NEW AMERICA FOUNDATION
ASSET BUILDING PROGRAM

ISSUE BRIEF

Issue Brief #3

September 2003

The Misleading Way We Count the Poor:
Alternatives to Our Antiquated Poverty Measure Should Consider Assets

By Reid Cramer, Research Director, Asset Building Program

Each September the Census Bureau releases its official calculation of the national poverty rate, intended to reflect the extent of economic hardship in the United States. Despite advances in available data and methodological techniques, the mechanics of the official poverty measure have not been significantly altered for four decades. The once useful metric has, unfortunately, not worn well. Today the official poverty measure provides an incomplete and inaccurate representation of the poor. Perhaps most troubling is that it misses important elements of poverty and thus provides a less valuable vantage for policymakers seeking to craft effective policy interventions.

Statistics on social conditions play an important role in the policy process. They raise awareness for policy issues and help justify resource allocations. In his groundbreaking book, *The Other America*, Michael Harrington attracted the attention of President Kennedy and his top advisors to the scourge of poverty by estimating that between 40 and 50 million Americans were poor. Drawing on this work, President Johnson's War on Poverty was supported by the claim that one-fifth of all American families had incomes "too small to even meet their basic needs."[1] But well-crafted social indicators should serve two additional basic functions. First, a good measure should help track performance and reveal the impact of policy efforts over time in achieving long-term strategic objectives. Second, a good measure should capture the most salient features of a problem, so whatever is being measured is relevant to the core policy objectives. It is on these grounds that the official poverty measure falls short. It fails to reflect the impact of government programs and policy efforts, and doesn't account for many of the key components of family well-being and hardship.

Critiquing the poverty measure is more than an academic exercise. The manner in which problems are defined portends their proposed solution. Defining poverty in terms of household income leads to proposals that focus on income supports. Yet the dynamics of a family's welfare are best understood by considering how they control the resources under their disposal, requiring an accounting of both income and assets. As most families rely upon income to support their daily sustenance and pay for food, shelter, and other necessities, they often draw upon a stock of resources deployed along with income to ensure their welfare. This perspective highlights the need for alternative measures of poverty and economic hardship which take into account the role of assets and other family resources. One such measure, the self sufficiency standard, focuses on identifying a realistic and geographically flexible level of resources at which families can meet their most basic needs without public support. Another alternative measure focuses on asset poverty by counting the number of families lacking sufficient wealth or resources to endure three months without income. Both of these alternatives improve upon the current approach as they more realistically capture the dynamic and complex relationship between economic well-being and household resources over time.

HISTORY OF THE POVERTY MEASURE AND ITS FLAWS

This year marks the 40th anniversary of the poverty line.[2] Using data from the most contemporary studies of food consumption and nutritional standards available at the time, the original poverty line was based on a cost estimate of a basket of goods required to sustain a minimally adequate diet.[3] The cost of this basket, which was varied by family size, was then multiplied by three because according to a survey of consumption patterns conducted in mid-1950s the average family spent one-third of their after-tax income on food. Families with two parents and two children were classified as poor if their before-tax income was less than $3,100 in 1963. To reflect changes in prices, thresholds have been inflated each year according to changes in the Consumer Price Index (CPI). So while the poverty line for a family of the same size was $18,556 in 2001, the basic structure of the measure has not been altered for the last forty years.

The Office of Economic Opportunity began using the poverty measure in 1965 and by 1969 it was adopted as the federal government's official statistical definition of poverty. Since this time the statistic has become the standard for assessing the changing fortunes of America's most vulnerable households. It could be argued that many of the assumptions used in creating the original measure were appropriate at the time. For example, the concept of equating family resources as before-tax income was reasonable given low taxes on the poor and the lack of large in-kind government transfer programs. Similarly, family income statistics were taken from the only available data source, the March Current Population Survey (CPS). Most importantly, the measure was intended to craft a compromise between an absolute standard based solely on survival needs of the poor and the more relative consumption patterns of society as a whole.

