



The Post-Welfare State in Canada: Income-Testing and Inclusion

by

Ken Battle and Sherri Torjman

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Introduction

It has become accepted wisdom amongst both advocates and opponents of globalization that nation states are struggling to cope with powerful economic forces which challenge their power and do not respect political boundaries. Governments everywhere are trying to rethink their roles and reinvent their ways of operating.

Citizens are questioning what they get for their taxes. This is especially true in countries like Canada which have experienced the twin pains of substantial tax increases and cuts in spending – notably on social programs – in the effort to eliminate government deficits and reduce the growing debt burden.

There is no question that advanced industrialized nations face common challenges arising from profound economic, social and political changes. But the notion that globalization necessarily creates convergence in social policy as well as in economies is wrong. Differences in history, culture and political systems, to name a few of the more obvious factors, continue to shape both ends and means in social policy.

The Canadian social security system¹ shares some similarities with other countries, especially Anglo-American nations such as the UK and the US. But we do have a unique system of social programs with its own particular mix of objectives and instruments. These programs reflect such distinctly Canadian characteristics as our decentralized federal system of government, our two founding languages (French and English) and our long tradition of a free market economy tempered by collective provision through limited government intervention. In Canada, social programs seek to civilize, not replace, capitalism.

This paper is intended to offer our Russian colleagues insight into how Canada is transforming its social security system. The paper focusses upon the growing use of the methodology of income-tested targeting to replace both universal income benefits and needs-tested social assistance.

Core Concepts in Canadian Social Policy

Before examining major changes in Canada's social security system in its transition to a post-welfare state, we first explore some core concepts that underlie social policy in the industrialized world and their application in Canada.

The 'Why' of Income Security

All nations struggle with the concept of economic security and how to ensure that citizens have sufficient income to meet their basic and special needs. There are several key policy issues which countries must face in determining how best to meet these needs.

The first challenge is to identify the causes or contingencies against which financial assistance is deemed to be required. Most nations have some form of public income support to provide financial security for seniors and retired persons – generally defined for the purposes of income security programs as age 65 and over. The United States, however, counts 67 as the retirement age for its Social Security system. Canada makes provision for reduced earnings-related public pensions as early as age 60, though the income security programs that form the foundation of the retirement income system become available at age 65.

Retirement income benefits (described below) can be delivered and paid for in a number of ways. Indeed, Canada's retirement income system consists of several tiers supported through a combination of tax revenues, employer and employee contributions, and private contributions by individuals.

There is typically not much debate in industrialized countries as to whether nations should provide income protection for seniors. It is generally agreed that citizens considered no longer able to work are entitled to some form of income support.

But while there may be general agreement on the need for such provision, there is no end of debate as to how best to provide these benefits. Indeed, Canada has seen heated discussions over recent proposed changes to its system of public pensions. And the debate is only expected to get more intense over the years as cost pressures mount in response to growing demands from an aging population.

The second area around which there tends to be general agreement in industrialized countries has to do with income security protection in the event of disability. It is not highly contentious to have in place some form of income security program for persons who were born with or acquired a disabling condition that prevents them from earning full or partial wages.

But like pensions, the issue is not clear-cut. Controversy in the disability area arises around two major issues. First, if there is some capacity for paid work, then what are reasonable labour market expectations? How much labour market attachment should workers have before they are considered employable?

The second issue arises around the best way to provide such financial assistance. Should it be through some type of income guarantee? Should it be through a form of public or private insurance toward which the individual has contributed to a certain extent? Should it be through a combination of insurance and public guarantee that together comprise a reasonable income?

Nations first must come to grips with the question of what they are trying to achieve through the provision of disability benefits. Do they want to compensate for an accident or injury? Do they seek to offset the costs of the disabling condition? Do they wish to provide income security in recognition of current and/or future incapacity to work?

It appears that Canada has said ‘yes’ to all these questions. The disability ‘system,’ such as it is, is composed of a patchwork of programs, each of which is financed and delivered in a different way.

Income support to replace earnings lost due to unemployment is another common element in modern income security systems. But here too, controversy reigns and many countries have changed their programs to lower costs, reduce dependency and encourage return to the labour force. What proportion of earnings should be replaced? For how long? What about people who become chronic recipients of unemployment assistance? How long should individuals be required to work before they become eligible for unemployment benefits? How should these programs be financed?

Another issue with which industrialized nations grapple is the extent to which they should ensure the financial security of certain households because it is good not only for those households but also for the well-being of the nation. This type of payment is made not so much for the purposes of compensation for a predictable eventuality, such as retirement, or an unpredicted risk, such as disability. Rather, it is seen more as an investment in the citizens of the country.

Most of the industrialized world makes payments to households with children for this very reason – as an investment in the next generation whose well-being is essential to the economic prosperity and social health of the nation. Even here, not surprisingly, debates arise around delivery.

Should payments be made to all families with children or targeted to lower-income groups? Should the amount of benefits vary according to the age or rank of children, and the income of the family? Should benefits be paid only as a supplement to families’ earnings from paid work? How much is appropriate and on what basis should benefit levels be determined?

Canada is currently engaged in this debate and is still struggling with these questions as it seeks to develop and expand its system of child benefits. The issues around which major policy decisions must be made are discussed in the description of child benefits that follows.

As in the case of disability, the answers to these questions lie in the policy objectives that a nation seeks to achieve. If it wants to provide some compensation to all families in respect of the costs they incur on behalf of raising children, it likely will pay benefits to all households with children, regardless of family income.

If, by contrast, the nation wishes to tackle the problem of child poverty, then it likely will provide an additional or targeted benefit that delivers financial aid to households whose income falls below a certain level. Additionally, if a nation seeks to encourage paid employment, then it may choose to reward participation in the paid labour market through supplementation of low earnings.

Finally, most industrialized nations have in place some form of ‘last resort’ program of income support. This type of program provides limited income benefits when all else fails. Households have insufficient or no work earnings and have no private resources to meet their basic needs.

In Canada, the last resort program is known as social assistance, and is commonly referred to as ‘welfare.’ It is administered by 13 different governments – each province and territory operates its own unique welfare system with distinct rules and benefits.²

Welfare is easily the most controversial of all income security programs – it is the least popular from the perspective of public support. Being on welfare is often viewed as a personal failure. It certainly is a guarantee of poverty; all jurisdictions pay benefits that fall below generally accepted measures of low income.

The ‘How’ of Income Security

a. Eligibility criteria

Once nations have identified the policy objectives they seek to achieve, it is somewhat easier to determine how to deliver these benefits. We say ‘somewhat’ easier because decisions as to the provision of income security benefits are never simple or straightforward.

The following factors must be considered. First, will the provision of benefits create a disincentive to work? Does the possibility that the household is entitled to benefits affect in any way its participation in the paid labour force?

For example, one of Canada’s major income security programs, Unemployment Insurance, has been subject to criticism over the years. The program (described below) is intended to provide temporary income support in the event of unemployment.

But Unemployment Insurance has been criticized on the grounds that it fosters dependency and lengthens the duration of unemployment. It has been accused of being a poorly designed income support and regional equalization program.

Unemployment Insurance also has been blamed for undermining the work ethic and feelings of self-worth that come from work, thereby eroding individual and community initiative. The program is deemed to discourage self-employment and small-scale enterprise. Some say it compounds the unemployment problem of certain regions with a high degree of dependence on the program, such as the Atlantic region, due to a weak economic base dependent largely on the fishery.

Programs that comprise the disability income system are subject to the same scrutiny. If individuals are unable to work because of a disabling condition, they typically are considered to be 'deserving poor.' Questions rarely are asked as to whether they 'deserve' to receive income assistance. Rather, the debate arises over how much to pay and who pays.

But when individuals have some form of disabling condition yet are still able to do some paid work, the policy challenges become immeasurably more complex. A major challenge lies in balancing the provision of income security with support for workforce participation. Unless persons with disabilities can be sure that they can return to an income security program if their employment arrangement falters, they are unlikely to seek paid work.

But the greatest controversies typically arise around social assistance – the program of last resort. Welfare recipients generally are seen as the 'undeserving poor' because they have had to turn to this program to meet their basic needs. The receipt of welfare usually is interpreted to mean that they have some personal weakness which prevents them from finding or keeping a job.

The fact that social assistance is viewed in this light is a serious problem. Policy responses often take the form of punitive approaches that seek to move recipients off the system as quickly as possible and get them back to work. Governments may see their role as taking steps to 'free' welfare recipients from their 'dependency.' Taxpayers want to prevent 'undeserving' welfare recipients from getting money 'for nothing in return.'

These negative attitudes and stereotypes make it difficult to design intelligent and humane income security policy. But they also highlight the importance of seeking policy responses that are both acceptable from a public (taxpayer) point of view and stable from the perspective of the recipient.

In short, in designing income security programs or reforming any dimensions of a given system, it is essential to be clear about the policy objectives being sought. At the same time, it is

important to recognize that certain program designs will be more robust in the long-term – with respect to public support, political stability and adequate financing.

Another key aspect of income security design has to do with whether a given program is developed as a social insurance or as a tax-supported benefit. Social insurances and tax-supported benefits are discussed below.

b. Income program design

i. Social insurances

Social insurances provide income protection by pooling contributions against designated risks such as unemployment, retirement and accidents on the job. Benefits are paid if contributors or eligible workers fall victim to the risk from which protection has been ‘purchased.’

There are three major social insurance programs in Canada: Employment Insurance (formerly known as Unemployment Insurance); the Canada Pension Plan and its twin operated by the province of Quebec, the Quebec Pension Plan; and workers’ compensation. The federal government is responsible for the administration of Employment Insurance and the Canada Pension Plan. Provincial governments run their own workers’ compensation systems.

In theory, a social insurance program is expected to adhere to insurance principles. Individual contributors seek to protect themselves from the insecurities associated with a given risk.

In the case of Employment Insurance, workers are protecting themselves from the insecurity associated with unemployment. The Canada Pension Plan replaces earnings in the event of retirement or severe disability. Workers’ compensation provides protection against the financial insecurities arising from injury on the job.

These programs are insurance-like not only in intent – i.e., providing protection against risk. They are also insurance-like in design. Prospective beneficiaries make financial contributions to the program in order to build up a pool of funds. The pool then is used to make payments if the risk against which protection has been ‘purchased’ happens to arise.

Employment Insurance premiums are deducted directly from employee wages. Employers also pay a set percentage of their payroll in respect of Employment Insurance premiums. Self-employed workers are not eligible for benefits.

Under the Canada Pension Plan, workers contribute a percentage of their wages (up to about average earnings) as contributions (i.e., premiums). Employers match the employee contribution. The self-employed make twice the contribution as both employee and employer.

Workers' compensation systems that fall under the auspices of provincial governments function somewhat differently. Only employers are expected to contribute to this form of social insurance. It is basically a collective provision that protects employers from potential financial ruin in the event that an employee experiences a work-related accident and decides to launch a lawsuit for damages.

Because workers and employers make direct contributions to social insurance programs, there is an implicit understanding regarding eligibility for financial assistance. Workers who have made the necessary payments for the required periods of time expect to be eligible for benefits.

In practice, however, the eligibility criteria are not as simple as the contribution in/payment out process would imply. In addition to the required payments, other sets of rules determine eligibility for benefits.

In the case of Employment Insurance, for example, workers must have made contributions to the plan for a minimum number of hours. They are entitled to receive benefits for a set number of weeks. The duration of benefits varies by the rate of unemployment in the area in which the worker claims the benefits.

ii. Tax-supported income programs

Three types of income benefits are supported through general government revenues. These come from various forms of taxation – e.g., income tax, sales tax, property tax, and customs and excise tax. Tax-supported programs include universal, income-tested and needs-tested programs.

Universal programs

Universal income security programs provide benefits to all households that meet certain criteria – such as old age or presence of children – regardless of level or source of household income. Eligibility is not affected by the receipt of assistance from other income programs.

