Why the United States Needs an Improved Measure of Poverty

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Chairman McDermott, Ranking Member Weller, and distinguished members of the Committee, I appreciate the opportunity to talk with you today about the need for an improved measure of poverty in the United States. Our current poverty line is based on data more than 50 years old and our poverty count does not measure the actual resources that many families have available to them.

I have been involved in the discussion of poverty measurement for many years. I was a member of the National Academies of Science's panel in the mid-1990s that recommended an improved poverty measure and which serves as the model for Representative McDermott's draft legislation, the Measuring American Poverty Act of 2008. Many of my remarks this morning are taken from the Presidential Address that I gave to the Association for Public Policy Analysis and Management last fall, in which I talked about the reasons why we have been so unsuccessful in implementing an updated and effective poverty measure in the United States (Blank, 2008).

Measuring Poverty

An economic measure of poverty requires two definitions. First, one needs to define a *poverty line or poverty threshold*, the level of income or other resources below which a particular type of family is considered poor. Second, one needs to define a *resource measure*, which delineates the ways an individual family's economic resources will be counted. The *poverty count* is the number of people who live in families with resources below the poverty threshold.

I emphasize these definitional items because it is important to think about poverty lines and resource definitions together. A statistically credible measure of poverty should have a poverty threshold that is consistent with its resource measure, so that the two can be used together. Unlike Representative McDermott's proposed legislation, many proposed changes in poverty measurement in the past have emphasized changing the way in which family resources are counted, without proposing to change the poverty threshold in a consistent way.

There are serious problems in the current poverty measure with both the threshold definition and the resource definition. No simple, minor change will make this historical poverty measure accurate; a major redefinition is required.

The Historical Poverty Measure in the United States

The current poverty measure was defined in 1963 by Mollie Orshansky in the Social Security Administration. Let me discuss first the poverty line and then the resource definition that she used and that is still in use today.

The current poverty line. Orshansky created a poverty line using the calculation

Poverty line = 3 x Subsistence food budget

The subsistence food budget for a family of four was based on the Economy Food Plan developed within the USDA in 1961 using data from the 1955 Household Consumption Survey. It was described as the amount needed for "temporary or emergency use when funds are low." The multiplier of 3 was used because the average family of three or more spent one-third of their after-tax income on food in the 1955 Household Food Consumption Survey. If the average family spent one-third of its income on food, then three times the subsistence food budget provided an estimated poverty threshold. This calculation was done for a family of 4, and so-called 'equivalence scales' were used to estimate how much was needed by smaller or larger families.

The current poverty line is this number, calculated in 1963 and based on 1955 data, updated by the Consumer Price Index in each year since.

While this methodology for calculating a poverty line was fine in 1963, and was based on the best data available, it is seriously flawed in 2008. *There is no other economic statistic in use today that relies on 1955 data and methods developed in the early 1960s*. All of our major statistics, from GDP to unemployment to the current account balance, are regularly updated and revised, and based on the most recent and best data available.

It is not too strong a statement to say that, 45 years after they were developed, the official poverty thresholds are numbers without any valid conceptual basis. If one sticks with a threshold based only on food costs, the current multiplier on food costs would be 7.8 rather than 3 because food is a much smaller share of family budgets now than 45 years ago. But basing the threshold numbers on a single commodity is almost surely not the correct way to calculate these thresholds because it leaves the numbers highly sensitive to the relative price of that commodity and insensitive to the price of any other necessary purchases. For instance, while food prices have fallen over the past 43 years, housing prices have risen. Our current poverty calculation is not responsive to these changes in price and spending patterns over time.

The current resource definition. The resource measure in Orshansky's calculations was straightforwardly defined as cash income. In 1963 this was a reasonable definition. Few low-income families were paying federal taxes. In-kind programs like Food Stamps, which provide non-cash resources to low-income families, were nonexistent or very small. Thus, cash income and disposable income were largely the same among low-income households.

