

# The Welfare State and Poverty: A Reply to Fred Gruen

Peter Saunders\*

## 1. Introduction

The review by Fred Gruen (FG) of my book *Welfare and Inequality: National and International Perspectives on the Australian Welfare State* (Saunders, 1994a) contains a good deal of analysis and argument with which I am in broad agreement. He has made a number of perceptive comments, many of them critical in the scholarly sense, and I am grateful to him for these. However, there are also a number of points raised by FG with which I would wish to take issue and I am pleased to have this opportunity to do so.

Some of these issues may appear to be narrow and technical in nature and hence of only limited interest and relevance. This is not so. As is made clear in my book, in FG's review article, and in what follows, these issues have a crucial bearing on the assessment of trends in poverty in Australia over the 1980s and on estimates of the effectiveness of policies designed to alleviate poverty and mediate inequality. In this sense, they are fundamental to any overall assessment of the achievements of the Australian welfare state. On this point at least, I suspect that FG and I agree.

It is when it comes to the details, however, that our views diverge. In focusing on these, I do not wish to downplay those aspects of my book with which FG agrees – nor would I want to detract attention from those sections of his review where he is generally complimentary about my work! Details of the analytical structure and theoretical framework are important, but so too is the need to view the welfare state in a broad perspective. This involves stepping across disciplinary boundaries and recognising that economic

---

\* Social Policy Research Centre, The University of New South Wales. Fred Gruen was kind enough to send me a copy of his review so that any response could appear with the review.

analysis, whilst important, can contribute only part to any overall assessment of policies which are not only economic in scope and impact but also political in motivation and social in purpose.

One of the leading welfare state analysts, Gosta Esping-Andersen has recently articulated this view in eloquent terms, arguing that the advanced welfare state became one of the hallmarks of post-war prosperity through bringing about economic, moral *and* political reconstruction (Esping-Andersen 1994). In focusing on some of the detailed issues raised by FG, I would not want this bigger picture to be lost. Indeed, one of the main motivations for writing my book was to draw attention to the broader framework, and to locate the role of economic analysis within it.

## 2. Poverty Research

The main area where FG is critical of my work concerns poverty research, specifically the methods I used to estimate poverty in Australia over the 1980s. Before considering this specific issue, I wish to address several other matters raised by FG. The first of these relates to his somewhat confusing discussion of the link between poverty and inequality.

In the opening paragraph of his review, FG quotes my evidence of the rise in *poverty* over the 1980s as an indictment of any welfare state which has the reduction of *inequality* as its fundamental aim. Again on page 129, after discussing my analysis of the impact of social wage benefits on income inequality, FG observes (correctly) that between 1984 and 1988-89 these benefits had the greatest income impact on the lowest three deciles of the household income distribution. But he then draws the implication that; 'the inclusion of community services seems to change the picture of the poor getting poorer quite substantially' (FG, p.129). This claim cannot be deduced from the results in my Table 6.4, which refer to changes in final income for deciles of gross household income with no allowance made for differences in need through the use of an equivalence scale.

Without such an adjustment, it is not possible to deduce what these results imply for the change in the living standards of poor, as opposed to low income, households. Having admonished FG for this oversight, it is nonetheless the case, as I have recently demonstrated, that his claim that the inclusion of social wage benefits does change the picture of the living standards of the poor (in 1988-90) is substantially correct (Saunders 1994b; 1995).

FG then proceeds to make several perceptive comments about Australian poverty research and the coverage given to it in my book. He is right to

criticise the lack of attention given to two groups – the homeless and Aboriginals – where poverty is known to be particularly acute. My excuse is that my focus was on measuring poverty using unit record data based on ABS household surveys which by definition do not include the homeless and in which Aboriginality is not identified. In any case, while there is some truth in FG's criticism that the current welfare research effort on poverty is dominated by the analysis of unit record data, there are other areas of research (e.g. the qualitative case studies of low income families undertaken by the Australian Institute of Family Studies, the Brotherhood of St Laurence and most recently by Thornthwaite, Kingston and Walsh, 1995) which have also made important contributions to our understanding of the causes and consequences of poverty.

