



# prospering together

ADDRESSING INEQUALITY AND POVERTY  
TO SUCCEED IN THE KNOWLEDGE-BASED  
ECONOMY

**AN ACTION CANADA  
TASK FORCE**  
FEBRUARY 2012



## **ACTION CANADA IS CANADA'S LEADING PUBLIC POLICY FELLOWSHIP**

**F**ellows are chosen from all sectors, including business, science, government, academia, and the professions. The program revolves around working conferences held across Canada, during which Fellows interact with leaders from government, industry, the media, academia, and NGOs. In addition, Fellows work in teams on policy projects that have, in past years, inspired Canadian public policy.

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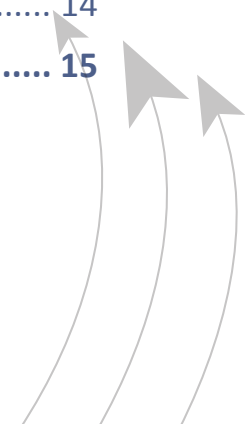
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One might think that inequality and poverty are the proper domain of social policy, not “economic and business policy,” this year’s Action Canada fellowship theme. Canadians are trained to think about economic and social policy as separate fields. Indeed, when the Action Canada Task Force on Inequality, Poverty, and the Knowledge-Based Economy (the “Task Force”) first met to discuss our project, we had a much narrower view of “economic and business policy” than we do today. The Task Force now considers economic and social policy to be inextricably linked; in fact, we believe that addressing what are traditionally considered social issues is crucial to Canada’s long-term economic prosperity. The evolution of the Task Force’s thinking itself demonstrates why inequality and poverty are important from an economic standpoint.

The Task Force began by focusing on Canada’s lagging productivity growth, which has been attributed to this country’s poor performance in innovation. These negative trends caught our attention because, according to conventional economic theory, innovation leads to productivity growth, that in turn leads to higher wages, incomes, and living standards for everyone. But, upon further examination, the Task Force discovered that in practice things are very different. Between 1980 and 2005, while labour productivity increased substantially, median real wages of Canadians barely increased. That is to say, the majority of Canadians did not see the expected benefits of the “innovation agenda.”

The Task Force then took a step back and investigated the basic ingredients for success in the twenty-first century economy. The consensus is that the most important resource in today’s economy is human capital—the knowledge, skills, competences, and attributes of people. Having identified the key elements of human capital, we asked ourselves what conditions promote or hinder the acquisition of these elements. The members of the Task Force came across a number of studies suggesting that inequality and poverty are detrimental to the various components of human capital.

Upon uncovering Canada’s performance in these areas, the Task Force realized that discourse surrounding “economic and business policy” in Canada is missing a key dimension. Canada ranks 17 out of 20 peer countries in terms of inequality. Over the

past 10 years, inequality in Canada rose faster than in the United States, the most unequal developed country in the world. Compounding the problem is the fact that Canada’s tax and transfer system is not correcting labour market outcomes as much as it did two decades ago. While the poverty rate has stayed roughly the same over the last 20 years, it remains high relative to international standards, particularly for children.

At this point the Task Force had come full circle. If success in the knowledge-based economy depends on human capital, and if inequality and poverty negatively affect the components of human capital, then Canada’s rising inequality and persistently high levels of poverty could be jeopardizing its capacity to prosper. The way in which Canada is pursuing the innovation agenda—paying little attention to our disturbing inequality and poverty trends—might actually be counterproductive. To us, this warranted further investigation.

Throughout the course of our research and consultation, we discovered that the debate on these issues is far more polarized than it should be. While the business community laments Canada’s slow embrace of the knowledge-based economy, and social justice advocates decry inequality and poverty, neither group seems to appreciate that they may actually have common interests on these issues. The Task Force hopes to demonstrate that the only way for Canadians to prosper in the knowledge-based economy in the long term is to do so *together*. For the new economy to take hold and be sustainable in Canada, Canadian leaders must ensure that Canada has access to the best minds and talent. This means making sure that everyone has the opportunity to contribute to and benefit from Canada’s future prosperity.

Canada needs a shift in thinking. As this report demonstrates, Canadians need to think about in-

**Canada needs a shift in thinking.... Canadians need to think about inequality and poverty as obstacles to – rather than consequences of – economic growth.**

equality and poverty as obstacles to – rather than consequences of – economic growth. We need to understand that prosperity is not the only solution to inequality and poverty, and realize that alleviating these social problems is crucial to our

long-term prosperity. The Task Force’s policy recommendation will start Canada down a path toward developing a twenty-first century economy that is competitive because it is inclusive.

