TAB C

FEDERAL BENEFIT LEVEL AND FEDERAL-STATE RELATIONS

Federal Benefit Level

The level of the Federal benefit in the ISP is one of the most visible program components. It will figure heavily in Congressional and public reaction to the plan because it not only affects the perceived adequacy of the program, but has implications for State and Federal expenditures as well.

The existing welfare system is made up of many programs: some of them fully Federally-funded, some jointly funded by the Federal and state and local governments, and some having no Federal participation at all. One of the basic goals of the ISP is to replace this system in such a way as to permit us to eliminate the major means-tested programs, especially the ones in which the Federal government participates; reduce substantially the size of the total governmental bureaucracy involved in transfer payments and simplify the administration of what remains; bring about a more appropriate Federal role in income assistance overall and permit the Federal government to exercise strong administrative control over the new transfer system.

In order to achieve these goals within a reasonable cost and with regard to other concerns, I have recommended a Federal benefit structure with a $3600 basic benefit level for families of four with no income. (Tab E describes fully the proposed benefit structure. Expressing the benefit structure in terms of a four person household or family has become conventional shorthand usage in describing transfer reform proposals.) While this benefit level may appear high to some, it reflects the recent growth in the programs that it would replace. The following considerations dictated our choices about the proposed benefit structure:

- Benefit levels must be high enough to permit virtually full replacement of the Federal financial share in the existing programs that would be superseded by the ISP. The present Federal participation in SSI and Food Stamps for the aged, blind, and disabled and AFDC and Food Stamps for single parent families set the necessary lower bounds for the Federal basic benefit in ISP. The proposed benefit structure would replace the Federal share of basic benefits in all states for both AFDC and SSI families. (See attached Table 1 for full display of Federal shares of AFDC plus Food Stamp levels in the states.)

- ISP levels should completely dominate combined AFDC and Food Stamp benefit levels -- including the state contributions -- in as many states as possible. This will enable us to limit to the maximum degree the number of states where state supplementation of ISP benefits would be necessary in order to maintain existing or probable benefit levels. The proposed benefit structure would do this in sixteen states. (See attached Table 2 for a full display of total AFDC plus

Food Stamp levels in the states.) The comparable ISP positions with respect to state supplements in SSI plus Food Stamps for the aged, blind and disabled are even more advantageous. The strong program and political reasons for limiting the need for state supplementation are discussed more fully below.

- Though the basic benefit level would for many units fall below the official poverty standard, we have designed the program so that households with some substantial though inadequate income from either present earnings or transfer programs based on past earnings will have a total income above that standard. Only with respect to households with no sizable source of other income would ISP be inadequate to match the poverty standard, and in many states it is probable that there will be state supplement programs targeted towards such households.

The benefit levels that are proposed are the minimum necessary to achieve the above objectives at acceptable net costs to the Federal budget. However, the proposed structure allows you some compromise room later in the likely event that during the Congressional debate some seek to raise the benefit level. We also hope that the proposed ISP benefit levels will provide a sufficient defense against any major new Federal commitments in subsidized housing for the poor. Clearly the ISP will strongly blunt pressure for a housing allowance or voucher program, and even any major expansion in the existing housing authorities.

Our proposed benefit structure would be expressed in December, 1974 dollars and adjusted upward for inflation thereafter. This should mitigate the political pressures for a more generous benefit structure and insure that the benefits will be high enough to replace the Federal share of existing programs at the time of implementation.

State Supplementation

Even with the Federal benefit structure that I have recommended, it is clear that as many as half of the states might wish to supplement the Federal benefit for some categories of low-income households so that large numbers of current recipients, especially AFDC type families, will not be made worse off. State supplementation, as noted above, can pose problems of program interaction and administrative complexity. The state supplements in the new Supplemental Security Income (SSI) program, for example, have proved to be especially burdensome, primarily because the Congress chose to mandate grandfathering of former aid to the aged, blind and disabled recipients in the form of state supplements. This seriously compromised the goal of establishing a program that can be easily administered and controlled.

These problems have been especially troublesome in the context of Federal (SSA) administration of those supplements, an option which 31 states have exercised. In light of the SSI experience, the possibility of not permitting Federal administration of state supplements under any circumstances was considered. This alternative was rejected on the grounds that it could create even greater overall administrative inefficiencies and generate some avoidable political problems.

It was therefore decided to offer the states the option of selecting Federal administration of their state supplements under the strict conditions that key program elements, e.g., the eligible filing unit and income, must be identical to or a simple subset of the Federal definitions so that additional data collection needs are avoided, any additional special determinations are minimal, and such exceptions which do exist can be handled in a manner consistent with the objective and automated nature of the Federal program. In effect, optional Federal administration of state supplements under ISP would be analogous to the provision already in the Federal Tax Code for optional Federal administration of state income taxes. Because there are no duplicate Federal and state administrative structures in the states that choose to exercise the option under these restrictions, Federal administration of state supplements will require significantly fewer total employees than the combined number of Federal and state employees if those states had to administer their own supplements (See Tab G for relevant administrative personnel comparisons.) Thus, offering the option will enable us to more adequately meet our goal of reducing the size of the welfare bureaucracy that remains at the state and local levels.

Some states may choose however to reject the option, deciding that their program goals for supplementation dictate retention of the discretionary and subjective rules that characterize the present welfare programs. In those instances the States would continue to bear the costs of maintaining their public assistance bureaucracies.

What must be prevented, if we are to avoid repeating the very troublesome SSI precedent in this area, is Congress allowing optional Federal administration of the latter type of welfare oriented state supplement. Not only would such a result be totally antithetical to the conceptual nature of this welfare replacement plan, but also it is administratively infeasible for a Federal agency to run what would amount to twenty-five or more separate assistance programs. Our position on this matter will have to rest on firm resolve, an emphasis on the SSI experience, and the linkage to the Federal tax system.

Regardless of whether a state chooses Federal or state administration, there is one subject in which Federal intervention is necessary unless we are prepared to see the work incentive feature of the ISP proposal diluted. If states were allowed to supplement completely without Federal regulation, the relatively low benefit reduction rate in ISP could be effectively doubled by the structure of the state supplements. For example, a state could decide to impose a benefit reduction rate on state supplements which was about as large as that on the Federal benefit. In order to preserve both equity and work incentives, state supplement benefit reduction rates must be held to 15% or less until the household's earnings exceeds the Federal breakeven level at which point they could impose a rate equal to the Federal 50% rate. While this provision will not be popular with the states, it is absolutely critical to the integrity of our proposal.

Despite our decisions to regulate state benefit reduction rates and to permit optional Federal administration of state supplements under controlled conditions, we otherwise decided to adopt a position of Federal neutrality about state decisions in this area as being most consistent with the proposal's underlying philosophy. Hence we rejected either mandating state supplements or directing Federal administration of them. It will be up to each State to decide whether or not it wishes to supplement and, with the exceptions discussed above, under what program and administrative conditions.

At the same time, however, we recognize that because of procedural anomalies in existing programs or unforeseen events between now and the time of passage, it may be necessary to offer a hold harmless to the states against cost increases over and above their current system expenditure levels, as was done in H.R. 1. This would permit those states who view it as desirable to supplement the Federal benefit to do so with the knowledge that their costs would not exceed former levels. As a practical matter, the hold harmless would add very slightly to program costs and pose only minor administrative problems. However, it would represent a departure from our basic stance of neutrality in state supplementation. For this reason, we chose not to include a hold harmless provision, although we would be prepared to utilize it as a bargaining chip in negotiations with Congress.

Finally, the possibility of grandfathering current recipients was also rejected. SSI has such a provision. The result is to continue the old program rules, rules which have no place in a welfare replacement plan. In keeping with our basic stance, the states may elect to operate their supplemental programs in such a way as to grandfather the eligibility and benefits of current recipients. The Federal government, however, should not be a partner to that effort.

<u>Emergency Needs</u>

Whatever a state's situation with respect to a supplement, it will have responsibility for administering its own emergency needs program. There will be cases of sudden and severe need which the Income Supplementation Program and many of the state supplement programs will not be able to address. For example, low-income families receiving benefits under both ISP and an ISP-consistent state supplement will encounter sudden losses that are unforseeable and cannot be budgeted for (e.g., the breakdown of a car essential for employment). Since some of these instances are now being handled by the present system, we are vulnerable to the criticism that we are creating an overall income maintenance scheme that is less responsive and less sensitive to the needs of the low-income population than the system which it would replace. Much of such criticism would be disproportionate and inaccurate. However, we can easily counter the objections and help fill the actual gaps by combining a residual emergency assistance authority with our new initiative in social services. The costs to the budget of Federal participation in state-administered emergency needs programs are very modest and will strengthen the chances of the overall ISP proposal in Congress.

TABLE 1

Federal Share of Basic AFDC/Food Stamp Benefits
(AFDC[1/] Plus Food Stamps[2/]
for a Family of Four With No Other Income
in Those Jurisdictions[3/] Where the Federal Share

	is less than $2700
1. Mississippi	2268
2. Ohio	2436
3. Maryland	2448
4. District of Columbia	2556
5. Indiana	2568
6. South Carolina	2568
7. Tennessee	2579
8. Louisiana	2580
9. Alabama	2604
10. Texas	2604
11. Rhode Island	2604
12. California	2604
13. Arkansas	2616
14. Nebraska	2616
15. Massachusetts	2628
16. Florida	2652
17. Connecticut	2652
18. Nevada	2664
19. Washington	2676

	is less than $3000
20. Maine	2712
21. Kentucky	2736
22. Wyoming	2748
23. Arizona	2760
24. Colorado	2760
25. Georgia	2772
26. New York	2796
27. New Jersey	2796

Table 1 continued

28.	Missouri	2808
29.	Delaware	2832
30.	Michigan	2832
31.	North Carolina	2844
32.	Iowa	2868
33.	Oklahoma	2880
34.	New Mexico	2892
35.	Pennsylvania	2976
36.	Oregon	2988
		is less than $3300
37.	Kansas	3012
38.	Illinoia	3048
39.	Minnesota	3072
40.	Montana	3084
41.	West Virginia	3096
42.	Virginia	3120
43.	New Hampshire	3132
44.	Wisconsin	3156
45.	Utah	3204
46.	Alaska	3264
		is less than $3600
47.	Hawaii	3312
48.	Vermont	3348
49.	Idaho	3360
50.	North Dakota	3432
51.	South Dakota	3456

See footnote to Table 1.

TABLE 2

The Largest Amount Paid for Basic Needs
(AFDC[1/] plus Food Stamps[2/])
for a Family of Four with No Other Income
in those Jurisdictions[3/] Where the Benefit
is less than $3000

		% AFDC Recipients[4/]	
1. Mississippi	2364	1.7	
2. South Carolina	2868	1.1	
3. Louisiana	2892	2.4	
4. Alabama	2928	1.5	
5. Arkansas	2928	.8	
6. Tennessee	2976	1.8	
	is less than $3300	9.3%	9.3%
7. Texas	3036	4.0	
8. Florida	3120	2.9	
9. Georgia	3228	3.2	
10. Kentucky*	3288	1.5	
	is less than $3600	11.6%	20.9%
11. Maine	3324	.7	
12. Missouri	3432	2.3	
13. Arizona	3444	.7	
14. North Carolina	3444	1.4	
15. Ohio	3576	4.6	
16. Nevada	3576	.1	
	is less than $3900	9.8%	30.7%
17. New Mexico	3636	.6	
18. West Virginia	3696	.7	
19. Delaware	3780	.3	
20. Maryland	3804	2.1	
21. Nebraska*	3804	.4	
22. Wyoming	3816	.1	
23. Oklahoma	3852	.9	
	is less than $4200	5.1%	35.8%
24. Indiana	3948	1.6	
25. Colorado	4092	.9	
26. Montana*	4164	.2	
27. Utah	4164	.4	
		3.1%	38.9%

		% AFDC Recipients	
28. District of Columbia	4224	1.0	
29. Illinois	4332	7.3	
30. Iowa	4356	.8	
31. Idaho	4380	.2	
32. Massachusetts	4452[5/]	2.8	
33. Rhode Island	4464	.5	
34. Virginia	4464	1.5	
35. California	4464	12.7	
		26.8%	65.7%
	is less than $4800		
36. North Dakota	4512	.1	
37. Kansas	4644	.7	
38. Connecticut	4644	1.1	
39. South Dakota	4668	.2	
40. Oregon*	4668	.7	
41. Washington	4692	1.4	
		4.2%	69.9%
	is less than $5100		
42. New Hampshire	4812	.2	
43. Pennsylvania	4848	5.8	
44. Vermont	4872	.2	
45. New York*	4932	11.5	
46. New Jersey	4932	3.9	
47. Minnesota	4992	1.2	
		22.8%	92.7%
	is less than $5700		
48. Michigan	5112[6/]	5.6	
49. Wisconsin	5280	1.3	
50. Alaska	5364	.1	
51. Hawaii	5664[7/]	.4	
		7.4%	100.0%

*Exact combined benefit levels for these states are currently uncertain; however, their relative positions are probably as indicated.

1/ For AFDC, the largest amount paid for basic needs for a family of four with no other income is derived by combining information from two sources: 1) preliminary data for NCSS publication D-2 for July 1974, reporting information on the "largest amount paid for basic needs" to an AFDC family of four; 2) data from a special SRS/APA survey taken about August 1974, TAB D

BACKGROUND ON TAX RELIEF

Structure of Tax Changes

In order to bring about the desired relationship between the tax and restructured transfer system it is essential that the exempt income levels* for families in the positive tax system be increased to the ISP breakeven levels of income. For example, for a family of four, income tax exempt income would be increased from $4,300 to $7,200.

