Chapter 1

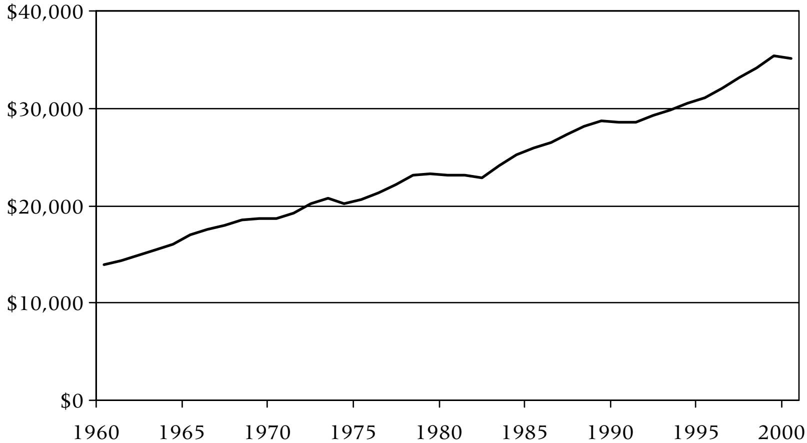
Introduction

Alan J. Auerbach, David Card, and John M. Quigley

The postwar era in the United States has been a time of rising national income and unprecedented gains in the economic well-being of American households. This prolonged period of growth led to a reduction in poverty rates but was also associated with a rise in the inequality of wealth and family income. Concurrent changes in demographics—increased immigration, the baby boom and bust, shifts in marriage and living arrangements, and continued suburbanization—have affected labor markets, the demand for social services, and the overall distribution of well-being. At the same time, changes in transfer and entitlement programs have affected the levels of support offered by the government to the poor, the aged, and the infirm.

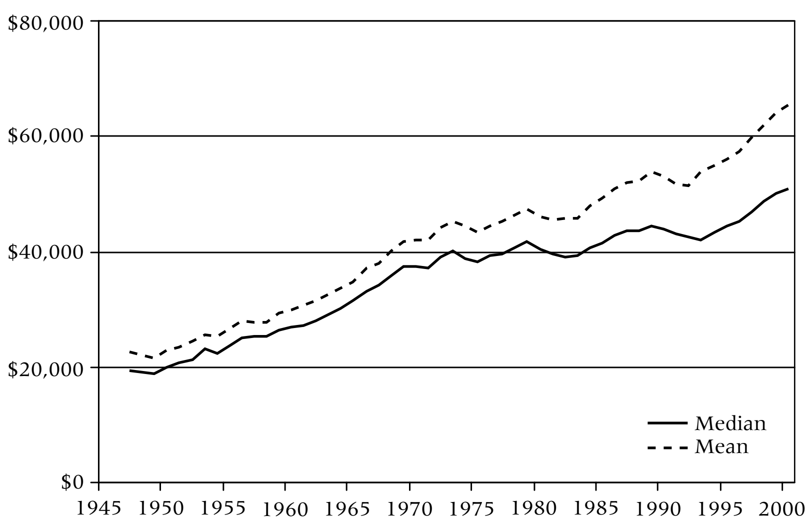
The chapters in this book analyze the complex interactions among demographics, poverty, the distribution of income, and public policy from a longer-run perspective, taking stock of our knowledge of trends and causes, and identifying key areas where positive economics can contribute further to our understanding of policy options. In considering these broader linkages, it is important to keep in mind the extent of absolute improvement in the well-being of Americans, their incomes, and their economic circumstances. Figure 1.1 shows the trend in inflation-adjusted income per capita during the period 1960 to 2000. Real national income per person grew by 250 percent over the forty-year period. Figure 1.2 shows how these increases in economic output have translated into trends in

Figure 1.1 Per-Capita Gross National Product of the United States, 1960 to 2000 (2000 Dollars)



Source: U.S. Department of Commerce (2004, 167, table 1).

Figure 1.2 U.S. Family Income, 1947 to 2000(2000 Dollars)



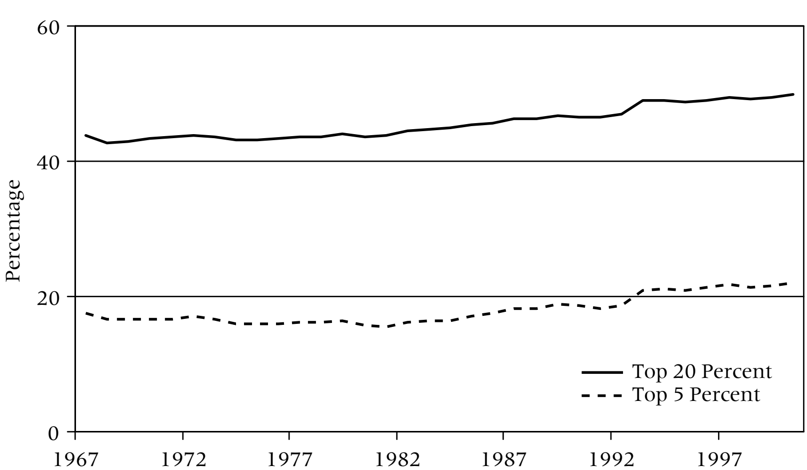
Source: U.S. Census Bureau (2001).

family income. Median family income—the level of income separating the top and bottom halves of the distribution—rose from about \$20,400 in 1947 (in 2001 dollars) to about \$52,300 at the turn of the century. To be sure, the increases have not been without interruption. Decreases occurred during major recessions—in 1975, for example, and in the early 1980s and early 1990s—but these declines were small, and the reverses were of short duration.

Figure 1.2 also reports the course of mean family income. This measure of family well-being has risen even faster, from about \$23,900 to \$67,400. The widening gap between mean and median family incomes reflects the increasing inequality in the distribution of family income, which has attracted much attention in recent years. Indeed, the systematic increase in the share of income accruing to upper-income families is shown clearly in Figure 1.3. From the mid-1960s through the end of the century, the share of income accruing to the top quintile of families increased from 43 percent to 50 percent, while the share of income garnered by the richest 5 percent of families increased from 17 percent to 22 percent.

Notwithstanding the widening of the distribution of income, poverty rates among American households have declined systematically.

Figure 1.3 Share of Household Income in Top 20 Percent and Top 5 Percent of Income Distribution, 1967 to 2000

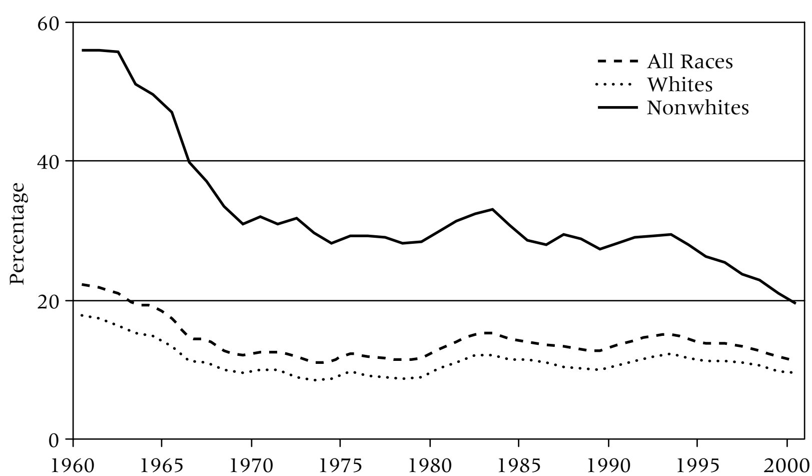


Source: U.S. Census Bureau (2000a).

