As part of his "war on poverty" initiative, President Lyndon Johnson visited with families in rural areas of the Fourth Federal Reserve District. In April 1964, he spoke with Tom Fletcher of Inez, Kentucky. Mr. Fletcher's family of 10 earned only $400 in 1963. Today, the situation in many rural counties has improved considerably, but poverty remains a persistent problem both in the Fourth District and across the nation.

Understanding the Persistence of Poverty

More than 40 years ago, Americans witnessed a pivotal moment in political history as President Lyndon Johnson declared an "unconditional war on poverty in America."[1] Had they known that the next few decades would bring unprecedented growth in output per person, those Americans might have reasonably assumed that by the beginning of the twenty-first century, the war on poverty would have been won.

Of course, they would have been wrong. Despite a variety of programs designed to lessen poverty—and some real successes over the years—the latest data indicate that more than 12 percent of U.S. residents still live below the poverty line *(see box on page 8 for official definition of poverty)*. The Fourth Federal Reserve District itself contains two cities that currently rank among the top 10 poorest major cities in America: Cleveland and Cincinnati.[2]

The persistence of poverty over the past few decades has led to many new initiatives to better understand the causes and consequences of poverty, including recent efforts by the Federal Reserve System and the Federal Reserve Bank of Cleveland *(see box on page 10)*.

Defining Poverty

To understand exactly *who* falls into the category of "poor," we turn to the U.S. Census Bureau. The bureau publishes annual poverty statistics based on established thresholds and adjusts them for inflation each year using the Consumer Price Index. For 2006, a family of four was considered in poverty if its annual income fell below $20,444. For a couple under age 65, the poverty threshold was $13,500, and for an individual living alone, it was $10,488.

The official definition of poverty has changed little since 1969, when the Bureau of the Budget accepted thresholds set forth by Mollie Orshansky, a statistician at the Social Security Administration. Having grown up in poverty herself, Orshansky spent her career advocating for children's welfare. In 1958, she set out to estimate the incidence of childhood poverty in order to make these children and their families more visible to the decision makers involved in developing policies and programs for the poor.

Mollie Orshansky developed the first U.S. poverty thresholds in the 1960s—formulas that are still in place for defining poverty today.

By 1964, Orshansky had perfected a formula for determining poverty thresholds. Using the "economy food plan" she had helped to develop while working at the U.S. Department of Agriculture, she estimated the minimum cost of food for families of various sizes. Applying the ratio of food expenditures to after-tax income from the 1955 Household Food Consumption Survey, Orshansky created a detailed matrix of poverty thresholds. The Bureau of the Budget adopted these thresholds (with minor revisions) as the federal government's official definition of poverty in 1969.

Today, the thresholds are used for statistical purposes to quantify Americans living in poverty. Poverty *guidelines*, a simplified version of the federal poverty thresholds, are typically used for administrative purposes, such as determining financial eligibility for certain federal programs. These guidelines are issued annually in the Federal Register by the Department of Health and Human Services.

Sources: Cassidy (2006); Fisher (1997); U.S. Department of Commerce, Bureau of the Census; Social Security Administration; and U.S. Department of Health and Human Services.

Poverty imposes punishing effects on individuals, families, and communities:

- Studies show a link between poverty and health, including a higher prevalence of chronic illnesses, more frequent and severe disease complications, and increased demands and costs for health-care services.[3]
- Poverty is linked to increased rates of teenage pregnancy, which can cause these children to face greater health-care and education challenges.
- Schooling outcomes are affected by poverty. Research shows that increases in income directly raise test performance results for students, even after controlling for other changes.[4]
- Poverty can also affect crime. In a recent social experiment that relocated families from poor to less-poor areas, violent criminal activity fell among the relocated residents.[5]

Unfortunately, poverty seems as entrenched as ever in our society. In this essay, we address three major questions:

- Why have 40 years of steady real economic growth failed to eliminate poverty?
- Why haven't antipoverty programs eliminated poverty?
- What can we learn from substantial shifts in poverty within the Fourth Federal Reserve District over the past few decades?

We know that our results will not be the final word on this longstanding issue. Every society faces a tradeoff between practicing benevolence through direct transfers and promoting incentives to engage in work and create wealth. We suggest that programs

1. Johnson (1965).
2. Schweitzer and Rudick (2007).
3. Woolf, Johnson, and Geiger (2006).
4. Dahl and Lochner (2005).
5. Ludwig, Duncan, and Hirschfield (2001).

encouraging the production of human capital through education and training may be the most fruitful approach to fighting the battle against poverty. This approach may also be the most self-sustaining for future generations.

As with all important research topics, a major part of the effort is finding and refining *new* questions that need to be answered. Still, we hope that this essay leads to a better understanding of the issues that have kept poverty rates high and the policies that may help end the war on poverty.

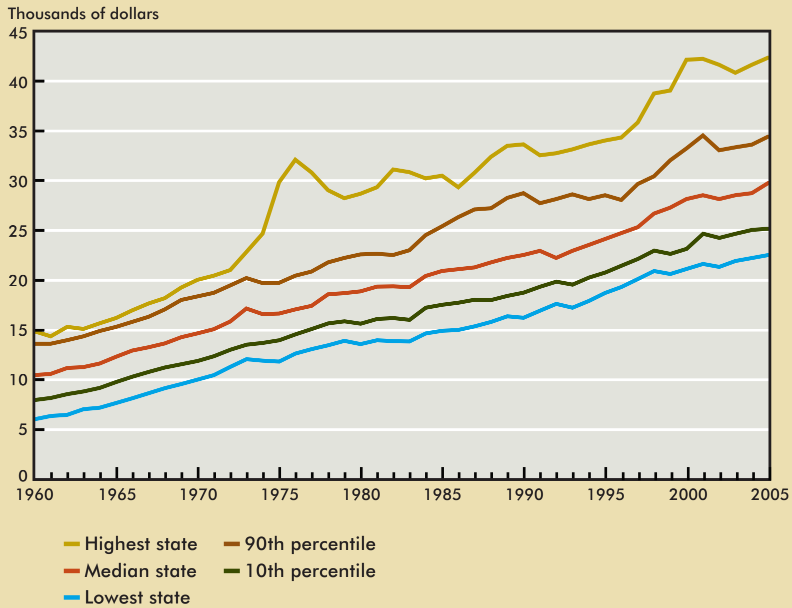
Why Hasn't Economic Growth Eliminated Poverty?

