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PUBLIC INVESTMENT IN HUMAN AND PHYSICAL INFRASTRUCTURE

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

JULY 19, 1989

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WEDNESDAY, JULY 19, 1989

PUBLIC INVESTMENT IN HUMAN AND PHYSICAL INFRASTRUCTURE

WEDNESDAY, JULY 19, 1989

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to notice, at 1 p.m., in room SD-138, Dirksen Senate Office Building, Hon. Lee H. Hamilton (chairman of the committee) presiding.

Present: Representatives Hamilton, Hawkins, Scheuer, and Solarz.

Also present: Joseph J. Minarik, executive director; William Buechner, Chad Stone, and John Mizroch, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, CHAIRMAN

Representative HAMILTON. The meeting of the Joint Economic Committee will come to order.

This afternoon the Joint Economic Committee is meeting to examine the recent record of government investment in human and physical infrastructure and the need for additional investment.

The committee is fortunate to have four expert witnesses this afternoon on the subject of public investment in human and physical infrastructure, Prof. James Tobin of Yale University, Prof. Alan Blinder of Princeton University, Mr. Donald Straszheim, chief economist, Merrill Lynch Capital Markets, and Mr. Jack Meyer, president, New Directions for Policy, representing the Ford Foundation.

Gentlemen, we are delighted to have you here, and we appreciate very much your appearance. As I indicated to you a moment ago, the House is in session and considering an amendment at the present time, and it's possible we will have to interrupt for a vote, but we are very pleased that you're here.

Your prepared statements, of course, will be entered into the record in full, and we would like for you to either give or summarize those statements now for us briefly so we can turn to questions.

Mr. Tobin, we will begin with you and move across the table in consecutive order.

Congressman Hawkins, do you have any comment to make?

Representative HAWKINS. Not at this time. Thank you.

Representative HAMILTON. All right.

Mr. Tobin, you may proceed.

STATEMENT OF JAMES TOBIN, STERLING PROFESSOR EMERITUS OF ECONOMICS, YALE UNIVERSITY, AND NOBEL LAUREATE IN ECONOMICS

Mr. TOBIN. Thank you, Mr. Chairman.

I am pleased to be back here at this committee. I have testified here a number of times, including occasions when I was a member of the Council of Economic Advisers. I think the Council and the committee together are the economics consciences of the Federal Government. They worry about the overall economic effects of Federal policies in precedence to the sectoral and special interests involved.

I'm going to begin here by trying to place the issue of public investment in a larger economic framework. I think the JEC over the years has had three major objectives for economic policy.

One of them is the maintenance of high employment as the Employment Act asks and mandates, and the stabilization of demand to avoid both recessions and inflations.

Second is growth in the longrun trend capacity of the economy when it's fully employed, so that it can yield even higher standards of living to the American people.

The third objective would be equity in the distribution of income, consumption and wealth, and intergenerational equity as between present Americans and future generations.

If one were to take stock today of how the economy has been doing relative to these three traditional objectives, we could be quite well satisfied about the first. We've had a long recovery, and it has brought us to an unemployment rate lower than anybody—in my profession anyway—thought would be possible and inflation safe back in 1980.

The Federal Reserve deserves, I think, most of the credit for managing this recovery, and for fine tuning it so that we've been brought to this low rate of unemployment without a significant increase in inflation.

The radical fiscal policies of the 1980's more or less disabled budgetary policy as a stabilization tool. The full responsibility for countercyclical stabilization, and for steering the economy in the short run, has been left to Federal Reserve monetary policy.

With respect to the second objective, growth in the economy over the longer run, I think there is considerable cause for dissatisfaction. In short, the policies of the 1980's have been a demand-side success and a supply-side failure. That's somewhat ironical, inasmuch as the policy was mostly advertised as supply-side policy.

The bottom line of supply-side policy is the growth of productivity of labor. That fell off in the middle 1970's and hasn't been restored to its previous rate. It used to be nearly 3 percent per year, and now it's about 1 percent per year.

We don't know very much about what caused that decline. There is a lot of disagreement and uncertainty among economists about the sources of the decline in productivity growth.

The third objective, equity, is also one on which we cannot be very well satisfied with the record of this decade. There are two points. The size distribution of wealth and income has changed toward inequality, with larger shares of income for higher income and higher wealth groups and smaller shares to poorer parts of the population.

As to intergenerational equity, we have impaired the prospects of future Americans by encouraging consumption today and especially the consumption of the more privileged and successful contemporary citizens.

That burden on the future is one implication of the low rate of productivity growth. It's harder to pursue a successful supply and productivity increasing policy than to manage demand. Longrun policies to accelerate growth are more difficult than the policies that stabilize the economy in the short run.

As I said, the economists don't really know why productivity declined so much in the middle 1970's and why it hasn't gone back up in the 1980's. One idea, to which economists have paid insufficient attention, is the role of public capital and public investment in productivity growth. There is some evidence that the decline in public capital formation, specifically amount of public capital per worker and relative to private capital equipment, has been a source of lower productivity growth.

But the safest conclusion, I think, is that the decline of productivity growth has been the result of a combination of factors and that its reversal will require a variety of favorable policies and events, one of which will surely be an increase in public investment.

There are a number of ways in which an economy provides for the future. One of them is private physical investment in plant and equipment, houses and durable goods that provide direct services to consumers or augment the productivity of workers.

Another is public investment. It does the same thing, but indirectly, yielding services to the society that increase productivity.

Another is foreign investment. By running trade surpluses, the country added to its ownership of assets overseas relative to foreigners' ownership of assets in the United States.

A fourth is the conservation of natural resources and the protection and improvement of the environment.

A fifth is human capital investment, by training and education and by promoting the health of children and adults.

A sixth is science and technology, the knowledge that we use in production.

In all those categories we have done poorly in the 1980's. I'm not going to repeat numbers that you will hear in other testimony here today or read. But one summary, which is frightening enough, is the following. I compare 1978 and 1988. Both of them are peak years or close to peak years, normal years of high prosperity from a business cycle point of view. The net national product corrected for inflation and measured in 1982 prices grew by nearly $800 billion over that period or by 29 percent. But of that increase, 81 percent, over four-fifths, went into increased personal consumption, and another 13 percent went into increased Federal expenses for defense. So that's a total of 94 percent of the additions to the net output over those 10 years, used either for consumption or for defense. That left only 6 percent to be used for those other purposes I listed as future-oriented dedications of national output.

The results were low private investment; particularly low public investment; depletion of America's foreign assets and foreign borrowing; reductions in per capita outlays for education, environmental protection, and research and development.

For all that the Federal Government bears a large part of the blame. Its tax cuts encouraged consumption; its deficits absorbed private saving that otherwise could have gone into productive private investment and into acquisition of wealth abroad. While the defense buildup may have been good policy—I'm not commenting on that—to finance it while at the same time lowering taxes sacrificed public investment—either Federal outlays or State and local outlays with Federal financial help—as well as other civilian public expenditures.

It happened that while the Federal Government was going on a binge of dissaving, negative saving, private saving rates themselves were also declining. Those things couldn't have happened at a worse time. We are having a demographic transition into the 21st century by which the number of active workers per retired person is being drastically reduced. That number was five active workers per one retired person in the early 1960's, it's between three and four now, and it will be two toward the middle of the 21st century if the demographic projections are correct.

For future retired workers to get Social Security and private pension benefits they expect, the active workers had better be more productive. It will take more capital per worker to make them so. It's for that reason that the Social Security trust fund is running surpluses, and it's for that reason that those surpluses should be off budget in fact as well as in name. Congress and the administration should not continue for very long the practice of counting those surpluses as deficit reducing.

It would be logical to use the transitional surpluses in Social Security funds partly for extra private capital formation—simply by removing that much government debt from the private capital market—and partly for extra accumulation of public capital.

The ability of 21st century workers to provide for their seniors depends on both types of investment. In this spirit the Federal Government might borrow from the old-age survivors and disability (OASDI) trust fund for specific incremental programs of public investment. Self-liquidating projects with their proceeds dedicated to the trust fund would be particularly eligible and appropriate, for example, loan financing of post-high school education and training.

As we all know, we have today a political taboo on new tax revenues. But it's very likely impossible under conventional budget accounting and Gramm-Rudman schedules to get rid of the deficit without increased tax revenues, and it's certainly impossible if Social Security surpluses are not counted as deficit reducing.

I would like to point out the following fact regarding budget revenues and outlays. In 1979, 10 years ago, non-Social Security revenues exceeded non-Social Security outlays other than defense and debt interest by 8½ percent of GNP. But now the margin between those revenues and those outlays is less than 5 percent of GNP. Any expenditures on Federal civilian programs larger than 5 percent of GNP has to be financed by borrowing, either from the general public or from the Social Security fund.

It's no wonder, therefore, that the political impasse that constrains Federal revenues is devastating to government outlays that are essential to economic growth.

It's wrong to accept the no-tax-increase constraint as if it were an unavoidable natural economic fact of life. The taboo is purely an artifact of demagogic politics, and it's extremely costly to the Nation.

Some needed resources may come from the defense budget if, as we can now hope, the cold war is winding down. But this looks to be a slow process, and I at least adhere to the principle that we should not cut defense simply in order to avoid raising taxes. We should cut defense if it's really the proper thing to do given international conditions and security needs.

Deficit reduction, genuine deficit reduction, is an important national priority. By releasing saving for private uses, it will increase domestically financed private investment, and lower our foreign borrowing and our trade deficit. A larger share of private capital formation owned by Americans is an essential element in improving the prospects of our children and their children. But it was never correct to single out private investment as the only important future-oriented type of expenditure or the only growth-generating use of national output.

Deficit reduction is therefore by no means the only reason Federal non-Social Security tax revenues should be increased as a share of national income. We need also to overcome the serious deficits in public investments and in other civilian governmental functions.

We are now learning, relearning from experience, how essential many government activities are for civilized societies and how misguided have been the blanket denigrations of governments as if they were always obstacles to economic and social progress.

While urging more resources for public investment, I want to stress also the importance of allocating such resources efficiently and selecting those projects with the more promising social benefits relative to their costs.

And we should, as is often possible, identify and charge the users and beneficiaries of particular projects, directly or indirectly, whether the capital investments are initially met from general tax revenues or from debt issues. For example, trucks should pay for the wear and tear they cause to highways, airline passengers and operators of noncommercial aircraft should pay in fares or excises or fees for expansions of airports and air control facilities, students should pay something for educations that augment their earning capacities and so on.

Yet there are many cases where the benefits of government facilities and programs are so diffuse and so general that it is appropriate to meet the major share of costs from general revenues. The very essence of government after all is to provide citizens with public goods that they cannot, for lack of scope or incentive, provide for themselves or for each other.

I think the Joint Committee here could perform a valuable function for the Nation by putting together in some detail a program of Federal public investments for the rest of this century, including, of course, Federal assistance to State and local governments where much civilian and public investment occurs.

I suggest that the 3½ percent of GNP, I cited above in our budget revenues for civilian expenditures be made up over 4 years by a combination of tax increases, user fees and excises and any defense savings that may be made possible by the abatement of the cold war.

Perhaps one-third of that increase in budgetary resources should be available for an incremental public investment program. In addition, as I suggested above, we could allow half of the next 10 years' accumulation in the OASDI trust fund to finance revenue-yielding public investments like student loans for education and training programs.

Thank you, Mr. Chairman.

Represenatative HAMILTON. Thank you, Mr. Tobin.

[The prepared statement of Mr. Tobin, together with a document entitled "A Warning About America's Third Deficit From 327 Prominent Economists," follows:]

PREPARED STATEMENT OF JAMES TOBIN

PUBLIC INVESTMENT, FEDERAL BUDGET, AND ECONOMIC GROWTH

I am pleased to be back at the Joint Economic Committee. I have testified here many times, including a number of occasions when I was a Member of the Council of Economic Advisers. This Committee and the Council are sister institutions established by the Employment Act of 1946. I take seriously that Act and its objectives, and I know you do too. This Committee is the economic conscience of the Congress. Here, as at the CEA, the overall health of the United States economy takes precedence over sectoral and special interests.

Considering my comparative advantages relative to your other witnesses today, who are more expert than I am with respect to specific public investments, I decided to devote my statement to a macroeconomic framework within which the issues before you today may be viewed.

Macroeconomic objectives and federal policies.

True to the Employment Act, the Joint Economic Committee has had three major objectives for the American economy and for federal policy. First has been the maintenance of high employment and the stabilization of aggregate demand to avoid recessions and inflations. A second has been growth in the capacity of the economy, when fully employed, to produce goods and services, so that Americans can enjoy high and rising living standards. A third objective has been equity in the distributions of income and wealth, both within each generation and between present and future generations.

Taking stock today, we can all be well satisfied with the economic performance of the United States relative to the first objective. The economy is operating in the zone of full employment, in the sense that additional aggregate demand pressure would add unacceptably to inflation.

Moreover, this inflation-safe zone seems to occur at considerably lower unemployment rates than most economists thought possible ten years ago. There are, of course, serious problems of unemployment in particular sectors, regions, and demographic groups. But these cannot be solved by the <u>macro</u>economic policy tools, monetary and fiscal, at the disposal of the federal government. They require structural solutions.

For the long recovery since the recessions of 1979-82, bringing the economy to low unemployment without triggering a new inflationary wage-price spiral, the Federal Reserve merits most of the credit. The Fed dedicated its monetary policies to overall macroeconomic performance, and did a skillful and successful job of fine-tuning. We used to regard federal fiscal policy as a coequal partner in stabilization of demand. But the radical budgetary and revenue measures of the 1980s made fiscal policy unfit for this role. Federal deficits became instead a major worry for the Fed as it sought to keep the economy recovering and growing without overheating.

With respect to the second objective, the trend of growth over the longer run, there is unfortunately much cause for dissatisfaction. The 1980s, it can be ironically said, have been a demand-side success but a supply-side failure. The bottom line of supply-side policy is the economy-wide rate of increase of labor productivity. In 1948-73 it averaged 2.8 percent per year; since 1973 it has averaged 1 percent per year.

The productivity-growth slump began in the 1970s, and so far neither policies nor other events have moved it significantly back toward its previous rate. The difference between, say, 1.5 percent and 3 percent annual productivity growth cumulates to a shortfall in level of productivity of 14 percent in ten years, 26 percent in 20 years, 36 percent in 30 years.

As for equity, the third objective listed above, we know that inequality in the distributions of income, wealth, and consumption increased substantially during this decade, and that labor incomes have fallen relative to property incomes. At the same time, we have impaired the prospects of future Americans -- in order that the more privileged and successful of us can consume more today. This burden on the future is, of course, one implication of the low rate of productivity growth.

Problems of growth policy.

Supply management is harder than demand management. To move aggregate demand the government has handles (interest rates, credit conditions, taxes, spending) that we know how to manipulate; at least we know the directions and the orders of magnitude of the effects. When it comes to raising productivity growth, readily available handles are much less obvious and reliable. Moreover, since the effects of any particular measures on national productivity are bound to be slow, small, and uncertain, they are very difficult to observe and to distinguish from other causes.

As a result, the economics profession is still quite unsure why productivity growth slowed in the 1970s. The Symposium on the Slowdown in Productivity Growth in the Journal of Economic Perspectives, Fall 1988, confesses the limits of our knowledge. The rise in the relative price of energy is a slight favorite among possible suspects, but the failure of productivity growth yet to rebound argues against it, at least as a unique explanation.

The Symposium did not consider the possible culpability of the dramatic decline in public infrastructure investment, of which the Committee will be aware from the Economists' Statement, from the experts here today, and from other sources. David Aschauer reports findings that attribute to public infrastructure development a major role in promoting growth. ("Is Public Expenditure Productive?", Journal of Monetary Economics 23 (1989), 177-200. While his qualitative findings are welcome confirmations of common sense, it would not be prudent to rely heavily upon his numerical estimates until they have been digested by the profession. It still seems likely that the productivity slowdown was due to a coincident combination of factors, and that its reversal will also require a variety of favorable policies and events.

Future-oriented uses of national output.

To think about growth and economic prospects, we must consider how the United States uses the output it currently produces, in particular how we as a society split the pie between immediate consumption and provision for the future. The most important uses of GNP that provide for the future are:

(1) Private net physical investment. Adding to the stock of privately owned durable goods: houses and other goods that provide direct services to consumers, plant and equipment that magnify the productive powers of human labor.

(2) Public net physical investment. Adding to the stock of publicly owned capital goods yielding similar services.

(3) Net foreign investment. Adding to American-owned income-producing assets abroad, net of foreign-owned assets here.

(4) Conservation of natural resources and environmental protection.

(5) Human capital investment. Educating and training children and adults, and promoting their health.

(6) Science and technology. Gaining new scientific knowledge and

applying science to develop improved technologies and new products.

In all these categories we have done badly in the 1980s. The numbers are familiar, and I will not rehearse them here. A frightening summary can be obtained by comparing 1988 and 1978, both prosperous years of low unemployment. Net National Product (excluding from GNP capital depreciation), corrected for inflation and for changes in inventories, increased by $778 billion in 1982 prices, or by 29 percent. Of this, 81 percent went into increased personal consumption and another 13 percent into increased federal expenditures for national defense. As the shares of national output allocated to these uses sharply increased, the shares of future-oriented uses of national output declined. The results were low private investment, low public investment, depletion of America's foreign assets and increased foreign debt, reductions in per capita real outlays for education, environmental protection, and research and development.

Federal fiscal policy and national investment.

The federal government bears most of the guilt. Its tax cuts encouraged consumption. Its deficits absorbed private saving that otherwise could have gone into productive private investment and into acquisition of foreign assets. Its attempts to finance a defense buildup while lowering taxes sacrificed public investments (either federal outlays or state and local outlays formerly given federal financial assistance), as well as other civilian public expenditures.

While the federal government was going on a binge of dissaving, private saving rates themselves were declining. The decline in national saving (from 8-9 percent of NNP to 2-3 percent) couldn't have come at a worse time. The country has a special need for more saving during the demographic transition now under way. The number of retired persons per active worker is drastically increasing. In the next century active workers had better be more productive, and that will take more capital per worker. It is for this reason that the social security trust fund is running surpluses, and it for this reason that those surpluses should be off-budget in fact as well as in name. Congress and the Administration should not count those surpluses as deficit-reducing.

It is logical to use the transitional surpluses in the social security funds partly for extra private capital formation and partly for extra accumulation of public capital. The ability of 21st century workers to provide for their seniors depends on both types of investment. In this spirit, the federal government would borrow from the OASDI trust fund for specific incremental programs of public investment. Self-liquidating projects, their proceeds dedicated to the trust fund, would be particularly eligible. On these grounds, loan financing of post-high-school education and training would be a strong candidate.

As we all know, meaningful deficit reduction is virtually impossible so long as there is a political taboo on increased tax revenues. It is very likely impossible under Gramm-Rudman schedules and conventional budget accounting, and it is certainly impossible if social security surpluses are not counted as deficit-reducing. Consider the following fact regarding "on-budget" revenues and outlays. In 1979 non-social-security revenues exceeded outlays other than defense and debt interest by 8 1/2 percent of GNP. Now that margin is less than 5 percent. Any expenditures on civilian programs larger than 5 percent of GNP has to be financed by borrowing, either from the general public or from the social security trust fund.

It is no wonder, therefore, that the political impasse constraining federal revenues is devastating to government outlays that could contribute to economic growth, indeed to outlays essential for that objective. It is wrong to accept the no-tax-increase constraint as an unavoidable natural economic fact of life. The taboo is purely an artifact of demagogic politics, extremely costly to the nation.

Some needed resources may come from the defense budget if, as we can now hope, the cold war is winding down. But this looks to be a slow process. In principle, moreover, we should not cut defense faster than international conditions really justify, simply in order to avoid raising taxes to meet urgent civilian needs.

Deficit reduction -- genuine deficit reduction -- is an important national priority. By releasing saving for private uses it will increase domestically financed private investment, lowering our foreign borrowing and our trade deficit. A larger share of domestic private capital formation owned by Americans is an essential element in improving the prospects of our children and their children. However, it was never correct to single out private investment as the only important future-oriented type of expenditure or as the only growth-generating use of national output crowded out by the fiscal policies of the 1980s.

Deficit reduction, therefore, is by no means the only reason federal non-social-security tax revenues should rise as a share of national income. We need also to overcome the serious deficits in our public investments (and in other civilian governmental functions). Clearly we are now learning, or re-learning, from experience how essential many government activities are for civilized societies, and how misguided have been the blanket denigrations of governments as obstacles to economic and social progress.

Concluding remarks on federal public investment outlays and their financing.

While urging substantial additional resources for public infrastructure investments and other future-oriented expenditures, I want to stress also the importance of allocating those resources efficiently. (See the useful Congressional Budget Office study New Directions for the Nation's Public Works, September 1988). We should select those projects with the more promising social benefits relative to costs.

Furthermore, we should, as is often possible, identify and charge the users and beneficiaries, directly or indirectly, whether the capital investments are initially met from general revenues or from debt issues. For example, trucks should pay for the wear and tear they cause to highways. Airline passengers and operators of noncommercial aircraft should pay, in fares or excises, for expansions of airports and air control facilities. Electricity consumers should pay for the costs of pollution or pollution abatement arising from the power they use. Students should pay something for higher educations that augment their earning capacities.

Yet in many cases the benefits of government facilities and programs are so diffuse and general that it is appropriate to meet the major share of the costs from general revenues. The very essence of government, after all, is to provide citizens with public goods that they cannot, for lack of scope or of incentive, provide for themselves or for each other.

To conclude with a somewhat more concrete suggestion, I think the Joint Economic Committee could perform a valuable function for the nation by putting together in some detail a program of federal public investments, including of course federal assistance to state and local governments. for the rest of the century. I suggest that the 3 1/2 percent of GNP gap in on-budget revenues for civilian expenditures, which I cited above, be made up over four years by a combination of tax increases, user fees and excises, and any defense savings made possible by the abatement of the cold war. About one third of this increase in budgetary resources would be available for the incremental public investment program. In addition, about half of the next ten years' accumulation in the OASDI trust fund would finance new revenue-yielding public investments like the student education and training loans mentioned above.

A Warning About America's *Third* Deficit From 327 Prominent Economists

A WARNING TO THE CONGRESS AND THE PRESIDENT FROM 327 AMERICAN ECONOMISTS

America Needs Increased Public Investment, Now.

In addition to our trade and fiscal deficits, America faces a "third deficit"—the deficiency of public investment in our people and our economic infrastructure. This deficit will have a crippling effect on America's future competitiveness.

Just as business must continually reinvest in order to prosper, so must a nation. Higher productivity—the key to higher living standards—is a function of public, as well as private, investment. If America is to succeed in an increasingly competitive world, we must expand efforts to equip our children with better education and our workers with more advanced skills. We must assure that disadvantaged children arrive at school age healthy and alert. We must prevent drug abuse and dropping out among teen-agers. We must fix our bridges and expand our airports. We must accelerate the diffusion of technology to small and medium sized business.

Yet these needs have been neglected throughout the past decade. In real dollar terms, federal spending in the 1980s on science and civilian technology has been significantly below the levels in the 1960s and 1970s. Compared to the late 1970s, the federal government is now spending less per person on education and less per worker on training. We are devoting less of our national spending to federal investments in highways, mass transit, airports and other transportation infrastructure.

State and local governments have not been able to pick up the slack. In the 1980s, state and local spending on both education and transportation as a percent of GNP has been below the level of the 1970s.

We fully understand the problem that the current US fiscal deficit poses for efforts to expand public investment in these areas. Many of the undersigned have been in the forefront of those arguing that the fiscal deficit must be reduced. But, in economic terms, budget deficit reduction and an expansion in public civilian investment are compatible. Indeed, over the long run we cannot eliminate the twin deficits and maintain our living standards unless we expand our public investment.

[illegible] adjustments in other parts of the Federal budget. Substantial savings are obviously possible in the military and agriculture sectors. And there is no escaping the need for more revenue.

Raising taxes is never popular. Neither is reducing spending on programs which benefit powerful economic or ideological interests. But there is strong evidence that the people know that there is no free lunch. Polls have shown that majorities support a change in priorities and that people are willing to pay for public services that are vital to the nation's future.

Thus, while there is no easy answer, there is an answer: it is to devote a portion of new revenue raised and/or savings made from reducing areas of excess spending, to critical public investments. We can afford it. For example, $30 billion in new public investment would come to approximately one-half of one percent of our GNP in fiscal year 1990. Such an investment, if properly administered, would be a bargain for today's working population. The present generation of workers will have to depend on a much smaller working population to support their retirement. Without adequate training and an efficient economic infrastructure, tomorrow's workers will not be able to maintain tomorrow's retirees in a comfortable and dignified standard of living.

The future will not wait. Each year of delay means another million dropouts and an increase in the number of American workers whose skills are inferior to those against whom they have to compete. It means more deterioration in our roads, bridges and airports. It means falling behind another step in the race for the technologies that will support tomorrow's higher incomes. It means compounding the already massive debt we are leaving to the next generation of workers by denying them the tools they will need to pay off that debt.

We therefore urge you to resist the temptation to deal only with today's crises, as important as it is to solve them. For the sake of our nation's future, we urge you to raise the monies needed to regain America's competitive edge—before it is too late.

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Representative HAMILTON. Mr. Blinder, please proceed.

STATEMENT OF ALAN S. BLINDER, PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY

Mr. BLINDER. Thank you, Mr. Chairman and Congressman Hawkins.

If I were to summarize the economic changes of the 1980's in a single phrase, I think it would have to be that America decided to favor the present at the expense of its future. Most obviously, the Federal Government's unprecedented reliance on deficit financing in a peacetime, nonrecession economy represents a departure from previous norms and a decision to enjoy life now and pay the bills later. The same could be said of our new national pastime, which is borrowing from foreigners to finance consumption.

Another notable feature of the 1980's is the focus of today's hearing: public investment of all kinds has declined relative to private investment, relative to GNP, or relative to almost anything else you can think of.

This neglect of the future has been exacerbated, I think, by our unending obsession with the budget deficit—which focuses attention on today at the expense of tomorrow. As long as Congress and the public remain myopically focused on today's budget deficit, the future is likely to get shortchanged, and we will find ourselves investing too little in human resources, too little in private capital, and too little in public capital, all to the detriment of future productivity and standards of living.

We have seen a very small example of this in the Govenment's handling of the savings and loan industry. For a long time after the problem was diagnosed, Congress refused to close down the S&L's that needed to be closed because that would have led to current budgetary expenditures and enlarged the deficit. As a result, the problem got bigger.

Even now that we are finally facing up to this problem, budget gimmicks are being suggested that would minimize the impact on current deficits even though they might raise the longrun cost and worsen future deficits.

America needs to become more future oriented, as Jim Tobin just said, which means more or less the same thing as investing more. The economists' statement that is sitting up there in very large print is prompted by the fear that America is both missing out on important public investment opportunities and also disinvesting—doing negative investment—in an alarming number of directions. The statement itself covers many areas, and each of us has his or her own opinions on which are the most important.

In the brief time allotted to me, I would like to emphasize just two of them. The first is investments in young children, especially disadvantaged young children. The second is investments in public infrastructure.

Now, in picking out those two, I don't mean to denigrate the importance of the others. Things like education, R&D, drug abuse, the environment, and so on are all important. It's simply that in a 10-minute testimony I have to pick and choose; and these two seemed particularly obvious and urgent.

Well, let me begin with what are often called children at risk. There are at least two reasons for spending more government funds on such activities as prenatal care, postnatal care, and preschool education for the sons and daughters of America's underclass.

The first is obviously humanitarian, based on the moral judgment that a nation as rich as ours shouldn't allow an underprivileged minority to live in such squalor.

But a second reason is more strictly economic. As we look to the future, and I don't mean very far into the future, we can see impending labor shortages in this country as the baby boomers age and the baby busters become of age.

If we want to maintain an educated and capable work force in the face of a declining youth population, we simply can't afford to write off a portion of this potential labor pool. And worse yet, if we write off this particular portion, significant numbers of them are likely to turn to crime, to drug abuse, to teenage pregnancy, to welfare dependency and therefore to become drains on society rather than contributors to it.

So I think that making the children of the underclass productive citizens is an urgent priority.

Unfortunately, we know relatively little about turning around the life of a wayward teenager. But in sharp contrast to that, a baby, not to mention an unborn baby, is a clean slate. And very young children are receptive, malleable, and resilient. A few gallons of milk, a little medical care, some advice on parenting to teenage mothers who know little about the subject, cost very little and yet seem to go a long way. Quality preschool education is much more expensive than that; but the evidence here, too, suggests that it's money well spent.

Now, I am an economist, not an expert on child development. And most of the research in these fields is not done by economists. In my prepared statement, I have cited a few illustrative results that lead me and many others to conclude that the finding that expenditures on early intervention yield high payoffs is about as well established as any conclusion in social science.

Now, you will note that prenatal care, postnatal care, and preschooling all require outlays today with very little immediate payoff, and yet pay handsome dividends some time in the future. They may even serve to reduce future budget deficits by lowering welfare and health expenditures, reducing the criminal population, and so on.

Unfortunately, in our current budgetary environment, programs whose costs are front loaded and whose benefits are back loaded labor under severe disadvantages. We can't afford them, we are told, until we get the deficit under control. I think that is a myopic attitude which, if maintained for long, will get us into deeper and deeper trouble. I think the truth is that we can't afford not to do these things.

Let me turn next to physical investment, especially in public infrastructure. Once again, this is a much discussed problem which is being shamefully neglected. In large measure, I think, the neglect stems from the budget myopia about which I have just spoken.

America's failure to maintain and expand its public capital stock has inconvenienced all of us and endangered many of us. Yet as a nation we seem to be doing little or nothing about it. Why is that? Well, I think the answer is that the current price tag runs very high. Last year, for example, the National Council on Public Works Improvement recommended a doubling of the rate of spending on public works. We look at numbers that are that big—tens of billions of dollars—and forget that the ultimate benefits may be larger yet.

Now, the problem of lagging infrastructure spending is not a new one. Chart 1, in my prepared statement, shows that spending on public infrastructure has been declining as a share of GNP since the late 1960's.

Chart 2, in my prepared statement, shows something even more astonishing—that public physical investment by the Federal Government has been declining or constant in absolute volume, never mind relative to GNP, for over 30 years—a period in which the economy has expanded enormously. We are basically spending the same number of real dollars now as we used to spend in the early 1950's.

Chart 3, in my prepared statement, shows that spending on public works relative to private capital spending has fallen to about half of what it was in the 1960's.

Now all of that suggests—it doesn't prove, but certainly suggests—that there has been substantial underinvestment in infrastructure, which means that there are problems in store for us in the future.

Inadequate public investment affects the quality of life in America just as surely as inadequate private investment would. If my flight leaves on time because the airport has more capacity, or my back aches less because the roads have fewer pot holes, I'm genuinely better off. However, those sorts of gains don't show up in the GNP.

When you realize that, I think it makes the recent research findings by David Aschauer, to which Jim Tobin just alluded, all the more amazing. Despite the fact that many of the benefits of public investment never appear in the GNP, Aschauer estimates that public investment has roughly as big an effect on GNP as does private investment. In fact, he advances the hypothesis that the main cause, or at least one of the main causes, of the alarming decline in America's productivity growth rate may have been the decline in the growth of the nonmilitary public capital stock.

You can see the circumstantial evidence for this in chart 4 of my prepared statement. It shows the tremendous coincidence in time between the productivity slowdown and the reduction in the nonmilitary public capital stock.

Now, how does a lagging public investment hurt productivity in the private sector? And why might this correlation not be a coincidence? Why might it actually make sense?

Well, in a few cases the answers are very, very obvious. For example, if trucks have to detour around bridges that have collapsed, private labor and capital will produce fewer trucking services per hour of work; and private productivity will fall directly.

More generally, I think it's useful to think of both private capital and public capital—and, of course, labor—as inputs into society's production process. One basic economic principle holds that any given input becomes more productive as it becomes relatively scarcer compared to other inputs. That's why labor is productive in a capital-rich economy, for example.

Now, if you look back at chart 3, in my prepared statement, which shows how much the ratio of public-to-private investment has fallen over the last few decades, that starts to make it believable, I think, that now—sitting in the year 1989, after all these years—public capital may well be more productive than private capital. Not because it is inherently superior, but simply because we have done so much more investing in private capital than in public capital.

And yet, despite that, the thrust of our public policy has been and remains geared toward encouraging private investment over public investment.

So, once again, it seems to me that American society, and the Federal Government in particular, has been and continues to squander opportunities for good investments because of its obsession with today's budget deficit.

Now what are we to do about this? Should we spend more on public investment, even at the cost of enlarging a budget deficit that most people agree is still too large? Well, my answer to that is yes—if we are unable to do something more sensible.

I would prefer a more sensible policy that finances new public investments not by enlarging the deficit, but by raising new tax money. The American public must be made to understand that the choice is not between paying taxes and never paying them. Rather, the choice is—as on the old TV commercial about the oil filter—between paying a little bit now or sowing the seeds of a big, big problem in the future.

Having now raised the dreaded T-word, let me close by suggesting a principle that might make the bitter pill easier to swallow—not a concrete policy, just a guiding principle. That principle is budget balancing at the margin—not budget balancing in total, but just at the margin. That means expanding expenditures and expanding taxes to match the expansion in expenditure.

If the voters can be convinced that the public investments I've spoken of, and others, really have high rates of return, then they ought to be willing to support tax increases earmarked for those high-return purposes.

In some cases, user fees are the natural means of financing the needed investments. Airports, highways, and bridges are good examples of that, and Jim Tobin has already mentioned them. It is conceivable to me that Americans would support user fees and other tax increases earmarked for rebuilding our public infrastructure.

The case of investment in underprivileged children is much harder. The concept of user fees obviously doesn't apply here because the users can't afford to pay any fees.

Fortunately, however, the number of dollars involved is not large. It is just conceivable that small tax increases earmarked for specific high-yield investments in children might command majority support even in the current antitax atmosphere.

One idea, for example, is to extend the payroll tax beyond the earnings ceiling imposed by Social Security, and then earmark the extra proceeds, the proceeds that don't go to the Social Security trust fund, for investments in our future labor force. That would seem to be a politically rational as well as economically rational use of payroll tax revenues.

But for me to sit here and speculate further on the political marketability of specific tax and expenditure programs seems silly. Politicians know a lot more about that than economists ever will. I just want to plant the thought rather than plant a program.

Thank you.

Representative HAMILTON. Thank you very much, Mr. Blinder.

[The prepared statement of Mr. Blinder follows:]

PREPARED STATEMENT OF ALAN S. BLINDER

SHORTCHANGING OUR FUTURE

If I were to summarize the economic changes of the 1980s in a single phrase, I think it would be: America decided to favor the present at the expense of the future. Most obviously, the federal government's unprecedented reliance on deficit financing in a peacetime, non-recession economy represents a decision -- whether conscious, subconscious, or unconscious -- to enjoy life now and pay later. The same can be said of our new national pastime: borrowing from foreigners. During the 1980s, personal saving rates plummeted to new lows and the consumption share of GNP rose to new highs. All this is well known.

Another notable feature of the 1980s is the focus of today's hearing: public investment of all kinds has declined relative to private investment, GNP, or virtually anything else you can think of. Where the Federal government is concerned, I think this neglect of the future has been exacerbated by our unending obsession with the budget deficit, which focusses attention on today at the expense of tomorrow. As long as Congress and the public remain myopically focussed on today's budget deficit, the future is likely to get shortchanged. We will invest too little in human resources, in private capital, and in public capital -- all to the detriment of future productivity and standards of living.

We have seen a small example of this deficit-induced myopia in the government's handling of the savings and loan industry. For months, even years, after the problem was diagnosed and well understood, Congress refused to take action to close insolvent S&Ls that were digging ever-deeper holes for the taxpayer. Why? Because closing down the S&Ls that needed closing would have led to current expenditures -- thereby enlarging the deficit. Rather than do that, Congress and the administration let the problem grow worse. Even now that the problem is finally being faced, budget gimmicks are being designed to minimize the impact on the current deficit, even at the expense of future deficits.

America needs to become more future-oriented, which means more or less the same thing as investing more. To an economist, investment is a general concept referring to any act that sacrifices something today in order to reap benefits in the future. Disinvestment refers to robbing the future to pay the present. The Economist's Statement that is the focus of this hearing is prompted by the fear that America is both missing out on important public investment opportunities and disinvesting in an alarming number of ways.

The statement itself covers many areas, and each of us has his or her own opinions on which are most important. In the time allotted to me, I'd like to emphasize just two that seem most pressing to me. The first is **investments in young children**, especially <u>disadvantaged</u> young children. The second is **investments in public infrastructure** like roads, bridges, airports, sewer facilities and the like. In picking out these two, I do not mean to deny the importance of others -- things like education, R&D, drug abuse, and the environment, to name just a few. It is simply that one must pick and choose in a 10-minute testimony.

Let me begin with what are often called children at risk. There are at least two reasons for spending more government money on such activities as prenatal care, postnatal care, and preschool education for the sons and daughters of America's underclass. The first is humanitarian. A widely-held moral judgment holds that a rich nation should not allow an underprivileged minority to live in squalor. Once the obligation to assist society's underdogs is acknowledged, the question becomes how best to do it. The evidence, some of which I will mention shortly, suggests that early intervention is the most cost-effective anti-poverty program we know.

The second reason is more strictly economic. As we look to the future -- and we don't have to look very far -- we can see impending labor shortages in this country as the baby boomers age and the baby busters come of age. The population aged 18-22, for example, is currently shrinking at a rate of approximately 2% per year. If we want to maintain an educated and capable work force in the face of a declining youth population, we cannot afford to write off a portion of the potential labor pool. Worse yet, if we write off this particular portion, significant numbers are likely to turn to crime, drug abuse, teenage prenancy, and welfare dependency -- in a word, to become drains on society rather than contributors to it.

Making the children of the underclass productive citizens is an urgent priority. Yet the sad fact is that we know pitifully little about turning around the life of a wayward teenager. In sharp contrast, a baby -- not to mention on unborn baby -- is a clean slate; and very young children are receptive, malleable, and resilient. A few gallons of milk, a little medical care, and some advice on parenting cost little and go a long way. Quality preschool education is much more expensive; but the evidence suggests that it is money well spent.

I am no expert on child development, and most of the research in the field is not by economists. Let me just cite a few illustrative results that lead me to conclude that the returns on early intervention vastly exceed the costs.

* It has been estimated that each dollar spent on the prenatal component of WIC saves $3 in short-term hospital costs and more in later years.

* Hospital care for an underweight or premature baby costs over $1000 per day, but prenatal care for a teenage mother can cost as little as $600 per prenancy.

* A Congressional report estimated that each $1 spent on the Childhood Immunization program saves $10 in subsequent medical costs; yet a significant minority misses out on this program.

* An experiment in Harlem in the 1960s exposed 2-3 year olds to just a few hours of what might be called "creative play" with trained adults. Several years later, when the kids were entering school, they were still significantly ahead of a matched control group in several measures of mental development.

* It has been estimated that each dollar spent on preschool education under Head Start eventually returns $4.75 in higher worker productivity and in budgetary savings from

lower welfare and special education expenditures.
All told, the conclusion that expenditures on early intervention yield high payoffs is about as well established as any conclusion in social science.

Prenatal care, postnatal care, and preschooling all share the charcteristic profile of a good investment: they require outlays today but pay handsome dividends later. They may even serve to reduce future budget deficits by lowering welfare and health expenditures, reducing the criminal population, etc. But, in our current budgetary environment, programs whose costs are front-loaded and whose benefits are back-loaded labor under severe disadvantages. We can't afford them, it is said, until we get the deficit under control. This is a myopic attitude which, if maintained, will get us into deeper and deeper trouble.

I turn now to physical investment, especially in public infrastructure. Once again this is a much-discussed problem which is being shamefully neglected -- in part, I think, because of the budget myopia I have just spoken about. America's failure to maintain and expand its public capital stock has inconvenienced all of us and endangered many. What air traveler has not experienced delays caused by inadequate airport capacity in a country that has not built a major new airport since 1973? Who has not seen construction halted for lack of sewer capacity, or bounced over dilapidated roads that are a menace to the well-being of humans and automobiles alike? Every now and then a bridge collapses, offering a grim reminder that many others are on the verge. Yet we do little or nothing. Why? I suggest that the answer is that the current price tag runs high. Last year, for example, the National Council on Public Works Impsovement recommended a doubling of the rate of spending on public works.[1] We look at these big numbers and seem unwilling to ask whether the ultimate benefits are larger yet.

