



AN ECONOMIST'S CASE FOR INCOME SECURITY IN THE 21ST CENTURY

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Introduction

The next decade will place large challenges on firms and governments across Canada. The overarching theme is the demographic transition of the "baby boomers" into retirement age, and, as a consequence, a slowdown in the supply of labour and the pace of economic growth, as well as heightened demand in key expenditure areas – particularly health.

These pressures will be felt differentially across regions and will pose challenges for fiscal federalism. Yet, all jurisdictions are entering this period with some degree of fiscal disequilibrium, with large deficits – many of them structural – and already substantial debt burdens relative to GDP. An extended period of fairly stringent expenditure restraint will be required in order to restore fiscal balance. Federal and provincial governments will face additional revenue pressures from slower trend growth, just as the fiscal burden of age-related expenditures in already-established programs is mounting.

Concurrently, Canada's languishing productivity performance demands critical investments in education, infrastructure, and interventions to enhance the efficiency of labour markets. These are areas of overlapping federal and provincial responsibility and a coherent strategy will require diligent intergovernmental cooperation. In particular, well-coordinated reforms to income security will be critical to the greater participation in labour markets and efficient allocation of workers across the federation.

Recent studies have flagged the slowing growth of the working age population and alleged a variety of implications from the consequent slowdown of labour force growth. As we observed in a recent special report, slowing labour force growth certainly has implications for the trend pace of output growth.¹ However, the allegation of future "worker shortages" is grossly overstated. Our economy will not experience such "jobs without people"² per se, but wages – particularly for skilled jobs – will inevitably be bid upwards by a lower influx of workers. Fewer new workers and higher labour costs also will place a premium on improved labour productivity – particularly through investments in capital and skill acquisition.

As a simple identity, an economy's growth in output is the sum of the growth the hours worked by the employed labour force and the growth in output produced in each hour worked (that is, labour productivity). Facing upward wage pressures, firms should rationally respond by investing in innovation and new equipment.

The critical questions are how much will wages rise and how will productivity respond?



Upward pressure on wages is not without potential costs and uncertainties. Even with better capital investment by firms, productivity may not respond as rapidly as wages are bid upwards. Observing Canada's dismal recent productivity performance, this demographic transition is keenly on the radar of central banks who recognize that such a rise in wages, absent of productivity improvements, would raise unit labour costs³, with consequent pressures on inflation.

As well, we cannot ignore rising income inequality. Gains in average wages over the past decades have accrued mainly to upper tiers of the income spectrum, reflecting the increasing returns to skilled workers. At the bottom of the household income spectrum, market incomes of the lowest quintile have stagnated in real terms and those in the second and third income quintiles have actually declined since the mid-1970s.

To mitigate this disparity, it would be difficult and less desirable to affect direct redistribution of income. Such redistribution reduces incentives for earning and investment by higher-income individuals. Our overwhelming preference is for improvements to the labour market returns for below-median wage workers, founded on advances in their productivity. Yet, given the complementarity of high tech capital and higher education, we suspect that an increased premium on worker productivity as labour force growth slows would intensify this trend. The divergence in labour market opportunities and outcomes could certainly strain social cohesion in Canada, as has certainly been witnessed in other developed countries.

In this context, while "jobs without people" is hyperbole, the "people without jobs" aspect of future-gazing must be an important policy concern – for businesses, households and governments. Labour market policies must turn to encouraging and enabling the participation of underrepresented groups. Policies that increase labour market integration and facilitate skills acquisition – particularly for marginalized groups like recent immigrants and aboriginals – can thereby mitigate some of the pressures induced by slowing labour force growth.

As well, heightened participation in labour markets by females has provided a strong push to labour force growth in the past decades and females have outnumbered males in undergraduate university programs for over two decades. Yet, even controlling for education level and work experience, women still face significantly lower average earnings relative to their male counterparts. The earnings gap narrowed up to the mid-1990s but appeared to stagnate thereafter.⁴ The earnings gap evident for women who take maternity

leave must be investigated and addressed if women are to equitably participate in the Canadian workplace. Enhancing the role of female workers will require efforts by businesses and governments to mitigate systemic barriers to their participation. In particular, the availability and cost of childcare remains a clear consideration for females during the period of child-bearing and child-rearing.

Since the goal of "income security" is more properly stated as ensuring an adequate and stable level of consumption, income security programs also should be designed with attention to different household circumstances and life stages. Different costs of consumption apply at different stages of the lifecycle (for instance, expenses during child-rearing or during a disability), requiring a different mix of policy tools.

As well, we must observe the role that income security, and the corresponding ability to participate actively in society, can play in individuals' sense of well-being and the cohesion of communities. As economists, we are often loathe to pay heed to such often-unquantifiable sociological factors. However, an evolving body of research increasingly points to the value of "social capital" and the contribution of individuals' subjective well-being to worker productivity.⁵

In this context, income security programs must be viewed as critical elements to achieve our broader labour market objectives. Income security is then intertwined with a broader array of social policies, and the income support programs powerfully shape the opportunities and incentives for citizens across their lifecycle. On one hand, income security programs can enhance individual opportunities within labour markets; but, on the other, distortions within these programs can discourage labour market attachment.

As examples: the provision of childcare and access to affordable housing and transit can enhance access of marginalized populations to employment; the structure of retirement benefits influences how much individuals save and how long they work; and the calibration of Employment Insurance benefits to regional unemployment limits the incentive to depart communities where job prospects are poor or where work is seasonal.

The desirability of outcomes is dependent on the efficiency of a program's design and its interaction with other measures. Canada's income security programs have evolved in a patchwork fashion – often resulting in perverse and conflicting incentives. Historically, governments have tended to plug holes once the leaks had already sprung. For instance, cyclical downturns had precipitated stop-gap measures in social assistance and Employment Insurance

(EI). To a degree, reactive policy is inevitable but, even where vulnerabilities of programs to aggregate shocks are apparent, too little emphasis has been placed on designing an income security system that works in both good times and bad.

Moreover, our social policies and income security programs tend to be “siloeed” from one another – particularly with regards to the preventive savings that early interventions may achieve. Governments can be notoriously short-term in their thinking. However, addressing income security challenges requires a “lifecyle” approach, recognizing that the seeds for success in one’s working life are laid in early adolescence and that preparation for retirement should be continual during employment years.

