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Negative Income Tax in Australia

IAN BRAYBROOK

Over the past five years in particular, Australian social workers have increasingly been made aware of the numerous facets of the problem of poverty. This awareness has sprung not only from Australian studies, such as that made by the Institute of Applied Economic and Social Research,¹ but also from overseas professional journals, specific texts and the mass media.

Although a successful attack on poverty must include the labours of a multiplicity of disciplines and professions, one aspect of 'poverty literature' is of special concern to social workers and others engaged in the field of social welfare. This is the suggestion that a possible solution to financial poverty² lies in the adoption of a *guaranteed annual income*. In particular, two methods which could be utilized to implement a guaranteed annual income are forwarded: negative income tax and children's allowances. It is suggested by the proponents of both schemes that if an annual income of a sufficient magnitude is guaranteed to all, then financial poverty will be eliminated.

There are, however, a number of dangers in Australia's embracing the details of such schemes and proposing them as the salvation of the poor of this country. The purpose of this paper is to suggest some of these dangers after briefly outlining one type of negative income tax programme so that firstly, its basics may be illustrated, and secondly, that it may provide an example for critical discussion particularly with respect to Australia. The outline presented is generalized and focused on only a small part of the complex totality of the literature. As with most generalized approaches, one must not lose sight of the **fact** that a proper understanding of the topic can only be gained by attention to the details of individual schemes.

WHAT IS NEGATIVE TAXATION AND A NEGATIVE TAX RATE?

Apart from the difficulty in coping with the unfamiliar and sometimes indigestible language of the socio-economists, it would seem that many social welfare personnel tend to refrain from critical examination of these types of welfare proposals because of uncertainty about their

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own technical expertise. Yet some of these concepts are not difficult. This is particularly true of some relating to the taxation aspects of the proposals and, thus, a good starting point is to review a little of what is already familiar about taxation.

We know that if we receive a certain amount of income we pay taxes to the Government.' These are usually paid annually and are determined according to a rate or scale which is related to the size of one's income. As well, the rate follows a progressive pattern. That is, the more income one receives the greater is the rate of tax levied. The rate need not be progressive: if each individual paid 20% of his income, regardless of the size of the income, the rate would be proportional. If the rate of tax paid decreased with increases in income, the rate would be regressive. The progressive tax rates usually applied in income tax schemes reflect attempts to achieve equity, which has two aspects. Firstly, persons in similar economic circumstances should be treated similarly, and secondly, inequalities in the distribution of income should be reduced. Therefore, income tax programmes have important social aspects as well as 'fund-raising' functions.

When a person's income is so small that he can be said to be in poverty, it is conceivable that a grant of money may be made to him by the Government which would bring his income above a certain line—a 'poverty-line'. In addition to this, a person whose income was slightly greater than the poverty-line level would find that a certain amount of his work earnings were subject to a special tax which operated to reduce the subsidy paid to him. If taxes paid to the Government are labelled *positive* taxes, then subsidies received from the Government because one has insufficient income, could be regarded as *negative* or *reverse* taxes. Just as the amount of tax paid to the Government is determined by a level of income and a rate structure, so can the amount of negative tax (subsidy) be determined in the same way. To distinguish this latter rate from the one determining positive taxes, it is helpful to call the latter rate a *negative tax rate*. Simply, negative tax rates are those rates which aid in the determination of the amount of subsidy paid to those with a specified low level of income.

BASIC ASSUMPTIONS OF NEGATIVE INCOME TAX SCHEMES

1. For most people in Western society, income is necessary in order to obtain the physical necessities of life: food, shelter and clothing.
2. Those who are not able to provide themselves and their dependents with adequate supplies of these necessities because they have insufficient income are poor.
3. Transfers of \$x to such people will lift them out of poverty.

TYPES OF NEGATIVE INCOME TAX RATE SCHEMES

There are numerous negative tax rate schemes in the literature and because of divergences in philosophical approach and administrative detail, it is perhaps unwise to generalize. However, for conceptual clarity two broad types of approach may be distinguished.

