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POVERTY and OPPORTUNITY
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Poverty, Opportunity and the Deficit: What Comes Next

A Commentary Series by

Spotlight on Poverty and Opportunity

About *Spotlight on Poverty and Opportunity*

Spotlight on Poverty and Opportunity is a non-partisan initiative aimed at building public and political will for significant actions to reduce poverty and increase opportunity in the United States. We bring together diverse perspectives from the political, policy, advocacy and foundation communities to engage in an ongoing dialogue focused on finding genuine solutions to the economic hardship confronting millions of Americans.

About the *Poverty, Opportunity and the Deficit* Series

With concern about rising deficits taking center stage in Washington, President Obama formed the bipartisan National Commission on Fiscal Responsibility and Reform to make recommendations on how to ensure a sound fiscal future for our country. As the Commission deliberated, *Spotlight on Poverty and Opportunity* believed their efforts to rein in deficits and manage the budget should include a focus on the potential impact on low-income people.

To make sure this critical issue was central to the debate, *Spotlight* presented a range of views from policymakers, economists and policy experts during the fall of 2010 on how the Commission's recommendations will--or should--affect low-income individuals.

Due to the overwhelming positive response to our first *Poverty, Opportunity and the Deficit* series, *Spotlight* will host a follow-up commentaries series in early 2011 that will ask contributors to focus on specific issues such as Social Security, taxes and tax expenditures, health care and economic stability and recovery.

To view the full *Poverty, Opportunity and the Deficit* series, visit
www.spotlightonpoverty.org/deficit-series

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The complete *Poverty, Opportunity and the Deficit* Series includes the following contributions:

Poverty, Opportunity, and the Deficit
By Douglas Holtz-Eakin, President, American Action Forum

Fiscal Reform and Poverty Reduction Are Mutually Reinforcing
By Maya MacGuineas, President and Jason Peuquet, Policy Analyst, Committee for a Responsible Federal Budget, New America Foundation

Don't Increase Hunger to Balance Budgets: How We Can Feed the Hungry and Help Our Economy
By Representative Jim McGovern

Poverty, Opportunity, and the Deficit
By Stuart Butler, Distinguished Fellow and Director, Center for Policy Innovation, Heritage Foundation

Why Deficit Reduction Is Necessary and Need Not Hurt the Poor
By Isabel Sawhill, Senior Fellow, Brookings Institution

The Conventional Wisdom is Wrong: We Can Afford Entitlements
By Heidi Hartmann, President, Institute for Women's Policy Research

What Happens to the Poor If the U.S. Reduces Its Debt Ratio and Its Deficits
By Bill Frenzel, Guest Scholar, Economic Studies, Brookings Institution

Protect and Defend Social Security, Even While Reducing the Deficit
By Nancy Altman and Eric Kingson, Co-Directors, Social Security Works and Co-Chairs, Strengthen Social Security Coalition and Campaign

No Time to Weaken Social Security
By Rebecca Dixon, Policy Analyst, National Employment Law Project

The Automatic IRA Helps Build Assets and Retirement Security
By David C. John, Senior Research Fellow in Retirement Security and Financial Markets, Heritage Foundation

Balance the Budget, but Not on the Backs of the Poor
By Rebecca Thiess and Andrew Fieldhouse, Federal Budget Policy Analysts, Economic Policy Institute

Means-Tested Programs Should Bear Part of the Deficit Burden
By Ron Haskins, Senior Fellow, Brookings Institution

Fighting Poverty and Unemployment in an Era of High Debt
By Harry J. Holzer, Professor, Georgetown Public Policy Institute

Following are a selection of commentaries from the series

Poverty, Opportunity, and the Deficit

By Douglas Holtz-Eakin, President, American Action Forum

Mr. McGuire: I want to say one word to you. Just one word.
Benjamin: Yes, sir
Mr. McGuire: Are you listening?
Benjamin: Yes, I am.
Mr. McGuire: Plastics.