Economists will recognize such an approach to income security across the “lifecyle” as a dynamic optimization problem where actions at each stage influence subsequent conditions. Where governments fail to ensure early investments or encourage beneficial behaviour, the future costs can be much more substantial.

More tangibly, research has demonstrated the incredible returns to investment in early childhood education – particularly when targeted to at-risk children – through reducing future transfer costs, as well as improving health outcomes and decreasing the probability of criminal behaviour.⁶ With regard to retirement preparation, research in behavioural economics highlights that individuals, if lacking a commitment device like a pension plan, will often save less than they would prefer, given their expectations for retirement and implicit preferences for lifecycle consumption smoothing.⁷

Policy-makers should always be cautious of condescending to individuals about their best interests. However, government has a possible policy role where identifiable market failures – particularly around the provision of social insurance and the presence of externalities – inhibit efficient outcomes. Seeking greater labour market efficiency, income security programs must be well-integrated, forward-looking and, in the context of Canadian federalism, coordinated between federal and provincial governments.

Canadian federalism has always been a path-breaking experiment, recognizing differences in regional perspectives and preferences while ensuring equality between individuals under a common citizenship. The aims of economic federalism can be summarized as to promote efficient flows of goods, services and people across the internal market, and to provide comparable services at comparable taxation levels. These goals for economic federalism are relevant to the social policy challenges facing Canadian governments

– and, in particular, to their ongoing efforts to enhance income security.

We therefore proceed by: first, discussing broad challenges for social policy within the Canadian federation; second, discussing the efficient design of income security programs in a federal context; and, third, discussing income security frameworks across childhood, working-age, education, disability, and retirement, evaluating the interplay and efficacy of different components. We conclude with some recommendations for future policy directions.

Social Policy Challenges for the Federation

Fiscal pressures across the Federation

In the present context, provincial governments will struggle to restrain expenditure growth and restore fiscal balance. The federal government’s plan to return to balance relies strongly on a rebound in Employment Insurance contributions and envisions a substantial downsizing of the federal public service. Even with the forecast revenue rebound and projected cuts, holding program spending growth below 2% will place pressure on existent transfer arrangements to individuals and households and allow scant room for additional transfer spending. For provinces, some governments will certainly struggle more than others, with intensified pressure from both ebbing revenue growth and heightened dependency ratios. Indeed, Ontario and Quebec both face debts relative to GDP that, with the next five years of projected deficits, will surge well beyond prior peaks.

Faced with these mounting fiscal pressures, governments will be reluctant for additional spending and a premium will be placed on honing the design of social spending. As well, as eastern Canadian manufacturing suffers through a protracted restructuring and western Canada benefits from emerging market commodity demand and Pacific trade linkages, inter-regional differences will become increasingly stark. Migration of younger workers in response to the differences in opportunities will likely further tilt the demographic imbalances across regions, with consequent impacts on fiscal capacity and need between provinces. And, with continuing differentiation of their industrial structure and trade partners, provinces’ labour markets will continue to face different cyclical shocks and pressures, requiring income security programs that are more responsive to regional conditions.

In the face of these challenges for the federation, the federal government will need to play a crucial coordinating role, revisiting the structure of key social insurance programs and the framework for federal transfers. In general, the as-



signment of expenditures seems roughly correct, with the federal government providing transfers to individuals and the provinces delivering programs. From a federalist vantage, the federal role in transfers ensures equality between individuals living in different regions, while provincial responsibilities for programs allows tailoring of services to regional preferences. However, provincial fiscal capacities are often not well-matched to these expenditure responsibilities. The fiscal capacity differences along federal-provincial and inter-provincial axes continue to present stresses. Fiscal federalism has rightly moved away from inefficient open-ended, cost-sharing formulae, but economic and demographic trends will likely place pressures on the present inter-governmental transfer arrangements.

At the same time as noting the fiscal pressures, we must also note the better immediate state-of-repair of public finances relative to 15 years ago. Although debt/GDP will mount – particularly on the provincial front – present deficits represent a lower share of income. Such radical “surgery” as was undertaken during the 1990s will not likely be required, but the looming brunt of age-related spending – most of it on the provincial ledger – is substantial. Mounting fiscal pressures will nonetheless restrain additional spending and compel a focus on the redesign of social spending in order to enhance fiscal efficiency.

The funding structure for the federal health and social transfers will need to be renewed in 2014 and will require a careful review of the matching of provincial fiscal capacity with expenditure requirements – particularly with respect to health care. Owing to demographic differences, differential fiscal needs may increasingly stress the sufficiency of equalization and program transfers. The prairie provinces, with a younger tilt, will have a much more favourable dependency ratio while a more aged population on the coasts may strain demand for age-related services. As well, while constitutionally education remains a provincial responsibility, the mobility of skilled workers across the federation requires that education be considered from a national, rather than provincial, perspective. This national context for education – particularly post-secondary education – demands national standards and support for educational quality and access.

Forums for Federalism

These challenges require forums for better cooperation between the federal and all provincial governments. Inter-governmental affairs have remained concentrated along channels between the federal government and individual provinces. Where the federal government undertakes discussions with all provinces, this is typically at the level of

the first ministers. A major gap in Canada’s structure for federalism has historically been strong and permanent all-province entities. Moreover, with the recent devolution of many facets of social policy to provincial governments, provinces have followed divergent paths, and many advantages of scale and knowledge sharing are not being reaped.

Yet, the challenges facing Canada arguably demand greater emphasis on such inter-provincial forums, focused on particular areas of shared responsibility and mutual interest. These forums importantly facilitate cooperation on policy but also act as clearinghouses for data and help identify critical gaps in information. To this end, in health policy, provinces have collaborated with the federal government on the creation of the Canadian Institute for Health Information (CIHI). CIHI fills an essential role in coordinating consistent health information and independently monitoring health care indicators of across the country. We see scope to broaden the cooperation between provinces in identifying and sharing best practices in health care delivery. In particular, as we recommended in a recent report, Canada would benefit from an inter-provincial agency that provides centralized guidance and facilitates quality standards in health care across different jurisdictions – similar to the cost-benefit advisory role played by UK National Institute for Health and Clinical Excellence.⁸

Within education, the Council of Ministers of Education, Canada (CMEC) provides a key forum for discussing access and quality across all levels of education. In particular, the Council has a focus on sharing educational data and, at the post-secondary level, useful initiatives on affordability and student aid, inter-provincial standards and credit transfer, and aboriginal access.

