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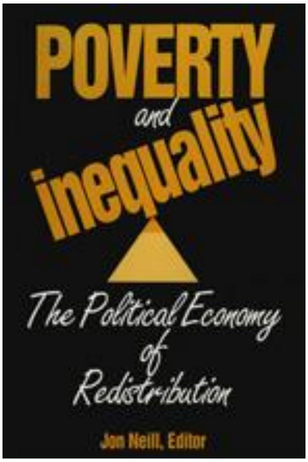

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Why Has Economic Growth Been Such an Ineffective Tool Against Poverty in Recent Years?

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In the 1960s, the U.S. economy was flying high. Between 1961 and 1969, we experienced the longest and strongest economic expansion in U.S. history. The economy grew by an average of 4.3 percent per year, while unemployment was at 3.5 percent by the end of the decade. At the same time, the share of the population below the poverty line fell 9 percentage points, from 22 percent in 1960 to 13 percent by 1970.[1] Most economic analyses indicate that it was the booming economic growth that reduced poverty in the 1960s.

Now fast-forward to the 1980s. After two back-to-back recessions during 1980 and 1982, there was a strong and rapid recovery. From 1983 through 1989, the U.S. economy experienced its second longest and strongest expansion, topped only by the 1960s. Economic growth during these years averaged 3.7 percent per year. Unemployment fell from over 10 percent in December 1982 to slightly over 5 percent by 1989. But the poverty rate, which was over 15 percent at the beginning of the expansion of the 1980s fell only modestly. By 1990, after six years of economic expansion, it had declined only 2.4 percentage points and was still above its level of a decade before.

Now move forward again into the 1990s. A mild recession in 1990-1991 was followed by strong aggregate growth in 1992-1993. Not surprisingly, poverty rates rose in 1990-1991. Very surprisingly, poverty continued to rise in 1992-1993. The poverty rate, 15.1 percent, was very near where it was in 1983 at the end of a sharp steep recession. For the first time in modern U.S. economic history, economic expansion was associated with *increases* in the share of poor persons in the population.

This paper is about what happened over these years that caused economic growth to decline as an effective antipoverty tool. The first part compares the expansions of the 1960s and the 1980s and indicates why economic growth had far less effect on the income distribution in the 1980s than two decades earlier. We will discover that the primary culprit is a change in the demand for less-skilled labor that has driven down wages among less-skilled workers. The second section discusses some of the reasons for these labor market changes, and the third section discusses their political and policy implications.

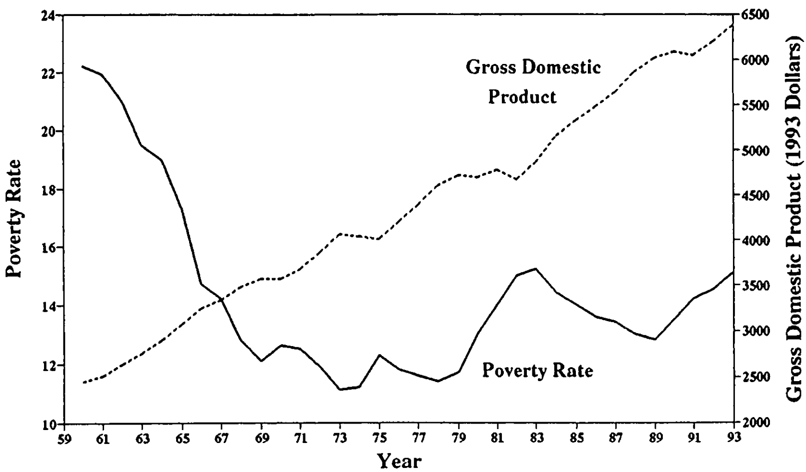
The Death of "Trickle Down Economics"

It has been an axiom of public policy and political rhetoric that economic growth helps the poor. More than one president has claimed that "the best thing we can do for the poor is to make the economy grow." This strategy, often referred to as "trickle down economics," is extremely attractive, because it promises that we can fight poverty without substantial costs. Economic growth is expected to make middle-income Americans better off *at the same time as* it decreases poverty. This is a win-win solution to poverty, requiring no higher taxes on one group in order to redistribute to another. Unfortunately, this solution has been largely ineffective over the past fifteen years.

