Mixed Brew for the ‘Coffee Shop’ Budget

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Mixed Brew for the 'Coffee Shop' Budget

In bringing down the 2007 Budget, the Finance Minister wanted all to know that he had listened to Canadians. He had talked to ordinary people on the streets. He sat down with folks in coffee shops across the country. He crafted the federal Budget on the basis of these conversations.

In our view, the resulting 'coffee shop' Budget offers up a mixed brew. There are several positive measures. Two are of particular note: The Working Income Tax Benefit (WITB) will offer help (though meagre) to the poorest of working poor Canadians struggling with the daily grind, and there will be a new savings vehicle for persons with severe disabilities.

Neither provides a comprehensive solution to the problem it addresses, but they are an important start. The Working Income Tax Benefit will be small to start but sets a foundation on which future budgets can build. The Disability Savings Plan is one of a set of measures needed to tackle the poverty in which many Canadians with disabilities are trapped – measures that must include both investments in better income security programs and a concerted focus on disability supports.

Other provisions of the Budget, however, are a large double double dose of unfocused spending. The 'new' child tax credit – in reality an obsolete program resurrected from the 1980s – tops this list. The funds for this inequitable scheme could have been far better spent on increasing the existing progressive Canada Child Tax Benefit or creating additional child care spaces. These latter investments would have been much more helpful to ordinary Canadian families than a child tax credit that gives $310 to millionaires who do not need it and nothing to the poorest who do.

Then there are parts of the Budget that make no sense from a social policy lens but a lot of sense from the perspective of the election that almost everyone expects to come within a year. This part of the menu is headed by the proposals to allow couples to split private pension income. This change will bring windfalls to high-income senior households. These must have been the ones ordering the lattés.

The new rules for Equalization and the Canada Social Transfer will help redress the so-called fiscal imbalance. The new funding formulas may help buy some political peace and bring more stability to federal-provincial fiscal relations, which would be a refreshing new filter for intergovernmental collaboration.

Finally, the fiscal context could allow for much more robust and direct investment in the basic needs of Canadians, like affordable housing. This serious problem was largely overlooked in the 2007 Budget, as were the many pressing needs of Aboriginal Canadians.

Ottawa has chosen instead to introduce a bundle of tax carrots that will serve a variety of particular groups but will provide little or no benefit to the broader population of low- and modest-income Canadians. The Budget could well have been named "Opportunities Lost." With a $19 billion price tag, never has so much been spent with so little result.

For some (mainly well-off) Canadians, the 'coffee shop' Budget will go down well. But for far too many ordinary Canadians, the mixed brew of 2007 will leave nothing but a bitter taste.

The Working Income Tax Benefit (WITB): a promising, though meagre, start

The Budget announced a welcome addition to Canadian social policy – an earnings supplement for the working poor. Christened the Working Income Tax Benefit (WITB), the new program fills a long-recognized gap in Canada's income security system.

WITB is a good old idea whose time has finally come. During the federal-provincial Social Security Review of the mid-1970s, Ottawa proposed a federal earnings supplementation program for the working poor as a complement to welfare reform, but these initiatives never saw the light of day because of intergovernmental wrangling and a worsening economy. However, other countries have implemented earnings supplements, including the Earned Income Tax Credit for working poor families in the United States and programs in the UK, Ireland and France. At home, provincial governments in Quebec, Saskatchewan and New Brunswick offer earnings supplements of varying forms.

Former Finance Minister Ralph Goodale floated the idea of a Working Income Tax Benefit in his government's 2005 Economic Statement. His successor, Jim Flaherty, carried the WITB forward in his 2006 Budget and launched it in the 2007 Budget. So it likely will receive the endorsement of the Liberals, and possibly the NDP as well.

The Working Income Tax Benefit shares some DNA with the Canada Child Tax Benefit and the National Child Benefit reform in terms of its design and delivery mechanism, one of its key objectives – lowering the welfare wall – and its potential for broad multi-party and intergovernmental political support.

Like the Canada Child Tax Benefit and the GST credit, the WITB is a geared-to-income refundable tax credit delivered through the federal personal income tax system. It is intended to serve as a federal top-up to the earnings of low-income working Canadians.

The maximum Working Income Tax Benefit will be $500 for single workers and $1,000 for single parents and couples. Recipients must be 19 or older, and those attending school full-time will not be eligible for the program. While the initial WITB benefits are very modest, especially for single recipients, hopefully they can be increased substantially over time, as has been done with the Canada Child Tax Benefit.

A positive feature of the Working Income Tax Benefit is its recognition of the typically higher barriers facing workers with disabilities. Low-income working Canadians with disabilities (provided they are eligible for the disability tax credit) will receive a supplement of $250 on top of their regular WITB payments.

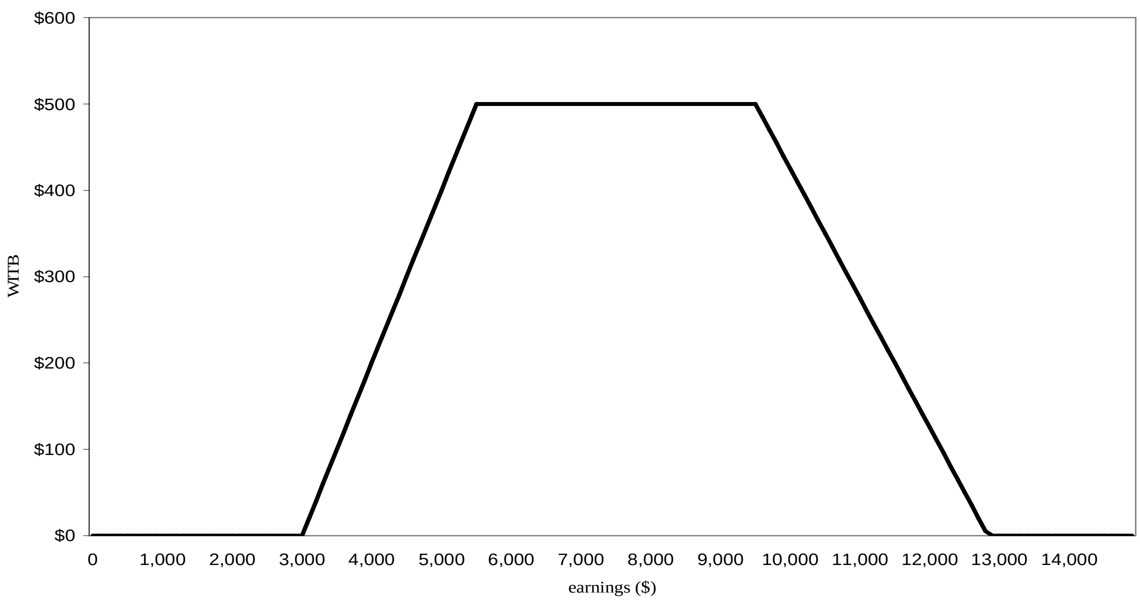
For single workers, WITB benefits will phase in at a rate of 20 percent of annual earnings above $3,000, reaching the maximum payment of $500 once earnings reach $5,550. The maximum $500 is payable between $5,550 and $9,500. The benefit will be reduced by 15 percent of net income above $9,500, ending at $12,833.

