HOW POVERTY DIFFERS FROM INEQUALITY

ON POVERTY MEASUREMENT IN AN ENLARGED EU CONTEXT: CONVENTIONAL AND ALTERNATIVE APPROACHES

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Executive Summary

The relative poverty measure is the most prominent and most–quoted of the EU social inclusion indicators. This paper argues that, while pragmatically defensible in the pre–enlargement setting, the estimates and relative rankings the below–60%–of–median–income measure produces in the enlarged EU context is stretching its validity, credibility and hence legitimacy as a prime indicator to an untenable degree. We argue that there is a need for a better grounded and in the present context more credible poverty standard, complementing and possibly replacing the relative poverty line.

The principal problem with the relative poverty line, as it is currently used, is that it precludes the possible existence of 'absolute' or 'primary' poverty as this is conventionally understood. In the pre–enlargement context it could be taken for granted, for all practical purposes, that vital functionings like adequate nutrition, clothing and shelter were by and large met, hence allowing for a fully relative poverty threshold conveniently defined as some percentage of mean equivalized income.

We argue that this is no longer the case in the enlarged EU context. This context requires a measure that keeps with the notion that poverty is essentially relative in advanced economies while at the

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same time taking account of the fact that poverty has an irreducible, absolute core. Any credible measure should subsequently build on the principle that certain vital functions have to be met before the relative nature can fully kick in. We then set out the criteria any alternative measure should meet, applicability to existing data (EU SILC) being among the most important and restricting.

We then go on to argue that a budget norm may well come closest to a workable alternative. A budget standard represents what is needed, in terms of goods, services and activities, to achieve a particular standard of living and at what cost in a particular country (region) and time. A low cost budget standard is designed not only to meet primary need at a frugal level, but also to allow social and economic participation consistent with community expectations. While it is in our view a workable alternative, as experience elsewhere has demonstrated, it is one that will require a significant initial investment of time and effort.

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Introduction and Overview

The relative poverty measure is the most prominent and most–quoted of the EU social inclusion indicators. It uses a poverty definition where persons with a household equivalent income that is less than 60 percent of median household equivalent income in the Member State where they live, are regarded as being 'at risk of poverty'. This paper argues that, while this measure was pragmatically defensible in the pre–enlargement setting, the estimates and relative rankings it produces in the enlarged EU context are stretching its validity, credibility and hence legitimacy as a prime indicator to an untenable degree. We argue that there is a need for a better grounded and in the present context more credible poverty standard, complementing and possibly replacing the relative poverty line.

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Real and imagined problems with the relative poverty measure

The relative poverty measure has always been a contested one. An often made criticism is that any relative poverty measure is in effect an (imperfect) inequality index. This is sometimes taken to imply that some level of relative income poverty is inevitable if we accept that incomes are not perfectly equally distributed. We will show below that this kind of criticism is mistaken. A more valid line of criticism is that it is not a good indicator of the extent of deprivation and disadvantage in any given society. This will be discussed later in this section.

Relative poverty is not inequality

Clearly, a country with a high degree of overall income inequality can theoretically have zero relative poverty if the redistributive mechanisms are in place to truncate the income distribution below the relative poverty line. The redistributive effort that would be required to truncate the distribution at a much used relative threshold like 50 per cent of median equivalent income is in fact a fraction of the actual redistributive flows that take place in most countries. It has been calculated that the aggregate poverty gap, expressed as a percentage of aggregate disposable income, is in the order of 3 to 4 per cent even in the case of a comparatively unequal country like the United States.

For more egalitarian countries like the Nordic ones, a redistributive effort amounting to around 1 to 2 per cent of aggregate disposable income would suffice to lift all the poor just above the poverty line (see Cantillon et al., 1997).

