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# Communiqué

**Embargo: For release *Thursday*, May 20, 1999, at 10:00 a.m.**

# *New child benefit system needs to go back to the shop for repairs, says C.D. Howe Institute study*

The National Child Benefit (NCB), announced in 1997, was intended to provide generous government support to low-income families, whether or not they are on welfare, while simultaneously making paid work a paying proposition. But if Ottawa and the provinces are to achieve these twin goals, their agencies will have to work harder on basic program design, says a study of the NCB released today by the C.D. Howe Institute.

The study, *Improving the National Child Benefit: Matching Deeds with Intentions,* was written by Adil Sayeed, a public policy consultant. He says that, in some provinces, for some very low income families, the benefit system does achieve the twin goals of reducing poverty and improving the gains from working. The more common result, however, is that the NCB is not improving incentives to work. The problem is that, for many families entering the paid work force, the tax rates on their incremental working income are much higher than before, creating a brand new "welfare wall."

Policymakers have long used "welfare wall" to describe the barrier to seeking paid work that is created by a social assistance system that drastically reduces benefits when recipients earn outside income. Under the federal-provincial NCB initiative, the provinces are responsible for deciding how to balance two competing objectives: lowering that welfare wall for low-income families, and reducing poverty.

Most provinces have deducted the new child benefit supplement from provincial welfare entitlements. As a result, says Sayeed, most families on welfare have no direct gain from the NCB, but they could be in a better position to work their way off welfare.

Some provinces — such as Ontario, Saskatchewan, and British Columbia — used their welfare savings to create earned-income supplements. For families earning less than $10,000 in these provinces, the system has reduced poverty and improved work incentives at the same time.

However, income testing of provincial cash benefits has raised marginal tax rates — the tax rate on incremental earned income — for families earning just enough to be off welfare. Sayeed says that, in Saskatchewan, low-income families with two children face a marginal tax rate of more than 91 percent. In Ontario and British Columbia, two-child families earning

$30,000 face a marginal tax rate of more than 69 percent. For these families, says Sayeed, the NCB has increased government cash benefits, but worsened work incentives.

Instead of using its welfare saving to fund cash benefits, Manitoba used it to implement a "Children First" strategy involving early intervention programs for families having problems, improved school nutrition, and "head-start" education for preschoolers. These initiatives, Sayeed says, do not raise welfare walls because eligibility is based on neighborhood and family characteristics rather than on income.

Sayeed argues that the other provinces should adopt variations on Manitoba's strategy rather than further raise their cash benefits to low-income families. High clawbacks on cash payments put punishing tax rates in front of low-income families taking on paid work. Support aimed directly at children growing up in disadvantaged circumstances may be more useful in combating the cycle of poverty.

This is the fifth in a series of C.D. Howe Institute Commentaries called "The Taxation Papers." The series deals with the tax policy opportunities presented by Canada's rapidly changing fiscal environment — in particular, ways to reform personal income tax policy within a sound economic framework, rather than allowing policy to be driven by short-term political considerations. Papers in the series seek to identify specific problems with past choices about the taxes used to finance government (the tax mix); define the best way of taxing families; show how personal income taxes have been or should be adjusted for inflation; and synthesize these issues within a rational frame-work for tax reform and tax reduction.

The series editors are Jack M. Mintz, who is Arthur Andersen Professor of Taxation at the Joseph L. Rotman School of Management, University of Toronto, and Finn Poschmann, a Policy Analyst at the C.D. Howe Institute.

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*Improving the National Child Benefit: Matching Deeds with Intentions*, C.D. Howe Institute Commentary 125, by Adil Sayeed (C.D. Howe Institute, Toronto, May 1999). 28 pp.; $9.00 (prepaid, plus postage & handling and GST — please contact the Institute for details). ISBN 0-88806-456-X.

Copies are available from: Renouf Publishing Company Limited, 5369 Canotek Road, Ottawa, Ontario K1J 9J3 (stores: 71½ Sparks Street, Ottawa, Ontario; 12 Adelaide Street West, Toronto, Ontario); or directly from the C.D. Howe Institute, 125 Adelaide Street East, Toronto, Ontario M5C 1L7. The full text of this publication will also be available on the Internet.

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***Communiqué***

**Embargo : à diffuser le *jeudi* 20 mai 1999 à 10 h**

# *Selon une étude de l'Institut C.D. Howe, le nouveau régime de prestation pour enfants devrait être remanié*

Lancée en 1998, la Prestation fiscale canadienne pour enfants (PFCE) visait à fournir un appui gouvernemental généreux aux familles à faible revenu, qu'elles dépendent ou non de l'aide sociale, tout en faisant du travail rémunéré une proposition lucrative. Mais pour qu'Ottawa et les provinces puissent réaliser ces objectifs communs, leurs organismes devront s'efforcer d'améliorer la conception fondamentale du programme, affirme une étude sur le PFCE publiée aujourd'hui par l'Institut C. D. Howe.

Intitulée *Improving the National Child Benefit: Matching Deeds with Intentions (Amélioration de la prestation nationale pour enfants : harmonisation des actions et des intentions)*, l'étude est rédigée par Adil Sayeed, un conseiller en politiques gouvernementales. Dans certaines provinces, explique-t-il, le régime des prestations réalise le double objectif de réduction de la pauvreté et d'amélioration de la rémunération pour certaines familles à très faible revenu. Cependant, le résultat qui se produit habituellement, c'est que la PFCE n'améliore pas l'incitation au travail. En effet, pour beaucoup de familles qui accèdent à un travail rémunéré, le taux d'imposition sur le revenu supplémentaire tiré du travail est bien plus élevé qu'avant, créant ainsi un nouveau « mur de l'aide sociale ».

Les artisans de la politique utilisent depuis longtemps l'expression « mur de l'aide sociale » pour décrire l'obstacle au travail rémunéré que constitue un régime d'aide sociale qui réduit considérablement les prestations lorsque les prestataires gagnent un revenu d'autre source. Dans le cadre de l'initiative fédérale-provinciale du PFCE, les provinces sont chargées de décider comment trouver l'équilibre entre deux objectifs concurrentiels, soit d'abaisser le mur de l'aide sociale pour les familles à faible revenu et de diminuer la pauvreté.

La plupart des provinces déduisent le nouveau supplément de la prestation nationale pour enfants de l'admissibilité à l'aide sociale provinciale. Par conséquent, indique M. Sayeed, la plupart des familles qui dépendent de l'aide sociale ne perçoivent aucun avantage direct de la PFCE, mais elles pourraient être mieux placées pour se libérer de la dépendance de l'aide sociale grâce au travail.

Certaines provinces, comme l'Ontario, la Saskatchewan et la Colombie-Britannique — utilisent les économies qu'elles réalisent sur l'aide sociale pour créer des suppléments au travail rémunéré. Dans ces provinces, pour les familles qui gagnent moins de 10 000 $, le régime a permis de réduire la pauvreté et amélioré du même coup l'incitation à travailler.

Cependant, le test du revenu des prestations provinciales en espèces a augmenté le taux marginal d'imposition — soit le taux d'imposition du revenu supplémentaire gagné — pour les familles qui gagnent juste assez pour ne pas dépendre de l'aide sociale. L'auteur explique qu'en Saskatchewan, les familles à faible revenu ayant deux enfants sont assujetties à un taux marginal d'imposition de plus de 91 %. En Ontario et en Colombie-Britannique, les familles ayant deux enfants et qui gagnent 30 000 $ sont assujetties à un taux marginal d'imposition de plus de 69 %. Pour ces familles, indique M. Sayeed, le PFCE a amélioré les prestations pécuniaires gouvernementales, mais réduit l'incitation à travailler.

Pour sa part, le Manitoba, au lieu de consacrer le montant économisé sur l'aide sociale au financement des prestations en espèces, s'en est servi pour mettre en œuvre une stratégie des « enfants d'abord » qui comprend des programmes d'intervention précoce pour les familles qui éprouvent des problèmes, pour améliorer l'alimentation en milieu scolaire et donner un « bon départ » à l'éducation des enfants d'âge préscolaire. Comme l'indique l'auteur, ces initiatives ne créent pas de murs plus élevés d'aide sociale puisque l'admissibilité dépend des caractéristiques propres aux quartiers et aux familles plutôt que du revenu.

