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POVERTY IN RELATION TO MACROECONOMIC TRENDS, CYCLES, AND POLICIES

James Tobin

Revised May 1993

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IRP-ASPE Conference

"Poverty and Public Policy: What Do We Know? What Should We Do?"

Madison, Wisconsin May 28, 1992

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Abstract

This survey concludes that general prosperity and economic growth have been considerably less powerful engines of progress against poverty in the U.S. than they were before 1973. Macroeconomic performance has deteriorated, and its relation to poverty has weakened too. It is shown that the incidence of poverty can be fairly well explained by regressions on unemployment rates and real wages, both in national time series and in state cross-sections. Recent downward deviations from these regressions appear to reflect structural labor market changes that make poverty less treatable by macro medicine.

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James Tobin*

Robert Lampman of the University of Wisconsin is the intellectual father of the War on Poverty, at least to the extent any economist can claim paternity. He was the principal author of Chapter 2 of the 1964 Economic Report of the President, where the economic rationale and strategy of the war were laid out. As an alumnus of the President's Council of Economic Advisers, called to Washington in December 1963 to help shepherd the annual Report into print, I participated in editing the chapter. Walter Heller, the Council's chairman, had proposed the anti-poverty initiative to President Kennedy, whose sympathetic interest had been whetted by reading Michael Harrington's The Other America and J.K. Galbraith's The Affluent Society. President Johnson enthusiastically adopted the War on Poverty, as an integral part of his Great Society and a corollary of the Civil Rights Revolution, a cause he had also embraced.

In June 1967 I published an article in The New Republic, titled "It Can be Done! Conquering Poverty in the U.S. by 1976." Sargent

Shriver, the anti-poverty "czar", had boldly, one could say recklessly, announced this ambitious bicentennial goal. When I wrote the article, it was not as outlandish as it sounds now. I was not relying solely or even principally on Shriver's direct programs. These, in Lampman's spirit, were measures to improve the earning capacities of individuals and communities by education of infants, children, youth, and adults; by improving public health and individual health in disadvantaged localities; by programs offering vocational training and job experience; by comprehensive neighborhood development initiatives. They could not be expected to work miracles in one decade. Over that short horizon, I put greater weight on the market magic of general prosperity and growth. My main argument was that the poverty remaining after those two forces had done their work was within the feasible reach of means-tested transfers like the negative income tax. Of course, those transfer programs were not enacted, and in 1976 the economy was just recovering from a deep stagflationary recession. The promised land receded. We'll be lucky to reach it by 2026.

I am afraid it's a mistake to declare wars against social and economic conditions or national crusades for societal reforms. The goals are elusive, the troops unruly, the enemies amorphous. Wars on poverty, energy dependence, and drugs have proved to be incapable of sustaining the degrees of commitment essential to their prosecution, even by the Presidents who declared them. William James longed for moral equivalents of war, but evidently Americans can't do better than football.

Macroeconomic progress and poverty reduction.

"Rising tides lift all boats" is an overused cliche. For our purpose, the proposition is that good macroeconomic performance reduces poverty. The idea is sometimes caricatured as "trickledown," but I think that label should be confined to proposals to better the lot of the poor by transfers or tax concessions to the rich. In any case the cliche sometimes serves as an excuse for doing nothing specific about poverty. Today the tides don't seem to rise as much, and leaks seem to consign some of the boats to the bottom.

In the past, until about 1970, macroeconomic progress was an extremely powerful engine of poverty reduction. In the 1930s Franklin Roosevelt saw one third of a nation ill-fed, ill-clothed. ill-housed. Backward application of Molly Orshansky's absolute poverty income thresholds puts the figure closer to two thirds.

The war against Germany and Japan was the most effective war against poverty in our recorded experience; some of its achievements showed up in the subsequent decade. In the 1940s military and economic mobilization truly generated jobs for all. In 1944 when defense purchases accounted for two fifths of GNP, the remainder available for civilian use was greater in real terms than the entire GNP of 1939.

During the 1940s and 1950s, shifts of labor from subsistence and other labor-intensive agriculture into jobs of higher value added in urban industry, much of it migration from South to North, were an important source of overall economic growth. Denison (1974) credits it with 19 percent of the growth in Net National Product per person employed 1941-48 and 14 percent in 1948-54. This was especially

important for reduction of poverty among migrants, both blacks and whites. Today the urban industries that gave them jobs have been moving away from big cities -- to suburbs, to the South, overseas. Many jobs have been lost to global competition and new technology, and many of the remaining ones have moved away. The few jobs that replace them are generally by location and specification inaccessible to the populations left behind, especially the minority populations. The obstacles to migration and occupational shift are formidable.

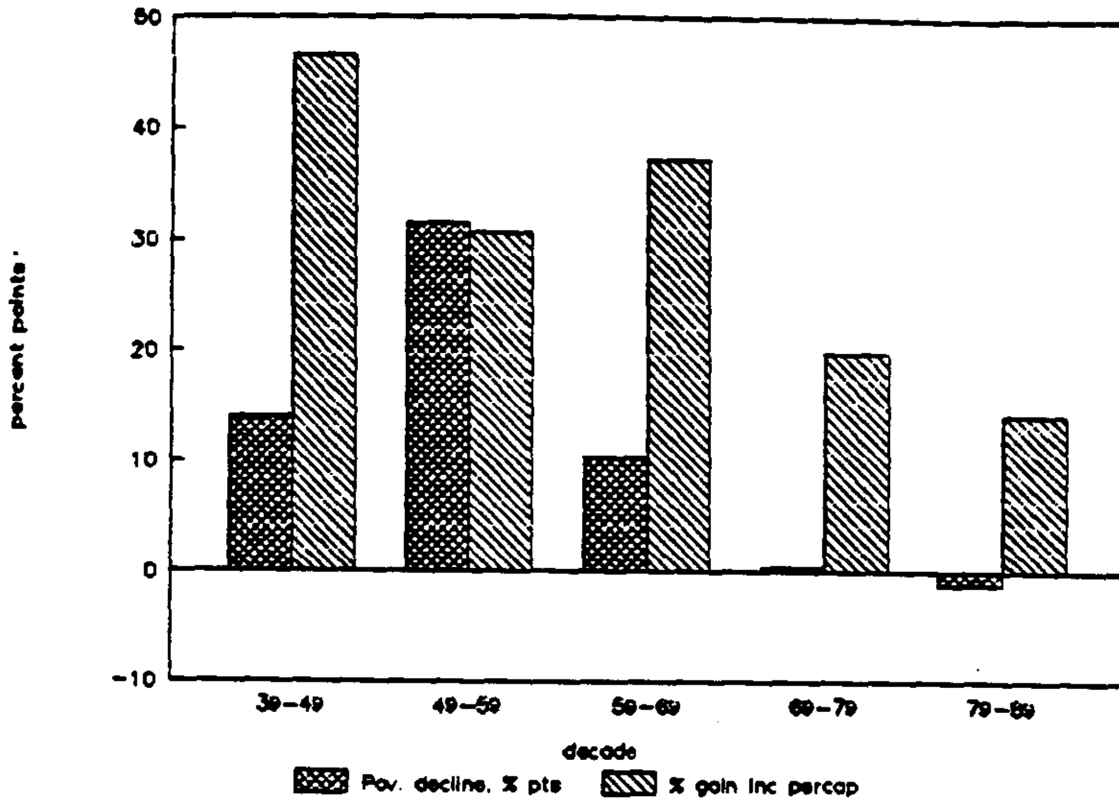
Figure 1 compares for five decades 1940-1990 reduction of poverty in percentage points and percent growth of per capita real GNP. Figure 2 shows the progress against poverty over the fifty years since 1939 for blacks and whites separately, and also plots the reduction in the percentage shortfall of real personal income per capita from its 1989 value. The latter is a graphically convenient measure of overall economic progress, to which the decline in poverty can be compared.