## social determinants of human capital

### INEQUALITY AND POVERTY MATTER FOR ECONOMIC REASONS TOO

This year, the Occupy Wall Street movement brought inequality and poverty to the forefront of the public agenda. Unfortunately, we believe the public missed part of the significance of this development. Inequality, as well as poverty, has an economic impact on *all* of society, from the top one per cent to the bottom one per cent. The success of Canadian companies in the knowledge-based economy depends on their ability to innovate. As the expert panel reviewing federal support for R&D recently stated, “innovation is the ultimate source of the long-term competitiveness of businesses and quality of life of Canadians.”<sup>1</sup> Canada’s ability to innovate derives directly from its human capital, which is strongly influenced by socioeconomic factors. As we explain below, the high-skilled workers that companies such as RIM and OpenText rely on to deliver globally competitive innovations are nurtured through favourable social conditions that are incompatible with elevated levels of inequality and poverty.

While the Occupy movement drew attention towards inequality and poverty as moral issues, we are strictly looking at the economic imperative to address them; specifically, the risk that they will undermine Canada’s ability to prosper.

### WHAT IS HUMAN CAPITAL?

The Blackberry did not appear out of the ether, so where did it come from? Economists use the

term “factor of production” to describe the various inputs that contribute to the production of something like a Blackberry. Traditionally, these inputs have included capital, raw materials and labour. But a Blackberry demands more than just machines, semiconductors and assembly lines; it also requires minds like those of Mike Lazaridis and the innovative employees at Research in Motion.

Beginning in the 1960s, economists introduced the notion of “human capital” to describe this less tangible – but absolutely crucial – factor of production. Today, we understand human capital to be “the knowledge, skills, competences and attributes embodied in individuals that facilitate personal, social, and economic well-being.”<sup>2</sup> Human capital derives from four building blocks: education, skills, health and social relationships. The more of these a society possesses, the richer in human capital it will be – and, ultimately, the more productive it is likely to be. Indeed, as the economy shifts toward producing increasingly complicated products and services, many economists argue that “human capital...is the most important source of national wealth and international competitiveness.”<sup>3</sup>

### WHY DOES HUMAN CAPITAL MATTER NOW?

Succeeding in the twenty-first century economy requires adapting to the forces of globalization: the internationalization of production, the rise of transnational enterprises, the mobility of capital and labour, and the global integration of markets.<sup>4</sup>

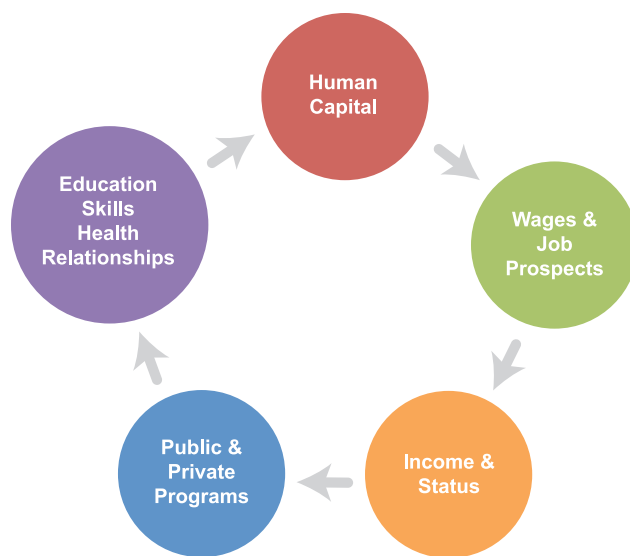
As a small, open economy, Canada has very little scope for ignoring these trends; in this global, hyper-competitive marketplace, Canada's healthy endowment of the traditional factors of production – capital, raw materials, labour, and even technology – is insufficient to build a high-wage economy.

