CALEDON
INSTITUTE OF
SOCIAL POLICY

caledon statement

February 1999 ISBN# 1-894159-37-3

The Social Fundamentals

Canadians have endured several years of tough fiscal medicine in the quest to slay the deficit. Programs were cut, taxes raised and new spending put on hold – all in the name of "getting the fundamentals right."

The fiscal fundamentals may be right - or at least getting there. But the social fundamentals are far from right. In fact, they lag well behind, having suffered years of massive cuts to federal transfers to the provinces, including Ottawa's withdrawal of the Canada Assistance Plan - the legislative base for welfare and social services.

Social housing has suffered dramatically after the federal government decided in 1993 that it no longer had a role to play in this crucial area. The coverage of Employment Insurance has been drastically reduced. And all Canadians, especially low-income households, pay a high price in respect of stealth taxes resulting from the partial deindexation of the income tax system and associated tax credits.

It is time to get the social fundamentals right. The 1999 Budget moves slowly in that direction.

Modest spending won't hurt

Since 1993, federal Budgets have been notoriously inaccurate in their fiscal projections. Up until the last few years, the Budgets used to greatly overestimate the deficit. Now they continue the tradition by underestimating the surplus.

True to form, the 1999 Budget understates the surplus in the coming year and does not provide an accurate picture of the available fiscal room. The Budget says that there will be a surplus of $3 billion in 1999-2000, once the contingency fund has been included. Our assessment is that the surplus is much more likely to be in the range of $7 to $10 billion. There is ample fiscal room to make a greater investment in our social infrastructure, to cut taxes more or to do more of both.

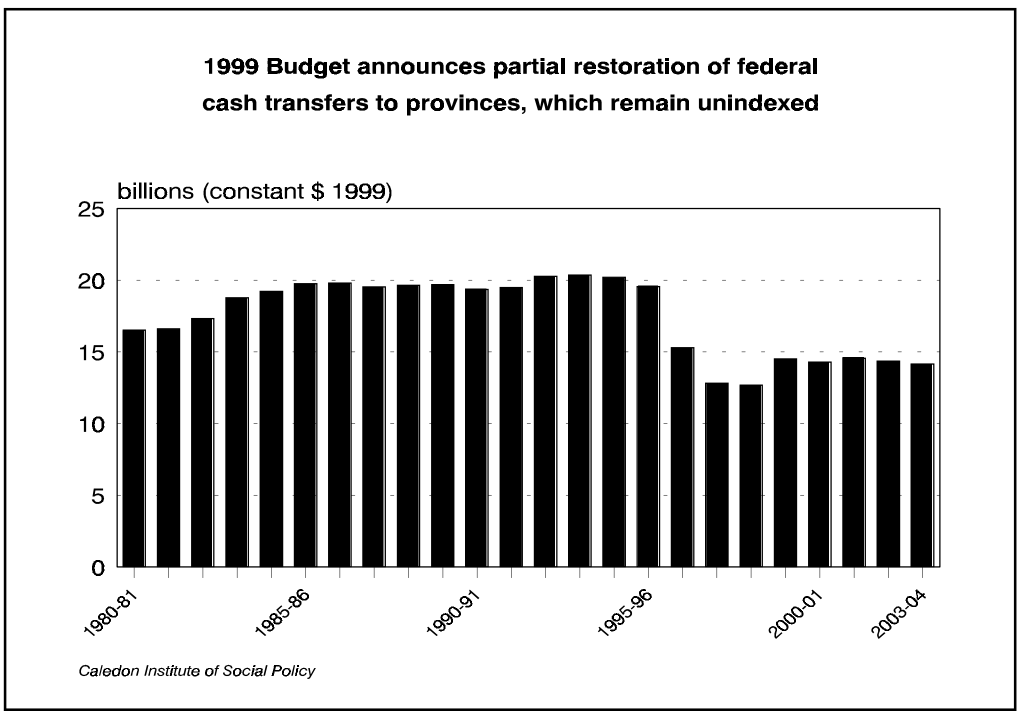
Spending more or taxing less will not endanger the struggle against the debt. The debt burden, as measured by the ratio of debt to Gross Domestic Product (GDP), is falling rapidly and will continue to fall, even if the economy turns out to be relatively stagnant next year.

