



The Need for More Pro-Growth Policies

By Kirk A. Johnson, Ph.D., and Rea S. Hederman, Jr.

On August 30, 2005, the Census Bureau reported that the poverty rate was essentially unchanged in 2004 and that the level of income inequality remained unchanged. Nevertheless, the familiar refrain that the “rich are getting richer” has been echoed once again. It is important to understand the Census numbers on poverty and income inequality and to draw the correct conclusion from them. While the report overstates both income inequality and poverty, the findings do show that Americans would benefit from expanded economic opportunities. Pro-growth policies, such as a less distortionary tax code, are the way to achieve this end.

The poverty rate increased to 12.7 percent in 2004, up slightly from the 12.5 percent reported in 2003. While a rise in the poverty rate is not a good sign, there are a variety of positive indicators in the latest report.

Poverty rose in only one region of the

country, the Midwest, while rates in the West, South, and North Central regions were unchanged. Poverty rose for white (non-Hispanic) adults but not for children or minorities. The poverty rate for Asians dropped by two percentage points, and it decreased among the elderly, from 10.2 to 9.8 percent.

The rise in poverty occurred almost exclusively among working age adults. This points the way to improvement: more pro-growth policies that produce more jobs, lowering the unemployment rate and poverty in America. Between late 2001 and early 2004, the unemployment rate fluctuated between 5.7 percent and 6.3 percent nationwide. Only in the past year, after the full force of the President’s pro-growth 2003 tax cuts had been felt, has there been a persistent decrease in the unemployment rate, which now stands at 5.0 percent, according to the Department of Labor.

Policymakers should resist calls for

increased government social spending. Welfare reform demonstrated that greater economic opportunity comes from increased work and economic independence, not from generous government programs. If the current positive employment numbers persist for the remainder of the year, the 2005 poverty rate will likely come in below the 2004 rate.

The poverty numbers, as the Census Bureau currently presents them, have a variety of flaws that limit their usefulness. The poverty rate is determined by the money income definition, which excludes in-kind, non-cash benefits, such as Medicare, Medicaid, food stamps, and other forms of assistance. The Census figures also do not include taxes or tax payments such as the Earned Income Tax Credit (EITC). If taxes were subtracted from income and non-cash benefits were added to income, the poverty rate would be more than two percentage points lower than reported, based on historical experience. For example, a single parent who earns \$11,000 per year and has two children would be considered poor by Census standards. However, that family would receive more than \$4,000 under the EITC, raising its income sufficiently to clear the Census definition of poverty.

Income inequality is an example of bad data informing public policy. The Census Bureau considers only money income in its inequality calculations and does not consider the effects of taxation. Because the United States has a progressive tax structure, low-income individuals pay few taxes, while high-income individuals pay most of the individual income taxes in America. Thus, Census reported that the top quintile earned 50.1 percent of money income in 2004, slightly above its 49.8 percent take in 2003. The share of income going

to the bottom two quintiles was unchanged at 3.4 percent and 8.7 percent, respectively. If taxes were included in these calculations, the results would show much less income inequality in the United States.

Another major problem with the Census numbers is that the Census Bureau bases its quintile statistics on households instead of individuals. Many households in the bottom quintile are single-parent households or single-person units. In contrast, households in the upper quintile are generally larger. Earlier work shows that the top quintile of households may account for almost a quarter of the population, compared to only fifteen percent in the bottom quintile. Thus, households in the upper quintile contain more earners than households in the lower quintile. Census data show that the level of income inequality is partly explained by the difference in hours of work between the different quintiles. The top two quintiles, for example, account for well over half of all work in the United States.

While the annual income and poverty report provides good information, it is limited in its usefulness. In particular, the report overstates both income inequality and poverty in America. Policymakers would therefore be wise to take the report's findings with a grain of salt.

Furthermore, policymakers should continue to enact pro-growth policies that expand the economic opportunities of Americans rather than support more social program spending.

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