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Income Inequality's Impact on Community Development

Plus:

CDFI Bond Fund
Adult Literacy
Dr. CRA

CI Notebook

by Laura Choi

Last year, Proctor & Gamble introduced a new discounted dish soap line as part of its growing offering of lower-priced consumer products. At the same time, the company launched its most expensive skin care regimen ever, designed to rival pricey department store brands. According to a recent *Wall Street Journal* article, P&G is strategically targeting its products to the higher-end and lower-end markets, while ignoring the middle, and they're not alone. A number of American companies are recognizing that the consumer market is polarizing, with growth at both ends, and erosion in the middle. This "consumer hourglass" is reflective of a broader trend of increasing income inequality in the United States. As a larger share of total income becomes concentrated among the country's top earners, low- and moderate-income (LMI) households are forced to make do with less. This is particularly concerning as their balance sheets were already stretched thin; further financial constraints threaten to destabilize these households and the neighborhoods in which they reside.

This issue of *Community Investments* explores the issue of income inequality from a community development perspective, examining the broad trends that have contributed to its rise as well as the impact of inequality at the individual and community level. The articles consider different facets of income inequality, such as the geographic segregation of income groups at the neighborhood and regional level, and the increasing polarization of the labor market. A "Community Perspectives" thought piece examines the causes and consequences of the broad changes in income distribution. In addition, we address the impact of poverty stressors on LMI households. Our "Eye on Community Development" section highlights important advancements in the community development field, including the CDFI Bond Program and new approaches to addressing adult literacy.

We hope this issue of *CI* sheds light on the complex topic of income inequality in the United States, and more importantly, on the community development field's role in addressing it. We believe the field can leverage various programmatic and policy responses to help build the incomes of LMI households and place more individuals on the path to upward socioeconomic mobility. As always, we welcome your comments and suggestions and hope that you will join in the discussion.

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This publication is produced by the Community Development Department of the Federal Reserve Bank of San Francisco. The magazine serves as a forum to discuss issues relevant to community development in the Federal Reserve's 12th District, and to highlight innovative programs and ideas that have the potential to improve the communities in which we work.

COMMUNITY INVESTMENTS
Federal Reserve Bank of San Francisco

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Addressing Widening Income Inequality Community Development

By Laura Choi

through

The median annual household income in the U.S. is slightly over $50,000.[1] In contrast, the highest paid CEO in the U.S. earned $84.5 million last year, a factor of roughly 1,700 times the median (and that was for only nine months of work).[2] To compare these two figures and decry income inequality in America is an oversimplification of a highly complex issue. But this comparison hints at a growing divide in our country, where a relatively small group of people controls a relatively large share of the income—the top one percent of Americans control nearly a quarter of all the country's income, the highest share controlled by the top one percent since 1928.[3] The existence of income inequality is accepted as a byproduct of capitalism, where the market rewards individuals for their varying levels of productivity, but how much is too much? And should we be concerned with the apparent rise in income inequality?

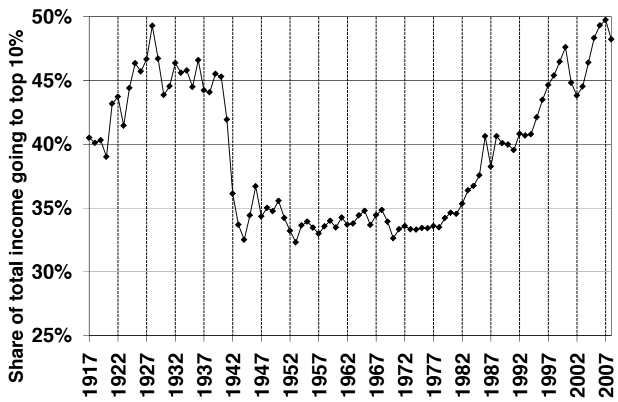
Community development practitioners are all too familiar with the effects of poverty, but less effort has been given to understanding the bigger picture of income inequality. Inequality exacts high social costs across all income groups. Emerging research suggests that crime, teen pregnancy, poor educational performance, drug use, obesity, mental illness, and lower life expectancy are positively correlated with income inequality (regardless of the overall level of income in an area).[4] As Richard Wilkinson and Kate Pickett write in their book, *The Spirit Level*, "The problems in rich countries are not caused by the society not being rich enough (or even by being too rich) but by the scale of material differences between people…What matters is where we stand in relation to others in our own society."[5] In addition, rising inequality has been linked to declining social capital and civic engagement. In his book *Bowling Alone*, Robert Putnam explains, "Community and equality are mutually reinforcing… In terms of the distribution of wealth and income, America in the 1950s and 1960s was more egalitarian than it had been in more than a century… [T]hose same decades were also the high point of social connectedness and civic engagement… Conversely, the last third of the twentieth century was a time of growing inequality and eroding social capital."[6]

Undoubtedly, a highly inequitable distribution of income is most troublesome for those with the least; understanding and addressing inequality is thus an important component of improving the lives of low- and moderate-income (LMI) individuals. The topic of income inequality is notoriously thorny, as it mixes elements of history, politics, economics, and philosophy, but this article aims to untangle some of these issues and consider them through a community development lens.

The Great Divergence

Figure 1 shows the income share of the top decile of earners over the past century, based on income tax data analyzed by economists Thomas Piketty and Emmanuel Saez.[7] From the mid-1920's until the early 1940's, income was highly concentrated among top earners, with the top decile earning roughly 45 percent of total income. However, a drastic shift occurred during World War II. Economists Claudia Goldin and Robert Margo dubbed this period the "Great Compression," in reference to the drastic flattening of the wage structure.[8] According to Goldin and Margo, this period saw a rapid increase in the demand for unskilled labor at the same time that the supply of educated labor was expanding, bringing wages across the labor market closer together. The income share of

Figure 1. *Top Decile Income Share in the U.S., 1917–2008*



Source: Piketty and Saez (2010).
Income defined as market income including capital gains. In 2008, top decile includes all families with annual income above $109,062.

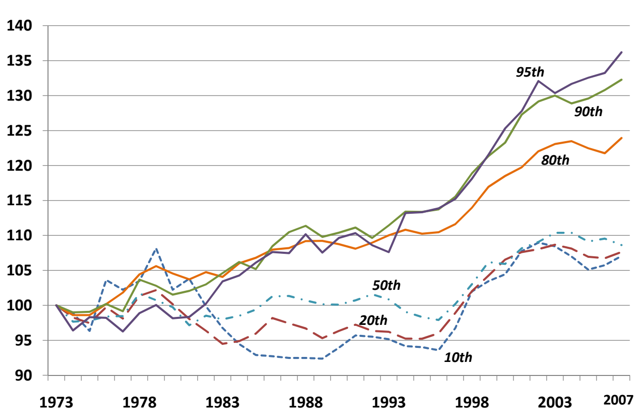
the top decile stabilized around 33 percent following the Great Compression, and with less income concentrated at the top, a strong middle class flourished throughout the 1940's and into the late 1970's. However, the shared prosperity of the midcentury period gave way to a rapid rise in income inequality beginning in the 1980's, a period economist Paul Krugman refers to as the "Great Divergence."[9]

Alternative measures of income inequality support the notion of a Great Divergence. Figure 2 shows the trajectory of real hourly wages for various earners since 1973, demonstrating that those at the top of the earning scale saw their wages rise much more rapidly than those at the bottom. Real hourly wages of those in the 90th percentile, where most people have college or advanced degrees, rose by 30 percent or more, while wages at the 50th percentile and below, where many people have at most a high school diploma, rose by only 5 to 10 percent.[10] Another commonly used tool to examine income inequality is the Gini index, which is a statistical measure of the inequality of a distribution. The Gini index ranges from a value of 0 to 1; when applied to income distributions, the lower the Gini index, the more equal the income distribution; as the index rises, so too does income inequality (a value of 1 would mean that a single person earns all of the income).[11] Figure 3 shows the Gini index for U.S. households over the past forty years and demonstrates that income inequality has been increasing fairly consistently over time. To provide some global context, consider that the most equitable societies (Sweden, Hungary, and Norway) presently rank in the low 0.2s; the U.S., at close to 0.47, is on par with the Ivory Coast, Cameroon, and Jamaica in terms of equitable income distribution.[12]

What Caused the Divide?

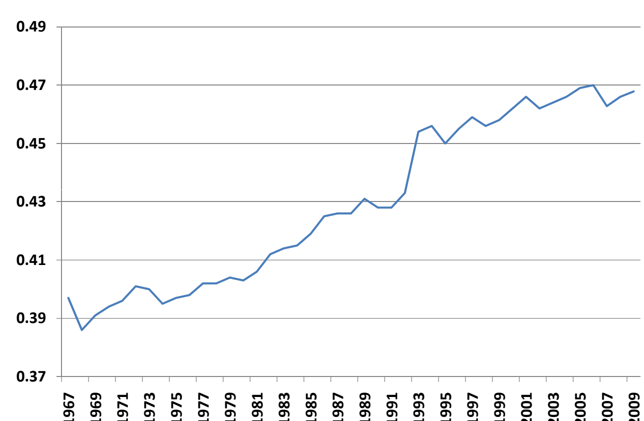
But how exactly did this rise in income inequality come about? The causes of the Great Divergence are wide ranging and interwoven; as a result, there is no singular answer to this question.[13] However, one of the most influential determinants of labor market outcomes and wages is education. Figure 4 shows the differences in the growth of real wages over time by educational attainment. Since 1973, real wages have risen about 20 percent for those with college or advanced degrees, while they have remained flat for high school graduates, and fallen about 15 percent for those with less than a high school education. The U.S. population has increased their overall schooling over the past 30 years, with a greater share of the total population graduating from high school and college; however, much of the increase in schooling since the 1970s is due to the dying out of older generations with comparatively

Figure 2. *Change in Real Hourly Wages for Select Percentiles, 1973–2007 (all workers, normalized 1973=100)*



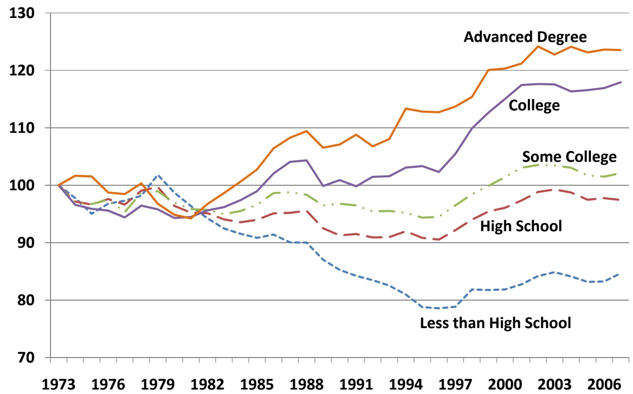
Source: Economic Policy Institute

Figure 3. *Gini Index for U.S. Households, 1967–2009*



Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements.

Figure 4. *Change in Real Hourly Wages by Education, 1973–2007*
(all workers, normalized 1973=100)



Source: Economic Policy Institute

little education, rather than steadily growing educational attainment among younger generations.[14] This slowdown of educational progress across successive generations, coupled with shifting demographics (the aging of the baby boomers and the labor market entry of the smaller baby bust cohorts) has resulted in a relatively smaller supply of skilled labor, relative to previous decades.[15] At the same time, the rise in the use of technology across almost all sectors of the economy has resulted in increased demand for skilled labor.[16] Economists Lawrence Katz and Claudia Goldin argue that the educational system has failed to produce an adequate supply of skilled labor to keep up with the pace of technological change over the past 30 years.[17] In contrast, remember that the Great Compression that took place in the early 1940's was essentially a reversal of this situation, where skilled labor was plentiful at a time when unskilled labor was in demand, flattening wages across the labor market. Today, employers are competing to hire highly skilled workers from a limited pool, creating a wage premium for those with better training and education; the result is the widening income gap across education groups. In addition, consider the impact of educational attainment on employability; in September 2011, the unemployment rate for those without a high school degree was 13 percent, but for those with a bachelor's degree, the unemployment rate was 4.2 percent.[18]

In addition to the decline in educational attainment, researchers have explored other potential causes for the rise in income inequality. One hotly debated topic is tax policy and the redistribution of income. Higher-income households pay more taxes, but also have greater access to special tax breaks; more than 90 percent of the tax savings from preferential tax rates on long-term capital gains and qualified dividends go to taxpayers in the top quintile of the income distribution, as do three-fourths of the savings from itemized deductions.[19] In addition, tax rates for the top earners have fallen since 1980; from the 1940's through the end of the 1970's, marginal rates of 70 – 90 percent were imposed on the highest income bracket, but this figure has since decreased to about 40 percent.[20] However, most of the value of tax credits goes to households in the bottom four quintiles; nearly 80 percent of nonrefundable credits and more than 95 percent of refundable credits benefit those households.[21] Richard Burkhauser of Cornell University argues that the inclusion of transfer income, such as Social Security and TANF, paints a more complete picture of the financial resources available to a household than wages and taxable income alone. Burkhauser finds that after factoring in taxes and transfers, the financial resources available to the bottom quintile of the population increased almost 15 percent from 1979 (the top quintile saw growth of almost 50 percent).[22] The debate around tax policy is highly complex and there is no clear answer about the extent to which it has caused income inequality, but it's clear that public policy plays an important role in addressing income inequality.

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Taking a more international perspective, immigration and globalization are also thought to have an impact on labor markets and wages, and thus inequality. Let's first consider immigration. Despite the popular notion that immigrants reduce wages and opportunities for native workers, research suggests that immigrants expand the economy's productive capacity by stimulating investment and promoting specialization.[23] Economist David Card argues that the impact of immigration on the relative wages of U.S. natives is small, suggesting instead that immigration has affected overall wage inequality because of the concentration of immigrants in the tails of the skill distribution.[24] Card estimates that immigration accounts for just a small share—about 5 percent—of the rise in overall U.S. wage inequality between 1980 and 2000.[25] Globalization, through an increase in international trade and outsourcing of employment across various industries, has also been widely blamed for job losses and depressed wages. The U.S. tends to export goods that rely on skilled labor and to import goods that rely more heavily on unskilled labor, fueling the demand for skilled labor and reducing the demand for less-skilled workers (thereby driving wages even further apart).[26] Imports of manufactured goods from developing countries more than doubled as a percentage of U.S. gross domestic product, from slightly over two percent in 1990 to close to 4.5 percent in 2006.[27] This rapid growth of trade has likely had significant distributional effects, but there is insufficient data to quantify the effect.[28] A recent paper by IMF researchers Jaumotte, Lall, and Papageorgiou supports the notion that trade globalization increases income inequality, but interestingly, the authors conclude that globalization and technological changes increase the returns on human capital, underscoring the importance of education and training in both developed and developing countries in addressing rising inequality.[29]

This is by no means a complete discussion of the causes of income inequality. Other considerations include the decline of organized labor, the fall of the real value of the minimum wage, and the rapid growth of incomes at the very top of the distribution (the so-called superstars, such as athletes, CEOs, and highly compensated finance professionals).[30] But addressing widening income inequality requires us to take the next step beyond identifying causes—we need to think critically about near- and long-term solutions for building financial resources and opportunities for LMI communities.

The Role of the Community Development Field

Federal Reserve Governor Sarah Bloom Raskin recently pointed out that, "Inequality is destabilizing and undermines the ability of the economy to grow sustainably and efficiently."[31] She went on to say:

> *[Inequality] is associated with increases in crime, profound strains on households, lower savings rates, poorer health outcomes, and diminished levels of trust in people and institutions. All of these forces drag down maximum economic growth and are anathema to the social progress that is part and parcel of such growth. These forces also bring people closer to being "scammed" or becoming vulnerable to financial schemes that promise quick and easy fixes. Finding ways to help more Americans safely grow their incomes and net worth in real terms arguably diminishes the destructive influence of income inequality by giving everyone a more secure footing in the economy and the same kind of flexibility and choice available to the more affluent.*[32]

When framed in this way, the role of the community development field in addressing income inequality is clear—to help LMI communities safely grow their incomes and access greater economic security and opportunity. This requires a two-fold approach. The first is to tend to the immediate needs of low-resource households by providing supports that help them earn and keep as much income as possible in the near-term. This includes traditional community development initiatives, such as the provision of affordable housing, access to affordable financial services, workforce development, and efforts to build savings.

