

Children's Allowances and Income-Tested Supplements: Costs and Redistributive Effects

by DOROTHY S. PROJECTOR*

IN THE CONTINUING discussion of poverty in the United States it is regularly noted, first, that children constitute a sizable proportion of the poor—about 40 percent, according to the 1967 count—and, second, that the existing public assistance programs are not designed to meet the needs of the majority of poor children. Any expansion of the present income-maintenance system would probably provide some assistance to children, but, it is argued, a program concentrated on children has advantages over other types of programs. It is said, for example, that children's allowances represent an investment in the future and can be effective in breaking the poverty cycle.

Some proposed plans would pay allowances to all children and thereby avoid the need for a means test; they thus might provide a cohesive element—unlike other programs that more clearly separate groups on the basis of need. Another commonly expressed position is that a children's allowance program already exists in the United States in the form of the exemption granted for children under the income-tax law but that the system is inequitable since it pays the largest benefit to those who need it least and nothing at all to those who need it most. The tax saving for families in the highest tax bracket, for example, amounts to \$420—70 percent of the flat \$600 exemption—but there is no tax saving for those with no taxable income.

This article presents an analysis of the costs, financing, and effects on the distribution of income for four plans that would make money payments to children or to families with children. The major characteristics of the four plans selected for analysis here are summarized in the table in the next column.

	Tax on allowance	Status of children's exemptions	Amount of allowance
Plan A ¹	At income-tax rates	Retained	\$120 per child per year.
Plan B ²	At income-tax rates	Eliminated	\$120 per child per year.
Plan C ³	Special tax	Retained	\$500 per year each for first 2 family members, \$300 for each additional member.
Plan D ⁴	Special tax	Eliminated	Per child per year: 1st, \$1,400 2d, \$900 3d, \$600 4th and subsequent, \$400.

¹ Children's allowance plan proposed by James C. Vadakin in *Children, Poverty, and Family Allowances*, Basic Books, Inc., 1968.

² Alternative proposal for children's allowances by James C. Vadakin (see footnote 1).

³ Income-tested supplement for families with children.

⁴ Children's allowance plan proposed by Harvey Brazer in "The Federal Individual Income Tax and the Poor: Where Do We Go From Here?" *California Law Review*, April 1969.

The arguments just cited in support of programs concentrated on children have apparently been given different weights in the design of the four plans. Plan A pays an allowance to all children and does not disturb the existing system of tax exemptions for children. Plan B pays allowances to all children and concerns itself with the equity argument by advocating the elimination of tax exemptions for children. Plan C limits payments to families below a stipulated income level, thereby emphasizing the objective of breaking the poverty cycle; it does not concern itself with the arguments about the merits of a universal system or the equity of the present income-tax system. Plan D also makes significant net payments only to families with income below specified amounts.

The amount of the benefit ranges from a rather modest \$120 per year for each child under Plans A and B to much more substantial amounts under Plans C and D. All the plans incorporate a method of taxing the benefit that reduces the net amount of the payment as family income rises. Plan A and Plan B add the allowance to taxable income, and Plan C and Plan D employ a special tax with high marginal rates. The amount of the payment is reduced much more gradually under Plans A and B than under Plans C and D.

* Division of Economic and Long-Range Studies, Office of Research and Statistics. The article is adapted from a paper given by the author at the Sixty-second Annual Conference on Taxation, sponsored by the National Tax Association in Boston, Massachusetts, September 29–October 3, 1969.

TABLE 1.—Components of cost for children's allowance and income-tested supplement proposals, 1967

[In billions]

Item	Plan A	Plan B	Plan C	Plan D
Gross allowance.....	\$8.4	\$8.4	\$8.2	\$69.3
Recoupment from:				
Allowance tax.....	1.4	1.6	4.0	54.3
Elimination of exemptions.....		7.5		7.5
Allowance less recoupment.....	7.1	— .6	4.2	7.5
Less AFDC.....			1.7	2.1
Net new benefits.....	7.1	— .6	2.6	5.5

Because the four plans differ so markedly with respect to size of allowance, manner of taxing the allowance, and treatment of the tax exemption, aggregate costs vary widely—from no net cost to more than \$7 billion, as of 1967. Moreover, the patterns of change in disposable income that would result from introduction of the plans would not be the same. Some groups of families would be more favorably treated by one plan than by another. For each of the plans, the cost and effects on the income distribution are analyzed here. The data presented show the changes in disposable income that would result from introduction of the plans for families grouped by number of children and by income. The data show which groups of families would experience income gains and which income losses under each type of plan. The main characteristics of the plans are then summarized and compared, especially with respect to their overall effect on the distribution of income.

PLAN A—ALLOWANCES TAXED AS INCOME, EXEMPTION RETAINED

Under Plan A, all children under age 18 would receive an allowance of \$10 a month. All children would be eligible, regardless of the income status of their families. The allowance would be supplemented by payments under aid to families with dependent children (AFDC) and other assistance programs and would be considered taxable under the Internal Revenue Code. Tax exemptions for children would be continued.

An annual allowance of \$120 per child, paid to the 70 million children under age 18 in the population as of 1967, would have cost \$8.4 billion. On the basis of 1967 population and income data, it is estimated that taxing the allowance under the present income-tax rate structure would have provided about \$1.4 billion in revenue and resulted

in a net cost of \$7.1 billion (table 1). Under this plan, the net cost would be financed from general tax revenues of the Federal Government.

