

Self-Employment and British Columbia's Poverty Reduction Strategy

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Abstract

The main purpose of this paper is to assess whether self-employment raises any special issues for B.C.'s poverty reduction strategy. While the incidence of low income is higher in self-employment than in paid work, the underlying causes of low-income are similar for both types of work arrangements, so initiatives targeted at the self-employed are not necessary. However, the self-employed do not appear to be as well served as paid workers by existing active labour market policies. Self-employment does not have any substantial advantage over paid work as a pathway out of poverty, so a policy tilt in favour of self-employment is not warranted for that reason. However, since self-employment is a last-resort option for some, reducing barriers to entry would have a favourable effect on poverty. The increase in the minimum wage will, even in the best of circumstances, reduce total hours worked in the low-wage sector. This is likely to increase the propensity to enter self-employment, which would put downward pressure on earnings relative to paid workers.

This paper also assesses how a Basic Income Guarantee (BIG) would affect self-employment. Implementation of a BIG is likely to result, all else being equal, in a lower level of necessity-driven self-employment. The impact on opportunity-driven entry is likely to be small, and it could be negative or positive. Implementing a BIG is therefore unlikely to make a substantial contribution to preparing for a new or emerging economy by encouraging entrepreneurship.

Introduction

The B.C. government has set out ambitious goals for reducing poverty and announced a broad range of policies to achieve these goals. This paper assesses whether self-employment raises any special issues for the government's poverty reduction strategy. In particular, the paper addresses the following questions:

- Do the low-income self-employed have characteristics that require a unique policy response?
- Do the self-employed have the same access to existing social security and active labour market programs as paid workers?
- Do other government policies discourage entry into self-employment?
- Should governments encourage entry into self-employment because it offers a pathway out of poverty?
- Does the government's overall poverty reduction strategy have any gaps in coverage or unintended consequences for the self-employed?

The B.C. government is also assessing the merits of a basic income guarantee (BIG) as an approach to reducing poverty. Accordingly, this paper reviews how a BIG would affect self-employment. The discussion of a BIG considers not only the impact on low-income self-employment but also the impact on what is sometimes described as opportunity entrepreneurship, since both have implications for the B.C. government's efforts to prepare for a new or emerging economy.

A review of the available evidence indicates that the incidence of low income is higher in self-employment than in paid work. This outcome reflects in part the fact that some individuals enter self-employment out of necessity, either because of limited opportunities in paid work or because of the need for flexible work arrangements to meet family-related responsibilities. Opportunities in paid work may be limited due to low occupational or language skills, or because of discrimination. As a result, women, who often have a greater need for flexible work arrangements, and immigrants, who are more likely to have low language skills, are overrepresented in the pool of the low income self-employed. However, women and immigrants are also likely to be overrepresented in the pool of low-income paid workers. As such, these findings do not suggest targeted initiatives are required to address low income in self-employment.

The self-employed do not have the same access to social security and active labour market policies as paid workers. The difference is not substantial for social security programs: except for employment insurance benefits, social security measures do not favour paid workers. In contrast, the self-employed are not eligible for programs accounting for about a third of total spending on active labour market measures. Only 2.1% of spending on active labour market programs is targeted exclusively at the self-employed, which is well below their share of total employment. This high-level comparison suggests that active labour market programs should be reviewed to ensure an appropriate balance between funding for programs that support paid workers and the self-employed.

The tax system also puts the self-employed at a disadvantage. Income from self-employment is more variable than income from paid work. In a progressive tax system, individuals with fluctuating incomes pay a higher average tax rate than persons with the same average income that is more stable. Income averaging should be considered as a method to promote horizontal equity between paid workers and the self-employed. It should also be assessed as a way to reduce the work disincentive effects of transfer payment clawbacks.

Self-employment does not have any substantial advantage over paid work as a pathway out of poverty, and so a policy tilt in favour of self-employment is not warranted for that reason. However, since self-employment is a last-resort option for some, reducing barriers to entry would have a favourable effect on poverty. The legal and administrative requirements for the self-employed are complex enough to constitute a barrier to entry, so providing training in how to set up and run a business is sound public policy, as are measures to simplify the administrative and legal requirements.

Personal bankruptcy laws affect the decision to enter self-employment by affecting the exposure of personal assets to business failure. While bankruptcy laws in B.C. are in the middle of the range for Canadian provinces, an assessment of the impact of increased sheltering of assets would be useful. The self-employed have a keen interest in resolving legal disputes quickly and inexpensively. The limited information available suggests that this standard is not met in B.C. Occupational licensing could also be creating a barrier to enter self-employment. There is evidence that licensing raises the wages of relatively low-skilled workers. However, it creates a barrier to entry that pushes other workers into lower-paying jobs. A cursory review does not suggest that excessive education and training for relatively low-skilled occupations are an issue in B.C.; nevertheless, a more in-depth assessment is recommended.

The government's overall poverty reduction strategy (i.e., including existing and recently announced measures) does not have any major missing elements that affect the self-employed. However, the increase in the minimum wage may make it more difficult for the government to achieve its poverty reduction goals. The increase is large relative to past changes in B.C. and other jurisdictions. The available evidence suggests there is some risk that such large increases could cause the employment income of low-income wage earners to fall rather than rise. Even in the best of circumstances, higher minimum wages mean that total hours worked in the low-wage sector will decline. This reality is likely to increase the propensity to enter self-employment, which would put downward pressure on the earnings gap.

The government should therefore set up a mechanism to assess the impact on workers affected by the legislation. The potential for adverse effects on the self-employed provides another reason for reviewing and possibly expanding the programs that target the self-employed, such as how to set up and run a small business, and making efforts to ensure the self-employed have access to language and skills training.

Introducing a BIG would reduce necessity-driven entry into self-employment, but its impact on opportunity entry, which is relevant to preparing for a new or emerging economy, is ambiguous. To paraphrase Henrekson (2005), generous income support makes necessity entry unnecessary. Further, the additional income will encourage necessity entrants to invest more in

their human capital, which addresses a fundamental cause of poverty. A BIG will encourage low-income opportunity entry as higher transfers reduce risk aversion and possibly increase access to credit. However, opportunity entry by individuals with higher incomes could decline somewhat, largely due to the adverse incentive effects of the higher taxes required to finance the BIG. The net impact on opportunity entry would be small, but it could be negative or positive. Implementing a BIG is therefore unlikely to make a substantial contribution to preparing for a new or emerging economy by encouraging entrepreneurship.

A Profile of the Self-Employed

Motivations for Entering Self-Employment

The literature makes a useful distinction between “push” and “pull” factors in driving entry into self-employment. Individuals can be pushed into self-employment because of limited opportunities in paid employment arising from poor labour market conditions or from structural factors such as low occupational and language skills and discrimination (Box 1). Individuals may be pulled into self-employment to take advantage of business opportunities or non-pecuniary factors such as being one’s own boss. These push and pull factors motivate the use of the terms “necessity”-driven and “opportunity”-driven entry into self-employment that are often found in the literature.

Statistics Canada has conducted two surveys that provide a perspective on the motivations for entering self-employment (Table 1). As can be seen from the table, there are many reasons for entering self-employment and not all can be easily classified as push or pull factors. For example, a substantial fraction of the self-employed in 2018 entered because of the nature of their work. Self-employment is the dominant arrangement for farmers, fishers, taxi drivers, hairstylists, and for many professionals, such as doctors and other medical professionals, lawyers, and accountants.

Persons pushed into entering self-employment are more likely to experience involuntary, chronic low income than persons pulled into self-employment. In 2000, almost 22% of entrants could not find suitable paid employment. The need for flexible and possibly fewer work hours to accommodate family-related needs is generally considered to be a factor pushing individuals into self-employment. As a result, the survey suggests that about 31% of the self-employed in 2000 entered more out of necessity than choice. By 2018, this share had fallen to 22%, as an improvement in employment opportunities was partially offset by increased entry to take advantage of flexible hours in self-employment. These estimates represent a floor for necessity-driven entry since many of the non-professionals entering self-employment due to the nature of their job may have chosen their occupation because of limited opportunities in paid work.

The dramatic decline in the share of entrants in total self-employment that could not find suitable paid employment from 2000 to 2018 likely reflects in large measure improved labour market conditions. The average unemployment rate in the five years preceding the survey reference date was approximately 2 percentage points lower in the 2018 survey. The substantial increase in entry due to work-family balance and the need for flexible hours may reflect in part

Table 1*Reasons for Entering Self-Employment*

National Responses to supplementary questions in Statistics Canada Labour Force Surveys (percentage of respondents)		
	2000	2018
Could not find suitable paid employment	21.8	5.0
Balance of work and family	4.2	8.6
Flexible hours	5.4	8.4
Possibility to work from home	2.6	n/a
Had to be self-employed (nature of job)	5.0	15.2
Joined or took over family business	7.3	4.8
Independence/Freedom/Own boss	28.4	33.5
Control/Responsibility/Decision-making	5.8	3.4
Challenge/Creativity/Success/Satisfaction	7.7	6.6
More money/Unlimited income	5.9	3.2
Other reasons	6.0	11.3

Sources: Delage, 2002; Yssaad and Ferrao, 2019

Details may not add to 100 due to rounding.

the increase in the participation rate of working-age females from 70.4% in 2000 to 75.1% in 2018.