Exempt income can be increased to the desired levels by adjusting the personal exemption and/or the standard deduction. To the extent the personal exemption is increased, taxes are lowered for all taxpayers. On the other hand, increasing the standard deduction benefits only taxpaying units that do not itemize, primarily lower income units. Therefore, raising exempt income by increasing only the standard deduction limits more the amount of tax relief and concentrates it on low and moderate income units. For this reason the decision was made to increase exempt income solely through the upward adjustment of the standard deduction leaving the personal exemption unchanged at $750.

Table 1 displays the five basic standard deductions that result from the method of equating the new higher tax exempt levels of income for various family types with their breakeven levels of income under ISP.

	New Standard Deduction** (for those with incomes less than the breakeven level)
Single Person not Aged, Blind, or Disabled (ABD)	$2,000
Single ABD	3,100
Two Person Family	3,300
Three Person Family	3,750
Four or more Person Family	4,200

* By income tax exempt income is meant the sum of the value of personal exemptions plus the standard deductions, i.e., the minimum amount of a family's income which is guaranteed to be non-taxable. Under current law the minimum standard deduction or low income allowance is $1300 and each personal exemption is worth $750. Thus, a four person family has exempt income equal to $1300 + 4 X $750 = $4300.

** These new standard deductions are expressed in December 1974 dollars. It is assumed that they would be increased at the rate of inflation between then and the time of full implementation of the proposal in such a way as to preserve the real value of ISP benefits.

If these new higher standard deductions were made available to all taxpayers the revenue loss would be considerable, $ 15.0 billion in 1978 (in December 1974 dollars), the first year by which the new schedule would have to be fully in place. This is a larger amount of tax relief than is desired. Therefore, the tax aspects of the plan have been designed so that the standard deductions are phased down above the breakeven level of income at a rate of 50 cents on the dollar.* Each dollar of additional income above the breakeven reduces the value of the standard deduction from the maximums in Table 1 (which are, therefore, applicable only to low-income households) down to the current law level of $2,000 for moderate income units.

Distribution of Tax Relief

The amount of tax relief that would be extended by the above structure is about $4.1 billion rather than $15 billion if the new standard deductions were not phased down at higher income levels. Of this $1.8 billion would go to families with adjusted gross incomes below the newly established tax exempt levels and the remainder to taxpayers with incomes in excess of these. The distribution of this tax relief is shown in Table 3.

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* An effect of this phase down is that it increases the actual marginal tax rates applicable to families in the phase down range of income. An additional dollar of income increases taxes by one hundred and fifty percent of the nominal tax rate since extra earnings add a dollar to adjusted gross income and reduce exempt income by fifty cents. This results in an effective marginal tax rate structure in which rates first fall and then increase as income increases above the breakeven level. Although average tax rates over this range would always be increasing with income, it may be difficult to justify such a marginal tax structure. HEW-Treasury staff are currently examining options which would directly change the explicit tax rates applicable to taxable incomes in such a way as to result in a more optimal tax rate structure while still yielding a roughly equivalent amount of tax relief.

Table 2

Adjusted Gross Income	Tax Relief ($ Millions)	Percentage of Total Relief
0-$1,999	$ 449	10.9
2,000-3,999	748	18.1
4,000-5,999	1024	24.8
6,000-7,999	989	23.9
8,000-9,999	573	13.9
10,000-11,999	332	8.0
12,000-14,999	17	.4
15,000 +*	5	100*
Total	4137	

Table 3 illustrates the amount of this tax relief that would accrue to a four person family at different adjusted gross income levels.

Table 3**

Adjusted Gross Figure	Amount of Tax Relief
below $4,300	0
5,000	$ 98
6,000	$249
7,200	438
10,000	243
12,000	38
over 13,333	0

* The relief to families with income in excess of $15,000 results because of (1) large family sizes, and (2) the fact that some high income tax units continue to profit from use of the standard deduction rather than itemizing.

** All figures in this table are for CY78 and expressed in December 1974 dollars. They assume the standard deductions specified in Table 1 and the 50% phase down.

TAB E

DETAILS OF BENEFIT STRUCTURE AND RECIPIENT POPULATION

For reasons discussed in the paper at Tab C, I am recommending a benefit structure that would yield an Income Supplement Program (ISP) benefit of $3600 per year in 1974 dollars to a four person family with no other income. However, there would be relatively few such families in the ISP recipient population. This paper will first illustrate the details of the benefit structure across the entire range of family types and their levels of earnings, and then discuss the composition of the recipient population.

BENEFIT STRUCTURE

The ISP has the basic characteristics common to all negative income tax type proposals: a family with no other income receives a basic benefit which is then reduced as family income increases. As a general rule, ISP benefits would be reduced by 50 cents for each dollar of other family income. This feature insures that a recipient will always be substantially better off for having worked an additional hour or for having received a wage increase.

With respect to non-wage or non-salary income, ISP rules would be slightly more complicated. Such income would be treated exactly like current earnings and reduce ISP benefits by 50 cents for each dollar up to certain bench marks; thereafter each dollar of such income would reduce ISP benefits dollar-for-dollar. The bench marks would be equal to the unit's basic benefit level. This pattern reflects a compromise between our policy goals to, on the one hand, introduce greater equity in our treatment under means-tested transfer programs of income from current earnings and income from wage replacement transfer programs (such as Social Security) which are based on contributions from past earnings and, on the other hand, the need to keep the net costs in transfer payments of the ISP proposal within desirable bounds.

The attached Table 1 illustrates the full benefit structure, demonstrating for a variety of family types the benefit levels and how they are phased down with other income.

- o A family of four with no other income would receive an annual benefit of $3600. If the earner should work half-time (1000 hours) at $2.00 per hour, the ISP benefit would fall to $2600. Total family income would be $4600.

- o Full-time work at the minimum wage would further reduce the benefit to $1600 and raise total family income to $5600. We estimate that the average ISP benefit for a two-parent family of four would be

$1269 per year, suggesting that in most such families at least one member will be working nearly full-time.

- As earnings continue to rise, the ISP benefit is gradually reduced until, for this type family, it falls to zero at $7200. This is known as the breakeven level of income.

- If the family head has full-time employment at the minimum wage, his or her earnings when combined with the ISP benefit would remove the family from poverty. This would be true for all recipient units.

- The effects of conditioning the benefit structure by family size can be seen in the case of a single individual. With no other income, a single person would be eligible for a $1200 benefit. In the more likely case that he or she is working full-time at the minimum wage (earning approximately $4000 per year) a single person would pay taxes rather than be eligible for a benefit.

- An aged, blind or disabled couple with no other income would receive a benefit of $3150. A family composed of three children and headed by a disabled parent with no other income would receive $3975 annually.

COMPARISON TO EXISTING PROGRAMS

Intact Families. If the family of four described above in the discussion of ISP were a two-parent family, it would not currently be eligible for any cash assistance program in which the Federal government now participates, except in certain limited instances (AFDC-UF, Emergency Assistance and special programs for veterans, Cuban refugees and Indians). However, such a family can presently, regardless of location, purchase Food Stamps with a face value of $1898 per year. If the family has no other income, it receives the stamps for free. The price of the stamps varies according to family income, generally increasing 30 cents for each dollar of additional family income. However, because taxes and large medical and housing expenses are not counted in determining income for the purposes of benefit calculation, the breakeven level for the Food Stamp program is often well above the $7200 breakeven level in the ISP.

Single-Parent Families. If the family of four is headed by a single parent, it could receive cash benefits from the state-administered AFDC programs, as well as Food Stamps. Since the amount of benefits differs greatly from state to state, we will consider the states of Georgia and Michigan for purposes of illustration.

AFDC and Food Stamp Benefits Payable to Families of Four*

	Earned Income			Breakeven Income
	0	2000	4000	Income
Georgia	3240	2700	1560	7000
Michigan	5120	4370	2870	11000

Georgia, a state with a relatively low AFDC benefit, provides a combined Food Stamp and AFDC benefit of $3240 to families of four with no income. Because of generous deductions for such expenses as day care in the calculation of family income, the income level at which eligibility ceases is about the same as that in the ISP. The ISP would completely replace the AFDC program in Georgia. Michigan on the other hand, has a high AFDC basic benefit which, when combined with the generous income disregards for such items as taxes results in a breakeven income of more than $11,000.

In addition to the inequitable benefit differentials among the states, the present welfare system is less efficient than ISP would be in focusing Federal transfer dollars to recipients with the lowest incomes (see Table 2). ISP would direct over 90 percent of its monies to persons who would be poor in the absence of ISP. Less than 10 percent of ISP expenditures would go to persons whose non-benefit income is above their appropriate poverty levels (e.g., approximately $5,000 for a family of four in December 1974 terms), but below their breakeven levels (e.g., $7200 for a family of four in December 1974 terms). Though comparable figures for the Federal share in the present system are virtually impossible to derive at this time, other comparisons indicate that the present system focuses

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* The benefit levels shown here are based on July, 1974 AFDC levels and the July, 1974 Food Stamp bonus schedule. Child care expenses of $50 per month were deducted in the Georgia example. No child expenses were deducted in Michigan since that state pays for child care expenses through the social services program. These benefit levels should be regarded as approximations since they are based on average work related expenses. Actual benefits will vary depending on the specific circumstances of each recipient household.

its resources less efficiently. For example, while the present welfare programs lift roughly 16 percent of the pre-transfer poor, or an estimated 4.5 million persons, out of poverty, ISP would reduce the poverty population by some 9-10 million persons, or 30-40 percent of the pre-transfer poor. The reasons for this greater antipoverty effect in ISP are several: higher levels of assistance to many whose present cash and/or Food Stamp benefits are insufficient to lift them from poverty; a somewhat less stringent assets test than those in current law programs; and a considerably more lenient treatment of non-wage income than now prevails. The last two changes will especially contribute to the virtual elimination of poverty among the aged. The resources that allow this increased aid to the pre-transfer poor derive from the $3.4 billion increase in Federal net expenditures for ISP, and the introduction into the ISP of program design elements (the annual accountable period and a definition of income that permits no exclusions or deductions) which focus transfer dollars more efficiently than does the present welfare system. This greater efficiency, it should be noted, can and probably will lead to the reduction and even elimination of benefits to some who are now eligible and participating in current law programs.

ISP RECIPIENT POPULATION

Eligibility for ISP benefits would be based primarily upon income and household size. Assuming a family does not have assets in which equity exceeds specified values, and the family's income is below the breakeven level, a family would be eligible to receive benefits. However, not all those eligible will elect to participate in the program, principally because large numbers of households whose incomes are close to their breakeven levels will not perceive the small benefits they could obtain from ISP as worth the effort of application and regular reporting. If transfer costs and the number of recipients are projected solely on the basis of a simple comparison of family income and eligibility levels, each would be overestimated. Therefore, projections have been reduced using specific assumptions about probable participation by various household types at various income and asset levels.

In the display below the effect of these adjustments on projections is indicated. While 35.8 million persons would be eligible for ISP benefits, only 27.2 million are expected to be in households that would apply and receive benefits. Similarly, gross transfer costs are projected to be $17.2 billion, or $3.3 billion less than an unadjusted figure that assumes full participation.

ISP Recipients and Transfers: FY 79

	Eligible	Recipients
Number of Units (million)	14.5	10.5
Number of Persons (million)	35.8	27.2
Transfers ($ billion) (1974 dollars) per year	20.5	17.2*

Table 3 provides a breakdown of the potential ISP recipient population. For each group the table displays the number of households (generally families), the number of persons, the aggregate transfers to that group, and the average transfer to that household type. The following points emerge from comparing data from existing programs to the data on Table 3:

o In the absence of the ISP initiative (for FY 79):

-- Some 6-7 million persons will be eligible to receive benefits for the newly federalized Supplemental Security Income (SSI) program for the aged, blind and disabled, and State supplements to that program. One-half of all ISP households (50.0%) would either be composed solely of aged, blind or disabled individuals or would contain such an individual.

-- Assuming that the current stability in the AFDC caseload continues, approximately 10 to 12 million persons will be in families receiving AFDC benefits. One quarter of the ISP recipient population would be in households generally comparable to this group of current cash recipients.

-- It has been estimated that those eligible for Food Stamps may well number as many as 50 million persons; a substantially larger number than the 35.8 million ISP eligibles. (However, because it is one of the in-kind programs which historically have had low participation rates, the number of persons participating in the Food Stamp program in FY 79 may be less than the 27.2 million we would expect to participate in the (ISP.)

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* See column 4 in Table 3.

- Virtually all of the potential ISP recipients would otherwise be eligible for Food Stamps and most of the families for public housing in the absence of ISP. As noted above, the Food Stamp eligible population is much larger than the ISP eligible population. Most of the growth in the Food Stamp program can be expected in the intact family category, the members of which are approximately 40 percent of ISP recipients.

- These intact families, often called the "working poor," are typically headed by an employed father whose substantial earnings over the year would typically make the benefit for this group quite modest ($1269 annually on the average), but sufficient to remove them from poverty. This group would therefore receive 14 percent of the benefits though it comprises almost 30 percent of the recipient population.

- The average benefits that households would actually receive are well below the basic benefit levels to which they would be entitled if they had no other income, for most will have substantial earnings or other income.(see Table 1). Even groups which we generally do not consider as being employed have in fact substantial income which would serve to reduce the benefits they would receive. For example, single-parent families with children would receive, on the average, $1000 below their basic benefit.