For single parents and couples, benefits will phase in at a rate of 20 percent of annual earnings above $3,000, reaching the maximum payment of $1,000 once earnings reach $8,000. The maximum $1,000 payment will go to those between $8,000 and $14,500. The benefit will be reduced by 15 percent of net income above $14,500, ending at $21,167.

For single workers with disabilities, the disability supplement to the Working Income Tax Benefit will phase in at earnings of $1,750, paying a maximum of $250 until net income reaches $12,833, then diminishing to end at $14,500. Their total maximum WITB will amount to $750 ($500 from the regular benefit and $250 from the disability supplement). For single parents and couples, the disability supplement is also a maximum $250 and will be reduced above net family income of $21,167, declining above this level to end at $22,834 ($24,500 in the case of two working eligible adults).

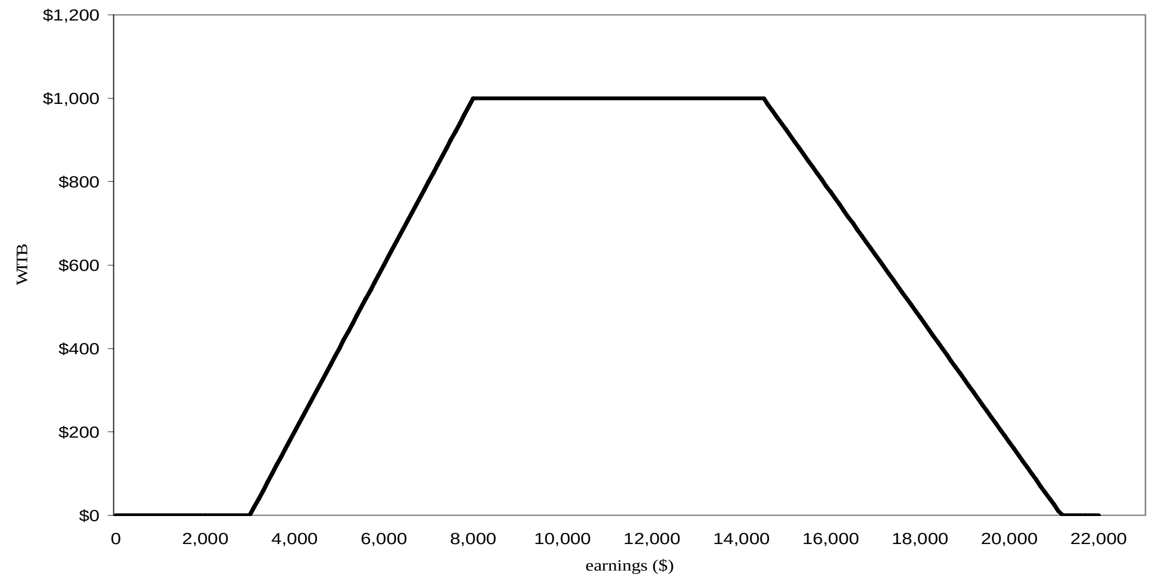
Figure 1 illustrates how the WITB will operate for single recipients, and Figure 2 does the same for single parents and couples.

Figure 1
Working Income Tax Benefit, single individuals



The Budget estimates that the Working Income Tax Benefit will reach 1.2 million Canadians who are already working, and is expected to encourage another 60,000 individuals (including welfare recipients) to enter the workforce. The program will cost an estimated $140 million in 2006-07, rising to $550 million in 2007-08 and $555 million in 2008-09.

Figure 2
Working Income Tax Benefit, single parents and couples



The Working Income Tax Benefit has two key objectives – to reduce disincentives to work for welfare recipients stuck behind the welfare wall, and to enhance incentives to work among the working poor.

The term 'welfare wall' refers to the conundrum that some welfare recipients can end up worse off financially if they leave social assistance for the workforce. They may forfeit cash benefits for spouses and allowances for children; special benefits; and valuable services such as supplementary health, dental and drug benefits, subsidized housing and access to supports for recipients with disabilities. They see their typically low earnings from work reduced by federal and provincial/territorial income taxes and payroll taxes (Canada and Quebec Pension Plan contributions and Employment Insurance premiums). And they face work-related expenses such as clothing, transportation and child care.

The National Child Benefit, launched a decade ago, has made significant progress in lowering that part of the welfare wall caused by the old two-tier system of child benefits. Welfare families used to receive both provincial/territorial welfare-embedded child benefits and federal child benefits, while the working poor got only the latter – for a child benefit worth about half of that paid to welfare families. The National Child Benefit aimed at replacing welfare child benefits with income-tested federal and provincial/territorial child benefits paying equal benefits to all low-income families, which effectively means raising the working poor up to the level of child benefits for welfare families. Now, families leaving welfare for work do not suffer a large cut in their child benefits.

The Working Income Tax Benefit also aims at lowering the welfare wall. However, instead of boosting child benefits, it will boost earnings from employment to 'help make work pay,' to use the British term. And whereas the National Child Benefit deals only with families, the WITB will help the broader group of workers with low earnings – singles, childless couples and families with children alike.

The Working Income Tax Benefit is geared not only to social assistance recipients moving from welfare to work, but also to the many working poor Canadians who never or rarely turn to social assistance. Close to half (44 percent) of low-income households contain at least one working poor adult [Fortin and Fleury] and just over one-third (34 percent) of poor kids are in families with at least one parent working full-time year-round [Campaign 2000: 2006]. About one in four workers earn $10 an hour or less.