Mr. McGuire may have had it right in 1967 when *The Graduate* hit American theatres. But today's word is capital.

That's right, capital. At a time when faith in private sector institutions is wavering and government policies are perceived to be at times an assault on the free-enterprise system, the key to pro-opportunity policies is capital.

Here's why. If one draws back from the financial crisis/recession-driven context of day-to-day discussions, the seminal event of the early 21st century is the entry to the global labor market of billions of workers in China, India, and elsewhere around the globe. The simplest economics suggest that this relative plentitude will lower the relative market earnings of unskilled laborers and raise the return to higher-skilled workers and capital investment.

This is bad news for poor wage-earners and an advantage to those with human and financial capital. Some will be tempted to react by ramping up pure redistribution, attempting to empower unionized labor, or closing U.S. borders to flows of goods, capital, and labor. Global market forces will overwhelm such ill-conceived government attempts to reverse the fundamentals at play.

A better strategy is to harness these very forces by building human and financial capital. The merits of fundamental reforms to the K-12 education system that emphasize choice and competition that reward performance and attainment are no longer a source of partisan divide. But a more thoroughgoing focus on building human capital at every stage of the career is necessary.

From a budgetary perspective, the goal should be not only to rein in the over-promises of existing entitlements, but also to reverse the basic strategy. Why provide an entitlement for retirement income, health care, and elder assistance? Why not provide the entitlement early in life so that pre-K school, primary education, nutrition, and preventive care provide the capacity for strong returns to human capital and the capacity to finance those same old-age needs in a vibrant market setting?

Why structure unemployment insurance, food stamps, Temporary Assistance for Needy Families (TANF), and other low-income programs as cash-flows conditional on meeting eligibility criteria? Why not integrate these programs with individual-specific accounts that can be managed to accumulate wealth and provide strong incentives for reliance on work and timely exit from support. Critics have focused on the supposed inability of participants to manage financial accounts and the riskiness of financial investments. The greater risk is to fail to build the human capital needed to address the former and to forego forever the potential returns to the latter.

These longer-run imperatives couple nicely with the demands for economic recovery. The U.S. economy is growing, albeit slowly, not declining. However, at this juncture, it is imperative that policy be focused on generating the maximum possible pace of sustainable economic growth. More rapid growth is essential to the labor market opportunities of the millions of Americans without work.

Households are caught in a double bind of badly damaged balance sheets and weak income growth. Policies that support the ability of households to accumulate wealth and repair their balance sheets while otherwise maintaining their consumption patterns will be the most beneficial. Similarly, pro-growth policies that stimulate investment will generate jobs and wealth.

In light of the budgetary pressures, this places a premium on tax policy that rewards innovation, investment, and saving decisions such as low marginal tax rates, low taxation of returns to equity, and capital cost recovery. In contrast, provisions for refundable tax credits, marriage penalty relief, and other targeted incentives may meet other policy objectives, but do not contribute to growth incentives.

Indeed, the impact of phase-outs of refundable credits may have even more perverse growth consequences. They contribute to high effective marginal tax rates that reduce the ability of families to rise from the ranks of the poor, or to ascend toward the upper end of the middle class. This growth and mobility is the heart of the American dream and is the most pressing issue at this time.

Douglas Holtz-Eakin is the president of American Action Forum. He is the former director of the Congressional Budget Office and former Chief Economist on the Council of Economic Advisers under President George W. Bush

Fiscal Reform and Poverty Reduction Are Mutually Reinforcing

By Maya MacGuineas, President and Jason Peuquet, Policy Analyst
Committee for a Responsible Federal Budget, New America Foundation

There is no question that major changes will have to be made to the U.S. budget in coming years. Surpluses are never expected to return, the debt is projected to climb to unprecedented levels, and major programs are significantly underfunded, leaving participants uncertain about what benefits they will receive in the future.

