AN UPDATE OF THE POVERTY PICTURE PLUS A NEW LOOK AT RELATIVE TAX BURDENS

by

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Many government programs alter the incomes of individuals and families and/or their command over goods and services in a very direct way. The following list comprises the major federal and state tax and transfer programs that take money directly from or transfer cash or in-kind benefits directly to the population:

Social Insurance Cash Transfers
- Social Security and Railroad Retirement
- Government Employee Pensions
- Unemployment Insurance
- Worker's Compensation
- Veteran's Benefits (non-income-conditioned)

Cash Assistance
- Veteran's Pensions (income-conditioned)
- Supplemental Security Income (SSI)
- Aid to Families with Dependent Children (AFDC)

In-Kind Transfers
- Food Stamps
- Child Nutrition
- Housing Assistance
- Medicare
- Medicaid

Income and Payroll Taxes
- Federal Individual Income Tax
- Federal Social Security Tax (employee share)
- State Individual Income Taxes

Clearly, only a small number of these would usually be referred to as welfare.

To get a proper picture of the amount of redistribution currently done by government, the appropriate procedure is to take into account the effect of all these programs.[1] This inclusive assessment also provides the necessary framework within which to identify the gainers and losers from the current system and to judge who needs help from tax-and-transfer reform (of which "welfare" reform, as usually discussed, is only a small part).

Impact on Poverty

The impact of government on reducing poverty when the effects of all these programs are taken into account is substantial—and substantially greater than is shown by the government's own poverty measure, which only counts the effect of the cash transfer programs. Table 1 shows the before and after picture estimated for 1976. The poverty count is seen to be much reduced by the tax-and-transfer system.

Cash transfers as counted in the official poverty figures almost halve the overall poverty count compared with pretransfer poverty (reducing it from 21 percent of all persons to 11.4 percent). When taxes and in-kind transfers are included, the poverty count is again almost halved (going from 11.4 percent to 6.5 percent). The poverty-reducing effect of the programs taken together as a system is substantially greater than the effect of cash transfers alone for all age, regional and demographic groups.

But the relative effects of the system do differ by group. These effects are not shown in the tables but are worth noting. Before taxes and transfers, for instance, 27 percent of the poor are aged. Only 7.5 percent of the poor are aged when all program effects are taken into account. Other groups, in contrast, become more prominent in the after-tax-and-transfer statistics. Of the pretransfer poor, 43 percent are under 25; the proportion under 25 rises to 55 percent when all programs have been taken into account. The South has 33 percent of the national population, 41 percent of the preprogram poor, and 56 percent of the poor after all programs have been accounted for. One out of eight Americans is nonwhite, but one out of four of the poor is nonwhite—both before and after the impact of public policy.

Changes in Income Shares

Obviously, redistributive public policy has dramatic effects on the income of many poor persons. This redistribution, of course, is at someone's expense. Without also including in our calculations the sources of the money to be redistributed, we do not get a picture of the overall effect of government redistributive policy. Table 2 shows, for

Table 1

Estimated Impact of Public Programs on the Poverty Population in Fiscal Year 1976

	Number of Persons (millions)	Percentage Poor: Before Programs	After Cash[a] Transfers	After All Programs
Age groups				
Persons under 25 years	95.8	20.4	14.6	8.1
Persons 25-64 years	98.3	14.1	8.1	5.3
Persons 65 years and older	22.9	54.1	12.8	4.6
All persons	217.0	21.1	11.4	6.5
Poverty-prone groups				
Mothers with children	19.0	58.4	41.8	14.0
Families with aged head	27.2	53.7	13.5	5.6
Nonwhite units	27.6	40.8	27.6	13.0
Units in South	71.4	26.5	16.6	11.0
Single persons	21.6	47.8	25.0	17.0

Note: The age groups taken together are exhaustive. The poverty-prone groups as shown in this table are overlapping categories.

Source: The estimates in Tables 1, 3, 4, and 5 are calculated from computer printouts of data prepared for the Congressional Budget Office by Mathematica Policy Research, Inc. The same basic data were used in the CBO's June 1977 Background Paper no. 17, *Poverty Status of Families under Alternative Definitions of Income.*

[a]The figures in this column are comparable to the government poverty statistics. In calendar year 1975, 12.3 percent of the population were poor by the government definition (analogous to the 11.4 percent figure for 1976 in this table).

fiscal year 1976, the estimated impact of overall government redistribution on the relative income shares of the bottom 20 percent, the top 20 percent, and the three middle quintiles. The first column shows the shares of personal income that go to each income group *before* the effect of taxes and transfers. As is obvious, these shares are extremely uneven, with half the total income going to the richest 20 percent and less than half of one percent to the bottom 20 percent.

The middle column shows the relative shares that accrue when the cash transfer programs (social insurance cash transfers, and cash assistance) are taken into account. This is the way the government officially defines income. Some minor lessening of inequality has resulted. Very roughly, 4.5 percent has been taken from the top and added to the bottom; and 2 percent has been taken from the medium high income group and given to the medium low one.