Thus the other aim of the Working Income Tax Benefit is to increase incentives for people to join the workforce, keep working (even for low earnings), and not have to resort to the tangled safety net of welfare. Some of these workers eventually will be able to climb the earnings ladder and escape poverty. On the other hand, the marginal tax rates of many low-income workers will be increased by 15 percent on the ‘downward slope’ of the WITB, so this could have some offsetting negative effect on the workforce.

While promising in theory, the Working Income Tax Benefit as proposed in the 2007 Budget seems geared more to the goal of helping recipients get over the welfare wall than helping low-income Canadians already in the workforce.

Single workers working full time at the minimum wage will not qualify for any benefits from the Working Income Tax Benefit. In Ontario, for example, the $8.00 minimum wage amounts to about $16,000 for full-time all-year work (assuming 40 hours a week for 50 weeks). Yet the WITB for single workers phases out at net income of just $12,833 – $3,167 *below* a full-time minimum wage income. Note that the working poor include not just minimum wage workers, but also people earning more than the minimum wage but not enough to raise them above the poverty line.

To qualify for the WITB, single workers will have to be working part time. Someone working half-time at Ontario’s minimum wage (about $8,000) will receive the maximum $500 benefit.

While single workers who qualify for the disability tax credit will receive a disability supplement that raises their total WITB payment by $250 to a maximum $750, those working full time at the minimum wage or modestly above it still will not qualify for any assistance from the WITB.

Single parents and couples will fare somewhat better. A single parent working full time at Ontario’s $8.00 minimum wage, or a couple earning that amount between them, still will earn too much to receive the $1,000 maximum, though they will get $775.

At its launch, then, the Working Income Supplement will provide a modest $500 maximum payment targeted to single low-income Canadians working only part time. Eligibility for the WITB will end at the low level of $12,833 in net income for single workers, and the maximum $500 goes only to those between $5,500 and $9,500 – low earnings indeed.

The WITB will be somewhat less stingy for single parents, couples and recipients with disabilities. Single parents and couples earning between $8,000 and $14,500 – below the full-time minimum wage – will get the maximum $1,000, with diminishing payments until eligibility ends at net family income of $21,167.

A laudable feature of the Working Income Tax Benefit – which responds to a concern raised by the Caledon Institute in an op ed in *The Globe and Mail* [Battle and Mendelson 2005] – is that Ottawa is willing to make changes to the design of the program to harmonize it with individual provincial and territorial income security programs (e.g., welfare earnings supplements and minimum wages). These variations in design of the WITB must be consistent with several principles: They must build on actions taken by the province or territory to improve work incentives for low-income residents; be cost-neutral to the federal government; provide for a minimum benefit level for all WITB recipients; and preserve harmonization of the WITB with existing federal programs.

Speaking of design, because it will be delivered through the income tax system, the Working Income Tax Benefit will encounter a problem in the case of recipients who experience ups or downs in their earnings – as often happens. Refundable tax credits such as the GST credit and Canada Child Tax Benefit calculate applicants' income as collected through the previous year's income tax form. This can result in a benefit as much as two years out of date: In January 2009, a recipient of the WITB could be getting a payment based on earnings in January 2007.

The Working Income Supplement cannot be effective if it is seriously out of sync with earnings. It cannot provide an incentive to keep working if its recipients see no rational relationship between their current earnings and their WITB supplement. Ideally, an earnings supplement like the WITB would be delivered on a timely basis, responsive to monthly changes in earnings.

The Budget states that, from 2008 on, families will be able to apply for an advance payment of one-half their estimated annual entitlement. This feature will follow the practice of Quebec's earnings supplement, the Quebec Work Premium. However, this provision will be, at best, a half-measure. With benefits remaining months and sometimes years after the fact, it is not clear that the Working Income Tax Benefit will be seen as anything more than an unexpected windfall tax credit, providing little or no real additional incentive to work.

The challenge for the provinces and territories is to harmonize the WITB with their own work incentives for social assistance recipients. Almost all jurisdictions now allow welfare recipients to work and gradually taper off welfare payments as earned income increases.

In Ontario, for example, the taper is 50 percent of earned income, so a single parent on social assistance earning, say, $20,000 has her welfare benefits reduced by $10,000. However, she will also be losing her WITB (which starts reducing at $14,500), so her effective marginal tax rate from the welfare and WITB reductions will now be increased to 65 percent, with federal policy contradicting provincial policy. To further complicate the harmonization challenge, the WITB payments will be out of time sequence, coming in the next year, when the single parent's earnings may have drastically changed.

Presumably, these issues will take up a good part of the discussions that the provinces will be having with the federal government. Quebec and Saskatchewan especially – with their carefully designed and balanced provincial income security systems – may want to administer the federal funds themselves and integrate the WITB with their own similar provisions. We shall be watching these discussions with interest.

WITB has economic as well as social justice purposes that must be taken into account in any evaluation or cost-benefit analysis. It should help reduce welfare caseloads – to some extent – and resulting costs. More Canadians working will translate into increased consumer spending and tax revenues. At a time of growing labour shortages, it is all the more important to help make work pay better for low-earning workers and keep them from falling into the welfare net where they might no longer participate in the labour force at all.

But simply exchanging welfare poverty for working poverty by offering a top-up to low earnings can never be an acceptable outcome. The Working Income Tax Benefit is no magic bullet. It is but one among several measures required to reduce poverty and improve opportunities for low-income Canadians. Other policies are needed as well, including training and educational upgrading; extension of supplementary health, dental and drug benefits to all low-income households; accessible and affordable personal supports for people with disabilities; quality, affordable child care; adequate and indexed minimum wages; and badly-needed reforms to the archaic welfare system and an Employment Insurance program that denies benefits to 60 percent of the unemployed.