Figure 3 plots for 1959-1990 annual poverty rates against per capita real personal income (NIPA). In Figure 3 can be seen the episodic setbacks to progress against poverty, relative to macro performance, in cyclical recessions. The setback in the 1980s was the most serious.

Figure 1

Progress against Poverty, Five Decades

Ten-year decline in percentage points, national poverty rate of persons, compared to percentage gains in real income per person. 1939-1989.

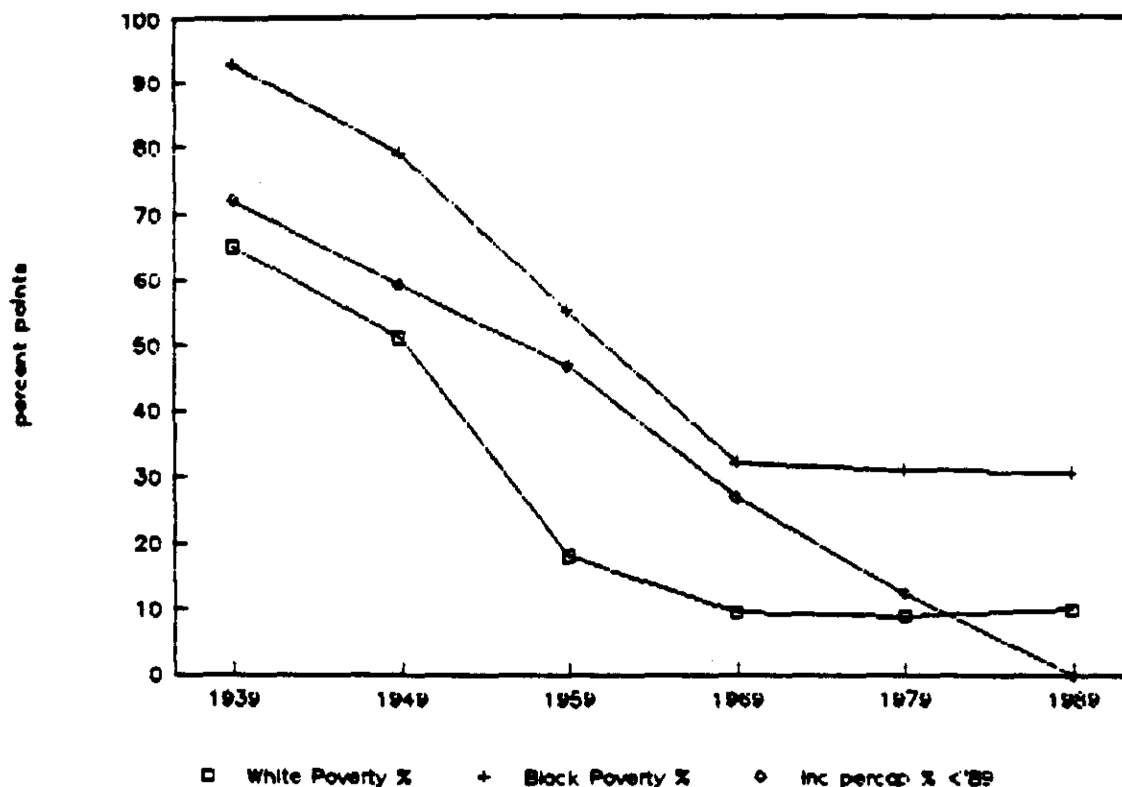


Source: Poverty rates prior to 1959 estimated by Reynolds Farley from decennial Census data for A Common Destiny, Report of National Academy of Sciences Committee on the Status of Black Americans 1988. Subsequent poverty rates official Census data. Personal income, U.S. Department of Commerce National Income and Product Accounts.

Figure 2

Poverty by Race and Aggregate Income, 1939-1989

Black and white poverty at ends of six decades 1939-1989, compared to personal income shortfall.
Poverty: percentage of persons living in poor households.
Personal income shortfall: percentage shortfall of national personal income (per capita in 1990 dollars) below 1989.

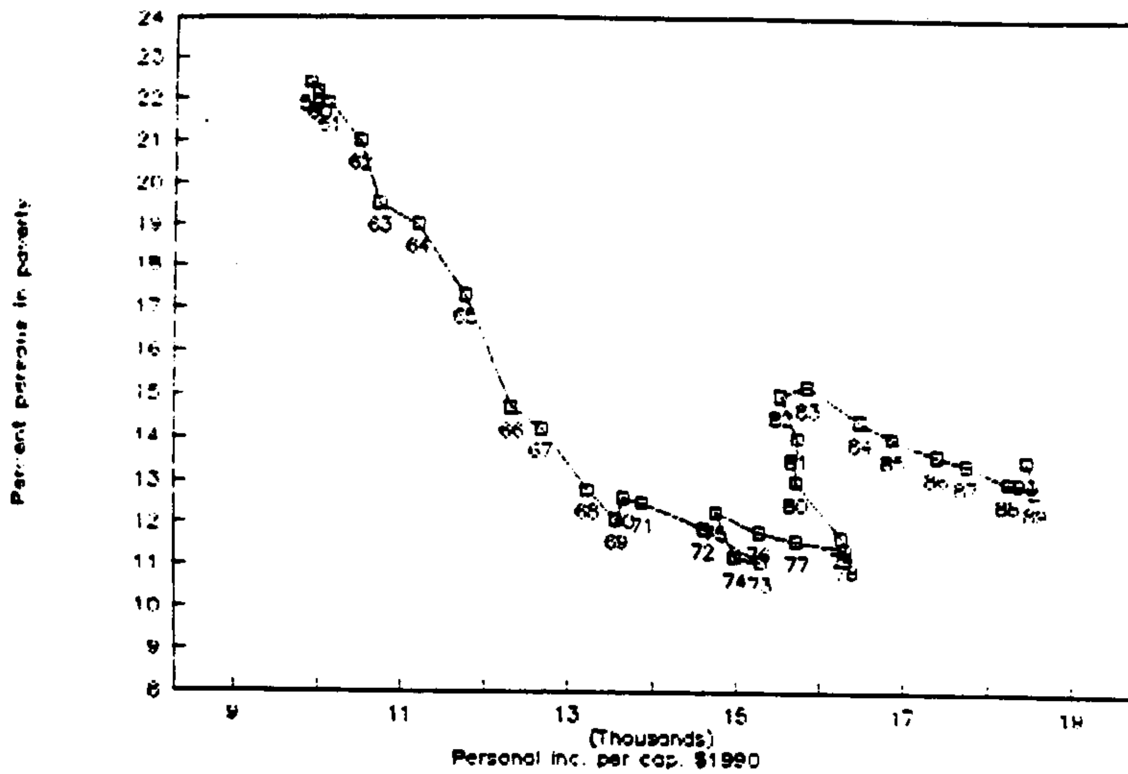


Sources: See Figure 1.

