

The Forgotten Fundamentals

During the recent election campaign, Canadians heard surprisingly little from the ruling Conservatives about the brewing economic storm that was threatening the world.

While the gale force winds of tumbling markets and tight credit were swirling across the globe, we were assured that we would feel only a slight breeze. Canadians could sit tight and had no need to worry. Our fiscal ship would remain steady and strong as it navigated rough economic waters because, we were told, all the fundamentals are in place.

Bad has turned to worse since the October 2008 election, but the Harper government has steadfastly maintained its ‘I’m-all-right-Jack’ line even while acknowledging the worsening world crisis. Last week’s Economic and Fiscal Statement rejected calls from a wide range of voices – economists, editorialists, think tanks, premiers, opposition parties and communities hit hard by the recession – for a fiscal stimulus package. The government argued that its past and ongoing tax cuts, spending measures and

supports to strengthen our financial institutions should do the trick. Flouting conventional wisdom world-wide that governments now have to spend and not save, the Finance Minister announced spending cuts and asset sales that would purportedly balance the nation’s books over the next few perilous years.

However, Finance Minister Flaherty is hedging his bets: “In the weeks ahead, we will determine the extent to which we will inject additional stimulus to our economy, joining the efforts of our international partners. These actions, or a further deterioration in global economic conditions, could result in a deficit.”

So the economic fundamentals may not be so solid after all.

Missing in this debate is another set of fundamentals – social fundamentals. The lessons of history have taught us that, in tough economic times, *social programs* can act as fundamental supports for both the economy and society.

Social programs that pay income benefits play two key roles. First, they act as *shock absorbers* when times are tough for individual households. Programs such as Employment Insurance, child benefits, public pensions and welfare are intended to ensure that the poor, unemployed, families with children and seniors have at least some money to pay for necessities such as food, clothing and shelter (however lacking such programs may be in practice). Second, they act as *fiscal stimulus* when times are tough for the economy: Social programs put money directly into the hands of large numbers of Canadians whose collective spending can restart the economic motor.

Ottawa currently has at its disposal some effective social programs that can play an important part in an economic stimulus package to combat the recession. Boosting three geared-to-income programs – the Canada Child Tax Benefit, refundable GST credit and Working Income Tax Benefit – would put additional money into the hands of lower-income households who are most likely to spend it immediately. Employment Insurance, which now serves only four in ten unemployed Canadians, must be restored and strengthened. Ottawa should also bolster its transfers to the hardest hit provinces and territories so that they do not bear the full burden of social assistance and other recession-linked cost increases.

The *Canada Child Tax Benefit* is our largest and most important child benefit. It is a broad-based program that serves the large majority of Canadian families with children, excluding only the wealthy. The amount of payment is geared to family income so that the Canada Child Tax Benefit pays its maximum benefit to low-income families, while a substantial amount is also paid to those above the poverty line but still of modest

means. The maximum annual payment, currently \$3,332 for the first child, should be raised to \$5,000 per child. The Canada Child Tax Benefit's Child Disability Benefit, currently a maximum \$2,395, should be increased to \$3,600.

Families receive their Canada Child Tax Benefit on a monthly basis, so the program puts cash into their hands on a frequent and regular basis. Our proposed benefit increases can be implemented quickly: Payments can be adjusted retroactively for the current fiscal year through the Canada Revenue Agency's data base, so the increase can be put into pay within a few months. There would be little or no additional administrative cost.

The Speech from the Throne signalled that the Harper government might consider increasing the Universal Child Care Benefit, a so-called \$1,200 per child annual payment – whose real value is less than \$1,200 because it is taxed by the federal and provincial/territorial governments and is not indexed. This would be a big mistake. The Universal Child Care Benefit is an inequitable scheme that is not a true child care program [Battle 2008]. It provides substantial payments to high-income families, while the after-tax value of its benefits varies according to family type (single parent, one-earner couple and two-earner couple) and province/territory. The Canada Child Tax Benefit, by contrast, is a nontaxable program that provides the same payment to all types of family with the same income in every province and territory. It is a progressive program; poor families get most and the well-off get least. Since lower-income families are more likely to spend any additional funds immediately, the Canada Child Tax Benefit will have much more stimulative punch for every dollar spent. Moreover, the Canada Child Tax Benefit is

paid on behalf of children under 18, whereas the Universal Child Care Benefit is restricted to children 5 and under.