FG makes some penetrating comments on the validity of some of the assumptions which underlie quantitative poverty research. Reference has already been made to the importance of adopting a broad definition of income which includes noncash social wage benefits – even if this gives rise to formidable conceptual problems (Saunders 1995). He also is right to emphasise the need to undertake more research into the issue of the extent of income pooling within income units, families or households.

On this latter issue, FG argues that incomplete income pooling may be a factor leading to the break-up of families and that, if it is, the women who are affected (primarily sole mothers) may be financially better off after the break-up than they were before. Furthermore, in so far as this is the case, 'the resulting increase in poverty is a substitution of measured poverty for previous unmeasured misery' (FG, p.132). This suggests that poverty estimates based on the equal income pooling assumption may be biased downwards for some individuals in those families where income pooling is incomplete and that where pooling has changed over time, the trend in poverty may be biased upwards. However, there may also be biases in the opposite direction for those individuals who benefit financially from incomplete income pooling. The net result is thus that the impact of incomplete pooling on the total poverty rate (though not necessarily on the structure of poverty by gender) and the poverty trend is ambiguous (Jenkins 1991).

Some Australian research on the income pooling question already exists (e.g. Glezer and Mills 1991) but more is needed. In research conducted with my colleague George Matheson on community perceptions of minimum income levels (see below) we found, as many others have, that estimates of the minimum income levels required by different families in order to make ends meet increase only modestly with family size (Saunders and Matheson 1992, Table 4.3). The standard interpretation of this result is, to quote Lee Rainwater (1990), that 'children are cheap'.

An alternative explanation is that parents put the needs of their children before their own needs and that the latter are foregone as the former become more pressing with increasing numbers of children. On this interpretation, it is not that 'children are cheap' but rather that, as a result of incomplete pooling of income, the living standards of parents are lower than those of their children. This would again lead to biases in the estimates of poverty, causing an overestimate of the extent of poverty among children and a corresponding underestimate of the extent of poverty among parents. The significance for both research and policy which attaches to such biases further supports FG's call to devote more attention to the income pooling issue.

### 3. Updating the Poverty Line

The major aspect of poverty research on which FG takes issue with me concerns the appropriate method used to update the poverty line over time. This aspect can influence estimates of poverty at a point in time and trends in poverty over time. If the trend in poverty is used as an indicator of welfare state effectiveness, how the poverty line is adjusted over time will have a strong bearing on the assessment of social policies. For this reason, the issue is thus both substantive and controversial.

One way of addressing the issue is to undertake a sensitivity analysis to investigate the robustness of estimates of poverty to the level at which the poverty line is set. This method, based on the dominance result derived by Atkinson (1987), recognises that only a partial ordering of poverty states may be possible if there is disagreement over where the poverty line should be set. The method has been applied to Australian data by Bradbury and Saunders (1990) and, more recently, by Saunders (1993), where it is shown that the main poverty trends are robust with respect to even quite large shifts in the poverty line.

Rather than apply sensitivity analysis, Chapter 9 of *Welfare and Inequality* contains estimates of poverty over the 1980s derived using the Henderson poverty line (HPL) framework which involves adjusting the poverty line to movements in household disposable income per capita (HDI). The details of this updating procedure are outlined in Chapter 8 (pp.252-256) of *Welfare and Inequality*, which also contains an explanation of how the updating method has evolved and notes several criticisms which have been levelled at it. Amongst these was the suggestion made by FG himself (Gruen 1987) that estimates of poverty should be derived from a poverty line held

constant over time in real terms – a suggestion which I argued (p.255) had much merit.

How to update the poverty line over time cannot be determined independently of the underlying concept of poverty itself. Use of updating by HDI in the HPL framework is justified on the grounds that poverty is relative and that, despite its shortcomings, HDI is a comprehensive and readily available measure of movements in the average level of community disposable income.