The second approach is to address the broader set of factors that influence the long-term earning potential and productivity of LMI individuals, with a particular focus on the next generation of workers. Nobel Laureate James Heckman argues that the best way to create greater productivity and prosperity is to achieve better outcomes for children.[33] This begins with major investments in education and human capital development. As previously discussed, the decline in educational attainment and the undersupply of highly skilled workers is responsible for a fair share of the growth in income inequality. Janet Yellen, former President of the Federal Reserve Bank of San Francisco and current Vice Chair of the Board of Governors of the Federal Reserve System, pointed to the importance of education for addressing inequality, saying, "Improvements in education are an imperative for reducing inequality and an easily justifiable investment, given its high social return."[34] Thus, increasing the scale and effectiveness of educational interventions is more important than ever. Such efforts include early childhood education, increasing high school graduation rates, or asset building programs to increase college affordability. The importance of fostering achievement among low-income children cannot be overstated. A recent report on the wellbeing of American children, by the Annie E. Casey Foundation, concluded, "Children who grow up in low-income families are less likely to successfully navigate life's challenges and achieve future success. The younger they are and the longer they are exposed to economic hardship, the higher the risk of failure."[35]

The community development field can also tackle issues that indirectly impact individual achievement. For example, poor health can significantly impair school and job performance, thereby impacting earnings and opportunities for advancement.[36] The emerging connection between health and community development provides an opportunity for the field to promote better health outcomes among LMI populations, thereby maximizing the earning potential of education and work related activities (to learn more about the Federal Reserve Bank of San Francisco's Healthy Communities initiative, see http://www.frbsf.org/cdinvestments/conferences/healthy-communities). Another example is the impact that "place" can have on an individual's achievement and earning potential. Socioeconomic conditions in very poor neighborhoods are associated with more limited opportunities for residents, including lack of access to high-quality schools, fewer jobs, and social and economic isolation, where residents are physically cut-off from the larger economy and community.[37,38] Community development efforts to address concentrated poverty at the neighborhood level can thus help LMI individuals access important skill building resources and earning opportunities.

While these community development efforts are aimed at those with the least, they have important implications across all levels of the income distribution. Federal Reserve Chairman Ben Bernanke summed it up this way, "The challenge for policy is not to eliminate inequality per se but rather to spread economic opportunity as widely as possible. Policies that focus on education, job training, and skills and that facilitate job search and job mobility seem to me to be a promising means for moving toward that goal. By increasing opportunity and capability, we help individuals and families while strengthening the nation's economy as well."[39] From a community development perspective, addressing widening income inequality is about helping LMI communities reach their full potential, thereby improving their capacity to participate in and contribute to the broader economy. CI

Understanding Both Sides of the Inequality Debate

While almost everyone can agree that poverty is undesirable, the issues surrounding income inequality are much less clear-cut. The debate involves complex issues, but developing an understanding of both sides is an important first step in analyzing the available research and developing potential policy responses. The following is a brief summary of some of the main points of contention in the debate around rising income inequality.

Data methodology

Changes in inequality over time are often reported based on the use of income data from the Census Bureau, which ranks households from highest to lowest income, then divides society into five groups and determines the share of total income received by each quintile.[1] The Census quintiles contain unequal number of persons.[2] Comparison of these quintiles over time shows that wealthier households have experienced greater income gains relative to poorer households. However, critics argue that this approach leads to an overstatement of the problem because the census statistics provide only a snapshot of income distribution at a single point in time and do not reflect that households may move into different income quintiles over time.[3] Thus, a comparison of quintiles over time means comparing incomes of different people at different stages in their earnings profile. However, others argue that the Census data is appropriate for observing trends in income distribution and whether the overall societal distribution of income has changed over time.[4]

Debate also exists about the appropriate definition for household income. The Census Bureau's official definition of income does not include non-cash resources such as subsidies for housing, food, and medical care for low-income households. Some argue that the exclusion of such noncash resources thus overstates the problem of income inequality.[5] However, other studies have found persistent growth in income inequality even after adjusting for alternative income sources, such as transfers and noncash resources.[6]

Efficiency and economic growth

In 1975, Yale economist Arthur Okun introduced the idea of the "leaky bucket," referring to the efficiency loss that occurs when money is transferred through taxation.[7] The problem of the leaky bucket creates an inverse relationship between equality and efficiency, which Okun referred to as "the Big Tradeoff." In addition to the problem of efficiency loss, another traditional argument is that inequality is a byproduct of a well functioning capitalist economy and that unconstrained opportunity encourages innovation and entrepreneurship, and therefore economic growth.[8] However, research over the past 20 years has challenged this assumption, suggesting that inequality and economic growth are inversely related and that inequality may actually "harm" growth.[9]

Consumption and quality of life for the poor

Some argue that consumption is a better indicator of economic well being than income, and that today's lower-income households are able to achieve greater consumption than ever before, suggesting that the gap between rich and poor is not as severe as imagined.[10] For example, the cost of consumer goods such as televisions and microwaves has fallen dramatically over time, allowing more low-income households to purchase them and "keep up" with higher income households. However, critics of this consumption approach argue that while the cost of nonessential consumer goods has fallen over time, the costs of essential items such as housing, transportation, and healthcare have increased over time, making the relative hardship greater.[11]

Ties that Bind:
Income Inequality and Income Segregation

By Naomi Cytron

Introduction

Income inequality in the United States has risen considerably over the past several decades. However, it is not just widening inequality that matters. Recent research shows that as income inequality rises, the wealthy and poor increasingly sort into different neighborhoods, concentrating in communities that differ considerably from one another. This particular geographic expression of income inequality is of concern because there are negative outcomes for those at the bottom end of the income range that are substantial and intertwined. Numerous studies show that communities of concentrated poverty contend with substandard schools and limited job opportunities, as well as higher rates of disease, crime, and violence than their more affluent counterparts.[1] These types of neighborhood effects mean that both quality of life and life chances are markedly diminished for those living and growing up in communities composed primarily of low-income households.

This article summarizes some recent research on patterns of residential segregation by income, and then explores implications for neighborhoods, regions, and the community development field.

Research on Income Segregation

The term "segregation" most commonly evokes issues of race. However, recent research examining U.S. residential patterns makes the argument that the basis of segregation has shifted over time from race to income.[2] In his research, Douglas Massey of Princeton University notes that during the first two thirds of the century, residential racial segregation at state and county levels fell while increasing at the census tract (which commonly serves as a proxy for neighborhood) level. But starting in the 1970s, this pattern began to change, with black-white segregation at the census tract level diminishing markedly during the last three decades of the 20th century. These decades also saw significant increases in both Asian and Hispanic populations, and while Hispanic isolation began to approach that of African Americans, both Asian and Hispanic populations remained relatively evenly distributed across U.S. metropolitan areas.[3] Massey attributes these patterns to the relative openness of housing markets following social and legislative changes brought about by the Civil Rights era.

During the same period, though, Massey's research shows that residential income segregation rose significantly, with the wealthy and poor increasingly sorting into different neighborhoods. He finds that in 1970, the average poor family lived in a census tract that was 14 percent poor; by 1990, this percentage doubled to 28 percent. Affluence also grew more concentrated, with the average wealthy family living in a neighborhood that was 31 percent affluent in 1970 and 36 percent affluent in 1990.[4]

Examining census data from this same period, Tara Watson of Williams College and the National Bureau of Economic Research finds that economic segregation rose most steeply during the 1980s. During this decade, "metropolitan residents systematically changed the income rank groups with whom they shared a neighborhood. Perhaps not coincidentally, the decade was also one of sharply growing inequality."[5] Indeed, her research shows that a one standard deviation rise in income inequality is associated with a 0.4-0.9 standard deviation rise in income segregation.[6] In other words, there is very strong relationship between rising income inequality and increasing spatial segregation by income.

By the same token, research shows that the economic boom of the 1990s buffered trends of growing income segregation to some extent; there was a dramatic drop in concentrated poverty during this decade, with the number of people living in neighborhoods with a poverty rate above 40 percent declining by 24 percent.[7] Additionally, while the per capita income gap between central cities and suburbs had widened from 1970 to 1990, it held steady during the 1990s.[8] This shift, though, fell short of a dramatic comeback—class segregation was still higher in 2000 than it was in 1970, with over 85 percent of the metropolitan population living in areas that were more segregated by income in 2000 than they had been 30 years earlier.[9]

The first decade of this century has been marked by economic fluctuation and distress, and preliminary analysis of the recent American Communities Survey data indicates that spatial disparities in income are once again on the rise. One study found that the number of high poverty places—whether defined as places with poverty rates exceeding 20, 30, or 40 percent—increased markedly from 2000-2010.[10] Notably, the number of places with poverty rates above 40 percent returned to the number observed at the end of the 1980s. The research also shows that poor/non-poor segregation rose in both metropolitan and non-metropolitan areas. The authors call this trend a "new economic balkanization of residence patterns."[11]

Implications for Neighborhoods and Regions

As noted above, increasing spatial separation of income groups is of concern because there are long term and multiplicative negative consequences for residents of low-income neighborhoods. Areas of concentrated disadvantage often struggle with public and private disinvestment, resulting in blight, few opportunities for employment, high levels of crime and elevated exposure to health risks. Where income inequality is expressed not just on a neighborhood-by-neighborhood basis but at a larger geographic scale, the effects can reinforce dysfunctional neighborhood-level outcomes. For instance, suburban areas that accommodate primarily high-income residents benefit from a larger tax base that can better support public services like safety, infrastructure, and schools. At the same time, the outmigration of wealthy residents from central cities to suburban areas—which triggers the exodus of jobs and retail outlets as well—results in a shrinking tax base and often a low level of political clout, which undercuts poorer areas in the urban core in a number of ways. Perhaps most critically in terms of economic opportunity over the long run, public school systems in central cities end up not having the resources to attract and retain skilled teachers or adequately meet the needs of students who may enter school underprepared, resulting in low academic achievement and high drop-out rates.

These conditions have long-term consequences not only for individual economic opportunity, but for regional productivity as well. As noted by Todd Swanstrom and his coauthors in their analysis of economic segregation at the metropolitan level, "spatial inequalities can set in motion a snowball effect that harms regional competitiveness by fueling the abandonments of older parts of the region, accelerating sprawl and its many costs, and making it more difficult for the region to form the broad coalitions necessary to address these problems."[12] On the flip side, income equality can be a key ingredient for economic growth. In a paper published by the Federal Reserve Bank of Cleveland, researchers analyzed economic growth in 118 regions in the 1994–2004 period and found that income equality—identified as one of eight factors relating to regional growth—was positively correlated with both employment and output.[13]

Implications for the Community Development Field

Given the strong relationship between income and place, the community development response must be sensitive to both neighborhood and regional context, as well as structural factors that drive income segregation. These include a metropolitan area's own demographic, social, political and industrial histories, as well as federal and local policies that influence the accessibility of housing of different size and cost. The intersections between race and class also cannot be ignored, as the legacies of explicitly racial housing policies, as well as other discriminatory practices that limit mobility, continue to affect income segregation. Additionally, job decentralization has contributed to the geography of inequality; most employment is now located more than five miles from central cities, making it difficult for central city residents to find and maintain employment. Even in metropolitan areas where low-income households have moved to the suburbs, the poor generally live in communities that have below average numbers of jobs. The race-class intersection is evident here: 70 percent of poor white suburbanites reside in jobs-rich areas, while only 59 percent of poor blacks and 55 percent of poor Latinos, do.[14]

Community development interventions, then, must be inclusive enough to tackle the multifold and reinforcing links between poverty and place, what Robert Sampson of Harvard University refers to as a durable tangle.[15] In large part, responding to this tangle requires the coordination of a variety of interventions at various geographic scales and across diverse sectors. These include public and private decisions that guide allocations of resources for education, health, and skill building. Additionally, local and regional policies that influence public transit provision, which matters for access to work and other non-neighborhood based activities and amenities, and density, which impacts housing affordability (see "What does zoning have to do with it?" below), affect outcomes for low-income households.

Encouragingly, geographically targeted, cross-sector strategies are receiving increased attention and funding from both the public and private sector. The Obama Administration has explicitly endorsed "place-based," cross-sector policy, seen through programs like the Promise and Choice Neighborhoods Initiatives, which aim to bundle localized investments in arenas including housing, education, transportation, and workforce development. Additionally, a number of community development intermediaries and private foundations have shifted their community development strategies from "scattershot" approaches to more focused, place-based initiatives. For example, Living Cities, a collaborative of 22 foundations and financial institutions, recently launched their "Integration Initiative," which focuses on bringing together decision-makers across sectors and jurisdictions in a region or metro area to align their work toward transforming local and regional systems, including transportation, health, housing and jobs.

Conclusion

In her keynote at last year's Healthy Communities Conference—an event co-hosted in Washington DC by the Federal Reserve Board of Governors, Federal Reserve Bank of San Francisco, and the Robert Wood Johnson Foundation to explore how the health and community development sectors can collaborate to promote better health outcomes for low-income people and communities—Melody Barnes, Director of the Domestic Policy Council, offered the White House's rationale for multidisciplinary approaches for addressing inequities. "People don't wake up in the morning and say 'I'm going to have an education day today and tomorrow I'm going to have a transportation day.' For families, all of these pieces are integrated so we have to start thinking about our policies and our approach in that same integrated fashion. So, for us, what we're trying to insure is that the days of thinking and working and talking in silos is, in fact, over."[16] Indeed, we should all work toward breaking down the silos that hamper our ability to untie the pernicious knots that continue to limit opportunity for low-income communities.

What does zoning have to do with it?

Recent research aims to tease out some of the underlying causes of economic segregation. Jonathan Rothwell and Douglas Massey hypothesize that certain types of zoning promote income segregation by limiting the ability of developers to produce affordable, multifamily housing in certain locations. They find that the setting of maximum allowable densities of residential construction has significant effects in determining the level of class segregation and change in segregation over time, "systematically channeling low-income households to different locations than their affluent counterparts."[17] They go on to note that, "although markets allocate people to housing based on income and price, political decisions allocate housing of different prices to different neighborhoods and thereby turn the market into a mechanism of both class and racial segregation."[18] Their research indicates that land-use policies, which are not typically thought of as having socio-economic effects, might indeed be mechanisms that generate and reinforce patterns of income segregation. Altering zoning policy, then, might serve to mitigate inequalities by enabling development of affordable housing in higher-income neighborhoods where the amenities might better support economic opportunity.

The Polarization of Job Opportunities in the U.S. Labor Market:

Implications for Employment and Earnings

By David Autor

Between December 2007, when the U.S. housing and financial crises became the subject of daily news headlines, and July 2011, the civilian unemployment rate nearly doubled, to 9.1 percent from 5.0 percent, while the employment-to-population ratio dropped to 58.1 percent from 62.7 percent—the lowest level seen in more than 25 years.

Job losses of this magnitude cause enormous harm to workers, families, and communities.[1] For instance, a classic study by economists Lou Jacobson, Robert LaLonde, and Daniel Sullivan found that workers involuntary displaced by plant downsizings in Pennsylvania during the severe recession of the early 1980s suffered annual earnings losses averaging 25 percent, even six years following displacement.[2] Studying the same group of workers with the benefit of 15 more years of data, labor economists Daniel Sullivan and co-author Till Von Wachter[3] show that the nonmonetary consequences of job losses are also severe; involuntarily job displacement approximately doubled the short-term mortality rates of those displaced and reduced their life expectancy on average by one to one and a half years. These studies suggest that the costs of the Great Recession will be multifaceted and persistent.

Moreover, the key challenges facing the U.S. labor market—almost all of which were evident prior to the Great Recession—will surely endure. These challenges are two-fold. The first is that for decades now, the U.S. labor market has experienced increased demand for skilled workers. During times like the 1950s and 1960s, a rising level of educational attainment kept up with this rising demand for skill. But since the late 1970s and early 1980s, the rise in U.S. education levels has not kept up with the rising demand for skilled workers, and the slowdown in educational attainment has been particularly severe for males. The result has been a sharp rise in the inequality of wages.

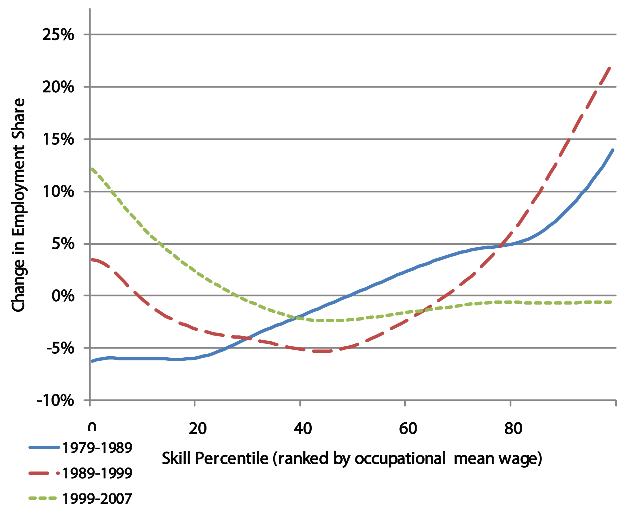
A second, equally significant challenge is that the structure of job opportunities in the United States has sharply polarized over the past two decades, with expanding job opportunities in both high-skill, high-wage occupations and low-skill, low-wage occupations, coupled with contracting opportunities in middle-wage, middle-skill white-collar and blue-collar jobs. Concretely, employment and earnings are rising in both high-education professional, technical, and managerial occupations and, since the late 1980s, in low-education food service, personal care, and protective service occupations. Conversely, job opportunities are declining in both middle-skill, white-collar clerical, administrative, and sales occupations and in middle-skill, blue-collar production, craft, and operative occupations. The decline in middle-skill jobs has been detrimental to the earnings and labor force participation rates of workers without a four-year college education, and differentially so for males, who are increasingly concentrated in low-paying service occupations.

This article is a summary of an in-depth analysis of the state of the U.S. labor market over the past three decades, commissioned by the Hamilton Project at the Brookings Institution and the Center for American Progress.[4] This analysis revealed key forces shaping the trajectory of the polarization of the U.S. job market, including: the slowing rate of four-year college degree attainment among young adults, particularly males; shifts in the gender and racial composition of the workforce; changes in technology, international trade, and the international offshoring of jobs, which affect job opportunities and skill demands; and changes in U.S. labor market institutions affecting wage setting, including labor unions and minimum wage legislation. The causes and consequences of these trends are discussed below and have important implications for the U.S. labor market, and income inequality more broadly, as the nation works towards economic recovery.

Employment growth is "polarizing" into relatively high-skill, high-wage jobs and low-skill, low-wage jobs

Long-term shifts in labor demand have led to a pronounced "polarization" of job opportunities across occupations, with employment growth concentrated in relatively high-skill, high-wage and in low-skill, low-wage jobs—at the expense of "middle-skill" jobs. This polarization is depicted in Figure 1, which plots the change in the share of U.S. employment in each of the last three decades for 326 detailed occupations encompassing all of U.S. employment.[4]

Figure 1. *Smoothed Changes in Employment by Occupational Skill Percentile, 1979–2007*



Source: Census IPUMS 5 percent samples for years 1980, 1990, and 2000, and U.S. Census American Community Survey 2008.

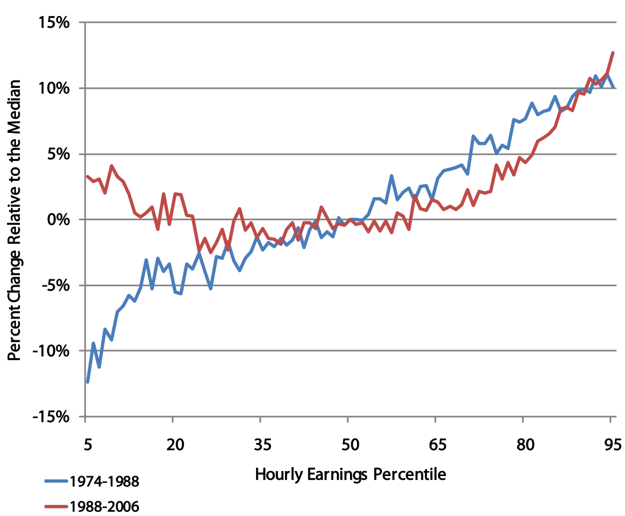
These occupations are ranked on the x-axis by skill level from lowest to highest, where an occupation's skill level (or, more accurately, its skill rank) is approximated by the average wage of workers in the occupation in 1980.[5] The y-axis of the figure corresponds to the change in employment at each occupational percentile as a share of total U.S. employment during the decade. Since the sum of shares must equal one in each decade, the change in these shares across decades must total zero. Consequently, the figure measures the growth in each occupation's employment relative to the whole.

This figure reveals a "twisting" of the distribution of employment across occupations over three decades, which becomes more pronounced in each period. During the 1980s (1979 to 1989), employment growth by occupation was almost uniformly rising in occupational skill; occupations below the median skill level declined as a share of employment, while occupations above the median increased. In the subsequent decade, this uniformly rising pattern gave way to a distinct pattern of polarization. Relative employment growth was most rapid at high percentiles, but it was also modestly positive at low percentiles (10th percentile and down) and modestly negative at intermediate percentiles.

Fast forward to the period 1999 to 2007. In this interval, the growth of low-skill jobs comes to dominate the figure. Employment growth in this period was heavily concentrated among the lowest three deciles of occupations. In deciles four through nine, growth in employment shares was negative. In the highest decile of occupations, employment shares were flat. Thus, the disproportionate growth of low-education, low-wage occupations becomes evident in the 1990s and accelerates thereafter.

Notably, this pattern of employment polarization has a counterpart in wage growth. This may be seen in Figure 2, which plots changes in real hourly wages relative to the median by wage percentile for all U.S. workers over two time periods: 1974 to 1988 and 1988 to 2006.[6] In the 1974 through 1988 period, wage growth was consistently increasing in wage percentile; wages at percentiles above the median rose relative to the median while wages below the median fell. From 1988 forward, however, the pattern was U-shaped. Wages both above and below the median rose relative to the median.

Figure 2. *Percent Changes in Male and Female Hourly Wages Relative to the Median*



Source: May/ORG CPS data for earnings years 1973-2009.

In short, wage gains in the middle of the distribution were smaller than wage gains at either the upper or lower reaches of the wage distribution. This simultaneous polarization of U.S. employment and wage growth suggests an important theme, explored in detail below—labor demand appears to be rising for both high-skill, high-wage jobs and for traditionally low-skill, low-wage jobs.

The Great Recession has quantitatively but not qualitatively changed the direction of the U.S. labor market.

The four major U.S. labor market developments referenced above and documented below—the polarization of job growth across high- and low-skill occupations, rising wages for highly educated workers, falling wages for less-educated workers, and lagging labor market gains for males—all predate the Great Recession. But the available data suggest that the Great Recession has reinforced these trends rather than reversing or redirecting them. In particular, job and earnings losses during the recession have been greater for low-education males than low-education females, and these losses have been most concentrated in middle-skill jobs. Indeed, there was essentially no net change in total employment in both high-skill professional, managerial and technical occupations and in low-skill service occupations between 2007 and 2009. Conversely, employment fell by eight percent in white-collar sales, office, and administrative jobs and by 16 percent in blue-collar production, craft, repair, and operative jobs.

This simultaneous polarization of U.S. employment and wage growth suggests an important theme–labor demand appears to be rising for both high-skill, high-wage jobs and for traditionally low-skill, low-wage jobs.

Key contributors to job polarization are the automation of routine work and the international integration of labor markets

Measuring employment polarization is easier than determining its root causes, but researchers are making progress in understanding the operative forces behind the data. A leading explanation focuses on the consequences of ongoing automation and offshoring of middle-skilled “routine” tasks that were formerly performed primarily by workers with moderate education (a high school diploma but less than a four-year college degree). Routine tasks as described by economists David Autor, Frank Levy, and Richard Murnane are job activities that are sufficiently well defined that they can be carried out successfully by either a computer executing a program or, alternatively, by a comparatively less-educated worker in a developing country who carries out the task with minimal discretion.[8]

Routine tasks are characteristic of many middle-skilled cognitive and production activities, such as bookkeeping, clerical work, and repetitive production tasks. The core job tasks of these occupations in many cases follow precise, well-understood procedures. Consequently, as computer and communication technologies improve in quality and decline in price, these routine tasks are increasingly codified in computer software and performed by machines or, alternatively, sent electronically to foreign worksites to be performed by comparatively low-wage workers.

After three decades of sustained increases, the return to skills as typically measured by the earnings ratio of college graduates relative to high school graduates is at a historic high.

This process raises relative demand for nonroutine tasks in which workers hold a comparative advantage. As detailed below, these nonroutine tasks can be roughly subdivided into two major categories: abstract tasks and manual tasks. These tasks lie at opposite ends of the occupational-skill distribution.

Abstract tasks require problem solving, intuition, and persuasion. Workers who are most adept in these tasks typically have high levels of education and analytical capability. Manual tasks, by contrast, require situational adaptability, visual and language recognition, and in-person interactions. Examples of workers engaged in these tasks include janitors and cleaners, home health aides, construction laborers, security personnel, and motor vehicle operators. Manual tasks demand workers who are physically adept and, in some cases, able to communicate fluently in spoken language. Yet they appear to require little in the way of formal education, at least relative to a setting where most workers have completed high school.

In brief, the displacement of jobs—and, more broadly, occupations—that are intensive in routine tasks contributes to the polarization of employment into relatively high-skill, high-wage and low-skill, low-wage jobs, with a concomitant decline in middle-skill jobs.

Technology, trade, and offshoring are not by any means the only potential explanation for employment polarization—nor is it necessarily the case that any one explanation accounts for the entirety of the phenomenon. Another frequently discussed explanation for the changing structure of employment and earnings in the U.S. focuses on shifts in labor market institutions, in particular, declining labor union penetration and a falling real minimum wage. There is little doubt that labor unions and the minimum wage contribute to changing employment and wage patterns, but it appears unlikely their role is paramount.

In the case of labor unions, their impact is largely confined to manufacturing and public sector employment, neither of which comprises a sufficiently large share of the aggregate economy to explain the overall polarization phenomenon. Moreover, polarization of employment into high-skill, high-wage and low-skill, low-wage jobs occurs across all sectors of the U.S. economy and is not confined to union-intensive manufacturing industries. This makes it unlikely that de-unionization or the decline of manufacturing employment is primarily responsible for employment polarization.

Nevertheless, the loss of middle-skill, blue-collar jobs in manufacturing—many at unionized firms paying relatively high wages—has likely been particularly harmful to the employment and earnings of less-educated males. The job opportunities available to males displaced from manufacturing jobs, particularly those displaced at midcareer, are likely to be primarily found in lower-paying service occupations. While these job losses may be primarily attributable to automation of routine production work and growing international competition in manufactured goods rather than to de-unionization per se, the magnitude of the income losses for males is surely magnified by the fact that the job losses are in union-intensive industries.

An often-discussed explanation for changes in the structure of U.S. wages and employment is the federal minimum wage. The minimum wage can affect wage inequality by boosting (or failing to boost) wages in low-paying jobs. But changes in the federal minimum wage over the last several decades appear an unlikely candidate for explaining the polarization of employment—that is, the growth of both low-and high-skill jobs—particularly because the timing of this explanation does not fit the main polarization facts. The federal minimum wage declined sharply in real terms (after adjusting for inflation) during the 1980s, which might in theory have led to a rise in low-skill, low-wage employment. Yet, as shown in Figure 1, the opposite occurred. From the late 1980s forward, the real federal minimum wage stabilized and then subsequently rose. We might therefore have expected low-skill employment to stagnate or decline. Instead, it grew rapidly.[9]

The earnings of college-educated workers relative to high school-educated workers have risen steadily for almost three decades

After three decades of sustained increases, the return to skills as typically measured by the earnings ratio of college graduates relative to high school graduates is at a historic high. In 1963, the hourly wage of the typical college graduate was approximately 1.5 times the hourly wage of the typical high school graduate. By 2009, this ratio stood at 1.95. The entirety of this 45 percentage point rise occurred after 1980. In fact, the college-to-high-school earnings ratio declined by 10 percentage points in the 1970s.

Moreover, this simple comparison of the wage gap between college and high school graduates probably understates significantly the real growth in compensation for college graduates relative to high school graduates in recent decades. College graduates work more hours per week and more weeks per year than high school graduates, spend less time unemployed, and receive a disproportionate share of nonwage fringe benefits, including sick and vacation pay, employer-paid health insurance, pension contributions, and safe and pleasant working conditions. And these gaps in nonwage benefits between high- and low-education workers have each grown over the past several decades.[10]

One important proximate cause for the rising relative earnings of college graduates is the slowdown in the rate of entry of new college graduates into the U.S. labor market starting in the early 1980s. Although this slowdown is by no means the only cause of changes in U.S. employment and earnings patterns—and, moreover, a cause whose genesis is not entirely understood—it is nevertheless a critical and often overlooked factor.

Rising relative earnings of college graduates are due both to rising real earnings for college workers and falling real earnings for noncollege workers—particularly noncollege males

The high and rising wage premium that accompanies a college education conveys the positive economic news that educational investments offer a high wage return. But this trend also masks a discouraging truth: the rising relative earnings of college graduates are due not just to rising real earnings for college workers but also to falling real earnings for noncollege workers. Real hourly earnings of college-educated workers rose anywhere from 10 to 37 percent between 1979 and 2007, with the greatest gains among workers with a postbaccalaureate degree.

Simultaneously, real earnings of workers with high school or lower educational levels either stagnated or declined significantly. These declines were especially steep among males: 12 percent for high school graduates and 16 percent for high school dropouts. The picture is generally brighter for females, but there was essentially no real earnings growth among females without at least some college education over this three-decade interval.

Though it is sometimes asserted that the "real" earnings declines of less-educated workers are overstated because they do not account for the rising value of employer-provided in-kind benefits such as healthcare, careful analysis of representative, wage, and fringe benefits data conducted by U.S. Bureau of Labor Statistics economist Brooks Pierce refutes this notion. Net of fringe benefits, real compensation for low-skilled workers fell in the 1980s. Further, accounting for fringe benefits, total compensation for high-skilled workers rose by more than did wages, both in absolute terms and relative to compensation for low-skilled workers.[11]

Gains in educational attainment have not generally kept pace with rising educational returns, particularly for males

Given the steep rise in wages for college graduates relative to noncollege graduates over the past three decades, one might have anticipated a substantial rise in college attainment among young adults. Yet, the actual increase in four-year college attainment was fairly muted, particularly for males. Between 1970 and 2008, four-year college attainment among white male young adults ages 25 through 34 rose only modestly, from 20 percent in 1970 to 26 percent in 2008.[12] Remarkably, among white females of the same age range, college attainment nearly tripled, to 34 percentage points from 12 percentage points. Thus, in three decades the white male-female gap in college attainment went from positive eight to negative eight percentage points.

Among young African-American adults, this picture is also mixed. The proportional gains in four-year college completion between 1970 and 2008 were substantially greater for blacks than for whites. Indeed, college completions rose more than two-fold among black males and more than three-fold among black females. Despite these gains, the levels of college completion for blacks remain substantially below that of whites. The black-white gap in college completion closed by only two percentage points among males in this period, and expanded by six percentage points among females.

The only ethnic category for which gains in educational attainment have been truly spectacular was "other nonwhites," a category that includes many Asian Americans.[13] In 2008, more than half of male and female young adults in this category had completed a four-year college degree. This is an increase since 1970 of 22 percentage points among males and 32 percentage points among females.

