REVITALIZING POVERTY REDUCTION AND SOCIAL INCLUSION

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In 2009, the Province of Manitoba introduced a poverty reduction and social inclusion strategy that was subsequently enhanced by the 2011 Poverty Reduction Strategy Act and the 2012 creation of a Workforce Development and Income Support Division. Manitoba's *Strategy for Sustainable Employment and a Stronger Labour Market* is not a static program. It comprises a series of key actions to be undertaken through 2015 and beyond which attempt to reduce poverty, encourage employment and smooth the transition "from assistance to independence" (Government of Manitoba n.d.:6). The purpose of this article is to explore the potential of three different policies to achieve the poverty reduction and social inclusion goals articulated in this strategy – raising minimum wages, introducing a guaranteed annual income (GAI) and introducing an earned income tax credit (EITC) that builds on the very small working income tax benefit that already exists at the federal level in Canada. These three policies have been at the forefront of recent debates on poverty alleviation in the post-recession period.

The article is organized as follows: first, we suggest that the fundamental approach of the provincial strategy is well founded, and that any approach to poverty reduction and social inclusion ought to consider the impact on current employment as well as future employability for all Manitobans. This is especially important for those

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most vulnerable to market downturns such as young people, new entrants to the labour market and people with disabilities. Second, each of the three policies is examined in isolation and assessed along three dimensions: the efficiency with which each policy addresses poverty, the relationship of each to employment, and the ease with which an individual can move into and out of the labour market. The ways in which these policies might be combined to enhance poverty reduction is considered in the final section, in which we advocate a pilot study designed to test the cost-effectiveness of an EITC in combination with minimum wage legislation.

I. PERSISTENT POVERTY AND EMPLOYMENT

In 2012, a new Workforce Development and Income Support Division was created by the Manitoba Government under Manitoba Entrepreneurship, Training and Trade.[i] This builds on the poverty reduction and social inclusion strategy introduced in 2009 (*All Aboard)* and the 2011 Poverty Reduction Strategy Act which, among other things, obligated the province to track a series of indicators and publish annual reports.[ii] The philosophy underlying this approach is the claim that "the best route out of poverty is through a well-paying job" and "Helping people get and keep good jobs so they can provide for themselves is a fundamental element of *All Aboard*, Manitoba's poverty reduction and social inclusion strategy" (Government of Manitoba n.d.:7). It might be argued that a poverty reduction scheme based on the claim that a good job is the best route out of poverty is fundamentally misguided because it shifts responsibility for systemic issues to the individual. However, the link between poverty reduction and employment is about more than assigning blame. Evidence has been accumulating for two decades suggesting that the effects of prolonged periods of unemployment, especially among young people, persist into the future in the form of reduced employability and lower wages (e.g. Nordstrom 2011). If such an association exists, then it is essential to look at the labour market opportunities and incentives associated with particular poverty reduction policies.

The theoretical basis for labour market scarring, which occurs when future remuneration or employment is negatively affected by periods of unemployment, can be found in human capital theory. This theory suggests that the deterioration of both firm-specific and general skills during periods of unemployment can reduce future employability and wages (Becker 1994). This deterioration is compounded if potential future employers percieve periods of unemployment as indicators of lower productivity (Lockwood 1991; Pissarides 1994). Some researchers have explored the psychological effects of discouragement on job search (Clark et al. 1991). These findings have led other researchers to examine the empirical evidence to determine whether labour scarring exists and whether its effects are transitory or long-lasting (e.g. Ruhm 1991).

A review of the long-term effects of unemployment on workers of all ages found mixed results of labour scarring (Arulampalam et al. 2001). For example, Ruhm (1991) using the US Panel Study of Income Dynamics, initially found no evidence that bouts of unemployment are associated with lower wages or increased future unemployment, while Jacobsen et al. (1993) did find stable evidence of labour scarring for workers of all ages. More recent evidence from Sweden shows that skill depreciation can occur outside of young workers due to unemployment spells (Edin and Gustavsson 2008). Similar evidence from Italy (Lupi and Ordine 2002) suggests that workers across the age spectrum are affected by unemployment spells, although these results are dependent upon local labour market conditions. However, the results for young workers are far more uniform and robust. Nordstrom found, in a systematic 2011 review, that early experiences in the labour market affect employment and wages far into adulthood (Nordstrom 2011). The evidence has consistently shown that duration of unemployment in youth is associated with lower wages and increased probability of unemployment in adulthood across developed countries, but that questions remain about how long this effect persists and whether it tends to diminish over time (Cruces et al. 2012).