Figure 1.4 shows the trends during the last four decades. Among whites, the incidence of poverty declined by nearly half, from 18 percent in 1960 to 9.5 percent in 2000. Among nonwhite households, the decline was even larger. In 1960, more than half of nonwhite households in America (56 percent) lived in poverty. By 2000, less than one fifth (19 percent) of nonwhite households had incomes below the poverty line. The declining trends in poverty rates have not been continuous, and there were periods, especially during the early 1980s, when poverty rates increased markedly. Nevertheless, for the period as a whole the reduction in poverty rates was remarkable. Despite this general progress, at the turn of the century differences in poverty rates for blacks and whites remain substantial. As indicated in Figure 1.4, by 2000 the poverty rate among nonwhites was still more than twice that for whites. In fact, at the end of the century the average poverty rate of nonwhites was about equal to the rate of whites forty years earlier.

These changes in the level and distribution of income and the incidence of poverty have arisen from changes in the labor market—the distribution of skills and labor supply and the incidence of unemployment—and from government policies. Secular changes in

Figure 1.4 Poverty Rates for Whites and Nonwhites, 1960 to 2000

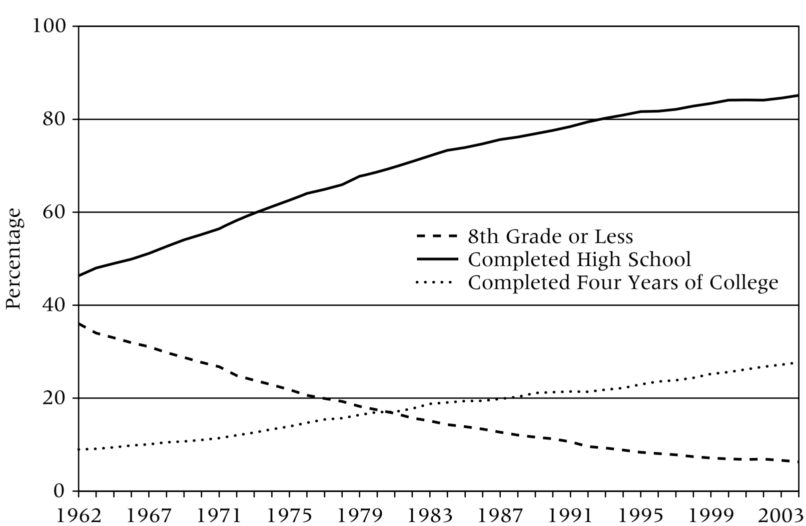


Source: U.S. Census Bureau (2000b).

skills, as proxied by the education levels of adults, have been enormous. As indicated in figure 1.5, in 1962 nearly 40 percent of adults had no more than eight years of formal schooling. By 2004, that percentage had declined to less than 7 percent. Meanwhile, the proportion of adults who have completed high school increased from 46 percent in 1962 to 85 percent in 1988, while the proportion with at least a bachelor's degree rose from 9 percent to 28 percent. Though not shown in the figure, there has also been a rapid rise in the fraction of adults with one to three years of postsecondary education, from 16 percent in 1960 to 51 percent in 2000.

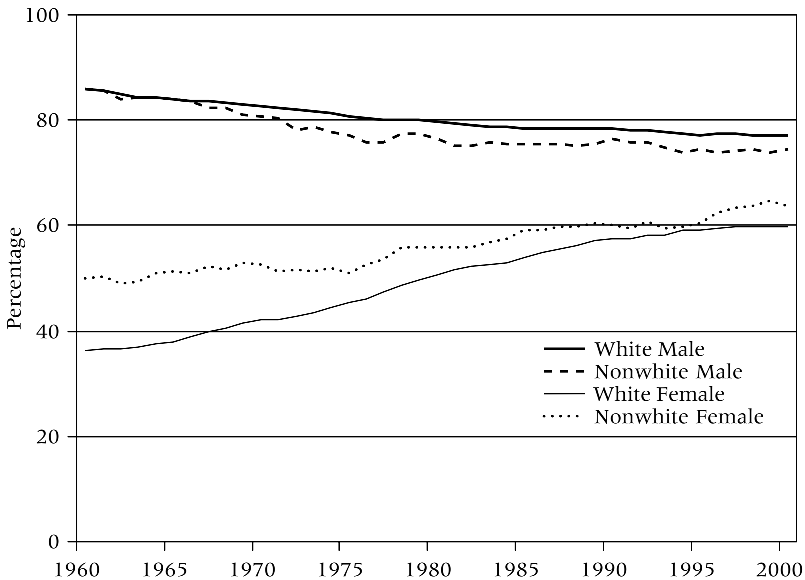
This upgrading of skills has been accompanied by substantial increases in the labor supply of women and a small decrease in labor-force participation among adult men. As indicated in figure 1.6, labor-force participation rates for white and nonwhite males declined from 86 percent to 77 and 75 percent, respectively, from 1960 to 2000. In contrast, labor-force participation rates for nonwhite women increased from 50 percent to 64 percent and participation rates for white women rose from 36 percent to 60 percent. Women with

Figure 1.5 School Completion Rates of Adults Age Twenty-Five and Older, 1962 to 2004



Source: U.S. Bureau of the Census (2003).

Figure 1.6 Labor-Force Participation of Adults Aged Twenty and Older, by Race and Sex, 1960 to 2000

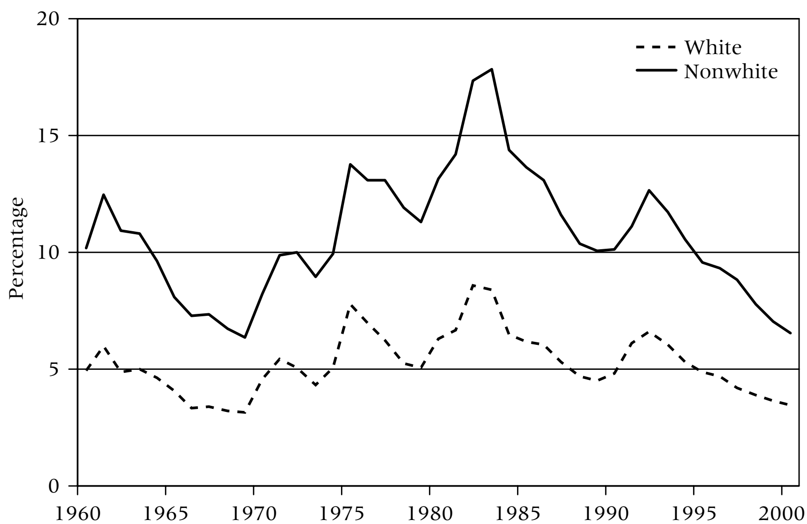


Source: U.S. Bureau of Labor Statistics (2000).

children have accounted for most of the secular rise in female labor supply. Currently, 77 percent of women whose youngest child is between six and seventeen years of age are participating in the labor force, and the participation rate for women with a preschool child is 62 percent. It is interesting that the participation rate of women with no children under eighteen years of age is only 54 percent.

