

POVERTY INDICATORS AND WORKING INCOME

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Abstract

This paper examines existing working poverty indicators in context of assessing working income and proposes integrating a living wage concept. By reviewing and systemization of the working poverty indicators, I describe the state of art regarding wage level assessment. This paper identifies limitations and blind spots in current approaches while emphasizing the importance of addressing working poverty in times of costs-of-living crisis. The findings stress the need to understand working poverty comprehensively by considering workers' living needs and necessary expenses. By incorporating a living wage indicator, policymakers and researchers gain insights into the challenges faced by low-income workers, prompting discussions on fair compensation, income redistribution, labor market dynamics, and tax policies. This study contributes to evidence-based policy interventions that enhance the economic well-being of low-income workers and their families.

Key words: Working Poverty, Wages, Living Wage

JEL Code: J31, J39, P36

Introduction

Working poverty is a critical issue with its importance on the rise. Overall decline of real wages resulting from the high inflation period in Europe impacts standard of living of working people across the continent. The inability to earn a sufficient income from work has profound implications for individuals' well-being and overall social development. As such, assessing working income and poverty indicators is a crucial area of research that aims to shed light on the extent and nature of this problem. In this paper, I delve into the existing working poverty indicators and their applicability in evaluating working income, aiming to address the limitations associated with them and identify potential blind spots.

One of the first studies to address the phenomenon of working poverty in the European context was conducted in 2002 by Ioakimoglou and Soumeli (2002). Globally, the majority of the poor are actually employed (Lohmann & Marx, 2018). Not only does employment fail to guarantee sufficient protection against poverty at the individual level, but even higher employment rates at the societal level cannot solve the problem of poverty.

The likelihood of falling into working poverty varies, among other factors, depending on household characteristics, such as the number and composition of its members. The quality of employment, including factors such as job duration, work hours, wages, etc., also plays a significant role in predicting working poverty. Individual characteristics like gender, age, education, or place of residence also contribute (Peña-Casas & Latta, 2004). These differences are not only found among individuals but also among countries, where political, social, and economic institutions play an important role.

Generally, those who work and whose household's disposable income does not reach the poverty threshold are considered working poor. According to Bruder et al. (2011), the description of the working poor is highly sensitive to assumptions enabling any quantification, specifically regarding who is considered poor, who is considered a worker, the reference population, the definition of income, and the choice of measurement units. In other words, research on working poverty combines the fields of labor studies and poverty research.

The objective of this study is to critically examine the current state of working poverty indicators and assess their effectiveness in capturing the true wage level experienced by individuals. By reviewing and systematizing the existing working poverty indicators, I seek to provide a comprehensive overview of the state of the art in wage level assessment. In doing so, I aim to identify any gaps or shortcomings in the current indicators' ability to accurately describe the wage levels of individuals. Furthermore, I propose the integration of the concept of a living wage into economic research as a complementary indicator of working poverty. The notion of a living wage takes into account not only the income earned by workers but also their living needs and necessary expenses. By incorporating this perspective, we can gain a more comprehensive understanding of the challenges faced by working individuals in meeting their basic needs and attaining a decent standard of living.

The remainder of this paper is organized as follows: In Chapter 2 and 3, I discuss the essential questions regarding measuring working poverty: who is poor and who is working. Chapter 4 presents the gap in measuring working poverty and last chapter discusses the living wage as a complementary indicator filling this gap.

Who is poor?

The need to quantify the significance of poverty in society has led to the development of statistical data and methods to create a variety of poverty indicators. All of these indicators face a common challenge, namely, defining the poverty threshold. There are two general approaches to this: *absolute* and *relative*.

Absolute measures of poverty rely on defining a certain minimum consumption basket, which is subsequently valued. This process yields the absolute poverty line. An alternative option, used, for example, by the World Bank in the form of extreme poverty, is the direct establishment of a nominal amount of \$1.90 per day or World Bank-defined extreme International Poverty Line at \$2.15). Absolute poverty measures are also utilized by the US Census Bureau, which calculates the minimum necessary expenditure on food and adjusts it based on the proportion of food in household budgets. Additionally, the National Academy of Sciences uses an expert-determined broader consumption basket that includes not only food but also expenses related to housing and clothing. This approach helps to calculate an experimental poverty threshold. One advantage of absolute measures is their direct interpretation, as they allow for the identification of specific material (or non-material) deficiencies based on the defined consumption basket. However, the main disadvantage is the need to determine the contents of the specific consumption basket, which is typically subjective and may be culturally or regionally specific.

