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Social Policy

Reducing Poverty:

*What has Worked, and What
Should Come Next*

John Richards

In this issue...

Anti-poverty initiatives over the last decade have lifted many people out of poverty, mainly through improved employment rates. To make further progress in tackling poverty, targeted interventions are in order that draw on past policy successes.

The Study in Brief

Canada's declining poverty rate over the last decade is evidence of substantial social policy success, which should be reflected in future policy approaches to battling poverty.

Over the last decade, Canada's unemployment rate has fallen; the employment rate has risen; and the overall poverty rate has declined. While not all is right with Canadian social policy, these trends suggest that some things are going well. A combination of favourable labour-market changes and effective policy changes has had a beneficial impact on poverty in Canada. In particular, the link between Canada's rising employment rate and falling poverty rate over the last decade has been very strong.

The impact on employment among those at high risk of incurring poverty should always be a criterion for assessing proposed policy reforms, and policies that embody powerful incentives to enter the labour market usually make sense. For instance, the introduction of new provincial welfare protocols probably explains much of the last decade's increase in the employment rate among groups with high rates of poverty. At the heart of new protocols has been a stricter exercise by social workers in judging whether a welfare applicant is or is not employable. Admittedly, making these judgments is prone to error, and good welfare policy means much more than restricting access among those classified as employable. However, in three of the four large provinces the changes in welfare policies and the magnitude of decline in caseloads have been dramatic.

There remain pockets of poverty across Canada that continue to be depressingly resistant to policy interventions. To the extent government policy can improve matters, refined interventions are required, not broad new transfer programs. Six dossiers that require attention: education among the poor; Aboriginal poverty; the mentally ill and physically handicapped; the ghetto poor; high effective tax rates on the "near poor"; and in-work benefits such as earnings supplements. A negative income tax for adults, as advocated by other poverty reports, would exacerbate the serious clawback disincentives to employment already facing the "near poor."

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In the 1990s, children living in poverty preoccupied social policy analysts. The high profile response was the National Child Benefit System, a negative income tax* paid by Ottawa targeting low-income families with children.¹ In this decade, adult poverty has assumed a comparably high profile. For example, the presence of an open drug market, widespread prostitution, homelessness, and mental illness in Vancouver's Downtown Eastside is a serious blot on the city's self-image. Over the last decade, the local and provincial governments have attempted many remedies — with negligible success. The most recent proposal, from the provincial government, acknowledges that deinstitutionalization of psychiatric patients, here as elsewhere in North America, has been pursued too far. The proposal is to renovate a century-old mental hospital in suburban Vancouver to accommodate and treat 1,100 mentally ill people currently living in downtown Vancouver (Cernetig 2007).

Several high-profile policy studies address the issues of adult poverty, including reports by the Toronto Task Force on Modernizing Income Security for Working-Age Adults (MISWAA 2006) and the Caledon Institute (Battle et al. 2006). These two reports propose a "new architecture" and extrapolate from the analysis of child poverty to make the case for a negative income tax as the foundation of adult anti-poverty policy. The thrust of both is to dismiss the "old architecture" as a failure. The MISWAA report (2006, 11) categorically affirms, "the income security system for working-age adults in Ontario does not work." Ken Battle (2006, 1) and colleagues "explain why current programs — especially welfare and Employment Insurance, the two core adult benefits — fail to meet the needs of working-age Canadians."

Conclusions such as these are throwing out the baby with the bathwater. To make them requires ignoring evidence of substantial social policy success in recent years. Over the last decade, the unemployment rate has fallen; the employment rate has risen; the overall poverty rate has declined.

Not all is right with Canadian social policy — certainly there is much wrong in Vancouver's Downtown Eastside. But these trends suggest that some things are going well. A combination of favourable labour-market changes and effective policy changes has had a beneficial impact on poverty in Canada.

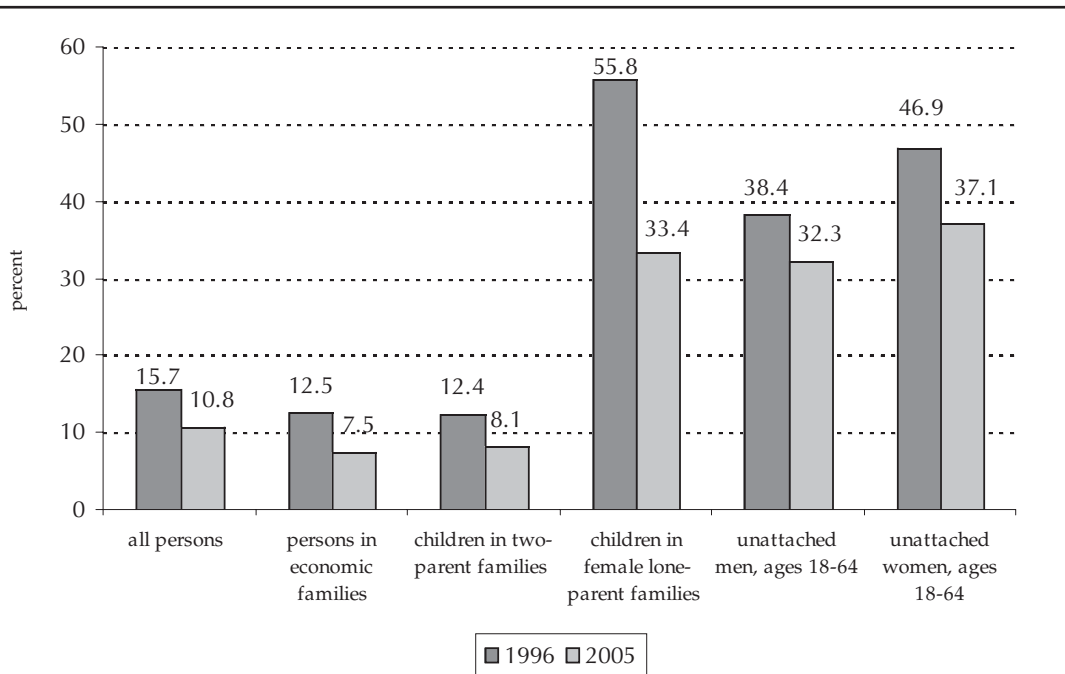
In summary, this *Commentary* proceeds as follows. The next section briefly documents trends in poverty in Canada. These include not only a notable decline in the poverty rate over the last decade, but higher median incomes among those demographic categories at the highest risk of experiencing poverty. Moreover, aggregate statistics point to a strong link between Canada's higher employment rate and lower poverty rate. There follows a comparative discussion of US and

Without implying they support the recommendations of this *Commentary*, I thank the commentators on earlier drafts: Robin Banerjee, Matthew Brzozowski, Yvan Guillemette, Jon Kesselman, David Laidler, Finn Poschmann, and Bill Robson. I also thank students in the SFU Public Policy Program class who studied the multiple problems of Vancouver's Downtown Eastside and who stimulated me to undertake this study.

* Many of the concepts used in this *Commentary* are briefly defined in a glossary. An asterisk denotes the first time a concept from the glossary appears in the text.

1 The annual cost to Ottawa of this, plus smaller related targeted programs, is now approximately \$9 billion (Canada 2007a, 283).

Figure 1: *Post-Transfer Post-Tax LICO Poverty Rates (1992 basis), by Selected Personal Characteristics, 1996 and 2005*



Source: Canada (2007c, 86).

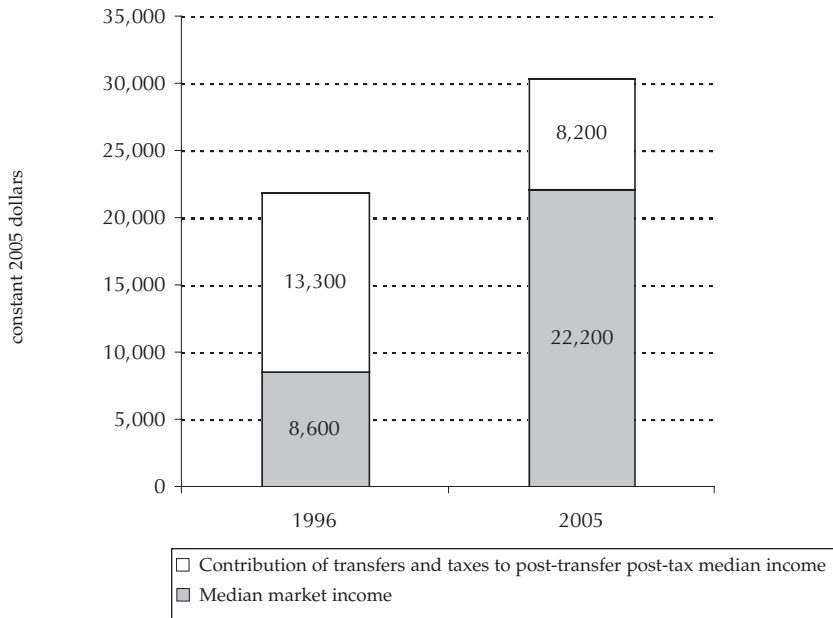
Canadian experience in welfare reform. I discuss the major strategies implemented in each country, which can be informally characterized as “soft love” or “tough love” in approach. Federal and provincial social policy reforms of the last decade were, in many instances, blunt instruments whose impacts have not been clearly assessed. This study employs simple difference-in-difference regressions to gain a tentative assessment of the importance of “supply side” shifts in welfare policy in the three provinces (Alberta, Ontario, and British Columbia) to have undergone the most dramatic shifts over the last 15 years. I conclude that to make further progress in tackling poverty, rethinking and refinement are in order. The final section introduces six dossiers in need of attention.

