



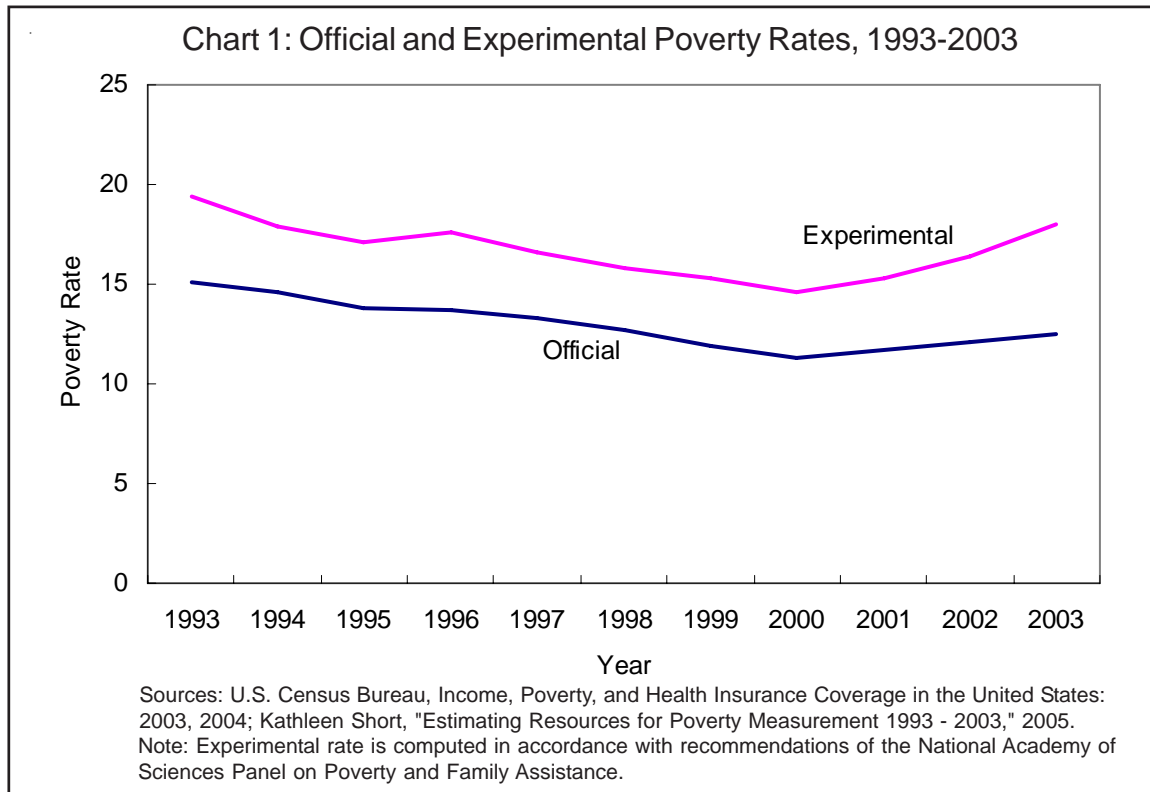
MONTHLY ECONOMIC MEMORANDUM

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JOINT ECONOMIC COMMITTEE – DEMOCRATIC STAFF
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MEASURING POVERTY



The poverty rate is an important policy benchmark. It is used by policymakers to track the economic status of the least well-off Americans and to assess the effectiveness of income-support programs. However, the official measure of poverty is based on a methodology that is now over 40 years old. Most poverty researchers believe that it has become outdated and may distort our understanding of trends in poverty and program effectiveness.

After extensive review and analysis, a 1995 National Academy of Sciences (NAS) panel of experts produced a number of recommendations for updating the official poverty measure produced by the Census Bureau. No official action has been taken, but researchers at Census and the Bureau

of Labor Statistics (BLS) have implemented the NAS recommendations on an experimental basis. Like the official poverty rate, a NAS-based experimental rate falls during the expansion of the 1990s and rises in the recession of 2001 (**Chart 1**). However, the experimental rate is consistently higher than the official rate, and it declines more in the expansion and rises more in the recession and its immediate aftermath.