When the tax on the allowance is taken into account, the value of the allowance declines with the income level of the family. Table 2 shows the amount of allowance, after tax, that families of differing size and income level would receive, given the 1967 level and distribution of income and the present income-tax structure.¹

Families with one child would receive an annual allowance after tax of \$98, on the average, and those with total money income less than \$3,000—who have little or no taxable income—would receive \$114. Those with total money income of \$10,000–\$15,000, who pay marginal tax rates of 19–22 percent, would receive \$95. At a given income level, families with larger numbers of children would receive amounts approximately proportional to the number of children in the family. Thus, families with less than \$3,000 in income and three children would receive \$360, on the average.

Plan A may be viewed as a way of changing the tax subsidy for a child. The present subsidy—that is, the value of the \$600 exemption—increases from zero for families with little or no income to \$420 per child for families with income subject to the 70-percent marginal tax rate. The value of the \$120 allowance declines with income level from \$120 per child to \$36 per child. Thus the total tax subsidy for a child would range from \$120 when taxable income is zero to \$456 when it is very large. To put it another way, the total tax subsidy under this proposal is equivalent to exempting \$1,337 of income from tax for those in the 14-percent marginal tax bracket and exempting \$651 of income for those in the 70-percent bracket. The uniform exemption of \$600 per child is, in effect, being supplemented by an exemption that vanishes in part as income rises.

The figures in table 2 represent increases in income that families with children would experi-

¹ For purposes of this article, families and unrelated individuals are grouped in the tables by the amount of their total money income in 1967, as reported in the March 1968 Current Population Survey by the Bureau of the Census. Total money income includes wages and salaries, income from self-employment, dividends, interest, public and private pensions, public assistance payments, and other periodic payments received by the family.

TABLE 2.—Average amount of allowance less tax for families and unrelated individuals under Plan A and Plan C, by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
Plan A							
All units	\$112	\$98	\$196	\$296	\$402	\$613	
Under \$3,000	55	114	235	360	480	729	
\$3,000-4,999	105	101	204	314	440	716	
5,000-6,999	127	100	200	302	405	627	
7,000-9,999	143	97	194	294	396	578	
10,000-14,999	138	95	192	287	384	554	
15,000-24,999	119	90	180	269	359	506	
25,000 or more	90	71	141	212	286	416	
Plan C							
All units	\$41	\$47	\$51	\$75	\$127	\$344	
Under \$3,000	129	428	574	715	930	1,491	
\$3,000-4,999	84	28	97	234	424	822	
5,000-6,999	9					200	
7,000-9,999							
10,000-14,999							
15,000-24,999							
25,000 or more							

ence from the allowance less tax but do not take into account the decreases in income that would result from financing the program. In this analysis it is assumed that the revenue needed to finance the programs would be raised by a surtax on Federal personal and corporate income-tax liability. The \$7.1 billion cost of Plan A would have required a surtax of 7.4 percent in 1967.

The surtax would affect the disposable income of families and unrelated individuals in several ways. The surtax on personal income-tax liability, which would yield about two-thirds of the amount needed, would increase the income taxes and thus lower the disposable income of all families and unrelated individuals with taxable income.

The surtax on corporate income-tax liability would lower corporate profits after tax and hence lower dividend income and retained corporate profits. It is usually assumed in analyses of this type, however, that such a surtax would lead to higher prices for goods and services and that corporate profits after tax would thus not decline by the full amount of the surtax. As in earlier studies,² it is assumed that the surtax on corporate

income-tax liability would result in price increases sufficient to raise corporate profits before tax by one-third of the amount of the surtax. Thus corporate profits after tax would decline by two-thirds of the amount of the surtax.

Price increases affect disposable income by lowering the real value of consumption. All families and unrelated individuals would therefore experience some decline in real disposable income, with the decline measured by a tax on their consumption expenditures sufficient to raise one-third of the corporate surtax. The decline in corporate profits after tax would result in decreases in dividend income and in retained corporate profits and thus lower the disposable income of all families and unrelated individuals receiving such income. The combined amount of the tax on personal income-tax liability, on consumption, and on dividends is shown in table 4 for all families and unrelated individuals. The tax on retained profits is not reflected in the figures in table 4 because the income data from the Bureau of the Census do not include a measure of retained profits.

Deducting the average surtax shown in table 4 from the average amount of allowance less tax (table 2) yields an approximation of the overall change in disposable income for families and unrelated individuals that would result from the introduction of Plan A. These figures are shown

² See Benjamin Bridges, Jr., "Current Redistribution Effects of Old-Age Income Assurance Programs," *Old-Age Income Assurance. Part II: The Aged Population and Retirement Income Programs* (Joint Economic Committee Print, 90th Cong., 1st sess.), December 1967, pages 95-176, and the references therein.