The problem is not new. Chart 1 shows that spending on public infrastructure has been declining as a share of GNP since the late 1960s. Chart 2 shows that public investment by the Federal government has been declining or constant in absolute volume, never mind relative to GNP, for over 30 years. Chart 3 shows that spending on public works relative to private capital spending has fallen to half what it was in the 1960s. All this suggests substantial underinvestment in infrastructure -- and problems in store for the future.

Inadequate public investment affects the quality of life in America just as surely as inadequate private investment would, even though many of the benefits from public investment do not appear in the GNP. If my flight leaves on time because the airport has more capacity, or my back aches less because the roads have fewer potholes, I am genuinely better off. But the gains will not be recorded in the GNP. This makes recent research findings by David Aschauer of the Federal Reserve Bank of Chicago all the more amazing.[2] Despite the fact that many of the benefits from public investment never appear in GNP, Aschauer finds that public investment has roughly as big an affect on GNP as private investment. In fact, he advances the

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1 National Council on Public Works Improvement, Fragile Foundations: A Report on America's Public Works, February 1988.

2 David A. Aschauer, "Is Public Expenditure Productive?," Journal of Monetary Economics, March 1989, pp. 177-200.

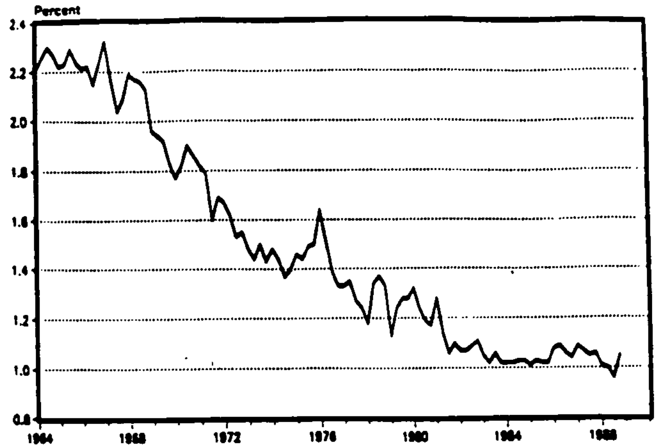


CHART 1

PUBLIC WORKS CAPITAL SPENDING AS A PERCENT OF GNP

Source: Department of Commerce

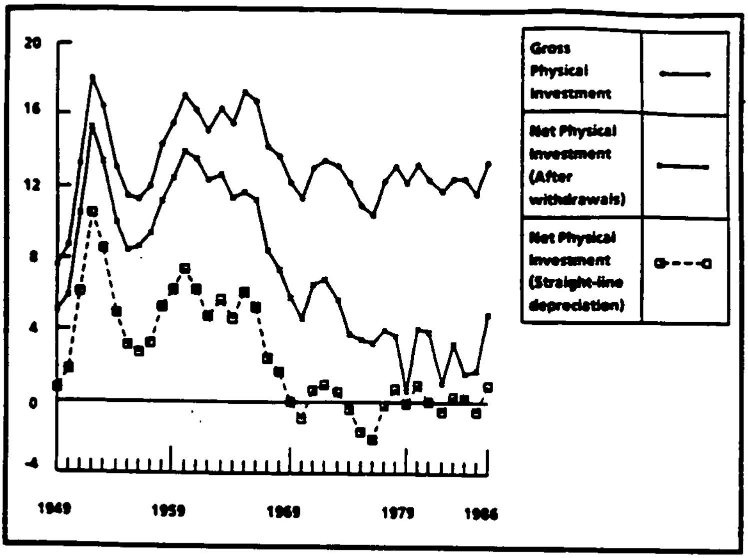


CHART 2

FEDERAL PHYSICAL INVESTMENT IN 1982 DOLLARS

Source: Congressional Budget Office

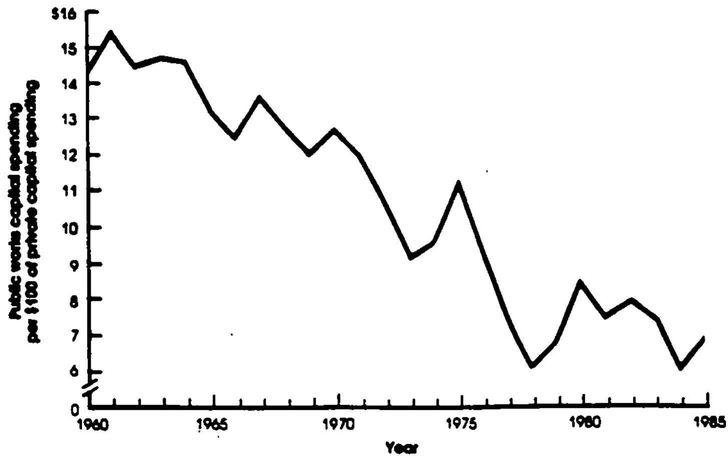


CHART 3

PUBLIC WORKS CAPITAL SPENDING AS A PERCENT OF PRIVATE CAPITAL SPENDING

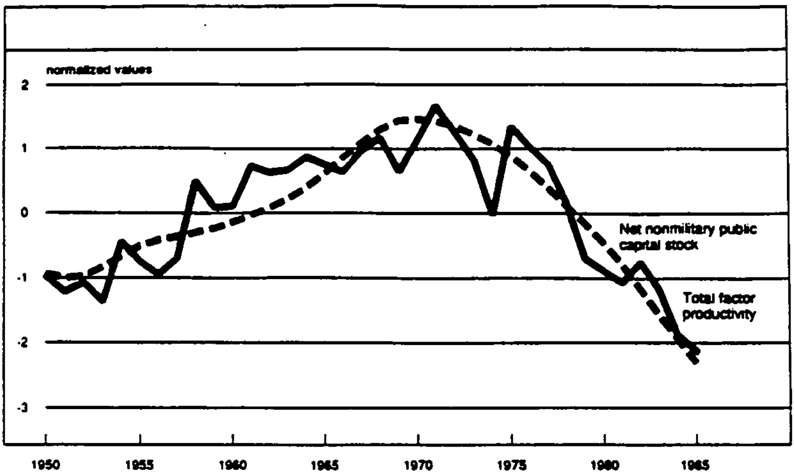
Source: National Council on Public Works Improvement hypothesis that the main cause of the alarming decline in America's productivity growth rate may be the decline in the growth of the nonmilitary public capital stock.

I will not dwell on the details of Aschauer's study, but merely display the circumstantial evidence and offer some reasons why his conclusions are reasonable. The growth rates of public infrastructure capital and total factor productivity in the United States for different decades are as follows:

Period	Infrastructure	Productivity
1951-1960	3.9%	1.7%
1961-1970	4.5%	1.8%
1971-1980	1.9%	0.8%
1981-1985	0.8%	0.7%

Chart 4, which comes from Aschauer's paper, shows the close correspondence between public nonmilitary capital and total factor productivity in annual data, after statistically controlling for time trends and several other things.

Why should lagging public investment have damaged productivity in the private sector so severely? After all, I just said that many of the benefits of public infrastructure are not even counted in GNP. In some cases, the answers are obvious. When trucks must detour around collapsed bridges, for example, private labor and capital produce fewer trucking services per hour of work. More generally, we can think of



Net nonmilitary public capital (adjusted for the effects of time) and total factor productivity (adjusted for the effects of time, private input, and capacity utilization); annual data 1949–85; sample size = 37.

CHART 4

PUBLIC CAPITAL AND PRODUCTIVITY

Source: David Aschauer, "Journal of Monetary Economics" public capital as an input into society's production process, just like private capital. A basic economic principle holds that any given input becomes more productive as it becomes relatively scarcer compared to other inputs. Now look back to Chart 3, which shows how much the ratio of public to private investment has fallen. This chart makes it believable, I think, that public capital may now be more productive than private capital. Yet public policy is geared toward encouraging private over public investment.

Once again, it seems to me, American society -- and the Federal government in particular -- is squandering opportunities for good investments because of its obsession with today's deficit. The bill for public infrastructure may seem large, but it pales in comparison with the costs of continued low productivity growth.

What, then, are we to do? Should we spend more on public investment even at the cost of enlarging the budget deficit? My answer is yes, if we can't do anything more sensible. But I would prefer a more sensible approach that finances new public investments with new tax dollars. That amounts to getting today's taxpayers to return to the future some of what they have already taken away. This is not as self-sacrificing as it may seem. Investments in bridges, highways, and airports begin paying dividends within a few years; investments in small children take longer to pay off, but still yield handsome returns within 5-15 years. Most voters can reasonably expect to live this long. The American public must be made to understand that the choice is not between paying taxes and not paying them. Rather the choice is as on the TV commercial about the oil filter: We can pay a little now or sow the seeds for a lot of trouble later.

Having raised the dreaded T-word, let me close by suggesting a principle that may make the bitter pill easier to swallow -- not a concrete policy, mind you, just a guiding principle. The principle is **budget balancing at the margin.** If the public investments I have spoken of really have high rates of return, and if voters can be convinced of this, then they ought to support tax increases which are **earmarked** for these purposes. In some cases, user fees are the natural means of financing the needed investments. Airports, highways, and bridges are good examples; indeed, the practice is firmly established there. It is conceivable to me that Americans would support user fees and other tax increases earmarked for rebuilding our public infrastructure.

The case of investment in underprivileged children is harder. User fees obviously do not apply because the users cannot afford fees. Fortunately, however, the number of dollars involved is not large. It is just conceivable that small tax increases earmarked for specific high-yield investments in children might command majority support even in the current anti-tax atmosphere. For example, extending the payroll tax beyond the earnings ceiling imposed by social security, and earmarking the proceeds for investments in our future labor force, might be both rational and politically palatable. For me to speculate further on the marketability of specific tax-and-expenditure packages, however, seems silly in this forum. Politicians know much more about this than economists ever will.

Representative HAMILTON. Mr. Meyer, please proceed.

STATEMENT OF JACK A. MEYER, PRESIDENT, NEW DIRECTIONS FOR POLICY, INC., REPRESENTING THE FORD FOUNDATION

Mr. MEYER. Thank you, Mr. Chairman.

I have submitted my prepared statement for the record. So I'll just summarize it here. I have also submitted to your committee the report entitled "The Common Good: Social Welfare and the American Future" which was published a couple of months ago by the Ford Foundation. I served as the principal author of that, but it was directed by a group of private sector leaders with diverse backgrounds, and your committee has that report.

Representative HAMILTON. Without objection, it will be made part of the record.

Mr. MEYER. Thank you.

Our report highlights what we call a social deficit, which we think is equally troubling as the fiscal deficit of this government and the trade deficit, and in fact is probably interrelated with these deficits. I compliment the committee for holding this hearing as a recognition of the interrelationship between social policy and economic policy.

By social deficit we mean a gap between the things we need to do to have a productive labor force and a fair and just society, on one hand, and the things we are doing, on the other. Now note that I said things to do and not just to spend. Part of this involves spending money, and part of it involves increased time and attention—voluntary activity—and part of it involves commitment and political leadership. Some of the new money would be spent by the Federal Government and some at the State and local levels.

I was struck by the unanimity on our panel that this wasn't an either/or situation—either government should do it or the private sector should do it, as has dominated so much of the rhetorical debate over the last decade. Rather, all sectors in society, business and labor, the voluntary sector and government at all levels need to make a greater commitment to reduce this social deficit.

We found an interrelationship between social and economic policy. A strong economy and responsible fiscal and monetary policies are our first line of defense against social problems, and in return prudent investments in human resources are good for our economy. We see too little of both going on.

We also noted the need to modernize the social welfare system in light of changing demographic circumstances and changing economic circumstances.

It has been a long time since we have taken a holistic look at our social welfare system. Our panel felt that it's usually judged piecemeal—what do we feel about welfare and what do we feel about long-term care? Different committees have different jurisdictions; foundations say, "we fund disability, but please don't ask about education, we are not into education," or vice versa. We feel that social problems are interrelated, and that we all need the social welfare system at some point in our lives. It isn't something for someone else.

We tried to follow a life cycle approach that recognized that a good investment in children helps adults, and a good investment in senior citizens helps all of us who are their children and grandchildren.

A good example of some of these interactions and also of the fact that there is more than Federal spending at issue here is the need to immunize our children against childhood diseases. Almost one of five American children has not been fully immunized by the age of 2, which is remarkable in a country such as ours. Part of this is inadequate coverage under programs like Medicaid and EPSDT.

Part of it is inadequate medical care by our physician community that doesn't make sure all kids are immunized. We have found in our research that even people in Medicaid are not always properly immunized, and they don't receive the proper prenatal care. Medicaid mothers are still very low on the scale in terms of receiving early prenatal care. So expanding insurance is part of the answer, but it's not all of the answer.

We found that investments in programs like Head Start and WIC do have positive benefits. We were alarmed to see a program like Head Start, with a proven track record based on longitudinal studies spanning two decades, receive funding for only about one of five children who are eligible for it.

We also looked at a variety of promising interventions that can be taken to help youth at risk. These programs involved remedial education, mentoring, one-on-one help, after school programs and a lot of sweeping reforms in our education system. Public education is in a shambles in many American cities; we need reforms involving greater accountability and fairer pay for teachers, and decentralized decisionmaking in the school system so that teachers can innovate and do a better job.

Let me just give you a couple of quick examples of what we meant by modernizing the social welfare system to meet changing circumstances.

When AFDC was founded, it was founded mainly as a program for widows with children so that these youth would not be destitute. It wasn't a work program, but it was designed to make sure that children didn't suffer if one left the household or passed away.

Today we have a very different set of circumstances, many AFDC recipients are teenage mothers who were never married. We do not consider either widows or unmarried parents as helpless people who must be taken care of; we expect them to try to be self-sufficient, and this is what they want also. A very large proportion of women with children are working. Regrettably, the dialogue has been conservative versus liberal, one side saying we ought to just make those people work and saying it's their fault, and the other side saying it's the environment's fault and we need to change the environment.

We believe we need to follow a social contract approach that recognizes that, yes, people have obligations to work if they are able to, but society has an obligation to help them become work ready.

We outlined a program that goes well beyond the Family Support Act passed by Congress last year to really break the cycle of dependency, one which would start by saying we need to make a heavier and fairer front-end investment in people who come on welfare, but they shouldn't stay on it forever.

What do I mean by that? Well, first of all, benefits are pathetically skimpy in some States even as they are relatively decent in others. A mother of three in Alabama, for example, in 1989 receives a maximum benefit of $147 a month, and that's a family of four. That is one-seventh of the Federal poverty line. In California it's six times that much.

We recommended a federally established floor on benefits for AFDC plus food stamps that equals two-thirds of the Federal poverty line. It's unconscionable for somebody to be screened out of welfare and thereby Medicaid in some instances because they are deemed to have too much money at one-third of the poverty line. By the same token, benefits, as skimpy and unfair as they are, can go on forever and can even be part of an intergenerational cycle.

We advocated making front-end investments and making people work-ready through child-care assistance, health-care assistance, transportation aid and so forth, and paying adequate benefits. But we also advocated time-limiting welfare for the first time in this country, and indicating that people must take a job if they are able after some period of time. If need be, a public service job would be made available. This is a controversial proposal, but this panel thought it was so important to break this cycle that it was willing to advocate a package of help and obligations, not help or obligations.

One other example involves unemployment insurance and other programs for helping displaced workers. Over the years these programs have featured only income maintenance. While income maintenance is important, in today's world many workers are changing careers several times and changing jobs.

Unemployment insurance was enacted over 50 years ago in an environment where the main concern was tiding over the breadwinner, which was usually an adult male, until the plant work came back again—until demand picked up. So it made sense simply to pay, for instance, 26 weeks of unemployment insurance benefits.

Today we need more than that. We need to help that worker find a new skill. But we find that in unemployment insurance, as in many other programs, there is virtually no money for that. We recommend reorienting spending under unemployment insurance and using some of the money for adult education, relocation and other transitional aid.

We see the same problem with disability. Disabled workers may qualify for programs ranging from worker's comp to SSI and DI and Medicare. But what they don't get is help in returning to work, and in fact the programs often punish them when they try to return to work. Yet, people with disabilities want to work. We are going to need every person who is able to work and wants to work in a labor force that will be very tight relative to a swelled elderly population.

So we feel that these investments are not only fair and just and humane, but also sensible in light of the burden that will be placed on tomorrow's worker to take care of so many additional retirees.

We also think we have to take another look at retirement incentives that now push older workers over a cliff in a demographic environment in which we are going to need more workers. There are a lot of things that our society does to encourage early retirement that need to be rethought.

And, finally, I would close by mentioning the area of long-term care. When Medicare, which is an excellent program, was enacted 24 years ago, we didn't think too much about chronic illness, disability, and people living into their 90's and beyond. We thought about the crying need at the time, which was acute medical care and hospital coverage. The elderly were relatively poor.

Today we increasingly have a need for care that falls outside the Government's social welfare system, and also I might add the private social insurance system—long-term care for the elderly. Our financing system for long-term care today is a combination of victim payment until you're broke, until you make a pauper of yourself, and then Medicaid.

We outlined a series of steps, a public-private partnership combining targeted Federal subsidies and incentives to encourage private long-term care insurance which we think could substitute for this victim payment system. I know the Congress has many proposals before it in this area.

So we felt that these investments need to be made, and some of them can be made by government and some by business and the voluntary sector. We felt they needed to be fully financed. We reviewed a large number of financing sources. This panel felt that taxing Social Security benefits the way we tax private pensions was one way to begin to marshal some additional revenues which could be targeted for needs across the life cycle, not just for children, but also for SSI expansion for the elderly and other needs in all age groups.

But the main concern is that a progressive financing mechanism be selected, whether it's taxing estates or raising the payroll tax base or an income surcharge or cutting back on government expenditures that are not well related to need.

What will really be needed is the political will to make these issues a priority in this country for the first time in a long time.

Thank you.

Representative HAMILTON. Thank you, Mr. Meyer.

[The prepared statement of Mr. Meyer, together with the report entitled "The Common Good: Social Welfare and the American Future," follows:]

PREPARED STATEMENT OF JACK A. MEYER

Mr. Chairman:

Thank you for the opportunity to testify before the Joint Economic Committee. I am pleased to present highlights of the Ford Foundation's recently-published report entitled The Common Good: Social Welfare and the American Future. This report was issued by a panel of private sector leaders selected by the Ford Foundation to reexamine the U.S. social welfare system and make recommendations for improving it.

This testimony is my attempt to summarize the key themes of The Common Good and to state, in my own words, its importance to the topic of this hearing. Although we achieved a remarkable consensus in the process of preparing this report, I am not formally speaking today for the panelists or the Foundation.

In my view, social policy and economic policy are intertwined, and this hearing reflects your committee's understanding of this relationship. A strong economy is our first line of defense against the problems of poverty and declining real incomes. Sound social policy, in turn, is good for our economy. The Common Good recognizes this interconnection. It stresses the importance of economic growth to our social welfare, and it outlines some of the steps our nation needs to take in order to foster sustainable growth.

While this panel's charge was to investigate social problems, it felt compelled to point out that policies which hamper economic growth exacerbate and perpetuate our social problems. The report expressed particular concern over the ongoing problem of the federal deficit. We are particularly troubled by federal budget policies that put a lein on the future of our children.

Our compulsion to demand more from our government than we are willing to pay for, while sending the bill for our profligacy to our children, is alarming. When we calculate what we are paying in interest on the national debt, we realize that it is eating into vital human and social needs.

While the Ford panel did not consider itself experts in economic policy, it felt the need to highlight the importance of sound fiscal and monetary policies to our social welfare.

The Common Good is built on several central themes:

* Our social welfare programs were well-conceived, but were designed to fit circumstances and meet problems that were very different from some of today's challenges. Thus, we need to build on the solid structure created between the 1930's and 1960's, but to thoroughly modernize the system to address changing needs.

* Our conceptual framework for analyzing social policy is built on a life-cycle approach. We feel that everyone needs some help at some point in their lives, and that the social welfare system should be analyzed in the way people lead their lives -- from childhood to adolescence, adulthood, and retirement years. Adopting this framework helps us avoid pitting the interests of one group against another, or viewing social policy as a zero-sum game.

* Our report is built on the twin precepts of enhancing opportunity and reducing vulnerability among all our citizens. We do not believe that opportunity and security are antithetical, but rather mutually reinforcing.

* In this vein, the report stresses the importance of work as the best way to build, as opposed to "receive," social protection. Government policies should encourage and facilitate work and assure that work lifts people out of poverty.

* Opportunities for work form antibodies against poverty and hardship, not only by generating income, but also by providing workers protection from the expenses associated with illness, disability, and old age.

* Revitalizing our social welfare system requires new commitments from all sectors of society -- federal, state and local government, business, labor, and the voluntary sector.

* Carefully targetted new public investments in human resource

development will often turn out to be cost-effective in the long-run, when the cost of neglecting social problems is properly taken into account.

* New Public Sector commitments must be fully financed.

Our report contains numerous ideas and recommendations keyed to augmenting human capital. These recommendations include, but are not limited to, calls for additional public spending under programs with demonstrated effectiveness that serve only a fraction of those in need. The report also proposes substantial reforms in social programs to improve their effectiveness. It calls on the private sector to fill in some of the troubling gaps in social protection. It also highlights numerous examples of promising public/private partnerships.

In the first category, the report recommends significant new federal funding for the Head Start and WIC programs to cover many more of the eligible population. It establishes a goal of universal health care coverage, to be achieved by a combination of Medicaid expansion and private sector initiatives and obligations.

The report also establishes the need for a fundamental overhaul of our clogged and fragmented child welfare system, based on substituting early intervention to hold families together for crisis management, on parenting education, and on effective case management.

A variety of successful models for helping at-risk youth are highlighted, including the Summer Training and Employment Program (STEP), Jobs for America's Graduates (JAG), and 70001. These models are interwoven with a discussion of the basic ingredients of reforming our public elementary and secondary education system, which is in a shambles in many cities across America. These ingredients include school-based management and decentralized decision-making, performance standards for youth, teachers, and administrators, one-on-one mentoring, after-school remediation efforts, and appropriate referrals to health care services. These reforms do not obviate the need for, and must be accompanied by, adequate funding for federal programs such as Chapter One and the Job Corps, which have been under attack in recent years.

In my view, these efforts have to be supplemented by an all-out attack on the problems of drug and alcohol abuse that are destroying the life prospects of too many of our youth (and adults as well). While no one has any easy answer to these problems, I believe that a successful approach must combine tough law enforcement and efforts to block the supply of drugs with a much greater effort in the areas of education and treatment. When it comes to drugs, it is not a matter of concentrating on supply <u>or</u> demand (as is so often debated), but <u>combining</u> efforts in both areas.

While the panel did not have the expertise to dig deeply into this area, it recognized that many problems facing our youth cannot be fully solved by efforts to enhance education and training alone. These efforts must be supplemented by attempts to shore up the values and aspirations of youth and to help them steer clear of the temptations that can devastate their lives. One concrete recommendation made by the panel was to make drug and alcohol abuse treatment available to all who need and desire it.

In keeping with the strong emphasis on the value of work in this report, the panel recommends a series of steps to encourage and reward work. While the recommendations aimed at youth noted above are vital to preparing people for work, the panel also recognized the importance of assuring people who work a decent living standard and of breaking the cycle of long-term welfare dependency in this country. To address income adequacy, the panel recommends additional funding for the Earned Income Tax Credit, making the child-care tax credit refundable, and an increase in the federal minimum wage. These areas are all under active consideration by the Congress.

To address the problem of long-term welfare dependency, the report recommends building on, but moving well beyond the important legislation enacted by Congress last year. To build on the additional job training, child support enforcement and extended assistance with health care incorporated into this legislation, the panel calls for a more sweeping overhaul of our welfare system.

The fundamental principle built into our thinking is one of reciprocal responsibility between government and disadvantaged people. Government must do a much better job of making peeple on welfare job-ready and helping them find a job. But people who can work must not be allowed to remain on welfare indefinitely. They must take a job and try to be self-sufficient.

The panel breathed life into this general principle with a two-pronged recommendation: 1) setting a federal floor under the sum of AFDC and Food Stamps equal to two-thirds of the federal poverty line, and 2) requiring that welfare be time-limited, with public service jobs provided to those who cannot find work at the end of this period. This dual approach would end the twin defects of our welfare system -- its unconscionable geographic inequities and its timeless nature. Benefits are pathetically skimpy in some states; yet whether skimpy or relatively generous, these benefits can go on forever, trapping the recipients in a seamless web of dependency.

The panel also calls for a fundamental overhaul of the Unemployment Insurance program. Recommendations include using more of the funds for retraining and reorientation of displaced workers, and a new approach to setting benefit schedules.

These changes in UI and AFDC are designed to modernize those programs to respond to changing demographic and economic conditions. They reflect the tremendous increase in female labor force participation that has occurred since AFDC was enacted. They also reflect the multiple job and career changes that many workers are experiencing in a global economy with rapid changes in technology. These programs need to be reoriented from income maintenance, pure and simple, to a combination of fair, but temporary income support coupled with powerful incentives and requirements to acquire marketable skills and find work.

The Ford report also makes a series of recommendations designed to reduce poverty among the elderly and disabled. It develops a combined public/private strategy for converting our highly unfair long-term care system from the present combination of victim payment and welfare to an insurance-based system.

The Ford report stresses that government spending alone will not solve our social problems. But it argues that carefully-targeted new outlays, coupled with program reforms, can make a critically important contribution. We felt a responsibility to develop cost estimates for our program expansion recommendations. We also felt obligated to offer a way to pay the bill.

Our estimate of the approximate cost of the new government spending initiatives is $29 billion a year. It should be noted that our recommendations could be phased in over a period of years to accommodate budget constraints, or to match a corresponding phase-in of a new revenue source.

In my view, there are three general classes of options for paying the bill. We could broaden the base of taxation, raise tax rates, or cut back federal spending in areas not related to vital human needs. I am personally opposed to raising tax rates at this juncture, and would prefer to see us "earn" our current tax rates by some combination of expenditure control and tax base broadening.

From a wide array of options, the Ford panel selected the more complete taxation of Social Security benefits as the primary financing mechanism. Social Security beneficiaries would be taxed on benefits received that exceed lifetime contributions. This would put the federal tax treatment of Social Security benefits on a par with the federal tax treatment of private pension income. And it would shield lower-income households (who have no federal income tax liability) from the burden of financing new commitments.

I support this approach as a way to recycle funds to meet our most pressing social needs among all age groups. The complete taxation of Social Security benefits would raise an estimated $97 billion over a five-year period, and this would go a long way toward meeting the cost of the panel's agenda.

We should not let honest differences of opinion about preferred financing sources deflect us from meeting vital human needs. The important thing is to make prudent new investments -- and pay our bills in a progressive way that recognizes differences among our people in ability to pay.

THE COMMON GOOD

Social Welfare and the American Future

Policy Recommendations of the Executive Panel

Ford Foundation
Project on
Social Welfare
and the
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Foreword

On Aug. 14, 1935, President Franklin D. Roosevelt signed the Social Security Act, historic legislation establishing Federal programs to provide old-age pensions, unemployment insurance, and aid to dependent children. To this day, these programs have constituted the core of the U.S. social welfare system. Much more than the sum of its parts, the Social Security Act of 1935 signaled official recognition of the Federal government's role in providing protection for Americans of all ages and, as President Roosevelt said, represented the "cornerstone in a structure which is being built but is by no means complete."

Over the years that cornerstone proved quite sturdy, remaining largely intact as such measures as health and disability insurance, food and nutritional services, and youth education and training programs were added to the system. Repeatedly, the American public has indicated the high value it ascribes to these programs, even in times of fiscal retrenchment. In recent years, however, new challenges have appeared, leading an increasing number of observers to ask whether the system needs refinement and rethinking.

Increasing global economic competition, changes in family structure, an aging population, and other developments have created new vulnerabilities for Americans and their families. Gaps in health insurance coverage, the lack of coordinated skill-development efforts to meet the needs of a changing work force, and the high cost of long-term care suggest the need to review the appropriateness of our social welfare system. Can it, as currently structured, be made more responsive to these and other needs, or is more fundamental change required to meet the social welfare challenges of the twenty-first century?

This is the question the Foundation set out to address in 1985 when it established the Project on Social Welfare and the American Future. The project was a special initiative that drew on, but remained independent of, the Foundation's regular programs. The project consisted of interlocking components of research, policy analysis, and deliberations by an eleven-member executive panel of citizens representing the business, academic, labor, civic, and civil rights communities.

The panel was chaired by Irving S. Shapiro (former member of the Foundation's Board of Trustees and former Chief Executive Officer of the duPont Company). Other members of the panel were Sol Chaikin (President Emeritus, International Ladies Garment Workers Union); James R. Ellis (Preston, Thorgrimson, Ellis & Holman); Robert F. Erburu (Chairman and Chief Executive Officer, Times Mirror Company); John H. Filer (Tyler Cooper & Alcorn); Hanna H. Gray (President, University of Chicago); Albert O. Hirschman (Professor of Social Sciences, Institute for Advanced Study); Vernon E. Jordan, Jr. (Akin, Gump, Strauss, Hauer & Feld); Eleanor Holmes Norton (Professor of Law, Georgetown University Law Center); Henry B. Schacht (Chairman and Chief Executive Officer, Cummins Engine Company, Inc.); and Mitchell Sviridoff (Director, Community Development Research Center).

In meetings held regularly throughout the course of the project, panel members undertook a careful review of needs and options in such policy areas as Social Security, health care, employment, and poverty. They also maintained a continuing dialogue about the broader goals and values that guide our social welfare choices. *The Common Good: Social Welfare and the American Future* is the report of the executive panel's findings and recommendations.

Panelists were assisted in their deliberations by briefings and commentary from leading social policy experts. Prof. Charles V. Hamilton of Columbia University directed the project's staff, which included assistant director Alice O'Connor, project associates Austin Cooper, Deborah McCoy, and Elena Pell, and staff consultants Leslie Dunbar and Mitchell Ginsberg.

Three outside consultants consistently provided expertise and guidance to staff and panel deliberations: economist Jack Meyer, president of the Washington-based research organization New Directions for Policy; political scientist Hugh Heclo of George Mason University; and Robert D. Reischauer of the Brookings Institution, who was recently appointed director of the Congressional Budget Office. The panel's report was drafted by Jack Meyer in collaboration with Hugh Heclo.

An interdisciplinary research advisory committee, chaired by Heclo, helped to shape questions related to the long-range future of the social welfare system. In addition, the Foundation supported twenty-eight independent research projects (see Appendix B), which will be of longstanding value in efforts to shape policy in years to come. The project also sought out the views and social policy priorities of those who have direct experience with the system—whether as expert policy analysts, program administrators, or members of the general public—in discussion sessions held around the country. These research and policy activities proved helpful in the preparation of reports and briefing materials for panel sessions on specific topics such as health and long-term care, the interrelated causes of and responses to poverty, and the role of the private sector in providing for social welfare. Believing that these unusually comprehensive reports would be of value to a wider audience, the Foundation has published several of them in a series of occasional papers (see Appendix C).

The Foundation funded the project with the expectation that the panel's report would present important policy recommendations for public debate. We are pleased with the panel's final product and hope it will receive serious attention and support.

Franklin A. Thomas
President
Ford Foundation

Chapter One

Reexamining Our Social Welfare System

Social welfare policy in the United States must be fundamentally reformed and modernized. Economic, demographic, and social conditions have changed, but our social policies have not adapted to these changes.

This report considers the social welfare system as a whole. It is fundamentally different from the reports that deal with individual topics like education, welfare, nutrition, or health care. They are separate reviews of the fragmented pieces of our social welfare system; this is an effort to transcend its splintered segments.

Our basic premise is that we must stop pitting one group against another in the struggle to improve social policy. We believe that if an unmet need is effectively addressed, we all benefit, not just those who have that need at that particular time. Similarly, if that need is neglected and problems fester, we all pay, and we usually pay more by delaying. It is essential that we improve economic opportunities and strengthen social protections for our most vulnerable citizens. These themes are not antithetical but complementary, and they cut across all age groups.

Today's international economy challenges our capacity to produce, as more working-age Americans are affected by economic decisions that are made abroad. Changing family structures and growing areas of concentrated disadvantage challenge us to invest in all our nation's children. An aging population signals a need for us to rethink relationships between generations, and to confront the widening gap between the affluent and the impoverished elderly.

These new developments threaten to overwhelm a social welfare system that was created in the 1930s under very different social and economic circumstances. This system underwent steady, if incremental, expansion through the 1960s and 1970s, followed by retrenchment in the 1980s. Recently, social welfare policy has not kept up with a changing world. Many people now find themselves faced with personal crises they are wholly unprepared to resolve on their own, and for which government offers little help.

More than 30 million Americans live in poverty. About one-quarter of young Americans fail to finish high school. Children who are at greatest risk of failure in school are now the fastest growing segment of the school population and of the future work force. The related phenomena of drug use and crime create a dangerous environment in urban America as well as a drain on our economy. The poor, and especially the elderly poor, are particularly vulnerable to these threats.

It is estimated that between 31 million and 37 million people lack any health insurance coverage and many others are underinsured. Most of these people are workers and their dependents. About half of our workers have jobs that do not provide private pensions, and such coverage of the work force has stopped growing. Meanwhile, unemployment insurance has become an increasingly threadbare component of the social safety net. Only about one-third of the unemployed receive such a benefit at any one point in time. As Americans live longer, they are more likely to need protection against the costs of long-term care for themselves and their family members; few are currently prepared for this eventuality.

Such problems signal a mounting social deficit that is as troubling as government budget deficits or the deteriorating physical infrastructure of roads and bridges. This report examines the shape and scope of that social deficit and offers a realistic, affordable program for addressing it in a comprehensive way. We should emphasize at the outset that we have found no quick or easy answers. The task of realigning the social welfare system with the needs of modern America will require efforts in the public and private sectors, a variety of methods, and many years. Most of all, it will require a realistic new consensus about our responsibilities to each other, now and in the future—a vision of where we are and where we want to go as a society.

There should be no illusions about the political difficulty of achieving such a consensus, especially in a time of budget deficits and general skepticism about public spending. Yet members of the project's executive panel agree that America has no choice but to try. As a result of years of neglecting our social infrastructure, the divisions in American society have increased in ways that threaten quality of life, peace of mind, and the economic future.

Lessons of Recent History

For much of America's history, social welfare needs were addressed exclusively through the family, voluntary organizations, and local governments. During the Depression, the nation discovered that this system, strong as it was, simply was not equal to the task of creating opportunity and protecting Americans' welfare without a more concerted, nationally based approach. The Federal government created new forms of social support to help reduce the insecurities that occur in every stage of life: Aid to Families with Dependent Children, Unemployment Insurance, and Social Security retirement benefits.

In subsequent years this base was steadily expanded to all social classes through a mixture of public and private efforts. The G.I. Bill made a college education available to millions. Public housing programs, Veterans Administration and Federal Housing Authority loans, tax rules, and a number of other housing subsidy programs helped millions afford home ownership. Encouraged by public policies, especially by changes in the tax code, the private sector extended the scope of social protection, offering employee fringe benefits like pension plans and health insurance. Washington stepped in again in the 1960s with Medicare for the elderly and Medicaid for the poor.

In the 1960s America also embarked on an even more ambitious experiment in offering opportunity to the disadvantaged. Congress passed such legislation as the Area Redevelopment Act and the Manpower Development and Training Act to focus on geographic "pockets of poverty" and workers left behind by structural changes in the economy. Encouraged by the civil rights movement, anti-poverty efforts concentrated on drawing disadvantaged persons into the labor market and breaking down barriers arising from racial discrimination or lack of education and skills. The diverse array of that era's programs included the Job Corps for poor teenagers, Head Start for preschoolers, civil rights legislation, and efforts to improve housing conditions and neighborhoods.

Not all the programs succeeded. Some were poorly conceived, promising more than reformers knew how to deliver. Others were well conceived but poorly implemented by our complex Federal system. Some efforts that were intended to expand opportunity wound up fostering dependency. For example, the 1962 Manpower Development and Training Act originally placed a strong emphasis on skill training and private-sector job placement. By the 1970s the field was dominated by the Comprehensive Employment and Training Act (CETA) program, which was criticized for spending too much on income maintenance and too little on skill training and private-sector job placement.

In the 1970s and 1980s the perception of failure in social welfare programs became widespread. Concern over the financial, social, and moral costs of dependency led some to claim that government had ceased to offer any answers to social problems and instead had itself become the problem, and that its attempts to help only interfered with private initiative and personal responsibility. Social protection, these critics asserted, ought to be left to private enterprise, charity, and voluntarism.

Yet political disputes over budgets and social programs in these years have made it clear that such attitudes do not reflect the priorities of the general public. Whatever faults they might perceive in social programs, Americans do not want to see them dismantled. Although many are concerned about the dependency of the poor, people at all levels have benefited from some government-supported social protections like Social Security, Medicare, and mortgage interest deductions. And it has remained clear that private charity and voluntarism, as important as they are, cannot fully meet the social needs of our citizens. Government participation is essential; we must learn from past experience how governments can respond more efficiently to the nation's social welfare needs.

Some lessons of that experience are obvious: Americans ought not to have to choose between the public and private sectors as avenues for dealing with problems of social welfare. Both are intimately linked; they should complement and support each other. Nor can we rely on economic growth alone to guarantee social welfare. A healthy economy, while essential, will not of itself generate the human investments and mutual caring that are necessary for a strong, just society. And while America has grown properly skeptical of programs that foster dependency, it has also learned that it is futile to ask people to take greater personal responsibility for their lives unless they have a real chance to escape from material conditions that foster insecurity and despair.

Years of experiment, success, and failure have also yielded a wealth of practical knowledge. We know, for example, what must be done to bring healthy babies into the world. We know that high-quality programs for preschool children pay dividends in later years. We know how to combine health, education, and family support services to help disadvantaged schoolchildren. We know that employment programs, though no panacea, can offer cost-effective improvements in the lives of many, including mothers on welfare.

Visions and Realities

An obvious conclusion arises from this accumulated knowledge. The best welfare policy offers individuals both economic opportunity and social protection, and it does so in a way that minimizes the waste of taxpayers' resources. Self-reliance ought to be encouraged, but it will be most effective within the context of a supportive social framework. Work is fundamental to an enlightened social welfare program, but people often need assistance in preparing for work, as well as some basic social support while they are working. At the same time, a government that offers help in the form of social programs must resist being exploited by people who will

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not try to help themselves. Nor should government waste money on programs that do not work.

We believe it is economically and socially prudent to design a policy that offers both opportunities and social protection for all American citizens. This is a way of recognizing that we are all interdependent. Today's poorly prepared preschoolers are tomorrow's marginal workers and nonworkers. Each of us will eventually depend on the skills and productivity of this emerging work force to maintain the country's economic competitiveness, to run an increasingly sophisticated national defense system, and to pay the Social Security bills in our old age. The poorly insured worker of today becomes tomorrow's indigent hospital patient, and society pays the tab by supporting the uncompensated health care that worker receives. Many families today are able to provide opportunities for their children precisely because their elderly parents are part of a system of protection that was created by our social insurance laws.

As taxpayers and as victims of a violent society we end up paying for the social wreckage that results from a lack of earlier investments in other people and their children. We cannot build enough prisons or buy enough home security systems to protect our private worlds from the social decay that spreads when true opportunity is denied to large numbers of people.

The panel believes that a union of individual opportunity and social protection makes sense in terms of how most Americans hope to lead their lives. Such a policy helps to define the kind of society in which we want to live.

Against this vision stands a sobering reality: in economic and social terms, America appears to be growing more divided rather than more united. In 1966, 45 percent of the public told pollsters they thought America was a place where "the rich get richer and the poor get poorer." By the late 1980s four out of five, 81 percent, agreed with that description of the country.

