Up and Down: The Rich, the Poor and Income Mobility

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Western societies are not 'layer cakes' where the rich stay rich and the poor stay poor. They are more like roller-coasters: people go up and down.

MOST people think that Western societies resemble a layer cake: the rich (the 'top' layer) stay rich, the poor stay poor, and the middle class stay in the middle. This is far from the truth. The best evidence we have ever had about Western societies is now becoming available from national economic panel surveys; that is, surveys in which large national representative samples are interviewed repeatedly over the years to find out how their lives, incomes and labour force experiences are changing.

The first of these huge surveys—the University of Michigan's Panel Study of Income Dynamics—began in the United States in 1968. The first ten years of evidence showed that despite annual poverty rates around 7–10 per cent, only 0.7 per cent had remained below the American poverty line every year, with 2.6 per cent being poor in eight or more years out of ten.[1] But many more were at risk of poverty than had ever been imagined. In those first ten years, just under a quarter of the population were poor at least once. Contrary to all previous impressions, it appeared that most poverty was short-term, that most families who enter poverty soon leave. The long-term and recurrently poor certainly existed but they were only about 5–6 per cent of the population, heavily concentrated in the black and Hispanic communities.

Things were much the same at the top end. The rich—very high-income earners—mostly did not stay rich, although they were a somewhat more stable group than the poor. It was tempting to conclude that it was easier to get rich than to stay rich.

Reactions to these findings were mixed. Many economists were unsurprised. From Adam Smith onwards they had claimed that capitalism promotes social and economic mobility. In Australia, advocates of making our labour market more like America's—of making it more 'flexible' and reducing union power—welcomed the Michigan findings (and later confirmatory results) as supporting their case.

Many sociologists and political scientists, on the other hand, regarded the findings with incredulity and scorn. They held a layer-cake view of society; they believed that deprivation is generally long-term, even inter-generational.

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The Michigan results were subjected to harsh scrutiny. The sample was checked for representativeness—it passed with flying colours—and no-one could really lay a glove on the basic results, although over the last fifteen years some important additions have been made.

In Europe, one reaction was that maybe the results were correct for the United States—a less class-based, 'frontier' society, which perhaps after all was as mobile as its celebrants claimed. But it was still confidently believed that Europe was different, that in Europe the layer-cake, or stratification theory of society, would prove to be correct. Panel studies began in two European countries (West Germany and the Netherlands) in 1984 and are now beginning to tell a similar story to the American panel.

In Australia we have no comparable panel but the Federal Government belatedly announced one this year. HILDA (Household Income and Labour Dynamics in Australia) is due to begin in 2000. A dollar to a cent that Australia will eventually be shown to be one of the most mobile societies of all.

SOCIAL STRATIFICATION THEORY—THE LAYER CAKE

Sociologists focus most of their attention on distributional issues; equity and inequality. (Economists tend to be just as one-eyed, focused mainly on efficiency.) The basic paradigm of much of sociology is social stratification theory, or the layer-cake view of society. This boils down to three basic propositions:

(1) inequalities (including income inequality) are long-term;
(2) inequalities of income, status, power, health etc are cumulative or mutually reinforcing (i.e. the same people have the best or worst of everything); and
(3) inequalities are substantially due to family social background.

All three propositions are very much open to question, but the first is the critical one. After all, if inequalities turn out *not* to be long-term, they are unlikely to be highly cumulative and family background could not matter very much. The big panel studies now coming on flow tell us how long lasting inequalities are. This article concentrates on income inequality, but the panels also tell us about housing, health, social status and the distribution of employment.

