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Self-reliance and Poverty

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In the current political and social climate, with its call for self-reliance as the means by which families and individuals should support themselves, the official U.S. poverty indicator may be measuring the size of a population that is of less interest to policymakers than in past years. We present here an alternative measure of poverty for the United States population that is based on a family's capacity for generating income rather than on its actual money income. This measure, called net earnings capacity (NEC), rests on a concept of self-reliance and is used to determine the size of the population that is unable to be self-reliant.

The Official Measure of Poverty

The United States was one of the first countries to establish an official definition of poverty, and the definition, developed over 30 years ago, has remained largely unchanged. Based on an economist's concept of "income poverty," comparing cash income to an assessment of income needs, it has been used to track the nation's poverty rate and the characteristics of people identified as poor (Fisher 1992; Ruggles 1990).

The official measure identifies poor families and the individuals living in them by comparing two numbers: the current annual cash income of the family unit and an estimate of the income necessary for a family of a particular size and composition to meet a minimum level of consumption. This second number is the family's "poverty threshold" or "poverty line." If the income of the family does not exceed its poverty line, the family is defined as "poor." The nation's "poverty rate" is the percentage of its population who live in poor families, so defined.

The official measure is open to many criticisms, both conceptual and practical. One important reason to be dissatisfied with it is that it does not measure permanent characteristics of a family; it relies on a single year of cash income of a family, while for many families annual income fluctuates. Unemployment, layoffs, the decision to undertake mid-career training or to change jobs, health considerations, and especially income flows from self-employment may all cause the money income of a household to change substantially from one year to the next.

In recent years some policymakers, reflecting the changing sentiments of many citizens, have called into question the basic concept on which the official measure rests and the policy approaches that follow from it. What the rate measures, so the discussion goes, is how short of income families are (in any given year) and the policy that follows from that measure is supplementing income through welfare and other transfers. However, some have argued that government income support has created a dysfunctional social class that generates more poverty because people become dependent on that support. Having some people with low cash income is not the fundamental problem; rather the problem is having a number of people who are not self-reliant. In this view, basing policy on a poverty measure that rests on income realizations can only mean that public support must always increase in order to compensate for the decrease in individual effort it creates.

Given the judgment that people need to rely on their own energies and resources, it is interesting to ask the following questions: What if there are people who do not have the capability to make it on their own in our market society? What collective responsibility does the nation have to them? One option for advocates of self-reliance is to consider what can be done to increase the ability of people who are not now economically independent to become so. How can public policy cope with a population unable to be self-reliant, what instruments are available, and which are the most cost-effective?

An Alternative Poverty Concept and Measure: Net Earnings Capacity

What sort of poverty measure might be relevant to those who place primary emphasis on self-reliance as a social objective? No measure consistent with this concern now exists. If one were to design such a measure, the objective would be to identify the size and composition of the population who cannot be self-reliant and the patterns of change in the size and composition of this population. We propose a measure that reflects a family's ability to achieve economic independence, that is, to attain a minimum level of living through the use of its own capabilities.

The main points on which this measure is based are as follows:[1]

- Net earnings capacity is an indicator of the capability of a family to generate an income stream that can be used for meeting needs. It reflects the full-capacity (full-time, full-year) earnings capability of a family.
- Full-time, full-year work is assumed to be the working time of people (age 18 to 65) who are fully using their human capital. Values greater or less than this amount could be used, but we accept it as a socially determined norm of full employment.
- Adjustments are made for illness, disability, and other characteristics related to long-run unemployability and reduced earnings capacity in order to obtain a more realistic estimate of the potential value of an individual's human capital or gross earnings capacity (GEC).[2]
- Child care costs associated with full-capacity work are subtracted from the GEC to arrive at an estimate of a family's net earnings capacity (NEC).
- A family with an NEC below the official poverty line is defined as living in NEC poverty. A family with an NEC above the poverty line is considered to be capable of being self-reliant.

NEC Poverty and Official Poverty Rates

We use annual data from the March Current Population Survey to estimate the rate of NEC poverty for families headed by a working-age person in the United States from 1975 to 1995. Our estimates of the overall prevalence of both NEC poverty and official poverty for 1975 to 1995 are shown in Table 1.

While the official poverty rate over the period ranged from about 10 to 14 percent, the NEC poverty rate ranged from about 6 to 11 percent. The primary factors that account for this difference are (1) the counting of transfer income (done in the official measure but not in the NEC measure), (2) the less than full-time, full-year work of many working-age adults (which affects the official poverty measure), and (3) the adjustment for child care costs (which affects NEC poverty but not official poverty).

