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Reducing Inequality and Poverty in America
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CAMBRIDGE – With a new American president and Congress taking office just six months from now, the time has come to rethink the government's programs aimed at helping the poor. The current election season has reflected widespread concern about the issue of inequality. Reducing poverty, rather than penalizing earned success, is the right focus for dealing with it.

The United States government now spends more than $600 billion a year on programs to help the poor. That's about 4% of America's total GDP. Half of those outlays are for health programs, including Medicaid and the health-insurance subsidies under the 2010 Affordable Care Act (so-called Obamacare). The other half are for a complex range of programs including food stamps, housing subsidies, the Earned Income Tax Credit, and cash relief.

To put that 4% of GDP in perspective, the federal government's total revenue from the personal income tax is less than 9% of GDP, implying that nearly half is spent on these means-tested programs. Spending on these programs also exceeds that for defense (3.3% of GDP) and the 3.3% of GDP spent on all other nondefense discretionary programs.

But, despite this large expenditure, the proportion of the population living in poverty is officially estimated at 15%, about the same as it was 50 years ago. Experts agree, however, that the government's poverty measure doesn't correctly reflect the progress that has occurred, because official statistics focus only on cash income and ignore almost all of the government's transfer payments.

Many of those who are poor, or would otherwise be poor, are also aided by Social Security benefits for retirees and survivors, and by Medicare for the disabled and those over age 65. Because eligibility for benefits under these programs does not depend on income or wealth, the amounts spent for these programs are not included in outlays targeted at the poor.

The existing approach to helping the poor needs reform. Myriad overlapping programs with different eligibility rules are difficult for the poor to navigate, create bad work incentives, and are unnecessarily costly to taxpayers.

The largest of the ten major means-tested programs is the food subsidy program, now called SNAP (Supplemental Nutrition Assistance Program). Some 46 million people, about one-seventh of the US population, receive monthly benefits totaling $75 billion per year. Despite its widespread use, the government estimates that only about 70% of those who are eligible receive benefits.

Eligibility to receive SNAP benefits is limited to households with incomes below 130% of the poverty level, about $1,700 a month for a family of three. Because a decision by a second adult to work could eliminate eligibility, the program discourages employment and reduces earned incomes.

Although SNAP is described as a nutrition program, the average benefit of $130 per month is far less than these low-income households spend on food. The program is thus really equivalent to a cash transfer. As such, it dominates the program launched by President Bill Clinton to provide cash assistance with significant restrictions.

When Clinton declared in 1996 that he would "end welfare as we know it," he worked with Congress to create the Temporary Assistance for Needy Families (TANF) program, which requires recipients to work and limits their lifetime eligibility to 60 months. As a result of these conditions, the $17 billion program has declined in scale and has a participation rate of less than 50% percent of eligible households.

How should programs for the poor be changed to increase participation and avoid adverse effects on work incentives? One bad idea that is getting a surprising amount of favorable attention is the so-called Universal Income Benefit: providing enough money to all households (below the age of 65) to keep them above the poverty line, even if they had no other income. The amount given to each household would depend on the number of adults and children, but not on the household's income or wealth.

This unconditional transfer would solve the problem of lifting all Americans out of poverty. But it would be impossibly expensive. Even if it replaced all of the means-tested programs for the poor other than the health programs, its net cost would

exceed $1.5 trillion a year, or more than 9% of GDP. To pay for that without raising the deficit would require doubling the personal income tax. So the Universal Income Benefit is definitely a non-starter.

The best way to help the poor is the negative income tax plan originally proposed by both Milton Friedman (the conservative economist at the University of Chicago) and James Tobin (the liberal economist at Yale University). All households below the age of 65 would receive an amount of money that would keep them out of poverty if they had no other income; but the amount of the transfer would decline gradually as their household income rose. Above a certain threshold, the household would pay an income tax as they do today; below that level, the "tax" would be negative.

he rate at which the transfer declines would be set to limit adverse incentives while protecting the household's living standard. The health-care programs for the poor would continue.

While there is no perfect solution to the difficult problem of dealing with poverty, some solutions are better – often much better – than others. The negative income tax may be the best way possible to achieve simplicity, inclusiveness, and moderate taxpayer cost.

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