

CHAPTER 20. POVERTY AND ECONOMIC INEQUALITY

INTRODUCTION TO POVERTY AND ECONOMIC INEQUALITY



Figure 1. Occupying Wall Street. On September 17, 2011, Occupy Wall Street began in New York City's Wall Street financial district. (Credit: modification of work by David Shankbone/Flickr Creative Commons)

OCCUPY WALL STREET

In September 2011, a group of protesters gathered in Zuccotti Park in New York City to decry what they perceived as increasing social and economic inequality in the United States. Calling their protest “Occupy Wall Street,” they argued that the concentration of wealth among the richest 1% in the United States was both economically unsustainable and inequitable, and needed to be changed. The protest then spread to other major cities, and the Occupy movement was born. Why were people so upset? How much wealth is concentrated among the top 1% in our society? How did they acquire so much wealth? These are very real, very important questions in the United States now, and this chapter on poverty and economic inequality will help us address the causes behind this sentiment.

CHAPTER OBJECTIVES

Introduction to Poverty and Economic Inequality

In this chapter, you will learn about:

- Drawing the Poverty Line
- The Poverty Trap
- The Safety Net
- Income Inequality: Measurement and Causes
- Government Policies to Reduce Income Inequality

The labor markets that determine what workers are paid do not take into account how much income a family needs for food, shelter, clothing, and health care. Market forces do not worry about what happens to families when a major local employer goes out of business. Market forces do not take time to contemplate whether those who are earning higher incomes should pay an even higher share of taxes.

However, labor markets do create considerable inequalities of income. In 2014, the median American family income was \$57,939 (the median is the level where half of all families had more than that level and half had less). According to the U.S. Census Bureau, almost nine million U.S. families were classified by the federal government as being below the poverty line in that year. Think about a family of three—perhaps a single mother with two children—attempting to pay for the basics of life on perhaps \$17,916 per year. After paying for rent, healthcare, clothing, and transportation, such a family might have \$6,000 to spend on food. Spread over 365 days, the food budget for the entire family would be about \$17 per day. To put this in perspective, most cities have restaurants where \$17 will buy you an appetizer for one.

This chapter explores how the U.S. government defines poverty, the balance between assisting the poor without discouraging work, and how federal antipoverty programs work. It also discusses income inequality—how economists measure inequality, why inequality has changed in recent decades, the range of possible government policies to reduce inequality, and the danger of a tradeoff that too great a reduction in inequality may reduce incentives for producing output.

20.1 DRAWING THE POVERTY LINE

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Explain economic inequality and how the poverty line is determined
- Analyze the U.S. poverty rate over time, noting its prevalence among different groups of citizens

Comparisons of high and low incomes raise two different issues: economic inequality and **poverty**. Poverty is measured by the number of people who fall below a certain level of income—called the **poverty line**—that defines the income needed for a basic standard of living. **Income inequality** compares the share of the total income (or wealth) in society that is received by different groups; for example, comparing the share of income received by the top 10% to the share of income received by the bottom 10%.

In the United States, the official definition of the poverty line traces back to a single person: **Mollie Orshansky**. In 1963, Orshansky, who was working for the Social Security Administration, published an article called “Children of the Poor” in a highly useful and dry-as-dust publication called the *Social Security Bulletin*. Orshansky’s idea was to define a poverty line based on the cost of a healthy diet.

Her previous job had been at the U.S. Department of Agriculture, where she had worked in an agency called the Bureau of Home Economics and Human Nutrition. One task of this bureau had been to calculate how much it would cost to feed a nutritionally adequate diet to a family. Orshansky found that the average family spent one-third of its income on food. She then proposed that the poverty line be the amount needed to buy a nutritionally adequate diet, given the size of the family, multiplied by three.

The current U.S. poverty line is essentially the same as the Orshansky poverty line, although the dollar amounts are adjusted each year to represent the same buying power over time. The U.S. poverty line in 2015 ranged from \$11,790 for a single individual to \$25,240 for a household of four people.