Forty-five years later, this resource definition is also seriously flawed, as cash income alone is no longer an adequate description of the economic resources available to low-income families. There is broad agreement that the resource measure should reflect a family's *disposable income*; that is, the income that a family has available for buying necessities such as housing and food, and after taxes and other mandatory expenditures are deducted. For instance, the recent expansion of the Earned Income Tax Credit (EITC) should provide more resources to low-wage earners; this is income we should count when estimating if a family is poor. Furthermore, many of the public assistance programs that have been created or expanded since 1963 provide benefits to low-income families through in-kind payments, such as food stamps or rental subsidies, neither of which are paid to the recipient as cash income. In a country that wants able-bodied adults to work, work expenses are unavoidable and necessary. This includes transportation costs to work as well as child care expenses for single-parent or dual-earner couples. Similarly, out-of-pocket medical expenses are typically necessary expenditures; those with large prescription drug payments each month have fewer discretionary resources than those with no medical expenditures.

Because the historical poverty measure is calculated based only on family cash income, it is unaffected by many changes in disposable income:

- If a disabled individual starts to receive Medicaid assistance and has lower out-of-pocket medical expenses, this will not affect their current poverty status.
- If a family receives food stamps and has more income left over for other items, this will not affect their current poverty status.
- If a worker receives an EITC refund check, this will not affect their current poverty status.

Clearly, a cash income-based definition of family resources is highly insensitive to many of our nation's most effective anti-poverty programs.

It is long past time to update both the definition of the poverty threshold and the resource definition to reflect the economic situation facing today's low-income families.

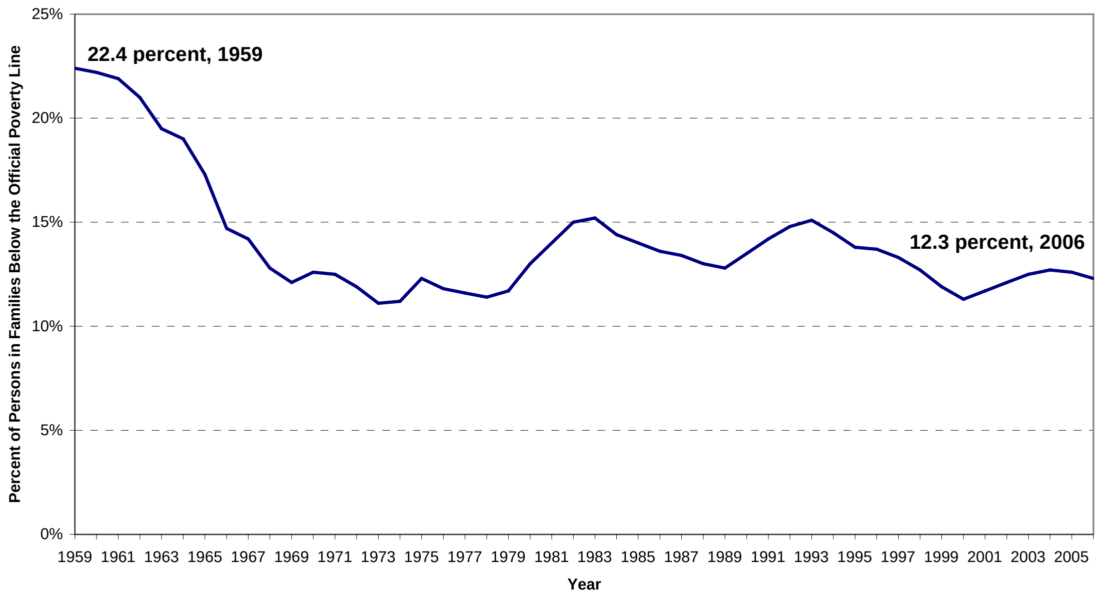
What Has Been the Effect of Using an Outdated Poverty Measure?