TABLE 3.—Average amount of allowance less tax and less value of exemption for families and unrelated individuals under Plan B and Plan D, by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
Plan B							
All units.....	-\$10	-\$16	-\$34	-\$43	-\$31	\$54	
Under \$3,000.....	46	71	178	315	431	679	
\$3,000-4,999.....	28	4	12	37	126	381	
5,000-6,999.....	-2	-9	-11	-10	-3	37	
7,000-9,999.....	-22	-18	-35	-47	-57	-62	
10,000-14,999.....	-42	-32	-61	-88	-118	-154	
15,000-24,999.....	-83	-63	-122	-188	-254	-367	
25,000 or more.....	-226	-176	-352	-527	-685	-1,086	
Plan D							
All units.....	\$87	\$163	\$176	\$151	\$189	\$399	
Under \$3,000.....	265	790	1,315	1,023	1,993	2,708	
\$3,000-4,999.....	367	621	985	1,164	1,202	1,512	
5,000-6,999.....	181	249	372	384	427	517	
7,000-9,999.....	-66	-20	-72	-146	-221	-349	
10,000-14,999.....	-105	-56	-133	-223	-327	-487	
15,000-24,999.....	-134	-82	-186	-308	-440	-661	
25,000 or more.....	-252	-176	-378	-594	-806	-1,286	

in table 5 by size of total money income for various groups of families and individuals. Table 6 relates this dollar change in disposable income to the amount of disposable income before introduction of the program (table 7).

Under Plan A, most families with children would experience an increase in disposable income even after the surtax is taken into account (see tables 5 and 8). To put it another way, the program would be paid for largely by families with no children and by single persons.

The change in disposable income for families in the lowest income bracket (under \$3,000), where the amount of the surtax is small, differs little from the allowance less tax, and the increase is roughly proportional to the number of children. Thus disposable income rises by 6 percent for one-child families, 13 percent for two-child families, 19 percent for three-child families, and so on—as table 6 shows. At a given level of total money income, however, the surtax declines with increase in family size (table 4). Hence, at higher levels of income where the surtax becomes substantial, the increase in disposable income per child is larger for large families than for small families. Families with income of \$5,000-\$7,000 and with one child would receive, for example, an income increase of \$49, but the increase would be \$156 (\$78 per child) for families with two children, \$263 (\$88 per child) for those with

three children, and \$373 (\$94 per child) for those with four children.

PLAN B—ALLOWANCES TAXED AS INCOME, EXEMPTION ELIMINATED

In his study of children's allowances, James C. Vadakin noted three alternatives to his proposal to consider the allowance as taxable income and retain the children's exemptions. Under these three alternative approaches to the relation between a children's allowance program and the existing income-tax structure, the allowance could have been:

- (1) excluded from taxable income, with present exemptions for children retained;
- (2) excluded from taxable income, with exemptions reduced or eliminated; or
- (3) made subject to taxation, with exemptions eliminated.

He concluded that the plan "which has been chosen is considered preferable in terms of the socio-economic effects which it would produce, its costs, and its political feasibility."³

As shown in the discussion of Plan A, the choice of taxing the allowance and retaining the exemptions would result in a tax subsidy that increases with income level from \$120 per child

³ James C. Vadakin, *Children, Poverty, and Family Allowances*, Basic Books, Inc., 1968, pages 188-89.

TABLE 4.—Average amount of surtax paid by families and unrelated individuals under four plans, by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
Plan A							
All units	\$95	\$111	\$110	\$104	\$90	\$74	\$87
Under \$3,000	6	6	5	4	4	4	6
\$3,000-4,999	26	27	22	17	11	8	30
5,000-6,999	50	50	44	39	32	21	59
7,000-9,999	80	81	73	68	60	50	92
10,000-14,999	135	133	125	117	111	100	153
15,000-24,999	278	266	262	247	240	227	307
25,000 or more	935	851	855	834	784	1,009	1,032
Plan B							
All units	-\$8	-\$10	-\$10	-\$10	-\$10	-\$9	-\$7
Under \$3,000	-1	-1	-1	-1	-1	-1	(¹)
\$3,000-4,999	-2	-3	-3	-3	-3	-3	-2
5,000-6,999	-5	-5	-5	-5	-5	-5	-5
7,000-9,999	-7	-7	-7	-7	-8	-8	-7
10,000-14,999	-12	-11	-12	-12	-12	-12	-12
15,000-24,999	-24	-22	-23	-23	-23	-24	-25
25,000 or more	-78	-71	-73	-73	-70	-92	-85
Plan C							
All units	\$35	\$41	\$40	\$37	\$31	\$25	\$33
Under \$3,000	2	1	1	2	2	1	2
\$3,000-4,999	9	9	6	4	3	3	11
5,000-6,999	18	18	15	13	10	5	22
7,000-9,999	29	30	26	24	20	16	34
10,000-14,999	49	49	45	42	39	34	57
15,000-24,999	102	98	96	90	86	80	114
25,000 or more	347	316	316	307	287	368	384
Plan D							
All units	\$75	\$87	\$91	\$91	\$83	\$78	\$64
Under \$3,000	5	7	6	5	5	4	5
\$3,000-4,999	22	24	25	25	22	19	22
5,000-6,999	42	42	41	42	41	40	43
7,000-9,999	65	65	64	65	64	64	67
10,000-14,999	106	103	102	102	102	103	112
15,000-24,999	212	201	205	201	202	203	225
25,000 or more	698	633	647	642	615	803	754

¹ Less than \$0.50.

for families with little or no taxable income to \$456 per child for families with income subject to the 70-percent marginal tax rate.

