Poverty Transitions
Ann Huff Stevens, Department of Economics, UC Davis

Background
What factors help individuals escape or avoid poverty from one year to the next? How important are labor market factors, such as unemployment rates, wage levels, and weeks worked during the year?

Empirical studies of poverty transition models help to answer these questions. Recent work by Center for Poverty Research Director Ann Huff Stevens shows that while movements into and out of poverty are often associated with changes in family structure, there remains an important role for labor market factors.

Methods
Using longitudinal data from the Panel Study of Income Dynamics from 1968 through 2003, Stevens estimates, for a nationally representative sample of individuals, the probability of moving into and out of poverty from one year to the next. Transition probabilities into and out of poverty are predicted as a function of: individual characteristics, such as gender, age, race, length of time poor, or employment status; family characteristics, such as the educational level of the head of household or whether there are one or two parents present; and broader economic factors such as state- or regional-unemployment rates or wage levels.

Results Summary
Changes in individual earnings (with no concurrent change in family structure) continue to account for a substantial fraction of transitions into and out of poverty in the United States.

Regional unemployment rates have substantial effects on poverty transitions. A three percentage point increase in the unemployment rate (roughly the magnitude experienced at the beginning of a recession) reduces the exit rate from poverty by approximately 6% per year, and raises the annual rate of re-entry into poverty by 9%.

The decline in real wage levels of the bottom 20% of workers has also reduced exit rates from poverty. The decline of $75 in weekly wages between the early 1970s and their low point in the mid-1990s is estimated to have reduced the annual exit rate from poverty by 13%.
Results

Figure 1 shows the distribution of major events associated with transitions into and out of poverty. Approximately one quarter of all spells of poverty begin with a reduction in the earnings of the head or spouse, but no major change in family structure. Another quarter of all poverty spells begin after a divorce, separation or other change in family structure.

Improvements in earnings also serve to move individuals out of poverty, with 22% of transitions out of poverty due to increased earnings as shown in Figure 2. An equal percentage (22%) of exits are associated with changes in family structure.

Stevens also estimates multivariate models to quantify the effect of either individual labor market indicators (such as weeks worked during a year), or more aggregate factors (like the unemployment rate or average wage levels) on an individual’s chances of moving out of or returning to poverty.

The effect of aggregate economic indicators on poverty transitions adds to our understanding of how business cycle changes or long-term economic trends affect the likelihood that individuals will become poor or escape poverty.

For example, Stevens shows that a one percentage point increase in the area unemployment rate reduces the exit rate from poverty by roughly 2% per year and increases the rate of poverty re-entry by 3%.

Focusing on the employment outcomes and choices of poor individuals (rather than aggregate employment rates), ten additional weeks worked during a year (working 30 weeks rather than 20) raises the exit rate from poverty by 16% and lowers the chances of returning to poverty by a third.

Of course, neither aggregate employment rates nor individual weeks of work will affect poverty substantially if the wages earned (along with other income) do not lead to total income above the poverty threshold for a given year and family size. Stevens also shows that prevailing wage levels for less-skilled workers affect the rate of exit from poverty.

To summarize the wages available to poor workers in the United States, Stevens uses the 20th percentile of the weekly earnings distribution in a geographic region for full-time male workers. This measure captures the broad trend in the United States towards declining or stagnant wages for less-skilled workers over the past several decades.

Stevens’ estimates suggest that a decline of $75 in this weekly wage measure (roughly the magnitude of the decline in this measure from the early 1970s to its low point in the mid-1990s) reduces the annual chances of escaping poverty by 13%.

For further reading:


