

Prosperity, inequality, and poverty

WORKING PAPER 10, SEPTEMBER 2007



The Institute for Competitiveness & Prosperity is an independent not-for-profit organization established in 2001 to serve as the research arm of Ontario's Task Force on Competitiveness, Productivity and Economic Progress.

Working papers published by the Institute are primarily intended to raise public awareness and stimulate debate on a range of issues related to competitiveness and prosperity.

The mandate of the Task Force, announced in the April 2001 Speech from the Throne, is to measure and monitor Ontario's competitiveness, productivity, and economic progress compared to other provinces and US states and to report to the public on a regular basis. In the 2004 Budget, the Government asked the Task Force to incorporate innovation and commercialization issues in its mandate.

It is the aspiration of the Institute and the Task Force to have a significant influence in increasing Ontario's competitiveness, productivity, and capacity for innovation. We believe this will help ensure continued success in the creation of good jobs, increased prosperity, and a higher quality of life for all Ontarians. We seek breakthrough findings in our research and propose significant innovations in public policy to stimulate businesses, governments, and educational institutions to take action.

Comments on Working Paper 10 are welcome and should be directed to the Institute for Competitiveness & Prosperity. The Institute for Competitiveness & Prosperity is funded by the Government of Ontario through the Ministry of Economic, Development, and Trade.

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Foreword and acknowledgements



I AM PLEASED TO PRESENT Working Paper 10 of the Institute for Competitiveness & Prosperity in support of the Task Force on Competitiveness, Productivity, and Economic Progress.

In this working paper, we turn our attention to how overall prosperity levels interact with inequality and poverty. We have been urging Ontarians to adopt a prosperity enhancing agenda to achieve our full economic potential. But as we meet with Ontarians, we are sometimes confronted with the concern that the benefits of rising prosperity will accrue to only upper income Ontarians. Others are concerned that rising prosperity will lead to a more Darwinian economy that will hurt the economic prospects of lower income Ontarians. These are important concerns and we try to address them in this working paper.

Our research indicates that rising inequality of income distribution has been the norm in recent decades across developed economies, including Canada and Ontario. But the evidence indicates that this rising inequality is not the direct result of increasing prosperity. It is fair to say that the cause of increasing prosperity is also the cause of increasing inequality of its distribution. While researchers have not reached complete agreement on the reasons for increased inequality, a consensus seems to be emerging on the importance of skills for the success of individuals and the economy overall. The increasing importance of technology and the ongoing globalization of markets mean that those individuals with up to date and flexible skills will be in demand and be rewarded. Provinces and countries that can draw on these skills will see increased overall prosperity. The impact on those individuals with less education and fewer skills is negative.

A more important challenge, however, is the impact of these trends on the incidence of poverty. Where growing inequality is related to changing market structures in Ontario, Canada, and the world, the incidence of poverty is very much related to conditions closer to home and has very specific features. As we dig below the surface of issues related to poverty, we find that it occurs more frequently and persistently in six specific high risk groups in Ontario: high school dropouts, recent immigrants, lone parents, the disabled, unattached individuals between 45 and 64, and Aboriginals. In fact, families with main earners in one of these risk groups are 3.7 times as likely as others to have inadequate income to cover the necessities of life.

Since each of these groups is excluded from Ontario's prosperity for its own reasons, each requires its own solution. To the extent we are not successful in helping individuals in these groups move out of poverty, we are hurting our future prosperity potential. We need the skills and capabilities of all Ontarians in creating economic success, and we cannot afford to exclude people in these high risk groups.

In our work, we have often spoken about virtuous circles – and this working paper points to another. Closing Ontario's prosperity gap and realizing our full economic potential means more income for individual Ontarians. It also means significantly more tax revenue for governments – which can be invested in helping at risk individuals escape poverty and ensure a better future for their children. As individuals escape poverty, they will contribute more to the province's economic progress. This greater involvement by all Ontarians means more prosperity and so on.

A determined effort to invest in people to gain skills will help them – and all Ontarians.

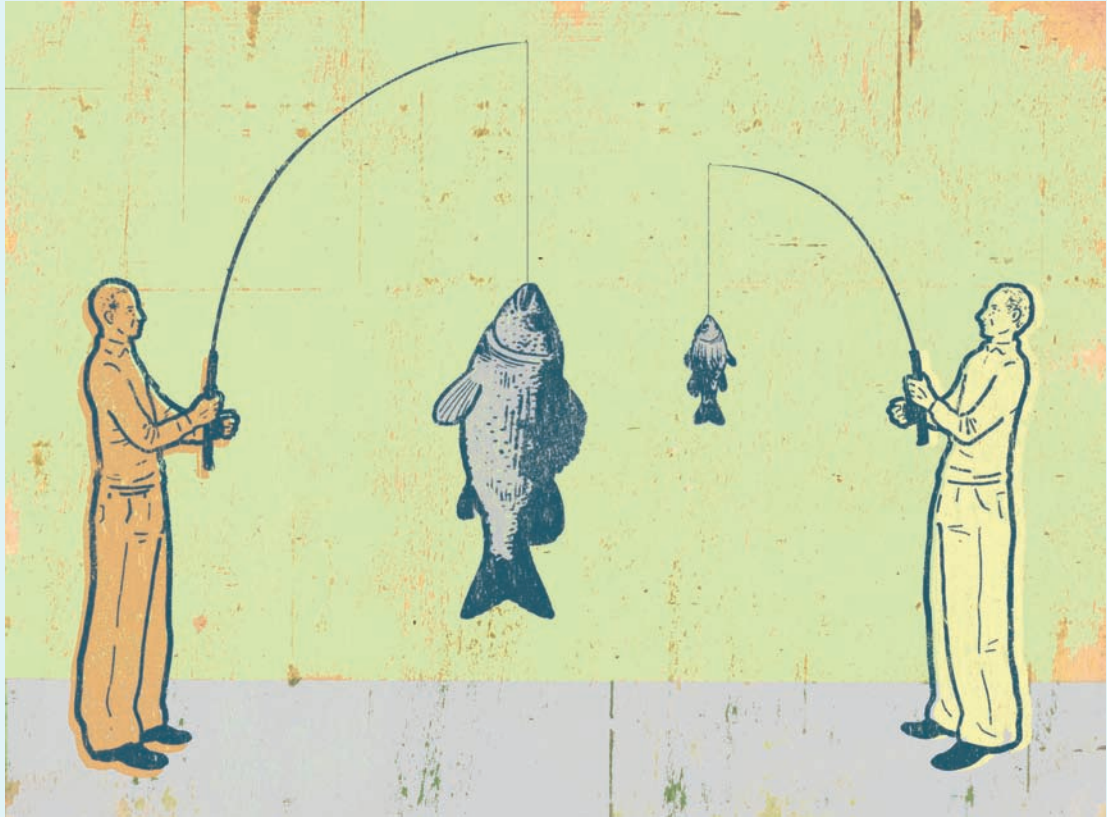
In summary, pursuing a prosperity enhancing agenda does not necessarily mean greater inequality or poverty. We continue to conclude that our economic focus needs to be on making the pie bigger. A determined effort to invest in people in high risk groups to gain the skills and opportunities to participate more fully in our economic success will help them – and all Ontarians.

We gratefully acknowledge the funding support from the Ontario Ministry of Economic Development and Trade.

We look forward to sharing and discussing our work and our findings. We welcome your comments and suggestions.



Roger L. Martin, Chairman
Institute for Competitiveness & Prosperity
Dean, Joseph L. Rotman School of Management, University of Toronto



Executive summary

OVER THE PAST FIVE YEARS, the Institute for Competitiveness & Prosperity has encouraged Ontarians to take actions to reach our full economic potential. While we have seen that we have a very competitive and prosperous economy by world standards, we are concerned about our large and growing prosperity gap – calculated as the difference in Gross Domestic Product (GDP) per capita achieved between what we in Ontario achieve and what we could reasonably accomplish. This prosperity gap represents lost opportunity for all of us. It also means that we run the risk of leaving our children with less economic opportunity than we inherited from our ancestors.

By our estimates, the prosperity gap of \$6,100 per capita, measured against the accomplishments of the most similar jurisdictions in North America, costs the average Ontario household \$8,400 in forgone personal disposable income annually. This additional income would readily pay for many important consumer spending items and investments in our future. In addition, the prosperity gap reduces government revenues at all levels in Ontario by \$26 billion annually at current tax rates. With this added revenue, governments would have more choices for public policy – for example, to increase spending in high priority areas and to lower tax rates for Ontarians.

We are sometimes confronted with the concern that, while our agenda may increase our overall prosperity, that gain may not be distributed equally among the population.

In our Fifth Annual Report, we urged Ontarians to adopt a prosperity enhancing agenda in order to achieve our economic potential. Initiatives included: raising our determination to narrow the prosperity gap by 2020; shifting our collective spending focus from consuming today's prosperity to investing in future prosperity; making our tax system smarter; and improving market and governance structures to encourage innovation and risk taking rather than entrenching the status quo.

But, as we meet with Ontarians, we are sometimes confronted with the concern that, while our agenda may increase our overall prosperity, that gain may not be distributed equally among the population. Some are concerned that rising prosperity will not lift all boats equally, but instead will primarily benefit upper income Ontarians. Others go so far as to argue that it will hurt the economic prospects of lower income Ontarians as we move toward what they fear may be a more Darwinian economy in which the rich get richer and the poor get poorer. Many point to the example of the United States which, among large developed countries, has the highest level of prosperity and one of the most unequal distribution of income.

An important question for us, then, is: Will an agenda of realizing our prosperity potential necessarily result in greater inequality? A related, but not the same question is: What is the relationship of increasing overall prosperity with the incidence of poverty? We need to understand how growth strategies to increase prosperity will affect inequality and poverty. Prosperity strategies that enrich only a few, or actually



increase poverty, are of little interest to Ontarians. Instead, we need the kinds of strategies that increase prosperity for as many Ontarians as possible and make real inroads into poverty. These are important challenges to our prosperity agenda and are the driving force behind this working paper.

Our research does show that inequality in Ontario and Canada has been increasing in recent years, even though overall prosperity has been advancing. And it also confirms that the high level of prosperity is less equally distributed in the United States than in most other countries.

But our closer investigation reveals that, although we have experienced increasing inequality in the distribution of our prosperity, we are not alone. In fact, in recent decades the distribution of income has become more unequal in most developed economies. Researchers and academics continue to study this phenomenon, but an emerging consensus is that as the world's economies become even more sophisticated, highly skilled workers are simply more valuable and earn higher incomes. And the difference in economic rewards received by them and less skilled workers widens. As emerging economies, like China and India, advance, we can expect that less-skilled workers in the developed economies will fall further behind. There will also be greater competitive pressure on higher skilled workers, as China and India move up the value chain and compete on more sophisticated bases. Still, these individuals will be better able to adapt to changing competitive circumstances and will enjoy higher rewards than lower skilled workers.

In effect, the increased inequality we are observing in most developed economies is mainly a consequence of changing market structures. It is not a necessary result of prosperity. In fact, we can find no strong link between higher prosperity and more or less equality of outcomes in the employment market. Nor do we observe a strong link between the level of prosperity and the equality of economic outcomes after considering government income redistribution policies.

Consistent with the view that inequality is the result of higher rewards for skilled individuals, the evidence indicates that the rich are getting richer. But the poor are not getting poorer. Our research indicates that the recent increases in inequality in Ontario and Canada are not coincident with increased poverty as measured by the percentage of Ontarians living below the low income cut off (LICO). Between 1980 and 1996, poverty and inequality did move in tandem – then, as prosperity was less equally distributed, a greater percentage of Ontarians found themselves not earning enough to secure life's necessities. But since 1996, as Ontario's economy has expanded, fewer Ontarians' incomes are below LICO. However, inequality is increasing.



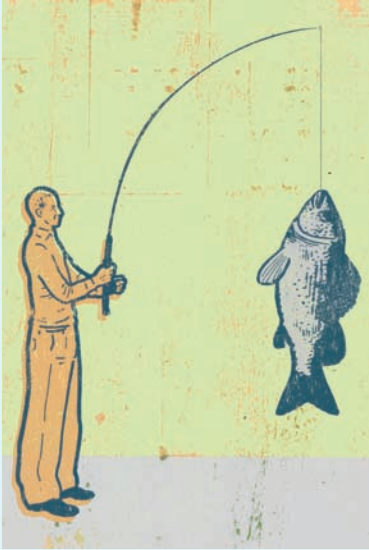
We would argue that this is a better outcome than the alternative – less inequality and more poverty. But it is not good enough. We should strive for an economy that draws on all people’s capabilities and creates economic success for everybody. Equality is not simply a measure of outcomes; it is also a measure of opportunities to contribute. And while the incidence of poverty may currently be relatively low, we can do better.

In order to understand poverty better, we need to dig below the surface because poverty is not a generic issue that affects Ontarians at random. It occurs more frequently and persistently in six specific high risk groups in Ontario: high school dropouts, recent immigrants, lone parents, the disabled, unattached individuals between 45 and 64, and Aboriginals. In fact, families with main earners in one of these risk groups are 3.7 times more likely to be in the bottom quintile of earnings than other families. Ontarians who are not members of these high risk groups are much less likely to find themselves at the bottom end of earnings or in poverty – and are three times more likely to be in the highest income quintile.

We think it is much more important to focus public policy on reducing poverty among these high risk groups than to strive for greater equality by holding back opportunities for other Ontarians. But addressing the incidence of lower incomes in these risk groups would have limited impact on inequality as defined by the Gini coefficient, the internationally accepted measure of inequality. For example, a \$5,000 subsidy to each family or unattached individual in the risk groups we identify would have a modest reduction in inequality of incomes, after taxes and government transfers.

In Ontario, we think addressing issues of poverty and inequality are inexorably linked to closing the prosperity gap and achieving our full prosperity potential.

Since each of these groups is excluded from Ontario’s prosperity for its own reasons, each requires its own solution. To the extent we are not successful in helping individuals in these groups move out of poverty, we are hurting our future prosperity potential. Children in poverty are less likely than other children to invest in raising their skills and to benefit from the future prosperity higher skills would bring. To be sure, Canada has an enviable record of intergenerational mobility. Compared to other developed economies, a person’s current economic success in Canada is less related to parents’ economic success. One third of our low income children become low income adults. This compares favourably to results in the United States, where nearly one half of low income children become low income adults and in the United Kingdom where this result holds for four in ten.



Canada's impressive generational equality results will wane if we experience increasing child poverty. If we want to benefit from the talents of all Canadians, we need to ensure that all are participating to the best of their abilities in our economy.

Andrew Sharpe of the Centre for the Study of Living Standards has observed that the goal of economic policy is to create virtuous circles, where higher investment leads to higher prosperity and in turn to more investment in economic progress.

Similarly, modern theories of economic growth emphasize the synergies between broad-based distribution of prosperity and investment in human capital. In Ontario, we think addressing issues of poverty and inequality are inexorably linked to closing the prosperity gap and achieving our full prosperity potential.

More prosperity will lead to a greater ability to invest in people – in educational and skills development opportunities, in incentives to work, and in early childhood education. As we have seen, Ontario's prosperity gap significantly reduces our ability to spend on public and private skill enhancing investments. To the extent we improve our prosperity and are able to make these investments, we will reduce poverty and, more importantly, increase the skills and capabilities of Ontarians to increase prosperity. As we have found repeatedly in our work, our economic progress is based less on natural resources and work effort and more on our ability to thrive in a knowledge economy. It is unlikely that rewards for skilled workers will be declining in the near future. We need to ensure that we are drawing on our collective skills and energies to realize our full prosperity potential.

As we review our agenda for prosperity, we see nothing that necessarily increases inequality and poverty. In fact, we are confident that our agenda will help us achieve the virtuous circle we have described. In this working paper, we examine some factors at play in creating this virtuous circle.

First, we review measures of inequality and discuss current trends in Ontario, Canada, and internationally. We conclude that, in recent years, inequality has increased in most countries. The most accepted explanation – although the jury is still out – is that a knowledge based economy places a greater premium on highly skilled workers and so economic rewards are increasing faster for them than for those with fewer skills. Nevertheless, in Ontario and Canada, greater inequality does not mean more poverty. In recent decades, inequality appears to have been affected by trends that are distinct from changes in prosperity. Poverty rates, however, seem to track more closely with economic cycles.



Second, we examine the relationship between the level and distribution of prosperity across developed economies and over time. We find no significant relationship either in income distribution through the workings of the market or after government intervention through taxes and transfers. The Netherlands and Australia, for example, have very similar levels of prosperity as measured by GDP per capita; yet market income distribution in Australia is among the most unequal, while it is among the most equal in the Netherlands. The United Kingdom and the United States have similar rates of inequality in the distribution of market income. Yet overall prosperity is much higher in the United States. We see the same phenomenon after consideration of the redistribution of market income – after taxes and transfers. And we see that a country’s rate of income inequality does not predict subsequent economic growth. In summary, achieving our prosperity potential will not necessarily lead to more or less inequality in the distribution of income.

Finally, we turn from inequality to assess the incidence and persistence of poverty among Ontarians, concluding that people in six high risk groups are much more likely than other Ontarians to be living in poverty. These high risk groups represent challenges for Ontario’s prosperity because they are not sharing in the prosperity growth we have achieved. But they also represent opportunities. Ontario’s prosperity would grow faster if we could benefit more fully from the skills and capabilities of people in high risk groups. The challenge for public policy is to ensure that programs and initiatives are highly focused on these high risk groups. Poverty is not a generic problem to be solved by generic solutions.

Ontario’s prosperity gap has consequences for all Ontarians – irrespective of income levels. We see nothing fundamental indicating that increasing our prosperity will lead to greater inequality. We continue to conclude that our economic focus needs to be on making the pie bigger so that there is more to distribute. But we do have poverty in the midst of our economic progress. Too many Ontarians are not participating in our economic success. Our research indicates that a determined effort needs to be made to help individuals in high risk groups to gain the skills and opportunities to participate more fully in the labour force. Investing in people will pay dividends in our overall prosperity, which in turn will afford even greater investments, and so on. We urge stakeholders in Ontario’s prosperity to address these challenges and achieve our prosperity potential for the benefit of all.

Global trends in inequality

The “right” balance of economic growth and equality can lead to greater prosperity for all



TODAY WE ARE SEEING increasing inequality in Canada, a trend that is also occurring in most other developed economies. The disparity seems to result from the accelerating sophistication of the world’s economies, which is escalating the premium for highly skilled individuals and reducing opportunities for those who are less skilled to work and earn a decent living. Many are concerned that growing prosperity leads inexorably to greater inequality. But, while measurement of inequality is complex and challenging, we do not think the evidence supports that conclusion. Instead, our research leads us to conclude that economic growth with some degree of inequality may create a virtuous circle that contributes to greater prosperity for all.

Prosperity is unequally distributed

Nearly all would agree at a general level that the overall distribution of prosperity is an important issue for an economy. A high rate of inequality, when too much of an economy’s prosperity ends up in the hands of a few, is unsustainable. One reason is that it means that not all skills and capabilities of individuals in the population are contributing to prosperity, and so the economy is not realizing its full potential. Another reason is that high inequality often leads to political and societal instability. At the other extreme, complete equality of economic outcomes has never been achieved. So, while most will agree that some degree of inequality is desirable, or at least inevitable, achieving consensus on the right distribution is difficult. In addition, measuring the rate of inequality is fraught with complexities. Nevertheless, economists have achieved some consensus on issues related to distribution of prosperity.

The traditional view of the relationship between prosperity and its distribution is the Kuznets hypothesis on the inverted-U relationship between inequality and output.¹ Simon Kuznets, a prolific economist, was a pioneer in development economics and won

¹ Simon Kuznets, “Economic growth and income inequality,” *American Economic Review* 45(1), 1955, pp. 1–28.

the Nobel Prize for his full range of work. In his research, he discovered an inverted-U shaped relationship between economic development and inequality – that is, as economies begin to develop, inequality in the distribution of prosperity increases, but, at some point, further development leads to a reversal of the trend in inequality and it begins to decrease.

In early stages of economic development, prosperity growth is associated with greater inequality. For example, access to natural resources is not equally shared, so that not everybody benefits from early, typically agricultural, development. As described by W. Arthur Lewis: “Development must be inegalitarian because it does not start in every part of an economy at the same time. Somebody develops a mine, and employs a thousand people. Or farmers in one province may start planting cocoa, which grows in only 10 percent of the country. Or the Green Revolution may arrive to benefit those farmers who have plenty of rain or access to irrigation, while offering nothing to the other 50 percent in the drier regions.”²

Later on, as economic prosperity continues to advance, labour becomes more valuable and wage earners – most of society – can bid up their earnings. The prosperity-inequality relationship reverses and, as prosperity increases, inequality decreases. At the same time, the capital held by the smaller number of rich people becomes less scarce. Financial markets then develop so that capital can be raised in small amounts and accumulated for large investments. Inequalities are

narrowed further through government redistributive tax and transfer mechanisms.

