Who's Minding THE Kids?

It's 2004. Do you know where the money for raising children will come from?

By William G. Gale

Last fall, President Bush signed a law providing heavily subsidized prescription drug benefits under the Medicare program. In the discussions leading up to the vote on these benefits – the largest new government entitlement program in almost four decades – supporters and opponents debated the effects of the legislation on the federal budget, seniors' health status, and other worldly matters. Rarely, if ever, were the implications for children considered. But paradoxically, Medicare spending is a children's issue. For that matter, so are the high-end tax cuts of the past three years that Republicans would dearly like to make permanent.

Our political leaders rarely make this link to children's issues clear, but it is very simple: little pills and big tax cuts have to be paid for and, one way or another, future generations are going to do the paying. The Medicare prescription drug benefit and the tax breaks both committed massive federal resources that could have been used for other purposes, notably for a major investment in youth that could pay big dividends to today's children and tomorrow's retirees.

MICHAEL SIPE (ALL)

FISCAL POLICY AND CHILDREN

Some public programs assist children directly – think spending for education, nutrition and indigent health care. Many of these programs are appropriately regarded as productive investments in the country's future. Indeed, evidence from controlled social experiments suggests that such programs can improve health and education as well as inhibit crime, drug use and teenage childbearing. Research also shows that investments in children's programs could generate very substantial returns in terms of lower government costs and higher tax revenues down the road.

Less obviously, policies that do not focus explicitly on children nonetheless can have significant impact on the young as well as the yet-to-be-born. For example, programs that raise productivity and economic growth, pay down the public debt, clean up the environment, strengthen infrastructure or beef up research can improve life prospects for future generations. The indirect effects of policy choices, however, rarely receive the attention they deserve.

Indeed, there is a remarkable disconnect between the way people talk about "regular" policies and "kids" policies. Debates about tax and fiscal issues focus on how economic growth, revenues and the distribution of tax burdens will be affected. But when a kids' issue comes up, the discussion typically turns to questions like whether children are acquiring the intelligence and skills they need to succeed as adults, whether they have access to health care, whether they live in safe neighborhoods and whether their parents can find affordable housing.

On the surface, these categories are quite distinct. In practice, they are largely two sides of the same coin. Economic growth is problematic without a healthy, skilled work force. If government revenues are very low, there won't be funding available for things like safe neighborhoods, good schools and vaccinations for kids. And whether housing or other goods are affordable depends significantly on tax burdens.

The first lesson, then, is that we have to stop talking about kids' issues as distinct from other issues. In an era of looming deficits and traumatic demographic change, we simply don't have the luxury of compartmentalizing these concerns.

THE CASE FOR A PRO-CHILD FISCAL AGENDA

It's way past time to enact a pro-child agenda. For starters, the story that a rising tide of economic growth lifts all boats no longer fits the experiences of a substantial minority of youth. Second, by incurring fiscal deficits, adults are foisting major burdens on all future generations and on families raising the next generation. Third, on a brighter note, spending on children can pay remarkable dividends.

Many Children Left Behind

One justification for expanded investment in children is that even sustained economic growth is not lifting all children's prospects. From 1966 to 2003, real income per capita more than doubled, while the poverty rate fell by almost two-thirds for the elderly and by 15 percent for the population overall. Yet the incidence of poverty among children was

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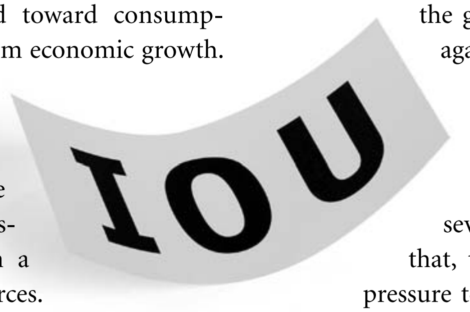
precisely the same in 2003 – 17.6 percent – as it was in 1966. One can legitimately debate the extent to which this lack of improvement in child poverty, in the teeth of a more than 100 percent increase in average income, is due to broader societal trends. What cannot be debated, though, is that a sizable segment of the youth population could benefit from well-designed government programs to boost cognitive skills and to improve behavior across a broad range of activities.

Many Burdens on Future Generations

We're not just leaving many youth behind; we're dumping hefty debts on current and future youth. Today's fiscal policies, which are channeling resources away from public and private investment and toward consumption, will retard long-term economic growth. Therefore, rather than raise the amount of resources available for future generations, the policies will mainly redistribute a fixed or even a declining pool of resources.