It is worth noting that FG's own position on the updating question seems to have evolved over time. In 1987, for example, he utilised HPL estimates of poverty after-housing costs in commenting on issues in Australian housing policy, although he observed that the poverty line increased in real terms as real incomes rose. He noted, however, that: 'There is nothing wrong with that – provided it is acknowledged' (FG, 1987, p.7). More recently, in his book with Michelle Grattan, he again appears to support a relative poverty line adjustment, albeit an amended one. Thus, it is argued that:

'In as far as one wants to maintain the income of age pensioners relative to wage earners, linking the poverty line to real (sic) per capita household income provides a misleading picture of age pensioners' living standards relative to wage earners. The increase in per capita incomes is largely the result of increased work effort. *Granted that we want the poverty line to reflect rising living standards in the community generally*, it may be sensible that such increased work effort (especially when accompanied by declining real wages) be explicitly discounted in any "updating" of the poverty line.' (Gruen and Grattan 1993, p.198; italics added)

A relative poverty line also receives implicit endorsement in FG's recent work with Ann Harding and Deborah Mitchell on welfare targeting, although here the poverty standard used is updated in line with movements in median income (Mitchell, Harding and Gruen, 1994).

However, it is misleading to claim that use of a poverty standard tied to median income 'does away with the necessity of updating' (FG, p.133). Instead, the median income approach does away with the use of an *external* income standard to update the poverty line, relying instead on a method derived from the unit record data which are used to estimate poverty. In light of FG's earlier criticism of the over-reliance on unit record file data in poverty research, his justification for the use of a poverty standard linked to median income seems somewhat obtuse.

FG is perfectly correct to note that there is no correct solution to the updating question. In his review, he is critical of my use of the HPL approach for its reliance on updating by HDI and implies that it is mainly (though not

entirely) this aspect of my research which produces the 'rising tide' increase in poverty between 1981-82 and 1989-90 which FG rejects (Saunders and Matheson 1991). His case for rejecting the HDI updating method relies upon data on community perceptions of minimum income levels collected throughout the post-war period as part of the Morgan Gallup Poll.

Figure 1 of FG's review updates my analysis of these data to 1994. The Figure shows movements in the average response (expressed in 1988 prices by deflating by the CPI) to the following question:

In your opinion, what's the smallest amount a family of four – two parents and two children – need each week to keep in health and live decently – the smallest amount for all expenses including rent?

FG cites my view that movements in the response to this question can shed light on the updating question because they reflect changes in community perceptions of what constitutes a minimum level of income. This is so. However, the most glaringly obvious feature of the trend shown in Figure 1 of FG's review is that the average response to the Morgan minimum income question is decidedly *not* constant in real terms over time.

Instead, there is a consistent net increase up until 1985, after which the mean response declines steadily in real terms.<sup>1</sup> Clearly, the pattern changed in the mid-1980s, but it is again misleading to claim that 'since the mid-1970s there has been no real increase in the consensual poverty line' (FG, p.135) as a glance at his Figure 1 makes clear. There is an urgent need to analyse these changes and identify the factors which have caused them. This process is begun by FG who proposes (p.136) several explanations, although in the absence of any rigorous analysis of the data it is difficult to regard these as any more than speculative at this stage.

One of the problems with this whole approach is that use of the *average* response to the Morgan minimum income question conceals the fact that there is a considerable variation in the responses to such questions. This has led researchers using such data to develop a consensual poverty line which rejects the use of the mean response in favour of more sophisticated methods (Goedhart et al. 1977). George Matheson and I have shown that although the overall mean response in 1988 to a minimum income question similar to that asked by Morgan was \$350 a week, 32 per cent of responses were below \$300 a week while 17 per cent were over \$500 a week (Saunders and Matheson 1992, Table 3.5).

These results relate to the perceptions of what respondents regard as the minimum income levels required to make ends meet in their *own* circumstances. If the analysis is restricted to just families comprising two adults and two children, the mean response (after excluding zeros and missing

values) is \$388 – very close to the mean response to the Morgan minimum income question in 1988 of \$392. Again, however, the variation about the mean is considerable, with over 17 per cent of responses being below \$300 and over 20 per cent above \$500. Relying on trends in the average response to such questions is thus somewhat simplistic and, as a result, unreliable.