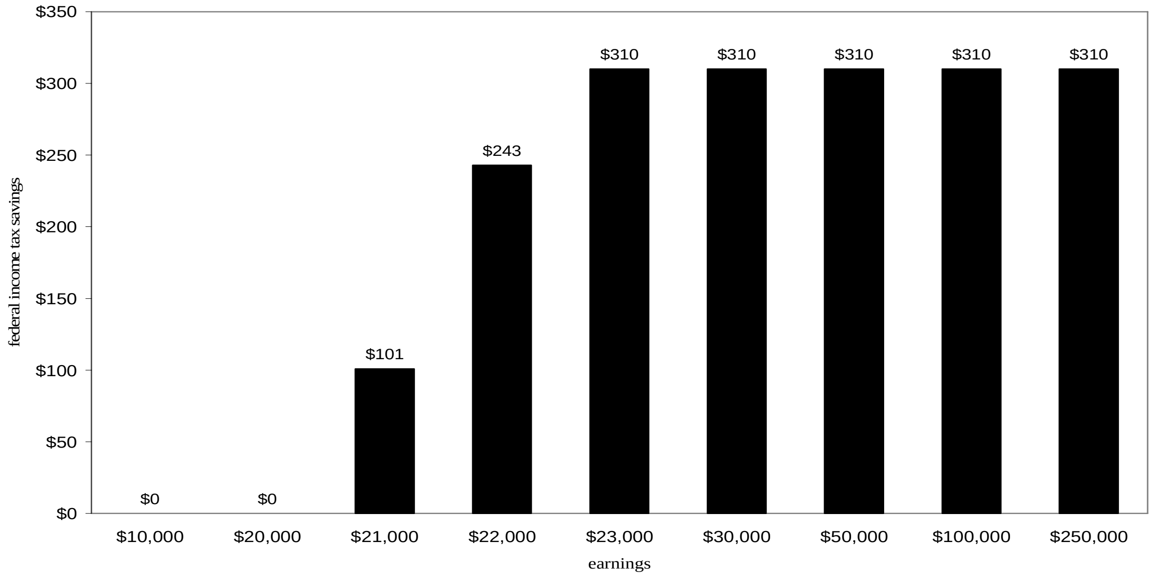
The "New" Child Tax Credit: a policy zombie resurrected

The Conservatives continued their back-to-the-future approach to federal child benefits by announcing a "$2,000 child tax credit." Recall that last year's Budget brought in the Universal Child Care Benefit, a throwback to the old Family Allowances program that was abolished in 1993. This year's Budget raises from the dead another social policy zombie, the non-refundable child tax credit, which lived between 1988 and 1992.

The Budget's "New $2,000 child tax credit" is neither new nor worth $2,000 – just as the Universal Child Care Benefit is not worth $1,200 a year (because it is reduced by federal and provincial/territorial income taxes). The child tax credit is a non-refundable benefit; its maximum real value, in federal income tax savings, will be $2,000 times the lowest income tax rate of 15.5 percent, or $310. All non-poor families will receive $310, including the very rich; some low-income families with a low tax liability will receive a smaller amount, while the poorest will get nothing at all because they do not owe income tax.

Take the example of a single parent with one child, illustrated in Figure 3. If she earns $23,000 or more, she will receive the full child tax credit of $310. At earnings of $22,000, the child tax credit will be worth $243; at $21,000, just $101. For single parents earning $20,000 or less, the child tax credit will be worth a big fat zero.

Figure 3
Value of Child Tax Credit, single parent with one child



In relative terms, the most that the child tax credit will be worth is 1.35 percent of earnings for a single parent earning $23,000. It will amount to just 0.62 percent of earnings at $50,000, and a mere fraction of one percent (0.12) at $250,000.

The child tax credit will reach some 3 million taxpayers. At a cost of $335 million in 2006-07 and $1.5 billion in 2007-08 and 2008-09, it will pay its maximum $310 amount to 90 percent of families – most of which have middle or high incomes. The poorest families will get nothing. This measure will make income inequality among families worse, not better.

It took Canada many years of hard work to evolve beyond the collection of disparate child benefit programs – Family Allowances, the child tax exemption, the non-refundable child tax credit and refundable child tax credit – that were each created for a different time and worked at cross purposes. By 1993, these programs had been replaced by a single, integrated, geared-to-income program, the Child Tax Benefit, which in 1998 was further simplified, enhanced and renamed the Canada Child Tax Benefit. The Canada Child Tax Benefit is a well-designed, effective and efficient social program that has been expanded to include the Child Disability Benefit. A number of provinces and territories use its delivery machinery to operate their own income-tested child benefits.

With the creation last year of the Universal Child Care Benefit (previously called the Choice in Child Care Allowance) and now the re-creation of a non-refundable child tax credit, added to the existing Canada Child Tax Benefit, few Canadian families – let alone the media, politicians and social advocacy groups – will have any idea which way is up when it comes to federal child benefits. Confusion will rein – and probably not by accident.

Last Budget's Universal Child Care Benefit and this Budget's non-refundable child tax credit are inequitable, wasteful programs that deliver benefits to upper-income families for whom the payments are a meaningless drop in their income bucket, while depriving low- and middle-income families of a badly-needed improvement in their child benefits. There are 865,000 low-income children in Canada – one child in eight. How can a government decide to spend billions of dollars to resurrect obsolete programs that do not gear their payments according to need? This is not intelligent social policy.

Smart social policy would not proceed with the child tax credit and would axe the Universal Child Care Benefit, redirecting their billions of dollars to further strengthen the progressive Canada Child Tax Benefit, which gears payments to income and serves nine in ten families, excluding only those with high incomes. All but wealthy families would receive a significant increase in benefits under an enhanced Canada Child Tax Benefit.

Child Care

The Budget signalled that the federal government will be directing new money toward child care – to the tune of $250 million a year. While this announcement is better than nothing, the amount of intended expenditure is paltry relative to the need for investment in this area. Ottawa plans to send the money to the provinces and territories through a general fund known as the Canada Social Transfer – with no guarantee that the dollars will be used for child care.

The good news in the 2007 federal Budget was that the words "child care" and "investment" actually appeared near each other. After last year's fiasco, there was question as to whether child care would be purged from federal government vocabulary (as actually has been the case with other words). The 2007 Budget tries to redress, in baby steps, the government's ill-considered decision to decimate the national child care system in Canada. Here's what happened.

Thirty-five years of hard work to create a national child care system were wiped off the books on a Tuesday afternoon last May. Canada's New Government affirmed in its 2006 Budget its intention to phase out the Early Learning and Child Care Agreements that had just been negotiated with the provinces. The ink on the pages was barely dry when the deal was, for all intents and purposes, declared null and void by the new regime in Ottawa.

While the political accord was dismantled, the federal government did promise to maintain its investment for one more year and spend $260 million in 2006-07. It also stated its intent to set aside $250 million per year beyond the termination of the agreements to create child care spaces. The precise nature of the expenditure was anybody's guess at that point. "Public consultations" were promised to determine how the money would be directed. It would have been interesting to see the invitation list.

