CALEDON
INSTITUTE OF SOCIAL POLICY

The No-Budge Budget

by

Ken Battle, Sherri Torjman and Michael Mendelson

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A. The Story Overall
The evidence is often not available or doesn't seem to matter

An unsettling pattern has emerged in federal Budgets in recent years. Measures are introduced in the name of good fiscal management. However, in many cases, the policy announcements are not backed up by evidence that would suggest these are the appropriate steps. Yet the evidence – or lack thereof – has not stopped the government from taking action.

Ottawa is warning that Canadians will have to rely more on their own financial steam as it turns its attention to a significant expenditure that it claims needs to be reined in: Old Age Security benefits for seniors.

There is no question that payments under the Old Age Security system – the Old Age Security (OAS) pension, Guaranteed Income Supplement (GIS) and Allowance – represent a large and growing expenditure. But there is no need to weaken the strong and effective set of programs that Canada is fortunate to have built over the years – at least not if the policy decisions were guided by the evidence.

Budget 2012 tries to soft-pedal the proposed change to Old Age Security – raising the age of entitlement from 65 to 67 – by emphasizing the gradual and lengthy nature of the implementation and assuring Canadians that the measure will not affect today's seniors or people currently age 54 or older. But in the overall direction – increasing the age of eligibility – the government appears to be unwilling to budge.

At the very least, Ottawa should be undertaking a comprehensive and transparent public review of elderly benefits and the Canada Pension Plan as well as various possible options for reform, rather than settling on its one approach – freedom 67 for Old Age Security – as the only game in town. And there are choices. We discuss a range of alternatives below.

The 2012 Budget makes a series of additional spending cuts to help repair the big hole in the nation's finances. Too bad it did not look at some of the questionable decisions from the recent past.

The 2006 Budget announced a new tax break called 'pension income splitting' whereby couples that previously paid tax on each spouse's individual income, like other taxpayer couples, can now split their income from private pensions and RRSPs so that each pays tax on half of private pension income.

Couples in which one spouse (typically the man) has all the private pension income – the traditional one-income couple – are the biggest winners since the higher-income spouse now pays tax at a lower rate. Pension income splitting does absolutely nothing to help single seniors (who lack spouses) or the poorest elderly couples that pay no tax. Many senior couples are enjoying a tax reduction, but the measure is regressive – the higher their income, the bigger the tax break. And the tax expenditure is costly – an estimated $925 million in 2011.

It could get worse. During the 2011 federal election campaign, the Conservatives proposed to build on pension income splitting with a similar measure, aimed this time at families with children. This change would allow parents to split, or share, up to $50,000 of their household income for tax purposes. The Conservatives estimate that this promise would reduce taxes for almost 1.8 million families that would save on average $1,300 per year.

Income splitting for families with children – as for pension income – is a regressive measure that would do little, if anything, for poor families while delivering sizeable tax cuts to the wealthy. Single-parent families – that have lower incomes and higher poverty rates – would derive no benefit at all from income splitting since they do not have a spouse with whom to share family income.

At least the Conservatives promised that family income splitting will not happen until the deficit is eliminated. That gives them several years to consider the deficiencies of this scheme.

These tax cuts were promised despite the serious problems that are affecting our prosperity and well-being as a nation. Poverty remains high in Canada – one in ten Canadians live on low incomes at last count – and inequality has grown substantially over the past 25 years. But we have reduced our ability to tackle these serious problems because federal funds have been diverted to other programs and tax breaks.

More specifically, important poverty- and inequality-reducing measures, such as the Working Income Tax Benefit and Canada Child Tax Benefit, are not being enhanced for lack of funds. Yet there does seem to be money floating around for other purposes, despite the lack of evidence to support the value of these investments.

Ottawa spends an estimated annual $3.5 billion on the Universal Child Care Benefit (UCCB) and non-refundable child tax credit. The UCCB replaced the investment the previous government had been making with provinces and territories in high-quality, affordable child care.

The problem is that these programs – zombies from another time – are poorly designed, providing similar benefits to families at all income levels, even the wealthy. They make a jumbled mess of federal child benefits, mixing differing designs that do not work well together. The federal government should end the Universal Child Care Benefit and non-refundable child tax credit, and use the resulting savings to bolster the carefully-crafted Canada Child Tax Benefit, which is working well for Canadian families and could pack an even-more-powerful punch with additional funds.

Worse still: The Universal Child Care Benefit, despite its name, is not tied to the use of child care. It does nothing to build the quality child care system that is sorely lacking in this country. Even the OECD has blown the child care whistle on Canada's poor performance in this vital area.

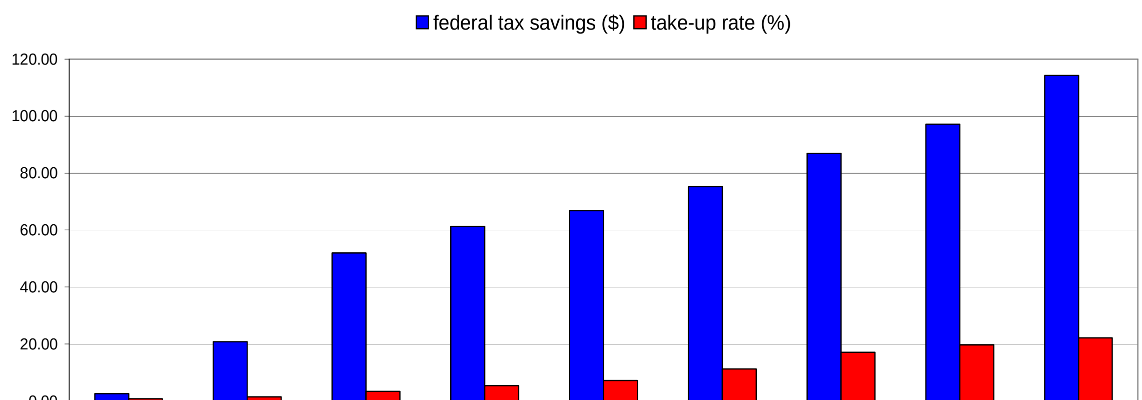
There is another bigger honey pot to be tapped. Ottawa spends an estimated $50 billion a year on a long list of tax credits for various purposes, including caregiving, tuition expenses, and children's fitness and arts programs. While the intent of these measures may be good, their design is not.

Current tax breaks – tax deductions and non-refundable credits – go primarily to non-poor Canadians, and generally favour the well-off in terms of their value. This is a questionable use of public funds, especially when Ottawa is looking for places to cut. Moreover, these funds would be better spent investing directly in places and programs – colleges, universities, parks, playgrounds and cultural programs – that benefit every citizen and not just the upper crust.

Figure 1 looks at just one measure to help make the point – the Children's Fitness Tax Credit in the 2009 taxation year, the most recent year for which data is available. The credit's maximum 'amount' for tax purposes is $500, which translates into a federal income tax savings of $75. The take-up rate – the percentage of taxfilers who claim the credit – ranges from a mere 0.78 percent (less than 1 percent) for taxfilers with incomes under $10,000 to 22.1 percent for those with incomes above $250,000.

The average federal tax savings from the credit varies from $2.64 for taxfilers with incomes below $10,000 to $114.20 for those with incomes over $250,000.[1] The higher their income, the greater the percentage of taxpayers claiming the Children's Fitness Tax Credit and the greater the tax break. The same pattern shows for other non-refundable tax credits and for tax deductions (e.g., deductions for contributions to Registered Retirement Savings Plans and Registered Pension Plans).

Figure 1
Children's Fitness Tax Credit, 2009 tax year,
average federal income tax savings and take-up rate



	under 10	10-20	20-30	30-40	40-50	50-80	80-100	100-250	250+
federal tax savings ($)	$2.64	$20.80	$51.99	$61.28	$66.74	$75.20	$86.86	$97.19	$114.20
take-up rate (%)	0.78	1.45	3.35	5.36	7.16	11.28	17.13	19.71	22.12

taxpayer income $000

Table A provides the estimated annual cost of several non-refundable tax credits that the federal government has introduced in recent years. Note that the 'amount' of non-refundable credits such as these as listed in the income tax form is not their true value: Their value in income tax savings is calculated as 15 percent of the 'amount.' These five credits alone total $535 million – more than half a billion dollars. *This is a staggering sum of public money, given the limited social value of these measures*.

Table A
Targeted Tax Credits 2011

	'amount'	**actual value**	**annual cost**
Children's Arts Tax Credit	$500	$75	$100 million
Children's Fitness Tax Credit	$500	$75	$115 million
Family Caregiver Tax Credit	$2,000	$300	$160 million
Volunteer Firefighters Tax Credit	$3,000	$450	$15 million
Home Buyers' Tax Credit	$5,000	$750	$145 million

A serious shortcoming of these tax benefits stems from their non-refundable design. Taxfilers who pay no income tax do not qualify for these credits because they have no tax to reduce. Even if they pay a small amount of income tax, they receive tax savings that are much less than the maximum.

Most people eligible for the maximum tax savings from non-refundable tax credits likely do not need them. They would undertake the activity that the government wants to encourage whether they received a modest tax cut or not. Or at least they need a tax break less than others who pay minimal or no tax because their incomes are so low in the first place. Ironically, these are the people who most need the assistance.

The Children's Arts Tax Credit introduced in last year's Budget is an excellent case in point. The intent of this measure is good. It recognizes the value of arts and culture in contributing to the well-being of children, their self-esteem and positive development, and the expression of their identity.