Canadian Poverty Trends

In terms of the low income cut off* (LICO), Canada’s traditional poverty threshold measure, poverty declined significantly over the last decade (See Figure 1). This is true for Canadians overall, and for several groups of particular concern. Between 1996 and 2005, among all Canadians, the post-tax, post-transfer LICO poverty rate fell from 16 to 11 percent. Over these nine years, the rate among children living in female lone-parent families fell from 56 to 33 percent. Among unattached men, it fell from 38 to 32 percent; among unattached women, from 47 to 37 percent.²

² See the glossary for elaboration of the LICO poverty threshold, and of income and tax definitions. As of 2005, Statistics Canada estimated 320,000 children in female lone-parent families to be ...

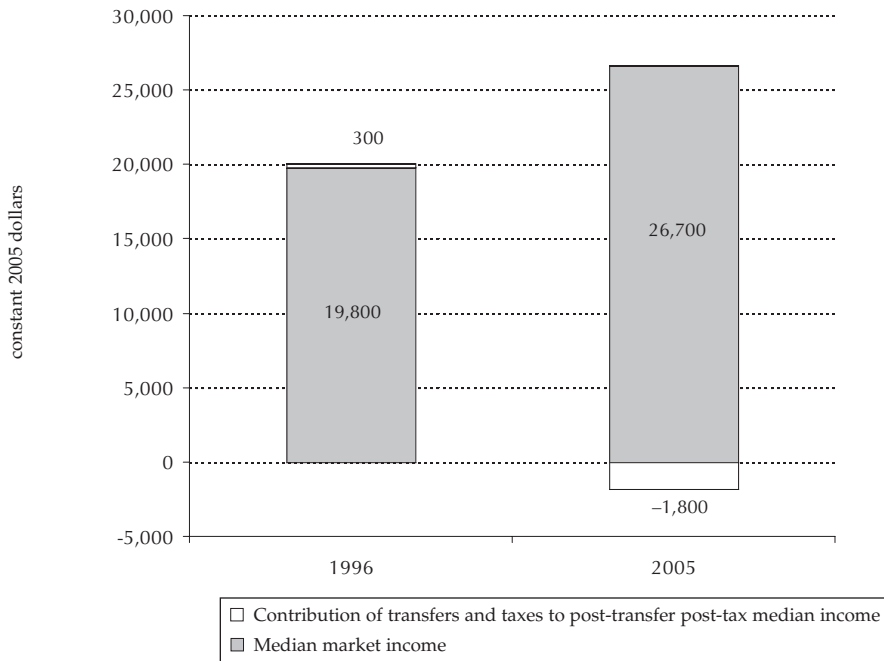
Figure 2a: *Median Market and Post-Transfer Post-Tax Income, Female Lone-Parent Families, 1996 and 2005*



Note: See glossary for interpretation of median income concept. All data are in constant 2005 dollars. Figure 2 compares median market income and median post-transfer, post-tax income for selected groups. The value labeled “contribution” is the difference between these two medians. It cannot be interpreted as median net transfers. In the case of adding two or more random variables, averages can be added. However, medians are in general not additive.

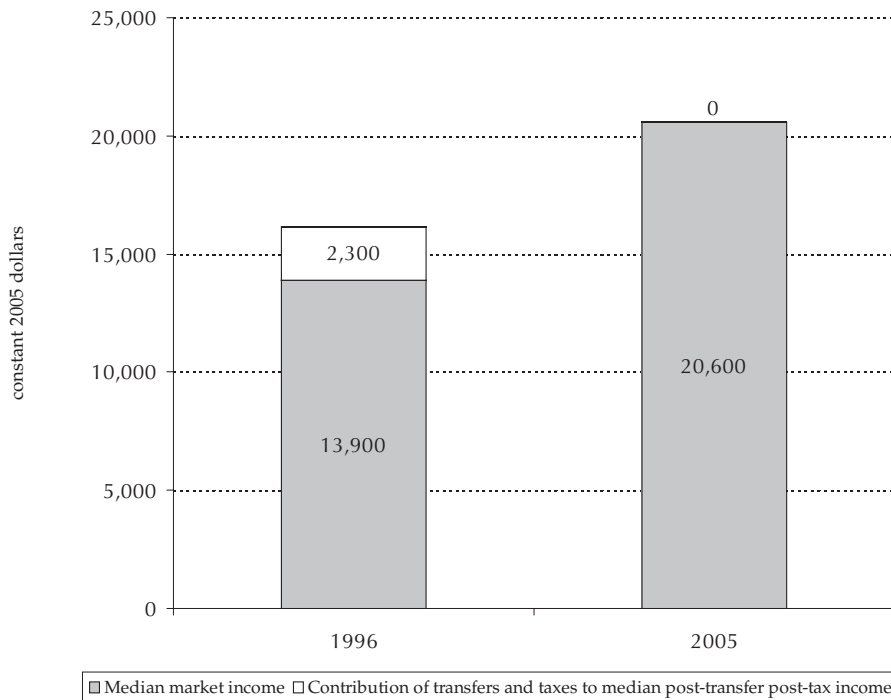
Source: Canada (2007c, 25, 63).

Figure 2b: *Median Market and Post-Tax Post-Transfer Income, Non-Elderly Unattached Men, 1996 and 2005*



Source: Canada (2007c, 25, 63).

Figure 2c: Median Market Income and Post-Transfer Post-Tax Income, Non-Elderly Unattached Women, 1996 and 2005



Source: Canada (2007c, 25, 63).

Figures 2a, 2b and 2c illustrate more encouraging news: the increase since 1996 in post-transfer, post-tax median* incomes among those in three groups at high risk of experiencing poverty. Not only are median incomes now higher, but the increases are primarily due to increased market earnings, not to increases in net transfers.

Changes in median market income among any group arise from a combination of two factors: changes in earnings among those working and changes in the employment rate among members of the group. Over the decade, median market income increased only slightly within families, holding constant the number of members working. The increases in post-transfer, post-tax median incomes and declines in the poverty rate within these particular categories have been driven primarily by the relative decline in “no earners” among them (Canada 2007, 25).