The 2006 Budget also talked vaguely of grants or tax credits to encourage employers and nonprofit community organizations to help build child care spaces. Budget 2007 acted on this promise. It brought in a tax credit to encourage businesses to create licensed child care spaces for the children of their employees and, potentially, for children in the surrounding community.

The measure will provide a non-refundable investment tax credit equal to 25 percent of eligible expenditures, to a maximum credit of $10,000 per child care space created. However, during pre-Budget consultations, this measure got little or no support from either business or child care advocates. It is unlikely that it actually will result in many new child care spaces.

Perhaps the government finally has heard the message that investment in child care is important. At least the 2007 Budget pays lip service to that fact.

But lip service is just about all this commitment is worth. The anemic $250 million annual promise, confirmed in the 2007 Budget, pales in comparison to the billions of federal dollars that would have gone into child care under the now-defunct Early Learning and Child Care Agreements. The 2005 Budget under the Liberals had 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.

The 2005 Budget itself built upon a stream of incremental investment. The 2001 Budget, for example, announced $2.2 billion over five years 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. 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 to early childhood development services for First Nations and other Aboriginal children. The 2004 Budget dedicated another $150 million for Early Learning and Child Care as well as another $10 million over four years for early learning and child care subsidies on behalf of First Nations children living on reserves.

Delivery is another significant dimension of the 2007 announcement. In addition to vastly reduced expenditure, the payment of funds through the Canada Social Transfer represents a very different route from a federal-provincial agreement that links spending with specification.

The Early Learning and Child Care Agreements were guided by clear principles intended to ensure high-quality early childhood development services. The associated reporting and monitoring requirements were to be provided through built-in quality assurance mechanisms.

While high-standard principles do not necessarily guarantee good quality, at least they set important benchmarks that can act as the basis for its assessment. And at least the money is more likely to be spent for its intended purpose. The federal government will now earmark 75 percent of funds through the Canada Social Transfer for social assistance and children' services. Earmarking is better than nothing – but much less than ideal.

Canada's New Government likely would respond to this critique by arguing that it *is* investing a significant sum in child care. After all, it introduced last year a new Universal Child Care Benefit – *quid pro quo* for unravelling the Early Learning and Child Care Agreements.

Caledon strongly opposed the Universal Child Care Benefit on several grounds [Battle 2006]. Its design is seriously flawed. It favours one-earner couples over two-earner couples and single parents. It delivers its largest assistance to those who least need the financial help. As a taxable benefit, it pays considerably less than its face value of $1,200.

The Universal Child Care Benefit that now passes as child care policy cannot seriously be called a child care plan. It offsets only a fraction of child care costs that range, for infants, between around $6,000 and $12,000, and for toddlers and preschoolers from about $5,000 to $8,000. (These figures exclude Quebec, which offers child care for a relatively low $7 per child daily fee.) It is a do-what-you-want-with-it measure, which may or may not be used in respect of its intended purpose. We argued that the same money could have been far better spent on enhancements to the Canada Child Tax Benefit.

Bottom line: If Canada's New Government were serious about promoting prosperity, it would have made a far more significant investment in the supply of child care. High-quality early learning and child care services are not just good social policy. They are equally crucial elements of economic policy because they invest in the critical first years of human capital development and enable parents to work or study.

Registered Disability Savings Plan

The disability agenda, as in the past, remains full and robust – but largely yet to be realized relative to the broad scope of measures required to address the wide-ranging needs of persons with disabilities. The disability community itself has identified two top priorities for government action.

First, the community has pointed to the need to enhance income security programs – in terms of eligibility, adequacy and efficiency – to reduce the high rate of poverty among persons with disabilities and to help offset their associated additional costs.

Second, the community has long argued that access to disability supports must be improved in order to promote participation – not only in the labour market but also in training and education, culture, recreation and the political life of the community. Disability supports refer to a cluster of goods and services that include technical aids and equipment, and personal services that provide attendant care and homemaker assistance.

This year's Budget introduced a Registered Disability Savings Plan that will help tackle, to some extent, the poverty problem. We say "to some extent" because, as in most areas of social policy, there is never a single magic-bullet solution to any given challenge. A package of measures typically is required to make a dent in both the scope and severity of a problem, especially when it comes to one as complex and persistent as poverty. The Budget announcement is one important piece of a large – but largely incomplete – puzzle.

The intent of the savings plan is to improve the quality of life of persons with disabilities, many of whom are not likely able to support themselves independently. While the new measure will not lift many people out of poverty, it at least will provide a better life than the abject poverty they typically experience.

Any person eligible for the disability tax credit or their parent or legal representative will be eligible to establish a Registered Disability Savings Plan (RDSP). While contributions to the Plan will not be tax deductible, the investment on contributions and the other associated measures introduced as part of the RDSP package, will accrue tax-free. Contributions to an RDSP will be limited to a lifetime maximum of $200,000 in respect of the beneficiary, with no annual limit. Contributions will be permitted until the end of the year in which the beneficiary reaches age 59.

The Registered Disability Savings Plan is a welcome initiative. It encourages financial contributions by family members toward the future support and enhanced independence of their relatives with disabilities. A changing context has created the need for such a measure. For the first time in history, because of medical and technological advances, Canadians with disabilities are outliving their parents. The assumptions underlying the development of traditional policies for persons with disabilities – such as being dependent upon and predeceasing parents – no longer hold.

One of the most important concerns for parents caring for sons and daughters with severe disabilities is to provide properly for their needs. Parents also want to ensure a good quality of life for their family member after their death. While support networks are crucial, they are not sufficient. Families want to provide financial security for their relatives with severe disabilities.

In order to achieve this objective, the group Planned Lifetime Advocacy Network (PLAN) had recognized for many years the need for a major policy innovation to help families provide improved financial security for their relatives. Members had proposed the development of a tax-deferred savings vehicle, called a Registered Disability Savings Plan, modelled on the current Registered Retirement Savings Plan.

To help explore more fully the dimensions of the proposal, PLAN received financial support to carry out required background research. Two papers were commissioned by the Caledon Institute, one of which dealt with possible design considerations of a tax-assisted savings plan and its potential size in terms of projected take-up and associated costs [Horner 2005]. The other paper examined the interface of the proposed measure with provincial and territorial social assistance programs to ensure that these would not offset the benefit of any new federal initiative [Shillington 2005].