Yet it is low-income children – excluded from the Children's Arts Tax Credit – who would benefit most from arts programs because they typically do not have access to various personal enrichment activities. Their families simply cannot afford what might be considered a 'frill' when they struggle daily with the choice of paying the rent or feeding the kids. Most of the families that actually get something out of the credit would have spent the money on their children anyway, so for them this is just a tax cut that accomplishes nothing at all for the public good.

If the federal government is serious about tackling the significant social need that it has identified, then it should use an instrument that is more appropriate to the Canadians who truly could benefit from this type of initiative. *Caledon's preference is to use scarce public resources to provide opportunities for all children, the poor in particular – not simply for those whose families already can afford to buy access to these activities in the first place.*

We were pleased to see that there were no new 'boutique' tax cuts for the wealthy in the 2012 Budget. At least the government restrained itself from introducing unnecessary expenditures that would only add to the already stretched finances.

Finally, untold (and basically unknown) billions will be spent on the criminalization of Canada, despite all the statistical evidence and expert opinion both at home and around the world showing the folly of this approach – and despite the fact that even the most died-in-the-wool punishment types in the US are now changing their minds about the overuse of prisons. A series of linked measures involving literacy, job training, addictions and mental health counselling, and the prevention of Fetal Alcohol Spectrum Disorder (FASD), would go much further over the long term to prevent crime.

If we accept Ottawa's argument that Canada has a serious fiscal challenge and must make difficult choices, we can save at least $1.5 billion annually right now simply by getting rid of the frivolous tax cuts introduced in previous Budgets. It would be a tough choice, but is it tougher than cutting food inspection and the National Aboriginal Health Organization, to name just a few items? The *No-Budge Budget* is aptly named.

This descriptor is all the more appropriate in light of the social policy centrepiece of Budget 2012: the proposed hike in the age of eligibility for Old Age Security.

B. The Big Story in Budget 2012: Two-Year Wait for Old Age Security
The evidence on sustainability of seniors' benefits

The aging of the baby boomers and increasing longevity of seniors have led some observers – most notably the federal government, as evidenced by musings from the Prime Minister and Finance Minister in the months before the 2012 Budget – to the conclusion that Old Age Security will be unsustainable in future years, so should be cut now to ease the rising cost burden. However, opinions differ as to how to interpret the term sustainability. We do not think that the evidence supports the claim that Old Age Security is unsustainable.

Old Age Security (OAS) is the foundation of Canada's retirement income system. The Old Age Security program provides three benefits: the base OAS pension which goes to all but wealthy pensioners, the income-tested Guaranteed Income Supplement for low-income seniors and the Allowance for low-income seniors ages 60 to 64 whose spouse or common-law partner is eligible for, or currently receiving, Old Age Security and the Guaranteed Income Supplement.

The Allowance is also paid to low-income widows and widowers ages 60 to 64 who have not remarried or entered into a new common-law relationship.

It is clear that the Old Age Security program's recipients and resulting costs are climbing and will increase substantially in coming decades. The most recent *Actuarial Report* observed that the number of Old Age Security pensioners (i.e., those who receive the base Old Age Security pension) is projected to rise from 4.7 million in 2010 to 6.8 million in 2020, 9.3 million in 2030, 10.5 million in 2040, 11.3 million in 2050 and 12.2 million in 2060 [Office of the Chief Actuary 2011a: 12]. OAS recipients will double in numbers between 2010 (4.7 million) and 2040 (10.5 million).

Total Old Age Security program benefits (i.e., OAS, GIS and the Allowance together) will rise from 6.4 million in 2010 to 9.3 million in 2020, 12.6 million in 2030, 14.1 million in 2040, 14.9 million in 2050 and 15.8 million in 2060. Between 2010 and 2040, the total number of Old Age Security payments will double.

As a result, expenditures on Old Age Security are on the upswing. But the federal government typically presents its projected costs over time in 'current' dollars, which do not take into account the effect of inflation as 'constant' dollars do. The difference between OAS spending measured in current and constant dollars is significant, and widens over time.

First, the results in current dollars. In 2010, basic Old Age Security pension expenditures amounted to $28.0 billion and are forecast to rise to $49.0 billion in 2020, $84.0 billion in 2030, $118.5 billion in 2040, $159.7 billion in 2050 and $216.1 billion by 2060 [Office of the Chief Actuary 2011a: 13]. According to these figures, basic OAS pension costs will quadruple between 2010 and 2040.

The trend in constant dollars, however, tells a different story. Converted to constant 2012 dollars, basic Old Age Security payments will increase from $29.1 billion in 2010 to $41.8 billion in 2020, $58.8 billion in 2030, $68.1 billion in 2040, $75.3 billion in 2050 and $83.5 billion in 2060. Between 2010 and 2040, basic Old Age Security outlays expressed in constant 2012 dollars will double in value. *So the cost of the basic Old Age Security pension is rising considerably in real terms, but nowhere near as much when expressed in current dollars*.

The picture is the same plotting total Old Age Security expenditures (i.e., OAS, GIS and Allowance) over time. Total Old Age Security expenditures in current dollars were $36.5 billion in 2010 and are forecast to rise to $64.2 billion in 2020, $108.7 billion in 2030, $151.9 billion in 2040, $201.4 billion in 2050 and $267.8 billion by 2060. According to these figures, total Old Age Security costs will quadruple between 2010 and 2040 – a big number indeed.

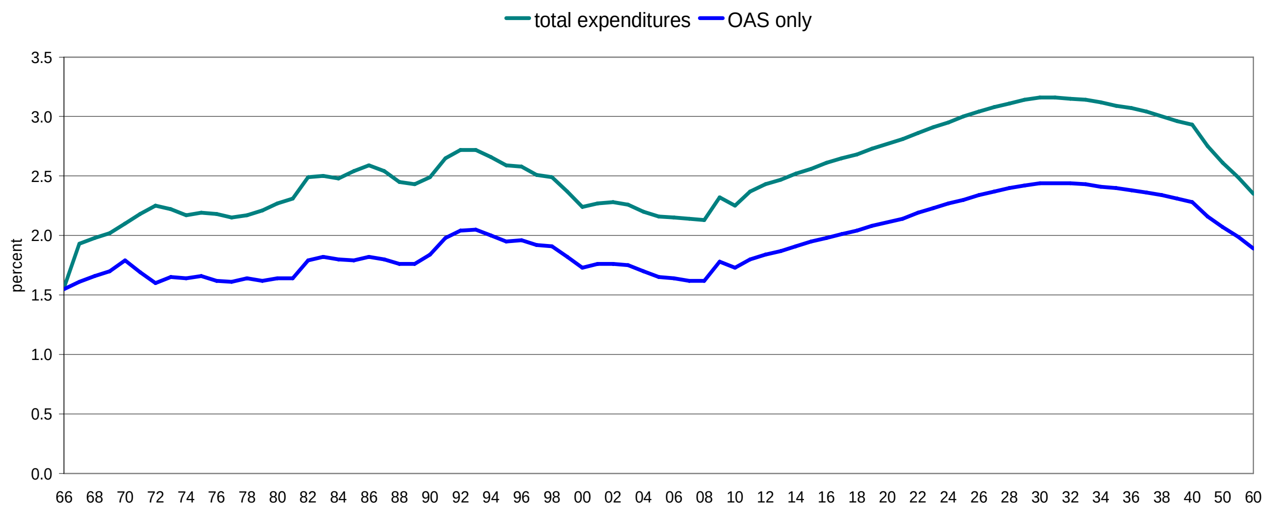
Converted to constant 2012 dollars, total Old Age Security expenditures will increase from $38.0 billion in 2010 to $54.8 billion in 2020, $76.1 billion in 2030, $87.2 billion in 2040, $94.9 billion in 2050 and $103.5 billion in 2060. Between 2010 and 2040, total Old Age Security expenditures will double. *So overall costs of the Old Age Security program are indeed rising considerably in real terms, but not nearly as much as indicated using current dollars.*

The Budget does not budge in its deceptive presentation of the cost of Old Age Security spending. It states that the cost of the program will rise from $38 billion in 2011 to $108 billion in 2030 – an increase of close to triple. The true figure, converted to constant 2011 dollars, is $74 billion in 2030, not $108 billion – an increase of close to double between 2011 and 2030.

Another key indicator is Old Age Security expenditures measured as a percentage of GDP (Gross Domestic Product). Basic Old Age Security pension expenditures amounted to 1.7 percent of GDP in 2010 and will rise to a peak of 2.4 percent in 2030, 2031 and 2032, then will fall steadily as the baby boomers die off to 1.9 percent by 2060 (close to today's 1.8 percent).

For the Old Age Security program overall (OAS, GIS and the Allowance), expenditures go from 2.3 percent in 2010 to a high of 3.2 percent in 2030 and 2031, and then will decline as the baby boom generation passes on to a forecast 2.35 percent in 2060 (not far off this year's 2.43 percent). Figure 2 shows the trends.

Figure 2
Total Old Age Security expenditures (OAS, GIS, Allowance) and OAS only, as percentage of GDP, 1966-2060



So even at their high point, total Old Age Security expenditures will represent a modest 3.2 percent of GDP, and will fall back to just 2.35 percent of GDP in 2060, which is slightly *below* today's figure (2.43 percent). These results do not indicate that Old Age Security is beyond the country's capacity to bear in the coming two decades.

Using several measures, the Parliamentary Budget Officer concurs that Old Age Security is sustainable in fiscal terms. Even assuming that Old Age Security benefits will receive some above cost-of-living increase in future (equal to one-half of the increase in real GDP per capita) to take into account higher living standards, the federal net-debt-to-GDP ratio will decline steadily from its current level [Matier 2012: iii]. Assuming Old Age Security will continue to be indexed only to inflation in future, the federal debt ratio will fall even faster.