The first alternative would also result in a tax subsidy, increasing with income level from \$120 per child to \$540 per child over the same income range. Neither Plan A nor this first alternative would therefore satisfy those who argue that the tax subsidy to upper-income families should not exceed the subsidy to lower-income families.⁴

⁴ For a discussion of the rationale for children's exemptions under the income tax, including a discussion of the position that the size of exemptions should increase with income level, see Harold M. Groves, *Federal Tax Treatment of the Family*, The Brookings Institution, 1963, and Richard Goode, *The Individual Income Tax*, The Brookings Institution, 1964.

The third alternative would satisfy that argument, however. Data for this type of program have been prepared and are discussed here and included in the tables as Plan B. (A plan paying an allowance of \$120 to each child with no tax on the allowance and retention of 80 percent of the exemption would be exactly equivalent to Plan A. In general, any plan with an allowance of \$600 a year or less that retains the exemption and taxes the allowance may be alternatively stated as a plan that retains part of the exemption and does not tax the allowance. Hence, the second alternative does not seem to be a real one.)

Under Plan B—the modified form of Plan A—the gross cost of the allowance would be the same as the cost under Plan A. Elimination of chil-

TABLE 5.—Average amount of change in disposable income for families and unrelated individuals under four plans, by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
Plan A							
All units.....	\$17	-\$13	\$87	\$192	\$313	\$540	-\$87
Under \$3,000.....	49	108	231	356	475	725	-6
\$3,000-4,999.....	78	74	181	297	429	708	-30
5,000-6,999.....	78	49	156	263	373	606	-59
7,000-9,999.....	63	16	121	226	335	528	-92
10,000-14,999.....	3	-37	67	170	273	454	-153
15,000-24,999.....	-159	-176	-83	22	120	280	-307
25,000 or more.....	-845	-780	-714	-622	-498	-592	-1,032
Plan B							
All units.....	-\$2	-\$7	-\$24	-\$33	-\$21	\$63	\$7
Under \$3,000.....	47	72	179	316	431	680	(1)
\$3,000-4,999.....	30	7	15	40	129	384	2
5,000-6,999.....	2	-4	-6	-5	2	42	5
7,000-9,999.....	-15	-11	-28	-40	-49	-55	7
10,000-14,999.....	-30	-20	-49	-76	-106	-141	12
15,000-24,999.....	-59	-40	-99	-166	-231	-344	25
25,000 or more.....	-147	-105	-279	-454	-615	-995	85
Plan C							
All units.....	\$6	\$7	\$12	\$38	\$96	\$318	-\$33
Under \$3,000.....	127	428	573	714	929	1,490	-2
\$3,000-4,999.....	75	18	90	231	421	819	-11
5,000-6,999.....	-9	-18	-15	-13	-10	195	-22
7,000-9,999.....	-29	-30	-26	-24	-20	-16	-34
10,000-14,999.....	-49	-49	-45	-42	-39	-34	-57
15,000-24,999.....	-102	-98	-96	-90	-86	-80	-114
25,000 or more.....	-347	-316	-316	-307	-287	-368	-384
Plan D							
All units.....	\$13	\$77	\$86	\$61	\$106	\$322	-\$64
Under \$3,000.....	260	784	1,309	1,619	1,988	2,764	-5
\$3,000-4,999.....	345	596	960	1,139	1,181	1,493	-22
5,000-6,999.....	139	207	330	342	386	477	-43
7,000-9,999.....	-132	-84	-136	-210	-285	-413	-67
10,000-14,999.....	-211	-159	-235	-325	-429	-590	-112
15,000-24,999.....	-346	-283	-391	-508	-642	-804	-225
25,000 or more.....	-949	-809	-1,024	-1,235	-1,421	-2,089	-754

¹ Less than \$0.50.

dren's exemptions would, however, increase tax revenues by \$7.5 billion. This amount, combined with the revenue from the allowance tax of \$1.6 billion would result in a tax recovery of \$9.1 billion.⁵ The net effect of this program, therefore, would be to increase tax revenues by somewhat more than its cost (table 1).

When the tax on the allowance and the value of the exemption loss are taken into account, more than half the families with children would experience a decline in income as a result of the program, as tables 3 and 8 show. The value of the

⁵ The aggregate amount of tax on the allowance under the modified plan is slightly larger than that under Plan A because loss of exemption increases taxable income and hence increases marginal tax rates.

exemption begins to exceed the amount of the allowance less tax for families with incomes as low as \$3,500. Families with one child in the \$5,000-\$7,000 income range would pay \$107 more in income taxes, on the average, because of the \$600 exemption loss and would pay \$22 allowance tax. The result would be a decline of \$9 in disposable income.

The larger family is heavily benefited by the present tax exemption. Such families in the middle- and upper-income range would therefore experience greater declines in disposable income than smaller families if exemptions were eliminated.