In addition to asking about the motivation to enter, the 2000 survey asked respondents about attitudes to self-employment after entry. Some of the necessity-driven entrants adjusted to self-employment and some of the opportunity entrants became discouraged over time. As a result, about 30% of the self-employed in 2000 would have moved into paid employment if the pay were commensurate with their education and experience. Questions designed to determine how many of the self-employed would have moved into paid employment were not asked in the 2018 survey.

Following Budig (2006), Glavin et al. (2019) distinguish between the professional and non-professional self-employed. They make the point that entry decisions of knowledge-intensive professionals are likely to differ substantially from non-professionals entering self-employment. Using panel data from the Canadian Work Stress and Health Study that follows entrants from 2011 to 2017, the authors find that job insecurity, insufficient work hours, and low personal income affect the entry decision of the non-professional self-employed but not the professional self-employed.

The Financial Situation of the Self-Employed

The B.C. government measures poverty using the Market Basket Measure (MBM) published by Statistics Canada. The cost of the goods and services in the basket, which is calculated by region, is compared to family disposable income to determine low-income rates. This approach cannot be used to assess the incidence of low income among the self-employed because complete information on the distribution of income is only available for individuals. As an alternative, I use the low income measure (LIM)—the percentage of persons earning less

Box 1: Discrimination as a Cause of Low Income

Discrimination in the labour market can take at least three forms. First, it is possible that minority groups will have less access to employment opportunities that do not require specialized training prior to entry, resulting in higher unemployment rates and lower employment rates for these groups. Second, minority groups may be paid less for performing the same work. However, given the legal sanctions against overt discrimination, the failure to offer equal pay for equal work is likely to be justified in terms of lower productivity. As a result, discrimination may take the form of classifying workers too low on the pay scale given their productivity. A third form is a variation on the second: occupational or educational credentials earned in foreign countries may be inappropriately discounted by employers or licensing authorities. This would lead to higher unemployment rates and employment mismatches for minorities.

All three forms of discrimination would increase the incidence of low income for ethnic minorities. Although ethnic minorities report experiencing discrimination and they have a well-documented earnings gap with the Canadian born, research on their labour market outcomes, particularly for immigrants, paints a more nuanced picture.

Indigenous peoples participate in the labour market at a much lower rate than other Canadians and earn less when employed (Patterson et al., 2019; 2016 Census). In contrast to other ethnic minorities, there does not appear to be any research that attempts to disentangle the effects of discrimination and other factors, such as isolation from market centres and differences in human capital on these outcomes. Immigrants have higher unemployment rates and lower participation rates than the Canadian born, but recent immigrants account for almost all the gap. Further, the participation gap for males aged 25 to 54 years narrowed substantially for recent immigrants from 2006 to 2018 (Patterson et al., 2019).

Fang and Heywood (2010) use the 1999 Workplace and Employee Survey to examine pay differentials for non-European ethnic minorities in non-union jobs. Since gaps in performance-based pay measures are more difficult to sustain, Fang and Heywood analyze gaps for both time-based and performance-based pay arrangements. After controlling for language skills and year of entry to Canada, they do not find any ethnic wage differential for women. They find a time-rate pay gap for males, but this gap disappears when the analysis is restricted to sales, technical, and production job categories where workers would find it easiest to choose employers that offer their preferred pay regime.

There is ample evidence that home country education of recent immigrants is heavily discounted by Canadian employers. Aydede and Dar (2017) demonstrate that the discounting persists even when occupations and source country education are well matched. If a year of education is the same quality wherever it is obtained, this outcome would suggest discrimination as a cause. However, Ferrer et al. (2006) find that lower literacy levels, which are taken as a proxy for general cognitive skills, explain a substantial part of the earnings gap. This finding suggests that quality differences are at play, at least in terms of foreign universities being able to generate “Canadian-usable” literacy. In addition, Ferrer et al. do not find any evidence that immigrants receive a lower return to literacy than the Canadian born. Li and Sweetman (2014) use country-level Program for International Student Assessment (PISA) scores in math and science as a proxy for educational quality. They find that educational quality affects the return to source country education, but not for persons immigrating at a young age and obtaining their education in Canada. Overall, the empirical evidence suggests that discrimination does not play a substantial role in the discounting of foreign education in the Canadian labour market.

than half of the median income—as an indicator of poverty. This measure is supplemented with partial information on the income and assets of households in which the primary earner is a paid worker or self-employed.

Measuring income from self-employment is not completely straightforward. Working proprietors of incorporated businesses pay themselves a salary, and the net income of the business, which may be paid out in dividends or retained in the firm, represents a return to capital. However, working proprietors are unlikely to make a rigorous accounting of wage and capital income. The need to finance investment from internal sources and the tax advantages of leaving income in a corporation and investing it passively encourage working proprietors to keep their wage and dividend income low.

One approach to estimating the wage income of the self-employed is to deduct an imputed return on the capital employed in owned businesses from the total return to the business. For the owners of unincorporated businesses (“unincorporated self-employed”), the imputed return is deducted from reported net business income. For the owners of incorporated businesses, the imputed return is deducted from the sum of wage, dividend income, and the change in retained earnings. This data-intensive approach can in principle be applied in Canada, using the Canadian Employer-Employee Dynamics Database (CEEDD), recently developed at Statistics Canada. The CEEDD provides a matched employee-employer database by linking personal and corporate income tax files, which allows wage income and dividends of working proprietors to be identified. The CEEDD also links financial statement information on revenues, expenditures, and balance sheets.

Grekou and Liu (2018) develop estimates of total business income (i.e., the sum of wage and capital income) for the incorporated self-employed in 2013 (Table 2). These estimates are consistent with the reported net income of the unincorporated self-employed, which includes both labour and capital income. Ideally, we would compare the wage income of the self-employed with the wages of paid workers excluding the incorporated self-employed. Unfortunately, Grekou and Liu do not separate wage and capital income. Further, data on wages of paid workers excluding working proprietors of incorporated firms is available for 2009 only.¹ However, Statistics Canada does publish data on income by class of worker, showing the average income of paid employees, including wages received by the incorporated self-employed, and the unincorporated self-employed.² Statistics Canada also publishes information on the distribution of employment income, including both paid workers and both categories of the self-employed.³

¹ LaRochelle-Côté and Uppal (2011) present estimates of individual incomes for paid workers (excluding the self-employed) and for the incorporated and unincorporated self-employed. However, the data for the incorporated self-employed include wage income from all jobs and capital income from all sources, not just from the owned business.

² Statistics Canada. Table 11-10-0239-01 Income of individuals by age group, sex and income source, Canada, provinces and selected census metropolitan areas. The data are available annually from 1976.

³ Statistics Canada. Table 11-10-0240-01 Distribution of employment income of individuals by sex and work activity, Canada, provinces, and selected census metropolitan areas.

<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110024001>

A comparison of the data developed by Grekou and Liu with Statistics Canada data on the income of all employees (wages and salaries of paid workers, including working proprietors of incorporated businesses and the net income of the unincorporated self-employed) indicates that the median business income of the self-employed (incorporated and unincorporated) is about 25% less than the median wage income of all individuals (paid workers and the self-employed) reporting employment income. The average income of the self-employed is, however, almost 60% higher than that of all employees. The ratio of the mean to median income confirms the greater incidence of high income in self-employment than in overall employment: this ratio is 2.9 for the self-employed compared to 1.3 for all employees. In contrast, the incidence of low income is much higher for the self-employed than for all employees. An estimate developed from Statistics Canada data suggests that about 28% of all employees were in low income—they earned less than 50% of the median wage income—compared to 40% for the self-employed.⁴ It is worth emphasizing that individuals are classified as self-employed based on their main source of employment income and that only income from the main source is included.

Table 2 also shows that the unincorporated self-employed, who account for 65% of total self-employment, have much lower incomes than the incorporated self-employed. The median income of the unincorporated self-employed is about a fifth of the median income of the incorporated self-employed. The gap in mean incomes is even larger, with the result that the mean income of the unincorporated self-employed is slightly over half the mean income of all employees. Similarly, the incidence of low income among the unincorporated is almost two-and-a-half times as high as the incidence for the incorporated (63% versus 27%, which is about the same as the incidence for all employees).

Table 2

Income of the Self-Employed¹ and All Employees, Canada, 2013

	Self-employed			All employees
	Not incorporated	Incorporated	Both	
Median (\$)	10,000	47,000	23,057	31,736
Mean (\$)	23,000	147,000	66,760	42,377
Mean/Median	2.3	3.1	2.9	1.3
LICO ² (\$)				15,868
Low income (%)	63.1	26.8	40.1	27.75

Notes: ¹The self-employed includes individuals whose primary source of income is self-employment. Self-employment income includes both labour and capital income.

² Low income cut-off (LICO): 50% of the the median income of all persons with employment income.