A debt model developed by the Caledon Institute projects alternative federal fiscal balances to the end of the fiscal year 2008-2009 and measures their effect on the debt burden. The model looks at the impact upon the debt burden of two scenarios: modest and extensive spending and tax cuts. In both cases, the debt burden falls steadily and dramatically over the coming decade.

Modest spending increases and tax cuts would see Canada's debt burden fall from 64.5 percent of GDP in 1998-99 (the Budget says 64.8 percent of GDP in 1998-99, but it is once again overestimating) to substantially less than 60 percent in 2000-01. By 2008-2009, the debt-to-GDP ratio would stand at 20 to 30 percent – an extraordinarily low figure by both international and historical standards.

Even very large spending increases and tax cuts result in a debt-to-GDP ratio of 30 to 40 percent by 2008-09, still among the lower ranks in the G7. In fact, the debt burden is on a long-term downward escalator even if there is an economic downturn or, still worse, a recession.

Some observers argue that the fiscal surplus should be directed mainly or even entirely



towards debt reduction. Our calculations show that applying funds directly to pay down the debt does not have much effect on the debt burden. Every $1 billion paid into the debt reduces the debt burden by about 0.11 percentage points (i.e., about a tenth of one percent). The debt burden has fallen by more than 10 percentage points in the past few years, but almost all of this decline is due to growth in GDP and very little to the big sacrifices in spending cuts and tax hikes.

Ottawa does, indeed, have some fiscal room. The announcements in the 1999 Budget begin to restore parts of Canada's social infrastructure, but we can and should do much more.

Healthier medicare

Perhaps no social program is more fundamental to Canadians than medicare. The Budget's injection of $11.5 billion into national health care over the next five years comes as no surprise. The funds are intended to repair some of the damage from the sudden and huge cuts to health care ushered in as part of the Canada Health and Social Transfer (CHST) that took effect in 1996.

Despite the substantial increase in expenditure, the transfers still will not fully restore the pre-cuts level. Moreover, the Achilles' heel in the new transfer package is that it has not been indexed to keep pace with changes in inflation or economic growth. (See the graph.)

Total health spending in Canada rose steadily from $38.6 billion in 1975 to $78.2 billion in 1994 (in constant 1998 dollars). Spending dropped slightly to $77.5 billion in 1995 and $77.4 billion in 1996 but started inching up again to $77.9 billion in 1997. It stood at $80 billion in 1998.

But these numbers represent total health spending – i.e., the sum of public spending by governments and private expenditures by individuals on such items as medications, dental care, private nursing care and assistive devices. The disaggregation of the figures tells an interesting story.

Public expenditure as a percentage of total health spending actually declined from 76.4 percent in 1975 to 69.7 percent in 1998. Private health care spending, by contrast, has grown steadily from 23.6 percent of total spending in 1995 to 30.3 percent in 1998.

Expenditures on hospital care have dropped from 63.3 percent of total spending in 1975 to 51.1 percent in 1998. Expenditure on physicians remained fairly flat between 1975 and 1998 at between 21 and 22 percent of health spending. Drug expenditure shows the biggest growth, rising from 12.4 percent of health spending in 1975 to 21.6 percent in 1998.

The new funds announced in the Budget will ease some of the hospital horror stories - overcrowding, long waiting lists for surgery, bed shortages and exhausted staff - that have dominated the headlines of late. They will succour the faith-healing process – restoring Canadians' shaken faith in the quality and availability of health care. The funds will also help salve the wounds of years of federal-provincial acrimony leading up to and following the CHST.

The new cost-sharing formula for the distribution of the CHST transfers will resolve some of the unfairness inherent in the original formula. The original distribution of the CHST transfers had built in the 'cap' or limits that had been applied to Ontario, Alberta and BC under the former Canada Assistance Plan, as well as all the other inequalities between provinces that had built up over time. The result was much higher per capita federal payments to some provinces than others. Quebec and Newfoundland were especially favoured under the previous CHST.

The Budget redresses this problem by distributing the new money in the CHST so that by the end of three years, every province will have an equal per capita allotment. Of course, doing so means that those provinces which were getting a windfall before will not get as much of an increase in their CHST. No doubt, we will hear loud cries from at least some of the provinces not getting as large an increase as others (no province will lose). But the federal government and provinces had to bite this bullet at some point. With large increases in Equalization payments going to the less wealthy provinces, including Quebec and Newfoundland, now is the best time to act on this issue.

