A review by the Federal Reserve Bank of Chicago

Business Conditions

1968 September

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The summer saw important steps taken toward stable growth and price stability. Taxes were increased, the rise in government outlays slowed, and the labor negotiations in the steel industry concluded without a strike.

But the momentum of price inflation asserted a year ago continues and demands for labor continue to press closely on the available supply. Unemployment is still less than 4 percent of the labor force, and job vacancies are numerous. The fiscal “package” of higher taxes and budget restraint has not yet produced any evidence of the “overkill” some feared.

Total spending—the gross national product—increased about $20 billion on an annual rate basis in the first two quarters. The annual rate of rise in spending—about 10 percent in the January-June period—comprised a 6-percent rate in real production, the rest being price increase. There is a widely held view that real activity will level off in the second half of 1968, while the rate of price increase slackens some. Important restraining influences are the less rapid growth of bank deposits and credit since late 1967 (which is believed to have a deferred impact on spending), the fiscal measures, and the liquidation of excess steel inventories built up as a hedge against a possible steel strike in August.

Aside from steel, most major industries expect rising—or, at worst, level—trends in output and employment through the rest of the year. Housing starts dropped sharply in May and June but recovered in July. Most analysts expect starts in the third quarter to about equal starts in the second quarter and, because of the improved outlook for credit availability, perhaps, to rise strongly in late 1968 and 1969.

Government expenditures are scheduled to rise more slowly in the months ahead, especially if hostilities in Vietnam are scaled down. Business outlays on plant and equipment appear to be rising only moderately, mainly because of price increases. Total inventory investment will be dampened by the

Sharp rise in business sales, inflationary pressures remain strong

![Graph showing sharp rise in business sales](http://fraser.stlouisfed.org/)

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liquidation of holdings of steel and some products made of steel, though inventories do not appear generally excessive in relation to sales.

It is the vast consumer sector—accounting for almost two-thirds of the gross national product—that holds the key to activity through early 1969. Personal income was more than 9 percent higher in July than a year before, as a result of rising employment and large increases in wages and salaries. In contrast with the first half of 1968, when spending lagged income, retail sales were up in July even more than income—10 percent over the year before—and apparently continued strong in August. Unless consumers hold back on expenditures, the expected slowing of total spending—and the hoped for lessening of upward price pressures—may not come.

The fiscal package

Since mid-1965, government expenditures have risen faster than private outlays, largely because of increased military costs related to the Vietnam war. The federal budget presented in January called for a smaller rise in expenditures in fiscal 1969—a 6-percent increase compared with 11 percent in fiscal 1968. Under the legislation passed June 28, the Administration was directed to hold the rise to only about 3 percent. For this to have been done, little rise from the level of the third quarter could have been allowed.

The declaration that an attempt be made to hold federal expenditures to $180 billion was contained in the same act that imposed a 10-percent surcharge on corporate (effective January 1) and individual (effective April 1) income taxes, accelerated the payment of corporate taxes, and extended certain excise taxes that were scheduled to expire. Altogether, these tax measures are expected to increase federal receipts about $15 billion in fiscal 1969.

Without the fiscal package, the federal deficit might have approached the huge $25 billion deficit for the year ended June 30. The inflationary potential of such a development was, of course, great.

The government probably will not be able to hold expenditures to the level contemplated. Special needs for Vietnam, interest on the public debt, veterans' benefits, and payments from Social Security trust funds are specifically exempt. It is currently estimated that, even with a $6 billion reduction in non-exempt items, increases for the exempt items will result in outlays of $185 billion. In addition, with large crops in prospect, outlays under the government's price support programs may exceed earlier estimates. Perhaps most important are strong pressures to greatly expand certain military programs—which may gain strength as a result of the invasion of Czechoslovakia—and to accelerate various urban and rural rehabilitation programs.

The impact of the tax surcharge—the most important part of the fiscal package—is also uncertain. Corporations have indicated their existing capital outlay programs will not be affected appreciably, especially in view of the recent rise in profits. For individuals, the surtax is equivalent to a $6 billion reduction in spendable income. Personal income rose $60 billion in the past year—ten times as much. For a family of four with an income of $10,000, the increase in tax liability for 1968 will be about $100. Typically, incomes of such families will rise $500 to $600 this year.

