HAVE ANTIPOVERTY PROGRAMS INCREASED POVERTY?

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Introduction

For two decades following the end of World War II, rapid growth, rising incomes, and declining poverty rates characterized the American economy. Real per capita disposable income increased by 32.6 percent between 1950 and 1965. Mean family income adjusted for inflation was 54 percent higher in 1965 than in 1950. Furthermore, the rapid growth and rising incomes were not confined to the nation's middle and upper income families. In fact, the largest income gains were registered by the bottom fifth of income recipients. Measured in constant 1972 dollars, the mean income of the bottom one-fifth of families rose from $1411 in 1950 to $2506 in 1965, an increase of almost 78 percent (U.S. Department of Commerce 1983, Table 17).

Steady progress was made against poverty during the period. By 1965 only 13.9 percent of American families were officially classified as poor, down from 32 percent in 1947 and 18.5 percent in 1959. Thus, in less than a generation economic progress had cut the overall poverty rate in half. Moreover, as Table 1 illustrates, the poverty rate declined steadily in all age groups. Among the elderly, the poverty rate fell from 57 percent in 1947 to 22.8 percent in 1965. For youthful families, those headed by an individual under age 25, the poverty rate fell from 45 percent in 1947 to 26.9 percent in 1959 and to 19.4 percent in 1965. The pattern for families in the prime working-age groups is similar.

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TABLE 1

THE OFFICIAL POVERTY RATE OF FAMILIES BY AGE OF HOUSEHOLDER FOR SELECTED YEARS, 1947–1982

Age of Householder	1947	1959	1965	1968	1970	1975	1980	1982
Under 25	45.0	26.9	19.4	13.2	15.5	21.0	21.8	26.1
25–44	27.0	16.5	12.8	9.3	9.5	10.3	11.8	14.2
45–54	27.0	15.0	9.6	7.0	6.6	6.6	7.6	8.9
65 & over	57.0	30.0	22.8	17.0	16.5	8.9	9.1	9.3
All Families	32.0	18.5	13.9	10.0	10.1	9.7	10.3	12.2

SOURCE: The 1947 data are from *Economic Report of the President: 1964*, Table 7. All other data are from U.S. Department of Commerce: Bureau of the Census, *Estimates of Poverty Including The Value of Noncash Benefits: 1979 to 1982.*

This progress, achieved with little assistance from income transfer programs and government antipoverty efforts, was thought to be insufficiently rapid, however. In 1964 President Lyndon Johnson called for a "Marshal Plan" commitment by the government to eradicate poverty within the next generation. He stated, "We cannot and need not wait for the gradual growth of the economy to lift this forgotten fifth of our Nation above the poverty line" (Council of Economic Advisers 1964, p. 15).

In the mid-1960s, poverty was widely perceived as a problem of inadequate opportunity and bad luck. Political entrepreneurs believed that it could be solved by taxing the nonpoor and using the revenues to provide education, job training, health care, and income maintenance for the poor. The very prosperity and economic growth that produced the dramatic decline in the incidence of poverty prior to 1965 also increased the attractiveness of government transfer programs as a device for bringing forth yet further reductions in poverty. When almost everyone is poor, taxing the rich to improve the welfare of the poor has only a negligible effect. There simply are not enough rich to do much about poverty. Increasing income, however, makes it appear feasible to do something about the status of low-income individuals and families. The 1964 *Economic Report of the President* (p. 77) expressed the dominant view:

> Conquest of poverty is well within our power. About $11 billion a year would bring all poor families up to the $3000 income level we have taken to be the minimum for a decent life. The majority of the nation could simply tax themselves enough to provide the necessary income supplements to their less fortunate citizens. The burden—

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one fifth of the annual defense budget, less than 2 percent of GNP—would certainly not be intolerable.

Growth of the Transfer Society

As the War on Poverty programs began in the latter half of the 1960s, there was a virtual explosion in government transfers. In 1965, transfers accounted for 7.5 percent of personal income, up only slightly from 6.7 percent in 1950. By 1975 total cash transfer payments had soared to 14.1 percent of personal income (see Table 2). Measured in inflation-adjusted dollars, cash transfers nearly tripled in just 10 years, expanding from $105.5 billion in 1965 to $273 billion in 1975.

