

# THE ECONOMICS OF POVERTY AND DISCRIMINATION

SEVENTH EDITION



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BRADLEY R. SCHILLER

Seventh Edition

*The Economics of Poverty  
and Discrimination*

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## *Preface*

**T**he principal impetus for this new edition was the Congressional passage of historic welfare reforms in 1996. The Personal Responsibility and Work Opportunities Reconciliation Act of 1996 terminated the program (AFDC) that had been the centerpiece of the U.S. welfare system for sixty years. In place of that federal entitlement, Congress created a block grant to distribute welfare funds to the states. Congress established new rules that sharply limit access to welfare for immigrants, nonworking adults, and longer-term recipients. At the same time, however, Congress gave the states much broader leeway to decide who gets welfare, how much they get, and under what conditions. Since July 1997 the states have been developing their own adaptations of the new welfare model. A primary goal of this edition is to describe the new Temporary Assistance to Needy Families (TANF) program and show how it fits into the nation's multilayered welfare system.

A second impetus for this new edition arises from the renewed battle over affirmative action. The gender and race preferences that have been the staples of affirmative action have come under intense assault. California's proposition 209 was not only a barometer of public opinion but also a threshold for the dismantling of gender and racial preferences. This edition re-examines the arguments for and against affirmative action; then it traces the development of equal opportunity policy through key court cases, legislation, and events.

This seventh edition also provides the most recent data on poverty and the maze of related public programs. Once again, an effort has been made to incorporate the latest research findings from diverse disciplines, including economics, sociology, political science, gerontology, and public health. Although my own training in economics gives a unique structure and perspective to the text, the discussion ranges far beyond the conventional boundaries of academic disciplines. This is particularly evident in expanded discussions of the urban underclass, the increasing feminization of poverty, the renewed IQ controversy, and the behavioral constraints on welfare reform. A review of the table of contents will confirm the breadth of the inquiry and the thoroughness of this revision.

The central focus of the text continues to be on the phenomenon of poverty, with discrimination examined as a potential contributing cause. The text begins with a



conceptual discussion of poverty and inequality, highlighting the differing views of causation. Three distinct causal perspectives are introduced in Chapter 1, namely Flawed Character, Restrictive Opportunity, and Big Brother. These competing “explanations” of poverty and inequality are referenced throughout the text in order to accentuate disparate views of why poverty persists and what role public policy should play.

Chapter 2 tries to quantify the dimensions of poverty. The seemingly mundane task of counting the poor has become increasingly controversial, as evidenced by the National Academy of Science’s 1995 report and the ensuing debate over poverty standards and census methods. Chapter 2 summarizes the key dimensions of this debate and emphasizes how our perceptions of poverty depend on the yardstick used. Data for 1995 are used to illustrate both the official poverty count and the impact of various adjustments.

Chapters 3–10 address the major causes of poverty. Each chapter focuses on a cluster of related causes, drawing on a broad range of research. Points of controversy are emphasized and analyzed in the context of the best available evidence. The intent is not to advocate one point of view but to encourage critical thinking on central issues in the poverty debate.

The more prominent policy options for eliminating poverty are examined in the final five chapters. Welfare reform gets a lot of attention, in keeping with the historic 1996 reforms. Chapter 11 reviews the motivations for those reforms and discusses their implementation and impact. Chapter 12 is devoted to social insurance programs. In addition to Social Security and Unemployment Insurance, the chapter includes an extended description of child-support enforcement and assurance. In each case, the theoretical and historical foundations of the policy option are reviewed, with an eye toward assessing its antipoverty potential.

The potential of unemployment and training policies to reduce poverty is examined in Chapter 13. The debate over whether economic growth creates “good” jobs or “bad” ones is reviewed, as are a host of skill-training programs. The impact of the Earned Income Tax Credit (EITC) on labor supply and income is also assessed in Chapter 13.

The renewed debate over affirmative action is the central focus of Chapter 14. The discussion reviews the history and experience of equal opportunity initiatives in both employment and education. The inherent conflict between affirmative action and reverse discrimination is examined in the context of legal milestones and the California and Texas experiences.

The ultimate objective of this book has not changed through seven editions. Its goal is to lay the foundations for a clearer understanding of poverty and discrimination and for a keener perspective on related public policy. Until we know why people are poor, or what kinds of programs are effective in combatting poverty and discrimination, we cannot expect these problems to disappear.

### **Teacher’s Manual**

Prepared by Steven Rock of Western Illinois University, the Teacher’s Manual for this edition offers a brief synopsis of each chapter, a set of true/false and discussion questions, and some lecture suggestions. The Teacher’s Manual is available on request from your Prentice Hall sales representative.



