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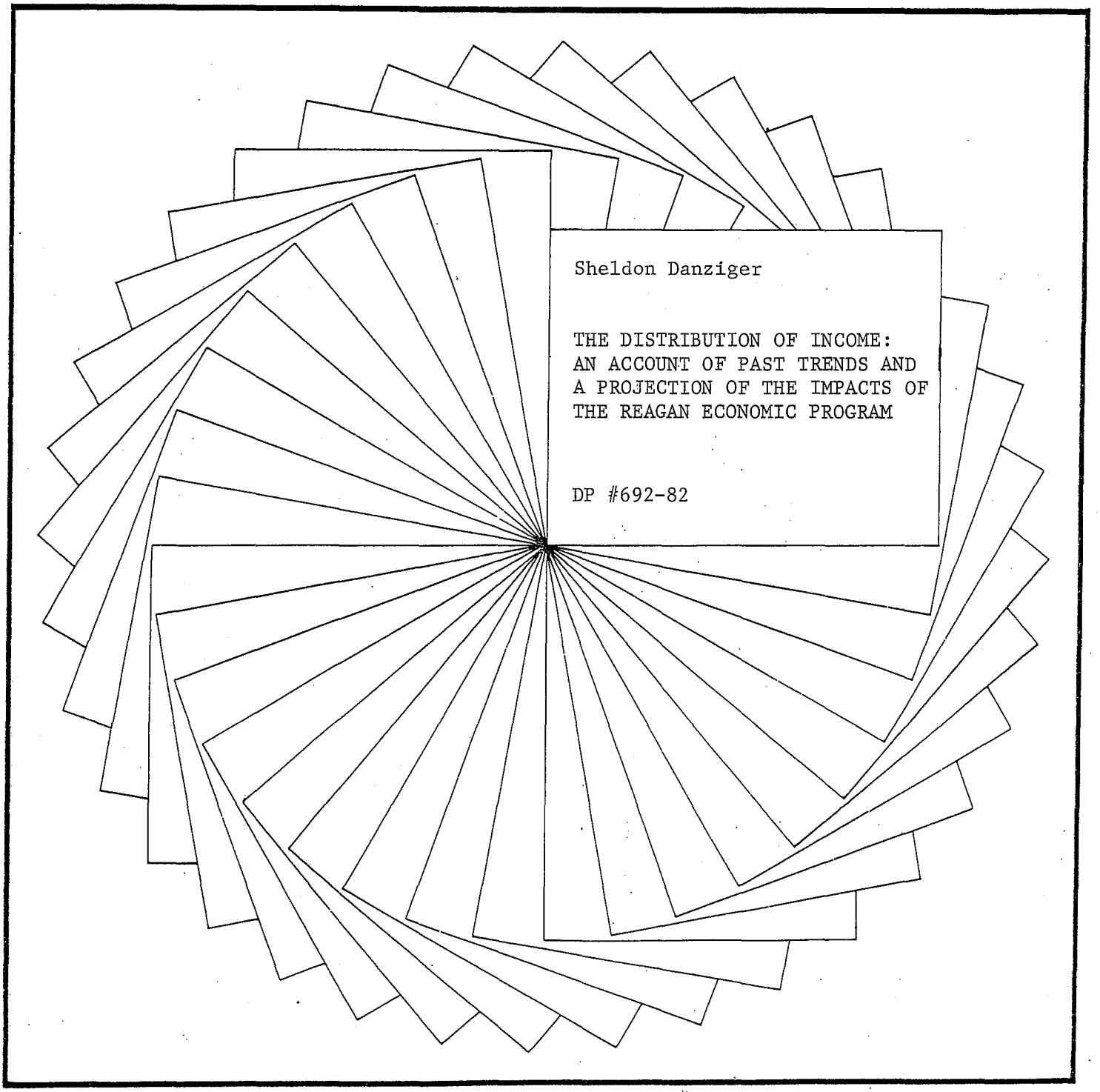

The Distribution of Income: An Account of Past Trends and a Projection of the Impacts of the Reagan Economic Program

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Abstract

This paper reviews trends in income inequality and poverty over the past 15 years and offers projections of the effect that present and proposed budget changes may exert on the income distribution in the next four years.

Income inequality has been increasing in the last 15 years, a fact accounted for in part by demographic change in household structure and in part by such labor market forces as unemployment and withdrawal from work by prime-aged men. Since 1965, government transfers have been the main factor in reducing poverty and inequality. Nevertheless poverty continues at high levels among certain population subgroups, especially families headed by women.

Projections of the effects of the present administration's policies show that poverty and income inequality will be increased both by the reductions in taxes for those at upper levels of the income distribution, and by the reductions in transfers and other social programs for those at lower levels. The largest losses are expected to be felt by female-headed families, minorities, and those just above the poverty line. Even if the economy recovers, those at the bottom of the income distribution cannot be expected to gain enough from the "trickle-down" of economic growth to offset their direct losses from the budget cuts.