Even these numbers do not reflect the full extent of the increased government involvement in fighting poverty. As Table 2 illustrates, the growth of means-tested assistance targeted toward the poor was even more rapid as programs providing in-kind benefits such as food, health care, and housing for low-income households were established and expanded. Measured in 1980 dollars, expenditures on these means-tested, noncash benefits rose from $4.6 billion in 1965 to $30.3 billion in 1975, an increase in real terms of 559 percent in

TABLE 2

GROWTH OF TRANSFER PAYMENTS, 1965–1982
(Billions of Constant 1980 Dollars)

Type of Benefit	1965	1970	1975	1980	1982
Total Cash Transfer Payments[a]	105.5	170.0	273.0	297.2	319.7
	(7.5)	(9.9)	(14.1)	(13.8)	(14.6)
Means-tested Cash Assistance[b]	14.7	15.1	27.4	23.6	22.1
Noncash, means-tested	4.6	16.8	30.3	39.1	40.0
Food stamps	0.1	1.2	6.7	8.7	8.7
School lunches	NA	0.3	1.3	1.5	1.5
Public housing	0.9	3.5	3.5	4.5	4.3
Medicaid	3.6	11.9	18.8	24.3	25.5
Total, means-tested	19.3	31.9	57.7	62.7	62.2

[a]Numbers in parentheses represent total cash transfer payments as a percent of personal income.

[b]Includes Aid to Families with Dependent Children, General Assistance, Supplemental Security Income, and means-tested veteran's pensions.

SOURCE: U.S. Department of Commerce: Bureau of the Census, *Estimates of Poverty Including the Value of Noncash Benefits: 1979–1982*, Table A, and *Economic Report of the President, 1983*, Table B-22.

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just 10 years. While expenditures on means-tested cash assistance actually declined during the 1975–1982 period, this decline was more than offset by continued growth, albeit at a slower rate, in noncash benefits. By the early 1980s, total means-tested expenditures in *real* terms were nearly three and one-half times the 1965 level.

Poverty Rates and the War on Poverty

Did the increase in expenditures and expansion of government antipoverty programs accelerate the decline in the poverty rate as President Johnson had anticipated? Incredible as it may seem, almost the opposite occurred. Just as government spending on the various antipoverty programs accelerated in the late 1960s, progress against poverty came to a grinding halt. The official poverty rate reached a minimum in the late 1960s. By 1980, the overall rate was 10.3 percent, virtually unchanged from the 10.0 percent rate of 1968. Moreover, as is clear from Table 1, the aggregate rate conceals important differences across age groups that have heretofore gone largely unnoticed. During the 1970s, the official poverty rate for the elderly continued to decline, from 17.0 percent in 1968 to 9.1 percent in 1980. The rate for families headed by an individual aged 45–54 increased marginally, from 7.0 percent to 7.3 percent. In contrast, the poverty rate for the other age groups increased significantly. By 1980 the official poverty rate for families in the 15–24 age grouping had risen to 21.8 percent (821,000 households), up from 13.2 percent in 1968. Similarly, the incidence of poverty among families headed by persons age 25–44 rose from 9.3 percent in 1968 to 11.8 percent in 1980 (3,168,000 households). Families headed by a person under age 45 now account for nearly two-thirds of the poor families in the United States. The increases in the official poverty rates for working-age households have continued into the 1980s. Thus, during the War on Poverty era, consistent progress against poverty has been limited to the elderly.

