

EXECUTIVE SUMMARY

The United States is now a year into what many predict will be a very serious recession. Economic turbulence of this type is likely to have far-ranging consequences that are not limited to the immediate future. Recent estimates are that, as a result of the economic downturn, an additional 2.6 to 3.3 million children will fall into poverty. Allowing these children to fall into poverty will prove to be a significant long-term drag on the U.S. economy. In fact, an addition of 3 million children to the ranks of the “poor,” would mean an overall economic loss of at least \$1.7 trillion over the lifetime of these children. That amounts to a yearly loss of about 0.27% of GDP, or \$35 billion dollars per year.

This analysis is based on previous estimates of the aggregate costs of childhood poverty, including the effects of childhood poverty on lifetime earnings and health outcomes. Specifically, research suggests that children who spend more than half of their childhood in poverty earn, on average, 39% less than the median income. Furthermore, a poor child loses approximately a quarter of a million dollars worth of “health quality” over the course of his or her lifetime. By aggregating these long-term effects across the millions of newly poor children, we can produce a baseline estimate of the economic costs of allowing additional children to become poor during this recession.

Finally, because the negative ramifications that stem from childhood poverty are particularly acute for those children who spend a large number of their early years in poverty, it is important to investigate whether recession-induced poverty is persistent or “merely” temporary. An analysis of data from the Panel Study of Income Dynamics reveals that more than half of children who fall into poverty during recessions are likely to remain in poverty for at least some time after the recession ends. In fact, about a quarter of children who suffer from recession-induced poverty will spend at least half of their remaining childhood in poverty.

Because recession-induced poverty is at least somewhat persistent among children, and because we know that extended poverty during childhood leads to long-term economic costs, we conclude that there is a material and measureable economic benefit to acting now to prevent the child poverty rate from skyrocketing. At bottom, if we are able to simply maintain the current child poverty rate, the US economy will benefit by at least \$1.7 trillion over the next several decades.

INTRODUCTION

Recently the National Bureau of Economic Research determined that the US economy ceased expanding and fell into a recession beginning in December of 2007.¹ This means that we had been experiencing an economic contraction for more than nine months even before the collapse of Lehman Brothers sparked an acute crisis. Now, about a year into the recession with no clear end in sight, the federal government has turned its attention to attempting to simultaneously calm nervous financial markets and to jumpstarting the wider economy with a broad stimulus package. Much of the discussion surrounding a potential program of federal spending to improve the economy focuses on investments that will both provide an immediate boost as well as pave the way for longer term economic growth. There has been little discussion, however, of the impact of this economic downturn on the long range development of our nation’s most important resource: its human capital.

There is no doubt that all recessions, even those less severe than we are now experiencing, have a measurable impact on the current labor force. Of course, recessions are associated with a significant rise in unemployment rates from which it usually takes several years to recover. An increase in joblessness means lost earnings and lost experience. For example, there is evidence that the economy even suffers from lost earnings of recent college graduates during recessions as these newcomers to the labor force find a much depressed market for their skills. The losses, in these cases, can take up to a decade to recover.²

But there is another aspect of recessions that often goes overlooked, and that is the long-term impact on economic growth that stems from the rise in childhood poverty that always accompanies prolonged economic contractions. According to a recent report released by the Center on Budget and Policy Priorities (CBPP), all of the last three recessions saw significant increases in child poverty. This is hardly surprising given that the most vulnerable elements of society are usually the ones who are hardest hit during tough times, and children decidedly fall into that category. In the recession of the early 1980's, for example, three and half million additional children fell into poverty, pushing the child poverty rate up an astonishing 5.9 percentage points, a roughly 36% increase over pre-recession levels. More recent recessions have brought with them similar, though less severe, increases in child poverty with 2.6 million children falling into poverty during the early 1990's recession, and 1.7 million during the recession that began in 2001.

Using estimates for rising unemployment and applying the relationship between unemployment rates and child poverty rates from the past three recessions, the Center on Budget and Policy Priorities comes to the conclusion that this current economic downturn will push between 2.6 and 3.3 million children into poverty.³

THE ECONOMIC COST OF POVERTY

Of course, the United States has a moral interest in working to prevent these children from falling into poverty, but less well understood is that there is a

material, and measurable economic impact from allowing additional children to experience the burdens of poverty. It is widely accepted that poverty, in all its forms, takes a broad economic toll. A report issued by the Government Accountability Office (GAO) last year summed up the relevant literature and concluded that, "Research shows that poverty can negatively impact economic growth by affecting the accumulation of human capital and rates of crime and social unrest."⁴ Furthermore, the GAO report goes on to note that, "recent empirical studies have begun to demonstrate that higher rates of poverty are associated with lower rates of growth in the economy as a whole." For example, Saurav Dev Bhatta found, in a 2001 *Journal of Urban Affairs* article, that US metropolitan areas with higher rates of poverty experience much slower economic growth than do those areas with lower rates of poverty.⁵ Studies such as these underline the fact that poverty, as a whole, acts as a drag on economic progress.