Conclusion

Although the U.S. labor market will almost surely rebound from the Great Recession, this article presents a somewhat disheartening picture of its longer-term evolution. Rising demand for highly educated workers, combined with lagging supply, is contributing to higher levels of earnings inequality. Demand for middle-skill jobs is declining, and consequently, workers that do not obtain postsecondary education face a contracting set of job opportunities.

Perhaps most alarmingly, males as a group have adapted comparatively poorly to the changing labor market. Male educational attainment has slowed and male labor force participation has declined. For males without a four-year college degree, wages have stagnated or fallen over three decades. And as these males have moved out of middle-skill blue-collar jobs, they have generally moved downward in the occupational skill and earnings distribution.

The obvious question, as Scrooge asks the Ghost of Christmas Yet to Come is: "[A]nswer me one question. Are these the shadows of the things that Will be, or are they shadows of things that May be, only?" Is the labor market history of the last three decades inevitably our destiny—or is it just that it could end up being our destiny if we do not implement forward-looking policy responses?

While this article is intended as a spur to policy discussion rather than a source of policy recommendations, I will note a few policy responses that seem especially worthy of discussion.

First, encouraging more young adults to obtain higher education would have multiple benefits. Many jobs are being created that demand college-educated workers, so this will boost incomes. Additionally, an increased supply of college graduates should eventually help to drive down the college wage premium and limit the rise in inequality.

Second, the United States should foster improvements in K-12 education so that more people will be prepared to go on to higher education. Indeed, one potential explanation for the lagging college attainment of males is that K-12 education is not adequately preparing enough men to see that as a realistic option.

Third, educators and policymakers should consider training programs to boost skill levels and earnings opportunities in historically low-skilled service jobs—and more broadly, to offer programs for supporting continual learning, retraining, and mobility for all workers.

Finally, another potential policy response is to consider R&D and infrastructure investments that will have broadly distributed benefits across the economy. Examples might include expanding job opportunities in energy, the environment, and health care. The return of the classic manufacturing job as a path to a middle-class life is unlikely. But it may be that various service jobs grow into attractive job opportunities, with the appropriate complementary investments in training, technology, and physical capital. Perhaps these could be the shadows of what is yet to come. CI

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Community Perspective:
Widening Inequality Hurts us All

By Robert B. Reich

How did America go from the Great Depression of the 1930s to thirty years of what might be termed the Great Prosperity between 1947 and 1977? And from there, to thirty years of stagnant incomes and widening inequality, culminating in a Great Recession and one of the most anemic recoveries on record? It was no accident.

The Great Prosperity

During three decades from 1947 to 1977, America implemented the basic bargain – providing its workers enough money to buy what they produced. Productivity grew in tandem with wages. Labor productivity – average output per hour worked – doubled. So did median incomes. Expressed in 2007 dollars, the typical family's income rose from about $25,000 to $55,000. The bargain was cinched.

But here's the really interesting thing. We became more equal. The wages of workers in the bottom fifth grew 116 percent – faster than the pay of those in the top fifth (which rose 99 percent), and in the top five percent (86 percent). By the late 1940s, the nation was "more than halfway to perfect equality," as the National Bureau of Economic Research wryly observed. But as the economy grew almost everyone came out ahead, including those at the top.

The Great Prosperity also marked the culmination of a reorganization of work that had begun during the Depression. Perhaps most significantly, government increased the bargaining leverage of ordinary workers. They were guaranteed the right to join labor unions, with which employers had to bargain in good faith. By the mid 1950s more than a third of all workers were unionized. UAW president Walter Reuther, among others, explicitly invoked the basic bargain: "Unless we get a more realistic distribu-

. . . widely-shared income gains were not incompatible with widespread economic growth; they were, in fact, essential to it.

tion of America's wealth," he threatened, "we won't get enough to keep this machinery going." Employers relented, and the higher wages kept the machinery going better than ever by giving average workers more money to buy what they produced. (Non-unionized companies, fearing their workers would otherwise want a union, offered similar deals.) And because health and pension benefits were not taxed, big employers added ever more generous provisions.

Americans also enjoyed economic security against the risks of economic life – not only unemployment benefits but also, through Social Security, insurance against disability, loss of a major breadwinner, workplace injury, and inability to save enough for retirement. In 1965 came health insurance for the elderly and the poor (Medicare and Medicaid). Economic security proved the handmaiden of prosperity. In requiring Americans to share the costs of adversity it enabled them to share the benefits of peace of mind. And by offering peace of mind, it freed them to consume the fruits of their labors.

Government also widened access to higher education. The GI Bill paid college costs for those who returned from war. The expansion of public universities – whose tuitions averaged about four percent of median family incomes during the Great Prosperity in contrast to the 20 percent then demanded by private universities – made higher education affordable to the American middle class. Consequently, college enrollments surged. By 1970, seventy percent of the nation's four-year post-secondary students were in public universities and colleges. The federal government, especially the Defense Department, also underwrote a growing portion of university research, especially in the sciences.

Notwithstanding all this, the nation also found the time and money in these years to rebuild Western Europe and Japan – spending billions of dollars to restore foreign factories, roads, railways, and schools. The effort proved an astounding success. The years 1945 to 1970 witnessed the most dramatic and widely shared economic growth in the history of the world, which contributed to America's Great Prosperity. In helping restore the world's leading economies and thus keep communism at bay, the new global system of trade and assistance created vast new opportunities for American corporations – far richer, larger, and more technologically advanced than any other – to expand and prosper.

Government paid for all of this with tax revenues from an expanding middle class whose incomes were rising. Revenues were also boosted by those at the top of the income ladder whose marginal taxes were far higher than today's. The top marginal income tax rate during World War II was over 68 percent. In the 1950s, under Dwight Eisenhower, whom few would call a radical, it rose to 91 percent. In the 1960s, the highest marginal rate was around 70 percent. Even after exploiting all possible deductions and credits, the typical high-income taxpayer paid a marginal federal tax of over 50 percent. But contrary to what conservative commentators had predicted, the high tax rates did not hobble economic growth. To the contrary, they enabled the nation to expand middle-class prosperity and fuel growth.

America of that era still harbored vast inequalities, of course. The very poor remained almost invisible. Blacks were still relegated to second-class citizenship. Few women dared aspire to professions other than teaching or nursing. But such barriers would eventually weaken or disappear. And although the era also engendered a blandness, uniformity, and materialism that many found abhorrent, the Great Prosperity offered more Americans more opportunities to make whatever life they wanted more than ever before. It significantly expanded the portion of total income going to the middle class. And it proved that widely-shared income gains were not incompatible with widespread economic growth; they were, in fact, essential to it.

The Great Regression, 1980 to 2008

During the Great Prosperity of 1947-1977, the vast middle class received an increasing share of the benefits of economic growth. But after that point, the two lines began to diverge: output per hour – a measure of productivity – continued to rise. But real hourly compensation was left in the dust.

Contrary to popular belief, trade and technology have not reduced the overall number of American jobs. Their more profound effect has been on pay. Rather than be out of work, most Americans have quietly settled for lower real wages, or wages that have risen more slowly than the overall growth of the economy per person. Although unemployment following the Great Recession remains unusually high, jobs are slowly returning – but in order to get them, many workers have to accept lower pay than before. Trade and technology have driven a wedge between the earnings of people at the top and everyone else. The pay of well-connected graduates of prestigious colleges and MBA programs – the so-called "talent" who reached the pinnacles of power in executive suites and on Wall Street – has soared. But the pay and benefits of most other workers has either flattened or dropped. And the ensuing division has also made most middle-class American families less economically secure.

The real puzzle is why so little was done in response to these forces that were conferring an increasing share of economic growth on a small group at the top and leaving most other Americans behind. With the gains from that growth, the nation could, for example, have expanded our educational system to encompass early-childhood education and better equipped our public schools. It could have supported affordable public universities, created more job retraining, and better and more extensive public transportation.

In these and many other ways, government could have reinforced the basic bargain. But it did the opposite. Starting in the late 1970s, and with increasing fervor over the next three decades, it deregulated and privatized. It slashed public goods and investments – whacking school budgets, increasing the cost of public higher education, reducing job training, cutting public transportation, and allowing bridges, ports, and highways to corrode. It shredded safety nets – reducing aid to jobless families with children, and cutting unemployment insurance so much that by 2007, only 40 percent of the unemployed were covered. It halved the top income tax rate from the range of 70 to 90 percent that prevailed during the Great Prosperity to 28 to 35 percent; allowed many of the nation's rich to treat their income as capital gains subject to no more than 15 percent tax; and shrunk inheritance taxes that affected only the top-most 1.5 percent of earners. Yet at the same time, America boosted sales and payroll taxes, both of which took a bigger chunk out of the pay of the middle class and the poor than of the well off.

We allowed companies to break the basic bargain with impunity – slashing jobs and wages, cutting benefits, and shifting risks to employees (from you-can-count-on-it pensions to do-it-yourself 401(k)s, from good health coverage to soaring premiums and deductibles). Companies were allowed to bust unions and threaten employees who tried to organize (by 2010, fewer than eight percent of private-sector workers were unionized). And nothing impeded CEO salaries from skyrocketing to 300 times that of the average worker (from 30 times during the Great Prosperity), while the pay of financial executives and traders rose into the stratosphere. We stood by as big American companies became global companies with no more loyalty or connection to the United States than a G.P.S. satellite.

Most telling of all, Washington deregulated Wall Street while insuring it against major losses. In so doing it allowed finance – which until then had been the servant of American industry – to become its master, demanding short-term profits over long-term growth, and raking in an ever-larger portion of the nation's profits. Between 1997 and 2007, finance became the fastest-growing part of the U.S. economy. Two-thirds of the growth in the Gross National Product was attributable to the gains of financial executives, traders, and specialists. By 2007, financial companies accounted for over forty percent of American corporate profits and almost as great a percentage of pay, up from ten percent during the Great Prosperity.

Between 1997 and 2007, finance became the fastest-growing part of the U.S. economy.

The Cause of Our Unraveling

Some argue America did so little because Americans lost confidence in government. They have cause and effect backwards. The tax revolts that thundered across America starting in the late 1970s were not so much ideological revolts against government – Americans still wanted all the government services they had before, and then some – as backlash against paying more taxes on incomes that had stagnated. Inevitably, government services deteriorated and government deficits exploded, confirming the public's growing cynicism about government's capacity to do anything right. Furthermore, the inflation of the 1970s wasn't due to government spending. It was the result of an eightfold hike in world oil prices engineered by the oil cartel and a drop in the value of the dollar. When inflation began to accelerate, federal spending was only one percentage point higher as a proportion of GDP than it had been in the first half of 1960s.

The real reason for the reversal of the pendulum was political. As income and wealth became more concentrated in fewer hands, politics reverted to what former Federal Reserve Chair Marriner Eccles described in the 1920s as when people "with great economic power had an undue influence in making the rules of the economic game." With hefty campaign contributions, and platoons of lobbyists and PR flacks, the rich pushed legal changes that enabled them to accumulate even more income and wealth – including tacit permission to bust unions, slash corporate payrolls, and reduce benefits; lower taxes for themselves; and deregulation of Wall Street. Since so much of their wealth depends on the performance of the stock market, they particularly wanted to free up the Street to put greater pressure on companies to perform. The plan worked. The Dow Jones Industrial Average took off – rising tenfold between 1980 and 2000.

Americans accepted the backward swing of the pendulum because they mitigated its effects. Starting in the late 1970s, the American middle class honed three coping mechanisms, allowing it to behave as though it was still taking home the same share of total income as it had during the Great Prosperity, and to spend as if nothing substantially had changed. Not until these coping mechanisms became exhausted in the Great Recession would the underlying reality be exposed.

Coping mechanism # 1: Women move into paid work. Starting in the late 1970s, and escalating in the 1980s and 1990s, women went into paid work in greater and greater numbers. For the relatively small sliver of women with four-year college degrees, this was the natural consequence of wider educational opportunities and new laws against gender discrimination that opened professions to well-educated women. But the vast majority of women who migrated into paid work did so in order to prop up family incomes, as households were hit by the stagnant or declining wages of male workers.

This transition of women into paid work has been one of the most important social and economic changes to occur over the last four decades. It has reshaped American families and challenged traditional patterns of child-rearing and child care. Its magnitude has been extraordinary. In 1966, twenty percent of mothers with young children worked outside the home. By the late 1990s, the proportion had risen to sixty percent. For married women with children under the age of six, the transformation has been even more dramatic – from twelve percent in the 1960s to fifty-five percent by the late 1990s.

Families seem to have reached the limit, however – a point of diminishing returns where the costs of hiring others to see to the running of a household or to take care of the children, or both, exceeds the apparent benefits of the additional income.

Coping mechanism # 2: Everyone works longer hours. By the mid 2000s it was not uncommon for men to work more than sixty hours a week, and women to work more than fifty. Professionals put in more "billable" hours. Hourly workers relied on overtime. A growing number of people took on two or three jobs, each demanding twenty or more hours. All told, by the 2000s, the typical American worker worked more than 2,200 hours a year – 350 hours more than the average European worked, more hours even than the typically industrious Japanese put in. It was many more hours than the typical American middle-class family had worked in 1979 – five hundred hours longer, a full twelve weeks more. Americans seemed to have reached a limit. Even if they can find the work, they can't find any more time.

Coping mechanism #3: Draw down savings and borrow to the hilt. After exhausting the first two coping mechanisms, the only way Americans could keep consuming as before was to save less and go deeper into debt. During the Great Prosperity the American middle class saved about nine percent of their after-tax incomes each year. By the late 1980s and early 1990s, that portion had been whittled down to about seven percent. The savings rate then dropped to six percent in 1994, and on down to three percent in 1999. By 2008, Americans saved nothing. Meanwhile, household debt exploded. During the Great Prosperity debt had averaged around 50 to 55 percent of after-tax income. That included what people owed on their mortgages. But starting in 1980 debt took off. In 2001, Americans owed as much as their entire after-tax income that year. By 2007, the typical American owed 138 percent of their after-tax income.

Americans borrowed from everywhere. Credit card solicitations flooded mail boxes; many American wallets bulged with dozens of such cards, all amassing larger and larger debt loads. Auto loans were easy to come by. Students and their families went deep into debt to pay the costs of college. But far and away, the largest borrowing was to buy homes. Mortgage debt exploded. As housing values continued to rise, homes doubled as ATMs. Consumers refinanced their homes with even larger mortgages and used their homes as collateral for additional loans. As long as housing prices continued to rise, it seemed a painless way to get additional money (in 1980 the average home sold for $62,000; by 2006 it went for $245,000). Between 2002 and 2007, American households extracted $2.3 trillion from their houses, putting themselves ever more deeply into the hole.

Eventually, of course, the debt bubble burst. With it, the last coping mechanism ended. Each of these mechanisms reached its inevitable limit. And when the debt bubble burst, most Americans woke up to a startling reality: They could no longer afford to live as they had been living; nor as they thought they should be living, given the growth in the economy; nor as they expected to be living, given how their pay used to grow when the economy grew; nor as they assumed they could be living, given the lavish lifestyles of people at the top of the income ladder.

The Future

The economic challenge ahead is to lift the means of middle-class Americans and reconstitute the basic bargain linking wages to overall gains – providing the vast American middle class with a share of economic gains sufficient to allow them to purchase more of what the economy can produce. One step toward reestablishing shared prosperity would be expanding the Earned Income Tax Credit. The EITC has not only helped reduce poverty but has increased the incomes of families most likely to spend that additional money, and thereby create more jobs. In 2011, the EITC was the nation's largest anti-poverty program. Over 24 million households received wage supplements. Given what's happened to middle-class incomes, the EITC should be expanded and extended upward. Under my plan, full-time workers earning $20,000 or below (this and all subsequent figures are in 2010 dollars) would get a wage supplement of $15,000. This supplement would decline incrementally to $10,000 for full-time workers earning $30,000; to $5,000 for full-time workers earning $40,000; and then to zero for full-time workers earning $50,000. Along with expanding the EITC, I'd recommend that marginal tax rates be lowered for the middle class. The income tax rates of full-time workers earning between $50,000 and $90,000 should be cut to ten percent of earnings, and of workers earning between $90,000 and $140,000 to 20 percent of their earnings.