The official poverty rate reflects the percentage of families with cash income below a certain threshold amount. This poverty income level has been adjusted over time for inflation.[1] The official poverty

[1]The Social Security Administration (SSA) developed the official definition of poverty. Since consumption survey data indicated that low and median income families of three or more persons spent approximately one-third of their income on food, the SSA established the official poverty income level at three times the cost of an economical, nutritionally adequate food plan for a family of a specified size. This method was used to derive the poverty income threshold adjusted for factors such as family size, sex of the family head, number of children under 18 years old, and farm or nonfarm residence. The poverty threshold is adjusted annually to account for rising prices. The chart below

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rate does not take into account noncash (in-kind) transfer payments. Because the noncash benefits have grown so much more rapidly than cash transfers since the inception of the War on Poverty, some analysts have argued that the official rate is a misleading indicator of changes in the number of families living in poverty.[2] A recent study by the U.S. Department of Commerce (1984) provides data for 1979–1982 on the poverty rate adjusted for noncash benefits and on noncash expenditures adjusted for inflation for the period 1965–1982. Given the size of the noncash transfers and the impact of the in-kind benefits on the adjusted poverty rates for 1979–1982, an adjusted rate for each group can be reconstructed for earlier years.[3]

The adjustments for noncash benefits are made in two alternative ways. One values in-kind transfers at *market value*, that is, what it costs to supply the goods and services to the recipient. The other attempts to estimate the *recipient value* or the amount of cash income for which recipients would be willing to trade their right to the noncash benefits. Because market value is relatively easy to compute, it is most often used in studies seeking to value in-kind benefits. However, since the recipient value method values noncash benefits at their estimated cash-equivalent to the recipients, it is accepted by most analysts as the more appropriate measure.

Adjusted poverty rates using both methods are presented in Table 3. Adjustment lowers the rate during the 1970s but the adjusted rate nevertheless follows a time path that is quite similar to that of

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illustrates how the poverty income threshold for a family of four persons has increased as prices have risen:

Year	Average Poverty-Income Threshold for a Family of Four
1959	$2973
1965	3223
1970	3968
1975	5500
1980	8414
1982	9862

[2]See Paglin (1979) and Browning (1975) for a presentation of this view.

[3]Mathematically, the adjusted poverty rate within age group a for each year i is equal to:

$$APR_{ai} = OPR_{ai} - \frac{MTE_i}{MTE_{80}}(OPR_{a80} - APR_{a80})$$

where
APR_{ai} = adjusted poverty rate during year i within age group a
OPR_{ai} = official poverty rate during year i within age group a
MTE_i = noncash, means-tested expenditures in year i
MTE_{80} = noncash, means-tested expenditures in 1980
OPR_{a80} = official poverty rate within age group a in 1980
APR_{a80} = adjusted poverty rate within age group a in 1980.

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TABLE 3

THE POVERTY RATE OF FAMILIES ADJUSTED FOR NONCASH BENEFITS BY AGE OF HOUSEHOLDER FOR SELECTED YEARS, 1959–1982

Age of Householder	1959[a]	1965	1968	1970	1975	1980	1981	1982
Adjusted By Market Value Method[b]								
Under 25	26.9	18.5	10.9	12.4	15.3	14.5	16.6	18.7
25–44	16.5	12.3	7.9	7.6	6.9	7.4	8.6	10.1
45–54	15.0	9.0	6.3	5.7	4.9	5.1	6.2	6.2
65 & over	30.0	22.0	15.0	13.7	3.8	2.5	2.5	2.6
All Families	18.5	13.4	8.7	8.3	6.4	6.1	7.2	8.0
Adjusted By Recipient Value Method[b]								
Under 25	26.9	19.0	12.3	14.2	18.7	18.8	20.9	24.0
25–44	16.5	12.5	8.6	8.5	8.5	9.5	10.7	12.3
45–54	15.0	9.5	6.7	6.1	5.8	6.2	7.5	8.0
65 & over	30.0	22.4	15.9	14.9	6.0	5.4	5.1	5.5
All Families	18.5	13.7	9.3	9.2	8.1	8.2	9.2	10.2

[a]The poverty rate for 1959 is the official rate taken from Table 1 of the text.
[b]See text, footnote 3, for a description of how the adjusted rates were derived for 1965, 1968, 1970, and 1975.

SOURCE: U.S. Department of Commerce, Bureau of Census, *Estimates of Poverty Including The Value of Noncash Benefits: 1979 to 1982.*

the official rate. For the elderly, the adjusted rate fell throughout the period, reaching 2.1 percent by 1980 using the market value method and 5.4 percent using recipient value.

