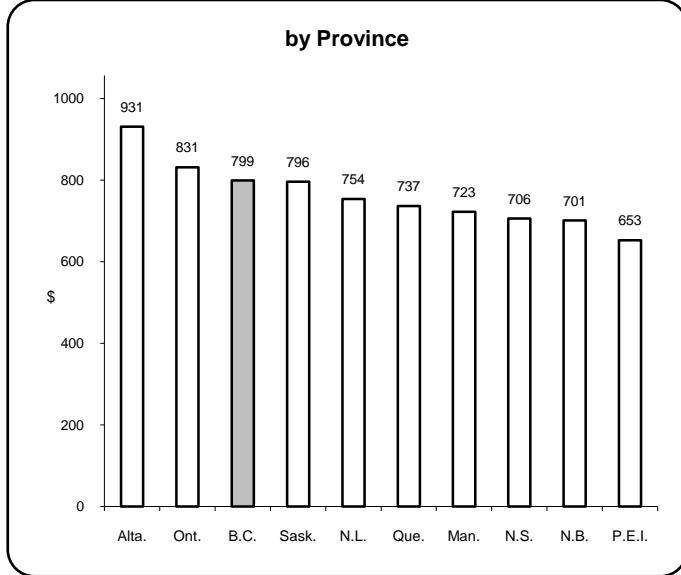
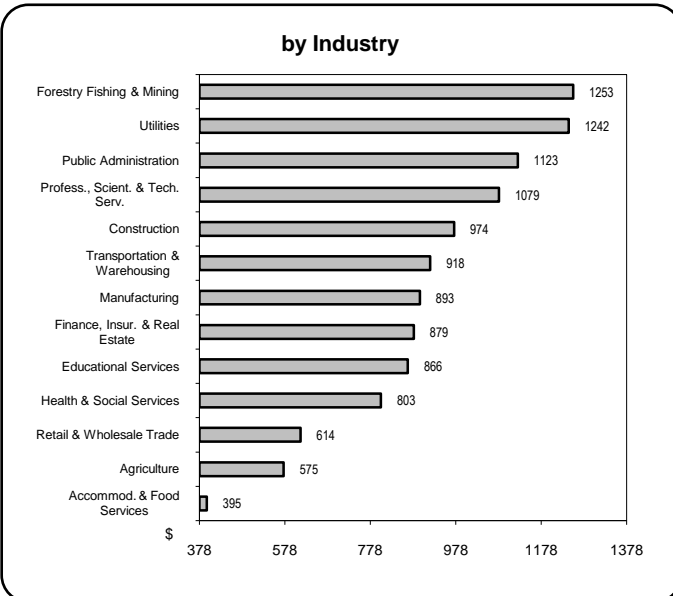
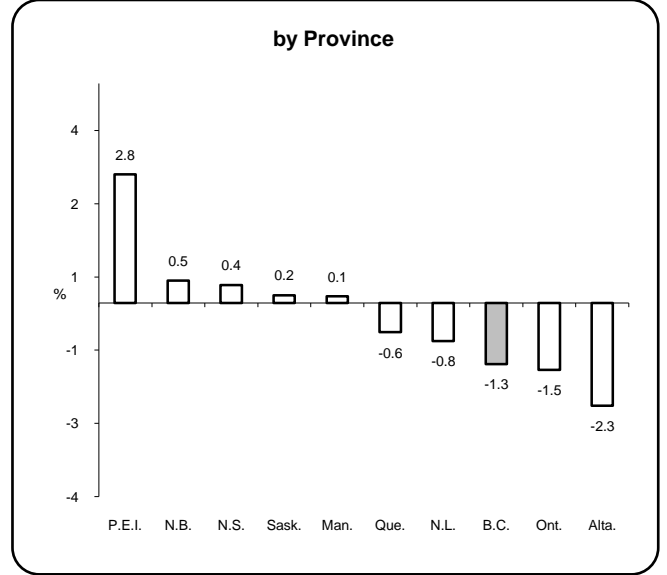


## Earnings & Employment Trends ♦ November 2009

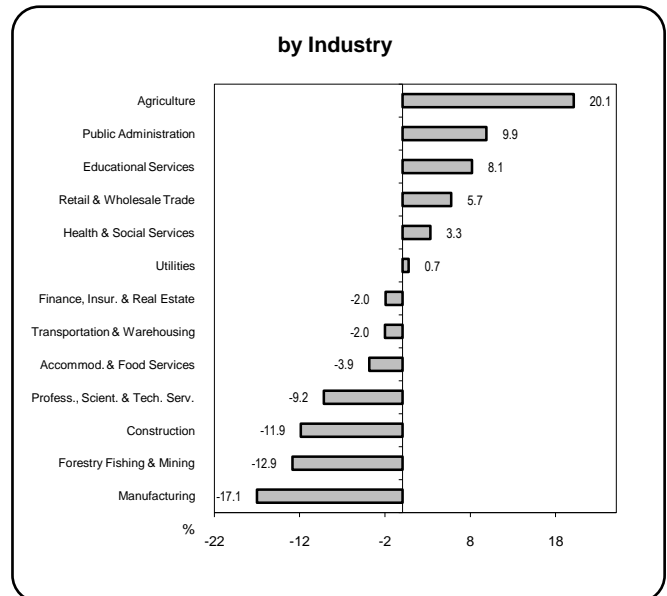
**Average Weekly Wage Rate\* - November 2009**



