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Caledon Institute of Social Policy

The Payback Budget of 2000

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Managing the Budget

The challenge

The year 2000 Budget marks a milestone in more ways than being the first budget of a new millennium: It is the first time in 25 years that Ottawa could honestly say it faces a string of surpluses.

The challenge facing Ottawa is what to do with the surpluses. Of course, it is better to be facing surplus than deficit, but this does not necessarily make political choices any easier. Indeed, it probably makes political choices more difficult, since expectations have been raised.

The Budget

For 2000-01, the Budget has allocated $2 billion to new spending initiatives and $3.6 billion to tax changes. The tax measures include $475 billion for the Canada Child Tax Benefit, which Ottawa counts as a tax reduction. But if we include the Canada Child Tax Benefit under spending, the ‘balance’ is about 45 percent for spending and 55 percent for tax cuts. For 2001-02, the ‘balance’ is about 41 percent for spending and 59 percent for tax cuts.

What is not captured in the above calculations is the relative importance of debt repayments. The 2000 Budget foresees a surplus of $4 billion and $5 billion in the years 2000-01 and 2001-02, respectively, most of which could go to debt repayment. Moreover, these are almost certainly underestimates, as they assume no reduction in debt and only modest economic growth. Were we to extend the forecast out another few years, the budget surpluses would keep growing, as shown in *The 1999 Economic and Fiscal Update*. Including these surpluses, the ‘balance’ looks a little different:

Initiatives in 2000 Budget	2000-1 %	2001-2 %
Tax changes (excluding child benefit)	32	40
Spending (including child benefit)	26	27
Surplus (most to debt repayment)	42	33

Our take

We discuss the prioritization between spending and tax cuts in the sections below, but what about the balance between debt repayment and the total of new initiatives? Some of the annual surpluses likely will be spent at the end of the fiscal year in areas such as one-time transfers to the provinces and capital injections to federal government departments, as has been done in the last few budgets – essentially any program that can benefit from a once-only expenditure and save money from being spent the next fiscal year. But at least $3 billion of the surplus each year is set aside as 'contingency reserve' and almost certainly will be devoted to paying down the debt.

'Paying down the debt' is a phrase that no doubt conjures up warm and fuzzy images for most Canadians. No doubt we are swimming against the tide in asking this question, but is paying down the debt the best way to spend the acknowledged $6 billion surplus and probably much more? To arrive at a rational decision, we should ask: "What is the highest rate of return on the $6 billion? How can Canada get the most out of this $6 billion and the billions to follow in future years?"

We can calculate exactly what paying down the debt will accomplish. With a net public debt of $576.8 billion and a Gross Domestic Product (GDP) of $998 billion, our debt burden, measured as a percentage of GDP, is 57.8 percent. Reducing debt by $1 billion reduces the debt burden to 57.7 percent – by just one-tenth of one percentage point.

Nor is there any mystery to the longer-term payoff: With a compound interest rate of about 7 percent (equal to the interest we pay on public debt), in five years' time a $1 billion payoff will be worth $1.4 billion, lightening the debt burden by .14 percentage points from what it otherwise would be. To calculate the effect of paying down $3 billion a year, just multiply by three. In other words, $3 billion paid this year will result in Canada's debt burden being .42 of one percentage point lower five years from now.

In short, paying down the debt is a very slow way to reduce the debt burden.

So how does debt burden get reduced? The answer is economic growth. One percentage point growth in GDP results in a decrease in debt burden of .57 percentage points, and such growth over five years results in 2.85 percentage points' reduction in debt burden. If we think about the effects of modest 5 percent per year nominal growth, the result is a very substantial reduction in debt burden by about 14 percentage points – without one cent of the debt itself being paid off.

Given this unassailable mathematical reality, we believe a clear-headed assessment is that there are much higher national priorities than paying down the debt. Three billion dollars a year could go a way towards an excellent system of child care and parent resource centres throughout Canada - and still have enough left over to give every low- and middle-income family another few hundred dollars or more of additional Canada Child Tax Benefit. Which investment would make Canada a wealthier, healthier and more congenial place to live 20 years from now? A huge improvement in child well-being, with many children having immediate access to better living standards and more support for their parents? Or a few additional points' reduction in the debt burden - which will, in any case, be reduced much more substantially by economic growth?

The answer to this question is self-evident to us. If there were a reasoned list of priorities drawn up, showing alternative uses for $3 billion or more a year, debt repayment would be a very low priority indeed. For this reason, we believe there is more fiscal room yet in the Budget. As pleased as we are to see reindexation and the gradual improvement in social spending and other 'paybacks,' there could be much more, much quicker. A lot was accomplished in the 2000 Budget, as we discuss below, but a bolder attack on social ills is now where real prudence lies. We look to this government to deploy the same determination and courage in tackling Canada's social deficit as it did in taking on the fiscal deficit.

Personal Income Tax System

The challenge

The average Canadian family's federal and provincial income taxes rose from $8,778 or 15.5 percent of income in 1980 to $11,541 or 20.2 percent of income in 1997 (measured in constant 1997 dollars). The rise in the income tax burden occurred mainly through:

1. the removal of full inflation protection from the income tax system in 1986 ('partial deindexation'), which has relentlessly inflated both federal and provincial income taxes each year
2. the removal of the federal income tax reduction for low- and middle-income taxpayers and the imposition of both general and high-income surtaxes
3. hikes in provincial income taxes, which only recently have begun to be rolled back
4. stagnation of market income (i.e., income from employment, savings and other non-governmental sources) and cuts to key government income programs (e.g., welfare and unemployment insurance), while income taxes have increased.

Through a combination of overt (federal surtaxes and abolition of tax reduction, provincial income tax hikes) and covert (partial deindexation) means, governments boosted income taxes to help defeat their deficits. Unfortunately, partial deindexation introduced a parade of distortions and inequities into the income tax system:

- ***stealth taxes*:** Most Canadians are unaware that partial deindexation – even in the current era of low inflation - has imposed years of invisible, automatic and steadily mounting federal and provincial income tax increases on them.
- ***the low inflation myth and the miracle of compound deindexation*:** Under the partial deindexation formula in place since 1986, tax brackets and credits have increased only by the amount of inflation over 3 percent a year; if inflation were 4 percent, for example, the

adjustment factor would be only 1 percentage point (i.e., 4 minus 3). When inflation is less than 3 percent, as it has been since 1992, the tax system is frozen; but this means that brackets and credits still lose value – by the amount of inflation (e.g., if inflation is 2 percent, they lose 2 percent). So partial deindexation matters even when inflation is low, all the more so since its impact compounds: Each year's cut builds on the sum of the previous years' cuts.

- ***'bracket creep'*****:** Tax brackets (i.e., the three broad bands of taxable income that are taxed at progressively higher rates) have declined in real terms each year, pushing about one in five taxpayers into higher brackets. In 1999, the second tax bracket (where the federal tax rate is 26 percent) began at taxable income of $29,590, but would have been an estimated $36,917 if the tax system had remained fully indexed. The top bracket of $59,180 (where the federal tax rate is 29 percent) would have been an estimated $73,834 if fully indexed. The basic personal amount, which effectively constitutes the first bracket (where the federal tax rate is 17 percent), was $7,044 in 1999 but would have been an estimated $8,055 if fully indexed.
- ***'credit corrosion'*****:** Nonrefundable tax credits and deductions also have lost value over the years, resulting in annual hidden inflation in federal and provincial income taxes for all taxpayers (due to erosion of the basic personal credit) and for large groups of taxpayers that benefit from a variety of tax-reducing credits and deductions (e.g., the spousal and equivalent-to-spouse credits, age credit, disability credit, pension income credit, education and tuition fees credits, child care expense deduction and RRSP deduction). Partial deindexation also has weakened the refundable GST credit and Canada Child Tax Benefit, resulting in additional federal income tax increases and child benefit losses.
- ***falling federal taxpaying threshold*****:** While the 1998 and 1999 Budgets partially restored the basic personal, spousal and equivalent-to-spousal credits, Canadians – especially single people – still begin to pay federal income tax at a very low level (for a single person under 65, $7,483 in 1999 as opposed to $10,650 in 1980, expressed in inflation-adjusted 1999 dollars).
- ***tax system pulls in working poor*****:** The OECD reckons that 1.4 working poor Canadians were pulled into the income tax system between 1988 and 1998. The 1998 and 1999 federal Budgets removed 600,000 low-income individuals from the federal tax rolls, but that still left 800,000 poor taxpayers (and the latter number would rise again if the tax system remained partially deindexed).
- ***only the poor pay more GST each year*****:** Low- and modest-income families and single people also are hit by erosion of the refundable GST credit's benefits and income threshold for maximum payments, which weakens their GST tax relief and targets such relief lower and lower down the income ladder each year.
- ***poor are hit hardest*****:** When we take into account partial deindexation's impact on the refundable GST credit as well as income taxes, lower-income taxpayers suffer the largest relative increase in their income tax and GST burden.
- ***waves of regressivity*****:** Taxpayers at the lower end of each of the three tax brackets bear the heaviest relative burden of inflation-induced income tax increases.
- ***high-income surtax cuts further down the income scale*****:** The 'temporary' surtax imposed on higher-income taxpayers between July 1985 and December 1986 was revived in 1989 and given a deeper bite; partial deindexation has gradually lowered the federal income tax threshold where the surtax takes effect.
- ***stealth taxes help pay for both federal and provincial income tax cuts*****:** More than half the cost of the federal tax reductions introduced in the 1998 and 1999 Budgets were paid for by stealth tax increases; the provinces also have been able to help pay for their recent and ongoing reductions in provincial income tax thanks to their deindexation windfall.
- ***phony tax cuts*****:** Tax 'cuts' are really nothing more than less-than-meets-the-eye partial compensation for years of accumulating tax increases stemming from partial deindexation.
- ***disappearing tax cuts:*** Tax 'cuts' are eroded by deindexation during and after their phase-in period.