Sources: Grekou and Liu, 2018; Statistics Canada Table 11-10-0240-01, <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110024001>, and author's calculations. Statistics Canada data in 2017 constant dollars were converted to current dollars using the overall Consumer Price Index (CPI).

⁴ Note that individuals have other sources of income than wages. In addition, household income is a better base than individual income for measuring the incidence of low income; this issue is discussed below.

Why is there such a big difference in the incomes of the two groups? Persons entering self-employment because of limited opportunities in paid work (necessity entrants) and other relatively low-skilled individuals with low earnings potential are unlikely to incur the substantial set-up and ongoing accounting costs of incorporation. In contrast, incorporation provides substantial tax advantages to high-income professionals and skilled tradespersons. Further, opportunity entrants can substantially reduce their risk through incorporation, which limits liability to amounts invested in the firm. Note, however, that operating an unincorporated business in the start-up phase offers the advantage of allowing losses to be deducted from other income as they are incurred.⁵

The complete distribution of business income of the self-employed is presented in Table 3.⁶ Two points are of note. First, slightly more than 10% of the self-employed have negative business income. Second, the distribution of income for both types of self-employed is skewed to high incomes, but more so for the incorporated self-employed: the ratio of incomes at the 90th and 50th percentiles is 5.1 for the unincorporated self-employed and 5.7 for the incorporated.

Table 3

Distribution of Business Income of the Self-Employed, Canada, 2013

Percentile	Not incorporated	Incorporated	Both
	Dollars (\$)		
5	-4,000	-19,000	-9,294
10	-1,000	-3,000	-1,706
20	2,000	7,000	3,765
30	4,000	20,000	9,646
40	7,000	32,000	15,823
50	10,000	47,000	23,057
60	14,000	66,000	32,351
70	20,000	93,000	45,762
80	29,000	143,000	69,231
90	51,000	266,000	126,874
95	84,000	459,000	216,339

Note: Includes individuals whose primary source of income is self-employment. Business income includes both labour and capital income.

Source: Grekou and Liu (2018) and author's calculations

The comparison of the incidence of low income is subject to two caveats. First, as discussed above, the relative income of the self-employed is overstated by the inclusion of an unknown amount of capital income. Second, the self-employed tend to underreport their income and claim tax deductions for business expenses that contribute to consumption enjoyment.

⁵ In contrast, losses incurred by an incorporated business must be carried forward and deducted from future profits.

⁶ Comparable information for all employees is not available.

Schuetze (2002) estimates that such concealment by the self-employed amounted to 11% to 23% of their total household income (Appendix A).

The higher incidence of low income in self-employment likely overstates the gap in the incidence of chronic low income, for two reasons. First, some opportunity-driven entrants will experience low income in the startup phase of their business, but this low income will likely be temporary either because the business becomes successful or because the proprietor returns to paid employment. Second, persons entering self-employment out of necessity are the most likely to experience chronic, involuntary low income. However, the rate of necessity-driven entry varies inversely with labour market conditions, which have improved substantially since 2013.⁷

LaRochelle-Côté and Uppal (2011) provide estimates of household income for paid workers and the two categories of the self-employed. The data source is the 2009 Survey of Labour Income Dynamics (SLID). Estimates are reported for households with income recipients aged 25 to 59 years. The market income measure is comprehensive; it includes wages, salaries, dividends, interest income, capital gains, net rental income, etc. The authors do not present the complete distribution of household income, so the incidence of low income cannot be calculated.

The household income measure is shown in Table 4, along with the individual income measure presented in Table 2. Recall that the individual income measure is for 2013, that it includes income from owned businesses only, and that business income from a corporation includes the change in retained earnings of that corporation. With those caveats in mind, the data in Table 4 suggest that the income gap between the unincorporated self-employed and paid workers narrows when income is measured by household: the ratio of median incomes rises from .315 to .566. Further, the distribution of income becomes flatter when income is measured by household; for example, the ratio of median to low incomes for the unincorporated self-employed declines from five to just under two.⁸ These two observations suggest that the incidence of low income for the unincorporated self-employed falls substantially when income is measured by household rather than by individual.

LaRochelle-Côté and Uppal provide information on the household assets and liabilities of paid employees and the self-employed. In 2009, the median net worth of the self-employed⁹ was 2.7 times larger than the net worth of paid employees. Excluding business assets, the ratio was a still-substantial 2.0.

Composition of the Pool of Low Income Self-Employed Individuals

Detailed information on the demographic composition of the pool of low income self-employed would help assess the need for tailored poverty reduction policies. For example, it would be useful to have a breakdown by gender and to identify the share of immigrants and

⁷ Recall that the share of the self-employed citing poor opportunities in paid employment as a motivation for entering fell from 21.8% in 2000 to 5% in 2018, which was consistent with a substantial improvement in labour market conditions.

⁸ The comparison is P50/P25 for household income and P50/P20 for individual income due to data constraints.

⁹ Estimates by category of self-employed are not available.

Table 4*Income of Employees and the Self-Employed, Canada*

	Employees ¹	Self-employed		
		Total	Incorporated	Unincorporated
Dollars (\$)				
Household market income (2009)	80,900	81,500	103,100	66,700
Average	67,000	54,500	75,600	37,900
Median				
Individual income (2013)				
Average	42,377	66,760	147,000	23,000
Median	31,736	23,057	47,000	10,000
Ratio				
Relative to paid employees				
Median household income		0.813	1.128	0.566
Median individual income		0.727	1.481	0.315
Dispersion measures				
Household income ²				
P90/P50	2.0	3.2	2.6	3.9
P75/P25	2.2	3.8	3.0	3.7
P50/P25	1.5	1.9	1.9	1.8
Individual Income				
P90/P50		5.5	5.7	5.1
P75/P20		12.2	13.3	10.0
P50/P20		6.1	6.7	5.0

Notes: ¹Paid employees for household income and all employees for individual income.

²Based on average adult equivalent income measures.

Sources: LaRochelle-Côté and Uppal (2011) Table 1 for household incomes. See notes to Table 2 for individual incomes.

Indigenous peoples in the pool. Unfortunately, such information does not exist. There is, however, some indirect evidence suggesting that women are overrepresented in the low-income pool. In 2013, women accounted for 46% of the unincorporated self-employed, where the incidence of low income is higher, but only 35% of the incorporated category.¹⁰ Further, in 2018, women were about two-and-a quarter times more likely than men to say that their entry into self-employment was motivated by the need to achieve work-family balance or to work flexible hours.¹¹ Individuals pushed into self-employment by these concerns are more likely to experience an earnings reduction, and hence to experience low income, than purely voluntary entrants.

¹⁰ Grekou and Liu (2018), Table 1.

¹¹ Yssaad and Ferrao (2019), Chart 3. In 2018, about 15.5 % of females cited the need to achieve work-life balance as the main motivation for entering self-employment, and a further 11% cited the ability to work flexible hours. The corresponding shares for males were 4.5% and 11%.

There is also some indirect evidence that immigrants account for a disproportionate share of the low income self-employed. Picot and Lu (2017) report that the incidence of persistent or chronic low income¹² was substantially higher for immigrants than for the Canadian born from 2000 to 2012.¹³ Given that the propensity to enter self-employment is higher for immigrants than for the Canadian born,¹⁴ it would not be surprising if immigrants were overrepresented in the pool of low income self-employed. Differences in the motivation for entering self-employment between immigrants and the Canadian born supports this supposition. The 2000 survey of self-employment presented by Hou and Wang (2011) indicates that the share of immigrants entering self-employment because they could not find suitable paid employment, and hence more likely to be in low income, was about 1.7 times greater than the share of the Canadian born. Further, 35% of immigrants would have left self-employment if suitable paid employment had been available; the corresponding share for the Canadian born was 27%. A higher share of immigrants in unincorporated self-employment is also relevant. Data presented in Green et al. (2016) show that in 2010 immigrants accounted for approximately 23% of the unincorporated self-employed compared to 18.3% of the incorporated self-employed.

Glavin et al. (2019) report the incidence of low income for paid employees as well as for recent professional and non-professional entrants into self-employment. The incidence of low income among paid employees and professional entrants is approximately the same, while the incidence for the non-professional self-employed is almost two-and-a-half times higher than for the other categories.

Summary and Policy Implications

The self-employed experience a higher incidence of low income than paid workers. However, low income is primarily an issue for the unincorporated self-employed: approximately 63% of this group was in low income in 2013 compared to about 27% for both the incorporated self-employed and all employees. Measured by household instead of by individual, the incidence of low income among the self-employed is likely to be much lower. Individuals entering self-employment out of necessity—broadly defined to include limited opportunities in paid employment and the need to achieve work-family balance and to work flexible hours—are more likely to operate unincorporated businesses and to experience chronic low income. Women and immigrants are likely to be overrepresented in the pool of the low income self-employed.

¹² Low income is considered persistent, or chronic, if an individual experiences low income for five consecutive years.

¹³ This is a simplification. The study compares immigrants who landed in Canada five to 20 years ago with the Canadian born and immigrants who landed in Canada more than 20 years ago. Both groups are restricted to persons 25 years and older.