When positive taxes and in-kind transfers are also included (as they are in the third column) we see some additional equalizing, with another 4.5 percentage points going from the top group to the bottom two. The middle group's share remains remarkably constant throughout. But, when all is said and done, the top 20 percent are still left with more than twice "their (proportional) share," and six times as much as the poorest group.

Although the changes in income shares appear modest, large sums are involved in bringing these changes about. Table 3 presents an accounting of the income shifts among the different demographic groups. Nearly $142 billion is collected from higher income individuals and families—none of which comes net *from* the aged. Of this, $119 billion is redistributed to the lower income groups, nearly two-thirds of which goes to the aged.

The aged are revealed to be doing, relatively speaking, very well indeed. The aged in the higher income groups have higher average incomes than similar nonaged units, although they have smaller family sizes and pay almost no taxes. The aged in the lower income groups are similarly favored. They have much larger transfers, also, despite small family sizes.[2]

Table 2

Impact on Income Shares of Households

Quintile	Share of Market Income	Share of Income after Cash Transfers	Share of Income after Taxes and All Transfers
Lowest 20%	0.3%	4.5%	7.2%
Medium Low 20%	7.2	9.6	11.5
Middle 20%	16.3	16.2	16.6
Medium High 20%	26.0	24.2	23.4
Highest 20%	50.2	45.6	41.3

Note: Households include families and unrelated individuals ranked irrespective of family size. Six out of seven in the lowest (pre-tax-and-transfer) quintile are either aged households, single person units, or female-headed families with children. Nine out of ten in the top quintile are nonaged, multiperson households.

Source: Congressional Budget Office, *Poverty Status of Families under Alternative Definitions of Income,* Background Paper no. 17, June 1977, p. 24.

Table 3

Income Changes among Groups
Due to the Tax and Transfer System

	Number of Persons (millions)	Preprogram Income ($billions)	Postprogram Income ($billions)	Net Change ($billions)
Lower income families[a]				
Aged	15.10	25.5	68.5	+ 43.0
Nonaged	74.00	156.3	193.7	+ 37.4
Lower income individuals[a]				
Aged	7.15	8.6	39.2	+ 30.6
Nonaged	8.28	23.6	31.6	+ 8.0
Total	*104.53*	*214.0*	*333.0*	*+119.0*
Higher income families				
Aged	4.14	44.2	44.2	− 0
Nonaged	102.23	711.7	586.6	−125.1
Higher income individuals				
Aged	.79	14.3	14.3	0
Nonaged	5.35	79.2	62.5	− 16.7
Total	*112.51*	*849.4*	*707.6*	*−141.8*

[a] *Lower income* is defined as under $14,000 for family units and under $7900 for individuals.

The Relation between Income and Impact

How does the system affect the various types of families at different income levels? Table 4 shows, for various aged and nonaged groups, the average net benefit or tax liability at different income levels. As can be seen, none of the aged on average pay positive taxes except the richest 20 percent (that is, those with annual family incomes over $21,700). Nonaged couples with and without children, in contrast, on average pay positive taxes when their incomes reach $7400. The very poorest groups (those with annual incomes below $1800) all receive on average substantial positive payments, but here again there are interesting differences. Aged poor couples (families in which by definition there are few children) receive a larger average sum than either poor couples with children or poor mothers with children.

These are the absolute amounts. Now we can ask: At what rates do these benefits decline as income rises? Table 5 presents the amounts that are lost in reduced benefits and/or increased taxes per dollar in moving from the average receipts of one group to the average for the next highest group—often referred to as marginal tax (or benefit reduction) rates. (A rate of 40 percent, for example, means that families which differ by $1000 in preprogram earnings differ, on average, by only $600 in postprogram income or command over goods and services.) These rates vary widely. The poorest mothers with children face a marginal rate of 58 percent, compared with marginal rates of 22-35 percent for those in the medium high groups and even lower average rates for the highest groups.

Table 4

Net Impact Per Unit, by Income Class

	Number of units (millions)	Income Class				
		Lowest (under $1800)	Medium Low ($1801-$7900)	Middle ($7901-$14,000)	Medium High ($14,001-$21,700)	Highest (over $21,700)
Aged groups						
Couples	6.10	$7315	$6894	$ 5049	$3454	$−3911
Single persons	7.96	4441	3750	2474	440	−6087
Nonaged groups						
Couples with children	27.24	5144	2595	− 244	−2259	−6385
Couples without children	14.25	5114	2343	− 366	−2516	−7260
Single persons	13.63	2070	135	−1783	−3596	−9400
Mothers with children	5.22	5565	3047	406	− 731	−4655

Note: Tax liability is indicated by (−).