The Budget

The 2000 Budget announces several major structural repairs and renovations to the personal income tax system. Far and away the most important change is the one least visible to taxpayers and politically easiest for Ottawa not to have made: reindexation of the personal income tax system.

Reindexation

Tax brackets and credits will be fully indexed effective January 1, 2000. Since the mid-1980s, they have been adjusted only by the amount of inflation over 3 percent; now they will be adjusted by the full amount of inflation. Tax credits include a variety of nonrefundable credits (e.g., the basic personal, spousal, equivalent-to-spouse, age, disability, caregiver, education and tuition fees, infirm dependant and medical expense credits) as well as refundable tax credits (i.e., the GST credit and medical expense supplement) and the Canada Child Tax Benefit. In addition, the income threshold where Old Age Security begins to be reduced for higher-income seniors ($53,215 in individual net income) also will be fully indexed.

Increase to basic personal credit, spousal credit and equivalent-to-spouse credit

In addition to being fully indexed, the basic personal amount will see modest increases to bring it to $8,000 by 2004, producing a federal tax credit worth $1,360 (as opposed to an estimated amount of $7,766 and resulting federal tax credit of $1,320 if just fully indexed). Adding in average provincial tax savings, the basic personal credit will reduce total income taxes by about $2,040 in 2004 - $60 or 3 percent more than if just fully indexed as of 2000.

The spousal credit also will enjoy a small real increase, reaching an amount of at least $6,800 by 2004, which translates into a federal tax credit (i.e., savings) of $1,156. If just fully indexed, the amount would reach $6,594 by 2004, for a federal tax credit of $1,121. Including average provincial income tax savings, the total federal-provincial tax credit from the spousal and equivalent-to-spouse amounts will come to a maximum $1,734 - $53 or 3 percent more than the $1,681 credit if just fully indexed as of 2000.

Increase to tax brackets

Not only will tax brackets be fully indexed, but they also will see real (i.e., above-inflation adjustment) increases. By 2004, the Budget promises to have raised the second tax bracket from the current $29,590 to at least $35,000 (full indexation alone would increase it to only about $32,223) and the top tax bracket from $59,180 to at least $70,000 (versus about $64,446 if just fully indexed as of 2000). The planned increases will add 8.6 percent to the value of the second and third tax bracket thresholds.

Reduction in middle tax rate

The middle tax rate will be lowered from 26 percent to 24 percent effective July 1, 2000 and will fall to 23 percent by 2004.

Removal of high-income surtax

The high-income surtax (levied at the rate of 5 percent of federal income tax above $12,500, which translates into income of about $65,000) will be phased out gradually within five years. As of July 1, 2000, it will apply above $18,500 in federal income tax (income of about $85,000); on January 1, 2001, the rate will fall from 5 to 4 percent. By 2004, it will be gone.

Improved tax assistance for persons with disabilities

The Budget improves several tax measures that benefit Canadians with disabilities and their families. These are discussed later in a separate section on changes related to disability.

Further investment in Canada Child Tax Benefit

The Budget announces further increases to the Canada Child Tax Benefit that will improve payments to non-poor as well as low-income families and extend the reach of the program higher up the income ladder, coming close to restoring universality. These changes are reviewed in the following section.

Our take

- In a recent series of reports (*No Taxation Without Indexation, How to Do a Children's Budget* <u>and</u> *a Tax Cut Budget in 2000, Will the 'Children's Budget' Include Kids with Disabilities*? and *Credit Corrosion),* the Caledon Institute proposed a number of reforms to the personal income tax system:
- reindex the personal income tax system (brackets, nonrefundable credits, deductions, the refundable GST credit) and the Canada Child Tax Benefit
- raise the second and third tax brackets (e.g., for 2000, from $29,590 to $32,000 and from $59,180 to $64,000, then phase in further increases over time)
- raise the basic personal credit and spousal and equivalent-to-spouse credits
- restore the refundable GST credit to at least its original value
- lower tax rates or insert a new tax bracket between the first (17 percent) and second (26 percent) tax brackets
- strengthen tax assistance for Canadians (adults and children) with disabilities
- raise the maximum Canada Child Tax Benefit to $2,500 per child and also improve benefits for non-poor families
- abolish (with a grandparenting clause) the spousal credit and apply the savings to the Canada

Child Tax Benefit

- convert the RRSP and Registered Pension Plan deductions to credits
- create a geared-to-income Canada Pension Plan contributions credit to provide fairer relief from regressive, rising CPP contributions.

The 2000 Budget goes a remarkable distance towards Caledon's proposals. The announced changes do more than simply augment and extend up the income scale the modest, targeted tax relief offered in the 1998 and 1999 Budgets. They also seek to address most of the key problems of the income tax system identified earlier - by putting a stop to partial deindexation and its evil twins, bracket creep and credit corrosion; by removing more poor people from the tax rolls, and keeping them off in future years; by lightening the federal and provincial income tax burden for all families and individuals, though for modest- and middle- income families with children most; and by improving tax assistance for persons with disabilities.

While the move to restore indexation has enormous importance, it should be noted that the Budget is not fully restoring tax brackets and credits to their original value. Most credits, such as the nonrefundable age and disability credits and the refundable GST credit, will be reindexed at their current levels, which have declined significantly over the years; there is no compensation for past losses.

The same holds for the income threshold for Old Age Security. Currently, benefits are reduced by 15 percent of net individual income above $53,215; this level will increase to $53,960 for 2000 as a result of full indexation. However, if the threshold had been fully indexed since its introduction in 1989, today it would be an estimated $65,383 - fully $11,423 more than its actual (newly reindexed) level for 2000.

Even the basic personal, spousal and spousal equivalent credits, which will see real (i.e., above-inflation) increases, still will not attain their original (1988) value. The basic personal amount is slated to rise to at least $8,000 by 2004, translating into a federal tax credit of $1,360. That still falls short of the estimated amount of $8,758 (worth a federal credit of $1,489) it would reach in 2004 had it been fully indexed all along. The Budget also announces more-than-inflation increases in the second and third tax bracket thresholds, but these will not lift them all the way back up to their original level. The second bracket will rise from $29,590 to at least $35,000 by 2004, but would be an estimated $40,209 ($5,208 more) if it had been fully indexed since 1988. The top bracket will rise from $59,180 to at least $70,000 by 2004, which is still a good $10,418 below its estimated level of $80,418 if partial deindexation never had existed.

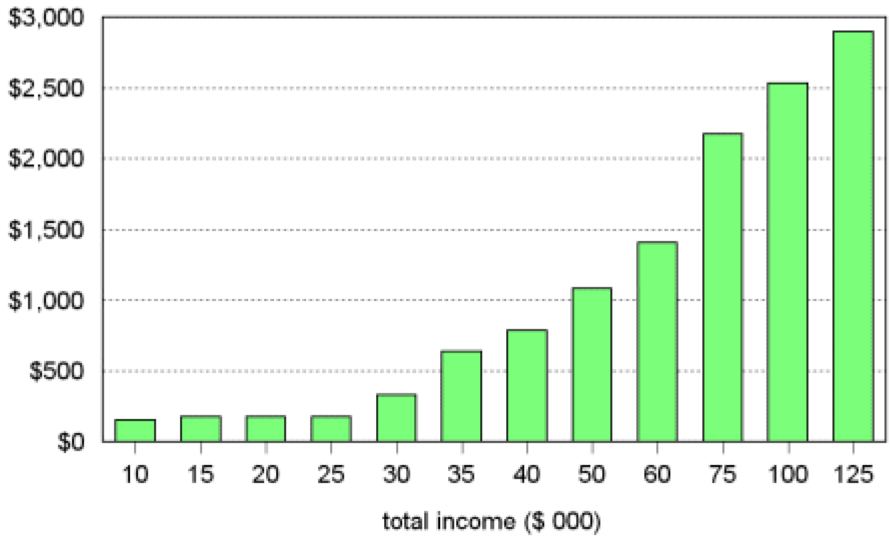
The 2000 Budget's tax relief is broad based, benefiting families with children, childless couples and individuals at all income levels. Even those too poor to pay tax will come out ahead: They no longer will risk being pulled into the tax system as a result of partial deindexation's effect of credit corrosion, which lowered the value of personal tax credits, the refundable GST credit and various provincial tax credits geared to the poor. Their income from the refundable GST credit, Canada Child Tax Benefit and provincial refundable credits will be secure from the insidious ravages of inflation.

While all Canadians will benefit, some will get more than others. But one's assessment of the impact of tax cuts, like beauty, lies very much in the eye of the beholder.

If we choose to focus on tax assistance as measured simply in dollars, then there is a pretty clear and obvious pattern of 'the more you make, the more you get.' This income-related relationship is most regular and consistent for taxpayers without children, who benefit from the various income tax changes but not, of course, the improvements in the Canada Child Tax Benefit.

For example, a single person under age 65 with income of $10,000 will come out ahead by $154 in 2004 as a result of the changes announced in the 2000 federal Budget. (Note that these estimates do not include reductions in provincial income tax.) As income increases, so does the amount of federal tax relief – e.g., $175 at $20,000, $329 at $30,000, $785 at $40,000, $1,085 at $50,000, $2,170 at $75,000, $2,532 at $100,000 and $2,895 at $125,000. Figure 1 illustrates the results.