TABLE 1

ISP BENEFIT STRUCTURE (IN 1974 DOLLARS)

	Benefits at Various Earnings Levels				Total Income at Various Earnings Levels				Breakeven Level of Earnings Total Income (Benefit = 0)	Average Benefit
	$0[a]	$2000	$4000	$6000	0[a]	$2000	$4000	$6000		
Single Individual	$1200	$ 200	*	*	1200	$2200	*	*	$2400	$726
Childless Couple	$2400	$1400	$ 400	*	2400	$3400	$4400	*	$4800	995
Single Parent, One child	$2400	$1400	$ 400	*	2400	$3400	$4400	*	$4800	1603
Single Parent, Three children	$3600	$2600	$1600	$600	3600	$4600	$5600	$6600	$7200	2593
Two Parents, Two Children	$3600	$2600	$1600	$600	3600	$4600	$5600	$6600	$7200	1269
SSI Individual	$2300	$1300	$ 300	*	2300	$3300	$4300	*	$4600	1281
SSI Couple	$3150	$2150	$1150	$150	3150	$4150	$5150	$6150	$6300	1293
Disabled Parent, Three Children	$3975	$2975	$1975	$975	3975	$4975	$5975	$6975	$7975	3722

a The benefit at zero income is the "basic benefit." When income is zero the total income of a family will equal the benefit.

* At this income level the family is above the ISP breakeven income and will therefor receive no ISP benefits and might have a positive tax liability.

TABLE 2

COVERAGE AND ANTIPOVERTY EFFECT OF ISP TRANSFER BENEFITS

Number of families* receiving a transfer (millions)	10.7
-- As a percent of all families	14
Number of persons receiving a transfer (millions)	27.2
-- As a percent of all persons	12
Transfers to families below poverty line**	15-16
(Billions of $)	90-95
-- As a percent of total transfers	
Number of poor families receiving a transfer (millions)	9-11
-- As a percent of all poor families	80-90
Number of persons in families below poverty line and receiving a transfer (millions)	24-26
-- As a percent of persons in poverty	80-90
Number of families escaping poverty (millions)	4-5
-- As a percent of all families in poverty	30-40
Number of persons escaping poverty (millions)	9-10
-- As a percent of persons in poverty	30-40

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* Unrelated individuals are included as families of size one.

** Since we do not know which poor families will participate and which will not, all poverty figures are expressed as ranges instead of point estimates. A unit is classified as poor if its income before means tested transfers is below the poverty threshold.

TABLE 3

ISP RECIPIENTS AND TRANSFERS: ESTIMATES FOR FY 79

Primary Filing Unit Characteristics	No. of Units (Millions)	No. of Persons (Millions)	Sum of Transfers (Billions/Year in FY 79 dollars)	Sum of Transfers (Billions/Year in December 1974 dollars)
1. Single-parent families with children; no ABD's* present	2.0 (19.2%)	7.5 (27.6%)	6.2 (27.0%)	4.6 (26.7%)
2. Two-parent families with children; no ABD's present	1.5 (14.4%)	7.6 (27.9%)	3.1 (13.5%)	2.3 (13.4%)
3. Families with children; at least one ABD	.6 (5.8%)	3.3 (12.1%)	2.5 (10.9%)	1.9 (10.9%)
4. Related adults; no children; no ABD present	.5 (4.8%)	1.1 (4.0%)	.8 (3.5%)	.6 (3.5%)
Related adults; no children; at least one ABD	1.6 (15.4%)	3.5 (12.9%)	3.3 (14.3%)	2.5 (14.5%)
6. Single adult; not ABD	1.2 (11.5%)	1.2 (4.4%)	1.4 (6.1%)	1.0 (5.8%)
7. Single ABD adult	3.0 (28.8%)	3.0 (11.0%)	5.7 (24.8%)	4.3 (25.0%)
Total Population	10.4	27.2		
Total Transfer Costs			23.0**	17.2

* ABD means person who is aged, blind, or disabled

** In addition to transfers, ISP costs would include: $1.2 billion for program administration, $0.1 for the work test, and $0.5 billion for emergency assistance. Total costs would be $24.8 billion in FY 1979 as shown in Tab F.

TAB F

BACKGROUND ON ISP COSTS

There are two independent cost components which must be estimated in order to arrive at the net transfer costs of ISP -- the gross transfer costs of ISP and the expenditures under those programs that will be eliminated or reduced because of ISP. In the latter case estimates are based on the continuation of the present set of income tested programs (except that CHIP would displace Medicaid); it is not assumed that, in the absence of ISP, any new ones would evolve or that existing programs would expand or contract appreciably because of changes in regulation or legislation or increases in participation among the eligible population above that reflected in the official OMB projections. To the extent any of these would occur, the cost estimates presented here would require adjustment.

The gross costs for ISP in FY '79, the first year in which the program would be fully implemented, are estimated to be $24.8 billion. Program offsets are estimated to be $20.2 billion. This yields FY '79 net costs of $4.6 billion which in today's dollars is $3.4 billion. The following sections provide detailed information on the derivation of these figures as well as other possible influences on costs which are not reflected in these estimates.

It is reasonable to assume that gross costs will remain relatively constant in real terms for some years after FY '79 then gradually fall. Benefits will be adjusted upward with inflation, but, over time, the average earnings of the eligible population will increase by even more than the amount of inflation, due to the real growth rate of the economy. This is the phenomenon that should cause costs to decline in the long run. However, in the early years of the program, an increase in participation among the eligible population may put upward pressure on costs. The assumption that costs would remain constant in the shorter term rests on the foundation that these two trends (increased participation and growth of income in excess of inflation) will be roughly offsetting.

DERIVATION OF PROGRAM OFFSETS ESTIMATE

Program offsets of ISP fall into two categories:

o Programs which would necessarily be eliminated in favor of ISP

	Estimate of Federal Program Outlays in FY 79 (Billions in FY 79 dollars)*
AFDC	$6.6
SSI	6.1
Food Stamps	5.5
WIN	0.3
	$18.5

o Programs not eliminated, but which would have lower outlays as a result of greater cash income among the low-income population.

Housing	$0.6
School Lunches	0.3
CHIP	0.8
	$1.7

DERIVATION OF GROSS TRANSFER COSTS

The gross transfer cost estimate for ISP is derived by utilizing the basic output of the computer simulation model known as TRIM (Transfer Income Model). This model can be programmed to estimate the cost of a program very similar to ISP, which then can be adjusted to reflect certain factors which the model cannot take into account. Below is a discussion of the assumptions built into TRIM and of the nature and cost impact of the adjustments made.

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* These are the official OMB "free fall" estimates which reflect no change to current program policies and adjust for both inflation and increases in program participation. A discussion of offsets using OMB "reduction" estimates which assume the implementation of various cost saving changes is contained in the final section of this tab.

Assumptions Built Into TRIM

The assumptions which were built into TRIM computer runs are listed below. As will be obvious, many of these are not entirely appropriate and are the reason for some of the adjustments listed later.

- The March 1973 Current Population Survey (which provides income data for CY 72) is aged to FY 79 to produce the expected profile of numbers and types of households and their (non-ISP) income; since the unemployment rate was 5.6 percent in 1972, this same rate is carried forward to FY 79 when the CPS is aged.
- The benefit structure of ISP is specified in December 1974 dollars and adjusted thereafter for inflation. The rates of inflation assumed are the official Troika estimates (1974, 11.2%; 1975, 10.9%; 1976, 7.8%; 1977, 6.6%; and 1978, 4.8%).
- These same rates of inflation of the CPI are assumed in projecting the levels of other sources of income (although additional assumptions such as for the growth rate of real wages are also necessary).
- A comprehensive filing unit definition is employed, which means that all related members of a household are assumed to be filing together for ISP eligibility and benefit determinations.
- All non-wage income up to the amount of the basic benefit for which a filing unit would be eligible is treated the same as earnings -- i.e., a flat 50 percent benefit reduction rate is applied; all non-wage income above this level is used to offset ISP benefits dollar-for-dollar.
- No ISP income-eligible filing units have assets above the limit permitted for eligibility and all such units participate in ISP.

Adjustments to TRIM Output

The following adjustments to TRIM output are necessary to arrive at appropriate gross cost estimates for ISP.

Upward Adjustments

	Billions
o Accounting Period Adjustment - As presently formulated, monthly ISP benefits for a filing unit would be based upon the previous twelve months' income, utilizing a system which carries forward for twelve months the amount of monthly income in excess of the breakeven level for the filing unit. This system is somewhat more responsive to fluctuations in monthly income than is the calendar year accounting period assumption which is built into TRIM.	0.3
o Certification of Separate Economic Status - TRIM assumes that all related residents living together will be required to file together. This is the general rule that would be prescribed for ISP; however, ISP rules would permit any subgroup of a household that can prove separate economic status to file separately. It is difficult to assess accurately how many people will be able to satisfy this condition, but many who are able will want to file separately (since they may then receive greater benefits than if they were the additional member of a larger unit where they would not have a separate minimum standard deduction).	1.0
o Labor supply reduction - The evidence from income maintenance experiments and studies using Census data suggest quite modest reductions in work effort occasioned by a program such as ISP. While very few persons would quit their jobs as a result of ISP eligibility, some marginal hours of work reductions might result among those recipients who would not otherwise be participating in a welfare program eliminated by ISP. As a consequence their earnings would be lower and benefits higher.	0.6
o Emergency needs - The following three categories of households may have requirements for a payment outside of the ISP to cover an emergency need: (1) ISP eligible households waiting for their first check (because of payment lag in the system); (2) ISP recipients	0.5

Billions

households who have exhausted their current payment; and (3) households which, because of the accounting period and/or the assets test, have low current income and no liquid assets, but are currently ineligible for ISP. The latter two categories are best dealt with at state/local levels, perhaps with some Federal cost sharing. The first category is more easily seen as a Federal responsibility and could be dealt with by the Federal government or by a state/local entity which represents the Federal government.

- Work Test - Some Federal funds would have to be provided to states for them to administer the work test mandated under ISP. 0.1

- Program administration - The IRS Task Force estimates that the annual costs of ISP would run somewhat over one billion dollars. 1.2

Downward Adjustments to TRIM Output

- Assets screen - Estimates based upon studies of the Survey of Economic Opportunity which provides data on asset holdings of households cross classified by income levels indicates that fifteen percent or more of the filing units that will be income eligible for the ISP will have other resources sufficient to make them ineligible to receive ISP benefits. 2.2

- Under reporting of income - There is a substantial amount of income that is not reported by respondents to the Current Population Survey (and, therefore, is not in our cost estimating income base), but which would be picked up by ISP reporting, audit and verification procedures. Independent data bases, such as income tax reports, provide information that make it possible to estimate the magnitude of this under reporting. 3.0

- Demographic Aging - A recent decline in the birth rate has resulted in a significant reduction in the average size of U. S. families. Between 1970 and 1974, average family size fell from 3.58 to 3.44. The demographic aging process in TRIM does not adjust for this reduction in the number of young children in families, and as a result, TRIM overstates expected transfers to families with children. 0.4

Billions

- o Participation Rates - Substantially less than all of the eligible households can be expected to participate in ISP. It is estimated that about 90 percent of eligible AFDC families, 90 percent of eligibles for SSI who are disabled and 65 percent of eligibles for SSI who are aged actually apply for cash benefits.* The current participation of eligible two-parent families and non-aged, non-disabled adults in Food Stamps is considerably lower, probably averaging closer to 30 percent. Under a comprehensive nationally uniform cash assistance program which is tied to the income tax system, we can expect these latter two groups to have substantially higher participation rates; therefore, we have assumed that 70 percent of eligible families of this type will participate. 4.4

  In adjusting for participation rates less than 100 percent, costs were reduced by a substantially smaller percentage (about 30%) than units, since participation rates in ISP are likely to increase with the size of the potential benefit.

Total Adjustments Made to TRIM

The necessary upward adjustments to the TRIM output total $3.7 billion. The total downward adjustments to TRIM necessary to account for all the factors mentioned above is $10.0 billion. Thus, the net adjustment to TRIM necessary to account for all factors mentioned above is $6.3 billion downward. Since before these adjustments are made TRIM indicates a gross cost of $31.1 billion for transfers alone, the final estimate utilized for total ISP program costs is $24.8 billion.

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* Actually far less than 65 percent of those aged eligibles for SSI are presently participating, but the official OMB projections assume that this is the rate which will prevail in equilibrium -- i.e., after the program has been in place for a few years. Accordingly, the assumption of 65 percent participation underlies the SSI offset estimate for FY 79 and we have used it as a base in determining likely participation of the same group under ISP.

OTHER FACTORS WHICH MAY INFLUENCE COSTS

In addition to the factors detailed above and reflected in the cost estimates provided, there are a number of other possible influences on costs that should be noted.

Influences Which Could Go Either Way

Many of the adjustments to the TRIM output are based upon estimates that have a fair amount of uncertainty attached to them. Although they are based upon the best available evidence, they could easily be over or under estimates of what would actually occur. In these cases, we have attempted to pick realistic mid-range values.

Obviously marked changes from the overall economic or demographic projections which form the basic input to the TRIM model would lead to sizeable shifts in the cost estimates. Here we have simply relied upon official troika and Census projections wherever they are available and made consistent, reasonable projections where not.

Upward Influences on Costs

The most important of the upward influences fall into two categories -- those that would be caused by regulatory or legislative changes in programs being offset and those that reflect possible structural changes in the ISP, particularly as it becomes the focus of Congressional actions.