U.S. economic growth over the past half-century has been staggering in historical terms. Even after adjusting for inflation, per capita income for the median state has grown from about $10,000 per year in 1960 to roughly $30,000 in 2005 (*see figure 1*). Although per capita income still differs across the states, even the state with the lowest per capita income in the early 1960s saw its income nearly triple over the next 45 years.

In the United States, for an average individual, one hour of work in 2005 bought more than twice as many goods as it did in 1960. Over the long term, small percentage changes in annual income growth lead to large changes in overall income levels. For example, suppose two individuals earned the average household income of $3,815 in 1950. The individual whose income grew at a 1 percent annualized rate would make about $6,600 in 2005, while the individual whose income grew at a 3 percent annualized rate would make about $19,400—roughly three times the former amount.

Although the growth in real income has been impressive, the gains have not reached everyone. As many observers have commented, the difference between the "haves" and the "have-nots" has grown substantially over the past 30 years or so.

Figure 1 Real Per Capita Income Growth of U.S. States



Note: Percentiles represent state per capita income levels. For example, the 90th percentile state is the fifth-highest-income state, while the 10th percentile state is the fifth-lowest-income state.

Sources: Authors' calculations and U.S. Department of Commerce, Bureau of Economic Analysis.

As shown in figure 2, income inequality has clearly increased in the United States over the past few decades. This figure depicts the growth rates of real wages between 1962 and 2005 at different points of the income distribution.[6] An upward-sloping line indicates that high earners (at the upper end of the income distribution) saw much larger increases than those who earned less (at the lower end of the income distribution).

Individuals at different points of the income distribution change; we know that relatively few of today's workers were working in 1962. But today's lowest-income workers earn only slightly more in real terms than did the lowest-income earners in 1962. At the low end of the income distribution (5th percentile), real incomes have increased just $1,100 over the past four decades, to $13,500 in 2005.

6. For the purposes of this example, wages and income both refer to annual labor income of full-time workers. Our methodologies follow Juhn, Murphy, and Pierce (1993).

Federal Reserve Keeps a Spotlight on Poverty

The Community Affairs function of the Federal Reserve System is dedicated to supporting the System's economic growth objectives by promoting community development and fair and impartial access to credit. Each of the 12 Federal Reserve Banks, along with the Board of Governors, has a Community Affairs Office that works to address issues threatening community reinvestment and asset accumulation, particularly among low- and moderate-income communities.

Here in the Fourth District, poverty is an issue not just in urban areas like Cleveland and Cincinnati but also in smaller cities and rural areas. By keeping a spotlight on poverty, Community Affairs believes we will move toward a more in-depth understanding of the issue.

Dr. William Julius Wilson, professor and director of the Joblessness and Urban Poverty Research Program at Harvard University, gave the keynote address at the Federal Reserve Bank of Cleveland's 2006 Community Development Policy Summit.

In June 2006, the Federal Reserve Bank of Cleveland focused its annual Community Development Policy Summit on concentrated poverty. The goal was to examine this issue from a community development perspective, versus the more traditional social services approach. The conference drew policymakers, bankers, researchers, and community development practitioners from across the region, all eager to share experiences, insights, and ideas.

President Sandra Pianalto explained in her opening address why the Federal Reserve is so dedicated to the analysis of poverty:

> *We are committed to the goals of community development. Our Community Affairs program helps us fulfill one of our most important public policy mandates—to enforce fair-lending regulations that protect consumers in the financial marketplace. We also believe that understanding the issues behind concentrated poverty will help us better assess overall economic performance.*

In addition, the Community Affairs offices across the Federal Reserve System have teamed with the Brookings Institution on a study of concentrated poverty. This study is looking at the causes and consequences of concentrated poverty in a variety of communities (rural and urban, immigrant and nonimmigrant, minority and nonminority) nationwide. The Federal Reserve strongly believes that a deeper understanding of this phenomenon will help public and private entities better integrate community reinvestment activities with traditional social services activities.

Note: Conference proceedings for the Federal Reserve Bank of Cleveland's 2006 Community Development Policy Summit are available online at *www.clevelandfed.org/CommAffairs/Conf2006/June/Index.cfm.*

The story is very different among upper-income earners (*see table 1*). Forty years of annual real income gains above 1 percent have accumulated into significantly higher real earnings: $110,000 in 2005 versus $67,200 in 1962 for the top 5 percent of earners (95th percentile). These substantial differences reveal that much of the average income gains seen nationally have been realized by relatively high earners.

Unfortunately, no one is entirely certain about what causes income inequality. Some researchers believe that increased globalization may contribute to inequality through immigration. Others cite the importance of international trade patterns, outsourcing, and changing institutions, such as the long-term decline in union membership.

