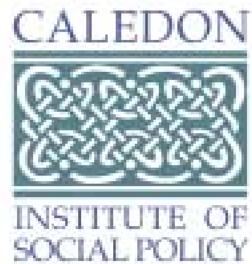

The Vote or Veto Budget:

An analysis of the 2005 federal Budget

by

Ken Battle, Sherri Torjman,
Michael Mendelson and Steve Pomeroy

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ISBN 1-55382-128-9

Published by:

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Table of Contents

Principles 1

Fiscal Policy 2
- The debt will go down on its own 2

Tax Cuts 4
- Personal income tax cuts: Mini-manna for the masses, pearls for the wealthy 4
- Raising the basic personal amount: A little for everyone 4
- Boosting tax deduction limits for RRSPs and RPPs: Targeted tax relief for the well-off 12

Program Measures 17
- Early Learning and Child Care: Strong bilateralism required to build a national system 17
  - Incremental funding adds up over time 17
  - Framework federalism allows flexibility 19
  - Strong bilateralism ensures adherence to national principles 20
  - Sustained federal funding 21
  - ELCC Council of Canada can act as a knowledge broker 21
  - Parental fees are an important source of financing 22
  - Child care expense deduction should be gradually reduced 22
- Employment Insurance: Financing changes threaten countercyclical protection 24
- New Deal for Cities and Communities: Can it address the urgent need? 25
  - Fiscal imbalance has long been a problem 26
- Housing: A major disappointment 28
  - Will there be funds left for a meaningful commitment? 29
  - Housing plays a central role in social well-being 30

Disability tax measures: Necessary but not sufficient 31
Disability tax credit: Improved eligibility and administration 32
Tax measures to support education and employment 33
Enhanced assistance for caregivers and families 34
Investments are required in the supply of disability supports 35

Supports for seniors 37
Raising the Guaranteed Income Supplement for poor seniors: Small patch on a flawed system 37
The overall retirement system is responsible for progress against poverty 41
Services for seniors should enable independent living 46

The Bottom Line 48

Endnotes 49

References 49

Principles

In our pre-Budget statement to the House of Commons Standing Committee on Finance during its consultations on the fiscal surplus, the Caledon Institute proposed three key principles against which to assess the 2005 federal Budget: transparency, balance and purpose [Torjman, Battle and Mendelson 2004].

It is only through *transparency* that it is possible to make intelligent decisions with respect to public finances. To this end, Caledon proposed the creation of a Parliamentary Budget Office to determine fiscal projections in a more accurate and non-partisan way. Clearly, the government has not gone that far in this Budget – at least not yet. But the House of Commons Standing Committee on Finance is exploring possible options (discussed below).

The second guiding principle that we identified in the pre-Budget consultation was *balance*. We used the concept to refer to relative expenditure on spending, tax relief and debt reduction. If this Budget could be summed up in one word, 'balance' would probably be appropriate, though not a policy balance among spending, tax relief and debt reduction.

The government sought instead to engineer in this Budget a political balance among the demands of the opposition parties, regions of the country and outside groups – literally hundreds of competing interests. Balance actually evolved into 'balancing act.'

We recognize that any government in a minority position with an all-party confidence vote hanging over its head likely would do the same thing. The need to secure House votes was the primary determinant of spending. Budget 2005 will be remembered for the imperative to ensure a positive vote (or abstention) rather than a negative veto.

Our question: Was the result acceptable social policy? The answer is a highly qualified yes – or perhaps – a qualified OK. Qualified mainly because the Budget bestowed two tax cuts – a small increase in the basic personal amount for all taxpayers, rich and poor alike, and a generous targeted-to-the-affluent enrichment of the tax deduction for RRSP contributions – that we believe are wasteful and unnecessary. A bigger and better return for the buck could have been achieved had much-welcome tax relief been targeted to low- and modest-income households. Qualified also because the Budget failed to take advantage of the federal surplus to address more fundamentally some of the critical issues facing Canada.

Finally, our pre-Budget submission identified *purpose* as the third principle that should guide the use of the surplus. Purpose means that policy proposals should be shaped by desired objectives. In our view, these objectives should include reducing poverty and inequalities in the distribution of income, ensuring the healthy development

of children, and enhancing self-sufficiency by investing in human and community capital formation. We can give only reserved approval on the 2005 Budget's progress towards these long-standing and crucial aims.

From a social perspective, the Budget sought to achieve several important objectives. These include improving access to early learning and child care, providing modest assistance to seniors and persons with disabilities, and enhancing the quality of life in communities. The latter focused primarily upon green and clean.

The measures introduced in the 2005 Budget will make some improvements in social policy. But the Budget's social measures do not go far enough. And in some key areas, such as reform of income security policy for working age Canadians and an acceleration of the schedule of increases to the Canada Child Tax Benefit, there are substantial pieces that are missing.

But single Budgets are only steps along a longer pathway. The litmus test for any particular Budget is whether it moves policy development in the right direction and at a pace that can make a positive difference in the lives of Canadians.

Our vote for this Budget outweighs our veto – though we put forward several concerns and caveats that we hope can guide the formulation of government priorities and associated expenditures in future.

Fiscal Policy

The debt will go down on its own

The first question about the 2005 Budget is not whether it is good, but whether it is credible. In the 2004 Budget, we were told that there would be revenue of $187.2 billion for the 2004-05 fiscal year. Instead, as of the 2005 Budget, revenue of $195.8 billion is expected for the 2004-05 fiscal year.

The surplus for the 2004-05 fiscal year had been forecast at $4.5 billion in the 2004 Budget. It now appears that, had the government not undertaken special measures to build added spending into the present 2004-05 fiscal year, the real surplus would have been closer to $13 billion.

The 2005 Budget forecasts a surplus of $4 billion for the 2005-06 fiscal year, but why should we believe it? After repeated huge underestimates of the Budget balance, what makes this year any different? The answer is: nothing. This year's Budget is as likely to be inaccurate as any Budget of the past few years. Without the capacity to develop forecasts in exacting detail for each revenue source, we have no way of knowing

whether there is a built-in hidden fudge-factor. We cannot have informed debate about priorities without some confidence of our understanding of the fiscal situation.

To address this issue, the Caledon Institute had proposed the establishment of an independent Parliamentary Budget Office along the lines of the Congressional Budget Office in the US. We are pleased that the House of Commons Standing Committee on Finance is considering this suggestion. We believe that all parties, including the government party, can gain from having an independent source of fiscal information.

A Parliamentary Budget Office not only will promote better public policy debate and empower Parliament. It also will save the government of the day from charges that it is 'crying wolf' when the time comes – as it certainly will – that a real fiscal problem confronts us.

In the meantime, we must try to make sense of this Budget's forecast of a $4 billion surplus in 2005-06, $5 billion in 2006-07, $6 billion in 2007-08, $6.5 billion in 2008-09 and $7 billion in 2009-10 – for a total forecast surplus of $28.5 billion over the next five fiscal years. The Budget plan is to use at least $3 billion of that amount every year to pay down the debt, while reserving the remainder as a contingency fund which, if not spent, will also go to reduce the debt. So we have between $15 billion and $28.5 billion going to pay down the debt over the next five years. Is this a wise way to spend these funds? Or are there other uses that would have more impact on social well-being?

Many Canadians think that paying down the debt is a good idea because it reduces the burden of the debt. However, the effect of additional debt repayment is actually very small. With a $15 billion debt repayment, the debt-to-GDP ratio will drop to 30.6 percent in 2009-10; without the $15 billion repayment, the debt-to-GDP ratio would fall to about 31.5 percent in 2009-10. Either way, Canada will have the lowest public debt in the OECD. Either way, we will soon meet the federal government's target of 25 percent of GDP. The difference is a matter of a year or so at most.

We do not see how this small acceleration of debt reduction will significantly benefit Canada in the future. There are dozens of pressing needs that these funds could address. We could invest much more to rebuild the crumbling infrastructure of our cities, ease the heavy burden on Canadians with disabilities and their families, build vastly expanded and modernized public transit systems, substantially reduce the risk and depth of child poverty, tackle pressing environmental concerns, fund adequately our education system and reduce student debt – and on and on.

We believe that Canada's GDP might be significantly higher ten years from now with some of these investment options than it would be with the debt repayment plan presented in the Budget. The result could well be that the debt-to-GDP ratio would actually be lower if we invest this money properly in our own future. The returns from

well-conceived and needed social investment may be much higher than the cost of carrying the debt. In both economic and social terms, this debt repayment plan may not be sensible.

Tax Cuts

Personal income tax cuts: Mini-manna for the masses, pearls for the wealthy

The 2005 Budget combines small general tax cuts with a targeted-to-the-affluent tax break. Caledon, by contrast, proposes targeted tax reductions for low- and modest-income Canadians.

The 2005 Budget announced an increase in three nonrefundable tax credits – the basic personal amount, the amount for a dependent spouse or common-law partner, and the amount for wholly dependent relatives.[1] The Budget also increased the tax deduction limit for contributions to Registered Retirement Savings Plans (RRSPs) and money-purchase Registered Pension Plans (RPPs). These changes waste money that could better be used to bolster tax relief to working poor and modest-income Canadians struggling to earn a living.

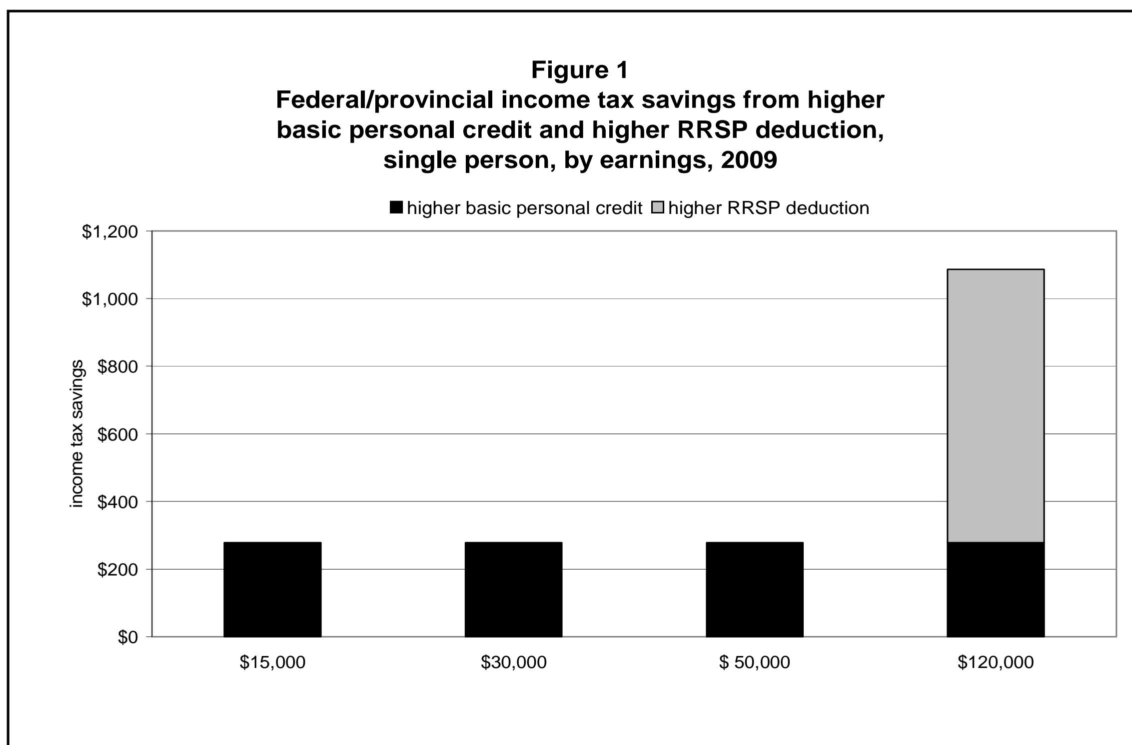
Our analysis focuses on the changes in income tax that result from the Budget's tax provisions. In other words, we calculate income tax with and without the new tax measures, and then show the difference between the two to gauge the impact of the Budget. Note that these results are not the amount of income tax that Canadians pay, but rather the difference in their tax bills before and after the changes announced in the Budget.

Figure 1 illustrates the impact on single taxpayers of the Budget's increase to the basic personal amount and RRSP deduction limit in 2009. All taxpayers will get the same tax reduction from the higher basic personal amount, which will lower their combined federal and average provincial/territorial income taxes by an estimated $278.

But in addition to the tax reduction from the higher basic personal amount, the elite group of taxpayers earning $120,000 will enjoy an $809 increase in tax savings resulting from the higher tax deduction limit for contributions to RRSPs. This change will bring their total income tax reduction to $1,087 – four times greater than the tax cut for the large majority of single taxpayers.

Raising the basic personal amount: A little for everyone

The personal income tax system does not levy tax on the first several thousands of dollars of income, allowing taxfilers to receive a basic amount of income that is tax-free. The 'basic personal amount,' as it is termed, exempts from taxation the first $8,148 of taxable income for the 2005 tax year.



This figure is also known as the 'federal taxpaying threshold' since it marks the level above which Canadians pay federal income tax.

The 2005 Budget will phase in increases to the basic personal amount by $100 in 2006, another $100 in 2007, $400 in 2008 and the boost required ($600 or more) to bring it to $10,000 in 2009. These enhancements come on top of the increases required to index the personal income tax system's brackets and credits fully to the cost of living.

The Budget also will raise the amount that a taxpayer can claim in respect of a dependent spouse or common-law partner, or a fully dependent relative, by $85 in 2006 and in 2007, $340 in 2008 and the amount required to raise it to $8,500 by 2009. For simplicity's sake, we will term the dependent spouse or common-law amount and the dependent relative amount collectively as the 'dependents amounts.'

The boost in the basic personal and dependents amounts is progressive in one important respect: It will raise the federal taxpaying threshold, thus removing an estimated 860,000 low-income Canadians (240,000 of them seniors) from the federal tax rolls when the increase is fully implemented by 2009. Previously, an estimated 1 million poor Canadians were freed from the federal tax net thanks to tax relief measures taken since 2000 – lower tax rates, ending the surtax, boosting the Canada Child Tax Benefit and restoring full indexation.

These changes helped ease the burden of years of mounting annual federal income tax hikes since 1988 – imposed mainly by means of stealthy changes resulting from partial deindexation of the income tax system – that had scooped some 1.4 million poor people into Ottawa's income tax net and pushed another 2.5 million taxpayers into higher tax brackets [OECD 1997: 112]. Partial deindexation and the imposition of surtaxes helped furnish the rising revenues that Ottawa needed to put an end to the federal deficit.

If the provincial and territorial governments follow suit by raising their own basic personal and dependents amounts, the taxpaying threshold for provincial and territorial income tax also will rise and substantial numbers of low-income taxpayers no longer will have to pay provincial or territorial income tax. However, the provinces and territories now can design their own tax credits, brackets and rates (though they must continue to use the federal definition of taxable income), so it cannot simply be assumed that they will change their tax systems exactly in step with Ottawa's plans.

Boosting the basic personal and dependents amounts is costly in terms of reduced tax revenues and may not suit some provinces' priorities and preferences. For this reason, we focus mainly on changes in federal income taxes (with the exception of the boost to the maximum RRSP and RPP deduction limits, which automatically reduce provincial/territorial income taxes because they involve taxable income).

