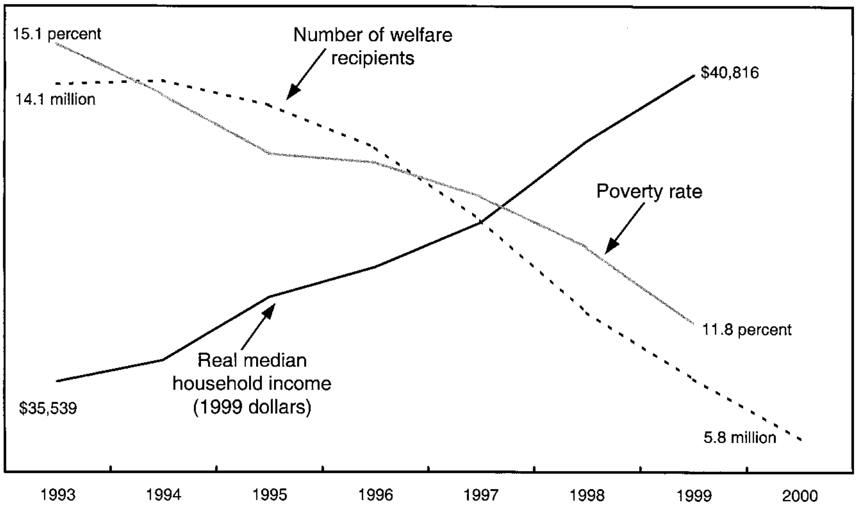
C H A P T E R 5

Living in the New Economy

Improvements in Income, Poverty, and Welfare Recipiency



Note: Annual figure for welfare recipients is the average monthly number, except for 2000 which is the June number. Real income is computed using the CPI-U-RS.
Sources: Department of Commerce (Bureau of the Census) and Department of Health and Human Services.

Strong economic growth since 1993 has raised incomes, lowered poverty, and helped reduce welfare rolls.

This Administration came to office on a platform of "putting people first." The Administration has kept that pledge. Although the phrase "New Economy" typically brings to mind technological innovation and globalization, arguably one of the most important changes from the old economy to the new has been an improvement in the well-being of the American people. By virtually any measure, Americans are better off today than they were 8 years ago.

The private sector has demonstrated great entrepreneurial dynamism and technological sophistication in bringing us the New Economy. But we need to recognize that even in a New Economy, private markets alone, for all their virtues, will not guarantee that all our national goals will be met. Private markets can create wealth, but they cannot ensure that all citizens, even those able to find jobs, will have adequate incomes. Nor will private markets ensure that all citizens have access to quality education and health care. Similarly, although private markets can generate growth, they cannot ensure that growth will reach all communities. Nor will purely private markets necessarily deal with the side effects of growth on both the environment and urban congestion.

Many of our most difficult national challenges will require government intervention through policies that assist individuals and communities in danger of being left behind. This chapter, therefore, considers policy areas that have a major impact on the opportunities given to all Americans to create a better life for themselves and their children. In particular, the chapter outlines recent reforms in the Nation's welfare system and policies designed to improve the educational system, expand health insurance coverage, and ensure smart growth. It also describes the considerable progress that has been made and identifies the tasks that remain to be accomplished.

Although the New Economy may not meet these challenges on its own, the faster growth it has generated does make meeting them considerably easier. In addition, the innovations that have occurred in information technologies, organizational redesign, and policy provide better tools with which to meet them. In each section of the chapter, particular attention is paid to the contributions such innovations have made and can make in improving the quality of life for all Americans. For example, in the welfare system, new policies that make work pay have dramatically reduced the number of families receiving cash assistance, while increasing employment. In education, educators have worked to implement higher standards for students and teachers and have brought aspects of the New Economy into the classroom through the increased use of computers. In health care, innovations in medical technology and managerial practices have increased the quality of care and helped rein in costs. Finally, across our communities, some localities are taking advantage of new techniques to combat problems of congestion and pollution and ensure smart growth practices. This chapter elaborates on these and similar policies that have helped grow the work force, sustain strong economic growth, and improve the quality of life for all Americans.

Good News from the American Economy

Record-setting gains in the stock market and growth in the net worth of wealthy individuals have received wide media coverage. But the most noteworthy aspects of the current economic expansion are its duration and its reach. The last few years in particular have brought tremendous gains to all segments of our society.

Employment gains have been dramatic. Between January 1993 and November 2000, 22.4 million new jobs were created. In 1999 the unemployment rate reached 4.2 percent—the lowest annual rate since 1969. Just as important, unemployment has stayed low, remaining below 5 percent for 41 consecutive months through November 2000. At the same time, wages have been increasing. After declining consistently from 1986 to 1993, real hourly wages for private sector workers rose by 7.4 percent between 1993 and 1999. These gains in employment and wages are echoed in growth in income and reductions in poverty. The real median household income reached a new high of $40,816 in 1999, an increase of 2.7 percent since 1998 and a total increase of 13.3 percent from 1993. In 1999 the poverty rate fell to 11.8 percent, its lowest level since 1979 and 3.3 percentage points below the 1993 rate of 15.1 percent.

These gains were shared by Americans at all income levels. Between 1998 and 1999, real income grew by 4.4 percent for those at the 20th percentile and by 3.5 percent for those at the 80th percentile. (The household at the 20th percentile has an income higher than 20 percent of all households and lower than the other 80 percent.) From 1993 to 1999 the comparable figures for real income growth were 15.0 percent and 14.2 percent, respectively. In addition, the most disadvantaged groups tended to experience the greatest improvements in financial well-being. Household incomes for African Americans and Hispanics saw record one-year increases, rising to all-time highs. The real median income for African-American households increased 7.7 percent between 1998 and 1999 (it is up 23.9 percent since 1993), climbing to $27,910. The real median household income for Hispanics rose to $30,735, an increase of 6.1 percent between 1998 and 1999 (and 16.5 percent since 1993).

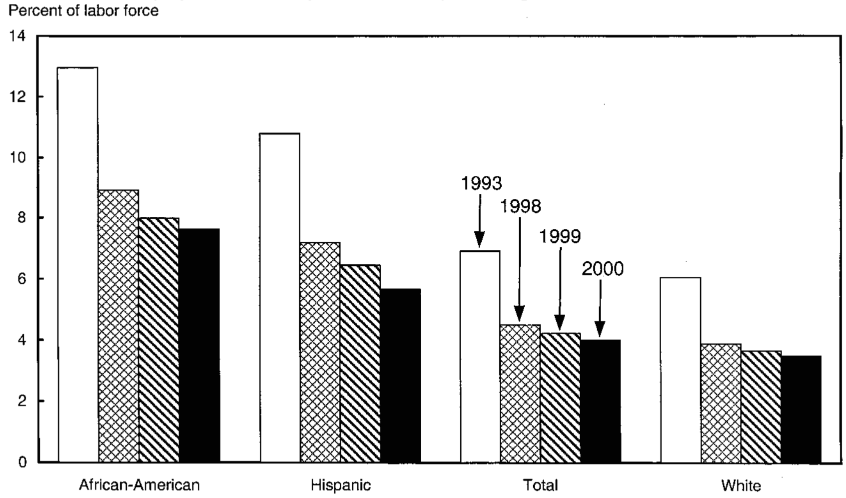
In 1999, unemployment for African Americans and Hispanics fell to the lowest rates on record. African Americans saw unemployment fall from 13.0 percent in 1993 to an average of 7.6 percent for the first 11 months of 2000, while Hispanics saw their unemployment rate drop to an 11-month average of 5.7 percent (Chart 5-1). Male earnings have also increased, particularly for African Americans. Between 1998 and 1999 the real median earnings for full-time African-American male workers increased by $2,379 in 1999 dollars, or 8.6 percent—a dramatic rise for a single year. With this sharp increase, the ratio of African-American male to white male earnings rose to 0.81, the highest level ever recorded.

Along with record increases in income have come record lows in poverty rates (Chart 5-2). The decrease in the poverty rate for African Americans between 1998 and 1999 was the largest 1-year decline in percentage terms since 1967-68, and the poverty rate for this group in 1999 reached an all-time low of 23.6 percent. Hispanics also experienced a record drop in poverty. At 22.8 percent, the poverty rate for this group is now at its lowest since 1979.

In the past, economic gains have often had a limited impact on households headed by women. Since 1993, however, the strong economy and a social welfare policy that emphasizes work have brought substantial benefits to this group. In March 1993 just 56.8 percent of women maintaining a family on their own were employed; this figure rose to 63.4 percent in March 1998 and 65.2 percent in March 1999. This increase in employment corresponded to an increase in income. Between 1993 and 1999 the median income for these

Job opportunities grew after 1993, and the African-American and Hispanic unemployment rates reached record lows in 2000.

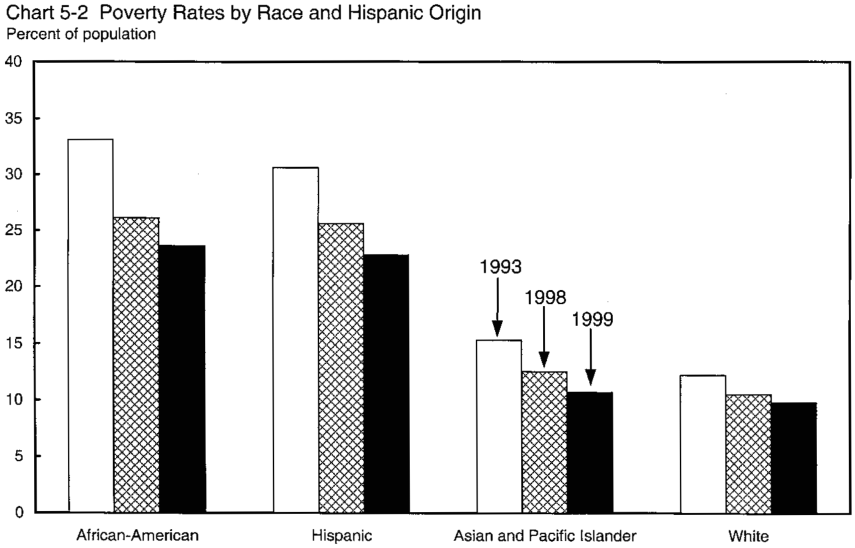
Chart 5-1 Unemployment Rates by Race and Hispanic Origin



Note: Figures for 2000 are 11-month averages.
Source: Department of Labor (Bureau of Labor Statistics).

Poverty rates fell for all measured racial and ethnic groups after 1993, with the largest declines for African Americans and Hispanics.

Chart 5-2 Poverty Rates by Race and Hispanic Origin



Source: Department of Commerce (Bureau of the Census).

families increased by 18.0 percent. Between 1998 and 1999 alone, the increase was 4.8 percent. The poverty rate for people in families headed by females also fell, from 38.7 percent in 1993 to 33.1 percent in 1998 and 30.4 percent in 1999.

Within this group are those most likely to have been affected by welfare reform: low-income single mothers and their children. (Low income is defined here as an income below 200 percent of the poverty line.) An analysis of a recently completed survey indicates that between 1997 and 1999 the proportion of low-income single mothers between 25 and 54 who were employed increased from 59.7 percent to 65.2 percent. Children as well as their mothers benefited from this change. Between 1998 and 1999 the poverty rate for children fell by 2 percentage points, to 16.9 percent, the lowest level since 1979 and the largest percentage-point decline since 1966. Poverty among African-American children declined by even more in absolute terms, falling by 3.6 percentage points to 33.1 percent. Since 1993 the poverty rate for all children has fallen by 5.8 percentage points.

Older Americans have also benefited from economic growth. In 1999 the poverty rate among the elderly fell below 10 percent for the first time on record. With the elimination last year of the Social Security earnings test for those aged 65 and over, older Americans will likely participate in the labor force in greater numbers, further improving their financial status.

In the past, residents of our central cities have seen little change in their poverty levels, yet here, too, the situation is improving. Over the last several years, central-city residents in large metropolitan areas experienced an above-average increase in median income and the largest declines in poverty of any geographic category.

The gains experienced by Americans over the past 8 years have not been limited to financial gains but include a long list of improvements in the quality of life. Low interest rates and a strong economy have contributed to the highest home ownership rate ever in America. In the third quarter of 2000, 67.7 percent of American families owned a home, up from 63.7 percent in the first quarter of 1993 and surpassing the Administration's goal, set in 1995, of 67.5 percent. Improvements in job opportunities, in combination with Administration initiatives to hire additional police officers, strengthen gun laws, and increase local resources to improve public safety, have contributed to a dramatic reduction in crime. In 1999 the overall crime rate fell to its lowest level in 26 years.

Again, some of the least well off Americans have benefited most. The violent crime victimization rate among those with annual household incomes of less than $7,500 fell at an average annual rate of 4.7 percent between 1993 and 1999, while victimization rates for those with incomes of $75,000 or more fell at an average annual rate of 2.8 percent. During the same period the number of violent crimes perpetrated against African Americans declined by an average of 4.6 percent per year, while whites experienced a 3.0 percent annual decline. Patterns by race for property crimes are similar.

The Nation's schools today are also showing improvements on several fronts. Between 1993 and 1998 the proportion of high-school graduates going directly to college grew by nearly 7 percent, and college enrollment is at an all-time high. Math SAT test scores have reached their highest level in 30 years, and average verbal SAT scores have held steady even though the number of nonnative English speakers taking the exam has increased. Minorities have also made notable academic achievements. Among high-school graduates aged 18–24, the proportions of African-American and Hispanic students continuing their education at a 4-year college are at record highs.

Improvements have also been made in the public health arena. The birth rate among teenagers declined 17 percent between 1993 and 1999. Infant mortality was down from 8.4 deaths per thousand in 1993 to 7.2 per thousand in 1998. Between 1997 and 2000 smoking among teenagers declined after rising for most of the decade. Over the past several years, death rates attributable to heart disease, cancer, stroke, and AIDS are down, and life expectancy has improved. A child born in 1998 can expect to live 76.7 years, up from 75.5 years in 1993.

Although these statistics present a glowing picture of the New Economy and the well-being of the Nation as a whole, more work remains to be done. Despite the recent gains, the incomes of minority groups remain significantly below those of whites, and their poverty rates significantly above. Infant mortality rates and life expectancy also differ substantially by race and ethnicity, as does access to a quality education. Certain areas of the country continue to experience unemployment rates of more than 10 percent, as well as distressingly high levels of poverty. Many Americans still lack health insurance coverage and access to adequate medical care.

Innovative policies have helped us share many of the gains of the New Economy, reduce the number of people on welfare, and improve employment opportunities. But new policies may be needed to contend with future changes in the economy. A slowing of economic growth will likely be felt most severely by those who have only recently begun to share in its benefits. Those most recently employed may lose their jobs and accompanying benefits such as health insurance. Federal, State, and local governments may feel pressure to cut back on investments in education if their revenues decline. Thus, continued improvements in the well-being of the American people likely depend on both sustained economic growth and active public policy.

Helping Families Help Themselves

The New Economy is popularly characterized by new technologies, new methods of communication, and new avenues of trade. But it also brings innovative ways of providing for the least well off Americans. Substantial changes have taken place in the organization of our welfare system and in the incentives it provides. These innovations, and in particular policies designed to increase the benefits of work, such as child care subsidies and rules that increase the fraction of earnings that welfare recipients can keep, have changed the tenor of American social welfare policy. Public policy now emphasizes employment and investment in the skills of those who are less well off. In doing so the Administration has helped low-income families leave welfare and enter the labor market, thereby promoting a more equitable distribution of the gains from the New Economy.

