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Before the
Senate Budget Committee
United States Congress

Hearing on "Assessing Inequality, Mobility and Opportunity"

Chairman Conrad, Ranking Member Sessions, I'm honored to testify before you today and I very much applaud your interest in the issues of income inequality, mobility, and opportunity. I can hardly think of any set of issues more pressing in the economic lives of American families.

As this committee well appreciates, even with recent improvements in the job market, the American economy still faces significant challenges, particularly the historically high levels of income and wealth inequality, the squeeze on middle-class incomes, and elevated rates of poverty.

The main findings of this testimony are:

- It is important to examine trends in income inequality through the lenses of various different data sources, as each has its own strengths and limitations. The fact that all of these series show similar trends toward increased dispersion of incomes is itself good evidence of the validity of their findings.
- A key factor driving the ups and downs in the inequality trend in recent decades is capital incomes, particularly capital gains; the fact that such income is given preferential treatment in our tax code relative to ordinary income from wages is thus a relevant issue for both inequality and tax reform.
- Some analysts and policy makers cite income mobility—movements by persons and families up and down the income scale over the course of their lifetimes, or from one generation to the next—as a reason why policy makers should be less concerned about historically high levels of inequality. However, a key finding here is that the rate of income mobility has not accelerated in recent decades; if anything, it may have slowed. Therefore, it is incorrect to argue that income mobility has offset the greater distance between income classes over time—i.e., higher inequality. It is also notable that there is considerably less mobility in the US than in most other advanced economies, including those with far lower levels of income inequality. This finding suggests that higher inequality may be blocking key opportunities, such as educational attainment, that would reduce inequality and enhance mobility.

- The potential interactions between our major economic and fiscal challenges remain a challenge for policy makers. Along with inequality, there is the related squeeze on low- and middle- class incomes, high rates of poverty, and the high, though declining, rate of unemployment. And, of course, a central concern of this committee is our bleak fiscal outlook. Addressing one of these problems could potentially exacerbate another.

For example, recent Congressional Budget Office analysis predicts that full and sudden expiration of the 2001 and 2003 tax cuts in 2013 would push unemployment higher.[1] Similarly, cuts to programs that are supporting low and moderate income families, like nutritional assistance, the Earned Income Tax Credit or the Child Tax Credit, could worsen poverty and inequality.[2] This worsening would further exacerbate inequality if we were to then turn around and use some of these savings to lower taxes on the wealthiest households.

While this may sound fanciful, it is not. In fact, the 2011 budget proposed by House Republicans does precisely this. As analysis from the Center on Budget and Policy Priorities shows, almost two-thirds of that budget's spending cuts over ten years — $2.9 trillion—come from programs targeted at households with low and moderate incomes.[3] And those budget savings are used to support tax cuts for the wealthiest households.

With this in mind, a central question of this testimony is how policymakers can address these three problems—inequality, economic slack, and the fiscal path—without solving one problem at the expense of exacerbating another problem. Most pointedly, revenue and spending policies designed to put the nation on a sustainable budget path must not exacerbate inequality, poverty, or the ongoing middle-class squeeze.

Inequality, Opportunity, and Mobility

Inequality

Based on a number of different data sources, each with their own strengths and limitations, inequality analysts have found the following:

- Low, middle, and high family incomes generally grew at similar rates from the late 1940s to the late 1970s, when they began to diverge.[4]

[1] See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2012-2022*, January 2012, Table 2-2, http://cbo.gov/ftpdocs/126xx/doc12699/01-31-2012_Outlook.pdf.

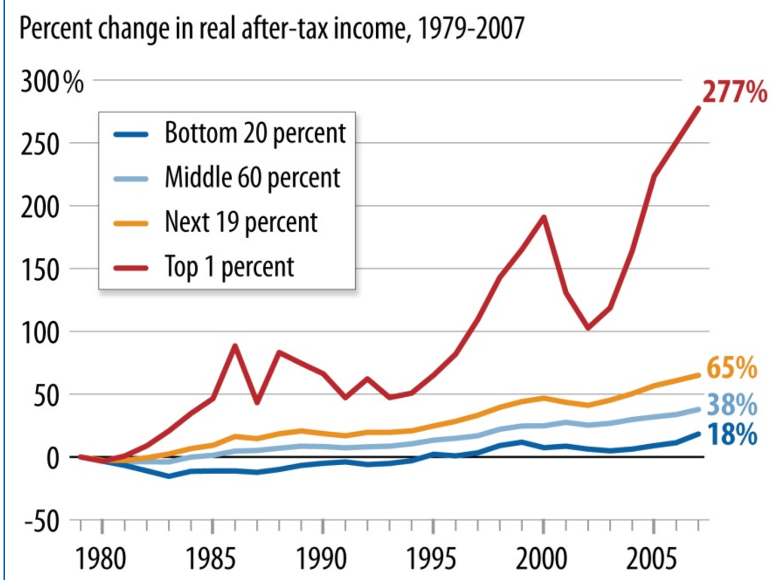
[2] See for example Arloc Sherman, *Poverty and Financial Distress Would Have Been Substantially Worse in 2010 Without Government Action, New Census Data Show*, Center on Budget and Policy Priorities, November 7, 2011, http://www.cbpp.org/cms/index.cfm?fa=view&id=3610.

[3] Robert Greenstein, *Chairman Ryan Gets Nearly Two-Thirds of His Huge Budget Cuts from Programs for Lower-Income Americans*, Center on Budget and Policy Priorities, April 20, 2011, http://www.cbpp.org/cms/index.cfm?fa=view&id=3451.