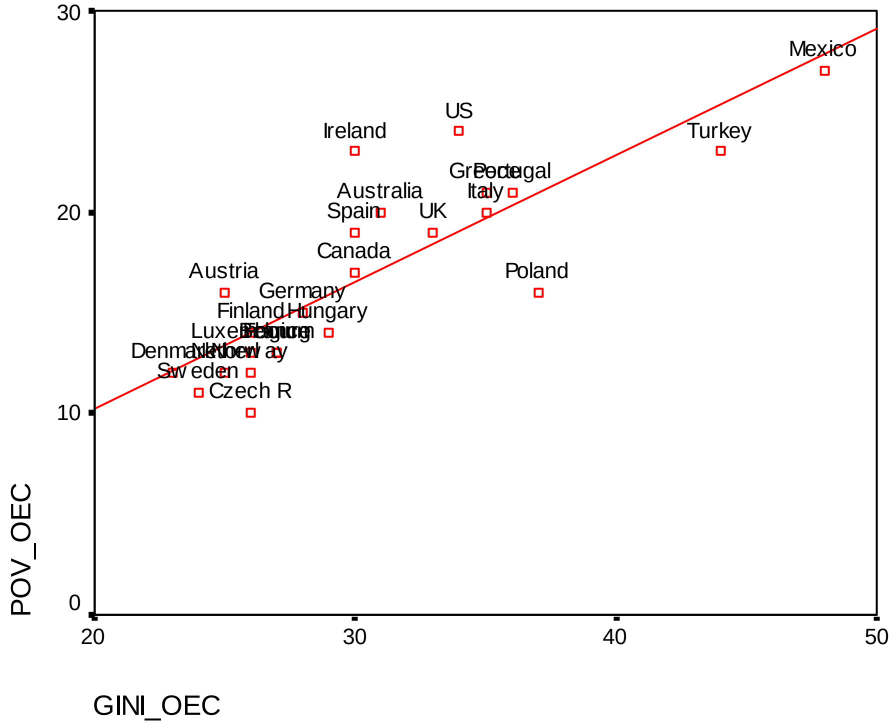
While theoretically a high level of income inequality does not preclude a low incidence of relative poverty, the actual empirical link is a strong one, as figure 1 shows. It is, however, not a one to one relationship. For example, while Canada and Ireland have a comparable Gini of around 30, their relative poverty rates differ substantially. The United States has considerably higher relative poverty rate than Poland, despite the fact that Poland has higher overall income inequality, as measured by the Gini. Turkey is even more of an outlier in this respect.

The fact that a substantial level of income inequality and a limited degree of relative poverty can go together is more evident if one looks at specific subgroups of the population. For example, countries like the Netherlands or New Zealand both have a substantial degree of income inequality among their elderly populations, but the incidence of relative poverty among the elderly is close to zero in both countries. Australia, with a comparable level of overall income inequality among its elderly population, has a poverty rate for that group of close to 25 per cent, being among the highest in the OECD area. (It may be added that for example in the case of the Netherlands, the elderly poverty rate dramatically increases once the threshold is shifted to 60 per cent of median indicating that many are in effect just above the 50 per cent line.)

Looking at the working aged population, similar variation can be observed, be it that not a single country quite achieves zero poverty according to the 50 per cent of median threshold. Still, a substantial degree of income inequality can be associated with utterly different poverty levels. Ireland, Germany, France and the Czech Republic all have market income inequality Gini's of around 40, but their relative poverty rates vary from under 4 per cent to over 12 per cent. Again, the strongly varying impact of redistributive mechanisms is evident.

Clearly, relative poverty is and can be different from income inequality. But what about the criticism that relative poverty measures do not adequately capture actual deprivation levels in a country or region?

Figure 1 Gini–coefficient of disposable income and relative income poverty incidence (60% median) in OECD countries



Notes: POV_OEC: relative poverty rate at 60% median
GINI_OEC: gini coefficient of income inequality
Data source: Förster and d'Ercole (2005)