For inter-provincial labour market issues, the Forum of Labour Market Ministers has emerged to fill a similar role, working in conjunction with the federal department of Human Resources and Skills Development. Improving the quality of labour market information has been a primary focus of the forum – particularly in regards to providing data local labour market conditions on a frequent basis. In a recent report, after wide consultation, we recommended on strategies to improve data collection and dissemination.⁹ However, very little progress has been made towards improving its quality and availability despite this and several other in-depth reports.

One issue is that the incremental cost of expanding the coverage of Statistics Canada’s Labour Force Survey is quite onerous if extended on a province-by-province basis. However, if provinces were to all collaborate through



StatCan on increasing the resolution of small area labour market statistics, the fixed costs would be spread across the participating provinces and the expanded LFS would be less expensive to each individual province.

While such moves towards inter-provincial collaboration generally bode positively, it should also be noted that an east-west divide is increasingly apparent in the bilateral provincial arrangements being explored and finalized. Specifically, Alberta and B.C. have concluded trade and labour market agreements, and Ontario and Quebec are finding increasing mutual interests around energy, environment and trade. Cooperation that is concentrated within regional blocs could yet be a potential strain for the broader federation. Having all-province forums and the participation of the federal government as a facilitating partner ease the potential for widening chasms between regions.

Federalism and Statistics

To design good policy across all of these areas, provinces and the federal government have a mutual interest in consistent, high quality statistical data on labour markets and social trends. Providing local, regional and national statistics is an unglamorous but essential component of federalism. Good and accessible statistics are critical to a responsive labour market and the effective design of social expenditures. Across regions, workers, employers and policy-makers benefit from centralized statistical information in making decisions about where to move for work, locate operations and allocate scarce public resources.

The functions of data collection and dissemination are logically assigned to the federal government, which benefits from economies of scale and can ensure consistency in the statistics reported for different geographies. The international reputation of Statistics Canada testifies to the investments that federal governments have made in statistical data.

A responsive 21st century labour market requires better and more timely information about local and regional labour market conditions and the characteristics of the labour force. On this front, our current Labour Force Survey is not adequate for providing “small area” data. Unlike the U.S. and Australia, Canada lacks a quarterly job vacancy survey and the cancelation of the Workplace and Employee Survey terminates what data we do have on job vacancies. None of the education-related surveys, such as the National Survey of Graduates or the Youth in Transition Survey, have consistent funding and are constantly in jeopardy of cancelation.

Past censuses have provided more complete information about labour markets and the labour force, but a census

each five years yields only an infrequent snapshot and the processing of the census unavoidably lags when new data is received (the 2006 census tabulations on labour activity, education level and occupation were not released until 2008). Nonetheless, a consistent and comprehensive census is an essential element of Canada’s nation-wide framework for labour market information.

The evidence is that the present federal government’s planned elimination of Statistics Canada’s long-form census will bias the data that we receive on local labour markets. As well, there is a substantial risk that this bias will impair the quality of data from other surveys, like the LFS, the sampling strategies of which are based on census data.

Designing good policy requires good statistics. Federal and provincial governments must cooperate to this end. Indeed, Statistics Canada must be mandated and function as a national resource, rather than a federal government agency.

Broadening Canadian Federalism

Two emerging facets in Canadian federalism should also be noted: the role of municipalities and the matter of aboriginal self-government. Cities and First Nations will increasingly become key considerations in the structure of federalism – particularly with respect to social policy.

Canada’s population is increasingly urban, and, while Canada’s major cities have populations greater than many provinces, urban communities are markedly under-represented within federal and provincial legislatures. While creations of provincial statute, municipalities nonetheless fund and provide many of the conduits for social services, such as social assistance, settlement support for recent immigrants, training and employment counseling, and public housing. As well, neighbourhood life and municipal infrastructure – particularly with respect to housing and transit – shape the “social capital” that is increasingly recognized as relevant to educational and health outcomes of individuals. Indeed, municipal infrastructure expenditures have grown considerably in their share of government fixed capital investment.¹⁰ With a continuing trend towards urbanization in Canada, federal and provincial governments will together have great interest in what happens in cities.

The quickening move towards aboriginal self-government also means a restructuring of arrangements around responsibilities for social expenditures. First Nations communities will presumably assume these responsibilities alongside their powers and the restructuring of transfer arrangements to First Nations governments will introduce new dimensions to Canadian fiscal federalism. Most recently

articulated by Assembly of First Nations National Chief Shawn Atleo, the rising calls to eliminate the antiquated and discriminatory Indian Act will require a new framework for the relationship of First Nations governments with federal and provincial governments. Funding arrangements and federal-provincial responsibilities for on-reserve aboriginal citizens will have to be revised. It is inevitable that this long-overdue dismantling of the Indian Act will compel an evolution of Canadian federalism.

Federalism and Income Security

Before turning to income security at different life stages, it is relevant to consider the aims of social policy from a federalist perspective. In a previous paper, we described the economic functions of social policy as providing social insurance (such as income security programs), making social investments (such as education) and facilitating social inclusion (such as settlement programs for recent immigrants).¹¹ Within a federation, where responsibilities for social programs may be assigned to either federal or subnational governments, the structure of social policy must be designed with consideration of potential distortions or inequalities that may exist across regions. From a federal perspective, we then identify the following goals for social policy:

- To minimize net fiscal benefits¹² between regions (that is, for a given individual, there are only negligible “arbitrage” opportunities through inter-regional differences in the value of benefits received minus taxes paid), ensuring comparable services at comparable levels of taxation;
- To facilitate mobility across the federation as right of citizenship and with the aim of an efficient internal labour market;
- To facilitate optimal investments in human capital, where provinces might underinvest, given that human capital (and thus the income tax base) is mobile and an individual province may not capture the full social benefit from subsidizing education; and
- To buffer region-specific shocks, providing “insurance” against regional-focused cyclical downturns for individuals living in those regions.