Figure 1 shows both the poverty rate and the size of the overall economy as measured by Gross Domestic Product (GDP), the most frequently used measure of overall economic capacity, from 1960 to 1993.[2] Between 1961 and 1969, the U.S. economy experienced its longest economic boom, as can be seen from the steep upward rise in GDP. Poverty fell 9 percentage points during that period. Between 1983 and 1989, the U.S. economy experienced its second-longest expansion. Poverty declined only 2.4 percentage points during that period, and remained well above its historic low of 11.1 percent in 1973. This is reinforced in the 1990s, when strong economic growth is associated with *increases* in poverty.

One measure of how surprising these changes are can be seen by going back to an economics article published in the mid-1980s by Alan Blinder and myself (Blank and Blinder 1986). In that article, we estimated the relationship between macroeconomic indicators and the overall poverty rate. Using data from 1959 (when official poverty numbers begin) to 1983, we were able to track poverty based on the core unemployment rate, the inflation rate, the share of government transfers to the poor, and several other macroeconomic indicators. We can use that historical relationship between the macro economy and poverty to predict the poverty rate over the 1980s, based on what actually happened in the macro economy. Our evidence would have predicted that by 1989 the poverty rate should have been down to 9.3 percent, driven by declining unemployment and low inflation. In reality, the actual poverty rate was 12.8 percent, much higher.[3]

Figure 1. U.S. Poverty Rate vs. Gross Domestic Product



This exercise provides clear evidence of two things: First, no economist should be so foolish as to engage in economic predictions. Second, the historical relationship between macroeconomic growth and changes in poverty has fundamentally deteriorated.

Over the past five years, I have been involved in several research projects, exploring these changes in the relationship between economic growth and poverty.[4] Let me first indicate what the causes of the sluggish decline in poverty are *not*. While the following stories are often told, they turn out not to explain what is happening:

1. The problem is *not* that we are mismeasuring poverty in the 1980s and 1990s. Poverty rates are based only on cash income and do not consider what we call "in-kind" transfers. In-kind transfers include noncash public assistance programs, such as food stamps or housing assistance. While it is true that in-kind transfers have expanded among the poor, most of this expansion occurred in the 1970s, when such programs were increasing rapidly. Poverty rates that include in-kind income decline by almost exactly the same amount over the expansion of the 1980s as do official poverty rates. This is perhaps not surprising since in-kind income did not grow in real terms over this time period.

2. The problem is *not* legislative changes in eligibility and benefits in public assistance programs. Some have suggested that the cuts Ronald Reagan implemented in the early 1980s offset the effects of economic growth. While it is true that welfare payments declined in real terms for poor families throughout the 1980s, this had little effect on poverty, largely because public assistance does little to actually move families above the poverty line. Most public assistance payments move recipients *closer* to the official poverty line, but the benefits are low enough that few families actually escape poverty because of public benefit payments. (The elderly, to whom we provide much more generous benefits, are an exception to this. Government assistance moves a substantial number of elderly persons and couples out of poverty. But the elderly were largely unaffected by the cuts of the early 1980s.)

3. The problem is *not* the changing demographic composition of the poor. Between the 1960s and the 1980s, the composition of the poor changed substantially. The share of the elderly declined, as did the share of poor married-couple families. An increasing share of the poor were single-parent families, typically single mothers. As it turns out, however, single-mother families are at least as responsive (or nonresponsive) to economic growth as other groups. If the composition of the poor had remained constant from the early 1960s through the 1980s, the poverty rate would have been just as unresponsive to the macro economy of the 1980s.

So what did happen? Let's start by discussing *why* economic growth would be expected to decrease poverty in the first place. Earnings, the most important component in most families' income, are the result of labor market effort multiplied by wages. How are these affected by the economic cycle?

The primary effect of economic growth on the distribution of income occurs through the availability of jobs. When the economy expands, employment grows and the demand for workers increases. Those who are unemployed, employed part-time, or not working at all, are most likely to benefit from employment expansions. And unemployed, part-time, and discouraged workers are disproportionately likely to be less-skilled individuals in low-income families. Those who are working 40 to 50 hours a week are typically unable to benefit as much from employment growth. In March 1993, when overall unemployment was 7 percent, unemployment among high school dropouts was 15 percent, among high school graduates it was 8 percent, while among college graduates it was just over 3 percent.[5] These unemployment differentials across skill levels have been relatively constant for many years in the U.S. economy.