But in today’s setting across developed economies, how are inequality and prosperity trends related? Is inequality good for prosperity? Previously, researchers concluded that inequality was necessary for economic growth. The current consensus is that inequality is not necessary for prosperity.³ In fact, we think the research points to the conclusion that creating more opportunities for more Ontarians by investing in people not currently participating fully in the economy – that is, reducing inequality – will lead to higher prosperity for all. As well, as more Ontarians contribute to our prosperity, poverty will decline. With a more prosperous economy will come further opportunities to invest in people. Among the points of evidence:

- OECD countries experienced fast productivity growth and decreasing inequality between the end of the Second World War and the early 1970s
- Across a diverse cross-section of developed and developing economies, analysis shows a negative relationship between inequality and growth – economies with greater inequality exhibit lower rates of economic growth.⁴ Our analysis across the smaller number of developed economies shows no relationship. In effect, for an economy to succeed in achieving development status, above

average inequality is a barrier; but among developed economies, inequality is less of a factor for economic growth.

- If income is concentrated at the top end, fewer people will be able to invest in the education required to raise their skills and the overall level of prosperity. And if we have inadequate opportunities for children with disadvantaged backgrounds to receive the education they need to move out of poverty, our economy will not benefit from their contribution, will under perform, and will be stuck in a vicious circle of high inequality and low prosperity. Nobel laureate James Heckman sets out the risks of illiteracy and low skills among children in lower income families – leading to reduced national productivity and prosperity for future generations.⁵ Currently, intergenerational income mobility is a strength for Canada. Statistics Canada researcher Miles Corak finds that only 20 percent of parental earnings advantage is passed on to children in Canada, a rate similar to Scandinavian countries. This compares favourably to countries like the United States, the United Kingdom, and France where 40 to 50 percent of the advantage is passed on.⁶

Since the 1980s, we have been witnessing higher inequality. Much of the research focus has been on UK and US inequality, but most developed economies have experienced a similar trend since 1980 (*Exhibit 1*).

² W. Arthur Lewis, “Development and distribution,” in: Mark Gersovitz ed., *Selected Economic Writings of W. Arthur Lewis*. New York: New York University Press, pp. 443-59.

³ For an overview of the new consensus, see Philippe Aghion, Eve Caroli, and Cecilia Garcia Peñaloza, “Inequality and economic growth: The perspective of the new growth theories,” *Journal of Economic Literature* 37, December 1999, pp. 1615-60.

⁴ Alberto Alesina and Dani Rodrik, “Distributive policies and economic growth,” *Quarterly Journal of Economics* 40(1), 1994, pp. 465-90.

⁵ James Heckman and Dimitri Masterov, “The Productivity Argument for Investing in Young Children,” NBER Working Paper No. 13016, 2007.

⁶ Miles Corak, “Do Poor Children Become Poor Adults? Lessons from a Cross Country Comparison of Generational Mobility,” Institute for the Study of Labor, March 2006.

Among the findings, several factors account for the emerging inequality:

- Relative wages paid to university graduates have increased sharply, demonstrating the increasing premium for education
- Average wages for older workers have increased relative to those for younger workers and those with lower levels of education
- Demand for workers with skills in computers and computerized equipment is higher than in the past
- Employment has shifted away from unionized manufacturing jobs, which provided relatively high wages for less well educated males, to lower paying non-union jobs in other sectors

- Minimum wages have eroded relative to general wage growth

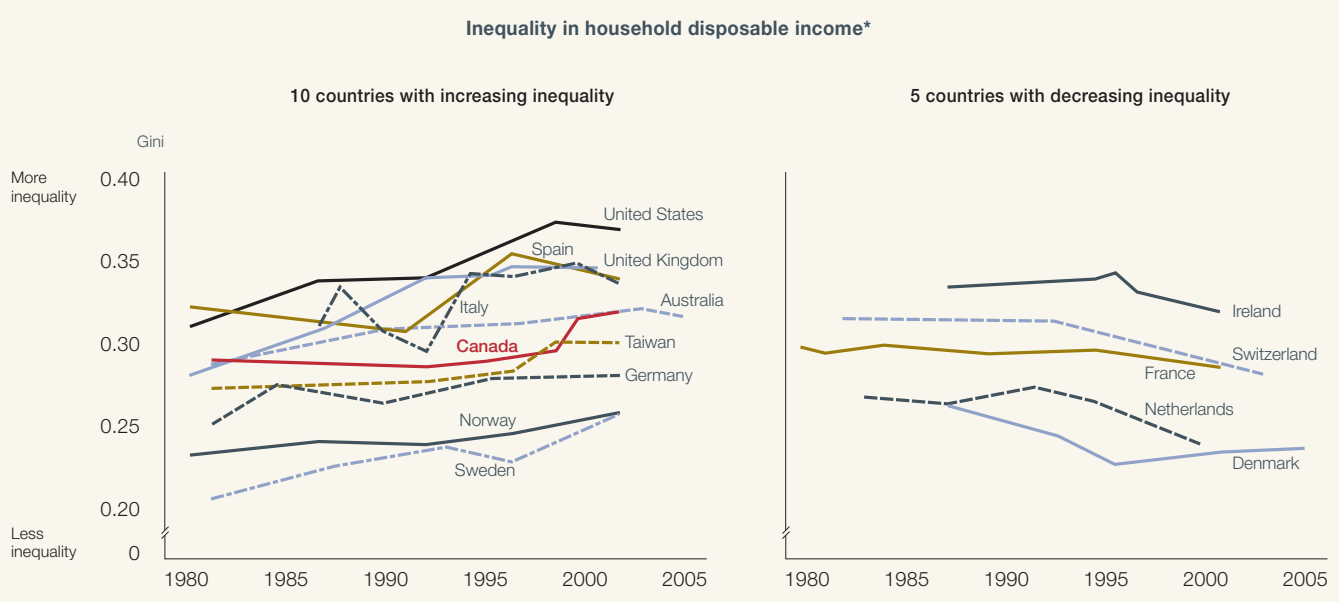
- Expansion of international trade and offshoring has increased the pressure on low-skilled workers in developed economies

- Compensation rewards have increased significantly for senior executives and other high earners.

Many economists have emphasized the contribution of the increased demand for skilled workers on rising income inequality. This skills-biased technical change (SBTC) explanation is best summarized by MIT economist, Daron Acemoglu: “The recent consensus is that technical change favors more skilled workers, replaces tasks previously performed by the unskilled, and exacerbates inequality.”⁷ Acemoglu

points to the increasing premium for educated workers in the 1970s and 1980s, despite the impressive growth in the supply of such workers. Recent research on the SBTC hypothesis by David Autor, Lawrence Katz, and Melissa Kearney⁸ shows that computers have taken over many routine cognitive tasks, such as record keeping, calculation, and repetitive customer services, and thus reduced the demand for them. Simultaneously, demand has shifted towards non-routine cognitive tasks, such as persuading others, managing organizations, and making medical and other diagnoses. These skills tend to be rewarded at the upper end of the wage distribution. Paradoxically, these trends do not weaken demand for non-routine, non-cognitive or manual tasks, such as janitorial services or truck driving, that cannot be replaced by technology. The result is polarization – increasing

Exhibit 1 Most developed economies have experienced increased inequality since 1980



*Household income after tax and government transfers divided by square root of household size. Households include families and unattached individuals. Source: Institute for Competitiveness & Prosperity analysis based on data from Luxembourg Income Study (LIS) Key Figures, accessed at <http://www.lisproject.org/keyfigures.htm> on August 14, 2007.

⁷ Daron Acemoglu, “Technical change, inequality, and the labor market,” *Journal of Economic Literature* 40(1), 2002, pp. 7-72.
⁸ David H. Autor, Lawrence F. Katz and Melissa S. Kearney, “Trends in U.S. wage inequality: Revising the revisionists,” <http://econ-www.mit.edu/files/580> [accessed on August 2007].

demand for workers at the top and bottom end of the earnings spectrum and lowering it in the middle.

Not everybody agrees with the SBTC explanation. Economists David Card and John DiNardo observe that most of the increase in inequality occurred in the first half of the 1980s at a time when personal computers were just being introduced. Instead, they point to real declines in minimum wages, falling union membership, and the recession in the early 1980s as the key driver of inequality increasing in the early 1980s.⁹ University of British Columbia economist Thomas Lemieux isolates the impact of increases in workers' educational attainment and experience on wage inequality. While he observes that these variables explain a meaningful proportion of the increase in inequality, he finds a large unexplained gap remains.¹⁰ In addition, economists Robert Feenstra and Gordon Hanson argue that the increasing importance of offshoring manufacturing intermediate inputs is a potentially important explanation for the increase in the wage gap between skilled and unskilled workers. The reason is that both offshoring and skill-based technical change shift demand away from low-skilled activities while raising relative demand and wages of the higher skilled.¹¹

A final theme in the literature is the interest in the very highest end of income distribution: incomes of the superstars. Some attribute much of the increased inequality to advances at the top end, and within that the real gainers are in the top 1 percent of income earners. These are unrelated to the

SBTC explanation, but instead are the result of winner-take-all situations, such as exceptionally high executive compensation. Here in Canada, we have seen a dramatic increase in the proportion of personal income garnered by the top 10 percent of tax filers – growing from 35 percent in 1985 to 42 percent in 2000. Of this 7 percentage point increase, the top 1 percent gained 5 percentage points, while the remaining 9 percent gained only 2 percentage points.¹² Economists Emmanuel Saez and Michael Veall suggest that the surge in top executive compensation has been a leading factor explaining the increase in top wage income shares in Canada and the United States.

In summary, we are seeing greater inequality across developed economies largely as a result of structural changes that are providing greater rewards to those with the particular skills in demand. These structural changes from technology and globalization are increasing prosperity and inequality simultaneously – but it is inaccurate to say that greater prosperity drives greater inequality.

Other prosperity-equality questions raise policy issues

In other explorations of inequality, several important considerations have emerged.

Do we prefer equality of opportunity or equality of outcomes?

Can we be satisfied with providing Canadians equality of opportunity, even if market-based outcomes are highly

unequal? Will equality of opportunities get us the highest possible equality of outcomes in the market? And, if we have inequality of market outcomes, is the role of government to redistribute so that outcomes are adjusted to be more equal? Since equality can also be related to intergenerational mobility, can greater equality of opportunity today lead to greater equality of outcomes in subsequent generations?

How important is “moral hazard”?

If people can count on government to guarantee equality of outcomes through taxes and transfers, then might they lose the incentive to invest in their own skills, to work harder, or to take risks? Alternatively, if government interventions are well designed to invest in people and to focus actively on incentives rather than on passive income support, will we make progress on equality of both opportunities and outcomes?

What is the linkage between inequality and poverty?

Andrew Sharpe argues that inequality is not the same as poverty. Although societies with lower rates of inequality tend to have lower rates of poverty and vice versa, “it is possible to reduce measures of inequality without reducing poverty if the changes in income affect only the top two-thirds of the distribution.”¹³ Raising the incomes of high risk groups may get them out of poverty, but may do little to change standard measures of inequality. At the extreme, if everybody's real income doubles, inequality remains unchanged. As we conclude in this working paper, while the two are related, reducing poverty should be the priority over reducing inequality.

⁹ David Card and John E. DiNardo, “Skill-biased technological change and rising wage inequality: Some problems and puzzles,” *Journal of Labor Economics* 20(4), 2002, pp. 733-83.

¹⁰ Thomas Lemieux, “Increasing residual wage inequality: Composition effects, noisy data, or rising demand for skill?” *American Economic Review* 96(3), 2006, pp. 461-98.

¹¹ Robert C. Feenstra and Gordon H. Hanson, “Global production sharing and rising inequality: A survey of trade and wages,” NBER Working Paper No. 8372, 2001

¹² Emmanuel Saez and Michael R. Veall, “The evolution of high incomes in Northern America: Lessons from the Canadian evidence,” *American Economic Review* 95(3), 2005, pp. 831-849; data available at <http://elsa.berkeley.edu/~saez/>

¹³ Andrew Sharpe, “Linkages between Economic Growth and Inequality: An Introduction and Overview,” in *Canadian Public Policy*, Volume XXIX, Supplement 2003, p. S5.

We find that broad-based inequality, as measured by the Gini (see *Measuring inequality and poverty*), has not been closely related to poverty rates as measured by the percentage of the population below the after-tax LICO. Rather, inequality has been trending upwards since 1980. Poverty rates appear to be much more cyclical – they rose in the early 1980s following the recession and fell through the balance of the decade before turning up in the early 1990s as the economy went through another recession. Poverty rates grew through much of the decade before starting to decline in 1997. Between 2001 and 2005, poverty rates were below the average for the past twenty years, while inequality was at its highest (*Exhibit 2*).

Is there a right measure for inequality and is less always better?

Different measures of inequality capture different elements of the phenomenon. The Gini measures are affected more than others by the middle part of the income distribution and can miss the effects of increased proportions of very rich and very poor. For capturing the extremes, analysts often use the ratio of income at the 90th percentile to income at the 10th percentile – the 90/10 ratio – or the 80/20 ratio. Other measures, like the Theil and the Atkinson indexes, are less readily understandable but have some analytical advantages over the Gini.

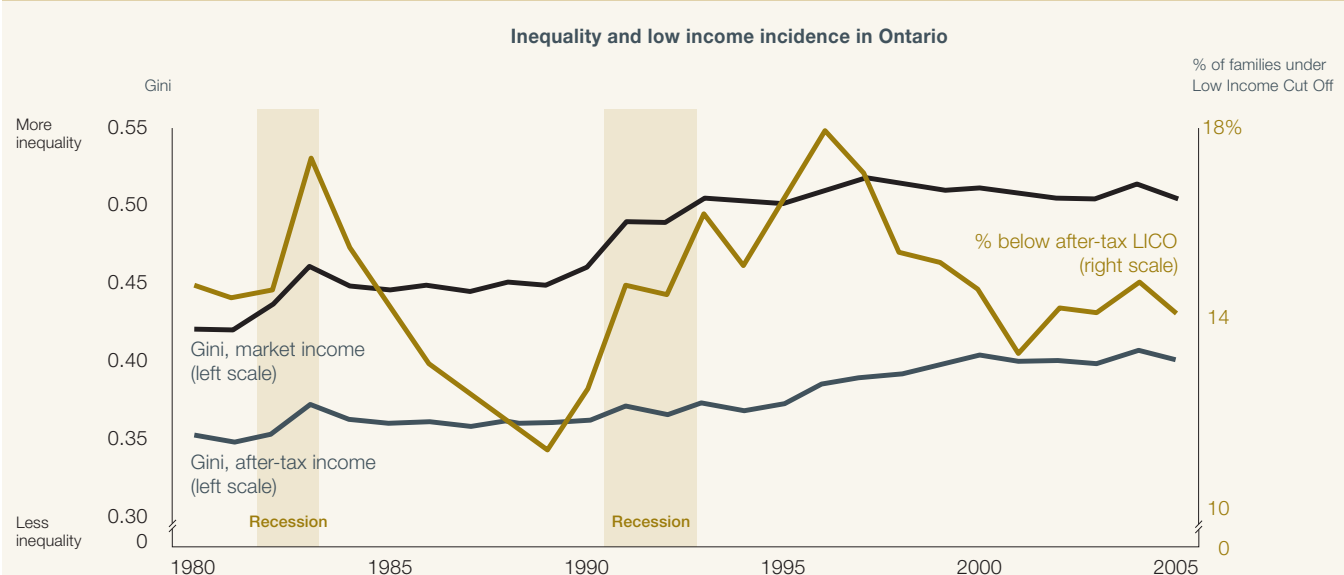
For any given measure, however, more or less is not always better. As we have discussed, there can be too much inequality and too much equality. But more productivity and prosperity are

better than less – unless one can demonstrate negative side effects. Perfect equality is not achievable or desirable. Most analysts agree that there is an optimum degree of inequality – but there is no consensus on what that optimum is.

Are people at the bottom end of income distribution “unhappy” even if they are objectively better off than most others in the world?

Research indicates that health outcomes are lower for people at the bottom end of the scale, even if they are much better off than people at the top of the economic scale in other countries.¹⁴ Economic historian Avner Offer analyzed results from the World Values Survey, a cross-country survey of reported happiness and other variables, and concluded that relative standing in income distribution was actually a more

Exhibit 2 Inequality has increased gradually; low income incidence has changed with economic cycles



Note on sources: % of families below LICO is based on family incomes unadjusted for family size, the standard definition. Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, *Income Trends in Canada, 1980-2005*, May 2007. Ginis are from Statistics Canada's *Income Trends in Canada, 1980-2005* which are based on family incomes not adjusted for family size. Ginis adjusted for family size are available in Andrew Heisz, "Income Inequality and Redistribution in Canada: 1976 to 2004," Statistics Canada, 2007. Ginis in the Heisz paper are lower, but follow very similar trends to the unadjusted Ginis used in this exhibit.

¹⁴ Shelley Phipps, "The Impact of Poverty on Health: A Scan of Research Literature," *Poverty and Health, CPHI Collected Papers*, 2003. Available online: http://secure.cihi.ca/cihiweb/dispPage.jsp?cw_page=GR_323_E&cw_topic=323.

important predictor of reported happiness than the absolute level of income.¹⁵

These are all concerns that policy makers need to address as they determine how to balance economic growth and inequality to achieve prosperity for the economy and the people who drive and live with the results.

How can we balance economic growth and equality to create a virtuous circle?

Andrew Sharpe notes that “the two-way linkages between economic growth and inequality may set up situations where virtuous (or vicious) circles can be created. For example, strong economic growth generates additional tax revenues that can be redistributed to the poor, reducing inequality, enhancing their opportunities to get ahead, and stimulating further economic growth. This growth in turn produces more tax revenue. Equally, the adoption of policies that redistribute income can reduce inequality and create better opportunities for the poor. This in turn strengthens growth and generates tax revenues. *Good economic policy-making is the hunt for virtuous circles. Growth-equality linkages represent a fertile environment for such a hunt* [our emphasis].”¹⁶

In summary, this working paper addresses these important questions:

- **Does realizing our prosperity potential in Ontario necessarily mean accepting greater inequality? Will only the rich get richer?**
- **Is reducing poverty different than reducing inequality? And if so, which is the priority?**
- **Can we achieve a virtuous circle by implementing prosperity enhancing policies that reduce poverty or inequality or both – and in turn increase our prosperity?**

¹⁵ Avner Offer, *The Challenge of Affluence*. Oxford: Oxford University Press, 2006, pp. 276-78.

¹⁶ Andrew Sharpe, “Linkages between Economic Growth and Inequality,” p. S11.

Measuring inequality and poverty

Inequality and poverty are different concepts. For example, it is possible to double everybody's income so that nobody lives in poverty, but leave inequality unchanged. And narrowing inequality through a reduction in income of higher earners will not lift people out of poverty.

Measurement of both concepts is complex. But economists and statisticians have developed various measures of inequality and poverty, each with its strengths and weaknesses.

Measures of inequality

The most commonly used measure of inequality is the Gini coefficient of inequality. The Gini measures income distribution and can be graphically represented by the Lorenz curve (Exhibit A). The horizontal axis of the curve shows the cumulative percentage of the population (this can be individuals, families, or households) arrayed from lowest to the highest income. The vertical axis shows the cumulative income of the population (this can be market income, income after transfers, or income after transfers and taxes). On the curve shown in Exhibit A, the bottom 40 percent of individuals with the lowest income earn 16 percent of total income.

If income is distributed completely equally, the income distribution curve would move along the 45-degree line. At the other extreme, if all income is held by one person, the income distribution line would move along the horizontal axis to 100 percent and then move straight up the right vertical axis.

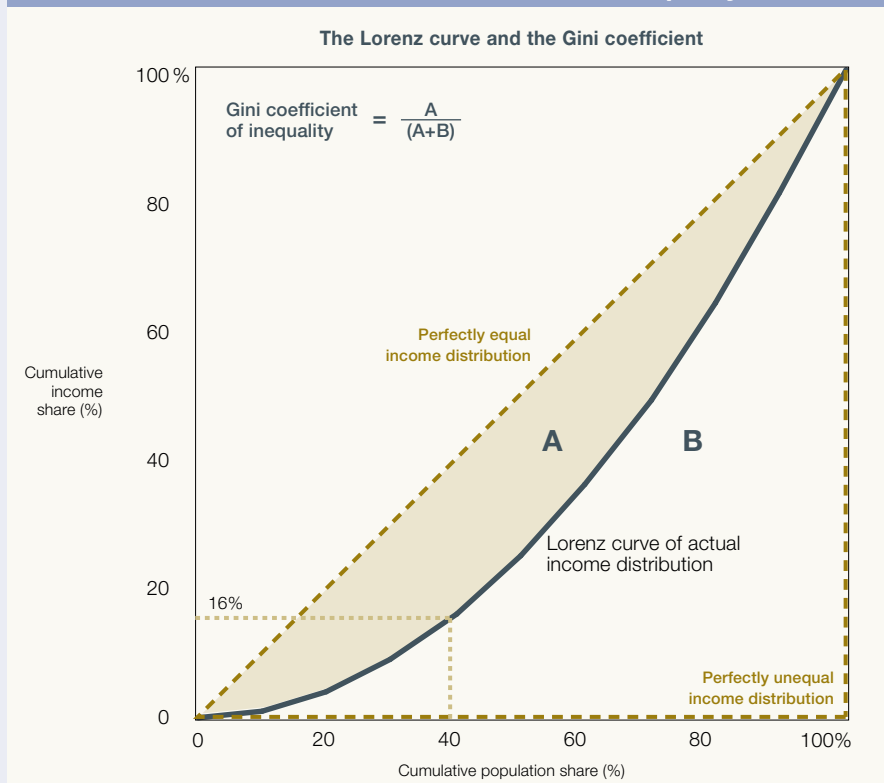
In any economy, the actual income distribution is somewhere in between perfect equality and inequality. Italian statistician, Corrado Gini developed a means of valuing the area between the actual distribution and perfect equality. The Gini value ranges from 0 – where incomes are equally distributed and the income distribution curve is the 45 degree line – to 1, where one individual receives all the income and the curve hugs the horizontal and vertical axes.