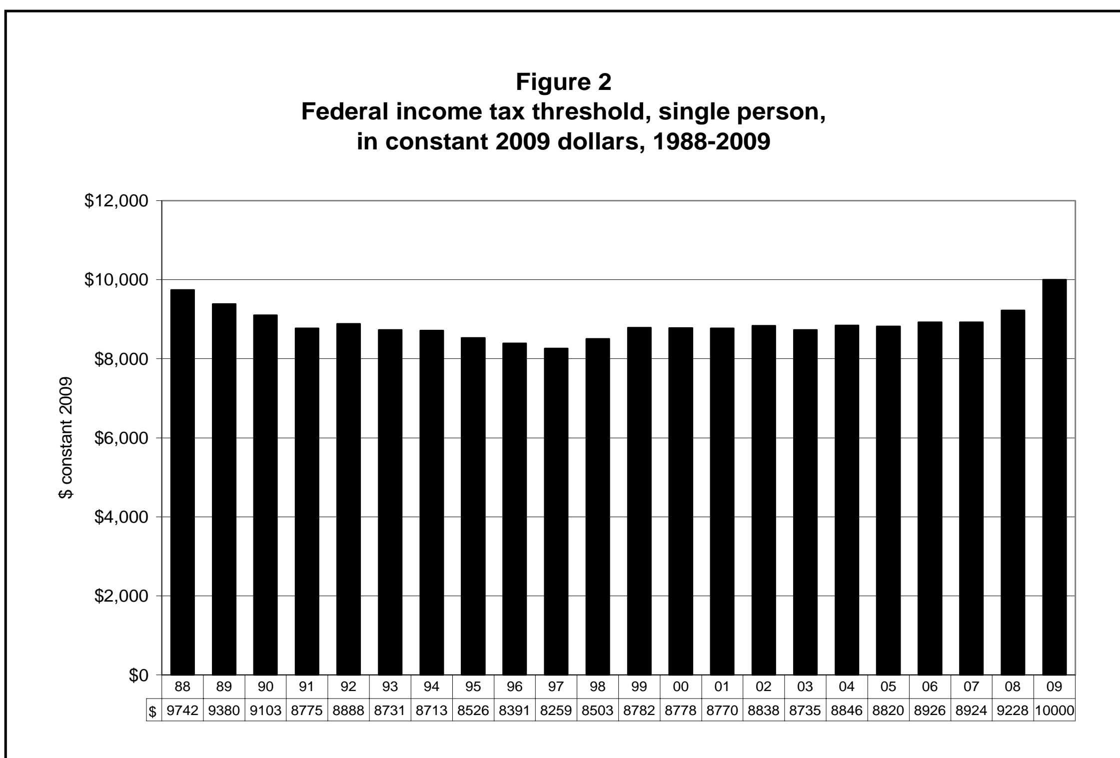


Figure 2 illustrates the federal taxpaying threshold for a single person from 1988 through 2009. The figures are expressed in constant 2009 dollars, to show real trends.

Partial deindexation lowered the federal taxpaying threshold steadily each year, which declined from $9,742 in 1988 to $8,259 by 1997. Ottawa then put a halt to the slide in the taxpaying threshold by means of targeted tax relief for lower-income taxfilers through a $500 geared-to-income supplement to the basic personal and dependents amounts, phased in half ($250) in 1998 and half ($250) in 1999. The taxpaying threshold rose from $8,259 in 1997 to $8,503 in 1988 and $8,782 in 1999.

The federal government subsequently extended the increases in the basic personal and dependents amounts to all taxpayers in 2000 and – most importantly – reindexed the federal income tax system to put a stop to annual hidden tax hikes from credit corrosion and bracket creep [Battle 1999]. The incremental increases announced in the 2005 Budget will lift the federal taxpaying threshold for a single Canadian starting in 2006 to reach the planned $10,000 in 2009.

While the restoration and gradual improvement in the basic personal and dependents amounts are welcome measures, the results are underwhelming. The federal taxpaying threshold for a single taxpayer slid from $9,742 in 1988 to $8,259 by 1997 and will reach $10,000 by 2009 – a mere $258 better than 1988. Surely we can do better than that.

Even with the increases since 1998, the federal taxpaying threshold for single Canadians still falls far below low income levels. We use as our measure of low income Statistics Canada's after-tax low income cutoff, which for one person in a metropolitan centre is an estimated $16,992 in 2005, or $18,392 in constant 2009 dollars.

Figure 3 shows that the federal income tax threshold for single taxfilers fell from 53.0 percent of Statistics Canada's after-tax low income cutoff in 1988 to 44.9 percent in 1997. Even with the improvements since 1998, the federal taxpaying threshold will reach only 54.4 percent of the after-tax low income cutoff for one person by 2009 – only slightly higher than it was back in 1988 (53.0 percent).

The 2005 Budget promises to deliver income tax relief to virtually all taxpayers by increasing the basic personal and dependents amounts. In order to assess this claim, we first must understand how these 'amounts' translate into income tax savings, since there is considerable confusion about this basic concept.

The value of the basic personal 'amount' is not the same as the dollar amount itself. The basic personal amount is used to calculate a 'nonrefundable credit' whose value in terms of income tax savings is the product of the amount and the lowest income tax rate, which is 16 percent for federal income tax. For example, in 2005 the basic personal amount of $8,148 will reduce federal income tax by $1,304 (16 percent of $8,148) over what it would be without the basic personal amount. Other familiar nonrefundable credits include those for dependents (also being raised in the 2005 Budget), age, disability, contributions to the Canada Pension Plan and Quebec Pension Plan, Employment Insurance premiums, pension income, caregiving, tuition and education, and medical expenses.

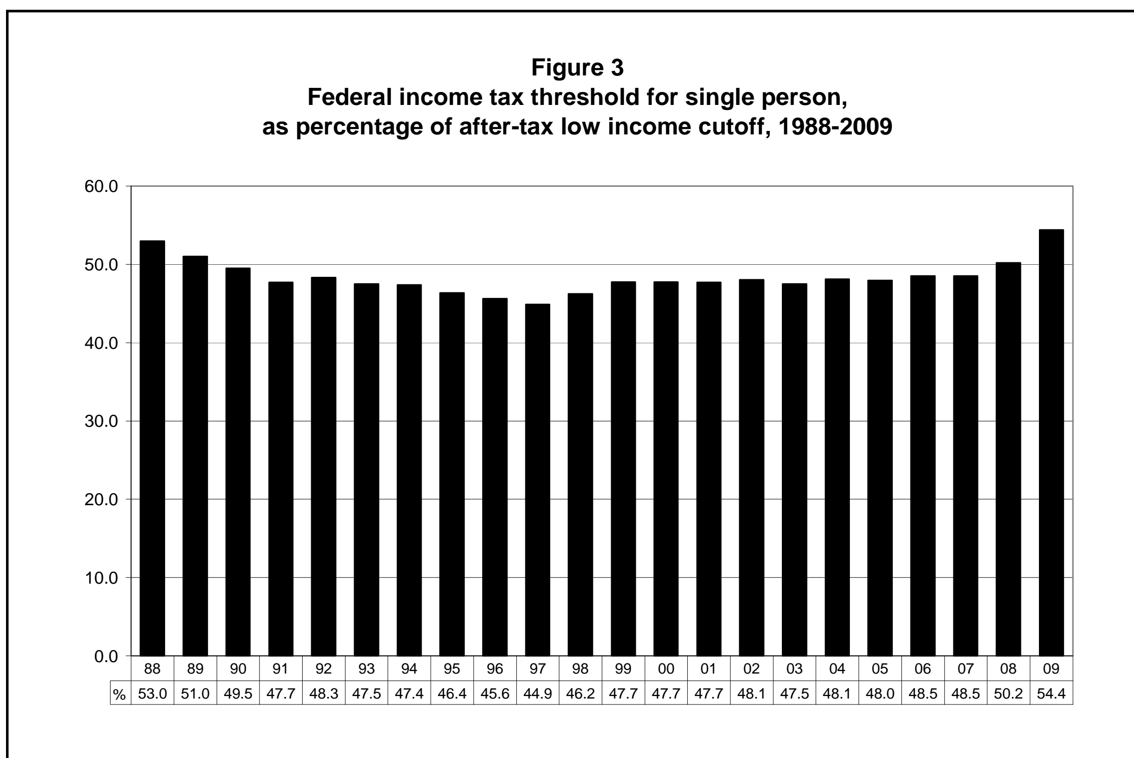
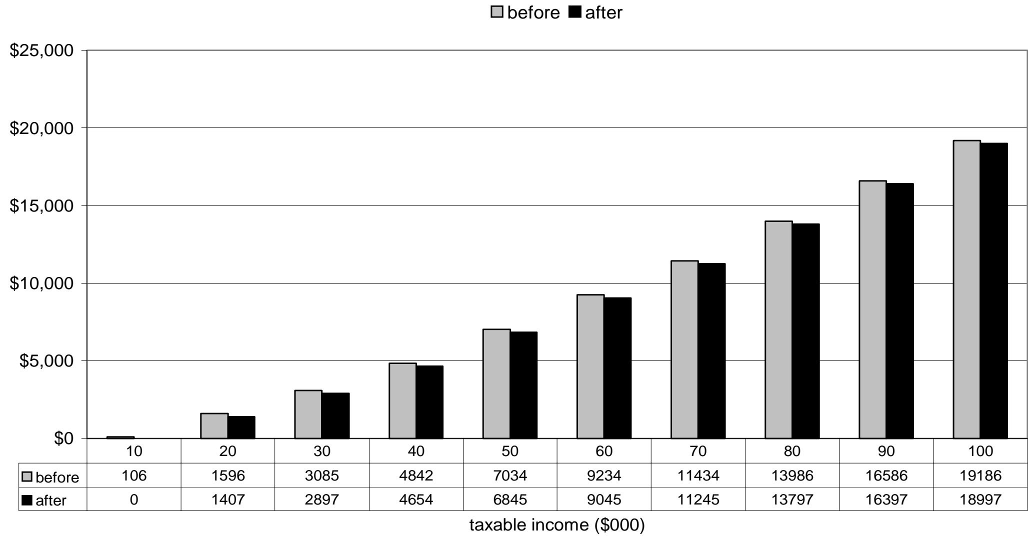


Figure 3
Federal income tax threshold for single person, as percentage of after-tax low income cutoff, 1988-2009

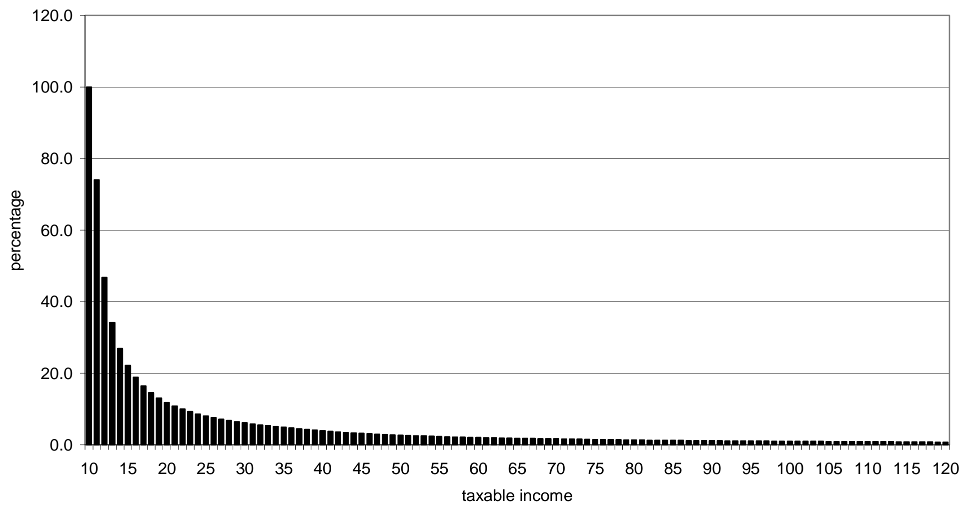
The 2005 Budget's phased increases to the basic personal and dependents amounts will yield very modest income tax savings. For single taxpayers, federal tax savings will come to $16 in 2006, $16 in 2007, $64 in 2008 and $189 in 2009.[2]

Figure 4 shows federal income taxes for single taxpayers in 2009 before and after the increase to the basic personal amount; clearly the tax reduction is small. With the exception of taxfilers with very low income who owe only small amounts of income tax and so will see a smaller tax reduction in dollar terms, income tax savings from nonrefundable credits like the basic personal credit are the same for everyone no matter what their income – working poor, middle income, affluent. However, in relative terms, the increases to the basic personal and dependents amounts will yield tax savings that are progressive in distributional impact because they decrease as incomes increase, and vice versa. We provide two measures of the relative impact of the higher basic personal amount announced in the 2005 Budget.

Figure 5 shows the percentage decline in federal income tax in 2009, when the increase to the basic personal amount will be fully implemented. The reduction ranges from 100 percent for taxpayers with taxable income of $10,000, who would pay federal income tax of $139 without the higher basic personal amount but will owe no federal tax with the planned increase, to less than 1 percent (0.8 percent) for those with taxable income of $120,000. The reason for the declining percentage increase is that income taxes go up as incomes rise.



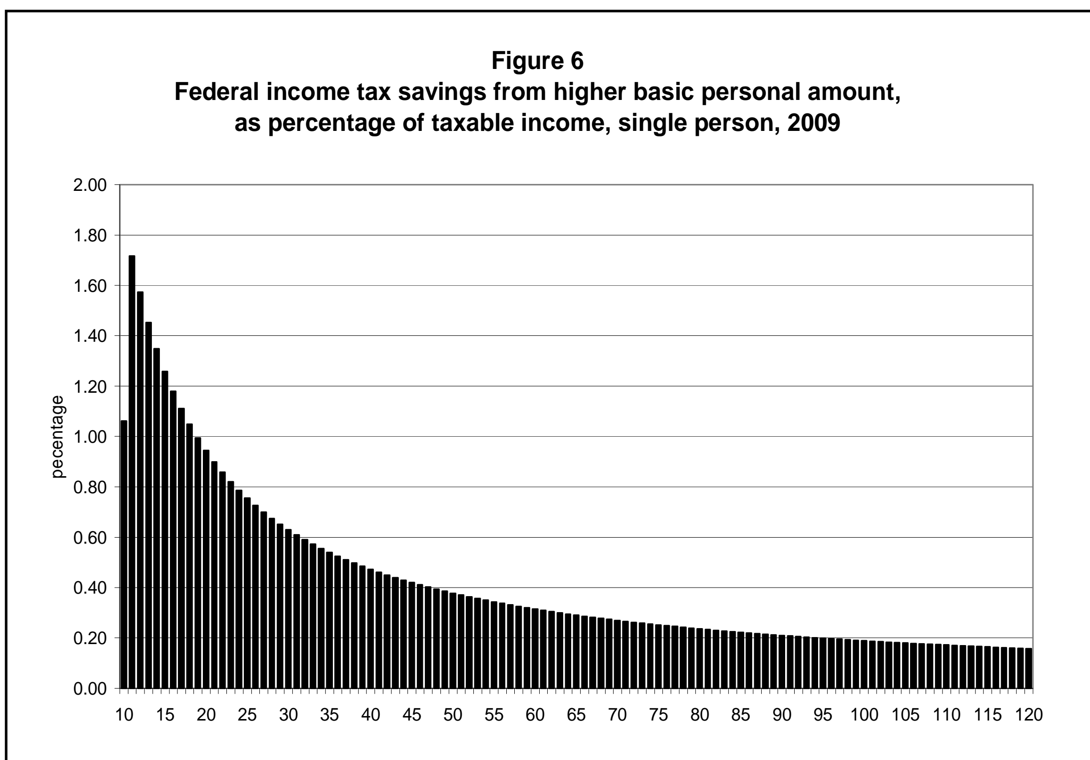
	10	20	30	40	50	60	70	80	90	100
before	106	1596	3085	4842	7034	9234	11434	13986	16586	19186
after	0	1407	2897	4654	6845	9045	11245	13797	16397	18997



Income tax savings from the higher basic personal amount are the same for virtually all taxpayers in the same demographic category (i.e., for all single taxpayers, for all one-income couples, for all two-income couples). But income taxes rise with income, so tax savings from the higher basic personal amount represent a substantial percentage of income taxes (before the higher basic personal amount) for those with small income tax bills and a tiny proportion of the income tax of high-income taxpayers.

A better measure of the relative impact of the rise in the basic personal amount is given in Figure 6, which shows the resulting federal income tax reduction as a percentage of taxable income. Federal income tax savings from the larger basic personal amount in 2009 will range from a high of 1.72 percent for single taxpayers with $11,000 in taxable income to a mere 0.16 percent for those with taxable income of $120,000 shown on Figure 6 (the percentage keeps declining over $120,000).