Of course, the tax increase will tend to retard the rise in consumer spending, but its effect could be substantially offset if the proportion of income saved declines from the very high rate of 7.7 percent in the second
Price increases are expected to continue even if activity rises less rapidly

Quarterly percent change, annual rate

Prices still rising

The general price level rose 3.1 percent in 1967, compared with 2.6 percent in 1966 and an annual average increase of 1.5 percent in the early 1960s. As the economy slowed down in the first half of 1967, the annual rate of increase dropped to 2.1 percent. But the revival of spending soon reversed this trend. In recent months, the rate of rise has been 4 percent, about the average for the past year. This is the most rapid rise in prices over an extended period since the Korean war.

A wide variety of prices have been rising. At midyear, every major class of consumer goods and services was more expensive than a year before. Food was up 3.5 percent, apparel 5.3 percent, and medical care 5.9 percent. The average of all consumer prices was up 4.2 percent.

In recent months, prices have increased for steel, appliances, machinery, electrical components, tires, textiles, and chemicals. Price decreases have been few and scattered, reflecting special situations of market imbalance for such commodities as stainless steel, lead, and copper. Higher prices for cars and trucks are a virtual certainty with the introduction of 1969 models.

Wage increases averaging 6 percent and more this year have added to upward pressures on costs, encouraging sellers to test customers' willingness to pay higher prices. But the upswing in prices cannot be characterized simply as a cost-push inflation. Higher wages and salaries also represent purchasing power. Rising demand has validated higher prices.

Unemployment among experienced workers remains at low level

Note: All data for third week in July.
Employment and unemployment

Total employment, after leveling in early 1967, has increased almost every month since. Nonfarm wage and salary employment reached a record 68.2 million in July—3.4 percent higher than a year before. Manufacturing employment also was at a record high, though by a smaller margin than the total. The largest increases in employment have been in trade and service industries and in state and local governments.

Unemployment rates were slightly higher this summer than they were in the spring, as some temporary workers failed to find jobs. Even so, total unemployment was only 3.7 percent—the lowest for any July since 1953. For married men, the rate was only 1.6 percent.

Unemployment is even less for experienced workers eligible for unemployment compensation. Only 2.0 percent of the covered workers were receiving unemployment compensation in July, compared with 2.5 percent a year before. The proportion was even lower in Illinois, Indiana, Iowa, and Wisconsin—ranging from 1.0 to 1.7 percent. The rate for Michigan, 2.7 percent, was higher than the national average.

Steel—the morning after

Steel labor negotiations were concluded without a work stoppage. As expected, the three-year economic settlement followed the general pattern laid down in the automotive, farm and construction machinery, and copper industries. Increases in compensation average about 6 percent a year, including additional pension and other welfare benefits. The agreements feature “front-end loading” which boosts the first-year increase for straight hourly pay. Only the possibility of an impasse on local issues, which disrupted auto output in late 1967 and early 1968, was likely to have caused walkouts at steel plants.

Output of raw steel has been declining irregularly since April. Contrary to seasonal trends, however, shipments reached a record high of 10.5 million tons in July. Almost all phases of steel operations were at a sharply lower level in August. On a quarterly basis, the low for steel output will probably be reached in the fourth quarter.

Shortly after the conclusion of negotiations, steel output dropped sharply and most steel companies announced layoffs. In the Chicago area, layoffs will affect mainly temporary help, as veteran workers take up deferred vacation time. Incomes of steelworkers with families are not expected to be affected substantially by the decline in output, and their spending for consumer goods will probably be maintained.

A number of factors will moderate the size and duration of the inventory adjustment in steel. Manufacturers did not stock up as
heavily as in 1965 and some other years when a strike threat was present. Inventories of steel held by manufacturers reached a peak of about 15 million tons in August, compared with 17 million tons in 1965. Consumption is much higher now.

Many steel buyers did not take the strike threat seriously and declined to invest in unneeded inventory. They were fortified in this position by the excellent manner in which delivery schedules were maintained before the August 1 deadline for reaching a new agreement, and by the growing availability of imports. For Chicago area producers, order cancellations did not exceed new orders in August as was the case after other strike-hedge inventory buildups. Some smaller steel producers not organized by the United Steel Workers maintained output in August, and their orders have continued at a good level since.