¹⁴ Hou and Wang (2011) demonstrate that the higher share of self-employment in total employment of immigrants reflects the higher average age of immigrants relative to the Canadian born. Age-corrected self-employment rates are the same for immigrants and the Canadian born.

The foregoing analysis does not offer much in the way of new insights into how to structure a poverty reduction strategy. It does, however, suggest a particularly high impact from policies that encourage flexible work arrangements, reduce the financial burden of daycare for children and other dependents, and promote language skills. In contrast, policies that discourage discrimination against immigrants are likely to have a less substantial impact on their earnings. Changes to immigrant selection criteria implemented since 2009—and particularly the Express Entry system implemented in 2015—will do much to improve the labour market performance of immigrants on entry. Under the new system, economic-class immigrants are selected in a two-step procedure. Potential immigrants meeting the minimum requirements for entry are placed in a pool from which employers and the federal and provincial governments can select individuals or families for immigration to Canada.¹⁵ Employers and governments can be expected to select individuals with skills in demand in Canada and to take steps to ensure that foreign credentials have been adequately evaluated prior to entry. As a result, more immigrants will be hired on arrival and paid competitively with the Canadian born.

The argument that self-employment offers a path out of poverty can be assessed relative to the path provided by paid work. While paid employment may provide some low-skilled individuals access to the first rung of a career ladder, others are not able to advance further without upgrading their education and skills. Low-skilled individuals with limited opportunities in paid work are not, in general, likely to fare much better in self-employment. (Note also that in some relatively low-paying occupations, self-employment is the dominant work arrangement.) Relatively skilled individuals with poor language skills, facing discrimination in paid work, or lacking familiarity with the dominant culture are a possible exception. However, successful self-employment by such individuals may require operating in an ethnic enclave, which would do little, in itself, to improve prospects for obtaining paid work. Further, the supply of entrepreneurs may outstrip the demand for their services if the market is restricted to the enclave.

Are Existing Policies Even-Handed?

Concern is sometimes expressed that the self-employed do not have the same access to social security and active labour market programs as paid workers. Since owners of incorporated businesses have the option of paying themselves a salary, equal access is a potential concern only for the unincorporated self-employed. The review of social security programs focusses on programs providing direct income payments. There is no reason to expect that access to subsidized goods and services depends on a person's employment status. This section also reviews barriers to enter self-employment and how the absence of income averaging in income tax determination hurts the self-employed.

¹⁵ See Sweetman (2017) for additional detail and for some remarks on how the new system will increase labour market competition between immigrants and the Canadian born.

Social Security Programs

A review of the major social insurance programs, defined as programs financed by redistributive taxation, offered by the federal and B.C. governments found only one program—employment insurance—that is biased against the self-employed.¹⁶ Eligibility for means-tested passive income support programs such as the Canada Child Benefit, the B.C. Early Childhood Tax Benefit,¹⁷ the GST/HST credit, and the B.C. climate change tax credit is based on “adjusted” family net income, which includes income from self-employment. Eligibility for federal Old Age Security payments and the Guaranteed Income Supplement (GIS) is not affected by employment status. The clawback of GIS payments is based on income earned through paid work or self-employment.

There are two major federal programs tied to employment, the Canada Pension Plan (CPP) and Employment Insurance (EI). The CPP treats income earned in paid and self-employment the same way. Both paid workers and the self-employed must participate in the Canada Pension Plan if earned income is greater than \$3,500. The plan is financed by equal contributions from employees and employers. Employees get a 15% tax credit for their contributions to the base component and a deduction for contributions to the enhanced component.¹⁸ The self-employed working for an incorporated business that they own are treated the same as other employees and employers. The unincorporated self-employed pay both the employer and employee share. The employer share is considered a business expense while a 15% tax credit is available for the base employee share and the enhanced portion is deductible. Net business income is the base for CPP contributions by the unincorporated self-employed.

The EI program has two components: passive income support measures related to employment experience (employment insurance benefits) and active labour market measures. The active labour market component is primarily delivered by provincial and territorial governments. It is discussed in the next section.

Given the moral hazard issue raised by allowing beneficiaries to initiate a claim, it is not surprising that the self-employed do not have the same access to EI as paid workers. The incorporated self-employed have complete access to EI if their ownership share of the corporation is less than 40%. Other self-employed individuals with at least \$6,947 in insurable earnings can “opt-in” to special benefits (maternity, parental, sickness, and caregiver) by paying the employer and employee share of the relevant premiums. The self-employed are eligible for special benefits if they reduce their working time by at least 40% and submit a medical certificate. If a claim is made, the participant must continue to pay premiums for as long as they remain in self-employment.

¹⁶ Employment Insurance is financed by employee and employer contributions, but the program does not respect basic insurance principles. In particular, there is no experience rating, and contribution revenue is used to finance active labour market measures as well as passive income support.

¹⁷ The Early Childhood Tax Benefit was replaced in October 2020 by the Child Opportunity Benefit, which extends support for children aged 7 to 18.

¹⁸ Starting in 2019, CPP contributions have been increased to fund higher benefits. These higher benefits are available only to current contributors, so contributions and benefits are tracked separately from the “base” benefits and contributions. The base program is not fully funded by contributions.

Active Labour Market Programs

Active labour market programs are implemented to encourage labour force participation and to reduce unemployment. They include labour market intermediation services, training and skills development, employment subsidies, business start-up incentives, and direct job creation. The federal government funds three major active labour market programs.

- The Canada Workers Benefit increases the supply of low-skilled workers by topping up the wage received with a refundable tax credit. Eligibility is based on “adjusted” family net income, which, as noted earlier, includes income from self-employment. Funding in 2019 is projected to be \$2.1 billion. Based on population shares, the amount spent in B.C. would be about \$300 million.
- EI active labour market programs are delivered by B.C. under a Labour Market Development Agreement (LMDA) with the federal government. Under this agreement, B.C. provides “a broad range of services to enable EI clients to obtain employment,” with a focus on skills training. The agreement allows payment of targeted wage subsidies and earnings supplements. EI clients are broadly defined to include persons who have contributed to the program for at least five of the last 10 years. The agreement also funds employee assistance services (counselling and job search) with no eligibility restrictions. Clients obtain assistance to enter self-employment or to obtain paid work. Funding in 2019–20 is \$2.2 billion; the B.C. share is \$300 million.
- The Canada-B.C. Workforce Development Agreement (WDA) is intended to benefit individuals who are unemployed and not covered by EI; underemployed and/or seeking to upgrade their skills; and members of groups facing employment barriers, including persons with disabilities. Total federal funding in 2019–20 is \$872 million; the B.C. share is \$80 million.

The federal government funds 23 smaller federal active labour market programs (Appendix B). Total funding for these programs in 2019–20 is \$1.3 billion. Based on population shares, about \$180 million of this amount would be spent in B.C.

Total funding for federal active labour market programs is \$6.5 billion in 2019–20 (Appendix B). The B.C. share of this spending is about \$900 million. The B.C. government spends an additional \$71 million on active labour market programs (Table 5).

Almost all of B.C.’s active labour market programs are funded wholly or in part through the LMDA, the WDA, and Western Economic Diversification programming (Table 5). The LMDA supports two program streams: WorkBC Employment Services and Community Employer Partnerships. Provincial funding supports counselling and job search for clients not eligible for LMDA programming because they are not EI claimants (\$24.2 million in 2019–20) and the Single Parent Employment Initiative (SPEI) (\$4.8 million in 2019–20). The SPEI targets single parents receiving income assistance who are deemed able to work. It provides paid work experience and subsidizes training and child-care costs.

WDA funding is being used to support three program streams: Skills Training for Employment (skills training, including employment readiness for vulnerable and underrepresented groups), the B.C. Employer Training Grant, and the Community Workforce

Response Grant (skills training); WDA funding also supports the Community Adult Literacy Program (CALP). B.C. funding, \$2.4 million in 2019–20, supplements the Aboriginal Community-Based Training Partnership and the CALP.

The federal department of Western Economic Diversification (WED) funds the Western Canada Business Service Network, which supports business start-ups and their growth. The largest component of the network is the Community Futures program, which funds community infrastructure projects as well as business start-ups and growth in rural areas. The B.C. Self-Employment Program, which allows participants to retain EI benefits and to receive additional income support while in self-employment, is funded by the Community Futures program.¹⁹ The network also includes programs supporting self-employment by disadvantaged groups. The B.C. share of the Business Service Network spending is about \$13 million.

The federal department of Immigration, Refugees and Citizenship supports the Career Paths for Skilled Immigrants program with \$2 million of funding and B.C. provides \$5.7 million. The program provides assessment services, counselling, and language training to participants.

I found only three programs that are wholly funded by the B.C. government.

- Tax credits for employer-based training, including apprenticeships, which cost \$22 million in 2018.
- The Indigenous Skills Training Development Fund (\$10 million in 2019–20), which serves communities along the liquid-natural gas (LNG) corridor. It supports skills development, including apprenticeship programs, as well as literacy and numeracy.
- The Self-Employment Program for individuals receiving income assistance who have disabilities or persistent, multiple barriers to employment and want to work. Funding in 2019–20 is about \$0.2 million.

