CALEDON INSTITUTE OF SOCIAL POLICY

# A Bigger and Better Child Benefit: A $5,000 Canada Child Tax Benefit

*by*

**Ken Battle**

**January 2008**

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Caledon Institute of Social Policy
1390 Prince of Wales Drive, Suite 401
Ottawa, ON K2C 3N6
CANADA

Phone: (613) 729-3340
Fax: (613) 729-3896
E-mail: caledon@caledoninst.org
Website: *www.caledoninst.org*

# Table of Contents


Executive Summary 1

Introduction 3

- 90 years of child benefits in one easy lesson 4
- core objectives 4

Evolution of child benefits 1918-2007 4

- phase 1 – regressive targeting: child benefits only for non-poor families 5
- phase 2 – untargeted universality: child benefits for all, though better-off families still got the most 5
- phase 3 – progressive universality: larger child benefits for poor families, but overall distribution still irrational 5
- phase 4 – progressive targeting: rationalization of several different child benefits into a single, progressive, income-tested program 7
- phase 5 – toward an integrated child benefit: the National Child Benefit 8
- losses for non-poor families 13
- four key trends over the long term, 1918-2005 13
- phase 6 – back to the future: child benefits changes in 2006 and 2007 14
- Universal Child Care Benefit (UCCB) 15
- the non-refundable child tax credit 20
- the current child benefits system: irrational increases 22
- families with young children 23
- families with older children 26

puzzling patterns 30

benefits for upper-income families 31

let confusion reign 32

A bigger and better child benefit: the $5,000 Canada Child Tax Benefit 33

the proposal: a $5,000 Canada Child Tax Benefit 34

benefits under the current system and the $5,000 CCTB 35

impact on the parental recognition objective 42

contribution of child benefits to income 44

impact on poverty reduction objective 45

cost 47

marginal tax rates 47

Conclusion 52

Endnotes 55

References 57

*Executive Summary*


Child benefits in Canada have undergone significant changes over the last two years, with decidedly mixed results.

Two new programs have been added to the existing federal Canada Child Tax Benefit. The Universal Child Care Benefit, created in 2006, pays $1,200 for every child age 5 or younger. The non-refundable child tax credit, launched in 2007, provides a federal income tax savings worth up to $300 for children of all ages.

On the positive side, thanks to these new programs, federal child benefits have increased not only for many (though not all) low-income families, but also – for the first time in decades – non-poor families. These changes enhance the federal child benefits system's capacity to serve its two core purposes – reducing child poverty and helping parents with the cost of raising children (the poverty reduction and parental recognition objectives, in short).

On the negative side, not all families have benefited from these changes. The Universal Child Care Benefit (UCCB) is targeted to children 5 and under and so excludes older children. The non-refundable child tax credit does not help low-income families, because they do not owe income tax. As a result, only one group of families has not enjoyed a boost in child benefits over the last two years – poor families whose children are aged between 6 and 17 – because they do not qualify for either the UCCB or the non-refundable child tax credit.

These two 'new' child benefit programs are in fact worn retreads from the past. Unlike the geared-to-income Canada Child Tax Benefit, they deliver sizeable benefits to high-income families and introduce a variety of inequities into the child benefits system.

Modelled on the extinct Family Allowances program, the Universal Child Care Benefit (UCCB) is subject to both federal and provincial/territorial income taxes, which means that most families do not end up with the full $1,200 per child under 6. In several provinces, even some low-income families do not keep the full $1,200.

Families of different types (i.e., single parents, one-earner and two-earner couples with children) but with the same income get different after-tax benefits from the Universal Child Care Benefit. Moreover, these differences in after-tax UCCB benefits extend across the country, so that families with the same income end up with different after-tax UCCB payments depending upon the province or territory in which they live.

Despite its title, the Universal Child Care Benefit is not tied to use of child care (families can spend it however they wish) and, even if it is used for this purpose, its $1,200 per year (less after taxes) buys little in the way of child care, decent or otherwise. The Universal Child Care Benefit is nothing more than a poorly designed child benefit.

Announced in the 2007 federal Budget, the 'new' non-refundable child tax credit is actually a program of the same name resurrected from the 1980s. The non-refundable child tax credit provides its maximum benefit – $300 per child annually in federal income tax savings – to families which owe federal income tax, thus excluding poor families below the taxpaying threshold. Rich families get the same $300 per child federal tax break as middle- and modest-income families, while the poorest get nothing.

The federal government's changes over the past two years have created a complex, irrational and unfair system of child benefits, undoing decades of progress – by Conservative and Liberal governments alike – towards a single, progressive and fair program, the Canada Child Tax Benefit. Canada can do much better, and the answer lies in strengthening the Canada Child Tax Benefit.

The Canada Child Tax Benefit offers a number of advantages. It is a non-stigmatizing, inclusive social program that delivers benefits to the large majority of Canadian families across the country. It is 'portable,' providing a stable and assured supplement to income no matter where families live or work (or do not work, in the case of families receiving Employment Insurance, social assistance or other such sources of income). It is a progressive program, paying benefits that decline as incomes increase. It pays the same amount to all families with the same income, regardless of the sources of that income, the province or territory in which they live, or their type of family. All low-income families receive the same maximum benefit from the Canada Child Tax Benefit, whether their major source of income is work, welfare or whatever.

Caledon proposes abolishing the Universal Child Care Benefit and non-refundable child tax credit and using the resulting savings to help pay for a bigger and better Canada Child Tax Benefit. The maximum amount under our proposal, payable to low-income families, would be $5,000 per child, up from the current maximum CCTB payment of $3,271 for a first child. A $5,000 child benefit would go a long way to meeting the cost of raising a child in a low-income family, and has been supported by social advocacy groups.

Our proposed $5,000 Canada Child Tax Benefit is more than just another in a series of increases for low-income families, crucial as these improvements have been. We have designed our reform option so that it also provides a sizeable increase in child benefits to the modest- and middle-income majority of families. Thus our proposal will enhance both the poverty reduction and parental recognition objectives of the child benefits system.

Canada should not continue to boost child benefits for low-income families only. That approach would further widen the child benefits gap between poor and non-poor families, and would be particularly unfair to modest-income families with incomes above the poverty line but below the average, which also struggle to raise their children. Limiting future increases in child benefits to low-income families could create a 'poverty wall' (a variant of the welfare wall), since families that manage to move from a low income to a modest income would suffer a sharp reduction in their child benefits that could leave them little better off – if not worse off – than when they were below the poverty line.

A mature and effective child benefits system must better serve both its poverty reduction and parental recognition objectives.

Our proposed $5,000 Canada Child Tax Benefit would have a significant impact on poverty. If there were no federal child benefits, the low-income rate for families with children would be 15.0 percent. Under the current system of federal child benefits, the low-income rate for families with children is 9.3 percent; our proposal would reduce that figure further to 8.3 percent. Without federal child benefits, there would be an estimated 566,600 low-income families with children; that number is 352,800 under present child benefits and would fall to 312,800 under our proposed $5,000 Canada Child Tax Benefit. The average depth of poverty, $10,159 in the absence of federal child benefits, is $7,546 under the current system and would be $7,153 under our option.

The current child benefits system costs the federal government $13 billion. Our proposed $5,000 CCTB would cost an estimated $17 billion – $4 billion more than the present system. This increased investment could be phased in over time, as has been the case for previous enhancements to the Canada Child Tax Benefit.

Our proposal is a win-win proposition. It would boost federal child benefit payments to $5,000 for every child in low-income families. It also would improve child benefits for the large majority of non-poor families, which have modest or middle incomes. Finally, after close to a century of development, Canada would have a strong and mature child benefit system that would both substantially reduce poverty and provide financial recognition for families' child-rearing responsibilities.

## *Introduction*

The federal government's 2006 and 2007 Budgets marked a turning point in the evolution of one of Canada's oldest and most important social programs – child benefits. For the first time in close to thirty years,[1] middle- and high-income families are enjoying an increase in their child benefits from Ottawa.

Boosting child benefits for modest- and middle-income families is a necessary and laudable move – one that the Caledon Institute has been recommending for years – complementing the hefty increases in Canada Child Tax Benefit payments for low-income families under the National Child Benefit reform. Unfortunately, the means by which the current federal government is implementing its changes to child benefits are flawed, unfair and retrograde. This paper explains why and offers a better alternative – an effective, fair and progressive $5,000 Canada Child Tax Benefit that will deliver larger payments to low-income families, reduce the extent and depth of child poverty, and supplement the incomes of the large majority of Canadian families with children, notably those with modest and middle incomes.

## *90 years of child benefits in one easy lesson*

To properly understand what's been happening to child benefits over the last two years, we first must go back to basics: What are child benefits? What are their purposes? How have they evolved over the years?

### *core objectives*

In Canada, child benefits – meaning cash payments on behalf of children, delivered either in the form of cheques or income tax reductions – historically have pursued two fundamental and related purposes, characterized as the *'poverty reduction'* and *'parental recognition'* objectives.[2] Under the poverty reduction objective, child benefits help fill the gap between the earnings of low- and modest-wage parents and their families' income needs, based on the long-recognized and still highly relevant reality that a market economy does not vary wages and salaries to take into account the number of family members dependant on that income. The parental recognition objective (known by economists as 'horizontal equity') recognizes child benefits as one way for society to provide some financial recompense for the fact that parents with children bear expenses that childless households at the same income level do not.

These dual objectives are interrelated. Both assume that society has an interest and obligation to help parents with their child-rearing costs because children are, as economists put it, a 'public good' or 'investment': Children grow up to become workers, taxpayers and citizens, and so it is in the interest of everyone – including those without children – that parents not face undue financial strain in the child-rearing work which they perform, in part, on behalf of everyone in society. The poverty reduction objective acknowledges that lower-income families have the least financial capacity and also seeks to mitigate the greater personal and societal risks of child poverty, in terms of children's immediate and long-term health, learning capacity and educational performance.

For low-income families, child benefits address both the poverty reduction and parental recognition objectives, while they focus on the latter objective for non-poor families. Concern about the parental recognition objective typically has focussed on middle- and high-income families, which have suffered a decline (and, for the highest-income families, disappearance, until recently) in their child benefits since the mid-1980s. It is only during the last two years, under the new federal government, that non-poor families have seen some restoration of their child benefits and a child benefits floor re-established so that even wealthy families once again receive some payments.

## *Evolution of child benefits 1918-2007*

The history of Canadian child benefits can be divided into six stages [Battle and Mendelson 1997; Battle 2007]. The first five phases in the evolution of federal child benefits occurred from 1918 to 2005, while the sixth and current stage has taken place over the past two years.

***phase 1 – regressive targeting: child benefits only for non-poor families***

The first phase in the history of federal child benefits, between the two world wars, can be characterized as regressive targeting. The personal income tax system, created as a supposedly 'temporary' measure to help finance Canada's contribution to the First World War, introduced a children's tax exemption in 1918. This program delivered its benefits in the form of income tax savings that increased in value as taxable income increased and excluded lower-income families that did not owe income tax – the majority, in those times of widespread poverty and modest average incomes. So Canada's first child benefit pursued only the parental recognition objective, and only for non-poor families that owed income tax.

***phase 2 – untargeted universality: child benefits for all, though better-off families still got the most***

The arrival of universal Family Allowances in the spring of 1945 heralded a second phase in the evolution of child benefits, *untargeted universality*. While federal child benefits were extended to include low- and modest-income families, via Family Allowances (also called the 'baby bonus'), the better-off still got more because they received both the children's tax exemption (whose value increased as taxable income rose) and Family Allowances. Child benefits now addressed both the parental recognition and poverty reduction objectives, though the former more strongly than the latter.

***phase 3 – progressive universality: larger child benefits for poor families, but overall distribution still irrational***

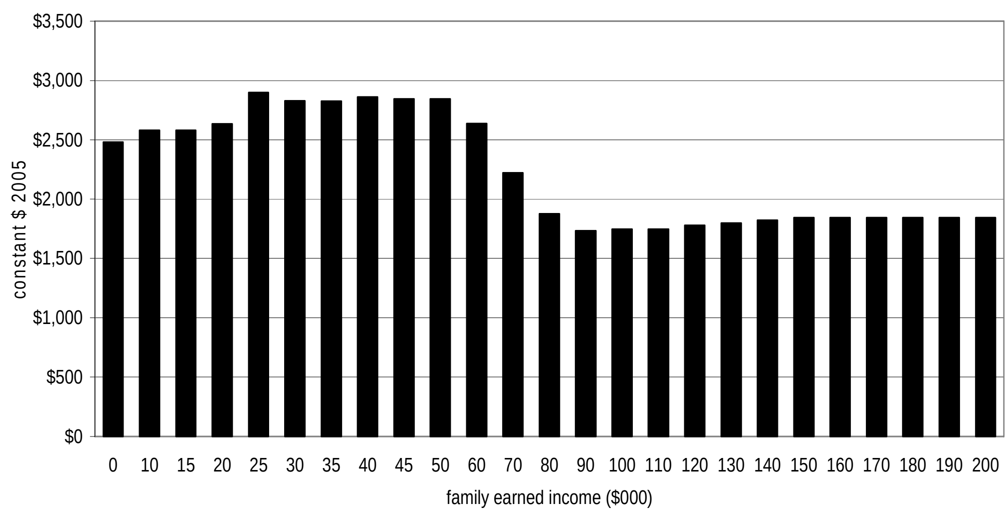
The 1970s ushered in a third phase, *progressive universality.* In 1973, Family Allowances were tripled in value, indexed to the cost of living and made taxable for the higher-income parent, mainly men. The latter change meant that Family Allowances became progressive; the higher the claimant's top marginal tax rate, the more he paid in income tax on Family Allowances and thus the lower his after-tax benefits.

In 1978, Ottawa created an innovative 'income-tested' child benefit administered through the personal income tax system – the refundable child tax credit. This revolutionary new program delivered its maximum amount to low-income families, a smaller payment to middle-income families in an amount that decreased as incomes increased, and nothing to the well-off. Initially a relatively modest program intended to augment benefits primarily for families with below-average incomes, the refundable child tax credit was the forerunner of today's federal Canada Child Tax Benefit and provincial/territorial income-tested child benefits, discussed later. As such, the refundable child tax credit laid the foundation for a new architecture of child benefits.

Let's look at the configuration of federal child benefits as it was in the late 1970s and early 1980s.[3] The overall distribution of benefits was irrational and inconsistent, resulting in 'vertical inequity': Some families with higher incomes got more than other families with lower incomes.

Figure 1 illustrates total child benefits under the 1984 system for two-earner couples with two children. (All figures have been converted to 2005 constant dollars because later we compare the 1984 system with that in 2005.) Family Allowances and the refundable child tax credit delivered their benefits in a progressive manner; benefits declined as income increased. However, the children's tax exemption worked in the opposite direction; its benefits were regressive because they increased as taxable income rose.

**Figure 1**
**Federal child benefits, 1984, two-earner couples with two children (one under 7), in constant 2005 dollars**




The distribution of benefits from the late 1970s-early 1980s federal child benefits system bore no logical or defensible relationship to need as measured by family income. In 1984, a two-earner couple with two children (one under 7) and earnings of $50,000 received more child benefits than a family with zero earnings ($2,844 versus $2,480, for a difference of $364 or 14.7 percent more for the $50,000 family). An upper-middle- income family earning $100,000 got $1,748 worth of child benefits; a poor family earning just $10,000 received $2,580 – only $832 more than the family with ten times as much income. The truly wealthy got more than the merely affluent: Families earning $200,000 got $1,844 while those with earned income of $100,000 received $1,748. And there was no ceiling to the income level at which child benefits were payable: A family earning a million dollars still received Family Allowances and the children's tax exemption.

The late 1970s/early 1980s child benefits system was not only universal in reach. It also provided relatively substantial child benefits to upper-income families. Although it addressed both child benefit objectives, the old system favoured the parental recognition objective over the poverty reduction objective.

Child benefits in the 1970s and early 1980s also suffered from a form of 'horizontal inequity' that compromised its pursuit of the parental recognition objective – unequal child benefits for families with the same number of children and the same incomes, but in which each parent's contribution to family income differed. A one-earner couple received larger income tax savings from the children's tax exemption than a two-earner family with the same total income, because the parent in the one-earner family was in a higher marginal tax bracket than the higher-earning parent in the two-earner couple. On the other hand, a two-earner couple received larger net (after-tax) Family Allowances than a one-earner couple at the same family income level because the higher-earning parent in the two-earner couple was in a lower tax bracket than the parent in the one-earner family. Nor did the two child benefits (Family Allowances and children's tax exemption) counteract each other to achieve equal overall benefits. Only the family income-based refundable child tax credit avoided this problem, since it treated all families at the same income level equally, regardless of each parent's share of family income or family type.

The late 1970s/early 1980s child benefits system was so complicated that no family without a computer tax model could possibly figure out how much it got from each child benefit program or what its total benefits should be. (Come to think of it, personal computers had barely been invented back then.) They could not simply multiply their monthly Family Allowance cheques by 12, because the actual value of the program depended on the marginal tax rate of the higher-income parent. So also did the value of the children's tax exemption hinge on the higher-income parent's tax bracket.

While the logic of the geared-to-income refundable child tax credit was easily grasped – the higher your income, the smaller your child benefit – few non-poor families would have been able to figure out their actual benefit. To complicate matters, the value of the refundable child tax credit depended on the family's net income, which is not the same as their total (gross) income. The definition of net income allows a number of deductions – including contributions to employer-sponsored registered pension plans and RRSPs, union and professional dues, receipted child care expenses, attendant care expenses, certain business investment losses, moving expenses, alimony or maintenance income, carrying charges and interest expenses, exploration and development expenses, and certain employment expenses. Thus many families, especially those with higher incomes, received a larger refundable child tax credit because their net income was less than their gross income.