Relative poverty and deprivation across EU countries

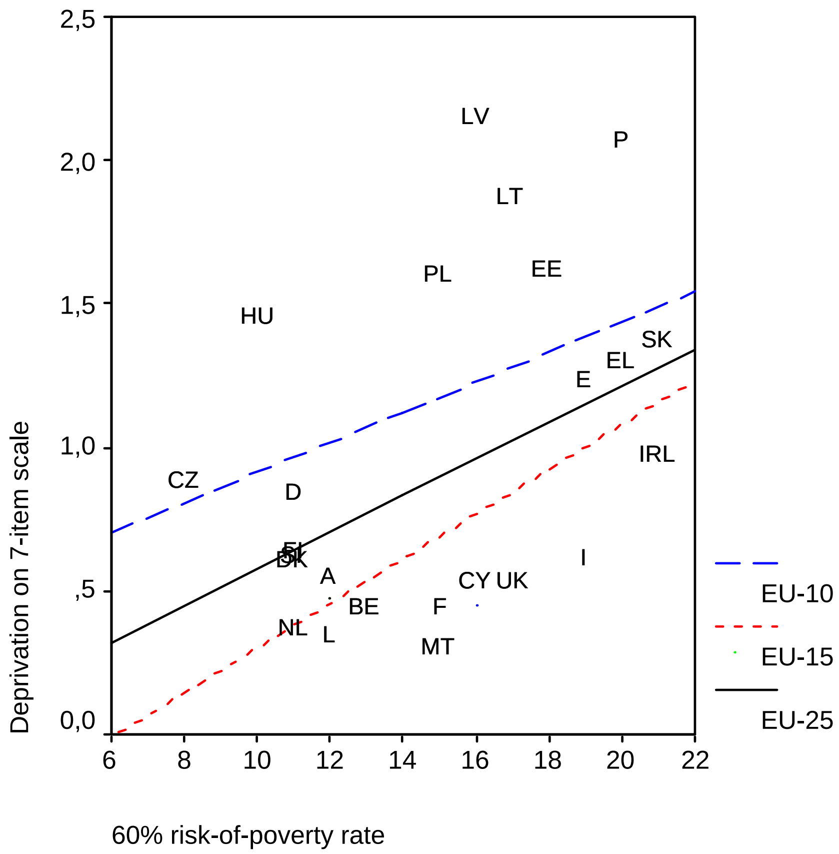
The relative poverty measure, defined as some percentage (first 50%, then increasingly 60%) of median/average equivalent disposable household income, became de facto standard measure for international comparisons during the 1980s. It was "officially" adopted as a prime EU social inclusion measure at the EU Laeken summit in 2001. Arguably facilitating its widespread adoption, apart from practical considerations, like it easy applicability, to a wide range of datasets, was the fact that the measure happened to produce country rankings and differences that – among the Member States of the EU at that time – were more or less consistent with general perception and intuition. The broad picture was that of the Nordic and Northern Continental countries enjoying comparatively low poverty and of poverty being highest in the Southern European countries: Italy, Spain, Portugal, and Greece.

The common–sense consistency is clearly no longer evident in an enlarged EU setting. The finding that Bulgaria, one of the poorest EU countries, counts as many poor people, relatively speaking, as

Belgium and marginally more than Germany is simply baffling. According to the World Bank, 6 % of Bulgarians fall below the Bank's 2$ per day (in PPP) absolute threshold. About 60 per cent of Bulgarians report having great difficulties coming by on their income, the highest in the EU countries surveyed by the European Foundation (Russell and Whelan, 2004). For Belgium the corresponding figure is under 5 per cent, for Germany 2 per cent.

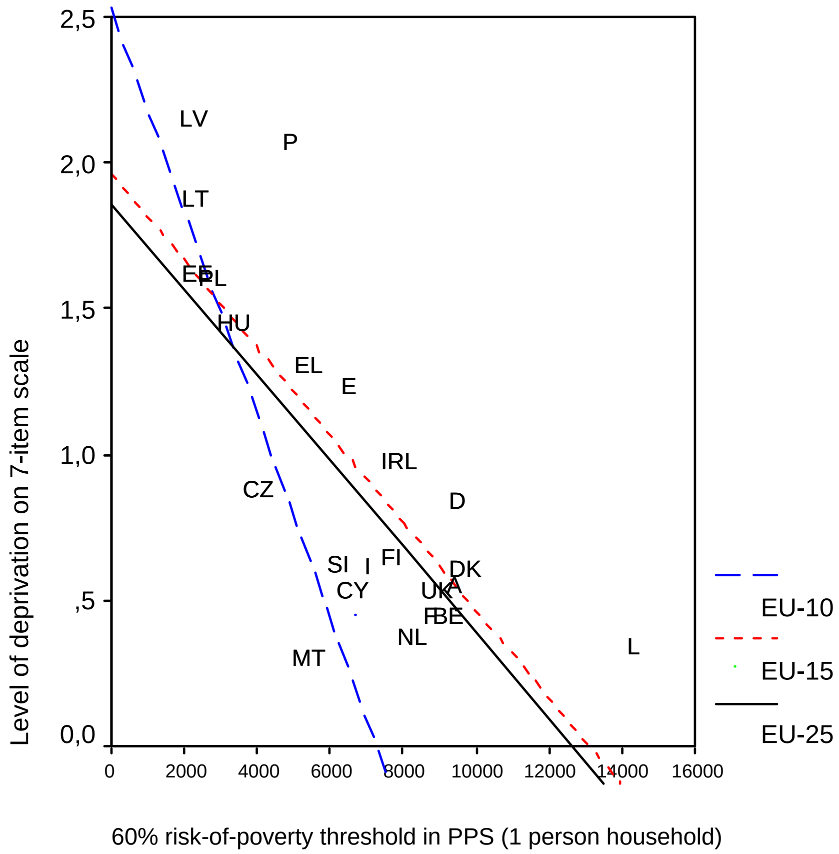
Figure 2 succinctly illustrates the problem. Material deprivation levels, as captured by a scale composed of 7 basic durable goods items, are in a completely different sphere in the new Member states. There is only weak correspondence between a country's level of relative poverty and the extent and depth of material deprivation experienced by the population. Material deprivation levels are a magnitude higher in Hungary than in Denmark or the Netherlands despite the fact that the countries have similar poverty rates. Other indicators with respect to economic strain give a similar picture. By contrast, the relationship between the overall standard of living and material deprivation is considerably stronger, as figure 3 serves to illustrate. Clearly, the problem is that as far as the enlargement countries are concerned, poverty levels are clearly and substantially underestimated compared to the old EU Member States.