The proposal for tax-assisted savings subsequently was considered and documented in the report of the Technical Advisory Committee on Tax Measures for Persons with Disabilities that had been appointed in 2004 by the Ministers of Finance and of Revenue. The idea of the Registered Disability Savings Plan is discussed in its *Disability Tax Fairness* report.

As a follow-up to the disability tax report, the 2006 federal Budget announced the formation of an expert group to advise the Minister of Finance on possible designs for such a savings scheme. In December 2006, the expert group issued *A New Beginning*, which recommended the introduction of a Registered Disability Savings Plan modelled on the current Registered Education Savings Plan.

In fact, the panel went beyond endorsing a Disability Savings Plan to recommend both a Disability Savings Grant and Disability Bond. These associated measures are important additions to the basic RDSP in that they enable low- and modest-income households, with limited capacity to save, to take advantage of tax-assisted savings. The Disability Savings Grant and Disability Bond are based on learn$ave – a federal program in which the government matches private contributions and even bolsters the amount for households below certain levels of income.

Under the Canada Disability Savings Grant (CDSG) announced in the Budget, contributions made in a year to Registered Disability Savings Plans will qualify for CDSGs at matching rates of 100, 200 or 300 percent, depending upon net family income and the amount of contribution. There is a lifetime limit of $70,000 on CDSGs paid on behalf of an RDSP beneficiary.

The new Canada Disability Savings Bonds (CDSBs) offer even more assistance to low- and modest-income households. Under this new provision, Ottawa will pay up to a maximum $1,000 a year to the RDSPs of low- and modest-income beneficiaries.

There will be a lifetime limit of $20,000 on CDSBs paid in respect of an RDSP beneficiary. The RDSP can receive CDSBs until the end of the year in which the beneficiary reaches age 49.

While these components are a welcome addition to the basic Registered Disability Savings Plan, the federal government and members of the disability community will have to take active steps to ensure that low- and modest-income households are aware of the grant and bond components of the RDSP and the fact that they potentially can benefit from these new measures. The learn$ave program upon which the new grant and bond are modelled has had a disappointingly low take-up rate, and is vastly underutilized relative to the numbers of potentially eligible households in the country.

Ottawa will also have to enter into discussions with the provinces and territories to ensure that welfare recipients do not risk losing part or all of their benefits as a result of the new Registered Disability Savings Plan, which effectively could represent a significant asset depending upon the levels of contribution. All provincial and territorial welfare systems have asset exemption guidelines that spell out the type and level of assets permitted without affecting welfare eligibility. Manitoba's recent introduction, for example, of a $100,000 asset exemption on trust funds within their welfare program is the kind of policy change that is required.

But while the Registered Disability Savings Plan and associated bond and grant components are crucial, they will not dramatically reduce poverty. Nor will they do much to redress the serious inadequacies in the provision of disability supports.

Even the Technical Advisory Committee on Tax Measures for Persons with Disabilities had noted throughout its report that tax-related assistance, while important, can in no way replace the program investments required to tackle poverty and to enhance the availability of disability supports. The Committee recommended that any new substantial funding to promote fairness and inclusion for persons with disabilities should not be allocated to tax measures.

The Caledon Institute has long endorsed and continues to agree with the Committee's view that future expenditure should be directed toward income security programs and disability supports rather than tax measures. While significant and helpful, tax measures are not the most appropriate instruments through which to enable the participation of persons with disabilities.

The Budget did announce a small – but welcome – component in the new Working Income Tax Benefit. As we noted, a positive feature of the WITB is its recognition of the typically higher barriers facing workers with disabilities. Low-income working Canadians with disabilities (eligible for the disability tax credit) will receive a supplement of $250 on top of their regular WITB payments.

But making a real dent in poverty will require a major national commitment and focus. On the income security front, the Caledon Institute is working on a set of proposals to restructure fundamentally the current configuration of income security programs for working age adults, including persons with disabilities [Battle, Mendelson and Torjman 2006a]. Proposed reforms to disability income programs involve the removal of persons with disabilities from provincial and territorial welfare programs, serving them instead by a new federal income-tested program similar in design to the Guaranteed Income Supplement for seniors. The nonrefundable disability credit would be made refundable so as to help poor persons with disabilities. A significant proportion of welfare caseloads – 45 percent on a national basis – consists of persons with disabilities.

The second major action that the federal government must take is to invest in the supply of disability supports so that these are more readily available and accessible throughout the country. 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. No investment in personal tax carrots can supply the type and range of disability services that are required.

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 disability supports. 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, supports for independent living, caregiving and relief for caregivers are among the most pressing social issues that Canada will face in the coming decades [Torjman 2006].

The federal government could initiate, for example, a National Strategy on Disability Supports, as it has done in the case of the National Strategy on Cancer and the National Strategy on Spinal Cord Injury. The objective would be to invest funds in the development of a more solid infrastructure of supports across the country – just like the investment in physical infrastructure in cities.

Tax changes affecting seniors: income splitting and the age credit

Budget 2007 reiterated two proposed tax changes for seniors that were part of Finance Minister Flaherty's surprise announcement on Halloween Day 2006 regarding income trusts. At the time, the Finance Department was concerned that the changes to the tax treatment of income trusts would be criticized by seniors in particular, especially well-to-do seniors who had invested significant parts of their RRSPs and financial portfolios into income trusts. Seniors, as any political observer knows, are more likely to vote than younger Canadians. They also have the time to make their displeasure known when governments do things they do not like.

The Minister, therefore, decided to include a sweetener to try to appease these seniors – a proposal to allow couples to split private pension income between them when calculating the income tax owed by each. Since splitting of pension income would be of no use to single pensioners and only of modest benefit to the majority of senior couples with only small private pensions, he added another sweetener – an increase to the nonrefundable age credit for persons aged 65 or more.

These two measures will not come cheap. According to Finance Department estimates, they will result in more than $6 billion in foregone tax revenues over six years. That would be money well spent if it went to the large numbers of seniors in Canada who have barely enough to get by and who could use the extra help. There is only one problem: That is not what will happen.

In fact, not one cent of the $6 billion will go to the 1.7 million seniors with incomes so low that they do not pay income tax. Other seniors will see only modest increases as a result of these measures. Those living alone will gain only a maximum of $158 year. The majority of elderly couples with little or no income from private pensions or RRSPs will benefit by less than $500 a year at best.

