Policy Analysis

Cato Institute Policy Analysis No. 41: The Tightening Grip of the Poverty Trap

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Executive Summary

Over the past 16 years, a "safety net" has been created for the disadvantaged and unemployed in our society. Food stamps, rent subsidies, medical care, and direct income supplements in the form of Aid to Families with Dependent Children (AFDC) are available to alleviate the worst hardships of poverty. Since 1968 transfer payments to persons have increased more than sevenfold, to $403 billion; even after adjusting for inflation, transfer payments have more than doubled in this period. Although much of this increase has occurred in Social Security and other government-funded retirement programs, the growth in transfer-payment programs aimed specifically at the poor and disadvantaged tells much the same story. In 1983 expenditures for AFDC, food stamps, and the like [1] totaled $105.6 billion -- nearly three times the amount in constant dollars spent in 1968 (figure 1).

Nonetheless, in the government's persistent effort to achieve parsimony in conjunction with fairness and equity, each of these programs has stringent criteria for its recipients. For people who receive AFDC, for example, there is an income test that, after four months, reduces this benefit, dollar for dollar, on any earned income above $75 per month. AFDC benefits can be sheltered from this 100 percent tax by expending the same amount in earned income on child care. Similar means test and income test strictures apply to recipients of food stamps, housing subsidies, unemployment compensation, and the like. These criteria of eligibility are designed to ensure that only the truly needy receive the help they so desperately lack. Excluding people in progressively higher income groups means that funds are not squandered on those who are less in need.

Although these means, retirement, income, unemployment, and other needs tests may be rationalized on both moral and budgetary grounds, they have marked adverse effects on the economic incentives of the poor. When combined with payroll and income taxes, the phased reduction of welfare benefits means that spendable income actually rose very little as gross wages increased to $1,600 per month (at least in our Los Angeles case study). With the tightening of eligibility requirements for food stamps and AFDC by the Reagan Administration spendable income (total spending power) actually declines as gross wages rise to $1,300 per month.

Figure One
Growth in Transfer Payments to the Poor and Disadvantaged 1950 - 1983
[Graph Omitted]

Sources: National income and product accounts; Survey of Current Business.

A Flawed Enterprise Zone Proposal

The enterprise zone legislation offered by the Reagan administration is incapable of freeing the inner city from this poverty trap. It reflects a misplaced fear of losing nonexist- ent revenues and a complete disregard for the impact of incen- tives on individual behavior.

There are four major weaknesses in the enterprise zone legislation supported by the Administration.[2]

First, the bill discriminates against employers currently located in the enterprise zone. Under the proposed legislation, disbursement of tax credits will be greater to those businesses making the greater additions to their payrolls. This works to the disadvantage of already-existing businesses relative to new companies, which by definition have base wages equal to zero. Newly relocated firms can pass these savings on by hiring more workers or paying more competitive salaries.

Second, the bill discriminates against low-wage individuals currently working in the enterprise zone by offering substantial tax incentives over a seven-year period to so-called economi- cally disadvantaged individuals (EDIs). Certification as an EDI requires, among other things, a 60-day period of unemploy- ment and a record of having received, or being eligible to receive, welfare assistance. The tax incentives narrow the tax wedge between an employer's labor costs and an employer's income for certified individuals. As a result, at the same wage received, a certified individual will cost an employer less then a noncertified individual. Or, at the same wage paid by the employer, wages received by the certified indivi- dual will be higher. The net result is to increase incentives among low-wage individuals to become unemployed until they become certifiable as EDIs.

Third, investment tax credits will increase incentives to locate capital equipment in the zone. Once the capital is in place, however, there will be no additional incentive to operate it in contrast to capital in place anywhere else in the United States or the world. The investment tax credit will distort the type of operations located in the inner city toward those intensive in the use of capital equipment, rather than those intensive in the use or workers. This does not solve the problem of inadequate demand for low-wage labor.

Fourth, the provisions of the bill are too complex. The reporting requirements, record keeping, et al., discriminate against small local entrepreneurs in favor of large corpora- tions with existing legal and personnel departments.