The literature on labour scarring suggests that poverty reduction requires a two-pronged approach. Individuals require income assistance, but they also require access to jobs. Any policy designed to address poverty must take into account the opportunities and incentives it creates for employment, particularly for the youngest and most vulnerable members of the labour market. Below, we consider the potential impact of three different policies designed to reduce poverty and enhance social inclusion.

II. Enhancing Minimum Wage

One of the indicators tracked by the Province of Manitoba as part of its poverty reduction strategy is minimum wage, which has sometimes been thought of as a key antipoverty policy. Increases to the minimum wage in isolation are unlikely to have a significant effect on poverty reduction for two reasons. First, while increasing the minimum wage has a minimal impact on total employment, it does nothing to create new employment opportunities, to enhance employment or employability or to make it easier for those collecting employment assistance or disability pensions to enter the labour force. Second, increasing minimum wage is an inefficient method of reducing poverty because most of those working for minimum wage do not live in low-income families and most of those living in low-income families do not have members working for minimum wage. We do not suggest that minimum wage increases have no role to play in poverty reduction, but we do suggest that minimum wage increases used on their own are insufficient to achieve the stated goals of the provincial poverty reduction strategy.

The association between minimum wage increases and employment remains controversial, in spite of being very well documented. In Canada, there seem to be very small, if any, effects on total employment associated with minimum wage increases (Baker et al. 1999; Gunderson 2008; Fortin 2010; Lemieux 2011; Brochu and Green 2012; Galarneau and Fecteau 2014). An increase in the minimum wage, however, is associated with an increase in unemployment among teenagers (who comprise most of those working for minimum wage) and the negative effect is larger in Canada than in the US (Fortin 2010; Gunderson 2008; Galarneau and Fecteau 2014). The size of the effect varies by industry and region, and depends on globalization, changes in technology, the rate of unionization and how close the minimum wage is to average hourly earnings (Galarneau and Fecteau 2014). The closer minimum wage is to the average hourly wage, the greater the impact on employment (other factors held constant). The effect on employment among adolescents seems to occur largely through reduced hiring (Brochu and Green 2012).

The empirical evidence suggests that the employment impact of marginal increases in the minimum wage range from zero (for adults) to somewhere between 3% and 6% (depending on the study) for teenagers. Pierre Fortin (2010) argues that when minimum wage reaches 50% of the average hourly wage, further increases will reduce youth employment by 6%, largely through diminished opportunities for employment. This would seem to be a credible upper bound for the employment impact of minimum wage increases and any effects that do occur are likely to be concentrated among young, part-time workers.

If minimum wage increases have small or no effects on employment, they have a similarly meager impact on poverty reduction. The most recent evidence from Statistics Canada demonstrates that the profile of employees paid at minimum wage in Canada has not changed since 1997 when the Labour Force Survey began collecting data on minimum wage earners: "61% of minimum wage employees were aged 15 to 24 in 2013 (57% in 1997). Also, 59% of them held a part-time job in 2013 (55% in 1997). Finally, in 2013, 61% of all minimum wage employees were in the retail trade or food and accommodation sectors (54% in 1997)" (Galarneau and Fecteau 2014:7). That is, minimum wage earners are still disproportionately young, part-time workers.

In Manitoba, there has been a substantial increase in the proportion of all workers who earn minimum wage, from 3.9% in 1997 to 6% in 2013, while in Canada as a whole the rate increased more modestly from 5.0 to 6.7% (Galarneau and Fecteau 2014:6-7). This increase in the proportion of minimum wage earners is matched by a reduction in the proportion of workers earning between the minimum wage and 10% above the minimum wage. These facts, together, suggest that the increase in the proportion of minimum wage earners in Manitoba is largely a consequence of legislated increases in the minimum wage. Workers who had previously earned slightly above minimum wage did not necessarily receive a wage increase when minimum wages increased.

