ECO 450G Notes - Spring 2003 Semester – February 11, 2003

Chapter 4 – The Working Poor

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I. Work Experience and Poverty

There are obviously a number of poor who are "subemployed" – having either part-time or part-year jobs, which provide insufficient income to lift the family out of poverty. Obviously, moving out of poverty depends on the intensity of work and the wage opportunities.

Weeks of Work and Hours
In principle, one could trace out poverty rates by annual hours of work. The CPS asks questions about the number of weeks employed in the last calendar year, and the usual hours worked per week (when employed).

Unfortunately, annual hours of work in the CPS can only be approximated, because "usual" hours of work per week may refer to the median or mode hours of work (or something else), rather than the mean. For example, suppose that a person worked part-time (20 hours) for slightly more than one-half of the year, and full-time for slightly less than one-half of the year. Then "usual hours" could be 20 hours (the median and mode), 30 hours (the mean), or perhaps 40 hours if the person's most recent job was full-time.

The questionnaire for the 1998 CPS can be found at:
http://www.census.gov/apsd/techdoc/cps/mar98/ques98.pdf

The exact question reads:

> "In the weeks that you worked, how many hours did you usually work per week?" (See Question 41 of the survey).

Obviously, the word "usually" can be interpreted in different ways, and it is not clear how this question accounts for second jobs / temporary jobs.

Schiller's Figure 4.1 shows that poverty rates decline rapidly, for both part-time and full-time workers as they work a greater portion of the year. Poverty rates are lowest for full-time, full-year workers. There are a number of issues with this table:

1) Poverty rates actually increase for part-time workers going from 1-13 weeks of work to 14-26 weeks. It is hard to know what to make of this increase – it may be possible that heads with 1-13 weeks of work are different in some way (e.g., family circumstances) than those with 14-26 weeks. This is purely speculation, however. Notice that at this level, full-time workers also have higher poverty rates than part-time workers. Again, it is not transparent why this should be so.
2) Poverty rates for those with zero weeks of work are not shown.
3) The work behavior is for the head of household, and does not account for family circumstances. Perhaps the most important family circumstance would be between married and single househlds.
4) Part-time is defined as 1-34 hours per week, full-time as 35-plus. Since a substantial fraction of full time jobs are centered at 40 hours per week, it is fairly clear how to translate "full-time" and "employed weeks" into annual hours. On the other hand, there is a great deal more dispersion in "part-time"hours.

The Working Poor
Less than half of the poor household heads (43%) have any work experience during the year. Of those working heads, however, two-thirds have a full time job (35-plus hours per week).

Schiller claims "the presence of so many workers among the poor is a blatant contradiction to the accepted wisdom that 'to get ahead, get a job'." One should note from his pie chart in Figure 4.2, however, that only a small minority (14.2%) of poor household heads have a full-time, full-year job. It could certainly be the case that many of those poor households would exit poverty if they increased their work effort.

How Much Work?
There are different classifications of the "working poor."

Department of Labor definition –	Persons who have devoted 27 weeks or more to working or looking for work and who lived in families with incomes below the official poverty threshold.
Gorham and Harrison definition –	All workers whose annualized earnings are too low to lift a family of four out of poverty.

As Schiller mentions, both definitions have problems.

More Measurement Problems
1) Usual hours per week – A person classified as "full-time" may occasionally experience "part-time" work. Around 10% of full-time, full-year workers actually had at least six weeks of part-time work.
2) Tips, commissions, bonuses – Schiller <u>incorrectly</u> claims that "The annual Census survey inquires about regular wages but neglects tips, commissions, and bonuses. These irregular forms of income may be particularly important for workers with low hourly pay (e.g., salespeople and food servers)."

This is incorrect. See for yourself in the 1998 CPS:
http://www.census.gov/apsd/techdoc/cps/mar98/ques98.pdf
Question 48a3, and 48aad *explicitly* discuss this. "How much did you earn in tips, bonuses, overtime pay or commissions from this employer in 1997?"

3) Self-employed heads – nearly 800,000 poor working heads (out of 5,400,000 poor working heads) classify themselves as self-employed. Computing the well-being of the self-employed is difficult for a number of reasons:

First, there is more potential to under-report income. Not all income receipts are easily audited by the Internal Revenue Service, for example.

Second, the self-employed may own assets of considerable value – e.g. a farm or business capital. The reason why assets matter is because the self-employed may have considerable discretion to reclassify "salary income" into "business capital." Consider a female head who runs a child-care center out of her home and either (a) renovates some of the rooms in her home and calls it a business expense, or (b) pays herself a salary, and then uses the salary to renovate the rooms. In either situation, she is fundamentally in the same economic situation, but in one case she would have much higher income than in the other.

Secondary Workers
Most individuals live in families, and families may supply more than one worker to the labor market. Figure 4.3 illustrates that a secondary worker is often decisive in keeping a family out of poverty. In two-parent families with children, the poverty rate is 59% when there are no workers, 17.5% with one worker, and 2.8% with two workers.

A number of issues come up here, as well. First, the classification of workers again does not tell us much about intensity of work – presumably the poverty rates are lowest when the workers are full-time, full-year. Second, the question arises on why so *few* families with zero workers (presumably over the course of the entire year) are not in poverty?

