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LABOUR SHORTAGES: HELPING A TRAPPED POOL OF POTENTIAL WORKERS HELP THEMSELVES

By Jason Dean, with the collaboration of Célia Pinto Moreira

In recent months, many of us have experienced the frustration of long lines at Tim Hortons, frequent out-of-stock messages when shopping online, or having to take the day off work to visit Service Canada. Normally, the abundance of help wanted signs everywhere would be an indication of a healthy, growing economy. But these days, they remind us of the continuing labour shortage that is slowing down our economy, with unemployment figures at 40-year lows and record-setting job vacancies.

The unemployment-to-job vacancy ratio, a measure of the number of unemployed people per job opening, reached an all-time low of 1.4 in the first quarter of 2022, with all provinces experiencing a decline.¹ Labour shortage patterns are found in all major sectors of the economy and seem to be getting worse. Employers are unable to fill roughly one million vacancies, and expectations of shortages are a leading concern for the immediate future.²

The trend is no doubt the result of an aging population, exacerbated by the pandemic, which has wreaked havoc on global supply chains and led to sizable shifts between occupations, with many fleeing jobs in accommodation and food services.³ However, there is another overlooked culprit: an income support system that encourages long-term dependency through perverse economic incentives

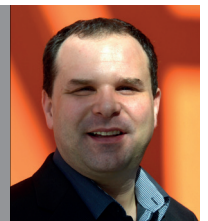


which trap many able-bodied recipients in a vicious cycle of poverty. The cumulative effect of decades of these programs that disincentivize work has been to sideline potentially productive workers and leave them with little hope of escaping.

SOCIAL ASSISTANCE IN CANADA

Income support in all provinces is provided through various social assistance programs which are considered a safety net of last resort intended for those who have exhausted all other sources of financial support. Jurisdiction rests with the provinces and territories, with each having its own programs which differ in terms of administration, eligibility criteria, and

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benefit provisions. However, their fundamental features and structure are similar across the country, providing direct cash payments and in-kind benefits such as dental, vision, drug, and supplemental health care.

If recipients decide to work, their social assistance payments are reduced when they exceed a certain earnings threshold. Income earned above this threshold is subject to sharp clawback rates for social assistance payments, typically between 50% and 100% depending on the province.⁴ Moreover, an employed recipient must pay income taxes and contribute to Employment Insurance and the Canada Pension Plan. A recipient could also face additional reductions if they are living in rent-gear-to-income housing, and those who work full-time face losing their in-kind benefits.

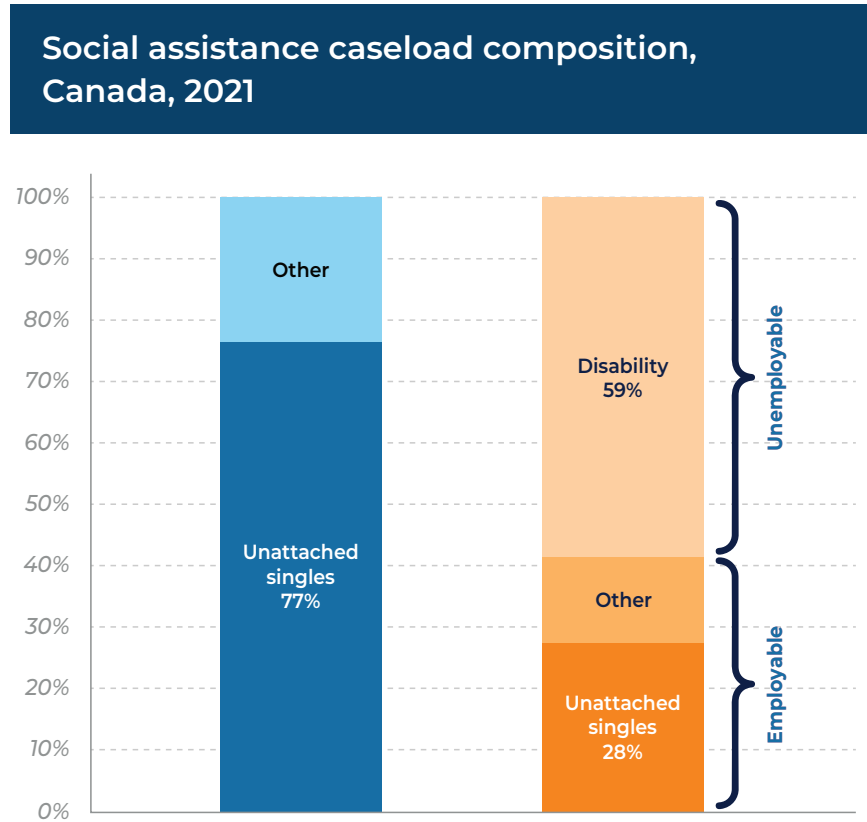
Clearly, these substantial penalties, coupled with the disutility of work and the loss of leisure, disincentivize work and substantially raise a recipient's "reservation wage," which is the minimum acceptable wage at which they will find it worthwhile to work. This is the core issue behind why recipients become trapped.

