The presidential election of 1932 was a political watershed for the United States. Herbert Hoover, seeking reelection on the Republican ticket, was saddled with a deep depression. Millions of people were unemployed. The standard image of the time was a breadline or an unemployed person selling apples on a street corner. Though the independent Federal Reserve System was to blame for the mistaken monetary policy that converted a recession into a catastrophic depression, the President, as the head of state, could not escape responsibility. The public had lost faith in the prevailing economic system. People were desperate. They wanted reassurance, a promise of a way out.

Franklin Delano Roosevelt, the charismatic governor of New York, was the Democratic candidate. He was a fresh face, exuding hope and optimism. True enough, he campaigned on the old principles. He promised if elected to cut waste in government and balance the budget, and berated Hoover for extravagance in government spending and for permitting government deficits to mount. At the same time, both before the election and during the interlude before his inauguration, he met regularly with a group of advisers at the Governor's Mansion in Albany—his "brain trust," as it was christened. They devised measures to be taken after his inauguration that grew into the "New Deal" FDR had pledged to the American people in accepting the Democratic nomination for President.

The election of 1932 was a watershed in narrowly political terms. In the seventy-two years from 1860 to 1932, Republicans held the presidency for fifty-six years, Democrats for sixteen. In the forty-eight years from 1932 to 1980, the tables were turned: Democrats held the presidency for thirty-two years, Republicans for sixteen.

The election was also a watershed in a more important sense;
it marked a major change in both the public's perception of the role of government and the actual role assigned to government. One simple set of statistics suggests the magnitude of the change. From the founding of the Republic to 1929, spending by governments at all levels, federal, state, and local, never exceeded 12 percent of the national income except in time of major war, and two-thirds of that was state and local spending. Federal spending typically amounted to 3 percent or less of the national income. Since 1933 government spending has never been less than 20 percent of national income and is now over 40 percent, and two thirds of that is spending by the federal government. True, much of the period since the end of World War II has been a period of cold or hot war. However, since 1946 nondefense spending alone has never been less than 16 percent of the national income and is now roughly one-third the national income. Federal government spending alone is more than one-quarter of the national income in total, and more than a fifth for nondefense purposes alone. By this measure the role of the federal government in the economy has multiplied roughly tenfold in the past half-century.

Roosevelt was inaugurated on March 4, 1933—when the economy was at its lowest ebb. Many states had declared a banking holiday, closing their banks. Two days after he was inaugurated, President Roosevelt ordered all banks throughout the nation to close. But Roosevelt used his inaugural address to deliver a message of hope, proclaiming that "the only thing we have to fear is fear itself." And he immediately launched a frenetic program of legislative measures—the "hundred days" of a special congressional session.

The members of FDR's brain trust were drawn mainly from the universities—in particular, Columbia University. They reflected the change that had occurred earlier in the intellectual atmosphere on the campuses—from belief in individual responsibility, laissez-faire, and a decentralized and limited government to belief in social responsibility and a centralized and powerful government. It was the function of government, they believed, to protect individuals from the vicissitudes of fortune and to control the operation of the economy in the "general interest," even if that involved government ownership and operation of the means of production. These two
strands were already present in a famous novel published in 1887, *Looking Backward* by Edward Bellamy, a utopian fantasy in which a Rip Van Winkle character who goes to sleep in the year 1887 awakens in the year 2000 to discover a changed world. "Looking backward," his new companions explain to him how the utopia that astonishes him emerged in the 1930s—a prophetic date—from the hell of the 1880s. That utopia involved the promise of security "from cradle to grave"—the first use of that phrase we have come across—as well as detailed government planning, including compulsory national service by all persons over an extended period.' Coming

Coming from this intellectual atmosphere, Roosevelt's advisers were all too ready to view the depression as a failure of capitalism and to believe that active intervention by government—and especially central government was the appropriate remedy. Benevolent public servants, disinterested experts, should assume the power that narrow-minded, selfish "economic royalists" had abused. In the words of Roosevelt’s first inaugural address, "The moneychangers have fled from the high seats in the temple of our civilization." In designing programs for Roosevelt to adopt, they could draw not only on the campus, but on the earlier experience of Bismarck’s Germany, Fabian England, and middle-way Sweden.

The New Deal, as it emerged during the 1930s, clearly reflected these views. It included programs designed to reform the basic structure of the economy. Some of these had to be abandoned when they were declared unconstitutional by the Supreme Court, notably the NRA (National Recovery Administration) and the AAA (Agricultural Adjustment Administration). Others are still with us, notably the Securities and Exchange Commission, the National Labor Relations Board, nationwide minimum wages.

The New Deal also included programs to provide security against misfortune, notably Social Security (OASI: Old Age and Survivors Insurance), unemployment insurance, and public assistance. This chapter discusses these measures and their later progeny.

The New Deal also included programs intended to be strictly temporary, designed to deal with the emergency situation created by the Great Depression. Some of the temporary programs became permanent, as is the way with government programs.
The most important temporary programs included "make work" projects under the Works Progress Administration, the use of unemployed youth to improve the national parks and forests under the Civilian Conservation Corps, and direct federal relief to the indigent. At the time, these programs served a useful function. There was distress on a vast scale; it was important to do something about that distress promptly, both to assist the people in distress and to restore hope and confidence to the public. These programs were hastily contrived, and no doubt were imperfect and wasteful, but that was understandable and unavoidable under the circumstances. The Roosevelt administration achieved a considerable measure of success in relieving immediate distress and restoring confidence.

World War II interrupted the New Deal, while at the same time strengthening greatly its foundations. The war brought massive government budgets and unprecedented control by government over the details of economic life: fixing of prices and wages by edict, rationing of consumer goods, prohibition of the production of some civilian goods, allocation of raw materials and finished products, control of imports and exports.

The elimination of unemployment, the vast production of war materiel that made the United States the "arsenal of democracy," and unconditional victory over Germany and Japan—all these were widely interpreted as demonstrating the capacity of government to run the economic system more effectively than "unplanned capitalism." One of the first pieces of major legislation enacted after the war was the Employment Act of 1946, which expressed government's responsibility for maintaining "maximum employment, production and purchasing power" and, in effect, enacted Keynesian policies into law.

The war's effect on public attitudes was the mirror image of the depression's. The depression convinced the public that capitalism was defective; the war, which centralized government was efficient. Both conclusions were false. The depression was produced by a failure of government, not of private enterprise. As to the war, it is one thing for government to exercise great control temporarily for a single overriding purpose shared by almost all citizens and for which almost all citizens are willing to make heavy sacrifices; it is a very different thing for government to control the economy
permanently to promote a vaguely defined "public interest" shaped by the enormously varied and diverse objectives of its citizens.

At the end of the war it looked as if central economic planning was the wave of the future. That outcome was passionately welcomed by some who saw it as the dawn of a world of plenty shared equally. It was just as passionately feared by others, including us, who saw it as a turn to tyranny and misery. So far, neither the hopes of the one nor the fears of the other have been realized.

Government has expanded greatly. However, that expansion has not taken the form of detailed central economic planning accompanied by ever widening nationalization of industry, finance, and commerce, as so many of us feared it would. Experience put an end to detailed economic planning, partly because it was not successful in achieving the announced objectives, but also because it conflicted with freedom. That conflict was clearly evident in the attempt by the British government to control the jobs people could hold. Adverse public reaction forced the abandonment of the attempt. Nationalized industries proved so inefficient and generated such large losses in Britain, Sweden, France, and the United States that only a few die-hard Marxists today regard further nationalization as desirable. The illusion that nationalization increases productive efficiency, once widely shared, is gone. Additional nationalization does occur—passenger railroad service and some freight service in the United States, Leyland Motors in Great Britain, steel in Sweden. But it occurs for very different reasons—because consumers wish to retain services subsidized by the government when market conditions call for their curtailment or because workers in unprofitable industries fear unemployment. Even the supporters of such nationalization regard it as at best a necessary evil.