1. *Rebate of unused tax deductions.* It is noted that the poor cannot make maximum use of the various deductions available in calculating taxable income. For example, few low-income families can utilize the \$1,200 deduction for superannuation and life assurance in Australia. This example could be considered as somewhat of a red-herring, for the purpose of the deduction is not primarily to recognize current costs of living, but rather, to encourage and reward a certain type of saving. However, the opportunity of saving if one is poor is low, whilst the need to spend the last dollar on necessities is high. On the tax deduction aspect, even if a poor person has some amount of these type of savings, his disadvantage is aggravated by the fact that under a progressive tax rate the person with the higher taxable income derives greater benefit from a deduction than a person with a lower taxable income. The working poor gain less from their deductions than do the 'working rich': the non-working poor who have no income, or whose income consists only of social security payments, cannot make any deductions.

This type of negative tax programme proposes that some percentage of the unused amount of deductions are paid to the poor, according to their income during a specified period and the number of dependents in the family unit. Details of administration and operation differ amongst the various plans and are not pursued here.⁴

2. *Subsidy linked to a poverty-line.* Under these types of schemes, negative taxes are paid to a family whose income is below a certain level—the 'breakeven level'—for above it the family pay taxes and are thus in what has been described as the positive sector of taxation; below the level, they are in the negative sector and receive a subsidy. Any work earnings are subject to the operation of a negative tax rate which reduces the amount of subsidy paid.

The first type of programme has interesting features which could be adapted to the Australian situation; however, the discussion below will be directed at the second type because of its relevance to existing social security programmes in Australia.

COMPONENTS OF NEGATIVE TAX SCHEMES

Having established what the negative tax schemes partly aim at and how one type of scheme broadly approaches its aim, the operation of the scheme needs to be outlined. This is most easily accomplished by reducing it to three necessary components.

Firstly, a poverty-line is drawn at a level determined by all or some of the following variables—age, sex and work status of individuals; the number of adults and children in the family group. As well, because a poverty-line is made at a point in time, allowance should also be made for the effects of increases in the costs of living. This is important because the notion of a poverty-line is one of adequacy of income to meet the costs of specified basic living requirements, the prices of which do not remain stationary. It is still not uncommon to hear that the poverty-line in Melbourne in 1970 is \$33 per week! Another way of viewing the amount of income up to the poverty-line is to call it a guaranteed income level, that is, an income level below which the Government will guarantee, by means of a subsidy, that no family will fall.⁵ Thus, the level at which the line is set is also affected by an estimation of what the economy can afford. This is illustrated by the fact that the amount of money available for government expenditure can be likened to a pie which is to be shared amongst a number of people. In Australia, these 'eaters' are usually titled Defence, Works, Payments to the States, National Welfare Fund, etc. Each section attempts to gain a greater share of the pie for itself and can forward excellent reasons as to why its share should be increased. If a poverty-line is drawn at the unrealistically high level of \$10,000 per annum and the Government will ensure that no family's income will fall below this level, Welfare's share of Expenditure will need to be substantially increased.

The second component of a negative tax scheme is what has already been mentioned as **the** 'breakeven level of income'. Usually this is higher than the amount set as the poverty-line because a subsidized person is able to keep a certain percentage of his work earnings. For example, in President Nixon's proposed welfare reform announced in August, 1969, a family of four is guaranteed an annual income of \$1,600,⁶ that is, the poverty-line is \$1,600 for a family of four.⁷ However, a progressively decreasing subsidy will be paid to that family, according to the amount of work income, **up** to the breakeven-line of \$3,920. Once a family's income is equal to the breakeven-line no subsidy is paid and the family move into the sphere of positive taxation—they pay taxes.

