

The Economics of Poverty

Krishna Pendakur

Professor of Economics

Simon Fraser University

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					
	rural	Less than \$	\$ 30,000 to \$	\$ 100,000 to	\$ 500,000 and
2005				499,999	
1 person	11,264	12,890	14,380	14,562	17,219
2 persons	13,709	15,690	17,502	17,723	20,956
3 persons	17,071	19,535	21,794	22,069	26,095
4 persons	21,296	24,373	27,190	27,532	32,556
5 persons	24,251	27,754	30,962	31,351	37,071
6 persons	26,895	30,780	34,338	34,769	41,113
7 or more	29,539	33,806	37,713	38,187	45,155

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 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.
- *Very* low support rate of \$600-\$1 100/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
 - still a lot for African- and S. Asian-origin people.
 - 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 Oreopoulos 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

- **Minimum wages:** David Card, Myth and Measurement: The New Economics of the Minimum Wage. Princeton University Press, 1997.
- **Rat Races and Inequality:** Robert Frank, Falling Behind: How Rising Inequality Harms the Middle Class. University of California Press, 2007.
- **Child Poverty:** Jeanne Brooks-Gunn et al, Neighborhood Poverty: Policy Implications in Studying Neighborhoods. Russell Sage, 2000.
- **Poverty Measurement:** Krishna Pendakur, "Consumption Poverty in Canada 1969 to 1998", Canadian Public Policy, June 2001, 27(2) pages 125-149. <http://www.sfu.ca/~pendakur/poverty.pdf>; Chris Sarlo, Sep 2007, "Measuring Poverty - What Happened to Copenhagen? ", Economic Affairs 27(3), pp 6-14; Chris Sarlo, May 2008, "What is Poverty? Providing Clarity for Canada" Fraser Institute Digital Publication http://www.fraserinstitute.org/commerce.web/product_files/What_is_Poverty.pdf.
- **Low-Income Cutoffs:** Statistics Canada, "Low Income Cut-offs for 2005 and Low Income Measures for 2004", Cat # 75F0002MIE---No. 004, <http://www.statcan.gc.ca/pub/75f0002m/75f0002m2006004-eng.pdf>
- **Child benefits in Canada:** <http://www.cra-arc.gc.ca/E/pub/tg/t4114/t4114-08e.pdf>
- **Response of Government Revenue to Tax Rates:** Mary-Anne Sillamaaa and Michael R. Veall, 2001, "The effect of marginal tax rates on taxable income: a panel study of the 1988 tax flattening in Canada", Journal of Public Economics, Volume 80, Issue 3, June 2001, Pages 341-356
- **Intergenerational Mobility:** Miles Corak, "Do Poor Children Become Poor Adults? Lessons from a Cross Country Comparison of Generational Earnings Mobility", IZA Discussion Paper 1993, March 2006, <ftp://repec.iza.org/RePEc/Discussionpaper/dp1993.pdf>
- **Homelessness:** John Quigley and Steve Raphael, 2001, "The Economic of Homelessness: A View from North America," European Journal of Housing Policy, 1(3): 323-336 (2001).; Brendan O'Flaherty, 2004, "Wrong person and wrong place: for homelessness, the conjunction is what matters", Journal of Housing Economics 13(1), March 2004, Pages 1-15.