Figure 1 shows the U.S. **poverty rate** over time; that is, the percentage of the population below the poverty line in any given year. The poverty rate declined through the 1960s, rose in the early 1980s and early 1990s, but seems to have been slightly lower since the mid-1990s. However, in no year in the last four decades has the poverty rate been less than 11% of the U.S. population—that is, at best about one American in nine is below the poverty line. In recent years, the poverty rate appears to have peaked at 15.9% in 2011 before dropping to 14.5% in 2013. Table 1 compares poverty rates for different groups in 2011. As you will see when we delve further into these numbers, poverty rates are rela-

tively low for whites, for the elderly, for the well-educated, and for male-headed households. Poverty rates for females, Hispanics, and African Americans are much higher than for whites. While Hispanics and African Americans have a higher percentage of individuals living in poverty than others, most people in the United States living below the poverty line are white.

Visit this website for more information on U.S. poverty.

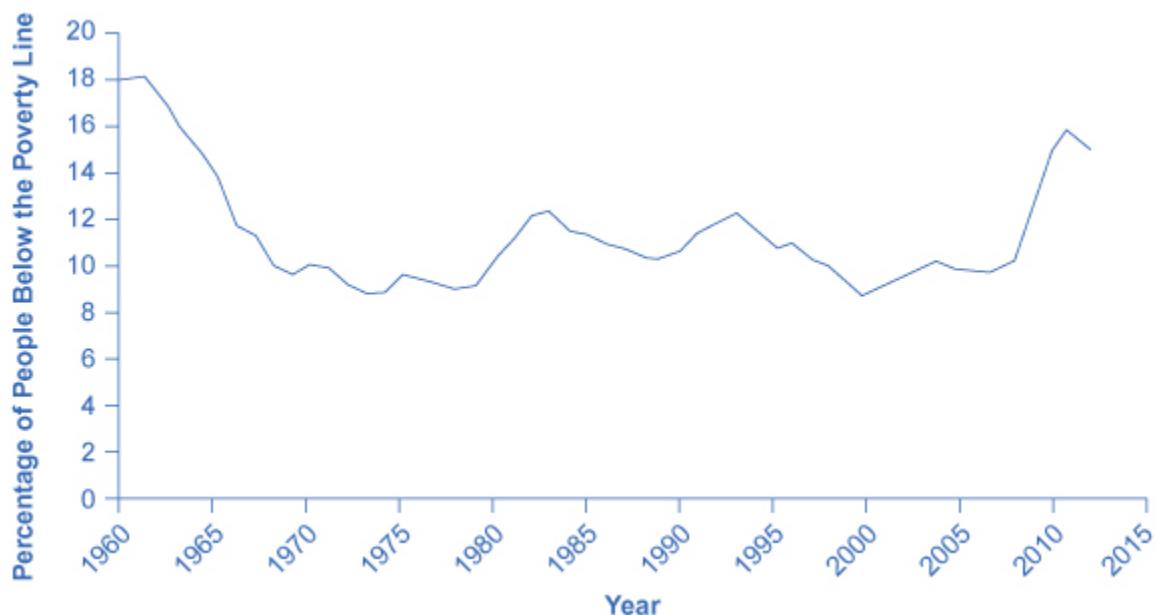


Figure 1. The U.S. Poverty Rate since 1960. The poverty rate fell dramatically during the 1960s, rose in the early 1980s and early 1990s, and, after declining in the 1990s through mid-2000s, rose to 15.9% in 2011, which is close to the 1960 levels. In 2013, the poverty dropped slightly to 14.5%. (Source: U.S. Census Bureau)

Group	Poverty Rate
Females	15.8%
Males	13.1%
White	9.6%
Black	27.1%
Hispanic	23.5%
Under age 18	19.9%
Ages 18–24	20.6%
Ages 25–34	15.9%
Ages 35–44	12.2%
Ages 45–54	10.9%
Ages 55–59	10.7%
Ages 60–64	10.8%
Ages 65 and older	9.5%

Table 1. Poverty Rates by Group, 2013

The concept of a poverty line raises many tricky questions. In a vast country like the United States, should there be a national poverty line? After all, according to the Federal Register, the median household income for a family of four was \$102,552 in New Jersey and \$57,132 in Mississippi in 2013, and prices of some basic goods like housing are quite different between states. The poverty line is based on cash income, which means it does not take into account government programs that provide assistance to the poor in a non-cash form, like **Medicaid** (health care for low-income individuals and families) and food aid. Also, low-income families can qualify for federal housing assistance. (These and other government aid programs will be discussed in detail later in this chapter.)