There are two ways to interpret the results of Figure 6. On the one hand, the increase to the basic personal amount will result in a progressive distribution of benefits so that tax savings in relative terms are higher for those with lower incomes and vice versa. On the other hand, the amount of the tax reduction relative to income is modest even for taxpayers with low incomes, modest for the middle-income majority and a pittance for upper-income Canadians.



The cost of the basic personal and dependents amounts to the federal treasury, in terms of foregone income tax revenue, is large. In 2005, before the changes announced in the Budget, the basic personal credit would cost the federal government an estimated $23.7 billion, with another $1.35 billion for the spouse or common-law credit and $680 million for the dependant credit [Department of Finance Canada, 2004b: Table 1]. Even a modest increase in these amounts will translate into sizeable costs, as the Budget's changes attest.

The 2005 Budget claims that the increase to the basic personal and dependents amounts will cost Ottawa a total $7.1 billion between fiscal years 2005-06 and 2009-10, with "most of the benefit going to those with low and modest incomes" [Department of Finance Canada 2005: 368]. It is worth looking more closely at who will get what from this tax cut, since the numbers do not support the claim.

The most recent taxation statistics, for 2002, show that the average income of Canadian taxfilers was $32,212. Assuming this figure increases by the rate of inflation, and assuming the latter is 2.0 percent, then by 2009 the average taxfiler income will be about $37,000. Over the course of its five-year implementation, 31 percent of the cumulative $7.1 billion federal tax reduction from the increase to the basic personal and dependents amounts – an estimated $2.2 billion – will go to taxpayers under $30,000. Another 17 percent or an estimated $1.2 billion will benefit those between $30,000 and $40,000, 14 percent or $990 million will go to those between $40,000 and $50,000, 10 percent or $707 million to those between $50,000 and $60,000, 20 percent or $1.4 billion to taxpayers between $60,000 and $100,000, and the remaining 8 percent or $566 million to taxfilers with incomes over $10,000.

Just under half (48 percent or some $3.4 billion) of the $7.1 billion worth of total federal income tax savings from the higher basic personal and dependents amounts will go to taxpayers below $40,000, which in fact is a bit higher than our $37,000 estimate of average taxfiler income in 2009. Not even one-half of the tax savings from the increases to the basic personal and dependents amounts will go to taxfilers with incomes below the average. Just over half (52 percent) or some $3.7 billion of the tax break will go to taxpayers above $40,000. Taxfilers over $50,000 will reap a substantial 38 percent or $2.7 billion in federal income tax breaks from the increases to the basic personal and dependents amounts.

Is this a sensible way to deliver income tax relief? Our answer is no.

Canadians working for low wages have their meagre earnings eroded by income taxes and payroll taxes (they were hit hardest in relative terms by the substantial hike in Canada Pension Plan contributions between 1997 and 2003), as well as employment-related expenses such as transportation, clothing and, in many cases, child care. Unlike well-paid employees, Canadians with below-average earnings rarely work for employers that provide supplementary health and dental care or employer-sponsored pensions.

Low-income Canadians have been hit by substantial tax increases over the past two decades. Between 1980 and 2002, families in the lowest income quintile (i.e., fifth) saw their average federal/provincial income taxes rise by 71.4 percent in real terms (from $700 to $1,200 in constant 2002 dollars) –

the highest increase of all groups – followed by families in the highest quintile (48.9 percent), fourth quintile (19.2 percent), middle quintile (8.1 percent) and second quintile (6.7 percent). Families in the bottom income group paid 3.5 percent of their income in income taxes in 1980 and 5.1 percent in 2002.

Ottawa's decision to raise the basic personal and dependents amounts for all taxfilers is a costly and ineffective formula for tax relief because it spreads the income tax savings thinly throughout all of taxland. Half of the not inconsiderable cost of the measure to the federal treasury will be required to fund tax breaks that are a mere drop in the bucket for Canadians with above-average incomes – money that could be far better spent to deliver much-needed tax relief to workers earning below-average wages. The federal taxpaying threshold could be raised higher and income taxes reduced significantly for low- and modest-income Canadians if the $7 billion that will be spread thinly to all taxpayers – including the wealthy – instead were targeted to those who most need a tax break.

What is required at this time is targeted, not universal, tax relief, which Caledon repeatedly has proposed could be delivered in one or more ways:

- a low income tax credit for low- and modest-income Canadians, modelled on the geared-to-income increase to the basic personal and dependents credits in 1998 and 1999

- an employment expense credit to help defray the costs of employment (e.g., clothing and transportation) for workers with low or modest earnings

- an income-graduated tax credit for Canada Pension Plan and Quebec Pension Plan contributions and Employment Insurance premiums, to ease the regressive burden of payroll taxes on lower-income contributors (the substantial increases to CPP contributions between 1997 and 2003 – though necessary in order to sustain this vital program fiscally and politically – were implemented in such a way that they made even heavier the already regressive burden on lower-income contributors)

- an increase in the refundable GST credit.

Boosting tax deduction limits for RRSPs and RPPs: Targeted tax relief for the well-off

The 2005 Budget does deliver one type of targeted tax relief – a more generous tax break for well-off Canadians saving for their retirement through individual Registered Retirement Savings Plans (RRSPs) and employer-sponsored Registered Pension Plans (RPPs).

Canadians who save in RRSPs or belong to Registered Pension Plans can claim an income tax deduction that partly offsets the cost of their pension contributions. Over the years, Ottawa has increased the RRSP and RPP tax deduction limits, though a couple of times it slowed the schedule of increases. The

latter move presumably was intended to help save the substantial cost of more generous tax breaks to the federal treasury, which was a pressing concern during the war against the deficit.

The 2005 Budget announced yet another round of increases to the RRSP and RPP tax deductions. It justifies the higher limits on three grounds – helping Canadians to better meet their retirement savings needs, allowing employers in Canada to provide competitive compensation packages to attract and retain skilled workers (the US provides more generous tax savings for retirement savings) and encouraging savings to support investment, productivity and economic growth [Department of Finance Canada 2005: 368]. The Budget is banking on a highly targeted-to-the-affluent tax break to advance these three objectives.

Table 1 shows the maximum amount that contributors to RRSPs can claim on their income tax from 2000 through 2010.[3] The previous schedule planned to increase the RRSP limit from $13,500 in 2002 to $14,500 in 2003, $15,500 in 2004, $16,500 in 2005 and $18,000 in 2006, after which it would be indexed to growth in wages. The new schedule is the same as the old until 2006 but then raises the tax deduction limit to $19,000 in 2007, $20,000 in 2008, $21,000 in 2009 and $22,000 in 2010, after which it will be indexed to wage growth. Our calculations of the old limits once they would have been indexed in 2008 assume annual wage growth of 2 percent.

The table also shows the level of earnings above which the RRSP tax deduction limit applies. Only high-earning Canadians can benefit from the maximum RRSP deductions. (The same applies to Registered Pension Plans.) In the current (2005) tax year, only taxpayers earning $91,667 or more can claim the

Table 1
Impact of higher tax deduction limits for RRSP contributions

	tax deduction limit		earnings threshold for maximum tax deduction		federal/ provincial tax savings	
	old $	new $	old $	new $	old $	new $
2000	13,500	13,500	75,000	75,000	5,755	5,755
2001	13,500	13,500	75,000	75,000	5,755	5,755
2002	13,500	13,500	75,000	75,000	5,755	5,755
2003	14,500	14,500	80,556	80,556	6,181	6,181
2004	15,500	15,500	86,111	86,111	6,608	6,608
2005	16,500	16,500	91,667	91,667	7,034	7,034
2006	18,000	18,000	100,000	100,000	7,673	7,673
2007	18,360	19,000	102,000	105,556	7,827	8,100
2008	18,727	20,000	104,040	111,111	7,983	8,526
2009	19,102	21,000	106,121	116,667	8,143	8,952
2010	19,484	22,000	108,243	122,222	8,306	9,379

maximum RRSP deduction of $16,500. When the new limits begin in 2007, the earnings threshold above which the maximum deduction applies will rise from $102,000 under the old schedule to $105,556 under the new schedule, and by 2010 will be $122,222 as opposed to an estimated $108,243 under the old system.

The rise in the RRSP tax deduction limit will increase federal and provincial/ territorial income tax savings only for high-income taxpayers. In 2005, total income tax savings (federal and average provincial/ territorial) for RRSP contributors with incomes high enough to claim the maximum deduction of $16,500 comes to an estimated $7,034.

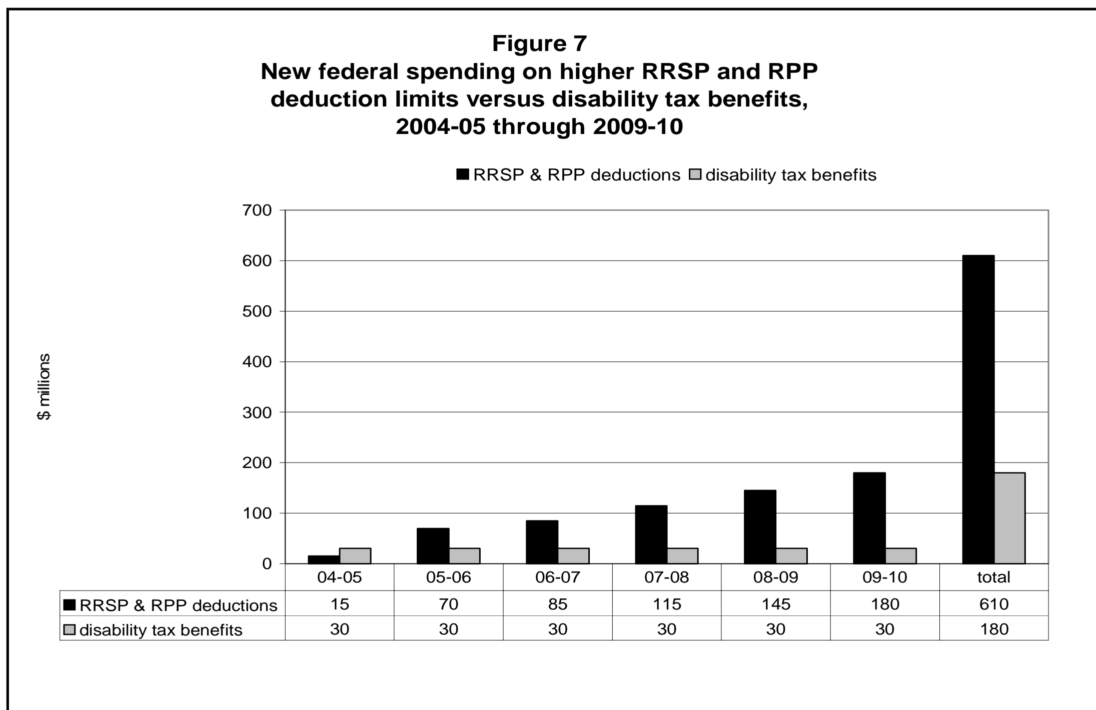
Under the old schedule, the tax break would have been $7,673 in 2006 rising to $7,827 in 2007, $7,983 in 2008, $8,143 in 2009 and $8,306 in 2010. Under the new schedule of increases to the RRSP deduction limit, total federal and average provincial/ territorial income tax savings will be a maximum $8,100 in 2007, $8,526 in 2008, $8,952 in 2009 and an estimated $9,379 in 2010. Taxpayers claiming the maximum RRSP deduction will enjoy increases in their total income tax savings of $273 in 2007, $543 in 2008, $809 in 2009 and $1,073 in 2010. Note that RRSP contributors between the old and new maximum earnings thresholds also will see income tax reductions.

However, the changes announced in the 2005 Budget will not enrich tax assistance for most RRSP and RPP contributors. Only contributors earning more than the old earnings threshold starting in 2007 (i.e., over $102,000 in 2007, $104,040 in 2008, $106,021 in 2009 and $108,243 in 2010) will enjoy more federal and provincial/territorial income tax savings than they would have under the old system.

Income tax assistance for contributions to RRSPs and Registered Pension Plans is costly relative to most other tax expenditures. In 2005, the net cost of tax assistance for RRSP contributions will amount to an estimated $8.6 billion – $7.6 billion for the deduction of contributions plus $6.1 billion for the non-taxation of investment income earned on the RRSP savings less $5.1 billion for the taxation of withdrawals from RRSPs. The net cost of tax assistance for RPP contributions will amount to an estimated $7.3 billion in 2005 – $5.8 billion for the deduction of contributions plus $9.4 billion for the non-taxation of investment income earned on the RRSP savings less $8.0 billion for the taxation of withdrawals from RRSPs [Department of Finance Canada 2004b: Table 1].

The increase in the maximum RRSP and money purchase RPP tax deductions will cost the federal treasury a cumulative total of $610 million over six years – an estimated $15 million in 2004-05, $70 million in 2005-06, $85 million in 2006-07, $115 million in 2007-08, $145 million in 2008-09 and $180 million in 2009-10. By way of comparison, the improvements announced in the Budget for tax assistance to Canadians with disabilities and their caregivers will total $180 million over six years – just 30 percent of the $610 million required to pay for the higher RRSP and RPP tax deduction limits.

Figure 7 illustrates the trend in expenditures for the two forms of tax assistance. While these tax provisions are intended for different purposes, it is of interest that there rarely seems to be a problem of sufficient funding when it comes to conferring tax breaks on wealthy Canadians.



The targeted-to-the-affluent tax cuts announced in the 2005 Budget will widen the existing inequalities in tax assistance for private pension savings. The tax deductions for contributions to RRSPs and RPPs produce a regressive distribution of benefits since income tax savings increase as taxable incomes rise. There are three reasons for the favour-the-wealthy character of these expensive tax breaks.

First, higher-income Canadians rely upon individual retirement savings and/or employer-sponsored pension plans for most of their retirement income and so are much more likely to contribute to RRSPs or belong to RPPs than are low- and middle-income taxpayers. In 2002, the most recent year for which data are available, the percentage of taxfilers contributing to RRSPs ranged from 2 percent for those with incomes under $10,000 to 10 percent for those between $10,000 and $20,000, 25 percent for those between $20,000 and $30,000, 39 percent for those between $30,000 and $40,000, 49 percent for those between $40,000 and $50,000, and 60 percent or higher for those above $50,000 (e.g., 69 percent for those between $80,000 and $100,000 and for those over $250,000).

Second, average RRSP contributions also increase with income. In 2002, average RRSP contributions ranged from $1,079 for the tiny group of contributors with incomes under $10,000 to $15,660 for those over $250,000; the average contribution was $4,283.

Third, the value of an income tax deduction in federal and provincial/territorial income tax savings depends on the taxfiler's top tax rate. The federal income tax system has a graduated rate structure ranging

from 16 percent of taxable income in the lowest tax bracket to 29 percent in the top tax bracket. Provincial and territorial income tax regimes also use a graduated structure but with lower and varying rates – the exception being Alberta, which has a single tax rate of 10 percent.

High-income RRSP contributors enjoy greater income tax savings because they contribute more and are in the top tax bracket, and middle-income contributors get more tax savings than average lower-income contributors for the same reasons. In 2002, the estimated total (federal and provincial/territorial) income tax savings for RRSP contributions ranged from $24 for claimants with income below $10,000 to $255 for those between $10,000 and $20,000, $456 between $20,000 and $30,000; $633 between $30,000 and $40,000, $961 between $40,000 and $50,000, $1,565 between $50,000 and $80,000, $2,831 between $80,000 and $100,000; $4,694 between $100,000 and $250,000 and $6,662 for those over $250,000.

In summary, with respect to the government's first objective – helping Canadians to save for retirement – the taxpayers these measures help most are undoubtedly those who need it least. With regard to the second objective – competitive compensation to keep Canadians in Canada – we doubt very much whether the workers attracted by substantially higher salaries in the US are going to be materially affected by these measures.