The yearly cost to the federal government of expanding the EITC and reducing middle-class taxes would be approximately $634 billion a year (in 2010 dollars). This lost revenue could be replaced by a tax on fossil fuels (coal, oil, and gas), based on how many tons of carbon dioxide such fuels contain. The tax would be collected at the mine or port of entry for each fossil fuel, and would gradually rise over time in order to push energy companies and users to spew less carbon into the atmosphere. If initially set at $35 per metric ton of carbon-dioxide or its equivalent, such a tax would raise over $210 billion in its first year alone. By the time it reached $115 per ton, it would yield about $600 billion per year. The public wouldn't directly pay this tax, but would indirectly pay it to the extent the prices of goods rise in proportion to how much carbon is used in their production. For example, a tax of $115 per ton would add about $1 to the price of a gallon of gasoline and 6 cents per kilowatt-hour to the price of electricity. But if the revenues from the carbon tax went into an expanded EITC and lower taxes on the middle class, most Americans would still come out far ahead. A carbon tax has two additional advantages. It would push energy companies and businesses to invest in new ways to reduce greenhouse gases, and in lower-carbon fuels and products. This would prevent overall emissions from increasing beyond current levels. The tax will also boost aggregate demand.

The Great Recession has accelerated the structural change in the economy that began in the late 1970s. Large numbers of Americans will not be rehired unless they are willing to settle for lower wages and benefits. Eventually jobs will return, but if the trend continues, more people will be working for pay they consider inadequate, more working families will be at or near poverty, and inequality will have widened.

Nor will households be able to borrow as before. Lending standards have tightened, and bank regulators and new regulations will require prudence. Meanwhile, a large number of Americans are paying off, paying down, or walking away from trillions of dollars of outstanding loans – in a vast "deleveraging" of household finances that is likely to continue for years. At the same time, tens of millions of boomers are approaching retirement with nest eggs that have shrunk to the size of peanuts, and must save in earnest.

All this means less consumption as a proportion of the overall economy than before the Great Recession. Although consumers have to replace cars, appliances, and other things that run out or wear out or finally break down, and businesses have to replace inventories that become so depleted they have nothing left to sell or ship, a lasting recovery cannot be based on replacements.

Where will demand come from without a buoyant American middle class? Absent their spending, private investors have little incentive to buy new equipment or software, new commercial buildings or factories; entrepreneurs have little incentive to embark on new research and develop new products and services. Government can fill the gap for a time, but government cannot continue indefinitely to stimulate the economy with deficit spending or by printing money. Nor can we rely on exports to fill the gap. Exports will remain a relatively small proportion of our economy. Other economies – even the Chinese – are relying on net exports to maintain their employment. It is impossible for every large economy, including the United States, to become a net exporter.

Hence our underlying dilemma. As we should have learned during the Great Prosperity – the thirty years after World War II when America grew because most Americans shared in the nation's prosperity – we cannot have a growing and vibrant economy without a growing and vibrant middle class. CI

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Stressing Out the Poor:

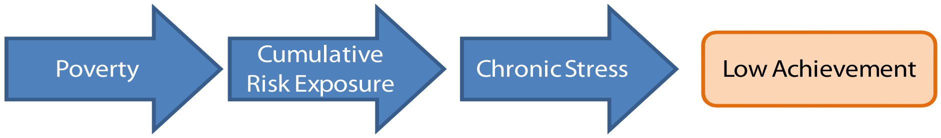
Chronic Physiological Stress and the Income-Achievement Gap

By Gary W. Evans, Jeanne Brooks-Gunn, and Pamela Kato Klebanov

It is well known that economic deprivation early in life sets children on a trajectory toward diminished educational and occupational attainment. But why is early childhood poverty so harmful? If we can't answer that question well, our reform efforts are reduced to shots in the dark.

In this article, we offer a new perspective on this question. We suggest that childhood poverty is harmful, in part, because it exposes children to stressful environments. Low-income children face a bewildering array of psychosocial and physical demands that place much pressure on their adaptive capacities and appear to be toxic to the developing brain. Although poor children are disadvantaged in other ways, we focus our analysis here on the new, underappreciated pathway depicted in Figure 1. As shown in this figure, children growing up in poverty demonstrate lower academic achievement because of their exposure to a wide variety of risks. These risks, in turn, build upon one another to elevate levels of chronic (and toxic) stress within the body. And this toxic stress directly hinders poor children's academic performance by compromising their ability to develop the kinds of skills necessary to perform well in school. We will unpack this new Risk–Stress Model in the balance of our article. However, before doing so, it's useful to first go over the evidence regarding the relation between poverty and achievement and then to present some of the well-known pathways through which this relationship is generated. With that background in place, we can then describe the Risk–Stress Model, as represented in Figure 1.

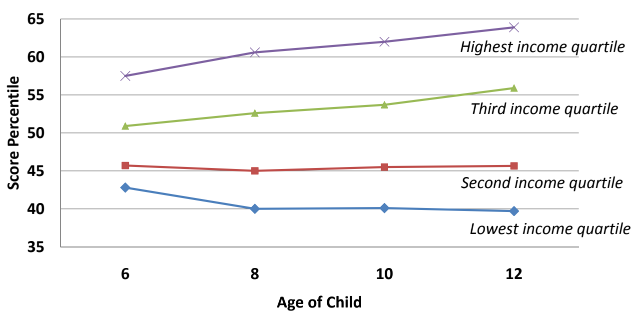
Figure 1. *The Risk-Stress Model—A new pathway to account for the income-achievement gap*



Poverty and Achievement

It is well known that children born into low-income families lag behind their middle- and upper-income counterparts on virtually all indices of achievement. To provide one example, a national study of elementary school children shows that children in the poorest quarter of American households begin kindergarten nearly 10 percent behind their middle-income and affluent classmates in math (Figure 2). Six years later, as they are about to enter middle school, the poorest quarter of American children have fallen even further behind, with the gap between themselves and their most affluent schoolmates nearly doubling.

Figure 2. *Average percentile rank on Peabody Individual Achievement Math*



Source: James J. Heckman (2006). "Skill Formation and the Economics of Investing in Disadvantaged Children." Science*, 312(5782): 1900-1902*

The splaying pattern revealed here, a general one that holds across various outcomes, may be attributed to the tendency for advantage and disadvantage to accumulate over time. This accumulation occurs in various ways; for example, children who score poorly at age six may be tracked into low-achievement school groups, which in turn exposes them to lower expectations, to less rigorous curricula, and to less capable peers, all of which further disadvantage them and generate ever more substantial between-group gaps. The Risk–Stress Model, to which we turn later, suggests that such splaying may also be attributed to the cognitive deficits and poorer health that chronic stress generates. Both cognitive deficits and ill health then repeatedly disadvantage poverty-stricken children in one educational setting after another.

Pathway #1: Parenting Practices

What types of forces have social scientists conventionally understood as explaining the achievement gaps illustrated in Figure 2? One reason poor children lag behind their more affluent peers is that their parents interact with them in ways that aren't conducive to achievement. For example, psychologist Kathryn Grant and her colleagues have documented a strong and consistent relation between socioeconomic disadvantage and harsh, unresponsive parenting. In one national dataset, 85 percent of American parents above the poverty line were shown to be responsive, supportive, and encouraging to their children during infancy and toddlerhood, whereas only 75 percent of low-income parents had the same achievement-inducing parenting style. While most low-income parents (i.e., 75 percent) do provide adequate levels of support and encouragement, these data reveal, then, a nontrivial difference across income levels in the chances that children will experience a problematic parenting style. There is considerable evidence that at least a portion of the cognitive developmental consequences of early childhood poverty is due to this difference.

Pathway #2: Cognitive Stimulation

It's also well known that children from low-income households tend to receive less cognitive stimulation and enrichment. For example, a child from a low-income family who enters first grade has been exposed on average to just 25 hours of one-on-one picture book reading, whereas an entering middle-income child has been exposed on average to more than 1,000 hours of such reading. Likewise, during the first three years of life, a child with professional parents will be exposed to three times as many words as a child with parents on welfare.

And it's not just simple parental effects that account for the achievement deficit. If a child is born into a high-income family, he or she may also benefit from high-quality stimulation and enrichment from extended family, from siblings and friends, and from more formal care providers. All of this redounds to the benefit of higher-income children while further handicapping low-income children.

So much for the well-known pathways by which disadvantage is transmitted. We turn now to another and less-appreciated aspect of low-income environments that may also harm cognitive development. The key concern here: children from impoverished households face a wide array of physical and psychosocial stressors. Their homes, schools, and neighborhoods are much more chaotic than the settings in which middle- and upper-income children grow up. Such conditions can, in turn, produce toxic stress capable of damaging areas of the brain known to underlie cognitive processes—such as attention, memory, and language—that all combine to undergird academic success. In the pages that remain, we document each of the steps in the Risk–Stress Model.

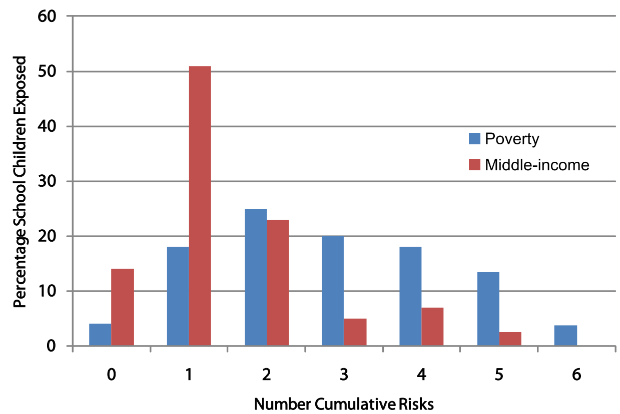
Poverty and Cumulative Risk Exposure

The stressors that poor children face take both a physical and psychosocial form. The physical form is well documented; poor children are exposed to substandard environmental conditions including toxins, hazardous waste, ambient air and water pollution, noise, crowding, poor housing, poorly maintained school buildings, residential turnover, traffic congestion, poor neighborhood sanitation and maintenance, and crime. The psychosocial form is also well documented; poor children experience significantly higher levels of family turmoil, family separation, violence, and significantly lower levels of structure and routine in their daily lives.

An important aspect of early, disadvantaged settings may be exposure to more than one risk factor at a time. A powerful way to capture exposure to such multiple sources of stress and strain is the construct of cumulative risk. Although there are various ways to quantify cumulative risk, one common approach is to simply count the number of physical or psychosocial risks to which a child has been exposed. In one UK study, the authors counted how often children were exposed to such stresses as: (a) living with a single parent; (b) experiencing family discord; (c) experiencing foster or some other form of institutional care; (d) living in a crowded home; and (e) attending a school with high turnover of both classmates and teachers. It was found in this study that inner-city children experienced far more of these stresses than did the better-off working-class children. The same result holds in the United States (see Figure 3). In rural New England, only 12 percent of middle-income nine-year-olds experienced three or more physical and psychosocial risk factors, whereas nearly 50 percent of low-income children crossed this same threshold (of three risk factors).

In a national U.S. sample of premature and low birth weight infants, Brooks-Gunn and colleagues similarly found that infants born into low-income families experienced nearly three times more risk factors than their middle-income counterparts by the time they were toddlers. These same low-income toddlers were seven times more likely than their affluent counterparts to experience a very high number of risk factors (> 6). The pattern is overwhelmingly clear: being born into early poverty often means exposure to many more physical and psychosocial risk factors.

Figure 3. *Cumulative Risk Exposure in Relation to Poverty/Not Poverty*



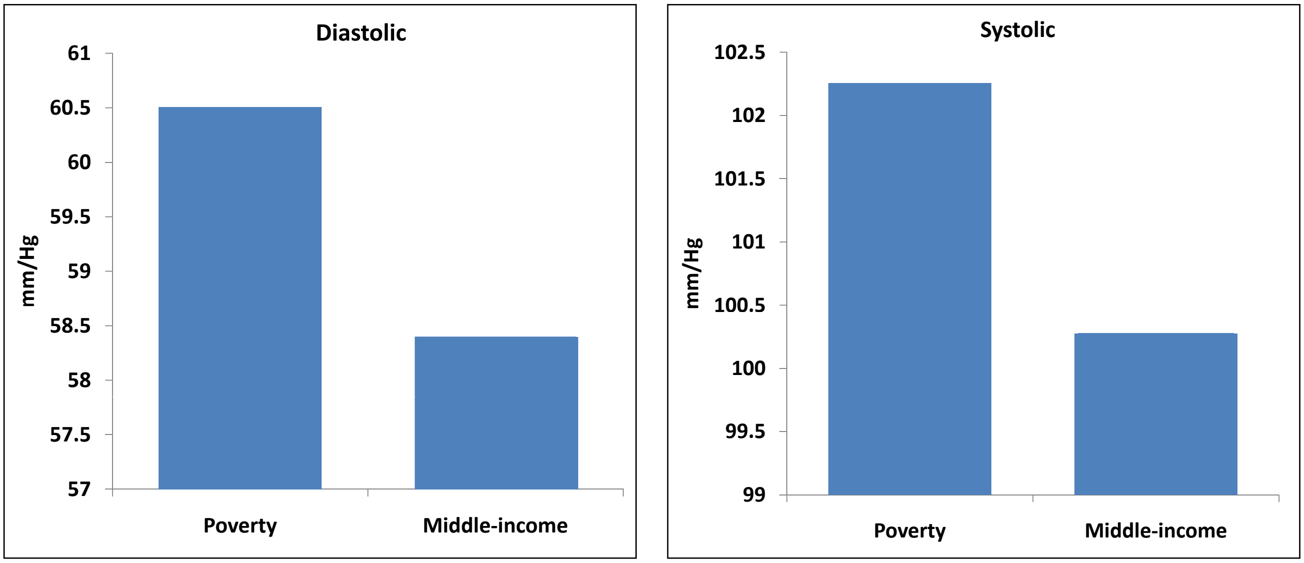
Note: Cumulative risks include family turmoil, violence, child separation from family, noise, crowding, and housing quality.
Source: Gary W. Evans and Kimberly English. 2002. "The Environment of Poverty: Multiple StressorExposure, Psychophysiological Stress, and Socioemotional Adjustment." Child Development, *73(4):1238-48.*

Cumulative Risk Exposure and Chronic Stress

But does such differential exposure indeed result in higher stress levels among poor children? The simple answer is that it does. In cross-sectional analyses of 9- and 13-year-old children, Evans and colleagues found that the risk exposure described in Figure 3 elevated baseline, resting blood pressure as well as overnight indices of such stress hormones as cortisol. At age 13, when challenged by mental arithmetic problems, children with higher levels of cumulative risk exposure did not show a typical healthy response, instead exhibiting a muted rise in blood pressure. These same children also didn't recover as successfully from the mental challenge posed by these arithmetic problems (as indexed by the longer time it took their blood pressure to return to pre-stressor baseline levels). The evidence thus suggests that children exposed to high levels of cumulative risk are less efficient both in mobilizing and then shutting off physiological activity.

