# The Other Competitive Advantage

# INTRODUCTION

## Riding the Political Merry-Go-Round

Albertans and Canadians are locked in perpetual debate. The public discussion about the value of public services and strong social programs versus privatization and a greater role for the private sector in the delivery of public services seems a never-ending circle. The two sides in the debate ride parallel horses on a political merry-go-round – each convinced of their correctness, but neither gaining a lead over the other. And consequently, the debate seems to lead nowhere.

The reason is that the two sides are not speaking the same language. Those who want to privatize speak the language of the free market and individualism. Those who defend public services talk of justice, equity and equality. They each debate perched on their own horse – one the horse of market wisdom and the other the horse of shared social responsibility.

Privatizers wants to persuade by the weight of economic argument -- competitiveness, efficiency and cost-effectiveness. Defenders of public services appeal to shared values, equality and concern for our neighbour. Neither persuades the other, because in effect they are not really talking to one another.

And through it all, the public is left confused and divided. Workers in particular feel the brunt of this confusion. Workers are told that their jobs and continued economic prosperity depend on privatization and simultaneously that a commitment to justice and equality is of paramount importance. What are they to do?

## The Social Justice of Public Services

The social arguments in favour of public health care and education, strong income support programs for injured workers, families in poverty and the unemployed and decent public pensions are well known. They have been repeated many times.

Public services are part of building a more just, more humane society. They are a tool to reduce inequality and ensure fairness and justice for workers, their families and neighbours. Defenders of public services should never lose sight of the fundamental moral and ethical reasons why we struggle to build and maintain public institutions for the greater good.

But that is not the purpose of this booklet.

## The Other Competitive Advantage

This booklet will address the other piece to the argument – the economic piece. It will ask if public services provide an economic benefit to our society. Do our social programs contribute to Canada's economic prosperity and competitiveness?

When a country or a region possesses a quality that allows it to produce something more efficiently, more effectively or more expertly, it possesses an advantage over others.

In economic terms, this is labeled a "competitive advantage". For example, if a nation has access to high quality, low-cost wood, it will have a competitive advantage in the lumber industry. If it has a pool of experienced computer programmers, it will have a competitive advantage in the computer sector.

Normally, economists see competitive advantage as existing solely in the private sector. Economists also tend to see it as applying only to corporations and business interests.

But the question needs to be asked whether public health care, public education and income security are also competitive advantages, for both employers and workers.

In short, does the public delivery of social programs constitute the *other* competitive advantage?

Undoubtedly the highest profile debate in Alberta and Canada has been around the future of our public health care system. Most of this debate has focused on which system is more efficient – public or private.

Advocates of private health care have touted increased private involvement as a solution to increasing costs and long waiting lists.  Public health care supporters point to Medicare's ability to provide quality health care to everyone, regardless of income.

There has not been much discussion about the other piece of the puzzle. Which system creates an economic advantage for workers and employers?

# A. Public Health Care

## A Private-Public Continuum

There are three primary ways in which workers get access to health care. The government can offer health services to all citizens through a health care system financed by taxation. Or the worker can receive benefits through their employer, funded jointly by the worker and the employer through premiums. The third option is to purchase it directly out of pocket.

The latter two are part of the private health system. The first is the public health care system.

No country in the industrialized world has a system that is exclusively public or exclusively private. Elements of both systems are evident in all countries. The private-public discussion is a debate about placement on the continuum. According to the OECD the U.S. has the most privatized health care system in the industrialized world, with only 46% of health expenditures coming from the public system. On the other end are Belgium, Denmark, Iceland, Britain, Sweden and Norway with about 83% public. Canada falls in the middle with 70%.

## Overall Costs

The first examination is how much each system costs. Countries with strong public involvement in health care spend less on health care than countries where the private sector has a larger role to play, both per capita and as a portion of their economy (Table 1). The U.S. spends 14% of its Gross Domestic Product (GDP) on health care, or over $4,000 (U.S.) per person. In comparison, Great Britain spends only 6.9% of GDP and $1,500 (U.S.) per person. Canada, again, falls somewhere in the middle.

Australia provides a useful glimpse into the nature of the two systems. In Australia, where public and private hospitals exist side-by-side, the public-private debate can be compared directly. Studies have shown that "Australian public hospitals were able to treat patients at 91 percent of the cost incurred by private hospitals." (Willcox, 2001)

One of the reasons for this increased efficiency is that the private sector has significantly higher administrative costs. Private health plans in Australia average 12 percent administration, while the public health insurance program needs only 3.5 percent.

The evidence is quite clear that public provision of health care is

Table 1: Health Spending, Selected Countries

| Country | Health Spending as % of GDP | Health Spending Per Capita (in U.S.$) | Public Health Spending as % of Total |
|---|---|---|---|
| Canada | 9.1 | 1,828 | 69.7 |
| United States | 13.9 | 4,095 | 46.4 |
| Belgium | 7.6 | 1,812 | 87.6 |
| Denmark | 8.0 | 2,574 | 83.8 |
| Germany | 10.7 | 2,733 | 77.1 |
| Great Britain | 6.9 | 1,508 | 83.4 |
| Iceland | 7.9 | 2,177 | 83.8 |
| Norway | 7.5 | 2,624 | 82.2 |
| Sweden | 8.6 | 2,219 | 83.3 |

Source: OECD, Health Data, 1999.

more cost-effective on the macro-level. However, proponents of private health argue that the issue of who pays is significant. Public health care requires tax revenue, either income taxes or payroll taxes, to finance the system. It is argued that these taxation burdens are harmful to the economy and act as a drag on Canada's competitiveness.

## Cost Savings Equals Competitive Advantage

The reality, however, is that public health care ends up costing both workers and employers less on their paycheques and payrolls than privately financed health care. This is borne out by comparing economic and cost data from Canada and the U.S.

In Canada our blend of public and private breaks down like this. Hospital, acute care and physician services are covered publicly for all citizens – which accounts for the bulk of health care costs. However, many employers offer supplementary health benefits for dental, pharmaceuticals and other extended health coverage. Workers without additional coverage pay out of pocket for things such as prescriptions.

By contrast, in the U.S., the public provision of health care is limited – offered only to those on welfare and senior citizens. The bulk of health care is provided via employer-sponsored benefit plans. There is a wide range of plans available. Many employers provide only basic hospital and acute care. Others provide benefit packages that include all health coverage, including dental and prescriptions. For workers without coverage, out-of-pocket payment is required for health care.

## Public Health Care: Employer's Payroll Payoff

A study by the Conference Board of Canada shows that total payroll costs for health care are more expensive in the U.S. than in Canada. "American employers pay 2 to 2.8 times that of their Canadian counterparts for health care benefits." (Conference Board, 1999) The study compared companies in four different industries with operations in both the U.S. and Canada to determine the amount they paid to ensure health coverage for their workers. The calculations included payroll taxes paid toward public health care. The U.S. sites pay more than twice per worker for health coverage, and almost double as a percentage of their payroll. The results are shown in Table 2.

The lower employer health costs in Canada lead to an overall cost advantage for Canadian products. Industry Canada found that in the automotive sector, the labour costs for cars built in Canada are 30% cheaper than the U.S. (Graph 1). The majority of this advantage is due to lower health costs. In Canada, health benefits costs are 41% of U.S. costs ($4.03 per hour compared to $9.82 per hour). (Industry Canada, 1998).

These figures have been confirmed more recently by the Canadian Auto Workers union. Using information provided by the big three automakers, the CAW calculates that Canada's hourly labor costs are $6 an hour cheaper due to our public health care system.

The primary reason for this differential is that public health care picks up the cost of hospital and acute care and physician services through taxation. This shifts the cost of these services from the employer's payroll to the public at large, at much cost savings.

Employers in Canada pay slightly more in taxes than American companies for health care, but that cost is more than offset by substantial savings on health care premiums.

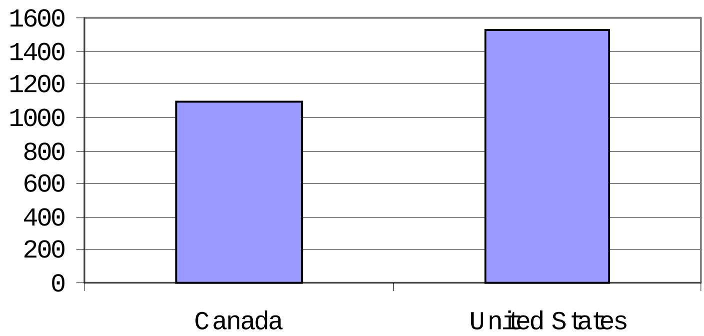
In the U.S. in 1998 the average monthly premium for employer-based health coverage was $178 for singles and $460 for family coverage. (Gabel et al, 1999). Since then, premium increases have ranged between seven and 11 percent each year, making estimates of current premium levels close to

## Table 2: Corporate Health Care Costs, Canada and U.S.

| Company/Industry | Canadian Sites $/Employee | Canadian Sites % Payroll | U.S. Sites $/Employee | U.S. Sites % Payroll |
|---|---|---|---|---|
| Business Service | 3,306 | 8.09 | 7,493 | 16.16 |
| Pharmaceutical | 6,505 | 13.84 | 12,457 | 20.66 |
| Auto Manufacturing | 13,626 | 22.82 | 27,658 | 34.21 |
| Information Technology | 5,794 | 14.49 | 15,045 | 29.30 |

Source: Conference Board of Canada, 1999

Figure 1: Comparison of Assembly Labour Costs, $ Per Vehicle




Source: Industry Canada, 1998

$600 per month for family coverage.

In Canada, employers only pay $93 a month on average for extended health benefits. While they pay slightly more in income taxes than their American counterparts, the overall cost savings to Canadian corporations is substantial.

Canadian companies are getting a real deal out of health care.

## The Worker's Advantage: Less Out-of-Pocket

Workers also fare much better financially under a public health care system. In most private health benefit plans, the employee is expected to pay a portion of the premium. There are also things such as deductibles and items not covered under the plan. For these things, the worker picks up the tab, either directly out of their pocket, or as a deduction on their paycheque.

And here, Canadian workers are at the advantage. In Canada, the average worker with an extended health plan pays $21 a month in premiums for single coverage and $53 a month for family coverage (Conference Board, 1996). In the U.S. the comparative figures are $36 for single and over $150 for family (Gabel et al 1999).

And the expenses don't stop there.

The average American household spends $1959 per year on health expenses, not including employer premiums and payroll taxes. (U.S. Bureau of Labour Statistics, 2001).