The failure of planning and nationalization has not eliminated pressure for an ever bigger government. It has simply altered its direction. The expansion of government now takes the form of welfare programs and of regulatory activities. As W. Allen Wallis put it in a somewhat different context, socialism, "intellectually bankrupt after more than a century of seeing one after another of its
arguments for socializing the *means* of production demolished—now seeks to socialize the *results* of production."  

In the welfare area the change of direction has led to an explosion in recent decades, especially after President Lyndon Johnson declared a "War on Poverty" in 1964. New Deal programs of Social Security, unemployment insurance, and direct relief were all expanded to cover new groups; payments were increased; and Medicare, Medicaid, food stamps, and numerous other programs were added. Public housing and urban renewal programs were enlarged. By now there are literally hundreds of government welfare and income transfer programs. The Department of Health, Education and Welfare, established in 1953 to consolidate the scattered welfare programs, began with a budget of $2 billion, less than 5 percent of expenditures on national defense. Twenty-five years later, in 1978, its budget was $160 billion, one and a half times as much as total spending on the army, the navy, and the air force. It had the third largest budget in the world, exceeded only by the entire budget of the U.S. government and of the Soviet Union. The department supervised a huge empire, penetrating every corner of the nation. More than one out of every 100 persons employed in this country worked in the HEW empire, either directly for the department or in programs for which HEW had responsibility but which were administered by state or local government units. All of us were affected by its activities. (In late 1979, HEW was subdivided by the creation of a separate Department of Education.)

No one can dispute two superficially contradictory phenomena: widespread dissatisfaction with the results of this explosion in welfare activities; continued pressure for further expansion.

The objectives have all been noble; the results, disappointing. Social Security expenditures have skyrocketed, and the system is in deep financial trouble. Public housing and urban renewal programs have subtracted from rather than added to the housing available to the poor. Public assistance rolls mount despite growing employment. By general agreement, the welfare program is a "mess" saturated with fraud and corruption. As government has paid a larger share of the nation's medical bills, both patients and physicians complain of rocketing costs and of the increasing
impersonality of medicine. In education, student performance has dropped as federal intervention has expanded (Chapter 6).

The repeated failure of well-intentioned programs is not an accident. It is not simply the result of mistakes of execution. The failure is deeply rooted in the use of bad means to achieve good objectives.

Despite the failure of these programs, the pressure to expand them grows. Failures are attributed to the miserliness of Congress in appropriating funds, and so are met with a cry for still bigger programs. Special interests that benefit from specific programs press for their expansion—foremost among them the massive bureaucracy spawned by the programs.

An attractive alternative to the present welfare system is a negative income tax. This proposal has been widely supported by individuals and groups of all political persuasions. A variant has been proposed by three Presidents; yet it seems politically unfeasible for the foreseeable future.

THE EMERGENCE OF THE MODERN WELFARE STATE

The first modern state to introduce on a fairly large scale the kind of welfare measures that have become popular in most societies today was the newly created German empire under the leadership of the "Iron Chancellor," Otto von Bismarck. In the early 1880s he introduced a comprehensive scheme of social security, offering the worker insurance against accident, sickness, and old age. His motives were a complex mixture of paternalistic concern for the lower classes and shrewd politics. His measures served to undermine the political appeal of the newly emerging Social Democrats.

It may seem paradoxical that an essentially autocratic and aristocratic state such as pre—World War I Germany—in today's jargon, a right-wing dictatorship—should have led the way in introducing measures that are generally linked to socialism and the Left. But there is no paradox—even putting to one side Bismarck's political motives. Believers in aristocracy and socialism share a faith in centralized rule, in rule by command rather than by voluntary cooperation. They differ in who should rule: whether an elite
determined by birth or experts supposedly chosen on merit. Both proclaim, no doubt sincerely, that they wish to promote the well-being of the "general public," that they know what is in the "public interest" and how to attain it better than the ordinary person. Both, therefore, profess a paternalistic philosophy. And both end up, if they attain power, promoting the interests of their own class in the name of the "general welfare."

More immediate precursors of the social security measures adopted in the 1930s were the measures taken in Great Britain beginning with the Old Age Pensions Act passed in 1908 and the National Insurance Act in 1911.

The Old Age Pensions Act granted to any person over the age of seventy whose income fell below a specified sum a weekly pension that varied according to the recipient's income. It was strictly noncontributory, and so was in one sense simply direct relief—an extension of Poor Law provisions that had in one form or another existed in Great Britain for centuries. However, as A. V. Dicey points out, there was a fundamental difference. The pension was regarded as a right whose receipt, in the words of the act, "shall not deprive the pensioner of any franchise, right or privilege, or subject him to any disability." It shows how far we have come from that modest beginning that Dicey, commenting on the act five years after its enactment, could write, "Surely a sensible and a benevolent man may well ask himself whether England as a whole will gain by enacting that the receipt of poor relief, in the shape of a pension, shall be consistent with the pensioner's retaining the right to join in the election of a Member of Parliament." It would take a modern Diogenes with a powerful lamp to find anyone today who could vote if receipt of government largesse were a disqualification.

The National Insurance Act aimed "at the attainment of two objects: The first is that any person . . . who is employed in the United Kingdom . . . shall, from the age of 16 to 70, be insured against ill-health, or in other words, be insured the means for curing illness. . . . The second object is that any such person who is employed in certain employments specified in the Act shall be insured against unemployment, or, in other words, be secured support during periods of unemployment." ‘Unlike old-age pensions, the system established was contributory. It was to be
financed partly by employers, partly by employees, partly by the government.

Both because of its contributory nature and because of the contingencies that it sought to insure against, this act was an even more radical departure from prior practice than the Old Age Pensions Act. "Under the National Insurance Act," wrote Dicey,

the State incurs new and, it may be, very burdensome, duties, and confers upon wage-earners new and very extensive rights. . . . Before 1908 the question whether a man, rich or poor, should insure his health, was a matter left entirely to the free discretion or indiscretion of each individual. His conduct no more concerned the State than the question whether he should wear a black coat or a brown coat.

But the National Insurance Act will, in the long run, bring upon the State, that is, upon the taxpayers, a far heavier responsibility than is anticipated by English electors. . . . Unemployment insurance . . . is in fact the admission by a State of its duty to insure a man against the evil ensuing from his having no work. . . . The National Insurance Act is in accordance with the doctrine of socialism, it is hardly reconcilable with the liberalism, or even the radicalism of 1865.5

These early British measures, like Bismarck's, illustrate the affinity between aristocracy and socialism. In 1904 Winston Churchill left the Tory party—the party of the aristocracy—for the Liberal party. As a member of Lloyd George's cabinet he took a leading role in social reform legislation. The change of party, which proved temporary, required no change of principles—as it would have a half-century earlier, when the Liberal party was the party of free trade abroad and laissez-faire at home. The social legislation he sponsored, while different in scope and kind, was in the tradition of the paternalistic Factory Acts that had been adopted in the nineteenth century largely under the influence of the so called Tory Radicals "—a group drawn in considerable part from the aristocracy and imbued with a sense of obligation to look after the interests of the working classes, and to do so with their consent and backing, not through coercion.

