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John C. Goodman, president of the National Center for Policy Analysis; S Jay Levy, chairman of the Levy Institute; and Peter G. Peterson, chairman of the Blackstone Group (left to right), discuss the economics of aging during a recent taping of Debates-Debates.

INSIDE:

Chairman S Jay Levy, appearing on the *Debates-Debates* television program, expresses concern about productivity in the United States as the ratio of workers to retirees drops toward an expected two to one by the year 2030.

In an interview with Assistant Director Sanjay Mongia, New York State Lieutenant Governor Betsy McCaughey Ross advocates federal regulation requiring greater disclosure by HMOs.

Resident Scholar Oren M. Levin-Waldman estimates that implementing a "Wisconsin-type" welfare plan nationally would require spending levels in the short term greater than those projected under the new welfare law.

In a new *Public Policy Brief*, Barry Bluestone and Teresa Ghilarducci recommend "wage insurance" to help boost wages and decrease income instability for the working poor and to reduce adult poverty.

Research Associate David R. Howell declares that changes in labor market institutions provide a more compelling explanation for wage stagnation among American workers than a shift in demand away from low-skill labor.

Alan S. Blinder rejoins the Levy Institute's Board of Advisors.

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The Jerome Levy Economics Institute of Bard College, founded in 1986, is a nonprofit, nonpartisan, independently funded research organization devoted to public service. Through scholarship and economic forecasting it generates viable, effective public policy responses to important economic problems that profoundly affect the quality of life in the United States and abroad.

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Debates-Debates

The Economics of Aging

It is frequently stated that the Social Security retirement system will be in bankruptcy by 2030 and that keeping the promise of an entitlement to all elderly persons can be done only at the cost of improved education and health care for the youngest, most vulnerable members of our society. In a recent segment of *Debates-Debates,* a PBS television program, a distinguished panel discussed the question that S Jay Levy raised last year in Levy Institute *Public Policy Brief* No. 18*, The Economics of Aging*, "Can We Afford Grandma and Grandpa?" Panelists offered remedies that ranged from privatizing the Social Security system to limiting protection to the frail, poor elderly.

The panelists who argued that the Social Security retirement system is still viable were **Jerry I. Mashaw**, Sterling Professor of Law at Yale Law School; **Robert Butler**, director of the International Longevity Center and professor of geriatrics at Mount Sinai Medical Center; and **Lydia Bronte**, director of the Project on Postponing the Illness of Aging and author of *The Longevity Factor*. On the opposing side were **John C. Goodman**, president of the National Center for Policy Analysis; **S Jay Levy**, chairman of The Jerome Levy Economics Institute; and **Peter G. Peterson**, chairman of the Blackstone Group and president of the Concord Coalition.

Goodman asserted that government bonds issued as promissory notes for the money that workers pay in Social Security taxes are empty promises that lay impossible burdens on future generations. He lamented that the money collected from working people during their productive years isn't being invested in projects that could increase the fund for future retirees and promote growth in the American economy.

Levy raised the question of who will be producing the goods for retirees to buy in 2030, by which time the ratio of workers (producers) to retirees will have dropped to two to one. He observed that it is unlikely that workers will be willing to support this pool of unproductive people at a very real cost to their own children and asked whether a society can function when most of its resources flow into the pockets of an unproductive cohort.

Peterson agreed that productivity is at the heart of the problem, noting that we save less and invest less than any other industrial country. He endorsed a system like that in Chile, which allows deductions from workers' paychecks for the retirement fund to be invested and thereby put back into the economy. The Chilean saving rate has been raised to 27 percent of GDP, while the U.S. saving rate hovers around 5 percent. Peterson suggested that American politicians have misused Social Security tax revenues by not investing those funds in projects that would bring cumulative returns in the future and would stimulate the economy.

Mashaw agreed that we should be doing a better job in managing the fund to make the money deducted for future retirement grow, but he argued that some marginal changes to the program would protect older workers and avoid means testing or privatization. He reminded the opposition that 90 percent of all Social Security payments go to individuals with incomes less than $25,000. He favored a more realistic retirement age, conforming to the longer, healthier lives workers now have, as one way to ensure solvency of the fund.

Bronte argued that age bias is pervasive in our society and that individuals who want to work are being forced into involuntary retirement in large numbers. She recommended tax breaks for corporations that retain older workers and the expansion of part-time job opportunities for older workers. Noting that 81 million "baby boomers" will reach age 50 in the next twenty years, she criticized the efficiency of policies that discourage the participation of older workers and asserted that involuntary retirement represents a large social loss.

Butler argued for improving productivity by making better use of the talents and skills of the country's 40 million retired persons. He also suggested that it makes economic sense to increase the income cap above the current $62,700 on which an individual pays Social Security taxes. He questioned the advisability of investing retirement funds in equity markets, which have been known to crash, noting that many private pension funds have failed while the Social Security program has continued to provide benefits to the elderly without exception.

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The Levy *Report* Interview

Betsy McCaughey Ross Discusses Health Care, Education, and Welfare

Betsy McCaughey Ross,
Lieutenant Governor of New York State

New York State Lieutenant Governor Betsy McCaughey Ross's entry into political life was her selection by George Pataki to be his running mate in the gubernatorial election of 1994. Previously, she had been a senior fellow at the Manhattan Institute for Policy Research and a professor and constitutional scholar at Columbia University. She received a B.A. from Vassar College and a Ph.D. from Columbia University. On Thursday, October 3, 1996, Lieutenant Governor McCaughey Ross discussed a wide range of policy issues with Assistant Director Sanjay Mongia. Excerpts of their conversation follow.

Mongia: Your article in *The New Republic* was widely credited with derailing the Clinton health plan. What principles would a McCaughey Ross health care plan emphasize, and how would it differ from the Clinton plan?