The relationship between the earned income of a family and the

amount of the subsidy paid is determined by the third component, the tax rate. It has been noted that with the type of scheme under consideration, the subsidy is paid to those whose income is below a breakeven level. The operation of the tax rate which aids in the determination of the size of the subsidy when a subsidized family is earning income, is as follows. In the positive sphere of taxation, a tax rate of 68 cents in the dollar means that 68 cents of each dollar earned is paid to the Government—leaving the person with 32 cents. Reversing the situation, a negative tax rate of 68 cents in the dollar (68%) means that for each dollar earned the person receives a subsidy of 32 cents. In effect, he 'loses' 68 cents of each dollar earned. Similarly, a negative tax rate of 10% would mean a subsidy of 90 cents for each dollar earned.

THE MECHANICS OF THE NIXON WELFARE PROPOSALS, 1969

To illustrate the interdependence of the tax rate, poverty-line and breakeven level, the following outline is given of the central mechanics of the Nixon welfare proposals.⁸

A family of four is guaranteed a 'basic federal minimum' of \$1,600 per annum, provided certain **work** requirements are met. Such a family would at present be on welfare and have no outside income. The recipients of the subsidy will be encouraged to gain earnings from work. 'Everyone who accepts benefits must also accept work or training, provided suitable jobs are available either locally or at some distance **if** transportation is provided.'⁹ As well, the first \$720 of yearly earnings would be disregarded in the calculation of the amount of subsidy paid. This is both a minor incentive to work and a recognition of the costs of work. However, the earnings after \$720 incur a penalty, in that the maximum benefit paid (\$1,600 for a family of four) is reduced by the application of a negative tax rate of 50%. This simply means that for each dollar earned over \$720, the amount of subsidy paid is reduced by 50 cents. (The usual reduction in American public assistance programmes has been a dollar for every dollar earned, a 100% negative tax rate.) The following table indicates the amount of subsidy paid for varying amounts of earned income.

Thus, a family which earns \$2,000 per annum is eligible for a subsidy of \$960, making their total yearly income \$2,960. A family which has income lower than \$720 receives the full subsidy of \$1,600. However, when a family income is \$3,920, the breakeven level is reached and subsidization ceases.

Because of the \$720 exemption, the operation of the 50% negative

TABLE 1

RELATION BETWEEN EARNINGS AND SUBSIDY
UNDER THE NIXON PROPOSAL

(Guarantee = \$1,600 for a family of four)

<i>Earned Income</i>	<i>Subsidy Paid</i>	<i>Income after Subsidy</i>
\$	\$	\$
0	1,600	1,600
10	1,600	1,610
720	1,600	2,320
1,000	1,460	2,460
2,000	960	2,960
2,720	600	3,320
3,000	460	3,460
3,919	0.50	3,919.50
3,920	0	3,920

tax rate is not easily deduced from the table, but it can be understood quite simply. When earned income is, say, \$2,720, i.e. \$2,000 when the \$720 exemption is 'overlooked', 50% of this amount is deducted from the maximum amount of subsidy able to be paid. Thus \$1,000 (50% of \$2,000) deducted from \$1,600 leaves a subsidy of \$600. This method can be used to calculate the subsidy paid for any amount of earned income. In each case the parameters for the tax rate, guaranteed income and breakeven level are 50%, \$1,600 and \$3,920 respectively. (Given the same level of guaranteed income and a tax rate of 10% under this scheme, the breakeven level would be \$16,720.)

The choice of a negative tax rate of 50% and not, say, 10% or 80%, is largely a reflection of the uncertainties of knowledge on the possible effects of the amount of subsidy on incentives to work. Will a man work more or less often if he is given \$x by the Government? This is crudely phrased but is part of the reality of the decision which must be made in determining the negative tax rate structure.¹⁰ Unfortunately, there is negligible empirical evidence relating to the effects of subsidies on incentives to work. Rather, the role of value judgements is dominant and it would seem that the 50% rate is chosen as an acceptable compromise between the pressures for an adequate, yet efficient, scheme. The higher the tax rate the higher is the breakeven level. This situation can, depending on the level set as the poverty-line, provide many non-poor with subsidies—an inefficient means of overcoming poverty. Alternatively, a low tax rate combined with a low breakeven level does not forward adequate funds to the poor,