**Auto sales surge**

After an uncertain start early in the year, auto sales strengthened, beginning in May. Most industry analysts now foresee a 9.3 million unit total, including imports, for the calendar year—the upper range of forecasts late last year and equal to the 1965 record. If so, the increase from last year will be 1 million units—12 percent. The year-to-year rise is partly a result of strikes that reduced production and sales in the fourth quarter of 1967. The situation was similar in 1965 when strikes reduced output in late 1964.

For three successive months—May, June, and July—daily average sales of domestically produced cars were at all-time highs. Auto sales have been aided by dealer contests and manufacturers’ rebates designed to bring down inventories that hit a near record of 1.7 million in June. Expectations of price increases on 1969 models may also have been a stimulus. But with all due consideration of special factors, the sales trend has been impressive.

Sales of imported autos, not counting Canadian built cars entering duty free under the auto trade agreement, were also at a record high in May, June, and July, with more than 80,000 deliveries a month. Sales of imports are now expected to exceed 900,000 this year and, for the first time since 1959, account for 10 percent of all new-car deliveries to U. S. customers. Continued market penetration by small imported cars, now including increasing numbers of Japanese autos, has induced some major U. S. producers to design small cars for introduction in 1969 or later years. Earlier it had been contended that such cars could not be produced economically in this country.

Sales of trucks have been even more vigorous than sales of autos. Truck sales may exceed 1.7 million, well above the high set in 1966. Stronger demand for trucks was accompanied in the second quarter by a sub-
stantial improvement in factory shipments of trailers.

**Capital expenditures**

New orders for machinery and equipment rose for four successive months—from February to June—also reaching a new record high. Backlogs of orders rose in May and June, but remained below the high level of 1967. Preliminary reports indicate a decline in these orders in July.

The picture for capital goods has been mixed. While demand for trucks and commercial aircraft has been strong, orders for locomotives and freight cars have been weak. Until midsummer, sales of farm equipment were far below last year, while construction equipment was improving. Order backlogs for machine tools have declined substantially and some producers have reduced output, but demand for most types of office equipment and electrical apparatus has been excellent. A huge backlog of demand is building up for equipment to control air and water pollution.

With most manufacturing industries operating well below capacity, capital goods producers are not likely to lead the economy upward as in 1965 and 1966. While construction contracts reported by F. W. Dodge were up 13 percent in the first seven months of 1968 over the same period in 1967, contracts for factory buildings were down 3 percent.

Compared with previous years, a larger share of expenditures on new plant and equipment are now going for replacement and modernization as opposed to expansion of capacity. Overall, machinery and equipment industries find demand for their products good but not spectacular. Many of these companies are operating at lower levels than in 1966 or even 1967. Mainly for that reason, manufacturing employment in some centers of the Seventh Federal Reserve District has not regained earlier peaks.

In June, the Department of Commerce survey indicated a rise in new plant and equipment expenditures in 1968 of 6.7 percent over 1967, with outlays by manufacturers up 3.5 percent. The increase would probably be less for manufacturers than the rise in prices. Recent developments remain generally consistent with these estimates.

**Housing starts revive**

There was grave concern early in the year that credit stringencies would severely restrict residential construction, and that housing starts might decline sharply, as in 1966, to an annual rate of less than 1 million by year-end.

Housing starts, at a rate of more than 1.5 million in the first four months of 1968, dropped to 1.3 million in May and June. But July saw a rebound to the 1.5 million level. Hopes are rising that starts for the year may exceed 1.45 million and reach the highest level in four years.

Credit availability is often the determining factor in residential construction, particularly at a time, such as now, when family formations are increasing and vacancy rates are low. Savings and loan associations, the major factor in the financing of one-to-four family homes, report net savings inflows fairly well maintained, in the face of fears of extensive withdrawals. Moreover, the Home Loan Bank Board recently reduced liquidity reserve requirements for these institutions, releasing additional funds for mortgage loans. Apartment financing has been augmented by increased lending by life insurance companies and pension funds.

In most of the Midwest, and particularly the Chicago area, home building has been
maintained at a high rate throughout 1968. Permits for new apartment units in the area reached a record high in July, and permits for single-family units were also relatively strong.

In most of the Seventh District, and many other areas of the nation, the effective ceiling on construction activity in 1968 has been availability of labor rather than availability of credit. Heavy demand for building trades workers in short supply is reflected in newly negotiated three-year contracts calling for increases in compensation as much as 8 percent a year.