Conversely, relative measures of poverty, primarily used in developed countries, establish the poverty line relatively to income distribution. This can involve the median or mean wages or incomes of individuals or households. One essential element and, at the same time, the most criticized aspect of analyzing working poverty in the European Union is the establishment of the poverty line for calculating the at-risk-of-poverty indicator (AROP), which is artificially set at 60% of the median equivalized disposable income of households after social transfers. Although it is used for international poverty comparisons, it does not indicate the same social and economic situation of households across all countries due to purchasing power inequalities. Criticism also arises regarding the assumptions associated with the use of equivalence scales, namely that household economies of scale are proportional to their incomes and are uniform across European countries (Crettaz, 2013). According to many authors, such an assumption can lead to a false assessment of poverty (Peña-Casas & Latta, 2004). An auxiliary indicator of low wages has also been developed in the literature from the relative at-risk-of-poverty indicator. It similarly sets the limit at 60% of the median wage in the economy. In the context of assessing the amount of the minimum wage, the threshold of 50% of the average wage is also used (Schulten and Müller, 2019). Ponthieux (2010) also suggests an indicator of poverty in earned income which is similar to the in-work at-risk-of poverty approach, but it employs individual earnings instead of household disposable income.

In addition to these monetary approaches to measuring poverty, the literature also introduces *multidimensional* indicators that do not attempt to express a nominal poverty line or

compare incomes or expenditures. Instead, poverty is determined through a set of non-monetary indicators related to household well-being. An example of a multidimensional indicator is the European indicator of material deprivation, which examines the lack of nine items among households, including or paying their rent, mortgage or utility bills or to keep their home adequately warm). If a household is unable to afford at least four out of the nine necessities, it is classified as severely materially deprived.

According to Mareš and Rabušic (1996), indicators can be classified as *prescriptive* or *consensual*. Prescriptive indicators are closer to objective absolute measures of poverty, as they are based on expert calculations of the poverty line, such as a standardized consumption basket or a reference budget. In contrast, consensual indicators are based on the decisions of relevant stakeholders, and the artificially set relative poverty line in relation to income distribution can be included among them.

Finally, possible categorization includes objective indicators, which establish specific criteria that must be met to classify an individual as poor, whereas subjective indicators rely on individuals' own perceptions of their poverty status.

Who is working?

The definition of a working individual varies in the criteria that must be met to classify someone as working. Consequently, the measurement of working poverty is sensitive to methodological differences. For instance, two illustrative approaches can be considered. The first approach requires full-time employment throughout the reference year, while the second approach allows classifying an unemployed individual as employed if they are actively seeking employment. The latter definition results in a higher incidence of working poverty, as it includes individuals who would not be considered working under the alternative method, but who likely have higher incomes. The origin of such discrepancies lies in defining genuine employment, including its duration and the type of work contract. Furthermore, each methodology faces challenges in dealing with self-employment.

Spannagel (2013) distinguishes three approaches. The first one corresponds to the methodology of the U.S. Bureau of Labor Statistics, where a working individual is defined as anyone who worked or actively sought employment for at least 27 weeks in the relevant year. This is a very broad method that allows classifying individuals as working even if they did not work. For such a wide group of people, terms such as "active poor" or "unemployed poor" are sometimes used (Peña-Casas & Latta, 2004). The French National Statistical Institute considers a person as employed only if they worked for at least one month in six months of being present

in the labor market. The strictest approach is that of Eurostat, which defines a working individual as someone who worked for at least seven months in the given year. The characterization of employment is closely related to the issue of non-standard or low-quality jobs: temporary employment, part-time work, agency work, or dependent self-employment.

The definition of a working individual is also connected to the indicator of individuals living in households with very low work intensity, which Eurostat includes in households where working-age individuals have worked less than 20% of the previous 12 months. Together with severe material deprivation (households lacking at least four out of nine items) and the at-risk-of poverty, this low work intensity forms the main composite indicator, known as the indicator of at-risk-of poverty and social exclusion (AROPE). The concept of work intensity refers to the proportion of time worked by adult household members between 18 and 59 years, excluding students up to 24 years of age, relative to the theoretically full working time during the reference year.