Figure 3

Poverty and Income per Person

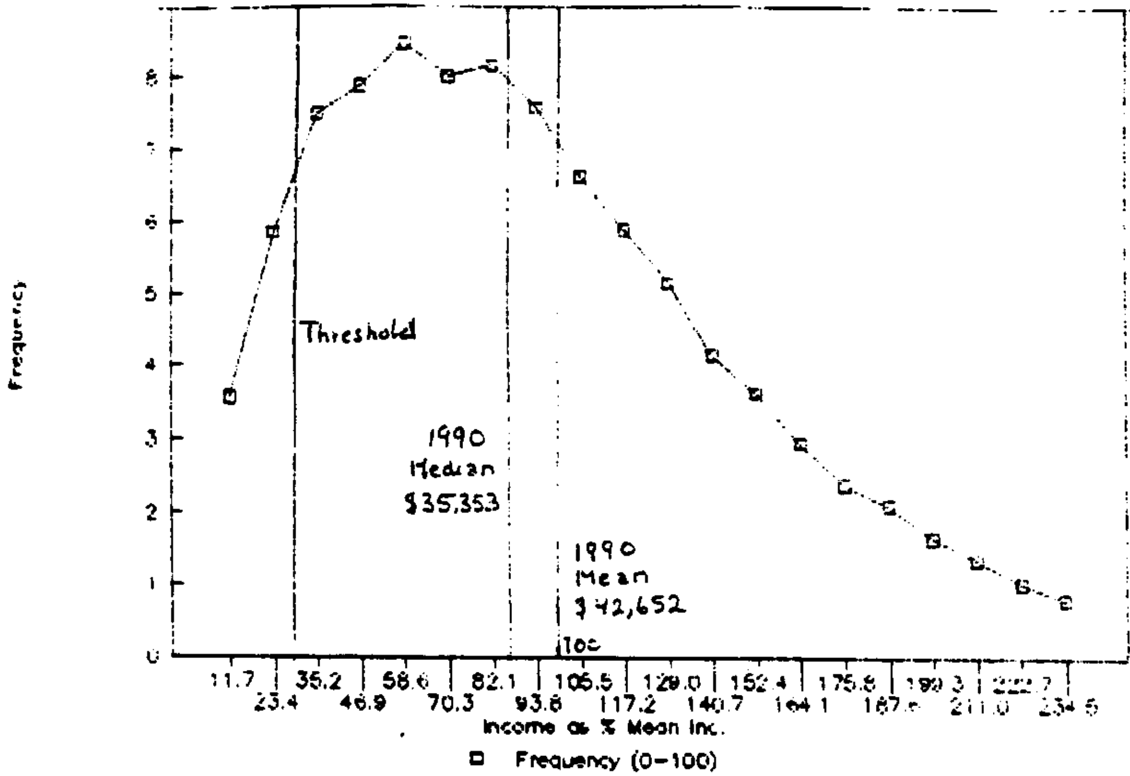
National poverty percentage plotted against personal income per capita (1990 dollars), yearly 1959-90



It was to be expected, -- and it was expected, certainly by Bob Lampman -- that there would be diminishing returns in poverty reduction to overall gains in per capita income, just because the densities of the income distribution would diminish as the poverty rate declined. When the Orshansky thresholds were near the mode of the distribution, a small proportionate rightward shift in the distribution, resulting from macroeconomic growth, could take a lot of people out of poverty. The numbers would be much fewer in the thinner left tails of the distribution. Figure 4 illustrates this effect by expressing the 1990 family income distribution in terms of the ratio of income to mean income and assuming the distribution thus transformed applied also in the past. Trends of overall economic growth take the form of leftward treks of the ratio of thresholds to mean or median income. Diminishing returns from this source were important before 1970, when the poverty threshold occurred at the high frequencies of the distribution, but they have not been of much significance since.

Figure 4

Family money income 1990: Frequency distribution, percent of families at indicated ratios of income to population mean income.



Disappointing macroeconomic performance since 1973.

Clearly macroeconomic performance has been less successful in reducing poverty since 1973 than before. Both of the two obvious possible explanations, the weakness of the tide and the leakiness of the boats, apparently hold. Macroeconomic performance itself has been disappointing, and so has been the response of poverty numbers to the macroeconomic performance that did occur.

The growth of per capita real Gross Domestic Product (GDP) slowed down. The trend growth of productivity per person-hour in the business sector has been about two percentage points lower since 1973 (0.8 percent per year) than in the previous quarter century (2.9 percent per year). Not only was the growth of potential output at full employment weaker, but potential was less frequently and fully realized. Cyclical recessions were more severe since 1973 and the unemployment rate averaged 2.2 points higher.

Figure 5 compares potential and actual GDP since 1973, Cyclical recessions and slowdowns generate increasing shortfalls of actual from potential, and it has taken long and slow recoveries to erase these gaps. Figure 6 shows how closely correlated these GDP Gaps are with the unemployment rate. This correlation, known among economists as Okun's law, is one of the most important and reliable regularities in macroeconomics. Arthur Okun also pointed out that, as is evident in Figure 6, changes in the GDP Gap are a multiple of the changes in unemployment rates. The reason is that the same cyclical macroeconomic forces that move employment up and down move labor force participation, hours of work, and productivity in the same directions. The average 2.2

points of higher unemployment since 1973 translates into an average percentage GDP Gap about 6 points higher.

Figure 5

Actual and Potential GDP

Actual and Potential Gross Domestic Product, trillions of 1987 dollars, yearly 1973-1991.