For families in the under-25 age group, however, the adjusted poverty rate in 1980 was well above the 1968 level using both methods. In fact, the recipient value poverty rate in 1980, 18.8 percent, was almost exactly equal to the 19.0 percent rate in 1965. Thus, 15 years after the explosion in government transfer payments began, the poverty rate for youthful families was essentially unchanged from its 1965 level even after allowance is made for the in-kind benefits. The rise in the adjusted poverty rate for this age group continued into the 1980s, reaching 24.0 percent in 1982.

For the 25–44 age group, the market-value adjusted rate stood at 7.4 percent in 1980, down only slightly from 7.9 percent in 1968. Using the recipient value method, however, the adjusted rate in 1980 was 9.5 percent, well in excess of the 8.6 percent rate in 1968. While the adjusted poverty rate for the 45–54 age grouping did not begin

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climbing until the latter half of the 1970s, by the early 1980s it too had risen above the levels of the late 1960s.

Thus, whether one looks at the official or adjusted poverty rates, the picture is the same. Except for the elderly, soon after the massive increase in transfer payments in the late 1960s, the steady progress of the pre-War on Poverty era came to a halt and the poverty rates of working age Americans began to rise.

Why Have Poverty Rates Risen?

Can the increasing poverty rates be explained by economic conditions? Per capita real GNP grew at an annual rate of 2.1 percent during the 1970s, a modest reduction from the 2.6 percent rate of the 1960s. However, the decade of slowest growth during the post-World War II era was the 1950s, when per capita real GNP rose by only 1.5 percent per year. Despite the slower growth during the 1950s, the poverty rate fell among all age groups. In addition, when the 1950–1980 period is divided into equal subperiods, the average annual rates of growth in per capita real GNP during the two subperiods are identical, 2.1 percent.[4]

Furthermore, financing the expanding transfer sector during the War on Poverty era required higher taxes which impede the efficient use of resources, reduce productivity, and retard economic growth. Thus, to the extent that the growth rate in the U.S. slowed during the 1970s, the expanding tax-transfer sector itself was at least partially responsible.[5]

If the state of the economy fails to explain the lack of progress against poverty in the face of massive increases in government transfer payments, what does? The application of simple economic theory suggests that the seeds of failure lie within the War on Poverty programs themselves. While government transfer programs have improved the standard of living for some of the poor through increased benefit levels and relaxed eligibility requirements, they have also stifled the incentives for the poor to improve their own economic status and for the nonpoor to avoid poverty. They have introduced a perverse incentive structure, one that penalizes self-improvement and protects individuals against the consequences of their own bad choices.

[4]Per capita *real* disposable personal income actually grew more rapidly during the latter period. It grew at an annual rate of 2.4 percent during the 1965–1980 period, up from 1.9 percent during the 1950–1965 era.

[5]See Lee (1985) for evidence on the impact of rising tax rates on economic growth during the 1970s.

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Recent studies of the Aid to Families with Dependent Children (AFDC) program using panel data show that there are two quite distinct groups of poor. One group, whom we shall call the hardcore poor, remain on welfare for many years. The second group, whom we shall call the marginal poor, participate in welfare programs for much shorter periods of time, often exiting the programs in less than one year. Indeed, only about half of all AFDC spells last beyond one year, with 16–18 percent surviving to the fifth year, and 5–7 percent to the tenth year (O'Neill 1984, p. 6).[6]

The hardcore poor are often victims of personal misfortune; their poverty is usually attributable to such factors as debilitating injury, disease, or physical, mental, or emotional disability. By and large, their poverty is not the result of their own decisions and actions, and their ability to improve their economic status is quite limited. In contrast, the marginal poor move into and out of poverty. Their poverty is sometimes due to temporary impediments to work such as injury, disease, economic recession, or a change in family status. In other cases, their poverty results from inappropriate individual choices or errors of judgment such as pregnancy or premature termination of schooling. Unlike the hardcore poor, the marginal poor retain some control over their economic status and they respond to economic incentives. Improving job opportunities reduce the incidence of poverty among the marginal poor, for example, while the hardcore poor remain poor through recessions and recoveries alike.