The public's impression seems all too accurate. The extent of inequality in individual earnings as well as in family incomes is greater today than it was twenty or thirty years ago. During the past decade we have made virtually no progress in reducing the poverty rate among the non-elderly population. As a nation, we are prosperous, but a substantial group of Americans live on the margins of that prosperity.

Several ongoing trends are likely to intensify such divisions. Growing competition in the international economic system is likely to force the United States to specialize increasingly in goods and services that require a highly skilled work force. The growth of knowledge-intensive jobs will leave a substantial group of Americans out in the cold unless we close the gap between the skills they possess and the requirements of a modern economy. Changing family structure may be similarly divisive. Prospects are bright for two-parent families in which one spouse devotes full time to a job that produces ample income and benefits like health insurance, while the other manages child care and other domestic duties and may also go to work to bring in more money. But this "typical" American family is shrinking in proportion to the population. More than half of the children born in America today will live in single-parent homes before age eighteen. Single parents find it much more difficult to manage work and child care and to link up with the opportunities and protections of the traditional labor market. For this and other reasons, nearly 25 percent of America's children under six now live in poverty. For minorities the percentage is 40 percent and both figures have been rising for more than ten years.

Persistent hard-core poverty among a small but growing proportion of our population has proven resistant to conventional remedies. Many of our inner-city areas contain isolated pockets of poverty, welfare dependency, joblessness, split families, crime, and drug use. All of these problems, of course, can be found throughout our society. But in some neighborhoods, their incidence is so high and their confluence so pronounced that young people growing up there have slim chances of succeeding in life.

The number of aged is rising in proportion to the total population. In twenty to twenty-five years, as the baby boomers retire, the aging of the population will be especially pronounced. Distribution of income and wealth among the aged is already more unequal than in the rest of the population. Such inequalities are more likely to grow than to diminish in the years ahead. Those who have been renters are much worse off than those who have owned homes and profited from the escalation of housing prices. The spread of employee benefits appears to have stopped well before reaching many low-wage earners.

These trends are especially worrisome because the current social welfare system appears oriented to picking up pieces rather than preventing the original breakage. Our policies typically do not help families with children until there is a crisis and the children are hurt. We spend large amounts to save the life of each low-birthweight baby, but skimp on the prenatal care that helps avoid future suffering. We stand aside as large numbers of children are damaged intellectually and socially in their first few years of life, and then rush in with remedial school programs and anticrime measures when the inevitable consequences of such neglect occur. We also ask the poor to go on welfare before health care is made accessible to them. We expect most jobless and very poorly paid workers to exhaust their unemployment benefits and their own resources before they can receive any help with retraining or other means of securing mobility in the labor market. We ask old people to "spend down"—a euphemism for impoverishing themselves—before assisting them with long-term care.

A more comprehensive strategy would be one that empowers people both in the workplace and in their varied family circumstances.

In the chapters that follow, we lay out specific recommendations that taken together would constitute a fundamental restructuring of social policy in America. Some of these recommendations would require new government spending. Others ask private enterprise to make a contribution. And some look to the voluntary sector for further help.

Solving the Funding Squeeze

Clearly, the scope for new government spending is limited in the years immediately ahead. As we shall show, however, it is possible to reallocate current revenues, so they are spent more wisely. We can also generate new revenue for much-needed social investments.

As we will discuss in Chapter 6, we found during our deliberations that one approach to financing the government's cost of meeting our agenda stood out as fair and sensible: The panel recommends that Social Security benefits exceeding an individual's lifetime contribution be subject to taxation. Such a step does not impose a "means test" on receiving Social Security. Rather, it permits all senior citizens to receive benefits, but recaptures a portion of benefits from higher-income people to help meet our nation's social welfare needs.

We do not view the full taxation of Social Security benefits as "hitting the elderly." It is a tax we will all pay one day when we become elderly. In other words, the elderly are not some group to be segmented and separated from the rest of us—they *are* us. Viewed from this perspective, the tax represents a way that we all can contribute to filling unmet social needs once we are in a position to pay it.

Furthermore, the panel feels strongly that the additional revenues generated by this taxation should be placed in a special fund, at least for a period of time, to be used to underwrite a portion of the cost of achieving a broad spectrum of social welfare goals. Eventually, we hope, we would not have to protect this fund but could treat it exactly like other revenue flowing into the Old Age and Survivors' Insurance (OASI) Trust Fund. During the next decade or two, however, as we reduce the "social deficit" described in this report, we must ensure that the new revenues match up directly with unmet needs across the age spectrum. In the short run at least, we see this as a sensible way to link the demand for taking action on the social deficit with the response to that demand.

The question that should be addressed is neither what is politically popular in the short run nor what "revenue-enhancing" gimmick can be found to pay the bills. The deeper issue is the need to create a fairer social system in which all will share both obligations and benefits.

Social Welfare and the Life Cycle

This report is organized according to the sequential phases of the life cycle: infancy and childhood, young adulthood, the working years, and old age. As the following vignettes suggest, a person's need for opportunity really begins before birth with prenatal care and extends through the retirement years. The same is true of a person's need for basic security.

A baby is born this year in an inner-city hospital, one of the majority who are destined to spend at least part of their childhood in a family headed by a woman. In theory the baby's future holds the equal opportunity open to all Americans at birth. In reality much will depend on the system of protections built around the child, by its family and by society at large. Will the baby be one of those already at a mental and physical disadvantage because of inadequate prenatal care or because their mothers were using crack? Will financial support from an absent father be forthcoming, and if not, will society help enforce the child's right to such support? Will decent day care and family services be available? Will the child grow up in a neighborhood where most adults have no jobs, crime is an everyday event, and most children are not functioning well by the time they enter kindergarten? Will the newborn baby live in a social milieu that protects its chance for a productive, rewarding life, or is it already condemned to dependency, poverty, and alienation?

A forty-five-year-old steelworker in Pennsylvania finds himself laid off because of foreign competition. Has the economy provided other jobs at decent wages? Is there unemployment insurance to help with the transition? If employers in the industry do not want an older worker, are retraining facilities available? Should illness strike, will the worker have good health benefits?

An eighty-year-old widow believes that she has lived long enough and worked hard enough to deserve respect and independence. She fears becoming an economic burden to her children. Has this elderly woman had a realistic opportunity to make financial provisions for her care should she no longer be able to function on her own? Must her protections be paid for by risking the economic well-being of her children and grandchildren?

It is a false dichotomy to picture opportunity as something only the young need and security the exclusive interest of the old. Senior citizens want opportunity also—not necessarily to work full time, but to maintain their independence, self-sufficiency, and dignity as long as possible. Similarly, a healthy breadwinner might seem able to do without the added measure of security—until a job disappears or an illness strikes.

Regrettably, the concept of opportunity has come to be associated with unassisted individualism and security with cradle-to-grave government protection. Neither of these approaches is what our country needs or what we call for. We believe in giving people a fair chance to succeed. This often requires giving them a boost to get on the ladder, as well as being there to catch them if they fall. The front-end boost and the protective net leave plenty of room for individual initiative. The individual is still expected to exert the energy to climb the ladder, and some will go higher than others. This is as it should be. But today some never even get to the first rung, and though we are all in danger of slipping, some never get a helping hand to get up again.

Each and every one of us has a stake in providing infants and young children, wherever they may live, the nutrition and emotional nurturing that allow them a decent start in life, both because it is right and because if we don't, they may burden us for decades with the costs of illness, dependency, and crime. All of us have a stake in helping adolescents and young adults make a successful transition from school to the increasingly demanding work force of the information age. All have an interest in retraining workers who are left behind by a changing economy so they will not be condemned to unproductive, dependent lives. And all can find personal reassurance in providing the elderly with freedom from the fear that an infirmity will devastate not only their health but also their family's financial and emotional underpinnings.

Such practical considerations argue strongly for the importance of dealing with the social deficit; the panel finds this effort to be not only right but also politically realistic. At the same time, there is a powerful moral reason to pursue the task. Social welfare policy is properly the concern of all Americans, not just because all may benefit from improving it but because improving it is the right thing to do. The moral integrity of our society depends in no small measure upon our ability to unite behind this belief.

With these considerations in mind, we will focus on infancy and childhood, the first phase of the life cycle.

Chapter Two

Infancy and Childhood: A Time to Sow

There is no more important contradiction in social policy than this: From child-development research we now know that the first few years of life play a crucial role in shaping a person's lifelong mental, emotional, and physical abilities. And yet it is for this stage of life that we seem to make our social investments most grudgingly and tolerate the greatest deprivation. To illustrate:

- About one in five children lives in poverty.
- More than 12 million American children—the equivalent of a medium-sized country—are now poor.
- Some 3.3 million children are now living with their teenage mothers; the proportion of out-of-wedlock births to teenagers has soared during the past twenty years.
- Child abuse and neglect are growing; more than 2 million cases are reported each year, about 900,000 of which are verified.

Although scientific knowledge about early childhood years has mushroomed, it is during these years that Americans are most likely to live in poverty. Simply put, our knowledge is not being applied.

As parents, grandparents, aunts, uncles, and friends, most of us have peered through the glass of a hospital nursery at rows of infants wrapped in blankets—so vulnerable yet so full of promise. If we could somehow look through that window to view all the nation's children, the spectacle would be alarming. In a typical recent year we would see one-quarter of a million babies born undersized (i.e., weighing 5½ pounds or less), often afflicted by illness and handicaps. Some will die. In some inner-city hospitals more than one in ten babies are born drug-addicted. Forty-two percent of the white babies will live with a single mother by age eight, and most of these infants will experience a major spell of poverty during that time. Eighty-six percent of the black babies will live with a single mother by age eight, and most will be poor during most of that time. Many will grow up in an urban environment devoid of opportunity and full of danger. If current trends continue, more than of 40 percent of the Hispanic children will experience poverty before age eighteen. Although many will also live in households headed by women, a growing proportion of poor Hispanic children will live in two-parent families.

To summarize, we could look through the nation's nursery windows and separate the fortunate babies born to hope and safety from the unlucky babies—perhaps one in four—born threatened and suffering. The fortunate majority of infants can look forward to a long life span and a good standard of living. They will be well fed and decently housed, see a pediatrician regularly and receive all of the appropriate immunizations, attend good schools, never suffer child abuse or neglect, and be raised in relatively safe neighborhoods. The large number of unlucky babies will experience a childhood lacking in the essential requirements for good health, physical safety, and proper mental and social development. By the time they reach kindergarten, they will already be falling behind through no fault of their own. Anyone looking at the rows of infants in a hospital nursery and consciously advocating policies that deliberately produce such outcomes would rightly be branded a monster. Yet such is the effect of our current policies.

Investing in Infants

It is easy to generate sympathy, if not tax dollars, for infants born burdened and suffering through no fault of their own. A more hard-nosed case for increasing our investments in young children can be made by calculating the long-range benefits from the point of view of pure self-interest. We can pay a little now to try to prevent blighted childhoods or we can pay a lot later for the consequences. In other words, money for decent prenatal care, or more than three times as much to deal with low-birthweight infants; several thousand dollars for a good preschool program to open the mind of a ghetto three-year-old, or tens of thousands of dollars to cope with a hardened teenage criminal. At the same time, we in today's work force will eventually depend on the abilities and economic productivity of the infants being born today. In 1950 there were seventeen workers to support each older retired person; today there are 3.5 workers, and by the next century there will be only about two workers for each retiree. Finally, wasted childhoods will produce inadequate workers at a time when we can ill afford it, when growing competition in the world economy is increasingly forcing the United States to specialize in goods and services that require a highly skilled, adaptable work force.

Beyond the nation's economic competitiveness or the future security of retirees, crime, disorder, and other social pathologies are being set in motion now by what is happening to too many children. Today's infants are literally the nation's future. Whatever America can or will be is taking shape today in the nation's nurseries. The underlying challenge is clear enough, and so too are the social costs. The question of how to provide opportunity and social protection to children is complex, for the well-being of all young children must be a societal as well as a parental concern. Parents have primary responsibility for their children, but we all have an interest in healthy babies and in children's adequate nutrition and cognitive development. Moreover, the problems of infants are closely connected to issues we will deal with in subsequent chapters: teen pregnancy, gaps in health insurance coverage, joblessness, and underemployment of parents.

This chapter develops an agenda for reform in prenatal care, preventive health care and nutrition, early childhood development, and family support services. It is an agenda that emphasizes larger social investments in children at the earliest possible stages of life. These stages represent "windows of opportunity," and they do not stay open very long. Delay often means that by the time remedial help arrives, the window is already shut. The panel believes that it is simple common sense to make investments that are preventive and that capitalize on the earliest possible opportunities.

Extending Prenatal Care

Thanks to modern science, childbirth is not the mystery it once was. Bringing a healthy baby into the world is something we know how to do, but too often in America we fail to do it. We know the basic elements of a healthy start in life: prenatal care with regular screening to detect health risks, counseling to educate expectant mothers about appropriate health and nutritional habits during pregnancy, and continued good nutrition and health care for the newborn child. We know that pregnant women who obtain regular check-ups and periodic examinations by an obstetrician early in their pregnancies are more likely to have healthy babies than those who delay care until late in their pregnancy or do not obtain it at all.

Through measures such as these, the nation has made great strides in prenatal care and achieved dramatic reductions in infant mortality. The leading cause of infant death and handicaps, however, is still low birthweight resulting from a lack of adequate prenatal care and nutrition. Despite advances in medical technology, babies with low birthweights are almost forty times more likely to die in the first month than are normal-sized infants; for infants with very low birthweights (3.3 pounds or less), the risk of death is 200 times greater.

Two notes of caution should be sounded here. First, the value of prenatal care is clear for women in almost all age groups, but it is not so clear that even the best prenatal care can avert dangerous outcomes in the pregnancies of very young girls (i.e., less than fifteen years old). Their pregnancies will be risky under any circumstances, and the best policy is to devote our attention and resources to helping such young girls avoid pregnancy. Second, the wonders of modern medical technology may lead to a social policy dilemma: We are increasingly able to save the lives of even the smallest newborns (i.e., 1½ pounds). We want people in all situations, including but not limited to the poor, to be able to avail themselves of lifesaving technologies, but we do not want these technologies to encourage the social behavior that triggers their use. The problem is complicated by the fact that underweight at-risk babies are found disproportionately among mothers who smoke, use drugs, and are very young; however, these babies can also be born to parents who have none of those characteristics.

Since the early 1950s the United States has achieved a reduction in its proportion of low-birthweight infants, but our percentage still remains one of the highest in the developed world. Moreover, there is a growing concentration of infant health problems among the poor, and the disparity between the life chances of white and nonwhite babies remains huge. Recent national data show that the infant mortality rate per 1,000 live births was 11.9 for white infants and 22.8 for black babies. Black births accounted for 16.5 percent of all live births, but for 30 percent of all low-birthweight babies, 34 percent of very low-birthweight births, and 28 percent of all infant deaths.

We have also learned that women with health insurance—either private or Medicaid—are more likely to seek prenatal care than women who lack coverage. At the same time, the women with the greatest risk of a low-birthweight delivery are those without health insurance and adequate prenatal care. During the 1980s the proportion of mothers who start prenatal care in the first trimester has stopped increasing and has possibly even declined.

It is reasonable to conclude that measures extending health insurance coverage to uninsured pregnant women can be expected to increase their use of primary and preventive obstetrical care. Furthermore, there is evidence that the additional outlays for insurance coverage would end up saving money in the long run. One careful study shows that an additional dollar spent on prenatal care saves an estimated $3.38 as a result of the reduced incidence of low-birthweight babies. The reduced suffering and the prevention of handicaps cannot be assessed.

At present, most families qualify for Medicaid by qualifying for the welfare rolls. State-by-state differences in eligibility standards for welfare assistance produce huge differences in access to health coverage. As a result, in many states poor families, even those living at less than half of the federal poverty standard, are effectively denied Medicaid because they are ineligible for welfare. More than 11 million American children are without private or public health insurance coverage, and half of all poor children are not covered by Medicaid. Yet, the babies in these families are at the greatest risk of being born weak and/or handicapped.

The Medicaid expansion provisions of the 1988 Medicare Catastrophic Illness legislation mark an important step in the right direction. This law grants Medicaid coverage to all pregnant women living in poverty and poor children below one year old. But a big problem remains: coverage for poor children above one year and poor adults who are screened out of Medicaid.

Studies also show that children receiving preventive care through the Medicaid Early and Periodic Screening, Diagnosis, and Treatment program (EPSDT) have fewer abnormalities and chronic health problems than nonparticipants. Preventive immunization and metabolic screening programs save as much as $14 for every dollar invested. Yet a significant and growing number of children in America are not receiving full immunization against preventable diseases. In 1980, 19.3 percent of two-year-olds had not been fully immunized against polio. By 1985 this figure had jumped to 23.3 percent, or nearly one child in five. Similarly, in 1985, 18.3 percent of two-year-olds had not received full immunization for measles; 22.7 percent for rubella; and 21.1 percent for mumps—all higher proportions than in 1980. Half of all black preschoolers are not fully immunized.

In a nation as wealthy as the United States, there is no good reason infants should be denied access to prenatal and well-baby care because their parents happen to live in one state rather than another, or have income just above rather than below an arbitrary welfare—or poverty—income line.

We propose a national commitment ensuring that all pregnant women have access to prenatal care and well-baby care. Health insurance coverage is part but not all of what is needed to fulfill this commitment. We also need to place greater emphasis on prevention and early detection of problems and on immunization even among those who have public and private insurance coverage.

Better Nutrition for Young Children

The logical next step is to improve the array of child and maternal services currently provided to low-income families. These services are offered through programs such as the Title V Maternal and Child Health Block Grant and, in particular, the Special Supplemental Food Program for Women, Infants, and Children (WIC).

WIC is a Federally financed program that provides screening, nutritional counseling, and food supplements for low-income pregnant women and for children up to age five who are diagnosed as nutritionally at risk. Under WIC, the U.S. Department of Agriculture allocates Federal funds to state health departments. These state agencies fund local health departments, hospitals, and health clinics to determine eligibility, offer education about nutrition, and prescribe proper foods for eligible recipients.

Several studies have found that this program can make a difference. Compared with similar groups of women who are not in the program, high-risk mothers in WIC tend to have a lower incidence of late fetal deaths and to deliver larger, healthier, less premature babies. The WIC newborns have larger head sizes, possibly implying better brain development. Babies and preschoolers in the program demonstrate superior cognitive development and less anemia than comparable infants and children who do not receive the assistance.

The payoff of WIC services seems clear, but our commitment to the program has been feeble. At present, states have the option of offering or not offering the WIC program to women with incomes of up to 185 percent of the poverty line. Because WIC is a discretionary program, states can and often do choose to serve only a limited number of those who are eligible and some states are reluctant to search vigorously for needy children who qualify for the program. Only about half of the eligible women and children are reached by the WIC program as it is currently constituted.

In recent years a few states (such as South Carolina and Massachusetts) have taken the initiative in trying to bolster the Federal WIC program with supplemental funding. As we will show later, a number of state and local models also seek to coordinate services to meet the multifaceted health and nutritional needs of young and vulnerable families. These efforts are laudable, but they must be bolstered by adequate investment at the national level so that services are available to all those who need them.

We recommend full funding for the WIC program as an entitlement for nutritionally at-risk women and children with incomes of up to 185 percent of the Federal poverty line. In addition to increased funding for WIC, greater attention should be paid to improving its basic management techniques. If ways can be found to economize on the use of resources, any given level of funding can be stretched to cover more people in need. Consider recent management innovations in the state of Texas. Instead of working with just one provider of food under WIC, the Texas state Board of Health opened the bidding and discovered that bringing a second bidder into the process saved $70 million over two years, as the second bidder offered the government a deeper discount. The state estimates that this will allow an additional 95,000 women, infants, and children to be served. Most states are now moving in the direction of competitive bidding.

WIC offers one more example of how children's good health and development require that different services be connected and made more accessible to parents and children together. For many low-income women, the main contact with government programs occurs when they enter a public hospital for labor and delivery. At this point they should have access to a system of referral to allied services, but by then their health and nutritional status is already seamlessly interwoven with that of their newborn. Pregnancy testing services should be linked to the food supplementation and nutrition system, which in turn must be connected to prenatal health care. And these strands of child-welfare policy must in turn be tied into what is happening to children with respect to day care and early child development. As we shall see, this is a challenging but not impossible set of connections to make.

More and Better Preschool Programs

Evidence accumulating during the last twenty years points strongly to the conclusion that high-quality development programs for disadvantaged preschoolers are among the soundest human investments. One does not have to be a certified child development expert to understand why. The early years of life are a critical period of development and learning, laying the groundwork for subsequent patterns of personality and intellect. Babies raised in a skilled, caring environment will generally differ from babies raised in a desensitizing, mind-numbing atmosphere. By the same token, three-, four-, and five-year-olds can be socially and intellectually deprived in a way that programs them for failure in the transition to school. Those early failures can then easily lead to a host of negative expectations and subsequent troubles. It should be emphasized that these circumstances are not the automatic result of living below a poverty income line or in a certain kind of family structure. Some single mothers with meager income are doing as much as one could ask of any parent, while some two-parent families with abundant resources are guilty of neglect.

The rising enrollment rates of three- and four-year-olds in preschool programs (from 21 percent of this age group in 1970 to 39 percent in 1985) testify to the widespread recognition of their value. The pattern of enrollment rates, however, indicates that early childhood education may be benefiting mainly the better-off children. Although more than half of higher-income families ($35,000 yearly income) enroll their three-year-olds in preschool programs, only 17 percent of three-year-olds from lower-income families ($10,000 or less) are in preschools. Yet it is precisely among poorer infants and children that the need for preschool experience is greatest, and it is among them that the evidence is strongest for the major positive impact of good early childhood development programs.

The types of targeted social investments we need to make will vary somewhat across the age span of young children. In general, we should move our resources to where the children are actually spending their days. In recent years, four- and five-year-olds are often connected to the public school system, which increasingly reaches out for these preschool children with part-day programs. On the other hand, one- and two-year-olds are usually not going to come in contact with the public schools or the Head Start program. Yet the more we learn, the more critical it appears that there be skilled development-enhancing care during these earliest years; by eighteen months some infants are already in need of remedial help. Because the child is often in a home during these years, the problem could be addressed with an effective program of home visits along with parent and caregiver education.

What good preschool child development programs do is help tilt the odds for poorer children away from failure and toward success. Studies show that quality programs help improve these children's social preparation and intellectual performance when school begins. There is less need for special education programs or repeating grades. The likelihood of completing high school, gaining college or vocational training, and holding a job is significantly increased. The few existing in-depth, long-term studies show that good-quality preschool development programs can improve poor children's achievement throughout the school years, reduce their delinquency and arrest rates, and also reduce the rates of teenage pregnancy and dependence on welfare.

A careful analysis of one such program, the Perry Preschool Project, studied both costs and benefits over the years. In the early 1960s black three- and four-year-olds from poor families in a single Michigan school district were randomly divided into two groups. One group participated for one to two years in a program of high-quality early childhood education; the other did not. After that, nothing else was done for either group as they grew up in a typically impoverished setting. Although the sample size in this experiment was small, the results suggest that the benefits to the participants and to the taxpayers were positive by the time the children were nineteen. For an initial investment of $5,000 per participant per program year, there were the following savings (in constant dollars) when compared with non-participants:

- $3,000 savings per child in reducing the costs associated with delinquency and crime
- $5,000 savings in special education or remedial programs later in school
- $16,000 savings in public assistance
- $5,000 more in taxes collected because of better employment and earnings

By the time the children who participated in the original 1961 Perry Preschool Project were in their middle to late twenties, the benefits of that small, early investment had continued to compound.

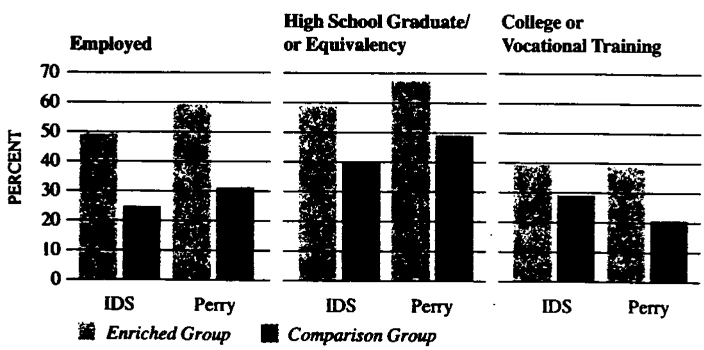
Other studies from the Head Start program and the New York longitudinal project have tended to confirm these results. The Perry project dealt with a small city environment (Ypsilanti, Mich.). The New York project, conducted by the Institute for Developmental Studies, operated with inner-city youths from New York City. Beginning in the mid-1960s, a program of educational enrichment was offered for up to five years to a sample of children starting at four years of age. The long-term payoff in jobs and education at ages nineteen to twenty-one becomes clear in relation to control groups that did not participate in the program. The results are remarkably comparable to the findings from Michigan (see Figure 2.1).

It is important to recognize that quality is as important as quantity in early childhood education programs. There is no evidence that developmental gains result simply from sending a young child out to be with another adult and a group of children in a classroom or a child-care center. Effective investment in disadvantaged preschoolers depends on both continuous parent involvement and well-designed, well-run programs of early childhood education. The essential components are staff with specific training in early childhood development and education and a knowledge of preschoolers' needs; adequate resources to provide the necessary services; group sizes that are appropriate to a classroom or a child-care center; and, for Hispanic children with limited proficiency in English, staff trained to help them as well as special bilingual or English-as-a-Second-Language materials. Trying to impose formal academic standards on young children through a traditional school curriculum is not what is needed. Neither is it good enough simply to dump disadvantaged preschoolers into day-care centers where there is no proven educational plan behind the day's activities. The multifaceted kinds of day care and the more promising programs of early childhood development must be combined into an integrated system.

The nation's primary national program for disadvantaged preschoolers is Head Start, which was created in 1965. Through a variety of local organizations, Head Start offers a wide mix of programs. There are literally stacks of evaluation studies demonstrating that high-quality Head Start programs do change young people's lives, and we know what is needed to strengthen less effective programs: well-trained teachers, validated childhood development curricula, hands-on supervision, and parental involvement.

Although funding for the Head Start program was not cut in the early 1980s, there still have not been nearly enough funds to train and compensate personnel, much less to meet the needs of disadvantaged three- and four-year-olds, or to provide even a small part of the services needed by low-income parents and infants below the age of three. Today, for example, about 2.5 million poor children—28 percent of all those of preschool-age—are eligible for Head Start, but because of funding limits, only one in five of these children is currently enrolled in the program. Thus, while an increasing majority of upper-income families are sending

Figure 2.1 Job and Educational Status of 19- to 21-Year-Olds With and Without Preschool Development Program Participation



Source: Martin Deutsch, Theresa J. Jordan, and Cynthia P. Deutsch, *Long-Term Effects of Early Intervention*, Institute for Developmental Studies, 1985.

their children to the best early childhood education programs that money can buy, the vast majority of already disadvantaged children are losing ground before they have even reached the school system.

During the 1980s somewhat less than half the states have initiated or expanded their own early childhood education programs. Some of these funds go to Head Start agencies, but there is an increasing tendency to use the public school systems as well. By 1987 only about 100,000 children were served by these state-sponsored early childhood education programs; more than half were in the two states of California and Texas. As a small fraction of its enrollees, Head Start has also begun to include preschoolers who are educationally disadvantaged regardless of income status. In some localities greater efforts are being made to provide training in early child development to mothers who care for children at home. High-quality early childhood education programs can occur in a variety of settings under many different auspices. Despite this diversity, it is nonetheless important to scale up and institutionalize successful Head Start models in order to help larger numbers of disadvantaged children.

One way to do this is to institutionalize Head Start in the public schools. The states should be encouraged to think of Head Start as an early childhood education program, rather than as an antipoverty program that is outside their public education jurisdiction. It is important to link an expansion of Head Start with the process of reaching out to preschool children that is now occurring in the public schools.

Not everything can be done at once. That fact, however, must not be allowed to distract from the fundamental, long-term goal: to make quality, early childhood development services available to all preschool children who are at risk of failure in school. Today's children deserve, and the nation needs, direct action now toward that goal.

We recommend a major expansion of the Head Start program. Our ultimate goal is to make Head Start available to all families who need and want to use it. The specific long-range objectives are:

- **to provide enough slots for the 80 percent of poor three- and four-year-olds who are now denied this service;**

- **to make at least one-half of these slots full-day programs for children with working parents;**

- **to expand family-support, referral, and home-visiting services to very low-income parents, especially teen mothers, with children below age three;**

- **to increase funding for improved staff compensation and staff training in early childhood development**

- **to address the needs of children whose knowledge of English is limited.**

It is unrealistic to think of achieving these goals in one year's time. They represent targets toward which we hope to move incrementally. The section on costs at the end of this chapter lays out a realistic near-term goal.

Improving Day Care

Changing economic and household arrangements are creating a new kind of vulnerability for many young families today. Not long ago the daytime care and nurturing of young children was centered in the household. Today more women with young children are entering the paid labor force either of necessity or by choice. About one-third of the women with preschool children work full time, and when those working part time are included, the proportion is more than half.

Although the number of licensed day-care centers has grown rapidly during the past decade, the growth in supply has not fully met the needs of either two-earner families or single-parent households. Nor has enough attention been paid to the quality of day care. In addition, the average cost of child care, an estimated $3,000 per year (full time), is beyond the means of many lower-income families, even with existing Federal assistance programs and the child-care tax credit.

America has not had as much experience with day care as with child health and nutrition, which makes it more difficult to offer social policy recommendations. Yet there is an urgent need for comprehensive policy in this area: Our society places a high value on the proper care and nurturing of children; good day-care services play an important role in helping parents earn the income that is necessary to a stable household; and there is a widespread need for day care among families at all income levels.

The goals of such a policy should be to increase the availability of quality day care, to help families with financial need defray the cost, and to assure the safety and well-being of children without unnecessarily impeding the provision of adequate care. Meeting these goals will require the participation of federal, state, and local governments, as well as private-sector employers, voluntary associations, and families.

Some families currently receive assistance with day care from their employers, but day care remains the employee benefit that is least frequently offered. The number of employers providing on-site information-referral services has grown more than 400 percent since 1983; however, only an estimated 3,000 of 6 million private employers provide some kind of day care.

A small number of families are receiving day-care services funded by Title XX Social Services Block Grants. The income tax system offers broader Federal assistance. It allows tax credits for day-care expenses and does not tax employer benefits. These tax benefits tend to favor middle- and upper-income families, however, and do little for working families near the poverty line with little income tax liability. Such families are often on the borderline that separates work from welfare, so that extending them some tax relief could provide the difference that would make them self-sufficient.

We recommend that the Federal government provide child-care subsidies for lower-income families through such steps as making the existing tax credit refundable. We also recognize that providing adequate day care is not just a matter of financing, but also concerns assurances of safety and an adequate supply of services. State and local governments can play an important role here by establishing certification and monitoring mechanisms that are more rigorous in enforcing safety standards. At the same time, however, local authorities should review existing zoning requirements to eliminate unnecessary barriers that now prevent day care from taking place in safe settings like homes or churches. Unrealistic specifications about the number of toilets in a home, for example, might block a mother from offering day care to four children in a safe home setting, while zoning rules may permit day care in a dangerously run-down commercial neighborhood.

A commitment to quality care must also be reflected in the compensation of day-care workers. Currently, they are in the lowest 10 percent of all wage earners, and many have no health benefits. Steps to improve their training, wages, and benefits should be linked to community-wide efforts to set and uphold standards for day-care centers.

Stronger Child Welfare Services

Improved prenatal, nutrition, preschool, and day-care services promise a brighter future for American children in years to come, but no child-welfare policy can be considered complete unless it addresses the young victims who are now suffering from neglect, abuse, abandonment, and homelessness. Their circumstances reflect a general pattern of failed family-support services. A distressingly large and growing number of children spend their early years in brutalizing and dangerous circumstances. The two million cases of child abuse now reported per year are approximately four times the 516,000 cases reported in 1977. At least another quarter of a million are in state-sponsored substitute care—foster homes, group homes, or institutions. By failing to stem the abuse and neglect from which these children are suffering, we sow the seeds of future violence and dependency.

Many of these problems overlap with the growing number of homeless people in America. Children have been joining the ranks of the homeless in increasing numbers. Here surely are the most vulnerable of all America's children. Most homeless children are of preschool age. Many are suffering abuse and neglect at the hands of parents who themselves were victims of violence and neglect as children. And although studies of homeless children often focus on small samples in only a few places, there is growing evidence that there are children whose medical, nutritional, educational, and emotional needs are woefully unmet. The problem of homelessness is the most poignant and troubling part of a much larger problem that includes the difficulty many families, especially young families, have in affording decent housing today.* This problem cannot be adequately addressed without considering ways to increase the supply of low-income housing, reform the income maintenance system, and improve access to health and social services.

Still, the present system of child-welfare services deserves attention. It is a maze of overlapping program jurisdictions and fragmented services, geared to addressing crises after they occur rather than averting them. Existing family services are designed to come into play mainly after children have experienced some severe and often traumatizing problem—abuse, illness, abandonment, poverty, retardation, and so on. Athough this emergency approach is important for children in immediate danger, it is inadequate for dealing with the overall stresses of con-

*A full-scale review of the housing problem is beyond the scope of this report. Recent findings and recommendations contained in the report *A Decent Place to Live: The Report of the National Housing Task Force* (commissioned by Senators Alan Cranston and Alfonse D'Amato and chaired by James Rouse) offer a realistic blend of public policy reforms and private-sector initiatives. The task force report acknowledges that the problem of affordable housing is not experienced exclusively by the poor, and that we need a mixture of policy reforms to help a broad range of Americans—assistance to the poor in conjunction with measures aimed at helping lower-to-middle-income young families gain a foothold in the housing market.

Particularly significant is the recognition of diverse local housing initiatives that have originated across the nation in recent years. Central to these efforts are new community development corporations and other "self-help" groups that could become part of a more flexible, decentralized delivery system for housing and community development. This new system amounts to a grass-roots infrastructure that can be nurtured with renewed Federal assistance. Such a system offers clear advantages over the mammoth, prescriptive Federal housing programs of the past.

temporary family life. We must find new ways of detecting the early warning signs of families and children in trouble. We must give parents information about how to cope with problems at home and where to go in the community to find services they need. Any realistic social welfare policy for the future should not be geared exclusively to "problem children" and "problem families," but to all families that, left stranded without support, are candidates for trouble.

Besides a child-abuse program, homeless services, or foster care, such support must necessarily involve related systems of medical care, education, nutrition, mental health, and early childhood development. Since the enthusiastic reforms of the 1960s, we have learned painfully that such coordination of services does not easily occur with a top-down organizational structure. It occurs more effectively at the community level—a local neighborhood or church group, a Head Start office, a hospital, a social service agency. In various parts of the country today, promising experiments seek the integration of educational, medical, housing, and child-protection services.

The Lafayette Courts Family Development Center, located in one of Baltimore's largest public housing high-rise developments, serves a population of 805 family units containing more than 500 children below age six. Eighty-five percent of the families are on welfare and 44 percent of the adults did not complete high school. The program aims to provide the entire family unit with a structured and comprehensive plan of services and support. Case managers work with each family to arrange an appropriate mix of services. They include:

- developmental child-care services, with on-site Head Start programs for children up to age three; full-day child care, and an after-school center with enrichment programs;

- on-site health services, with a well-child and adolescent clinic, prenatal care, immunization, and scheduled screening and referral for adults;

- adult education classes, including general equivalency degree courses on site and advanced courses at Morgan State College;

- employment services, with job-readiness workshops, employment counseling, testing and referral for occupational training, and a school-year summer jobs program for teenagers;

- family-support counseling, with workshops on parenting and family stress.

This coordination requires that someone pull together a host of different funding streams and programs. In the case of the Lafayette Family Center, officials in the city public housing authority also have been able to play the role of landlord, offering services that are a mixture of new and redirected resources. Private philanthropy has renovated the building to permit on-site services. Other capital costs and some operating expenses come from Community Development Block Grants. Employment and training services are funded out of the Federal Job Training Partnership Act. Day-care slots are jointly budgeted from state Investment in Job Opportunities funds and the Purchase of Care program in the Department of Social Services. The Health and Recreation Departments provide in-kind services and help with contracting out.

Another promising experiment is the widely publicized Beethoven Project in Chicago. Begun with support from both the U.S. Department of Health and Human Services and the Harris Trust, this project targets about 150 infants born in six high-rise buildings of the nation's largest public housing complex, children who will eventually attend the neighborhood's Beethoven Elementary School. The preparation of this future kindergarten class of 1993 begins before birth with prenatal care for the mothers. Health screening and continued health services follow after birth, together with day care, nutritional aid, and counseling for parents in child development. At age three the children will be enrolled in Head Start.

Learning from State Experience

By no means should family-support centers be regarded as limited to public housing or welfare clients in urban settings. In the past four years six states have initiated programs to extend their preventive resources to a wide variety of families. In Missouri, the Parents as Teachers program reaches 53,000 families; participation is open to any parent with a child under three. Monthly home visits and group discussion meetings among parents offer guidance on good child-development practices, while identifying and referring children who show signs of developmental problems. In Kentucky, a state where nearly half of the adults lack a high school degree, the Parent and Child Education Project offers parents and preschool children in twelve rural districts an opportunity to develop together. The program includes parent education and tutoring three days a week for a high school equivalency diploma.

Probably the most extensive state effort is Maryland's three-year-old system of Family Support Centers. This statewide network of eleven local centers is funded and guided by a public-private partnership composed of the state's Department of Human Resources, private foundations, and local communities. An umbrella non-profit corporation, Friends of the Family, coordinates the effort. Centers are community-based, with drop-in facilities aimed especially at serving all young families with children under age three. The centers offer parenting education, ongoing child-development assessment, help with education and job skill training for parents who lack schooling, access to health care (prenatal, reproductive, well-baby, etc.), developmentally appropriate child care, and assistance in arranging outside day care. The emphasis is on increasing parents' capacities to care for their children so as to prevent problems from reaching the crisis stage.

These programs should not be oversold. There are few research results on them and no guarantee that every one will register clear success in changing children's lives. The best programs, such as Maryland's, contain a central intermediary body that controls the standards of service and staffing and issues ongoing evaluations. These experiments could be testing grounds for the rest of the nation's social welfare practices, while national and state government policies could facilitate such experimentation and learning. The basic outline seems clear enough: Our systems of health care, nutrition services, day care, and child development should be connected and delivered to those children and parents who need them the most.

We recommend that state and local governments make a major effort to test and implement new approaches to family-support services that feature effective early intervention, parent education, and careful coordination of diverse public programs. We need a better link between government services at the state and local levels and private voluntary organizations.

The Federal government also has an important role to play in child welfare, and we recommend that steps be taken to:

- **provide adequate funding of programs like Social Services Block Grants, AFDC-Foster Care, those in the Child Abuse Prevention and Treatment Act, and those in the child-welfare services provisions of the Social Security Act;**

- **increase support for research on child-welfare problems at the National Institute of Child Health and Human Development;**

- **offer financial and informational support to state governments and local entities to help them improve their services to children in need and prevent the need for such services in the first place.**

The Cost of Our Proposals

The estimated cost to the Federal government of the recommendations in this chapter is $6.2 billion. We have indicated that two Federal programs geared to infants and children—WIC and Head Start—should be extended to a much broader group of children in need of help. In fiscal year 1988 Federal outlays for the WIC program totaled about $1.8 billion, and the program served 3.4 million people. The maximum potential number of people who could qualify for the program has been estimated at 6.5 million to 7.5 million, or about twice the number served today. If WIC were made an entitlement program, and all of the people eligible on income grounds actually qualified and participated, its cost would increase by $1.5 billion to $2 billion a year.

WIC. Households are eligible for WIC if they qualify as nutritionally at risk and have incomes up to 185 percent of the Federal poverty line. It is probable that in practice the population that participated would be limited by the nutritional-risk requirement and the likelihood that some who are eligible would not participate. Thus, the actual additional cost of making WIC an entitlement program would likely be less than the amounts noted above. To be on the safe side, however, we will assume that current costs double, and allocate an additional $1.7 billion for WIC outlays (see Figure 2.2).