One prominent theory behind income inequality is what economists refer to as "skill-biased" technological change. That is, workers who acquire the appropriate skills can take advantage of new technologies and increase their wages, while unskilled workers cannot. In fact, research has documented that large bursts in technological advances—for example, during the Industrial Revolution that began in the eighteenth century or perhaps in today's Information Age—lead to greater income inequality.[7] Increasing inequality, then, may be a natural outcome of the labor market in response to changing fundamentals underlying the supply and demand of labor.

A logical way for workers to combat these labor market forces and increase their incomes is to acquire additional education and skills. The strength of this theory is evident in table 1, which lists real annual income by educational attainment at different points in the income distribution. In 1962, a high-school dropout who was the median earner for that group (the 50th percentile) earned $29,100 annually. However, a college graduate at the same percentile earned $44,000 annually.

7. Greenwood (1999).

Figure 2 Real Wage Growth Across the Income Distribution, 1962-2005

Note: Labor income includes income from wages and salaries. Figure is computed for full-time, full-year workers who are not self-employed. Percentiles are listed in ascending order of the income distribution. For example, p10 indicates the point at which only 10 percent of the working population earns less than these workers, while p90 indicates the point at which 90 percent of the working population earns less than these workers.

Sources: Authors' calculations; U.S. Department of Commerce, Bureau of the Census; and U.S. Department of Labor, Bureau of Labor Statistics, Current Population Survey.

Table 1 Real Annual Income, 1962

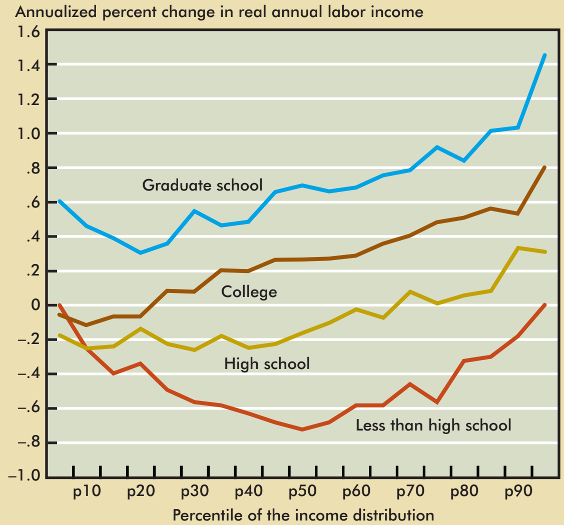
	5th Percentile Wage Earner	50th Percentile Wage Earner	95th Percentile Wage Earner
High-School Dropout	$ 10,100	$ 29,100	$ 54,900
High-School Graduate	$ 13,400	$ 32,300	$ 63,400
College Graduate	$ 20,100	$ 44,000	$ 97,000
Graduate School	$ 19,400	$ 48,500	$ 109,900
All	$ 12,400	$ 32,300	$ 67,200

Real Annual Income, 2005

	5th Percentile Wage Earner	50th Percentile Wage Earner	95th Percentile Wage Earner
High-School Dropout	$ 10,000	$ 21,200	$ 54,600
High-School Graduate	$ 12,400	$ 30,000	$ 72,000
College Graduate	$ 19,500	$ 49,000	$ 136,000
Graduate School	$ 25,000	$ 65,000	$ 203,500
All	$ 13,500	$ 37,300	$ 110,000

Sources: Authors' calculations; U.S. Department of Commerce, Bureau of the Census; and U.S. Department of Labor, Bureau of Labor Statistics, Current Population Survey.

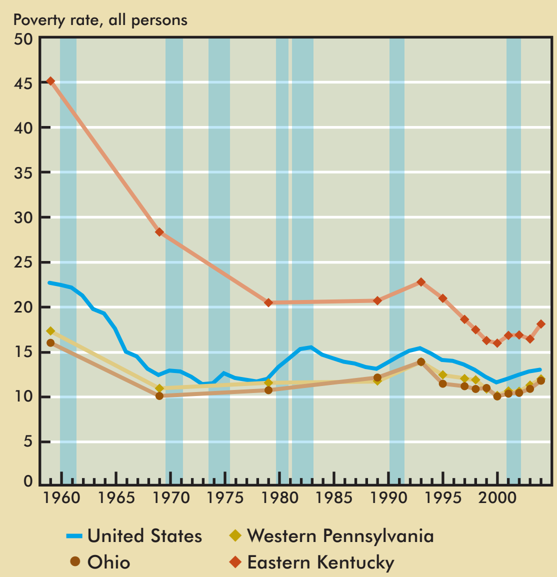
Figure 3 Real Wage Growth by Educational Attainment, 1962-2005



Note: Labor income includes income from wages and salaries. Figure is computed for full-time, full-year workers who are not self-employed. Percentiles are listed in ascending order of the income distribution. For example, p10 indicates the point at which only 10 percent of the working population earns less than these workers, while p90 indicates the point at which 90 percent of the working population earns less than these workers.

Sources: Authors' calculations; U.S. Department of Commerce, Bureau of the Census; and U.S. Department of Labor, Bureau of Labor Statistics, Current Population Survey.

Figure 4 U.S. and Fourth District Poverty Rates, 1959-2004



Note: Blue bars indicate recessionary periods.

Source: Authors' calculations based on U.S. Department of Commerce, Bureau of the Census, decennial census data and Small Area Income and Poverty Estimates Program.

The earnings gap between the more and less educated has been growing wider since the 1960s, as shown in figure 3. Wages of workers with graduate degrees have been growing faster than for those who hold only a four-year college degree. The trend is similar for college versus high-school graduates, and for high-school graduates versus high-school dropouts. Indeed, the wage picture is comparatively bleak for high-school dropouts. Not only did their wages fall in comparison to their higher-educated peers, but for many high-school dropouts, their own real wages actually fell over time.