McCaughey Ross: I took a stand against the Clinton plan because it would have forced virtually all Americans into low-budget health plans that would have reduced the quality of their health care and diminished their personal choice. HMO abuses constitute the single largest health problem in the United States. Sixty million Americans are enrolled in HMOs, and managed care does offer important advantages to cost-conscious consumers and employers, but if we are going to encourage people to join HMOs, we have to make sure HMOs are putting patients ahead of profits and, most importantly, that patients know everything they need to know to choose a safe health plan.

State governments are responding to the huge number of horrific tales of denied or delayed care. There are currently over 300 bills in state legislatures to curb HMO abuses. But states can only do so much. About half the families in the United States (about 57 percent in New York State) who get their health insurance through their employers cannot be protected by anything state lawmakers do because of the federal ERISA [Employee Retirement Income Security Act] laws. That's why New Yorkers and all Americans need federal protection. We need a federal law that will stop the discharging of patients from hospitals before they are well enough to leave safely. We need a federal law that will require HMOs to disclose, in plain language, the penalties and incentives that are used to discourage doctors from referring patients to specialists, ordering diagnostic tests, and allowing sufficiently long hospital stays.

Mongia: Are you concerned that this incentive structure will encourage undertreatment and other practices that will have an adverse affect on both the quality and the long-term costs of health care?

McCaughey Ross: Yes. It sets up a conflict of interest between the patient and the doctor. For example, under the withhold provision, what a doctor prescribes for a patient ultimately comes out of the doctor's own pocket. A dermatologist recently told me that if she orders a biopsy for a patient on a mole or skin blemish and the biopsy comes back negative, she has to pay for the test. That kind of penalty discourages a doctor from being thorough, which is not in the interest of the patient. HMOs should have to disclose the penalties and incentives that are used to discourage doctors from providing all the care their patients need. If HMOs are not willing to disclose that information, they probably shouldn't be in the business of health care.

Mongia: So you believe that HMOs should be subject to federal oversight and regulation.

McCaughey Ross: I believe that a federal law is necessary because such a large percentage of families cannot be protected by state law. In general, I do not argue for the heavy hand of regulation, but this is a case in which regulation is necessary to ensure adequate disclosure.

Disclosure is a fundamental concept in our marketplace system. When you want to buy a can of soup, you can read the ingredients on the label. When you buy cigarettes, you see the warning on the pack. People ought to know the facts in order to choose a safe health plan. Not all managed care organizations use withholds and financial bonuses to influence doctors' decisions, and you should be able to find out which ones do.

Mongia: What can states do to encourage greater transparency and disclosure?

McCaughey Ross: States can, and should, pass disclosure bills. New York has taken a step in the right direction by increasing the disclosure requirement. Some states have gone further. For example, Maryland outlawed the withhold last year, and Oregon has a provision on the ballot this year to virtually ban capitation. With adequate disclosure as the first step, the marketplace will often achieve the right results. But for the marketplace to work in the interests of consumers, there must be adequate disclosure.

Mongia: Critics allege that measures such as these will create further burdens on the health care industry and increase costs that will eventually be borne by the consumer.

McCaughey Ross: These are not bills that require HMOs to alter the way they do business. Disclosure bills simply require that HMOs deal honestly with the consumer. If they are not willing to disclose this information, they shouldn't be in the health care industry. What argument could possibly be made against disclosure? How can secrecy be in the best interests of patients and their families?

Mongia: Many HMOs respond that they object to disclosure bills not because they want to maintain secrecy, but because the bills are an added regulatory burden.

McCaughey Ross: I think that's just double talk. Would you apply that same argument to the ingredients in food?

Mongia: It sounds like you want transparency similar to that in the financial services industry.

McCaughey Ross: The financial services industry is a perfect example of an industry that has regulated itself in an optimal way. We have the finest securities regulation in the world, and for that reason we have the biggest and best operating market. The health care industry should self-regulate and set higher disclosure standards. That is the way to prevent the heavy hand of regulation from raising costs in the health care industry.

Mongia: Though you criticized the Clinton health plan, you share its fundamental goal of universal health insurance. How do you define universal health insurance?

McCaughey Ross: I would like health insurance to be accessible and affordable for every American who wants it. There are 2.5 million people in New York State without health insurance and 41 million people without it nationwide; 85 percent of those people are working, and 75 percent of them are working in small businesses. I recently took a taxi and there was a picture of a teenage girl hanging from the rearview mirror. I started to talk with the driver and he identified the girl as his daughter. He was worried--she's sick, and he doesn't have any health insurance. You can hear a similar story from the waitress who serves you lunch, the dry cleaner who presses your suit, and the pharmacist who fills your prescription. People who work for small businesses are uninsured because small businesses cannot afford insurance. The best way to make health insurance more accessible is to reduce the cost of health insurance for small businesses.

Mongia: How do you propose achieving that?

McCaughey Ross: One way to reduce the cost is to give small businesses the same advantages large companies and unions enjoy. Currently, small businesses pay at least 30 percent more than larger companies for similar benefits, and they pay at least 30 percent more in administrative costs. The ERISA laws need to be altered to enable small businesses to pool their purchasing power across state lines. For example, the National Federation of Independent Businesses has 600,000 members; it would be terrific if the federation could self-insure its members or buy coverage on a large-group basis for its members.

I would like to make two other points about health care. First, the Kassebaum-Kennedy bill is a very good bill, and I applaud the president for signing it. It solves a small but serious problem, namely, lack of portability for some workers. It helps people who leave a job with health benefits and are lucky enough to get another job with health benefits within 60 days. The bill ensures that these people will not lose their coverage, even if they have a preexisting condition. Unfortunately, the enormous amount of public attention focused on this legislation has led many people to believe that the health insurance problem is solved. In fact, the real issue for most Americans is not portability, it's affordability.

Second, throughout the health care debate it is important to recognize the necessity of supporting medical education and research. As managed care becomes more prevalent, it imperils teaching hospitals and academic medical centers. HMOs are slashing payments to teaching hospitals and barring all but their most seriously ill patients from seeking care in those hospitals. As a result, teaching hospitals are suffering increasing financial distress. They no longer have surplus funds to support basic research and clinical trials. To see the effects, look at California, the state with the highest penetration of managed care. Several academic medical centers there are approaching financial crisis. I don't want to see that happen in New York or other states.