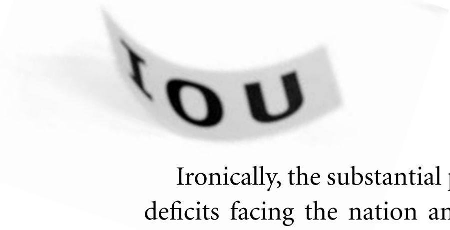
If they are made permanent, the recent tax cuts and the Medicare prescription drug law will conservatively cost the federal government more than $34 trillion in reduced revenues and increased expenditures – the equivalent of the entire U.S. GDP for three years!

These initiatives are best thought of as loans, though, not grants. They must eventually be paid for either with tax increases or spending cuts, and the patterns of repayment are not necessarily linked to who receives the benefits. The resulting redistribution will occur through two broad channels – within generations and across generations. In both cases, it will undermine the economic prospects of the young.

Start with the impact within generations. Examined in isolation, the recent tax cuts offer some relief to most families. But it is misleading to look at who benefits without also considering how the tax cuts will eventually be financed. In a recent paper, Isaac Shapiro of the Center on Budget and Policy Priorities, along with Peter Orszag, a Brookings economist, and I, show that under plausible ways of paying for the tax cuts, most families with children will actually end up worse off.

The policies will redistribute resources across generations by raising the fiscal burdens on future generations and by reducing the burdens on current generations. By raising spending and cutting taxes now without accelerating economic growth, spending will have to be cut or taxes raised down the road if the government budget is ever again to be balanced.

The inter- and intragenerational redistributions noted above will exacerbate the effects of several federal budget trends that, taken together, will create pressure to reduce federal funds for children. Along with Alan Auerbach, a University of California economist, Orszag and I have estimated that under current policies, the nation faces a long-term fiscal gap of between 7 and 10 percent of GDP. This implies that the country would have to raise taxes or cut spending immediately and permanently by between one-third and one-half (between $700 billion and $1 trillion in today's economy) in order to restore fiscal balance. According to estimates by a Cato Institute economist, Jagadeesh Gokhale, the intergenerational burdens created from a gap of this magnitude are equivalent to assigning a debt of several hundred thousand dollars to every child born from now on.



Ironically, the substantial projected budget deficits facing the nation amount to another justification for digging even deeper to invest in children. Deficits reduce national savings and future national income, and impose higher fiscal burdens on coming generations. If we can't actually reverse these policies and avoid the damage to the young, at least we could endow future generations with the productive skills needed to dig themselves out of the mess later on. Thus, while it will create pressure to cut all spending, the current fiscal situation actually helps to justify making an exception for investment in children.

Instead of boosting prospects for children, federal policies are on a path that will lead to significant cuts in spending on proven programs for children.

Kids are a good investment

Well-designed investments in children would pay significant dividends. The return on education has risen sharply over the past two decades, making it more than competitive with expected returns on financial assets. Evidence suggests that particularly rich returns would come from investing in early-childhood education. Well-structured programs aimed at preschoolers have produced big improvements in school records and later, in the participants' earned incomes. Yet today we are spending a tiny fraction of total federal resources on children under the age of five, and that modest commitment is likely to wane in light of the budget competition from tax cuts, defense spending and entitlements for the elderly.

Besides making today's children more productive, investments in children have two key features that add to their attraction. First, they are more likely than tax cuts to produce dividends that are broadly shared. Second, the benefits are more likely to remain in the country.

Unlike other nations – notably, France and Italy – we do not routinely subsidize the education and care of the very young. Child-care debates in this country have focused on the benefits of such care for working mothers, but should be redirected to examine how educationally-oriented programs could help children, along with the economy's future productivity. About half of all 3- and 4-year-olds, a disproportionate share from more affluent families, are already enrolled in preschool programs. This opportunity ought to be extended to less advantaged children as well. With welfare reform moving more mothers into the job market, we shouldn't miss the opportunity to put more of their children on a path to success.

SPENDING CUTS TO COME?

Instead of boosting prospects for children, though, federal policies are on a path that will lead to significant cuts in spending on proven programs for children. Of course, no political leader actually puts it that way, but the arithmetic is pretty compelling.

The difference between total federal revenues and spending on interest, defense and elderly entitlements represents the amount left for all other federal programs, including those for children. This difference fell by two-thirds, to under 3 percent of GDP in 2004, (from 8.6 percent in 2000), and is slated to remain at about that level for the next decade under plausible assumptions. By 2030, in the absence of major corrective policy changes, the difference is likely to turn negative. That is, interest on the debt, defense outlays and retirement programs alone will exceed federal revenues.