Welfare Reform

Two of the most impressive achievements of the past 8 years have been the reduction in the number of Americans receiving welfare, and the increase in the numbers of current and former welfare recipients who are working. The Administration has worked hard to reform welfare. It began by allowing a record number of States to implement changes in their welfare programs on an experimental basis, through waivers from Federal welfare regulations. As of August 1996, 43 States had received waivers and set up alternative programs that emphasized work and parental responsibility.

These changes at the State level were followed by changes at the national level, in particular the bipartisan Personal Responsibility and Work Opportunity Reconciliation Act signed by the President in 1996. This act replaced the Aid to Families with Dependent Children (AFDC) program with one that provides needy families with temporary assistance, established time limits for receiving welfare benefits, and shifted the emphasis from simply providing assistance to helping families leave welfare and enter the labor market. Policies that offer tax credits to subsidize the earnings of low-income workers, provide assistance with child care, and expand eligibility for health insurance support the welfare-to-work transition.

The new program, Temporary Assistance for Needy Families (TANF), differs from the AFDC program in three fundamental ways. First, it gives States much more discretion in using Federal funds. Under the AFDC program, States set eligibility and benefit levels (within Federal guidelines) and received matching funds from the Federal Government to help with the program costs. The new program provides States with block grants that are used to finance cash benefits, job preparation, and other worker support programs. States now have much more flexibility in spending, and they have used this flexibility to meet the particular demands of their constituencies—for example, allocating additional funds for child care subsidies or allowing welfare recipients to keep a greater fraction of their earnings. States are also eligible for bonuses for helping people get and keep jobs and decreasing out-of-wedlock births. In the future, bonuses will be offered for increasing participation in the food stamp, Medicaid, and children's health insurance programs; for providing child care to a larger fraction of eligible children; and for increasing the proportion of children living in married-couple families.

Second, the new system imposes time limits and work requirements on welfare recipients. In general, States can no longer use Federal funds to pay benefits to recipients beyond a lifetime limit of 60 months. States can exempt some recipients from this requirement, set even shorter time limits, or use their own funds to continue support beyond the 5-year limit. In 1999, 38 States used the 60-month time limit, and the remainder implemented other policies (8 States had shorter time limits, 3 had no time limit, and others intended to use longer periods). Recipients must also work in some capacity after receiving benefits for 2 years, but States have flexibility in deciding how to implement this requirement, particularly in terms of strengthening it. In 1999, 28 States had welfare policies that imposed immediate work requirements rather than the 2-year requirement.

Finally, States can now design the parameters of their program to suit the needs of their residents. Although even before 1996 States had the freedom to set benefit levels, the new program allows them to set income and asset limits for eligibility as well and to establish their own methods of calculating the income of potentially eligible families. The majority of States have used this freedom to decrease the implicit tax on earnings. The AFDC program reduced benefits dollar for dollar for any earnings of more than $90 per month after 12 months of work. This 100 percent "tax" on earnings created a strong disincentive to work, as it was possible for a recipient to see little if any increase in income from additional hours of work. Many States now use a more gradual benefit reduction rate to encourage greater work force participation. They are also investing in a wide range of supports to help welfare recipients and other low-income working families enter the work force and succeed on the job.

The Effects of Welfare-to-Work Programs

Since August 1996, welfare caseloads have fallen dramatically. Between August 1996 and June 2000, the number of people receiving welfare declined by half, to 5.8 million. Including reductions that have taken place since 1993, caseloads have fallen by 8.3 million, or 59 percent. Declines in some States have been even more dramatic. In Wisconsin, for example, the number of welfare recipients fell by 75 percent between August 1996 and June 2000, and it has fallen by 84 percent since 1993.

The 1996 reforms have undeniably been successful in reducing the number of people receiving welfare. But reductions in caseloads are not the only measure by which to judge the reforms: the well-being of the millions of former welfare recipients is at least as important. Much of what we know about outcomes for welfare leavers comes from studies undertaken in individual States. To date, studies monitoring the outcomes of those who have left welfare have been conducted in over 30 states. In addition, some of the data from State waiver experiments undertaken before the nationwide welfare reform have implications for current programs.

Available data on the results of welfare reform often differ from State to State and do not represent nationwide averages. This Report therefore supplements this information with new results based on the Census Bureau's Survey of Income and Program Participation (SIPP), providing some of the first evidence on the effects of welfare reform for a nationally representative sample. The results from the SIPP are based on a sample of people who were observed for at least 12 months after leaving the welfare rolls. These individuals were first observed between December 1995 and March 1996 and were reinterviewed every 4 months until the period between November 1998 and February 1999, the exact month depending on the month of the initial interview. The new data cover the experiences of some of those first affected by welfare reform and may not reveal the effects of the time limits on receiving benefits or the long-term impact on families.

One of the most important issues in evaluating welfare reform is the incidence of recidivism, that is, the return of individuals to the welfare rolls. Both SIPP data and a synthesis of State studies show that approximately 25 percent of those who leave welfare return within 12 months. (Most studies of recidivism, including those cited here, do not treat transitions of less than 2 months as true changes.) The majority of those who do return to welfare do so quickly: the SIPP data show that 18 percent of those who exit return within the first 6 months of leaving, and only 7 percent during the second 6-month window. Further, the probability of returning to welfare declines with time. In Maryland 25 percent of former recipients returned to welfare within 12 months, but only 10 percent returned in the next 12 months, and approximately 1 percent did so in the third 12-month period.

Helping Welfare Leavers Find and Keep Jobs

A key factor in success after welfare is the ability to obtain a job and remain employed. The Administration provided a total of $3 billion in fiscal 1998 and fiscal 1999 in the form of Welfare-to-Work grants to help States and local communities move long-term welfare recipients and noncustodial parents into jobs. The Administration also implemented the Workforce Investment Act, which allows States to provide job placement assistance to residents, with priority given to low-income individuals (Box 5-1).

Box 5-1. The Workforce Investment Act

The Workforce Investment Act of 1998 was the result of a bipartisan effort by the Congress and the Administration. The law requires that basic job and career information and assistance be available to all Americans and creates a system developed around one-stop career centers in order to knit together multiple programs at the local level. The law also provides for intensive assessment, counseling, job search assistance, and training, with priority given to people on public assistance and to low-income individuals.

The law initiates three reforms that are designed to maximize training choices: individual training accounts, systems for identifying eligible training providers and their programs, and extensive information on program performance such as success in job placement, post-placement earnings, and rates of skill attainment. These reforms were designed so that trainees will have the opportunity and the purchasing power to enter the training program of their choice rather than be channeled into one of a handful of locally contracted programs. The reforms provide an abundance of reliable information that will empower trainees, allowing them to make informed choices.

Employment programs for welfare recipients generally use one of two approaches to helping welfare leavers find jobs. The "work first" approach aims to get people employed as quickly as possible. It is based on the belief that work itself will give inexperienced workers the skills (human capital) they need to remain in the labor force and move to increasingly better jobs. This approach focuses on maintaining an attachment to the labor force rather than on initial wages. The alternative approach relies on comparatively extensive education and training before welfare leavers enter the labor market. It delays their entrance into the work force in the expectation that, once employed, they will have better jobs than they could otherwise have obtained.

The work-first approach is the more common, and past studies of initial outcomes have indicated that it is the more successful: gains in employment levels and earnings for program participants were higher in areas with work-first programs than in areas using a training-based approach. However, a new study comparing outcomes across counties in California over a 9-year period finds that results for the two approaches are similar in the long term. A separate study comparing the outcomes of 11 different welfare-to-work programs over a 2-year period finds that the most successful approach combined an emphasis on work with assistance in completing the General Educational Development (GED) diploma.

Employment rates among former welfare recipients are high. Administrative data from studies conducted in several different States show that between 62 and 75 percent of those leaving welfare were employed at some point in the following year, and approximately 40 percent were employed in all four quarters. Results are similar at the national level. SIPP data show that 66 percent of welfare leavers were employed at some point in the following 12 months, and 43 percent had earnings in all four quarters. However, few leavers were continuously employed. Only 32 percent of welfare leavers worked 50 weeks or more during the year, and just 40 percent of this group (12.8 percent of all leavers) worked 35 or more hours in each week. Thus, although labor force participation has increased significantly among former welfare recipients, there is considerable room for further gains.

Importantly, employment rates increased even among those who remained on welfare. In fiscal 1999, 33 percent of welfare recipients were working, compared with fewer than 7 percent in 1992. Developing an attachment to the labor market even while on welfare is important, because it increases the probability of success after leaving welfare.

The importance of the booming economy to these successes should not be understated. Theories of human capital accumulation and the tenets behind work-first programs suggest that time spent working increases productivity, job skills, and wages. The long economic expansion and historically low unemployment rates have given current and former welfare recipients the chance to accumulate work experience that would be expected to serve them well in a future downturn. The longer the expansion continues, the better prepared they will be to weather the consequences.

Earnings

Although employment is important in and of itself, so, too, are earnings. Welfare leavers are unlikely to thrive in the workplace if they are no better off financially than they were before leaving the welfare rolls. Evidence from State studies indicates that, at least initially, few leavers are significantly better off. Median quarterly earnings for those who found employment varied from \$2,000 to \$3,000, or approximately \$700 to \$1,000 per month. For the majority of leavers in Wisconsin, earnings after leaving welfare were lower than the sum of earnings and welfare benefits prior to exit. For the sample of SIPP leavers, the median monthly household income plus food stamps for the year following exit was \$1,605, compared with \$1,509 in the 2 months preceding exit. For 44 percent of leavers, household income plus food stamps in the year following exit was more than \$50 per month higher than in the months before; for 49 percent it was at least \$50 lower.

The idea behind work-first programs is that an initial job will lead to earnings growth over time. Because many former welfare recipients find employment in low-wage industries such as food services, their prospects for earnings growth may not seem extremely bright. Yet 39 percent of SIPP leavers had monthly earnings in the second 6 months after leaving welfare that were $50 or more higher than in the first 6 months. Twenty-eight percent saw a reduction in earnings of $50 or more over the two 6-month periods immediately following exit. Thus at least some former welfare recipients did have earnings growth in the year of exit through increases in hours, wages, or both.

Income gains from the Earned Income Tax Credit (the EITC is discussed in detail below) are not included in these calculations. Although its benefits are not recorded in the SIPP data, the credit provides a substantial subsidy to low-income workers, and including its effects would improve incomes and poverty rates considerably. Although its figures do not focus specifically on welfare leavers, the Census Bureau estimates that in 1999 the fraction of households with after-tax incomes of less than $10,000 a year falls from 9.9 percent to 9.3 percent when the EITC is factored in. At a maximum credit of $3,880 in 2000 for a low-income worker with two children, the EITC could add up to $323 per month to a family's income.

Making Work Pay

As the earnings of welfare recipients increase, they can lose not only their cash assistance but also other benefits such as food stamps and Medicaid. At the same time, they incur explicit payroll taxes and additional expenses associated with work such as child care and transportation costs. In the past these costs have been large. One study found that the implicit marginal tax rate for AFDC recipients —the net amount paid in taxes, forgone benefits, and work-related expenses from a $1 increase in income—could easily exceed 50 percent. In other words, earning $1 more in the labor market increased their disposable income by less than 50 cents.

The Administration's welfare reform proposals have attempted to reduce these implicit taxes and increase the rewards from work, through a higher minimum wage and an increased EITC, through increased subsidies for child care, and through expanded health insurance coverage that includes working families not previously eligible for public programs. The Administration has also worked to help single parents collect the child support payments due them. These programs do more than help ease the transition from welfare to work; they also benefit working families who may have never received welfare. By reaching out to both groups, the Administration has worked to ensure that no working family is left behind.

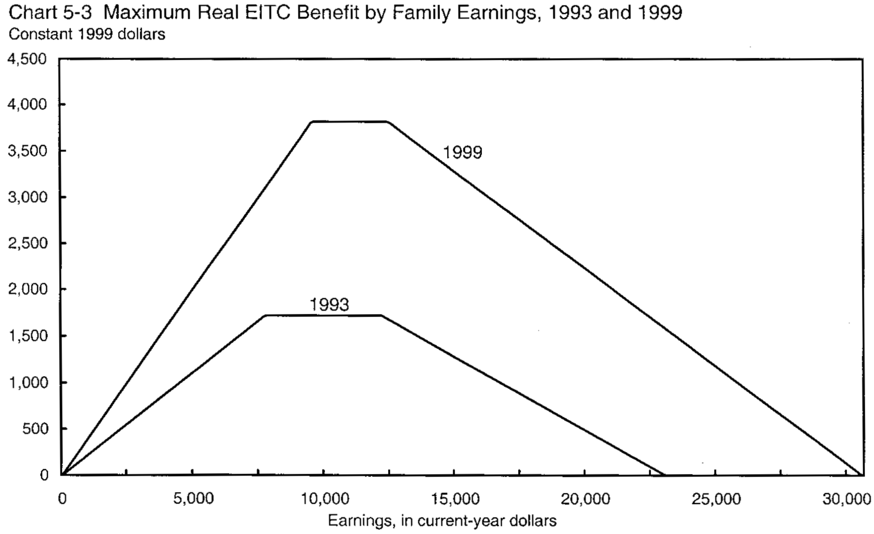
The Earned Income Tax Credit

Operating through the income tax system, the EITC provides a wage subsidy for many low-income workers. The amount of the subsidy depends on how much the family earns and on whether the family has zero, one, or two or more children. By effectively increasing the wage rate, the EITC offers those eligible an added incentive to participate in the labor force. In 2000, families with two or more children received a subsidy of 40 cents for every dollar of earned income up to $9,700, for a maximum credit of $3,880. This tax credit is refundable, so that even families who pay little or no income tax can benefit fully from the tax provision. Rather than falling to zero when earnings surpass $9,700, the credit remains at $3,880 until earnings reach $12,700 and then gradually declines. For two-child families it phases out completely when earned income reaches $31,152 (Chart 5-3). The gradual phaseout reduces the disincentive to earn income beyond the level at which the credit peaks.

The EITC has been expanded greatly since 1990, with increases in both benefits and scope of coverage. The 1993 expansions increased benefits for approximately 15 million tax-filing units (assumed to be roughly equivalent

The EITC was expanded greatly after 1993.

Chart 5-3 Maximum Real EITC Benefit by Family Earnings, 1993 and 1999



Note: Maximum EITC benefit is that for a family with two or more qualifying children. Real benefit is computed using the CPI-U-RS.
Sources: Department of Labor (Bureau of Labor Statistics) and U.S. Congress (Joint Committee on Taxation).

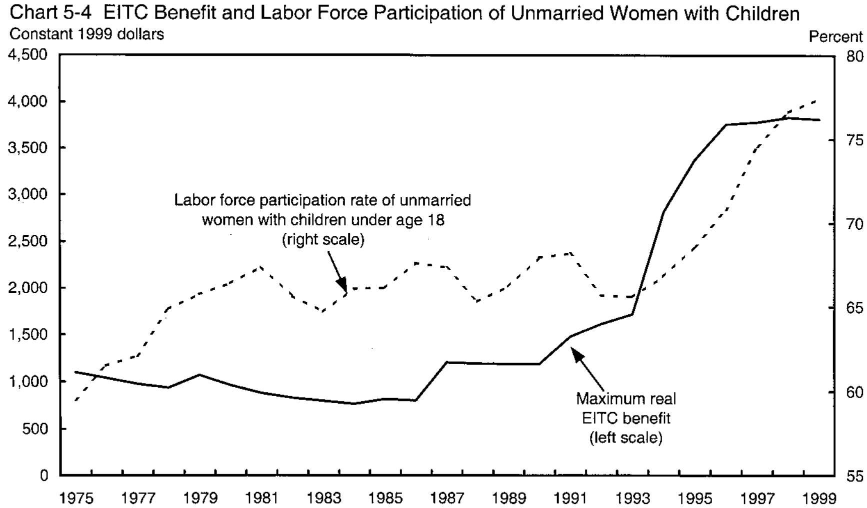
in number to households), in large part by raising the subsidy for families with two or more children. The 1993 expansion also, for the first time, allowed workers without children to claim a tax credit. As a result of both the 1990 and the 1993 expansions, credits paid increased from $15.5 billion in 1993 to nearly $31 billion in tax year 1999. At the same time, the number of tax returns claiming the EITC increased by roughly 30 percent, from 15 million to nearly 19 million. The program now pays out nearly as much as the Federal outlays on the TANF and food stamp programs combined.