The Risk–Stress Model, as represented in Figure 1, implies that the effect of family poverty on stress is mediated by risk exposure. Although one would ideally like to test that mediation, it's also important to simply document the association between poverty and stress (thereby ignoring the mediating factor). Many investigators have indeed documented that disadvantaged children have higher chronic physiological stress levels, as indicated by ele-

Figure 4. *Resting blood pressure in nine-year-old, White rural children.*



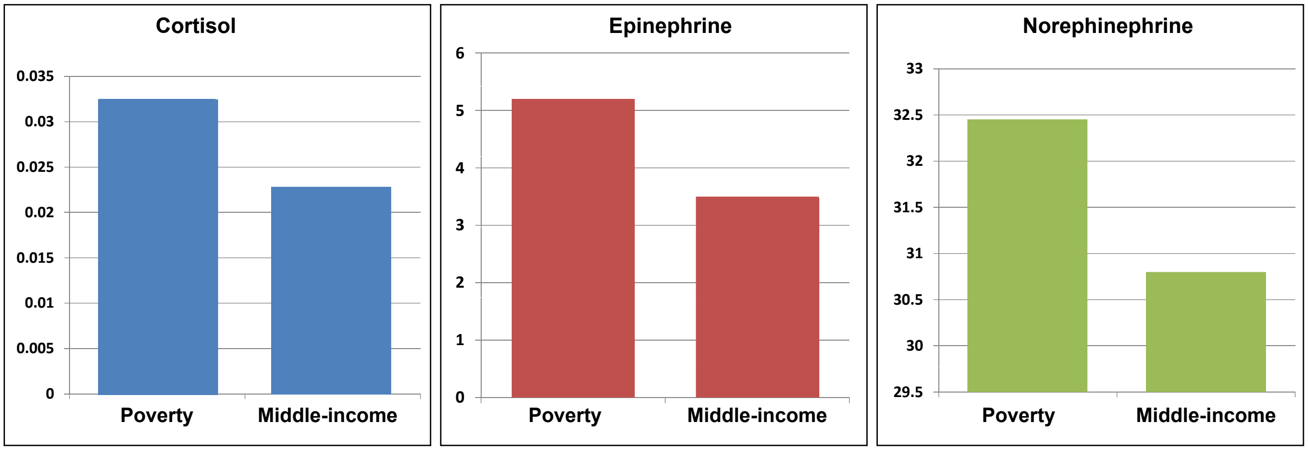
Source: Gary W. Evans and Kimberly English. 2002. "The Environment of Poverty: Multiple Stressor Exposure, Psychophysiological Stress, and Socioemotional Adjustment." Child Development, *73(4):1238-48.*

vated resting blood pressure. A smaller number of studies have also uncovered higher levels of chronic stress hormones, such as cortisol, among disadvantaged children. To provide just a few examples, Figures 4 and 5 show elevated resting blood pressure as well as higher overnight urinary stress hormones in a sample of nine-year-old rural children.

The foregoing data, which pertain to nine-year-olds, don't tell us when such stress symptoms emerge. Do poverty-stricken children show evidence of elevated stress early on in their lives?

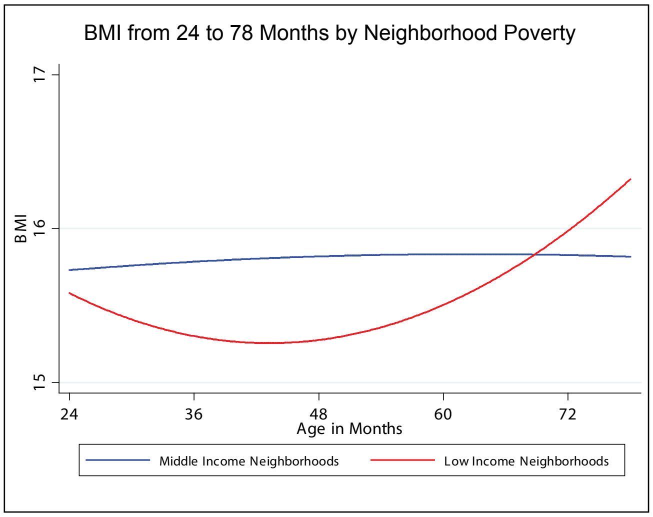
Or do such symptoms only emerge later? With support from the Stanford Center for the Study of Poverty and Inequality, we sought to answer this question by reanalyzing a national data set of very young at-risk children. The Infant Health and Development Program (IHDP) is a representative sample of low birth weight (< 2500 grams) and premature (< 37 weeks gestational age) babies born in 1985 at eight medical centers throughout the country. This sample of nearly 1,000 babies is racially and economically diverse (52 percent Black, 37 percent White, 11 percent Hispanic).

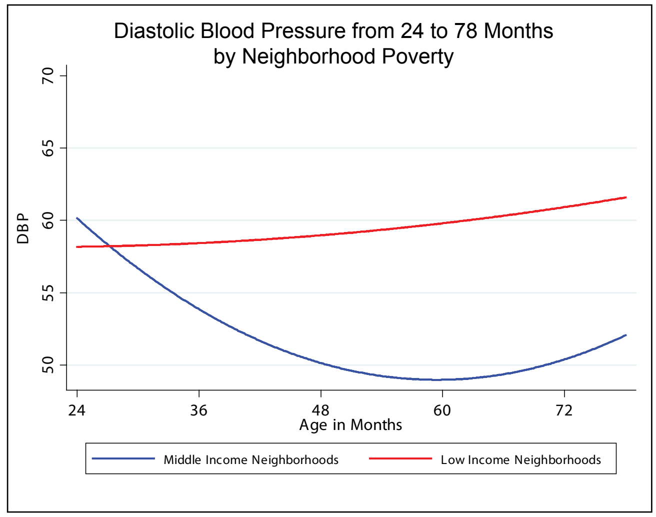
Figure 5. *Overnight stress hormones in nine-year-old, White rural children.*



Source: Gary W. Evans and Kimberly English. 2002. "The Environment of Poverty: Multiple Stressor Exposure, Psychophysiological Stress, and Socioemotional Adjustment." Child Development, *73(4):1238-48.*

Figures 6 and 7. *Developmental trajectories in chronic stress in relation to neighborhood poverty.*





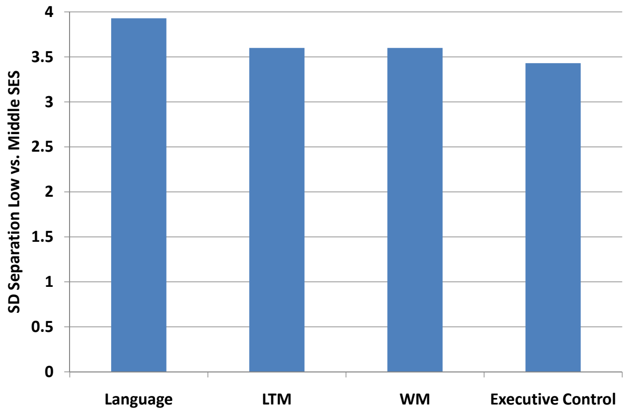
We assessed resting blood pressure and child's height and weight at 24, 30, 36, 48, 60, and 78 months of age. The collection of physical health data at such young ages and over time provided us with an unprecedented opportunity to examine the early trajectories of chronic stress among a high-risk sample of babies. Both baseline blood pressure levels and Body Mass Index (BMI) reflect wear and tear on the body and are precursors of lifelong health problems. The former is indicative of cardiovascular health and the latter of metabolic equilibrium. BMI, which reflects fat deposition, is measured as height divided by weight (kg/m2).

We sought to assess whether these two measures of stress are elevated in poverty-stricken neighborhoods. Low-income neighborhoods, as defined in our study, have median household incomes below $30,000 (in 1980 dollars), while middle income neighborhoods have median income levels exceeding $30,000 per household. As is evident in Figures 6 and 7, babies growing up in low-income neighborhoods have health trajectories indicative of elevated chronic stress. Additional statistical controls for infant birth weight, health, and demographic characteristics did not alter these trajectories. These figures also reveal, even more importantly, that elevated stress emerges very early for children growing up in low-income neighborhoods. BMI, for example, proves to be unusually low among poor children under five years old, but it then takes off as these children grow older. The blood pressure measure, by contrast, registers high among low-income children from almost the very beginning of our measurements (i.e., 24 months). This research confirms, then, that low-income children are more likely than others to develop dangerous stress trajectories very early on in their childhood. As we discuss below, this has profound consequences for their likelihood of success in school and beyond.

Chronic Stress and the Achievement Gap

The next and final step in our chain model pertains to the effects of chronic stress on achievement. Here we turn to an important longitudinal program on poverty and the brain at the University of Pennsylvania conducted by Martha Farah and her colleagues. In a series of studies with multiple samples drawn from lower- and middle-class Black families in Philadelphia, Farah and colleagues show that several areas of the brain appear vulnerable to early childhood deprivation. Using batteries of neurocognitive tests of brain function and brain imaging studies, Farah and other neuroscientists can map the areas of the brain that are recruited by neurocognitive tasks. As shown in Figure 8, among the areas of the brain most sensitive to childhood socioeconomic status (SES) are language, long-term memory, working memory, and executive control. What the graph depicts is the separation, in standard deviation units, between a low- and middle-SES sample of 11-year-old Black children from Philadelphia. For this sample, one standard deviation represents about one-fifth of the total distribution of scores. Samples differing by 3.5 or more standard deviations are virtually non-overlapping. Given that the samples differ by about 3.5 standard deviations for all four areas of brain functioning, this means that there is virtually no overlap between poor and middle-class Black children when it comes to language, long-term memory, working memory, or executive control. Eleven-year-old Black children from lower SES families reveal dramatic deficits in multiple, basic cognitive functions critical to learning and eventual success in society. These results reveal the starkly cognitive foundation to the poor performance of low-income children.

Figure 8. *Effect sizes measured in standard deviations of separation between low-and middle-SES 10–12-year-old, African American children.*



Source: Martha J. Farah, David M. Shera, Jessica H. Savage, Laura Betancourt, Joan M. Giannetta, Nancy L. Brodsky, Elsa K. Malmud, and Hallam Hurt. 2006. "Childhood Poverty: Specific Associations with Neurocognitive Development." Brain Research, 1110(1): 166-74.

But is this achievement gap attributable to cumulative risk and chronic stress? With a recent follow-up of the sample depicted in Figures 4 and 5, Evans and colleagues have now provided the first test of the final link in the Risk–Stress Model. The baseline finding from their research is that working memory in early adulthood (i.e., age 17) deteriorated in direct relation to the number of years the children lived in poverty (from birth through age 13). If, in other words, a child lived in poverty continuously, his or her working memory was greatly compromised. The main result of interest, however, was that such deterioration occurred only among poverty-stricken children with chronically elevated physiological stress (as measured between ages 9 and 13). That is, chronic early childhood poverty did not lead to working memory deficits among children who somehow avoided experiencing the stress that usually accompanies poverty.

Conclusion

Childhood socioeconomic disadvantage leads to deficits in academic achievement and occupational attainment. It's long been argued that such deficits arise because poor children are exposed to inadequate cognitive stimulation and to parenting styles that don't encourage achievement. We don't dispute the important role of these two variables. But we have outlined here evidence for a new, complementary pathway that links early childhood poverty to high levels of exposure to multiple risks, which in turn elevates chronic toxic stress. This cascade can begin very early in life. Even young babies growing up in low-income neighborhoods already evidence elevated chronic stress. This stress then accounts for a significant portion of the association between poverty and working memory, a critical cognitive skill involved in language and reading acquisition.

The Risk–Stress Model suggests that the poverty–achievement link can be broken by addressing (a) the tendency of poverty to be associated with physical or psychosocial risks (e.g., environmental toxins, family turmoil), (b) the effects of such risks on stress, and (c) the effects of stress on achievement. If this model bears up under further testing, it would be useful to explore which of these pathways is most amenable to intervention. CI

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CDFI Bond: *Opportunity of a Decade*

By Cathy Dolan

Transformational Potential

There is a new game-changing program available for community development financial institutions (CDFIs). The CDFI Bond Guarantee Program offers CDFIs up to $1 billion of affordable, long term, government guaranteed debt financing per year, through 2014, to promote community and economic development in our nation's low-income, low-wealth, and other disadvantaged communities. It significantly improves CDFIs' access to capital, offering financing terms that make sense for CDFIs and the communities they serve and helping CDFIs meet substantial unmet capital demand in target communities. At the same time, it has the potential to transform the way CDFIs capitalize themselves, improving sustainability and financial stability.

Quite frankly, the CDFI Bond Guarantee Program could forever alter the landscape and future of the industry. For that reason alone, we need to make sure it works well for CDFIs and the communities they serve.

What is the CDFI Bond Guarantee Program?

The purpose of the CDFI Bond Guarantee Program is to create a new CDFI investment vehicle for community and economic development purposes. Passed as part of the Small Business Jobs Act of 2010, it is intended to support CDFIs' role as economic engines of growth in the nation's disadvantaged markets.

Select features of the CDFI Bond Guarantee Program include:

- $3 billion in bond guarantee authority through 2014 with minimum bond size of $100 million;
- CDFIs will be able to issue taxable bonds with terms up to 30 years;
- The Federal Government Guarantee ensures repayment of verifiable losses of principal, interest, and call premium, if any, on bonds and notes;

- The Program is being administered by the CDFI Fund at the U.S. Department of the Treasury;
- The Federal Financing Bank will buy 100 percent of bonds and notes issued to simplify execution and minimize cost and pricing;
- Participating CDFIs will be required to establish a risk share pool of three percent of the bond or note amount;
- Proceeds can be used by CDFIs to finance or refinance activity that meets the community and economic development definition of the Riegle Act (the enabling legislation for the CDFI Fund).

The CDFI Fund states that the program rules will be issued in the fall of 2011 and bonds are poised to be issued by the spring of 2012. The Program provides up to $3 billion of total financing before it sunsets in September, 2014, unless reauthorized.

Why is the CDFI Bond Guarantee Program so important now?

The timing for this new program couldn't be more opportune. With unemployment rates above nine percent and slowing GDP growth, economic recovery has been disappointingly weak. Low growth prospects lead to corporate hesitation to invest in new ventures and hire new workers. However, with interest rates at historic lows, it's an ideal time to borrow and invest for the future. In fact, recent monetary policy decisions have pushed long term rates even lower; as of September 25, 2011, 30-year treasuries are below three percent. This may be a "once in a lifetime" opportunity to lock in 30 year debt at rates this low. Once economic activity ignites, capital will become more expensive and more difficult to raise. There is no better time than now to give CDFIs access to $1 billion per year of up to 30 year debt, at rates similar to government securities.

Why CDFIs?

CDFIs have a long history of financing and meeting the needs of entities and individuals that lack access to the mainstream financial system. But as the boundaries of the mainstream financial system contract, the need for CDFIs to fill the gap increases. Indeed, while there are reports that corporate cash levels are at record highs, the capital tills of small businesses and entrepreneurs are empty. Large companies are reticent to invest in new initiatives, and banks' tightened credit standards have constrained small business and consumer lending. While policy makers and regulators work hard to make capital more freely available, in order to spark job creation and economic growth, the only thing growing is cash accounts. Lending and investment, particularly in underserved markets, remain low.

CDFIs, which are positioned to address these issues, report increasing demand for credit in their markets, partly in response to declining bank lending. According to The Opportunity Finance Network (OFN) 2011 2nd Quarter CDFI Market Conditions Report (a publication based on quarterly surveys of CDFIs), 54 percent of respondents reported an increase in the number of financing applications received year-over-year and 55 percent reported an increase in loan originations.[1] Among survey respondents, 25 percent reported that they are capital-constrained and could have made more loans in the second quarter of 2011 if financing capital had been available. To meet estimated demand in the next 12 months, the respondents reported they would need an additional $880 million in capital.

The respondents made these estimates assuming they were limited to the type of debt financing currently available to CDFIs, which is generally less than 10 years in term and priced based on market spreads over treasury securities or LIBOR. In March 2011, OFN expanded the scope of this survey to gauge broader market demand for CDFI Bond-type financing—up to 30 years in term and priced at a small spread over treasury securities. The responses indicated an overwhelming confidence in CDFIs' ability to absorb $1 billion per year to meet the needs of community businesses and individuals in low-income, low-wealth and otherwise disadvantaged markets.

What is the critical path to success?

What will make the CDFI Bond Guarantee Program a success? And how do we ensure CDFIs derive maximum advantage from the Program and dramatically impact communities in need? There are many important principles that will lead to a successful bond program, including performance and outcome based evaluation and efficient and affordable participation among CDFIs, but most critical are the following objectives:

1. The need for flexibility to accommodate the variety of financial structures that CDFIs use to serve low-income, low-wealth communities

One of the CDFI industry's strengths is its diversity of products and practices. In order to adequately meet the needs of their underserved communities, CDFIs need to be flexible and responsive to the unique factors that affect those businesses outside the mainstream financial system. That means the program can't be cookie cutter or one-size-fits-all in nature.