Increasing the *refundable GST credit* is another way to boost spending by lower-income households. Like the Canada Child Tax Benefit, the refundable GST credit is a geared-to-income program that pays its maximum amount to low-income families, though it is paid quarterly rather than monthly. Annual maximum benefits are currently \$242 for each eligible adult and the first child in single-parent families and \$127 per child for other children. For example, a single parent with one child currently receives up to \$484 a year. Maximum benefits from the refundable GST credit should be doubled, so that this family would receive \$968. Like the Canada Child Benefit, this increase to the refundable GST credit could be put into pay quickly through the Canada Revenue Agency at little or no administrative cost.

One small nugget buried in the Economic Statement is the announcement that “working with provinces and territories, the Government will consider options to further lower the “welfare wall” by building on progress made with the Working Income Tax Benefit.”

The Working Income Tax Benefit is a promising new program targeted to the working poor, who make up about half Canada’s low-income population. But at a maximum annual payment of just \$500 for single workers and \$1,000 for couples and single parents, it is far too modest and reaches only poor workers who are employed part time. It is so parsimonious that Canadians working full time at the minimum wage are not eligible for any assistance. Benefits should be doubled and the eligible income ranges extended to put extra cash into the hands of

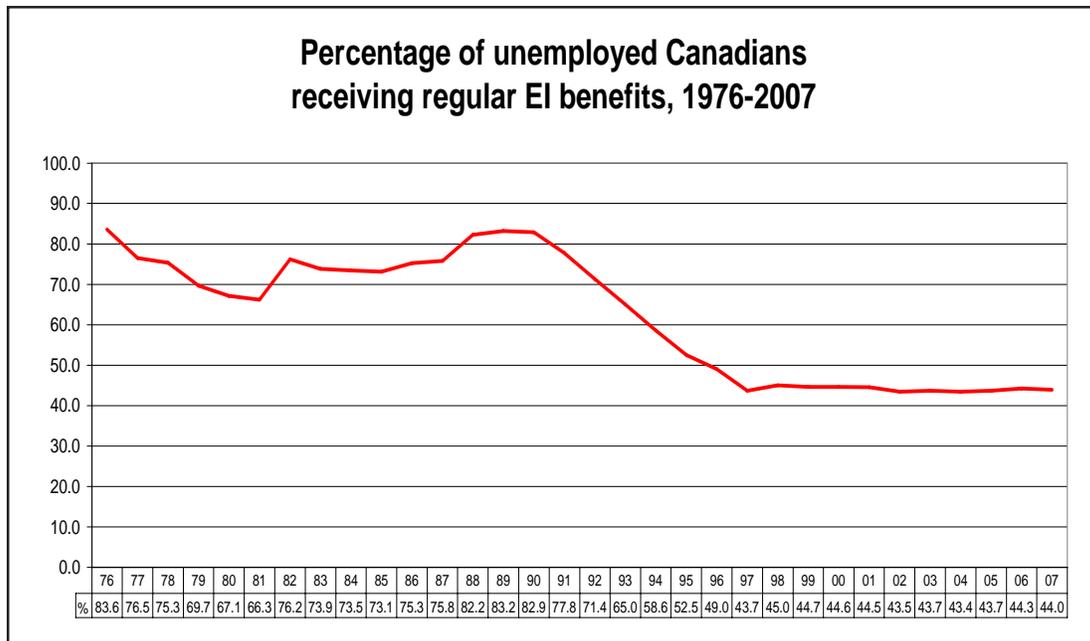
more Canadians who work but remain poor [Battle and Torjman 2008].

Born out of the Great Depression, *Employment Insurance* (EI) is another potentially powerful policy lever, especially in tough economic times. Workers who become unemployed through no fault of their own due to plant closures, economic downturns or seasonal employment may be eligible for this replacement income – with emphasis on the word ‘may.’ Unfortunately, the practice of the program no longer lives up to its intent.