In comparison, the average Canadian family spends $1152, including health care premiums, which constitute about 30% of expenditures. Deducting this amount, the comparable Canadian figure is about $806 per year.

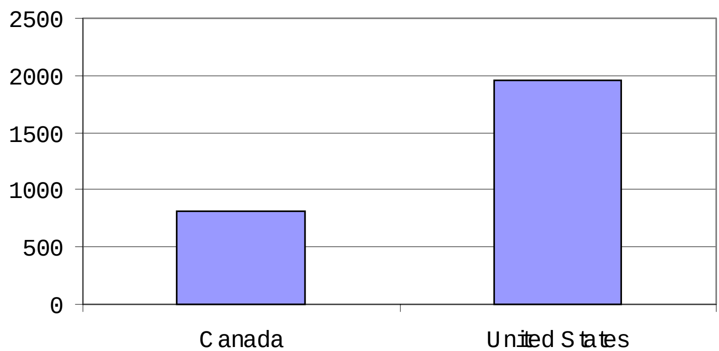
Taxes, of course are also a health cost to workers. Canada does have slightly higher income tax rates than the United States. The difference ranges between 0.5% and 6.5% depending on which state or province the worker lives in (Conference Board 1999). It should be remembered, however, that only a portion of income taxes goes to health care, so only a portion of the difference can be attributed to health care.

Many point to Alberta's health care premiums as a cost to workers, or sometimes their employer. This cost is not insignificant, at $88 per month for a family -- an amount recently increased by the Klein government as part of its plan to increase the private sector's role in health care. This health care flat tax should not be discounted as a cost to workers.

Most provinces do not have premiums, although some, such as Ontario have small payroll taxes.

However, U.S. workers have nothing to grin about. In the U.S. workers and employers must each pay 1.45% of gross income (3.9% total) to Medicare in the form of a payroll tax. Medicare is the public health plan for seniors. For a worker earning $50,000, this would cost them and their employer $82 each per month, for a total of $164 – a figure higher than Alberta's newly increased premium level.

Figure 2: Out of Pocket Health Expenses, Average Worker ($ per year)




Source: U.S. Bureau of Statistics, 2002

Table 3: Health Outcomes, Selected Countries

| Country | Female Life Expectancy (years) | Male Life Expectancy (years) | Infant Mortality Rate (per 1,000 live births) |
|---|---|---|---|
| United States | 79.5 | 73.8 | 7 |
| Canada | 81.4 | 75.7 | 5 |
| Sweden | 82.0 | 77.4 | 3 |
| Great Britain | 79.8 | 74.8 | 6 |
| Germany | 80.6 | 74.4 | 5 |

Source: U.S. Census Bureau, 2000

So while Albertans have to pay a small portion of our annual health care budget, Americans are required to pay to ensure there is health coverage for them when they retire. And the cost of the U.S. system is higher than Alberta's arrangement.

Workers end up saving money under a public health care system. Something that is a nice bonus to the security of knowing that universal health care is available.

## Paying More for Less: Paying Less for More

So, Canadians are paying less for our health care than Americans. And private health care costs more than public health care. But this is only part of the story. Maybe Canadians are receiving lower quality health care. Or less of it. This is certainly an argument made by advocates for privatization, that private health care delivers better health care.

A competitive advantage is not simply producing a product cheaper. It can also be producing a better quality product. To measure whether public health care truly delivers a competitive advantage to Canada, we need to examine if public health care systems are capable of delivering a similar level of quality for a lower cost.

Of course, health care is not a product like VCRs. It is not a simple matter of comparing products and determining which is better, but there are some tools which can help us determine if public systems consistently produce good health in comparison to private health care.

### *Health Outcomes*

One possible measure is how well each system delivers good health. When comparing some key health outcomes, such as life expectancy and infant mortality, the United States lags behind nations with a greater portion of public health care spending (Table 3).

Of course, health outcomes are the result of a complex web of socio-economic and environmental factors. U.S. outcomes could very well be lower due to other factors, including environmental quality and income inequality. It is likely a combination of causes. But as we discover below, it is likely that some of these factors are linked and that the nature of who receives quality health care in the system is a key factor.

### *Utilization*

When one examines how the health system is used, one quickly discovers that Americans use their health system differently than countries with stronger public health involvement.

"The likelihood that a patient will be hospitalized is about average among developed nations; but once admitted, the U.S. patient on average will likely be subject to strikingly more intensive treatment and will be sent home much faster than anywhere else." (Aaron, 1991: p. 82). Despite early release, U.S. expenditures per hospital bed and per patient-day are much higher than other industrialized countries, due mostly to the intensity of the treatment while in hospital. Table 4 shows the gap between the U.S. and other, more public, nations in hospital stays.

It is likely that the U.S. system is under greater pressure to move patients in and out of hospital quickly, due to the higher cost of a hospital bed. Since this data was published, hospital stays have dropped significantly in Canada, but similar trends are also found in the U.S., creating the likelihood that similar differences still exist, although slightly narrowed.

Longer stays in hospital do not necessary mean a patient is receiving more care, but do indicate an important difference in medical approach. The U.S. private system puts priority on high technology, higher intensity procedures, which also come with a much higher price tag. Combined with the level of health outcomes in the U.S., there is some reason to speculate whether the high-priced fancy procedures are worth the extra cost.

While some may feel that newer technology is a good thing, it is equally possible that much of the drive for new innovation is revenue related: higher fees can be charged for new procedures, even if the medical benefit of the new procedure may be marginal.

Table 4: Average Length of Hospital Stay (Number of Days)

| Country | Prostate Cancer | Pneumonia | Hip Fracture |
|---|---|---|---|
| United States | 7.2 | 7.8 | 14.2 |
| Canada | 17.0 | 16.8 | 32.9 |
| Sweden | 13.6 | 10.8 | 15.3 |
| Great Britain | 13.0 | 39.9 | 29.7 |
| Australia | 12.4 | 11.6 | 25.2 |

Source: Aaron, 1991.

*Comprehensiveness*

How much health care is provided for the dollar is an important measure of a system.

As was noted earlier, the U.S. system is a grab bag of employer-based policies, individual coverage and public delivery for select populations (welfare recipients and seniors). This means a wide range of what individual American workers receive in health benefits.

Canada covers all acute and physician services, with some provinces also picking up pharmaceuticals. Other nations, such as Sweden and Germany offer prescription, dental and other medical services under their public health delivery.

When taking into account the added comprehensiveness of many nations, the expense of the U.S. system becomes even more stark.

While in most nations, acute care and hospital stays are ensured, the U.S. is not so uniform. Medicare, the public program for seniors has a maximum 90 day hospital stay lifetime. 30% of private plans have a lifetime maximum for health benefits of $750,000 or less. (Aaron, ibid.) At U.S. rates, a short hospital stay can quickly eat up such a maximum.

Only 12% of employer health plans in the U.S. offer presciption drug coverage, compared to a majority of Canadian extended health plans. 13% of plans in the U.S. cover only basic acute care, which is universally accessible in Canada.

In addition, 47% of American health plans have a deductible of more than $150 for health services.

The growth of Health Management Organizations (HMO's have increased from 4% of all plans in 1977 to 27% of plans in 1998) in the past decade has tightened the limits to U.S. coverage even more. Patients are now often limited by their insurance company in what drugs they may purchase and even what doctors they see.

For the extra cost employers and workers pay for health in the U.S., they receive less in return than what Canada and most other nations offer through the tax-based public system.

## Who is Served

The most telling part of a private health system in comparison to public health systems is the distribution of who is served. Much has been said of the forty to fifty million Americans who have no health insurance of any kind. For these citizens, health comes 100% out of pocket, or – more likely – not at all. But the story goes much deeper.

17 million of those uninsured are workers. 15% of full-time workers and 22.4% of part-time

workers have no insurance coverage, despite being gainfully employed. (Journal of Accountancy, 2001).

And an additional 20% of workers do not receive the entitlement of coverage provided by their employer – mostly because they cannot afford the premiums and choose to decline eligibility. In total it is estimated that only 60% of workers in the U.S. are protected by health insurance. (Gabel, 1999).

Looking at socio-economic differences tells a more dramatic story. Low income earners were twice as likely to be uninsured than higher income workers. Only 34% of workers who did not have a high school diploma have insurance coverage. Blacks are more likely to be without insurance, and Hispanics are three times as likely as whites to be without coverage. Younger workers and women are also less likely to have coverage. (Aaron, 1991).

Health insurance in the United States is heavily weighted in favour of those with money and education. But it is not only the U.S. In Australia, where citizens can purchase optional private insurance coverage, 70% of higher income earners opt into the private system, while less than 20% of lower income earners do so, despite the existence of a government subsidy for doing so. And for those who opt in, there is speedy access to the more expensive private hospitals.

## The Economics of Restricted Access

How is this an economic argument? It is economic on two levels. First, a worker without adequate health coverage is a less secure worker. This has two effects. The worker is less likely to spend money, needing to hold some savings back to cover medical costs. This draws money away from active circulation, where it can be used to purchase goods and services, thereby strengthening the economy.

That uninsured worker is also likely to forego treatment of minor ailments or not take advantage of early intervention. In other words, they will not go to the doctor if they can avoid it due to the cost of the visit. This approach to health care can lead to a greater level of sickness later on. It also plays out in the statistics. While the U.S. as a whole has lower rates of absence from work due to illness, lower income workers are more likely to miss work than Canadian workers.

The second economic argument is the issue of value for dollar. The U.S. system costs approximately 50% more to operate than the Canadian system. And for that, only about 60% of the workforce is properly covered. This kind of differential in benefit per dollar is a clear indication of inefficiency and wastefulness in the system. Dollars going to health care in the U.S. are freed up in Canada to be put to more productive use -- giving Canada an advantage.

## Going Public Builds the Economy

Private health care delivers less for more money. By maintaining a strong public presence in health care, Canada gives itself a competitive advantage over our neighbour to the south. Our labour costs are cheaper and both workers and employers pay less out of pocket for health care, even when including the tax burden in the calculation.

Public health also uses the dollars more effectively, ensuring a more broad based access to health services.

And while Canada has a clear advantage over the U.S. economically due to our health care system, it does not mean that there is nothing more we can do to increase that advantage.

The private piece of our health care pie is eating up increasingly larger amounts of money. The cost of employer-based health care plans increased 26% in five years in Canada (Conference Board of Canada, 1997). Prescription drugs – the most private dominated portion of Canada's health system – increased 41% per capita between 1995 and 2000, and have increased six fold since 1980. This is by far the fastest rate of growth in health spending (CIHI, 2000).