M. Sayeed soutient que les autres provinces devraient adopter des variantes de la stratégie manitobaine plutôt que d'augmenter davantage leurs prestations en espèces aux familles à faible revenu. Les dispositions élevées de récupération sur les paiements en espèces placent de lourds taux d'imposition sur les familles à faible revenu qui décrochent un emploi rémunéré. Or, un soutien visant directement les enfants élevés dans un milieu défavorisé pourrait s'avérer plus utile pour lutter contre le cycle de la pauvreté.

Ce document est le cinquième volet d'une série de Commentaires de l'Institut C.D. Howe intitulée « Les cahiers de la fiscalité ». Celle-ci traite des possibilités de politiques fiscales qu'offre le milieu fiscal en évolution rapide au Canada et plus particulièrement, des moyens de réformer les politiques de l'impôt sur le revenu des particuliers dans un cadre économique rationnel, plutôt que de laisser des raisons politiques à court terme dicter ces politiques. Les documents qui font partie de cette série cherchent notamment à cerner les problèmes exacts qu'ont posés les choix de taxes et d'impôt pour financer le gouvernement dans le passé (soit la composition des recettes fiscales), à établir la meilleure façon d'imposer les familles, à démontrer comment l'impôt sur le revenu des particuliers a été rajusté ou devrait être rajusté en fonction de l'inflation, et à résumer toutes ces questions dans un cadre rationnel pour la réforme fiscale et la réduction d'impôt.

La série est dirigée par Jack Mintz, professeur de fiscalité titulaire de la chaire Arthur Andersen à l'École de gestion Joseph L. Rotman de l'Université de Toronto et Finn Poschmann, analyste de politique auprès de l'Institut C.D. Howe.

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*Improving the National Child Benefit: Matching Deeds with Intentions,* Commentaire n$^{o}$ 125 de l'Institut C.D. Howe, par Adil Sayeed, Toronto, Institut C.D. Howe, mai 1999, 28 p., 9,00 $ (les commandes sont payables d'avance, et doivent comprendre les frais d'envoi, ainsi que la TPS — prière de communiquer avec l'Institut à cet effet). ISBN 0-88806-456-X.

On peut se procurer des exemplaires de cet ouvrage auprès des : Éditions Renouf ltée, 5369, chemin Canotek, Ottawa ON K1J 9J3 (librairies : 71½, rue Sparks, Ottawa ON, et 12, rue Adelaide Ouest, Toronto ON) ou encore en s'adressant directement à l'Institut C. D. Howe, 125, rue Adelaide Est, Toronto (Ontario) M5C 1L7. On peut également consulter le texte intégral de cet ouvrage au site Web de l'Institut.

# Improving the National Child Benefit:

## Matching Deeds with Intentions

by

*Adil Sayeed*

Government payments supporting family income, such as child benefits or welfare, are usually income tested: benefits are reduced in proportion to additional wages that recipients might earn. While the payments do benefit those who receive them, and may help in fighting poverty, the fact that they are income tested is usually seen as a disincentive to seeking additional income by working.

The National Child Benefit (NCB), a federal-provincial initiative, is an attempt to resolve the conflict by reducing poverty and improving work disincentives at the same time. Ottawa is contributing $2 billion toward the effort, while leaving the provinces to decide how best to achieve the NCB's goals. Ontario, Saskatchewan, and British Columbia are introducing earned-income supplements for families with children. For families earning less than $10,000 per year, the new benefits in those provinces do reduce both poverty and work disincentives.

But families further up the earnings scale face increased disincentives. Saskatchewan families earning $20,000 now face a marginal tax rate (MTR) of more than 91 percent; Ontario and BC families earning $30,000 face an MTR of more than 69 percent. This suggests that earned-income supplements do not resolve the conflict between poverty reduction and work attachment. Instead, they shift the work disincentive problem a bit further up the earnings scale.

Over the next two years, the provinces will have another $300 million to add to their spending on NCB programs. If the provinces raise family benefits and the taxback rates used to target those in need, then working families will face even higher MTRs. Instead, the provinces should follow the example of Manitoba's "Children First" strategy by investing NCB funds in intervention programs to improve the prospects of children in disadvantaged circumstances.

## *Main Findings of the Commentary*

- Welfare and other transfer payments such as the Canada Child Tax Benefit (CCTB) provide a minimum income floor for families unable to support themselves. But, because benefits are targeted on those most in need, families on welfare, as well as families with wage incomes not much above welfare benefits, face severe work disincentives in the form of high marginal tax rates (MTRs) — in many cases, more than 75 percent.
- Under the new federal-provincial National Child Benefit (NCB) initiative, the provinces have primary responsibility for deciding how to balance two competing objectives: reducing poverty and lowering work disincentives for low-income families.
- Most provinces have accepted the federal government's invitation to deduct the new NCB Supplement from provincial welfare entitlements. As a result, many families on welfare derive no direct income gains from the NCB.
- But some families are in a better position to work their way off welfare. Three provinces — Ontario, Saskatchewan, and British Columbia — used their NCB-induced welfare savings to introduce earned-income supplements: cash payments that, over a limited income range, increase rather than decrease when families earn more. For families earning less than $10,000 in these provinces, the NCB has reduced poverty and work disincentives at the same time.
- However, income testing of provincial NCB cash benefits has raised MTRs for families earning just enough to be off welfare. In Saskatchewan, two-child families earning between $17,500 and $22,980 now face an MTR of more than 91 percent. In Ontario and British Columbia, two-child families earning $30,000 face an MTR of more than 69 percent. For these families, the NCB has improved disposable incomes, but also worsened work incentives.
- Instead of using NCB-induced welfare savings to fund cash benefits, Manitoba has implemented a "Children First" strategy involving early intervention programs for families having problems, improved school nutrition, and "head-start" education for preschoolers. These initiatives do not raise work disincentives because eligibility is based on characteristics such as neighborhood and family type rather than income.
- The other provinces should adopt variations on Manitoba's strategy rather than further raise their cash benefits to low-income families. High taxback rates on such cash payments subject low-income families to punishing MTRs. Support aimed directly at children growing up in disadvantaged circumstances may be more useful in the long run in combating the cycle of poverty.

When the federal and provincial governments announced their agreement on the National Child Benefit (NCB) in January 1997, they stated that their objectives were to help prevent and reduce the depth of child poverty; promote attachment to the work force; and reduce overlap and duplication (Canada 1997). Almost everyone agrees that these are worthy goals. However, the Gordian knot of social policy has always been the conflict between the reduction of poverty reduction and attachment to work. By proposing to meet both of these objectives with the NCB, Ottawa and the provinces held out the promise of resolving this long-standing conflict.

The purpose of this *Commentary* is to assess how well the NCB programs launched in July 1998 have met their objectives and to suggest a policy direction for provinces that are applying the next two federal NCB installments, scheduled for July 1999 and July 2000.

## *Outline of the* Commentary

The first section consists of an overview of the roles of the federal and provincial governments in the NCB; Ottawa took the lead in financing the program, but left the key policy decisions up to the provinces. I outline first the federal contribution — a $2 billion increase in the Canada Child Tax Benefit (CCTB) — then the mechanism by which more than a third of the federal contribution ends up in the hands of the provinces for use on their own family programs. The provinces' key policy decisions are presented in a summary of provincial program initiatives since July 1998.

The second section begins with some policy background on the conflict between reducing poverty and maintaining work incentives. The discussion of work incentives draws on a recent *Commentary* by James Davies, *Marginal Tax Rates in Canada: High and Getting Higher* (Davies 1998).

I present a simple framework for making some qualitative comments about the NCB's impact on poverty reduction and work attachment. Poverty reduction is gauged by looking at the NCB's impact on the disposable incomes of families with low earnings. Work-attachment effects depend on NCB-related changes in marginal tax rates (MTRs). The MTR is the total amount by which a family's tax payments increase and income-tested benefits fall for each dollar that its earnings rise.

The second section closes with two methodological explanations: first, of the rationale for relying on particular family-case examples to illustrate the impact of the NCB and, second, of the decision to analyze the NCB in five representative provinces — New Brunswick, Ontario, Manitoba, Saskatchewan, and British Columbia.

With this background in place, in the next section I assess the NCB in four of these five provinces, including New Brunswick's decision to emphasize poverty reduction and the use of NCB funds by Ontario, Saskatchewan, and British Columbia to introduce earned-income supplements for low-income families with children.

The discussion of the NCB in Ontario, Saskatchewan, and British Columbia — the three provinces to spend NCB funds on earned-income supplements for low-income families — sets the stage for a review of the key policy issues faced by designers of these programs: targeting mechanisms, the speed at which benefits respond to changes in family earnings, and the question of whether the same eligibility rules should apply to both wage earners and the self-employed.

