An Alternative to the Nixon Income Maintenance Plan

RICHARD ZECKHAUSER AND PETER SCHUCK

THE Nixon Administration proposal for a fundamental overhaul of the welfare system has generated heated controversy among the numerous interests concerned with poverty and related problems. The great bulk of the criticism leveled at the Nixon plan has focused on three of its facets: the adequacy of the federal guarantee level, its treatment of high-benefit states and cities, and the work requirement for mothers of school-age children.

Few observers, however, have directed their scrutiny to the questions of the impact of the Nixon plan on work incentives, and the relation between the Nixon plan's work incentive provisions and the efficacy of the plan generally. We shall concern ourselves exclusively with these questions for several reasons. First, work incentive provisions are at the core of any income maintenance scheme; they determine to a large extent its cost, its target population and its social philosophy. The second reason, derived from the first, is that the work incentive element of any such scheme is—and for the foreseeable future will continue to be—absolutely critical to its political acceptability to the American people.

It is true, of course, that the various elements of the Nixon plan (e.g., level of income guarantee, marginal tax rate on earned income, tax break-even point, target population, etc.), no less than those of income maintenance plans generally, are so intimately interconnected that altering any one element in effect alters the entire plan. Similarly, a given effect on, say, work incentives, may perhaps be obtained by manipulating non-work incentive elements of a plan. Nevertheless, we assume that the work incentive element is itself so salient to the utility and political feasibility of a plan that it may usefully be analyzed in isolation, taking the other elements of the plan as given.

The Nixon plan

Although the details of the Nixon plan are still subject to the legislative process, the general outlines of the plan are quite clear.

The authors wish to thank Milton Friedman for his helpful comments.

Under the Nixon plan, the federal government will guarantee an income to every family. The guarantee would be $1600 for a family of four and would vary with family size.[1] Several factors are worth noting here:

(a) This is a *guarantee;* it establishes a floor beneath which state welfare assistance will not be permitted to sink. States must maintain their current level of benefits; the federal government, however, will assume 10 per cent of the cost of these benefits now paid by the states. In 30 states, the guarantee level is already exceeded by present benefit levels. In these states, therefore, the federal contribution will be increased only by an amount equal to 10 per cent of the present state contribution. In the remaining states, however, the federal government will supplement the existing state payments to the extent necessary to bring total benefits up to the guarantee level.

(b) The guarantee will not apply to an adult who is single (unless he is handicapped or aged) or to a married couple without children. It will, however, apply to the "working poor" whose annual income is less than $3920.

(c) The guarantee plan will replace the Aid for Dependent Children (ADC) program but will not replace the categorical programs, such as aid to the blind and aid to the permanently disabled.

(d) The guarantee is not designed to move family incomes above the federally-defined "poverty floor," which at present is over $3700 for a family of four.

The income guarantee is linked to a work incentive scheme. For those families covered by the guarantee who earn income,[2] the first $720 of such income would be received without reducing the guarantee level.[3] President Nixon emphasized that this $720 exclusion was inserted "to make up the costs of working and provide a strong advantage in holding a job" in contradistinction to the present system which "discourages the move from welfare to work by cutting benefits too fast and too much as earnings begin."

When the amount of earned income exceeds $720 per year (or a total annual income of $2320 for a family of four in low-benefit states where the $1600 federal floor is also a ceiling), the federal guarantee is automatically reduced $.50 for every $1 of earned income in excess of the "tax-free" $720. This scheme produces a tax break-even

[1]It appears that beneficiaries under the Nixon plan may also be entitled to receive additional benefits under the food stamp program.

[2]According to Christopher Green, only 49 per cent of the income of the poor is labor income. Under the Nixon plan, unearned income, with some exceptions, will be treated the same as labor income with regard to the reduction of benefits. The one difference is that the $720 exclusion applies only to earned income.

[3]Theoretically, part of such families' earned income would remain subject to federal income tax. As a practical matter, however, statutory exemptions and deductions would protect most, if not all, of such income. In any event, the pending tax bill would diminish, if not end, the payment of federal income taxes by most people with income below the federally-prescribed poverty line. Such people would, however, remain subject to Social Security payroll taxes as well as state and local taxes. For the effect of these largely regressive taxes on the poor, see Joseph Pechman, "The Rich, The Poor, and the Taxes They Pay," *The Public Interest* (Fall, 1969).

point of $3920 for a family of four; that is, a family of four with earned income of $3920 receives no benefit from the federal guarantee.