While many in the media talk about the unsustainability of Medicare, public expenditures have remained approximately flat during the past ten years. The area of growth has been in private health spending.

If Canada wants to increase our competitive advantage, we need to find ways to lower the portion of our health system that is privately operated and financed. Private health care is a brake on our economic engine, slowing down the rate of economic growth.

# B. Public Education

While Canadians have been pre-occupied with the raging debate over private health care, a more silent and equally concerning drift has occurred. In education, privatization and the use of the private sector to educate our children and adults are growing. The calls from some quarters for a parallel private school system have been building. And while they haven't made front page news like in health care, the results could be just as serious.

The challenge to public education in Canada does not seem as imminent to many Canadians. A small private education system has always existed in our country, but has never appeared to be a threat to the strength and stability of the public system. While this is somewhat true, there is a growing industry of private education taking hold, and it is important to take stock of its economic impact.

When talking education, it is important to distinguish between childhood education (the primary and secondary school system), and advanced education – the post-secondary system of colleges and universities. They are all broadly part of the education system, but countries tend to treat each portion of the system differently.

## The Public-Private Continuum

As in health care, no education system in the world is exclusively public. There is some element of private involvement in every system.

When a country operates a public education system, tax dollars are utilized to build and finance the infrastructure and programming for schools and post-secondary institutions. On the other hand, private involvement can come in three forms. A whole private school system can be set up in parallel to the public system, which is the case with private colleges in the U.S. and religious-based schools in Canada. Or the private sector can take over one portion of management of the system, such as the construction of new schools or the administration of a school. This also occurs frequently in the U.S. The private entity may receive public subsidy for these roles, or may be self financing through tuition and other fees.

The third private involvement in education is the direct payment from students for education in a public facility. In other words, tuition. This is the case in Canada for post-secondary institutions. This is considered private financing because the cost of the service is expected to be borne by the receiver of the service, and is therefore a form of privatization.

Table 5 shows the relative portions of public and private expenditure in education across selected nations. Finland and Sweden top the list of public education, with 99.7% and 98.6% of all funds coming from and going to the public system. At the opposite end is United States at 75% and Australia at 76.7% public. Canada falls toward the bottom end at 83.1% public expenditure.

Table 5: Public Education Spending as Percentage of Total Education Spending

| Country | Public Education Spending (%) |
|---|---|
| United States | 75.4 |
| Australia | 76.7 |
| Canada | 83.1 |
| Sweden | 98.6 |
| Denmark | 95.6 |
| Netherlands | 91.5 |
| Germany | 78.9 |
| Austria | 92.4 |
| Finland | 99.7 |

Source: OECD, 2001

It becomes clear that no industrialized nation has a predominance of private involvement in education. Countries with lower levels of public involvement have small but noticeable private parallel primary and secondary schools. The largest difference, however, is due to the existence of tuition at the post-secondary level. Sweden, Finland and other countries charge no tuition to students for advanced education, substantially lowering private involvement.

Unlike in health care, there is no discernable pattern in how private involvement affects overall costs of the system. Sweden, U.S. and Canada all spend about similar amounts for education in total.

## The Economic Value of Education

"Education is an investment" is a common political refrain in all countries. Education is touted as a way to build economic value and strength through a well-educated workforce. The studies on the matter demonstrate this clearly.

Starting in early childhood, investment in quality child care for pre-school children helps strengthen academic performance. Kids who attend child care perform better upon entering school than kids who were not in child care (Cleveland & Krashinsky, 1998). Other studies have shown that Headstart programs, which target young children from vulnerable and at risk families, return $7 in economic and social benefit for every $1 spent on the program (ESPC, 1995).

A high school education also has clear economic advantages. The total annual return on public dollars spent to educate a student to the end of high school is 33.4% for men and 38.5% for women (Vaillancourt, 1995). Similar gains have been found for money spent on university education.

The primary reason for this is that education brings with it higher wages for the individual, and the capacity to support higher skill employment for society. This raises the level of tax revenue and lowers social costs such as income security, criminal system and other areas. Figure 3 shows the income growth that comes with education.

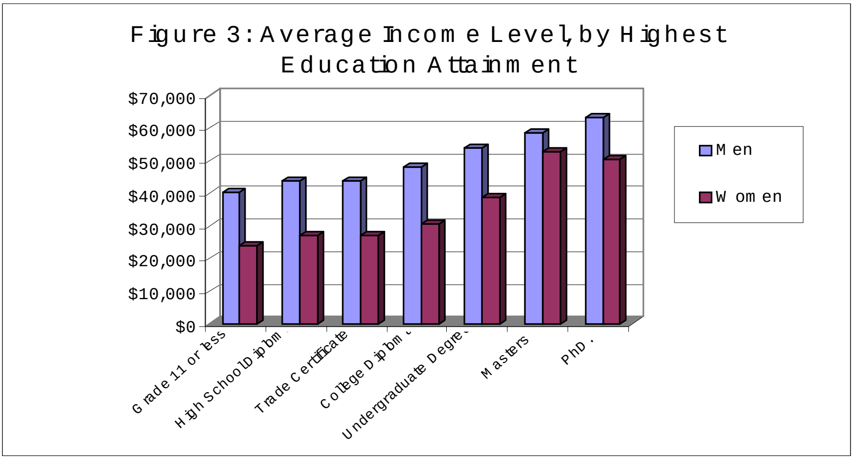
The economic gain is particularly pronounced for women, and higher education levels are identified as one of the key reasons for the shrinking wage gap between men and women.

U.S. studies have shown that due to increasing education levels since 1960 the American economy, as measured by the Gross Domestic Product (GDP) is 18% larger today than if those education levels had not occurred. (Saxton, 2000)

## Childhood Education: The Cost of Going Private

Most of this value has been attained by the public education system. Proponents of privatization, however, argue that private schools can deliver better results for less money. They claim that the private sector can be more efficient at delivering quality education.

Evaluation of private education in Canada has been fairly minimal, given the relatively small size of our




Source: Allen, 1996

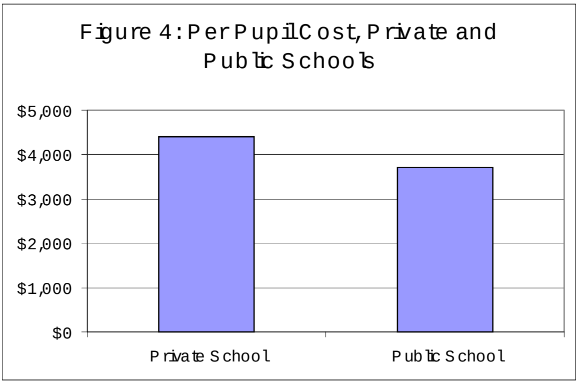



Figure 4: Per Pupil Cost, Private and Public Schools

Source: American Federation of Techers, 1998

private school system. However, in the U.S., which has a larger private school sector (in 1993, 9% of students in the U.S. attended private school), there have been some thorough comparisons of the two systems, and the public system comes out on top.

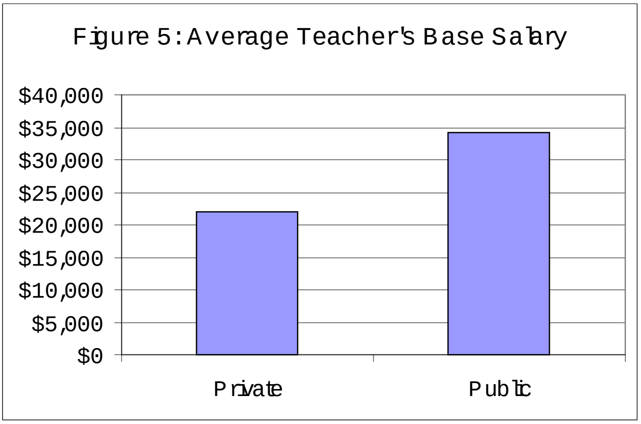
The first difference that must be noted is that different types of students attend private school. Private school students are far more likely to be white and come from higher income families. Children from homes that earn more than $50,000 are five times as likely to attend private school. Conversely, low income children are sparsely represented. Black and Hispanic students are small minorities of private schools (National Center for Education Statistics, 1997).

The likely reason for this disparity is the fact that private schools charge an average of $3,100 in tuition per year. Many also receive taxpayer funding as well. In addition, they are also usually located in upper-middle class neighbourhoods. The two factors combine to make private schools inaccessible for lower income families.

## *Paying More ...*

But how do private schools compare in terms of the cost of educating students? The case study of The Edison Project is illuminating. The Edison Project is a for-profit corporation with the goal of running 1,000 for-profit schools in the U.S. through contracts to school boards. It currently operates 25 schools. The American Federation of Teachers (AFT) has conducted a thorough analysis of the project, and concluded that Edison costs significantly more per pupil to operate than comparable publicly operated schools. Figure 4 shows that Edison costs 16% more than a public school in the same district. And Edison has fewer special needs students than public schools. Edison has to subsidize each of its schools through corporate donations and deficit financing.

## ... *And Getting Less*




Source: National Centre for Education Statistics, 1997

Private school students do not perform any better than public school students, despite all the supposed advantages of less diversity, no special needs kids and extra corporate funding. The AFT study finds that in most Edison schools, students perform poorly in comparison to public school children in comparable programs. "Edison students have fallen behind students in comparable schools." (AFT, 1998; p. 3)

Results in Chile tell a similar story. Under Pinochet, Chile privatized its education system by issuing "vouchers" to families, who could then purchase education at any school they chose, private or public. Despite the fact that mostly higher income families opted for private schools, private school pupils score lower on national achievement tests than public school pupils (Carnoy, 1996).

One reason for this discrepancy is that public school teachers tend to be better educated and receive more professional development during the year than their private school colleagues. Public school teachers also receive higher salaries than private schools (Figure 5).

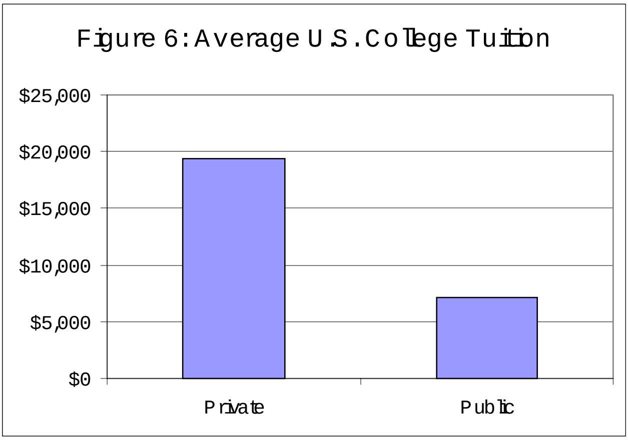
The result is that teacher turnover in private schools is substantially higher than public schools. More stable, better educated teachers results in higher quality education.