Given the above aims of social policy in a federation, income security certainly requires some degree of federal coordination. It is then also relevant to consider the main policy levers for income security. Within a federation, fiscal efficiency may warrant assigning each tool to a different order of government, while nonetheless avoiding a patchwork

of competing influences. The design of retirement income security has followed a pillared approach. We would extend such a framework to income security in other phases of the lifecycle. In a general, we propose four pillars to support income security at each life stage:

- Base benefit with income-tested tax-back;
- Compulsory contribution-based social insurance;
- Incentives for self-insurance through saving; and
- Expenditure-contingent refundable tax credits or in-kind transfers.

For retirement, the Old-Age Security and the Guaranteed Income Supplement (OAS/GIS) comprise the first pillar, the Canada Pension Plan (CPP) comprises the second, and the tax treatment of retirement savings plans and pensions comprise the third. A nascent pillared approach is present for supporting income security for families with children, incorporating income-tested child tax benefits and tax deductions for dependents.

Similarly, an analogous framework for working age adults appears underway. Ultimately, one can envision that such a framework would consist of: 1) a guaranteed annual income coupled with a working-income tax benefit as the first pillar; 2) EI as the second pillar; 3) the elimination of asset rules and modification of TFSA treatment encouraging a third pillar of self-saving; and 4) a housing benefit, segregated from social assistance and calibrated against average rent, as the fourth pillar.

In all of these “life stage” income security programs, there is abundant room for cooperation – as well as friction – between the federal and provincial governments. Against the backdrop of fiscal pressures, the funding and generosity of income security and broader support programs will likely become an increasing arena for federal-provincial tensions.

Income Security Across the Lifecycle

During Childhood

Provinces in particular are placing an emphasis on support for children and for parents with children. The last years have seen some major innovations on the child benefit front, recognizing the pernicious effects of child poverty. The federal government has been reluctant to devote funding to early childhood education and childcare, preferring direct transfers to parents. However, certain provinces have pushed ahead with initiatives around childcare and early childhood education programs, targeted to at-risk communities. The funding burden and differential availability of

these programs between provinces may become a tension in the federation.

The well-being of children will always be linked to the well-being of the families in which they reside and, thereby, the income security of their parents. As we discuss below, although positive strides have been taken, there remain abundant gaps in the framework for working-age income security in families with children. Where parents fall short, children suffer.

For students and worker retraining

Income security during post-secondary education (PSE) and periods of retraining impacts individuals' acquisition of human capital. As an economy near the technological frontier, aspiring to produce goods and services at the top of the value-added chain, Canada has an interest in workers undertaking optimal investments in their human capital.

Returns to education certainly accrue privately but there are abundant positive externalities from an educated population. These certainly include participation in civil society, but there are also agglomeration economies from a skilled workforce. For example, an individual engineer will perform better when immersed in a setting with other skilled professionals, being able to specialize and complementing one another's specialties. Society has a definite interest in promoting individual skill acquisition. Yet, with workers mobile, provinces and Canada arguably face "leakages" on recouping their full investment if workers undertake education in one jurisdiction but depart to employ those skills in another province or country.

As well, educational attainment directly impacts income security across the lifecycle. The prevalence of and real wages for low-skilled jobs have steadily diminished. Those with only a high school diploma face diminishing prospects in labour markets, and, with competition from abroad in the manufacture of low-skilled goods, this trend will only deepen. Recognizing that skills are increasingly requisite for employment, promotion of participation of marginal groups in post-secondary education mitigates their risk of unemployment and income inadequacy during their working life.

Indeed, especially during periods of rapidly changing industrial structure, such as that accelerated by the most recent downturn, workers must often undertake re-training in order to adapt to changing demands for occupation. Particularly with mid-life family commitments, workers face a trade-off between sustaining household income with a stopgap job or undertaking retraining that would widen their employment opportunities.

For retraining, the EI program imbeds programs for retraining benefits and provincial social assistance programs generally incorporate support for those undertaking further education. Importantly, through the Labour Market Agreements (LMAs) between the federal and provincial governments, progress has been made on extending training funding to individuals beyond those in the EI system. Committing \$500 million annually for 2008 to 2014, the federal government concluded a series of bilateral arrangements with all provincial governments to fund retraining, particularly focused on low-skilled workers who are not eligible for EI benefits. The agreements grant provinces autonomy in planning training initiatives for their particular labour markets, but the range of funded programs includes adult literacy programs, apprentice supports, immigrant integration services, and technical skills training.

The periods of education or retraining involve temporarily foregoing earned income and there is significant uncertainty about future returns. Since creditors have no assets against which they can claim, it is very difficult to borrow on one's future human capital. This represents a "liquidity constraint", inhibiting the optimal acquisition of human capital. As well, an individual student's perceived trade-off between the opportunity cost of foregone present earnings and unpredictable future returns may undershoot the social gains to their educational investment.

To this end, there is a critical government role in upholding quality standards across PSE and retraining. The value of a course of training is found in the ultimate application of students' accumulated knowledge and skills. Increasingly, higher education must prepare students to be flexible to new economic conditions and capable of independent lifelong learning. Yet, in undertaking PSE or retraining, students place great trust in the expertise of institutions of higher learning to structure academic programs that will suitably hone their skills and equip them for the workforce.

Certainly, students have a responsibility to approach their scholastic progress with personal effort and persistence. However, as the merchants of knowledge, educators have a responsibility not just to spew material in thousand-person lecture halls and expect its regurgitation on multiple-choice exams, but to diligently mentor students' intellectual development. With university budgets increasingly stretched, larger classrooms and diminished professor interaction diminish the quality of student learning. All universities are struggling to cope with their fiscal pressures and many have adapted creatively. However, the deterioration of quality in Canadian university teaching and learning misrepresents the

value of a degree to those students who seek it, betraying a public trust. Governments have a role in safeguarding those standards.