Though the largest changes should be implemented gradually so as not to derail the economic recovery, already we have seen many bills stall in Congress due to concerns about adding to the debt. (Though there seems to be a startling blind spot about the tremendous multi-trillion dollar cost of extending the Bush-era tax cuts). Calls for fiscal responsibility will only grow as our debt continues to mount.

At the same time, growing income inequality persists and poverty has been rising as the recession has taken a huge toll on wages and employment rates among lower-income Americans. The poverty rate increased to 13.2 percent of households in 2008, up from 12.5 percent in 2007, and is expected to have climbed even higher in 2009 and up to the present. In addition, the percentage of people close to the federal poverty line, known as the "near poor," has also increased significantly since 2007.

Changes to the budget are inevitable. We will have to reduce the U.S. debt burden if we want to pass along a vibrant economy to the next generation of Americans—one that can offer a job for anyone who seeks one, and an adequate safety net for those who cannot work. The sooner we begin, the easier it will be to protect the most vulnerable in society. Smaller changes will be needed initially if we get started as soon as the economy will permit, and there will be more time for those who are affected to prepare and adjust.

The risk is that if we fail to act on our own accord to fix the budget, and wait instead until market pressures force our hand, we will not be able to pick and choose to craft a smarter, leaner budget, and instead will put at great risk those who depend on government the most. Under a wait-until-there-is-a-crisis scenario, it is much more likely that everyone will have to share the burden of fiscal adjustment – even the most vulnerable – as savings would have to be identified immediately. Just look at Ireland and Greece, where sudden demands from markets and creditors to realign spending and revenues paths have prompted protests and strikes over widespread government cuts. Protecting the most vulnerable in our society will be more difficult if our creditors suddenly demand cutbacks.

Not only will acting sooner better insulate lower-income Americans, but focusing on pro-growth reforms could actually make the economy stronger relative to what would have occurred absent any changes. By streamlining our outdated tax system, shifting resources from consumption to investment, and reducing spending on unnecessary and wasteful programs, future economic growth could be substantially stronger.

But growth is not enough—the benefits of growth will have to be widespread, as growth alone does not automatically assist all segments of society. Policymakers will have to make sure that wage growth and job creation do not just happen for middle- and upper-income Americans, but for everyone. Since much of the American safety net is predicated on current or previous employment (for instance, the earned income tax credit and unemployment insurance), ensuring job creation at all income levels will play a large role for both fiscal reform and poverty reduction.

Finally, changes that ask the most from those who are doing best are only fair in this economy. Progressive tax policies – which are different than irrational pledges not to raise any taxes on the bulk of the population – make sense given the wide disparity in income growth. A progressive consumption tax, for instance, would be both good for the economy and fair in terms of distribution. The estate tax should certainly remain—why should a minimum wage worker pay a greater share of his or her paycheck in taxes than someone who inherits his or her money?

On the spending side, given the choice between across-the-board or targeted benefit cuts in entitlement programs, it only makes sense to reduce benefits for those who need them least and protect those who depend on programs like Social Security. In fact, we should strengthen these programs for the least well-off. We should turn social insurance programs into real insurance programs that truly offer protections when needed and better direct the limited resources to the highest needs.

Low poverty levels are vital to sustained fiscal health. Spending on Medicaid, unemployment insurance, food stamps, and other programs aimed at assisting lower-income Americans constitute a large and growing portion of the federal budget. Any serious plan to control future deficits must understand this and ensure the most vulnerable in society are protected to the greatest extent possible.

Some critics contend that fiscal reform and poverty concerns are mutually exclusive goals, as higher taxes or lower government spending would invariably affect lower-income Americans, either directly or indirectly. But these critics ignore the fact that by spreading the burden of adjustment over more people and over a longer period of time, we can avoid a fiscal crisis while actually strengthening the economy. They ignore the fact that if we do not act in the near future, a fiscal crisis in some form or another will surely make creditors force changes upon us. We must remember that it is always better to make fiscal changes on our own terms.