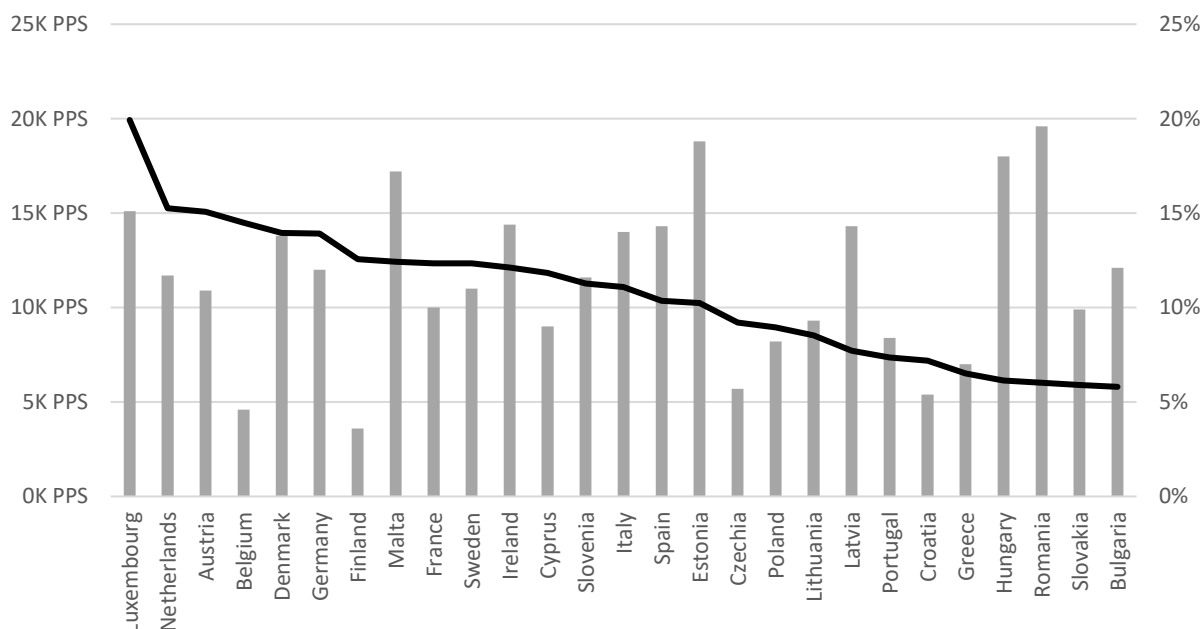
Who is working poor?

In the context of working poor, individuals falling under both of the aforementioned categories are considered as such. This description clearly indicates that there exist, or can exist, numerous approaches to measuring working poverty. In this subsection, the focus will therefore be on the main indicator of working poverty and illustrate the key choices that need to be made when selecting a working poverty indicator.

The primary indicator used in the EU, which is also part of the Sustainable Development Goals (SDGs), is the in-work at-risk-of-poverty rate. This indicator expresses the percentage of employed individuals living in households below the poverty threshold (60% of the equivalized disposable household income after social transfers) in the total population. The following figure depicts the rate of working poverty and its poverty threshold in purchasing power parity. There is a distinct difference in the purchasing power of working poor (single household) individuals defined by this indicator. For instance, the purchasing power at the poverty threshold is 3.4 times higher in Luxembourg compared to Bulgaria. This implies that the household of a working poor individual in Luxembourg may have three times the purchasing power, i.e., a threefold consumption basket to satisfy basic needs, compared to a Bulgarian household that is not considered poor. Assuming that basic material needs of individuals do not fundamentally differ across the European Union, the indicator of the at-risk-of-poverty rate among the working population does not allow for meaningful international comparisons. Rather than measuring

poverty, it is closer to indicators of income inequality as it compares the income distribution of specific households to the 60% median threshold.

Fig. 1: At risk of poverty threshold (black line; thousands of PPS) and In-work at-risk of poverty rate (gray columns; %) in 2022



Source: Eurostat

The headline indicator in the EU is relative distribution-based one. However, the new European Directive on Adequate Minimum Wages in the EU¹ explicitly calls for the utilization of an absolute basket-based indicator to assess the adequacy of minimum wages. By referencing purchasing power and the cost-of-living, the directive emphasizes the need for a comprehensive approach that takes into account the specific goods and services required for a decent standard of living. However, operationalizing this basket-based indicator at the European level poses challenges due to the absence of a consensus-based indicator that can be uniformly applied across member states.

In the search for a poverty indicator that would overcome the limitations of relative indicators also with the “low wages” derivatives, the advantages of absolute indicators must be used. They can capture income insufficiency on specific goods and services. The most frequently used indicators at the European level - material deprivation of severe material deprivation - belong to the absolute multidimensional indicators. Their main shortcoming is that they only concern very serious material deficiencies. Although, they have some relevance

¹ Directive (EU) 2022/2041 of the European Parliament and of the Council of 19 October 2022 on adequate minimum wages in the European Union, henceforth referred to as “the directive”.

in comparison to global indicators of extreme poverty, they are not the most suitable for evaluating the income of households or individuals, because some of the evaluated items are also closely connected to wealth.