But new funds, even with a more fair distribution, will do little to tackle the fundamental problems in health care. The underlying structural problems will remain unaddressed unless there is a strategic reconfiguration of the health care system.

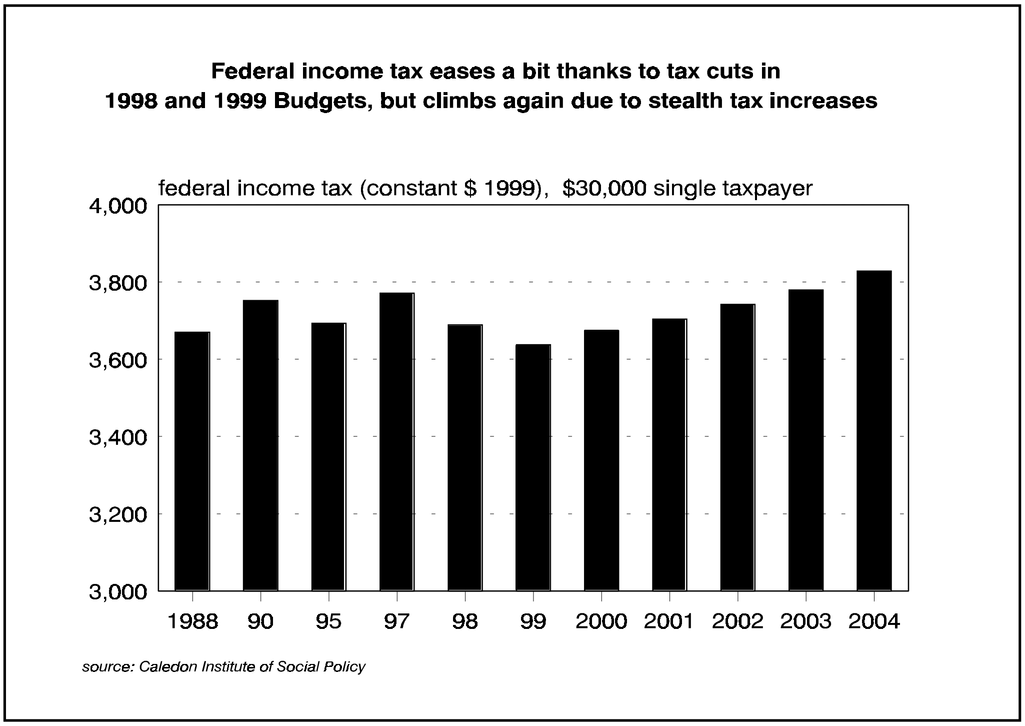
Our ailing medicare system must be able to deliver health care services more efficiently and effectively. It needs a framework for the provision of high-quality long-term care. It also requires a good dose of health; it needs to figure out how to promote a healthy population that relies less on costly medical treatment.

Other key issues remain unresolved – even with restored funding. There is no clear process for determining the specific services that are 'insured' or financially covered under medicare - the heart of the medicare contract with Canadians. Additional funds may enable the purchase of expensive diagnostic and treatment technologies but will not resolve the problem of how to evaluate and keep pace with rapid technological change and avoid obsolescence of newly purchased costly equipment. There is pent-up demand for earnings increases for health personnel. And there is the pressing problem of how best to meet the health needs - and demands - of an aging population.

The investment of $65 million in 2000-01 and $175 million in 2001-02 in the Canadian Institutes of Health Research will help respond to some of these issues by supporting various forms of health research. It also will encourage the pooling of research results to ensure that information on effective health care delivery can be shared widely throughout the country. The funding for the Canadian Institute for Health Information will improve accountability with respect to the use of health care dollars.

But the need for more and stronger community-based supports for health care has been evident for decades. The Liberal Party promised in its second Red Book that it would embark upon a national home care program to address this problem in a systematic way. So far there has not been much action on this front. Hopefully, the newly signed Social Union Framework Agreement will encourage Ottawa and the provinces to take joint action on this pressing and growing national need.

One option would involve collaborative work to develop the network of community-based health care that would incorporate both preventive services and supports for long-term care. The latter should include attendant services to assist with the activities of everyday living, technical aids and equipment, homemaker assistance to help with household tasks and respite services to provide temporary relief for family caregivers.