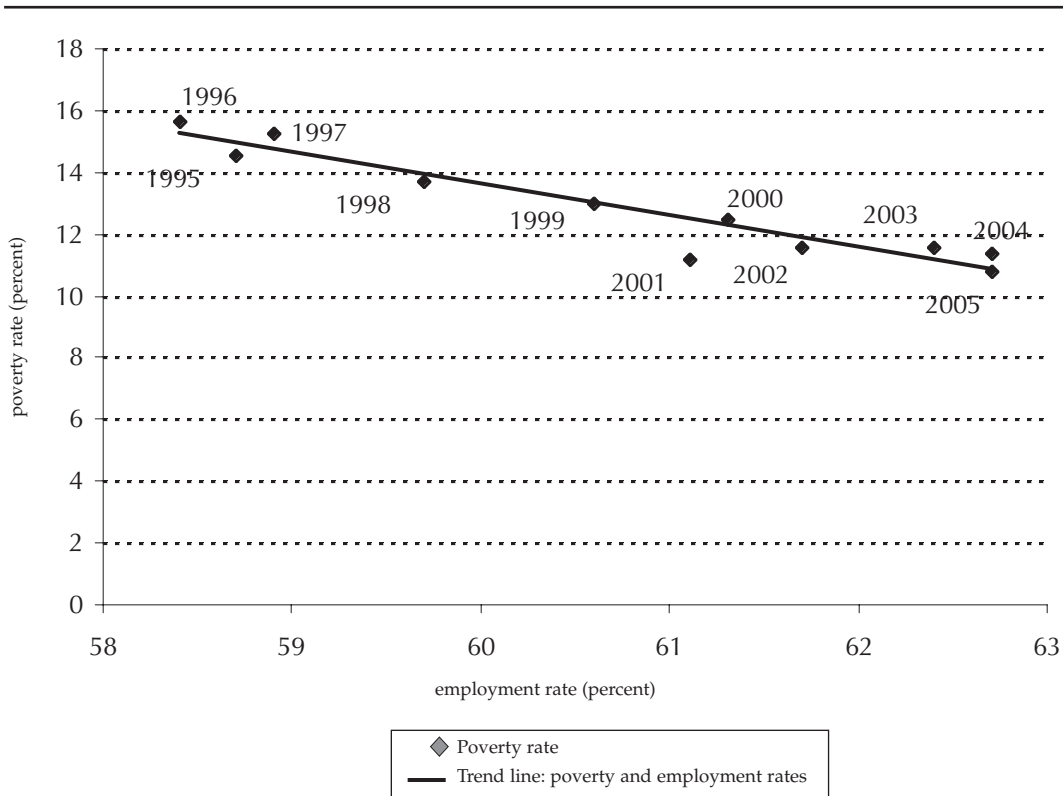
Figure 3 is a scatter plot illustrating the relationship between Canada’s poverty and employment rates over the last decade. These statistics are at an aggregate level, but they are highly suggestive: the link between Canada’s higher employment rate and lower poverty rate is very strong. The higher employment rate appears to be the key proximate variable to explain the decline in poverty.

This brings us to the question: why has employment income dramatically increased among those at risk of poverty? There is no definitive answer, although

footnote 2 cont’d

poor, in terms of the relevant LICO. The comparable number of poor unattached men was 641,000; of women, 535,000 (Canada 2007, 87).

Figure 3: *Post-Tax LICO Poverty Rate (1992 basis), All Persons, by Canadian Employment Rate, 1995-2005*



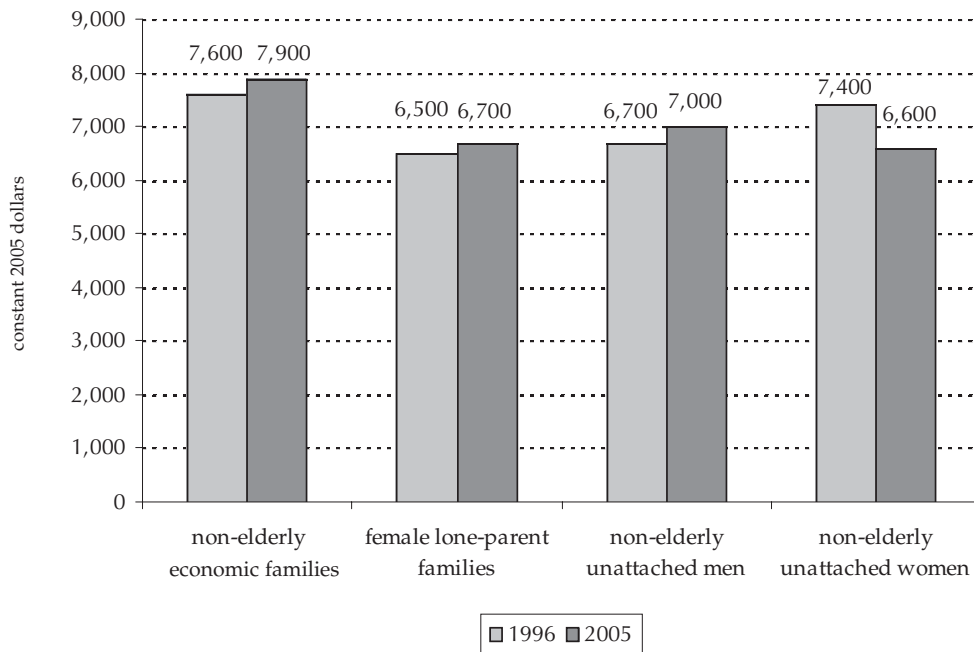
Source: Canada (2007c, 86), CANSIM.

partial explanations have been put forward, including improved education levels in the case of lone mothers.³ As I discuss below, there is considerable evidence pointing to the importance of changes to provincial welfare protocols, changes rendering access to welfare more difficult among those deemed employable. These changes had the effect of increasing labour supply among the low skilled. Other

³ A study by John Myles and colleagues (2006, 5) of employment and earnings trends among female lone-parent families provides a partial explanation of why incomes have risen for that vulnerable group. Using data from the three Censuses (1981, 1991 and 2001), they note that “employment rates among Canadian lone mothers rose 12 percentage points to 73% between 1980 and 2000, and average earnings of all lone mothers (including those with zero earnings) were up by 39%. As a result, the [LICO poverty] rate among lone mothers declined from 59% in 1980 to 56% in 1990, and to 48% in 2000.” Their study is concerned primarily with assessing the role of improved education levels in explaining these trends. In decomposing the increase in employment rates among lone mothers, they conclude that, for those over 40 years of age, the majority of the 1980-2000 increase in employment is probably attributable to an increase in education levels, as opposed to other factors such as changes in social policy and macroeconomic conditions (Myles et al., Table 4). For younger mothers, little employment increase occurred in the 1980s; most of the increase took place in the 1990s. For these younger mothers, education improvements explained only a minority of the increase; the majority was attributable to other factors.

A limitation of this study from our perspective is that the end-point, 2000, is too early to capture the full effect of major changes in provincial welfare utilization policies. These ...

Figure 4: *Poverty Gaps, by Selected Types of Families and Unattached Individuals, 1996 and 2005*



Source: Canada (2007c, 110).

policy innovations also matter, as does the overall increase in labour demand arising from sustained growth of the Canadian economy over the last decade.

Policies to restrict access to transfer income and induce the low skilled to enter the labour market have an adverse side effect. The minority who do not, for whatever reason, obtain employment often become worse off. One measure of this is the poverty gap*, the distance between a poverty threshold and the average income of those whose incomes are below it. Over the course of the last decade, the gap increased somewhat for three of the four categories illustrated in Figure 4. However, it is worth noting that, over the decade 1996 to 2005, market income inequality, as measured by the Gini coefficient*, did not rise. It declined, if only slightly.⁴

footnote 3 cont'd

changes began in the mid-1990s. In some provinces (such as British Columbia), major changes occurred after 2000. The authors acknowledge the limitations of Census data in assessing policy-induced changes in employment among lone parents, and note that "provinces with above-average reductions in social assistance (Alberta, Ontario) and above-average support for child care (Quebec) also experienced above-average gains in lone mothers' employment. In all three cases, the above-average change was due to above-average effects of 'behavioural change'" (Myles et al. 2006, note 14).

- 4 Between 1996 and 2005, the market income Gini coefficient among all families declined from 0.448 to 0.439, meaning inequality was reduced. Among the three at-risk groups discussed in this section, inequality of market incomes remained very high, but nonetheless declined. Among female lone-parent families, the coefficient declined from 0.604 to 0.532. Among non-elderly men, it fell from 0.540 to 0.523; among non-elderly women, from 0.554 to 0.516 (Canada 2007c, 80).

*The US Experience:
“Soft Love,” “Tough Love” and the
Importance of Employment as a Policy Goal*

The pioneers of rigorous policy analysis directed at poverty programs are largely American. Since the 1960s, US debate over anti-poverty policy has been intense. It reached a crescendo in 1996 when a Republican-controlled Congress enacted legislation to end the New Deal era federal grant (Aid to Families with Dependent Children (AFDC)) destined to fund state welfare programs. In its place, Congress proposed a new block grant (Temporary Assistance for Needy Families) that imposed time limits on welfare access, and mandated states to launch programs inducing welfare-to-work among those deemed employable. Over strenuous opposition from many fellow Democrats, then-president Bill Clinton signed the legislation. If this was “tough love,” it must be added that during Clinton’s first term, Congress also undertook “soft love” in the form of a major expansion of the program (Earned Income Tax Credit) that supplements effective wage rates among low-income families with children.

Over the second half of the 1990s, the combination of a vibrant economy and ambitious “soft” plus “tough” love programs directed at increased employment succeeded in reducing the US welfare caseload by over half. To cite a prominent analyst, writing about post-1996 outcomes:

More significant caseload declines and larger increases in labor force participation among less-skilled mothers occurred than many observers would have predicted. Entry into welfare fell, and exits from welfare rose. There remains debate as to how much these results were due to a strong economy, to program reform, or to their interactive effects. While some of this change in behavior is due to traditional labor supply responses to growing wages and increased financial incentives to work, the changes were greater than historical experience would lead one to expect. (Blank 2002, 1159).