Why must Canada compete in the knowledge-based economy? Why can't we just continue to rely on our natural resources, instead of our human ones? Setting aside the environmental impact, this course would make us vulnerable both to commodity price fluctuations and to a flattening world, in which Chinese steel competes with Canadian steel. On top of that, a dependence on resource exports will drive our dollar up, making it harder to export anything else (and Canada's non-resource/manufacturing sectors account for a much higher share of employment and economic output than our natural resource sector).<sup>5</sup> To raise Canadians' standard of living, we *must* move from our "excessive dependence on raw materials and undifferentiated products across many sectors to a much greater reliance on value-added differentiated products and Canadian innovations across sectors."<sup>6</sup>

Consequently, Canada's future prosperity depends on finding ways to combine the traditional factors of production in innovative ways. To do this, Canada must harness the talents and ingenuity of its people: its human capital. This view is reflected in the federal government's flagship economic plan which promises to "create the best-educated, most-skilled...workforce in the world."<sup>7</sup>

Some may argue that Canada should rely on immigration to develop this workforce. Macro-demographic indicators, however, are not promising. As much of the world's population – like Canada's – ages and birth rates decrease, demand for human capital will increase. The World Economic Forum projects that, by 2030, the U.S. and Europe will require an additional 70 million workers to sustain economic growth. In this competitive market for human capital, it is unlikely that Canada will be able to successfully attract and retain all the talent it needs from other countries.

Outsourcing our human capital development cannot be our only strategy for prospering in the



**FIGURE 1.** The relationship between inequality and poverty (shown as income and status) and human capital development in a knowledge-based economy.

knowledge-based economy. We need to provide the conditions that allow everyone – immigrants and non-immigrants of all backgrounds – to contribute to our long-term prosperity.

## THE HUMAN CAPITAL DEVELOPMENT PROCESS

Figure 1 describes the process by which inequality and poverty affect human capital development. A person's level of human capital depends on the acquisition of education, skills, health and social relationships. But how do we acquire these ingredients of human capital? There are many paths to the acquisition of human capital, but these are highly dependent upon a person's income and social status, i.e. their socioeconomic background. For example, a poor family may not be able to afford to enroll a child in an early-learning program; or, a teen from a low-income neighbourhood who likes computers may not be able to talk to a career counselor about what professions are available to her.

As illustrated in Figure 1, the human capital development process is cyclical rather than linear. An individual's stock of human capital is likely to

impact her income and status down the line. With the proper social environment, the teen who likes computers has a better chance of becoming the next Bill Gates. Higher income and status, in turn, will facilitate access to education, skills, health and social relationships – for both this generation and the next. A Canadian without adequate access to human capital programs will have lower income and status; and, as a result, her children will have less access to the ingredients of human capital. Therefore, depending on a Canadian’s initial endowment of income and status, the human capital development cycle will either be virtuous or vicious.

## THE IMPACT OF POVERTY AND INEQUALITY ON HUMAN CAPITAL DEVELOPMENT

Both theoretical and empirical studies demonstrate that, through a number of mechanisms, poverty and inequality are intimately connected to the four elements of human capital.

### POVERTY

The basic mechanism through which poverty affects human capital is straightforward: if people are not able to access the goods and services that allow them to accumulate basic human capital, then they will be less competitive in the labour market and will earn lower wages. Studies have established numerous links between poverty and human capital development:

**Education and Skills** – As Carniero and Heckman have shown, the seeds of human capital are sewn in early childhood with the development of basic cognitive and non-cognitive skills, a process that is affected by family circumstances.<sup>8</sup> Poverty continues to impact academic development later in life, as well. The opportunity costs of post-secondary education for a high-school graduate from a low-income family, for example, are likely to be more significant and less avoidable than those of a peer from an affluent background.<sup>9</sup>

**Health** – Poverty is associated with a wide range of health issues such as increased chronic illness

and shorter life expectancies.<sup>10</sup> These conditions are directly attributable to the material deprivations that come from living in poverty—food insecurity, inadequate housing, high unemployment, hazardous working conditions, environmental contamination, crime, and violence.<sup>11</sup>

**Social Relationships and Economic Segregation** – Poverty limits access to the types of social relations that are conducive to economic opportunity. People living in poverty tend to have fewer social ties, and the ties they do have are often with people of lower social status.<sup>12</sup> People living in poverty are therefore less likely to have contacts who can help them to find employment, encourage them to pursue their education, or lend them money to start a business.

