OPPORTUNITY Solutions Project

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Jonathan Ingram
Senior Research Fellow

Opportunity Solutions Project (OSP) strongly supports the Office of Management and Budget's (OMB) efforts to more correctly measure inflation in updating annual poverty thresholds. The current process uses an outdated inflation index that substantially overstates annual price increases, exaggerating poverty levels and material hardship. OMB should adopt a more accurate measure of annual inflation, such as the personal consumption expenditures price index, to annually adjust poverty thresholds. This approach would bring OMB inflation adjustments in line with other federal agencies, such as the Congressional Budget Office, Federal Reserve, and the Council of Economic Advisors. It would also allow OMB to more appropriately measure poverty rates moving forward and ultimately preserve resources for the most vulnerable.

Poverty and material hardship are declining, but official measures don't reflect it

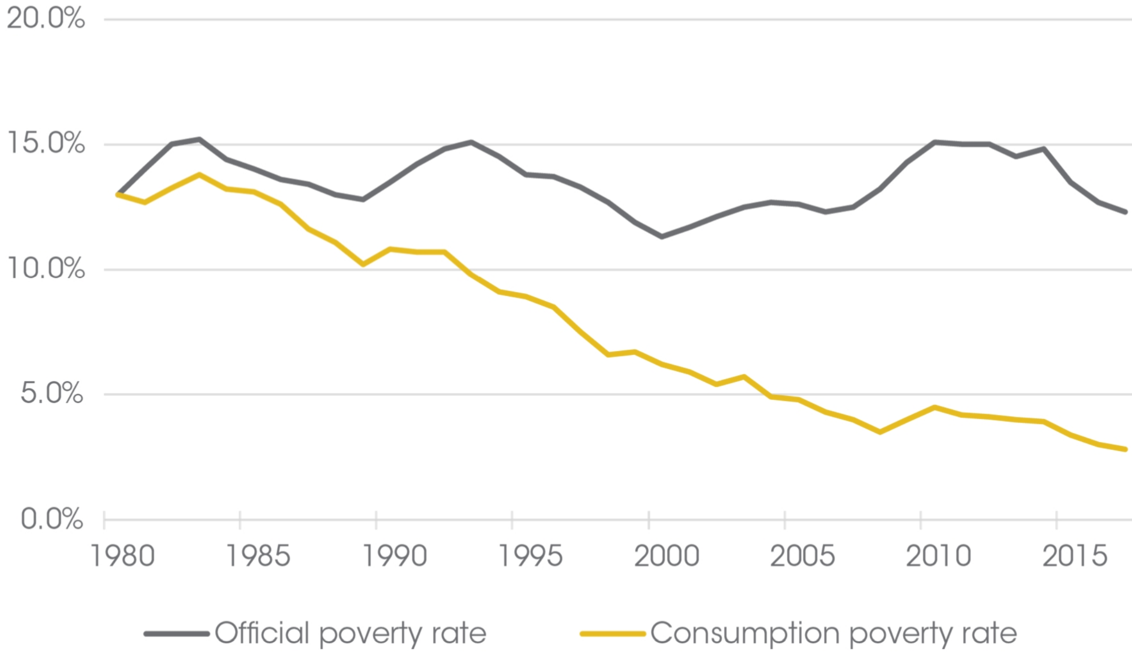
According to the Census Bureau, the national poverty rate has barely changed over the past 40 years. In 1980, the official poverty rate was 13 percent.[1] But after nearly 40 years, the official poverty rate had inched down less than one percentage point, reaching 12.3 percent in 2017.[2] But this is a statistical artifact of the way poverty and inflation are calculated, stemming from the kinds of data available in the 1960s.[3]

The current poverty threshold does not reflect the kind of material hardship experienced in the 1960s that the War on Poverty was initiated to solve. For example, more than three-quarters of households falling below the official poverty line own one or more vehicles.[4] Virtually all poor households own television sets and microwaves, nearly 85 percent have air conditioning, roughly two-thirds own washers and dryers, and nearly half own dishwashers.[5] A whopping 95 percent of households earning less than $30,000 per year have cellphones, with nearly three-quarters of those households owning smartphones.[6-7] And nearly three-quarters of households with income below $25,000 own one or more computers, while most have broadband internet.[8]

Several researchers have offered a better approach to measuring poverty that captures actual consumption of food, housing, transportation, and other goods or services.[9-10] This approach better reflects the actual standard of living that families face and has proven to be more reliable estimate of material hardship than the official poverty measure.[11]

Using a consumption-based approach, it becomes clear that poverty has fallen to record-low levels. By 2017, the consumption poverty rate had dropped to 2.8 percent, indicating that poverty has declined by nearly 80 percent since 1980.[12]

Consumption poverty has dropped nearly 80 percent since 1980



Source: American Enterprise Institute

The current poverty thresholds exaggerate poverty levels

Federal officials attempt to adjust the poverty thresholds to account for inflation. The purpose of this is to maintain a constant level of real resources needed to escape poverty over time. But a substantial body of research shows that these poverty thresholds have increased far faster than actual inflation, in large part because they were based on the consumer price index for all urban consumers (CPI-U)—an outdated measure of annual inflation that is no longer regularly used by most federal and independent researchers.[13-17]

The CPI-U has numerous methodological problems, the largest being that it doesn't adequately account for consumers' decisions to substitute one product for another if prices increase.[18] A better measure of inflation is the personal consumption expenditures price index (PCEPI), maintained by the Bureau of Economic Analysis (BEA), which takes into account actual spending behaviors. After extensive analysis of various inflation indices, the Federal Reserve began using PCEPI in its economic projections and long-run inflation targets, finding it more accurately captured actual inflation rates than the CPI-U.[19-20] The Congressional Budget Office and the Council of Economic Advisors also use this index as its preferred approach to adjusting for inflation over time.[21-22]

Because poverty thresholds are updated with the outdated and inaccurate CPI-U, the federal poverty line is nearly 30 percent higher than it should be, based on more appropriate measures of inflation like PCEPI.[23]

If inflation were correctly measured, 10.5 million fewer people would be in poverty

If the poverty thresholds were adjusted by an appropriate inflation index, today's poverty rate would be substantially lower than the official statistics suggest. Had this change been implemented in 1963, the number of individuals in poverty would have been fewer than 29.2 million in 2017—a difference of more than 10.5 million.[24-28]

This has meaningful implications on the number of people enrolled in welfare programs. In food stamps, for example, the use of CPI-U to update poverty thresholds had inappropriately added more than 1.3 million enrollees by 2017, costing taxpayers nearly $1 billion per year.[29-30] Similarly, millions of individuals only qualify for other welfare programs—including Medicaid, TANF, ObamaCare exchange subsidies, and more—because the poverty thresholds have been inappropriately increased beyond actual inflation. Ultimately, this leaves fewer resources available to provide services to the truly needy.

OMB should adopt the PCEPI to adjust poverty thresholds

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23. Between January 1963 and April 2019, the consumer price index for all urban consumers (CPI-U).

24. Author's calculations based upon data provided by the U.S. Department of Commerce on the change in PCEPI since 1963, data provided by the U.S. Department of Labor on the change in CPI-U since 1963, and data provided by the U.S. Department of Commerce on the number of individuals falling below the official poverty line and an alternative poverty line established by a different inflation measure.

25. Since 1963, CPI-U has grown by 738 percent and the PCEPI has grown by 546 percent. If poverty thresholds had been updated with PCEPI instead of CPI-U, the federal poverty line would be set at approximately 77 percent of the level it is currently set.

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