In the last 25 years the United States has won 40 Nobel prizes in medicine and physiology, more than twice as many awards as the rest of the world combined. Nations that have adopted single-payer systems--Germany, England, and Canada--have made reductions in medical spending where they are least visible to voters; they've made those cuts in medical education and research because the public will not feel the effects right away. Those nations are not in the forefront of medical research because they are not spending enough money on it. If you're seriously ill, the best place to be is the United States. We must make sure that preeminence is maintained.

Mongia: Let's shift topics to the economy. By most accounts and nearly all measures, the national economy has performed well in the past few years. The budget deficit has been reduced to $117 billion, the unemployment rate has plummeted to 5.2 percent, household income has shown modest gains, and the previously unyielding poverty rate has fallen during the past two years. Given the relatively steady performance of the U.S. economy, what strategy do you advocate as a responsible means to boost the growth rate?

McCaughey Ross: Education. We must ensure that young people have the math, science, and language skills to compete in a rapidly changing, highly competitive global workplace. We need a workforce that can adapt rapidly, workers who can train and retrain themselves in accordance with changes in technology and the knowledge base. In New York State only 39 percent of high school graduates earn a Regents diploma. The rest earn a competency diploma that, in some cases, requires only sixth-grade math skills. Adults cannot make it in the workplace today with sixth-grade math skills.

Mongia: Does the effort to improve education require a commitment of additional financial resources?

McCaughey Ross: It requires higher standards, smarter spending, and earlier starts. From 1980 through 1995 school spending in New York State skyrocketed by 168 percent. Remarkably, school enrollment dropped 6 percent during that period. The school districts spent more on fewer students and taxed local residents again to pay for it. New Yorkers are devoting 49 percent more resources (in real dollars) to each student now than in 1980, but still only 39 percent of graduates earn a high-quality Regents diploma.

One of the keys to more effective spending is earlier starts, and New York is behind the nation in this area. New York spends huge sums on costly remedial programs and special education programs to try to correct problems that could have been prevented or corrected far more easily and at lower costs in the early years. That is why I've rolled out a major policy initiative to expand early educational opportunities.

Through the Educational Excellence Project I am trying to double the size of the New York State prekindergarten program over the next five years. The program targets at-risk children. Research demonstrates that children who attend a New York State prekindergarten program are 50 percent less likely to need special education and 26 percent less likely to be held back in the early grades. That means brighter futures for children and definite savings for taxpayers. By reducing the likelihood of special education, the prekindergarten program saves taxpayers $11,731 for each child enrolled. The program pays for itself in less than five years; by the time preschoolers in the program finish third grade, 68 percent of the program's cost is offset in reduced special education needs alone.

This program has a 32-year record of success. Its only shortcoming is that it is too small. Currently, it serves only 19,600 children statewide, and it is available in only one in seven school districts. In participating districts children have to be selected by lottery, and many are left on waiting lists. Special education enrollment has soared since 1980, while New York State spends only $50.2 million a year on the prekindergarten program, which is less than half of one percent of the state education budget.

Mongia: Your description of the program suggests that expansion is a wise, even virtuous, idea. What are the obstacles to expansion?

McCaughey Ross: Although educators agree that the early years are the most important in influencing future performance and that the long-term costs of not providing prekindergarten are substantial, there are political obstacles to expanding the program. On the one hand, politicians are pressured by taxpayers who want school budgets reduced; on the other hand, they are pressured by constituents who want to see grades K through 12 improved. The last thing politicians are likely to do is spend money on a program they are not legally required to provide. Prekindergarten is not legally required in New York State, but that is a shortsighted perspective.

However, this year the politicians will not be able to ignore this program. Since the initiative to expand the program was unveiled in September, the League of Women Voters, the New York State PTA, the School Boards Association, the National Education Association, the New York

State United Teachers, the Children's Aid Society, the City University of New York, children's advocates, taxpayers' advocates, and educational advocates have all endorsed the program and made it a high priority.

Mongia: Will you concede that doubling prekindergarten spaces will add costs to the program?

McCaughey Ross: It requires start-up funding, but ultimately pays for itself. As I mentioned, the rapid increase in educational spending in an era of diminishing enrollment demonstrates that there is money to be saved within the educational system. Resources have to be redirected to more cost-effective programs. This is, perhaps, the most cost effective of them all.

Mongia: You seem to be making a keen distinction between expenditure and investment. What other programs or initiatives meet your test of sound public investment?

McCaughey Ross: The prekindergarten program adds significant social value and lowers long-term costs. That should be one of the benchmarks for any government program. We must consider not just the cheapest initial approach, but the long-term financial consequence. For example, that principle should apply to the building of roads: the road should not crumble during the first frost heave.

Of course, many functions of government should be privatized. There are many areas in which government should not be involved because the private sector has demonstrated far greater expertise. However, there are some functions, such as education, that are important for government to maintain and that fall under the umbrella of public investment. The public trusts that these functions will be performed in a manner consistent with public values. For example, I would be reluctant to privatize prisons. Some states are considering the privatization of prisons, but we have to balance the cost efficiency of operating a prison with a rigorous adherence to the legal requirements related to observing the rights of prisoners.

Mongia: The process of devolution means not only that power is shifted from Washington to the states, but also that less federal aid will be available to the states. Are you convinced that New York State has the resources to meet this added responsibility?

McCaughey Ross: We will have to make sounder, more cost-effective policy decisions and use the flexibility we gain through devolution. Before I entered government, I believed that a federal waiver was equivalent to more flexibility. But I now recognize that getting a waiver from the federal government costs millions of dollars and thousands of person-hours. The money expended on processing a federal waiver should be spent on child care or health care, not on more red tape.

Mongia: The new welfare law mandates time limits and work requirements for able-bodied persons on assistance. If a welfare recipient is actively seeking a job in the private sector but cannot find such a job, should government (federal, state, or local) act as employer of last resort?