Canadian data since the 2008 recession also demonstrate that the profile of the Canadian minimum wage earner has not changed in response to economic turmoil. Despite the variations in economic conditions over time, more than 59% of minimum-wage workers in Canada were under the age of 25 in 2009 and 61% were under 25 in 2013, compared to 57% in 1997 (Statistics Canada 2010; Galareneau and Fecteau 2014). A 2010 Statistics Canada profile concluded that most of these were part-time workers attending an educational institution. Many lived with their parents or another family member (60%). Of the 25% who lived with a spouse, 74% of the partners were working and, in most cases, earning more than minimum wage (Statistics Canada 2010).

This is not to deny the existence of real hardship among the working poor. Almost a third of minimum-wage earners are adults between the ages of 25-54 and, among these, women are over-represented. Even among those aged 15-19, some are self-supporting individuals living alone rather than students working part-time for pocket money. The Survey of Consumer Finances has been used to show that those aged 15-19 contribute a significant portion of total household income for families living below the low-income cutoff

(LICO)[iii], with 30% of teens living in low-income families claiming to contribute 26% or more of household income (Sen, Rybczynski and Van De Waal 2011:46).

Increasing the minimum wage, however, is not an efficient way to reduce this hardship. Neumark and Wascher (2008) and Gunderson (2008) showed how little overlap exists between minimum wage workers and low-income families. Two more recent provincial studies, one in Ontario and another in Quebec, validate these results and conclude that minimum wage increases are not an efficient poverty reduction tool by demonstrating that people who earn minimum wage do not necessarily live in low-income families (Mascella, Teja and Thompson 2009; Clavet, Duclos and Lacroix 2009). Nationally, these results remain valid. Galarneau and Fecteau (2014) use Statistics Canada Survey of Labour and Income Dynamics to demonstrate that only 10% of workers paid at minimum wage belonged to families living below the LICO in 2013. Therefore, increasing the minimum wage is likely to increase the incomes of many people (most of them adolescents) who do not necessarily live in poverty, while doing little to address persistent poverty among those families without a minimum wage earner.[iv]

Perhaps the greatest limitation of using minimum wage increases alone as a method of reducing poverty is that its impact is limited to those who are in the labour market. Minimum wage policy is not designed to make transitions into the labour force smoother for those currently receiving income supplements through other schemes. Enhancing employment opportunities for youth, the currently unemployed and people with disabilities can happen only by addressing the ways in which income support schemes are designed.

Overall, minimum wage policy may be a component of a reasonable poverty reduction and social inclusion scheme. By itself, however, it cannot increase opportunities for employment or make entry into the labour market easier. Moreover, as a poverty reduction tool, minimum wage increases are not efficient because they cannot be targeted to those families and individuals most in need.

III. A GUARANTEED ANNUAL INCOME

A guaranteed annual income (GAI) can be designed in a variety of ways, but we focus on one variant that has a Manitoba history: between 1974 and 1979, *Mincome* was introduced as an experiment in Winnipeg and Dauphin, with a variety of other communities serving as controls.

Any individual with no income from any other source was guaranteed a stipend keyed to the LICO which varied by community and family size. As income increased, benefits were reduced, albeit less than proportionately. Consequently, people well above the LICO received at least some benefit from the program.

Winnipeg was designed as a classic experiment in the sense that a small proportion of the total population was selected to participate and families were randomized into treatment and control arms. The treatment arm received the GAI, while the control arm received standard treatment. In Winnipeg, the size of the guarantee and the rate at which benefits were reduced varied among recipients. Dauphin, by contrast, was a saturation site in which all families were eligible to participate and offered the same deal: if they had no other income from any source, they received 60% of the LICO. As income from other sources increased, the benefit was reduced by 50% of the increase. Hum and Simpson (1991) and Forget (2011) describe the features of the experiment.