Figure 1 Federal income tax cut, single person under 65, by income, 2004



data: Department of Finance Canada

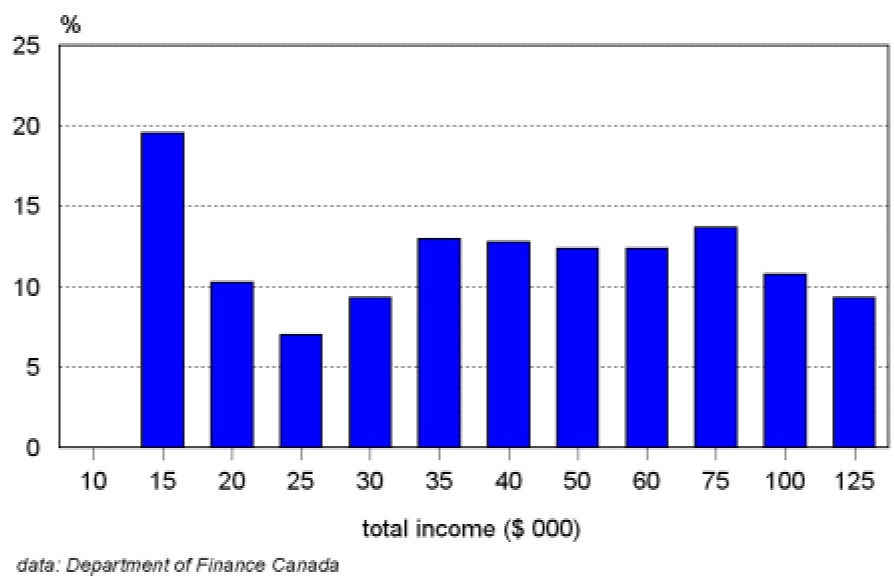
This 'the more you make, the more you get' pattern of tax cuts actually should come as no surprise, and indeed is rooted in the very progressivity of the income tax system. Higher-income taxpayers pay more income tax than middle-income taxpayers, and a lot more than lower-income taxpayers, and so will see the largest dollar savings from the tax measures announced in the 2000 Budget.

To take a simplified hypothetical example, suppose that every taxpayer received a 10 percent cut in federal income tax. The $10,000 single person's federal tax bill - $137 in 2004, before this Budget's changes - would be reduced by $14. The $30,000 taxpayer's $3,529 federal tax bill would go down by $353. The (relatively few) taxpayers with incomes of $125,000 would see their federal taxes decline by a hefty $3,109, from $31,089 to $27,980. Even if the tax cuts were designed so that lower-income taxpayers got a larger percentage reduction than higher-income taxpayers, the latter still would enjoy larger tax savings in strict dollar terms. For example, a 20 percent tax cut would amount to $27 for the $10,000 taxpayer, while a 5 percent reduction would lighten the $125,000 taxpayer's federal tax by $1,554.

It is true that the 2000 Budget includes a tax change targeted to upper-income taxpayers – the gradual elimination of the 5 percent high-income surtax, which only the well-off pay. But even without the end of the high-income surtax, affluent Canadians still would enjoy substantial income tax savings from the broad based tax changes shared with other taxpayers. For example, of the total $2,895 in federal tax relief for a $125,000 non-elderly single person in 2004, the largest part ($1,103) will result from the reduction in the middle tax rate (from 26 to 23 percent), followed by $852 from the increases in the second and third tax bracket thresholds, $785 from the abolition of the high-income surtax and $155 from the improvement in the basic personal and spousal credits.

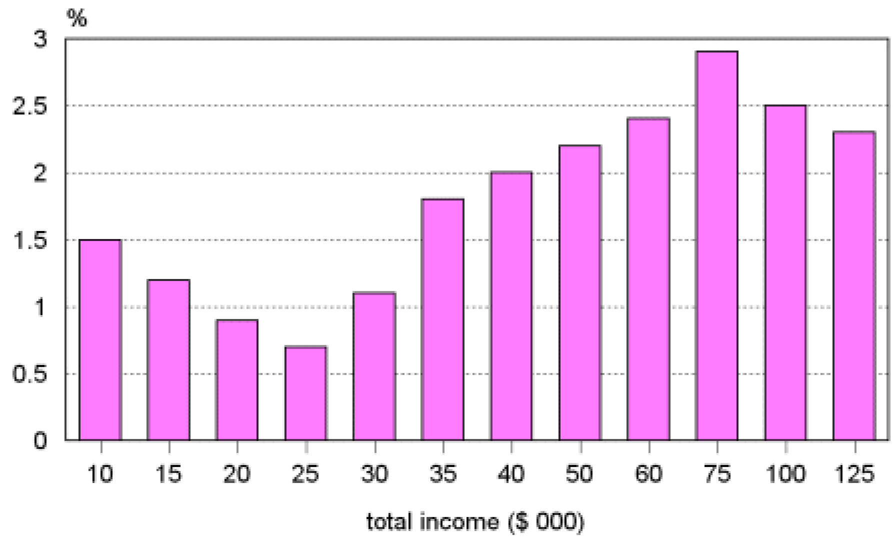
However, measured in relative terms, the 2000 Budget's tax cuts are not nearly so pro-affluent as the dollar amounts might suggest. Figure 2 gives the tax savings for single non-elderly taxpayers as a percentage of their federal income tax. The biggest reduction is for taxpayers with income of $15,000, who see a 19.5 percent drop in their federal income tax. Reductions for taxpayers in the $20,000-and-up range vary from a low of 7.0 percent for those at $25,000 to a high of 13.7 percent for those with income of $75,000. People at the top $125,000 level will see a 9.3 percent decline in federal income tax – less than most other income groups.

Figure 2 Federal income tax cut as % of federal tax, single person under 65, by income, 2004



Yet another relative measure – federal income tax savings as a percentage of income – presents a somewhat different picture that is somewhere between the absolute and percentage-of-tax approaches: somewhat regressive, though not as stark and regular as in absolute terms. Figure 3 pictures the results. Federal tax savings as a percentage of income decline from 1.5 percent for the $10,000 single earners to 0.7 percent by $25,000, but then rise again to a peak of 2.9 percent at $75,000, declining to 2.3 percent for those with income of $125,000. (No results are available for $10,000 individuals since they receive more in federal refundable credits than they pay in federal income tax.)

Figure 3 Federal income tax cut as % of income, single person under 65, by income, 2004



data: Department of Finance Canada, Caledon Institute of Social Policy

The results are similar for single elderly taxpayers and elderly couples. Their dollar amount of federal income tax savings rises with income. For single seniors, federal income tax reductions range from $229 for those in the $15,000-$25,000 group to $2,827 for those at $125,000. For elderly couples, federal tax savings go from $36 for those in the $15,000-$20,000 range to $2,900 for those at $125,000.

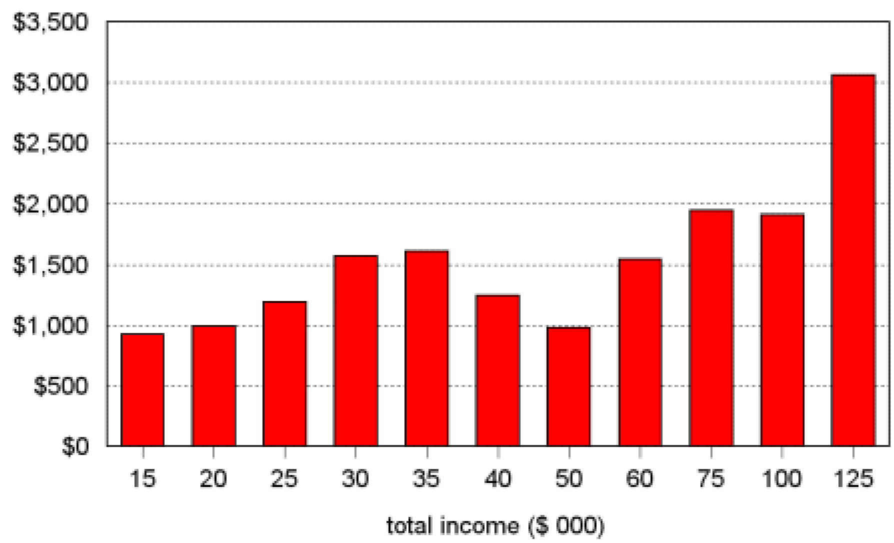
Measuring federal income tax savings as a percentage of federal tax, though, lower-income seniors fare best. Federal tax savings range from 84.2 percent for single seniors with income of $15,000 to 8.1 percent at $125,000. For senior couples, tax savings range from 45.2 percent at $30,000 to 8.9 percent at $125,000.

Measuring federal income tax savings relative to total income, tax savings for single seniors show no clear pattern – e.g., 1.5 percent at $15,000, 0.9 percent at $25,000, 2.2 percent at $40,000, 3.5 percent at $75,000 (the highest) and 2.3 percent at $125,000. The results for elderly couples go from 0.2 percent below $20,000 to a peak of 2.6 percent at $60,000, but are smaller for those with incomes in the $60,000-and-up range, declining to 2.3 percent at $125,000.

The picture is different for families with children because of the boost to the Canada Child Tax Benefit, which helps low- and modest-income families most in relative terms even though fully 9 in 10 families with children will see some improvement in their federal child benefit. For families with children, tax relief is apportioned in a progressive ‘the more you make, the less you get’ manner.

Figure 4 shows that net federal tax savings for two-earner couples with two children range from $924 for families with income of $15,000 to $3,059 for those at $125,000, with ups and downs for incomes in between. While the distribution of dollar savings is more or less regressive, it is far from perfectly so: Families between $30,000 and $35,000 see larger savings than those between $15,000 and $25,000, but also more than those from $40,000 to $60,000; tax savings increase for those at $75,000, decline a bit for those at $100,000 but then rise to peak at the $125,000 income level.