As seen in Exhibit 3 in this working paper, Ginis for market income in developed economies range from 0.35 to 0.50. For incomes after income taxes and after government transfers (such as employment insurance, welfare payments, child tax credits, etc.), Ginis are lower (meaning less inequality) and typically range between 0.20 and 0.40 (see *Exhibit 1 and Exhibit 4*).

The Theil index is less used than the Gini coefficient. It compares the income and population distribution structures by summing, across groups, the weighted logarithm of the ratio between each group's income and population shares. The advantages of the Theil index are that it is more sensitive to changes at the bottom and top end of the distribution and that it measures the contribution of sub-groups to inequality. However, it is not an intuitive measure and is difficult to interpret.

The Atkinson index attempts to incorporate normative judgments about social welfare. It is based on the level of per capita income that, if enjoyed by all equally, would provide the same total welfare across society as is generated by the current income distribution. But its calculation is dependent on an estimate of society's preference for equality – making it difficult to calculate a measure that everybody understands and agrees on. Simple ratios can also describe inequality. The most common measure is the 90/10 ratio, which divides the income of individuals or families at the 90th percentile by those at the 10th percentile. The ratio is an intuitive measure that shows the income distance between the richest and poorest in a society. Ratios based on 80/20 or 95/5 are also used. Ratio analysis can be employed to decompose the 90/10 ratio. For example, the 90/50 shows how much the richest in

Exhibit A The Gini coefficient measures income inequality



the society are ahead of the middle class; and the 50/10 ratio shows how far the middle class are ahead of the poorest.

Measures of poverty

Researchers draw on several measures to assess the incidence of poverty. These measures tend to be absolute or relative.

Absolute measures are based on a poverty line, which is set at some level to afford a minimum standard of living with basic amounts of food, clothing, shelter, and other necessities. Unlike the United States and other countries, Canada has no official poverty line. As Statistics Canada puts it, “defining poverty is far from straightforward. The underlying difficulty is that poverty is a question of social consensus, defined for a given point in time and in the context of a given country. Decisions on what defines poverty are subjective and ultimately arbitrary.”^a

Relative measures relate more closely to inequality. For example, some use ratio analysis as discussed above, assessing the income of the bottom 10 percent of the population against that of the top 90 percent (or 20 percent versus 80 percent). But this does not really improve our understanding of poverty and its trends. By definition, it does not tell us whether the incidence of poverty is growing or falling – since there will always be 10 percent of the population below the 10 percentile mark.

Another relative measure is the low income measure, which sets a poverty line at one-half the median income. This does allow for assessment of trends in the incidence of poverty, as the poverty line will move. However, it is an arbitrary measure, and there is no guarantee that those below or above this measure are in or out of poverty. It also suffers from its relativity – as it is tied to the median of income distribution.

The measure that attracts most support from analysts and researchers is the percentage of people living below the Low Income Cut Off (LICO). The cut off is set at an income that is required to purchase necessities of life – such as food and shelter. The cut off is estimated by agencies, such as Statistics Canada, for economic families and for persons not in families based upon family expenditure and income after tax. Various low income cut offs are set at before- or after-tax income levels, differentiated by size of family and area of residence, where families spend 20 percentage points more of their after-tax income than the average family on food, shelter, and clothing. For example, an average family may spend 40 percent of their income on base necessities, while a family living below LICO would spend 60 percent of its income on these necessities.

Statistics Canada has clearly and consistently emphasized that LICO is not a measure of poverty but rather an indicator of the percentage of the population who are substantially worse off than average. With this caveat, we use LICO as an indicator of the incidence of poverty in Canada.

^a Statistics Canada, Income Statistics Division, Low Income Cut Offs for 2006 and Low Income Measures for 2005, Catalogue no. 75F0002MIE — No. 004, May 2007, p.6.

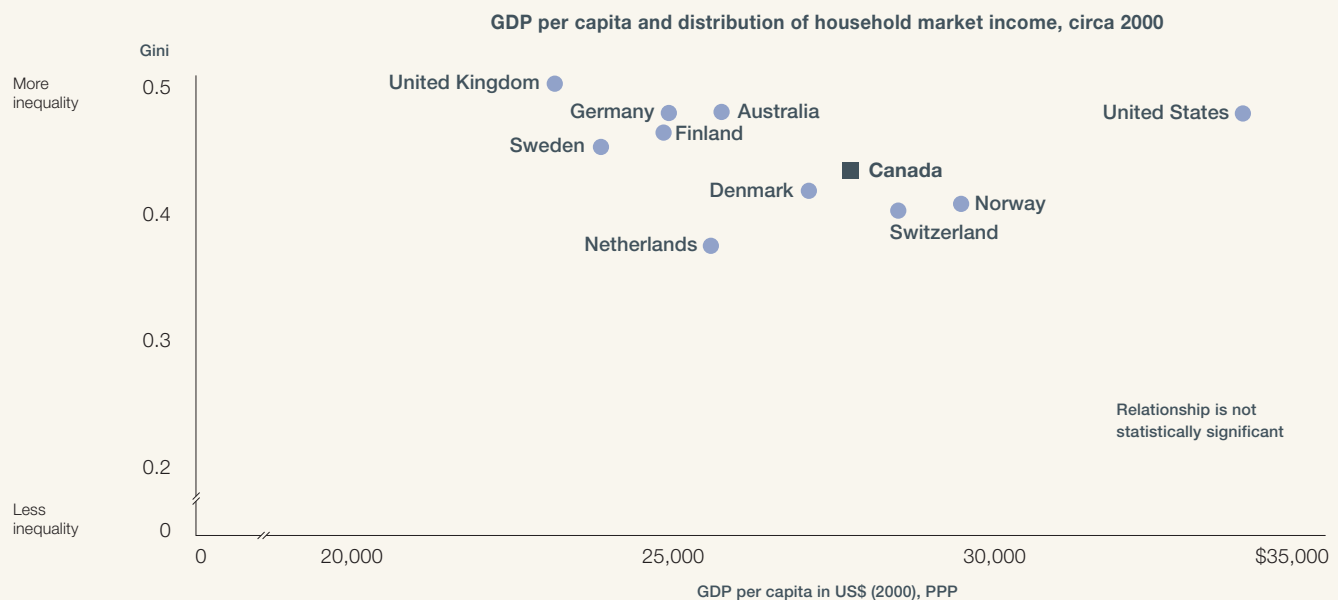
The quest for the virtuous circle



Narrowing the prosperity gap requires all Ontarians to achieve their potential to contribute to economic growth

ACROSS DEVELOPED ECONOMIES like Canada's we find no evidence that prosperity is necessarily related to inequality. In the competitive marketplace, some countries have high inequality and high overall prosperity. Others achieve solid prosperity and have more equitable distribution. In all countries, governments play a key role in moderating distributional differences,

Exhibit 3 Prosperity and distribution of market income are not related in developed economies



Note: Households include families and unattached individuals. Ginis adjusted for household size. Market income Ginis not available for Austria, Belgium, France, Ireland, and Italy. Source: Institute for Competitiveness & Prosperity analysis based on data from Luxembourg Income Study (accessed on August 14, 2007) and World Economic Forum, *Global Competitiveness Report 2001-2002*.

so that after income taxes and transfers, inequality declines considerably. But these redistributive policies are driven by public policy, not by economic factors.

Nevertheless, it is true that rising inequality is more prevalent in developed economies, including Ontario, than is falling inequality. And here in Ontario, a rising tide of gross domestic product (GDP) is not lifting all boats equally. While personal income is inextricably linked to GDP, the link is weakening. Personal income growth, including wages and salaries, is not advancing as fast as GDP growth. And our growing prosperity gap, as defined by GDP per capita, is resulting in all economic groups falling further behind their potential. Turning this around requires good economic policy that increases prosperity and drives a virtuous circle that benefits all Ontarians.

Growing prosperity does not necessarily increase inequality

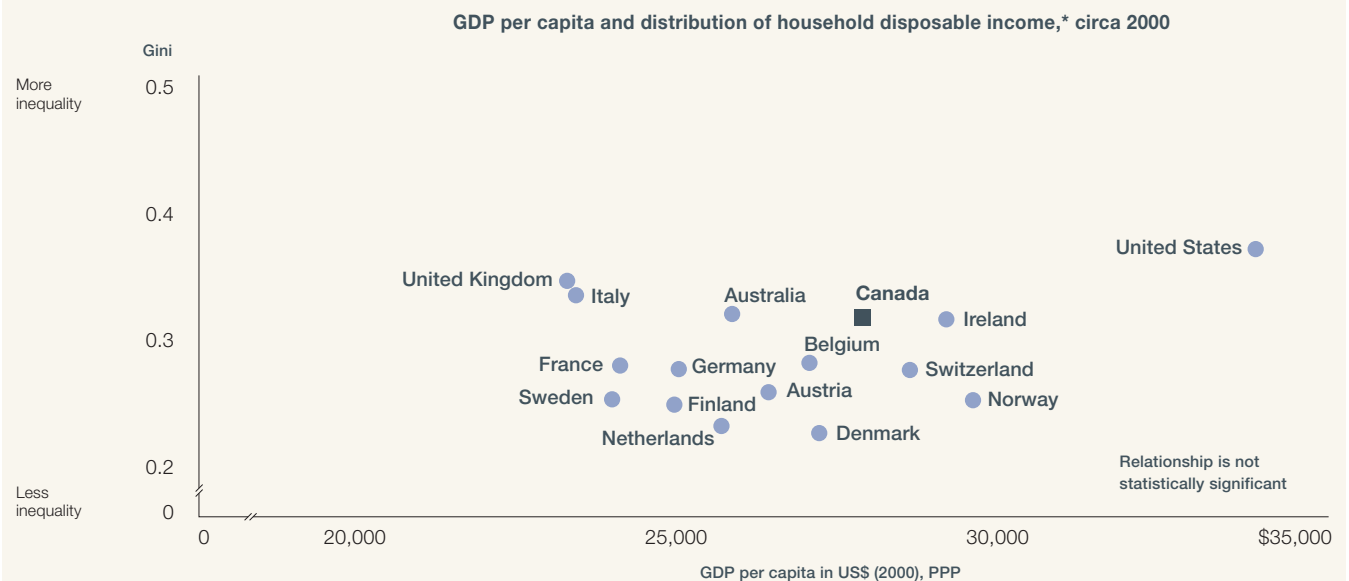
Across developed economies, we find that there is no positive relationship between prosperity and inequality of market outcomes (*Exhibit 3*). Market income consists of employment and investment income. On average, employment income – salaries, wages, and benefits – is the more important source of market income. However, at higher income levels, investment income increases in importance. To be sure, a statistically significant relationship emerges if the United States is excluded from the analysis; however, this relationship is in fact negative – greater average prosperity is associated with less inequality.

The distribution of market income is a measure of outcomes from the

competitive marketplace, and inequality is typically highest with this measure. Governments effect redistribution of market incomes through progressive income taxes and through income transfers, typically to those with lower market incomes. These efforts compress earnings, and distribution of after-tax, after-transfer incomes is typically more equal than that of market incomes.

When we examine the redistributive effect of income taxes and transfer payments, we also find that there is no relationship in developed economies between overall income levels and their distribution (*Exhibit 4*). In effect, the amount of redistribution that we see in developed economies is not driven by the relative prosperity of the economy. The impact of redistribution that occurs in a country is a decision

Exhibit 4 Prosperity and distribution of disposable income are not related in developed economies



* After tax and government transfers.
 Note: Households include families and unattached individuals. Gini's adjusted for household size. Market income Gini's not available for Austria, Belgium, France, Ireland, and Italy.
 Source: Institute for Competitiveness & Prosperity analysis based on data from Luxembourg Income Study (accessed on August 14, 2007) and World Economic Forum, *Global Competitiveness Report 2001-2002*.

for each country and is based on structural, political, and cultural factors. Switzerland is the lowest transferer of income through tax and transfer policies; Canada, as it turns out, is the third lowest, after the United States and Switzerland, among the countries analyzed here.¹⁷

Inequality is increasing in most countries, including Canada and Ontario

Inequality of market and government tax-and-transfer outcomes, as described by the most commonly used measure, the Gini, has been increasing in Ontario since 1980. The market income Gini grew from 0.41 in 1980 to 0.50 in 2005 – an increase of 0.09 points (*Exhibit 5*). This is a meaningful increase in inequality – Statistics Canada advises that a change of 0.01

is statistically significant.¹⁸ Nearly all the period’s increase in inequality of market income occurred between 1980 and 1997; since 1997 inequality of market incomes has decreased slightly.

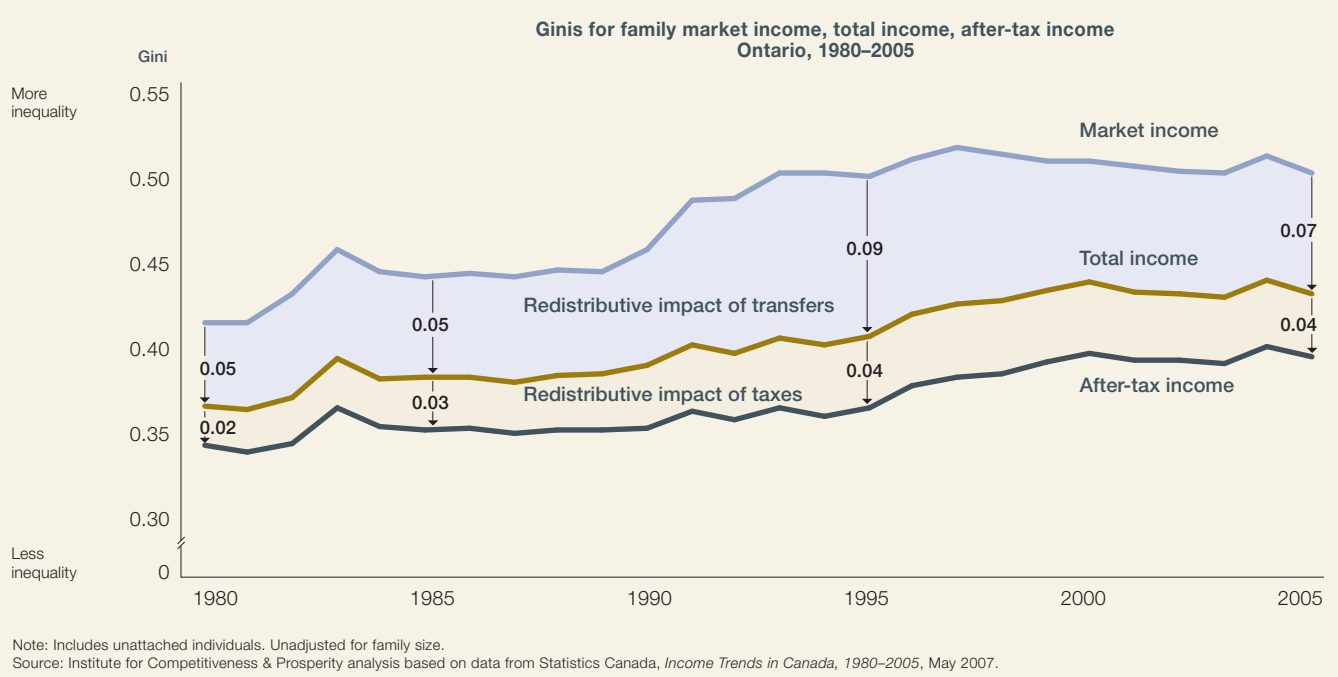
However, over the past 25 years, there has been less of an increase in inequality in income after tax and after transfers. The Gini grew only 0.05 points, from 0.34 in 1980 to 0.39 in 2004. Analyzing the reduction in the Gini between market income and after-tax, after-transfer income indicates how much tax and transfers are affecting inequality. Transfers have been more important to reducing inequality than has our progressive income tax system. This is to be expected, since most transfers are received by people at the bottom end of the distribution, while not all income taxes, even though they are borne more heavily by those with higher income, are

transferred to lower income people. Tax revenues support government initiatives beyond transfer programs.

The impact of transfers grew steadily from 1980 to 1995 and has since declined. Similarly, the impact of income taxes on inequality grew from 1980 to the early 1990s and then held steady. Income tax burdens have increased significantly for the highest quintile, but transfers to the lowest two quintiles have not increased significantly over the past twenty years.

Analysis of trends in Ginis indicates that the increase in after-tax, after-transfer inequality has been driven largely by market outcomes rather than by changes in government redistribution policies. So, while the impact of redistribution through transfers and taxes has increased over the past twenty-five

Exhibit 5 Ontario market income inequality has increased since 1980



¹⁷ As measured by the differences in the Ginis for market income and disposable income. See Andrea Brandolini and Timothy Smeeding, "Inequality Patterns in Western-Type Democracies: Cross-Country Differences and Time Changes," Luxembourg Income Study Working Paper Series, no. 458 (April 2007), <http://www.lisproject.org/publications/liswps/458.pdf>.
¹⁸ Statistics Canada, Income Statistics Division, "Income Trends in Canada 1980 to 2001 – User's Guide," Catalogue no. 75F0002MIE No. 003, 2003, p. 23.

years, market income inequality has grown faster. Since 1995, inequality in after-tax, after-transfer income has increased – the net effect of unchanged market income inequality and the reduced impact of transfers and taxes. The redistributive impact of transfers and income taxes reached its zenith in 1995 and has been declining since then. However, their redistributive impact in 2005 is on a par with the 1980–2005 average.

While taxes and transfers are having less of an impact on inequality as measured by the Gini, on an absolute basis, governments have been effecting greater distribution of dollars through tax and transfer policies. Drawing on census results for 1980, 1990, and 2000, we find that families at the 10th percentile of income received \$2,500 more in transfers (net of income taxes)

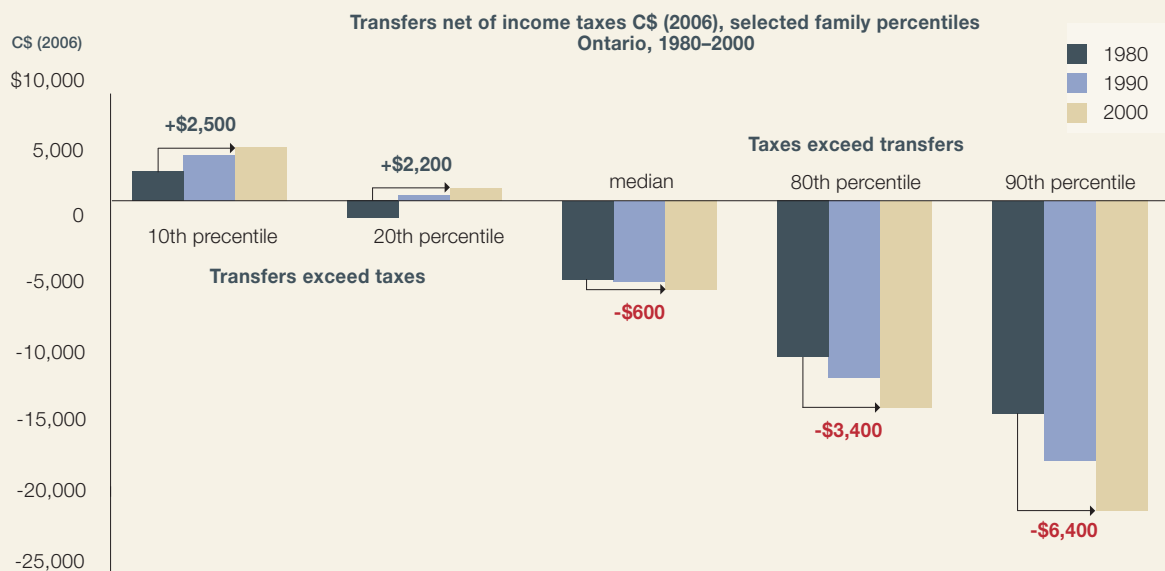
in 2000 than in 1980 (*Exhibit 6*). As a percentage of after tax income, the net amount of transfers rose from 33 percent in 1980 to 51 percent in 2000. For those at the 20th percentile the growth in net receipts was \$2,200. At the 90th percentile families paid \$6,400 more in taxes (net of transfers) than in 1980. As a percentage of family after-tax income, this increased slightly from 30 to 35 percent.

Is the middle class disappearing?

Many economic observers and pundits have decried the shrinking middle class – but it is difficult to reconcile this with the data. To be sure, the percentage of the population whose earnings are above 75 percent of the median, but below 150 percent of the median has been declining since 1989. But it has been a moderate decline (*Exhibit 7*).

A review of the relative earnings of the top and bottom deciles against the median sheds light on the relative performance of the various income strata. The ratio of earnings between the highest and lowest deciles has been increasing since the start of the 1990–92 recession. However, in 2004 the ratio of 4.3 was largely unchanged from 1976 (*Exhibit 8*). Earnings growth for the median family has trailed earnings growth for the 90th percentile, as can be seen by the slightly increasing 90/50 ratio in the exhibit (although as we have seen, the fastest growth in income has been at the 99th percentile). The 50/10 ratio has been flat. This indicates that earnings at the top of the distribution have outpaced earnings at the middle and bottom.