### INEQUALITY

While the effect of poverty on human capital development is more apparent, what is not commonly explored is that inequality, by itself, can also impact human capital development:

**Education and Skills** – Children in developed countries with higher income inequality have lower math and literacy scores than children in countries with lower income inequality.<sup>13</sup> Studies on literacy in developed countries, including Canada, have concluded that lower disparities in literacy scores are correlated with higher average scores.<sup>14</sup> In many cases, the most privileged students from relatively equal countries performed better than the most privileged students from countries with greater inequality.<sup>15</sup> In the U.S., dropout rates demonstrate a positive correlation with income inequality too strong to be attributed solely to poverty.<sup>16</sup> Experimental studies also show that a child’s awareness of social status can undermine her performance in problem-solving tasks.<sup>17</sup>

**Health** – A series of longitudinal studies conducted in the U.K., which control for poverty, provide compelling evidence that income inequality is linked to poor health outcomes for both men and women.<sup>18</sup> These studies also suggest that, once a basic level of income is reached, the distribution of income becomes a more important determinant of health.<sup>19</sup>

**Social Relationships and Economic Segregation** – The impact of inequality is not limited to individuals, but extends to communities as well. As wealthy families move into exclusive communities, the tax base for public services in other communities dwindles. Conversely, if wealthy families stay in the urban core, housing prices are pushed up, resulting in longer commuting times for less affluent families, as they are forced to live farther from where they work. All of this hinders the human and social capital that is so crucial in the knowledge-based economy.<sup>20</sup>

Moreover, some commentators have argued that high concentrations of wealth tend to weaken

equality of opportunity through the privatization of services.<sup>21</sup> As an income gap forms, the wealthy tend to rely increasingly on private schools, healthcare, and other more exclusive institutions for the development of human capital. When this trend toward privatization is combined with cuts to public programs or redistribution mechanisms, then the negative effect on access to human capital is stronger. Indeed, as Lindert has shown, in his study of income inequality in Britain and America across three centuries, when inequality is greatest, redistribution toward the poor is lowest.<sup>22</sup> This may be explained by the observation that, during times of high inequality, elites tend to enjoy greater political power.<sup>23</sup>

## how canada looks today

**D**isparities in income and status clearly play an important role in the human capital development process. While an individual's income is not the same as her status, they tend to be highly correlated. We thus rely on recognized statistical indicators of income distribution, such as income quintiles and Gini coefficients,<sup>24</sup> and poverty measures to assess Canada's inequality and poverty levels. The trends revealed in the next section raise serious questions about Canada's ability to succeed in an economic context where human capital is the most valuable asset.

### RISING INCOME INEQUALITY

Income inequality has been rising over the last three decades in Canada. As shown in Table 1, from 1976 to 2009, two-thirds of Canadians experienced a decline in their real market income.<sup>25</sup> While the wealthiest quintile of the population added \$35,000 to its average market income – a 27.5 per cent increase – the remaining four quintiles suffered an average 7.9 per cent decline in their market income.

Quintile	Market income (\$)		Change	
	1976	2009	\$	%
Lowest	3,900	3,300	-600	-15.4
Second	26,500	22,200	-4,300	-16.2
Third	48,800	45,400	-3,400	-7.0
Fourth	71,400	76,300	+4,900	+6.9
Highest	127,100	162,100	+35,000	+27.5

**TABLE 1.** Change in market income since 1976 (all family units)

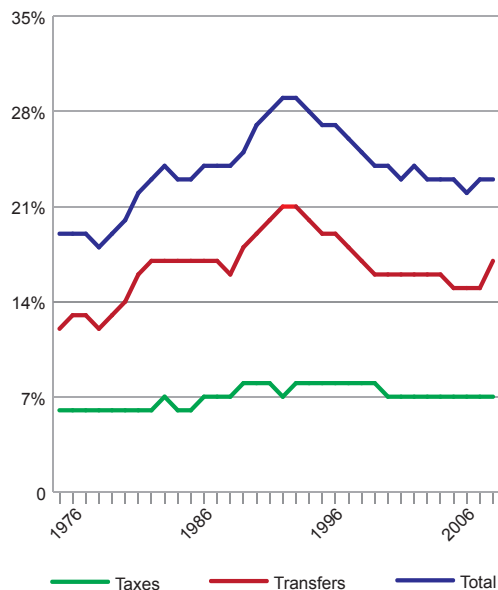
Source: Statistics Canada, CANSIM, Table 202-0701.

Note: Market income in constant 2009 dollars.

In addition, Canadian workers hardly benefitted from the productivity gains achieved over the last 25 years. While labour productivity rose 37.5 per cent between 1980 and 2005, median earnings of full-time, full-year workers in Canada rose only \$58, from \$41,343 to \$41,401. During the same period of time, the top-earning quintile increased its share of overall after-tax income from 44.7 per cent to 51.7 per cent, while all four remaining quintiles lost ground.