Head Start. The Head Start program serves about one in five children aged three to five years old who are living in poverty, and only about one-fifth of those served are in full-day programs. Additional funding for the Head Start program could be used to cover more children, increase the proportion of children receiving full-day services, and extend coverage to children under three years old.

A report by the Congressional Budget Office suggested that the long-range impact of Head Start on such goals as increasing basic skills, avoiding crime, and finding employment is unclear as a result of the difficulty of finding adequate control groups. But the report pointed out that Head Start potentially could serve a number of more immediate purposes, including providing high-quality child care to children of working parents; increasing access to health screening, immunization, and a variety of social services; providing helpful cognitive stimulation to the children; offering employment and training to low-income adults; and making it possible for two parents to work.

Expanding Head Start will be more expensive than expanding WIC. The annual cost per child served under Head Start has been estimated at $2,400, compared with a little less than $500 for WIC. Serving as many needy children as possible through Head Start involves scaling up the program to serve the 80 percent not being served now, as well as having more children in full-day programs.

It is difficult to put a precise price tag on this effort at scaling up. Clearly, some parents of eligible children may choose not to enroll them in Head Start programs. Other eligible children may already participate in state and local programs or may have started kindergarten. A realistic goal for the early 1990s is to serve half of the eligible population that is not being served now. We estimate that it will cost $2 billion to meet that goal (see Figure 2.2).

Figure 2.2 Summary of Government Outlay Increases for Proposals to Help Children

Program	Outlay Increase	New Recipients
WIC	$1.7 billion	3.4 million*
Head Start	2.0 billion	0.9 million
Medicaid	1.0 billion	2.0 million
Chapter 1	1.5 billion	1.0 + million**
Total	$6.2 billion	7.3 million

*Assumes that most of the people eligible on income grounds will qualify and participate

**Rough estimate; the benefits of additional outlays are more students and longer periods of help per student

Health. Ultimately, all children and pregnant women in families below the poverty line ought to be covered by either Medicaid or a private health insurance policy. We are reluctant to advocate expanding Medicaid to the entire poverty population, which includes many families headed by a worker whom we hope to see covered under private health insurance (see Chapter Four).

The Medicare catastrophic illness legislation passed by Congress in 1988 includes provisions that make more low-income pregnant women and children under one year of age eligible for Medicaid. This is a useful first step, but we need to go much further. There are approximately 12 million to 13 million people living below the poverty line without health insurance. About 4 million of these are children under eighteen years of age. An estimated one-half of these children would qualify for the type of mandatory private coverage that we advocate below. The cost of providing Medicaid coverage to the remaining group of low-income uninsured children is approximately $1 billion (see Figure 2.2). It is important to note that this new coverage is "Medicaid only." It is not an extension of Aid to Families with Dependent Children (AFDC). We do believe that AFDC eligibility requirements should be updated. But we do not believe that an extension of Medicaid should be tied to AFDC.

Ideally, both Medicaid and employer-sponsored group health insurance ought to be broadened to assure health coverage for all Americans. It is important to put some restrictions on cash welfare assistance in order to maintain the incentive to work, though this goal can be met with higher cash assistance benefits than now exist in some states. But health coverage for the poor ought not to be held hostage to these necessary restrictions on cash assistance.

Chapter I. Chapter 1 of the Education Consolidation and Improvement Act of 1981 funds compensatory education programs for low-income and educationally deprived students. Evaluations of the Chapter 1 program have shown positive short-term effects on student performance, and some evidence suggests a favorable longer-term impact.

The real level of outlays per poor child for this program has fallen in recent years, as slight absolute increases in funding have not kept pace with the combination of inflation and the higher number of children living in poverty. The proportion of poor children served by Chapter 1 fell from 75 percent in 1980 to 54 percent in 1985. Outlay increases of $1.5 billion per year would make up most of the erosion in real benefits per poor child associated with inflation, and enable many school districts either to extend services to some newly poor children or maintain services for a longer part of some children's schooling (see Figure 2.2). That might help avoid the erosion of shorter-term gains that has been found in some evaluations.

Conclusion

Neither we nor any other group have solutions for all the profound problems of social welfare that shape the earliest stages of life in America. The amount of new government spending that we have recommended to help children in need—$6.2 billion—would go a long way toward meeting the needs of disadvantaged children. It is worth noting, however, that the recommended budget would not extend help to each and every child in need—a reflection of current budget realities and the value of learning as we go. We believe this investment in better opportunities for American children will produce great future benefits for our whole society.

Chapter Three

Young Adulthood: Preparing for a World of Work

Too many young Americans are failing to make an adequate transition from school to work. They drift aimlessly through their young adulthood—often with disastrous consequences. There has been a growing inequality between the prospects of those who attend college and those who do not. The latter are finding it increasingly difficult to obtain a decent job, start a career, and support a family.

Approximately one in four American teenagers leaves high school before receiving a diploma, and dropout rates are higher for minorities. An estimated 40 percent of Hispanic students leave before finishing high school, and among blacks in some urban areas the dropout rate is climbing toward 50 percent. Some individuals manage to obtain a high school equivalency degree later; however, there has been no progress in reducing the overall dropout rate during the last decade. High school dropouts are 2½ times more likely than graduates to be without a job, 3½ times more likely to be arrested for a crime, and 7½ times more likely to be dependent on public assistance.

Young males with less than a college education have had trouble in the labor market during the past fifteen years. The real value of their earnings has fallen sharply, their job prospects have become more marginal, and their ability to support a family above poverty levels has diminished. The proportion of eighteen- to twenty-four-year-olds counted "inactive"—i.e., not employed, not enrolled in school, and not in the military—has almost doubled during the past twenty years to approximately 12 percent for white males, and more than doubled to almost 30 percent for nonwhite males.

For girls, pregnancy is the most important reason for leaving school. By age twenty, approximately 20 percent of white teenagers and 45 percent of black teenagers have been pregnant—one of the highest rates of pregnancy for teenagers in the developed world. Because of the greater prevalence of abortions and contraception, fewer teenage girls are having babies today than thirty years ago, but more and more teenage mothers are unmarried and remaining so. The proportion of babies born out of wedlock to white girls between the ages of fifteen and nineteen rose from 6 percent in 1955 to 49 percent in 1986; for black girls, the proportion increased from 41 percent to 90 percent; for Hispanics the current figure is 45 percent. Teenage mothers are half as likely to graduate from high school as are other girls. The children of "child-mothers" generally have lower achievement scores, are more likely to repeat school grades, and are more frequently on welfare than other children.

Though today's labor market is tightening, the economic situation facing young adults *as a group* is improving because a smaller cohort of young people is entering the market. But because of the increasing skill requirements of jobs in all sectors of the economy, the cost of being poorly prepared for work is much higher than it was a decade or two ago. The problem today is not so much a lack of jobs, but rather a growing mismatch between the skill requirements of jobs and the skills that many young people bring to the labor market.

Experience has shown that skill training is not all that is required to reach many young people who are completely disconnected from our institutions of education and work. Reaching these youths requires finding ways to motivate them to have goals in life and to aspire to success. It also involves helping some of them obtain treatment and overcome problems related to alcohol and drug addiction. We should not underestimate the difficulty of these challenges.

The trends outlined above represent an immense challenge to the American systems of education, training, and social welfare—systems that are grounded in the concepts of work and personal effort. Through gainful employment, Americans expect and are expected by society to be able to make their way in the world and to build the first line of defense against the inevitable hazards of life. To enter adulthood unprepared for the world of work is to see access to opportunities and job-related protections slipping away.

Compound Problems, Intertwined Answers

The trends are ominous. A growing undereducated subgroup of teenagers will soon become a growing and underprepared work force.

Demographic trends indicate that the youth cohort—sixteen- to twenty-four-year-olds—is diminishing in size. By 1995 there will be fewer Americans in this age group than there were in 1979. At the same time, the pace of technological change and growing international economic competition demand that this smaller work force also be more educated, skilled, and productive.

The evidence indicates that this challenge will confront a work force containing a higher proportion of young adults from disadvantaged backgrounds. Given differences in fertility rates and immigration patterns, it is likely that by the year 2000, the proportion of sixteen- to twenty-four-year-olds who are in racial or ethnic minority groups will increase from one in six to almost one in three. Minority and economically disadvantaged youths today are much more likely to drop out of high school. If they do stay to obtain their diplomas, the education they have received generally compares poorly with that available in suburban schools and affluent neighborhoods. Minority and poor youth are concentrated in the bottom fifth of the score distribution on virtually every major standardized test used in this country. At the same time, college enrollment rates for blacks and Hispanics declined from the 1970s to the 1980s.

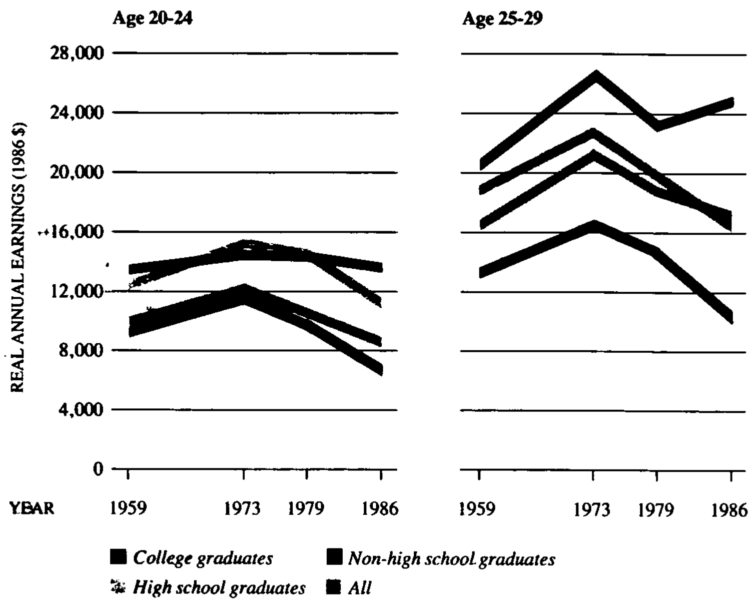
There was a time when many poorly educated teenagers could eventually make the transition from school to work through blue-collar manufacturing jobs and craft apprenticeships. Since the early 1970s structural economic changes have severely reduced this segment of the youth labor market. Today those whose formal schooling stops with high school are entering the service and retail trade sector of the economy at almost the same rates at which college-educated youths entered this sector in 1960. But the jobs the high school graduates find are now more often in the low-paid, unstable, dead-end segments of the service economy.

The problem is especially severe among young black males, but by no means is it confined to one race. In 1974 nearly half of the employed black men aged twenty to twenty-four were in what could be considered career manufacturing jobs (blue-collar craft, operative, foreman work); the real median income of black males in that age group had risen 68 percent since 1959. By 1984 only about one-quarter of black males of that age were in such jobs, and the real income for this age group had fallen 44 percent since 1973. For white males of the same age, real median income had risen 28 percent from 1959 to 1973 and fallen by 32 percent between 1973 and 1984.

There are really two stories here (see Figure 3.1). One has to do with the general sluggishness of U.S. economic performance from the early 1970s to the mid-1980s, and the way this adversely affected the incomes of all young people. From the 1950s to the early 1970s, each successive cohort of young workers could look forward to doing better than its predecessors. Because of the slowdown in U.S. economic growth after 1973, this is no longer true.

The second story concerns the growing split among young adults engaged in the transition from school to work. Since 1973 those with a college education have been better able to hold their own and in their later twenties even bounce back from earlier economic troubles. However, young people with only a high school diploma or less have seen their income positions continue to erode. By 1986—during the

Figure 3.1 Real Median Annual Earnings for Males in Their Twenties, by Schooling and Selected Years



Source: Andrew Sum, Neal Fogg, and Robert Taggart, *Withered Dreams: The Decline in the Economic Fortunes of Young, Non-College-Educated Male Adults and Their Families* (prepared for the William T. Grant Foundation Commission on Family, Work, and Citizenship, April 1988), Table 7, p.A-5.

fourth year of an economic recovery—young males with only a high school degree actually were earning 7 percent to 10 percent less than their counterparts had earned in 1959. Those without the degree were earning 20 percent to 25 percent less than their 1959 counterparts. Between 1959 and 1979, male college graduates between the ages of 25 and 29 earned 15 percent to 18 percent more than high school graduates of the same age. By 1986, the gap had grown to 51 percent.

Behind the bare statistics lies a complex pattern of social disorder. Changes in the U.S. economy are dealing a severe blow to the earnings capacity of many young men, particularly those with limited education and skills. This is one important factor in the formation of young families, as it dims the marriage prospects for young mothers and strains those two-parent families in which the breadwinners lack basic skills. The disadvantaged children of unwed mothers and poor two-parent families have become a growing proportion of the nation's future work force.

Between 1974 and 1985, the poverty rate for children in families headed by persons aged twenty to twenty-four rose from approximately 25 percent to almost 50 percent. A growing proportion of those families are headed by mothers who have never been married. Their limited schooling and their predicament as sole earners in the modern labor market mean that nearly 90 percent of their children are growing up in poverty. The web of misfortune does not touch only families headed by women. Among married couples headed by a man with only a high school education, a child poverty rate that was 6.8 percent in 1973 had tripled to 21.6 percent by 1986. In the years ahead, all of these disadvantaged children will be the ones with the most meager prospects for educational attainment and real economic independence.

It is important to emphasize that growing numbers of young Americans are trapped by a complex of interconnected problems: leaving school early, teen parenthood, welfare dependency, joblessness, delinquency, and an unstable family life. Too often in the past, attention and resources have shifted from one thread to another, with efforts directed at dealing with the concern of the moment—delinquency, illegitimacy, poverty, welfare dependency, unemployment, inadequate schooling. These efforts have led to a growing recognition that those in greatest need are suffering from not just one problem but many, and that greater effort, more resources, and more time will be needed to help them.

We view this complex problem as the Achilles heel of our society. Many approaches to dealing with disadvantaged youth have proved promising—one-on-one mentoring, after-school remedial help, summer jobs, and others. But when all is said and done, we must soberly admit that we simply do not have any magic answer for reaching young people. We know that training helps, but it is not a panacea. We know that values and motivation are important, but these elements cannot be imposed from the outside—they must grow from within a community.

In short, we can and should do all we can to prepare our youth, to lead them to the starting line. But we cannot run the race for them. The motivation to do this must come from within. Unhappily, there is no quick solution for interwoven problems that have been generations in the making. By urging recognition of this fact we are not counseling despair but realism. The first step is to transcend the intellectual stereotypes and divisions of the past.

Many local communities, neighborhood and church groups, private businesses, and grass-roots leaders have become more realistic in their approach to pressing social problems. Should programs for school dropouts or teen pregnancy be preventive or rehabilitative? Any sensible program must be both. Should initiatives be public or private? Again the answer from the front lines is that public institutions like schools must work more closely than ever before with private business leaders and volunteer groups. Should we have national or local programs? Once again, realism demands both. Without an adequate and sustained flow of national resources, local initiatives in poor communities too often die for lack of funds; without the commitment of local leaders, the programs remain empty bureaucratic shells.

This chapter offers no blueprint for all communities to follow. However, the essential concept is clear enough: Expanding the future life options of young men and women who are troubled by multiple problems requires more than one-dimensional treatments of particular symptoms. Effective programs must offer help that embraces basic skills, training (including English as a Second Language for Hispanics and others), employment, pregnancy prevention, and realistic planning for the future. No program can prevent all individual misfortunes, but policies can and should try to prevent problems from compounding to the point at which any real hope of a better life is extinguished.

Even as we encourage this kind of multidimensional, community-based approach to investing in American youth, one area calls out for immediate attention—the vital need to rid our youth of the plague of drug and alcohol addiction. Although we have no easy answers, **we recommend that drug and alcohol treatment on demand be made a reality in this country, not just for youths, but for all Americans.** We have generally avoided recommending new entitlement programs in this report, **but one entitlement we do need is the guarantee of help in overcoming addiction for all who seek it. We also recommend further research, demonstrations, and evaluations of innovative programs to help solve this critical problem.**

Reducing School Dropout Rates

Dropping out of school is typically a direct route into unemployment or at best an unskilled job with little potential for growth or real security. One study has found that more than one-quarter of male dropouts and nearly one-third of female dropouts are without jobs, and of those working, only a small fraction have skilled jobs. Teenagers quit school for a variety of reasons: lack of interest and motivation, family problems, peer pressure, the lack of positive role models, disgust with bad schools and teachers, poor self-esteem, academic failure.

Reducing the school dropout rate requires a blending of programs that attempt both to improve schools and stimulate individual students who are at risk of failure. Success hinges on making better opportunities available to young adults, increasing their awareness of these opportunities, and providing clear incentives for them to seize the opportunities. In short, there must be real and personal rather than bureaucratic and impersonal reasons to stay in school.

Today's most promising dropout-prevention programs are characterized by concerted action aimed at expanding the life options of disadvantaged youngsters. This is achieved in several different ways. It is too early to prove scientifically which of the current efforts are effective, but the early returns are generally positive. Communities across the country need to learn from these programs and develop their own set of coordinated actions. The general types of programs are briefly outlined below.

Educational Incentives for Youth. Some programs are attacking the school dropout problem directly by offering personal incentives to remain in school. They are usually funded by contributions from businesses, wealthy individuals, or universities.

Incentive Programs to Keep Students in School

Students graduating from East Harlem's Public School 121 (an elementary school) will receive college tuition if they complete the next six years of school and graduate from high school. This program, started by businessman Eugene Lang, also features counseling, student activities, and more student decision making. The program led to the establishment of the "I Have a Dream" Foundation that is helping about twenty other cities form such programs. In January 1988 New York Governor Mario Cuomo proposed a new statewide Liberty Scholarship Fund modeled along the lines of the Lang incentive program and made a public commitment to halve New York's dropout rate during the next five years.

The city of Cleveland is experimenting this year with a new program placing college tuition grants aside for students who achieve specific grades in high school. In Cincinnati, the Kroger Company has launched the Partnership in Education program with the Washington Park Elementary School. Students receive financial awards from the company for good attendance, good grades, and staying in school. The funds are applied to college tuition.

The importance of these investments lies in their ability to signal opportunity and to stimulate continuing efforts by saying to teenagers that somebody cares whether they finish school. The message is clear: "If you exert the effort to stay in school, maintain regular attendance, and get decent grades, we will see to it that your effort pays off." This type of deal links individual and social responsibility so that opportunity is created—but it must also be earned.

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School-Based Reforms. New programs are developing to improve schools by decentralizing decision making so that it takes place at the level of the individual school. Principals and teachers are allowed more autonomy and independence, and teachers are given greater freedom to develop innovative programs for students in and outside the classroom. For example, in Florida's Dade County, twenty elementary, middle, and secondary schools and nine "magnet" schools—which draw students from a broad region into one school on a competitive basis—are participating in a new four-year project in decentralized, school-based management. This experiment features a curriculum geared to individual student needs, budget decentralization, and an enlarged role for collegial teacher decision making at the local school level.

Some communities are making teachers more accountable for their performance and connecting performance to career ladders. These new approaches try to break away from the top-down, bureaucratic control of large public school systems. It is important to chip away at the stifling rigidity and inertia of many school systems. It is equally important to reassert the once controversial but increasingly accepted notion that there are good schools and bad schools. Parents and officials need to pressure the bad schools to improve, and to reward that improvement when it occurs.

Collaborations Between Schools and Businesses

There are also encouraging signs that the business community is taking a more active interest in the quality of public schools. Schools and businesses share an interest in preparing young adults to hold jobs in today's economy. In recent years, their common concerns about the quality of schools and the quality of new workers have led to a wave of collaborative endeavors. A United States Department of Education survey of 9,000 school districts in 1984 showed that 22 percent had one or more active school-business partnerships. Most of these are "adopt-a-school" activities undertaken by local businesses, but some involvements are much more extensiye.

School-business collaborations alone cannot revitalize depressed schools and school systems. Change must be anchored in the educational system itself—broadly defined to include teachers, administrators, community leaders, and concerned parents. However, the business community can become a powerful catalyst for improvement. The number of systematic, sustained efforts by business is growing, although much more needs to be done to focus school-business partnerships on serving the most at-risk, disadvantaged youths.

Educational Efforts Sponsored by Businesses

In Lawndale, Illinois, Chicago business leaders are developing a new privately funded school. Founder Joseph Kellman, president of [illegible] Glass and Mirror Company, has initiated Corporate/Community Schools of America, a group that proposes to open business-directed schools in other cities if the Chicago experiment proves successful.

Other initiatives funded or sponsored by businesses include Rich's Academy in Atlanta, an alternative high school for dropouts and low achievers who cannot function in a regular school setting; John Hancock Company's program to provide a range of services to English High School in Boston, including tutoring, career counseling and school renovation; and Honeywell's effort to tutor minority students who are having academic difficulty in the Virginia suburbs of Washington, D.C.

The Valued Youth Partnership program in San Antonio, cosponsored by Coca-Cola and the Intercultural Development Research Association, identifies high-risk students as "valued youth" and gives them an opportunity to serve as tutors of younger children. Since the program was implemented, absenteeism has declined; the dropout rate is lower; and the student tutors' grades, self-image, and behavior have improved.

The evidence suggests that serious school-business partnerships have achieved some modest success in their efforts to increase school attendance, reduce dropout rates, and improve academic performance. In its initial years the Boston Compact has witnessed a 6 percentage-point increase in the high school attendance rate, a 14-point increase in those city schools with the worst attendance rates, and substantial districtwide improvements in reading and math skills. However, the unchanging 43 percent high school dropout rate has led the compact to devise new strategies. The Philadelphia Academies, which deal exclusively with disadvantaged students, have achieved attendance rates that exceed 90 percent and high school graduation rates of approximately 80 percent. These are substantially ahead of the districtwide high school average (75 percent and 67 percent, respectively).

All of these programs illustrate the importance of self-esteem and a sense of purpose in achieving academic success, especially for those youths who already are not doing very well in life and who usually lack individual teacher attention and additional school support services. Business-school partnerships cannot work miracles but they can add an important impetus to school reform. Many public schools can also do much better by combining an emphasis on the life goals of disadvantaged students with mentoring, counseling, and a more innovative approach to the curriculum. Alternative schools may best draw out the abilities of students who are more deeply estranged from the existing educational system. **Various combinations of school reforms and business partnerships should be pursued to ensure that we do not give up on disadvantaged youths.**

Partnerships Between Schools and Businesses

A recent national survey highlights nine school-business partnerships that are being [illegible] praised. The most well-known is the Boston Compact, [illegible] in 1982. The compact is an example of a partnership aimed at a citywide school system, rather than a business-to-single-school relationship. It represents an ongoing agreement between business, education, and community leaders that specifies [illegible] goals for business in exchange for measures of educational improvement in the city schools. The program [illegible] on summer jobs, apprenticeship programs, scholarships for postsecondary education, and other help with the school-to-work transition. Special programs include younger, dropout-prone students, but [illegible] are directed toward older youth. Recently the National Alliance of Business [illegible] provided grants to seven other communities [illegible] [illegible] Boston Compact. Other [illegible]

Other partnerships are more student-focused in the sense of serving smaller groups of carefully targeted youths, usually with special classes and part-time jobs outside the traditional high school curriculum. The New Horizons program started in Richmond in 1980 and the Teen Opportunities program begun in Birmingham in 1981 are examples. The Philadelphia High School Academies program is unique in that it serves disadvantaged students during all four years of high school.

The four Philadelphia Academies (Business, Electrical, Automotive, and Health) offer a structured curriculum with few electives and an emphasis on both basic skills and vocational training, together with work experience in the junior and senior years. The academies are housed in ten comprehensive high schools and enroll 1,200 to 1,500 students. Academy students are drawn from those with low academic achievement records, test scores in the twentieth to fiftieth percentile within the district, and moderate to good school attendance records in the past. More than 100 city businesses are involved, providing substantial financial support, job placements, and advice on curriculum and program development.

Integrating Remedial Education, Work Experience, and Life Options Services. A number of models are emerging across the country that combine remedial education with part-time work and other services. Some programs focus on helping dropouts return to school or obtain graduate equivalency certificates. Other efforts are geared more to helping disadvantaged, non-college-bound students make a successful transition from school to work. In a variety of sites, experience is revealing effective strategies for action. The most promising programs offer a combination of services and have a centrally placed, core leadership that is responsible for setting clear standards, adopting methods that have been tested by experience, training staff on-site, and maintaining quality control.

The Summer Training and Education Program (STEP). This is a successful attempt to weave remedial education together with other necessary services. Although advantaged and disadvantaged children learn at about the same rate during the school year, the skills of disadvantaged children erode during the summer. Advantaged children generally score higher on standardized tests at the end of summer than they did at the beginning, but low-income children fall farther and farther behind, as home and peer influences often displace learning gains achieved in the school year. STEP is designed to stem the "summer learning loss" phenomenon by combining work, education, and counseling.

The STEP experiment has shown better results in each of its three years. In the summer of 1985 the first group of approximately 1,500 participants outscored the control group in both reading and mathematics by about one-quarter of a grade equivalent. Although that was progress, it was not enough to counteract summer learning losses entirely. By 1986, the first year of a two-summer involvement with the second group, STEP was able to stem the learning-loss phenomenon completely. Indeed, STEP's results with the second cohort were more than double those of the first. Most of the learning loss was avoided in reading, and in math participants registered a small gain over the summer. By the third summer, participants achieved a net gain in the level of their academic skills that was equivalent to one-half a grade level, more than gains experienced by similarly disadvantaged youth who were not in the program. Moreover, the program has had positive results with both black and Hispanic youths.

Although results are preliminary, it seems quite possible that by simply avoiding the learning losses that would otherwise occur in two or three summers of ado-

[illegible]

cerned with "life planning." The latter sessions seek to show the connections between the cost of raising a family, the kinds of jobs needed to support a family, the education necessary to obtain such jobs, and the effect of early pregnancy on life goals.

The project began operations in 1985 and has functioned for three summers. Participating schools normally provide academic credit for gains made during the summer and offer follow-up activities to help participants sustain these gains during the next school year.

The Comprehensive Competencies Program (CCP)

Developed by the Remediation and Training Institute, CCP is a self-paced learning program that maximizes the amount of time students spend on clearly specified learning tasks as well as the amount of time teachers can spend with individual students. Its educational materials are based on approaches that have been proven through research to be effective in reaching disadvantaged individuals. This curriculum is combined with the business world's technique of franchising to ensure efficient delivery of uniformly high-quality-services.

CCP is now being used in 250 learning centers by a variety of community-based organizations, private industry groups, secondary and postsecondary institutions, and it reaches 30,000 teenagers and adults annually. The CCP program uses a comprehensive array of instructional techniques, including computer exercises, workbooks, audiovisual devices, supplementary readings, and personal teacher assistance. A new English-as-a Second-Language (ESL) program is currently being disseminated in the system. Most organizations combine CCP with other training and work experience.

lescence, disadvantaged students could pick up at least one grade level and reduce the amount of time teachers must spend reteaching what has been forgotten between school years. STEP also appears to be having strong positive effects on sexual knowledge, attitudes and behavior—thereby reducing pregnancy rates among fourteen- to sixteen-year-old girls.

A persistent problem in many efforts to keep disadvantaged youth in the mainstream has been a lack of sustained good management and quality control in the various programs. Too often, decentralization has translated into failure to use techniques of remedial instruction that have proven effective. The Comprehensive Competencies Program (CCP) is a valuable illustration of how local initiative can be combined with business efficiency and professional educational competence. CCP provides quality remedial education materials and support services to a wide variety of local groups, using techniques that have been proven effective by social science research.

The results show that disadvantaged students with multiple problems and a record of failure in other settings can achieve significant learning gains. CCP enrollees include many dropouts, single parents, delinquents, welfare recipients, and members of minority groups. During twenty-eight hours of total instruction time they gain an average of one grade level in reading and 1.4 grades in mathematics. Impressive results also have been shown with a newly developed program for Hispanics with a limited knowledge of English.

Teenagers who are headed neither for college nor for a clear vocation are too often neglected. Although they will soon be leaving school, they generally receive

JAG for High School Seniors

JAG began in the state of Delaware in the late 1970s, and since then has expanded its operations to thirteen states serving 12,000 students annually in more than 275 high schools. The JAG Board of Directors is made up of state governors, education commissioners, business CEOs, and labor leaders. Emphasis is placed on creating statewide school-to-work transition programs and drawing upon the leadership of governors and state commissioners of education and labor. Six state legislatures currently provide special appropriations to support JAG.

Each local JAG program targets high school seniors who are identified by school officials and JAG staff as being most at risk of dropping out or becoming unemployed after graduation. These are usually general education students who have not enrolled in college preparatory or vocational education courses, who have little employment experience, and whose grades are average or below average.

Most classes are offered as an integral part of the school day. JAG offers a curriculum and testing system that requires the mastery of twenty-nine employment-related competencies. It is based in part on CCP materials. In addition to a common curriculum, each local JAG program provides career counseling, instruction in employment competency, job placement services, and nine months of follow-up services after graduation.

little if any instruction about the world of work, career options, or job-search techniques. High school counselors and others in the educational system usually spend little time with them. Jobs for America's Graduates (JAG) tries to fill this gap. It is probably the largest school-to-work transition program for non-college-bound youths, and it is certainly the largest to gain the support of state governments.

JAG is a formal school-to-work transition program that seeks to link work at school with work in the labor market. Research has shown that the ultimate success of the program depends on the amount and the quality of time that a job counselor spends with each student. Often these counselors not only help with career planning and direct job placement but also coordinate special educational help for those students who have low basic skills.

Evidence for the success of the program has accumulated during the last eight years. When JAG participants are compared with a control group, the JAG students have more consistent work records, are twice as likely to be employed (72 percent vs. 36 percent), earn 25 percent higher wages, and gain greater increases in their incomes—20 percent annually and more than 50 percent for minorities. Overall, those benefiting from JAG are 86 percent more likely to be working full time after high school graduation than comparable groups. The results appear strongest for seniors who are most at risk of failing to make the transition from school to work—minorities, those who have never worked before, those from welfare families, and those who have a record of low achievement in school.

Reducing the Number of Teen Pregnancies

No discussion of the problems of young adulthood can be complete without considering teen parenthood. More than one million teenage girls become pregnant each year in the United States, and nearly 470,000 give birth. Teenage pregnancy rates in the United States are significantly higher than in most other industrial countries. It is particularly disturbing that U.S. girls *under* age fifteen are five times more likely to give birth than young adolescents in any other developed country for which data are available.

Generally speaking, the fact that mothers are teenagers tends to dampen the life prospects of both the mothers and their children. There is evidence that, compared with those who have their children later, early childbearers are much more likely to experience economic hardship and family disruption in later life, to drop out of school, and to fail to find stable and remunerative employment. An increasing proportion of teenage mothers are becoming welfare recipients under the Aid to Families with Dependent Children (AFDC) program. Moreover, these unmarried young mothers and their children make up the bulk of those who stay on the welfare rolls for extended periods. In 1985 welfare, Medicaid, and Food Stamp costs for families begun by births to teenagers were $16.65 billion.

Although early motherhood clearly affects chances for the socioeconomic success of young women, it by no means dictates the results. A recent study by sociologist Frank Furstenberg tracked teenage mothers for seventeen years in Baltimore, revealing that the best word to describe the subsequent life patterns of teenage mothers is "diverse." These women follow several different paths to recovery from the initial setback to economic self-sufficiency that results from early motherhood. About half eventually make it into the middle class as adults.

Furstenberg's study also found that informal support networks, parental support, and role models were very important elements in teenage mothers' achieving economic independence. Other factors that work in a mother's favor are strong motivation and self-image and staying in or returning to school. Indeed, decisions to complete high school and to postpone additional births are crucial. According to Furstenberg's study, programs such as that of Baltimore's Poe Alternative School and Sinai Hospital, which offer comprehensive medical and social services to improve prenatal and neonatal care, are successful in changing behavior (e.g., using contraception) in ways that increase the mothers' likelihood of staying in school and postponing further pregnancies.

For many young women in the United States, the delivery of a first child leads to their first contact with the social welfare system. If that system provides immediate health-care services and helps a young mother learn parenting and job skills, there is every reason to hope that she and her child can become self-sufficient and comfortable.

This evidence from Furstenberg's study indicates that staying in school, getting a job, and developing skills *can* make a difference for young mothers—even if they are temporarily trapped in a cycle of poverty and dependency. The "children of children" may face tough odds, but they are not doomed to failure, and their prospects for success hinge not only on their own ability, but also on the degree to which their mothers are helped to overcome the disadvantages of early parenthood. Studies have shown that family background—above all, the educational attainment of the mother—is a crucial determinant of a child's life chances. Clearly mother and child must be helped together, with equal priority given education and remedial help for the parent and the child.

At the same time, local program operators report that, in comparison with twenty years ago, they are now having to deal with a much more difficult group of troubled teenagers who are experiencing multiple problems, are without family supports, and are often caught up in drugs. Any realistic approach must acknowledge that teenage pregnancy is not a self-contained "problem" but part of a complicated pattern of personal and social disarray. If all pregnant teenagers suddenly became married or if their pregnancies miraculously disappeared, we would still be left with the same millions of young people—both girls and the boys they could potentially marry—who are lacking a basic education, are ill-equipped to function in the modern labor market, and are otherwise unprepared for adult responsibilities.

Unfortunately, attention to the real problem is too often obscured by a fruitless debate between those who claim that information, counseling, and contraceptives are the answer and those who contend that these measures simply encourage sexual activity among teenagers, who would benefit from instruction on abstinence and moral values. There is much reason to believe that a successful effort to reduce the number of teenage pregnancies will require both increased knowledge about the consequences of sexual activity and greater personal motivation to use that knowledge in realistic, constructive planning for the future.

The most successful school clinic programs are not simply contraceptive dispensaries, but also offer comprehensive health care, counseling, and education for adolescents. The number of school-based clinics has grown rapidly in the last few years, totaling 124 schools in thirty states by 1988. Although research results are preliminary and more evaluations need to be done, there is good evidence from some sites, particularly St. Paul and Baltimore, that school-based, comprehensive health-care programs do reduce the incidence of pregnancy in teenagers. Similarly, major studies of teen pregnancy make it clear that sex education must encompass more than just information about sex or contraceptives. It must extend to the attitudes, motivation, and behavior of boys as well as girls. Amid the pressures of peers and the media, young people should be taught to think clearly about personal sexual behavior and the relevance of pregnancy to the achievement of personal educational and occupational goals.

New, realistic programs to help reduce the number of pregnant teenagers include: peer counseling to encourage teenagers to postpone sexual activity; community-based and school-based clinics that offer health-care services and counseling on the use of contraceptives; family life and sex-education programs; and enhancement of self-esteem through athletic activities and the performing arts. One such program is the Multi-Service Family Life and Sex Education program in New York City. This project helps about 150 adolescents and their parents with counseling sessions, educational assistance, and job experience. An experimental three-year project began in 1988 on Chicago's South Side and in Newark and Camden, New Jersey, focuses on teenage parents who are already on the welfare rolls. This Teenage Parent Demonstration emphasizes not only the obligation of such young people to work toward their economic self-sufficiency, but also the public assistance system's responsibility to provide services and support. Case managers help participants fulfill plans for continued education, skills training, and work experience. These efforts are linked to child care, medical services, parenting education, family-planning workshops, and housing assistance. The program also seeks to enforce child support from absent fathers by establishing paternity, acquiring support awards, and offering job-search and placement services to fathers. Teenage parents are part of the larger body of families that need active support in caring for children. Although especially vulnerable, they are but one more example of a situation in which social welfare policies must improve parents' ability to care for their children, rather than waiting until childrearing failures compound the problems. Programs such as Maryland's Family Support Initiative (discussed in Chapter Two) are particularly relevant to the problems of pregnant teenagers.

It is vitally important to develop a two-part strategy. The first part would encourage teenagers not to become pregnant. The second would help teenagers who do become parents to return to school while learning how to be good parents and providers. Programs featuring services to teenage mothers—ranging from counseling on nutrition and health to day-care services in the public schools—need to be designed to help avoid welfare dependency and keep young mothers in the mainstream of society. We must provide these services even as we encourage

fathers to contribute to their children's upbringing and—through education, training, and employment—help put them in a position to experience the benefits as well as the responsibilities of two-parent families.

Coordinating Efforts

The examples cited in this chapter carry an important message: We ought to invest in human capital with the same entrepreneurial spirit and concern for long-range payoffs that venture capitalists bring to investments in new enterprises. No sensible investor expects every initiative to succeed or every investment to pan out. But if we are to have a viable economy and society, we simply cannot afford to write off a major chunk of the coming adult generation.

Clearly, we must also bring better management techniques and quality control to efforts aimed at preparing youth for the world of work. At present, responsibility for addressing needs among the huge and growing number of young people who lack the educational and occupational skills that are required to become productive citizens is—to put it mildly—unfocused. The tendency has been to isolate self-contained "problems"—educational deficiency, teen pregnancy, joblessness, family disorders, and so on—then to fund isolated programs run by self-contained agencies. As a result, efforts to deal with adolescents at risk of failure are typically piecemeal, dominated by short time frames, inadequately funded, and uncoordinated. A realistic policy is possible, but Federal, state, and local levels of government should be responsible for coordinating the various programs.

Efforts to help disadvantaged adolescents may draw upon many Federal programs, including the Job Training Partnership Act (JTPA), the Job Corps, summer jobs programs, Chapter 1 of the 1981 Education Consolidation and Improvement Act, and the Magnet Schools Assistance Program. Chapter 1 offers funding for educational services to disadvantaged students and the handicapped. **Funding should be increased to restore the real value of previous commitments in the Chapter 1 program. The growth of private-sector initiatives and public-private partnerships is no excuse for failing to fund federal programs adequately. Far from being incompatible, a community-level approach and sustained national funding are necessary to each other. We believe that efforts to slash funding for Federal programs aiding disadvantaged adolescents should be resisted.**

State governments are potentially in an excellent position to advocate coordinated approaches and proven practices because they generally have the legal and regulatory powers to guide local programs in education, child-welfare services, juvenile justice, vocational education, and other areas. Unfortunately, apart from campaigns against alcohol and drug abuse, most state governments have not yet seized this leadership opportunity. Although no one should underestimate the political and bureaucratic obstacles to state-level action, these obstacles are not insurmountable. Such states as Oregon, California, and Massachusetts have launched important efforts that have improved the management and delivery of services to at-risk youth. Moreover, in the past decade many state governors have shown they can take the lead in promoting educational excellence.

Reforms have raised academic standards and graduation requirements all across the country. These worthwhile efforts, however, can easily have the unintended consequence of making it more difficult to find educational alternatives for young people who did not do well even at the lower standards. It is time for states to make a similar "quality" commitment to helping below-average students. Under existing law, state governments have some discretion over Federal money that could do much to energize and shape local creativity. JTPA allows states to use 6 percent of total JTPA funds for incentives and technical assistance and 8 percent to improve ties between job training and the educational system. Governors may designate local service delivery areas for job training, review local plans, and control 22 percent of their allocations of Federal job-training dollars. And under Chapter 1 of the 1981 Education Act, state governments have authority to write the rules for how these Federal funds are used to help educate disadvantaged students.

We recommend that state governors and legislatures use these and other opportunities to leverage local action in a concerted, sustained attack on the problems of young people who are at risk of failing to make the school-to-work transition. Drawing upon the experience of the few states already active in this area, we **recommend the creation of interagency state youth councils composed of senior officials from educational, job training, and human service agencies. Such councils should be charged with developing strategies to coordinate service delivery, share information, and maintain continuity and quality control in local programs for at-risk youth.**

Local communities must take prime responsibility for designing and coordinating better programs to prepare young people for the job market. Localities do, of course, differ, but the examples in this chapter illustrate the basic elements that are necessary for success. These elements include:

- the use of schools as centers for delivering integrated services to adolescents;

- early detection and early interventions that forestall problems instead of merely reacting to them after the fact;

- willingness to recognize the interrelated nature of such problems as leaving school, teen parenthood, unemployment, and welfare dependency;

- positive incentives and life-option counseling, so that young people have personal reasons to succeed in school and work;

- private-sector involvement in educational and employment programs, together with adequate funding of public-sector programs.