We would challenge the government to demonstrate more than a handful of cases where RRSP limits mattered. Does it make sense to spend hundreds of millions of dollars to try and influence a few people who might otherwise go to the US? While Canada does have to compete with the US to retain highly skilled workers, it is a fantasy to think we can ever compete based on tax break-enriched compensation packages. We must compete instead on our quality of life. It is this very quality of life that is being undermined by inadequate investment in essential public services, such as education and public transportation.

Finally, Ottawa claims that these tax breaks will enhance savings. Many of the people affected by these measures are already saving more than the new RRSP limits. For these people, all that will happen is a transfer of assets from taxable savings to non-taxable RRSP savings. The net increase in savings, if any, will be miniscule.

Of course, we will hear little or no criticism of the RRSP changes. The financial industry, which supplies the economists who are most often cited by the media, stands to make good profits by administering expanded RRSP accounts. Nonetheless, the targeted-to-the-wealthy increases in RRSP and RPP tax deductions announced in the 2005 Budget are both unnecessary and regressive.

Program Measures

Early Learning and Child Care: Strong bilateralism required to build a national system

The 2005 Budget announced an additional $5 billion infusion to help the provinces and territories build a national early learning and child care system. This federal cash is necessary, but money alone cannot ensure the high-quality system that Canada so desperately needs.

It has taken decades of effort on the part of parents, researchers and advocates to convince governments that early learning and child care (ELCC) are crucial to Canada's social and economic health. High-quality early learning and child care services are not just 'social policy': They equally are crucial elements of economic policy because they invest in the critical first years of human capital development and enable parents to work or study.

The large majority of Canadian families, including those with preschool children, have both parents in the workforce. Most single parents work outside of the home. Child care is necessary if parents are to participate in the workforce or undertake the education and training that employers demand. Child care is essential for poor families struggling to climb over the welfare wall and find and keep jobs.

Quality early learning and child care can improve children's subsequent performance in school, lessen the learning risks linked to low income and enhance parents' childrearing and coping skills. And ELCC is not just for families with parents in the workforce: Services such as parental supports and respite also can help families that care for their children at home.

But Canada lags far behind other advanced nations when it comes to early learning and child care. The demand for quality, affordable ELCC far outstrips our supply. Services are uneven between and, in most cases, within provinces and territories: There is nothing approaching a national system. Most families rely on unregulated child care bought or traded on the market (typically from neighbourhood providers) or provided by relatives.

Incremental funding adds up over time

Recent federal Budgets have put money into early learning and child care services – put back, in part, in compensation for previous cuts in federal transfers to the provinces/ territories. The 2005 Budget continues this process of incremental investment.

The 2001 Budget announced $2.2 billion over five years (2000-01 through 2005-06) to fund the September 2000 Early Childhood Development Agreement through which Ottawa was to help the

provinces and territories increase their investment in a broad range of early childhood development services: promoting healthy pregnancy, birth and infancy; improving parenting and family supports; strengthening early childhood development, learning and care; and strengthening community supports for families.

In 2003, the federal government extended this funding at $500 million per year after 2005-06. Moreover in 2002, Ottawa committed $320 million over five years (2003-04 through 2007-08) to early learning and child care for First Nations and other Aboriginal children.

Advocates and experts welcomed the Early Childhood Development (ECD) Agreement but were concerned that the money came with no strings attached. As a result, provinces and territories could spend these funds as they liked within a broad range of services – and not necessarily on quality child care, one of the key services in scarce supply (initially Ontario, the largest province, did not invest in increasing the supply of child care).

In March 2003, Ottawa and the provinces/territories announced another agreement – under the catchy title Multilateral Framework on Early Learning and Child Care (ELCC) – intended to increase the supply of child care and preschool spaces, reduce the cost of such services for low- and modest-income families, and improve the quality of these services. The 2003 federal Budget allocated $935 million over five years (2004-05 through 2007-08) to finance the Early Learning and Child Care Agreement, consisting of $900 million over five years to the provinces and territories and $35 million over four years for First Nations children.

Again, while this initiative was welcome and significant, the schedule of payments under the Early Learning and Child Care Agreement allocated relatively small amounts for the first few years ($25 million in 2003-04 and $75 million on 2004-05) that resulted in even smaller sums for each province and territory. The 2004 Budget antied up another $150 million for Early Learning and Child Care ($75 million more for 2004-05 and 2005-06), as well as another $10 million over four years for early learning and child care subsidies for First Nations children living on reserves. With this additional spending, Ottawa's total expenditures of $150 million in 2004-05 and $225 million for 2005-06 could create "up to 48,000 new child care spaces or provide up to 70,000 fully subsidized spaces for children from low-income families" [Department of Finance Canada 2004a: 114].

The 2005 Budget announced an additional federal investment totalling $5 billion from 2004-05 through 2009-10, phased in at $200 million in 2004-05, $500 million in 2005-06, $700 million for 2006-07 and $1.2 billion for each of the remaining fiscal years up to 2009-10. All in all, these various and rather confusing federal spending initiatives on early learning and child care since the 2001 Budget add up to a cumulative $9.6 billion from 2001-02 through 2009-10. Of this sum, $465 million – just 4.9 percent – goes to First Nations children and families on reserve. While the grand total looks substantial, on an annual basis – $1.2 billion each in the last three fiscal years of the payment schedule, 2007-08 through 2009-10 – this is a relatively modest federal expenditure for an area of Canadian social policy that is so crucial yet still so undeveloped and inadequate.

Framework federalism allows flexibility

Certainly federal cash is essential to help fuel the construction of the national early learning and child care system sketched in skeletal form in the October 2004 Speech from the Throne, but there is far more to the story than funding. The early learning and child care system is to be based on four core objectives, given the acronym "QUAD" – quality, universally inclusive, accessible and developmental.

Quality entails "evidence-based, high-quality practices relating to programs for children, training and supports for early childhood educator and child care providers, and provincial/territorial regulation and monitoring." The system should be "universally inclusive – open to all children without discrimination." It should be "accessible – available and affordable for those who choose to use it." And the system should be "developmental, focused on enhancing early childhood learning opportunities and the developmental component of ELCC programs and services" [Department of Finance Canada 2005: 119].

Ottawa and the provinces/territories (Quebec abstaining) are negotiating how to translate these broad objectives into programmatic reality. During the first two years of the 2005 Budget's financial commitment to early learning and child care, $200 million in 2004-05 and $500 million in 2005-06, federal funds will be put into a third-party trust upon which the provinces and territories can draw on a per capita basis. The purpose of this arrangement is to get federal money out the door so that the provinces and territories – which differ significantly in the state of progress (or lack thereof) in formulating their early learning and child care services – can start or keep building their systems without having to wait until "a framework for quality programs and services across the country is developed" [Department of Finance Canada 2005: 120].

The Social Development Minister has characterized this first $700 million as "good faith" money to affirm Ottawa's continuing commitment while governments negotiate the framework for an ELCC system [Monsebraaten 2005]. Some social advocates have criticized this feature as unaccountable, no-strings-attached money that provinces can spend wherever they wish – whether on early learning and child care or somewhere else.

However, we think it makes sense for the new federal money to flow right away for political as well as policy reasons. The lure of significant dollars will exert political pressure – here the advocacy community has a key watchdog role to play – on the provinces and territories to invest the money in ELCC. On the policy front, additional federal money will help spur and enable action in building ELCC systems in the provinces and territories.

Building an early learning and child care system throughout Canada is almost as big a challenge as was building medicare back in the 1960s and 1970s. Medicare was the first example of what the Caledon Institute calls 'framework federalism' – a country-wide system of provincial/territorial social programs founded on a national framework of core objectives and principles, and funded jointly by the federal and provincial/territorial governments.

Framework federalism seeks to allow provinces and territories flexibility to tailor their programs to their needs and capabilities. The Canada Health Act enshrines the famous five principles of medicare – universality, comprehensiveness, accessibility, portability and public administration. The ongoing National Child Benefit reform of child benefits is another example of framework federalism.

A similar set of core principles for early learning and child care has been developed over the years by experts and advocates [see, for example, Child Care Advocacy Association of Canada 2004; Battle and Torjman 2000]. They have called for a national ELCC system built upon such tenets as universal accessibility, high quality, inclusiveness, comprehensiveness, affordability, public/non-profit administration and accountability – reflected (though not in their entirety) in the current initiative's four QUAD principles.

However, negotiating a broad national vision and core principles is just the first stage in building a nation-wide system of early learning and child care. Ottawa and the provinces/territories now have to put flesh on the bones of the skeletal national framework, elaborating the four QUAD principles. They must tackle the contentious issue of whether the new system should allow funding to for-profit ELCC services – which advocates and experts claim can sacrifice quality for profit.

Most of the difficult work required to build a national system of early learning and child care has to take place at the provincial and community levels. In addition to helping out with badly-needed money and negotiating with the provinces/territories a national multilateral framework, the federal government should play a leadership role through strong bilateralism.

Strong bilateralism ensures adherence to national principles

Caledon urges the federal government to pursue a strategy of what we term 'strong bilateralism.' In return for its larger financial investment, Ottawa should negotiate detailed, substantive bilateral agreements with each province and territory so that strategic investments can be made towards planning and building a comprehensive early learning and child care system in each jurisdiction in accordance with the guiding national principles.

Such bilateral agreements would interpret and implement the national framework within each province and territory. Detailed plans would plot over a number of years the creation of an ELCC system guided by and adhering to the broad national principles, but respecting each individual jurisdiction's priorities, state of development, needs and resources. The bilateral agreements would tackle the tough policy development work required to move from principles and objectives to delivering ELCC services on the ground, in communities throughout Canada – including service delivery mechanisms and plans, multi-year funding, parental fee structures, coverage, regulations, curriculum, staffing (e.g., education and training targets, pay and benefits), roles for stakeholders, evaluation and accountability processes, and public reporting [Child Care Advocacy Association of Canada 2004].

Bilateral agreements should be subject to public and stakeholder consultation and input before they are signed by governments. If a province or territory does not want to develop such a plan at this time, it need not do so: Federal funds will be available when and if it decides to proceed and establish a plan built upon the national framework. But apart from the initial 'good faith' funds for this fiscal year and the next, no further federal ELCC funds should flow without a bilateral agreement with each province and territory.

The federal government has a stewardship role to play in the national ELCC system. Ottawa must ensure that each jurisdiction's ELCC plan reflects and respects the QUAD principles.

Sustained federal funding

The 2005 Budget commits federal funding for ELCC through 2009-10. This cannot simply be 'startup money' that will end in 2009-10 once provinces and territories get their systems up and running. Ottawa must provide ongoing sustained funding for ELCC, the same as for health care. This funding should be assured and indexed, not left as a hanging question mark inhibiting provincial and territorial development of services.

Multiple partnerships

The national ELCC system cannot be constructed by governments alone. Stakeholders outside the three levels of government – ELCC experts and advocacy groups as well as parents, employers, unions and professional associations, schools, academics and the voluntary sector – must play an active role.

ELCC Council of Canada can act as a knowledge broker

Following the lead of the recently established Canada Health Council, the federal and provincial/territorial governments should set up an ELCC Council of Canada that would play a crucial knowledge broker role in creating, developing, researching and evaluating early learning and child care systems and services across Canada. It would gather and analyze research evidence on high-quality practice to be used as a benchmark for assessing implementation of ELCC services.

The ELCC Council would be made up of representatives from key stakeholders, including parents, the research and advocacy sectors, and government.

Parental fees are an important source of financing

While most of the funding for a national early learning and child care system should be public, there is also an important role for parental fees. Parental fees can contribute badly-needed funding to help grow and sustain the ELCC system. A well-designed parental fee schedule can help secure vital political buy-in from the broad middle class (and upper-income families too), since many families would pay less than they do now.

Excluding Quebec, parental fees currently average just under 50 percent of child care costs, ranging between 34 and 82 percent. If provinces and territories adopted European parental fee schedules, they would average just 25 percent of total costs [OECD Directorate for Education 2004: 72]. A recent international report advocates that Canada adopt a financing system made up of 40 percent federal funds, 40 percent provincial/territorial funds and 20 percent parental fees [OECD Directorate for Education 2004: 75].

Quebec employs a flat-rate fee schedule of $7 per day per child, along with subsidies for low-income families. But flat-rate schemes are regressive, since their burden declines as incomes rise, and they exacerbate the existing regressivity of payroll taxes (EI premiums and C/QPP contributions) and consumption taxes (GST and sales taxes). We suggest instead a graduated, progressive parental fee schedule that takes into account families' financial capacity and could collect more than a flat-rate fee. Parental fees could range, for example, from 0 to 50 percent of child care costs [National Council of Welfare 1988; OECD Directorate for Education 2004: 75].

However, we recognize that the structure of parental fees likely will differ from jurisdiction to jurisdiction. This design variation is entirely appropriate so long as every province and territory meets the objective of maintaining accessibility.

While Quebec's fee schedule might not be as progressive as one would want, it does help meet the goal of accessibility, so we do not see a federal role in changing Quebec's method. On the other hand, we do see a federal role in making the accessibility criterion sufficiently operational that – if a province's fee structure does impinge upon the principle – then some part of the federal funding for ELCC care to that province would be withdrawn.

Child care expense deduction should be gradually reduced

A significant but often overlooked element of the current child care funding system is the child care expense deduction. The lesser-earning parent can claim as an income tax deduction two-thirds of child care expenses up to a maximum $7,000 per child under age 7 and a maximum $4,000 for children ages 7 to15, in respect of receipted child care expenses incurred while the parent is working or attending school.

The tax deduction ceiling is $10,000 for child care expenses incurred for children eligible for the disability tax credit.

The nature and quality of the child care for which the tax deduction is claimed are not eligibility requirements. All that matters is that the claimant has a receipt from the caregiver.

Like the tax deductions for contributions to RRSPs and Registered Pension Plans, the child care expense deduction has a regressive impact, providing federal and provincial/territorial income tax savings that rise with income for two reasons. First, child care expenses increase with income. Second, the value of the child care tax deduction in terms of income tax savings goes up as the claimant's top tax rate increases.

In 2002, the most recent year for which tax data are available, child care expense claimants with incomes under $10,000 claimed on average $1,224 for a total federal-average provincial/territorial income tax savings of $29. Those between $40,000 and $50,000 claimed on average $3,180 and received in return a tax break of $867. Claimants with incomes over $250,000 averaged child care expenses of $5,583 and so reduced their total tax bill by an average $2,373.

The child care expense deduction is a significant expenditure for the federal and provincial/territorial treasuries. The cost to Ottawa in 2005 is an estimated $550 million [Department of Finance Canada 2004b: Table 1]. Adding in average provincial/territorial revenue losses, the child care expense deduction costs governments a total of about $809 million in 2005.

The child care expense deduction should be reduced gradually as Canada builds a national ELCC system that is funded mainly publicly. [Quebec provides a child care expense credit, but only for parents using child care outside the public $7 a day system.] It would make little sense to allow parents to claim parental fees as a child care expense deduction when such fees are needed to help fund what is chiefly a publicly financed system.

But the child care expense deduction should not disappear altogether because not all parents would choose to use their provincial/territorial system. Since they are still paying taxes that help fund the ELCC system, whether they use that system or not, denying them the child care expense deduction would be an unwise move in political – if not public policy – terms. Moreover, ELCC systems will be phased in over time and so will not be immediately accessible to all who want them; the child care expense deduction can defray some costs now for parents waiting to access the emerging public system. As the ELCC system becomes more accessible, the child care expense deduction can be reduced and the savings redirected to the publicly financed system.

Employment Insurance: Financing changes threaten countercyclical protection

The 2005 Budget announced significant planned changes to Employment Insurance (EI) financing. Under the proposals, the Employment Insurance Commission would take over responsibility for setting the EI premium rate in light of an estimate by the Chief Actuary of the amount required to pay for EI over the coming year. The government would retain the capacity to override the Commission if it did not agree with the rate. Because it would have to do so publicly and within a strict time limit of one month, overriding the Commission would not be a step undertaken lightly.