The Old Age Security program, for example, used to deliver benefits to all citizens aged 65 and over. Beneficiaries qualified on the basis of their age and Canadian citizenship. However, changes starting in 1989 moved the program from universal to income-tested, though benefits are reduced for or denied to only very well-off seniors.

Canada also used to have in place a universal system of Family Allowances. All families with children qualified for the monthly payment, whatever their income.

Universal programs are costly because they are designed to serve a large pool of the population. However, universal programs do not have to pay everyone the same amount of benefit.

In Canada, benefits from Old Age Security are subject to both federal and provincial income tax, as were (the now dismantled) Family Allowances. The programs sent the same benefits to all seniors and the same benefits to all families with children.

But the real value of the benefits (after paying income tax on them) was progressive. It decreased with seniors' and families' marginal tax rate. The poor got the full amount while the well-off ended up with only about half the benefit.

Governments also can lower the costs of various income programs by adding to the list of eligibility criteria an element of 'need' in the form of income-tested and needs-tested benefits.

Finally, two of Canada's social insurance programs – Employment Insurance and the Canada/Quebec Pension Plan – are universal in the sense that level of income does not affect eligibility. Both are progressive because benefits are taxed.

Income-tested programs

All of Canada's tax-supported income security programs, including the new Canada Child Tax Benefit, the trio of federal benefits for seniors (Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance) and the refundable Goods and Services Tax credit, are delivered on an income-tested basis.

Income-testing narrows the range of recipients that potentially qualify for benefits. It also determines how much they receive.

Households whose net incomes fall below a level or ‘threshold’ receive the maximum benefit. Above the threshold, benefits are reduced as income increases. The ‘reduction rate’ is the amount by which benefits are reduced as income rises. Benefits end entirely when net incomes exceed a designated amount, known as the ‘cut-off point.’

Needs-tested programs

Needs-tested benefits narrow the range of eligibility even further. Needs tests are used to determine eligibility for a given benefit and also may be used to determine level of payment. Social assistance is the major needs-tested program in the country.

Needs tests are employed to determine the presence and extent of household need. They do this first by determining whether households qualify on the basis of their liquid and fixed assets. ‘Liquid assets’ include cash and other cash-convertible securities, such as bonds. These liquid assets must fall below designated levels.

An assessment also is made of the household’s ‘fixed assets’ such as house, car or equipment and tools. These assets must fall below certain levels in order for households to qualify for benefits.

If both liquid and fixed assets are in the permissible range, the next step in the needs-tested process is to determine the total income available to the household. Possible sources include earnings, income from self-employment, interest and dividends from investments, rental income and private sources.

Total income is then assessed against household need. The latter includes both basic requirements and special needs.

Basic requirements consist of essentials such as food, clothing, housing and utilities. Family composition is also taken into account (i.e., benefits vary by family size and by number and ages of children). Special needs refer to health- or disability-related requirements such as special eyeglasses, hearing aids, wheelchairs, medications and orthotic appliances.

c. Assessment of program design

The advantages of social insurances include the fact that they are intended to provide efficient, effective and fiscally responsible income replacement for the workforce. In theory, there is

a sense of fairness and reciprocity. Workers who have made the required payments receive their entitlement if and when the given risk against which insurance was ‘purchased’ happens to arise. The use of collective provision offers economies of scale and efficiency over private, for-profit insurance.

Recent policy changes that substantially have curtailed entitlement to Employment Insurance, the Canada Pension Plan disability benefit and workers’ compensation have been criticized as negative changes. They are negative not just from the perspective of potential beneficiaries who receive lower entitlements or nothing at all. The policy changes are deemed negative in that they decouple contribution from entitlement. They basically destabilize the ‘social contract’ that allows for continued public support of social insurances.

Public confidence in Employment Insurance, for example, has been shaken by the fact that just over one-third of unemployed workers in Canada currently receive benefits under the program. There is a general feeling that workers are not getting what they are paying for. They pay into the program when they are working, but most get nothing in return when they become unemployed.

Income-tested programs have their own unique advantages. They are seen to be objective, administratively simple and nonstigmatizing. Eligibility can be established easily through the income tax form. There are no decisions made on the basis of a detailed assessment of personal circumstances. There is little or no contact between recipients and government officials. Once eligibility is established, payments can be triggered automatically by computer. Benefits can be delivered on a consistent and equitable basis throughout the country.

The major disadvantage of income-tested programs is that they do not take into account any special needs or circumstances that may give rise to additional expenses. Households with high incomes may receive no benefit (e.g., the Canada Child Tax Benefit) even though they may incur high costs related to the special health or educational needs of a given child. Canada’s income-tested programs adjust only after the fact – as long as 18 months – to a change in family income.

This very weakness of income-tested programs is the key strength of needs-tested benefits. The latter take into account not only income levels but also special circumstances that may give rise to exceptional costs.

The primary disadvantage is that needs-tested programs are considered ‘intrusive.’ They require extensive information to determine eligibility for income benefits. They employ administrative discretion in which personal judgment is applied to assess the circumstances of households and their extent of need. Applicants in one region or jurisdiction may qualify for benefits while those in similar circumstances in a different province may not.

Income Security Reform in Canada

The breadth and pace of change to social programs in Canada are quite out of keeping with the country's traditionally modest national character. Its social security system has been undergoing nothing less than a transformation that began in the late 1970s, gathered steam in the 1980s, accelerated in the 1990s and continues in this first decade of the new century.

This paper emphasizes the development of the technology of income-tested targeting and its displacement of traditional universal and needs-tested techniques. But this innovation must be understood in the broader context of major changes in other social programs, including social insurances as well as social, employment and health services.

This paper first describes the 'universalist' model that inspired the development of the post-World War Two system of social programs in Canada. We contrast the universalist model to the 'residualist' model that predated it but has never completely disappeared even to this day.

The reality of Canadian social security provision never fully realized the universalist vision. Yet this model continues to dominate the thinking and rhetoric of trade unions, social advocacy groups, the left of the ruling Liberal Party, Canada's New Democratic Party and academics who teach social work and social policy.

We refer to the new model that is emerging in Canada and countries such as the UK as the 'post-welfare state.' It continues to pursue the same fundamental objectives of social policy set out in the universalist model more than half a century ago. But the post-welfare model seeks more effective mechanisms better suited to the changing economic, social and political realities of the new century.

The emerging post-welfare model recognizes that governments cannot do it all on their own. The model emphasizes the need to help nongovernmental actors – e.g., employers, unions, communities and social groups – play a more active role in the design and delivery of social programs.

The post-welfare model draws upon the residualist philosophy of voluntary action – or 'civil society.' Thus the new social policy in Canada is about better achieving the goal of 'civilizing capitalism.' And the purpose of social policy remains as highly relevant in the post-industrial era as in the industrial age that both demanded and enabled the rise of collective social provision.

The Canadian version of the post-welfare state is very much an emerging work in progress. Our system still contains elements of both the universalist and residualist approaches. However, we can identify several key concepts of the post-welfare approach as it is being developed in Canada:

- broad based and progressive income-testing replaces universality in income security policy (but *not* services)
- attention to unintended work disincentive effects (both real and imagined) of social programs – e.g., marginal tax rate issue regarding income-tested social benefits
- attention to interactions and links between social programs and the tax system
- desire to balance ‘active’ and ‘passive’ social programs; between reactive and preventive approaches
- concern to harmonize federal and provincial social programs, reduce duplication and overlap, work together (as explained below, by means of partnership federalism through the Social Union process)
- concern about the financial sustainability of social programs
- recognition that there are several players (public, private sector and voluntary) in social policy, and the need to better utilize and combine their resources through partnership
- increasing recognition that communities have a major role to play in social policy design as well as delivery
- emphasis on the economic functions of social policy, especially in education and training to ensure a competitive workforce, and in supplying the social infrastructure (e.g., universal health care; education) that supports economic growth and attracts a talented workforce
- emphasis on the need to measure the outcomes of social policy and on social reporting made available to the public and social advocacy groups.

The emerging post-welfare state in Canada is by no means free of controversy. Despite the renewed emphasis on the role of civil society, nongovernmental social groups generally have opposed the new approach and its thrust to replace the old universal and needs-tested income assistance with the new methodology of income-tested systems.

The Universalist Model of Social Policy

Canada's social safety net was created largely in the second half of the 20th century. But it was inspired by the work of social reformers in the 1920s, 1930s and 1940s. They provided the philosophical and programmatic foundation for the 'universalist' model of social policy. That model strongly influenced the politicians and civil servants who created most of Canada's social programs in the 1950s, 1960s and early 1970s. It still inspires and shapes the thinking of social groups in particular and the 'left' generally in Canada.

The universalist model of social security developed out of opposition to the 'residual' philosophy of social policy that predominated until the Great Depression of the 1930s. The residual approach is based on a *laissez-faire* view of society that sees the private market as dominant. The approach believes that government should play a limited role in altering the production and distribution of income, goods and services. People should obtain their income from work in the paid labour force or from capital.

If, for whatever reason, that normal source of income disappears (e.g., because workers lose their job or retire) or is inadequate (e.g., because of low wages), then they should look for another job or rely on their savings. Failing these options, they must appeal to family, friends or charity. At most, government should serve only as a last resort for temporary and emergency assistance, and only for the poor and destitute.

The universalist welfare state is founded on the conviction that government has a legitimate and major role to play in altering the market economy's unequal distribution of income, wealth and opportunity. Industrialization brings increased prosperity and a better standard of living for most. But the private market cannot on its own eliminate risks to economic security from unemployment, low wages, illness, disability and old age.

Nor can the traditional private institutions of the family, church or charities adequately support families and individuals in need. The risks and insecurities of a modern economy and society cannot be borne solely by individuals on their own, their families or private institutions. The state has a responsibility to protect and compensate citizens from income loss or inadequacy, and to ensure universal access to essential education and health care. These two items have been judged too important to leave to the private market.

The state discharges these responsibilities mainly through social programs – income supports, social services, employment programs and health care. However, economic policy and the educational system also play an essential preventive role by reducing unemployment, encouraging

economic growth and investing in human capital. Social programs should be the first line of defence against economic insecurity, not the last resort.

The universalist model regards social benefits as rights to be granted to citizens according to objective criteria of need. These benefits are not privileges to be handed out at the discretion of welfare administrators after an exhaustive investigation of applicants' needs. The model envisages a much broader set of social programs than does the residualist approach, pursuing several objectives and directed to large segments of the population, not only to the poor.

The prevention and alleviation of poverty remain fundamental goals of universalist social policy. But social programs are also intended to help maintain living standards for non-poor citizens experiencing income interruptions. They help compensate for the extra expenses incurred by families raising children and by persons with disabilities. Social and employment services ensure that citizens can participate more effectively in modern society and cope with economic disruptions and changes. Social programs provide universal access to essential health care.

As its name suggests, the universalist model is based on a foundation of universal social programs such as public pensions, child benefits and health care. These should be available to Canadians in all income groups. Eligibility should not be affected by the receipt of assistance from other income programs. By delivering benefits to all, universal social programs are said to foster widespread public support for the social security system – including programs that are not universal but rather are targeted to poor and modest-income Canadians.

Strictly speaking, universality refers to social programs that are available to all recipients regardless of income. However, universal income programs do not have to provide the same level of benefit to all. In Canada, universal income payments (e.g., old age pensions, Family Allowances and contributory public pensions) have been counted as taxable income. This means that the amount of benefit decreases as taxable income increases.

Universal programs can employ qualifying criteria than other income, such as age in the case of public pensions and dependent children in the case of child benefits. Universal programs can be funded either out of general revenues or through payroll taxes levied on employees and/or employers. (General revenues refer to the money governments collect through income, consumption and property taxes, and other levies.)