Programs funded under Labour Market Development Agreements are restricted to EI claimants, albeit broadly defined. As a result, the self-employed are not eligible for programs accounting for about a third of total spending on active labour market measures, although LMDA programs support entry into both paid work and self-employment. A further 30% of spending supports paid work only. In contrast, only 2% of spending on active labour market programs is targeted exclusively at the self-employed.

Since the self-employed account for about 20% of total employment, it could be argued that self-employment is “underfunded” by active labour market programs. A counterargument is that the federal and B.C. governments provide substantial support for the creation and growth of small businesses through other programs. These programs include the special low rate of tax for small incorporated business, the lifetime capital gains exemption on small business shares, and several financing programs. Lester (2017) estimated the cost of such support at \$6.8 billion in 2015–16. However, these programs provide few benefits to persons who have entered self-employment out of necessity and could therefore benefit from active labour market programs.

¹⁹ The amount of Community Futures spending on the B.C. Self Employment Program is not available.

Table 5

B.C. Active Labour Market Programs

Table 5: BC Active Labour Market Programs					
	Target Clients	Employment Type Supported	Services	Funding 2019-20 (\$Millions)	
				Federal	BC
<i>Labour Market Development Agreements</i>					
WorkBC, including Apprentice Services and Assistive Technology Services	EI recipients, except for employment assistance which is not targeted.	Both	Skills development, wage subsidies	299.3	
Community and Employer Partnerships		Paid Work	Counselling and job search		
Single Parent Employment Initiative	Single parents receiving income assistance deemed able to work	Paid Work	Training, paid work experience, child care costs while receiving income assistance.	1.4	4.8
Provincial supplements	Non-EI recipients	Both	Counselling and job search		24.2
<i>Workforce Development Agreements</i>	Unemployed without access to EI; underemployed and/or seeking skills training; disadvantaged groups.	Both	Skills development; work experience and employment readiness programs.		
Programming for vulnerable groups	Vulnerable and underrepresented groups	Both	Skills development (including employment readiness) and income support		
Skills Training for Employment	Broad range of vulnerable groups	Paid Work	Skills development (including employment readiness) and income support	35.0	
Bladerunners	Unemployed persons aged 15-30	Paid Work	Skills development, employment readiness	4.3	
Pre-Apprenticeship Training	Vulnerable and underrepresented groups	Paid Work	Skills development	10.0	
Aboriginal Community-based Training Partnership	Aboriginals in post-secondary education	Paid Work	Adult education and skills development	7.3	2.0
BC Employer Training Grant	Not targeted	Paid Work	Skills development	10.0	
Community Workforce Response Grant	Unemployed or underemployed individuals	Both	Skills development	10.0	
Community Adult Literacy Program	Adults 19 years and older	Both	Literacy skills	0.5	2.4
<i>Western Canada Business Services Network</i>					
Community Futures	Individuals, business owners; community development agencies	SE	Economic planning, business advisory services, loans, self-employment assistance programs	10.5	
BC Self Employment Program	EI recipients	SE	Retain EI benefits and receive additional income support when entering SE	n.a.	
Women's Enterprise Initiative	Females	SE	Access to capital, training, business advisory services	1.0	
Francophone Economic Development Organization	Francophone individuals and business organizations	SE	Access to capital, training, business advisory services	0.5	
Entrepreneurs with disabilities	Persons with disabilities	SE	Training, business advisory services	0.5	
Indigenous Business Development Services	Indigenous entrepreneurs and business organizations	SE	Business advisory services	0.2	
Career Path for Skilled Immigrants	Immigrants	Paid Work	Credential assessment, counselling, work experience, language training.	2.0	5.7
Training Tax Credit for Employers (refundable)	BC sole proprietors, partnerships and corporations. Enhanced credit for First Nations individuals and persons with disabilities.	Paid Work	Skills development		22.0
Training Tax Credit for Apprentices (refundable)	Not targeted. Enhanced credit for First Nations individuals and persons with disabilities.	Paid work	Skills development		
Indigenous Skills Training Development Fund	Indigenous communities along the LNG corridor	Both	Skills development, literacy and numeracy		10.0
Self Employment Program for persons with disabilities	Persons with disabilities or facing persistent multiple barriers to employment receiving income assistance who want to work	SE	Reduced inclusion of self employment income and assets when determining level of income assistance.		0.2
Total funding				392.5	71.3

Necessity-driven entry into self-employment accounted for about just over a fifth of total self-employment in 2018, or about 4.4% of total employment.

Income Averaging for Calculating Tax Liabilities

In a progressive tax system, an individual with a fluctuating income can pay a higher average tax rate than a person with the same average income that is more stable. Given that income from self-employment is more variable than income from paid work, the absence of income averaging puts the self-employed at a disadvantage.

Gordon and Wen (2017) explore the size of the tax penalty arising from fluctuating incomes using a sample of approximately 7,000 individuals from 2005 to 2010. Individuals included in the sample participated in the labour market and had income of at least \$8,000 on average over the six-year period. Income includes salaries, wages, net unincorporated business income, investment income, capital gains, and government transfers. In the base case analysis, the Working Income Tax Benefit (replaced in 2019 by the Canada Workers Benefit) is included in income, but other refundable tax credits are not. Gordon and Wen calculate the “fluctuation penalty” as the difference in income tax liabilities using actual incomes and average incomes, divided by average incomes. Income fluctuations raise the average tax rate by more than one percentage point for about 8% of persons in the sample. The fluctuation penalty ranges from 4% to 14% of income for 1% of the population.

Individuals with low income are disproportionately affected by the fluctuation penalty. The average fluctuation penalty is .6% of average income for the first quintile compared to .2% or less for the other quintiles. When all refundable tax credits are included in income, the penalty rises to .7% for the first quintile and falls to .10% or less for the remaining quintiles. Another perspective on the impact on low-income individuals is that individuals in the first income quintile account for almost 60% of the top 5% of individuals paying a fluctuation penalty in the base case analysis.

The self-employed, who experience a high incidence of low income, are disproportionately affected by the fluctuation penalty. The increase in the average tax rate caused by fluctuating incomes is .2 percentage points for paid workers, .7 for the incorporated self-employed, and .9 percentage points for the unincorporated self-employed. Within the top 1% of affected persons, the self-employed account for about 35% of the income earned but only about 8% of total income earned.

Barriers to Enter Self-Employment

Since some of the low-income self-employed have entered this work situation as a last resort, keeping entry barriers as low as possible will contribute to poverty reduction. A general point to be made is that while Canada has a relatively favourable ranking in the World Bank’s

Ease of Doing Business Index,²⁰ the absolute requirements to set up and report on the activities of a business are sufficiently complex and time consuming to represent a barrier to entry. As a result, the existing programs that provide training to deal with the legal and administrative requirements of self-employment represent sound public policy. However, they should be reviewed to determine if funding is at an appropriate level. The administrative and legal requirements associated with self-employment should also be reviewed with an eye to further simplifying requirements.

Bankruptcy Provisions and Contract Enforcement

Entry into self-employment could also be affected by bankruptcy provisions and the legal framework for enforcing contracts.²¹ Self-employment is inherently more risky than paid employment, so bankruptcy laws should strike the right balance between protecting creditors and not requiring that the self-employed put their entire personal fortune at risk by starting a business. The protection of creditors is a federal responsibility under the Bankruptcy and Insolvency Act, but provincial governments establish how much assets can be protected in the event of a personal bankruptcy, which is directly relevant for owners of unincorporated businesses. However, owners or incorporated businesses are also affected by personal bankruptcy rules because they are often asked to provide personal guarantees. B.C.'s limits are in the middle of the range for the provinces (Appendix C). Nevertheless, they should be reviewed to determine if any adjustments are warranted.

Provinces also play a role in enforcing contracts. The self-employed have an interest in well-functioning small claims courts, which have the potential to resolve some legal disputes quickly and inexpensively. There is only limited information available on the efficiency of the B.C. small claims system. The Justice Education Society states that “more than 90%” of complaints are settled out of court through mediation and settlement and trial conferences but does not provide any statistics on timelines for accessing these services.²² The cases that go to trial usually take more than a year to get a judgement. Such a lengthy delay suggests that a review of the trial procedures and funding levels for the small claims court system would be appropriate.

Occupational Licensing

Before entering many occupations, candidates must pay fees and/or meet requirements imposed or endorsed by governments for education and training. These requirements are often justified by the need to protect the health and safety of consumers. If such regulations are to provide a net social benefit, governments must get the right balance between the social cost of

²⁰ Canada ranks 22nd out of 190 countries (low scores are better), which is lower than the U.S. and the U.K. but higher than the other G7 countries. Note that the index has been created with a focus on starting and operating incorporated businesses and that provincial laws and regulations affect only half of the 10 components of the ranking. The report is available at: https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf

²¹ See Jia (2015) for a discussion of how personal bankruptcy law affects entry.

²² The Justice Education Society “Frequently Asked Questions,” <http://www.smallclaimsbcc.ca/faq>

meeting the requirements and the social benefit of a higher-quality supply of goods and services.