### ***phase 4 – progressive targeting*: *rationalization of several different child benefits into a single, progressive, income-tested program***

A fourth phase in the evolution of child benefits, *progressive targeting,* began in the 1980s and continued throughout the 1990s. The children's tax exemption was reduced in 1987 and then converted to a non-refundable child tax credit in 1988 as part of the federal government's income tax reforms. Whereas the children's tax exemption was a regressive program providing benefits in the form of income tax savings that increased with taxable income, the non-refundable child credit gave virtually all taxpaying families equal income tax savings. However, like the children's tax exemption, the non-refundable child tax credit excluded poor families below the taxpaying threshold, and was worth less than the maximum in the case of families whose income tax liability was less than the value of the non-refundable credit. The equivalent-to-married exemption, a child benefit paid on behalf of the first child in single-parent families, also was converted to a non-refundable credit. The refundable child tax credit got a substantial boost in the latter half of the decade, including a supplement for children under the age of 7.

The federal government announced the imminent demise of universal child benefits in 1989 by requiring upper-income families to repay more or (if their incomes were high enough) all of their Family Allowances through an income test (unpopularly labelled 'clawback') operating through the income tax system. The measure was phased in over three years so that, as of 1991, well-off families received what amounted to temporary Family Allowances, since they had to pay back at income tax time the benefits they had received the previous year – truly an Alice-in-Wonderland innovation in social policy. The federal child benefits system, which had been indexed to inflation since 1973, was partially de-indexed in 1986 – a stealthy and regressive change designed to increase federal revenues in the war against the deficit [Battle 1998]. Full indexation of child benefits and the personal income tax system was not restored until 2000.

The 1990s brought a formal break with universality and a momentous shift to a wholly income-tested federal child benefits system. In 1993, the three major child benefits – Family Allowances, the refundable child tax credit and the non-refundable child tax credit – were replaced by a single, income-tested Child Tax Benefit which increased payments for working poor families (through a Working Income Supplement for low-earning families); maintained benefits for other low-income families; reduced payments to middle-income families; and stopped paying benefits to high-income families. Like Family Allowances, the new Child Tax Benefit was delivered on a monthly basis.

Though driven as much by the imperative of deficit-cutting as progressive policy reform, the rationalization of federal child benefits from a multiple-program to a single-program system was a giant step forward in terms of the architecture of income security for Canada's families with children. Prior to 1993, different programs had different designs and distributional effects that, as we discussed earlier, resulted in two forms of inequity – vertical (child benefits were not geared consistently to income) and horizontal (families with the same income received different amounts of benefit depending on each parent's share of family income).

### *phase 5 – toward an integrated child benefit*: *the National Child Benefit*

In 1997 Canada entered a fifth phase of child benefits, an *integrated child benefit* that broadened the scope of reform beyond federal programs to include provincial and territorial child benefits. This large-scale reconstruction of Canadian child benefits is known as the National Child

Benefit. We provide here only a brief explanation of this historic advance in Canadian social policy; for a more detailed account, see Battle and Mendelson 2001.

The core metaphor of the National Child Benefit reform is ‘the welfare wall,’ a term coined by Sherri Torjman of the Caledon Institute of Social Policy [Torjman and Battle 1993]. Parents on social assistance who managed to find paid work risked forfeiting thousands of dollars in welfare-embedded cash child benefits and in-kind benefits (e.g., supplementary health and dental care, disability supports, child care and special benefits such as winter clothing allowances). At the same time, they saw their (typically low) wages reduced by federal and sometimes provincial/territorial income taxes as well as by federal payroll taxes, and stretched by employment-related costs such as child care, clothing and transportation. Thus the welfare system, in conjunction with the tax system, unwittingly created barriers to employment for families on welfare.

Before the National Child Benefit reform, welfare families received child benefits from two sources – provincial social assistance benefits paid on behalf of children and federal child benefits. Other low-income families, notably the working poor and unemployment insurance recipients, typically got federal child benefits only. Families on welfare received considerably larger – indeed, about twice as large – child benefits as those paid to other low-income families. And this cash advantage does not count the value of the social assistance system’s in-kind benefits on behalf of children such as supplementary health and dental care, shelter allowances and special benefits like winter clothing allowances.

Just before the introduction of the National Child Benefit in July 1998, combined federal-provincial child benefits ranged from around $2,220 to $2,820 per child annually for welfare families in most provinces (add another $213 per year for each child under 7 for whom the child care expense deduction was not claimed), whereas federal child benefits for children in working poor families were a maximum $1,520 annually for one child. For two children, the gap between welfare families and other low-income families was wider. For example, for families with one child under 7 and one child over 7, total child benefits from the federal and provincial government amounted to $5,253 per year for a welfare family, which is close to double the $2,753 in federal child benefits for other low-income families with two children (using a rough average of $1,500 per child per year for welfare assistance-provided child benefits, excluding the special adult equivalent benefit for the first child in single-parent families).

Welfare provided a cash advantage to some low-income families, but it was an inferior way to deliver child benefits compared to income-tested child benefits. Needs-tested social assistance in Canada is exclusionary, socially marginalizing and divisive. The welfare system is discretionary and involves a relatively high degree of client-worker interaction. Welfare imposes a significant social stigma on its recipients. It is a rules-and-regulations-ridden, highly complex system in which recipients typically are treated in a manner that tends to reinforce their economic powerlessness. Over time, employment skills and self-confidence may ‘rust’ and atrophy.

Income-tested child benefits delivered through the income tax system are quite different. While the amount of payment is geared to the level of net family income, federal income-tested child benefits – starting with the 1979 refundable child tax credit and followed in 1993 by the Child Tax Benefit and its similar 1998 successor, the Canada Child Tax Benefit – are not narrowly targeted to the poor in terms of reach. This ‘broad based’ characteristic – while no longer universal, the system is still extensive in coverage, now reaching upwards of nine in ten families with children – advances the social policy objective of social cohesion, since the large majority of families are served by the same program and no vulnerable group is excluded.

Another virtue of income-tested child benefits is their non-stigmatizing and efficient administration, through the same income tax system that covers Canadians in all income groups throughout the country. Recipients qualify and re-qualify for child benefits based only on a simple test of their income. Benefits are delivered on a frequent (monthly) basis.

The federal-provincial/territorial National Child Benefit reform sought to lower the welfare wall by creating an income-tested, non-stigmatizing child benefit that covers all low-income families and treats them equally, whether they are working or not, while enabling the provinces and territories to take additional actions to assist low-income families. The new child benefit structure can be characterized as ‘integrated’ in the sense that it sought to replace the archaic two-tier system of income-tested federal child benefits and needs-tested provincial/territorial child benefits embedded in welfare with a single, income-tested child benefit (which could be federal only or a mixture of federal and provincial/territorial programs).

The main engine of reform was the Canada Child Tax Benefit (CCTB), a restructured version of the preceding Child Tax Benefit, composed of two layers – a basic benefit for poor and most non-poor families, on top of which operates the National Child Benefit Supplement (NCBS) targeted to low-income families. As Ottawa gradually increased payments under the NCBS portion of the Canada Child Tax Benefit, the provinces and territories were free – and indeed expected – to reduce their social assistance-provided child benefits by the amount of the federal increase. However, the provincial [4] and territorial governments agreed to ‘reinvest’ the resulting savings in other programs and services for low-income families with children “ such as early learning and child care services, supplementary health care, and income-tested child benefits and earnings supplements.

Governments’ goal under the National Child Benefit reform was to raise the federal Canada Child Tax Benefit to the point where it alone, or in combination with provincial/territorial income-tested child benefits, displaced basic welfare-embedded child benefits – estimated at about $2,500 per child in 1998, or about $3,050 in today’s dollars. That level of maximum benefit would achieve the goal of an ‘integrated child benefit’: All low-income families, regardless of their major source(s) of income, would receive the same amount of federal child benefit, and the distinction between child benefits for the working poor and the non-working poor would thereby be eliminated. Integration in the form of similar structures also extended to provincial and territorial child benefits, which – like the federal Canada Child Tax Benefit – are income-tested programs, though the former are targeted to lower-income families whereas the CCTB is broad based and serves the large majority of families.

The federal and provincial/territorial governments set out three formal objectives for the National Child Benefit. They are: “to help prevent and reduce the depth of child poverty; to promote attachment to the workforce – resulting in fewer families having to rely on social assistance – by ensuring that families will always be better off as a result of finding work; and to reduce overlap and duplication through closer harmonization of program objectives and benefits and through simplified administration" [Department of Finance Canada 1997]. A series of annual intergovernmental reports, as well as the first formal evaluation, show progress towards all three of the National Child Benefit reform's objectives [Federal, Provincial and Territorial Ministers Responsible for Social Services 2007; 2005].

The federal government followed through in its commitment to the National Child Benefit by means of substantial increases to the maximum payment from the Canada Child Tax Benefit in its early years, from 1998 through 2002. The 2003 Budget announced a further multi-year series of enrichments to the Canada Child Tax Benefit through 2007.

The maximum Canada Child Tax Benefit payment for the first child rose from $1,625 in its first year (July 1998 to June 1989) to $2,632 for July 2003-June 2004 and reached $3,271 for July 2007-June 2008. The maximum benefit for a second child went from $1,425 for July 1988-June 1989 to $2,423 for July 2003-June 2004 to $3,041 for July 2007-June 2008, and for the third and each additional child from $1,425 to $2,427 to $3,046 over the same period.

Expressed in inflation-adjusted 2007 dollars, the maximum Canada Child Tax Benefit for the first child was $1,974 in 1997, the year before the National Child Benefit reform began. By July 2007, it had reached $3,271 – a substantial $1,297 or 65.7 percent real increase over 1997.

The 1988 target of $2,500 (about $3,050 in today's money) for an integrated child benefit was reached in July 2005, when the maximum payment for the first child was $2,516 in constant 1988 dollars ($2,950 in current 2005 dollars). This level marked the completion of a new architecture for child benefits – an *integrated child benefit* providing equal and portable benefits to all low-income families, delivered through an inclusive system that also serves middle- and upper-middle-income families.

Increased investments in the Canada Child Tax Benefit in the 1990s and 2000s much more than made up for reductions in expenditures on federal child benefits in the 1980s. By 2005, Ottawa was spending $9.6 billion – $2.4 billion or one-third more than its 1984 expenditure of $7.2 billion (in constant 2005 dollars) on child benefit programs.

So too has the National Child Benefit helped reduce overlap and duplication of federal and provincial/territorial programs – the third formal objective of the reform. In a number of jurisdictions, the federal Canada Child Tax Benefit is being used to deliver provincial/territorial child benefits, resulting in administrative savings and efficient delivery to families.

In 2003, the Canada Child Tax Benefit added a Child Disability Benefit payable on behalf of children with severe disabilities who live in low- and modest-income families. The Child Disability Benefit's reach has since been extended so that virtually all families with an eligible child will receive some payment (for one child, eligibility ends at $154,728 in net family income). The Child Disability Benefit currently pays a maximum of $2,000 (over and above regular child benefits).

The year 2004 brought another CCTB-delivered new program, the Canada Learning Bond. Intended to help low-income families save towards their children's post-secondary education, the Canada Learning Bond pays $500 at birth and $100 each year thereafter (to a cumulative total of $2,000) for each child in families that receive the Canada Child Tax Benefit's National Child Benefit Supplement (i.e., that portion of the CCTB that is targeted to low- and modest-income families with net incomes under $37,178).[5]

Child benefits have been contributing a growing share of the incomes of poor families. For a family with one child under 6 and earned income of $15,000, federal child benefits increased from 15.0 percent of earnings when the Child Tax Benefit was launched in 1993 to 15.8 percent when the Canada Child Tax Benefit began in 1998, 22.1 percent in 2005 and reached 29.8 percent in 2007 with the addition of the Universal Child Care Benefit to federal child benefits.[6] A two-earner couple with earned income of $25,000 and one child under 6 saw its child benefits go from 11.7 percent of earnings in 1993 to 12.6 percent in 1998, 21.3 percent in 2005 and 28.2 percent in 2007.

The increase in federal child benefits for low-income families is striking over both the short and long term. In 2007, federal child benefits pay more than quadruple (4.6 times) what Family Allowances delivered in 1946 for a low-income family with two children – $7,767 versus $1,697 (in inflation-adjusted 2007 dollars). Figure 2 illustrates the trend for low-income two-earner couples with two children, one under 6 and the other 6-17.[7]

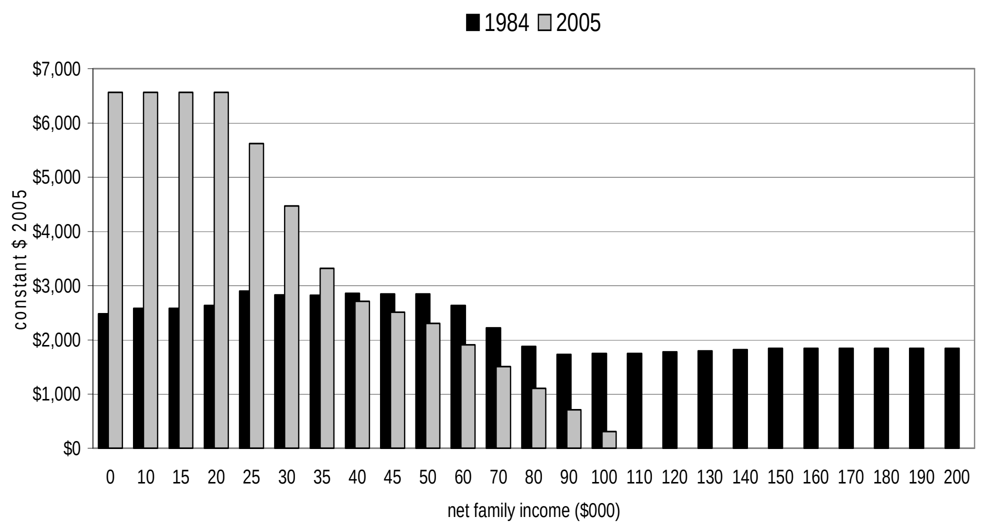
**Figure 2**
**Federal child benefits, 1946-2007, low-income families with two children (one under 6), in constant 2007 dollars**

*losses for non-poor families*

Low-income families have enjoyed substantial improvements in their federal child benefits, but the opposite is the case for most non-poor families, which make up the majority of Canadian families with children. Figure 3 shows the distribution of payments under the Canada Child Tax Benefit as of 2005, the last year before the new Conservative government's 2006 and 2007 changes (which restored some of the losses to non-poor families, as explained later), and compares it to that of the multiple-program system as it was in 1984. We use the example of two-earner couples with two children, one under 7 and the other over 7. All figures are expressed in constant 2005 dollars.

Families with net incomes up to $35,000 got more in 2005 than in 1984, but those with net incomes of $40,000 and above fared better under the old system. Gains were as high as around $4,000 for families with incomes of less than $20,000, while losses peaked at $1,844 and above for families at $150,000.

**Figure 3**
**Federal child benefits, 1984 and 2005, two-earner couples with two children (one under 7), in constant 2005 dollars**




*four key trends over the long term, 1918-2005*

Our history of child benefits reveals numerous changes over the years, but several clear patterns stand out. The long-term evolution of federal child benefits throughout the 20th century and up to 2005 shows five major and related trends.

First, there has been a long-term trend towards progressive income-testing of child benefits – i.e., gearing their amount to need as measured by family income, so that poor families get the most and the amount of benefits declines as incomes increase. However, while the Canada Child Tax Benefit calculates the amount of payments on the basis of family income, it is not “ contrary to what some people think “ targeted narrowly to low-income families in terms of eligibility for benefits. To the contrary, the Canada Child Tax Benefit now covers about nine in ten families with children, excluding only those with high incomes.

Second, child benefits for low-income families have increased substantially in value over time, especially in the 1990s and into the 2000s.

Third, non-poor families have experienced a loss in their child benefits. Since the late 1970s, the poverty reduction objective generally has been given higher priority than the parental recognition objective, with a substantial boost in child benefits to the poor and reductions in payments to non-poor families.

Fourth, spending on federal child benefits has risen steadily in recent years, as Ottawa has boosted the Canada Child Tax Benefit under its commitment to the federal-provincial/territorial National Child Benefit reform. The cost of gains to low-income families has exceeded savings from reductions to non-poor families. Expenditures rose from $6.1 billion in 1996 (in inflation-adjusted 2005 dollars) to $9.6 billion by 2005.

Fifth, there was a structural and administrative rationalization of child benefits at both the federal and provincial/territorial levels. All jurisdictions except Prince Edward Island now operate income-tested child benefit programs. Multiple programs with different objectives, designs and distributional effects have been replaced by a single common structure – a geared-to-family-income child tax benefit that provides equal benefits to all families with the same income, regardless of the source of income, each parent’s contribution to family income and family type. Up to 2005, both Conservative and Liberal governments contributed to the incremental rationalization of federal child benefits.

### *phase 6 – back to the future*: *child benefits changes in 2006 and 2007*

The federal child benefits system recently entered a sixth stage with the new Conservative government’s creation of two supposedly new programs – the Universal Child Care Benefit in 2006 and the non-refundable child tax credit in 2007. These child benefits enhance both the poverty reduction and parental recognition objectives, though the latter more than the former. Far from new, however, both programs are retreads from the past. Both undermine years of progress towards a fair, rational and progressive child benefits system.