Exhibit 6 The dollar redistributive impact of taxes and transfers in Ontario increased between 1980 and 2000



Note: Families include both census families and unattached individuals; adult-equivalent family income defined as family income divided by the square root of family size; territories excluded; main earner of age 25 to 64. Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, Census microdata; code to impute taxes to census records provided by Kevin Milligan, University of British Columbia.

Exhibit 7 The proportion of individuals in middle income families is declining moderately

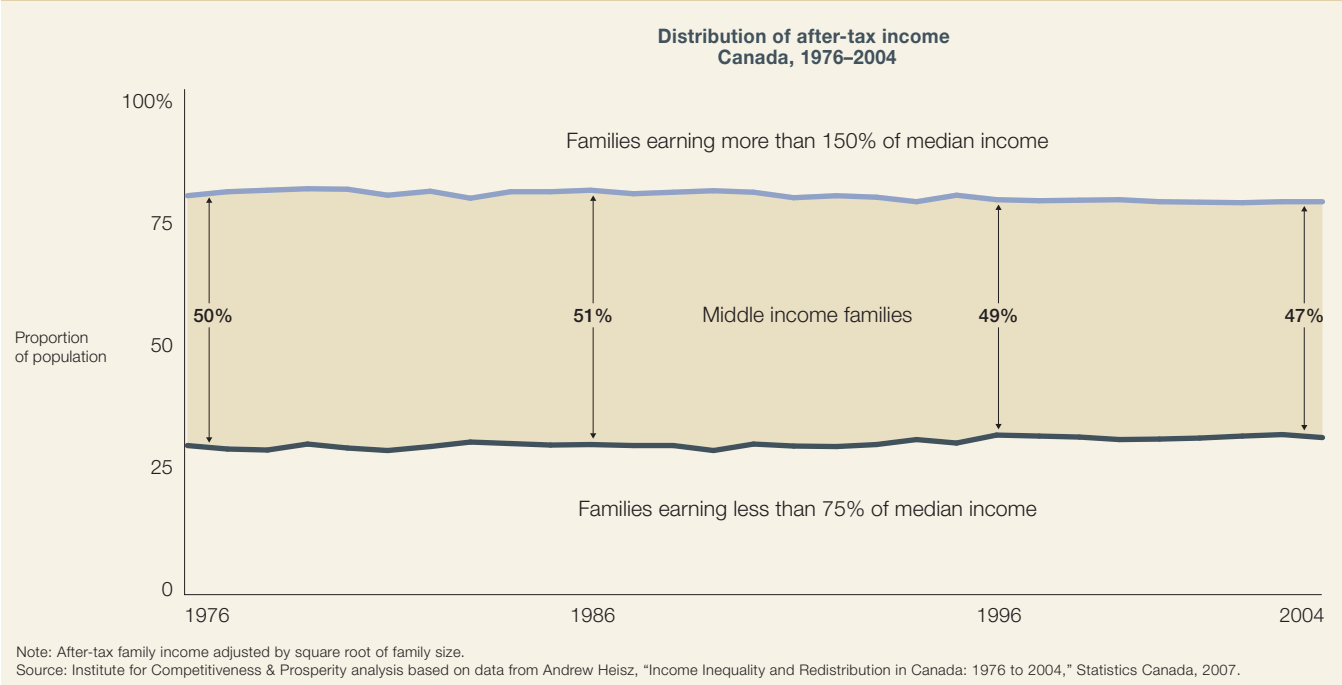
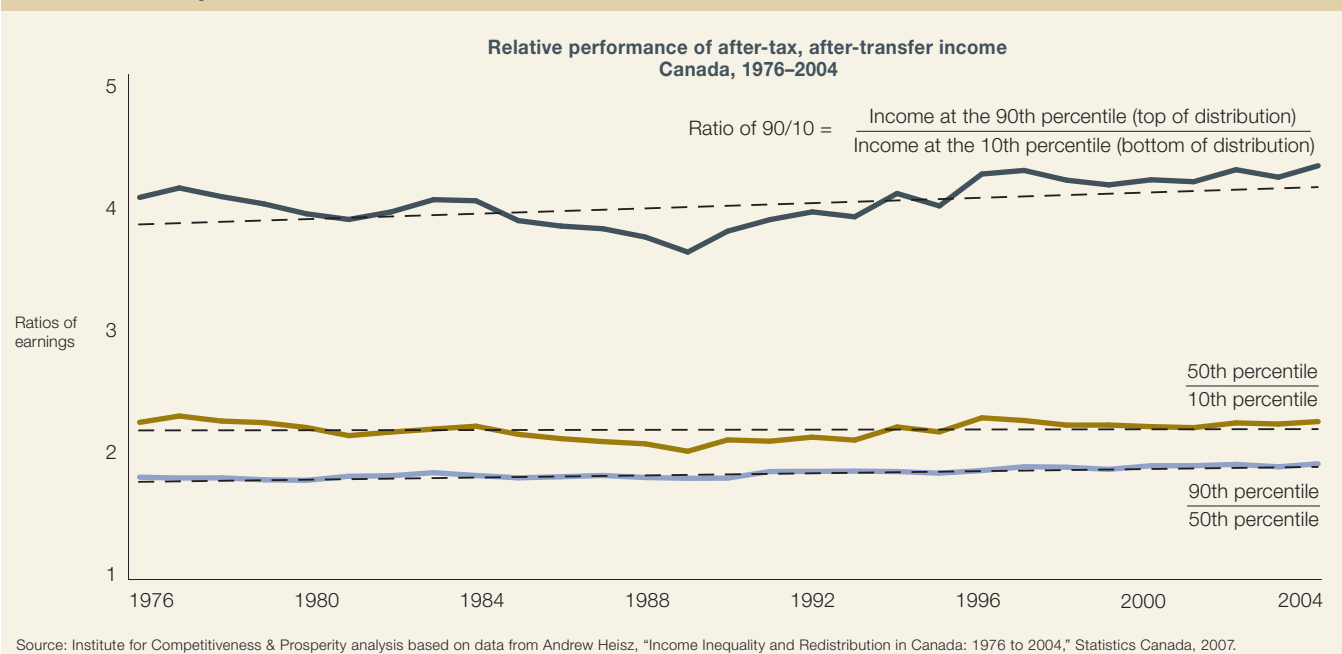


Exhibit 8 Earnings at the bottom and the median have not kept pace with earnings at the top of the income distribution



Are GDP and personal income becoming de-linked?

In recent years we have seen that prosperity growth, as measured by GDP, has outpaced growth in personal incomes. Nevertheless, the two are closely related – a more competitive and prosperous economy means more income for individuals in Ontario (*Exhibit 9*).

Part of this disconnect is because profits (which are part of GDP, but not personal income) are currently at historically high percentages of GDP, while wages as a percentage of GDP declined through the 1990s (*Exhibit 10*). Corporate profits are increasing while, as we have noted in previous reports, business investment has not kept pace. Instead, increased corporate profits appear to be directed at reducing corporate debt. Corporate

debt-equity ratios have steadily declined since 1995 – from a quarterly average of 1.07 to 0.89 in 2006.¹⁹

It is also true that on a per family basis, market income is not keeping pace with per capita GDP growth. In 2005, average market income per economic family²⁰ was \$55,600. If this had kept pace with GDP per capita growth since 1981, it would have been \$76,000. Half of this gap is the result of smaller families; a further 12 percent is the result of more unattached individuals, who typically earn less, and fewer nuclear families. Another 15 percent is the result of wages not growing as fast as GDP. The balance is the result of other unexplained factors.

While the connection between Ontario's prosperity, as defined by GDP, and family income has weakened somewhat,

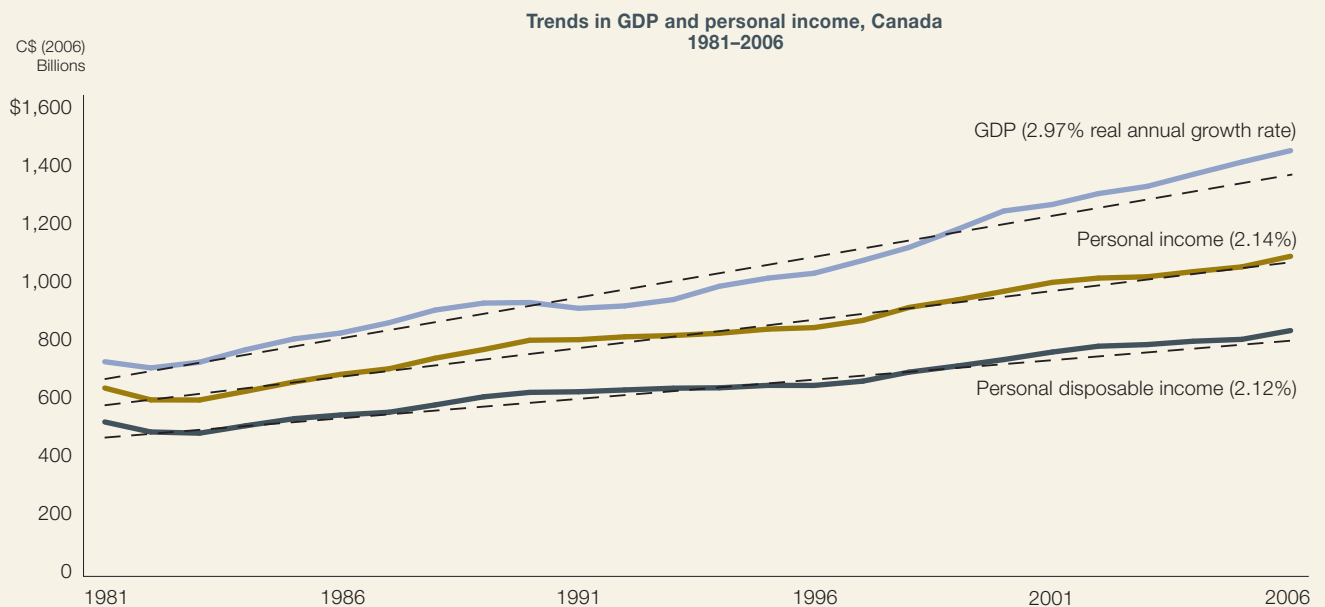
there is still a strong link. By not achieving our prosperity potential, Ontarians at all economic strata are affected.

How does lagging GDP growth affect average and lower income Ontarians?

It is fair to say that Ontarians at the lower end of income are doing better than their counterparts in the peer states. These are the fourteen US states whose population is at least one-half of Ontario's. This is an impressive outcome. While we trail the peer states in overall prosperity, we have succeeded in ensuring that those at the 20th percentile of after-tax, after-transfer income have done better than those in the peer states (*Exhibit 11*).

At 20th percentile of after-tax, after-transfer family income, Ontario families

Exhibit 9 Personal income growth has not kept pace with GDP – but it is closely related



Note: GDP deflated by GDP deflator; personal income and personal disposable income deflated by CPI. Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, National Income and Expenditure Accounts (CANSIM Tables 384-0012 and 380-0016).

¹⁹ Statistics Canada, National Balance Sheet Accounts (CANSIM Table 378-0007) and Quarterly Changes in Financial Position (Table 187-0002)
²⁰ Economic families include nuclear married or common-law families and unattached individuals.

are ahead of their peer state counterparts. Yet Ontario's advantage has shrunk considerably. In 1980, income for Ontario families exceeded their peer state counterparts by \$7,500 per family. In 2005, this lead had fallen to \$3,500.

This trend tracks the increasing prosperity gap. Between 1980 and 1985, Ontario's GDP per capita actually led the median of the peer group. Between 1985 and 1989, Ontario was only slightly behind its peers. But the severity of the 1990–92 recession widened the prosperity gap considerably and it has expanded since then.

At the median, after-tax, after-transfer income of Ontario families has fallen behind that of the 14 peer states. Median family income in Ontario led the US peers until 1990 when it fell behind. It has not caught up since then. Over

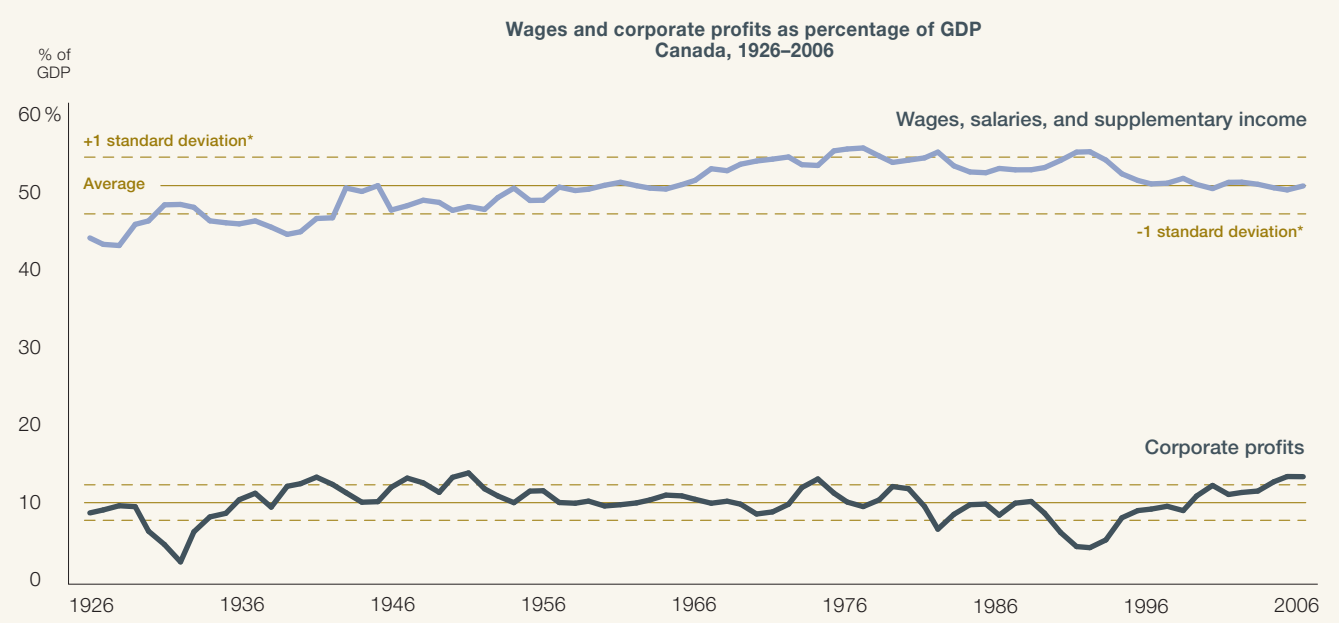
the 25 years between 1980 and 2005, Ontario's median after-tax, after-transfer income has grown at a real annual rate of 0.4 percent; in the peer states this growth rate was 1.1 percent.

For those Ontario families nearer the top of earnings distribution, Ontario's lead versus the peer states ended in 1982 and has widened steadily since then.

These results are for economic families of two or more persons which account for 85 percent of Ontarians. Results for unattached individuals are not shown in Exhibit 11, but their patterns are similar – at the 20th percentile, Ontario results lead the peer states, but at a reduced margin from 1980; at the median, Ontario trails the peers after leading until 1992; and the 80th percentile fell behind in 1983 and still trails.

These results are not adjusted for family size because the adjustments at specific family income percentiles are not readily available from our source of Canadian results, the Survey of Labour and Income Dynamics. However, we estimated family sizes for Ontario and assessed the results versus the peer states. The results are unchanged at the median and the 80th percentile. However, because we estimate that Ontario families are larger than in the peers at the 20th percentile, adult equivalent incomes are about the same in Ontario and in the peer states. Until 1994 families at Ontario's 20th percentile led their counterparts in the peer states. While the levels may differ after the family size adjustment, the trends are identical. After-tax, after-transfer incomes at the bottom, the median, and the top grew faster in the peer states than in Ontario over the past 25 years.

Exhibit 10 By historical standards, profits' share of GDP is high and wages' share is average



*Just over two-thirds of annual results are within plus or minus one standard deviation of the average. Source: Institute for Competitiveness & Prosperity based on data from Statistics Canada, National Income and Expenditure Accounts (CANSIM Tables 384-0012 and 380-0016).

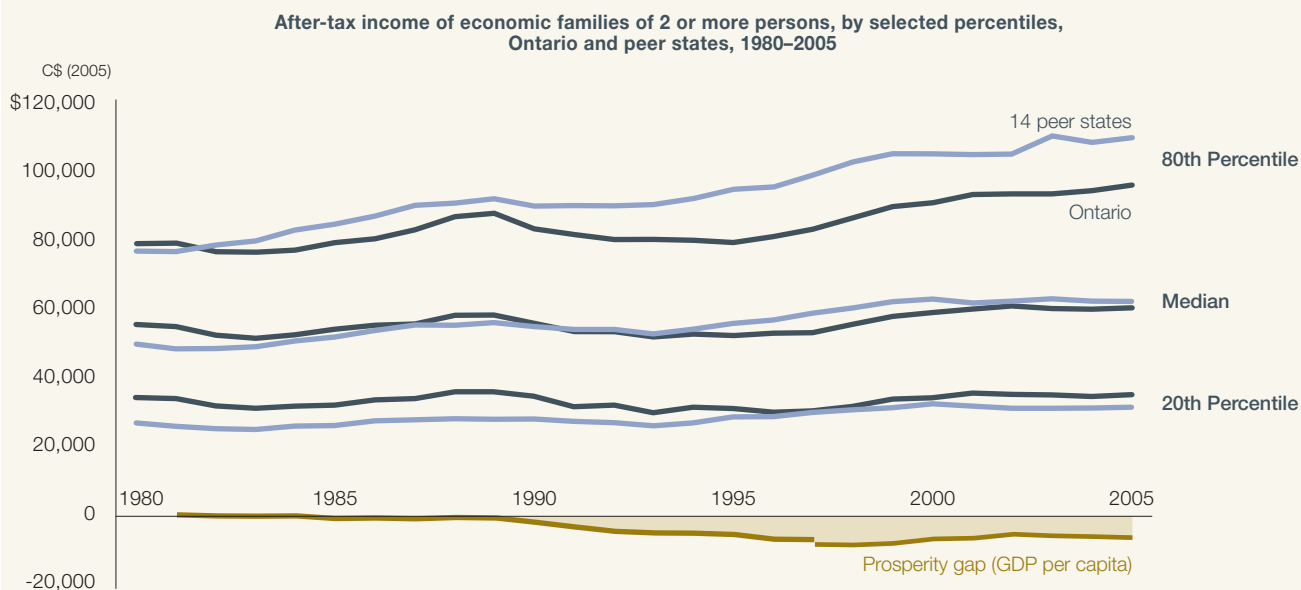
Finally, we attempted to adjust incomes for non-cash government transfers. In the United States, the most important transfers of this type are food stamps, subsidized school lunches, Medicaid for low income people, and Medicare for seniors. The US Current Population Survey, makes estimates of the value of these transfers. In Canada, the principal non-cash transfer is through our publicly funded health care system. Since all Canadians effectively have health insurance, we applied the total cost of publicly funded personal health care to all families equally. Thus the benefit to a family is the insurance premium avoided, not the actual cost of health care received. Both countries have non-cash transfers for assisted housing and energy supplements, but we were unable to make equivalent adjustments. We estimate these to be small relative to

health insurance and food stamps. With these adjustments, Ontarians lead their peer counterparts at the 20th percentile and at the median while trailing at the 80th percentile. Again, the 25-year trends show more growth in the peer states than in Ontario.

We see two principal conclusions from these results. First, we should be gratified that the structure of Ontario's economy coupled with its tax and transfer system results in better outcomes for those at the bottom of the economic ladder than for counterparts in the US peer states. Second, however, this advantage will not endure if our prosperity gap continues to widen. The prosperity gap matters to all Ontarians. Realizing our prosperity potential in Ontario will ensure that we can help all Ontarians.

In summary, inequality is not linked directly to prosperity – other structural and global factors seem to be at play. GDP drives the amount of income to be distributed, although the relationship is not as strong as in the past. Currently, lower income Ontarians are doing better than their peer state counterparts. But by lagging in prosperity, we see that all quintiles in Ontario may fall behind. We also see that poverty in Ontario worsens in bad economic times and improves in better economic times. The real challenge is to tackle poverty; doing so will also reduce inequality.

Exhibit 11 Ontario exceeds peer states at bottom of earnings distribution; but this advantage has faded



Note: US figures converted to C\$ using the bilateral 2005 household consumption expenditure PPP.
 Source: Institute for Competitiveness and Prosperity based on data from Statistics Canada, National Income and Expenditure Accounts (CANSIM Tables 380-0057) and Survey of Labour and Income Dynamics (CANSIM Table 202-0604); and US Department of Commerce, Bureau of the Census, Annual Social and Economic Supplement of the Current Population Survey.

Poverty and risk groups

Moving high risk groups out of poverty requires specific tailored solutions



A MAJOR GOAL of increasing the overall level of prosperity is to ensure all Ontarians advance economically to achieve good living standards and opportunities for their children to contribute to and benefit from Ontario's future prosperity. But we know that, despite Ontario's ever advancing prosperity achievements, some in the province live in poverty. Ontario's poor tend to be in six high risk groups; that is, poverty is more of a focused occurrence than a broadly based or general phenomenon. But we find no connection between the economic experience of these groups and the overall growth in Ontario's prosperity. In fact, we conclude the opposite is true.