Case Study: A Los Angeles Family

The net effect on spendable income of the combination of needs tests and taxes for an inner-city family of four in Los Angeles is shown in table 1. The family is assumed to consist of one adult and three dependent children. In addition it is assumed that the family avails itself of the maximum city, county, state, and federal welfare benefits to which it is entitled, based on its income. These benefits include AFDC, food stamps, MediCal (California's Medicaid), and a housing subsidy.

As shown in table 1, the impact of incremental increases in gross wages of $100 per month has been calculated up to $1,600 per month. The wage figure is the total cost to the firm of employing one person. The income figures, therefore, include employer contributions to Social Security and unemploy- ment insurance contributions. Several biases exist that cut in a number of directions, but the central point is obvious. Mar- ginal tax rates for inner-city inhabitants are prohibitively high. Over the entire wage range from zero to $1,600 per month (equivalent to a gross paycheck of $1,463 per month), the fami- ly's monthly spendable income rises by $69. This corresponds to an average tax "wedge" of 95.7 percent. More shocking, between zero and $1,200 per month in gross wages, the family loses $46 in monthly spendable income -- an average tax in excess of 100 percent.

This loss in net spendable income is concentrated between gross wages of $700 and $1,200 per month. As monthly wages paid rise by $500 in this span, the family loses its entitle- ment to $385 in AFDC benefits and $9 in food stamps. In addi- tion the housing subsidy is reduced by $23 and the value of medical benefits declines an estimated $130. At the same time the family's tax liabilities increase by a total of $161 -- $8 in state income and disability insurance taxes, $68 in payroll taxes, and $85 in federal income tax. (Details of these calcu- lations are given in the appendix.)

The net result is to impose an effective tax rate of 142 percent on monthly gross wages of between $700 and $1,200, and an even more incredible 278 percent on gross wages of between $1,000 and $1,100 per month.

Never before has there been such a paucity of opportunity for the law-abiding poor to better themselves. Disincentives

Table 1 The Effect of Taxes and Income Tests on Family Spendable Income from Wages and Welfare Benefits			
Monthly Gross Wages ($)	Net Monthly Family Spendable Income($)	Increase in Spendable Income ($)*	De Facto Marginal Tax Rate (%)
0	1,261	n/a	n/a
100	1,304	43	57
200	1,341	37	63
300	1,366	25	75
400	1,391	25	75
500	1,419	28	72
600	1,429	10	90
700	1,423	-5	105
800	1,418	-5	105
900	1,420	2	98
1,000	1,432	12	89
1,100	1,253	-178	278
1,200	1,215	-39	139
1,300	1,217	2	98
1,400	1,296	39	61
1,500	1,294	38	62
1,600	1,330	37	63

Sources: County of Los Angeles, Department of Social Security; Department of Social Services; and Housing Authority.

*May not correlate exactly with data on net family spendable income owing to rounding.

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have always been part of the welfare system. What has changed is the severity of those disincentives.

In 1978, for example, under the Carter administration, if this same family of four had earned income of between zero and $620 per month, it would have had more to spend. Thus the loss of welfare benefits and the incurring of tax payments were less than the increases in monthly wages of from zero to approximately $629 (in 1984 dollars).

This is called the incentive range, because individuals are better off when they earn more. It would be grossly inaccurate, however, to convey the impression that incentives in this range are high. In 1978 the increase in spending power was only $152, as family earnings rose from zero to $629 per month. This corresponds to an average effective tax rate of 76 percent. In spite of the offensive nature of this confiscation, it still represents the best the poor have. In 1982 and 1984 this incentive range (in 1984 dollars) ranged up to $101 and $1,000 respectively (table 2). Again these incentive ranges for the years 1982 and 1984 do not live up to their billing. For 1981 the incentive range represents an effective tax rate of 79 percent, and for 1984 the effective tax rate is 83 percent.

In 1978 the average family's net spendable income declined $9 as gross wages rose to $1258 from $620 per month.