McCaughey Ross: In New York State the public sector does act as the employer of last resort for people on AFDC. We have a workfare requirement and those who report to their public jobs are eligible to collect $557 per month for a family of three. I believe that it is wrong to hand out cash payments to able-bodied, healthy adults who simply refuse to work. But it is also wrong to deny children or the disabled food, clothing, or the other staples of life. Mayor Giuliani has demonstrated how successful the workfare program can be in reducing the number of families on welfare.

Mongia: Don't you agree, though, that there appears to be a general aversion to the expansion of the public sector?

McCaughey Ross: I believe that many of these welfare reforms will help restore public confidence in the social safety net. They will restore public confidence that the government can meet the needs of the poor, the elderly, and the disabled and meet them with care, compassion, and common sense.

Mongia: The new welfare law also contains controversial provisions dealing with immigration. You have been critical of efforts to change the Constitution to deny citizenship to children born in the United States to illegal immigrants.

McCaughey Ross: That proposal shows an outrageous disrespect for the most fundamental principles of our society.

Mongia: The welfare bill has provisions to deny eligibility for some forms of public assistance to legal immigrants. The Senate is weighing legislation to deny public schooling and other services to children of illegal immigrants. If lawmakers are convinced that immigrants are a public charge, why not reform immigration policy--regarding both legal and illegal immigration--rather than make scapegoats out of immigrants under the guise of welfare reform?

McCaughey Ross: Denial of benefits to legal immigrants who have obeyed the law, have paid their taxes, have participated in American life, and now need the social safety net is unjustifiable. A provision to deny education to any child is shortsighted, shocking, and obviously foolish--it's destructive. Do we want a caste of Americans who are denied literacy and who are unable to read? Fast forward 15 years to when these children are young adults. They will be unemployable and they will fill our jails.

Illegal immigration is a huge and costly problem. The right way to correct that problem is to enforce the immigration laws and secure the nation's borders. If the federal government is unwilling to do that, it should pick up the tab for the cost of illegal immigration. Expecting four states (California, New York, Texas, and Florida) to pick up the cost of illegal immigration is tantamount to expecting the states with the largest defense installations to pick up the cost of national defense.

Mongia: Will you support Mayor Giuliani's effort to launch a constitutional challenge to the provisions in the welfare bill that deny aid to legal immigrants?

McCaughey Ross: I want to study the text of Mayor Giuliani's constitutional challenge. I can tell you that I fully support the mayor for reelection. I think he's the finest mayor we've had in New York City in a long time. He's the mayor of all the people, without regard to party or ethnicity.

Mongia: Some observers claim that the public has lost faith in all institutions--the political system, educational institutions, the church, the criminal justice system, and so on. What can public officials do to restore this faith?

McCaughey Ross: I believe that government officials can restore a measure of public confidence in the political system by talking about the important issues. We should not dwell on petty personal attacks, bickering, and infighting; too much attention is focused on the politics of personality, and it's a waste of time. Public servants must focus on the issues that really matter, and they are health care, education, and job security. Those are the three issues that I focus on.

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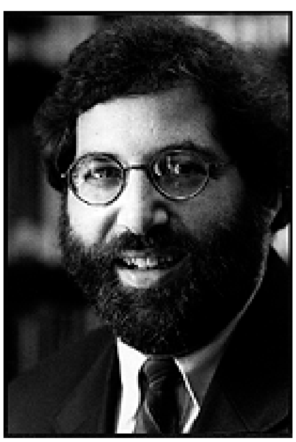
The Cost of Meaningful Welfare Reform

Policy Analysis by Levy Institute Resident Scholar Oren M. Levin-Waldman



Oren M. Levin-Waldman

President Clinton recently signed into law what may be the most sweeping welfare reform since the adoption of public assistance programs in 1935. This legislation, known as the Personal Responsibility Act, replaces the traditional Aid to Families with Dependent Children (AFDC) program with federal block grants to the states. Previously, AFDC was administered through a cooperative arrangement between the states and the national government. The national government provided, on average, 55 percent of funding and the states administered the programs and financed the rest. Although the federal government promulgated a set of regulations governing the administration of AFDC, eligibility criteria, and minimum levels of benefits, states were always free to offer more assistance and other types of assistance not necessarily provided for in AFDC.

The new welfare law differs from the old in that it imposes cumulative time limits on benefits and requires recipients to participate in work programs. However, the principal difference between the old and new welfare structures is that national funding is no longer guaranteed; rather, it is subject to annual congressional appropriation. The welfare reform promises $55 billion in savings over the next six years, with $23 billion of the savings coming from reductions in the food stamps program. Previously, food stamp benefits were based on income, and those who received less in AFDC could expect to receive more in food stamps. Food stamps essentially served to equalize disparities among states in AFDC levels.

In response to claims that the poor will be hurt by the new welfare law, its advocates retort that many states have been successful in instituting welfare reform that works. The example that is cited as the greatest success by members of both political parties is the "Wisconsin plan." The Wisconsin plan began a couple of years ago as a federal waiver called Wisconsin Works W-2. The objective is to break the poverty culture of dependency; by requiring welfare recipients to work, the plan encourages them to achieve self-sufficiency. The program does not provide training. It is based on the assumption that the poor are poor not because they lack the necessary skills to lift themselves out of poverty, but because they are not in the habit of working. The best training, therefore, is the actual experience of working for wages. W-2 also assumes that everyone is capable of some level of work.

The W-2 program consists of four work options: unsubsidized employment, subsidized employment (trial jobs), community service jobs (CSJs), and W-2 T (transition). Upon individuals' entry into the W-2 program, all efforts are made to steer them into private sector jobs. Job centers and private staffing agencies attempt to match program participants with employer needs. W-2 assumes that most participants will be able, with some assistance, to find such unsubsidized employment.

Individuals who are willing to work but lack sufficient experience or skills are eligible for the subsidized employment or trial jobs option. The state gives subsidies to employers who provide jobs in which W-2 participants receive training. The subsidies, averaging $300 a month, offset the cost to employers of training and supervising new employees. Trial jobs are subsidized for no more than 24 weeks and most are expected to become permanent, unsubsidized jobs.