What is most troublesome about the rise in income inequality is not that the rich have gotten richer, but that those at the lowest part of the income distribution have made such little progress in terms of real wage growth.

Why Haven't Antipoverty Programs Eliminated Poverty?

President Johnson noted in 1964 that the war on poverty was "not going to be a short or easy struggle," but initially it looked like the United States was gaining some ground.

The 1960s saw a lot of progress on poverty, as shown in figure 4. In less than 15 years, poverty was cut in half—from more than 22 percent in 1959 to just over 11 percent in 1973. Then the decline seemed to stop cold. Since 1973, U.S. poverty rates have hovered between 11 and 15 percent. Data for 2005 indicate that 12.6 percent of U.S. residents live below the poverty line. Although poverty rates typically move with the state of the economy—declining during expansions and rising during recessions—the persistence of high poverty rates is still surprising for an economy that has boosted average incomes nearly threefold since 1960.

Recognizing that economic growth has been insufficient to lift all citizens out of poverty, the United States provides assistance for the less fortunate among our fellow citizens. Federal and state governments offer support for poor families through a wide range of programs:

- Means-tested transfers, commonly known as welfare, require people to meet specific income standards and are provided through programs such as food stamps and Temporary Assistance for Needy Families (TANF), formerly known as Aid to Families with Dependent Children.
- The U.S. tax code has been written to provide some support for low-income families—for example, through progressive income tax rates and the Earned Income Tax Credit.
- Social insurance has no income requirements but provides general benefits that help low-income households—Social Security and Medicare, for example.

While means-tested transfer payments have declined in real terms, real social insurance spending has increased from less than 6 percent to more than 9 percent of real GDP over the past 35 years, driven largely by increases in Social Security and Medicare benefits (*see figure 5*).

One reason why means-tested programs have not eliminated poverty is that they are not large enough to move all family incomes above the poverty line. For example, after existing cash benefits are accounted for, the average difference between a family's income and its poverty threshold in 2005 was $8,125. As a result, about $120 billion in cash transfers—or 4 percent of the federal budget—would be needed annually to lift families and other poor individuals out of poverty.[8]

However, another reason why means-tested programs do not reduce the official poverty rate is that many of them rely on in-kind transfers and are not really a direct transfer of income, which would be counted in the official poverty definition (*see box at right*). This is true for programs such as Medicaid, food stamps,

8. Authors' calculations based on Congressional Budget Office data (2006).

Alternative Measures of Poverty

Social scientists are engaged in a vigorous debate about how to measure poverty. Official U.S. statistics use a pre-tax income definition that has changed little over time. Critics of the current measure say it does not measure the economic well-being of the poor for a number of reasons. First, pre-tax income fails to accurately measure the economic resources available to a family because it excludes noncash benefits such as food stamps, medical and housing assistance, and the Earned Income Tax Credit, but includes payroll and income taxes. The Census Bureau publishes a set of alternative measures of poverty income that adjust for taxes paid and noncash benefits received. Incorporating these adjustments into the poverty rate calculation typically reduces the poverty rate by 2 to 3 percentage points a year, a sizable reduction.

Second, the official statistics use a specific Consumer Price Index series (CPI-U) to adjust incomes for inflation. This series does not contain all of the improvements that have been made in measuring consumer price inflation over the past several decades. According to Meyer and Sullivan, poverty statistics constructed using an alternative price index published by the Bureau of Labor Statistics (CPI-U-RS) show a marked reduction in the U.S. poverty rate versus the official statistics.

Finally, some social scientists argue that the poverty yardstick should be based on what families consume rather than on their income levels. Using a consumption metric offers a number of benefits. For example, it can better capture the ability of families who suffer a job loss to maintain their standard of living by borrowing or by tapping into savings. Income surveys, such as the one used to measure poverty rates, often underreport transfer payments that families obtain through government assistance programs. These payments are particularly important for low-income families. Empirically, consumption-based poverty indices generally paint a more optimistic view of the progress on poverty than do the official statistics, particularly for elderly Americans.

Sources: Dalaker (2005), Johnson (2004), and Meyer and Sullivan (2006).

The Role of Public Programs in Balancing Household Budgets

Families who fall beneath the poverty threshold vary widely in their spending needs, income levels, and eligibility for public assistance. Who qualifies for help—and how much help they qualify for—also varies from state to state depending on how federal programs are implemented. These variances can make it difficult to evaluate the overall effectiveness of antipoverty programs.

Fortunately, the National Center for Children in Poverty at Columbia University has developed a Family Resource Simulator, a web-based tool that simulates the impact of federal and state support (for example, Earned Income Tax Credits, child-care subsidies, health-care coverage, food stamps, and housing assistance) on family budgets. The Family Resource Simulator can calculate how much a family needs to cover its basic budget, demonstrate the effects of various programs, and help identify and simulate policy alternatives that might better meet the needs of low-wage workers and their families.

Using the Family Resource Simulator, we can analyze the circumstances of both a low-income single mother with a young child and a low-income two-parent household with two children. (For this example, we will assume these families live in Pittsburgh.) While the simulations show how a poor household can manage to make ends meet, the expenses shown here are minimal. Many poor households have additional expenses (such as car payments, debt payments, and health needs) that are not included in these simulations. Still, the simulations illustrate the important role of public programs in helping low-income families meet their financial obligations.