[4] See Chad Stone, Hannah Shaw, Danilo Trisi and Arloc Sherman, *A Guide to Statistics on Historical Trends in Income Inequality*, Center on Budget and Policy Priorities, Figure 1, http://www.cbpp.org/cms/index.cfm?fa=view&id=3629.

- Since the latter 1970s, income grew much more quickly at the top of the income scale than at the middle or the bottom, as can be seen in Figure 1.

FIGURE 1:
Income Gains at the Top Dwarf Those of Low- and Middle-Income Households



Source: Congressional Budget Office

This time period coincides with various developments that analysts have identified as associated with higher levels of wage, income, and wealth inequality:

- increased globalization, particularly import penetration from low-wage producers;[5]
- diminished unionization, as unions are associated with a more equitable distribution of earnings;[6]
- higher unemployment, which like less unionization, reduces the bargaining power of many in the workforce;[7]
- ongoing technological change, which increases the relative demand for more highly educated workers;[8]
- the decline in the real value of the minimum wage;[9]
- regressive changes in the tax code, particularly tax cuts to high marginal income tax rates and rates on non-labor income;[10]
- financial deregulation and "innovation" and the increased "financialization" of industry: the increase of the financial sector as a share of economic activity and the associated growth of income sources, such as capital gains, that are concentrated at the top of the income scale.

Many of these are, of course, related. Increased globalization has contributed to industry shifts, e.g., a smaller manufacturing share and larger financial share of both employment and output, which

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[5] See David Autor, David Dorn, and Gordon H. Hanson, *The China Syndrome: Local Labor Market Effects of Import Competition in the United States*, MIT Working Paper, August 2011, http://econ-www.mit.edu/files/6613.

[6] See Jared Bernstein, Lawrence Mishel and Heidi Shierholz, *The State of Working America 2009/2009*, April 2009, pp. 198-209.

[7] See Jared Bernstein, "Slack Attack," *On the Economy*, June 22, 2011, http://jaredbernsteinblog.com/slack-attack/.

[8] Claudia Goldin and Lawrence F. Katz, *The Race Between Education and Technology*, June 2008.

[9] See David S. Lee, "Wage Inequality in the United States During the 1980s: Rising Dispersion or Falling Minimum Wage?," *The Quarterly Journal of Economics*, August 1999, http://piketty.pse.ens.fr/fichiers/Lee1999.pdf.

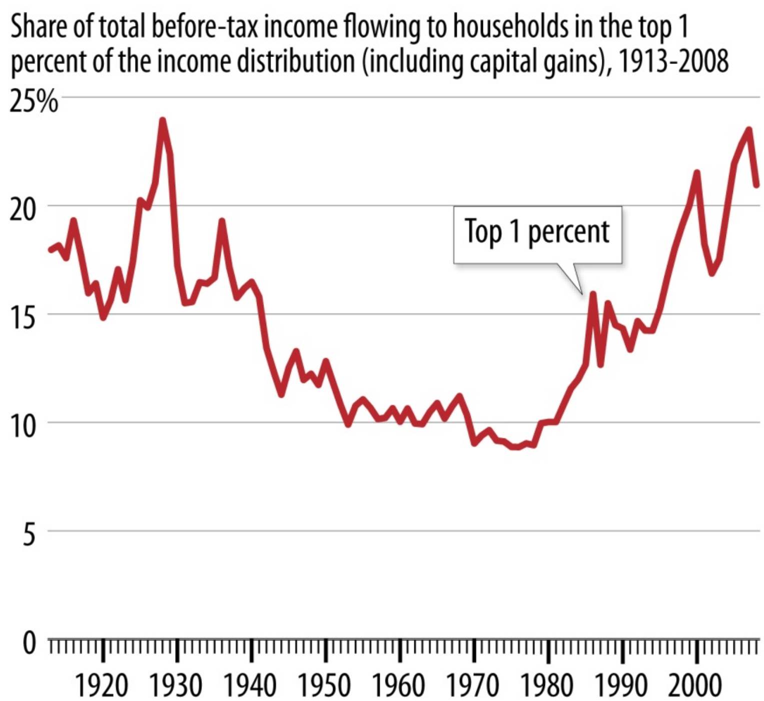
[10] See Piketty et al, 2011.

have both raised non-employment for affected workers (particularly non-college-educated men) and led to less unionization (as employment declined in more heavily unionized sectors).

Changes in the tax code favoring non-labor income combined with deregulation of financial markets gave rise to far more aggressive uses of methods like securitization, "shadow banking" (off-balance sheet holdings), and income shifting to favorably treated income sources like capital gains, which is associated with higher inequality.

A much even longer term view is provided by research that looks at the share of national income held by the top 1 percent of households, this time including realized capital gains. Prior to the great recession, when asset losses reduced the share of income accumulating at the top of the scale, the top 1percent of households held 23.5 percent of national income, the highest share since 1928, another business cycle that didn't end well, to say the least. (See Figure 2)

FIGURE 2:
Income Concentration at the Top Has Risen Sharply in Recent Decades



Source: Piketty and Saez, based on IRS data

Inequality data tend to be available with a lag, but we can gain some insight into where inequality stands right now through looking at profit and compensation shares of national income. As noted, capital incomes took a hit in the recent recession (note the 2008 downturn in the top 1 percent share at the end of the series in Figure 2). But since then profits, which correlate positively with the top 1 percent share, have more than recovered, and in fact, the most recent data (from the third quarter of 2011) show corporate profits as a share of national income to be at their highest level in the history of these data, going back to 1947. Compensation as a share of national income, conversely, is at its lowest level since the mid-1960s.[11]

While the benefits of corporate profits of course reach well beyond the top 1 percent, these findings suggest that after contracting in the great recession, income concentration is again on the rise.

