

Why Is There so Much Poverty?

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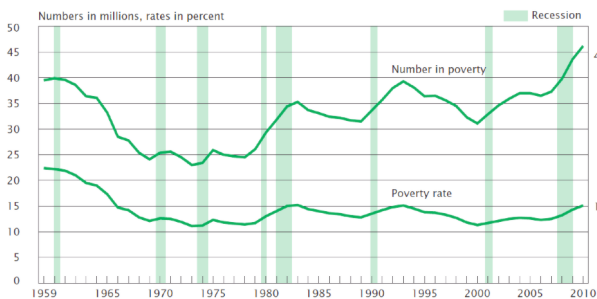
THE UNITED STATES, ONE OF THE RICHEST countries in the world, has a problem with poverty. There's just too much of it.

The latest statistics show that 49 million Americans are in poverty and another 90 million are in "near-poverty" (i.e., have incomes less than twice the poverty line).¹ These two groups, which together account for 48 percent of all Americans, would form a country with a population ranked the tenth largest in the world. Although many Americans assume that poverty is mainly found elsewhere, in fact the

poverty in some parts of the United States is as dire and concentrated as it gets.

We have long been a high-poverty country. As shown in Figure 1, the official poverty measure dropped to a historic low of 11.1 percent in 1973, but that level was never again achieved over the course of the following four decades. The recent recession, like most prior ones, has caused a surge in poverty. The official poverty measure now stands at 15.1 per-

Figure 1. Trends in the size of the official poverty population and in the official poverty rate



Note: The data points are placed at the midpoints of the respective years.

Source: U.S. Census Bureau, Current Population Survey, 1960 to 2011 Annual Social and Economic Supplements

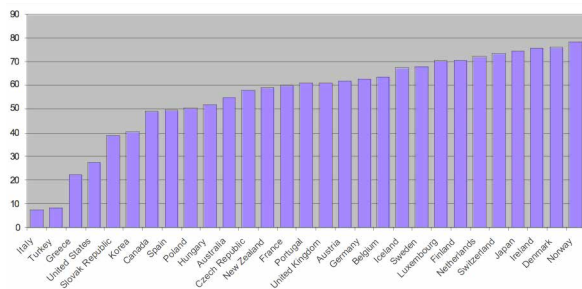
cent, the highest level in the last half century, and most scholars expect that poverty will remain high for many more years.

Why are high poverty rates such an entrenched feature of U.S. life? The standard argument here is that our high poverty rate is an unfortunate byproduct of running a competitive and deregulated economy. If we really want less poverty, so the argument goes, we have no choice but to opt for European-style market regulations that have the unfortunate side effect of strangling productivity and reducing output. The standard-issue economist thus intones that Europeans pay dearly for their comparatively low poverty rate by settling for a much reduced gross national product (GNP). Under the American formula, by contrast, we opt for a highly competitive and regulation-free economy, with the happy result that there are more goods and services for everyone. To be sure, the cost of this choice is a high poverty rate, but in principle we could choose to spend some part of our large national product on a better safety

net for the poor.

The foregoing story, however frequently repeated, is wildly off the mark. What's wrong with it? The first point that should be made is that, even though we could choose to use our relatively large GNP to build a strong safety net, we haven't opted to do so. As is well known, the United States has a distinctively anemic safety net: We rank a stunning 26th among the 29 richest countries in the amount of income support provided to those who have lost their jobs

Figure 2. Net income replacement in the first five years after job loss among OECD countries (i.e., net benefits/net earnings in employment)



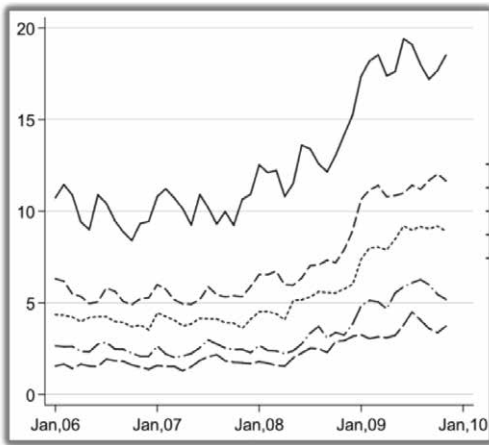
Source: OECD, *Benefits and Wages 2007*. Paris: OECD, 2009.