The Budget also announced an investment of $190 million over the next three years to better meet the health needs of First Nations and Inuit communities. These funds are welcome, given the serious health and social problems that these communities face. The addition of $287 million over the next three years for prenatal nutrition, food safety, reduction of toxic substances and innovations in rural and community health are important preventive initiatives. First Nations and Inuit people in the territories, who are also in great need of these services, should not be forgotten when these funds are distributed just because their health services are financed in a different way.

Sleight-of-hand tax cuts

The Budget does not get the fundamentals right when it comes to the income tax system. Following the pattern set in the 1998 Budget, the 1999 Budget bestows relatively small tax breaks that will lose ground to inflation as early as next year. Income taxes will dip a bit for a year, then resume their upward climb.

Last year's Budget offered modest tax relief to low- and middle-income Canadians. Low-income taxfilers were granted a $500 increase in their basic personal amount and spousal and equivalent-to-married amounts, which for each credit translated into a maximum federal income tax saving of $85 per person and $170 per family. The three percent general surtax was lifted from taxpayers earning up to $50,000 and reduced for those between $50,000 and $65,000.

This year's Budget gives low- and middle-income Canadians another small tax break. It increases and equalizes the personal, spousal and equivalent-to-married amounts for all taxpayers.

The basic personal amount for low-income taxfilers increases from $6,956 to $7,131, while the amount for non-poor taxpayers goes from $6,456 to $7,131. Translated into what really matters – tax credits that reduce federal and provincial income tax - the basic personal federal credit for low-income taxfilers increases from $1,183 to $1,212 (for a federal tax cut in 1999 of $29 per person), while the credit for non-poor taxpayers rises from $1,098 to $1,212 (a federal income tax cut of $114). The spousal and equivalent-to-married federal tax credits for poor taxfilers rise from $1,000 to $1,029 (for a tax cut of $29) while the tax credits for non-poor taxpayers increase from $915 to $1,029 (a $114 tax cut per person).

Upper-income taxpayers get tax relief through the elimination of the three percent general surtax that was lifted from non-affluent Canadians in last year's Budget. They also receive the same increase in the basic personal, spousal and equivalent-to-married amounts and resulting tax credits as other non-poor taxpayers.

In absolute terms, upper-income tax cuts outpace those of the poor and middle class. For example, a single taxpayer with income of $100,000 will save $813 in federal income tax from the tax reductions, compared to $379 for a $50,000 single person and $178 for someone with income of $20,000. But the pattern is reversed when measured as a percentage of federal tax: The $20,000 taxpayer's federal income tax saving amounts to 9.5 percent of federal tax, compared to 4.2 percent for the $50,000 taxpayer and 3.3 percent for the $100,000 person.

But the small tax breaks bestowed in the 1998 and 1999 Budgets are all fatally infected with the partial deindexation virus: The income tax system remains partially deindexed, as it has been since 1986. As a result, the tax reductions offer only temporary, modest and – perhaps worst of all - sleight-of-hand tax relief.

After years of stealthy tax increases, federal and provincial income taxes will ease a bit thanks to the 1998 and 1999 Budgets. But as early as 2000, income taxes resume their upward march because tax brackets and credits remain partially deindexed - as they have been since 1986. Some taxpayers are pushed into higher tax brackets; all taxpayers experience a steady decline in the value of their tax credits.

Ottawa estimates that last year's tax reductions removed 400,000 low-income Canadians from the federal tax rolls, with another 200,000 taken off this year, for a total of 600,000. This is a laudable achievement. But it still does not fully make up for the fact that 1.4 million working poor Canadians were pulled into the tax net as a result of more than a decade's worth of partial deindexation, which steadily lowers the taxpaying threshold. Worse, next year more poor people will be added to the tax rolls because of partial deindexation, which will inexorably whittle away year after year the 600,000 figure in this year's Budget.

Indeed, stealth taxes will help pay for Ottawa's income tax cuts, and also will offset the loss in provincial income tax revenues. All provinces except Quebec base their income tax systems on the federal tax system, which means that the provinces lose income tax revenue when Ottawa grants federal income tax cuts. But the provinces also benefit from stealth tax increases.

In 1999-2000, the federal government's income tax reductions will cost $1.5 billion in lost revenues. But partial deindexation will raise tax revenues by around $840 million, lowering the net cost of the tax cuts by a substantial 56 percent.