Thus the after-tax wage increases were little more than offset by the family's reduced eligibility for welfare benefits. Within this disincentive range, the family's standard of living remained essentially unchanged as its earnings changed. As a result the effective equivalent tax rate was roughly 100 percent on any additional work effort. Beyond $1258 per month, however, spendable income began, once again, to rise with higher earnings (table 2).

By the fall of 1981 the top of the incentive range had increased to $901 per month. Because of spending reductions achieved under the Reagan administration's first budget, however, the disincentive zone became a chasm of declining living standards. In the course of increasing gross wages by $564 a month, the family's spendable income declined by $97, an effective tax rate of 117 percent.

In 1984 the disincentive zone began at $1,000 a month. As gross wages for a family increased to $1,600 per month, their spendable earnings actually declined by $102 -- an effective tax rate of 117 percent in this income range (table 2).

To understand the effect of such a system, imagine the choice facing a disadvantaged individual being paid $1,000 per month when he or she is offered a promotion with a 20 percent

Table 2

Comparison of Effect of Taxes and Income Tests on Family Spendable Income From Wages and Welfare Benefits Under Carter and Reagan Administrations (in March 1984 dollars)

[Graph Omitted]

Sources: County of Los Angeles Department of Social Security, Department of Social Services, and Housing Authority.

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pay increase (cost to the employer) to $1,200 per month. The decision to accept the promotion will require the individual not only to take on more responsibility but also to accept a $217-per-month reduction in spendable income. Unless the individual perceives the promotion as an investment in the future and hence is willing to forgo current consumption, he or she will turn the job down, perpetuating the low income that entraps the family.

Dimensions of the Poverty Trap

The overall effect of these high effective tax rates on the poor and disadvantaged has been nothing short of tragic.

During the 1970s nonwhite and low-skilled workers fell further and further behind their white and high-skilled counterparts in the economic areas of participation in the labor force, employment, and earnings. At the same time, the rising crime rate of the inner city and further deterioration of the minority family unit created additional adversities for the disadvantaged sectors of our society.

The relative deterioration in the position of nonwhites and the low-skilled is not a result of the exceptional economic performance of whites and the high-skilled, but rather has occurred in spite of poor white performance. Nevertheless, although white performance has been discouraging, nonwhite performance has been even worse.

To those immersed in the political rhetoric of our times, such a contradiction must appear incredible. To an economist, however, these results are a fully predictable consequence. Dramatically increased economic disincentives and other legislated barriers have disenfranchised many nonwhites from participation in U.S. economic prosperity.

Rising crime rates in the inner city are partially fueled by high unemployment rates and an antiquated penal system. The inner-city unemployed have little incentive to obtain a job, in that any legitimate source of revenue would be accompanied by a reduction in welfare benefits and additional taxes. In the unlikely event that the criminal is apprehended and convicted, prison would merely take away some of the time that to him is so abundant.

The quality of life in the inner city has been disrupted in several aspects by these extraordinarily high effective tax rates created by welfare-related legislation. Each aspect in its own way testifies to the power of incentive to influence human behavior.

Labor Force Participation Rates

Participation rates in the labor force (the percentage of the population either looking for work or actually working) give an indication of the incentive to work. On one level, participation in the labor force by nonwhite males has fallen, both on an absolute basis and relative to that of white males. The participation rate for nonwhite males was significantly lower in 1982 than it was in 1968. White male participation rates, by contrast, declined only slightly (table 3). The proportional decline in participation rates for males is even greater for nonwhites because the initial level (1968) of participation was lower.

At first glance the decline in overall participation rates evident between 1968 and 1982 appears to be a continuation of a trend established between 1958 and 1968. An analysis of participation rates by age, however, reveals that for males between the ages of 25 and 55, participation rates during the 1958-68 decade remained essentially unchanged. Participation fell among the young and the elderly. One reason for the fall in teenage participation rates was the 60 percent increase in the minimum wage to $1.60 an hour that occurred between 1958 and 1968. The decline in participation rates among those 56 years and older is undoubtedly attributable in part to improvements in retirement plans during this period (table 3a).

