Promoting Equality of Economic Opportunity through Budget Reform

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The issues of opportunity and equality have increasingly moved to center stage in both economics and politics. Most elected officials and candidates for office express belief in opportunity, partly because they buy into a fundamental tenet that anyone can or should be able to "make it" in America. Yet the debate becomes quite confused, in no small part because equality and opportunity are not the same thing. Equality can apply to almost anything, whereas opportunity (and mobility) generally relate to growth in future well-being and prospects. Moreover, while an opportunity agenda might focus on growth in general (e.g., education for the most talented), an opportunity *for all* agenda emphasizes inclusion of those with fewer means, greater needs, or current exclusion on some arbitrary basis like race.

When researchers look to measures of opportunity and mobility, they tend to focus on gains in earnings, private wealth, human and social capital, and other market command over resources. They might, for instance, look at the growth in the private earnings of succeeding generations of families. (See, for instance, Reeves and Sawhill, this volume.) When coming to a conference like this one and discussing policy, they usually focus on items like education and early childhood interventions or community resources that promote longer-term well-being. (See articles by Magnuson and Duncan and address by Rosengren, this volume.) They don't suggest that opportunity or mobility has been enhanced by an increase in Social Security benefits from one generation to the next, whatever the merits of that program.

Why are these definitional distinctions so important? They force us to avoid naïve interpretations of policy interventions whereby everything gets defined as promoting opportunity, and no distinctions are made as to the long-term effect of various interventions. In particular, we must distinguish rigorously between individual support programs that focus on current consumption and those that focus on opportunity and mobility. More years of retirement support might promote greater equality of current consumption, but it is not the same as more years of education aimed at promoting growth in future earnings and well-being. Efforts to promote earnings through programs like the earned income tax credit (EITC) might be progressive, but in terms of current consumption, they are less progressive than a pure welfare approach like the classic Aid to Families with Dependent Children (AFDC) that distributes the highest benefits to those with no earnings at all. Within programs also, distinctions can be made: programs whose primary focus is on consumption often penalize work and earnings but can still be designed in ways that do so less.

Obstacles to Promoting Opportunity through Government Programs

Though I believe that the United States and, indeed, much of the developed world is looking for ways to move forward on an opportunity and mobility agenda, there are three major obstacles.

First, we have no flexibility in our budget to orient future revenue growth in this direction. Uniquely in all of our history, all or more than all future resources that government might likely attain, even with higher tax rates, have been pre-committed. I detail this in greater detail in *Dead Men Ruling*,[1] but these extraordinary commitments, largely to retirement, healthcare (mainly in retirement), interest on the debt, and tax subsidies, generally do not have a focus on growth in earnings and wealth, human and social capital, or sometimes, as with growing tax subsidies that promote opportunity for homeownership, they are not inclusive. Programs that most people would define as having an opportunity-for-all or mobility focus, such as education, job supports, and investments in children—the types of programs largely examined in this volume—are scheduled to decline as a share of GDP and often even in real terms.

Second, we must accept that progressive income maintenance is not sufficient as a measure of promoting opportunity and mobility. Mobility and opportunity focus on individual growth and are effectively investment oriented. Investment means less consumption today to promote better things tomorrow, whereas a consumption-oriented agenda, to some extent, has the opposite focus (with some exceptions, such as school lunch programs that promote learning as much as they do food consumption). Think of how most income maintenance programs measure their success by the extent to which they "backfill" to make up for any inadequacy in current consumption needs—a poverty level of income (measured officially by a minimum consumption level) or some adequate "replacement rate." This is emphatically not to argue that they haven't had great success at worthy objectives, but it is to suggest that opportunity and mobility have a greater focus on the future and on investment. In my measures of budget allocations, opportunity and mobility have been given limited attention.[2]

Third, success on the opportunity and mobility front involves different and, in many ways, stricter performance criteria that can be misinterpreted at times to imply that programs have failed when they have not. Give people support to consume, and we are likely to succeed in increasing their levels of consumption of food, health care, or whatever. Give people opportunity, and they may or may not respond. They may not study, or hang onto saving, or work, or only increase those activities modestly relative to the amount of money invested. That does not mean that they fail.

As an example, suppose we create a wage subsidy program that increases the income of a low-income household as much as some alternative welfare program, but the gains in earnings are still less than the cost to government. The pure welfare program costs $100 and leads to no increase in the individual's private earnings. Still, it is measured as successful in decreasing poverty. The wage subsidy instead provides subsidies of $100 and also leads to $50 of additional earnings for the same recipient. Is the wage subsidy a success? Measured relative to no program at all and only on the criterion of

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[1] C. Eugene Steuerle, 2014, *Dead Men Ruling: How to Restore Fiscal Freedom and Rescue Our Future*, New York: Century Foundation Press.