(see Figure 2). Because our safety net is so underdeveloped, some commentators have suggested that the best way to take on U.S. poverty is to build a better safety net, a prescription that takes for granted the high rates of poverty generated by our economy and accordingly focuses our reform efforts on after-market remediation.

We should indeed build a better safety net. But we shouldn't also rule out reforming the labor market institutions that are overwhelming our safety net with so much poverty in the first place. The main reason why labor market reforms tend not to be on the table is, as we've noted, the widely-shared presumption that the U.S. economy is finely-tuned for competition and efficiency. The obvious corollary of this presumption is that any tinkering with the labor market (e.g., increasing the minimum wage) would introduce inefficiencies, reduce total output, and thus make it even more difficult to afford an enlarged safety net.

This brings us to our second point that our mar-

Figure 3. Unemployment rates by educational qualifications



Source: Hout, Michael, Asaf Levanon, and Erin Cumberworth. 2011. The Great Recession, edited by David B. Grusky, Bruce Western, Christopher Winter. New York: Russell Sage Foundation.

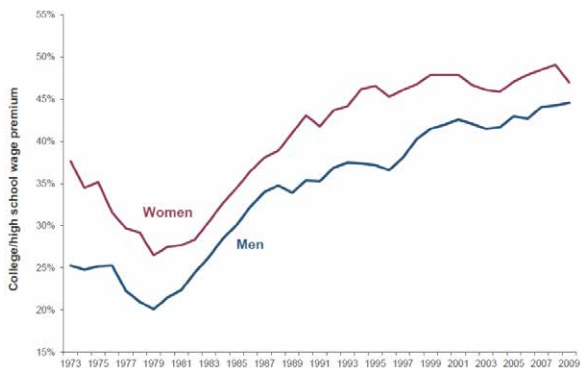
ket institutions, far from being efficient, are instead riddled with bottlenecks that are both inefficient and poverty-generating. The real reason, in other words, why we have so much poverty is that we're running an uncompetitive economy that protects the rich from competition and prevents the poor from competing.

This is a strong claim but we can offer some sup-

port for it. The high unemployment and low wages among poorly-educated workers arises in part because there are just too many of them chasing after the few jobs for which they're qualified. In effect, there's a vast reserve army of poorly educated labor, with the result that unemployment among such labor is extremely high and wages extremely low. As shown in Figure 3, about eighteen percent of the least-educated workers are now unemployed, whereas only five percent of those who are college-educated are unemployed. The returns to a college education are also increasing and imply an ever-worsening market situation for the less-educated (see Figure 4). Although recent college graduates can't always find good jobs, the scholars trumpeting the travails of the college educated haven't appreciated that the recession has hit less-educated workers yet harder; and hence the advantage of college graduates relative to the less-educated remains substantial and is growing.

The latter results are suggestive of uncompetitive practices. If our economy were truly competitive,

Figure 4. Trends in the wage benefits to completing college rather than high school



Source: Economic Policy Institute, Current Population Survey, Outgoing Rotations.

labor would freely flow to where returns are highest, and growing cross-sector disparities in earnings would induce workers to secure the requisite education. This hasn't happened.

Why haven't the ranks of the reserve army been thinned out as less-educated workers react to their increasingly difficult labor market situation? Although there are many reasons for this puzzling behavior, an especially important one is that two types of bottle-

necks are preventing workers from behaving as they would in a truly competitive market. The supply of potential college students is artificially lowered because children born into disadvantaged families are poorly prepared for college and, in any event, lack the money to afford it. The supply of college graduates is also kept artificially low because the best private universities ration their available slots and the best public universities haven't any funds to expand. Is Stanford University, for example, meeting the rising interest in its degrees by selling some profit-maximizing number of them? Have top public institutions stepped into the breach and increased the number of available slots? The evidence indicates very clearly that they haven't.