In general, the misgiving among many Democrats over implications of the 1996 legislation proved unfounded. Average income transfers to the poor declined but so, too, did the proportion living below US poverty thresholds. In the case of female lone-parent families, for example, the poverty rate fell from 35 percent in 1992 to 25 percent eight years later. Over this period, their employment rate rose by 10 percentage points. Admittedly, poverty among such groups remains high, and over the decade the post-transfer, post-tax poverty gap rose slightly (Blank 2002; Cancian et al. 2003).

In the US — and UK — a certain convergence among liberal and conservative social policy analysts has arisen. They differ on how much “soft love” versus “tough love” policy is appropriate, but most acknowledge that an increased employment rate among those at high risk of poverty is a highly desirable policy goal, and that both positive incentives (such as earnings supplements*) and negative incentives (such as restrictive rules governing access to welfare among those deemed employable) are necessary to realize it.

Why this emphasis on employment? In summary, increasing employment among the poor generates a number of desirable benefits, both for the employed adult and for family members:

- It is important for the obvious reason that it generates income. An adult working full-time, even at very low wages, brings him/herself — although admittedly not if children are involved — above standard poverty thresholds.⁵
- 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 and the US. Employment induces a more active lifestyle than that associated with reliance on transfer income. Accordingly, employment goes some way to reducing the incidence of lifestyle diseases (such as adult-onset diabetes) linked to obesity.⁷
- Finally, prolonged unemployment is associated with psychological depression and increased rates of self-destructive behaviour — including suicide — notably among men (WHO 2004).

The above arguments imply that an element of paternalism in social policy design is legitimate. The goal of social policy is not solely to increase utility among the poor by raising their current income. To the extent that one family member's employment has significant external benefits on others, it is legitimate for government to impose a variety of constraints on income transfer programs with the goal of inducing employment. Such constraints include imposing delays on access to welfare among those deemed employable, conditioning receipt of welfare on participation in training programs, manipulating the relative reward from work and leisure (non-employed time) by diverting available budgets from transfer programs to employment subsidy programs, and so on.

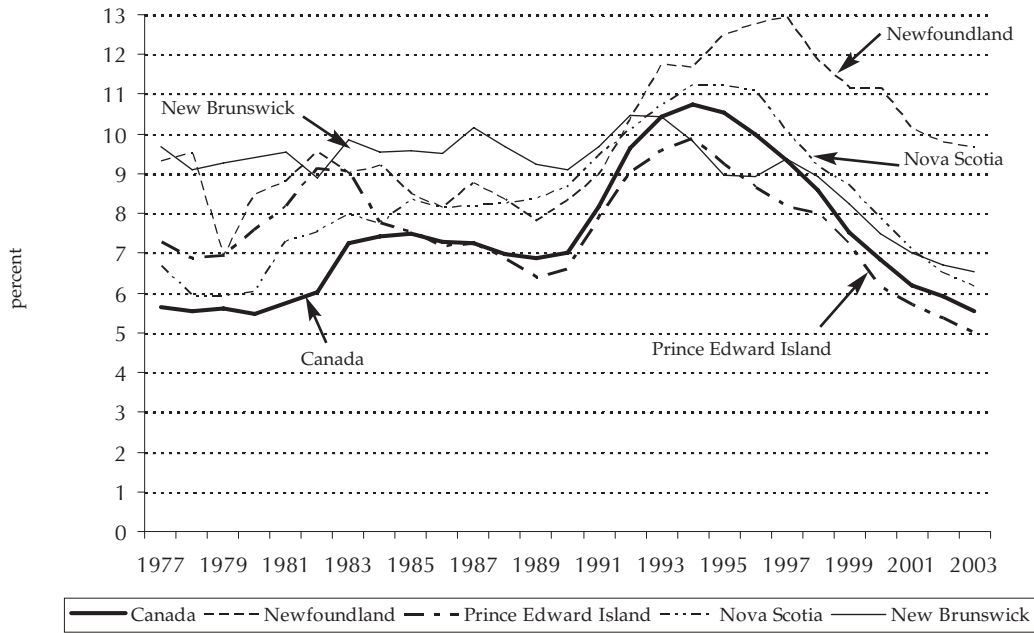
Employment is not a panacea. A core professional responsibility of those administering social assistance and related programs is making the professional judgment as to who is, and who is not, employable. Among those deemed employable, effective programs gauge degree of job readiness, assure childcare where needed, and so on. Among those deemed non-employable — the mentally and physically handicapped — employment may still be valuable, but it is

5 The 2004 post-tax LICO in Canada for a single person ranges from an \$11,000 annual income in rural areas to \$16,900 in cities of population above 500,000. To realize this income via wages requires — for a person working 40 hours/week and 48 weeks/year — a net hourly wage between \$5.75 and \$8.80.

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

7 Richards (2006, 39-47) offers a short survey of the literature on obesity trends, in particular among indigenous populations. See also Cutler et al. (2003).

Figure 5a: *Social Assistance Beneficiaries, 1977–2003, Canada and Atlantic Provinces (percent of jurisdiction's population)*



Source: Author's calculations from data in Canada (2007b, Table 435).

secondary. The primary goal is to provide appropriate services and income transfers.

And What About Canada?

Provincial Welfare Reform

Proportionately, the decline in welfare utilization in Canada is similar to that in the US. From 1994, the peak year of welfare utilization, to 2003, the latest year of data included in Figures 5a, 5b and 5c, the Canadian welfare utilization rate fell by nearly half. It has now returned to rates prevailing in the 1970s.

Casual observation of the increases in Canadian welfare utilization during the early 1980s and early 1990s recessions, and the decline post-1995, suggests that reliance on welfare is "demand driven." However, there are marked differences in welfare utilization trends across provinces, differences that disappear in aggregate national data. Once we examine utilization in particular provinces, it becomes obvious that "supply driven" changes (in provincial protocols determining access to welfare and in benefit levels) matter. How much do they matter?

Table 1 summarizes results from simple difference-in-difference regressions that attempt to explain the impact of "supply side" shifts in three provinces. Difference-in-difference models assume that relevant variables other than the policy shifts bear not only on the province in question but also on some other

Figure 5b: *Social Assistance Beneficiaries, 1977–2003, Canada and Central Provinces (percent of jurisdiction’s population)*

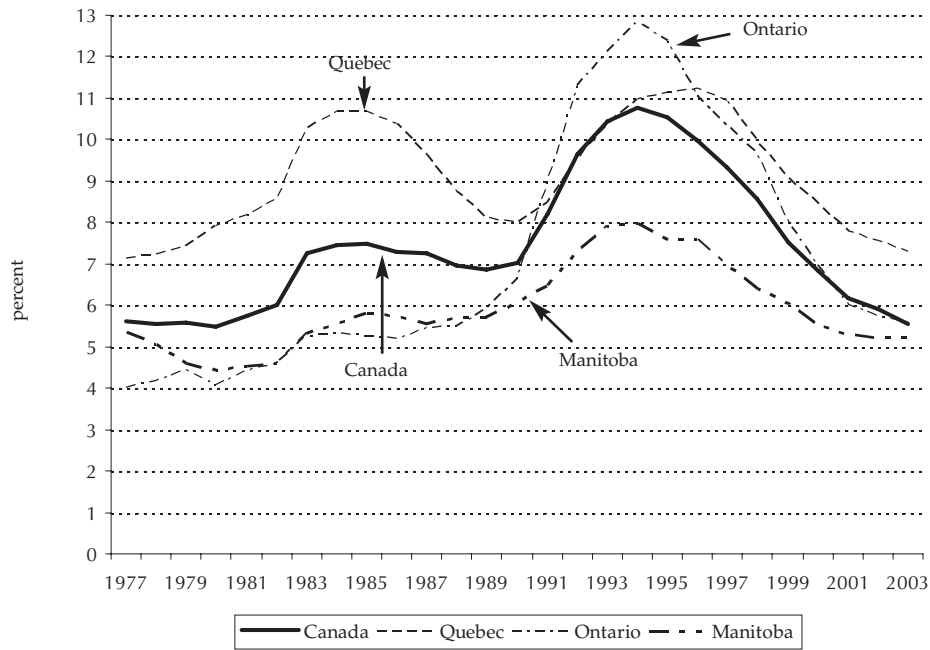


Figure 5c: *Social Assistance Beneficiaries, 1977–2003, Canada and Western Provinces (percent of jurisdiction’s population)*