A series of budget reduction proposals have been adopted by the Administration which, if all were accepted by Congress, are estimated by OMB to reduce the FY79 outlays for the programs eliminated by ISP by $1.7 billion below the free fall estimates reported earlier in this tab. These have not been assumed in the cost estimating process because, particularly to the extent that recent experience is a guide, it appears more realistic to assume that they will be rejected by Congress. However, if some are adopted, this would have the effect of lowering program offsets and raising ISP net costs.

There are potential elements of ISP which are not without merit, but which were rejected for sound policy reasons as the program was developed. It is possible that some of these would be reconsidered and adopted by the Administration at a later date if their inclusion were to advance substantially the possibilities for Congressional passage of ISP and this plus were not outweighed by the negative aspects that intially led to their rejection. The only two such elements that seem at all likely to fulfill these criteria at this time are a standard deduction for work related day care expenses of single parent families and permitting present SSI recipients who are members of larger households to file separately with a one-third grant reduction without having to certify separate economic status. Each of these is estimated to cost on the order of half a billion dollars.

Downward Influences on Costs

As was mentioned in the beginning of this tab the program offsets are based upon the assumptions of no unplanned increase in participation among the eligible populations, no liberalizations of existing programs and no additional programs being added to the welfare system. The possibilities for each of these are discussed briefly below, since the true cost cost ISP should take into account changes that would be made to the welfare system in the absence of this proposal.

- Increased participation

  Participation in the Food Stamp program is running low overall (under 50%) and particularly low for the non-cash recipient group. A minor increase in these present rates is assumed in the Food Stamp FY79 estimate. Because of the great potential for increased participation in this program, rapidly rising food prices and the increased publicity of Food Stamps, the participation could easily increase by much more than is expected.

- Program improvements

  If ISP is not adopted, there will be considerable interest both within Congress and the Administration in making changes in the present welfare system which further the goals of efficiency, equity, adequacy, etc. such as instituting a national minimum in AFDC and moving to consolidated grants. (See Tab ____ for more information on these). These improvements would increase Federal costs for the present system by $1-$2 billion over the program offset estimates used to cost out ISP.

- Add-ons to the Welfare System

  In the absence of a comprehensive cash assistance program for the lower income population there will be continued pressure to add on additional categorical programs to fill "gaps" in the present system. Although most of these probably could be resisted, others undoubtedly could not. Foremost among the latter is the "Work Bonus" or some other scheme to aid lower income workers, particularly those paying OASDI payroll taxes.

TAB G

ADMINISTRATIVE PERSONNEL COMPARISONS

The passage of the Income Supplement Program (ISP) would profoundly affect personnel requirements among the various levels of government. This paper estimates probable staffing requirements according to the likely configurations for income support programs. The options shown range from no change in the present system to a major welfare replacement. The first section examines total staffing, the second the ratio of administrative to transfer costs as an indicator of administrative efficiency. Because so much uncertainty exists on these matters, the paper concludes with a section listing some particularly important caveats. Appended is a note on the methodology used.

Total Staffing

Absent any change the public assistance system would continue to be composed of Food Stamps, Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), Emergency Assistance and General Assistance.* The ISP initiative would completely replace the first three and change significant aspects of the last two. (General Assistance is solely a State program.) Table 1 shows that in FY 77,** with no changes, total personnel needs would be about 137,000, of which about 27,000 would be Federal and 110,000 State/local

Table 1

Public Assistance Personnel Needs with No Welfare Replacement and No Major Changes in Present System

FY 77

	Recipients (million)	State & Local Employees (thousand)	Federal Employees (thousand)	Total Employees (thousand)
Food Stamps	25.6	25.6	3.0	28.6
AFDC	12.3	61.2	.8	62.0
SSI	5.9		23.4	23.4
State Administered Supplements to SSI	1.4	14.1	-	14.1
General Assistance	0.9	8.7	-	8.7
		109.6	27.2	136.8

* This list ignores other income tested transfers, such as public housing, Medicaid and veterans' assistance.

** These figures were originally prepared when ISP was costed out to FY 77. When costs were extended to 79, there appeared to be no compelling reason to re-calculate personnel estimates, particularly given the limitations of available data.

If we assume no replacement of the basic set of programs, it is probable that one or more programs will be added. The prime candidate is the Assisted Health Insurance Program (AHIP) component of the Administration's Comprehensive Health Insurance Program (CHIP). It is also possible that a Housing Allowance and a Work Bonus will pass into law absent an ISP which would foreclose their need. The upper panel of Table 2 summarizes these probable situations should there be "No Replacement" of the present programs. It is estimated that AHIP income information collection, a universal Housing Allowance, and a Work Bonus would require 30,000; 40,000; and 3,000 new employees, respectively. It should be noted that AHIP or something like it is likely to become law regardless of whether or not there is a welfare replacement initiative. Thus, either way AHIP will require additional personnel at some level of government, but the amount needed to collect information on income and filing unit characteristics would be very minimal if ISP exists and AHIP conforms its comparable program elements to those in ISP (e.g., income and filing unit definitions). Under these conditions the information generated by ISP would be both available and useable to income test eligibility under AHIP.

Total government employment for income support programs given welfare replacement (i.e., ISP) would depend on the manner in which State supplements were handled. The lower panel of Table 2 summarizes employment needs assuming ISP and with three different possible methods of handling State supplements. (See Tab C for a discussion of the issues involved in State supplementation.)

Public sector payrolls would be the largest if there were no Federal administration of State supplements. This is because there would then be, in effect, two parallel income transfer systems -- the Federal ISP system and the several State systems running autonomous State supplement programs. As Table 2 shows, Federal administration of State supplements, whether for some or all States, involves little added burden for the ISP agency. The ISP caseload would already contain most of those eligible for State supplements, and the extra State supplement computation is a simple matter for the automated Federal system to handle so long as the States rigorously adhere to Federal definitions and categories (the only conditions under which the Federal government would administer State supplements). Thus while 122,000 employees (58,000 Federal and 64,000 State/local) would be needed in the "no Federal administration" case, only 66,000 (60,000 Federal and 6,000 State local) would be needed if the Federal government administered all supplements. In the more likely intermediate case of partial Federal administration of State supplements, total employment would be more in the area of 70,000. The actual figure, of course, depends upon exactly how many States would opt for Federal administration.

Table 2

Public Assistance Personnel Needs with and without Welfare Replacement

Program Configuration		State & Local Employees (thousand)	Federal Employees (thousand)	Total Employees (thousand)
No Replacement		110	27	137
" "	w/CHIP (AHIP)[a]	30		+30
	w/Housing Allowance	40[b]		+40
	w/Work Bonus		3	+ 3
Replacement (ISP) and				
No Federal administration of State supplements		64	58	122
Optional Federal administration of State supplements[c]		11	59	70
Federal administration of all State supplements		6[d]	60	66

a. AHIP collection of information on income and other filing unit characteristics only; AHIP will require additional personnel for other functions whether or not ISP exists.

b. Distribution of effort between levels of government unclear at present.

c. Precise figure depends upon State decisions on administration. The estimate here was derived on the assumption that those States which have opted for Federal administration of State supplements to SSI would also do so for ISP.

d. It is extremely unlikely that all States which might choose to supplement ISP would also opt for Federal administration; however, this line is shown for comparison purposes. The residual group of State and local employees is shown on the assumption that there would be a State-administered Emergency Needs Program.

Administration Efficiency

Staffing figures are only one measure of relative administrative costs. In programs such as Food Stamps, there are significant additional expenses involved in the operation of the program. To obtain a more complete indication of total costs and to demonstrate the relative efficiency of different modes of making transfer payments, the total administrative costs of individual assistance programs were divided by their gross transfer costs to determine as a percentage of transfers the amounts additionally required for administration.

As can be seen in Table 3, the Income Supplement Program has the smallest ratio of administrative costs to transfer costs of any of the other programs -- approximately half that of present cash programs, and even less than that of Food Stamps. If the Income Supplement Program replaces other transfer programs, its potential for administrative efficiency would allow more benefits to be transferred at a lower relative cost.

Table 3

The Percentage of Total Administrative to Gross Transfer Costs

Program	Percentage
AFDC	9.5
SSI	9.1
ISP	4.5
Food Stamps (to non-public assistance recipients)	15.0*

Caveats

Data limitations, the still changing nature of ISP and CHIP program designs, and the uncertainty surrounding administrative and substantive choices of the States in current law or future programs mean that

* The figure for Food Stamps is an estimate based on actual program data and limited information which gives a general indication of the magnitude of hidden and unreported costs. Reported costs are close to 10 percent of transfer costs and do not reflect joint program costs which have not been allocated to overhead, indirect expenditures and some administrative costs. State data reported to the Senate Committee on Nutrition and Human needs and a recent study in Los Angeles County indicate that these costs probably add another 40 to 60 percent to total administrative expenditures.

estimates presented here can only be general and tentative. These limitations arise from several sources:

- <u>The lack of reliable information on current State public assistance staffing</u> - The existing data on the number of State and local staff performing cash eligibility determinations are unreliable and often officially not available, primarily because of weaknesses in the manner in which States report personnel statistics. One obvious defect is the shift of personnel into the social service category with its higher Federal reimbursement formula, leading to an understatement of the number of staff engaged in cash transfer related duties.

- <u>The lack of State and local cost information on the Food Stamp Program</u> - The only reliable Food Stamp cost data currently available are those related to Federal program costs and Federally-cost-shared personnel. These costs only cover a portion of total Food Stamp administrative requirements, and most States and localities do not separate out or report their total direct costs and substantial indirect costs. Thus estimates of the total figures can only be approximate. *

- <u>Uncertainty about developments in present and proposed programs</u> - There are many factors which could materially affect the estimates developed here

  - If, as some predict, the Food Stamp program experiences very rapid growth over the next few years, the administrative burdens borne by State and local governments could increase to the point where they could no longer be handled as marginal additions to staff and facilities needed for other functions

  - Passage of the Comprehensive Health Insurance (CHIP) is possible and enactment would require the States to significantly increase staff levels to handle the eligibility functions required for the assisted portion (AHIP) of the program, including the collection of relevant income and asset information.

  - Similarly, the shape of the State supplemental portion of the ISP is still unknown. The implications for total staffing under a Federally-run supplement are very different from those if the supplements are left as the sole responsibility of the States. In either case, the behavior of States in deciding whether or not

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*A recent legislative change provides for a 50 percent Federal matching of all Food Stamp administrative costs. When this provision becomes effective more complete administrative cost data should become available, permitting the development of more precise administrative cost estimates.

to supplement, and, if given the option, whether or not to administer their own supplemental programs or to transfer responsibility to the Federal agency can only be guessed on the basis of tenuous assumptions. In addition, State staff made superfluous by a Federal program will not always be eliminated immediately but will decrease through attrition over time.

- Tentative nature of Federal personnel estimates for an ISP - Another, less serious, reason for uncertainty regarding administrative staff comparison is that although the staffing estimates for the ISP were derived in a systematic manner, the number of unknown factors in the early stages of program development make it more difficult to achieve the degree of precision in these projections which will be possible later in the planning process.

Appendix: Technical Notes

Personnel needs for FY 1977 were estimated by calculating current ratios of recipients per employee and applying these ratios to expected recipients in FY 1977.

Table 4

Recipients per Employee

Program	State & Local Ratio	Federal Ratio
Food Stamps	1001	8,630
AFDC	201	15,409
SSI	99	252
GA	104	------

Recipients per Employee

1. Recipients per employee for state and local government have been calculated by dividing the number of recipients by the number of employees engaged in income maintenance for each program. Employee figures were provided by the National Center for Social Statistics. For state-administered supplementation of SSI, the number of employees and recipients in the adult categories in FY 1972 was used to calculate the state and local ratio.
2. Federal recipients per employee were calculated in the same way. For Food Stamps, the number of employees as reported in the Federal Budget was used. For AFDC the number of Federal employees was estimated to represent 28 percent of the SRS staff, since this is the percentage of the funds dispensed by SRS that goes to AFDC. For SSI, the number of staff needed in FY 1975 as estimated by SSA was used.

Personnel Needs with and without an Income Supplement Program

1. For existing programs, the number of Federal, state and local employees was calculated by taking the estimated recipients and dividing by the number of recipients per employee. This assumes that the relationship between recipients and employees is linear. State and local recipients per employee for AFDC and the adult programs were used for the estimates of state administration of AFDC and SSI supplements. Absent any other

change, only those states now administering SSI supplements were assumed to administer them in FY 1977. Employees administering the supplement for those states that have opted for Federal administration are included with Federal employees administering the regular SSI program.

2. FY 1977 recipients for AFDC and SSI were estimated by projecting the caseload estimate shown in the FY 1975 Budget. Food Stamp recipient estimates were developed from the TRIM model using CPS data. State supplements were handled by extrapolating from the current situation in a similar manner.

3. With a reform, 30 states will supplement AFDC and 10 states SSI, containing 64 percent and 32 percent of the caseload respectively. These estimates are based on a comparison of the ISP benefit levels with the sum of AFDC or SSI benefits and the bonus value of Food Stamps. These estimates should be considered an upward bound for reasons discussed in Tab C.

   The SSI benefit estimate additionally includes any state supplements. Although fewer states would administer a supplement to SSI recipients under a reform program, the percentage of the caseload in those states which are assumed to supplement the ISP could be greater than that in the 18 states currently administering their own SSI supplement. This could occur because some states with large caseloads like New York have chosen Federal administration for their supplement under SSI but might be required to administer their supplement under ISP.

