The original documents are located in Box 13, folder "Welfare Reform - Caspar Weinberger Proposal (1)" of the Richard B. Cheney Files at the Gerald R. Ford Presidential Library.

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

MEMORANDUM FOR THE PRESIDENT

DEC 20 1974

SUBJECT: Welfare Replacement Proposal

This memorandum is a follow-up to my decision memorandum on welfare reform alternatives of December 18. Its purpose is to transmit to you final materials bearing on this subject.

These materials are contained in the attached book. A brief description of its contents appears just inside its cover. Tab A is a concise, but essentially complete, overview of the ISP and its tax relief aspect. Other tabs contain my previous memoranda to you on that subject, more detailed information on various aspects of the ISP, and a summary and analysis of Mrs. Griffiths' recently introduced proposal which is founded on similar objectives and concepts, but different in design.

The materials relating to the ISP were reviewed in an earlier draft by the Cabinet members whose responsibilities would be affected by the proposal and reflect their comments and concerns.

Based on what they have written me, my conversations with them, and their comments at the November 13 and December 4 briefings, I think it fair to say that Secretaries Simon, Brennan and Butz are supporters of this welfare replacement proposal as a domestic initiative for this coming year's agenda. While Secretary Lynn has long believed in the essential approach that underlies the proposal, he has expressed reservations about the wisdom of proposing it at this time. As you know, I strongly hold that the time for action is now.

I have transmitted the attached materials to these other domestic Cabinet officials and suggested that any further communication they wish to make regarding the proposal be forwarded immediately and directly to you.

You should also be aware that there is reluctance in some quarters of Treasury, especially in the Internal Revenue Service, to take on the administration of the proposal's cash assistance program. Despite that resistance, I continue to believe that some form of Treasury administration, preferably by the IRS, is central to the program's future integrity. Bill Simon has stated that in fairness to his people, expecially Commissioner Alexander, you should make the decision. Should you decide to proceed with the welfare replacement proposal, you are requested to indicate your choice of the appropriate administering agency at Tab A (Tab A-1 provides additional background information relevent to this choice).

In the event you decide to embrace this welfare replacement proposal, let me suggest that we introduce the cash assistance component in the State of the Union in the context of a discussion of the Federal government's overall income security system, along with the relevant announcements on National Health Insurance, reforms in Social Security, and the proposal's tax relief component. I believe it vital to shift the attention in Congress, the press, and the nation away from "welfare reform" as such and towards what has become, in fact, the dominant function of the Federal government -- providing for the income security needs of the nation. The issues that require emphasis now are how to make that system more simple and equitable and how best to bring it under greater fiscal and policy control.

As you know, an examination of these broader considerations together with an analysis of how the income security system relates to the functioning of the economy have led me to the conclusion that we have no good alternative but to attack the core problem, the welfare mess, in a direct and uncompromising fashion.

I also wish to call your attention to the tax relief aspect of the proposal. Bill Simon and I agree that a minimum amount of tax relief of about $4 billion, concentrated on low and middle income taxpayers, must accompany the ISP if it is to be done properly. However, this component of the proposal is flexible both with respect to timing and amount. You may wish to focus on this as you consider possible related economic initiatives.

I am pleased to be able to transmit the results of this major interagency undertaking to you. The other Secretaries and their staff deserve praise for the extent and quality of their contribution to this effort.

/s/ Cap Weinberger

Secretary

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Tab B-3: December 18 Memorandum to the President on an Alternative Course to Welfare Replacement

In this memorandum, a companion piece to the memorandum in Tab B-2, Secretary Weinberger selects from the broad range of options those alternatives to welfare replacement which merit further consideration, assessing possible costs and impacts.

Tab C: Federal Benefit Level and Federal-State Relations

This paper describes the reasons behind the Federal benefit levels chosen for ISP and what, given this program, the relationships of the Federal and state governments would be in the area of income maintenance. The paper outlines the suggested inclusion in ISP of optional Federal administration of state supplements under strict conditions comparable to the provision in the Federal Tax Code for optional Federal administration of state income taxes with conforming definitions. The paper also discusses Federal participation in a residual state administered emergency needs program that would accompany state social services and would address certain problems that the ISP cannot address without fatally compromising its program goals.

Tab D: Background on Tax Relief Associated with ISP

This paper outlines the technical dimensions of the tax relief components of this proposal.

Tab E: Details of Benefit Structure and Recipient Population

This paper describes more fully the benefits which various household units under different conditions can be expected to receive under the ISP. These results are contrasted to comparable cases under the existing programs.

Tab F: Background on ISP Cost Estimates

This paper explains the three elements which go into the calculation of program cost: (1) gross costs as calculated by a computerized model; (2) the cost of present programs in FY 79, since these must be subtracted from gross costs to arrive at net costs; and (3) adjustments to gross cost which reflect factors that cannot be taken into account by the computerized costing model.

Tab G: Administrative Personnel Comparisons

This paper projects manpower needed to administer present welfare programs with and without some probable additions to the current welfare system and compares those figures to the estimates developed by the IRS Task Force on the manpower needed to administer ISP with and without Federal administration of state supplements.

Tab H: Comparison to Plan of Subcommittee on Fiscal Policy

This paper outlines briefly Mrs. Griffiths' recently submitted welfare reform proposal and compares it with the Income Supplement Program.

Tab I: Labor Supply Effects and Program Costs

Using data from the Income Maintenance Experiments and other sources, the paper discusses the likely effects of ISP on the work behavior of the lower income population and estimates the total impact of this effect on program costs.

Tab J: Income Supplement Program Work Test

This paper discusses: the issues which are involved in the design of a work test; the extent to which the various options simultaneously fulfill ISP and work test goals; and the principal elements of a recommended form of work test. It is recommended that the ISP legislation mandate the states to operate, for specified categories of recipients, a work registration-type work test modeled on that used in the state Unemployment Insurance systems.

Tab K: Administrative Structure of ISP

This paper outlines the key program elements of the ISP, its administrative structure, and its reporting and data processing system.

Tab L: November 6, 1973 Memorandum for the President

Included is a copy of the Secretary's earlier memorandum to President Nixon on the basis of which the development of the Friedman concept (or negative income tax) as presented here was directed.

TAB A

OVERVIEW OF THE PROPOSAL AND PRESIDENTIAL DECISIONS

INTRODUCTION

The welfare replacement proposal presented here would rationalize, simplify, and make more equitable the Federal tax and transfer systems:

- o The major categorical, means-tested (welfare) programs would be superseded and eliminated by a simple cash transfer program -- the Income Supplement Program (ISP) -- that would be partially integrated with the tax system.

- o Other, more minor, programs targeted on the low-income population could either be reduced or folded into appropriate special revenue sharing packages.

- o The requisite changes in the tax system, necessary to allow an integration of the ISP, would simplify and make more equitable the tax system and afford reasonable tax relief to low and moderate income taxpayers.

- o The opportunities for restructuring the social insurance programs (Social Security, Unemployment Insurance) would be greatly enhanced.

- o The detrimental consequences of economic disruptions entailing high rates of inflation and/or unemployment on the group least able to bear them -- the lower income population -- would be ameliorated.

This tab describes the income supplement program and its relation to other Federal programs and state activities. The structure of the proposal is nearly complete; however, the question of the ISP administering agency requires your consideration. Your decision on this issue is requested at the end of this tab.

THE BASIC STRUCTURE

The proposal would integrate as fully as possible the present tax system and the new income-tested transfer system. Thus, the general characteristics of the resulting program structure are:

- o All citizens will be a member of a family unit which has either a potential tax liability or potential eligibility for a cash income supplement, depending upon the composition of the unit and its income.

- o Each unit will have a breakeven level of income established by the sum of the personal tax exemptions allowed its members and its standard deduction.

- o Those family units with income below this breakeven level are eligible to receive a cash income supplement equal to one-half of the difference between their actual income level and their breakeven income level. Such a schedule provides for a gradual phasing down of the cash supplement as income increases so that families are no longer eligible for a supplement when they reach the breakeven level, a point at which tax liabilities would generally begin. The extent to which they have a tax liability at income levels above the breakeven is determined by how much of their income is in the tax base. This structure has the virtues of:

  -- providing a greater income supplementation to those with greater need;

  -- providing strong work incentives, and

  -- generally resulting in no one being simultaneously eligible to receive an income supplement and having an income tax liability.

- o There would be an assets test to preclude eligibility for those tax units with incomes below the breakeven level, but who have otherwise adequate resources.

The income tax system would remain largely unchanged in its operation, save that the sum of the personal exemptions and the standard deduction would be increased to achieve the breakeven levels of the Income Supplement Program.

The systematic linkage of the tax and transfer systems, both initially and over time, is an important element of the proposal. If the ISP were in place at a future time when the Congress wanted to increase transfer benefits to the low-income population, they would coincidently have to raise the levels of the minimum standard deduction and/or personal exemptions in the tax system for at least those taxpayers close to the breakeven. Because of the simultaneous impact on tax revenue and expenditures, any action aimed at increasing benefits by an amount greater than that necessary to adjust for inflation could not therefore be lightly, or quietly, taken. A considerable measure of fiscal control is thereby gained through this linkage, for public attention would focus on one program and one Congressional committee rather than be diffused among many programs and committees as at present.

Benefit Levels

Though most persons eligible to receive cash transfers under this program have some income of their own, whether from present earnings or from a program such as Social Security which is based on past earnings, some recipients will not. The amount of benefits which people without other income are eligible for under the existing welfare programs which we would eliminate has been a major determinant of the benefit levels for the ISP. People therefore tend to characterize proposals like the ISP by the amount they would provide to the four-person family or household which has no income of its own. This amount is termed the basic benefit.

The proposal has been developed on the basis of what I recommend as the minimum benefit structure necessary to totally replace the Federal role in present, principally state-administered, welfare programs. (A detailed discussion of the full benefit schedule for different sizes and types of tax units appears in Tab E. That tab also includes information on the ISP eligible population and compares the benefits under the present welfare programs to those under the ISP.) The operation of the benefit reduction rate of 50 percent on the proposed basic benefit levels would produce the following typical benefit payments:

- $3600 a year to the female headed family with three children and no other income. Some states might wish to provide additional supplements to families in these circumstances. The Federal government would be largely neutral, however, as to whether they did or not.
- $2300 to the aged or totally disabled individual who is no longer in the labor market and has no other income.
- $1650 in ISP benefits and $4950 total income for the aged couple receiving a Social Security benefit typical

of a past low-to-moderate income earnings history. This result would not only redress certain inequities in the present programs, but would also blunt future pressures for the kind of highly expensive Social Security increases we have witnessed over the past few years.

- $1600 in benefits and $5600 total income for the four-person family whose head is working full-time at the minimum wage. This is sufficient to lift the family out of poverty since its total income would be over $5000. The breakeven level of income for this typical family would be $7200.

- Nothing to the unrelated individual who is working even as little as two-thirds time at the minimum wage. His breakeven level is $2400.

These levels are expressed in terms of December, 1974 dollars since they are derived primarily from the basic benefit levels now applicable to the categories of the population eligible under current welfare programs. The dollar amounts would be adjusted for inflation over subsequent years.

I realize the proposed schedule of benefits will appear high to some, but not to anyone who is familiar with the basic benefit levels and their results in the current welfare system. As indicated in Tab C, which provides greater background on this issue, we have very little flexibility if we are to cash out existing Federal programs. Some new money must be put into the system to eliminate the Federal financial participation in major welfare programs while disadvantaging only those recipients of current programs who have the highest incomes. Moreover, much of the increment in benefits results from the broader coverage in conjunction with the Food Stamp cash out under the ISP relative to the present system. Working-poor male-headed families, for example, will for the first time be uniformly covered by a Federal cash assistance program, as will similar unrelated individuals and childless couples.

The net benefit costs of the ISP are estimated to be only $3.4 billion per year and could not start any sooner than FY79, the earliest possible year of full implementation given the magnitude of the undertaking. The net cost estimates are, I should note, relative to projected outlays under present programs only. I repeat my conviction that, by the end of this decade, the ISP would actually prove to be less costly than the alternative of accepting the rapid growth of the current welfare system and the high probability of new appendages such as a work bonus or housing allowance.

Tax Relief

The other major aspect of this proposal which will have a fiscal impact is the amount of tax relief provided in conjunction with it. A certain minimum level of tax relief, estimated to be $4.1 billion (in current dollars) and restricted to lower and middle income taxpayers, is necessary to provide the partial integration of the tax and transfer systems that is integral to the proposal. Treasury and HEW have reached a tentative agreement on how this minimum tax relief would be structured. Briefly, the current tax exempt income levels would be raised so that the ISP breakeven income level and the tax exempt income level of the Federal income tax, would be the same. This would be accomplished by raising the minimum standard deduction (low income allowance) for all taxpayers. Personal exemptions would remain unchanged.

As regards tax relief, such a system would have the following implications. (A fuller discussion of the new structure of standard deductions and the amount and distribution of tax relief under this proposal is contained at Tab D.)

- No taxes would be paid on income below the ISP breakeven, since this level is determined by the sum of the minimum standard deduction and personal exemptions. Thus a family of four would have tax exempt income of $7200 rather than $4300 as at present ($750/person in personal exemptions and a $1,300 minimum standard deduction). If this family had $7,200 of income, their tax relief could be over $400. The greater the amount by which income is below the breakeven, the less the tax reduction.

- Above the breakeven level, the tax reduction for a family of four gradually tapers off from this maximum to zero at $13,333 of income.

Of course, considerable flexibility exists with regard to the timing and amount of tax relief to be given in conjunction with this proposal. If any fiscal stimulus is desired during the next three years, this $4.1 billion of tax relief, or some larger amount, could be partially or fully phased in prior to the implementation of ISP. It would be crucial, however, that this be done in a manner compatible with the ISP structure.

