The Economics of Poverty

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Outline

• Why are people poor?
  – Luck, Markets and Justice
  – Measurement
  – Policy Action

• The Economic Effects of Poverty
  – persistent vs transitory poverty
  – wasted resources
  – homelessness
Why Are People Poor?

• Bad Luck vs Bad Choices
• luck is stuff beyond our control; choices are what we control
• Bad Luck
  – stuff happens: you lose your job; you get sick; your marriage dissolves
  – stuff happened: you got pregnant in high school; you were undisciplined in college; your parents had no time; you got HIV
  – long ago: you have schizophrenia; your genes have mechanical rather than mathematical aptitudes; you got FAS in the womb
Social Responsibility

• Bad Choices
  – you joined a gang; you dropped out of school; you decide that working is harder than not working;

• Equality of Opportunity
  – social insurance should cover bad luck but not bad choices
  – but, are choices really choices?
  – how far back do we trace bad luck?

• Equality
  – social insurance should cover everything
Distributive Justice

• As a society, we do not like inequality and poverty---we redistribute to reduce them.
• Redistribution may be motivated on the basis of need.
  – Poor people have greater need than rich people, which justifies redistribution.
• Redistribution may be motivated on the basis of what rich people want
  – Less crime, less unsightly poverty, etc.
Who’s Poor? Measuring Poverty

• Low Income Cutoffs, or, LICOs
  – To measure poverty, you need a threshold below which to call someone poor.
  – *Income levels at which families or persons not in economic families spend 20% more than average of their before tax income on food, shelter and clothing.*

• In 1992, 38.5% of expenditure was on necessities, so 58.5% is *big share*.

• LICOs are income levels associated with necessities being a big share of expenditure.
## 2005 LICOs

### Low Income Cut-Offs (1992 base) after tax

<table>
<thead>
<tr>
<th>2005</th>
<th>rural</th>
<th>Less than $30,000 to $99,999</th>
<th>$100,000 to $249,999</th>
<th>$250,000 to $499,999</th>
<th>$500,000 and over</th>
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<tr>
<td>1 person</td>
<td>11,264</td>
<td>12,890</td>
<td>14,380</td>
<td>14,562</td>
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<tr>
<td>2 persons</td>
<td>13,709</td>
<td>15,690</td>
<td>17,502</td>
<td>17,723</td>
<td>20,956</td>
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<tr>
<td>3 persons</td>
<td>17,071</td>
<td>19,535</td>
<td>21,794</td>
<td>22,069</td>
<td>26,095</td>
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<tr>
<td>4 persons</td>
<td>21,296</td>
<td>24,373</td>
<td>27,190</td>
<td>27,532</td>
<td>32,556</td>
</tr>
<tr>
<td>5 persons</td>
<td>24,251</td>
<td>27,754</td>
<td>30,962</td>
<td>31,351</td>
<td>37,071</td>
</tr>
<tr>
<td>6 persons</td>
<td>26,895</td>
<td>30,780</td>
<td>34,338</td>
<td>34,769</td>
<td>41,113</td>
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<tr>
<td>7 or more</td>
<td>29,539</td>
<td>33,806</td>
<td>37,713</td>
<td>38,187</td>
<td>45,155</td>
</tr>
</tbody>
</table>
LICO features

• They can be a bit high relative to typical conceptions of deprivation.
  – So, regular folks may ignore these measures.
• Because they are based on income, gross or net, they may mis-classify.
  – A borrower looks poor, a saver looks rich.
  – If people save for a bad future, or borrow against a good one, this is wrong.
  – Under reporters and cheaters look poor.
• For more, see Pendakur 2001.
LICO weaknesses

- Homeless people are under-counted
- Cheaters are over-counted
- People living off wealth are over-counted
- Poverty lines seem to creep upwards over time
- Why $1/day in Africa, but $35/day here?
Individual Costs of Poverty

