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INSTITUTE OF  
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**Lessons for the Russian Federation from the  
Reform of Income Security Programs in Canada**

*by*

**Ken Battle and Sherri Torjman**

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## ***Purpose***

The purpose of this follow-up note to our long paper is to reflect upon the findings of the research carried out on income security in Russia and to link these findings to the lessons learned from recent and ongoing income security reform in Canada.

## ***A Note of Caution***

Although the Russian Federation and Canada share at least three defining characteristics – federal systems of government, long cold winters and a passion for hockey – they are unlike in many more ways. These differences include not only their traditions of social policy, but also the political and economic systems in which social programs operate. These profound differences must be clearly understood before we can suggest lessons to our Russian colleagues from Canada’s social policy experience.

Canada is a liberal parliamentary democracy, organized into a strongly decentralized federation of one central, ten provincial and three territorial governments, with a market economy. Government’s role *vis-à-vis* the economy is threefold: It makes fiscal and monetary policies; sets various regulatory frameworks for trade and commerce; and operates a comprehensive network of social programs that are closely connected to the economy in several ways.

Canada’s tax/transfer system plays a crucial redistributive role (both among individuals and provinces) by substantially reducing market income inequalities and establishing an income floor below which (in theory) no citizen is allowed to fall. Publicly funded core health and education systems provide services that are deemed too important for the market to operate on its own (the latter suffers from efficiency and equality limitations). However, in the case of health care, Canada actually has a mixed public/private system (with public financing of core services, but delivery by doctors largely in their roles as self-employed professionals, not public servants). At the same time, employers depend increasingly on social programs to furnish the crucial ‘social and intellectual’ infrastructure that nourishes economic growth and innovation and enhances a nation’s international competitiveness.

Yet Canada’s social programs, in turn, are dependent on, linked to and constrained by the market economy. They are financed through income, payroll and other taxes that are paid by employees and employers. The economy clearly affects social expenditures. It sets both fiscal and ideological limits on the generosity and design of social programs. During times of recession, rising expenditures for income programs (especially Employment Insurance and social assistance) contribute to government deficits and inevitably provoke calls from the corporate sector and the political

right to reduce spending. Canada's federal and provincial governments have just emerged from several years of both overt and covert cuts to major social programs, as well as tax increases, that were imposed to vanquish the deficit and curb the mounting debt.

The need to make social programs work hand in hand with the labour market is a currently fashionable but, in fact, enduring theme in Canadian social policy. Throughout our history, there has been concern about some social programs creating disincentives to work and attempts (the most recent being the National Child Benefit) to reform social programs so that they encourage rather than hinder labour force participation.

As noted in our initial paper, the founders of the Canadian welfare state did not envisage income security programs as a primary or permanent source of income for the non-elderly population: That should remain the role of employment earnings obtained from participation in the labour force. A full employment economy was posited as the essential foundation for an effective and sustainable social security system.

In practice, though, Canada never pursued a policy of full employment and experienced rising rates of unemployment in the decades after the Second World War. As a result, income programs became a more important source of income than the nation's social policy pioneers intended – a fact that critics from the right lament at every occasion. Nonetheless, employment remains Canadians' major source of income, and there are strong cultural norms favouring paid work and discouraging reliance on income programs.

All of this is to say that we must be cautious in offering lessons to Russia from Canadian social policy. The Russian Federation is going through one of the most rapid and profound political and economic transformations in world history. A strong social security system cannot be built on a weak or turbulent economic and political base. Income security programs cannot and should not be expected to make up for the lack of stable employment income for the substantial majority of the population. Reforming social programs to function effectively in and for the emerging political and economic system in the Russian Federation is an enormous challenge.

However, the problems discussed in the Russia paper are by no means unfamiliar to Canada – even if they appear to be much more daunting in Russia's case than Canada's – and in this respect at least Canadian experience can offer some instruction. Canada has been making significant structural changes to its income security system in recent years, as detailed in our paper, which in part attempt to deal with the same basic problems that the Russian Federation faces.

The key Canadian income security reform technique is 'broad based income testing' of child and elderly benefits that used to be delivered universally to all families and seniors, regardless of need. Although income support for the elderly is primarily a federal government responsibility,

until recently income support for children was divided between the federal and provincial levels. The current reform increases the federal financial commitment and seeks to shift the share of provincial spending from income benefits for children into a wide range of services, which are primarily a provincial responsibility.