Though universal social programs naturally loom large in the universalist model of social policy, there also is an important role for programs that do take applicants' level of financial need into account. Social programs that are not universal – sometimes called 'targeted' programs – are intended to serve people in specified income ranges. Usually, the programs target low-income or low- and middle-income groups. But there are some benefits (e.g., income tax deductions for

contributions to occupational pension plans and individual retirement savings plans) that exclude the poor and deliver their largest payment to upper-income taxpayers.

There are two very different types of targeted social programs: ‘Needs-tested’ social programs, notably social assistance, impose a detailed and intrusive test of applicants’ resources including earnings, assets and needs. ‘Income-tested’ programs, such as the Canada Child Tax Benefit, require only a simple and non-intrusive test of applicants’ income based on their annual income tax return. We will explore this crucial distinction later in the section on social assistance and child benefits.

Growth of the Universalist Welfare State

Building the Welfare State

The universalist model gained ground in the 1930s and 1940s. But it took two cataclysmic events – the Great Depression of the 1930s and the Second World War – to move Canadian social policy from theory to reality.

The first major income security program was introduced in 1914. The province of Ontario brought in a workers’ compensation system to deal with problems faced by employees, employers and the legal system in cases of on-the-job injury. This program was established as a social insurance paid for by employers. They could claim compensation in the event that the risk – in this case work-related accident or injury – actually occurred. Other provinces soon followed suit.

The federal government entered the social policy field in 1918 when it introduced the children’s tax exemption one year after the wartime creation of the income tax system. (This exemption subsequently was converted in 1988 to a nonrefundable child tax credit.) The original tax exemption allowed modest tax relief in recognition of the additional costs of raising children. Because this tax break was targeted at parents who owed income taxes, most families did not qualify for this assistance. Most families at that time had low or modest incomes and so did not owe income taxes.

The provision of benefits for the elderly was another early and vital building block of Canada’s income security system. Various provinces had been paying benefits to poor seniors over age 65. In order to increase these payments and to reduce disparities in rates across the country, the federal government began to share the cost of these pensions under the Old Age Assistance Act of 1927.

In addition to workers' compensation and elderly benefits, some local governments throughout the country provided financial aid for emergency purposes. This was the earliest form of public social assistance provision in that it made available financial aid as a last resort in the absence of other resources. The amount of assistance varied widely because local governments were responsible for determining both the eligibility criteria and level of benefits.

It was only when the country faced devastating economic and social circumstances in the 1930s that a national system of protections began to evolve. Close to one-quarter of Canada's working-age population was unemployed. Local governments were going bankrupt because they could not meet the unprecedented demand for financial aid. Provincial governments were equally hard pressed.

One of the tough lessons of the Depression was that existing income security provisions – rooted as they were in the residualist model – were inadequate to meet the challenges posed by high unemployment. It generally was recognized that a senior level of government had to become involved in order to ensure that benefits were provided at a reasonably adequate level and in an equitable fashion. Only the federal government had the fiscal capacity to ensure basic income security for such a large proportion of the population across the country.

The federal government took steps to tackle the widespread effects of unemployment by introducing the Employment and Social Insurance Act of 1935. Despite the need for a strong national program, provinces challenged the authority of the federal government to introduce this piece of legislation. The challenge resulted in an *ultra vires* (outside the authority) judgment by the Supreme Court.

Ottawa³ persisted in this area, knowing full well it could not allow a repeat of the economic devastation the country had endured during the Depression. A Constitutional amendment adopted in 1940 permitted the federal government to provide benefits for persons temporarily out of work under the newly introduced Unemployment Insurance Act. This program has evolved over the years, expanding until the early 1970s and since contracting. (Its current design is described below under Employment Insurance.)

The onset of World War Two and its mobilization of the nation's resources in the war effort brought another important reason for the federal government to become involved in the income security system: to stimulate the economy and thus prevent a recession when wartime production ceased. Households had to have sufficient purchasing power in order to help rebuild the postwar economy.

In 1945, the federal government introduced Family Allowances which paid an equal monthly benefit to all families with children. Its purpose was to recognize the extra costs related to child

rearing and to bolster the postwar economy by regularly putting cash into the hands of consumers – specifically mothers.

Ottawa added the income-tested refundable child tax credit in 1978 to provide additional financial assistance to low- and middle-income families with children. In 1993, the income-tested Child Tax Benefit replaced Family Allowances, the nonrefundable child tax credit and the refundable child tax credit. In 1997, the Canada Child Tax Benefit simplified and increased payments under the federal-provincial National Child Benefit reform, described below.

In the area of pensions, it was noted earlier that various provinces had paid benefits to persons over the age of 65. In order to raise these payments and reduce the disparity in rates across the country, the federal government began to share their cost under the Old Age Assistance Act of 1927.

Old Age Assistance was a means-tested program that paid benefits according to the income and assets of recipients. ‘Means-tested’ refers to the fact that applicants had to qualify not only on the basis of their age but also their level of income and available liquid assets. (‘Liquid assets’ refer to cash or cash-convertible assets, such as bonds. The value of fixed assets, such as a house, is not included.)

The program was replaced in 1952 by Old Age Security – a federally financed and operated program that paid monthly benefits to all Canadians age 65 and over, regardless of income or work history. The expanded role of the federal government in this area was not possible without a Constitutional amendment. It allowed Ottawa to use its spending power to pay for pensions – formerly seen as the primary domain of provincial governments.

A Constitutional amendment was not required for the earlier cost-sharing arrangement under the Old Age Assistance Act of 1927 because the provinces still maintained full control of their respective programs. Two income-tested programs – the Guaranteed Income Supplement for poor seniors and the Spouse’s Allowance for poor near-aged spouses and widowed persons – were built on top of universal Old Age Security. About half the provinces added their own income-tested supplementary programs for their aged poor.

In 1966, the federal government created the earnings-related Canada Pension Plan (Quebec built a parallel Quebec Pension Plan). The Canada Pension Plan is financed and administered by Ottawa. But it is a joint federal-provincial effort whose change requires agreement of three-quarters of the provinces with three-quarters of the population. Together, the Canada and Quebec Pension Plan cover virtually the entire workforce including the self-employed, and provide a package of retirement, survivor, disability, children’s and death benefits.

That same year, the federal government stepped into another large area of social policy – provincial welfare and social services – through the introduction of the Canada Assistance Plan (CAP). CAP was intended to achieve several objectives. It helped consolidate the existing patchwork of provincial programs that provided benefits to various categories of recipients: single-parent mothers, persons with disabilities and blind persons.

The Canada Assistance Plan shifted the provision of financial assistance from *cause* of need to *presence* of need, regardless of cause. The injection of federal funds through CAP helped build an infrastructure of welfare and social services throughout the country. Unlike Unemployment Insurance, Old Age Security and child benefits, which Ottawa operated directly, the Canada Assistance Plan allowed the federal government to share the cost of welfare and social services designed and administered by the provinces.

Reality Versus Theory

The rise of the universalist theory of the welfare state and the remarkable growth of social programming did not, however, produce a fully-fledged universalist welfare state in Canada. The history of our social policy does not indicate a steady shift from the residual to the universalist approach.

Even before the spending cuts of recent years, Canada's social security system fell a good distance short of a fully realized universalist model. The system remains instead an uneasy compromise of elements from both the residual and universalist concepts whose influence has ebbed and flowed over the years. The residual approach's grudging attitude to social spending naturally gains strength during tough economic times, when social programs' alleged high cost makes them vulnerable to attack.

Canada never pursued, let alone realized, the goal of full employment that plays a pivotal role in the universalist model. This limited employment objective was increasingly diluted over time. 'Acceptable' levels of unemployment rose as governments after 1975 saw as their priority fighting inflation over unemployment and pursued restrictive fiscal and, especially, monetary policies.

Granted, much of the universalist vision of social policy *was* put in place between the 1940s and 1970s. Canada's network of social programs grew enormously in content, coverage and cost. In addition to the numerous federal and provincial income programs mentioned above, universal health care ('medicare') was built between the late 1950s and early 1970s, under the jurisdiction of the provinces but with federal financial assistance tied to national conditions.

It was during that period that both the federal and provincial levels of government became involved in social housing. Ottawa cost-shared provincial social services and provided funds to the provinces for health and postsecondary education, as well as establishing the Canada Student Loans Program for postsecondary students. The federal government created the Vocational Rehabilitation of Disabled Persons Act. Both federal and provincial programs for training, counselling, direct job creation and other employment services were developed. The income tax system became a favourite vehicle for dispensing a variety of social and economic benefits, technically known as ‘tax expenditures.’

But Canada never achieved the universalists’ dream of a comprehensive set of social and employment programs that would protect citizens against the various risks of contemporary life and provide a decent minimal income. With the notable exception of income security programs for the aged, the objective of ensuring a ‘social minimum’ (i.e., an adequate income floor) was neither attempted nor achieved.

Social assistance, in particular, is a major social program that remains resolutely residualist. It has never been governed by substantive national standards. It embodies meagre and widely varying benefits, poverty traps, punitive administration and social stigma. The wartime proposal for a federal program for unemployed workers who do not qualify for or who exhaust their Unemployment Insurance benefits never came to pass. As a result, many jobless Canadians end up on provincial welfare.

Neither is there a comprehensive income security system for persons with disabilities, many of whom have to rely on social assistance. Canada’s medicare system never expanded as planned by its creators to cover a wide range of preventive and community-based services. Policy-makers are only now beginning to address this weakness.

***Roots of Reform:
Canadian Context***

Pressures to reform Canada's social programs have arisen out of several profound changes – economic (fiscal and labour market), social and political.

Economic Changes

The major expansion of Canada's social security system ended in the mid-1970s. A federal proposal to supplement the incomes of the working poor was defeated. Canada's economic growth began to sputter with the world oil price shock and the rise of low growth and high inflation.

Mounting government deficits and accumulating debt pushed Ottawa and the provinces increasingly to reduce public – especially social – spending in the 1980s and 1990s. The forces of social policy reform-through-restraint gathered strength as Ottawa managed to convince most Canadians that the deficit had to be cured no matter how bitter the medicine.

Canada's long retreat from any semblance of a full-employment economy has been one of the heaviest pressures on the welfare state. It is the main reason for the divergence between the theory and practice of universalist social security.

Rising unemployment has placed high demands on welfare, Unemployment Insurance, social services and employment services, health care and other social programs. To make matters worse, mass unemployment has robbed federal and provincial treasuries of badly needed tax revenues, and resulted in hikes in income taxes, consumption taxes and payroll taxes.

Canada's official unemployment rate has fallen considerably over the past few years. But the real unemployment rate remains high. (The 'real' rate counts those who have given up an active job search or are working part-time because they cannot find full-time work.) There are still regions and communities afflicted by chronic joblessness.

Like the US, Canada's labour market is characterized by a growing split. There is a core of good jobs requiring advanced education and specialized skills in return for good pay, career advancement, and generous pension and other work-related benefits. At the same time, there is a 'nonstandard' labour market for part-time, seasonal and temporary employees, the self-employed and people who hold down multiple jobs. Its characteristics are the opposite of the core workforce – low skills, poor pay for many, instability, few if any work-related benefits such as supplementary health care and dim career prospects.

There is evidence of earnings polarization, with growth in both lower-paid and higher-paid jobs, and shrinkage of middle-income employment. The latter includes many well-paid blue-collar jobs in traditional industries, such as manufacturing and transportation, which have been victims of technological change. Middle-management positions have been cut in the downsizing of public and private bureaucracies.

Canada also has seen a growing polarization of working time. Hours of work are increasing for some full-time workers who tend to have high incomes. At the same time, there has been a growth of part-time work, much of it involuntary and most producing low earnings.

Social Changes

Social and demographic changes also are rocking Canada's social security system. The typical family of the 1950s and 1960s – father in the labour force, mother working at home, three children – has been transformed by profound changes in the economy, society and culture.