Although the increases in labor-force participation of the adult population have been accompanied by rises in employment rates and per-capita hours of work, unemployment remains a significant concern in the U.S. labor market. As shown in figure 1.7, unemployment rates at the end of the century were at the levels of the mid-1960s. (In the post-2000 recession, rates rose about two percentage points above their 2000 levels.) Unemployment rates for both whites and nonwhites are highly correlated with the business cycle, though over most of the past four decades, unemployment rates for nonwhites have remained about twice the rates for whites.

Figure 1.7 Unemployment Rates by Race, 1960 to 2000



Source: U.S. Bureau of Labor Statistics (2000).

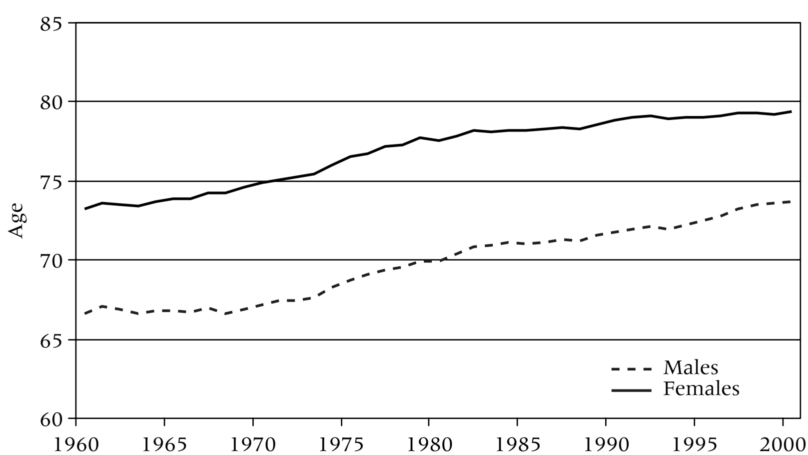
Secular rises in the educational attainment of Americans have been accompanied by equally large changes in the economic returns to these skills. In 1960, the average full-time worker with less than a high school diploma earned $13,300 (in 2000 dollars). The average high school graduate (with twelve to fifteen years of education) earned $19,900, and a college graduate earned $30,600. By the late 1990s, the economic returns to these levels of education were $11,600, $22,700, and $41,100, respectively. The economic disadvantage of less-skilled workers had become much more pronounced. For those without a high school diploma, real incomes actually declined.

The economic changes in the past four decades were accompanied by equally profound changes in the demographic characteristics of the U.S. population. As shown in figure 1.8, life expectancies have risen substantially—by more than 10 percent for both men and women. Estimated life expectancy for men born in 1960 is sixty-seven years and for women, seventy-three years. For people born in 2000 the corresponding estimates are seventy-four years and seventy-nine years. Put another way, a male born in 1960 could expect to live two years beyond the customary retirement age of sixty-five. Males born in 2000 can expect to live nine years beyond the traditional age of retirement.

Associated with increased life expectancies have been pronounced changes in the age distribution of the population. Increased longevity, together with the decline in fertility rates since the end of the baby boom in the mid-1960s, has meant that the fraction of the elderly has risen while the fraction of the population below the age of eighteen has declined. As is evident from figures 1.9 and 1.10, these changes are similar for males and females. The rise in the fraction of the population over sixty-five years of age, from about 8 to 12 percent between 1960 and 2000, has led to increasing attention to the problems of financing private and public pension systems.

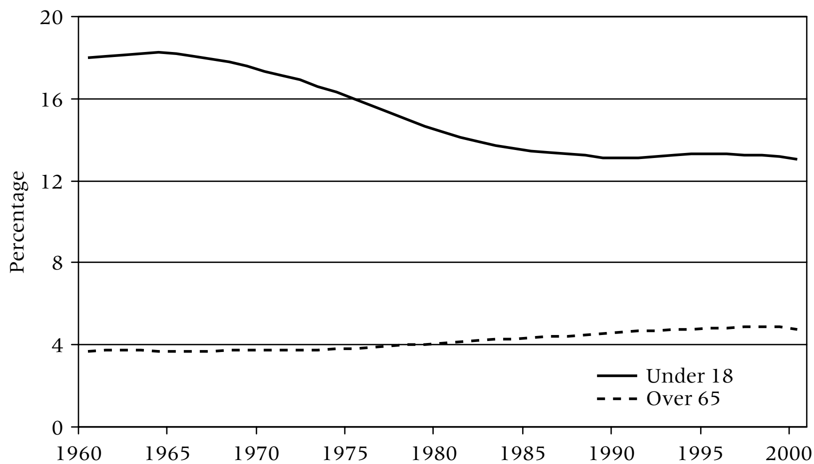
An equally important demographic factor has been the greatly increased levels of immigration. Before the elimination of national quotas as a result of the Immigration Act of 1965, foreign migration to the United States averaged about 265,000 per year. As shown in figure 1.11, legal immigration inflows gradually increased over the 1970s and 1980s, reaching a rate of about 600,000 per year in the

Figure 1.8 Life Expectancy at Birth by Sex, 1960 to 2000



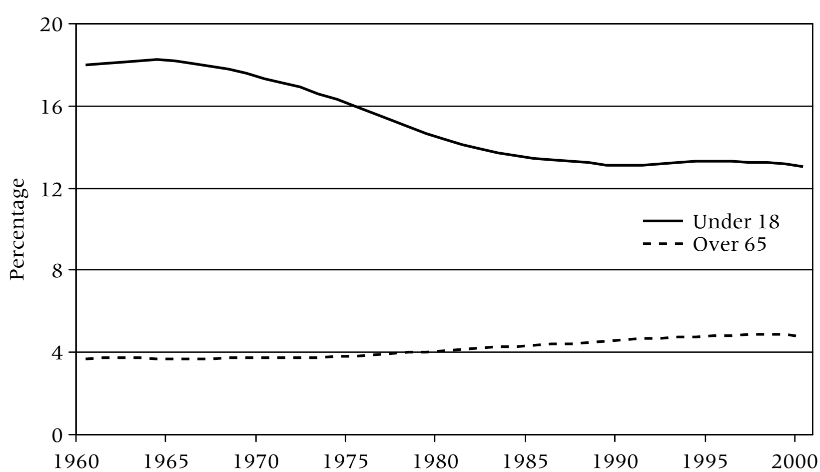
Source: Social Security Administration (2002, 132–36, table 11).

Figure 1.9 Age Distribution of the Female Population, 1960 to 2000



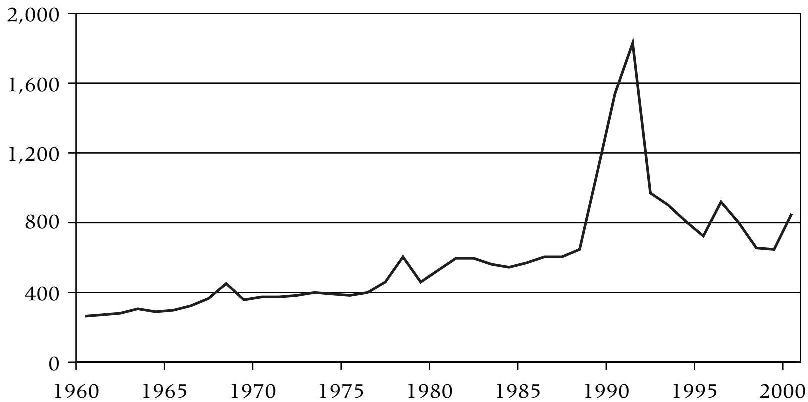
Source: Social Security Administration (2002); calculations by www.mortality.org.