Refundable GST credit

Low-income single parents receive a supplementary refundable GST credit of $105 (the same as the amount for a child), over and above the basic adult benefit of $199. This supplementary credit is phased in at low income levels, which means that some single parents with small earnings get only a partial benefit. The Budget will pay the full $105 supplementary GST credit to all low-income single parents.

Unfortunately, the refundable GST credit remains infected with the partial deindexation virus, which has eroded its value over the years and targeted it further down the income ladder, increasing the regressivity of this major consumption tax. Thus the poor are the only Canadians who in effect pay more GST each year.

Growth in National Child Benefit

The Budget announces important improvements in the Canada Child Tax Benefit that forms Ottawa's commitment to the federal/provincial National Child Benefit System.

The maximum benefit, which was previously increased from $1,020 to $1,650 for one child and $1,450 for each additional child in July 1998, rises again to $1,805/$1,605 in July 1999 and $1,975/$1,775 in July 2000. The net family income level above which families do not qualify for the larger benefit for low-income families will increase from $25,921 to $27,750 in 1999 and $29,590 (the upper limit of the first tax bracket) in 2000. This change will pass along part of the increase in child benefits for low-income families to those with net incomes between $25,921 and $29,590 and will avoid having to jack already high marginal tax rates even higher for families between $20,921 and $25,921.

The Budget also makes a commendable start in the restoration of federal child benefits for modest- and middle-income families, which since the mid-1980s have seen their benefits eroded by inflation and by the replacement of the children's tax exemption with the non-refundable credit (later folded into the Child Tax Benefit). By raising the net family income threshold for the $1,020 per child base Canada Child Tax Benefit from $25,921 to $29,590, the federal government will provide a modest but long overdue increase in federal child benefits for two million non-poor families. Child benefits for two children will increase by $184 for most eligible families with net income over $29,590. For example, the Canada Child Tax Benefit for a $50,000 family with two children will increase from $836 to $1,020.

While the Canada Child Tax Benefit pays its largest amount to low-income families, it is not 'targeted-to-the-poor' in terms of its coverage: To the contrary, the Canada Child Tax Benefit serves 85 percent of all families with children. By increasing child benefits for non-poor families, the Budget will add about 100,000 middle-income families to the Canada Child Tax Benefit; the net family income threshold where eligibility ends will rise from $66,721 to $70,390 for families with two children, for example.

The increase in the maximum Canada Child Tax Benefit, which goes to low-income families, will cost $850 million (as announced in last year's Budget) building on the first $850 million that Ottawa committed when the federal and provincial governments launched the National Child Benefit in 1996. The improvement in child benefits for non-poor families is being financed through an additional $300 million investment in the Canada Child Tax Benefit. The federal government has boosted its total child benefit budget from $5 billion to $7 billion between 1997 and 2000.

The Budget demonstrates Ottawa's continuing commitment to the National Child Benefit, itself the first substantive model for the new partnership federalism embodied in the recent Social Union Framework Agreement. The provinces and territories, which have reinvested the first $850 million increase in federal child benefits in a range of income programs and social and health services for low-income families with children, will have another $850 million to build on those initiatives and/or undertake new ventures.

The Budget's welcome beginning to restoring federal child benefits for modest- and middle-income families marks another advance in social policy. Over the past few years, Ottawa has put substantial cash on the table that could help grow the Canada Child Tax Benefit into an effective income support system not only for the poor, but also for the majority of Canadian families with children.

But there is a considerable distance to go yet in building an adequate and effective child benefit system, and the key is cash: Ottawa must announce substantial new financial commitments in its 2000 Budget to further develop the National Child Benefit.

The immediate goal is to fully replace welfare payments on behalf of children, which could be reached by 2000 through a third installment in the Canada Child Tax Benefit and associated provincial reinvestment in other programs and services for their low-income families with children. We are calling for a $2,500 maximum payment for each low-income child in 2000, as a suitable way for Canada to mark the new millennium. Early in the next decade, the maximum Canada Child Tax Benefit should be raised quickly to $4,000 to substantially offset the cost of raising a child for low-income parents. And child benefits for non-poor families should be increased in step with the improvements for low-income families.

Unemployment assurance

It is time to look yet again at one of Canada's most important social fundamentals: unemployment insurance. The Budget makes reference to the small premium reductions of recent years. But the serious problems with both the program's coverage and financing remain in place.