A growing number of Canada's families feel insecure and vulnerable. Many turn to social programs for support at the same time that governments have been cutting back on funding for those very programs.

One of the most significant changes in the family arises from the dramatic increase in women's participation in the paid labour force since the 1960s. In seven out of every ten couples with children, both parents work outside the home. Nearly two-thirds of married women with children under age 6 are in the labour force. The majority of single parents are now in the labour force as well.

Not only are most parents employed, but an increasing number are working longer hours on the job in order to make ends meet. They have less time for housework, shopping and the other domestic labour required to maintain a household – not to mention time to spend with their children. Juggling the dual and sometimes conflicting demands of their responsibilities as workers and parents is a stressful and tiring daily struggle for most parents. The burden is especially hard on mothers, who continue to shoulder most of the responsibility for caring for children and housework

Another major stress on today's families is the high rate of marriage breakdown and remarriage. Canada has one of the highest divorce rates in the world, along with Sweden, Denmark and the United Kingdom. Four in ten marriages end in divorce, though seven in ten divorced Canadians get married again. More and more parents and children have to adjust to life in 'blended' families from two previous marriages.

Divorce and separation also create single-parent families. One out of every five families with children is now headed by a single parent, most of whom (82 percent) are mothers. Single parents not only have to carry most, if not all, of the burden of caring and providing for their children. They also run a high risk of poverty. Six in ten one-parent families led by women live on low incomes. Many (42 percent) end up on welfare, although the majority of single parents work in the labour force, typically in low-wage jobs.

Families are smaller today; most have only one or two children. Unlike earlier generations, they cannot rely upon older children to help take care of their younger brothers and sisters. Families also move more often, so many are isolated from traditional support networks of relatives.

These social changes are placing heavy demands on Canada's social programs – welfare, child care, child welfare and health care – which were not built for the world of the 1990s. An added stress is the aging of the population, which will place increasing pressure on the pension system, social services and health care as the baby boom generation reaches old age.

Moreover, these demographic, social and economic forces are additive. Divorce, unemployment and low earnings threaten to condemn a growing group of Canadians to poverty in old age. Child poverty brings an above-average risk of a range of health problems, accidents and below-average school performance. These risks can work against poor children when they reach adulthood, resulting in a greater likelihood of unemployment and low wages, increased demands for social programs and lost tax revenues.

Political Changes

Political changes also have motivated and shaped changes to social policy and challenged the universalist model. The Keynesian-inspired civil servants and politicians who designed and built the postwar welfare state have long retired. They have been replaced by neoconservative bureaucrats, especially those in the federal Finance Department that has dominated social policy over the past two decades. Both financial and political elites in Canada have proved more conservative than the general population, and more supportive of cuts to social spending and taxes.

The major social policy changes made by the Conservative government in the 1980s built a momentum that prepared the way for even more radical changes by the Liberals in the 1990s and into the new century. The Conservatives proved that the universalist welfare state was no longer a 'sacred trust,' if it ever had been. Polls taken for the Social Security Review, which the Liberal government undertook in 1994-95, found that a majority of Canadians believe that social programs require substantial change.

Central to this readiness for social security reform was the Conservatives' successful campaign in convincing Canadians about the serious problem of the mounting debt and the need to put the nation's finances in order. In addition, federal cuts to Unemployment Insurance and to social transfer payments to the provinces under the Conservatives began to break down traditional resistance to federal social policy change from the provincial governments. So the Liberals have advanced the move towards the post-welfare state that was begun by the Conservatives.

The other political factor that has played an important part throughout the history of Canada and its social programs is federalism. For much of the postwar period, Ottawa played a leadership role in the distribution of power and influence over social programs as between the federal and provincial governments. But the pendulum has been swinging back in the 1990s and first decade of the new century. The two levels of government now play equally important roles. This power shift is so important a force in understanding the current reforms to Canadian social policy that it merits a somewhat longer explanation.

Canada is a federated structure whose governance framework is set out in the British North America Act of 1867. The framework was supplemented by the introduction of the Constitution Act in 1982.

Under the British North America Act, the federal government was designated as responsible for the "peace, order and good government of the country." The Act confers a federal spending power that allows Ottawa to make payments to individuals, institutions or other governments for purposes that the national Parliament does not necessarily have the power to regulate. The federal government claims that this Constitutional interpretation gives it the power to spend money and attach conditions to these funds even if the purposes fall within the clear purview of the provinces.

This constitutional interpretation has resulted in the following division of powers. The federal government is responsible for issues of national and international concern. Primary federal areas of responsibility include customs, foreign policy, fisheries and oceans, communications and transportation. Provinces, by contrast, are concerned with municipal issues and services to people such as health, education, welfare and social services.

Ottawa generally has jurisdiction over areas that affect the well-being of the entire nation, including the armed forces, international trade and communications. The federal Department of Human Resources Development is responsible for several national income security and employment training programs, although the latter recently have been devolved to the provinces. (The province of Ontario has not yet signed a bilateral labour market agreement with Ottawa.) Both the federal and provincial governments are involved in the areas of justice, finance, revenue and transportation.

In the area of transportation, for example, the distinction in jurisdiction is made along the lines of scale. Transportation concerns that apply to interprovincial or international travel lie in the federal domain. By contrast, provincial and, in some cases, municipal governments are responsible for local or intra-provincial transportation.

Constitutional responsibility for health and welfare-related issues was accorded clearly to the provinces. The jurisdictional split when it comes to income programs is more complex.

In the area of income security, the federal government has responsibility for certain income programs. For example, it takes primary responsibility for the major programs deemed to be social insurances – namely Employment Insurance and the Canada Pension Plan. Even here, the issue is not ‘neat’; the province of Quebec runs a sister program called the Quebec Pension Plan and significant changes to the Canada Pension Plan require the agreement of a majority of the provinces. Provincial governments administer workers’ compensation programs as well as last-resort social assistance programs.

The federal government is responsible as well for the delivery and costs of the three key elderly benefits: Old Age Security, the Guaranteed Income Supplement and the Spouse’s Allowance. Ottawa also pays for and administers the Canada Child Tax Benefit. And the federal government effects a significant redistribution of income through a progressive income tax system. It both collects revenues and distributes social benefits through refundable credits, nonrefundable credits and deductions.⁴

Social Union Framework Agreement

The division of federal and provincial powers has been influenced in recent years not only by the terms of Canada’s Constitution. The division of powers also has been shaped by a new commitment signed in February 1999 entitled the Social Union Framework Agreement.

The Agreement sets out the basic rules for how these two levels of governments should work together in future. It is intended to promote a respectful and collaborative approach to resolving major social issues that are not clearly defined as exclusively federal or provincial. It also seeks to ensure that governments act more responsibly with public funds.

A key feature of the Social Union is that work in any substantive area should be conducted in a collaborative fashion. Ottawa alone no longer should spell out the rules with which provinces must comply to receive federal funds. Rather, the Social Union intent implies that any rules, whether in the areas of funding, program delivery or reporting, should be set jointly by the federal and provincial governments.

But this concept of governmental ‘equality’ does not negate the fact that one party may be a more appropriate delivery agent than the other in certain areas. The federal government, for example, is best suited to support income programs because it is able to ensure the same benefits for all Canadians.

Ottawa also has the capacity to generate the revenue required to provide adequate and equitable benefits throughout the country. The provinces, by contrast, are better equipped to deliver health care and social services. These can be tailored to individual need and regional differences.

The thinking that shaped the Social Union negotiations viewed federal and provincial relations as a partnership in which both levels of government have an important role. Partnership effectively results in different responses to the same problem. It can give rise to differences across regions in the same policy area. The resulting variability throughout the country is seen not only as inevitable. It is also viewed as desirable as jurisdictions work within their respective fiscal and political priorities.

Another important element of the Social Union Framework Agreement is the concept of public accountability. All governments are seen as accountable both individually and collectively to the public and to groups that have a special interest in certain issues, such as services for children or supports for persons with disabilities.

In short, the Social Union is intended to operate effectively in three spheres. First, it is concerned with the reform of social programs. Second, it is a means of renewing the Canadian federation through new forms of intergovernmental relations. Third, it is intended to encourage public accountability.

***Roots of Reform:
International Context***

International ‘themes’ and comparative research also have had an important impact upon the shape of income security in Canada. The work of the Organization for Economic Co-operation Development (OECD), in particular, has encouraged investment in active programming. This programming seeks to discourage dependence on income support programs and to encourage links to the paid labour market.

In the mid-1980s, the OECD identified as a problem the heavy provision of so-called ‘passive’ income support for the unemployed. Since then, it has monitored regularly the expenditure of member countries on active and passive labour market programs. The OECD *Jobs Study* included a list of more than 60 policy recommendations for strengthening active labour market policies.

The theme of active programming was embraced by Canada’s Social Security Review in the mid-1990s. The concept certainly influenced the major outcome of the Review: the shift from Unemployment Insurance to Employment Insurance and the associated move toward active labour market measures (described below).

The concept of active programming also has reshaped provincial welfare systems in Canada. All jurisdictions have introduced measures to encourage the transition from ‘dependency’ to ‘self-sufficiency.’ The ‘active’ programs have different titles such as the Supports to Employment Program in Newfoundland, Ontario Works, Employment First in Manitoba, the Saskatchewan Training Strategy, Supports for Independence in Alberta and Productive Choices in the Northwest Territories. Despite the differences in name, the intent is the same: to find ways to help move recipients off welfare and into the paid labour market.

The OECD also has conducted research on the ‘passive’ side of the income equation. A three-volume OECD study on social exclusion and social assistance presents an in-depth comparison of welfare systems in ten member countries, including Canada.

The study found that all the countries experience a serious common problem: Many households find little financial reward from working. The welfare taxback rates on increased earnings are higher than in any tax regime. Social assistance provides in-kind benefits, a fact that makes it difficult to leave the program. Recipients who leave welfare have work-related expenses such as clothing, transportation and child care. Their wages are reduced by Canada Pension Plan contributions, Employment Insurance premiums and income taxes.

When all factors including income taxes, payroll taxes, work-related costs and loss of in-kind benefits are taken into account, many recipients are better off on social assistance than at work. OECD countries effectively face the same policy challenge with respect to social assistance: how to balance its 'safety net' function with its work incentive function.

One way to resolve this tension between the active and passive dimensions of welfare is to reframe the challenge. The real challenge is not how to redirect money away from social programs that create 'dependency.' The real challenge is to find ways to help low-income households enter and stay in the labour market. In our view, this central challenge can be resolved through work on two related policy areas *outside of social assistance*: family policy and employment support.

Family policy includes both income support and services. One method of assisting low-income households is by directing more money to lower-income families. The pioneers who constructed Canada's income security system saw a key role for child benefits in filling the gap between wages and income needs for low- and modest-income families.

Working families also need a wide range of social and health service supports to enhance their parenting capacity, ease the conflicts between work and home, and help deal with problems that income alone cannot solve. Child care, early childhood development and supplementary health care are key items among a range of positive supports for families with children.

Another problem arises from the fact that prospective workers often are blocked from entering the labour market because of the costs associated with return to work. These include transportation for job interviews; work clothing; license to drive a vehicle for work purposes or to operate equipment; professional dues or license fees; and work tools or protective gear. There is a need for financial assistance for the transitional period during which the unemployed establish themselves in the labour market.

In short, the key policy responses with respect to the reform of social assistance lie outside social assistance. Canada's approach in this regard is discussed in the next section.

Overhaul of Social Assistance and Child Benefits

Almost all major social programs in Canada have undergone or are in the process of experiencing changes in the transition from the universalist to post-welfare state. Some of these shifts have been incremental, though a series of such seemingly modest changes over time can add up or lead to more significant structural reform. Other changes have been more immediate and radical.

The most dramatic reform in income security in recent years involves an overhaul of the social assistance and child benefits system in Canada. As noted, social assistance has been plagued by numerous problems over the years and is the subject of ongoing attack – both by governments that support it and by a public that, for the most part, resents the expenditure of tax revenues for this purpose.