Total Old Age Security payments (assuming indexation to inflation) measured as a percentage of revenue will rise from 15.9 percent in 2010-11 to 16.8 percent in 2020-21 and 19.8 percent in 2030-31 and then fall steadily to 18.9 percent in 2040-41, 17.4 percent in 2050-51, 16.1 percent 2060-61, 14.3 percent in 2070-71 and 12.8 percent in 2080-81.

Old Age Security expenditures measured as a percentage of program spending increase from 14.8 percent in 2010-11 to 18.3 percent in 2020-21 and 20.9 percent in 2030-31 and then decline to 20.3 percent in 2040-41, 19.1 percent in 2050-51, 18.0 percent 2060-61, 16.3 percent in 2070-71 and 14.9 percent in 2080-81.

Such varied evidence does not, in our view, warrant cutting Old Age Security. But cut Ottawa intends to do, as explained below.

age of entitlement for Old Age Security will increase from 65 to 67

One of the biggest announcements in the 2012 Budget is the proposal to increase the age of entitlement for Old Age Security from 65 to 67. This change applies to all three components of the program – Old Age Security, the Guaranteed Income Supplement and the Allowance. These benefits are described in the endnotes.[2]

The increased age of eligibility for Old Age Security will be phased in over time. It will not begin its rise for another 11 years, which the government says will give the affected population "ample time to make adjustments to their retirement plans" [Minister of Finance 2012].

The eligibility age will be increased gradually over six years, starting in April 2023, and will reach 67 in January 2029 – 17 years from now. This announcement must stand as one of the longest-term commitments in the history of Canadian governments. In fact, though, it is exceeded – and perhaps influenced – by the United States government, which passed legislation in 1983 to gradually raise the age of eligibility for Social Security by two months each year for five years, starting 2003, to reach 66 in 2008 and finally 67 in 2025, which will be 42 years from start to finish.

Among Canadians with Old Age Security and the Guaranteed Income Supplement, anyone age 54 or older as of March 31, 2012 (born on or before March 31, 1963) will not be affected by the change and will continue to receive elderly benefits when they reach 65. The age 65 rule also will continue to apply to people who get the Allowance and the Allowance for the Survivor. If they are 49 years or older as of March 31, 2012 (born on or before March 31, 1963), they will be exempt from the new system.

Raising the age at which seniors receive Old Age Security is a significant change in Canadian social policy. We think this measure is unnecessary and ill-advised, as explained below, and we offer some better policy alternatives.

take your old age pension later

As a complement to raising the age of eligibility for Old Age Security, the Budget proposes to allow seniors to choose their own age for starting benefits, within limits. They will be able to begin taking their Old Age Security pension by up to 5 years later than the normal age (which is increasing from 65 to 67), which means up to age 72 once the 67 normal age is phased in. Unlike the increase in the age of eligibility of OAS, which will not be fully phased in until January of 2029, this variable age feature will take effect fairly soon, on July 1, 2013.

However, seniors cannot begin Old Age Security *earlier* than the normal age. That change would be seen to create an incentive to leave the workforce earlier, which Ottawa does not want to happen in view of anticipated labour shortages, resulting losses in income taxes and a declining ratio of working-age people to seniors.

Payments will be ‘actuarially adjusted,’ which means that the amount will vary with the age that beneficiaries choose to begin receiving their payments. Each year above the normal age of eligibility, benefits will increase by $467 per year (in constant 2012 dollars). However, the Guaranteed Income Supplement will not be actuarially adjusted, but rather available at the current standard rate, as at present.

This is not a new idea: The Canada Pension Plan and Quebec Pension Plan offer an actuarially adjusted benefit, ranging from as low as age 60 to as high as age 70 (the normal age is 65), with the amount depending on the age that recipients choose to start receiving their monthly cheques. The UK also makes such a provision, as do most OECD countries. Note, however, that the Canada Pension Plan and Quebec Pension Plan allow beneficiaries to take up their pension up to five years *before* the normal age, whereas Old Age Security can only be taken up *after* the normal age.

A variable age Old Age Security offers some advantages and suits some workers in the changing workforce. By providing an incentive for some seniors to keep on working past the normal age (now 65, rising to 67), it might help deal with the problem of labour shortages in some occupations and some parts of the country. A variable age Old Age Security will afford some seniors some choice in their personal retirement income plans – rather than forcing them to begin drawing their pension when the government dictates.

But this is the best we have to say about Budget 2012's changes to Old Age Security. Raising the age of entitlement for the program will bring some serious negative consequences, none more lamentable than the impact on low-income seniors.

Old Age Security age hike will hit poor seniors and seniors with disabilities hardest

Lifting the age of eligibility for the Old Age Security from 65 to 67 is a regressive move that will hit low-income seniors hardest: They most rely on Old Age Security for their income and will suffer most as the program is *de facto* cut by reducing the number of years that seniors can receive benefits.

Ottawa's assurance that the long lead time for raising the age of entitlement from 65 to 67 will allow Canadians to "plan their retirement and make adjustments" [Minister of Finance 2012: 197] is cold comfort for the working poor and people on social assistance, for whom life is a daily struggle for survival on inadequate incomes. Planning and making adjustments for their future old age are beyond their control.

Low-income Canadians typically work in non-standard jobs that are low paid, unstable, often part time, tedious or even dangerous, and lacking in employer-provided benefits, such as private pensions and supplementary health benefits. When they reach 65, low-income workers see an improvement in their standard of living as they move from the low-wage workforce to Old Age Security. That no longer will be the case for those low-income seniors age 65 or 66, who will have to wait two more years before they can look forward to receiving benefits. Not all working poor seniors age 65 or 66 will be able to keep on working, especially those who are in poor health. They will have to resort to welfare or support from family members once Old Age Security begins at 67.

Social assistance recipients will face the same problem, since they do considerably better on Old Age Security than welfare. In 2009, the most recent year for which data is available, provincial welfare incomes for single employable recipients ranged from $6,637 in Nova Scotia to $9,652 in Newfoundland, with most in the $6,000 to $7,000 range [National Council of Welfare 2012]. Contrast welfare incomes to the $14,033 from the maximum Old Age Security/Guaranteed Income Supplement in 2009. Making low-income seniors ages 65 and 66 continue to work or stay on welfare for an extra two years is unfair and – in view of our critique of the unsustainability argument – unnecessary.

Old Age Security and the Guaranteed Income Supplement substantially reduce the poverty rate among seniors. The two programs together cut the low income rate from around 30 percent without them to 12 percent with them for persons age 66, and from 32 percent to 12 percent for those age 67 [Canadian Labour Congress 2012: 6].

Senior women benefit even more: The low income rate for women ages 65 to 69 is cut from 35 percent (without OAS/GIS) to 14 percent (with OAS/GIS). Elderly benefits reduce the low income rate for men ages 65 to 69 from 27 percent to 11 percent [Canadian Labour Congress 2012: 6]. Low-income seniors will now have to keep working in the low-wage labour market or rely on welfare for two more years, to age 67, which effectively will reduce income overall for low-income Canadians aged 65 and 66 and, as a result, will raise their low income rate.

One expert calculates that, unless low-income seniors ages 65 and 66 are compensated for this lost OAS income by working or going on welfare or finding some other income, their numbers could more than double from 50,000 to 120,000. Of course, many of these people will find other sources of income, but that will not fully offset losses in Old Age Security and the Guaranteed Income Supplement, so there will still be a net increase in their numbers and incidence of poverty [Wolfson 2012].

It gets worse. The Budget glows that "as Canadians are living longer and healthier lives, many may prefer to work longer" [Minister of Finance 2012: 196.] Not low-income seniors, who generally receive Old Age Security for a shorter time than middle- and upper-income seniors because the poor have the shortest lifespan on average[3] [Tjepkema and Wilkins 2011: 32]. Raising the age of eligibility for benefits will further reduce the number of years that poor seniors typically can draw Old Age Security.

Spokespersons for Canadians with disabilities are concerned about the plan to increase eligibility for Old Age Security from 65 to 67. People with disabilities disproportionately live in poverty, many on welfare. The percentage on social assistance ranges from 40 to 60 percent of all recipients, depending on the province or territory [Council of Canadians with Disabilities 2012]. Some people with disabilities are part of the working poor. Low-income seniors with disabilities on welfare or in the workforce will have to wait two more years to move up to the better benefits available from Old Age Security and the Guaranteed Income Supplement.

compensation for the provinces and territories

Raising the age of entitlement for Old Age Security will produce mixed results for the provinces and territories. It will increase their social assistance costs because many low-income seniors age 65 or 66 who under the current system would be on Old Age Security now will have to turn to welfare to tide them over until they reach 67.

On the other hand, most provinces[4] and the three territories provide income supplements for their low-income seniors. The number of recipients of provincial/territorial income supplements for the low-income elderly and attendant costs will decline if the provinces and territories follow Ottawa's move to raise the eligibility age for elderly benefits from 65 to 67. The former factor likely will outweigh the latter, leaving the provinces and territories with a net increase in costs.

Budget 2012 acknowledges this effect and pledges to provide federal compensation for "net" additional costs the provinces and territories incur from the increase in the age of entitlement for Old Age Security. But how broadly will that commitment be applied? There is a range of provincial/territorial programs in addition to welfare and income supplements for the elderly that could be affected by the increased age of entitlement for Old Age Security.

oh what a tangled web Ottawa will weave

The impact of increasing the Old Age Security age from 65 to 67 on provincial/territorial welfare programs and income supplements for the low-income elderly is but the tip of the iceberg. Old Age Security is a large program with links to many other income programs and social services – federal, provincial/territorial, municipal – that potentially will have to adjust to the change in Old Age Security.