Figure 2: Material deprivation index and relative poverty incidence



Data source: Russell and Whelan (2004); Eurostat

Figure 3: Material deprivation index and level of the poverty line in PPP



Data source: Russall and Whelan (2004); Eurostat

Is poverty relative or absolute?

The discussion above takes us back to the old debate whether poverty is relative or absolute. The view that poverty is relative is now widely accepted. It means is that, broadly speaking, "poverty has to be seen in terms of the standard of living of the society in question." (Callan and Nolan, 1991, p. 252). The relative view is contrasted with the absolute definition of poverty, which is couched in terms of "the minimum necessaries for the maintenance of merely physical efficiency", i.e. surviving and being able to earn one's living (Rowntree, B.S., 1901, cited in Townsend, 1979, p. 33). (The identification of Rowntree with the absolute approach seems to have been based on a misunderstanding of his work, see Veit–Wilson, 1986, but this does not matter very much for the argument at this point).

The main criticism levelled against the absolute view is that in the definition of poverty relative elements unavoidably tend to creep in. For instance, it may be possible to specify for a person in a given climate and performing certain activities how many calories he needs to maintain physical efficiency, independently of culture and society. But which foodstuffs are used to satisfy the calorie requirement is determined by availability and, in particular, by social conventions. Similarly for clothing: even the most stringent poverty standards do not require that people dress in clothes made of plastic bags and old newspapers, even if those would be the cheapest kind of covering and would be adequate to keep the body dry and warm. Inevitably, poverty definitions take account of actual behaviour and social norms. (Rein, 1970; Townsend, 1979). For this reason, Townsend (1979, p. 38) argues that in practice, 'absolute' definitions of poverty have "represented rather narrow conceptions of relative deprivation."

The basic failing of the absolute view on poverty is that it does not appreciate that needs are socially determined. In the famous definition by Townsend (1979, p. 31), "individuals [...] can be said to be in poverty when they lack the resources to obtain the types of diet, participate in the activities and have the living conditions and amenities which are customary, or are at least widely encouraged or approved, in the societies to which they belong." Being a member of a certain society implies that one has to satisfy social obligations and expectations. Not having the resources to do so means that one is in poverty (Townsend, 1985, p. 661–2). Douglas (1976) states "that the ultimate object of consumption activity is to enter a social universe whose processes consist of matching goods to classes of social occasions" (p. 206). Poverty is, then, a matter of not being able to find a "creditable place" in the social universe, because one cannot deploy the necessary number or kind of goods to mobilize sufficient "marking services [i.e. social recognition] from other consumers".

One of the few writers who has defended an absolute view of poverty is Sen (1983). He argues that poverty is an absolute notion in terms of a person's capabilities, even though it may be relative in terms of commodities or incomes. According to Sen (1983), there is "an irreducible absolutist core in the idea of poverty [...] if there is starvation and hunger, then – no matter what the *relative* picture looks like – there clearly is poverty" (p. 159, italics in original). Sen proposes that poverty is best conceptualized in terms of capabilities. Now, Sen argues that the list of capabilities that a person needs to have in order to escape poverty is much less variable from one country to another than the commodity requirements to achieve those capabilities. The list would include such basic capabilities as to be sheltered, to be clothed and to have enough food, but also the capability to live without shame and the ability to participate in the activities of the community. The resource requirements of the latter type of capability are particularly likely to vary tremendously from one community to another.