The fifth province, Manitoba, is reviewed in the next section. Manitoba is targeting long-term poverty prevention by spending a significant portion of its NCB funds on programs aimed at improving the lifetime prospects of children being raised in disadvantaged circumstances.

In the concluding section, I review the dilemma facing the provinces in deciding how to spend the next two NCB installments. MTRs for many families with two or more children and incomes between $20,921 and $35,000 exceed 50 percent. Some families earning these modest incomes face MTRs of more than 70 percent — well above those faced by families with incomes of more than $100,000. If further increases in child benefits are taxed back over the $20,921 to $35,000 income range, MTRs will be driven even higher. The *Commentary* ends with a policy recommendation that future NCB spending should go to programs aimed at improving the lifetime prospects of disadvantaged children rather than to income-tested cash benefits.

## How the NCB Works

The National Child Benefit does not consist of one program delivering uniform payments across the country. Rather, it encompasses 12 different sets of programs across the ten provinces and two territories built on a platform provided by a federal payment to low-income families.

### *Federal Child Benefits*

In July 1998, the federal government converted the Working Income Supplement (WIS) portion of the monthly CCTB for low-income families with children under age 18 into a new benefit called the National Child Benefit Supplement. In the February 1999 budget, Ottawa announced that this supplement would be increased in July 1999 and again in July 2000. In addition, the starting threshold for income testing the basic CCTB would rise from $25,921 to $29,590. Table 1 summarizes the features of the CCTB before and after these changes, using numbers for a family with two children.

**Table 1:** ***Features of the Canada Child Tax Benefit, Before and After the Introduction of the National Child Benefit***[a]

| | Pre-NCB | Post-NCB |
|---|---|---|
| | *(dollars, except as noted)* | |
| *Base CCTB* | | |
| Maximum annual benefit[b] | 2,466 | 2,466 |
| Maximum payable up to net family income of: | 25,921 | 29,590 |
| Taxback rate[c] *(percent)* | 5 | 5 |
| Partial CCTB cuts out at net family income of: | 75,241 | 78,910[d] |
| *CCTB Supplement* | | |
| Benefit name | Working Income Supplement | NCB Supplement |
| Maximum annual benefit | 500 | 1,710[e] |
| Earned income eligibility requirement | 3,750 | 0 |
| Rate at which benefit rises with earned income *(percent)* | 8 | 0 |
| Earned income required for maximum benefit | 10,000 | 0 |
| Maximum payable up to net family income of: | 20,921 | 20,921 |
| Taxback rate *(percent)* | 10 | 19.7[f] |
| Partial benefit cuts out at net family income of: | 25,921 | 29,590 |

[a] For a family with two children.

[b] This represents $2,466, the basic benefit of $1,020, plus a supplement of $213 for each child under age 7 for whom the tax deduction for child care expenses is not claimed, times two children. Otherwise, the maximum benefit is $2,040.

[c] The taxback rate is 2.5 percent for one-child families.

[d] For two-child families that do not qualify for the $213 per child supplement, the CCTB cuts out at a net family income of $70,390.

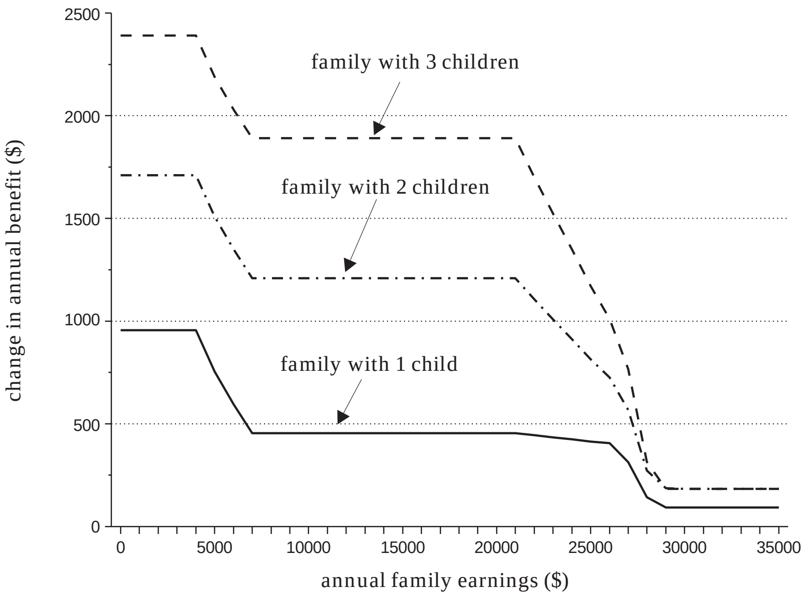
[e] In July 2000, the maximum annual NCB Supplement will rise to $955 for the first child, $755 for the second, and $680 for each additional child.

[f] The NCB Supplement taxback rate is 11.0 percent for one-child families and 27.6 percent for families with three or more children.

Source: Author's calculations.

The NCB Supplement will cost $1.7 billion more per year than the WIS and the change to the basic CCTB will cost another $0.3 billion. Only low-income families with employment earnings had been eligible for the WIS; now, all families with annual incomes of less than $29,590 are eligible for the new NCB Supplement, regardless of whether any of their earnings come from employment.

**Figure 1:** ***Impact of Changes to the Canada Child Tax Benefit***
(year 2000 versus 1996 configuration)




Note: Earnings from work are assumed to be the only source of income.

Source: Author's calculations.

Families with annual employment earnings of less than $3,750 gain the most from the new structure. These families were not eligible for the WIS, but now receive the NCB Supplement. Net gains decline as annual earnings rise from $3,750 to $10,000 — the range over which WIS entitlements increased — and flatten out thereafter. Figure 1 shows the impact of the federal CCTB changes on families at different income levels. The three lines show the net changes in federal benefits from the pre-NCB structure to the new structure as fully implemented in July 2000 for families with one, two, and three children.

## *The Role of the Provinces*

The large CCTB gains for families with very low earnings do not result from a greater emphasis on poverty reduction on the part of the federal government. Rather, the CCTB changes were designed to substitute federal benefits for provincial welfare payments to families with low earnings. Ottawa invited provincial governments to reduce welfare payments to families with children by one dollar for each dollar the families received from the NCB Supplement. Families on welfare would be no better off, but no worse off; they would simply receive a greater portion of their benefits from Ottawa and a smaller portion from the provinces.

Provincial governments could then use their welfare savings to increase spending on other programs for low-income families with children. Thus, the provinces had primary responsibility for balancing the competing NCB policy objectives of poverty reduction and work attachment. Each provincial government faced two key decisions:

- Would the province focus on poverty reduction by allowing families on welfare to benefit from the federal NCB Supplement, or would it accept the federal invitation to deduct the supplement from welfare entitlements in order to fund other programs for low-income families with children?
- If the province chose to use the welfare savings to fund other programs, would these take the form of cash benefits designed to encourage work attachment, such as earned-income supplements, or of early intervention programs designed to improve the lifetime prospects of children growing up in disadvantaged circumstances?

## *What the Provinces Have Done*

The $2 billion federal contribution will ultimately generate about $750 million per year in potential welfare savings that the provinces can use to finance other family programs.[1] With the provinces free to develop their own programs, the impact of the NCB on a particular family depends on where that family lives. The approaches chosen by various provinces and territories can be grouped as follows:

- New Brunswick and Newfoundland are the only provinces that pass the federal NCB Supplement through directly to families on welfare, forgoing the opportunity to channel welfare savings into other programs for low-income families with children.[2]
- Five governments — Nova Scotia, Ontario, Saskatchewan, British Columbia, and the Northwest Territories — have opted to pay income-tested cash benefits to low-income families with children. All these governments are also increasing funding for noncash services but the cash benefits are the focal point of their NCB programming.
- Four governments — Prince Edward Island, Manitoba, Alberta, and Yukon Territory — are providing in-kind (noncash) services and programs for families.
- Quebec, which formally withdrew from the NCB negotiations prior to their completion, deducts the federal NCB Supplement from welfare entitlements and uses the savings to finance a restructuring of its own family programs. However, no specific components of Quebec's reforms have been identified as NCB-funded.

## The Analytical Framework

### *Conflicting Objectives: Poverty Reduction vs Work Attachment*

Governments provide welfare and other benefits to reduce the poverty of those unable to support themselves. Social welfare benefits are targeted to reach those most in need, thereby minimizing welfare spending and the tax rates needed to finance it.

The existence of a safety net may reduce the incentive that some individuals feel to support themselves. The rate at which benefits are reduced as recipients' incomes increase — the taxback rate that is used to target assistance — may further reduce work incentives.

Provincial welfare programs embody the starkest conflict between poverty reduction and work attachment. In a world without welfare, adults who are unable to work because of disability or adverse labor market conditions would have to rely on private charity to sustain them and their children. However, the tight targeting of welfare benefits creates MTRs so high that the short-run gains from working are minimal for those on welfare. By providing a minimum income floor for households that have no means of support, governments also erect a welfare wall of high MTRs that reduce the incentive for recipients to return to full-time work.

To illustrate the income floor and MTR wall for families on welfare, consider the following three situations for a hypothetical single parent in Ontario with two children under age seven. The family is on welfare, and the NCB has not yet taken effect.

In situation A, the parent has no employment earnings and is entirely dependent on welfare and other transfer payments. In situation B, the parent has a part-time job with an annual salary of $10,000. In situation C, the parent has a full-time job with an annual salary of $25,000.[3]

In situations B and C, the parent is employed year round at a constant hourly wage and weekly number of hours, so that his or her annual earnings are made up of 12 equal monthly amounts. In both situations, the family has access to free child care, from either a relative or a public subsidy. In situation C, when the parent files an annual tax return and claims the Ontario Tax Reduction for dependants, the Ontario income tax withheld from the year's regular paycheques is refunded.

Table 2 shows how the pre-NCB tax and benefit systems affected Ontario families on welfare at these three different earnings levels. (For a detailed explanation of the assumptions used in these and other calculations in this *Commentary*, see Box 1.)

A single parent in Ontario with two pre-school-age children and no earnings (situation A) could depend on an annual income floor of $16,714 from welfare and other benefits. Now suppose that parent were offered a part-time job working 16 hours per week at $12.02 per hour, for an annual salary of $10,000 (situation B).[4] After employment insurance (EI) and Canada Pension Plan (CPP) premium deductions and benefit taxbacks, the family would be $5,653 better off with the part-time job.[5] To put it another way, premiums and taxbacks would cut the net after-tax wage on the parent's first $10,000 in earnings to $6.79 per hour.

**Table 2: *Taxes and Benefits for an Ontario Family on Welfare Before the Introduction of the National Child Benefit*** [a]

| | Situation A | Situation B | Situation C |
|---|---|---|---|
| | | *(dollars)* | |
| Annual earnings | 0 | 10,000 | 25,000 |
| Plus welfare | 13,242 | 8,993 | 291 |
| Plus federal CCTB | 2,466 | 2,966 | 2,592 |
| Plus federal GST credit | 608 | 608 | 608 |
| Plus OPSTC[b] | 398 | 283 | 157 |
| Less EI premium | 0 | – 255 | – 638 |
| Less CPP premium | 0 | – 228 | – 753 |
| Less federal income tax | 0 | 0 | – 1,772 |
| Less provincial income tax | 0 | 0 | 0 |
| Total disposable income | 16,714 | 22,367 | 25,437 |

[a] Single-parent family with two children.

[b] Ontario Property and Sales Tax Credit; to calculate the credit, I assumed a monthly rent of $554, the maximum covered by Ontario welfare for a three-person family.

Source: Author's calculations.

Suppose the single parent were then offered the chance to move up to a full-time shift of 40 hours per week, for an annual salary of $25,000 (situation C).[6] He or she would be only $3,070 better off after an increase in weekly work hours from 16 to 40. The average tax rate on annual earnings from $10,000 to $25,000 would be 79.5 percent.[7] Taxes and benefit taxbacks would have cut the net wage for the additional time at work to $2.46 per hour. Obviously, this high MTR is a barrier to work — a welfare wall.

Under the NCB, a single parent in Ontario with two children is no longer eligible for a welfare benefit with annual earnings of $25,000, because the maximum welfare benefit is reduced by the amount of the NCB Supplement. Once the full supplement increase is in place in July 2000, the annual earnings level at which this particular family would exit the welfare system will have fallen by more than $3,000. As soon as an Ontario family stops receiving welfare, the MTR it faces drops by more than 37 percentage points. The reduction in the earnings level needed to exit from welfare and its high MTRs is one way that the NCB has lowered the welfare wall.

High MTRs for welfare recipients are not peculiar to Ontario. In all provinces, once net earnings exceed a basic exemption, welfare recipients face very high total MTRs. Thanks to this welfare wall, the poorest households in Canada face the highest MTRs. As Davies (1998) shows, MTRs at the bottom end of the earnings scale are much higher than those at the top end. Table 3 compares the MTRs facing single-parent, two-child families on welfare with those facing a similar family with earnings in excess of $100,000 in the five provinces under study.

Across Canada, 590,000 families with children were on welfare in March 1997 (Canadian Council on Social Development 1997).[8] In other words, nearly 16 percent of all families

**Box 1:** ***Methodology***

Throughout this *Commentary,* I present estimates of disposable incomes and marginal tax rates for hypothetical families with children at different earnings levels.

For real-world families, such calculations are complex. Income and payroll taxes applied by the withholding schedule to regular paycheques approximate, but do not exactly match, the final taxes assessed when annual returns are filed. Taxable income does not necessarily correspond with total income because of deductions for items such as child care expenses or pension and Registered Retirement Savings Plan contributions.

A further complication is that taxbacks for welfare families with earned income occur almost instantaneously, since welfare benefits are paid monthly and recipients are expected to report changes in circumstances immediately. By contrast, the Canada Child Tax Benefit (CCTB) taxback operates with a considerable time lag: a family's CCTB entitlement is recalculated each July after annual tax returns are filed. Thus, a change in family income that occurs in January 1999 would not result in a corresponding CCTB adjustment until July 2000.[a]

The calculations in this *Commentary* are based on the following simplifying assumptions:

- Work income and welfare are the only sources of income.
- Annual work income is earned in 12 equal monthly amounts. In other words, there is no allowance for seasonal employment.
- No one in the family has any deductions for tax purposes.
- Employment insurance (EI) and Canada Pension Plan (CPP) contribution rates are for 1999.
- Federal income tax rates are the rates that will apply in 2000 when the tax cuts announced in the February 1999 federal budget are fully phased in.
- Provincial tax rates and benefit levels are based on official announcements to March 31, 1999.
- CCTB payments are for the 1999 taxation year and payable from July 2000 to June 2001. Benefits are based on the mature system announced in the 1999 federal budget.
- The CCTB, goods and services tax (GST) credit, and other provincial cash benefits are the amounts to be paid based on annual earnings and income, even if payment does not begin until July after the annual tax return has been filed.
- Disposable income is equal to gross earnings less final income and payroll taxes, plus welfare, the CCTB, the GST credit, and any provincial cash benefits.

A different set of assumptions would produce different MTR and disposable income estimates for any particular family case. However, a change in assumptions would not alter the basic patterns shown here of how MTRs and disposable incomes change as family earnings rise.

Note that the calculations do not include the impact on MTRs from income tests applied to publicly provided goods and services, such as child care and social housing. These MTR effects are important for those families to which they apply, but such programs are not as widely available as income transfers such as welfare and the federal CCTB. For example, provincial govern-

with children under 18 were facing MTRs similar to those shown in the table.

## Measuring Policy Impacts

Finding an appropriate balance between poverty reduction and work attachment is made more difficult by the lack of consensus on the definition of poverty and on the precise impact that government benefits and MTRs have on work attachment.

### Effects on Poverty Reduction

Many Canadians believe that Statistics Canada's low-income cutoffs (LICOs) define a tarments ration public housing and child care subsidies by limiting the total number of spaces and / or dollars that they are willing to provide. As a result, only a small percentage of families that meet the income eligibility test for child care subsidies actually receive a subsidized space. By contrast, all families that qualify for provincial welfare or the federal CCTB can receive benefits by filing an application form or, in the case of the CCTB, simply by filing an annual tax return. Accordingly, my calculations do not include the MTR effects of income-tested programs that are rationed rather than made available to all eligible applicants.

Factors such as transportation, clothing, and other employment expenses, which likely play a role in decisions about whether, where, and how much a person works, are also not included.

Another factor not accounted for in the calculations is the value of drug, dental, and vision benefits provided to welfare recipients. Many low-wage jobs do not come with employer-provided health benefits; thus, the loss of these benefits should be factored into the MTR a welfare recipient faces when reaching the earnings threshold for continued welfare eligibility.

For welfare-dependent families with high drug costs — resulting, for example, from the health problems of one or more family members — the potential loss of health benefits can be a powerful work disincentive. For most welfare families, however, the value of annual health benefits received from welfare is relatively small. For example, in Ontario the average drug benefit per welfare case was $600 in fiscal year 1997 / 98. Because the average is boosted by high drug costs for a relatively small proportion of cases, the median value of drug benefits for families on welfare is likely much lower — probably a few hundred dollars or so — and this is the value of the disposable income "notch" for the average household created by the loss of drug benefits at the precise point where welfare eligibility is lost.

Although an annual loss of a few hundred dollars for most families with typical health costs would probably not have a decisive influence on the choice between full-time work and remaining on welfare, families exiting from the welfare system likely perceive this "notch" as unfair. Ontario established its Trillium Drug Benefits Plan to address this problem. The plan provides public drug insurance based on income and annual drug costs and protects Ontarians against catastrophic — that is, very high relative to family income — drug costs.

[a] Indeed, one possible defense of high MTRs is that the tax and benefit systems are too complex for ordinary people to grasp. Families with modest earnings are unlikely to have tax planners advising them of their overall MTR. However, social policy cannot be founded on a hope that the system is now so complicated that ordinary people do not understand how high MTRs really are. Individuals can be affected by MTRs without necessarily being able to calculate them to the nearest percentage point. A widespread feeling that "government takes everything and won't let us get ahead" stems from an accurate perception that a large chunk of earnings gains ultimately disappears after all taxes and benefits are factored in.

get level of minimum income below which no household should be allowed to fall. For example, Campaign 2000, a coalition of social policy advocacy groups, is urging the federal and provincial governments to meet the target proposed by the Senate of ensuring that by 2000 no child lives in a family whose income is below the LICO. However, Statistics Canada representatives have repeatedly warned that LICOs are not poverty lines (Fellegi 1998). Sarlo (1996) challenges the use of LICOs as targets for antipoverty policy and has put forward his own calculations of basic needs.

How does one measure the success of the NCB in reducing poverty in the absence of consensus on a definition of poverty itself? In this study I use the change in disposable income — earned income plus government benefits less income and payroll taxes — for families at different points on the earnings scale as a reasonable indicator of poverty reduction. Poverty is deemed to have been reduced if families with no or low employment earnings end up with higher disposable incomes. Ottawa and the provinces have promised regular NCB impact reports; in these reports, governments may

**Table 3: *Marginal Tax Rates for Low- and High-Income Families,[a] Selected Provinces***

| | Family on Welfare[b] | High-Income Family[c] |
|---|---|---|
| | *(percent)* | |
| New Brunswick | 78.1[d] | 49.2[e] |
| Ontario | 89.4 | 48.8 |
| Manitoba | 76.5 | 48.9 |
| Saskatchewan | 100.0 | 50.3 |
| British Columbia | 82.5 | 51.8 |

[a] Defined here as a single-parent family with two children

[b] MTRs include all taxes and benefit taxbacks in addition to welfare taxbacks. Families on welfare are subject to a variety of MTRs at different earnings rates. In this table, the peak pre-NCB rates on annual earnings above $10,000 are shown for a single parent with two children in each province. While few families on welfare have annual earnings above $10,000, a family would have to pass through the MTR ranges applicable in its province in order to exit from welfare permanently.

[c] Defined here as a family with income greater than $100,000.

[d] New Brunswick's welfare taxback changes slightly after a family has been on welfare for six months. I averaged the two welfare taxbacks over 12 months to compute the MTR for New Brunswick families on welfare.

[e] In New Brunswick, the MTR shown for income greater than $100,000 actually starts at $101,900, when the province's high-income surtax takes effect. In all other provinces, the top MTR starts at below $100,000.

Source: Author's calculations.

well develop technically complex quantitative measures of poverty reduction. In the meantime, focusing on changes in disposable income makes it possible to draw some general qualitative conclusions about the NCB's impact. This unsophisticated approach might not be appropriate in most poverty studies, but the NCB is so straightforward in terms of its impact on disposable incomes that a more sophisticated approach is not necessary to draw a general conclusion about whether or not it has reduced the depth of poverty in a particular province.

## Effects on Work Attachment

There is considerable debate over the magnitude, but little over the existence, of the negative effect that benefits have on the work attachment of at least some individuals (see, for example, Moffitt 1992; Charette and Meng 1994). To some extent, government benefits deter at least some recipients from seeking work or, for those already working part time but still receiving partial benefits, from seeking jobs with higher wages and / or longer hours.

Similarly, the high MTRs shown in Table 3 clearly reduce work attachment (see, for example, Blundell 1996; Kay 1990). To some extent, they deter individuals from seeking work, pursuing jobs with higher wages or longer hours, accepting offers of overtime, and devoting time to education and training to increase their future value on the job market; it is the debate over the magnitude of the effect that keeps economists busy.

Given that these effects exist, how can one measure the NCB's impact on them? A thorough quantitative assessment would require a two-step process: first, calculations of changes in benefit levels and MTRs for families in different circumstances; second, empirical estimates of the change in aggregate work hours likely to result from the changes in benefits and MTRs. In this study, I take only the first step, but this is enough to draw some qualitative conclusions about the likely direction of work attachment effects resulting from NCB-induced changes in benefits and MTRs.

## The Number of Children

NCB programs not only differ across provinces, but the impact they have differs among families even at the same income level according to the number of children in the family. In this study, I focus on the typical, or median, family with two children.

Taxback rates for the federal CCTB and for some provincial benefits rise with the number of children in the family. In addition, maximum CCTB and provincial benefit levels rise with the number of children, thereby expanding the family-income zones subject to taxbacks. Thus, MTRs are slightly lower for one-child families than for two-child families. MTRs for families with three or more children are slightly higher in some income zones. Overall, however, MTRs for two-child families are broadly representative of MTRs for all families with children.

Regardless of the number of children, the basic pattern of MTRs is the same: very high MTRs for all families on welfare are followed by slightly lower MTRs as families move off welfare and into the CCTB and provincial benefit taxback zones.

### Single Parenthood

The proportion of families with children under age 18 headed by single parents has been rising steadily; it hit 18.5 percent in 1997 (Statistics Canada 1998, table 2.3). Moreover, single-parent families account for 70 percent of families with children on welfare (Canadian Council on Social Development 1998). Accordingly, I use the case of a single parent with two children to illustrate the income floor and MTR wall for families on welfare.

### One-Earner Couples

In the rest of the paper, however, MTRs and disposable income changes are presented for one-earner couples, even though they represent a minority of families on or off welfare. I use the one-earner couple case because MTR and disposable-income calculations for this family type are easier to present than for any other family type, and because the changes in the MTR as earnings rise for a one-earner couple are representative of the changes in the MTR as earnings rise for the more complicated cases of single parents and two-earner couples.

For example, Figure 4 (on p. 17), which shows MTR estimates for one-earner couples with two children in British Columbia, would look only slightly different if the MTR estimates were reproduced for single parents with two children and access to free child care from a relative. Only slight differences would arise from the fact that single parents lose their eligibility for welfare and other benefits, thereby escaping the taxbacks associated with these programs, at slightly lower earnings levels than do couples.

It may be true that only a minority of single parents has access to free child care from relatives. If the MTR estimates in Figure 4 were recalculated for single parents paying child care costs, the earnings level at which the MTR changes would shift up the income scale because child care expenses are deductible in calculating income tax liability and welfare entitlement in most provinces. But the basic configuration of MTRs for single parents with child care expenses does not differ from that for one-earner couples.

Another possible objection to using one-earner couples for illustrative purposes is that two-earner couples are now the predominant family type among families with children under age 18.[9] MTR and disposable income calculations for two-earner couples are feasible, but complex. Income tax is assessed on an individual basis, while eligibility for welfare and other benefits is based on family income. Both the MTRs and the disposable incomes of two dual-earner couples living in the same province with the same income and number of children can differ significantly if one couple consists of two spouses with equal earnings and the other of a primary earner and a spouse with a much lower salary. In fact, a dual-earner couple in which one spouse earns sufficiently more than the other that the primary earner is in a higher income tax bracket will face different MTRs depending on which spouse is considering the change in earnings. As in the case of the single parent, the income tax deduction for child care expenses is another factor complicating MTR and disposable income calculations for dual-earner couples.

However, the basic configuration of MTRs and disposable incomes for two-earner couples does not differ from the set of estimates for one-earner couples used in the rest of this *Commentary*. MTRs are very high for all two-earner couples eligible to receive a floor income from welfare.[10] MTRs fall for two-earner couples once earnings rise high enough to exit welfare, but they remain at high levels nevertheless, because of the taxbacks on the federal CCTB and other benefits.