It is no exaggeration to say that the shape of Britain today owes more to Tory principles of the nineteenth century than to the ideas of Karl Marx and Friedrich Engels.

Another example that doubtless influenced FDR's New Deal was Sweden, The Middle Way, as Marquis Childs would title his book,
published in 1936. Sweden enacted compulsory old-age pensions in 1915 as a contributory system. Pensions were payable to all after the age of sixty-seven regardless of financial status. The size of the pension depended on the payments individuals had made into the system. Such payments were supplemented by government funds.

In addition to old-age pensions and, later, unemployment insurance, Sweden went in for government ownership of industry, public housing, and consumers' cooperatives on a large scale.

RESULTS OF THE WELFARE STATE

Britain and Sweden, long the two countries most frequently pointed to as successful welfare states, have had increasing difficulties. Dissatisfaction has mounted in both countries.

Britain has found it increasingly difficult to finance growing government spending. Taxes have become a major source of resentment. And resentment has been multiplied many fold by the impact of inflation (see Chapter 9). The National Health Service, once the prize jewel in the welfare state crown and still widely regarded by much of the British public as one of the great achievements of the Labor government, has run into increasing difficulties—plagued by strikes, rising costs, and lengthening waiting lists of patients. And more and more people have been turning to private physicians, private health insurance, hospitals, and rest homes. Though still a minor sector of the health industry, the private sector has been growing rapidly.

Unemployment in Britain has mounted along with inflation. The government has had to renege on its commitment to full employment. Underlying everything else, productivity and real income in Britain have at best been stagnant, so that Britain has been falling far behind its continental neighbors. The dissatisfaction surfaced dramatically in the Tory party's sizable election victory in 1979, a victory gained on Margaret Thatcher's promise of a drastic change in government direction.

Sweden has done far better than Britain. It was spared the burden of two world wars and, indeed, reaped economic benefits from its neutrality.
Nonetheless, it too has recently been experiencing the same difficulties as Britain: high inflation and high unemployment; opposition to high taxes, resulting in the emigration of some of its most talented people; dissatisfaction with social programs. Here, too, the voters have expressed their views at the ballot box. In 1976 the voters ended over four decades of rule by the Social Democratic party, and replaced it by a coalition of other parties, though as yet there has been no basic change in the direction of government policy.

New York City is the most dramatic example in the United States of the results of trying to do good through government programs. New York is the most welfare-oriented community in the United States. Spending by the city government is larger relative to its population than in any other city in the United States—double that in Chicago. The philosophy that guided the city was expressed by Mayor Robert Wagner in his 1965 budget message: "I do not propose to permit our fiscal problems to set the limits of our commitments to meet the essential needs of the people of the city." Wagner and his successors proceeded to interpret "essential needs" very broadly indeed. But more money, more programs, more taxes didn't work. They led to financial catastrophe without meeting "the essential needs of the people" even on a narrow interpretation, let alone on Wagner's. Bankruptcy was prevented only by assistance from the federal government and the State of New York, in return for which New York City surrendered control over its affairs, becoming a closely supervised ward of state and federal governments.

New Yorkers naturally sought to blame outside forces for their problem, but as Ken Auletta wrote in a recent book, New York "was not compelled to create a vast municipal hospital or City University system, to continue free tuition, institute open enrollment, ignore budget limitations, impose the steepest taxes in the nation, borrow beyond its means, subsidize middle-income housing, continue rigid rent controls, reward municipal workers with lush pension, pay and fringe benefits."

He quips, "Goaded by liberalism's compassion and ideological commitment to the redistribution of wealth, New York officials
helped redistribute much of the tax base and thousands of jobs out of New York." 8

One fortunate circumstance was that New York City has no power to issue money. It could not use inflation as a means of taxation and thus postpone the evil day. Unfortunately, instead of really facing up to its problems, it simply cried for help from the State of New York and the federal government.

Let us take a closer look at a few other examples.

**Social Security**

The major welfare-state program in the United States on the federal level is Social Security—old age, survivors, disability, and health insurance. On the one hand, it is a sacred cow that no politician can question—as Barry Goldwater discovered in 1964. On the other hand, it is the target of complaints from all sides. Persons receiving payments complain that the sums are inadequate to maintain the standard of life they had been led to expect. Persons paying Social Security taxes complain that they are a heavy burden. Employers complain that the wedge introduced by the taxes between the cost to the employer of adding a worker to his payroll and the net gain to the worker of taking a job creates unemployment. Taxpayers complain that the unfunded obligations of the Social Security system total many trillions of dollars, and that not even the present high taxes will keep it solvent for long. And all complaints are justified!

Social Security and unemployment insurance were enacted in the 1930s to enable working people to provide for their own retirement and for temporary periods of unemployment rather than becoming objects of charity. Public assistance was introduced to aid persons in distress, with the expectation that it would be phased out as employment improved and as Social Security took over the task. Both programs started small. Both have grown like Topsy. Social Security has shown no sign of displacing public assistance—both are at all-time highs in terms of both dollar expenditures and number of persons receiving payments. In 1978 payments under Social Security for retirement, disability, unemployment, hospital and medical care, and to survivors totaled more than $130 billion and
were made to more than 40 million recipients.' Public assistance payments of more than $40 billion were made to more than 17 million recipients.

To keep the discussion within manageable limits, we shall restrict this section to the major component of Social Security—old age and survivors' benefits, which accounted for nearly two-thirds of total expenditures and three-quarters of the recipients. The next section deals with public assistance programs.

Social Security was enacted in the 1930s and has been promoted ever since through misleading labeling and deceptive advertising. A private enterprise that engaged in such labeling and advertising would doubtless be severely castigated by the Federal Trade Commission.

Consider the following paragraph that appeared year after year until 1977 in millions of copies of an unsigned HEW booklet entitled Your Social Security: "The basic idea of social security is a simple one: During working years employees, their employers, and self-employed people pay social security contributions which are pooled into special trust funds. When earnings stop or are reduced because the worker retires, becomes disabled, or dies, monthly cash benefits are paid to replace part of the earnings the family has lost."

This is Orwellian doublethink.

Payroll taxes are labeled "contributions" (or, as the Party might have put it in the book Nineteen Eighty-four, "Compulsory is Voluntary").

Trust funds are conjured with as if they played an important role. In fact, they have long been extremely small ($32 billion for OASI as of June 1978, or less than half a year's outlays at the current rate) and consist only of promises by one branch of government to pay another branch. The present value of the old-age pensions already promised to persons covered by Social Security (both those who have retired and those who have not) is in the trillions of dollars. That is the size of the trust fund that would be required to justify the words of the booklet (in Orwellian terms, "Little is Much").

The impression is given that a worker's "benefits" are financed by his "contributions." The fact is that taxes collected from persons at work were used to pay benefits to persons who had retired or to
their dependents and survivors. No trust fund in any meaningful sense was being accumulated ("I am You").

Workers paying taxes today can derive no assurance from trust funds that they will receive benefits when they retire. Any assurance derives solely from the willingness of future taxpayers to impose taxes on themselves to pay for benefits that present taxpayers are promising themselves. This one-sided "compact between the generations," foisted on generations that cannot give their consent, is a very different thing from a "trust fund." It is more like a chain letter.