Credit and the outlook

Largely because of the expected impact of the long-awaited fiscal restraints, interest rates on all maturities of market instruments declined sharply in July. In August the discount rate paid by member banks on borrowing at the Federal Reserve Banks was reduced from 5.5 to 5.25 percent in line with the historical policy of keeping the discount rate in touch with related market rates.

If credit becomes more readily available this will help the consumer and business sectors fill any slack in the economy developing from fiscal measures. Consumer expenditures on soft and hard goods in July and August, aided by increased use of instalment credit, indicate that no general decline in the economy is imminent. Aside from steel, and possibly autos, business inventories are fairly low.

Despite the buildup in steel, business inventories at the end of June were only 1.50 times sales of the month, compared with 1.55 a year earlier. Strength in retail sales this summer, coupled with a slower rise in factory output, suggests this ratio has since moved even lower. Inventory adjustments have played major roles in business fluctuations of the past. Most companies will probably maintain growth in inventory investment for the rest of the year.

Selected market interest rates

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<th>Weekly averages of daily figures</th>
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1Salomon Brothers & Hutzler.
2Moody's.
Aiding the poor: the negative income tax

The nation’s dramatic economic advance has prompted widespread concern over the persistence of poverty. Degradation and deprivation in urban slums, stagnating small towns, and some rural areas offer disquieting contrast to a nation of growing affluence.

The last four or five years have seen the emergence of a variety of proposals—and the launching of a number of programs—designed to better the lot of needy people. Some of the recommendations have simply called for higher standards under existing aid programs, such as for more units of public housing or more liberal Social Security and public assistance payments. New programs have been started to provide literacy and vocational training, job counseling and placement services, aids to industrial development, and additional funds for education—all in an effort to get at the root causes of poverty.

What is the negative income tax?

Probably no proposal for helping the poor has attracted more popular attention than the negative income tax. To some of its advocates, the negative income tax promises to supplant most of the existing programs for helping the needy—if not all of them—and to eliminate most of the administrative apparatus they require. No less important, it promises to assist many poor people not benefited under current programs. Other advocates make less sweeping claims for the proposal, contending only that it deserves consideration as an additional means of dealing with poverty—and a promising one.

A tax is a payment to the government. A negative tax must therefore be a payment received from the government. The amount of income tax one pays depends on his income, allowances being made for exemptions and deductions. The amount of negative income tax a person received would depend on his lack of income—or, more precisely, on the gap between income and the amount he is believed to need. The “tax” might conceivably fill the gap completely, or it might make up only part of the difference.

More than a thousand university economists issued a statement last May, calling for adoption of such a plan—or, more generally, a national system of income guarantees and supplements. This group, contending that welfare programs have failed to aid millions of needy people and inadequately aided most of those receiving assistance, would have income and family size determine payments. But contending also that welfare programs often penalize industry and thrift and discourage the building of stable families, the group proposed a plan that would protect incentives to work, save, and train for employment.

Most advanced nations have had family or child allowance plans for years. Closely resembling negative taxes, these plans provide regular payments to families on behalf of the children—at least up to some maxi-
mum number. Payments are made as a matter of right, without regard for financial circumstances.

Financed out of regular tax revenues, allowances benefit most families much as the negative income tax would do. But they are obviously no help to single people, childless couples, or the elderly. As under a negative income tax, benefits are provided without an express test of means, but in contrast to the negative tax, child allowances provide payments not only to the poor but also to those in comfortable circumstances.

**Current aids to the poor**

This country now has an elaborate network of income maintenance, or protection, systems, largely a legacy of the Great Depression. But unlike child allowances or the negative income tax proposals, the system is highly selective. Only a fraction of the people classed as poor benefit from the programs. Moreover, most of those that do benefit receive much less than enough assistance to lift them out of poverty.

Social insurance constitutes the backbone of the system. “Earned” benefits are paid to retired people, the disabled, widows with young children, and, provided they have had previous employment, the temporarily unemployed. Workmen’s compensation, financed privately to help victims of industrial accidents, is another element in the system.

Backstopping the insurance-type programs is public assistance, which covers a variety of income maintenance programs financed out of general taxes. Public assistance provides subsistence-level incomes for people that can clearly demonstrate their need for help. Recipients are those ineligible for benefits under insurance plans, for whatever reason, or not having sufficient benefits to cover their needs.