   These calculations reflect the present levels. The absence of any provisions in the proposed program for Federal cost-sharing or hold harmless guarantees in supplementation, and possibly no participation in administration makes this assumption problematical. These estimates may therefore overstate total state and local personnel needs under ISP. Another factor which may make these estimates too high is that supplementation has been assumed in some states in which the actual state benefit would be very low. Few states are in fact likely to supplement unless the average benefit would be significant.

4. The recipient estimate for ISP is taken from the IRS Task Force Report adjusted to reflect changes in the estimated caseload.

TAB H

COMPARISON OF THE INCOME SUPPLEMENT PROGRAM TO PLAN OF SUBCOMMITTEE ON FISCAL POLICY

Recently Congresswoman Martha Griffiths introduced a comprehensive welfare reform bill titled "The Tax Credits and Allowances Act of 1974" (H.R. 17574). It provides for major changes in the Federal income tax structure and considerable tax relief; for replacing the Food Stamp program and the Federal portion of AFDC in part with a new, Federally funded and administered means-tested cash transfer program and in part with rebatable tax credits; and for a variety of other changes in related income transfer programs, such as Unemployment Insurance.

In significant ways, especially in overall theory, the Griffiths' plan and the Income Supplement Program are quite similar. In equally significant ways they differ. This paper will first outline the major elements of the Griffiths' proposal and then compare and contrast that plan with the Income Supplement Program.

THE GRIFFITHS' PROPOSAL: INCOME SECURITY FOR AMERICANS

The Griffiths' Income Security for Americans plan would create a new income assistance system by:

- o Eliminating personal exemptions and the low-income allowance (or "minimum standard deduction") in the Federal income tax and replacing them with a $225 refundable tax credit for each individual in the country. Such a tax credit would extend tax relief to all families with income less than about $23,500. Since it is refundable, current non-filers and non-taxpayers would also benefit.

- o Eliminating the AFDC and Food Stamps programs and replacing them with a new Allowance for Basic Living Expenses (ABLE) program for all low-income families and individuals with the exception of those eligible for SSI.

- o Retaining, but restructuring somewhat, the Supplemental Security Income program.

- o Abolishing the itemizable day-care deduction in the Federal Income Tax in favor of a new adjustment to gross income in the tax system and in the ABLE program for work expenses.

Rebatable Tax Credits. The current $750 personal exemption and the low-income allowance of $1300 would be replaced by rebatable tax credits of $225 for each individual in the country. The effect of this change, along with complementary measures to integrate the grant programs with the tax system, is to raise the tax exempt income level (i.e., the highest income at which no tax liability is incurred) for a typical four person family from its current level of $4300 to $7200. In addition, the introduction of the tax credit would extend tax relief to all four person taxpaying units with income of less than $23,500.

Since the tax credit is rebatable, units that incur no tax liability would have the full credit paid to them in cash. Units that have a tax liability of less than the tax credit for which they are eligible would receive the difference between the credit and their tax liability. The key point is that the unused tax credits are rebated.

The Allowance for Basic Living Expenses Program, ABLE. Federal funding would largely be ended for Aid to Families with Dependent Children (AFDC), and the Food Stamp program would be abolished and be replaced by a new system of allowances operated by the Internal Revenue Service (IRS) in conjunction with the Federal income tax. These Allowances for Basic Living Expenses (referred to as ABLE grants hereafter) would be payable to qualified low-income families and individuals every month. Allowances would be uniform throughout the Nation and available to all the poor, except the aged, blind, and disabled and their dependents who would remain covered by the Federal Supplemental Security Income (SSI) program. The basic structure of the ABLE program is as follows:

> Benefits: The annual basic benefit for a two-parent, two-child family with no other income would be $2700, while that for a one-parent, three-child family would be $2100. This more generous treatment of married adults is considered to be an important feature of the bill. The following table presents basic benefits for various family types:

Family Type	ABLE Benefit at Zero Income*
Unrelated Individual	$ 825
Childless Couple	2050
One Parent, One Child	2050
Two Parents, Two Children	2700
One Parent, Three Children	2100
Benefit to succeeding children through: six	225
seven and above	0

Benefit Reduction Rates: ABLE payments would be reduced as other income accrued to the family and the benefit reduction rate would vary depending on the type of income. The benefit reduction rates are as follows:

- Earned income -- 50 percent on earnings less deductions for social security taxes, implying that most earners would face rates no greater than 47 percent.
- Public housing subsidies -- 80 percent.
- Veterans pensions and farm subsidies -- 100 percent.
- All other income (e.g., property income, retirement benefits, child support) -- 67 percent.

Breakeven Income. The level of income at which a family would become ineligible for ABLE benefits would, because of the complex schedule of benefit reduction rates and a proportional work expenses deduction, depend on the source of the family's income and the labor force activity of the

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* These benefit levels may seem relatively low to anyone familiar with the present welfare system. It must be remembered that the ABLE benefit must be combined with the value of the tax credit to determine the basic benefits in the ISA plan. This interaction is examined below.

adults. However, "normal" breakeven incomes can be determined. For a two-parent, two-child family not entitled to the work expense deduction and with income only from earnings not subject to the social security payroll tax, eligibility would cease at an annual income of $5400. The more typical case, however, is a similar family in which both parents work in covered employment. In that case the breakeven income level would be about $6000 because of the payroll tax deduction and the work expenses deduction.

Tax Credit-ABLE Interaction. The benefit levels in the ABLE program may seem low to those familiar with benefits in current welfare programs (e.g., AFDC and Food Stamps). In this regard the interaction between the revised tax system and the ABLE program must be examined. The net disposable income to an ABLE family with no other income is the sum of its ABLE benefit and the amount of its rebated tax credit. Thus, $900 in rebated tax credits (4 times $225) would be added to the ABLE basic benefit of $2700 for a four-person family, yielding to a family with no other income total benefits of $3600 (identical to that proposed for the Income Supplement Program).

The effects of the combination of ABLE payments and tax credits may be seen by examining the ABLE and/or tax status of a four person family (with no deductions) at various income levels:

Income	ABLE and/or Tax Status
0 - $5400	Unit receives an ABLE payment that varies with its income: from a $2700 benefit at zero income to a zero benefit at income of $5400; unit receives a $900 tax credit and pays no taxes.
$5400 - $7200	Unit has net tax credit which falls from $900 at income of $5400 to zero at income of $7200. Unit receives no ABLE payment.
$7200 - $23,500	Unit incurs net tax liability that would be lower than that under current law. In income range of $7200-$7563 unit would use a new, alternative tax computation method.

(As indicated above, a more typical case would be for families that have deductions, the consequence of which is that these income limits would be raised somewhat.)

Tax credits would be rebated to ABLE and SSI recipients, together with benefit payments under those programs, by the IRS and the SSA respectively. Those families eligible for tax rebates who are not ABLE or SSI participants (e.g., a family of four with earnings of $6600) would apply to the IRS for their rebate, although the administrative means to do this are not clearly spelled out in the plan.

Tax Credit and ABLE Costs. The net cost to the Federal government of the Income Security for Americans program is estimated at $15 billion in 1977 -- $6.8 billion additional in transfers and $8.2 billion in tax relief. In current dollars these costs are $12.9 billion, $5.7 billion, and $7.2 billion, respectively.

COMPARISON OF THE INCOME SECURITY FOR AMERICANS AND INCOME SUPPLEMENT PROGRAM PROPOSALS

The ISA and ISP proposals each would create a universal means-tested cash transfer system that in significant ways would be tied to the Federal tax system. This section will outline areas where the plans are similar or different.

Components of the Income Assistance System. The ISA proposal would retain a somewhat altered SSI program, whereas ISP would fold SSI, AFDC, and Food Stamps into one cash transfer program. The Federal government would therefore, under the ISA approach, maintain two separate income assistance programs, administered by separate agencies (IRS and SSA). Provisions of ISA minimize potential overlaps between SSI and ABLE.

Integration with the Tax System. The ISP would have a simpler integration with the tax system than the ISA plan. Under the ISP proposal, a family's cash supplement would gradually diminish from the appropriate basic benefit to its tax liability threshold, an amount equal to its personal exemptions and standard deduction in the tax system. Beyond that tax exempt level, the family would incur a tax liability according to the present tax schedule with one exception. Under current planning, its appropriate standard deduction would be phased down over a range of taxable income until it equals the $2000 standard deduction in current law.

The ISA plan requires a more complicated integration. In order to forgive taxes at levels below the points at which families cease to be eligible for a cash transfer (i.e., their breakevens), the ISA would in effect create an alternative tax schedule with standard deductions equal to those breakeven points and marginal tax rates equal to those in the transfer programs (i.e., approximately 50 percent). A family would compute its tax liability under either the regular tax schedule (15 percent standard deduction up to $2000 and the present marginal tax rates) or the alternative tax schedule apply its tax credits against both figures, and pay the lesser of the two amounts.

Benefit Structure. The ISA makes a clear distinction between a second parent and an additional child. The former brings to the family an additional $600 relative to the latter. The ISP benefit structure does not make such a distinction. The effect of the ISA treatment is to provide what the ISA report calls a "marriage bonus." Relative to current programs the ISA would make larger families relatively worse off.

Except for that distinction, the basic benefit levels of both plans are quite similar. However, the benefit levels of the ISA and ISP plans depart somewhat as income accrues to a family. This is because the benefit reduction rates for different kinds of income in the two plans differ. In addition, though the earned income breakeven levels for transfer payments theoretically are the same those in the ISA would be higher because of deductions for work expenses and payroll taxes. In essence, for those who work, the ISA has a lower benefit reduction rate on earned income and, as a result, a higher breakeven income level.

Work Test. The ISP proposes a work registration requirement modeled on that in the Unemployment Insurance system. The ISA proposal "recommend(s) that a work registration requirement and the attendant costly bureaucracy not be attached to a new program." The Griffiths' report notes that "We have found little evidence or experience to support -- and several grounds to oppose -- reliance on administrative pressure and sanctions."

Filing Unit. The two plans depart considerably on filing unit definitions. ISP has a quasi-household definition (all persons related by blood, marriage, or adoption living under one roof) as opposed to the filing unit definitions in ISA which are patterned more on those in the tax system. The distinction in the ISA plan between ABLE units and SSI units enlarges considerably the number of separate filing units.

Benefit Reduction Rates. Except for those with considerable amounts of non-wage and salary income, the ISP has one benefit reduction rate, 50 percent, that applies to all income. For those with non-wage and salary income in excess of their basic benefit, the benefit reduction rate is 100 percent on that amount.

The ISA has a complicated but sophisticated structure of benefit reduction rates. While the nominal rate on earnings is 50 percent, the effective rate is at most 47 percent for those in social security covered employment and/or those who take advantage of work related expense deductions. The rates on income from other sources, as noted above, vary according to those sources.

Treatment of Work Related Expenses. The ISP, as currently designed, makes no provision for the deduction from income of work related expenses. In contrast, the ISA plan in its ABLE component permits single-parent and husband-wife families with children to deduct from income a fraction of gross earnings (10 percent to 20 percent, depending on family type) up to a maximum ($500 to $1500). Similar deductions would also be permitted in the positive tax system. The effect of this treatment of work related expense would be to raise transfers and lower tax revenues.

Income Definition and Accounting System. ISP and the ISA's ABLE component generally share common definitions of income and a similar accounting system. The income definition and accounting system in SSI would continue unchanged, at least initially. For purposes of the rebatable tax credit, it appears that either the tax system's income definition or ABLE's income definition would be used whichever yields the greater benefit to the filer. The report does not discuss in detail the accounting system implications of the rebatable tax credit.

Assets Test. The ISP plan would exclude from consideration assets which are difficult to value, difficult to liquidate, or are given preferred treatment in the tax system as a reflection of social values (e.g., assets needed for a business or a personal house). This leaves essentially only liquid assets against which the assets test is applied. A unit is categorically excluded from ISP if they are above the appropriate limit. The ISA plan does not have an assets limitation as such. Instead it would include in the income base the yearly income value of all assets and reduce benefits by 67 cents for each dollar of such income value. While the ISA approach is more equitable,it is far more difficult to administer and was explicitly rejected by the IRS Task Force.

Protection of Current Recipients. The ISA plan would require that the states make supplemental payments, for two years after its enactment, to families receiving AFDC in a base period in amounts needed to maintain total family income at base period levels. These state supplements would be additional to the ABLE grant and the rebatable Federal tax credit. The ISP plan opposes any "grandfathering" of current recipients. Under the ISA plan, it is not clear whether just basic AFDC benefit levels (plus 80 percent of any Food Stamp bonus value), are grandfathered, or whether each state's AFDC computation rules are also brought forward in time. The need for grandfathering in ISA is greater than in ISP because of the former's lower basic benefit levels for single-parent families. States would administer their own state supplements.

The ISA provides for the protection of states against any incremental costs resulting from the required grandfathering by holding the states harmless at the calendar 1976 share of AFDC payments.

Administration. Under ISP, the entire tax and transfer system would be administered by one agency. The Secretary of Health, Education, and Welfare has stated his view that the IRS is the appropriate administering agency; failing that, he prefers a new agency within Treasury. The tax credit and ABLE components of the ISA would be administered by the IRS, while administration of SSI would remain with the Social Security Administration. It is probable that under ISA, the IRS would have to create two new systems -- one for ABLE and one for the rebatable tax credit -- in addition to its current structure for collecting the

Federal income tax.