Public schools deliver higher quality education at a lower cost than private education. In other words, public education is the most effective way to deliver the economic benefits that arise from education. Public schools provide a competitive advantage to countries that rely on them.

## The Post-Secondary Question

What about post-secondary education? Does the private sector do a better job of educating our adults? Post-secondary education includes universities, colleges and technical institutes.

Canada again remains predominantly public in our post-secondary system. However, a growing sector of private institutes and colleges plays a role in our system.




Source: National Centre for Education Statistics, 1999

Due to a lack of standardized measurements, it is difficult to determine whether private or public institutions deliver better education quality. However, examination of income levels and job competitiveness suggest that public institutions are equally capable of educating and training adults as their private counterparts, and possibly better.

Where there is a clear difference is in cost. In Canada, private, for-profit trade institutes charge more than double in tuition than public institutions. In the U.S. where the network of private colleges and universities is well-developed, private tuition is almost 300% higher in private colleges (Figure 6).

Of course, public colleges receive tax dollars to fund a portion of their operations. But, public institutions tend to have lower overall expenditures than private institutions. This savings is due mostly to lower administration costs and the lack of a need for profit.

Public colleges and universities offer a greater value to the individual student, through lower tuition, and to society as a whole through lower overall costs.

## The Real Price of High Tuition

Tuition is a form of private funding for education. Asking students to pay a portion of their education costs may seem reasonable on the surface. After all, they will receive a sizeable economic benefit from their education, so it is fair to ask them to pay for some of the cost.

Setting aside for the moment the fact that these students will be paying for the cost down the road through higher taxes, there is a clear economic argument against high tuition costs.

In the past 10 years, tuition in Canada and Alberta has tripled. Student debt loads have increased proportionately. The cost of a four year bachelor's degree can now earn a student a debt load of over $30,000.

This increase in cost has had a direct impact on the accessibility of post-secondary education. For the past three decades, Canada has had the highest levels of enrollment in the world. This has clearly worked to our economic advantage. However our participation rates have been dropping. Ten years ago, at any one time, 7.1% of adults were enrolled in some form of post-secondary education. This figure was almost twice most OECD nations (Conference Board of Canada, 1999).

However, participation rates are now under 5%, a drop of 30%. At the same time, every other nation, except the United States, has seen an increase in their participation rates. This drop is due to the growing cost of post-secondary education. Fewer students can afford to attend.

The drop in participation rates are not evenly distributed across all socio-economic levels in Canada. Two recent studies in Ontario found that participation among low income familes dropped 40% to 50% when tuition increased in the 1990s (CFS, 2001). As the cost of education increases, institutions increasingly become enclaves for the wealthy and privileged.

What kind of economic impact does this have? If the access to higher education is restricted to a smaller segment of society, the economic benefits from that education – higher wages – becomes restricted to that small segment. This has two effects.

First, it decreases the overall ability of our workforce to reflect new economic needs. Jobs demanding high education levels will become increasingly difficult to fill and lead to a "dumbing down" of our entire economy.

Second, the overall tax windfall from the higher wage levels will be reduced. Governments will earn less revenue, placing greater pressure on other public services. By opening post-secondary doors wide, the economic spin-off grows. By restricting access, as has been the case in Canada during the 1990s, we choke off some of that economic prosperity.

## The Advantage of Strong Public Education

The economic argument for education is never doubted. But the economic advantage that comes with strong public education is equally clear. Public education costs less to operate and produces competitive to superior levels of quality. If our goal is to maximize the advantage that comes with education, then clearly the route is through a well-financed public education system, at elementary, secondary and post-secondary levels.

Unfortunately, our public education system has been under stress during the past decade. Underfunding and rising individual costs have strained the effectiveness of the system. We need to reverse this trend if we are to ensure continued economic advantage in the future.

Fortunately, the private sector has gained little more than a small toehold in the education field meaning there is still time to correct the errors. Obviously, the first solution is enhanced funding for all levels of education. The tax windfall down the road will more than pay for any financial outlay today.

Reduction and possible elimination of tuition and other individual direct expenditures has a strong economic argument. Higher individual costs dampen accessibility and weaken the economic impact.

Also, other nations, such as Sweden and Finland, provide post-secondary education tuition-free. Tax dollars fund the entire operating costs of universities. While in Canada such a policy would create a hue-and-cry from fiscal conservatives, these nations have found a way to create an economic advantage over Canada. Their workers are educated in the most cost-effective way possible, minimizing costs and maximizing benefits. And, in effect, the students of today who receive a free education will pay for the tuition of tomorrow's students, and thereby "contribute" their portion.

It is a decision of how long term we are prepared to look. If we choose to look down the road at the economic advantage that comes from widely-accessible, affordable education, we stand to reap substantial benefits. A more short term outlook saves us money today, but will cost us significantly in the future.

## C. INCOME SECURITY

One of the realities of being a worker in a market economy is income insecurity. Unemployment, layoff, disability, wage reductions all are very real possibilities from day to day for workers. To balance this inherent insecurity, governments around the world have traditionally played an active role in providing some level of income support to workers. This support comes in many forms and in widely varying degrees of benefit level.

In recent years, calls for a scaling back of these income security programs have dominated the political agenda, taking effective and strong hold in most industrial countries. Benefits have been reduced and rules made more punitive and demanding.

When countries cutback on public programs designed to provide income support to low income or unemployed workers, this can be seen as a form of privatization. With income security programs, funds allocated from tax revenue or payroll deductions are used to support individual workers and citizens in need of assistance. When these are scaled back, the individual is required to find other forms of assistance, or go without. That support may take the form of drawing on savings, mortgaging their home, relying on family or friends, turning to charities or food banks, or other more desperate measures such as crime. All are a form of private income security provision.

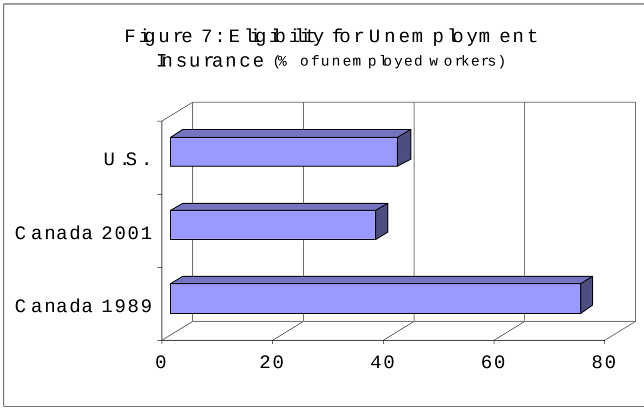
The level of income support provided to workers in need varies widely between nations. Many nations provide comprehensive social assistance. This range is shown in Table 6. Scandinavian nations spend between 9% and 10.5% of GDP on income support

Table 6: Income Support to Working Age Population, Private and Public

| Country | Public Income Support (% of GDP) | Private Social Spending (% of GDP) |
|---|---|---|
| United States | 2.4 | 8.6 |
| Canada | 5.2 | 4.5 |
| Sweden | 9.4 | 3.0 |
| Denmark | 10.0 | 1.3 |
| Finland | 10.4 | 1.8 |
| Great Britain | 6.5 | 4.0 |
| OECD Average | 5.8 | -- |

Source: OECD, 2001

to the working age population. At the other extreme is the U.S. at 2.4%. Canada is below the OECD average at 5.2%




Source: Canadian Labour Congress, Bureau of Labour Statistics, 2001

The same table also shows relative level of private social expenditure in the same nations. This is money spent in the nation by individuals, charities and other private entities on social assistance purposes. It is an inverse picture of public support. The U.S. is by far the highest at 8.6%, and Denmark the lowest at 1.3%. Canada falls on the higher end at 4.5%.

The range of models and program designs that nations use is bewilderingly diverse. The diversity makes a full discussion of income security models impractical for the limited space available here. As a result, we will limit the discussion to the three income security strategies in predominant use in Canada: unemployment insurance, welfare and minimum wage.

## 1. EI: The Fading Economic Stabilizer

Canada's largest income support program is the Employment Insurance Program (EI). It pays qualified unemployed workers a percentage of their previous wage income for a limited period of time. It is intended to soften the impact of short and medium term unemployment and aid re-employment. It is funded through joint employer-employee payroll contributions.

EI premiums and benefits have long been the focus of debate around economic effects. Those calling for cutbacks (privatization) state that the payroll contributions are "job killers" and that the benefits structure distorts natural market tendencies, creating intentional unemployment and suppressing worker relocation.

Defenders have traditionally used social justice arguments to bolster support for EI. However, economic evidence is persuasive that the existence of a strong EI program has a net positive effect on the economy.

Here, however, we should pause to point out that EI has been dramatically altered in the past ten years. Two rounds of reforms have dramatically reduced the scope and coverage of EI, leaving it much weaker than in the 1980s. Benefits have been reduced and the number of unemployed workers eligible to receive benefits has plummeted. The name has even been changed from Unemployment Insurance to Employment Insurance.

The reforms have been so profound, that it is necessary to see Canada as possessing two unemployment insurance regimes. The first existed up until the 1990s. The second is the one in place today.

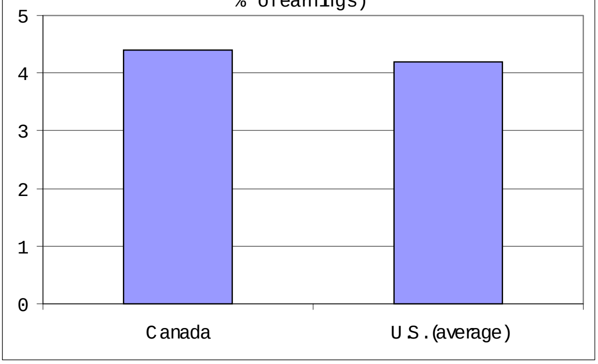
This division is heightened when one compares Canada's system to the U.S. system. The U.S. has an insurance program similar in design to Canada's, although it has traditionally been much narrower in its scope and lower in benefit entitlements.

Canada's new EI system looks very much like the U.S. system. Figure 7 shows the percentage of workers eligible for unemployment benefits under the three systems. The old system (called UI in this booklet) achieved almost universal coverage, while the U.S. and new EI system pay benefits to a small fraction of workers.