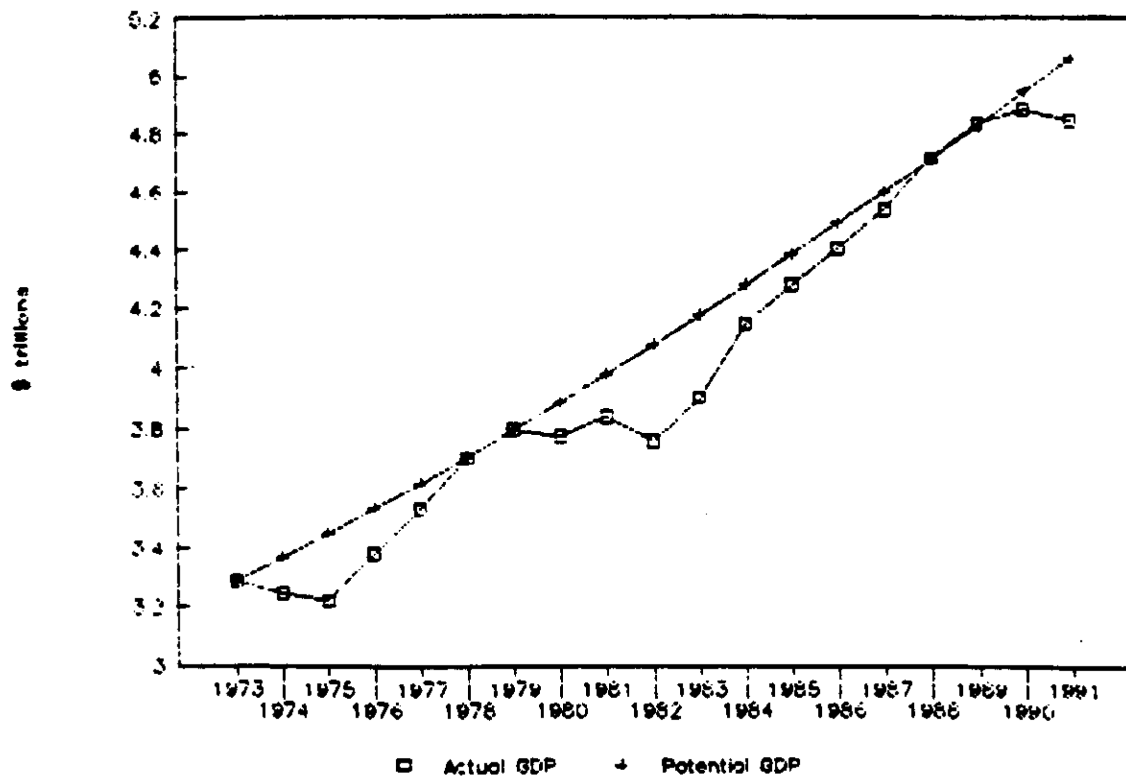
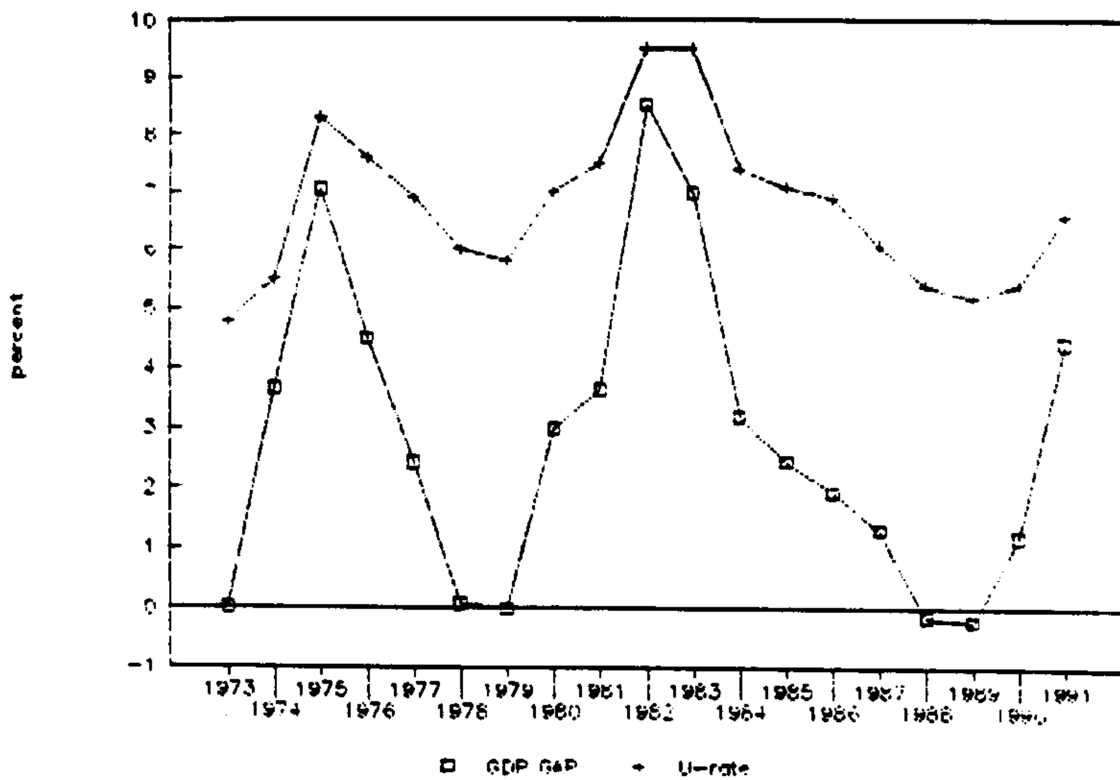


Figure 6

Output Gap and Unemployment Rate

Gap between Actual and Potential GDP, as percent of Actual GDP, compared to yearly average national unemployment rate, 1973-91.



Parts of the recent story of weaker macroeconomic performance are breaks in the relationships between broad measures --like per capita real GDP, personal income per capita, and overall unemployment rates -- and measures closer to the determination of poverty status. In particular, both Cutler and Katz (1991) and Blank (1991) have called attention to changes in the structure of wages disadvantageous to the poor.

Real hourly and weekly earnings have been declining for twenty years. The growth of worker productivity has slowed down. Moreover, earnings have even fallen behind productivity, an unusual phenomenon. However, as Cutler and Katz point out, the share of labor in business value added has stayed fairly constant. Compensation inclusive of fringe benefits has risen roughly in step with productivity. This is the labor cost that matters to employers. But the explosion of employment-related fringe benefits, largely for health insurance, has been of value mainly to long-term employees with high wages and salaries. It has meant little to workers and families at risk of poverty, for whom the relentless decline of take-home pay has been the grim reality.

Cutler and Katz point out that the rise in the wages of unskilled and less educated workers relative to skilled and better educated workers, a stylized fact of past business cycle recoveries, did not take place in the 1980s. Blank finds, using CPS data, that the jobs taken by the working poor are relatively less well paid than in the past. Likewise, Medoff (1992) has found from CPS data that since 1979 such job openings as can be found by job losers are, relative to the universe of jobs, lower in pay and more frequently without pensions and health insurance.

Estimating macroeconomic effects on poverty.

Two macroeconomic outcomes of crucial importance for the prevalence of poverty are real wages and unemployment. As economy-wide real wages rise, more and more workers are able to earn enough for themselves and their families to escape poverty. Decade to decade, it is the trend in real wages that matters. But the trend has not been constant; wage growth has slowed since about 1973.

The overall unemployment rate is a barometer indicative of opportunities to work. It would be expected to be an important determinant of poverty, even though most unemployed are not poor and most poor are not unemployed (according to the Census definition, which requires an individual both to be entirely jobless and to be looking for work).

Changes in poverty rates from year to year can, I have found, be fairly well explained by these two macro variables, specifically by regressions on changes in average real weekly earnings and in

anunemployment rate. First differences of the dependent variable and these two explanatory variables are used to avoid spurious correlations and biased estimates due to serial persistence. A third independent variable is also both logical and empirically successful. It is the level of the ratio of the poverty threshold for four-person families (constant in real terms) to the previous year's median family income.