The overall change in disposable income, shown in table 5, incorporates an income-tax reduction of

TABLE 6.—Percentage change in income after federal income tax liability for families and unrelated individuals under four plans, by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
Plan A							
All units.....	0.2	-0.2	1.0	2.1	3.6	6.6	-1.4
Under \$3,000.....	3.1	6.2	13.0	19.2	25.1	39.4	-4
\$3,000-4,999.....	2.1	2.0	4.7	7.4	10.8	17.6	-8
5,000-6,999.....	1.4	.9	2.8	4.6	6.4	10.3	-1.1
7,000-9,999.....	.8	.2	1.6	2.9	4.3	6.6	-1.2
10,000-14,999.....	(¹)	-.3	.6	1.6	2.5	4.0	-1.4
15,000-24,999.....	-.9	-1.0	-.5	.1	.7	1.6	-1.8
25,000 or more.....	-2.6	-2.4	-2.2	-1.9	-1.5	-1.6	-3.2
Plan B							
All units.....	(¹)	-0.1	-0.3	-0.4	-0.2	0.8	0.1
Under \$3,000.....	3.0	4.1	10.1	17.0	22.8	37.0	(¹)
\$3,000-4,999.....	.8	.2	.4	1.0	3.2	9.6	.1
5,000-6,999.....	(¹)	-.1	-.1	-.1	(¹)	.7	.1
7,000-9,999.....	-.2	-.1	-.4	-.5	-.6	-.7	.1
10,000-14,999.....	-.3	-.2	-.5	-.7	-1.0	-1.3	.1
15,000-24,999.....	-.3	-.2	-.6	-1.0	-1.3	-2.0	.1
25,000 or more.....	-.5	-.3	-.9	-1.4	-1.9	-2.7	.3
Plan C							
All units.....	0.1	0.1	0.1	0.4	1.1	3.9	-0.5
Under \$3,000.....	8.0	24.3	32.3	38.5	49.1	81.0	-1
\$3,000-4,999.....	2.0	.5	2.3	5.8	10.6	20.4	-3
5,000-6,999.....	-.2	-.3	-.3	-.2	-.2	3.3	-.4
7,000-9,999.....	-.4	-.4	-.3	-.3	-.3	-.2	-.5
10,000-14,999.....	-.5	-.5	-.4	-.4	-.4	-.3	-.5
15,000-24,999.....	-.6	-.6	-.6	-.5	-.5	-.5	-.7
25,000 or more.....	-1.1	-1.0	-1.0	-.9	-.9	-1.0	-1.2
Plan D							
All units.....	0.2	0.9	1.0	0.7	1.2	3.9	-1.1
Under \$3,000.....	16.3	44.8	73.7	87.3	105.1	150.3	-3
\$3,000-4,999.....	9.2	15.8	24.7	28.5	29.7	37.2	-.6
5,000-6,999.....	2.5	3.8	5.9	6.0	6.7	8.1	-.8
7,000-9,999.....	-1.7	-1.1	-1.8	-2.7	-3.6	-5.1	-.9
10,000-14,999.....	-2.0	-1.5	-2.2	-3.0	-3.9	-5.3	-1.1
15,000-24,999.....	-2.0	-1.7	-2.3	-2.9	-3.7	-4.9	-1.3
25,000 or more.....	-2.9	-2.5	-3.2	-3.8	-4.4	-5.7	-2.3

¹ Less than 0.05 percent.

\$600 million under procedures similar to those outlined for the tax increase—that is, income-tax liabilities were reduced in proportion to existing liabilities and price decreases were assumed to account for one-third of the reduction in corporate tax liability. The reduction in taxes does not change the general conclusion that families with children and with incomes of \$7,000 or more would experience declines in income as a result of Plan B.

PLAN C—INCOME-TESTED SUPPLEMENT

All families with children and with income below a stipulated amount would be eligible for

benefits under an income-tested supplement program such as the Administration-sponsored family assistance plan. A program of this general character is considered here as Plan C.

Under Plan C the payments would be \$500 a year for the first two members of a family and \$300 for each additional member. The benefits would not be considered taxable income under the Internal Revenue Code, and children's exemptions would be continued. As the family's earnings increased, the benefit would be reduced, however. Families could earn as much as \$720 a year without loss of benefits, but above that amount the benefit would be reduced 50 cents for every \$1 of earnings until it reached zero. Thus, families with one adult and one child and with earnings

TABLE 7.—Average income after federal income tax liability—families and unrelated individuals by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
All units.....	\$7,248	\$8,443	\$8,851	\$9,013	\$8,692	\$8,174	\$6,028
Under \$3,000.....	1,592	1,750	1,776	1,854	1,891	1,839	1,545
\$3,000-4,999.....	3,742	3,761	3,886	4,000	3,975	4,015	3,655
5,000-6,999.....	5,503	5,502	5,620	5,738	5,784	5,879	5,351
7,000-9,999.....	7,569	7,560	7,652	7,791	7,872	8,030	7,366
10,000-14,999.....	10,706	10,670	10,736	10,791	11,039	11,210	10,572
15,000-24,999.....	16,938	16,914	17,064	17,230	17,377	17,619	16,993
25,000 or more.....	32,558	31,970	32,391	32,745	32,271	36,948	32,449

less than \$2,720 would receive some benefit, and families with two adults and four children and with earnings below \$5,120 would also receive some benefit.

To prepare the estimates for this plan, several assumptions were made:

(1) The payment to husband-wife families with no outside income was taken as \$1,000 plus \$300 for each child under age 18 (with no payment to other family members such as children aged 18 or older and still living at home). In other types of families, the benefit was taken as \$1,000 for a family with one child under age 18, \$1,300 for a family with two children, and so on.

(2) Families receiving AFDC payments—about 1.2 million—were distributed among family-size and income groups in a manner consistent with late 1967 information on the number of children in families and with an aggregate cost of \$2.2 billion in 1967. In making the estimates it was assumed that families receiving AFDC payments that were smaller than those they would receive under Plan C would get an increase in disposable income amounting to the difference between their benefit under Plan C and their AFDC payment. Families with AFDC payments larger than those they would be eligible for under Plan C would experience no change in disposable income. To avoid a decline in income for these families, Plan C payments would have to be supplemented.