An analysis of the experience of nonwhite females relative to white females yields much the same result. Participation rates rise for both groups, but, on a relative basis, the participation rate of white females rose by a much greater amount (table 3).

An individual may have many diverse reasons for not participating in the labor force, but the economist focusing on incentives would surmise that rational individuals would not participate when the cost of participation exceeded the expected returns. As the costs of participating in the labor force rise and the benefits fall, participation should decline. As both the probability of finding work and the gains from working decrease, participation should fall. When all these events occur at the same time, it should not be surprising that participation rates fall.

Employment Rates

One measure of the likelihood of finding work is the employment rate (100 percent minus the unemployment rate). This dimension of the poverty trap reveals the same trends as the participation rate, only to a more alarming extent.

Table 3
Participation in Labor Force, by Age and Race, 1958-1982

	White			Nonwhite		
Age	1958	1968	1982	1959	1968	1982
Male						
16-17	46.8%	47.7%	49.3%	45.1%	37.9%	26.3%
18-19	69.4	65.7	70.5	71.7	63.3	54.9
20-24	86.7	82.4	86.3	88.7	85.0	77.0
25-34	97.2	97.2	95.6	96.3	95.0	88.8
35-44	98.0	97.6	96.0	96.4	93.4	90.2
45-54	96.6	95.4	92.2	93.9	90.1	83.7
55-64	88.2	84.7	71.0	83.3	79.6	63.8
65+	35.7	27.3	17.9	34.5	26.6	16.7
All Ages	84.3%	80.4	77.4	84.0	77.6	71.0

Combined						
Female						
16-17	28.8	33.0	44.6	23.2	22.3	24.1
18-19	52.3	53.3	64.6	41.2	46.9	44.5
20-24	46.1	54.0	71.8	48.3	58.4	59.9
25-34	33.6	40.6	67.8	50.8	56.6	68.6
35-44	41.4	47.5	67.5	60.8	59.3	70.8
45-54	46.5	51.5	61.4	59.8	59.8	62.5
55-64	34.5	42.0	41.5	42.8	47.0	44.5
65+	10.1	9.4	7.8	13.3	11.9	8.3
All Ages Combined	35.8	41.6	54.4	48.0	49.3	53.9

Source: U.S. Department of Labor, Bureau of Labor Statistics, Employment and Earnings, January 1983; Employment and Training Report of the President.

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Table 4, which shows employment rates for males and females by age and race, clearly illustrates the trend since 1968. In every age category, for those participating in the labor force, the probabilities for nonwhites of being among the employed has decreased dramatically relative to those for whites. This also is true for female employment rates when whites and nonwhites are compared.

Table 4
Employment Rates by Age and Race, 1958-1982

	White			Nonwhite		
Male						
16-17	85.1%	87.7%	75.8%	72.9%	73.4%	53.1%
18-19	83.5	91.8	80.0	73.3	81.0	57.3
20-24	88.3	95.4	85.7	80.5	91.7	70.8
25-34	94.4	98.3	91.1	85.3	96.2	81.9
35-44	95.6	98.6	93.8	88.6	97.1	87.8
45-54	95.2	98.5	94.7	89.7	97.5	91.5
55-64	94.8	98.3	94.9	89.9	96.4	90.5
65+	95.0	97.6	96.8	91.0	96.0	90.7
All Ages Combined	93.9	97.4	91.2	86.2	94.4	81.8
Female						
16-17	84.4	86.1	78.8	74.6	66.1	58.9
18-19	89.0	89.0	82.4	70.0	73.6	54.7
20-24	92.6	94.1	89.1	81.1	87.8	73.2
25-34	93.4	96.1	92.0	88.9	91.6	83.6
35-44	94.4	96.9	93.6	90.8	95.0	89.9
45-54	95.1	97.7	94.5	95.0	96.8	91.7

55-64	95.7	97.9	95.0	93.8	97.2	93.6
65+	96.5	97.2	96.9	94.4	96.0	95.4
All Ages Combined	93.8	95.7	91.7	89.2	91.7	83.6

Source: U.S. Department of Labor, Bureau of Labor Statistics, Employment and_Earnings, January 1983; Employment and Training Report of the President.