There is widespread agreement among virtually everyone who looks at the current poverty measure that it is seriously flawed as an economic statistic. What effect has this had?

Our poverty measurement has been impervious to most of the policies designed to improve life among low-income families that were implemented in the decades after 1963. The 1970s saw rapid growth in food stamp and housing benefits. In the 1980s, Congress enacted major tax reforms that reduced tax burdens on low-income families. In the 1990s, the expansion of the EITC provided wage subsidies to many low-wage workers. Since the 1980s, the dollars paid to public medical care has expanded enormously. In the late 1990s Food Stamp participation fell sharply, but (due to substantial program revisions) rose again in the early 2000s.

None of these program changes had any measurable affect on the U.S. poverty rate, nor could they have any effect given how poverty is measured. Indeed, the official U.S. poverty rate, shown in Figure 1, has been largely flat since the early 1970s, with some cyclical movement over the business cycle. In 1988 President Ronald Reagan declared "My friends, some years ago the federal government declared war on poverty and poverty won." Looking at Figure 1, this seems a reasonable conclusion.

Figure 1.
Official Poverty Rate, 1959-2006



Data Source: U.S. Census Bureau. Historical Poverty Tables, http://www.census.gov/hhes/www/poverty/histpov/hstpov1.html.

Although public spending on the poor grew rapidly after the 1960s, its effects were invisible because our official statistic did not reflect the effect of these antipoverty programs on the resources available to poor families. *In a very fundamental way, our poverty statistics failed us and made it easy to claim that public spending on the poor had little effect.*

Economic statistics are designed to help us track trends in economic well-being, and to interpret the effects of environmental and policy changes. Because our historical poverty statistics are so poorly measured, we have no effective measure of how most of our anti-poverty policies have improved the economic well-being of low-income families over time.

The only group who has experienced a major decline in the official poverty data over the past 30 years is the elderly. It is not coincidental that the elderly are the one group for whom we have provided greatly expanded assistance in the form of cash income, through expansions in Social Security and in Supplemental Security Income. Hence, our assistance to this group was reflected in our official statistics

The NAS Proposal for a Modern Poverty Measure

The panel convened by the National Academies of Science (NAS) in the 1990s spent more than two years reviewing the research on different approaches to poverty measurement. The final panel report, released in 1995, recommended a redefined modern poverty measure (Citro and Michael, 1995). This new measure was conceptually consistent with Orshansky's efforts but addressed many of the problems with the 1963 definition.

The NAS panel recommended calculating a *poverty line* based on expenditures on necessities (food, shelter and clothing), "plus a little more." Their report emphasized the importance of updating this threshold calculation regularly, to reflect changes in spending patterns on necessities over time. The NAS panel recommended basing the *resource definition* on disposable income, which measures the resources available to low income families after they pay their tax bill, receive any public assistance, pay their medical bills and pay any work-related expenses. The panel addressed many other issues that I do not discuss here, such as equivalence scales (determining appropriate expenditures for families of different sizes) and geographic price variation.

Since the NAS panel report, broad support has emerged within the social science research community for the approach that they suggest. The Census Bureau has used the NAS report as the basis for alternative poverty calculations. Research papers have discussed how to best make the measurements proposed in the report, such as effectively measuring child care expenses and improving the equivalence scales. As Mr. Levitan will testify, New York City has developed a city-specific poverty measure based on this approach.

Moving Toward a Modern Method of Poverty Measurement

Mr. McDermott's draft legislation, the Measuring American Poverty Act of 2008, would be an effective way to move the poverty measurement agenda forward. This legislation proposes to commission the Census Bureau to develop a modern poverty measure based on the NAS-recommended approach, to publish these numbers regularly, and to update this measure as new data and new statistical approaches become available.

This approach would break through the political logjams that have prevented the development and utilization of an updated poverty measure.