Figure 1.10 Age Distribution of the Male Population, 1960 to 2000



Source: Social Security Administration (2002); calculations by www.mortality.org.

Figure 1.11 Annual Immigration, in Thousands



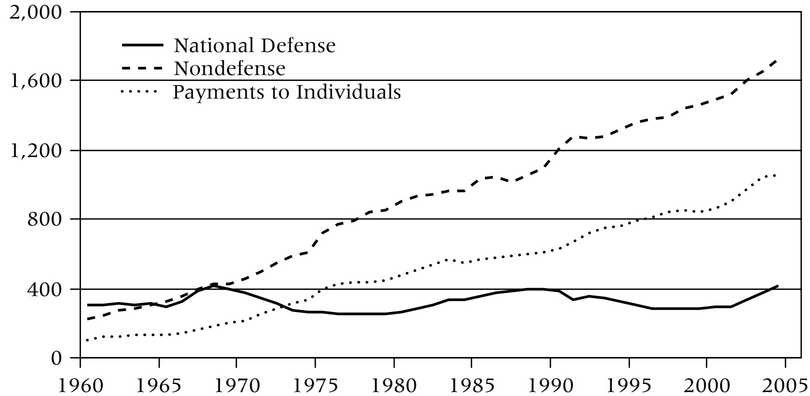
Source: Department of Justice (2001, table 1).

mid-1980s. Illegal immigration flows probably contributed a further 150,000 to 200,000 people per year, many of whom were legalized in the late 1980s (generating the "spike" in the legal-flow data reported in figure 1.11). Over the 1990s, legal inflows have risen to about 800,000 per year—and illegal inflows add as many as 200,000 additional people. Currently, immigration contributes about one-third of the net rate of increase of the U.S. population.

Against this background of fundamental economic and demographic trends, the chapters in this book pose a series of key questions about the role of government policy in altering the level and distribution of economic well-being. To set the stage for the individual chapters, it is helpful to give a brief overview of some of the general trends in overall government spending and taxation that have emerged over the past forty years.

Since the beginning of the Kennedy administration, real spending by the federal government has quadrupled, from $527 billion in 1960 to $2,143 billion in 2004 (in 2000 dollars). Figure 1.12 shows the trends in outlays for national defense and nondefense spending. Beginning in 1969, just after the peak of spending on the Vietnam War, nondefense spending surpassed spending on defense. Defense spending subsequently declined, returning to its 1968 level briefly during the Reagan administration. Figure 1.12 also reports transfers and other payments to individuals, the largest component of non-

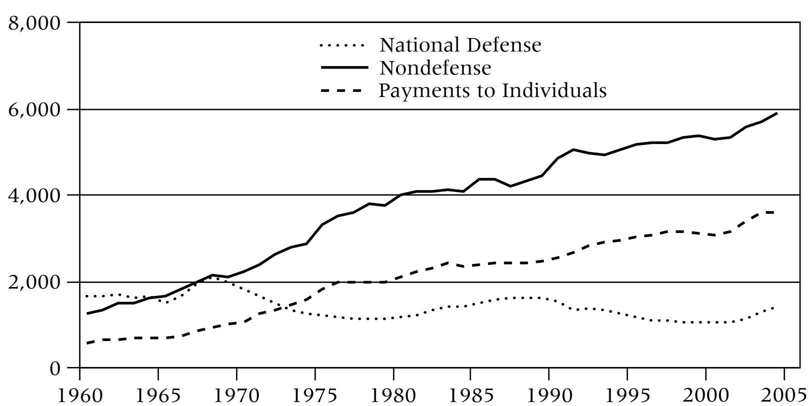
Figure 1.12 Federal Outlays by Category, 1960 to 2004 (Billions of 2000 Dollars)



Source: Office of Management and Budget (2005, table 6.1).

defense spending. By the mid 1970s, payments to individuals exceeded military expenditures. Figure 1.13 shows the same series in per-capita terms. By 2004, defense outlays totaled about $1,400 per capita while nondefense outlays amounted to $5,900 per person. Of the latter figure, about $3,600 represented transfers to individuals.

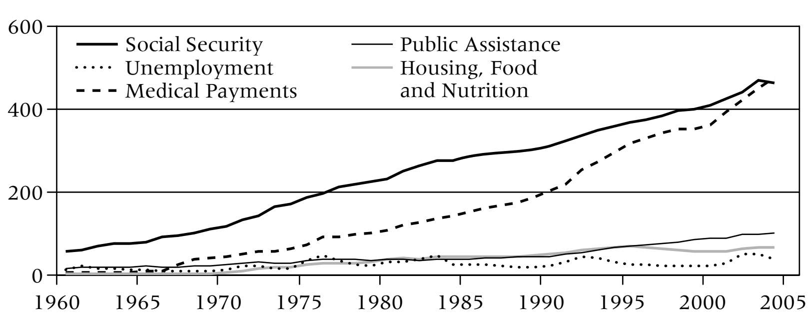
Figure 1.13 Federal Outlays Per Capita by Category, 1960 to 2004 (2000 Dollars)



Source: Office of Management and Budget (2005, table 6.1).

More detail on the trends in government spending programs is provided in figure 1.14, which shows spending in five key areas: Social Security payments to individuals (mostly old-age and survivors insurance plus disability insurance); unemployment assistance; payments for public assistance and related programs (mostly welfare payments to individuals, Earned Income Tax Credit payments, and supplemental security payments); medical care (mostly Medicare and Medicaid payments); and housing, food, and nutrition programs. As indicated in the figure, there was a steady increase in federal outlays for all five program areas over the past four decades, though the growth rates vary substantially across areas. Outlays for unemployment assistance increased at the slowest rate, 2.3 percent per year, rising to $38 billion by 2004 (in 2000 dollars). Social Security payments increased by 4.8 percent per year, to $462 billion by 2004, while outlays for public assistance increased by 4.8 percent, from a much lower base, to $101 billion in 2004. Payments for housing, food, and nutrition programs increased by 8.4 percent per year, from an even smaller base, to $67 billion in 2004. The fastest growing program area—outlays for medical care—increased by 10.5 percent per year during this long period, to $477 billion in 2004. Growth in medical-care spending has been particularly rapid in the past five years, rising by $125 billion (in constant 2000 dollars) between 1999 and 2004. Medical payments amounted to almost 23 percent of the $2.1 trillion in federal outlays in 2004. Medical-care and Social Secu-

Figure 1.14 Government Payments to Individuals by Major Category (Billions of 2000 Dollars)