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INTRODUCTION AND SUMMARY

The size distribution of household income has remained stable over the past thirty years, despite significant changes in various economic and demographic factors--fluctuations in economic growth, increases in government transfer payments, increases in female labor force participation and the changing age and household composition of the population. This paper reviews the evidence on the trends in income inequality and poverty and offers some projections as to how the fiscal year 1982 budget cuts and those proposed for fiscal year 1983 might affect the income distribution.

After a review of the evidence on the trend in inequality and an analysis of the effect of several important demographic and economic factors, the following conclusions are derived.

- The degree of inequality in Census money income was relatively constant over the 1950-1980 period, but it has been increasing steadily for the past fifteen years.
- Demographic change has accounted for some of the increase in inequality. However, because labor market forces contributed to an increase in pretransfer inequality, inequality would not have decreased, even if there had been no demographic change.
- Government transfers dramatically reduce inequality within several population subgroups and have a significant impact on the aggregate degree of inequality. If transfers had not been growing, the increase in inequality would have been substantially larger.

- The contribution of working wives to family incomes has reduced inequality while fringe benefits have increased inequality, but these effects are smaller than those of transfers.

Because some have argued that government policies should not be addressed to the income distribution per se, the trend in poverty is then examined. It is shown that:

- The growth of income transfers, not labor market improvements, has been the primary factor in the reduction of poverty in the past fifteen years.
- Poverty remains at high levels for many subgroups among the population, especially female-headed families with children.
- Income transfer programs create disincentives to work and save, but their magnitude has been relatively small and poses no threat to the overall efficiency of the economy.

Then, some projections of the effects of the Reagan Administration's economic program are offered.

- Reduction in taxes for those toward the top of the income distribution and decreases in transfers and other social welfare programs for those toward the bottom will increase poverty and income inequality.
- Because of their reliance on income transfers, employment and training programs and regular public sector jobs, female-headed families, minorities, and those in the second income quintile who become unemployed are likely to experience the largest losses from the Administration's program.
- The incidence of poverty as officially measured is likely to return to the levels that existed in the mid-1960s, shortly after the War on Poverty was declared.
- Even if the economy recovers, the gains that trickle down to those at the bottom of the income distribution are not likely to be large enough to offset the direct losses from the budget cuts.

THE PERSISTENCE OF INEQUALITY

Table 1 presents the familiar Census money income data on two summary measures of inequality; the Gini coefficient[1] and the income shares

Table 1

The Trend in Income Inequality, Selected Years, 1950-1979

	Share of Census Money Income Received by Quintile:					Gini Coefficient
	1	2	3	4	5	
A. All Households (Families and Unrelated Individuals)[a]						
1979	3.8%	9.7%	16.4%	24.8%	45.3%	.419
1975	3.9	9.9	16.7	24.7	44.5	.411
1970	3.6	10.3	17.2	24.7	44.1	.407
1970	3.8	10.7	17.5	24.7	43.4	.399
1965	3.6	10.6	17.5	24.8	43.6	.403
1960	3.2	10.6	17.6	24.7	44.0	.410
1950	3.1	10.6	17.3	24.4	44.9	.417
B. All Families[b]						
1979	5.3	11.6	17.5	24.1	41.6	.365
1975	5.4	11.8	17.6	24.1	41.1	.358
1970	5.4	12.2	17.6	23.8	40.9	.354
1966	5.6	12.4	17.8	23.8	40.5	.349
1965	5.2	12.2	17.8	23.9	40.9	.356
1960	4.8	12.2	17.8	24.0	41.3	.364
1950	4.5	12.0	17.4	23.4	42.7	.379

Source: U.S. Department of Commerce, Bureau of the Census, "Money Income of Families and Persons in the United States: 1979." Current Population Reports, Series P-60, No. 129, November, 1981, Table 14.

[a]The 1979 income cutoffs for the quintiles of families and unrelated individuals are $6,212, $11,970, $18,795, and $27,982.

[b]The 1979 income cutoffs for the quintiles of families are $9,830, $16,220, $22,985 and $31,590.

received by each quintile. Data for households--families and unrelated individuals--are presented in Panel A and for families only in Panel B. While the data for any two years are quite similar, several trends are apparent. First, the income share of the lowest quintile increased over the 1950-79 period, while the share of the second quintile declined. As emphasized below, the gains made by this bottom quintile result primarily from the increase in government income transfers. Second, while the trends are not very large, overall inequality declined from 1950 to about 1966 and then began to increase.[2] Again, as emphasized below, this trend towards increased inequality shows no sign of being reversed.

The Census data reported in Table 1 do not include government or private in-kind benefits such as Medicare, food stamps, housing assistance, or employer-provided pensions and health insurance.[3] These non-cash items have increased rapidly as a percentage of total income in recent years. While no study of inequality has incorporated the effects of both in-kind transfers and fringe benefits, existing studies do suggest that they have opposing effects.

