1969

Policy and Poverty, Part 1

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pp 17-27
to Kalachek

First Draft
Not for quotation
or imputation

Policy and Poverty

by

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1. Introduction

In a rich country, poverty is a matter of income distribution. This is true whether one measures poverty in an absolute or a relative sense. Poverty in the sense of relative deprivation is a matter of the shape of the distribution of income: no matter how high the absolute income, those with incomes much below the average are adjudged poor. Thus in a rich country public policy aimed to eradicate poverty can take the form of programs designed to truncate the lower tail of the distribution of income so that very few are far below some average, an average which for countries afflicted with relative poverty is acknowledged to yield an adequate level of living.

Before we proceed it is best to make precise the definition of income that seems to be appropriate for a discussion of relative deprivation poverty. Almost all of those classed as poor in a rich country enjoy a private disposable income (earned income minus direct taxes plus transfer payments) sufficient to maintain life at a standard far above that which all but a tiny minority achieve in countries such as India and Pakistan where absolute poverty is the lot of almost all. Part of the poverty problem in the United States centers around the social and personal reaction to how income is received. The welfare recipient can be

poor, even if welfare standards are adequate, if cash income derived from welfare is personally and socially demeaning. Thus social dividend or negative income tax proposals which seemingly remove such stigmas have a receptive audience.

It follows that poverty in the United States relates to the subjective evaluation of well being, what economists have called utility, as much as to the size distribution of conventionally defined income. The relevant income for the study of poverty would measure the total satisfaction, adjusted for purely personal events, that a household gets from both privately procured and publicly provided goods and services. Note that a job in and of itself may be an ingredient in income thought of in this manner.

Such a satisfaction income concept can also encompass a horizon that extends over several generations, so that economic opportunity, in the sense of an expected higher income and status for children, becomes a part of present income. In an open society if the typical horizon is long, the relevant income of the current ambitious and confident poor can be substantially higher than their measured income.

This satisfaction income concept, like utility, cannot be measured directly. A proxy for this income concept might be some measure of the view of the purely relative poor about the fairness or equity of the economy. Thus the existence of a concensus about equity joins efficiency, growth, and stability as a criterion for

judging an economy [1] and as a goal of public policy.

Relative deprivation poverty in contrast to absolute poverty is truly a many-faceted beast. A thorough study of such poverty as a public policy problem primarily dealing with the distribution of income involves measuring the differential social impacts of various measures that could be taken to affect the distribution of measured income. This is beyond my competence, and I believe beyond the present state of the arts in the relevant social disciplines. Thus, even though the social impact of policies designed to affect the distribution of income may be more significant in determining views about dimensions such as equity than changes in the distribution of private disposable income plus public goods, the emphasis in this paper will be with measures that could be undertaken in order to achieve a more equal distribution of private disposable income as well as to increase the publically supplied goods.

In designing public policies to affect income ditribution it is necessary to keep in mind that "There are some economic forces so powerful that they constantly break through all barriers errected for their suppression." [2] However, economics after Keynes is not a dismal science. To a modern economist the constraining powerful economic forces do not so restrict what can be so that what exists

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1/ Tibor Scitovsky

2/ William J. Baumal "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis" A.E.R. June 1967 pp. 414-426

must be accepted as inevitable. But as Baumal reminds us, the possibility of policy does not mean that a "good" idea will necessarily achieve a desired goal.

Economic forces can frustrate programs if either the policy objective is inconsistent with such forces or if the program is so poorly conceived that it quite unneccesarily runs afoul of a barrier, even though the objective is, in principle, attainable. Thus an essential step in designing programs is to determine whether forces exist which would make a program ineffective, and whether a particular policy goal is in fact impossible to achieve--perhaps given some set of non-negotiable institutional characteristics--or whether the difficulty arises because the policy instruments that are being proposed are not efficient. Such analysis should make it possible to select programs that get around barriers that are due to the policy instruments used and abort attempts to achieve impossible goals. In addition, if a "non-negotiable" institutional constraint is an effective barrier to the achievement of a policy goal, the radical question of the value of such institutions needs to be faced.