There seem to be two kinds of reasons why resource requirements to achieve particular capabilities (or, in other words, to satisfy certain needs) are relative, i.e. why they tend to rise with the standard of living. In the first place, local circumstances and social conventions influence what you need to obtain certain functionings. For example, fur coats are inappropriate in Kinshasa, as well as Roman togas in present–day Belgium. To a large extent, what is conventional is determined by what most people actually do or have, and thus by the average standard of living.

Secondly, resource requirements may also be relative in a more direct or stronger sense (cf. Goodin, 1990). The usefulness of a certain commodity may depend directly on how many others have the same commodity. For instance, a telephone is of more use to you, when your family and friends also have one. Conversely, not having a telephone while everyone else does may make it much more difficult to maintain social contacts and to find or keep work. In the latter case, one is not just 'achieving relatively less than others, [but] achieving absolutely less because of falling behind others" (Sen, 1983, p. 155). The most obvious examples are status goods which are used as symbols to achieve some kind of social distinction. For instance, expensive cars are only expensive compared to other cars. But it is also true that the amount of education that you need to get a job depends in many cases on how much education other people, who compete with you on the labour market, have got (cf. Goodin, 1990, for more examples).

Without wanting to deny the importance of the fundamental debate sketched above, we would suggest that in practical terms the implications of a relative and an absolute conception of poverty may not differ that much. Sen probably would agree to the statement that, because resource requirements for many basic functionings are relative, the poverty line must be put at a higher level in rich countries than in poor ones; also, as a country gets more prosperous, the poverty line is likely to increase in real terms. What he does not accept is that the poverty lines should necessarily rise by x percent, each time median income rises by x percent, (and even more strongly, that if median income would happen to drop by y percent, the poverty line should decrease by the same percentage). However, the same may well be true for proponents of the relative view on poverty. Believing that poverty is about not having the resources to fully participate in society, does not imply believing that the level of the resources needed to reach that goal always moves immediately and proportionally whenever there is a change in median income. In other words, despite the theoretical differences of opinion, there may well be broad consensus that any credible income poverty line should be relative to some extent, but not fully so.

Criteria and properties for useful measures of poverty

Of course, an ideal poverty measure, which would enjoy universal support, and which would enable us to perfectly identify any person in poverty across all societies and times, is nowhere in sight, and a search for such a measure would probably not be very fruitful. We have to work with imperfect measures. Here it is important to keep in mind that measuring poverty is not an academic exercise, but serves important practical purposes, such as guiding policy and informing public debates. Any useful poverty measure should therefore meet the criteria set out by Atkinson et al. (2002) for social indicators. These include:

– an indicator should capture the essence of the problem and have a clear and accepted normative interpretation

– an indicator should be robust and statistically validated

– an indicator should be responsive to policy interventions but not subject to manipulation

– an indicator should provide a sufficient level of cross–country comparability

– an indicator should be built on available underlying data, and be timely and susceptible to revision

It appears that the relative poverty measure fails the first and the third of these requirements. Firstly, the normative interpretation of a measure that says that poverty is equally high in Bulgaria and in Belgium is at best unclear, and for any Bulgarian such a statement is probably unacceptable. Secondly, a general rise in income that leaves all relative positions unchanged does of course nothing for the extent of relative poverty. This implies that a strategy of economic growth that benefits all income groups equally (in percentage terms) will not be reflected in lower relative poverty rates. In a sense, the relative poverty measure is biased in favour of redistribution policies. This may be adequate for rich countries, where poverty may be largely relative, but is not so for the poorest EU Member States, where economic growth is probably needed to relieve widespread deprivation.

This does not mean that we should throw away the relative poverty measure. It should perhaps be re–interpreted as a measure of relative low income, rather than as an indicator of poverty in any substantive sense. Its relevance would be to show the extent to which societies in general and welfare states in particular manage to prevent persons from having a material standard of living that is far below the average one. Preventing citizens from ‘falling too far behind’ is a valid goal, which countries can pursue at rather different levels of economic development, and using many different kinds of economic and social policies.