Should the poverty line be adjusted to take the value of such programs into account? Many economists and policymakers wonder whether the concept of what poverty means in the twenty-first century should be rethought. The following Clear It Up feature explains the poverty lines set by the World Bank for low-income countries around the world.

HOW IS POVERTY MEASURED IN LOW-INCOME COUNTRIES?

The World Bank sets two poverty lines for low-income countries around the world. One poverty line is set at an income of \$1.25/day per person; the other is at \$2/day. By comparison, the U.S. 2015 poverty line of \$20,090 annually for a family of three works out to \$18.35 per person per day.

Clearly, many people around the world are far poorer than Americans, as Table 2 shows. China and India both have more than a billion people; Nigeria is the most populous country in Africa; and Egypt is the most populous country in the Middle East. In all four of those countries, in the mid-2000s, a substantial share of the population subsisted on less than \$2/day. Indeed, about half the world lives on less than \$2.50 a day, and 80 percent of the world lives on less than \$10 per day. (Of course, the cost of food, clothing, and shelter in those countries can be very different from those costs in the United States, so the \$2 and \$2.50 figures may mean greater purchasing power than they would in the United States.)

Country	Share of Population below \$1.25/Day	Share of Population below \$2.00/Day
Brazil (in 2009)	6.1%	10.8%
China (in 2009)	11.8%	27.2%
Egypt (in 2008)	1.7%	15.4%
India (in 2010)	32.7%	68.8%
Mexico (in 2010)	0.7%	4.5%
Nigeria (in 2010)	68.0%	84.5%

Table 2. Poverty Lines for Low-Income Countries, mid-2000s. (Source: <http://data.worldbank.org/indicator/SI.POV.DDAY>)

Any poverty line will be somewhat arbitrary, and it is useful to have a poverty line whose basic definition does not change much over time. If Congress voted every few years to redefine what poverty means, then it would be difficult to compare rates over time. After all, would a lower poverty rate mean that the definition had been changed, or that people were actually better off? Government statisticians at the U.S. Census Bureau have ongoing research programs to address questions like these.

KEY CONCEPTS AND SUMMARY

Wages are influenced by supply and demand in labor markets, which can lead to very low incomes for some people and very high incomes for others. Poverty and income inequality are not the same thing. Poverty applies to the condition of people who cannot afford the necessities of life. Income inequality refers to the disparity between those with higher and lower incomes. The poverty rate is what percentage of the population lives below the poverty line, which is determined by the amount of income that it takes to purchase the necessities of life. Choosing a poverty line will always be somewhat controversial.

SELF-CHECK QUESTIONS

Describe how each of these changes is likely to affect poverty and inequality:

- a. Incomes rise for low-income and high-income workers, but rise more for the high-income earners.
- b. Incomes fall for low-income and high-income workers, but fall more for high-income earners.

REVIEW QUESTIONS

1. How is the poverty rate calculated?
2. What is the poverty line?
3. What is the difference between poverty and income inequality?

CRITICAL THINKING QUESTIONS

1. What goods and services would you include in an estimate of the basic necessities for a family of four?
2. If a family of three earned \$20,000, would they be able to make ends meet given the official poverty threshold?

PROBLEMS

1. In country A, the population is 300 million and 50 million people are living below the poverty line. What is the poverty rate?
2. In country B, the population is 900 million and 100 million people are living below the poverty line. What is the poverty rate?

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GLOSSARY

income inequality when one group receives a disproportionate share of total income or wealth than others

poverty the situation of being below a certain level of income needed for a basic standard of living

poverty line the specific amount of income needed for a basic standard of living

poverty rate percentage of the population living below the poverty line

SOLUTIONS

Answers to Self-Check Questions

- a. Poverty falls, inequality rises.
- b. Poverty rises, inequality falls.