Several studies have found that in-kind transfers reduce inequality. They have a significant impact on the income share of the lowest quintile of households, and smaller impacts on the share of the other quintiles.[4] For example, G. William Hoagland estimates that the quintile shares after all transfers (cash as well as in-kind), and after federal taxes, were 6.4, 11.0, 16.9, 24.1, and 41.7 percent in 1976.[5] Compared to the data in Table 1, the shares of the lowest three quintiles are higher, and those of the highest two quintiles are lower.

Timothy Smeeding has measured the effect of employer-provided fringe benefits (e.g., vacation and holiday pay, paid sick leave, insurance

contributions such as health or life, and deferred compensation such as pension plans) on the degree of inequality.[6] Their effect is the opposite of that of government transfers in kind, although it is relatively small. Table 2 shows that the lowest quintile of workers receives 2.4 percent of all wages and salaries, but 2.2 percent of total compensation. A similar reduction occurs in the share of the lowest quintile of full-time full-year workers. The large differences in the measures between all workers and those working full-year full-time points out the large impact of unemployment on inequality and suggests the magnitude of the reduction in inequality that would result from full employment. Smeeding also suggests that if better measures of the job perquisites of high-income earners (e.g., stock option plans, expense accounts) were available, the inequality-increasing effect of fringes would be larger. However, even though government transfers in kind and fringe benefits have opposing effects, Census data, such as that reported in Table 1, probably overstate the extent of inequality to a small degree.[7]

THE ROLE OF DEMOGRAPHIC AND ECONOMIC FACTORS

In this section, the roles of several demographic and economic factors in accounting for the trend in inequality are examined. In recent years there has been a rapid change in the demographic composition of households. This change is evident in Table 3, where the population is divided into 12 exhaustive and mutually exclusive groups, distinguished by type of household unit (family or unrelated individual), sex of head, and age of head. The age categories are young (less than 25 years of age), prime-age (25-64), and aged (65 and over). Between 1965 and 1978,

Table 2

The Size Distribution of Wages and Salaries and of Total Compensation, 1979[a]

	Income Share of Quintile:			Gini Coefficient
	1	2+3+4	5	
All Workers				
Wages and Salaries	2.4%	50.3%	47.3%	.453
Total Compensation	2.2	50.1	47.7	.459
Full-Year Full-Time Workers[b]				
Wages and Salaries	8.0	53.2	38.0	.310
Total Compensation	7.8	53.4	38.8	.313

Source: Timothy M. Smeeding, "The Size Distribution of Wage and Nonwage Compensation," paper presented to the National Bureau of Economic Research Conference on Income and Wealth, October 1981.

[a]Total compensation represents costs to employer of pay for time worked and of deferred compensation and insurance contributions.

[b]Full-year full-time workers work 35 or more hours per week, for 50 weeks per year or more.

Table 3

Demographic Composition of Households, Selected Years, 1965-1978[a]

	1965	1972	1978
FAMILIES HEADED BY:			
Young Males	4.4%	5.1%	3.7%
Prime-Age Males	57.8	53.1	47.3
Aged Males	9.6	9.0	8.9
Young Females	0.5	0.9	1.0
Prime-Age Females	6.0	6.8	7.8
Aged Females	1.7	1.6	1.5
All Families	80.0	76.5	70.2
INDIVIDUALS WHO ARE:			
Young Males	0.7	1.9	2.9
Prime-Age Males	4.9	5.5	8.0
Aged Males	2.0	2.0	2.1
Young Females	1.4	1.7	2.7
Prime-Age Females	5.4	5.9	7.0
Aged Females	5.7	6.6	7.2
All Individuals	20.1	23.6	29.9
All Households	100.0	100.0	100.0
Number of Households (millions)	60.4	70.9	82.4

Source: Updated version of table from Sheldon Danziger and Robert Plotnick, "Demographic Change, Government Transfers, and Income Distribution," Monthly Labor Review, April 1977.

Note: Young = under 25; prime-age = 25-64; aged = 65 and over. Family (Census definition) = two or more persons related by blood, marriage, or adoption and living together; unrelated individuals (Census definition) = persons 14 and over who are not living with any relatives.

[a]Totals may not add to 100.0 because of rounding.

the total number of units grew by about 36 percent, while population grew by only about 12 percent. Families declined from 80 to 70 percent of all households, and the largest group of families, those with prime-age male heads, fell from 57.8 to 47.3 percent of all units. There was an increase in the percentage of units accounted for by all six groups of unrelated individuals.

Families headed by prime-age men have the highest mean income, while units headed by women, the aged, and the young have below average incomes. Thus, the demographic shift toward lower income units has tended to depress the mean income for all households and to increase the degree of inequality among households. Table 4 shows the mean Census income for each of the twelve demographic groups for 1965, 1972, and 1978. The income growth rates for ten of the twelve demographic groups exceeded the 16.3 percent aggregate growth in income for the 1965-1978 period. The same is true for the 1972-1978 subperiod, in which real incomes declined in the aggregate, even though they increased for eleven of the twelve groups.