Several Canadian studies corroborate the existence of a such a trap. Benefits levels are associated with longer duration on social assistance,⁵ and tend to foster continued reliance on support,⁶ not only for current recipients, but across generations as well.⁷ For instance, in Ontario, only 1% of recipients leave the program for work in any given month, and 20% remain on the program for more than five years.⁸ In Quebec, there is roughly a 30% chance that children of social assistance recipients will also collect benefits in early adulthood. This perpetual dependence is commonly referred to as a "welfare trap."

AN UNTAPPED POOL OF EMPLOYABLE LABOUR

In Canada, roughly 8% of the population benefits from income support programs.⁹ Ontario and Quebec combined represent about 70% of Canadian recipients. Figure 1 shows the break-

Figure 1



Note: The "other" category includes single parents and couples with and without children.
Source: Author's calculations. Mohy Tabbara, *Social Assistance Summaries, 2021*, Maytree, July 2022; Statistics Canada, Table 17-10-0009-01: Population Estimates, Quarterly, September 28, 2022; Employment and Social Development Canada, *Social Assistance Statistical Report: 2009-2013*, 2016; Government of Manitoba, *Manitoba Families Annual Report 2021-2022*, September 2022.

down of recipients by family type and their potential for employability. The first bar shows the breakdown by household type. By far, the largest uptake of social assistance is among unattached singles, at 77% (83% for Quebec, 73% for Ontario).

Perverse economic incentives trap many able-bodied recipients in a vicious cycle of poverty.

The second bar shows the breakdown of cases into employable and unemployable. For Canada as a whole, roughly 60% of recipients are enrolled in a province's disability program where there are no expectations to find employment. The proportion of recipients in this category varies across provinces. (It is 17 percentage points lower in Quebec than in Ontario, which reflects differences in the

criteria used to determine disability status.)

Employable recipients are encouraged to engage in activities that will help them integrate into the labour market. The largest component of those employable are unattached singles, accounting for 28% of all recipients for Canada as a whole (39% for Quebec). The total number of Canadians in this category in 2021 was 348,946,¹⁰ representing a substantial pool of untapped labour that could ease the current shortage.

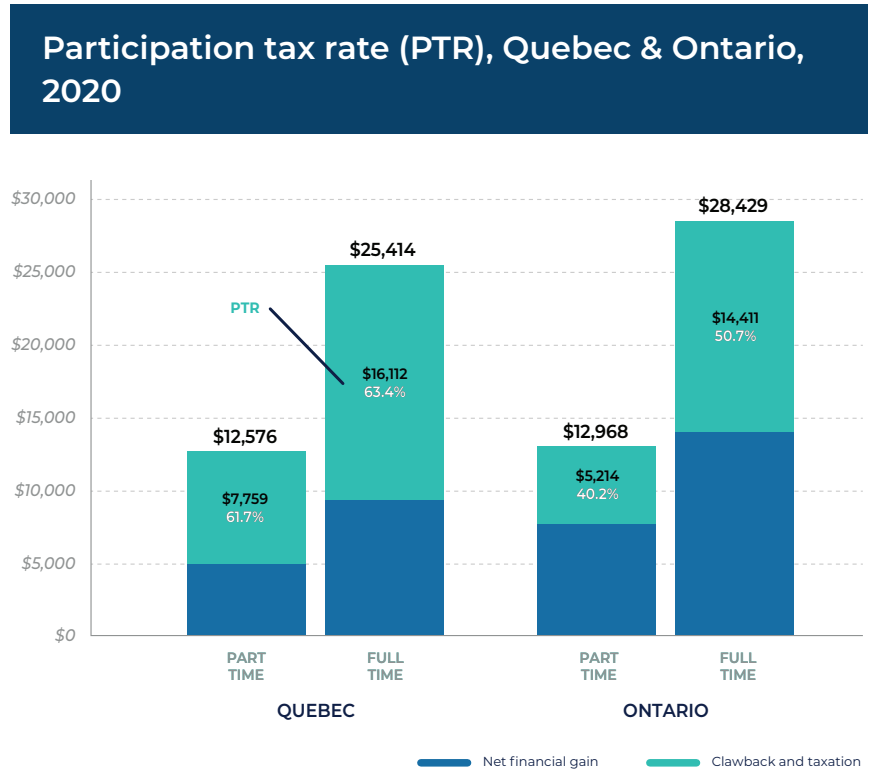
Why are so many employable but not working? The best way to answer this question is to explicitly quantify the disincentive to work. This involves a comparison of what must be given up versus what is retained of employment earnings. Some recent studies have quantified the disincentive by calculating the *marginal effective tax rate* (METR), which captures the loss from income taxation and benefit reduction associated with an additional dollar of employment income.¹¹ It specifically reflects the disincentive for someone already employed to take on extra work. These studies reveal that low-income families can actually face an METR as high as 60%, much larger than that faced by high-income families.