This wage subsidy has been effective in attracting more workers into the labor market (Chart 5-4). According to one estimate, the EITC alone was responsible for 34 percent of the increase in annual employment among unmarried mothers between 1992 and 1996.

In addition to increasing the probability of employment for low-income people, the EITC has done much to improve the well-being of those who receive it. Many workers do not have jobs that pay enough to raise their incomes above the poverty level. But when the credit is taken into account, the earnings of these workers can rise substantially. Calculations of after-tax income excluding and including the EITC indicate that in 1999 the credit lifted 4.1 million individuals out of poverty. Of these, 2.3 million were children. The provision has also been effective in targeting benefits to the most needy. Estimates based on 1997 data indicate that between 50 and 60 percent of its benefits accrue to families with incomes below the poverty line.

A leap in the labor force participation rate of unmarried mothers closely followed increases in the maximum EITC benefit.

Chart 5-4 EITC Benefit and Labor Force Participation of Unmarried Women with Children



Note: Maximum EITC benefit is that for a family with two or more eligible children. Real benefit is computed using the CPI-U-RS.
Sources: Department of Labor (Bureau of Labor Statistics) and U.S. Congress (Joint Committee on Taxation).

The Minimum Wage

The minimum wage operates in tandem with the EITC: the credit provides an effective wage subsidy, and the minimum wage laws ensure that the subsidy is based on an acceptable wage. The real value of the minimum wage declined substantially from 1992 to 1995, falling to just 71 percent of its peak value, recorded in 1968. Subsequent Administration-backed efforts led to increases in the minimum wage in 1996 and 1997. Even with these most recent increases, however, the minimum wage in 1999 was less than 80 percent of its 1968 level (after controlling for inflation).

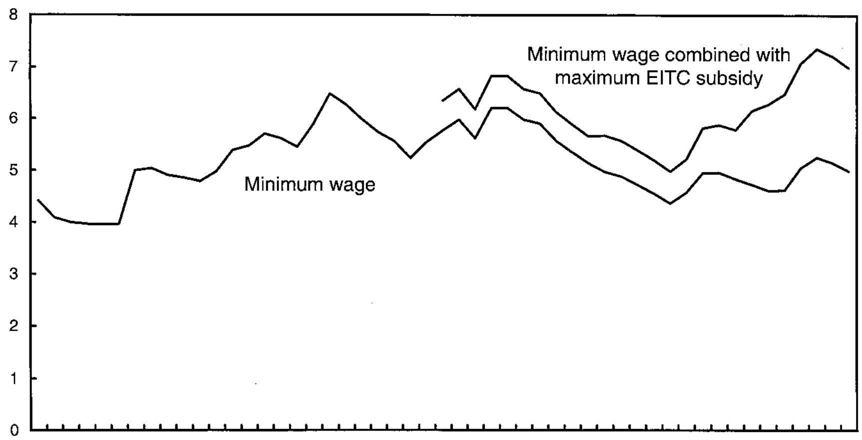
However, when the minimum wage is combined with a possible 40 percent subsidy from the EITC, the true minimum wage for workers with two or more children and earnings of less than $9,700 is $7.21 an hour (Chart 5-5). This hourly rate is higher in real terms than the peak minimum wage rates of the 1960s. Even so, an individual working full-time at the minimum wage would have a yearly income of just $14,188 (including the credit), well below the poverty line for a family of two adults and two children.

Child Care

For many parents, one of the most difficult barriers to employment is finding affordable, good-quality child care. For low-income families and new entrants to the labor market, the costs of child care may make working impossible. Recognizing these costs as a barrier to work, the Administration

When combined with the real maximum EITC subsidy, the real minimum wage is as high as it has ever been.

Chart 5-5 Real Minimum Wage Combined with the Real Maximum EITC Subsidy
Constant 1999 dollars



Note: Maximum EITC subsidy is that for a family with two or more eligible children. Real values are computed using the CPI-U-RS.
Sources: Department of Labor (Bureau of Labor Statistics) and U.S. Congress (Joint Committee on Taxation).

has worked to make child care more affordable for low-income families and to provide assistance with child care expenses to a greater number of families. Federal funding for child care has increased substantially, and the various existing child care programs have been combined to create the Child Care and Development Fund. This fund provides States with block grants for the purpose of subsidizing approved child care arrangements. States can transfer additional funds from their TANF block grants to help finance child care subsidies. In fiscal 1999, States spent a total of $5.2 billion in Federal dollars on child care, including both child care allocations and TANF block grant transfers. They also added $1.6 billion of their own funding. These resources benefited an average of 1.8 million children per month. Despite this investment, however, many States have waiting lists for benefits, and many families who qualify for the subsidies do not receive benefits. It is estimated that only 12 percent of eligible children were served by this program in fiscal 1999.

The Food Stamp Program

The food stamp program helps to ensure that low-income individuals receive adequate nutrition. Benefits are available to households with incomes up to 130 percent of the poverty line. In fiscal 1998 the vast majority of benefits (nearly 90 percent in dollar terms) went to households with children or elderly individuals. In 1999, 27 percent of participating households had earned income. Enrollment in the food stamp program has fallen dramatically since 1994, from a high of 27.5 million participants to 18.2 million in 1999, in part because of the strong economy. Of concern, however, is the fact that the participation rate for eligible families declined from 71 percent in September 1994 to 62 percent in September 1997. This decline is particularly marked for families with children. In 1999 only 51 percent of children in families with incomes below the poverty line received food stamps. Even among the very poorest children—those in families with incomes less than 50 percent of the poverty line—data indicate that only 58 percent received food stamps in 1999, down from 76 percent in 1993. (Not all poor families are eligible for food stamps. Limitations on the value of assets that an eligible family may hold may exclude some families.)

Several factors could be responsible for the decline in participation. Changes in the laws governing the program have excluded some immigrants and restricted the eligibility of able-bodied adults without dependents, decreasing the pool of potential participants. The strong economy and the growing number of people with jobs may have further reduced the number of eligible individuals. But these factors alone cannot explain all of the steep decline in participation rates, and it is likely that some eligible families are not receiving the benefits they need (and are entitled to receive). This is especially true of families just leaving the welfare rolls. Rules governing participation in the program are often a factor here. States require that wage-earning food stamp recipients have their incomes recertified at regular intervals, often every 3 months and even more frequently in some States. For low-wage earners without much time off, this requirement could well be a substantial deterrent to participation. A recent study underscored this concern, attributing a large portion of nonparticipation to the costs to recipients of regular recertification.

In response to these recent trends, the Administration has implemented a series of changes in the regulations governing the food stamp program. These changes substantially reduce the need for recertification for those leaving welfare and the newly employed and give States greater flexibility in processing applications. States will soon be able to receive bonus awards under the TANF program for increasing participation rates for low-income working households. In the future, $20 million will be allocated for these awards. Finally, the Administration has provided funding for educational and outreach campaigns aimed at improving nutrition for low-income families and the elderly.

Child Support

Child support payments from noncustodial parents are an important source of income for poor children. In 1997 child support lifted an estimated half a million children out of poverty. Child support is particularly important for families leaving welfare. Divorced or separated women who leave welfare and do not receive child support have a significantly greater chance of returning within 6 months than those receiving even small amounts of child support.

An important component of the Administration's policies to help working families is ensuring that single and divorced parents receive the child support payments they are entitled to under the law. Between fiscal 1992 and fiscal 1999 the dollar value of child support collections doubled, from $8 billion to $16 billion—an increase of more than two-thirds after adjusting for inflation. During the same period the number of child support cases involving collections increased from 2.6 million to 6.1 million.

However, much of the money collected never reaches the custodial parent. Many States reduce TANF benefits dollar for dollar when a noncustodial parent provides support, lowering the incentive for noncustodial parents to provide for their children. The President proposed legislative changes that would make it easier for States to pass along a portion of child support payments to custodial parents receiving assistance. This change would give parents an incentive to cooperate with the system. Some States, such as Wisconsin, are already experimenting with this type of policy, with some success. Results show that noncustodial parents are more willing to pay child support when they know that at least some of the money will go to benefit their child. Ultimately, widespread use of this policy should increase collections of child support payments.

Access to Health Insurance

Historically, individuals and families leaving the welfare rolls have lost their Medicaid coverage as they did so. During the 1980s a series of Medicaid expansions and the introduction of Transitional Medical Assistance began providing health insurance benefits to former welfare recipients and low-income families, easing the transition to work. Before the 1996 welfare reform a Federal mandate required that States offer Medicaid coverage to children and pregnant women in low-income families, regardless of whether they were already receiving welfare. This group included children under the age of 6 and pregnant women in families with incomes below 133 percent of the poverty line, and children between the ages of 6 and 19 in families with incomes below 100 percent of the poverty line. Many States opted for even broader coverage, setting higher income thresholds and covering children of all ages. Adults could obtain Medicaid for up to 12 months after leaving welfare under the Transitional Medical Assistance program or through State programs for the medically needy. The 1996 legislation expanded Medicaid coverage to low-income single-parent and some two-parent families, and to families leaving welfare. In 1997 the State Children's Health Insurance Program (SCHIP) was created to target children in low-income families. SCHIP is further discussed later in the chapter.

Looking to the Future

The success thus far in helping families leave welfare is tempered by the realization that many families still depend on public assistance. As the time limits for TANF begin to bind, the focus must be on how to help those who have been unable to secure employment. Furthermore, as already noted, some who have left the welfare rolls are no better off financially than they were while receiving benefits. Investments in job skills, a continued strong economy, and policies that ensure a living wage can all help these people succeed in the labor force. However, when the economy does begin to slow, policies must be in place to help those who lose their jobs. If former welfare recipients are among the last hired, they may be among the first laid off, and they run the risk of returning to public assistance. These challenges are not insurmountable, but they require the continued commitment of government and the private sector to reach workable solutions.

Reaching out to Underserved Communities

Providing opportunity and independence for American families sometimes requires more than a strong national economy and responsible welfare policy. Areas where poverty has become entrenched and the local economy is weak may need additional assistance. Some of the most intractable poverty is found in America's central cities and rural areas. Because these areas are home to large numbers of Americans—in 1999, 30 percent of the population lived in the central cities and 20 percent outside metropolitan areas—this situation is cause for great concern.

In 1967, when statistics for these areas were first recorded separately, the poverty rate for central cities was 15.0 percent, compared with a nationwide rate of 14.2 percent. In contrast, poverty in nonmetropolitan areas was over 20 percent. By this measure the central cities were nearly as well off as the rest of the country, but nonmetropolitan areas suffered from disproportionately high poverty. Between 1967 and the early 1990s, however, the incidence of poverty shifted: conditions in the central cities worsened, and nonmetropolitan areas saw a slight improvement. By 1993 the proportion of central-city residents living in poverty had reached an all-time high of 21.5 percent, and the poverty rate in nonmetropolitan areas had declined slightly, to 17.2 percent—well above the national poverty rate of 15.1 percent in both cases. Since 1993, however, the situation has improved dramatically, especially for central cities. In 1999 the poverty rate for central cities was 16.4 percent and that in nonmetropolitan areas stood at 14.3 percent. Yet these rates remain well above the national average of 11.8 percent.

The strong national economy and current policies to make work pay, discourage out-of-wedlock births, and improve schools in poor neighborhoods can be expected to provide some relief. But given the persistently high poverty rates in these locales, additional strategies may be required. To reach out to residents of these locales, the Administration has enacted a series of programs that directly target communities.

Central Cities

Central cities offer some advantages for low-income workers. Central-city residents likely have ready access to public transportation, and city governments often provide more generous support services than governments in other locales. But cities often have one key drawback: fewer job opportunities. Recent research shows that most job creation today is taking place in the suburbs. One study by the Department of Housing and Urban Development (HUD) found that, from 1992 to 1997, job growth was slower in the cities than in the suburbs and that the job mix in cities is increasingly shifting toward high-technology industries, which provide fewer opportunities for low-skilled workers.

Central-city residents also face other barriers to employment. Low-income workers are unlikely to own a car and must rely on public transportation. Yet a recent study found that nearly half of all low-skilled jobs in the suburbs are not accessible by public transportation. Compounding this situation is the fact that minorities still face discrimination in housing and employment markets. Studies have shown that minorities have difficulty renting and purchasing housing in the suburbs and are less likely to be hired by white-owned or suburban firms. The cost of housing in the suburbs may also make it difficult to move to homes near suburban jobs.

From a policy perspective, several approaches are available to address the mismatch between where low-skilled workers live and where they can find work. The first is to rebuild the economies of our central cities. The second involves seeking ways to overcome the transportation hurdles that commuters from the central city face. The third approach is to help low-income families obtain housing in areas where jobs are available. Providing training is yet another way to address this issue, improving workers' skills and thus their employability at a range of jobs. The Administration has pursued policies that incorporate all four approaches.

When this Administration took office, a number of programs already addressed underserved communities. The long-standing problems in these areas, however, clearly called for additional policy measures. The Administration developed a number of strategies for rebuilding the economies of America's central cities, including Empowerment Zones and Enterprise Communities. The Empowerment Zone/Enterprise Community initiative aims to assist communities by encouraging investment from private businesses through tax credits, wage credits, and improved access to credit markets. Since 1995 over $1 billion has gone to 78 designated urban areas under these initiatives, supplemented by over $10 billion leveraged through other public investment.

To help solve commuting problems, the Administration's Transportation Equity Act for the 21st Century established a new Job Access and Reverse Commute Program designed specifically to connect low-income persons to employment and support services. Similarly, the Bridges to Work program provides job placement, transportation, and job retention services in a select group of cities. In addition, the Administration has made owning a car easier for low-income families receiving food stamps, by giving States the flexibility to raise the limit on the value of a car counted as an asset for eligibility purposes. HUD programs also address transportation problems by subsidizing low-income families in both public and private sector housing. HUD's housing voucher and certificate programs help over 1.4 million families pay the rent for apartments in the private market. This portable form of assistance helps families locate near jobs.

Two Administration housing initiatives focus on improving employment outcomes for low-income families. The Moving to Opportunity demonstration program combines counseling with voucher assistance to help families move from high-poverty public housing projects to private housing in low-poverty areas. The Welfare-to-Work voucher program provides housing subsidies and services to families eligible for or recently leaving TANF to help adults in the family obtain and keep jobs. Preliminary evidence from a Moving to Opportunity program in Baltimore suggests that the program also helps children by improving their educational outcomes.

Rural Communities

Like the central cities, many of America's rural communities face high rates of poverty and unemployment. But these communities also face a number of unique problems. First, they tend to have smaller, less diversified economies than do the central cities and thus can be severely affected by the closing of only one or two industrial plants. Second, many rural communities are geographically isolated from major markets, making it hard for residents to find jobs and for businesses to reach their customers. Third, rural communities often offer little in the way of public transportation, so that commuting problems are likely to be more acute than in urban areas. Although recent advances in telecommunications promise to reduce some of this disadvantage, rural communities also lag behind urban communities in access to this technology. Finally, rural governments often lack the economies of scale needed to make investments in public services economical.