Family Resource and Expense Simulation, 2003

	Single mother earning $500/month with a young child	Single mother earning $1,000/month with a young child	Married couple earning $600/month with two children	Married couple earning $1,200/month with two children
Resources				
Earnings	$ 500	$ 1,000	$ 600	$ 1,200
Federal Earned Income Tax Credit (EITC)	$ 170	$ 212	$ 240	$ 350
Temporary Assistance for Needy Families (TANF)	$ 66	$ 0	$ 197	$ 0
Food stamps	$ 259	$ 167	$ 405	$ 306
Total Resources	**$ 995**	**$ 1,379**	**$ 1,442**	**$ 1,856**
Expenses				
Rent and utilities*	$ 151	$ 275	$ 209	$ 336
Food	$ 284	$ 284	$ 574	$ 574
Child care*	$ 22	$ 43	$ 22	$ 0
Health insurance*	$ 0	$ 190	$ 0	$ 316
Transportation	$ 136	$ 182	$ 191	$ 182
Other necessities	$ 243	$ 243	$ 321	$ 321
Payroll and income taxes	$ 53	$ 94	$ 64	$ 95
Total Expenses	**$ 889**	**$ 1,311**	**$ 1,381**	**$ 1,824**
Resources minus Expenses	**$ 106**	**$ 68**	**$ 61**	**$ 32**

* These costs are significantly offset by Section 8 housing, child care, and health insurance benefits.
Note that the results assume that in the two-parent family, the second parent is not employed and therefore the family has no child-care costs. When the family receives TANF cash assistance, however, both parents are required to participate in work activity, and the family has child-care expenses.

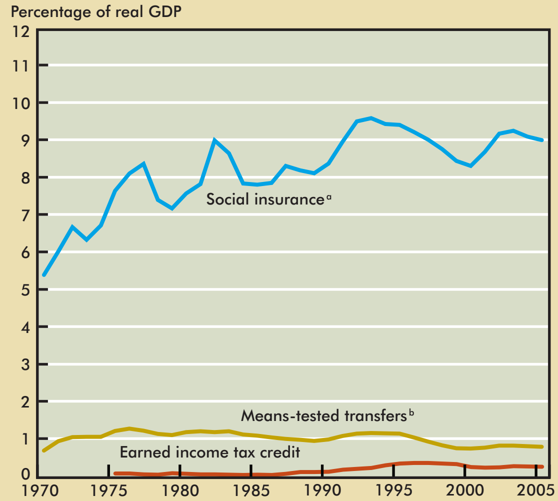
Source: Columbia University, National Center for Children in Poverty.

housing assistance, Head Start subsidies, and school nutrition programs. Each of these programs provides important benefits, but they are provided as goods or services (rather than cash) for low-income families who meet additional requirements. Of the transfer programs, only TANF raises the reported income levels of families, thus directly lowering the poverty gap (*see box on page 14*).

Programs that are not viewed as welfare also make a big difference for poor households. The major U.S. social insurance programs—Social Security, Medicare, unemployment insurance, workers' compensation, and disability insurance—can affect poverty rates as well. Social Security, while not structured to be an antipoverty program, redistributes a large amount of money from workers to retired families and is associated with a precipitous decline in poverty rates among the elderly. Medicare provides benefits, including hospital insurance and supplementary medical insurance. It covers almost all people over age 65 and eligible people under age 65. Roughly half of Medicare benefits are granted to families and individuals who would otherwise be poor.[9]

Public policy debate often centers on the incentives that accompany means-tested transfer programs. Researchers, politicians, and the public alike have voiced concern that welfare policies should be designed to avoid creating a disincentive for poor people to work. Means-tested programs have always struggled to reflect a balance between concern and efficiency. These programs have been repeatedly reined in or reformed over the years, most recently by the Welfare Reform Act of 1996 (*see figure 5*). The Act has certainly been effective in moving people off the welfare rolls by shifting people toward work.[10]

Figure 5 Social Insurance and Antipoverty Spending, 1970-2005



a. Social insurance includes Old-Age Survivors Insurance benefit payments, Medicare, unemployment insurance, workers' compensation, disability insurance, Medicaid, and Supplemental Security Income.

b. Means-tested transfers include Temporary Assistance for Needy Families (and its predecessor, Aid to Families with Dependent Children), food stamps, housing aid, school food programs, Head Start, and Special Supplemental Nutrition Program for Women, Infants, and Children.

Sources: Danzinger and Haveman (2001); Sengupta, Reno, and Burton (2004); U.S. Social Security Administration; Office of Management and Budget; Congressional Budget Office; U.S. Department of Health and Human Services; U.S. Department of Agriculture, Food and Nutrition Service; U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; and authors' calculations.

It remains to be seen whether the income that poor people earn from working will be enough to elevate their families out of poverty without the assistance of transfer programs. In the 10 years following the 1996 reform, however, poverty rates have largely moved with the performance of the economy rather than showing a trend either up or down.

An important alternative to traditional welfare programs has also evolved: the Earned Income Tax Credit (EITC). The EITC is a tax code provision that lowers the taxes of low-income workers so that some families receive tax refunds even though they paid no income taxes. Federal EITC spending totaled about $35 billion in 2006, accounting for roughly 0.3 percent of real GDP.[11] The EITC provides post-tax earnings, so it does not affect the official definition of poverty, but for working families it offers substantial added financial resources.