This proposal is a substantial departure in policy: It would hand over the power to set rates for a major revenue source ($17.2 billion in 2005-06) to a non-governmental Commission. Moreover, if these plans were implemented, the EI fund would not, in theory, be in surplus every year, as the premiums paid would be more or less sufficient to cover the coming year's costs. Additions to the notional EI account (now about $46 billion – but actually just a bookkeeping entry in the federal accounts) typically would no longer accrue annually, except by increments of notional interest payments on the existing funds. EI premiums would no longer contribute to government surpluses.

However, this change is a little less important in its fiscal impact than it first appears. EI premiums and EI costs already have largely been balanced. While the annual increment of EI premiums collected over benefits plus administration costs was approaching $7 billion in 2000, by 2003 this amount had been cut to about $1 billion due to successive annual reductions in EI premiums.

As forecast for 2005-06 and on, the amount of funds now collected by the EI premium and the amount paid out in benefits and administration would have been more or less in balance in any case. So this change will have little or no impact on the government's bottom line in this or future years.

Rather, our most important concern is that this proposed financing change will remove altogether any potential countercyclical element of EI. When unemployment rises, EI premiums will go up, not down. Similarly, when unemployment goes down, EI premiums will follow them and decrease. Instead of maintaining consumer demand in a declining economy, EI will accentuate the decline. Rather than dampening demand in a rising economy, EI premium cuts will add to demand.

The government proposes – in the words of the Budget – to "limit" this pro-cyclical effect by restricting the change in premiums in any one year to 15 cents (not saying whether this is 15 cents each for employers and employees or 15 cents in total). But 15 cents is not insignificant and, in any case, still goes in the wrong direction.

None of this is simple or straightforward. In an era in which governments are committed to balanced budgets, no matter what the state of the economy, it may be impossible to implement counter-cyclical policies anywhere.

It might be proposed, for instance, that the notional EI fund could be used to stabilize EI premium rates by drawing down the fund rather than raising EI premiums when unemployment goes up. But, as noted, the fund is only notional, so a payment from the fund to EI requires a budgetary transaction that is an expenditure on the government books. A payment out of the EI account adds to the government deficit or subtracts from the government surplus.

If the notional EI fund is used for rate stabilization, and if the government remains committed to a balanced budget, then a payment to EI out of the notional EI fund will result only in compensating budget cuts or tax increases. The program will thereby remain as pro-cyclical as if the EI premium itself had been increased.

On the other hand, it might be possible to set up a countercyclical element if the EI Commission is empowered to establish an independent EI fund, as was recommended by the House of Commons Standing Committee on Human Resources, Skills Development, Social Development and the Status of Persons with Disabilities. The Budget acknowledged the report of the Standing Committee and claimed that it took into account the recommendations. However, the Budget proposal is actually not in accord with the Committee's recommendations and is silent on a number of critical issues around which the Committee made specific recommendations – e.g., the establishment of an independent EI fund, the composition of an empowered EI Commission and the disposition of the existing notional EI fund.

Given the dissonance between government plans and the Committee's report, the minority status of the government and the political sensitivity of anything to do with EI financing, it could well be that the plans proposed by the Budget will be significantly altered during the Parliamentary process. The Caledon Institute urges that this be an open process, not a backroom bargain. More importantly, we see this debate as only a prelude to a more profound discussion about the nature of EI itself.

We believe that the EI program is no longer serving its primary purpose well – namely, providing adequate temporary bridging assistance to unemployed Canadians while they look for work. Financing, like form, should follow function. We would hope that any financing solutions be seen as temporary and a beginning to a deeper discussion about the role of the EI program in the broader system of income security for working-age Canadians. In the coming months, the Caledon Institute will be publishing proposals for radical reform of Canada's programs for working age people, including EI and welfare, which we hope will be a useful contribution to this discussion.

New Deal for Cities and Communities: Can it address the urgent need?

The 2005 Budget announced a new Deal for Cities and Communities. It builds on the agreement introduced in the 2004 Budget, which afforded a full rebate on the Goods and Services Tax (GST) and the federal portion of the harmonized sales tax for municipalities. The New Deal also adds to existing

infrastructure programs, such as the Municipal Rural Infrastructure Fund, all of which the federal government has promised to renew.

The new Budget will deliver more than $7 billion to municipalities over ten years to help fund infrastructure priorities such as roads, sewers, transit and clean water. Revenue from the gas tax, the main source of new federal funding, will be delivered as follows: $600 million in 2005-06, $600 million in 2006-07, $800 million in 2007-08, $1 billion in 2008-09 and $2 billion in 2009-10.

These funds are intended for investment in physical infrastructure and are crucial to repair, replace and upgrade aging municipal hardware. The money is also necessary for the greening of buildings and physical plant as well as processes, such as waste management.

Over the years, Caledon has made the case for direct public investment in cities and communities. There are several social reasons for this investment – improved health is the most immediate and apparent. But there are other broader social reasons, which we discuss below.

The links between good health and a clean environment are both clear and obvious. Costs to the health care system likely would drop significantly from improved air quality alone. Recent and regular smog alerts in large urban centres are costly in both financial terms and in human suffering from debilitating respiratory illnesses, such as asthma and emphysema.

Fiscal imbalance has long been a problem

Municipalities long knew that these investments were required. But problems consistently arose from the fact that the fiscal capacity of municipalities typically falls well below the investments that they must make.

In most provinces, municipalities have only limited fiscal instruments for revenue-raising purposes. They rely primarily on property taxes, license permits and user fees – generally not enough to sustain the range of programs and services that they operate – let alone support investment in repair and upgrades.

In big cities, in particular, the need for physical repair and upgrading is urgent. Toronto alone has had a population of three million people since 1975 but has added only three new subway stops in the past 30 years. A few dollars from the gas tax will pay for only one year's increase in the Toronto Transit Commission budget. The city's sewer and water systems are in desperate need of repair. There are now health threats from rats due to garbage proliferation.

The need for appropriate financing for cities goes well beyond physical hardware. In some provinces like Ontario, municipalities are responsible for social expenditures in such areas as social

assistance, social housing and home care. These areas of social need generally have big price tags and typically exceed the carrying capacity of most local governments.

The property tax base is too limited and regressive to address effectively the wide range of social, economic and environmental challenges that most cities now confront. Canada's cities simply do not have the fiscal capacity to make necessary investments in green infrastructure, renewed transportation and affordable housing.

Some urban centres face additional extraordinary costs arising from unique serious economic and social problems. In some cases, they have lost their economic base or it has shifted dramatically, creating a need for retraining.

Many communities in Canada experience high rates of unemployment and poverty. Many neighbourhoods also must cope with stresses related to groups at high risk of marginalization – e.g., Aboriginal Canadians living in urban areas, highly skilled immigrants who are unemployed or underemployed, and persons with disabilities who are unable to find accessible housing or paid work.

Funds announced in other sections of the Budget may help address some of these problems. For example, over the next five years, $398 million will be allocated in respect of settlement and integration programs for new Canadians. A portion of these funds will facilitate the recognition of credentials acquired offshore and will enable recent immigrants to obtain both basic and work-related language skills. While the money may not go entirely or even directly to local governments, they will benefit nonetheless through improved employment and lower settlement costs in their respective regions.

On that note, the Budget signalled that investment of $2.1 billion in the current year and over the next five years to enhance regional development. The funds will be dispersed primarily through agencies responsible for the social economy and local economic development in regions that have been hit hard by trade-related and resource-based shocks to the economy. However, the largest urban area of Canada, and also the centre of much of its economic growth – southern Ontario – is excluded from any of these funds.

In addition to tackling negative stresses, major urban centres incur additional costs resulting from worldwide economic shifts. In the context of globalization, they are under strong pressure to become world-class players on the global stage in the search for knowledge workers. Urban areas face new demands arising from the need to attract the best talent in the world.

To draw the highly skilled workers that they require to compete economically, cities must offer not only interesting and remunerative employment. They also must improve their 'quality of place.' Municipalities must pay far more attention to social and environmental factors than they might have in the past. They are viable as urban regions in a global economy only to the extent that they have – and are seen to have – a good quality of life.

The arts, recreation and libraries all make for culturally attractive communities. The accommodation of diversity and disability make for inclusive communities. But perhaps the centrepiece of high-quality neighbourhoods is the availability of affordable, decent housing. Unfortunately, the 2005 Budget made no new investment in this regard.

Housing: A major disappointment

In a Budget heralded as being all things to all people, one of the few sectors left out was affordable housing. The Budget contains no financial commitment to expand the supply of affordable housing required to accommodate the 1.7 million (one in every seven) households deemed to be in core housing need, as defined by the Canada Mortgage and Housing Corporation (CMHC).

The lack of investment in this area was a big disappointment, especially in light of the expectations raised by the Liberal election platform – i.e., the promise of $1.5 billion in new funding over five years. A proactive Minister recently had been appointed and the Housing and Homeless portfolios had been integrated under his management.

The Budget also came on the heels of a six-week, cross-country consultation on the design of a comprehensive national housing framework. Though the details of such a national strategy must be refined and articulated, there were high expectations that the Budget would at least set aside the funds necessary to implement such a program.

While not explicitly allocating funds for housing, the Budget did imply that current programs would be renewed when they expire next year. Potentially this renewal includes the Residential Rehabilitation Assistance Program ($384 million over three years) and the Supporting Community Partnerships Initiative (SCPI) homeless funding program ($258 million over three years), both of which are due to expire in March 2006. The renewal should also include the Affordable Housing Initiative – though the $320 million set aside in the 2003 federal Budget for phase 2 has not yet been spent.

The only new money announced in the 2005 Budget – $295 million – is intended for Aboriginal housing on reserve. The purpose of this investment is to fund the construction and rehabilitation of 6,400 dwellings on reserve. There is not, however, a concurrent commitment to Canada's growing non-reserve population, who account for 70 percent of the total Aboriginal population.

At first glance, the 2005 Budget does not look good for housing. But there is a glimmer of hope. A cryptic reference to "the same is true for our housing initiatives" follows the statement that the government intends to renew infrastructure programs due to expire over the next few years. The Budget makes a soft but notable commitment to housing. Given the lead time required to design and build new housing, it is crucial to know there will be a source of funding in future so that work toward new development will continue. The Minister needs to clarify and emphasize this point.

The apparent logic for not announcing new funding in this Budget is that there remains a significant amount of unspent monies from previous Budgets. The Affordable Housing Initiative (AHI), in particular, initially had allocated $680 million in 2001, and subsequently $320 million in 2003, for a total of $1.0 billion. The initiative was designed as a capital fund to be allocated among provinces and territories on a 50-50 cost-shared basis. The provinces and territories were expected to design and implement a menu of programs to address affordable housing needs.

To date, less than $200 million of this pool has been spent (in new housing completed and funded) and up to an additional $300 million has been committed but not yet spent. At least $500 million remains to be committed by March 2008.

The delay in spending these funds relates, in part, to the fact that it takes from two to three years to carry out a planning and approval process and to complete construction of new housing. Another significant reason for the delay arises from protracted negotiations on agreements for cost-sharing and program design elements with a number of provinces – most notably Ontario, with the largest share of the overall allocation based on population.

Once the Housing Minister completes the national consultation work, it is expected that he will go forward to Cabinet with a proposal to establish and fund a comprehensive strategy, in partnership with the provinces and territories, to address need across the spectrum. A comprehensive strategy would include homeless shelters, transitional and supportive housing, and permanent affordable housing.

Will there be funds left for a meaningful commitment?

The critical question is whether there will be any money left to fund a meaningful commitment to housing and to have a significant impact upon the substantial need that exists. This need is due, in large part, to the federal withdrawal in 1993 of funding for affordable housing and the absence of any federal funding for new affordable housing between 1994 and 1999.

The current Budget is comprehensive and long term in estimating available revenues and allocating these across a range of significant spending initiatives and tax cuts, with much of the resources flowing toward the back end of the five-year fiscal framework. There is legitimate concern as to whether the government has left any room for new priorities such as a comprehensive national housing framework.

One source of funding may derive from the surpluses generated by the federal housing agency, the Canada Mortgage and Housing Corporation (CMHC), under its commercial mortgage insurance activities. In 2003, the CMHC recorded an after-tax profit of $667 million.

The Corporation's five-year plan projects this surplus to exceed $700 million annually and to total more than $3.5 billion between 2004 and 2008. In 2003, the CMHC Board of Directors adopted a policy to set aside 100 percent of the annual surplus to meet a capitalization guideline established by the Office of the Superintendent of Financial Institutions (OSFI).

Essentially, this practice means holding liquid capital reserves against unanticipated risk related to mortgage insurance and securitization activities.[4] The federal government has the option of backing CMHC (and currently charges a fee to CMHC specifically to cover the shortfall between CMHC total capitalization and the OFSI target), and utilizing these annual surpluses to fund other initiatives.

While current practice represents prudent financial management, it is a policy decision and not a regulated requirement. It would be analogous to the Government of Canada allocating the entire federal surplus to debt reduction with nothing for program spending. Advocates for affordable housing suggest that it would be appropriate to retain the bulk of such spending for affordable housing initiatives.

Housing plays a central role in social well-being

Recent research has increased awareness about the role of housing in both supporting a strong and productive economy and as a critical part of the social safety net – two areas that figure prominently in the Budget. Without concurrent commitments to housing, the government's goals in these broader areas are weakened.

While the Budget highlights the need, for instance, to invest in early learning and child care services, child poverty is exacerbated by high housing costs and the unavailability of affordable housing. Families are left with an untenable choice. They either must live in housing that is in poor condition (with associated negative health impacts) and in some cases in unsafe neighbourhoods, or they must pay so much of their limited income for adequate housing that there is little left for food and other necessities. Children who are undernourished and without safe housing cannot learn as well as others. Sound, affordable housing is actually a key element for effective early learning and care of children.

The federal paper *Towards a New Canadian Housing Framework*, prepared as background to the national consultations, highlighted the types of households most in need. Prominent among these are seniors, Aboriginals and new immigrants – again, three groups targeted by the 2005 Budget. While the Budget will enhance modestly the Guaranteed Income Supplement (discussed later), the increase is less that the rise in monthly rental costs that seniors have faced over the past four years.

The Budget seeks to improve the integration of new Canadians with specific emphasis on facilitating access to the labour market and earnings. But many jobs do not generate sufficient income to afford housing, especially in those markets where immigration levels are highest – large urban centres. The fact

that many new Canadians face serious challenges related to housing affordability calls for a housing initiative to complement the settlement strategy.

Finally, in the area of health care, community-based delivery is emerging as an approach to manage rising costs. This model is predicated upon the availability of appropriate housing especially to enable frail seniors and adults with disabilities to live in the community with access to these new community-based health services. A well-housed population is a healthier population – with dividends for the health care system.

Disability tax measures: Necessary but not sufficient

The bulk of disability-related measures in the 2005 Budget focused upon the recommendations of the Technical Advisory Committee on Tax Measures for Persons with Disabilities. The Committee was announced in the 2003 federal Budget with a mandate to advise the Ministers of Finance and National Revenue on ways to improve disability tax measures, with a particular emphasis on the disability tax credit. Persons with impairments in mental functions were deemed to be especially disadvantaged in eligibility determination because the symptoms and their associated impact have not been as well understood as impairments in physical function.

Caledon was pleased to see such strong support for the work of the Committee, having been involved directly in this process (Caledon Vice-President, Sherri Torjman, served as co-chair of the Committee). The Minister of Finance announced his intention to proceed with virtually all the recommendations in the Committee report [Technical Advisory Committee 2004].

We agree with the Committee's conclusion that tax measures, while important and helpful, are not the most effective instruments to enable the participation of persons with disabilities. The government must focus far more attention on such areas as the disproportionately high rates of poverty among persons with disabilities and access to disability supports, without which many Canadians are unable to participate in the community and society. Unfortunately, the Budget did not announce any measures in this regard. We strongly urge the government to turn its attention to these areas.