## The Scope of This Study

In this study, I analyze the NCB in five selected provinces:

- New Brunswick, one of two provinces to forgo the federal government's invitation to use the NCB Supplement to generate welfare savings;
- Ontario, Saskatchewan, and British Columbia, the three provinces introducing earned-income supplements; and
- Manitoba, which is pursuing a "Children First" strategy emphasizing social intervention programs to improve the lifetime prospects of children growing up in disadvantaged circumstances.

Restricting the study's scope to five provinces keeps it to a digestible size. The five provinces selected have NCB programs that are broadly representative of the different provincial NCB strategies.

Even though Quebec is the second most populous province, it is not covered. Quebec has endorsed the NCB objectives, is treating the federal NCB Supplement as income to be deducted when calculating welfare entitlements, and is using the welfare savings to finance other family programs. But it dropped out of the NCB negotiations and is not an official NCB participant. When Quebec recently revamped its own array of family programs, it did not identify specific reforms as being NCB-financed. Given the resulting paucity of available information on the NCB's impact in Quebec, I have not attempted to analyze it. (For a review of recent changes to Quebec family benefits, see Baril, Lefebvre, and Merrigan 1997.)

### *New Brunswick*

New Brunswick's approach to the NCB stands out from that of most other provinces. All others save Newfoundland are deducting the NCB Supplement dollar for dollar from welfare or other benefit entitlements. As a result, the level of earnings at which families exit from welfare has fallen in each of these other provinces.[11] Table 4 shows the before-tax earnings levels at which welfare eligibility runs out for couples with two children, before and after the NCB took effect, in the provinces covered in this study.

The important practical effect of reducing the earnings required to exit from welfare is to allow families to escape sooner from the high MTRs shown in Table 3. Deducting the federal NCB Supplement from welfare entitlements tilts the NCB toward the work-attachment objective. In the eight provinces that have this policy, many of the poorest families — those that have no earnings and are entirely dependent on welfare — are not benefiting directly from the NCB in terms of disposable income. By sacrificing immediate poverty reduction for the work-attachment objective, these provinces hope to reduce future poverty by reducing long-term welfare dependence.

Rather than taking welfare savings for use in financing other programs for low-income families, New Brunswick allowed families on welfare to keep the NCB Supplement starting in July 1998.[12] Thus, New Brunswick chose to emphasize immediate poverty reduction during the first stage of the NCB. It remains to be seen whether New Brunswick continues this

**Table 4: *Annual Earnings Required for a Family to Exit from Welfare Before and After the Introduction of the National Child Benefit, Selected Provinces*[a]**

| | Pre-NCB | Post-NCB |
|---|---|---|
| | *(dollars)* | |
| New Brunswick[b] | 19,000 | 19,000 |
| Ontario | 27,630 | 24,440 |
| Manitoba[c] | 19,800 | 16,340 |
| Saskatchewan | 12,460 | 11,580 |
| British Columbia | 18,675 | 18,675 |

[a] Family defined as a couple with two children.

[b] Earnings cutoffs in New Brunswick change slightly when the welfare taxback changes after a family has been on welfare for six months. I averaged the two welfare taxbacks over 12 months to compute annual earnings cutoffs for New Brunswick families on welfare.

[c] The earnings levels used for Manitoba represent the point at which a family would switch from welfare to the Child Related Income Supplement Plan.

Source: Author's calculations.

policy when the NCB Supplement increases in July 1999 and again in July 2000.

## Ontario and Saskatchewan

When the NCB began in July 1998, Ontario and Saskatchewan both allocated the bulk of their NCB-related welfare savings to new cash benefits for low-income families with children.

The centerpiece of Ontario's NCB programming is the Ontario Child Care Supplement for Working Families (OCCSWF). This new monthly benefit rises with employment earnings beyond a minimum eligibility level of $5,000 per year. The maximum annual benefit of $1,020 per child is reached at earnings of $10,100. Like welfare and the federal CCTB, the OCCSWF targets low-income families. OCCSWF benefits fall by 8 percent on the portion of net family income above $20,000.

Saskatchewan is using its welfare savings to finance a new earned-income supplement, as well as to restructure previously existing benefits for low-income families with children. In terms of family income, the Saskatchewan Employment Supplement (SES) is more tightly targeted than Ontario's OCCSWF: benefits fall when annual income exceeds $12,900, as opposed to $20,000 in the case of the OCCSWF. The SES reduction rate for a family with two children is 25 percent, versus 8 percent for the OCCSWF. As a result, a Saskatchewan family with two children loses SES eligibility when its annual income exceeds $22,980, while the same family in Ontario retains OCCSWF eligibility up to an income of $45,500.

Saskatchewan is also restructuring family benefits that existed before the NCB. Prior to July 1998, Saskatchewan paid Family Income Plan (FIP) benefits to low-income families that were not on welfare. When a family on welfare earned enough to reduce the welfare entitlement below the FIP entitlement, the family switched automatically to the FIP. As part of its NCB package, Saskatchewan is replacing the FIP with a new Saskatchewan Child Benefit (SCB) for all low-income families, including those on welfare. At the time of the NCB's implementation in July 1998, welfare entitlements for families with children were reduced by the amount of the federal NCB Supplement and the SCB. Saskatchewan families on welfare with no earnings are no better off and no worse off after the changes.

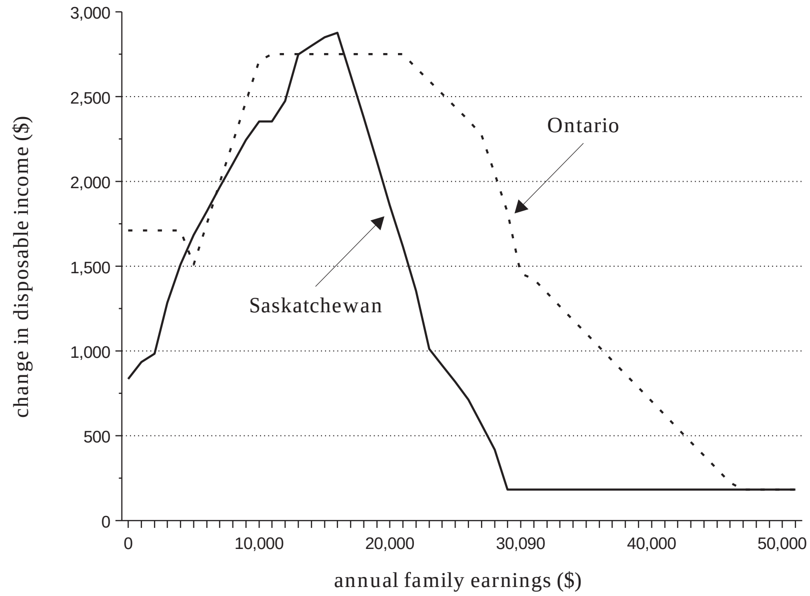
Earned-income supplements such as Ontario's OCCSWF and Saskatchewan's SES attempt to improve work incentives and reduce poverty at the same time. These benefits increase the disposable incomes of families with low earnings, including welfare families with low earnings, and also reduce the MTRs such families face.

### Poverty Reduction

The NCB increases disposable incomes for couples with two children (not on welfare) in Ontario and Saskatchewan, as shown in Figure 2.[13] In both provinces, low-income families that are not on welfare reap NCB gains, which rise steadily over the first several thousand dollars of annual family earnings. At most earnings levels, NCB gains are greater for low-income families not on welfare in Ontario than Saskatchewan for two reasons:

- Ontario's OCCSWF is the first provincial monthly benefit available for low-income Ontario families that are not on welfare.[14] For Saskatchewan families, the SES and SCB replace FIP benefits.
- Ontario's OCCSWF is not as tightly targeted according to income as are Saskatchewan's SES and SCB.

**Figure 2:** ***Impact of the National Child Benefit on Disposable Income of Families in Ontario and Saskatchewan***




Note: The family is defined here as a one-earner couple with two preschool children. Earnings from work are assumed to be the only sources of income.

Source: Author's calculations.

The picture for families on welfare in the two provinces is similar to that depicted in Figure 2 for families not on welfare. The major difference is that families on welfare with earnings too low to qualify for the new earned-income supplements do not reap NCB gains.