As well, an entering post-secondary student lacks perfect information about the correspondence between their aptitudes and particular programs. Within a knowledge-based economy, increasingly reliant on innovation, it will be increasingly rare for students to undertake training that leads to a defined career. A linear and undeviating path of skill acquisition for every student may not be optimal. In an economy that seeks to generate value by new technology and knowledge, pushing the frontiers often requires individuals who have pursued a longer and circuitous path of training, spanning multiple disciplines. Students cannot appreciate the holes in their own training – or the gaps in knowledge generally – until they have sufficiently immersed themselves in a discipline. Support for education must recognize that creative and innovative students rarely tread established trails.

Better information about labour market trends and informed career counseling can help alleviate students' perceived risks, but financial aid programs are needed to ease the opportunity costs and liquidity constraints. Students require early introduction to the financial aid available and this should be particularly targeted to those at risk of not attending PSE.

In an earlier report on Canadian Post-Secondary Education¹³, we identified the following as key planks of a national strategy to improve PSE access:

- Ensure better outreach to and preparation of students well before they reach PSE, addressing non-financial barriers to participation;
- Provide a more generous and targeted financial assistance program, ensuring close monitoring of access and transparency of financial aid allocation; and
- Improve support programs for enrolled students, ensuring predictability of costs and funding across the length of a student's program, safeguarding degree completion.

Indeed, these were the major pillars of the Canadian Millennium Scholarship Foundation's (CMSF) mandate. During its 2000 to 2010 existence, the CMSF made major strides in improving PSE access for marginalized groups, encouraging student achievement and youth engagement, and facilitating a nation-wide alliance around shared aims in post-secondary education. Alongside targeted scholarship

and bursary funding, a core component of its role was to monitor and report on access. In 2008, the Federal government announced that CMSF was not to be renewed, and created the Canada Student Grants Program (CSGP) as a replacement. Relative to the CMSF, the latter program has a larger annual funding commitment and a broader reach – although there are certain concerns that targeted support for lower-income students may be diminished. Importantly, the CSGP lacks the data collection and reporting mandate fulfilled by the CMSF. Similarly, the recent termination of federal funding for the Canadian Council on Learning eliminates a centralized clearinghouse for information on quality in education.

In an increasingly knowledge-based national economy, a crucial federal role is to collect data on PSE access and quality, as well as to provide analysis of national and inter-provincial trends. However, particularly for assessment of financial need and educational access, data and analysis is scant and irregular. Studies on access have been infrequent and lag changes to student aid systems. If access is to be guaranteed, provinces and the federal government must collaborate to undertake timely and ongoing data collection and monitoring, with frequent reports on trends in student financial need. Recognizing that educational access is critical to the advancement of marginalized groups, governments and PSE institutions should gather socio-economic data on their students in order to identify whether they are adequately improving access for underrepresented groups.

Policy decisions about PSE funding and the assignment of student aid must rely on evidence. We have noted that StatCan's educational surveys are constantly in jeopardy. Alongside consistent funding for these surveys, better administrative datasets from provinces and institutions are required in order to closely monitor access and to improve design of financial aid, ensuring that all able students can pursue higher education. The federal government, working collaboratively with the provinces, can fulfill a vital role in providing consistent, cross-province information on access and financial need.

From present evidence, even with government loan programs and grant support, there remain evident barriers to able students from low-income and lower-middle income families to undertaking post-secondary education. High school students with A-plus averages from the lowest income quintile are much less likely to attend university than those from the highest income quintile. This wide divergence in the probability of university attendance between high-school graduates of different family incomes but with



equivalent high school grades highlights both a grievous inequity and a waste of potential human capital.

In this, promotion of private family saving has been largely ineffective. The uptake of tax-favoured Education Savings Plans has been concentrated in the upper-income tiers and therefore represents a subsidy for those who are already likely to attend PSE rather than a boost to those who are less likely. Moreover, transfers to students do not appear well-targeted in regards to family background, given the universality of many post-secondary transfers. The tuition tax credit is not well-appreciated by lower-income students but is used extensively by students and families in upper half of the income spectrum.

In the context of Canadian federalism, cross-province differences in student aid and the costs of living away from home can often inhibit students' access to chosen programs. Post-secondary education remains a provincial jurisdiction and, while the federal government contributes to student aid through the Canada Student Loans program, the much of financial aid is provided provincially and bursary funding is often delivered by individual post-secondary institutions. The result is an often confusing patchwork of financial aid programs that often hinder attending post-secondary programs in other provinces. Better federal-provincial coordination of financial aid and enhancing cross-province mobility for students should certainly be major objectives.

As well, the mechanisms for financial support differ widely across the country, as does the average extent of unmet student financial need between provinces. The Canada Student Loan program designates how need is to be assessed for these federal loans, but different provinces assess need differently, with varying cost allowances for different spending items faced by students (for instance, the allowable costs for living, childcare and educational supplies) as well as different inclusions of student resources (for instance, the assessed contribution from a student's parents).

On a common basis of assessment, students' average financial need, financial support and unmet need differ widely between provinces (notably, data on PSE students financial need in Ontario and Quebec were not provided to the CMEC/CMSF-sponsored study by McElroy [2009]).¹⁴ As well, provinces differed widely in the emphasis placed on repayable (i.e. loan) versus non-repayable (i.e. grant or bursary) support. Such differences present challenges for the sufficiency of PSE access across the federation.

All provinces have an interest in ensuring that all Canadians can achieve their potential, accumulating the right skills and attaining the knowledge that allows each individual to

be a creative and innovative contributor to the Canadian economy. Yet, the very mobility of labour means that a given province may not capture the full benefits from PSE investments or support for worker retraining. Coordination between the provinces is essential to ensure quality of and access to PSE and retraining. There is an essential role for the federal government in providing a common framework to support access to higher education, as well as in supporting nation-wide agencies that facilitate data collection and analysis.