Administration

The ISP program would be administered in an efficient and professional manner with minimal intrusion into the lives of our lower income citizens. Concerns that the transfer program would be impossible or undesirably complex to administer led then Secretary of the Treasury George Shultz in January 1974 to direct Commissioner Alexander of the Internal Revenue Service to appoint a Task Force to inquire into the administrative aspects of a program virtually identical to the ISP as proposed here. After three months of intensive effort, the Task Force, on which I was represented, concluded that the program was administratively feasible, and, provided that the Task Force's recommendations were adhered to, that it could be administered with high standards of efficiency and effectiveness at reasonable costs.

Tab K provides a summary of the Task Force's recommendations on the administrative structure for the new program. That staff work of this detail has already been completed puts us in an unusually good position to begin legislative drafting and Congressional consultations.

The Task Force concluded that the ISP had no operational design feature that either required or precluded the choice of any particular agency to administer its operation. I strongly favor IRS administration. However, I recognize that the decision on an administering agency can have far-reaching effects. Consequently, substantial background on the agency alternatives is appended to this paper at Tab A-1. You are asked to make the choice of the administering agency for the ISP at the end of this tab.

Because the ISP is a cash transfer program, as opposed to the Food Stamp program which it replaces, and because it has been designed to be efficiently administered, it would result in considerable savings in administrative costs and possibly substantial manpower savings. It is estimated that ISP administrative costs as a fraction of gross transfers would be 4.5 percent. The comparable figures for SSI, AFDC, and Food Stamps are 9.1 percent, 9.5 percent, and 15 percent, respectively. In addition, public assistance personnel needs with no replacement of the welfare system are estimated to range upward from a minimum of 137,000 employees, depending on future programmatic developments. Under ISP, total personnel needs would range from 66,000 to 123,000, depending upon state decisions relating to their own supplementation programs. (For more details on this subject, see Tab G.)

RELATIONSHIP TO EXISTING PROGRAMS AND TO THE STATES

This proposal would considerably simplify the entire structure of Federal income security programs. The following programs are necessarily eliminated:

- Aid to Families with Dependent Children (AFDC) - This program, targeted primarily upon female-headed families, is generally thought of as the welfare program. It was a primary object of the past welfare reform initiative and is the target of our present management improvement effort.

- Supplementary Security Income Program (SSI) - This is the newly Federalized welfare program for the aged, blind and permanently and totally disabled.

- Food Stamps - This nationwide program covers virtually the entire low-income population and is expected to increase in size from about $2 billion in FY 73 to possibly $6 billion in FY 79.

Expenditures under another group of programs should be reduced since they are income tested and are targeted on groups which would have their income supplemented under this reform proposal. These are:

- Housing

- School Lunches

- Health Insurance

While the proposal presented here does not include alterations in the social insurance programs of our Federal income security system (primarily Social Security and Unemployment Insurance), its implementation is an essential prerequisite to future proposals to rationalize and restructure those programs along desirable lines. Elements have been introduced into these programs, and more are being proposed, which attempt to provide minimal income support for the low-income population but in a manner that is less efficient and costly than ISP, and which tends to direct those programs away from their originally intended purposes of wage replacement for workers of all income levels. Only when we have a national cash income supplement program such as the one proposed here will it be possible to reform the social insurance programs.

This proposal would minimize the need for Federal involvement in the personal lives of our citizens and result in a more appropriate division of responsibility between the Federal and state governments in the performance of public functions. These objectives are well served by the Federal government assuming the full financial and administrative responsibility for the provision of a comprehensive, nationally uniform cash assistance program. Local conditions or attitudes may require higher levels of cash assistance for selected categories of the low-income population than the Federal government can or should provide on a national scale. Consistent with the New Federalism philosophy, states and localities would be given virtually full discretion to further supplement ISP transfers as they see fit. (More detailed information on the relationship of the Federal government to any state supplementation programs that might evolve out of this proposal is contained in Tab C.)

Finally, the effective provision of services requires the discretion that derives from detailed knowledge of potential recipients and such local conditions as labor market characteristics. Thus, the states and localities would play the primary role in whatever continued public sector activity there is in this regard. In conjunction with this proposal we would complete the movement started under the Comprehensive Employment and Training Act of 1973 to convert to the special revenue sharing mode of funding all manpower and social monies.

The ISP includes a work test provision which will buttress the proposal's work incentive features while answering any public or Congressional concerns that some persons would seek to avoid working through public support. Consistent with the move toward maximum state discretion in the provision of services and in order to avoid the creation of a large Federal bureaucracy, the work test would be state administered. The general parameters would be specified in the law and Federal regulations. It is anticipated that the existing State Employment Service network, which administers the work registration requirement of the Unemployment Insurance system, would serve as a model for a Federally-mandated and supported, but state-administered work test. Some of the current expenditures for the WIN program and the Food Stamp work test would be transferred to other appropriate authorities (e.g., Comprehensive Employment and Training Act) in order to support the ISP work test. (Further discussion of the work test is contained in Tab J).

PRESIDENTIAL DECISIONS

Your decision on the choice of the administering agency is needed so that all of the details of the proposal can be finalized. This requires a substantial amount of background material which we have provided in a separate paper at Tab A-1.

Administering Agency Decision

The issue is discussed and the advantages and disadvantages of the options are presented at Tab A-1. The options are:

1. administration of the entire tax and income tested transfer system by the IRS;

2. administration of ISP by a new agency within Treasury; and

3. administration of ISP by the Social Security Administration.

Decision

I want the IRS to administer the entire tax and transfer system ______________

I want a new agency in Treasury to administer the ISP ______________

I want the Social Security Administration to administer the ISP ______________

TAB A-1

BACKGROUND ON ADMINISTERING AGENCY DECISION

The IRS Task Force charged by then Secretary Shultz to examine the administrative feasibility of an integrated Federal tax and transfer system concluded that the transfer function - or Income Supplement Program (ISP) - could be administered at reasonable cost and meet high standards of efficiency and effectiveness so long as the Task Force's recommendations were adhered to. The Task Force also found that, as presently defined, the ISP has no program design feature that would require or preclude the selection of one agency rather than another to assume operational responsibility for the program. The program's procedures and operations are sufficiently different from those employed in existing federally administered programs that a free standing operational system will be required no matter where administrative responsibility is lodged. (The probable manpower and other resource requirements of that system are discussed in Tab G). Thus the program could be administered either as a component of an existing agency, such as IRS or SSA, or by a newly created special purpose agency.

The purpose of this paper is to identify what I believe are the crucial policy issues which should govern the choice of the administering agency and then to assess, according to those criteria, three options for your decision: IRS, a new agency in Treasury, or SSA.

ISSUES AFFECTING THE SELECTION OF AN ADMINISTERING AGENCY

The ISP departs sharply from past proposals to deal with the "welfare mess" because it would replace -- and not merely reform -- the present array of means-tested programs with a single comprehensive income supplementation program that is conceptually tied to the tax system. The ISP is directly tied to the income tax system through the relationship of ISP benefit levels and breakeven points to the level of income tax personal exemptions and standard deductions. This proposed integration follows our desire to:

- o Force an understanding in Congress and among others of the relationships between tax and transfer policies. Increases in transfer benefits will require increases in personal exemptions and/or standard deductions, thus introducing a strong measure of fiscal discipline and a more equitable treatment of taxpayers.

- o Prevent the typical household or family from being in the position of both paying taxes and receiving an ISP transfer. Through this and other techniques we would eliminate, as much as possible, notches and overlaps that discourage work effort or occasion avoidable inequities.

The choice of the administering agency will affect how well these integration goals will be maintained at all levels and stages of the policy development process, both initially and over time.

Similarly the proposed integration of the tax and transfer systems follows from our desire to treat all citizens equitably and uniformly in terms of program operations. At present, moderate and high income persons deal with the efficient and objective IRS while low income persons deal with a highly inefficient and erratic welfare system. The ISP sheds the traditional welfare approach by placing responsibilities on program participants that are more like the responsibilities faced by the overwhelming majority of citizens in their dealings with government. While this expectation of self-reliance must be supported by the ready availability of expert advice for those who need it (as it is in the tax system), great care must be taken to rebuff any attempts to build in costly and ineffective service programs, subjective case by case determinations of need, and provisions for special needs, any of which would alter these fundamental characteristics of the proposal. In other words, the way the program is administered will have as much to do with distinguishing the ISP from the existing system as will the program design of the proposal. Whether our efforts to preserve that distinction are successful will depend, in large measure, on the nature and location of the agency selected to run the program.

Public acceptability of this proposal is obviously a critical determinant of legislative success or failure. The ISP must stand convincingly as a totally new approach, as a program that will administer income conditioned cash benefits in an efficient and tightly controlled fashion. The deficiencies inherent in the present non-system have resulted in unjustifiable differences in treatment and high error rates, thus creating cynicism towards welfare among both the public at large and the recipient population. Whether or not these destructive attitudes will carry over and taint the ISP will depend on the tone and approach of the administering agency.

In summary, the selection of the administering agency will have a significant impact, both initially and over time, on the substance of the program, its basic operating characteristics, the legislative outcome, on treatment of recipients and their attitude toward the program and on program integrity and continued public acceptance. Considering these factors as well as the availability of existing management capabilities, we have narrowed the potential options to the three presented below. A fourth potential option, a new agency within HEW, was rejected because our experience with the Family Assistance Plan (FAP) proposal indicates how vulnerable such an agency would be in the legislative process to the reintroduction of traditional welfare practices and ancillary service programs.

It should be noted that once the welfare replacement program is implemented the policy making function would, of course, reside with whatever agency and department you select to administer it.

ADMINISTRATIVE OPTIONS

Three alternatives are evaluated. They include ISP administration by the Internal Revenue Service (IRS), a new agency in the Treasury Department, and the Social Security Administration (SSA). The advantages and disadvantages of each option are considered below.

Internal Revenue Service

Advantages

- Simultaneous consideration of substantive policies common to the tax and transfer systems at the time of implementation and subsequently is considerably strengthened if both systems are within the same agency. While each system will be essentially a free standing operation, IRS administration of both will insure that the overlaps and interactions will be handled as directly and simply as possible and promote the possibility of greater integration of the two systems over time, especially with respect to such policy questions as income definition.

- While differences in both procedures and the population served impose different requirements on operations, the treatment accorded ISP recipients and taxpayers will be more uniform if both activities are controlled by the same agency. In addition, the income tax system's tradition of placing clear responsibility for certain actions on citizens is precisely the approached needed and intended for the ISP.

- The addition of social service programs, subjective determinations, and other undesirable welfare type program features is more effectively deterred by IRS administration since the inappropriateness of such features to an income transfer program would be unequivocally emphasized in the context of IRS administration.

- IRS administration will enhance the acceptability of the proposal in Congress, particularly among those persons who might oppose a "reform of the welfare system, but not its "replacement" by a substantially different concept which represents a sharp departure from past programs.

- IRS has demonstrated capabilities in the areas of compliance and enforcement which are critical to maintaining the integrity of the ISP and insuring both voluntary compliance and public credibility.

- IRS's reputation as a tough but fair agency and the high regard for its management capabilities will promote public acceptability of the program.

Disadvantages

- The ability of the IRS to perform its vital job of revenue collection, which depends on the public's belief in the integrity of the system, could be impaired if the negative image of the current welfare system were transferred to the new program and served to dilute public confidence and respect for the IRS and the tax system as a whole.

- IRS presently has only limited experience with the low income population.

- Enforcement techniques and the traditional attitudes of enforcement personnel may be inappropriate for this population.

- Implementing a program of this size may well prove disruptive to normal IRS operations. Workloads are already heavy and will continue to grow at a rapid rate, even in the absence of the assignment to IRS of major new responsibilities such as those required by the Employee Retirement Income Security Act of 1974. This growth in responsibilities will pose serious management challenges to IRS in and of itself.

New Agency in Treasury

Advantages

- Maintaining the linkages and controlling the overlaps and interactions between the ISP and the tax system will be facilitated if another agency in Treasury administers the ISP, although to perhaps a lesser extent than if IRS had responsibility for both.

- Placing the ISP in the Treasury will also help insulate it from pressures to graft on undesirable traditional welfare program features.

- Information matching with income tax returns will be readily accomplished.

- An organization in Treasury will benefit to some extent from IRS' operational expertise and image. Since the orientation of an agency is to a large extent a function of its environment, traditional IRS attitudes and practices would probably carry over and shape the parallel agency in Treasury.

- Establishing the new program within a new agency would cause much less disruption of existing agencies.

Disadvantages

- Judgments about the capabilities and public image of any new agency cannot be rendered until its performance is tested.

- The simultaneous consideration of tax and transfer policies would take place principally at the level of the Secretary rather than originating at the operating agency level.

Social Security Administration

Advantages

- By the time the ISP is implemented, SSA will have had several years experience operating a national means-tested cash transfer program for a large portion of the aged, blind and disabled portion of the ISP eligible population (the new Supplemental Security Income (SSI) program for the low income aged, blind and disabled).

- SSA is highly regarded for its management capabilities.

- SSA is viewed positively by the public and the Congress.

- SSA has long established interactions at the staff level with IRS in the areas of program policy and information matching.

Disadvantages

- It would be comparatively easy to sever the conceptual ties between the ISP and the tax system if the programs are split between HEW and Treasury. While it is theoretically possible to have simultaneous consideration of tax and transfer policies across departmental lines, the enforcement of such a process could only come from the White House and OMB with a considerable investment of staff resources. Unless there is institutional pressure from within the Executive, it is very unlikely that Congress would long maintain the linkages between the two systems or at all consider possible overlaps and interactions.

- Information exchange with the IRS is more complex and could be precluded if restrictive legislation is passed.