The structure of the War on Poverty transfer programs produces four effects, each of which operates to retard progress against poverty and increase the incidence of poverty among the marginal poor.

The Higher Real Benefit Effect

For individuals with few skills and low wages, antipoverty benefits offer an alternative to income from employment. Increases in the real value of benefit payments make dependency on the government even more attractive compared with the alternative of self-support. Thus, while the higher benefits tend to reduce the severity of poverty, they also increase its incidence. Just as unemployment compensation raises the unemployment rate by increasing the duration of unemployment,[7] higher antipoverty benefits raise the poverty rate by increasing the duration of poverty among the marginal poor (O'Neill 1984).

[6] See Bane and Ellwood (1983a, 1983b) for complementary findings.

[7] See Ehrenberg and Oaxaca (1976), Feldstein (1978), and Classen (1977).

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The expansion in total spending on transfer programs during the War on Poverty era not only increased real benefits per recipient, but as Table 4 shows, the benefit levels for many transfer programs also rose more rapidly than per capita disposable personal income. For example, while real personal income rose by 41 percent during the 1965–1980 period, the real value of per recipient food stamp benefits increased by 136 percent. Measured in 1980 dollars, the average annual Medicare hospitalization payment rose by 207 percent over the same period, and medical benefits increased by 361 percent between 1967 (the initial year for these programs) and 1980. Social Security benefits also grew more rapidly than personal income—53.6 percent in real terms compared to 41.0 percent—during the 1965–1980 period.

Although payments made to participants in means-tested cash transfer programs such as AFDC and Supplementary Security Income (SSI) grew more slowly than personal incomes, benefits did rise faster than the rate of inflation so that the purchasing power of the cash benefits nevertheless increased. In addition, by the 1970s recipients of AFDC and SSI in most states were also eligible for in-kind benefits from food stamps, Medicaid, housing programs, and school lunch subsidies. Once the in-kind benefits are taken into account, the real transfer incomes of many individuals participating in the AFDC and SSI programs also expanded more rapidly than per capita disposable personal income. These higher benefit levels induce some individuals to substitute income transfers for employment earnings, resulting in a greater incidence of poverty and a higher poverty rate.

TABLE 4

GROWTH OF PER RECIPIENT REAL BENEFIT LEVELS, 1965–1980

Program	Benefits Per Recipient[a] 1965	1980	Increase (%)
Food Stamps	201	475	136.6
Medicare (hospital)	319[b]	981	207.4
Medicare (medical)	93[b]	427	361.2
Social Security (monthly)	221	339	53.6
Personal Income (per capita)	6246	8808	41.0

[a]Benefits per recipient are expressed in constant 1980 dollars.
[b]Data are for 1967, the initial year of the program.

SOURCE: *Statistical Abstract of the United States* (Washington, D.C.: Government Printing Office, respective years).

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The High Implicit Tax Effect

While the higher real benefits paid by the War on Poverty transfer programs make poverty more attractive, the programs have also reduced the incentives of the marginal poor to help themselves once they enter poverty. Indeed, these government programs penalize efforts at self-improvement because the benefits payable under the transfer programs aimed most directly at the poor decrease as earned income rises. As an individual or family increases employment earnings, benefits from programs such AFDC, food stamps, Medicaid, school lunches, and rent supplements fall.

The rate at which the benefit payments from each program are reduced per dollar of nontransfer income received is the implicit marginal tax rate associated with that program. For example, food stamp benefits are reduced by $30 for each $100 of monthly earnings up to $800. Families are eligible for free school lunches until income reaches 125 percent of the official poverty level, and reduced-price lunches are available until income reaches 195 percent of the official poverty level. The implicit marginal tax rates associated with cash transfer programs such as AFDC and unemployment compensation are high, typically in the 50 to 60 percent range. The marginal tax rates associated with individual programs, however, understate the disincentives faced by the recipients. Most of the poor receive benefits from several programs simultaneously. When the implicit marginal tax rates associated with each of these programs are considered together, the *compound multi-program implicit marginal tax rate* is very high.

