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The two poverty reports: an economist's view

We have been recently blessed with two, not one, reports on Poverty in Canada. Abundant ammunition for academic debates has been provided by a Senate Committee that underwent a schism in the process of investigation, and consequently produced the above two reports. The resignation of the four authors of *The Real Poverty Report* from the Senate Committee and the subsequent recriminations that followed have assured a new hearing for the complaints of the impoverished. Whether or not their actions and proposals will reduce the probability of acceptance for, anti-poverty measures (as Lithwick suggests in a review) remains to be seen.[1]

The essential difference between the two Reports is their approach to the economic system. Adams et al. argue that poverty is produced by the normal functioning of the Canadian economy, wherereas the Senate Report places far less emphasis on this point. Two thirds of *The Real Poverty Report* is devoted to the shortcomings of the economic system and recommendations for reform. This book is a product of the left progressive tradition, and, despite its radical rhetoric, it is not Marxist in its orientation. The authors perceive two crucial defects in the economy: 1) that high unemployment is tolerated and even generated by, the government; 2) that the market power of the, large corporations and labour unions has produced wide income differentials among individuals. The Senate Committee does recognize the problem of market power of labour unions, but. any discussion of corporations is conspicuously absent.

High unemployment is, according to *The Real Poverty Report*, a "result of policies chosen by the Canadian government to fight inflation." The authors believe that structural reforms in the economy would improve the putative trade-off between unemployment and inflation. (Examples of two such structural reforms are manpower training and regional development planning.) Nevertheless macro-economic monetary and fiscal policy still have an important role in fighting unemployment, and, as a result, the authors suggest a Swedish style investment fund to facilitate its implementation. That there is room for improvement in macro policy is well documented in a brief presented by T. A. Wilson of the Institute for Policy Analysis, University of Toronto, to the Senate National Finance Committee. The main points of the brief were essentially that the government should restrain the growth of the money supply, and should implement sales and income tax reductions immediately.[2] This was almost exactly the opposite of what the government was doing at that time. The Senate Report also asserts "that 'full employment' must be the prime objective and responsibility of government fiscal and monetary policy." Adams et al. exhibit a tendency to under-estimate the potency of a vigorous and appropriate monetary and fiscal policy for combating unemployment. The importance of full employment to an anti-poverty program can not be over stressed. As a recent study on the incidence of unemployment revealed: in 1964 a 4.7-per-cent unemployment rate did not mean everybody was unemployed 4.7 per cent of the time, rather it meant that 15 per cent of the population were unemployed 33 per cent of the time. This point may be obvious but it is essential that we are periodically reminded of it, for many are poor because they are unemployed for extended periods of time.

The Real Poverty Report argues that competition in the Canadian economy has actually helped entrench monopolies with 1) patent protection, 2) tax deductions for advertising expenses, and 3) tariff protection. Moreover the loophole ridden and judicially castrated Combines Investigation Act has done precious little to hinder the establishment of concentrated market power. The lack of competition in certain industries has enabled owners and managers as well as strong labour unions, to reap large rewards. Profits and wages in these industries are high while in competitive industries such as textiles, they are low. The solution to this problem suggested by Adams et al. is a combination of increasing competition in some sectors and reducing it in others. Presumably, they support the new Competition bill that would strengthen the anti-combines legislation to the evident discomfort of the business community. They support subsidized entry of competitors in some industries as well as the establishment of crown corporations to compete in others. They would do away with patents; 95 per cent are owned by non-residents anyway. They would make the capital market more liquid by putting a surtax on retained earnings which would ease the financial problems of new entrants. On the other hand, they would reduce competition by permitting price fixing. Ceiling prices for outputs of high-wage concentrated industries and floor prices for the output of low-wage competitive industries would be set by the government. The correlation between high wages and the capital intensity of an industry is also noted. Since worker productivity is higher, capital-intensive industries can pay high wages. Consequently spreading the capital around more would tend to equalize wages. Reducing the barriers to entry m an industry is one suggested way of accomplishing such redistribution. Also they propose getting rid of barriers to the movement of labour between one region and another and between one job and another. Reduction of these barriers can be accomplished with a more vigorous manpower policy, and more democratic and less restrictive trade unions.

The authors of *The Real Poverty Report* recommend a major institutional reform in Canadian collective bargaining. They believe that more widespread unionization followed by centralized collective bargaining both within industries and across the economy as a whole, such as is the case in Sweden, would lead to a great reduction in wage differentials. The government is, in theory, able to influence the nationwide bargaining in the interests of macroeconomic stabilization policy. In practice, centralized collective bargaining has not conferred the gift of price stability on either Sweden or the Netherlands, but perhaps it has contributed to greater income equality.