During Working Life

Again, income security for working-age adults can be viewed as comprised of similar pillars as is the retirement income security system.¹⁵

Ideally, self-saving – equivalent to the third pillar of retirement security – provides a buffer and ensures that lower income workers have incentive to accumulate assets that can ease the impacts of an unemployment spell. However, workers should not have to liquidate their assets before being able to access other income supports or in-kind transfers. To this end, the federal government's recent creation of Tax Free Savings Accounts (TFSA) presents an important opportunity to enhance earnings and savings incentives among low-income workers – both in preparation for retirement and to buffer subsequent income shocks.¹⁶ Provincial governments differ in whether they exempt assets in TFSA and other registered accounts, and asset limits for provincial income support are arguably inconsistent with these registered savings accounts. To this end, we have advocated in a previous report for larger asset exemptions for claiming social assistance and, in particular, the exclusion of TFSA from asset tests.¹⁷ Similarly, the Toronto City Summit Alliance's 2006 report on Modernizing Income Security for Working Age Adults (MISWAA), "Time for a Fair Deal", recommended that social assistance asset limits be raised to \$5,500 for a single person and \$9,000 for a family.¹⁸

Secondly, a contribution-based Employment Insurance program fulfills a "second pillar" of working-age income support, providing income during an unemployment spell based on compulsory contributions. For working-age income security, the Employment Insurance program represents the greatest risk of federal-provincial tensions. Provincial governments are keenly aware of the disparities in access and coverage that result from the linking of the variable entrance requirement and benefit duration to the regional unemployment rate. The independent initiative by the Mowat Centre to review EI, projecting a report on

the program in Spring 2011, is likely to heighten pressure on the federal government for reforms.

As we observed in a previous report, the provinces have a definite argument that these differences can result in unfairness between otherwise alike workers in different regions who have the same insurable hours and equal probability of re-employment.¹⁹ More specifically, the probability of re-employment is the critical element in maintaining incentive compatibility and fairness within the EI system. That is, workers with identical probabilities of re-employment once unemployed will have equal incentive to keep their job and search for a new job once unemployed. As well, since horizontal equality (that is, equal treatment between alike individuals) is an objective, workers with the same re-employment probability should have equal access and benefit duration – regardless of when and where they became unemployed.

However, the variable entrance requirement and the length of benefits for a given number of insurable hours are calibrated to the regional unemployment rate, which is an imperfect proxy for the probability of re-employment, not accounting for the contraction or expansion of jobs or the turnover in the employed pool. At the extreme, where total jobs are contracting and no firm is hiring, an unemployed worker in a 6% has a 0% probability of re-employment, the same as an unemployed worker in a 14% unemployment region. The table provides an example of how a worker in a higher unemployment region can actually have better re-employment prospects if turnover is greater.

This inequity can be exacerbated during downturns when employment is rapidly contracting in formerly low-unemployment regions. When regional employment is in contraction, any laid-off worker faces a diminished probability of re-employment, even if unemployment is initially low. Indeed, their probability of re-employment may be equal to or even less than a region with a higher level of unemployment. As well, workers laid off in the early phases of a cyclical downturn, who also tend to be those with least seniority, face a higher standard for access and a lesser duration of benefits – even though, once their benefits expire, such workers will be searching for re-employment at a time when the unemployed pool has further burgeoned.

In-line with the insurance objectives of EI, there is room to enhance the responsiveness of the EI system to cyclical downturns. The use of a more precise metric for “re-employment probability” would be one option. Admittedly, such a measure would be difficult to compute from the existent Labour Force Survey and might not be readily

understood by the public.

However, the inclusion of a “vacancy rate” measure within the benefit structure could improve the fairness and responsiveness of the EI system. Although a vacancy rate is not presently calculated, as we note above, a vacancy survey has been recommended to improve our overall labour market information.

As well, incorporating the change in unemployment rate, rather than only the level as presently, would improve the responsiveness of the EI system to downturns. Another option would be for an automatic “flattening” of the variable entrance requirement and structure for benefit duration in response to a cyclical downturn. This was our recommendation in our earlier report. However, the federal government is somewhat understandably reluctant, given the costs of expanding access to the program.

As well, in regards to benefit duration, where Canada is facing a downturn that impacts across all regions, it is reasonable to expand the maximum benefit duration, recognizing that benefits may expire well ahead of the probability of re-employment improving throughout the country. The federal government commendably extended benefits by 5 weeks in its 2009 budget. In order to make EI benefit duration automatically more responsive to downturns, a trigger for an extension of benefits – both for new claimants and ongoing recipients – could be built into the program and linked with changes in the nation-wide unemployment rate.

Concurrently, there is well-founded concern that the structure of EI inhibits the migration of labour from high unemployment regions, subsidizing seasonal industries and leading to persistent pockets of unemployment.

There is a legitimate policy goal in mitigating the need for individuals to move in response to cyclical downturns. There are social and financial costs associated with migrating to a new region in search of work. As well, in communities facing temporary downturns, the simultaneous sale of housing as workers departed would needlessly single household net worth. To this end, some differentiation of EI benefits between regions is reasonable. However, workers should migrate in response to permanent and structural downturns that would warrant a re-allocation of labour to higher demand parts of the federation. There is evidence that the current EI program inhibits such efficient migration.²⁰

As well, in regions where EI is used frequently and for predictable seasonal unemployment spells, the program subsidizes the preservation of a labour pool that substantially exceeds demand. This artificially lowers wage costs for seasonal industries, discouraging their investment in

more capital and limiting the incentives to enhance industry productivity. Along these lines, the present structure of the program arguably limits the efficient allocation of labour across the federation. While politically expedient, the draw on the EI program by seasonal industries heightens overall EI program costs.

A significant federal-provincial tension may yet be a desire to introduce risk rating or intensity rules within EI. Intensity rules were included in the amendments to EI/UI but these were revoked in 2001, despite evidence that these provisions had reduced recurring use, particularly in high frequency regions.²¹

The “first pillar” is where our working-age income security systems remain most incomplete. While moves have been made to lessen marginal effective tax rates as individuals move off Social Assistance, programs still involve high tax-back of benefits as income is earned. Nonetheless, recognizing the pernicious barriers to leaving social assistance, governments appear to be committed to deconstructing the “welfare wall”. Although some tweaking of the rate structure could improve its incentive effects further²², the recent Working Income Tax Benefit (WITB), which was a key recommendation of the 2006 MISWAA report, was a landmark innovation by the federal government to this end.