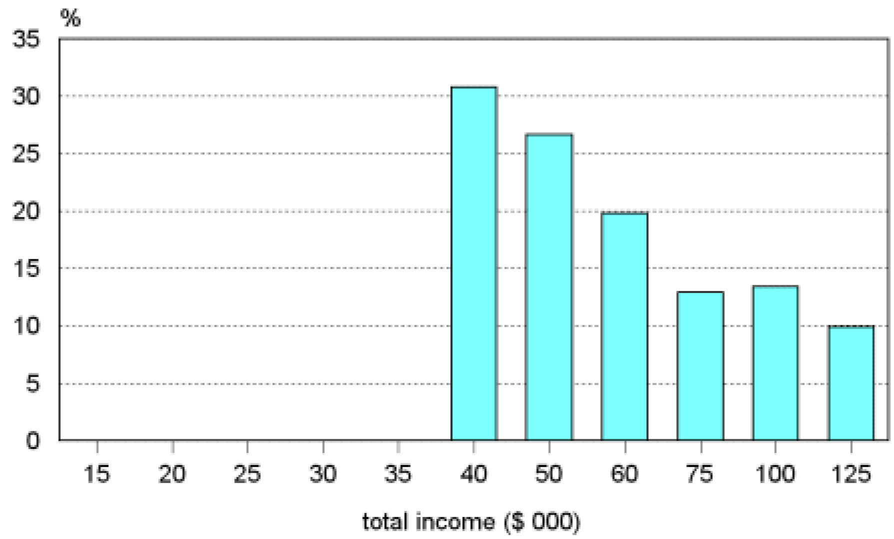
Figure 4 Federal income tax cut, two-earner couple with two children, by income, 2004



data: Department of Finance Canada

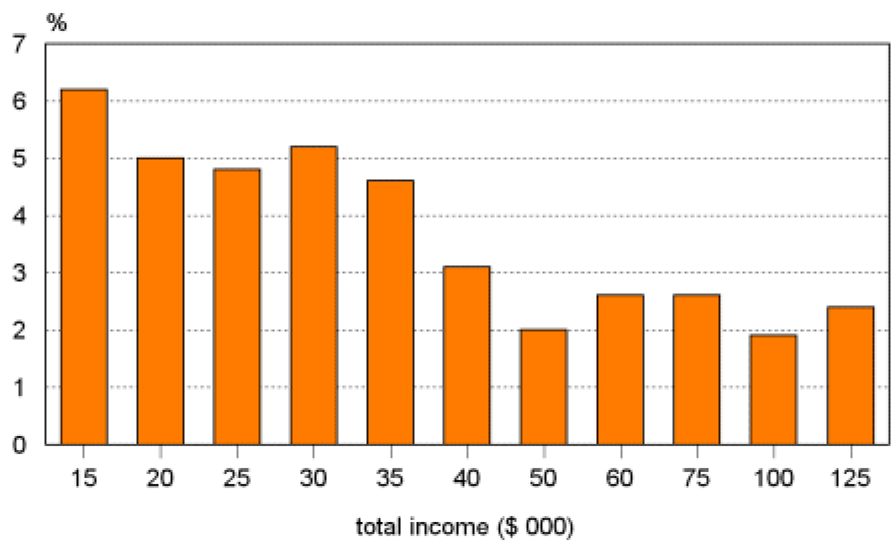
Gauged as a percentage of federal tax, though (see Figure 5), gains are highest at $40,000 and lowest at $125,000 (again, estimates for families under $40,000 are not possible because they get more from the Canada Child Tax Benefit and refundable GST credit than they pay in federal income tax). Measured as a percentage of income (see Figure 6), tax cuts are generally larger for those with low or modest incomes and smaller for those with middle or high incomes.

Figure 5 Federal income tax cut as % of federal tax, two-earner couple with two children, by income, 2004



data: Department of Finance Canada

Figure 6 Federal income tax cut as % of income, two-earner couple with two children, by income, 2004



data: Department of Finance Canada, Caledon Institute of Social Policy

The results are similar for single-parent families. Federal tax savings rise with income, but measured in relative terms – both as a percentage of federal tax and of income – are generally progressive.

The Budget estimates that families with children will average a 21 percent federal income tax cut in

2004 thanks to the 2000 Budget's changes, as opposed to the 15 percent average reduction for all Canadians. Adding to the mix the various tax relief measures implemented in the 1997 through 1999 federal Budgets, families with children will see a 30 percent cut in their federal income tax in 2004 versus 22 percent for all Canadians.

The importance of the surprise move to restore full indexation to the tax system and the Canada Child Tax Benefit cannot be overstated: Without this fundamental reform, the income tax cuts and child benefit improvements announced in the 2000 Budget would be built on a foundation of sand, as inflation each year reimposed hidden income tax hikes and child benefit losses. In effect, taxpayers and parents would have found themselves trying to go down an up escalator, as their taxes inexorably climbed because of credit corrosion and bracket creep.

Restoration of full indexation is a progressive tax reform. Though it will benefit Canadians at all income levels, reindexation is particularly important for low- and modest-income families and individuals. Not only will full indexation stem the decline in the federal taxpaying threshold, which has added increasing numbers of low-income people to the tax rolls, but it also solidifies income from the refundable GST credit, the Canada Child Tax Benefit and various provincial refundable tax credits.

The federal Budget of 2000's tax reforms also have an important provincial dimension. All provinces except Quebec base their income tax on the federal system, and so have profited from hidden tax increases imposed by partial deindexation. Quebec also does not fully index its tax system, so profits from tax hikes by stealth.

No longer. Now taxpayers will be protected from inflation-generated hikes in their provincial as well as federal income taxes because the former are based on the latter. In any case, Alberta announced it would restore full indexation of its provincial income tax system in its own Budget, released a few days before Ottawa's. Quebec, too, has decided to reindex its income tax system, though not for three years.

The significance of reindexation is reflected in its cost to the federal treasury. The 2000 Budget estimates the total federal cost of reindexation at $6.9 billion over the next three fiscal years (2000-01 through 2002-03), which amounts to 40 percent of the estimated $17.1 billion in total personal and corporate tax relief over that same period.

While we favour a more progressive tax system and do not subscribe to the campaign from some tax-cutters for much lower taxes for the rich, we recognize the reality that there are and should be income tax cuts in Canada, both at the provincial and federal levels. The tax cuts in the 2000 Budget are not perfectly progressive – a practically impossible task when implementing broad based tax reductions in a progressive income tax system – but they are the least regressive package of tax cuts any government in Canada has so far implemented, including all provincial governments. Two features of Ottawa's changes – the restoration of full indexation and the additional investment in the Canada Child Tax Benefit – are very progressive. The federal tax cuts are much fairer to low- and moderate-income Canadians – especially families with children – and less generous to the well-off than a straight percentage tax cut as was implemented by, for example, Ontario. The federal tax relief package certainly is far fairer than the 'flat' (one-rate-fits-all), non-progressive provincial income tax system now being touted in Alberta.

Child Benefits

The challenge

The federal government is attempting to juggle two balls in the air when it comes to reforming child benefits. First, it must continue to increase payments to low-income families with children. Second, it wants to begin to restore losses in child benefits suffered since the mid-1980s by the non-poor majority of Canadian families with children – particularly those in the modest- and middle-income range. The problem is that the less money Ottawa adds to the child benefits budget, the more these two worthy objectives must compete against each other.

As its part of the ongoing federal-provincial reform of child benefits known as the National Child Benefit, the federal government has been significantly increasing its spending on a redesigned Canada Child Tax Benefit. The provinces and territories, for their part, generally are reinvesting savings from welfare expenditures on behalf of children (which are being replaced by the increasing federal Canada Child Tax Benefit) on a range of programs and services for low-income families with children (e.g., child benefits, earnings supplements, child care, early childhood development, supplementary health care).

The key objective of the current phase of reform is to raise the Canada Child Tax Benefit to a level (about $2,500 per child) where it can replace the previous combination of federal and provincial child benefits that went to welfare families – thus creating a new, portable, non- stigmatizing child benefit paying equal amounts to all low-income families (including the working poor, which until recently got only about half the amount of child benefits received by welfare families). Although the geared-to-income Canada Child Tax Benefit continues to serve the large majority (8 in 10) of families with children, the lion's share of new spending has been devoted to improving benefits for low-income families. To date under the National Child Benefit, Ottawa has increased its child benefits budget by $2 billion or 40 percent; all but $300 million of this new money has gone to low-income families.

In order to focus most of the new spending on low-income families, the part of the Canada Child Tax Benefit that goes to the poor (known as the National Child Benefit Supplement) is rather steeply targeted. The 'reduction rate' (i.e., the percentage by which benefits are reduced for every additional dollar of income) as of July 2000 is slated to be 11.0 percent above $20,921 for one child, 20.1 percent for two children and 27.6 percent for larger families; the Supplement ends once net family income reaches $29,590. Some critics complain that this hefty reduction rate contributes to high effective marginal tax rates for working poor families (some say 'middle-income' families, which is wrong). (Effective marginal tax rates are the percentage of additional income that people pay in income and payroll taxes and give up as income-tested social benefits are reduced.)

While crucial, improvements to federal child benefits for low-income families have served to widen the gap between them and non-poor families. The latter have suffered significant erosion in their child benefits since the mid-1980s as a result of various changes (partial deindexation, conversion of the children's tax exemption to a nonrefundable credit and abolition of universal family allowances). As a result, one of the traditional objectives of child benefits - recognizing the additional expenses borne by Canadians who raise children, which put them at a financial disadvantage relative to childless people with the same income – increasingly has been weakened in recent years.