Demographic change has contributed not only to a decline in the growth rate of income but also to an increase in income inequality because the demographic groups that have grown have higher than average Gini coefficients. Table 5 reveals that the Gini coefficient for all units increased by 6.6 percent, while it actually decreased for seven of the groups.

Three economic factors are important determinants of the trend in household income inequality--income transfers, wives' contributions to family income, and the distribution of male earnings. For example, consider the group with the strongest labor market attachment--families headed by prime-aged men. Table 5 shows that their Gini coefficient

Table 4

Mean Census Money Income by Demographic Group, Selected Years, 1965-1978[a]

	Mean Income			Percentage Change		
	1965	1972	1978	1965-72	1972-78	1965-78
FAMILIES HEADED BY:						
Young Males	$12,118	$13,595	$14,457	12.2%	6.3%	19.3%
Prime-Age Males	18,613	23,146	23,838	24.4	3.0	28.1
Aged Males	10,997	13,068	14,129	18.8	8.1	28.5
Young Females	5,290	5,010	5,494	-5.3	9.7	3.9
Prime-Age Females	9,635	10,960	11,055	13.8	0.9	14.7
Aged Females	10,396	12,868	12,159	23.8	-5.5	17.0
INDIVIDUALS WHO ARE:						
Young Males	5,430	7,079	7,623	30.4	7.7	40.0
Prime-Age Males	9,956	12,990	13,498	30.5	3.9	35.6
Aged Males	4,955	6,290	6,911	26.9	9.9	39.5
Young Females	3,921	5,021	6,027	28.0	20.0	53.7
Prime-Age Females	7,661	8,482	9,151	10.7	7.9	19.4
Aged Females	4,060	5,104	5,725	25.7	12.2	41.0
ALL HOUSEHOLDS	14,454	17,038	16,815	17.9	-1.3	16.3

Source: See Table 3.

[a]All incomes are expressed in 1978 dollars.

Table 5

Inequality in the Distribution of Census Money Income
1965 and 1978

	1 1965 Gini Coefficient	2 1978 Gini Coefficient	3 Percent Change[a]
FAMILIES HEADED BY:			
Young Males	.279	.278	-0.4%
Prime-Age Males	.300	.311	3.7
Aged Males	.437	.406	-7.1
Young Females	.438	.445	1.6
Prime-Age Females	.375	.396	5.6
Aged Females	.405	.378	-6.7
INDIVIDUALS WHO ARE:			
Young Males	.445	.385	-13.5
Prime-Age Males	.403	.409	1.5
Aged Males	.378	.413	9.3
Young Females	.518	.403	-22.2
Prime-Age Females	.423	.402	-5.0
Aged Females	.416	.375	-9.9
ALL HOUSEHOLDS	.392	.418	6.6

Source: Table 3.

[a]Defined as ((1978 Gini - 1965 Gini)/1965 Gini) · 100.

increased by 3.7 percent. However, if it were not for income transfers, the increase would have been 8.1 percent. Table 6 shows the reduction in the Gini coefficient due to cash transfers in 1965 and 1978. In each year, transfers substantially reduced aggregate and within-group inequality, and this effect increased over time for inequality within each of the twelve groups.[8] The reduction in the Gini coefficient due to transfers--14.5 percent in 1978--is the largest single factor affecting inequality. This inequality-reducing impact of transfers is largest for aged household heads and for families headed by females because they are the primary beneficiaries of social security and welfare programs respectively.[9]

Table 7 shows that the earnings of wives have a small equalizing impact on the distribution of income among husband-wife families for white, nonwhite and Hispanic households. This effect has persisted over the recent past, even though the most rapid increases in work occurred among the wives of husbands with earnings above the median. The Gini coefficient of census money income was relatively constant for whites and fell slightly for nonwhites between 1965 and 1978, even though the Gini coefficients of husbands' earnings increased by about 11 percent for both white and nonwhite husbands.[10] Thus, the increased contributions of wives' earnings and of government transfers, which both tend to reduce inequality, offset the increased inequality of husbands' earnings.

Some portion of the increased earnings inequality among men can be accounted for by higher levels of unemployment and labor force withdrawal, attributable in part to rising transfers. However, Peter Henle and Paul Ryscavage even find a "slow but persistent" trend toward inequality among all wage and salary earners who worked year-round full-

Table 6

Percent Change in Gini Coefficient due to Cash Transfers, 1965 and 1978

	Change in Gini Coefficient[a]	
	1965	1978
FAMILIES HEADED BY:		
Young Males	-2.1%	-3.8%
Prime-Age Males	-3.2	-7.2
Aged Males	-32.6	-37.5
Young Females	-25.3	-32.4
Prime-Age Females	-22.4	-21.6
Aged Females	-24.4	-37.3
INDIVIDUALS WHO ARE:		
Young Males	-2.6	-3.8
Prime-Age Males	-7.8	-6.8
Aged Males	-46.9	-45.7
Young Females	-0.5	-4.3
Prime-Age Females	-10.8	-13.9
Aged Females	-44.0	-49.5
All Households	-11.1	-14.5

Source: See Table 3.