For example, as Table 5 shows, a mother with two children and no earned income residing in Pennsylvania would qualify for annual cash and in-kind benefits of $7568 from AFDC, food stamps, Medicaid, and the Earned Income Tax Credit. If the family's earnings rose to $2000, transfer benefits would be reduced and taxes increased, leaving the family with spendable income of $8391. Thus, additional earned income of $2000 generates only $823 in additional spendable income, equivalent to a marginal tax rate of 58.8 percent. At higher levels of earned income, this implicit marginal tax rate is even greater. If earned income rose from $4000 to $5000, spendable income would *decrease* from $9214 to $7694, an implicit marginal tax rate of 252 percent. If income increased further to $6000, the family would lose eligibility for AFDC, and its after-tax-and-transfer income would decrease again, this time by $246. In fact, a family earning $6000 has less spendable income than a family with no earned income, and a

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TABLE 5

THE EFFECT OF TRANSFER BENEFITS AND TAXES ON THE INCENTIVE OF A PENNSYLVANIA MOTHER WITH TWO CHILDREN TO EARN INCOME (SEPTEMBER 1983)

Annual Gross Wage	Transfer Benefits[a]	Income and Employment Taxes[b]	Spendable Income	Implicit Marginal Tax Rate
0	7568	0	7568	—
2000	6525	134	8391	58.8
4000	5482	268	9214	58.8
5000	3040	346	7694	252.0
6000	2059	611	7448	124.6
7000	1719	810	7909	53.9
8000	1378	1021	8357	55.2
9000	1038	1240	8798	55.9
10000	698	1469	9229	56.9

[a]The following benefits are included: AFDC, Earned Income Tax Credit, food stamps and Medicaid. The Medicaid benefits were valued at the 1978 national average adjusted for inflation between 1978 and 1982.
[b]Includes social security and federal and state income taxes.

SOURCE: Data are derived from U.S. House of Representatives: Committee on Ways and Means, *Background Material on Poverty* (Washington, D.C.: Government Printing Office, 1983) Table 10, page 89.

family earning $10,000 each year, equivalent to a full-time year-round job paying $5 an hour, would have spendable income of $9229, just $1661 more than a family with no earned income at all. The loss in transfer benefits and the increased taxes when earnings rise from zero to $10,000 is equivalent to a tax rate of 83 percent on earned income.

Such high implicit marginal tax rates pose a significant disincentive to work for those individuals whose potential earnings are relatively low.[8] Many transfer recipients who would otherwise engage in market work will decide to work fewer hours or not at all. Clearly, then, some portion of transfer income is merely replacement income—that is, it replaces income that the recipient would have earned in the absence of the high implicit marginal tax rate effect. The larger the

[8]Marginal tax rates in the 40, 50, and 60 percent range have been shown to reduce the incentives of high income recipients to earn taxable income (Lee 1985). Paradoxically, many transfer recipients face implicit marginal rates in excess of those faced by taxpayers in the highest marginal tax brackets.

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size of this replacement component, the smaller the *net* positive impact of income transfers on the measured income of the poor.

The Skill-Depreciation Effect

Individuals who have not utilized their skills for extended periods of time find it difficult to compete with otherwise similar individuals who have continuous labor force participation. Thus, the long-term consequences of the current programs will be even more destructive than the short-term effects. As the marginal poor spend more time dependent upon transfers and less time in the work force, their skills depreciate and their work record deteriorates. They become less and less able to support themselves. Over time, more and more of the marginal poor will be transformed into hardcore poor.

The data on labor force participation of householders living in poverty illustrate the importance of the skill depreciation effect. Between 1966 and 1980, the proportion of poor households headed by a person *who did not work at all during the year* rose from 39.7 percent to 49.6 percent. For female headed households in poverty, 61.5 percent of the household heads did not work at all in 1980, up from 52.7 percent in 1966. Thus, while the labor force participation of all females was climbing, the rate for poor females was declining.[9] Clearly, these ominous trends provide little reason for optimism that the poor will be better able to provide for themselves in the years ahead.