The 1999 Budget acknowledged this problem by spending $300 million to begin restoring benefits for modest- and middle-income families (by raising the net family income threshold above which the base Canada Child Tax Benefit is reduced from $25,921 to $29,590). However, the increase - about $95 per child per year- was modest indeed.

The problem is that increases to the base Canada Child Tax Benefit are costly. They raise payments to modest- and middle-income families, which account for the largest number of families with children. They extend the reach of the Canada Child Tax Benefit higher up the income scale (currently benefits end at net family income of $70,390 for families with one or two children, which can amount to $80,000 or more in terms of gross income), which also raises costs. While in an ideal world it would be nice to boost substantially benefits for non-poor families, especially those in the $30,000-$70,000 range, in the real world the resulting cost competes with the cost of raising benefits for low-income families. So Ottawa must perform a balancing act.

The Budget

The 2000 Budget announces increases in payments to all families that receive the Canada Child Tax Benefit, poor and non-poor alike. In addition, it will extend benefits so high up the income ladder that around 9 families in 10 will receive some payment - thus almost restoring the universality of child benefits (that had ended in 1991).

The five-year target is to increase the maximum Canada Child Tax Benefit, which goes to low-income families, from the current $1,975 per child per year for the first child to $2,400 by 2004, and the maximum $1,775 for each additional child to $2,200. A combination of changes will be made to achieve this goal, including full indexation of both benefits and income thresholds for maximum payments, above-inflation increases to both the base Canada Child Tax Benefit (which goes to low- and middle-income families) and the National Child Benefit Supplement (for low-income families), real (above- inflation) increases in the income thresholds above which the base benefit and Supplement are reduced, and lowering the rate at which the base benefit is reduced for each dollar of additional net family income.

Towards this target, several changes will be implemented in 2000 and 2001:

- both benefits and income thresholds for maximum payments of the base Canada Child Tax Benefit and the National Child Benefit Supplement will be fully indexed, as of January 2000.
- the base Canada Child Tax Benefit, which goes to low- and middle-income families, will see a modest increase ($70 per child per year, including indexation) on July 1, 2000, rising from its current (July 1999-July 2000) maximum amount of $1,020 to $1,090 per child.
- the income threshold where the base Canada Child Tax Benefit begins to be slowly reduced will climb from the $29,590 level announced in the 1999 Budget for July 2000 (i.e., the lower threshold for the old second tax bracket) in step with the planned increases (due to full indexation and above-inflation real increases) in the second tax bracket, to a projected $30,004 by July 1, 2000, $30,544 as of July 2001 and at least $37,000 by July 2004.
- by July 2001, the maximum amount of the National Child Benefit Supplement for low-income families will be increased by $200 (including indexation and the already planned $170 per child raise announced in last year's Budget) from its previously scheduled $985 to $1,155 for the first child, from $755 to $955 for the second child, and from $680 to $880 for the third and each additional child.
- the income threshold where the National Child Benefit Supplement for low-income families

ends, slated to reach $29,590 in July 2000, will rise as the second tax bracket increases (i.e., to at least $37,000 by 2004).
- total maximum benefits under the Canada Child Tax Benefit (i.e., from the base benefit and the National Child Benefit Supplement) will increase from the current (July 1999 - July 2000) $1,805 for the first child to $2,265 as of July 1, 2001 and from $1,605 to $2,067 for each additional child.

Our take

Caledon views the National Child Benefit as a crucial but temporary phase in the construction of a strong family income security system. The chief policy priority currently is to complete the reform of child benefits for low-income families by reaching the $2,500 per child target. A second aim is to begin restoring child benefits for non-poor families, concentrating on modest- and middle-income families first. Our ultimate aim is for a much larger (e.g., $4,000 per child) maximum payment to low-income families, with concomitant improvements for non-poor families.

Caledon has made three recommendations for immediate action:

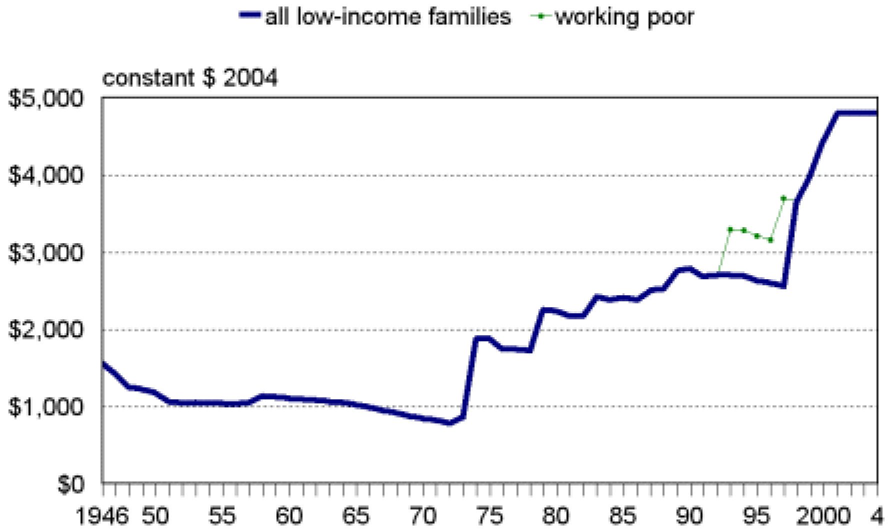
- raise the maximum Canada Child Tax Benefit to $2,500 per child, thereby equalizing child benefits for all low-income families and ensuring that poor families no longer will forfeit thousands of dollars of income from social assistance for children if they move from welfare to the workforce
- broaden the Canada Child Tax Benefit to restore and boost payments to modest- and middle-income families (e.g., through a $2,500 maximum benefit reduced by 10 percent for one child and 5 percent for two or more children above net family income of $25,000), thus delivering a *de facto* sizable federal tax cut and laying the foundation for an effective, broad based family income security system
- fully index all child benefit programs, federal and provincial

The 2000 Budget sails full square towards our twin aims of a $2,500 maximum Canada Child Tax Benefit and substantial restoration of benefits for non-poor families, most importantly those with modest or average incomes. By 2004, the maximum payment to low-income families – $2,400 for the first child and $2,200 for each additional child – comes very close to meeting our proposed $2,500 target, and easily could be reached if not exceeded. Non-poor families will enjoy substantially larger child benefits, in some instances doubling or tripling their payments, or even more.

The Budget's improvements to the Canada Child Tax Benefit will continue the vital process of federal investment and provincial reinvestment of welfare savings in other programs and services for low-income families with children. By 2004, Ottawa will spend $9 billion on the Canada Child Tax Benefit – $4 billion or 80 percent more than it did when the National Child Benefit reforms began. Translated into inflation-adjusted dollars, the 1997 expenditure amounts to $5.7 billion in 2004 dollars, so the real increase between 1997 and 2004 will amount to a still sizable $3.3 billion or 58 percent. Low-income families will receive about $6 billion or two-thirds of the $9 billion total spending in 2004, while non-poor families will get the other $3 billion or one-third.

Looked at over the long term, the improvement in federal child benefits for low-income families is striking. In 2001, the Canada Child Tax Benefit will pay triple what Family Allowances delivered in 1946, the first full year of that program – $4,800 versus $1,566. Figure 7 illustrates the trend for a family with two children.

Figure 7 Federal child benefits for two children ages 5 and 10, low-income families, 1946-2004



source: Caledon Institute of Social Policy

The announced changes will deliver larger absolute child benefit increases to middle-income and upper-middle-income families with net incomes in the $50,000-$80,000 range than to modest-income families between $35,000 and $45,000. However, when measured in relative terms, as a percentage of income, the increases are progressive (i.e., vary inversely with income). By increasing the base Canada Child Tax Benefit, raising the income threshold for maximum base payments and lowering the rate at which the base benefit is reduced, the Budget will have the effect of extending the reach of federal child benefits. Under the present system, eligibility for benefits ends at net family income of $70,390 for families with one or two children; this ‘disappearing point’ will rise to an estimated $88,795 by 2004 (which in gross income easily could exceed $100,000). The Canada Child Tax Benefit currently reaches 80 percent of families with children; coverage will rise to around 90 percent by 2004 under the changes set in motion by the 2000 Budget.

Universalists can rejoice (or at least smile) at the substantial progress in restoring a universal base to federal child benefits, which will become almost universal - and could be made virtually universal with a small additional cut in the reduction rate. Critics who complain about the significant weakening in recent years of the horizontal equity objective of child benefits for non-poor families (especially those in the higher income reaches) doubtless will be pleased at the sizable improvement in their benefits.

On the other hand, the increases for better-off families and the near-restoration of universality will be achieved at the expense of low- and modest-income families, which will see smaller-than-otherwise gains in their child benefits.

Our main complaint is the slow pace of reform. Granted, by 2004 Ottawa will have boosted its child benefits spending under the National Child Benefit by 58 percent in real terms. But the federal government could and should go faster - and, preferably, farther - on its child benefit investment. Canada's families – particularly those with low or modest incomes – need better child benefits now, so the faster the planned improvements can be put into force, the better.

Families stuck on welfare are being made to wait a very long time for improvements in their overall child benefits. While they doubtless will benefit from the increase in the base Canada Child Tax Benefit, which provinces are unlikely to claw back from social assistance, this gain is modest indeed ($70 per child per year). The sooner we reach the target of a $2,500 maximum per child under an integrated child benefit system that does away with welfare-delivered child benefits, the sooner we can devote additional resources to raise the maximum payment higher and thus deliver real increases to families on social assistance, not just the working poor.