Unemployment Insurance has been tightened periodically since the introduction of the Act of 1971 that extended coverage to virtually all employees (though not the self-employed). The 1990s brought several stringent changes in the form of tougher qualifying requirements and reductions in the level and duration of benefits.

The impact of the stricter rules on Unemployment Insurance's coverage of the unemployed has been devastating. In 1989, 87.3 percent of the unemployed received regular UI benefits. By 1997, the rebranded program - Employment Insurance or EI - paid benefits to only 41.7 percent of Canada's unemployed.

No other social program has seen such a drastic slashing of its clientele. But reduced coverage is not the only problem. Workers who must leave the program earlier than ever and those who do not even qualify in the first place have no access to the training funds tied to the 'active' labour market measures embedded in the program.

The fundamentals of financing also have to be restored. The EI program – especially in its present reduced form, paying lower benefits to fewer than half the unemployed – does not require the current level of premiums. Even with a series of premium reductions in recent years, the surplus in the EI Fund was $19 billion in 1998 and is expected to rise to $25 billion in 1999.

EI premiums should be collected and deposited into a separate fund to be used expressly for income protection for workers in the event of job loss, short-term illness or maternity and parental leave. They are not - and never were - intended as monies for general deficit and debt reduction.

The use of the Employment Insurance fund has moved so far from its original purpose that one has to question whether EI still can be called 'social insurance.' The government should announce a major reform to get this fundamental fundamental back on track. It is clear that the program as it is currently designed is not fulfilling its necessary role in a dynamic and insecure economy.

Deafening silence on disability issues

The Budget did precious little in respect of disability issues. There were merely some small additions to the medical expense tax credit. It now will include the amounts paid to persons providing care and supervision in a group home for those with severe physical and mental disabilities eligible for the disability tax credit. The credit will cover certain medical therapies that do not require a qualified therapist or medical practitioner to administer as well as the cost of tutoring for persons with learning disabilities. The list of equipment eligible for the credit will include talking textbooks for use at an educational institution.

But the lack of action on the program front is disheartening, given the landmark document that Ottawa signed on October 27, 1998 with all the provinces (except Quebec). *In Unison*: *A Canadian Approach to Disability Issues* sets out a vision for advancing the disability agenda from the perspective of full citizenship for persons with disabilities. It states clearly the actions that must be taken in three key areas: disability supports, employment and income.

The document discusses the need to ensure access to disability supports through greater portability and reduced cost. It sets out several actions to promote the employability of persons with disabilities as well as the creation of new job opportunities. It talks about ways to improve income security programs.

The federal government could have acted on this document, if for no other reason than to show Canadians that the new Social Union rhetoric actually can be made real and substantive.

Ottawa could have started to engage provinces in a dialogue on disability supports that would link directly to the pressing need to strengthen home care. It could have set out a bold new plan for engaging the private sector in opening up employment for persons with disabilities. The Budget could have provided additional tax relief for respite care.

With a federal-provincial vision document in hand, Ottawa had a brilliant opportunity to take definitive leadership. The deafening silence about the federal-provincial work that had preceded the Budget and the ensuing joint vision paper is a very loud message. It is incomprehensible that the government could not find one single measure to support from this historic vision paper.

Ottawa shelters itself

The federal government's recent policy on social housing has succeeded in sheltering itself from this pressing national concern. The lack of high-quality, affordable housing is not a new problem. But it has been made far worse since the federal decision in 1993 virtually to abandon the social housing field and from the subsequent withdrawal of funds for the construction of new social housing. The growing number of homeless people sleeping out on frigid streets is merely the tip-of-the-iceberg of a huge problem.

Ottawa no longer can shelter itself from the fact that it should be playing a leading role in tackling this national crisis - and international embarrassment. Again, the Social Union Framework Agreement could be used to kickstart the federal-provincial work required to ensure high-quality, affordable accommodation for all Canadians.

The bottom line

The 1999 Budget takes some small steps towards restoring the social fundamentals, especially in its enhancement of funds for health care, child benefits and modest tax breaks. But the social fundamentals have been thrown so far off course in the fight against the deficit that nothing less than deep structural reforms in some areas and reinvestment in other areas are required at this time. On this count, the 1999 Budget falls short.

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