Several such regressions are reported in Table 1, for post-transfer poverty 1961-90 and for pre-transfer poverty 1967-88. In them the constant is constrained to be zero, so that no time trend in poverty is built in. Trends may improve fits, but when they have no convincing rationale they are statistical artifacts of little help for understanding, forecasting, and policy-making. The earnings variable is in constant 1982 dollars, because poverty thresholds are defined in real dollars. The unemployment variable is the rate for white male adults, chosen for its quality as a macro cyclical barometer rather than its direct relevance to persons at risk of poverty. The third variable serves as a proxy for the density of the income distribution in the neighborhood of the poverty line, As illustrated above in Figure 4, and now again in Figure 7, macroeconomic progress against poverty can be described as a downward trend in this ratio. Using its level in the year before as a regressor for the change in poverty is like using a nonlinear function of the previous level of the poverty rate itself, recognizing that the potential for trend poverty reduction declines with the actual poverty rate.

Figure 7

Poverty and Median Income

National percentage of persons in poverty, plotted against the ratio of family poverty threshold to median family income, yearly 1960-90.

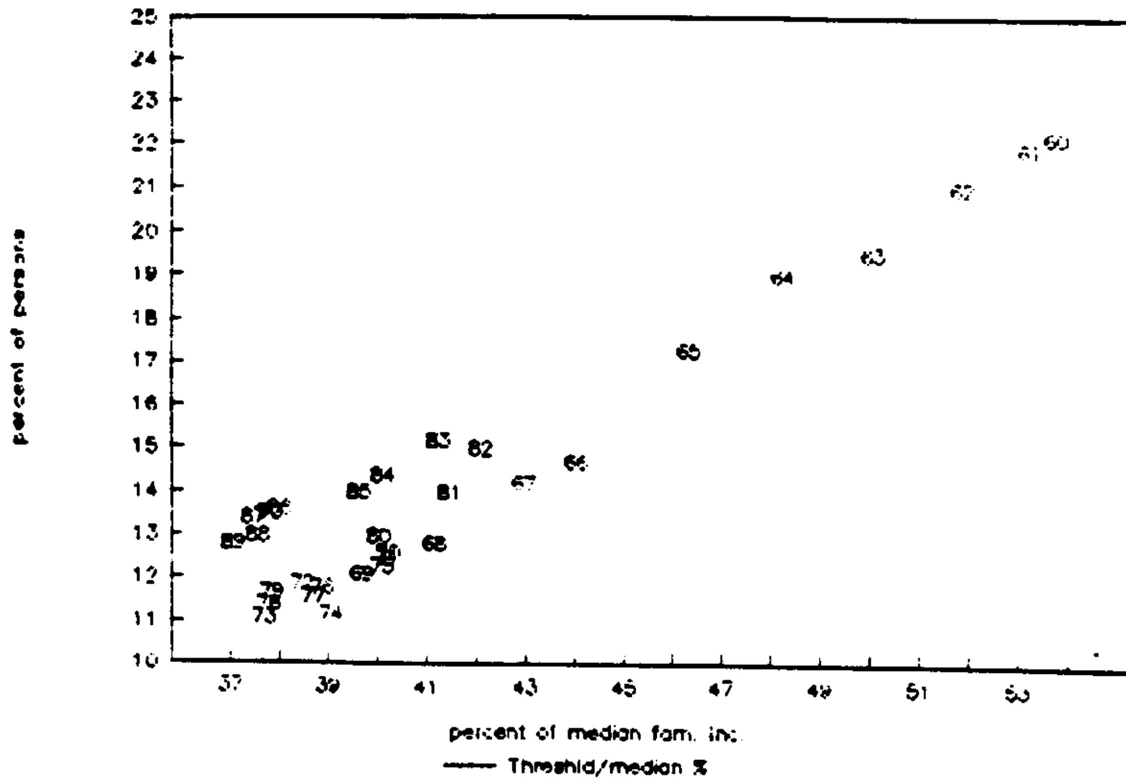


Table 1
Time Series Regressions of Annual Changes in Poverty Rates

Sample years	Dependent Variable	Const.	DE ($1982)	T/M (-1) (%)	DUWM (% pts)	Adjusted R sq.
1. 1961-83	DPP (% pts)					0.59
Coefficients		0	-0.04	-0.0089	0.465	
(Standard errors)			(0.024)	(0.0033)	(0.168)	
Variable mean	-0.3		0.46	42.78	0.16	
Variable st. dev.	0.92		7.01	5.08	1	
2. 1961-90	DPP (% pts)					0.58
Coefficients		0	-0.053	-0.0075	0.386	
(Standard errors)			(0.020)	(0.0026)	(0.125)	
Variable mean	-0.25		-0.07	41.3	0	
Variable st. dev.	0.71		6.31	4.33	0.99	
3. 1961-90	DFP (% pts)					0.61
Coefficients		0	-0.038	-0.0073	0.382	
(Standard errors)			(0.018)	(0.0024)	(0.115)	
Variable mean	-0.25		-0.07	41.3	0	
Variable st. dev.	0.71		6.31	4.33	0.99	
4. 1968-83	DPPP (% pts)					0.78
Coefficients		0	-0.039	0.001	0.555	
(Standard errors)			(0.019)	(0.003)	(0.132)	
Variable mean	0.3		-1.31	39.77	0.36	
Variable st. dev.	0.9		7.52	1.53	1.07	
5. 1968-83	DPPP<65 (% pts)					0.79
Coefficients		0	-0.038	0	0.633	
(Standard errors)			(0.019)	(0.003)	(0.137)	
Variable mean	0.29		-1.31	39.77	0.36	
Variable st. dev.	0.97		7.52	1.53	1.07	

NOTATIONS OF VARIABLES

DPP	First difference, poverty rate (%) of all persons.
DFP	First difference, poverty rate (%) of families.
DPPP	First difference , pre-transfer persons' poverty.
DPPP<65	First difference, pre-transfer poverty, persons age less than 65.
DE	First difference, average weekly earnings in 1982 dollars.
T/M (-1)	Previous year's value, poverty threshold income for 4-person family as percent of median family income.
DUWM	First difference, unemployment rate, white males age 20 and older.

Table 2

Cross-section Regressions of State Poverty Rates
(Fifty States and the District of Columbia)

Sample years	Dependent Variable	Const.	DHE	DUR	PP 1979	Adjusted R sq.
CHANGES BETWEEN TWO YEARS						
1A. 1979-1987	DPP (% pts)					0.56
Coefficients		-0.069	-0.766	0.709		
(Std. errors)			(0.476)	(0.098)		
Variable mean	-0.71		0.238	-0.639		
Variable std. dev.	2.23		0.455	2.217		
1B. 1979-1987	DPP (% pts)					0.57
Coefficients		-0.087	-0.683	0.744	0.064	
(Std. errors)			(0.484)	(0.104)	(0.065)	
Variable mean	-0.71		0.238	-0.639	11.23	
Variable std. dev.	2.23		0.455	2.217	3.5	
LEVELS, ONE YEAR		Const.	HE	UR		
2. 1986	PP (% pts)					0.77
Coefficients		17.93	-1.737	1.806		
(Std. errors)			(0.279)	(0.145)		
Variable mean	13.82		9.6	6.96		
Variable std. dev.	4.44		1.15	2.21		
3. 1985-86	PPP (% pts)					0.74
Coefficients		19.76	-1.725	1.673		
(Std. errors)			(0.281)	(0.146)		
Variable mean	14.85		9.6	6.96		
Variable std. dev.	4.23		1.15	2.21		

NOTATIONS OF VARIABLES

PP	Poverty rate (%) of all persons.
DPP	Change in PP from 1979 to 1988, in percentage points
PPP	Pre-transfer poverty rate of all persons.
HE	Hourly earnings in current dollars.
DHE	Change in hourly earnings from 1979 to 1987, in 1979 dollars.
UR	Unemployment rate, all workers.
DUR	Change in UR from 1979 to 1987.