Early Childhood Development

The challenge

The 2000 Budget boosts spending on the Canada Child Tax Benefit as part of the federal-provincial reform of income assistance for children known as the National Child Benefit. The federal government also is extending the duration and scope of paid parental leave benefits under Employment Insurance. The 2000 Budget features broad income tax relief to boost the disposable incomes of all taxpayers, including families with children.

But there is more to family policy than income security programs and the tax system. Families also need a wide range of supporting services - social, health, education and employment - to help parents balance their responsibilities at home and work, enhance their parenting capacity and assist them in dealing with problems that income alone cannot solve. Children can benefit from a head start on learning and development during their critical early years.

And the large majority of families, including those with preschool children, now have both parents in the workforce. Most single parents are employed as well. Child care is a prerequisite for employment in a modern economy. But child care is also one among a variety of early childhood development services that can have a powerful educational value.

The Budget

The 2000 Budget commits the federal government to convene a meeting with the provinces in order to explore possible collaborative efforts around early childhood development. They are to "reach an agreement by December 2000 on an action plan for early childhood development." But the Budget announcement came as no surprise. The September 1999 Speech from the Throne already had signalled Ottawa's intention to begin a dialogue with the provinces for this purpose.

Our take

The restatement of the federal government's intent to talk with provinces about early childhood development is nothing more than a tiny baby step. The announcement of a meeting commits Ottawa to nothing more than that – a meeting of bodies but not necessarily of minds. In the brave new world of the Social Union Framework Agreement, a meeting may be as far as the federal government can proceed on its own. Unfortunately, federal 'action' could stop at the 'talk' stage.

We hope instead that the 2000 Budget contains an implicit 'between-the-lines' promise that the federal government indeed is prepared to commit substantial funding (to be announced in next year's Budget) to build an early childhood development system throughout Canada. But it is not Ottawa and its money alone that will decide the fate of the National Children's Agenda: The provinces should seize the initiative - as they did with the National Child Benefit – and use the occasion of a federal-provincial meeting not as a baby step but as a first step towards a bold vision for a national system of early childhood development services.

In a recent report entitled *Ottawa Should Help Build a National Child Development Fund*, Caledon proposed that the federal government invest a total of $7.5 billion over five years towards early childhood development. A National Child Development Fund would support the establishment and expansion of early childhood development services and family supports. The creation of such a fund would respect the provisions of the Social Union Framework Agreement.

Under the Caledon proposal, the federal government would transfer the money to the provinces and territories, subject to general conditions paralleling those applied in medicare: comprehensiveness, universality, accessibility, quality and accountability. The system of early childhood development ideally would be built upon desirable practice guidelines, such as service integration, mixed delivery and community base.

Health

The challenge

The pressures on Canada's health care system continue unabated. These forces include the drastic and unplanned cuts in health spending made by several provinces, the rising demand for health services from a relatively affluent and aging population, and costly new diagnostic and procedural technologies. Cost pressures also stem from a health care system that is highly demand driven and largely institutionally based.

Provinces and territories are primarily responsible for delivering health care services. Ottawa provides health services only to designated populations, including First Nations communities on reserve and the military. However, the federal government does play a crucial funding role. It contributes to the cost of insured health care through cash transfers and tax points under the Canada Health and Social Transfer (CHST).

As part of its efforts to combat the deficit, Ottawa performed major surgery on its social transfer payments to the provinces when the CHST took effect in 1996. In 1999, the federal government injected $7.5 billion over three years back into health care to stem the massive hemorrhage of funds out of the transfer arrangement. It also invested in a wide range of health research and information initiatives, all of which enabled Ottawa to dub its 1999 health care announcements collectively as the 'Health Budget.'

The Budget

The 2000 Budget announces a one-time boost of $2.5 billion in cash transfers in respect of health care. These funds are available over a four-year period, but most provinces likely will withdraw the entire amount immediately rather than 'draw down' the money over time.

Our take

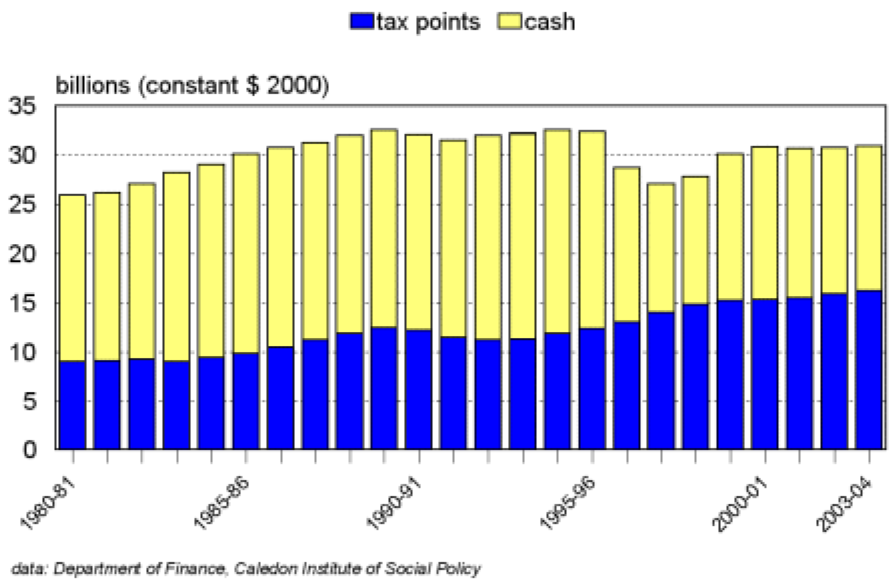
The infusion of new funds for health care is necessary, but buyer beware: The increase is worth less than its face value. A major fault line continues to shake the foundation of the CHST financing arrangement. Because the overall Canada Health and Social Transfer is not indexed, the cash portion is steadily eroding both in value and as a percentage of the total transfer.

There are two problems. There is a growing gap between the cash transfer, which is declining in real terms, and health costs, which are rising more than inflation. And federal clout to enforce the conditions of the Canada Health Act requires substantial real dollars: The cash portion of the transfer is real, but the tax points are theoretical when it comes to federal power to enforce the conditions of the Canada Health Act. Pay means say in health care.

The trends in federal transfer payments to the provinces for social and health programs are illustrated in Figures 8 through 10. (All dollar figures are expressed in constant 2000 dollars to show real changes.)

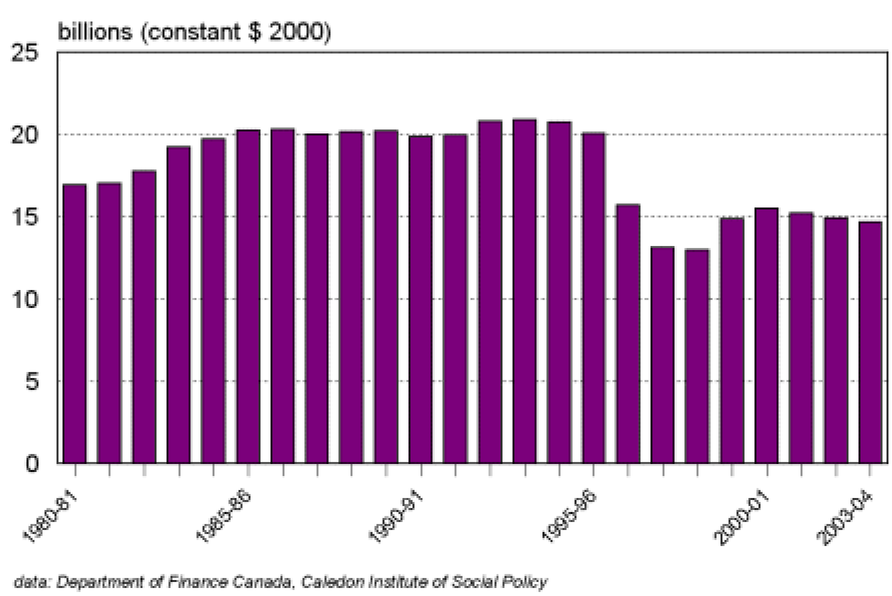
Figure 8 indicates that total federal transfers (in the form of tax points ceded to the provinces and cash) declined sharply with the introduction of the CHST in 1996 from $32.6 billion in 1994-95 to $27.1 billion in 1997-98, but then recovered somewhat and will reach a forecast $30.9 billion in 2003-04.

Figure 8 Total federal transfers to provinces for social and health programs, by tax points and cash, 1980/81-2003/04



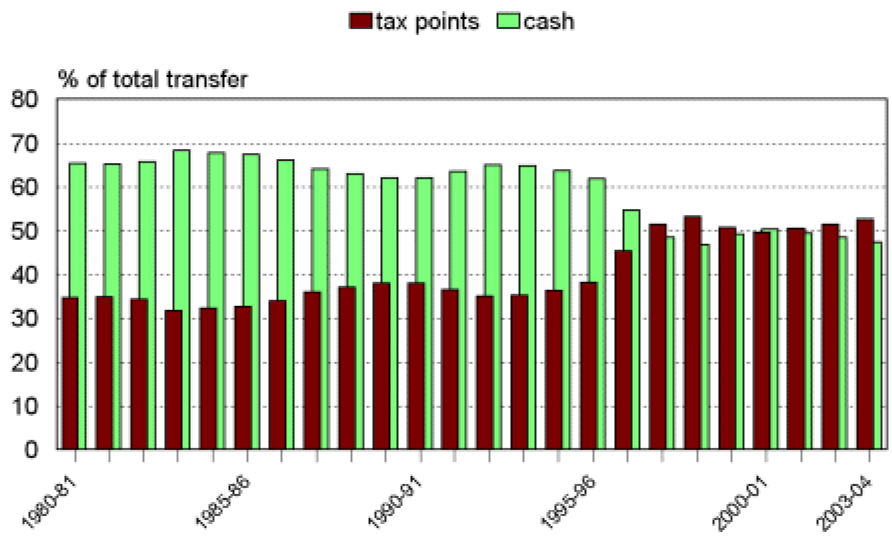
But when we focus on cash transfers - Ottawa's real source of leverage over provincial social and health spending - the picture is darker. Federal cash transfers fell from $20.7 billion in 1994-95 to $13.0 billion in 1998-99, will recover to $15.5 billion this fiscal year (2000-01) but will lose ground again and decline to a forecast $14.6 billion by 2003-04. See Figure 9.