Furthermore, the Nixon plan permits a state to opt to reduce the work incentive by up to $.17 for every dollar earned, so that the family might retain only $.33 of every dollar earned in excess of the $720 "tax-free" base. Some states might exercise this option and thereby save state funds.

The problem of work incentives

The Nixon plan unquestionably is a vast improvement over the existing welfare system with respect to work incentives. To be sure, almost any plan would be, for the traditional means test is in effect a 100 per cent marginal tax on earnings; that is, for every dollar earned by the welfare recipient, his benefits are reduced by a dollar. Indeed, a greater disincentive to work can scarcely be imagined.[4] The Nixon plan instead imposes a positive marginal tax rate of 50 per cent on earned income where total income (guaranteed benefits plus earnings) is between $2320 and $3920. As noted above, states may opt to increase this marginal tax rate up to 67 per cent.

In order to assess the utility of this work incentive scheme, it is necessary to discuss the goals of work incentive policy generally, and the consequences of particular work incentive schemes. Apart from the political necessity of such a policy, at least two major social and economic purposes are served thereby. First, work incentives, by reducing labor force defections, integrate the employable poor into the larger society and enhance its and their economic vitality. Second, work incentives, by subjecting the employable poor to the motivating force of higher wages, permit the labor market to allocate workers efficiently among firms, industries and geographical areas.[5]

Virtually all of the income maintenance plans proposed in recent years contain a work incentive element based, as is the Nixon plan, upon a positive marginal tax (usually rather high) on earned income at low levels of earnings. Proponents of such schemes contend that only substantial positive marginal rates can (1) keep participation in the plan within reasonable limits by having a low tax break-even point, and (2) keep the cost of the plan for any given target population reasonably low. Thus, the editors of the *Yale Law Journal* note that "a program with near-zero tax rate . . . would cost over $150 billion a year if—as is likely—almost every family in the

---

[4]In recognition of this, the 1967 Social Security amendments exempted the first $30 per month of earned income and one-third of the remainder. Moreover, the OEO recently funded a pilot project with fractional marginal tax rates in several New Jersey cities. New York City recently undertook a similar project. Data from these projects are not yet available.

[5]Of course, the second objective must be realized if the first is fulfilled, for while it may be necessary to motivate one to work in the first instance, it surely is unnecessary to further motivate him to work for higher wages.

country elected to receive supplements.[6] On the other hand, a very high marginal rate would probably cause severe disincentives to work (particularly for low wage jobs which carry few nonfinancial rewards), and would seriously interfere with the labor market's allocation of workers by reducing workers' sensitivity to wage differentials. Experience with the 100 per cent marginal rate under the traditional ADC means test tends to confirm these fears.

In fact, relatively little is known about the effects on work incentives of positive marginal tax rates on earned income. Economic theory posits (1) that positive marginal tax rates produce a "substitution effect," i.e., they reduce the price of leisure relative to the price of work, and (2) that positive average tax rates produce an "income effect," i.e., they reduce the net compensation from work.

The resultant of these two effects, however, is not clear. If the "income effect" tends to induce people to work harder in order to make up for the reduced compensation and if this tendency outweighs the opposite tendency of the "substitution effect," positive tax rates on earnings may in fact enhance work incentives. If, however, both effects tend to reduce work incentives or if the two effects have opposite tendencies and the income effect does not predominate, then the resultant effect will be a disincentive to work.

The empirical evidence on this score is not extensive but such evidence as does exist suggests that positive tax rates on the earnings of the very poor which are large enough to significantly reduce the cost of an income maintenance plan are also large enough—when combined with the physical, social and psychological barriers to work endemic to the very poor—to produce disincentives to work.[7] The validity of this conclusion for any particular plan depends, of course, upon the specific elements of the plan, particularly the level of the income guarantee and the economic alternatives of the target population.