(3) Families not receiving AFDC payments were assumed to have the Plan C benefits provided under the rule given in (1) above, and the benefit was reduced on the basis of the family's total money income for 1967, as reported in the March 1968 Current Population Survey. The estimates incorporate the assumption that families retain the first \$720 of annual income with no reduction in benefit and that the benefit is reduced 50 cents for every \$1 of income in excess of \$720. Thus a family could receive \$720 a year in social security benefits or other unearned income without loss of benefits.

(4) Income-tax liability is forgiven in such a way that the marginal tax rate does not exceed 50 percent for families receiving the income-tested supplement and for families with income slightly above the level at which the supplement reaches zero (the break-even level).

Under the income-tax structure in existence in

1967, families who are eligible for an income-tested supplement may also be liable for income tax. The result is that the marginal tax rate may exceed 50 percent because the family loses 50 cents in benefit for every \$1 of earnings and also pays 14 cents in income tax out of each \$1 of earnings. For such families the estimates presented here assume that income taxes are completely forgiven. For families with income slightly above the break-even level, the estimates assume partial forgiveness of income-tax liability.⁶

On the basis of these assumptions and 1967 population and income data, the aggregate cost of the income-tested supplements under Plan C is estimated to be about \$2.6 billion. The cost to the Federal Government is slightly higher than \$2.6 billion because of some shift in welfare costs from State and local governments. For both Plan C and Plan D, where there is a similar problem, the cost of new benefits, rather than the cost to the Federal Government, was assumed to be financed by the surtax on Federal personal and corporate income-tax liability. A preferable procedure would have involved financing the cost to the Federal Government in this manner with some offset from forgiveness of State and local taxes.

Benefits under Plan C would be concentrated on families with incomes less than \$3,000, though larger families with somewhat higher incomes would also receive sizable supplements (table 2). With the surtax taken into account, families with one child and less than \$3,000 in income would receive a 24-percent increase in disposable income, on the average; those with three children, a 39-percent increase; and those with five or more children, an 81-percent increase (table 6).

All families without children, all single persons, and most middle- and upper-income families with

⁶ For a discussion of this problem, see James Tobin, Joseph Pechman, and Peter Mieskowski, "Is a Negative Income Practical?" *Yale Law Journal*, November 1967.

TABLE 8.—Families and unrelated individuals by total money income in 1967

Total money income	Total families and unrelated individuals	Families having specified number of related children under age 18					Families with no children and unrelated individuals
		1	2	3	4	5 or more	
Number (in thousands).....	62,948	9,154	8,756	5,453	2,984	2,671	33,930
Percent.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Under \$3,000.....	21.7	10.3	7.2	7.3	8.3	11.9	32.8
\$3,000-4,999.....	13.8	11.5	10.2	9.6	11.2	15.9	16.1
5,000-6,999.....	15.4	16.6	16.7	17.2	18.5	16.9	14.0
7,000-9,999.....	20.8	25.2	28.2	27.9	27.5	25.8	15.7
10,000-14,999.....	18.4	24.0	25.3	25.4	22.7	20.4	13.5
15,000-24,999.....	7.8	10.0	9.8	10.1	9.6	7.2	6.3
25,000 or more.....	2.0	2.4	2.6	2.6	2.1	1.9	1.7
Number of children (in thousands).....	70,119	9,154	17,512	16,359	11,936	15,597

children would experience declines in disposable income as a result of the program. On the average, the declines would be small in relation to income—1 percent or less of disposable income—but for particular families, especially high-income families, the percentage decline would be larger.

One more child would add \$300 to the family's benefit when income was very low. At somewhat higher incomes, however, the large family could receive more than a small family does for an additional child. This difference occurs because the benefit reaches zero at a lower income level for the small family than for the large one. For example, husband-wife families with one child would not receive any net benefit if their income was \$3,320 or larger; families with two children would continue to receive benefits until their income was \$3,920 or larger; and those with three children would get their benefits until income was \$4,520 or larger. Thus at income of \$3,720, the family with one child would receive zero benefit; the family with two children, \$100; and the family with three children, \$400. To put it another way, the increment for the second child would be \$100 and for the third child \$300. Table 2 shows this effect for families with income of \$3,000-\$5,000: For families with one child the average benefit is \$28; for two-child families, it is \$97 (\$48 per child); for three-child families, \$234 (\$78 per child); and for four-child families, \$424 (\$106 per child).

PLAN D—ALLOWANCES SPECIALLY TAXED

Under Plan D, an annual allowance would be paid to all children under age 18, as follows:

First child, \$1,400; second child, \$900; third child, \$600; fourth and subsequent children \$400. The allowance would not be taxable income but would be subject to a special children's allowance tax. Children's exemptions under the regular income tax would be eliminated. The program would replace AFDC, though it is assumed that no assistance recipient would experience a decline in income as a result of the introduction of the program.