Table 5

Impact Rates, by Income Class

	Income Class				
	Lowest (under $1800)	Medium Low ($1801-$7900)	Middle ($7901-$14,000)	Medium High ($14,001-$21,700)	Highest (over $21,700)
Aged groups					
Couples	11%	29%	24%	31%	10%
Single persons	18	23	30	32	16
Nonaged groups					
Couples with children	41	48	32	27	19
Couples without children	52	44	33	29	21
Single persons	44	33	29	35	28
Mothers with children	58	46	18	22	13

Note: These are marginal rates (explicit and implicit) for all income classes except the highest (for which, being open-ended, we can only calculate average rates). They are the rates faced by each group as a whole. See Qualification 1 at the end of this article.

Implications for Reform

Subject to certain important qualifications (spelled out in the final section), Tables 4 and 5 may be construed as giving us the dimensions of the current tax and transfer system viewed as a universal credit income tax. Table 4 shows the average benefits or taxes of each group in each income category. Table 5 shows the implicit tax rates (the rate at which the average benefit falls as income rises).

The view underlying this way of presenting the facts, of course, is that at present we do, in fact, have a redistribution system with many parts. Any reform should be coordinated among all of them. In other words, don't redraw a part of the elephant without seeing what it does to the picture as a whole. This, in turn, implies that the appropriate criterion is the combined impact of all parts of the system—whether in fact it is simplified into one program called a credit income tax or whether it is, as now, made up of many different ones. Looked at in this way, several features stand out.

First, the relative treatment of aged and nonaged poor families suggests a need for careful examination of priorities. The older units have higher "guarantees" despite the presence of children in the younger units. Moreover, older units have lower implicit and explicit tax rates, which are hard to justify on incentive grounds. Among the highest income groups, the much lower net tax burden for the aged is startling.

Second, even within the nonaged groups the treatment of couples with children seems comparatively stingy. Such families receive almost no preference relative to childless couples, despite their having twice as many mouths to feed. Relative to single mothers with children, intact families end up with distinctly less at each level of pretransfer income and have generally one more male adult to provide for. These patterns reflect the often noted neglect of the "working poor" in the lower quintiles, but the pattern appears to persist at higher income levels as well.[3]

(continued on page 10)

Update of the poverty picture
(continued from page 7)

Third, the average implicit tax rates in the richest quintile for all the demographic groups (see Table 5) suggest that the burden on those with the highest incomes is far short of "confiscatory," and certainly is smaller than a casual look at tax schedules might suggest.[4]

Qualifications

1. These measures are, of course, averages over large groups of households. Different households are affected differently according to the set of programs they are eligible for *and* according to the subset that they participate in. The schedules shown in Tables 4 and 5 are, thus, much smoother than reality.
2. Social insurance programs are not directly conditioned on income because they are aimed at providing income security against the threat of specific income-reducing events—retirement, disability, death, illness. This consolidation of the social income programs into an accidental "pseudocredit income tax" conditioned strictly on income ignores their original rationale.
3. The consolidation of Medicare as in-kind social insurance and Medicaid as an in-kind, income-tested benefit might be challenged unless the employment-related private subsidies for health insurance are included as well. Such inclusion would probably have the net effect of reducing further the relative burden on the high income groups.
4. However much a consolidated impact schedule might resemble a unified negative income tax or credit income tax schedule, the fact that many programs are involved—each with its own rules, regulations, *and* personnel—means administrative overhead costs of substantial magnitude. It may be argued that such costs are the inevitable result of the political coalitions needed to achieve any redistribution at all. They should, in any case, be recognized as waste relative to the potential efficiency of a more unified system of income supports.

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[1]Such calculations were released by the Congressional Budget Office in *Poverty Status of Families Under Alternative Definitions of Income*, Background Paper no. 17, June 1977. The basic methodology used in the paper for including in-kind programs in the income distribution statistics was developed not by the CBO but by Timothy Smeeding in *Measuring the Economic Welfare of Low Income Households and the Anti-Poverty Effectiveness of Cash and Non-Cash Transfer Programs*, Ph.D. dissertation, University of Wisconsin-Madison, 1975.

[2]Further calculations show that, on a per capita basis, aged households poor on a preprogram basis are raised by the tax and transfer system to income levels more than double those for preprogram poor nonaged families with children ($4500 versus $2000).

[3]If education is considered an in-kind transfer, and there are good arguments in favor of its inclusion, the position of families with children improves in relation to that of childless units. Its inclusion would not improve the relative position of two-parent families vis-à-vis one-parent families. Nor is it clear that it would improve the position of the poor relative to the rest of the population.

[4]Corporate taxes, property taxes, and sales taxes are not included in our calculations. There is no general agreement on the real incidence of these taxes, or how their inclusion would change relative burdens.

THE TREATMENT OF ASSETS AND INCOME FROM ASSETS IN INCOME-CONDITIONED PROGRAMS

Prepared for the Federal Council on the Aging by the Institute for Research on Poverty

CONTENTS

Copies of this publication are available from the Superintendent of Documents, U. S. Government Printing Office, Washington, D. C. 20402.

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