The nonproblem of incentives

The Nixon plan seeks to meet the problem of incentives by abolishing it as a problem. First, it obviates the cost problem by combining a 50 per cent positive marginal tax rate on earnings (possibly 67 per cent through the state option provision) with a very low income guarantee. Second, it requires as a condition of aid under the plan that all poor people deemed capable of employment, including mothers of school-age children, register for and accept "suitable" employment or job training. Both of these provisions effectively

---

[6] Comment, "A Model Negative Income Tax Statute," *Yale Law Journal*, 78, (December 1968) p. 269-275.

[7] See Christopher Green, *Negative Taxes and the Poverty Problem* (Washington: Brookings Institution, 1967), pp. 117-22. These disincentives might extend to working families whose best efforts merely bring them slightly above the income guarantee level unless, of course, the income guarantee level were set at a very low level.

make (in many states) the real possibility of starvation, rather than calculations of economic utility, the guarantor of work effects.[8]

Like the present ADC system, the Nixon plan "solves" one problem by creating another. Just as the "man in the house" rule has had tragic consequences for family cohesion among the welfare population, so the coupling of an extremely low income guarantee with a mandatory work requirement may well, if the latter is enforced, erode whatever dignity and independence have escaped the ravages of the ADC system.

Clearly, the work requirement provision was inserted in the Nixon plan for the same reason that similar provisions have been included in past welfare legislation—to palliate criticisms of "giveaway" programs and to make the legislation politically acceptable. We recognize that similar requirements in existing welfare programs have sometimes not been enforced in "liberal" jurisdictions, and that the framers of the Nixon plan may well anticipate that its work requirement will generally remain unenforced.

Such an expectation, even if entertained, is probably unrealistic. In a period of spiralling welfare costs, hard-pressed taxpayers are likely to exert political pressures for stricter enforcement of requirements for receiving assistance. If such pressures prevail, even the most well-intentioned, Solomonic bureaucrat will be confronted with the awesome responsibility of deciding what employment or training is "suitable" for a poor man or woman.[9] Must a man move to another city to find employment in order to qualify under the plan? Must he stay on a job that is not to his liking or which offers no opportunity for advancement? Will people unable to meet the work requirement boycott the plan in favor of illicit sources of income? These and myriad other questions are raised by the work requirement of the Nixon plan, a work requirement that not only panders to the false stereotype that the welfare rolls are burdened with large numbers of individuals who are physically, mentally and emotionally able, but unwilling, to work, but also ignores the limited job opportunities that exist for the hard-core poor and their unique disabilities in adapting to "the world of work." In short, by effectively converting the concept of work incentive into one of work coercion, the Nixon plan opens up a veritable Pandora's box of problems with hidden costs and ethical dilemmas.

---

[8]Indeed, in view of the low guarantee level and the work requirement, it is likely that a confiscatory marginal tax rate, at least at the lower levels of earned income, would not significantly reduce this most powerful work incentive.

[9]The allegations that Mayor Lindsay was manipulating the enforcement of welfare regulations for political purposes, whatever their truth, suggest that grave risks are inherent in permitting public officials to exercise discretion in an area at once so sensitive to public pressures and so critical to the dignity of the individuals involved. *New York Times*, Sept. 19, 1969, p. 1 and Sept. 20, 1969, p. 1. Some of the unique problems deriving from the enormous discretion granted to low-level social workers in the public assistance area are set forth in the recent report of the President's Commission on Income Maintenance Programs, Ben Heiman, chairman (preliminary copy, November 12, 1969), pp. 305-309.

As we have seen, virtually all income maintenance plans which have been advanced have several characteristics in common. First, they are single plan programs; all members of the target population, however diverse their attributes and needs, are subject to the same plan.[10] Second, while most, including the Nixon plan, are "negative" in the aggregate (i.e., they result in a net transfer of income to the poor), all are "positive" at the margin (i.e., as the recipient earns money, a portion of each dollar so earned[11] is "taxed" at a positive rate and returned to the government in the form of reduced benefits to the individual.) As we have also seen, such plans, including the Nixon plan, suffer from their inability to produce in a single plan a program which, at a politically acceptable cost, will provide both a reasonable income level for those unable to work or to find work, and realistic and effective work incentives for those able to find work without compromising their dignity or independence. To repeat, this inability ensues because positive marginal tax rates on earnings sufficiently low to encourage work also are sufficiently low to make the cost of the program unacceptable. And we have seen that the Nixon plan's efforts to escape this contradiction are likely to prove futile and counter-productive.