The same holds true for benefit levels. The U.S. system pays about 50% of the worker's previous wage. Canada used to provide 60% replacement, but has dropped that figure to 55%. The maximum number of weeks in each country is also similar.

The cost of each system is also similar. Premium rates have

Figure 8: Unemployment Insurance Premiums (Employee and Employer - % of earnings)




Source: Government of Canada; U.S. Bureau of Labour Statistics dropped in Canada, and are now about the level of the U.S. (Figure 8).

It is clear Canada intended to harmonize our unemployment insurance program with the U.S. And they appear to have succeeded. However, we may have harmed our country's economy in the process.

## Softening the Bumps

UI was often criticized on two fronts. First, the cost of the system reduced the number of jobs in the economy and second that it created incentives for workers to remain unemployed, rather than find work. Upon examination, neither argument holds up.

Studies by Human Resources Development Canada examined UI's impact on the recessions of 1981-82 and 1990-91. They show that the UI system before reforms was highly effective at stabilizing the Canadian economy. In fact, the existence of a system with wide eligibility saved tens of thousands of jobs during the two recessions. (TABLE 7) The end result is that the recessions were less deep and shorter than if UI had not been available.

The flip side is that during boom years, the existence of UI does slow the economy slightly, but the job saving effects during recessions outweigh any lost potential during boom times.

In fact, one HRD study demonstrated that the UI program was the most effective method for stabilizing the economy. Tax reductions and other transfers have a much lower effect, or no effect.

The studies also compare the performance of Canada's pre-reform UI system with the U.S. system and found that "the UI system in Canada has a significantly larger stabilizing effect than the UI system in the United States." (Dungan & Murphy, 1995; p. 34) In other words, Canada's unemployment program worked far more effectively than the American system, making Canada's recessions shorter and less severe than in the U.S.

This data is, of course, pre-reform. It is unlikely that our EI system today would be as effective. The main reason the former system

Table 7: Total Employment, With UI Program and Without UI Program

| | 1981/82 Recession | 1990/91 Recession |
|---|---|---|
| With UI | 10,675,000 | 12,240,000 |
| Without UI | 10,631,000 | 12,219,000 |
| Jobs Saved | 44,000 | 30,000 |

Source: Stokes, 1995 -

worked so well at economic stabilization was its wide-reaching effect. Most unemployed workers were eligible. Today, very few are eligible, meaning, there can be less stabilizing influence.

Lower benefits also lessen the economic impact. A third HRD study showed that consumer consumption falls when UI benefits are cut. If UI benefit levels are dropped "from 60 percent to 50 percent, consumption drops by between 3 percent and 6 percent. … The more important a claimant's income is to the household, the greater the fall in consumption." (Browning, 1995; p. 32) Less spending by families intensifies the recession.

EI reforms have lowered the positive impact unemployment insurance can have on the economy, and eliminated any advantage Canada held over the U.S. in this area. UI is a competitive advantage lost.

## Riding the UI Gravy Train?

Analyses of economic data debunk most of the stereotypes about unemployed workers and the "gravy train" of UI. Quite the opposite; UI actually assisted in the search for new work.

A comparison of unemployed workers shows that UI recipients are out of work for a shorter period of time and spend more time looking for work than non-recipients. "When not working, non-recipients spend little of their time searching for work, while the opposite is true for UI recipients." (Card & Riddell, 1996; p. 19) UI doesn't discourage job searches, it encourages it. This is likely the result of the added financial security arising from benefits, as well as the explicit job search requirements under UI rules. As a result, unemployment is shortened.

Additional evidence is found in the lack of impact of the EI reforms on length of unemployment. Average duration of unemployment has not decreased since the EI reforms. Duration of unemployment is cyclical, following the unemployment rate. Duration is no shorter today than it was in equivalent years in the 1980s.

Interestingly, UI recipients find employment at higher wage levels than non-recipients. They are also likely to find employment at a rate higher than their previous employment. This has the effect of UI partially paying for itself through higher payroll contribution revenue.

Researchers have also failed to find evidence that workers aim to work the minimum number of weeks to be eligible for UI benefits and then quit. Workers are no more likely to become unemployed at the threshold level than before or after that magic number.

In hindsight, all the reasons why UI had to be reformed have ended up being phantoms. They don't exist, meaning Canada has shrunk its unemployment insurance scheme for no good reason. The only measurable effect of the reforms is that fewer workers are covered, and that it is now less effective at softening the impact of an economic downturn.

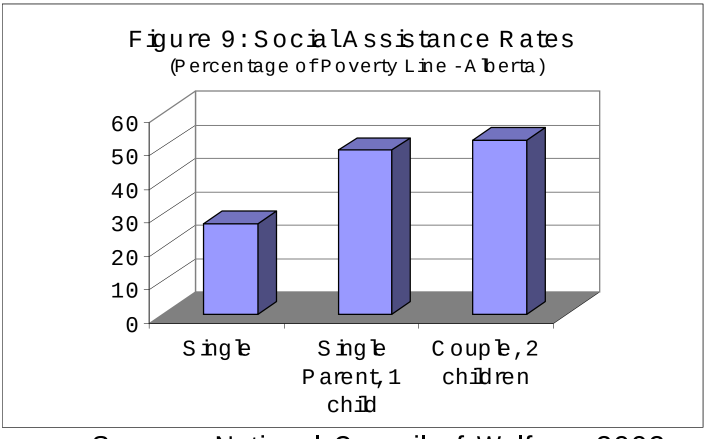
Another approach to unemployment reform might be to look across the ocean at Europe. European nations have adopted different strategies for bolstering employment and ensuring economic security. France has reduced the workweek, leading to measurable increases in employment rates. The Dutch reformed their tax and income security system to encourage alternatives to layoffs – job sharing, shift reductions and part-time employment. The result was that economic downturns have been softened and shortened. Other nations, such as Sweden, are far more aggressive at worker retraining and education – using the time on unemployment to build their skills and make them more marketable.

The U.S. model is a model of privatization. Canada should be looking at ways of restructuring its public commitment to unemployment insurance to enhance its economic effect, not eliminate it.

## 2. Social Assistance

Social assistance, more commonly known as welfare, is the weak sister of income security programs. In North America benefit levels are low, recipients are criticized and stereotyped. There are regular calls for lowering benefit levels and making assistance harder to get. Work-for-welfare is commonly suggested as a solution for "welfare dependency".

In Canada, welfare recipients on average receive 40% of the poverty line. Figure 9 shows how benefit levels compare to the poverty line in Alberta. The U.S. is




Source: National Council of Welfare, 2002 comparable in their rates. Comparisons to European countries is difficult because most use a different structure and model for their income security programs.

Social assistance should not be seen merely as welfare cheques. Housing assistance, which has been cutback in the past decade, and medical and other support should also be included. Social assistance is also capable of providing more active forms of support, such as training, education and job search assistance. It is in the area of housing and active support that Canada and the U.S. fall far behind European nations.

Proposals calling for reduced benefits and work-for-welfare can be seen as a form of privatization, as their goal is to reduce the level of public support for citizens in need and to shift the individual's income to private sources.

Obviously, the goal of moving welfare recipients into employment is desirable socially as well as economically, and should be one of the two goals of social assistance programs.

However, the privatization argument oversimplifies the situation. First of all, there are two types of social assistance recipients. In Alberta, about 40% of recipients are considered employable. The rest are considered unemployable for a variety of reasons. They may have physical disabilities or mental health difficulties. They may be a single parent with a very young child. It is important to view these men and women as equally important in our society, but a program designed to minimize public assistance and shift to private charity and employment will not work well for this population.

While there is strong debate about an appropriate definition of unemployable, and what options may exist to provide employment for people currently perceived as "unemployable", that is beyond the scope of this booklet. The booklet accepts the current approach to employability for simplicity sake, and should not be misunderstood as acceptance of the approach.

A discussion about social assistance must recognize the inherent differences between the two populations it serves, and the strategies employed must be appropriate to each.

## Unemployable Recipients

The strongest argument in favour of providing adequate income support to people considered unemployable is the social justice argument. It can be considered our collective obligation to ensure a way for these citizens to live and survive. Even those who argue for privatization acknowledge this portion of the argument.

However, it is still valuable to look at the impact of social assistance to this population. What would be the impact upon our economy if social assistance did not exist? Or if the amount recipients received was lowered?

Currently, recipients receive less than half of the poverty line. While hardly a sizeable income, it is large enough to provide some level of independence. Most require supplementary assistance, from families, charities or organizations such as the food bank. Still, they are, for the most part, able to maintain modest accommodation.

If no such minimal level of public support existed, the demand on charities and private organizations would expand dramatically. Some, such as the right-wing think tank Fraser Institute, consider this a good thing. They argue charities and organizations can operate income security more efficiently.

This argument falls down very quickly however. While on a macro-level charities operate more cheaply than government programs, there is more to efficiency than cost.

Charities and private organizations do not have the infrastructure to ensure all who need assistance receive it. Their approach is, by necessity, piecemeal and smaller scale. What this means is that a large percentage of people currently receiving public assistance would fall through the cracks and receive no help from any source. Also, charity revenue sources are less stable and more susceptible to economic downturns and whims of public opinion. This, too, reduces their overall efficiency and effectiveness. They are unable to provide consistent, uniform coverage for those in need. This is a role for government, which has the infrastructure.

If public income assistance ceased to exist, another consequence would appear. People currently finding a way to scratch out an independent life in the community would no longer be able to do so. The inevitable fallback is institutional settings. More individuals would end up in various institutions such as prison, acute hospitals, mental hospitals and nursing homes. Housing an individual for a month in any of these institutions is more costly than providing assistance to allow them to live independently.

Ultimately, society would not save money by eliminating public assistance. Much of the cost would simply transfer to private charities. Government expenditures would likely increase due to added burdens on their institutional programs.

This same logic builds an argument for increasing income support benefits for people considered unemployable. It is well documented that the current system allows people to fall through the cracks. A portion of people in need fall into crime or end up in institutions. An increase in support levels would lower the incidence of these negative effects, and thereby end up saving more money. It would also lower dependency on charity, and allow philanthropic funds to be redirected to other social needs.

Unfortunately, no one has conducted a rigourous examination of the economic advantages provided by a decent, humane social assistance system (an indication of the low priority afforded this vulnerable population). Our focus in Canada has, sadly, only been on the price tag, not the economic benefits that come from keeping people independent and healthy.

## Employable Recipients

But what about those who are considered capable of work? What is the impact of providing social assistance to this population?