<u>Costs</u>. The ISP and the ISA differ considerably in net cost to the Federal government. The ISP would cost, in today's dollars (December 31, 1974), \$3.4 billion in increased transfers and would cause \$4.1 billion in reduced taxes. The ISA would cost in today's dollars \$5.7 billion in increased transfers and would cause \$7.2 in reduced taxes. The reasons for the higher costs and tax relief in ISA are:

- -- The lower benefit reduction rate in ABLE, because of the payroll tax and work expense deductions.
- -- The higher breakeven levels, which extend eligibility to a larger population.
- -- The retention of the SSI program, leading to a greater number of filing units in the total ISA transfer (ABLE, SSI, rebatable tax credit) population. In addition, the number of ABLE filing units is greater than if ISP filing units rules were used in that program.
- -- The tax system's narrower definition of income might allow individuals or families who have considerable tax free income or substantial deductions to receive a rebated tax credit.
- -- The ISA's tax credit and its introduction into the tax code of ABLE rules as an alternative means to calculate tax liability, extend greater tax relief than the approach in ISP.
- -- The ISA would introduce into the tax system a work expense deduction as an adjustment to gross income. This causes greater aggregate tax reductions than the current itemizable personal child care deduction which ISA would eliminate.

TAB I

LABOR SUPPLY AND PROGRAM COSTS

INTRODUCTION

Static economic theory predicts that taxes and transfers have the potential to reduce work effort: taxes because they reduce the reward from work and transfers because they make work less necessary. That theory, however, gives no clue as to the magnitude nor the significance of any reduction. For many years economists and others have been concerned lest the high marginal tax rates (i.e., taxes on the last dollar earned) in progressive tax systems reduce the incentive to work of earners of high incomes. Nevertheless, investigations into the work effort response of physicians and lawyers have detected no such response to high rates of taxation.

In the 1960's comprehensive income-tested cash assistance plans, which provide a basic benefit paid to families with zero income and then reduce that benefit as family earnings increase, began to be discussed. People soon realized two things. First, the amount of the benefit paid and the rate at which it is reduced as earnings increase* could reduce work effort. Second, the welfare system as it then existed (and now exists) was of this same basic structure and could be reducing the work effort of welfare recipients.

There are several reasons to be concerned about reductions in work effort caused by a transfer program.

- o Work itself is valued. Moreover, since transfer benefits are financed by taxes levied on those working, it is not fair for transfer recipients who could be working to choose leisure and be supported by taxpayers.

- o If a transfer recipient reduces his/her work effort, family earnings and thus family income falls. Since the amount of transfer varies inversely with income, a reduction in work effort has two undesirable consequences:

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* This is the benefit reduction rate, which is like a tax rate in its effect because it determines how much total income increases with an increase in earnings.

-- the cost of the program to the Federal treasury is increased; and

-- the efficiency of the program is reduced since it takes more Federal funds to provide a given standard of living after the work effort reduction than before.

o A reduction in work effort means a reduction in the potential level of goods and services that can be produced by the nation's work force. That is, if all members of the labor force were employed, voluntary reductions in work effort by some would result in a reduction in the gross national product. To the extent that the economy is operating at less than full employment, any voluntary work effort reductions would cause a reduction in potential GNP, but no change in actual output. Economists call such output reductions a "real" cost to society since society actually (or potentially) loses something -- the goods and services not produced by those who voluntarily reduce their work effort. This is to be distinguished from the cost noted in the above paragraph which involves a redistribution of, rather than a reduction in, society's resources.

It should be noted that not all reductions in work effort are undesirable. Many in society would prefer that mothers of young children be home caring for those children rather than be working out of the home (or at least that they have the option of doing so). Also, a reduction in hours worked, or even a resignation to enable one to search for a better job or to engage in training, can in the long run pay dividends to society as well as to the individual. It should also be noted that labor supply response to a transfer program can take two forms: (1) reducing hours worked, and (2) quitting a job entirely. While both are worrisome, the latter is generally considered the more serious concern since it raises the specter of the able-bodied loafer.

SOURCES OF INFORMATION ON LABOR SUPPLY RESPONSE

Concern over possible work effort reductions led to the launching of a series of government-sponsored, controlled experiments with income transfer plans which in many ways are quite similar to ISP and to a very large number of statistical studies of existing data. The purpose of these studies was to produce quantitative estimates in the three areas of concern discussed above: work effort reduction, program cost increase, and reduction in the gross national product.

There are two basic types of studies that produce estimates of labor supply responses to income-tested transfer programs.

Experimental Studies. In the New Jersey Graduated Work Incentive Experiment, the results of which were published by DHEW in December, husband-wife families were actually enrolled in various income-tested cash assistance plans with different levels of basic benefits and benefit reduction rates. Their incomes, work effort, and other characteristics were followed and recorded. Similar data were also gathered over the same three year period from members of a "control group" of quite similar families who received no benefits from the experiment. The experimental and control families were then compared with the knowledge that differences in behavior were caused primarily by the income transfer plan. Basic benefits in the experiment were 70%, 100% and 125% of the poverty line ($4550 for a family of four in 1974) and benefit reduction rates were 30%, 50% and 70%. Statistical methods were applied to analyze the data in order to estimate the effects of the various plans on measures of work effort. Other experiments are investigating similar concerns, primarily for other target populations.*

Studies Using Census Cross-Section Data. The purpose of the experiments described above was to generate data reflecting the behavior of transfer program participants. In addition, other sources of data exist which contain observations on the income, earnings, and work effort of a wide range of persons (but not the same persons over time, as is the case with the observations in the experiment). These data bases, collected as a matter of course by the Census Bureau and other groups, can also be used to estimate the effect on work effort of a program like ISP.

ESTIMATES OF LABOR SUPPLY RESPONSE

The range of estimated work effort responses to transfer plans is large and is dependent on the statistical methods used,the data base, the population in question, and a number of other factors. Nevertheless, some generalizations from the data seem permissible and are presented below as the best information available on the subject. These changes in work effort will then be used to derive the consequent changes in program cost and in GNP. The three principal areas of concern will be discussed in turn.

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* HEW is currently funding three other income maintenance experiments. Two, Seattle-Denver and Gary are still in the operating stage. Data from the rural experiment are currently being analyzed. Preliminary results suggest findings consistent with those from New Jersey.

Work Effort

The results of the New Jersey experiment suggest that very few male family heads, most of whom would be newly covered by ISP, would quit their jobs. Hours reductions, the experiment suggests, would average about six percent. While it is difficult to predict how various workers will react, it is likely that much of this hours reduction would reflect reduced overtime and moonlighting. Among wives with working husbands the reduction would be considerably greater, ranging up to 40%, although the base from which this reduction might occur is quite small since very few low-income families have wives working regularly in addition to the husband.

Many studies of the work effort response of male family heads using cross-sectional Census data have been undertaken. Among those considered to be the most sound methodologically, the range of work effort reduction for male family heads is predicted to run from a very small percentage to 15-18 percent. The average estimate from among these studies, about eight percent, is roughly consistent with that found in the New Jersey experiment. Estimates of work effort response for wives from the cross-sectional studies are also quite consistent with the experimental results.

There have been no experimental and relatively few cross-sectional studies of the labor supply behavior of unrelated individuals and older persons. Generally, the few existing studies suggest work effort reduction on the order of 15 percent.

As is noted in the qualifications section below, much of the ISP recipient population is now covered by transfer programs which expose them to greater potential work disincentives than those to be found in ISP. In addition the entire ISP-eligible population (including unrelated individuals) is currently eligible for Food Stamp benefits. The estimate of change in program costs has been adjusted to reflect the existence of these current-law transfer programs.

Program Costs

If hours worked are reduced, income will fall and as a result program costs will rise. It is estimated that the labor supply reduction that is predicted by the existing literature would lead to an increase in ISP program costs of approximately $600 million. This amount is included in the basic program cost estimates as discussed in Tab F.

Gross National Product

A reduction in the amount of work would reduce society's capacity to produce. Employing reasonable assumptions regarding how such a reduction would affect the economy, it is estimated that as a consequence of ISP, and assuming roughly full employment in FY 79, GNP might fall by about $1.7 billion or less than one-tenth of one percent of FY 79 GNP.

CONCLUSION

It is unlikely that the ISP would result in much work effort reduction among men that support families. Indeed, popular concerns about such an eventuality seem to have been much exaggerated. The modest labor supply effects we might expect led us to add $600 million to program costs which is reflected in the cost data throughout this proposal. This estimate can be considered an upper bound in that it assumes that the work test would have zero impact. In fact, what scant evidence there is on the efficacy of work tests indicates that they can be expected to have little effect.

APPENDIX: CAVEATS AND QUALIFICATIONS

As noted in the text, estimating labor supply response is a complex undertaking. This appendix will list a number of factors to be borne in mind when using the results of labor supply studies.

The New Jersey experiment introduced a temporary change in the lives of participants and for this reason may not be fully reflective of their true long run behavior in response to a permanent program. Also, during the experiment the state of New Jersey changed the structure of the local welfare system by adding an unemployed fathers component to AFDC. It is unclear how these factors may affect the results, but on balance a modest underestimate is likely to have occurred. Further analyses of the data for New Jersey are underway and it is expected that more information on these issues will be forthcoming.

The basic assumption of the cross-sectional studies, that the measured response to wage and income variations in the data accurately reflects the likely behavioral response to an alteration in transfer policy, is a tenuous one. In addition, the cross-sectional estimates do not account for the fact that workers in families whose incomes are above, but close to, the breakeven point (income level at which eligibility ceases) might reduce their work effort so as to qualify for benefits. The magnitude of such an effect is difficult to gauge, but to the extent that it occurs the estimated change in labor supply would be too small. Hence the estimates of change in work effort have been adjusted upward to reflect this problem.

Another problem in using the results of the labor supply studies to predict behavior is that many participants in any new transfer plan will have been receiving benefits under existing programs, such as AFDC or Food Stamps. For this reason, the existence of the basic benefit and benefit reduction rate in ISP will not be a new event in the lives of participants and ignoring this fact could lead to considerable overestimates of labor supply response. There is no fully satisfactory way to handle this problem. For the purposes of producing the estimates presented in the text, the following assumption has been made: the ISP will produce no change in the work effort of AFDC and SSI recipients. This is reasonable since the basic benefit and benefit reduction rates in the three programs are not too dissimilar.

All those who would be eligible for ISP benefits are currently eligible for Food Stamp benefits. The Food Stamp basic benefit and benefit reduction rate are one-half and 60 percent of those in ISP, respectively. Thus even for members of intact families, childless couples, and unrelated individuals, the potential work disincentive effect of ISP would not be new. In order to account for this fact, the reduction in earnings for those currently covered by Food Stamps and to be newly covered by ISP has been reduced by 40 percent.

TAB J

INCOME SUPPLEMENT PROGRAM WORK TEST

Available evidence suggests that only in rare instances would the receipt of an Income Supplement Program benefit cause persons to cease working. Nevertheless, in order to insure that none can question the integrity of the program, I am recommending that the ISP legislation mandate the states to operate, for specified categories of recipients, a registration-type work test.

This tab briefly discusses the issues involved in the design of a work test and describes the principle elements of the recommended form of work test.

Basically there are three issues involved in developing a work test:

- o At what level of government -- Federal or state -- should the work test be administered?
- o How much manpower service delivery should be authorized by the work test? and
- o What administrative mechanism should be used to deliver services? In particular, should existing delivery systems and legal authority(ies) be used or should new mechanisms be developed?

I believe that the experience of the Federal government's manpower and social service programs over the last decade has taught us that such services are best administered by state and local government. This view is central to the block-grant approach behind the new Comprehensive Employment and Training Act of 1973. Among other things, this new Act closed down the programs that tried to create a delivery system directed from Washington. Thus, a state-administered work test fully supports the Administration's view of the appropriate distribution of functions across levels of government. In addition, the alternative of a Federally-administered work test can easily become very expensive. It is well to recall that the second version of FAP contained a Federally-administered work test which became so heavily laden with supportive services and the costs of creating a new delivery system that over 30% ($1.7 billion) of H.R. 1's net welfare expenditures would have gone to such ends rather than direct cash assistance.

The questions of the level of service delivery and which delivery mechanism are closely related. Experience with the heavily service-oriented work requirement in the Aid to Families with Dependent Children program suggests that such work tests are expensive, administratively cumbersome and cost-ineffective. Many evaluations of the manpower programs launched in the 1960's suggest that in the absence of an adequate number of jobs, these programs, too, are not cost-effective. Thus, a work test that both well serves those subjected to it and provides for simple and efficient government would stress job finding as a goal.

The discouraging evidence on the likely efficacy of a wide range of manpower and social services suggests that the Federal government should not require their use. Instead, the Federal government should make certain that those ISP recipients who could probably profit from assistance in job finding be required to accept such services. Job finding services will ultimately be provided at a local level since their provision at any other level makes little sense (although, of course, various localities should share information so that regional disparities in labor supply and demand do not persist). Thus, state administration of the work test is indicated with the states developing procedures within Federal guidelines that spell out the Federal government's overall goals for the ISP work test. It is important to remember that such a Federal-state relationship already exists with respect to the work test in the states' Unemployment Insurance programs, and therefore the existing Federal-State Employment Service network already is equipped to perform precisely the tasks envisioned here for the ISP work test.

Finally, the absence of a work test in ISP could be easily challenged on equity grounds. The Federal government, as already noted, mandates a work test in Unemployment Insurance, a Federal-state program in which the Federal presence is relatively restrained and which is based on "social insurance" principles. It would be inconsistent for the Federal government to impose a less stringent work requirement on recipients of ISP which will be a fully Federal endeavor financed from the general revenue (with the possible exception of state supplementation programs).