The specifications of these equations are simple, straightforward, and parsimonious. They implement a priori hypotheses, without trial-and-error "data mining." The results confirm expectations of the signs of the coefficients. Over half of the variance in year-to-year changes in poverty is explained. It is not surprising that other systematic and stochastic determinants are at work.

Welfare benefits and other transfers would affect post-transfer poverty rates more than pre-poverty rates; the better fits shown for the latter equations (Table 1. 4 and 5) were to be expected. Likewise it is logical that unemployment has a bigger effect on pre-transfer poverty. Regressions 1 and 2 in Table 1 provide some evidence that in the 1980s unemployment effects became smaller and wage effects larger than before. The slowdown in progress against poverty in the 1980s is evident in Figure 7. The poverty rate was higher in that decade relative to the ratio of the poverty threshold to median income.

Earnings and unemployment also explain variations in poverty rates among states. Table 2 reports results for single-year cross sections, for both official poverty rates and pre-transfer rates. The table also shows a regression for cross-sections of changes in official poverty by state between two years, 1979 and 1987. The fit of this regression is not significantly improved by adding the 1979 poverty rate as a third explanatory variable.

It is reassuring that all the cross section regression coefficients on earnings and unemployment variables have the same signs as in the national time series regressions. In Table 2 equations 1A and

1B are similar to the time series regressions of Table 1 in that the change in the poverty rate is the dependent variable. However, in the state cross-sections "change" is for each state the difference between two years nine years apart, 1978 and 1987. Only the unemployment rate is significant by usual standards. The earnings coefficient passes the test only marginally, at a 10% significance level. That those coefficients are larger in absolute magnitude than their counterparts in Table 1 is to be expected. They reflect the associations of poverty with these two explanatory variables not only in economy-wide trends and cycles but also in the sharper swings in the fortunes of particular states and regions.

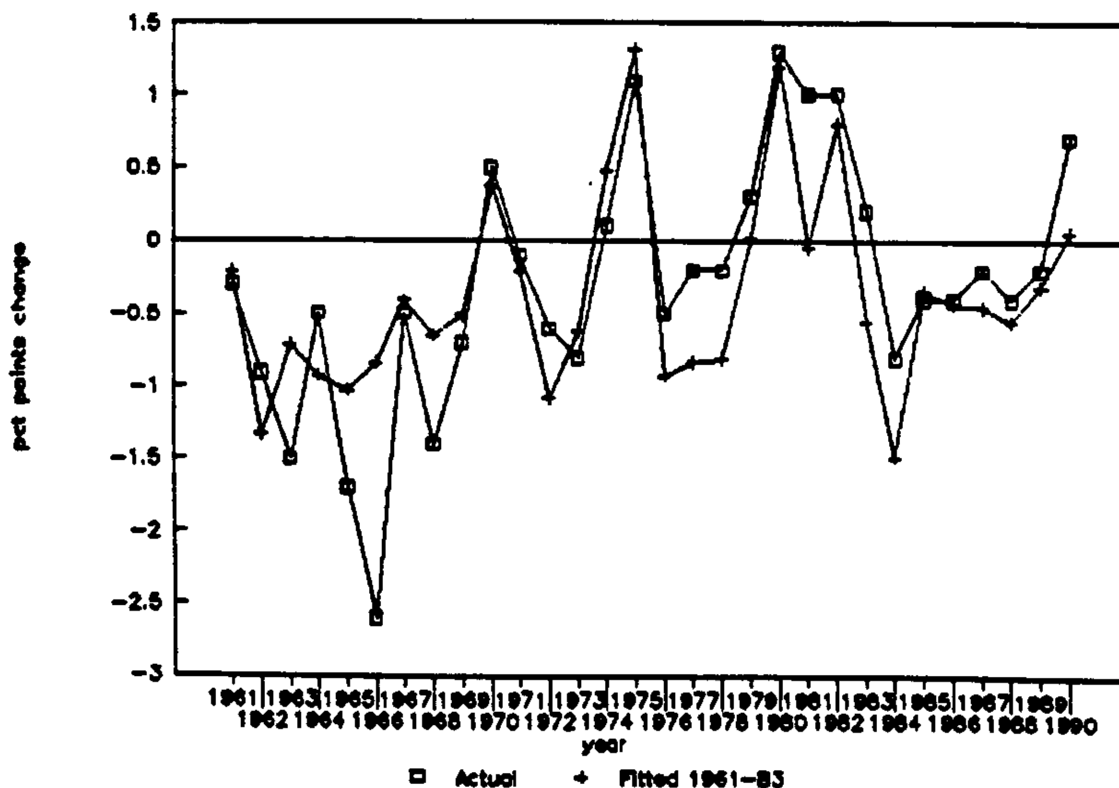
In the state cross-section regressions, 2 and 3, the dependent variable and the two basic explanatory variables are levels in a single year. The coefficients are larger than in the change regressions. They reflect persistent interstate differences in prosperity and affluence, in all their dimensions. A state with a chronically high unemployment rate or a chronically low wage rate is likely to suffer a high poverty rate. But gains in earnings and employment over one year or even nine years will not reduce a poor state's poverty to the levels of states that have long been prosperous. Lasting differences among states in affluence will be reflected in the generosity of welfare benefits and other transfers. This may be the reason why here, unlike the national time series regressions of Table 1, the macro variables explain post- and pre-transfer poverty about equally well.

There is some evidence that year-to-year poverty changes in recent years have been algebraically greater than equations fitted to

Figure 8

Yearly Changes in Poverty 1961-90

Changes in national percentage of persons in poverty, actual and as estimated from 1961-83 regression on three macro variables: first difference of average real weekly earnings; first difference of an unemployment rate; the <u>level</u> of the ratio of the poverty threshold for four-person families (constant in real terms) to the previous year's median family income.



observations through 1983 would predict. This is illustrated by Figure 8, for changes in official poverty for all persons, which exceeded such forecasts in every year 1984-90. (This was not a wholly new phenomenon; within the sample period most of the unexplained residuals were positive after 1976.) The errors of forecasts averaged 0.26 percentage points over 1984-90 and reached 0.64 in 1990. Similar consistent over-optimism shows up in forecasts 1984-88 from 1967-83 regressions for pre-transfer poverty rates for all persons and for persons of ages less than 65.