Kleiner and Vortnikov (2017) document the cost for the U.S. in terms of the higher wages resulting from higher entry costs of successful entrants and limits on supply from barriers to entry. They find that occupational licensing raises wages by about 11% after controlling for human capital and other observable characteristics. The percentage change is larger for high-income than for low-income occupations.

Carpenter et al. (2012) provide an in-depth analysis of occupational licensing of low- to middle-income occupations in U.S. states. The authors found 102 occupations classified by the Bureau of Labour Statistics in which practitioners make less than the national average income and which are licensed in at least one state. They note that about half of these occupations offer opportunities for self-employment. Carpenter et al. make two points that suggest the costs of licensing exceed its benefits. First, most of the 102 occupations are practised in at least one state without licensing and only 15 are licensed in 40 states or more. Further, when an occupation is licensed, the specific requirements vary substantially by state. For example, the requirement for manicurist training ranges from four months to three days. If public safety were the key motivation for licensing, rules would be more uniform by state. Second, the authors find that the stringency of the licensing requirements for an occupation is not highly correlated with the health and public safety risks associated with it. As an example, Carpenter et al. note that the average cosmetologist spends 372 days in training whereas the average emergency medical technician spends only 33.

These observations suggest that U.S. states have not achieved the appropriate balance between the benefits and costs of occupational licensing. While the wages of successful candidates are higher, the barriers to entry reduce overall employment. Relatively low-skilled paid workers and self-employed will be pushed into lower-paying occupations.

In B.C., entry into 280 occupations is regulated. However, I did not find any analysis of the costs and benefits of such regulation. Although a cursory inspection of licensing requirements in B.C. did not suggest that excessive education and training for relatively low-skilled requirements are an issue in B.C., a more in-depth assessment is recommended.

Health and Safety

The self-employed are at a disadvantage with respect to private health insurance. Coverage costs are driven up, relative to large businesses, by limited ability to pool risk and spread administration costs. Owners of unincorporated businesses are particularly disadvantaged relative to employees of large firms, but less so relative to individuals in low-paying paid work. However, the disadvantage experienced is substantially mitigated by B.C.'s Fair PharmaCare program, which provides universal publicly funded insurance for prescription drugs and some medical devices. The co-pay amount is zero for families with income less than \$13,750 and 30% of costs for families with higher income. There is also a family maximum payment and a deductible amount that rises with income. For example, a family with income of

just over \$30,000 pays the first \$650 in drug costs (2.2% of income) and a maximum of \$900 (3% of income).

The self-employed are well served by a government-sponsored insurance program covering workplace injuries. The program is funded by employer contributions. Owners of incorporated and unincorporated businesses with paid help are required to contribute. Self-employed individuals without paid help can, in certain circumstances, purchase optional coverage for on-the-job injury.

The B.C. Government's Poverty Reduction Strategy

In March 2019, the provincial government announced measures that will help reduce B.C.'s overall poverty rate by 25% and cut the child poverty rate in half by 2024. The B.C. government recognizes that federal initiatives—enhancements to the Canada Workers Benefit, the Canada Child Benefit, and the Guaranteed Income Supplement—will contribute to achieving this goal. Key provincial measures are:

- increases to income and disability rates
- increases to child benefits
- funding for additional licensed child-care spaces
- increases to the minimum wage

The government also announced improvements to some active labour market programs, particularly for training. However, it is difficult to determine if these changes are funded by additional provincial money or by federal programs such as the Labour Market Development Agreement and Workforce Development Agreement.

How will these initiatives affect the self-employed living on low income? Increases to income and disability assistance rates are likely to have a small negative impact on labour market participation, possibly with greater effects on the self-employed who have entered out of necessity. The impact is likely to be small because employable income assistance recipients are expected to participate in the labour market, which limits the opportunity to take advantage of higher rates.²³

The additional income arising from increases to child benefits will reduce the labour supply of families with children. Since self-employment is a last-resort option for some, the impact is likely to be more pronounced for self-employment than for paid work. The reduction in child-care costs resulting from additional funding for child-care spaces will increase the labour supply of families with children by increasing the net return from working. The impact will be augmented by the effects of the operating subsidy for existing child-care centres announced in 2018 and enhancements to a provincial child-care grant implemented in 2018 and 2019. Since the lower cost of child care will reduce the need for flexible work arrangements, preferences could shift in favour of paid work over self-employment, although the impact on the level of self-employment could still be positive.

²³ Income assistance recipients deemed employable are required to submit a plan for returning to employment.

In summary, the increases to income and disability rates, increased child benefits, and additional child-care spaces are likely to have a small impact on the level of necessity-driven self-employment that could be positive or negative. As discussed below, increases to the minimum wage are likely to increase the supply of necessity-driven self-employment.

In recommending an increase in the minimum wage to \$15, the British Columbia Fair Wages Commission (2018) noted that “[t]he overwhelming evidence from Canada and other jurisdictions is that minimum wage increases have little or no impact on the overall employment level when economic conditions are good.” However, the Commission acknowledges that the proposed increases are larger than typically experienced. A \$15 minimum wage would represent a 38% increase from its level in 2016. It would raise the minimum wage to 55% of the median wage for full-time workers in B.C., which is about 12 percentage points higher than in 2016 and 14 percentage points higher than the average from 1997 to 2016.²⁴ Based on analysis by Green (2017), the Commission states that the employment effects are unclear but that negative impacts can be mitigated by phasing in the increase.

The Commission focusses on how the higher minimum wage will affect overall employment levels; their report does not assess the minimum-wage policy in terms of its impact on poverty reduction, as in Green. The issue is whether low-income wage earners will have more or less income as a result of a higher minimum wage. If workers affected by the minimum wage experience job losses or reductions in hours worked, their total employment income could fall rather than rise. Most of the empirical work on minimum wages finds that the employment effects are too small to cause an overall decline in the employment income of the affected group, particularly for small increases.²⁵ However, in most of these studies, the data used are not adequate to support strong conclusions about the impact of minimum wages on the employment income of the affected workers.

Jardim et al. (2017) assessed the impact of increases in the minimum wage in Seattle using a dataset that includes wages and hours worked for all paid workers in the Seattle area. This rich dataset permits a more rigorous analysis of the impacts of minimum-wage increases on the employment income of the affected workers than is possible using aggregated data. Seattle’s minimum wage was increased 38% in two roughly equal steps over two years. The increase raised the ratio of the minimum wage to the median wage from .37 to .50, which is similar to the impact of moving to a \$15 minimum wage in B.C. Jardim et al found that the first increase caused total hours worked to decline but the percentage change was less than the effective increase in wage rates, so the gross income of affected workers increased slightly. However, the second increase caused hours worked to fall by a larger percentage than the effective increase in the wage rate, causing a net reduction in the wage income of the affected workers.

While the data used by Jardim et al. represent an improvement over most other studies, Green (2017) notes several other issues with the analysis that are serious enough to question

²⁴ Data on median wage rates is available starting in 1997.

²⁵ See Schmitt (2015) for a review and assessment of U.S. research on the impacts of minimum wages.

the results but not to reject them outright. In particular, Green draws attention to the fact that the impact of minimum wages will vary with the size of the jurisdiction imposing them. Employment losses will appear to be larger if employers are able to shift activity to a nearby jurisdiction to avoid paying the minimum wage, as they may have done in response to higher minimum wages in Seattle.

It is worth emphasizing that even in the best of circumstances, higher minimum wages will cause total hours worked in the low-wage sector to decline. While it is possible that the reduction will be spread across all employees, it is more likely that some workers, especially the least skilled, will lose their jobs. Some of these individuals will apply for income assistance, while others will be pushed into contract work, black-market jobs, and self-employment. On the other hand, increases to child benefits and higher subsidies for child-care costs are likely to reduce the propensity to enter self-employment. The net impact on the propensity to enter self-employment and the resulting pressure on earnings from low-wage self-employment are impossible to predict. It is, however, highly likely that the gap between earnings from self-employment and paid work for low-income workers will rise with the minimum wage, even with some expected spillover effects from child-care policy.

Since there is some risk that the minimum wage increases will make it more difficult to achieve its poverty reduction goals, the government should set up a mechanism to assess the impact on workers affected by the legislation. Further, the government should consider expanding programs that target the self-employed, such as how to set up and run a small business and make additional efforts to ensure the self-employed have access to language and skills training.

Access to financing is a possible area for improvement in the poverty reduction strategy. The 2017 Survey on Financing and Growth of Small and Medium Enterprises²⁶ indicates that only about a third of micro business start-ups (one to four employees) obtained credit from financial institutions and 85% were at least partially financed from personal sources. According to a report by Intuit Canada (n.d.), almost 60% of the self employed start their business with less than \$5,000 in capital, and the share rises to 77% for the self-employed without paid help. It is certainly possible that the availability of even such a small amount of financing is an obstacle to self-employment.