THREE WELFARE-CAPITALISMS AND THREE NATIONAL PANELS[2]

The Swedish political scientist Gosta Esping-Andersen coined the term 'welfare-capitalism' to describe the main features of Western political economies[3]. He preferred 'welfare-capitalism' to just 'capitalism' in recognition of the fact that all Western governments tax and spend 30–60 per cent of GDP and spend more than half of the money on welfare broadly defined—social security, education and health. Esping-Andersen then went on to argue that there are essentially three main types of welfare-capitalist state. These three types of state promote much the same goals or values but give them different priority. Liberal welfare-capitalist states—such as the US and Australia—give priority to economic efficiency and growth, and aim to avoid work disincentives by restricting most welfare programs only to those 'in need'. Social democratic states, like the Scandinavian countries and the Netherlands, also give high priority to economic growth, but aim to drastically reduce poverty and income inequality. Conservative/corporatist welfare states, like Germany, France and Italy, give high priority to growth and to the maintenance of social stability, especially family income stability. Separate social insurance programs are organized for different sections of the community (public servants, blue- and white-collar employees), which are intended to provide incomes close to what is normal for the family when (e.g. due to sickness or unemployment) breadwinners are unable to earn their usual market incomes.

By sheer good fortune, the three countries which happen to have long-running economic panels have been more or less the best economic performers of their welfare-capitalist type in the last fifteen years. The US has had the highest economic growth per capita among liberal regimes and the Netherlands among social democratic regimes. West Germany has been the best performer of the large conservative/corporatist regimes[4], although in recent years the costs of reunification have been substantial and the growth rate is now lower than two small corporatist countries, Austria and Belgium. So the panel studies give us just about the three 'best cases' of welfare-capitalism, and provide an ideal comparison of regime performance.

The evidence in this article covers the decade 1985–94; these being the latest years for which all the panels are available.

It is widely believed that the US has outperformed all European countries economically in recent years, and this is often attributed to America's flexible labour markets and low welfare state 'burden'. Well, it is a good idea to be sure of one's facts before one tries to explain them. Table 1 shows that, in the 1985–94 decade, American economic growth per capita was much the same as Dutch and German (although the German results, but not the Dutch, would look worse if more recent years were included). In the US, rising incomes have been concentrated at the top end of the distribution. In the Netherlands and Germany the gains have been much more widely distributed (Table 1).

The main international difference shown here is that, while only just over half of Americans were better off at the end of the decade than the start, about two-thirds of Dutch and Germans shared in the fruits of growth.

Now what about social mobility and income mobility in particular? It might perhaps seem obvious that the Ameri-

Table 1: The Fruits of Economic Growth 1985–94

	US (%)	Netherlands (%)	Germany (%)
Growth per capita over 10 years	17.2	19.1	17.4
Better off in 1994 than 1985	53.0	66.5	69.9

Sources: Per capita growth: OECD, *National income Account, 1960–94,* Paris, OECD, 1996. Estimates of percentages better off in 1994: the three panel surveys.

Table 2: Income Mobility of Top and Bottom Quintiles (20 Per Cent) 1985–94: Disposable (Equivalent) Incomes

	US (%)	Netherlands (%)	Germany (%)
Per cent of those in top 20 per cent in 1985 who were in bottom half of incomes in 1994	14.4	28.8	20.7
Per cent of those in bottom 20 per cent in 1985 who were in top half of incomes in 1994	18.6	28.5	23.2

Sources: the three panels.

Table 3: Earnings Mobility of Prime Age Men (25–59): Top and Bottom Quintiles (20 Per Cent) 1985–94

	US (%)	Netherlands (%)	Germany (%)
Per cent of those in top 20 per cent in 1985 who were in bottom half in 1994	15.8	12.0	4.2
Per cent of those in bottom 20 per cent in 1985 who were in top half in 1994	8.1	23.4	9.4

Sources: the three panels. Only men in paid employment in both years are included can liberal economy, with weak unions and a very flexible labour market, would foster higher rates of income mobility (sometimes translated as 'greater opportunities to get ahead') than more regulated economies like the Dutch and German. Again, the evidence fails to confirm what appears obvious to free marketeers. Tables 2 and 3 are based on

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dividing incomes into quintiles (bottom 20 per cent, second 20 per cent … top 20 per cent). Table 2 looks at disposable household incomes (i.e. incomes after taxes and benefits) adjusted for household size.[5] This gives the best picture of changes in material standard of living. Table 3 looks at mobility of individual (not household) labour market incomes and the analysis is restricted to what economists like to call 'prime age males'; men between 25 and 59 in their prime earning years. This restriction, while in some ways unfortunate, is conventional and avoids problems of exaggerating mobility by comparing people with vastly different work histories.