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During the 10-year period ending in 1968, by contrast, employment rates for whites and nonwhites, males and females alike, increased. Moreover, employment rates increased the most for black males.

As with labor force participation, there are many reasons a person may be unemployed. Unemployment takes place when firms cannot profitably hire workers at acceptable wages. Legislated contributors to unemployment can be direct, as with a minimum wage so high that no employer finds it worth while to hire the youth and low-skilled of the inner city. The minimum wage literally prohibits the employment of people who are, in strict economic terms, worth less than $3.35 per hour. Those who have less productive ability because they are young, inexperienced, uneducated, or not fluent in English are particularly hard hit by such legislation. Despite the obvious beneficial intent of the minimum wage law, its effect on youth and low-skilled workers is so disastrous that an outside observer could well believe it was designed to create unemployment.

The extraordinarily high effective marginal tax rates facing welfare recipients also contribute directly to the relative loss in employment of nonwhites. Other legislation contributing to unemployment is less obvious. Further regulatory burdens, higher taxes on employers, and a worsening capital shortage all contribute to a decline in the demand for workers. As these changes have occurred in the past decade, the results have been additional unemployment and a disturbing fall in the purchasing power of the average worker's paycheck. This is illustrated by the third link in the poverty chain, as follows.

Real Earnings

Between 1968 and 1981 real earnings of black males employed year-round in most age groups grew faster than real earnings of white males on a relative basis (table 5). The same is true for nonwhite females (table 6). Between 1959 and 1968, by contrast, the median income of white males and females rose relative to that of their nonwhite counterparts (tables 5 and 6).

On the surface this trend appears to be encouraging, but closer evaluation yields a more disturbing insight. Given the large increases in unemployment and decreases in participation rates among nonwhite males 20 years and older, large numbers of low-income blacks no longer are employed and earning income year-round. The increase in the median income of black males employed year-round apparently reflects the exclusion of lower- income males and females from the calculation rather than an elevation in overall black welfare.

This interpretation of the data is supported by changes in the median family income. For both black and white families living in the central cities, median income in constant 1983 dollars declined between 1969 and 1981 (table 7). For blacks the decline was 71 percent greater than that for whites. The gap between black and white median family income in metropolitan areas outside the central city narrowed somewhat. On an overall basis, however, the disparity between the standards of living enjoyed by black and white families increased during the 12 years ending in 1981 (table 7).

To make matters worse, this increased disparity in living standards occurred at a time when the purchasing power of the average worker's income, adjusted for taxes, was declining. Real spendable earnings for a nonagricultural production (or nonsupervisory) worker with three dependents peaked in 1977 at $287.08.[3]

The Tragic Results

This fall in the purchasing power of the average worker's wages is tragic when compared to the almost-constant advance in real wages that has occurred over the past century. The tragedy is felt most intensely by marginal workers who, by the very nature of their marginality, are the first to lose their jobs when the demand for workers falls. For marginal workers the question is not whether or not their wages will keep up with inflation, but whether they can remain productive, self-supporting members of society. The costs cannot be fully expressed in dollars. The personal degradation of continually seeking work and being told that one's services are unwanted must also be taken into account. The fact that this type of degradation is focused on minority races can only add to the victim's feelings of resentment and social anomie.

An individual's decision not to participate in the labor force is an active statement of how that person sees his or her abilities relative to society's values. The individual could well say that the chances of finding a job are so low that it is not worth trying. Or it may be that the wages would be so low relative to welfare opportunities that it is not worthwhile to seek work. One way or another, nonparticipation is tantamount to having no hope of engaging in the productive activity that for the most people is a central part of life.