These comments aside, it has to be acknowledged that the mean Morgan response increased, as FG observes, by only 70 per cent between 1981-82 and 1989-90 – far less than the corresponding increases in median income (89 per cent), in average weekly earnings (79 per cent) or in the CPI (83 per cent). As a result, FG concludes that:

‘... a poverty line based on the consensual approach would produce a substantial drop in the proportion of the population in poverty over the period 1981-82 to 1989-90.’ (FG, p.135)

It is difficult to know what to make of this claim. Firstly, it is not strictly correct in the sense that it has not been derived from application of the consensual approach to compare poverty in 1981-82 and 1989-90. Rather, it appears to rest on the view that if the 1981-82 HPL had been updated to 1989-90 in line with movements in the average Morgan response then poverty would have declined. This conclusion seems to be based on the view that if the poverty line declines in real terms then poverty too must decline. This does not follow logically, nor will it necessarily be true empirically.

Consider, for example, the estimates shown in Table 1. In deriving these, I have applied the HPL methodology to estimate the extent of poverty in 1981-82 at varying percentages of the poverty line. Thus, Henderson poverty in 1981-82 is estimated to be 10.7 per cent, but poverty would be only 7.5 per cent at a poverty line which is 10 per cent lower, or 15.3 per cent at a 10 per cent higher poverty line. These calculations were then repeated for 1989-90 adjusting each poverty line *by the movement in the CPI* between 1981-82 and 1989-90. The poverty comparisons are thus each based on a poverty line held constant in real terms over time, but held constant at different real income levels.

Two points are immediately apparent: first, poverty increases between 1981-82 and 1989-90 even if the poverty line is held constant in real terms; second, while this is true for each of the eleven poverty lines show in Table 1, the extent of the increase depends on the real income level at which the poverty line is held constant. It is also the case that if the poverty line were to decline in real terms between 1981-82 and 1989-90 by 10 per cent – about the extent of the real decline in average response to the Morgan minimum income question over the period<sup>2</sup> – the estimated trend in poverty would be downward, but even this is not so clear cut at low poverty lines.

**Table 1:** Estimates of Poverty Among Income Units in 1981-82 and 1989-90 at Different Poverty Lines

Poverty Line <sup>(a)</sup>	(Percentages)	
	1981-82	1989-90
0.5 HPL	2.1	2.7
0.6 HPL	2.7	3.6
0.7 HPL	3.7	4.7
0.8 HPL	5.3	6.4
0.9 HPL	7.5	8.7
1.0 HPL	10.7	12.1
1.1 HPL	15.3	17.0
1.2 HPL	20.0	21.6
1.3 HPL	25.1	27.0
1.4 HPL	29.6	32.3
1.5 HPL	34.2	37.2

**Note:** (a) HPL = the Henderson Poverty Line (in 1981-82). Poverty lines for 1989-90 are updated in line with movements in the Consumer Price Index. Further details are provided in the text.

**Sources:** 1981-82 *Income and Housing Survey* and 1990 *Survey of Income and Housing Costs and Amenities*, unit record files.

In any case, such comparisons (like those which are implicit in FG's claim quoted above) have little meaning, being based on HPL estimates for 1981-82 but which for 1989-90 use a hybrid poverty line indexed to HDI up to 1981-82, but to the mean Morgan response thereafter. The validity of poverty estimates based on this latter poverty line are, at best, dubious. If we are to take them seriously, some justification is needed for the use of this combination of poverty lines in the two years. In particular, if the HPL framework is rejected, why use the 1981-82 HPL as the real income benchmark against which to measure poverty in other years?

Table 1, along with the sensitivity estimates presented in Table 11 and Figures 5 to 11 of Saunders (1993), indicates that the evidence of a 'rising tide' of poverty over the 1980s is robust. FG may not like this finding and given its importance he is right to challenge it. But this requires more than a demonstration that if the poverty line is allowed to fall far enough then poverty too will decline. In short, FG's rejection of the 'rising tide hypothesis' simply doesn't hold water!



## 5. Summary

In his review article, FG raises many important issues which need to be addressed. I am heartened by the fact that my book has prompted him to engage in this debate and I am grateful for the care with which he has studied my work and for the many penetrating comments he has provided on it. I am sorry that he feels that I have belittled the achievements of the Australian welfare state. Much of my book was devoted to establishing the opposite proposition by identifying the many positive contributions of Australian social policies and exposing the shortcomings of many of the alleged criticisms of the welfare state.