These under-predictions of poverty since the mid-eighties are consistent with the findings of Cutler and Katz, Blank, and Medoff cited above. I can report two additional possibilities, related to each other. One concerns the relationship to the overall civilian unemployment rate of unemployment rates specific to age-sex-race populations vulnerable to poverty, as estimated by simple regression without trend or other explanatory variables. For black males, both teens and adults, unemployment rates since 1983 are higher than would be expected from equations fit through 1983. For black adults these errors of forecast are as high as 2.3 percentage points and average 1.6 over 1983-91; for black teens, they are as high as 5.2 points and average 3.6. In both cases 1959-1991 regressions with a multiplicative dummy variable, which turns out to increase the sensitivity of specific unemployment to general unemployment after 1982 by about 15 percent for black adults and 17 percent for black teens, fit well.

These effects do not apply to black females. Indeed the reverse appears to be true: their recent unemployment rates are lower relative to the economy-wide rate than past relationships would predict.

The second findings reinforce the first. They concern the relationship of the labor force participation rate of a demographic group to its own unemployment rate and/or the general unemployment rate. Broadly speaking, regressions of this kind support the familiar "discouraged worker" effect: higher unemployment rates make for withdrawal from the labor force. This effect appears to be stronger since 1983 for black males, especially teens and young adults. Their labor force participation is less after 1983 than regressions on pre-1983 unemployment observations predict. No such behavioral change is evident for whites or for black females.

Together these results add up to disturbing declines in the employment/population ratios of potential workers and breadwinners in demographic groups vulnerable to poverty, declines not easy to overcome by strong macroeconomic performance.

Some clues to these adverse developments are provided by Medoff (1992). He finds that aggregate job vacancies, as measured by the Conference Board's Help Wanted Index, are abnormally low in recent years, relative to contemporaneous unemployment rates. Vacancies are what pull people from NILF (not in labor force) into LFP (labor force participation, employed or looking for work). As already noted, Medoff also finds that meaningful vacancies are for jobs inferior in pay and other terms.

All these findings are consistent with the view that changes in the nature and location of jobs are adverse to persons and families at risk of poverty, independently of overall macroeconomic performance.

I confess I come to conclusions of this kind reluctantly. In the

past I have been skeptical, even scornful, of periodic structural explanations of higher unemployment rates and higher poverty rates. I have thought that the American people are very mobile and adaptable and that our economy adjusts quickly to sectoral shocks, provided an overall macroeconomic climate of prosperity is maintained. Think of our smooth economic demobilization after World War II, how it confounded the pessimists. Think of the fashionable structural explanations of high unemployment in 1960-61 and 1979-82, both followed by recoveries that brought unemployment rates below what they had been at previous cyclical peaks. In my experience, structural hypotheses have usually been excuses for policy-makers to do nothing to stimulate the economy.

This may be the case today too, although the current structural problems should lead to the opposite conclusion, namely that more macroeconomic stimulus is needed and is safe. Since labor shortages are the sources of wage inflation, the fact that vacancies are scarce, even while unemployment rates are below rates at the troughs of previous business cycles, suggests that expansionary monetary and fiscal policies will be helpful and not inflationary.

Expansionary monetary policy, the province of the Federal Reserve, would consist mainly in further reduction in the discount rate, at which the Fed lends to banks, and in the money market rates the Fed controls by its open market operations. In addition, the Fed in cooperation with the Treasury, could enter government bond markets with a view to lowering long-term rates. Besides stimulating business investment and home-building, these measures would have as a by-product a lower foreign exchange value of the dollar, making American goods more competitive in

world markets and trimming our trade deficit.

Expansionary fiscal policy would also be desirable, probably essential. This is the first business cycle in forty years in which no fiscal stimulus has been given to help recovery, by new expenditures or tax cuts or both. Fiscal stimulus to aggregate demand for goods and services and labor is necessarily deficit-increasing, at least in the short run. At present, fiscal policy is paralyzed by the political fear of adding to the mammoth deficits inherited from the last twelve years.

Whether recovery comes about by deliberate policy or by good fortune, even when prosperity is restored the prospects for poverty-vulnerable workers are not promising. More of them are likely to be unemployed or not in labor force than before 1980.

The unemployment-inflation tradeoff.

An overall unemployment rate between 5 and 5 1/2 percent is very probably as low as we can hope and expect. The Federal Reserve, whose monetary and interest rate policies are the major macroeconomic controls on the economy, will probably not want to allow lower unemployment, without convincing evidence it would not trigger ever higher wage and price inflation. At present estimates of the inflation-safe national unemployment rate, unfortunately, the unemployment rates of black male teens and adults will be extremely high, and evidently even higher than in the past. Moreover, many potential workers vulnerable to poverty, again more than in the past, will not even be in the labor force. Joblessness in these disadvantaged groups does virtually nothing to mitigate the wage and price inflation rates that concern the Federal

Reserve.

Could the unemployment target of federal monetary and fiscal policy be moved below 5 percent? Policy-makers probably exaggerate the social costs of inflation, but they will probably be unwilling to accept more inflation risk as the long as the public also exaggerates those costs. But policy-makers could respond to evidence that inflation is a lesser risk than in the past. In 1979-80 the Federal Reserve and most economists thought the inflation-safe unemployment rate was 6 percent or higher. Thanks to good wage and price behavior in the 1980s, the Fed kept the recovery going until unemployment fell below 5 1/2 percent.

Are there reasons to expect further improvement in the inflation-unemployment tradeoff? The scarcity of vacancies, cited above, is one reason. Moreover, both employers and employees, union and nonunion alike, are more sensitive than formerly to competitive threats to their markets and jobs. There is renewed interest in public and private programs to train and re-train workers and to assist conversions and adjustments of firms, industries, and localities.

These developments might enhance somewhat future contributions of macroeconomic performance to poverty reduction. But not by much. It would be wishful thinking to count on significant help from this source, especially over short and medium runs.

Macroeconomics and the politics of anti-poverty policy.

Another avenue of transmission of macroeconomic performance to poverty is political, the adequacy and efficacy of anti-poverty programs and transfers. As we know, the political climate of the last two

decades, especially the 1980s, has been inclement. War on Poverty programs on which Bob Lampman, Sargent Shriver, and Lyndon Johnson pinned their hopes have been stingily financed, even discontinued. Means-tested cash assistance has fallen sharply in purchasing power. According to the IRP tables distributed for this conference, differences between pre-welfare and post-transfer poverty percentages and poverty deficits have narrowed during the last decade. (I realize that causation cannot be surely inferred from those comparisons. Disciples of Charles Murray could doubtless contrive explanations based on extreme endogenous welfare dependency.) At the same time, government outlays for open-ended in-kind programs of benefit to the poor have greatly increased. One such program is food stamps, which has the political protection of agricultural interests. The most important, the most expensive, and the fastest growing is Medicaid, though not because poor patients are getting noticeably higher quality care. Faced with exploding health care costs, federal and state politicians and voters feel they are doing their bit, or more, for the poor, and their hearts harden against cash assistance.

The general macroeconomic disappointments of the last twenty years probably have a great deal to do with the political unpopularity of means-tested cash assistance. Lyndon Johnson's instincts were that it is easier to cut pieces of the pie for the poor when the pie is rapidly growing. The declining trend of real wages made the great middle class cynical of government, fed up with taxes, and skeptical that welfare beneficiaries deserve help.

