

A New Understanding of Poverty

SUMMARY

- The impression we obtain about the prevalence of poverty, its time trend, its risk factors and remedies, depends largely on how we define and measure poverty. The choice of a poverty measure is not merely a technical detail; it sets terms of debate and shapes policy.
- The most widely used poverty measures today are ‘relative poverty’ measures. These do not measure physical deprivation, but lack of income relative to others. Using these measures, the living standards of all people in a society may rise while measured poverty may increase!
- The use of relative benchmarks has been taken further in recent publications such as *The Spirit Level*, which assert that all material consumption beyond a minimum level is completely useless in itself, serving no purpose other than to signal social status. But the way in which these authors draw on the literature on ‘subjective well-being’ is extremely selective.
- Evidence suggests that the income level that people need in order to participate in a given society in a dignified manner is affected by the incomes of others. However, the relevant reference groups are not simply the inhabitants of the national territory. Reference groups typically consist of people with similar socioeconomic characteristics. The income the

poor need to participate in society in a dignified way will also depend on a number of other factors (such as changing technology and the prices of particular goods and services).

- All income-based poverty measures are flawed in various ways. These flaws arise from, amongst other sources, benefit under-reporting, temporary income fluctuations, differences in access to benefits in kind, and regional price differences. Expenditure data lead to quite a different story about the development of poverty in recent decades.
- Most current poverty measures, whether relative or absolute, unduly direct the policy focus on the nominal incomes of those at the lower end of the income distribution. They divert policy attention away from much simpler and cheaper policy options of poverty amelioration, such as relaxing supply-side constraints in key product markets.
- People widely disagree when asked, in abstract terms, what constitutes poverty. But when asked, more tangibly, what is truly necessary to lead a decent life, there is a more robust consensus. A poverty measure should be based on the ability to purchase goods and services that it is widely believed are necessary to lead a decent life. This would automatically incorporate information about relevant developments in product markets.
- Flawed poverty measures lead to serious policy failures in the arena of tax and benefit reform.
- A realistic poverty measure would point to policy solutions such as the reform of the tax and benefit system to include benefit simplification; the removal of penalties on family formation; low benefit withdrawal rates; and a full-time work requirement for in-work benefits.

- The single most important reforms would be supply-side reforms such as the thorough liberalisation of the land-use planning system. This would enable greater labour mobility and a lower cost of housing. Supply-side reforms would improve the material conditions of the least well-off, not only directly but through many different channels.