ECO 450G Notes - Spring 2003 Semester – January 28, 2003

Chapter 3 – Labor Force Participation

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I. Income Sources

There are important differences in income sources for families with children compared with families without children. Moreover, among families with children, the patterns of income sources vary for two-parent families and single parent families.

Two Parent Families

Schiller's Table 3.1 – Income Sources for Two Parent Families

	Poor	Non-poor
Earnings	76%	98%
Interest, dividends	18%	75%
Pensions	2%	5%
Social Security	10%	6%
Cash welfare	17%	3%
Food stamps	38%	2%
Public Housing	13%	1%

There are a number of features to take away from the above table.

First, "poor" and "non-poor" are defined over the course of the previous calendar year, and each of the sources means that the family did receive some amount of income from that source over the year. For instance, the first cell says that 76% of poor families received *some* amount of earnings over the previous year; it does not discuss the intensity of work however.

Second, a number of the comparisons are interesting.

Virtually all non-poor families with children have earnings, while a substantial fraction of poor families do not.

Non-poor families receive more income from assets (e.g., stock dividends, etc.). In the text, Schiller claims that "The median American family owns net assets of roughly $100,000." According to a number of sources, including the Census, that number cannot possibly be correct for the entire U.S. population. The U.S. Census Bureau reported that "median household net worth in 1995 was $40,200." See http://www.census.gov/prod/2001pubs/p70-71.pdf , page 5. Among all married households, including the elderly, median net worth was $64,694. Among all female headed households, median net worth was $14,949. In many cases, virtually all of that net worth is in the form of home equity, not liquid assets. Excluding home equity, median net worth would be $11,773 for *all* U.S. households (see page 12 of the Census document).

Additional note: Schiller's $100,000 could not have come from the *CPS*, because the CPS does not report the value of assets (and liabilities).

Pensions and social security are relatively small factors for families with children.

A substantial fraction of poor married households receive food stamps, and a smaller fraction receive cash benefits or public housing. A small fraction of non-poor households (less than 3%) receive these different welfare benefits.

> One question that arises is why do *any* non-poor households receive welfare income? There are several explanations.
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> > First, the income limits for some welfare programs is greater than the poverty line. For example, a household can receive food stamps if their income is under 130% of the poverty line (though their actual food stamp benefit is fairly small). Similarly, public housing income limits are tied to the median income limit within a county, which can be greater than the poverty line (recall the chart on the Pennsylvania family from Lecture 1).
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> > Second, actual welfare eligibility is oftentimes based on *monthly* income, not annual income as in the *Current Population Survey (CPS)*. Suppose that a middle-class married couple was unemployed for several months during the calendar year, so that their monthly income was transitorily low. In that case, the family would be eligible for welfare benefits and may decide to collect it. But once the family becomes employed again, their income goes up and they are ineligible. For some of these families, over the course of the calendar year, the monthly earnings in the months that they were employed would lift the family out of poverty, yet they still collected some benefits.
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> > Third, the *CPS* defines family status as of the March interview date (where the survey-taker asks about the previous year). Family status can

change during the year; suppose, for example, that a female headed household with children got married. When the household was unmarried (for part of the year), they were more likely to be poor and on welfare, but they show up as married (and non-poor) here.

Figure 3.1 shows the relative importance of *SOME* income sources for poor and non-poor married families. The most important fact to take away from the table is that for both groups, earnings comprise the overwhelming majority of income. For poor families, earnings comprise 81% of total annual income, and for non-poor families, 93%. Note, however, that these pie-charts exclude in-kind income such as food stamps and housing; both of these would diminish the importance of earnings, especially for poor households. Nevertheless, earned income is clearly a dominant factor in annual income for married households with children.

Single Parent, Female Headed Families

Schiller's Table 3.2 – Income Sources for Female Headed Families		
	Poor	Non-poor
Earnings	67%	100%
Interest, dividends	11%	48%
Pensions	1%	6%
Social Security	11%	13%
Cash welfare	47%	11%
Food stamps	64%	15%
Public Housing	34%	9%

As can be seen by this second table, there are a number of contrasts between poor married households and poor female-headed households. There are also a number of comparisons between non-poor households.

As with married households, there is a large gap in fraction who report earnings for female headed households who are poor and non-poor.

Both poor and non-poor female heads are less likely to have asset income than their married counterparts.

Both poor and non-poor female heads are substantially more likely to participate in welfare. The same kind of reasons outlined above explain why non-poor female heads may participate in these programs. More than one-third of poor female heads participate in cash welfare, food stamps, and public housing. Many participate in all three.

Figure 3.2 shows the relative importance of *SOME* income sources for poor and non-poor female headed families. Relative to married couples, earnings is a less important income source. Again, if in-kind income was included in these numbers, earnings would be dramatically less important.