We recommend that every community consider establishing a committee composed of school, job training, and business representatives. Such a committee should be charged with assessing the state of the community's resources and opportunities for young people and developing an action plan to deal with the deficiencies.

Conclusion

The problems explored in this chapter are most concentrated in inner-city areas and among the poor, but they are certainly not confined to those areas or groups. The educational achievement of all young Americans has deteriorated in recent years. A depressingly high proportion finish high school only marginally literate and wholly unprepared for the labor markets of the future.

We have not discovered any sure bets or easy strategies for addressing the cluster of problems that include teen pregnancy, school dropout rates, and deficient basic skills. There are promising models in selected communities, but they cannot and should not be transformed overnight into national programs. What works in Baltimore may not work in Phoenix. Nevertheless, models can be emulated and adapted to varied local circumstances.

In a recent publication issued by this project*, Gordon Berlin and Andrew Sum offered a simple litmus test to gauge the need to invest in young people. "If your child were falling behind in school, would you think it important to get him or her

**Toward A More Perfect Union: Basic Skills, Poor Families, and Our Economic Future* by Gordon Berlin and Andrew Sum. Occasional Paper 3, Ford Foundation Project on Social Welfare and the American Future. New York: Ford Foundation, 1988.

extra academic help in the evenings, the weekends, and during the summer? If we as a nation want to begin improving our rate of real economic growth, restoring growth in real wages and real family incomes, and reducing poverty and disparities in the incomes of various racial and ethnic groups, we should do no less for all of our nation's children."

The initiatives we call for in this chapter do not rely heavily on new Federal spending programs. The single exception to this is our call for funding drug and alcohol abuse treatment for all who need to seek it; we have recommended that $1 billion be earmarked for that effort. This does not mean, however, that the ideas presented in this chapter carry no price tag. Many of the models we have described will require a commitment of community resources. States, cities, private businesses, and voluntary organizations will have to find new funds—and redeploy existing ones—to improve basic skills, help young people stay in school, and promote more successful transitions from school to work. If these efforts are to be effective, Federal programs *must* complement and support them.

Because it has not invested sufficiently in its youthful human capital, American society is now faced with a major salvage operation. An important part of the nation's future depends on the success of this effort.

Chapter Four

The Working Years: Increasing Economic Opportunity and Social Protection

The American ethos stresses the importance of pursuing individual opportunity through work. At the same time, work traditionally has enabled employed persons to weave sturdy safety nets that protect themselves and their families by a combination of government social insurance (Social Security and Medicare) and employer-provided benefits (private pensions, group health plans, and disability insurance).

There are two problems with this system: It excludes too many people, and it was designed long ago and needs a thorough overhaul. Approximately 2 million Americans work full time all year, while remaining below the official poverty line. When their children and other family members are included, some 6 million impoverished Americans live in family units in which someone works full time twelve months a year. This is a problem that affects single- and two-parent families alike. For example, during the past decade increases in the Hispanic poverty rate have been chiefly due to lower real incomes among Hispanic workers in two-parent families. About 24 million workers and their dependents risk personal financial disaster because they have no health insurance coverage whatsoever. Further, only about 30 percent of more than 6 million people who are unemployed receive any unemployment compensation; this is the lowest proportion in the program's fifty-year history.

Current policy puts too little emphasis on work opportunities. At the same time, it provides too little protection for those who are seeking work or working at low-paid jobs. Recently passed Federal welfare reform measures begin to move in the needed direction, but much more should be done to improve the incomes, opportunities, and social protections of American workers. We believe that creating an appropriate work-based response depends less on designing one big program and more on putting together many different components of social support for Americans during their working years.

Economic Growth: A Necessary but Not Sufficient Condition

Vigorous economic growth is not a panacea for all social problems, but it is an important precondition for achieving the goals presented in this report. Only a strong economy will generate a supply of jobs that complements much-needed investments in children and young people. A vigorous economy is also vital to the peculiarly American system of employment-related social welfare protection. To benefit from work-based "credits" and social insurance, one must first gain access to them. Providing sufficient access requires generating enough jobs for the working-age population.

There is a clear relationship between the pace of economic growth and the reduction of poverty rates. Slow growth during the 1973–83 decade increased poverty rates by 4.5 percentage points and reduced by about 20 percent the share of the total national income that the poorest fifth of the population received. A stagnant economy leaves our social welfare system with unmanageable "zero sum" choices. Any addition to the standard of living for one group must come from a reduction in the living standard of another group. Strong economic performance makes it much easier to meet one set of social needs without reneging on other commitments.

For all these reasons, a solid social welfare policy for the United States depends on a sound economy. Unfortunately, between 1973 and the mid-1980s the U.S. experienced higher than normal rates of unemployment, stagnant real wages per worker, and sluggish productivity. Annual productivity increases, which had averaged 3.3 percent between 1947 and 1965 and 2.5 percent between 1966 and 1973, slowed to less than one percent between 1974 and 1982. After rising throughout the postwar years, wages adjusted for inflation stopped growing and in some cases actually declined from 1973 through the mid-1980s.

Economic stagnation created greater inequality among Americans in terms of their lifetime prospects for material well-being. Following the early 1970s, fewer jobs paid enough for their holders to afford a middle-class standard of living. Those who had already attained such a standard often could not keep up, while those who had not attained it had to struggle harder and more often failed.

In the past two or three years there has been some improvement in economic conditions. Real output and productivity have grown at a brisk pace, and the depreciation of the U.S. dollar against the yen and several European currencies has helped spark a recovery in exports. Job growth has been substantial and unemployment is relatively low. Demographic forces portend tight labor markets in the future.

Yet during the past ten to fifteen years, the growth in real wages per worker has remained less robust than in the earlier postwar period. Furthermore, it has become increasingly apparent that even in tight labor markets, when the labor force is more or less fully employed, people with limited education and deficient basic skills continue to suffer. Indeed, the problem we face today is not so much slack demand or sluggish overall productivity as the number of new entrants into the labor force who are simply unqualified for work. That is why this report puts so much emphasis on education and training.

As earnings per worker have failed to increase very much since the early 1970s, the struggle to maintain living standards has taken several forms. The number of workers per household has increased. By 1985 more than half of all women of working age were in the labor force, compared with about 35 percent in 1944, which was the peak of World War II, a time when many women were drawn into the work force.

By delaying childbearing and having fewer children, Americans, on the average, have reduced the number of family members who must be supported by a single income. They have also been saving less and borrowing more to finance their consumption in the 1970s and 1980s. In the 1985–88 period, personal savings as a percentage of disposable income have been in the range of 3 percent to 5 percent. That compares with 5 percent to 9 percent during most of the postwar period. Similarly, in the late 1980s the United States switched from being a creditor to a debtor nation, annually borrowing from abroad sums equal to more than 3 percent of its gross national product. These funds have not been used to raise the level of investments but to cover huge Federal deficits and thus finance further domestic consumption.

Clearly, social and attitudinal changes, along with economic pressures, drive such long-range trends as the rise in female participation in the labor force, the decline in childbearing, and the reduction in savings. To some extent, however, these trends reflect adjustments made by American families to the squeeze on the real earnings of their primary breadwinners. These changes will not keep the proverbial wolf from the door forever. While the effects of economic stagnation may be postponed, they cannot be made to disappear. One cannot continue borrowing in order to consume and expect that the bills will never come due. The nation has already mortgaged a significant part of its future growth in the 1990s simply to service the debt it owed to foreign creditors in the 1980s.

The fact that the economy has picked up in the past couple of years is encouraging, but it is no cause for complacency. On the contrary, the current period, which has been characterized by tightening labor markets and continued employment gains, provides an excellent opportunity for action. Many of the recommendations offered here would be harder to accomplish in a slack economy with high unemployment.

This is not a report on economic policy as such; however, there is no escaping the fact that viable social policies must be built on a solid foundation of prudent economic management. This means facing up to some unpleasant but necessary realities: **The Federal deficit should be reduced through steps that achieve real long-term savings rather than one-time or illusory savings. Policy makers must be willing to make politically difficult changes in our entitlement programs, our discretionary non-defense programs, and our non-critical national defense outlays. Citizens must stand ready to provide the revenue necessary to finance national commitments.**

We are spending about $150 billion a year just on the interest on the Federal debt. This enormous cost of servicing our government's debt robs money that might be used for our vital social welfare needs. The mounting debt foists costs that we should be paying ourselves onto our children and grandchildren, and will hamper their capacity to meet their own needs down the road.

A more responsible fiscal policy will permit a more expansionary monetary policy, and this combination should help create jobs. Reducing the Federal debt will take some pressure off our meager private savings. But **we will still need to arrest the decline in savings and to increase our investments. This means that consumption will have to grow more slowly.**

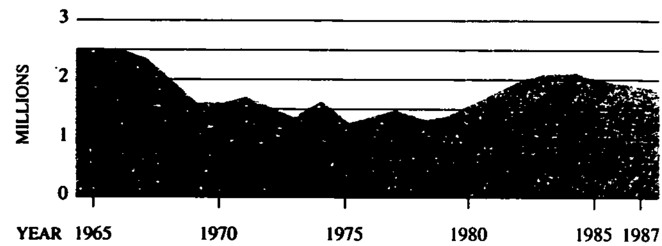
Productivity growth will be facilitated by an increase in saving and investment. **We also need to enhance productivity through flexible compensation, incentive pay, and profit-sharing arrangements, along with reforms in obsolete work rules. Measures that allow workers to change jobs without losing pension and health benefits would also foster the kind of flexibility and mobility that we need if our labor force is to become more competitive.**

Improving the Return on Work

In the long run, if young people receive better education, training, and access to health and nutrition services, they will be better qualified for good jobs. But efforts on behalf of young people, outlined in the previous two chapters, have to be coupled with more immediate help to those who are already in their working years. At present many people work full time—or as much as they can, given their family responsibilities—and yet do not earn enough to support themselves or their families at society's minimal level.

One way of illustrating the situation is to look at the number who are working but remain below the official poverty line. Most of these people are employed part time or full time for only part of the year, but a significant minority—some 2 million persons with perhaps double that number of dependents—are working full time all year around. The jobs they hold are the most marginal in terms of employment, security, pay, benefits, and opportunities for advancement. As Figure 4.1 shows, the 1980s have seen the number of such workers with very weak purchasing power rising significantly in comparison with the 1970s.

Figure 4.1 Number of Persons Working Full Time Year-Round and Living Below the Poverty Line



Source: U.S. Bureau of the Census. In *Working but Poor*, by Sar Levitan and Isaac Shapiro. Baltimore: Johns Hopkins University Press, 1987, p. 4.

There is no one simple policy that will neatly address the problems of the working poor, since they are a very diverse group. Even if we could afford it, few people would feel that we had dealt with the issue if we simply guaranteed everyone a minimum, poverty-line income through some combination of welfare reform, food stamps, and the like. Studies of low-income Americans' own preferences show that they have a very strong attachment to work, regardless of race, sex, ethnicity, or age. Their own hopes for bettering their lot lie with jobs, education, and training—not with government handouts. The jobs of poor women are particularly inadequate, with impoverishing pay, not enough hours, few employee benefits, and scant opportunities for advancement. A more meaningful response to the problems of the working poor would aim to improve the income and benefits that come from work and to recast the passive support system that tides people over when they are not working.

The minimum wage represents society's effort to establish a floor below which market forces will not be allowed to drive down the living standards of workers. Minimum-wage workers tend to be part-time employees (some of whom want full-time work) and women, including a disproportionately large share of female heads of families. About half of such workers are age twenty-five or older, and there is a historical tendency for wages of workers below the poverty line to cluster around the minimum wage level.

Since the beginning of 1981 the minimum wage has remained frozen at $3.35 an hour, and therefore its real value after inflation has declined sharply. As Figure 4.2 shows, it has become increasingly impossible to support a family even at the poverty line while working full time for the minimum wage. Economists have long debated the effects of minimum-wage legislation in deterring employers from hiring. There is evidence that suggests that an increase in the minimum wage has some adverse effects on the job prospects of teenagers and young adults, but the effects are relatively slight.

The earnings of today's lowest-paid workers must be undergirded by a higher minimum wage. **We recommend restoring the purchasing power of the minimum wage to its 1981 level.**

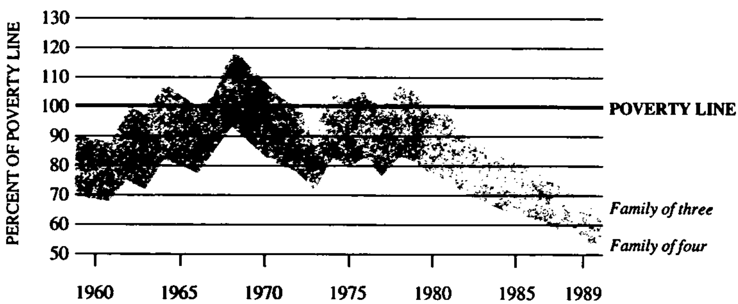
Even if we restore the purchasing power of the minimum wage, however, the standard of living afforded by a full-time job would not be sufficient to lift all families out of poverty if there was only one worker in the household. Although the minimum wage could be lifted still further, the potential impact on inflation and on employment opportunities for low-skilled workers would make this an unattractive option. Fortunately, we need not rely exclusively on the minimum wage to improve workers' earnings. There is a second tool, the Earned Income Tax Credit (EITC).

Started as a little-noticed amendment to the tax laws in 1975, the tax credit is set as a percentage of initial earnings and phased out as earnings rise. When the income taxes due are small or nonexistent (as they are for low-wage employees), the worker is refunded the difference between the tax liability and the size of the credit. The EITC is currently set at 14 percent of family earnings up to $6,200.

The wages paid a worker take no account of the number of family members dependent on that wage and neither, under current law, does the EITC. Thus a family consisting of two persons and with earnings of $7,000 a year receives the same credit in 1988 as a family of six—$868. If both of these families earn just enough to reach the poverty threshold for their respective family sizes, the two-person family will receive an EITC payment of $868, while the larger family with a higher poverty threshold receives only $239. This inequity occurs because the ceiling on the tax credit does not vary with family size, while family financial needs obviously do vary with family size.

Although labor markets cannot vary compensation in relation to family responsibilities, public policies can and should take account of the presence of dependents. Hardship is much greater among those workers struggling more or less permanently in the low-wage sectors of the economy and facing major responsibilities as breadwinners.

Figure 4.2 Value of Full-Time Work at the Minimum Wage in Relation to the Official Poverty Line



Source: U.S. Department of Labor. In *Working but Poor* by Sar Levitan and Isaac Shapiro. Baltimore: Johns Hopkins University Press, 1987, p. 52.

We recommend expanding the Earned Income Tax Credit by varying its benefits with the size of a recipient's family. A straightforward method of adjusting the EITC by family size would be to increase the credit rate according to the number of dependents. A 4 percentage-point increase for each additional dependent would add about $250 per additional dependent to the maximum size of the credit. Thus, the 14 percent rate that currently applies to all families would apply to a family with one dependent child, households with two dependent children would get an 18 percent tax credit, those with three children would get 22 percent, and families with four or more children would qualify for a 26 percent credit. In addition, better administrative procedures could be developed to refund EITC benefits on a regular advance basis rather than in a lump-sum payment at the end of the tax year.

Assuring Health-Care Coverage

An employee benefit package offers many important features, including employer contributions to pensions and disability insurance. The lack of basic health-care coverage, however, is a major problem. Assuring such coverage not only affords protection but also fosters opportunity and productivity by improving health, reducing the amount of time away from work, and keeping workers financially solvent.

At present an estimated 31 million to 37 million Americans have no health insurance coverage. Many others have coverage, but their insurance does not provide protection against the major expenses of catastrophic illnesses. The large number of uninsured people in the United States results from significant gaps in the two major systems that cover the working-age and young population: Medicaid and employer-provided group health insurance. About 24 million people—or two-thirds of the uninsured—are either full-time workers or their dependents. Medicaid, a Federal-state program, now covers fewer than half of the poor. Thus, aside from the elderly, at least one in six Americans falls into a deep chasm between these two systems. Getting into the work-based health insurance system requires having the right kind of job. Jobs in certain industries or occupations do not typically provide coverage, nor does the part-time work that now accounts for one of every six jobs.

Eligibility for Medicaid varies from state to state. In general, families headed by a working adult find it very difficult to qualify, even when the worker earns the minimum wage and household income is well below the poverty line. These workers' incomes are too low to achieve a decent living standard, but too high to allow them to qualify for Medicaid in many areas of the country. Their jobs often do not provide private health insurance.

In the past, many of the people who were uninsured had their health-care costs paid for by the "hidden tax" of cost shifting. Doctors and hospitals increased their bills to paying patients to offset the costs of treating the uninsured. Today, this cost shifting to cover uncompensated care is becoming more difficult. Large employers are bargaining more aggressively with service providers, either indirectly through their insurance carriers or directly as self-insured purchasers. Meanwhile, cutbacks in government financial support for community health centers and the National Health Service Corps, as well as new limits on Medicaid services and eligibility, have further eroded health services to the indigent.

These changes affect the willingness of doctors, hospitals, and other providers to treat the uninsured—poor and nonpoor alike. To be uninsured in America today is to be more vulnerable to exclusion from the health-care system. The challenge is to replace the eroding and inefficient cross-subsidies with new, more direct ways of paying for those with limited access to coverage.

The national goal should be universal health coverage for all Americans. To achieve it, we recommend a blend of private-sector initiatives and public-sector reforms. The answer to this problem is not simply to qualify for Medicaid all of those currently lacking insurance. This would give some businesses an incentive to drop coverage, and it would solidify the questionable link between welfare and health insurance. At the same time, if we rely solely on voluntary employer initiatives to expand private coverage, the results are likely to fall short. Many employers find health coverage too expensive and cannot or will not provide it on their own. A requirement that all workers be given a full package of benefits may lead to significant job losses, particularly for lower-paid workers, many of whom have only a tenuous attachment to the labor force, working a few weeks a year or a few hours a week.

It is realistic and fair to insist that the private sector assure basic health protection for those workers with a strong, permanent attachment to the labor force. Indeed, assuring people who take a job and stick with it for a significant period of time that they will have private health insurance enhances the attractiveness of work and diminishes the appeal of welfare dependency.

We recommend a new approach that requires employers either to offer a basic package of health insurance coverage to workers (that includes catastrophic expense coverage) or to contribute an amount per employee to a public fund that will finance coverage for uninsured workers.

Eligibility would be restricted to workers with established job tenure (e.g., a certain number of hours worked in the first three months of a job) and to those working some minimum number of hours per week. The government guarantee should be adequate to purchase a certain minimum level of health benefits, but not so generous as to compete with employer-sponsored health plans.

With this approach, the private sector would take special responsibility for assuring coverage to a group with which it has a natural link—workers with a strong attachment to the labor force.

This strategy should be accompanied by a series of steps to assist those who are only marginally employed or who are unable to work for reasons of ill health or disability. These steps feature some basic reforms in our public assistance system:

- **We recommend that the Federal government extend the AFDC program to establish a minimum cash-benefit level that assures Medicaid eligibility to**

at least the poorest of the poor. (This will be discussed in more detail in the section on welfare later in this chapter.)

- **Medicaid coverage should not be limited to those who receive cash welfare assistance.** Federal law now permits states to extend Medicaid to people who live below the poverty level but do not receive cash assistance; the new welfare reform law mandates a year's coverage for those who are just off the welfare rolls. Beyond this, special emphasis should be placed on extending Medicaid, without time limitations, to people who are poor, categorically ineligible for cash assistance, and not working enough hours or weeks to qualify for the mandated coverage specified above.

- **Medicaid should place more emphasis on early treatment and preventive health care.**

Redesigning Unemployment and Welfare Programs

For people of working age, two basic components of the income-maintenance system are Unemployment Insurance (UI) and Aid to Families with Dependent Children (AFDC). Both were initiated in the mid-1930s under conditions that were very different from those of today. These programs should be fundamentally reoriented to reflect present economic and demographic circumstances.

Instead of enhancing employment opportunities and real social protection, both UI and AFDC have evolved into systems that too often involve no more than income maintenance. Neither program places enough emphasis on training and retraining people to develop skills that are needed in today's labor market. At the same time, both programs provide cash benefits that have eroded in real terms and that vary widely from region to region, so that benefits in some states are simply too low. Both programs should be redesigned to do the following: first, provide more adequate short-term income support for assistance between jobs and for training people for long-term participation in the labor market; and second, offer greater incentives for people to take a job after this up-front investment is made.

Unemployment Services. Although a growing economy is a prerequisite for ensuring opportunity to the working-age population, there will undoubtedly continue to be periods of economic recession and substantial unemployment. Furthermore, the continuous ebb and flow of economic activity across the nation means that some regions, states, and labor market areas will experience periods of significant unemployment even when the nation's overall economy is relatively healthy.

For the past half century, the unemployment compensation system has helped those with substantial work histories weather limited periods of joblessness. But as the economy and labor force have changed and the state unemployment insurance trust funds have been battered by recessions, the UI program has become a less adequate component of the safety net. In 1986 only one-third of the unemployed received UI benefits, and in some subsequent months the proportion has dropped to one-quarter. By contrast, during the 1970s about half of the unemployed received benefits, compared with more than 60 percent in Germany, Japan, and Sweden. Recent labor market entrants and many re-entrants do not receive benefits because they lack sufficient work histories, while others have exhausted their twenty-six weeks of coverage.

Unemployment Insurance was designed when adult males dominated the labor force and many of them worked at one job or one career all their lives. The system's goal was to tide such workers over during a layoff from a job to which they were likely to return when demand picked up. Today's work force is more diverse, and many laid-off workers will never return to their prior jobs. In a rapidly changing economy, more people will change occupations, industries, and regions in which they are employed. They still need some income maintenance. Even more important, they need new skills, retraining, or relocation assistance. Yet UI today continues to focus on income maintenance, not on changes in the labor market.

By becoming not just a safety net but more of a bridge, UI can help workers adapt to a changing, more global economy. Encouraging workers to adjust actively and positively to change is much preferable to retarding change. Workers who can "retool" their skills not only expand their opportunities, but also build a more lasting security than they could hope to acquire with the help of income maintenance policies.

A number of steps would reshape Unemployment Insurance to conform to the needs of tomorrow's unemployed workers. First, **we should tighten up administration of the program, particularly at the front end.** That means insisting that in order to qualify for benefits, new claimants who are unlikely to get their old jobs back quickly make a serious effort to obtain new jobs. In the past, only lip service has been paid to the "work test."

Second, **unemployed persons in declining labor markets should be able to receive their benefits as lump-sum payments that can be used to move to a more promising labor market**. Federal funds would appropriately be used to support this because the benefits of a more mobile labor market are truly national in scope.

Third, we should recast the schedule of UI benefits so that they are high for the first few weeks, and then decline gradually as more training and employment services are provided. This would substitute for the current system of constant-rate benefits that end abruptly after twenty-six weeks. The goal would be to combine better protection in the first few weeks, which are often critical to locating a new job, with stronger incentives to return to work. **Benefits for those who have experienced a long period of unemployment should be extended beyond the normal termination period only if the recipient agrees to participate in a serious retraining program.**

A declining-benefit approach would require the same total amount of money that is currently earmarked for UI. This idea is not proposed to save money, at least in the short run, but to create incentives for workers to return to work. Another option would be to pay the current level of benefits for thirteen of the first twenty-six weeks of unemployment, then phase down the level of the benefit over a period that might extend for another twenty to twenty-five weeks. In any case, it is important to recognize that there is nothing sacred about the current schedule simply because benefits have been paid at a constant rate for a specified time period since the program was started in the 1930s.

Finally, **solvency standards should be established to put the state unemployment systems on a sounder and more equal financial footing**. Although some states have done a great deal to restore the fiscal health of their systems during the past few years, many could not withstand even a mild recession. National, rather than state, revenue bases should be tapped to finance the extra costs that occur when the national unemployment rate is extremely high or when an individual state experiences an unemployment rate that is persistently above the national average. In addition, interstate differences in unemployment benefits are greater than can be justified by differences in the cost of living, and these disparities have not been shrinking. **These differences should be narrowed by increasing benefits in those states with particularly low benefit levels.**

In summary, we need to assure those who lose their jobs a decent standard of living while they are unemployed. We also need to structure unemployment compensation so that it encourages and facilitates a return to work.

Welfare Programs That Assure Adequate Incomes and Work. People who have little or no previous experience in the work force cannot use the unemployment compensation system as a safety net. For some, the AFDC welfare system fills this role.

For too many years social welfare reform in America has been defined almost exclusively in terms of "fixing" the AFDC program, with its misleading stereotypes of welfare queens, chiseling, and lifetime membership on the welfare rolls. Since policy makers have established a program that specifically sets apart families with children that are headed by women, and pays them welfare checks, it is not too surprising that the public is led to perceive "the welfare problem" as entirely a matter of unmarried women raising children at taxpayers' expense. The facts are that most female heads of families are not on AFDC, and of those who are, roughly half use welfare as a temporary source of emergency financial help and not as a permanent means of support. To be sure, there are major problems with AFDC, especially for recipients who are more or less permanently enmeshed in passive dependency. Yet AFDC is only one subordinate part—not the heart—of the social welfare challenge facing America.

The current AFDC system is woefully out of date in ways that are actually quite similar to those noted with regard to Unemployment Insurance. Benefits are inadequate and vary widely by state. Despite the revolution that has occurred in female labor-force participation since AFDC was enacted a half century ago, there is too little emphasis on employment prospects.

The Family Support Act of 1988 does begin to address this problem. Its central features include the creation of a Job Opportunities and Basic Skills (JOBS) training program for AFDC members. The new law features education and training, job search, health benefits, and child-care support for program enrollees in transition to work; limited work requirements for two-parent families; and increased enforcement of child-support payments. The new JOBS program, however, will affect only a portion of AFDC recipients in the next few years. In addition, with the exception of an extension of the Unemployed Parent program to all states, there are no provisions for more adequate benefit levels.

The AFDC program remains an anachronism today. To fit today's economic, demographic, and social circumstances, AFDC should be fundamentally overhauled to become a work readiness and support program, rather than a limitless income-maintenance program. For those on AFDC who can work, there is not enough opportunity or incentive to do so; for those who cannot work, or who are legitimately engaged in uncompensated activities such as the care of very young children, there is too little security because of inadequate payments and services. In short AFDC, like UI, lacks a realistic strategy for achieving both opportunity and security.

Much has been learned in recent years about the value of work in welfare programs. Experiments conducted by the Manpower Development Research Corporation (MDRC) suggest that welfare recipients generally accept programs combining job-search assistance, training, and work obligations. Such programs have led to worthwhile improvements in employment and income for single mothers on AFDC, as well as gradual reductions in their welfare dependency. The results of the MDRC research, together with other studies, do not reveal any dramatic "magic bullet." They do show that significant numbers of single parents on welfare can be helped to make the transition from welfare dependency to work.

Many states are now experimenting with new models of work and training that blend public help to the recipient, including day care and health coverage, with obligations to work. It has become clear that if they are to compete successfully in the marketplace, welfare recipients who have meager education and skills, little work experience, and have long been dependent on welfare require genuine, in-depth labor-market services (counseling, training, on-the-job experience, for example). This is something quite different from the pro forma, paperwork exercises that take place at too many state employment and welfare offices today.

At the same time, AFDC benefit levels are generally quite low, and there are huge discrepancies in the benefits offered by various states; maximum benefits for a family of four in California are five times as high as in Alabama. Participation in AFDC programs nationwide is limited by stringent asset tests that exclude all those with more than a token amount of resources or material possessions. Furthermore, little systematic effort is made to help those on welfare improve their employability and find a job.

We recommend that a national minimum benefit standard be established. No civilized country should tolerate benefit levels (AFDC plus Food Stamps) below half of the poverty threshold. **A national minimum benefit equal to two-thirds of the Federal poverty level (AFDC plus food stamps) is an achievable goal for the early 1990s.** In the long term, there is a need for more innovative approaches that expand employment opportunities. Raising benefits payments for those able to work makes sense only if cash assistance is used as a form of temporary support in emergency situations, not as a source of permanent income.

The welfare system should be overhauled to emphasize work instead of long-term dependency. Improving work readiness through education and training should be part of the new program. But an equally important part is making it clear to able-bodied healthy adults that welfare is time-limited—it will not go on forever. One way to accomplish this is to put a **limit on the length of time that those who can work are entitled to welfare benefits. This would be coupled with the provision of a public-sector job for those who have exhausted their benefits but cannot find work.** Government would, in effect, become the employer of last resort, providing jobs for those who cannot find work.

This approach would dramatically change today's welfare system, which is relatively cheap but open-ended. We would put more resources in at the front end, but make it clear that after some limited time period, welfare stops—and in its place comes work combined with other assistance such as day care. This would send a new message to people: "We will help you through a combination of support services and temporary welfare, which will be more generous than today's benefits, at least in many states with very low benefit levels. We will help make you job-ready with serious job-search assistance, training, health benefits, and temporary subsidies for child care or transportation. We will give you a reasonable time period to capitalize on this investment and land a job. After that, we will terminate benefits, but offer a backup public-sector job. Then, your choice will be between the job we offer and making it on your own, not between work and welfare."

Such a signal directly addresses the problem of persistent poverty and long-term welfare dependency. There are varying definitions of persistent poverty and the "underclass" in America. Estimates range widely from 2 million to 8 million people, but it is likely that no more than 10 percent to 15 percent of all poor people live in the poorest neighborhoods of our central cities. Substantial attention is paid to this problem in proportion to its size, because of serious social consequences that flow from concentrated destitution. A general absence of stable families, successful schools, and employed adults makes some inner-city neighborhoods breeding grounds for yet another generation of poverty and hopelessness. Into this already depressing setting, today's welfare system injects a message of passive maintenance and dependency. It is time to change that system and turn its signals toward work and personal responsibility.

No one should underestimate the challenge of providing useful public service jobs as a backup to welfare. Realistically speaking, many welfare recipients will not be able to find work, even with extensive job training and social support services. This will be particularly true for those in slack labor markets. America does not have much experience in running a national jobs program, and a smaller-scale public-service employment program was terminated in 1981. Developing a new one will require substantial resources and ingenuity.

In summary, the changes needed in AFDC are not so different from the reforms needed to refocus our larger social welfare system. The key terms are the same: investing in people, offering decent protection against insecurity, making opportunity real through work. In the case of AFDC this translates into a quid pro quo comparable to that for Unemployment Insurance. Government should offer people a greater front-end investment in employability and more adequate benefits for a reasonable period. In return, the recipient should be obliged to demonstrate a heightened sense of personal responsibility and a willingness to capitalize on the larger, but more time-limited public investment.

Community Programs

Our proposals aimed at helping working-age adults represent a mixture of new government spending and mandated changes in wages and employee benefits. These measures can touch the lives of individuals and families in a positive way, and thus indirectly improve circumstances in low-income communities. The major limitation of such reforms is that they are administered to individuals without directly addressing conditions in the neighborhood of which the individual is a part.

One effective way to deal with neighborhoods is to support community development corporations (CDCs). The Watts Labor Community Action Committee in Los Angeles, Chicanos Por La Causa in Phoenix, the Tacolcy Economic Development Corporation in Liberty City (Miami), and other CDCs make neighborhood-by-neighborhood improvements in housing conditions, street appearance, and safety. Concentrating on housing, commercial development, and the services that support these activities, such corporations provide an organizational structure for local community leaders to control capital, run social programs, and rekindle people's hopes. CDCs may promote street spruce-ups, neighborhood food shopping at fair prices, decent living space for the elderly, and recreational space for youth. They produce visible, tangible results that can provide power bases for community leaders and help attract new funds and residents to deteriorated neighborhoods.

The effect of community development corporations is to create an environment that signals renewal, not deterioration. Their efforts to change and improve communities are in step with the self-improvement efforts of individuals. Their success reinforces the values of the larger society. During the last two decades, several thousand development corporations have been created, along with several national organizations that fund and assist them with technical expertise. Thus, a system for expanding and strengthening them is already in place, a system that can absorb a significant infusion of new financing.

The problems of troubled neighborhoods are compounded by concentrations of the poor. At the same time, many low-, moderate-, and middle-income families find it increasingly difficult to acquire start-up homes or find housing at affordable rents. CDCs could play an important role in experiments that use tax incentives or tax credits to encourage the construction of low-, moderate-, and middle-income housing in troubled neighborhoods.

Community development corporations are only one important part of an effort to improve the environment in which people grow up and develop. We have also pointed out the need to rid our cities of crime and drugs and to rebuild their deteriorating infrastructure. Although our report concentrates on ways to build *human* capital, we are aware of the corresponding need to modernize our physical surroundings and improve the environment in which people can develop.

Estimating the Cost

Our proposals in this chapter have been aimed at helping adults by a combination of new government spending and mandated changes in wages and employee benefits. (See Figure 4.3 for a summary of the new government spending these proposals would require.) The estimates are the approximate costs of the reforms recommended in this chapter in the first year that they are fully implemented. These figures could vary for several reasons. For example, the estimated cost of a Federal floor on cash-assistance benefits ($3.7 billion) is predicated on our recommendation to set that floor so that the sum of AFDC and Food Stamp benefits equals 65 percent of the Federal poverty line (see Figure 4.3). Note that the estimated total cost of this step is a net figure that allows for the decline in Food Stamp outlays that would accompany an increase in AFDC benefits. It includes about $2 billion in new outlays by state governments, which share the cost of AFDC with the Federal government.

Figure 4.3 Summary of Government Outlay Increases for Programs to Help Working-Age Adults (First Year)

Program Initiative	Outlay Increase
Expansion of the EITC	$ 2.3 billion
Floor under AFDC benefits	3.7 billion
Expansion of Medicaid (adults)	3.0 billion
Retraining and UI reform	1.0 billion
Public-service jobs	2.0 billion
Total	$12.0 billion

The estimated cost of Medicaid expansion—$3 billion—is predicated on the coverage of adults who are poor, who lack both Medicaid and employer-sponsored group health insurance, and who would not be covered by the proposed mandated benefits program discussed in this chapter. (The cost of covering similarly situated poor children under Medicaid was included in the budget estimate in Chapter Two.)

An estimated 4 million adults would be covered by this expansion of Medicaid, and the cost estimate is predicated on a modest contribution by these beneficiaries of 10 percent of the actuarial cost of the Medicaid insurance.

A variety of programs can be devised for retraining or relocating displaced workers and for restructuring UI benefits. We think that a commitment of about $1 billion to this task, as was proposed in the 1987 budget deliberations, is a place to start if the money is spent in the ways outlined in this chapter.

It is hard to estimate the cost of providing public service jobs to those on welfare who cannot find a job after a specified period. It will depend on such factors as the time limit put on AFDC and the wage rate paid for these jobs. It will also vary with labor market conditions. The best time to try such an experiment is in a tight labor market like the one that is currently developing. We estimate a cost of $2 billion annually for this program.

The cost of the mandated health-care benefit package will depend upon its precise specifications. Initially imposed on employers, this cost could be partially shifted to workers in the form of lower employee compensation, or to consumers in the form of higher prices. To the extent that firms cannot shift the cost by adjustments in wages, prices, or dividends, they may try to find ways to produce goods and provide services with fewer workers.

The Congressional Budget Office has developed a cost estimate for one mandated health-care bill, S.1265, legislation that would affect 51 million people, 23 million of whom were previously uninsured, and that would add $27.1 billion in incremental costs to employment-based health plans. Of this total, $21.8 billion would come from employer contributions to new policies for workers who were previously uninsured, $3.3 billion from employee contributions to these policies, and $2 billion from new benefits that would be required under existing policies. The Congressional Budget Office has also estimated that $17 billion of this $27 billion price tag is money that is already being spent—directly or indirectly—on providing care to uninsured people. Such outlays include a portion of the cost of uncompensated medical care and a portion of the taxes paid to support the Medicaid program. Thus, the net cost of a mandated benefits approach—about $10 billion—is much less than the gross cost.

Chapter Five

Old Age: A Time to Reap and Sow Again

Public attitudes toward old age in America reflect two contradictory stereotypes. One portrays the elderly as needy, feeble, and dependent. A more recent caricature presents them as affluent, self-absorbed, and overindulged by taxpayers. The realities of old age are more complex, and the prevailing stereotypes serve mainly to distract attention from the real problems. Older citizens were once among the most destitute of Americans. Today the improved economic status of the elderly—resulting from a combination of public and private efforts (Social Security, Medicare, tax laws, personal savings, home ownership, and the like)—is a major success of U.S. social welfare policy.

Average per capita income for those older than 65 is now on a par with income per person in younger families, and the aggregate poverty rate for the elderly is below that of younger Americans. But there are huge disparities in resources and protection among the elderly. In 1984 only 7 percent of married couples sixty-five years of age or older lived in poverty, but 28 percent of white elderly single women were poor. For elderly single black women, the poverty rate was 62 percent. The poverty rate among the Hispanic elderly was 27 percent. Overall, about 12 to 13 percent of the elderly now live in poverty.

Social Security reforms in the past were designed to produce surplus reserves that would help ease the burden of paying for the large number of retiring baby boomers in the next century. However, these growing surpluses have not been treated as a form of national savings and investment to enhance economic growth—and thus to increase the resources needed in the coming retirement bulge. Instead, the Social Security surplus is being used simply to offset deficits elsewhere in the Federal budget. Meanwhile, Medicare, the national health insurance for the elderly, faces a mounting financial crisis. Current projections indicate that Medicare's Hospital Insurance trust fund will not be able to pay for current services shortly after the turn of the century. The day of reckoning could come even sooner if the experts' rather rosy assumptions about economic growth in the 1990s and the

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costs of the new Medicare catastrophic illness legislation are not borne out. In addition, large numbers of Americans are currently pauperized and emotionally drained by the expense of long-term care. As our population ages in the years ahead, the situation is only going to become worse. Yet we have not developed a workable public or private insurance approach to cope with the problem of long-term care.

In summary, the present system represents a paradoxical mixture of generosity and stinginess, huge spending and huge gaps. Few realize that the inequality of wealth is greater among the elderly than among other age groups. Moreover, the disparities in old age between the haves and the have-nots are likely to grow in the years ahead. This is because of the emerging difference between two groups: those depending almost exclusively on Social Security benefits that will grow more slowly than in the past, and those who will have profited from the escalating values of home ownership, from tax-favored savings initiated in the 1970s, and from expansions in private pension coverage that are most extensive for workers in higher-paying jobs.

Tragically, however, there is one great equalizer as Americans reach very old age and lose the physical or mental capacities to live independently. Only the extremely affluent will be able to pay for long-term care from their own resources. If we could look into the nursing homes of America, we would see, as we did in looking at infants through the nursery windows, the fundamental human vulnerability that we all ultimately share.

The basic theme of this chapter is straightforward: Some elderly Americans are not receiving enough help, while others are not contributing as much as they could. There is a growing mismatch between the vulnerability of old people and our social institutions that were designed to assuage it. Those elderly who can contribute more should do so—to help those who have been left behind, to help ensure a solvent Medicare system and a humane system of long-term care for themselves and others. New policies must not undermine the economic security and opportunity that have already been achieved for older citizens. But there are fair, progressive ways for the affluent elderly to help fill the gaps that exist in our social protection system, and we should not shrink from asking them to do so.

Protecting the Weakest Today

Older Americans have three lines of defense against economic hardship. First, almost all the elderly have access to Social Security and Medicare, two public social insurance programs to which people contribute throughout their working years. The poorest may claim income-tested benefits, mainly in the form of the Supplemental Security Income program, Medicaid, and Food Stamps. As a second line of defense, a significant number of Americans have private pensions and health insurance to complement Social Security and Medicare, although these "private" provisions are also publicly subsidized by favorable tax treatment. Finally, a much smaller minority of older Americans have financial assets that generate significant income to help meet expenses. This combination of supports meets the income needs of most older Americans quite well, but it still leaves too many in poverty.

Discussions of Social Security have a habit of concentrating on what will be happening ten, twenty, and even fifty years into the future. It is also important to remember income needs that are currently going unmet. Today, Social Security is the single most important source of retirement income for older Americans. If it were not for Social Security benefits, nearly half of our aged, rather than the current 12 percent, would live in poverty. In general, the lower one's income level, the more important Social Security becomes as a component of the household budget.