The first necessity is to debunk the stereotype that welfare recipients have long term dependencies. Two longitudinal studies of social assistance recipients demonstrate a high level of mobility and varying levels of benefit dependency.

The reality is that employable recipients seem to move back and forth between employment and social assistance. In a study of Alberta recipients, an average of 45% of recipients had paid employment at some period during a calendar year (Shillington, 1998). The employment was low wage, unstable work. But there is no evidence to claim that welfare recipients do not want to work.

The problem identified by the Alberta study is that the work didn't pay enough to allow the person to get ahead, and so when the job disappeared, reliance on social assistance was again the only option. In fact a sizeable portion of recipients held a job and received social assistance benefits at the same time due to inadequate wages. This is a problem of wage levels, not social assistance levels.

The strategy of cutting benefit levels and reducing rates by cutting people off welfare has not panned out. It was based on the theory that by removing welfare dependency, these people would turn to gainful employment. This has not been the case. Studies in Ontario showed that of people cut off the welfare system, only 28% found employment (Canada and the World Backgrounder, 1996a). The question is what happens to the remaining 72%?

They tend to move to other jurisdictions or turn to charity for help. When Alberta cut welfare rolls in the mid-1990s, food bank usage doubled. In Toronto, demand for homeless shelter beds jumped 47% in the year that the Ontario government cut welfare recipiency. At the same time, the provincial budget for homeless shelters had to jump 16% to accommodate the demand. The resources required to support people in need of income support doesn't disappear. It shifts.

Work for welfare (sometimes called workfare) is also a failure, economically. Programs to make people work for their welfare cheque are economically unviable. U.S. research shows that workfare costs between $1,000 and $7,000 more per recipient than passive income support (Canada & the World Backgrounder, 1996b). This might be worth the money if it was effective in helping people find employment, but it is not. Quebec found that after 10 years of work-for-welfare programs, that it had no impact on ability to find stable employment.

Recent research is showing that the most effective way to lower dependency on social assistance and move people into stable employment is to increase the value of work. Pilot programs in three provinces were established in the mid-1990s that turn work-for-welfare on its head. For recipients who found employment, an "earnings supplement" was provided to increase the value of their employment wages. So, in effect, rather than losing their benefits upon finding a job, or working for basic welfare benefits, the recipients were able to earn more money by working.

The findings have been very clear. Making work pay more leads to higher levels of employment and longer durations of employment. And the interesting economic side-effect is that total costs of the program were less than if the old system remained. In other words, more people were working, and even with a government-provided supplement, costs went down. (SRDC, 1996)

It appears that the strategy of "punishing" social assistance recipients into self-sufficiency is a failure economically. The more economical approach is to find a way to put more money in their pocket and assist them in making the transition to employment.

## 3. Minimum Wage

At first, the issue of minimum wage may not seem like a publicly delivered social program. In a traditional sense it is not. But the minimum wage is a key strategy in establishing a minimum level of security for working people. It is a public guarantee of the amount a worker has the right to earn when employed. In this manner, it is a public interference in the marketplace with an explicit goal. That goal is identical to unemployment insurance or welfare. In this case the target audience is low wage workers who are employed.

There is quite a bit of range in minimum wages. The U.S. has set their minimum wage at $5.15 ($8.10 Canadian). Canada has ten provincial minimums ranging between $5.90 in Alberta to $8.00 in B.C. Britain is 3.6 pounds (about $6.60 Canadian).

The core of the argument about mimimum wage is that governments should not increase them, because increasing the minimum wage reduces employment in service sector industries. Those that want an increase defend it based upon social justice arguments. These are the same positions as in other private vs. public debates.

But again, there is an economic argument for increasing minimum wages. A comprehensive examination of minimum wage hikes in various U.S. states showed consistently that a rise in the minimum wage led to an increase in total employment or no effect on employment. While the increases were modest, they clearly contradict the belief that a higher minimum wage leads to less employment.

Raising the minimum wage also has little or no effect on the overall business environment. It has no effect on the number of food service outlets, for example, or on the overall stock price and profitability of companies most affected by the increase.

Finally, the cost of the minimum wage appears to be transferred by the employer to the customer, through price increases. It should be noted, however, that these increases are small. It is estimated a 90 cent increase in the minimum caused a one-time increase in prices of 0.3 percent in affected industries (Card and Krueger, 1995). This amount is insignificant on the economy as a whole.

A second positive affect of a higher minimum wage is it has a ripple effect for workers just above the minimum. This ripple causes their wages to increase proportionally as well. However, it quickly fades out, and so cannot be seen as leading to a general increase in wages.

## The Living Wage

These facts apply to relatively small increases in wage minimums. What would the effect be of a larger increase on the economy? Some observers have called for “living wage” policies, which call on governments to require contractors to pay a living wage to their workers. A living wage is substantially higher than the minimum, calculated to ensure a worker receives a wage capable of keeping them out of poverty. Critics argue this kind of policy would greatly escalate the cost of doing business and lead to less investment and fewer jobs.

Studies of U.S. cities that have implemented living wage policies show no such outcomes. After the implementation of the policy, the cost to produce goods and services (in affected industries) went up between 0.5% and 1.8% (Pollin & Luce, 1998). This increase is unlikely to substantially impact the level of investment and employment in the economy.

In reality, cities that implemented the policy found a net gain on their economic growth. This is attributed to the increased wages paid to the lower income workers in the area, adding to their purchasing power and net contribution to the economy.

One final benefit is reduced government expenditures and increased government revenues from income tax. The cities found that for each affected worker, government subsidies decreased between 20% and 40%, and tax revenue increased by approximately the same amount. This shift frees up financial resources for other purposes and reduces the overall burden on the economy.

Far from being a job destroyer, ensuring decent wages for the bottom income earners appears to have a net benefit for the economy. Policy makers in Canada would be well advised to consider the value in using minimum wage and living wage strategies to both increase the income security of low wage workers, but also bolster the overall strength of the economy.

# D. Public Pensions

## Public Income Security

Active government efforts to ensure income security appear to have clear economic advantages. By ensuring a stable guarantee of income, governments can stabilize their economy and actually generate greater levels of economic activity than by leaving the market to resolve income issues.

Income security programs are by their nature an interference in the market. But the interference seems more than justified by the overall economic benefit derived from it. And this is not to mention the achievement of important social policy goals as well.

Canada and the U.S. have adopted income security policies that aim to minimize public investment and maximize "disincentives" for greater dependence. They do this through training, a stable and reliable level of income support and through a goal of making work more valuable.

Canada and Alberta would be well-advised to think about an approach that makes work more valuable and more attainable.

The existence of adequate retirement pensions for a nation's seniors is universally perceived as both necessary and desirable. All sides in political debate realize that ensuring that retired citizens have an adequate income is both a socially desirable goal and an economically prudent one. After all, seniors without a form of income become a draw on the economy. When they have income, they continue to contribute to economic wellbeing.

Where we see the emergence of the two sides is over who should provide the pensions. Advocates for a public pension plan argue, based on principles of equality and justice, that it is the best way to ensure all have an adequate income upon their retirement. Private pension advocates argue that public pensions are inefficient, bloated and the payroll taxes required to pay them kill jobs. They argue instead that private arrangements will interfere less with the natural operations of the market.

In recent years, privatization advocates have added an additional argument to their basket – that of financial crisis. They claim that public pension schemes are unsustainable with the coming retirement of the baby boomers and that they will soon be bankrupt. They utilize this fear to offer privatization as the cure.

But what validity is there to these arguments? What is the real effect of public pensions on the economy?

# The Public Private Continuum

There are four possible ways to ensure an individual's retirement income. The government can provide a tax-funded flat-rate monthly pension to either all citizens over a certain age or to seniors without a sufficient level of personal income (income-tested). Second, the government could fund an employment-based pension scheme through mandatory payroll deductions. Third, specific employers can provide a pension plan funded by employer and employee contributions, and managed privately. Fourth, individuals can finance their own retirement through savings, investments or, more commonly, through Retirement Savings Plans (RSPs).

The first two methods would be considered public, the latter two would be private. While governments often subsidize private pensions through preferable tax treatment (contributions tax sheltered), the administration, management and funding of the pension are privately controlled.

Canada has all four tiers in our pension system. We provide Old Age Security (OAS) to all seniors (with a tax clawback from higher income seniors) and a Guaranteed Income Supplement (GIS) to low income seniors directly from the government. The Canada Pension Plan (CPP) is a mandatory contributory employment-based scheme funded by employers and workers. Employers and workers can also choose to purchase employer-based pension plans or RSPs.

By comparison, the U.S. only has three tiers. They have a mandatory employment-based public pension plan, called Social Security, and the two private options.

There is a wide range between nations on the private-public

Table 8: Pension Finance

| | **Public Spending as % of total** | Total Spending as % of GDP |
|---|---|---|
| Canada | 53 | 5.3 |
| United States | 14 | 9.4 |
| Denmark | 85 | 10.0 |
| Sweden | 40 | 16.9 |
| Switzerland | 12 | 21.0 |
| New Zealand | 98 | 7.4 |
| Chile | 28 | 18.2 |

Source: International Labour Office, 2000 continuum, as shown in Table 8. There is also a large difference between nations between their contributory portion and the portion paid directly by the state. Direct state financing is an indication of universal or means-tested pension programs provided regardless of work history.

The U.S., Chile and Switzerland show low levels of direct public investment in pensions, and lower overall public participation. At the other end lie Denmark, Finland, and New Zealand. Canada lies somewhere in the middle, with higher than average public financing – this is due to OAS and GIS.

Pension systems that have a lower proportion of public involvement are more expensive. The U.S. spends about 9.4% of its GDP on pensions in total. Chile is at 18.2% and Switzerland the highest in the world at 21.0%.

However, there is no consistency among countries with larger public pension schemes. Canada's expenditure is one of the lowest at 5.3%. However, other nations, such as Sweden and Denmark, spend more than 10%.

The range in pension expenditures is due to the wide range of benefit entitlements from systems around the world. Sweden, Finland and other European nations offer pension benefits that are consistently at higher levels than Canada or the U.S.

On the surface it may seem that you get what you pay for in pensions, but a more closer examination will show that this is not necessarily the case.

## Comparing Public Pensions

Table 9 shows the contribution rates for selected countries public employment-based pension plan. Canada has among the lowest contribution rates in the world for its public pension plan.