• Poverty is bad for people.
  – Money matters more for poor than nonpoor people.
  – Rich people use their money to compete in consumption rat races, poor people use their money for survival. See Robert Frank, 2007, Falling Behind.
  – Long-term poverty is persistent, short-term poverty is not.
Child Poverty

- Poverty is bad for children
  - Bad for their health, eg, low birthweight, greater mental and physical illness.
  - Associated with dropout, teen pregnancy.
  - Bad for their education attainment, bad for their income.
  - Lifetime consequences of childhood poverty.
    - Corak 2007 reports that, although only one-sixth of adults are low-income adults, about one-third of low-income children become low-income adults.
    - Brooks Gunn and Duncan 1997, The Effects of Poverty on Children summarize the American literature.
Social Costs of Poverty

• *Social Costs* are costs borne by other people.
  – 1. Intervention may be warranted by big individual costs combined with a preference for equality or lack of poverty.
  – 2. Intervention may be warranted by big social costs even in the absence of inequality or poverty aversion by society as a whole.

• We seem to be afraid of saying #1.
Social Costs of Poverty

• Publicly-funded services
  – Prisons, lawyers, cops
  – Amulances, emerg, doctors
  – Social workers
  – Estimates of the total cost of these for homeless people are pretty high, eg, SFU report puts it at up to 50k per year per homeless person.
  – *But*, you have to subtract the amount used when housed.
Social Costs

• Foregone tax revenue
  – Poor people are poor primarily because they do not earn much money.
  – Thus, they pay little or no net tax because refundable credits exceed payroll taxes.

• If you could turn a person with a kid making 20k into a person with a kid making 50k, tax revenue increases by about 15k.
Markets and Incomes

- Incomes are determined by markets.
- Markets have nothing whatsoever to do with justice or deservingness.
  - Therefore, we do not deserve our income, we just get it.
  - Distributive justice is distinct from market rewards.
  - Taxation is not unjust. Its only problem is that it changes incentives.
Redistribution

• Markets *might* generate efficiency
  – good uses of resources
• Markets do not generate equity
• To get equity and fairness, we need intervention by government.
Anti-poverty Policy

- Markets *might* generate efficiency, but there is no reason to expect equity.
- Anti-poverty policy is redistributive. That is the point.
  - Think through the redistributive effects.
  - Think through the incentive effects.
  - Evidence matters. Theory does not tell you everything.
Example 1: Minimum Wages

• Minimum wages define a lower limit to legal wages paid to workers.

• Redistributive Effects
  – They do not cover all employment, and make employers want to hire less legal low-wage workers.
  – So, potential redistribution is some low-wage workers make more money, others make less money.
  – Employers of low-wage workers either make lower profits and/or charge more to customers.
  – Consumers pay more for stuff.
Minimum Wages, cont’d

• Incentive Effects
• Firms might hire less labour.
  – The evidence suggests that, at low levels,
    • the employment effects are very small,
    • consumers pay the bill.
    • See David Card The Economics of Minimum Wages.
  – Raising the minimum wage to, eg, $10-hour would likely have no effect on employment of low-wage workers.
  – In contrast, European evidence suggests that at higher levels, minimum wages affect the demand for labour.
  – Eg, at $25 per hour, there is a noticeable decrease.
Example 2: Government Transfers

• Income Transfers
  – We write people a lot of cheques. It is very easy. CRA uses tax credits.
    • *Refundable* credits can be had regardless of whether or not taxes are paid by a person.
    • *Nonrefundable* credits are taken off tax bills.
    • *Universal* transfers to everyone.
    • *Targeted* transfers to just some people.