Yet the fact is that given that the opportunities for poor men may differ, and that the optimal plan for a particular individual will depend upon his particular set of opportunities, a multiple plan assistance program—a program that enables different individuals to enroll in different plans—will clearly be optimal in any real-life situation. No one would suggest that there should be an individual plan for each poor or potentially poor man within the society, but the opposite extreme of a single plan for all individuals is also unsatisfactory.

Accordingly, we propose an alternative structure, using for simplicity only two plans. The first plan, called Plan I, would be directed primarily at those who cannot work or find suitable employment. It would consist of a fixed, sizeable income guarantee with a substantial positive (though not confiscatory) marginal tax on earnings.[12] The people on this program would be primarily the handicapped, the aged, and any others, such as those in economically depressed areas, for whom steady employment is not a significant possibility. Persons enrolled in job training programs might be assisted under this plan during the period of their training.

Plan II would be directed toward those who can find satisfactory work. It would consist of either no stipend or a relatively small one, and a progressive *negative* marginal tax on earnings (i.e., a bonus paid by the government on the basis of earnings). In view of the existence of hourly wage differentials, the bonus would be paid on

[10]A rigorous elaboration of a multiple plan program is given in Richard Zeckhauser, "Optimal Mechanisms for Income Transfers," RAND Corporation Paper P-3878 (June, 1968).

[11]In some plans, as in the Nixon plan, there is a base of income which may be earned without causing a reduction of benefits.

[12]Plan I could be the Nixon plan, except that the income guarantee level would have to be considerably higher in order to support a dignified existence, and there would be no work requirements for the reasons discussed above.

the basis of hourly wage rates rather than total annual earnings, thus giving the "high" wage poor the same incentive to work full time as the low wage poor. Moreover, given the preferences of our society regarding income distribution among the poor, the size of the bonus rate would be graduated progressively; the lower the hourly wage rate, the higher the bonus rate. Thus, a possible Plan II would require that the government pay a bonus of $1 per hour to a person earning $1 per hour, a bonus of $.75 per hour to a person earning $1.50 per hour, a bonus of $.50 per hour to a person earning $2 per hour, etc. Such a plan would, in effect, make up 50 per cent of the differential between the actual wage rate and $3 per hour. Obviously, numerous variants would be possible.

Factors other than the wage rate might come into play as well. The ethical bases that underlie any redistributional program would seem to imply that the size of the bonus should in some way be related to the size of the recipient's family. The figures suggested above seem roughly appropriate for the family of four example. If the recipient has any nonwage income, that factor too should be taken into account. We would probably like to establish a ceiling income above which no wage bonuses would be paid. This same ceiling might give the point at which individuals receiving assistance would enter the regular income tax brackets. For a family of four, this ceiling might be in the neighborhood of $5,500. With such a provision, a recipient with no outside income whose base wage was $2.50 an hour would receive the wage bonus of $.25 for the first 2000 hours that he worked.

It is readily apparent that Plan II provides a potent work incentive, particularly when compared with Plan I, a plan such as the Nixon plan. Because of this incentive, and assuming as we do that the work incentive elements (i.e., the work requirement and the right to retain some marginal earnings) of the Nixon plan will be ineffective, Plan II results in higher total income to the worker at less cost to the government. Consider, for example, a man with a family of four earning $1.25 per hour. Under the Nixon plan, he would receive $1600 from the government and could earn $720 (that is, work for 576 hours) without reduction of benefits. Beyond this point, he would in effect be working for only $.625 per hour and probably would not work at all, at least at licit activities. Under Plan II, however, he would receive $2.125 per hour and would choose to work, say, 1800 hours. The Nixon plan would produce 576 hours of work for a total income of $2320 at a cost to the government of $1600, while Plan II would produce 1800 hours of work for a total income of $3825 ($2250 earnings + $1575 bonus) at a cost to the government of $1575. Here, Plan II dominates the Nixon plan in that it generates greater earnings at less cost to the government.

