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COMMENTARY

SOCIAL POLICY

Reducing Lone-Parent Poverty:

A Canadian Success Story

John Richards



In this issue...

From 1996 to 2007, the poverty rate among the two million Canadians living in lone-parent families fell by more than half – from nearly 50 percent to just over 20 percent. What did Ottawa and the provinces do right? And what comes next?

THE AUTHOR OF
THIS ISSUE



JOHN RICHARDS is Professor, Public Policy School at Simon Fraser University, and is the Roger Phillips Scholar in Social Policy at the C.D. Howe Institute.

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THE STUDY IN BRIEF

From 1996 to 2007, the poverty rate among the two million Canadians living in lone-parent families fell by more than half – from nearly 50 percent to just over 20 percent – as measured by the low-income cutoff (LICO) rate. The proximate cause is a dramatic increase in employment and hence average market income among these families. There are several underlying factors at work.

In mid-1990s, most provinces adopted “tough love” initiatives that rendered welfare access more difficult for those classified as employable, a category including most single parents. Accompanying the “tough love” were “soft love” initiatives intended to provide benefits to working parents – such as better support for child care and the national child benefit system, which provides income to low-income families with income above welfare thresholds.

While lone-parent poverty has fallen dramatically, Canada’s overall poverty reduction since mid-1990s has been similar to other OECD countries. And, as measured by the low-income measure (LIM – the percentage living below half of the median income), Canada’s poverty rate in mid-2000s was above that of the typical OECD country.

Further reductions in Canadian poverty are likely to be more complex than welfare-to-work programming. In many provinces, the majority of welfare recipients are now “persons with disabilities.” A high-profile category is the urban homeless, most of whom combine mental illness with abuse of drugs or alcohol. Here, effective policy requires provision of housing and expensive services.

The study includes a methodological appendix on defining poverty thresholds. In addition to the LICO, the Canadian government maintains two other measures: the LIM and the market basket measure (MBM). The study recommends replacing the LICO by the LIM as the standard poverty measure.

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Over the past 15 years, the poverty rate among the two million Canadians living in lone-parent families has fallen by more than half. While their poverty rate remains over twice the national average, the improvement since the mid-1990s has been dramatic. What did Canadian social policy get right?

This *Commentary* discusses Canadian poverty trends over the past three decades, especially the major welfare-to-work social policy initiatives undertaken in the 1990s. True, some of the poverty reduction since the mid-1990s is due to favourable labour market conditions, but much of the credit lies with reforms to social assistance programs. Although new workfare initiatives in provinces with above-average welfare utilization may yield future benefits, in terms of higher average incomes among the poor and lower welfare budgets, in general the potential for additional workfare programming in Canada is minimal. Further progress in lowering poverty rates requires tackling seemingly intractable problems such as low education levels among certain groups and mental illness linked to drug/alcohol abuse.

Canadian Poverty Trends

In Canada, the ubiquitous poverty rate, as reported by the media and used in analyses, is the percent of a relevant group with incomes below Statistics Canada's after-tax, low-income cutoff (LICO). The LICO thresholds are the income level – with adjustments for family and community size – below which households are expected to spend at least 20 percentage points more of their after-tax income¹ on the necessities of food, shelter and clothing than does the average

household. These thresholds are adjusted annually to reflect changes in the consumer price index. Between infrequent rebasing exercises, the LICO is an “absolute” poverty measure inasmuch as the real values of the thresholds do not change.

Statistics Canada also produces a second, less known poverty measure, the low-income measure (LIM). The LIM thresholds – adjusted for family size only – are set at half the relevant after-tax median income. Since median income changes annually, so too do the LIM thresholds. The LIM poverty rate is a “relative” measure that includes those with incomes substantially below the income of the typical (median) Canadian.

Whether measured by LICO or LIM, poverty rates for elderly and lone parent families, two groups historically at high risk of poverty, have declined substantially over the past three decades (Figure 1). However, the causes for these declines are different. Higher transfer income has been central to lowering poverty among the elderly, while the decline in lone-parent family poverty has coincided with higher market incomes despite lower government transfers.

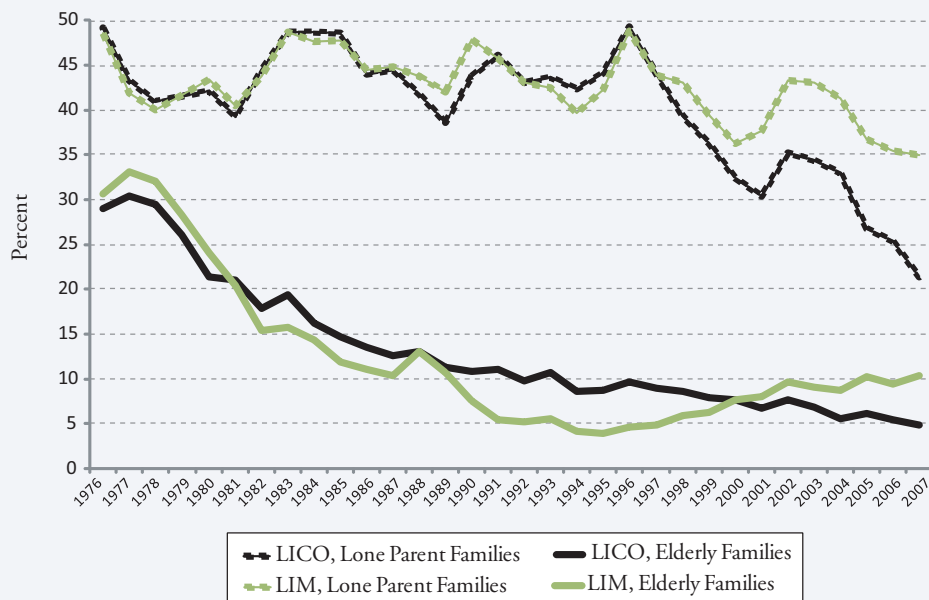
From the mid-1970s to the mid-1990s, the lone-parent poverty rate ranged between 40 and 50 percent, based on either the LICO or LIM. The rate rose during recessions and declined during periods of employment growth, without any evident longer-term trend. From 1996 to 2007 (the latest year of available data), the lone-parent poverty rate fell by 28 percentage points in terms of the LICO and by 14 points in terms of the LIM.

Trends in after-tax income also illustrate, over this 1996-to-2007 period, the improved fortunes of lone-parent families (Table 1). The great majority of these families, 82 percent, are headed by women.² During these years, their annual after-tax income rose on average by more than \$12,000. The proximate reason was the increasing employment rate among members of such families. Between 1996 and 2007, the share of female-led, lone-parent families with no earners fell by more than half (Figure 2).