### *Universal Child Care Benefit (UCCB)*

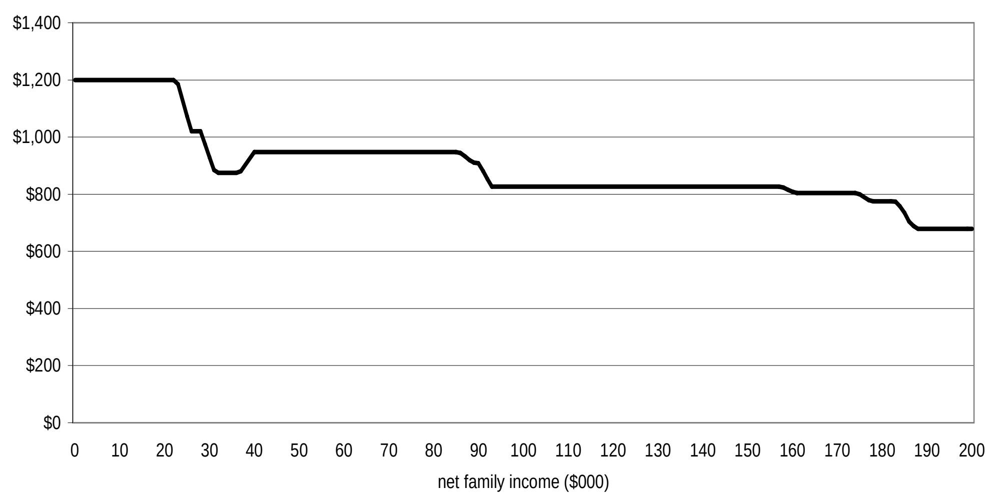
One of the Conservative government's five major election planks and policy initiatives during its first year in office, the Universal Child Care Benefit was announced in the 2006 federal Budget and sent out its first payments in July of that year.[8] The program pays $100 a month for a total of $1,200 a year and – as reflected in its title – is restricted to children under 6 because it supposedly is intended to help pay for child care costs. The Universal Child Care Benefit is taxable in the hands of the lower-income parent in the case of couples, and the sole parent in the case of single-parent families.

The Canada Child Tax Benefit did not escape unscathed from the introduction of the Universal Child Care Benefit. To help pay for the new program, the Canada Child Tax Benefit's young child supplement was abolished. This benefit amounted to $249 annually for eligible children 5 and under as of July 2006, the last year it was paid.

As a taxable program, the Universal Child Care Benefit raises the taxable income of the lower-income parent in a couple or the single parent by $1,200 a year for each child aged 5 or younger. The poorest families, typically those on welfare or with meagre earnings, are generally below the taxpaying threshold and so pay no income taxes on their new benefit. But the large majority of families pay federal and provincial/territorial income taxes on their $1,200 UCCB.

The resulting distribution of after-income-tax UCCB benefits is generally progressive, meaning that after-tax benefits fall as taxable incomes rise. Figure 4 illustrates the results in 2007 for Ontario two-earner couples with two children, one under 6 and thus receiving the UCCB.

**Figure 4**
**Net (after-tax) Universal Child Care Benefit, two-earner couples with two children (one under 6), Ontario, 2007**



Welfare families owe no income tax on their UCCB; working poor and modest-income families pay a small amount of tax on their UCCB; middle-income families pay more and upper-income families the most on their UCCB.[9] The Universal Child Care Benefit is less progressive than the Canada Child Tax Benefit because the UCCB decreases in broad stages according to tax brackets, whereas the CCTB declines smoothly as net incomes increase above the threshold for maximum benefits.

There are several flaws in the design of the Universal Child Care Benefit.

First, it is a stealthy program. Doubtless many families that receive the Universal Child Care Benefit do not realize that they must repay part of it to the federal and provincial/territorial governments at income tax time. Even if they do understand that they end up with less after taxes, UCCB families are unlikely to know the precise, or for that matter, even rough amount – unless they know their federal and provincial/territorial top marginal tax rates and so can perform the necessary calculations, or can instruct their tax accountant to do so. The Universal Child Care Benefit is a stealthy program in another sense: The Canada Child Tax Benefit's young child supplement was axed to help pay for the UCCB; likely few of the families that received the supplement – most of them lower-income – are aware of this loss, as it was certainly not publicized by the federal government that ended it.

Second, the Universal Child Care Benefit suffers from the same failing as the venerable and extinct Family Allowances program on which it is modelled – 'horizontal inequity.' The UCCB is taxable in the hands of the lower-income parent, whereas Family Allowances were taxed in the hands of the higher-income parent. But the resulting horizontal inequity is the same: Families with the same income but different income shares between the parents receive different amounts of after-tax UCCB benefits (the exception being families with such low incomes that they end up with the full $1,200 because they are below the taxpaying threshold). For most of the income range, one-earner couples end up with larger benefits than single parents and two-earner couples with the same total income.

Take, for example, the case of three types of Ontario families with one child under 6 and identical net income of $80,000 in 2007. The one-earner couple pays $225 in federal and provincial income taxes on its $1,200 Universal Child Care Benefit and so ends up with $975 after tax; the lower-earner parent owes no income tax even with the extra $1,200, but the higher-earning spouse gets a smaller married credit (whose value is linked to the lower earner's income) and so pays more federal and provincial income taxes. Assuming a 40/60 percentage split of income for two-earner couples, the lower earner pays federal and provincial income taxes on the $1,200 Universal Child Care Benefit, which come to $253, so the family's net (after-tax) benefit is $947. The single parent adds $1,200 to her taxable income and pays the most federal and Ontario income taxes on the UCCB – $341 – leaving her with a net benefit of $859. In summary, federal and Ontario income taxes payable on the $1,200 UCCB in 2007 for families with one child under 6 and net income of $80,000 range from $225 for one-earner couples to $253 for two-earner couples and $341 for single parents.

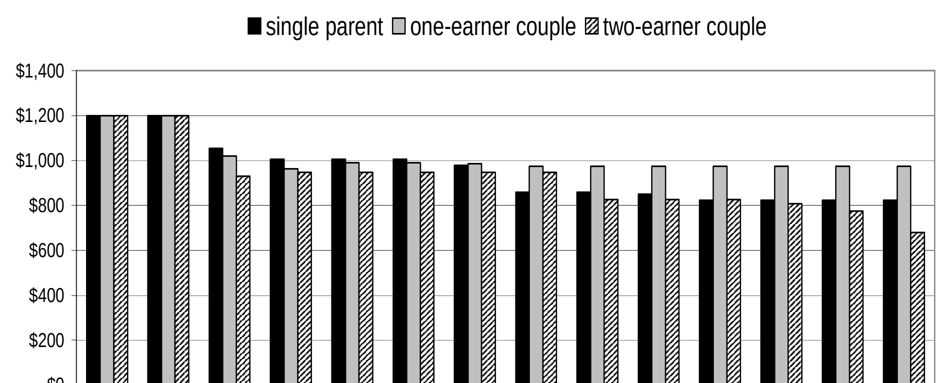
Figure 5 expands the analysis to other income levels. All Ontario families with net incomes up to $20,000 pay no income tax on their Universal Child Care Benefit, so keep the full amount of

$1,200.  From $30,000 through $60,000, single parents fare best followed by one-earner couples and then two-earner couples.  At $70,000, one-earner couples are first, then single parents and two-earner couples.  At $80,000, one-earner couples come out ahead, followed by two-earner couples and single parents.  From $100,000 up, one-earner couples get the highest after-tax UCCB followed by single parents and two-earner couples.  In summary, in Ontario single parents have the highest after-tax UCCB between $30,000 and $60,000, while one-earner couples come first at higher income levels.

To complicate matters further, families across Ontario's western border, in Manitoba, show a somewhat different picture, and the same applies to the other provinces and territories, all of which vary somewhat.  All eligible Manitoba families with $10,000 in net family income keep the full $1,200 UCCB.  At $20,000, the province's single parents keep $1,057 while one-earner couples and two-earner couples keep the full $1,200 in after-tax UCCB.  From $30,000 and up, one-earner couples have the largest after-tax UCCB ($1,094), while the rank for one-earner and two-earner couples varies from one income level to another.

Is this a rational way to run a national social program?

**Figure 5**
**Net (after-tax) Universal Child Care Benefit, by family type and income, Ontario, 2007**




| | 0 | 20 | 30 | 40 | 50 | 60 | 70 | 80 | 100 | 120 | 140 | 160 | 180 | 200 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| single parent | 1200 | 1200 | 1055 | 1006 | 1006 | 1006 | 979 | 859 | 859 | 850 | 823 | 823 | 823 | 823 |
| one-earner couple | 1200 | 1200 | 1020 | 963 | 991 | 991 | 986 | 975 | 975 | 975 | 975 | 975 | 975 | 975 |
| two-earner couple | 1200 | 1200 | 930 | 947 | 947 | 947 | 947 | 947 | 826 | 826 | 826 | 808 | 775 | 679 |

net family income ($000)

A third flaw in the Universal Child Care Benefit stems from the decision to abolish the Canada Child Tax Benefit's young child supplement in order to help finance the UCCB, which hurt mainly lower-income families.  Low- and modest-income families typically received the young child supplement (worth $249 annually as of July 2006) because they did not claim the child care expense deduction, and vice versa for higher-income families (for whom the child care expense deduction is worth much more in tax savings).[10] The loss of the young child supplement effectively further reduced net UCCB benefits for lower-income and modest-income families, and created a divide between them and higher-income families (which did not lose the young child supplement because they did not receive it in the first place).

Unfortunately, unless they heard complaints from some advocacy groups (using information from the Caledon Institute), few families would be aware of this change, coming as it did with all the government's publicity about the creation of the Universal Child Care Benefit. But the inequity persists, regardless of how deeply it is buried in the recent history of child benefits.

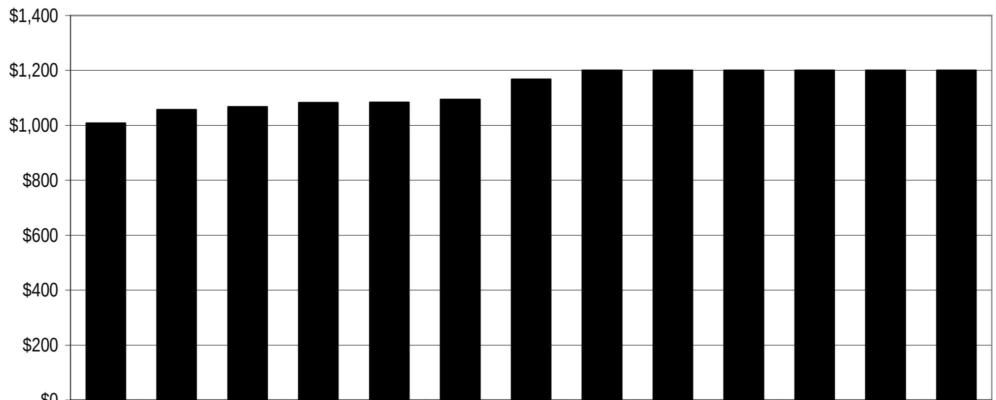
A fourth weakness of the Universal Child Care Benefit, yet another form of stealth, is its claim to be a child care program offering parents "choice in child care." Despite its name, the UCCB is not a child care program in the usual sense of that term because it not restricted to child care uses. This stands in contrast to designated child care programs such as the child care expense deduction, which reduces federal and provincial/territorial income taxes for families in which the claiming parent incurs child care expenses to work or study, and child care subsidies for low-income parents, which are built into provincial/territorial child care systems. The Universal Child Care Benefit is in fact a child benefit because – like the federal Canada Child Tax Benefit and income-tested child benefits offered by the provinces and territories – families use the money as they decide, though most doubtless spend most or all of it on their children. While a child benefit can be used for child care, it is not tied to that use.

Of course, there is nothing stopping families from putting the Universal Child Care Benefit towards their child care expenses, and doubtless some of them do just that. But they will not get very much child care for $1,200 a year, especially if they want quality, regulated care. Parent fees for full-time centre-based regulated care range, for infants, between about $6,000 and $12,000, and for toddlers and preschoolers from about $5,000 to $8,000. (These figures exclude Quebec, which offers a relatively low $7 per child per day fee – though the total cost for Quebec remains about the same even though more of it is paid out of general revenues than parent fees.)

Most Canadian families still use private, unregulated child care, whose cost is not known but likely ranges from modest for some family-based care to expensive for nannies and designer child care centres. The Universal Child Care Benefit provides a windfall subsidy to upper-income families using child care, most of which already enjoy a significant federal and provincial/territorial income tax savings from the child care expense deduction. But the UCCB does little to ease the often heavy financial burden of child care expenses for the large majority of families with low or middle incomes that do not have access to subsidized child care, get little or nothing from the child care expense deduction and often cannot find affordable, good quality care. So much for "choice in child care."

A fifth and final peculiarity of the Universal Child Care Benefit involves another form of horizontal inequity – an interprovincial/territorial form of horizontal inequity – that stems from the program's taxability. Families with the same net income in various provinces and territories often end up with different after-tax benefits because their UCCB is subject to variable provincial/territorial income tax regimes (with different tax brackets, rates and credits).  Figure 6 gives the example of single parents earning $20,000 and raising one child under 6.

**Figure 6**
**UCCB after federal and provincial/territorial income taxes, single parents with one child under 6, net income of $20,000, by province/territory, 2007**




| | Que | Man | Sask | PEI | Nfld | NS | Yukon | NB | Ont | AB | BC | NWT | Nunavut |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ | 1,008 | 1,057 | 1,068 | 1,082 | 1,084 | 1,095 | 1,168 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 |

At the relatively low income of $20,000 shown in Figure 6, none of the families pay federal income tax on their Universal Child Care Benefit because they are below the federal taxpaying threshold.  In six jurisdictions – British Columbia, New Brunswick, Ontario, Alberta, the Northwest Territories and Nunavut – neither do families owe provincial/territorial income tax on their UCCB, so their gross and net UCCB benefits are the same – $1,200 per child.  But in the remaining seven jurisdictions, families are above the provincial/territorial taxpaying threshold and so pay provincial/territorial income tax on their UCCB.  Their net (after-tax) benefits range from a low of $1,008 in Quebec (which levies the highest income taxes of all the provinces and territories) to $1,168 in Yukon. So the promise of a "$1,200 Universal Child Care Benefit" rings hollow even for many low-income families.

After-tax Universal Child Care Benefit amounts also vary across Canada for other types of families at other income levels.  Readers who want to explore this issue further can contact the Caledon Institute for our estimates of net UCCB benefits for the three different family types at other incomes levels in each province and territory: We have 7,839 variations available (the three family types used here for the ten provinces and three territories for income levels between $0 and $200,000) and can generate even more if required.

Figure 7 illustrates after-tax UCCB benefits for one-earner couples with net income of $60,000 and two children, one eligible for the UCCB. All families at this income level pay both federal and provincial/territorial income taxes on their UCCB payments. Families living in high-taxed Quebec get the lowest net UCCB – $970, or $162 less than families in Yukon, which end up with $1,132.

**Figure 7**
**UCCB after federal and provincial/territorial income taxes, one-earner couples with two children (one under 6), net income of $60,000, by province/territory, 2007**

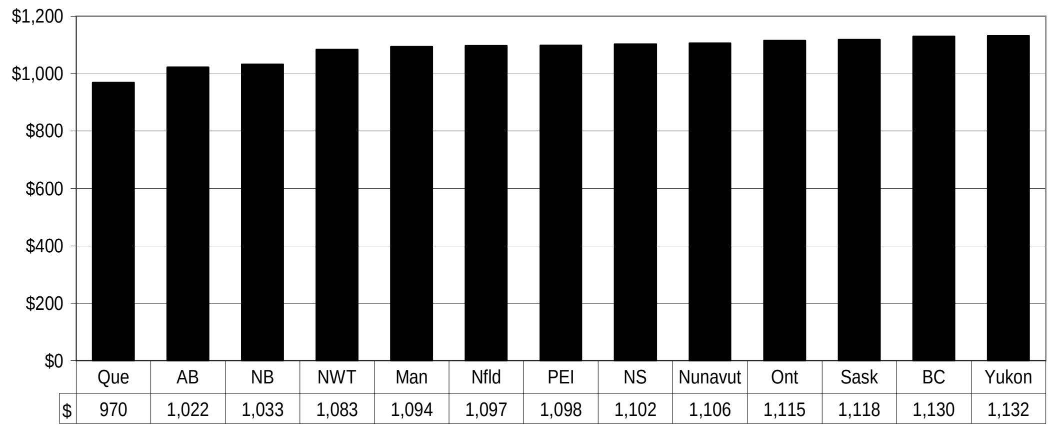
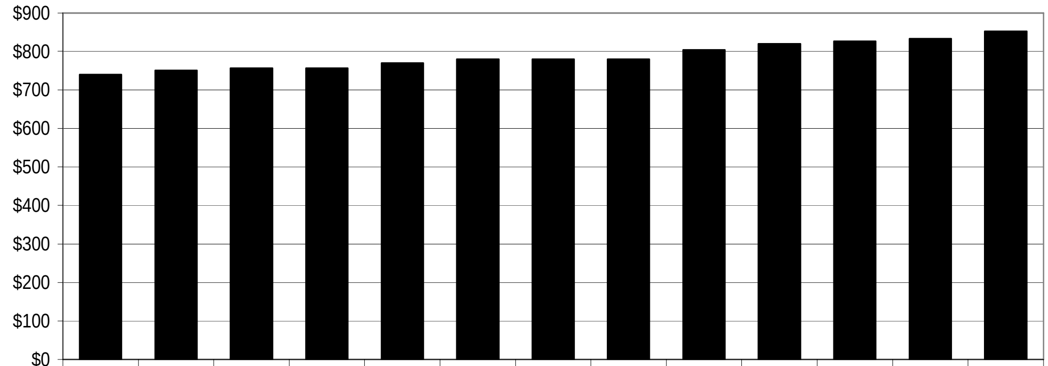



Figure 8 shows similar interjurisdictional differences in after-tax UCCB benefits looking at the example of two-earner couples with net incomes of $75,000 and two children, one receiving the UCCB. Net UCCB benefits vary from $740 in Quebec to $852 in Nunavut.

### *the non-refundable child tax credit*

The 2007 federal Budget continued the Conservative government's back-to-the-future changes to child benefits by announcing a "$2,000 child tax credit" payable on behalf of children under 18. Unlike the Family Allowance-modelled Universal Child Care Benefit, the child tax credit did not even get dressed up with a new name, as it is the same program with the same name that operated between 1988 and 1992.