To that end, eligible uses need to include all financing sectors, including housing, small businesses, community facilities, retail and commercial real estate development in distressed markets, and personal financial credit products targeted at disadvantaged populations.

Moreover, the terms of the bond need to accommodate the way CDFIs provide capital to their targeted markets. CDFIs offer term financing, lines of credit, construction loans, secondary capital investments, and revolving lines of credit, and the program should accommodate all these types of financing products.

2. Financing via the CDFI Bond Guarantee Program is used and controlled by CDFIs with a proven track record of mission based financing.

The prospect of a new government-guaranteed debt program could attract the attention of entities that fashion themselves as community development lenders, but who lack the mission-based orientation and track record of responsible financing that the CDFI industry has long stood for and upheld. This program should be reserved only for those entities that have a proven record of responsible financing, with a strong mission of creating access to responsible and affordable financial services for disadvantaged and underserved communities. This program should not be available to CDFIs in name only.

3. Underwriting based on CDFI's assessment of risk

Program risk criteria and issuer selection should be based on the CDFI industry's performance track record, not on that of the mainstream financial services industry. There will be a temptation to look to mainstream financial service providers and programs to assess the overall program risk and individual bond applications because this is a new program to a largely unregulated sector, and Treasury (CDFI Fund) has few precedents to guide it. However, the CDFI industry has thrived for the past thirty years precisely because non-CDFI regulated institutions and for-profit finance companies operate so differently.

The markets served by CDFIs are unique and, by definition, outside the mainstream. CDFIs understand how to underwrite and manage the risk of businesses, individuals, and community projects in underserved markets because they are close and responsive to their borrowers, willing and able to provide technical assistance when necessary, and flexible enough to work with borrowers when difficulties arise. This high-quality track record is evidenced by OFN's Inside the Membership Report, which shows a weighted average cumulative net charge-off rate of 1.4 percent and weighted average delinquency of more than 30 days of 9.2 percent, as of year-end 2009.[1] As of the second quarter of 2011, problem loans seem to be in decline, as OFN's Market Conditions Report shows that members' rate of delinquency of more than 30 days had improved to 6.5 percent.

This performance track-record is indicative of CDFIs' unique ability to underwrite and manage risk. When assessing the risk of the CDFI Bond Guarantee Program and designing underwriting criteria for use in the selection of bond applicants, it will be critical for the CDFI Fund to use CDFIs' track record and not that of the mainstream financial services sector.

Conclusion

The CDFI Bond Guarantee Program is meant to encourage the creation of a new type of security that would provide access to responsible financing for disadvantaged communities at meaningful volumes, affordable cost, and long terms. If successful, this program could dramatically improve access to capital, recapitalize CDFI balance sheets (improving profitability and financial stability) and help banks and other mainstream financial institutions increase their financing in partnership with CDFIs for the benefit of low-income and low-wealth communities. This could lead to important increases in the number of jobs created and retained, the supply of quality affordable housing, and access to vital community facilities and services. In short, the CDFI Bond Guarantee Program would give CDFIs access to a reliable supply of capital with a term and cost structure that has never before been available.

As our economy struggles to regain footing, CDFIs have a vital role to play as engines of growth and the CDFI Bond can help make it happen. As Federal Reserve Chairman Bernanke recently said, "Providing responsible credit for individuals and small business through community development financial institutions can stimulate economic activity that generates local tax revenues."[2]

The imperative is clear. The CDFI Bond Guarantee Program needs to become a reality as soon as possible so CDFIs can increase financing to under-served markets and contribute to job creation and economic growth. OFN encourages all those interested in the program to join the CDFI Bond Alliance, which will actively shape the discussion on the design and implementation of the CDFI Bond on behalf of CDFIs for the full lifecycle of the program—from initial rule promulgation, through bond issuance, and ultimately to encourage reauthorization. For more information, visit http://opportunityfinance.net/financing/ CI

Cathy Dolan *is Chief Operating Officer of Opportunity Finance Network (OFN), the leading network of private financial institutions that creates growth that is good for communities, investors, individuals, and the economy.*

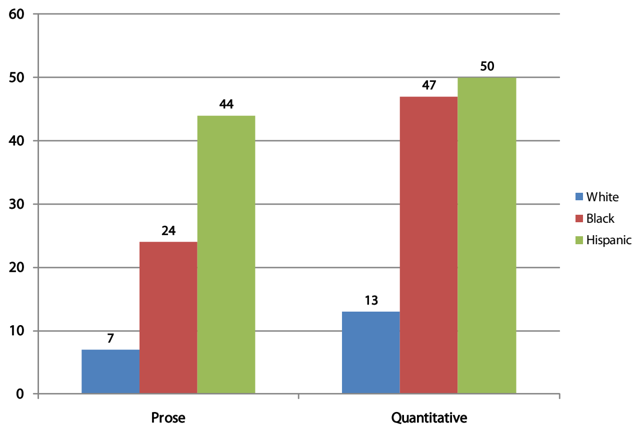
Building Literacy Skills and Transforming Lives

By Cathay Reta and Mari Riddle

"You won't believe what my mother did yesterday," said Linda. "She bought a new refrigerator on credit. Do you know how much it's going to cost by the time she finishes paying for it?" she exclaimed, pointing out that her mother would be paying 21 percent interest. Linda had read the terms of agreement for her mother's new department store credit card, marking a significant personal achievement. Just five years ago, Linda couldn't read at more than a 3rd grade level, much less understand the financial complexities of a credit agreement.

Linda used to be one of the 30 million adults in the United States who can't read or write well enough to perform important daily tasks, such as reading food labels or filling out a job application. They may be individuals who dropped out of school early or immigrants who had little formal education in their home countries. The constraints of limited educational attainment are worsened by a lack of literacy skills, creating significant economic and personal hardship for these adults and their families. Adult low literacy can be connected to almost every socio-economic issue in the United States: more than 60 percent of all state and federal corrections inmates can barely read and write; low health literacy costs $73 billion each year in the U.S.; and low literacy's effects cost the U.S. $225 billion or more each year in non-productivity in the workforce, crime, and loss of tax revenue due to unemployment.[1] Low literacy is more prevalent among low-income and minority populations, with Blacks and Hispanics more than three times more likely than whites to be below basic literacy proficiency (see Figure 1).[2] Additionally, 41 to 44 percent of U.S. adults in the lowest level on the literacy scale are living in poverty.[3]

Figure 1. *Percentage of Adults Below Basic Literacy Proficiency, by Race*



Source: National Center for Education Statistics, 2003 National Assessment of Adult Literacy
Note: Prose literacy relates to the skills required to search, comprehend, and use continuous texts. Quantitative literacy allows for the identification and performance of computations using numbers embedded in printed materials.

The statistics are staggering, but there are stories of hope and success, like Linda's. Adult learners are varied and unique, but their motivations are universal. They want to support their children's education. They want better jobs. They want to be more involved in their communities. The ability to read and write is a core foundational skill for each of those motivators.

"Being able to read, write, do basic math, and use a computer are critical building blocks that the 30 million Americans who function at below basic literacy levels are in need of in order to find and keep sustainable employment," says David C. Harvey, president and CEO of ProLiteracy, the oldest and largest nonprofit organization dedicated to advancing the cause of adult literacy and basic education. "Having access to literacy resources and literacy instruction contributes to these adults being able to find jobs, earn a living wage, and improve their health—all of which have far-reaching effects on our country's ability to compete globally," says Harvey.

The need for adult literacy education has never been greater. "Right now, millions of Americans are struggling to find work, and policymakers are emphasizing the need to create jobs and retrain our workforce. As part of that retraining, we must invest in adults who struggle with the simplest reading, writing, and math tasks. They are most in need of such investment to help them find and keep jobs," says Harvey. Even for those employed, American businesses spend more than $60 billion each year on employee training, much of that for remedial reading, writing and mathematics.[4]

This article demonstrates how advancements in adult literacy education can significantly improve the lives of individuals with low literacy skills, their families, and their communities. It also provides specific examples of integrated initiatives that aim to weave literacy instruction into broader skill building efforts, such as financial and health education.

Transforming Families – Breaking the Cycle of Illiteracy

At Centro Latino for Literacy, a Los Angeles-based nonprofit organization and member of ProLiteracy, most of the students are in their 20s and 30s with young children, and they are motivated to break the intergenerational cycle of illiteracy. Consider the story of student Julia Rodríguez. "I'm from Guerrero, Mexico and I'm 34 years old. I was the oldest, and I had to help my parents take care of my younger siblings. We were very poor and there was no money for school. Over time, my siblings went to school, but I stayed working. Now I'm a mother of three and I'm very motivated to learn so that I can help my children succeed. They are my inspiration to learn."

Rodriguez is on the right track. According to an October 2010 report from the National Institute for Health, improving mothers' literacy skills may be the best way to boost children's achievement.[5] A mother's reading skill is the greatest determinant of her children's future academic success, even outweighing other factors such as neighborhood and family income. Adults who improve their literacy skills gain the ability to read with their children and support their schoolwork. They also become more effective role models. Jasmin, the 11 year old daughter of another Centro Latino student, said, "My mom really gives her all to learn to read . . . We help her so that she doesn't get discouraged. I tell her, 'You can do it, Mom!' I am so proud of her and she inspires me because she's always pushing forward." Young people like Jasmin show the transformative power of adult learning, where investments in education reach not only the adults, but their children as well.

Health Literacy

"I tried to donate blood for my daughter who was ill with cancer. When they handed me medical history forms to complete, I ran out of the room because I couldn't fill out the forms. It was embarrassing," recounts an adult student in a San Diego County literacy program. She's not alone. Enrique Ramirez, another student, shares, "The nurses told me to take the elevator and go to where it says 'x-rays.' I took the elevator and I just went home because

I couldn't read the signs. It's a scary thing when you don't know the words."

The Community Health Improvement Partners (CHIP), a coalition of San Diego health care systems, is working to address the impact of low literacy skills on individuals' health and the cost to the health care system. Research shows that low health literacy skills among 90 million adults in the United States results in $73 billion of potentially avoidable health care expenditures annually.[6] Many patients are unable to read basic health materials, comprehend directions for taking medications, or understand information on an appointment slip. In one California study, 65 percent of adults with low reading skills reported they avoid going to the doctor because of difficulties associated with completing the paperwork.[7] And, 75 percent of medical professionals answered they were aware of medical errors that were the product of low literacy levels.[8]

In 2007, CHIP and the San Diego Council on Literacy (SDCOL) formed a partnership to address health literacy challenges in San Diego County. Together, the organizations developed a plan which is now being implemented under the name of Health Literacy San Diego.[9] First, the agencies and their partners are training front and back office medical staff on how to identify and support low literate patients, especially those who are English speakers who read below the eighth grade level but do not disclose their difficulty with the paperwork. Focus groups revealed that medical staff members were aware of the needs, but they were frustrated by a lack of training in how to handle them. Jose Cruz, CEO of SDCOL, reports, "One technique that we teach trainees is to use the 'teach back' method with their patients. Patients, in turn, teach back to the staff what they heard from their doctor during their appointment." This helps to make sure patients understand their condition and what they need to do. Second, Health Literacy San Diego has developed curriculum to integrate health literacy topics and vocabulary into literacy lessons taught by its affiliated programs throughout the county. "We are addressing the cultural, language, and literacy barriers that impact health outcomes for adults with low literacy skills," says Cruz.

Financial Literacy

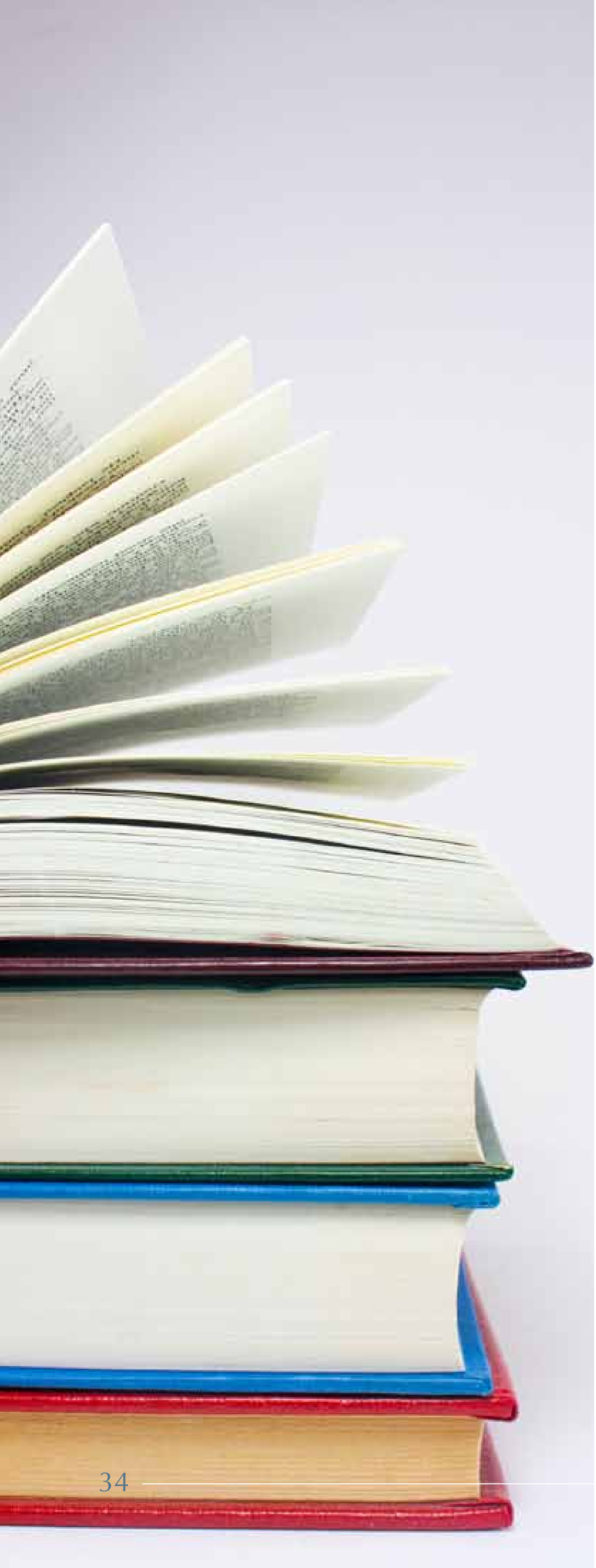
As evidenced by the recent financial crisis, the U.S. financial system is highly complex and consumers often struggle to make sense of new products and regulations—low literacy adults are likely to struggle even more. Efforts that aim to improve functional literacy in conjunction with financial literacy can play a significant role in helping individuals achieve financial stability. Project Read, an adult literacy program of the South San Francisco Public Library, began a Financial Well-Being Project three years ago that targets low-income individuals with low literacy skills. The program offers financial education and coaching which helps clients create spending plans, build emergency savings funds and plan strategies to build wealth. "Classes are fun, positive and as basic as possible," says Fernando Cordoba, Literacy Services Coordinator and instructor. The program has also helped to connect participants with Opportunity Fund, a non-profit social enterprise organization that provides microloans to low-income individuals looking to start or expand a small business.

Cordoba shares that it is difficult to bring about behavioral change. Students can easily gain financial knowledge in the classes, but they are reaching beyond that. "They [the adult students] already handle money and it's hard to change patterns," he says. Project Read uses incentives such as gift cards for completing assignments and raising credit scores. These are good motivators, but what really makes a difference is the personal, individual attention students receive, and the trust they have with Project Read. According to Cordoba, successes have come with students who have an ongoing relationship with the program. "They are looking for structure, and we provide that," he says. Along with that structure, students gain confidence and trust. "A lot of students tell us they are leery of financial institutions that seem to be more interested in 'selling them' something rather than helping them. They understand that our services are truly student-centered," says Cordoba.