I owe Brian Murphy more than the standard acknowledgement for help in preparing this monograph. I do not implicate him in my interpretation of trends in lone-parent poverty and the use of poverty measures, but without his advice and critique of earlier drafts, this *Commentary* would not have been possible. Thanks also for comments by Jonathan Kesselman, Colin Busby and anonymous reviewers.

- 1 As defined by Statistics Canada, after-tax income comprises market income plus government transfers less personal income tax.
- 2 The total number of lone-parent families remained nearly constant over the years under review. Approximately 575,000 of 700,000 such families are headed by women.

Figure 1: Lone-Parent and Elderly Family After-tax LICO and LIM Poverty Rates, 1976-2007



Source: Statistics Canada (2009), preliminary data.

Table 1: Average Lone-Parent Family Incomes, Canada, 1996 and 2007

	1996	2007 (2007 constant dollars)	Change
Lone-parent families, all			
1. Market income	21,883	37,200	15,317
2. Transfer income	10,629	9,400	-1,229
3. Total income (1 + 2)	32,512	46,600	14,088
4. Personal income tax	3,439	4,800	1,361
5. After-tax income (3 - 4)	29,073	41,800	12,727
Lone-parent families, female			
6. Market income	18,653	33,100	14,447
7. Transfer income	11,150	9,800	-1,350
8. Total income (6 + 7)	29,803	42,900	13,097
9. Personal income tax	2,709	3,400	691
10. After-tax income (8 - 9)	27,093	39,500	12,407

Source: Canada (2007b, 24,42,62); Canada (2009, 23,41,61).

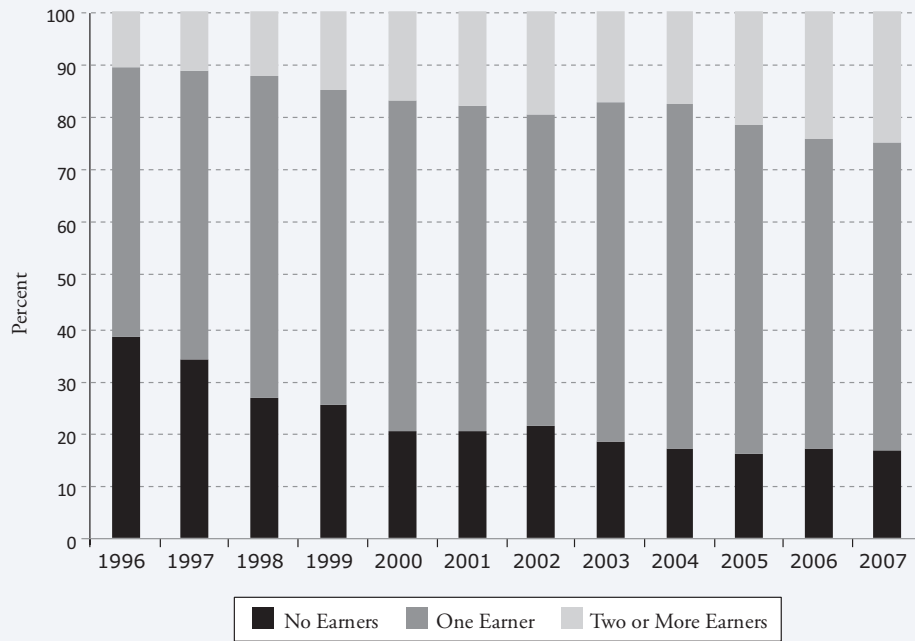
The Role of Welfare-to-work Programming

In the 1970s, approximately 5 percent of the Canadian population received general welfare provided by provincial governments. In the recession of the early 1980s, this statistic rose to more than 7 percent (Figure 3). During the subsequent economic recovery and until the mid-1990s, most provinces adopted regulations governing benefit levels and access that, by historical

norms, were very generous. Notably, this was true of Quebec under the Parti Québécois (until its defeat in 1985), of Ontario under the Liberals and NDP (1985-1995), of British Columbia under the NDP during its first term in office (1991-1995) and in most of Atlantic Canada.

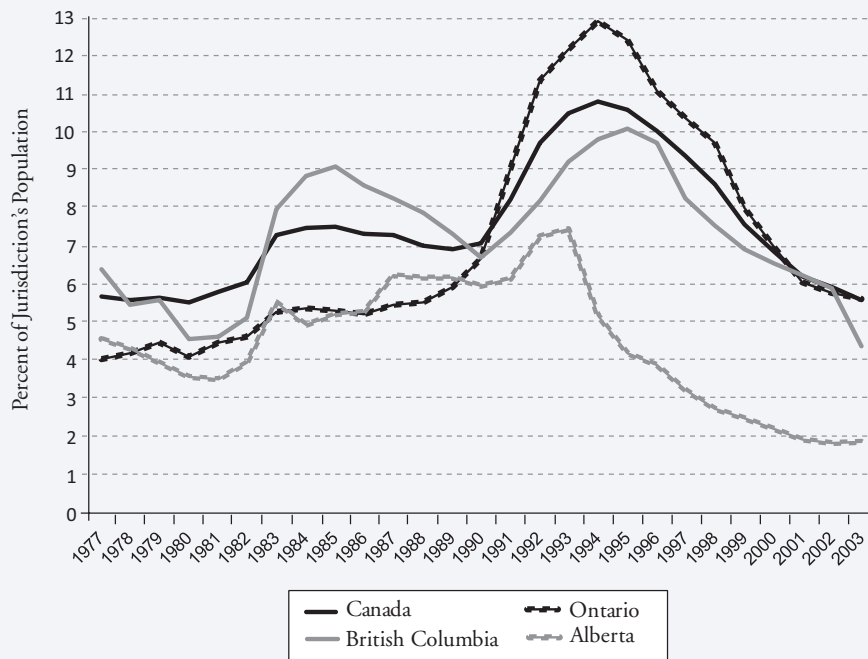
Welfare utilization declined very little over the 1980s from its recession high point of about 7 percent. In the wake of the early 1990s recession,

Figure 2: Distribution of Female Lone-Parent Families, by Number of Earners in Family, 1996-2007



Source: Canada (2007b, 113; 2009b, 114).

Figure 3: Welfare Utilization Rates, Canada and Selected Provinces, 1977-2003



Source: Author's calculations from Canada (2007a).

welfare utilization spiked, peaking in the mid-1990s at more than 10 percent of the Canadian population. Utilization has subsequently returned to rates prevailing in the 1970s.