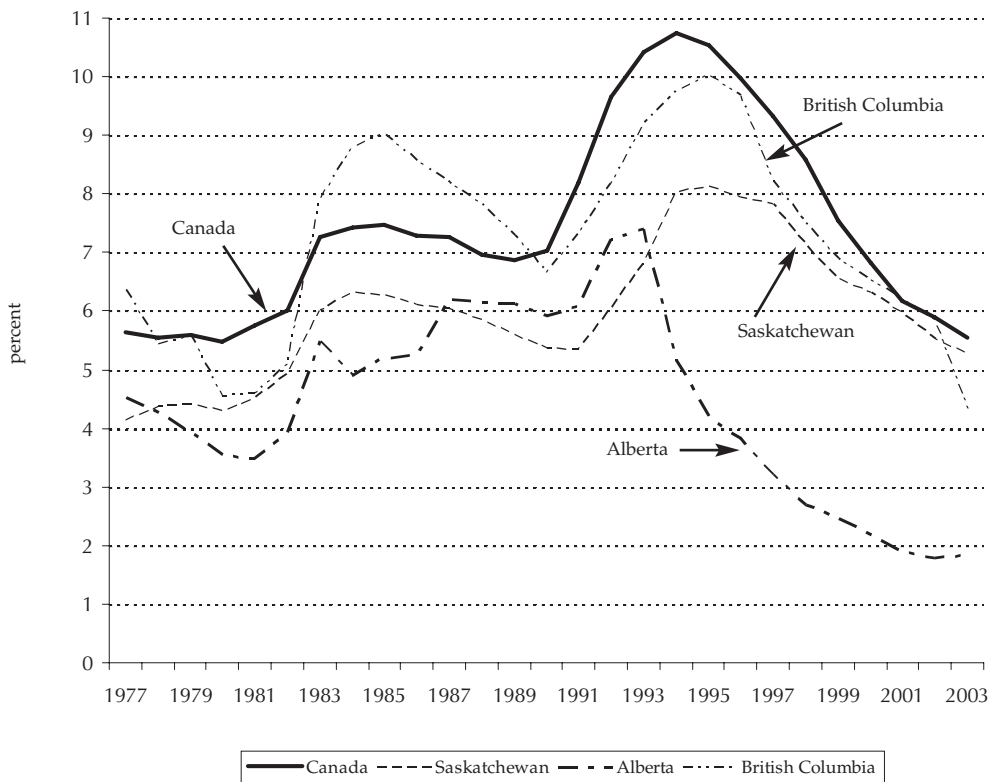


Table 1: *Difference-in-Difference Models of Welfare Utilization in Selected Provinces, Relative to Manitoba*

	Alberta	Ontario	British Columbia
intercept	0.033	-0.067	-0.033
Cardinal reforms (1: 1994-1997; 0: elsewhere)	-0.847****		
Peterson/Rae reforms (1: 1986-1995; 0: elsewhere)		0.603***	
Harris reforms (1: 1996-1999; 0: elsewhere)		-0.646**	
NDP reforms, first term (1: 1991-95; 0: elsewhere)			0.408*
NDP/Liberal reforms (1: 1996-2003; 0: elsewhere)			-0.382*
R ²	0.26	0.39	0.16
R ² adjusted	0.23	0.34	0.09

Note: The level of significance of each variable is indicated by the following legend:
 * 0.30 level of significance (2-tail test)
 ** 0.075 level of significance (2-tail test)
 *** 0.025 level of significance (2-tail test)
 **** 0.01 level of significance (2-tail test)

Source: Data used in the regressions are derived from Canada (2007b).

province, taken as the control. If a particular provincial policy innovation matters, the change should have an impact on the change in welfare utilization in the relevant province relative to change in the control province where policy remained stable. Manitoba is a province whose welfare policies have been fairly stable over the last two decades. In the exercise reported here, it serves as the control against which to measure changes in the three others.

The two provinces that have undertaken the most dramatic welfare policy shifts over the last two decades are undoubtedly Alberta and Ontario. In both provinces, benefit levels were reduced but probably more important were new protocols determining welfare eligibility among those deemed employable. (See the Appendix for a discussion of welfare benefit levels.)

Alberta is the simpler of the two cases. Ralph Klein became premier in late 1992 and won re-election for his government in 1993. Over the preceding decade, Alberta welfare utilization was similar to that of other western Canadian provinces. But under the guidance of Mike Cardinal, the social services minister, Alberta reduced benefit levels and adopted new protocols to restrict welfare access among those deemed employable. The province implemented these changes rigorously during Klein's first term, from 1994 through 1997. Over these years, Alberta welfare utilization fell by 4.2 percentage points of the provincial

population. Thereafter, provincial welfare utilization protocols maintained limited access among the employable. In comparing differences in differences between Alberta and Manitoba over the 26 years from 1978 to 2003, the variable serving as a proxy for the Cardinal reforms is highly significant statistically. Based on the coefficient of the regression, the Cardinal reforms accounted for about four-fifths of the observed 1993-1997 decline in welfare utilization.⁸

In Ontario, the Liberal and NDP governments in power between 1985 and 1995 implemented the country's most generous benefit levels and most relaxed welfare access regulations. Over the decade, Ontario welfare utilization increased by a dramatic 7.1 percentage points of provincial population. The variable representing then-prevailing provincial welfare policy is statistically significant. Based on its coefficient, provincial policy explains about four-fifths of the increase. Obviously, these policies interacted with the prevailing early 1990s recession to generate the very large increase in provincial welfare utilization in the early 1990s.

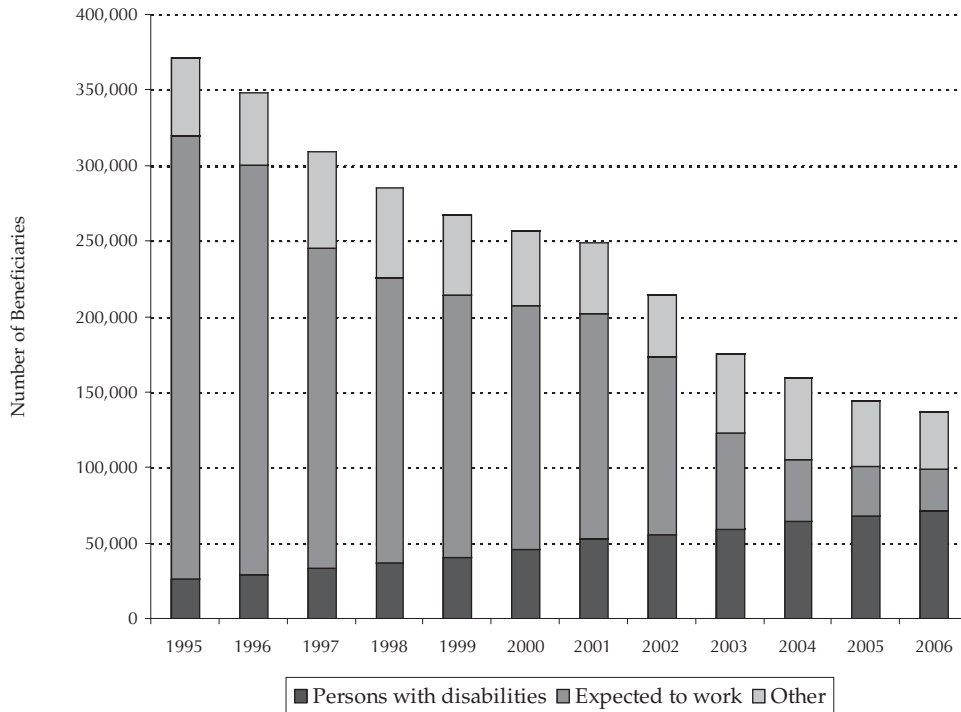
Welfare policy became a high-profile issue in the 1995 Ontario election and the newly elected Conservative government copied Alberta precedents. Ontario reduced benefit levels and simultaneously rendered access more difficult. According to the regression coefficient, provincial government policy accounts for somewhat over half of the observed decline between 1995 and 1999 of 4.4 percentage points of provincial population. Other variables, notably the economic recovery, explain the residual.