## Effect of Transfers and Taxes on Income Distribution (All Family Units)



**FIGURE 2.** Percentage reduction in Gini coefficient (authors' calculation)

Source: Statistics Canada, CANSIM, Table 202-0705.

Moreover, analysis by Yalnizyan establishes that there has been a continuous concentration of income in the hands of the very top earners.<sup>26</sup> Indeed, between 1997 and 2007, the top one per cent captured approximately 32 per cent of income growth. Furthermore, the most dramatic increase in income share was experienced by the richest 0.01 per cent of Canadians, who increased their share of national income five-fold between the mid-1970s and 2007, reaching 2.8 per cent at the end of this period.

The inability of labour to capture its “fair share” of productivity gains, along with income growth being concentrated among top earners, raises serious questions about whether Canada’s current approach to fostering greater productivity can actually improve the economic well-being of most Canadians in a meaningful way.

## ERODING THE REDISTRIBUTION EFFECT OF TAXES AND TRANSFERS

Government transfers (such as social assistance, employment insurance, child benefits, and old-age security) and taxes can dampen the impact of labour market disparities. Progressive transfers and taxes ensure that after-tax income is less unequal than market income.

As shown in Figure 2, the redistribution effect of taxes and transfers has been declining for at least two decades in Canada. In 1994, taxes and transfers lowered market income inequality by 31 per cent, but in 2009 they did so by only 25 per cent. The impact of these trends is particularly severe for low-skilled workers, who are hit by both lower labour market incomes and lower benefits in the form of taxes and transfers.

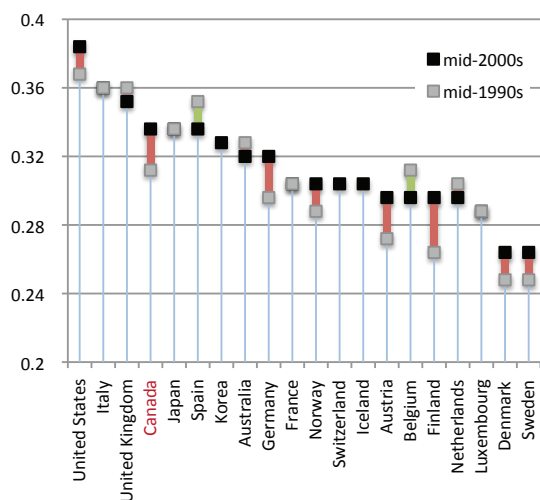
Given the links between inequality and human capital development discussed earlier, the double shock of rising labour market inequality and lower redistribution towards those most disadvantaged raises serious questions about Canada’s ability to compete in the knowledge-based economy.

## AN OVERALL HIGH LEVEL OF INEQUALITY

Amongst the top 20 OECD countries (GDP per capita), Canada’s income inequality, measured by the Gini coefficient,<sup>27</sup> is higher than 16 peer countries (Figure 3).

In addition, as Figure 3 indicates, while income inequality has risen in most OECD countries over the last 10 years, the increase in Canada has been among the largest. Noticeably, inequality is rising faster in Canada than in the United States, the developed country with the highest level of income inequality.

## Inequality in the Top 20 OECD Countries, Mid-1990 and Mid-2000s



**FIGURE 3.** Gini coefficient (after taxes and transfers), total population, top-20 OECD countries (GDP per head), mid-1990s and mid-2000s

Source: Authors' compilation of data from OECD *Divided We Stand – Why Inequality Keeps Rising* (Paris: OECD, 2011)  
 Note: Mid-90s data for Korea, Switzerland and Iceland is not available.

## PERSISTENTLY HIGH LEVELS OF POVERTY

At the international level, Canada has higher levels of both overall poverty and child poverty than most peer countries. Out of the top 20 OECD countries (GDP per capita), Canada ranks 15<sup>th</sup> in terms of overall poverty and 16<sup>th</sup> in terms of child poverty (see Figure 4). Canada's overall poverty level is nearly 2 points above the OECD all-country average, while its child poverty level is over 4 points above the average.