The implication is that to address poverty is to address problems in specific groups – each with its own concerns and solutions. And most of these solutions cost money – we need to invest in these groups of people. If we want to address the issues of poverty, our governments need the revenue to fund the necessary investments. As we

have seen, by not achieving its full prosperity potential, governments in Ontario miss out on significant amount of tax revenues that could fund these investments – without increasing tax rates.

Poverty is identified among high risk groups

Poverty is not distributed randomly throughout society. While inequality and poverty are two different phenomena, the two are related. So, not surprisingly, people who experience low incomes are also at the bottom of the income distribution. Six groups of Ontarians are much more likely to be below LICO and are over represented in the bottom of the income distribution:

- High school dropouts
- Recent immigrants – those who have immigrated in the last ten years
- Lone parents – most frequently mothers
- Disabled
- Individuals aged between 45 and 64 who are living alone (“unattached”)
- Aboriginals.

These groups are vastly over represented below LICO. An individual in one or more of these groups is 3.7 times as likely as other Canadians to have income (after taxes and transfers) that is inadequate to afford the necessities of life. Within these risk groups, unattached individuals, 45 to 64 have the highest incidence of income below LICO. Our analysis of the data from the 2001 census indicates that, for those 45- to 64-year olds, living by oneself is associated with a 30 percent probability of having income below LICO. Unattached individuals in this age group who did not obtain a high school diploma experience an even higher probability – 39 percent – of being below LICO. On the other hand, being employed (irrespective of education) reduces the probability to 15 percent (*Exhibit 12*).

Recent immigrants and lone parents were close behind in the risk of falling

below LICO. Aboriginals and high school dropouts were slightly better off; the probability of individuals in these two groups being below LICO is 14 to 15 percent, controlling for other risk factors. Unfortunately, our data source, the Canadian census, does not measure incomes of the disabled – but they are over represented in the bottom of the income distribution.

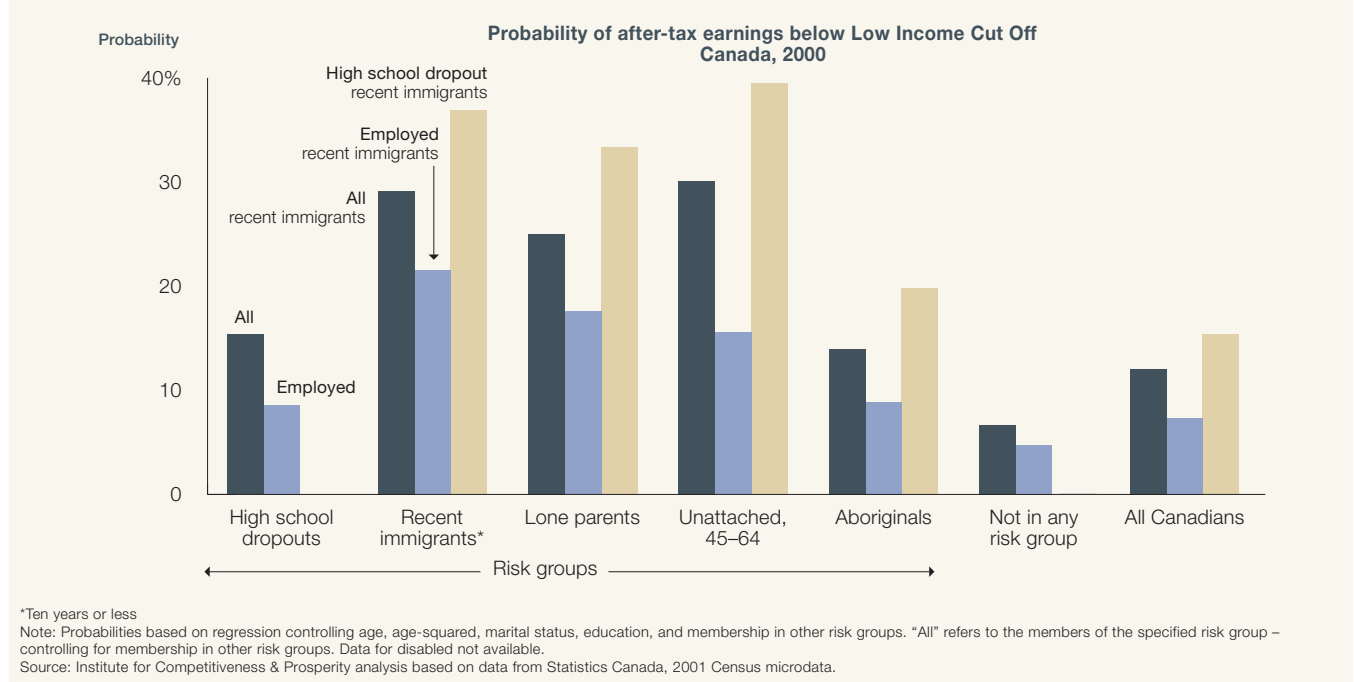
As the exhibit shows, probabilities of earning income below LICO increase dramatically for each risk group when the individuals are also high school dropouts. High school dropouts who are not members of these other risk groups have a relatively low likelihood of being below LICO. However, for those who are in the other risk groups, their probability of earning income below LICO increases substantially.

Canadians who are not in any of these risk groups are much less likely to live in poverty, as measured by LICO – with the probability being below 7 percent in 2000. Clearly, this is too high – but the data indicate that poverty is highly concentrated across these identifiable risk groups, and we need to ensure that poverty fighting initiatives are aimed at the specific challenges they face.

Some generalizations, however, are warranted. Given that employment reduces the probability of being below LICO, public policy needs to aim at ensuring that members of these risk groups are working. And the importance of a high school diploma is heightened for members of these risk groups.

Over the period 1990 to 2000,²¹ the poverty incidence of these risk groups has hardly changed. In fact, all but

Exhibit 12 Likelihood of being below LICO is higher for certain risk groups



²¹ Information on the incidence of individuals' income falling below LICO is unavailable in censuses before 1990.

one has worsened slightly. While the incidence of single parents below LICO fell between 1990 and 2000, they still had high poverty incidence in the most recently available information.

Michael Hatfield, an economist with Human Resources and Social Development Canada, first identified the above average incidence²² and the persistence of poverty among these groups.²³ Using data from the Survey of Labour Income Dynamics, Hatfield tracked individuals over the 1996–2001 period. He found that the high risk groups accounted for 26 percent of the population, aged 25 to 64, but fully 62 percent of those experiencing persistent poverty.²⁴ His research indicated that in a single year, 1996, these risk groups accounted for 58 percent of individuals with income below LICO.

This is consistent with our findings using the data from the 2001 census. From the perspective of inequality, the same pattern emerges. The six high risk groups are heavily concentrated in the bottom quintiles of income distribution. Fully 57 percent of lone parents have after-tax, after-transfer earnings that place them in the bottom quintile of Ontario’s distribution. More than 80 percent are in the bottom two quintiles. Other risk groups exhibit similar patterns (*Exhibit 13*). As with incidence below LICO, high school dropouts do not fare as badly as the other risk groups; still, 59 percent of them are in the bottom two quintiles of Ontario’s earnings distribution.

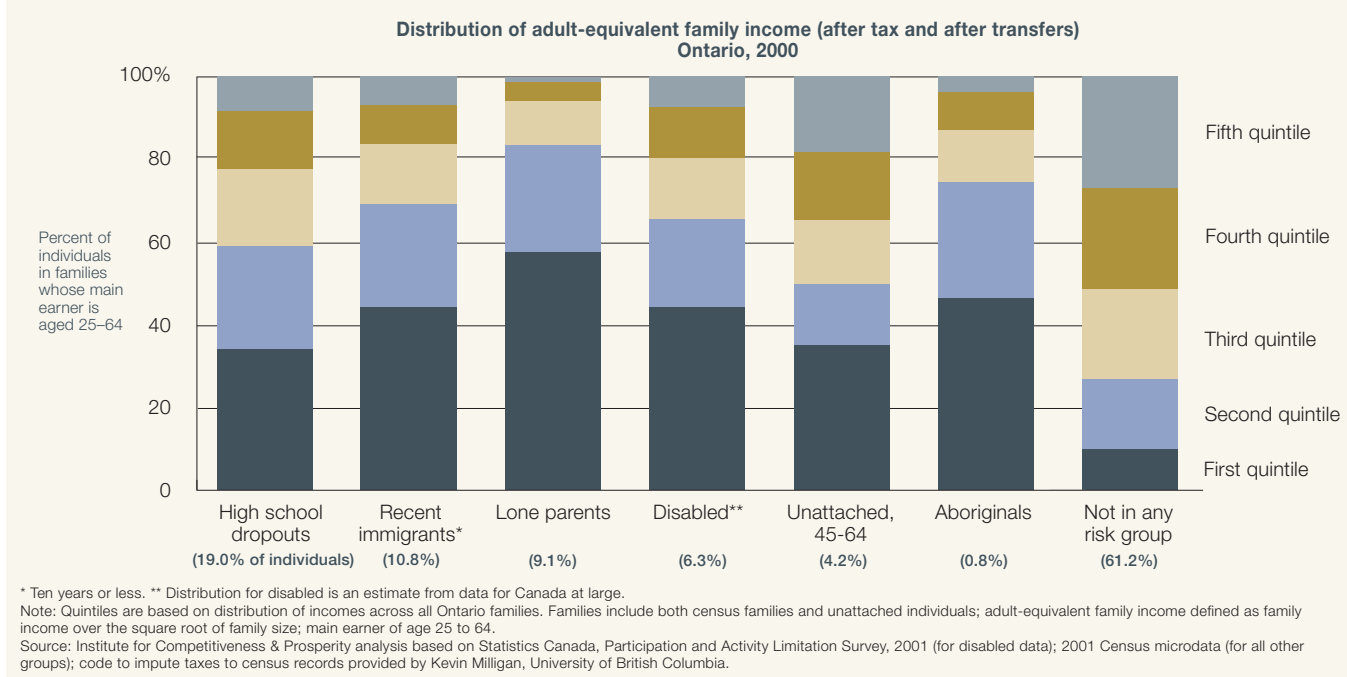
For the 61 percent of Ontarians who are not in any of these risk groups, a relatively small percentage find

themselves in the bottom of Ontario’s income distribution. In 2000, just under 10 percent of these individuals were in the bottom quintile of Ontario’s earnings distribution. By contrast, more than half were in the top two quintiles.

These results are consistent for the different definitions of income (market income only, market income plus transfer income, and as shown in the exhibit, after-tax, after-transfer income) and for the census years 1980, 1990, and 2000.

While inequality and poverty are related, it is important to note that addressing the incidence of lower incomes in these risk groups would have limited impact on inequality as measured by the Gini coefficient. For example, a \$5,000 subsidy to each family or unattached individual in the risk groups we identify

Exhibit 13 Members of risk groups tend to be in lower income quintiles



²² Michael Hatfield, "Vulnerability to Persistent Low Income," *Horizons*, Volume 7, Number 2, Policy Research Institute, Ottawa, December 2004, pp. 19-26.
²³ Hatfield did not single out high school dropouts as a high risk group, since many of them were found in the other high risk groups – and his research indicated that high school dropouts who were not parts of other high risk groups did not experience excessively high rates of persistent low income. But we found they do experience well above average rates of low income in a given year.
²⁴ In Hatfield's definition, a person experiences persistent low income if the cumulative income, after tax and transfer, of his household fell short of the cumulative LICO income over the 1996-2001 period.

would have a modest reduction in after-tax, after-transfer the Gini (from 0.34 to 0.32). Alternatively, a subsidy of \$2,000 to each low income family or unattached individual plus \$2,000 for each child in low income families would have about the same impact on the Gini.

High school dropouts are falling further behind the rest of the population

Among the risk groups we have identified, high school dropouts are not the worst in economic performance. In fact, when we isolate each group, we find that high school dropouts who exhibit none of the other risk characteristics, perform best among the high risk groups. But members of other risk groups who are also high school dropouts perform much worse economically than those who have completed high school. And, as measured by probability of being in the bottom one or two income quintiles and being below LICO, high school dropouts' performance has deteriorated most steadily over the last decades.

Dropping out of high school is becoming a male phenomenon. In 1980 males made up just under 47 percent of the population aged 25 to 64 without a high school diploma; in 2007 they accounted for 51 percent of that group.

High school dropouts have fallen further behind the rest of the population in earnings since 1980. Much of this is because of a slight deterioration in their labour force participation relative to the population and a more significant increase in their unemployment. By 2000 the utilization rate (the percentage of adults who are employed), for high school dropouts stood at about 59 percent versus near 80 percent for those

who had completed high school. In 2006, the situation had not improved – the difference in utilization rates for high school dropouts versus all Canadians stood at about 20 percentage points. High school dropouts tend to secure lower paying jobs – average annual wages for high school dropouts were \$30,300 versus \$40,800 for all Canadian workers in 2006, based on Labour Force Survey results.

Our analysis of the 2003 International Adult Literacy and Skills Survey, which we discuss later, indicates that high school dropouts have the least developed skills of the groups we have been examining. In prose literacy, document literacy, numeracy, and problem solving, high school dropouts are much more likely to be in low skill cohorts, and their average scores are well behind those of the rest of the population.

One area of hope is in skilled trades. The evidence indicates that high school dropouts who successfully gain trade certification improve their economic outcomes. For somebody who has not completed high school, securing a trade certificate adds about 20 percent to his or her annual income. In fact, these individuals out earn high school graduates without a trade certificate (*Exhibit 14*).

The returns from a trade certificate (versus dropping out of high school) are higher for men than for women. For women, the returns from university education are higher than for men. This may explain why more women and fewer men are currently attending university.

In a knowledge economy, it is almost certain that those without a base level of skills will be left behind. We are seeing that now. The public policy imperative is to find ways to encourage (even coerce – as in Ontario now) youth to complete their high school diploma. We need creative ways to help students complete their high school studies. We need to make a concerted effort to strengthen apprenticeship programs, including creatively addressing the economic challenge of ensuring the benefits and costs are borne by the same people. Currently, apprenticeship suffers from a free rider problem. Employers who invest in apprenticeships are creating skills that other employers can benefit from. In its 2004 budget, the Ontario government aimed to reduce costs to employers through a refundable tax credit for businesses hiring apprentices. The undisputed beneficiary of apprenticeship is the individual who gains a certification. How do we build incentives so that the individual pays the costs and gains the benefits from the investment?

Education is a route out of poverty and inequality

Our research into inequality and poverty indicates yet again the importance of education, not only for Ontario's competitiveness and prosperity overall, but also as a way to assist the disadvantaged move into the economic mainstream.

As we have pointed out in the past, more education means higher labour force involvement and higher earnings.²⁵ Yet the evidence indicates that students from lower income families are less likely to receive post secondary education, particularly at a university. Economists Laval Lavallée, Bert Pereboom, and Christiane Grignon

²⁵ Institute for Competitiveness & Prosperity, Report on Canada 2007, *Agenda for Canada's prosperity*, March 2007, p. 33. See Thomas Lemieux, Craig Riddell, and Brahim Boudarbat 2003, "Recent Trends in Wage Inequality and the Wage Structure in Canada," in D. Green and J. Kesselman (eds.), *Dimensions of Inequality in Canada*. Vancouver: UBC Press, 2006, pp. 1-46 – for evidence on the growth in returns to post secondary education in Canada between 1980 and 2000.

found, for example, that youth from the highest income quartile in Canada are more than twice as likely to attend university than those in the lowest quartile.²⁶ Statistics Canada researcher Marc Frenette finds a similar pattern, but not as pronounced – 31 percent of 19-year olds in the bottom quartile were attending university in 2003 versus 50.1 percent in the top quartile.²⁷

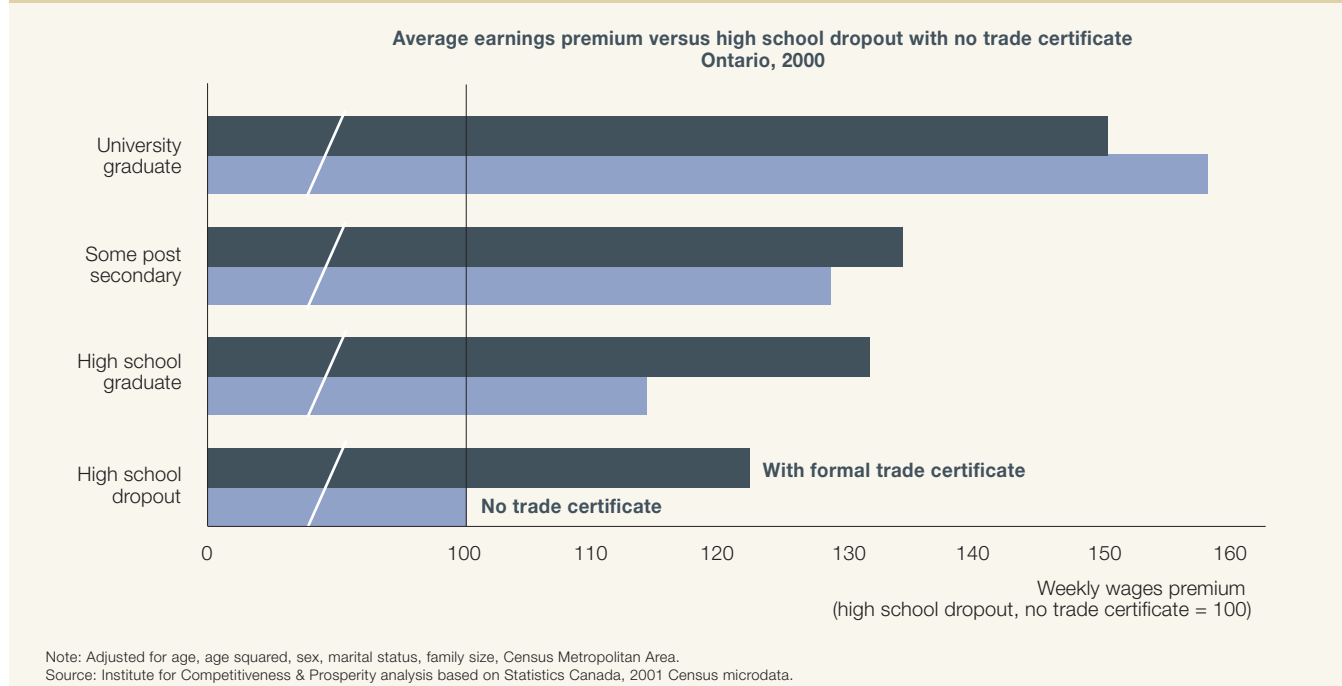
While family income is an important predictor of pursuit of post secondary education, researchers find other factors that are more important, though still related to income. Atiq Rahman, Jerry Situ, and Vicki Jimmo from Statistics Canada found that if one or both parents had post secondary education or if the youth came from a two-parent family, the probability of

pursuing post secondary education increased.²⁸ More recently, Marc Frenette linked university attendance with performance on standardized tests, high school grades, parental influences, and high school quality; in fact, he attributed to these factors 84 percent of the university attendance gap between youth from the top and bottom quartiles. Only 12 percent of the gap could be linked to financial constraints.²⁹

Obviously, income does matter and drives some of these other characteristics. For example, families with higher income are able to enrich their children's education and create an environment more positively disposed to post secondary education. Frenette finds that these factors are more prevalent as income increases.

Frenette's study, along with research conducted in the United States,³⁰ indicates that credit constraints are not the key challenge facing lower income families when they consider post secondary education. Lack of information on the costs and benefits of post secondary education are likely more important barriers. According to polling data gathered by the Canada Millennium Scholarship Foundation, Canadians whose family income is below \$30,000 estimate the cost of undergraduate university tuition at nearly \$7,000; more affluent Canadians estimate the cost to be \$2,000 less than that. In 2003–04, when the survey was conducted, the actual average tuition was \$4,025. On the benefit side, lower income Canadians estimate that the average university graduate earns \$39,000; other

Exhibit 14 Higher education and trade certification increase earnings



²⁶ Laval Lavallée, Bert Pereboom, and Christiane Grignon, 2001, "Access to Postsecondary Education and Labour Market Transition of Postsecondary Students," Canada Student Loan Program, HRDC, mimeo.
²⁷ Marc Frenette, "Why Are Youth from Lower-income Families Less Likely to Attend University? Evidence from Academic Abilities, Parental Influences and Financial Constraints", Statistics Canada Working Paper 11F0019MIE – No. 295, February 2007, p. 7.
²⁸ Atiq Rahman, Jerry Situ, and Vicki Jimmo, "Participation in Postsecondary Education: Evidence from the Survey of Labour and Income Dynamics," Statistics Canada Working Paper 81-595-MIE2005036.
²⁹ Marc Frenette, "Why Are Youth from Lower-income Families Less Likely to Attend University? Evidence from Academic Abilities, Parental Influences, and Financial Constraints."
³⁰ See Pedro Carneiro and James Heckman 2002, "The Evidence on Credit Constraints in Post-Secondary Schooling," *The Economic Journal*, Vol. 112, Issue 482.

respondents estimated the income to be around \$42,000. The actual result, according to the most recent census, was \$62,000.³¹ This lack of information, along with other characteristics, may explain why students receiving aid to attend post secondary institutions are less likely to complete their degree than those who receive no aid.³²

As important as high school and post secondary education are for people's economic well being, many economists consider early childhood education even more important. Nobel laureate James Heckman and Dimitri Masterov describe how individual productivity can be fostered by investments in young children, particularly children in poverty or other adverse circumstances.³³ They are concerned that, in the United States, over 20 percent of workers are functionally illiterate and innumerate. This will be a drag on productivity, but also a source of social problems, including crime and its costs. The authors identify the importance of cognitive and non-cognitive abilities for a productive workforce, and gaps that emerge early are difficult to change.