**Figure 8**
**UCCB after federal and provincial/territorial income taxes, two-earner couples with two children (one under 6), net income of $75,000, by province/territory, 2007**




| | Que | NB | Nfld | NS | PEI | Man | Sask | BC | AB | Yukon | Ont | NWT | Nunavut |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ | 740 | 750 | 756 | 757 | 770 | 780 | 780 | 780 | 804 | 820 | 826 | 833 | 852 |

The "new $2,000 child tax credit" is neither new nor worth $2,000. The child tax credit is a non-refundable benefit; its maximum real value, in federal income tax savings, is $2,000 times the lowest income tax rate of 15 percent (in 2007), or $300. In an Alice-in-Financeland admission, the 2007 Budget does acknowledge that the actual value of the "$2,000" child tax credit is $2,000 times the lowest tax rate of 15 percent, but leaves readers to do their own math – the missing answer is $300.[11] All non-poor families receive $300 per child, including the very rich; some low-income families with a small tax liability (between $1 and $299) will receive a smaller amount, while the poorest will get nothing at all because they do not owe income tax.

Take the case of a single parent with one child in Ontario. If she has net income of $23,000 or more, she will receive the full non-refundable child tax credit of $300. At an income of $22,000, the child tax credit will be worth $286; at $21,000, $147; and at $20,000, just $7. Single parents with net incomes of $19,000 or less are not eligible for the child tax credit because they do not pay federal income tax.

The non-refundable child tax credit pays its maximum $300 per child to 90 percent of families – most of which have middle or high incomes. The poorest families get nothing. The child tax credit makes income inequality among families worse, not better.

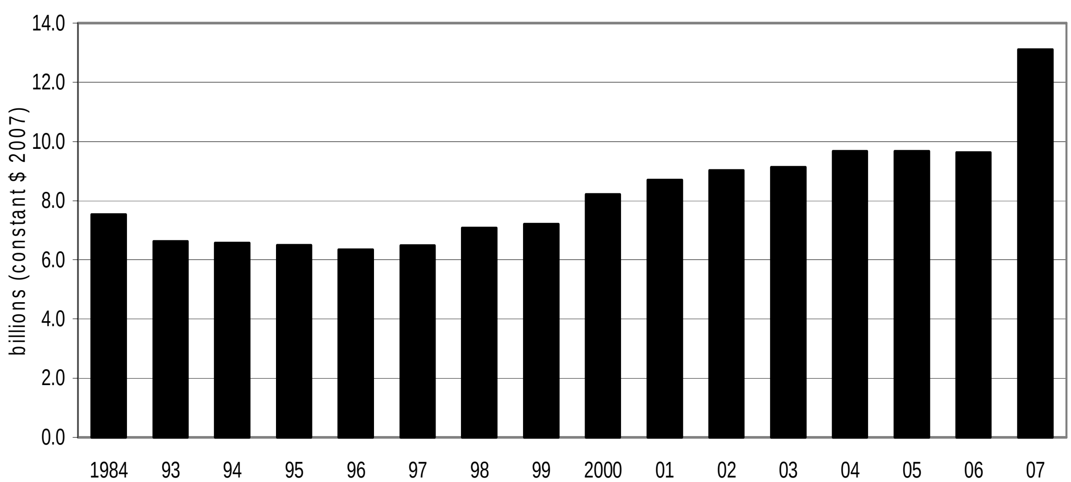
The non-refundable child tax credit reaches some 3 million taxpayers. At a cost of $335 million in 2006-07 and $1.5 billion in 2007-08, it is not inexpensive.

Yet that sizeable money buys relatively modest benefits. In relative terms, the most that the non-refundable child tax credit is worth is 1.3 percent of income for a single parent with an income of $23,000. It amounts to a fraction of one percent (0.6 percent) at $50,000, and a mere 0.12 percent for families with incomes of $250,000.

### *the current child benefits system*: *irrational increases*

Despite their flaws, the Universal Child Care Benefit and non-refundable child tax credit have raised the level of federal child benefits for most families – for all families with children under 6 in the case of the UCCB, and for all non-poor families in the case of the non-refundable child tax credit. The federal government's spending on child benefits, which had been rising steadily in recent years with the series of increases to the Canada Child Tax Benefit, grew again with the addition of the Universal Child Care Benefit and the non-refundable child tax credit. By 2007, Ottawa was spending an estimated $13.1 billion on its three child benefit programs – $5.6 billion or 74 percent more than its 1984 expenditure of $7.5 billion (in constant 2007 dollars). Figure 9 shows the trend.

**Figure 9**
**Federal child benefits expenditures, 1984-2007, in constant 2007 dollars**



### *families with young children*

Let's look more closely at who gets what from the current system of child benefits and how it compares with the system as it was just two years ago, before the arrival of the Universal Child Care Benefit and the non-refundable child tax credit. We deal first with federal child benefits for families that have a child or children under 6, and are thus eligible for the Universal Child Care Benefit.

Figure 10 illustrates the three federal child benefit programs in 2007, using the example of Ontario single parents with one child under 6. The Canada Child Tax Benefit is still by far the largest program and delivers its benefits in a very progressive manner; payments begin to diminish at net income of $20,883 and disappear at $101,328. The Universal Child Care Benefit is universal and only mildly progressive, after-tax benefits ranging from $1,200 for one-parent families with net incomes under $26,000 to $823 for those with net incomes $121,000 and higher. The non-refundable child tax credit pays nothing to families at $19,000 or less, begins to phase in at $20,000 and reaches its peak of $300 for incomes $23,000 and above, so for most of the income range it is a flat-rate rate benefit.

**Figure 10**
**Canada Child Tax Benefit, Universal Child Care Benefit and non-refundable child tax credit, single parents with one child under 6, Ontario, 2007**

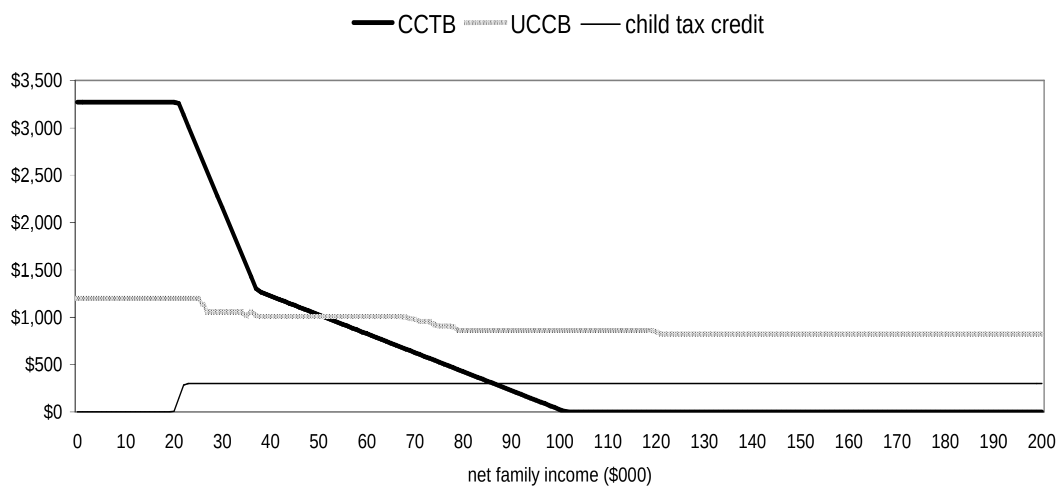
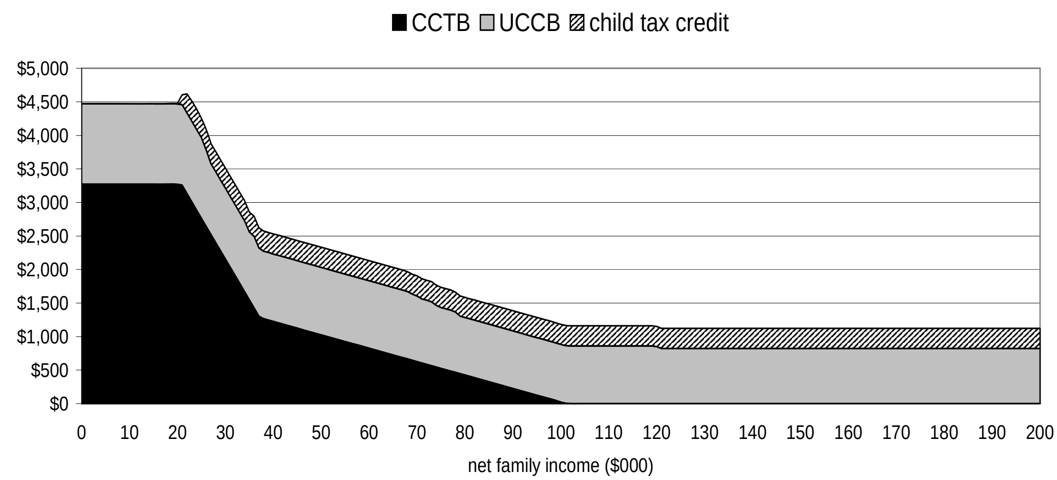



Figure 11 layers the three child benefit programs one on top of the other to provide an illustration of who gets what in terms of total benefits. Combined benefits are flat at low income levels – $4,471 at net incomes less than $20,000, though they increase to $4,621 at $22,000 as the non-refundable child tax phases in.[12] Total payments fall fairly steeply from about $21,000 to $38,000 as the National Child Benefit Supplement declines and then ends, with a more gradual decline from $38,000 to $102,000 as the base Canada Child Tax Benefit diminishes. Families with net incomes at $102,000 and above do not get any Canada Child Tax Benefit but still receive the Universal Child Care Benefit and the non-refundable child tax credit: Total benefits are fairly flat for these (relatively rare) upper-income single parents.

**Figure 11**
**Canada Child Tax Benefit, Universal Child Care Benefit and non-refundable child tax credit, single parents with one child under 6, Ontario, 2007**




The figures differ for other types of family but the overall pattern of child benefits is much the same. The federal child benefits system is generally progressive; payments decline in value as incomes rise throughout most of the income range, except for the initial plateau of maximum payments to low-income families, and the flat-rate value of the non-refundable child tax credit. But it is not progressive for upper-income families, which all receive about the same amount.

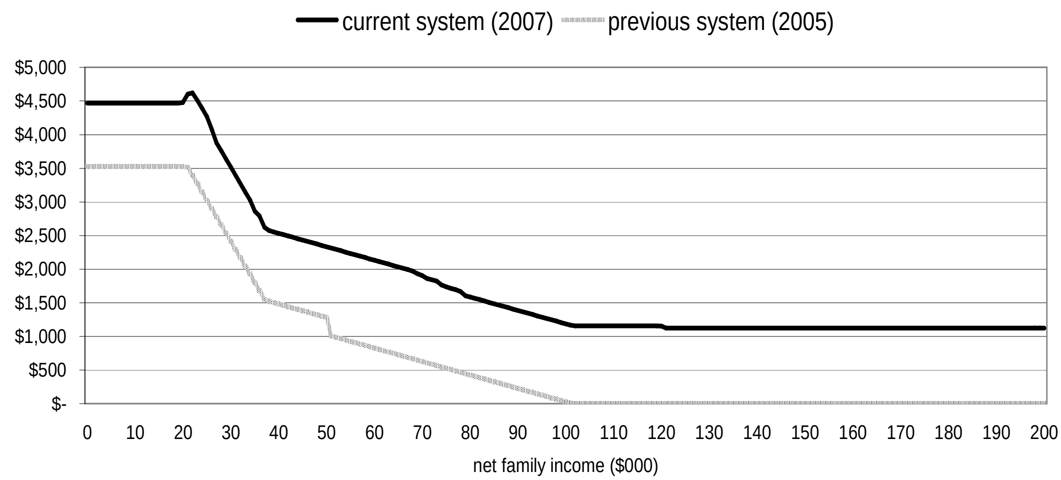
So far, so good? Not really, if you believe that the child benefits system should also be progressive in its treatment of families with high incomes.

The plot thickens when we compare the current three-program system (Canada Child Tax Benefit, Universal Child Care Benefit and non-refundable child tax credit) with the single program (Canada Child Tax Benefit, including the young child supplement) that preceded it.

Figure 12 compares what Ontario single parents with one child under 6 get in 2007 from the current three-program system to what they would have received if the previous one-program system (i.e., just the Canada Child Tax Benefit, including the young child supplement) had still been in effect this year. We have indexed the 2003 Canada Child Tax Benefit to 2007 to allow for a true comparison with the current child benefits system. The bold line shows the current system, while the shaded line indicates the previous system. Note that the downward jog in the line at $50,000 reflects our assumption that the young child supplement ends at that level. Benefits are higher under the new system and extend all the way to the highest income levels. Benefits under the previous system were more progressive in distribution and did not extend beyond $102,000.

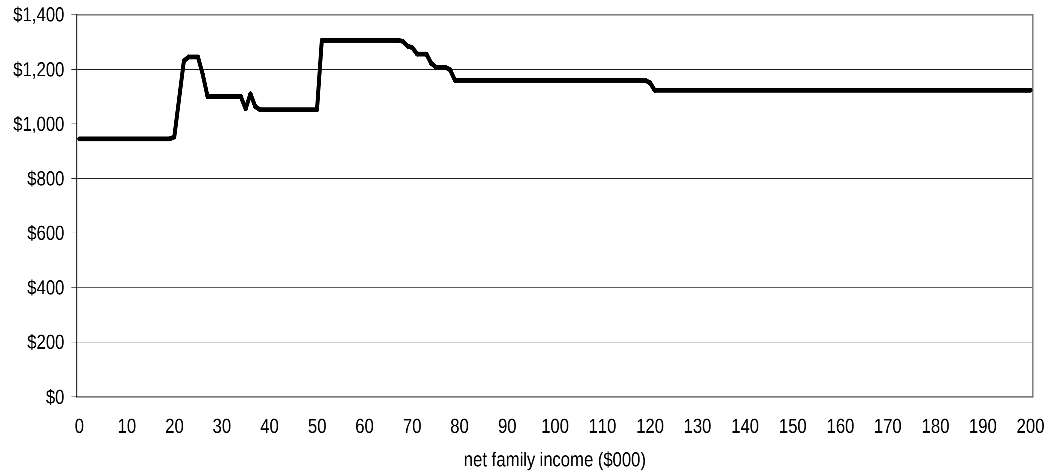
Low-income families see the smallest increase in their federal child benefits – $945; they get $1,200 more from the Universal Child Care Benefit but lose $255 from the abolition of the young child supplement. Gains rise to $1,245 between $23,000 and $25,000 as the non-refundable child

**Figure 12**
**Federal child benefits, current (2007) versus previous (2005) system, single parents with one child under 6, Ontario, 2007**




tax credit phases in, then fall to $1,051 between $38,000 and $50,000 as the Canada Child Tax Benefit declines and families pay federal and provincial income taxes on their Universal Child Care Benefit. Increases jump from $1,051 at $50,000 to $1,306 at $51,000 because we have assumed that, under the previous system, families above $50,000 claimed the child care expense deduction and so were not eligible for the young child supplement; they did not get the latter and so do not experience its loss under the new system. Above $79,000, the increase in child benefits levels off to $1,159 between $79,000 and $119,000 and $1,123 above $121,000, resulting from the UCCB (which declines in value as tax brackets increase) and the flat benefit from the non-refundable child tax credit.

**Figure 13**
**Increase in federal child benefits,**
**current (2007) versus previous (2005) system,**
**single parents with one child under 6, Ontario, 2007**




The same roller-coaster ride characterizes the pattern of changes in child benefits for one-earner couples and two-earner couples, but the results differ from one family type to another. Figure 14 shows total child benefits under the current and previous systems for one-earner couples in Ontario with two children (one under 6), while Figure 15 gives the gain in benefits at different income levels. Families with incomes under $19,000 see the smallest increase – $945 – while the largest gain – $1,591 – goes to families between $51,000 and $68,000. Above that level, increases are almost as much ($1,586 between $69,000 and $78,000 and $1,575 above $79,000), so the graph resembles a plateau above family incomes of $51,000.

Figure 16 gives total child benefits under the current and previous systems for two-earner couples in Ontario with two children (one under 6), while Figure 17 illustrates the gains. Low-income families with net incomes under $20,000 see the smallest increase in their child benefits ($945) while the largest gain ($1,436) goes to families at $24,000; however, families between $108,000 and $157,000 get almost as large an increase ($1,426) as those at $24,000. The line jiggles up and down as the three programs with different designs distribute their benefits at various points of the income spectrum.