The next policy development on the “first pillar” front will likely be a guaranteed annual income (GAI), for which advocates from across political parties have been pushing. Such a measure would extract basic income support from the monitoring-intensive administration of social assistance and effectively imbed a GAI as refundable tax credits alongside the WITB within the income tax system. Like the OAS/GIS, delivery through the personal income tax system would income-test the measure while ensuring that the disincentive to earned income is minimized. For integration within the federal personal income tax system, the move to a GAI would logically be federally-coordinated, with payments delivered via the Canada Revenue Agency.

The above reforms would construct a working-age income security system that mirrors the effective system that Canada has developed for seniors. However, there is arguably room to add a “fourth pillar” to the design of income security through expenditure contingent transfers. Imbedding such in-kind or expenditure contingent measures in the income security system can improve the efficiency of delivery and better calibrate support to consumption costs.

For instance, the linking of dental and drug benefits to social assistance creates somewhat invisible high marginal effective tax rates as individuals leave welfare and thereby

lose these benefits. A solution would be to auto-enroll low-income and marginally-employed individuals in these benefits on an insurance basis, rebating premiums through the income tax system, with some private contribution to premiums as income is earned.

As well, other goods, such as housing and transit, play a direct role in individuals’ access to employment opportunities and social inclusion, but can often be crowded out by other expenditures. Moreover, the differential costs of housing, whether between different municipalities or neighbourhoods, can affect the concentration of poverty and result in substandard housing, with consequent impacts on social cohesion.

Recent proposals have highlighted the role that a housing benefit can play in broadening access to housing and in alleviating the socio-economic segregation that can occur in cities.²³ As well, a provincially or federally administered housing benefit can address the revenue-expenditure mismatch that exists in municipal governments’ role in public housing. While public housing serves a distributional function, municipalities lack the appropriate tax bases to fund such services.

Such housing benefits would involve some proportional contribution on the difference between the standard share of income spent on rent and an average rent – typically for the given municipality or region. While broadening a family’s access to housing, the measure is incentive compatible since individuals personally face an increased cost for a higher rent and, since the measure effectively designates a minimum share of income to be spent on rent, it encourages additional earned income.

During Retirement

In regards to retirement income security, provincial governments have pushed for strategies to mitigate the possibility of inadequate retirement savings. The lack of pension coverage for many workers is widely viewed as heightening the risk of insufficient retirement incomes. As well, likely due to differences in industrial structure and pension legislation, the degree of pension coverage differs markedly across the country, ranging from the highest pension coverage rate in Quebec workers where roughly 43% of employed workers have an employer-sponsored registered pension plan (RPP) to the lowest in Alberta, where 32% of workers are covered by a pension. Moreover, for those workers who are covered, the extent of defined benefits differs widely between provinces, ranging from a DB plan for 57% of RPP members in Saskatchewan to 88% of RPP members in Quebec.

While pensions are constitutionally a provincial responsibility, the federal government has a definite coordinating role in retirement income security and the federal income tax system shapes incentives for retirement savings. As well, the federal government administers the CPP and funds the OAS/GIS system. For the latter, the sufficiency of pension coverage and retirement savings impacts to the fiscal cost of old-age transfers.

Provincial governments in Ontario, B.C. and Alberta commissioned independent studies to assess present retirement incomes and recommend on options for expanding pension coverage.²⁴ The result of the Alberta-B.C. review was a proposal for a jointly-administered supplementary public pension plan, with automatic enrolment but opt-out. The initial discussions of retirement income security signaled the willingness of provinces to move independently on reforming retirement income security. However, pension portability and cross-province consistency urge a federal role in a pan-national strategy.

To this end, the federal finance minister has now taken the lead, appointing an expert panel, headed by Jack Mintz to examine the issue and recommend on measures.²⁵ Mintz's report was read as concluding that there was no pension crisis. However, Mintz did observe a substantial share of middle-income households that were not meeting targeted replacement rates.

As well, in taking a snapshot of present retirees, the study was primarily backward-looking, rather than providing a projection of how cohorts that are presently of working age will fare during retirement. The income security of present retirees owes to pension coverage under a very different industry structure and norms for employer attachment during an employee's working life. Labour markets have continued to evolve, with self-employment and contract work increasingly prevalent, and the share of employees covered by a pension in the private sector has continued to shrink. However, it should be noted that a slightly higher share of the population has pension coverage relative to a decade ago, owing to women's increasing participation in the labour force. Nonetheless, the changing character of work and the apparent dearth of autonomous retirement saving compel a more forward-looking approach in order to assess the future prospect for retirement income security.

Our own work suggests that there are substantial differences in retirement income replacement between retirees who had similar pre-retirement income, depending on whether or not they are covered by an employer pension. Indeed, based on the savings of present working-age co-

horts, our modeling anticipates that the share of retirees with inadequate income replacement will increase as these younger cohorts retire in the future.

Recognizing that present behaviour points to shortfalls in retirement income replacement for many middle income households in future retiree cohorts, the provinces have continued to push for nation-wide measures to enhance retirement savings. At the most recent meeting of finance ministers in early June 2010, the federal minister committed to further study and a tentative plan to enhance replacement rates under the CPP.

In our recent report on retirement income security, we identified that the nuanced distributional issues requires more modeling (using StatCan's unique microsimulation tools) and better data (in particular, an up-to-date snapshot of household wealth across age groups and income classes) in order to make informed decisions on expanding pensions.²⁶ To this end, we advised a "rush prudently, don't run blindly" approach that prioritized investments in modeling and data collection through Statistics Canada. However, we noted that certain measures can only improve the incentives to save and invest and recommended their immediate implementation. Broadly, these are:

- Enhancing the financial literacy of the Canadian population;
- Adjusting the tax treatment of registered retirement savings plans (RRSPs) and defined-contribution plans to be on an equal footing with defined-benefit employer pension plans; and
- Harmonizing pension regulations between provinces and clarifying funding requirements for pension plans, as well as encouraging the build-up of capital buffers relative to a fund's risk-weighted assets.

While we urged these "can only help" measures, given persistently paltry RRSP contribution rates, we do not think that they will remedy the retirement savings gap.