II. Labor Force Status

Participation and Poverty

Recall, the <u>definition of labor force participation</u> includes not only all people who are working for pay, but also people who are actively looking for jobs. Hence, both employed persons and unemployed persons are counted as labor force participants. Non-participants are people who are neither working for pay nor actively seeking paid employment.

Figure 3.4 shows that poverty rates doubled in most case in 1998 when the household head did not participate in the labor force for the entire year. Poverty rates went up from 3% to 16% for two-parent families, and from 18% to 53% for female headed families.

Several questions arise from these statistics:

Why are poverty rates so *low* among two-parent families, even with non-participation? For example, poverty rates for married households, regardless of work attachment, seem to lower than for female heads.

The most obvious point to make here is that we look at the *household head* in making these tabulations. The household head is often defined as the person who is responsible for paying the rent or mortgage; when more than one person is responsible, there is no clear rule on which of them is the head. Suppose that the head is the husband, as is often the case. If the wife was working during the year, this may help keep the married household out of poverty.

Why are poverty rates so *high* for female heads, even for those who do participate in the labor force?

Note that labor force participation means working at any time during the previous year. Thus, a temporary, part-time job would count as being “in the labor force,” but the earnings from such a job would probably not move the household out of poverty. Moreover, “in the labor force” includes those who are *unemployed* but seeking work. Obviously they have no earnings when unemployed.

Nonparticipants
In the year 2000, the U.S. population was about 276 million. About half of the population did not participate in the labor force. This group included:

Children
Retired individuals (mostly the elderly)
Full time students over age 16
Institutionalized, disabled, or sick people
Homemakers
Many women with children actually do work, however. Over 70% of women with pre-school children work.
"Other" – they may be "dreamers and drifters"

Unemployment
Those who aren't working but are actively looking for a job are counted as unemployed, but in the labor force. The duration of unemployment is important for poverty. Many unemployed (around 40%) are unemployed for five weeks or less – a relatively short period of time.

III. The Process of Economic Deterioration
People rely on different sources of income during their unemployment spell. Unemployment Insurance (UI) benefits are only available to those who have a history of employment and have been laid off (rather than fired or quit). There is often a short waiting period before you can start collecting. These benefits often replace about one-third of wages, and are often restricted to 26 weeks.

The book notes that 9% of long term unemployed recipients were poor prior to taking up UI, but 19% were poor while on UI and 34% were poor when UI ran out.

It would be *wrong* to infer from the first two numbers, 9% and 19%, that collecting UI causes poverty. Rather, economic circumstances are changing over the course of the unemployment spell – for example, a family may draw down on assets, and the deterioration in these other factors is increasing poverty rates.

IV. Subemployment
In addition to those who are *employed* and *unemployed*, there are other classifications of job behavior.

Discouraged workers - individuals who are not actively seeking work because the prospects of find a job are so bleak. They are classified as being out of the labor force. They cite job market reasons for not looking.

Marginally attached workers - individuals who are not actively seeking work because of personal reasons such as child care.

Underemployed - individual who is at work, but not working to capacity, for example working at a menial job or a part-time job.

Subemployment - the whole grouping of these three concepts – discouraged workers, marginally attached workers, and the underemployed.

V. The Question of Causation

Why to the poor work so little?

Do the Poor Really Try?

The explanations from chapter 1, which related to flawed character, restricted opportunity, and big brother, come into play here. Those who claim restricted opportunity would point to the fact that the stated reasons for being unemployed are legitimate – illness, disability, child care, etc. Those who would claim flawed character would argue that it is more socially acceptable to claim those reasons – illness, disability, etc., than the true unstated reason – laziness or personal choice. Less than 10% of those who spent time outside of the labor force say it was because they “couldn’t find work” – rather other elements that involve personal choice.

Macroeconomic Forces

Economy’s state obviously has effect on work opportunities. During the great depression, unemployment was 25%. In the early 1980s, it reached 10.8%. These forces lead to several issues limiting the opportunities of the poor.

The Hiring Queue – Employers are likely to hire the most-skilled first. This suggests that those with the least skills have an even more difficult time finding a job during a recession when labor demand is low. One implication of the hiring queue is that the average skill of both the employed and unemployed goes up during a recession; employers take a more select group of employees, so the average skills of the employed goes up. Moreover, some good people with skills who used to be employed are now unemployed, raising up the average for the unemployed.

There are four distinctions in unemployment: cyclical (varying with the economy), frictional (time off when moving from one job to another), seasonal (time off as the seasons change, for example in agriculture), and structural (varying with occupations or areas – such as declining industries).

VI. Poverty Impact of Cyclical Unemployment

Unemployment and poverty rates follow similar patterns. Poverty among married households is very responsive to changes in the unemployment rate, while female headed households are less responsive (recall that female heads rely less on earnings than married couples).