### *families with older children*

The analysis so far has looked at families with at least one child under 6 in order to measure the impact of the two new-old programs – the Universal Child Care Benefit and the non-refundable

**Figure 14**
**Federal child benefits, current (2007) versus previous (2005) system, one-earner couples with two children (one under 6), Ontario, 2007**

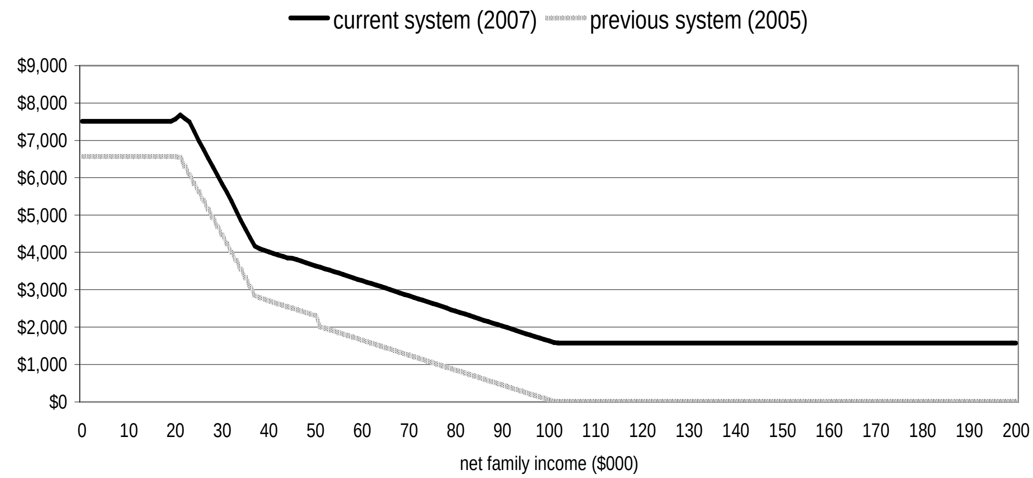



**Figure 15**
**Increase in federal child benefits, current (2007) versus previous (2005) system, one-earner couples with two children (one under 6), Ontario, 2007**

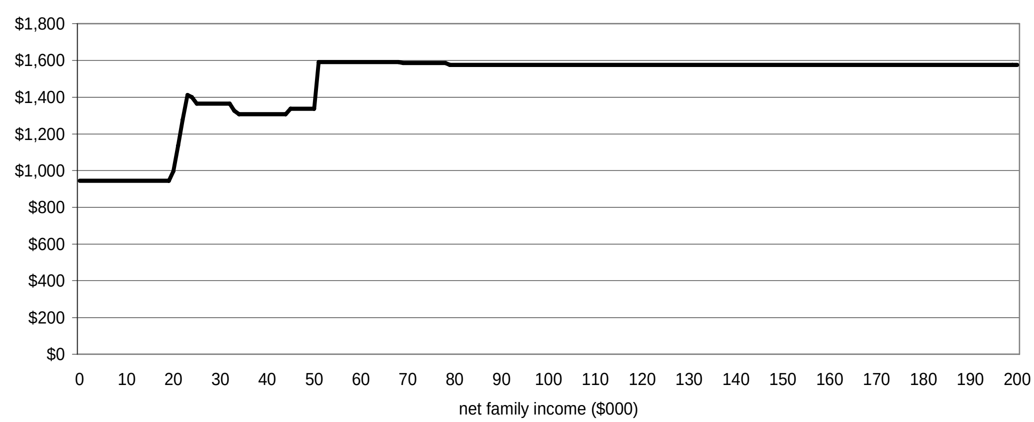


**Figure 16**
**Federal child benefits, current (2007) versus previous (2005) system, two-earner couples with two children (one under 6), Ontario, 2007**

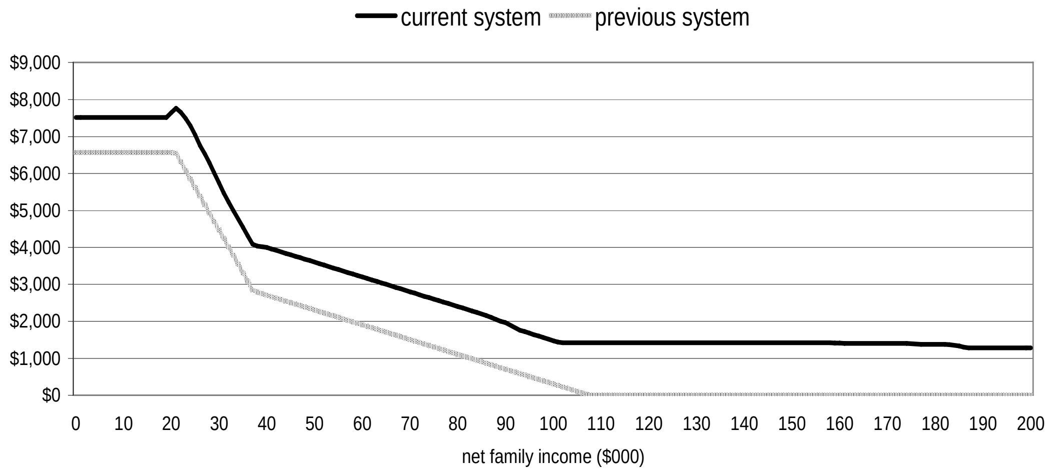
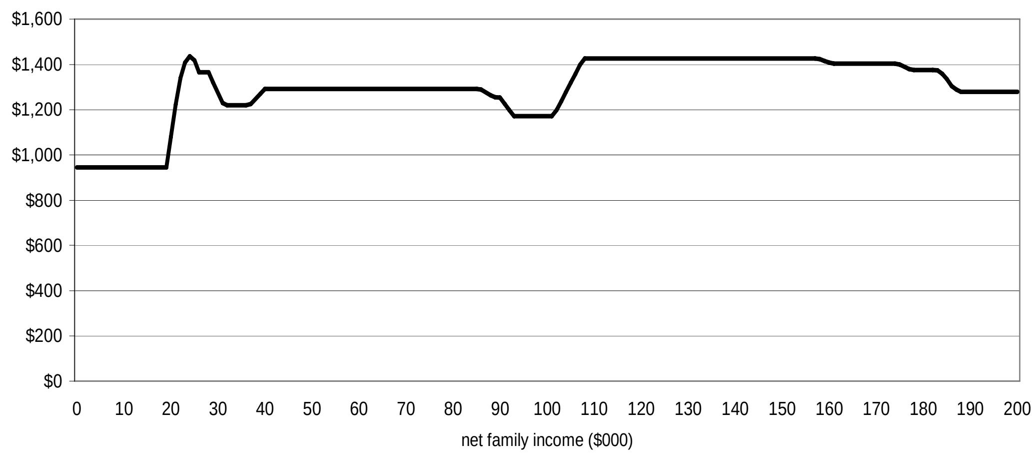



**Figure 17**
**Increase in federal child benefits, current (2007) versus previous (2005) system, two-earner couples with two children (one under 6), Ontario, 2007**

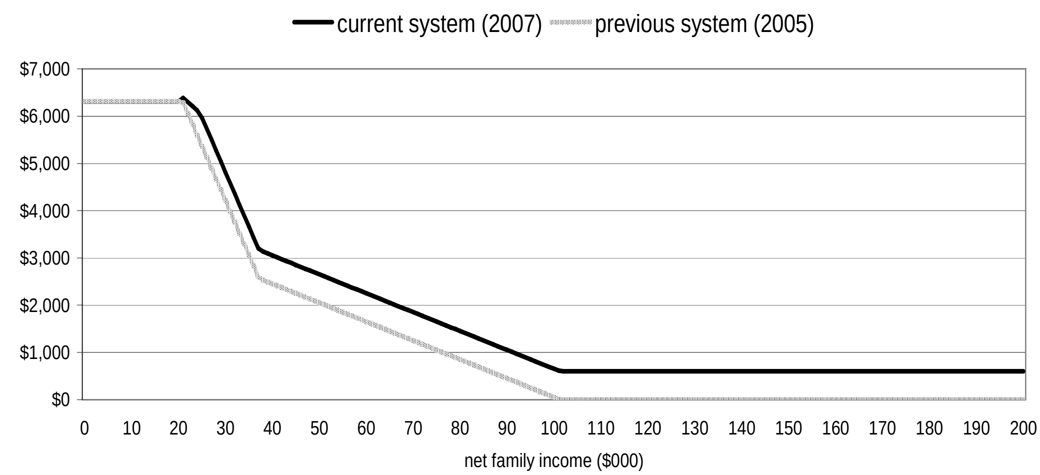


child tax credit.  What about families with children aged 6 or older who do not qualify for the UCCB and receive only the Canada Child Tax Benefit and non-refundable tax credit?

Figure 18 shows benefits from the Canada Child Tax Benefit and non-refundable child tax credit for two-earner couples in Ontario with two children aged between 6 and 17.  In 2005, they received only the Canada Child Tax Benefit.  In 2007, they now qualify for a new program, the non-refundable child tax credit.

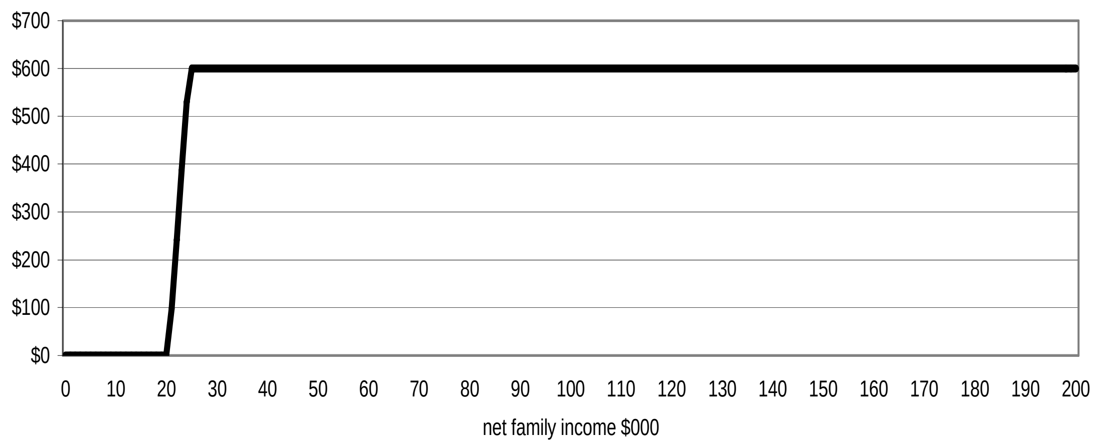
Up to incomes of $20,000, child benefits are identical under both the current and previous systems because families are eligible for only one program, the Canada Child Tax Benefit.  Above that level, the non-refundable child tax credit phases in and pays all families above $25,000 the maximum $600 ($300 for each child) federal income tax break.  At $102,000 and above, families no longer receive the Canada Child Tax Benefit and get only the $600 worth of federal income tax savings from the non-refundable child tax credit.  So the non-refundable child tax credit creates an effective $600 floor to the child benefits system for all two-child families with incomes of $25,000 and above.  There is also a floor resulting from the non-refundable child tax credit for families with different numbers of children over 6.

**Figure 18**
**Federal child benefits, current (2007) versus previous (2005) system, two-earner couples with two children 6-17, Ontario, 2007**



The increase in child benefits under the current system is illustrated in Figure 19. Low-income families under $21,000, both of whose children are 6 or older, see no improvement in their federal child benefits over what they received in 2005. Most families end up $600 ahead because they get the non-refundable child tax credit

**Figure 19**
**Increase in federal child benefits, current (2007) versus previous (2005) system, two-earner couples with two children 6-17, Ontario, 2007**




***puzzling patterns***

Three main conclusions can be drawn from these rather odd pictures.

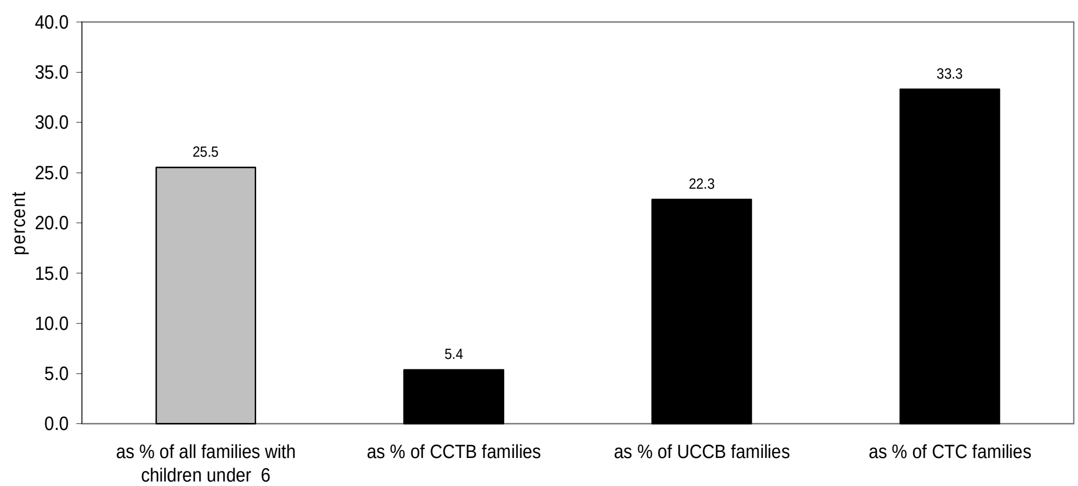
The erratic ups and downs in the line representing the increase in child benefits under the new system result largely from the conflicting designs of the Canada Child Tax Benefit (which is based on family income and excludes families with high incomes) and the Universal Child Tax Benefit and non-refundable child tax credit (which are based on individual income and are payable all the way up the income range). Second, the pattern of increases in child benefits differs from one family type to another, though all are irrational and all result in the smallest gains for poor families. Indeed, for poor families whose children are all 6 or over, there are no increases at all. Third, while the new system offers higher child benefits to most families – with the stark exception of low-income families all of whose children are 6 or older, which see no improvements – it does so unfairly: Poor families get the smallest increase, while upper-income families enjoy sizeable gains.

### *benefits for upper-income families*

By intent and design, the new child benefit programs distribute a significant share of their benefits to higher-income families. Let's look first at families with children under 6, which are eligible for the Universal Child Care Benefit.[13]

In 2007, an estimated 380,400 families with children under 6 have gross incomes of $100,000 or more, representing 25.5 percent of the total 1,490,300 families with children under 6. Of the 3,933,300 families receiving the income-tested Canada Child Tax Benefit, only 5.4 percent (211,100) have incomes over $100,000. But families with incomes over $100,000 constitute 22.3 percent of families in receipt of the Universal Child Care Benefit (368,600 of 1,650,700) and a hefty 33.3 percent of non-refundable child tax credit beneficiaries (222,800 out of 669,500).[14] Figure 20 illustrates the results.

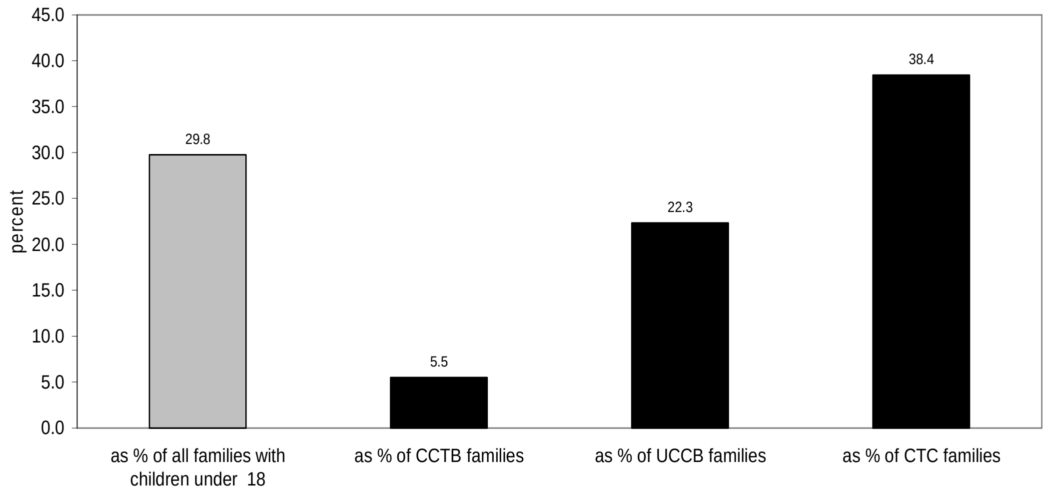
**Figure 20**
**Families with children under 6**
**and incomes over $100,000, 2007**




The picture is much the same when we broaden our view to all families receiving federal child benefits, illustrated in Figure 21. In 2007, families with children under 18 and with gross incomes of $100,000 or more account for 29.8 percent of all families with children under 18 (1,163,400 out of

3,908,000). Of the 9,037,900 families receiving the Canada Child Tax Benefit, just 5.5 percent (495,900) have incomes over $100,000. Families with incomes over $100,000 constitute 22.3 percent of families in receipt of the Universal Child Care Benefit (368,600 of 1,650,700) and a substantial 38.4 percent of families eligible for the non-refundable child tax credit (587,900 out of 1,530,300).

**Figure 21**
**Families with children under 18**
**and incomes over $100,000, 2007**




### *let confusion reign*

Canada's new child benefits system is not only complex and unfair: It is virtually incomprehensible.

Mention child benefits, and Canadians generally think of 'the child tax benefit' or, if they are of a certain age when the Family Allowance was the chief program, perhaps 'the baby bonus.' These are colloquial terms for the Canada Child Tax Benefit, the sole federal child benefit between 1998 and 2005. Now people must contend with two additional programs that, under their gloss, deliver less than they promise.

The Universal Child Care Benefit – a close relative of the extinct Family Allowances – is not really a child care program and, for most families (including the poor in several jurisdictions) is worth less than its much-touted $1,200 per child under 6, due to its taxability. The raised-from-the-dead non-refundable child tax credit excludes low-income families and is worth $300 per child, nowhere near its advertised $2,000. The three current programs – the Canada Child Tax Benefit, Universal Child Care Benefit and non-refundable child tax credit – differ one from another in design and distribution of benefits.

Few Canadian families likely have any idea what they actually get from federal child benefits or how these programs operate. Confusion reigns – and perhaps not by accident: Social policy by stealth is alive and well in Ottawa.

### *A bigger and better child benefit*: *the $5,000 Canada Child Tax Benefit*

Our historical review demonstrated that it took Canada decades 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 in and for a different time and sometimes 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, enriched and renamed the Canada Child Tax Credit.

The Canada Child Tax Benefit offers a number of advantages. It is a non-stigmatizing, inclusive social program that delivers monthly cash benefits to the large majority of Canadian families across the country. It is 'portable,' providing a stable and assured supplement to income no matter where families live or work (or do not work, in the case of families receiving Employment Insurance, social assistance or other such sources of income). It is a progressive program, paying benefits that decline as incomes increase. It pays the same amount to all families with the same income, regardless of the sources of that income, the province or territory in which they live or the type of family. All low-income families receive the same maximum benefit from the Canada Child Tax Benefit, whether their major source of income is work, welfare or whatever.