Schiller cites a study by Levitan that computed that "50 to 70 percent *more* two earners families would be in poverty without the earnings of the secondary worker." There are several things to note about that – the poverty rate would still be extremely low, because the base of 2.8% is very low – an increase in 50% would lead to a poverty rate of about 2.8%+1.4%, or 4.2%. In addition, these calculations almost surely assume no behavioral response – e.g., that if the secondary earner left her job, that the primary earner would not increase his labor supply. This kind of criticism is the same as the "latent poverty" criticisms from earlier chapters.

II. Searching for explanations

Why are full-time full-year workers poor? Schiller makes several points. Obviously earnings is equal to wages multiplied by hours, or wH. If H is high, then w must be low. He also mentions that

"it might also be the case that the poor simply have above-average needs, due to either larger families or special expenses, for example, medical bills."

We have learned that larger families will result in a higher poverty threshold, so that part of the statement is correct. Other 'special expenses', however, do not enter the poverty line. The poverty line simply measures income flows against a dollar threshold, adjusted for family size and inflation.

III. Minimum Wage Jobs

The nominal federal minimum wage has increased over time, from $0.25 in 1938 to $5.15 in 1997. It is not indexed to inflation, and only increases when there is political agreement on doing so. Note that a number of states have, by their own choice, imposed minimum wages higher than the federally mandated minimum wage.

> See http://www.dol.gov/esa/minwage/america.htm for state-by-state variation. Kentucky's minimum wage is the federal one of $5.15. The state of Washington currently has the highest minimum wage of $7.01 per hour.

Living wages – a number of cities / localities have imposed minimum wages on some subset of workers (oftentimes, those employed by a company that is dealing with the local government). The proposed wage rates are oftentimes around $10 per hour. See http://www.epionline.org/livingwage/index.cfm for an overview. The highest living wage is currently in Santa Monica, California, with a rate of $14.25 per hour for employees without benefits. See http://www.epionline.org/livingwage/santa_monica.cfm for more details.

As Schiller notes, a full-time, full-year job of 2,000 annual hours would result in income of $10,300 which is slightly below the threshold for a two-person family (but ignores a rather large potential EITC refund).

Figure 4.4 shows that the real value (accounting for inflation) of the minimum wage has generally eroded over time.

There are a number of issues to take away concerning minimum wages and poverty:

1) Many people who earn the minimum wage are not in poor families – for example, many teenagers and secondary workers. Only 20% of minimum wage workers are in poor families.
2) Wages often increase rapidly for those who start off at the minimum wage – these jobs are "stepping stones" to higher wage jobs.
3) Raising the minimum wage potentially has employment effects if the minimum wage is above the market-clearing wage. This is a source of great discussion in the economic literature – with different studies coming to dramatically different conclusions on the extent of the disemployment effects.
    - Card and Kruger find, in an influencial 1994 article in *American Economic Review*, that raising the minimum wage in New Jersey did not have disemployment effects (using Pennsylvania as a control).
    - Neumark and Wascher, in a comment, argue that there are disemployment

effects when better data is used to measure hiring.

IV. Low Wages

One wage earner in a family of four would need an $8/hour job to escape poverty. Table 4.3 in the text shows annual earnings of the head of poor families. Note that a surprisingly high number of full-time, full-year heads (12.7%) report earnings of less than $2,000, translating into an hourly wage rate of about $1/hour. These clearly suggest that there is measurement error in either earnings or annual hours. Moreover, if we divide earnings by full-time, full-year hours of work, about 41.1% of poor heads are apparently earning less than the minimum wage. This seems implausibly high.

Table 4.4 shows the distribution of wage rates by age groups; nearly 25 million workers were paid less than $8/hour. Among low earners, many were able to escape poverty however. The most common way that low earners escaped poverty is by having a small family size, and other common ways included having other workers in the family, unearned income, and welfare benefits.

Poor Jobs

The reported occupations of poor heads of household are concentrated in a number of areas – the most common of which are "Other service workers," "Craftspeople and precision production," "Salesworkers," and "Clerical workers."

V. Why are Wages so Low?

Economics would suggest that wage rates are determined by *supply* and *demand*. There is ample supply of workers for unskilled jobs, hence wages remain low.

Schiller argues that the demand side of the market is neglected in antipoverty discussions, and by doing so ignores tremendous potential for eliminating poverty. He says that "the distribution of wages and incomes is partly a reflection of collective social decisions regarding the merits of particular kinds of output. ... Had we decided instead to dredge more rivers, to build more houses, or to clear up our cities, the extent and nature of poverty might now be marked different."

Again, Schiller's analysis assumes no behavioral responses. If unskilled occupations paid more, one could reasonably expect that skilled individuals would shift into them. For example, child-care workers and social workers are often paid very little – yet might be rewarding in a number of ways. One might expect that more skilled individuals would shift into occupations like those if they were more handsomely rewarded.

VI. Summary

Many people are poor despite relatively high attachments to the labor force – regardless of the measurement issues.

VII. Does Prosperity Trickle Down

Do the poor benefit from general economic growth or do they live in an isolated subeconomy?

The trickle down perspective

Asserts that people at the bottom of the economic hierarchy benefit from increased prosperity as higher income levels, because of multiplier effects.

The dual labor market perspective

Asserts that a variety of barriers, such as discrimination (either overt or in a statistical sense) or unions reduce the benefits from growth at the top of the income distribution.