The Role of Capital Incomes

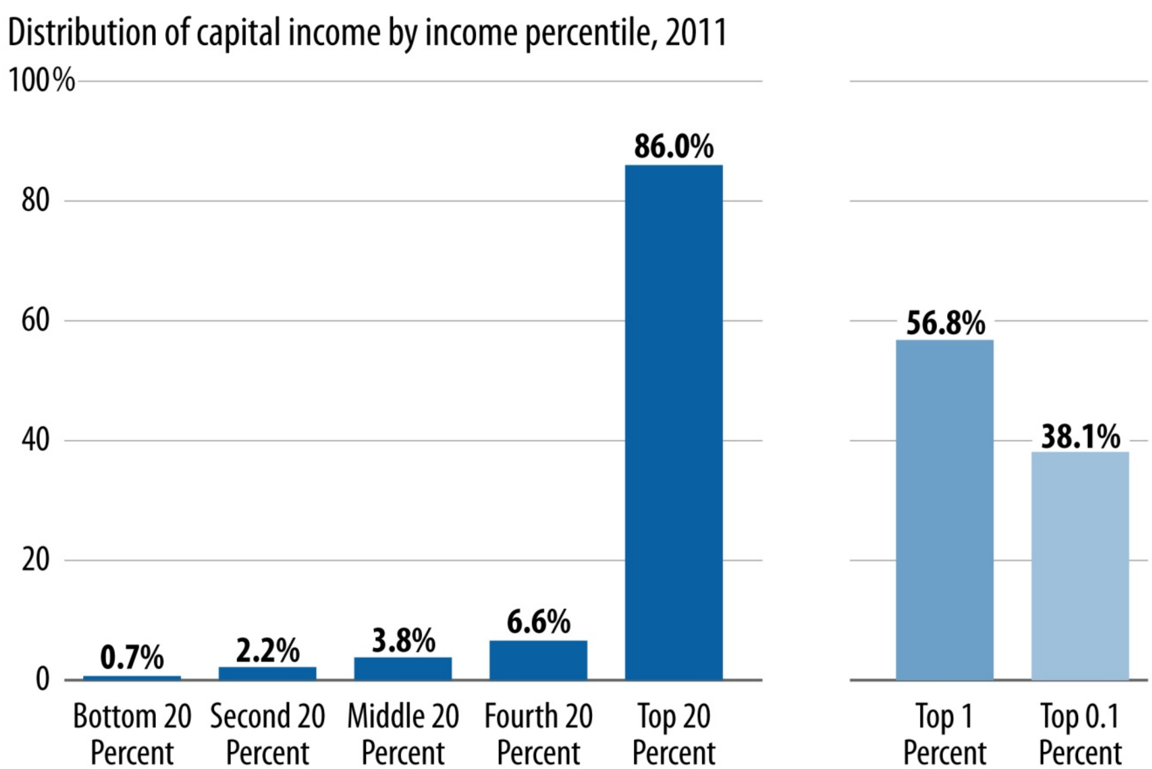
The relationship between profitability and inequality raises the role of capital incomes, particularly realized capital gains. In fact, in recent decades, capital gains, dividends, and other sources of non-

[11] See National Income and Product Accounts, table 1.12, http://www.bea.gov/national/nipaweb/index.asp.

wage income have become an increasingly determinant source of changes in inequality, especially in measures that break out the top 1 percent, where such income is concentrated.

Figure 3, using data from the Tax Policy Center, shows the concentration of capital income by income class. Note that 86 percent of all capital income accrues to the richest fifth of households, 57 percent goes to the top 1 percent, and 38 percent goes to the 120,000 households in the very top 0.1 percent of the income scale, whose average income was about $7 million last year.

FIGURE 3:
Capital Income Highly Concentrated



Note: Figures are for calendar year 2011, current law. Capital income includes taxable and non-taxable interest income, income from dividends, realizes capital gains or losses, and imputed corporate tax liability. The cash income percentile classes used are based on the income distribution of the entire population and contain an equal number of people, not tax units.

Source: Urban Institute-Brookings Institution Tax Policy Center

A recent study by the Congressional Research Service, using high-quality data on tax filers, provides more insight on this connection between capital income and inequality.[12]