The basic reason why Canadian welfare utilization fell in the late 1990s – whereas it did not in the 1980s – is that senior officials in the majority of provincial social service ministries concluded that generous welfare access risked creating a serious problem of intergenerational welfare dependency. This shift in policy was most evident in Alberta, British Columbia and Ontario (Figure 3). These three large provinces reduced the real value of welfare benefits and exercised much more rigorous discretion in assessing eligibility among those without mental or physical disabilities (Kneebone and White 2009). Lone-parent families were a large component of the welfare caseload impacted by the new regulations. In British Columbia, for example, welfare beneficiaries in 1995 who were simultaneously members of such families accounted for 151,000 out of 341,000 “temporary assistance clients”; by 2008, the comparable statistic had fallen to 28,000 (BC 2010).

The advent of the National Child Benefit System (NCBS) was a second major policy shift to induce low-income family members to enter the labour market. Introduced by Ottawa in collaboration with the provinces in 1998, the system functions as a negative income tax. The threshold at which clawing back of the transfer begins has been set above \$20,000 in annual family earnings. Since the provinces did not intend for the NCBS to increase transfer income for welfare recipients, most offset the transfer by lowering welfare benefit schedules dollar-for-dollar. As a result, the NCBS has enabled low-income families to exit welfare at lower earnings levels, while retaining significant non-welfare transfer income in the “near poor” \$15,000 – \$35,000 market income range.³

Several other measures contributed to an increase in labour market participation among lone-parent families. In the mid-1990s, Ottawa undertook significant changes to the unemployment insurance program, the effect of which was to reduce access by repeat users and seasonal workers. Until then, Canada had been among the most generous OECD countries in terms of access to benefits (Kerr 1999). Other initiatives of note are more generous child care support (particularly in Quebec) and supplements (in some provinces) to low earnings, variable by number of dependent children. In 2007, Ottawa introduced a nationwide earnings supplement, the Working Income Tax Benefit, a refundable tax credit for low-income wage earners to encourage them to remain or enter the workforce.

Why Pursue Welfare-to-work Policy?

Despite the above initiatives, transfers inevitably remain a major income source for the poor. In the mid-2000s, market income (earnings plus investment income) and government transfers comprised roughly equal shares of income among below-LICO-level families aged 25-64. By far, the most important transfer is provincial social assistance,⁴ (Table 2).

An obvious question to pose is, “Why should governments aggressively attempt to induce substitution of market income for transfer income among the poor?” In other words, “Why is a dollar of earnings more valuable than a dollar of transfer income?” There are at least four answers:

- Earnings provide households with independence from the vagaries of regulations governing transfers and from the discretion in interpreting them by social workers. An adult working full time, even at low wages, brings him or her – unless children are involved – above standard poverty thresholds.⁵

3 A problem created by the NCBS and other targeted income transfers is the imposition of very high marginal effective tax rates on the “near poor” family income range of \$20,000 – \$40,000 (Poschmann 2008).

4 Table 2 underestimates transfer income inasmuch as it does not capture the value of various in-kind transfers such as government subsidies for child care.

5 For example, the 2007 after-tax LICO in an urban centre with a population above 500,000 was \$17,954 for a single person, \$21,851 for a family of two. Working 40 hours/week for 48 weeks (equal to 1,920 hours/year), the wage rate required to assure an income above these LICO values was \$9.35 for one person and \$11.38 for a lone parent with one child. These calculations assume no income tax liability or transfer income.

Table 2: Income by Source among Working Age Families with Below-LICO Incomes, Ages 25-64, Canada, 2004

	Negligible or No Earnings	Some Earnings	All
	<i>(percent)</i>		
Earnings	0.8	66.6	43.2
Transfers	83.3	28.9	48.2
Federal	27.7	19.0	22.1
National Child Benefit	6.1	8.1	7.4
EI	1.5	5.1	3.8
OAS/GIS/SPA	1.1	0.2	0.5
CPP/QPP	11.8	2.4	5.7
GST Credit	7.2	3.1	4.6
Provincial	55.6	9.9	26.1
Social Assistance	50.4	6.9	22.3
Family Programs	0.7	1.0	0.8
Tax Credits	3.4	1.6	2.3
Investment Income	6.2	0.5	2.5
Private Pensions/Alimony/Other	9.7	4.0	6.0

Notes: Earnings refer to wages and salaries from paid employment, plus income from self-employment. The population includes families with incomes below after-tax LICO and no one aged 65 and over.

Source: Statistics Canada special tabulation, SPSD/M, Version 16.1.

- The role model effect of a working parent increases the probability that children complete high school and avoid teenage pregnancy, two strong indicators of intergenerational escape from poverty. This effect exists even among lone-parent families where parental employment may reduce time for parenting.⁶
- For the first time in history, the poor are more obese than the rich, at least in industrialized countries such as Canada. Employment induces a more active lifestyle than that associated with reliance on transfer income. Accordingly, employment makes a contribution to reducing the incidence of lifestyle diseases (such as adult-onset diabetes) linked to obesity (Cutler et al. 2003).
- Finally, prolonged unemployment and dependence on transfer income is associated with psychological depression and increased rates of self-destructive behaviour, including suicide, notably among men (WHO 2004).

Another consideration: policy shifts interact with macroeconomic conditions. From the end of the early 1990s recession until the onset of the 2009 recession, Canada experienced a prolonged period of nearly uninterrupted economic prosperity. A supplementary question worth addressing is, “How much credit do macroeconomic conditions deserve in explaining the post-1996 decline in lone-parent poverty?”

One way to answer this question is to compare the impact of a buoyant labour market on poverty rates in the 1980s with that in more recent years. The best single proxy for the impact of macroeconomic conditions on poverty is probably the employment rate, not the unemployment rate. The concept underlying the unemployment rate – without a job, but actively seeking work – is not relevant to many among the poor whose labour market attachment may be tenuous. Regressions (1) and (2) in Appendix 1 analyze lone-parent LICO poverty rates on the unemployment and employment rates over the three decades. The latter has a higher explanatory potential.

⁶ Among the best surveys of the literature on intergenerational explanations of poverty is Haveman and Wolfe (1995).

