Chapter 8 Review: Expenditure Programs for the Poor: John

Readings: Rosen: Chapter 8, all

Outline

I. Programs Examined
   A. What we are looking at
   B. What we are not looking at

II. Effective Marginal Tax Rates and Incentives: AFDC as an example
   A. Overview of AFDC
   B. Incentives under AFDC
   C. Love those indifference curves

III. An Alternative: The Negative Income Tax
   A. Tax = -a + bY
   B. Indifference curve analysis
   C. Pros
   D. Cons

IV. A 2nd Alternative: Workfare

V. The 1996 Welfare Reform Act

VI. EIC or EITC: Earned Income Tax Credit
   A. Credit (i.e. cash transfer) not deduction or exemption
   B. How the EITC works
   C. Indifference Curve Analysis

VII. Food Stamps

Problems

1. End of chapter Discussion Question #1.

2. End of chapter Discussion Question #3.

3. End of chapter Discussion Question #4.

4. End of chapter Discussion Question #5.

5. How permanent is the “underclass of poverty” in America and how does this affect the usefulness of poverty and income distribution statistics? More specifically, answer the following questions. (flashback to chapter 7)
   a. What (roughly) are the “turnover” rates among the highest and the lowest income groups (the poorest 20% and the richest 20%)? Give me some numbers (see p 148).
   b. When measuring poverty and income distribution, we tend to use data that is a snapshot of the economy at a given point in time (i.e. we use “stock” data, not “flow” data). If there is
a good degree of mobility between income groups, does this mean the poverty is less of a problem or more of a problem that our snapshots indicate? Explain your answer.

6. Give me a brief history of recent welfare changes in the United States. What programs were eliminated? What programs were changed? How were these programs changed? Discuss changes in support and incentives to work as a result of these reforms.

7. What is workfare? How does workfare differ from the AFDC system of transfers? What are some of the arguments for workfare? What are some arguments against workfare? You may make you arguments by comparing workfare to other systems (ex. “Workfare has better incentives to work than this system but worse incentives to work than that system.” … or … “Workfare provides more poverty relief than this system but less poverty relief than that system.”) have there been any recent (say the past ten years) in the status of workfare as part of poverty relief in the U.S.?

8. Erda is a consultant for the government of Gothland. She is assisting the government in developing a program designed to help the poor. Her task is to explain the pros and cons of 1) a system in which the poor receive cash, and 2) a system in which the poor receive vouchers useable only for specific products (ex. food stamps and housing vouchers).

   a. Explain the basic difference between the two programs using indifference curve analysis. Which type of program does indifference curve analysis tend to support? Why?

   b. Are there any arguments for the other type of program? Is so, what are they?

9. Brunhild is a consultant for the government of Asgard. Asgarrd has a program AAFDC (Asgard Aid to Families with Dependent Children) which is identical to the United States AFDC program. Bruhild has been asked to critique the AAFDC program and suggest alternatives.

   a. Explain the AAFDC program using indifference curve analysis.

   b. What are the drawbacks of this AFDC type program?

   c. Suggest another means of helping the poor, in particular a program discussed in class. If possible, use indifference curve analysis. What are the advantages and disadvantages of this program?

10. Gulliver is a consultant for the government of Lillyput. Lillyput has a program known as LICE (Lillyput Incentive Credit for Earnings) which is identical to the United States’ EITC program. Gulliver has been asked to critique Lillyput’s LICE program.

    a. Explain the LICE program using indifference curve analysis.

    b. What are the drawbacks of this EITC type program?
Suggest another means of helping the poor, in particular a program discussed in class. If possible, use indifference curve analysis. What are the advantages and disadvantages of this program?

11. Briefly critique the current U.S. food stamp program’s use of transfer in kind rather than cash. What are some arguments against keeping food stamps as a transfer in kind system? What are some arguments for keeping food stamps as a transfer in kind rather than a cash system?

10. a. On a single graph, draw the AFDC budget lines for two individuals; one making $5 per hour and one making $20 per hour. Assume the individuals have a maximum of 320 discretionary hours per month (i.e. max leisure = 320 hours per month). Use these AFDC numbers:
  
  \[
  \begin{align*}
  \text{max AFDC payment} & = \$600/\text{month} \\
  \text{allowable income before phase-out begins} & = \$250 \text{ per month} \\
  \text{effective marginal tax rate during phase-out} & = 100\%.
  \end{align*}
  \]

  You should have two different AFDC budget lines (one for each individual).

b. Which individual is the most likely to get “hung-up” on a corner solution? Explain why this is. Illustrate this with indifference curves.

11. a. On a single graph, draw the Negative Income Tax budget lines for two individuals; one making $5 per hour and one making $20 per hour. Assume the individuals have a maximum of 320 discretionary hours per month (i.e. max leisure = 320 hours per month). Use the following numbers:
  
  \[
  \begin{align*}
  \text{Guaranteed income} & = \$500 \text{ per month} \\
  \text{Marginal tax rate} & = 25\%.
  \end{align*}
  \]

  You should have two different AFDC budget lines (one for each individual).

b. Has the negative income tax completely eliminated the possibility of a corner solution? If not, tell me which individual is the most likely to get “hung-up” on a corner solution? Explain why this is. Illustrate this with indifference curves.

12. a. On a single graph, draw the Earned Income (Tax) Credit (EIC) budget lines for two individuals; one making $5 per hour and one making $20 per hour. Assume the individuals have a maximum of 320 discretionary hours per month (i.e. max leisure = 320 hours per month). Use the numbers given below. Use page 167 of your book as a guide.
  
  \[
  \begin{align*}
  \text{EIC marginal subsidy rate during phase-in} & = 40\% \\
  \text{Phase in ends when income reaches} & \$800/\text{month} \\
  \text{Phase out begins when income reaches} & \$1,050/\text{month} \\
  \text{EIC is phased out at a marginal rate of} & 20\%.
  \end{align*}
  \]

  You should have two different EIC budget lines (one for each individual).
b. Has the earned income tax credit completely eliminated the possibility of a corner solution? If not, tell me which individual is the most likely to get “hung-up” on a corner solution? Explain why this is. Illustrate this with indifference curves.