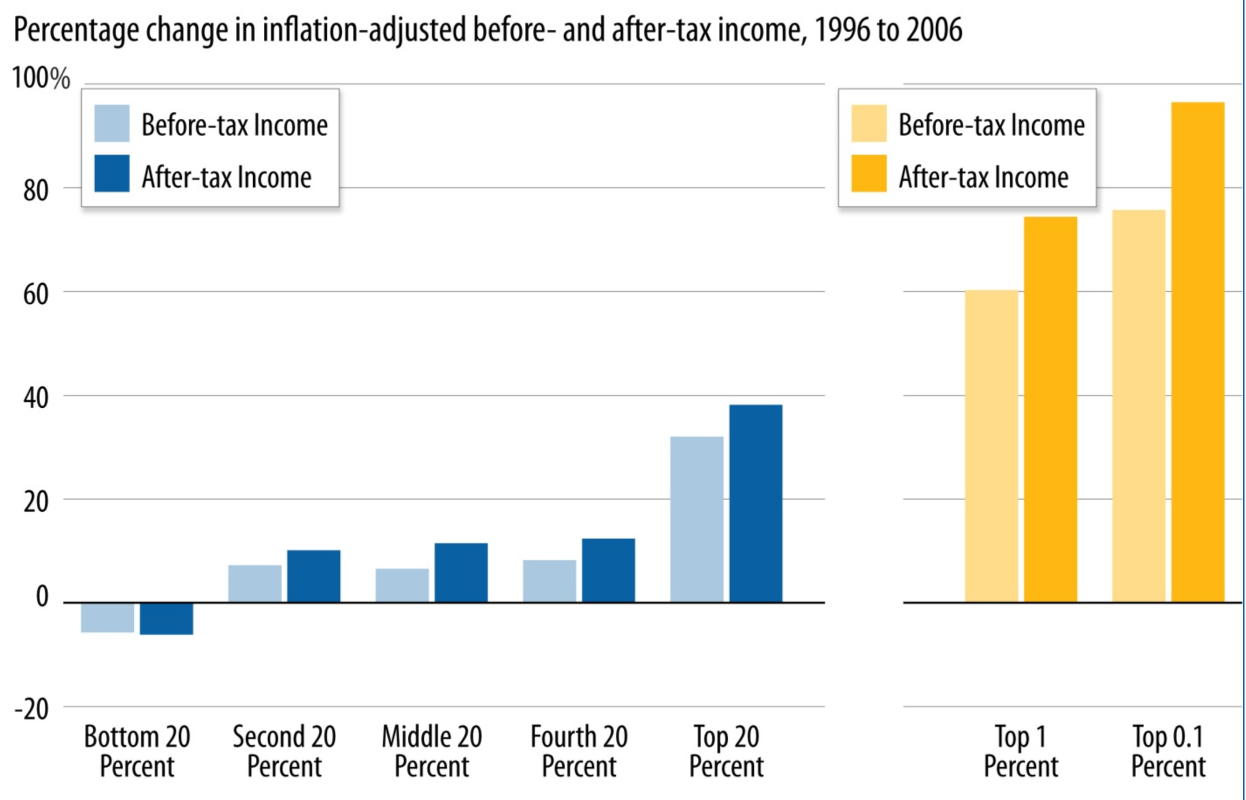
- The share of income from dividends and capital gains grew from 10 percent to 14 percent among all tax filers and from 31 percent to 38 percent among the top 1 percent; since this

[12] Thomas L. Hungerford, *Changes in the Distribution of Income Among Tax Filers Between 1996 and 2006: The Role of Labor Income, Capital Income, and Tax Policy*, Congressional Research Service, December 29, 2011, http://taxprof.typepad.com/files/crs-1.pdf

type of income is much more concentrated at the top to begin with, its increasing share is one explanation for inequality's growth.

- The wage and salary share, on the other hand, fell sharply, and this too boosted inequality, since its distribution is much less skewed than capital incomes
- Figure 4, using the CRS data, shows the familiar pattern of inequality's growth, in this case from 1996-2006, both pre- and post-tax income. The patterns of growth here reveal numerous important points:
  - Due to tax cuts over these years, the growth in after tax income was greater than that of pretax for all income groups.
  - However, since tax cuts, including the much-reduced tax on capital gains and dividends, were most generous to those with the highest incomes, after-tax income inequality grew slightly more quickly than pretax income. In other words, while the system of federal taxation is still progressive, it became less so over these years, and thus did less to offset the growth of pretax income inequality.

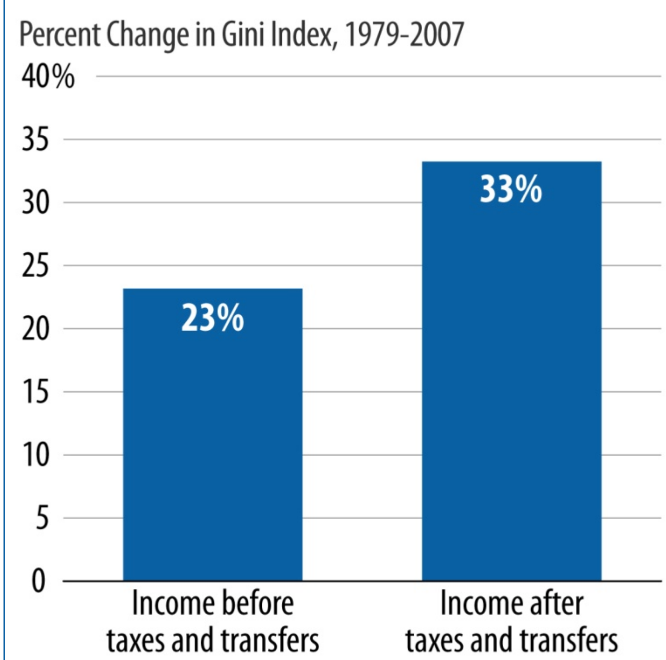
FIGURE 4:
Growth in After-Tax Income Exceeds Growth in Before-Tax Income For All Income Groups