The Committee's recommendations for reform of the tax system can be grouped into three major themes. First, there is a package of proposed changes to clarify the legislative and interpretive intent of the disability tax credit and to improve its administration. The second group of proposals focus primarily upon the itemizable costs of disability and, more specifically, upon various tax measures that enable persons with disabilities to pursue education, training or paid employment. The third group of recommendations are intended to improve tax measures that recognize the additional costs of caregiving.

While disabilities vary widely in their nature and impact, they often give rise to a common problem. Persons with disabilities are likely to incur additional costs and to require special assistance in order to participate actively in and contribute to society.

Disability tax credit: Improved eligibility and administration

The first theme within the reform package proposes changes to the disability tax credit – the primary tax measure concerned with the non-itemizable or hidden costs of disability. The Committee's proposals regarding the disability tax credit call for legislative, interpretive and administrative changes that embody the principles of fairness and equity.

The disability tax credit provides income tax relief to individuals with severe impairments in function that restrict them in the activities of daily living. It is also available to those who require extensive therapy to sustain a vital function. The credit is based on the assumption that persons with severe and prolonged disabilities likely incur a range of disability-related costs – such as expenses related to transportation, special clothing and additional heating or cooling costs – which they are not able to claim under the medical expense tax credit. These are considered to be the 'non-itemizable' or hidden costs of disability.

For 2004, the disability tax credit was 16 percent of $6,486, which provided a federal income tax reduction of up to $1,038. The credit can be transferred to a supporting relative. Families caring for children with severe and prolonged impairments may receive additional tax relief through a supplement to the disability tax credit. For 2004, the supplement was worth an additional federal tax savings of up to $605 (16 percent of $3,784).

From the perspective of eligibility, the credit had a number of serious limitations. The impairment in the 'perceiving, thinking and remembering' category, for example, did not capture the full range of mental functions, such as serious mood disorders. Another problem arose from the fact that individuals with cumulative restrictions in their ability to carry out basic activities of daily living often did not qualify for the credit, even though the combination of their symptoms create a serious marked restriction.

Other shortcomings relate to the provision that persons who require life-sustaining therapy may be eligible for the disability tax credit. But 'therapy' is not defined in the Income Tax Act. The Committee proposed that the interpretation of life-sustaining therapy adequately reflect the time taken for essential preparation, administration and necessary recovery as recently interpreted in decisions of the Tax Court of Canada.

The Committee also had made several recommendations to improve the administration of the disability tax credit, including the training of staff and adherence to policies and procedures when adjudicating claims. An advisory committee reporting directly to the Minister of National Revenue was

proposed to oversee the implementation and monitoring of the administrative recommendations. The Minister of National Revenue actually began taking action to strike such a Committee several weeks before the Budget was introduced.

Tax measures to support education and employment

With respect to the education and employment measures that comprise the second theme, the Technical Advisory Committee explored several options for enhancing existing and creating new incentives to work. Canadians of working age with disabilities tend, on average, to have lower incomes than persons without disabilities. The former typically have both lower levels of education and employment than other Canadians.

The Committee had put forward an interim recommendation in January 2004 that a new deduction be provided for the cost of disability supports purchased by persons with disabilities in order to pursue employment or education. The federal government did, in fact, introduce a disability supports deduction in its 2004 Budget.

The disability supports deduction recognizes disability expenses for the purposes of employment and education more completely than its predecessor, the attendant care deduction. The new deduction allows persons with disabilities to deduct expenses for disability supports, up to the taxpayer's total earned income. The attendant care deduction was limited to two-thirds of the taxpayer's earned income.

The attendant care deduction also required that taxpayers be eligible for the disability tax credit to claim the deduction. The disability supports deduction, by contrast, expects only that the need for some eligible expenses be certified by a health practitioner. It is therefore available to all persons who require disability supports, and not only to those eligible for the disability tax credit.

Another improvement embodied in the new disability supports deduction is that individuals will be able to deduct amounts that the federal or a provincial/territorial government has paid to them as a cash benefit intended explicitly for the purchase of disability supports for education or employment. If recipients are required by a government program to count these payments as income, they will be able to fully claim these amounts under the new measures. The introduction of the disability supports deduction puts in place a mechanism to ensure that government assistance intended for disability supports will no longer be taxed.

Finally, a deduction reduces taxpayers' gross income, leaving them with a lower net income for the calculation of their income taxes. By reducing net income, the new measure may also put more money in the pockets of some Canadians with disabilities by increasing their benefits from net family income-based programs, such as the federal Canada Child Tax Benefit and GST credit and provincial/territorial child benefits and refundable tax credits.

To further improve the disability supports deduction, the Committee recommended in its final report that the cost of such items as job coaches and readers, Braille note takers, page turners, print readers, voice-operated software, memory books, assistive devices used to access computer technology, and similar disability-related expenses be added to the list of expenses recognized by the deduction.

In respect of employment, another noteworthy provision within the federal income tax system is the refundable medical expense supplement. It provides modest financial aid to low-income workers with above-average medical expenses, including persons with disabilities. The measure tries to compensate, to a limited extent, for the loss of health-related benefits when individuals with high heath-related costs move off social assistance to enter the workforce. As their income rises, they frequently lose eligibility for disability supports and supplementary health benefits – and end up paying for these items on their own.

For 2004, the maximum refundable medical expense supplement was 25 percent of the allowable portion of expenses that can be claimed under the medical expense tax credit plus 25 percent of the amount claimed under the disability supports deduction announced in the March 2004 federal Budget, up to a maximum of $562. To ensure that the supplement is targeted to persons entering or currently in the labour force, it is available only to workers with earnings from employment or self-employment above $2,809 in 2004.

Unlike most tax credits, the medical expense supplement is refundable – which means that individuals who do not owe income tax can benefit as well. If the amount of a worker's refundable medical expense supplement exceeds his or her net federal tax, the individual receives the difference.

The Technical Advisory Committee had recommended increasing the medical expense supplement from $562 to $1,000. The Budget responded to this recommendation by raising the maximum amount of the supplement to $750.

Enhanced assistance for caregivers and families

The third cluster of Committee proposals focused upon the tax measures that afford some recognition of the costs that caregivers incur in providing support for persons with disabilities. The extra cost of raising a child with a disability can cause financial hardship. The needs of the child often force one parent to quit work or seek a part-time or less demanding job. Like most families, these parents want to ensure that they can provide the developmental opportunities that are available to other children.

In the area of direct costs, the Committee recommended a doubling of the limit of medical expenses that caregivers may claim in respect of a dependent with a severe disability. In fact, the Budget went further than the Committee proposal. It doubled the limit of the expenses claimable in respect of a dependent with a disability from $5,000 to $10,000, as suggested. But it did not include the requirement that the additional amount be available only to those with dependents who qualify for the disability tax credit – which means

that the government chose to leave the eligibility criteria more flexible than had been proposed by the Technical Advisory Committee.

The Committee also recommended an increase to the Child Disability Benefit, which builds on the main federal instrument for providing financial assistance to families with children – the Canada Child Tax Benefit (CCTB). The CCTB is an income-tested benefit delivered through the tax system. It consists of two major components: the CCTB base benefit paid to the vast majority families with children, and the National Child Benefit supplement, which provides additional assistance to low-income families.

The Canada Child Tax Benefit has a supplement, the Child Disability Benefit, which was introduced in the 2003 federal Budget. It is paid to families on behalf of children with severe and prolonged disabilities who are eligible for the disability tax credit. The benefit helps recognize the special needs of low- and modest-income families with a child with a disability.

For the July 2004-June 2005 benefit year, eligible recipients receive their annual Child Disability Benefit entitlement of up to $1,653 per qualified child as part of their

monthly Canada Child Tax Benefit. The Committee recommended that the federal government increase the amount of the Child Disability Benefit by $600 to raise the total maximum annual benefit from $1,653 to $2,253 and that the amount continue to be indexed to the cost of living, as is the case for the Canada Child Tax Benefit. The Budget announced the government's intention to increase the benefit to $2,000 beginning in July 2005.

Finally, the Technical Advisory Committee recommended a modest step to allow greater flexibility to families saving privately to ensure a better quality of life for their children with severe disabilities and to save for their education. Families caring for these children have been calling for greater tax recognition for private savings so that they can put aside some money for their relatives after the parents' death.

Such recognition of private savings would help move away from the welfare mentality in which recipients are expected to plead 'cap-in-hand' for assistance. The encouragement of private savings carries for many families a strong message of self-sufficiency and resilience. The Budget indicated the government's commitment to review this proposal.

Investments are required in the supply of disability supports

But while the disability tax credit is important and improvements in its scope and fairness are essential, the credit by itself cannot provide the type of recognition and supports required by persons with disabilities and their families. For example, families need to build caring networks for and around their relatives, particularly children with severe disabilities. Some of the major problems these individuals face

are isolation, loneliness and the absence of caring relationships – which are often more important to their well-being than money.

The Committee recommended that any new substantial funding to promote fairness and inclusion for persons with disabilities not be allocated to tax measures. The Caledon Institute supports the Committee's recommendation that future expenditure should be directed toward income security programs and disability supports rather than tax measures.

One possibility is to invest in the supply of supports so that these are more readily available to all persons with disabilities. The investment-in-supply approach is particularly important to low-income individuals and Aboriginal Canadians with disabilities, most of whom do not benefit from current tax provisions.

Many Canadians with disabilities who require assistance to live independently or who want to participate in education, training or the labour market are unable to do so because they have limited access to these supports. Forty-four percent of persons with

disabilities are not in the paid labour force; they cite barriers and other disincentives, such as lack of supports, as the reason. One-quarter of Canadians with disabilities on income support programs, such as welfare, name loss of supports as a reason for not looking for work.

These same supports are also important for seniors, many of whom require some assistance with independent living as a normal part of aging. With a rapidly aging population, caregiving and relief for caregivers are likely the most pressing social issues that Canada will face in the coming decades. This issue is discussed below.

The fact that the Budget did not announce reforms to disability income programs or disability supports should not stop the government from working in these vital areas. A legacy of reports has made the case for improvements in the three building blocks that are essential to enabling full citizenship: disability supports, employment and income.

The message was reinforced in the federal-provincial/territorial *In Unison* document that preceded the federal 2005 Budget by seven years. There is a pressing need to bring together the key players both within and outside of government to work on detailed program and associated financing mechanisms for reform in these areas. The case for action has long been made.

Supports for seniors

The Budget introduced some initiatives regarding income support and services for seniors. There will be a modest increase in the Guaranteed Income Supplement that helps low-income seniors. The

federal government was far less definitive in the area of services, announcing the expansion of the New Horizons program and the creation of a Seniors Secretariat. While the functions of the latter were not spelled out in the Budget, we offer some suggestions as to what such a body might do.

Raising the Guaranteed Income Supplement for poor seniors: Small patch on a flawed system

The 2005 Budget announced a long-awaited increase in the Guaranteed Income Supplement for low-income seniors. Caledon has long called for improvements in income benefits for the low-income elderly, and so we welcome this change. However, we also have recommended a fundamental restructuring of income security programs and tax benefits for elderly Canadians to create a fairer and more progressive foundation to the retirement income system.

Canada has a mixed public-private pension system intended to achieve two basic objectives – anti-poverty (ensuring a basic income floor so that no senior need live in poverty) and earnings-replacement (so that Canadians at all income levels can achieve a standard of living in retirement comparable to that during their pre-retirement years).

Three federal programs make up the foundation of our retirement income. Old Age Security (OAS) is a quasi-universal program that serves almost all (98 percent) Canadians 65 and older, excluding only the top 2 percent of affluent seniors with incomes over $98,547.[5] The Guaranteed Income Supplement (GIS) is a geared-to-income program targeted to low-income seniors; 39 percent of OAS recipients qualify for the GIS. The Allowance (formerly known as the Spouse's Allowance) serves low-income seniors 60 to 64 whose spouse or common-law partner (same sex or opposite sex) receives or is entitled to receive Old Age Security and the Guaranteed Income Supplement; the Allowance for the survivor helps low-income seniors 60 to 64 whose spouse or common-law partner has died. The Allowance excludes low-income seniors aged 60 to 64 who never married or are divorced or separated.

The second tier is made up of the earnings-based Canada Pension Plan and Quebec Pension Plan, which cover all working Canadians (employees and the self-employed) throughout their working life. The third tier is composed of employer-sponsored private pension plans (Registered Pension Plans or RPPS) and individual retirement income savings plans (Registered Retirement Savings Plans or RRSPs).

The personal income tax system also plays a significant part in Canada's pension system. It provides a nonrefundable tax credit that reduces income tax for Canadians 65 and older, as well as a nonrefundable credit for those with income from private pensions and retirement savings. The tax system includes a nonrefundable tax credit that reduces the burden of the premiums (called 'contributions') that employees and employers pay to finance the Canada Pension Plan and Quebec Pension Plan. The income tax system also provides a tax deduction that partly offsets the cost of taxpayers' annual contributions to RRSPs and Registered Pension Plans, and exempts from taxation investment income accruing in these plans.

The 2005 Budget announced increases to the Guaranteed Income Supplement (GIS) and the Allowance, Canada's major income programs for low-income seniors and near-seniors. Maximum GIS benefits will rise by $36 for single seniors ($18 on January 1, 2006 and $18 on January 1, 2007) and by $58 for couples ($29 on January 1, 2006 and $29 on January 1, 2007). The Allowance will see a corresponding increase.

These improvements are literally historic: The last time that the Guaranteed Income Supplement was increased (over and above its normal quarterly indexation to the cost of living) was way back in 1984. When the raise begins to take effect in 2006, it will be the first real increase in 22 years.

The GIS raise is modest – though not insignificant – both in terms of dollar amount and impact on poverty. The maximum GIS for single seniors will increase from a projected $6,780 in 2005 to $7,131 in 2006 ($216 or 3 percent more than the $6,915 under the old rates) and $7,486 in 2007 ($432 or 6 percent more than the $7,054 before the increase). Maximum GIS payments for elderly couples will go up from a projected $8,832 in 2005 to $9,367 in 2006 ($348 or 4 percent more than the $9,009 under the old rates) and $9,885 in 2007 ($696 or 8 percent more than the $9,189 before the increase).

Figure 8 tracks the maximum benefit for single seniors from Old Age Security and the maximum Guaranteed Income Supplement. Old Age Security began in 1952 and was joined by the Guaranteed Income Supplement in 1966. Because benefits are indexed to the cost of living, in real (inflation-adjusted) terms they have remained level at about $12,900 (combined OAS and maximum GIS) since 1985. The increases to the Guaran-teed Income Supplement announced in the 2005 Budget barely show up on the graph in the upturn in 2006 and 2007. Figure 9 shows the same picture for elderly couples.

The enrichment of the Guaranteed Income Supplement slightly favours elderly couples over singles. Maximum payments to single seniors will be 3 percent higher than what they would have been under the existing system in 2006 and 6 percent higher in 2007; elderly couples eligible for the maximum GIS will enjoy increases of 4 and 8 percent, respectively. Currently, the maximum Guaranteed Income Supplement for single seniors represents 77 percent of the maximum paid to elderly couples. The increase announced in the 2005 Budget will reduce that percentage a bit to 76 percent.

The enhancements to the Guaranteed Income Supplement are relatively small, but they still will reduce the low income rate somewhat because elderly Canadians are concentrated on the lower rungs of the income ladder. Even a small improvement in the GIS will move enough seniors above the low income line to make a (similarly modest) dent in the low income statistics. However, the Budget did not provide any estimates of the poverty reduction impact of the GIS increases.