If poverty, in general, has a negative effect on growth, then childhood poverty certainly has a special role to play. There have been several attempts to quantify the economic costs associated with child poverty. More than a decade ago the Children's Defense Fund (CDF) published "Wasting America's Future: The Children's Defense Fund Report on the Costs of Child Poverty."⁶ This expansive look at child poverty and its effects estimated that the yearly costs associated with future reduced worker productivity and employment fell between 0.5% and 2.5% of GDP.⁷ This year, that translates to a loss of between \$65 and \$325 billion dollars in lost economic activity. The 1994 CDF analysis does not account for losses stemming from the long-term health effects of poverty, nor does it include the costs of crime that result from childhood poverty. Nevertheless, this groundbreaking report demonstrated clearly that childhood poverty has very real, and measurable effects for our economy far into the future.

More recently, a team writing under the auspices of the Center for American Progress (CAP) found that the aggregate costs to the present-day economy of childhood poverty approach 4% of GDP annually.⁸ In their 2007 paper entitled "The Economic Costs of Poverty in the

United States: Subsequent Effects of Children Growing Up Poor,” Harry Holzer *et al.*, review the relevant literature on the “average statistical relationships between children growing up in poverty and their earnings, propensity to commit crime, and quality of health later in life.” After establishing the strong connection between growing up poor and experiencing these negative outcomes, the authors then, using a variety of conservative assumptions, combine the estimated losses associated with forgone earnings, health problems, and crime into an aggregate estimate of the costs to the US economy of childhood poverty .

Though Holzer *et al.*’s analysis is preferable to the earlier CDF report due to its more recent publication date as well as its inclusion of crime and health costs, the two reports are actually in basic agreement. As mentioned, CDF’s report found that the economic costs of child poverty were in the range of 0.5% to 2.5% of GDP, counting only the negative productivity and higher unemployment that comes from growing up poor. The more recent CAP report estimated the same costs to be about 1.3% of GDP, a bit less than the midpoint of CDF’s estimate. Furthermore, in the 13 years between the publication of the two reports, child poverty rates have fallen somewhat. In 1994, the child poverty rate was just under 22%. Fortunately, that rate fell consistently throughout the 1990’s. By 2000, the child poverty rate was down to 16.2%. Over the past seven years, however, the rate has begun rising again, but 2006 levels (17.4%) were still well below those of 1994. It should not be surprising, therefore, to find that the costs of childhood poverty had diminished somewhat between 1994 and 2006. Indeed, we would expect such an outcome. Therefore, despite the 12 years separating the two analyses, the authors come to strikingly similar conclusions. Persistent childhood poverty means significant lost economic activity. These costs, taking into account only lost earnings and lower productivity, likely exceed 1% of GDP.⁹

ESTIMATING THE ECONOMIC COSTS STEMMING FROM RECESSION-INDUCED CHILD POVERTY

We know that poverty in general, and child poverty specifically, significantly hinder future economic

growth. We also know, as mentioned already, that the Center on Budget and Policy Priorities estimates that between 2.6 and 3.3 million additional children are likely to fall into poverty as a result of the current economic turbulence. If we do nothing to prevent these children from descending into poverty, what are the likely long-term costs to the US economy? Using the conclusions from Holzer *et al.* we can estimate the economic impact of allowing additional children to fall into poverty during this current recession.

As discussed, Holzer *et al.* detail three distinct negative ramifications of child poverty: lost future earnings, diminished lifetime health quality, and increased propensity towards criminal behavior. They attribute to childhood poverty a yearly cost amounting to 1.3% of GDP stemming from lost productivity and earnings, 1.2% of GDP stemming from increased healthcare costs, and 1.3% of GDP stemming from increased crime. These estimates are based, in large measure, on either existing poverty rates, or assumptions of relatively low future childhood poverty (15%). How do these estimates change if we take account of the rise in childhood poverty that is likely to occur if we do nothing to mitigate the effects of the current recession?

