

TESTIMONY OF
ERIC A. **HANUSHEK**
DEPUTY DIRECTOR
CONGRESSIONAL BUDGET OFFICE

BEFORE THE

SUBCOMMITTEE ON CENSUS AND POPULATION
COMMITTEE ON POST OFFICE AND CIVIL SERVICE

AND THE

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

MAY 15, 198*

This statement should
not be released before
its delivery, scheduled
for 9:30 **a.m.** EDT,
May 15, **1984**

The measurement of poverty is inherently subjective, and any estimate of the number of poor persons will be imprecise. Nonetheless, the attempt is worthwhile. It enables the nation to assess how well it is doing in alleviating need, and it can also help in directing limited government resources to assist those persons who are most lacking.

The current method for measuring poverty has a number of shortcomings, however. One concern is that an important part of federal assistance to low-income persons—programs that provide benefits in kind, rather than in **cash**--is not counted when considering how well off they are. As a result, some of those who are counted as poor may, in fact, be better off than others who have more cash income but who **benefit** from fewer in-kind programs. Other shortcomings may have the opposite effect, **however**--understating needs among the low-income population.

My remarks today will cover three topics:

- o How poverty is now measured;
- o Criticisms of the current measure and options for altering it; and
- o Possible **effects** of changing the poverty measure.

THE MEASUREMENT OF POVERTY

The current federal poverty measure was developed in the 1960s as a standard of what is needed to get by, rather than as a measure of how well off any person is compared to the average. It is based on the cost of the

Department of Agriculture's 1961 economy food plan, designed to meet recommended dietary allowances at the time. Since comparable standards for the cost of minimally adequate amounts of housing, clothing, or medical care were not available, the poverty line was determined by multiplying the cost of the food plan by three. This factor was derived from a 1955 household **food** consumption survey which showed that the typical family of three or more spent one-third of its after-tax income on food. The poverty threshold varies with the age of the household head and with family size. Initially, the thresholds were updated using estimates of the increase in **food** costs. Since 1969, however, they have been updated annually by the Consumer Price Index (CPI). 1/ In 1982--the latest year for which income data are **available**--the poverty line for a family of four was \$9,862.

Each year, the Census Bureau publishes estimates of the number of poor persons in the nation as a whole, using income data taken from the Current Population Survey. 2/ This procedure measures total cash income, before taxes, for **families** and unrelated individuals. Cash assistance payments from government programs, such as Social Security and Aid to

-
1. At present, the federal government uses two slightly different definitions of poverty. The Census Bureau definition, also referred to as the statistical definition, is used to count the number of poor persons and is employed in formulas that allocate federal dollars among states and localities. The Office of Management and Budget definition, often referred to as the administrative definition, is used to judge income eligibility in programs. The OMB poverty thresholds must be forecast forward from the Census levels to obtain values for the current program year.
 2. The decennial Census is used to estimate poverty rates for states and cities.

Families with Dependent Children, are included, but noncash benefits such as food stamps, housing assistance, Medicare, and Medicaid are not considered income when judging an **individual's** or family's poverty status. Using this method, the Census Bureau estimates that 15 percent of the population was poor in 1982.

CRITICISMS OF THE CURRENT MEASURE

A number of difficulties exist with the current method of measuring poverty, including how the minimum thresholds are set, the treatment of taxes, and the exclusion of in-kind benefits from income. 3/ While most recent attention has focused on the treatment of in-kind **benefits**, the other problems may be equally important.

Establishment of Poverty Thresholds

The poverty thresholds themselves have been criticized because they are based on a direct estimate only of food requirements. Minimum needs for shelter, clothing, medical care, and other goods and services are not assessed directly. A related problem is that the current poverty thresholds are out of date. For one thing, the proportion of income spent on food by the average family has changed since 1955. If the 1977-1978 food

-
3. Not considered here is the problem of underreporting of income in the Current Population Survey, particularly from such nonwage sources as interest, dividends, rents collected, and some transfer payments, such as Aid to Families with Dependent Children. While this underreporting may cause the poverty rate to be overestimated, it has to do with inaccuracies in the data and is not a conceptual issue regarding the measurement of poverty, which is the focus of my statement.