Only a fortunate few will see substantial tax savings from income splitting, which will significantly reduce the taxes of well-to-do senior couples. As Caledon has shown in a commentary published in 2006, a senior couple with $100,000 in pension income will see a tax reduction of $7,280 [Tamagno and Battle 2006]. That is nine times the $802 in tax savings of a couple with $30,000 in private pension income, and more than 23 times the $310 savings of a couple with $20,000 in private pension income.

Caledon has always been in favour of strengthening the income security of Canada's seniors, who have made enormous contributions to building our country and who, in many instances, live on modest incomes. It is hard to understand how the goal of better income security for seniors is advanced by showering money on lucrative tax breaks for a small minority at the top that are living comfortably, while ignoring entirely those at the bottom who have so little income that they pay no tax.

Caledon has put forward an alternative to the government's proposals that would cost no more and target its benefits on low- and middle-income seniors [Tamagno and Battle 2006]. Caledon's proposal includes three elements: scrapping entirely the proposed splitting of pension income; implementing the increase in the age credit, and making the increase refundable so that seniors with incomes too low to pay tax will receive a benefit; and doubling the pension income credit from its current $2,000 to $4,000.

If the government truly wanted to help seniors, it would turn its attention to measures other than the tax system. Like most industrialized countries, Canada is likely to experience serious labour shortages in coming years due to an aging population. While there has been a slight increase in the effective retirement age after many years of decline, there is clearly a need to provide more incentives for those who can work longer to do so.

The appropriate response is not through obligatory measures, such as a regulated increase in the retirement age, that compel people to work longer. The burden of such measures typically is felt by people in physically difficult or monotonous jobs, often held by low-income workers.

A more suitable response is to reduce, and ideally to remove, existing disincentives in the pension system – particularly in the federal and provincial laws that regulate employer-sponsored pension plans. Current pension programs operate in black and white terms. A person is either working or not. The reality is that much of the aging population is gray – both physically and literally. They work less than full time but still remain active to some extent in the paid labour market.

The 2007 Budget did introduce a positive change in this regard. Income Tax Regulations currently prohibit phased retirement arrangements by preventing employees from accruing pension benefits under a defined benefit registered pension plan if they receive a pension from the plan of the same or a related employer. This policy reduces incentives for older workers to remain in the labour force. The Budget proposed to permit an employer to simultaneously pay a partial pension to an employee and provide further pension benefit accruals to the employee. In the interest of flexibility, the Budget also announced an increase to the RRSP/RPP maturation age limit to 71 years of age. These are both steps in the right direction.

Taxes

Canada now has the best fiscal balance of any country in the G8. So if things are so good, why do they seem so bad? Where are all the benefits of this terrific fiscal performance? The answer in the 2007 Budget is clear: The benefits will come in future income tax reductions.

In a move reminiscent of the Ontario Conservative government's efforts to use legislation to fix parameters for future budgets, Canada's 2007 Budget promises to pass legislation which will 'guarantee' that future interest savings on federal debt due to debt reduction will be devoted to personal income tax reductions. No mention was made of the impossibility of binding future Parliaments.

In reality, the 'guarantee' can stand only as long as the government of the day wants it to remain in place, so the legislation can only be seen as little more than a publicity ploy. However, this should not distract us from the real policy issue: Are income tax reductions the most sensible investment for our fiscal bonus?

While we have been racking up fiscal surpluses, Canada has been suffering from a rapidly growing public investment deficit. Infrastructure is beginning literally to fall apart. For example, almost every city in Canada requires billions of dollars just to bring its sewer and water system back to basic standards of repair. Public transit in most Canadian cities and towns is falling behind the levels available in comparable urban centres in every other developed country in the world – including the US where, even under a Republican administration, the federal government has pumped billions into transit. The railroad track bed in the Windsor-Quebec City corridor remains at more or less the level of a century ago, incapable of anything remotely resembling a high-speed carrier.

The public deficit is also manifested in services. We somehow have managed to talk endlessly about the critical importance of the early years to give all children a fighting chance at a productive life, without actually mounting any national effort in early childhood education or developing a high-quality child care system. Our postsecondary school system is funded at levels lower than almost any US state. The justice system is becoming less accessible to lower- and even middle-income Canadians. We have almost no social housing provisions, with deteriorating housing conditions afflicting hundreds of thousands of families, despite many of those families working full time.

The list goes on and on. It is all too familiar and its familiarity breeds the usual contempt – or, if not contempt, then bland indifference. The difficulty is that the list is real. Canada's quality of life is in danger. We are like a business owner refusing to reinvest and instead running down the company's assets. For the first several years, all seems just fine. The balance sheet looks great. With big cuts in staff, maintenance, research and all the other 'extras,' there are big profits – for a few years. Then the price must be paid. Canada is taking the profits now and is refusing to reinvest in its people. Instead, we are running down our physical, human and social capital.

We are already among the lowest taxed countries in the G8. In 2005, Canada's total government revenue amounted to 41.0 percent of GDP, compared to 32.8 per cent in the US and 31.7 percent in Japan. But all other G8 countries' revenues were higher than ours.

The US total government deficit was 3.8 percent of GDP in 2005, and our surplus was 1.7 percent. So when you take into account the deferred taxes (deficit) in the US, and the surplus in Canada, the real comparison is 41.0 – 1.7 = 39.3 percent in Canada and 32.8 + 3.8 = 36.6 percent in the US. Similarly, Japan's deficit is 5.8 percent of GDP, so its real comparison is 31.7 + 5.8 = 37.5 percent of GDP [Finance Canada 2006].

Since 2005, the situation has continued in Canada's favour, so that by 2007 we are likely very close to the US in our total deficit-adjusted government revenue, and not too far even from Japan. We are taxed at far lower levels than any of the European countries.

Canada does not need income tax reductions. This is a poor and unimaginative way to spend the fiscal bonus. Canada needs reinvestment and restoration of its physical and social infrastructure. Otherwise, we will end up with a few more dollars in our pockets, but much poorer in our overall standard of living.

The fiscal balance

The fiscal balance is a cake of many layers. It ranges from the federal-provincial fiscal arrangements – which today consist mainly of the Equalization program, the Canada Health Transfer and the Canada Social Transfer – to the much broader question of whether the total flow of government funds in and out of any province is negative or positive. Both Ontario's and Quebec's demands regarding the fiscal balance have been posed in relation to the latter broader question. But in the practical world, both will likely be satisfied by the right answer in respect only of the fiscal arrangements.