THE APPLICABILITY OF NEGATIVE TAX SCHEMES
IN AUSTRALIA

It is possible that supporters of this 'new' type of welfare scheme will overlook the fact that such a scheme has been operating in Australia for over 60 years. At the Commonwealth level, the 1908 Invalid and Old-Age Pensions Act established a selective type of negative tax rate scheme. That is, a minimum annual income level was set and any earnings from work were subject to the operation of a negative tax rate of 100%. As well, a certain amount of work earnings were discounted for pension purposes. Although the poverty- and break-even-lines of the pension schemes have been updated over the years, the negative tax rate structure remained stationary until October 1969 with the introduction of the 'tapered means test'. This revision also applies to widows' pensions.

Before 1969 the following type of tax rate structure applied to pensions: up to a certain amount of earnings (\$10 per week for a single pensioner) the pension rate was not affected. However, earnings over this amount subjected the pension to a reduction of one dollar for every dollar earned. That is, the extra dollar earned subjected the pension to a 100% negative tax rate—a 'knock-out means test'.^{1,2} The same type of negative tax rate structure applies to present unemployment and sickness benefits. Table 2 indicates this. Note: (a) the first \$312 of yearly earnings of an adult on such a benefit is disregarded, (b) beyond this figure the guaranteed income is subject to a negative tax rate of 100%, (c) the guaranteed income is \$520 per annum for an adult and the breakeven level \$832.

With respect to pensions, it has been noted that a change occurred with the introduction of the tapered means test, when the 100%

TABLE 2
RELATION BETWEEN INCOME AND ADULT RATE OF
UNEMPLOYMENT & SICKNESS BENEFIT

<i>Earned Income</i>	<i>Net Percentage of Subsidy Paid</i>	<i>Subsidy Paid</i>	<i>Income After Subsidy</i>
\$		\$	\$
0	100	520	520
200	100	520	720
312	100	520	832
400	83.1	432	832
600	44.5	232	832
800	6.2	32	832
832	0	0	832
1,000	0	0	1,000

negative tax rate was replaced with a 50% rate—'the most significant and far-reaching reform of the means test which has been undertaken since pensions were introduced'.¹³ The guaranteed income level and the breakeven level vary with a combination of the following factors: marital status of the pensioner, the number of dependents on the pensioner, and whether or not supplementary assistance (rent allowance) is paid. For example, a single aged pensioner receiving supplementary assistance is guaranteed a minimum income of \$884 per annum, whilst a 'Class A' widow who receives supplementary assistance and has 10 children, one of whom is under 6 years, receives a guaranteed income of **\$2,964** per annum.

Thus, in Australia, there are negative tax rate schemes in operation and it is noted that they are specific in terms of their linkages to some of the categories inherent in the social security system. Undoubtedly, the introduction of the tapered means test was significant on a number of fronts, A brief glance at the Parliamentary debates of August-October, 1969, will reveal the dissatisfaction felt on both sides of the House with the 100% negative tax rate,

Whether or not the monetary levels attached to the poverty- and breakeven-lines are of sufficient magnitude to lift the recipients of the subsidy out of financial poverty is not a question which can be considered here. However, it should be realized that the ceiling of these lines is, in effect, increased by the various fringe benefits accompanying a significant number of pension payments.

One American argument for the use of negative tax rates of less than 100% lies in the meeting the needs of the working poor, that is, the negative taxes are paid to supplement work earnings. It can be seen that the present Australian practice is reversed: a certain amount of work earnings are permitted to supplement the social security payments of the 'non-working' population.

SOME PECULIARITIES OF OVERSEAS SYSTEMS

At the beginning of the paper it was suggested that there are a number of dangers in haphazardly embracing overseas propositions on negative tax schemes. These dangers are a function of the peculiarities within each country, and must be acknowledged when comparing each country's approach to the scheme.