The child benefits system required reform for different reasons. It was a patchwork of several programs intended to achieve various purposes.

The reform discussed below has resulted in a reconfigured social assistance and child benefits system. It means that the bulk of income security benefits paid to Canadian families are delivered on an income-tested basis. Income testing has become, in effect, the central organizing principle for a major income security program (the Canada Child Tax Benefit) which provides financial assistance to nearly eight out of ten Canadian households.

Social Assistance

Social assistance (commonly known as ‘welfare’) is Canada’s income program of last resort and is delivered by the provincial governments. It provides financial aid to individuals and families whose resources are inadequate to meet their needs and who have exhausted other avenues of support. While welfare generally is directed toward persons who are unemployed, it also can assist working households whose needs exceed their resources.

Each province sets its own rules that govern eligibility and level of assistance. Despite their differences, all jurisdictions have several features in common. Applicants generally qualify for welfare on the basis of three factors: provincial definitions, the value of their liquid assets and a needs test.

Provincial definitions set out the rules for the types of individuals and families that may apply for welfare. For example, most jurisdictions do not allow strikers to receive social assistance except under certain limited conditions. There are also rules regarding the eligibility of full-time students at postsecondary educational institutions and parental dependants.

A second component of eligibility is known as the ‘liquid asset exemption guidelines.’ Liquid asset exemptions refer to the amount of cash or cash-convertible assets that a given household may have and still be eligible for welfare. Allowable limits vary by jurisdiction. There are also rules regarding the maximum value of fixed assets – e.g., house, furniture, car or equipment.

The central eligibility criterion for welfare in every province is the needs test. A needs test takes into account a household’s basic needs such as food, clothing, shelter and utilities. It also considers the household’s special requirements such as medication, health-related diets or equipment for a disabling condition.

The needs test then identifies the resources available to meet those basic and special needs. Resources include earnings, government benefits, private savings, support payments, insurance claims, pensions and income derived from any other source.

A household may be eligible for social assistance if it qualifies according to the various rules and its needs exceed available resources. Each province employs a unique set of rules to determine the rates of assistance provided in their respective jurisdiction. Rates vary on the basis of family size, age of children, marital status of the family head, employability of the family head and other factors, such as the presence of a disabling condition.

Earnings exemption guidelines are another key component of social assistance. ‘Earnings exemption guidelines’ refer to the amount of income that welfare recipients may earn from outside employment without affecting their welfare entitlement. Once their earnings exceed a specified limit, their welfare cheques are reduced by a designated amount.

These guidelines vary throughout the country. In some provinces, such as Quebec, earnings exemptions take the form of a flat-rate amount. Welfare cheques are reduced by one dollar for every dollar of income earned over and above that amount. In other jurisdictions, such as Yukon, exemptions are expressed as a percentage of earnings. Recipients may keep a certain percentage of their employment-related earnings to a designated maximum before their welfare cheques are reduced.

Most jurisdictions employ a combination of flat-rate and variable exemptions. Recipients may earn up to a certain level as well as an additional amount that represents a percentage of their earnings. Welfare payments are reduced beyond that point.

Despite the variability in social assistance benefits, all jurisdictions pay benefits that fall below commonly accepted definitions of poverty.

Welfare benefits for a single parent with one child, for example, ranged from 70 percent of the poverty line in Newfoundland, 60 percent in Prince Edward Island, 63 percent in Nova Scotia, 62 percent in New Brunswick, 57 percent in Quebec, 60 percent in Ontario, 50 percent in Manitoba, 59 percent in Saskatchewan, 50 percent in Alberta and 60 percent in British Columbia (these are the latest available figures for 1999, published by the National Council of Welfare). Poverty line comparisons are not available for the Territories because the poverty line standard used for these calculations does not apply to the northern regions of the country.

Welfare benefits for single persons considered able to work were even lower. In 1999, rates ranged from nine percent of the poverty line in Newfoundland to a 'high' of 41 percent of the poverty line in Ontario. Benefits for single persons with disabilities went from a low of 42 percent of the poverty line in Alberta to a high of 70 percent in Ontario in 1999. For two-parent families with children, 1999 welfare incomes ranged from a low of 45 percent of the poverty line in Quebec to 62 percent in Prince Edward Island.

Welfare benefits are considered inadequate not only in absolute terms – that is, their actual value. They are also inadequate in relative terms because they are not indexed to increases in the cost of living. Increases tend to be spotty and erratic. While the cost of living has risen over the years, welfare benefits have been frozen or reduced in most jurisdictions.

In addition to providing benefits that are low in both absolute and relative terms, most provinces have introduced new rules which make it more difficult for certain households to get on or remain on welfare. The purpose of these tightened eligibility rules is to reduce the size of the welfare caseload.

Quebec, for example, was the first jurisdiction to bring in a parental contribution. Adults 18 years of age and over who have not yet declared their independence (e.g., they are not married; they have no children of their own to support) are considered dependent. Their parents are required to contribute maintenance and support.

Ontario announced in 1995 that an employable person quitting or losing a job without just cause was disqualified from applying for welfare for three months. Several provinces have reclassified single parents with young children as employable – which means that they can remain on social assistance only for a short period before they are expected to start participating in 'active,' work-related measures.

Some provinces, such as Ontario, have completely revamped their welfare systems. In 1997, the province replaced two existing welfare laws with Ontario Works, intended for employable welfare recipients, and the Ontario Disability Supports Program for persons with long-term disabilities. Ontario Works has been particularly controversial. It was the first time that any province had introduced a program which made it mandatory for recipients to participate in work-related or community service program.

Other jurisdictions have not undertaken as fundamental a reform as Ontario. But over the past few years, they all have introduced some type of ‘active programming’ – a concept promoted by the OECD.

While these programs vary, they typically follow the same general pattern. They seek to provide welfare recipients with the supports and skills they need to move off the program as quickly as possible. The assistance may take the form of job search, preparation of résumés, literacy training, skills development, academic upgrading and referral to employment.

In addition to the active measures that focus on work skills and requirements, provinces have introduced various supports – such as earnings supplements, extended health benefits or child care subsidies – designed to encourage workforce participation. Jurisdictions have brought in these measures in respect of the National Child Benefit reinvestment strategy, discussed below.

Child Benefits

Canada is undertaking a major restructuring of its principal federal and provincial child benefit programs through a joint federal-provincial initiative called the National Child Benefit. The initiative is at the leading edge of the transition from the universalist to post-welfare state in Canada.

In Canada, child benefits historically have pursued two fundamental objectives. These can be characterized as the ‘anti-poverty’ and ‘horizontal equity’ objectives.

Under the anti-poverty objective, child benefits help fill the gap between the earnings of low- and modest-wage parents and their families’ income needs. The need to fill the gap is based on the fact that a market economy does not vary wages and salaries to take into account the number of family members dependant on that income. The horizontal equity objective views child benefits as one way for society to provide some financial recognition for the fact that families at all income levels with children face costs that childless households at the same income level do not.

These twin objectives are linked. Both assume that society has an obligation to help parents with their childrearing costs because children are viewed at least partially as a ‘public investment.’ Children grow up to become workers, taxpayers and citizens. It is in the interest of everyone – including those without children – that parents not face undue financial strain in their childrearing ‘work.’ Parents do this work, in part, on behalf of everyone.

The anti-poverty objective acknowledges that lower-income families have the least financial capacity. This objective also seeks to reduce the higher personal and societal risks of child poverty in terms of children’s immediate and long-term health, learning capacity and educational performance.

For low-income families, the anti-poverty and horizontal equity objectives of child benefits are basically the same. Concern about the horizontal equity objective typically has focussed on non-poor families, which have suffered a substantial decline in their child benefits since the mid-1980s. (For some high-income families, child benefits have disappeared altogether.)

The anti-poverty and horizontal equity objectives of child benefits are fundamental to the universalist conception of social policy. But they remain central to the post-welfare model as well. The key issue is not the validity of the objectives of child benefits – which are as valid and important today as they were a century ago. The major issue is how best to achieve them. The National Child Benefit seeks to construct a more effective and efficient means of pursuing the anti-poverty and horizontal equity objectives of child benefits.

The rise of income-tested targeting

The long-term trend in Canadian child benefits has been toward greater ‘targeting.’ This means that child benefits are geared to need as measured by family income. Since the late 1970s, the anti-poverty objective has been accorded greater weight at the expense of the horizontal equity objective.

However, while Canada’s child benefits system calculates the amount of payments on the basis of family income, it is not targeted narrowly to the poor in terms of eligibility. Rather, it is a broad based system that covers the large majority of families (eight out of ten households with children).

In recognizing the need to restore the child benefit system’s horizontal equity capacity, payments are now being increased for non-poor families. Coverage will expand to more than 90 percent of all families with children within the next few years.

The history of Canadian child benefits can be divided into five main periods. The first phase, between the two World Wars, can be characterized as ‘regressive targeting.’ The personal income tax system provided a children’s tax exemption that delivered its benefits in the form of tax savings which increased with taxable income and excluded families that did not owe income tax. In fact, most families were excluded in those times of widespread poverty and low average incomes.

The arrival of universal, monthly Family Allowances in 1945 heralded the second phase: ‘untargeted universality.’ Child benefits were extended to include low- and modest-income families. But better-off households still got more because they received both the children’s tax exemption and Family Allowances.

The 1970s ushered in the third phase: ‘progressive universality.’ Family Allowances were tripled, indexed to the cost of living and made taxable. A new income-tested program administered through the personal income tax system – the refundable child tax credit – delivered its maximum payment to low-income families. It paid a declining amount to middle-income families and nothing to the well-off.

The fourth phase, ‘progressive targeting,’ began in the 1980s. It evolved through a series of changes culminating in 1993 with a single, income-tested Child Tax Benefit. It increased payments for working poor families with children, maintained benefits for other low-income families, reduced amounts for middle-income families and excluded high-income families.

Canada recently entered a fifth phase: an ‘integrated child benefit.’ It broadens the scope of reform to include provincial child benefits and promises to strengthen both the anti-poverty and horizontal equity objectives.

Rationale for reform

To understand the rationale behind Canada’s unfolding National Child Benefit reform, it is helpful to explain briefly the major weaknesses of the child benefits system that it is replacing. The old ‘system’ was not really a system in the true sense of the word. Rather, it was an uncoordinated group of programs provided by two levels of government.

Throughout much of its history, the federal child benefits system suffered from an irrational distribution of benefits. The separate components of the system were integrated in 1993 into a single, family income-tested Child Tax Benefit. The latter was renamed the Canada Child Tax Benefit in 1997. The new program is similar to the former one in that provides maximum payments to low-income families and diminishing benefits to middle-income families.

While achieving its anti-poverty objective in its distribution of benefits, the federal child benefit is not narrowly targeted to the poor. This ‘broad based’ characteristic helps advance the goal of social inclusion. The large majority of families are served by the same program and no vulnerable group is excluded.

Among the Canada Child Tax Benefit’s other virtues are its anonymous, nonstigmatizing and relatively efficient administration through the same income tax system that covers Canadians in all income groups and throughout the country. Recipients qualify for benefits based only on a simple test of their income. There is almost never any direct contact between recipients and administrators. Benefits are delivered on a frequent (monthly) basis.

Meanwhile, until very recently, all the provinces delivered what amounted to cash child benefits through their social assistance systems, which provided benefits on behalf of children as well as adults. There was little coordination with the federal child benefits system. The two differed in purpose, design and delivery.

Child benefits delivered through provincial social assistance systems pursue only an anti-poverty objective. Along with adult benefits, they are intended to provide funds for a family to meet basic necessities. By contrast, federal child benefits are intended only to *supplement* other sources of income.

Unlike income-tested child benefits’ good performance in terms of inclusion, needs-tested social assistance in Canada has always been an exclusionary and social program. The social assistance system is discretionary and involves extensive client-worker interaction.