Private financial institutions, such as credit unions, and charities, such as Community Micro Lending, offer micro loans to B.C. business start-ups. WED provides start-up capital through its Community Futures, Women's Enterprise Initiative, Indigenous Business Development Services, and Entrepreneurs with Disabilities programs. However, there is not enough information available to determine to what extent micro loans, often described as loans under \$20,000, are available through these programs.²⁷ Obtaining up-to-date information on the

²⁶ Available at <https://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html>.

²⁷ The only information provided is the average loan size, which is about \$47,000, in the Community Futures and Women's Enterprise Initiative programs for the period prior to 2014.

lending activity of WED and the micro loans activity of non-government actors would facilitate an assessment of the need for more government funding of micro loans.

Impacts of a Generic Basic Income Guarantee on Self-Employment

This section analyzes how a universal basic income guarantee (BIG) would affect the labour supply of the self-employed and paid workers while distinguishing between recipients and payors. Impacts on the propensity to enter self-employment from paid work are also reviewed. In this analysis, I assume there are no other transfer programs in place when the BIG is introduced and that it is financed by progressive income taxation. As demonstrated by Boadway et al. (2018), there is no fundamental difference between universal and income-tested BIGs when they are financed by progressive income taxes. Under both approaches, income is redistributed from individuals with higher income to those with lower income through a combination of transfers and tax increases. The fiscal cost of achieving a given amount of redistribution is the same, and the two approaches can be structured to have the same impacts on marginal tax rates.

A BIG will have the standard income and substitution effects on labour supply, but these impacts are likely to be different for necessity and opportunity-driven self-employment. In addition, distinguishing between paid workers and the self-employed draws attention to how income-induced changes in risk aversion could affect the composition of employment.

Labour Supply Effects

The additional income of BIG recipients will increase the demand for consumer goods and services, leisure, and various forms of investment in human capital, such as education and on-the-job training. The income effect will therefore reduce the labour supply of low-skilled paid workers and the self-employed. More formally, a BIG would drive up the reservation wage of the low skilled, reducing their labour supply to both paid work and self-employment. However, the impact is likely to differ by class of worker. Persons who have entered self-employment out of necessity are likely to respond the most strongly, since, to paraphrase Henrekson (2005), a generous BIG makes necessity entry unnecessary. The response of the opportunity-driven self-employed is likely to be the weakest. Some opportunity entrants will experience low income in the start-up phase of their business. The expected income of such individuals will be higher than the BIG, so they are not likely to reduce their labour supply in response to the income transfer. Indeed, the additional income could increase the propensity to enter self-employment by improving access to credit. Lending to finance a start-up would be less risky if the borrower has a guaranteed source of income.

The negative income effect will be reinforced by a negative substitution effect arising from higher marginal tax rates of BIG recipients in the clawback zone. Considering the classic income and substitution effects, the labour supply of all three categories of workers is expected to decline, although the impact on the opportunity-oriented self-employed and paid workers is likely to be small.

The payors of the BIG are likely to be the opportunity-driven self-employed and paid workers. The reduction in income experienced by these workers will prompt them to increase their labour supply. The increase in marginal tax rates implemented to finance the BIG will have an offsetting impact on labour supply. Therefore, the net impact from the classic income and substitution effects on the labour supply of opportunity-driven self-employed and paid workers with higher income cannot be determined a priori.

Employment Composition Effects

Many advocates of a BIG expect it to have a favourable impact on opportunity-driven entry into self-employment. For example, Van Parijs (2017, p. 24) writes that “a basic income can be expected to help unleash entrepreneurship by better buffering the self-employed ... against the risk of uncertain and fluctuating incomes.” Standing (2017, p. 99) expresses a similar idea, noting that “having economic security would make people more willing to take entrepreneurial risks.” Boadway et al. (2018) also suggest that increased income security would encourage entrepreneurship. Waldman (2014) in a blog post entitled “VC for the people,” states that a basic income would make people more risk tolerant, encouraging those who now accept unfulfilling and underpaid work to “opt for entrepreneurship, or education, or art, or child-rearing or just to hold out for a better gig.” Entrepreneurs have also expressed interest in basic income policies. For example, Mark Zuckerberg has spoken in favour of a universal basic income to provide a cushion that would allow recipients to try new things, particularly entrepreneurship.²⁸

The views expressed in the preceding paragraph can be restated more formally in terms of risk aversion. Theoretical considerations—diminishing marginal utility of income—suggest that risk aversion falls as income rises. This proposition has been confirmed by Hartog et al. (2000) who derive a measure of risk aversion from survey responses to questions about the reservation price for participation in a specified lottery. Income risk is higher in self-employment than in paid work,²⁹ and there is evidence that persons with lower risk aversion are more likely to enter self-employment from paid work (Caliendo et al., 2009).³⁰ A BIG could therefore encourage entry into self-employment through its effect on risk aversion of recipients. Lower risk aversion could affect opportunity-driven entrants and entrants attracted by the flexibility provided by self-employment who are concerned about income variability. Since the transfer would be received by individuals with low or no income, the impact on risk aversion could be substantial.

²⁸ Mark Zuckerberg, Harvard University commencement address, May 25, 2017.

<https://news.harvard.edu/gazette/story/2017/05/mark-zuckerbergs-speech-as-written-for-harvards-class-of-2017/>

²⁹ Working with data for Germany, Fossen (2012) finds that income variance is higher for the self-employed than for paid workers with similar characteristics. Wen and Gordon (2014) provide some recent Canadian evidence, but do not control for individual characteristics.

³⁰ The study examines how risk attitudes reported in 2004 affect the decision to enter self-employment in 2005. Studies that compare risk aversion of individuals already in self-employment with individuals in paid work are subject to the criticism that self-employment experience makes people more willing to take risks. Note that risk aversion is not found to play a role in transitions from unemployment or inactivity to self-employment.

The lower disposable income of payors, who are potential opportunity entrants, will increase risk aversion, which would reduce their propensity to enter self-employment. However, the impact is likely to be small since the percentage change in income will be small.

The propensity to choose self-employment over paid work is also influenced by income taxes. However, as discussed extensively in the literature, their impact is theoretically ambiguous. Self-employment offers opportunities to underreport income and to make some personal expenditures tax deductible. The value of these opportunities increases with average and marginal tax rates, so it is common to posit that higher tax rates will increase entry into self-employment. Further, a progressive tax system could increase entry by more risk-averse individuals since the government is implicitly sharing some of the risk.³¹ In contrast, as discussed earlier, high marginal tax rates, or more generally the overall progressivity of the tax system, could have a negative impact on entry by increasing the effective tax rate on fluctuating incomes. Tax progressivity could also reduce entry by individuals expecting to earn substantially more in self-employment than in paid work by “taxing success.”

While the empirical literature does not resolve the theoretical ambiguities (Box 2), it would be reasonable to conclude that the higher tax rates required to finance the BIG would reduce the propensity of the payors of the transfer to become self-employed by increasing tax progressivity. The propensity to enter self-employment by recipients of the BIG experiencing a partial clawback of benefits would also decline.

Summary

The impacts of a generic BIG on labour supply and the composition of employment are summarized in Table 6. The main conclusions are:

- The impact of a BIG on overall labour supply is theoretically ambiguous but is likely to be negative.
- Considering both labour supply and compositional effects, it would be reasonable to conclude that the partial effect of a BIG would be to reduce the level of necessity-driven entry into self-employment. The combined impact of income and substitution effects is negative for this group and is likely to be strong enough to offset the positive impact from lower risk aversion that affects a subset of necessity entrants.
- Low-income opportunity-driven self-employment is affected on the intensive and extensive margins by the higher tax rates experienced in the clawback zone. But these impacts on effort and entry affect only a fraction of the opportunity-driven self-employed; in contrast, lower risk aversion affects entry by all individuals in this category. An increase in the level of low-income opportunity-driven self-employment is therefore the most likely outcome.

³¹ The insurance argument also applies to individuals expecting to suffer losses in the start-up phase of their business. By remaining unincorporated while the business is unprofitable, the self-employed can deduct losses from other income, which reduces the after-tax cost of the losses and increases the return to an ultimately successful business.

- High-income opportunity-driven self-employment will be pushed in opposite directions by the income and substitution effects; the net effect on effort is likely to be small. The choice between self-employment and paid work will be negatively affected by higher marginal tax rates and to a lesser extent, higher risk aversion. The overall impact is likely to be negative, so the overall impact of a BIG on opportunity-driven entry could be positive or negative.

Table 6

Impact of a Generic Basic Income Guarantee on Labour Supply and the Composition of Employment

	Self-Employed		Paid workers	Overall
	Necessity entrants	Opportunity entrants		
Recipients				
Income effect	—	0	—	—
Substitution effect	0	– in clawback zone	– in clawback zone	–
Overall	–	–	–	–
Composition effects				
Risk aversion	+	+	–	0
Higher marginal tax rates	n/a	– in clawback zone	+ in clawback zone	0
Payors				
Income effect	n/a	+	+	+
Substitution effect	n/a	–	–	–
Overall	n/a	?	?	?
Composition effects				
Risk aversion	n/a	–	+	0
Higher marginal tax rates	n/a	–	+	0

Conclusion

This paper has reviewed whether self-employment raises any special issues for B.C.'s poverty reduction strategy. The main findings are as follows:

1. The incidence of low income is higher in self-employment than in paid work. Women and immigrants are overrepresented in the low income pool of the self-employed, suggesting that more emphasis be given to programs that encourage flexible work arrangements, reduce dependant care costs, and promote language skills.
2. The self-employed do not appear to be as well served as paid workers by active labour market policies. The absence of income averaging when calculating tax liabilities also puts the self-employed at a disadvantage.