Maya MacGuineas is the President of the Committee for a Responsible Federal Budget at the New America Foundation, where Jason Peuquet is a Policy Analyst.

Why Deficit Reduction Is Necessary and Need Not Hurt the Poor

By Isabel Sawhill, Senior Fellow, Brookings Institution

We need to reduce our long-term deficits. We cannot forever spend more than we collect in taxes. And if we continue on our current path we risk another economic crisis that is likely to produce even more unemployment than we have now.

To be sure, we should not cut the deficit right now—that would be very bad for the economy. We should combine stimulus now with legislative initiatives that gradually rein in spending and raise taxes once the economy has recovered.

But if we continue to ignore the huge accumulation of debt in our future, or assume it can be addressed without cutting domestic spending, it is the least advantaged who are likely to suffer the most.

Why do I say this?

First, if we have another economic crisis that produces high rates of unemployment for an extended period, social programs will do no more than temporarily reduce the harm inflicted on the least advantaged. The safety net is no substitute for a job and a growing economy. Deficits matter because, in the longer term, they undermine the economy's ability to produce the jobs that are especially critical to moving people out of poverty and into the middle class.

Second, many progressives believe that we can solve our fiscal problems by cutting defense and raising taxes. Although I believe they are right to fight for both of these solutions, I do not think they will be sufficient. As I have argued in more detail elsewhere (see my debate with Greg Anrig in the September issue of *Democracy: A Journal of Ideas*), the numbers simply don't add up unless taxes are raised across the board to unprecedented levels—and not just for the wealthy. This level of taxation is not only politically unfeasible but unfair to the many middle and working class families who are currently struggling and whose incomes were stagnating even before the recent downturn.

Third, any effort to protect Social Security and Medicare from future spending reductions – as many advocates are now arguing – will simply put more pressure on programs that serve the disadvantaged and their children. The rapid growth of spending on entitlements has already forced the Obama Administration to propose a freeze in non-security domestic spending.

In California, Governor Schwarzenegger has proposed an elimination of the state's welfare-to-work program as well as most child care assistance for low-income families, a harbinger of what may happen at the national level as the budget squeeze plays out over the next decade or two. This should give pause to those who argue that we can't touch health or retirement benefits for those over about age 55, since they won't have time to adjust to the changes. There's no such "adjustment time" permitted for single moms with a low-wage job who are suddenly forced to spend one third of their income on child care.

Those who care about protecting the less advantaged need to be willing to find savings in the largest and fastest growing portion of the federal budget—the big three entitlement programs: Social Security, Medicare, and Medicaid. In 2010, 71 percent of all revenues are devoted to just these three programs.

What kinds of changes should advocates for the poor support?

First, they should support reforms that leave the core commitments behind Social Security and Medicare intact and ensure that no one is left bereft of access to basic health care and a decent income in old age.

Second, they should support reforms that gradually trim benefits for the more affluent over time while protecting those at the bottom.

Third, they should support reforms that recognize that not all spending on health care improves health. Specifically, we need to move toward reimbursement rates for providers that are tied to evidence of effectiveness. The goal should be to improve health, not just access to health care. Thanks to the recent health care bill, health care itself is now nearly universal. But some estimates suggest that as much as a third of all health care spending does not improve health—an estimate that is further reinforced by the good health outcomes achieved in other advanced countries that spend far less than the U.S. on health care.

But the answer for those who care about low-income Americans is not to ignore deficit reduction. It's to pursue sensible deficit reduction in a way that protects poor people now and ensures a more prosperous future for everyone.

Isabel Sawhill is a Senior Fellow at the Brookings Institution.

Fighting Poverty and Unemployment in an Era of High Debt

By Harry J. Holzer, Professor, Georgetown Public Policy Institute

There is a growing consensus among economists that we are in the middle of a recession that is both severe and persistent, with high unemployment lasting for years to come. There is also a growing body of evidence that such high and persistent unemployment will not just hurt workers and their families in the short term, but could potentially "scar" millions of individuals over a much longer time period.