It is an historical accident that our official poverty measure was established by a directive within the Office of Management and Budget (OMB Statistical Policy Directive 14), but it has made updating this statistic very difficult. Any change to this historical poverty definition had to come from within the Executive Office of the President, which oversees OMB. It should be obvious that it is extremely difficult to expect the White House – no matter which party controls it – to undertake an impartial review and revision of a sensitive government statistic. In fact, oversight of the historical poverty definition within OMB is a major reason why none of the proposals to update and revise this statistic have been successful.

No other major economic statistic is defined by an OMB directive. All other major economic statistics are under the control of official U.S. statistical agencies, which are charged with regularly reviewing and updating them. These agencies provide professional expertise, close knowledge of available data, and a long history of providing government statistics without political interference.

The proposal to create a modern poverty measure, housed with the Census Bureau, regularizes the poverty measure and puts it on a par with other government statistics, placing it within the statistical agency in charge of collecting and disseminating much of the data on which the poverty measure is based.

The Census Bureau has long calculated a variety of alternative poverty definitions, including a variety of definitions based upon the NAS recommendations. It has never had the authority to select among these alternative definitions, but has always been directed to look at multiple options. This bill gives Census the authority to use their expertise to create a single modern poverty measure based upon the NAS recommendations, using the best data and analytic approaches available.

At the same time, it is important to continue to calculate and report the historical poverty measure, making it available to those programs or analysts who wish to continue to use it. A number of programs have eligibility provisions that are tied to the current poverty measure. Over time, as programs come up for reauthorization, Congress can decide whether to continue to use the historical measure or whether to utilize the modernized poverty measure. This will assure that there are no disruptions to the programs that have relied on the historical measure for many years. Those who choose to switch to the newer measure can take steps to transition to the newer measure over time, using grandfathering clauses to assure there is no one who abruptly loses benefits because of definitional changes.

A Comparison to the European Union

Mr. McDermott's proposed legislation directs Census to develop two measures of poverty, one looking at pre-tax and pre-transfer poverty and the other measuring poverty based on after-tax disposable income. The bill also authorizes money for the National Academies to develop a "Decent Living Standard" measure.

I want to say something about the value of comparing multiple measures of economic need, each measuring a different concept. The European Union has worked to develop a set of EU-wide economic statistics over the past two decades, including new measures of poverty. The EU has historically taken a very different approach to poverty than the United States, using a poverty threshold that is defined as a share of median income. The effect of this is to raise the poverty line with every increase in change in real income in the society. This makes it difficult to make progress against poverty.

While the EU continues to use a percent-of-median-income poverty line, they have moved away from a single poverty measure and have chosen instead to require that EU members regularly report on a collection of measures of economic and social deprivation, each of which focus on a different aspect of economic opportunity or disadvantage. EU nations annually report not only poverty rates within their countries, but also on joblessness, literacy, life expectancy, and other measures of well-being. This allows countries to have a fuller picture of the problems of economic disadvantage and how it overlaps with other types of disadvantage.

I find much to admire in this approach. While the U.S. collects many of these statistics, they are not regularly reported at the same time as the poverty measure, so we tend not to think about them as complementary and overlapping sources of information about disadvantaged populations within the United States.

I want to emphasize the value of looking at multiple statistics to understand and interpret problems and progress among low-income families. The pre-tax and pre-transfer poverty rate tells us something about the market distribution of incomes. By comparing this to a poverty measure based on total disposable income, we can say something about the overall effect of our tax and transfer system, showing how much it improves economic well-being among low-income families.

In the end, no income-based statistic can capture all the important dimensions of well-being, such as health, education, crime, or family functioning. The poverty rate is a measure of income adequacy and should be supplemented with measures that look at these other dimensions of family well-being.

Is Consumption Data an Alternative to Income Data?

Some have argued that consumption data provides a better measure of household resources and that the income data is flawed (Meyer and Sullivan, 2008.) Measuring consumption behavior is valuable and useful. It is not, however, appropriate to use in a national poverty measure.