The HEW booklets, including those currently being distributed, also say, "Nine out of ten working people in the United States are earning protection for themselves and their families under the social security program." 12

More doublethink. What nine out of ten working people are now doing is paying taxes to finance payments to persons who are not working. The individual worker is not "earning" protection for himself and his family in the sense in which a person who contributes to a private vested pension system can be said to be "earning" his own protection. He is only "earning" protection in the political sense of satisfying certain administrative requirements for qualifying for benefits. Persons who now receive payments get much more than the actuarial value of the taxes that they paid and that were paid on their behalf. Young persons who now pay Social Security taxes are being promised much less than the actuarial value of the taxes that they will pay and that will be paid on their behalf.

Social Security is in no sense an insurance program in which individual payments purchase equivalent actuarial benefits. As even its strongest supporters admit, "The relationship between individual contributions (that is, payroll taxes) and benefits received is extremely tenuous." 13 Social Security is, rather, a combination of a particular tax and a particular program of transfer payments.

The fascinating thing is that we have never met anyone, whatever his political persuasion, who would defend either the tax system by itself or the benefit system by itself. Had the two components been considered separately, neither would ever have been adopted!

Consider the tax. Except for a recent minor modification (rebates under the earned income credit), it is a flat rate on wages up to a
maximum, a tax that is regressive, bearing most heavily on persons with low incomes. It is a tax on work, which discourages employers from hiring workers and discourages people from seeking work.

Consider the benefit arrangement. Payments are determined neither by the amount paid by the beneficiary nor by his financial status. They constitute neither a fair return for prior payments nor an effective way of helping the indigent. There is a link between taxes paid and benefits received, but that is at best a fig leaf to give some semblance of credibility to calling the combination "insurance." The amount of money a person gets depends on all sorts of adventitious circumstances. If he happened to work in a covered industry, he gets a benefit; if he happened to work in a noncovered industry, he does not. If he worked in a covered industry for only a few quarters, he gets nothing, no matter how indigent he may be. A woman who has never worked, but is the wife or widow of a man who qualifies for the maximum benefit, gets precisely the same amount as a similarly situated woman who, in addition, qualifies for benefits on the basis of her own earnings. A person over sixty-five who decides to work and who earns more than a modest amount a year not only gets no benefits but, to add insult to injury, must pay additional taxes—supposedly to finance the benefits that are not being paid. And this list could be extended indefinitely.

We find it hard to conceive of a greater triumph of imaginative packaging than the combination of an unacceptable tax and an unacceptable benefit program into a Social Security program that is widely regarded as one of the greatest achievements of the New Deal.

As we have gone through the literature on Social Security, we have been shocked at the arguments that have been used to defend the program. Individuals who would not lie to their children, their friends, or their colleagues, whom all of us would trust implicitly in the most important personal dealings, have propagated a false view of Social Security. Their intelligence and exposure to contrary views make it hard to believe that they have done so unintentionally and innocently. Apparently they have regarded themselves as an elite group within society that knows what is good for other people better than those people do for themselves, an elite that has a duty and a responsibility to persuade the voters to pass laws that will be good
for them, even if they have to fool the voters in order to get them to do so.

The long-run financial problems of Social Security stem from one simple fact: the number of people receiving payments from the system has increased and will continue to increase faster than the number of workers on whose wages taxes can be levied to finance those payments. In 1950 seventeen persons were employed for every person receiving benefits; by 1970 only three; by early in the twenty-first century, if present trends continue, at most two will be.

As these remarks indicate, the Social Security program involves a transfer from the young to the old. To some extent such a transfer has occurred throughout history—the young supporting their parents, or other relatives, in old age. Indeed, in many poor countries with high infant death rates, like India, the desire to assure oneself of progeny who can provide support in old age is a major reason for high birth rates and large families. The difference between Social Security and earlier arrangements is that Social Security is compulsory and impersonal—earlier arrangements were voluntary and personal. Moral responsibility is an individual matter, not a social matter. Children helped their parents out of love or duty. They now contribute to the support of someone else's parents out of compulsion and fear. The earlier transfers strengthened the bonds of the family; the compulsory transfers weaken them.

In addition to the transfer from young to old, Social Security also involves a transfer from the less well-off to the better-off. True, the benefit schedule is biased in favor of persons with lower wages, but this effect is much more than offset by another. Children from poor families tend to start work—and start paying employment taxes—at a relatively early age; children from higher income families at a much later age. At the other end of the life cycle, persons with lower incomes on the average have a shorter life span than persons with higher incomes. The net result is that the poor tend to pay taxes for more years and receive benefits for fewer years than the rich—all in the name of helping the poor!

This perverse effect is reinforced by a number of other features of Social Security. The exemption of benefits from income tax is more valuable, the higher the other income of the recipient. The restriction on payments to persons sixty-five to seventy-two (to
become seventy in 1982) is based solely on earnings during those years and not on other categories of income—$1 million of dividends does not disqualify anyone from receiving Social Security benefits; wages or salary of more than $4,500 a year produce a $1 loss of $1 of benefits for every $2 of earnings.

All in all, Social Security is an excellent example of Director's Law in operation, namely, "Public expenditures are made for the primary benefit of the middle class, and financed with taxes which are borne in considerable part by the poor and rich." 15

Public Assistance

We can be far briefer in discussing the "welfare mess" than in discussing Social Security—because on this question there is more agreement. The defects of our present system of welfare have become widely recognized. The relief rolls grow despite growing affluence. A vast bureaucracy is largely devoted to shuffling papers rather than to serving people. Once people get on relief, it is hard to get off. The country is increasingly divided into two classes of citizens, one receiving relief and the other paying for it. Those on relief have little incentive to earn income. Relief payments vary widely from one part of the country to another, which encourages migration from the South and the rural areas to the North, and particularly to urban centers. Persons who are or have been on relief are treated differently from those who have not been on relief (the so-called working poor) though both may be on the same economic level. Public anger is repeatedly stirred by widespread corruption and cheating, well-publicized reports of welfare "queens" driving around in Cadillacs bought with multiple relief checks.

As complaints about welfare programs have mounted, so have the number of programs to be complained about. There is a ragbag of well over 100 federal programs that have been enacted to help the poor. There are major programs like Social Security, unemployment insurance, Medicare, Medicaid, aid to families with dependent children, supplemental security income, food stamps, and myriad minor ones most people have never heard of, such as assistance to Cuban refugees; special supplemental feeding for women, infants, and children; intensive infant care project; rent supplements; urban
rat control; comprehensive hemophilia treatment centers; and so on. One program duplicates another. Some families who manage to receive assistance from numerous programs end up with an income decidedly higher than the average income for the country. Other families, through ignorance or apathy, fail to apply for programs that might ease real distress. But every program requires a bureaucracy to administer it.

Over and above the more than $130 billion per year spent under Social Security, expenditure on these programs is around $90 billion a year—ten times the amount spent in 1960. This is clearly overkill. The so-called poverty level for 1978, as estimated by the Census, was close to $7,000 for a nonfarm family of four, and about 25 million persons were said to be members of families below the poverty level. That is a gross overestimate because it classifies families solely by money income, neglecting entirely any income in kind—from an owned home, a garden, food stamps, Medicaid, public housing. Several studies suggest that allowing for these omissions would cut the Census estimates by one-half or three-quarters. But even if you use the Census estimates, they imply that expenditures on welfare programs amounted to about $3,500 per person below the poverty level, or about $14,000 per family of four—roughly twice the poverty level itself. If these funds were all going to the "poor," there would be no poor left—they would be among the comfortably well-off, at least.

Clearly, this money is not going primarily to the poor. Some is siphoned off by administrative expenditures, supporting a massive bureaucracy at attractive pay scales. Some goes to people who by no stretch of the imagination can be regarded as indigent. These are the college students who get food stamps and perhaps other forms of assistance, the families with comfortable incomes who get housing subsidies, and so on in more varied forms than your or our imagination can encompass. Some goes to the welfare cheats.