- Retaining the ISP in HEW may not be a sharp enough change to signal the ISP as a totally new approach.

- Undesirable welfare policy and administrative concepts are more likely to be grafted onto an HEW program as our recent experience with the SSI program has so painfully proven.

- SSA has relatively little experience in the areas of compliance and enforcement.

- Integrating a program this large into SSA may prove disruptive of normal operations. Even though SSA would be relieved of the new SSI program of welfare assistance to the aged, blind and disabled, (which would be eliminated by the ISP), the normal social insurance (OASDI) caseload and earnings report maintenance duties of SSA are projected to grow rapidly enough over the next few years to constitute serious management challenges to that agency in and of themselves.

TAB B-1

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D. C. 20201

November 12, 1974

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Welfare Replacement

This memorandum is a summary and overview of the materials that I will present to you on Wednesday, November 13, concerning the welfare replacement proposal that is being prepared for your consideration as part of the 1975 legislative agenda.

The proposal, the result of more than two years' interagency staff work, is currently in the final stages of Cabinet review. In it I recommend that we eliminate the Federal participation in the existing major welfare programs and institute instead a simple, Federal Income Supplement Program integrated as much as possible with the Federal Income Tax. I will be conferring with Secretary Simon later this month about the proposal's administrative and tax relief aspects, and I hope that we will be able to submit jointly the entire proposal by this month's end. (Appended to this memorandum is a copy of the Table of Contents to the entire proposal in its current draft form.)

The Current Situation

As I examined the current array of means-tested transfer programs, and the prospects for both natural growth in those programs and likely new legislation, I have become convinced that the Federal government must find a fairer, more straightforward and effective means to assist the low-income citizenry. The major existing programs -- Aid to Families with Dependent Children, Supplemental Security Income, Food Stamps, Public Housing, and Medicaid -- truly constitute a non-system. The current state of affairs is simultaneously:

- Inequitable -- Across the nation, persons and families with identical needs can receive vastly different amounts of welfare assistance in which the Federal government participates, depending on where they live, the sex of a family head, or other factors not clearly related to need. These benefits have in some jurisdictions and for some families cumulated to assistance levels well above that which rational policy concerning Federal dollars should allow, while others who live elsewhere or have a father at home, but are equally needy, receive much less.

- Wasteful and Inefficient -- The system is composed of several different, overlapping and separately administered programs, each of which has its own extremely complicated rules and procedures. Thus, the total "system" is very inefficient. For example, the administrative costs of the Food Stamp program are estimated to be 15% of total benefits paid, compared to only 4.5% for the proposed Income Supplement Program.

- Confusing and Demeaning -- The present system is premised on the belief that it is proper and necessary to inquire into, limit and control extensively the behavior patterns of recipients and that the poor, unlike other Americans, are unable as a group to make their own decisions sensibly. The resulting rules are so confusing that few people, administrators and recipients alike, understand their operation. Public acceptance of income assistance to the poor is understandably eroded when no one can easily explain the conditions under which their tax dollars are being transferred to others.

- Discourages Work Effort -- The system as a whole has built into it disincentives to work:

  -- benefit reduction and positive tax rates can cumulate to extremely high levels so that the return from an extra dollar of earnings can be as little as a few cents, and

  -- unintended penalties in the form of "notches" have crept into the system. These are situations where a small increase in work effort can result in total loss of benefits.

This situation will not right itself; indeed, there is evidence that it will only get worse:

- New in-kind and other incremental programs are continually being pressed. A few months ago only the addition of a housing allowance program was being seriously considered; now this Department and the Federal Energy Agency are embarked on a Congressionally-mandated study of a fuel stamp program. Senator Long continues to advocate his "work bonus" proposal. OEO has sponsored experiments with transportation stamps that have gained media and Congressional interest.

- Our existing social insurance programs continue to be stretched to serve welfare functions. Proposals to modify the Unemployment Insurance system to achieve essentially welfare purposes are now being advanced by the AFL-CIO. The Social Security system already contains several very expensive welfare components, and I expect efforts to reinforce those aspects will continue to be mounted.

Therefore I have concluded that we should abandon the existing non-system for one which is fairer, relatively simple to understand and administer, and which will focus our assistance dollars on those who need them the most while preserving incentives to work.

The Welfare Replacement Proposal

The major categorical, means-tested programs -- AFDC, SSI, and Food Stamps -- would be eliminated and superseded by a simple, universal cash transfer program -- the Income Supplement Program (ISP) -- that would be integrated with the tax system as much as is now feasible. As a consequence of such a structure the tax liability of or transfer payment to all American citizens would be based on the same simple, objective yardstick -- its income relative to the basic structure of our Federal tax system, and the same basic principles that guide the administration of our tax laws would also apply to the administration of Federal income assistance.

- All citizens would be a member of a family or household that typically has either a potential liability for tax payment or potential eligibility for a cash income supplement.

- For each family or household, there would be a level which equalled the sum of its personal tax exemptions and the appropriate standard deduction. If a family has income above this level, it incurs a tax liability basically in accord with the provisions of the present Federal income tax code. If a family has income below this level, it would be eligible to receive a cash income supplement equal to one-half of the difference between its income and that standard (known as its "breakeven" income level). In the cases of families with no other income, they would thus receive a basic benefit equal to exactly one-half their breakeven levels. Since most families have some other source of income, average benefits are much less than the basic benefit level.

- The benefit levels proposed are just high enough to cash out the Federal participation in the present system and to provide a reasonably satisfactory "floor", within realistic fiscal constraints.

- The gradual phasing down of cash supplement from the basic benefit to the breakeven as other income increases has the following virtues:

  -- provides a greater income supplementation to those with greater need;

-- preserves work incentives because benefits would be reduced by only half of increased earnings; and

-- generally assures that no one would be simultaneously eligible to receive an income supplement and liable to make an income tax payment.

- In order to assure that the purchasing power of ISP benefits and the value to taxpayers of the new tax exempt levels of income will not be eroded by inflation, at least certain aspects of the integrated structure would be indexed.

- There would be an assets test to preclude eligibility for those households that have adequate resources but for some reason have income below the breakeven level.

- There would be a strong work requirement to avoid the justified criticism that our present system enables some who could work to get public assistance and not work.

The Federal income tax system would remain largely unchanged in its operation, save that the sums of personal exemptions and standard deductions for differently sized households would be increased to achieve the breakeven levels of the Income Supplement Program.

There are two sides to this proposal's costs. First, there are the net costs for the ISP payments as such. This cost is estimated to be $3.8 billion. Most of these net expenditures would go either to male headed intact families in which one or both parents work or to single parent families in low AFDC benefit states. The second cost is the amount of tax relief you elect to provide in conjunction with the proposal. A certain minimum level, estimated to be on the order of $5 billion and restricted to lower income taxpayers, is necessary in order to provide the necessary integration of the Income Tax and the Income Supplement Program.

These costs should be viewed in proper perspective. First, they would not occur until calendar years 1978 or 1979 when our fiscal resources are predicted to be in a position to cover them. Second, the net costs on the benefit side assume that there would be no major alterations or additions to Federal participation in the existing welfare system in the absence of this proposal. While prudent for estimating purposes, it seems to me certain that Congress will enact costly program changes in the present system over the next two to three years, unless we seize the initiative now. Finally, the tax relief (or revenue loss) for lower and middle income persons inherent in this proposal seems only just. The current rate of inflation is substantially increasing the tax bite because of the progressive nature of the tax schedule. The tax relief component should therefore be viewed as returning to the citizenry that which the interaction of inflation and the tax system is now taking from them.

As part of the staff work leading to the submission of this proposal, a major effort to explicate the administrative implications was undertaken by an IRS led Task Force. That study concluded that the program I am proposing could be administered with high standards of efficiency at reasonable costs by an appropriate Federal agency. I believe that the new Income Supplement Program should be administered by the IRS along with its administration of the income tax if we are to be successful in changing both the nature and public perception of the Federal role in income assistance. In the alternative, administration by a new special purpose agency in Treasury would achieve many of the same ends.

What the proposal for coordination of the welfare and tax systems recognizes and builds on is that both have the same mechanical function - a cash transfer between the individual and the government - and the same rationale for computing the amount of the transfer - ability to pay or, negatively phrased, inability to pay or need.

The strengths of the Income Supplement Program contrast sharply with the present confusing array of programs. They are characteristics of the present tax system and result from the proposed coordination of the two programs:

- Comprehensiveness. It allows us to simplify and rationalize our means-tested transfer system by collapsing three separate and overlapping programs into one.

- Objectivity. It avoids undue interference in the lives of those it seeks to help and provides benefits in cash, not in-kind.

- Efficiency. It increases considerably the anti-poverty effectiveness of the Federal participation in the transfer system -- 86 percent of its benefits will go to those below the poverty line, and it is estimated that ISP administrative costs will be only 4.5 percent of gross transfers. (The comparable administrative cost figures for existing programs are 10 percent or higher.)

- Equity. It assists all low-income American citizens according to uniform national criteria -- for example, no longer will one family face excessively high benefit reduction rates or a precipitous termination of assistance by reason of extra earned income, while another family better situated to take advantage of certain rules can retain its former level of benefits despite substantial increase in income. ISP would have a uniform work incentive so that each dollar of earned income will always leave a recipient unit better off.

In addition to these objectives, the Income Supplement Program is equally important and needed for what it would make possible in broad areas of related domestic policy:

- Provide an alternative to further distortions in our social insurance programs and allow us to move them, especially Social Security, back towards their original objectives;

- Complement rational reform in related areas such as national health insurance (including the replacement of Medicaid), social services funding, and housing programs for the poor;

- Provide the Federal government with a mechanism to adjust for the adverse effects of inflation on the low-income population, lessening the need for the proliferation of special programs to address special price increases;

- Provide an automatic buffer against income losses resulting from the loss of a job or a decrease in hours worked for those lower income workers not covered by Unemployment Insurance, allowing greater latitude in fiscal policy; and

- Begin to distinguish more clearly the respective roles of the Federal and State governments in domestic affairs. The Federal level of government -- because of the equity it can insure and the efficiency it can introduce -- is the appropriate means through which to address the basic national concerns with income security. State and local government, with or without Federal financial assistance, are much better situated to deal with individual and diverse service and emergency needs and programs.

Alternatives and Public Reaction

Before arriving at my decision to propose a welfare replacement strategy along the lines outlined above, I spent over a year's time examining all the alternatives. Though I found them all seriously wanting, you should be aware that an incremental reform strategy has its strong proponents and seeming attractions. (Under this approach we would attempt to redress the present problems of inadequacy and inequity by adding new in-kind programs and welfare components to the social insurance programs.) In addition, many Congressional conservatives are attracted to some kind of "revenue sharing" approach, even though the Income Supplement Program is the product of conservative intellectual thought (principally the economist Milton Friedman).

Such alternatives might be politically less controversial at the start. But both extensive analysis within HEW and elsewhere in the Executive Branch, and the three year long study by Congresswoman Griffiths' Fiscal Policy Subcommittee have convinced me that these alternatives would only drive the transfer system even more out of control than it now is.

The Income Supplement Program is a major undertaking that will not be readily accepted by all sectors of American society nor enacted immediately by the Congress. Its enactment and implementation will require much effort over a sustained period of time. A variety of legitimate concerns will be raised, many of which I believe we are prepared already to address fully. However, there simultaneously exist strong conservative, liberal and bureaucratic vested interests in the present system; these will be difficult to overcome.

If I were persuaded that the disorder of the present programs could be contained or somewhat improved, I might be tempted to recommend only a series of modest improvements in the existing welfare system for you to present to the Congress. My assessment is to the contrary. A modest approach just does not address the fundamental issues, and does not even provide a promise of success. Time is not on our side. Left alone or altered modestly, the present situation will inexorably worsen, making a fundamental reform even more difficult later. Many in the new 94th Congress are going to read the recent election results and our current economic plight as justification for massive public employment programs, use of social security and unemployment insurance to achieve welfare ends, or new discrete in-kind and cash programs to "solve" particular problems. Unless we have a comprehensive initiative that commands attention and directs the Congressional debate towards fundamental policy concerns, we are likely to be overrun by, and may even have to endorse, such piecemeal but expensive additions to the Federal role in domestic affairs. I am convinced, therefore, that proposing and enacting the Income Supplement Program will more than merit the requisite investment of time, effort, and political capital.

/s/ Cap Weinberger
Secretary

Attachment

cc: Secretary
Under Secretary

Will Taft
David Lissy

Wm Morrill
John Palmer

M. Barth

TAB B-2

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON

December 4, 1974

NOTE FOR THE PRESIDENT

SUBJECT: Attached Materials on Welfare Reform

At your request we have prepared a memorandum on what might be accomplished in the context of the existing welfare system as opposed to the replacement of the major welfare programs by the Income Supplement Program. That memorandum immediately follows this note. I am also sending you a Welfare Reform Options Paper, prepared in late 1973, which examined this and other subjects in more detail and provided the basis for much in this memorandum. An outline of the 1973 Options Paper is at Tab A to the Memorandum.

Because the subject is inherently detailed and complex, the Memorandum may run to more pages than your schedule will allow you to read. Thus, we have tried to capture the central points in the Memorandum in an Introduction and Summary section. I urge you also to read the Conclusion section for some of the broader perspectives that I believe you might find useful as you consider what to do about the welfare programs as such.

Secretary

Attachments

December 4, 1974

MEMORANDUM FOR THE PRESIDENT

SUBJECT: An Alternative Approach to Welfare Replacement

INTRODUCTION AND SUMMARY

At the November 13 briefing on the Income Supplement Program (ISP) you requested an analysis of what we might accomplish within the context of the present welfare programs if the ISP were not proposed to the Congress.