To be sure, most of the decline through 2014 is due to underlying demographic trends; the tax cuts and Medicare enrichment account for just one-third of the change. But it is also worth emphasizing that, from the perspective of providing resources for children, recent fiscal policies have effects that are both substantial and in the wrong direction.

The budget squeeze will put pressure on all federal programs. However, prospects for increasing or even retaining funding for children's programs are particularly problematic. Spending is divided into two categories: (a) entitlements and mandatory spending, and (b) appropriated and discretionary spending. Mandatory spending follows rules that are enshrined in the law. Every year, even in the absence of Congressional action, payments are made according to existing law – and these payments typically grow with time. Discretionary outlays, by contrast, must be appropriated annually. Hence, discretionary programs face battles every year and are the most likely to bite the dust when budgets are tight. Mandatory programs can be altered, of course, but in the absence of specific Congressional action, they live on.

The key point from the perspective of children's welfare is that several critical programs – including Head Start, WIC nutrition supplements, Title I education funding and others – are discretionary programs. Hence, they have second-class status in budgeting. By contrast, the great bulk of spending on the elderly is mandatory.

A second key characteristic of federal budgeting is that almost all recent social policy initiatives have occurred on the tax side of the ledger, typically as credits or deductions. This undermines children's programs for the simple reason that about half of all kids live in households that are too poor to pay federal income tax. Unless tax credits are refundable, an approach Congress has resisted in recent years, tax breaks cannot help those children.

Proposed cuts along the lines described above are already materializing. In an effort to reduce the budget deficit without raising taxes or rolling back the Medicare prescription benefit, the Bush administration's 2005 budget proposes significant reductions in child-oriented programs, including education, Head Start, WIC and low-income housing assistance.

The recent federal tax cuts will also squeeze state budgets because a number of states link their income taxes to the federal code. And since many children's programs are financed through the states, the resulting state budget pressures could be as damaging to prospects for children as the pressures at the federal level.

WHAT WOULD IT TAKE?

Given the budget outlook, can Uncle Sam afford to take responsibility for children? The best answer is that the old guy can't afford not to. An expanded effort would certainly be justified. Federal spending for the elderly is three times as large as spending for children. And between 2000 and 2014, it is projected to increase by as much as the current level of children's spending. Surely, if the nation can marshal resources to keep granny away from the dog food at the supermarket, it can do more for kids.

It is worth noting that the massive infusion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of resources for the elderly over the last half-century has been extraordinarily successful in reducing poverty and increasing life expectancy. A similar national effort for children could provide equally dramatic results for the prospects of today's youth and future generations.

It's time to stop separating children's issues from other aspects of fiscal policy. We are passing on huge fiscal burdens to future generations.

As outlined by my Brookings colleague, Isabel Sawhill, a coordinated effort to put kids first would include (in no particular order) increased cash supplements for low- and moderate-income families with children, increased parental leave, expanded after-school programs, marriage-promotion programs, improved health services like universal prenatal/perinatal screening, insurance for all children under the age of 18, aggressive intervention and treatment for severe behavioral and emotional problems, early-childhood education, universal preschool for 4-year-olds and improved neighborhoods for poor children.

At least two major changes in federal fiscal policies would probably be required to make such a program practical. First, most of the 2001-2003 tax cuts would have to be allowed to expire as scheduled in 2010. This is probably the single most important policy initiative affecting prospects for increased funding for children over the next five years. If the tax cuts are made permanent, federal finances will be set in stone for the foreseeable future. If the cuts are allowed to expire, by contrast, more than 2 percent of GDP would be available, a relatively small part of which could finance an ambitious investment in children.

Second, changes in the budget process would help to protect such changes by removing children's programs from the vicissitudes of annual budgeting. A trust fund or formal set-aside for children's programs could protect their money from pressure to satisfy other interests first. As always, the devil is in the details. But just as it is possible to imagine independent boards managing the Social Security trust fund or the nation's money supply, one can imagine an independent intermediary that advised Congress on how to invest a public trust fund for children. If such funds were provided as a block grant to the states, with a proviso that their effectiveness be rigorously evaluated, chances are that much good could be accomplished.

A third, more modest possibility, an annual child-impact statement on how newly enacted policies affect children, would at least raise the visibility of these concerns.

It's time to stop separating children's issues from other aspects of fiscal policy. We are passing on huge fiscal burdens to future generations, and, at the same time, doing a wretched job of equipping the most at-risk members of the next generation with the tools they need to cope in today's grab-it-while-you-can economy.