Yet this much must be said for these programs. Unlike that of Social Security recipients, the average income of the people who are subsidized by these vast sums is probably lower than the average income of the people who pay the taxes to support them—though even that cannot be asserted with certainty. As Martin Anderson put it,
There may be great inefficiencies in our welfare programs, the level of fraud may he very high, the quality of management may be terrible, the programs may overlap, inequities may abound, and the financial incentive to work may be virtually non-existent. But if we step back and judge the vast array of welfare programs . . . by two basic criteria—the completeness of coverage for those who really need help, and the adequacy of the amount of help they do receive— the picture changes dramatically. Judged by these standards our welfare system has been a brilliant success. 17

**Housing Subsidies**

From small beginnings in the New Deal years, government programs to provide housing have expanded rapidly. A new Cabinet department, the Department of Housing and Urban Development, was created in 1965. It now has a staff of nearly 20,000 persons that disburses more than $10 billion a year. Federal housing programs have been supplemented by state and city government programs, especially in New York State and New York City. The programs started with government construction of housing units for low-income families. After the war an urban renewal program was added, and in many areas, public housing was extended to "middle-income" families. More recently "rent supplements"—government subsidization of rents for privately owned housing units—have been added.

In terms of the initial objective, these programs have been a conspicuous failure. More dwelling units were destroyed than were built. Those families who got apartments at subsidized rents benefited. Those families who were forced to move to poorer housing because their homes were destroyed and not replaced were worse off. Housing is better and more widely distributed in the United States today than when the public housing program was started, but that has occurred through private enterprise despite the government subsidies.

The public housing units themselves have frequently become slums and hotbeds of crime, especially juvenile delinquency. The most dramatic case was the Pruitt-Igoe public housing project in St. Louis—a massive apartment complex covering fifty-three acres that
won an architectural prize for design. It deteriorated to such an extent that part of it had to be blown up. At that point only 600 of 2,000 units were occupied and the project was said to look like an urban battleground.

We well remember an episode that occurred when we toured the Watts area of Los Angeles in 1968. We were being shown the area by the man who was in charge of a well-run self-help project sponsored by a trade union. When we commented on the attractiveness of some apartment houses in the area, he broke out angrily: "That's the worst thing that ever happened to Watts. That's public housing." He went on to say, "How do you expect youngsters to develop good character and values when they live in a development consisting entirely of broken families, almost all on welfare?" He deplored also the effect of the public housing developments on juvenile delinquency and on the neighborhood schools, which were disproportionately filled with children from broken families.

Recently we heard a similar evaluation of public housing from a leader of a "sweat-equity" housing project in the South Bronx, New York. The area looks like a bombèd-out city, with many buildings abandoned as a result of rent control and others destroyed by riots. The "sweat-equity" group has undertaken to rehabilitate an area of these abandoned buildings by their own efforts into housing that they can subsequently occupy. Initially they received outside help only in the form of a few private grants. More recently they have also been receiving some assistance from government.

When we asked our respondent why his group adopted their arduous approach rather than simply moving into public housing, he gave an answer like the one we had heard in Los Angeles, with the added twist that building and owning their own homes art of the government assistance that "sweat-equity" received was the services of CETA workers. These people were paid by the government under the Comprehensive Employment and Training Act and assigned to various public projects to acquire training that it was hoped would enable them to get private jobs. When we asked our respondent whether the sweat-equity group would rather have the help of CETA workers or the money that was being spent on them, he left no doubt whatsoever that they would prefer the money. All in all, it was
heartening to observe the sense of self-reliance, independence, and energy displayed on this self-help project by contrast with the apathy, sense of futility, and boredom so evident at public housing projects we visited.

New York's subsidized "middle-income" housing, justified as a way to keep middle-income families from fleeing the city, presents a very different picture. Spacious and luxurious apartments are rented at subsidized rates to families who are "middle-income" only by a most generous use of that term. The apartments are on the average subsidized in the amount of more than $200 per month. "Director's Law" at work again.

Urban renewal was adopted with the aim of eliminating slums — "urban blight." The government subsidized the acquisition and clearance of areas to be renewed and made much of the cleared land available to private developers at artificially low prices. Urban renewal destroyed "four homes, most of them occupied by blacks, for every home it built—most of them to be occupied by middle- and upper-income whites." The original occupants were forced to move elsewhere, often turning another area into a "blighted" one. The program well deserves the names "slum removal" and "Negro removal" that some critics gave it.

The chief beneficiaries of public housing and urban renewal have not been the poor people. The beneficiaries have, rather, been the owners of property purchased for public housing or located in urban renewal areas; middle- and upper-income families who were able to find housing in the high-priced apartments or townhouses that frequently replaced the low-rental housing that was renewed out of existence; the developers and occupants of shopping centers constructed in urban areas; institutions such as universities and churches that were able to use urban renewal projects to improve their neighborhoods.

As a recent Wall Street Journal editorial put it,

The Federal Trade Commission has looked into the government's housing policies and discovered that they are driven by something more than pure altruism. An FTC staff policy briefing hook finds that the main thrust seems to come from people who make money building housing—contractors, bankers, labor unions, materials suppliers, etc. After the housing is built, the government and these various "constituencies" take less interest in it. So the FTC has been getting complaints
about the quality of housing built under federal programs, about leaky roofs, inadequate plumbing, bad foundations, etc."

In the meantime, even where it was not deliberately destroyed, low-priced rental housing deteriorated because of rent control and similar measures.

Medical Care

Medicine is the latest welfare field in which the role of government has been exploding. State and local governments, and to a lesser extent the federal government, have long had a role in public health (sanitation, contagious diseases, etc.) and in provision of hospital facilities. In addition, the federal government has provided medical care for the military and veterans. However, as late as 1960 government expenditures for civilian health purposes (i.e., omitting the military and veterans) were less than $5 billion, or a little over 1 percent of the national income. After the introduction of Medicare and Medicaid in 1965, government spending on health mounted rapidly, reaching $68 billion by 1977, or about 4.5 percent of national income. The government's share of total expenditures on medical care has almost doubled, from 25 percent in 1960 to 42 percent in 1977. The clamor for the federal government to assume a still larger role continues. President Carter has come out in favor of national health insurance, though in a limited form because of financial constraints. Senator Edward M. Kennedy has no such inhibitions; he favors the immediate enactment of complete government responsibility for the health care of the nation's citizens.

Extra government spending has been paralleled by a rapid growth in private health insurance. Total spending on medical care doubled from 1965 to 1977 as a fraction of national income. Medical facilities have expanded, too, but not as rapidly as expenditures. The inevitable result has been sharp increases in the price of medical care and in the incomes of physicians and others engaged in rendering medical services.

The government has responded by trying to regulate the medical procedures followed and to hold down the fees charged by physicians and hospitals. And so it should. If the government spends
the taxpayers' money, it is right and proper that it should be concerned with what it gets for what it spends: he who pays the piper calls the tune. If the present trends continue, the end result will inevitably be socialized medicine.