This paper will take up some economic forces that can frustrate programs to end or alleviate poverty. However, to the extent that inflation, for example, is a result of policies designed to eliminate poverty, the political response to inflation and whether or not inflation is equitable as among classes becomes important. Thus what is attempted here can be extended by investigating the social,

cultural, and political forces that also cannot be suppressed excepting perhaps at a large cost.

In this paper I will first sketch a feasible program of radical changes in the distribution of income by biasing the distribution of the increments to income and then examine a number of barriers which must be taken into account in designing policies to eliminate poverty or redistribute income in the United States. This will be followed by some suggestions for a policy strategy which hopefully gets around the listed barriers. The barriers which will be taken up deal with

1) The Macroeconomics of the Negative Income Tax
2) The Limitations upon Economic Growth,
3) The Stability of Relative Wages, and
4) The Feedbacks from Sustained Full Employment.

I doubt if my list is exhaustive.

The major conclusion of the paper is that an effective program of income equalization or poverty elimination will need to be linked to the production of output, which can take the form of public goods. Instead of transfers by taxation which won't work a program of expansion of public employment and public sector output might do the job. One reason is that potentially the poor could receive a large portion of their income in public goods, the second reason is that such a program could add many of the present poor to the public payrolls. It is necessary in designing such a program that the well off,who are, so to say, being discriminated against, receive recognizable benefits from the income equalization program.

One obvious barrier to the elimination of poverty that will not be discussed is due to the existence of a military establishment whose fun and games absorb some 10% of the Gross National Product. This is an especially relevant barrier to the elimination of poverty, for income used here includes the perceived benefits from the output of the public sectors. We can assume that for many Americans the perceived benefits from foreign adventures, military procurement and space spectaculars are less, per dollar of expenditure, than from private procurement and public goods such as schools, parks and safety on the streets. This barrier will not be discussed in detail because I assume, perhaps heroically, that it does not reflect powerful forces inherent in the American enterprise economy. No matter how powerful the military-industrial-research institute complex may be, they are not, I hope, an essential characteristic of American Capitalism.

Underlying this paper is the view that good intentions, bright slogans and cadres of happy warriors are not enough. Programs must be consistent with the nature of the beast; the behavior rules of the economy determine whether programs can possibly have the intended effect. Policy programs not designed to avoid or not powerful enough to overcome such economic barriers will clearly be counterproductive. Hopes raised then dashed are a clear danger to

the fabric of society. Every policy failure becomes evidence to those who do not accept the policy goal that in fact it is impossible of realization. The capabilities of our economy to generate a viable and desirable social order have not been tested, and they will not be tested unless the implications of programs designed to achieve policy goals are thought through before they are implemented.

11 The Arithmetic of Radical Income Equalization

During the Great Depression Huey Long articulated radical income equalization ideals with his slogans "Share the Wealth" and "Every man a King". The call to share what in principal already existed, reflected the stagnationist view of the economy which for obvious reasons was then dominant. In an optimistic era such as the recent past, when the arithmetic of compound interest inspired the prevalent view of normal functioning of the economic income equalization or the elimination of poverty could be visualized as being achieved by biasing, in favor of the poor, the distribution of the increments of income due to economic growth.

In the 1969 Economic Report of the President, the Council of Economic Advisors wrote that "Only a small redistribution of the benefits of growth is needed to speed greatly the reduction in poverty....If the increase in real income for the non-poor is lowered merely from 3 percent to $2\frac{1}{2}$ percent a year and if that differential of about $2.8 billion annually is effectively transferred to those in poverty, then family incomes for those now

poor can grow about 12 percent annually. This redistribution would eliminate the 1967 poverty gap of $9.7 billion in less than four years. Since any program of redistribution would be likely to reach some of the near-poor and might raise some poor families substantially above the property line before others are affected, perhaps a better projection of the time required would be 6 to 8 years." 1/

There is no doubt that the modest result envisaged by the Council is arithmetically feasible. The body of this section consists of an arithmetic example of what is involved in biasing the distribution of the growth in income so as to achieve income equalization or the elimination of official poverty within a designated period. The possible variations in programs with the broad objectives of income redistribution are infinite. Two principles underlie the program presented. These are that the portion of the population being discriminated against (the better off) should nevertheless enjoy some improvement in their life standard during each period, and that the period during which the distribution of the benefits from growth are biased toward the poor should be rather short. In addition to these principles, it is necessary to decide for exactly how long the program should be in effect, the target group and the distributive objective of the income equalization program before

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1/ Economic Report of the President, January 1969, p. 160

a specific program can be spelled out. The period chosen for the example is a decade, and the target is a radical equalization program designed to place a large proportion of the total population close to the present days median income, adjusted for economic growth over the decade.