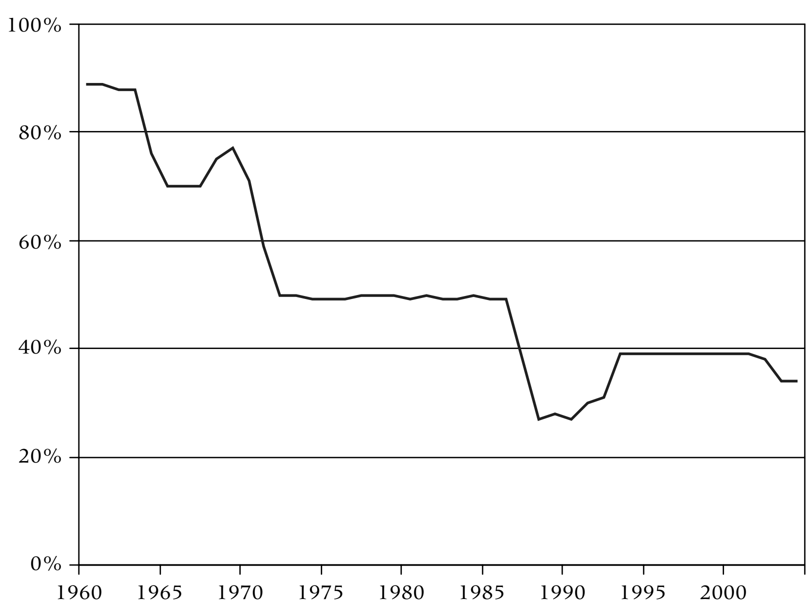
Source: Office of Management and Budget (2004, table 11.3).

rity payments together account for almost 45 percent of federal government outlays.

Finally, figure 1.15 crudely summarizes the course of federal tax policy, indicating the marginal tax rate on the highest-income individuals during the period, as represented by the statutory tax rate on wage income for those with one million dollars of income (in constant 1992 dollars). The recent decline in tax rates stands in sharp contrast to the continued increases in per-capita spending documented in figures 1.12 to 1.14, underscoring the source of concern over the sustainability of current policy directions.

The chapters in this book focus on the linkages and interactions between government programs and policies, on the one hand, and the economic and demographic forces described earlier, on the other hand. Although the scope of the terrain is broad, the chapters are not intended to represent comprehensive surveys of scholarly research. Instead, we asked leading contributors in the fields of public finance

Figure 1.15 Highest Federal Tax Rates on Ordinary Income, 1960 to 2004



Source: National Bureau of Economic Research (2003).

and public policy to focus on specific issues they found most relevant to assessing these linkages.[1] Several chapters focus on questions related to the distributional impacts of government policies: What determines the take-up rate of benefits offered by different government programs? How are the relative labor-market opportunities of young black and white men linked to incarceration policies? Other chapters present an evaluation of specific policies: the effects of Social Security on poverty among the elderly, and the accomplishments of the welfare reforms of the 1990s. Two of the chapters present historical assessments: What can we learn from the past about public-health expenditures and demographic outcomes? How has the concentration of wealth in industrialized countries been affected by the different tax policies pursued by their governments?

Along with economic, demographic, and policy changes, the past forty years have seen a massive change in social science research, made possible by modern computers and advances in quantitative methods. As a result of this explosion of research, we now know far more than earlier generations about the interactions between demographic and economic trends, public policies, and the distributions of individual and family outcomes. Nevertheless, the authors are careful to emphasize important unanswered questions. The discussion in each chapter makes it clear that there are many open questions and new directions for research that will surely be addressed in the coming years.

In chapter 2, "What Did the 1990s Welfare Reforms Accomplish?," Rebecca Blank considers the far-reaching changes wrought by passage of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) in 1996. She documents the course of welfare reform from the cautious experiments of the 1980s to the more ambitious waiver programs of the 1990s and ultimately to the passage of PRWORA. As Blank indicates, by converting the matching-grant provisions of the old welfare system into a block grant and by introducing time limits, welfare reforms rewarded efforts by the states to encourage the welfare-to-work transition, to increase earnings "disregards" for recipients (amounts not counted against the calculation of their benefits), to impose sanctions, and to impose more stringent time limits on welfare beneficiaries.

Changes in welfare rules weren't the only policy innovations of the 1990s, and any evaluation of the effects of welfare reforms must recognize these other changes in the economic environment. Importantly, the booming economy of the 1990s had an enormous impact on the low-wage segment of the labor market making it easier to implement reforms encouraging labor-force participation.

Blank's chapter documents the dramatic changes brought about by this combination of policy reform and economic good fortune. Her review reveals that welfare caseloads fell by 50 percent in the decade of the 1990s, that labor-force participation rates for single mothers increased sharply through 1999, before declining modestly, and that during the recent downturn, unemployment rates among less-educated women have not risen as fast as rates for other groups. Increases in incomes and declines in poverty rates among single mothers were substantial, but they were less dramatic than changes in caseloads and labor-force participation.

This chapter provides the first systematic research comparing changes in income and poverty rates, caseloads, and labor-force participation among groups of single mothers. Blank presents evidence by race and level of education and by the age of the mother's youngest child. A striking result of these comparisons is the large gains in earnings shares made by women who had little or no earnings in the mid-1990s. There were also large gains in labor-force participation and substantial reductions in poverty among these women. All this suggests that those single mothers who were most disadvantaged in the labor market had no greater difficulty finding work after the rules were changed.

Blank provides a synthesis of the results of the many studies that have sought to interpret these findings—sample surveys of women leaving welfare, analyses of government data such as the Current Population Survey, natural experiments, and a few controlled experiments. Experimental studies suggest, for example, that "work first" programs, which place mothers directly into employment without regard to wages or skill requirements, can be more effective than job-training programs at getting women working. Other studies suggest that work programs can have modest positive effects on the well-being of children.

Finally, Blank considers the important lessons from efforts during the past decade at welfare reform: the importance of interactions and synergies—the strong economy, the Earned Income Tax Credit (EITC), the other changes in policy—in affecting outcomes; the asymmetric responses of labor-force participation during the recent slowdown in the economy; and the interactions among public assistance programs, family composition, and fertility.

Blank's chapter concludes by identifying an important set of unanswered research questions about the effects of these policy changes on outcomes, the effects of macroeconomic conditions on low-wage labor markets, and the longer-run effects of time limits on single-parent households.

In chapter 3, "The Take-Up of Social Benefits," Janet Currie explores the distribution of in-kind benefits to selected recipients—individuals or groups targeted as "deserving" as a result of their demographic attributes or poverty status. Currie's chapter is concerned with an important feature of public-assistance programs long neglected by economists, namely, the imperfect targeting of beneficiaries by the design and execution of programs. These design features matter. If the take-up of benefits by eligible individuals or households is too low, a program will fail to reach its goal of providing assistance to the targeted group. If the take-up of benefits by ineligibles is too high, then a government transfer program is wasteful, or worse, counter productive.

After a review of the received model of social stigma as a deterrent for some eligible households to participate in public programs, Currie finds the model of limited value. She stresses instead the variations in the costs of participation in government programs, including information, transactions, and transport costs, and the problems of principal-agent coordination.

Currie provides a comprehensive survey of the literature on the take-up of means-tested transfer programs in the United States and a more limited survey of analogous programs in the United Kingdom. Her empirical results reveal an astonishing variation in take-up rates across programs, even when entitlement programs offering similar services are compared. Currie deconstructs several of these programs, exploring the extent to which the effects of information and transaction costs can vary.

One important normative question in evaluating these variable take-up rates is: do the barriers to program participation screen out the "undeserving" people? Currie's synthesis of research on disparate programs—Supplemental Social Insurance (SSI), school lunch programs, and Medicaid, for example—indicates the difficulty in devising program rules to target programs only to those who "need" them.