Russia is attempting to simplify and rationalize its complex, categorical collection of income supports and services. It faces problems financing its social programs, with an imbalance between regions' responsibilities and their fiscal capacity. Its social benefits rarely take into account criteria of financial need, which exacerbates the financing problem.

## *Lessons from Canada*

### *i. Integration of Benefits*

The Russian Federation has an incredibly vast array of income benefits that vary by cause, region and delivery. The Russia paper notes that federal law mandates an astonishing 156 kinds of social benefits delivered to 236 different categories of the population. Few of these benefits systematically take into account need; most are paid to categories of the population.

Although Canada has a fairly complex income security system, in part because the federal, provincial/territorial and (in some cases) municipal governments each deliver benefits both through direct spending and through the tax system, it is far less unwieldy than Russia's. First, Canada has far fewer programs. The federal government operates only eight major income programs (Old Age Security, the Guaranteed Income Supplement and Spouse's Allowance for seniors; the Canada Pension Plan; Employment Insurance; the Canada Child Tax Benefit; veterans benefits and allowances, and social assistance for Aboriginal people on reserves) as well as a variety of tax expenditures that reduce federal and provincial income tax.

The provinces, territories and (in a few provinces) municipal governments operate social assistance. Quebec runs the Quebec Pension Plan, parallel to the Canada Pension Plan. Provinces and territories are responsible for Workers' Compensation programs and offer various income tax breaks, mainly in the form of refundable tax credits.

Some Canadian programs offer a package of income benefits within a single system. The Canada Pension Plan and Quebec Pension Plan provide not only retirement benefits, but also survivor, disability and death benefits. Employment Insurance offers unemployment, parental and sickness benefits. Workers' Compensation and veterans benefits combine income and health care services.

Moreover, Canada has integrated some of its income benefits in an effort to overcome conflicting designs; create simpler, more transparent programs; and reduce administrative overlap and duplication. The most notable example is the area of child benefits, which have seen two forms of integration.

First, three federal programs with different designs and objectives (Family Allowances, the refundable child tax credit and nonrefundable child tax credit) were integrated into a single broad based income-tested Child Tax Benefit. Eligibility and level of benefit are calculated on the basis of family income (maximum benefits to low-income families, diminishing benefits to most non-poor families).

Second, federal and provincial child income benefits are in the process of integration under the National Child Benefit, with federal increases triggering decreasing provincial child benefits delivered through their needs-tested social assistance systems and the development in most jurisdictions of income-tested child benefits and earnings supplements. Most of these benefits and supplements are delivered by the federal income tax system on behalf of the provinces and territories. Thus the integration of federal and provincial income programs for children involves both design and delivery elements.

But integration of social benefits is much easier to espouse than achieve. The federal government recently attempted to combine its three elderly benefits into a single, family income-tested broad based program (to be called the Seniors Benefit) analogous in design and philosophy to the Canada Child Tax Benefit. However, this proposal sparked criticism from both left and right – for different reasons – and the government abandoned the reform. Pension policy in Canada, as in the US and most other countries, is a politically explosive undertaking that must overcome strong, entrenched interests.

So also has the National Child Benefit provoked attacks from social groups complaining that some low-income families – those on social assistance – see no net increase in their child benefits, whereas others – the working poor – enjoy a significant real increase. This criticism is misleading – the whole point of this stage of reform is to raise working poor families up to the level of child benefits received by social assistance families. But it demonstrates that significant reforms of social programs typically raise issues about ‘winners and losers.’

Consolidation is never easy politically even though it appears logical from a program perspective and desirable from an administrative perspective. People may feel that they are losing something – despite the fact that the benefit which they received in past has been rolled into something new. They must be informed why and how the benefit is changing. Any consolidation should try to ensure that lower-income people are not worse off prior to any reform – that they are at least

the same, if not better off, financially – and that reductions, if deemed necessary for cost reasons, affect only higher-income people.

Much remains to be done in streamlining income benefits in Canada besides elderly benefits. There are several tax-delivered benefits (in the form of income tax reductions) for persons with disabilities or their families that are difficult to understand and access, and that have some qualifying linkages (i.e., to qualify for a certain benefit requires qualifying for another). Some progress has been made in recent years in improving these programs (in terms of increasing benefit levels, providing some refundable benefits to low-income people and widening eligibility), but the result has been even more programs and an even more unintelligible system.