**Employment Growth\* - November 2009**



\* Latest 12 month average



\* Month over same month previous year (unadjusted)

Prepared by: BC Stats

Source: Statistics Canada Labour Force Survey

**Feature Article: Low Income Cut-Offs are a Poor Measure of Poverty**

## Low Income Cut-Offs are a Poor Measure of Poverty

By **Dan Schrier**

For over 40 years, Statistics Canada has produced a statistic called Low Income Cut-Offs (LICOs), and for almost as many years, that statistic has been improperly cited as a measure of poverty in Canada. This, despite the fact that Statistics Canada has continually emphasized that it is inappropriate to equate LICOs with poverty lines. The LICOs are meant to quantify the extent to which some Canadians are less well-off than others and as such, is a measure of inequality, not poverty—it is possible to be worse off than the average citizen without being poor.

According to Statistics Canada, “Low income cut-offs (LICOs) are income thresholds, determined by analysing family expenditure data, below which families will devote a larger share of income to the necessities of food, shelter and clothing than the average family would.”<sup>1</sup> For example, according to the 1992 Family Expenditures Survey, which is the most recent base for the LICOs, the average family spent 43% of its after tax income on food, shelter and clothing. Statistics Canada adds 20 percentage points to this figure using the rationale that a family spending that much more than the average would be in “straitened circumstances.”

The 20 percentage point figure is purely arbitrary and was selected when the LICOs were first published back in 1967 because it was

thought that a good rule of thumb was that anyone spending more than 70% of their income on necessities should be considered to be in “straitened circumstances.” At the time, the average family was spending 50% of its pre-tax income on food, shelter and clothing.<sup>2</sup> However, when the LICOs calculation was eventually re-based using a more recent survey of family expenditures to account for changes in the average spending on necessities, the 20 percentage point figure remained. As a result, the current base year (1992) calculations are based on a figure of 63% for after-tax income and 55% for before-tax income.

This arbitrary methodology used to determine LICOs alone is not enough to dismiss them as a measure of poverty, because any definition of poverty involves some subjectivity and is therefore arbitrary in nature. There are a number of other qualities of LICOs that make them a poor choice for use as a poverty line.

One of the biggest criticisms of LICOs is that the goal posts are constantly moving due to the relative nature of the measure. This means that no matter what actions a government takes to eradicate poverty, that goal can never be attained if LICOs are used as a benchmark. To illustrate, take a hypothetical future Canada where every citizen earns no less than \$100,000 (and assume there has not been rampant inflation in the meantime, such that buying power is not dissimilar to what exists today) and millionaires are common. In that kind of Canada, those at the low end of the income scale (i.e.,

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<sup>1</sup> Statistics Canada (June 2009). *Low Income Cut-Offs for 2008 and Low Income Measures for 2007*. Catalogue no. 75F0002M, no. 002. Minister of Industry, 2009, p.4.

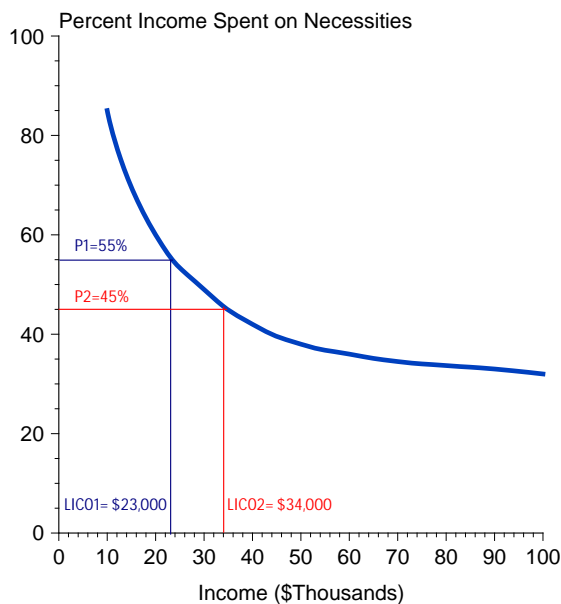
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<sup>2</sup> After-tax LICOs were not calculated at that time. The equivalent before-tax figure for 1992 was 35%.

those earning “merely” \$100,000) would be considered poor if LICOs were used as a measure of poverty. An argument can be made that the definition of poverty should change over time and be a reflection of current societal conditions, but it would be a stretch to consider someone to be poor just because their neighbours can afford a yacht and they can’t.