Source: Congressional Research Service

- A recent CBO study of income inequality covering more years—1979-2007—finds this same result: "The equalizing effect of transfers and taxes on household income was smaller in 2007 than it had been in 1979."[13]
- One consequence of the combination of sharp growth in capital incomes along with regressive changes in taxes and transfers is the decline in the effective tax rates—their federal tax liability divided by their incomes—of those at the very top of the income scale. For the richest 400 taxpayers, the effective federal tax rate on their income fell from about 26 percent in the early 1990s to 18 percent in 2008, a period when their annual incomes increased 700 percent.[14]

FIGURE 5:
Taxes and Transfers Less Effective in Reducing Inequality



Source: CBPP calculations from Congressional Budget Office data

These findings raise a central point of my testimony. I strongly urge policy makers, particularly those with oversight over federal tax and transfer policy, to avoid what economist Alan Blinder has labeled, in a metaphor germane to events of last weekend, "unnecessary roughness," i.e., exacerbating market-driven inequality with regressive changes to taxes and transfers. Figure 5 shows the percent change in the Gini index—a measure of income concentration—from the CBO data comparing market, or pretax, incomes with after tax and transfer income. Note the increase in inequality was ten percentage points higher when taxes and transfers are included.

Mobility and Opportunity

There is little disagreement in the trends above: income inequality is historically very high. But some policy makers and analysts cite economic mobility—the movement of persons and families up and down the income scale over their lifetimes and across generations—as a reason for less concern about elevated levels of inequality. Their argument is essentially this: sure, there's greater distance

[13] Congressional Budget Office, *Trends in the Distribution of Household Income Between 1979 and 2007*, October 2011http://cbo.gov/ftpdocs/124xx/doc12485/10-25-HouseholdIncome.pdf. Note that CBO income data also include transfer income, an omitted income source in the CRS data.

[14] See Chuck Marr, "5 Reasons Why the "Supercommittee" Must Consider Tax Increases," *Off the Charts*, Center on Budget and Policy Priorities, August 3, 2011, http://www.offthechartsblog.org/5-reasons-why-the-%E2%80%9Csupercommittee%E2%80%9D-must-consider-tax-increases/.

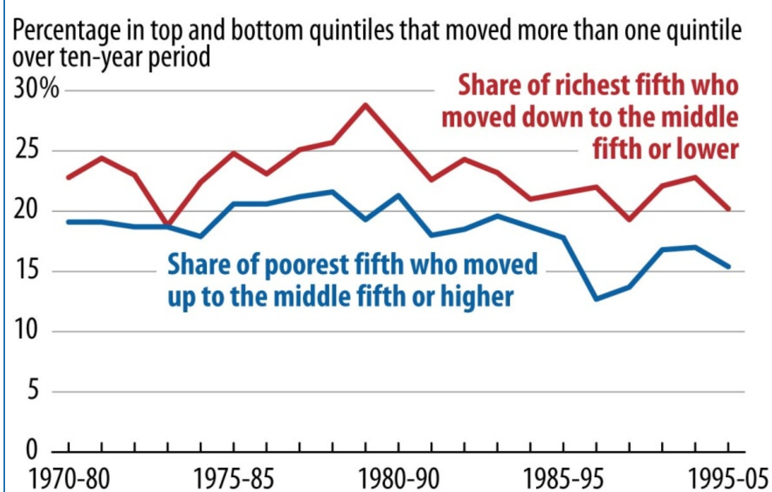
between income classes than there used to be. But since people move relatively freely between these income classes, that greater distance is not problematic.

A moment's reflection reveals the fatal flaw in this argument. It's not enough to cite the *existence* of mobility to offset sharply *increased* inequality. That explanation depends on accelerated mobility. That is, the rate at which households switch places in the income distribution—some move up while others move down—must increase if we are to be convinced the mobility is offsetting greater inequality.

In fact, there is no evidence that the rate of mobility has increased, and there's some evidence to the contrary. A recent paper by Boston Federal Reserve economist Katharine Bradbury documents a statistically significant decline in the rate of mobility. The slowdown isn't dramatic; Bradbury accurately labels it "slight."

Figure 6 uses two measures from Bradley's analysis to disprove the claim that faster mobility has offset higher levels of inequality. The lines in the figure represent mobility over ten-year spans. They show the share of families in the richest fifth who move down the income scale to the middle or lower fifths and the share of families in the poorest fifth who move up to the middle or higher. The lines basically drift down starting in the late 1970s, meaning there's less movement between the rungs on the income ladder. Bradbury found that the downshift over time was statistically significant.

FIGURE 6:
Income Mobility Declining Slightly



Source: Katherine Bradbury, *Trends in U.S. Family Income Mobility, 1969-2006*, Federal Reserve Bank of Boston, Working Paper No. 11-10, October 20, 2011

Another important insight regarding income mobility relates to international differences. Here, recent comparative work has found less mobility in the United States compared to almost every other advanced economy.[15] This may strike some listeners as surprising, given the supposed linkage between our more free market approach to economic policy compared to that of countries like those of Scandinavia, for example, which have considerably higher levels of mobility. Yet, the data clearly show this to be the case.

This raises the question as to whether there is a causal relationship between higher inequality and lower mobility. While such causal linkages are notoriously hard to prove, research has suggested potentially convincing linkages. In a recent presentation on inequality, Council of Economic Adviser's Chairman Alan Krueger showed that, in fact, countries with higher levels of inequality

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15 See Bernstein, Mishel and Shierholz, Chapter 2.

tend to have less intergenerational mobility (i.e., the economic status of adult children was positively correlated with that of their parents).[16]

Access to opportunity, or lack thereof, may play an important in these relationships, a point I return to below.

Why Do Inequality and Mobility Matter?

