National Center for Policy Analysis

BRIEF ANALYSIS
No. 206
For immediate release:
Wednesday, June 5, 1996

Taxpayer Choice

After more than 30 years of the War on Poverty, the federal government has proven one thing: it does a bad job of dispensing welfare. Hardly anybody is happy with the result. However, there is a better alternative: taxpayer choice.

Is there a reason that government should dispense welfare in the first place? The traditional economic argument is that spending money to relieve poverty has beneficial social effects beyond the interest of individual givers. In addition, given freedom of choice, some people will try to become "free riders" on the charitable gifts of others and fail to contribute their "fair share."

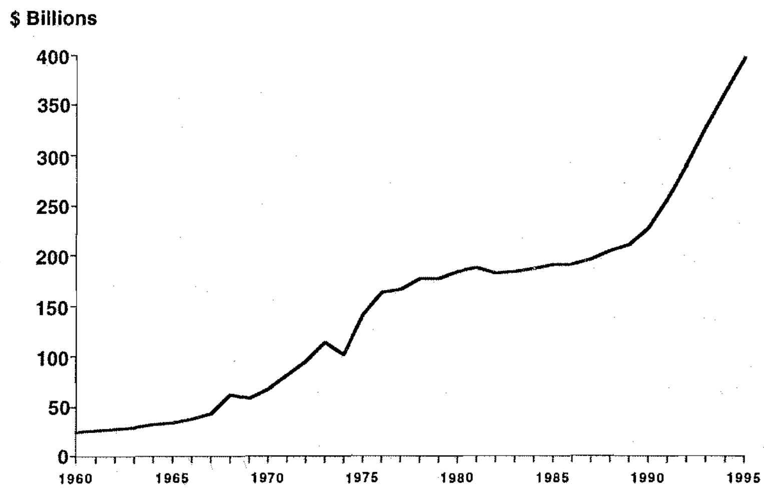
However, it does not follow from a requirement to contribute to charity that the government should nationalize the charity industry. Government requires licensed drivers to carry automobile liability insurance, but few would argue that it should nationalize auto insurance.

How Taxpayer Choice Could Work. The basic idea of taxpayer choice is simple: Government would continue to force people to give their "fair share" through income taxes. However, individual taxpayers rather than politicians would be able to allocate their welfare tax dollars to any qualified charity — public or private. Private charities would compete on an equal footing with government welfare programs for welfare tax dollars, and the market would be free and open. Anyone could start a private charity and qualify for "tax dollar contributions," provided the charity had a social welfare purpose and satisfied certain other minimal requirements.

When taxpayers donated to a qualified charity, they would be permitted to claim a credit on their federal income tax returns. Each dollar donation would reduce a taxpayer's tax liability by one dollar. The taxpayer choice plan is revenue neutral. All tax credits would be exactly offset by reductions in block grants or matching fund payments to the states in which the taxpayers reside.

The Failure of the Current Approach. According to the Congressional Research Service, we have spent $5.4 trillion (in constant dollars) on federal means-tested poverty programs since 1960. [See the figure.] Yet the poverty rate is higher today than it was in 1965, when the War on Poverty was started. Currently we are spending almost $400 billion (about two-thirds of it federal dollars) on federal antipoverty programs each year. Take out Medicaid and the total is about $240 billion — an amount equal to about $6,100 per poor person or $24,400 for a family of four.

Spending on Antipoverty Programs



Source: Congressional Research Service.

Note: FY 1960-1992 benefits in constant 1992 dollars. FY 1993-1995 in current dollars. Includes federal, state and local spending on means-tested benefits under federal programs.

Of course, not all poverty money is spent on poor people. According to a Census Bureau report:

- Only 43 percent of all poor families receive food stamps, and 23 percent of food-stamp families have incomes above the poverty level.
- Only 19 percent of all poor families live in public housing or receive housing subsidies, and 40 percent of the families receiving housing benefits are not poor.
- Only 41 percent of all poor families are covered by Medicaid, and 35 percent of all Medicaid beneficiaries are not poor.

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- Amazingly, *46 percent of all poor families receive no means-tested benefit of any kind from government,* while 40 percent of all families who receive at least one means-tested benefit are not poor.

Private vs. Public. Under government entitlement programs, beneficiaries do not have to explain how they plan to change their behavior or even to show a willingness to change. By contrast, the best private charities often make assistance conditional on behavioral changes. Overall, the private sector has shown that *only* through hands-on management — often using subjective judgment — can we give aid without encouraging dependency.

There is mounting evidence that the private sector does a better job of getting aid promptly to those who need it most, encouraging self-sufficiency and self-reliance, preserving the family unit and using resources efficiently. The War on Poverty was launched to create a social safety net. Yet today the private sector provides the *real* social safety net, helping people whom government programs simply do not reach. Ninety-four percent of all shelters for the homeless in the United States are operated by private-sector organizations, and as many as 80 percent of low-income people initially turn to the private sector in times of crisis. Yet the federal government has a monopoly on welfare tax dollars and the most serious defects of the U.S. welfare system all stem from that monopoly.

When spending decisions are made through the political process, powerful special interests invariably influence how the dollars are spent. It is no accident that more than two-thirds of federal welfare spending ends up in the pockets of people who are distinctly not poor. Further, since the public welfare monopoly faces no marketplace competition, it can spend money in wasteful and inefficient ways, fail miserably to achieve its objectives and generally misbehave without fear of losing customers to a competitor.

Taking the First Steps. If taxpayers have the right to decide how welfare tax dollars will be spent, how much should they be allowed to allocate? In general, each taxpayer's share could be calculated by dividing the total federal welfare spending by total personal income tax payments in each state to obtain the fraction of personal federal income taxes taxpayers should be free to allocate.

In 1994, federal personal income taxes amounted to $543 billion. The federal government spent about $168 billion on means-tested programs other than Medicaid, or about 31 percent of all personal income taxes. Thus if this proposal were fully implemented, individuals in the average state could have allocated up to 31 percent of their personal federal income taxes to qualified private charities, an amount equal to about $1,600 per year per household. If the state government share of the nation's welfare bill were included, taxpayers could allocate about 40 percent of their tax bill (about $2,100 per household) to private charity.

Bills before Congress don't go quite that far. One by Senator Dan Coats (R-IN) would allow a maximum of $500 per taxpayer ($1,000 for a couple). Another by Representatives Jim Kolbe (R-AZ) and Joe Knollenberg (R-MI) would limit the amount to $100. Yet these bills are a step in the right direction.

What organizations would be allowed to receive welfare tax dollars? Most nonprofit organizations (to which people currently can make tax-deductible donations) are classified as 501(c)(3) organizations under the Internal Revenue Service code. These organizations may engage in research, the promotion of art and other activities far beyond the scope of what would be allowed under the taxpayer choice plan.

To implement taxpayer choice, we need a narrower designation — call it 501(c)(3)(+) — for organizations that provide relief and other services to the poor. Organizations with a broader mission such as churches and colleges could form a 501(c)(3)(+) subsidiary. The goal would be to define a "qualified charity" and to assure that all taxpayer choice donations went to traditional welfare activities. Internal Revenue Service scrutiny would be maintained.

The theory behind taxpayer choice is that individuals are required to devote a percent of their income to the relief of poverty, but they can choose the receiving organization. In other words, government chooses the amount that must be given; taxpayers choose the recipient. The result will be a massive shift of funds from government programs that do more harm than good to private-sector programs that actually work.

This Brief Analysis was prepared by NCPA President John C. Goodman.