[a]Defined as (100 • (Census Money Income Gini - Pretransfer Gini)/Pretransfer Gini).

Table 7

Working Wives and Family Income Inequality[a]

	Mean Income[b]		Gini Coefficient	
	1967	1978	1967	1978
Whites				
Total Family Income	$9379	$21,730	.323	.322
Total Family Income Less Wives' Earnings	8130	18,342	.339	.343
Change due to Wives' Earnings	15.4%	18.5%	-4.6%	-6.1%
Nonwhites				
Total Family Income	$6702	$18,439	.350	.335
Total Family Income Less Wives' Earnings	5319	13,980	.345	.343
Change due to Wives' Earnings	26.0%	31.9%	+1.4%	-2.3%
Hispanics				
Total Family Income	n.a.	$16,502	n.a.	.322
Total Family Income Less Wives' Earnings	n.a.	13,628	n.a.	.334
Change due to Wives' Earnings	n.a.	21.7%	n.a.	-3.5%

Source: Updated version of Table 2, from Sheldon Danziger, "Do Working Wives Increase Family Income Inequality?" Journal of Human Resources, Vol. 15, Summer 1980.

[a]Families include only those households with husband and wife present.

[b]Census money income in current dollars.

n.a. Not available.

time and for eight of ten broad occupational groups.[11] These increases in earnings inequality are well documented, but not very well understood.

There is little evidence to suggest that the recent increase in inequality will be reversed. The inequality-increasing effect of demographic change will be reduced somewhat by the aging of the baby boom and the reduction in new labor force entrants. Continued increases in the percentage of wives who work and of fringe benefits as a percentage of total compensation should continue to have relatively small effects. In recent years, increased male earnings inequality has been offset by the growth of income transfers. Now, however, increased unemployment and reduced income transfers are both contributing to increased inequality.

THE DECLINE AND RISE OF POVERTY

The summary measures of inequality presented to this point are affected by changes in either the incomes of the poor or the nonpoor. However, it has often been argued that government policies should not be addressed to income distribution per se. For example, two Administration representatives recently wrote:

> Inequality of incomes in itself becomes something to be corrected only to the extent that the poorest do not have sufficient resources to provide for their needs.[12]

To reflect this concern with those at the bottom of the distribution, the remainder of this paper emphasizes the trend in poverty.

Table 8 shows the percentage of persons living in households with incomes below the poverty line, using three measures of income. The results mirror those for inequality. First, over the 1965-1980 period poverty declined primarily because of transfers. In the absence of

Table 8

Persons Living Below Official Poverty Lines, 1965-1980
(Percentages)

	Census Money Income	Adjusted Income[a]	Census Money Income Less Transfers
1965	15.6	12.1[b]	21.3
1968	12.8	9.9	18.2
1970	12.6	9.3	18.8
1972	11.9	6.2	19.2
1974	11.6	7.2	20.3
1976	11.8	6.7	21.0
1978	11.4	n.a.	20.2
1980	13.0	6.1[c]	20.0[b]
Percentage & Change			
1965-72	-23.7	-48.8	-9.9
1972-80	+9.2	-1.6	+4.2
1965-80	-16.6	-49.6	-6.1

Source: Sheldon Danziger and Robert Plotnick, "The War on Income Poverty: Achievements and Failures," in Welfare Reform in America, edited by P. Sommers (Boston: Martinus Nijhoff, 1982); adjusted income is from Timothy Smeeding, "The Antipoverty Effect of In-Kind Transfers: A 'Good Idea' Gone Too Far?" Policy Studies Journal, 1982, in press.

[a]To account for in-kind transfers and taxes paid.

[b]Estimate.

[c]1979 is the last year for which Smeeding has data on adjusted income.

transfers, poverty would have declined by 6.1 percent. The official Census measure that includes cash transfers shows a decline of 16.6 percent, while the adjusted income measure, which accounts for in-kind transfers received and federal taxes paid, shows a decline of almost 50 percent. Second, there was a large decline during the 1965-1972 period which was followed by stationary and then increasing poverty.

Again, there are large differences in economic status across the various demographic groups. For example, despite the growth of transfers, the official incidences of poverty in 1978 among children living in female-headed households were 31, 58, and 61 percent for whites, blacks, and Hispanics. Their number now, and the recent upward trend in the size of this group, refutes the view that poverty has been "virtually eliminated."[13] Between 1965 and 1978, welfare recipiency increased from 26 percent of all female heads to 38 percent; and the percentage of female heads who worked remained constant at about 65 percent. Thus, despite increased welfare recipiency, and the maintenance of work effort, poverty among female heads remains a serious problem.