3. The following policies should be reviewed to ensure that they are not creating unnecessary barriers to enter self-employment:
 - procedures for starting a business and reporting on its activities
 - asset exemptions in the case of personal bankruptcy
 - resolution of legal disputes
 - occupational education and training requirements
4. The planned increases in the minimum wage are large enough to raise concerns that they will harm rather than help efforts to reduce poverty. Even in the best of circumstances, there may be downward pressure on the income of necessity-driven entrants into self-employment.

This paper has also reviewed how a Basic Income Guarantee (BIG) would affect self-employment. Implementation of a BIG is likely to result, all else being equal, in a lower level of necessity-driven self-employment, a higher level of low-income opportunity-driven self-employment, and a reduction in high-income opportunity-driven self-employment. The net impact on opportunity self-employment is likely to be small, but it could be negative or positive. Implementing a BIG is therefore unlikely to make a substantial contribution to preparing for a new or emerging economy by encouraging entrepreneurship.

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Appendix A: Concealment of self-employment income

As discussed earlier, the self-employed can underreport income and claim deductions for business expenses that also contribute to consumption enjoyment, which increases the relative return to self-employment.³² There are a substantial number of empirical estimates of the degree of income concealment by the self-employed. The standard approach, pioneered by Pissarides and Weber (1989), involves, loosely speaking, estimating the relationship between income and expenditure on food of paid workers and using that relationship to determine the income of the self-employed given their reported expenditures on food. In the absence of a panel dataset, Pissarides and Weber use instrumental variables to account for transitory income shocks.³³

Schuetze (2002) applies the Pissarides and Weber model using six years of pooled data from 1969 to 1992 on food expenditures and reported after-tax income. He finds that the self-employed in Canada, defined as those with at least 30% of total income from self-employment, concealed between 11% and 23% of total household income on average. (Concealment includes both underreporting of income and overstatement of expenses and deductions.) Hurst et al. (2014) apply the same approach using both pooled yearly observations and successive three-year panels on reported income and expenditures. Using the yearly data, educational attainment dummies are used to instrument for transitory income; using the panel data, permanent income is defined as a three-year average of reported income. Using either approach, Hurst et al. find that the U.S. self-employed underreport their household income by about 30%.

Engström and Hagen (2017) assess how using an explicit measure of permanent income affects estimates of underreporting of self-employment income. The dependent variable in their regression equation is pooled survey data on food expenditures over the 2003 to 2009 period. However, the authors can link income tax records for the 2000 to 2012 period to everyone in the expenditure survey, which allows them to calculate permanent income using various averaging periods. Engström and Hagen report that the degree of underreporting³⁴ declines steadily as current income is replaced with longer averages of income. Using the maximum averaging period possible in their data (three lags and three leads), the estimate of underreporting falls almost a third to 21.8% from 32%. This result suggests that the underreporting estimate found by Hurst et al. is overstated because of the short averaging period used to define permanent income.

Engström and Hagen also compare estimates obtained using current income and instruments to account for transitory income with estimates obtained using an explicit measure of permanent income. Instruments developed from educational attainment of the household

³² This benefit is partially offset by the upward pressure on average tax rates arising from income variability.

³³ The higher variance in self-employment income implies that transitory income shocks will be more important for the self-employed than for paid workers. Pissarides and Weber (1989) account for this impact by adjusting the estimate of underreporting by the relative income variance of the two income types.

³⁴ Given that after-tax income is used as an explanatory variable, they are capturing overstatement of deductions as well as underreporting of income.

head, housing, and capital income are tested. Underreporting estimates based on education and housing instruments are lower than when permanent income is used, while a higher estimate is obtained using the capital income instrument. In a regression including both permanent income and the instruments, the coefficient on capital income is insignificant, leading Engström and Hagen to conclude that it is the best available instrument for permanent income. If these results apply to Canada as well as to Sweden, Schuetze's estimates would be understated since he uses education and housing as instruments to account for transitory income.

Appendix B: Federal Active Labour Market Programs

Annex C -- Federal Active Labour Market Programs				
	Target Clients	Employment Type Supported	Services	Funding 2019-20 (\$Millions)
Labour Market Development Agreements	EI recipients, except for employment assistance which is not targeted.	Both	Skills development, wage subsidies, counseling and job search.	2200
Canada Workers' Benefit	Low-income workers	Both	Wage subsidies	2100
Workforce Development Agreements	Unemployed without access to EI; underemployed and/or seeking skills training; disadvantaged groups.	Both	Skills development; work experience and employment readiness programs.	872
Youth Employment and Skills Strategy	persons aged 15-30	Paid Work		474.9
Skills Link	Disadvantaged groups		Skills development	
Career Focus	Post-secondary graduates		Employment, labour market information	
Summer Work Experience	Secondary and post-secondary students		Temporary employment	
Indigenous skills and employment training	Indigenous peoples	Paid Work	Skills development	300.6
Apprenticeship grants	Not targeted	Paid Work	Skills development	112.8
Apprenticeship Job Creation Tax Credit	Employers	Paid Work	Skills development	97.0
Skills and partnership fund	Indigenous peoples	Paid Work	Training-to-employment	50.0
Future skills	Disadvantaged groups	Both	Labour market information	47.7
Western Canada Business Services Network				
Community Futures	Individuals, business owners; community development agencies	SE	Economic planning, advisory services to business, access to capital, self-employment assistance programs	28.2
Women's Enterprise Initiative	Females	SE	Access to capital, training, business advisory services	3.9
Francophone Economic Development Organization	Francophone individuals and business organizations	SE	Access to capital, training, business advisory services	2.2
Entrepreneurs with disabilities	Persons with disabilities	SE	Training, business advisory services	1.5
Indigenous Business Development Services	Indigenous entrepreneurs and business organizations			0.7
Opportunities Fund	Persons with disabilities	Both	Training, wage subsidy, adaptive equipment	38.8
Union Training and Innovation	Disadvantaged groups	Paid Work	Training	35.5
Canada Service Corp	persons aged 15-30	N/A	Volunteer	30
Foreign credential recognition	Immigrants	Both	Funding and work experience	21.4
Literacy and essential skills	Disadvantaged groups	Both	Skills development	18.0
Skilled Trades Awareness and Readiness	Not targeted	Both	Information, training, employment	9.3
Sectoral initiatives	Not targeted	Paid Work	Labour market information	5.7
Student work placement	Post-secondary students in STEM and business	Paid Work	Wage subsidies	2.7
Federal internship program for newcomers	Immigrants	Paid Work	Employment	n.a.
Language classes	Immigrants	Both	Language training	n.a.
Total funding				6452.9
Supporting paid work only				1079.2
Supporting self employment only				35.8

Appendix C: Provincial Bankruptcy Property and Income Exemptions

Provincial Personal Bankruptcy Regulations in Canada -- Non-farm Property Exemptions (Amounts are in Dollars)										
	British Columbia	Alberta	Saskatchewan	Manitoba	Ontario	Québec	New Brunswick	Prince Edward Island	Nova Scotia	Newfoundland & Labrador
Home equity	12,000 ¹	40,000	32,000	2,500	0 ²	10,000	0	0	0	10,000
Household furnishings and goods	4,000	4,000	4,500	4,500	11,300 ³	6,000	5,000	2,000 ³	6,500	4,000
Car equity	5,000	5,000	one income-earning	3,000	5,650	Unlimited	6,500	6500 ⁴	3,000 ⁵	2,000
Clothing	All essential	4,000	Unlimited	All essential	5,650	Unlimited	Unlimited	Unlimited	All essential	4,000
Vocational tools	10,000	10,000	4,500	7,500	11,300	Unlimited	6,500	2,000	1,000	10,000
Food and fuel	None	12 months' supply of food	None	6 months' supply	Included in household furnishings	Unlimited	3 months' supply	Included in household furnishings	Unlimited	12 months' supply
Retirement Plans ⁶	All	All	All retirement plans; some life insurance policies	Locked-in pension plans; certain life insurance policies	Most pension plans, life insurance policies and certain RRSPs	Employer sponsored pension plans	All	RRSPs	RRSPs, RRIFs, DPSPs	Certain pension plans
1. \$9,000 outside of greater Vancouver and Victoria										
2. Exemption for home equity less than \$10,000										
3. Includes food and fuel exemption										
4. Available if required for work										
5. \$6,500 if required for work										
6. Contributions to RRSPs in 12 months preceding bankruptcy are not protected.										
Sources: Bankruptcy Canada.ca (https://www.bankruptcy-canada.ca/bankruptcy-exemptions-canada/); Earl Sands, Licensed Insolvency Trustee. http://www.nsbankruptcy.com/ ; provincial legislation.										