Every year since 1990, at least 1 million Canadian children have lived in poverty. In 2009, for a four-person household, this meant an after-tax income of less than \$37,360.<sup>28</sup> While the rate among children has decreased by about 2.4 points since 1995, at 15 per cent it is still higher than it was in 1976. The percentage of adults living in pov-

erty has also increased in the last 35 years, from 10 per cent in 1976 to 13.1 per cent in 2009. That year, nearly 3 million adults lived below the Low Income Measure (LIM) threshold. It should be noted that certain groups are much more susceptible to poverty than others. Specifically, recent immigrants, aboriginal peoples, racial minorities, disabled people, and children of single mothers are all overrepresented among Canada's poor.<sup>29</sup>

## THE POLARIZATION OF LABOUR FORCE

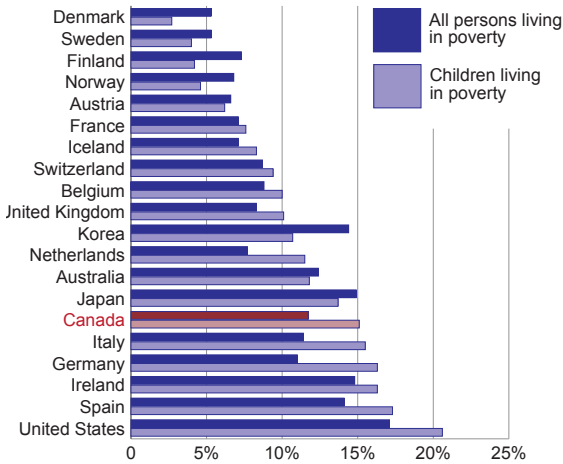
While the advent of globalization and technology has resulted in lower prices for consumers, it has also led to a "hollowing out" of middle-wage jobs.<sup>30</sup> In other words, in the knowledge-based economy, it is less and less possible to sustain a middle class with jobs involving routine processing of goods and information, as these jobs have been transferred to low-wage economies or eliminated by automation and information technology.

The result is a job market that is increasingly polarized between high-wage, high-skill managerial and technical jobs on the one hand, and low-wage, low-skill service jobs that cannot be outsourced, such as food preparation and retail, on the other. This increased polarization manifests itself as a wider earnings gap between more- and less-educated workers and between older and younger workers. Not only do low-skilled workers earn less, studies show that they work fewer hours because they are more likely to have part-time or temporary jobs; of course, this further increases the earnings gap between low- and high-skilled workers. Moreover, unemployment and non-working time is concentrated among Canada's least skilled workers.<sup>31</sup>

Studies of European industries have shown that wage polarization is greatest in sectors with strong innovation (new products and new markets) and a high proportion of university-educated workers.<sup>32</sup> These factors are likely behind the Canadian trends discussed in the previous section.

In addition, research clearly shows that, throughout the 1980s and 1990s, the increasing use of in-

## Poverty (Overall and Children) in the Top 20 OECD Countries, Mid-2000s

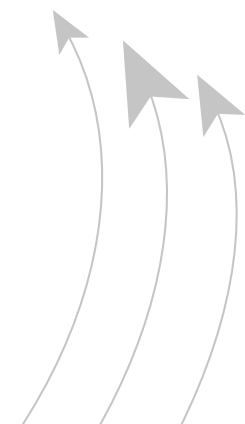


**FIGURE 4.** Persons Living in Poverty (Indicator: Low Income Measure), top 20 OECD countries (GDP per head), mid-2000s

Source: OECD, Income Distribution—Poverty; Child Well-Being, mid-2000s

formation technology and concomitant increase in demand for skills – and cognitive skills, in particular – resulted in higher wage inequality.<sup>33</sup> For example, in both the U.S. and U.K., investments in new technologies were associated with increased demand for workers capable of using them,<sup>34</sup> which is not surprising. Of course, those workers attract higher wages than their less-skilled counterparts. As technological development continues, and even accelerates, in the next decade, polarization within the labour market is likely to increase as well.

Therefore, Canada is experiencing the effects of a massive, global economic transformation, one that provides enormous opportunity for those who have the right mix of human capital, and adverse consequences for those who don't. But, in this new paradigm, in which human capital is the basis of collective prosperity, countries that allow the forces of globalization and technology to sideline huge swaths of their populations will find their economies sidelined as well.



# what does this mean for human capital?

Returning to Figure 1, we can see how the above trends interact with the Human Capital Cycle. Polarization of the job market impacts the “wages and job prospects” step of the process, such that high-skilled, high-wage workers find themselves in a virtuous human capital cycle, which provides greater and greater opportunities for them and their children. Low-skilled, low-wage workers, in contrast, find themselves in a vicious human capital cycle that will become increasingly difficult to escape as the trends described above accelerate.