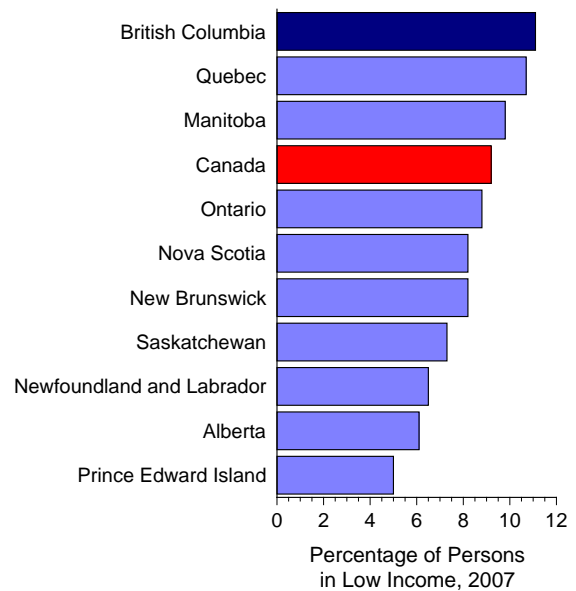
While this scenario is not very realistic, it is quite possible for the proportion of earnings spent on food, shelter and clothing to decline due to either an increase in income, or a decrease in prices. Under this scenario, the LICOs will increase such that people with higher incomes will now be under the low income cut-off as illustrated in the hypothetical chart below. In other words, an improvement in the standard of living could result in more people falling under the LICOs, which is counterintuitive to their use as a measure of poverty.

A reduction in the percentage of income spent on food, shelter and clothing will result in an increase in the LICO



One of the biggest problems with LICOs when used to analyze incomes in British Columbia is that they do not take account of regional differences in costs of food, shelter and clothing. There is recognition of differences between rural and urban areas and different LICOs are calculated for different population sizes;<sup>3</sup> however, there is no accounting for regional variation. Based on LICOs, British Columbia had the highest incidence of low income in the country in 2007, but these LICOs are based on national expenditure figures.

According to Statistics Canada's Low Income Cut-Offs, BC has the highest incidence of low income in the country



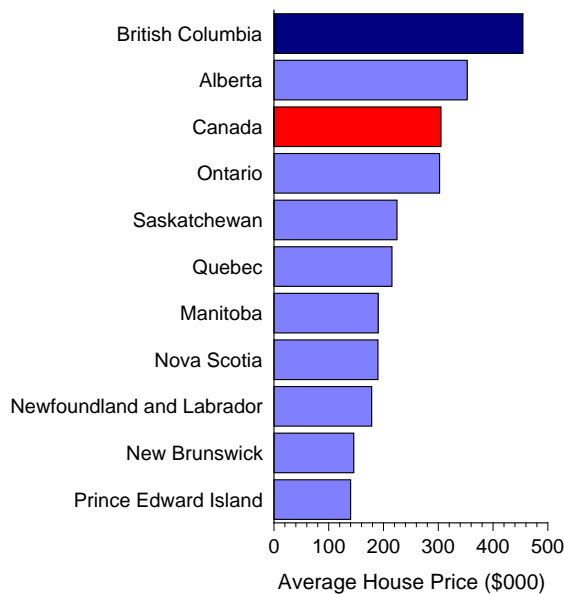
Source: Statistics Canada

To see how this can be problematic, one need look no further than the difference in the price of housing by province. British Columbia has by far the highest housing prices, on average, in the country. In 2008, the average house price in

<sup>3</sup> Rural areas, urban areas less than 30,000 population, urban areas with population 30,000 to 99,999, urban areas with population 100,000 to 499,999 and urban areas with population 500,000 or more.

BC was almost 50% higher than the Canadian average. The problem is exacerbated even further when urban areas are compared. According to the Canadian Real Estate Association, the average price of a house on the Vancouver market in October 2009 was \$638,948 and in Victoria, the average price was \$481,500. The large urban area with the next highest average price was Toronto, at \$423,507, a third lower than the price in Vancouver. The average price of a house in Vancouver was three times that of one in Winnipeg and more than double that of one in Montreal.

British Columbia's average housing price was almost 50% higher than the national average in 2008



Source: The Canadian Real Estate Association

While the difference in rents are not quite as dramatic, they are still significantly higher in Vancouver compared to most other cities with greater than 500,000 population across the country. Given that the cost of shelter comprises by far the largest portion of spending on food, shelter and clothing, this renders LICOs a

dubious means of regional comparison, let alone as a measure of poverty.