<u>Description of the Work Test</u>

The legislation enacting the ISP would mandate the states to operate a work registration-type work requirement and provide funds for that purpose. The major features of such a work test would be:

- Federal regulation or legislation would establish two types of recipients. The first type would consist of all those who would be categorically excluded from the work test, such as the aged, blind, and disabled population; minors; those needed to care for members of the two previously mentioned groups; and the already employed. The second type would include the remainder -- those presumptively able bodied persons with no child care or other home responsibilities and who are not already employed.

- The presumptively able bodied recipients of ISP benefits who are available for job placement would be referred to the State Employment Services for assistance in obtaining an appropriate job or training opportunity. In the event that such persons refused to cooperate with the State Employment Services, their ISP eligibility would cease and the amount of their families' benefit would be reduced accordingly,

- Funding for the work test, which would include funds currently expended to support the work requirements in the WIN and Food Stamp programs, would be placed in existing authorities. While final decisions await further consultation with the Department of Labor, it is likely that funds to support the work test would be delegated to the Secretary of Labor and expended under Comprehensive Employment and Training Act authorities and/or the provisions of the Wagner-Peyser Act (the Federal-State Employment Services system). This would allocate to the States and localities which would administer the work test under ISP the funds to support the services they deem appropriate.

Summary

I would mislead you if I argued that the work test recommended here is vital to the ISP for programmatic reasons or that it would pay for itself. Indeed, available evidence suggests the opposite. I do feel, however, that a work test based on something like required referral of unemployed ISP applicants to the State Employment Services would answer any concerns regarding the proposal's commitment to work, while minimizing the administrative burden and financial costs associated with such efforts. The alternatives of Federal administration and/or intensive service delivery promise only to build large bureaucracies which would perform functions that are, in significant ways, foreign to the ISP proposal and in which we can have little confidence of high social return.

TAB K

ADMINISTRATIVE STRUCTURE OF THE INCOME SUPPLEMENT PROGRAM

As part of the interagency planning in support of this proposal's preparation, a Task Force, directed by the Internal Revenue Service with members from HEW and Treasury, examined its administrative feasibility and standards of operation. In order to be able to reach a judgment on those issues the Task Force had, in effect, to design an operational system for ISP and determine what the resource needs of such an endeavor would be. The principal findings in the Task Force Report, submitted in late April, may be summarized as follows:

- The benefits payments portion of the proposal is administratively feasible, both in terms of the proposal's goals of objectivity, simplicity and universality, and in terms of the IRS's standards of program integrity -- provided that there is reasonable adherence to the Task Force's recommendations concerning pre-legislation planning, systems testing and implementation, enrollment phase-in and proposed levels of assistance to recipients and enforcement in the ongoing program.

- Using a set of operating assumptions, the Task Force designed, in broad outline, a structure for ISP and estimated its personnel and other resource needs. These estimates, which relied on both analogous IRS activities and directly relevant experience from the HEW Income Maintenance Experiments, compare favorably to IRS manpower and administrative resources devoted to revenue collection.

- The ISP has no operational program design feature that would either require or preclude the selection of one agency rather than another to assume operational responsibility for the program; it could be administered by an existing agency, such as IRS or SSA, or by a newly created special purpose agency.

The remaining sections of this tab describe ISP's basic substantive elements and administrative structure, outline its field operations and conclude with some observations on feasibility conditions.

PROGRAM ELEMENTS

A household's eligibility for benefit payments and the amount of such payments would be determined by the composition of its membership, the amount of its nonbenefit income, and the nature and value of the assets owned by its members.

- <u>Filing Unit Rules</u> - As a general presumption, all individuals related by blood, marriage or adoption who live in the same household would be regarded as members of a single unit for purposes of ISP benefit determinations. In contrast, the filing unit for tax liability would continue to be defined primarily in terms of individuals because of the limits on the extent to which one individual should be compelled either to compute or pay a tax liability on another's income. This departure from the tax system in the ISP is necessary because it is the income of a family or household that is the single best measure of the need of its individual members. Any alternative which would attempt to measure the actual extent of income pooling and joint consumption among individuals within a household would be administratively infeasible and intrusive.

  In addition to the general definition of a filing unit, there would be rules to cover the special situations of foster children, nonseparated spouses who are living apart, non-resident children under age 18, and sub-families in a household that can certify themselves as separate and distinct economic units.

- <u>Income Definition</u> - The definition of income which would be countable in the calculation of benefits would include all gross receipts in cash or in kind from any source, with the exception of a very few types of receipts specifically identified as excludable.

  Items were excluded only if: they represented income that was not truly available to meet current needs; their inclusion would defeat a program goal; the reporting and compliance consequences would be disproportionately great; an unreasonable economic incentive would otherwise obtain; or their inclusion would grossly violate a generally accepted social viewpoint. Using this approach the definition of income for the ISP would be very broad, including items such as Social Security benefits and gifts which are not treated as income for Federal income tax liability.

  Few expenditure deductions from income would be permitted in the computation of benefits under the ISP. The only departure from the presumption against deductions would be in the area of those existing "adjustments to income" allowed in the tax system, such as expenses incurred in the production of self-employment income.

- <u>Assets Test</u> - In addition to having to meet the principal criteria of income eligibility, a filing unit could not own more than a specified dollar amount of certain types of assets. The test would exclude from consideration business related assets, owner occupied dwellings and reasonable amounts of land appurtenant, one automobile, the cash value of life insurance, and furniture and personal effects located in the place of residency. These proposed exclusions from the assets test are based on considerations of administrative feasibility and accepted social views regarding housing and essential personal property. The fair market value, net of applicable encumbrances, of the household's nonexcluded assets could not exceed certain benchmarks. Within a range bounded by a minimum for a filing unit of one or two persons and a maximum for a unit of seven or more, the benchmark increases with additional members. This approach is of necessity somewhat arbitrary. However, the alternative of imputing income from nonexcluded assets, while theoretically more equitable, would entail considerable administrative complexity.

- <u>Accounting System</u> - The program would consider eligibility only on a yearly basis. Unlike the tax system's fixed calendar year, the year for ISP purposes would be defined in terms of a twelve month moving period. In addition all determinations would be retrospective; that is, based only on income for an elapsed period of time. These two features (a moving calendar year and retrospective reporting), in combination with a method of accounting for the income stream called the "carry forward," provide the best possible compromise among the competing policy objectives of equity, responsiveness to change in family income and composition, and administrative efficiency. Alternatives that would have involved the fixed calendar year or prospective estimates of a unit's future income stream were examined but rejected, for they would have entailed serious over and underpayment problems, collection consequences, and greater opportunities to manipulate the program.

  In order for the preferred accounting system to function with reasonable responsiveness, the ISP population will be required to report either once every month or once every three months. A unit will be designated as a monthly or quarterly filer depending on the constancy of its income. Units with a history of stable or no income would file quarterly; those with a history of fluctuating income monthly.

- <u>Self-Employed</u> - The ISP, just as its tax system counterpart, would perforce have some special rules for the unique situations of the self-employed. As noted, the tax system's adjustments to income would generally be allowed as deductions from the income base. Similarly, business related assets, that is, property reasonably related to and needed for the production of income, would be excluded from that eligibility test. While the Internal Revenue Code would offer primary guidance on these two matters, special rules will be needed to prevent the incorporation into the ISP of measures, however desirable in the tax system, which are inappropriate in measuring income need; for example, accelerated depreciation, capital loss carryovers, and the like.

The most significant departure from normal practice in the treatment of the self-employed would be in the accounting system. Self-employment net income which is suitable for monthly or quarterly reporting, as in the case of a carpenter, would be thus measured and reported along with all other income in that filing unit. However, much self-employment, as in the case of a farmer, involves irregular income and expense patterns. For these situations, the program would take the previous year's actual lump sum self-employment income, divide it into twelve equal segments and impute the average monthly amount into the current year as if it were received in that year. Once imputed this self-employment income would be treated no differently than other income in the operation of the ISP accounting system.

ORGANIZATIONAL STRUCTURE

The operational base of the agency would be a field structure of approximately 1000 field offices supervised by some 40 area offices. The field offices would contain groups of front line personnel primarily concerned with enrollment and assistance to filing units in reporting on changes in income, assets, and household composition. These same people would, however, perform various verification functions which can be done in the office. Each field office would additionally contain a conferee to conduct informal redeterminations of assistors' decisions when questioned by a filing unit, and personnel to keypunch data from applications, income and other periodic reports directly into the national computer system. The area offices would exercise direct management control over the field offices and provide administrative support to them. In addition, the area offices would house education staff to inform the public about ISP benefits and obligations, investigation staff to perform indepth or on-site enforcement activities beyond the capacity of field office personnel , and an administrative law judge to hear formal appeals from contested decisions not settled at the conferee level.

Complementing the field structure would be about seven data processing centers which would receive information directly from terminals in the field offices, process it and prepare the payment tapes for use by the

Bureau of Accounts. The agency would be centrally directed by a national office supported by staff at the regional level. In keeping with the nondiscretionary and substantively simple nature of the ISP, the number of personnel needed at the national and regional levels would be few, and approximately one-third of them would be assigned to inspection activities in the field.

SYSTEMS DESIGN

The central concept in the systems design is the placing of decentralized data entry and access in the field offices. To accomplish this, each field office would be provided with one or more terminals that would allow it directly to enter or access data into or from the national computer system by means of a data link to its associated data processing center. In practice, all data communications between a field office and its data processing center would be routed through a mini-computer and communications concentrator located at the appropriate area office. This intermediate link would provide communications traffic control, detection of errors or missing data elements and data formatting.

Decentralized data entry implies that all reports from the program's filing units, such as the monthly or quarterly income change reports, must be delivered to the field offices by mail or hand. The laternative of consolidated report collection and data entry in either the area offices or at the data processing centers was considered but rejected. While that alternative might yield economies of scale in data processing, it was determined that the collection, human review and edit, and data conversion of reports at consolidated points would introduce unacceptable delays in processing and responding to filing errors and omissions. In addition, decentralized data entry is the logical extension of any capacity in the field for immediate query and response. It was the judgment that such a capacity would be essential if the program is to be responsive to recipients, efficient in correcting agency errors, and effective in the prevention of duplicate filing and other improper actions.

PROGRAM OPERATIONS

Enrollment. Four features of program operations are especially important--enrollment, periodic reporting, enforcement and sanctions, review and appeal. They are each briefly described below. The agency design provides for a public information or education staff to inform the public of the program, and a system of toll free operators so that people can obtain more detailed descriptions of the program's eligibility requirements. However, persons who believe that their households might be eligible would have to take the initiative and contact their nearest field office. Manifest ineligibles would be screened out by field office personnel by means of a short questionnaire. These personnel would then assist those who would appear to fall within the program's income and asset criteria in the application and enrollment process. Upon completion and review of supporting documentation, the information would be entered into the national computer system by field office terminal and automatically compared to a master directory file to prevent any duplicate filing or other improper action.

Periodic Reporting. A critical aspect to the program is its periodic reporting requirements. Depending on the constancy of their income, recipient households would have to report on their income either every month or every three months. Each income report updates the households moving twelve-month accountable period, while obsolete information from the year previous is dropped from the base used to calculate benefits. After receipt in the field office, each income report would be reviewed and, if it has no obvious errors or omissions, entered into the national computer system. In the event of an omission or obvious error, the head of the household would be contacted and asked to come to the office to complete or correct the form. Benefit payments would be made monthly.

Thus, a typical sequence in the ongoing program would be as follows: A family receives a form to report January income in early February, completes it and sends or carries it to the appropriate field office by mid-February. Personnel in the field office review the report, contact the family if necessary, and enter the information into the national computer system. In early March, the family receives a check based on its income history through January. Coincidently, the family receives a form to report on February's income, and the cycle would then repeat itself.

All filing units would also be subject to an annual assets review report which would be handled in exactly the same manner as the periodic income reports.

Enforcement. The need for program integrity demands a vigorous enforcement program, particularly in the early years of operation. Efforts to encourage accurate reporting would include:

- mandatory face-to-face assistance on initial enrollment, with a requirement that certain information be documented;
- educational activities involving the use of news media and direct distribution of information to recipients;
- audit examinations conducted randomly and as a result of apparent discrepancies detected through the use of third party information obtained through computer information matching; and

periodic face-to-face reviews on a sample basis of reports submitted by filing units not otherwise examined.

Some of this activity would happen as a by-product of other program operations. The enforcement activity as such would be divided into two levels: verification, which is a set of activities that can be done by normal field office personnel in the office; and investigation, which requires specialized personnel to conduct in-depth office reviews or on-site visits.

Sanctions, Review and Appeal. A variety of sanctions would be available to the agency to assure its enforcement activities:

- In cases of willful fraud, criminal prosecution would be available, though limited in practice to either flagrant first offenses or a second willful offense after previous warning.

- In cases of knowing fraud that, on balance, do not warrant criminal prosecution, or in cases of inexcusable neligence, a flexible civil monetary penalty would be available, not to exceed 100 percent of the over-payment in question.

- Cases that involve either noncompliance with a work requirement, should there be one, or a household member misleading the unit's head in reporting on the household's income or assets, would result in the elimination of the offending party from the unit for purposes of setting its basic benefit level. Such a person would, in the latter instance, also be barred for a year from filing for benefits as a new and separate unit. In addition, if a filing unit continued to keep inadequate records after warning and instruction in bookkeeping, the agency could, in cases of notorious noncompliance, reduce the unit's guarantee level until compliance was obtained.