The rising poverty rate among youthful families (see Table 3) that has accompanied the growth of War on Poverty expenditures is particularly discomforting. As transfers make dependency more attractive relative to work experience, schooling, and other forms of human capital investment, youthful recipients fail to develop skills that have in the past enabled the young to escape from poverty. Withdrawal from the labor force by recipients in their teens and twenties will only increase the poverty rate among these individuals as they move into their thirties and forties. Clearly, the long-run destructive effects of the current system have not yet been fully realized.

The Moral Hazard Effect

The poverty of the marginal poor, unlike that of the hardcore poor, is at least in part the result of conditions over which they exercise some control. Some choose a lifestyle that increases the likelihood of poverty. Some consciously choose leisure over work; others are

[9]See Murray (1984) for additional evidence on the negative impact of transfer programs on the labor force participation of low-income families.

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poor because they failed to complete school, or because of drug or alcohol abuse, or because they have chosen to bear children without the means to provide adequate support. These individuals have made choices that severely limit their ability to be independent and self-supporting.

Unfortunately, it is not always easy to distinguish between the unfortunate and the irresponsible. At best, government programs make such distinctions in the grossest of terms. While income transfers increase the standard of living of the hardcore poor who are unable to help themselves, they also reduce the cost to others of making those very choices that are most likely to bring on poverty. In short, by offering "insurance" against adversity over which the marginal poor have some control, the programs encourage the very situations that they were designed to combat. In the insurance industry, this is referred to as the "moral hazard problem." Recognizing this problem, private insurance companies seldom offer protection against adversities the occurrence of which is substantially affected by the behavior of potential policyholders.[10]

Existing government transfer programs attempt to reduce the severity of the moral hazard problem by adopting detailed rules and guidelines intended to limit abuse and to promote legislative intent. The regulations, however, eliminate the possibility of solutions tailored to each individual recipient which would in fact minimize moral hazard. Indeed, the regulations encourage potential recipients to alter their behavior so as to meet program eligibility requirements rather than to make choices that would reduce or eliminate their need for income transfers.

The impact of the moral hazard effect manifests itself in several ways. For example, the number of "unrelated individuals" in poverty fell from 4.9 million in 1959 to 4.7 million in 1968 in spite of increasing population. Since 1968, however, the number has risen steadily, reaching 6.2 million in 1980, as dependence on government has replaced dependence on family. The rise in the poverty rate among families headed by persons in the 15–24 age group between 1965 and 1980 reflects the availability of government support for those who choose high-risk life styles (involving, for example, sexual promiscuity or drug or alcohol use) that families often refuse to subsidize. The availability of government transfers has also made it less costly

[10]For example, fire insurance policies do not cover damage due to a fire set by the policyholder. Similarly, the authors are unaware of any private company offering insurance against income loss due to dropping out of school, nonmedical absenteeism, alcoholism, or drug addiction, all of which are subject to the moral hazard effect.

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for husbands in low-income households to desert and for unmarried fathers to avoid responsibility for their children. Thus, the transfer programs have contributed to the dramatic rise in the number of female-headed households in recent decades.[11] Interestingly, there is one eligibility requirement for government transfer benefits that cannot be satisfied by a change in an individual's behavior: age. Therefore, moral hazard is not a problem in programs for the elderly. This helps explain why, alone among age groups, the poverty rate for those over 65 has continued to decline during the War on Poverty era.

Conclusion: An Agenda for Welfare Reform

While the intentions of the architects of the War on Poverty were noble, their approach to reducing the incidence of poverty has proven counterproductive. The current system of income transfers confronts the poor with perverse incentives that discourage self-help efforts in the short run and induces recipients to make decisions that retard their ability to escape poverty in the long run. The system unwittingly encourages behavior that leads to and perpetuates poverty. The need for policy reform is clear.

To be effective, public policy to alleviate poverty must be consistent with four basic principles. These four principles provide an agenda for welfare reform.