However, the arguments set out above imply that we also need an alternative measure of poverty that does meet all the requirements set out by Atkinson et al. (2002). These are not trivial; especially the latter criterium imposes a rather stringent constraint. It means, in effect, that any alternative measure should draw on the principal statistical instrument available today, the EU–SILC. This requirement effectively precludes the use of poverty measures that build on sophisticated sets of ‘direct’ indicators of disadvantage and exclusion. (The simple deprivation index used by Russell and Whelan (2004) is informative as far as it goes. However, there are important problems of cross–country comparability, as the meaning of any item will differ greatly, depending on social, economic and climate circumstances.) Any workable alternative measure has to be an income based one.

Lastly, as Molly Orshansky (1969:39) has written: “We need benchmarks to distinguish the population group that we want to worry about. A benchmark should neither select a group so small, in relation to all the population, that it hardly seems to deserve a general program, nor so large that a solution to the problem appears impossible”. From this perspective, a measure according to which 65 per cent of the population is poor in one country and 0,65 per cent in another, is not useful. In other words, we require that a poverty line produce plausible results.

Could a budget standard offer a valid alternative?

Given these rather stringent requirements, what are the possibilities? One option is to follow the recommendations formulated by the USA Panel on Poverty and Family Assistance about the American poverty line (Citro and Michael, 1995). They proposed that the poverty line be set at a certain percentage of median annual expenditure on the necessities of life (food, clothing and housing), multiplied by a (low) factor to account for other expenditure. The method seems to work in the USA, and it would be interesting to assess its validity in the EU comparative context. The conclusions are not evident. One problem would be that expenditure on housing is very much determined by government policies, and therefore varies quite strongly across countries. Also, varying cultural habits imply that households at roughly the same level of economic well–being in different countries spend rather different proportions of their income on food and clothing. In other words, in some countries, food is indeed a necessity, while in others, much of food consumption is essentially a luxury.

We believe that in the long run, budget standards offer the greatest potential for a credible and comparable poverty line. A budget standard is a specific basket of goods and services which, when priced, can represent a particular standard of living (Bradshaw, 1993). In principle, using the method to estimate a minimum income standard is very simple: one draws up a list of goods and services that are deemed necessary, estimates their lifetimes, allocates prices and adds up the resulting amounts.

A budget standard can overcome the problems with the relative threshold while satisfying the criteria we set out. Any basket will surely contain items and services relating to basic functionings like proper and healthy nutrition, adequate clothing and shelter, proper heating in winter etc. (For some enlargement countries this part of the basket alone could conceivably produce a threshold higher than the current relative one.) Clearly, the requirement is that these primary needs are met on the basis of a frugal and carefully managed use of resources.

But that basket may and in our view should also contain non–vital items that can nevertheless be deemed necessary to lead a normal life in the society/country for which it is composed. The criterium here is that such goods and services are necessary to allow social and economic participation consistent with community expectations in the workplace, at home and elsewhere. For example, if the vast majority of the population has a telephone then this is an item that may have to be included on grounds that people will otherwise be excluded from social and economic life. One could even include the ability to participate in at least one cultural event each month or to take one week of holiday out of the home each year.

Note that households are not actually required to consume this bundle of goods and services that are deemed to be necessary. What is important is that they have the opportunity to consume the identified bundle from the resources available.

Budget standards have been used in the pioneering poverty studies by Rowntree (1901) and Rowntree and Lavers (1951). In the sixties and seventies the budget standard approach has been subjected to heavy criticism. The critics' fire was mainly directed at the claim that budget standards provide a way to establish a non–subjective, or 'scientific' subsistence poverty line. Against this, it was maintained that these standards are based on actual patterns of living, and inevitably involve value judgments at several points (Rein 1970; Townsend, 1979). This criticism is certainly justified as far as it goes. But it seems to leave room for drawing up budgets, in which the (partial) dependence on prevailing standards and conventions, and actual patterns of living, is explicitly recognized, and where all value judgments are made explicit. E.g., Bradshaw's team developed 'low cost budgets' using the criteria that any item owned by 75 percent or more of the population, or regarded as a necessity by at least 67 percent, is included in the budget.

The most important advantage of budget standards is that they are very concrete and show exactly to what standard of living, in terms of potentially available goods, services and activities, the resulting income levels correspond. They can be easily decomposed into budgets on subdomains. This makes them appealing to a lay audience. Experience in countries like the United Kingdom, Canada, Australia, as well as in Belgium, has shown that budget standards are persuasive and credible for the general public. Not everyone will agree with all choices made, but the resulting discussions should be regarded as a very positive impact of budget standards. Budget standards are also flexible: items can be taken out or replaced by other ones. This concreteness and flexibility comes at a price, though.