The tragedy of unemployment is not fully reflected in the figures. The average unemployment rate misses the high and growing unemployment rates of nonwhite youth. For nonwhites currently not in school and within the 16-19 age group, for example, the participation rate is 40.6 percent. Of those participating, only 55 percent are employed. Taken together

Table 5
Median Annual Income of Males Employed Year-round, By Age and Race (in 1983 dollars)

				1959-68		1968	
Age	1959*	1968	1981	Increase	Percent Change	Increase	Percent Change
20-24	$ 9,246	$16,618	$13,938	$7,372	79.9%	$-2,680	-16.1%
25-34	17,224	23,141	21,476	5,917	34.4	-1,665	-7.2
35-44	19,415	25,928	26,349	6,513	33.5	421	1.6
45-54	18,198	24,588	27,453	6,390	35.1	2,864	11.6
55-64	15,726	22,394	25,985	6,668	42.4	3,590	16.0
All Ages Combined	14,824	23,044	23,199	8,220	55.5	$155	0.7
Nonwhite							
20-24	$ 5,924	$12,832	$11,461	$6,908	166.6%	$-1,371	-10.7
25-34	9,950	16,374	16,784	6,424	64.6	410	2.5
35-44	10,990	16,286	17,836	5,296	48.2	1,550	9.5
45-54	9,612	16,727	16,611	7,116	74.0	-117	-0.7
55-64	7,688	14,218	17,052	6,531	84.9	2,834	19.9

Sources: Bureau of the Census, Current Population Reports 1981, Series P-60, No. 137, table 46; 1960 Census of the U.S., United States Summary. Vol. 1, Part 1, table 219.

*Median income is not available for persons employed year-round in 1959; the general category of persons was used in that year.

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Table 6 Median Annual Income of Females Employed Year-round, By Age and Race (in 1983 dollars)							
				1959-68		1968-81	
Age	1959*	1968	1981	Increase	Percent Change	Increase	Percent Change
White							
20-24	$6,203	$12,268	$11,234	$6,065	97.8%	-1,304	-8.4%
25-34	6,843	14,605	14,842	7,762	113.4	236	1.6
35-44	7,503	13,855	15,339	6,352	84.7	1,484	10.7
45-54	8,100	13,631	14,258	5,530	68.3	628	4.6
55-64	5,971	13,852	14,522	7,881	132.0	670	4.8
All Ages Combined	5,160	13,422	13,422	8,261	160.1	451	3.4
Nonwhite							
20-24	$3,083	$10,166	$9,925	$7,083	229.7%	-240	-2.4%
25-34	4,426	11,507	13,707	7,081	160.0	2,201	19.1
35-44	4,467	10,458	12,603	5,991	134.1	2,185	20.5
45-54	3,456	10,023	12,480	6,568	190.1	2,457	24.5
55-64	2,827	8,453	11,552	5,626	199.0	3,099	36.7
All Ages Combined	3,145	10,198	12,530	7,053	224.3%	2,332	22.9

Sources: Bureau of the Census, Current Population Reports 1981, Series P-60, No. 137, table 46; 1960 Census of the U.S., United States Summary. Vol. 1, Part 1, table 219.

*Median income is not available for persons employed year-round in 1959; the general category of persons was used in that year.

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these statistics mean more than 75 percent of this age group are either looking for work and are unable to find it, or are not even bothering to look for work. These individuals are developing habits and a life-style in which productive activity is absent. Moreover they are missing the training and experience that past generations of nonwhites have used to gain entry to the business world.

Family Deterioration

Disruption of the family unit is yet another aspect of the web of welfare disincentives that is a predictable outcome of our welfare benefit structure. Public assistance agencies allocate benefits generally on the basis of family units, and these benefits increase less than proportionately as family size increases. Two families of three members each generally will be eligible for more benefits than one family of six members when there is no outside income. This incentive leads to the breaking up of the family as income is earned. If the family of six earns income, its benefits fall at a faster rate than for two families of three or three families of two (table 8).