Figure 9 Federal cash transfers to provinces for social and health programs, 1980/81-2003/04



As a result, cash transfers make up a shrinking share of total federal transfers to the provinces, declining from 68.2 percent in 1983-84 to a forecast 47.4 percent in 2003-04. Figure 10 plots the trend.

Figure 10 Share of federal transfers to provinces for social and health programs, tax points versus cash, 1980/81-2003/03



data: Department of Finance Canada, Caledon Institute of Social Policy

The previous Established Programs Financing legislation originally was designed not only to keep pace with inflation, but also to increase according to changes in both population and GDP. The CHST also should be indexed to population and GDP growth to better respond to the sizable cost increases experienced in the health care system. The *ad hoc* addition of federal money at the end of the fiscal year, which has been the hallmark of the last two federal budgets, is not a sound basis for financing the health care system. Steady and predictable funding is required. The federal and provincial governments need to negotiate a new formula for long-term federal support of health care.

But just pumping additional federal money into the provinces will not guarantee that more funding actually goes into health. Instead, provinces could take the additional federal cash and use it to offset expenditures they otherwise would have made. In effect, federal money simply could substitute for provincial financing, without accomplishing any net increase for health care financing. Those provinces that are cutting taxes and at the same time screaming for more federal funds look suspiciously as if they need Ottawa's money to pay for their tax cuts. This will do nothing for health care.

What is needed is an agreement which ensures that additional federal money goes directly to improve the health care system and not simply into provincial coffers. With more elderly and more medical intervention in the form of pharmaceuticals, the two areas of greatest need in our health care system are home care and access to drugs. A national home care program would help provinces shift from costly hospital and institutional care to less expensive home care, while providing portable benefits for Canadians wherever they live. A national drug plan would ensure that all Canadians, rich or poor, would have access to the drugs they need, and would put home care (where people pay for their own drugs) on a level playing field with institutional care (where drugs are paid for).

Canada lags behind other OECD countries with respect to our investment in public health care as a share of the public/private mix. The public share of financing for health care in Canada is 70 percent with 30 percent a private share. The OECD average is a 75/25 public/private financing split. As long as home care and drugs are not adequately covered, the private share of spending will increase since demand for home care and drugs will continue to rise more quickly than overall health care costs.

For this reason, we support the call for health care financing talks to start with Health Ministers. New federal funding for health care should be put on the table, but it should be in response to a *health* plan, not just a demand by provinces for more money. Let the provinces show Canadians their plan to improve health care, before Ottawa shows the provinces the money.

Disability

The challenge

On average, Canadians with disabilities have lower levels of education and higher rates of unemployment than other Canadians. Families with children with disabilities face inordinate stresses and financial costs for which they receive minimal assistance.

The Budget

The 2000 Budget announces several measures with respect to disability. It makes permanent the Opportunities Fund at $30 million a year. This fund supports a wide range of work-related measures for persons with disabilities, who typically do not qualify for benefits under Employment Insurance.

The Budget also introduces several changes to the disability tax credit. It will bring in a supplement of up to $500 to provide more assistance for the caregivers of children with severe disabilities. Eligibility for the disability tax credit will be broadened to include individuals with severe and prolonged disabilities who require extensive therapy on an ongoing basis. The unused portion of the disability credit can be transferred to a wider group of supporting relatives including siblings, aunts and uncles.

The child care expense deduction will rise from $7,000 to $10,000 for children eligible for the disability tax credit. The list of items eligible for the medical expense tax credit will be expanded to include the cost of modifications to new homes to assist individuals with severe mobility impairments.

Restoration of full indexation of the income tax system will preserve the (previously-declining) value of several disability-related tax breaks, including the disability credit, the medical expense credit, the caregiver credit, the infirm dependant credit and the child care expense deduction.

The 2000 Budget provides funding of $11.5 million over three years for the Health and Activity Limitation Survey (HALS). The survey will be carried out as part of the 2001 Census.

Our take

The announcement that the $30 million Opportunities Fund has been made permanent is a critical step. The fund helps support a wide range of employability measures for which there is no other financing available. Employment programs for persons with disabilities typically are not funded under the employment measures supported through Employment Insurance. Moreover, many persons with disabilities do not qualify for EI and its associated employment programs because of the program's tighter eligibility criteria.

The tax changes are consistent with the recommendations in the Caledon report *Will the 'Children's Budget' Include Kids with Disabilities?* The indexation of the tax system is a positive measure for all Canadians, including those with disabilities. For example, the disability tax credit had lost value over the years as a result of partial deindexation. The maximum disability amount was $4,233 in 1999, which produced a federal tax credit worth $720 and combined federal/average provincial tax savings of $1,080. Had the income tax system been fully indexed all along, the disability amount would have been $5,131, worth a federal tax credit of $872 and $1,308 in federal-average provincial tax savings in 1999 – $228 or 21 percent more. The Budget announcements will ensure that, from now on, the disability tax credit and all other tax credits and deductions will keep pace with inflation.

But the reindexation of the disability tax credit does not redress its other serious problems. The credit currently employs a definition of disability that is so restrictive as to keep out a significant population that should qualify for such assistance. The Budget does recognize some of the eligibility problems by adding a clause with respect to the requirement of extensive therapy on an ongoing basis. The intent of this provision is to ease eligibility for the credit – an important step not just for access to the credit itself: Eligibility for other tax provisions, such as the extended provisions of the child care expense deduction, is contingent upon qualifying for the disability tax credit.

The additional funds in recognition of the caregiving responsibilities of families with children with severe disabilities, as well as the expansion of the child care expense deduction for children who qualify for the disability credit, also are positive changes. They help recognize the added responsibility of parents with children with disabilities and the need for respite from their onerous caregiving responsibilities.

While the Budget steps are all welcome announcements, it is time to start thinking beyond relentless incrementalism for the future disability agenda. There is a need for major structural reform of services for persons with disabilities, including children. The federal and provincial governments already have a blueprint for such reform in the *In Unison* vision paper they jointly signed in 1998. It sets out a framework of clear objectives and policy directions around citizenship, personal supports, employment and income security.

There are two issues here. The first is to ensure that any developments with respect to the National Children's Agenda include the needs of children with disabilities. The second is to build a national system of community supports that not only promote independent living for persons with disabilities, but also tie in closely with essential health care reforms. The Caledon report *Home Care*: *More Than Care at Home* proposed a comprehensive model for the delivery of personal supports that would be linked to a new national home care initiative.

The Budget's announcement that the Health and Activity Limitation Survey (HALS) will be resurrected is important because it restores funding for essential data collection. While HALS was undertaken as a post-Censal survey in 1986 and 1991, it subsequently was eliminated in federal cost cutting. As a result, national information on persons with disabilities was not collected subsequent to the 1996 Census. This gap is unfortunate because the 1996 data would have reflected some of the impact of major cuts to health and social services made in the early and mid-1990s. Moreover, a third 'wave' of information would have formed the basis for compiling some trend data on the status of persons with disabilities. While the lack of 1996 data leaves a major gap in the overall picture, the restoration of funding at least will help get the crucial task of data collection back on track.

Right-of-Landing Fee

The challenge

Immigrants and refugees currently pay a right-of-landing fee – commonly known as a 'head tax' – when they come to Canada. Applicants for 'landing' are charged a processing fee of $500 per adult and $100 per child as well as a right-of-landing fee of $975 per adult. These levies create a heavy burden for people who typically come to Canada with few resources.

The Budget

On the heels of the 2000 Budget, the Minister of Immigration announced the government's intent to remove the right-of-landing fee from Convention refugees. These are persons who fall within the definition of the UN Convention relating to the Status of Refugees (1951) and the associated 1967 Protocol.

Our take

The removal of the right-of-landing fee from Convention refugees is a positive development. Canada is the only country in the world that levies such a fee on people seeking safety from persecution. Caledon published *The Price of Protection*, written by the Maytree Foundation, which recommended the removal of this 'head tax.' While we strongly support the government's announcement, it is essential to ensure that the removal of the fee applies to Convention refugees' families as well.

Employment Insurance

The challenge

Two dimensions of Employment Insurance are touched by this Budget: parental leave provisions and EI premiums.

Parental leave is part of the EI system intended to help parents take time off paid employment in respect of birth, adoption and parenting of newborns. The current measures allow a maximum 15 weeks' maternity leave and an additional 10 weeks' leave for either parent, for a combined total 25 weeks' leave.

The Budget also affects the financing of Employment Insurance. Ottawa knows it must continue to reduce EI premiums. There is a widening gap between the premiums collected for Employment Insurance and the income and employment benefits the program provides. EI premiums also could go down to help offset the sizable ongoing increase in Canada's other major payroll tax – Canada Pension Plan contributions – that will rise steadily and significantly until 2003 in the transition from the 'pay-as-you-go' to a 'partially-funded' financing arrangement intended to keep the important public pension plan fiscally and politically sound.