Future prospects.

What can we expect in the future? According to the regressions of Table 1, return to an overall unemployment rate of 5 percent, with a corresponding adult white male rate of 3.6 percent, 0.7 points below 1990, could by itself lower poverty rates for persons, pre- and post-transfer, by 0.3 to 0.4 points. This would be a once-for-all contribution of successful countercyclical macroeconomic policy. Judging from the present dispositions of our monetary and fiscal policy-makers, so low an unemployment target may well be unrealistically ambitious.

Full recovery, to whatever target will appear inflation-safe to the Federal Reserve, seems likely to take several years. One reason, of which the weak Help Wanted numbers cited above are symptomatic, is the irreversible nature of many recent layoffs and prospective eliminations of jobs. Some of these are belated adaptations by American companies to the global competition assailing them these last ten years. Others are permanent cutbacks of the armed services and of defense-related jobs all over the country, the clouds of which peace dividends are silver linings. Since the armed services have provided important opportunities for minority youth, their force reductions are particularly bad omens for progress against poverty. This cyclical recovery will depend in unusual degree on the creation of new jobs rather than the restoration of old ones. Permanent new jobs will require policies that generate and are expected to sustain adequate aggregate demand. Commitment to a sustained long-run program of public investment in infrastructure, education and training, and environmental protection would be a good way to promote recovery in the short run while meeting long-term social

needs.

I am more optimistic about the trend of real wages. Productivity growth in manufacturing was a bright spot in the 1980s recovery. Companies whose structural adjustments are eliminating jobs are also becoming more efficient, leaner as well as meaner. Modest improvements in productivity growth should now show up in earnings as well as, indeed more than, in compensation. The trend ahead is likely to reduce fringe benefits relative to take-home pay. But the yields in poverty reduction will be small and slow. An increase of the real wage by one percent a year will reduce poverty by only about 0.13 points a year.

These unemployment and earnings effects together would lower poverty by a bit less than 2 points in one decade -- nothing to write home about. We will need specific war-on-poverty measures and more adequate and effective transfers to achieve speedier progress.

As to the possibility that improved macroeconomic performance will soften the hearts of taxpayers and of politicians seeking their votes, it is hard to imagine conversions that will make additional budgetary resources available for new battles against poverty or more adequate transfers.

The federal budgetary outlook is grim. Since the defense share of GDP hit its 1980s peak in 1986 at 6.5 percent of GDP, the share fell to 5.4 percent of potential output in 1991. The Clinton budget will reduce it further to 3.2 percent in 1997, a decline in annual expenditures of more than $100 billion in 1991 dollars. But increases in other outlays are eating up these peace dividends. The principal villains are interest

on the debt, the legacy of the profligate tax cuts and defense spending of the Reagan-Bush years, and health care, especially Medicare and Medicaid.

Although the Clinton economic and fiscal program for the five years 1993-97 contemplates using a third of the gross budgetary resources resulting from tax increases and expenditure cuts, mainly defense savings, for new non-defense initiatives, these are largely for public investments in infrastructure and education. There is little for anti-poverty programs beyond further liberalization of the refundable Earned Income Credit against personal income taxes. Welfare reform is geared to reducing dependency more than to reducing poverty.

Whatever is done to reform health care will have major fiscal consequences. Without reform, Medicare and Medicaid will add two percent of GDP to the federal deficit between 1996 and 2002. The reforms are likely to help the poor, especially those uninsured or dependent on Medicaid. But they will reinforce the squeeze on other government programs.

Entitlements to non-needs-tested transfers, especially Social Security, are often the targets of deficit hawks who do not have to run for office. But the Social Security Trust Fund is running ever-growing annual surpluses, now about $70 billion. The Clinton tax plan would raise from 50 to 85 percent the fraction of benefits taxable to the affluent elderly. If Social Security benefits of future retirees are to be reduced, the natural corollary would be to reduce the Social Security taxes they contribute while active workers. If so, no deficit reduction would be achieved. Otherwise payroll contributions would become ordinary

taxes, regressive ones at that, blatantly used for general federal purposes. While it would be possible and defensible to reduce equally Social Security benefits and contributions and then to increase ordinary income taxes in order to reduce the deficit, this triple play would be politically dubious.

Unfortunately, in my opinion, the Reagan Administration has succeeded all too well and all too permanently in its objective of crippling civilian government by giving away tax revenues, creating a political taboo against raising taxes, and generating a deficit and debt to brandish against civilian expenditures. The victory may yet be sealed by a constitutional amendment requiring super-majorities in both Houses of Congress either to adopt a deficit budget or to raise taxes.

While chronic budget deficits of the magnitudes of the last twelve years are harmful, cures for them can easily turn out to be worse than the disease. The point of deficit reduction is to free savings absorbed by the deficit for financing of productive investments by the private sector. This process, the reverse of "crowding out," requires reductions in interest rates to entice businesses and households to borrow money and build plants, buy equipment, introduce new technology, engage in research and development, and construct houses. The theory is that these capital investments will benefit future Americans, raising their productivity, wages, and living standards.

The process requires the active cooperation of the Federal Reserve to bring interest rates down and overcome the immediate adverse effects of deficit reduction on business activity and jobs. Without the Fed's aggressive help deficit reduction could arrest or reverse cyclical

recovery and actually diminish private investment and other future-oriented uses of resources. Even in prosperous times, the effects of deficit reduction on the future well-being of the society depend on how it is done. If it occurs at the expense of consumption by present-day affluent taxpayers or of unnecessary and unproductive defense or nondefense expenditures, future generations come out ahead. If it comes at the expense of public investments in education, infrastructure, housing, inner city development, improved health care, jobs programs, and welfare reform, the verdict is not so clear. Given the patent economic and social deficiencies of America today, my personal judgment is that those public investments, neglected as they have been the past twelve years, will serve future generations better than holding down the federal debt in order to channel more funds to private borrowers.

A final remark.

Looking back to the optimistic expectations I had 25 years ago, I do not think I can account for the extent of their disappointment by macroeconomic factors or by any economic factors. My own city of New Haven is a miniature version of the web of urban pathologies of New York, Washington, Detroit, and Milwaukee, possibly also of Los Angeles. Manufacturing jobs have moved to the suburbs or more distant locations. Middle and upper class households, predominately white, have moved out too. Minority populations and poverty are concentrated in city neighborhoods. According to the 1990 Census, only 21 percent of the 49,00 city households but 39 percent of the 255,000 suburban residents (in New Haven County outside the city itself) have incomes over $50,000

a year. The median city household income is $22,000, the suburban median is $40,000. The major problems of poverty, troubled public schools, welfare, joblessness, homelessness, ill health, crime, drug trade, family instability, fiscal crisis are in the city. The tax base is outside the city, and there is no way to tap it to help the city. These urban problems reinforce each other. Together they constitute a socio-economic system dynamically unstable downwards -- a vicious circle.

What unforeseen developments are the most obvious negative "shocks" -- to use economists' jargon -- to which the demoralization of inner city neighborhoods could be attributed? They are drugs, guns, and AIDS, all obviously interrelated. They are outside my assigned topic, and understanding them or prescribing remedies are outside my competence as well.

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