In previous generations, there was much more opportunity for mobility within the human capital cycle due to the availability of secure middle-wage jobs, particularly in manufacturing. People who started off in the cycle with low income and status could aspire to a decent living, which would allow them to make human capital investments in themselves and their children, thus benefiting the economy as a whole. Today, largely due to the impact of globalization and technology on labour markets, such opportunities are scarce.

At the same time, in the last several decades, the burden of human capital development has shifted increasingly to the individual, through the combination of higher post-secondary education costs and lower income security.<sup>35</sup> As the steps in the human capital ladder have become harder to climb, it is not surprising that the earnings mobility of Canadian workers has declined.<sup>36</sup> If left unaddressed, these trends risk exacerbating inequalities that already exist in Canada’s system of post-secondary education, where young people from high-income backgrounds are more than twice as likely to have a degree or be pursuing one than those from low-income backgrounds.<sup>37</sup>

**Meeting the social challenges posed by the 21<sup>st</sup> century economy is not a matter of charity for the few, but one of long-term prosperity for all.**

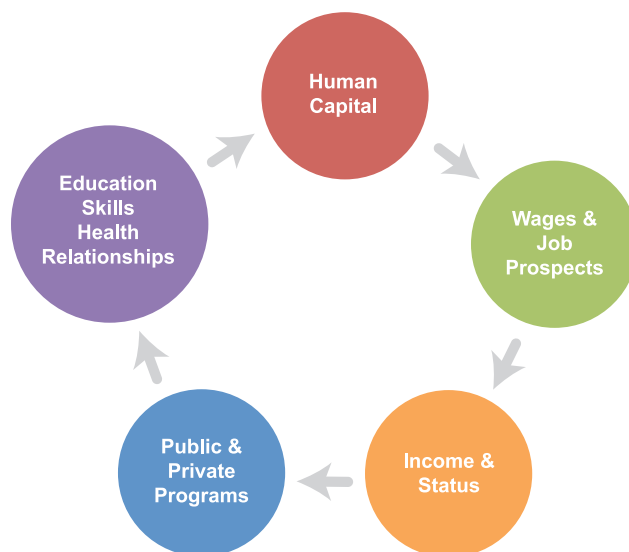


FIGURE 1. The relationship between inequality and poverty (shown as income and status) and human capital development in a knowledge-based economy.

As the statistical trends discussed above reveal, as much as 60 per cent of Canada’s population is likely being affected, in the form of declining market incomes, by the forces of globalization and technology, and the disparities they cause in the job market. We want to be very clear about this point: meeting the social challenges posed by the 21<sup>st</sup> century economy, namely inequality and poverty, is not a matter of charity for the few, but one of long-term prosperity for all. The solution, however, is not for Canada to resist the shift to the new economy, but rather to put itself in a position to succeed within it by ensuring that our economy and society are both working toward that objective.

**A**s this report has shown, globalization and the shift toward the knowledge-based economy are forcing structural changes upon Canada, which, if ignored, jeopardize our human capital development and long-term prosperity.

In this period of economic transformation, Canada requires *all* of its citizens to contribute to the prosperity of the country. Without the proper policy planning, Canada will fail to develop the talent and ingenuity of a significant portion of its population. As this economic reorganization touches upon a number of policy areas, the challenge calls for a holistic approach that will, in a coordinated way:

- 1. Address the root causes of inequality and poverty; and**
- 2. Ensure Canadians are provided with adequate social mobility vehicles.**

Given the extent of this challenge, we are not recommending specific policy changes at this stage; instead we are proposing a different way of thinking about the relationship between economic and social policy, one that is compelled by the demands of the knowledge-based economy. In order to address the greatest economic challenge Canada faces today, policy makers need to see social challenges, like inequality and poverty, as impediments to our long-term prosperity. This requires a comprehensive approach to policy analysis, which is best accomplished through a novel mechanism.