Since skills accumulate, starting early and continuing to invest in young children over time is an important investment in an economy's productivity and social fabric. Family environments are a large determinant of education and skills and growing numbers of children face adverse environments that restrict development. Heckman and Masterov conclude that primary and secondary schooling come too late and other remedies, such as job training and second-chance high school diploma programs, are prohibitively costly. Instead, a policy of investing in early

childhood development, particularly high-quality kindergarten, provides a wide array of significant benefits to disadvantaged children. They write, "Enriched preschool centers available to disadvantaged children on a voluntary basis coupled with home visitation programs have a strong track record of promoting achievement for disadvantaged children, improving labor market outcomes and reducing involvement with crime."³⁴

Even with the positive returns on investment, the types of targeted school-based early life interventions that Heckman and Masterov point to are costly to implement. The Perry Preschool Program is the most often cited program. It involved weekly home visits with parents and intensive, high quality preschool services for one or two years. The program cost \$19,000 per child, but children in the program were much less likely to be involved in crime (versus a control group) and achieved consistently higher test scores and literacy rates. The study indicated a 9:1 benefit-to-cost ratio. Another frequently cited program is the Chicago Parent Child Centers. In this non-experimental program, the centres provided half day preschool programs for three- and four-year olds during the nine months they were in school. It also provided an array of services, including health and social services, free meals, home visits and field trips. Its benefit-to-cost ratio exceeded 7:1.

Closer to home, the Pathways to Education Program has proved to be an effective model for ensuring that young people from at-risk communities stay in school, graduate, and move on to postsecondary programs. It is a community-based education initiative in Toronto aimed at changing the

expectations of poor teenagers. Its flagship program in Toronto's Regent Park provides academic tutoring, career mentoring, financial assistance for transportation to and from school, and helps build stable relationships between young people, parents, and school staff.

Results are impressive:

- Over 90 percent of the eligible high school age youth in the Regent Park community participate in the Pathways program
- Dropout rates were reduced from 56 percent to 10 percent
- Absenteeism was lowered by 50 percent, and the incidence of youth with serious attendance problems by 60 percent
- Enrollment in college or university grew from 45 percent of graduates to 80 percent (and over 90 percent of those were the first in their families to attend post-secondary institutions).

According to calculations by the Boston Consulting Group:

- The Return on Investment today for every dollar invested in Pathways is \$25
- The long-term benefit to society for every dollar invested in Pathways is \$12
- The cumulative lifetime benefit to society of a student in Pathways (compared to the pre-Pathways students) is \$400,000
- The Net Present Value to society for every Pathways student is \$50,000.³⁵

³¹ Canada Millennium Scholarship Foundation, "Low-income Canadians' perceptions of costs and benefits – a serious barrier to higher education," Mimeo, 2004. Available online: www.millenniumscholarships.ca/en/

³² Lori McElroy, "Student Aid and University Persistence – Does Debt Matter?" Canada Millennium Scholarship Foundation, 2005.

³³ Heckman and Masterov, "The Productivity Argument for Investing in Young Children."

³⁴ *Ibid.* p. 4.

³⁵ The complete Boston Consulting Group study is available at www.pathwaystoeducation.ca

In addition, there is evidence that Pathways reduced teenage pregnancy significantly, thereby lowering the incidence of lone parenthood, another poverty risk factor.

The Pathways program is now being expanded through community partnerships to five new neighbourhoods including two in Toronto, one in Kitchener, one in Ottawa, and one in Montreal. At \$4,000 per student, the Pathways program is less costly than the Perry Preschool program – but is still a significant initial outlay.

In a survey of recent research findings of the benefits and costs of childcare, John Richards and Matthew Brzozowski,³⁶ concluded that the two most significant benefits were increased employment by mothers and improved school performance by children in subsequent stages of education, but a fading benefit in later grades. US research indicates that benefits are related to the gap between the quality of the childcare centre and the home as a learning environment, although some research indicates that cognitive skills are enhanced regardless of socioeconomic status.³⁷ The two broad types of costs are the public costs of running or subsidizing the childcare system and the potential psychological costs for pre-school infants and their parents.

They cite a major Canadian cost-benefit study in 1998 by Gordon Cleveland and Michael Krashinsky³⁸ which indicates a positive benefit of a national childcare program. However, Richards and Brzozowski point out that the experience of Quebec's universal child care program, which provides child care to all children for under ten dollars a day,

indicates that labour costs may rise beyond the original costs, especially if the system has only public centres without competition. They also cite the recent research by economists Michael Baker, Jonathan Gruber, and Kevin Milligan who studied the impact of Quebec's universal childcare.³⁹ The authors noted that, as a result of the policy, child care use increased by one third and there was a large rise in the labour force participation by married women. They found evidence that children's outcomes worsened along a variety of behavioural and health dimensions, such as aggression, motor skills, and illness. They also found more hostile, less consistent parenting, worse adult mental health, and lower relationship satisfaction for mothers. The authors caution that long-term studies may show different results.

According to Richards and Brzozowski, because this study was conducted among two-parent families, "their results should generate doubt as to whether, for a two-parent families, the benefits of national childcare program should outweigh the costs, both financial and psychological."

They conclude by cautioning against the federal and provincial governments' launching universal childcare programs. Instead governments should target reasonable quality programs for families likely to be disadvantaged in preparing children for primary and secondary schooling. Such targeting would be accomplished through focused assistance to childcare centres in low-income neighbourhoods and through fees geared to income. Finally, the authors recommend that families eligible for public support of childcare expenses

should be able to choose among a variety of childcare types, not just a state-sponsored centre. Availability of options brings the cost performance and innovation benefits of competition.

Clearly, the public policy response to the benefits of early childhood development needs to move well beyond universal child care programs toward targeted – and more costly per child – interventions.

Recent immigrants are not participating fully in the Canadian dream

Recent immigrants' earnings have been falling behind other Canadians' earnings. But this is not a new phenomenon. Since 1985, results from the census have shown immigrants' incomes falling behind those of native born Canadians, and this gap is widening. In the 2001 census, immigrants to Canada within the past five years were 2.5 times as likely as Canadian born to have income below LICO. This performance is slightly better than in 1995 when the effects of the 1990–92 recession were still evident. The pattern is similar for immigrants in Canada for more than five and fewer than ten years (*Exhibit 15*). This is especially true for university educated immigrants.

A key factor explaining their poor economic performance may be the sheer number of new immigrants, which increased dramatically from 1985 to 2004 and has remained mostly at these new levels since then. This trend is even more important when the recession of 1990–92 is considered. Until then, immigration levels were managed like a tap – when the economy was

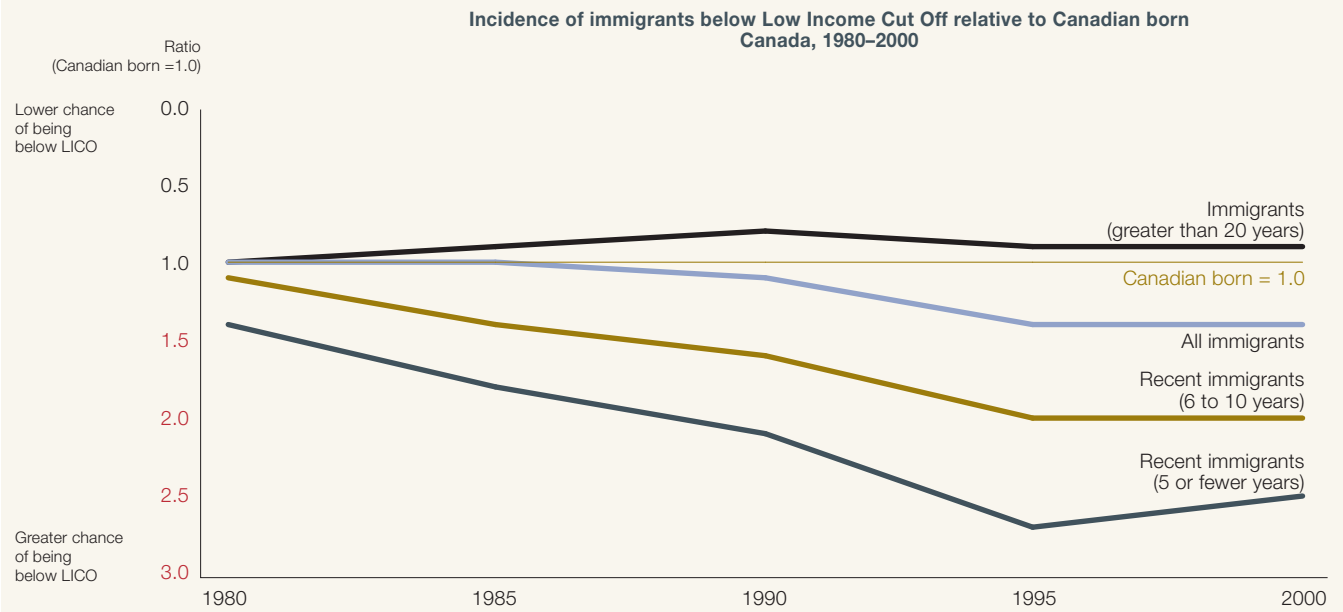
³⁶ John Richards and Matthew Brzozowski, "Let's Walk before We Run: Cautionary Advice on Childcare," *CD Institute Commentary* No 237, August 2006

³⁷ Susanna Loeb et al., "How much is too much? The influence of preschool centers on children's social and cognitive development", *Economics of Education Review* 26, 2007 pp.52-66.

³⁸ Gordon Cleveland and Michael Krashinsky, "The Benefits and Costs of Good Childcare, The Economic Rationale for Public Investment in Young Children – A Policy Study." Childcare Resource and Research Unit, Centre for Urban and Community Studies, University of Toronto. Available online: <http://www.childcarecanada.org/pubs/other/benefits>

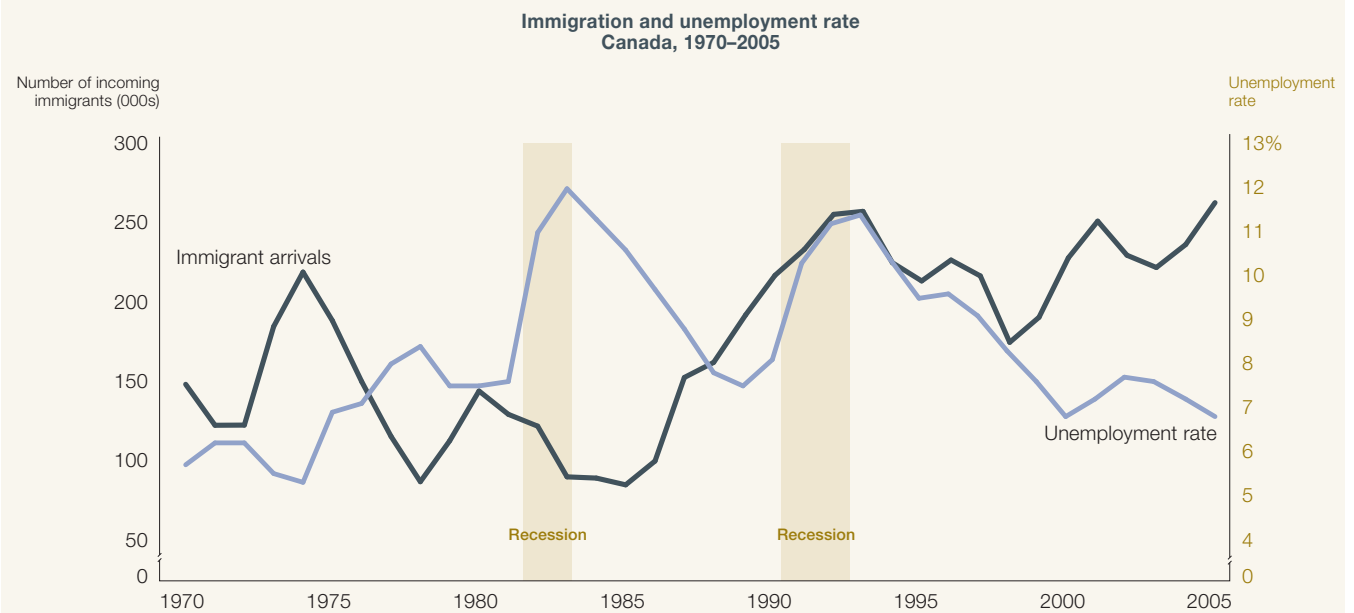
³⁹ Michael Baker, Jonathan Gruber, and Kevin Milligan, "Universal Childcare, Maternal Labor Supply, and Family Well-Being," NBER Working Paper No. 11832, 2005.

Exhibit 15 Incidence of low income has increased among recent immigrants



Source: Institute for Competitiveness & Prosperity analysis based on data from Picot and Hou, "The rise in low-income rates among immigrants in Canada," Statistics Canada, 2003.

Exhibit 16 Immigration was not reduced in the early 1990s recession



Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, Estimates of Total Population, Canada, Provinces and Territories (CANSIM Table 510-037); National Income and Expenditure Accounts (Table 380-0017); and Labour Force Survey (Table 282-0002).

performing well, more immigrants were admitted, and when the economy slowed down, fewer were allowed to enter. But immigration grew significantly just as Canada and Ontario entered their worst recession in years (*Exhibit 16*).

As well as being more numerous, immigrants are more educated than in the past. In 1995, 21 percent of immigrants to Canada had a university degree; in 2000 this percentage had risen to 26 percent. The percentage of native born Canadians with university degrees rose at a much slower rate from 16 percent to 18 percent over the same period. In the United States, there was hardly any difference in these growth rates, where the percentage of immigrants and native-born Americans with a university degree rose from 23 percent to 26 percent between 1995 and 2000 (*Exhibit 17*). Immigrants with university

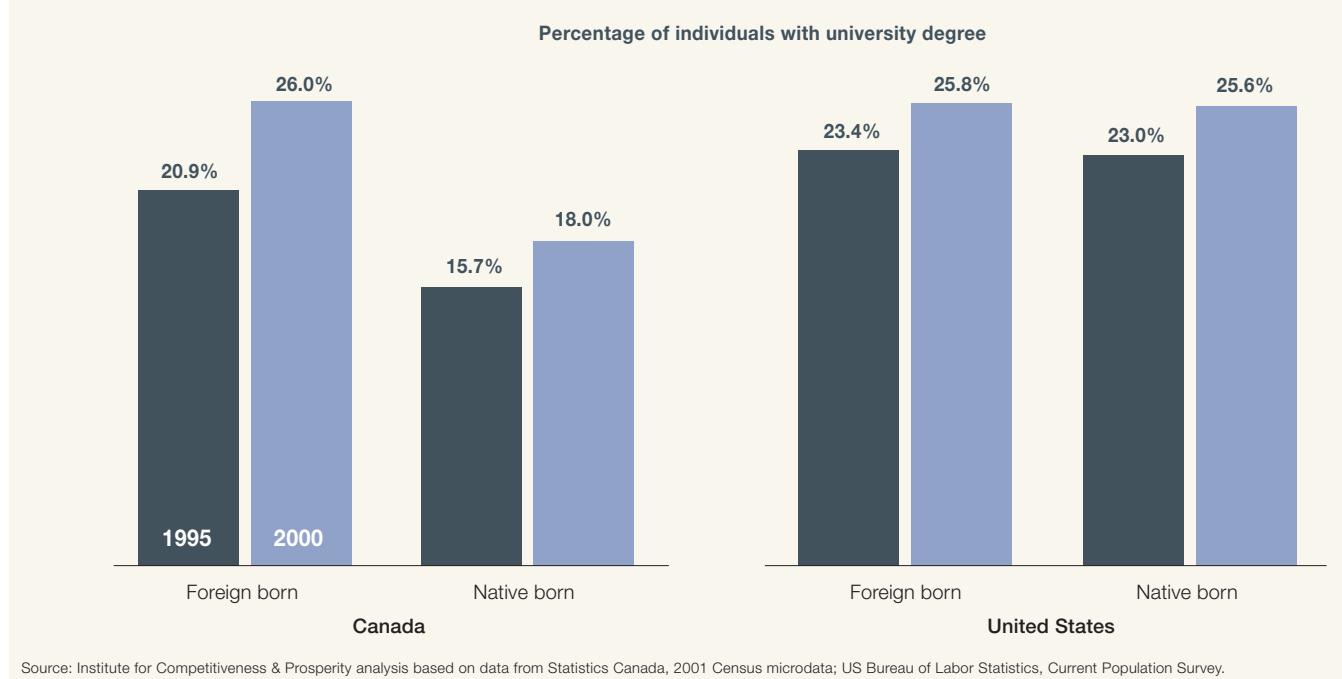
education have fallen farthest behind their Canadian born counterparts. In fact, as we shall see, studies indicate that even adjusted for relative language capabilities, university educated recent immigrants have skills levels below their Canadian counterparts. Public policy needs to focus on investments in developing the softer, less technical skills in recent immigrants.

Results from the International Adult Literacy and Life Skills Survey (IALSS) indicate the importance of skills development, particularly language skills among Canada's immigrants. The IALSS was conducted in 2003 in seven developed countries, including Canada, to assess proficiency among four skill domains – prose and document literacy, numeracy, and problem solving. Prose questions assess skills ranging from identifying recommended dosages in

instructions on a medicine label to writing in one's own words the difference between a panel and a group interview. Document literacy questions range from identifying a percentage of a group with a certain characteristic in a chart to identifying the average price of a radio that received the highest overall quality score. The simplest numeracy task was to determine how many soft drink bottles were in a picture; one of the more difficult tasks was to perform compound growth calculations. A typical problem solving question was to plan the logistics for an upcoming family reunion.⁴⁰

The sample size for the Canadian IALSS is 23,038 (including 3,552 born outside Canada) and it was designed to reflect the population as found in the 2001 census. The survey was administered in respondents' homes and each respondent was given as much time

Exhibit 17 Increase in proportion of immigrants to Canada with university education was above average



⁴⁰ Our research is consistent with findings by Statistics Canada. See *The Daily*, November 9, 2005, "International Adult Literacy and Skills Survey," Catalogue no. 11-001-XIE. Available online: <http://www.statcan.ca/Daily/English/051109/d051109a.htm>

as needed to complete the survey. The survey was designed to measure skills across countries and so cannot be viewed as a measure of Canada-specific skills.⁴¹

Results from IALSS indicate that, at each level of educational attainment, immigrants' skills trail those of their Canadian counterparts. Some of this gap is due to language difficulties, but not all. Focusing on university graduates, we see that on average, immigrants' skills trail their Canadian counterparts' proficiencies. The gap is much wider for those who do not report English or French as the language used at home (*Exhibit 18*). Nevertheless, among immigrants without difficulties in one of our official languages, their achievement in IALSS trails that of Canadian-born university graduates.⁴²

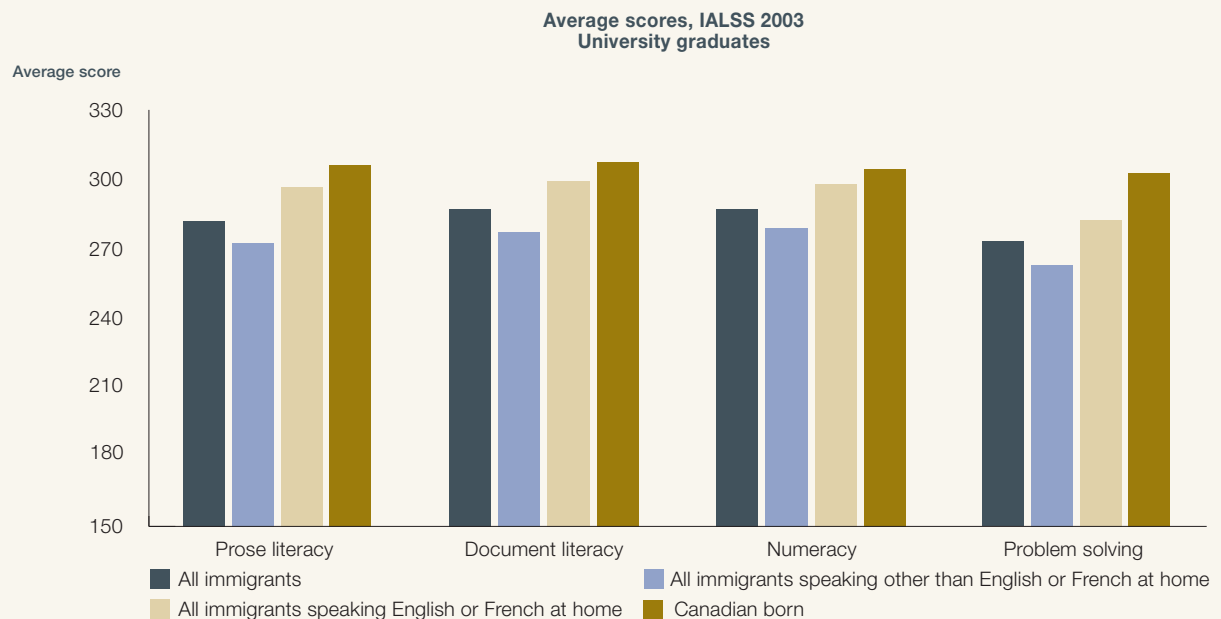
The gap in skills is narrowest for numeracy skills and widest for problem solving skills. Recent research by economists Bernardo Blum and Marigee Bacolod shows that the most highly valued and paid jobs in the US economy are going to people with a combination of cognitive and interpersonal skills.⁴³ This may indicate that gaps in language and cultural affinity will be an increasingly high barrier to be overcome by immigrants.