Currently about one-third of retirees have private pension income in addition to Social Security. Compared with those who are dependent solely on Social Security, these people are in a much better position to cover their expenses and stay within reach of their pre-retirement living standard. Those without a private pension are about four times as likely to live below the Federal poverty line as those with such pensions. In the years ahead, the number of retirees with private pensions will gradually increase, a trend reflecting the growth of employer-based pension coverage from the 1940s through the 1970s. Since the late 1970s, however, private pension coverage has declined moderately, and projections show employer-provided pensions will not be available to more than about one-half of the work force in the foreseeable future. For instance, of the unmarried women who will retire during the next five to fifteen years, almost two-thirds will lack private pensions. Overall, nearly half of today's workers receive employer contributions to a private pension, but a smaller proportion will actually see those pensions, in part because some workers still lose pension protection when they change jobs. Nevertheless, the proportion of people who will actually benefit is higher today than it used to be.

Although many older people possess some assets, few are able to derive significant income from them. Net wealth is much less evenly distributed than either income or private pension coverage, so that the richest 5 percent of the elderly account for well over half of all the net wealth of older Americans. About one-quarter of the elderly have no home equity, and many older citizens who are homeowners are understandably reluctant to re-mortgage their homes to generate income through reverse annuity mortgages.

In America today we see—or rather we too often fail to see—a large group of people who have little retirement income other than Social Security, and who, because of a limited earnings record, may find even that benefit to be minimal or nonexistent. They lack private pensions, and are in no position to gain either the current tax advantages or the long-range protection produced by salary-reduction plans, IRAs, Keogh plans, and the like. These destitute people are most likely to be living alone, to be very old, of minority race, and female. Single women represent almost two-thirds of the 3.5 million elderly persons living in poverty. Despite the rising living standards and economic security of the elderly in the aggregate, this large subgroup lacks adequate resources to meet basic housing, food, and health-care needs.

Many measures might have a long-term impact in helping the poorest of older Americans: an expansion of private pensions could be encouraged through tax breaks, for example, and reverse annuity mortgages could be made more accessible. Many poor would also eventually benefit from changes in long-term care. But one program can help destitute old people here and now. The Supplemental Security Income (SSI) program offers Federally financed cash benefits representing 77 percent of the poverty level for individuals (i.e., $4,032 a year in 1986) and 91 percent for couples. Somewhat fewer than half of SSI beneficiaries receive a very modest state supplement (median value in 1986 was $36 per month), and the real value of these supplements has declined by half since their initiation in the mid-1970s. About one-half of those eligible for SSI benefits do not even participate in the program. More than half of the elderly poor cannot get financial help with the unreimbursed costs of Medicare treatment because they are not on the SSI rolls and thus have trouble meeting Medicaid eligibility rules.

We recommend the following initiatives to improve basic income support for the impoverished aged:

- **an increase in Federal SSI benefits to assure minimum poverty-line incomes for those elderly without other sources of income;**

- **an easing of restrictive limits on liquid assets ($2,000 for individuals and $3,000 for couples in 1989) in order to qualify for SSI;**

- **a more effective outreach program to increase participation among those eligible for SSI.**

Protecting the Many Tomorrow

Social Security is likely to provide a basic minimum income for most Americans who retire in the future. Contrary to some popular impressions, the main danger in the years to come is not that the system will go broke. It is that the Federal government will consume the financial surplus that should be accumulating toward the day some twenty-five years from now when the unusually large baby-boom generation begins to retire.

The Social Security amendments of 1983 averted a crisis in the program and were also designed to set Social Security on a sustainable long-term path. The reforms reflected a roughly even split between tax and benefit changes. Scheduled payroll tax increases were accelerated, a portion of benefits above certain income levels was taxed for the first time, and the normal retirement age was raised starting in the early part of the next century and reaching age sixty-seven in the year 2022.

With these changes—and with moderate assumptions about economic growth, mortality, and fertility—the Social Security system should be healthy for the next fifty years. Of course, it is possible that weaker economic growth and smaller increases in productivity and real wages could produce trouble in the next century. Even should these possibilities occur, however, the solvency of the Social Security system could be maintained without Draconian measures. It is difficult to imagine a future in which a payroll tax increase of about 1 to 1 1/2 percentage points would fail to remedy any revenue shortfall. Such a tax increase would probably have some adverse effects on employment, but its impact would certainly be no greater than that of the payroll tax increases we have weathered in the last several decades.

The real problem to be faced in Social Security financing is not actuarial but political. The 1983 reforms were deliberately and prudently designed to accumulate a surplus that could be drawn on gradually to relieve the cost burden that will occur when the unusually large cohort of baby boomers begins retiring in the next century. The balance in the Old Age, Survivors' and Disability Insurance (OASDI) trust fund, which is the source of benefit payments to eligible retirees, must grow now to avert a deficit later (see Figure 5.1). The balance in the OASDI trust fund, which was $109 billion in 1988, will likely triple to $352 billion in 1997, and could grow to trillions of dollars during the next two or three decades. These surpluses represent necessary accumulations for the long-range solvency of the system.

The more immediate danger is that the growing balance in the Social Security trust fund will be diverted in ways that remove these funds from the pool of savings and put them into current consumption. Every politician can develop a laundry list of new spending initiatives, or bailouts for old programs, that could be funded from the surplus.

We recommend that the Social Security surpluses be saved and invested, not spent for consumption of current services.

Rescuing Medicare

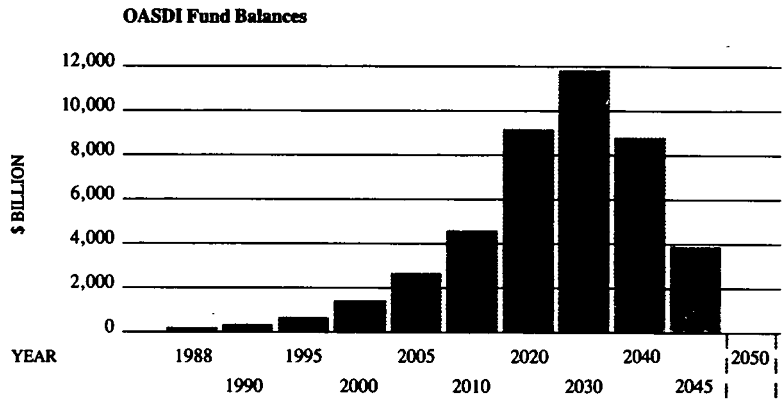
Although Social Security has achieved a delicate financial balance over the long term, Medicare is headed for financial trouble in the near future. Current projections indicate that the Hospital Insurance trust fund of Medicare will be exhausted in the early part of the next century; a weaker-than-expected economic performance would hasten the day of reckoning, as would health-care costs that grow more rapidly than anticipated. (See Figure 5.1 for a graphic depiction of the difference between the Medicare and Social Security situations.) The Hospital Insurance trust fund that covers Part A, or the hospital part, of Medicare will gradually build a somewhat large balance in the next several years, and then quickly become exhausted about fifteen years from now. By contrast, the OASDI fund will accumulate huge positive balances that dwarf the size of the very temporary positive balances in the Medicare fund.

The Medicare health insurance system, a vital source of protection for tens of millions of older Americans, must be kept solvent. In 1989 legislation enacted by Congress will add to Medicare by providing new protection against catastrophic acute-care expenses. The new coverage will be financed through a combination of monthly premium increases and a tax liability surcharge on senior citizens. This is a worthwhile improvement that will safeguard older Americans from some devastatingly large health bills. However, we should realize that the premium increases that are slated to finance this new coverage will do almost nothing to remedy the underlying financial imbalances in the existing Medicare system. And if those added premiums fail to keep pace with the cost of the new extra coverage, the imbalances will loom even larger.

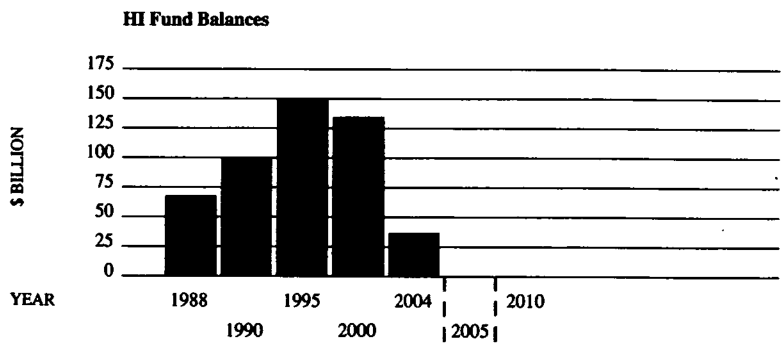
It is important to note the difference between the financing sources that are used to pay for the new Medicare protection and the major financing source that we have proposed for meeting the cost of our commitments. The Medicare catastrophic illness protection will be paid for by a flat increase in premiums that all recipients will pay and a surcharge on the tax liability of senior citizens. Our major financing source is neither a premium nor an income tax surcharge; it is a policy decision that an important source of income that was previously exempt from taxation will now no longer be exempt. Thus, what we recommend is a broadening of the base of taxation, as opposed to an increase in the rate of taxation.

The central challenge in Medicare is to devise ways of bringing expected outlays and revenues into line with each other through a combination of cost-control measures, premium increases, and tax increases. Health-cost management techniques put in place in recent years, such as the prospective payment system for hospital reimbursement, will continue to help. But most experts do not expect that

Figure 5.1 Current and Projected Balances in the OASDI and the HI Trust Funds



Source: 1988 Annual Report of the Board of Trustees of the Federal Old Age and Survivors' Insurance and Disability Insurance Trust Fund, Table G-1.



Source: 1988 Annual Report of the Trustees of the Federal Hospital Insurance Trust Fund, Table 11.

such cost-control measures will avoid the painful choices between raising taxes and increasing the financial contributions that the elderly make to Medicare. The situation is made more difficult by the fact that Medicare is headed for trouble even though it hardly addresses one of the most important and rapidly growing needs—long-term care for chronic illness. Consequently, it seems likely that Medicare is going to require both new cost-control measures and new money so the program can assure actuarial soundness in the Hospital Insurance trust fund and extend a greater measure of government protection for long-term care.

Although cost-containment policies are in place for hospitals, Medicare needs a new system of paying individual physicians in order to help bring their cost increases under control. The current system underwrites cost escalation and fails to create incentives for physicians to economize on the use of health services. Other measures might include a greater emphasis on alternative health-care delivery systems and greater government efforts to steer Medicare patients toward "preferred providers" who charge reasonable fees and have demonstrated their cost-effectiveness. These reforms are easier to outline than to implement. One should not underestimate the difficulty of decelerating Medicare cost increases without jeopardizing the quality of health care or access to it.

Creating Protection for Long-Term Care

Even though our society spends about $100 billion per year on Medicare and about $50 billion on Medicaid, the elderly remain vulnerable to the costs of lingering illnesses and disabilities. These costs can be huge ($20,000 to $30,000 annually for nursing home care), and they remain largely outside the social-insurance model of protection.

Aggregate statistics suggest some of the financial problems (but not the emotional strains) that many Americans are going through to help chronically ill spouses and other relatives. Of the $38.1 billion spent for nursing home care in the United States in 1986, only 1.6 percent (or $600 million) was paid for through Medicare and only 0.8 percent (or $300 million) was financed by private health insurance. Thus, less than 3 percent of the total nursing home bill in 1986 was covered by any insurance system. Direct payments by patients and their families accounted for 51 percent of the total, and Medicaid, the means-tested welfare program for health care, paid 41 percent. (The remaining 5 percent of nursing home spending was accounted for by private charity and other government programs.)

The U.S. health-care system is drastically imbalanced in dealing with long-term care. Many of the long-term-care needs of older people are more social than medical in nature; they involve lingering disability rather than disease, are enduring or degenerative rather than episodic or traumatic, and are largely outside the purview of doctors and hospitals. Yet health-care financing for the elderly is still designed for the traditional physician-directed, medical model of hospital care and short-term episodes of acute illness.

The insurance system is also quite fragmented. Care of the elderly calls for an integrated approach to acute and chronic needs. In fact, in some cases a properly managed acute-care system can help avoid the need for long-term care to the extent that it emphasizes prevention, recovery, and independence for patients who have had acute-care episodes. At present, however, reimbursement systems for hospitals and doctors are separate from and poorly coordinated with reimbursement systems for home-care attendants, medical-equipment suppliers, and nursing homes. The public system of reimbursement is not well coordinated with the private voluntary network that provides services such as meals-on-wheels, companionship, and transportation for the elderly.

The result is a regrettable mismatch between needs and services. The most complex, heroic, and often hopeless medical procedures to prolong life are routinely covered, while preventive care, long-term help for chronic disability, rehabilitation, and health education are often neglected. Expensive institutional care is heavily reimbursed, but many home and community-based services are not well covered. Some middle- and upper-middle-income people with minor medical needs pay little for their care, since they are well covered for these routine problems by the combination of Medicare and private "Medigap" insurance. Others who are financially comfortable may suddenly be reduced to poverty should they require long-term care that falls outside the public and private insurance systems. Although the very rich can afford their services and the very poor are covered by Medicaid, all others in need of long-term care are thrown back on their own resources. Once they have "spent down" and become completely destitute, a welfare program in the form of Medicaid comes to the rescue on condition that they enter or remain in a nursing home.

The gap between changing needs and the traditional insurance system will become even larger as our population ages. Today, about 3 million people, or a little over 1 percent of the population, are eighty-five years of age or older. In the coming decades this figure is projected to continue growing to at least 16 million people, or 5 percent of the population, by the middle of the next century. Since we know that the need for assistance with the activities of daily living rises sharply with advancing age, demographics demand that we find ways to finance long-term care efficiently and fairly.

There is something fundamentally wrong with a system in which people must impoverish themselves to find even minimally decent care in their final years. People disagree about how much the government, as opposed to the private sector, should be involved in a new insurance-based approach to financing long-term care. This question is important, but in our view, **the critical issue is to move toward an insurance-based model—whatever the combination of public and private insurance—instead of the present system that relies so heavily on asset depletion and welfare.**

The three major sectors of social protection—the private insurance industry, government insurance programs, and the voluntary sector—must all participate actively in solving the long-term-care problem. **We recommend the use of public subsidies to encourage the spread of private long-term-care insurance**, recognizing that without government participation many people will necessarily be left uncovered and in jeopardy. These subsidies should be national in scope, although this expanded role for the Federal government does not rule out state government involvement.

Government's role could take the form of Medicare coverage for long-term-care expenses after the elderly have incurred a certain amount of out-of-pocket costs. This approach should be supplemented by government subsidies for the purchase of private long-term-care insurance by lower-income households. In this way, government would help people insure themselves against the front-end expenses associated with long-term care, and would provide public coverage for the bigger costs of extended care.

Although some might prefer that the government provide full insurance coverage for long-term care through Part C of Medicare, such a program appears beyond our Federal budget constraints at this time. A more targeted approach to government involvement is appropriate. In particular, we recommend:

- **encouraging private insurance for long-term care, by means of labor-management efforts to integrate such insurance into a flexible benefit package, as well as targeted subsidies (as described above) to help lower-income people purchase private insurance;**

- **educating the public about the need for long-term-care protection;**

- **greater coordination of acute- and long-term-care benefits,** using savings from a better-managed acute-care system—with less unnecessary care—to help finance an extension of long-term-care coverage;

- greater public and private insurance coverage for home care;
- better organization and use of the private nonprofit sector to provide coordinated services to the elderly, since many of the types of services they need (transportation, delivered meals, counseling) are not normally provided by an insurance-based system;
- respite care sponsored by community organizations to relieve spouses and children who care for disabled people; business can also help by arranging for counseling and some flexibility in work time for employees who are also care givers.

The Price Tag

The package of cash-assistance reforms proposed here would cost about $2.6 billion in new spending in the first year. This total is heavily dominated by the proposed increase in SSI benefits. The estimate of $2.5 billion for this new step represents the cost of closing about one-half of the gap between the Federal poverty line and the current level of SSI benefits. It would be possible to recommend a larger increase that would close the gap completely. However, as we noted in our discussion of expanding benefits for children, it is important to recognize fiscal constraints and the need to meet our long-term goals in stages. It is worth noting that the additional $0.1 billion recommended for easing the SSI asset test would permit more than a doubling of the very low asset limits that now screen many low-income senior citizens out of SSI.

Estimates of the cost of greater government involvement in long-term care for the elderly are highly sensitive to assumptions about several program parameters. For example, adding long-term-care coverage to Medicare will cost much more if the coverage becomes available immediately, considerably less if the elderly must spend their own resources for a substantial period of time before qualifying. Obviously, the greater the degree of asset protection under a public program, the greater the government cost. The cost estimate provided here—about $7 billion—is that of a program with a three-year waiting period. This estimate also includes a small amount of funding to begin a program that helps lower-income people purchase private long-term-care insurance. If the waiting period were reduced to two years, the cost would rise to about $15 billion. A program with a rather short waiting period of a few months would cost from $30 billion to $40 billion.

Other factors that affect the cost estimates include whether home care is included in the benefit package, the coinsurance rate (the proportion of costs paid by patients and their families), and the provider payment rates (nursing home reimbursement rates). Costs can be held down, for example, by raising the coinsurance rate or lowering payments to providers. But such steps, if carried too far, could defeat the program's goals. A universal entitlement program for long-term care with a short or no waiting period, low coinsurance rates, and full coverage for home and institutional care might cost the government from $30 billion to $40 billion in the first year, in 1987 dollars. New government spending on that scale isn't likely, given the existing deficit.

Figure 5.2 Projected Costs of Reforms in Programs for the Elderly

Program Initiative	**Outlay Increase**
Raise SSI benefits	$2.5 billion
Ease SSI asset test	0.1 billion
Subsidize long-term care	7.2 billion
Total	$9.8 billion

A more realistic program would involve either a two- or a three-year waiting period for Federal coverage, coinsurance rates on the order of 30 percent, and a standard that specifies the degree of disability that is required for eligibility. People would be expected to obtain private insurance to help them cover expenses during the waiting period, but the government would subsidize a portion of the premium on a sliding-scale basis for those who cannot afford it. Under such an arrangement, Medicare benefits would begin where the private coverage ends. The difficulty of setting and maintaining a standard of disability for coverage, however, should not be underestimated.

In addition to the net increase of about $7 billion in government outlays, there would also be a big change in the mix of government spending, from the Federal-state sharing of costs that occurs today under Medicaid to a largely Federal-only spending approach under the new program. This would open up some interesting possibilities of tradeoffs: States could take over some of the funding from the Federal government in areas such as economic development in return for the Federal government's expanded role in long-term care.

Chapter Six

How to Pay the Bill

In twenty years, social welfare policy in America has passed from soaring confidence to doubt and retrenchment. There has also been a lot of partisan bickering and ideological warfare. The time has come to rise above this partisanship and to tackle our problems head-on. If all the recommendations in this report were implemented, the annual increase in government costs would be about $29 billion. This includes the recommendations for children involving Head Start, WIC, and Medicaid expansion; more funding for drug treatment; the minimum welfare benefit requirement; expanding the Earned Income Tax Credit; new job-training outlays; a public-sector jobs program; and a package of increases to help senior citizens. About one-third of this amount would be allocated to raising SSI benefits and introducing a modest long-term-care program. Since it would be possible to phase in both these new initiatives over time, we could make great progress toward the goals developed in this report with new government outlays in the range of $10 billion to $15 billion per year, phased in during the 1989–92 period and allowing time for our other recommendations to be phased in over a period of several years.

One caveat should be noted. These cost figures are our best estimates of the initial cost to the Federal government when the new initiatives are fully phased in. We have seen a number of instances in which such initial projections turned out to underestimate the eventual cost of the effort. Some factors that inflate costs, such as poor management, are within our control. Others—such as the increased demand for social services that arises when new government coverage draws additional people into a social program—are more difficult to control. What we have done in this report is to make as accurate an estimate as possible of the initial cost of the social investments we propose.

Financing Mechanisms

It is reasonable and fair to ask that those who are financially able help share the cost of social reform. The best way to do that would be to tax Social Security benefits more completely. We believe that approach to be preferable to turning Social Security into a means-tested program. While means-testing might target benefits to those most in need, it would also convert Social Security from the basic pillar of our social insurance system into a welfare program, a socially divisive step.

Beginning in 1984 a portion of Social Security benefits was included in taxable income for the first time. Under present law, one-half of the benefits for individuals with adjusted gross incomes that exceed $25,000 ($32,000 for couples) is subject to income tax, with the proceeds earmarked for the Social Security trust fund. Roughly 10 percent to 15 percent of the elderly now pay taxes on their benefits, and if the income thresholds remain constant over the years, the proportion of people who pay this tax will grow. Lowering the thresholds or eliminating them would bring in more revenue.

An equitable way to expand such taxation would be to tax Social Security benefits rather than freeze or cut cost-of-living adjustments in benefits. This would shield lower-income people from a greater burden while raising substantial amounts of revenue from the higher-income elderly. **Thus we recommend the complete taxation of Social Security benefits that exceed lifetime contributions, using the additional revenues to finance increases in Federal assistance to needy people of all ages.** For example, if a worker contributed $100,000 to Social Security during his or her lifetime, any benefits received in excess of that amount would be reported as taxable income. With this approach, approximately 85 percent of Social Security benefits would be taxed, yielding a total of about $97 billion in Federal revenue over the next five years. We believe that taxing Social Security more completely is preferable to freezing or limiting cost-of-living adjustments in Social Security benefits. Limits on cost-of-living adjustments would apply equally to the elderly widow living on a fixed income and to a wealthy couple. This is clearly unfair.

The actual flow of funds from such additional tax revenues to the needy could be accomplished in more than one way. The important requirement in any such plan is that new outlays must be fully financed in a way that produces no net increase in the Federal government's borrowing requirement.

The revenues collected through additional taxation of Social Security benefits could flow into the Old Age and Survivors' Insurance (OASI) trust fund. A preferable approach, however, would be for the government to establish a special new trust fund earmarked for meeting all the needs identified in this report, including all phases of the life cycle. Such a trust fund could receive additional revenue from the increased taxation of Social Security benefits. The fund could also receive revenues from other sources if the new tax treatment of Social Security does not provide sufficient funding. Increased taxation of Social Security benefits would also increase state tax revenues, which might also be targeted to meet the range of social needs identified in this report.

If a decision were made that it is unwise to divert the money raised by taxing Social Security benefits from the OASI trust fund, it would still be possible to achieve the goal of financing a significant part of our broad agenda of social reform through the greater taxation of Social Security benefits. One approach is to direct the added tax revenues to the OASI fund, while earmarking a portion of the 1990 increase in the payroll tax to address our unmet social needs. The theory behind this is that with the trust fund surplus bolstered by new revenue from taxing benefits, we could afford *not* to put a portion of increased payroll taxes into the trust fund. With this approach, current Social Security recipients might view the taxation of their benefits as a fair way of allocating funds to meet the needs of the elderly poor, while the broader social needs would be paid for by workers' contributions to the payroll tax. A drawback of this approach is that it uses the payroll tax to redistribute income, and that is not one of its major goals. Another approach would place the Supplemental Security Income (SSI) program into the Social Security trust fund, freeing up general revenue in the amount of SSI outlays.

Our preferred approach—setting up a special fund—would reinforce the idea that America is one society with a variety of unmet needs, a place where each group has a stake in what happens to all others. The children and workers of today are also the elderly of tomorrow, and elderly Americans have an immense concern for the well-being of their own and the nation's children and grandchildren. A fund that gives concrete expression to that idea would help counter the divisive "we" versus "they" mentality in social welfare policy.

The Congressional Budget Office has estimated that the additional tax revenue from taxing Social Security as we propose would be $97 billion over the 1989-93 period. Although this would amount to about $19 billion per year if it is spread evenly over the five years, in actuality the revenue gain would start at smaller amounts and grow to nearly $26 billion per year in the latter part of this period. As indicated above, we estimate the full cost of our agenda to the Federal government to be about $29 billion annually when all the program changes are phased in. This figure, however, is a current one, and by 1994 the cost of meeting our agenda would be higher.

It is likely that by the end of five years the annual revenue gain from our proposal would be enough to meet a significant part of the cost of our full agenda. Moreover, as we have stressed in this chapter, some of the more expensive recommendations could be phased in gradually. Indeed, the full taxation of Social Security benefits could also be phased in to smooth the transition for current beneficiaries. The point is that it is possible to implement our recommendations in such a way as to coordinate the required new Federal outlays with the expected revenue gains from the additional Social Security taxation.

A cautionary note should be sounded with respect to the unacceptably high Federal budget deficit. Under a business-as-usual scenario, the Federal deficit, even with the benefit of including the growing Social Security surplus, and assuming no recession and no new programs, will be edging downward only slightly during the next several years, reaching a projected level of $129 billion a year in 1993. If one believes, as we do, that any Social Security surplus should reflect real national saving to be used to meet our obligations to future retirees, and that our targets for reducing the deficit should be geared to the non-Social Security budget, the problem of the deficit is much more serious. In fact, the gap between these two concepts of the deficit—one that includes Social Security and one that excludes it—is likely to grow, reaching about $100 billion in about five years. The projected deficit in 1993, if one excludes the Social Security surplus, is about $220-230 billion; with Social Security the deficit is $129 billion.

In this climate, it is reasonable to expect that many will want to use any new source of revenues to reduce the Federal deficit instead of financing unmet social needs. There is also a danger that if a special fund is set up to meet social needs, the government would cut back what it was already spending on those problems, leaving no net gain. These kinds of pressures face any attempt to move ahead on social problems. In this report we have emphasized both the need to bring the Federal deficit under control and the need to make some additional outlays for much-needed social programs.

Our charge is not to devise a detailed plan for reducing the deficit by proposing expenditure and revenue options. Others with more expertise can do this better than we can. We recognize, however, that the enormity of the Federal deficit will complicate our effort to link any new revenue source with a social agenda that requires a corresponding amount of new government outlays. Ultimately, we need a combination of expenditure and revenue measures that will enable us to capitalize on new targets of opportunity by making prudent increases in government outlays even as we take the tough steps that are necessary to reduce the deficit. We would also like to stress that there are other ways to finance the agenda we have developed. While we strongly prefer the more complete taxation of Social Security benefits, our recommendations should not stand or fall on this preference.

Other options include increases in personal income or corporate tax rates, increases in excise or estate taxes, greater taxation of employee benefits, raising the payroll tax base, and expenditure cuts in program areas ranging from national defense to a host of non-means-tested entitlement and discretionary programs. Of course, it would be possible to combine these categories of options into one financing package. These sources could also be used to make up any shortfall in revenue if our preferred option does not generate enough revenue to meet the actual cost of our recommendations.

Those who are directly responsible to the voters are best equipped to determine the combination of choices that will command the support of a broad cross-section of our people. While no one wants increased taxes or reduced benefits, most Americans also subscribe to the view that a good nation is a caring one.

Chapter Seven

Politics, Commitment, and Paying the Bill

Policy analysts may find it useful to divide a society's problems into their component parts, but the exercise is misleading. When we dwell separately upon the problems of infancy and early childhood, adolescence and young adulthood, older adults, and the aged, we risk obscuring a larger point: the extent to which all the groups of any society are interconnected. However compelling the special needs of each distinct group, each also remains dependent upon the welfare of the others.

The elderly are not alone in their passionate interest in social programs that help with the costs of long-term care. Working adults share this concern, for without such help, the destitute aged may impose crushing financial burdens on their sons and daughters. Similarly, if we rescue young children, even before birth, from the blighting effects of poor nutrition and medical care, not only is their suffering diminished but society saves billions of dollars in future medical costs. The benefits of education are equally profound. America's competitiveness in the world economy, as well as its internal tranquility, depend heavily upon our ability to produce a skilled, well-educated work force, rather than relegating more and more of our young people to an alienated, unproductive underclass.

The continued neglect of these and other social problems threatens to deepen the current conflicts in American society, for the forces of division do not stand still. Most Americans still live in the traditional nuclear family, with two parents to share in producing income, caring for children, and maintaining the home. But more and more families are headed by single parents who find it much harder to cope. In an economy that demands more and more highly skilled workers, those who are well educated can count on commensurate rewards and those who are not so prepared will be able to count on less and less.

We cannot overstate the shortsightedness of ignoring America's social challenges. Granted that not all previous attempts to address them have met with success, and that huge Federal budget deficits discourage new program initiatives. However, these difficulties hardly argue for inaction. Some previous attempts have in fact succeeded, and much has been learned from those that have failed. Some new initiatives could provide help without requiring massive new public expenditures, while others could invest new public funds in the wholly reasonable expectation of a greater return in labor productivity, new tax revenues, and reduced costs.

The panel believes that the American people will accept new social welfare initiatives to the extent that such initiatives respect broadly shared values and have a reasonable prospect of success. We believe that any new approaches to social welfare policy ought to rest on the following principles:

The first is pragmatism. Although the public rightly expresses impatience with social programs that misapply resources or promise more than they can deliver, there is every reason to believe popular support could be generated for those that address obvious problems in a cost-effective way. Programs of prenatal care and early childhood nutrition and development, for example, have been shown to be sound investments that yield vast dividends by averting the costs associated with stunted physical, emotional, and intellectual growth. Business partnerships with high schools have proven effective in expanding school resources and improving student performance. There is a widely felt need for all Americans to be covered by some form of health insurance, and there are workable ideas for a fair sharing of the cost. Similarly, there is broad, often painful, recognition that it makes no sense to continue financing long-term care by forcing certain families to deplete their assets and go on welfare, when equitable, insurance-based programs can be created.

The second principle essential to the acceptance of a new social welfare agenda is respect for the family. For the vast majority of Americans, the family plays the most important role in nurturing individual growth and protecting people in times of adversity. Many of today's most urgent social problems are the direct result of family breakdown. Government policy should strengthen the family rather than undermine it. In this light, programs that help young children are of particular value. They can help prepare children for responsible parental roles. There is also a need for programs that retrain displaced workers and programs that offer direct financial support and do not condition benefits on the absence of a spouse in the home.

The third principle is individual accountability. Social policy should offer protection as well as opportunity, but it ought not to offer the protection in such a way that it fosters dependency and closes off opportunity. For example, programs of aid to unemployed parents ought to condition the benefits on the parents' willingness to pursue job training or education.

A Summary of the Panel's Recommendations

Recognizing these principles, the panel offers the following specific recommendations for each stage of the life cycle. We have made it clear in this report that both the public and private sectors will have to devote some new resources in order to achieve the objectives we have proposed. We have also tried to acknowledge the difficulty of some of the problems we seek to solve. To pay the Federal government's cost of fulfilling our recommendations—a figure the panel estimates at $29 billion a year—we believe that Social Security benefits should be given the same Federal tax treatment as private pensions. Comparable taxation of Social Security and private pension benefits would help raise more than half of the revenues that are required to finance the panel's program of assistance to needy people of all ages. There is no lack of sound ideas. All that is needed is the political will.

Stage 1 – To improve the lives of infants and young children in impoverished homes

- The Federal government should fully fund the WIC program as an entitlement for nutritionally at-risk women and children with incomes up to 185 percent of the Federal poverty line. At the same time, administrators must find ways to improve the management of WIC benefits.

- The government should commit itself to the goal of giving all pregnant women access to prenatal care and well-baby care. Breathing life into this goal will require an outreach effort aimed at people who need these services. It will also involve offering incentives that encourage primary-care physicians such as internists, pediatricians, and obstetricians to serve indigent patients and to provide preventive care.

- The Head Start program should be expanded to increase the number of slots so that many more of the eligible three- and four-year-olds can participate. More of these slots should be for full-day programs for children with working parents. Very low-income parents, especially teenage mothers with children below age three, should receive expanded family support, referral, and home visiting services. Staff of early childhood development programs should receive better compensation and training.

- Adequate Federal funding should also be provided for other measures that benefit children, including Social Services Block Grants, AFDC-Foster Care, the Child Abuse Prevention and Treatment Act, the child welfare services provisions of the Social Security Act, and continued research on child welfare problems at the National Institute of Child Health and Human Development. It is also important to provide financial and informational support to states and localities that seek to improve services for young children.

- The Federal government should subsidize lower-income families by refunding an amount equal to the existing tax credit for day-care services to families whose incomes are too low to permit taking a credit.

- States and localities should test and implement new approaches to providing family-support services that feature effective early intervention, parent education, and the coordination of diverse public programs.

Stage 2 – To ease the transition from school to work
for poor adolescents and young adults

- The panel endorses the pursuit of business partnerships with schools to enhance school resources.

- The panel endorses ongoing efforts to prevent teenagers from becoming pregnant and to provide counseling, health services, and day care for those who do.

- The panel calls for treatment on demand for all drug users who seek help.

- The Congress should maintain or restore adequate funding for programs aimed at disadvantaged adolescents, including the Job Training Partnership Act, the Job Corps, the Summer Youth Employment Program, and Chapter 1 of the Education Consolidation and Improvement Act.

- State governors and legislatures should use their power to direct Federal funds to leverage local action in a concerted, sustained attack on the problems of young people who are at risk of failing to make the school-to-work transition. There should be interagency state youth councils composed of senior officials from education, job-training, and human-services agencies. The councils should be charged with coordinating service delivery, sharing information, and maintaining continuity and quality control in local programs for at-risk youth.

- Every community should consider establishing a committee composed of school, job-training, and business representatives, to be charged with assessing the state of local youth resources and developing a plan to deal with deficiencies. Such committees ought to bear in mind:

  the usefulness of schools as centers for delivering integrated services to adolescents;

  the need for early detection to forestall problems;

  the interrelatedness of leaving school; teenage parenthood, unemployment, and welfare dependency;

  the need to offer young people personal reasons to succeed in life and work;

  the importance of private-sector involvement.

Stage 3 – To enhance opportunities and secure protections for Americans of working age

- The Federal budget deficit should be reduced in steps that achieve real long-term savings. These may include reductions in entitlement benefits, discretionary non-defense programs, and non-critical national defense outlays. They may also include tax increases.

- The Federal government should do what it can to arrest the decline in savings and to increase private investment.

- Business and labor should encourage flexible compensation, incentive pay, and profit-sharing arrangements, along with changes in obsolete management practices and work rules. Other desirable measures should enable workers to change jobs without losing pension and health benefits.

- The purchasing power of the minimum wage should be returned to its 1981 level.
- The earned income tax credit should be expanded by varying its benefits with the size of the recipient's family.
- The Federal government should require employers either to offer a basic package of health insurance coverage to workers or to contribute an amount per employee to a fund that will finance coverage for uninsured workers.
- Medicaid should be reformed in the following ways:

  Coverage should be assured to the poor who do not qualify for employer-mandated coverage.

  Coverage should not be limited to those receiving cash welfare assistance.

  The program should place more emphasis on early treatment and preventive health care.

- Unemployment Insurance should be reformed in these ways:

  Administration of the program ought to be tightened up, especially by requiring claimants to make more serious efforts to seek work.

  Unemployed persons in declining labor markets should be able to receive their benefits as lump-sum payments that can be used to move to a more promising labor market.

  The schedule of UI benefits should be recast so that they are high for the first several weeks, and then decline gradually as more training and employment services are provided. Benefits for those who have experienced a long period of unemployment should be extended beyond the normal termination period only if the recipient agrees to participate in a serious retraining program.

Solvency standards should be established to put the state unemployment systems on a sounder and more equal financial footing. In addition, differences in benefit levels between states should be narrowed by increasing benefits in states where they are particularly low.

In regard to AFDC:

By the 1990s the Federal government should establish a national minimum benefit standard (AFDC plus food stamps) equal to two-thirds of the Federal poverty level.

The welfare system ought to emphasize work instead of long-term dependency, especially by setting a limit on the length of time those who are capable of working may receive welfare benefits. Such a limit would be coupled with the provision of a public-sector job for those who have exhausted their benefits but cannot find work.

Stage 4 – To enhance protection of the aged and their families

- The government should increase Federal SSI benefits to assure decent income for all the elderly, ease restrictive limits on liquid assets in order to qualify for SSI, and conduct outreach programs to increase the participation of those eligible for SSI.

- The government should save and invest the surpluses building up in the Social Security trust funds, instead of spending them for consumption of current services.

- Regarding long-term care:

  The critical issue is to move toward an insurance-based model, whatever the combination of public and private insurance. Public subsidies could encourage such a move, as could labor-management efforts to integrate such insurance into a flexible benefit package.

  Families and individuals should not have to pauperize themselves in order to become eligible for public long-term-care benefits.

The public must be educated about each individual's need for long-term-care insurance.

Acute- and long-term-care benefits should be better coordinated.

There is a need for greater public and private insurance for home care.

With better organization, the private nonprofit sector could provide better coordinated services to the elderly.

Community organizations might provide more respite care to the families of those who are caring for the disabled elderly.

Appendix A

Notes and Sources

The major sources used in developing the analysis and recommendations contained in this report are listed under each chapter head. In addition, the following sources were used in calculating the figures on income, demographics, benefits, program expenditures, and new revenue outlays cited throughout the report:

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Zedlewski, Sheila, and Jack A. Meyer, *Toward Alleviating Poverty Among the Elderly and Disabled* (Washington, D.C.: Urban Institute Press, 1987).

Appendix B

Research Funded by the Ford Foundation Project on Social Welfare and the American Future

Coalition on Human Needs, Washington, D.C.
"How the Poor Would Remedy Poverty: A Survey"

Fay Cook, Northwestern University
"Convergent Perspectives on Social Welfare Policy: The Views from the General Public, Members of Congress and AFDC Recipients"

Mary Corcoran et al., University of Michigan
"The Intergenerational Transmission of Poverty and Welfare"

Martha Derthick, University of Virginia
"The Plight of the Social Security Administration Since 1970"

David Ellwood, Harvard University
"Social Welfare Reform: A Categorical Perspective"

Tekie Fessehatzion, Jackson State University
"The Effects of Government Public Assistance Programs on the Economic Well-Being of the Mississippi Delta Poor"

Edward Gramlich, University of Michigan
"Local Government and Private Charity Responses to Federal Welfare State Programs"

Russell Hanson, Indiana University
"The Dynamics of Welfare in a Federal System: A View from the States"

Leonard Hausman, Brandeis University
"Employer Benefits and the Future of the Social Protection System"

Hugh Heclo, George Mason University
"The Responsible Society: Taking Stock of American Social Policy"

Bruce Jacobs, University of Rochester
"Media Portrayals, Public Understanding, and Policy Options for U.S. Programs Benefiting the Elderly"

Christopher Jencks, Northwestern University
"An Assessment of Poverty and Hardship in America"

Ira Katznelson, New School for Social Research
"Setting the Social Welfare Policy Agenda"

Robert Lerman, Brandeis University
"Developing a Strategy for Reducing Poverty Outside the Welfare System"

Frank Levy and Richard Michel, Urban Institute, Washington, D.C.
"Economic Growth, Standards of Living, Income Inequality and Related Welfare Needs and Responses"

Michael Lipsky and Stephen R. Smith, Massachusetts Institute of Technology
"Recent Changes in Government/Non-Profit Relations"

Manpower Demonstration Research Corporation, New York, N.Y.
"Work/Welfare Initiatives: Lessons from a Multi-Site Demonstration"

Kay McChesney, University of Southern California
"Homeless Women and Their Children"

Keith Melville and John Doble, Public Agenda Foundation, New York, N.Y.
"Social Welfare Policy, the Public Perspective: Focus Groups and Citizen Review Panels on Reform Proposals"

North Carolina Center for Public Policy Research, Raleigh, N.C.
"Sitting Down Together: Community Forums on Future Aging Policy in North Carolina"

Ann Schnare and Sandra Newman, Urban Institute, Washington, D.C.
"A Reassessment of Shelter Assistance in America"

Robert Shapiro, Columbia University
"Trends in Public Opinion Toward Social Welfare Policy"

Theda Skocpol, Harvard University
"The Politics of Social Provision in the United States"

Timothy Smeeding, Vanderbilt University
"The Luxembourg Income Study Project"

Social Science Research Council, New York, N.Y.
"The New Survey of Income and Program Participation"

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Harold Watts, Columbia University
"Family Stability and Economic Well-Being Among Black and White Children"

Harold L. Wilensky, University of California, Berkeley
"The Political Economy of Welfare in International Perspective"

William J. Wilson, University of Chicago
"Poverty and Family Structure in the Inner City"

Research Advisory Committee

Hugh Heclo, George Mason University, *Chair*

Fay L. Cook, Northwestern University

Edward M. Gramlich, University of Michigan

Ira Katznelson, New School for Social Research

Alicia Munnell, Federal Reserve Bank of Boston

William J. Wilson, University of Chicago

Appendix C

Occasional Papers of the Ford Foundation Project on Social Welfare and the American Future

1. David T. Ellwood, *Divide and Conquer: Responsible Security for America's Poor* (1987).

2. Judith M. Gueron, *Reforming Welfare with Work* (1987).

3. Gordon Berlin and Andrew Sum, *Toward A More Perfect Union: Basic Skills, Poor Families, and Our Economic Future* (1988).