British Columbia is a third example of a province that has undertaken major shifts in protocols determining welfare access. Over the NDP's first term of office, 1991 to 1995, BC welfare policy mirrored that in Ontario pre-1995. In the NDP's second term, 1996 to 2001, and under the subsequent Liberal government, 2001 to the present, the province reversed direction, with protocols that tightened welfare access. The difference-in-difference regression results give the appropriate sign to the variables designed to capture these policy shifts, but are of limited statistical significance. Of more interest is the administrative data in Figure 6. It summarizes the effect of protocol changes implemented post-1995 on the relative size of various categories of social assistance recipients. A few conclusions can be drawn:

- Social workers distinguished more carefully among those "expected to work," "persons with disabilities," and "others."
- Among those "expected to work," access to welfare has become more difficult. Officials implemented protocols to divert claimants towards training or immediate employment. The effect has been to reduce the number of beneficiaries in this category by over 90 percent in the 1995-to-2006 period. (Slightly over half the reduction in this category was effected while the NDP was still in office.)
- Having in place protocols to restrict employable claimants, officials became more generous in designating "persons with disabilities." The number in this category has nearly tripled over the decade.

⁸ One potential explanation for the impact of the Cardinal reforms is that large numbers of potential welfare beneficiaries left the province. There is no evidence from BC social service data of a post-1993 jump in out-of-province claimants from Alberta. Since BC also began restricting welfare access in this four-year interval, there may have been some increase in the west-to-east flow of potential welfare applicants.

Figure 6: *British Columbia Social Assistance Beneficiaries 1995-2006, by Administrative Designation*



Note: The BC Ministry of Employment and Income Assistance categorizes welfare beneficiaries according to the reason for seeking assistance. Until recently, the largest category has been for those unemployed but “expected to work.” Those identified as disabled, due to a short- or long-term physical or mental handicap, are not expected to work. The residual category includes “expected to work — mental condition,” “expected to work — temporarily excused,” “expected to work — persistent multiple barriers,” and “children in home of relatives.”

Source: British Columbia (2007).

- In aggregate, the number of beneficiaries declined from 370,000 in 1995 to 140,000 in 2006 — or from just under 10 percent of the provincial population to slightly over 3 percent.

Federal Initiatives

At the federal level, the major “tough love” reform has been to the EI program, an element in the Chretien government’s post-1995 commitment to end two decades of continuous federal deficit. While many reports over the previous decade had recommended reform, it required a strategic cabinet decision to end the deficit before Ottawa acted. Changes to the program increased work requirements and penalized frequent users. One result of reform has been a decline in the percent of the unemployed receiving EI benefits, from roughly 80 percent in the late 1980s to 40 percent a decade later. For the Caledon Institute, the EI changes over the 1990s “[have] broken the social insurance contract that Canada’s social policy pioneers

cherished as a crucial element of a modern social security system" (Battle et al. 2006, 22).

This critique of EI reform invites several observations. The first is to recall that the Canadian unemployment rate has fallen dramatically since the early 1990s. Consequently, the difference is not great between i) 60 percent of the unemployed not receiving EI at present unemployment rates of 6 percent, and ii) 20 percent without coverage during the early 1990s when the unemployment rate was twice as high. It is 1.2 percent of the labour force. The second is to note that changes in EI eligibility and benefits were among the shifting incentives that contributed to the rise in the Canadian employment rate and consequent decline in aggregate Canadian poverty rate. The third observation is that regionally differentiated access to EI persists and, in the affected regions, EI continues to act as a major subsidy to seasonal unemployment and disincentive to the pursuit of more productive employment options. By leaving intact the principle of regionally variable conditions for access to unemployment insurance, the 1995 reform probably did not go far enough in terms of restoring the credibility of the program as insurance against unintended bouts of unemployment.

The major exercise of "soft love" in Ottawa over the last decade was introduction of the National Child Benefit System (NCBS) in 1998. Prior to its implementation, Ottawa negotiated with the provinces as to what they would do with savings in welfare budgets. Most provinces lowered benefits dollar-for-dollar to offset increased federal child benefits, and undertook to spend the savings on related programs of benefit to low-income families, whether or not on welfare. Hence, the NCBS has not, in most provinces, increased incomes among those in receipt of provincial welfare.

In all provinces, the NCBS facilitated provincial welfare reforms aimed at reducing utilization. By substituting income from this negative income tax for welfare, the NCBS has enabled poor families with children to exit provincial welfare at a lower level of earnings. It has also supplemented the income of parents with earnings slightly above welfare cutoff levels. However, it is hard to assess what independent impact on welfare utilization should be attributed to the NCBS — as opposed to provincial welfare policies and the state of the labour market. In the case of Alberta, probably very little is due to the NCBS. Between 1993, the previous peak year of Alberta welfare utilization prior to 1998, and introduction of the NCBS in 1998, provincial welfare utilization fell by 4.7 percentage points of provincial population. The subsequent decline, up to 2003, in welfare utilization was only 0.7 of a percentage point.

In the case of Ontario, welfare utilization peaked in 1994. It had declined by 3.2 percentage points of provincial population by the time the NCBS was introduced in 1998. Over the subsequent five years to 2003, it fell an additional 4.1 percentage points. It is less clear in Ontario than in Alberta that provincial welfare initiatives are the primary variable to explain the decline. First, major shifts in welfare policy may require a full government term in office to realize their full impact. Ontario undertook major welfare redesign two years later than did Alberta. By the time of introduction of the NCBS, provincial initiatives had been in effect for only half as long as had analogous initiatives in Alberta. Another reason for ambiguity is the regression results reported above. They imply that Ontario's

relaxed welfare utilization policy from 1985 to 1995 explains much of the increase in utilization over the decade; they are less convincing in attributing the post-1995 decline to provincial policy.

Six Dossiers

It is hard to document such things, but it seems fair to conclude that, relative to their American counterparts, Canadian analysts have been more inclined to advocate “soft love” as opposed to “tough love” policy reforms, and more concerned with national than with regional policy reforms. Accordingly, welfare reform has not received much analysis — despite the fact that changes in provincial welfare protocols over the last decade have been dramatic, and that they probably explain much of the increase in the employment rate and subsequent decline in Canada’s poverty rate.

Undeniably, problems of poverty persist. Pockets of deep poverty have prompted some to conclude that post-1995 policy reforms, at both the federal and provincial levels, have (to use the Caledon Institute’s wording) “broken” Canada’s social insurance contract. The MISWAA Task Force report (2006, 32, 42) makes the same case, and proposes that Ottawa devote an incremental \$8.5 billion annually on targeted programs for adults with annual incomes below \$21,000, most of it devoted to a negative income tax for adults costed at \$7 billion annually.

Arguably, this critique should be reversed. Cumulatively, events in the two decades prior to 1995 “broke” the social contract between poor and non-poor Canadians. At present, it is not ideal, but it is in better shape than it was. By the early 1990s, large groups of employable Canadians were in danger of developing a casual, seasonal link with the labour market. An unreasonably large proportion of the population relied on social assistance — it peaked nationally at 11 percent in 1994. Repeat use of unemployment insurance was a prominent feature of the labour market in particular regions, and had discredited the program in the eyes of Canadians who expected it to serve as temporary income for those afflicted by unanticipated bouts of unemployment.

By the early 1990s, federal-provincial relations had become exceptionally acrimonious. Federal politicians were accusing their provincial counterparts of abusing the original intent of agreements whereby Ottawa cost-shared certain provincial social programs. The most prominent such conflict surrounded Ottawa’s “capping” the growth of its cost sharing support for provincial welfare budgets in the three wealthiest provinces (Ontario, BC, and Alberta). Ottawa accused them of using the federal transfers to fund overly generous welfare programs. In their turn, provincial politicians were accusing Ottawa of arbitrary redefinition of transfers to the provinces. Neither federal nor provincial politicians were addressing the need for a long-overdue redesign of their respective social programs.

Since the mid-1970s, Canadian public debt had inexorably risen as a share of GDP. Among OECD countries, Canada’s debt/GDP ratio in the mid-1990s (over 68 percent) was exceeded only by Belgium and Italy. Federal trusteeship of the most indebted provinces (Saskatchewan and Newfoundland) and a massive sell-off of foreign holdings of Canadian sovereign debt were discussed in the corridors

of power. A decade later, the debt/GDP ratio (approaching 30 percent) is much lower and there is no talk of placing particular provinces under trusteeship. Federal-provincial conflicts are still with us, but disagreements over redesign of federal-provincial equalization policy can hardly match the gravity of social policy and fiscal problems of the early 1990s.

None of this means Canada has achieved Dr. Pangloss's "best of all possible worlds." It does mean that we should be reluctant to undo incremental social policy initiatives undertaken by both orders of government over the last decade — initiatives that in terms of aggregate poverty measures have generated unambiguous benefits. Also, we should be reluctant to embark on an expensive new transfer program, as proposed by MISWAA. A negative income tax for adults inevitably poses new disincentives to employment, similar to those created by the clawback* features of the NCBS.