The Canada Child Tax Benefit is such a well-designed, effective and efficient social program that it has been expanded over the years to add the Child Disability Benefit and is used to help deliver the Canada Learning Bond. A number of provinces and territories also use the Canada Child Tax Benefit's delivery machinery to operate their own income-tested child benefits, which generates administrative savings.

In contrast to the Canada Child Tax Benefit, the Universal Child Care Benefit and non-refundable child tax credit are ill-designed, retrograde schemes that deliver sizeable benefits to upper-income families for whom the money is a minor drop in their income bucket, while depriving lower-and middle-income families of a badly-needed boost in their income. There were 788,000 low-income children in Canada at last count (2005) – one child in nine [Statistics Canada 2007]. How can the federal government justify spending billions of dollars to resurrect obsolete programs that do not gear their payments according to need? This is not intelligent social policy; nor is it an intelligent way to spend tax dollars.

There is a better way: Simplify federal child benefits from three programs to one by getting rid of the Universal Child Tax Benefit and non-refundable child tax credit. Use the money saved to help finance a stronger Canada Child Tax Benefit paying a maximum amount of $5,000.

### *the proposal: a $5,000 Canada Child Tax Benefit*

For years, the Caledon Institute and social advocacy groups have urged the federal government to invest in the Canada Child Tax Benefit to reach a $5,000 maximum payment, and to its credit Ottawa has responded by significantly boosting the program since its inception in 1998. We have chosen $5,000 as a target because it is, by rough estimate, approximately the cost of raising a child in a low-income family [15] [Battle and Mendelson 1997: 18-21; Mendelson 2005: 3-9; 60-63]. While it is unrealistic to expect child benefits – or any other single program – to eliminate child poverty on their own, a strong Canada Child Tax Benefit can substantially help low-income families pay for their child-rearing expenses, reduce the depth of poverty and lower the incidence of poverty.

But our proposed $5,000 Canada Child Tax Benefit is more than simply another increase for low-income families, important as that is. We have designed our reform option so that it also provides a sizeable increase in child benefits to the modest- and middle-income majority of families. Thus our proposal will enhance both the poverty reduction and parental recognition objectives of the federal child benefits system. As we explained earlier, the poverty reduction performance of child benefits has been enhanced over the years partly at the expense their parental recognition capacity for non-poor families.

Going back as far as the 1979 introduction of the refundable child tax credit and through its evolution to the Child Tax Benefit in 1993 and Canada Child Tax Benefit in 1998, Ottawa has periodically increased child benefits for low-income families. Maximum payments were substantially enriched during the National Child Benefit reform from 1998 through 2007 by enhancing the National Child Benefit Supplement (NCBS), that portion of the Canada Child Tax Benefit targeted to low-income families. Given the National Child Benefit reform's priority of restructuring federal and provincial/territorial child benefits, it made both policy and fiscal sense to focus increases on low-income families.

But we cannot continue to boost child benefits for low-income families only while ignoring other families. That would further widen the child benefits gap between poor and non-poor families, and would be particularly unfair to modest-income families with incomes above the poverty line but below the average, which also struggle to raise their children. Limiting future increases to low-income families could create a 'poverty wall' (a variant of the welfare wall), since families which manage to move from a low income to a modest income would suffer a sharp reduction in their child benefits that could leave them little better off – if not worse off – than when they were below the poverty line. A mature and effective child benefits system must better serve both its poverty reduction and parental recognition objectives.

Our proposal would raise the Canada Child Tax Benefit's maximum amount from the current $3,271 (for the first child) to $5,000 by increasing the basic benefit to $3,012 for the first child, $3,242 for the second child and $3,327 for the third and each additional child. The reason for these variations is that, under the present CCTB, the maximum National Child Supplement (NCBS) is $1,988 for the first child, $1,758 for the second child and $1,673 for the third and each additional child. Because we want to augment payments to non-poor as well as low-income families, we put our increase on the base benefit (which goes not only to low-income families, but also to the large majority of non-poor families) rather than the targeted-to-the-poor NCBS. Adding our enhanced base benefit to the current NCBS produces a total maximum payment of $5,000 for every child, regardless of his or her order in the family.

The other parameters of the Canada Child Tax Benefit remain the same.[16] The reduction rate (i.e., the percentage decline in benefits as incomes increase over the threshold) for the base benefit remains 2 percent for one child and 4 percent for two or more children. The threshold for the base benefit is net family income of $37,178 in 2007. The reduction rate for the NCBS remains 12.2 percent for one child, 23.0 percent for two children and 33.3 percent for three or more children. The net family income threshold for the NCBS remains $20,883 for 2007.

### ***benefits under the current system and the $5,000 CCTB***

Figure 22 illustrates our proposed $5,000 Canada Child Tax Benefit and compares it with the present system (i.e., the current CCTB, Universal Child Care Benefit and non-refundable child tax credit) using the example of Ontario two-earner couples with two children (one under and one over 6 years old). The $5,000 CCTB pays higher benefits to the large majority of families, ending at a relatively high net family income of $193,000, making it a quasi-universal program. The current system is fully universal, paying upper-income families in this example (i.e., two-earner couples with two children) a minimum of $1,279.

The $5,000 Canada Child Tax Benefit option would deliver larger benefits up to net family income of $156,000, above which the current system pays more. Under the $5,000 CCTB, gains for most families would range between $1,900 and $2,488, though the increases would tail off above $110,000 and end at $156,000.

**Figure 22**
**Federal child benefits, $5,000 CCTB versus current system, two-earner couples with two children (one under 6), Ontario, 2007**

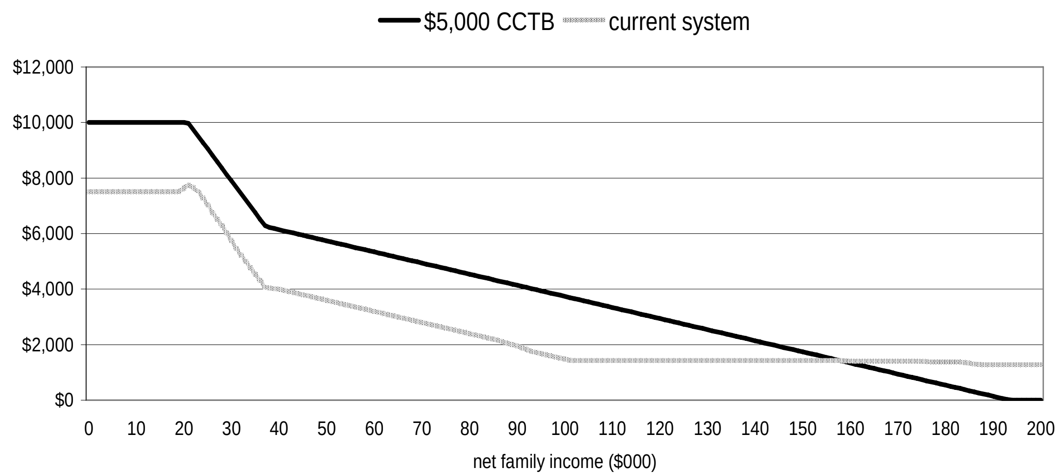



Table A shows the same results but for select income levels, indicating resulting gains and losses from our proposal. Two-earner couples with two children (one under 6) with incomes up to $100,000 would see significant improvements in their child benefits, generally more than $2,000. High-income families at $200,000 would get nothing and so would suffer a $1,279 loss in their child benefits.

**Table A**
**Federal child benefits, $5,000 CCTB option versus current system, two-earner couples with two children (one under 6), Ontario 2007**

| net family income | current system | $5,000 option | change |
|---|---|---|---|
| $ | $ | $ | $ |
| 0 | 7512 | 10000 | 2488 |
| 10,000 | 7512 | 10000 | 2488 |
| 20,000 | 7646 | 10000 | 2354 |
| 30,000 | 5745 | 7903 | 2158 |
| 40,000 | 4001 | 6141 | 2140 |
| 50,000 | 3601 | 5741 | 2140 |
| 75,000 | 2601 | 4741 | 2140 |
| 100,000 | 1479 | 3741 | 2262 |
| 150,000 | 1426 | 1741 | 315 |
| 200,000 | 1279 | 0 | -1279 |

Figure 23 looks at the case of single parents in Ontario with two children under 6. The $5,000 CCTB option would deliver higher benefits to virtually all single-parent families, since very few have high incomes.

**Figure 23**
**Federal child benefits, $5,000 option versus current system, single parents with two children under 6, Ontario, 2007**

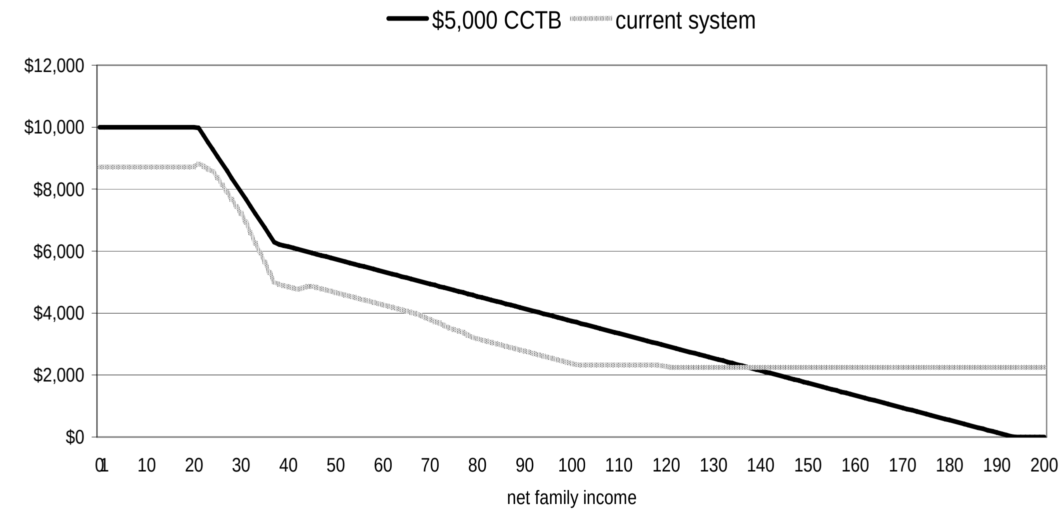


**Table B**
**Federal child benefits, $5,000 CCTB option versus current system, single parent with two children under 6, Ontario, 2007**

| net family income | current system | $5,000 option | change |
|---|---|---|---|
| $ | $ | $ | $ |
| 0 | 8712 | 10000 | 1288 |
| 10,000 | 8712 | 10000 | 1288 |
| 20,000 | 8719 | 10000 | 1281 |
| 30,000 | 7215 | 7903 | 688 |
| 40,000 | 4846 | 6141 | 1295 |
| 50,000 | 4666 | 5741 | 1075 |
| 75,000 | 3468 | 4741 | 1273 |
| 100,000 | 2371 | 3741 | 1370 |
| 150,000 | 2246 | 1741 | 505 |
| 200,000 | 2246 | 0 | -2246 |

Figure 24 shows child benefits under the current system and the $5,000 CCTB option for one-earner couples raising two children (one under 6) in Ontario. Again, most families would fare considerably better under the proposed $5,000 Canada Child Tax Benefit. Table C shows current and proposed benefits, and attendant gains or losses, for representative income levels.

**Figure 24**
**Federal child benefits, $5,000 CCTB versus current system, one-earner couples with two children (one under 6), Ontario 2007**

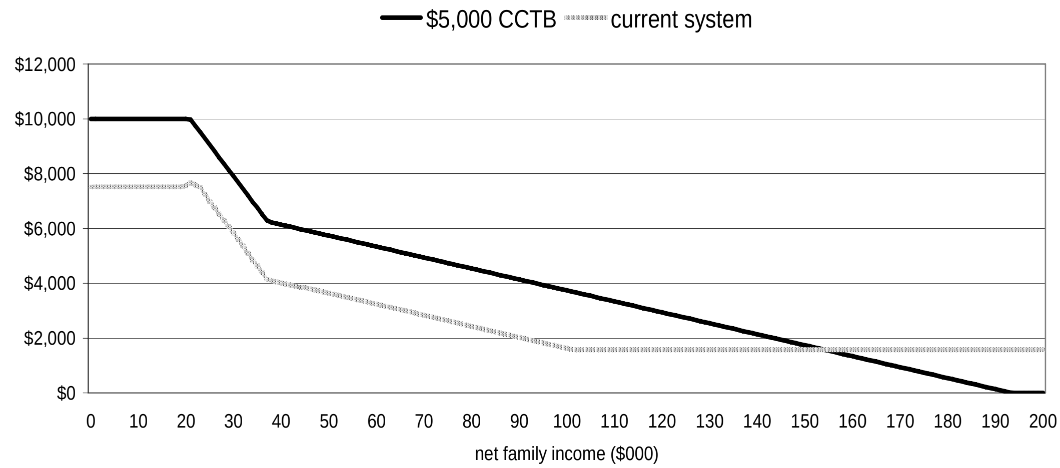


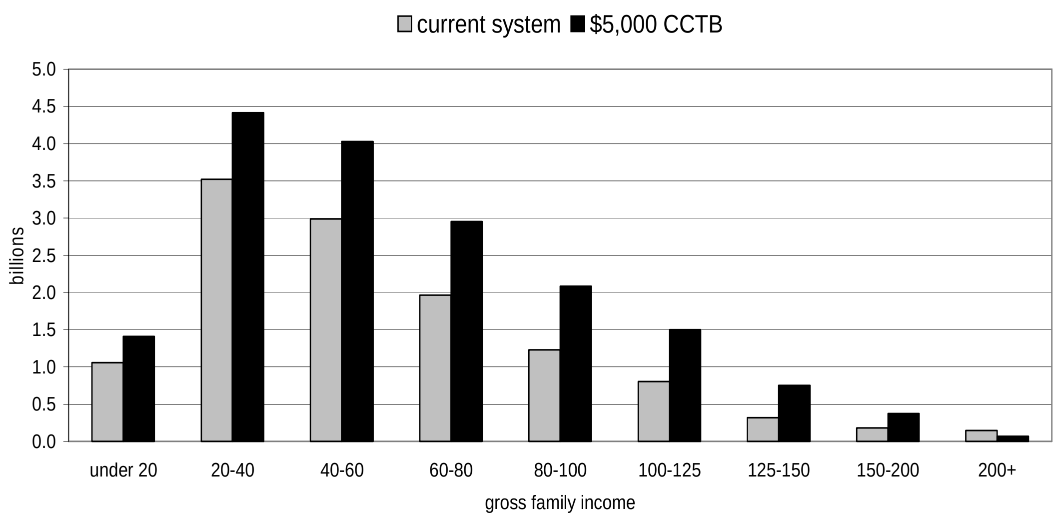
**Table C**
**Federal child benefits, $5,000 CCTB option versus current system, one-earner couples with two children (one under 6), Ontario, 2007**

| net family income | current system | $5,000 option | change |
|---|---|---|---|
| $ | $ | $ | $ |
| 0 | 7512 | 10000 | 2488 |
| 10,000 | 7512 | 10000 | 2488 |
| 20,000 | 7565 | 10000 | 2435 |
| 30,000 | 5835 | 7903 | 2068 |
| 40,000 | 4016 | 6141 | 2125 |
| 50,000 | 3644 | 5741 | 2097 |
| 75,000 | 2639 | 4741 | 2102 |
| 100,000 | 1628 | 3741 | 2113 |
| 150,000 | 1575 | 1741 | 166 |
| 200,000 | 1575 | 0 | -1575 |

The exact numbers will differ for different types and sizes of families in different provinces and territories, though increases in child benefits under the $5,000 Canada Child Tax Benefit option are greater in the case of families with children over 5 – since they are not eligible for the Universal Child Care Benefit. But the overall picture remains the same. The proposed $5,000 Canada Child Tax Benefit is a better deal for the large majority of Canadian families.

Figure 25 uses a different methodology and comes up with the same overall conclusions.[17] We look at the distribution of child benefit expenditures under the current system and the $5,000 CCTB option for all families with children under 18. At all but the highest income range ($200,000 and up), families would get more under the $5,000 Canada Child Tax Benefit option than the present system of Canada Child Tax Benefit, Universal Child Care Benefit and non-refundable child tax credit.

**Figure 25**
**Federal child benefit expenditures, $5,000 CCTB versus current system, families with children under 18, 2007**




***impact on the parental recognition objective***

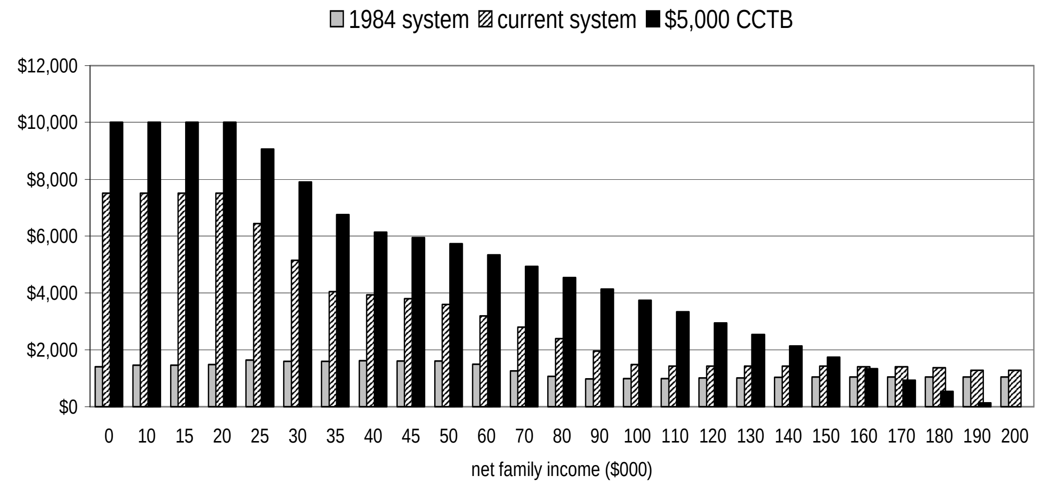
At the beginning of this paper, we noted that the federal government's two new child benefit programs – the Universal Child Care Benefit and the non-refundable child tax credit – strengthen the parental recognition objective, since non-poor families are receiving their first real increase in many years.