To avoid cumbersome tables, I have only printed results for people who began the decade in the top or bottom quintiles. These groups could be labelled the initially well-off (although not really the rich) and the initially poorly-off (although not exactly the poor). So the question answered in these tables is: 'What had happened by the end of the decade to people who started off at the top and bottom ends of the income distribution?'

Three results stand out—none of which could readily have been foretold. First, there is a high degree of mobility in all three countries. Second, the social democratic regime—the Netherlands—appears to have the highest rates of mobility, especially of disposable incomes. The conservative/corporatist regime—Germany—seems to display just as much mobility of disposable incomes as the American liberal market regime, although German male earnings are less volatile. Finally, in all three countries disposable incomes (standards of living) are even more volatile than labour earnings.

Family disposable incomes are highly volatile: the layer-cake view looks sadly wrong. Think of it this way: if incomes fluctuated completely randomly, half of those who started in the bottom quintile would finish the decade in the top half of the income distribution …and vice-versa. In fact, in all three countries 18–30 per cent of those who start in the bottom quintile wind up in the top half, and 14–30 per cent of those who start at the top wind up in the bottom half. In the US and Germany, the well-off are a somewhat more stable group than the poorly-off, although in the Netherlands both groups are highly volatile. It seems clear that all three types of welfare-capitalist society are highly dynamic: very much societies in flux.

One reason the poor are a highly volatile group is that government benefits lift many families out of poverty. In the Netherlands, where government benefits are most generous, only 19 per cent of those who become poor (using the OECD's semi-official definition of poverty) are still in poverty two years later.[6] In Germany, the comparable figure is 34 per cent. In the US, most people of working age who escape poverty do so through the labour market rather than with government help. Even there, however, only 43 per cent of people remain poor after two years. So most poverty in all these societies is short-term.[7] In absolute terms, however, quite large numbers of people are persistently or long-term poor, and persistent poverty is gradually increasing due to long-term unemployment. To escape poverty, these people need labour market assistance, not just cash benefits.

The international comparisons in Tables 2 and 3 make it appear that the Netherlands, with its huge welfare state alongside its efficient economy, promotes considerably greater income mobility than the US—disposable income mobility appears nearly twice as high. There is more than one way of measuring mobility, however. Our tables show changes in people's *relative* positions in the income distribution. But the American distribution is a great deal more dispersed (less equal) than the Dutch and German, and if one takes this into account by measuring income shifts as a proportion of median income, then it appears that American incomes are a bit more volatile than German and not much different from Dutch. Still, this is not to gainsay the evidence in Tables 2 and 3; both the relative change and absolute change perspectives are valid.

Family disposable incomes are even more subject to change than individual labour earnings because they are affected by family changes and government intervention, as well as the ups and downs of the labour market. People's labour earnings tend to keep rising until their early fifties and then decline towards retirement. Family changes—children, divorce, re-partnering—increase or decrease the number of mouths to feed. And the government intervenes by heavily taxing small well-off families and heavily supporting large poor families.

No panel study has ever followed a national sample throughout entire lifetimes. By extrapolating from panels and other surveys, it is, however, possible through computer simulation to estimate lifetime income mobility and hence lifetime income inequality. Many commentators would probably be aston-

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ished to learn that, over a lifetime, the ratio of the top 10 per cent's income to the bottom 10 per cent's in most Western countries is only two or three to one. This compares with an annual income ratio of ten or fifteen to one. So lifetime income distribution in our societies could be seen as already quite equal.

INTERNATIONAL SIMILARITIES AND DIFFERENCES—POLICY IMPLICATIONS

Evidence from the US, the Netherlands and Germany shows that these 'best cases' (*not* typical cases) of welfare-capitalism have important similarities as well as important differences. Contrary to views quite widely held in Australia, income and labour earnings mobility are not a special feature of the US economy. All three countries have high rates of mobility. Also, all three countries have enjoyed fairly good and quite similar rates of per capita economic growth for most of the 1980s and 1990s. The US is not way ahead of the field, as is often claimed.

The two European countries do differ from the US in other respects. For at least the last 20 years, the fruits of economic growth have been much more widely and equally shared than in the US. In the US, barely more than half the population have become better off in this period. Large majorities have moved ahead in Europe.