In the area of Manpower policy, Adams et al. have many concrete recommendations as well as some of a more philosophical bent. First they hold that the Department of Manpower and Immigration should concern itself more with its clients, the workers, rather than viewing itself as an arm of the employer. In order to be really effective they claim that Manpower must have a list of all vacancies, and they must couple their training program with accurate forecasts of the job market. Furthermore, the programs must be reformed so that they can reach the people who need them most. The 52 week maximum training period must be lifted in order to provide opportunities to those who need at least that period in just basic education such as reading, writing and arithmetic before they can qualify for more technically oriented programs. What neither of these reports stresses adequately, is that Manpower programs can be seen as an investment in human capital and that all of society benefits from the greater productivity of the poor. A recent study of the Manpower programs in Ontario has shown that in terms of payoff, these programs are among the most productive that government can undertake.4 The people trained earn more and pay higher taxes (or perhaps go off welfare). Such information should make the spending of tax dollars on Manpower programs more palatable to the Canadian taxpayer. [3]

Not surprisingly, the Canadian tax system comes in for some harsh criticism in *The Real Poverty Report*. They point out that those with an income of $2000 or less pay, on the average, 57 per cent of income in taxes, whereas those with an income over $10,000 pay only 38 per cent. The impact of the fiscal system on the poor becomes less unfair if we take into consideration the benefits in money and kind which the poor receive from the government. Nevertheless, it is absurd to take money from people and then return it as a great benefactor. The authors make a laudable plea for less reliance on regressive taxes such as the sales and excise tax, property tax and import duties, which take a higher proportion of income from the poor than from the rich, and for more reliance on the income tax, a truly progressive tax which takes a higher proportion of income from the rich. Canada is the only developed country in which over 50 per cent of revenue comes from taxes that can be classified as regressive.

The tax reform legislation that has just passed Parliament is characterized as a "travesty of the idea of reform." They base this assertion on the facts that deductions for dependants remain the same, the marginal rates for incomes over $60,000 have been reduced, tax credits have not been introduced except for dividends, charity deductions have been raised and estate and gift taxes have been abolished. I do not think that their criticisms are entirely fair. The reform is not all that it might have been given the hope aroused by the Carter Commission proposals, but it is still a major reform. The wealthy will pay higher taxes in spite of the lower rates because of the introduction of the capital gains tax. Moreover, the most glaring loophole in the new legislation (that is.. the abolition of estate and gift taxes) is being remedied by provincial action to increase succession duties.. If this gap was left unfilled, there would be a substantial transfer to the wealthy. ($4.8 billion according to John Bossons of the Institute for Policy Analysis, University of Toronto). *The Real Poverty Report* adds its voice to others calling for a net wealth tax at a rate of one to two per cent. However, they claim that in order really to reduce inequality of income, rates would have to be as high as 20 per cent. In the context of the present power configurations in Canada, such a proposal is, at best, utopian.

Both of the reports are very hard on the failings of the existing welfare system. They both have several interesting chapters on the present welfare scheme including a detailed account of the activities of the agencies that come into day to day contact with the poor as well as a discussion of intergovernmental arrangements for the provision of welfare services. Both also catalogue the deficiencies of present health, housing and legal aid policies from the point of view of the poor. The Senate and *The Real Poverty Report* are in remarkable agreement about the defects, and the main solution that both offer is a Guaranteed Annual Income supplemented by upgrading of present social services.

Considering the radical nature of *The Real Poverty Report's* recommendations for reform of the economic system, it is surprising that their guaranteed annual income scheme is so modest. Their poverty line and the income guarantee level are essentially the same, that is around $3500 for a family of four or $1500 for a single unattached individual, although they arrive at these levels by different paths. Adams et al. define the relative poverty level to be 50 per cent of average living standards, whereas the authors of the Senate Committee Report mention current official poverty lines and welfare benefit levels and then produce their own figures like a rabbit from a hat. The Senate Committee set the income guarantee level at 70 per cent of the poverty line so their poverty line is actually higher than that in *The Real Poverty Report*. An improvement in both of their poverty lines is that they increase with increases in the general standard of living.. Using these criteria, around 20 or 25 per cent of Canadians can be classified as poor.

Both reports are also in basic agreement that any guaranteed income plan must furnish some work incentives for the poor, if they are not to be perpetuated as a class outside of the pale of society. The poor, two-thirds of whom are already working, are allowed keep some proportion of their earnings as an incentive. For example, if a man were a recipient of a guaranteed annual income, he would have, let us say, 50 per cent of each additional dollar earned taxed away by the government in the firn of a reduction in his grant, until, when he was making 200 per cent of the income guarantee line, he would no longer be receiving the grant from the government. The level at which he no longer receives the guaranteed income is called the break-even point. It would always be in his interest to work to make an additional dollar. In contrast, the current welfare system takes a welfare dollar away from him for each dollar he earns over some pittance. However, the Senate Report and *The Real Poverty Report* differ on the recovery rate (that is, the amount of the grant to be recovered for each additional dollar earned). The Senate Committee recommends a recovery rate of 70 per cent, whereas Adams et al. suggest a temporary rate of 60 per cent, with an ideal recovery rate of 50 per cent to be implemented in the future. Both reports stress that the tax system should be integrated with the guaranteed annual income. It is very important that positive tax rates not begin to take their bite out of income until the individual is past the break-even point. Otherwise the incentive dulling effect of the recovery rate and the tax rate will compound each other. Under the new tax legislation, a rate of 14.8 per cent would be paid by a married taxpayer with two children on income between $3500 and $4500, $5000 being the break-even point in the Senate proposals with a recovery rate of 70 per cent. Depending on how the tax base was actually defined, the recipient of the guaranteed annual income could find himself paying 84 per cent of any additional earned income between $3500 and $4500 in taxes. The disincentive would be even greater for income between $4500 and $5000 where tax rates are successively 17 and 20 per cent. If such rates are said to provide disincentives for the working rich, they can hardly do less for the working poor. The Senate Committee should have been aware that the tax system was not going to be tailored to fit their proposal. They should have tailored their proposals to fit the tax system. [4]