This is not how a competitive market works. When the demand for hybrid cars, for example, increased dramatically in the U.S., car manufacturers didn't set up "admissions committees" charged with evaluating the qualifications of prospective buyers. Instead, they ramped up production to a

profit-maximizing level, and the shortage-driven uptick in prices soon corrected itself. There's no such self-correcting feature built into our education system. Instead, college degrees are carefully meted out, and the returns to a college degree have accordingly remained artificially high. We have become so accommodated to the high prices for college-educated labor that we don't appreciate the rationing that underlie them.

This failure in the education market generates failure in the labor market by bloating the ranks of the poorly-educated class. If overcrowding at the bottom of the labor market were eased by making education more widely available, the market situation of workers would improve because (a) those who secured college degrees would earn more as a result, and (b) those who didn't take advantage of their new-found educational opportunities would still benefit because some of their former competitors have now been siphoned off. The best way to raise wages for the working poor is to trim the size of the reserve

army and thereby limit the number of competitors chasing after the shrinking supply of low-skill jobs.

The two main alternatives to labor market reform are (a) protectionist policies designed to increase the number of manufacturing jobs in the U.S., and (b) a ramped-up safety net that delivers more benefits to unemployed or poor workers. The main disadvantage of both approaches is that they don't resonate well with our core commitments to a competitive and pro-work economy. Because of these commitments, many in the U.S. are deeply suspicious of protectionist policies, and most are opposed to a European-style safety net that provides substantial benefits to those who aren't working for pay. The simple implication: By addressing poverty with protectionism or redistribution, we could indeed prop up the bottom of the distribution, but with all the angst and opposition that such policies evoke in a pro-market society. In times of crisis, protectionist or Europeanist policies may sometimes be muscled through, but support for them will ultimately

weaken as the economy rebounds, cries for “less regulation” intensify, and our core values reassert themselves. This dynamic was revealed, for example, in the widespread opposition to the most recent stimulus package (i.e., the American Recovery and Reinvestment Act of 2009) despite ample evidence that it successfully reduced poverty.

Does this mean that we’re consigned to running a high-poverty regime in the United States? Not at all. We’ve argued here that there’s a third road available that allows us to fight poverty successfully within the context of our core commitments. It’s hardly un-American to suggest that all children, rich and poor alike, should be provided a high-quality primary and secondary education that allows them to go to college and to pursue the high returns that college affords.

If the reform that we’re advocating is straightforwardly consistent with our core values and commitments, it’s nonetheless radical in the sense that it requires taking those commitments seriously. It will not suffice to continue on with the usual half-hearted

reform efforts. We need a radical overhaul of our education system to provide the same opportunities to all children and to provide enough higher-education slots to meet the additional demand that equalizing reform would generate.

In the education reform industry, most initiatives are promoted on the basis of their effects on “school quality,” and any effects on equalizing opportunity are treated as a convenient side benefit. That is a betrayal of our core values. We should instead make the issue of equalizing opportunity central to all discussions of educational policy. This should be our main goal in just the same way that equalizing civil rights was in the 1960s and 1970s.

If we were to commit to this objective, as many other countries have, we could readily choose from a wide range of reforms in implementing it. We could choose to allocate opportunities via lottery rather than money (as South Korea has); we could choose to equalize early childhood training; we could choose to equalize the quality of primary and secondary

training; or we could choose to commit seriously to eliminating financial barriers to access. This is not the place to debate which of these reforms is optimizing. There are many ways to skin the cat, and what matters for our argument is only that the cat be skinned. The main problem is not that we don't know how to secure equal opportunity. We've just given up on it and opted instead for a lip-service commitment to one of the core values of our country.

The Occupy narrative, which has recently emphasized just such issues of educational access, is quite consistent with the logic of institutional reform laid out here. It has been disheartening to watch commentators, even sympathetic ones, try to shoehorn the Occupy protests into some radical anti-American agenda. If there's anything at all radical about those protests, it's simply that core American values of fair competition and equal opportunity have finally been taken seriously.