4. Lawrence D. Brown, *Health Policy in the United States: Issues and Options* (1988).

5. David P. Weikart, *Quality Preschool Programs: A Long-Term Social Investment* (1989).

6. Frank Levy, *Poverty and Economic Growth* (forthcoming).

Representative HAMILTON. Mr. Straszheim, please proceed.

STATEMENT OF DONALD H. STRASZHEIM, CHIEF ECONOMIST AND FIRST VICE PRESIDENT, MERRILL LYNCH CAPITAL MARKETS

Mr. STRASZHEIM. Mr. Chairman, Congressmen Hawkins and Solarz, I appreciate the chance to come and talk to you today about infrastructure which is a pressing longrun problem.

I have a prepared statement for the record in its entirety, but I will be brief. I should also state my views are mine alone and do not necessarily represent those of my employer.

Unfortunately, there is no easy, quick, or cheap solution to our infrastructure problems. We have recently produced a report titled "Our Neglected Infrastructure." A copy of that is attached to my prepared statement.

Representative HAMILTON. A copy of it will be made part of the record, without objection.

Mr. STRASZHEIM. Very good. The cover chart on that report simply shows a very quick, but clear point. Over the last quarter century our commitment to infrastructure spending has declined from 2.2 percent of GNP to about 1 percent.

It is not clear exactly what the "right" level of spending on infrastructure is, nor is it obvious that that level would not change over time, but I think it is clear that what we are spending now is not enough and the evidence is all around us. The highways are pot holed and patched, bridges are out—there are isolated evidences of major problems there, mass transit systems are decayed and insufficient, there are air traffic control delays, and on and on. There is no reason to cite all of those statistics. They are really evident to all of us.

I think one of the problems is the returns to our infrastructure spending are earned over a long time. When budgets are tight, as they seem to have been now for many years, the infrastructure spending is sacrificed, it's considered as discretionary, and as a result we devote less and less of our resources to the infrastructure. There seems to be no well organized lobby for the infrastructure perhaps because the benefits to that spending are diffused over all citizens.

I think there is also a problem here that contributes to the infrastructure difficulty, which is the asymmetry in policy choices we make in the public sector. We seem as a government to choose policies which have shortrun benefits and longrun costs, and we avoid policies with shortrun costs and longrun benefits.

Maybe we should reconsider the issue of multiyear budgeting. It has been in the discussion recently, and it deserves consideration. Maybe we should reconsider the idea of capital budgeting in one way or another. It's not a new idea, but I still think it is a good idea.

Parenthetically, we are now again approaching budget decisions, as we seem to be all the time with Gramm-Rudman and the like. From my perspective creative accounting, budgetary gimmicks, and off-budget financing of one sort or another are part of the problem and not part of the solution.

It seems to me it would be more accurate to say the way we made decisions on infrastructure spending, defense spending, transfer payments spending, and all the rest is more fiscal result than fiscal policy.

To restore our infrastructure will take money and lots of it. There is no easy answer. Perhaps there is a significant amount of money in the military portion of the budget over a long period of time, but that requires decisions outside of this government.

If it is decided that additional dollars are needed, I would suggest that alcohol taxes, tobacco taxes, and gasoline taxes are a useful place to look.

The reason that the infrastructure problem is so pressing, it was just an inconvenience, but now it is a real cost to us all, cost to us as consumers and as producers. I know of no economist who would not make the point that productivity is a key, long-term ingredient to our economic growth, and there is growing evidence that our lack of infrastructure spending and our absence of spending in the public sector is hurting our national productivity.

I cite in the report that we produced, on page 5 the four charts which make basically the same point. Our public works capital spending versus private capital spending has been declining for 25 or 30 years. Our productivity is beginning to decline right along with our reduced spending on infrastructure.

If you look at our productivity growth and our public investment versus the same statistics of our major European competitors and Japan, they are on the top of the list and we are on the bottom, and our public spending versus private continues to decline.

David Aschauer, of the FRB of Chicago did an interesting study on this subject. What happens, trucks are slowed as they detour around bridges that are out, we all suffer internal delays at Washington National, at O'Hare, at Atlanta, and on and on. I think there is plenty of evidence to make that point.

The trade statistics that came out yesterday for the month of May would be regarded by most economists as unsatisfactory. I think there is a link between those trade statistics and our poor economic performance, and our lack of spending on infrastructure. It seems to me that we need to devote substantially more spending in this area.

Other areas which are the marriage of infrastructure and the emerging environmental concerns, are water supply, waste water treatment, solid waste disposal, hazardous waste disposal. These facilities are quickly becoming inadequate and it's going to take again a lot of money to make those facilities satisfactory, and I think there is plenty of evidence to that point as well.

One quick comment on education. There are two lines from the vast wasteland of television advertising that I think are striking here. One is the mind is a terrible thing to waste, and another is if you think school is hard, try 40 years at the minimum wage. We need better physical plant in our educational facilities, we need better teachers. That profession needs to be an honorable one again, as it was in the past. We need more motivated students. Maybe there is some substantial opportunity here for progress without new funding, but new funding will be a necessary condition although not surely a sufficient condition.

Last, just one quick comment on the current economic situation. Our view is that the economy is going to grow very little, if at all, in the second half of this year. Our views are somewhat less optimistic than the administration numbers released yesterday, but I would simply point out that infrastructure decisions are longrun decisions and ought to be made largely independent of shortrun economic ups and downs in the cycle.

Mr. Chairman, thank you.

[The prepared statement of Mr. Straszheim, together with the report entitled "Our Neglected Infrastructure," follows:]

PREPARED STATEMENT OF DONALD H. STRASZHEIM

I appreciate the opportunity to appear today before the Joint Economic Committee and to submit this statement on what I regard as one of the nation's pressing longer term problems—our neglected infrastructure. The views expressed here are mine alone and do not necessarily represent those of my employer.

Pursuant to the focus of these hearings, I begin with some observations on our physical infrastructure, followed by a brief comment on our investment in human capital and a comment on the current economic situation as it relates to our infrastructure. Following that is a copy of the report our organization produced on May 19th, titled "Our Neglected Infrastructure."

I. Our Neglected Infrastructure

Spending on our nation's infrastructure has slowed dramatically in the past quarter century, from over 2.2% of GNP to roughly 1% at present. While there is no immutable rule which indicates that infrastructure spending should be necessarily a constant share of output, nor one which indicates what the "proper" level should be—by definition, arbitrary–this decline since the mid-1960s is striking indeed.

The returns to infrastructure spending are earned over a long period of time and are diffused among the citizenry at large. Without a powerful, cohesive, and well organized lobbying force behind it, infrastructure spending seems to be regarded as substantially discretionary, at least in the short run. Therefore, when public sector budgets are tight as they seen to have been at all levels of government in recent years, infrastructure spending is sacrificed. At best, we paint over the rust and patch the pot holes—the cheaper, short run solution. Only as a last resort—and often when it is far more costly—do we tear down, build from scratch, and resurface the roadway.

The definition of our infrastructure is necessarily arbitrary. In our recent study, we looked at spending on highways and bridges, mass transit, airports and air traffic control, water supply and treatment, solid waste disposal, and hazardous waste disposal. We did not study the level of spending on human capital, schools, government buildings, and the like.

The result of the neglect of our infrastructure is all around us. For a time our decaying infrastructure could be passed off by the public—and our elected officials I might add—as largely a matter of inconvenience. But now, after so many years of neglect, the public is not just inconvenienced. There are serious economic costs for every American citizen. Our decaying infrastructure appears to have slowed our productivity growth, and accordingly has harmed our international competitive position. The work recently done by David Aschauer of the Federal Reserve Bank of Chicago I find convincing. Our public capital stock has not keep pace with our private capital stock. And, they are complements—not substitutes. Our lagging productivity, which all economists see as central to economic growth and a rising standard of living, is at least in part the result of our neglected infrastructure. It is no accident that Japan's high productivity growth goes with their high commitment of national resources to their infrastructure—where our situation is, sadly, just the reverse.

Our infrastructure spending itself is changing also, with a greater share being devoted to operations and maintenance, and less being devoted to the capital account. As the capital stock becomes older and older, this is of course a downward spiral. I would argue that our May 1989 merchandise trade statistics released on July 18 were unsatisfactorily in the red. The long run neglect of our nation's infrastructure is one of the factors—but of course not the only factor—contributing to our unsatisfactory trade position.

Every citizen has been confronted by closed highways and bridges, by detours, by temporarily reduced speeds, by outdated mass transit systems that constantly break down, and by airport and air traffic control delays which have become so commonplace that they are the rule rather than the exception. These difficulties inconvenience us as consumers. They hobble us as producers. These problem elements of our infrastructure are easily recognized and understood to be inadequate. They will not be cheap to bring up to speed. But as they grate on the public's nerves on a daily basis, and if the public can be taught the full economic costs, they will hopefully be upgraded.

But more attention also needs to be devoted to three other major areas—water supply and waste water treatment, solid waste disposal, and hazardous waste disposal. The relevant statistics here, a few of which are cited in our report, are striking in terms of the balloning cost of neglecting these public concerns. If we, the richest nation in the world, aren't better able to lead by example in these areas which link the infrastructure to our environment, how can we expect, for example, statements which we make to other poorer countries around the world to do more in this area to hold much weight?

Improving our nation's infrastructure will take money—lots of it—and for many, many years. It has become fashionable to criticize solutions to public problems which emphasize "throwing money at them." And perhaps there are some creative ways to help solve our infrastructure problems through incentives of one sort or another—what might be called the public use of private interest. While money is not a sufficient condition for bringing our infrastructure to an acceptable level, it is a necessary condition.

Where do we get the money? From new sources or from other programs? I don't have the answer. But I do want to make a more general observation about federal budgeting as I think the infrastructure problem is a good case in point. The time horizon of our elected officials, many would argue, is the next election. While that is painting with too broad a brush, I think that there is, understandably, some truth to the point. I have heard a statistic which I cannot confirm that the average tenure in office—during the entire decade of the 1970s of assistant secretaries and all those of equivalent or higher rank in the executive branch of the government—was 22 months.

As a consequence, we have an asymmetry in the kinds of policy choices we make. We tend to choose policies with short run benefits and long run costs, and we tend to avoid policies with short run costs but long run benefits. Infrastructure, unfortunately, is in the latter category. In order to make progress on the infrastructure, we must begin to reverse this mentality. We must think longer term. Few want to raise taxes, and few want to sacrifice existing government programs—which have beneficiaries and constituencies. The budget process, it seems to me, has become largely disfunctional in recent years. We have more of a fiscal result than a fiscal policy. Creative accounting and budgetary gimmicks are part of the problem, not part of the solution. Parenthetically, the approaching savings and loan bailout will be expensive, but putting such spending "off-budget" is not the answer.

II. Investment in Education

While the analysis we recently conducted focused on our physical capital, I can't resist a quick comment on our educational system and investment in human capital. A well-educated labor force is crucial to our international competitiveness, and to continued increases in our standard of living. In many of our largest cities especially, our educational standards seem to me to be declining and declining badly. In the worst of them, middle school and secondary school education seems to be little more than warehousing. There is an opportunity here for a major role to be played by governmental leadership. I was personally encouraged by the election campaign statements during 1988 in which President Bush indicated a desire to be known as the education president. This area too, as with our physical infrastructure rebuilding noted above, will be expensive. Our educational plant in many areas is badly decayed. And we must make teaching a competitively paid profession if we are to get the quality of teachers most Americans think we need.

III. The Current Economic Situation

I and my colleagues in the Economics Department at Merrill Lynch believe that after a long expansion, the economy is slowing substantially and second half 1989 economic growth will be near zero. The evidence of the slowdown is all around us. The rise in interest rates over the last year, and the lack of further progress on trade have been major contributors to the slowdown. Inflation is likely to peak in the 6% range before coming down in 1990. Interest rates, both short term and long term, appear to have already hit their cyclical peak and are likely to decline further into 1990. The dollar is likely to decline somewhat further as U.S. interest rates fall relative to foreign interest rates, and as U.S. economic activity is slower than economic activity abroad. As 1990 unfolds, we believe the economy will again begin to recover.

For a variety of reasons, the approaching period of economic weakness, recession or not, will likely be mild, not severe. We have had rolling recessions in agriculture, energy and commercial construction, sectors which are not likely to be weakened appreciably further. Additionally, inventories in most sectors of the economy are well under control. And lastly, the current weakness is likely to start at an inflation rate of 6% and not 12% as in 1981/82, and at a prime interest rate of 11%, not 21 1/2%, again as in the previous episode.

While this is our view of the current cyclical setting in the economy, I would argue that fiscal decisions regarding our infrastructure should be made largely independent of the current economic circumstance. The infrastructure focus should be over many years, not the recurrent cyclical ups and downs that the economy undergoes.

Merrill Lynch

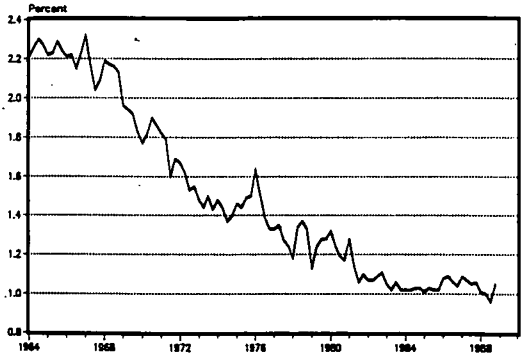
Weekly Economic & Financial Commentary

SUPPLEMENT

May 19, 1989

Our Neglected Infrastructure

Capital Outlays for Public Works as a Percent of GNP



SOURCE: Department of Commerce.

- Growth in spending on the nation's infrastructure has slowed dramatically.
- Our highways, bridges, and airports have become inadequate. Treatment of solid wastes, wastewater, and hazardous wastes is a growing problem.
- Our deteriorating infrastructure is seriously compromising the productivity and international competitiveness of the United States.
- Infrastructure spending must—and will—move higher on the national agenda and will yield a variety of investment opportunities.

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Summary

- The returns on infrastructure spending are earned over a long period. As a consequence, many elected officials regard infrastructure spending as discretionary.
- So, when public sector budgets are tight—as has been the case in recent decades—infrastructure spending is sacrificed.
- Evidence of our neglected infrastructure is all around us.
- We have only just begun the costly repair, and government budgets seem to be getting tighter.
- Our nation's inadequate infrastructure hurts commerce, industry, and the general public. A decaying infrastructure has slowed growth of productivity and has harmed the international competitiveness of the United States.
- The general public is gradually becoming aware that infrastructure problems are more than isolated personal inconveniences. They hurt everyone's standard of living.
- Necessity will dictate more spending on our infrastructure. Even though costly to public budgets, the infrastructure's ranking in spending-priority lists will rise.
- Improving our infrastructure will provide new investment opportunities in pollution control, engineering and construction, machinery, components, and a wide range of building materials.

Cover Chart: Our Neglected Infrastructure

The definition of a nation's infrastructure is admittedly hazy, but at the very least includes highways, mass transit, airports and airways, waterways and water supply, and waste-disposal facilities—all of which are essential to the national economy.

- Capital spending for those facilities has increased over time, but has not kept pace with economic growth.
- In 1964, we devoted almost 2.3% of our gross national product to capital spending on infrastructure.
- That share is now about 1.0% of GNP.

Portfolio Managers, Analysts Note: Follow-Up Reports

This report highlights a variety of industries—and notes certain companies—that will find their business climate affected by this issue.

We intend to produce a series of follow-up reports which provide more industry detail, and to include in these reports both in-depth analyses and specific recommendations on how to participate in such an investment theme.

A Declining Priority

Total public spending for our nation's infrastructure—capital and maintenance—dropped from 3.5% of GNP to 2.5% between 1960 and 1985. Perhaps equally important, the composition of infrastructure spending also changed materially (Chart 2).

- Slower growth of capital spending accounted for all of the decline.
- Spending for operations and maintenance continued to expand—but too slowly to maintain an aging infrastructure.

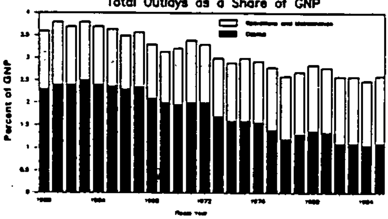
Government spending priorities have gradually shifted from infrastructure—where the payoff is realized over a long period—toward social programs—where the payoff is immediate and more visible.

- Federal, state, and local governments together devoted 6.8% of their budgets to public works in 1984, down from 19% in 1950 (Chart 3).
- Federal outlays for infrastructure dropped from 10.9% of total non-defense spending in 1962 to 4.5% in 1987 (Chart 4).

Chart 2

Infrastructure: A Declining National Priority

Total Outlays as a Share of GNP



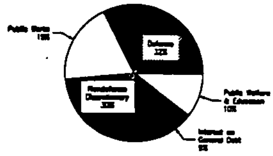
SOURCE: US Office of Management and Budget, "Budget Appendices of the United States", Bureau of the Census, "Government Expenditure Series", and "The Economic Report of the President", for various years.

Chart 3

Shift in Spending Priorities

All Government Spending in 1984 Dollars

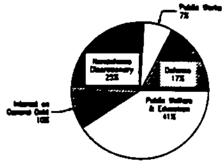
1950



$239 Billion

SOURCE: Apogee Research.

1984



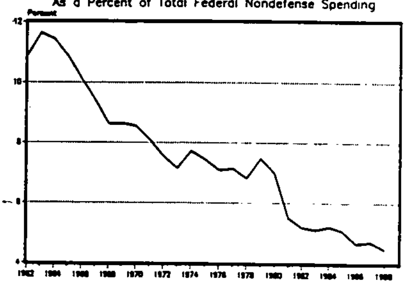
$1,428 Billion

SOURCE: Apogee Research.

Chart 4

Declining Federal Infrastructure Outlays

As a Percent of Total Federal Nondefense Spending



SOURCE: Office of Management and Budget.

A Bad Report Card

The stock of infrastructure has plateaued at something less than $1.0 trillion. Most of that stock was built before 1975 (Chart 5).

- Between 1960 and 1975, real public-works assets per capita grew by 40%—from $2,767 to $3,889, or at an annual rate of 2.3%.
- But during the next 10 years, our per capita infrastructure assets grew by less than 0.1% a year—far below growth of GNP.

And the condition of our infrastructure is marginal, at best. After a three-year study, the National Council on Public Works Improvement stated that..."If our public works were graded on an academic scale, their recent performance would earn a scant C." The grades given in the study were:

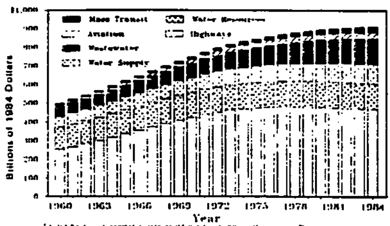
Highways	C+
Mass Transit	C–
Aviation	B–
Water Resources	B
Water Supply	B–
Wastewater	C
Solid Waste	C–
Hazardous Waste	D

Source: Fragile Foundations: A Report on America's Public Works, National Council on Public Works Improvement, 1987.

Chart 5

Public Capital Stock Plateaus

Public Works Net Capital Assets



* [illegible]

SOURCE: U.S. Department of Commerce, Office of Business Analysis

The Infrastructure-Productivity Link

U.S. infrastructure has also eroded in relation to the private capital stock. The problem is that the infrastructure complements private capital in production of goods and services. A well-functioning infrastructure also encourages private investment and economic development.

- In 1960, the government spent $15 for every $100 that private business spent for capital improvements. By 1985, that ratio had been cut in half (Chart 6).
- The per capita stock of infrastructure dropped from $16,000 in 1972 to $14,000 in 1984, but private-capital stock per capita continued to climb (Chart 7).

The erosion of our infrastructure in relation to our private capital stock has hampered growth of productivity. Deteriorated highways and closed bridges slow the transportation of goods from factory to market. Air and highway traffic delays add to labor costs.

David Aschauer, an economist at the Federal Reserve Bank of Chicago, has found striking evidence linking the dearth of investment in public capital to the slowdown in private sector productivity growth (See Chart 8).

The Group-of-Seven countries with the highest rates of productivity growth—Germany and Japan—also devote the largest share of their national product to infrastructure investment (Chart 9).

The bottom line is clear. If we are concerned about our living standard and our ability to compete internationally, we should also be concerned about the nation's infrastructure.

An Example:

A large steel company in a Midwestern city estimates that it paid at least $1 million a year in additional costs to detour its trucks 18 miles around a major bridge that the state had closed for lack of repair.

Chart 6

Public Investment Lags Private

Public Works Capital Spending vs Private Capital Spending

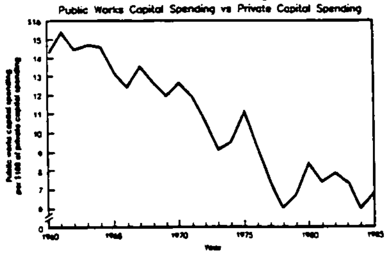
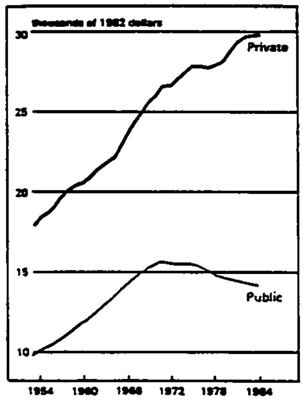


Chart 7

Infrastructure Investment Lags

Capital Stock per Worker



SOURCE: David Alan Aschauer, Federal Reserve Bank of Chicago.

Chart 8

Lagging Infrastructure Hurting Productivity

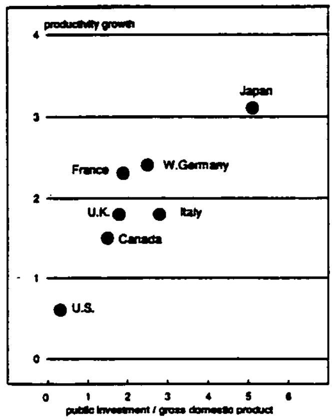
U.S. Productivity vs Investment in Public Works

SOURCE: David Alan Aschauer, Federal Reserve Bank of Chicago.

Chart 9

U.S. Lags G-7 Nations

Productivity Growth vs Public Investment



SOURCE: David Alan Aschauer, Federal Reserve Bank of Chicago.

Highways and Bridges: Crumbling and Costly

Highways and bridges are the nation's single-largest public-works capital asset. Spending for highways has declined over time and represented about 46% of total public-works spending in 1987 (Chart 10).

Our highways are hurting. New highway construction peaked in 1968, and spending for maintenance in relation to vehicle-miles traveled slowed markedly after 1975 (see Charts 11 and 12). With the average life of a road estimated at 28 years, many of the roads constructed in the 1950s had reached the end of their useful lives by the early 1980s. Yet, net public investment in highways declined by 0.5% each year between 1980 and 1983.

- More than 25% of interstate pavement had deteriorated or was in a deteriorating condition in 1985.
- Non-interstate highways are in similar shape.
- About 30% of our bridges are past their estimated 50-year average useful life. At the end of 1986, the Federal Highway Administration estimated that 23% of the nation's 575,000 bridges were structurally deficient.

Thanks to the 5¢ a gallon increase in fuel taxes in 1982, capital spending for highways began to rise again in 1983, and the downtrend in net highway capital assets bottomed in 1984.

But the recent increase in spending is clearly insufficient.

- In real terms, the cost to rehabilitate existing highways and bridges is estimated at $40 billion annually between 1989 and 2000.
- But, in 1987, real spending on rehabilition was only about $24 billion (Chart 13).

Meanwhile the need for roadway infrastructure continues to grow. Vehicle-miles traveled increased at a steady 3.0% annual rate between 1960 and 1985, and growth is projected at a 2.6% annual rate at least until the mid-1990s.

- Trucks are transporting a rising share of freight. In 1985, trucks accounted for about 40% of freight transport—up from 22% in 1965.
- Regional shifts in economic activity and growing intersuburban travel have created more congestion and greater need for roadway infrastructure.

Foregoing spending on highway infrastructure will mean additional expenses for mass transit, for business-transportation delays, and for auto maintenance and repair, among other things.

Chart 10

Composition of Infrastructure Outlays

Total Government Spending for Infrastructure

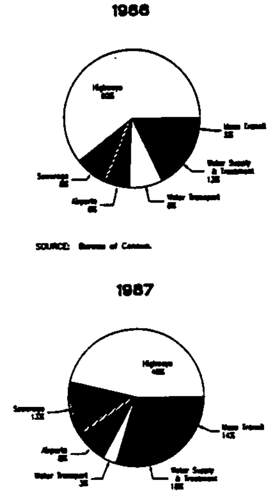


Chart 11

Road Construction Long Past Peak

Capital Spending for Roads & Bridges vs Miles Traveled

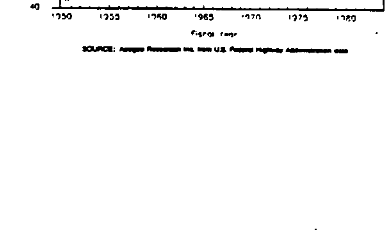
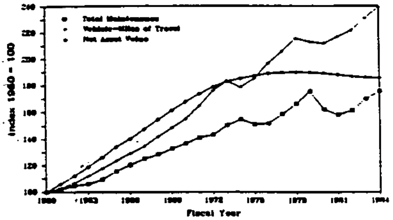


Chart 12

Highways Erode from Low Maintenance

Net Asset Value, Miles of Travel and Maintenance Spending

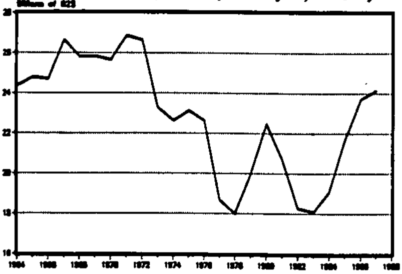


SOURCE: Apogee Research, Inc., from U.S. Department of Commerce [illegible] and U.S. Department of Transportation, Federal Highway Administration data.

Chart 13

Highway Spending on Rise, But Not Enough

Total Government Capital Outlays for Highways & Bridges

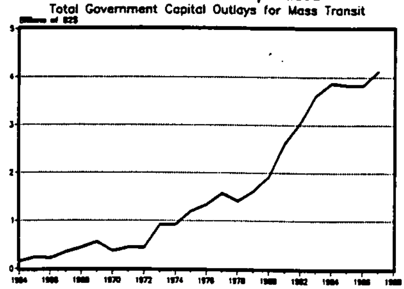


SOURCE: Bureau of Census.

Chart 14

Mass Transit Overcapitalized

Total Government Capital Outlays for Mass Transit



SOURCE: Bureau of Census.

Mass Transit: Misallocated Resources

In contrast to spending on roadways, capital spending for mass transit has risen dramatically since the early 1970s. Controversial federal-aid programs are responsible for much of that gain. The result is mass-transit systems that are overcapitalized in some areas and undercapitalized in others (Chart 14).

- Mass-transit fixed assets rose from $10 billion in 1965 to $34 billion in 1984, and the number of passenger trips actually declined (Chart 15).
- The mass-transit share of public works spending nationwide rose from 5% in 1965 to almost 14% in 1984 (Chart 10).

Meanwhile, public preferences have shifted from mass transit. Public transportation as a share of urban travel declined from 3.6% in 1986 to 2.6% in 1987.

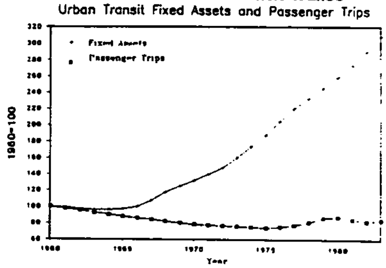
Many smaller cities with public bus systems have significant overcapacity. At the same time, many rail systems across the country still have major capacity shortages.

- The older subway systems in cities such as New York, Chicago, and Philadelphia still need substantial rehabilitation.
- Almost 60% of maintenance facilities and railyards across the country are rated bad-to-poor.

Chart 15

Demand for Mass Transit Wanes

Urban Transit Fixed Assets and Passenger Trips



Source: Apogee Research, Inc. from U.S. Department of Commerce data.

Airports and Air Traffic Control: Costly Delays

Total public spending for aviation—airports and air traffic-control systems—has risen considerably since 1960, but has not kept up with the rate of growth in air travel. Public spending per passenger mile fell from a high of 80¢ in 1960 to 20¢ in 1985 (Chart 16). That reduction, along with a sharp increase in air travel, has contributed to a major rise in congestion and delays.

- The average airport delay has risen from 11.2 minutes in 1976 to 13.6 minutes in 1984. Anecdotal evidence suggests that delays are far longer at present.
- The economic and personal costs of delays are substantial—the cost to the airline industry alone totals about $1 billion a year.

The Department of Commerce projects that the need for airway infrastructure will grow at a 3.3% annual rate between 1984 and 1995.

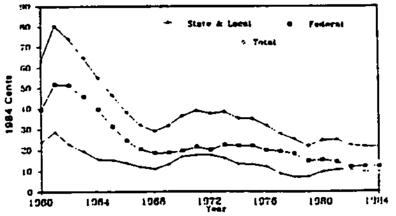
Spending for airports and airways has increased by about $1 billion since 1982—thanks to higher taxes on airplane tickets. But far more spending will be necessary (Chart 17). The Congressional Budget Office estimates that real capital spending for airports should increase by another $2.5 billion annually during the next 10 years—roughly double the current spending level.

To update the nation's air traffic control system with the latest technology—an attractive prospect in terms of efficiency and public safety—could easily double the aforementioned spending levels.

Chart 16

Air Travel Outpaces Spending

Aviation Public Spending per Billion Revenue Passenger Miles

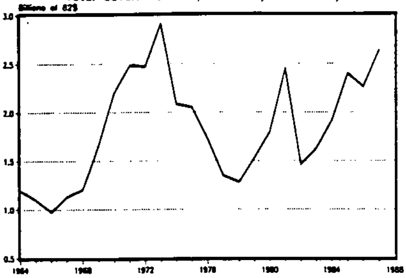


SOURCE: Apogee Research, Inc., from the U.S. Bureau of the Census and U.S. Department of Transportation data.

Chart 17

Spending for Airways on Rise

Total Government Capital Outlays for Airways



SOURCE: Bureau of Census.

Water Supply and Treatment: Progress and Problems

Both older and young cities will require major spending for water supply and treatment.

- Many older cities are experiencing declines in the quality of water supply and in water pressure because of old and leaky pipes. Replacement costs will be $4-to-6 billion annually.
- In the West and South, rapid population growth has put new demands on water systems. Expansion costs will add another $4-to-6 billion annually.

Facilities to remove wastes from water used by individuals and industry before it is returned to the natural environment have been materially improved over the past decade.

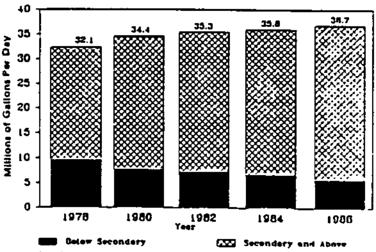
- From 1978 to 1986, the total value of wastewater-treatment facilities rose from $110 billion to $138 billion— the fastest growth of any infrastructure category.
- The quality of wastewater from controlled sources has improved markedly in response. But, an increase in uncontrolled sources of pollution—from farms and roadways—has kept overall water quality about constant.
- The number of persons served by wastewater facilities rose by 17% between 1976 and 1987, and the share of the population served by sub-standard treatment facilities declined (Chart 18).

Despite advances in the last decade, new standards set for wastewater treatment by the Environment Protection Agency in 1988 will require a $60 billion capital infusion.

Chart 18

Better Water Quality from Controlled Sources

Population Served by Treatment Plants by Level of Treatment



SOURCE: U.S. [illegible]

Solid Waste Disposal: Crisis in the Making

A serious crisis is developing in solid-waste disposal. About 95% of approximately 450,000 tons of solid waste generated each day is disposed of in landfills that are rapidly filling.

- New environmental regulations and public opposition have made new disposal sites increasingly difficult to locate.
- In addition, more than half the present landfills fail to meet the latest environmental regulations and need to be replenished. That requires the addition of liners, drainage systems, and pollution-control equipment.

Costs of solid-waste disposal are rising rapidly.

- Municipalities paid $3-to-4 a ton to manage solid waste in 1979. The cost is now $20 a ton nationwide. And in many cities on the east coast, the costs exceed $100 per ton.
- In our "throwaway" society, waste-disposal per capita increased from 2.3 pounds a day in 1960 to 3.1 pounds a day in 1985.
- But per-capita public spending on solid-waste disposal rose more—from $11.90 in 1960 to $21.44 in 1985.

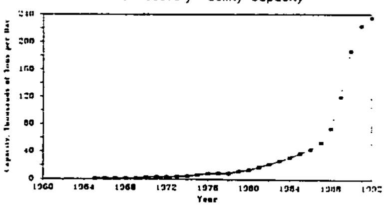
Spending for resource-recovery facilities is growing rapidly because of worsening landfill problems. By burning wastes, resource-recovery facilities are able to reduce volumes by about 95% and to generate energy as a by-product.

- By 1991, resource-recovery facilities will be capable of handling an estimated 240,000 tons of solid waste a day—about half of the total waste generated daily (Chart 19).
- Building that capacity will cost about $17 billion.

Chart 19

Resource Recovery Capacity Poised to Jump

Resource Recovery Facility Capacity



SOURCE: [illegible]

Hazardous Waste: A Time Bomb

Each year, industries in the United States generate more than two tons of hazardous waste per capita.

- In recent years, federal and state laws governing hazardous-waste disposal have been strengthened.
- But progress in final disposal of hazardous wastes has been slower than expected.
- As a result, only a fraction of the current production of hazardous wastes is being treated safely.

The past mishandling of hazardous waste leaves about 900 currently identified uncontrolled disposal sites eligible for federal cleanup. That number could run into the thousands. Cleaning up such sites could easily cost $100 billion.

Different Cities; Different Problems

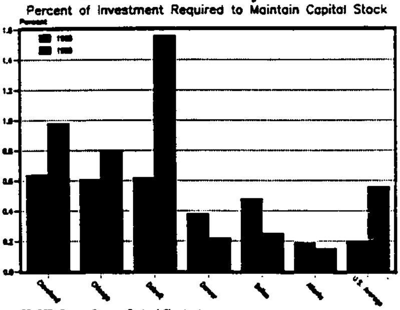
As the infrastructure grows and ages, a greater share of spending must be devoted to maintaining the current level of infrastructure.

- In 1965, 20¢ of every dollar spent for infrastructure nationwide was needed to maintain the stock of public capital. By 1985, 56¢ of every dollar was needed for the same purpose (Chart 20). The problem is greatest in older cities.
- In Cleveland, where 80% of the infrastructure was put in place before 1970, 98¢ of every infrastructure dollar is used just to maintain the current level (Charts 20 and 21).
- In Detroit, infrastructure spending would have to increase by 56% from the current level just to maintain existing infrastructure at its present decayed condition—leaving no funds for future needs.
- By contrast, in Dallas, where only 40% of infrastructure assets were in place before 1970, just 15¢ of every dollar is used to maintain infrastructure in its current condition.

Chart 20

More Severe Older City Problems

Percent of Investment Required to Maintain Capital Stock

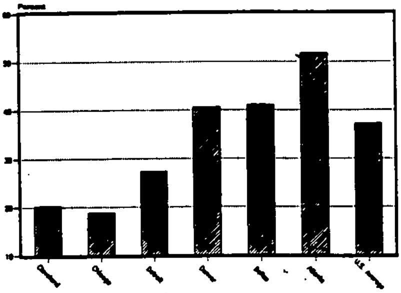


SOURCE: Federal Reserve Bank of Cleveland.

Chart 21

New Cities, New Infrastructure

Percent of Infrastructure Put in Place Since 1970



SOURCE: Federal Reserve Bank of Cleveland.

Our changing economy means changing infrastructure requirements.

- The relative importance of service, high-tech, and financial-service industries is increasing in the U.S. economy. Those industries use fewer materials, and produce less pollution.
- Computer and communication technologies are allowing greater dispersion of economic activity and creating more need for transportation systems on the periphery of urban areas.
- Advanced composite materials will be lighter and easier to transport. But, production of those materials will increase the need for hazardous waste management.
- Growing environmental concerns—hazardous waste, the "greenhouse effect," ozone depletion, food-supply safety, groundwater contamination and others—imply both more and different infrastructure needs.
- A migrating population also changes infrastructure needs. In 1970, 48% of the U.S. population lived in the South and West. That share is expected to rise to 62% by 2010.

How Much Spending Is Necessary?

While estimates of the cost to rebuild our infrastructure vary considerably, they all have one common characteristic—all are high.

- The Association of General Contractors (AGC) estimates that rebuilding the U.S. infrastructure to a predetermined set of engineering standards will cost $112 billion a year between 1989 and 2000 (Table 1).
- The Congressional Budget Office (CBO) and the Joint Economic Committee (JEC) project that $50-to-65 billion in annual spending will be necessary over the same period.
- The National Council for Public Works Improvement recommends that annual real capital spending over the next decade for new and existing public works should double from the 1985 level of $45 billion.

Table 1

Comparison of Annual Capital Investment Requirements And Actual Capital Outlays (In billions of 1982 dollars)

Infrastructure Category	AGC Study	CBO Study	JEC Study	Actual Outlay 1985-86
Highways and bridges	$62.8	$27.2	$40.0	$23.4
Other transportation (mass transit, airports, ports, locks, waterways)	17.5	11.1	9.9	8.0
Drinking Water	6.9	7.7	5.3	4.5
Wastewater treatment	25.4	6.6	9.1	5.7
TOTAL	$112.6	$52.6	$64.3	$41.6

Figures include approximately $2 billion in direct federal capital spending; the rest is state and local government expenditures.

Source: National Council on Public Works Improvement. *Fragile Foundations: A Report on America's Public Works.*

Less Help From Federal Government

At the federal level, pressure for reduction of the current budget deficit makes the possibility of any real increase in spending on infrastructure during the next few years remote.

Federal spending accounts for less than a third of total spending on public works, but for more than one-half of spending on capital projects (Chart 22). Real federal spending for capital projects has been flat to down for the past 10 years (Chart 23).

- About 80% of federal outlays for infrastructure capital take the form of grants-in-aid to state and local governments. Grants-in-aid in 1988 were no higher in real terms than they were in 1978.
- And, direct federal spending for infrastructure capital—mainly for water projects and airports—was lower in 1988 than in 1978.

More than two-thirds of federal outlays for public works are financed from trust funds, which are funded largely with excise-tax receipts.

Ironically, the government's two main infrastructure trust funds, the Highway and Airport and Airways Funds, have run annual surpluses since the early 1980s and currently hold cash balances of more than $20 billion. Those trust funds are part of the unified budget. But when gasoline taxes and other user fees were raised in the early 1980s, some of the new revenue was retained in the trust funds to yield a smaller overall budget deficit instead of being used for improving the infrastructure.