The scope of federal and provincial child benefits also differs significantly. Federal child benefits have served all or almost all families with children. Social assistance-delivered child benefits, by contrast, are restricted mainly to non-working poor families. Social assistance excludes most other low-income families, such as those on Employment Insurance and the working poor. Social assistance benefits have been politically vulnerable to cuts.

One of the major problems inherent in the uncoordinated patchwork of federal income-tested child benefits and provincial needs-tested child benefits is that the system could never deal effectively with the problem of persistent and extensive child poverty in Canada. Social assistance is narrowly targeted and unpopular. The reality is that social assistance benefits will always be extremely low.

Another significant problem with the two-tiered system has been characterized as the ‘welfare wall.’ Social assistance families with children traditionally received child benefits from two sources: provincial social assistance benefits paid on behalf of children and federal child benefits.

Other low-income families, notably the working poor and Unemployment Insurance poor, typically got federal child benefits only. Social assistance families enjoyed considerably larger – indeed, about double – child benefits than those paid to other low-income families. Neither does this cash advantage count the value of the social assistance system’s ‘in kind’ benefits, such as supplementary health and dental benefits, shelter allowances and winter clothing allowances.

Just before the introduction of the National Child Benefit in July 1997, combined federal-provincial child benefits ranged annually from around \$2,220 to \$2,820 per child for social assistance families in most provinces. Another \$213 per year was paid for each child under age 7 for whom the child care expense deduction is not claimed. By contrast, federal child benefits for children in working poor families were a maximum \$1,520 annually for one child.

For two children, the gap between social assistance and other low-income families was wider. For example, for families with one child under age 7 and one child over 7, total child benefits for a social assistance family from the federal and provincial governments amounted to \$5,253 per year. That amount is close to double the \$2,753 in federal child benefits for other low-income families with children.

The term ‘welfare wall’ was coined to dramatize the features of the tax/transfer system – in this case, child benefits – that can erect barriers to moving from social assistance to the workforce. Parents on social assistance who managed to find paid work risked losing thousands of dollars in social assistance-provided child benefits and ‘in kind’ benefits. Moreover, their typically low wages were reduced by federal and sometimes provincial income taxes as well as federal payroll taxes. They also had to pay employment-related costs, such as child care, clothing and transportation.

Structural reform: The National Child Benefit

The reform of child benefits – known as the federal-provincial National Child Benefit – seeks to lower the welfare wall by creating an integrated, nonstigmatizing child benefit. It treats all low-income families equally, whether they are working or not. It also enables provinces to take additional actions to assist low-income families.

The main engine of reform is the new federal child benefit. As the federal government increases payments under the Canada Child Tax Benefit, provinces are allowed to reduce their social assistance-provided child benefits by the amount of the federal child benefit increase. Provinces must reinvest the resulting savings in other programs and services for low-income families with children.

Over time, governments' objective is to raise the Canada Child Tax Benefit to the point where it alone, or in combination with provincial income-tested child benefits, fully displaces social assistance-delivered child benefits. These are estimated at a target of about \$2,600 in today's dollars.

A \$2,600 maximum Canada Child Tax Benefit would come close to achieving the goal of an integrated child benefit. All low-income families, regardless of their major source(s) of income, should receive the same level of child benefit. The distinction between child benefits for the working poor and the non-working poor would be eliminated.

Objectives of reform

The federal and provincial governments have set three formal objectives for the National Child Benefit. It is intended to help prevent and reduce the depth of child poverty. It seeks to promote attachment to the workforce – resulting in fewer families having to rely on social assistance – by ensuring that families will always be better off as a result of finding work. It is intended to reduce overlap and duplication through closer harmonization of program objectives and benefits, and through simplified administration.

The Caledon Institute – which played a key technical and political role in developing the National Child Benefit – supported the choice of *depth* of poverty rather than *incidence* or rate of child poverty as an objective. Depth of poverty refers to reducing the average distance of families below the poverty line.

Progress in lowering incidence is a poor indicator of the effective reduction in poverty. If governments were to employ reduction in incidence as a key indicator, a program that reduced the depth of poverty of those who were least well off but failed to bring them above the poverty line would be judged inferior to a program providing a few dollars to those who are best off among the poor, thereby bringing many people above the poverty line. Reduction in the depth of poverty is, on the other hand, a good indicator of the extent of change in the experience of poverty among families.

We argued that it is unrealistic to set the prevention of child poverty as a formal objective of child benefits, though other programs (including some of the provincial reinvestments under the National Child Benefit) can play a preventive role. We also endorsed the work incentive objective, with the caution that the National Child Benefit is no magic solution. Rather, it is one among a range of initiatives required to dismantle the welfare wall. We supported the harmonization objective, which should underlie all intergovernmental relations.

We added some objectives to supplement governments' three: adequacy, fairness, dignity and independence, and economic stabilization.

Once the displace-social assistance target of \$2,600 per child per year is reached, the Canada Child Tax Benefit should be raised further, within the first decade of the 21st century, to reach about \$4,200 maximum per child annually. That amount is a rough estimate of the annual cost of raising a child in a low-income family. We recommended that a study be conducted to come up with more accurate and detailed estimates. The \$4,200 goal is an estimate of the amount needed to achieve the anti-poverty objective.

We urged the federal government to improve child benefits for modest- and middle-income families. These households have seen substantial losses since the 1980s. This improvement would help achieve the horizontal equity goal.

Adequacy also requires full indexation of the benefit to the cost of living. While the federal government did fully index the benefit as of 2000, the provinces have not yet followed suit.

The objectives of dignity and independence will be advanced through the broad based, income-tested Canada Child Tax Benefit. Finally, Caledon recommended that the system be seen as an important part of economic stabilization. The program is an efficient vehicle to put cash into the hands of parents and thereby maintain consumer demand during downturns and help cushion the effect of recessions.

Progress

Over the past few years, the federal government has made a series of substantial increases to the Canada Child Tax Benefit. These have boosted payments to low-income families. The increases have enabled provinces to redirect social assistance savings into a range of income programs and social services for low-income families with children.

Provincial reinvestments to date total \$305.2 million in 1998-99 and \$498.2 million in 1999-2000. Child care took first place – 39.4 percent in 1998-99 and 34.6 percent in 1999-2000. This was followed by income-tested child benefits and earnings supplements (31.1 percent in both fiscal years), initiatives by Ontario municipalities and by Aboriginal communities (21.8 and 20.9 percent), early childhood development (4.5 and 9.3 percent) and supplementary health care (3.1 percent the first year and 4.1 percent the next year).

By 2004, Ottawa will spend a forecast \$9 billion on the Canada Child Tax Benefit. This amount represents, in inflation-adjusted 2004 dollars, a \$3.3 billion or 58 percent increase since the reform began. Low-income families will receive about \$6 billion or two-thirds of the \$9 billion total spending in 2004. Non-poor families will get the other \$3 billion or one-third.

The federal government's stated target is to increase the maximum Canada Child Tax Benefit to \$2,400 for one child and \$2,200 for each additional child by 2004. These rates will come close to meeting the Caledon Institute's proposed \$2,600 level (which in 2004 dollars will come to \$2,800).

The other crucial advance is that the federal government, in its 1999 and 2000 Budgets, began restoring child benefits for non-poor (mainly modest- and middle-income) families. In so doing, the federal government has broadened the scope of reform beyond the child benefit system's anti-poverty objective to begin bolstering its horizontal equity performance. Thus the two fundamental objectives of child benefits are being simultaneously strengthened.

Criticisms

The complexity of the National Child Benefit and of Canada's child benefits system more generally have placed the reform beyond the understanding of the Canadian public, most journalists and, indeed, most politicians. So the National Child Benefit debate has been confined largely to social advocacy groups, most of which have opposed the reform.

a. Treatment of social assistance families

The chief criticism of the National Child Benefit is that it discriminates against social assistance families. These families are often referred to as the ‘poorest of the poor.’

Social assistance families will not get an increase in their net child benefits. Rather, they will see only an increase in the proportion coming from the federal Canada Child Tax Benefit and a decline in the share from provincial social assistance. In some provinces, these households will see new income-tested child benefits. By contrast, the working poor and other low-income families not on social assistance will enjoy an increase in their child benefits.

To make matters worse, the supporters of the National Child Benefit had been arguing that it was a key anti-poverty measure. But it arrived after several years of cuts to social assistance benefits that had shrunk drastically most families’ income. It also was introduced amid growing efforts on the part of most provinces to require recipients to enter the workforce. These efforts took the form of ‘workfare’ and tightened eligibility rules in many provinces.

This criticism misses the essential point of the National Child Benefit. Its purpose is to restructure income security by equalizing child benefits for all low-income families. It seeks to raise payments for poor families not on social assistance to the level paid to social assistance families.

Social assistance families are receiving the same increase in their federal child benefits as other poor families, though their social assistance-delivered child benefits typically are reduced accordingly. This process has given rise to a great deal of anxiety on the part of vulnerable social assistance recipients and anger on the part of critics.

A key issue here is strategy. Ottawa should have fully implemented the reform (as proposed in a 1995 Caledon report⁵) rather than phasing it in through an incremental, multi-year approach. The federal government also should have put enough money on the table. It could have displaced social assistance-delivered child benefits immediately. It could have raised the level of the new Canada Child Tax Benefit high enough to exceed the previous amount of combined federal and provincial child benefits paid to social assistance families.

Social assistance families still would have seen a smaller net increase in child benefits than the working poor. But at least the former would have been a little better off than before. The idea that one type of benefit was simply replacing another would have been apparent and easily explained. The incremental strategy that was adopted instead has contributed to the criticism of the National Child Benefit.

However, even without a real increase in child benefits for social assistance families, it can be argued they will be better off under the National Child Benefit than before. Social assistance is a highly stigmatizing program prone to overt cuts or steady erosion on the part of the provinces.

For example, a get-tough-on-social assistance approach was a prominent part of Ontario's Conservative government election platform. It followed through with a 21.6 percent cut in social assistance for most recipients in October 1995. The cuts did not harm the government's political fortunes, and indeed they may have helped. The Ontario Conservatives – residualists in their philosophy of social policy – were easily re-elected, unlike the previous two provincial administrations, which had raised social assistance rates.

Income-tested social programs, in contrast to social assistance, have seen real and substantial increases in benefit rates for lower-income recipients, with broad public support. The Canada Child Tax Benefit, which was fully indexed as of 2000, is in a far better position than social assistance to enjoy further increases in the coming years. If one is truly worried about the adequacy of social assistance recipients' incomes, the best option is to provide a larger proportion of their incomes out of a politically popular and expanding program, such as the Canada Child Tax Benefit.

It is also essential to remember that the social assistance population is a dynamic, ever-changing group. About half of social assistance recipients leave for the workforce every year. Under the old system, these recipients lost all of their social assistance-delivered child benefits. But the Canada Child Tax Benefit is a 'portable' benefit that accompanies families no matter what their primary income source.

Social assistance families will no longer lose child benefits if they move to the workforce. Working poor families will continue to receive their child benefits from the federal government even if they go on social assistance or Employment Insurance. If they improve their earnings, families will continue to receive the Canada Child Tax Benefit – though in a smaller amount if their income increases enough – far up the income scale.

Another important factor is that social assistance families receive the Canada Child Tax Benefit without stigma, just like the large majority of Canadian families. Payment is automatic and painless. It involves little or no contact with government officials. Moreover, some social assistance families will benefit from some of the provincial reinvestments, though more so if they move into the workforce.