The special tax would reduce the allowance as the family's income increased, but all families would receive an allowance after tax of at least 5-percent of the gross allowance. The special tax as a percentage of the allowance would increase with income, up to 95 percent at about \$8,000, and is the same for families of all sizes. The rate at which the allowance would be reduced for every \$1 of income would first increase and then decrease with income level and, for a given income level, increase with the number of children in the family. For example, the \$1,400 allowance for the married taxpayer with one child would be reduced 15 cents for every \$1 of income less than \$2,000, 19 cents for the next \$4,000 in income, and 13.5 cents for the next \$2,000, until the allowance after tax reached \$70 at an income of \$8,000. The \$2,900 allowance received by a married taxpayer with three children would be reduced by 32 cents, 40 cents, and 25.7 cents, respectively, for every \$1 of income throughout these ranges, until the allowance was reduced to \$145 at income of \$8,000.

The estimated gross cost of paying the allowance to the 70 million children counted in 1967 is \$69.3 billion (table 1). On the basis of 1967 population and income data, it is estimated that revenue from the special children's allowance tax would have amounted to \$54.3 billion and revenue

from eliminating the exemptions would have been \$7.5 billion. Because it is assumed that the plan would replace the AFDC program, which was costing slightly more than \$2 billion in 1967, the net amount of the new benefits under Plan D would have amounted to about \$5.5 billion in 1967.⁷ The cost to the Federal Government would have been somewhat higher because of the shift in AFDC cost from the States. As noted in the discussion of Plan C—the income-tested supplement program—the net cost of new benefits was assumed to be financed by the surtax on Federal personal and corporate income-tax liability.

When the allowance tax and the exemption loss are taken into account, families with children and with income less than \$7,000 would receive an increase in disposable income as a result of Plan D (table 3). The value of the exemption begins to exceed the allowance less tax at income around \$7,000, so that most families with children and with income of \$7,000 or more would experience declines in disposable income as a result of the program. As noted for Plan B—the program with allowances taxable as income and the exemptions eliminated—the exemption loss means especially large income declines for larger families in the middle- and upper-income range who are heavily benefited by the present exemption.

Data on the overall change in disposable income after the surtax is taken into account are given in tables 5 and 6. Families with children and with less than \$3,000 in income would receive substantial increases in income: 45 percent for the one-child family, 87 percent for the three-child family, and 150 percent for the family with five or more children. Middle- and upper-income families with children would experience declines in income ranging from 2 percent to 6 percent, on the average; for those without children, the declines would average 1–2 percent.

The benefit schedule under Plan D would provide for a declining allowance per child: \$1,400 for the first child and \$900 for the second. The

benefit per child for large families is thus smaller than that for small families when the family's income is very low. Moreover, the special tax that reduces the allowance by the same percentage for all family sizes, at a given income level, assures that the benefits per child are smaller for the large family throughout the income scale.

Because the value of the children's exemption is approximately proportional to the number of children above the lowest income levels, the net effect of this type of plan is to remove a subsidy that is proportional to the number of children in the family and to replace it with a subsidy less than proportional to that number.

SUMMARY COMPARISON OF THE FOUR PLANS

Plan A would pay the smallest allowance per child and have the largest cost. It would result in modest income increases for most families with children. At middle- and upper-income levels, larger families would receive somewhat larger increases per child than would smaller families.

Plan D would pay the largest allowance per child and ranks second in terms of cost. The special allowance tax that reduces the allowance at high marginal rates as income rises and the elimination of exemptions keep the cost low in comparison with Plan A.

Plan D would result in substantial income increases for the roughly one-half of the families with children and with income less than \$7,000. The allowance schedule and the method of taxing the allowance assure that the overall increase in disposable income per child would be smaller for large families than for small, at a given income level. About one-half of the families with children would experience declines in income through this type of plan, and the declines would be larger for large families than for small, at a given income level.

Plan C—the income-tested supplement program—ranks second in terms of size of allowance and third in terms of total cost. Although there is no tax recovery from elimination of exemptions, the cost of Plan C is less than that of Plan D because the allowance is less and because as income rises above \$720 the allowance is generally reduced at a higher marginal rate under Plan C than under Plan D.

⁷ See Harvey Brazer, "The Federal Individual Income Tax and the Poor: Where Do We Go From Here?" (*California Law Review*, April 1969), who estimates that the cost of this program would have been \$7.6 billion on the basis of 1966 income and population data. The \$2 billion difference between 1966 and 1967 in the estimate of cost results largely from an increase in the estimate of the children's allowance tax—from \$52.1 billion in 1966 to \$54.3 billion in 1967.

Under Plan C, most families with children and with income less than \$3,000 and many with income as high as \$5,000-\$6,000 would receive benefits. The allowance schedule adds \$300 for each child at low income levels, but as income rises the net benefit per child for the large family exceeds that for the small family. Families with children and with income of \$7,000 or more would experience declines in disposable income, with the largest declines for the smaller families.

Plan B, providing allowances taxable as income and eliminating exemptions, would increase tax revenue about \$600 million more than its gross cost. Families with children and with income less than \$5,000 would receive modest increases in income, but families above that income level would experience some decline. The income decreases are largest for families with several children.

On the basis of the data presented thus far, it is clear that all four plans would redistribute income from upper to lower income units and hence would move the distribution of income toward a greater equality. To provide some indication of how much of a shift would occur and how the plans compare in this respect, the group data on disposable income before and after introduction of the plans have been used to estimate Lorenz curves that show how large a share of aggregate income is received by any given percentage of families with the smallest incomes. Such a measure is widely used as an indicator of the degree of equality in the distribution of income and as a way of comparing distributions for different times and places. It is used here to compare the actual distribution of disposable income in 1967 and the four hypothetical distributions that would have resulted if these programs had been introduced.