Participants earn no less than the minimum wage and are further subsidized through the earned income tax credit (EITC).

Community service jobs are available to those who need to practice the work habits and skills they must have in order to be hired by private businesses. CSJ work assignments are limited in duration to six to nine months each. Although participants may qualify for more than one assignment, they may not be in the program for more than 24 months. W-2 assumes that individuals who start in the CSJ option will move into subsidized employment and then into unsubsidized employment. Hence, W-2 sees itself as less a welfare program than an employment one, and it is operated by the new Department of Workforce Development (DWD).

The W-2 T or transition option is for those who are legitimately unable to perform independent, self-sustaining work, even in a community service job. Participants are typically those whose application for Supplemental Security Income (SSI) is pending or those who have mental or physical disabilities. Nevertheless, in order to receive cash, they still need to engage in some work activities consistent with their capabilities.

Were this type of plan to be implemented nationally, welfare costs would increase considerably. The expected cost in Wisconsin for fiscal year 199798 is $1.1 billion, of which $653 million is to come from federal block grants and $447 million from state funds. In 1995 there were 72,366 AFDC cases in Wisconsin, with a total cost of $15,200 per case. Implementing this plan nationwide would boost total spending (i.e., the aggregate value of all components of W-2) to $72.5 billion. Under the old welfare structure, nationwide AFDC spending was roughly $23 billion, of which $12.8 billion came from the federal government and $10.4 billion came from the states. According to the Congressional Budget Office, the base level of the federal block grant is to be fixed by the new law at $16.4 billion annually through 2002, and states would be required to come up with the remainder. However, the new law requires states to spend at a rate equal to only 80 percent of what they were spending under the old law.

In the short term, states may spend at least $2 billion less to implement parts of the new law. It should also be noted that the new welfare law relies heavily on wage subsidies in the form of the EITC, which currently costs around $25 billion. Program costs, however, do not include EITC expenditures. The legislation does provide for $14 billion in child care funding and includes strict new child support enforcement measures. It is estimated that enforcement of child support will raise an additional $24 billion. Assuming these projections to be accurate and adding the $16.4 billion in federal block grant assistance, there would still be a shortfall of $18 billion to match the spending levels of the Wisconsin plan.

The problem with relying on states to devise their own programs is that there is no guarantee that they will opt for one as ambitious as Wisconsin's. On the contrary, given the fiscal constraints in most states, it is more likely that they will opt to meet only the minimum requirements under the law. Even those states that opt for a Wisconsin-type plan might try to modify it for cost reduction. The basis for cost savings lies in the ability to limit eligibility for those very programs that might do more to prepare people for the world of work. It shouldn't be too surprising to see states push individuals into unsubsidized employment, in which case the unemployed would be required to take whatever jobs exist. With the recent increase in the minimum wage, coupled with the EITC, unsubsidized employment could be a more attractive option than it was a few years ago. Thus, for any state plan to be viable, any scaling back of the EITC in the future could jeopardize the marginal benefits there may be from the new welfare law.

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New *Public Policy Briefs*

Making Work Pay: Wage Insurance for the Working Poor

In ***Public Policy Brief*** **No. 28,** ***Making Work Pay*****, Barry Bluestone and Teresa Ghilarducci** argue that a program of "wage insurance" is needed in the current environment of stagnating wages, increasing income instability, and rising adult poverty. The War on Poverty succeeded in reducing the elderly poverty rate from 30.0 percent to 10.5 percent over the past three decades. Nonelderly adults made up an absolute majority (50.2 percent) of all poor persons in the nation in 1994, up from 40.1 percent. With the overall growth in the number of persons in poverty in the United States from 25.4 million in 1970 to 38.1 million in 1994, the number of poor nonelderly adults nearly doubled, from 10.4 million to 19.1 million.

Bluestone and Ghilarducci note that essential components of a wage insurance system already exist in the earned income tax credit (EITC) and the minimum wage. But the EITC and the federal wage floor must be seen as complements to one another, not substitutes for one another, in order to meet important criteria for any insurance program: high target efficiency and minimal adverse behavioral effects. Properly used, the EITC and the minimum wage fit together like well-cut jigsaw puzzle pieces; the considerable strengths of the EITC offset weaknesses in the minimum wage, while the minimum wage's greatest benefits offset some of the shortcomings of the EITC.

The authors show that low income is being "democratized" as job instability increases. Due in part to corporate downsizing, an increasing number of once-secure working-class and middle-class families are experiencing temporary or periodic poverty. Falling wages for at least the bottom 20 percent of the workforce and rising job and wage instability for much of the middle class portend a society in which work no longer serves as an effective guarantee against privation. Institutionalizing a form of wage insurance based on the EITC and a rising minimum wage can help protect a large segment of workers in this economic environment.

The modest minimum wage increase to $5.15 recently passed by Congress will raise the income of over 12 million workers who now earn between $4.25 and $5.14 per hour. Moreover, findings suggest that nearly 9 million workers currently earning between $5.15 and $6.14 per hour will see their wages rise by an average of 10 percent when the $5.15 wage floor goes into effect. This means that more than 21 million workers--one out of six in the workforce--will see their wages improve as a result of enacting the higher minimum wage.

The EITC's greatest asset, from the perspective of battling poverty, is its target efficiency. More than 46 percent of the total tax credit goes to families who are living at the official poverty line, and more than two-thirds of the credit goes to families with income under $20,000. The EITC has still another advantage, one that is often overlooked by both its supporters and its detractors: It is a form of wage insurance for the temporary poor in an era of job instability and earnings insecurity. In any single year about one in six families is eligible for the tax credit, and over a period of a decade nearly 40 percent of families will have a year or more in which their wage income declines sufficiently for them to be eligible for the EITC.