Chart 22

Where the Money Comes From

Government Capital Outlays for Public Works

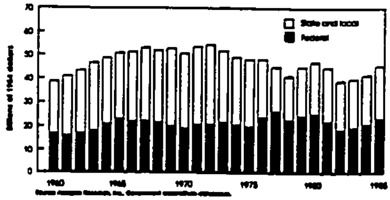
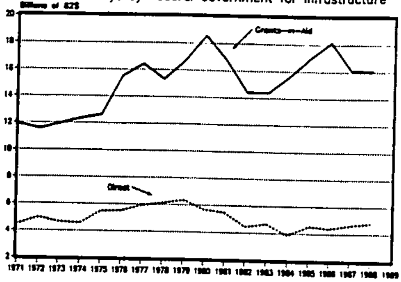


Chart 23

Federal Government Contributes Less

Capital Outlays by Federal Government for Infrastructure



SOURCE: Office of Management and Budget.

More State and Local Money?

As long as current sentiment about federal deficit reduction prevails, any real increase in spending for infrastructure will come from state and local governments.

- State and local governments account for 50% of capital spending for the nations public works, but for 87% of total outlays for their operation and maintenance (Chart 24).
- Spending for operations and maintenance has continued to expand in line with growth of the economy, but state and local spending for infrastructure capital peaked in 1972.

The leveling of Federal grants-in-aid is forcing states to assume greater responsibility for infrastructure projects.

- Limits on property taxes, limits on spending levels and other fiscal austerity measures will continue to restrict the availablity of general tax revenues for state and local infrastructure projects.
- But higher user and impact fees are easier to approve when infrastructure is deteriorating.
- Voters are usually receptive to new municipal-bond issues for particular infrastructure improvements when the need is evident.
- Special districts and authorities that issue bonds without voter approval are another financing alternative at the state and local level.
- The leasing of private-sector infrastructure facilities by municipalities is also on the rise.

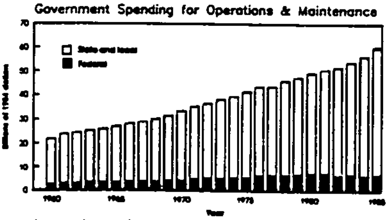
New restrictions in the Tax Reform Act of 1986 sharply curtailed issuance of tax free municipal bonds for infrastructure projects, especially for solid-waste disposal, airports, and industrial-pollution control.

Efforts are currently under way to roll back those restrictions for infrastructure projects, but new tax initiatives--for any purpose—will not be easy to get enacted in the present budget climate.

Chart 24

Burden on States Rise

Government Spending for Operations & Maintenance



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Representative HAMILTON. Thank you very much, Mr. Straszheim.

Thank you all for excellent statements.

We will begin the questions with Congressman Hawkins.

Representative HAWKINS. Thank you, Mr. Chairman.

I think I can be very brief because fortunately there is nothing for me to refute. I think that one could not agree more with the witnesses today.

The common sense you make, however, is not translated, unfortunately, into action here in the Congress or here in the Federal Government itself.

You indicated in the statements that were presented to the committee that there is one possible answer, and the answer seems to be either to change the priorities or to increase taxes. It seems to me that is what it basically boils down to.

In view of the fact that we are not likely to change priorities, but to move in the opposite direction, it seems very difficult then to increase taxes as well. The President is obviously opposed to it, and even if the Congress were so disposed, and I am not altogether sure that that is also true, may I ask whether or not there is some possibility that the situation may be relieved if we can obtain the type of economic growth which is compatible with deriving the added or sufficient revenues to meet our needs without increasing taxes for the time being, leaving aside whether or not the tax structure itself can be made fairer or more progressive, et cetera?

Would you indicate, and perhaps I could refer to you, Professor Tobin, since you were the first witness, whether or not the current economic growth is vigorous enough to do some of the things we need to do without necessarily taking the money away either from defense, which seems out of the question now since we are moving in the opposite direction, or increasing taxes, which politically seems to be virtually impossible at this time?

In other words, I'm asking whether or not we could do it through economic growth, which doesn't seem to have to be so great that it would threaten inflation, or if inflation is a threat, that inflation could be controlled otherwise than by continuing on what may be stagnant economic growth?

Mr. TOBIN. Well, I think the short answer to your question is no. You can't expect growth alone to solve the problem. In fact, the lack of budgetary and tax policies enabling us to reduce the deficit and to engage in public investment is one of the main reasons we have low economic growth. Given that those policies might be the sources of the economic growth problem, it's hard to expect that economic growth will bail us out.

Right now we have reached the point in the recovery from the recession at the beginning of this decade where we have reduced unemployment and excess capacity about as far as we can. We had high economic growth during most of the 1980's after 1982 because we started with a lot of slack in the economy, a lot of unemployment, and a lot of excess capacity. Now we don't have that slack to take up.

Now we are dependent upon the rate of growth of the capacity of the economy to produce with a constant unemployment rate. That growth rate is around 2½ percent. Of that growth rate, right now only 1 point of the 2½ percent is attributable to productivity increase, and thus increases real income per worker. The rest of it is the result of increases in the labor force. That number also will decline in the future, for demographic reasons.

What we have been talking about this morning is how to increase the rate of growth of productivity, because that is going to be the source of improvement in standards of living for the future.

It may be that it will just happen spontaneously. It could be that we would have a burst of invention, innovation, and entrepreneurial activity that would make productivity return to the levels it was immediately after the Second World War.

It may be that the American people will increase their private saving on their own accord. We have saved smaller percentages of their incomes in the 1980's than before, but Americans have never been big savers compared with other countries.

I think it's whistling in the dark to count on those miracles, those spontaneous changes, and to do nothing of a policy nature to bring about the desired result which is, as you say, an increase in growth.

You should, I believe, regard the Federal Government's policy problem as one of taking steps to improve the rate of economic growth. You should not wait for spontaneous increases in economic growth to bail the Congress and the administration out of the consequences of the fiscal policies they have been following for the last 10 years.

Representative HAWKINS. You're saying in effect that you can't get the growth without the investment that is recommended. However, how can we convince the responsible individuals, the Congress and the President, not to heed the recommendations that are being made to cut back on the very programs that have been mentioned here as being cost effective?

Everyone agrees that WIC is cost effective, as are Head Start, chapter 1 preschool programs, et cetera, and that in the long run they would pay for themselves and they help productivity-wise and they would provide added revenues and effect savings. However, how can one explain then that we go on receiving recommendations to cut spending from the President and from the Council of Economic Advisers? I've never heard anyone from the Council of Economic Advisers suggest to this committee, since 1980 at least anyway, that we should make these investments.

What you said today, you're among the first to have made that point I think. One of the subcommittees headed by my friend Congressman Jim Scheuer I think documented very well what education could do for the Nation.

I talked to the chairman of the Public Works Committee about what the condition of the infrastructure is, and he related to me a case, arising out of I guess it was the State of Tennessee, where the school buses cannot cross some of the bridges because they are unsafe, and the children get out of the bus and walk across the bridge and then get back into the bus. Now in a country such as ours that is a deplorable situation.

It's difficult to explain or to understand how it is that we can then continue as we do, and nobody seems to be accountable.

Mr. TOBIN. I'm an economist and not a politician, but as a citizen and an amateur political commenter, then I would say that it's really up to the elected leaders of the country not to respond in a myopic way to the latest polls of public opinion which are influenced by the ideology and propaganda which they themselves have put forward in the past, but to lead public opinion and teach the public what the national needs really are. That has been done in the past in times of national need by other Presidents and other Congresses, and we are waiting for it to be done now.

Representative HAWKINS. I suppose you're saying that we are the politicians and we should give the answer, and you're probably right, Professor Tobin.

I think I've used my 5 minutes, but I certainly would suggest that the submission of this document [1] with its cogent message and the numbers of individuals that you've been able to assemble to sign it can do a lot more than some of us who are politicians to help persuade the country that we are headed in the wrong direction.

Mr. TOBIN. That's what we're trying to do.

Representative HAWKINS. And I think you've done that, and for that I think we are deeply grateful.

Perhaps I'll have additional time later.

Thank you very much.

Representative HAMILTON. Suppose you had to go over on the floor right now of the House of Representatives and vote on a bill for $15 billion for public infrastructure, period. Would you vote for the bill?

Mr. Blinder, I think you said you would, or at least I interpreted your——

Mr. BLINDER. This is without $15 billion of revenue?

Representative HAMILTON. Just $15 billion for public infrastructure today. Would you vote for it?

Mr. BLINDER. Yes, and I would be biting my lips saying I wish there were taxes with it.

Representative HAMILTON. Look, we don't always have those choices over there. You would vote for it.

Would you vote for it, Mr. Tobin?

Mr. TOBIN. Yes, I would vote for it, but I would certainly much prefer a bill with taxes.

Representative HAMILTON. I understand you would prefer that.

Mr. Meyer, would you vote for it?

Mr. MEYER. No, not without an accompanying revenue source and some idea of what was in it.

Representative HAMILTON. Mr. Straszheim.

Mr. STRASZHEIM. Yes, I would.

Representative HAMILTON. You would vote for it?

Mr. STRASZHEIM. You bet.

Representative HAMILTON. Well, of course, the question is to try to get some sense of priorities on this.

Another thing I want to bring up is this relationship between the public infrastructure and productivity. Now I have sat on this com-

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[1] See document, entitled "A Warning About America's Third Deficit From 327 Prominent Economists," referred to by Representative Hawkins, beginning on p. 16.

mittee for a good long time and have listened to economists over and over again say to us we don't understand productivity very well, and we don't understand what increases productivity.

Now all of the sudden the four of you, all very distinguished people with great records and all the rest come in here and tell us we have to have infrastructure because that gets productivity up.

Did you change your mind? Have the economists changed their minds here? Where have you been the last 10 years?

Mr. TOBIN. Well, I have been saying that public investment was important, along with private investment, from the very beginning of this decade. But the administration and the Congress were in the business of giving all sorts of incentives and tax concessions for private investment, and neglecting public expenditures and investments. I haven't changed my mind. But I have stated my view that the estimate of the productivity of public investment as uncertain in magnitude. I have no doubt that the sign is right, that more public investment will help productivity.

Representative HAMILTON. You're sure of that correlation?

Mr. TOBIN. Just the sign.

Representative HAMILTON. What?

Mr. TOBIN. Just the sign, positive rather than negative.

Representative HAMILTON. I see. I'm interested in that correlation. I noticed that Mr. Straszheim said there is growing evidence that you get productivity increases with additional public investment, and you pointed out those charts.

What I'm trying to pin down is whether among economists today now there really is a fairly strong, solid consensus that public investment in infrastructure, and I'm talking now largely about physical infrastructure, does in fact bring us more productivity.

Is there?

Mr. BLINDER. I think that would be an exaggeration. The research on this is very new. It has had some peer review, but it hasn't really been ripped apart so that its guts are displayed in public to see if it can really survive the toughest sort of intellectual scrutiny. That has to happen before you have a real scientific consensus.

Representative HAMILTON. Your sense of it is that it does have an impact?

Mr. BLINDER. As I look at the evidence what we have to date, it looks fairly strong. One of the things I like about it is that as you strip it away and look at the relationship in greater detail, it seems to still hold up. For example, you take out government consumption thus focusing on the capital stock and the correlation improves. Take out military spending, and the correlation again improves. Now we're focusing on the civilian capital stock. Take out—and as somebody who works in a university I hate to say this—educational structures, courthouses, et cetera, and leave in bridges, highways, sewer treatment plants, et cetera, and the correlation improves again.

So all the things that make sense on a priori grounds, that things that should be contributing to private sector productivity seem to be causing the statistical correlation. The other nice things that government does, like subsidize education and things like that, seem to have a smaller effect. So this is one of the aspects I find appealing. You have a statistical correlation, and you have a somewhat sensible story, and it all does seem to hold together as you peal the onion.

But, in all honesty, nobody can sit here in 1989 and say there is an absolute professional consensus that has congealed on this point.

Representative HAMILTON. Mr. Straszheim, did you want to say something?

Mr. STRASZHEIM. Yes, and I would second that. The analysis is new, but I think the reason it is new is this just wasn't an area that people looked at before. We didn't have a decaying infrastructure and so people didn't look to that as potentially one of the aguments causing the productivity decline. I have taken no poll, but my guess is that much of the professional economic community would also be behind this same general conclusion.

Representative HAMILTON. As you were talking, all of you this afternoon, I keep thinking about local officials in my constituency. If you go into a local community in my area, Indiana, and you ask those local officials what do you have to do to get jobs in your community and what do you have to do to get economic growth in your community—and now that may not be the same thing as productivity, but it's important obviously—almost invariably they will respond by saying you have to improve this highway or you have to build this water system or you have to do something involving public infrastructure, almost invariably, and I have been impressed by that over and over again.

Now I gather also from what you say that your sense right now is that if we make additional investment and to put that investment where it will do the most good right now, we ought to expand public capital rather than private capital. Is that right?

Mr. TOBIN. No.

Representative HAMILTON. Not right. Mr. Blinder, you said that.

Mr. BLINDER. I would say so.

Representative HAMILTON. Mr. Meyer, you're shaking your head pretty hard over there.

Mr. MEYER. I don't think it's an either/or. I think these problems are too big to be solved by public spending alone frankly.

Representative HAMILTON. I'm trying to get a sense of priorities though for right now. Which is more important to make the investment in right now?

Mr. MEYER. Well, I would say public, but in an area like education and training we see estimates that the private sector is spending $30 to $40 billion and probably will have to spend more. I'm a little concerned about the emphasis on quantity and public versus private as opposed to what are we spending it on. We have had some programs that have had disastrous results and some programs that have had wonderful results.

I think the biggest burden we can place on our children is continuing to come up and vote for $15 billion bills with no revenue source, each time saying, "Well, what difference could that make in a $5.2 trillion economy?" You add them up and you have what we have in this government today, which is a hopelessly overcommitted Federal Government which has over $150 billion of interest per year to pay, which is also a burden on tomorrow's generation.

So irresponsible fiscal management can create problems down the road just as neglect of investment. I don't mean to be ornery. I've made it clear in my testimony that I agree with my colleagues here that these are crying needs, but not everything works. Just throwing the money out there is unwise. You know, some of that money goes for downtown sports arenas being built under UDAG and some of it goes for subway systems in cities that have a questionable need for them. So it's not all decaying bridges.

If we can target to real needs where we know there is a payoff, whether it's a decaying bridge or a decaying child, where there are programs that are proven, now that makes sense. This isn't an either/or situtation. It doesn't mean that IBM shouldn't be doing what it's doing to retrain workers or that a voluntary association shouldn't be helping a kid at risk. We need both in this country.

Representative HAMILTON. We have had some witnesses before the committee here recently that have recommended to us that we take the Social Security trust fund reserves and put that into public infrastructure, invest that in public infrastructure. How does that strike you?

Mr. TOBIN. Mr. Chairman, I said in my testimony that it would be a good allocation for part of the Social Security reserve, provided you accompanied it by moving to an on-budget deficit concept. Then there would be a conscious decision to use the Social Security fund for future-oriented purposes, either reducing the debt sold to the general public in the capital markets or making investments that would increase productivity in the future.

I would like also to comment on your previous question, if I may, Mr. Chairman.

Representative HAMILTON. Sure.

Mr. TOBIN. More than 70 percent of the net national product of the country goes for personal consumption. As I said in my statement, if you look at the increase in net national product and consumption over the last 10 years, 1978 to 1988, more than 80 percent of that increase went into higher personal consumption.

So it would seem that the major change in priorities that is needed is not substituting public investment for private investment, but substituting investment, public and private, for consumption, particularly the consumption of the more affluent citizens of the country.

Representative HAMILTON. Mr. Blinder, on the Social Security question.

Mr. BLINDER. I hardly ever disagree with Jim Tobin, but on this one I do. I think it's a very risky strategy to follow for two reasons. The first, and less important, is that the definition of what might qualify under this rubric, I fear, would become too wide in the political process.

Representative HAMILTON. The definition of what, investment?

Mr. BLINDER. Investment, anything that is future oriented.

Mr. TOBIN. The Social Security funds.

Mr. BLINDER. And what would be a legitimate use of the investment of the Social Security funds? There is a great danger that it would slip over into things that are consumption oriented rather than investment oriented.

Mr. TOBIN. I said it should be confined to revenue yielding investments and suggested educational and training loans as the major vehicle.

Mr. BLINDER. The second, and I think the most important problem, is that money is too fungible. It's very easy to take money and label it and say, "Here is the Social Security money; we're using it for bridges and highways." These might be the same bridges and highways that would be built anyway, in which case we'd wind up with a bigger budget deficit.

The key thing if this strategy is to work and make sense, and I don't see how we could do it administratively, is to allocate the Social Security trust fund money to these purposes and make sure it stimulates inframarginal investment. It must actually raise the amount that we spend on these good things, rather than simply relabel the money. And I don't really see how we could be sure that that would happen. So I fear that what we would wind up doing is just depleting the trust fund.

Representative HAMILTON. Mr. Meyer.

Mr. MEYER. I favor a variation of this theme. As I indicated in my testimony, I would favor taxing Social Security benefits the way we tax private pensions, which is to tax beneficiaries on amounts that exceed their lifetime contributions.

It has been estimated by the CBO that this would bring in $97 billion in Federal revenue over the fiscal years 1990 to 1994 period, and it would shield about half of the senior citizens from any burden. About half the senior citizens in this country don't pay Federal income taxes. It would be a progressive measure, more progressive than freezing COLA's. We also have a very limited estate tax in this country. You have to have $600,000 before anything is taxed. We could lower this threshold.

I think we have to take another look at these options in an environment where we have these crying needs, including needs among the elderly for long-term care and for adequate benefits under SSI. If we could recycle this money and perhaps address the problem of fungibility that Professor Blinder quite properly brought up by earmarking the extra revenues in a special fund, I think it could be very helpful.

I guess the bottom line is that when no one wants to raise tax rates, and I join in that, I don't particularly want to raise them, and we don't seem very capable of cutting spending, perhaps we have to do a bit more tax-base broadening, even beyond the 1986 Tax Reform Act. We can use the revenues from that base broadening, whether we tax employee benefits or Social Security benefits, to help our neediest citizens.

Representative HAMILTON. Did you want to comment on the Social Security question, Mr. Straszheim?

Mr. STRASZHEIM. Yes, Mr. Chairman. I am uninspired by the idea of earmarking the Social Security funds for infrastructure spending. It seems to me that that is a focus on process, and that the focus really ought to be on making the hard choices.

The other point I want to make is you talked about the hypothetical $15 billion for infrastructure. The interstate highway system program in the 1950's and early 1960's and some still today was an enormously productive use of public moneys.

In contrast, it seems to me, we have spent a lot of money in the last two decades on mass transit systems in a variety of major cities which didn't really contribute much in terms of longer run productivity and simply really took rich suburbanites from the suburbs to their employment downtown. So you have to look carefully at within infrastructure spending where you devote those resources.

Representative HAMILTON. We have a number of questions to pursue with you.

Congressman Scheuer.

Representative SCHEUER. Thank you, Mr. Chairman.

I regret that I had to take a short interval between our JEC hearing this morning and our JEC hearing this afternoon.

Representative HAMILTON. There is a circuit overload today.

Representative SCHEUER. This is fascinating. I have enjoyed listening and I'm sorry I missed the direct testimony, but I still have a few questions.

Mr. Blinder, you mentioned that as you eliminate military expenditures, the productivity effect of infrastructure investments increases, and as you eliminate education expenditures it increases further. Did you mean to say that?

Mr. BLINDER. Educational facilities. Infrastructure can mean a lot of things, yes.

Representative SCHEUER. You're talking about buildings?

Mr. BLINDER. Buildings.

Representative SCHEUER. How about direct expenditures on education? We have a terrible problem of productivity in our work force today, a 25-percent rate of adult illiteracy, a 25-percent dropout rate in secondary schools, which goes to 40 percent with blacks and 50 percent with Hispanics and 70 percent in downtown core areas of blacks and Hispanics. It's crippling and disabling.

How about direct expenditures in improving the elementary and secondary system? As Congressman Gus Hawkins said, we have had very productive hearings on Head Start. Head Start has a cost effectiveness of 6 or 7 to 1 in terms of avoiding dropouts and avoiding future expenditures.

We had testimony that one experiment in providing free massive postsecondary education to a selected group had also a cost-effectiveness ratio of about 7 to 13 to 1, and I was a beneficiary of that program. I went to Columbia Law School free at the taxpayers' expense. That was called the GI bill of rights, and it not only had a fantastic cost-benefit repayment of the taxpayers' dollars out of the increased taxes that these young people paid, but it produced the trained cadre of manpower that projected this country into the postindustrial era in the late 1940's, 1950's, and 1960's.

We have a recent Presidential commission that said we ought to extend the free education system by 2 years to include grades 13 and 14. It wasn't so recent actually. It was 1947, the Truman Commission on Higher Education.

If you look at the period from when we started grades K to 12—which was around 1910—to now, 1947 was sort of in the middle, and you might look at it and say well, the demands of our society for a trained work force would be such that if the Truman commission thought we ought to extend free education 2 years in 1947, we ought to have an additional 4 years now to include grades 13 to 16, and maybe even some postgraduate college work in science, math, and engineering where we seem to be falling short.

I think it was Professor Tobin who mentioned expenditures in loan programs. What would be wrong, especially for low-income folks, with just wiping out that whole loan philosophy. They don't feel comfortable with it, they don't like it, the rate of defaults is astronomical. What's wrong with saying, as the Truman commission recommended, that the needs of our society are such that what was relevant and appropriate in 1910, grades K to 12, is no longer appropriate and that we ought to go down a couple of years with a Head Start Program at least for every kid at education risk—and now we serve only one-sixth of them—and we ought to go up not just K to 12, but we ought to go K to 16. That's direct expenditures for education for every American kid who can't afford it. Forget about loans.

How would that rate on your productivity effectiveness scale?

Mr. BLINDER. You asked a lot of questions. I suspect not all of that would rate highly, though some of it would.

Representative SCHEUER. Which would and which wouldn't?

Mr. BLINDER. What I think I know is that programs like Head Start and preschool education seem to have very high financial rates of return. The evidence on that seems to be quite strong.

What I suspect, but feel less secure about because I'm not aware of such solid evidence, is that proliteracy programs for the low end of the educational spectrum and scientific and engineering education for the high end are likely to have high social payoffs. I think the evidence there is much less solid than for preschooling. But maybe it's because we just haven't looked hard enough. I just feel on shakier scientific grounds speaking about elementary and secondary schooling.

I feel most shaky—and most dubious, I guess I should say—in saying we ought to be sending more kids to college and picking up the bill through the public sector. And this comes from someone who makes his living in a university. I don't have a strong feeling that we underinvest in the number of people we send through 4-year colleges in this country, which is very high by world standards.

Representative SCHEUER. OK, then we're really getting somewhere. Then you're saying we should shoot with a high-powered rifle and an eight-power scope and not a 12-gauge shotgun?

Mr. BLINDER. Yes.

Representative SCHEUER. We ought to zero in on an enriched preschool education for every kid at education risk.

Mr. BLINDER. Absolutely.

Representative SCHEUER. And then during the school career focus help in literacy training so that everybody can read, write, and count and read a job instruction sheet as well as reading a menu and traffic signs and all of that. And then at the other end of the spectrum provide special help—and I take it you're talking about grants and not loans—in science, math, and engineering to produce a technologically superior work force. Would those be three areas where the cost-benefit calculus for society would be pretty unquestionable?

Mr. BLINDER. As I said, I feel secure about the first of those, the preschooling, and I'm tempted to say yes about the other two that you mentioned. But I just feel that the social scientific evidence to make such an assertion is a good deal weaker, at least the part of it that I know about.

Representative SCHEUER. A member of our staff, William Buechner, did a cost-effectiveness study on the payoff to society of the GI bill of rights, and he did a beautiful job, and the calculus, as I recall, is approximately between 7 to 1 and 12 or 13 to 1. For every dollar that we spent on free postsecondary education to that more or less randomly selected group, 1,000 got caught up——

Mr. BLINDER. No, and let me say two things about that. There is evidence that they actually weren't randomly selected, that the Armed Forces Qualification Test and other things helped select a superior Armed Forces in the Second World War when it was so massive——

Representative SCHEUER. I can tell you as a guy with some experience——

Mr. BLINDER. You were one of them. [Laughter.]

Representative SCHEUER [continuing]. That is a lot of baloney. [Laughter.]

They may have screened out the absolutely educationally deprived and people who were borderline IQ's, maybe the bottom 5 or 10 percent of society, but for the rest of us, and I happened to be one of those crazy kooks who volunteered, shame on me, but for the most part these were guys who, you know, were called up. They got a post card, Uncle Sam needs you, greetings, and they served and there wasn't much of a self-selection process in serving.

The self-selection process became effective later. Out of that vast pool who picked postsecondary education, there was some self-selection. And let me tell you that I went to Columbia Law School right after World War II. In February 1946, most of the draftees who had been in for several years got out after V-J Day in September 1945 and the people at Columbia Law School patted me on the head kindly after I graduated and I was in the top 20 percent of the class, but they said, boy, if you hadn't picked this particular class, of all those sharp cookies who got out of the service in September 1945 and came into our law school in February 1946, you would have been a law review man and you might even have made editor, who knows. But that was the classiest group of young people they ever had.

Mr. TOBIN. Congressman, maybe the solution is to require 4 years of getting older and more mature and more interested in life before you give them a college education. I would like to ask you about an amendment to your free education through grade 16, which would be to make years 13 and after free only in the sense that lack of capital funds would not deter qualified people from going to college or graduate school but——

Representative SCHEUER. And that if they could pay they would.

Mr. TOBIN [continuing]. They would pay later by some kind of surcharge on their income tax, so that to the extent that they gained from the education they would pay back what they were given.

Representative SCHEUER. I have no problem with that. But we did have a lot of evidence that the business of taking out 20,000 or 30,000 or 40,000 dollars' worth of loans for a talented black or Hispanic kid from a minority background or low-income background was a daunting prospect to lay on him. They already have the feeling, and we had a brilliant sociologist from the University of the District of Columbia who said that a lot of these low-income minority kids already feel the school system really wasn't designed for them. It really excluded them in its basic concept and its basic construction. They didn't feel it was designed for them and that they are expected to fail and a lot of them do fail.

The process of converting higher education opportunity from grants and scholarships to loans is further evidence to them that society really means to screen them out, that this is really a given, and that whole structure is a turnoff because they feel it isn't designed for them. It's designed to screen them out.

They did testify, and maybe they were too idealistic, I don't know, and maybe they knew too much about the psyche of low-income neighborhoods, but they did testify that a grant program should be developed whereby we said to these kids if you make it through 12th grade you are going to have a university education. They know that's already true for the average middle-class kid, but they say it just isn't true for us. Society designed it that way.

And if we could say to them, you know, do a good job, be literate, complete 12 years of elementary and secondary school and you can expect as a given, as an entitlement, to go on to a successful post-secondary education experience, these witnesses felt that that would be a real come-on, a real incentive and an invitation to them that made sense that they were going to be treated like the average middle-class white kid who has an expectation from birth, unless something goes really wrong, of going to college.

That's why I am really strongly against the proposals that have come from the Senate side of a program that links college attendance for these kids who are educationally deprived with 2 or 3 or 4 years of service either in the military or in a public service of some kind because they say, hey, that's not the way society treats these middle-class white kids. They are really laying it on us with all kinds of extra burdens to get a postsecondary education experience.

I'm sorry I rambled on, Mr. Chairman.

Representative HAMILTON. You're doing very well.

Congressman Hawkins.

Representative HAWKINS. I'm intrigued with my distinguished colleague and his background. However, I think the question is how many of your colleagues in the House and the Senate have the courage to vote for the money to do what you are talking about? The GI bill of rights was rather an expensive program and it was very productive.

Representative SCHEUER. It was a fantastic investment to our society.

Representative HAWKINS. And I agree with you, but I'm saying that if it were in the House today, first of all, it would not meet Gramm-Rudman targets and, as Mr. Tobin says, that's a politician's answer. I'm not trying to tell them how we can persuade our colleagues to vote for the money for these programs. In the long run we concede that they are cost effective, and they concede that. The Committee for Economic Development concedes it, and every businessman says the same thing. And yet we can't get the taxes increased to pay for them, and we can't take the priorities away from others. So that, it seems to me, is where we run into the problem.

I have simply suggested that if we had other economists of the same stature out there plugging perhaps they could persuade our colleagues in the House to change their minds about the reason why we must in a global economy do this if we are going to survive. I think this is a beginning at least of some encouragement that we do have a list of distinguished economists. They are saying most economists agree. I think the beginning of making some sense out of the thing is irrefutable. I think it makes sense and I think it challenges the country.

You're right, and I'm agreeing with you, Congressman Scheuer.

Representative SCHEUER. Well, if we took a concept of life-cycle costing, for these young kids as compared to what their alternative lives are going to be, we can't afford not to make these investments. They aren't expenditures that are nonproductive. They are investments in the future of these kids and in the future of our country, and they are so cost effective that they literally shriek at us, "grab me" and take advantage of this opportunity to create a productive work force that will give you a return of anywhere from 7 to 13 to 1 for postsecondary education.

I have a terrible problem. There seems to be a communications gap. We have brilliant, stimulating, thoughtful witnesses like you, and we have Benjamin Friedman writing a book about what we have to do for our country. We have MIT coming out with a book of six kinds of structural improvements that we have to make in our society for labor, for industry, and for government. The signals are all there and you take a half a dozen of these books that have been written in the last year or two and throw them together. There isn't a dime's worth of difference between them.

You know, you would take a number of economists going from the moderate left to the moderate right, and they wouldn't disagree with what we ought to do to make this country productive. How do we get the message from academia to the decisionmakers?

Is that a permissible question?

Representative HAMILTON. Sure. [Laughter.]

Representative SCHEUER. How do we bridge that gap?

Representative HAMILTON. I'm certainly not going to rule it out of order. [Laughter.]

Mr. BLINDER. I think one of the things that has to be done is to get this budget deficit behind us and bite the tax bullet. That would enable Congress to focus on things that aren't of 1-week and 2-week horizons. I think that, until this is done, this is going to be an endemic problem that comes up in every sphere of public activity.

Representative HAMILTON. Gentlemen, could I ask you about the suggestion I think Mr. Straszheim made in his testimony about the need for a capital budget. Do we need in the U.S. budget a capital budget? Does that help us on this problem of increased investment? Would that help?

Mr. BLINDER. I think it might. Let's put it this way. It's very hard to see how it could do any harm. It might help, in a sense, if we focused attention on capital expenditures. And it would be more natural, for Congress to be looking at information on rates of return on these investments and ranking the ones that have higher rates of return.

Representative HAMILTON. Do you like the idea, Mr. Straszheim?

Mr. STRASZHEIM. Yes, I do. We are talking about a lot of areas here, all of which cost a lot of money, and I needn't point out to you that to govern is to choose, and what I think would be beneficial is for someway for the Congress to be able to look at different areas in the budget realizing just what spending increases or decreases in these different areas mean.

Representative HAMILTON. Would you put the areas of spending that Mr. Meyer is talking about in the capital budget, so-called social infrastructure spending?

Mr. STRASZHEIM. I think I probably would, but I would simply look at defense spending as in some ways a black hole, but necessary in the sense that it doesn't give you productivity enhancements in general. Entitlement payments are a very difficult sort of animal, as of net interest costs, grants in aid being another, and then sort of all of the rest, and in large measure it's all of the rest where the infrastructure spending and a lot of the education spending funding goes, and that is the area that you are also aware has been dramatically cut in years past.

Representative HAMILTON. If you talk to OMB today, they include three types of spending under investment. One is direct physical capital investment, the second is conduct of research and development and the third is conduct of education and training.

Is that OK, if you had a capital budget for those items and everything else would be in the regular budget?

Mr. STRASZHEIM. That would be a good start.

Representative HAMILTON. Now there are two ways of thinking about a capital budget. One is to simply rearrange the figures, and the other way is to really finance the capital expenditures in a different way than you finance the ordinary expenditures.

Do you have any comment about that?

Mr. TOBIN. Yes, I do anyway. I would not like to have a capital budget if it meant that there was a presumption that expenditures in the capital budget are debt financed and everything else is tax financed. I think at times it would be desirable to finance some capital expenditures by taxes, and at other times—not now—desirable to finance some current expenditures by borrowing. So I would not like to have the deficit defined in an objective or normative way as referring only to noncapital outlays.

I would like to make another comment. The first step in this regard should be, I think, for the national accounts of the United States to recognize public investment as a category. This is done by every other country in the international system of national accounts. The only major country that doesn't do it is the United States. That would not be a policy step, but an objective accounting step that would put our national accounts figures in the same format as those of other nations. It's certainly desirable to do capital-budgeting to improve information, but not I think as an automatic license to finance capital expenditures by borrowing or as a prohibition at all times against financing other expenditures partly by borrowing.

Representative HAMILTON. Mr. Meyer.

Mr. MEYER. I agree with that, and I think it's important to note how much of our $1.2 trillion budget falls into other categories. I've just made a little note here. Social Security, over $200 billion; Medicare near $100 billion; national defense, around $300 billion; interest on the debt over $150 billion. When you sum those, you get about $750 billion. They all are important, but not exactly what we are thinking of as investments in tomorrow's labor force.

What we are thinking of as investments in tomorrow's labor force would often get lost in a rounding error in the defense or Social Security programs. The Job Corps, $600 or $700 million, WIC, $1.8 billion, and so on. The problem is not that we don't have the right kind of budget although a case can be made certainly to make more informed decisions by developing a capital budget.

The problem is the lack of priority. In a government where the year-to-year increases in some programs are greater than these targeted investments, we need to make sure that the latter are not thrown out, and that even as we reduce the deficit, we properly make these relatively small investments. In a $5.2 trillion economy, spending a few hundred million to turn around some at-risk kids is really a small investment.

I don't believe we are not doing it because we have the wrong kind of budget. I believe we are not doing it because we don't have the political leadership. I think it has come out here today that there is a broad agreement in the so-called intellectual or research community, as Congressman Scheuer mentioned, from moderate conservative to moderate liberal in the social sciences, not just among economists, but also other disciplines, that some of these investments pay off.

We are not failing to act because we don't have the studies, and you've pointed to studies your committee has done. We have a lot of studies in these areas. We are not doing it because we don't assign a high enough priority to it relative to other things. We are not willing to say, couldn't we get that extra billion to increase WIC or Head Start trimming back some other program which has a very limited justification in today's environment? Couldn't we get it by broadening the base of taxation a little bit or by raising the tobacco taxes?

In other words, we know what needs to be done in many areas, but we just don't seem to evaluate it to top priority.

Representative HAMILTON. Well, this country has elections, and when a Presidential candidate runs on a platform of no tax increase and the American people vote for that for three or four elections in a row, politicians pay attention to that.

Mr. MEYER. Well, I think we could do these things without a tax increase.

Representative HAMILTON. We live by our choices, and the choice was very, very clear for us and has been. While I agree with my friend, Congressman Gus Hawkins, who has been a tremendous leader in the Congress for the kinds of things you're talking about in your report, it's no mystery to me why this institution doesn't have the political will to move ahead. The American people have spoken and they are very clear about this point. If you walk down the street of an Indiana town today and ask people do you want a tax increase, you'll be overwhelmed; 70, 80, or 90 percent of them will tell you no.

Mr. MEYER. But they also want all those programs that add up to 1.2 times what they are willing to pay in taxes.

Representative HAMILTON. That's the great dichotomy. That's the thing we have to struggle with here.

Now let me ask you about the Federal versus State responsibility. Usually when you talk about infrastructure, public infrastructure and physical infrastructure, you think really more State and local expenditure. Today the Federal Government only puts in 17 percent, if you knock out the defense side of physical infrastructure expenditure. Everything else is State and local. If you look at education, we put a very modest amount of money at the Federal level into education. It's 7½ percent—or whatever it is—of total education expenses in the country.

Now is that the right kind of distribution? Are you telling us here that you want to see the Federal Government participate much, much more in infrastructure development and increase that 17 percent substantially?

Mr. TOBIN. Mr. Chairman, the Federal Government used to have much larger programs of grants in aid to State and local governments for public investments in education and infrastructure than it does now. I think the answer to your question has to be given on a case-by-case basis. It really depends on the national as opposed to local interests in particular kinds of public investment. There are some problems of environment, for example, that go beyond State boundaries and even national boundaries, where some national assistance for local investment is justified. That's also true in education. People move around a lot. Good education in one area isn't beneficial just to that locality or that State.

As a matter of equity, it has been recognized within States that it's not equitable for the children in rich communities to be educated more lavishly than those in communities with smaller tax bases. That logic would apply to having a Federal program in education as well. So I think you have to do it on a case-by-case basis. There are things that should be purely local and there are things where there are national considerations at work.

Representative HAMILTON. I don't see, and maybe I'm just not familiar with enough States, but I don't see a lot of States around the country today increasing their expenditures dramatically to deal with infrastructure. Now maybe it's beginning to happen, and I hope it is going to happen. It's not happening in my State.

Mr. TOBIN. Well, sometimes in the past we have had Federal matching programs which tried to induce State and local interest in outlays that were considered nationally important.

Representative HAMILTON. I just want to raise a question. I think what you and others are doing—those who signed this letter—is a very positive and worthwhile step, and in many respects it has to be done at the State legislative level as well because they are much bigger actors than we are on the physical infrastructure side.

Well, we have been going at this quite a while. I still have a lot of questions, but I'm also aware that we have some voting to do shortly in the House.

Congressman Hawkins, do you have anything further?

Representative HAWKINS. May I simply ask one specific question of the witnesses. Do you think the public would support a trust fund for education specifically and perhaps support a proposal that would provide some method of depositing money in that trust fund built on a benefit theory?

Let us begin with the amounts of money that Federal contractors obtain through Federal contracts in doing business with the Federal Government. If each of them would contribute five-tenths of 1 percent of the contract and deposit that into an education trust fund that would be used exclusively for the purposes of education, including postsecondary as well as preschool education, that would be one means of increasing productivity and helping to provide the productive work force for the Nation and benefit all of us. And it would answer the question of whether or not education would be given the type of priority in budgeting that it deserves so that it would not always be the last thing to receive funding after everything else, other priorities have been provided for.

I guess the question basically is, Should we have such a trust fund as we do for highways, et cetera, and some of the other needs? Is it at all intriguing as a possible answer?

Mr. BLINDER. Well, I suggested the general principle of earmarking at the margin in the testimony, and a trust fund is one accounting device to achieve the earmarking. It depends very much on what you're earmarking and for what purpose it's being earmarked.

We were talking before with Congressman Scheuer about education being a broad category. It could mean a lot of different things, some of which may have very high payoffs and some of which may not have very high payoffs. So it's hard to react to a proposal in the abstract. I would have a very different attitude toward preschooling, on the one hand, versus just sending more kids to college on the other hand.

The second issue is what goes into the trust fund. The specific thing that you mentioned, it seems to me is thinking about it for about 30 seconds which is all I had, that it's a tax on Federal contracting as opposed to a tax on tobacco or a tax on gasoline. There are a lot of things that we could tax, and the nature of that particular tax would be to discourage Federal contracting a little bit, because it's a small tax. It's not obvious to me that, if I were going to pick one tax to use to finance a scheme like that, that this tax would be the best one. I think I could think of better taxes.

Rpresentative HAWKINS. Thank you.

Mr. Meyer.

Mr. MEYER. I think it would help gain public support to have some notion of a payback. I'm intrigued by the concept of a reverse GI bill to help make moneys available. But I am a little disturbed about suggestions that this be an out-and-out grant for everyone that wants to go to college.

I think Americans are a little bit outraged by the student loan default situation, particularly when they hear that some of these are doctors who are now making $150,000 a year. There is a kind of feeling that we are willing to give you a helping hand if capital markets don't work to make this money available. You ought not to be blocked from going to school, but you ought to pay it back, and I believe that everyone ought to pay it back on an equal basis. I don't think we should redistribute income, as one proposal last fall would have done, by having different people pay back different amounts depending on their subsequent income. I think we can redistribute income better through the tax system and transfer programs.

So I think if you said this is not a gift, but that it is solving a problem of timing, and that people would be required to pay the loan back, you could get support for this kind of concept.

Representative HAWKINS. Thank you. That's all.

Representative HAMILTON. Gentlemen, thank you very much for your testimony this afternoon. We appreciate it greatly.

The committee stands adjourned.

[Whereupon, at 3 p.m., the committee adjourned, subject to the call of the Chair.]

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