A variety of agencies and programs exist to help these communities. Technical assistance, grants, and loans offered through the Rural Utilities Service provide assistance with basic infrastructure needs such as electricity, telecommunications, and water and waste facilities. The Rural Housing Service helps rural communities build and renovate community facilities and housing. Its programs provide housing assistance to families with moderate and low incomes; it also helps communities develop and improve facilities such as fire stations, libraries, and hospitals.

The Rural Business-Cooperative Service cultivates partnerships between the private sector and community-based organizations. It also provides technical assistance and funding for projects that generate employment. Rural businesses also get a boost from the Empowerment Zone/Enterprise Community initiative, as many of the areas these programs target are in rural communities. Finally, the Telecommunications Act of 1996 is addressing the digital divide by providing funds to help schools and libraries and rural medical facilities in low-income communities develop modern communications infrastructure.

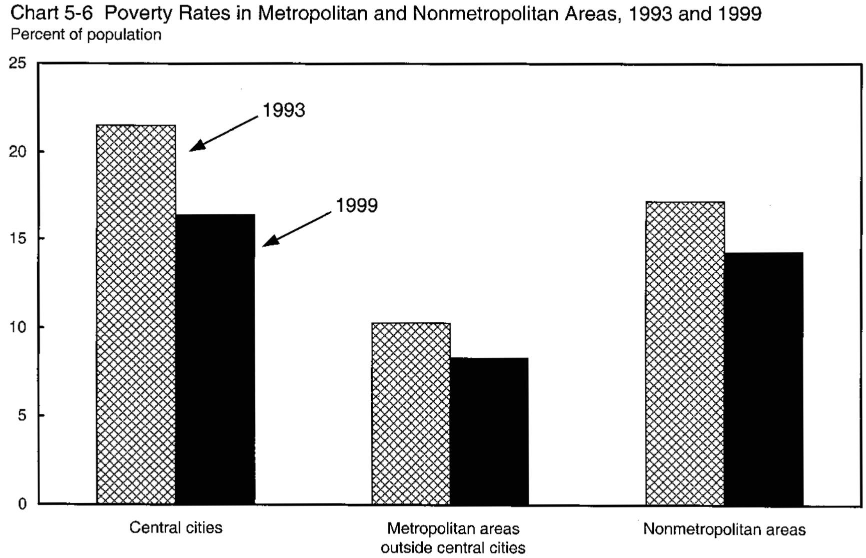
At the regional level the Administration has supported several initiatives addressing the problems of rural development, including a Task Force on the Economic Development of the Southwest Border, the Mississippi Delta regional initiative, and the Denali Commission in Alaska. These initiatives coordinate Federal, State, and local development assistance to areas with historically high poverty rates and limited employment opportunities.

Results

These programs, coupled with the strong national economy and policies aimed at making work pay, have led to substantial improvements in the quality of life for those living in central cities and rural areas. The unemployment rate in the Nation's central cities fell from 8.2 percent in 1993 to 5.3 percent in 1999, while unemployment in rural areas declined from 5.9 percent to 3.7 percent. Increased employment has meant reductions in poverty and increases in median incomes (Chart 5-6). As noted, the poverty rates in both central cities and nonmetropolitan areas fell significantly between 1993 and 1999, with the largest drop in central-city rates (2.1 percentage points) occurring in the last year. This change was so large and affected so many people that it accounted for 80 percent of the total reduction in poverty from 1998 to 1999. The median household income in the central city has also increased, rising 5 percent in real terms from 1998 to 1999—more than double the 2.1 percent increase in the median income in metropolitan areas as a whole. The gains in income for African Americans were particularly striking. After adjusting for inflation, the median income for African-American households in central cities increased by 13.9 percent between 1998 and 1999. These economic gains have been accompanied by a decline in the number of people on welfare. Caseloads in the largest central-city areas declined by 40.6 percent between 1994 and 1999. Increases in the median household income in rural areas were less dramatic than those in the cities, rising just 0.9 percent in real terms between 1998 and 1999.

Poverty rates declined from 1993 to 1999 in both metropolitan and nonmetropolitan areas, but especially in central cities.

Chart 5-6 Poverty Rates in Metropolitan and Nonmetropolitan Areas, 1993 and 1999



Source: Department of Commerce (Bureau of the Census).

Despite these clear improvements in the well-being of our poorest communities, much remains to be done. Poverty rates and unemployment are still too high. It is too soon to judge the effectiveness of the Administration's community-based policies, but reaching out to these communities demonstrates a willingness to seek creative solutions to some of the Nation's most pressing problems.

Education in the New Economy

What students learn in school is crucial in determining their future options and, more broadly, in enhancing the productivity of the Nation. Thus it is imperative that all children be given adequate opportunities to learn. To this end the United States has invested in a quality public education system. Unfortunately, not all communities can afford to invest equally in the education of their children, and the Federal Government has worked to reduce this inequality. And by promoting educational innovations such as more challenging curricula and the increased use of technology in the classroom, the Federal Government is working to improve the quality of schooling for all children.

Investments in human capital play an important role in the New Economy. Last year's *Report* focused on the demand for educated workers and on postsecondary education and training. This year's *Report* examines America's public elementary and secondary schools—institutions that are also important to the development of our future work force. Although many factors go into producing a quality education, and parents, families, and communities surely rank among the most important, the discussion here focuses on the components of the education system more directly under the control of Federal, State, and local governments. This discussion highlights the effects of class size, teacher quality, and school infrastructure and equipment. Strengthening these inputs to the education process is key to improving educational outcomes.

A Role for Federal Education Policy

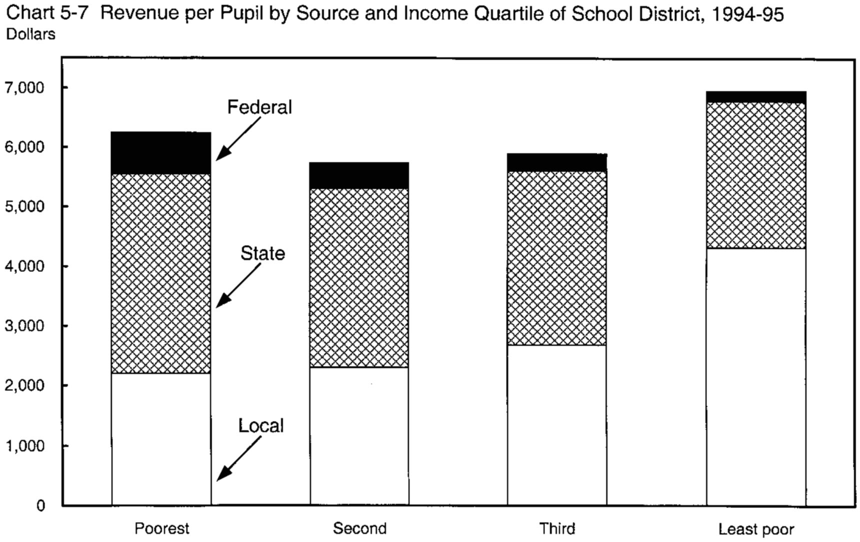
To prepare America's young people to join the New Economy, innovations must be sought in the provision of education that will increase its quality for all. These innovations include a committed effort to reduce class size, investments in teachers, higher standards for schools, the widespread adoption of computer technologies in the classroom, and new charter schools that provide parents with a choice in their children's education but retain public accountability.

The Federal Government has long sought to improve access to education for the Nation's poorest children and to help States ensure that their public schools are of high quality. Federal funds are used primarily to help implement needed reforms, expand new programs, provide access to new technology, and pay part of the cost of education for students with disabilities. Many Federal education programs are targeted to schools and school districts serving students from lower income families. By directing funds to these important areas, the Federal investment in schooling can have an impact greater than the expenditure itself would suggest.

In the United States, primary responsibility for elementary and secondary education rests with the States and with local school districts. Excluding school-based health and nutrition programs, the Federal Government provides just a little more than 6 percent of all funding for kindergarten, elementary, and secondary education. However, this figure belies the disproportionately large impact that Federal dollars can have on schools. Federal spending in the poorest schools reduces inequalities across school districts but does not fully compensate for the overall pattern of funding disparities created by differences in local property tax bases and State funding levels (Chart 5-7). A study of 1994–95 data found that the Federal Government spent more than four times as much per student in the poorest quartile of school districts as in the wealthiest quartile, but that the wealthiest school districts still had the highest level of expenditure per student.

Poorer school districts rely more on Federal support than do wealthier districts.

Chart 5-7 Revenue per Pupil by Source and Income Quartile of School District, 1994-95



Note: School district revenues are for the 1994-95 school year; income quartiles are based on school district poverty rates from the 1990 Census.
Source: Department of Education.

The largest Federal education program for kindergarten through 12th grade (K-12) is Title I of the Elementary and Secondary Education Act, which provides funds to schools based on the number of poor children and the child poverty rate in the local area. Since passage of this legislation in 1965, these funds have been targeted to schools serving the poorest children. The ability to target funding to the most needy schools improved significantly after 1994, when the distribution of funding began to be based on newly available biennial data from the U.S. Bureau of the Census on child poverty in smaller geographic areas (such as counties). In the 1997–98 academic year, 96 percent of those schools with the highest poverty levels received Title I funds, up from 79 percent in 1993–94. In 1997–98 the highest-poverty quartile of school districts received 43 percent of all Federal funds for K-12 education and 50 percent of Title I funds—amounts that reflect the share of the Nation's poor children in these districts (49 percent). At the same time, these school districts received less than a quarter of all State and local funds. Clearly, Federal funds in general and Title I funds in particular are a critical resource for improving equality in education.

Reducing Class Size

For decades the merits of various educational spending programs, including those aimed at reducing class size, have been the subject of much debate. Are they in fact effective in improving student achievement? Mounting evidence is showing that smaller classes are beneficial, especially for disadvantaged students and those in the early grades.

The most compelling evidence comes from the Project STAR (Student-Teacher Achievement Ratio) experiment in Tennessee in the late 1980s. To determine to what extent smaller classes improve academic outcomes, Tennessee authorized and financed an experiment that randomly assigned students and teachers in kindergarten through third grade to classes with a standard number of students (22–25) or to smaller classes (13–17 students). The results showed better performance for children in the smaller classes: these children did better on standardized tests of reading and math than students in larger classes.

A follow-up study showed that the students enrolled in smaller classes in the early grades continued to do better on standardized tests in middle school than other students. These students were also more likely to take college-entrance exams in high school. The results were especially strong for minority students. For example, white students in general are more likely to take a college-entrance exam than African-American students. But when the probabilities were calculated for white and African-American students who had been placed in small classes in elementary school, this difference narrowed substantially. Some 46 percent of white students and 40 percent of

African-American students who had been in small classes took a college-entrance exam; the corresponding figures for students in standard-size classes were 45 percent and 32 percent, respectively.

The quality of the Tennessee experiment's design and the outcomes it generated persuaded many scholars that reductions in class size can improve educational outcomes for children. Teachers in smaller classes can spend more time on individual instruction and review, and less on student discipline and routine administrative tasks, than teachers in larger classes. Teachers of small classes are also more likely to get to know their students, interact with them frequently on a one-to-one basis, and provide frequent, in-depth feedback. Results are now emerging from programs in other States that reinforce the conclusions of the Tennessee study.

In 1998 the Administration proposed a 7-year initiative to reduce class sizes in grades 1–3. Its goal is an average of 18 students per class nationwide. In its first 2 years the program enabled school districts to hire an estimated 29,000 new teachers, reducing class size for 1.7 million children. Smaller classes are expensive, however. One study estimates that reducing class size in grades 1–3 nationwide to an average of 18 students would cost $5 billion per year. Despite the expense, the expected gains in students' future earnings appear to be large enough to make the investment worthwhile.

The Importance of Teachers

The quality of teachers may play an even more important role than class size in improving student outcomes. Parents, students, and professional educators agree that teacher effectiveness is an important factor in student achievement, and several recent studies find that differences among teachers have significant effects. Further, these analyses show that some measurable characteristics, such as holding a master's degree, are not necessarily indicative of a teacher's ability to enhance student performance. And although a teacher's effectiveness seems to increase with experience in the first years of teaching, these gains to seniority are not significant beyond 3 to 5 years. These results suggest that much of the difference in teachers' effectiveness stems from variations in attributes that are hard to measure, such as talent and motivation.

Many schools are finding it difficult to attract and retain highly effective teachers. Some of this difficulty likely stems from the existing pay scales in public schools. In the last several decades, teachers' salaries have fallen relative to those in other occupations. A large majority of public school teachers are women, and for women in particular the rewards of teaching have shrunk by comparison with other opportunities. In 1940 fewer than 32 percent of women with a college degree earned more than the average female teacher. By 1990 this fraction had risen to 55 percent. This trend continued throughout the 1990s, with starting salaries in most occupations increasing at a much faster rate than starting salaries in the teaching profession. One study found that from 1994 to 1998 the average salary for persons with a master's degree in nonteaching fields increased by 32 percent in real terms, while the real increase in the average salary for teachers was less than 1 percent. Other factors that affect job quality for teachers, such as crowded classrooms, unsafe schools, and limited opportunities for professional development and advancement, also affect schools' ability to attract and retain teachers.

The challenge of attracting and retaining effective teachers in sufficient numbers will become particularly acute in coming years. Between July 2000 and July 2008, the number of children aged 5–17 will rise by nearly 1 million, significantly increasing the need for teachers nationwide. Yet in this same period about 750,000 teachers are expected to retire, and many others are likely to leave the field to pursue other occupations. Given these statistics, the United States will need an estimated 2 million new teachers in the next 8 years. The demand for teachers will be further heightened by mandates to reduce class size. Meeting the target of 18 students per class in grades 1–3 will require staffing an estimated 100,000 additional classrooms.

These increases in the demand for teachers will make it increasingly difficult to maintain consistently high teacher quality in all classrooms. The magnitude of the challenge is already becoming clear. In 1996 California began a massive program designed to reduce class size in the early grades (K–3). Expenditures for the program, which seeks a statewide class size reduction from an average of 28 students to a maximum of 20, are running $1.5 billion per year. The State has been largely successful in achieving its goal: by the 1998–99 school year, more than 92 percent of California's students in the targeted grades were in classes of 20 or fewer students. But the share of fully credentialed teachers instructing these classes fell from 98 percent in the 1995–96 school year to 87 percent in 1998–99. This decline indicates that the demand for well-trained teachers is outstripping the supply and that continued increases in this demand will likely make it more difficult for schools to find qualified instructors. Ultimately, the benefits of nationwide reductions in class size will depend on the ability to attract and retain greater numbers of talented teachers (Box 5-2).

This Administration has supported investments in teachers. Its Class Size Reduction Initiative requires that teachers hired with Federal funds available under the program be fully certified. The initiative allows school districts to spend up to 25 percent of their allocated funds on professional development and testing for new teachers. Districts that have met the appropriate goals for

Box 5-2. Rewarding Effective Teachers

Traditionally, teacher salaries have been based on education levels, experience, and responsibilities, leaving school systems little room to reward the most effective teachers. Recently some schools and school districts have experimented with alternative, performance-based pay systems. These new methods may help improve the quality of instruction in several ways. First, by establishing specific criteria for evaluation, performance-based awards can help clarify and prioritize goals, thus providing better guidance for teachers. The awards may also provide teachers with additional motivation to work to achieve these goals. Tying teacher compensation to performance may also help attract talented people to the teaching profession and retain them, if they know that their hard work and skills will be rewarded. But although performance-based pay systems may offer new ways to reward exemplary teachers, they should not substitute for appropriate baseline salaries.