Incremental change to the existing system has a history. Twice--in 1962 and 1967--we made substantial revisions in the Aid to Families with Dependent Children (AFDC) program; in 1969 Food Stamps was transformed from a small demonstration project into a nationwide program; and in 1972 the Congress "federalized" public assistance to the aged, blind, and disabled in the form of the Supplemental Security Income (SSI) program. In addition to these measures in income assistance, new programs were directed at the poverty population in the fields of education and child development, manpower training, public employment, urban development and housing, community action, legal services and so on.

Results from this decade of "tireless tinkering" are best described as mixed. Poverty surely declined, but more by reason of economic expansion, broad demographic changes and growth in the income assistance programs than by reason of the explicitly "anti-poverty" endeavors as such. It was the growth in the income assistance programs (especially AFDC) that disquieted many, for it did not come from any conscious national policy. Rather that growth was and is even now a haphazard compounding of uncoordinated, separate decisions made at the Federal, state and local levels by the courts, several different Federal agencies, the Congress, and state executives and legislatures. No one can say with any certainty where the "system" is going and what it is doing to the recipient population, nor can we see any broad accomplishments from these many programs. We just go on expanding each piece.

The Family Assistance Program (with its companion SSI program) was the first real attempt to formulate a conscious national policy on income support to the poor. In the aftermath of that proposal's failure in 1972, we engaged in an extensive interagency analysis of what the principal program options are for a national income support policy. This eventually led to a wholly new plan, to the Welfare Replacement Proposal, presented to you on November 13. One of the products of interagency analysis was a lengthy Welfare Reform Options Paper, completed in the autumn of 1973, which covered much of the territory you requested us to study. A copy of that Options Paper is attached, a brief description of its contents is at Tab A of this memorandum.

I think it is proper to say that there is no one alternative to the approach embodied in the Income Supplement Program. Rather, should we decide to stay with the existing programs, we face a wide range of possibilities, which have to be measured in accordance with several, often competing objectives:

- Adequacy — Although hard to define, adequacy is nonetheless a desirable characteristic of a system in which both those who work and those who cannot work have access to some level of income which is adequate for subsistence.
- Equity — People in similar circumstances should be treated similarly. Those who earn more should end up having more total income for their own use; and those who have greater needs (e.g., more children) should receive relatively more.
- Work Incentives — Those who can work should find it financially rewarding to do so and should be required, if they have no caretaker responsibilities, to be working or actively seeking work as a condition of receiving assistance. In addition, recipients should not receive so much income assistance without working that they lose all incentive to get work or go on working.
- Objectivity — Discretionary authority in the hands of program administrators should be kept to the necessary minimum.
- Administrative Efficiency — The system should be as simple and straightforward as possible; administrative costs, the burden on participants, and fraud and error should be minimized; system objectives should be fulfilled at minimum cost.

- *Coherency and Control* — The system as a whole should be coherent, and consistent, and be understandable in its operation and effect, have the intended effect, and be subject to policy and fiscal control.

For the purposes of this memorandum we have extracted and updated selected material from the 1973 Options Paper and arranged its presentation under somewhat different headings. We have tried to give you a sense of how the various possibilities weigh in terms of the objectives described above, what the probable impacts on cost and caseload would be, and how we expect each option to be received by Congress and the states. While I encourage you to read this material to gain an understanding of the technical, administrative, political and policy complexities involved, the following will give you a quick overview of what follows except for the concluding section.

- *Changes in Existing Programs.* In this section we outline those measures which might be undertaken to rationalize each of the three major welfare programs -- AFDC, Food Stamps and SSI -- short of major structural changes in them. In the case of AFDC, this would involve considerable national standardization. (An alternative approach for AFDC is also discussed.)

  If we assume favorable Congressional and State reaction, enactment of the changes discussed under this heading would enhance the equity, administrative efficiency, objectivity and the predictability of the current programs. Two measures would increase costs and caseload in the interests of work incentives and equity, but most measures would eliminate those program defects that have led to caseload growth among relatively high income recipients, leading most probably to net savings. Firm figures are impossible to give because of State variations in AFDC payment levels and practices. Similarly, the net effect on work incentives is mixed but the balance is probably favorable. Very substantial inequities between the states and our treatment of single parent versus intact families would remain. Assistance in many areas would still be very inadequate and little overall improvement in the fiscal and policy control of the overall welfare system will result.

o <u>Major Modifications and Additions.</u> Here are outlined those often suggested measures that would either fundamentally transform the AFDC program or would add major new programs, such as an Earnings Supplement or a Housing Allowance, to the existing three.

The modifications in AFDC -- a national minimum and a nation-wide mandate of the Unemployed Fathers (UF) option -- presuppose a national standardization of the program and would go the last step in transforming AFDC into a fully national program on the Food Stamps model. States would still administer the program and have the option of setting higher levels than the minimum. These steps would reduce present interstate inequities, impose a national criterion of adequacy in AFDC, and be achievable with relatively minor impact on cost and caseload. The administrative inefficiencies and policy defects that are inherent in the categorical nature of AFDC would remain untouched, arguably made worse, by these modifications.

An Earnings Supplement and/or a Housing Allowance are the most often suggested proposals to redress the imbalance in our low coverage of low-income families where both parents are present and the father is more or less fully employed at low wages. A comprehensive Housing Allowance would additionally cover AFDC and SSI recipients. Unquestionably these and other proposals for new programs would improve the adequacy and interstate equity of the overall income support system, most especially with respect to the "working poor." However, such proposals also demand the creation of new structures to administer them or substantial personnel additions to present transfer bureaucracies, and would aggravate work disincentives because of compounded benefit réduction rates. It is also my judgment that they would lead to very high net budget costs because of a probable unwillingness in Congress to reduce AFDC and SSI grant levels despite the introduction of a Housing Allowance, and would exacerbate the political problems that have made it difficult to subject the present system to coherent policy and fiscal control.

o <u>Program Integration.</u> In this final section we discuss five sets of measures that could be undertaken to reduce the excessive amount of overlap and duplication in the existing programs. These measures would become even more necessary should new programs, such as a Housing Allowance, be added. All would improve administrative efficiency, equity and possibly work incentives. However, the most ambitious and potentially useful undertaking -- full scale administrative integration -- would equal the Income Supplement Program (ISP) in controversy and far surpass it in complexity.

The political perception should not be underestimated. What would be important, but not highly visible features of the ISP initiative (for example, frequent reporting and an annual accountable period) and thus not likely to invoke much controversy, would become major steps if we tried to implement them in existing programs, and would be strongly opposed.

Finally, we should keep in mind that Mrs. Griffiths' long-awaited welfare reform proposal is being privately circulated on the Hill and will soon be made public. We will, of course, have to react, and to the extent that we reject a major effort such as the ISP, we will have to show why we oppose her comprehensive proposal from the perspective of a more limited "tinkering" strategy.

CHANGES IN EXISTING PROGRAMS

There are a number of changes that could be made in the existing AFDC, Food Stamps and SSI programs that would both improve their operations and make more predictable their results. These changes would not, by themselves, materially advance either adequacy or equity in the overall income assistance system, nor would they make a comprehensive, logical system out of the three separate programs. For the former of these goals to be significantly addressed, major structural revisions on the order of those reviewed in the next section would be needed. Of course, along with seeking some of the program design changes discussed in this section, we could seek at the same time to integrate the operations and rationalize the overall effects of the programs. This possibility is also explored in a later section of this memorandum. However, no strategy of incremental reform can result in a fully integrated system.

Revise Programs, Especially AFDC, Along ISP Characteristics

Inherent in the design of the Income Supplement Program (ISP) are a number of features which if imposed on the existing programs would rationalize their operations, make their effects more understandable, and more fully subject them to conscious policy choices at the national and state levels. In order of probable impact in terms of costs, caseload and therefore political controversy, they are:

-- Standardize Eligibility Criteria and Benefit Computation Rules. Such measures include instituting flat grants that vary only by family size and a standard work-related expenses deduction. These and similar changes could be enacted in AFDC and Food Stamps; many are already in effect in SSI.

-- Improve Work Incentives in AFDC. In order to be initially eligible, a family's income must be well below that level at which an already participating family's grant is phased down to zero. This creates an incentive for a working mother to reduce her earnings so as to become eligible. This disincentive could be eliminated by establishing both initial and continuing eligibility on the same income criterion. In the AFDC-UF (Unemployed Fathers) program, work effort beyond 100 hours a month results in a total loss of benefits. This problem could be alleviated by, for example, moving to an income test for partial unemployment similar to that used in Unemployment Insurance.

-- Administrative or Procedural Changes. We should amend all programs to require recipients to report frequently relevant information and we should base benefit calculations on a retrospective time period.

-- Accountable Period. Our public assistance programs do not now measure a potential recipient's income on an annual basis. This allows payments to some recipients during months when their income is temporarily low even though their total yearly income would make them ineligible.

In addition to these changes largely common to all three programs, we need to limit the administration by our Social Security Administration of State supplements to SSI. The provision for Federal administration of State supplements is correct in concept, but unfortunately the Congress chose not only to "grandfather" in all recipients under the superseded State aid to the aged, blind and disabled programs, but also to allow Federal administration of that highly mixed caseload. This has imposed an intolerable and costly administrative burden.

Even though these measures appear technical, their introduction would have significant impact. Families similarly situated in terms of income and size, both within a given state and among the several states, would be treated more equally, and administration of AFDC and Food Stamps would become more objective and efficient. In fact many States are, under the pressure of our Federal Quality Control program which was started in 1973, beginning to adopt changes of this sort in order to reduce their error rates. However, because the categorical nature of AFDC would remain (in many states only families with an absent father are eligible), these various changes would necessarily leave in effect all the present inequities in our treatment of single-parent and intact families. In addition, these changes do nothing about the adequacy of AFDC levels in low-payment jurisdictions. In the absence of basic benefit levels being raised (or some sort of grandfathering provision being instituted) some of these changes would lead to substantial reductions in aid to families who now benefit from itemizable income disregards and infrequent reporting of their status. The overall effect on work incentives would be mixed, for the various changes we have mentioned would eliminate the relatively generous disregards for work related expenses, but would make the overall work incentive structure more rational.

The politics involved with these minor changes or "tinkering" would be quite controversial. For example, we would move AFDC from a grant-in-aid program with substantial discretion at the state and local levels to the very edge of becoming a national program administered by the states, on the model of the Food Stamps program. Even though these measures would tighten control, reduce error and actual fraud, and in a broad sense enhance objectivity and efficiency in program operations, state and local officials would no doubt sense their prerogatives being violated. However, the states would retain control of the single most important variable in AFDC, the payment level.

In addition, since absent major changes such as those discussed later, many current recipients would be made worse off, many of the measures are certain to provoke Congressional opposition. Interest groups, especially the day-care lobby, who attach symbolic importance to certain items of family income or expenditures now disregarded by present law, would strongly oppose the standardization changes.

Frequent reporting and retrospective determination, a good minor reform by itself, would demand data processing capabilities beyond those currently in place, and it is questionable whether either the Congress or the states would perceive the initial investment costs worth the substantial long term savings.

There is also a body of interest group and Congressional opinion that argues, despite fairly conclusive evidence to the contrary, that the welfare poor cannot cope with the demands of frequent reporting. Unfortunately, the introduction of an annual accountable period, which would have a very sizable favorable impact on internal program equity and cost and caseload control, presupposes such administrative changes.

In regard to our suggestion earlier that we propose tightening the conditions under which the Federal government, through the Social Security Administration, administers state supplements to SSI, I have to warn that Congress has not been favorable to that issue in the past, given that the indigent aged are involved. We should, however, pursue this proposal regardless of whether we also go forward with the Income Supplement Program.

In summary, if we assume favorable Congressional and state reaction, enactment of the changes discussed here would enhance the equity, administrative efficiency, objectivity and most especially the predictability of the current programs. While some measures would increase caseload and costs, most would eliminate those program design defects that have led to caseload growth among relatively high income recipients. Due to state by state variations in AFDC it is impossible to give a firm figure on the net effect, but our work on the ISP proposal indicates that more would be saved by the tightening measures than would be spent by the two measures that would expand eligibility. (We would, of course, be running the risk that Congress would accept the cost and eligibility expanding features while rejecting the tightening proposals.) Substantial inequities between the states and our treatment of single parent versus intact families would remain, and assistance in many areas would still be very inadequate.

Finally, I am quite skeptical about favorable reaction by Congress, the states and the bureaucracy. We would be dealing with several different sets of committees, each wed to its own vision of the poor and their needs. What is accepted as commonplace in other contexts -- for example, measuring income on an annual basis -- becomes "oppressive" in the minds of many when applied to low-income population. As mentioned before, the states are used to their own discretion in the AFDC program and, despite the savings in state as well as Federal money that these changes would occasion, generally oppose any moves toward national standards in that program.

An Alternative Approach to AFDC

There are a variety of measures which some states, to the extent permitted by current law, have employed to contain caseloads in AFDC. Typically, these proposals reinforce the categorical nature of AFDC based on the notion, implicit in the program's beginning, that it is a program for single parent families with an unemployable female head. It has been argued that Federal law should be amended not only to permit but mandate such changes. Examples of this alternative approach are:

-- establish a gross income eligibility limitation as a percent of the State's welfare needs standard;

-- redetermine eligibility without earnings exemption for recipients who have received earned income for four consecutive months; and

-- categorical exclusion of strikers from AFDC and AFDC-UF.

These and similar measures would, if enacted, hold down costs and caseload in the short run. But I would not propose most of them as part of a package for long term incremental reform, for they are opposed to such other policy objectives as providing work incentives, improving equity and introducing more efficiency and objectivity in program administration.