What is the reason for this? In part the answer is the level of benefits. CPP covers approximately 25% of a worker's previous earnings. Germany provides a pension of about 75% of past earnings. In Sweden, retired

Table 9: Pension Finance

| Country | Employer Portion | Employee Portion |
|---|---|---|
| Canada | 4.7 | 4.7 |
| Germany | 9.75 | 9.75 |
| Norway | 14.1 | 7.8 |
| Sweden | 18.86 | 6.03 |
| United States | 6.2 | 6.2 |

Source: U.S. Social Security Administration, 2001 workers receive up to 90% of their past work income. The U.S. provides 40% replacement. (U.S. Social Security Administration, 2001)

The Canadian figure, however, is misleading. OAS replaces 15% of employment income for the average retired worker, bringing the total Canadian benefit to about 40%, comparable to the U.S. level.

The conclusion from these numbers is that both the U.S. and Canada offer much poorer benefits to retired citizens than most industrialized nations. But that comparing these two countries, Canada offers a much more cost-effective pension plan, leading to a comparative advantage with the U.S.

Much of the comparative advantage arises out of Canada's decision to shift a portion of retirement expenditures to general revenues, and away from payroll taxes. Even if the cost of OAS was applied to payrolls, Canada's pension system would still be cheaper than the U.S.

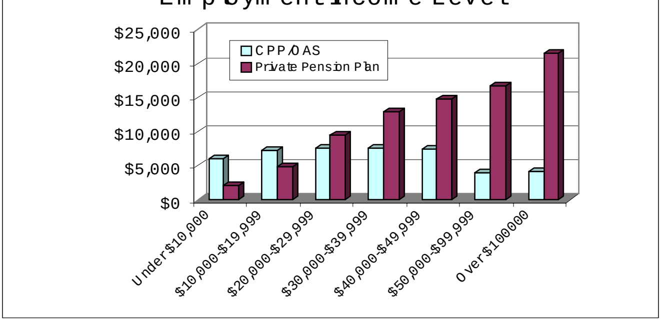
Canada's CPP/OAS costs less, and delivers approximately similar benefits than the United States. Canadian employers have another source of costs savings when compared to their U.S. counterparts.

## The Cost of Private Pensions

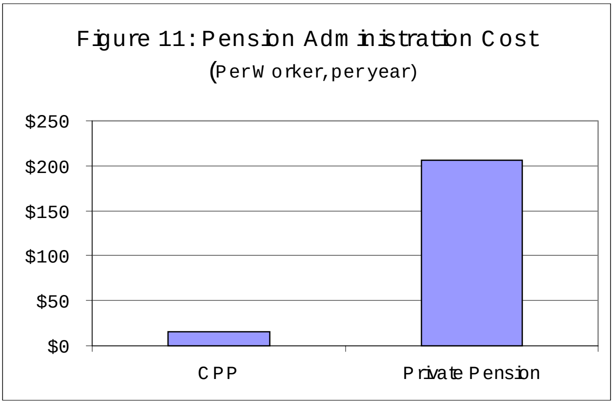
Some may argue that our system could be made cheaper yet by shifting to greater reliance on private pension arrangements. However, this argument turns out to be wrong. Private pensions cost more.

There are three fundamental problems with private pensions that undermine their economic advantage. First, private pensions are very capable of providing supplementary income to workers in the plan. However, if public pensions were eliminated and the only source of retirement income were private plans, they would fail to provide comprehensive coverage.

Figure 10: Pension Income by Employment Income Level




Source: OECD, 1995




Source: Department of Finance (James), 1997

Currently in Canada, only 37% of workers are enrolled in private, employer-sponsored pension plans. The remaining 64% will have no private pension. (OECD, 1995)

Also, private plans tend to reward higher income earners more, and lower income earners less. Public pensions provide a higher base income, and reduces inequalities between income levels (Figure 10).

The second flaw is that private plans are administration heavy. Much evidence exists of the more expensive nature of private plans. During the Pinochet years, Chile privatized their pension system, establishing a system of private funds to handle worker pension contributions. It was supposed to save the country millions of pesos and make retired workers more secure. Unfortunately the opposite has happened. Workers are receiving lower benefits and the system is chewing up more employer, worker and government money.

One of the central reasons is administration. In Chile, administration accounts for 15% to 20% of contributions. By contrast, Canadian and U.S. public pensions have administration expenses of less than 2%. (Century Foundation, 1998)

Actuaries in Chile have determined that workers' rate of return under the new scheme have been lowered dramatically. Under a public system, their contributions would have earned 12.7% between 1991 and 1995. Their real rate of return under the privatized system was 2.1%

Comparisons within Canada are also available. Figure 11 shows the administration differences between CPP and private, employer-sponsored pension plans, and the average cost per worker. Expenses are $190 per year more under private pensions. This is money that is eaten up by the company, and is not available for investing for the benefit of the worker.

The third weakness of privatized plans is that they do less well at ensuring the stable financial position of the retired worker. Returning to Chile, the United Nations calculates that 40% of Chilean retirees under their privatized system will not earn enough pension income to survive, and will require additional support from government, counteracting any government savings from privatization.

Back at home, a Federal government Department of Finance working paper determined that a privatized pension scheme would not be in our best interest because private pension schemes do a poor job of providing benefits for a long life expectancy. In other words, private pensions tend to run out before the retired worker dies.

The same Finance study points out why employer-sponsored private pension plans can't match public pensions. While they are desirable and useful income supplements, they are "an imperfect substitute for a mandatory public plan. This is because a mandatory public plan achieves the greatest possible actuarial risk pooling, provides for full portability, indexes against inflation and covers both employees and the self-employed." (James, 1997; 35)

In other words, public plans spread the risk around, and are therefore able to provide better benefits, with lower administration costs.

Private plans cost more, and ultimately are unable to offer the same level of benefits to the worker. Private plan contributions are higher, taking money away from other economic uses, and benefits are lower, providing less spending power for retired workers. In total, public pensions provide the better economic value.

## The Catch-22 of RSPs

Of course, RSPs address some of the flaws of a privatized pension scheme. They have low administrative costs, for example. They are flexible and can be carried by a worker from employer to employer. As a result, many observers call for enhanced RSP savings. They claim that RSPs not only ensure a secure

Table 10: RSP Contributions

| Income Level | % Who Invest in RSPs | Average RSP Contribution |
|---|---|---|
| Under $20,000 | 8.4% | $1,610 |
| Under $50,000 | 22.4% | $2,598 |
| Over $50,000 | 69.4% | $6,369 |
| Over $100,000 | 76.6% | $12,326 |

Source: Stanford, 2001

retirement, but also that the extra savings, usually invested in the economy to earn interest, help spur the economy.

Unfortunately, RSPs end up looking like the least desirable option, for three reasons.

First, RSPs don't seem to spur additional savings and thereby increasing the investment pool. Studies are showing that rather than put additional savings into RSPs, most people simply shift their savings from other sources to RSPs, creating zero effect on the economy. (Merette, 2002)

Second, RSPs suffer from worse high income bias than employer plans. Despite lucrative tax shelters, only higher income earners are investing in RSPs (Table 10). Only 8.4% of people with incomes under $20,000 invest in RSPs, while 76.6% of those with incomes over 100,000 have RSPs. This means, that come retirement, only those who have had higher incomes will have sufficient money set aside for retirement.

Third, RSPs cannot guarantee the level of the benefit. Unlike CPP or most employer plans, the pension amount is not calculated based on income and years of contribution. It is determined by how much money is in the account on the day you retire.

When the stock market slumped in 2001, those depending upon RSPs for their retirement were shocked by the results. People intending on retiring were required to postpone their retirement indefinitely, until their portfolio regained its value (Kuttner, 2001). Either that or accept a much reduced pension.

Imagine having a retirement date of September 15, 2001? If the stock market plunges, so does your pension.

While they seem like a quick pension fix, RSPs end up falling far short of the goal of ensuring adequate pension incomes, or of the goal of spurred economic activity.

## Does CPP Have a Future?

Of course, the trump card by privateers is that CPP won't be around in twenty years, so we have no choice. A scary thought, without a doubt. They state that with the baby boomers retiring, the CPP account will be emptied and we will have no public pension left.

But it doesn't hold much water. CPP contributions have been rising in recent years, and will top out in 2003 at 9.9% total employer/ employee contributions. At that level, the CPP fund is projected to be fully funded and actuarily sound to at least 2030 – well after the boomer bulge of retirements. (Merette, 2002)

The latest Actuary Report of the CPP, released in 2001, is very clear. "The Plan is sustainable over the long term, as it is projected that there will be more cash inflows than outflows over the entire projection period [to 2075]".

In other words, CPP is in fine shape at its current level of funding, and workers can count on its presence when they retire. There is no reason to consider privatization.

## An Argument For Higher Benefits

Quite the contrary from privatization, there is a strong argument for increasing the level of public pensions, both OAS and CPP. When compared to other industrial nations, Canada's level of pension benefits is low. We replace a much lower portion of a worker's income when they retire.

There are, of course, strong social justice arguments in favour of higher benefits. But there are also three strong economic arguments, as well.

First, by giving more money to seniors, it has been shown that spending on goods and services will increase. Seniors tend to save less than younger citizens, meaning they spend a higher proportion of their income directly in the economy. A transfer to retired workers will lead to higher consumer spending, and therefore lead to greater economic growth and more jobs.

Second, new research is showing that rather than being a drain on the economy and a burden to younger workers, the coming wave of retirees will actually spur enhanced economic growth and increase the income levels of younger workers. (Merette, 2002)

The reason for this is that the pressure on job markets from the exiting of baby boomers will increase the wages of those remaining in the workforce. The relative shortage of workers in comparison to the job supply – caused by increased retirements – will require employers to pay more to attract and keep employees. This increased income will then lead to greater economic activity.

The third argument returns us to the comparison of public and private. Increased public pension levels reduce the need for private pension options. If public pensions provide adequate income replacement, then employers and workers are less likely to establish private plans and RSPs (OECD, 2000). Since public pension contribution rates are lower and more effective, this will free up additional money for workers and employers to use elsewhere in the economy.

The added efficiency of public pensions will likely offset the extra payroll tax and income tax burden caused by enriched benefits. This is how Canada could increase our competitive advantage in the area of pensions.

# E. Workers' Compensation

Workers Compensation for workplaces injuries (WCB) is almost a century old, and it seems to have succeeded in making everyone unhappy. Employers chafe at the cost of the system and workers are unhappy with claim adjudication and benefit levels.

Recently, some voices have been heard calling for privatization of the WCB. They argue that benefit rates are too rich and the resulting premium rates – essentially a form of payroll tax on employers – stifle economic growth and that a private system could be operated cheaper. On the other side of the debate, some worker advocates are calling for a return to the court-based lawsuit system to attain compensation, which is another form of privatization.