How does the $5,000 CCTB proposal compare in its parental recognition performance? Better than the current system.

Figure 26 compares child benefits for two-earner couples with two children (one under 6) in Ontario as they were in 1984 (in inflation-adjusted 2007 dollars), as they are in 2007 and as they would be under our proposed $5,000 Canada Child Tax Benefit. Families with incomes up to

$90,000 receive more under the current system than they did in 1984, but less at higher income levels. The proposed $5,000 Canada Child Tax Benefit would pay all low-income families and modest-, middle- and upper-middle income families more than the present system; only high-income families

**Figure 26**
**Federal child benefits, 1984 system, current system and $5,000 CCTB, two-earner couples with two children (one under 6), Ontario 2007**




fare better under the status quo than our option. The $5,000 CCTB outperforms the current child benefits system in terms of the parental recognition objective for all but high-income families.

The current federal child benefits system is flat up to $20,000 and then more or less progressive up to about $100,000 in net family income – payments decline as incomes increase – but flat above that level, which means that extremely wealthy families get as much as upper-middle-income families with far smaller incomes. By contrast, the $5,000 Canada Child Tax Benefit's income-tested design (above $20,000) means that child benefits decline gradually as incomes rise all the way up to high income levels, where eventually they would disappear (at $193,000 in this example of an Ontario two-earner couple with two children (one under 6).

Thus our proposed $5,000 CCTB would pursue the parental recognition objective in a geared-to-income manner, so that low-income families got more cash assistance to meet their parenting costs than modest-income families, and modest-income families more than middle-income families, and middle-income families more than upper-income families, and the latter more than very well-off families. The $5,000 Canada Child Tax Benefit option would provide what might be called 'income-tested parental recognition,' to coin a catchy phrase.

### *contribution of child benefits to income*

Recent increases to federal child benefits have enabled them to contribute a growing share of income over the years for poor families. Our proposed $5,000 Canada Child Tax Benefit would lift that percentage even higher.

Figure 27 shows federal child benefits as a percentage of income for a single parent in Ontario with one child under 6 and earned income of $15,000. Child benefits rose from 15.0 percent of income in 1993 to 15.8 percent in 1998, 22.1 percent in 2005 and 29.8 percent in 2007. Under the $5,000 Canada Child Tax Benefit, the 2007 rate would reach 33.3 percent – one-third of earnings.

**Figure 27**
**Federal child benefits as percentage of income, single parents with earnings of $15,000 and one child under 6, Ontario, 1993-2007**

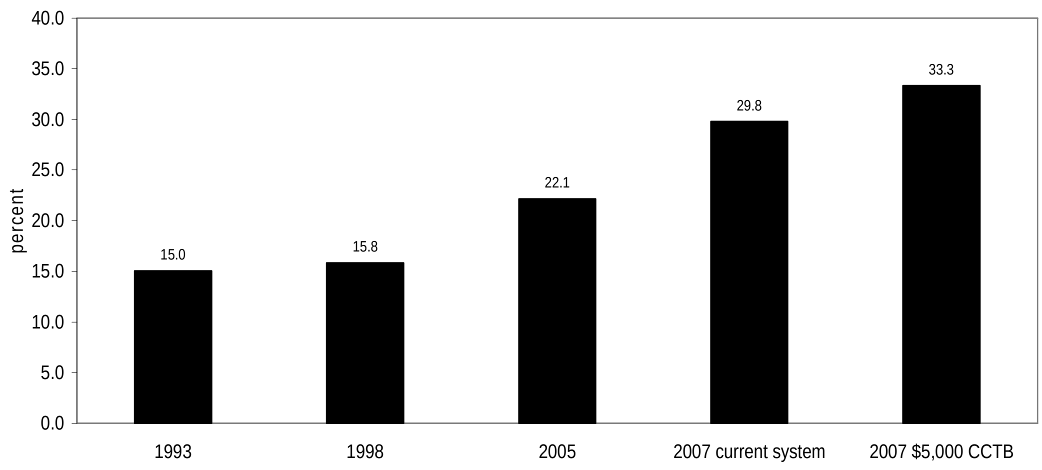
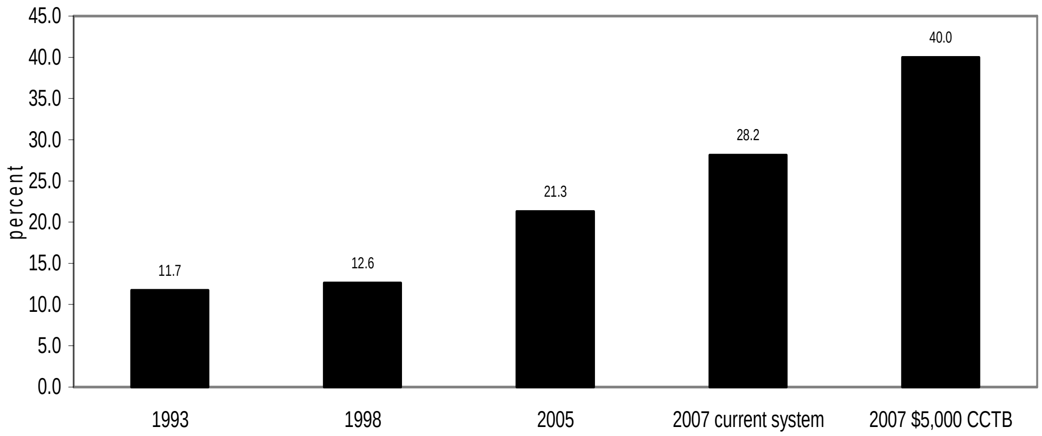



Figure 28 illustrates child benefits' contribution to income for two-earner couples in Ontario earning $25,000 and with two children, one under 6. Federal child benefits for these families went from 11.7 percent of earned income in 1993 to 12.6 percent in 1998, 21.3 percent in 2005 and 28.2 percent in 2007. If our proposed $5,000 CCTB were in place, it would constitute a very substantial 40.0 percent of that working poor family's income.

Figure 28
Federal child benefits as percentage of income, two-earner couples with earnings of $25,000 and two children (one under 6), Ontario, 1993-2007



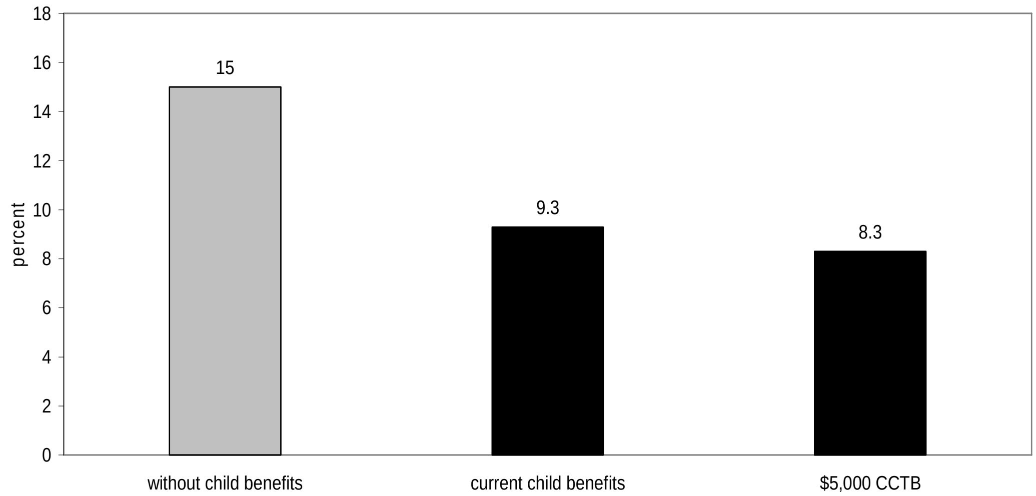

### *impact on poverty reduction objective*

The $5,000 Canada Child Tax Benefit option packs a harder punch against poverty than the current child benefits system. To measure the impact of child benefits on poverty, we first calculate the rate (also known as the incidence) of low income[18] among families with children if there were no child benefits at all. (The rate of family poverty means the percentage of families with low incomes.) Next we calculate the poverty rate including current federal child benefits and then what it would be under the $5,000 Canada Child Tax Benefit option.

The rate of low income among families with children under 18 would be 15.0 percent in the absence of federal child benefits. Adding current federal child benefits to total family income lowers the poverty rate for families with children under 18 to 9.3 percent, for a substantial 5.7 percentage points or 38.0 percent reduction. Our proposed $5,000 Canada Child Tax Benefit would lower the low-income rate further to 8.3 percent, which amounts to a sizeable reduction of 6.7 percentage points or 44.7 percent less than the poverty rate without child benefits.

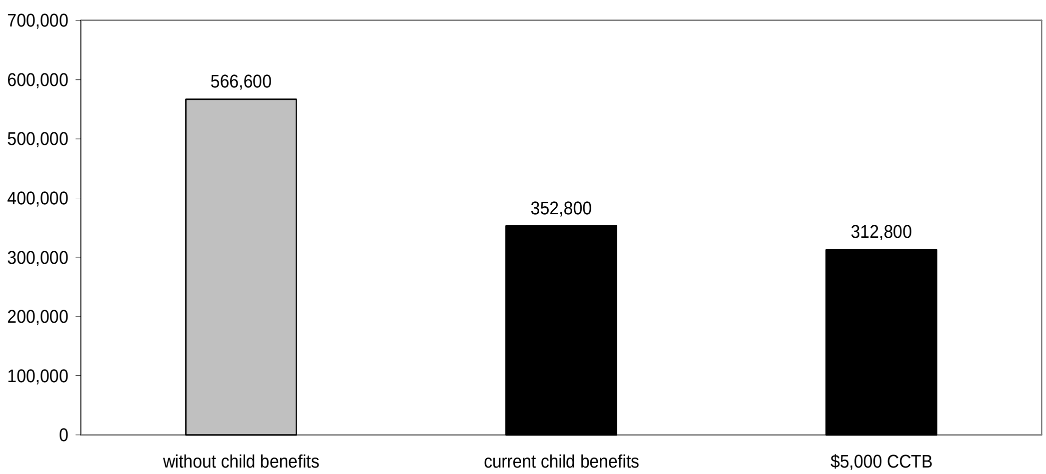
Figure 29 shows the results. If there were no federal child benefits, 566,600 families with children would end up below the poverty line. Child benefits substantially reduce this number. Under the current federal child benefits system, 352,800 families have low incomes – 213,800 fewer than if there were no federal child benefits. The $5,000 Canada Child Tax Benefit would cut the number of

Figure 29
Low income rate, families with children,
with and without federal child benefits, 2007




families with low incomes to 312,800 – 40,000 fewer than under current federal child benefits and 253,800 fewer than in the absence of child benefits. Figure 30 gives the numbers.

Figure 30
Number of families with low incomes,
with and without federal child benefits, 2007



The depth of poverty – the average number of dollars that low-income families fall below the low income cut-offs – would be $10,159 in the absence of federal child benefits. The current child benefits system shrinks the average depth of poverty among families with children to $7,546. The proposed $5,000 Canada Child Tax Benefit would reduce the depth of poverty to an estimated $7,153 – a relatively modest ($393) decrease over the current child benefits system, though a large reduction of $3,006 or 29.6 percent over the depth of poverty without child benefits.

On the face of it, the $5,000 Canada Child Tax Benefit might seem to have a modest impact on poverty – compared to the existing child benefits system, only a one percentage point reduction in the low-income rate, 40,000 fewer low-income families and a $393 decline in the average depth of poverty. However, a one percentage point reduction from 9.3 percent to 8.3 percent translates into a not insignificant 10.8 percent decline in the incidence of family poverty, and 40,000 fewer poor families is nothing to scoff at.

Moreover, we must remember that the proposed $5,000 CCTB would boost child benefits not just for low-income families, but also for the large majority of non-poor families, generally by around $400 to $500 per child. Unlike past increases in the Canada Child Tax Benefit, which were limited to low-income families, our proposed $5,000 CCTB is intended to improve child benefits' performance of both core objectives – poverty reduction and parental recognition. We must balance the two objectives, and their attendant costs – an important consideration to which we now turn.

### *cost*

The federal government currently spends $9.5 billion on the Canada Child Tax Benefit, $2.1 billion on the Universal Child Care Benefit (net of federal income tax) and $1.5 billion on the non-refundable child tax credit, for a total of $13.1 billion. Our proposed $5,000 Canada Child Tax Benefit would cost an estimated $17 billion.[19] So the net cost of our proposal – factoring in expenditures on the three current programs, which would be replaced by our larger Canada Child Tax Benefit – would amount to about $4 billion. In other words, it would require an additional $4 billion over what Ottawa now spends to finance our proposed bigger and better child benefit.

The federal government boosted its child benefits budget by $6.5 billion between 1993 and 2007, spending $6.6 billion in 1993 (in constant 2007 dollars) and $13.1 billion in 2007. It would take just $4 billion or 61 percent of that $6.5 billion increase to pay for the additional cost of the $5,000 Canada Child Tax Benefit proposed in this paper. This increased investment could be phased in over time, as has been the case for previous enhancements to the Canada Child Tax Benefit.

### *marginal tax rates*

The term 'marginal tax rate' means the percentage of each additional dollar that workers pay in income and payroll taxes and health premiums (in British Columbia, Alberta and Ontario) and give up through reduced income-tested benefits as income rises. If families manage to increase their earnings – e.g., a spouse enters the paid labour force or moves from part-time to full-time work, or one or both parents works longer hours – they keep only part of their pay because they see a reduction in their income-tested benefits and a rise in their income taxes and (depending on their earnings level) payroll taxes and health premiums.

Many economists and policy-makers have expressed concern that high marginal tax rates on earnings unwittingly create a disincentive for workers to increase their income. This problem is thought to be particularly serious for low- and modest-income workers in receipt of income-tested benefits, such as the federal GST credit and Canada Child Tax Benefit and provincial/territorial child benefits and refundable tax credits.

We think that fears about marginal tax rates, while not entirely misplaced, are often exaggerated, especially where marginal tax rates are not confiscatory (i.e., below roughly 70 to 75 percent). While some people may decide that working longer is 'not worth it' because they perceive that they have to give back much of their earnings to government, most workers likely have no knowledge of their actual marginal tax rates – particularly where the 'tax back' on income benefits may not occur until a year or more later, due to the retrospective nature of our income tax system.

In any case, there is more to labour market behaviour than marginal tax rates, even if we assume Canadians know the level of their marginal tax rates. A number of other factors influence workers to increase or reduce their labour supply or to join the workforce – such as the work ethic; the desire to get ahead; balancing work and parenting responsibilities; the availability and cost of child care; potential longer-term career advantages; welfare rules which expect participation from employable recipients; loss of access to subsidized housing, child care, supplementary drugs and health benefits for families moving from welfare to work; and the realization that – even with high marginal tax rates – they still come out ahead in financial terms.

Better quantitative and qualitative research is needed to explore the real effects of transfer payments in influencing labour market behaviour, to distinguish hypothetical problems from actual behavioural responses in the real world. For example, a study undertaken for the evaluation of the National Child Benefit found that, among working parents, there was a reduction in hours of work ranging from 8 to 12 percent by moving from full-time to part-time work. This (relatively modest) decline in labour supply was deemed to result from "the additional disposable income made available through the NCB Supplement, [which] enables parents to spend more time with their children" [Federal, Provincial and Territorial Ministers Responsible for Social Services 2005]. However, there is no way to tell whether the change in labour supply was due to parents deciding that they now could afford to earn a little less and spend more time with their children due to higher transfer payments (what economists call an 'income effect') or being discouraged from earning more due to higher marginal tax rate (what economists call a 'substitution effect').

Increasing marginal tax rates are an unavoidable by-product of a progressive tax/transfer system. Our income tax system is based on ability to pay, and thus imposes increasing rates so that taxpayers pay more tax as their taxable income increases. Ontario, which we use below to analyze marginal tax rates, also imposes a health premium; this tax is broadly progressive, charging more as incomes rise, though over wide income ranges so that premiums resemble rising plateaus. Progressive income programs, including most federal and provincial/territorial child benefits, pay higher amounts to lower-income families and vice versa. The Universal Child Care Benefit uses the federal and provincial/territorial income tax system to achieve some degree of progressivity (though not for higher-income one-earner couples, for which benefits are flat). The Canada Child Tax Benefit and its provincial/territorial variants build in progressivity by gearing payments to level of income. The one exception to the progressivity characteristic is the federal non-refundable child tax credit, which pays nothing to the poorest families and a flat-rate amount to almost all other families, including the rich.

Cost is another issue that must be taken into account. For example, we can reduce that portion of marginal tax rates caused by income-tested child benefits by lowering the 'reduction rate' on the Canada Child Tax Benefit's National Child Benefit Supplement and/or the base benefit – i.e., the percentage decline in child benefit payments as net family income increases. But this change would raise costs in two ways. First, all families with incomes above the threshold for maximum benefits receive larger child benefits. Second, the income level above which families do not qualify for benefits rises, so that more families receive payments. Cost is a key concern for policy-makers, and must be weighed against the desire to reduce marginal tax rates.

Nonetheless, marginal tax rates must be taken into account when putting forward proposals to change any aspect of the tax/transfer system. What impact would our proposed $5,000 Canada Child Tax Benefit have on marginal tax rates? We begin by examining marginal tax rates under the current tax/transfer system.