LOST EARNINGS

Holzer *et al.* review a wide literature on income mobility and the lifetime effects of growing up poor and conclude that, on average, a child who spends most of his childhood in poverty will make, as an adult, 39% less than the median yearly earnings, while a child who spends between a quarter and a half of his childhood in poverty will experience an earnings shortfall approximately half as severe. These conclusions, combined with the data point that close to 10% of American children from 1974 to 1994 lived in poverty for at least half of their childhood and another 8% experienced poverty for at least a quarter of their childhood, leads them to conclude that the gross yearly loss in earnings attributable to poverty is about 2.1% of GDP.¹⁰ Finally, the authors subtract 40% from this conclusion in order to account for the share of the costs that is a product of hereditary rather than environmental factors.¹¹ Three fifths, then, of 2.1% produces their final estimate of a 1.3% of GDP annual cost as a result of lost earnings.

This estimate is especially useful because we can easily calculate the impact of higher poverty rates. Essentially, Holzer's methodology suggests that a 1 percentage point rise in the rate of children experiencing persistent poverty produces an additional economic loss of about 0.09% of GDP. Similarly, a 1 percentage point rise in the rate of children experiencing intermittent poverty produces an additional economic loss of about 0.045% of GDP.

According to the CBPP analysis, between 2.6 and 3.3 million children will fall into poverty as a result of this recession. The Census Bureau's annual American Community Survey suggests that there are about 74 million children in the United States, meaning that an increase of 3 million children in poverty is equivalent to a 4% increase in the overall child poverty rate.¹² However, Holzer's analysis is not based on the overall poverty rate, it is based on the rate of children who live in persistent and intermittent poverty. As alluded to above, an analysis of the Panel Study on Income Dynamics showed that 9.6% of American children fell into the first category, and an additional 8% fell into the second.¹³ If this pattern holds for these newly poor children and roughly half of these children experience persistent poverty and the other half only intermittent poverty, we can expect future annual loss of approximately 0.3% of GDP (see below for a fuller discussion of the persistence of recession-induced poverty). In today's economy, a 0.3% loss would translate to about \$39 billion.

HEALTH

In order to estimate the health costs that stem from childhood poverty, Holzer computes two separate costs: increased direct healthcare expenditures resulting from poverty and decreases in "health capital." Holzer computes that childhood poverty costs the country about \$26 billion per year, or about 0.2% of GDP, in additional healthcare expenditures, assuming a child poverty rate of only 15%.¹⁴ Dwarfing these costs, however, are those that come from a lower life expectancy, a greater incidence of serious illness, and a generally lower quality of health. According to an analysis of relevant literature, Holzer *et al.* conclude that these costs can approach one quarter of a million dollars, per child, over the course of her life. Estimating that

600,000 children are born into poverty every year (which again assumes a 15% poverty rate), Holzer calculates that this diminished health capital results in a yearly loss of \$149 billion, or about 1.1% of GDP.

For our purposes, we can treat the 3 million additional children who will fall into poverty during this recession as "newborns" who will now suffer the lifetime consequences of poverty experienced during childhood. Specifically, each of these children will lose approximately \$250,000 in health capital over the course of their lifetimes. In the aggregate, this amounts to an overall loss of nearly \$750 billion. If we then prorate that total lifetime loss over sixty years, roughly approximating the adult life of these children, the yearly losses amount to about \$12.5 billion, or about 0.1% of current GDP.¹⁵

CRIME

Compared to their estimates regarding earnings and health losses, Holzer and his team employ a significantly different approach when estimating the impact of childhood poverty on the costs of crime. Instead of beginning by determining the costs that are attributable to an individual's experience with poverty and then aggregating those across all poor children, in this case they start with the aggregate costs to society of criminal activity and seek to determine the share that results from poverty. For our purposes, this approach is further complicated by the fact that, in determining the "crime costs," Holzer relies on a relative definition of "poor," rather than an absolute one (for the other two categories, Holzer appears to use the absolute standard). After a review of relevant studies, Holzer determines that about 40% of all crime results from poverty. Applying this to the annual \$700 billion price tag that comes with "street crime," and then discounting another 40% as being hereditary rather than environmental, Holzer concludes that the annual "crime cost" of poverty is \$170 billion.

The path to this conclusion, unfortunately, does not allow us to make an informed estimate of the additional crime costs that will come with allowing 3 million children to fall into poverty. Holzer identifies a share of total crime that comes from poverty, but does not attempt to unravel how that share might change if

poverty increases or decreases. As a result, though we can be certain that adding 3 million children to the ranks of the very poor will have some “crime costs” in the future, we will have to leave it to others to attempt a more precise estimate of these added costs, and therefore our final estimate will take account only of health costs and forgone earnings.