The Budget mentions welfare and income support programs provided by Veterans Affairs Canada and Aboriginal Affairs and Northern Development Canada that currently end at age 65, which "will be aligned with changes to the OAS program" [Minister of Finance 2012: 198]. Presumably, "aligned" means these programs will be extended to age 67, which will cost the federal government more. The Budget also says that the federal government will discuss with the provinces and territories the effect of the proposed changes to Old Age Security on Canada Pension Plan disability and survivor benefits. While Ottawa operates the Canada Pension Plan, the program is the creature of both orders of government when it comes to major changes to it.

Raising the age for Old Age Security from 65 to 67 begs many complicated and important questions for *all* government programs and tax benefits that affect elderly Canadians. Will the normal age for the Canada Pension Plan and Quebec Pension Plan be increased from 65 to 67? The non-refundable age credit provides both federal and provincial/territorial income tax savings. Presumably, it will have to increase its age of eligibility in line with Old Age Security's rising eligibility age.

The provinces and territories offer a variety of programs and services geared to lower-income seniors – e.g., prescription drug plans, property tax relief, housing and home care – that currently begin at age 65; will that age rise to 67? Most provincial/territorial governments provide income supplements to their elderly poor; will they start at 67? Will the standard age of retirement for employment pensions also increase to 67? And what about disability plans – public (e.g., Workers Compensation) and private – which now end at 65?

There are many changes in both the private and public sector that will need to be considered, some with substantial fiscal and policy implications. Fortunately, the Department of Finance has ample time – a good 10 years – in which to untangle this mess.

boondoggle for the wealthy?[5]

The Budget provision to allow deferral of Old Age Security for up to five years beyond the usual age of entitlement, accompanied by an actuarial increase (0.6 percent for each month of deferral), will result in a windfall for some wealthy seniors. Those who choose to continue working, and who would otherwise have an income that would subject them to the clawback on Old Age Security (which reduces or removes benefits from well-off seniors), will be able to avoid the clawback for up to five years. If their income goes down after the period of the deferral because they have stopped working so no longer have other earnings, or have substantially lower earnings, they might (a) no longer be subject to the clawback, or be subject to less of the clawback, and (b) get a reward for avoiding the clawback during the period of the deferral in the form of a higher (lifetime) Old Age Security pension. This is a classic example of an unintended consequence of a change in public policy.

the sustainability chimera

The age of entitlement for Old Age Security will begin to rise on April 2023 and will reach age 67 on January 2029. Ironically, this means that the federal government will begin implementing its cost-cutting changes at the very time that Old Age Security expenditures – measured as a percentage of key economic indicators such as GDP (Gross Domestic Product), employment earnings, federal revenues and expenditures – show a marked and steady relative *decline* as the baby boomers die off.

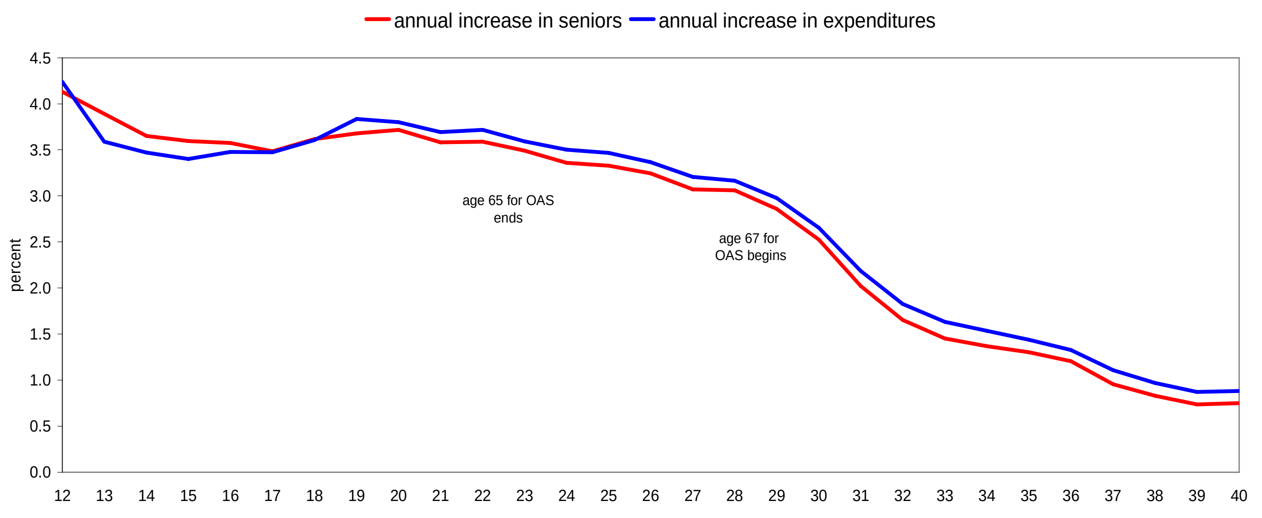
As illustrated earlier in Figure 2, Old Age Security expenditures will rise from 2.3 percent of GDP in 2010 to 2.8 percent in 2020 and 3.2 percent in 2030, but then will fall to 2.9 percent in 2040, 2.6 percent in 2050 and a projected 2.4 percent in 2050.

The numbers differ but the story is the same for Old Age Security spending measured as a percentage of employment earnings, federal program spending and revenues: The percentages all begin to decline around 2030. The age of eligibility for Old Age Security will reach 67 in January 2029 – around the time that expenditures begin to fall in relative terms. So *Ottawa will be reaping its savings from raising the age of eligibility for Old Age Security just as the scope for savings steadily shrinks.*

Figure 3 digs deeper into this telling finding to look at the annual change in the number of seniors and the cost of the Old Age Security program (shown in constant 2012 dollars). The two trends are close, as one would expect, indicating that the number of recipients is obviously the key driver of costs.[6]

The annual increase in the number of seniors and resulting costs begin to decline around 2020, falls rapidly after 2030 and will keep declining to 2040, the latest years for which data are available. The age of entitlement for Old Age Security will start climbing in April 2023 and will reach 67 in January 2029 – the backdrop to which is the steady and sizable *decline* in the growth

Figure 3
Annual increase in number of seniors and Old Age Security expenditures (in constant 2012 dollars), 2012-2040



of seniors and OAS expenditures. Those who believe that we must cut Old Age Security in order to sustain the program should have made their case when the annual growth in expenditures was robust. In this sense, the Budget 2012's increase in the eligibility age for Old Age Security comes too late.

policy fixes

There are additions or alternatives to increasing the age of eligibility for the Old Age Security program.

above all, protect poor seniors

The federal government should take steps to shield low-income elderly women and men from the impact of the increase in the age of entitlement for Old Age Security. To protect poor seniors, many of whom work in physically difficult or monotonous jobs, for whom postponing retirement would be difficult, and to avoid downloading of costs to the provinces and territories for increased welfare expenditures, Ottawa should provide an income-tested benefit for low-income seniors ages 65 and 66. It already has the mechanism in place to do so, in the form of the Allowance (the third of the programs that make up Old Age Security).

The Allowance for the Survivor could be extended to all low-income single near-seniors (persons ages 60 to 66, since 67 will be the age of eligibility for Old Age Security), and the

Allowance could be extended to all couples in which both members are 60 to 66. This change would ensure that low-income Canadians ages 65 and 66 would receive an income benefit so that they would not have to work two years more or resort to welfare. It would also make it unnecessary to compensate the provinces and territories for increased costs of welfare.

lower the clawback

Well-off seniors give up some or all of their Old Age Security benefits through an income test, more (un)popularly known as the "clawback." In 2012, the clawback kicks in at net individual income of $69,562 and reduces Old Age Security to zero at net income of $112,772. Only 6.0 percent of seniors are affected by the income test, and just 2.3 percent receive no Old Age Security.

To slow the increase in Old Age Security spending, the federal government could increase the reach of the clawback – by reducing the income threshold or raising the reduction rate or both. This change would bring more seniors into clawback range and reap more savings for Ottawa – part of which could go to paying for increases to benefits we have proposed for the elderly poor (i.e., providing an income-tested benefit to poor seniors aged 65 and 66 and boosting the Guaranteed Income Supplement) [Battle, Torjman and Mendelson 2011]. But at least this would be a progressive measure, affecting better-off seniors and not touching the majority of seniors who have low or average incomes.

However, it is essential not to lower the clawback so far that it digs into the large group of middle-income seniors for whom Old Age Security is still a significant source of income. The income test for couples should be based on their combined income, not their individual income as at present. One thing that should not be changed is indexation of the income test to the full cost of living, to avoid the temptation of cuts through social policy by stealth that would result from no or partial indexation.

integrate elderly benefits into a single, geared-to-income program

Yet another possibility is to combine Old Age Security, the Guaranteed Income Supplement, the age credit and the pension income credit into a single income-tested program, based on family income, with a progressive design. The federal government attempted this kind of reform a decade ago in the form of a 'Seniors Benefit.' Ottawa withdrew its proposal in the face of opposition from women's groups and Bay Street. But this option remains the most sensible design for elderly benefits. If the federal government had gone ahead with that reform, we probably would not be having this debate now, since the Seniors Benefit would have slowed spending on elderly benefits – and not on the backs of the poor.

a pig in a poke

The 2012 Budget proposes but one approach – raising the age of entitlement for Old Age Security from age 65 to 67. But it provides no evidence to help Canadians assess the merits of this scheme, or lack thereof.