Children growing up in poor households or with unemployed parents under great stress are at risk of worse performance in school and lower educational attainment; youth who are not able to find work at a critical early point in their careers will likely suffer elevated joblessness and lower earnings over time; and the long-term unemployed among adults will suffer both diminished earnings and serious health problems as they find it increasingly difficult to replace the jobs they lost.

In such an environment, the federal government should be willing to undertake some essential expenditures, at least in the short-term, to strengthen the incomes of and support services for these families and help generate more jobs in the private and public sectors. And the need to invest in cost-effective longer-term strategies that improve the education and earnings of low-income children, youth, and adults should also be beyond question at this point.

Yet this is not happening. Concerns over huge budget deficits and accumulating public debt, along with excessive partisan rancor in Congress, have together choked off efforts to fund more job creation in both the private and public sectors, and have even made it difficult to extend unemployment insurance to those without work for up to 99 weeks.

How valid are the concerns over deficits and debt? And should we not fund more safety net and job creation efforts in the short-term, as well as critical antipoverty efforts in the longer term, because of the bleak fiscal outlook?

While the nation's fiscal outlook is certainly bleak, some important caveats should be added.

First, the nation's fiscal problems are mostly long-term, not short-term; the accumulation of public debt relative to Gross Domestic Product (GDP) will increase gradually over the next decade and beyond, but is not a severe constraint on public borrowing or economic activity right now.

Second, deficits rise automatically in recessions, as revenues fall off and spending automatically increases; indeed, these increases have been compounded by the extreme efforts needed to stave off another Great Depression in the past few years. The deficit will thus decline automatically with recovery, though not by enough to balance our fiscal books over the longer run.

Third, deficit spending in a recession remains economically stimulative; if it is well-targeted towards efforts that improve the employment and earnings capacity of the poor and unemployed – or at least prevent their scarring – such spending provides both economic and fiscal benefits over time. In other words, sensible short-term or even longer-term expenditures in this area will help pay for themselves over the long term.

Fourth, and perhaps most important, we must stay very clear on exactly what has caused the nation's looming long-term fiscal crisis and what has not. Several major factors contribute to the problem:

1. Enormous growth in the costs of federal retirement programs, especially Medicare and Medicaid
2. Declining federal revenues, especially from the ill-conceived tax cuts of the previous decade—which overwhelmingly benefited high-income groups
3. Dramatic increases in spending on defense and homeland security – including the costs of two wars – since 2001

Unavoidable increases in interest payments on the growing public debt will also contribute to the problem over time, in ways that cannot be avoided.

Notice what is not on this list: discretionary nondefense spending. As a percentage of GDP, such spending has declined over several decades; and even its recent temporary spike from spending under the stimulus package leaves it well under the levels we experienced in most recent decades since the 1950s.

Of course, some categories of spending on the poor – like food stamps – are entitlements, while others – like the Earned Income Tax Credit – are tax expenditures. But it is in the category of discretionary spending that much of the education, training, employment, and other supports for the poor and unemployed would fall.

Ironically, the unwillingness of our leaders in Washington to honestly address the real causes of the long-term fiscal crisis leads them to cap the discretionary component, though it accomplishes very little fiscally, because this is the easiest route to take politically. But, in that context, many of our most critical efforts to relieve the severe human costs of poverty and unemployment, both over the short-term and long-term, get sacrificed.

It is time for an honest conversation about exactly what causes the public debt to accumulate, and what really needs to be done, while we stop scapegoating programs for the poor and unemployed that could really do some good.

Harry J. Holzer is currently a professor of public policy at Georgetown University. He is also an Institute Fellow at the Urban Institute. Mr. Holzer was previously Chief Economist of the U.S. Department of Labor during the Clinton administration.

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