The other big difference is in employment and working hours. But even here the favourable picture usually given of the US needs revision. It is true that American employment levels, for women as well as men, are higher than in Europe, and unemployment is lower than in most European countries (although not lower than in the Netherlands). But there is another side to the story. The typical American employee works his (or her) butt off. Americans average about 2000 working hours per year and only get two weeks' holiday.[8] Dutch and German employees work only about 1400 and 1500 hours a year respectively (one quarter less!) and get four to six weeks' holiday. (The higher American hours of work also mean commensurately higher average incomes.)

Most people would probably feel that high levels of employment and low unemployment are desirable, but work is surely not such an unambiguous good that we can simply say, as presumably we would of income, 'the more the better'. America's flexible labour market should probably be credited with generating high levels of employment, but also with generating chronic overwork. Certainly, many Americans report in surveys that they wish they had more leisure and less work.

So, Australian advocates of an American-style labour market, some of whom are to be found in the Commonwealth Government, may be advocating a mixed blessing. The US economy generates more employment but not higher growth than leading European economies. The fruits of growth are more equally shared in Europe and people have more leisure.

NOTES

1 Greg J. Duncan, *Years of Poverty, Years of Plenty*, Ann Arbor, Institute for Social Research, 1984.

2 Much of the material in this paper is drawn from Robert E. Goodin, Bruce Headey, Ruud Muffels and Henk-Jan Dirven, *The Real Worlds of Welfare Capitalism*, Cambridge, Cambridge University Press, 1999.

3 G. Esping-Andersen, *The Real Worlds of Welfare Capitalism*, Oxford, Polity Press, 1990.

4 Results in this paper refer to West Germany only, not united Germany. The panel has now been extended to East Germany but ten years of data are not yet available.

5 The income measure is so-called 'equivalent income'. Following OECD practice, household incomes are equivalized by counting the first adult in the household as one unit, other adults as 0.5, and children as 0.3. This has the effect of adjusting for economies of scale in larger households. The procedure is somewhat arbitrary but is clearly preferable to making no adjustment and thus assuming that large and small households with the same income have equal standards of living.

6 Households are defined as poor if their equivalent income is less than half of median equivalent income in the society in which they live. Clearly this is a relative rather than an absolute definition of poverty.

7 An apparent paradox is that, at any given moment, a majority of the poor are long-term poor. The resolution of the paradox is that, the longer one remains in poverty, the less likely it is that one will escape. So, although most people who enter poverty leave within two years, the accumulation of long-termers is such that a majority of the poor are in this group.

8 OECD, *Employment Outlook*, Paris, OECD, 1998.

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Musing...

The Meaning of Poverty

MICHAEL WARBY

'Poverty' has come to be a classic example of how different people use the same word in different ways. To most people, poverty involves some sense of genuine deprivation. That is what gives the term its bite, why it seems particularly shameful to be told that large numbers of Australians are living in poverty.

But 'poverty' has come to be a term of art, meaning an unacceptable level of inequality, thereby enlisting general sentiment against poverty in the argument against inequality. It is claimed that there is no real concept of absolute poverty, that poverty is always relative to the society in which it occurs.

Suppose you were told about a group of households of whom 72 per cent owned washing machines, 50 per cent clothes dryers, 20 per cent dishwashers, 98 per cent refrigerators, 29 per cent freezers, 98 per cent stoves, 60 per cent microwaves, 93 per cent colour TVs, 60 per cent VCRs, 7 per cent PCs, 78 per cent telephones, 50 per cent air conditioners and 72 per cent one or more cars. Would you call them poor? According to the official US definition of poverty they are—that is the profile of ownership by 'poor' American households in 1994. (And the US attempts to define 'poverty' in absolute terms as three times the income required to provide a nutritionally balanced diet.)

'Poor' Americans have a higher rate of ownership of most consumer durables than was the middle-class standard in 1971 with the exception of cars (US average 80 per cent in 1971), telephones (93 per cent) and freezers (32 per cent). Yet we are told that the American rate of poverty barely declined over that period.

Is this a usage of 'poverty' that connects in any way with the experience of, say, a Calcutta slum dweller?

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