Thus, when the economy expands, the main reason why those in families at the bottom of the income distribution catch up, relative to those in the middle, is that they gain more from the employment expansion that accompanies an economic boom. This clearly happened in the 1960s, when both the probability of working and weeks of work among the employed expanded more rapidly among persons in low-income families than in higher-income families. But it also happened in the 1980s. The evidence indicates that adults in low-income households took advantage of growing employment opportunities in the 1980s even more than they did in the earlier decades. Work effort was *more* responsive to changes in the economy in the 1980s than in the 1960s. If we look only at the growth in work behavior, we would have expected poverty to fall *faster* in the 1980s.

If labor market effort expanded as much in the 1980s as the 1960s, the only remaining factor is wages. In the 1960s, real wages expanded throughout the income distribution. GDP growth of 1 percent in the 1960s was correlated with a $2.18 increase in real weekly wages among workers in low-wage families. This expansion in wages reinforced the growth in employment occurring at the same time, so that workers both expanded their hours of work and earned more every hour. The result was that poverty plummeted during that decade.

Among the poorest groups in the population in the 1980s, however, real wages actually *fell* with economic growth. Both high school dropouts and high school graduates have experienced a steady decline in their earnings starting in about 1979 that has continued through the past fifteen years. The result was that the poor worked more during the economic expansion of the 1980s, but earned less per hour over time. Unlike the 1960s, these two effects *offset* each other. While poverty did decline, the decline was much more modest than expected as falling real wages limited the economic gains that increased labor market involvement should have produced. Both my own research and the research of others suggests that the difference between the responsiveness of poverty and of the income distribution to economic growth between the 1960s and the more recent decade is entirely due to these wage changes.

What's Happening to Wages?

Table 1 shows wage changes among men and women at different skill levels over the past twenty-five years. In order to abstract away from questions of changes in work effort, the table shows weekly wages (inflation adjusted) among nonelderly men and women who worked full time year-round. The decade between 1969 and 1979 was a bad decade for all workers. A series of recessions combined with high inflation rates left virtually all workers with lower wages in 1979 than they had earned ten years earlier. Since 1979, however, there has been sharp divergence in the wage changes experienced by more- and less-skilled workers. Average weekly wages among men who are high school dropouts have fallen by 15.6 percent, while they have risen by 15.7 percent among men who hold college degrees. The distribution of earnings has also widened among women, although this is largely because of big increases in earnings among more educated women. Women without a high school degree have faced virtually stagnant weekly earnings since 1969, while women with college degrees have seen their earnings grow by 31 percent. A growing body of literature has documented these changed among many groups using a wide variety of data sources. There are two primary conclusions that emerge from this literature.[6]

Table 1. Average Weekly Earnings by Years of School and Sex Among Nonelderly Adults Who Work Full Time and Full Year

	Men			Women		
Education level	**1969**	**1979**	**1992**	**1969**	**1979**	**1992**
Less than a high school degree	$489	$474	$400	$279	$281	$284
Percent change		-3.1	-15.6		+0.7	+1.1
High school degree	601	565	536	340	335	379
Percent change		-6.0	-5.1		-1.5	+13.1
Post-high school training, no college degree	699	626	641	388	377	451
Percent change		-10.4	+2.4		-2.8	+19.6
College or higher degree	911	841	973	523	489	642
Percent change		-7.7	+15 7		-6.5	+31.3

SOURCE: Tabulations from the Current Population Surveys, March 1970, 1980, and 1993, based on the civilian population ages 18-65 Inflation adjustments are based on the GDP deflator.

First, these wage changes are spread throughout the economy. They are occurring among men and women in virtually all industries and occupations. Less-skilled men in both manufacturing and nonmanufacturing industries have experienced similar real wage declines. Although the trends are strongest among younger workers, they are occurring among older workers as well.

Second, as is visible in table 1, there appear to be substantial gender differences in these trends. While the least-skilled women have not experienced wage increases, neither have they experienced the wage decline of their less-skilled brothers. While this has helped close the female-to-male wage gap, presumably those who wanted to bring men's and women's wages closer together did not want to do it by decreasing men's wages. It is also worth noting that wages among less-skilled women remain far below those of men. The average male high school dropout earned $400/week if he worked full time year-round in

1993, while the average female high school dropout earned only $284/ week at full-time work.