However, the poverty measure became an obsolete indicator of social hardship soon after the federal government began expanding its welfare benefit programs in the 1960s. Programs that provide in-kind or after-tax benefits are not included in the current measure, so the impact of many social policy efforts are not reflected in the official measure. Furthermore, consumption patterns have shifted greatly in the last fifty years and the assumptions embodied in the poverty threshold are out-of-date with contemporary living standards. Families at all income levels now spend a smaller portion of their income on food and more on housing, transportation, and child care. Updating the original thresholds by the rate of inflation also means that the purchasing power afforded a family today is the same as it was in 1963.[4] More glaring is the omission of accounting for regional differences in the cost of living, which is particularly relevant given the large range of housing costs throughout the country. The poverty measure also relies on a definition of family resources that is based on pre-tax income. Not only is income a rough proxy for consumption, but it is less predictive when it does not subtract payroll and income taxes, add the value of near-cash benefits such as food stamps or count the resources provided by the Earned Income Tax Credit. Finally, the current poverty measure suffers because it does not use the most complete statistical survey available to tabulate income, the Survey of Income and Program Participation.

For all of these reasons, the utility of the original measure has eroded. There is now widespread consensus among scholars and policymakers that the official poverty measure is a flawed statistic that no longer provides a useful yardstick to assess the extent and composition of those facing material hardship.

PROPOSED CHANGES TO THE OFFICIAL POVERTY MEASURE

Efforts to address deficiencies in the poverty measure have been underway for many years. Congress directed the National Academies of Science (NAS) to convene a Panel on Poverty and Family Assistance which issued a comprehensive report in 1995 on the measurement of poverty.[5] Proposed reforms primarily focused on the way income and needs are calculated, arguing that the revised thresholds should represent the dollar amount necessary to pay for a basic set of goods that includes food, clothing, shelter, utilities, and other expenses such as household supplies, personal care and transportation. Without committing to a new threshold, it was suggested that Consumer Expenditure Survey data be used to establish a standard, which would then be adjusted to reflect the needs of different family types and regional differences in housing costs. Family resources would be measured in a manner that accounts for the value of money income from all sources as well as the value of "near-money" benefits such as food stamps, housing subsidies, and home energy assistance. A set of necessary expenses would also be subtracted from the calculation of family resources; these include the cost of child care, work-related expenses, taxes, and health care. Taken as a whole, the NAS approach addresses several of the major flaws of the official measures, specifically taking into account government spending, regional differences in cost of living, and a more realistic account of household finances.

Building on the NAS recommendations, the Census Bureau released its first report on alternative poverty measures in 1999. In general, these experimental measures produce higher poverty estimates. For example, the official rate estimated that 11.7% of the population (32.9 million people) lived in poverty in 2001, while the experimental measures ranged from 12.3% to 13.5%, representing a difference of between 1.7 and 5.0 million people over the official estimate. More significantly, the experimental measures provide additional insight into the limitations of the current approach by demonstrating how the official measure overstates poverty among children as a result of the failure to account for the cash benefits of the EITC program and underestimates poverty among the elderly as a result of higher out-of-pocket medical expenses.

Resistance to amending the official measure along the lines of the NAS recommendations is rooted in political and practical considerations. Elected officials are reluctant to embrace a change which increases the number of people counted as poor and other analysts are wedded to a statistic which has some semblance of historic continuity. This intransigence is regrettable because the proposed refinements would increase our understanding of the impact of recent policy efforts. Yet the proposed reforms would also fail to address one of the most glaring deficiencies of the current measure, which is the reliance on an accounting of income to capture the dynamics of poverty and economic well-being. Not only is income a poor proxy for consumption but consumption at any particular time is an inadequate reflection of long-term hardship. Poverty is a problem in the United States not because it is merely an episodic condition but because it is persistent and intergenerational. Alternative measures are needed to more effectively capture the relationship between economic well-being and household resources over time.

INCOME AND ASSETS: A MORE APPROPRIATE CONCEPTION OF RESOURCES

A more sophisticated approach for measuring the extent of economic hardship considers how financial resources relate to economic well-being and the capability of households to be self reliant. Does a family have sufficient resources to sustain itself through times of economic disruption brought on by job loss, long-term illness, or other events that commonly lead to income volitility? From this perspective, family assets are an indicator of well-being independent of income or the immediate consumption it provides. For several reasons, the consideration of assets offers a valuable and informative perspective, and should be incorporated in the ongoing efforts to measure economic hardship.

Economic well-being is a condition more closely related to consumption than income. Assets can be used as a source of consumption and tapped to smooth over income fluctuations. In a pinch, households draw down on their savings, take out loans, borrow from others, or sell assets they own. In doing so, they limit the extent to which they have to restrict their consumption even when their incomes drop. While some with low incomes may be temporarily unemployed, others may be retirees or college students. The relationship between income and consumption depends on a household's savings rate, access to credit, taxes, and income stability. So changes in income need not be reflected in changes in consumption, which explains the persistent research finding that even for the lowest income households, consumption far exceeds income.[6] The importance of assets as a source of security to cushion income shocks applies to households at all levels of the economy.