The incentives to divide a family are even more striking when one considers that in a family unit with two adults, one of the two must be working unless he or she is disabled or has been unsuccessful in searching for work. In a family unit with only one adult, it is unnecessary that he or she work or search for a job as long as there are school-age children at home. Breaking up the family unit, therefore, means that welfare benefits are increased and the need for one adult to work is eliminated.

Rewards for family division are most pressing when one member is fully employed. The income of one adult may sufficiently reduce benefits so that the family's spendable income suffers. By keeping himself or herself separate from the rest of the family through lack of marriage or other legal connection, the employed adult allows the other parent to be eligible for the full array of entitlement programs. Thus eligibility requirements may make family desertion a parental duty, not an act of cowardice or irresponsibility. It should not be surprising that more than half the black children under the age of 18 are not living with both parents and that nearly half of all black births are illegitimate. Tables 8, 9, and 10 illustrate these family trends.

Conclusion

The financial incentive structure of the past 16 years has visited a tragedy on inner-city residents. Given current

Table 7
Median Income of Families. 1969 and 1982 (in 1983 dollars)

	White				Nonwhite			
Area	1969 Income($)	1981 Income($)	Income($)	Percent Change	1969 Income($)	1981 Income($)	Income($)	Percent Change
Inside Central City	27,240	25,068	-2,222	-8.1	17,819	14,020	-3,799	-21.3
Metropolitan Outside Central City	30,458	31,572	710	3.7	18,795	19,409	614	3.3
All Families	26,611	25,762	-849	-3.2	16,303	14,526	-1,777	-10.9

Source: Bureau of the Census, Current Population Reports, Series P-60, No. 137.

Table 8
Maximum Benefits Under Major Welfare Programs

Benefit	One Family of 6	Two Families of 3	Three Families of 2
Food Stamps	$361	$398	$417
AFDC	802	1,052	1,272

Source: Department of Social Services, Los Angeles.

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legislative initiatives, the inner-city poor may well find themselves even more isolated in the coming decade. In the 1960s, rapid, sustained economic growth created a climate of increased opportunities, higher standards of living, and the hope of a better life for the poor and disadvantaged. The economic expansion in the 1980s, however, threatens to leave the inner-city family dependent on, and penned within, the public assistance structure. Who among the poor will ask their families to take a 20 percent or 30 percent cut in their standard of living so that they can have the privilege of going to work? It would be a further tragedy for minorities to continue to fall behind while their white counterparts catch hold in an expanding economy.

A Positive Plan

What is needed is a reversal of those policies that have tightened the grip of the poverty trap by turning the safety net of a moral society into an immoral labyrinth that uses poverty itself to entrap the poor. Policy must be directed toward ensuring that the fruits of economic recovery can be harvested in the barrios and ghettos that make-up the inner city. A first and necessary step in that direction can be outlined in a five-point program:

1. Eliminate effective tax rates in excess of 100 percent through the relaxation of means, needs, and income tests.

2. Establish a corporate tax rate on operations inside the enterprise zone of a maximum of 10 percent.

3. Eliminate payroll taxes (both employer and employee) on the first 10,000 in annual earned income for individuals who live and work in the enterprise zone.

4. Eliminate or reduce the minimum wage for teenagers employed in the enterprise zone.

5. Require economic impact statements for all new and existing regulations and other forms of government strictures that apply to businesses and individuals in the enterprise zone, in order to identify regulations that would constrain economic activity and employment within the zone.

Table 9
Female Family Householders, by Race

Percent of Families				
1960	1968	1981	1960-68 Increase (%)	1968-81 Increase
White				
8.1	8.9	11.9	0.8	3
Nonwhite				
20.9	27.7	41.7	6.8	14.0

Sources: U.S. Bureau of the Census, 1960 Census of Population, Vol. 1; and Current Population Reports, Series P-20, No. 371 and earlier issues.

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Table 10
Rate of Illegitimacy in Births, by Race

1960 Rate(%)	1968 Rate(%)	1980 Rate(%)	1960-68 Increase(%)	1968-80 Increase(%)
White				
2.3	5.3	11.0	3	5.7
21.6	31.2	48.5	9.6	17.3

Source: U.S. National Center for Health Statistics, Monthly Vital Statistics Reports.