Often, results like those above on the evolution of inequality and mobility trends have been discussed exclusively in terms of fairness. That is an important criterion, especially to national policy makers. The concept of fairness is a deeply embedded and widely accepted principle of American society in the sense that those who work hard and "play by the rules" will achieve improving living standards and better opportunities for themselves and especially for their children. To the extent that high inequality and stagnant (or declining) mobility blocks such outcomes, the "American dream" is threatened.

Note that this explanation of fairness is based on opportunity, not outcomes. This is important distinction as some critics of those of us concerned about these inequality issues argue that our policy goal is equality of outcomes. It is not. It is equality of opportunity.

But fairness is not the only critique of the impact of the inequality and mobility results presented above. We should also be mindful of their impact on growth and the macroeconomy. Here again, some of these findings were summarized by Alan Krueger in the recent speech noted above:

- ***Less robust (or debt-financed) consumption.*** Seventy percent of the US economy is accounted for by consumer spending, so if that part of GDP lags, economic growth slows. It is also the case that the propensity to consume out of current income is higher among lower-income households (i.e., compared to wealthier households, they're more likely to spend than save their income).

  Based on an estimate of these relative propensities and the large shift in the share of national income that accrued to the top 1 percent over the past few decades, Krueger calculates that aggregate consumption could be 5 percent higher in the absence of such large income shifts. Applying "rules of thumb" on the relationship between aggregate growth and jobs, and assuming both economic slack and that this income was not simply replacing demand elsewhere in the economy, this extra consumption growth could reduce unemployment by 1.75 percentage points, implying about 2.6 million more people with jobs.

  Krueger cites an important caveat about this type of calculation. In the face of stagnant earnings in the 2000s, many in the middle class borrowed to make up—or more than make up—the difference, in which case middle-class consumption did not fall as much as it would have absent this leverage. To point out that this method of improving middle class living standards is both unsustainable and extremely risky is an obvious understatement.

[16] See Alan Krueger, *The Rise and Consequences of Inequality*, address at the Center for American Progress, January 12, 2012, http://www.americanprogress.org/events/2012/01/krueger.html.

- ***Inequality and longer term growth.*** Krueger also points to recent research showing that "in a society where income inequality is greater, political decisions are likely to result in policies that lead to less growth." Economist Mancur Olson also hypothesized about this relationship decades ago.

  As more income, wealth, and power is concentrated at the top of the income scale, narrow coalitions will form to influence policy decisions in ways less likely to promote overall, or middle-class, well-being, and more likely to favor those with disproportionate power and resources. In the current economics debate, we clearly see these dynamics in a tax code that bestows preferential treatment on those with large amounts of assets, like capital gains and stock dividends, relative to wage earners.

Inequality, Opportunity, and Mobility

Putting together the findings suggests a hypothetical causal chain or even a negative feedback loop: from higher inequality, to reduced opportunity, to diminished mobility. Reduced opportunity — say, less educational access for children from lower income families — both reinforces high levels of inequality and further diminishes mobility. As in research I note below, this loop is particularly likely to occur when inequality diverts overall growth from low-income families, leading to high and persistent child poverty. Causally, this chain of events is likely to operate through everything from diminished access to quality education, starting with pre-school (early educational interventions have been shown to have lasting positive impacts on later earnings and mobility[17]), to inferior public services, like poor quality libraries and parks, to lack of health care, inadequate housing in underserved communities, and even a polluted physical environment.

To the extent that higher inequality and less mobility lead more children to be exposed to these risk factors, we may well find that as society grows ever more unequal, those falling behind are losing access to the ladders that used to help them climb over the mobility barriers they faced.

In fact, research on the impact of poverty in early childhood has found some of these connections to be operative.

- Duncan and Magnuson (2011) find that the future earnings and hours worked of children from low-income families (incomes below $25,000) was significantly more responsive to extra income than those outcomes for children from higher income families.[18]
- Ratcliffe and McKernan (2011) find worse adult outcomes, including less educational attainment, premarital births, and worse employment histories for children who experienced multiple years of poverty compared to those who did not.[19]

[17] See James Heckman, *Letter to Joint Select Committee on Deficit Reduction*, University of Chicago, September 21, 2011, http://www.heckmanequation.org/content/resource/letter-joint-select-committee-deficit-reduction.

[18] Greg J. Duncan and Katherine Magnuson, "The Long Reach of Early Childhood Poverty," *Pathways*, Stanford Center on Poverty and Inequality, Winter 2011, http://www.stanford.edu/group/scspi/_media/pdf/pathways/winter_2011/PathwaysWinter11_Duncan.pdf.

[19] Caroline Ratcliffe and Signe-Mary McKernan, *Childhood Poverty Persistence: Facts and Consequences*, Urban Institute, June 30, 2010, http://www.urban.org/publications/412126.html.

- Bailey and Dynarski (2011) find growing gaps between children from low- and higher income families in college entry and graduation. For example, they note that "rates of college completion increased by only four percentage points for low-income cohorts born around 1980 relative to cohorts born in the early 1960s, but by 18 percentage points for corresponding cohorts who grew up in high-income families."[20]
- Various studies find that severely disadvantaged neighborhoods are associated with negative outcomes for children and youth, including reduced cognitive development, less education attainment, and worse health outcomes.[21]

Consider the role of inequality in this opportunity framework. Turning back to Figure 4 from the CRS, it can be seen that will average, pretax income grew by 20%, 1996-2006, but that of the poorest families actually fell 6% in real terms while that of low-income families in the second income fifth grew by 7% (well under 1% per year). Had these families' income grown at the average rate, their average income would have, in fact, been about $3,000 higher than it was in 2006. That extra income, according to the research cited above, could have made a real difference in the lives of the children in these families when they grow to adult.