Regression (3) illustrates the much higher potential of a buoyant labour market to lower lone-parent poverty post-1996 relative to its impact during the 1980s' economic expansion.⁷ In the 1980s, the employment rate rose from a trough in 1983 to a peak in 1989; the second employment rate increase started from a 1996 trough. Regression (3) implies that a one-point increase in the employment rate from 1996-2007 led to a decline in the LICO poverty rate of 4.31 points, whereas a one-point increase in the 1983-1989 period led to a much smaller decline of 1.86 points. If a rising employment rate had had the same impact post-1996 as in the 1980s, the lone-parent poverty rate would have declined post-1996 by 9.5 points. The actual estimate of the joint impact of rising employment rate and social policy is 22.0 points.⁸ This evidence is far from definitive but it is consistent with the conclusion that post-1996 welfare-to-work policies were much more effective in reducing poverty rates than their 1980s' equivalents.

International Comparisons: the Red Queen and Rising Complexity of Realizing Poverty Reductions

There is a strong case that post-1995 welfare-to-work policies, together with favourable labour market conditions, were effective in lowering Canada's lone-parent poverty rate in recent years. That said, the trends in Canadian poverty overall are less optimistic. While the all-person LICO poverty rate did decline over the past decade, the decline was unexceptional in international terms (as will be discussed below).

Meanwhile, the all-person LIM rate has been essentially static over the past three decades (Figure 4). It averaged 12.8 percent between 1976 and 1985, declined slightly in 1986-1995 to 11.6 percent and increased between 1996 and 2007 to again average 12.8 percent. Canada's LIM poverty rate in mid-2000s was well above the OECD average.

The optimistic interpretation here is that, like Alice and the red queen, our social policy prevented the LIM poverty rate from worsening. ("In our country," observed Alice after running with the queen, "you'd generally get to somewhere else – if you run very fast for a long time, as we've been doing." The queen replied, "Now, here, you see, it takes all the running you can do to keep in the same place.")

Between 1976 and 2006, the distribution of Canadians' market incomes became more unequal. The bottom two deciles declined (about 10 percent each). The fifth decile, the median, rose modestly (by 12 percent). The largest percentage increases (over 20 percent each) took place in the eighth and ninth deciles (Myles 2010, Figure 1; Boudarbat et al. 2006). The most plausible explanation for the declines in the bottom deciles is technological change favouring knowledge-intensive jobs, combined with rising competition from export-oriented manufacturing sectors in successful developing countries such as China and India. Furthermore, it appears that people over this period became more likely to partner with like – husbands with low earnings became more likely to partner with low-earning wives, husbands with high earnings with high-earning wives (Myles 2010).

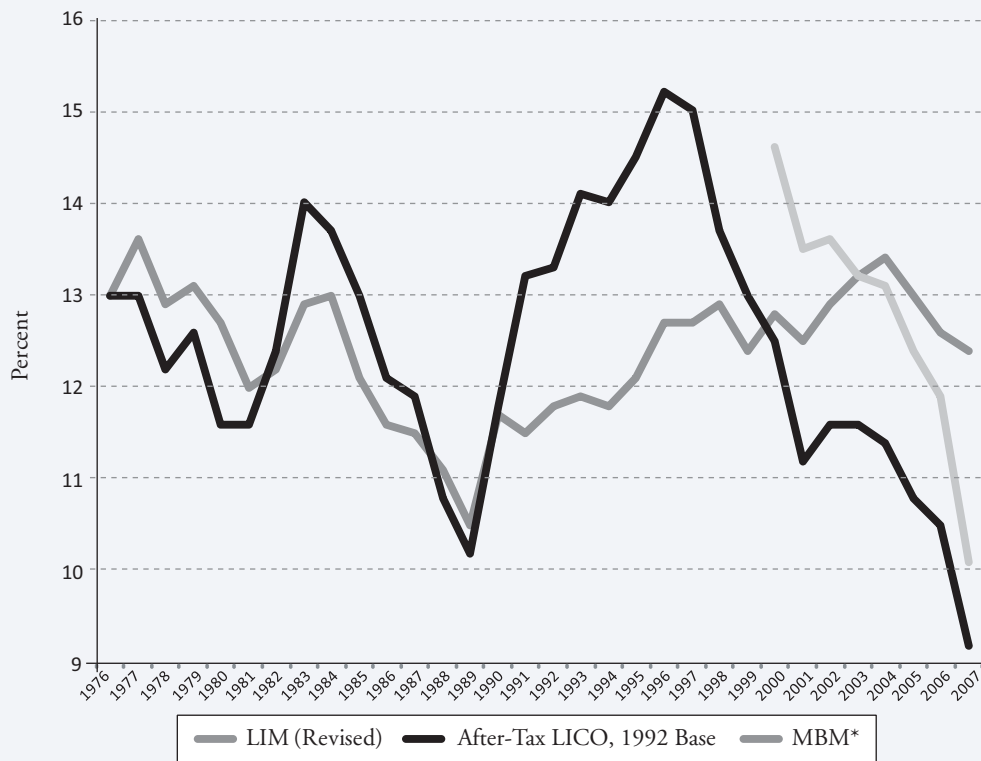
In an ambitious recent survey of income distribution in member countries the OECD (2008) compared changes in "absolute" poverty by first defining a fixed real-income threshold for each country – half its median income in 1995.⁹ Adjusting thresholds for the respective country's price changes over the subsequent decade, the OECD estimated a country's population share below this "absolute" poverty threshold in 2005. The ratio of the two poverty rates yields the statistics reported in Figure 5 for all countries other than Canada. In one, Germany, there was an increase in the absolute poverty rate. In all others, the ratio is below one, implying a decrease.

7 Regression (4) repeats the above exercise using LIM as opposed to LICO lone-parent poverty rates. Similar results arise inasmuch as the employment rate induced a larger decline in the LIM from 1996-2007 than from 1983-1989, although the ratio of the two coefficients is smaller than using the LICO.

8 Between 1996 and 2007 the Canadian employment rate rose by 5.1 percentage points. Based on the two coefficients, the impact on lone-parent LICO poverty rate is a reduction of either 9.5 points (= 5.1 x 1.86) or 22.0 points (= 5.1 x 4.31).