When people plan for their future, they have longer time horizons than 12 months. Assets provide a better sense of being able to take advantage of life opportunities than income. While income represents a flow of resources over a period of time, assets represent a stock of resources in hand. It is the combination of the stock and flow of resources which households consider when they assess their well-being and make decisions about the future. As Michael Sherraden observed in his seminal book *Asset and the Poor*, "over the long term, flows and stocks (income and assets) play complementary roles. It is not a matter of choosing one or the other. Rather, it is a matter of balancing one with the other"[7] Accordingly, household financial welfare is the product of a long-term, dynamic process rather than a cross-sectional accounting of finances at a single point of time. The key is that the command over resources enables households to plan for the future. Assets provide a better representation of this long-term, dynamic perspective than income because assets reflect the longer, often lifetime, time horizons of many families.

Likewise, some assets provide ongoing beneficial services to their owner. This is particularly the case with one of the primary components of wealth—owner-occupied housing. For many, homeownership represents a means to accumulate asset through the accrual of equity and real estate appreciation, but it also has a range of benefits at the household level as a shelter and a means of accessing a bundle of goods and services provided at the local level. Homeownership can offer access to good schools and neighborhood amenities as well as other location-linked opportunities. It has the additional benefit of ensuring stability in housing costs, removing households from the vagaries of the rental housing market.

Assets have other effects on well-being that make them valuable as a social indicator.[8] Beyond the aphorism "it takes money to make money," assets can provide a foundation for risk-taking that leads to accruing more resources. They also provide benefits to offspring, as they facilitate opportunities and can be passed on between generations. Yet perhaps most fundamentally, the allocation of wealth is linked to the distribution of power so that at some point its unequal distribution has detrimental social consequences, particularly in a democratic society requiring political participation. In order to understand the structure of social division and social equity, we must consider the distribution of assets in the society as a whole.

An additional reason to move beyond an accounting of income to estimate economic well-being is justified in practical public policy terms. Knowing the extent of the problem and the character of a problem provides a foundation for addressing it. The manner in which a problem is defined leads to solutions. When the problem of poverty is framed in terms of income, policy interventions will naturally focus on income as well. The need to create opportunities to save and build assets as a means to address poverty will be neglected. Estimating poverty by measuring income does not provide a complete picture of economic hardship and well-being. Those lacking assets and other resources are also, by definition, poor. Assets provide a stake that income alone cannot provide. In this vein, we should focus on developing a measure of asset poverty.

Asset poverty is a term which can describe a family with insufficient resources to sustain a household at the most basic level for an extended period of time. It is a concept which policymakers should increasingly focus their attention on to gauge the impact of policy efforts. What is needed is a standard definition of asset poverty. Oliver and Shapiro first proposed a definition for asset poverty in their 1997 book, *Black Wealth/White Wealth*. They defined "resource deficient" households as those without enough net financial worth reserves to survive three months at the poverty line.[9] This approach to asset poverty is designed to measure vulnerability, accounting for those households that do not have sufficient resources to survive economic disruption or invest in their future. Robert Haveman and Edward Wolff have built upon this approach and used existing data sources to estimate a series of asset poverty measures. Their estimates of asset poverty, reflected in Table 1, reveal that the number of households with precarious resource shortages substantially exceeds the official poverty rate, and that the disparity has grown over the last twenty years. In 1998, one out of eight Americans were officially classified as poor (34.3 million people or 12.7%), but the ranks of the asset poor included one of every four (69.1 million people or 25.5%).