consumption survey was used to set the poverty thresholds in the same way the earlier one was, the poverty lines would be fixed at 3.7 times minimum food **costs--about** 23 percent above present levels. Other updates might have the opposite effect, however. For example, if the present version of the **CPI--which** measures housing costs more accurately than earlier ones--had been used since the late 1960s to update the poverty thresholds, the poverty line for a family of four would be about 9 percent lower than it is now. 4/

Another concern is that the poverty thresholds do not recognize **cost-of-living** differences among different parts of the country. 5/ Geographically specific poverty thresholds might provide a more refined picture of need, but, unfortunately, adequate data are not now available to estimate those with any precision. **Cost-of-living** differentials could, however, be great. For example, in 1982 the recently discontinued Bureau of Labor Statistics "lower living standard" budget for a **4-person family--a** concept that **differs** significantly **from** the market basket used in poverty **standards--** ranged between about \$13,700 and \$17,100 within the continental United States.

-
4. See: Background Material on Poverty, a committee print of the Subcommittee on Oversight and the Subcommittee on Public Assistance and Unemployment Compensation of the Committee on Ways and Means, U.S House of Representatives (**WMCP:98-15**, October 17, 1983).
 5. Until 1981, lower thresholds were used for farm families to reflect household production of food.

Treatment of Taxes

The current treatment of taxes presents another problem, because it is inconsistent. While the poverty thresholds are based on an estimate of minimally adequate after-tax income, the determination of whether a particular person or family is poor is made in terms of pre-tax **income**--ignoring the fact that money paid in taxes is not available for private spending. Although persons with incomes near the poverty line generally pay little in federal income taxes, 6.7 percent of their earnings go for payroll taxes.

The treatment of taxes could be made consistent either by considering a person's or family's after-tax income in judging poverty status, or by raising the poverty thresholds to make them measures of minimally adequate levels of before-tax income. Either approach would increase the count of poor persons. The latter change might be more difficult to implement, however, because it would require setting numerous different thresholds, depending on what share of income was **from** taxable sources.

Exclusion of In-Kind Benefits

A final issue concerns the exclusion of the value of in-kind benefits from income in measuring **poverty**. While such benefits were probably a relatively small part of income when the poverty thresholds were first established, they have been a major component of our efforts to alleviate poverty, and have grown appreciably in recent years. For example, in

constant 1982 dollars, spending on the major means-tested **noncash** benefit programs increased from \$5.3 billion in 1965 to **\$46.9 billion** in 1982. 6/

In a pair of recent reports, the Census Bureau used three different techniques to estimate the value of **federally** provided in-kind benefits. 7/ The first **technique--the market-value approach--estimates** what it would take to purchase the in-kind benefits in the private market. Valuing noncash benefits at their market prices tends to overstate their contribution to reducing poverty, however, since the government may be providing amounts of one good or service well in excess of what the individual would have purchased privately, while leaving other needs unsatisfied. The second valuation method attempts to measure the cash-equivalent value to the recipient of in-kind **benefits--that** is, the amount of cash that a recipient would be willing to give up to obtain them. Census researchers approximate this concept by estimating the "normal" expenditure on the item by consumers with incomes and other characteristics similar to the program beneficiaries but who do not receive the in-kind benefits. The third

-
6. These **figures** include spending for food stamps, school lunches, housing assistance, and **Medicaid**. Other federal in-kind benefits not counted in these figures include Medicare, **veterans'** health care, and educational assistance for postsecondary students. In-kind benefits provided by state and local **governments--other** than state spending for **Medicaid--are** also excluded.
 7. U.S. Department of Commerce, Bureau of the Census, "Alternative Methods for Valuing Selected In-Kind Transfer Benefits and Measuring Their Effect on Poverty," Technical Paper 50, March 1982; and "Estimates of Poverty Including the Value of Noncash Benefits: 1979 to 1982," Technical Paper 51, February 1984.

approach--the so-called poverty-budget-share value--is like the cash-equivalent value, except that the "normal" expenditure is what unassisted consumers with cash incomes at the poverty line pay for the good or service. 8/

Analysts tend to prefer the cash-equivalent concept as being the best approximation of the value of the benefit to the recipient, though estimates may be **difficult** to develop. Estimation problems are least severe when the good is provided at a level that is not likely to greatly exceed what a low-income person would otherwise purchase, as in the case of food stamps. Estimation problems are greatest when the opposite is true, as with medical benefits.