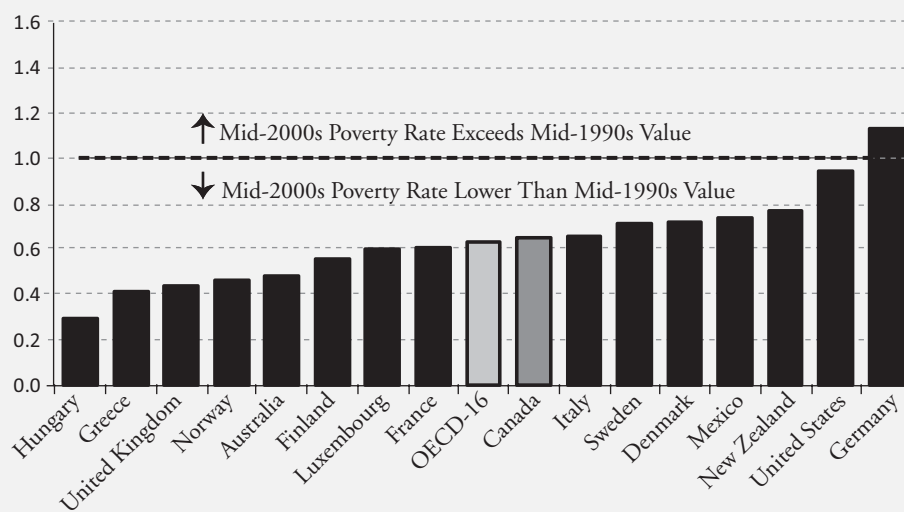
9 By construction, the fraction with incomes below the threshold was the country's 1995 LIM poverty rate.

Figure 4: All-Person Poverty Rates, Canada, 1976-2007



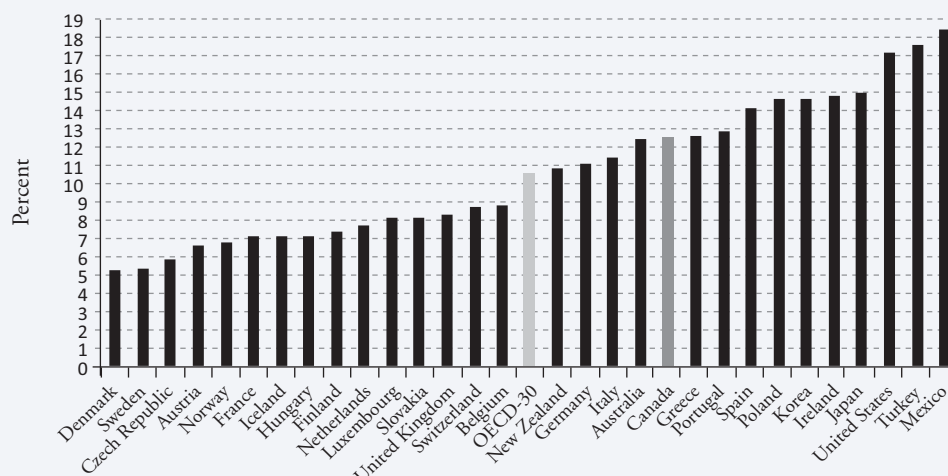
*Market Backed Measure is a third poverty measure. See definition in Appendix p.13.
Sources: Statistics Canada (2009), preliminary data; Canada (2009c).

Figure 5: Absolute Poverty Rates: Ratio of Mid-2000s Value Over the Mid-1990s Value, 16 OECD Countries



Sources: OECD (2008, Figure 5.4); Statistics Canada (2009), preliminary data.
Note: For all countries except Canada, the ratio is the share of residents whose mid-2000s incomes fell below the respective country's mid-1990s half-median real income, adjusted for inflation. The Canadian statistic is the ratio of the average 2006-2007 after-tax LICO poverty rate to the analogous 1996-1997 average.

Figure 6: Relative (LIM) Poverty Rates, 30 OECD Countries, mid-2000s



Sources: OECD (2008, figure 5.1) for all data except Canada. Canadian statistic is 2006-2007 average of revised LIM data series.

The OECD did not include Canada in this exercise, but comparing the ratio of the average LICO poverty rate in 2006-2007 to 1996-1997 is a comparable exercise. Over these years, the LICO income thresholds were constant in real terms. Canada’s “absolute poverty” rate in the mid-2000s was 65 percent that of a decade earlier, a decline close to the OECD average. However, Canada’s “relative poverty” (LIM) in the mid-2000s was two percentage points higher than the OECD average (Figure 6).

Rather than compare ourselves to the OECD average, perhaps the more relevant comparison for Canada is to the UK, a country with a similar single-payer health insurance system, a similar mix of transfer income plus welfare-to-work policies and a similar relative size of government. Canada does not fare well in such a comparison. The UK achieved a mid-2000s LIM poverty rate of 8.3 percent, fully 4.2 points below Canada’s. Over the past decade, the UK also lowered its absolute poverty rate by 56 percent, compared to Canada’s 35 percent decline (Figure 5).

Concluding Observations

Despite past successes, Canada may well have reached the limit of welfare-to-work policy as means to reduce poverty – at least in Ontario, Alberta and British Columbia. In these provinces, most people whose incomes remain below the LICO threshold present complex problems. For

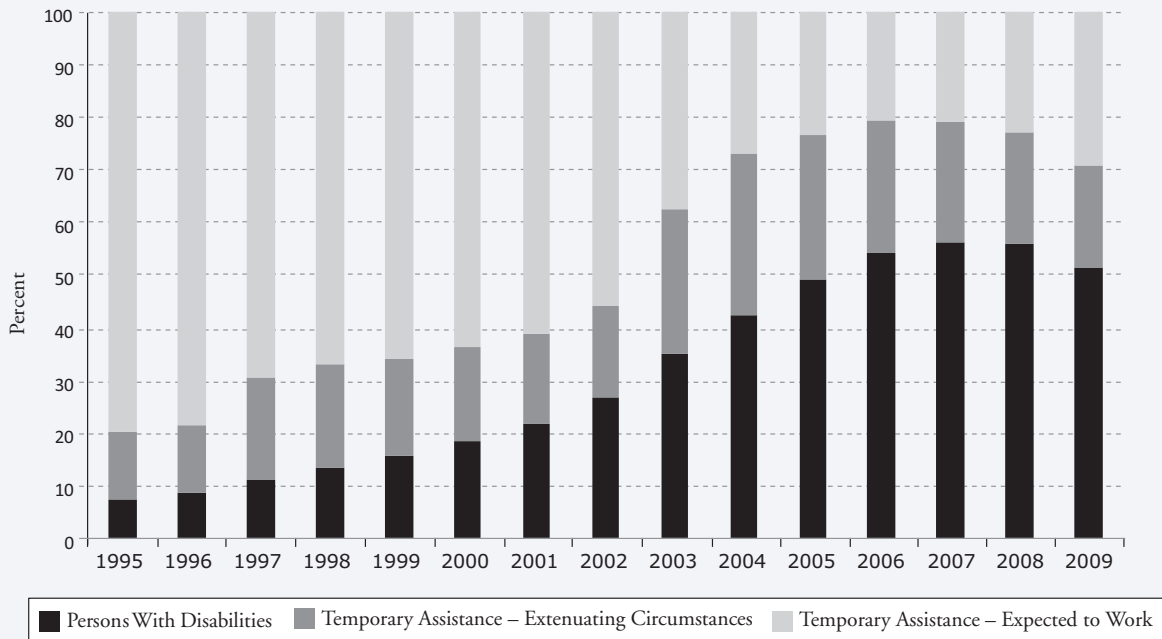
these people, increasing fiscal incentives to enter the labour market and restricting access to transfer income are unlikely to achieve much.