Addressing Native Language Literacy

The challenges connected to low English literacy skills are compounded for immigrant adults illiterate in their own native languages. It's common for non-literate Spanish speakers to enroll in English as a Second Language programs only to find them too difficult. After struggling to keep up, these students may drop out. There is a pressing need for native language literacy, as evidenced by a 2006 report, *The Integration of Immigrants in the Workplace,* which estimates that 32 percent of adults enrolled in ESL classes lack basic literacy skills in their native language, making them "slower in learning a second language than their literate counterparts."[10]

Centro Latino helps non-literate Spanish speakers to learn English and other vital skills by teaching them first to read and write in Spanish. This approach builds the foundational skills and confidence needed to learn English and pursue other goals. Centro Latino is located in the Westlake/Pico Union neighborhood immediately west of downtown Los Angeles and serves over 1,000 Spanish speakers each year in a county where almost 216,000 adult Spanish speakers cannot read or write in any language. The organization's clients have endured severe poverty and isolation in their youth and generally have had fewer than three years of formal education.



At Centro Latino, adults learn basic reading and writing skills in Spanish through Leamos™, a web-based literacy curriculum. Leamos is a self-paced application that allows students to progress through lessons at their own rate. As a result, most participants learn to read and write in approximately 100 - 150 hours (two to five months) at the computer. Leamos teaches Spanish-speaking youth and adults to read and write as a crucial first step in enabling them to learn English, overcome their fear of technology, improve job readiness, and access information and services. The web-based platform allows non-literate Spanish speaking adults to access the materials any place with internet access, such as the public library.

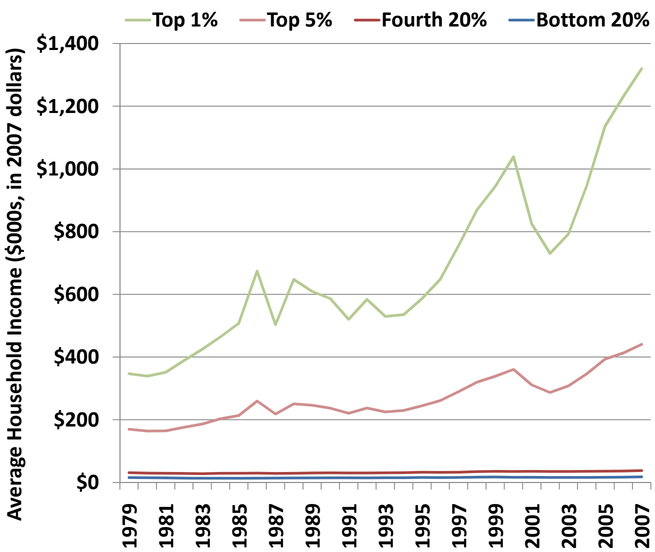
Conclusion

As the United Nations Educational, Scientific and Cultural Organization (UNESCO) states in its literacy strategy, literacy is about empowerment - not what literacy can do for people but rather what people can do with literacy.[11] This is certainly true in the United States. Just ask Centro Latino student Ana Martínez, who says, "Before I could not read the names of the streets and my husband would have to direct me on how to get around. Since studying [at Centro Latino], I am able to read street names and get along on my own. I can now read story books to my granddaughter...I am now able to list and measure the clothes I make at the garment factory I work in. I learned how to create and monitor a budget. This has helped me to manage my income including monthly expenses. In the past, I would try to save but was not successful because I didn't have a system." And Ana is not alone. For every adult who becomes literate there is a story of newfound independence. The transformative power of literacy improves the economic, social, and physical health of individuals and their families for generations to come.

Cathay Reta *is a consultant who coordinates the ProLiteracy California Initiative, part of ProLiteracy, the world's largest organization of adult literacy and basic education programs today.* **Mari Riddle** *is President and Chief Executive Officer of Centro Latino for Literacy, a Los Angeles-based nonprofit dedicated to teaching literacy and providing educational opportunities to Latino adult and youth who have not had the benefit of an education.*

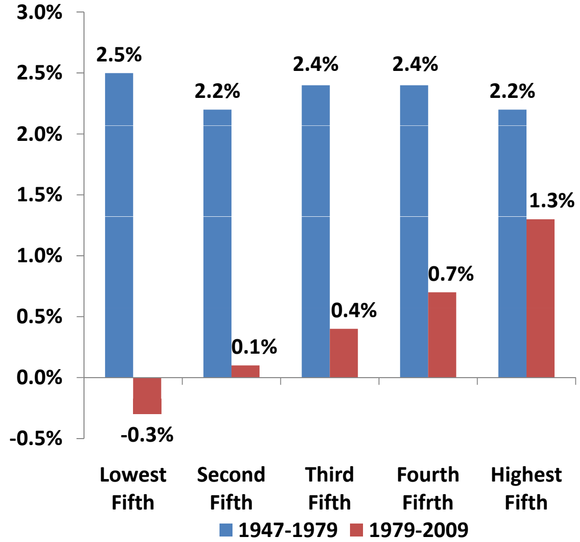
DATA SNAPSHOT

Average Household Income (Post-Tax), 1979–2007



Source: Congressional Budget Office

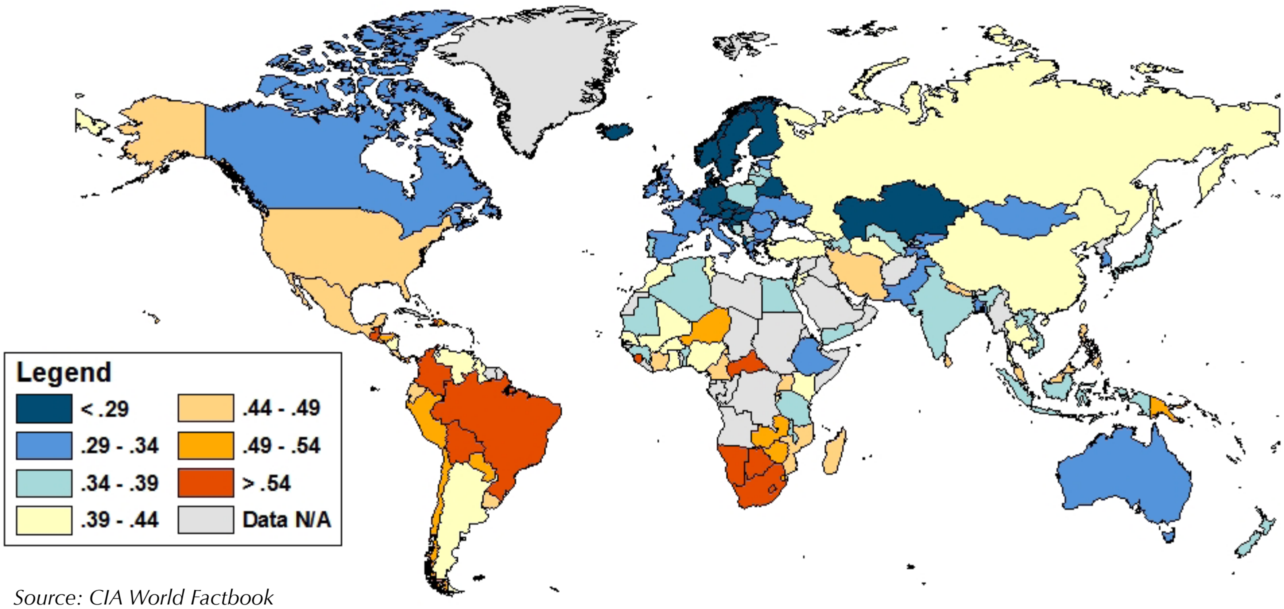
Real Family Income Growth by Quintile, 1947–1979 and 1979–2009



Source: Economic Policy Institute analysis of U.S. Census Bureau data

Gini Index

The Gini index measures the degree of inequality in the distribution of family income in a country. The lower a country's Gini index, the more equal its income distribution; the higher the index, the greater the level of income inequality.



Source: CIA World Factbook

RESEARCH BRIEFS

Economic Downturns and Inequality

More than two years into the U.S. recovery, researchers have started to look at how the recent recession may have impacted income inequality. How does an economic crisis impact earnings and income inequality, if at all? What can we learn from previous recessions? What factors influence whether or not a financial crisis will increase inequality?

Carlo V. Fiorio and Catherine Saget survey the existing literature on global financial crises and find no relationship between crises and changes in earnings inequality (i.e. wage distribution) but point out that in most cases income inequality (which takes into account income from capital and social transfers) decreases after a financial crisis. Their findings suggest that each country's institutional structure impacts how inequality changes after a financial crisis. In Finland, for example, inequality levels remained basically unchanged despite a striking increase in unemployment from 1990-1993, which the authors attribute to a strong public benefit system that supplied generous unemployment benefits including training programs. In contrast, the East Asian financial crisis of 1997-1998 correlated to an increase in inequality, potentially due to policies enacted after the crisis that promoted economic recovery by benefitting the corporate and financial sectors, while increasing poverty through cuts in social services.

Using Current Population Survey data, Fiorio and Saget find a minor increase in U.S. earnings inequality, but when they account for the unemployed (counting their wages as zero), the increase becomes much larger. They attribute this increase in inequality to low wage workers being more likely to lose their jobs during the recession and because social transfers and the wages from replacement jobs are both lower than earnings received by these workers prior to the crisis.

Fiorio, Carlo V. and Saget, Catherine. (2010). "Reducing or aggravating inequality? Preliminary findings from the 2008 financial crisis." International Labour Office, Policy Integration Department, Geneva.

The Low Income Housing Tax Credit and Racial Segregation

The Low Income Housing Tax Credit (LIHTC) is an indirect Federal subsidy used to finance the development of affordable rental housing for low-income households. The program is administered by the Internal Revenue Service (IRS) and has a provision that awards developers with higher tax credit allocations for siting projects in Qualified Census Tracts (QCTs), which are high-poverty neighborhoods that are often populated with a high concentration of minorities. Despite the success of LIHTC in increasing the supply of affordable rental units, one oft-cited concern is that the program is contributing to racial segregation, but is this actually the case?

Keren Horn and Katherine O'Regan use data from HUD and the census, along with data collected on the racial composition of LIHTC tenants in three states, to address this question. They examine three channels through which the LIHTC could potentially affect racial segregation: the siting of LIHTC units relative to other non-LIHTC units that serve low-income populations; the racial composition of residents in LIHTC projects; and changes in neighborhood composition in areas in which tax credit projects are built. They find that LIHTC units are only slightly more likely to be located in high-minority tracts than other units occupied by near-poor and poor renters, and that neighborhoods of high minority concentration experience declines in minority representation over time, rather than an increase. Additionally, Horn and O'Regan find that increases in the use of tax credits between 1980 and 2000 in metropolitan areas are associated with declines in racial segregation.

Despite the finding that the LIHTC program, on average, is not associated with an increase in racial segregation, the authors recognize that persistent racial segregation remains a challenge in this country. They conclude that targeting criticism of the LIHTC on concerns of racial segregation may take efforts away from identifying other important areas of improvement for the program.

Horn, Keren and O'Regan, Katherine. (2011). The Low Income Housing Tax Credit and Racial Segregation. Furman Center for Real Estate and Urban Policy, New York University, Working Paper. http://furmancenter.org/research/publications/tag/subsidized+housing

Defaults and Saving among Low-Income Tax Filers

Previous research has demonstrated the powerful effect that default setting can have on financial decision-making, particularly in the area of 401(k) savings behavior. By simply switching the default to automatic enrollment, requiring users to opt-out if they do not wish to save, participation rates in defined contribution plans tend to increase dramatically. But do the effects of this type of nudge extend to other savings programs and populations?

The results of a recent study suggest that default setting does not impact savings behavior among low-income tax filers. In 2009, a new initiative designed to increase retirement savings allowed tax filers to purchase U.S. Savings Bonds with their federal income tax refunds and advocates supported the policy's "saveable moment" approach. Erin Todd Bronchetti, Thomas Dee, David Huffman, and Ellen Magenheim conducted a field study at eight Volunteer Income Tax Assistance sites during the 2010 tax season to test whether default setting would affect the take up rate among low-income tax filers to receive some or all of their refunds in U.S. Savings Bonds. They find that regardless of whether the default requires an opt-in or opt-out of the savings bond option, the participation rate in the savings program is roughly nine percent. The authors point out that the success of increasing saving among higher-income 401(k) participants through default switching should not be automatically generalized for other policy settings, particularly among lower-income populations. One possible explanation for why the nudge was ineffective was that 75 percent of filers indicated they already had plans for how to spend the refund. Nearly 70 percent of low-income filers stated that they had trouble paying bills and only 17 percent stated they had plans to save some of their refund, demonstrating the resource constraints facing this population.

The authors emphasize that, "401(k) defaults may be powerful because they coincide with the pre-existing intentions to save of relatively affluent individuals... To the extent that low-income filers do not have strong intentions to save at tax time, defaults may have little effect." One implication of these findings is that prior to implementing default switching interventions to impact the savings behavior of low-income individuals, more needs to be done to shift their savings expectations. For example, matched savings programs have demonstrated that the poor can effectively alter their savings expectations and develop assets. Further research is necessary to measure the impact of defaults for different populations under difference scenarios.

Bronchetti, E., Dee, T., Huffman, D., and Magenheim, E. (2011). When a Nudge Isn't Enough: Defaults and Saving among Low-Income Tax Filers. NBER Working Paper 16887. http://www.nber.org/papers/w16887.pdf

DOCTOR CRA

by John Olson

Dear Dr. CRA –

We're all waiting anxiously for word from Washington on the changes to the CRA. While we're waiting, is there anything I can do to be getting ready?

Sincerely,
Anxiously Awaiting New Rules

Dear Anxious,

We know it's tough not knowing what to expect from the CRA reform process, but that doesn't mean you can't start thinking about how you'll respond to the changes when they do come. It's a good time to review your CRA program to make sure you are prepared to implement any changes. Some things to think about:

Plan to comment on any proposed changes. When I hear a concern about a new rule, my first question is always "did you submit a comment?" Far too often, the answer is "no." The agencies really do read all comments and want to hear about the impact of the proposed rule on your financial institution. It's important for everyone with an opinion to submit a written comment. Detailed instructions for submitting comments will be provided in the proposal itself.

Create a strategy for interpreting and implementing the changes. Do you have up-to-date policies and procedures for your CRA compliance program? How will you amend and distribute the new procedures? How will you communicate the changes to senior management? How will you communicate the changes to lenders, branch managers, and other key staff? Thinking through these questions beforehand and developing your plan can make the implementation phase more efficient and successful.

Receiving new rules can be a challenge, but I encourage you to also see it as an opportunity. It could be your chance to raise awareness of your CRA program in your institution, to implement a strategy you've been wanting to try, and to re-engage your CRA stakeholders throughout the bank. Use the new rules as your chance to re-evaluate your program and take it in a new direction!

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Ties that Bind: Income Inequality and Income Segregation

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The Polarization of Job Opportunities in the U.S. Labor Market: Implications for Employment and Earnings

1. Statistics refer to the U.S. civilian labor force ages 16 and above and are seasonally adjusted. Source: U.S. Bureau of Labor Statistics (www.bls.gov, accessed on 4/11/2010).
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Endnotes

6. Although economists would typically view the wages paid to a job as the best summary measure of the job's skill requirements, lay readers may take some assurance that wages as a skill measure are highly correlated with logical alternatives, such as education and experience. Moreover, the ranking of occupational skills based on either wage or educational levels is quite stable over time. Thus, the conclusions here are not sensitive to the skill measure (wages, education-experience) nor the choice of base year for skill ranking (here, 1980).
7. The reason for using a different data source and time period for this figure from the prior figure is that the Census data have large enough sample sizes to be useful for the occupation level exercise, but they are less than ideal for measuring hourly wages. I use the May/ORG data for hourly wages, which are a superior source.
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13. Notably, the college completion rate for this group was higher in 1990 (29 percent) than in 2008 or 2008 (24 percent and 27 percent).

CDFI Bond: Opportunity of a Decade

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2. Speech by Chairman Ben Bernanke on April 29, 2011 at the Federal Reserve Community Affairs Research Conference in Arlington, Virginia. http://www.federalreserve.gov/newsevents/speech/bernanke20110429a.htm

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