The researchers' experimental poverty measure is quite different from an alternative measure published in a recent official Census report. That measure selectively incorporates many NAS recommendations that lower measured poverty, while ignoring others that would raise it. The result is a

significant step backwards from previous Census reports that have included NAS-based alternative measures.

Defining poverty. In the United States, poverty is defined as not having enough income to meet basic needs such as a nutritionally adequate diet and decent housing. People are defined as poor if their family income is below the poverty threshold (or poverty line).

When the official poverty measure was first proposed in the 1960s, thresholds were set for families of different sizes and types based on a variety of family characteristics. For a typical family of three or more, the poverty threshold was set at three times the cost of a nutritionally adequate diet (because expenditures on food were roughly a third of the typical family's budget at the time). Available income was defined as cash income before taxes, including government cash transfers such as welfare and Social Security.

Over the years, the thresholds have been adjusted for inflation using the consumer price index (CPI), but the way poverty is measured has remained largely unchanged. Thus, the official poverty rate measures the percentage of people whose pre-tax cash income falls short of the amount required to meet what were judged to be basic needs in the 1960s, adjusted for inflation.

An outdated measure. Critics of the official measure point to changes since the 1960s both in the resources available to the disadvantaged and in their needs. For example, there is a broad consensus that income should include near-cash benefits such as food stamps and housing subsidies, which have increased in importance since the 1960s; that it should be adjusted for taxes, including the positive contribution of the earned income tax credit (EITC); and that work-related expenses such as transportation and child care, which have increased significantly as more mothers have entered the workforce, should be subtracted from income.

There is also agreement that the current poverty thresholds are based on outdated patterns of consumption. Over the years, housing, medical care, and child care costs have all become a larger share of family budgets, while the importance of food costs has declined. In addition, the current poverty thresholds do not adjust adequately for differences in family size and composition; they do not reflect differences in the cost of living across geographic areas;

and they assume that the spending needs of elderly adults are less than those of non-elderly adults.

The NAS recommendations. In 1995 the NAS Panel on Poverty and Family Assistance responded to these criticisms, recommending changes to both the poverty thresholds and the measure of income used to determine a family's poverty status. In 2004 the Academy convened a follow-up workshop to gain consensus on certain methodological issues raised by the original NAS report. On the threshold side, the NAS panel recommended using actual expenditure data to develop a reference threshold for a family of two adults and two children representing sufficient resources to purchase basic items such as food, clothing, shelter, and utilities, plus a small additional amount for other expenses.

Although the panel recommended accounting for medical expenses on the income side of the poverty measure, there is now some consensus that including such expenses in the thresholds is a reasonable, less complicated alternative. The panel recommended adjusting the reference threshold to reflect differences in family size and composition as well as geographic differences in housing costs, and it recommended annual updates in the reference threshold to reflect changes in the pattern of spending on the basic items.

In measuring income, the panel emphasized the importance of using a definition of family resources that is consistent with the spending needs assumed in the poverty thresholds. Thus, it embraced a broad definition of income that would include the cash value of in-kind benefits such as food stamps and housing subsidies, the imputed value of homeownership, and the value of refundable tax credits such as the EITC in addition to cash income and government cash transfers. The panel also recommended subtracting necessary expenses, including taxes, work-related expenses, and child support payments, which absorb resources that would otherwise be available for meeting basic needs.

Alternatives to the official measure. For many years the Census Bureau has published income and poverty statistics computed using a variety of alternative definitions of income to assess the effects of taxes and benefits on available household resources. However, those effects have been measured relative to the existing thresholds, with all their flaws, and therefore do not capture the full range of the NAS recommendations.