## *ii. Determination of Eligibility*

Russia appears to rely to a great extent on a combination of needs testing and categorical demogrants (i.e., benefits go to all persons within a category not defined by level of income or other economic indicators of need) to determine eligibility. Canada also had such a mixture, but is in the process of moving to increasing use of income testing.

Needs testing is undesirable for several reasons: Social assistance, Canada's major remaining needs-tested income program, is a highly rules-and-regulations-bound system that is discretionary, costly to administer, highly intrusive in applicants' and recipients' lives and stigmatizing. Income testing, by contrast, is much simpler (eligibility for and amount of benefit is determined by a simple test of income), non-intrusive, inexpensive to administer and non-stigmatizing.

However, the latter approach requires a well-designed administrative mechanism. Ideally, the national tax system can be used for this purpose, as in Canada, since it can deliver as well as collect money within a single apparatus. But such an answer is likely not possible in Russia – because of fragmented income benefits and particularly in light of recent reforms which have regionalized the income tax system.

In the absence of a national tax system, it is possible to put in place a special-purpose delivery by having people fill in forms and apply for the program. But this approach is more costly to operate (because it requires building a new system) and typically brings problems of public awareness and take-up: Potentially eligible recipients fail to apply because they do not know of the program or do not want the hassle of dealing with government. The advantages of having the Canada Child Tax Benefit and other income-tested programs delivered through the income tax system is the fact that people are already reporting their incomes. Indeed, eligibility is determined automatically for them on the basis of their level of net income.

Income testing through the income tax system, as in Canada, requires virtually universal compliance with that system. Such is not the case in Russia. One of the weaknesses of tax-based income testing is that it can result in a considerable lag between the period for which income is calculated and the receipt of benefit. This ‘responsiveness’ problem becomes more serious if people suffer a large drop in income. They fall from middle income to low income and hence would qualify for the maximum level of income support – but have to wait some months before the system can respond to their changed circumstances.

Needs-tested systems, by contrast, are very responsive because they test income and other circumstances frequently, though at the cost of intrusiveness and stigma. How serious the responsiveness issue would be in Russia depends on the design of the program and the distribution and regularity of incomes. If most recipients have low, albeit irregular, incomes, then the responsiveness problem is not serious (they already would qualify for the maximum payment).

In Russia, some people may be reluctant to report their income to authorities and remain outside the income tax system or any other purpose-built income testing mechanism. People may be paid ‘under the table’ and it may be difficult to get a true sense of their actual economic situation.

For these reasons, Russia may prefer to maintain a needs-tested approach that includes a detailed assessment of assets and, perhaps, other indicators of need. But we know from our experience in Canada that needs testing is a costly, inefficient and stigmatizing route. Indeed, welfare is the most ‘despised,’ least desirable form of income security. There are also problems in counting assets as deemed income. Even though a household may have shelter, it still may not have sufficient cash to pay for food, utilities and clothing. The major advantage of needs testing is its ability to respond rapidly to changes in recipients’ circumstances, and to identify and ideally to help compensate for extraordinary costs associated with health- and disability-related conditions, and other special needs (e.g., funeral costs; special transportation).

By far, the simplest way to deliver income benefits is through demogrants, which pay (usually the same amount to) all people in a category (e.g., families with children, veterans, seniors) regardless of their income, assets or other economic characteristics. By the same token, though, universal programs are blunt instruments that fail to directly take account of economic need and do less to attack poverty than targeted programs. Canada abandoned two of its major demogrants, universal Old Age Security and Family Allowances, in the early 1990s in favour of income-tested systems.

In Russia, however, an income-tested approach likely would pay a similar (maximum) amount to a larger percentage of the population, simply because incomes are more concentrated at the low end. Depending on its design, then, an income-tested program in Russia might end up very

similar to a demogrant in distributional terms. Still, an explicitly income-tested approach can vary its benefits according to income level and thus can be targeted to need unlike a flat-rate demogrant (even one that is subject to income tax). This strength could become quite important to the extent that Russia's economy grows in such a way as to create a larger middle (and upper) class.

### *iii. Type of benefit*

The cost of any income security scheme that provides a non-trivial benefit is bound to be substantial, especially if it is a broad based income-tested program or demogrant. Canada's federal government spent a total of \$60.3 billion on its income security programs in 1998-99 (note that this figure excludes federal transfers to the provinces for their income programs, primarily needs-tested social assistance) which amounts to 49.5 percent of total federal program expenditures and 6.7 percent of Canada's GDP. The largest single expenditure was on elderly benefits (\$22.8 billion), which are increasing steadily in real terms because of the aging of the population.