9. Danzinger and Haveman (2001).

10. Blank (2000).

11. Office of Management and Budget (2006).

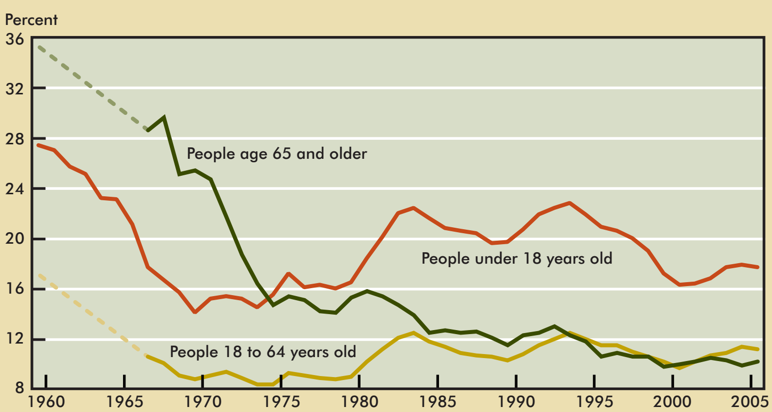
The Changing Face of Poverty

The Census Bureau monitors progress on the war on poverty for three age groups: children, adults, and senior citizens. Over the past five decades, the age distribution of poverty has shifted significantly.

Helped in part by Social Security reforms, senior citizens have experienced the greatest gains in the war on poverty. Their poverty rate has fallen by nearly three-quarters since 1959. However, it is important to keep in mind that the poverty rate is set at three times the cost of food and adjusted for inflation. It does not take into consideration rising medical expenses and may not fully represent the daily struggles that all senior citizens, especially those living in poverty, face.

Children and adults have also benefited from falling poverty rates, which have declined by more than one-third since 1959. But today, children form the group with the highest poverty rate, with 17.6 percent of our nation's children belonging to poor families in 2005. Children have been the poorest age category since 1974.

Poverty Rates by Age Groups



Note: Full age breakdowns are available annually after 1966.

Source: U.S. Department of Commerce, Bureau of the Census.

Research has linked the increase in EITC spending to a reduction in welfare dependence and an increase in labor force participation rates.[12] Although the 1996 welfare reforms lowered direct payments to households, poverty rates continued to fall until the 2001 recession. This outcome could be linked in part to the beneficial effects of the EITC.

Finally, many proposals have been advanced at both the federal and state level to increase the minimum wage, which intuitively might be expected to lower poverty. However, recent research suggests that raising the minimum wage may actually *increase* the number of poor families because the resulting loss in employment would likely exceed the number of people lifted out of poverty.[13]

What Can We Learn from Poverty Trends within the Fourth Federal Reserve District?

While the national poverty rate has been relatively constant, the composition of poverty has changed.[14]

- The poverty rate of Americans age 65 and older declined well into the 1990s (*see box at left*); however, rising child poverty rates have offset this decline. Today, the people in our society who are most likely to be poor are children.
- Poverty is more common in some household types, such as single-parent households. Increasing numbers of single-parent families and households composed of unrelated individuals have contributed to the stubbornness of high poverty rates.
- Minorities experience higher poverty rates, although the time pattern for poverty among minority groups largely follows the national poverty pattern of a sharp decline from 1959 to 1973 and then relatively steady levels.

12. Wirtz (2003).
13. Neumark and Wascher (2001).
14. Burtless and Smeeding (2001).

- Finally, poverty rates and population have both declined in rural areas (*see box at right*).

Some of these broad national patterns are also apparent within the Fourth Federal Reserve District, which includes Ohio, eastern Kentucky, western Pennsylvania, and the northern panhandle of West Virginia.[15] Changes in poverty have been uneven across our region, and this pattern can help us determine which programs seem to be most effective in the long battle against poverty.

Many of the Fourth District counties that had the highest poverty rates in both 1959 and 2004 had small populations. Then, as now, many of these counties were located in eastern Kentucky. However, a large fraction of the poor now live in the major urban counties of the District. The five most populous counties (Cuyahoga, Ohio; Allegheny, Pennsylvania; Franklin, Ohio; Hamilton, Ohio; and Summit, Ohio) accounted for almost a third (32 percent) of the poor population in the District in 2004. This is not surprising, because these counties accounted for a similar fraction (30 percent) of the total population of the District. However, in 1959, just 26 percent of the District's poor lived in these counties, when these counties made up a larger share (36 percent) of the overall population.

Clearly, the biggest geographic shift in the incidence of poverty has been away from the rural portions of the District and toward the metropolitan areas. Poverty rates among rural and nonrural counties are now far more similar than they were nearly 50 years ago.

15. We do not include counties for West Virginia in the Fourth District due to the small number of observations in the data.

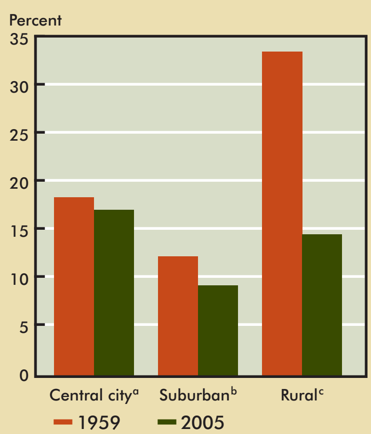
Where Poverty Lives

Over the past half-century, the distribution of our population has changed considerably. In 1959, the American population was fairly evenly split among central cities, suburbs, and rural areas. Today, central cities are still home to about one-third of the population. Rural areas have dropped to about 16 percent, while the suburbs now hold claim to more than half of American citizens.

Despite the influx of families into the suburbs, the poverty rate of suburban areas is, and has consistently been, the lowest of the three residential categories. Also heartening is the pattern in rural areas, where the poverty rate has been cut by more than half since 1959. But the poverty rate in our central cities has remained almost steady since 1959, now standing at 17 percent—the highest rate among the three locations.

Poverty was and continues to be unevenly distributed across communities.

Poverty Rates by Residential Group



a. Central city refers to areas characterized as central or principal cities.