The radical income equalization objective turns out to be almost inconsistent with the principle that the well off should continue to benefit at an appreciable rate throughout the program. It is shown that the sacrifice of growth of income by the well off increases as time elapses; this would be true of a more modest program as well.

However, the difficulties with any radical income equalization program lie in the economics, not in the arithmetic. Assuming the validity of the projected growth in income and population, many different feasible programs can be constructed. The deep question is whether there exists any economic mechanism by which the arithmetically possible goals can be achieved.

In the optimistic mid-sixties fiscal-dividend was a popular phrase. It referred to the rise in government receipts that would accompany a growth in income with tax schedules unchanged. The fiscal dividend was supposed to make both a rise in government spending and a lowering of the tax schedule possible. For example a rather generous children's allowance of some $25 a month for all children through fourteen years of age would cost in the neighborhood of two years' fiscal dividend. Thus in a growthman's world

it is only necessary for a transfer scheme to cost less than the growth in the government's tax take with fixed schedules for it to involve no rise and even to allow for a reduction in tax schedules. If a transfer scheme involves transfers in excess of the increment of the tax take with a fixed schedule but less than the rise in income, then even though the tax schedule would have to be raised, it would still be possible for all to enjoy a rise in income. Only if a transfer scheme involves transfers greater than the rise in income would it necessarily require a decline in income for some.

In the above paragraphs the technique for achieving radical income equalization is identified with some unspecified transfer scheme. These could take the form of a negative income tax, wage supplements or some set of specific programs such as child allowances and old age pensions. Transfer payments need not carry the entire burden of income equalization if sharp changes in relative incomes from work can be affected or if public employment is undertaken.

Income is defined here as personal income. Thus the income concept is narrower than that which was deemed most appropriate for the study of poverty which is disposable income plus income in kind from public goods.

Rainwater has called for a nation of average men. This is interpreted here as the existence of an income distribution in which approximately 50% of the family units are in a narrow lowest income class, with the incomes of the other 50% of the population distributed

as in the upper tail of the present income distribution. In Rainwater's idea this narrow lowest class is to be centered around the present median income.

In 1966 the median income was about $7,400., i.e., it was in the $7,000-7,999 income class. The income equalization target that was selected for the arithmetic exercise was to bring all incomes below the median class up to an $8,000 level in 1976, and to allow all incomes in the median income class and above to increase at a growth rate inconsistent with this income equalization objective and the postulated rate of growth in aggregate income.

Table 1

Distribution of Income Families 1966

Total Money Income	% of Families per Interval	% of Families Cumulative	% of Family Income per Interval	% of Family Income Cumulative	Annual growth rate necessary to achieve objectives indicated
Under - 1000	2.3	2.3	.14	.14	32.0
1000 - 1499	2.3	4.6	.34	.48	20.4
1500 - 1999	3.1	7.7	.64	1.12	16.4
2000 - 2499	3.4	11.1	.91	2.03	13.5
2500 - 2999	3.2	14.3	1.04	3.07	11.3
3000 - 3499	3.5	17.8	1.35	4.42	9.4
3500 - 3999	3.3	21.1	1.47	5.89	7.9
4000 - 4999	7.1	28.2	3.78	9.67	5.9
5000 - 5999	8.4	36.6	5.47	15.14	3.8
6000 - 6999	9.47	46.0	7.10	22.34	2.1
7000 - 7999	9.3	55.3	8.25	30.59	*
8000 - 8999	8.1	63.4	8.15	38.74	*
9000 - 9999	7.0	70.4	7.88	46.62	*
10,000 - 11,999	11.2	81.6	14.59	61.21	*
12,000 - 14,999	9.2	90.8	14.71	75.92	*
15,000 - 24,999	7.5	98.3	16.87	92.79	*
over - 25,000	1.7	100.0	7.22	100.0	*