Public assistance is provided under programs for particular types of dependency. The original Social Security Act of 1935, for example, made provision for aid to the “deserving needy”—the aged, the blind, and dependent children.

Other categories of deserving needy have since been recognized—the permanently and totally disabled, the mothers (and fathers on a small scale) of dependent children and the medically indigent, and people otherwise ineligible for aid but unable to bear the full costs of medical care. Costs of these “categorical” programs are shared about equally by the federal government and the states. Local governments contribute in some cases.

General assistance is another type of public aid. Financed by state and local governments, general assistance, once known as “poor relief,” dates from the poor laws of Elizabethan England. General assistance now serves as a catch-all program for aiding needy people that do not fit into categories covered by federally supported programs.

While eligibility for federal sharing in the costs of the assistance programs requires states to meet requirements laid down by the Social Security Act, the levels of support provided and the standards for eligibility vary widely from state to state. Under general assistance, of course, the standards used are not affected by federal law at all. While living costs vary in different parts of the country, the dispersion in aid payments per recipient is far more than the difference in living costs. Variation in state and local fiscal capacities accounts for part of the spread. But at least equally important are state-to-state differences in attitudes toward the problem of dependency.

**How many poor are there?**

The population of poor is hard to size up.
Nearly 9 million Americans receive public assistance. Since eligibility for aid depends on demonstration of need, these people must be reckoned as part of the nation’s poverty group. But by any reasonable yardstick, the number receiving public assistance is far short of the total number of people making up the poverty group.

The yardstick used in selecting the level of economic wellbeing separating those living in poverty from those who are not—usually income—is necessarily arbitrary. Most efforts to specify the income level (or rather the income levels related to family size) delineating the scale of poverty have been built on the estimated cost of a minimal diet. The application of a multiple reflecting an average relationship between expenditures for food and all family expenditures gives an estimate of a subsistence-level family budget. The number of family members has been taken into account, along with whether it is a farm or nonfarm family.

To delineate poverty, the Social Security Administration uses a budget that would have amounted to about $65 a week for a four-member, nonfarm family in 1966. Among nonfarm families of four, therefore, annual incomes of about $3,300 separated the poor from the non-poor. The typical nonfarm family of seven or more, with a 1966 income of roughly $5,400 or less, was considered to be living in poverty, however, while a single woman living on a farm was above the poverty line with an income of only little over $1,100.

The Social Security criteria provide an estimate of nearly 30 million people living in poverty in 1966—15.3 percent of the total population. For individual categories of the population, the incidence of poverty ranged widely. The percentage of the white population living below the poverty line was 11.9, but more than half the white population of single people aged 65 and older were under the poverty line. Although only about one in eight whites lived below the poverty level, two out of five nonwhites were below. Nearly half the nonwhites under 18 and more than three-fourths of the nonwhites aged 65 and older lived in poverty.

The criteria for delineation of the poor are supplemented by criteria for identifying the “near-poor”—people living above the poverty level but close to it. The Social Security criteria define the near-poor as those having incomes up to about a third above the poverty cutoff—roughly $85 a week for an average nonfarm family of four. According to this measure, there are about half as many near-poor as there are poor. These two categories—the poor and near-poor—embraced 45 million people in 1966—23 percent of the U. S. population.

The estimated 30 million living in poverty represent 11 million households—families and single people. The “income deficit” of these households—the amount needed to raise them to the non-poverty line—is believed to have been roughly $11 billion in 1965. To have raised both poor and near-poor households to the cut-off above the near-poor category would have cost close to $20 billion.

**The role of current aids**

Many of the 11 million poverty families are benefited, of course, by existing programs, but not enough to raise them above the poverty level. These programs (including Social Security, public assistance, and veterans’ assistance) are believed to have prevented some 4.7 million families from falling below the poverty line in 1965. Social security boosted nearly 3.6 million families at least as far as the poverty mark. Public assistance...
Government plans for providing financial aid to the needy take several forms and differ significantly in certain respects. Most, however, can be classed as public assistance, family (or child) allowances, or negative income taxes.