A review of immigrants' success in integrating into the Canadian economy summarized reasons why recent immigrants were falling behind economically. Drawing on their own research and that of others, Garnett Picot of Statistics Canada and Arthur Sweetman of Queen's University identified the following causes:

Changing characteristics of new immigrants

Between 1981 and 2001, the country of origin of immigrants changed dramatically. Traditional sources – the United States, Northern and Southern Europe, the Caribbean, Latin America, and Southeast Asia – now account for a smaller share of immigrants, falling from 65 percent in 1981 to 28 percent in 2001. Other regions – Eastern Europe, South, East, and West Asia, and Africa – became more important sources of immigrants, rising from 35 percent in 1981 to 72 percent in 2001. As the authors observed, “their human capital may initially be less transferable due to potential issues regarding language, cultural differences, education quality, and possibly discrimination.”⁴⁴ The authors cite other research that indicates that immigrants, on average, have poorer English and French

Exhibit 18 Literacy, numeracy, and problem solving skills of immigrants trail Canadian counterparts



Source: Institute for Competitiveness & Prosperity analysis based on data from International Adult Literacy and Skills Survey (IALSS).

⁴¹ Serge Coulombe and Jean-Francois Tremblay, "Migration, Human Capital, and Skills Redistribution across the Canadian Provinces," *Skills Research Initiative*, Working Paper 2006 D-07, Government of Canada, 2006, p. 8.

⁴² Statistics Canada, "International Adult Literacy and Skills Survey."

⁴³ Marigee Bacolod and Bernardo Blum, "Two Sides of the Same Coin: US "Residual" Inequality and the Gender Gap, January 2005. Available online: www.rotman.utoronto.ca/bblum/personal/front.htm

⁴⁴ Garnett Picot and Arthur Sweetman, "The Deteriorating Economic Welfare of Immigrants and Possible Causes: Update 2005, Statistics Canada Catalogue Number 11F0019 – No. 262, 2005, p. 16.

language skills. As we have discussed, literacy-related skills for recent immigrants are lower than for Canadian born individuals with comparable education. In 2005, the top four source countries for immigrants to Canada were China, India, the Philippines, and Pakistan. In the 1970s the top four source countries were the British Isles, United States, India and Portugal.⁴⁵

Declining returns to foreign labour market experience

Researchers have observed that workers' earnings increase with years of experience as they gain skills and build social networks that make them more productive and valuable to employers. Various studies indicate that foreign work experience is increasingly discounted in the Canadian labour market. In the past, older immigrants to Canada earned significantly more than younger immigrants – presumably because of their work experience. This work experience premium fell between 1980 and 2000. This decline is found only among immigrants from the non-traditional source countries, especially in Eastern Europe, Asia, and Africa. Researchers have not converged on reasons for the declining returns to foreign labour market experience. Some speculate that the technology used in these countries may not be directly applicable to the Canadian workplace and, with the increasing importance of technological skills, foreign work experience is worth less. Others note that because of the increasing numbers of highly educated workers in Canada, employers have less incentive to evaluate the foreign work experience of immigrants. More research is required in this area.

Deterioration of earnings for all new labour market entrants

Between 1980 and 2000, earnings of young men fell. Since entering immigrants were, in effect, entering the labour force along with Canadian-born young men, it may be that the cause of the earnings decline for the young also affected new immigrants. However, this factor – known as the cohort effect – has become less important in recent years.

Competition from more highly educated Canadian born

Through the 1980–2000 period, the number of university educated women in the labour force quadrupled; the number of men with comparable education doubled. Consequently, highly educated immigrants in recent years have faced stiffer competition than in earlier years. In contrast to Canada, Australia has realized improvements in economic outcomes for immigrants. One of the reasons is that in 1996, the Australian government instituted changes to its immigration policies to be more selective in immigrant screening. Australia attracts a higher percentage of its immigrants from English speaking countries than Canada. It screens deliberately for skills in need. Since 2000, new arrivals to Australia have achieved better results in securing positions overall and for those with professional or managerial status in earning high salaries and in using their credentials.

The effects of these changes were recently analyzed by Australian researcher Lesleyanne Hawthorne.⁴⁶ Her study compared changes in immigration outcomes in Australia since the policy changes and with Canada over the same period. Hawthorne found that 76 percent of principal economic applicants to Australia found work

within six months of arrival by 1999/2000, compared to 52 percent in the 1993 to 1995 period. For Canada, 62 percent of principal economic applicants were employed within six months of arrival by 1999, compared to 64 percent in 1994. So while labour market outcomes have hardly changed for economic category immigrants coming to Canada in the 1990s, work rates surged by 24 percent for the same category of immigrants in Australia.

Hawthorne concludes: "Should Canada wish to improve labour market outcomes for the economic category in the period ahead, a more radical overhaul of economic selection criteria seems warranted than the gentle fine-tuning associated with the 2002 Immigration and Refugee Protection Act, from which benefits remain in doubt (Sweetman 2006). The stakes are high for both economic migrants and Canada."⁴⁷

Traditionally, our federal policy has not placed a priority on matching Canada's skills needs with immigrants' skills in contrast with Australia's policies. Some argue that this is misguided, as it reduces the economic benefits of immigration to Canada and places hardship on recent immigrants. In response, others contend that a focus on attracting only high skilled immigrants amounts to poaching from countries in desperate need of those skills. In addition, they point out, Canada should welcome immigrants irrespective of their skill and provide them with an opportunity to create a good life for them and their future generations. Both points of view have merit.

But Canada's current more passive approach requires that we create

⁴⁵ Statistics Canada, 2001 Census, One hundred years of immigration to Canada (table version), <http://www12.statcan.ca/english/census01/products/analytic/companion/etoimm/time.cfm> (accessed on August 15, 2007).

⁴⁶ Lesleyanne Hawthorne, "Labour Market Outcomes for Migrant Professionals: Canada and Australia Compared," University of Melbourne, April 2007.

⁴⁷ *Ibid.*, p. 3.

conditions for immigrants to succeed economically. We need to ensure that we are investing adequately in programs aimed at upgrading the skills of recent immigrants. In a sense, these investments are no different than investments in post secondary education. And because many immigrants already have the base level of technical or professional skills gained through formal education in their home country, it is quite likely that the incremental investments to enhance their skills will add very positive returns to Ontario's economic performance. Currently, both levels of government are increasing their emphasis on integration and skills development.

The Ontario government has placed a high priority on improving economic outcomes for international immigrants to the province. Its plan, *Breaking Down Barriers*,⁴⁸ has three main themes.

First, the Province is attempting to provide solid settlement assistance to newcomers. With recent signing of the Canada-Ontario Immigration Agreement, the province will invest an additional \$920 million over five years to front-line service providers. The Province is also spending more than \$146 million annually for newcomer services and has increased its funding to support community agencies in their efforts to assist settlement by immigrants.

Second, recently passed legislation is now in place to ensure fairer access by immigrants to regulated professions. The *Fair Access to Regulated Professions Act, 2006* requires Ontario's thirty-four regulated professions to ensure their licensing processes are fair, clear, and open and that they are assessing credentials more quickly. The Province has also established Global Experience

Ontario, a one-stop access and resource centre for internationally trained individuals to provide information for people who intend to apply to a regulatory body or obtain licenses to work in their field.

Finally, the Province is investing in skills development among immigrants. Among the initiatives, the Province is partnering with Ryerson University and the Professional Engineers of Ontario to provide opportunities for academic courses to help meet requirements, focused counseling, and work experience through a co-op program. It is investing \$5.6 million in the Ontario college system to improve pathways to employment for internationally trained individuals. It has targeted programs in the social services and health care fields. The Province continues to expand its bridging programs with \$53 million in investment. These help integrate foreign-trained professionals into the workforce by supporting them to gain required licensing or through mentorship, counseling, job placements, and internships. It is also investing over \$50 million annually in occupation-specific language training, English/French as a second language, and citizenship and language training. It has also created a foreign trained professional loans program providing up to \$5,000 loans for assessment, training, and exam costs.

As outlined in its 2007 Budget, the federal government has recently launched a foreign credential referral office (FCRO) with a \$13-million investment over two years, funded from existing sources. This new office is designed to help internationally trained individuals who plan to work in Canada to get their credentials assessed and recognized more quickly. Its approach includes in-person services, a dedicated

phone service, an expanded online service, increased employer awareness, and overseas pilot projects.

Additionally, a two-year investment of \$51 million will be made to improve the Temporary Foreign Worker Program and create a new avenue to immigration with a two-year, \$33.6-million investment that will allow skilled foreign workers and Canadian educated foreign students who are already in Canada to apply for permanent residence without leaving the country.

Part of the solution to better economic integration of immigrants is ongoing collaboration between employers, community organizations, regulatory bodies, and all three levels of government. The Toronto Region Immigrant Employment Council (TRIEC) is a leading organization in effecting this collaboration to find solutions for individuals and for improvements in public policy. It is an initiative of the Maytree Foundation and is also funded by the federal and provincial governments and private corporations, notably the TD Bank Financial Group.

TRIEC's Mentoring Partnership brings together skilled immigrants and established professionals in occupation-specific mentoring relationships. Since its establishment in late 2004, the program has registered nearly 1,500 mentors, matched more than 2,000 mentoring pairs, and enlisted over 45 organizations from the public, private, and voluntary sectors. The hireimmigrants.ca program provides employers with the tools and resources to accelerate the integration of skilled immigrants into their organizations. Among its services are e-tips of promising practices from other employers,

⁴⁸ Global Experience Ontario, *Breaking Down Barriers: Ontario's Comprehensive Plan for Newcomers*, 2007.

tele-seminars, and development of a Web-based source of regional resources. TRIEC recognizes organizations that have demonstrated innovation and excellence in integrating immigrants in the workplace. It has also launched an awareness campaign to engage employers and the public in being part of the solution to improve skilled immigrants' access to employment.

Other leading organizations include Career Edge whose Career Bridge program creates paid internship opportunities with employers providing relevant work experience to professional level newcomers and the Consortium of Agencies Serving Internationally-Trained Persons (CASIP) comprising eight community-based employment organizations and community colleges to enhance their services to internationally trained people in the Toronto region.

Lone parents' incomes have improved, but remain low

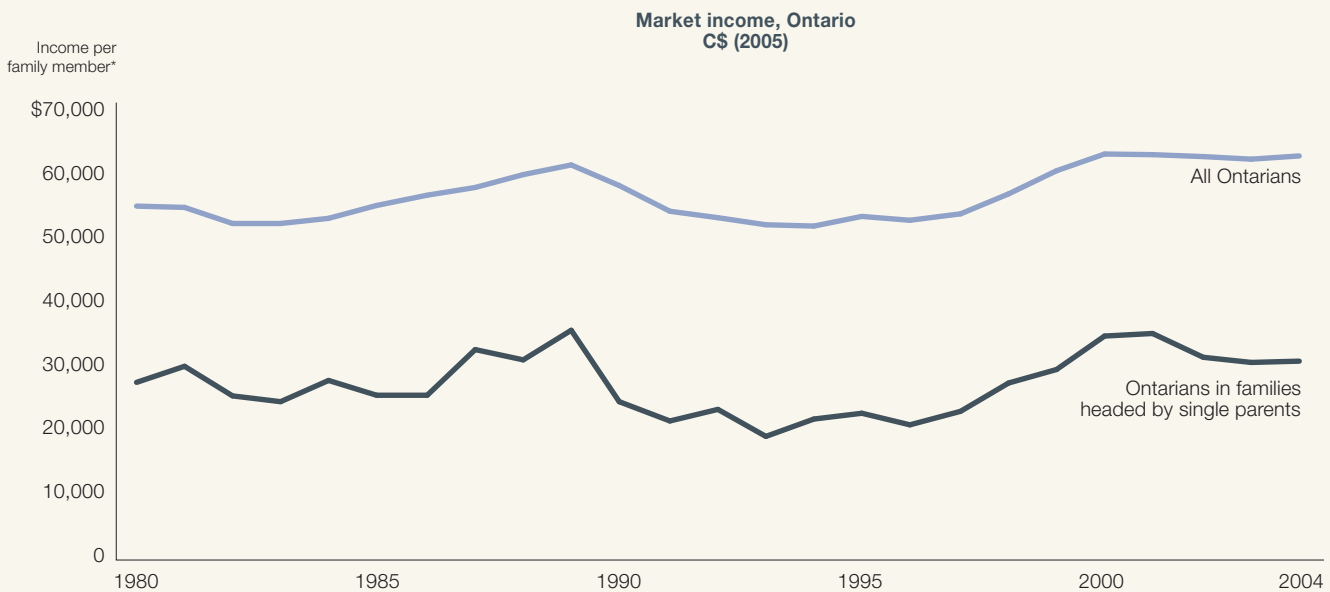
The number of lone parents and children in lone parent families has been increasing in recent years. As we have seen, families with lone parents have the worst economic outcomes – as defined by probability of being in the bottom two quintiles of income (market and after-tax, after-transfer). Fully half of lone parent families are in the bottom quintile and just under 80 percent are in the bottom two quintiles (see Exhibit 13). A third of lone parent families in 2000 were below LICO.

Yet single parents have made the most progress (up to 2000) in moving out of the bottom quintile; their situation remains unchanged if we consider the bottom two quintiles. This progress appears to have been the result of greater involve-

ment in the labour force. Participation rates of single mothers have risen faster than those for other Canadians (and Ontarians). And their unemployment rate fell fastest between 1995 and 2000 (it also increased fastest between 1990 and 1995). Single fathers are a small proportion of single parents and have not shown the same trends in participation and unemployment. Still, lone parents trail all others in market income and after-tax, after-transfer income (Exhibit 19).

Participation and employment results differ by level of education. Single mothers who are high school dropouts have much lower attachment to the labour force than other Ontarians – with lower participation rates and higher unemployment rates. Single mothers who are university graduates do not differ from other Ontarians in participation and employment.

Exhibit 19 Income in families headed by single parents continues to trail other Ontarians



*Family income divided by square root of family size.
 Note: Market income includes income from employment, investments, alimony, and other non-government transfers.
 Source: Institute for Competitiveness & Prosperity based on data from Statistics Canada, *Income Trends in Canada, 1980-2005*, May 2007.

How to help the working poor

One popular means of addressing poverty is the minimum wage. In fact, in the last Ontario budget, the general minimum wage rate was increased from \$6.85 to \$8.00 per hour and is to increase by 75 cents per hour annually to reach \$10.25 on March 31, 2010.

A recent paper by economist Morley Gunderson prepared for the Ontario Ministry of Finance (February 2007), provided an in depth assessment of this policy option for reducing poverty.^a Gunderson concludes: “Minimum wages are, at best, an exceedingly blunt instrument for curbing poverty and the evidence suggests they essentially have no effect on reducing overall poverty and only a very small effect on reducing poverty amongst the working poor.”^b Some reasons for this are that many of the poor do not work or work few hours; many minimum wage jobs are held by youths; minimum wages are poorly targeted toward individuals irrespective of their family situation or need; and minimum wages affect only a small proportion of the population. In Ontario, 50 percent of minimum wage workers are teens or youths who live with their parents, 31 percent are couples (about 70 percent of these have a spouse employed at a job earning above the minimum wage), just about 11 percent are unattached individuals, and 8 percent are single heads of families.

A high minimum wage set by fiat through legislation hurts some of the people it is designed to help. It is a timeless economic lesson that when the price of something goes up, buyers usually buy less of it. When wages are set to be higher than the rate at which employers value the jobs, fewer affected workers will be hired or hours worked will be reduced. Having reviewed various studies, Gunderson concludes that “minimum wages in Canada are very likely to create an adverse employment effect, especially for teens and to a lesser extent for young adults.” As we have seen in this working paper, success in gaining employment mitigates against being in a high risk group. So a policy that hurts employment prospects for such individuals and has limited effects on poverty does not offer a lot.

Instead of requiring employers to pay more, why not skip the middleman and subsidize low income workers directly? Such a program already exists in the United States and has been introduced in Canada. The Earned Income Tax Credit (EITC) in the United States is a federal tax refund for workers, who qualify based on family income rather than individual income or wages. This means that an upper-class teenager working at a fast food restaurant will not get a benefit, but someone trying to support a family will. There tends to be general agreement among most economists that the EITC is an effective instrument to curb poverty. Since its introduction in 1975, it has been expanded regularly irrespective of which political party is in power.

In Canada, the 2007 federal budget announced a Canadian version of EITC, Working Income Tax Benefit (WITB). The maximum annual WITB will be \$500 for a single person and \$1,000 for single parents and couples. The initial amounts of the WITB are modest. However, they can be steadily increased similar to the National Child Benefit Supplement. More challenging than the amounts, are the phase out points of the WITB. A single person with a net income of \$12,833 will not be entitled to any benefit from the WITB, nor will single parents and couples who earn \$21,197. This means that the WITB phases out entirely at about \$3,167 less than what a full-time, minimum wage worker would earn. There are clearly challenges with the design of the WITB. Nonetheless, it is a positive step forward and should be built upon in the future.

In Ontario, the Ontario Child Care Supplement has features of the EITC, as it is a tax free payment to supplement the incomes of working families for child care.

^a Morley Gunderson, “Minimum Wages: Issues and Options for Ontario,” Ontario Ministry of Finance, February 2007.

Available online: <http://www.fin.gov.on.ca>

^b *Ibid.*, p.21.

The key public policy challenge is to create incentives for low skilled single mothers that make it economically advantageous for them to find and keep employment. As we have shown in previous work, low income Canadians face very high effective marginal tax rates as they move up the income ladder, to around the \$20,000 mark. A recent experiment by the Social Research and Demonstration Corporation (funded by HRSDC) indicates that programs can be designed to encourage single mothers to work. The Self Sufficiency Project, based heavily on incentives to make it economically advantageous for lone mothers⁴⁹ to work, initially delivered positive employ-

ment results. The experiment supplemented wages for single mothers who transitioned from welfare to work. The supplement covered the difference between the actual wage and an annual benchmark of \$37,500. Early results were encouraging, improving employment outcomes and reducing welfare receipts. However, the supplement was in effect for only three years. Once it ended, a significant percentage of the participants' employment fell and the long-term benefits did not match the three-year costs.

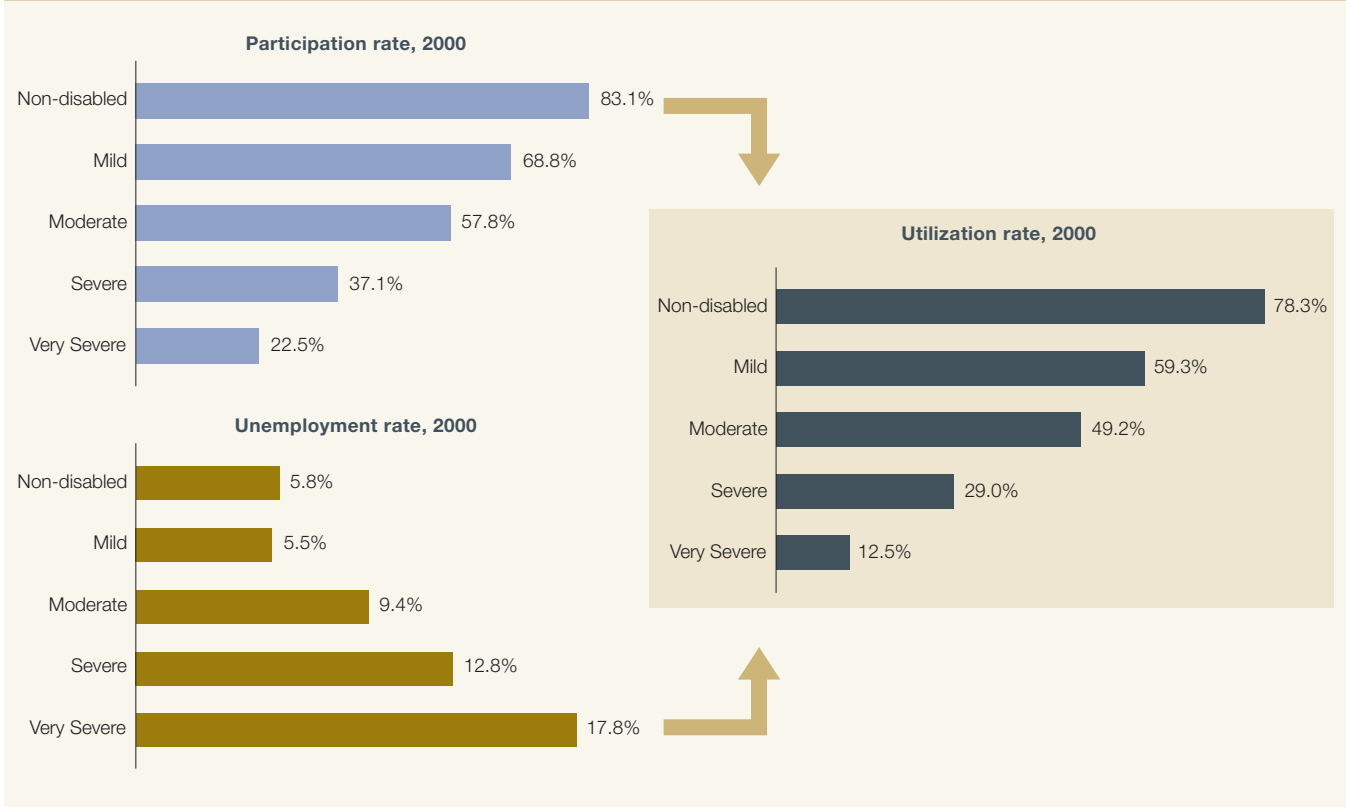
The key lesson learned is that incentives can succeed in helping single parents and other low income

people find work. But the incentives must persist for the benefits to last. The experiment lends support to the positive potential from the recently announced federal Working Income Tax Benefit (WITB), Canada's equivalent to the US Earned Income Tax Credit – which appears to be a successful program for the working poor. (See *How to help the working poor.*)

Key challenge for the disabled is labour force engagement

Disabled tend to be less well educated and participate less in the labour force than the able bodied (*Exhibit 20*). As expected, income is lower as the

Exhibit 20 Disabled have lower utilization rates, especially those with more severe disabilities



Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, 2001 Census microdata, Participation and Activity Limitation Survey, 2001.