During and after the increase in the age of eligibility for Old Age Security is phased in, what will be the net cost of the reform, factoring in its impact on federal and provincial/territorial income and consumption taxes, and the cost of compensatory payments to the provinces and territories? What would a gender lens and disability lens tell us about the scheme, especially its impact on the vulnerable? What impact will the age 67 rule for Old Age Security have on the array of federal and provincial/territorial programs and tax benefits, and age-related programs in the private sector, that use the OAS definition of eligibility?

Ottawa also should broaden the scope of reform to explore alternatives such as those discussed above – protecting poor seniors by providing an income benefit (such as expanding the Allowance) for those age 65 and 66, lowering the clawback on Old Age Security or creating a new income-tested program to replace Old Age Security. So too should expansion of the Canada Pension Plan be put back on the reform agenda. The proposed change in the age of eligibility for Old Age Security is 11 years in the future. Ottawa has ample time to produce an options paper and allow for public discussion of the alternatives.

C. The Good Story in Budget 2012

Budget 2012 introduced some positive measures in several areas. These include improvements to the education system and some other measures for Aboriginal Canadians, employment supports for persons with disabilities, the financing of community infrastructure and innovation procurement. Each of these areas is discussed below.

Aboriginal and First Nations issues

education

Along with some useful measures to help Canadians with disabilities, the Harper government's determination to make tangible progress on First Nations education stands out in a Budget which is otherwise troubling from a social policy perspective.

The 2012 Budget confirms that the government will "work with willing partners to introduce a *First Nation Education Act* and have it in place for September 2014" [Minister of Finance 2012: 149]. This commitment reflects a recognition that piecemeal band-aid fixes are not going to achieve sustainable and widespread improvements in First Nations schools. Instead, comprehensive rebuilding of the First Nations education system is needed to create the kinds of institutions and programs which the rest of Canada takes for granted.

The new Act should give the Department of Aboriginal Affairs and Northern Development much-needed marching orders and a mandate to negotiate and fund agreements with First Nations wanting to establish better-functioning school systems. The new Act should also give First Nations a written legal framework setting out what is expected in order to complete an agreement. This framework should replace vague and ephemeral expectations which have resulted in protracted, expensive negotiations in which neither First Nations nor the Department knows what is expected or what may be offered.

There are many precedents for this kind of legislation; for example, the *First Nations Land Management Act* sets out a framework agreement for First Nations wishing to take over their own land management. This Act has facilitated land management agreements throughout Canada. In no sense does the forthcoming *Education Act* replace Treaty rights. Just the reverse: The *Education Act* should provide a legal vehicle through which Treaty rights to education on reserve can be recognized in law and implemented. Of course, we will need to wait and see what the new *Education Act* actually says, but if it delivers what it promises it will strengthen, not weaken, Treaty rights.

The Budget does not commit a specific amount of money to renew First Nations education under the new *Education Act*, and this has been the subject of some concern among First Nations. We believe that these concerns are due to a misunderstanding of the Budget. Ironically, a source of confusion has been the fact that additional funds have been provided for other educational initiatives in the Budget (discussed below) and these have been mistakenly interpreted as the money that will be provided under the planned new legislation. This is a misinterpretation of the Budget commitment.

For those who can read the Budget's cryptic tea leaves, the need for added funding as part of the new legislation is recognized in the Budget's declaration that: "The Government will also work to explore mechanisms to ensure stable, predictable and sustainable funding for First Nations elementary and secondary education" [Minister of Finance 2012: 149]. Once again, we will need to wait for the new Act and critically analyze what it actually does. But at this time, the signals are positive.

The Caledon Institute of Social Policy is proud to claim some part of the credit for the federal government's commitment to a *First Nations Education Act*. In 2006, we published an analysis of educational attainment data from the Census, which showed that the biggest barrier facing First Nations students was not completing high school [Mendelson 2006a]. That paper helped focus attention on what may seem obvious now, but was not so clear at the time: If First Nations students could not graduate from high school, they were much less likely to get a post-secondary diploma or degree. We argued that not only was it a benefit to First Nations and the students themselves to get postsecondary credentials, but the long-term prosperity of all of

Canada and especially the West would be endangered by the continuing under-performance of the First Nations school system. Our work contributed towards much increased attention to the primary and secondary school system for First Nations students.

When we presented our findings to First Nations audiences, one of the first questions always was: What would you do about it? In response, we wrote a series of papers analyzing the policy issues, building on the work of others, not least the Royal Commission on Aboriginal Peoples. We proposed a *First Nations Education Act* to establish a framework for a revitalized, successful First Nations education system [Mendelson 2009; 2006b]. In these papers, we argued that Ottawa had relinquished control of First Nations schools in response to the demands of First Nations, but had done nothing to set up a school system. It was like giving someone a car without a steering wheel and no gas tank (and a lot of other missing parts). First Nations had to be given the tools with which to build a functioning education system.

We remain vigilant and will be undertaking a careful review of the new *First Nation Education Act* when a draft is completed for consultation. Nevertheless, we are optimistic that this initiative indeed does start Canada down the long road to enabling First Nations to build a first-rate school system. Along that road there will be many potholes, unexpected detours and jarring bumps, but we believe the 2012 Budget shows that the federal government has taken this issue firmly on board.

The Budget also provides $175 million over three years to build and renovate schools on reserve. While this funding is welcome, it appears to be more or less in line with previous years' funding. In 2009-10, $85 million was provided for school building and renovation and, in 2010-11, $105 million was provided. A specific amount was not broken out in the 2011 Budget (as it was part of a larger amount generally for on-reserve infrastructure); however, it is likely that a similar sum was also provided in that year. As many First Nations have argued, a much larger amount is probably needed to get First Nations schools up to standard. Equally or perhaps even more important, buildings have to be properly maintained or they deteriorate rapidly and incur much higher costs for repair or replacement. We have no way of knowing whether the amount of money available for maintaining existing and building new schools is sufficient.

We believe that the problem of lack of accountability for capital assets will eventually be corrected in the new Act as responsibility for capital would, we hope, go to first Nations school boards and regional educational bodies. We would expect these First Nations organizations to establish small units to plan, monitor and ensure proper maintenance of capital facilities, working in close partnership with similar units in provincial/territorial Ministries and school boards. But this will be a long time in coming.

In the meantime, we would urge the Department to consider using a modest part of this funding to establish a specialized unit, either under its authority or as a First Nations-government partnership, which could exercise a planning and monitoring function on all school capital across all reserves, assisting willing First Nations to ensure proper maintenance of buildings and, where needed, help in planning and selecting new school buildings. We envisage a trusted, independent intermediary with expert knowledge on issues of school capital that would be available to assist Bands on a voluntary basis. This could be the kernel from which to build much better capital planning and operations under the new Act.

Finally, the 2012 Budget also commits $100 million "over three years for First Nations education to provide early literacy programming and other supports and services to First Nations schools and students, and to strengthen their relationships with provincial school systems" [Minister of Finance 2012: 149].

Funding for three years for early literacy programming and other supports and services to First Nations schools and students seems to repeat some of the mistakes inherent in past programs. School programs cannot just be turned on and off for three years, especially in the more remote and isolated reserves. It often takes a year or more just to get a program up and running and integrated into a community and a school.

Moreover, the communities most able to take advantage of this kind of time-limited program funding are inevitably the best functioning communities with the best schools and the most capable staff, rather than those most in need of added funding. Indeed, part of the reason for advocating an *Education Act* is precisely to get away from this kind of one-off time-limited program funding. It would make a lot more sense to add this money to the base funding for on-reserve schools across Canada. At $33 million a year, it would add about 2 percent to annual base funding, going a little way towards making up the shortfall over the last decade-and-a-half.

other social initiatives

Budget 2012 includes an additional $11.9 million for the Family Violence Prevention Program on reserve in 2012-13. This brings the total budget for the Family Violence Prevention Program to $30.4 million for an additional year.

The 2012 Budget also renews the Urban Aboriginal Strategy, which is making an important contribution towards improving economic opportunities and the quality of life for Aboriginal people living in Canada's cities and towns.

Both of the above are welcome and positive initiatives. More questionable is the Budget's commitment to require rigorous (our interpretation) compliance with provincial social assistance rules for on-reserve social assistance. On some reserves in Canada, the standard applied had been 'reasonable comparability' rather than strict compliance. Reasonable comparability permits greater flexibility. For those reserves where there is a discrepancy with provincial rates and regulations, this may prove a difficult transition, especially if the reserve is highly dependent on assistance – in which case, it may imply a loss of income for a whole community and not just a few households. The exact implications of this undertaking, and how it will be implemented, remains to be seen.

The Budget also says that the government will improve work incentives and training opportunities in on-reserve social assistance, but no dollar amount is provided for this purpose. Although work incentives and training may, in the long run, save money and more importantly give social assistance recipients a chance to improve their lives, the unavoidable reality is that, at least in the short run, these measures cost money. The government's intentions in this instance are not clear.

other Aboriginal and First Nations-related measures

Aside from the spending initiatives listed (including the above) in the 2012 Budget, the base allocation for the Department of Aboriginal Affairs and Northern Development will be *reduced* by $252.6 million over three years. Most of the reduction ($165.6 million) is scheduled to occur in 2014-15.

The reductions include $12.5 million for the First Nations Statistical Institute ($2.5 million in 2012-13) and then an ongoing reduction of all its funding of $5 million in succeeding years. The Institute has had a long and difficult gestation. Nevertheless, it has now begun to produce useful syntheses of data and seems to be on the path to becoming an important source of information for policy making. An alternative which the government might perhaps consider would be to continue supporting the Institute at a reduced level while it attempts to find a means to continue as a non-profit organization, perhaps affiliated with a university, rather than its current Crown Corporation structure. At least some of the value of the investment already made might be preserved in that way.