The first area relates to the means tests which are a part of the income maintenance programmes of many countries. Such a subject is a separate paper in itself; however, the general point to be stressed in this context is that many of the American public assistance means tests are more ruthless, more degrading and more searching than any of the

means tests currently applied in Australia's social security and social welfare schemes. An American commentator has noted that 'the use of the highly impersonal income tax mechanism would certainly eliminate the degradation involved in the current public assistance means tests with its presumption of ineligibility and its detailed investigation'.¹⁴ As well, the (American) means test, according to another writer,¹⁵ has the negative effects of discouraging the accumulation of wealth, the earning of income, and family formation, President Nixon joined this attack and extended it to the system generally in his Message to the Nation in August, 1969: 'The present welfare system . . . breaks up homes . . . often penalizes work [and] it robs the recipient of dignity'.¹⁶

Thus, a significant factor in the movement for negative tax schemes in the United States is to eliminate the objectionable features of the means tests and replace them with one which is largely impersonal, and which is based on objective factors such as wealth and income.¹⁷ This could be achieved by placing the administration of the schemes within the machinery of the normal tax system. However, the Australian experience of the negative tax schemes and the means tests accompanying them are not those which the American writers wish to avoid. On the contrary, our Commonwealth schemes are administered by a non-taxing agency and the means tests employed are impersonal and objectively based on income and wealth.

Any suggestion that the means tests in Australia discourages the accumulation of wealth and the earning of income is weakened, when it is noted that, for example, a single age pensioner can have income of \$40 per week or property totalling \$21,200 before his eligibility for a pension ceases.

A second feature to note in the American public assistance schemes is that, unlike Australia, there is little or no co-ordination amongst the various schemes throughout the country. This reflects the fact that schemes are predominantly controlled by State and local government with little Federal supervision. Thus a feature of the 1969 Nixon welfare proposal was to 'start on the sharing of the Federal tax revenues with the States',¹⁸ and thus both directly and indirectly to increase Federal supervision of public assistance. A value of negative tax schemes with centrally-supervised poverty- and breakeven-lines would be that the inequalities in the American schemes would be lessened. This objective compares favourably with the Australian situation where negative tax schemes have been centrally controlled for just over 60 years.¹⁹ A keynote of our social security payments is relative uniformity throughout the States as compared with the lack of uniformity in the American situation.

Another distinguishing aspect between America and Australia is the decisive effect of the size of the race problem on the public assistance programmes in America. In 1966 one-third of America's poor were non-white.²⁰ The focus on this group is made finer by the growing unrest of many Americans with the types of disadvantage faced by the non-white population. Australia, however, is not racked with race division and its concomitants. Rather, the predominant groups in poverty here are, as in America but excluding the non-white, the aged, the family with a female head, and the large families.

In Britain at the beginning of this year, the Institute of Economic Affairs published *Policy for Poverty—A Study of the Urgency of Reform in Social Benefits and of the Advantages and Limitations of a Reverse Income Tax in Replacement of the Existing Structure of State Benefits*.²¹ The 'urgency' in the sub-title refers to the failure of the 'welfare state' to effect its purpose of removing poverty. 'A reverse income tax is designed to replace current British social benefits as more humane, less wasteful, and less harmful.'²² The particular type of negative tax form presented—the Minimum Income Guarantee—has a negative tax rate of 100% on all work earnings. We know enough of the history and administration of the British social security schemes to beware of transposing, in toto, the British arguments for a negative tax scheme.

There are other differences between the countries which are of relevance to this topic; however, those indicated above are sufficient to point to the dangers inherent in closely correlating the situations between the countries when negative tax schemes are being discussed.