⁴⁹ The incentive was available to single mother and single fathers, but 90 percent of participants were women.

severity of disability increases. The public policy challenge is to find cost effective ways to increase access by the disabled to the work force.

Unattached individuals 45 to 64 are increasing and lagging economically

The number of unattached individuals between ages 45 and 64 is increasing at a much faster rate than all individuals in that age group (54 percent increase between 1980 and 2000 versus a 13 percent increase for all individuals aged 45 to 64). The data indicate a variety of reasons for being unattached – for example, marriage breakdown,

widowhood, never been married. They tend more than others in their age group to be disabled, both with and without a high school diploma. These unattached individuals are two-and-a-half times as likely to have income below LICO, especially those who are high school dropouts or disabled or both.

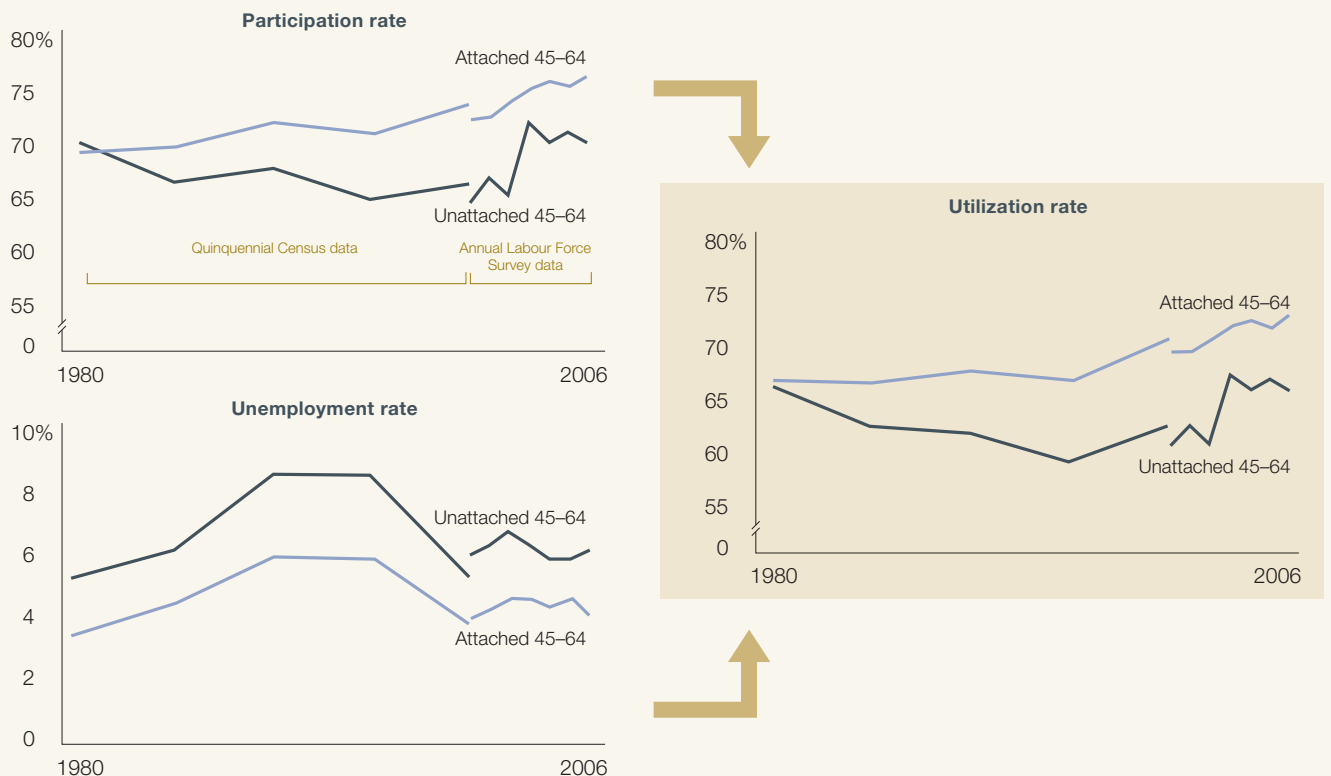
The key economic factor affecting this group appears to be low labour force participation. In 1980, unattached individuals 45 to 64 had a participation rate equal to the age cohort as a whole. This has drifted lower over the past twenty years so that in the 2001 census the gap in participation rate was about 5 percentage points. The group

has experienced chronically higher unemployment rates (about 2 to 3 percentage points higher in unemployment). Consequently, its utilization rate has drifted lower (*Exhibit 21*). In general, the educational attainment profile of this group appears to be as well educated as all Canadians, aged 25-64.

Attachment to the work force is the key challenge for Aboriginals

As a group, Aboriginals (on and off reserves) tend to participate in the labour force much less than other Canadians, and they have chronically higher unemployment (*Exhibit 22*). Between 1985 and 2000, Aboriginals

Exhibit 21 Unattached individuals, 45-64, are falling behind in labour utilization



Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, Census microdata (1980-2000 data), Labour Force Survey (2000-2006 data)

increased their participation rate in the labour force from 70 to 74 percent. Over the same period, non-Aboriginals increased their participation rate from 77 percent to 80 percent. So the participation gap narrowed slightly. Unemployment rates for Aboriginals fell from 20 percent to 14 percent, while non-Aboriginals experienced a decline from 8 percent to 6 percent. Consequently, the utilization rate – the percentage of adults who are working – increased for Aboriginals over the 1985–2000 period. Still a sizable gap existed between them and non-Aboriginals. While Aboriginals are as likely to participate in the labour

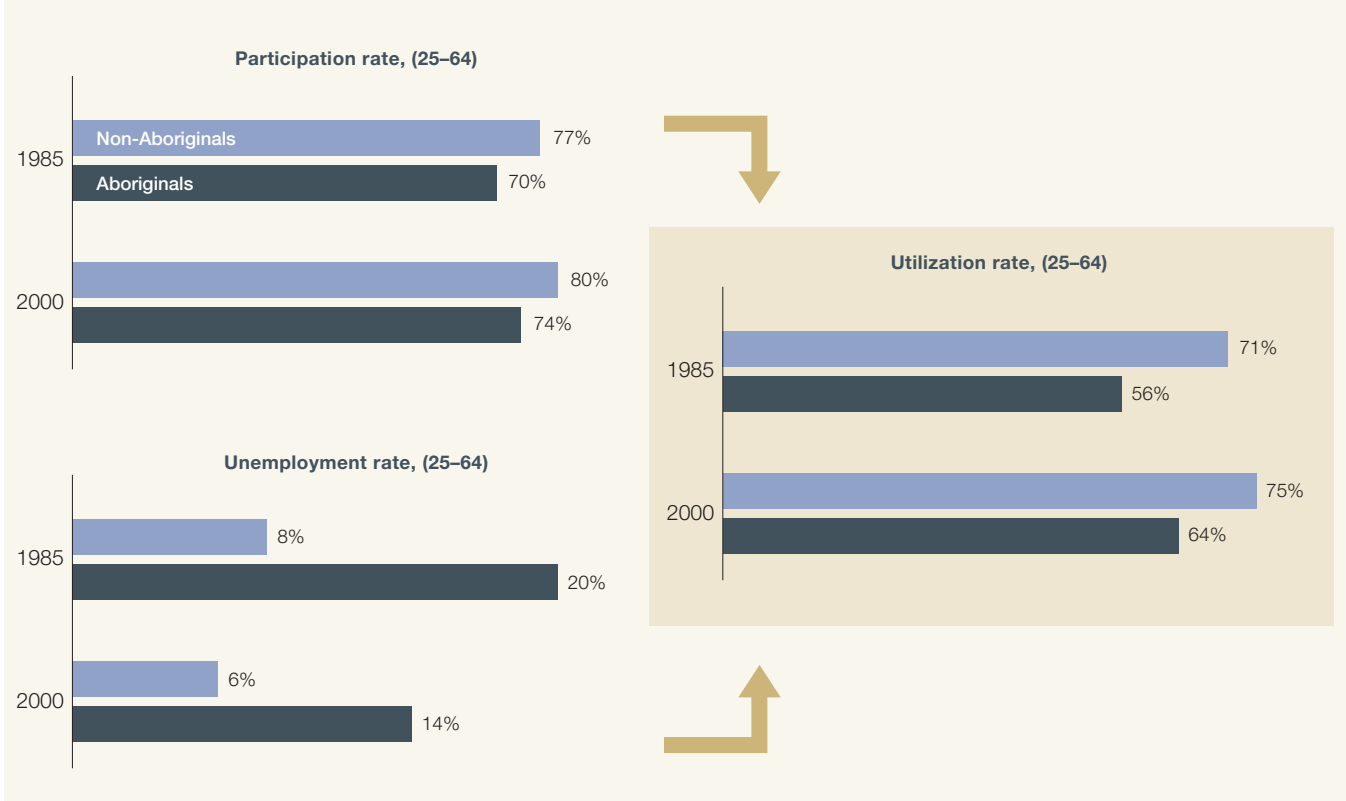
force as those in other risk groups, their unemployment rate is much higher.

Hatfield’s study noted that off-reserve Aboriginals outperformed the other risk groups in securing stable paid employment,⁵⁰ while still under performing those outside the risk groups. Our analysis, which includes on-reserve and off-reserve Aboriginals, does not indicate this advantage versus other risk groups. It seems reasonable to conclude that on-reserve Aboriginals are under performing their off-reserve counterparts considerably.

In exploring their economic performance more closely, we find that Aboriginals

are also more likely to be part of other risk groups – particularly single parents, high school dropouts, and the disabled.⁵¹ Aboriginals, not in any other risk group, achieve better economic performance than Aboriginals who have these other risk factors. Nevertheless, they still trail the economic performance of Ontarians not in these risk groups. An additional challenge facing Aboriginals and their economic success is that higher education has less impact on their performance than it does for non-Aboriginals (*Exhibit 23*). These results occur despite increasing transfers to Aboriginals.

Exhibit 22 Aboriginals are under utilized in the labour force



Source: Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada, 2001 Census microdata, Participation and Activity Limitation Survey, 2001.

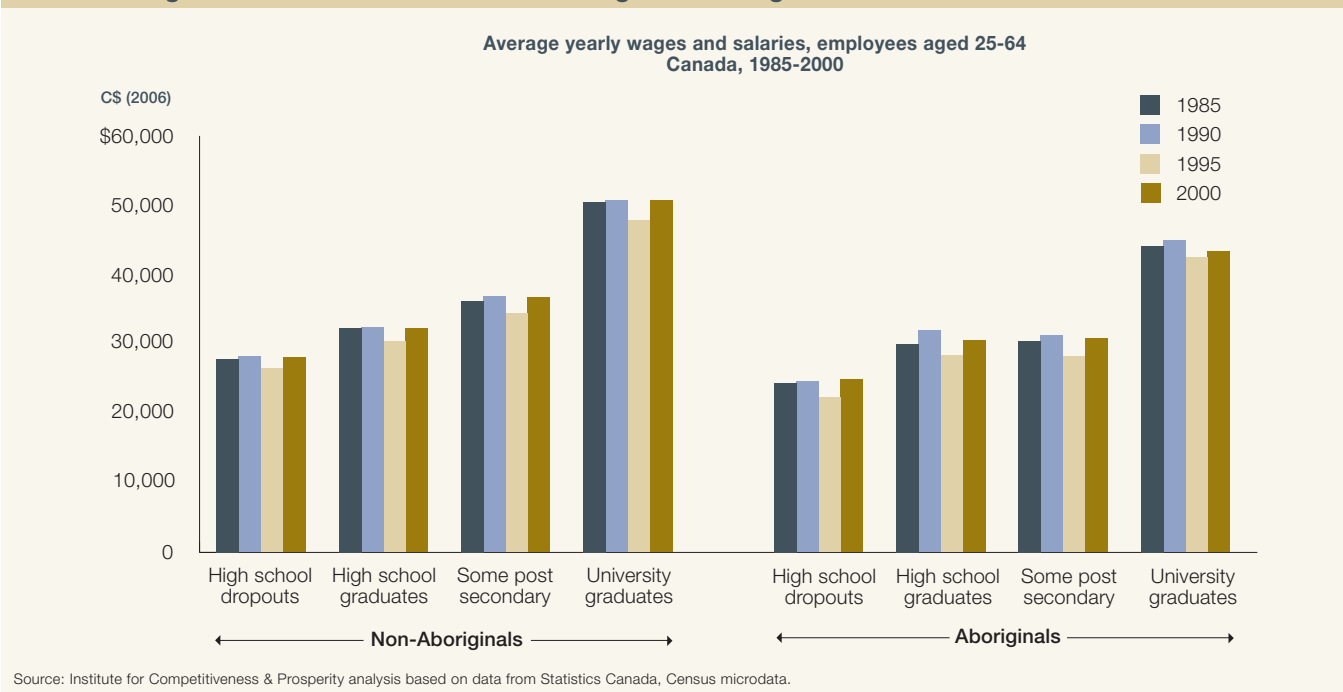
⁵⁰ Hatfield, p. 22. For more detail, see Dominique Fleury, “Economic Performance of Off-Reserve Aboriginal Canadians: A Study of Groups at Risk of Social Exclusion” cited in Hatfield, p. 25.
⁵¹ Government of Canada, *Advancing the Inclusion of Persons with Disabilities 2005*.

To date, we have not conducted much research into the economic circumstances of this risk group, and so our conclusions are by necessity rather general. But, as others have concluded,⁵² our current policies are not successful in helping Aboriginals contribute to and benefit from our economic success. According to recent research, the two most critical areas with respect to Aboriginals' educational attainment are the transition from primary to secondary school, and the much higher dropout rates and lower performance prevalent in on-reserve as opposed to off-reserve high schools. More research is needed to identify the causes of these problems and to determine the types of resources and support that are needed.⁵³ We need creative, innovative strategies focused

on their unique circumstances; we know that the status quo is meeting few goals.

Poverty in Ontario is focused among specific high risk groups. Addressing these challenges of poverty require innovative, and potentially costly, solutions. Increasing Ontario's prosperity would generate the tax revenues to fund these investments. Helping more Ontarians to participate more fully in the economy would, in turn, increase our overall prosperity. Public policy needs to be aimed at achieving this virtuous circle.

Exhibit 23 Higher education does not benefit wages of Aboriginals as much as those of other Canadians



⁵² For example, see Coryse Ciceri and Katherine Scott, "The Determinants of Employment Among Aboriginal Peoples," in Vol. III of Jerry P. White et al. eds., *Aboriginal Policy Research: Moving Forward, Making a Difference*. Toronto: Thompson Educational Publishing, 2006, pp. 3-32.
⁵³ Jerry White, Paul Maxim, and Stephen Obeng Gyimah, "Labour Force Activity of Women in Canada: A Comparative Analysis of Aboriginal and Non-Aboriginal Women," *Canadian Review of Sociology and Anthropology*, vol. 40, pp. 391-416.

Achieving the “right” income and equality balance

Prosperity growth will provide the financial resources to address poverty among high risk groups



OUR RESEARCH in this working paper and by others indicates that a prosperity agenda is the best course to address income distribution and poverty. If economic policy is about creating virtuous circles, then closing our prosperity gap and reducing poverty can and should work together.

More prosperity gives us opportunities to invest in people and more investment in people means greater prosperity. Closing Ontario’s prosperity gap and realizing our full economic potential means more income for individual Ontarians. It also means significantly more tax revenue for governments – which can be invested in helping at risk individuals escape poverty and ensure a better future for their children. As individuals escape poverty they will contribute more to the province’s economic progress. This greater involvement by all Ontarians means more prosperity and so on.

Currently, we see that greater inequality in market incomes is occurring in many parts of the developed world. Research indicates that factors related to prosperity *are* at play. But it is not true that prosperity necessarily leads to more inequality, which follows its own course and does not track prosperity growth closely. Prudent taxation and redistribution policies can and do bring about a more equitable distribution of prosperity.

The challenge of a prosperity agenda is to avoid extremes, and we have not seen anything to indicate that Ontario is at such an extreme. Poverty is, however, a vexing issue. And the evidence indicates that poor economic conditions lead to greater incidence of poverty. Our research also indicates that poverty is concentrated among specific risk groups in Ontario, and much of the challenge they face is in achieving greater attachment to the labour force. Each group has its own challenges and public policy ought to be tailored to these specific challenges.

Our review of the conditions affecting groups at poverty risk in Ontario point to some recurring themes.

Developing skills and capabilities is key for individuals to avoid poverty and to move up the economic ladder

At a minimum, we should be encouraging our youth to complete their high school studies. Even better, they should be persuaded to gain a post secondary education or trade certification. In the Fifth Annual Report of the Task Force on Competitiveness, Productivity and Economic Progress, published last November, we urged Ontario's youth to invest in their educational attainment and for governments to increase their investment in post secondary education. We also agreed with the Ontario government's efforts to insist that our children complete high school through initiatives, such as requiring them to keep learning in a classroom, apprenticeship, or workplace training program until at least age 18, instead of being allowed to drop out at age 16. These clearly support both a prosperity agenda and a poverty agenda.

Having a job reduces the probability of being in poverty, whether or not an individual is in a risk group

Programs and policies that lead to good job creation conditions in general are important to reducing poverty and inequality. One way to accomplish this is to ensure that labour regulations

are not unintentionally discouraging job creation, as we concluded in our agenda for prosperity. Our research also indicates that incentive-based approaches should be developed to encourage individuals in high risk groups to find work.

Reducing poverty requires highly focused and innovative public policies and programs

We have seen examples of innovation, such as the Self Sufficiency Project and the Working Income Tax Benefit, which are departures from existing approaches. Clearly, there will be failures along the way – but in many cases existing approaches are failing. In the past, we have encouraged business leaders to be more innovative and aspire to be global leaders. This encouragement applies equally to elected officials and public servants – we should strive for the best policy initiatives for helping people escape poverty.

Addressing intergenerational poverty issues is critical

By aiming to improve equality of opportunity for Ontarians today, we should make progress in achieving greater equality of outcomes in the future. Investing in **early childhood education** is one area of promise. However, these investments need to be focused on at-risk children, and we need to differentiate these interventions from basic child care programs. Ensuring access to **post secondary education for lower income Ontarians**

is also an important contributor to greater equality. However, the real challenge may be related more to information than financial aid, since the research indicates that awareness of costs and benefits of post secondary education are not well understood in lower income families.

Our prosperity agenda is completely compatible with a poverty reduction agenda. But prosperity growth will not automatically reduce poverty on a large scale. It does, however, provide the financial resources for well designed public policies that are targeted at specific causes and at risk groups. Let the effort begin.

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How to contact us

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Should you have any questions or comments, you may reach us through the web site or at the following address:

The Institute for Competitiveness & Prosperity
180 Bloor Street West, Suite 1100
Toronto, Ontario M5S 2V6
Telephone 416.920.1921
Fax 416.920.1922

Executive Director

James Milway

416 920 1921 x222

j.milway@competeprosper.ca

Researchers

Lance Bialas

416 920 1921 x228

l.bialas@competeprosper.ca

Alberto Isgut

416 920 1921 x227

a.isgut@competeprosper.ca

Sana Nisar

416 920 1921 x223

s.nisar@competeprosper.ca

Daniela Scur

416 920 1921 x224

d.scur@competeprosper.ca

Summer Researchers

Fernando Leibovici

Lloyd Martin

Jerome McGrath

Andréa Rinaldi

Louis-Philippe Roy

Roksana Tkachenko

Eric Wayman

Anzhelika Zinger

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ISBN 978-0-9737377-8-3