The official poverty rate is more sensitive to business cycle fluctuations than the NEC rate. While the official poverty rate rose nearly 40 percent during the recession of the early 1980s, the NEC poverty rate rose less than half of this amount. Given that the NEC measure reflects longer-term (or permanent) earnings potential as opposed to the shorter-term actual income amount reflected in the official measure, the closer tie between current labor market conditions and the official poverty rate is expected.

Table 1 Percent of Individuals in NEC Poverty and Official Poverty, 1975 to 1995

	NEC Poverty			Official Poverty		
	1975-1977	1993-1995	Average Annual Growth (Percent)	1975-1977	1993-1995	Average Annual Growth (Percent)
All	5.79	10.54	3.38	10.19	13.72	1.67
Race of head						
White	3.55	6.50	3.41	6.67	8.28	1.21
Black	17.72	24.34	1.78	27.94	29.45	0.29
Hispanic	12.67	19.66	2.47	21.88	27.74	1.33
Other	4.52	9.57	4.26	13.64	16.66	1.12
Sex of head						
Male	2.84	5.77	4.02	5.94	7.89	1.59
Female	22.14	20.55	-0.41	33.74	26.05	-1.43
Education of head						
Less than high school graduate	12.58	28.22	4.59	20.13	35.61	3.22
High school graduate	4.20	11.87	5.94	7.66	14.82	3.73
Some college	2.23	7.16	6.68	5.63	9.39	2.88
College graduate	0.47	1.22	5.46	2.29	3.09	1.67
Families with no children						
All	4.43	7.18	2.71	7.05	9.17	1.47
Married couples	1.93	3.62	3.55	2.70	3.12	0.80
Single men	8.76	11.08	1.31	12.94	15.17	0.89
Single women	9.56	11.81	1.18	17.32	17.66	0.11
Families with children						
All	6.37	12.44	3.79	11.55	16.31	1.94
Married couples	2.53	5.06	3.93	6.37	8.38	1.54
Single fathers	10.97	22.39	4.04	11.00	19.42	3.21
Single mothers	29.34	38.08	1.46	43.15	45.16	0.25
White	20.23	27.23	1.67	31.35	32.58	0.21
Black	39.08	46.72	1.00	56.71	55.22	-0.15
Hispanic	40.86	48.10	0.91	55.03	57.37	0.23
Other	32.63	36.26	0.59	40.89	40.03	-0.12
Single mothers on welfare	44.98	58.73	1.49	68.88	77.19	0.63
Single mothers not on welfare	17.72	26.16	2.19	24.05	26.59	0.56

Note : The growth rate is calculated using the average 1975-1977 and 1993-1995 poverty rates and assuming 18 years of growth.
Source : U.S. Bureau of the Census, March Current Population Survey data files.

NEC poverty has grown at a substantially faster rate than has official poverty. Over the 1975 to 1995 period the prevalence of official poverty grew by about one-third, with an average annual growth rate of 1.7 percent. NEC poverty grew by nearly 185 percent, with an annual growth rate of 3.4 percent, or twice the growth rate of the official poverty. This growth in economic inadequacy in terms of both current income and earnings potential is troubling when one considers the growth in affluence in the United States over the period; inflation-adjusted disposable income per capita increased from $13,400 to $18,900 (1992 dollars), an increase of over 40 percent.

The overall poverty trends hide a variety of patterns of poverty growth among subgroups of the U.S. population. For example, the growth in NEC poverty among the population groups shown in Table 1 ranges from -0.4 percent per year (for individuals living in families headed by a female) to over 6.6 percent per year (for individuals living in families headed by someone with some college). The groups with NEC poverty growth rates in excess of the national average (3.4 percent per year) are families headed by whites, males, persons with less than a high school degree, persons who are high school graduates, married couples with no children, and married couples with children.[3] Families headed by whites, males, and couples are not generally thought of as economically vulnerable. Nevertheless, even though in 1995 the poverty rates for these groups were still low relative to the overall 10.5 percent national rate, they had large relative increases in NEC poverty in this period.

The most surprising story in Table 1 concerns the groups that have experienced the lowest growth in NEC poverty over the period. These groups tend to be those with the highest overall levels of both NEC and official poverty. The groups with the lowest trends in the NEC poverty index from 1975 to 1995 are blacks, Hispanics, female heads of household, black single mothers, and Hispanic single mothers.

The rates show that a large percentage of individuals in black, Hispanic, and mother-only families are unable to be self-reliant. Among these groups, the NEC poverty rate in 1995 ranged from 19.7 percent to over 48 percent, compared to an overall NEC poverty rate of 10.5 percent. However, these same least well-off and most vulnerable groups experienced either decreases or below average growth in NEC poverty. Among these groups, the annual growth ranged from -0.41 percent to 2.47 percent, compared to the overall NEC annual growth rate of 3.4 percent.