This program has a number of very attractive characteristics, but the entire experiment was designed (as were its four US counterparts) to address one significant concern: if individuals or families were given a guaranteed income, would they reduce their work effort or leave the work force altogether? Hum and Simpson (1991) describe the labour market results of the Canadian experiment, which were consistent with the findings of the four comparable US experiments. There was a reduction in total hours worked of approximately 13.5% which is larger than the changes in employment associated with marginal changes in the minimum wage. However, the details of the employment effect speak to the particular strengths of the GAI.

There was, as is the case with minimum wage hikes, virtually no impact on the number of hours worked by adult primary earners. Two groups of workers did reduce the hours they worked significantly: married women and adolescents. The outcomes for adolescents, however, are unambiguously positive, while those for married women are more nuanced. Adolescents reduced their hours worked very significantly – by up to 80% in some studies – largely because they took their first full-time job at a later age (Hum and Simpson 1991). Before we conclude, however, that labour scarring might be an issue, it is important to examine the data more closely. Forget (2011) re-examined the data and found that young people who reduced their hours of work so heavily were returning to high school. There was a significant increase in the number and proportion of students who completed high school during the period rather than leaving school before graduation to take full-time employment. As a deep body of literature suggests high school completion significantly increases the probability of future employment and increases lifetime earnings. It is protective against labour scarring (see Galarneau and Fecteau (2014) for a summary of the evidence).

Married women reduced their work hours by using the GAI to "buy" themselves longer parental leaves, when they took time off work to give birth they prolonged their absence. It is important to remember that this effect may be dependent on the policies and practices of the period; women were just entering the labour force in large numbers when this experiment took place. Moreover, paid parental leave in the mid-1970s was much more limited than it is today. It is well known that attachment to the labour force is associated with career progress and higher lifetime earnings (cf. Phipps et al. 1998), yet as a society we have decided that longer parental leaves are beneficial for families. The availability and design of parental benefits does seem to influence maternal job market behaviour, however the relationship between maternal employment, return to work patterns and parental benefits is a matter of ongoing empirical investigation. It seems reasonable to conclude that women are more attached to the labour force today than they were in the mid-1970s when these experiments were conducted, and therefore that the employment response today would likely be smaller than it was then. Nevertheless, North American policymakers have always been somewhat ambivalent about how and whether social programs ought to be designed to encourage mothers of young children to participate in the labour market; at what stage in a child's life should maternal "independence" be a goal and when is income assistance appropriate?

Mincome was designed specifically to encourage the smooth transition of individuals into the labour market – from "assistance" to "independence" in the words of the current poverty reduction strategy – because benefits would be phased out gradually as employment income increased thereby eliminating the threshold effect that faces individuals who bump up against the income maxima stipulated in assistance programs. There would always be an incentive to work more as compared to traditional social assistance programs where each additional dollar earned through the labour market meant a reduction of benefits by a dollar. This design feature was novel in the 1970s and it was so successful that it has subsequently made its way into the design of most income assistance programs, in at least a minimal way. As an automatic feature of an income assistance program, it encourages individuals to accept part-time or low-paid work even if that is all that is available to them, because the program acts as a wage subsidy.

This design feature has both positive and negative consequences. New mothers might be enabled to work part-time, balancing their family responsibilities while maintaining their connection to the labour force and relying on the GAI to ensure that their family income is sufficient to maintain a reasonable quality of life. Young people, who might struggle to find well-paying or full-time work, can build labour market connections while still benefiting from the GAI if their family income qualifies. People with disabilities might choose to develop and maintain a labour market connection with part-time work even if they feel unprepared for full-time work, while relying on the GAI to supplement their income. Under a GAI, there is no requirement for an individual to justify or rationalize the labour force choices made. That is, a new parent need not "qualify" for parental leave, the family can decide how best to allocate its activities. A person who feels physically or mentally unable to maintain a full-time job need not be labelled "disabled" by a recognized authority, with requirements for ongoing monitoring to ensure that the disability has not changed. Individuals faced with parental or family care requirements need not meet narrow and prescribed regulations in order to "qualify" for meager income supplements. The program, instead, relies on the families and individuals involved to make their own decisions; it is not coercive. The *Mincome* evidence demonstrates that coercion was not, in fact, necessary: there was no flight from the labour market.