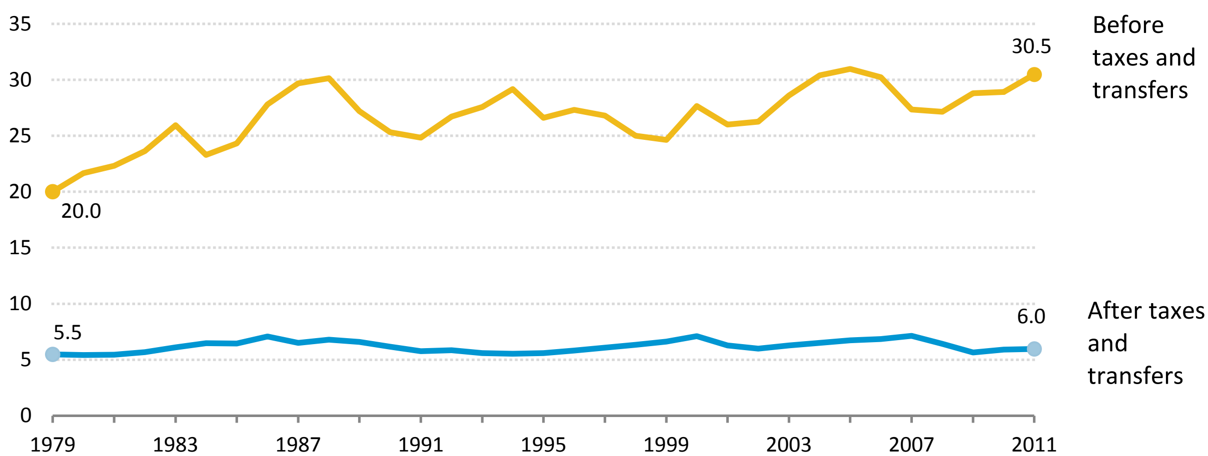
[2] Adam Carasso, Gillian Reynolds, and C. Eugene Steuerle, 2008, "How Much Does the Federal Government Spend to Promote Economic Mobility and for Whom?" Washington, DC: Urban Institute, http://www.urban.org/research/publication/how-much-does-federal-government-spend-promote-economic-mobility-and-whom

earnings produced relative to government cost, it fails a benefit-cost test. Measured relative to the welfare program, it costs the same and leads to additional private income of $50.

A Puzzle

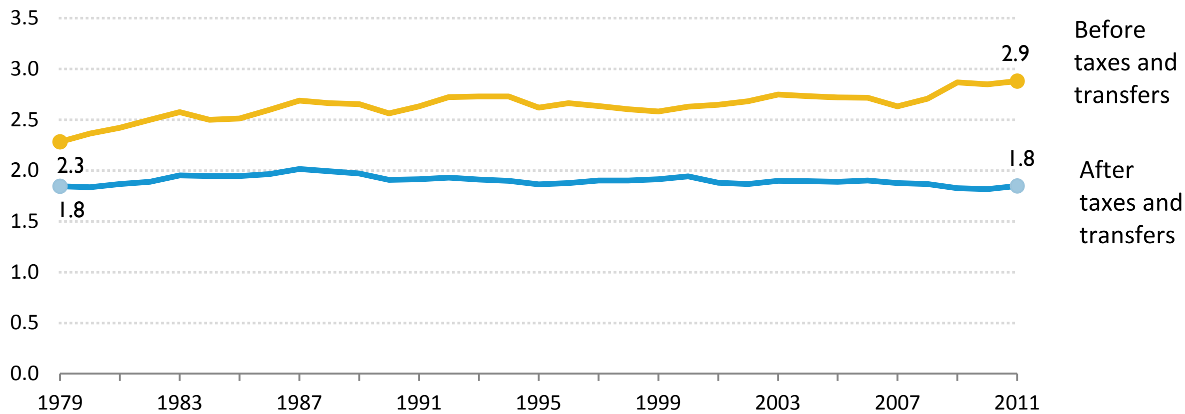
Let me leave you with a puzzle arising from some CBO data that allows me to compare incomes of different quintiles two ways: before taxes and transfers; and after taxes and transfers. Here I compare the relative income of the top and bottom quintiles (figure 1), as well as the second and fourth quintiles (figure 2) of the income distribution (note: I am not focusing on issues related to the top 1 percent). What is fairly clear is that on an after-tax, after-transfer basis, the ratios haven't changed much at all over the 30 year period from 1979 to 2009. However, in terms of command over market measures of income from work and saving, those distributions have become much worse.

Figure 1: Ratio of Top to Bottom Income Quintiles Before and After Taxes and Transfers
Households ranked by market income group



Source: Washington, DC: Urban Institute. 2016. Author's calculations from Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2011* (November 2014).
Notes: Households are ranked by market income (income from private sources and excluding government tax and transfer benefits) and adjusted for family size.

Figure 2: Ratio of fourth to bottom income quintiles before and after taxes and transfers
Household ranked by market income group



Source: Washington, DC: Urban Institute. 2016. Author's calculations from Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2011* (November 2014).
Notes: Households are ranked by market income (income from private sources and excluding government tax and transfer benefits) and adjusted for family size.

How should we interpret these trends? Did government programs reduce significantly the growing inequality in private or market incomes? By their very design, limited focus on opportunity, did government programs increase the inequality in private or market incomes? Both?

Regardless of how you answer those questions, consider that government at all levels spends, including tax subsidies, over $60,000 per household,[3] the majority of which goes for individual supports over and above public goods like defense or general government. Given this base of support, might it not make sense to focus growing revenues over time more intently on expanding programs that directly promote opportunity, while simultaneously examining whether other programs can be designed to provide fewer disincentives to earn, save, and build up human and social capital?

[3] Author's calculation from BEA and OMB data. While tax expenditures are not strictly additive due to interactions between subsidies, adding their sum is a common and useful starting point for analysis of their magnitude.