National health insurance is another example of misleading labeling. In such a system there would be no connection between what you would pay and the actuarial value of what you would be entitled to receive, as there is in private insurance. In addition it is not directed at insuring "national health"—a meaningless phrase—but at providing medical services to the residents of the country. What its proponents are in fact proposing is a system of socialized medicine. As Dr. Gunnar Biorck, an eminent Swedish professor of medicine and head of the department of medicine at a major Swedish hospital, has written:

The setting in which medicine has been practiced during thousands of years has been one in which the patient has been the client and employer of the physician. Today the State, in one manifestation or the other, claims to be the employer and, thus, the one to prescribe the conditions under which the physician has to carry out his work. These conditions may not—and will eventually not—be restricted to working hours, salaries and certified drugs; they may invade the whole territory of the patient-physician relationship. . . . If the battle of today is not fought and not won, there will be no battle to fight tomorrow.'

Proponents of socialized medicine in the United States—to give their cause its proper name—typically cite Great Britain, and more recently Canada, as examples of its success. The Canadian experience has been too recent to provide an adequate test—most new brooms sweep pretty clean—but difficulties are already emerging. The British National Health Service has now been in operation more than three decades, and the results are pretty conclusive. That, no doubt, is why Canada has been replacing Britain as the example pointed to. A British physician, Dr. Max Gammon, spent five years studying the British Health Service. In a December 1976 report he wrote: "[The National Health Service] brought centralized state financing and control of delivery to virtually all medical services in the country. The voluntary system of financing and delivery of medical care which had been developed in Britain over the preceding 200 years was almost entirely
eliminated. The existing compulsory system was reorganized and made practically universal."

Also, "No new hospitals were in fact built in Britain during the first thirteen years of the National Health Service and there are now, in 1976, fewer hospital beds in Britain than in July 1948 when the National Health Service took over." And, we may add, two-thirds of those beds are in hospitals that were built before 1900 by private medicine and private funds.

Dr. Gammon was led by his survey to promulgate what he calls a theory of bureaucratic displacement: the more bureaucratic an organization, the greater the extent to which useless work tends to displace useful work—an interesting extension of one of Parkinson's laws. He illustrates the theory with hospital services in Britain from 1965 to 1973. In that eight-year period hospital staffs in total increased in number by 28 percent, administrative and clerical help by 51 percent. But output, as measured by the average number of hospital beds occupied daily, actually went down by 11 percent. And not, as Dr. Gammon hastened to point out, because of any lack of patients to occupy the beds. At all times there was a waiting list for hospital beds of around 600,000 people. Many must wait for years to have an operation that the health service regards as optional or postponable.

Physicians are fleeing the British Health Service. About one third as many physicians emigrate each year from Britain to other countries as graduate from its medical schools. The recent rapid growth of strictly private medical practice, private health insurance, and private hospitals and nursing homes is another result of dissatisfaction with the Health Service.

Two major arguments are offered for introducing socialized medicine in the United States: first, that medical costs are beyond the means of most Americans; second, that socialization will somehow reduce costs. The second can be dismissed out of hand — at least until someone can find some example of an activity that is conducted more economically by government than by private enterprise. As to the first, the people of the country must pay the costs one way or another; the only question is whether they pay them directly on their own behalf, or indirectly through the mediation of
government bureaucrats who will subtract a substantial slice for their own salaries and expenses.

In any event, the costs of ordinary medical care are well within the means of most American families. Private insurance arrangements are available to meet the contingency of an unusually large expense. Already, 90 percent of all hospital bills are paid through third-party payments. Exceptional hardship cases no doubt arise, and some help, private or public, may well be desirable for them. But help for a few hardship cases hardly justifies putting the whole population in a straitjacket.

To give a sense of proportion, the total expenditures on medical care, private and governmental, amount to less than two thirds as much as spending on housing, about three-quarters as much as spending on automobiles, and only two and a half times as much as spending on alcohol and tobacco—which undoubtedly adds to medical bills.

In our opinion there is no case whatsoever for socialized medicine. On the contrary, government already plays too large a role in medical care. Any further expansion of its role would be very much against the interests of patients, physicians, and health care personnel. We discuss another aspect of medical care—the licensing of physicians and its bearing on the power of the American Medical Association—in Chapter 8 on "Who Protects the Worker?"

THE FALLACY OF THE WELFARE STATE

Why have all these programs been so disappointing? Their objectives were surely humanitarian and noble. Why have they not been achieved?

At the dawn of the new era all seemed well. The people to be benefited were few; the taxpayers available to finance them, many—so each was paying a small sum that provided significant benefits to a few in need. As welfare programs expanded, the numbers changed. Today all of us are paying out of one pocket to put money—or something money could buy—in the other.
A simple classification of spending shows why that process leads to undesirable results. When you spend, you may spend your own money or someone else's; and you may spend for the benefit of yourself or someone else. Combining these two pairs of alternatives gives four possibilities summarized in the following simple table:  

**YOU ARE THE SPENDER**

<table>
<thead>
<tr>
<th>Whose Money</th>
<th>You</th>
<th>Someone Else</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yours</td>
<td>I</td>
<td>II</td>
</tr>
<tr>
<td>Someone Else's</td>
<td>III</td>
<td>IV</td>
</tr>
</tbody>
</table>

*Category I* in the table refers to your spending your own money on yourself. You shop in a supermarket, for example. You clearly have a strong incentive both to economize and to get as much value as you can for each dollar you do spend.

*Category II* refers to your spending your own money on someone else. You shop for Christmas or birthday presents. You have the same incentive to economize as in Category I but not the same incentive to get full value for your money, at least as judged by the tastes of the recipient. You will, of course, want to get something the recipient will like—provided that it also makes the right impression and does not take too much time and effort.

(If, indeed, your main objective were to enable the recipient to get as much value as possible per dollar, you would give him cash, converting your Category II spending to Category I spending by him.)

*Category III* refers to your spending someone else’s money on yourself—lunching on an expense account, for instance. You have no strong incentive to keep down the cost of the lunch, but you do have a strong incentive to get your money's worth.
Category IV refers to your spending someone else's money on still another person. You are paying for someone else's lunch out of an expense account. You have little incentive either to economize or to try to get your guest the lunch that he will value most highly. However, if you are having lunch with him, so that the lunch is a mixture of Category III and Category IV, you do have a strong incentive to satisfy your own tastes at the sacrifice of his, if necessary.

All welfare programs fall into either Category III—for example, Social Security which involves cash payments that the recipient is free to spend as he may wish; or Category IV—for example, public housing; except that even Category IV programs share one feature of Category III, namely, that the bureaucrats administering the program partake of the lunch; and all Category III programs have bureaucrats among their recipients.

In our opinion these characteristics of welfare spending are the main source of their defects.

Legislators vote to spend someone else's money. The voters who elect the legislators are in one sense voting to spend their own money on themselves, but not in the direct sense of Category I spending. The connection between the taxes any individual pays and the spending he votes for is exceedingly loose. In practice, voters, like legislators, are inclined to regard someone else as paying for the programs the legislator votes for directly and the voter votes for indirectly. Bureaucrats who administer the programs are also spending someone else's money. Little wonder that the amount spent explodes.

The bureaucrats spend someone else's money on someone else. Only human kindness, not the much stronger and more dependable spur of self-interest, assures that they will spend the money in the way most beneficial to the recipients. Hence the wastefulness and ineffectiveness of the spending.

But that is not all. The lure of getting someone else's money is strong. Many, including the bureaucrats administering the programs, will try to get it for themselves rather than have it go to someone else. The temptation to engage in corruption, to cheat, is strong and will not always be resisted or frustrated. People who resist the temptation to cheat will use legitimate means to direct the
money to themselves. They will lobby for legislation favorable to themselves, for rules from which they can benefit. The bureaucrats administering the programs will press for better pay and perquisites for themselves—an outcome that larger programs will facilitate.