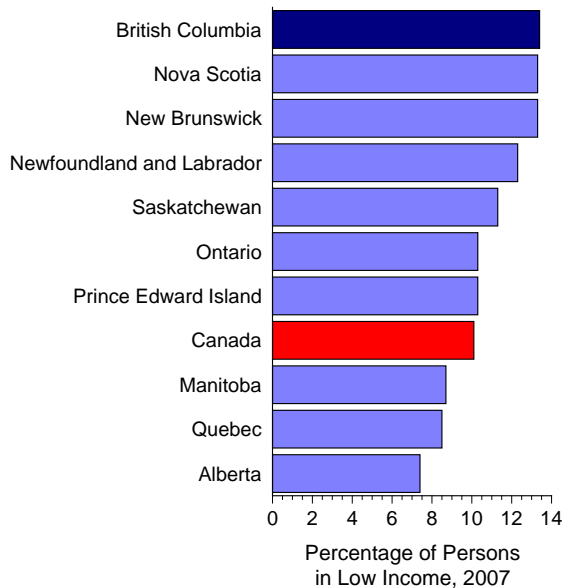
With all the problems related to using LICOs as an indicator of poverty levels, another measure was developed called the Market Basket Measure (MBM) of low income. Unlike LICOs, the MBM is not a relative measure. Low income measurement is instead based on the actual costs of "necessities." The basket of goods and services that comprise these necessities were chosen to reflect a basic standard of living in the current socio-economic environment in Canada. While the MBM is not an official measure of poverty, it is likely a better indicator of poverty levels than are the LICOs.

Nevertheless, there are criticisms of the MBM as well. Unavoidably, the choice of goods and services to include in the basket is arbitrary, which opens the door to criticism. The MBM is designed to measure a level at which a Canadian family can enjoy a modest standard of living and includes items such as magazine subscriptions and video rentals. The main criticism of this approach is that it does not arrive at a true poverty threshold and that there is still no way to determine how many Canadians do not even have the resources to cover their basic needs.

This argument is valid, but so too is the argument that an income that simply covers basic needs is not enough to lift someone out of poverty. There are needs beyond just the physical and in a country as wealthy as Canada, it can be argued that every citizen should be able to enjoy some comforts beyond just subsistence living. However, that doesn't mean that there isn't still the need for such a measure to determine the proportion of the population that is in dire need of assistance.

If we accept the MBM’s definition of low income, British Columbia still ranks last in the country in terms of the percentage of the population in low income.

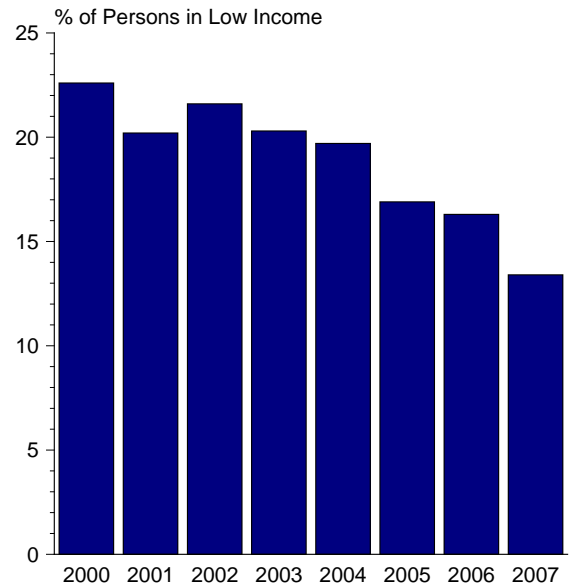
Using the Market Basket Measure, BC still has the highest incidence of low income in the country, but there is less provincial variation



Source: Human Resources and Skills Development Canada

However, there has been some positive movement over the last several years, with that percentage for British Columbia falling from 22.6% in 2000 to 13.4% in 2007. This trend has been consistent across most groups with the exception of unattached males. The ratio for this group was only slightly lower in 2007, at 33.0%, compared to 34.3% in 2000. By way of contrast, unattached females have seen a significant improvement with incidence of low income dropping from 40.4% in 2000 to 24.8% in 2007. There has also been progress with respect to children as the ratio of persons under 18 years old living in low income in BC fell from 26.1% in 2000 to 18.4% in 2007.

According to the Market Basket Measure of low income, the share of British Columbians in low income has been trending down



Source: Human Resources and Skills Development Canada

There is still no official measure of poverty in Canada and neither the LICOs nor the MBM are ideal indicators to use for that purpose, but if they are all that are available, the MBM is probably the better measure.