As a result of several major changes introduced in the 1990s to tighten access to EI and reduce the amount and duration of payments, the numbers of eligible beneficiaries have dropped dramatically over the years. Only an estimated 44.0 percent of unemployed Canadians qualified for benefits under this so-called ‘social insurance’ at last count (in 2007). Coverage is even lower in a number of provinces – e.g., 23.8 percent in Alberta, 29.0 percent in Ontario, 37.7 percent in Manitoba, 38.1 percent in BC and 42.6 percent in Saskatchewan. All workers must pay EI premiums, but fewer than half the unemployed receive benefits in return. The graph shows the dramatic downward trend in EI coverage.

Some of Canada’s most vulnerable groups – older workers, part-time workers, recent immigrants, new entrants to the labour force, persons with disabilities and low-wage workers generally – are typically excluded from EI. So too are the self-employed.

Ottawa should take immediate steps to restore EI as a key element in the stimulus package. A pivotal change would be to increase coverage by reducing the number of



hours worked to qualify for benefits. The federal government could apply more broadly some transitional measures, originally introduced in 2000, which it recently extended in New Brunswick and Quebec. The effect of these measures is to apply a higher unemployment rate than would otherwise be the case so that potentially eligible EI recipients in those areas can now qualify for benefits. The wage replacement ratio could also be raised to 70 to 75 percent, having dropped to just 55 percent of average insurable earnings.

These proposed EI changes would help, but they represent only a short-term fix. Employment Insurance is in desperate need of a major overhaul [Battle, Mendelson and Torjman 2006]. In the meantime, it is an important fiscal lever that can be cranked up immediately.

But there is a major flaw in the current financing of Employment Insurance that has turned it into an ‘automatic destabilizer’ instead of its intended role as an economic stabilizer. EI premiums are required to

reflect the anticipated cost of the program in the year to come, and to make up any past year’s deficit in the EI account. There is a 15 percent ceiling on any year’s EI premium increase. But EI costs, with or without benefit improvements, are likely to go up much more than 15 percent in each of the next two or three years. As a result, under current financing rules we could see 15 percent increases in premiums every year for the next three or four years or more. While the Cabinet can freeze premiums by Order-in-Council, this action would just leave the threat of higher premiums for the next year, and provide no basis for the rational financing of EI.

Increasing payroll taxes when the economy requires fiscal stimulus is exactly the wrong thing to do – just as cutting premiums when the economy is growing is also foolhardy. EI financing has to be reconfigured so that it is counter-cyclical rather than pro-cyclical – i.e., premiums should go up when times are good and go down when times are bad. Fortunately, premiums have

already been set for the coming year, so the federal government has several months to develop new EI financing formulae that make economic sense.

For the first time since the Great Depression, Canada's provinces and territories will be entering into a severe economic downturn without any federal programs that are responsive to added provincial/territorial costs. In the past, the Canada Assistance Plan paid 50 percent of eligible social assistance costs to the provinces and territories. But the Canada Assistance Plan is long gone, having been replaced in 1995 by a single block transfer, the Canada Health and Social Transfer (CHST). In 2004, the CHST was divided into the *Canada Social Transfer* and *Canada Health Transfer*. The most vulnerable provinces and territories will require some assistance from Ottawa to cope with their inevitably rising spending.

Currently, Ontario gets less than an equal per capita Canada Health Transfer due to an arcane adjustment related to a decades' old tax transfer. With the recession's severe impact on Ontario, this adjustment is not fair to the taxpayers of that province who must carry an unequal burden. One change that Ottawa could make immediately is to pay an equal per capita cash transfer to all equalization-receiving provinces, including Ontario. More generally, the federal government should consider a new program to relieve some of the cost in a province or territory whose social assistance and other social benefit spending rises above a stated percentage of its GDP.

From the perspective of Canadians who are vulnerable to unemployment and all that comes with it, Canada is entering this recession less well prepared than at any time

since the downturn of the early 1950s. At a time when no government or financial expert appears equipped to provide solid advice, the lessons of history may be the best guide to our future.

Canada has been able to weather economic storms in the past and to grow the economy because of our system of social programs that act as both safety net and fiscal stimulus. These fundamentals *are* in place. Let's use them – now.

*Ken Battle, Sherri Torjman and
Michael Mendelson*

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Caledon Institute of Social Policy

401-1390 Prince of Wales Drive
Ottawa, ON K2C 3N6
CANADA

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