It should be clear from my response that there are many areas of agreement, but also several issues on which FG and I continue to disagree. These include questions of methodology and technique, as well as issues of interpretation and values. Poverty research, like much of social policy, engages its practitioners in each of these and while some of them will continue to be a source of general dispute, others can be resolved. This response will hopefully be seen as a contribution to that process.

## Notes

1. I would like to thank Fred Gruen for making available to me the data used to construct his Figure 1.
2. The real change in the average Morgan response between 1981-82 and 1989-90 is equal to  $1.70 / 1.83 = 0.93$ .

## References

- Atkinson, A. B. (1987) 'On the Measurement of Poverty', *Econometrica*, Vol. 55, No. 4, pp. 749-764.
- Bradbury, B. and Saunders, P. (1990) 'How Reliable are Estimates of Poverty in Australia? Some Sensitivity Tests for the Period 1981-82 to 1985-86', *Australian Economic Papers*, Vol. 29, No. 55, pp. 154-181.
- Esping-Andersen, G. (1994) *After the Golden Age: The Future of the Welfare State in the New Global Order*, Occasional Paper No. 7, World Summit for Social Development, United Nations Research Institute for Social Development, Geneva.
- Glezer, H. and Mills, E. (1991) 'Controlling the Purse Strings', *Family Matters*, No. 29, August, pp. 35-36.
- Goedhart, T. Halberstadt, V., Kapteyn, A. and van Praag, B. (1977) 'The Poverty Line: Concept and Measurement', *Journal of Human Resources*, Vol. 12, No. 4, pp. 503-520.
- Gruen, F. (1987) 'Housing Australians: Puzzles, Policies; But "No Solutions"', *Discussion Paper No. 175*, Centre for Economic Policy Research, Australian National University.

- Gruen, F. (1995) 'The Australian Welfare State: Neither Egalitarian Saviour Nor Economic Millstone?', *Economic and Labour Relations Review*, Vol. 6, No. 1, pp. 125-138.
- Gruen, F. and Grattan, M. (1993) *Managing Government. Labor's Achievements and Failures*, Longman Cheshire, Melbourne.
- Jenkins, S. P. (1991) 'Poverty Measurement and the Within-Household Distribution: Agenda for Action', *Journal of Social Policy*, Vol. 20, No. 3, pp. 457-484.
- Mitchell, D., Harding, A. and Gruen, F. (1994) 'Targeting Welfare', *Economic Record*, Vol. 70, No. 210, pp. 292-340.
- Rainwater, L. (1990) 'Poverty and Equivalence as Social Constructions', *Working Paper, No. 55*, Luxembourg Income Study, Luxembourg.
- Saunders, P. (1993) 'Economic Adjustment and Distributional Change: Income Inequality and Poverty in Australia in the Eighties', *Discussion Paper No. 47*, Social Policy Research Centre, University of New South Wales.
- Saunders, P. (1994a) *Welfare and Inequality. National and International Perspectives on the Australian Welfare State*, Cambridge University Press, Melbourne.
- Saunders, P. (1994b) 'The Role, Value and Limitations of Poverty Research', *Discussion Paper No. 53*, Social Policy Research Centre, University of New South Wales.
- Saunders, P. (1995) 'Welfare and Inequality: Australian in the 1990s', in P. Saunders (ed.) *Social Policy and Northern Australia: National Policies and Local Issues*, Reports and Proceedings No. 120, Social Policy Research Centre, University of New South Wales, pp. 5-35.
- Saunders, P. and Matheson, G. (1991) 'An Ever Rising Tide? Poverty in Australia in the Eighties', *Economic and Industrial Relations Review*, Vol. 2, No. 2, pp. 143-171.
- Saunders, P. and Matheson, G. (1992) *Perceptions of Poverty, Income Adequacy and Living Standards in Australia*, Reports and Proceedings No. 99, Social Policy Research Centre, University of New South Wales.
- Thornthwaite, T., Kingston, C. and Walsh, P. (1995) *Drawing the Line on Poverty. An Assessment of Poverty and Disadvantage in Queensland*, Queensland Council of Social Service, Brisbane.