The Institute is the only specific item listed for elimination in the Department. The remaining $160.6 million ongoing reduction in base funding, as of 2014-15, remains to be identified. If all these cuts were to come from Departmental operations and not out of payments going to First Nations, a greater than 10 percent reduction in operating costs would be required. This might perhaps be achievable, but there will be a cost – much reduced capacity in the Department, including diminished oversight of expenditures of about $7 billion in transfer payments to First Nations and others.

Despite these worrisome items, overall the 2012 Budget is promising for First Nations. If real progress can be made on education, much else will become possible that now seems out of reach.

Progress for Canadians with disabilities

Budget 2012 puts forward some positive measures to help Canadians with disabilities.

The Budget offers several improvements to the design and administration of the Registered Disability Savings Plan, a recent innovation for persons with severe disabilities and their families [Styan 2012; Minister of Finance 2012: 180-181].

The Budget proposes $30 million over three years to bolster the Opportunities Fund for persons with disabilities. This Fund enables prospective workers with disabilities to participate in the paid labour force. The Budget also announced the creation of a panel on labour market opportunities to help members of this group improve their workforce engagement. These linked announcements are welcome developments. Recent evidence shows that investments to support the labour market participation of persons with disabilities have clearly paid off [Torjman and Battle 2012].

It used to be the case that persons with disabilities fared poorly in the labour market compared to other Canadians. But over the past decade, the bleak picture has brightened.

Data from the Survey of Labour and Income Dynamics shows that, between 1999 and 2009, there was a substantial increase in the numbers of Canadians with disabilities aged 16 to 69 who were employed year-round. The count swelled from 1,328,325 in 1999 to 2,189,042 in 2009 – a jump of 860,717 or 64.8 percent.

As a proportion of all persons with disabilities aged 16 to 69, those who worked sometime during the course of the year increased from 51.9 percent in 1999 to 58.0 percent in 2008. Not surprisingly, the years 2007 and 2008 saw some retrenchment in the employment of persons with disabilities, dropping from 60.0 percent in 2006 to 58.4 percent in 2007 and 58.0 percent in 2008.

Yet even with this downward shift, the increase in employment over that period for Canadians with disabilities was larger than that observed for Canadians without disabilities, whose employment rate went from 79.2 percent in 1999 to 82.9 percent in 2008. The employment gap between these two groups narrowed by 2.4 percentage points, from 27.3 in 1999 to 24.9 in 2008.

Both demand and supply factors help explain the overall rise in the labour force participation of persons with disabilities.

On the *demand* side of the equation is the pull of the labour market. Employment conditions strengthened considerably across the country throughout the first decade of the century until the recession hit in 2008-09. The demand for labour appeared to boost job opportunities for all Canadians, including persons with disabilities. Faced with a tighter labour market, employers seemed more inclined than in the past to accommodate, hire, retain and promote individuals with disabilities.

But the *supply* side of the equation also helped change the landscape. More people with disabilities were seen as potential employees because they had improved, generally, their levels of knowledge and skills. As a group, they were bringing more talent and proficiency to the labour market.

Between 1999 and 2008, the overall educational attainment of people with disabilities rose considerably. The proportion of adults with disabilities aged 16 to 69 with a postsecondary degree, diploma or certification increased by 12.0 percentage points from 35.4 percent in 1999 to 47.4 percent in 2008. This growth even surpassed the rise of 9.7 percentage points among the population without disabilities – from 45.2 percent to 54.9 percent – over that period.

The evidence speaks clearly to the importance of investing in key factors which enable employment, such as postsecondary education, accessible workplaces and the availability of aids and supports. These investments have paid off in terms of higher workforce participation and improved earnings, on average, for people with disabilities.

Ideally, the announcements in Budget 2012 will help sustain this positive momentum. Unfortunately, there is one group that has not fared so well in recent years.

Persons with greater functional impairment did not experience the same level of employment gains between 1999 and 2009. The new measures announced in Budget 2012 should pay special attention to the needs of these individuals – so often left out of the employment equation and social participation, more generally. The bolstered Opportunity Fund can help create opportunity for these Canadians.

Community infrastructure

Budget 2012 allocated $150 million over two years to support repair and improvements to existing small public infrastructure facilities through the Community Infrastructure Improvement Fund. This announcement is good news. For years, Caledon has argued the importance of investing in local infrastructure to promote the social and economic well-being of communities.

We have also pointed out that infrastructure investments should be made directly in venues and facilities rather than indirectly through tax breaks to individual taxpayers. In the case of recreation, for example, families cannot possibly build and maintain – through their small tax breaks from claiming the Children's Recreation Tax Credit – the essential public infrastructure involved in recreation. This infrastructure includes parks, trails, fields, arenas, rinks and pools, and the training and payment of qualified staff [Torjman 2012a].

The 2012 Budget announcement on infrastructure was also significant in light of the fact that the physical hardware of the country – roads, sewers and bridges – is in serious need of upgrade and repair. In 2007, the Federation of Canadian Municipalities had pegged the total infrastructure deficit at $123 billion. The cost of new infrastructure was an estimated $115 billion at that time.

A key problem arises from the fact that the vast majority of publicly-owned recreation facilities and other forms of community infrastructure were built between 1965 and 1980. Facilities of this age not only require capital renovation or replacement, but are also more expensive to operate. In 2005-06, the national recreation infrastructure deficit for Canada's arenas, pools and community centres alone was about $15 billion – the estimated cost of repairing or replacing existing inventory.

A positive development on this front took place in 2009 when Ottawa introduced, as part of its two-year Economic Action Plan, a federal Recreation Infrastructure Program worth $1 billion. The federal $500 million was matched by contributions from other orders of government and recipients. This was a good first move, but still left a big gap between identified need and actual investment.

Another notable development was the broader federal infrastructure plan, Building Canada, worth $33-billion from 2007-14. Building Canada consists of a suite of programs to meet infrastructure needs across the country, including a Gas Tax Fund and full rebate of the Goods and Services Tax paid by municipalities. But 2014 is around the corner, and new forms of revenue will have to be found unless the agreement is renewed.

So the funds set aside in the 2012 Budget are a welcome announcement. But two challenges remain.

The first is a fiscal one that is rooted in the fact that municipalities do not have a secure and adequate source of financing over the long term to pay for all the infrastructure repairs and upgrades that they are invariably required to do. There is need for a long-term funding formula that provides a predictable and reasonable source of revenue for local governments. Budget 2011 made an important breakthrough when it committed to legislating a permanent annual investment of $2 billion in municipal infrastructure through the Gas Tax Fund.

The second challenge is political. It has to do with the process for selecting the identified communities to which the new funds would be directed and the specific facilities to be upgraded. It is essential to ensure a transparent and accountable process that is not linked to the ridings of only one political party. Ottawa should put forward a proposed procedure that it plans to follow.

One option that Caledon recommended in 2005 is to develop an inventory of viable projects that require upgrades and repairs [Mendelson 2005]. This list could help guide the expenditure of new funds. It would also help provide direction in the event of another recession or employment stimulus program. Infrastructure investments should be guided by methodical prioritization rather than a haphazard or partisan process.

Innovation through procurement

On another positive note, the 2012 federal Budget announced its plans to support innovation through procurement. Ottawa will build on the Canadian Innovation Commercialization Program introduced in 2010 by adding $95 million over three years, starting 2013-14. An additional $40 million will be allocated every year after that time to make the program permanent.

We were pleased to see this announcement for several reasons. Caledon recently published a paper on procurement which argues that governments can advance important social purposes in several ways, including their hiring, investment and purchasing practices [Torjman 2012b].

Governments are major purchasers of goods and services, and they can support social goals through the power of their purchase. Governments at all levels can buy directly from social enterprises. These are organizations that produce goods and services but also meet a social goal. For example, social enterprises may hire workers, such as racialized youth or Aboriginal Canadians, who typically are marginalized from the paid labour market.

In addition to direct purchase, governments can use their procurement power to require the attainment of broader ‘community benefits.’ These refer to the notion that the benefits of a given contract should be felt more broadly throughout the community rather than just by the firm or organization that derives monetary gains in the form of cash payments.

In terms of employment, for instance, community benefits can mean that the winning firm offers job opportunities to designated groups – such as persons with disabilities, Aboriginal youth, new Canadians or young offenders. The company would promise to hire, in fulfillment of the contract, a certain number or percentage of individuals who are typically underrepresented in the labour market.

Community benefits can also involve the training of prospective employees. This form of skills development helps raise awareness among employers and community members, more generally, about the value of people who often get overlooked as potential workers.

Training may not result in immediate employment because participants may have to complete an apprenticeship or may require additional skills. But the very act of being engaged as trainees may afford them the confidence to pursue a skilled trade or return to school. The experience may also provide trainees with contacts and letters of referral they otherwise would not have had.

Community benefits can involve the entire supply chain. Successful bidders may be required to import products that explicitly avoid the use of child labour or that are made with environmentally-friendly supplies.

We acknowledge that Budget 2012 does not talk about social procurement *per se* but rather about government purchase in support of innovation. We would encourage Ottawa and other governments to look more broadly at their power of procurement to achieve important social ends.

But a big caveat in the Budget comes in the form of one small sentence. It is – figuratively and possibly literally – a bombshell buried at the end of the paragraph on procurement. The Budget states: "The program will include an added military procurement component" [Minister of Finance 2012: 67]. There is no reference to how much money or to the purpose of this "component."