It is important to note that the two proposals differ in the methods advocated for distributing funds to needy recipients .. The authors of *The Real Poverty Report* are in favour of a universal demogrant scheme (demo grant being the current jargon for a family grant) that would provide money to the families on a weekly or monthly basis, and the Senate Committee goes on record as being in favour of a negative income tax. Neither program would differ appreciably in administrative feasibility, and both would reduce administrative expenditures over current programs. Nevertheless, the demo grant is a better scheme because it provides the poor with a steady income and does not involve them in problems of financing with which they may be unable to cope. The poor can not adjust their consumption to the variations of their income flow as readily as the more wealthy in that they must borrow at outrageous rates from finance companies and pawnbrokers whereas their middle - class counterparts can go to their banker and secure loans at reasonable rates. The demogrant could be retrieved from recipients who were above the break-even point through a payroll deduction.

A major drawback of all Guaranteed Annual Income programs is that they are expensive and the cost of the program increases more than proportionally wth the poverty line and almost exponentially with reduction in the recovery rate. : Adams et al. estimate that their scheme with a recovery rate of 50 per cent, taking into consideration revenue saved by the elimination of family allowances, youth allowances and old age security, and the revenue lost by abolition of taxes on income below the break-even point, would cost, in 1967, $2.5 bil1ion dollars or 4 per cent of GNP. This compares to a Guaranteed Annual Income cost of $0.5 billion with a recovery rate of 70 per cent by their estimate, and $0.65 billion by the Senate estimate or around 1 per cent of GNP. They extrapolate that a program such as they recommend, with a recovery rate of 60 per cent, would cost $1.5 billion or 2.3 per cent of GNP. The program cost is less than the cost of various transfer and give away programs to industry, but the costs are high enough and the purpose unorthodox enough to make the financial conservative balk. Following the radical proposals for economic reform enunciated by Adams et al., the austerity of their guarantied income plan is a disappointment. We can expect senators to reduce the guaranteed income level to a minimum so that the program would be political1y acceptable to a cost conscious majority. The authors of *The Real Poverty Report* have no such constraint as an excuse for not stating loudly what the poor really need.

Costs of the program could be kept down by segmenting the program into two parts. One part would provide a poverty line income to those unable to work through a lump sum grant. The other would provide those able to work with a smaller lump sum grant and with an opportunity to keep a larger share of their earnings than under the comparable unsegmented plan. People would themselves decide which plan they wanted just as they assess their tax obligations under the Income Tax Act. This type of plan would have the advantage that a larger lump sum grant could be provided to those unable to work without necessitating a greater recovery rate with the concomitant disincentive effect for the working poor. Disincentives under this scheme would only be greater for those whose earnings were so low that they would have to choose not to work at all. Given that there are essentially two groups of poor, such a dichotomous plan would be what is needed. Neither the Senate Report nor Adams et al. discussed this scheme. Both the Senate Report and *The Real Poverty Report* emphasize that costs can be held down by other policies such as a minimum wage rate set at 60 per cent of the average wage in an area.
Critics of the program object to its cost, to the lack of connection with living costs in various regions, and to the principle that people should be given money rather than the goods and services they need. The last point is based on the attitude intrinsic to our current welfare system that the poor are morally deficient and unable to make decisions for themselves. Nevertheless, the human suffering, social waste of human resources, and the administrative wastes and disincentives built into our current system make a guaranteed income scheme necessary even at such a high cost. Some such program should be adopted and should become more generous with time. But such a program should not become an end in itseli. It must be remembered that it is a

means to enable people unable to work, the handicapped, dependent mothers, the sick, as well as the working poor, to provide a decent living standard for themselves and their family so that the cycle of poverty can be broken and they can live a decent life. 0

FOOTNOTES

1. N. H. Lithwick, *Globe and Mail*, Saturday, December 11, 1971.

2. *Globe and Mail*, Wednesday, June 7, 1971, page B2. The brief was based on work done by G. V. Jump, J. A. Sawyer, and J. W. Winder.

3. Ozay Mehmet "Evaluation of Institutional and On-the-Job Manpower Training in Ontario", *Canadian Journal of Economics*, vol. IV, No.3, (August, 1971).

4. *The Real Poverty Report*, page 141. The figures come from W. I. Gillespie, *The Incidence of Taxes and Public Expenditure in the Canadian Economy* (Ottawa, 1966) Table A-9, page 207.