Table 9 presents data on the dependence on cash transfers of all households and of pre-transfer poor households, classified by the age, sex, and race of the head. Over 40 percent of all households and 80 percent of pretransfer poor households received cash tranfers. For the poor, these transfers constituted 72.0 percent of their Census incomes. While the number of transfer recipients and the average benefit have grown in recent years, significant gaps in coverage and inadequacies in benefits remain. While almost all of the aged poor received transfers, almost 40 percent of nonaged poor households received none. And the

Table 9

Dependence on Cash Transfers, All Households and Pretransfer Poor Households, 1978

Household Head	All (Poor and Nonpoor) Households		Pretransfer Poor Households	
	Percentage Receiving Cash Transfers	Cash Transfers as a Percentage of Census Money Income	Percentage Receiving Cash Transfers	Cash Transfers as a Percentage of Census Money Income
Nonaged Males				
White	25.1%	4.1%	59.6%	62.7%
Nonwhite	31.5	5.2	59.9	43.0
Hispanic	25.7	4.5	44.3	34.7
Nonaged Females				
White	32.9	10.4	61.3	60.1
Nonwhite	53.7	21.3	76.8	62.4
Hispanic	50.4	23.4	73.8	72.7
Aged Males and Females				
White	95.9	44.8	98.9	83.1
Nonwhite	95.7	54.8	97.9	83.3
Hispanic	93.9	46.5	98.5	82.5
All Households	41.8	10.8	80.3	72.0

Source: Sheldon Danziger and Robert Plotnick, "The Receipt and Antipoverty Effectiveness of Cash Income Maintenance Transfers." Institute for Research on Poverty, Discussion Paper No. 683-81, December 1981.

probability of receiving enough aid to escape poverty is much lower among the nonaged than the aged.

Contrary to conventional wisdom, the receipt of transfers is quite similar regardless of race, once economic need has been taken into account. A greater percentage of all minority households receive transfers because they are more likely to be pretransfer poor. However, among the poor, whites are more likely than minorities to be removed from poverty by transfers because they receive larger amounts on average.

The recent growth of income transfer programs has had important beneficial effects--protection against income losses due to unemployment, retirement, disability and death; guarantees of access to minimum levels of food, shelter, and medical care; and the reduction of poverty and inequality. This growth has been accompanied by some declines in work effort and savings that have contributed to sluggish economic performance. But the magnitude of these disincentives has been overstated. A review of the available research indicates that the decline in aggregate work effort due to income transfers is less than 5 percent. The estimates of the effect of transfers on savings are quite speculative--they range from zero to 20 percent.[14] These disincentives pose no serious threat to the growth of the economy, and they could be reduced by reforming the various programs. The elimination of the programs will lead to small gains in efficiency but large increases in inequality.

THE REAGAN ADMINISTRATION'S ECONOMIC PROGRAM: PROJECTED IMPACT ON THE INCOME DISTRIBUTION

The Reagan Administration has undertaken a "drastic fiscal retrenchment" to reduce government presence in the economy and to curtail

social welfare programs which have grown rapidly over the past fifteen years. While the President claims that the "safety net" is being maintained, the short-run direct effects on poverty and inequality are clear. The tax changes will increase the disposable incomes of those toward the top of the income distribution, and the budget changes, especially those in the income transfer programs, will lower the incomes of those toward the bottom of the distribution. As a result, both poverty and income inequality will increase.

Consider the effects of the budget cuts on one of the poorest groups, women heading households with children. They will be disproportionately affected. Many relied on CETA jobs. Others working in the private sector have either lost eligibility for Aid to Families with Dependent Children (which also results in a loss of Medicaid benefits) or have had their benefits significantly reduced by the new rules on work expenses and allowable assets. For example, the University of Chicago's Center for the Study of Welfare Policy showed that the typical AFDC mother who works would experience a 20 to 30 percent decline in her monthly income.[15]

Ironically, for many women the new AFDC rules provide less of an incentive to work than do the prior ones. For example, before the FY 1982 changes, the typical working welfare mother with one child in Wisconsin earned $432 per month, reported average work expenses of $108, and received $217 from AFDC. Her monthly disposable income was $140 higher than that of a nonworking AFDC mother with one child who received $401 per month. Under the new rules, after four months of welfare recipiency her earnings reduce her welfare benefits even further, and she receives only $44 from AFDC. Her income after work expenses is actually

$33 per month lower than that of the nonworking woman, and 32 percent below what it was in FY 1981. Given cases like this, it should come as no surprise that program administrators expect some of these women to quit working. If the woman in this example does quit, AFDC costs would not fall from $217 to $44, but would rise to $401.