Separately, the Census Bureau has conducted research to examine how implementing the NAS recommendations integrating adjustments to the threshold with changes in the definition of income would affect the poverty count. A number of reports and working papers have shown that it is straightforward to implement many of the NAS recommendations. However, issues of data availability or lack of a methodological consensus have affected other measurement issues, such as the treatment of medical and child care expenses and differences in housing costs across geographic areas. The overall difference between any NAS-based measure and the official measure is larger than differences among variations of NAS-based measures that take different approaches to individual measurement issues. Nonetheless, Census has not published a consistent alternative poverty measure implementing all of the NAS recommendations whose behavior can be compared over time with that of the official measure.

The experimental poverty rate shown in Chart 1 is not an official Census statistic, but it reflects work by researchers at Census and BLS that incorporates all of the NAS recommendations on which a broad consensus has emerged and that were feasible to implement with available data. It illustrates important ways that an up-to-date measure implementing the NAS recommendations would differ from the official poverty measure.

What difference would it make? Individually, many of the NAS recommendations would lower the poverty rate. These include expanding the definition of family resources to include the EITC and the cash value of in-kind benefits such as food stamps. On balance, however, the recommendations that would raise the poverty rate turn out to offset the increase in countable income, and the poverty rate under the experimental measure is consistently higher than the official rate.

Subtracting work expenses raises the poverty rate among households headed by a working mother or a low-income couple, but another significant effect comes from the use of thresholds that reflect current expenditure patterns and the cost of basic necessities. Prices of such necessities, particularly shelter, utilities and medical care, have risen faster over time than the level of prices in general. The official poverty measure is updated every year by the Consumer Price Index (CPI), which measures the general price level

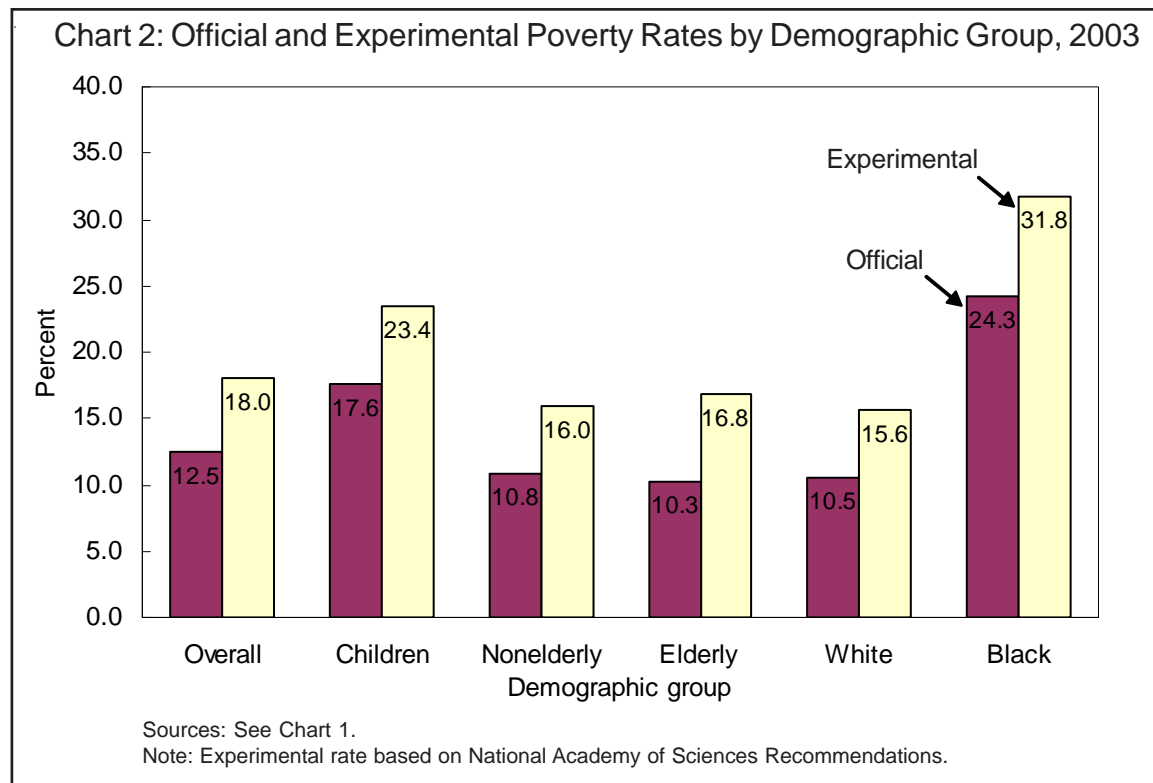
rather than the cost of basic necessities. As a result, the official thresholds no longer reflect the expenses incurred meeting basic needs.