To be effective, performance-based pay systems must be carefully designed. Because student achievement depends on many factors that teachers cannot control, such as family circumstances and previous education, fair, performance-based systems should reward teachers for gains in student achievement rather than for absolute levels of performance. Furthermore, because student learning involves cooperative effort, incentives must be designed to create a cooperative, not a competitive, environment for teachers. For example, team-spiritedness might be enhanced by basing a portion of the awards on schoolwide rather than class-by-class achievement. Finally, the standards used to assess performance must be carefully constructed. If student outcomes are to be the basis of a performance-based pay system, measures such as gains in student test scores, increases in attendance, and increases in graduation rates should be considered—and they have been in a few schools.

The design of these school-based performance awards systems varies widely. In some cases the awards are given directly to individual teachers; in others the rewards benefit all teachers in a school equally. In the Charlotte-Mecklenburg school district in North Carolina, for example, awards were based on a broad array of student outcomes including subject mastery, dropout rates, and absenteeism. Schools received points for meeting annual improvement goals, and teachers in these schools benefited directly: in the highest-performing schools (classified as "exemplary"), each teacher received $1,000. Teachers in "outstanding" schools (those with slightly lower gains) received $750. In contrast to this equal division of awards, the program implemented at the Vaughn charter school in Los Angeles offers awards that vary

continued on next page...

Box 5-2.—*continued*

substantially from teacher to teacher. Teachers at Vaughn are provided the opportunity to receive cash bonuses in each semester for effective performance in a number of areas, including the teaching of specific academic subjects and more general skills such as classroom management and lesson planning. Performance is assessed through self-evaluations, peer review, and reviews by administrators. For a veteran teacher, performance-related awards can total up to $13,100 per year.

A nationwide program that can also provide incentives to teachers beyond the traditional pay scales has been developed by the National Board for Professional Teaching Standards. The board has established distinct programs of national board certification, which have drawn the support of policymakers and educators alike. Many States and local school districts are providing incentives to teachers to complete this certification process. To become certified, teachers must compile an extensive portfolio of their work, including classroom videotaping, and take a full-day exam. Once certified, teachers are encouraged to act as mentors to new teachers and to support colleagues seeking such certification.

Studies of their effects on teachers have found that many award systems that are based on schools' performance help improve cooperation among teachers, but that these programs vary in their effectiveness in increasing teacher motivation. Teachers in many programs also reported that they feel increased pressure at work and work longer hours. Systems that reward individual teachers also have positive aspects. The system at Vaughn has helped attract new recruits, and many current teachers were pleased with the program. However, some problems were also encountered. One teacher complained that the peer review process, which result in differing amounts being paid to teachers, "pits teacher against teacher." These difficulties indicate that additional research and experimentation might be useful in arriving at the best compensation strategies.

reducing class size in the early grades have the option of using their entire allocation for activities to improve teacher quality. The Teacher Quality Enhancement Grant program helps States improve the quality of teaching. To date it has helped prepare about 20,000 new teachers for high-need school districts, and it will help prepare many thousands more in coming years. Funding for another Federal professional development program—the largest in the budget (and currently called the Eisenhower Professional Development Program)—increased from $275 million in 1993 to $335 million in fiscal 2000.

The Need for Modern Schools

The physical condition of classrooms may also affect the quality of the educational experience and, in the most severe cases, the safety of students. Communities across the country are struggling to address the problems of aging schools. In 1999 the average public school was 40 years old, and schools in largely poor or minority districts were even older. Many of these aging buildings have outdated electrical systems that must be upgraded for computers, and asbestos in the walls of some schools increases the cost of such upgrades. Some buildings need to be renovated extensively to accommodate disabled students. Many schools will need more classrooms as enrollments increase and average class size is reduced, putting additional pressure on aging facilities.

The National Center for Education Statistics estimates that getting America's schools into good physical condition will require an investment of $127 billion. Some 39 percent of our public schools already have temporary additions, about one-fifth of which are in less than adequate condition. Schools with a relatively high proportion of poor and minority students are more likely than other public schools to have temporary buildings, and thus will have the most difficulty housing additional classes.

New Educational Technology and Internet Access

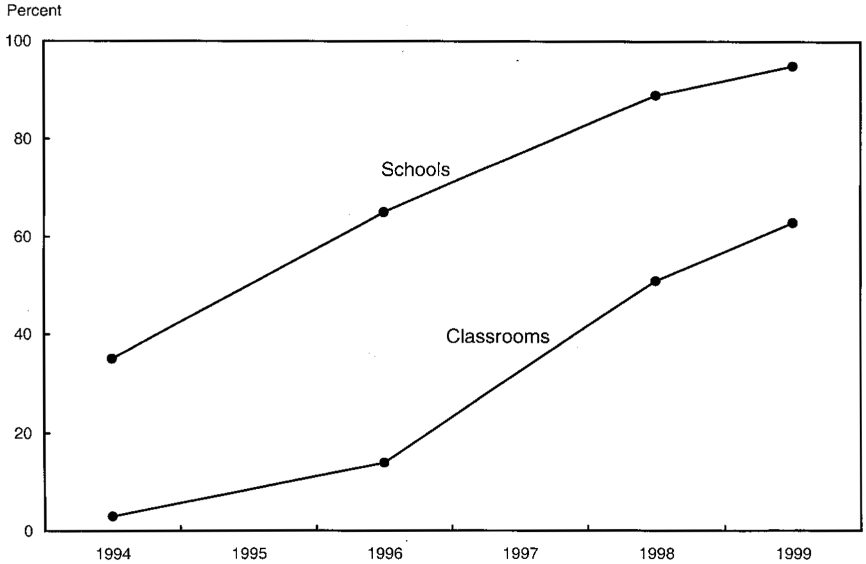
Today's workers are increasingly required to be computer literate. Schools must be able to teach students the skills they will need to work with computers and other new technologies. In addition, Internet access is becoming an important classroom resource, helping students learn by connecting them to libraries, museums, and educational materials around the world. Internet access has become increasingly widespread in American classrooms over the past 8 years, and Federal programs, especially the E-rate program discussed below, have played a large role. The E-rate program provides up to $2.25 billion per year to schools and libraries to offset the cost of telecommunications services, Internet access, and internal connections.

Tremendous strides have been made in connecting public schools to the Internet (Chart 5-8). With the help of the E-rate program, the number of public schools with Internet access nearly tripled between 1994 and 1999, and by 1999 some 95 percent of all public schools were on line. Increases in Internet connectivity within classrooms were even more dramatic. In 1994 only 3 percent of public school classrooms had Internet hookups; by 1999 that figure had risen to 63 percent.

The Federal Government has helped local school districts make the transition to the digital age, committing $5.7 billion over the last 3 years through its E-rate program to connect school and library computers to each other and

Access to the Internet in schools grew dramatically in the 1990s.

Chart 5-8 Share of U.S. Public Schools with Internet Access



Source: Department of Education (National Center for Education Statistics).

to the Internet (Box 5-3). These funds have targeted schools with a high proportion of low-income students. Schools where 75 percent or more of students are eligible for free school lunches receive approximately 10 times as much funding per student from the program as schools with the smallest percentage of such students.

Other Federal programs have also helped schools purchase new educational technology. In addition to the E-rate program, in fiscal 2000 the Federal Government spent $766 million on education technology programs through Title III of the Elementary and Secondary Education Act. Some $425 million of this was provided through the Technology Literacy Challenge Fund. Schools also used portions of their Title I funding to invest in technology. A large share of these funds was used to purchase computers and train staffing using new technology. During the 1997–98 school year, Federal funds paid for one-fourth of all new computers in schools (Chart 5-9). Federal funds were especially important in helping elementary schools with large numbers of low-income students acquire technology, accounting for nearly 60 percent of new computers in these schools.

For computers to improve the quality of instruction, teachers must know how to use them and how to integrate them into the classroom. A recent study found that only 53 percent of all public school teachers with computers or Internet access used these resources for classroom instruction. Teachers

Box 5-3. Reducing the Digital Divide

Since 1993, computer use in America has grown at an enormous rate, revolutionizing the way Americans communicate, work, and do business. Access to a computer—and knowing how to use it—are increasingly important for success in today's society. Currently more than half of all U.S. households have computers, and more than two-fifths have Internet access at home. But computer use varies greatly with income and education. People in households earning more than $75,000 per year are almost four times as likely to use the Internet as those in households earning less than $15,000 per year. Adults with college degrees are more than eight times as likely to use the Internet as adults who have not completed high school. Race is also a factor. African Americans and Hispanics are substantially less likely than white and Asian Americans to use the Internet. A recent study finds that income and education explain only around half of this difference. Individuals from disadvantaged groups that already face obstacles in the workplace are at risk of falling even further behind if they lack computer know-how.

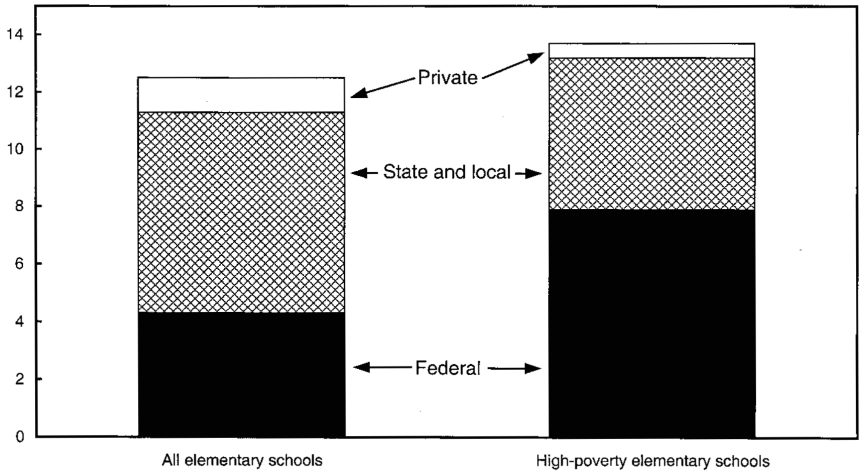
There is encouraging news, however. Notable changes are occurring among school-age children, suggesting that the widespread availability of computers in the classroom is playing a role. Across all income and demographic groups, Internet usage among children aged 9–17 is higher than the national average. And over the last few years Internet usage has grown faster among African-American and Hispanic children than among white children, and faster among children in households earning less than $35,000 per year than among children from wealthier households.

who have received more professional development in using computers and the Internet, and teachers in schools with relatively few low-income students, were the most likely to report using computers and the Internet. Newer teachers were also more likely to use computers "a lot" to create instructional materials.

Despite the growth in the number of classrooms with computers, only one-third of teachers with access to computers and the Internet said that they felt well or very well prepared to use them. These results clearly show that more investment in teacher preparation is needed. The Federal Government has addressed this issue through its Preparing Tomorrow's Teachers to Use Technology grant program. This program supports 352 partnerships among colleges, educational agencies, and nonprofit organizations, providing training for teachers in integrating technology into the classroom.

In 1997-98, high-poverty elementary schools obtained more computers through Federal funds than did other schools.

Chart 5-9 Sources of New Computers Received by Elementary Schools in 1997-98
Number of computers per 500 students



Note: High-poverty schools are defined as those with at least 75 percent of students eligible for free or reduced-price lunches.
Source: Department of Education.

Standards and Accountability

Over the last decade, changes have taken place in America's public schools that go far beyond increasing the investments just described. Among the most important changes are new ways of improving accountability for educational outcomes.

Initiatives that establish clear performance outcomes and systematically test student progress aim to help teachers and students focus their efforts on those areas needing the most work. Spurred in part by legislation passed in 1994 (the Improving America's Schools Act and the Goals 2000: Educate America Act), State after State has implemented standards for what students need to learn. As of October 2000, 48 States and the District of Columbia had adopted such standards; the majority of States adopting standards have done so since 1994.

The establishment of these standards has been followed by an increase in standards-based assessment. Forty-eight States and the District of Columbia now administer tests to assess student performance relative to these standards in reading and math, and many States do so for science and social studies as well. Thirty-six States currently publish some form of report card for each school, measuring school performance against a number of indicators, including student assessment test scores.

Both the standards themselves and the assessments based on them have been controversial. Many argue that classroom instruction is now geared toward preparing students for the exams—that teachers are, in effect, "teaching to the test." However, when implemented correctly, such assessments can help improve the quality of the educational experience—and educational outcomes—in several ways. First, tests that are challenging and well constructed can help raise the expectations of students, teachers, and parents. These expectations can motivate all parties to improve their performance. Second, by clearly outlining the material to be covered and the degree of mastery required, these measures of accountability may help teachers focus on what are generally agreed to be the most important topics. Finally, these tests provide parents, teachers, and students with information that highlights those areas in which students are less than fully prepared.

The Federal Government has played an important role in the standards movement. Since 1994 it has devoted more than $2.6 billion to helping agencies in every State implement school reforms through the Goals 2000 Act. Even before that legislation was passed, the government supported the development of voluntary national standards that States could use as a basis for their own standards. In addition, the Improving America's Schools Act tightened Title I accountability at the school and the district levels by requiring States to hold students in Title I schools to the same challenging standards as other students and to assess all students in Title I schools against these standards.

The Federal Government has also increased its efforts to track student progress, undertaking evaluations that help in assessing State-level reforms. In recent years the National Assessment of Educational Progress has been expanded to track student performance in each State. Thanks to these assessments a valuable set of baseline indicators now exists for measuring student progress that can help researchers and education professionals evaluate the effectiveness of new policies (Box 5-4). The Individuals with Disabilities Education Act Amendments of 1997 further require that children with disabilities be included in State- and district-level assessment programs, so that the performance of these children will be measured as well.

Increasing Public School Choice

A persistent thread during the last decade of educational change has been the call for parental choice in their children's education. Allowing parents to choose among different public school models would likely benefit students by allowing them to choose the method of instruction that offers the best fit for their child's learning skills and interests. In responding to parental demand, educators would offer the most effective educational models and innovations.

Many States have responded to the demand for choice by allowing parents, teachers, and other interested parties to establish independent public schools

Box 5-4. Ensuring That Gains Are Maintained

Effective teachers, adequate facilities, and well-constructed standards can help students learn more. However, these investments are of little value unless students retain what they have learned. Numerous studies have demonstrated that knowledge and skills deteriorate while children are away from school, especially during summer vacations. Drawing their conclusions from an analysis of many previous studies, one group of researchers found that children lost an average of a month's worth of learning over summer break.

Much of the Federal Government's role in education policy has been aimed at helping children in low-income families receive a quality education, thus mitigating the effect of family income on schooling outcomes. When children are not in school, it appears that family characteristics play an important role in determining learning. Many studies have noted that the deterioration of skills associated with summer vacation was greatest for children in low-income families. These differences appear to be particularly large for reading: students from middle-class families experienced a small gain in test scores over the summer, whereas students from low-income families fell behind. The result was a gap between the two groups in reading skills equal to approximately 3 months of schooling.

These differences suggest that public schools can do even more to help children from low-income families succeed. One possibility is to lengthen the school year. If students attended school year-round, there would be less opportunity for skills to deteriorate. Alternatively, summer enrichment programs targeting low-income communities can help poor children overcome some of the disadvantages they face at home and in their neighborhoods. In addition to changes in the school calendar, communities can offer after-school enrichment programs.