Further they avoid the central design problems of the present programs that could be remedied by changes discussed earlier. For example, some states are not very efficient in focusing income support on the most needy because they permit itemizing of work related expenses, and because assistance is not reduced by reason of other income between the state's actual payment level and its standard of need. Trying to contain the consequences of these defects by means of yet more complicated rules that encourage a dependency attitude on the part of AFDC recipients moves in the wrong direction. Earnings from work and income assistance should not be regarded as mutually exclusive.

MAJOR ADDITIONS

The measures discussed in the preceding section would improve somewhat the administrative efficiency, internal equity and objectivity of the three major welfare programs, result in somewhat better control of costs and limit caseloads. They would not, however, promote other goals. For example, the interstate inequities in the level of AFDC benefits would remain, as would the categorical nature of that program with its exclusion from cash assistance and comparable benefits of the so-called working poor. In addition, many would continue to view the system as providing inadequate benefits. Changes in the existing set of programs or major additions that would help lessen these deficiencies are discussed in this section. They are: (1) a national minimum benefit for AFDC; (2) a mandating of the AFDC-Unemployed Father program option to all states; (3) an Earnings Supplement or "work bonus" program; and/or (4) a housing allowance.

National Minimum Benefit for AFDC. In some states, AFDC payments fall far short of providing access to basic consumption needs. Each state sets its own payment standards and Federal assistance to states is based on amounts the states are able and willing to allocate to the AFDC program. The limited ability of states with low per capita incomes is recognized in the matching formula which provides a proportionately greater share of Federal funds to low-income states, but this has not provided incentive for a number of low-income states to increase their payments significantly. The maximum payment in 15 states is less than one-half of the poverty level. As a result, Federal resources help to support families above twice the poverty level in some states while in other states many families receive only the most minimal assistance.

A national minimum benefit in AFDC would improve benefit adequacy and, if primarily Federally-financed, would better target Federal support on those most in need. Substantial restructuring of Federal-state relationships would, however, be required. Decisions would have to be made on the minimum level of benefits to be mandated, changes in Federal-state sharing of costs, and possible changes in Federal-state division of administrative authority. The increased cost (above present expenditures) of an AFDC minimum, set roughly at proposed ISP levels, is estimated at $700 million, most of which would probably have to be financed by the Federal government.

A national minimum benefit in AFDC would have a number of beneficial aspects. It would reduce significantly interstate variations in payment levels and increase the target efficiency of Federal funds in securing more adequate incomes for the poorest AFDC families. On the other hand, such a change would result in no substantial restructuring of the welfare system. The problems stemming from the multiplicity of overlapping categorical cash and in-kind programs would persist. Intact families would still be excluded; and because benefit levels would be higher, incentives for family instability might actually increase in those states now below the national minimum.

We could not move to a national minimum in AFDC without simultaneously enacting virtually all the standardization changes discussed in the previous section. The combination of two actions would mean that AFDC would become a fully national program, though state administered. This is now the case with the Food Stamp program. This would properly be regarded as a major change in Federal-state relations and would likely invoke the same criticisms about increased power at the Federal level that we assume the ISP proposal would generate.

Some of the critical issues involved in such a move are the choice of a method to finance the national minimum, and therefore, the relative roles of the Federal and state governments, incentives for efficient administration and "hold harmless" provisions for both states and recipients.

Mandatory AFDC-UF Program. The recession of the early 1960's brought attention to the needs of intact families when the father was unemployed for an extended period of time. In 1961, the Social Security Act was amended to include unemployment of a parent (amended again in 1967 to specify unemployment of a father) as an eligibility condition for receipt of AFDC. The use of this eligibility condition is optional with the states. Currently, 24 states and the District of Columbia administer AFDC-UF programs. Most of the remaining states have never participated in this program.

In order for a family to receive AFDC-UF benefits, the father must have been previously employed for a specified minimum period of time, must not be receiving unemployment insurance benefits, and must have been unemployed for at least 30 days. Unemployment is defined by regulation as employment of less than 100 hours in a month.

One of our minor proposals could be a requirement that all states include the families of unemployed fathers in the AFDC program. This would help alleviate the problems of extended unemployment of some additional male heads of families with children. However, since the categorical requirements of the program are so narrow and most of the larger states have already adopted it, such a change will have minimal impact. We estimate it would result in an additional 50,000 families receiving assistance at a cost to the Federal government of $90-$130 million (depending upon whether it is done in conjunction with a AFDC national minimum or not).

Earnings Supplement. Another response to the inequity of excluding most intact families from cash assistance would be to develop a program that covers specifically a portion of that population. Added impetus to this idea has also been given by the growing recognition of the burden of the payroll tax on the low-income population. This was the origin of the "work bonus," supported by Senator Long. This program was passed by the Senate in 1972 and died along with the Family Assistance Plan, in Conference. A similar program has again passed the Senate and has been pending in conference for almost a year.* It would add a benefit of 10 cents to each dollar earned by those family heads with incomes below $4000 per year. Thus, the maximum benefit under the program would be $400, with an average benefit likely to be about $250 per year. As income rose above $4000, benefits would be reduced by 25 cents on the dollar until eligibility ceased at an income of $5600. A presumed advantage of such a program is that over a range (earnings below $4000) earnings would increase by more than the full amount of any wage increase.

It is estimated that in 1976 such a program would transfer about $500 million to more than 10 million persons in some three million families all of whom are currently covered by the Food Stamp program and many by AFDC. About 65 percent of the transfers would go to families below the poverty line. Earnings supplement plans that have higher transfer levels have also been proposed. For example, a plan that added 50 cents to each worker's wage for each dollar earned (and later reduced benefits by 33 cents on the dollar) would cover the same 10 million persons and cost about $1 billion.

Housing Allowance. Another way to increase significantly the adequacy and equity of our welfare system while simultaneously fulfilling certain goals of housing policy would be to enact a housing allowance. Such a program would seek to insure that (some or all) low-income households could afford safe and sanitary housing by "filling the gap" between a minimal housing cost standard and the price the consumer could afford to pay. More specifically, the housing allowance would be the difference between the "fair market rent" for decent housing and, say, 25 percent of family income.

For an urban four person family this could translate into a plan offering a basic benefit of $1800 per year in today's dollars which would then be reduced by 25 cents per dollar of other income. This relatively low benefit reduction rate (25 percent) -- a consequence

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* It is part of a very large controversial bill that makes many AFDC and other changes.

of the desire to insure that families do not spend more than a quarter of their income on housing -- implies that benefit eligibility would cease at an annual income of $7200.

Present plans within the Department of Housing and Urban Development would implement a housing allowance (if proposed and enacted) over a multi-year period. This would be another "in-kind" program rather than an unrestricted cash payment. Initially eligibility would be restricted to the aged, low-income population and later extended to the low-income working population. Ultimately eligibility would be extended to the entire low-income population including AFDC recipients. While a housing allowance could be restricted to, for example, the aged population, this would raise severe questions of equity.

HUD estimates that in 1976 a non-categorical housing allowance would cost about $9 billion with 40 million persons in nearly 12 million households eligible. This of course would be in addition to AFDC, SSI and Food Stamps.

Thus the coverage of a housing allowance for the entire low-income population would be slightly greater than ISP, with net benefit costs well over twice as great.

In fact the combined benefit structures of the two comprehensive programs -- a housing allowance and Food Stamps -- would be roughly the same as the proposed ISP; however, these would be in addition to, rather than in lieu of the present AFDC and SSI programs.

Consequences of Program Additions and AFDC Modifications

The consequences of the various proposals discussed under this heading would involve major changes in the existing support system.

The modifications in AFDC, a national minimum and a national mandate of the UF (Unemployed Fathers), would take us that last step toward transforming AFDC into a fully national program with states administering it and determining upper, but not lower, limits on benefit levels. On the other hand, those steps to reduce present interstate inequities and impose a national criterion of adequacy in AFDC could be achieved with relatively minor impact in costs and caseloads.

However, no amount of change in AFDC will redress the imbalance in our present treatment of the so-called "working poor," families where both parents are present and the father (and often the mother also) are more or less fully employed, although at low wages. It is to that portion of the low-income population that the Earnings Supplement and Housing Allowance proposals would provide the greatest net benefits although the latter would be comprehensive in its coverage and, therefore, would also assist substantially present cash assistance recipients. Unquestionably these and most other proposals for new programs would improve adequacy and equity in the overall income support system, but we would I fear, end up only aggravating some of the worse features of the present system. (The technical and political difficulties of integrating several different means-tested programs are discussed in the next section.) For example:

o Each new welfare program could demand the creation of a new administrative apparatus to administer it: a new unit in IRS to run the earnings supplement, and either a new component in the Social Security Administration or HUD or substantial personnel additions there and in the state and local welfare bureaucracies to administer a Housing Allowance.

o Absent some very unlikely changes in our present cash assistance programs we would be adding these new programs -- much as we now do Food Stamps -- on top of AFDC and SSI. We could theoretically reorder matters to reduce AFDC and SSI to residual, subordinate cash programs. But I am skeptical that the Congress and the states would, for example, reduce AFDC assistance to recognize that housing needs were being met by a Housing Allowance any more than such an adjustment occurred when the Food Stamp program was introduced. This layering on of new programs without reduction in or elimination of existing ones would not only lead to very significant net costs, but also would further aggravate the problems of work disincentives and lack of coherency and control already associated with the present welfare system.

My own political assessment is that any gap filling strategy, especially one that includes an expansion of in-kind programs, merely leads to more uncontrolled and rapid growth in overall transfers. We could easily end up in the situation that now exists in some European countries where moderate income people pay substantial taxes and receive some of it back in the form of government subsidies that control their consumption.

PROGRAM INTEGRATION: PROBLEMS AND PROSPECTS

Departmental and Joint Economic Committee studies emphasize that the problems of the current welfare system cannot be resolved if programs are viewed in isolation. Many of the problems associated with the "welfare mess" have been caused by the continuous creation of categorical programs without much regard for the way in which these programs fit together. Because the largest transfer programs have been planned and administered independent of one another, there have been unintended consequences. The negative impact of high cumulative benefit reduction rates on work incentives, and the inequities of categorization are now widely recognized and discussed. While tinkering with the current system can do little to remedy these ills, the administrative inefficiencies of the current system are problems that are more amenable to marginal improvement. Though here the prospects for major improvements are also less than overwhelming, national program integration becomes even more important as the addition of major new programs is considered.

In the existing welfare system each program has its own eligibility criteria, income exclusions and disregards, assets limits and accountable periods; and, almost without exception, each program has its own administrative structure for carrying out the necessary functions of eligibility and income certification, computation of benefits, and distribution of payments. Even allowing for desirable differences, it is clear that there is an excessive amount of overlap and duplication in such an uncoordinated collection of programs.

Below are outlined five alternative improvements that could be made within the context of the existing system. We attempt to assess the relative effectiveness and political prospects of each alternative. They range from marginal improvement to major reconstruction, from the difficult to the improbable.

1. Transfer the Food Stamp Program to HEW. This often suggested transfer would pave the way for more recognition that Food Stamps are more an income transfer than an agricultural support program. Food Stamp benefits could presumably be delivered, through the SSI program, for the aged, blind and disabled population, while other recipients continued to collect Food Stamp benefits through the local welfare agency. Some changes could be made to bring income definitions (exclusions, disregards, deductions) into conformity with the SSI program and the AFDC program, but differences in filing eligibility units would remain because SSI is an individual-oriented program, AFDC is family-oriented, and the Food Stamp Program is household-oriented.

These changes would be of some value, but would occasion no dramatic increase in efficiency. I have therefore questioned the net advantage of adding yet another program to the panopoly which HEW already administers or oversees, absent more fundamental reforms.

2. Standardize Program Definitions Among Various Transfer Programs. This would involve conforming, or at least coordinating, eligibility rules, income exclusions and deductions, assets limits and work tests with various programs. Eligibility unit rules are less subject to standardization because they reflect the categorization of benefits that underlies the current welfare system. Simplifying program definitions, while seemingly sensible and non-controversial, has encountered strong opposition in the past, sometimes because there is disagreement about appropriate definitions, but more often because some recipients would be disadvantaged by the changes. In the latter cases, changes can be effected only by setting a high average for recipients, a costly process. Coordinating programs is also difficult when changes must be approved by more than one Department and, more importantly, more than one Congressional committee. Furthermore, conforming AFDC to other welfare program definitions would require a major increase in Federal regulations of a grant-in-aid program.

In the current system, coordination of program definitions could foster efficiency in those programs administered by the same agency (such as AFDC, Medicaid and Food Stamps), but would not be as useful for other programs (such as public housing). In almost every program standardization of income exclusions, disregards and deductions would be a marked departure from current practices and, as such, would encounter substantial resistance.

3. Institute a Dependents' Allowance in SSI. The SSI program covers only those who are aged, blind and disabled. If SSI adults have dependent children, these latter must be covered under AFDC. Rather than having two different cash assistance programs, one Federally administered, and the other state administered, dealing with the same families, it would be more sensible for both administrators and the families if SSI were broadened to cover dependent children of adult recipients. A major drawback to this is that it would increase the costs of assistance to those children to the Federal government since the basic SSI program is 100 percent Federally financed.

4. Integrate the Administration of all Major Means-Tested Income Transfer Programs. This approach would be a reform on the scale of the ISP proposal. It would require a complete restructuring of all current programs. All programs would use the same basic set of definitions, the same field operation and standardized procedures to determine eligibility, calculating benefits and making payments -- in essence, the whole system would be run as one unit. Such a proposal would be an ambitious undertaking, in some respects more ambitious than ISP. It would require major changes in all existing programs and heretofore unimagined cooperation of more than a dozen Congressional committees and several Federal agencies and their counterparts at the state and local levels. But it is the only alternative, within the context of the current system, that even comes close to realizing the administrative efficiency of the ISP.