Public assistance is designed to assist only the needy, who qualify for monthly cash assistance by demonstrating a lack or insufficiency of income. Their need is measured against a modest public assistance standard reflecting family size, medical needs, and local living costs. Any earned income reduces the assistance payment commensurately. (Under a 1967 amendment to the Social Security Act, modest earnings in households receiving AFDC assistance—Aid to Families of Dependent Children—are not so offset.) The effect, a 100-percent tax on earnings, is held to discourage initiative.

Under family allowance plans, aid is paid to all families, regardless of income or means as otherwise measured. The amount of the payment reflects only the number of children in a family. With some plans, aid begins only with the second child in the family. With others, aid is paid for only the first five or six children. Income taxes may exempt the family allowance or treat it as part of taxable income. Tax liability begins only after deductions and allowances are made for family size, as it does under the conventional income tax. The incentive to find employment is preserved because earnings do not affect the allowances.

made the difference between poverty and non-poverty for only about 400,000 families. Together, all the other public income-maintenance plans made the critical difference for 1.1 million people.

One of the principal sources of dissatisfaction with current efforts to help the poor is the persistence of poverty, despite the efforts. Although there is room for dispute over the precise size of the poor population (mainly because of disagreement on the definition of poverty) it clearly is large, whatever the criteria. It is also clear that the elimination of poverty, by whatever means, is bound to be costly.

Expenditures under government income-maintenance programs totaled roughly $47 billion in fiscal 1967. Social security was much the largest program. It and other insurance-type programs entailed outlays of more than $30 billion. Payments to veterans were roughly $7 billion, and expenditures under health and medical programs totaled upwards of $4 billion.

These income-maintenance programs are alike in that their benefits are available to poor and non-poor alike. A substantial part of the $47 billion spent in fiscal 1967 went to recipients above the poverty level. By contrast, the public assistance programs, which aid only needy people, involved expenditures of about $5.5 billion.
Family allowance plans have been criticized as encouraging growth in family size—a factor often associated with poverty—although evidence that this is true is not clear. The criticism that family allowance plans fail to aid single people and retired and childless couples is valid, however.

The negative income tax aids only the needy, eligibility being established by reference only to income and family size. A "means test" is met, in effect, by filing an income tax return. A negative tax rate of less than 100 percent—perhaps 33\(\frac{1}{3}\) or 50 percent—applied to earnings up to the positive tax margin provides some incentive to earn outside income.

Existing income-maintenance programs could conceivably be modified to raise the poor above the poverty level, wiping out poverty as it has been defined. Social Security benefits to old people, the disabled, and widows with minor children might be adjusted so that a beneficiary's total income from all sources at least equaled the poverty minimum. Such a change would, of course, have serious implications for the current method of financing Social Security.

Alternatively, standards under public assistance programs could be aligned with the minimum budgets used in delineating the extent of poverty. Such a change as this would entail not only substantial increases in benefits but also the adoption of national standards, although recognition of differences in living costs should still be feasible.

**Work incentive effects**

Greater use of current public assistance programs—or even of Social Security—would retain a feature of these programs that has drawn sharp criticism. That is the implicit 100-percent tax (modified slightly in 1967 by amendments to the Social Security Act) on earnings of assistance recipients. As public assistance is now administered, standard budgets are underwritten for individual receiving "units." Aid is provided to cover the difference between budgeted needs and any
income otherwise available. An increase in a receiving unit’s income, as from outside earnings, results in a dollar-for-dollar reduction in the monthly assistance grant. In short, income remains the same whether any of it is earned or not. This is widely believed to be a deterrent to efforts employable aid recipients could make to find work and financial self-sufficiency.

Negative income tax plans have usually proposed subsidies covering only part, such as half, of the budget deficits of the poor. Under these plans, therefore, the implicit tax on outside earnings would not be fully confiscatory. Incentives to seek work would remain. Yet, by keeping negative tax payments below the amounts needed to eliminate budget deficits, the proposals imply a condition of continuing poverty not only for those indisposed to enter the labor market but also for those unable to enter.

Negative income tax plans, as a result, hardly offer a full solution to the poverty problem. Their discrimination against people unable to earn incomes would probably dictate retention of public assistance. This would preclude the dismantling of the administrative structure some advocates of the negative tax consider highly desirable.