As evidence, consider the evolution of provincial welfare rolls in British Columbia, both the count and the distribution across administrative categories (Figures 7 and 8). Not all welfare recipients have incomes below the relevant LICO, and not all people below LICO-income levels receive welfare. However, welfare caseloads comprise a large subset of the poor, and social assistance is by far the most important government transfer for the working-age poor.

While the recent recession has increased somewhat the number and share of BC “expected-to-work” recipients, the number of 2009 welfare recipients remained less than half the comparable 1995 statistic. Having drastically reduced the expected-to-work category, the province has acknowledged more adequately the importance of physical and mental syndromes leading to poverty. The “persons-with-disabilities” category has tripled in number, expanding from less than 10 percent to more than 50 percent of the total. Among “persons with disabilities,” there are multiple reasons for poverty that cannot be addressed by typical welfare-to-work programs. Here, a prosperous society should be prepared to spend generously.

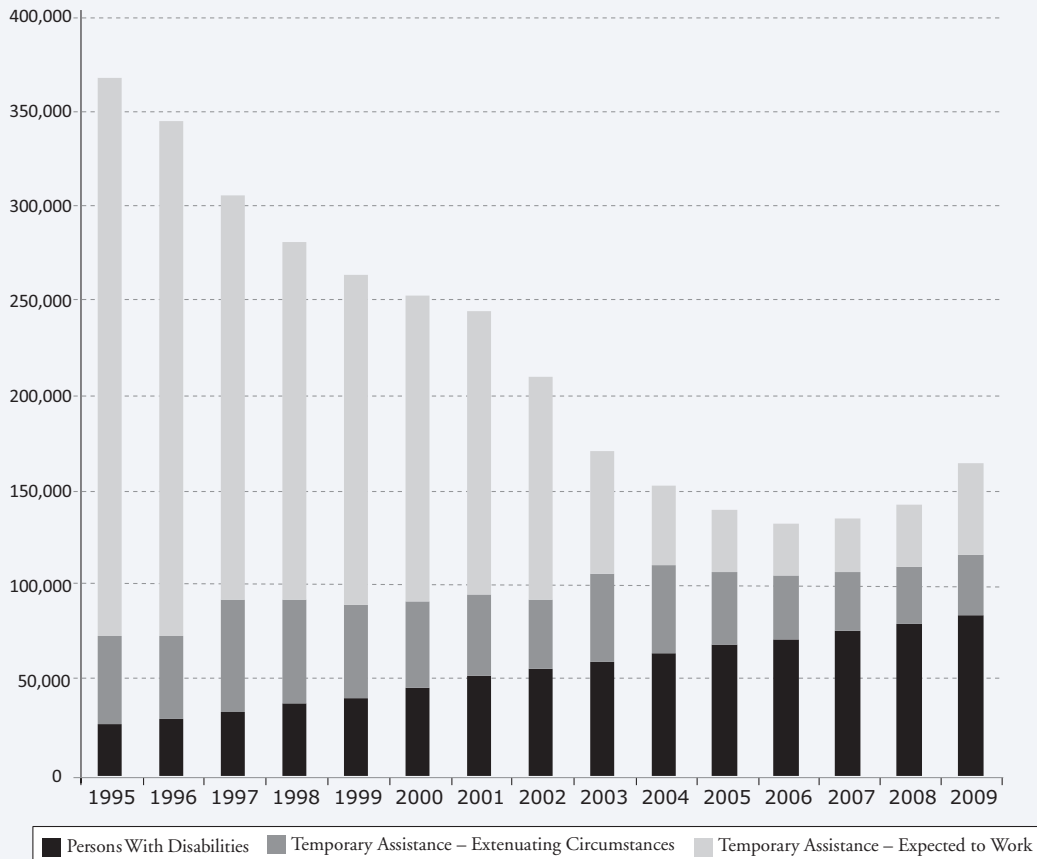
Among those classified as disabled, an illustrative subset is the urban homeless. Starting in the 1970s, states and provinces undertook “deinstitutionalization” of psychiatric patients. By

Figure 7: Distribution of British Columbia Social Assistance Beneficiaries, by Administrative Categories, 1995-2009



Source: British Columbia (2010).

Figure 8: Number of British Columbia Social Assistance Beneficiaries, by Administrative Categories, 1995-2009



Source: British Columbia (2010).

the 1990s, NIMBY (not in my backyard) dynamics created neighbourhoods in many North American cities characterized by high concentrations of homeless, the majority suffering from mental illness and addictions. From New York City to Vancouver, many engaged with this population have advocated “housing first” as policy – the provision of reasonable quality housing plus intense services with no prerequisites in terms of client behaviour (Padgett et al. 2006).

Linked to this strategy are “community courts” in which those accused of minor crimes sacrifice due process by pleading guilty in exchange for enhanced access to social services. The housing first initiative is expensive: in British Columbia, approximately \$40,000 per person annually (Creighton et al. 2010). While recidivism is high, it may well be that per-client government costs are less than the avoided costs associated with the status quo: higher costs of legal interventions, higher costs of emergency hospital services and higher criminal damage costs.¹⁰

Nevertheless, there remain many low-income Canadians who, if they apply for provincial welfare, are classified as “expected to work.” Among this group, the key long-term policy goals are to discourage formation of families without stable partners and dropping out of high school. Lone-parent poverty may have declined dramatically, but the probability of a lone-parent family member living below the LICO poverty threshold in 2007 was still four times that of someone in a two-parent family with children – 21.3 percent compared to 5.1 percent (Canada 2009b).

Independent of lone-parent family formation, dropping out of school also carries a high probability of future poverty. Based on the 2006 census, adults without high-school certification are roughly 1.5 times more likely than those with high school, and twice as likely as those with a trade certificate, to report an after-tax income below the unattached individual LICO.¹¹

Despite intergenerational progress in high-school completion rates, dropouts remain disturbingly high among large groups of young adults. The youngest age cohort for which it is reasonable to expect completion of secondary studies is that aged 20-24. Across Canada, the best results in this age cohort are among women in Ontario and British Columbia, where the incomplete high-school rate at the time of the 2006 Census was under 10 percent. By contrast, among francophone Quebec men in this cohort, the comparable rate was nearly 20 percent, and among those who identified as Indian/First Nation, the high-school incompleteness rate was nearly 50 percent. Better education outcomes among such groups is an obvious priority, but one not easy to realize.