Food Stamps. Food stamps are the easiest of the noncash **benefits** to value, with the three valuation techniques yielding similar results. Since the stamps are directly redeemable for food, their market value is equal to their face value. Also, since the amount of stamps a person receives generally does not exceed the amount that a low-income person would otherwise spend for food, the **stamps'** cash-equivalent and poverty-budget-share values are both close to their market value.

Housing Assistance. Valuing housing subsidies presents greater problems. Under most housing assistance programs, the government pays a

8. For programs that serve, on average, persons with incomes above the poverty line, such as Medicare, the average cash-equivalent value will exceed the average poverty-budget-share value. Where **beneficiaries'** incomes, on average, fall **below** the poverty line, the opposite will be true.

share of the housing costs for many lower-income renters living in publicly or privately owned projects. Estimating the market value of the subsidy thus requires estimating what each subsidized dwelling would have rented for in the private market. This is a difficult task, particularly in the case of publicly owned projects and in cases where few equivalent unsubsidized housing units exist in the same type of market. Estimating the cash-equivalent or poverty-budget-share value compounds this problem by also requiring estimates of typical housing expenditures **for** unsubsidized tenants. Applying these techniques, the Census Bureau estimates that the average value of housing assistance in **1982** was about **\$1,530** per household under the **market-value** technique, **\$1,140** under the cash-equivalent approach, and **\$1,060** under the **poverty-value** method. 9/

Health Care. Medicare and **Medicaid** are perhaps the most difficult in-kind benefits to value, and the results are especially sensitive to the technique used. In all cases, these **benefits** are valued as an insurance policy rather than as the actual claims paid on behalf of a particular individual. This avoids counting as better off those persons who are ill in a given year and thus have large medical bills paid by the government.

Valuing benefits at their market value could, nonetheless, produce misleading estimates of poverty, because the market value far exceeds what low-income persons would otherwise spend on medical care. For a single

9. The way these estimates are developed means that the value attributed to housing subsidies will vary among regions and types of markets. This results in housing assistance recipients who live in more costly markets being judged better off than their counterparts who reside in places with less expensive **housing--and**, perhaps, with lower prices for other goods and services as well.

person aged 65 or over with cash income below the poverty line, for example, the market value of Medicare and Medicaid together averaged more than \$2,500 in 1982. Because the poverty threshold for such a person was about \$4,600 in that year, using the market-value approach would go far towards defining away poverty for this group. By contrast, Census Bureau estimates of the cash-equivalent and poverty-budget-shares values of Medicare and Medicaid were much lower--about \$460 and \$500, respectively. However, for technical reasons these may be too low. For example, the household expenditure surveys used to develop these estimates are quite old--from a time when the proportion of expenditures going for medical care was much lower. These difficulties in valuation make health benefits the least attractive candidates for inclusion in measures of income.

Implications for the Poverty Thresholds. However they were valued, including noncash benefits other than food stamps as income would necessitate a reconsideration of the poverty thresholds in order to maintain consistency. The consumer expenditure survey that established the poverty level at three times the cost of the minimum adequate diet compared food expenditures to cash income only. Thus, consistency suggests that a new, larger multiplier would have to be developed to reflect the inclusion of all in-kind benefits--including private ones such as employer contributions to health benefit plans and charity health care--in the expanded definition of income.

EFFECTS OF CHANGING THE POVERTY MEASURE

If the Census Bureau altered its procedures for measuring poverty, the count of poor persons would necessarily change, but the impact on federal programs would depend on the specific alteration.