## Work Attachment

The change in MTRs resulting from the NCB (for couples with two children in Ontario and Saskatchewan) is illustrated in Figure 3.[15]

If we look only at families with annual earnings below $10,000 in these two provinces, the new earned-income supplements appear to have resolved the conflict between poverty reduction and work attachment, thereby unraveling the Gordian knot of social policy. For families with low earnings in these two provinces, the NCB has raised disposable incomes and lowered MTRs.

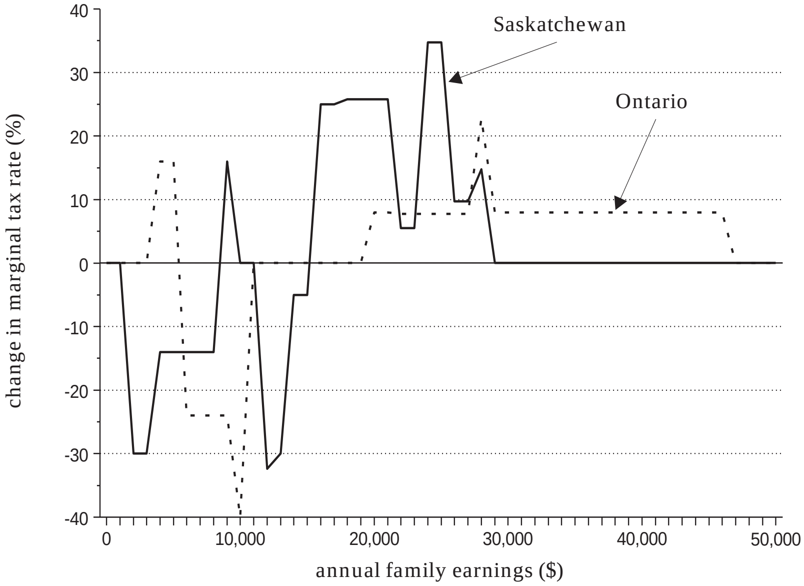
Earned-income supplements increase incentives for parents on welfare to take on part-time work. Table 5 updates three sample situations for an Ontario family on welfare to include the NCB. Thanks to the OCCSWF, an Ontario single parent on welfare now keeps $7,154 of his or her first $10,000 in annual earnings, up from $5,653 before the NCB. The net after-tax wage for someone working a part-time shift of 16 hours per week is $8.60, up from $6.79 before the NCB.

However, once annual family earnings pass the threshold at which earned-income supplements are income tested, the familiar conflict between poverty reduction and work attachment reemerges.

As Figure 3 also shows, in both Ontario and Saskatchewan MTRs have increased for families earning modest salaries just high enough to place them above the eligibility range for welfare benefits.

In Ontario, the NCB has raised the MTR by eight percentage points for families with

**Figure 3: *Impact of the National Child Benefit on Marginal Tax Rates of Families in Ontario and Saskatchewan***




Note: The family is defined here as a one-earner couple with two preschool children. Earnings from work are assumed to be the only source of income.

Source: Author's calculations.

two children under age seven and earnings of $20,000 to $45,500 — the range in which OCCSWF benefits are reduced. Ironically, MTRs for Ontario families subject to the OCCSWF taxback are higher than they would have been if neither the OCCSWF nor the income tax cut implemented by the Harris government had taken place.[16] In other words, for many working families, the microeconomic effect of the tax cut on work incentives has been blunted by the OCCSWF taxback.

The data in Table 5 make it clear that, even with the NCB payments, families on welfare do not have much incentive to move from part-time to full-time work. With the NCB in place, our hypothetical Ontario single parent moving from a work week of 16 hours (situation B) to one of 40 hours (situation C) would still only be $3,718 better off. Although this represents an improvement over the $3,070 net gain such a worker would have received before the NCB, the average tax rate over this earnings range is still 75 percent. The net after-tax wage is $2.98 per additional hour worked. Any positive effect of the NCB on work incentives for Ontario families diminishes when annual earnings exceed $10,100, the point at which the OCCSWF is maximized.

In Saskatchewan, MTRs for working families with earnings of between $15,921 and $25,921 and two children under age 18 rose by as much as 35 percentage points when the NCB took effect in July 1998. Families earning between $17,500 (the threshold at which Saskatchewan income tax begins for a one-earner family with two children) and $22,980 (the eligibility cutoff for the new SES) face a combined MTR of over 91 percent. In other words, if a Saskatchewan parent earning an annual salary of $17,500 were offered a promotion or new job with a $5,480 raise — a salary increase of nearly one-third — he or she would be only $461 better off at the end of the day after taking into account taxes and the reduction in benefits.

An MTR of more than 90 percent is precisely the problem the NCB is designed to remedy for families on welfare. Saskatchewan has, in fact, reduced MTRs for families with earnings low enough to be eligible for welfare, while sharply *increasing* MTRs for families earning just enough to be off welfare.

Make no mistake: working families that face higher MTRs in Ontario and Saskatchewan are better off financially after the NCB. Families with relatively modest earnings have higher disposable incomes. But the associated rise in MTRs reduces incentives for the families subject to the new provincial taxbacks. Saskatchewan and Ontario have not resolved the conflict between the poverty-reduction and

**Table 5:** ***Taxes and Benefits for an Ontario Family on Welfare after the Introduction of the National Child Benefit*** [a]

| | Situation A | Situation B | Situation C |
|---|---|---|---|
| | | *(dollars)* | |
| Annual earnings | 0 | 10,000 | 25,000 |
| Plus welfare | 11,532 | 7,283 | 0 |
| Plus federal CCTB | 4,176 | 4,176 | 3,371 |
| Plus federal GST credit | 608 | 608 | 608 |
| Plus OCCSWF[b] | 0 | 2,000 | 1,640 |
| Plus OPSTC[c] | 432[d] | 317 | 163 |
| Less EI premium | 0 | – 255 | – 638 |
| Less CPP premium | 0 | – 228 | – 753 |
| Less federal income tax | 0 | 0 | – 1,772 |
| Less provincial income tax | 0 | 0 | 0 |
| Total disposable income | 16,748 | 23,902 | 27,620 |

[a] Defined here as a single-parent family with two children.

[b] Ontario Child Care Supplement for Working Families.

[c] Ontario Property and Sales Tax Credit. As in Table 2, I assumed a monthly rent of $554, the maximum covered by Ontario welfare for a three-person family.

[d] This figure shows a net gain of $34 relative to the pre-NCB situation shown in Table 2 because the CCTB, which is not counted as income for the purpose of calculating tax credits, has been substituted for welfare payments, which are treated as income for tax credit purposes.

Source: Author's calculations.

work-attachment objectives but merely shifted it up the earnings scale from welfare recipients to working families with modest earnings.

## British Columbia

British Columbia was in a unique position prior to the NCB. It had already implemented the BC Family Bonus (BCFB) for low-income families both on and off welfare. The child benefit component of welfare benefits was replaced by the BCFB in 1996 (see Michael Mendelson Associates 1997).

British Columbia accepted the federal invitation to substitute the NCB Supplement for provincial benefits and is applying it against BCFB entitlements, using the initial round of savings to finance the BC Earned Income Benefit (BCEIB), which replicates the old federal WIS. As a result, BC families with low earnings, whether on or off welfare, were not directly affected by the NCB's implementation in July 1998.

The BCFB had already generated effects in British Columbia similar to those now being felt in other provinces as a result of the NCB. Families entirely dependent on welfare were no better off, but no worse off, when the BCFB replaced the child portion of welfare entitlements. BC families that had low earnings but were not on welfare received a boost to their disposable incomes from the BCFB. And, as Figure 4 shows, MTRs are formidable for BC families with modest earnings beyond the range for welfare eligibility.