5. Cash Out Food Stamps for AFDC Recipients and SSI Recipients. Elimination of in-kind forms of transfers in forms of cash would greater simplify the present welfare system. Food Stamps, in theory, could be cashed out for current recipients of cash assistance. Of course, this has been tried once for SSI recipients. Under the terms of H.R. 1, SSI recipients were to be categorically ineligible for Food Stamp benefits. However, in many states former recipients of Old Age Assistance and Food Stamps, who were supposed to receive equal cash benefits under SSI, were actually disadvantaged. This experience suggests that it will be difficult to cash out only part of the Food Stamp program; if we do not go for all of it, we are likely to get none of it.

CONCLUSION

As you weigh the options of either adopting the Income Supplement Program (ISP) or attempting to improve our income support system through some of the above modifications (and possibly additions) to the present assistance programs, you might wish to consider that:

- Though we often fail to realize it, we already have a national "guaranteed" annual income through a combination of Food Stamps, the public assistance programs of SSI and AFDC, residual general assistance programs of state and local government, and miscellaneous Federal measures including some of the veteran programs, the minimum benefit in Social Security, emergency extensions of Unemployment Insurance, and special programs for Indians and Cuban Refugees. The social realities that occasion low income -- old age, disability, unemployment, family breakups, and low skill jobs with correspondingly low wages -- often do not easily lend themselves to direct intervention or short term solution by government. While we must continue our efforts to deal with the problems of unemployment and underemployment of the low-income population, there do not appear to be any near term solutions. An income support strategy is thus an inevitable and critical component of our social policy. The relevant questions are then: How will the income support function be performed? To what extent do we wish to continue segmenting the low-income population into particular categories for income support? At which level of government should primary financial and administrative responsibility for supplementing the incomes of the poor rest? And what is the best program or mix of programs that will further best the objectives outlined at the beginning of this memorandum?

- Should we decide to forego an ISP initiative at this time, we will nonetheless have to reconsider the same issues again over the next two years in different guise. For example:

  -- You will soon have to consider HUD's Housing Allowance proposals, which, though improving adequacy and equity in the overall transfer system, would do so at great cost and to the detriment of the other goals of an effective income support system.

-- Congress will itself be proposing various gap filling measures such as Senator Long's Work Bonus, a Fuel Stamp program, and some quite substantial public employment programs.

In the absence of a well-defined income support strategy, we are much more vulnerable to the addition of new categorical or in-kind programs that have wide support because each addresses a single important problem. But no one pays attention to the totality of all public assistance programs -- the end result being an even more complex and uncontrollable set of interacting programs.

o In the much needed debate about the public sector's command of our national resources, we will remain limited in our ability to explicitly set priorities for the governmental sector until we reorder and rationalize our income transfer programs, we cannot hope to begin that task until we strike a balance among the competing objectives for the means-tested income support programs. For example, control of our major social insurance program, Social Security, will not be possible in the absence of a coherent and comprehensive minimum income support system.

o All these considerations argue for a long range perspective. What you choose today could determine the future disposition of the Federal government's resources. Based on its past performance, the Congress, as soon as it perceives any excess of future revenues over expenditures, will dispose of much of those resources by adding to our income transfer programs in ways that are popular, but do not necessarily focus the dollars on those with the greatest need. In short, most of the alternatives would cost as much as ISP, or Congressional additions to the existing system would use up our equivalent or greater amount of the Federal revenues by Fiscal Year 1978. The President, in his unique position to focus national debate, can prevent this past pattern from repeating itself, but only by presenting a comprehensive strategy that commands Congressional deliberation.

Clearly, I believe that the Income Supplement Program approach addresses these concerns better than any alternative. However, it is also the case that we could attempt to design a strategy that builds upon the existing programs. In order for that latter strategy to address the basic policy and fiscal trade-offs in our larger income transfer system, we would have to propose some fundamental and controversial changes in the existing programs, especially AFDC, and at least consider some substantial additions. Thus, either way -- should you choose the ISP "replacement" approach or should you direct the development of an interdepartmental "reform" package that adds up to a coherent whole -- there would be a controversial and heavily debated program before the Congress for an extended period of time. But if we do not propose a major reform the present pattern of piecemeal and uncontrolled growth will reassert itself.

Secretary

Attachments

TAB B-3

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D. C. 20201

MEMORANDUM FOR THE PRESIDENT

SUBJECT: An Alternative Course to Welfare Replacement

At the conclusion of my briefing for you on the Welfare Replacement Proposal on November 13, you requested that I provide you with information on what you might consider as an alternative should you decide not to go ahead with the Income Supplement Program. On December 4 I transmitted to you a memorandum which described and evaluated a number of different steps which might be included in any such alternative. This material was the subject of a very lively meeting last week of your senior staff and domestic Cabinet officials.

Subsequent to that meeting, I have selected from the broader set of possible steps described in my earlier memo those which I believe would merit serious consideration. Information on these is contained at Tabs B and C, including a more detailed assessment of the possible cost and other impacts of such steps. Those attachments are, therefore, supplements to the December 4 memo.

Using the criteria of logical consistency and probable political reactions, I have selected a package consisting of the following:

- AFDC restructuring, including:
  - -- a national minimum and mandating the Unemployed Fathers (UF) option nationwide
  - -- grant consolidation and standardizing deductions
  - -- eligibility to the breakeven and mitigating the unemployment notch in the AFDC-UF option
  - -- more frequent income reporting, retrospective computation and a longer accountable period
- conforming changes in Food Stamps, where relevant
- tightening conditions for Federal administration of State supplements to SSI
- various program integration measures, including cashing-out Food Stamps for AFDC and SSI recipients, standardizing program definitions across as many means-tested programs as possible, and instituting a dependent's allowance in SSI.

Of course, you could submit some of the above proposals and not others. Or you may wish to submit different ones that I do not recommend.

Tab A provides the decision portion of this memorandum. My recommendation is that you approve the Income Supplement Program.

We estimate that all the above measures would increase costs by about $2 billion annually and caseloads by three or more million persons. While many of the above recommendations tighten program eligibility and administrative oversight, those effects are initially more than offset by the ones that increase costs and caseload for reasons of improved equity, adequacy and work incentives.

As you know, we have not been successful with such "balanced" packages in the past. Congress either passes a couple of the tightening measures without coming to grips with underlying problems, or it adopts all the measures that broaden eligibility and ignores the measures that would better focus our resources on those in greatest need. If that were done with this package, total costs would of course be increased. The composition of the next Congress leads me to fear the latter course this time around--in which case the costs of this alternative course to welfare replacement is likely to cost more than the ISP in the very near term.

I have also provided information on an Earnings Supplement and a Housing Allowance, as possible additions to the welfare system. Just this weekend Senator Long convened the Senate Finance Committee to attach once again his "work bonus" version of an earnings supplement to other legislation. However, I retain my belief that we should not sponsor any measure that adds new programs to the existing welfare system, although I do not believe we can successfully stave off the work bonus in the absence of an alternative comprehensive approach.

Finally, as you know, Congresswoman Griffiths has submitted a full scale welfare replacement plan, parts of which we oppose, but it may be difficult to prevent passage of that comprehensive plan or to secure passage of parts of a noncomprehensive program if we do not have our own full scale replacement plan.

It is my strong conviction that time is not on our side. If we do nothing, costs, inequities, and the weaknesses of the present non-system will increase as individual groups secure enactment of haphazard additions to each of the many programs.

My continued consideration of the alternatives has reinforced by conviction of the importance of moving ahead with the approach embodied in the Welfare Replacement Proposal. I do not believe that any set of measures that operates on the margin of the existing structure of welfare programs offers a suitable alternative to a comprehensive approach. The alternatives do not correct the deep-rooted deficiencies in the welfare system. They lay no foundation for badly needed steps to control and restructure the other income transfer programs along sounder lines. In sum, unless we have a comprehensive initiative that focuses congressional deliberation and action on the entire income security system, we are in danger of having to deal from a position of extreme weakness in domestic social and economic policy.

Nevertheless, we welcome this opportunity to submit these alternatives to you and, needless to say, we will vigorously carry out any decision you make.

Secretary

Attachments
Tabs, A, B and C

COMPANION PIECE TO DECEMBER 4 MEMORANDUM ON WELFARE REFORM

INTRODUCTION

My December 4 memorandum presented a wide range of incremental changes to the welfare system short of major replacement which you asked me to explore more fully. Based on the December 6 discussion of that memorandum with Cabinet representatives and your staff, I have selected a package of those changes and provided more data about them in this document. The criteria for selection have been:

- Logical consistency, including combinations of certain elements described in the December 4 memo.
- The political possibilities for enactment.

Detailed information on the structure and impact of various elements of the package (some of which are not further considered here) is contained in the tabs. (The cost estimates provided are for FY76 and use the official budget projections as a base.) The included items are suggestions only. Before proceeding with any of these I would want to have considerably more analysis, development and impact estimating done.

I do not believe this package to be on an equal footing with the Income Supplement Proposal (ISP). That is, it is not another way of addressing the concerns that led me to recommend the ISP. Rather, it takes only very partial steps toward some of the desirable goals -- and in some instances moves away from others.

I view this incremental strategy as simply a vehicle to make marginal improvements to the existing system. In fact I do not think it correct to call it "incremental." That term implies short steps eventually leading to a new solution. I do not believe the various patchwork measures will give us a real system. It is impossible to achieve more fully the goals we all subscribe to -- equity, efficiency, objectivity, adequacy, work incentives and fiscal and policy control -- with only an incremental strategy. Each alteration to the existing welfare system, itself replete with inequities and inefficiencies, is bound to exacerbate one problem, even as another may be helped.

Further, an incremental reform strategy for welfare does not even begin to address the larger and pressing issues in our overall income security system. For example, without an ISP type program in place we have no real means to cushion the disproportionate impact of inflation and unemployment among the poor, which may force us to embrace more expensive and undesirable policies in other areas instead. Nor, in the absence of an ISP type program, can we both appropriately distinguish the function that should be served by our social insurance programs (as opposed to means-tested programs) and insure that we can maintain their integrity over time.

Nevertheless, we of course welcome the opportunity to present various alternatives, repairs to existing programs and other changes for your consideration.

CHANGES IN AFDC, FOOD STAMPS AND SSI

We have considered here program design changes and major modifications in the existing AFDC program. Obviously we could not prevail with Congress if we recommended only changes that rationalized and generally tightened AFDC standards. Desirable though these latter changes are from the viewpoints of internal program equity and integrity, administrative efficiency, and objectivity, they would, by themselves, attract no support in this next Congress.

In addition, if we decide to move the AFDC program away from its present state option standards based on individual need assessments towards national and non-discretionary criteria, implementation of such changes is more easily accomplished and their impacts more accurately estimated if we at the same time are putting in place a national AFDC minimum.

I have not discussed here what, in my earlier memorandum, was designated as retargeting AFDC more tightly towards its original mission. Congress would not accept such legislation, and there have been just too many labor market, demographic and policy changes since the 1930's for that to be a desirable or feasible option.

Aid to Families With Dependent Children

In the absence of the ISP I would suggest a legislative package that would:

- -- Institute a national AFDC minimum
- -- Require grant consolidation
- -- Standardize work related expenses (Already proposed in our FY 75 budget control recommendations.)
- -- Establish eligibility to the breakeven

-- Mitigate the unemployment "notch" in the AFDC-UF program

-- Mandate the Unemployed Fathers (UF) option nationwide

-- Institute more frequent reporting, retrospective computation, and longer accountable time period. (Already partly proposed in our FY 75 budget control recommendations.)

These measures to reform AFDC are more fully described in tabs as well as in my earlier memorandum. This memo discusses these AFDC proposals as a total package, though you should be aware that Congress might choose to adopt some and reject others. This danger is discussed more fully later.

The introduction of the national AFDC minimum, the likely "averaging up" process in grant consolidation, extending initial eligibility to the breakeven (i.e., the level of income at which a family ceases to be eligible for assistance because of other income), smoothing out the unemployment test in the Unemployed Fathers (UF) option, and requiring that program to be included in each state's AFDC plan -- would collectively increase the level of benefits for present recipients, add some new recipients, and increase net costs to the Federal government.

On the other hand, abolishing the distinction between actual payment levels and state standards of need, moving to a standard work related expenses deduction, mandating the states to require more frequent reporting, basing benefit computations on past events, and introducing a longer accountable period would serve to remove some AFDC families from the caseload, reduce benefits to others who would nonetheless remain on the caseload, and operate collectively to hold down total costs. (Restructuring the reporting and computation systems in each state would, however, require some heavy initial investments in computers for each state, probably with sizable Federal matching of those costs.)

The total impact on the Federal budget of all these changes in AFDC, if enacted together, is estimated to be an addition of $1.1 billion annually. Caseloads could be expected to increase by 2.5 million persons annually.

Because of the state-by-state variations in payment levels that now exist, the effect of these measures on AFDC recipients is difficult to estimate specifically. The prime beneficiaries would be present and new recipients in low paying (usually Southern) states and those newly covered by the Unemployed Father option; those most disadvantaged would be present recipients in high benefit states who have a substantial amount of non-benefit income from other sources. For the same reasons, the effects on work incentives would be mixed. Extending eligibility to the breakeven and mitigating the UF notch would encourage work effort (or, at least, cease to penalize it); but removing the distinctions between the payment level and the standard of need and imposing a standard work related expense deduction could cause some limited work withdrawal.

The measures that would increase caseload would also cause additional staffing needs in state and local welfare bureaucracies. However, the measures that would simplify eligibility and benefit determination and the proposal to introduce data processing systems in all the state welfare bureaucracies would increase the productivity of caseworkers. We would thus hope to achieve savings in personnel over time although it should be noted that past initiatives to improve the system have not resulted in personnel savings, but increases.