## **A MECHANISM TO PREPARE CANADA FOR THE KNOWLEDGE-BASED ECONOMY**

Effective and thoughtful policy responses to the consequences of the ongoing structural changes in the economy are necessary to ensure Canada's long-term prosperity. The Task Force recommends the formation of a body that will (1) conduct further investigation on the link between inequality /

poverty and human capital development in Canada; and (2) deliver more specific policy recommendations as to how Canada can adapt its economic and social policy to globalization and the shift toward a knowledge-based economy. Necessary features of such a mechanism are:

### **Capacity to engage all levels of government**

Inequality, poverty and human capital not only transcend jurisdictional lines, they also present a complexity that requires the engagement of all levels of government – federal, provincial/territorial, municipal, and aboriginal. For example, the federal government, with its responsibility for direct and indirect taxation, employment insurance, and aboriginal peoples, has a major role to play. And meaningful progress cannot be made without the involvement of provincial and territorial governments, whose responsibilities include direct taxation, education, social services, and employment legislation. Municipalities should also be included due to their role in the delivery of front line services such as childcare and housing. Finally, Canada's aboriginal governments will be vital in this process; as stated earlier, aboriginal peoples are disproportionately affected by poverty, aboriginal youth are the fastest growing segment of our population, and the North will be a major part of Canada's economic future.

### **Capacity to engage communities and the general population**

As those who are most directly impacted by government policies, citizens, interest groups and businesses are important sources of insight and ideas. To tackle the problems related to inequality and poverty, community-specific solutions will often be needed; thus engaging in a dialogue with these groups and their leaders is vital. Moreover, extensive participation of civil society in a consultation process increases the effectiveness and legitimacy of the ultimate policy recommendations.

## Capacity to generate new research evidence

Government resources must be complemented with external capacity to generate a well-balanced analysis. Expertise on different aspects of inequality, poverty and human capital development is distributed across various government departments – at all levels – as well as the private sector and academia. The mechanism should be capable of assembling, temporarily at least, these disparate sources of knowledge, to work on an integrated assessment of the situation and deliver policy recommendations.

## Independence and obligation to report to the public

Work conducted within this mechanism's mandate will likely enter politically sensitive areas. To ensure the legitimacy of the process and its outcomes, it should be politically independent and have an obligation to report to the public. Such a process is consistent with the open and inclusive consultation we are calling for, and increases the likelihood of arriving at recommendations that attract widespread support. As a result, an independent and transparent mechanism is most likely to produce reforms that are both effective and viable, which is the ultimate objective.

## A ROYAL COMMISSION ON ECONOMY AND SOCIETY

Since the mid-1930s, royal commissions have been established on numerous occasions to investigate social or economic challenges of national importance. Recent examples of royal commissions include the 1982 *Royal Commission on the Economic Union and Development Prospects in Canada* (the MacDonald Commission) and the 2001 *Royal Commission on The Future of Health Care in Canada* (the Romanow Commission). Unquestionably, the state of Canada's economy and society in the global, knowledge-based economy is of the same magnitude, scope and complexity. It warrants a royal commission.

**We must recognize that our long-term prosperity depends on enabling all Canadians to contribute to it.**

As a mechanism for further investigation and policy development, a royal commission also satisfies the four necessary features listed earlier. First, a royal commission engages the federal government and, with the proper terms of reference (such as the provision included in the Romanow Commission), the provinces and territories as well. Provincial and territorial interests can also be voiced with the appointment of a balanced and representative group of commissioners with different backgrounds. Second, a royal commission can be designed such that consultation with citizens, interest groups, businesses and other stakeholders is integral to its mandate. Third, as an ad hoc mechanism, a royal commission allows for the assemblage of government and non-government resources for the purpose of a well-defined, time-limited assignment; should the commission's work reveal a need for future monitoring, it could recommend the creation of a permanent body, or the reorganization of existing resources so as to match a new mandate. Finally, a royal commission benefits from complete independence and reports directly to the public.

Of course, for all its positives, a royal commission also has drawbacks, most notably the extensive resources required to fulfill its mandate, and a long timeframe before it releases its conclusions. However, the magnitude of the changes the global economy is experiencing, their widespread impact on Canadian society, as well as their long-term implications compel the establishment of a royal commission. It is the best mechanism we have for determining how to meet the complex challenges of the knowledge-based economy.

That said, finding the appropriate time to establish a royal commission should not postpone further research and thinking on the issues raised in this report. We need to start a national dialogue that involves all parts of Canadian society – both inside and outside government – with the view to identifying policy weaknesses and solutions. As this report has stressed, this process of discussion and reflection, whether it takes place within a royal commission or some other process, must bring a different kind of thinking to the challenges that Canada will face in the 21<sup>st</sup> century. We must recognize that our long-term prosperity depends on enabling all Canadians to contribute to it. We must, therefore, find ways of prospering together.

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