A second and purely positive question is: what can be done to affect take-up rates? Currie suggests that take-up rates for programs will be higher when businesses as well as individuals profit from program participation: commercial tax preparers promote take-up of the EITC; hospitals also benefit if eligible pregnant women are covered by Medicaid before delivery. There may also be some benefit in bundling applications for certain programs—Medicaid and food stamps, for example—so that information costs are reduced.

Currie's survey of the take-up of program benefits in Britain also reveals a large variation in estimates of the fraction of eligible individuals who receive program benefits. Take-up of the British version of the EITC is roughly the same as that across the Atlantic, but take-up of the British version of SSI is a good bit higher than in the United States.

Currie's survey strongly suggests that economists should pay much more attention to rules about program eligibility and to information about how those rules are enforced and disseminated. She also provides anecdotal evidence about natural variation in services and outreach across states or regions which could be exploited to learn more about these important issues.

In chapter 4, "Government Programs and Social Outcomes: Comparison of the United States with Other Rich Nations," Timothy Smeeding produces a comparative analysis of the incidence of poverty in the United States and seven other highly developed countries: Canada, the United Kingdom, Belgium, Germany, the Netherlands, Finland, and Sweden. Smeeding then analyzes the extent to which government programs mitigate the prevalence of poverty in the population as a whole, as well as poverty among key subgroups such as children and the elderly. He concludes with some comments about policies the United States might undertake to reduce the number of households living in poverty.

Measuring poverty is in itself a challenging task that raises questions that have occupied economic researchers for years. First, how does one compare the living standards of families that differ in size and composition? Here, the standard approach is to adjust income using equivalence scales that reflect variations in the per-capita cost of living among family types. Second, should comparisons be made using a relative measure or an absolute one? Smeeding argues that poverty should be viewed as a relative concept, relying primarily on incomes below half the median as an indicator of poverty. Third, how should income and living standards across countries be compared? Smeeding uses not market exchange rates but "purchasing-power parity" (PPP) exchange rates, which measure the relative strengths of currencies in purchasing a constant market basket of goods. Fourth, how broad an income measure should one use in measuring a family's available resources? Smeeding includes not only after-tax disposable income, but also government transfer payments.

The most novel and most challenging aspect of Smeeding's analysis is its cross-country approach. Aside from dealing with the exchange rate issue, Smeeding and his associates have devoted considerable effort over the years to the collection of comparable data for the different countries. This work has been undertaken through the Luxembourg Income Study.

To summarize Smeeding's findings, by the year 2000 the United States was a clear outlier in many respects. It stood out in aggregate economic performance, with per-capita gross domestic product substantially higher than that of the next-highest country, the Netherlands, and an unemployment rate that was substantially lower than that of all but one of the other countries—again, the Netherlands. But the U.S poverty rate also stood out. At 17.0 percent, the rate was substantially higher than the sample average of 9.8 percent, and much higher even than the second-highest poverty rate in the group, the United Kingdom's 12.3 percent. As in most of the other countries, poverty among the U.S. elderly has lessened over the past couple of decades, even as general poverty and poverty among households with children has increased, but the U.S. poverty rates in all subgroups are well above the international average. In certain at-risk groups, the U.S. poverty rate is startlingly high, reaching, for example, 51.3 percent among children living in families with low-education parents.

Why is poverty so prevalent in the United States? Smeeding argues that in the other countries, government intervention, through the tax system, social insurance (universal transfer programs), and social assistance (targeted transfer programs), make the difference. Poverty rates as measured by market incomes—money earned from working—are actually lower in the United States than in most of the other countries. But government interventions are estimated to reduce the poverty rate by 62 percent on average in the other countries, but only by 28 percent in the United States. These measures do not provide precise estimates of the extent to which the programs actually reduce poverty, of course, because one cannot observe what market incomes would have been in the absence of government intervention. But the differences between the United States and all the other countries are nevertheless very suggestive of the lack of government intervention as a key factor in the high U.S. poverty rate.

Smeeding also dismisses the labor market as a source of the discrepancy between poverty rates in the United States and in other developed countries. Indeed, as others have observed, the United States stands out for its high labor-force participation rates and long work weeks. These patterns exist, not only in the aggregate population, but also among lower-income workers. Yet many in the United States who work remain in poverty. For example, among single-parent U.S. families in which the household head works more than 1,000 hours per year, 33 percent remain in poverty; the international average of those who remain poor while working is just 13.5 percent.

Given that the United States has a much higher average living standard than other countries, one might ask whether our high incidence of poverty, relative to our median income, really means that the poor are worse off in an absolute sense. Here, the evidence is mixed. Comparing living standards across countries among the poor, which Smeeding defines as those in the poorest tenth of the population, he finds that the U.S. poor, overall, have about the same income as those in the tenth percentile in other countries. But among children living in one-parent families, the poor in the United States fare worse, even when an absolute standard is used.

Thus, poverty in the United States is widespread, and it is particularly acute in certain subgroups, such as single-parent families. Smeeding blames this outcome—especially when measured against the situation in other countries—on a lack of effective government intervention, and argues that the United States can do considerably more to eliminate poverty.

In chapter 5, "Income and Wealth Concentration in a Historical and International Perspective," Emmanuel Saez provides another international comparison of incomes. Saez's focus differs from Smeeding's in a number of respects—most important, Saez is concerned with activity near the top of the income distribution rather than near the bottom. Economists have a number of reasons for investigating patterns in the concentration and composition of income and wealth among the rich, ranging from a wish to understand the role of entrepreneurship in economic growth to concerns about social cohesion and the distortions imposed by progressive taxation. During the last few decades of the twentieth century, increasing income dispersion in many countries, especially the United States, directed increased attention to the causes and consequences of concentrations of income and wealth. These concerns in some respects echoed those voiced a century earlier.

Saez also departs from Smeeding in the types of data sources used. A key finding of the cross-country research that Saez summarizes (much of which he has produced himself, independently and in collaboration with others) is that there is great heterogeneity among those at the very top. In particular, it is useful to disaggregate even within the top 1.0 percent of the income distribution, as patterns within the top 0.1 percent differ markedly from patterns among those in the "bottom" 0.9 percent of the top percentile. Given how much of a country's income and wealth may accrue to those in the top 0.1 percent of the population, very fine groupings may be productive from a research perspective. But survey data are not very helpful for these purposes because there is scant coverage of the very rich. Thus, following methods first developed in the 1950s by Simon Kuznets, the line of research pursued by Saez uses statistics from income tax returns to measure the incomes of those at the top, and he compares these incomes to aggregate measures based on national accounts. To a lesser extent, with the same methodology, estate tax returns can be used to analyze wealth concentrations.

An advantage of using data from income tax returns is that, although income taxes have grown in their population coverage over time, they applied earliest to those with the highest incomes. Thus, one can observe data going back to early in the twentieth century, when income taxes were first established. A disadvantage is that any researcher is constrained by the components of income covered by the tax system, so that income intentionally or unintentionally excluded from the tax base (through tax evasion, for example) is not directly observable. Nonetheless, the research that Saez organizes and discusses has yielded rich time series for several countries that provide fascinating details on the course of income and wealth concentration during the twentieth century. These time series invite the formulation of hypotheses to explain these patterns.