Caledon has long argued that public funds, especially when they are scarce and deemed to be in relatively short support, be used for positive social purposes. Military components, however defined, do not qualify.

D. Employment Insurance: a quagmire still

The Caledon Institute of Social Policy and numerous other organizations have called for a fair Employment Insurance program – one which would treat every unemployed worker equally, regardless of region or province. Today, only a minority of unemployed Canadians are getting Employment Insurance (EI), and lack of coverage is especially troubling in Ontario and in the West [Mendelson and Battle 2011]. The 2012 Budget introduces several modifications to the Employment Insurance program and a significant change in Employment Insurance financing. Unfortunately, these measures neither address nor even acknowledge the major failings of Employment Insurance.

working while on claim

Since 2008, under a nation-wide 'Working While on Claim' pilot project, Employment Insurance benefits have been reduced dollar-for-dollar for beneficiaries with part-time earnings who are also collecting EI benefits, when their earnings exceed an exemption of either the greater of $75 or 40 percent of their EI benefits. The 2012 Budget changes this rule so that Employment Insurance benefits will decrease by 50 percent of earnings. For example, if weekly earnings are $200, EI weekly benefits will be reduced by $100.

Under the old rule, Employment Insurance recipients working part time whose income exceeded the exemption would experience no increase in total income, even when their earnings rose, until earnings were large enough to fully eliminate all of their EI benefits. Under the new rule, an Employment Insurance beneficiary's total income will always increase by half of their rise in earnings, until their earnings are double their Employment Insurance benefits.

To illustrate how the new provision will work compared to the current system, the Budget provides the example of an Employment Insurance recipient getting $450 in weekly benefits while earning $600 a week in part-time work. Under the existing rule, this recipient could earn up to $180 (40 percent of $450) above which her Employment Insurance benefits would be reduced by one dollar for each additional dollar she earned. Consequently, she would lose $420 ($600 less $180) in EI benefits, so she would have an income of $630 ($30 in EI benefits plus her part-time earnings of $600). Under the new rule, her Employment Insurance benefits will be reduced by $300 (50 percent of $600), so she would have a total income of $750 ($150 in EI benefits plus her part-time earnings of $600) – a sizable improvement of $120 a week more than under the present system.

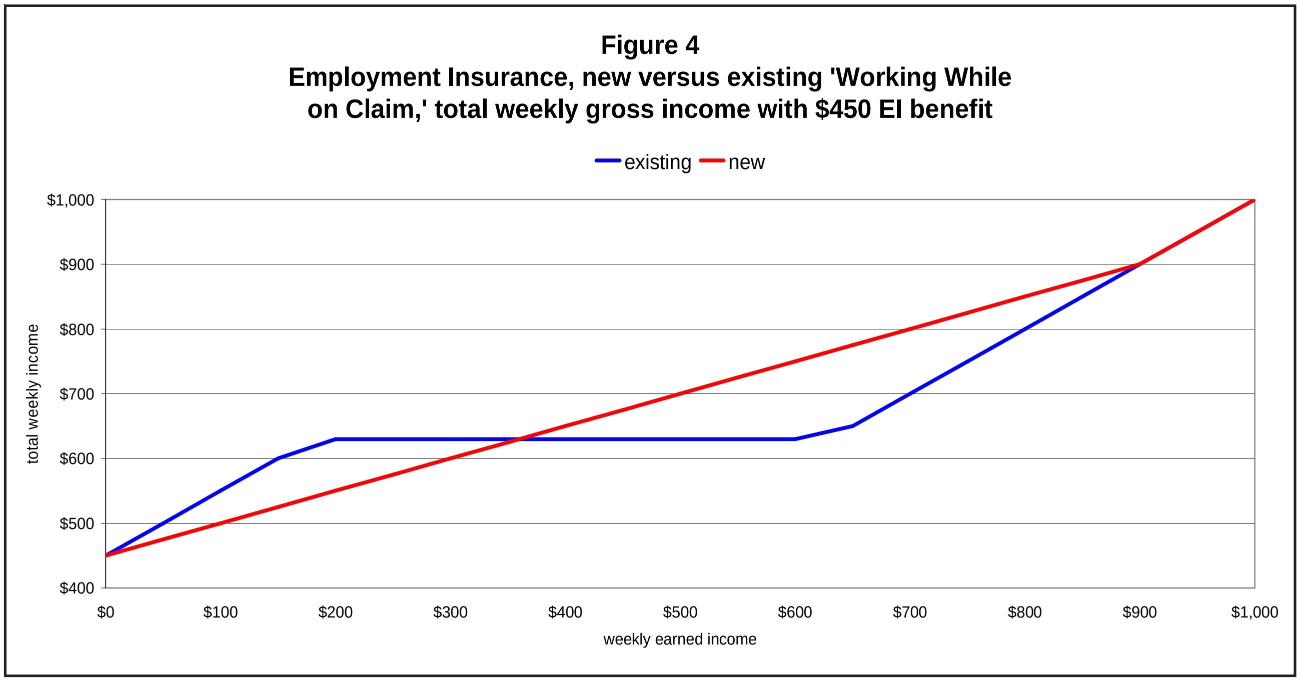
However, we get a quite different result if the recipient were earning only $200 a week in a part-time job. Under the current rule, the amount of money she can earn before her benefits are reduced does not depend upon the amount of her employment earnings. Rather, it depends upon the amount of her EI benefits. So she could still earn up to $180 (40 percent of $450) above which her EI benefits would be reduced for each additional dollar she earned. Consequently, with $200 in part-time earnings, she would lose $20 ($200 less $180) in Employment Insurance benefits, making her EI benefit $430. She would end up with a total income of $630 ($430 in EI benefits plus her part-time earnings of $200).

Under the new rule, her Employment Insurance benefits would be reduced by $100 (50 percent of $200), so she would have a total income of only $550 ($350 in Employment Insurance benefits plus her part-time earnings of $200). In this case the Budget's new, ostensibly improved work incentive will leave her with $80 *less* per week.

Figure 4 below shows the total income of an Employment Insurance recipient with $450 in weekly Employment Insurance benefits, as her part-time weekly earnings increase from none to the doubtless mythical amount of $1,000 per week, under the existing 'Working While on Claim' rule compared to the new rule.

Our first observation: For EI beneficiaries earning smaller amounts in part-time wages compared to their Employment Insurance benefits, the new rule will result in larger reductions in benefits and less total income compared to the old rule. In the example of $450 weekly Employment Insurance benefits shown in Figure 4 (used here because it was the example given in the Budget), she would have to earn more than $360 a week before beginning to be better off under the new rule. On the other hand, the new rule is much more generous than the old one for beneficiaries making larger weekly wages compared to their Employment Insurance benefits.

A second observation is that the old pre-Budget rules resulted in a sizable range of income (see the blue line between weekly earnings of $200 and $600) where extra earnings result in no improvement in income at all – what is called a 100 percent 'marginal tax rate.' This feature is obviously unfair to recipients who might have a chance to work a few extra hours only to find that they lose all the extra money they earn. The new rule corrects this defect.



A third observation is that the new rule will allow earnings to be quite high before Employment Insurance benefits run out altogether – in Figure 4, the so-called ‘breakeven’ point is $900 per week. The breakeven point is always double the amount of benefits when there is a 50 percent reduction rate. With average weekly regular Employment Insurance benefits of $370 in 2011, the average breakeven earnings would be $740 a week.

Thus, there will be winners and losers due to the change in the ‘Working While on Claim’ rule. There was a serious problem with the old rule, which the Budget does correct, but at the expense of low-income earners among those working while on claim.

The 2012 Budget provides an additional $46 million on an annualized basis in 2013-14 to pay for the change in rules, which implies that – according to the government’s model – there will be more winners than losers, but this remains to be seen. At somewhat greater cost, the federal government could have minimized the number of losers by exempting, say, the first $75 of earnings and then applying a 50 percent or even 55 percent marginal tax rate on subsequent earnings.

job search and labour markets

The 2012 Budget allocates $21 million over two years towards improving labour market information for the unemployed looking for work. The Budget also announces that new legislation will be introduced “to strengthen and clarify what is required of claimants who are receiving regular Employment Insurance benefits and are looking for work” [Minister of Finance 2012:

146]. There is no further explanation of either of these initiatives, so it is not possible to assess in any detail what is actually intended.

With regard to labour market information, one of the perennial demands of social reformers in the 1930s was the establishment of labour market exchanges to provide comprehensive information about job openings and to make job search much easier. There has been some progress on this front. Nowadays, there are many government employment centers. Moreover, readily accessible private sector websites, such as Workopolis and Monster, have become the main way of advertising new job vacancies. But apparently none of these alternatives quite do the job, as we can see by the government's intention to spend another $21 million doing something more (unstated) along these lines.

There is a simple and cheap solution. All employers could be required to post job openings on a single government or non-profit website. This would create a national labour market information resource for all of Canada at little cost (perhaps even making money through advertising or other means). This comprehensive information would create an immensely valuable new tool that would improve Canadian labour market liquidity, provide job searchers with instant and complete information, and serve as a fantastic (and free) resource for employers. The database would provide real-time information for planners and others so that labour skills, and training, could be much better matched to actual labour market demand. This is a rare case in which a mandated monopoly would be least expensive and most economically efficient.

With regard to job search requirements for Employment Insurance beneficiaries, the current program requires them to actively engage in job search, but it is a bit of a mystery as to how and to what extent this requirement is enforced. In principle, we do not object to job search requirements, but they must be designed so as to be minimally intrusive and helpful to recipients wanting a job. They must *not* be designed to require useless and dispiriting form filling or time-wasting with no real employment potential – for example, demanding a list of firms where employment was sought or attending useless classes on how to look for a job.

