Congressional Research Service

Memorandum July 9, 2008

TO: House Ways and Means Committee
Attention: Matt Weidinger

FROM: Thomas Gabe
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Domestic Social Policy Division

SUBJECT: **Effects of Alternate Income Definitions on Poverty Estimates**

This memorandum responds to your request for information about the effects of various income definitions on poverty estimates. If you have questions concerning this information please don't hesitate to call me at 7-7357.

The "official" U.S. Census Bureau statistical measure for counting the poor is based on families' total pre-tax money income compared to poverty income thresholds, which vary by family size and age composition. Families with measured incomes below established income thresholds are considered by definition to be "poor." For example, in 2006, the most recent year for which poverty estimates are available, a family of four, comprised of two adults and two children, was considered poor if its measured income was below $20,444; a single parent (under age 65) with one child was considered poor if its family income was below $13,896; and, a single person age 65 or over and living alone was considered poor if its income was below $9,669. Based on the official definition, an estimated 36.5 million people, or 12.3% of the population were considered poor in 2006 (the most recent year for which data are available).

As per your request, you were especially interested in the effects of using a more comprehensive definition of income than that used under the current "official" measure. One limitation of the current "official" poverty measure is that it is based only on families' pre-tax money income. Although the official poverty measure counts most sources of money income received by families (e.g., earnings, social security, pensions, cash public assistance, interest and dividends, alimony and child support, among others), it ignores a variety of government provided noncash benefits that affect family economic well-being, and fails to account for the effects of taxes and tax credits on families' incomes. For example, in FY2007 the federal government provided $30.3 billion in food stamp benefits, most of which went to poor households. Similarly, in FY2007 the Treasury paid an estimated $38.3 billion in the form of Earned Income Tax Credits (EITC) to families with relatively low earnings who owed no income tax. Neither food stamps nor the EITC are counted as income under the official poverty definition. Nor does the official poverty measure take into account the value of housing subsidies (e.g., public housing and rent assistance), or the effect of medical assistance (e.g., medicare, medicaid) on families' medical expenses. Additionally, the current poverty measure does not take into account a variety of work-related expenses (e.g., FICA payroll taxes, work-related transportation expenses, or child care expenses) nor does it take into account federal or state income taxes or property taxes that families bear. As such, the official poverty measure falls short in its ability to capture the effects of major income support programs and government policies on family economic circumstances.

Table 1 illustrates the estimated effects of applying more comprehensive measures of income and resources for measuring poverty than what are currently used under the "official" U.S. poverty measure. The estimates are based on Congressional Research Service (CRS) analysis of U.S. Census Bureau Current Population Survey (CPS) Annual Social and Economic Supplement (ASEC) data for 2007. The data capture family demographics in March of 2007, and income and poverty status in the preceding year, 2006. The estimates rely on Census Bureau income definitions and alternative income and resource measures developed by the Census Bureau in its work to develop a series of "experimental poverty measures" to address weaknesses of the current poverty measure.[1]

Table 1 shows that in 2006, an estimated 36.5 million people, or 12.3% of the non-institutionalized civilian population were estimated to be poor under the official U.S. Census Bureau poverty definition (**Defn. 1**). A variety of income and resource and expense definitions are shown in the table, showing the marginal effects of various income, resource, and expense concepts. The marginal effects shown in the table are *cumulative effects* shown at each step, dependent on the previous steps. Consequently, marginal effects would differ, depending on the cumulative ordering of the income, resource, and expense concepts used.

- The table shows that adding capital gains and losses to the official poverty income definition has only a minimal effect on poverty reduction (see **Defn. 2**).

- However, accounting for estimated work-related expenses, such as FICA taxes, federal retirement contributions among federal workers, and other incidental work-related expenses (e.g., transportation to and from work, licenses, union dues) (see **Defn. 3**), raises the number who would be considered poor from 36.346 million to 42.139 million, or by 5.7 million persons -- a poverty rate of 14.2%, compared to the "official rate" of 12.3%. (The CPS does not provide estimates of work-related child care expenses, so they are not included here.)