For the same level of expenditure, a highly targeted (either income-tested or needs-tested) program can provide a larger maximum benefit, though of course to far fewer recipients – usually, only or mainly the poor. As noted above, Canada has been moving in the direction of broad based income-tested income security programs away from both demogrant and needs-tested benefits. However, the move from demogrant to income-tested programs has not been undertaken as a cost-saving exercise. The income test on Old Age Security affects only a tiny minority of upper-income seniors, while the Canada Child Tax Benefit not only serves the large majority of families, but also is significantly raising maximum benefits for the poor and modestly improving payments to the non-poor.

Several provincial governments provide earnings supplements for lower-income families with children, and earnings supplement experiments for single parents are under way in British Columbia and New Brunswick. As noted in the paper, both levels of government operate significant child benefit programs that help the large majority of working families and all non-working families. However, neither the federal nor provincial governments offer earnings supplements for the working poor generally (i.e., including single people and childless couples) mainly for two reasons: concerns about cost and about 'interfering' in the private wage market.

While the government of Russia might want to consider some form of earnings supplementation to top up earnings, similar concerns would hold as for Canada. We would suggest beginning with improving child benefits before launching large-scale earnings supplements for all lower-income workers (which in Russia's case likely would prove extremely costly given its high concen-

tration of low-wage workers). Moreover, earning supplements are predicated upon a well-functioning wage system; they are meant only to supplement low wages.

In Canada, the federal and provincial governments set minimum wages (the federal rate equals the rate applicable in each province) though they are not indexed to either prices or average wages and are relatively low. Again, however, this form of income security is predicated upon the existence of a well-functioning wage system and on its own cannot be expected to assure that paid work can adequately support all workers (especially those with dependants).

#### *iv. Jurisdiction*

One of the key lessons from income security reform in Canada is the crucial importance of interjurisdictional cooperation. Problems have arisen in the past (and continue to arise) from lack of coordination and the inability of the senior levels of government to agree to coordinated structural change in their interdependent income programs. The only serious attempt to institute a system of earnings supplements (in the mid-1970s) failed in part because of the inability of the federal and provincial governments to strike a deal. The current National Child Benefit is a rare and welcome example of – and, hopefully, model for – close cooperation between the central and provincial governments.

Reform of programs and redesign of benefits cannot succeed without considering the respective roles of the various levels of government. If programs are not structurally integrated, at least there might be improved coordination between levels of government (e.g., sharing of administrative data). Canada's positive experience in child benefit reform underlines the importance of close cooperation and joint work at the level of both politicians and public servants. The National Child Benefit was engineered and implemented by a federal-provincial officials working group that is still operating actively. A similar organization has been established for reform of services and supports for Canadians with disabilities (another important area in which the federal and provincial governments are very much intertwined in responsibility and expenditure).

Canada's social security system overall has tried to cope (with debatable success) with the problem of imbalance of responsibility and revenue capacity mentioned in the Russia Paper. Canada has used three main instruments.

In the 1970s, the federal government ceded some tax points to the provinces (i.e., allowed the provinces to occupy a larger part of the income tax field) to enhance their revenue generating capacity. The Canadian central government provides social transfer payments and equalization payments intended to help pay for provincial social expenditures and to help level the playing field

between poorer and richer provinces. And the federal government has increased its role in one key area of income security – child benefits – with compensating payments to the provinces. They can shift their expenditures from social assistance to other program and services for low-income families with children. Russia could consider the Canadian experience in this important aspect of income security policy on a federal system of government.

#### ***v. Public Role in Reform***

Canadian governments (especially the federal government) have long followed a tradition of seeking the views on public policy reform of the general public and of nongovernmental interest groups, through such mechanisms as Royal Commissions, public inquiries and task forces and (on a permanent basis) Parliamentary committees that head witnesses and accept written briefs. In recent years, there has been increasing emphasis on the need for governments to form ‘partnerships’ with various nongovernmental actors (e.g., employers, unions, voluntary groups, communities) both to design and implement public policy reform.

There is cynicism from some quarters (especially social groups) about the extent to which these consultative and partnership efforts are mere window dressing that play only a tangential role in policy making and merely give the appearance of democratic government. Nonetheless, these partnership arrangements have played an important role from time to time in generating ideas and responding to government proposals.