Although both the experimental rate shown in Chart 1 and the official poverty rates decline over the 1990s and rise after 2000, the movements of the experimental rate are more pronounced. Its sharper decline during the 1990s expansion largely reflects its broader definition of income. In particular, because it uses a post-tax measure of income, the experimental measure captures the significant poverty-reducing effect of expanding the EITC in the early 1990s.

The steeper rise in the experimental poverty rate after 2000 primarily reflects differences in the behavior of the thresholds. Over the 2000-2003 period, the prices of basic items—especially shelter utilities, and medical services—rose much faster than the overall CPI and much faster than they did in the 1993-2000 period. As a result, the poverty thresholds used to compute the experimental rate increased more than the official thresholds, leading to larger increases in the number of people falling below the poverty line compared with the official measure.

As the NAS panel recognized, choosing the initial level of the reference threshold is ultimately a matter of judgment, because there is no definitive measure of basic needs. Following the panel's own judgment about a reasonable estimate of a poverty-level budget, the experimental reference threshold is based on average expenditures at the 30th and 35th percentiles of the distribution of expenditures on food, clothing, shelter, and utilities. Choosing a point further down the expenditure distribution would result in lower thresholds, thereby lowering the overall poverty rate.

Impact on population subgroups. Because the overall poverty rate using the experimental measure discussed in this analysis is higher than the official poverty rate, the poverty rate of most subgroups is also higher (**Chart 2**). However, the distribution of poverty is somewhat different. For example, families with children account for a slightly smaller share of the poor under the alternative measure, since many of the new sources of income included in the alternative income definition target those families. In contrast, elderly families account for a greater share of the poor, because the alternative measure raises the thresholds for the elderly to the same level as similar non-elderly families.



Recent Census work. Although the Census Bureau has conducted important research on implementing the NAS panel's recommendations, its latest report, *The Effects of Government Taxes and Transfers on Income and Poverty: 2004*, does not report any NAS measures. Instead it computes four alternative poverty rates using four different income concepts: money income (the official definition), market income, post-social insurance income, and disposable income (the closest to the NAS definition). The thresholds are modified slightly from the official thresholds by the use of a different inflation index and improved adjustments for family size and type.

In principle, a streamlined presentation highlighting a few key measures could make it easier to see the impact of government programs on poverty. However, the actual Census report represents a significant step backwards from the NAS recommendations. Specifically, the report ignores the NAS panel's warning about changing the income definition without making consistent adjustments to the thresholds. For example, although the disposable income definition includes the value of housing subsidies and the imputed value of homeownership, the thresholds are not updated to reflect current housing costs. In fact, the

alternative inflation adjustment results in thresholds that are lower than the official thresholds. In addition, Census's alternative measures do not account for medical or child care expenses—two important adjustments that would, all else equal, result in more families falling below the poverty line. These selective omissions produce a much lower poverty rate under the disposable income definition than would arise from implementing all of the key NAS recommendations together.

Conclusion. Given the importance of the poverty rate in shaping public perception and public policy, a measure that accurately captures the material well-being of low-income Americans and changes in poverty over time is essential. Poverty estimates based on the NAS panel's recommendations for revising the official measure differ significantly from the official poverty estimates in ways that give more insight into both current needs and the effects of recent policy initiatives. Research on experimental measures demonstrates that the NAS recommendations can be implemented in a meaningful and useful way. There is no scientific reason why Census should abandon using the panel's full set of recommendations as a guide for presenting consistent time series of alternative poverty measures.