The Policy Agenda Implied by These Developments

This committee has been in the forefront of some of the most important policy developments in areas that directly and indirectly effect inequality and mobility, particularly tax and transfer policies. As stressed in my introduction, we are at a unique historical moment where policy makers must engage in a delicate balancing act. The fiscal imperative to achieve a sustainable budget path in the long run must be balanced with the need for continued stimulus in the short run, such as the full year extensions of the payroll tax holiday and UI benefits. And as shown in Figure 5, changes in taxes and transfers over the past decade have already led them to be less effective as a levee against increased inequality. Legislators must be careful to avoid exacerbating this problem, or better, to begin to correct it.

Tax Reform: This has broad implications for tax reform. Allowing the high-end Bush tax cuts to expire at the end of this year, as President Obama has proposed, is consistent with this approach. Because high-income households are not liquidity constrained in their after-tax income, tax increases on them are not expected to create "fiscal drag" and this part of the tax cuts alone is expected to generate about $850 billion in savings over ten years, including interest.

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[20] Martha J. Bailey and Susan M. Dynarski, Gains and Gaps: Changing Inequality in U.S. College Entry and Completion, Working Paper, December 2011, http://www-personal.umich.edu/~baileymj/Bailey_Dynarski.pdf.

[21] See for example Nancy O. Andrews with Christopher Kramer, "Coming Out as a Human Capitalist: Community Development at the Nexus of People and Place," *Community Development Investment Review*, Federal Reserve Bank of San Francisco, Volume 5, Issue 3, 2009; Julia Burdick-Will et. al., "Converging Evidence for Neighborhood Effects on Children's Test Scores: An Experimental, Quasi-experimental, and Observational Comparison," *Project on Social Inequality and Educational Disadvantage*, Brookings Institution, March 2, 2010; Jens Ludwig et. al., "Neighborhoods, Obesity, and Diabetes: A Randomized Social Experiment," *The New England Journal of Medicine*, October 20, 2011, http://www.nejm.org/doi/full/10.1056/NEJMsa1103216; Margery Austin Turner et. al., *Helping Poor Families Gain and Sustain Access to High-Opportunity Neighborhoods*, Urban Institute, October 2011, http://www.urban.org/publications/412455.html.

The above discussion of capital incomes should also be considered in this context. Recent revelations about the comparatively low effective tax rates paid by prominent wealthy individuals, like investor Warren Buffet or former Massachusetts Governor Mitt Romney, have also amplified these issues. Low effective rates of certain very high-income individuals are clearly a function of significant shares of their income coming from source with favorable treatment through the tax code, such as the current 15% on certain capital gains and dividends.

Ending the favorable treatment of these income sources is consistent with the goals of both deficit reduction and moderating inequality. According to the Joint Committee on Taxation, for example, the cost of the tax benefits of the current preferential treatment of long-term capital gains and dividends is $450 billion, 2011-2015.[22]

Though a full analysis of the response to rate changes is beyond the scope of this testimony, policy makers do, of course, need to be mindful of behavioral responses to tax changes. Summarizing a robust literature, the main response to tax changes among high income or high wealth households appears largely unrelated to "supply-side" effects, like greater capital investment leading to higher productivity, wage, or job growth. Instead, beneficiaries of these tax cuts are more likely, to rearrange their taxable income in ways to avoid taxation, such as the strategic timing of realization of capital gains.

In this regard, recent research looks at the relationship between top marginal tax rates, income inequality, and growth.[23] Comparing these variables across time and various countries, this research generates the figures shown in the appendix. The top panel finds a significant negative relationship between changes in top marginal rates and the change in the share of pretax income accruing to the top 1% (e.g., lowering high-end tax rates is correlated with growth in the share of income at the very top of the scale); the bottom panel shows no relationship between these high-end tax cuts and average income growth. The authors conclude that much higher tax rates on the compensation of the highest earners would be consistent with greater revenue collection and less inequality, while not injurious to growth.

Spending Cuts: Unless we are prepared to reduce government spending to the point where essential functions would be inoperable, it should be clear that the nation cannot get on a sustainable budget path on the back of spending cuts alone. It is, however, equally clear that spending cuts will be part of the mix. In fact, thus far, they have been the *only* ingredient in the mix.

In this regard, I urge policy makers to be guided by principles put forth by both the Bowles-Simpson Fiscal Commission and the Gang of Six. Both of these deficit reduction efforts recognized that cuts in key federal programs like SNAP and the EITC would increase poverty and hardship, and both decisively ruled such cuts out.