The Budget

The 2000 Budget doubles the maximum duration of combined maternity and parental leave benefits from the current six months to one year to allow parents more time at home with newborns and newly-adopted children. This measure already had been announced in the 1999 Speech from the Throne and is at least in part a response to Quebec's announced initiatives in this area. The specific Budget provisions refer to an extension of parental leave to a maximum 35 weeks for a total maximum 50-week leave for parenting. (The Budget refers to 'one year.' But because there is a two-week waiting period before EI benefits take effect, the actual time off is a maximum 50 weeks.)

On the financing side of EI, premiums have been declining steadily since 1994, falling from 3.07 percent of insurable earnings (4.30 percent for employers) that year to 2.40 percent of insurable earnings for employees in 2000 (3.36 percent for employers). In addition, the maximum annual earnings on which premiums are paid were reduced from $42,380 in 1995 to $39,000 in 1996, and have been frozen at that level ever since (which means a real decline in amount). As a result, maximum annual premiums have fallen significantly, from $1,245 in 1994 ($1,743 per worker for employers) to $936 ($1,310 for employers) in 2000 - cuts of $309 and $433, respectively.

By 2004, employee premiums are expected to fall to $2.00 per $100 of insurable earnings.

Our take

Parental leave is a core element of family-friendly workplace policy. The increase in combined maternity and parental leave provisions under Employment Insurance is crucial in helping families care for infants at home.

But there are some problems with these provisions. EI benefits pay only 55 percent of insurable earnings (as noted, the maximum level was reduced in 1996). While the maximum weekly EI benefit is $413, the actual average weekly maternity benefit is much lower – $280 in 1999. Many parents would not be able to live on that amount – especially if they are single parents and EI is their only source of income.

Another problem is that Employment Insurance does not cover the self-employed. The program thereby excludes a large and growing proportion of the Canadian workforce.

But the eligibility problem goes well beyond the self-employed. Most unemployed are no longer eligible for EI. And the eligibility requirements for maternity benefits are even more stringent than regular benefits. However, the 2000 Budget did make an important change by reducing the number of hours required to qualify for parental leave from 700 to 600 hours.

Ottawa would have been hard-pressed not to reduce Employment Insurance premiums. The EI Fund posted a $26 billion surplus in 1999. While the money is accounted for as a separate fund, it is included as general revenues within federal budgets. The problem is that the funds are not being used entirely for the purposes for which they were collected. Equally important, the majority of unemployed Canadians are not getting access to the income support and retraining programs for which they already have paid.

The problem can be traced to the shift from Unemployment Insurance to Employment Insurance in 1996. The new Act tightened up three key levers on the income side of the program: eligibility criteria, benefit levels and duration of benefits. Eligibility is now calculated on the basis of number of hours rather than number of weeks worked. The purported purpose of the change was to 'allow more flexibility' in the program and to enable more of the growing group of part-time workers to qualify for EI.

At the same time, however, the Act restricted eligibility by toughening the work requirement. To qualify for EI regular benefits, workers now must put in from 420 to 700 hours (the equivalent of 12 to 20 weeks), depending on the unemployment rate in the region. This measure represents an increase of between 180 and 300 hours over the former entrance requirement.

Claimants applying for sickness, maternity or parental benefits required 700 hours of work. The 2000 Budget made a significant change by reducing the number of hours required to qualify for parental leave from 700 to 600 hours. New entrants to the labour market and those who have been out of work for some time must establish a reasonable attachment to the workforce – a minimum 910 hours – to eligible for EI.

As a result of the stricter qualifying rules, EI coverage for unemployed workers has dropped dramatically. The percentage of unemployed workers covered by the program in 1997 was less than half its level in 1989 – falling from 74 percent to 36 percent of the unemployed. But drastically reduced coverage is not the only problem.

Most of the unemployed are not qualifying for EI and hence are not eligible for the work-related measures associated with the program. The long-term unemployed, the underemployed, new employees and part-time workers are finding it especially difficult to gain access to labour market measures that would help them improve their job prospects.

The EI Fund is clearly 'out of sync' with the cost of benefits it delivers. Ottawa has two choices: to lower premiums even more or to restore coverage of the unemployed. We prefer the second option because of the crucial role that this program has played in the past and should play in future as a source of income stabilization in uncertain labour markets. But earnings replacement is not EI's sole function: Its retraining measures also are fundamentally important in a world in which skill requirements are rapidly changing.

Housing

The challenge

Canada faces a crisis in affordable housing – particularly in major urban centres throughout the country. The picture is starkly clear, however we measure it.

There are thousands of people living on the streets, huddled in blankets on sewer grates. Shelters are full and turn away hundreds every week, including families with young children. Many Canadians may be fortunate to have a roof over their heads but are 'hanging' on month by month, skimping on food to pay rent.

There is another important indicator of need: the thousands of households on waiting lists for social housing. In Calgary and Edmonton, for example, there were 3,005 and 2,440 households, respectively, on waiting lists in 1998. At last count, 9,159 households were in line for affordable housing in Vancouver and 1,360 in Victoria. Montreal had 8,000 households on lists for social housing while the nation's capital counted a distressing 15,000. Toronto is truly at a critical level with a whopping 41,139 households requesting social housing.

Another indicator of housing need is that close to 2 million Canadian households spend half their gross income on housing. Among renter households, 1.2 million pay half or more of their income on housing. The housing crisis is not 'just' a problem of homelessness; low- and even modest-income working families are now being caught up in the dilemma – eat or pay the rent – that has long afflicted the poor on welfare.

The Budget

The 2000 Budget restates an announcement that Ottawa already had made in December 1999: a $753 million investment over three years to help alleviate and prevent homelessness.

The Budget also introduces a new infrastructure program that provides for sharing with municipalities and other partners the cost of roads, sewers, "green infrastructure" and affordable housing. The infrastructure program will spend $100 million in 2000-01, $350 million in 2001-02 and $550 million per year for the following four years. Once the total reaches $550 million per year, $400 million is intended for municipal infrastructure (including affordable housing), while the remainder will go for highways.

Our take

The federal government has put some desperately needed funds into tackling homelessness. Close to half – $305 million – of the total $753 million investment goes to the Supporting Communities Partnership Initiative that will work with governments and other partners to "provide flexible funding for local housing strategies." A total of $170 million over three years will be directed towards existing federal measures to fight homelessness, including the Urban Aboriginal Strategy and the Shelter Enhancement Initiative. The balance - $268 million over three years - is intended for the Residential Rehabilitation Assistance Program for the renovation and repair of existing housing. Again, though, none of this is new money: All had previously been announced.

The municipal infrastructure program, which includes funds for housing (if the municipalities choose to use it for that purpose) is the only 'new' money that the Budget commits. The problem is that affordable housing will have to compete with roads, sewers, "green infrastructure" and other 'physical hardware.' This new money will not go a long way when spread over so many competing demands and across hundreds of municipalities. The funds may or may not make their way into desperately needed affordable housing, but even if they do, the money is a drop in the bucket.

Both the already-announced homelessness money and the new housing money (if it goes towards housing at all) hardly compensate for the damage from the federal withdrawal in 1993 of support for affordable housing. The funding announced last December and in the 2000 Budget will barely scratch the surface of an effective response. As further compensation for a social housing stock left in shambles, the federal government could have taken far more bold steps than it did. Several possible measures are outlined in a forthcoming Caledon paper on housing.

One possibility is a nonprofit foundation endowed by the federal government, possibly using funds earned through the sale of mortgage insurance and mortgage-backed securities. The monies would be used to lever investments by other sectors for the construction of new social housing units.

Ottawa could expand even further its Residential Rehabilitation Assistance Program (RRAP) to extend the life of existing affordable housing. (RRAP provides renovation funding for rental units and rooming houses with rents affordable for low-income Canadians.) Tax changes could encourage investment in the construction of rental housing. The federal government could help promote private market choice by increasing funds for rent supplements provided by provinces.

As in the field of health, however, the constitutional responsibility for housing lies with the provinces. Ontario, Canada's largest province, has no housing policy at all; has seen virtually no rental construction in a half a decade; and, worst of all, seems totally unconcerned with the growing housing crisis in its midst. The federal government cannot just stand by and wash its hand of responsibility. Its withdrawal from affordable housing has contributed to the current situation. In fact, within a few years, the lack of affordable housing could become a true national crisis and a fundamental impediment to labour mobility and the economy, as well as a source of ongoing social malaise.

Ottawa should start providing leadership, developing a coherent vision, an effective strategy and a proposed financing plan for tackling the affordable housing problem. The Social Union Framework Agreement sets out the rules of the federal-provincial process that could be initiated to begin coming to grips with the housing crisis. If the provinces cannot agree, and some provinces continue to ignore the problem, it may be time for Ottawa to consider unilateral action using the tax instruments under its sole control.

Conclusion

The 2000 Budget surely will rank among Canada's most important. It restores stability to the income tax system and ensures that tax reductions and improvements in child benefits are real, not illusory. It signals the end of policy by stealth.

But the task of reform is far from over. Subsequent budgets must continue the vital task of social reconstruction following the successful war against the deficit. Medicare must be revitalized and protected, a national early childhood development system built, child benefits further expanded, welfare dismantled and rebuilt from the ground up, labour market programs made to work, the housing crisis tackled – and this is but a partial list of pressing social and economic problems.

None of these challenges can be tackled successfully by one level of government alone. They all require the same kind of close collaboration between the provincial and federal governments that is enabling fundamental reform of child benefits under the National Child Benefit. At the same time, though, they all require federal cash, commitment and concerted action.