Column 1 of table 9 shows the estimated distribution of aggregate disposable income in 1967. According to this estimate, the 10 percent of families and unrelated individuals with the lowest income received 1.3 percent of aggregate disposable income, the 20 percent with the lowest incomes received 4.1 percent of the aggregate, and so on.

Columns 2 through 5 show the distributions that would have resulted from introduction of the four plans discussed here. Plan D would have effected the greatest movement toward equal dis-

TABLE 9.—Cumulative distribution of aggregate disposable income by income tenths, 1967: comparison of actual distribution with four hypothetical distributions

Families and unrelated individuals ranked by size of disposable income	[In percent]				
	Before children's benefit program	After children's benefit program			
		Plan A	Plan B	Plan C	Plan D
Lowest 10 percent.....	1.3	1.4	1.4	1.4	1.4
Lowest 20 percent.....	4.1	4.2	4.2	4.4	4.5
Lowest 30 percent.....	8.7	8.8	8.8	9.1	9.6
Lowest 40 percent.....	15.0	15.2	15.1	15.4	16.4
Lowest 50 percent.....	22.8	23.2	23.0	23.3	24.5
Lowest 60 percent.....	32.2	32.6	32.4	32.7	33.8
Lowest 70 percent.....	43.3	43.7	43.5	43.7	44.6
Lowest 80 percent.....	56.4	56.9	56.7	56.7	57.5
Lowest 90 percent.....	72.3	72.8	72.4	72.6	73.0

tribution of income. (Generally speaking, as the distribution of income becomes more equal, the share of income received by units with the smallest incomes moves closer to the proportion of units in that class.) Plan D increases the share of the lowest 10 percent from 1.3 to 1.4 percent, the lowest 20 percent from 4.1 to 4.5 percent, the lowest 30 percent from 8.7 to 9.6 percent, and so on.

When similar methods are used to evaluate the other plans, Plan B is found to result in the least movement toward equality. Plan C in comparison with Plan A shows larger shares for the lowest 60 percent and by a summary measure of the Lorenz curve such as the Gini coefficient would undoubtedly show a greater movement toward equality than Plan A does. Thus, though all four plans would result in some movement toward a more equal distribution of income, the general shape of the distribution is little changed, even by the plan with the greatest effect—Plan D.

TECHNICAL NOTE

The population of families and unrelated individuals was divided into the following groups:

- Male head, wife present with—
 - One child
 - Two children
 - Three children
 - Four children
 - Five or more children
- Other male head or female head with—
 - One child
 - Two children
 - Three children
 - Four children
 - Five or more children

Male head, wife present, no children—
 Head under age 65
 Head aged 65 or over
All other families

Unrelated individuals under age 65
Unrelated individuals aged 65 or over

Information on the distribution of units in these groups by total money income was available from data published by the Bureau of the Census, in "Income in 1967 of Families in the United States," *Current Population Reports* (Series P-60, No. 59, 1969) and from special tabulations that were included in the Current Population Survey for March 1968.

Within each of these 15 groups estimates of income subject to Federal individual income tax and of tax liability were prepared for units in each total money income class. All income was considered subject to tax except the public assistance payments received by AFDC families and an estimate of tax-exempt income received by units with head aged 65 years or over. Taxable income was derived from total money income by using the minimum standard deduction for units at low income levels and by assuming that deductions amounted to a percentage of total money income at higher income levels—15 percent for married taxpayers, 13 percent for head of household returns (groups 6–10 and 13), and 17 percent for single persons. These percentages were based on the relation between deductions and adjusted gross income shown by the 1966 *Statistics of Income* of the Internal Revenue Service. Except for the open-end classes, all units in each total money-income class were assumed to have income equal to the midpoint of the class. A figure of \$750 was used for units with less than \$1,000 income; \$100,000 for units with income of \$50,000 or more and head aged

65 years or more; and \$72,000 for other units with income of \$50,000 or more.

The estimates of taxable income and of tax liability served as the basis for estimating the allowance tax under Plans A and B, the value of dependents' exemptions, and the surtax on personal income-tax liability. The allowance tax under Plan C and Plan D was estimated on the basis of total money income. Distributive series on consumption expenditures and on dividend income needed for the estimates of surtax on corporate income-tax liability were developed from the Survey of Consumer Expenditures, 1960–61, conducted by the Department of Agriculture and the Department of Labor, and from the 1966 *Statistics of Income*.

Total money income reported in the Current Population Survey aggregates to less than the comparable total in the National Income and Product Accounts of the Department of Commerce—about \$520 billion on the method used here, compared with about \$565 billion for the national accounts. This is the usual result in comparing income aggregates based on cross-section data with other aggregates, and it is usually assumed that the "missing" income is concentrated in the upper-income brackets. Because of the understatement of income and because total money income does not include capital gains—an important source for upper-income units—the estimates of taxable income and of tax liability for upper-income families may be too low. On the other hand, the estimates of tax liability totaled \$64 billion, compared with \$63 billion in income tax after credits shown by the preliminary 1967 *Statistics of Income*. Hence the suggestion is that the estimates of tax liability for units in the lower-and-middle-income range may be too high.