As shown in the table below, neither the minimum wage nor the EITC is by itself an ideal solution to the wage poverty problem. Yet when the two are combined, the sum is greater than its parts. On three criteria (income adequacy, target efficiency, and labor demand employment effects), the minimum wage is weak. These are precisely the strengths of the EITC. On four other criteria (labor supply employment effects, productivity enhancement, minimal fiscal impact, and limited moral hazard), the minimum wage is clearly the preferred program. What makes the two fit together so well is that the existence of a higher minimum wage actually reduces the negative productivity, fiscal impact, and moral hazard effects of the EITC, while the EITC makes up for the weak target efficiency and income adequacy of the minimum wage.

Strengths and Weaknesses of the Minimum Wage and the EITC

Attributes of Good Social Insurance	Minimum Wage	EITC
Income adequacy	-	+
Target efficiency	-	+
Labor demand employment effects	-	+
Labor supply employment effects	+	-
Productivity enhancement	+	-
Minimal fiscal impact	+	-
Limited moral hazard	+	-

Bluestone and Ghilarducci argue for a comprehensive and coherent strategy aimed at the working poor and those susceptible to highly fluctuating incomes. Changes in the food stamp program enacted as part of the recent welfare reform legislation and proposed cuts in the EITC work in precisely the opposite direction. A $23 billion cut in food stamp benefits between 1997 and 2002 and the increased FICA tax liability accompanying the increase in the federal minimum wage reduce the effective hike in the wage floor from $0.90 to $0.73 per hour for nonimmigrants. For legal immigrants working full-time, who will now be denied food stamps, the lost benefit is more than double the earnings gain attributable to the increase in the minimum wage. In addition, the congressional resolution for balancing the federal budget by 2002 includes an $18.5 billion reduction in EITC benefits. These changes undermine the objective of assuring that families that work will not be mired in poverty and dependency.

Wage insurance becomes more necessary in a political climate of welfare overhauling and budget cutting that gives with one hand while taking with the other. Efforts to improve education and training programs, expand community development efforts, promote unionization, and narrow the gender pay gap can reduce the long-run cost of wage insurance.

Institutional Failure and the American Worker

According to **David R. Howell,** research associate of the Levy Institute and professor of economics at the New School for Social Research, the economic slowdown that has characterized most developed countries since the mid 1970s has been accompanied by increasing competitive pressures that have called into question customary wage and employment arrangements in the private sector. Meanwhile, political and fiscal pressures have threatened many traditional regulatory and redistributive functions of government. These developments have been strikingly painful for American workers.

Most economists and policymakers believe that the source of the growing gap in the United States between wages for high-skill workers and wages for low-skill workers is the sharp decline in the demand for low-skill workers in the 1980s. This shift in labor demand is seen as primarily the result of the growing use of computer-based technologies in the workplace, although it is increasingly recognized that rising imports from less-developed countries may have played an important role in shifting labor demand in some manufacturing industries. In this conventional view, the fundamental problem is a growing mismatch between the level of skills required by employers and the level of skills possessed by workers; with the drop in the demand for low-skill work, there are simply too few low-skill jobs for the number of low-skill workers. Since few people are prepared to recommend constraining either technological progress or foreign trade, advocates of the skill mismatch thesis urge that firms and individuals be allowed to adjust to market forces. Public intervention, if any, should be limited to efforts to reduce the supply of low-skill workers by developing a more effective education and training system.

In a forthcoming *Public Policy Brief*, Howell challenges the skill mismatch thesis. He claims that evidence refutes the prevailing belief that a substantial shift in demand away from low-skill work characterized the 1980s. Although it is clear that skill levels among workers have increased over most of this century, there is no evidence that this upward trend accelerated in the 1980s; indeed, the employment data suggest a deceleration in the growth of skill requirements, with little change observable after 1983. Because the use of computer-based technologies did not begin to take off until the mid 1980s and the technologies were used in that decade primarily for clerical and administrative tasks in offices, computerization is not a compelling explanation for the wage collapse. The widespread acceptance among economists and policymakers of the demand-shift argument appears to stem less from the strength of the evidence than from the argument's consistency with the simple demand and supply model of the labor marketa model that rules out a significant role for wage-setting institutions and norms.

Howell believes that to be compelling, an explanation must incorporate changes in labor market institutions (such as collective bargaining), regulations (the minimum wage), and norms (the prevailing beliefs that underlie the strategies and policies of decision makers); it is these changes, together with shifts in demand and supply, that determine changes in labor market outcomes. The institutional explanation proposed by Howell begins with two underlying and related developments that began to affect wage-setting practices substantially in the late 1970s. First, similar to the national experience in the 1920s and 1950s, there was a sharp swing in national preferences away from collective and public solutions and toward private and market solutions. This shift legitimated laissez-faire government policies and sent a strong message to employers that, consistent with a long tradition in American labor relations, good management meant an aggressive, confrontational approach toward labor. Second, there was a significant increase in competitive pressures, which underlined the need for employers to cut costs.

In this economic and ideological context, new management methods (for example, just-in-time inventory control) and innovative technologies (for example, computerization) were introduced in "best-practice" or "high-road" firms, but the dominant strategy in most firms was to attack labor costs via "low-road" strategies--demands for wage and benefits concessions and the shifting of work to low-wage workers through outsourcing, relocation, and the use of part-time and contingent workers. These strategies had a far greater effect on the level and structure of wages than did skills.

Howell declares that if the source of the wage collapse lies not in skill mismatch but in the dismantling of institutional barriers to unbridled wage competition, the current focus by economists and policymakers on human capital solutions is misplaced. Taking the earnings problem seriously requires intervention in the wage-setting process. Since it is well known that in the process of national economic development wage competition tends to bid down the wages of low-skilled workers to subsistence levels, a traditional job of government has been to constrain this competition by promoting safe, secure jobs that pay well. By taking the laissez-faire path--downsizing government, eliminating safety net programs, and promoting wage competition in the low-skill labor market--policymakers in the United States chose to disengage government from this responsibility, with devastating results for individuals, families, and communities.