What has caused these wage changes? That question is much discussed among economists, and a growing literature is attempting to explain various causal forces. In general, most analysts agree that it is changes in the demand for more- versus less-skilled labor that is driving these trends. In other words, employer demand for less-skilled labor has been falling over the last fifteen years, and this is driving down wages among this group. Two particular economy-wide changes have been strongly linked to these wage changes: the growing importance of international competition to U.S. firms and changing technology. Let's look at each of these in turn.

The Growing Internationalization of the U.S. Economy

As the U.S. economy is increasingly linked with the world economy, U.S. workers are in competition with workers around the globe. In this global labor market, skilled workers in the United States have a comparative advantage. The United States has more skilled, college-educated workers than any other country in the world. Less-skilled U.S. workers, however, are presumably at a comparative disadvantage relative to less-skilled workers in industrializing countries, such as those in the Pacific rim countries. Because the cost of living and the wage levels of less-skilled workers are substantially higher in the United States than elsewhere, demand for U.S. less-skilled labor might be expected to decrease while demand for less-skilled labor in lower-wage countries would rise.[7]

The evidence indicates that growth in international economic competition is not adequate by itself to fully explain U.S. wage changes. Those industries that have been experiencing rapid growth in international competition have not necessarily experienced greater declines in wages among less-skilled workers. But there is evidence that this trend is at least one of the causal reasons behind these shifts.

Changing Technology in the U.S. Economy

The other story for which there is substantial evidence is the possibility of technology shifts that have been demand-increasing for more skilled workers and demand-decreasing for less-skilled workers.[8] The rapid spread of computer-based technology in all industries and occupations is often mentioned as an example. In manufacturing industries, "smart" machines mean that these companies hire more computer programmers and computer-literate production line overseers and fewer workers to perform repetitive labor. In the service industries, the rapid spread of personal computers has decreased clerical demand and replaced many persons in less-skilled filing and data entry positions.

There is evidence to support both of these explanations for the wage changes of the past fifteen years, and almost surely both of them are happening at once. These changes are also linked to a variety of other institutional changes that are correlated with declining wages among the less skilled. For instance, union jobs continue to disappear in the United States, in part because of the economic pressures of changing trade and technology. Since unions typically raise the wages of the least skilled, this accounts for about one-fifth of the decline in wages among less-skilled workers.[9]

The most discouraging aspect of these two explanations is that neither of them promise any reversal of these wage trends. If anything, virtually all economists who have looked at these issues predict that the current trends toward a more internationalized economy and increasing use of "smart" technology, will continue in the near future. This means further declines in the earning ability of less-skilled workers.

Policy Implications

There are two major policy implications that emerge from the above discussion, both of them posing serious challenges to those who want to run effective policies to combat poverty in the United States.

Implication 1: Economic growth is unlikely to be an effective antipoverty tool in the near future.

For the past fifteen years, the employment expansions that occur when the economy grows have been offset by declines in real wages among less-skilled workers. As a result, the antipoverty "kick" that economic growth provided in earlier decades has not been available. To the extent that these wage trends are likely to continue, it is unreasonable to expect economic expansions during the 1990s to have substantial antipoverty effects.

Economic growth has historically been the most attractive antipoverty tool available. It provided broad-based income redistribution to low-income families at a time when the overall economic pie is growing. Thus, it required few hard political choices. In particular, it did not require higher taxes on middle- and upper-income families in order to provide services to lower-income families. There were also no administrative or overhead costs associated with a decline in poverty spurred by economic growth, since no government-run programs were required.

If economic growth is no longer available, this leaves us with two markedly less politically attractive alternatives. The first alternative is to pursue broad-based income redistribution through national cash-transfer programs for low-income families. This was originally proposed by Richard Nixon, who wanted to replace many small antipoverty programs with a nationally based (albeit relatively low) cash guarantee for the poorest families. While his plan was enacted for elderly families and resulted in the Supplemental Security Income program which provides substantial cash redistribution to elderly and disabled persons, it was politically unpalatable for other poor families. If anything, since Nixon's time, cash income redistribution has become even less politically viable in the United States. In the current environment, the push has been to decrease cash transfers to the nonelderly even further.

The second alternative is to give up on broad-based redistributional programs and instead work to design targeted programs that provide specific services to clearly defined groups of persons. This would include such programs as Headstart, food stamps, housing assistance, or employment and training efforts. These programs often link specific behavioral requirements to benefits. For instance, parents as well as children are required to actively participate in Headstart activities, while employment and training programs typically impose attendance or effort requirements on participants.