Factors Underlying Trends in NEC and Official Poverty Rates

Although the economic, demographic, and cultural factors that underlie trends in NEC poverty and official poverty measures are numerous and interact in complex, sometimes puzzling ways, it is possible to identify the most important of these factors and their likely effects on trends in poverty.

- *Decreasing female poverty, increasing male poverty:* brought about by a decline in the real value of income transfers (tends to increase relative female official poverty, but has no effect on NEC poverty), increased labor force participation of women (tends to decrease relative female official poverty, but has no effect on NEC poverty), increased female wage rates, and increased male joblessness.[4]
- *Rising white relative to black and Hispanic poverty:* attributable to the rather steady increase in absolute wage rates of minority workers and their relative wage rates (compared to white workers).
- *Rapid increases in poverty in families headed by a loweducation worker:* caused by the absolute fall in wage rates earned by those with little education and few skills (tends to affect official poverty less than NEC poverty because a falling wage rate decreases actual earnings less than earnings capacity).
- *Increasing overall poverty rates, especially NEC poverty:* caused primarily by the substantial increase in wage inequality "within" age-race-schooling groups (tends to affect NEC more than official poverty because the relative deterioration of wages at the bottom of the distribution weights all of the potential work hours of the low-wage population in the estimation of NEC poverty, but only the hours actually worked in the estimation of official poverty).

Policy Implications

The net earnings capacity measure is not intended as a replacement for the current official measure, but as a supplement to it. Certainly, the official measure identifies an important segment of the population, namely, families that lack sufficient money income to meet a minimum living standard. As such, it is well-suited to identifying families in need of short-term monetary assistance. Our measure is better suited to identifying families in need of longer-term skill-enhancing assistance. The earnings capacity measure identifies those individuals with insufficient skills and abilities to generate minimally acceptable earnings levels.

The rapid growth in this type of poverty is discouraging for a society that prides itself on being one in which individuals are able to prosper and thrive by working hard and playing by the rules. The message that workers and their families must rely on their own resources appears to have come at a time when demographic and economic trends have made it more difficult for those with few skills to make it on their own. The decline in earnings capacity highlights the dilemma faced by self-reliance advocates. If income support measures are ruled out as eroding work effort, encouraging dependence, and fostering the growth of income poverty, what policy measures are available to reduce the prevalence of those who are unable to be self-reliant? Two general policy approaches are (1) increase the level of education, training, skills, and other income-generating characteristics of those at the bottom of the human capital distribution and (2) increase the "return" that individuals with low earnings capacity receive on the use of their human capital.

The first approach suggests designing and increasing resources devoted to programs to improve schools and to provide training services for those with few skills. Programs similar to Head Start could increase the value of early education. Direct financial aid for postsecondary school could stimulate later human capital investments. Teaching the skills needed in the "high technology" economy could develop human capital further. These are the types of programs that will be needed if self-reliance is the nation's policy goal. How best to design and implement such programs and to ensure that they are cost-effective becomes a question of major importance.

The second approach is the more controversial, as it directly calls into question the productivity returns reflected in market-determined wages. Policy measures capable of reducing NEC poverty through increasing the returns to market work often carry with them their own distortions and inefficiencies. Such measures include raising the national minimum wage, subsidizing wages for those at the bottom of the wage distribution, and subsidizing the earnings of those whose work is insufficient to move their families above the poverty line (such as through the earned income tax credit).[5] The question is again how to create effective and costeffective measures.

Some may argue that we have ignored aspects of human capital accumulation and family formation involving choice. But regardless of how choices affect income potential, the fact remains that certain families and individuals lack the ability to be self-reliant, lack the ability to earn their way to minimum income thresholds. If self-reliance and economic independence are to be the standards by which we gauge our success as a nation, and if income maintenance is not a feasible policy instrument, we cannot avoid the question of how to provide those now not able to be self-reliant with the skills, capabilities, and returns on their efforts they need. In the face of demographic and economic trends that appear to be generating increases in the prevalence of NEC poverty, finding an answer to this question assumes greater urgency.

Notes

1. This discussion is based on a technical paper that describes in detail the procedures we use to devise this "self-reliance" poverty measure and the norms on which it is based. See Haveman and Bershadker (1998).
2. We ignore short-run constraints placed on a person's earnings capacity by the demand-side of the labor market. Our individual earnings capacities simply estimate what the individual could earn in the economy if he or she held a job paying a wage commensurate with his or her observed human capital characteristics.
3. The two highest education groups were excluded from this listing even though their percentage rates of growth were above average. It is difficult to interpret the percentage increase calculation, given that the base level is a very low number.
4. "Male poverty" here refers to families headed by single men, with and without children, and married couples, with and

without children; "female poverty" here refers to families headed by single women, with and without children.
5. For a discussion of such wage and employment subsidies as an antipoverty strategy, see Haveman (1988).

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