It should be possible, of course, to provide benefits through the negative tax that fully met the minimum needs of people without other incomes, while graduating the benefits upward from that level by some fraction of income received from other sources. But that would increase costs considerably, assuring recipients that worked of incomes consistently above the poverty line and assisting many who, in terms of the poverty standard, did not need help.

**Rules versus authorities**

Much of the appeal of the negative income tax and similar plans lies in their seeming objectivity—in their formulism. This feature, it is believed, would narrow to the vanishing point the range of discretion in the administration of aid to the needy and reduce the cost of operating the assistance system. Such plans would also scrap the distasteful means test that discourages many clearly in need from applying for aid.

The use of formulas in establishing tax liabilities is a well entrenched feature of the present income tax. On the face of it, it seems logical to apply the same methods to the determination of entitlement to financial assistance. But there is a vital difference between, on the one hand, determining tax liabilities, which amount at most to only a fraction of a taxpayer’s income and, on the other, setting the total amount of a beneficiary’s income.

The individual income tax is based essentially on the ability to pay. Current income is widely thought to be about the best measure of this ability. But current income is a far from perfect measure, neglecting to take into account the value of non-yielding or low-yielding salable assets that the person may own and nonpecuniary income he may receive and treating fluctuating incomes differently from steady incomes. There are also arbitrary elements in the provision made for differences in family size and allowable deductions.

But despite its imperfections, the individual income tax still has few rivals in fairness and effectiveness. And in practice, its imperfections may not even be very serious when it is considered that the “effective” tax—the tax actually paid after allowances are made for exemptions and deductions—amounts to a fifth or less of the before-tax incomes of all but the well off. Suppose, for example, the formula to determine tax
liability gives a result of 10 percent “too high” (or too low) relative to some ideal measure of taxpaying ability. Such an “error” would amount to little more than 2 percent of after-tax income. Even an error as great as 25 percent would equal only about 6 percent of the taxpayer’s take-home pay. But if a poor person’s benefits under the negative tax were similarly underestimated by the tax rule used, the result could be disturbing, because the error would fall with full impact on the beneficiary’s total income.

There are persuasive reasons, therefore, for believing that, even with the adoption of a negative income tax, or some plan akin to it, provision would still have to be made for supplemental assistance to people dealt with harshly in the computations. In the light of this, prospects for elimination of the costly and sometimes cumbersome administrative apparatus used in aiding the poor appear none too bright.

Not only is the feasibility of doing away with the current administrative structure questionable, but there are also reasons to doubt the advisability of such a move. Many recipients of public support need face-to-face counseling in stretching their limited incomes, finding jobs or job training, arranging for medical and dental care, and the like. Slum dwellers, particularly, are often unfamiliar with city life and need help in coping with it. To such people, regular visits by welfare workers may provide a sorely needed bridge to a baffling world outside.

**Aid and the causes of poverty**

Two major goals have motivated plans for income assistance and supplementation: the humanitarian goal of alleviating obvious distress and the economic goal of providing ways for the poor to gain financial independence. Since a lack, or insufficiency, of income is all that separates the poor from life under conditions of minimum decency, cash aids in the form of grants or negative taxes would probably suffice as ways of satisfying the humanitarian objective. But helping the poor help themselves is another matter. Achievement of this objective is likely to entail the outright provisions of a variety of services, such as remedial medical care, basic educational training, vocational counseling and guidance, job training and placement, and, for the poor in big city slums, orientation into urban living, and, for the poor in rural areas and small towns, aid in relocation to places where opportunities can be found.

Some of the proponents of plans for “automatic” aid to the needy are convinced that, by lifting the poor up to some minimum income level, the conditions that cause poverty and dependency will eventually disappear. They think people now locked in a “culture of poverty,” once exposed to better living, will in time generate incentives to gain self-sufficiency. This has a plausible ring, but results could be a long time in appearing.

Existing programs for assisting the poor appear suited—at least in principle—for doing a far better job than they have in relieving poverty and, for those able to work, in pointing the way to productive lives. Standards obviously need to be liberalized, and they need to be made more uniform geographically. But the existing “welfare apparatus” could play a vital role in dealing with the problems of the poor by tailoring aid to the requirements of individuals.

A negative income tax or other guaranteed income plan could be fitted into the existing arrangements for dealing with poverty. But it seems likely that assistance and other welfare programs would continue to be needed, particularly in efforts to remove the causes of poverty along with its effects.
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