The wage subsidy effect of a GAI also has potential negative consequences. Employers may find themselves able to fill a low-paying job with workers who would not be prepared to take that job were it not for the existence of a GAI. That is, in a labour market in which employers have market power, these employers might be in a position to reduce wage offers and thereby capture some of the benefits of a GAI that might otherwise go to employees. This suggests the need for some ongoing minimum wage legislation to discipline the labour market, particularly during market downturns.

A GAI, then, has moderate employment effects for secondary earners and is well-designed to smooth the transition between assistance and independence. It enhances the social inclusion of people with disabilities because it does not require that conditions be policed and monitored. Moreover, its design means that benefits can be efficiently targeted towards low-income families through existing infrastructure in the tax system. This also allows for one of the major benefits of the GAI that we have not discussed in detail, which is the simplicity of its administration.

A GAI, however, has three limitations that need to be acknowledged. First, if potential employers have market power as they may during market downturns, there can be downward pressure on wages that wage legislation needs to address. Second, despite evidence to the contrary, there is still a popular belief that, given the opportunity, individuals offered a GAI will choose to work less. This makes a GAI politically difficult to implement. Third, the fiscal costs of the program depend very much on how the scheme is designed. While there are likely to be substantial savings from other social programs if a GAI effectively addresses poverty and reduces bureaucracy, the net costs are still likely to be considerable (Forget 2011). An untried program with open-ended net costs is a radical policy proposal and it is unlikely that Manitoba has the fiscal capacity to operationalize such a scheme without federal support.

IV. AN EARNED INCOME TAX CREDIT

The US introduced an earned income tax credit (EITC) at the national level in 1975 and, since then many countries including Canada, have introduced similar (but often much smaller) earned or working income tax credits. An EITC is a refundable tax credit for low and moderate income earners, often limited to individuals or families with dependent children. An EITC usually begins to take effect at a relatively low level of earnings and the family receives a proportion of total earnings until the maximum benefit amount is reached. At that point, the total amount paid out remains stable over a range of earnings. At a pre-determined family income, the value of the tax credit begins to decline until the benefit reaches zero (OECD 2003). As with a GAI, an EITC is targeted towards low-income earners and is therefore a relatively efficient poverty reduction tool, although (as with minimum wage increases) an EITC has no capacity to increase incomes for those not participating in the labour market. It does, however, provide some incentive for individuals to participate in the labour market who might otherwise not.

The design of an EITC is very similar to that of *Mincome* with one striking difference: the income subsidy depends on earned income so there is a very strong incentive for individuals to enter and stay in the labour market. That is, the EITC is designed specifically to deal with the fear that individuals offered a GAI would reduce their work hours because there is no guaranteed income assistance for those who do not work and no minimum payout. In contrast, the gradual phase-out of the EITC is similar to that of the GAI; an individual is always better off earning another dollar in the labour market because his/her benefit will be reduced less than proportionately. Like the GAI, this design facilitates a smooth transition into the workforce and creates work incentives. Unlike the GAI, the work incentives are coupled with the requirement that families participate in the labour market if they are to benefit from the EITC.

There are a variety of EITC programs among the various states and these natural experiments have given rise to a number of empirical studies. There is very strong empirical evidence that an EITC increases employment and income among affected families (Strully 2010; Dahl 2009; Hotz 2003; Ellwood 2000; Meyer 2000; Eissa 1996). It increases employment in single parent families, especially those headed by women (Simpson 2010; Strully 2010; Dahl 2009; Eissa 1996; Meyer 2000). Perversely, it might not increase employment among very low-income two-parent families, particularly those whose EITC refund might be reduced if family income were to rise further (Ellwood 2000; Hotz 2003). Meyer and Rosenbaum (2000) identify one mechanism responsible for employment increases with the EITC: single mothers are particularly incentivized to work.

An EITC has a number of very attractive features: there is no employment disincentive, and the empirical evidence suggests that employment among most groups increases. It is therefore very consistent with a provincial focus on employment as the best route out of poverty. It is relatively efficient, in the sense that it can be targeted to low-income families through the tax system. Its design facilitates smooth transitions into the workforce because the benefits are retained over a substantial income range. Unlike a GAI, an EITC may be more politically feasible; if there remain popular fears that individuals who are given a GAI will reduce their work effort, there can be no such concern about a program that explicitly rewards work effort. In the United States the EITC has received broad support from across the economic and political spectrum for both its efficiency and its poverty alleviating qualities.