CONCLUSION

Financial poverty exists to some degree in every Western country and the difficulty of devising programmes to overcome it will remain for many years. This paper has indicated that two methods of attacking poverty—negative income tax and children's allowances—are presently being debated overseas. Both of these methods are currently operating in Australia, and indeed, have been for over 60 and 30 years respectively. Whether or not these types of schemes satisfactorily attack the problem of poverty, here or overseas, needs to be discussed further. Whatever the outcome of overseas discussion, it is stressed that programmes in this country are the product of our own philosophies and peculiar situations, none of which are exactly applicable to any other country.

REFERENCES

1. Harper, R. J. A., 'Survey of Living Conditions in Melbourne—1966', *Economic Record*, 1967, 43 (102).

2. In this context, financial poverty is 'not enough income to meet the necessities of life'. As a social worker I would argue that financial poverty is not to be equated with 'poverty'. The present usage, however, is operationally precise when discussing schemes such as negative tax.
3. As only income tax is to be considered, taxes such as commodity taxes are excluded.
4. For example, see Nicol, Helen O., 'Guaranteed Income Maintenance', *Welfare in Review*, 1966, 4 (4), p. 3.
5. For those who suspect government enforcement and the weakening of client self-determination as exemplified by the use of the words 'will fall, it is possible to substitute 'should fall'.
6. President Nixon, however, is at pains to point out that his scheme is not a guaranteed income type because the subsidy is linked to certain work tests. In this paper, I argue that a guaranteed income and a work test are not necessarily incompatible. See *Weekly Compilations of Presidential Documents*, August 11, 1969, 5 (33), p. 1107.
7. It is necessary to understand that the term 'poverty-line' will be used loosely in the remainder of the paper. It will generally be seen to refer to the annual upper level of certain social security benefits. However, this level may or may not be that level at which people are able to adequately provide themselves with the necessities of life. In terms of the level of American poverty-lines, an income of \$1,600 for a family of four does not represent an adequate amount.
8. *Weekly Compilations*, op. cit.
Time, August 15, 1969, pp. 10-12.
Newsweek, August 18, 1969, pp. 11-13.
9. *Weekly Compilations*, op. cit., p. 1106.
10. Instead of referring to a tax-rate, our purpose may be best achieved by utilising a number of tax rates within the one plan. See Green, Christopher, *Negative Taxes and the Poverty Problem*, Washington DC: Brookings Institution, 1967, 126-130.
11. In August 1968, an income maintenance experiment was begun in New Jersey, U.S.A. See Watts, H. W., 'Graduated Work Incentives: An Experiment in Negative Taxation', *American Economic Review*, 1969, LIX (2). One aim was to study the effect of subsidies on the work habits of certain families. A preliminary analysis is scheduled to be completed by June 1970.
12. Commonwealth Parliamentary Debates, House of Representatives, 9.9.69, p. 941—Minister for Social Services.
13. *Ibid.*, p. 944.
14. Garfinkel, Irwin, 'Negative Income Tax and Children's Allowance Programmes: A Comparison', *Social Work*, 1968, 13 (4), p. 39.
15. Briar, Scott, 'Why Children's Allowances?', *Social Work*, 1969, 14 (1), p. 8.
16. *Weekly Compilations*, op. cit., p. 1105.
17. Let it be noted that the assailants of the American-type means tests and their controls include the leaders of thought in social security. For example, Eveline Burns: "Our public assistance programme I say frankly is a disgrace and in many ways it tramples on constitutional rights, as when we have midnight searches and indulge in certain other kinds of strictly unconstitutional activities."—in a paper delivered to the Canadian Conference on Social Welfare, Ottawa, 1968.
18. *Weekly Compilations*, op. cit., p. 1109.
19. Prior to Federal schemes, some individual States had their own negative tax rate schemes. These formed the bases of the fact and value judgements of the Federal schemes.
20. Orshansky, Mollie, 'The Shape of Poverty in 1966', *Social Security Bulletin*, 1968, 31 (3), p. 10.
21. Institute of Economic Affairs, *Policy for Poverty*, Research Monographs No. 20, 1970.
22. *Ibid.*, p. 6.