1. *Except for the handicapped and the elderly, all adults must be required to work in order to be eligible for long-term (say, more than 3 months) welfare benefits.* The concept of providing long-term public assistance to those who do not work was developed during a different environment. For men, it arose during the massive unemployment of the Great Depression; for women, it originated prior to the movement of large numbers of married women, even those with small children, into the labor market. A work requirement will substantially alleviate the negative long-term impact on the poor of both the skill-depreciation effect and the moral hazard effect.

2. *The welfare system must recognize the importance of the family, church, private charity, and community action in the alleviation of poverty.* In contrast with the government, private voluntary donors have the capacity to structure help for the poor in ways that minimize moral hazard and avoid the perverse incentive effects. Private action

[11]For whites, the proportion of families headed by a female rose from 8.8 percent in 1967 to 11.9 percent in 1981. For blacks, the proportion of female-headed households rose from 23.6 percent in 1967 to 41.7 percent in 1981. While the trend has been upward since World War II, the increase has been much more rapid since the mid-1960s.

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complements economic growth in reducing poverty; government transfer programs impede the capacity of economic growth to reduce the incidence of poverty by retarding growth itself. Apart from temporary assistance such as short-term unemployment compensation, government transfer programs should be directed only at the hard-core poor—handicapped adults and disadvantaged children—for whom perverse incentives and moral hazard are much less relevant.

3. *The welfare system should be structured to reenforce certain traditional values that encourage individual, parental, and family responsibility.* Throughout history, certain social values have played an important role in meeting the needs that accompany economic hardship. It is indeed appropriate for a free society to seek to establish institutional arrangements that will make individuals accountable for their actions. The idea that society should pay for individual irresponsibility is counterproductive. It has undermined progress against poverty in the past and, unless rejected, it will continue to do so in the future.

4. *Transfer recipients should not be allowed to use children as hostages in order to blackmail society.* No disadvantaged child is undeserving. However, we must find ways of helping children that will not be used and abused by undeserving, irresponsible adults. Transfer programs targeted directly at children and a work requirement associated with receipt of AFDC would reduce the misuse of children by adults seeking income transfers for themselves.

The problem of poverty continues to fester not because we are failing to do enough, but rather because we are doing so much that is counterproductive. We must not continue to cast the issue in terms of the compassion of tax-transfer proponents versus the callousness of their critics. If we want to do something *effective*, the issue must be redrawn between those who would continue the government programs of the past and those who seek new approaches with long-lasting benefits and fewer harmful side-effects. The current approach treats the symptoms, but it also unwittingly promotes the disease. In contrast, while still providing for the welfare of those who truly cannot help themselves, the principles we have enunciated would encourage self-help and discourage long-term dependency and personal irresponsibility. The future welfare of the poor and the vitality of our economy may well depend on how we resolve this important issue.

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THE POLITICS OF POVERTY AND THE POVERTY OF POLITICS

Dwight R. Lee

> [T]he poor [may] deserve more, but if the government tries to provide more, it will not do anyone any good.
>
> —Nathan Glazer[1]

Introduction

The notion that we have to depend on government to assist the poor has acquired the status of revealed truth. Even those who acknowledge the unparalleled success of market economies at creating wealth are uneasy about, if not outright hostile to, the market distribution of this wealth. There can be no denying that some people will be left behind by market competition. Indeed, the very success of the market at creating wealth comes from the fact that it constantly threatens people with poverty; and when consumers signal with their thumbs down, the threat is carried out without mercy.

But even if it is assumed that the market fails to generate a distribution of income that most people find satisfactory, does this justify government programs to promote a more acceptable income distribution? The answer depends crucially on whether or not there are reasons for believing that such government programs will improve matters. If, for example, government welfare programs impose a heavy burden on economic productivity, yet are incapable of changing the distribution of income in a more acceptable direction, then the "failure" of the market with regards to income distribution would provide no justification for government intervention in the market process.

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[1]"Reagan's Social Policy—A Review," *The Public Interest* (Spring 1984): 94.

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