The National Child Benefit holds out the promise of more than just a restructuring and enhancement of child benefits. By removing a large group (children) from social assistance caseloads, it marks a major step forward in the essential task of dismantling the social assistance

system and replacing it with more effective programs. The aim should be to transform adult social assistance from its current conception as a last-resort family income support program for families. It should be modernized in the form of a wage substitution program for adults, more suitable to an 'active' income security system.

b. The welfare wall is more than child benefits

Social advocates complain that the National Child Benefit does not deal with the variety of obstacles that make it difficult for families to move from social assistance to the workforce. A major barrier is the lack of affordable and accessible child care. Another obstacle is the fact that many jobs typically available to low-income parents do not pay a living wage. Many families are worse off financially than if they were on social assistance.

While these are important problems, the National Child Benefit on its own cannot solve them. It is intended to lower the part of the welfare wall that results from differential child benefits and to reduce the depth of poverty.

Under the National Child Benefit, some provinces are reinvesting social assistance savings in child care. They are also extending supplementary health care to the working poor. But these initiatives cannot substitute for the range of reforms that are needed to combat poverty. Such reforms include a national early childhood development system, supplementary health benefits, employment programs and decent adult income supports replacing traditional social assistance.

c. The incentives issue: Marginal tax rates

Some economists claim that the National Child Benefit reform could be defeating its own purpose by imposing high effective marginal tax rates. These supposedly discourage the work ethic of the very families it is intended to help. (By 'effective marginal tax rate,' we mean the percentage of additional income paid in income and payroll taxes or forgone due to income-tested programs' reduction rates.)

The Canada Child Tax Benefit has resulted in higher marginal tax rates for some working poor families because of the wish to target limited new spending on low-income families. (Families in the \$21,000 - \$30,000 net family income range have been affected.)

For example, an Ontario family with net income of \$27,000 saw its effective marginal tax rate rise from 39.5 percent to 54.2 percent as a result of the high reduction rate imposed on the National Child Benefit Supplement. At the same time, recipients of social assistance who moved into the labour market enjoyed a large reduction in their marginal tax rates.

The impact of this mix of higher and lower effective marginal tax rates on labour market behaviour remains an open question. The factors that can influence families' decisions regarding paid work are complex. These decisions cannot simply be assumed as given according to the usual interpretations of economic theory. Issues such as social expectations, opportunities, transportation, child care, workplace policies and many other factors fit into the equation. It is not clear, nor does economic theory suggest, that the marginal tax rate is the most important of these variables.

The National Child Benefit has objectives beyond the labour market, unlike 'pure' income supplements for the working poor. The new child benefit's impact on the depth of poverty and disposable income is equally – if not more – important than its effect on labour market behaviour.

d. Lack of responsiveness to changes in income

One of the long-standing concerns about using the income tax system to deliver social benefits is its lack of responsiveness to changes in income. There can be a considerable lag – up to 18 months – between assessment of income and calculation of amount of the Canada Child Tax Benefit. The program can adjust quickly to change in family composition, such as marriage breakdown or death of a spouse. But it is not designed to respond rapidly to changes in income due to getting or losing a job.

Despite the stated concerns, lack of responsiveness has not been a problem in practice. Indeed, the case might be the opposite. In a focus group held by the Caledon Institute in British Columbia, the reaction to the possibility of more regular (e.g., monthly) income testing was negative. This was seen as reintroducing the much-reviled social assistance monthly reporting requirements. Recipients were more than willing to give up any potential benefit of improved responsiveness in return for lack of intrusiveness.

Responsiveness may be a 'non-issue' because of the program's design. There is a significant range of income before there is any reduction in benefits. Many people with low incomes will always receive the maximum benefit, whether in or out of the workforce. So the issue of responsiveness does not arise for them. Aside from change in family composition (usually due to marriage breakdown to which the system does adjust soon after notification), there could well be relatively

few families that drop in one year from a comfortable income to a low income and thus need maximum child benefits as fast as possible. Unfortunately, this question has not yet been investigated.

A work in progress

The National Child Benefit has not reached its goal of fully replacing all social assistance-embedded child benefits throughout Canada. Families on social assistance still receive some child-related benefits in most or all provinces.

If the federal government gradually were to boost the Canada Child Tax Benefit towards the \$4,200 level which Caledon and other social groups have proposed, then getting rid of all remaining social assistance benefits for children would help pay for such a costly program. Other cost-shifting changes, such as the reform of the shelter allowance component of social assistance and the elimination of secondary child benefit programs, also must be considered.

In addition to a sizable increase in the maximum payment, Caledon has advocated returning the Canada Child Tax Benefit to a single-tier structure, as was used in the original refundable child tax credit. There would be a moderate reduction rate on benefits for non-poor families.

This design offers several key advantages. It makes the child benefits system easier to understand. It boosts child benefits for poor and non-poor families alike, thus respecting both the anti-poverty and horizontal equity objectives. Finally, a single tier would resolve concerns about the potential work disincentive effects of high effective marginal tax rates.

From Unemployment Insurance to Employment Insurance

Employment Insurance used to be known as Unemployment Insurance, one of Canada's first modern social programs based on the universalist model. Introduced in 1940, Unemployment Insurance originally was meant to replace earnings for workers who are temporarily between jobs.

Initial coverage under the program was limited to jobs deemed to have a risk of unemployment – generally, in industry and commerce. This coverage extended to less than half – 42 percent – of the labour force. The majority of jobs were not covered, including those in agriculture and forestry, fishing, transport, teaching, health care and government service, as well as part-time work.

Expansion

Over the next 31 years, the federal government expanded Unemployment Insurance beyond its original purpose of short-term jobless insurance for only part of the workforce. By 1971, almost all workers, including self-employed fishermen, were covered. Qualifying requirements – the number of weeks of work necessary in order to receive benefits – were reduced and benefits were raised.

Benefits also were extended to cover workers who lose wages because of illness, maternity or retirement. ‘Regionally extended benefits’ were introduced as well. The latter increased the duration of benefits for recipients living in areas in which the unemployment rate exceeded the national jobless rate. A sliding scale was used, adding weeks of benefit according to the severity of unemployment in the region. A portion of Unemployment Insurance funds was set aside for developmental purposes to help unemployed workers participate in approved training or job creation projects.

Employers and employees financed most of the program through premiums. Employers contributed a certain percentage of their payroll while employees contributed a set proportion of their wages up to a designated maximum. The federal government paid for regionally extended benefits, fishermen’s benefits and developmental programs.

Retrenchment

But the 1971 Unemployment Insurance Act, which had expanded and enriched the program, collided with mounting inflation, deficits and unemployment throughout the 1970s. As a result, Unemployment Insurance expenditures rose substantially and became one of the federal government’s most expensive programs. Moreover, its costs increase at the worst possible time – during recessions. The time had come to start reining in the program.

The next 25 years saw various changes that chipped away at Unemployment Insurance by making it harder to qualify for assistance and reducing the level and duration of benefits. Eligibility requirements were tightened, the maximum length of benefits was shortened and the benefit rate lowered.

A major turning point in the life of the program came in 1995 when the federal government introduced a new philosophy to underpin Unemployment Insurance. Ottawa announced that, effective July 1996, ‘Employment Insurance’ would replace the old program. The name change was intended to signal a fundamental philosophical shift – from ‘passive’ dependence to ‘active’ employ-

ment. The objectives of the overhaul were to keep unemployed workers off the program, move current recipients off as quickly as possible and encourage greater workforce participation through skills training and upgrading.

The new Employment Insurance Act provides for two types of benefits: income benefits and employment benefits. Income benefits pay temporary income support for income claimants while they look for work. The new Act changed the three key levers on the income side of the program: eligibility, benefit levels and duration of benefits. The purpose of these changes was purportedly to ‘strengthen incentives to work.’

Eligibility for benefits is now based on number of hours rather than number of weeks worked. The stated purpose of this change was to allow more flexibility in the program and to enable part-time workers, in particular, to qualify for Employment Insurance.

At the same time, however, the Act tightened up the eligibility criteria by substantially increasing the number of hours required to qualify for benefits. Workers now must put in from 420 to 700 hours (or the equivalent of 12 to 20 weeks), depending on the unemployment rate in the region. This change represents an increase of between 180 and 300 hours over the former entrance requirement.

Claimants applying for sickness, maternity or parental benefits need 700 hours of work. (Changes announced in the February 2000 federal Budget reduced the eligibility requirement to only 600 hours of work.) New entrants to the labour market and those who have been out of paid work for some years must establish a reasonable attachment to the job market before they are considered eligible for Employment Insurance. Newcomers or those re-entering the labour market must work a minimum 910 hours before qualifying for the program.

Benefits are calculated as 55 percent of average insurable earnings. The upper limit in the band of earnings over which benefits are calculated (called the ‘maximum insurable earnings level’) fell from \$42,380 to \$39,000. Maximum benefits dropped to \$413 a week.

Employment Insurance also imposed an ‘intensity rule.’ Recipients face a penalty of a one percentage point reduction in their benefit replacement rate after each 20 weeks of benefits, reducing the rate from 55 percent to as low as 50 percent. This rule was intended to reduce the heavy repeat reliance on Employment Insurance by seasonal workers, encouraging them to seek full-time work.

Employment Insurance continues Unemployment Insurance’s practice of imposing an income test. Better-off recipients must repay part of their benefits at the rate of 30 percent above \$39,000 for those collecting benefits for 20 weeks or more, and above \$47,750 for those with less than 20 weeks.

A Family Income Supplement (a maximum \$413 a week) was introduced in order to provide higher benefits to families with annual incomes of less than \$25,921 that are eligible for the Canada Child Tax Benefit. The Family Income Supplement varies by number of children. The Employment Insurance benefits of these households, along with the Family Income Supplement, could represent up to 80 percent of their insured income.

The new Employment Insurance Act reduced the maximum length of claim from 50 to 45 weeks. The savings produced through changes to the income component of the program were directed toward employment benefits. These include a package of measures – wage subsidies, earnings supplements, self-employment assistance, job creation partnerships, and skills loans and grants – to help workers prepare for and find a job. A three-year, \$300 million fund also was created and paid for by federal tax revenues to generate economic growth and new jobs.

As a result of these changes, Employment Insurance coverage of unemployed workers has dropped dramatically. The percentage of the unemployed covered by the program in 1997 was less than half of what it was in 1989 – falling from 74 percent to 36 percent of the unemployed.

In response to concerns about the drastically reduced coverage under the program, Ottawa introduced legislation in September 2000 to amend the Employment Insurance Act. The proposed legislative amendments would eliminate the intensity rule and ease the benefit repayment provision.

Unemployment Insurance was conceived as a critical component of the universalist model of social policy. Like child benefits, it has just as important a role to play in a post-welfare state approach.

But in our view, neither Unemployment Insurance nor Employment Insurance works. They should be replaced by a new system of income support for adults that retains an insurance-oriented program for those only occasionally or short-term unemployed. The new system would replace both social assistance and the regionally extended benefits of Employment Insurance by a more effective income-tested program with strong labour market components.

*Elderly Benefits:
Uneasy Compromise between Universalist and Post-Welfare Models*

We conclude this description of Canada's transition to a post-welfare model with a discussion of the attempted reform of elderly benefits in Canada. These are not considered 'active' programs in that they are intended for persons who have left the labour market. But the story is an interesting one in the sense that the evolution to the post-welfare state has been far from easy – or complete.

Canada has a multi-tier retirement income system with public and private elements. The base is made up of an almost-universal, income-tested old age pension program, along with more targeted programs for poor seniors. Both are financed through general government revenues.

The second, also public, tier is the contributory earnings-related Canada Pension Plan (and, in Quebec, parallel Quebec Pension Plan) that covers the entire workforce.

The third private tier is composed of employer-sponsored pension plans, known as occupational pension plans, and individual retirement savings accounts, known as Registered Retirement Savings Plans. Both of these plans are used mainly by some middle-income and most upper-income Canadians.

There is a fourth public tier that consists of income tax breaks. These partially offset the cost of contributions to the Canada and Quebec Pension Plans, occupational pension plans and retirement savings plans.

A Mix of Direct and Tax-Delivered Programs

There are five programs in the base tier, three paid directly and two through the income tax system.