The advantage of Plan II over Plan I will depend, of course, on the individual's wage rate and the number of hours he would choose to work under each plan.[13] In no case will he choose Plan II when,

[13] If, as appears quite likely, the income guarantee level in the Nixon plan is raised in the future, the relative attractiveness of Plan II will increase.

for the number of hours he would work under Plan II, he would receive more total income with Plan I. The comparison of Plans I and II for the same number of hours worked is not relevant, for the very purpose of Plan II is to provide a greater work incentive. For more than 1307 hours worked, Plan II yields more total income than Plan I regardless of wage rate. Table I presents some figures that might be used as a basis of comparison. The table makes the generous assumption that an individual works 800 hours under Plan I.

TABLE 1: *Total Income to the Individual and Cost to the Government (in dollars).*

PLAN I 800 HOURS			PLAN II						
				1600 HOURS		1800 HOURS		2000 HOURS	
WAGE RATE	NET INCOME	COST	NET EFFECTIVE WAGE	NET INCOME	COST	NET INCOME	COST	NET INCOME	COST
1.25	2460	1460	2.125	3400	1400	3825	1575	4250	1750
1.75	2660	1260	2.375	3800	1000	4275	1125	4750	1250
2.25	2860	1060	2.625	4200	600	4725	675	5250	750

A plan such as Plan II that uses negative marginal tax rates can be shown, for any set of preferences of a particular worker, to dominate any plan, such as the Nixon plan, that employs positive marginal tax rates. Thus, Plan II may cost less in aggregate, be preferred by all members of the target population operating under it, and provide a stronger work incentive than Plan I. Table II indicates the benefits to the recipient and the cost savings to the government if Plan II rather than Plan I is chosen.

For example, if an individual who earns \$1.75 per hour works 800 hours under Plan I, he will receive \$1400 on which he will pay a tax of $\$(1400 - 720) \times 50$ per cent = \$340. His net income will be the base of \$1600 + \$1400 - \$340 = \$2660. The cost to the government will be \$1600 - \$340 = \$1260. Assume that he works 1800 hours under Plan II. His income will be \$3150 and he will receive a bonus from the government of \$.625 per hour for an additional \$1125. The individual receives an additional \$1615 and the government saves \$135, because Plan II is chosen.

To estimate the aggregate cost of our multiple plan program is, at best, a hazardous venture. The implementation of the program would activate a number of variables, some of whose values cannot be predicted with great accuracy. The major imponderable, of course, is the magnitude of the gain our program offers over the Nixon plan with regard to the critical matter of work incentives.

Table II indicates that the cost to the government for an individual under Plan II rather than Plan I will be higher only in the case of an individual who receives a relatively low wage and who would have worked a substantial number of hours under Plan I. It seems to us unlikely that there are many low-wage individuals who would work a substantial number of hours if they faced a 50 per cent marginal tax rate. This means that on average, the cost to the government of a recipient working under Plan II will be somewhat less than if he had worked instead under Plan I. This in turn implies that the aggregate cost of our proposed program will not exceed the cost of a program which would include only Plan I. Any increase in the Plan I guarantee level accompanied by an equivalent bonus increase for Plan II would magnify any work incentive or cost advantages of our program.

TABLE 2: *Net Effect of Plan II over Plan I*[1]

WAGE RATE		HOURS WORKED UNDER PLAN I		
		500	800	1200
$1.25	Additional Income to Recipient	1600	1365	1115
	Savings in Cost to Government[2]	25	−115	−365
$1.75	Additional Income to Recipient	1877.50	1615	1265
	Savings in Cost to Government	397.50	135	−215
$2.25	Additional Income to Recipient	2202.50	1865	1415
	Savings in Cost to Government	722.50	385	−65

[1] Based on the assumption that the individual works 1800 hours under Plan II.
[2] Negative values for these savings indicate that Plan II costs the government more than Plan I in the particular instance.

The cost estimates of the President's Commission on Income Maintenance Programs give some indication of the type of aggregate net cost we might expect for our program.[14] For 1971, it is estimated that a 50 per cent positive tax rate program with a $2,000 guarantee level would cover 7.8 million households at a net cost of $3.5 billion. If the guarantee level were raised to $3,200, 16.7 million households would receive payments and the net cost would increase to $14.0 billion. The costs of multiple plan programs with the bonus for Plan II, proportionately modified in response to changes in the guarantee level in Plan I, should roughly parallel these figures. In assessing any cost estimates of this nature, it is important to realize that there is substantial imprecision in the data and in the projection of future trends in population and income growth.[15]

It is natural to ask what would happen to the structure of wages if Plan II were adopted by significant numbers of individuals. One

[14] Their estimates are net of offsetting savings in existing programs to all levels of government.