The welfare reform conversations over the last decade have been focused on how to effectively implement this second alternative. Extensive discussion at the federal and state level has focused on such issues as which groups to target, which behavioral requirements to impose, and how to efficiently provide these services to the targeted recipients.

In contrast to economic growth, such antipoverty efforts require extensive governmental planning and management. An organizational structure must be established to run programs and verify eligibility. In addition, such services clearly cost money up front. The administrative costs of implementing and managing these programs are often substantial and usually cost more than broad-based cash redistribution efforts.

Much of the frustration with our antipoverty system has been a frustration with such targeted, heavily managed services. Major discussion is occurring about how to streamline these programs to make them more efficient and to ensure that they treat more participants more effectively. Such discussion was perhaps inevitable in a world where targeted service-provision programs provide the major effort against poverty. Clearly, the ineffectiveness of overall economic growth as an antipoverty tool has left us with much less politically palatable alternatives.

Implication 2: Jobs alone will not solve poverty.

The other implication of the recent labor market changes is that employment is a less-effective way to escape poverty. Compared to thirty years ago, moving people out of poverty by moving them into employment is much harder. This is true for two reasons.

First, the changes in wages among less-skilled workers means that jobs pay less. Full-time work at the minimum wage provides only $8500, while the poverty line for a family of three is $12,500. Thus, efforts to move low-income adults out of poverty via employment will require more than just finding a job. Increases in employment will increase earnings, but for many low-income workers, this will not move them above the poverty line. Hence, in addition to programs designed to move people into jobs, we also have programs that supplement earnings by collecting child support from absent fathers, by subsidizing child care, or by supplementing wages through the Earned Income Tax Credit. Clearly, this costs more.

Second, as a growing share of the poor are single parents, this also limits the effectiveness of employment-based strategies, even in the absence of wage deterioration. Single parents often face more time constraints. They must act as the sole parent for their children as well as the primary family earner, making it harder for them to locate and keep a full-time job. In addition, many single parents must earn enough not just to cover their living expenses, but also to cover child care expenses. This increases the level of wages they need to make employment an effective strategy for escaping poverty.[10]

The United States has long focused on economic self-sufficiency as the preferred way out of poverty, at least among families headed by nonelderly adults. Our reluctance to provide cash assistance mirrors our insistence that the best way to help the poor is to assist them into employment in the mainstream economy. Unfortunately, when the jobs available to less-skilled adults pay less and less over time, the "employment strategy" becomes a harder one to implement as a way to assist families out of poverty.

The decline in real wages among less-skilled workers over the past fifteen years has seriously limited our ability to address poverty through government action. On the one hand, these changes have meant that we can no longer rely on economic expansions to do some of our work for us, decreasing poverty without explicit policies or programs on the part of the government. On the other hand, these changes have made it harder for us to operate targeted programs aimed at increasing employment and earnings among the poor. Given this, it is perhaps not surprising that there is a sense of frustration about U.S. antipoverty efforts. Let's be clear where the source of the problem lies, however. What have changed most significantly in the last fifteen years have been the economy and the labor market for poor workers. This makes the task harder for all who would design public programs to combat poverty. Not impossible, but harder.

NOTES

1. The poverty rate is the share of persons in the population who live in households whose cash income falls below the official U.S poverty line. Poverty lines vary with household size.

2. Figure 1 puts GDP in 1993 dollars, which is to say that it is inflation-adjusted and expressed in terms of 1993 purchasing power

3 These estimates are report in Blank (1993).

4. The following discussion is based on the evidence in Blank (1993) and Blank and Card (1993). Supporting evidence is also presented in Cutler and Katz (1991).

5. Data tabulated from the Current Population Survey tape, March 1993.

6. For a fuller discussion of these wage trends, see Levy and Murnane (1992), Danziger and Gottschalk (1993), or Juhn et al (1993). For a discussion of the broader set of labor market changes that have affected less-skilled workers, see Blank (1995)

7 For evidence on the impact of trade competition on wage differentials, see Katz and Murphy (1992), Murphy and Welch (1993), and Sachs and Shatz (1994)

8 For evidence on the impact of changing technology on wages, see Bound and Johnson (1992), Davis and Haltiwanger (1991), or Berman, Bound, and Griliches (1993)

9. See Freeman (1993) or Card (1992).

10 For a further discussion of the implications of these changes on employment-based strategies, see Blank (1994)

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