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New Working Paper

Rethinking Health Care Policy: The Case for Retargeting Tax Subsidies

In **Working Paper No. 171, Senior Fellow Walter M. Cadette** states that the rise in health care expenditures has slowed dramatically in recent years as both business and government have succeeded in imposing cost constraints on the system. But prospects for universal coverage have diminished. The financial stress placed on hospitals by cost cutting has threatened the subsidies to the uninsured poor that cost shifting made possible in the past. Insurance in the individual and small-group market has become prohibitively expensive for some, especially for potentially costly subscribers, as underwriters have become ever more adept at screening them out. Medicare and Medicaid face new limits in an environment of budget cutting. And many employers have retreated from earlier commitments to health insurance, especially for the relatively low-paid workforce.

Against that background, the ranks of the uninsured (about 40 million) are almost sure to continue to grow. The portability legislation signed by President Clinton this year protects some employees from loss of their health insurance if they change jobs. But it does not address the broader and deeper problem of access to health care for the vast majority of the uninsured, who are locked out by reason of income.

If that problem is to be addressed, the nation must rethink how health care is financed. Cadette lays out the case for transforming the tax exclusion of employment-based health insurance into an income-scaled tax credit for the purchase of basic but comprehensive health insurance (catastrophic policies) for all. Such a plan could be budget neutral (more than $80 billion of revenue now forgone through the tax exclusion would be freed up with its elimination). And real economies in the use of medical care are likely to result when people have to use after-tax income to pay for any insurance costing more than the tax credit they receive. Such a plan would protect people from the financially devastating consequences of a serious, unforeseen illness, but at the same time would end the use of insurance (and the associated cost of claims processing) for payment of routine and thoroughly predictable expenses.

Medicare could be integrated into an income-scaled tax credit plan in a way that reflects the principle that subsidies for health care should be based on need just as much for the elderly population as for the population at large. A heavily subsidized health care plan that is blind to income for everyone over the age of 64 may have made sense in the mid 1960s, when Medicare was founded, but the approach that may have been reasonable 30 years ago has not been seriously reexamined in the light of vastly changed circumstances. Health care then was a much smaller share of GDP, the average income of the elderly was significantly below that of the population at large, and life expectancies were lower than they are today.

Medicaid also could be fashioned as a tax credit plan. The plan would eliminate the disincentive to get a job, namely, the loss of health insurance benefits, that recipients now have. This so-called notch problem will have to be addressed if the nation is to make a serious effort to move people off welfare and into work.

However difficult it will be, a constituency for transforming the exclusion into an income-scaled tax credit can be fashioned. The point to be stressed most is that individual health insurance is the only insurance that is truly portable, as it cuts the increasingly tenuous link between health care and employment. The tax credit plan provides health care security for most middle-income Americans. The benefit from a credit, even net of a lost tax exclusion, could extend well into the middle-income groups. At the same time it puts the poor on the same footing, so that in acting in their own best interests by supporting the plan, middle-income Americans would also be supporting universal coverage.

The benefits for relatively high-income Americans would have to be viewed--and sold politically--in a broader context. They would have to be seen in the virtues of a universal system: an end to cost shifting (a hidden tax, but a tax all the same), relief from the squeeze on hospital revenue that threatens the quality of health care even for those of unlimited means, and a clear conscience that people in need are cared for.

Corporate America could well be part of the constituency for transforming the exclusion into a credit. It has benefited from the exclusion, which is a way of leveraging compensation costs. But it is not well served by the damage to morale and to employee relations in general that has come about because of the need to control health care costs, a need that is rooted in the tax-free way the nation has financed much of its health care. Being "the heavy" when employees feel deprived of needed care for themselves and their families is not a role Corporate America could possibly want. Business probably would retain a role in health insurance under a tax credit plannot as a provider, but as a sponsor. Retaining a role would foster employee welfare, yet end the hopelessly ambivalent position employers now find themselves in as administrators of health insurance.

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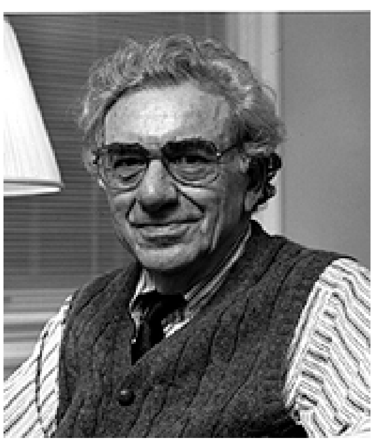
Levy Institute News

In Memoriam

Hyman P. Minsky, Distinguished Scholar



Hyman P. Minsky, distinguished scholar at the Levy Institute and professor emeritus of economics at Washington University in St. Louis, died on October 24 in Rhinebeck, New York. He was 77.

Dr. Minsky joined the Levy Institute in 1990 as a distinguished scholar and was a member of its Board of Advisors. His pathbreaking work on the instability and fragility of the financial system in a capitalist economy served as the genesis of his "Wall Street paradigm." At the Institute he was continuing his research on debt and the economy, and his work was the impetus and the guide for the Institute's research project on reconstituting the financial structure.

Dr. Minsky expanded on John Maynard Keynes's work on unstable financial markets to develop his paradigm, which states that the accumulation of debt must eventually curtail firms' investment, leading to financial retrenchment and recession. "A fundamental characteristic of our economy," he said, "is that the financial system swings between robustness and fragility, and these swings are an integral part of the process that generates business cycles." These swings can push the economy into booms and busts. In prosperous times, when corporate cash flow exceeds what is needed to pay off debt, a speculative boom develops and lending may soon exceed what borrowers can pay off from their revenues. In response to this crisis situation, lending is curtailed, even to companies that can afford loans, and the economy contracts.

Dr. Minsky argued that these booms and busts are inevitable in a free market economy in the absence of government action. The government can restrain the tendency to move to excess through regulation, central bank actions, and other tools. As Robert Pollin, professor of economics at the University of California at Riverside, notes, Minsky pointed out that the existence of a high proportion of nondefaultable debt outstanding (government debt) can have a stabilizing effect on the economy. However, as Steven Fazzari, Levy Institute research associate, points out, "Minsky noted that although government monetary and fiscal policy may temporarily contain financial instability, policy cannot prevent it from breaking out periodically."