Moreover, our modeling suggests and our intuition is that further research will show conclusively that lack of pension coverage is the main stress to retirement income adequacy. While arguing that data-driven analysis should inform the ultimate design, we identified three key options for expanding pension coverage:

- Enhanced replacement rates under the Canadian Pension Plan;

- A public supplementary defined contribution pension plan with mandatory enrolment but opt-out for all workers without a pension (voluntary opt-in for self-employed workers); and
- Legislation that enables multi-employer pensions and broadens the ability of financial institutions to offer third-party pensions.

While seeing potential merits in all proposals, we expressed our preference for a hybrid of the second and third options. Such a strategy would preserve the autonomy around retirement saving decisions and improve flexibility in the ways to save, but would address the commitment problem many individuals face in saving consistently. The default opt-in feature could be attached to either the supplementary DC option or a multi-employer plan.

There are substantial benefits to an expanded CPP/QPP in its risk pooling, lower cost annuitization and scale advantages in management expenses. However, recognizing that the goal is to increase income replacement for the ‘at-risk’ population of retirees, we would contend that an expanded CPP/QPP is not well-targeted, crowding out the private retirement savings of those who already do save.

During Disability

Income support during disability reflects social insurance at its purest. The susceptibility to disability or an impairing accident is beyond choice and most every society accepts the moral obligation to ensure that those suffering from a disability are adequately supported and have the ability to participate. The income support system is similarly a pillared one, with base benefits provided through provincial social assistance programs, and contribution-based insurance against debilitating on-the-job accidents provided through workers compensation. Additionally, the personal income tax system imbeds deductions for disabled individuals, recognizing that, because of the individual’s impairment, a higher level of income is required for the same utility relative to an unimpaired individual. A recent innovation has been to introduce a registered disability savings plan, encouraging savings to support disabled individuals, and this could be viewed as a third pillar of support.

Where policy needs additional focus is in supporting labour market participation of disabled individuals and making preventative and restorative investments, as well as facilitating the employment transition of those with a long-term disability and supporting workplace adaptations that enable that transition.

Facilitating labour market participation of disabled individuals will increasingly be compelled by the demand for labour. Employers have a pressing moral responsibility and economic interest in making capital investments that enable access for those with impairments. Policy can support greater inclusion by knowledge-sharing on best practices, and through tax credits and capital cost treatment for accessibility-targeted investments.

As with educational investments with an eye to future outcomes, policy must become more holistic with respect to future benefits of investing in prevention and treatment deliberating disabilities. This is particularly true with respect to addressing mental health issues, in which we include combating substance addiction. The work of the Mental Health Commission of Canada has focused the lens on the productive costs to Canadian society of not addressing mental health.²⁷ The commission posited the need for a national strategy to this end. In an era of knowledge-led economic growth, Canada cannot afford lost human capital. Minds cannot be wasted.

Public policy should recognize the full range of supports needed to facilitate the difficult recovery and integration of those with mental health issues, including addiction. Income, dietary and housing supports are key components, but policy also must ensure the access to cohesive and consistent communities of care, recognizing the propensity for relapse where a broader network support is not present. The environmental determinants of mental health – and in particular the socio-economic influences – should be actively investigated and addressed, especially where these are shown to yield high rates of return relative to the social costs otherwise.

For Recent Immigrants

The settlement and labour market integration of recent immigrants is also an area where policies are grievously haphazardly-assigned and uncoordinated, with consequent pressures on the income security system. The census data to 2006 shows that each cohort of immigrants has experienced a widening wage gap with domestically-born Canadians compared to their predecessor. Worryingly, the wage gaps with domestically-born counterparts for university-educated immigrants are even more exaggerated than for those without a university degree.

While some progress has been made on credential recognition, language remains a challenge and employers continue to undervalue foreign experience. The inability to function in an official language environment will limit employment



opportunities for immigrants.²⁸ With immigration a federal purview but the costs of settlement support largely on provincial ledgers, we should consider both improved strategies to enable immigrants' integration into Canadian labour markets and adjustments to the point system that would improve prospects for immigrant success. Specifically, recognizing that language skills matter and that foreign experience is undervalued by employers, we should re-design the point system to reflect the evidence about what factors most help immigrants achieve success.²⁹

While the focus on in-demand occupations in a point system has superficial appeal, these sectoral demands have been transient and, most importantly, the Auditor General's report on the program observed that the analysis to identify these occupations had been weak.³⁰ The point system should be reformed using data on immigrant's employment outcomes, emphasizing attributes that enhance immigrants' long-term flexibility in Canadian labour markets.

To this end, provinces will likely petition for greater say in policy design for immigrant selection and funding for settlement. The federal government initiated a provincial nomination program in 2008, but, as was noted in the recent report by the Auditor General, the program devolved responsibility to the provinces and resulted in a wave of uncoordinated nominations by employers, purportedly as a response to regional labour market demand. With immigrant status tied to a particular employer, the system was rife with abuse and created potentially abusive situations for foreign workers. As well, from the Auditor General's report, there was little analysis in the program's design nor follow-up assessment in its subsequent refinement. Again, while

provinces can be important conduits to matching immigrant qualifications with the demands of regional labour markets, the federal government has a critical analytical and coordinating role to play. Good data and centralized analytical capacity are core capacities for the federal government to competently play this role.

Conclusion:

In summary, it seems likely that the present federal-provincial relationships will be stressed by tightening fiscal constraints, continuing divergence in labour demand and demographic structure between regions, pressures to reform patchwork programs, and petitions by marginalized groups and cities for a enlarged federalism. Cooperation between provinces, rather than a singular focus on federal-provincial arrangements, will increasingly emerge as a new pillar within Canadian federalism. As well, federalism will have to remain sufficiently malleable to adapt to the inevitable emergence of municipalities and aboriginal governments as key players in the federation.

In particular, income security for children, working-age adults and retirees are areas where policy will feel pressure for reforms. In this paper, we have exhibited the directions in which we believe reforms should proceed, outlining both opportunities and challenges for federal-provincial collaboration.

Inevitably, the challenges of income security, and of the broader labour market objectives with which it is intertwined, will continue to influence the evolution of Canadian federalism.

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