Saez provides time series on top income percentiles since around World War I for six countries: the United States, Canada, the United Kingdom, France, the Netherlands, and Switzerland. In all countries except Switzerland, the patterns through the end of World War II are similar. First, there was a sharp decline in income concentration over this period. Saez attributes this decline to the successive shocks of the Great Depression and World War II, and also to a reduction in the concentration of capital income. In five of the countries, for those with the highest incomes, capital income has come to represent a much smaller share of income than was true a century ago. Switzerland, by contrast, did not experience a drop in its income concentration, which Saez attributes at least in part to its avoidance of the World War II conflict. This prevented severe economic disruptions and reduced the sharp pressures for increases in progressive income taxation experienced by the other countries.

After World War II, the common trends of all the countries (excluding Switzerland) break down, with income concentration rising sharply in the "Anglo-Saxon" countries, the United States, Canada, and the United Kingdom, but not in the "Continental" countries (France and the Netherlands). The increase in concentration has brought the share of income in the top 0.1 percent of the population back up to levels not seen since World War I, at least in the United States. But the driving force this time is labor income, not capital income, and perhaps because it takes time for accumulations from labor income to translate into wealth, there has yet to be such a sharp rebound in the concentration of U.S. wealth.

How can one explain this divergence between the Anglo-Saxon countries and the Continental countries? One possible explanation is the significant declines in top marginal tax rates in Anglo-Saxon countries, which could have spurred not only increases in actual income but also shifts in the composition of income toward components subject to tax. This explanation is more plausible for the United States and the United Kingdom than for Canada, which did not implement significant reductions in top marginal tax rates. Saez argues that Canada's proximity to the United States may have forced incomes up there as well to keep mobile workers from leaving. But the timing of income increases in the United States does not match perfectly the changes in income tax rates, suggesting that the process may relate more to a long-term tax environment than to specific legislation or particular tax changes. This leaves open alternative, and possibly complementary, explanations, such as changes in the strength of corporate governance that may have permitted surges in executive compensation.

If there is one "success story" in the area of poverty alleviation, it is the reduction in poverty among the elderly that has been accomplished by old-age pension systems. As noted earlier in the discussion of Smeeding's international comparison of poverty, old-age poverty has been trending downward even as the frequency of poverty among children has been rising. Nowhere is this development more noticeable than in the United States, where the establishment and continual growth of the Social Security system has been given credit for a substantial decline in poverty among the elderly. In chapter 6, "Social Security and the Evolution of Elderly Poverty," Gary Engelhardt and Jonathan Gruber ask: how much of this decline is due directly to Social Security, and how much to other factors that have increased economic well-being over the same period?

As Engelhardt and Gruber note, the drop in the U.S. poverty rate among the elderly has been very rapid, from 35 percent in 1960 to 10 percent in 1995, from a rate more than twice that of the non-elderly population to a rate lower than that of the non-elderly population. But there have been many other changes—in the labor market, living arrangements, health status, private and pension saving, and so forth—that could also have exerted important influences on elderly poverty. How is one to determine the separate impact of Social Security? Here, an unintentional variation in policy—a temporary mistake in the structure of Social Security benefits during the 1970s—has provided us with a quite powerful large-scale experiment.

As the United States moved to a regime in which Social Security benefits were indexed for inflation, the indexation scheme initially implemented was inadvertently structured so that recipients' real benefits actually rose with inflation as a result of a "double-indexing" of nominal benefits. This mistake was corrected in 1977, but not before real benefits among those retiring had risen sharply. To deal with the political difficulty of cutting benefits that had resulted from this windfall, the government allowed those born prior to 1917—those who, roughly, had already reached the early-retirement age of sixty-two—to keep the higher level of benefits. Those born after 1921 received benefits based on the corrected formula. For those in the transition birth cohort, born between 1917 and 1921—the so-called "notch" cohort—a transition from higher to lower benefits was implemented. Because the large swing in real benefits affected cohorts born just six years apart and because the changes related only to birth year and not to other circumstances, the variation in benefits can be used to distinguish the effects of changes in benefit rules from other contemporaneous changes.

Using as their measure of poverty an income below 40 percent of the median income among the non-elderly, adjusted for family size, Gruber and Engelhardt estimate the impact of Social Security benefits on the incidence of poverty among different subgroups of the elderly over time. Because actual benefits also may have changed as a result of behavioral changes, such as variations in labor-force participation, the authors construct an instrument for benefits by calculating the benefits that would have been received in each birth cohort by an individual with the work history and real-income profile of a male born in 1916 who earns the median income. Using this instrument for actual Social Security benefits and a number of other controls (such as education) that one would also expect to matter, the authors estimate the impact of changes in Social Security benefits on the poverty rate.

The results, although varying by specification, are very strong, suggesting an elasticity of around 1, that is, a decline of 10 percent in the poverty rate for each 10 percent increase in the level of benefits. This responsiveness is large enough to explain fully the drop in elderly poverty between 1967 and 2000, a period in which the poverty rate fell by more than half. Interestingly, the effect is larger for elderly families, defined as families headed by elderly persons, rather than for elderly households, defined as households in which elderly families live. As Gruber and Engelhardt discuss, this difference can be reconciled by the fact that changes in benefits also influence living arrangements, with higher incomes making it more likely for the elderly to live alone rather than with children or with other non-elderly relatives. To the extent that choices to live alone are voluntary, the apparent increase in household poverty associated with living alone biases downward the observed impact of increased benefits on poverty reduction.

Thus, increases in Social Security benefits have had a powerful effect on the elderly poverty rate and have altered living arrangements as well. The impact of these benefit increases on other aspects of behavior, such as labor-force participation, has been considered in earlier work, but Gruber and Engelhardt identify a further important question to be addressed by future research: How has this poverty alleviation affected consumption and other, broader, measures of well-being?

A key element of well-being is health. This is particularly so among the elderly, for whom significant health problems are common, for whom health expenditures are very large, and among whom health status and life expectancy vary considerably. In chapter 7, "The Measurement and Evolution of Health Inequality: Evidence from the U.S. Medicare Population," Jonathan Skinner and Weiping Zhou analyze trends in health-care inputs—spending—and outcomes in the U.S. elderly population, considering how these measures have varied by income level over time. They present variations in access to health care and the effectiveness of the U.S. health-care system for its users according to their income class. They review changes in these measures over time, especially with the development of the Medicare system.

In the absence of information on individuals' health measures and incomes, Skinner and Zhou used data grouped by postal code, classifying U.S. zip codes by average income, and considered how health measures vary by average neighborhood income.

A more significant problem is that there are no perfect measures of health-care access and effectiveness. One simple measure of access and effectiveness, though an indirect one, is health-care expenditures per capita. Skinner and Zhou do not have direct observations on total per-capita expenditures, but they observe per-capita Medicare expenditures, which account for a large share of health-care spending for the elderly. Of course, health-care spending is not a direct measure of either access or effectiveness. Spending may be higher for one group simply because that group is sicker, or because prices vary geographically. Moreover, as Skinner and Zhou suggest, some increases in health-care spending may be of little benefit to those on whose behalf the expenditures are incurred.