Food Stamps

The Food Stamps program is already a national program based on relatively non-discretionary criteria. Thus, most of the AFDC changes discussed above are not relevant to the Food Stamps program. I would, however, advocate that two of the changes recommended for AFDC also be applied to Food Stamps:

-- Standardizing work related expense deductions. (Already proposed in the FY 75 budget control recommendations.)

-- Instituting more frequent reporting and retrospective computation with a longer accountable period.

The effect of these measures in the Food Stamps program would be similar to their effects in the AFDC program, but, because the Food Stamp population has more earned income, the impact on recipients in reduction of benefits would be much greater. The extra demands in initial personnel staffing at the state and local levels would also be greater.

I would also endorse the other expense deduction consolidations proposed by the Department of Agriculture for the Food Stamps program as part of its FY 75 budget control recommendations.

Supplemental Security Income

Although the provision for Federal administration of state supplements was correct in concept, the "grandfathering" by Congress of all cases converted from the old state programs as well as excessive payment variations has imposed an intolerable and costly administrative burden. I would propose to tighten considerably the conditions under which the Federal government would administer state supplements to SSI -- thus returning the Federal administration option to its original legislative intent. Because some states might be unwilling to accept those conditions, we might have to propose to give those states additional funds under the hold harmless guarantee if they take back administration of their supplement caseloads, thereby easing the political pressures against the change. (Further information on this is in the tabs.)

MAJOR ADDITIONS

In my December 4 memo, I discussed the possibility of an earnings supplement and/or housing allowance as components of a welfare reform strategy. I would not recommend that you sponsor either one. Although both programs would increase the overall adequacy of our income support system -- particularly with respect to those not now covered by AFDC or SSI (primarily the "working poor") -- they would do so by further exacerbating other important problems that are inherent in our present multi-program system. In particular, the costs and complexities of the system would continue to increase dramatically over time, becoming even less subject to fiscal and policy control. A housing allowance, for example, has all the problems and disadvantages of the Food Stamps program.

PROGRAM INTEGRATION

We believe there are three possible program integration options.

I remain strongly opposed to any transfer of responsibility over the Food Stamps program from the Agriculture Department to HEW unless Food Stamps were "cashed-out."

In addition, the alternative of total administrative integration of our major welfare programs, while interesting in theory, has several fatal problems. It rests on a utopian assumption that competing agencies and interest groups and different Congressional committees would be able to submerge their parochial interests. It would require the creation of large Federal field bureaucracy (probably as a component of Social Security) which I regard as an unacceptable cost in this context given the relatively limited gains. In short it would be a more complex and less politically feasible undertaking than ISP with few of the advantages.

The three major measures I would recommend if we decide not to sponsor ISP follow.

1. Cashing-Out Food Stamps for AFDC and SSI Recipients

All AFDC and SSI recipients would receive the bonus value of Food Stamps as a cash addition to their basic AFDC or SSI benefit. (Non-assistance households -- i.e., those who are not eligible to receive AFDC or SSI -- would continue to be eligible for Food Stamps.) This step, if it is to be administratively feasible, should only take place in the context of a national AFDC minimum.

Some recipients might be disadvantaged by the consolidation of disregards in the two programs, but most would benefit because they would automatically realize the value of the Food Stamp bonus in cash. (At present some AFDC and SSI cash recipients do not participate in the Food Stamp program for various reasons.) Thus, although the cash-out would result in substantial administrative savings, its overall effect would be to raise program costs. (More information on this is contained in the tabs.)

2. Standardize Program Definitions

While I remain pessimistic of success in standardizing definitions across programs (AFDC, SSI, Food Stamps, and possibly the housing and education entitlement programs for the low-income population because differing Congressional committees and lobby groups are involved), it is a logical and often suggested step. The Domestic Council could take the lead and create interdepartmental study groups to draw up common legislation. If any legislation along these lines did pass, however, it would mean higher costs to the Federal government because of the inevitable "averaging-up" syndrome that takes hold whenever there is grant and definitional consolidation.

3. SSI Dependent's Allowance

At present there are some households where one spouse or the married couple receives benefits under the SSI program and the other spouse and children in the family receive benefits under AFDC. To eliminate this unnecessary duplication, I would include a dependent's allowance for the SSI program. Initial estimates are that the net costs to the Federal government would be on the order of $400 million annually, principally due to the fact that SSI is completely Federally financed and AFDC contains a state share.

OVERALL PROSPECTS

Predicting the costs of a complex package is hazardous. Proposals have a way of changing shape as legislation is developed and enacted. Nevertheless, assuming the set of proposals described and subject to the caveat I set out at the beginning of the memorandum, a guess of the overall net cost would be about $2 billion. For this expenditure of Federal funds as well as time and political capital, the advances made will not be too substantial.

Some of the possible gains follow:

The present system would be appreciably more adequate for those AFDC recipients in low paying states. It would be made only somewhat more equitable, objective, and administratively efficient; work incentives would be slightly strengthened. While many present recipients would be marginally disadvantaged and some removed from the rolls, a larger number of low-income families will be advantaged by receiving greater aid or becoming eligible for cash assistance because of the expansion of AFDC-UF. Despite the overall increase in costs and caseloads, some advances would be effected in the extent to which we can maintain policy and fiscal control over the welfare system.

However, the odds are not strong that this set of proposals would, in fact, be enacted.

- Proposing an integrated AFDC reform package has the potential danger of Congress accepting only those measures which necessarily increase caseloads and Federal costs, and not those which reduce them and/or result in greater control. For example, the Congress might accept a proposal to finance fully or at 90 percent a national minimum with Federal funds, but at the same time reject a change in the matching formula for benefit levels higher than that. This would result in considerable fiscal relief to high benefit level states at substantial cost to the Federal government and no reduction of Federal matching at the margin for even higher benefit levels. Extending eligibility to the breakeven without also moving to a standard work related deduction, grant consolidation and more frequent reporting could intolerably increase caseloads, Federal and state expenditures and create breakeven levels equal to median family income. We estimate that if Congress accepted only our liberalization measures and not the others, the net costs could run well above $3 billion and result in major increases in caseloads.

- The Congress could as well accept some of our improvements and then add to them in ways that are inconsistent with our basic purpose. An example that is highly probable based upon past experience is that we might cash out Food Stamps as part of a move toward a national minimum benefit for AFDC, only to have the Congress turn around and provide categorical Food Stamp eligibility for some or all "former" recipients as they did in SSI. Such a measure could easily add $.5 billion or more to the costs of an incremental approach.

- Another possibility, which in the absence of a coherent strategy to assist the low-income working population I consider a near-certainty, is the enactment of Senator Long's "work bonus" proposal, possibly in a more expensive form than he has advanced. This proposal embodies an inefficient mechanism to provide assistance to only a subset of the low-income working population. Excluded from coverage are non-Social Security covered workers, generally the poorest of the "working poor." Most importantly, the work bonus would add yet another program, this one to be administered by a new unit in IRS, to the crazy quilt that now exists.

As a result of the possibilities I have just enumerated, I am convinced that if we embark on this piecemeal reform strategy we would find costs, caseloads, and administrative burdens growing rapidly. Just tabulating the highly probable threats I have outlined above could easily result in increased costs in excess of the proposed ISP in the near term. In the longer term I would predict the outcome to be far more disastrous. Another attempt to bring order and policy control to the welfare system will come a cropper -- fundamentally, I would argue, because it would not be centered around a comprehensive, coherent, consistent philosophy toward the Federal role in income assistance and a strategy for achieving it.

Finally, a reform approach of this type cannot be sold as an overall strategy or comprehensive approach to deal with the basic weaknesses, costs and deeprooted faults of the present chaotic mass of programs. Despite conclusions parallel to those of my Department on welfare and the overall income security system reached by the group in Congress that has put most study into this -- Congresswoman Griffiths' Subcommittee on Fiscal Policy -- we should not expect the Congress on its own to develop and adopt an overall strategy or comprehensive approach. That will come only if the President provides the initiative to focus Congressional energies. However, if Congress should pick up Mrs. Griffiths' program, and we do not introduce and sponsor an overall reform program, we will get no political advantage from a program that may pass.

- This new Congress undoubtedly sees itself elected to "do something" about the problems of inflation and unemployment and will, unless we pose an alternative, pass new piecemeal programs that will not target our scarce resources on those most in need. For example, even if the Work Bonus is passed, another obvious "gap" in our income security system is the unemployed who are not eligible for Unemployment Insurance or AFDC-UF (e.g., new entrants and re-entrants to the labor market). There is increasing conviction, especially in the liberal community, of the need for <u>both</u> large-scale public service employment <u>and</u> direct cash assistance through an extension of the UI system to meet the needs of this population. Since such measures are unlikely to be well targeted on the low-income population, they could become extremely expensive ($10 to $20 billion is an easily imaginable figure).

- Also, we will have difficulty redirecting or staving off pressures on the social insurance programs to have them serve essentially welfare ends, much less even beginning to redirect them to their original wage replacement purposes. The worst and quite probable outcome of those pressures, given the growing awareness of the impact of the payroll tax, could well be general revenue financing of an unreformed Social Security system.

In sum, unless we have a comprehensive initiative that focuses Congressional deliberation and action along the lines we want for our overall income security system, we are going to be dealing from a position of extreme weakness in domestic social policy.

This section details each of the possible separate proposals that may be made, singly or in groups. The term "recommendation" below simply means that if that particular proposal is to be made, we are suggesting one of the ways it could be drafted. The following proposals are included:

- National minimum benefit for AFDC
- Consolidated grants and elimination of the difference between the standard of need and maximum allowable payments
- Extend eligibility to the breakeven for applicants
- Mandatory AFDC-UF program
- Change food stamp reporting and computation rules and introduce longer accountable period
- Tighten administration of state supplements under SSI
- Earnings supplement
- Housing allowance
- Cash out food stamps for AFDC and SSI recipients
- Dependents' allowances in SSI

National Minimum Benefit for AFDC

A national minimum benefit would reduce the disparity between high payment and low payment states by improving benefit adequacy in states with very low payments, and would target Federal support on families with the greatest need.

Recommendations:

- o Require a minimum benefit level for a family of four persons of $220 per month ($2640 annually). This amount plus the Food Stamp bonus would be $3600.
- o Provide 90 percent Federal sharing of the average payment based on a payment level of $220 per month.

Number of states affected: 15 states pay maximum benefits of less than $220 a month to a family.

Increases in benefit levels and eligible population: About 3,200,000 present recipients will receive increases in benefits ranging from a negligible amount to somewhat over $100 per month. In addition about 335,000 persons would become newly eligible.

Reduced or cancelled benefits: About 370,000 persons in 5 states (Arizona, New Mexico, Mississippi, Maine, and Missouri) would have benefits reduced and a small proportion would be discontinued. These are states with needs standards greater than $220 per month. The number affected will depend on the benefit level selected when grants are consolidated and a single benefit level established. Families with reduced benefits will be those with income (largely earnings) in addition to the AFDC benefit.

Increased Federal Cost: $700,000,000

Effect on work incentives: Work incentive will be reduced somewhat in the ten states which limit maximum payments to amounts considerably below the needs standard applicable to families with income.

Change in administrative structure: No major changes are needed at the state and local level. Need determination should be simplified with consolidation of grants. Federal monitoring to assure compliance may need to be increased.

Consolidated Grants and Elimination of the Difference Between the Standard of Need and Maximum Allowable Payments

A number of states have moved toward simplification of determination of payment amounts by establishing amounts by family size rather than making an individual determination of family needs. However, 18 states limit payments by setting a cap on payments which is lower than the standard of need. In these states, families with no other income receive payments well below subsistence levels, but the payment is not reduced for families with other countable income equal to the difference between the maximum payment and the standard of need. (A few states pay a percent of the deficit between the need standard and income.) The result is that the needs standard applies only to persons with access to other income.

Recommendations:

(1) Require all states to establish flat grants according to number of persons in the family, with allowance for shelter costs permissible where extreme variations exist within the state.

(2) Require all states to establish a single payment standard applicable to all families of the same size.

Effects:

(1) Consolidated flat grant. A standardized payment level will increase benefits to families with benefits below the selected level and will decrease benefits for families above the level. Families receiving reduced benefits due to change to a flat grant will be those with greater needs when determined on an individual basis.

Thirty-three states have already achieved a substantial degree of consolidation. Twelve of the 18 states that have not consolidated are included in states that would be affected by the proposed national minimum benefit or in the elimination of the difference between needs and payment standards.

About 52,500 families out of the 350,000 families in the remaining six states would have reduced benefits due to consolidation of standards.

Costs: Increased Federal cost - $25,000,000 (assuming a 5 percent increase in total costs in order to limit reductions to no more than 15 percent of the caseload).

(2) Elimination of the difference between needs and payment standards. Families receiving reduced benefits in the states that adopt a single payment standard will be those with income from earnings or other sources. Families with no other income will receive an increase in benefits.

Currently, 18 states have maximum payments that are lower than the standard of need. Five of these states have needs standards below the proposed national minimim. In the remaining 13 states, 250,000 families (out of 500,000 total) would have their benefits reduced.

Costs: Increased Federal costs - $33,000,000 (assuming a 5 percent increase in total costs in order to minimize reductions).

Effect on Work Incentives: In states which eliminate the difference between the needs standard and the maximum payment, there will be some loss of work incentive. Currently, in these states, recipients have the advantage of a zero tax rate on some level of earnings or a reduced tax rate on all earnings. The national disregard on earnings will apply instead.

Administrative Structure: No major changes are needed and administrative processes should be simplified.

Comments: It must be recognized that this proposal (and indeed many of the others considered elsewhere) would be contrary to the New Federalism concept by requiring states to follow a path laid down by the Federal government.

Extend Eligibility to the Breakeven for Applicants

Eligibility for applicants who have not received AFDC in one of the previous four months is determined by the amount of gross income less work expenses but without applying the earnings disregard applicable to families already receiving AFDC. This encourages working mothers to discontinue employment in order to receive AFDC.