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## ACKNOWLEDGMENTS

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## Part I: The Dimensions of Poverty

### CHAPTER

# *Views of Inequality and Poverty*

**A**merica is a very rich nation. With only 5 percent of the world's population, America produces more than 20 percent of the world's output. While over half of the world's population struggles along with less than \$1,500 per year in per capita income, the average American enjoys well over \$25,000 in annual income. The typical American family has a kitchen outfitted with a microwave oven, a conventional oven/stove, and a refrigerator with built-in freezer. In Indonesia, Ethiopia, Kenya, Haiti, and Pakistan most families don't have any appliances and often no kitchen at all. The running water, hot showers, and indoor toilets that are taken for granted by the average American citizen are still considered luxuries by most people in the rest of the world. While Americans consume 3,600 calories a day and pursue exercise and diet programs to work the fat off, one-fifth of the world's population struggles to get enough food just to maintain body weight and support light activity (2,600 calories per day, according to the World Health Organization). With one doctor for every 500 people, Americans fret over the health care "crisis." In Ethiopia there is only one doctor for every 88,000 people, and life expectancy is only 48 years (versus 76 years in the United States). Few people around the world associate the word *poverty* with America.

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### THE CONTINUING CONTROVERSY

Within the United States, however, poverty is still an issue of intense concern. As rich as America is, its abundance is not shared equally. Some people have so little, in fact, that we consider them to be poor. They include the homeless persons who wander the streets, the welfare families who crowd into substandard housing, the farm workers who can't afford indoor plumbing, and the aged who need public assistance to provide food and shelter.

#### **Too Little Assistance?**

To many observers, such impoverishment in a land of evident abundance is unacceptable. Since we have enough income and wealth to assure everyone a decent standard of living, it is argued, we have a social and a moral obligation to do so. From this perspective,

continuing poverty is a symptom of societal failure—the failure to use our wealth to assure a socioeconomic structure that is equitable and accessible to all. Those who view poverty in this way demand that we reslice the economic pie so that everyone has at least an “adequate” piece. They want to eliminate not only poverty, but also reduce the inequalities that keep some people in million-dollar mansions and others seeking shelter in abandoned cars.

### Or Too Much?

Not everyone shares these views. Many people are convinced that America’s so-called poverty problem is greatly exaggerated. Relatively few Americans, they say, experience real impoverishment. The so-called poor often own their own homes, and a car, and have a television, modern plumbing, and a microwave oven as well. If they need more food, they can get food stamps; if they are sick, they get free medical care (Medicaid or Medicare), and the government provides housing at little or no cost.

Many people argue not only that we have *already* fulfilled our obligation to the poor, but that we have perhaps provided *too much* help to people at the bottom of the income ladder. In a market-based economy incomes tend to reflect how much people produce. In 1996, Michael Eisner made over \$200 million—\$78,000 an *hour*—as chief executive officer of the Walt Disney corporation. In that same year, 30 million American households had incomes of less than \$20,000. Maybe that wasn’t fair or equitable, but it might have been an efficient way to slice the pie. Michael Eisner has led his company’s efforts to develop new movies, plan a new theme park, and market Disney-brand clothes and toys. Judging by Disney’s sales success, these were the kinds of goods and services American consumers wanted. By supplying them, Eisner helped raise the American standard of living. In other words, Michael Eisner increased the size of the pie. He took a large slice, but still left enough for everyone else to enjoy a bit more as well. By dangling such huge rewards, a market system encourages people to produce more output.

The situation at the bottom of the income ladder looks far different. Among the so-called poor there were 6 million families that worked only sporadically, or not at all. They contributed little or nothing to the nation’s output of goods and services. To the extent that people *choose* not to work, why should the rest of society be obliged to take care of them? It is even possible that *helping* the poor may actually *discourage* them from working. If society offers a “free” slice of the pie to people who don’t work, why should other people work hard for similarly sized slices? The provision of welfare benefits, food stamps, free medical care, and subsidized housing may destroy the *incentive* to work. The combination of higher taxes on the rich and more assistance to the poor may end up shrinking the size of the pie we are attempting to reslice.

### Equity and Efficiency

Are economic incentives and notions of equity really so incompatible? Even if the market incentives were so important to our economic prosperity, must the slices received by the poor be so small? And those served to the rich so large? Would Michael Eisner have worked just as hard for, say, only \$20 million? That would have left a lot more pie for the hungry and homeless. In other words, couldn’t we *redistribute* incomes somewhat more equally, without impairing our production of goods and services?