[15] These cost estimates are highly sensitive to the year for which they are estimated. Although population grows, thus increasing payments over time, cost reductions due to growth in income are expected to substantially outweigh this factor. Estimates for the net additional cost of the Nixon plan made when it was first introduced ranged around $4 billion. The Commission estimate seems somewhat low in comparison. Tobin, Pechman and Mieszkowski, using 1962 data, estimated a $20 billion net cost for a program with a 50 per cent positive tax rate and a $2600 guarantee level. See "Is a Negative Income Tax Practical," *Yale Law Journal*, 77 (November 1967), p. 23.

might fear that a government bonus on wages would tend to lower the market wage paid by employers.[16] This would mean that the benefit from the bonus would go partly to employers, not entirely to workers. This fear is unfounded. At the bottom of the wage scale, minimum wage legislation prevents any fall in wages. Above the minimum, other factors militate against reductions in wages. Wage differentials, we remember, are rental payments on skills in short supply. Given that the minimum wage is set, the continuing demand for skilled and semiskilled workers will simply maintain existing differentials and hence existing wage levels. Where nonmarket forces such as unions restrict the supply of particular skills, we should expect these forces to continue to operate regardless of which plan is in effect.

There is one circumstance under which wages paid by employers might be reduced. If previously unemployed workers equip themselves to compete for positions which now pay above the minimum wage, the skills for which wage differentials are paid will become less scarce, and the wage for these skills may fall somewhat toward the minimum wage. It seems unlikely that such competition could occur on a large scale. If it did, we might, on balance, regard such a development with favor.[17]

The one disadvantage of Plan II is that it reduces somewhat a worker's incentive to increase his wage rate, because he receives only 50 per cent (in the formulation of Plan II set forth above) of any wage increase.[18] This might discourage efforts to increase his skill level, to take on a more onerous job, or to migrate to a higher wage firm or geographical area. This drawback is also inherent in the Nixon plan.

It is important to consider the administrative complexities that would accompany the two plans. A plan such as Plan I will tend to encourage recipients to under-report earnings whereas a plan such as Plan II will tend to encourage him to overreport hours worked and under-report the wage rate. Which plan would create the greatest difficulties in administration is an empirical question; suffice it to say that neither plan is obviously preferable in this regard.

Let us reiterate: under our proposed multiple plan program, a plan such as Plan II, which employs negative marginal tax rates, is not designed to be used by all members of the target population. As we have seen, a scheme such as Plan I (or the Nixon plan with a higher income guarantee and no work requirement) is necessary for the

---

[16]Even in the theoretically most unfavorable circumstances, the reduction could never be by more than the bonus.

[17]To increase employment opportunities, minimum wage requirements might be relaxed under the multiple plan program for individuals who operate under Plan II and who would receive under Plan II net hourly earnings (wages plus bonus) substantially in excess of the present minimum wage. If such an innovation were to be instituted, some of our conclusions on the structure of wages would be altered, but the relative attractiveness of the multiple plan program would be undiminished.

[18]The fact that his income is increased may provide an opportunity for him to get training so as to increase his skill level. Alternatively, it may provide him sufficient income to reduce his incentive to increase his skills and hence his wage.

support of those who cannot work or who are only marginally employable. Our proposed solution is to permit all members of the target population to choose whether to enroll in Plan I or Plan II, with a procedure to permit a switch from one plan to another if their status changes.

Our proposed program has no work requirement. Although this approach entails a risk that some persons capable—from all standpoints—of working will select Plan I, it is likely that such persons will be relatively few in number, particularly so long as the guarantee level remains far below the poverty level. Accordingly, we feel that it would be fruitless, costly and inefficient to make an attempt—probably in vain—to thwart these persons. The element of free choice that pervades our proposal offers, we believe, a clear gain for the dignity and independence of the poor.

Only a multiple plan program can provide adequate income to those who cannot work and adequate work incentives to those who can. Any enlightened income maintenance policy must, at a minimum, accomplish these ends.