Welfare-to-work programming is no panacea. It does not resolve the policy dilemmas posed by the urban homeless. However, such programming has produced benefits. Large reductions in lone-parent poverty demonstrate that the generous social assistance regimes pre-1995 were a bad investment from the perspective of both the poor and taxpayers.

10 Most of the experimentation with “housing first” has been in the United States. Ottawa has recently funded the Mental Health Commission of Canada (MHCC 2009) to research the potential of “housing first” strategies in five Canadian cities.

11 The LICO threshold for these calculations is \$14,562 for an unattached individual in cities of population 100,000 – 500,000. See the calculation undertaken in Richards (2009). The census statistics cited in this paragraph all derive from the same publication.

Appendix 1		Poverty and Employment Rates: Regression Results, 1976-2007, annual			
Regressand	Lone-parent families LICO Poverty Rate (1)	Lone-parent families LICO Poverty Rate (2)	Lone-parent families LICO Poverty Rate (3)	Lone-parent families LIM Poverty Rate (4)	
	<i>(percentage points)</i>				
Constant	13.24**	212.16**	71.57*	14.70	
Unemployment rate, 1976-2007 (percent)	3.13**				
Employment rate, 1976-2007 (percent)		-2.87**			
Employment rate, 1976-83, 1990-95 (percent) (ER x [1 - Index 1983-1989 - Index 1996-2007])		-0.48	0.49		
Index, 1983-89 (1983-1989 = 1, elsewhere = 0)			84.05*	101.03*	
Employment rate, 1983-1989 (percent) (ER x Index 1983-1989)		-1.86**	-1.18*		
Index, 1996-2007 (1996-2007 = 1, elsewhere = 0)		226.99**	138.74**		
Employment rate, 1996-2007 (percent) (ER x Index 1996-2007)		-4.31**	-1.84**		
R2 adjusted	0.51	0.63	0.86	0.51	
Legend * 0.05 significance (one-tail) ** 0.005 significance (one-tail)					
Note: All regressions are Ordinary Least Squares (OLS). Number of observations is 32. The 1983-1989 interval encompasses the years of sustained rising employment rate in the 1980s. The 1996-2007 interval encompasses the comparable years of sustained rising employment rate following the early 1990s recession. Data source: Statistics Canada.					

Appendix 2 A Primer on Poverty Measures and a Modest Suggestion

Poverty is at once a simple idea - people are poor if they cannot afford what most others can - and a very complex one. A fulsome analysis would encompass income handicaps arising from physical or mental disabilities and from a lack of education. It would assess the depth of poverty (given the income threshold used to define poverty, how far below it are those deemed poor?), its duration (how many of the current poor are facing an exceptional crisis or have endured long-term or frequent bouts of poverty?) and potential to be economically independent (what share of income among those at risk of poverty derives from market income as opposed to government transfers?). On the other hand, there exists a public demand for readily understood measures of the extent of poverty and of its trend over time

Currently, the Canadian government defines three poverty thresholds and publishes poverty rates arising from two of them.

Low-income Cutoff (LICO)

On average, Canadian households in 1992 spent 43 percent of after-tax income on the necessities of shelter, food and clothing. Members of a household are deemed poor if, given the size of their household and size of the community in which they live, they expect to spend at least 20 percentage points above average on these necessities. At the time of the 1992 rebasing, the LICO income thresholds were set such that families with incomes below them could expect to spend 63 percent or more of their after-tax income on these three essentials. Calculating the thresholds was derived by a regression analysis that estimates share of income devoted to necessities as a function of household income, family size and population of city or rural community.

The combination of Statistics Canada's seven household- and five community-size intervals generates 35 LICO thresholds. Adjusting for household size accommodates scale economies from living in larger families. Adjusting for community size to some extent accommodates

the inherently higher cost of living, particularly of housing, associated with larger cities. Beyond the community-size adjustment, LICO thresholds do not reflect cost differences across Canada in prices of goods or services.

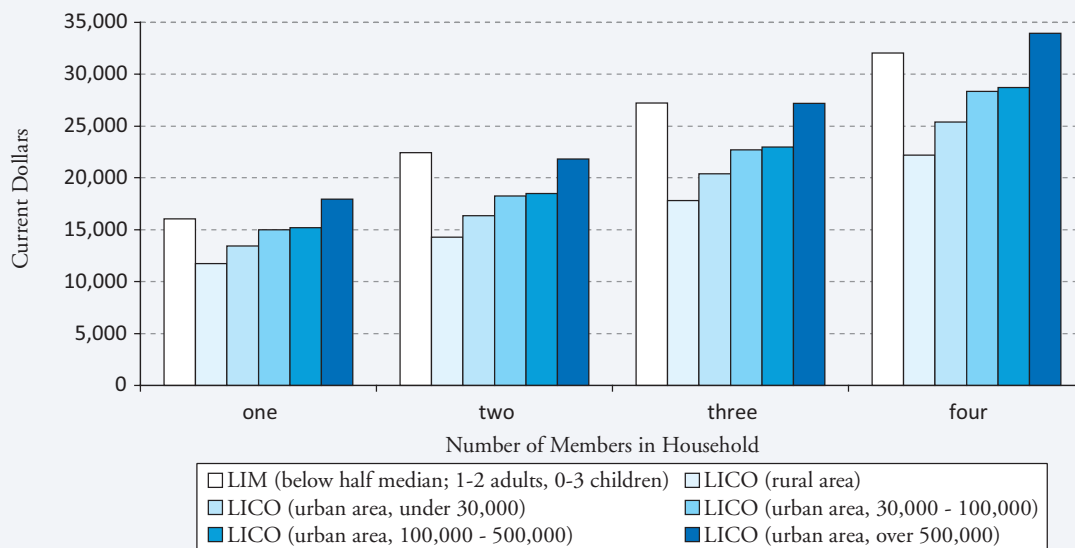
Using the same criterion and methodology, Statistics Canada also previously arbitrary. Why not 30 points, or 40 points? And should all expenditures on housing (summer cottages), food (fancy meals on special occasions) and clothing (high-end women's fashion) be included as necessities?

The most recent LICO rebasing exercise took place in 1992. Subsequently, these 1992-based thresholds have been adjusted annually by changes in the consumer price index. Therefore, the LICO is a "relative" poverty measure inasmuch as the base has been adjusted at intervals to reflect average expenditure patterns among all Canadians. Between rebasing exercises, the LICO becomes an "absolute" poverty measure. To speak of the LICO poverty rate rising or falling in the time series illustrated in this Commentary is to refer to changes in the fraction of people whose incomes are below one of 35 constant real-income thresholds defined in 1992.