**Figure 31**
**Marginal tax rates, two-earner Ontario couples with two children (one under 6), current federal child benefits, 2007**

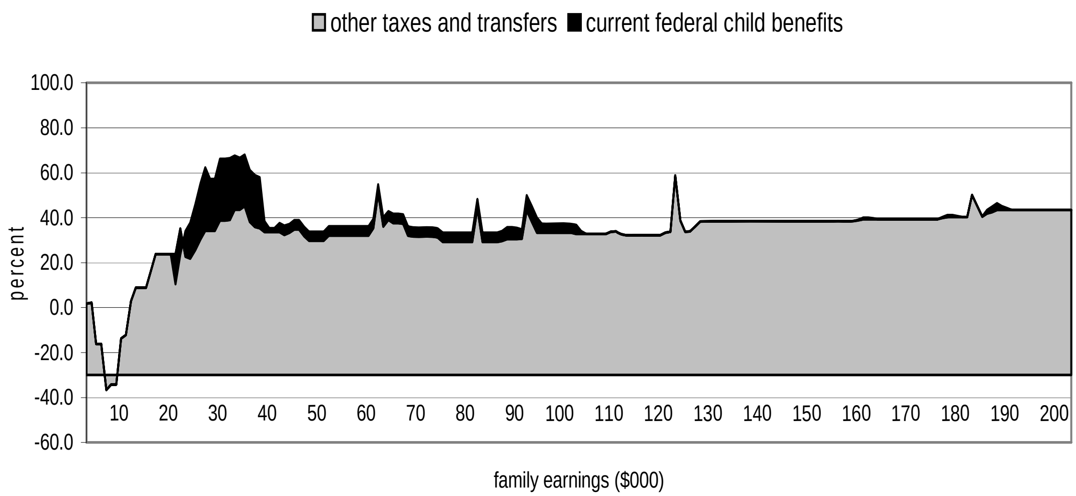
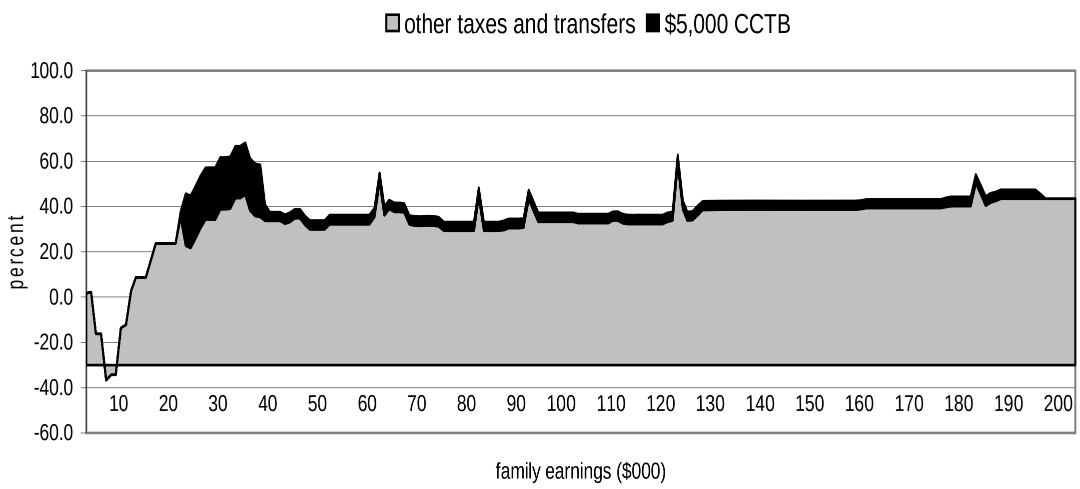


Figure 31 shows marginal tax rates in 2007 for employed two-income couples with two children, one under 6, living in Ontario and with no income from social assistance. The large shaded part on the bottom shows the part of marginal tax rates due to federal and Ontario taxes and income-tested benefits other than current federal child benefits, while the dark portion on top illustrates that part of marginal tax rates due to federal child benefits. Families with earnings of $33,000 face the highest marginal tax rate of all, at 68.1 percent, which means they keep only about $3 of every $10 of additional earnings up to $33,999.

Federal child benefits account for a sizeable part of marginal tax rates between $21,000 and $37,000, ranging from 34 to 68 percent. The main cause is the relatively high reduction rate for the Canada Child Tax Benefit in that income range; the National Child Benefit Supplement – that part of the CCTB that is geared to low-income families -– declines at the rate of 23 percent of net income above $20,883 for families with two children, disappearing at $37,170.

**Figure 32**
**Marginal tax rates, two-earner Ontario couples with two children (one under 6), $5,000 CCTB, 2007**



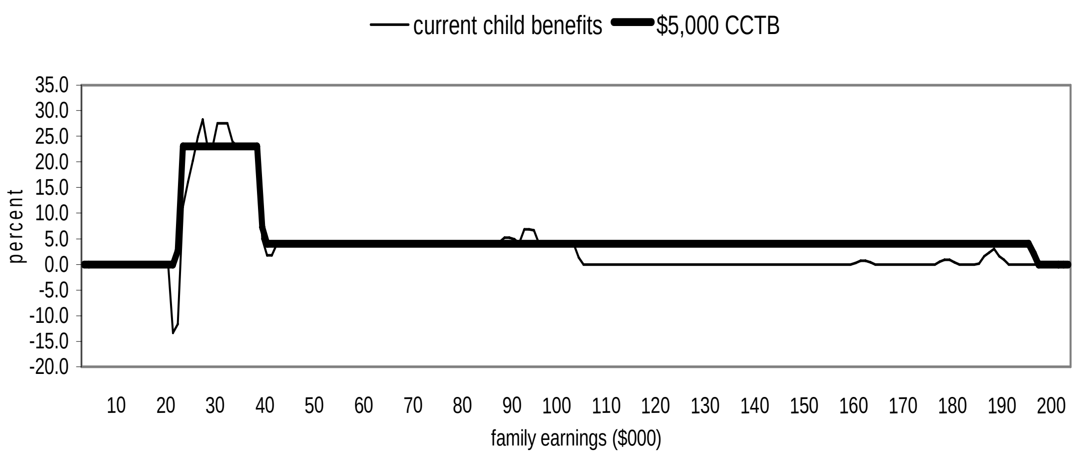

The picture is similar if we replace the current system with our proposed $5,000 Canada Child Tax Benefit. Figure 32 shows that, as under the current system, marginal tax rates under our proposal would be relatively high – in the 41-68 percent range – for modest-income families between $21,000 and $37,000.

What, you might well ask, are those several spikes in marginal tax rates at $60,000 and above under both the current system and our proposal? They result from the parents moving into successively higher Ontario health premium rates.

The negative marginal tax rates at the low end of the earnings range, between $5,000 and $7,000, are due to the phasing in of the federal Working Income Tax Benefit, which increases in value and thus lowers rather than raises marginal tax rates.

To gauge the impact of the proposed $5,000 Canada Child Tax Benefit on marginal tax rates, we plot its contribution to marginal tax rates as well as the contribution of current federal child benefits. Figure 33 shows the results, which resemble an 'Etch A Sketch' drawing (i.e., the children's toy where you use a dial and straight lines to make drawings).

**Figure 33**
**Portion of marginal tax rates due to federal child benefits, Ontario two-earner couples with two children (one under 6), current system and $5,000 CCTB, 2007**




Our proposed $5,000 Canada Child Tax Benefit would not exacerbate marginal tax rates for lower-income families. To the contrary, as illustrated in Figure 33, our proposal would result in a small reduction (between 2 and 5 percentage points) in marginal tax rates for two-earner couples in Ontario with two children (one under 6) and incomes between $24,000 and $26,000 and between

$28,000 and $30,000 because, under the current system, they begin to pay income tax on their Universal Child Care Benefit (which no longer would exist under our proposal).

The drop in marginal tax rates at $19,000 and $20,000 under the current system results from the phasing in of the non-refundable child tax credit between $19,000 and $24,000, which serves to lower marginal tax rates because benefits increase. However, this effect is outweighed for families with incomes between $21,000 and $24,000 by the decline in the Ontario Child Benefit, which increases marginal tax rates.

Our proposed $5,000 Canada Child Tax Benefit would result in a four percentage point rise in marginal tax rates for families between $102,000 and $193,000 because the boosted Canada Child Tax Benefit would extend higher up the income range. It is doubtful that such a small increase in marginal tax rates would cause upper-income families with children to abandon the labour market in droves – an economically senseless act indeed.

### *Conclusion*

The federal government has boosted spending on child benefits over the past two years, but its two 'new' programs – the Universal Child Care Benefit and the non-refundable child tax credit – look backward, not forward. Ottawa should get rid of them and use the resulting savings to help finance a bigger and better Canada Child Tax Benefit.

Our proposal for a single, stronger Canada Child Tax Benefit is a win-win proposition. It would boost federal child benefit payments to $5,000 per child for low-income families, covering much of the basic cost of raising a child in a poor family and reducing the extent of poverty. It also would improve benefits for the large majority of non-poor families, which have modest, middle or upper-middle incomes. Finally, after close to a century of development, Canada would have a strong and mature child benefits system that better serves both its poverty reduction and parental recognition core objectives.

**Table D**
**Current federal child benefits system versus proposed $5,000 Canada Child Tax Benefit**

| characteristic | current system: CCTB, UCCB and child tax credit | proposed system: $5,000 CCTB |
|---|---|---|
| simple or complex | complicated<br><br>three programs with different designs and impacts | single program, relatively easy to understand |
| transparent or stealthy | what you get is not what you keep: most families must repay part of their $1,200 UCCB in federal and provincial/territorial income taxes<br><br>child tax credit worth $300, not $2,000 'amount' touted in 2007 federal Budget | families keep what they get: maximum $5,000 per child for low-income families and diminishing payments to non-poor families |
| distribution of benefits | flat rate for low-income families, more or less progressive for modest- and middle-income families, flat rate for upper-income families | flat rate for low-income families, then smoothly progressive distribution of benefits for non-poor families |
| treatment of different family types | UCCB generally favours one-earner couples over single parents and two-earner couples<br><br>child tax credit and CCTB treat family types the same | treats all family types the same |
| coverage | universal overall:<br><br>CCTB covers all but upper-income families<br><br>UCCB covers all families with children under 6 | quasi-universal:<br><br>covers all but very high-income families |

| characteristic | current system: CCTB, UCCB and child tax credit | proposed system: $5,000 CCTB |
|---|---|---|
| | child tax credit covers all families with children except poor families that don't owe federal income tax | |
| child benefits for poor single parents, one child under 6 in Ontario | $4,471 | $5,000 |
| child benefits for non-poor single parents, one child under 6 in Ontario | range from $3,514 per child at $30K to $2,133 at $60K and $1,586 at $80K | range from $3,888 at $30K to $2,556 at $60K and $2,156 at $80K |
| child benefits for poor one-earner couples, two children (one under 6) in Ontario | $7,565 at $20K | $10,000 at $20K |
| child benefits for non-poor one-earner couples, two children (one under 6) in Ontario | $5,835 at $30K<br>$3,244 at $60K<br>$2,428 at $80K<br>$1,628 at $100K<br>$1,575 at $200K | $7,903 at $30K<br>$5,341 at $60K<br>$4,541 at $80K<br>$3,741 at $100K<br>$0 at $200K |
| child benefits for poor two-earner couples, two children (one under 6) in Ontario | $7,646 at $20K | $10,000 at $20K |
| child benefits for non-poor two-earner couples, two children (one under 6 in Ontario) | $5,745 at $30K<br>$3,201 at $60K<br>$2,401 at $80K<br>$1,479 at $100K<br>$1,279 at $200K | $7,903 at $30K<br>$5,341 at $60K<br>$4,541 at $80K<br>$3,741 at $100K<br>$0 at $200K |
| poverty impact | poverty rate without federal child benefits is 15.0 percent, 9.3 percent with current federal child benefits<br><br>566,600 low-income families without and 352,800 with current child benefits | poverty rate without federal child benefits is 15.0 percent, 8.3 percent with $5,000 CCTB proposal<br><br>566,600 low-income families without and 312,800 with $5,000 CCTB proposal |

| characteristic | current system: CCTB, UCCB and child tax credit | proposed system: $5,000 CCTB |
|---|---|---|
| | average depth of poverty $10,159 without federal child benefits, $7,546 with current federal child benefits | average depth of poverty $10,159 without federal child benefits, $7,153 with $5,000 CCTB proposal |
| impact on provincial/ territorial tax and benefit systems | provinces/territories decided to flow through the $1,200 UCCB to welfare families, and to exempt UCCB from definition of net income used for their income-tested benefits<br><br>taxability of UCCB increases provincial/territorial income tax revenues | no impact on provincial/ territorial income tax revenues or income-tested programs |
| marginal tax rates | current child benefits contribute to relatively high marginal tax rates for incomes between $21,000 and $37,000, ranging from 34-68 percent | small (2-5 percentage point) reduction in marginal tax rates between $24K and $26K and $28K-$30K<br><br>small (4 percentage point) increase in marginal tax rates between $102K and $193K |
| cost | $13 billion | $17 billion |

**Endnotes**

1. In July 2004, the reduction rate for the base Canada Child Tax Benefit was lowered from 2.5 percent to 2 percent for families with one child and from 5.0 percent to 4.0 percent for families with two or more children. This change produced a small and unnoticed increase in the Canada Child Tax Benefit that slightly enhanced benefits for non-poor families and increased coverage at high income levels.

2. Child benefits traditionally have pursued a third objective, 'economic stabilization,' by putting cash into the hands of parents and thereby stimulating consumer demand, aiding recovery from recession. However, this objective is rarely mentioned any more, even though Canada spends more on child benefits now than in the past. Doubtless this report's proposed $5,000 Canada Child Tax Benefit would strengthen this lost third objective of Canadian child benefits.

3. The calculations take into account average provincial income taxes on Family Allowances and provincial income tax savings from the children's tax exemption. Provincial income taxes are an average 55 percent of federal income taxes.

4. Quebec formally abstained from the National Child Benefit reform. However, Quebec families received the National Child Benefit Supplement, and Quebec supports the philosophy of the reform – indeed, had already been moving from a welfare-embedded child benefit to an income-tested program in its own child benefit system, before the National Child Benefit came along.

5. However, families must obtain a SIN number for their child, open up an RESP and apply for a Canada Learning Bond before receiving these funds. There has been very little publicity about the availability of the Bonds. Consequently, take-up has been very low, around 5 percent.

6. In 2007, the single parent receives $3,271 from the Canada Child Tax Benefit and $1,200 from the Universal Child Care Benefit but nothing from the non-refundable child tax credit. The two-earner couple with two children (one under 6) receives $5,365 from the CCTB, $1,073 in after-tax UCCB and $600 from the non-refundable child tax credit.

7. The separate line for working poor families between 1993 and 1997 indicates the higher benefits resulting from the $500 Working Income Supplement.

8. During the election campaign, the Universal Child Care Benefit was called the Choice in Child Care Allowance.

9. Note the oddity that, between $37,000 and $40,000, net benefits go up (not decrease, as is generally the case) because of the Ontario income tax reduction's impact on the lower-income parent; the tax reduction ends lower with the UCCB than without the UCCB.

10. Some lower-income families receive subsidized child care, while others pay for child care provided by caregivers who do not supply the receipts required to claim the child care expense deduction (because they do not claim that income on their income tax return). Note that one-earner couples, including many with high incomes, generally do not claim the child care expense deduction and so received the young child supplement (unless their net incomes were so high that they did not qualify for the Canada Child Tax Benefit).

11. When introduced in the 2007 Budget, the child tax credit was worth $310 because the lowest tax rate was 15.5 percent. However, the Economic Statement of fall 2007 dropped the lowest tax rate from 15.5 to 15.0 percent, so the value of the child tax credit for 2007 is $300, not $310.

12. The increase in total benefits as the non-refundable tax credit phases between $20,000 and $22,000 is more than the decline in the income-tested Canada Child Tax Benefit.

13. Figures in this section were estimated using Statistics Canada's Social Policy Simulation Database and Model (SPSD/M). The Social Policy Simulation Database and Model is a tool designed to analyze the financial interactions of governments and individuals in Canada. It allows the assessment of the cost implications or income redistributive effects of changes in the personal taxation and cash transfer system. The SPSD/M is a non-confidential, statistically representative database of individuals in their family contexts, with enough information on each individual to compute taxes paid to and cash transfers received from government. The database was constructed by combining individual administrative data from personal income tax returns and unemployment insurance claimant histories with survey data on family incomes and on expenditure patterns. The database has been constructed in such a way as to provide a statistically representative sample of Canadians.

The SPSM is a microsimulation model that calculates taxes and transfers for individuals and families. These calculations are performed for everyone on the SPSD and then aggregated to obtain estimates.

The analysis in indicated parts of this study is based on Statistics Canada's Social Policy Simulation Database and Model. The assumptions and calculations underlying the simulation results were prepared by Ken Battle and Andrew Mitchell and the responsibility for the use and interpretation of these data is entirely that of the author.

14. Of the estimated 380,400 families with children under 6, 368,600 - 96.9 percent - received the Universal Child Care Benefit in 2007. Coverage is not 100 percent likely because the UCCB is a new program and not all eligible families apply, especially upper-income families that do not receive the Canada Child Tax Benefit (which was used to publicize the new UCCB).

15. Our original target was $4,000, which translates into around $5,000 in today's dollars.

16. However, we would drop the current $90 per year supplement for families with three or more children, in order to provide an equal maximum $5,000 payment for every child.

17. Estimates in this section obtained from Statistics Canada's SPSD/M. Note that Figure 25 shows gross, not net, family income.

18. We use Statistics Canada's after-tax low income cut-offs as our measure of poverty, and employ the terms low income and poverty synonymously. Estimates in this section obtained using Statistics Canada's SPSD/M.

19. Cost estimates obtained using Statistics Canada's SPSD/M.

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