Poverty amidst affluence?

EDITORIAL: POVERTY AMIDST AFFLUENCE?

John Meadowcroft

The countries of Central and Western Europe, North America, Australasia and most of East Asia are today the wealthiest societies that the world has ever known; those of us fortunate enough to live in these countries enjoy a standard of living unprecedented in human history and can reasonably expect that our children and grandchildren will enjoy even greater prosperity. The benefits of this prosperity are not only material in a narrow sense, but also include access to an unprecedented quality and quantity of healthcare, education, leisure time and travel opportunities. It is true, to paraphrase Harold Macmillan, that we have never had it so good.[1]

Yet there are legitimate concerns that the full benefits of this affluence are not shared by all members of these wealthy societies. There are anxieties that, within this sea of prosperity, islands of poverty endure. Indeed, much social policy throughout the developed world is driven by these concerns and the concomitant desire to help those deemed to be ‘excluded’ from affluence.

These concerns are not new to the IEA and its authors – they have always formed an important strand in the Institute’s work. Particularly noteworthy was the 1990 publication of US social policy analyst Charles Murray’s groundbreaking work *The Emerging British Underclass*.

Murray argued that in the UK – as had already happened in the USA – a distinct class of people was emerging who lived lives of relative poverty, worklessness and frequently lawlessness largely outside the norms and values of mainstream society. Many of their parents had lived similar lives and unless change could be effected their children’s lives would follow the same trajectory. Murray argued an underclass was emerging defined not by income or degree of poverty, but by type of poverty; the underclass were trapped in poverty by a culture of dependence on state support and rejection of traditional norms of work and self-reliance that eroded the motivation to invest in the future or change for the better.

In one sense the concerns that Murray articulated were not new; the parallels with ‘the *residium*’ of Victorian society – the poorest of that era who were also deemed to inhabit a distinct social and cultural milieu – are readily apparent. A distinct aspect of Murray’s analysis, however, was that it came after 40 years of unprecedented economic growth in the already-developed world that had facilitated 40 years of unprecedented state intervention aimed at the alleviation of poverty.

There is ample evidence that worldwide post-war economic growth did lift large numbers of people out of poverty (for example, Henderson, 2004, Ch. 2), but little evidence that the billions of pounds of public money spent by governments across the world on anti-poverty strategies during that time had a similarly positive impact. Sixty years after the creation of the modern welfare state in the UK and 40 years after the launch of the War on Poverty in the USA, it seems clear that government spending to alleviate poverty does not bring about a straightforward reduction in the number of poor people.

This edition of *Economic Affairs* is the latest attempt by IEA authors to engage with the continuing problem of ‘poverty amidst affluence’. The articles herein, written by an international cast of scholars and researchers, focus on a number of key questions. Firstly, what is the extent of poverty within developed nations? This also speaks to the question of how should poverty be understood and defined? Secondly, what do we know about the causes of poverty? Clearly, if anti-poverty measures are to be successful it is imperative to know what factors cause poverty and what factors might alleviate it. Thirdly, what have been the results of government action aimed at the alleviation of poverty? Fourthly, how should poverty be understood in a global context, given that we live in a world where the economic (and other) barriers between nations are becoming less salient?

The extent and nature of poverty within developed nations

The second article (after this introduction) in this symposium, by Professor Chris Sarlo of Nipissing University in Canada, examines the distinction between absolute and relative poverty in the context of the commitment made by the developed nations at the World Summit on Social Development in Copenhagen in 1995 to produce official measures of both absolute and relative poverty and to strive to eradicate absolute poverty within a reasonable time frame. Sarlo notes that despite this commitment official measures of absolute poverty are rare in the developed world; almost all official measures of poverty are relative measures.

Sarlo describes how the absence of official measures of absolute poverty has led to a number of difficulties. Perhaps most importantly, because absolute poverty is not measured we do not how much of it exists. As a result, although absolute poverty probably still exists even within the most wealthy societies, anti-poverty strategies tend to be geared towards the amelioration of relative poverty. Consequently those in most need may be neglected.

This focus on relative poverty has also led to a separation of policy-makers' and popular conceptions of poverty. Because most people understand poverty in a commonsense way to describe material hardship, but policy-makers often use the term to describe economic inequality, there can be significant misunderstandings in public discourse about 'poverty'.

The use of relative measures of poverty without reference to absolute measures can also give a misleading impression of the levels of poverty in different countries. Sarlo illustrates this point with the example of a 2005 UNICEF report that used only a relative measure of poverty and consequently claimed that Canada and the UK had higher child poverty rates than Hungary, the Czech Republic and Poland. Indeed, if a relative measure of poverty alone is used then most developed countries would probably have higher poverty rates than most undeveloped countries where almost the entire population is equally and absolutely poor – but therefore not poor according to the standard relative measure of 60% of median national income.

Relative poverty, then, speaks to economic inequality and the personal preferences of many intellectuals for a more egalitarian society. In reality, however, without economic inequality there can be no economic progress and therefore no prosperity. Economic inequality is the driving force of prosperity because progress can never take place in a uniform fashion, but always involves one group of people advancing ahead of their peers, and because inequalities provide essential information about the likely consequences of different courses of action (Hayek, 1960, Ch. 3; Meadowcroft, 2005a, 2005b, Ch. 4).