Consumption does not typically measure what we mean by economic poverty. Consumption data measure something different than income data. Current consumption reflects a combination of current income, past income, and current consumption behavior. Hence, some individuals with low current income are able to consume more today because they take on debt or have savings. Poverty usually means that an individual lacks the income to consume at an adequate level. If a wage-earner has lost his job and his family is without income, most of us would consider that family poor, even if they are currently living on savings and maintaining a (temporarily) higher consumption level. If an elderly family is choosing to consume far less than they are able to, based on their income, they should be considered not poor, even if their consumption is quite low.

For most people, of course, consumption and current income are pretty much the same. Some have argued that U.S. consumption data reveals quite a few families who appear income poor but have much higher actual consumption. This is not as mystifying as it may at first appear. First, the income data collected within the survey that also collects consumption data (the Consumer Expenditure Survey) have historically been less complete and less accurate than the income data collected in our major income survey, the Current Population Survey. Second, there is a problem of high respondent nonresponse, especially among lower-income persons who respond to the Consumer Expenditure Survey; this must be carefully accounted for in order to compare similar populations between these two surveys. In a recent article, Richard Bavier (2008) indicates that when the consumption data and the income data are appropriately reconciled, the differences between them are relatively small. Indeed, both of them show very similar trends in poverty and need.

It is also worth noting that using consumption data resolves only a small set of issues in the measurement of poverty. Most of the difficult decisions – how to develop appropriate poverty thresholds; how to impute the value of in-kind benefits; how to determine equivalent poverty levels for families of different sizes; etc – are unaffected by the use of consumption versus income.

Finally, consumption data is quite costly to collect. As a result, our consumption survey is relatively small with only about 20,000 households from across the United States. This is much smaller than the samples sizes in our income survey, rendering consumption data less reliable as a source of national information on low-income families. And it makes it even more difficult to get reliable information on low-income families within subgroups by age, by race or ethnicity, or by geographic region.

The NAS report discusses the possible use of consumption data and concludes that it measures a different concept and that the current data we have available are not adequate for a national poverty measure. While there have been some improvements to the consumption data, the conclusions of that report are still relevant.

Conclusion

The actual level of poverty in this country is an important concern, indicating something about how many of our fellow citizens are in economic need. The level of poverty will always be somewhat arbitrary, no matter how it is set. I am concerned that the debate over how to best modernize the U.S. poverty statistic should not be derailed by arguments about whether a new measure raises or lowers the poverty rate relative to the level determined by the historical poverty measure. With the NAS measure, taking account of taxes (especially the EITC refunds) and in-kind income will lower poverty. But subtracting off work expenses and medical out-of-pocket expenses will raise poverty. Regardless of what this does to the overall poverty count, these are the right calculations to do in order to calculate economic need based on disposable income among low-income families.[1]

Most important is a poverty measure that tracks progress (or lack of progress) over time in an effective manner. We need a statistic that demonstrates how policy and economic changes affect the economic outcomes among low-income families. This means that getting the trend right over time is far more valuable than arguing about the level of

[1] Indeed, one could benchmark a new poverty measure so that it produced exactly the same level value of poverty as the historical poverty measure in some transition year. Of course, the distribution of poverty across groups and regions would differ under a different measure, even if the total number was identical.

poverty. It is the *change* in poverty that tells us whether economic opportunities are improving or deteriorating among our most disadvantaged citizens.

The modern poverty measure proposed by the National Academy of Sciences panel reflects the best consensus about how to improve poverty measurement in the United States. Since it was proposed, we now have over a decade of research showing how this recommendation can be effectively implemented with available data. If we want to track the well-being of America's low-income families, and if we want to effectively measure the effects of our antipoverty policies, then we must update and modernize the measure of poverty in the United States.   It is long past time to make this change.

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