Both groups--Bowles and Simpson and the Gang of Six—highlighted as a basic guiding principle that deficit reduction should be achieved in ways that do not increase poverty. Those plans avoided

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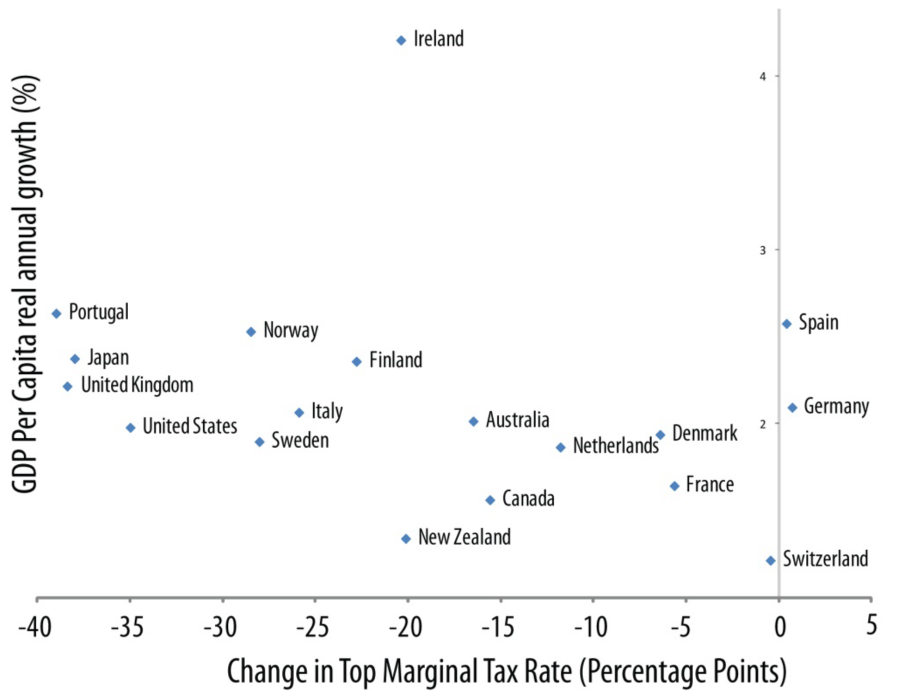
[22] The Joint Committee on Taxation, Estimates Of Federal Tax Expenditures For Fiscal Years 2011-2015, January 17, 2012, http://www.jct.gov/publications.html?func=startdown&id=4386.

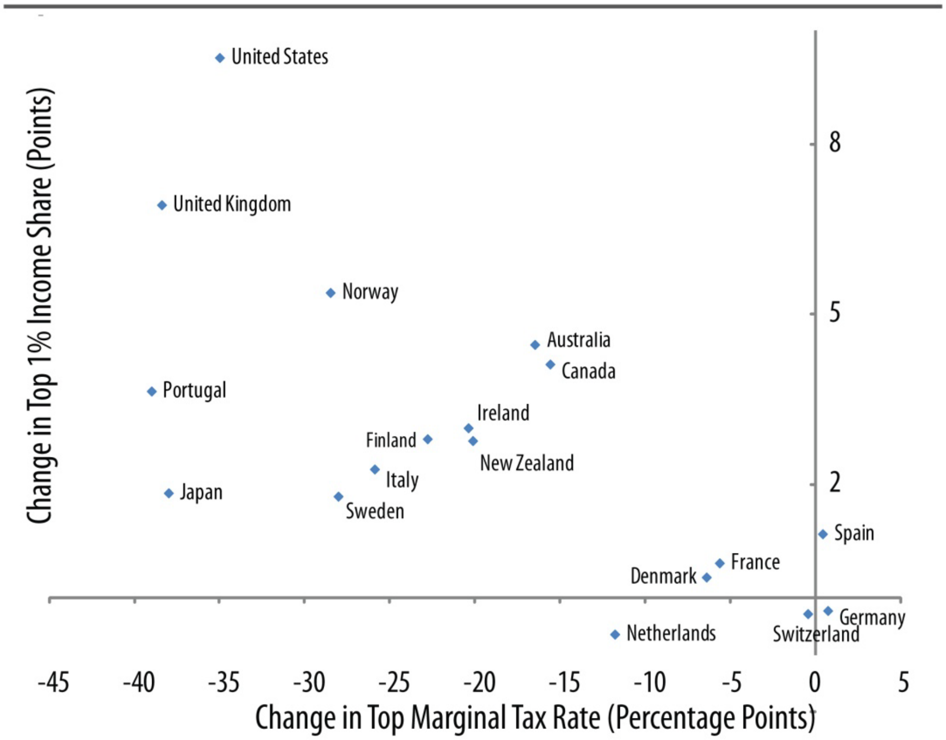
[23] Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, *Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities,* National Bureau of Economic Research Working Paper 17616, November 2011: http://www.nber.org/papers/w17616.pdf?new_window=1

cuts in means-tested assistance programs other than Medicaid. The Gang of Six also instructed the Agriculture Committees not to meet their deficit-reduction target by substituting food stamp cuts for some or all of the savings those committees would be directed to produce in agriculture programs, and barred the tax-writing committees from cutting the EITC or Child Tax Credit to achieve the savings they were asked to produce through tax reform.

In fact, many discretionary programs that serve low- and moderate-income families have already been the target of budget cuts. For example, LIHEAP – which helps low-income families with their heating and cooling bills – saw its funding dramatically decreased in 2011. Other cuts to discretionary spending, like the recent eligibility cuts to Pell Grants in 2012, are particularly dangerous in that they have the potential to further reduce the mobility prospects of young adults and children. Congress should avoid additional cuts to programs that help families overcome mobility barriers, programs like Head Start, Title I, and job training.

Appendix
Marginal Tax Changes, Economic Growth, and Income Shares





Note: Changes are based on averages from 1975-1979 and 2004-2008. In cases where data for those years were not available, the first five years after 1975 and the most recent 5 years are selected.

Source: CBPP analysis based on data from OECD and World Top Incomes Database. Figure originally appeared in Piketty, Saez, Stantcheva, 2011.