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[1] For a discussion of Census Bureau methodology in developing alternative income and resource measures for measuring poverty, as well as efforts to apply alternate income thresholds for measuring poverty, see U.S. Census Bureau Report P60-216, *Experimental Poverty measures: 1999*, issued October 2001, available on the internet at: [http://www.census.gov/prod/2001pubs/p60-216.pdf]. For more recent Census Bureau reports using the revised measures, see: U.S. Census Bureau Report P60-227, *Alternative Poverty Estimates in the United States: 2003*, issued June 2005, available on the internet at: [http://www.census.gov/prod/2005pubs/p60-227.pdf], and recent table updates (*Tables of Alternative Poverty Estimates: 2005*) at: [http://www.census.gov/prod/2005pubs/p60-227.pdf], and U.S. Census Bureau Report P60-232, *The Effects of Taxes and Transfers on Income and Poverty in the United States: 2005*, issued March 2007, and available on the internet at: [http://www.census.gov/prod/2007pubs/p60-232.pdf].

- Adding federal and state income taxes liabilities (**Defn. 4**) raises the number of poor persons slightly, to 43.091 million, or about 6.6 million more persons than are counted under the official definition, amounting to 14.5% of the non-institutionalized civilian population falling below their respective poverty income thresholds, based on their family size and composition.

At this point, having adjusted the income measure for work-related expenses and income taxes, the effects of government inkind assistance and tax credits bring about reductions in the estimated number of persons counted as poor.

- Federal and state tax credits, such as the EITC and the Child Tax Credit reduce poverty from 43.091 million (**Defn. 4**) to 36.624 million (under **Defn. 5**), accounting for 12.4% of the population falling below the poverty standard – just slightly above the official poverty income definition which fails to take into account work related-expenses, taxes, and tax credits.

- Adding the market value of food stamps and school lunches (**Defn. 6**) reduces the estimated number of poor to 34.030 million, accounting for 11.5% of the population as poor – 2.4 million fewer people than under the official definition.

- The estimated value of public housing assistance and rental subsidies (**Defn. 7**) reduces the number estimated as poor to 32.695 million, or 11.0% of the population – about 3.8 million fewer than under the official definition

- The final step (**Defn. 8**) shows the estimated effects of the estimated value of medicare and medicaid on poverty reduction. The Census Bureau provides estimates of the "fungible value" of medicare and medicaid, intended to estimate the extent that these programs free up resources that families would have otherwise spent on medical care. Based on this definition, in combination with all previous adjustments, the estimated number of poor is 31.024 million, about 10.5% of the population – about 5.4 million fewer people than under the official Census Bureau poverty definition.

TABLE 1. Effects of Various Income Definitions on Estimated Number and Percentage of People in Poverty in 2006

	Number in 1,000s	Percent of total	Difference in number from the "official" definition (Defn, 1) (Number in 1,000s)	Percentage point difference from "official" definition (Defn 1.)	Percentage change from "official" definition (Defn 1.)
Total Population	296,450	100.0%			
Poor based on various income concepts for measuring poverty					
Defn. 1: Money income ("official" current poverty definition)	36,460	12.3%	0	0.0%	0.0%
Defn. 2: Defn. 1 plus capital gains less capital losses	36,346	12.3%	-115	0.0%	-0.3%
Defn. 3: Defn. 2 less FICA taxes, federal retirement contributions, work exp	42,139	14.2%	5,678	1.9%	15.6%
Defn. 4: Defn. 3 less federal and state income taxes before credits	43,091	14.5%	6,630	2.2%	18.2%
Defn. 5: Defn. 4 plus federal and state income tax credits	36,624	12.4%	164	0.1%	0.4%
Defn. 6: Defn. 5 plus market value of food stamps and school lunches	34,030	11.5%	-2,431	-0.8%	-6.7%
Defn. 7: Defn. 6 plus public housing assistance	32,695	11.0%	-3,765	-1.3%	-10.3%
Defn. 8: Defn. 7 plus fungible value of medicare and medicaid	31,024	10.5%	-5,436	-1.8%	-14.9%

Source: Table prepared by the Congressional Research Service (CRS) based on analysis of U.S. Census Bureau Current Population Survey (CPS) Annual Social and Economic Supplement for 2007.