If not all increases in health-care spending translate into improved health-care outcomes, then why not look directly at outcomes instead? Skinner and Zhou do this as well, considering how life expectancy has changed over time among different income groups. But there are problems in relating life expectancy to health-care access and effectiveness, because other factors may lead to variations in mortality, including individual lifestyle choices such as diet and exercise as well as genetic and environmental conditions.

Thus, in addition to analyzing the inputs and outputs of the health-care system, Skinner and Zhou consider a third type of variation in the access and effectiveness of the health-care system, namely, the penetration of significant medical technologies. Given the rapid technological progress in health care, it is often the case that different generations of technology for dealing with serious medical conditions coexist, as the newest and most effective treatments force out older, less effective ones only gradually. In some cases, however, new treatments are deemed so effective, relative to cost, that they quickly become dominant technologies that should be expected to be used on the entire population for which they are applicable. For these treatments, "The target rate approaches one hundred percent regardless of income or demographic group." (An example is mammography screening.) In such a case, lack of usage indicates a failure of the health-care system to provide access to the most effective care, and this provides one dimension by which to gauge how well the health-care system performs.

These three approaches prove useful, because the resulting trends differ. If one considers trends in Medicare spending, then it appears that Medicare growth has effected a remarkable redistribution of resources to the poor elderly over time. Between 1987 and 2001, Medicare spending grew rapidly for all income groups, as did medical spending for the U.S. population as a whole. But spending among the lower-income elderly grew especially fast, so that the dollar change in spending per capita in the bottom income decile exceeded that in the top decile by $1,410. This number is nearly as large as the total increase in median household income over the same period, and it is larger than the average level of per-capita benefits from the EITC, a major income-support program for the working poor.

But this apparently huge transfer of health-care resources to the poor stands in stark contrast to the trend in survival probabilities, which shows a much greater improvement among higher-income groups. Comparing ten-year survival rates in 1992 to those in 1982, Skinner and Zhou find a 0.2-year increase in life expectancy in the bottom decile, a 0.5-year increase in the fifth decile, and a 0.8-year increase in the top decile—a large divergence over so short a period.

It is hard to know how much of the differing trends in inputs (spending) and outputs (life expectancy) are due to trends in other, unmeasured, inputs, such as diet or exercise, and how much is due to the variations in the effectiveness of health-care spending. Skinner and Zhou's results do suggest that a large part of the surge in Medicare spending on home health care was simply wasted. This brings them to their third measure of health-care access and effectiveness, the penetration of cutting-edge treatments. Here the results are mixed. They find that individuals in lower-income deciles are less likely to be exposed to leading technologies, but there is limited evidence that this gap has diminished over time. However, they conclude that these differences alone would account for only a very small fraction of observed differences in mortality.

In chapter 8, "The Socioeconomic Status of Black Males: The Increasing Importance of Incarceration," Steven Raphael provides a sobering assessment of the importance of incarceration in explaining differences in the incomes and labor-force attachment of black males and white males. Raphael documents the alarming trends in incarceration rates among African Americans. Using data from the public use samples of the last four decennial censuses, Raphael estimates that the fraction of employed black males declined from 73 percent in 1970 to 57 percent in 2000; for black high school dropouts, the employment rate declined from 71 percent to 34 percent.

At the same time, the proportion of black males institutionalized increased from 3 to 8 percent. For high school dropouts, the proportion increased from 4 to 19 percent. For black high school dropouts between 26 and 30 years of age, the fraction of those incarcerated increased from 6 percent in 1970 to 34 percent in 2000.

Of course, these static estimates of the prison population substantially underestimate the fraction of prime-age males with a record of conviction and jail time. Raphael makes use of administrative records on all prison terms served in California prisons in the 1990s to estimate the likelihood that individuals of differing sociodemographic characteristics have served a term in prison during the previous decade. Raphael estimates that 17 percent of white high school dropouts between forty-five and fifty-four years of age had served a prison term in the previous ten years. For blacks the estimate is 90 percent.

Raphael observes that "for black high school dropouts, serving time in prison is virtually a certainty." He goes on to estimate the effect of incarceration on the labor-market prospects of workers—estimating the time lost from other labor-market activities and the effects of the stigma of a prison record on the employability of workers.

Finally, Raphael's empirical analysis suggests the extent to which the large differential in black and white employment rates can be attributed to the much higher involvement of blacks with the criminal justice system. His estimates make sobering reading, and his projections suggest that the proportion of black males with criminal records will increase, even if current incarceration rates remain unchanged.

Raphael's analysis suggests that policies about sentencing, in particular differential sentences for apparently similar behavior (such as trafficking in powdered versus crystallized cocaine) and the extent of judicial discretion are relevant. Prisoner reentry programs appear to be crucial to reducing the labor-market consequences of entering the criminal justice system, but these programs are rare.

The final chapter in this volume, "Public Health and Mortality: What Can We Learn from the Past?" by Dora Costa and Matthew Kahn, provides a historical analysis of public assistance in large U.S. cities during the early twentieth century. In this era the United States was spending twice as much on hospitals and health care as it was on public transfers, poor relief, and welfare. Costa and Kahn argue that the role of public infrastructure investments in reducing mortality during the period between about 1910 and 1930 represented "the foremost public policy success of the twentieth century."

Costa and Kahn begin by investigating the determinants of state and local generosity in public programs in the early twentieth century. Analyzing data from large U.S. cities in 1907 and in 1930, the authors conclude that localities with more minorities and immigrants appeared to be more likely to support redistributive expenditures than homogeneous cities. This finding is contrary to the findings of research on more recent periods. The authors attribute these heightened expenditures, not to heightened altruism in the earlier era, but rather to the greater possibilities for contagion and epidemics in the early decades of the last century.

Costa and Kahn investigate a historical version of the "welfare magnet" hypothesis: that immigrants were attracted to cities with more generous redistribution policies. They find little support for this in the historical record. They also investigate whether public spending "crowded out" private philanthropy and find some support for a substitution of public for private provision of redistributive activities.

Costa and Kahn report an extensive series of tests to establish whether these public expenditures "mattered" in improving the health of the populations that were targeted. They present two kinds of evidence: microdata from the 1910 and 1940 censuses and aggregate data for cities. They study mothers' expected experiences with infant deaths and child mortality, and find significant effects of spending upon outcomes for whites and little or no effects for blacks. Public expenditures, sewer connection, and health examinations had important effects on mortality in the first third of the twentieth century, at least for whites.

In summary, the chapters in this book provide a very broad perspective on the role played by government policy in affecting the distribution of income and the prevalence of poverty. Although much of the focus is on the United States today and in the recent past, valuable lessons can be learned from other countries' experiences as well.

A number of conclusions are evident. First, the problems of poverty, particularly among certain groups in the population, have not disappeared with growing affluence and cannot be expected to do so in the future. Second, for a variety of reasons, even extensive policy interventions do not ensure success at poverty reduction. At the same time, though, one can identify clear evidence of successful intervention, from such policy endeavors as improved sanitation, welfare reform, and the expansion of public pensions. The continuing study of intervention successes and failures will help inform future decisions in this most critical area of public policy.

Note

1. Detailed commentary on each of these chapters was provided by two senior researchers in the field. Unfortunately, space limitations preclude

their inclusion in this volume. These comments are available on-line at the Robert D. Burch Center for Tax Policy and Public Finance at the University of California, Berkeley (http://emlab.berkeley.edu/~burch/).

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