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The reason why the poverty rate fell

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The massive decline in the U.S. poverty rate reported today by the Census (it fell from 14.8% of all families below to the poverty line to just 13.5%, the largest drop since the 1960s) may have come as a surprise to many economists and political commentators but it should not have. The one thing we have learned from the last three business cycles is that the poor benefit greatly from sustained economic growth.

When a recession occurs the unemployment rate can fall quickly, but it usually takes a long time before it returns to its previous pre-recession levels. no matter how aggressive our infrastructure spending may be. What eventually helps low-income workers is an economy where labor–skilled and unskilled–becomes difficult to find. When that happens companies bid against one another to find workers or else become creative-perhaps by investing in labor-saving equipment or else taking a chance on workers who haven't been in the labor market for a while and don't have the most sterling resumes.

When the unemployment rate approached 4.5% in the late 1990s poverty rates also declined significantly, as wages all across the income distribution grew steadily. Productivity grew smartly as well during this time–while the facile explanation for this was that businesses finally managed to take advantage of IT innovations, the same companies that were using IT to boost productivity were also the same ones that hire lots of low income workers (i.e. big box stores like Wal-Mart and Target) and they had every incentive to figure out how to do more with fewer workers, who were becoming more expensive. In Chicago the grocery chain Dominick's sought out people living in government housing projects and spent significant resources training them to work for them, with surprising success. In Peoria another grocery chain, Kroger's, worked with a local social service organization to train and employ young adults with Down Syndrome to work in their stores, also with a great deal of success. With luck more firms will have the need to get creative on employment soon.

Today's numbers reflect the fact that strong and sustained economic growth and not redistribution are the best way to help low-income Americans. There's lots that the next president and Congress can do on that front–in the last year the Department of Labor alone has imposed regulations that will cost businesses tens of billions of dollars a year to implement, and the FCC's going to throttle investment in high speed internet for the now-inviolate right for a Netflix customer to not have to wait three minutes for his movie to load.

The lesson macroeconomists painfully learned in the 1970s was that they're no good at forecasting the ebbs and flows of the business cycle and we're better off concentrating our efforts on thinking about the things that can boost productivity and long-run growth. Today, however, that lesson has been all but ignored as we debate whether society would survive a quarter-point rise in the discount rate and how much of a free lunch new infrastructure spending would be.

A better lesson for politicians would be that 3% growth is 50% more than 2% growth and that it's worth contemplating how to reach that copasetic rate once again. It should be a lesson for the rest of us as well.

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