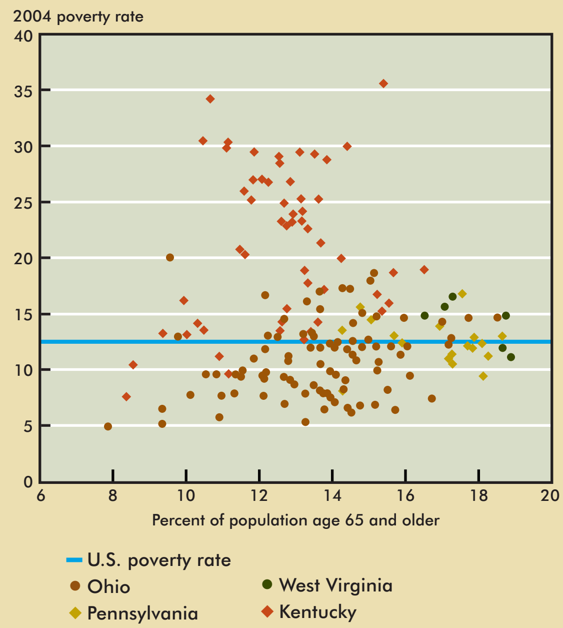
b. Suburban refers to areas within the Metropolitan Statistical Area (MSA), but outside the central or principal city.

c. Rural refers to non-metropolitan areas or areas outside of MSAs.

Census Bureau statistical areas change over time as new areas are recognized to have reached the minimum required city or urbanized area population, and as counties (or cities and towns in New England) are added to existing areas when new decennial census data show them to qualify. Terminology and methodology have also changed over time.

Source: U.S. Department of Commerce, Bureau of the Census.

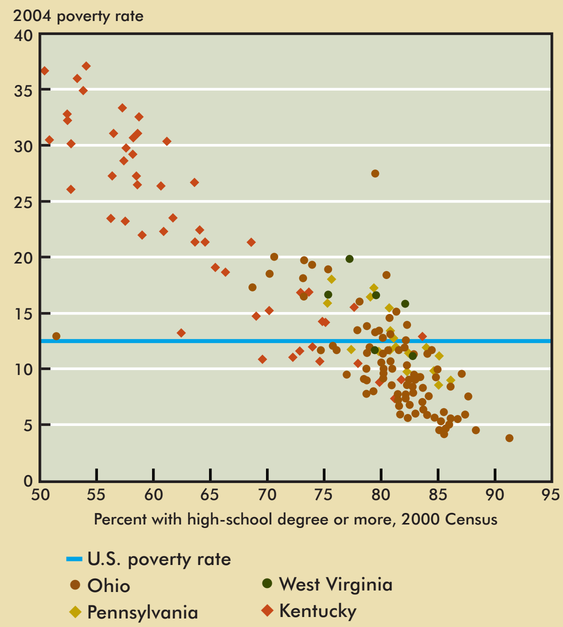
Figure 6 Fourth District County Poverty Rates and Share of Residents Age 65 and Older



Note: Plotted points signify Fourth District counties.

Source: Authors' calculations based on U.S. Department of Commerce, Bureau of the Census, Small Area Income and Poverty Program data.

Figure 7 Fourth District County Poverty Rates and Share of High-School Graduates



Note: Plotted points signify Fourth District counties.

Source: Authors' calculations based on U.S. Department of Commerce, Bureau of the Census, Small Area Income and Poverty Program data.

It turns out that age patterns have little impact on county differences within the Fourth District. Figure 6 depicts the 2004 poverty rates of Fourth District counties versus the fraction of the population age 65 and older. We see no strong pattern connecting age and poverty rates in these counties. Historically, age has mattered quite a lot, but poverty among the elderly is little different from poverty among other adults—due mainly to expanded transfers to older citizens through Social Security.

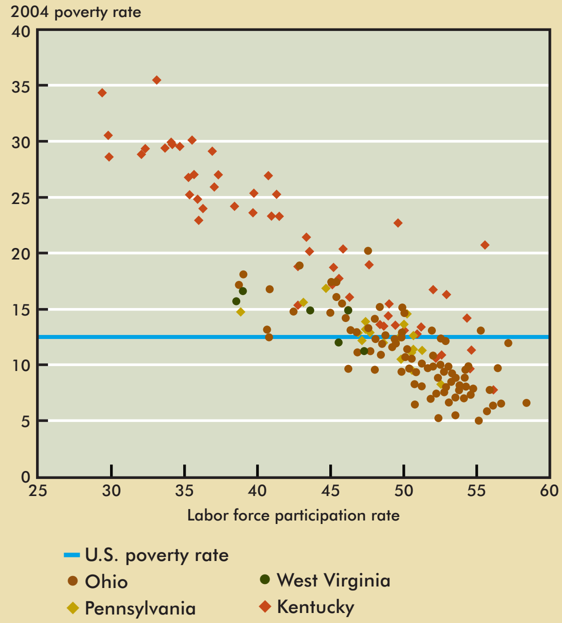
However, county poverty rates can be predicted very accurately by knowing one important fact about the residents: educational attainment. Figure 7 indicates a striking relationship between county poverty rates and education. With the exception of a few outliers, the Fourth District counties lie along a downward-sloping line: Places where more people lack a high-school diploma have higher poverty rates. These results suggest that lower high-school attainment is likely to be a key factor keeping poverty high in eastern Kentucky counties (orange diamond). Even so, these counties have made a great deal of progress, moving from an average of 24 percent of adults holding at least a high-school degree in 1960 to more than 70 percent by 2000.