Poverty Counts

Any change in the procedures for measuring poverty would alter estimates of the number of poor, but the **magnitude--and** even the **direction--of** change would depend on the specific revisions made. The Census Bureau estimates that if the value of all major in-kind benefits was included as income, but the poverty thresholds were left unchanged, the poverty rate for **1982** would drop from **15** percent to between 10 percent and about 13 percent, depending on the valuation technique used. If the poverty thresholds were also **changed--or** if other aspects of present procedures such as the treatment of taxes were also **changed--poverty** estimates would decline by a smaller amount, and might even increase.

Program Effects

Changing how poverty is measured could affect the operation of both entitlement programs and grants to states and localities, but impacts would be greatest if the **programs'** enabling legislation were also changed to make use of the amended measure to target aid or set benefit levels.

Entitlement Assistance Programs. Of the major federal entitlement programs, only the Food Stamp program and certain of the child nutrition

programs include statutory references to the poverty guidelines. In both cases, eligibility is limited to persons from households with cash incomes no greater than specific multiples of the Office of Management and Budget poverty guidelines. Thus, even in these programs, including the value of in-kind benefits as income for the purpose of estimating the size of the poverty population would not automatically change the number of persons qualifying for assistance. If, however, the poverty thresholds were also changed, or other modifications were made, the number of **persons--and** thus total program **costs--would be affected.**

If authorizing statutes for the **benefit** programs were also amended to **reflect** changes in the **definition** of poverty, the **effects** on assistance to the poor could be widespread. **If**, for example, the value of one in-kind benefit was counted as income in determining eligibility for other assistance, fewer persons would be eligible and those qualifying would receive less. Any such move, however, would require careful specification of a hierarchy of noncash benefits so that, for example, food stamps were not counted as income in setting housing assistance payments at the same time that housing subsidies were counted in determining food stamp **benefits.** 10/

-
10. Even such a hierarchy would not eliminate all problems. While in-kind benefits have a cash-equivalent value, they cannot be used to purchase other types of goods and services. For example, if the face value of food stamps was considered as income for tenants in federally subsidized housing, their rent payments would be set at 30 percent of the total of cash income plus food stamps, rather than cash alone, as is now the case. However, because tenants would not be allowed to pay their rent with food stamps, a household with very little cash income and, thus, a large food stamp entitlement, might have to apply virtually all of its cash income toward rent, leaving it unable to purchase anything other than shelter and food.

Grants to States and Localities. Federal poverty guidelines are also used to target assistance in programs that provide grants to states and localities to finance specific public services. Here, altering the definition of poverty would not affect program costs, which are controlled through annual appropriations, but might affect who **benefits from** these programs.

In some **cases--such** as Head Start and the Maternal and Child Health Care Services **program--states** and localities are required to target the use of federal funds on poor persons, or on persons with incomes below some multiple of the poverty threshold. In these instances, a change in the procedures for judging whether persons are poor would affect eligibility if it were carried over to program operating rules.

In other **instances--such** as Community Development Block Grants and Urban Development Action **Grants--the** number of poor persons in a city or state is used as one factor in determining whether a jurisdiction is eligible for assistance, or in setting each jurisdiction's share of available funds. In these cases, changing Census poverty estimates could affect the allocation of federal aid but only to the extent that the distribution of poor persons under the new definition differed from the distribution of the poverty population under the present definition. Furthermore, in some cases, reliable state- or city-level estimates of the poverty population under an amended definition would take some time and expense to develop. For

example, if the value of in-kind benefits were counted as income, poverty counts **for** cities would not be available until the next decennial Census, and then only if the Census were greatly expanded to include questions on the reciprocity of in-kind benefits.

CONCLUSION

In conclusion, numerous questions have been raised regarding current procedures for measuring the extent of poverty. In some **cases--such** as the exclusion from income of those federal benefits that are closest to **cash--**immediate changes could be made. In other **cases--such** as where to set poverty thresholds, how to correct the current inconsistent treatment of taxes, and how to treat more **difficult-to-value** in-kind **benefits--additional** research may be called for. In any event, because of the importance of poverty measures, the government may wish to delay any immediate shift in current practices and, instead, consider the entire range of possible changes together as part of a broad reassessment of how to **define** need.