The attempt by people to divert government expenditures to themselves has two consequences that may not be obvious. First, it explains why so many programs tend to benefit middle- and upper-income groups rather than the poor for whom they are supposedly intended. The poor tend to lack not only the skills valued in the market, but also the skills required to be successful in the political scramble for funds. Indeed, their disadvantage in the political market is likely to be greater than in the economic. Once well-meaning reformers who may have helped to get a welfare measure enacted have gone on to their next reform, the poor are left to fend for themselves and they will almost always be overpowered by the groups that have already demonstrated a greater capacity to take advantage of available opportunities.

The second consequence is that the net gain to the recipients of the transfer will be less than the total amount transferred. If $100 of somebody else's money is up for grabs, it pays to spend up to $100 of your own money to get it. The costs incurred to lobby legislator and regulatory authorities, for contributions to political campaigns, and for myriad other items are a pure waste—harming the taxpayer who pays and benefiting no one. They must be subtracted from the gross transfer to get the net gain—and may, of course, at times exceed the gross transfer, leaving a net loss, not gain.

These consequences of subsidy seeking also help to explain the pressure for more and more spending, more and more programs. The initial measures fail to achieve the objectives of the well-meaning reformers who sponsored them. They conclude that not enough has been done and seek additional programs. They gain as allies both people who envision careers as bureaucrats administering the programs and people who believe that they can tap the money to be spent.

Category IV spending tends also to corrupt the people involved. All such programs put some people in a position to decide what is good for other people. The effect is to instill in the one group a feeling of almost God-like power; in the other, a feeling of childlike
dependence. The capacity of the beneficiaries for independence, for making their own decisions, atrophies through disuse. In addition to the waste of money, in addition to the failure to achieve the intended objectives, the end result is to rot the moral fabric that holds a decent society together.

Another by-product of Category III or IV spending has the same effect. Voluntary gifts aside, you can spend someone else's money only by taking it away as government does. The use of force is therefore at the very heart of the welfare state—a bad means that tends to corrupt the good ends. That is also the reason why the welfare state threatens our freedom so seriously.

WHAT SHOULD BE DONE

Most of the present welfare programs should never have been enacted. If they had not been, many of the people now dependent on them would have become self-reliant individuals instead of wards of the state. In the short run that might have appeared cruel for some, leaving them no option to low-paying, unattractive work. But in the long run it would have been far more humane. However, given that the welfare programs exist, they cannot simply be abolished overnight. We need some way to ease the transition from where we are to where we would like to be, of providing assistance to people now dependent on welfare while at the same time encouraging an orderly transfer of people from welfare rolls to payrolls.

Such a transitional program has been proposed that could enhance individual responsibility, end the present division of the nation into two classes, reduce both government spending and the present massive bureaucracy, and at the same time assure a safety net for every person in the country, so that no one need suffer dire distress. Unfortunately, the enactment of such a program seems utopian dream at present. Too many vested interests—ideological, political, and financial—stand in the way.

Nonetheless, it seems worth outlining the major elements of such a program, not with any expectation that it will be adopted in the near future, but in order to provide a vision of the direction in which we should be moving, a vision that can guide incremental changes.
The program has two essential components: first, reform the present welfare system by replacing the ragbag of specific programs with a single comprehensive program of income supplements in cash—a negative income tax linked to the positive income tax second, unwind Social Security while meeting present commitments and gradually requiring people to make their own arrangements for their own retirement.

Such a comprehensive reform would do more efficiently and humanely what our present welfare system does so inefficiently and inhumanely. It would provide an assured minimum to all persons in need regardless of the reasons for their need while doing as little harm as possible to their character, their independence, or their incentive to better their own condition.

The basic idea of a negative income tax is simple, once we penetrate the smoke screen that conceals the essential features of the positive income tax. Under the current positive income tax you are permitted to receive a certain amount of income without paying any tax. The exact amount depends on the size of your family, your age, and on whether you itemize your deductions. This amount is composed of a number of elements—personal exemptions, low income allowance, standard deduction (which has recently been relabeled the zero bracket amount), the sum corresponding to the general tax credit, and for all we know still other items that have been added by the Rube Goldberg geniuses who have been having a field day with the personal income tax. To simplify the discussion, let us use the simpler British term of “personal allowances" to refer to this basic amount.

If your income exceeds your allowances, you pay a tax on the excess at rates that are graduated according to the size of the excess. Suppose your income is less than the allowances? Under the current system, those unused allowances in general are of no value. You simply pay no tax.23

If your income happened just to equal your allowances in each of two succeeding years, you would pay no tax in either year. Suppose you had that same income for the two years together, but more than half was received the first year. You would have a positive taxable income, that is, income in excess of allowances for that year, and would pay tax on it. In the second year, you would
have a negative taxable income, that is, your allowances would exceed your income but you would, in general, get no benefit from your unused allowances. You would end up paying more tax for the two years together than if the income had been split evenly. 24

With a negative income tax, you would receive from the government some fraction of the unused allowances. If the fraction you received was the same as the tax rate on the positive income, the total tax you paid in the two years would be the same regardless of how your income was divided between them.

When your income was above allowances, you would pay tax, the amount depending on the tax rates charged on various amounts of income. When your income was below allowances, you would receive a subsidy, the amount depending on the subsidy rates attributed to various amounts of unused allowances.

The negative income tax would allow for fluctuating income, as in our example, but that is not its main purpose. Its main purpose is rather to provide a straightforward means of assuring every family a minimum amount, while at the same time avoiding a massive bureaucracy, preserving a considerable measure of individual responsibility, and retaining an incentive for individuals to work and earn enough to pay taxes instead of receiving a subsidy.

Consider a particular numerical example. In 1978 allowances amounted to $7,200 for a family of four, none above age sixty-five. Suppose a negative income tax had been in existence with a subsidy rate of 50 percent of unused allowances. In that case, a family of four that had no income would have qualified for a subsidy of $3,600. If members of the family had found jobs and earned an income, the amount of the subsidy would have gone down, but the family's total income—subsidy plus earnings—would have gone up. If earnings had been $1,000, the subsidy would have gone down to $3,100 and total income up to $4,100. In effect, the earnings would have been split between reducing the subsidy and raising the family's income. When the family's earnings reached $7,200, the subsidy would have fallen to zero. That would have been the break-even point at which the family would have neither received a subsidy nor paid a tax. If earnings had gone still higher, the family would have started paying a tax.
We need not here go into administrative details—whether subsidies would be paid weekly, biweekly, or monthly, how compliance would be checked, and so on. It suffices to say that these questions have all been thoroughly explored; that detailed plans have been developed and submitted to Congress—a matter to which we shall return.

The negative income tax would be a satisfactory reform of our present welfare system only if it replaces the host of other specific programs that we now have. It would do more harm than good if it simply became another rag in the ragbag of welfare programs.

If it did replace them, the negative income tax would have enormous advantages. It is directed specifically at the problem of poverty. It gives help in the form most useful to the recipient, namely, cash. It is general—it does not give help because the recipient is old or disabled or sick or lives in a particular area, or any of the other many specific features entitling people to benefits under current programs. It gives help because the recipient has a low income. It makes explicit the cost borne by taxpayers. Like any other measure to alleviate poverty, it reduces the incentive of people who are helped to help themselves. However, if the subsidy rate is kept at a reasonable level, it does not eliminate that incentive entirely. An extra dollar earned always means more money available for spending.

Equally important, the negative income tax would dispense with the vast bureaucracy that now administers the host of welfare programs. A negative income tax would fit directly into our current income tax system and could be administered along with it. It would reduce evasion under the current income tax since everyone would be required to file income tax forms. Some additional personnel might be required, but nothing like the number who are now employed to administer welfare programs.