The relationship between participation in the labor force (persons who are either working or looking for work) and poverty is also quite strong. Figure 8 illustrates that counties with higher labor force participation rates (the number of participants divided by the population above age 16) are associated with lower poverty rates. Of course, education levels and labor force participation rates are related. Increased education levels are associated with higher levels of participation in the labor market, along with higher earnings when working.

After studying several other interesting variables that could help explain underlying differences (such as the age composition of the population, the unemployment rate, and minority status), we find that labor force participation and education remain the most important determinants of county poverty rates. However, the effect of high-school completion is approximately twice as large as the effect of labor force participation rates and is statistically more reliable.

The result relating education and poverty is encouraging, but it remains preliminary. In further research, it will be important to develop models that establish a causal relationship from education to poverty rates. Otherwise, people might be led to support public policies that would address an outcome of high poverty rather than a cause. It is certainly true that high school completion rates reflect a variety of family and individual circumstances, as well as the quality of local schools. Nonetheless, the importance of human capital in driving long-term economic growth suggests the need to develop policies that encourage education and skill acquisition.

Figure 8 Fourth District County Poverty Rates and Labor Force Participation



Note: Plotted points signify Fourth District counties.

Source: Authors' calculations based on U.S. Department of Commerce, Bureau of the Census, Small Area Income and Poverty Program data.

Helping to Break the Cycle of Poverty

Just as poverty has been persistent, analysis of policy options has been ongoing for decades. The challenge is to develop more permanent solutions that not only help those in poverty but also provide the incentive to boost human capital. For instance, a simple solution for eliminating poverty is to make direct transfers to the poor. By moving about $120 billion annually to Americans below the poverty line, the U.S. government could effectively move the official poverty rate to near zero. However, such a program would do little, if anything, to improve the human capital and educational outcomes that might instead lessen the incidence of poverty in the first place.

General income growth has not proven enough to eliminate poverty. In his speech declaring war on poverty, President Johnson listed education as one of the solutions. Concerns about both inequality and poverty point to the need to boost education levels, as evidenced by the declining real income for high-school dropouts over the past 40 years. Given the strong link between education and income, it seems natural to believe that for many citizens in poverty, furthering their education may be a promising avenue.

Boosting high-school graduation rates will likely require a broad range of policies. Education remains a local policy concern, and results continue to vary substantially from one school district to the next. From an educator's perspective, poverty represents a challenge rather than an effect: It has been clearly established that living in poverty reduces the educational outcomes of children.[16]

Successful education requires the interaction of a ready student with a prepared school and a supportive community. If communities are to raise the educational attainment levels of their children, they will need to move beyond the status quo and examine new strategies.

16. Corcoran (2001).

Moving to Opportunity

Does moving from a high-poverty neighborhood to a low-poverty neighborhood improve economic, health, and social outcomes for families? The U.S. Department of Housing and Urban Development undertook an experiment in 1994 to find the answer.

Families from more than 4,000 public-assistance households in Baltimore, Boston, Chicago, Los Angeles, and New York were randomly selected over a three-year period (1994–97). The control group received no new assistance, but continued to be eligible for public housing. The treatment group received a Section 8 voucher that could be used only in neighborhoods with a poverty rate of less than 10 percent, and they also received mobility counseling.

In 2002, data were collected on outcomes from five key areas: economic self-sufficiency, mental health, physical health, risky behavior, and education.

The results of the experiment surprised researchers. Earnings and employment differed little for adults in the control and treatment groups, while mental health outcomes improved for those who moved. Female teenagers benefited most: Those who moved to lower-poverty neighborhoods engaged in less risky behavior, experienced improved mental health, and achieved higher academic performance. However, male teenagers generally fared worse along a range of social and health dimensions compared with the control group. This outcome ran exactly opposite to the researchers' hypothesis that male youths would benefit most by moving away from high-poverty neighborhoods often plagued with drug- and gang-related problems.

We can conclude from this study that housing mobility in itself does not appear to be an effective antipoverty strategy—at least over a five-year time horizon. We can also conclude that neighborhoods *do* have an effect on the social aspects of residents' lives, but in ways that we do not yet completely understand.

Sources: Kling (2006) and Kling, Liebman, and Katz (2007).

Research has pointed to some potential reforms to consider. For example, early child-care and education programs provide opportunities to address the physical, intellectual, and educational needs of young people living in poverty. In a Federal Reserve Bank of Cleveland *Economic Commentary*, Clive Belfield laid out the costs and benefits of early-childhood programs for Ohio, which have been connected to substantial gains for disadvantaged children.[17] The recent literature on compulsory schooling changes shows that even among those students most likely to drop out, adding more months of school boosts their income possibilities, potentially lowering poverty. Retaining and graduating challenged high-school students is critical; however, the research in this area has yet to establish any definitive program recommendations.[18]

Encouragingly, the past decade has witnessed a period of tremendous experimentation in education. One study conducted by the U.S. Department of Housing and Urban Development even attempted to discover whether physical moves from low- to higher-income neighborhoods and schools could help improve outcomes for poor families. The "moving to opportunity" experiment revealed that the effects of community are complicated, but they do exist (*see box at left*).

A careful rethinking of the weapons used in the battle against poverty can help the nation devise new strategies. Over the years, concerns about incentive effects have generally limited the role of transfer programs. Ultimately, the balance between helping the poor through transfer programs and by encouraging work must be decided through the political process. Further success, we argue, might be achieved through programs that bolster high-school completion, higher education levels, and the greater acquisition of skills.

17. Belfield (2005).
18. The Federal Reserve Bank of Cleveland's 2004 Education and Economic Development conference looked at several education initiatives. For more information, see *www.clevelandfed.org/research/conferences/2004/november/index.cfm*.

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