Three limitations of an EITC persist. First, a very attractive feature of the GAI is that it leaves the decision about whether and how to allocate their effort towards the formal labour market to individuals and families. We suggested that there was little evidence that total employment would be much affected, but that a GAI nevertheless allowed people with disabilities, mothers of young children and people with caregiving responsibilities to make decisions that best met their family needs without the need for a bureaucracy to monitor compliance. An EITC, by contrast, is explicitly coercive. It creates strong incentives for employment. This is both its strength and its weakness.

Second, like the GAI, an EITC is a wage subsidy and, as such, creates an incentive for employers to reduce wage offers if the labour market is dominated by firms with market power. It provides incentive for employers to free-ride on government subsidization of the wage and reduce wage offers. If the economy is such that employers have the power to implement such wage reductions, they would be able to internalize the benefit of the program to the detriment of the families who are the nominated beneficiaries of such a scheme. Such market power may be countered with a minimum wage policy that can provide a hard floor for wages. Finally, of course, an EITC does nothing to address poverty among families with no earned income. An EITC would necessitate other social assistance programs for those families who are unable to work.

V. REVITALIZING POVERTY REDUCTION AND SOCIAL INCLUSION

This article has examined the capacity of three different policies, in isolation, to further the articulated goals of the current Poverty Reduction and Social Inclusion Strategy of the Province of Manitoba. We laid out the advantages and disadvantages of these policies in terms of their effectiveness in reducing poverty and improving employment. We made the argument that both of these goals are necessary parts of a social assistance program designed to reduce poverty and transition Manitobans into sustainable, economically self-sufficient living.

What would an effective, politically feasible poverty reduction strategy look like in Manitoba? Such a strategy could make use of the special strengths of all three policies, combining the phased withdrawal of benefits associated with both *Mincome* and most EITC schemes with a binding minimum wage indexed to inflation. A phased withdrawal of benefits would provide incentive and support for Manitobans to transition into the workforce without harsh penalties. In a perfect world, we would trust families to choose behaviours that optimize their well-being. In the real world, an EITC may be just coercive enough that we could reap many of the benefits of a GAI, while accommodating the innate cynicism that we attribute to taxpayers. Such a plan would also appeal to the business community because of its ability to boost overall employment without shifting the entire burden of legislated wage increases onto private businesses. Minimum wages, indexed to inflation, would ensure that these businesses paid their fair share. This would avoid the degradation of the minimum wage in real terms and provide a hard wage floor to support an EITC.

We would like to end with a concrete proposal: that the Province of Manitoba undertake a formal pilot study of the cost-effectiveness of a significant provincial EITC in combination with minimum wage legislation and monitoring to reduce poverty, encourage employment, and improve the quality of life of all Manitobans.

VI. NOTES

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i The Department of Entrepreneurship, Training and Trade is now known as the Department of Jobs and the Economy.

ii All Aboard is described on this website, which also publishes annual reports: http://www.gov.mb.ca/allaboard/ (accessed 18 July 2014). The Poverty Reduction Strategy Act can be found here: http://web2.gov.mb.ca/laws/statutes/ccsm/_pdf.php?cap=p94.7 (accessed 18 July 2014).

iii The LICO is regularly updated by Statistics Canada, and varies by community and family size, and whether it is measured before or after taxes and transfer payments. It is one of several low-income measures designed specifically to measure relative poverty.

iv The only Canadian study to simulate the effects of an increase in the minimum wage on poverty goes much further. Creating a worst-case scenario by combining the disemployment effect among adolescents with the above results, the authors conclude that a 10% increase in the minimum wage is significantly correlated with a 3-5% drop in employment among adolescents, and a 4-6% *increase* in the number of families living below the LICO (Sen, Rubczynski, Van De Waal 2011). This is a model rather than a data analysis exercise, but it demonstrates that increasing the minimum wage is not necessarily associated with a reduction in poverty.