Both after-school and summer learning programs can also be a boon for working parents, particularly for lower income parents who may have difficulty arranging alternative care for their children. Not only can such programs assure parents that their children are in a safe, enriching environment, but they can also allow working parents to invest in their jobs and gain important labor market skills that can further benefit their children through increases in family income and exits from welfare.

The Administration has worked to assist local communities develop after-school activities through its 21st Century Community Learning Centers Program. This program has funded more than 3,600 after-school and summer programs. Preliminary evaluations indicate that these programs have had beneficial impacts on the academic and social behaviors of participating children.

chartered by State or local education agencies. These charter schools are given autonomy over their operations and are exempted from certain State and local regulations (although not from standards-based assessment) in exchange for strict public accountability and results. Charter schools have great potential as laboratories of educational innovation, allowing individual schools to explore a variety of educational methods while remaining publicly accountable.

The Administration has strongly supported the development of charter schools, having overseen the creation of the Public Charter Schools Program in 1994 and passage of the Charter School Expansion Act in 1998. In 1991 Minnesota became the first State to allow charter schools, and by the end of 1999, 36 States and the District of Columbia had made provisions allowing for such schools. At the beginning of the 2000–01 school year, 2,069 charter schools were operating nationwide, up from just 34 at the start of the 1993–94 school year.

Helping Students Make the Transition from Secondary School to College

Federal programs are also helping students make the transition from secondary school to college or work. The Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) bring middle schools with a high proportion of poor students together with local colleges and universities. These partnerships helped prepare more than 250,000 students for college in fiscal 2000. The programs provide entire classes of students and their families with academic enrichment programs as well as information about choosing a college, applying for financial aid, and preparing for college entry; in some cases they will also provide college scholarships. The TRIO programs such as Upward Bound currently serve 730,000 low-income, first-generation college and disabled students, helping them prepare for and succeed in college. And after 6 years of receiving seed money from the Federal Government, all States have instituted local school-to-work programs to benefit secondary school students as they prepare for their working lives.

Over the past 8 years, Federal assistance to Americans investing in their college education has also increased. Direct Pell grants have risen from a maximum of $2,300 per student per year to $3,300. The HOPE Scholarship and Lifetime Learning tax credits have also reduced the cost of education for American families. Fees and interest rates on student loans have been reduced, and restructuring the Federal student loan program has saved billions in taxpayer dollars.

Innovation and Access in Health Care

The American health care system today reflects the successes and the promise of the New Economy. Americans are healthier now than they were just 10 years ago. Between 1990 and 1998 life expectancy at birth rose approximately 1.3 years, and life expectancy at age 65 rose more than half a year. The rate of chronic disability among the elderly declined by 14.5 percent between 1982 and 1994. Medical innovations are in part responsible for these improvements, as are factors such as improved nutrition and exercise. Yet health care continues to present challenges that demand an ongoing role for the government.

A stream of technological innovations has raised the quality of care and improved health outcomes. Innovative diagnostic tools and new treatments have improved the medical system's ability to treat many diseases and conditions. These innovations enable medical professionals to identify health problems more accurately and to offer treatments that are less invasive and promise better outcomes. One good example is the use of drug therapy to treat some conditions that formerly required surgery.

These improvements in treatment are expensive, however, and overall health care costs have risen as people demand more and better care. The upward pressures on expenditures are exacerbated by traditional fee-for-service insurance, which offers weak incentives for patients or providers to limit their health care consumption. Managed care has evolved as an organizational innovation to control rising health care expenditures. It attempts to create incentives for both patients and providers to make efficient health care consumption choices—to utilize treatments, especially costly technological innovations, only when they are medically appropriate.

However, health insurance coverage remains a problem. Around 42.6 million Americans have no health insurance coverage, often because they cannot afford it. Thus the government has a continuing role to play in providing health insurance to those in need of assistance. The Administration recognizes the importance of health insurance and has worked to extend coverage to those most in need of it. The State Children's Health Insurance Program, for instance, has extended health insurance to an estimated 2.5 million children nationwide.

Technological Innovations

Dramatic innovations in medical care, often driven by computer technology or research in fields such as biotechnology, have led to more accurate diagnostic techniques, better surgical procedures, and treatments for previously untreatable conditions. Evidence indicates that technological innovations have been beneficial as a whole. One study found that the lifetime value of improved health (including longer life) attributable to improved medical care outweighed the significant costs. Nevertheless, examples of innovations are particularly revealing, because aggregate studies are unable to fully measure the impact of these innovations.

For example, by providing very high resolution anatomical and pathological images, magnetic resonance imaging (MRI) enables much more precise diagnosis of a number of diseases and conditions than traditional computed tomography (CT) scanning. In the 1990s MRI technology and computers were further combined to create "open MRI" systems, which can be used to provide continuous pictures to guide surgeons during brain operations. Modern techniques for abdominal aneurysms illustrate how surgical procedures have improved. The development in the 1990s of endovascular surgery, a minimally invasive procedure that uses intraluminal stents (scaffolding-like wire-mesh devices used to prop open artery walls), has led to remarkable improvements over open surgery to repair abdominal aneurysms. Experts reporting on the results of clinical trials have testified that endovascular surgery reduces operating procedure time by 20 percent, reduces blood loss by two-thirds, halves the number of patients requiring a transfusion, and reduces intensive care unit time from 3.5 days to less than 1 day and the hospital length of stay from 9.3 days to 3.4 days. Mortality is comparable to that from open surgery, but endovascular surgery produces only half the number of severe treatment-related adverse effects.

In addition, innovative techniques and treatments now allow physicians to treat some previously untreatable conditions, such as Alzheimer's disease, which affects some 4 million Americans. A new drug therapy that enhances cognitive function and delays the progress of the disease was introduced in 1993, the result of advances in neurobiological research. New drug treatments for other conditions have also come on the market. Facilitated by the streamlining of the drug approval process in 1997, the number of new drugs approved by the Food and Drug Administration that are significant improvements over existing drugs grew from an average of 12.5 per year in 1990–93 and 13.3 in 1994–96 to 14.7 in 1997–99.

Innovations that produce better care can save money by reducing the number of medical inputs required to produce the same or a better health outcome. The development of minimally invasive laparoscopic surgery, made possible by advanced digital technology, has reduced the costs of abdominal surgery. Laparoscopy has reduced the postoperative hospital stay for gall bladder surgery by up to 6 days, and the time patients need to take off work by a month, reducing overall costs. Drug therapies can prevent peptic ulcers or substitute for expensive abdominal surgery for severe ulcers, and new psychotropic drugs may keep many people who suffer from depression out of the hospital and reduce or eliminate the need for extensive psychotherapy.

However, many innovations actually raise the cost of health care because they require more medical staff time and more expensive equipment than traditional treatments in order to produce better outcomes. MRI scans, for example, are extremely expensive, as are certain types of highly innovative brain surgery. Intensive cardiac interventions are being offered with increasing frequency. Among Medicare patients, the use of coronary bypass surgery tripled between 1984 and 1991. Catheterization procedures quadrupled, and angioplasty use rose 15-fold. As a result, the cost of treating a heart attack rose 36 percent faster than inflation between 1984 and 1991. But life expectancy after a heart attack rose by 8 months during the same period. Overall, innovations in acute interventions accounted for about 55 percent of the decline in mortality from heart attacks between 1975 and 1995.

Both interventions that lower costs and interventions that increase them can contribute to higher total expenditure. Cost-saving innovations may lower the cost per patient of treating a condition, but if more people then use them, or use them more often, total costs are likely to increase. Innovations that raise per-patient costs unambiguously raise the total cost of health care, even if the number of treatments does not rise. More frequent use of these expensive new procedures raises costs even further. Treatments for previously untreatable conditions also raise overall health care expenditure.

Organizational Innovations to Control Health Care Costs

Medical innovations have been the primary reason for the rapid growth in health care expenditure in the last two decades, accounting for more than half of the long-term increase. These technological innovations have exacerbated the dilemma of providing high-quality care while holding costs at a reasonable level. To balance these conflicting goals, health care decision-makers must meet two challenges: they must determine when improved outcomes justify the additional expense, and they must structure the health care system so that it uses medical technology in the most cost-effective way.

Because health insurers pay for most health care, the incentives embedded in the health insurance system strongly influence the efficiency of the entire health care system. Before the 1990s the predominant health insurance arrangement was that known as fee-for-service. Under this system patients face low copayments, and providers are reimbursed on a cost-based method after each medical encounter. The system provides those who determine a course of medical treatment with great flexibility and satisfies health care consumers' desire to obtain the highest-quality care available (including expensive technologies). From a physician's point of view, fee-for-service plans are desirable because they take into account the complex nature of medical needs and the variety of appropriate responses available. However, because reimbursements are based strictly on utilization, patients and medical personnel using these plans have few direct incentives to use the most cost-effective technologies and practices. Physicians have incentives to overprescribe services and procedures, and patients have incentives to let them.

To address these problems, managed care has introduced an incentive structure that encourages providers to choose services more efficiently. Managed care employs two mechanisms, one financial and one nonfinancial, to alter providers' incentives and treatment choices. The first is capitation, a method of payment that gives providers a fixed payment for each patient in a risk pool. Under this arrangement, providers have a strong incentive to reduce treatment costs, because they retain whatever is left over from the payment after all medical treatment is provided. The second mechanism is utilization management, which includes establishing treatment guidelines, controlling access to specialists, and monitoring physicians' performance to reduce low-valued services.

Managed care organizations can influence the expected profitability of new technology by reducing reimbursement and restricting utilization. When they do, hospitals and physicians are likely to acquire and use fewer new and expensive technologies. By balancing patients' desire for better health care with incentives for providers to reduce costs, managed care can encourage more cost-effective use of technology while promoting innovations that improve health and keep costs in line.

At the same time that it seeks this balance, however, managed care creates a different set of problems. These include incentives for health insurance plans to select only healthy patients and to underprovide services. Managed care organizations have a strong incentive to sign up healthy patients whose health care costs will be low. This incentive can override the goal of improving efficiency. Furthermore, providers have an incentive to restrict even cost-effective services because they receive no additional revenue from providing them. Because patients frequently lack information about the effectiveness of alternative treatments and are thus unable to act as knowledgeable consumers, this problem can be severe (Box 5-5). As a result, patients may not get expensive but medically necessary services. Thus patients need meaningful protections against incentives that lead to too little care being provided.

The optimal reimbursement design, in terms of offering incentives that balance cost and access, likely lies somewhere between fee-for-service and capitation plans. Such a plan would involve partial cost sharing by providers and patients through copayments and coinsurance, but the ideal incentive structure has not yet been identified. As managed care plans have evolved to allow patients more choices, the plans' ability to influence utilization has diminished. Consolidation among physicians and hospitals in the 1990s created intermediary organizations between providers and managed care

Box 5-5. The Rise of E-Health: On-Line Medical Information

The Internet is becoming an important source of medical information for consumers, for at least two reasons. First, it empowers patients by providing them with medical information that increases the value of a medical appointment. Interactions with physicians are more efficient if patients know what questions and concerns to raise beforehand. Second, for general information the Internet offers an attractive alternative to a costly consultation.

Tens of thousands of Internet websites provide medical and health-related information. About 60 million Americans searched for health information on line in 1998, and that number was expected to increase in 2000. An analysis of patient electronic inquiries to a university dermatology department found that 40 percent of the inquiries could be answered by a librarian, 28 percent could be answered by a physician via e-mail, and only 27 percent required a visit with a physician. Without the Internet many of these questions might not have been asked or answered at all, and unnecessary visits might have occurred. The Internet thus has the potential to effectively supplement the physician's role in providing medical information and thereby to improve efficiency.

However, the websites currently available may present problems. Not all on-line medical information is easily comprehensible to the lay reader, and some sites raise conflict-of-interest issues. Although the Internet can reduce the cost of obtaining medical information, it cannot make information on complex medical issues understandable to all. To the extent that it leads patients to self-diagnose and self-treat inappropriately, then, on-line information can be harmful. Furthermore, the quality of information varies greatly, in part because commercial interests can influence content. These problems can actually increase the demands on physicians, who must spend time clarifying misleading or misinterpreted information.

For these reasons the government has a role in overseeing and regulating medical information websites. Several government agencies, including the National Institutes of Health, the Food and Drug Administration, and the Agency for Healthcare Research and Quality, have taken the initiative either to provide information directly or to provide links to reliable medical websites.

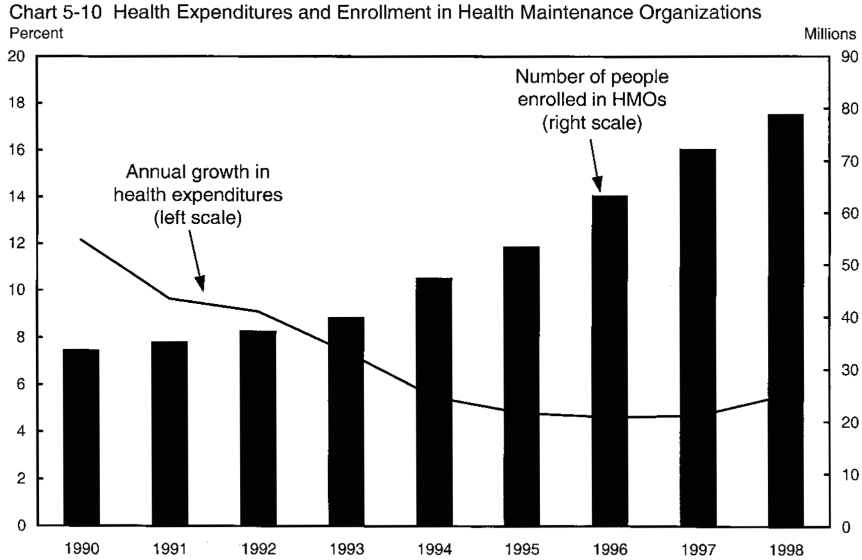
plans, so that fewer providers actually operate on a strict capitation basis. For these reasons managed care plans at the beginning of the 21st century differ markedly from the original managed care organizations, and the mechanisms that managed care uses to influence cost-effectiveness have been significantly altered.

Empirical evidence suggests that managed care was one of the factors that slowed the growth in total health care expenditure in the 1990s (Chart 5-10). Managed care slowed health care inflation not only by reducing the use of expensive procedures, but also by lowering physician and hospital fees relative to fees under traditional insurance. However, further reductions in utilization may not be feasible, simply because continued reductions could prevent patients from receiving medically necessary treatment. In addition, managed care's ability to restrict fees in the future is uncertain, because fees cannot fall below costs. Whether reductions in health care expenditure will continue is thus an open question, and recent indications suggest that expenditures are again beginning to grow.

If technological progress remains the key factor behind rising health care costs, managed care can continue to generate significant cost reductions only by influencing the types of innovations that are used. If managed care can increase the use of cost-saving innovations, the rate of growth may be slowed. But if patients continue to demand access to the latest technology and are willing to pay for any innovation regardless of its medical efficacy or cost-effectiveness, managed care may be unwilling or unable to impose further cost-saving innovations. Evidence of managed care's impact on the types of technology that are adopted and the rate at which innovations are introduced is mixed. Some researchers have found that increasing enrollment in managed care organizations restricts the adoption and use of cost-increasing technologies. One study, for example, found evidence that neonatal intensive

Growth in health expenditures slowed in the 1990s while HMO enrollments rose.

Chart 5-10 Health Expenditures and Enrollment in Health Maintenance Organizations



Sources: Department of Health and Human Services (Health Care Financing Administration) and Employee Benefits Research Institute.

care units are introduced and used more cost-effectively in areas with a high concentration of managed care organizations. However, another study found evidence that health maintenance organizations (HMOs) slowed general technological growth in the early and mid-1980s but had little effect on technological growth by the early 1990s. Thus managed care's ability to influence how innovations will affect costs remains to be seen.