By dispensing with the vast bureaucracy and integrating the subsidy system with the tax system, the negative income tax would eliminate the present demoralizing situation under which some people—the bureaucrats administering the programs—run other people's lives. It would help to eliminate the present division of the population into two classes—those who pay and those who are
supported on public funds. At reasonable break-even levels and tax rates, it would be far less expensive than our present system.

There would still be need for personal assistance to some families who are unable for one reason or another to manage their own affairs. However, if the burden of income maintenance were handled by the negative income tax, that assistance could and would be provided by private charitable activities. We believe that one of the greatest costs of our present welfare system is that it not only undermines and destroys the family, but also poisons the springs of private charitable activity.

Where does Social Security fit into this beautiful, if politically unfeasible, dream?

The best solution in our view would be to combine the enactment of a negative income tax with winding down Social Security while living up to present obligations. The way to do that would be:

1. Repeal immediately the payroll tax.
2. Continue to pay all existing beneficiaries under Social Security the amounts that they are entitled to under current law.
3. Give every worker who has already earned coverage a claim to those retirement, disability, and survivors benefits that his tax payments and earnings to date would entitle him to under current law, reduced by the present value of the reduction in his future taxes as a result of the repeal of the payroll tax. The worker could choose to take his benefits in the form of a future annuity or government bonds equal to the present value of the benefits to which he would be entitled.
4. Give every worker who has not yet earned coverage a capital sum (again in the form of bonds) equal to the accumulated value of the taxes that he or his employer has paid on his behalf.
5. Terminate any further accumulation of benefits, allowing individuals to provide for their own retirement as they wish.
6. Finance payments under items 2, 3, and 4 out of general tax funds plus the issuance of government bonds.

This transition program does not add in any way to the true debt of the U.S. government. On the contrary, it reduces that debt by ending promises to future beneficiaries. It simply brings into the open obligations that are now hidden. It funds what is now
unfunded. These steps would enable most of the present Social Security administrative apparatus to be dismantled at once.

The winding down of Social Security would eliminate its present effect of discouraging employment and so would mean a larger national income currently. It would add to personal saving and so lead to a higher rate of capital formation and a more rapid rate of growth of income. It would stimulate the development and expansion of private pension plans and so add to the security of many workers.

WHAT IS POLITICALLY FEASIBLE?

This is a fine dream, but unfortunately it has no chance whatsoever of being enacted at present. Three Presidents—Presidents Nixon, Ford, and Carter—have considered or recommended a program including elements of a negative income tax. In each case political pressures have led them to offer the program as an addition to many existing programs, rather than as a substitute for them. In each case the subsidy rate was so high that the program gave little if any incentive to recipients to earn income. These misshapen programs would have made the whole system worse, not better. Despite our having been the first to have proposed a negative income tax as a replacement for our present welfare system, one of us testified before Congress against the version that President Nixon offered as the Family Assistance Plan.26

The political obstacles to an acceptable negative income tax are of two related kinds. The more obvious is the existence of vested interests in present programs: the recipients of benefits, state and local officials who regard themselves as benefiting from the programs, and, above all, the welfare bureaucracy that administers them." The less obvious obstacle is the conflict among the objectives that advocates of welfare reform, including existing vested interests, seek to achieve.

As Martin Anderson puts it in an excellent chapter on "The Impossibility of Radical Welfare Reform,"

All radical welfare reform schemes have three basic parts that are politically sensitive to a high degree. The first is the basic benefit level provided, for example,
to a family of four on welfare. The second is the degree to which the program affects the incentive of a person on welfare to find work or to earn more. The third is the additional cost to the taxpayers.

. . . To become a political reality the plan must provide a decent level of support for those on welfare, it must contain strong incentives to work, and it must have a reasonable cost. *And it must do all three at the same time.*

The conflict arises from the content given to "decent," to "strong," and to "reasonable," but especially to "decent." If a "decent" level of support means that few if any current recipients are to receive less from the reformed program than they now do from the collection of programs available, then it is impossible to achieve all three objectives simultaneously, no matter how "strong" and "reasonable" are interpreted. Yet, as Anderson says, "There is no way that the Congress, at least in the near future, is going to pass any kind of welfare reform that actually reduces payments for millions of welfare recipients."

Consider the simple negative income tax that we introduced as an illustration in the preceding section: a break-even point for a family of four of $7,200, a subsidy rate of 50 percent, which means a payment of $3,600 to a family with no other source of support. A subsidy rate of 50 percent would give a tolerably strong incentive to work. The cost would be far less than the cost of the present complex of programs. However, the support level is politically unacceptable today. As Anderson says, "The typical welfare family of four in the United States now [early 1978] qualifies for about $6,000 in services and money every year. In higher paying states, like New York, a number of welfare families receive annual benefits ranging from $7,000 to $12,000 and more." 

Even the $6,000 "typical" figure requires a subsidy rate of 83.3 percent if the break-even point is kept at $7,200. Such a rate would both seriously undermine the incentive to work and add enormously to cost. The subsidy rate could be reduced by making the break-even point higher, but that would add greatly to the cost. This is a vicious circle from which there is no escape. So long as it is not politically feasible to reduce the payments to many persons who now receive high benefits from multiple current programs, Anderson is right: "There is no way to achieve all the politically necessary conditions for radical welfare reform at the same time."
However, what is not politically feasible today may become politically feasible tomorrow. Political scientists and economists have had a miserable record in forecasting what will be politically feasible. Their forecasts have repeatedly been contradicted by experience.

Our great and revered teacher Frank H. Knight was fond of illustrating different forms of leadership with ducks that fly in a V with a leader in front. Every now and then, he would say, the ducks behind the leader would veer off in a different direction while the leader continued flying ahead. When the leader looked around and saw that no one was following, he would rush to get in front of the V again. That is one form of leadership—undoubtedly the most prevalent form in Washington.

While we accept the view that our proposals are not currently feasible politically, we have outlined them as fully as we have, not only as an ideal that can guide incremental reform, but also in the hope that they may, sooner or later, become politically feasible.

CONCLUSION

The empire ruled over until recently by the Department of Health, Education and Welfare has been spending more and more of our money each year on our health. The main effect has simply been to raise the costs of medical and health services without any corresponding improvement in the quality of medical care.

Spending on education has been skyrocketing, yet by common consent the quality of education has been declining. Increasing sums and increasingly rigid controls have been imposed on us to promote racial integration, yet our society seems to be becoming more fragmented.

Billions of dollars are being spent each year on welfare, yet at a time when the average standard of life of the American citizen is higher than it has ever been in history, the welfare rolls are growing. The Social Security budget is colossal, yet Social Security is in deep financial trouble. The young complain, and with much justice, about the high taxes they must pay, taxes that are needed to finance the benefits going to the old. Yet the old complain, and with much justice, that they cannot maintain the standard of living that they
were led to expect. A program that was enacted to make sure that our older folks never became objects of charity has seen the number of old persons on welfare rolls grow.

By its own accounting, in one year HEW lost through fraud, abuse, and waste an amount of money that would have sufficed to build well over 100,000 houses costing more than $50,000 each.

The waste is distressing, but it is the least of the evils of the paternalistic programs that have grown to such massive size. Their major evil is their effect on the fabric of our society. They weaken the family; reduce the incentive to work, save, and innovate; reduce the accumulation of capital; and limit our freedom. These are the fundamental standards by which they should be judged.