To reduce poverty further, there are numerous dossiers in need of attention. Here, I flag six. Addressing each may require some of the \$7 billion not spent on a national negative income tax. But before either Ottawa or the provinces spend money, each requires hard analysis.

K-12 Education Among the Poor

Poverty analysts are well aware of the standard measures of income inequality. They should be equally aware of concepts such as socio-economic gradients* applied to standardized test scores of student performance in core subjects. It goes without saying that, until Canadian governments more effectively measure and publicize outcomes within the school system, it is of no use to learn such concepts.

For any community to escape poverty in a modern industrial economy, a necessary condition is the ability to secure paid employment at reasonable wages. The minimum requirement for most jobs is completion of secondary schooling. Overall, Canada's public school system performs at a level somewhat above the average among OECD countries (Bussière et al. 2004). But among particular groups, performance is woefully inadequate.

From a long-run perspective, current inequality in income distribution is less important than inequalities in acquisition of human capital by the young. The importance of education in increasing employment and lowering poverty is the central policy message of the Statistics Canada study on lone-parent poverty discussed earlier (Myles et al. 2006).

Redressing low education levels among particular culturally marginal groups is a multi-generation exercise. But good schools matter. Many innovations are worth considering. Targeted early childhood education programs may yield significant benefits in terms of children's subsequent school success.⁹ Relevant cultural content in the curriculum may lower high-school dropout rates among students from historically marginalized groups, such as Aboriginals.

⁹ A colleague and I surveyed numerous case studies of early childhood education programs (Richards and Brzozowski 2006). In random control studies, children typically displayed benefits from such programs in early years of primary education; in later years, the benefits often faded. The value of formal early childhood education programs among children of middle-class, two-parent families appears dubious however.

Aboriginal Poverty

Poverty rates among on-reserve Aboriginals remain distressingly high. The dominant strategy pursued by Ottawa over the last generation has been to finance Aboriginal-led governments — band councils in the south, territorial governments in the north — and leave to them the design of core social programs. This strategy has generated some positive results, but has removed from general consideration the evident failures. On-reserve employment rates are woefully low. They are particularly low in the prairie provinces, which collectively account for nearly half the Canadian Aboriginal population. The on-reserve welfare utilization rate in the most recent Indian Affairs report was 36 percent; youth suicide, among men in particular, is two to three times more prevalent than among non-Aboriginal youth. In the northern territories, suicide rates are higher yet.¹⁰

The most inexcusable policy failure is on-reserve education. Among the 15- to 24-year-old cohorts at the time of the 2001 Census, only one-quarter had completed high school, a ratio less than half that for non-Aboriginals. Off-reserve, Aboriginal education results were better, but not good enough. Ottawa has a responsibility to intervene and professionalize on-reserve K-12 education. The provinces have a responsibility to undertake more aggressive affirmative action to improve high-school completion among off-reserve Aboriginals.¹¹

The Mentally Ill and Physically Handicapped

In those provinces that have restricted access to welfare by the employable, a much higher share of the caseload now comprises those with serious mental and/or physical disabilities. Further progress will require that social workers simultaneously restrict access to welfare among the employable, and be generous to the disabled. Appropriate services and redesign of transfers to the latter can enable these people to lead more normal lives — including independent living and employment. Benefits for the disabled should be further enriched relative to those for beneficiaries classified as employable. Among some who are classified as disabled, part-time employment can be therapeutic. The clawback rates imposed on benefits should not prevent paid employment.¹²

The Ghetto Poor

For a half-century, US social policy has been concerned with the syndrome of social problems arising from ghetto conditions: out-migration of the middle class leading to deterioration of local services (of schools in particular), high rates of street crime and of drug/alcohol abuse, and geographic concentration of the

10 In 2003/04, the average number of on-reserve welfare beneficiaries was 146,600; the on-reserve population was 409,700 (Canada 2005). Richards (2006) surveys Aboriginal epidemiological data, including potential years of life lost due to various causes of death, including suicide.

11 For a more adequate analysis of social policy problems among Aboriginal Canadians, including discussion of education outcomes, readers may refer to my book-length analysis (Richards 2006).

12 Feres (2007) discusses fiscal disincentives to employment among BC welfare beneficiaries designated as “persons with disabilities.”

severely mentally ill. Canada, too, has its ghetto neighbourhoods. Tackling the problems of, for example, Vancouver's Downtown Eastside probably requires a combination of better drug rehabilitation programs; geographic dispersion of mental-health services throughout the metropolitan region; and tougher policing of property crime, drug dealing and businesses ancillary to the drug trade (such as pawn shops). For the long-term homeless, there is a need for provision of shelter.¹³

High Effective Tax Rates on the "Near Poor"

The Achilles' heel of the NCBS — and other targeted income transfer programs that phase out benefits over an income range above the welfare cutoff level — is to erect a high fiscal barrier against increasing hours of work or skill upgrading among the "near poor." To contain the cost of targeted income programs, benefits are usually designed with high clawback rates on incremental income above a low threshold (of about \$22,000 annual family income in the case of the NCBS).

Clawback of benefits as earnings rise creates the same disincentive as does imposition of income and payroll taxes. While the marginal effective tax rate (the sum of tax rates plus clawback rates) varies across provinces, for a lone-parent Canadian family with one child, the current effective tax rate is on average above 50 percent over the entire family earnings range of \$20,000 — \$40,000 (Canada 2006, 71). For a single-earner family with two children, this rate is about 60 percent. Over most of this income range and for most individuals, the largest component of the tax/clawback burden — larger than federal-provincial income tax — is attributable to clawback of the NCBS and various provincial top-ups.

The 2006 OECD survey (2006, 9-10) of Canada admonished Ottawa and the provinces to address the excessive tax burden on "near poor" families. There are, in principle, two ways to do so: lower the targeted benefit (thereby allowing for a lower clawback rate over a given earnings range over which the benefit is clawed back) or lower the clawback rates applied to these targeted benefits (thereby according benefits to those with higher incomes). The former is politically unacceptable in most cases. On the other hand, to lower clawback rates is expensive in terms of foregone tax revenues. It entails a significant increase in tax credits to a large number of presently ineligible families with children, and raises their marginal effective tax rates as well.

In-Work Benefits

Seven of ten provinces have introduced earnings supplements to augment the effective wage rate of those at very low incomes. Modeled on the US Earned Income Tax Credit, their intent is to increase participation among the poor in the labour market. These programs have been extensively evaluated and have a measurable impact on participation (Eissa & Hoynes 2005). As with negative income taxes (such as the NCBS), the Achilles' heel of earnings supplements is to

13 The most ambitious programming to tackle long-term homelessness in a major North American city is that of New York (Smith et al. 2005).

worsen the effective tax burden among the “near poor” over the phase-out range of the supplement.

In the 2007 federal budget (Canada 2007a, 78-82), Ottawa added to existing provincial programs a national equivalent, the Working Income Tax Benefit (WITB). Budgeted at \$550 million annually, it is administered via the income tax system. Relative to provincial earnings supplements, the national program has two advantages:

- *Lower delivery costs to government:* Provincial earnings supplement programs have been designed to provide the supplement shortly after an individual achieves the earnings to which the supplement is linked. This requires provinces to operate quick-response delivery systems. A national equivalent delivered via the income tax system entails few incremental costs and can accordingly lower aggregate program delivery costs.
- *Lower compliance costs among beneficiaries:* Since most adults complete income tax forms — whether or not they pay income tax — a national program will increase take-up among the eligible population. Research on comparable programs in the US concludes that about one-third of those eligible do not receive the benefit. The provincial programs require beneficiaries to incur the cost of application. The cost is not only bureaucratic hassle. Some eligible beneficiaries shun the stigma of “welfare” and perceive these programs as “welfare” with a different label.

On the other hand, a national program introduces serious disadvantages relative to provincial equivalents:

- *Weakened link between payment and work:* Implicit in most wage contracts is that payment not be delayed, that the paycheck follow shortly after the work is performed. Provincial delivery systems can arrange payment of earnings supplements within two weeks of a beneficiary’s claim submission, and hence maintain the “feel” of wages. Any delivery system relying on the income-tax system introduces lags that can readily exceed 12 months. A WITB payment becomes one targeted transfer payment among several. A quick-delivery provincial program probably has a greater ability than a national tax-based program to induce a potential beneficiary, someone not currently in the labour force, to seek employment.
- *Loss of potentially beneficial interaction with social workers:* Families with incomes below \$15,000 are frequently experiencing multiple problems. In addition to — or in lieu of — increasing income to families in this income range, effective aid often entails provision of multiple services ranging from supplementary health insurance (such as dental care) to childcare subsidization and counseling. While provincial earnings supplements linked to social agencies may discourage take-up, an anonymous federal earnings supplement may eliminate beneficial contact with provincial social workers.