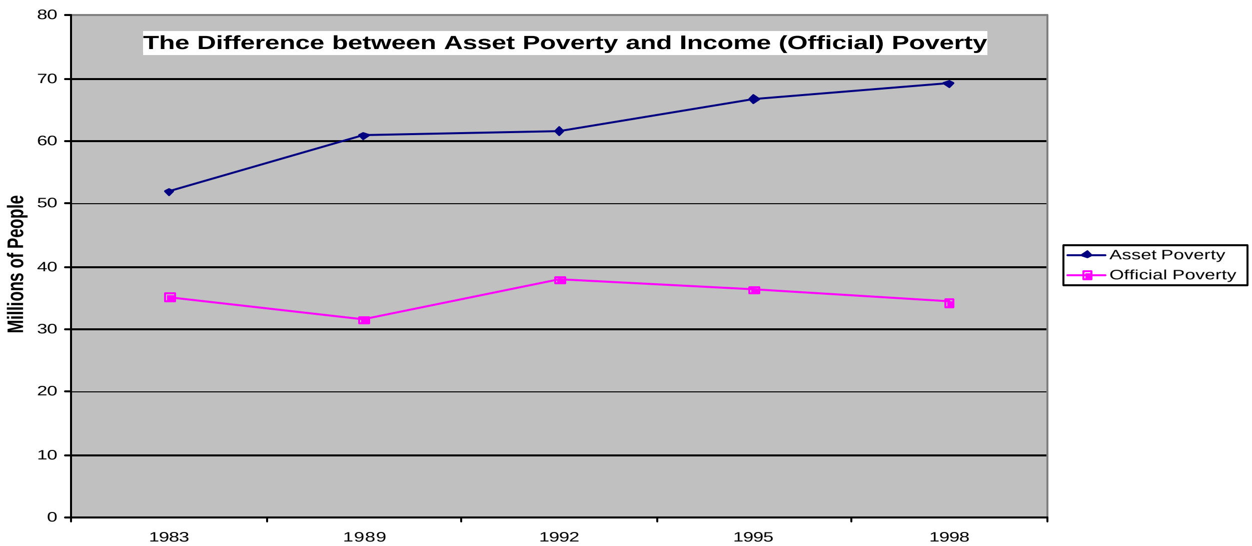
The work of Haveman and Wolff has should serve as a point of departure for subsequent efforts to produce ongoing estimates of asset poverty in the United States. The Corporation for Enterprise Development has done just that in its *State Asset Development Report Card*. This innovative report compiles the most up-to-date data available on asset distribution and policy for each of the 50 states and provides a useful basis for comparison.

Table I

A Comparison of Poverty Rates: Asset Poverty vs. Income (Official) Poverty

	Asset Poverty	Official Poverty
1983	22.4%	15.2%
1989	24.7%	12.8%
1992	24.0%	14.8%
1995	25.3%	13.8%
1998	25.5%	12.7%

Source: Haveman, Robert and Edward Wolff (2000) and U.S. Census Bureau



CONCLUSION

The persistence of the official poverty measure shortchanges anti-poverty policy efforts because it provides little more than a trend line of fluctuations in the business cycle. Analytical arguments against adopting a new measure are restricted to the benefits of historic consistency and a uniform eligibility standard for a range of federal programs. Yet we know more about the dynamics of persistent poverty today than we did forty years ago. Families are most vulnerable when they lack the resources to endure economic upheavals. In this sense, we know that assets matter. Assets provide stability and create a foundation from which families can take advantage of the opportunities offered by a prosperous society. This is particularly true in American society where even small asset holding can make a big difference in the lives of many lower-income families.

The recognition that assets play a role in providing economic protection means that they should be part of the equation in developing a standard definition of poverty. What is needed is an asset measure. The importance of an asset measure is that it can be used to gauge how well our society is meeting the needs of the citizenry to reach their potential. It allows us to assess the effectiveness of our public policy interventions to see if we are on the right path. More importantly, we need an asset measure that is aligned with the prevailing policy approach to promote increased stakeholding in the economy through homeownership, investment, and savings. The policy mechanisms used to achieve many of these objectives has been the tax code, an approach which limits the participation of most low-income households.

The potential for assets to expand or inhibit opportunities makes them a valuable social indicator, one that should be tracked and monitored over time. The next step is to refine a measure of asset poverty that incorporates a set of reasonable assumptions and is operationally feasible. Regardless of what specific measure is devised, it should be endorsed and monitored on an ongoing basis by the Census Bureau. If the official measure is to remain untouched, the asset poverty measure should at a minimum be added to the set of experimental measures tracked by the federal government. In our society, we have goals that extend beyond subsistence toward prosperity and achievement. To monitor the success of this national project we need a better account of the extent of hardship and economic well-being; a new asset poverty measure is a place to start.

[1] President Lyndon B. Johnson's Annual Message to the Congress on the State of the Union, January 8, 1964.

[2] In July 1963, Mollie Orshansky of the Social Security Administration published an article in the *Social Security Bulletin* describing an initial version of her poverty thresholds which defines the poverty line for households of varying size.