Improving Health Insurance Coverage

Considering the progress that has been made in medical innovation, access to high-quality health services is becoming increasingly valuable. Because these services, particularly treatments for nonroutine health care, can be very expensive, health insurance is the best means of ensuring that people receive the care they need. The number and proportion of Americans without health insurance decreased in 1999 for the first time since 1987, when comparable statistics first became available. As has been noted, however, around 42.6 million Americans remained without insurance coverage. This section discusses the current state of the health insurance system and some approaches that have been considered for extending health insurance to more people.

The Health Insurance System

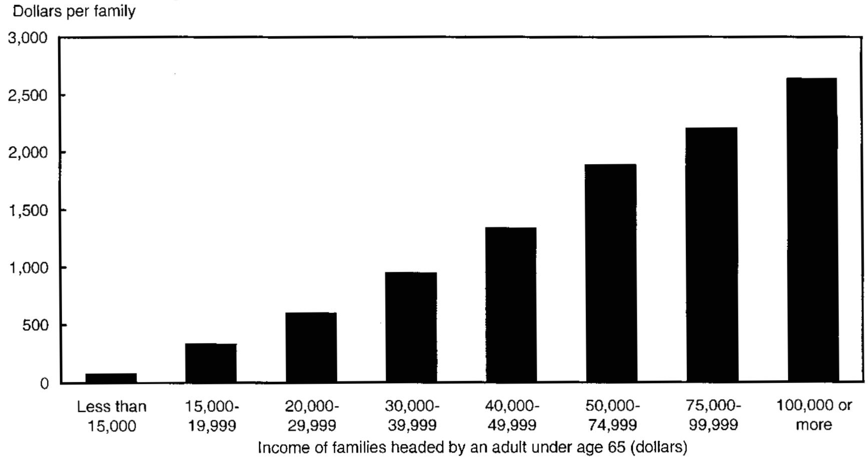
The American health insurance system relies primarily on employer-sponsored health plans. Employer-sponsored programs cover about 63 percent of all Americans, and 74 percent of all who are insured. One reason for the prevalence of this type of group insurance is that the Federal tax code favors it. The insurance premiums that firms pay on behalf of their employees are not included in the employees' taxable income. In addition, certain arrangements, such as flexible spending accounts, allow employees to make contributions toward their health care expenses with before-tax dollars.

The employer-sponsored insurance system offers several important benefits. First, it encourages groups, especially large groups, to pool risks effectively. In addition, firms can hire benefits administrators to evaluate policies and ensure that quality plans are offered. Finally, insurance companies can offer large employers lower premiums, in part because economies of scale reduce their administrative costs.

Because low-income individuals have a lower marginal tax rate and are less likely to have insurance, the tax-preferred treatment of employer-sponsored health insurance often does not provide them with significant benefits (Chart 5-11). People who do not obtain health insurance through their employer must buy insurance with after-tax dollars. This group includes not only the unemployed but also people who work for employers that do not offer health insurance. These groups are more likely to need a subsidy to be able to purchase health insurance.

As income rises, so too does the tax benefit from exclusions and deductions for health expenses.

Chart 5-11 Average Federal Tax Benefit for Health Expenses, 2000



Note: Estimates include the likelihood of receiving employer-provided health benefits and the value of the tax benefit of employer-provided health insurance.
Source: John Sheils, Paul Hogan, and Randall Haught, "Health Insurance and Taxes: The Impact of Proposed Changes in Current Federal Policy," October 1999, The Lewin Group, Inc. Used with permission.

People without employer-sponsored health insurance who do not qualify for publicly funded programs must enter the individual insurance market in order to obtain coverage. This market can present problems that limit affordable access. Some insurers may choose not to cover people with preexisting health problems or may cover them but exclude the preexisting condition. Insurers may also charge premiums based on an individual's perceived risk. For example, people with diabetes may have to pay significantly higher premiums because they are more likely to experience health problems. In some cases the premiums can become unaffordable. The fact that the cost of administering policies is higher for individual than for group policies raises the premiums for individuals still further.

Publicly provided health insurance programs—Medicare, Medicaid, and SCHIP—are an important source of coverage for many people. Created in 1965, Medicare and Medicaid provide health insurance for the elderly, people with disabilities, and low-income Americans. Over 39 million individuals received medical insurance through Medicare in 1999. Medicaid, which offers Federal assistance to States in providing medical care to low-income Americans, served more than 40 million people in 1998. Historically, eligibility for Medicaid was linked to eligibility for welfare assistance—that is, eligibility was primarily restricted to single-parent families with very low incomes. In the late 1980s and the early and mid-1990s, Medicaid coverage was gradually extended through a series of expansions. The 1996 Personal

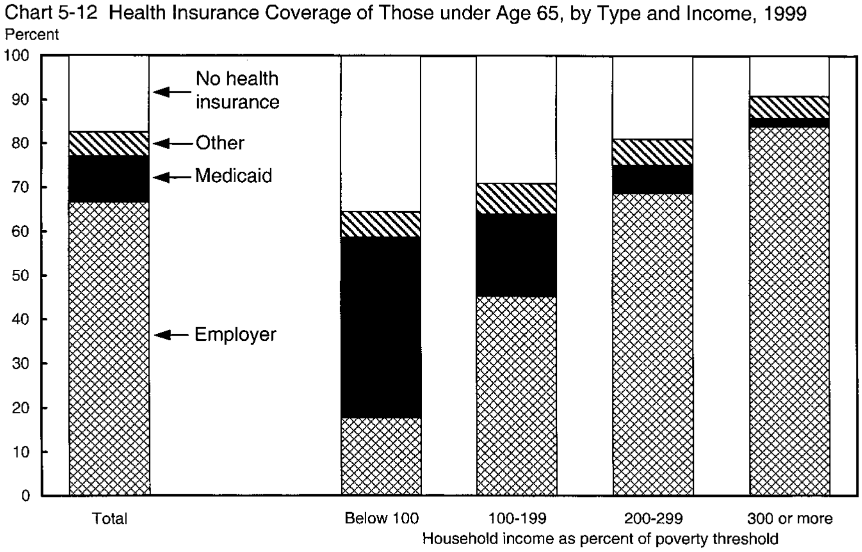
Responsibility and Work Opportunity Reconciliation Act formally delinked Medicaid from cash assistance eligibility and further extended it to cover more low-income households, including two-parent families. In 1997 the Federal Government created SCHIP to target the growing number of uninsured children in families with incomes that are too high for Medicaid but not sufficient to cover the cost of private insurance. Through SCHIP, States can provide eligible children with Medicaid coverage, coverage through a separate non-Medicaid program, or a combination of both.

The likelihood that an individual will have health insurance and the source of that insurance vary with income and other demographic characteristics (Chart 5-12). Because Medicare covers virtually all elderly Americans, only 1.3 percent of this group were uninsured in 1999, compared with 17 percent of the nonelderly. Among the nonelderly, those in low-income households are more likely to be without insurance. Among nonelderly people in households below the poverty line, 36 percent were uninsured in 1999. Medicaid was the source of insurance for almost two-thirds of the non-elderly in this group who had coverage, whereas 28 percent were covered by an employer's plan. In contrast, 91 percent of nonelderly people in households with incomes above 300 percent of the poverty line were covered, and of these, 92 percent were covered by an employer plan.

Part-time employees are less likely than full-time employees to be insured, because employers often exclude part-time and temporary workers from

Higher income people generally receive health insurance through employers. Lower income people tend to receive it through government programs, or not at all.

Chart 5-12 Health Insurance Coverage of Those under Age 65, by Type and Income, 1999



Source: Department of Commerce (Bureau of the Census).

their health insurance plans. Twenty-five percent of those in households with only part-time workers were uninsured in 1999. Seventy-four percent of adult workers employed in small businesses were insured, compared with 88 percent of those working in large firms, although some in both groups were covered under another person's policy. These figures reflect the fact that small businesses are less likely to offer health benefits than large firms, possibly because small businesses have a large share of part-time workers. Health insurance coverage also differs significantly across racial and ethnic groups. Non-Hispanic whites are least likely to be uninsured (11 percent), compared with African Americans (21 percent), Asian Americans and Pacific Islanders (21 percent), and Hispanics (33 percent).

Lack of health insurance can be costly not just for individuals but for society. The uninsured often obtain care in an emergency room rather than in a physician's office, and emergency room care is more expensive than office visits. Because they often receive inadequate care, the uninsured tend to have more severe health problems and are therefore more likely to require more expensive care when they do seek treatment. Evidence indicates that initiatives to expand Medicaid coverage have been associated with significant increases in the use of primary care facilities and reductions in expensive and avoidable hospitalizations. One recent study found that expanding Medicaid eligibility was associated with a 22 percent decline in avoidable hospitalizations. The costs of hospital care for people who cannot pay are often absorbed by providers, passed on to the insured through increases in the cost of both health care and health insurance, or borne by taxpayers through tax increases imposed to finance public hospitals and insurance programs.

Reforming Health Insurance

Proposals to expand health insurance coverage must be considered carefully, because of the risk that unintended consequences can so severely erode the existing system that the overall effect is to worsen coverage. Some proposals, such as expanding tax deductions to all purchases of individual insurance, might have such unintended consequences. To evaluate such proposals, this *Report* uses three measures: how much the proposal would reduce the ranks of the uninsured, how much it would cost to insure each additional individual, and how the prices and coverage of existing insurance plans would be affected.

How many formerly uninsured people an initiative is able to cover depends on how generous the subsidy is, how the subsidy is provided, and who is eligible. For instance, a partial subsidy may fail to increase coverage, because even modest out-of-pocket expenses can discourage participation, especially by relatively healthy low-income families. Such families may choose to forgo health insurance, unless it is made very inexpensive, to pay for immediate necessities such as food and housing. Similarly, subsidies that become available only after premiums are paid may not help people who lack the funds to pay even these up-front costs. Further, a complex application process may have the unintended side effect of keeping qualified individuals from participating. Eligibility criteria must also be carefully designed, not only to determine how many uninsured people can use the new subsidy, but also to limit the number of people who already have insurance but are eligible for the new subsidy.

The second measure—the subsidy's total cost relative to the amount of increased coverage—reflects how efficiently the proposal expands health insurance coverage. This relative cost can be driven much higher if a new subsidy crowds out existing insurance arrangements. This situation can occur when people drop their current coverage in favor of a newly subsidized alternative, or when an employer, expecting its employees to use a newly offered subsidy, stops offering insurance coverage. When crowding out occurs, government expenditures go not just to the newly insured but also to people who had coverage and are simply switching to the new plan to take advantage of the subsidy. If for these people the new subsidy is more generous than their old subsidy, the cost to the government increases. If firms drop coverage and employees do not get replacement coverage, the net increase in coverage drops and the cost relative to increased coverage again rises.

Third, newly enacted subsidies may affect the prices and coverage of existing insurance plans, for instance through adverse selection. Adverse selection occurs when relatively healthy, low-risk individuals decide that the cost of their current health insurance is greater than the benefits and therefore seek cheaper insurance or go without. As these people (whose health care costs tend to be low) leave the original pool, the average cost of insuring each person remaining in the pool increases. When the medical costs of treating the remaining participants rise and premiums increase as a result, still more people leave the pool. The result is a spiral of rising premiums and declining enrollment, so that those who still wish to purchase health insurance sometimes find that the premiums are prohibitively high, and they may remain (or become) uninsured.

Employer-sponsored group health insurance is a good basis for risk pooling. Workers are attracted to a firm for many reasons, of which health insurance is but one, and so a wide range of health risks is likely to exist within each firm. The existing tax subsidy encourages workers to remain in the group pool. But any subsidy that makes individual insurance more attractive can lead to adverse selection in the group pool. Adverse selection can also affect the market for individual insurance. Proposals to reduce premium variability due to health risk rating in the individual insurance market must also be careful to employ pooling mechanisms in order not to drive out healthy individuals. Increased reliance on the individual insurance market also raises concerns about the quality of the insurance plans purchased, because of limited regulation and consumer bargaining power.

Empirical evidence indicates that crowding out and adverse selection do occur and thus are real concerns in proposals to expand health insurance coverage. Studies of the expansion of Medicaid coverage to children in the late 1980s and the first half of the 1990s found that the crowding out of private insurance coverage was responsible for around 10–20 percent of the increase in Medicaid coverage. Because Medicaid covers mostly low-income people who are less likely to have private insurance, the crowding out was particularly modest.

Studies of the choices employees make when offered a choice of several health insurance plans found evidence of adverse selection. One study found that premiums for plans with relatively generous benefits increased much faster than premiums for other plans, presumably because of the poorer health status of the people selecting the more generous plans. Another study found that, in one firm, healthy employees were the least likely to choose the most generous benefit plan. The premiums for that plan ultimately became so expensive that the employer dropped it.

Types of Subsidies

In general, efforts to extend health care coverage by offering public subsidies use one of three approaches. The first approach, tax deductions, allows individuals who purchase health insurance in the individual insurance market to reduce their taxes by deducting their health insurance premiums from their taxable income. A second approach, tax credits, reduces an individual's taxes by the full amount of the credit. A third approach extends government-provided insurance to more people. SCHIP, for instance, finances health insurance for children in lower income households.

These three options differ in how well they extend coverage, in their cost relative to increased coverage, and in their effects on existing insurance plans. Tax deductions provide only partial subsidies, and the subsidy is smaller for those with low incomes, who are the most likely to be uninsured. These weaknesses mean that tax deductions are unlikely to effectively expand health insurance coverage. By making individual coverage more attractive, tax deductions could also crowd out employer-sponsored plans, reducing the number of newly insured people on a net basis. Because a tax deduction for individual insurance would provide many who already purchase individual coverage with a more generous benefit than they currently receive, but is not likely to significantly increase coverage, the cost relative to increased coverage is also high. By subsidizing individual coverage, a tax deduction can also cause adverse selection that undermines existing coverage, and it can lead to increased reliance on the individual insurance market, with its associated concerns. Thus tax deductions fare poorly on all three criteria.

Tax credits, if well designed, can help many people, including lower income families and individuals, purchase insurance. To be effective, the credits must be generous enough to make insurance affordable. Further, to enable lower income people to afford premiums, the credits ideally would be refundable, so that those with little or no tax liability can receive the credit. Ideally, they would also be payable incrementally through the year, so that those who have difficulties paying up-front costs are helped. However, these features also make administering the credits more difficult. Because such credits would apply to individual insurance, they have the drawbacks discussed earlier. They can raise the cost relative to the amount of increased coverage and reduce current risk pooling. These problems can be ameliorated through income cutoffs that restrict eligibility to those populations least likely to be able to afford coverage.

Government-provided insurance can fully subsidize insurance and thus cover many of the uninsured. But if such a program provides full insurance, some individuals who are already insured and become eligible for the program can be expected to switch, increasing the cost relative to the amount of increased coverage. Again, income cutoffs to restrict eligibility to uninsured populations can limit the crowding out. Because government-provided insurance does not increase the subsidy for individual insurance, adverse selection is much less likely to occur.