Dr. Minsky presented his theories on lending and economic activity in *John Maynard Keynes* (1975), *Stabilizing an Unstable Economy* (1986), other books, and a large body of professional articles. Although mainstream economic thinking did not originally pay much attention to the importance of the financial system for macroeconomic activity, "during the past 15 years there has been an outpouring of new research, both theoretical and empirical, that rediscovers and validates Hy Minsky's views," observes Fazzari. "This new work has changed the landscape of macroeconomics and policy analysis and it assures that his research will have a major influence on economic thinking for years to come."

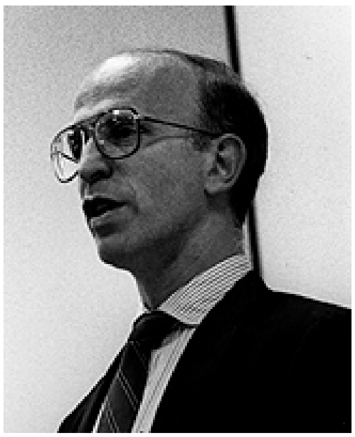
Among Dr. Minsky's many awards and distinctions was the prestigious Veblen-Commons Award, which was bestowed on him in 1996. This award is given by the Association for Evolutionary Economics to recognize the contributions of an outstanding scholar in the field of evolutionary institutional economics and to acknowledge exemplary standards of scholarship, teaching excellence, public service, and cogent research.

Born on September 23, 1919, in Chicago, Dr. Minsky received a bachelor of science degree in mathematics from the University of Chicago in 1941. He was in the U.S. Army from 1943 to 1946, during which time he served overseas in Europe. Influenced by Henry Simon, he changed fields and went on to earn a master's degree in public administration in 1947 and a doctorate in economics in 1954 from Harvard University. In his work at Harvard, where he studied with Joseph Schumpeter and Wassily Leontief, he specialized in finance.

From 1965 to 1990 Dr. Minsky taught at Washington University in St. Louis. While in St. Louis he had a long association with and served on the Board of Directors of Mark Twain Bancshares. In addition to his positions at Washington University and the Levy Institute, he taught at the Carnegie Institute of Technology, Harvard University, Brown University, the University of California at Berkeley, and Centro di Studi Economici Avanzati in Trieste, Italy. Dr. Minsky served as a mentor to a number of younger colleagues, offering inspiration and support.

Dr. Minsky is survived by his wife, Esther, a daughter, Diana, and a son, Alan.

Alan S. Blinder Rejoins the Board of Advisors



The Board of Governors of The Jerome Levy Economics Institute is pleased to announce the appointment of Alan S. Blinder to the Board of Advisors. Blinder is returning to the board after serving as a member of President Clinton's Council of Economic Advisers and, most recently, as vice chairman of the Board of Governors of the Federal Reserve.

Blinder is Gordon M. Rentschler Memorial Professor of Economics at Princeton University. He writes extensively on a wide range of economic issues for both academic and popular audiences. He is the author of several books and dozens of journal articles and was a columnist for *Business Week* (1985 to 1992) and *The Boston Globe* (1981 to 1985). Blinder received a B.A. from Princeton University and a Ph.D. from the Massachusetts Institute of Technology.

New Scholars and Projects

Distinguished Scholar Wynne Godley has returned to the Levy Institute to continue work on his Levy Institute/New Cambridge Model of the U.S. economy, an accounting-based model that utilizes stocks and flows measured at both current and constant prices. He has used the model to question the efficacy of the international payments adjustment system in light of the deterioration of the U.S. trade deficit since 1991. Godley is a professor of applied economics at Cambridge University and is a former member of the U.K. Treasury advisory body known as the "Six Wise Men." He received a Ph.D. from Oxford University.

Visiting Scholar David A. Aschauer is pursuing research interests in two areas of fiscal policy. The first line of research builds on his long-term investigation of the impact of federal expenditures (especially infrastructure investment) on economic growth and development. Aschauer is developing a new methodology for research in this area to provide further empirical evidence linking public capital and the performance of the national, state, and local economies. In his second line of research Aschauer is examining the desirability of a productivity budget for the federal government. He examines reasons for the use of public sector debt, rather than current taxation, for the financing of public expenditures that raise long-term productivity growth. Aschauer is Elmer W. Campbell Professor of Economics at Bates College. He received a B.A. from the University of Kansas and a Ph.D. from the University of Rochester.

As part of an ongoing exchange program, three Cambridge University visiting scholars--**Andrew Paulson, Susannah Rodgers,** and **David Seddon--**will pursue their independent research interests at Blithewood during the 1996-97 academic year. All are recent graduates of Christ's College, Cambridge.

Levin-Waldman Discusses Unemployment Insurance Reform on CNNfn

Resident Scholar Oren M. Levin-Waldman, author of *Public Policy Brief* No. 26, *Making Unemployment Insurance Work*, was invited to discuss his research with Deborah Marchini on the CNNfn program *Before Hours*. He stated that as workers are increasingly laid off due to plant closure, corporate downsizing, technological change, and intense global competition, insecurity in the workplace is mounting. Moreover, the rate of long-term unemployment (the ratio of those unemployed for more than 26 weeks to total unemployed) has risen considerably in the postwar era; while 7.2 percent of the unemployed were long-term unemployed in 1949, that rate had jumped to 17.3 percent by 1995. Even with sharp reductions in the national unemployment rate (standing at 5.2 percent in September), the rate of long-term unemployment remains a stubborn problem.

Levin-Waldman recommended that unemployment insurance benefits for the long-term unemployed be contingent on mandatory participation in training programs that are linked to business needs. Workforce development initiatives that emphasize public-private partnerships and public policies that encourage a more prominent role for business in these arrangements may improve the efficacy of worker training programs.

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