In the context of the welfare trap, the focus instead is on the incentives surrounding the transition from inactivity to employment. Also, workers generally cannot choose their hours worked on the margin, but rather decide to work either part-time or full-time. The disincentive in this scenario is better quantified by calculating the *participation tax rate* (PTR) which shows the cumulative effect of all taxes and benefit reductions for a recipient who decides to work. The PTR shows the percentage of gross employment income that is taken away in the form of reduced benefits (cash and in-kind) and changes in net taxation (such as changes in income tax payable and non-refundable provincial and federal tax credits).

THE DISINCENTIVE TO WORK IN ONTARIO AND QUEBEC

The PTR varies from province to province. Figure 2 shows the PTRs for Ontario and

Figure 2



Note: See Appendices 1 and 2 on our website for detailed calculations of the PTRs.

Quebec in 2020. These two provinces cover 70% of the Canada-wide caseload, with Quebec offering an illustration of the most generous province, and Ontario providing a level of benefits equal to the average across other provinces.¹² The rates are calculated for employable unattached singles for part-time and full-time employment scenarios.

The participation tax rate (PTR) shows the cumulative effect of all taxes and benefit reductions for a recipient who decides to work.

The employment earnings used in the calculation are based on what a recipient could earn at the minimum wage. This reflects their relatively lower education levels and work experience, which limit their opportunities to secure high-paying jobs.¹³ To accurately capture all relevant benefits and opportunity costs associated with the transition between inactivity and work, the calculations incorporate all changes in income tax, provincial and federal tax credits, and supplementary health care costs.

In Quebec, whether recipients work part-time or full-time, the PTR is just over 60%, meaning they keep less than 40% of any income they earn. In Ontario, the disincentive is somewhat less severe, especially for part-time workers who face a PTR of about 40%. However, a recipient who decides to work full-time at the minimum wage will still lose just over half of their employment income.

The main reason behind the much lower PTR in Ontario for part-time workers is the much higher clawback rate in Quebec. Both provinces have a monthly earnings exception of \$200, but the clawback rate in Quebec is 100% versus only 50% in Ontario.¹⁴ In fact, the part-time PTR in Quebec would fall to roughly 20% if the clawback rate were reduced to 50%.¹⁵ Despite the differences in clawback rates, in both provinces, working full-time exhausts all social assistance benefits. Since Ontario's benefits are less generous, recipients lose less when they work, which is why the Ontario PTR for full-time workers is lower than Quebec's.

To put some flesh on these numbers and provide further insight, the height of each bar in Figure 2 shows gross employment income, and is simply broken down into the proportion that is relinquished due to clawbacks and changes in taxation (top portion), and the net financial gain or amount kept (bottom portion). For instance, a Quebec recipient who transitions off social assistance into full-time work at the minimum wage (the second bar in Figure 2) would lose a whopping \$16,112 (63.4%) of their \$25,414 in employment earnings. In other words, their net financial gain from working full time for the entire year is only \$9,302 (36.6%).

It is important to note that these PTRs are a conservative estimate of the disincentive effect facing recipients. The real disincentives can be much more severe because the calculations presented here do not incorporate increases in rent payments for those living in subsidized housing where their rent is geared to their income. Work-related expenses such as transportation, uniforms, and new clothing all further reduce the net gain to working. Moreover, there are other more intangible considerations such as the disutility of work, which is conceivably quite high given the low educational levels among recipients that limits their opportunity to secure more interesting, meaningful work. Thus, employment for many entails a sacrifice of valuable leisure for time spent working in

potentially unpleasant and unstimulating work environments.

CONCLUSION

Canada's approach to providing income support is a failure. Rather than alleviate poverty, it traps the very people it is intended to help with a perverse incentive structure that creates daunting barriers to employment. This is especially disheartening when considering the heavy annual burden these programs impose on taxpayers, some \$44 billion in 2020.¹⁶ Moreover, the extent of the labour shortages we are experiencing would be significantly less severe if just the pool of roughly 350,000 employable unattached singles contributed their labour.

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There is no easy solution. A policy that completely removes any clawbacks and allows recipients to unconditionally retain their benefits would solve the welfare trap, but would be both expensive and unfair to those working and not collecting benefits, and would entice many to find ways to become eligible for social assistance. However, the above analysis suggests that there is significant room for improvement within the current policy framework. Two of the largest provinces, Quebec and British Columbia, claw back 100% of recipient earnings; as we saw for Quebec above, cutting this in half can go a long way toward incentivizing part-time work. Increases in monthly earnings exceptions would provide an additional punch.

The incentive for full-time work could be improved by increasing the amount and payment structure of the Canada Worker Benefit, a federal wage subsidy for low-income workers.¹⁷ In its current form, the subsidy is completely exhausted at a level of income lower than what is earned full-time at the minimum wage. Also, since the benefit is delivered through the income tax system, a significant disconnect exists between the work decision

and its reward. A more immediate, monthly payment would conceivably have a stronger impact on work incentives.

Finally, current policies surrounding education and training are focused on the short term. In most provinces, recipients are not allowed to enroll in post-secondary education. To meet the often-stated and laudable goal of encouraging self-sufficiency, recipients should have access to educational programs aligned with the needs of employers in a knowledge-based economy like Canada's.

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