THE PERSISTENCE OF RECESSION INDUCED POVERTY

Before concluding, it is necessary to evaluate whether recession induced poverty should be treated the same, in terms of long-term economic costs, as the persistent child poverty that exists even in growth periods. Holzer and his team make a distinction, at least in determining the value of lost earnings, between those children who spend at least half of their childhood in poverty and those who spend at least a quarter of their childhood in poverty. In fact, they make no calculation at all for those children who only spend one to four years of their childhood in poverty. Therefore, in order to make a fair estimate of these costs, it is important to determine how likely it is that children who fall into poverty during this recession will stay there for some significant additional portion of their childhood.

To answer this question, we conducted an original analysis of data from the Panel Study of Income Dynamics (PSID). The PSID is a, “nationally representative longitudinal study of nearly 8,000 U.S. families. Following the same families and individuals since 1968, the PSID collects data on economic, health and social behavior.” Essentially, by following the children in the PSID sample through the various economic ups and downs over the years of their life, we can get a better sense of what happens in the future to children who fall into poverty during recessions. Fundamentally, we want to know how likely it is that children who experience recession-induced poverty will continue to live in poverty even after the recession ends. By answering this question, we can make a more accurate assessment of the long-term costs of recession-induced child poverty since the more prolonged the poverty, the more severe the future consequences.

Our analysis looked at children who fell into poverty during two recent recessions, that which occurred from 1980 to 1983 and that which occurred from 1990 to 1993.¹⁶ We followed these children, children who lived in families with income above the federal poverty line in the year before the recession began but who fell into poverty during the recessionary years, for about ten years after the recession ended. Among children who fell into poverty during the 1980’s recession, approximately 26% of them spent at least half of their remaining childhood in poverty even after the recession ended. Another 17% spent at least a quarter of their remaining childhood in poverty. Finally, another 21% experienced at least 1 year of additional poverty after the recession ended. All together, for nearly two thirds of these children, poverty plagued them even after the economy recovered.

The numbers were very similar for the 1990’s recession cohort. 29% of the children who fell into poverty during that recession lived at least half of their remaining childhood in poverty after the recession ended and an additional 10% lived in poverty for at least a quarter of their remaining childhood.¹⁷ Though it may seem like a small share (39%) of these children experienced several years of post-recession poverty, it is worth comparing this group of children to their contemporaries who did not fall into poverty during the recession. Among children who stayed out of poverty during the early 1990’s despite the economic turbulence, only 3% fell into poverty at any point during the rest of their childhood (on the other hand 65% of the children who started out, in 1989, already in poverty, continued to experience poverty after the recession ended). In other words, children who fell into poverty during the recession were 13 times more likely to experience additional years of childhood poverty after the economy recovered than were children who did not succumb to recession-induced poverty.

THE BOTTOM LINE

It is clear that falling into poverty during a recession carries with it a significant chance of persistent poverty that follows a child forward even after the recession ends. Nevertheless, it is also clear that some portion of the children who suffer recession-induced poverty will

climb out of it after the recession ends and therefore escape most of the long-term disadvantages that come with childhood poverty. Our best estimate, based on our analysis of the PSID data is that, if we do nothing, about 60% of the 3 million children who are projected to fall victim to poverty during this recession will experience the persistent or intermittent poverty that causes long-term damage. Of these, about half will fall into the more damaging former category.

Using our analysis of the PSID data, we can adjust our estimate to take account for the fact that not all of the children who fall into poverty during this recession will experience the full extent of the long-term negative effects of prolonged childhood poverty. This adjustment reduces our estimate of lost earnings from 0.3% of GDP to about .17% of GDP, which would mean about \$22 billion per year.

Considering only the long term health and earnings affects of childhood poverty, and based on very conservative assumptions, the future yearly costs of allowing 3 million additional children to fall into poverty during this recession surpass at least \$35 billion per year. Over the lifetime of these children, these costs will aggregate into a total economic burden of approximately \$1.7 trillion (in 2008 dollars).¹⁸

ENDNOTES:

1 <http://wwwdev.nber.org/cycles/dec2008.html>

2 http://www.columbia.edu/~vw2112/papers/nber_draft_1.pdf

3 Sharon Parrott . “Recession Could Cause Large Increases in Poverty and Push Millions Into Deep Poverty: Stimulus Package Should Include Policies to Ameliorate Harsh Effects of Downturn” Center on Budget and Policy Priorities. November 24, 2008.