* See Table 2

Table II

Hypothetical Income Equalization Program

	Percent Rate of Growth of Per Capita Income in "Upper Income Groups"	Growth of Family Income Since 1966 (Billions)		Cost of Redistribution		Percent Cost of Redistribution/ Growth of Family Income	
		During year	Total	Total	Increment during year	Total since 1966	Increment d year
1967	1.89	16.52	16.52	2.96	2.96	17.9	17.9
1968	1.79	17.19	33.71	6.45	3.49		
1969	1.69	17.87	51.58	10.53	4.08		
1970	1.57	18.58	70.16	15.31	4.78	TO BE COMPUTED	
1971	1.43	19.34	89.50	20.92	5.61		
1972	1.26	20.11	109.61	27.52	6.60		
1973	1.06	20.90	130.51	35.27	7.75		
1974	0.82	21.75	152.26	44.41	9.14		
1975	0.54	22.61	174.87	55.20	10.79		
1976	0.19	23.52	198.39	68.00	12.80	34.2	54.4

The arithmetic example assumes a 4% growth rate of real GNP and a 1.25% growth rate of population. Thus a 2.75% growth rate in per capital income was assumed. On the basis of the most recent observations the growth rate assumed for real GNP may be a bit small, and the growth rate assumed for population may be somewhat high. If this is so then, as the income to be redistributed is fixed in per capita terms by the redistribution goals, the income available for increasing the real per capita income of the upper income groups will be greater than assumed. Thus the virtual stagnation of the above median per capita income toward the end of the program decade will not be necessary.*

For every income class below the $7,000 level, the ratio of $8,000 to the midpoint of the income class was calculated. From this the rate of growth which if compounded over a decade would transform the class midpoint income into the target income can be determined. Thus $8,000 ÷ $2,250 = 3.56 and a 13.5% annual rate of growth of real income will transform the income of the midpoint of this income class into $8,000. (See Table 1 for the required growth rates for all income classes.)

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* If real GNP grows at 4.5% and population at 1% then per capita income would grow at 3.5%. As the amount needed for redistribution will decrease due to the smaller population and as the growth in total GNP has increased, the amount available in each year to make the well off better off increases.

The burden of such an income equalization program increases with time. In the first year of such a program some $2.96 billion would be redistributed; this is but 17.9% of the $16.52 billion rise in income during the year. In the 10th year (1976 in the example) family income will have grown by $198.4 billion but in this the final year of the program the total cost of redistribution will be $68.0 billion, 34.2% of the decade's increase in income will have gone into the redistribution pot. As a result of this increased burden of the redistribution program, the rate of growth of per capita income of the upper income group decreases from 1.89% in the first year to 0.19% in the 10th year.

It seems obvious that the program detailed here, though arithmetically feasible, might be politically unpalatable. A redistribution program must yield "benefits" to all, and a rise in per capita income of the just above middle groups by 0.19% while rapid advances of the impoverished are taking place seems politically indigestible. It also seems obvious that there is not enough income in one half of 1% of income, the redistribution postulated by the President's Council, to affect a radical equalization of income in a finite time; the ratio of the increment in redistribution to the increment of income growth is 54.4% in the 10th year. This means that some 2.1% of the overall income in the terminal year would have to be distributed via some scheme from the upper income to the lower income groups.

A more modest target or one stretched over more years will be arithmetically feasible and might also be more attractive politically. Thus if the original program is sustained for 7 years the upper income groups would still be enjoying in excess of 1% increase in per capita income in the terminal year. Over the 7 year time interval, the bottom $500 group would have risen to about $3,000 and the group with a midpoint of $1,250 per year would have risen to about $4,560. The $4,500 midpoint class income would have risen by some 31% to about $6,000. That is the radical program might be adopted for a shorter time, leaving the final approach to the Rainwater goal for a longer stretch of time.

It is a characteristic of the algebra of geometric processes of redistribution that the burden of the program grows and is greatest in its final stages. Thus growing political objections to redistribution programs can be expected as they progress unless the programs of redistribution simultaneously yield benefits perhaps in kind to the already well off. A transfer by taxation scheme (negative income taxes) might not be politically acceptable even for a modest goal whereas a work program with the same income equalization results, that yields perceived benefits to the upper income groups might be acceptable. A program for radical income equalization cannot be accepted as the basis for action just because the arithmetic checks out.