We can, though, gauge the impact of the GIS increase on the low income gap – meaning the number of dollars that Old Age Security and the maximum Guaranteed Income Supplement fall below the low income cutoffs (we use Statistics Canada's after-tax low income cutoffs, estimated by Caledon for 2007). The low income gap for OAS/GIS benefits to single seniors is so deep that the GIS raise will

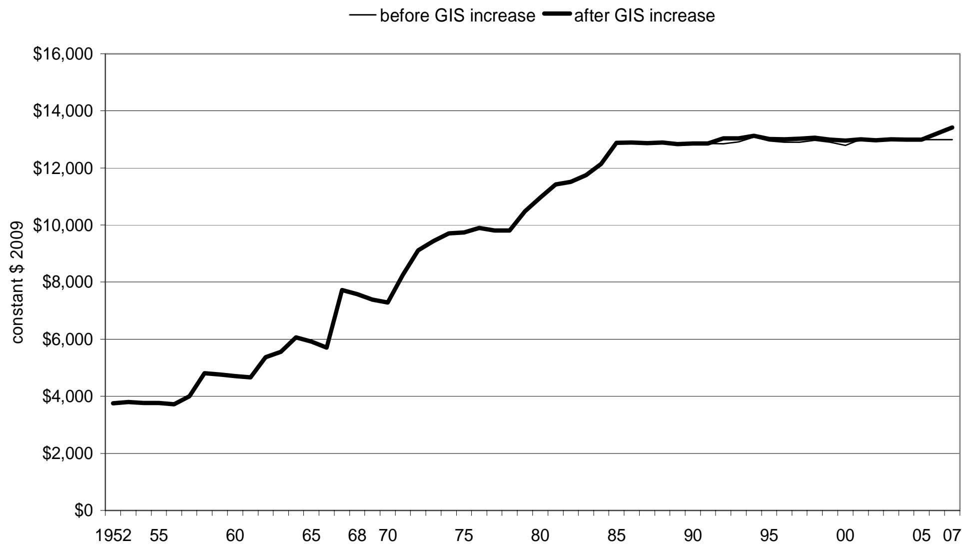


Figure 8
Benefits from Old Age Security and maximum Guaranteed Income Supplement, in constant 2007 dollars, single seniors, 1952-2007

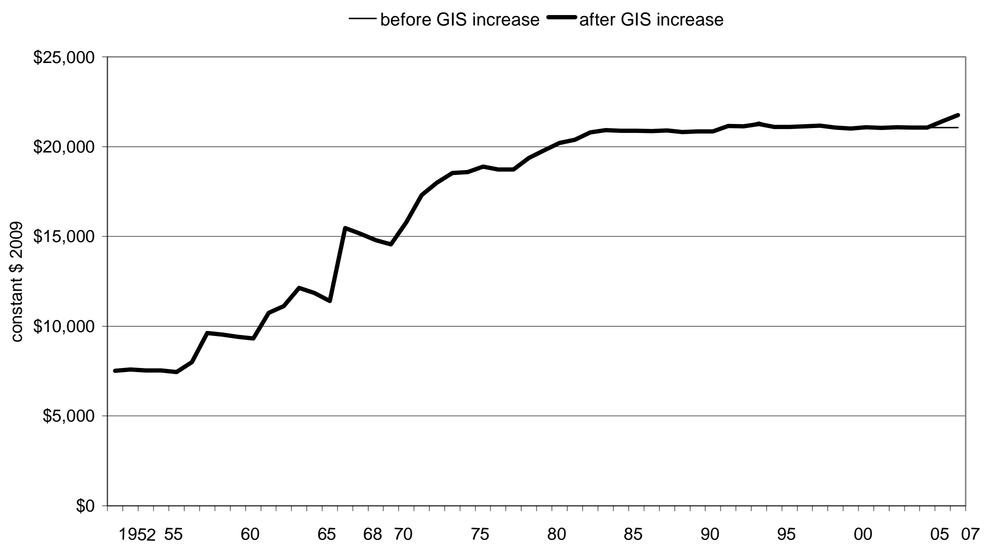
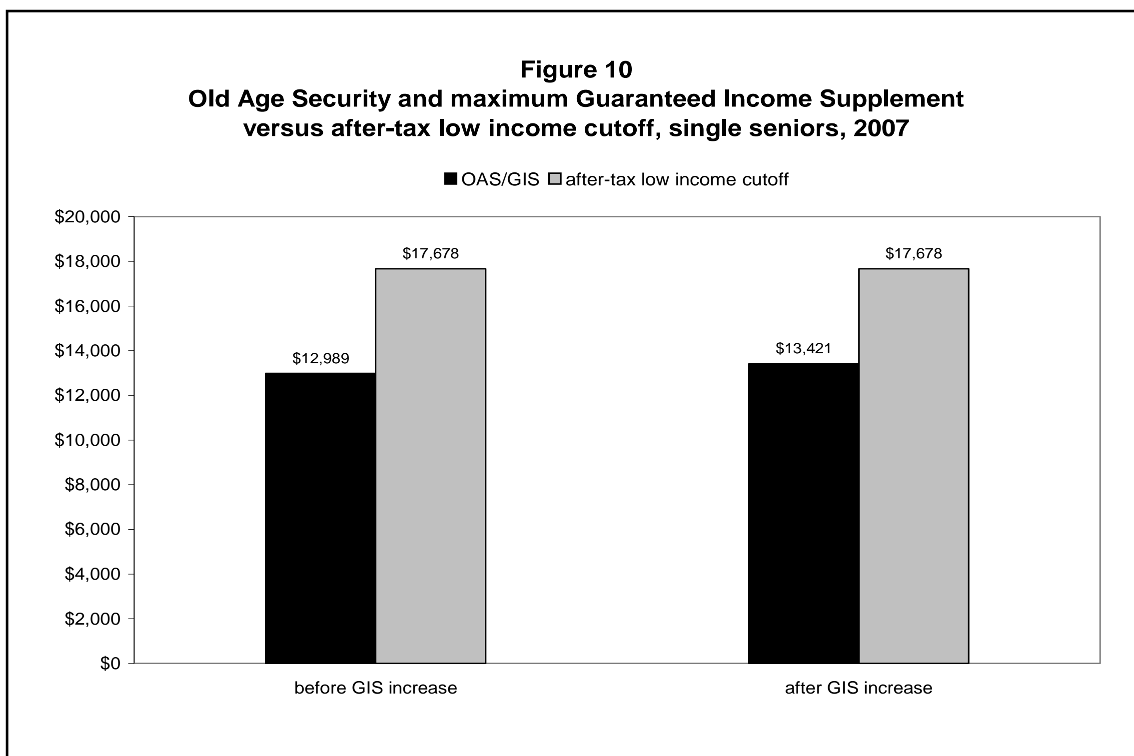


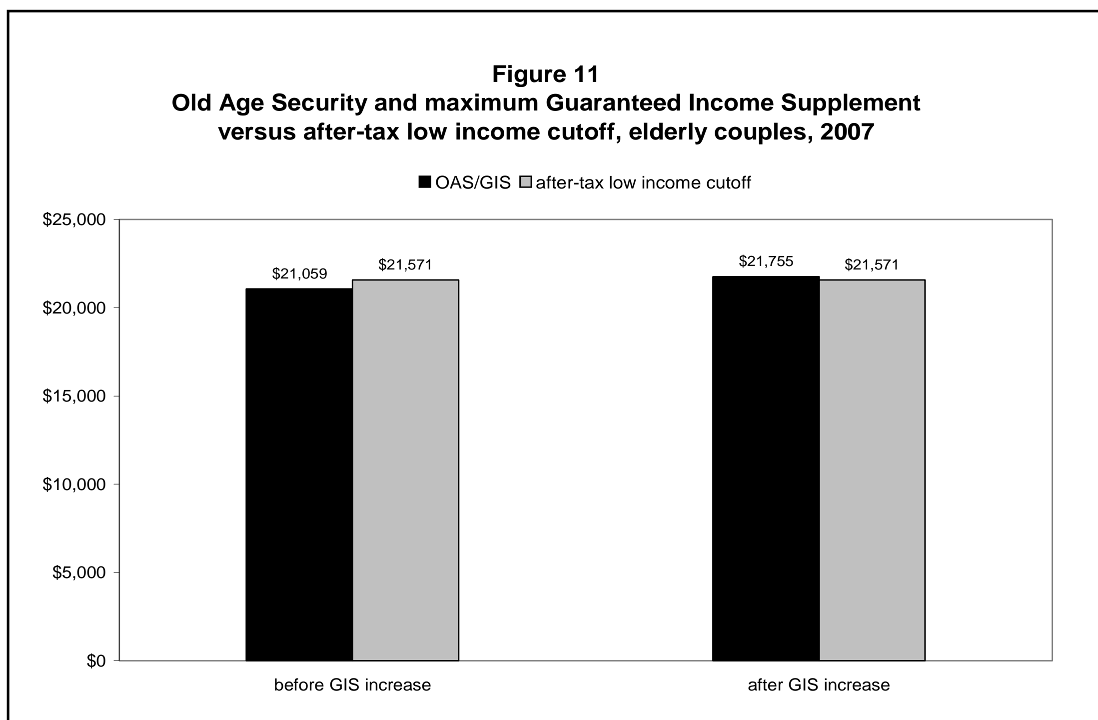
Figure 9
Benefits from Old Age Security and maximum Guaranteed Income Supplement, in constant 2007 dollars, elderly couples, 1952-2009

reduce the gap only modestly. By contrast, the existing gap for OAS/GIS to elderly couples is so small that the GIS increase actually will raise them just over the low income cutoffs.

Figure 10 compares total income from OAS and the maximum GIS for single seniors in 2007, before and after the increase announced in the Budget, to the after-tax low income cutoff for single Canadians living in metropolitan centres over 500,000. In 2007, OAS and the maximum GIS would amount to $12,989 without the boost announced in the 2005 Budget – $4,689 below the after-tax low income cutoff. With the GIS increase, the low income gap will decline by $432 to $4,257.

Figure 11 shows the same comparison for elderly couples. OAS and the maximum GIS without the increase would amount to an estimated $21,059 in 2007 – just $512 below the after-tax low income cutoff. With the GIS increase, maximum benefits from OAS and the GIS will reach $21,755 – $184 above the low income cutoff.



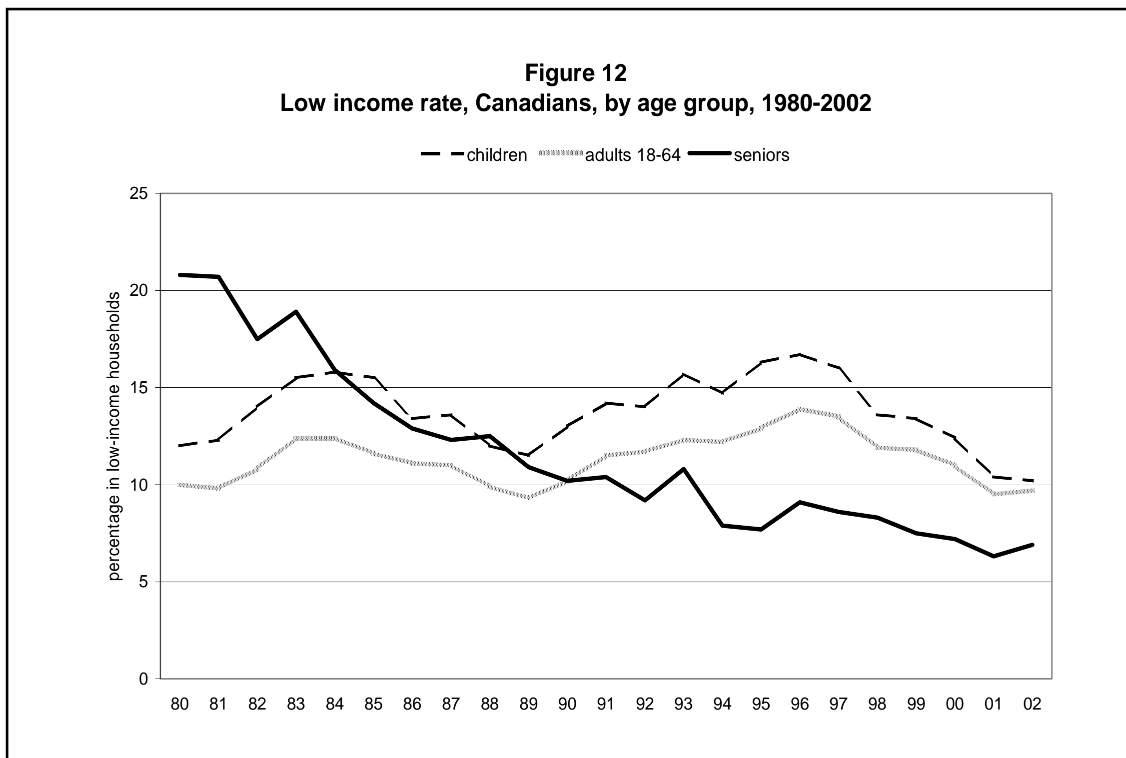


The overall retirement system is responsible for progress against poverty

Much has been made of Canada's substantial progress in reducing the risk of poverty among seniors, and rightly so – especially since poverty among children and adults 18-64 has seen no long-term decline. Figure 12 shows the percentage of seniors, children and non-aged adults with low incomes, using Statistics Canada's after-tax low income cutoffs. The low income rate for seniors declined from 20.8 percent in 1980 to 6.9 percent in 2002. In fact, seniors now have a lower incidence of poverty than children and non-elderly adults.

Families whose major earner is 65 or older enjoyed a significant reduction in low income, from 7.1 percent in 1980 to 2.7 percent in 2002 – among the lowest of any category. The decrease in the incidence of poverty among unattached seniors – i.e., those living alone or with non-relatives – is dramatic, falling among women from 56.1 percent in 1980 to 19.5 percent in 2002 and for men from 45.5 percent in 1980 to 14.4 percent in 2002.

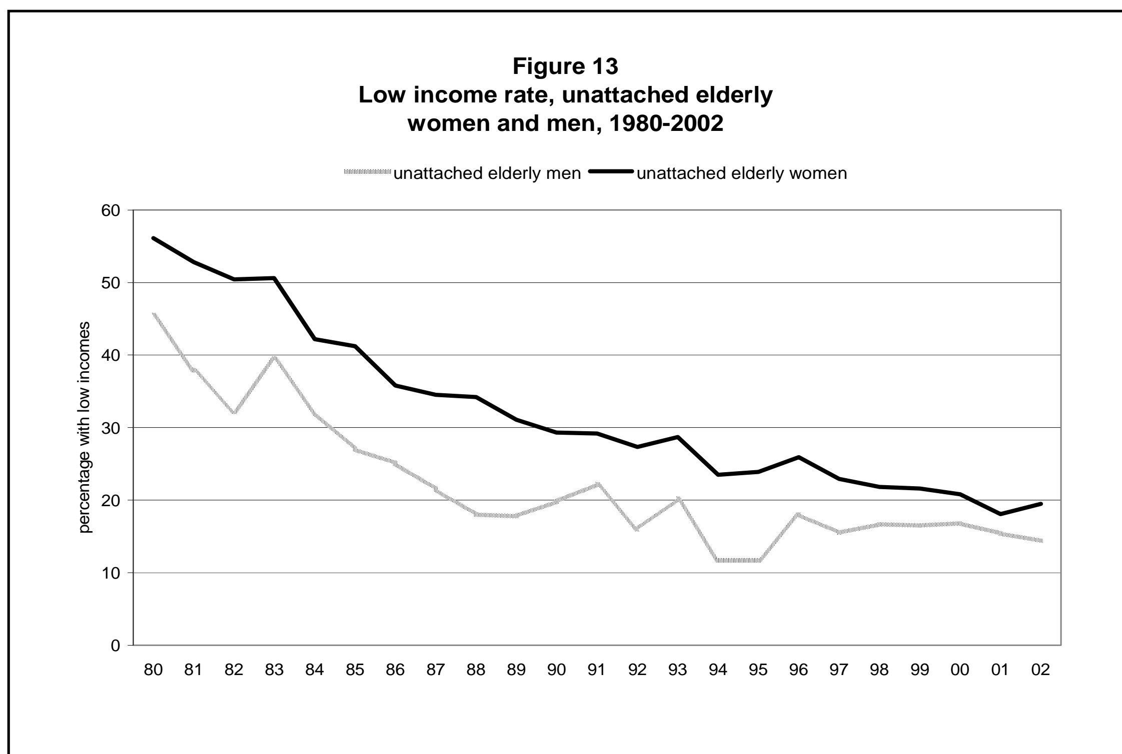
However, a substantial percentage of unattached seniors – one in five women and one in seven men – still live on low incomes at last count. Moreover, the low income rate for unattached women 65 and over edged up from 18.1 percent in 2001 to 19.5 percent in 2002, while the trend among unattached elderly men has been rather erratic since the mid-1990s, though it has fallen steadily since 2000. Figure 13 illustrates the trends.