Any sanction would be applied only after a determination by a front line employee, review by his supervisor, and notice and opportunity for a hearing to the affected filing unit. After an informal discussion with the employee and his supervisor, the first recourse to the affected party would be to request an informal administrative review by a field office conferee. The next level would be to an administrative law judge at the area office level. However, for the convenience of appellants, many of the judges would travel a circuit among the field offices in their areas. Decisions of an administrative law judge would be reviewable in a de novo proceeding in the U.S. District Courts.

The same review and appeal process would be available in instances where a party feels aggrieved over a routine agency determination; for example, rejection of an enrollment application, amount of a given monthly check, or refusal to certify separate economic status from a larger household.

FEASIBILITY CONDITIONS

The Task Force concluded that certain conditions should be adhered to in order for ISP to be administered at reasonable cost and in an efficient and effective manner. A brief overview of those conditions follows:

- Compliance - As noted, persons on the program would be required to submit monthly, quarterly or annual reports on income, assets and household composition. Widespread noncompliance in the form of late or incomplete reports could seriously undermine the administrative feasibility of the program. The Income Maintenance Experiments have shown, however, that the incidence of such deficiencies is well within acceptable levels if the system is properly structured. IRS planning for its new National Tax Administration offers assurance that the computer hardware and procedures exist to handle large and complex reporting volumes.

- Enforcement - The program is equally dependent on reporting accuracy. Understatement of income or assets, overstatement of household size, or duplicate filing in more than one household could, if on a large scale, have severe fiscal consequences and undermine public confidence. The Task Force thus concluded that a sizable and visible enforcement effort should be built into the program. The Task Force set an initial annual coverage of twenty percent of the caseload for verification or examination. After the first three years, the coverage could be reduced to around ten percent.

- Implementation Schedule - The Task Force concluded that the time required to place in position the manpower, facilities and equipment necessary to effectively enroll and administer ISP was approximately four years. The principal constraint is that twenty months must be allowed subsequent to enactment for data processing equipment procurement, installation and operational testing. When combined with the need for a phase-in of initial enrollment, thereby preventing an expensive workload peak, the first payment under ISP could not be made before the twenty-fifth month after enactment. Fortunately, the two years of systems design, contract bidding, office site selection, and personnel training can take place between the time the legislation is introduced and its enactment.

TAB L

TAB L

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D. C. 20201

November 6, 1973

MEMORANDUM FOR THE PRESIDENT

Subject: Major Domestic Program and Tax Reform

My staff and I have been struggling over the past eight months with the reform of our social programs, including specifically the welfare system. The problems we confront are complex and difficult -- some say intractable.

While there is much in the diagnosis of these issues to warrant pessimism about whether there is any solution, I have been exploring one concept which in its elegant simplicity, boldness and scope offers a way out of the mess. I advance it in this memo now, because if you find it attractive and acceptable, we could:

- develop the proposal quietly with a very small group as the domestic centerpiece of your State of the Union Message;
- provide a surprise initiative which in its boldness and balance could capture the imagination of the American people, if not the Congress; and
- reassert your leadership in the domestic field in a very strong and affirmative way.

BACKGROUND

When I step back from the details of the problems which your major reforms have encountered, I find a common set of issues and obstacles which have impeded them.

- Although the approach to broad social problems which relies on a multiplicity of narrow categorical assistance programs has been widely recognized as a failure, or at least not effective, recommendations to eliminate these assistance programs in favor of direct assistance to individuals, or revenue sharing, is usually not well received. Without a broad based understanding and support, we have been left to do battle one at a time with particular recipients, interest groups and Congressional committees with a strong stake in the existing structure of such categorical programs. This posture is not a winner.

- The interrelationships of the domestic assistance programs have become as important as the content of each one. To ignore these interrelationships is to pile one program on top of another with undesirable, unintended and costly results. Congresswoman Griffiths' ongoing studies have been documenting this fact in excruciating detail in the public welfare area. The involvement of 19 different Congressional committees in various income security programs does not help. In retrospect, your Family Assistance Plan probably ran into as much trouble for what it did not address as for what it contained.

- There has been no assured means of linking domestic assistance programs--reformed or otherwise--with fiscal sanity. The piecemeal approach to expenditures and taxes in the Congress, and the schizophrenic public attitudes of support for specific programs and distaste for the total bill must be addressed with some specific linkages. Your 1974 budget engendered a growing concern with this issue in the Congress, and attempted to deal with it by means of a ceiling. Governor Reagan, with the same consideration in mind, has proposed a specific Constitutional ceiling in California.

- We have not really come to grips with public frustration and dissatisfaction with the performance and size of the Federal bureaucracy and a related, growing dissatisfaction with the equity of the tax system. Much of the latter stems, I believe, from disillusionment about results achieved for taxes paid. While you have made consistent efforts to reduce the Federal payroll, improved efficiency is swamped by program additions and changes. Only major structural reforms are likely to make more than a marginal difference.

If I were persuaded that the disorder and costs of the present programs could be contained or somewhat improved, I might be tempted to recommend a series of modest improvements in welfare for you to present the Congress and the country. My assessment is to the contrary. A more modest approach just does not address the fundamental issues, and does not provide promise of success. Time is not on our side. Left alone or altered modestly, the present situation will inexorably get worse, making fundamental reform even more difficult later.

A few examples in the welfare system may undergird this assessment. Food stamps costing about $2.2 billion in FY 1974 are now projected to cost about $6 billion--perhaps more--by FY 1976. Our efforts to cash them out for a part of the low income population--the aged, blind and disabled--is rapidly eroding to nothing. Senator Long is gaining support for his work bonus which would pay a modest benefit to low income workers covered by the payroll tax. Appropriate in purpose, the Long proposal trivializes a good idea in a way that is likely to create more problems than it solves, since it adds yet another means-tested transfer program to the existing system. The drumbeat of social security increases, which puts you in an impossible position, continues apace. The list could go on and on.

You are slowly but surely being pushed into a corner of choosing between tax increases and an economically sane budget without attaining reform. Minor tinkering or sequential changes do not seem to work with the Congress and, in any event, do not deal with fundamental structural problems and program interrelationships. Only a major reform initiative seems to offer a way out.

MAJOR TAX REFORM

The reform proposal which I have in mind is based on Milton Friedman's concepts. It is fundamentally tax reform, but deals simultaneously with the tax, welfare and domestic assistance systems. Through such an approach, we could:

- Tie virtually all of our income support programs for the low income population to the positive tax system and the IRS in such a way that these separate programs and many related service activities would no longer be required. The Federal bureaucracy could be significantly simplified and reduced.

- Construct a system that requires benefit increases and tax increases to be considered simultaneously. By locking tax and benefit structures together, it would be virtually impossible to adjust one without adjusting the other. Indeed, this action could perhaps be coupled with a constitutional amendment which would limit the maximum percent of income that could be taken in Federal taxes unless voters agreed to a higher level.

- Remand to the States most of the individualized services and any cash supplementation which they might desire to make as a proper State and local role.

- Adjust the personal exemption levels and tax brackets in a way that will greatly improve the equity of the positive tax system.

As I noted at the outset, this concept is the only one which embodies features designed to meet all of the major issues and obstacles which I have described. Specifically, this system would be designed along the following lines:

- All individuals or families would file an income tax return. Those above a set amount would pay taxes; those below it would be eligible to receive cash benefits (some below the set amount who have non-taxable income would not receive benefits).

- The benefit schedule would be based upon the level of personal exemptions and standard deduction that the income tax system prescribes for the taxpayer or his family. For example, a family might receive a cash benefit equal to one-half of the difference between its income and the sum of its personal exemptions and standard deduction. Such a schedule would provide for a gradual phasing down of the cash benefit as family income increases, thus:

  - paying greater benefits to those with greater need;

  - preserving work incentives; and

  - insuring that no one who is eligible for benefits would also have a tax liability; and conversely, that no one with a tax liability would receive benefits.

- Benefits would be set initially at levels that would permit at least the elimination of the Federal role in AFDC and cashing out of Food Stamps. The new Supplemental Security Program (SSI) for the aged, blind and disabled would also be superseded by this program. Such benefit levels would require that the level of personal exemptions and possibly the standard deduction in the tax system be raised. Any future increase in benefit levels would require concomitant changes in taxes. Consideration could also be given to some device--perhaps a Constitutional amendment to require a referendum--to make tax increases above some level subject to the vote of the public.

- It would be possible to eliminate or sharply curtail Federal programs in social services, manpower, housing and other anti-poverty activities, leaving such activities to the States. I would expect that we could make very large reductions in Federal employees in this Department and other agencies as well.

- Subsequently, should inflation occur, we could widen the tax brackets to which given tax rates apply, thus preventing both decreases in the real value of the benefits transferred and increases in the real tax burden on taxpayers.

DISCUSSION

We have done some initial exploration of several important questions about this reform proposal: how would the benefit structure work and what would it cost us? what problems would it raise?

Our estimates at this point are necessarily preliminary, but interesting enough to warrant some optimism. The basic structure we have used for estimating purposes is a $3,000 benefit for a family of four without other income and a benefit structure for the aged, blind and disabled which is the same as they are receiving under the SSI program. A benefit reduction rate as earned income rises of 50% is assumed so that there are no payments above $6,000 made to a family of four.

- This benefit schedule would provide $2,000 to a two person family or $3,900 to a six person family if they had no other income. Since most individuals and families have some income, a more typical case would be a family of four with a $4,000 income who would receive $1,000 or the same family earning $5,000 who would receive $500. At today's minimum wage, a father heading a family of four earns about $3,200. Under the benefit schedule, his family would receive $1,400 in cash benefits, just enough to raise the family above the 1974 poverty threshold.

- The total benefits to low income persons would run about $17-19 billion in FY 1976. Over 90% of these benefits would go to those below the poverty level, which would cut the dollar poverty gap approximately in half.

- These costs would be automatically offset through the elimination of the AFDC, Food Stamp, and SSI programs which we estimate will cost the Federal government $14-15 billion in FY 1976. This would leave an initial gap of $3-5 billion.

- A preliminary list of programs which would be eliminated or sharply curtailed as a result of the general plan would include social services, manpower programs, low-income housing subsidies and miscellaneous anti-poverty programs. A conservative estimate of the FY 1976 cost offsets in this category would be $2.5 to $3.5 billion, thus offsetting much of the potential net cost. Potential personnel savings might add another $500 million to $1 billion savings.

- We estimate that the benefit program would provide $1.5 to $2.5 billion in fiscal relief to the states. If we turn social service programs largely back to the states, such relief could provide a potential source of financing either services or supplements, if the states so choose.

- Raising the exemption levels will result in reduced total Federal receipts which we have not yet priced out with Treasury. This loss either could be partly or completely offset with rate adjustments, or it could be accepted. The decision would depend on how much tax relief we could and wished to provide.

- The net costs, if any, would be highest in the first and second year. This comprehensive concept would, I am confident, be a smaller burden on the taxpayers than the present system in the long run.

When I consider the major problems which this reform proposal raises, I find two: the potential difficulties with the Congress, and concern with the work requirement.

The difficulties with the Congress come in two forms. First, the proposal cuts across many committees and thus is threatening to them and their categorical programs. I see no way to avoid this problem; indeed we should seek it out since it is necessary to any significant program reform and implies Congressional reform as well.

Second, the Congress will be sorely tempted to add the benefit program without eliminating other programs such as food stamps. This difficulty is clearly most serious and, like the first, cannot be avoided. If we judge this problem overwhelming, we simply give up any hope of major reform. I do not understand you to be willing to admit defeat on this issue, and I share that view. The only way to deal with this issue is to put the proposal forward strongly and insist on comprehensive reform. It strikes me as an impeccable position.

Some will no doubt attack this reform as not containing a strong work requirement. It would be possible to put one in for able-bodied adults, but I would strongly counsel against such a course. It seems to me that a work requirement properly belongs and can be effectively administered only at the state and local level. With whatever funds the state chooses to use for supplementation or social services, they should be empowered to impose such work tests or requirements that are appropriate and favored in their particular setting. If we attempt to impose work requirements from the Federal level, we face the following problems:

- Logically, we incur an obligation to provide jobs in the public sector if all else fails. In the past, we have settled for weak work registration requirements which have little impact.

- We are forced to maintain confusing, large and expensive bureaucratic structures independent of IRS to categorize the population and to provide manpower training and other support services which have not proved very effective.

- We begin to unravel the basic simplicity of the system and fall back toward the FAP proposal.

The incentives to work built into the reform proposal are strong relative to our present system, and there is reason to believe that they will work for most low income persons. Recent studies show a strong work ethic among the poor, and experimental evidence demonstrates that work effort among male heads of families would not be affected significantly by such a program.

In summary, the Congressional and work requirement problems have satisfactory answers and, in any event, are far outweighed by the advantages and opportunities of this reform:

- Programmatic, tax and Congressional reform.

- A certain means to link expenditures and taxes.

- A strong measure to reduce the size of the Federal government.

- A bold, comprehensive approach which would virtually wipe out the old Federal welfare system in favor of a unified and simplified approach.

- The use of the IRS system as a single efficient administrative device in which the public has confidence and all participate. This action would also have by-product benefits in tax collection.

- American citizens, particularly those of low income, would be treated equitably across the country under a set of objective criteria which would reduce the amount of subjective governmental intervention in their personal affairs.

- The anti-poverty effects would be much better than current programs which now transfer funds to individuals well above the poverty line.

RECOMMENDATION

I recommend that you adopt the Friedman concept in principle and direct a small group from HEW, Treasury, OMB and the Domestic Council to develop fully a specific proposal for inclusion in the State of the Union message.

Approve ____________ Disapprove ____________ See Me ____________

Joseph W. Weinberger

Secretary