Thus, at the same time that the proposed income tax reductions are cutting tax rates for the rest of the population, welfare beneficiaries who already face high benefit reduction rates (which are equivalent to tax rates) are experiencing even higher rates and work discinentives. If the lowered income tax rates lead the nonpoor to work more, as is hoped, and the higher rates lead welfare recipients to work less, the gap between the income classes will increase even more.

In addition to welfare women, many low-income two-parent working families in the second quintile of the income distribution will suffer large income losses. Households in this group have experienced the greatest reduction in their income share over the recent past, partly because their incomes are too high to qualify for government transfers and because their jobs are more cyclically sensitive and offer lower fringe benefits than those in the higher quintiles. They are now bearing the brunt of the increased unemployment rate in the private sector, and the reduction in employment and training programs. According to Lester Thurow, these programs accounted for 14 percent of the earnings received by the bottom two quintiles of the labor force.[16] These households now find that the extent of protection against income loss that was provided by food stamps and extended unemployment compensation during recent recessions has been reduced.

Minorities will also be disproportionately hurt because of the reductions in income transfers, employment and training programs and regular public sector employment. Michael Brown and Steven Erie show that in 1976 27 percent of all blacks as compared to 16 percent of all whites worked in the public sector.[17] About 55% of the net employment increase for blacks since 1960 occurred in the public sector, and much of the increase was in social welfare programs. Thus, reductions in government employment in general, and social welfare employment in particular, will affect blacks more than whites.

But, what of the supply-side miracle? Suppose that the Administration's program does succeed in stimulating economic growth. As suggested above, the major factor contributing to the reductions in poverty and offsetting increases in inequality was the growth in government transfers. Peter Gottschalk has examined the evidence concerning the trickle-down hypothesis.[18] He concludes that there is little reason to think that the earnings gains from economic growth that accrue to those with labor market disadvantages are likely to be large enough to significantly reduce poverty. He analyzed the economic situation of a sample of middle-aged married men over the 1966-1975 period and found that even though real earnings increased on average, inequality and the proportion of husbands with low earnings also increased. In fact, 43 percent of those with low earnings in a given year had low earnings in all six survey years, and 78 percent had low earnings more than half of the survey years. This indicates a good deal of permanence within the low earnings population, even during prosperous years.

In another paper, Gottschalk also shows that, unless policies are implemented to alter the structure of the labor market facing the poor,

then poverty would decline little in the 1980s even if unemployment remained at 6 percent and cash transfers grew as fast as national income.[19] This does not mean that economic growth which raises average living standards is not desirable, but rather that growth alone is not a sufficient antipoverty strategy.

Table 10 uses a simple forecasting model to project the incidence of poverty for 1982, 1984, and 1986. The projections were derived by using the Reagan Administration's official estimates of prices, unemployment rates and transfers as reported in the FY 1983 budget, and the regression coefficients from the following equation estimated by Gottschalk (standard errors are shown in parentheses):[20]

$$\underset{\text{Poverty}}{\text{Incidence of}} = \underset{(4.8)}{35.9} + \underset{(.233)}{.594}\ \text{Time Trend} - \underset{(4.1)}{16.3}\ \text{Ln(Real Transfers)} + \underset{(.35)}{1.17}\ \text{Unemployment Rate.}$$

Whereas poverty as officially measured was 13.0 percent in 1980, it is projected to reach 15.2 percent by the end of 1982 because of the reduction in income transfers and the rising unemployment rates. This is a level of poverty not seen since the mid-1960s (see Table 8). Even if the Administration's 1986 forecasts of an unemployment rate of 5.8 percent and an inflation rate of 4.6 percent are realized, poverty in 1986 will be higher than it was in 1980 under both the official definition and the one that adjusts the Census data for in-kind transfers and taxes.

In sum, even if the Administration's program generates a recovery, the gains that trickle down to those at the bottom of the income distribution are not likely to be large enough to offset the direct losses from the reduced transfer and other social programs.

Table 10

Projection of the Percent of Persons with Incomes Below Poverty Lines,

Year	Official Measure	Adjusted to Account for In-Kind Transfers and Taxes
1980	13.0% (actual)	7.5%
1981	13.7	8.2
1982	15.2	10.2
1984	14.3	9.3
1986	13.7	8.7

Source: Estimates by Sheldon Danziger and Peter Gottschalk using data on projected unemployment rates, price levels, and social spending as reported in Budget of the United States, Fiscal Year 1983. The official incidence for 1980 is from U.S. Bureau of the Census, Current Population Reports, "Money Income and Poverty Status of Families and Persons in the United States: 1980" P-60, No. 127, August 1981. Adjusted incidence is estimated from the series for 1968 to 1979, published by Timothy Smeeding, "The Anti-poverty Effect of In-Kind Transfers: A 'Good Idea' Gone Too Far?" Policy Studies Journal, 1982, in press.