A look at the economics of WCB quickly demonstrates that a publicly operated WCB system is more effective, and actually benefits the economy compared to either privatized option.

## Private/Public Continuum

Every industrialized nation has some form of regulated, mandatory compensation for workplace injuries. Most European nations, such as Germany and Sweden, possess a disability income program that provides income replacement, regardless of the origin of the injury or disability. These programs are funded through tax revenue, or through payroll tax levies on employers.

Canada also has an exclusively public WCB system. Canada has, in effect, 12 separate WCB systems as each province operates its own Board. However, the model used across all provinces is identical. Canada has a mandatory public WCB that holds exclusive jurisdiction in the area.

Some jurisdictions have a blended public/private system, where a public WCB operates in competition with private insurance plans. Sometimes the public WCB is an insurance provider of last resort for employers who are refused by all private plans. Many U.S. states have a form of this model.

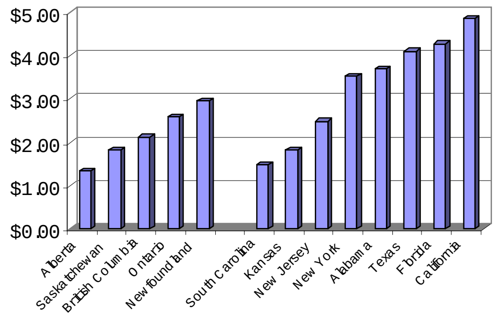
Other jurisdictions have no public body at all, and simply regulate the provision of private insurance plans. Employers have the freedom to choose which plan to join, or to self-insure in some cases.

No country leaves the resolution of workers' compensation to the courts.

## The Cost of Private WCB

The European approach to disability insurance differs widely

Figure 12: WCB Premium Rates (per $100 insured payroll)




Source: WCB-Alberta, 1998

from the North American model. Canada and the U.S. have similar systems – in terms of what is covered and how – differing mostly on whether the delivery is private or public. This makes the U.S. a strong comparison case for the efficiency of either system.

The starting place to determine which is more efficient is to look at premium rates. Figure 12 shows the highest, lowest and other selected premium rates in the U.S. and Canada. It shows quite clearly that premium levels are markedly lower in Canada than in the U.S. Seventeen U.S. states have premium rates higher than Canada's highest rate.

There appear to be three reasons for the difference. First are administration costs. Administrative expenditures in U.S. jurisdictions are generally higher than in Canada. The WCB in Nova Scotia calculated that 80% of compensation funding in Canada goes directly to injured workers in the form of benefits and services. In the U.S., only 60% of funds go to workers. The rest is taken up by administration and expenses. This is due to the need for U.S. private plans to make a profit and to pay taxes.

The second reason is that Canadian plans, by providing near universal coverage under one plan, can perform a better job of pooling risk and keep premium rates down (Dorgan, 1990).

The third reason is the lower cost of health care in Canada. While WCB pays directly for health services, separate from Medicare, it still receives the benefits of the efficiencies in the public health system. U.S. plans pay additional amounts for health care due to the private nature of their system.

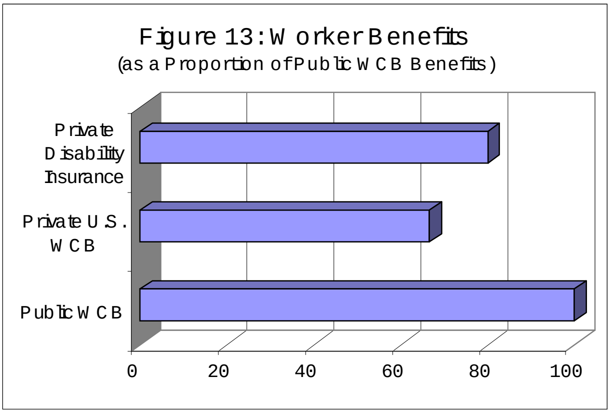
Studies examining jurisdictions that have moved from public WCB systems to private plans have shown that the switch leads to higher premium rates in most cases (Dewees, 2000) And another study comparing WCB costs in Ontario and B.C. with the U.S. demonstrated higher efficiency and lower costs in the two Canadian jurisdictions (Thomason & Burton, 2000)

It is very clear. Public WCB systems lower payroll costs for employers. This lower level of payroll taxation provides Canada with another layer of competitive advantage over the U.S.

## Benefits to Workers

It is possible that the Canadian WCB system is cheaper because it provides lower benefit levels to workers. Research into comparative benefit levels disproves this theory as well. Canada has higher benefit levels than the U.S.

Figure 13 shows the difference in total benefit coverage for injured workers under three regimes: Canadian WCB, U.S. WCB and disability insurance. U.S. WCB plans typically pay only two-thirds of Canadian rates, and private disability insurance, such as LTDI, offer only about 80% of what workers receive under WCB.

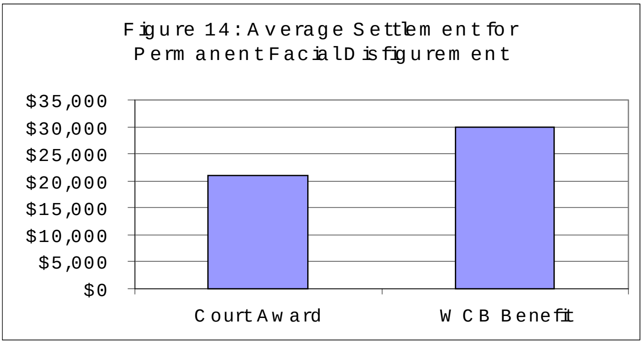



Source: WCB-Alberta, 1999; Dorgan Consultants, 1990

Despite legitimate concerns from workers about claim acceptance and appeals, there is no evidence to suggest that Canadian WCB is any more likely to refuse claims or try to minimize claim costs by forcing workers back to work early.

If anything, there is evidence that this problem is greater in the U.S. This is due to the fact that in competitive regimes, the employer is free to choose the compensation plan that best suits their needs. The needs of the employer are not necessarily the interests of the worker. In addition, the private insurer has a built-in incentive to keep the employer happy or face the risk of losing the business. This could all lead to greater pressure on workers and more denied claims.

## A Return to the Courts?




Source: Hyatt & Law, 2000

There has been a growing chorus of people, including injured workers, calling for workers to regain their right to sue employers for workplace injury. They argue it would allow workers to receive bigger settlements than WCB rules allow.

There is no doubt that the WCB system is cheaper for the employer. The protection from costly lawsuits is an economic gain for the employer. But what about the worker?

The cost of lawyers and legal proceedings in the court is enough to make court-based compensation unrealistic for most workers. Most would simply not have the money to finance such a lawsuit. But setting that reality aside, there is evidence that the benefit levels provided by WCB are comparable to settlements from court actions. A comparison study of facial disfigurement cases in Ontario shows that WCB pension benefits would pay more than a worker is likely to receive in the courts (Figure 14).

Publicly run WCB, despite its problems and weaknesses, still offers a strong economic benefit to injured workers. It provides higher benefits and a greater level of security and immediacy than the courts.

## The European Path?

The fact that public WCB is economically more viable and desirable than private workers compensation should not make Canadians complacent. Workers have many valid concerns with the state of our WCB system. Complex cases befuddle case managers, modified work is rife with problems and biases toward employer interests still plague the system. What we now know, however, is that a move to privatize is not the answer.

But what of a shift toward the European model of a more universal system not tied to origin of injury?

There is no comparative research available on the European model versus the North American model. European systems appear more expensive on the surface, but they are more comprehensive in their coverage and benefit levels are higher on average.

The key advantage might be the shift from payroll taxes to general tax as a source of revenue for the program. It is likely this shift could result in added economic efficiencies for employers and workers.

Research by the Roeher Institute suggests that a comprehensive disability income support program, replacing WCB, CPP-Disability and other income support programs for people with disabilities would be less expensive and more adequately cover income loss due to disability. The system would cover more people with disability and injury, would even out the large income inequalities between people with disabilities and would lower overall costs.

The comprehensive program would be cheaper because much of the expense in WCB currently is due to claims adjudication and determining if the injury is "work-related". This layer of administration would not be necessary. It would also eliminate the duplication of administration found in CPP-Disability, WCB and other programs.

Rather than debating whether WCB should be privatized, which is clearly an economic dead-end, Canadians should be engaged in a debate about how we can more effectively deliver disability income support in a public system.

# Conclusion: Climbing Off the Merry-Go-Round

The debate leading nowhere now has somewhere to go. Defenders of public services can climb off the merry-go-round and begin to build an alternative to privatization based in sound ethics and morals as well as sound economics.

The case of economic superiority made by advocates for privatization turns out to be more of a mesh bag – more holes than substance. And with this knowledge the era of parallel debate leading nowhere can come to an end.

In all five areas examined here, providing services through a public model offers Canada and Alberta a strong economic advantage. Public delivery of health care, education, income security, pensions and WCB costs less and provides more. It is a classic case of economic efficiency. To the extent that Canada has adopted public delivery, we gain a clear and distinct competitive advantage, especially over nations that use private delivery to a greater level.

But we should not be complacent. The past decade has been a hard one for public services. Much of the economic benefit measured has been watered down by cutbacks, reforms and encroaching privatization. In some areas, such as income security, we have already lost our advantage. In others, such as health care and pensions, the impact is weakening.

We have the choice of two paths. We can continue down the road of short term calculation, and receive the temporary tax cuts and the illusion of individual choice. The consequence, however, will be lower economic growth and fewer jobs in the long run. Our recessions will be deeper and longer, our spending power lessened. We will end up paying more individually to receive fewer and lower quality services.

Or we can choose to look at our economic prosperity in the long term. By taking the effort to offer strong public delivery of services in health care, education, income security, pensions and WCB, we can rev our economic engine and benefit from more jobs, higher wages, more stable business cycles and more efficient delivery of social programs. The net result is that public programs pay for themselves through enhanced economic efficiency and growth. This is especially true in the long run, but the payoff begins right away.

A pre-requisite to changing paths is to change our perspective. We need to spend less time comparing ourselves to the United States. We need to look at other nations in the world and see what innovative strategies they employ. If we focus on implementing strategies and programs that deliver the greatest public good in the most effective manner, then our competitive advantage over the U.S. would grow larger, leaving no need to concern ourselves with their inefficient way of doing things.

We need to stop looking in our rearview mirror at what the U.S. does, and instead look at the road ahead of us and to where we can go if we strengthen our economy through efficient public delivery of services.

That is the other competitive advantage. And it is waiting there for us to take it.

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