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APPENDIX

This appendix provides the formulas used to calculate the reduction of income (through taxes) and welfare benefits in the computation of net monthly family spendable income.

The following tax and welfare disincentives apply to a family of four (a head of household and three dependent children) living in Los Angeles.

A. **Tax Liabilities Incurred**

1. Employer taxes: 7 percent employer's share of Social Security, plus 3.5 percent unemployment insurance contribution up to $7,000 in wages, plus 1 percent contribution to mandatory workmen's compensation. Total: 11.5 percent of gross wages paid.

2. Employee Social Security tax: 6.7 percent of gross wages.

3. Employee disability insurance (SDI): 0.9 percent of gross wages.

4. State and federal income taxes: increase progressively to 23 percent.

B. **Welfare Benefits Lost**

1. Aid to Families with Dependent Children (AFDC). Payments terminate when income exceeds 150 percent of AFDC (standard of need). In the case of this family of four, the AFDC maximum aid payment is $625 and the 150 percent figure is $938. As wages are earned, the monthly payment of $625 is reduced progressively. For the first three months of employment, benefits are reduced about $67 per month as gross wages rise $100 per month. In the fourth month benefits are reduced dollar for dollar as additional income is earned above $75 per month. In other words, once an individual is above a minimum established by a formula, AFDC benefits fall by one dollar for every dollar earned. When computing AFDC benefits, it is assumed that half the working adult's wages are sheltered by expending the money on child care, which is deductible up to $160 per child per month. It also is assumed that Medicare -- full health insurance for a family of four -- has market value of $166 per month.

2. Rent subsidy. The Los Angeles County Housing Authority will pay the difference between the tenant's portion of the rent (not more than 30 percent of the tenant's net income) and the actual rent. In our example, the family of four is eligible for a two-bedroom apartment with rent up to $539 per month including utilities. The tenant's share of the rent is calculated by taking all monthly "money income" (wages plus AFDC benefits) and subtracting a child care credit of $25 per child per month. The tenant's portion of the rent is 30 percent of the remaining monthly income. At zero income, with AFDC benefits of $625 per month and subtracting $75 in child care credits for three children, the family in our example would pay 30 percent of the remaining $550, or $265 per month. The rent subsidy would be $373, paid by the Housing Authority. The family becomes ineligible for rent subsidy when its annual income reaches $21,900.

3. Medical. For this family of four, as long as its total income (including AFDC benefits) does not exceed $834 per month, all medical costs will be paid. When the family's income exceeds $834, each dollar of additional income must go to pay any medical costs that are incurred. For example, if the family's income is $1,000 (exceeding the "maintenance need" level by $166) and its medical expenses during a given month were $2000, the entire $166 would go toward paying the medical costs.

4. Food stamps. This benefit is reduced in proportion to money income (wages plus AFDC benefits). For a family of four, food stamp payments range from $253 per month (with zero money income) to $10 per month (with $1,073 in gross income). Because of California's AFDC payments, at zero wages this family qualifies for $92.20 per month in food stamp benefits.

Appendix Sources:

State Department of Social Services, Los Angeles County Welfare Office, Department of Social Services, West Los Angeles Housing Authority of the County of Los Angeles, Applications and Eligibility Supervisor, Los Angeles South West Family Aid, Department of Social Services, Los Angeles California Franchise Tax Board, Los Angeles Internal Revenue Service

FOOTNOTES

[1] Transfer-payment categories include government unemployment insurance benefits, Aid to Families with Dependent Children, food stamps, supplementary security income (SSI), categorical and general public assistance, workman's compensation, and railroad retirement.

[2] Legislation as set forth in Enterprise Zone Act of 1982, H.R. 6009, 97th Congress, 2nd session (March 31, 1982).

[3] U.S. Department of Labor, Bureau of Labor Statistics, 1983, Employment and Earnings; Employment and Training Report of the President.