Notes

[1]Values of the Gini coefficient range from zero, which means perfect equality of income, to one, total inequality. Thus, a declining Gini coefficient means that the income distribution is becoming less unequal and a rising Gini coefficient means the income distribution is becoming more unequal.

[2]This point has also been made by Henry Reuss, "Inequality, Here We Come," Challenge, September/October 1981.

[3]Census money income is defined as money income received during the calendar year as wages and salaries, net income from self-employment, property income (for example, interest, dividends, and net rental incomes), government cash transfers, and other forms of cash income (for example, private pensions and alimony).

[4]These studies are reviewed in Sheldon Danziger, Robert Haveman, and Robert Plotnick, "How Income Transfer Programs Affect Work, Savings, and the Income Distribution: A Critical Review," Journal of Economic Literature, Vol. 19, September 1981; IRP Reprint No. 429.

[5]G. William Hoagland, "Measuring the Effectiveness of Current Transfer Programs in Reducing Poverty," in Welfare Reform in America, edited by P. Sommers (Boston: Kluwer, Nijhoff, 1982).

[6]Timothy Smeeding, "The Size Distribution of Wage and Nonwage Compensation," paper presented to the National Bureau of Economic Research Conference on Income and Wealth, October 1981.

[7]The overstatement of poverty in the Census data is much larger, as is shown below in Table 8. Fringe benefits do not increase poverty, so the poverty-reducing impact of government transfers in kind is not offset.

[8]The effect of tranfers on inequality is generally measured by comparing pretransfer and posttransfer incomes. Pretransfer income is defined by subtracting government transfers from posttransfer income. This definition assumes that transfers elicit no behavioral responses which would cause income without transfers to deviate from observed pretransfer income. However, transfers do induce labor supply reductions so that recipients' net incomes are not increased by the full amount of the transfer. For example, consider an individual who earns $3000. After the passage of a public assistance program, with an income guarantee of $3000 and a tax rate of 50%, the person reduces hours of work and earns $2500. A transfer of $1750 is now received and total income is $4250, but the individual's final income is only $1250 higher. Because pretransfer income in the absence of transfers is not observed, most studies measure the redistributive effect as the difference between pretransfer and posttransfer income ($4250-$2500), not as the increase in final income. Thus, true pretransfer income is likely to be higher than measured pretransfer income. Pre/post comparisons, therefore, such as the ones made here, are likely to provide upper-bound estimates of the effect of transfers on inequality.

[9]For example, in 1974 social security benefits were received by 22 percent of all families. They reduced the Gini coefficient by about 9 percent for all families, but by 29 percent for households headed by an aged person. Cash welfare benefits were received by 8 percent of families, reduced the Gini coefficient by 3 percent for all families and by 19 percent for families headed by a nonaged female. See Sheldon Danziger, "Income Redistribution and Social Security: Further Evidence," Social Service Review, Vol. 51, March 1977.

[10]Between 1967 and 1978, the Gini coefficient of earnings for white husbands increased from .394 to .437, or by 10.9 percent, while that of nonwhite husbands increased by 11.2 percent, from .392 to .436.

[11]Peter Henle and Paul Ryscavage, "The Distribution of Earned Income Among Men and Women, 1958-77," Monthly Labor Review, April 1980.

[12]Robert Carleson and Kevin Hopkins, "Whose Responsibiity is Social Responsibility: The Reagan Rationale," Public Welfare, Fall 1981.

[13]According to Martin Anderson, Welfare (Hoover Institution Press, 1978):

> The "war on poverty" that began in 1964 has been won. The growth of jobs and income in the private economy, combined with an explosive increase in government spending for welfare and income transfer programs, has virtually eliminated poverty in the United States.

For a further discussion of its trend in poverty, see Sheldon Danziger, "Children in Poverty: The Truly Needy Who Fall Through the Safety Net," Children and Youth Services Review, January/March 1982.

[14]Danziger, Haveman, and Plotnick (see note 4).

[15]University of Chicago, Center for the Study of Welfare Policy. "The Poor: Profiles of Families in Poverty," mimeographed (Washington, D.C.: March 20, 1981).

[16]Lester Thurow, "Equity, Efficiency, Social Justice and Redistribution," Nebraska Journal of Economics and Business, Vol. 20, Spring 1981.

[17]Michael Brown and Steven Erie, "Blacks and the Legacy of the Great Society," Public Policy, Vol. 29, Summer 1981. Thurow (see note 16) also points out that the ratio of black to white wages is higher in the public than the private sector.

[18]Peter Gottschalk, "Earnings Mobility: Permanent Change or Transitory Fluctuations?" Review of Economics and Statistics, 1982, in press.

[19]Peter Gottschalk, "Transfer Scenarios and Projections of Poverty into the 1980s," Journal of Human Resources, Vol. 16, Winter 1981.

[20]Peter Gottschalk, "Have We Already Lost the "War on Poverty?" mimeographed, Institute for Research on Poverty, February 1982.