• In Canada, we have lots of income transfers, including child benefits, welfare, climate action credits, energy incentives, tons of stuff.
Government Transfers, cont’d

• In-kind transfers
  – Canada transfers a lot of income. Other countries mostly transfer things.
  – USA has food stamps and rent vouchers.
  – UK and much of Northern Europe have subsidized and social housing.
  – Everyone except the USA has subsidized and universal health care.
Government Transfers, cont’d

- Incentive effects
- high *implicit tax rates*
  - Remember the Guaranteed Annual Income for Need (GAIN) idea?
  - top up income to the GAIN level
  - No country does this anymore---why?
  - *Implicit* 100% tax on earnings
  - earn a dollar, but total income doesn’t rise: GAIN is a top-up.
Example 3: Child Transfers

• Redistributive effects
• *universality vs targeting*
• The Universal Child Care Benefit is $100/month/child under 6 for *every family.*
  – So, it is hugely expensive: 2 million children get $2.4 billion/year.
• The Canada Child Tax Benefit (CCTB) targets only low-income families with income < $37,885
  – about $100/month/child under 18.
  – about 1 million children get about $1 billion/year
Child Transfers, cont’d

- *targeting* allows for bigger transfers given the budget
- targeting implies implicit taxes
  - CCTB reduces your benefit by $2 for every $100 above $37,885
  - equivalent to 2% extra tax on income between $38k and about $98k
  - small 2% surtax over a big range
Child Transfers, cont’d

• National Child Benefit Supplement
  – up to $150/child. This is real money.
  – lower threshold: you get it all if family income is less than $21,287
  – implicit extra tax rate is 12% (1 kid), 23% (2 kids) or 33% (3 kids).
  – these are high surtaxes: regular tax rates at this level are 20.7%.
  – family of 5 with $21k faces 53% tax rate
    • Highest regular tax rate is 43.7%
    • Working more hours looks a bit crazy

• Most provinces, including BC, eat this federal money. Some let it go directly to families.
Child Transfers

- universal programs
  - are easier to sell, but more expensive
- targeted programs
  - are hard to sell, but cheaper
  - can be snuck in
  - need high implicit tax rates to be cheap
  - are large, total of UCB, CCTB, NCBS, GSTC, for families under $20k with 2 kids are about $5k/year.

- Child transfers have been successful.
Example 4: Welfare

- Aimed at the very unfortunate.
- \textit{Very} low support rate of $600$-$1100$/month depending on family size.
  - Less than $\frac{1}{2}$ LICOs.
- Byzantine and bureaucratic.
  - Take-up rate is less than $\frac{1}{2}$ of legal eligibles.
- Some ties to other social and health services.
- Some earnings are allowed.
  - Implicit surtax rates are typically 50\%.
Welfare, cont’d

• Incentive effects
  – education and work are massively discouraged except at a very small scale.
  – implicit tax rates are much higher than those associated with federal child transfers.

• Redistributive effects
  – benefit rates are extremely low, and are below plausible “survival” levels.
  – Sarlo’s 2007, 2008 Fraser Institute studies suggest that single individuals need at least 50% more money than current benefit rates just to survive.
Example 5: Taxation as Redistribution

- Our tax system is redistributive
  - Rich people pay a larger share of income in tax than do poor people (Except for the very rich, of course.)

- Tax rates have dropped for both rich people and poor people over the last 15 years.
  - Big declines in marginal tax rates for rich people
    - 56% in 1994 to 45% in 2008.

- Tax cuts reduce revenue
  - by about $\frac{3}{4}$ the size of the tax cut
  - Eg, a 20% tax cut results in 15% less revenue
Taxation = Expenditure

• Governments balance their books in the long term, so total taxes=total expenditure.
• We choose our tax rates.
• Statements about affordability are equivalent to statements about desirability.
• We have been cutting tax rates, and therefore expenditure (rates), for 15 years.
• Maybe it is time for tax rate increases on rich people.
Homelessness

- There’s more than there was.
  - at least 2500 homeless people in the GVRD
- Lots of shelter deprivation
- Correlated with
  - drug addiction, mental illness, family breakdown, poverty, Aboriginal origin, etc
- But, none of those things are new, so why is there so much homelessness now?
Has Poverty Changed?