We look forward to seeing what the government actually proposes.

calculation of Employment Insurance benefits

The biggest programmatic Employment Insurance change announced in the 2012 Budget involves the way that benefits are calculated. The ongoing cost of this measure as reflected in the allocation for 2013-14 is an astonishingly high $250 million, which stands out in a Budget otherwise implementing massive cuts in important programs. Is this change worth it?

To explain this program change, we first have to describe what it is a change *from*.

For most Employment Insurance recipients, weekly benefits are calculated by dividing total income earned in the previous 26 weeks (up the Maximum Insurable Earnings limit of

$22,950 for 26 weeks in 2012) by the number of weeks worked, then multiplying by 55 percent. However, there is a complicated adjustment in which the number of weeks worked is *assumed* to be higher than the amount actually worked if the recipient worked relatively few weeks in the preceding 26 weeks – and the amount assumed to have been worked is variable depending upon local unemployment rates (of which there are a considerable number – 58). For example, a worker may have worked for 14 weeks but could be assumed to have worked for 20 weeks, so his weekly insurable earnings would be calculated as his total earnings divided by 20 rather than by 14, resulting in much lower weekly insurable earnings and therefore lower weekly Employment Insurance benefit. The higher the local unemployment rate, the fewer the assumed number of weeks worked, so this is a measure which favours unemployed Canadians living in higher unemployment regions.

Just to make matters still more complicated, 25 of the 58 Employment Insurance economic regions are 'designated economic regions.' In these regions, a pilot project has been running in which the best 14 weeks of the last 52 weeks are used to calculate benefits (but subject to the same maximum). The reason for the pilot project was ostensibly to test whether Employment Insurance contributors would be encouraged to work even if they had to accept much lower wages for some time. In the regular method of calculation, lower wages for a period of insurable earnings would depress the average and result in lower Employment Insurance benefits, thereby sometimes making it uneconomic to take a job with lower wages.

The new proposal in Budget 2012 greatly simplifies this messy system: "All claimants will have their Employment Insurance benefit amount calculated based on the highest weeks of earnings over the preceding year. The number of weeks that will be used will range from 14 to 22, depending on the unemployment rate in the particular Employment Insurance region" [Minister of Finance 2012: 148].

It is not clear whether this change will allow Employment Insurance applicants to choose the best of the number of weeks worked when they have worked more than the amount designated for their region, or instead whether the range of 14 to 22 weeks will also be an assumed minimum. It is also not clear whether this will be the best of 26 weeks or of 52 weeks (52 weeks is used in the designated economic regions). If, for example, it is an assumed minimum, then someone working, say, 10 weeks in a low unemployment region will have their average earnings calculated by dividing their 10 weeks of earnings by 14 weeks. On the other hand, if the 14 to 22 weeks range is not a minimum, then the change will increase many recipients' Employment Insurance benefits, although more so in high unemployment regions than in low unemployment regions.

In whatever way the weeks are calculated, this is one more measure favouring so-called high unemployment regions and maintaining, if not exaggerating, the current regional imbalances in Employment Insurance. The assumption seems to be that the difficulty in finding a job for a particular unemployed worker is primarily reflected in the local unemployment rate. This may have been more or less correct in 1945 when travel was difficult and extremely expensive so that labour markets were effectively restricted to small local areas, and when most workers used their muscle power and were, with just a little training, interchangeable. But this situation does not reflect today's Canadian labour market.

Labour markets are no longer local. Skills are not interchangeable. There is no reason to assume that a medical technician in St. John, New Brunswick, will find it more difficult to find a job than a medical technician in St. John's, Newfoundland, despite the differences in unemployment rates between those two cities. The factors determining how difficult it is to find a job for any individual are specific to their skills and employment record. The demand for these skills may be high or low – entirely independent of the average rate of unemployment.

The local unemployment rate relative to the national rate is no longer a good indicator of the relative difficulty of finding a job. It is discouraging to see that this obsolete and unfair system may be exacerbated by an expensive Budget measure. The simplification is welcome, but why not compromise between 22 and 14 and just use the best 18 weeks for everyone regardless of where they live?

Employment Insurance financing

For the last decade, the Caledon Institute of Social Policy has been pointing out that there are no functioning guidelines for financing the Employment Insurance program. Although Employment Insurance legislation sets out financing rules, these would have made premium changes so unrealistic – increasing payroll taxes when the economy is doing poorly and decreasing taxes when the economy is doing well – that the rules have never been used to determine the level of EI premiums. Instead, Cabinet has had to employ its override authority to determine premium rates on an *ad hoc* basis.

The 2012 Budget proposes a new financing regime for Employment Insurance. Over the next several years, the government will limit Employment Insurance premium increases to 5 cents per $100 of insurable earnings. The Budget estimates that this gradual rate of increase will last until the 2016-17 fiscal year. In each of those years, the Employment Insurance account is forecast to have a surplus, including the fiscal year just ended (2011-12). The financial projections are as set out in Table B [Minister of Finance 2012: 241].

The reason the Budget gives for the seemingly arbitrary scenario of five years of 5 cent increases and growing surpluses is to balance the Employment Insurance operating account against a deficit accumulated over a number of past years, notwithstanding that the choice of 'starting year' for the accumulated operating deficit is itself arbitrary and ignores the huge previous accumulated surplus. Supposedly, after the Employment Insurance operating account is 'balanced' in or around 2016-17, the Canada Employment Insurance Financing Board (which in the meantime would seem to have nothing to do) will set the rate annually at a level that would theoretically break even at the end of seven years, but with no greater change than 5 cents in premium rates per year.

Table B Employment Insurance operating account, in billions of dollars, 2011-12 to 2016-17						
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
EI premium revenues	$18.7	$20.1	$21.5	$23.0	$24.2	$23.6
EI benefits	$17.5	$18.7	$19.3	$19.3	$19.5	$19.8
Surplus	$1.2	$1.4	$2.2	$3.7	$4.7	$3.8

The Canada Employment Insurance Financing Board will doubtless engage an excellent interpreter of dreams to tell them whether the next seven years will be fat or lean. However, failing prophetic dreams as a guide to public policy, we are sceptical about the viability of the government's plan over the long run.

The long-run plan is not viable because the length and depth (or height) of business cycles are entirely unpredictable. The notion of keeping even a 'nominal' account that balances over some period – notwithstanding the Biblical resonance of the choice of seven years – is never going to work in the real world. Unless the Board had the exceptional ability to forecast a downturn in the midst of a boom, or vice versa, the government's plan would, in 2016-17, presumably have the Board reducing premiums in good times in order to 'balance the operating account over seven years.' This just will not happen. When the time comes to act, the government of the day will do what it must, just as has this government.

In short, this new financing rule has as little prospect of actually being put into practice as the financing plan it replaces. Instead, we should be realistic. A simple rule of thumb is that premiums should increase rapidly when unemployment is low and decrease rapidly when unemployment is high. In good times, Employment Insurance premiums should exceed Employment Insurance expenditures to create a surplus, and in bad times the opposite should happen.

In the meantime, assuming the economy keeps recovering slowly and inflation remains minimal, a few years of predictable 5 cent increases in premiums seems entirely reasonable. We are supportive of what the government is actually doing, while sceptical about what it says it will be doing.

Conclusion

Government investment should be shaped by a clear evidence base. Public funds should be directed toward amenities that improve the quality of life for all Canadians – not just those whose plates are already full. Above all, policies should help, not harm, the poor and unemployed.

Endnotes

1. While the maximum federal income tax savings is $75, some of the averages are higher because they include taxpayers claiming the Fitness Tax Credit for more than one child.

2. Old Age Security forms the first tier of Canada's pension system. Often referred to simply as 'the old age pension,' the Old Age Security (OAS) program is the foundation of our retirement income system. Old Age Security is made up of three parts: The basic OAS pension is paid to all Canadians 65 and over except for a small group of affluent seniors. The Guaranteed Income Supplement (GIS) is an income-tested benefit targeted to low-income seniors 65 and over. The Allowance is a payment to low-income seniors ages 60 to 64 whose spouse or common-law partner is eligible for, or currently receiving, Old Age Security and the Guaranteed Income Supplement. The Allowance is also paid to low-income widows and widowers ages 60 to 64 who have not remarried or entered into a new common-law relationship. The Allowance does not cover persons ages 60 to 64 who had never married or who had divorced or were separated.

   The basic Old Age Security pension is by far the largest part of the program, with a projected 5.1 million beneficiaries in 2012 receiving a total of $31.3 billion. The Guaranteed Income Supplement serves 1.8 million low-income seniors and sends out $9.4 billion. There are some 89,000 beneficiaries of the Allowance and their benefits will total $577 million in 2012.

3. Men in the lowest income quintile, at age 25 live, on average, 48.2 more years or 73.2 years in all, while those in the highest income group, at age 25, live an average of 55.3 more years or 80.3 years in all – 7.1 years more than the poor. Women in the lowest income group, at age 25, live 55.0 more years or 80.0 years in all, in contrast to 59.9 years for women in the highest income quintile or 84.9 years in all – 4.9 years more than the poor.

4. The three territories and all provinces except Nova Scotia, Prince Edward Island and Quebec provide income support programs for their low-income seniors.

5. Our thanks to Edward Tamagno, Caledon Policy Associate, for contributing this critique.

6. Other factors in the future decline in OAS expenditures relative to GDP, identified by the Office of the Chief Actuary, include expected slower growth in inflation compared to growth in the GDP and projected higher incomes [Office of the Chief Actuary 2011b: 10].

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