The dossier of earnings supplements deserves more policy analysis than it has received. In my opinion, the overall advantage here lies with provincial over federal intervention.

Conclusion

The link between Canada's rising employment rate and falling poverty rate over the last decade has been very strong. In addition to increasing incomes among many families at high risk of incurring poverty, this rise in employment will hopefully generate a range of other long-term benefits for the relevant families.

Based on the evidence of the last quarter century, several policy conclusions should be underlined. First is that the impact on employment among those at high risk of incurring poverty should always be a criterion for assessing proposed policy reforms, and policies that embody powerful incentives to enter the labour market usually make sense.

Second, introduction of new provincial welfare protocols probably explains much of the last decade's increase in the employment rate among groups with high rates of poverty. At the heart of new protocols has been a stricter exercise by social workers in judging whether a welfare applicant is, or is not, employable. Admittedly, making these judgments is prone to error, and good welfare policy means much more than restricting access among those classified as employable. In three of the four large provinces the changes in welfare policies and the magnitude of decline in caseloads have been dramatic. It is hard to be precise however as to how much weight to place on welfare reforms relative to other factors — recovery from the early 1990s recession, reforms to unemployment insurance, and perhaps introduction of the NCBS — that also influenced decisions to enter the labour market.

And finally, there remain pockets of poverty across Canada that continue to be depressingly resistant to policy interventions. To the extent government policy can improve matters what is required are refined interventions, not broad new transfer programs. A negative income tax for adults, as advocated by MISWAA for example, would inevitably run counter to the first conclusion: it would exacerbate the clawback disincentives to employment already facing the "near poor."

The policy innovations of the last decade got much right. Whatever further innovations we introduce, let us not lose sight of the value of employment — even at low wages — in reducing the scourge of poverty.

Glossary

Clawback rate. The rate at which one or more targeted transfers declines as earnings increase.

Earnings supplements. Targeted transfer programs whose main intent is to induce labour force participation. They supplement earnings over an initial phase-in income range, thereby increasing the effective wage received. Beyond some threshold, the earnings supplement is clawed back as income rises. Over the phase-out range, the clawback adds to the marginal effective tax rate burden.

Gini coefficient. Measures the degree of inequality in income distribution. Values of the Gini coefficient can range from 0 to 1. A value of zero indicates income is equally divided among the population with all units receiving exactly the same income. At the opposite extreme, a Gini coefficient of 1 denotes a perfectly unequal distribution where one unit possesses all income in the economy. A decrease in the value of the Gini coefficient can, by and large, be interpreted as reflecting a decrease in inequality, and vice versa.

Low income cut-offs (LICOs). Convey the income level at which a family may be in straitened circumstances because it has to spend a greater proportion of its income on necessities than the average family of similar size. The threshold is defined as the income below which a family is predicted to spend 20 percentage points more of its income on food, shelter and clothing than does the average family. There are separate cut-offs for seven sizes of family (from unattached individuals to families of seven or more persons) and for five community sizes (from rural areas to urban areas with a population of more than 500,000.) LICO is an unduly complex means to define a poverty threshold. While it is entrenched as the principal poverty threshold in Canadian poverty studies, it is not used outside Canada. Most international comparative studies use as a poverty threshold an index based on some fraction (usually half) of median income. What can be said in defence of LICO methodology is that it generates values within 10 percent of equivalent thresholds defined in terms of half median income.

Marginal tax rate. The rate at which one or more taxes increase as earnings increase.

Marginal effective tax rate. The sum of marginal tax rates plus clawback rates (see above) per dollar of incremental earnings.

Mean (or average) income. Computed as total income divided by the number of units in the population.

Median income. The value for which half of the units in the population have lower incomes and half have higher incomes. To derive the median, units are ranked from lowest to highest according to their income and then separated into two equal-sized groups. The value that separates these groups is the median income (50th percentile).

Because the median corresponds exactly to the midpoint of the income distribution, it is not, contrary to the mean, affected by extreme income values. It is not affected by unusually high values for relatively few people. Since income distributions are typically skewed to the left — that is, concentrated at the low end of the income scale — median income is usually lower than mean income.

Negative income taxes. Targeted transfer programs whose main intent is to provide a rules-based income transfer to low-income individuals. Beyond some income threshold, the benefit is subject to clawback. Most such programs have incorporated clawback rates in the 25 to 50 percent range, well below the 75 to 100 percent clawback rates associated with traditional welfare programs.

Poverty gap. A measure of the severity of poverty among those whose incomes fall below the relevant income threshold. It is here defined as the difference between the relevant LICO threshold and the average income of those whose incomes are below it. The higher the gap, the deeper the poverty.

Socio-economic gradients. Provide a summary measure of the ability of a jurisdiction's school system to overcome socio-economic disadvantages and generate decent education outcomes across all communities. More specifically, gradients measure average student test performance in a jurisdiction as a function of the socio-economic status of students' families. In any comparison of school systems across provinces — or internationally — the shallower the slope of the gradient the better the school system's ability to overcome socio-economic disadvantage; the "higher" the gradient curve the more effective the system is in teaching children at that stage in their careers.

Targeted transfers. Programs, such as the National Child Benefit System (NCBS) or the recently announced Working Income Tax Benefit (WITB), that vary benefit levels as a function of family or individual income.

Total income. Income from all sources including government transfers before deduction of federal and provincial income taxes. All sources of income are either market income or government transfers. **Market income** is the sum of earnings (from employment and net self-employment), net investment income, and (private) retirement income. It is equivalent to total income minus government transfers. **Post-transfer post-tax income** is total income less income tax; expressed alternatively, it is market income plus net transfers. **Net transfers** are government transfers less income tax. Government transfers include all direct payments from federal, provincial and municipal governments to individuals or families. Income tax is the sum of federal and provincial income taxes payable (accrued) for the taxation year. Income taxes include taxes on income, capital gains and RRSP withdrawals, after taking into account exemptions, deductions, non-refundable tax credits, and the refundable Quebec abatement. The distinction between taxes as rules-based government levies on individuals' total income and, on the other hand, transfers to individuals as means to realize social policy, is difficult to establish. Many features of the tax system (such as particular deductions and non-refundable tax credits) have social policy functions but are not government transfers per se (Canada 2007c, 115-119).

Appendix

Welfare Benefit Levels

Changes in welfare benefit levels are easier to measure, but probably of less importance than changes in protocols determining welfare access. In some instances — notably Alberta in 1994 and Ontario in 1995 — provinces made large cuts (roughly a fifth) in nominal welfare benefit levels. Much of the decline summarized below arose, however, not from reducing actual benefit levels but from freezing nominal levels.

Among the four large provinces (Quebec, Ontario, Alberta and British Columbia), the (unweighted) average peak cash benefit for a single employable person among these provinces over the years 1990-94 was \$8,600. By 2005, the average had declined in real terms by a quarter, to \$6,400.¹ In Ontario, the decline from the peak 1990-94 value to 2005 was a third. In the early 1990s, Ontario benefit levels were much more generous than in any other province. By 2005, they were still above the four-province average, but much less so.

Another important category of beneficiary is lone-parent families. The (unweighted) four-province average peak cash benefit between 1990 and 1994 for a lone-parent family with one child was \$17,400. By 2005, this average had declined by a fifth, to \$14,400. Again, Ontario benefits were the most generous in the country in the early 1990s, and the proportionate decline was largest in this province. By 2005, Ontario benefits were still above the four-province average, but much less so.

The trend to lower cash benefit levels has probably come to an end. Since 2005, some provinces have announced modest increases. Furthermore, reference to cash benefits ignores the increases since the 1990s in the value of various in-kind benefits. These range from health benefits (both those available to the general public and welfare-specific benefits such as dental insurance) to child care subsidies (paid to care providers).

Expenditure data have certain conceptual advantages over income as measure of well being among the poor. People may smooth consumption over time by borrowing from savings. An example of an expenditure-based study is Brzozowski's (2007) assessment of the impact of 1995 welfare benefit cuts among Ontario single mothers. Their average consumption declined in the years immediately following the 1995 welfare benefit reductions; their average consumption had recovered to pre-1995 levels by 2000.

1 The calculations in this appendix are based on National Council of Welfare data (Canada 2006). In addition to provincial welfare benefits, they include additional federal and provincial cash benefits. The most important such benefit is the Child Tax Benefit, payable to low-income families with children. All amounts are expressed in 2005 dollars.

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