Meeting the Challenge of Covering More People

The Administration has taken a number of steps to extend coverage to more people. As noted above, the number of uninsured nationwide declined in 1999 for the first time in 12 years. Particularly noteworthy successes include the creation of SCHIP, which is intended to cover up to 5 million children when fully implemented. Other successes include extending Medicare and Medicaid coverage to persons with disabilities who are returning to work, providing Medicaid coverage to young adults leaving foster care, and covering low-income uninsured women diagnosed with breast and cervical cancer. In addition, the Health Insurance Portability and Accountability Act of 1996 limits exclusions for preexisting conditions in employer health insurance plans and plans sold to people converting from an employer's plan to individual insurance. In its last budget, submitted in February 2000, the Administration proposed a health insurance initiative to extend publicly provided health insurance to around 5 million more people. This proposal included a FamilyCare program to extend SCHIP to the parents of children covered by Medicaid and SCHIP; accelerated enrollment of eligible but uninsured children in Medicaid and SCHIP; and expanded health insurance options for vulnerable populations such as legal immigrants, early retirees, and displaced workers.

Although much has been done to ensure access to health care for millions of Americans, a number of challenges lie ahead. The benefits of innovative prescription drugs make access to these drugs more valuable, especially for the elderly and persons with disabilities. As a result, in its last budget the Administration proposed a prescription drug benefit within the Medicare program. We must also prepare for a growing elderly population and expected increases in long-term care needs. Meeting this challenge requires increased investments to ensure the solvency of the Medicare program and provide financial assistance to the increasing number of families with members needing long-term care. To address these needs, in its last budget the Administration proposed providing tax credits for long-term care, and in the midsession review of that budget it proposed placing the Medicare trust funds in a lockbox. Finally, we must continue to work toward providing access to the health care system for the millions of Americans who remain uninsured.

Building Livable Communities

Just as the New Economy has transformed the structure of economic activity to provide better options and opportunities for Americans, so has it transformed the way we organize our communities and build new ones. The economic forces stimulating today's rapid growth do not automatically create incentives to preserve community amenities and environmental quality. With the support of Federal and State initiatives, regional governments are beginning to experiment with new economic and planning tools that can channel the economic drivers of growth in ways that preserve the quality of life Americans desire. Changing the way people think about growth in their communities will also change the kinds of public investments and policies that shape the landscapes of the new century.

The 20th century witnessed the evolution of the American suburb, especially in the 1990s, when suburban growth accelerated. From 1990 to 1999 the suburban population grew by nearly 19 percent, compared with 6 percent in the central cities. The New Economy has brought about a change in the patterns of job location as well. Job creation is shifting away from the central city. New jobs and new industries are springing up on the fringes of cities, often in so-called technology parks and research corridors. Between 1979 and 1999 the central cities' share of overall metropolitan office space fell significantly. In 1979 central cities accounted for 74 percent of office space and suburbs for only 26 percent. By 1999 the share of the central cities had dropped to 58 percent, and the suburban share had mushroomed to 42 percent.

Rural areas just beyond the edge of urban settlements have experienced particularly rapid growth. In metropolitan counties that were primarily rural in 1990, the population rose by 20 percent between 1990 and 1999—a much higher rate than in any other type of county. As farmland is converted to other uses, these counties are becoming low-density urban areas.

Although many Americans still seek the high quality of life available in America's cities, the suburbs have a special attraction. They promise American families the best of both worlds: the amenities and quality of life that many prefer and the availability of jobs formerly associated primarily with cities. But this trend has its drawbacks. Rapid growth can create problems that affect an entire region. Local communities, especially those experiencing rapid development, must invest in plans to channel growth in ways that are consistent with social well-being and environmental quality.

Business and Suburbanization

Economists have noted a positive relationship between the concentration of economic activity and productivity. In the past, access to natural resources and effective means of transportation were often the driving force behind a region's economic gains. In contrast, economic growth today is often based on so-called agglomeration economies. These develop when firms in the same industry cluster together in a region in order to share ideas, customers, and pools of workers with specialized skills. Agglomeration economies exist in Manhattan's financial industry, among Boston's mutual fund companies, and in California's Silicon Valley, where many high-technology firms have gathered. Because they are often free of the traditional resource-related needs that tied earlier industries to specific locations, New Economy firms are able to choose from a wide array of potential business sites. They can choose to locate in a community because of the proximity of other firms or simply because of its cultural and recreational amenities and general livability.

Several economic explanations have been offered for the resulting pattern of development. First, for many firms, central cities may exhibit diseconomies that offset the benefits associated with locating there. The building stock may be costly to upgrade, making rents in revitalized or redeveloped urban areas expensive. Similarly, the unintended consequences of environmental clean-up laws can discourage firms from reusing contaminated or abandoned urban properties. Despite more than $2.3 billion in leveraged economic development devoted to these "brownfields" through the national Brownfields Initiative, hundreds of thousands of properties remain unused because of real or perceived environmental contamination. For these reasons it may be more cost-effective for firms to start from scratch in outlying areas.

Sprawl and Its Challenges

With growth occurring more on the outskirts of cities than in the central cities themselves, land in many metropolitan areas is now being consumed at a rate that exceeds population growth. An average of 2.3 million acres of land undergoes development each year, and a significant share is used for low-density residential development in fringe suburbs and smaller cities. This growing, often unplanned development is commonly known as sprawl. Sprawl is characterized by low-density residential and commercial settlements and often forces residents to rely exclusively on automobiles for transportation.

Sprawl often imposes significant costs on entire regions. Many suburban communities are becoming increasingly congested and are thus in danger of losing the very attributes that make them attractive places to live and work. Growing populations strain public resources such as schools and parks. Affordable housing moves farther away from jobs, increasing average commuting distances throughout metropolitan areas. Commuting is only one factor in increasing traffic congestion. Four out of five household automobile trips are now taken for noncommuting purposes, and distances from homes to destinations such as stores, schools, and recreational facilities are increasing. Limited public transportation makes congestion even worse, increasing demand for new roads—and creating more congestion.

Unplanned growth affects the quality of the environment, including water, air, and land resources. Increases in paved surfaces, including roads, buildings, and parking lots, can contribute to deteriorating water quality and to an overall loss of greenspace. This leads to less effective natural drainage, diminishes water quality, and in some areas dramatically increases the potential for flooding. For example, residents along California's Russian River experienced four major floods in 3 consecutive years. Hydrologists attribute such events in part to urbanization's effects on stream flow: downstream runoff into streams and rivers increases as the area devoted to roads, parking lots, and other impervious surfaces that keep water from filtering into the soil increases.

Increased traffic affects not only the daily commute but also ambient air quality. Automobile emissions lead to hazardous air pollution by elevating concentrations of ozone and particulate matter. Although national air quality trends have improved over the last 20 years, in 1999 approximately 62 million people nationwide still lived in counties with pollution levels that exceeded national standards. Pollution affects the health of residents, and some are more vulnerable than others. Pediatric asthma, for instance, is aggravated by particulate matter, sulfur dioxide, and ozone. Between 1982 and 1996 the incidence of this disease increased by 76 percent.

Regional Coordination and Sprawl

Jurisdiction over transportation routes and systems, as well as over housing and economic development decisions, is often fragmented among different local and State governments, resulting in little coordination of land-use planning. Regional commissions can help to deal with the spillover effects that community decisions have on neighboring municipalities. Sprawling communities are often divided by great fiscal disparities and distinctly zoned land uses. Planners with an interest in regional growth may be able to help communities accommodate new growth collaboratively.

Regional coordination has been particularly important in transportation. Communities are making significant investments in transportation and are coordinating their land-use plans with these investments. Ridership on public transportation is up nationwide. In 1999 transit riders made more than 9 billion trips, the most in nearly 40 years. The Transportation Equity Act for the 21st Century provided $36 billion in Federal funding for transit for fiscal 1998–2003, around 50 percent more than during the previous 6-year period. Finally, State and local officials are increasingly choosing to tap into financial assistance available for surface mass transit, transferring over $1.5 billion to transit projects in fiscal 2000 alone.

Individual Decisions and Sprawl

One of the difficulties in dealing with development issues is that the costs and the benefits of development are typically borne by different entities. Decisions benefiting private individuals may have adverse public effects, but private decisionmakers are unlikely to weigh these social costs. For example, many individuals prefer homes on large private lots far from both city centers and major highways. But these homes require new roads and the installation of public utilities. If many people choose to live in such homes, the negative spillovers their decisions generate—increases in traffic congestion, air pollution, impervious surfaces, and property taxes—may outweigh the benefits they and their neighbors receive. The results of such decisions are evident in many areas of the country and are particularly vivid in Atlanta (Box 5-6).

The true economic costs of building a new home include the costs of associated spillovers, and these costs should be recognized, but quantifying these social and environmental burdens is more difficult than identifying the private costs of development. Some positive steps can be taken in this direction, however. For instance, studies have found that the additional tax revenue received from new development does not cover the costs of building new roads and providing public services (including utilities) to new residents. If developers and homeowners were required to bear the full cost of these services, including infrastructure, the resulting pattern of development would look much less like sprawl. Many

Box 5-6. Challenges to Smart Growth in Atlanta

Ranked by some as the U.S. city most threatened by sprawl, Atlanta continues to expand at a phenomenal pace. From 1980 to 1998 the Atlanta area's population grew almost 68 percent, with virtually all of this growth occurring beyond the city limits. According to one study, the Atlanta metropolitan area loses 500 acres of greenspace, forest, and farmland each week. Water quality in the Chattahoochee River and Lake Allatoona is deteriorating, and the city's air is in violation of clean air standards. The costs of traffic congestion from lost time and wasted fuel are estimated at an overwhelming $2.3 billion a year. The average time spent per person per day in a vehicle on Atlanta's roads and highways has been estimated at 1 hour and 11 minutes. Motorists in Atlanta lead the Nation in miles driven per person per day, logging a total of over 100 million miles daily. The region's growth has further isolated minority and low-income communities and created tremendous geographical imbalances in the availability of jobs and housing. Atlanta's residents may be enjoying the benefits of the New Economy, but they are clearly suffering the resulting costs of sprawl.

The Atlanta Regional Commission (ARC) is attempting to limit this expansive growth and coordinate development. To help this coalition of regional governments, in 1999 the State created the Georgia Regional Transportation Authority (GRTA), assigning to it broad powers to manage projects involving transportation, air quality, and land use in heavily polluted areas, particularly the city of Atlanta itself. Metropolitan governments are opposing a perimeter highway proposal because it threatens investment in the center city and encourages further sprawl. The ARC, supported by the State government, is trying hard to provide and encourage alternatives to single-motorist auto-mobile transportation. The ARC and the GRTA are also seeking to encourage development that incorporates elements of smart growth by revitalizing older communities and emerging population centers through efforts to promote livability and increase the mix of land uses and housing types. But the sprawl continues, and Atlanta faces a serious challenge: it must channel future growth in order to build sustainable, attractive communities.

governments have begun to assess impact fees on new construction so that the financial burdens of infrastructure and public service provision are taken into account in development decisions.

Communities are beginning to use other kinds of economic incentives to achieve outcomes more consistent with smart growth. For example, communities such as South Bend, Washington, have imposed fees on development that increases impervious surface area, in order to encourage development that has fewer detrimental effects on water quality and minimizes the potential for flooding. Other communities are using road pricing to improve traffic patterns. In San Diego, solo drivers in the express lanes of one major freeway pay higher prices during congested times than during off-peak hours. Electronic transponder technology helps identify individual motorists and assess tolls, making this system possible without the significant slowdowns caused by toll plazas. Other communities are using transferable development rights to provide incentives for keeping land in agriculture and other uses that maintain open space and provide ecological benefits.

The Administration's Response

The Administration's 30-point Livable Communities Initiative encourages smart growth. It sets forth several principles aimed at aligning Federal policy efforts with smart growth priorities and encouraging planning and coordination over larger regions to resolve negative spillovers. The Livable Communities Initiative seeks to sustain prosperity, expand economic opportunity, enhance the quality of life, and build a stronger sense of community. It provides funds for regional smart growth efforts, including Better America Bonds for State, local, and tribal governments. The initiative aims to reuse brownfields and preserve greenspaces, ease traffic congestion, restore a sense of community, promote collaboration among neighboring municipalities through regional governance, and enhance economic competitiveness. In addition, its smart growth initiatives attempt to counter various socially undesirable effects of sprawl such as racial segregation, concentrated poverty, decreased personal interaction, and a less active civil society. Initiatives at the State and the local level are beginning to have real impacts on communities—for instance, in the State of Maryland and the city of Chattanooga, Tennessee (Box 5-7).

An educated work force that views quality of life and favorable economic conditions as priorities often characterizes areas of new and rapid growth. These communities have both the constituency needed to demand change and the resources necessary to implement it. Business and community leaders are already recognizing the costs and impacts of sprawl and acting to mitigate the negative effects. In metropolitan areas such as Chicago, Denver, Omaha, and Philadelphia, leaders are acting to improve land use and transportation decisions and enhance environmental quality. The success of these endeavors will depend on the ability of these communities to make hard choices and find creative solutions to the challenges of sprawl.

Box 5-7. Examples of Smart Growth

Maryland has established several specific goals for its smart growth program. These include preserving the State's most valuable remaining natural resources, supporting existing communities and neighborhoods by targeting State resources to development in areas where the necessary infrastructure is already in place, and saving taxpayer dollars by avoiding the unnecessary cost of building the infrastructure required to support sprawl. The program also stipulates that the State will regularly evaluate the program's effectiveness. By winning Federal grant money, reprioritizing within the State budget, and designing financial incentives for businesses, local governments, and home-owners, Maryland has been able to leverage the funds necessary to emerge as a leader in the smart growth community while preserving local decisionmaking authority.

Similarly, the success of Chattanooga, Tennessee's, smart growth initiative affirms the conviction that Americans can enjoy both economic prosperity and a high quality of life. Chattanooga's economy was historically based on iron foundries, textile mills, and chemical plants, but in recent decades these were not providing the growth and employment the city required. However, through thoughtful economic development efforts, Chattanooga has become a model for other cities seeking environmentally sound urban renewal. Using extensive grants from private foundations together with Federal and local public funds, Chattanooga has built successful public-private partnerships throughout its visionary redevelopment process. The city now prides itself on being a laboratory for sustainable development projects involving rezoning, reclamation, revitalization, and redevelopment. Illustrating how older cities can thrive in the New Economy, Chattanooga boasts a 22-mile Riverwalk with picnic areas, the world's largest freshwater aquarium, a sculpture garden, waterfront housing developments, an electric-bus public transit system, footbridges, and an arts district.

Conclusion

The ongoing, unprecedented economic expansion has done much to improve the well-being of the American people. However, an important part of the Administration's role during the expansion has been to ensure that no one is left behind. And indeed, government policies have helped—and will continue to help—many of the most disadvantaged Americans. Policies easing the transition from welfare to work, improving educational opportunities, increasing access to health care, and improving the health of our communities have helped distribute recent economic gains more fully. Improving outcomes for those in danger of being left behind benefits the Nation as well as disadvantaged populations.

This Administration has maintained policies that support strong economic growth and low inflation. Many previously unemployed Americans have been moved from welfare to work, increasing the supply of workers at a time when the demand for workers is high. Investments in the education of young people help ensure that future generations will have the necessary skills to succeed in the New Economy and increase productivity. Health care initiatives have helped Americans maintain access to recently developed, innovative technologies. The Administration has also worked to guarantee that our communities enjoy the amenities that families desire: safe streets, clean air and water, reliable transportation, and access to greenspace.

Despite this substantial progress, many challenges remain. Confronting these challenges will require ongoing public policies that combine initiatives to support economic growth with efforts to reach out to those still in need of assistance. The Nation has made enormous strides in helping the least well off among us, but substantial disparities persist in income levels, educational quality, access to health care, and quality of life. These differences must be addressed. At the same time, we must consider how to help those who need additional assistance even in this period of strong economic growth: our elderly, our disabled, and our children. We are certainly better off than we were 8 years ago, but we can do more to ensure an even brighter future for all Americans.