate now. For the great majority of families on welfare, this removes any financial incentive to work since the family's income is the same whether it works or not.

Under the negative income tax, this 100% tax is lowered to assure families some net gain from working. For example, a family of four persons enrolled in the New Jersey negative tax program might be eligible for a payment of \$3,300 a year if it had no other income. This is approximately the Social Security Administration poverty line for a family of that size. It might then be subject to a negative tax rate of 50% — that is, for each dollar the family earned on its own, it would receive 50 cents less in payments. Thus if the family earned \$2,600 in one year, it would receive half of that, or \$1,300, less from the program — that is, it would get \$3,300 minus \$1,300, or \$2,000 from the program. It's total income for that year would then be \$4,600 — the \$2,600 it earned plus the \$2,000 it received from the negative income tax. If the family in the next year earned \$6,600, it would again lose half of that, this time \$3,300, in payments. In other words, the basic payment of \$3,300 which it would have received if it had had no other income, would be reduced to zero. So, at \$6,600 of other income, the family would just cease to be eligible for the negative income tax payments. It would, of course, become eligible again if its income fell.

The New Jersey experiment will test out several such programs, including the one just used as an example. The experimental variables will be the amount of income families are guaranteed if they have no other income, and the rate at which this amount is reduced as other family income rises.

The key question to be asked is how these different variants of negative income tax affect earnings. This does not bespeak a special concern with laziness among the poor. On the contrary, it is a standard feature of tax analysis. Imposing any new tax almost surely has an impact on the prevailing distribution of income. A high transfer tax on the sale of stocks tends to reduce the volume of such sales since investors have to find the sale that much more profitable in order to cover the tax. Therefore, projecting revenues of a proposed transfer tax by merely applying the tax to current sales is faulty because the volume of sales is likely to change as a direct result of the tax. Graphic evidence of this was offered several years ago when the whole New York Stock Exchange threatened to leave New York City if the local transfer tax were raised, about as thorough a decline of the tax base as one can imagine.

Similarly, calculating the cost of a negative tax by just figuring out what it would cost at present income levels is risky. People may use the money for improved health care, raising their productivity. They may use it for education or for job training or retraining, to develop their talents and upgrade their skills. All these activities are likely to raise earnings. On the other hand, they may decide that the negative tax lowers their net wage so much that they would prefer to reduce work and take more leisure time, or perhaps retire early. They might also continue as they are — considering their job decisions independent of this supplementary source of income.

Very likely, people's work decisions will be sensitive to the amount of money they are eligible to receive, and to the tax rate at which this amount is reduced as their earned income rises. By covering a broad range of income guarantees and tax rates, the experiment will be able to suggest which configuration of levels and rates gives the greatest assistance to families while avoiding serious work disincentive effects.

Closely allied with people's work behavior is their physical mobility. Families who participate in the program will not be required to stay in the same house, or city, or even in New Jersey as a prerequisite for receiving payments. They may decide to move to areas of greater job opportunity, or to areas of lower living costs -- the New York-northeastern New Jersey area has the highest cost of living in the nation and its central city unemployment rates are well above the national average. The patterns of movement adopted by these people are of particular interest at this time when perverse differences in the level of welfare payments in different jurisdictions are producing a massive influx of people into the cities -- people uprooted from rural areas, especially in the South, without anything in their experience to prepare them for urban living. It will be interesting to see whether the negative tax, with its uniform Federal standards, can stem or reverse this flow, and counter the disturbing trend toward population control through welfare legislation.

Also of interest are people's spending and saving patterns. Many assistance programs today, such as Food Stamps and Medicaid, give goods and services directly, to be sure that people receive them and do not divert funds earmarked for one purpose to some other use. It is not at all clear whether people who are given money will not decide to spend it this way on their own, or at least in some way which society would not find self-defeating. It may be much more efficient, and much more conducive to self-support, to have one comprehensive income program which lets poor families, like the rest of us, make their own market choices.

This again is in contrast to welfare where specific budgeting of items as small as children's shoelaces is the rule. This forced reliance on caseworkers to make the most minute economic decisions undercuts self-esteem and reinforces dependence. This is not to say that social services are not important; they surely are, and one of the objectives of the negative tax experiment will be to determine the extent to which families receiving money with no strings attached do require budgeting, homemaking and other services and voluntarily avail themselves of those services in the community.

Welfare is also facing growing criticism today for its man-in-the-house rule, which contributes to the high rate of family breakdown at low income levels by denying support to families if there is an adult male present. The New Jersey experiment plans to observe whether a negative tax, because its financial assistance is available to families

before they break up, will have an affirmative impact on family stability.

The experiment will also consider administrative aspects of the negative tax program. What will it cost to operate? Will this be a substantial saving over welfare administrative costs? Will there be special problems of tax awareness and compliance among families who have had little contact with the present income tax system? What techniques of payment and audit are most appropriate?

There are other issues which we hope to begin to resolve in the negative tax experiment, but these are some of the major ones to which answers must be found. They are important issues to the nation because the concept of a guaranteed income is important. We must modernize the program of the thirties. Those programs were inaugurated because people could look around them and see that in an industrialized economy, forces operated which would keep people from finding jobs no matter what their own initiative and ability. Economists have learned to manage the economy better since then, and fewer people are out of work or underemployed now — but the same forces are still operating and the situation is more complex, not simpler. Right now, Congress is deliberating a tax rise and spending cut. This will benefit the nation as a whole by curtailing price rises, but it means that more people will have difficulty finding and keeping jobs. Our society must have the ability to make such a collective choice between inflation and unemployment, but it should stand ready to compensate

the people whom it makes a conscious decision to dis-employ. These people, plus all the other people who are not able to work or earn a living wage, again largely because society's collective choices have not given them their fair share of public goods and services – all these people deserve the assurance of a minimum standard of living. The question of how to provide this assurance has become one of the chief controversies of our day. Its resolution demands facts, not guesswork or well-meaning convictions. That is why I am so pleased to be able to come here today and tell you about a fact-finding program which I consider a landmark in the rational planning of public policy. Thank you.