The core program within the base tier is Old Age Security, created in 1952. It pays a flat-rate, but taxable, monthly payment. While the benefit is income-tested on the basis of individual income, it still goes to almost all (95 percent) of Canadians age 65 and older. It excludes only those with high incomes. Benefits are fully indexed to the cost of living on a quarterly basis.

For the fourth quarter of 2000 (i.e., October-December), the maximum monthly payment is \$429. However, this amount is subject both to taxation and to an income test. The income test

applies only to individual net income above \$53,960, which represents only five percent of seniors. Recipients must have lived in Canada for at least 10 years or have immigrated from countries which have international social security agreements with Canada.

The second program, the Guaranteed Income Supplement, was created in 1967 for low-income seniors. The Guaranteed Income Supplement is far more targeted than Old Age Security, though benefits are not taxable.

The maximum Guaranteed Income Supplement payment (\$510 a month for a single person and \$327 for each member of a couple, for the fourth quarter of 2000) goes to seniors with no income other than Old Age Security. Benefits are reduced by 50 cents for every dollar of other income, excluding Old Age Security. In the case of a couple, eligibility for and the amount of the Guaranteed Income Supplement are based on the combined income of the two spouses. Like Old Age Security, the Guaranteed Income Supplement is financed out of federal general revenues.

The Spouse's Allowance was legislated in 1975 to provide benefits equal to the sum of Old Age Security and the Guaranteed Income Supplement to the 60- to 64-year-old spouses of pensioners who receive the Guaranteed Income Supplement. In 1979, the Spouse's Allowance was expanded to maintain benefits to recipients who become widowed. When they reach 65, they move on to Old Age Security and the Guaranteed Income Supplement.

In 1985, the program was extended further to cover all low-income widowed persons aged 60 to 64, even if they had not first qualified for the benefit when their spouses were alive. Like the Guaranteed Income Supplement, the Spouse's Allowance is an income-tested program that pays its maximum amount to the poorest seniors. It includes a partial and declining amount to eligible women and men with some other income. The Spouse's Allowance is not taxable.

In addition to these federal benefits, several provinces and territories – Ontario, Manitoba, Saskatchewan, Alberta, BC, Yukon and the Northwest Territories – provide income-tested supplements for seniors. These supplements generally are paid to recipients of the Guaranteed Income Supplement because they already have qualified for the federal program on the basis of low income. These benefits vary widely in value. Nova Scotia provides income assistance through its welfare system for seniors deemed to be 'in need' on the basis of a needs test.

This first layer of the Canadian pension system also includes two tax breaks for seniors and private pensioners who owe income tax. These are the income-tested age credit and the pension income tax credit.

The age credit provides a nonrefundable tax credit to taxpayers age 65 or older. It is worth a maximum \$900 in total federal and average provincial income tax savings. The age credit is income-tested above individual net income of \$26,284.

The pension income credit is also nonrefundable through not income-tested. It provides a tax break of up to \$255 in combined federal and average provincial taxes to taxpayers who have income from occupational pension plans or individual retirement savings plans. Taxpayers with incomes too low to owe income tax do not benefit from these two tax breaks.

Reforms

a. From universality to broad based income-testing

Old Age Security used to be seen as a centrepiece of the universalist model of Canadian social policy, along with universal Family Allowances. Yet both programs were replaced by income-tested benefits with little political difficulty, even though seniors and children's groups mounted strong public campaigns to fight the changes.

The end of universality began in 1989. The Conservative Finance Minister introduced a special tax on Old Age Security and Family Allowance benefits which became known as the 'clawback.' Old Age Security and Family Allowance recipients with individual net incomes over \$50,000 had to repay their benefits at the rate of 15 cents for every dollar of net income above the \$50,000 threshold.

The clawback of Old Age Security benefits from seniors with net incomes over \$50,000 affected only four percent of seniors when it was introduced in 1989. Relatively few elderly Canadians have incomes that high and the measure was phased in one-third at a time over three years.

But the Conservative government at the time was careful to only partially index (to the amount of inflation over three percent a year) the \$50,000 trigger level for the clawback. Partial deindexation meant that the trigger level for the clawback declined steadily in real terms each year and so hit more and more seniors.

Only in 2000 was the threshold fully indexed, rising from \$53,215 in 1999 to \$53,960 for 2000. But the latter amount is worth only \$42,540 in 1989 dollars. This means that the threshold fell by \$7,460 in constant dollars – a sizable 14.9 percent decline – between 1989 and 2000.

While Old Age Security is now an income-tested benefit, it is targeted high up the income range. The 2000 Budget's decision to fully index the income threshold above which the income test is applied means that the gradual erosion in the reach of Old Age Security has ended. It will remain a very broad based social program serving the great majority of seniors.

The seniors' lobby and social advocacy groups fought the clawback just as hard as they had the partial indexation proposal four years earlier. But the Conservatives' campaign to convince the Canadian public of the seriousness of the debt/deficit problem had helped change the political climate. The government did not withdraw the clawback.

The clawback was one of the pivotal events in the history of the Canadian welfare state. It removed the 'sacred' universal foundation of the public pension system. Significantly, there was almost no public opposition to this fundamental change toward a post-welfare social security system.

One explanation is that the clawback was a complex and hard to understand technical measure. It was a technical change that most Canadians could not fully grasp. But another possible explanation is that Canadians no longer were as firmly wedded to the notion of universality as they were in the past.

The 1994 federal Budget took a small but firm step along the difficult road to pension reform. It imposed an income test on the age credit, which used to be available to all seniors who owe income tax. The full age credit is now available only to elderly taxfilers with net incomes under \$26,284. It is reduced by 15 cents for every dollar of net income above that threshold. This means that seniors with net incomes over \$49,824 do not qualify for any age credit.

The 1995 Budget took another step toward a fully income-tested old age pension. Starting in July 1996, the clawback on Old Age Security is applied before cheques are sent out to seniors, on the basis of last year's income, rather than after they fill in their tax return as was previously the case.

b. One victory for the universalists: The failure of the Seniors Benefit

In 1993, the Caledon Institute proposed a radical restructuring of federal elderly benefits. The proposal would replace the five existing programs – Old Age Security, the Guaranteed Income Supplement, the Spouse's Allowance, and the pension and age credits – with a single, family income-tested program for low- and middle-income seniors.

Caledon put forward two major arguments for its proposal. These arguments focussed upon sustainability and equity.

Old Age Security costs are the single most important cause of rising social spending in Canada. The country has a rapidly aging population. It is exerting upward pressure on public and

private expenditures on pensions, health care and social services. Reform of old age pensions is essential if Canada is to maintain an adequate level of basic income support for the rising number of low-income seniors in the decades to come.

Caledon's other argument was directed at the unfairness of the existing elderly benefits system. The five current programs present an irrational array of income tests.

Old Age Security and the age credit are income-tested on an individual basis. The pension income credit is income-tested on an individual basis. It is not available to people with private pension income who are below the taxpaying threshold, though relatively few would fall in this category. But the Guaranteed Income Supplement and Spouse's Allowance are income-tested on the combined income of both spouses – i.e., family as opposed to individual income.

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

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

The federal government adopted Caledon's idea and called its proposed new program the Seniors Benefit. It was structured as a two-tier structure with two benefit components and two reduction rates (i.e., the Guaranteed Income Supplement component on top of Old Age Security, with reduction rates of 50 and 20 percent, respectively). The two tax benefits were eliminated and their funding incorporated into the new system.

The Seniors Benefit's major reform would have been to create a single, family income-tested program. The proposal was designed to ensure that low- and middle-income seniors not suffer any loss in income. Neither would current seniors lose because the new benefit included phase-in provisions.

The Seniors Benefit would have paid the majority of seniors either more than or the same as they got under the current system. Three in four elderly households would have received more or the same.

Elderly households with incomes under \$40,000 – about the average income for couples and more than double the average income for single seniors at the time – would have been better off or no worse off under the new program. Some couples in the \$40,000-\$50,000 income range would have received somewhat more and some somewhat less, depending on the income mix of the spouses. Couples with income over \$45,000 (above the \$40,000 average income) would have gotten less. Those above \$78,000 (almost double the average income) no longer would have received elderly benefits.

The proposed Seniors Benefit ran into strong criticism from those on both the left and right of the political spectrum. It eventually was withdrawn in the summer when Parliament was in recess and many media and Canadians on holiday. It was attacked for its family income test and its alleged damage to incentives for saving for retirement.

In their fight against the Seniors Benefit, women's groups advanced the 'poor wives with rich husbands' argument. According to this line of reasoning, even in some wealthy families, elderly women have little or no income of their own other than Old Age Security. They are completely dependent on their husbands. The Seniors Benefit would have removed the only source of income for these poor wives with rich husbands. (The same argument had been used to oppose the abolition of universal Family Allowances, but was dismissed.)

There may be some wives whose wealthy husbands deny them income. There are no estimates as to how large a problem this is. But the question remains as to why social programs should be seen as an answer to the unequal distribution of income between spouses.

The critics also claimed that the Seniors Benefit was yet another attack on universality. Ironically, the reform would have reduced or removed benefits for only well-off seniors. It would have improved benefits for poor and modest-income seniors. So universality won out over fairness in the feminist assault on the Seniors Benefit.

The other major attack on the proposed Seniors Benefit came from those on the right. The private pension industry selling individual retirement savings plans argued that the 20 percent reduction rate on the Old Age Security part of the Seniors Benefit would discourage Canadians from saving for their retirement. (They really meant investing in Registered Retirement Savings Plans, since such private pension income would reduce the amount they would get from the Seniors Benefit.)

The notion that middle- and upper-income Canadians would impoverish themselves in old age by not investing in retirement savings accounts or occupational pension plans so that they could qualify for a Seniors Benefit is hard to believe. But the criticism received considerable media

attention and the political pressure on the federal government from the pension industry was strong. Faced with opposition from both left and right, the federal government withdrew its proposed Seniors Benefit.

Conclusion

The reform of Canada's income security system can be characterized as a transition from a universalist to a post-welfare model. This model includes a substantial reliance on income-tested income security programs. While this paper focusses upon income security in particular, social services and education are an equally important part of this evolution.

The many changes described in this paper can be summed up as follows. Income security reform in Canada over the past decade has sought to achieve several major goals. First, Employment Insurance and welfare, in particular, have become more 'active.' They have incorporated measures to help recipients move off programs of income support and enter the paid labour market.

Second, income security reform has sought to find ways to make work an attractive option. The National Child Benefit has made a substantial contribution to this objective by equalizing child benefits between working poor and welfare families and by investing in work-related supports.

Finally, income security reform is intended to reduce poverty in Canada. The introduction of and enhancements to the National Child Benefit are an important step forward for working households. But while progress has been slow and steady, there is still a long way to go on the anti-poverty front.

Endnotes

1. We use 'social security system' broadly to characterize the entire collection of public and private social programs and benefits, including income security (e.g., public and private pensions, social assistance, child benefits, Unemployment Insurance, workers' compensation and tax-delivered benefits), social services and health care. 'Welfare state' is a synonym, though not commonly used in Canada.
2. We include in the term 'provinces' the three Territories – Yukon, Northwest Territories and Nunavut – that have the same social policy responsibilities as the 10 provinces.
3. 'Ottawa' is used in this paper as a synonym for the federal government.
4. Nonrefundable credits reduce income tax for people who owe income tax; they provide no benefit to the lowest-income Canadians who are below the taxpaying threshold. Refundable tax credits, by contrast, extend assistance to poor people who are below the taxpaying threshold. Tax deductions allow eligible taxpayers to reduce their taxable income. They are both nonrefundable and regressive (their value increases with the taxpayer's marginal tax bracket).
5. Battle, K. and L. Muszynski. (1995). *One Way to Fight Child Poverty*. Ottawa: Caledon Institute of Social Policy, January.