Recommendation: Require applications of the standardized earnings deductions in determining initial eligibility.

Effects on Benefits and Caseload: There would be an increase in approved benefits for families with a working mother at the point of application. The number will depend on the employment rates of applicants and the earnings of women related to the benefit level in each state. Assuming a national minimum benefit level of $220 a month, the breakeven for eligibility for a family of four would vary from $360 (plus child care) to high as $600 (plus child care) in a few high payment states. There would be no reduction of benefits resulting from this change. The increase in the eligible caseload would be on the order of 335,000 persons.

Increased Costs to Federal Government: Because of the state-to-state variations in payment levels, and because costs here are highly dependent on assumptions about other changes being simultaneously enacted (e.g., standard expense deductions, longer accountable period, mandating AFDC-UF), it is impossible at this time to specifically estimate the net costs to Federal and state governments of extending eligibility to the breakeven. However, we expect the costs to be on the order of $220 million in Federal money at the same time the changes that control potential breakeven levels of income were enacted.

Effect on Work Incentives: Would remove the present work disincentive that effectively requires female family heads to become unemployed (or substantially reduce earnings) in order to fall within initial eligibility criteria. Removes therefore also the inequity in treatment between single parent families who have the same income but only some of whom receive assistance.

Change in Administrative Structure: No major changes are needed at the state or local levels in the welfare bureaucracies. This particular change increases caseload and personnel needs but the amount is too highly dependent on the changes that would control breakeven levels and increase caseworker productivity to accurately estimate at this time.

Mandatory AFDC-UF Program

Currently, 24 states and the District of Columbia administer AFDC-UF programs. States not included are generally low income, low benefit states with limited state funds to families with unemployed fathers. Mandating the program in these states would not be feasible except in combination with a national minimum benefit level largely financed from Federal funds.

AFDC-UF is a limited program designed to assist families of working men not covered by unemployment insurance or who have exhausted UI benefits. The definition of unemployment (less than 100 hours work in a month) can result in a severe loss of income when a partially employed father increases his hours to more than 100 per month. Although the notch effect is a disincentive to full time employment and results in inequities between fully and partially employed workers, it is not possible to eliminate the notch completely within the context of a program which must distinguish between employed and unemployed persons. It would, however, be possible to reduce somewhat the inequity between lower and higher wage workers by moving toward a definition of "unemployment" that incorporated both hours and earnings in its definition. This, too, would result in a notch, but in spite of this defect, mandating the UF program would help alleviate the problems of extended unemployment of some additional male heads of families with children.

Recommendations:

- o Require all states to administer the AFDC-UF program.
- o In conjunction with a national minimum benefit, provide 90 percent Federal sharing of costs in low benefit states.

Effects: 190,000 additional persons (monthly average) would be assisted.

Increased Federal Cost: $130,000,000

Effect on Work Incentives: Availability of assistance could reduce work incentive but effect is likely to be small. The more equitable treatment of intact relative to single-parent families may also prevent breakup of some families. Recipients are required to register for employment and accept work or training.

Administrative Changes: Minor increases in manpower and additional costs of $3 million shared by Federal and state governments.

Change Food Stamp Reporting and Computation Rules and Introduce Longer Accountable Period

Recommendation: Evidence from several years of experiments strongly suggests that recipients should report income monthly or quarterly and have their benefits adjusted only on the basis of past events. In addition, the period over which income is measured should be lengthened from the immediate need bias of present law to a longer, more equitable period. Somewhat comparable changes have been already recommended by the Department for AFDC.

Effect on Benefit Levels and Caseload: Assistance to present recipients would be lowered because of more income being accurately remembered and reported, decrease in overpayments which are not recouped, and the longer accountable period. No new recipients would be added by this change, and few recipients would lose benefits entirely.

Effect on Costs: Based on estimates of what comparable changes might accomplish in the AFDC program, these changes should, in the absence of any other changes, decrease Food Stamp transfer payments by about $60 million. Arguably the savings would be greater given the higher incidence of earned income in the Food Stamp population.

Effect on Work Incentives: None

Effect on Administrative Structure: If the added burdens of monthly reporting and retrospective computation were imposed with no introduction of sophisticated data processing systems, personnel needs could increase by 50,000 state and local employees. Assuming that the needed data processing facilities were to be made available administrative costs would initially increase by at least $140 million for hardware, but probably no new personnel would be needed. Over time administrative costs would fall because of increased caseworker productivity.

Tighten Administration of State Supplements Under SSI

Although the provision for Federal administration of state supplements was correct in concept, the "grandfathering" of all cases converted from the old state programs as well as allowing intrastate payment variations for optional state supplements has imposed an intolerable and costly administrative burden on the Federal government. This situation in large part has necessitated the pending request for an increase of 7,200 employees in the Social Security Administration.

Recommendations:

- Mandatory Supplements. These are cases which were converted from the superseded state aged, blind and disabled programs. We would propose to limit Federal fiscal liability for erroneous payments in these cases only if the states accepted fiscal liability for erroneous AFDC payments. No states currently administering mandatory supplements could opt for Federal administration.

- Optional Supplements. In these cases we would allow variations only by unit size (individual or couple) and for condition (blindness, disability, and age) -- thus returning the Federal administration option to its original legislative intent. States desiring additional payment variations would have to administer their own supplements. To offset increased administrative costs, states electing their own administration would be eligible for one-time payments up to 150% of their 1975 hold harmless levels. These costs would be less than the current 1976 estimate for hold harmless and anticipated cost overruns due to fiscal liability.

Number of states affected: 32 states currently have Federal administration of mandatory supplements and 17 states have Federal administration of optional supplements.

Number of recipients: 1.2 million recipients receive Federally administered state supplements.

Changes in benefit levels: In those instances where the states choose to stay with Federal administration of their state supplement caseloads under stricter Federal conditions, they would have to either disadvantage some current recipients or "average up" benefit levels. The latter could be costly but only to state revenues. (This might, however, lead to increased political pressures to change the Federal "hold harmless" formula.)

Increase in eligible population: None

Increased Federal cost: A one-time net cost of $100 million, which is more than offset by currently unbudgeted overruns due to state supplement arrangements.

Administrative structure: Some states, deciding to take back management of their state supplements, would have to recreate a payment apparatus to handle the caseload. We estimate at the outside some 10,000 additional state employees.

Earnings Supplement

An earnings supplement adds a "bonus" to each dollar of earnings of covered workers up to some income level. Thereafter, the benefit is reduced as in any income-tested program (e.g., AFDC). This may be illustrated with respect to the "work bonus" proposal of Senator Long, now pending in conference. It would add a benefit of 10 cents to each dollar earned by those family heads with incomes below $4000 per year. Thus, the maximum benefit under the program would be $400, with an average benefit likely to be about $250 per year. As income rose above $4000, benefits would be reduced by 25 cents on the dollar until eligibility ceased at an income of $5600. A presumed advantage of such a program is that over a range (earnings below $4000) earnings would increase by more than the full amount of any wage increase.

The data that follows will apply to the "work bonus;" however, more generous earnings supplement proposals have been proposed and these would, accordingly, be more costly and administratively burdensome.

Number of Recipients: Ten million persons in three million families. All would be "new" recipients.

Net Transfer Cost: $500 million

Effect on Work Incentive: In the range of total family income up to $4000 per year the ES would add to earnings and, theoretically at least, provide a modest work incentive. In the "phase out range" between income of $4000 and $5600, however, recipients would face a 25 percent benefit reduction rate which could have a modest disincentive effect. The balance of these two offsetting effects is difficult to predict, but is, in any case, unlikely to have a substantial impact on work effort.

Administrative Structure: It is estimated that the work bonus, to be administered by a new division within the Internal Revenue Service, would have administrative costs of about $42 million and require 2800 new employees. Administrative costs as a fraction of total transfers would amount to 8.3 percent.

Housing Allowance

A housing allowance program would be based on the "gap-filling" premise and would in that respect be similar to the Food Stamp program. The housing allowance benefit, paid in cash but ear-marked for housing expenditures, would be defined as the difference between the "fair market rent" for decent, safe and sanitary housing and the amount of income (25 percent) that a family could afford for housing needs. A housing allowance would provide additional earmarked assistance to households not now eligible for cash assistance payments. It would increase the costs and complexity of the welfare system, and increase work disincentives if only slightly. Currently, HUD is moving to implement the spirit of of the housing allowance approach through alterations in existing programs. Thus, a national housing allowance as such might never be legislated even though it was in fact implemented. The ultimate effect on costs and caseloads presented below reflects HUD estimates for the housing allowance.

Impact on Recipients

1. Current recipients of housing assistance through existing housing subsidy programs probably would retain eligibility for those programs; that is, existing programs probably would not be replaced by the housing allowance program. Participation in the housing allowance program would probably be precluded for participants in other housing assistance programs (but past experience suggests that such a policy is not guaranteed). In any case, the current 2,063,000 households receiving housing assistance would not be dis-advantaged by the program.

2. New recipients of housing assistance under a universal housing allowance program could number up to 33 million persons in 10 million households. Total eligibility would be about 40 billion persons in 12 million households if participants in current programs are included. Virtually all of these persons would be eligible for food stamps as well, so in that sense there would not be many new "welfare" eligibles.

Costs

HUD estimates the gross costs of a non-categorical housing allowance to be about $9 billion in FY 76. (Revisions of the estimating assumptions are now in process, but the changes would go in both directions and the net change and direction are uncertain.)

Net costs would be the same as gross costs if, as projected, current housing assistance programs would not be replaced.

Impact on Work Incentives

The cumulative marginal benefit reduction rate would increase slightly (77% to 82%) for recipients of AFDC and Food Stamp benefits and more significantly (30% to 55%) for recipients of Food Stamp benefits only. Work disincentives would be increased slightly.

Administrative Structure

The addition of a non-categorical housing allowance would increase total manpower requirements by at least 35,000 man-years. This figure is based on assumptions of a Federally-administered program and integration with the SSI program for SSI-eligibles and applies only to the eligibility and payment functions. A Federal-State administrative model would increase the man-year requirements (due to scale economies). Also, this estimate does not include the provision of housing services and equal housing opportunity services, which would add at least another 10,000 man-years.

Comments: This proposal is not recommended under any circumstances.

Cash-Out Food Stamps for AFDC and SSI Recipients

At present AFDC and SSI recipients may choose to also participate in the Food Stamps program. If they do so, then their cash assistance income along with their other income is counted for purposes of determining their Food Stamp purchase price. The Food Stamp bonus value is the difference between that purchase price and the face value of the stamps.

Recommendation: Cashing-out Food Stamps would mean adding to the basic benefit levels of SSI and the new AFDC national minimum the value of the Food Stamp bonus at those levels of income and integrating the benefit reduction rates by increasing those rates to seventy-seven percent in AFDC and sixty-five percent in SSI.

Effect on Caseload and Benefits

In terms of potential eligibility, the level of benefits for AFDC and SSI recipients would not increase. However, actual benefits would increase for those who would continue assistance because some AFDC and SSI recipients do not now choose to participate in Food Stamps. In a cash-out they would, on the other hand, automatically receive the Food Stamp bonus value in the form of an increase in their AFDC or SSI basic benefit levels.

No new people would be made eligible by a cash-out, though actual caseloads might marginally increase because those who did not participate in AFDC or SSI before the cash-out might be tempted to do so as a result of the now higher (Food Stamps - inclusive) benefit levels. On the other hand, as indicated below, some units that would have been eligible for Food Stamps under the Food Stamp regulations will not be eligible for the cash programs because the latter will have lower breakevens.

Some recipients would sustain losses in benefits because of the consolidation of deductions that would take place in combining the cash programs and the Food Stamp bonus value. In addition, the marginal benefit reduction rate on income between the old cash breakeven levels and the old Food Stamp breakeven level would rise from thirty to seventy-seven percent, causing a considerable reduction in benefits to people in that range and, in many cases, total removal from assistance.

Effect on Costs

Costs will tend to rise because of automatic receipt of the Food Stamps bonus value, as opposed to the failure of some cash recipients to now participate in Food Stamps. On the other hand, costs will decline because of lower breakevens, consolidation of deductions, and considerable administrative savings. We expect the net effect to be an increase in costs on the order of $630 million.

Effect on Work Incentives

Some work withdrawal might be caused by the consolidation of work related deductions and the higher marginal benefit reduction rate in some ranges of income.

Effect on Administrative Structure

Cashing out Food Stamps would completely eliminate the dual cash-Food Stamp eligibility process that must be now undertaken in favor of one process. We would as a result expect savings in program costs on the order of $225 million.

Dependents' Allowances in SSI

The SSI program covers only those who are aged, blind and disabled. If SSI adults have dependent children, the children must be covered under AFDC. Including the dependents in SSI would rationalize administration by having only one agency deal with the family as a unit.

Recommendation: Include allowances for dependents (including the spouse living with the SSI recipient when minor children are in the house) as follows:

Spouse - one-half of the basic benefit
First and second child - one-half of the basic benefit
Third and additional children - one-third of the basic benefit.

Effects:

Number of dependents added - 540,000

Total Federal Cost	$ 430 million
Federal Share of Current AFDC	$ 207 million
Net Increase in Federal Cost	$ 223 million

Effect on Benefits to Recipients: Benefits would be increased for AFDC recipients in low payment states. There could be some income reduction for some families in high payment states, particularly those with high rental costs or who have special needs included in AFDC.

Number of recipients: There would be little change in the eligible population. However, the state administered AFDC agencies can be expected to encourage application for SSI in order to reduce state expenditures.

Effect on Work Incentives: There would be no change in work incentives if the AFDC disregard is applied to earnings of dependents. If the SSI disregards are applied, work incentive would be increased.

Change in Administration: Savings in state administration would not be significant.