Low-income Measure (LIM)

Statistics Canada calculates – but does not regularly publish – a second poverty rate, the low-income measure (LIM) rate, employing the criterion that members of a household are poor if their incomes are sufficiently far below median family incomes adjusted for family size. Since this criterion is readily applied internationally, it is widely used in comparing poverty rates among countries. The LIM is a "relative poverty" measure: members of a household are poor if their incomes fall below a specified fraction (usually 50 percent) of median household income for a particular year. Poverty rates based on this criterion make no attempt to determine what goods and services are necessary to escape poverty.

Figure A1 Sample LIM and Lico After-Tax Thresholds, 2007



Source: Canada (2009a).

Market Basket Measure (MBM)

Over the past decade, the federal Department of Human Resources and Skills Development (HRSD) has promoted a third poverty measure, based on a detailed assessment of a basket of goods and services deemed essential to a four-person family composed of two adults and two children (Canada 2009c). The MBM calculates this basket in major cities and, as with the LIM and LICO, applies an equivalence scale to accommodate scale economies of larger households.

At the national level, the MBM has closely tracked changes in the after-tax LICO, but on average has been 1.7 percentage points higher. Once disaggregated, some major anomalies emerge between the LICO and MBM. For example, Quebec’s MBM poverty rate is well below its LICO poverty rate because housing costs are lower, particularly in Montreal, than in other large cities with populations over 500,000.

The virtue of the MBM is to cost necessities precisely. This virtue is also its weakness: there is no transparent rationale for what is included in

the “basket.” Its construction depends on multiple professional judgments, many of which are opaque. As indication of the decisions required to construct the MBM, the food component specifies weekly volumes for more than 60 items - from cheddar cheese to turnips. For cities deemed not to have adequate public transit, the MBM includes the estimated cost of maintaining a five-year old Chevrolet Cavalier. Substituting a six-year old Chevrolet Cavalier would lower the MBM threshold by \$900 (Canada 2009c, Appendices A and B).

By defining the basket precisely, the MBM minimizes the role of choice. For example, if two households are identical in all respects except that one lives in Montreal and the other in Vancouver (both of which are in the same LICO community-size interval), the LICO criterion implies both are either poor or not poor. The MBM might well designate the Vancouver household poor and the Montreal household not. (Montreal’s MBM 2007 threshold for the reference four-member household was \$26,600, Vancouver’s \$31,800. The difference arises primarily due to

Vancouver's higher rents.) However, to differentiate here ignores what may be a conscious household choice of Vancouver over Montreal. If the choice of city of residence is explicit – based, for example, on job or school prospects – it makes little sense to label one household poor and the other not.

In considering the conundrums posed in defining poverty measures, two fundamental questions arise.

1. Should households be deemed poor if “most or all income must be spent on essentials” or if “income is significantly below the median”?

Each rationale has been used in defining poverty thresholds. The LICO and MBM rely on the first: a household is poor if it requires most or all of its income to purchase what some agency – Statistics Canada for the former, HRSD for the latter – concludes to be essential goods and services. The LIM relies on the second rationale: members of a household are poor if their income is significantly below the income available to the typical citizen of the country.

The second rationale is ultimately the more defensible. Defining essential goods and services in order to construct the LICO or MBM, or defining the fraction of median income for the LIM, inevitably entails somewhat arbitrary judgments. The virtue of the second rationale is transparency and simplicity. It is impossible to reach consensus on what constitute the essentials in the “basket.”¹² It is easier to conduct a public discussion on the parameter used to define the LIM thresholds. Also, it is feasible to define several LIM poverty rates, using thresholds set at, say, 40 percent, 50 percent and 60 percent of median income.

2. Should poverty measures be “absolute” or “relative”?

Between exercises in rebasing, both the LICO and MBM are “absolute” measures inasmuch as their respective poverty thresholds are fixed in

real terms independent of trends in the median or other statistics defining the aggregate income distribution. If the benchmark remains unexamined for long periods (say several decades), its credibility as a measure of income required to purchase essential goods and services becomes dubious. By construction, the LIM avoids the conundrums of periodically redefining cultural expectations concerning essentials; it “rebases” annually.

However, a relative measure that rebases annually poses other problems. One application of a poverty measure is in assessing trends over the medium term (of five to 10 years) in the fraction of a particular population (such as lone-parent families) below a particular “absolute” threshold unchanged in real terms. If governments implement new policies, one measure of success is that the income distribution of the targeted population shift, say a smaller fraction falls below an absolute income threshold. Provided the absolute benchmark is more-or-less reasonable, it matters little what it is. What matters is to use a constant threshold over time.

Annual rebasing, implicit in the LIM, can generate perverse outcomes. During a recession, median income falls and with it the value of LIM thresholds. Those with low incomes depend disproportionately on transfer income, an income source that in the short run will usually be more stable than market income. During a recession, real incomes among those below the LIM threshold may well fall, but by proportionately less than the median. Hence, recessions appear to be a means to combat poverty. Consider the divergence between elderly family poverty as measured by the LICO and LIM in Figure 1. During the early 1990s recession, the poverty rate was roughly constant as measured by the LICO; it fell by half according to the LIM.

12 In 2000, Statistics Canada invited a range of statisticians and social policy experts to discuss potential rebasing of the LICO. Cotton and Webber's (2000) summary of the ensuing disagreements is a sobering illustration of the difficulties in reaching consensus on what should define essentials. Squires and White (2006) undertake an equivalent exercise for the United Kingdom.

A Simple Suggestion

The LIM provides a more readily understood poverty measure than either the LICO or MBM, and Statistics Canada could readily publish annual LIM poverty rates. The LIM is a “relative” measure. To satisfy the need for an “absolute” measure, Canada could adopt the procedure employed by the OECD (see discussion in text). At regular intervals of, say, 10 years, Statistics Canada could declare the current LIM thresholds as the benchmark against which “absolute” poverty will be reported for the following decade. In due

course, the LICO and MBM would, hopefully, fade from consideration, thereby saving the time currently devoted to divining what Canadians consider to be essential goods and services.

By a simple adjustment to the LIM, it is also possible to address, somewhat, the concerns of MBM advocates who want regional price differences acknowledged in construction of poverty measures. If the Montreal price level is lower than the national average and Vancouver’s higher, a regional adjustment would set lower nominal Montreal LIM thresholds than in Vancouver.

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