Other critics of the existing inequities go even further, questioning the whole relationship between income and contributions to output. The market does *not* reward people, they argue, in relationship to their ability and effort. Some people command high incomes because they have the “right connections,” “inside information,” or other insulation from the competitive forces of the marketplace. At the other end of the income distribution, many people are forced to accept low incomes because they are “locked out” of good jobs, schools, and neighborhoods. In other words, the market *discriminates*, giving some people better opportunities than others.

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## CAUSES AND CURES

These contrasting explanations of inequality are mirrored in arguments about the causes of poverty. The presence of millions of poor people in the midst of the world’s richest country begs explanation. Are the poor “left out”—excluded from access to the social and economic systems that assure most Americans a comfortable living? Or are the poor simply shiftless and lazy—with no desire to contribute to society or their own personal welfare?

### Flawed Characters

People tend to have very firm ideas about what causes some people to be poor and others rich. To many it is simply a question of flawed characters. From this perspective, poverty is regarded as the natural result of individual defects in aspiration or ability. In colonial times, this perspective was aptly summarized by the puritanical Humane Society, which concluded that “by a just and inflexible law of Providence, misery is ordained to be the companion and punishment of vice.” In more modern times, theories of sin and immorality have not fared well, and there now exists a general reluctance to ascribe to the laws of Providence the misery of the poor. Instead, we speak in terms of “motivation” or “work ethic”: Poverty is thought to result from insufficient amounts of either. According to this view, modern poverty originates from flawed characters, much as in puritanical times.

A theoretical foundation for the Flawed Character argument can be found in the economic concept of *human capital*. Everyone starts out with a certain set of abilities. The critical question is how much those abilities are developed and expanded via later *investments*. Going to school and doing assigned homework represent an investment of time that will increase a person’s productive capabilities. A retail clerk who takes night classes in accounting expects to get better job opportunities as a result of such efforts. A software writer who spends weekends examining new program codes expects her increased knowledge to result in superior products. A father who reads books to his children every night is making an investment in his offspring’s human capital. In all such cases, the investments in human capital are expected to generate a later payoff in the form of better jobs and higher incomes.

The human capital theory implies that people who get ahead are those individuals (and families) that make the necessary investments. By implication, those who don’t make it—the poor—have only themselves to blame. They chose to watch MTV rather than do homework. They didn’t want to give up evenings or weekends for special



classes. Or they chose to watch television rather than read to their kids. They ended up poor because they didn't invest enough time, energy, or money in the development of their own human capital. They might even be part of a cultural underclass that disparages such investments, focusing instead on more immediate gratifications.

There are three essential links in the human capital explanation of flawed characters. The first is the assumption that human capital is rewarded in the marketplace. If college graduates don't make more money than college dropouts, then investments in college don't pay. There must be consistent and tangible payoffs to human capital investment if we expect people to make such investments.

The human capital model also assumes rational *choice*. People need to know what their options are and be able to choose from among them. If they voluntarily make the wrong choices, their poverty is understandable.

Finally, the human capital interpretation of flawed characters depends on the existence of pervasive opportunity. From this perspective, anyone who wants to move up the income ladder can do so by making the required effort—the human capital investment.

The Flawed Character argument applies both to jobs and schools. In the labor market, people who do not find good jobs are assumed to lack sufficient initiative or diligence. To the extent that they are less able, as measured by education, skills, or ability tests, their disadvantage is to be explained by earlier lack of motivation in school. Individuals who do not work hard in school end up failing in the job market as well. Thus, the Flawed Character perspective sees individuals as in full control of their socioeconomic status.

### **Restricted Opportunity**

An alternative explanation of poverty claims that impoverishment may result from forces beyond the control of the individual. According to this argument—the Restricted Opportunity argument—the poor are poor because they do not have adequate access to good schools, jobs, and income. They are discriminated against on the basis of race, sex, or income class. As a result, they can't get the education, the jobs, or the housing they need to get ahead. Even government services are denied them. They don't get adequate police protection; they get few tax breaks; and they are denied more mainstream public services (e.g., transportation service, street repair, public facilities). In the face of these external barriers, no amount of work ethic or effort assures escape from poverty.

The Restricted Opportunity argument denies a critical premise of the Flawed Character argument. If individuals don't have an equal opportunity to acquire education, then their lack of human capital isn't so easily explained by poor choices they might have made. Likewise, if the achievements of minority workers are rewarded less in the marketplace, the incentive to invest in their human capital is diminished as well.

Restrictions on opportunity need not originate in overt discrimination. One of the most rapidly growing segments of the poverty population is single mothers and their children. The failure of absent fathers to provide financial support for their children handicaps a mother's ability to raise the children or secure employment.

A basic implication of the Restricted Opportunity argument is that only the provision of improved opportunities would assure a reduction in the number of people we