A case for a living wage

The concept of a living wage represents an adequate remuneration for individuals that meets their biological and social needs. This type of working poverty indicator considers the individual income - wages - of the worker while also taking into account their familial and societal needs. The concept encompasses poverty in a broader sense beyond material deprivation using basket-based method of estimating the wage necessary to afford a basic standard of living. The creation of a reference budget offers several advantages over other approaches, as it directly and transparently identifies basic needs or social rights by constructing a specific consumption basket valued at market prices. However, disadvantages include the inability to differentiate between various needs and the situations of different individuals, normative creation of such a basket, and the reliance on reliable data sources. A living wage serves as a reflection of the adequacy of wages relative to the necessary expenditures of an individual. Similarly to various approaches in setting relative poverty thresholds of constituting absolute indicators, where is many living wage methodologies across Europe and world. Despite those differences, they share the basic understanding of the concept.

It is important to note that a person's income, including wages, salary, or self-employment earnings, is not their sole source of income. However, the majority of working poor individuals indeed earn low wages. Thus, wages are not only the primary income source but also insufficient to ensure a decent standard of living. A living wage does not aim to replace market forces in setting wages, nor policy decisions regarding the minimum wage, remuneration in the private and public sectors, or the design of tax and benefit systems. Instead, it serves as an indicator of working poverty, describing the situation of low-income employees.

A living wage fills the inadequately addressed space between poverty as a severe lack of basic needs and the modest material dignity of a working individual living with economic insecurity as their income, despite their work efforts, is not sufficient to meet the standard of living. While the feeling of uncertainty, vulnerability, and a lack of perspective cannot be captured by a single threshold, deriving it from human needs that enable a modest life and participation in social, cultural, and political life makes such an indicator more transparent and facilitates a more accessible interpretation of working poverty.

Considering the aforementioned points, a living wage serves as an objective absolute indicator of working poverty, focusing on the source of this type of poverty - low wages. This indicator differs from existing poverty measurement tools. Unlike the main indicator used in the European Union, which pertains to income inequality around the median disposable income, the living wage indicator specifically relates to material poverty. It does not arbitrarily set the poverty threshold at 60% of the median wage as other low wage indicators, but rather bases it on a reference budget consisting of concrete goods and services. Similarly, it distinguishes itself from multidimensional indicators of material deprivation that monitor a limited number of basic needs. The concept of a living wage falls under the prescriptive indicators category as it is derived from expert calculations of the poverty threshold, in contrast to consensual indicators based on the decisions of involved stakeholders.

The preference for studying wages instead of income in the discourse of working poverty can be attributed to several factors. Firstly, international treaties, including the Universal Declaration of Human Rights, The Preamble to the ILO's Constitution, or the European Social Charter, emphasize the importance of providing fair compensation for labor. By focusing on wages, which directly reflect the remuneration for work, these agreements highlight the need for just and equitable compensation. Secondly, low wages are widely recognized as the most significant determinant of working poverty. Insufficient earnings significantly contribute to the inability of individuals and households to meet their basic needs and maintain a decent standard of living. As a result, addressing the issue of low wages becomes crucial in tackling the pervasive problem of working poverty.

Furthermore, working poverty is an indicator specific to employed individuals, making a focus on work-related incomes relevant. By concentrating on wages, policymakers and researchers can better understand and address the challenges faced by those who are employed yet still experience poverty. This approach recognizes that inadequate wages play a fundamental role in determining the economic well-being of workers and their families.

Lastly, the practical implications of labeling low wages as such have important political ramifications. Framing the issue as a consequence of labor market dynamics, household characteristics, and tax policies prompts discussions on income redistribution and policy interventions. Recognizing that market forces alone may not ensure decent wages highlights the necessity of addressing the problem through appropriate policy measures.

Conclusion

This study explores the significance of a living wage in the context of working poverty. It aims to understand the relevance of incorporating a living wage indicator in research on working poverty and its implications for future practice.

The relevance of a living wage in the working poverty research is supported by its ability to capture the inadequacies of low wages in providing a decent standard of living. By focusing on wages as a primary source of income, this indicator recognizes the crucial role that fair compensation plays in addressing working poverty.

The results indicate that a living wage provides a more comprehensive understanding of the challenges faced by low-income individuals and families. By considering concrete goods and services required for a modest life, it offers a transparent and accessible interpretation of working poverty. Moreover, it sheds light on the limitations of other poverty measurement tools that solely focus on income inequality or a limited number of basic needs.

This new understanding should help to shape future policies and initiatives aimed at reducing working poverty. By recognizing the pivotal role of a living wage, policymakers can design and implement targeted measures to ensure fair remuneration for work and improve the economic well-being of low-income workers and their families. By highlighting the issue of low wages and emphasizing the need for just and equitable compensation, it prompts discussions on income redistribution, labor market dynamics, household characteristics, and tax policies.

Future studies should delve into the living wage methodologies usable in both research and policy. It lays the groundwork for future research into the living wage policies, their impact on reducing working poverty rates, and the potential implications for economic and social outcomes.

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