The major disadvantage of budget standards (as a method to estimate poverty lines) is that their development and maintenance require a serious effort. In practice, constructing a budget standard is a time consuming and complicated task. One must ensure that the budget is complete, one must collect realistic prices for every last item and so on. This requires a team of experts and a lot of time and energy. A variety of sources of information is used in the selection of items: other budgets, expert opinion, actual spending patterns, public opinion, moral judgments. It may in practice prove difficult to reach a consensus among experts. (One way to resolve this problem may be through involvement of the general public, e.g. using discussion groups where experts and interested laymen and –women talk and reflect about the choices to be made.) It may even be more difficult to garner political support. The very concrete and transparent nature of the goods and services baskets that underlie budget norms make them also vulnerable to political controversy.

Also, they are devised for very specific household types (e.g. a couple with two children aged 10 and 4, living in a rented terraced house in York), making the validity of generalizations to other situations uncertain. For obvious practical reasons, the number of model families for which budgets are composed has to fairly limited. Yet, the model families have to be specified in great detail, not only as regards family composition (sex and age of family members), but also in terms of place of residence, type and quality of the dwelling, activities of the household members, and so on. Achieving cross–household consistency is certainly a challenge if the budgets are developed independently.

Another problem is that budget standards may seem unrealistic when compared with actual expenditures. E.g. the ‘modest–but–adequate’ clothing budgets of Bradshaw (McCabe and Rose, 1993, p. 76) are equal to actual expenditure on clothes by households in the upper income groups. This points to what is perhaps the fundamental problem of budget standards: the uneasy mix of expert judgment, actual household spending patterns and public opinion in the selection of items. Choices often seem ad–hoc and arbitrary. (Yet the resulting budget amounts may be less arbitrary than one might expect: an adaptation of Bradshaw’s low cost budgets to Belgium for three household types produced results that were rather close to budgets developed totally independently by Flemish social workers; both the total amounts as well as several budget components matched quite well; see Van den Bosch, 1997).

It follows from this discussion that no budget standard will ever be incontestable. The normative judgements on which it is inevitably based will always be a matter for debate. Practicality will require that working assumptions are made and possibly that some corners are cut. But this is true of any workable alternative. Plus, with the computing resources currently available it is a relatively easy to develop a flexible framework which allows for changes in judgements and assumptions and which brings to light their implications.

How to go forward?

The task of developing comparable budget standards for 25 EU Member States, at very different levels of economic development, with rather different patterns of consumption, etc. is of course a daunting one. Before embarking on this huge project, it would be wise to have a pilot project among, say, five countries (but including Member States from all regions of the EU), preferably those where budget standards have already been developed (this is the case in many countries of the EU), and where teams with experience in budget standards are present.

The big challenge for any such project would be to develop budget standards that would be credible and relevant within the national contexts, yet also comparable across countries. The easiest way to retain comparability would be to price the same basket of goods and services in the various countries, but such a procedure would obviously fail the first criterion of credibility. Yet, it could provide a good starting point: after this first step items that seem irrelevant or out of place could be removed, and if necessary, replaced by other goods or services. Van den Bosch (1997) used such a procedure to adapt the Bradshaw (1993) UK budget standards to the Belgian context, with credible and useful results.

Moreover, any such effort might be made (slightly) easier by the following considerations:

– Many of the judgements on which a budget standard is based may already have been articulated and possibly officially endorsed in other contexts. For example, nutritional guidelines will exist in many countries. There may be housing guidelines. From the viewpoint of legitimacy it seems advisable to refer as much as possible to officially endorsed guidelines where these exist, provided that their scientific basis is sound.

– Instead of calculating budget standards for a host of households it may be more practically feasible to calculate a budget for a reference household and then to apply an equivalence scale. This is in effect what National Research Council panel set up to review the official US poverty line recommended. It suggested that a budget (containing a very limited set of items) be calculated for a household of two adults and two children. The thresholds for other households could then be derived for other households by the application of an equivalence scale.

– To make the process of determining what to include and what not to include less arbitrary and also in order to keep with the notion of poverty being relative, actual ownership rates of certain goods and services may be used as a criterium. For example, a good or service may be deemed essential if say 75, 85 or 95 per cent of the population has access to it.

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