Sarlo concludes that both absolute and relative measures of poverty are useful; both provide important information about what is happening within a society that may usefully inform public policy. To use one measure without the other, however, leads to confusion, misunderstanding and misdirected public policy.

The third article in this collection, by Dr Nicholas Eberstadt of the American Enterprise Institute, sets out the problems caused by one specific poverty measure. Eberstadt shows that the poverty rate used by the US government as the principal measure of poverty since the 1960s – one of the few official measures that seeks to capture absolute poverty – does not appear to reflect the real level of poverty in the USA.

Reported results from the poverty rate do not correspond with other indicators of poverty, so that although the US poverty rate has stayed fairly constant between 11% and 15% since 1973, the self-reported annual consumption of the poorest families has risen dramatically during the same period. The poorest families in the USA report an annual pre-tax income of $9,155, but also record spending $17,837 every year: for example, in 2004 the reported annual consumption of the poorest families was 195% of their reported annual income. There is no evidence that this discrepancy reflects an increased indebtedness among poor families. Rather, Eberstadt suggests more likely explanations to be changes in the way the data is collected, income under-reporting and annual income variability. What is clear, however, is that the material condition of America's poorest families has improved in the last 30 years, but the official poverty rate does not reflect this.

Eberstadt's article suggests that the US poverty rate may be an example of Goodhart's Law that once a social indicator becomes a target to inform policy-making it ceases to convey the information it previously conveyed. Like Sarlo, Eberstadt argues for the development of multiple indices of poverty that more accurately reflect the real level of material deprivation rather than reliance on one single benchmark.

Understanding the causes of poverty within affluent societies

Although we do not know the extent of absolute poverty within wealthy nations, it seems clear that genuine poverty does exist within affluent societies. Understanding what causes this poverty must be the key to alleviating it. In the fourth article in this symposium, Dr Joel Schwartz of the Washington-based Hudson Institute provides an account of how understanding of the causes of poverty has developed in America in the past 40 years.

Schwartz describes that when the War on Poverty was launched by the Johnson administration in 1964, it was widely believed that poverty was simply caused by lack of money. Indeed, it would no doubt appear to be intuitively correct to most lay people that being poor is simply a result of not having enough money and therefore redistributing resources to the poor would solve the problem.

However, Schwartz argues that the War on Poverty and other government programmes based on the allocation of more resources to the poor have in fact produced unanticipated and unintended perverse consequences. Perhaps the most striking of these has been the entrenchment of poverty among those in receipt of state assistance.

According to Schwartz, this has happened because allocating greater resources to the poor may reward the kind of behaviour that leads to poverty while simultaneously removing the incentives to change that behaviour: the attempt to give people a hand-up may in fact hold them down. As a result of the failure of numerous government programmes, in the USA at least it is now widely accepted across the political spectrum that giving direct state assistance to the poor may do less good and more harm than was previously envisaged.

Schwartz argues that empirical evidence shows that enduring poverty should be understood as a cultural phenomenon principally caused by self-defeating behaviour. Helping people out of poverty requires focus on their behaviour and how they respond to different incentives. Indeed, Schwartz highlights evidence suggesting that whether someone lives in poverty or not will be determined by three relatively simple variables: whether or not they graduate from high school; whether or not they work full-time, and whether or not they marry the co-parent of their children. People who graduate from high school, work full-time and marry are unlikely to be poor in the long-term, whereas people who do not do these things are likely to be and remain poor. For Schwartz, the key to alleviating poverty is ensuring that people make the right choices at key moments in their lives. How this is to be achieved, however, remains a challenge for the future.

Schwartz's conclusions will be counterintuitive and challenging to many, but they raise important issues that cannot be ignored by anyone concerned about the plight of the poor within affluent societies and the role of incentives in influencing people's behaviour.

The failure of government anti-poverty strategies

Schwartz's article presents an account of the failure of US anti-poverty strategies based on the model of alleviating poverty via direct state assistance. In the fifth article in this symposium, Patricia Morgan, a Visiting Fellow at the University of Buckingham, addresses the reasons for and the consequences of the Blair government's failure to achieve its stated aim of reducing child poverty by a quarter by 2005, with a view to halving it by 2010 and eradicating it completely by 2020.

In reality, of course, this plan was doomed to failure from the outset because the child poverty the government wished to eradicate was measured relatively and therefore could only have been eliminated by the creation of an egalitarian society, an outcome beyond the scope of the policies introduced.

However, analysing the policy on its own terms, Morgan describes how the government identified lone parents as the key target group for additional support. It was believed that if enough lone parents could be taken out of poverty then the goals for the reduction of child poverty would be attained. This was despite the fact that the children of lone parents do not and have never constituted the majority of relatively poor children.

As a result of the government's policies a part-time working lone parent (without childcare costs) saw a rise in real income of 39% between 1997 and 2002, and 11% between 2002 and 2004. Lone parents received additional payments more than five times larger than couple families and, on average, came to depend on benefits for two-thirds of their income. Overall, relative child poverty did fall in the first seven years of the Blair government, but then rose again.