• Strongest predictors of income
  – age and education.
• Gender
  – used to matter a lot to wages, now it matters a little.
  – still matters a lot for hours (income=hours*wages).
• Ethnicity, race
  – used to matter a lot, now it matters a little for most
  – Aboriginal people are staggeringly poor.
• Immigration
  – Used to matter a little, now it matters a lot
Events Cause Poverty

• Bad events
  – Marital breakdown
  – Loss of social networks
  – Illness
  – Mental illness
  – Criminal victimisation and violence
  – Incarceration
  – Deinstitutionalisation, asyla, prisons

• Bad events are correlated with gender, age, Aboriginal origin.
Homelessness is not just Poverty

• Market for rental shelter is different
  – Collateralised with damage deposits
  – Not much price variation
    • 90 10 ratio for a 1bdr in Vancouver is about 3
    • For clothing, this would be like 100
  – Lower limits on quantity and quality

• People cannot afford shelter at these prices, even though they can afford food and clothing.
Homelessness, cont’d

• Homelessness is a range of conditions
  – sleeping rough, on the street, unsheltered, shelter deprived, bad shelter, crowded
  – serious long lasting consequences
    • Mental and physical illness
    • Loss of skill and employability
    • Social isolation, exposure to violence

• Why are people outside the rental market
  – Why do people rent zero when the consequence are so grave
Causes of Homelessness: Evidence

• Variation in homeless populations across cities and over time is driven by
  – High rents
  – Low incomes
  – See Quigley and Raphael 2003

• Bad events happen to people everywhere, but they result in homelessness mainly when the person has low income and faces high rents. See O’Flaherty 2005.
High Rents

• Why are rents so high
  – Condo Act of mid 1970s made it easier for builders to build apartment buildings intended for owning residents.
  – Federal government gave up on building subsidized housing beginning in the 1980s and finally killed it good in the early 1990s.
  – Provincial government gave up in 2000s.
  – Building boom in Vancouver overbuilt a lot of rental stock, replacing it with condos.
  – So, we got a big contraction in the supply of rental shelter for low-income people.
Example 6: Public Housing

- Problem is low supply of rental housing for low-income people. We need more units.
- Rent control is the opposite of a solution: it results in fewer units and more inequality.
- Solutions are:
  - Publicly-built rental housing;
  - Privately-built publicly-subsidized rental housing;
    - subsidies can be in the form of density bonuses.
Public Housing, cont’d

• Incentive effects
  – If you build subsidized housing that nonpoor people want, they will take it. It is hard to keep them out.

• Redistributive effects
  – There are poverty spillovers: poor neighbours make you more poor, especially for kids.
  – So, socially/economically mixed buildings may be good.
  – See Oreopoulous 2006
Some Bottom Lines

- **Minimum wages**
  - the jury is out: $10 an hour would have little effect on small business incomes and the employment of low-wage workers.

- **Tax rates have been declining for 15 years: it is time to raise them on rich folks.**
  - Rich people have no special right to their money, they are mainly just lucky.
  - The revenue can be used to reduce poverty.
More Bottom Lines

• Poverty begets poverty, so some things have a big impact
  – Reducing child poverty
  – Reducing the incidence of long-term poverty
  – Reducing homelessness

• Health-care expenditures have swamped all others since the 1980s.
  – Some redirection is in order.
More Bottom Lines

• We have extensive transfers to households with children.
  – Vast majority of intended households receive the transfers, along with some unintended.
  – Expand these programs.

• We gave up on building public housing.
  – Spend real money on building housing for low-income people.
  – Change laws to encourage, or subsidize, rental shelter.
Readings

- **Child benefits in Canada**: [http://www.cra-arc.gc.ca/E/pub/tg/t4114/t4114-08e.pdf](http://www.cra-arc.gc.ca/E/pub/tg/t4114/t4114-08e.pdf)