As we argued above, the modest increase in the Guaranteed Income Supplement likely will translate into a modest reduction in the low income rate among seniors, so should either accelerate the downward trend or – if the low income rate is rising (as happened among unattached aged women between 2001 and 2002) – slow the increase somewhat. But one cannot expect miracles from so small a raise in the Guaranteed Income Supplement.

The long-term progress against poverty among Canada's aged is attributable not solely to the Guaranteed Income Supplement, even though that program is vital to low-income seniors and doubtless reduces the depth and incidence of elderly poverty. For one thing, the low income rate for the aged kept declining significantly after 1984, when the GIS last saw a real increase. Canada's substantial progress against poverty among the elderly results from the maturation and growth of its retirement income system overall – not just the anti-poverty Guaranteed Income Supplement.

Public pension programs – Old Age Security, the Guaranteed Income Supplement, the Allowance, provincial/territorial income supplements, the earnings-based Canada and Quebec Pension Plans – have reduced the depth of poverty among low-income seniors and helped many of Canada's elderly rise above the low income line. The increasing labour force participation of women, with their attendant retirement income from the earnings-based Canada Pension Plan or Quebec Pension Plan (and, though for relatively few, private pensions and savings plans as well), also has contributed to declining poverty among seniors.



The Budget's enrichment of the Guaranteed Income Supplement most obviously will enhance the anti-poverty objective of Canada's retirement income system, but it also will strengthen slightly its earnings-replacement capacity. While Old Age Security, the Guaranteed Income Supplement and the Allowance are protected from inflation, through quarterly indexation to the Consumer Price Index, they are not linked to changes in average earnings. Inflation sometimes outpaces wage growth, and sometimes it is the other way around. If wages rise faster than inflation, then the portion of seniors' income from OAS and the GIS will decline relative to the earnings of Canadians in the workforce. This is a more serious problem for lower-income seniors, who rely on OAS and the GIS for most or all of their income.

Maximum benefits from OAS and the GIS for a single senior in 2007 would represent an estimated 34.4 percent of average earnings without the GIS increase announced in the Budget but will climb to 35.6 percent once the GIS enhancements are taken into account. For a married pensioner, OAS and the maximum GIS will be an estimated 28.8 percent of average earnings thanks to the GIS enrichment as opposed to 27.9 percent before the increase.

Why such a modest increase in the Guaranteed Income Supplement, especially one that has taken so long – 22 years – to deliver, despite the urging of seniors groups? The answer, quite simply, is cost.

Even small increases in GIS rates are expensive – for two reasons. First, the GIS is a large program, currently serving close to 1.5 million seniors at a cost of $6 billion, so even modest enhancements in benefits entail significant costs. The increases announced in the Budget will cost an additional $755 million in 2009-10.

Second, raising the maximum benefit in an income-tested program like the Guaranteed Income Supplement extends the 'disappearing point' – the level at which eligibility for partial payments ends – higher up the income ladder. The maximum GIS benefit is reduced at the rate of 50 percent of other income (excluding Old Age Security) such as Canada Pension Plan and Quebec Pension Plan retirement benefits, employer-sponsored private pension plans, retirement savings from RRSPs, and other sources including employment earnings. In the first quarter of 2005, eligibility for the GIS for single seniors ends when other income reaches $13,464.

When the GIS raise is fully implemented in January 2007, the income level at which eligibility for partial benefits payments ends would have been an estimated $14,004, but the GIS increase will lift this threshold to $14,868. Because so many seniors are concentrated at the lower end of the income spectrum, even small increases to the benefit will add more people to the GIS rolls. The GIS raise announced in the 2005 Budget will improve benefits for 1.6 million low-income seniors – including 50,000 who would not have qualified for the GIS before but now will become eligible for partial payments.

Public policy change involves choices – and the 2005 federal Budget exhibits a rather paradoxical choice in spending sizeable sums on both poor seniors and affluent contributors to private pensions and savings plans. The Budget will raise the maximum Guaranteed Income Supplement by $432 for poor single seniors and by $696 for poor elderly couples in 2007. But high-income taxpayers deducting the maximum amount for their RRSP contributions will enjoy a larger income tax break that will increase by an estimated $273 in 2007, $543 in 2008, $809 in 2009 and $1,073 in 2010.

The GIS enhancement for poor seniors will cost the federal treasury $2.7 billion from 2005-06 through 2009-10. The boost to the maximum tax deduction for RRSP and RPP contributions will cost Ottawa about $610 million between 2004-05 and 2009-10 – less than the $2.7 billion for GIS recipients, but a substantial amount nonetheless. Moreover, the total cost of the enrichment of the RRSP and RPP tax breaks, once provincial/territorial income tax losses are factored in, will come to about $900 million. The increase to the basic personal and dependents amounts also could incur provincial/territorial revenue losses, but only to the extent that they follow the federal lead in changing their own income tax systems – which is not assured.

Policy-makers must think hard about the future consequences of changes to public programs, such as seniors' benefits and tax assistance for private pensions and retirement savings. Canada has an aging population that is steadily driving up the cost of public pension programs and pension-related tax expenditures. While these demographically-driven cost increases are economically sustainable, they will continue to exert mounting pressure on the public purse as the baby boom generation reaches old age.

The number of Old Age Security recipients grew from 671,240 in 1952-53 to 3,753,957 in 2003-04, and expenditures (in constant 2005 dollars) rose from $2.4 billion in 1952-53 to $28.6 billion in 2004-05. The Guaranteed Income Supplement served 703,550 low-income seniors in 1966-67 and 1,463,093 in 2003-04, and costs went from $1.3 billion in 1966-67 to $6 billion in 2004-05. The cost in foregone federal revenue of tax deductions for contributions to RRSPs and Registered Pension Plans grew from $8.8 billion in 1988 to an estimated $13.4 billion in 2005.

While the increases to the Guaranteed Income Supplement announced in the 2005 Budget are welcome (though modest), they fail to address a basic flaw in the structure of the elderly benefits that form the foundation of Canada's retirement income – inequity in the payments to aged couples, resulting from incompatible program designs.

Old Age Security and the nonrefundable age credit (which reduces income taxes for low- and modest-income seniors) are based on individual income; the value of seniors' Old Age Security after subtracting the income tax paid on this benefit (and the repayment required of the small group with high incomes) depends upon their own income and does not take account of the income of their spouse in the case of couples. The pension income credit (which reduces income taxes for all but the poorest taxpayers with pension income) also is based on individual income. But the Guaranteed Income Supplement and the Allowance are income-tested on the combined income of both spouses – i.e., family as opposed to individual income. Family income testing is also used by other major income programs including the Canada Child Tax Benefit, refundable GST credit and provincial/territorial child benefits and refundable tax credits.

The result of these mixed income definitions is that elderly couples with the same total income can receive different amounts of elderly benefits, depending on each spouse's share of family income. Throughout most of the income range, what can be termed 'two-income couples' receive more benefits than do 'one-income couples.'

One-income couples have the advantage over two-income couples at the low and high ends of the income spectrum. In the extreme case, an elderly spouse with little or no income other than Old Age Security, but living with a wealthy spouse, could receive the maximum Old Age Security (paying no income tax and not subject to the income test). By contrast, elderly single people or couples with even quite modest incomes end up with less after-tax Old Age Security because they are in taxpaying range and must pay tax on their benefits.

The federal government attempted to correct this design flaw in the 1996 Budget, which proposed a 'Seniors Benefit' that would have replaced Old Age Security, the Guaranteed Income Supplement, and the age and pension income tax credits. (Caledon earlier had proposed such a reform to the architecture of old age pensions.) The proposed Seniors Benefit layered a targeted-to-the-poor portion (essentially the GIS) on top of a broadly based portion (like the current Old Age Security, but somewhat more targeted),

and eligibility for and the amount of benefit from the new program would be based on the combined income of both spouses in the case of senior couples.

The proposed Seniors Benefit would have been financed partly by redirecting spending on higher-income seniors to lower-income seniors. It would have paid the majority of seniors either more than or the same as they get under the current system: Three in four elderly households would have received more or the same. Elderly households with income under $40,000 – about the average income for couples and more than double the average income for single seniors at the time – would have been better off or no worse off under the new program. Some couples in the $40,000 to $50,000 income range would have received somewhat more and some less, depending on the income mix of the spouses. Couples with income over $45,000 (above the $40,000 average income) would have got less, and those above $78,000 (almost double the average income) no longer would have received elderly benefits. Nine in ten single aged women would have come out ahead under the Seniors Benefit.

At the end of the day, Ottawa decided not to proceed with the Seniors Benefit, which was criticized by interest groups on both the left and right [Battle 2003]. So the old age pension foundation of the retirement income system – even with the 2005 Budget's long-awaited increase to the Guaranteed Income Supplement – continues unchanged with its irrational mix of income tests that results in inequitable payments among senior couples and benefits going to some high-income seniors – money that should be used to improve benefits for lower-income elderly women and men. Canada has succeeded in creating the architecture for a family income-based child benefits system that delivers it largest payment to low-income families yet still serves the large majority of families with children. The same architecture should be used to reform old age pensions.

Services for seniors should enable independent living

With regard to services for seniors, Caledon and other organizations have called over the years for enhanced investment in home supports that enable independent living. Our pre-Budget consultation paper identified home supports as one of three priority areas for expenditure. The Budget announced no new direct spending in this respect, though we hope that some of the billions of new health care dollars will find their way into home care supports and services.

Home supports refer to a range of goods and services – technical aids and equipment, home care, homemaker services and attendant care – that help offset the effects of functional limitation. These supports are essential not only for persons with disabilities, many of whom require various forms of equipment and services in order to carry out basic activities and participate actively in communities. They are also essential for the entire population, since most Canadians will require some form of assistance as they age.

We have noted in the past that there are several ways to invest in the supply of disability or home supports [Torjman 2000]. One possibility is to craft a federal-provincial/territorial agreement based on shared national principles and objectives, as is the basis of medicare and the emerging early learning and child care systems. The federal, provincial and territorial governments already invest in a wide range of home supports, though the current (and growing) need far outweighs their availability.

A fund of this nature is intended to help generate new and continued investment over a sustained period of time in the provision of a range of personal supports. The federal investment could lever similar provincial/territorial contributions derived from a combination of sources: provincial revenues, municipalities, community funds and geared-to-income fees.

Alternatively, we have pointed out that the federal government could include discussions of the wide range of home supports in negotiations with provinces and territories over home care. Even though home care dollars have increased in recent years, the slice of funding for supports at home and in the community is miniscule relative to the overall health care pie.

An investment in disability or home supports not only would relieve the burden on the health care system. It also would help de-link disability-related equipment and services from income programs so that there is no need to remain on these programs in order to receive these essential supports. As discussed earlier regarding the refundable medical expense supplement, social assistance recipients have access to these essential goods and services; the working poor generally do not. This imbalance creates clear disincentives to moving off welfare and into the workforce.

Such proposed funding arrangements would have an impact upon the individuals who require the supports. But there is another group of Canadians who should not be forgotten in this story – the caregivers of ailing spouses, aging parents or family members with severe disabilities. While these informal caregivers provide 85 to 90 percent of care at home, they are often overlooked in any deliberations on health care.

The Seniors Secretariat announced in the Budget should pay special attention to the needs of these caregivers. One of the most important concerns that they have identified is the need for respite or reprieve from caregiving responsibilities.

There is no one single program or service that can address all needs. Rather, caregivers have stated that the sense of reprieve they are seeking derives from a number of possible interventions delivered within or outside the home. These include temporary breaks, personal emergency system, information on care receiver needs, adult day care for the care receiver, housekeeping, outdoor home maintenance, counselling and peer support. Even being able to work a few hours or days a week is a form of relief for some caregivers who may worry about their financial circumstances or the security of their employment [Torjman 2003].

The newly announced Seniors Secretariat can do three things to help advance the respite agenda. It can develop the relevant policy framework. It can work on program design. And it can support the learning and technical assistance required to promote good practice.

A policy framework is often a first step in moving forward a given agenda – especially in a case like respite, in which a wide range of approaches is possible and, in fact, desirable. A policy framework helps set out a common statement of vision, values, objectives and possible measures. Because many of the solutions fall within provincial and territorial domain, a common statement helps ensure that all relevant players are 'on the same page.' They should all be singing from the same songbook and in the same key even though their tune may be slightly different.

The work on respite has developed to the point where the government clearly is in a position to write such a framework document. Substantial work is already under way which sets out the key elements that would comprise such a framework. Caregiver 'voice' and 'choice' have emerged as important principles that should underpin any program or system.

We recognize that the presence of such a framework does not necessarily result in a political agreement. That process takes a long time to negotiate. It typically is influenced by factors on the federal-provincial/territorial scene that may have nothing to do with the issue under consideration. But there may be individual jurisdictions interested in pursuing this agenda. They can proceed, knowing they are adhering to the values, principles and objectives that caregivers themselves have identified as essential.

The Seniors Secretariat announced in the Budget can also coordinate a process in which some of the essential design work is carried out. There are many challenges to designing a comprehensive system of respite, including the fact that the range of practice must be diverse to respond both to individual preferences as well as cultural sensitivities and geographic needs.

The development of a program framework and program design may take some time. In the meantime, there is plenty of work to do in supporting the many groups across the country already actively involved in providing various forms of respite. The Seniors Secretariat could play an important role in helping these diverse groups learn from each other the elements of exemplary practice.

The Bottom Line

The 2005 Budget gets our vote for its support of early learning and child care, a historic increase in the Guaranteed Income Supplement for poor seniors and tax measures for persons with disabilities. But we veto its costly tax breaks that benefit only high-income Canadians and general tax breaks spread so thinly as to be wasted. Funds could have been used far more effectively for social purposes such as targeted tax relief, reducing child poverty, expanding the supply of affordable housing, and providing supports for seniors and persons with disabilities.

Endnotes

1. Wholly dependent relatives include a dependent parent or grandparent, child, grandchild, brother or sister under 18, or of any age if they are mentally or physically infirm.

2. Tax savings will be even smaller for low-income taxpayers who owe small amounts of federal income tax. For example, a taxpayer with income of $10,000 will see federal tax savings of $106 in 2009, whereas taxpayers above $10,000 all will get a $189 federal income tax cut.

3. The maximum contribution that can be claimed as an income tax deduction is calculated as the lesser of 18 percent of earnings and a maximum amount (the 'limit'). The maximum deduction limits are the same for money purchase RPP contributors except that they are based on current year earnings and so are a year ahead of the RRSP limits, which are based on previous year earnings.

4. Securitization refers to CMHC mortgage-backed securities (MBS). Based on pools of CMHC-insured mortgages, CMHC provides a guarantee of timely payment – i.e., that a holder of a bond secured by a mortgage will receive monthly payment in full and on time. CMHC receives a fee in addition to the mortgage insurance premiums on the underlying mortgages. Under MBS, a lender can bundle a volume of individual mortgages (usually $75 million+) and sell these as securities in the bond market. The lender then takes the cash and uses it to fund new mortgages, thereby increasing the flow of funds available for mortgage financing. The competitive financing and CMHC/Government of Canada mitigation of risk help keep mortgage rates low compared, for example, to Canada five-year bonds.

5. The income test on Old Age Security begins at $60,806; benefits decline above that level and end once income reaches $98,547. About 3 percent of OAS recipients receive partial benefits and just 2 percent get nothing.

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