So are the new fiscal arrangements in the 2007 Budget the 'right answer'?

Equalization has always been a difficult program to understand, and the changes in the 2007 Budget are certainly not going to make things any easier, at least in the short run. The Budget has set out three different sets of rules and allowed each province to pick the rules most advantageous to it over the next several years. It is all extremely messy, but it may have one big advantage: It just might work.

The differing rules allow for a lengthy transition period for Equalization recipient provinces. By about 2014 (when the legislated program ends), it should be possible to get all the provinces back onto a single set of clear and much simplified rules. The new rules also will allow for more predictable payments to recipient provinces.

There is at least one aspect of the transitional plan that some provinces may find objectionable: The federal government will place a ceiling on recipient provinces' Equalization so that their fiscal capacity can never exceed that of non-recipient provinces. This ceiling seems reasonable, as it otherwise would mean that residents of one province could pay federal taxes to support Equalization benefits going to a province with higher fiscal capacity. Given the obvious fairness of this ceiling, it is hard to see that any sustained negative campaign will undermine the proposal.

There will likely be other provincial complaints. But overall, the 2007 Budget's proposal on Equalization is clever, and fundamentally acceptable. In our view, this is one the highlights of the Budget.

The Budget plan for the Canada Health Transfer (CHT) and Canada Social Transfer (CST) partially removes another long-standing irritant. The federal-provincial transfers from which the CHT and CST evolved included both a transfer of cash and of 'tax points' to the provinces. 'Tax points' are simply a percentage point of income tax.

In 1977, the federal government gave up several points of income tax and the provinces took them over, for no change to the taxpayer. However, tax points are worth more in Alberta and Ontario than in other provinces, because residents of these provinces on average have higher incomes. Consequently, the federal government reduces its cash payments to Alberta and Ontario by the amount which today's value of the tax points exceeds the value in the other provinces (which included Equalization those provinces got on the tax points). Not surprisingly, this practice has been rather annoying, especially to Ontario which, unlike Alberta, is not counting up billions in surpluses.

The 2007 Budget removed the calculation of the value of the tax points from the amount of the CST, and converted it to a straightforward equal per capita cash transfer. This change will please Alberta and Ontario. Saskatchewan and to a lesser extent BC, Nunavut and Yukon will potentially be negatively affected by this change, but again a transition plan is in place. Saskatchewan and BC have large surpluses, and the Territories will benefit from a new Territorial Funding Formula. Overall, the move to a cash-only transfer makes sense and is well planned. It was time for a federal government to bite the bullet.

Unfortunately, the bullet-biting for the much larger Canada Health Transfer has been postponed until the current plan for the CHT expires in 2014-15, after which the federal government has promised to move to an equal per capita transfer for the CHT as well. If a week is a long time in politics, how long is a decade? It is likely that Ontario will not be satisfied to wait quietly until 2014, so we have not seen the end of this issue. Still, the principle of a cash-only transfer has been established.

Unlike Equalization, the Canada Health Transfer and the Canada Social Transfer are intended to be more than unconditional transfers of cash. They are meant to assist the provinces in delivery of specific programs according to some national principles and conditions. The Budget largely left the CHT unchanged, except for some highly-targeted additional funding for waiting times, which we will not discuss here.

But in addition to moving to all-cash transfers, the Budget introduced another substantive change to the Canada Social Transfer. The CST had previously been treated as one big grab bag of money, to cover a vaguely defined set of services described as postsecondary education, social assistance and social services. One exception was the Early Learning and Child Care Agreements, which had been rolled into the CST but earmarked within it.

The 2007 Budget now earmarks 25 percent of the CST for postsecondary education, and the remainder for social assistance and children's programs. Without further conditions attached to the CST, the earmarking will have no real effects at present. However, it does lay a foundation for some higher degree of accountability in the future and it allows outside organizations to estimate the amount of federal funds going to postsecondary education. In short, this is a step in the right direction towards a more accountable and meaningful federal transfer.

The 2007 Budget has taken several important and positive steps with respect to federal-provincial fiscal relations. Notwithstanding the Finance Minister's optimistic predictions, it will not end, once and for all, the complaints of provinces. Nor will it resolve issues concerning the other layers of the cake – the broader question of an overall negative or positive position in the federal system. But it does end the stasis and the sense of irresolvable contradictions that have been plaguing Canada for the last decade. We can untie Gordian knots, even ones as wickedly entangled as the Equalization program.

Aboriginal Peoples

One of the most disappointing aspects of the 2007 Budget was its treatment of Aboriginal issues. The Budget threw a few small bits and pieces together, rather than confronting what is perhaps the most serious social challenge facing Canada.

The Kelowna Accord was a solemn agreement signed by the provinces, territories, First Nations and Aboriginal organizations, and the previous Canadian government. When the new federal government unilaterally rejected the Kelowna Accord, it gave the impression that it had a different approach it wanted to promote. Now it becomes apparent that Canada's New Government has no plan at all, unless doing as little as possible can be characterized as a plan.

The government's non-plan of doing next to nothing will not work. Tearing up the Kelowna Accord was a serious action that has spread dismay among Aboriginal peoples. Unilateral rejection of the Accord has made advocates of negotiation and reconciliation look foolish and naïve. Consequently, there will be escalating emergencies and confrontations.

The real impact of the do-nothing strategy will be to throw lots of money at the Aboriginal crisis of the month, while failing to address any of the underlying social and economic conditions. In the meantime, real funding per capita for core services such as education continues to decrease. More importantly, no initiative is being brought forward to improve the effectiveness of core services as a basis for success of a new generation.

Conclusion

Overall, the 2007 budget is a very mixed brew. There are some positive elements – the Working Income Tax Benefit, the tax-assisted savings plan for persons with disabilities, and the new federal-provincial fiscal arrangements. But there are also some highly regressive and backward-looking elements, such as the child tax credit and income splitting for seniors, which exclude the poor and exacerbate inequality. Equally negative are the plans to reduce taxes rather than invest in essential requirements to sustain our quality of life.

However, the worst part of the Budget is not what is there but what is not: No measures to reduce child poverty, no early childhood education or meaningful national child care, no plans to address real infrastructure needs now, no commitment to tackle the abysmal reality of Aboriginal life in Canada, and no housing program. If this were a coffee shop, we would take back our cup and ask for a better one.

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