[3] The minimum diet costs were derived from a 1955 Household Food Consumption Survey on food buying patterns combined with nutritional guidelines of the Economy Food Plan developed by the U.S. Department of Agriculture in the early 1960s.

[4] All price indexes embody hundreds of arbitrary decisions and compromises. Since 1980, the census Bureau has used the CPI for urban consumers as the standard for adjusting the poverty thresholds. The CPI-U overstated the annual inflation rate during the 1970s because of the way it computed housing costs (Boskin et al. 1996). Although this error in the CPI-U was corrected, earlier poverty statistics were not revised.

[5] Citro, Constance and Robert Michael, editors (1995). Measuring Poverty: A New Approach. Washington, D.C.: National Academy Press.

[6] The Bureau of Labor Statistics' Consumer Expenditure Survey consistently finds that the poorest 20 percent of households (measured by their income) report spending over twice their income in any given year. In 2001, this quintile earned $7,946 but spent $18,883.

[7] Michael Sherraden (1991). *Assets and the Poor: A New American Welfare Policy*. New York: M.E. Sharp, Inc. Page 146.

[8] Scanlon and Page-Adams (2001) present an insightful review of the research literature on the effects of asset holding on neighborhoods, families, and children.

[9] Melvin Oliver and Thomas Shapiro (1997). *Black Wealth/White Wealth: A New Perspective on Racial Inequality*. New York: Routledge. Page 88.

REFERENCES AND RESOURCES

Boskin, Michael and Ellen Dulberger, Zvi Grilliches, Robert Gordon and Dale Jorgenson (1996). "Toward a More Accurate Measure of the Cost of Living." Washington, D.C.: Final Report to the Senate Finance Committee.

Citro, Constance and Robert Michael, editors (1995). *Measuring Poverty: A New Approach*. Washington, D.C.: National Academy Press.

Corporation for Enterprise Development (2002). *State Asset Development Report Card*.

Fisher, Gordon (1997). "From Hunter to Orshansky: An Overview of (Unofficial) Poverty Lines in the United States from 1904 to 1965." U.S. Census Bureau.

Fisher, Gordon (1997a). "The Development of the Orshansky Thresholds and Their Subsequent History as the Official U.S. Poverty Measure." U.S. Census Bureau.

Harrington, Michael (1962). *The Other America*. New York, NY: Macmillan.

Haveman, Robert and Andrew Bershadker (2001). "The 'Inability to be Self-Reliant' as an Indicator of Poverty: Trends for the U.S., 1975-97." *Review of Income and Wealth* 47: 3: (September) 335-60.

Haveman, Robert and Edward Wolff (2000). "Who are the Asset Poor: Levels, Trends and Composition, 1983-1998?" Working Paper 00-12, Center for Social Development, Washington University in St. Louis.

Mayer, Susan E. and Christopher Jencks (1989). "Poverty and the Distribution of Material Hardship." Journal of Human Resources, 24: 88-114.

Mayer, Susan E. and Christopher Jencks (1993). "Recent Trends in Economic Inequality in the United States: Income versus Expenditure versus Material Well-Being," in Dimitri Papadimitriou and Edward Wolfe, editors, *Poverty and Prosperity in America at the Close of the Twentieth Century.* London: Macmillan, pp 121-203.

Oliver, Melvin and Thomas Shapiro (1997). *Black Wealth/White Wealth: A New Perspective on Racial Inequality*. New York: Routledge.

Orshansky, Mollie (1963). "Children of the Poor," Social Security Bulletin, Vol. 26, No. 7, July 1963, pp. 3-13.

Scanlon, Edward and Deborah Page-Adams (2001). "Effects of Asset Holding on Neighborhoods, families, and Children: A Review of the Research." In *Building Assets: A Report on the Asset-Development and IDA Field*. Ray Boshara, editor. Washington, D.C.: Corporation for Enterprise Development.

Sen, Amartya (1999). *Development as Freedom*. New York: Anchor Books.

Sherraden, Michael (1991). *Assets and the Poor: A New American Welfare Policy*. New York: M.E. Sharp, Inc.

Short, Kathleen and Thesia Garner (2002). "A Decade of Experimental Poverty Thresholds: 1990 to 2000." Paper prepared for the Annual Meeting of the Western Economic Association.

Wolff, Edward (2001). "Recent Trends in Wealth Ownership, 1983-1998." In *Assets for the Poor*. Edited by Thomas Shapiro and Edward Wolff. New York: Russell Sage Foundation.