Morgan argues that these measures to help lone parents relatively disadvantage children in couple families: for example, it has been calculated that, as a result of the Blair government's reforms, by 2005 a two-child couple needed to work 74 hours a week at the minimum wage to clear the relative poverty threshold, whereas a lone parent with one child working only 16 hours was already above the threshold. The government's reforms, it is contended, shifted the burden of poverty from one group of relatively poor people (lone parents) to another group (couple families).

Perhaps equally disturbing, in common with Schwartz's analysis of the failure of the US War on Poverty, Morgan also argues that the Blair government's reforms have discouraged behaviour that is likely to lead people out of poverty and re-enforced behaviour likely to perpetuate poverty. Because lone parents are far less likely to leave poverty at any point in their lives compared to couple families, Morgan argues that policies that handicap couple families may prevent people who are usually able to leave poverty from so doing, while by encouraging lone parenthood such policies may effectively condemn others to a lifetime of hardship.

Even if we do not wish to be 'judgmental' about different lifestyle choices such as single parenthood (and I do not), if it is empirically the case that lone parenting is more likely to lead to long-term poverty for both child and parent it would seem to be inconsistent to pursue policies that may encourage the formation of lone-parent families if we wish to reduce poverty. The challenge, then, may be how to respond to the needs of some of the most vulnerable members of society while not enacting policies that ultimately disadvantage those very same people.

Poverty, global capitalism and ideas

The final article in this symposium, by Johnny Munkhammar of the Swedish think tank Timbro, sets the problem of poverty within a global context. Munkhammar notes that as a result of globalisation and the spread of markets in recent years more and more people in the developing world have been lifted out of poverty; it is those poor countries that attempt to exist outside of global markets that are stagnating rather than developing. This stagnation results from the failure of governments to enable their citizens to participate in the marketplace, either by erecting barriers to trade or by failing to provide the secure property rights and rule of law necessary for trade to take place.

Munkhammar shows that the root cause of persistent poverty is the same in the developing and the developed world: government failure. The poor within affluent countries are excluded from participation in the market and the prosperity this would bring by a 'social model' of government intervention that restricts labour markets and stymies business, with the result that, for example, average youth unemployment in the EU is now 17% – a human tragedy that rarely receives the attention it deserves. Furthermore, as similarly noted in the articles by Schwartz and Morgan, government hand-outs have created a vicious circle by disincentivising the behavioural strategies that might overcome such obstacles.

Munkhammar traces the origins of these flawed policies to Marx's nineteenth-century critique of capitalism and the claim that unfettered free markets would create immiseration. Although Marx's thesis has now been discredited and his ideas have been abandoned throughout the former Soviet bloc, his legacy lives on in the pockets of poverty to be found within affluent capitalist societies and the flawed policies still pursued in much of the 'developing' world.

Conclusion

This symposium provides a strong indictment of the failure of the modern welfare state to achieve its core task of alleviating poverty over a 60-year period in which enormous resources have been devoted to this end. There is a strong case that the welfare state entrenches rather than alleviates poverty and as such harms rather than helps the poor.

The question must be asked, then, why and how does the welfare state persist in its present form with apparently little political impetus for significant reform? The answer probably lies in two factors. Firstly, there are powerful vested interests who benefit from the welfare state. The most obvious of these interests are the employees of the organisations who deliver welfare services who stand to lose out from any wholesale reform. These are often articulate, educated people who are able to put their case in public and are often backed by strong public sector trade unions.

Perhaps paradoxically, the second vested interest who benefit from the status quo are the affluent. As Goodin and Le Grand (1987, p. 3) noted two decades ago, 'the non-poor' very often play a key role in determining the size and scope of the welfare state and they very often do this 'with an eye to their direct benefit'. The affluent are very often beneficiaries of the welfare state as they receive universal benefits and are equipped to navigate their way around the large state bureaucracies to claim assistance from a wide range of government programmes.

Secondly, as Caplan and Stringham (2005) have recently maintained, it is probably an error to attribute any government policy purely to the activities of vested interests. While the power of vested interests may be important, it is probably also the case that most government policies command widespread public support; if examined on a case-by-case basis there are in fact very few government policies that are not widely supported by the public. Hence, the welfare state has persisted because most people believe it is a good thing that helps the poor and it is feared that radical reform might jeopardise this assistance. It is the role of the IEA and this journal to challenge such opinion with evidence and argument. The articles in this symposium have shown that if poverty amidst affluence is to be eradicated, a rethinking of the role and nature of the welfare state is probably a prerequisite.

1. In a 1957 speech Prime Minister Harold Macmillan noted that the UK enjoyed a level of prosperity unheard of in the lifetime of the country, and continued: 'Indeed, let us be frank about it – most of our people have never had it so good'. It is worth noting that in the 50 years since that speech the UK has enjoyed more or less continual economic growth and rising living standards.

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John Meadowcroft is a Lecturer in Public Policy at King's College London (john.meadowcroft@kcl.ac.uk).