4 Government Accountability Office. “Poverty in America: Economic Research Shows Adverse Impacts on Health Status and Other Social Conditions as well as the Economic Growth Rate.” January 2007.

5 S. Dev Bhatta. “Are Inequality and Poverty Harmful for Economic Growth?” *Journal of Urban Affairs*, 22 (3-4): 2001.

6 Arloc Sherman. “Wasting America’s Future: The Children’s Defense Fund Report on the Costs of Child Poverty.” Children’s Defense Fund. Beacon Press, Boston: 1994.

7 The report estimated that the costs were between \$36 billion and \$177 billion annually. In 1994, the year the report was published, the GDP of the United States was just over \$7 trillion. Consequently, in terms of GDP, the CDF report estimated an affect of 0.5% to 2.5%.

8 Harry J Holzer, Diane Whitmore Schzenbach, Greg J. Duncan, Jens Ludwig. “The Economic Costs of Poverty in the United States: Subsequent Effects of Children Growing Up Poor.” Center for American Progress. January 24, 2007.

9 It is worth noting that a recently released British study of childhood poverty in the United Kingdom came to very similar conclusions. Indeed, the report written by Jo Blanden, Kristine Hansen and Stephen Machin, entitled, “The GDP Cost of the Lost Earning Potential of Adults who Grew up in Poverty,” found that the economic costs associated with forgone earnings resulting from childhood poverty amount to between 1% and 1.8% of GDP. The UK and the USA have similar levels of child poverty, especially when compared to other developed countries. However, despite the similarity, it is important to mention that the United Kingdom uses a relative measure of poverty whereas the United States employs an absolute measure. There are likely other society and structural differences between the two countries that make a direct comparison of these studies more difficult. Nevertheless, the similarities are striking.

10 The exact calculation includes adjustments for the fact that median earnings are about 60% of average earnings, and furthermore that earnings are about 65% of GDP. Therefore their equation looks like this: $(.098*.39*.60*.65) + (.08*.39*.5*.6*.65) = .0021$

11 Holzer’s use of 40% is based on the work of Christopher Jencks and Laura Tach and their 2006 article, “Would Equal Opportunity Mean More Mobility?” which appeared in S. Morgan, D. Grusky and G. Fields eds. *Mobility and Inequality: Frontiers of Research from Sociology and Economics*. Stanford, CA: Stanford University Press. Both Jencks and Tach as well as Holzer *et al.* note that this estimates is very rough and that different studies have produced different estimates. Holzer deliberately uses 40%, however, both because Jencks and Tach are convincing and because it is on the high end of the spectrum of estimates of the role heredity. Holzer writes that, “the 40 percent figure might well overstate the role of inherited traits for those from low income families.”

12 The Census Bureau projects about 75 million children in 2010, so population growth will not substantially alter the child poverty rate.

13 Rebecca Blank. “It Takes a Nation.” Princeton, NJ. Princeton University Press. 1997.

14 Though the clear implication is that these costs would rise with a rising child poverty rate, unfortunately Holzer’s article does not give us the tools to calculate by how much the costs would rise with a 4% increase in poverty. Therefore, we will exclude these costs entirely, keeping in mind that this analysis seeks only to estimate a lower bound of the true costs associated with allowing these children to fall into poverty.

15 The life expectancy of the poorest segments of American society is about 75 years. Among those clustered near the median of economic resources, life expectancy is about 2 years older. See, for example, Pear, Robert. “Gap in Life Expectancy Widens for Nation.” *New York Times*. March 23, 2008.

16 This analysis is limited to children in the PSID who were under the age of 18 at the time of the end of the recession. Because we are trying to discern the impact of recession-induced poverty on children, we excluded those persons who became “adults” in the midst of the recession. We did not analyze the cohort of children who fell into poverty during the most recent recession, in 2001, because the PSID only has data up to 2004, which prevents us from following those children very far into the future. For all analyses conducted, we weighted the results based on the individual core PSID weights from the year prior to the beginning of the recession.

17 Because the PSID did not collect family income data in several years during this period, we did not calculate the percentage of children who spent at least one additional year in poverty.

18 \$12.5 billion per year in health costs multiplied by 57 years of adulthood equals 713 billion. 22 billion times 45 years of employment equals 990 billion. Together, that makes \$1.7 trillion.

*Michael Linden is the Senior Director of Tax & Budget Policy
at First Focus. He can be reached at MichaelL@firstfocus.net.*

*First Focus is a bipartisan advocacy organization that is committed to making children and their families a
priority in federal policy and budget decisions. To learn more visit www.firstfocus.net.*