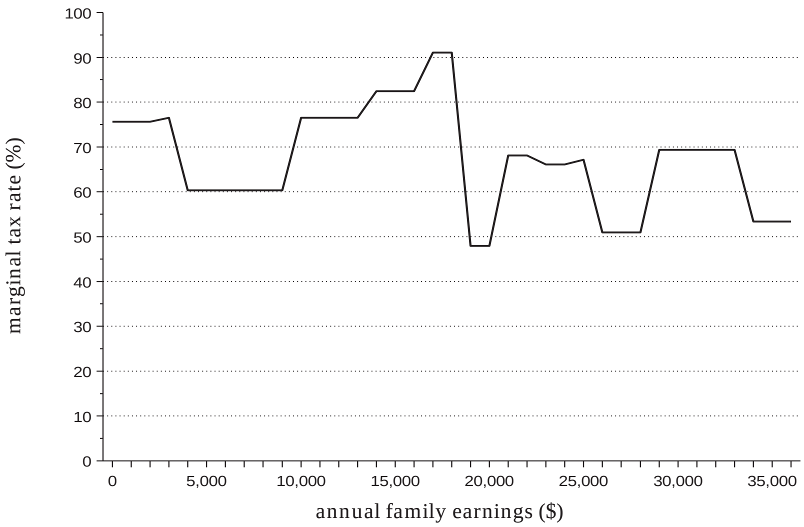
For families on welfare with two children and earnings of between $3,750 and $10,000, the BCEIB lowers the MTR to 60 percent — just as the federal WIS did before the BCEIB took its place. The MTR rises to more than 75 percent on earnings in the range of $10,000 until welfare eligibility is lost. Once off welfare, such a family escapes a 91 percent MTR and moves into a 48 percent MTR zone. However, the MTR bounces back above 66 percent on earnings of between $20,921 and $25,921, where the family is subject to taxbacks on both the BCEIB and the BCFB. The MTR exceeds 69 percent on earnings of between $29,590 and $33,750, the point at which BCFB eligibility runs out.

The NCB consolidates the policy trail that British Columbia had already blazed by creating the BCFB. Hence, the BC government often credits the BCFB with inspiring the federal government and other provinces to embark on the NCB initiative.

## Comparing Family Benefits in British Columbia, Ontario, and Saskatchewan

Now that the rest of the country has followed British Columbia's example, it is worth com-

**Figure 4:** ***Marginal Tax Rates for Families in British Columbia***




Note: The family is defined here as a one-earner couple with two preschool children. Earnings from work and welfare payments are assumed to be the only sources of income.

Source: Author's calculations.

paring the impact of that province's programs and those of other provinces on families with low earnings. Ontario and Saskatchewan are the provinces most appropriate to compare with British Columbia, since all three now pay earned-income supplements and the new Saskatchewan Child Benefit (SCB) is similar to the BCFB.

Figure 5 compares annual disposable incomes for one-earner couples with two children under age seven in the three provinces. Federal benefits and taxes are the same for families with equal annual earnings in all three, so any differences in the disposable income lines in Figure 5 result from differences in provincial benefits and taxes. I have excluded welfare benefits in order to focus on earned-income supplements and other payments intended to provide a platform of child benefits separate from welfare.

Saskatchewan families with no earnings enjoy the most generous platform of nonwelfare benefits now that the province has introduced the SCB. BC families with no earnings are a bit better off than Ontario families because Ontario provides only an earned-income supplement, not an all-purpose child benefit also going to families with no earnings.

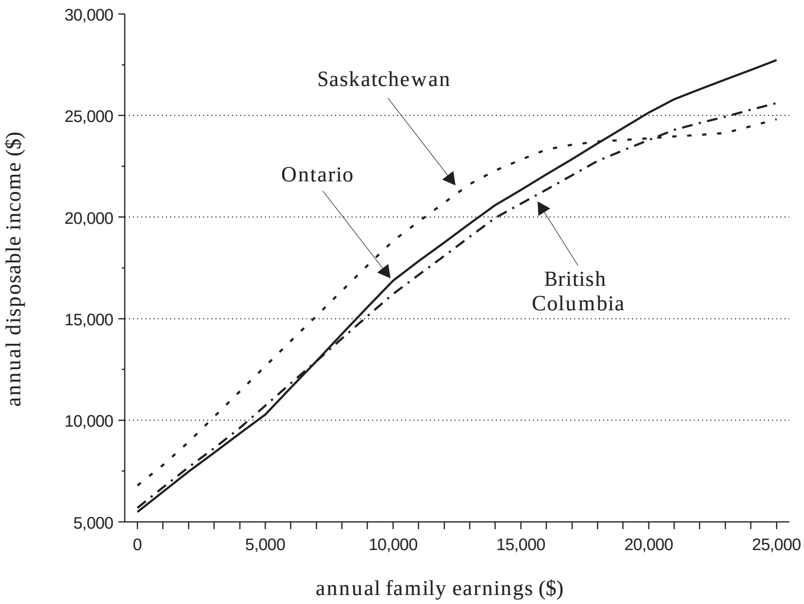
All three provinces supplement annual earnings of up to $10,000. At this earnings level, Saskatchewan families still lead in disposable income, but Ontario families have caught up with those in British Columbia. Families in Saskatchewan fall behind those in Ontario at annual earnings of just over $18,000, and behind those in British Columbia at earnings of just over $20,000. This reversal occurs because Saskatchewan taxes back benefits earlier and at a faster rate than does British Columbia or Ontario. Recall that disposable income is all but frozen once a Saskatchewan family with two children enters the 91 percent MTR zone on annual income of between $17,500 and $22,980.

Figure 5 provides a practical illustration of the tradeoff between the poverty-reduction and work-attachment objectives. Saskatchewan provides the most generous platform of nonwelfare benefits for families with no or very low earnings, but limits the cost of providing the most generous benefits by imposing the most onerous targeting regime. Benefits for families with no earnings are least generous in Ontario, but that province has the most relaxed targeting regime. British Columbia steers a middle course.

## *Designing Earned-Income Supplements*

A comparison of the three provincial earned-income supplements resulting from the NCB — Ontario's OCCSWF, Saskatchewan's SES,

**Figure 5:** ***Disposable Income Relative to Earnings for Families in Ontario, Saskatchewan, and British Columbia***




Note: The family is defined here as a one-earner couple with two preschool children. Earnings from work are assumed to be the only source of income.

Source: Author's calculations.

and British Columbia's BCEIB — sheds light on the difficult choices facing governments when designing such programs.

## Targeting

Funding for earned-income supplements is limited by the size of the NCB-related welfare savings pool in each province and by decisions to use part of these savings to fund other family programs. Therefore, as with most other government programs, eligibility for earned-income supplements has to be restricted in some way to meet a budget constraint.

Ontario chose to target the OCCSWF by age, restricting eligibility to families with children under age seven. In addition, children receiving public day care subsidies are not eligible for the OCCSWF on the grounds that their parents are already benefiting from a provincial program for working families.

Saskatchewan and British Columbia give their supplements to families with children up to age 17. Neither has adopted Ontario's approach of denying benefits to families with children in public day care. However, these two provinces target their benefits more tightly according to family income than does Ontario.

## Choice of Earnings Measurement Period

Another decision that must be made is to choose the length of the period over which to measure a family's earnings and income when calculating the benefit entitlement. This policy affects the speed with which benefits are adjusted when earnings levels change.

British Columbia is following the federal CCTB model by piggybacking the BCEIB on top of Revenue Canada's CCTB delivery system. A family's earnings and income in 1997, as reported on the 1997 tax return, determine its monthly BCEIB benefits from July 1998 to June 1999. Benefit payments will not be updated for 1998 changes in family earnings and net income until July 1999.

British Columbia's approach has the advantage of minimizing administrative and compliance costs. Benefits are based on information reported on annual tax returns, which most adults file in any case. Revenue Canada charges each province an annual administration fee of 1 percent of the value of benefits delivered on its behalf. It is unlikely that a province could establish its own administration structure for processing applications and delivering benefits at a lower cost.

Ontario is establishing its own separate application and delivery structure. Because the province prohibits sending benefits to children receiving public day care subsidies, Revenue

Canada cannot administer its program on the basis of information reported on annual tax returns. The Ontario government decided that the cost of a separate application and delivery structure was worth paying in order to deny OCCSWF eligibility to children also receiving a public day care subsidy. In all other respects, however, Ontario is following the federal CCTB model by basing eligibility on family earnings and income reported on the most recent tax return.

The disadvantage of the tax-return-based approach is that earned-income supplements recalculated annually are not very responsive to changes in family earnings. Thanks to Ontario's new OCCSWF, the MTR for Ontario families with two children drops by 40 percentage points when annual earnings reach $5,000 and remains at this lower level until earnings reach $10,100. The OCCSWF should provide a powerful incentive to raise earnings up to the $10,100 level required to maximize benefits, but its impact is delayed.

For example, consider an Ontario woman who supports her family with a combination of welfare and earnings from working 14 hours per week at the minimum wage of $6.85 per hour, for an annual salary of $4,987. Then suppose that, in January 1999, she is offered the chance to double her weekly work hours from 14 to 28, thereby raising her annual salary to $9,974. She would immediately lose 70.35 percent of this earnings gain to a reduction in her monthly welfare benefits and a further 6.05 percent to higher CPP and EI payments. Offsetting gains from the OCCSWF would not arrive until July 2000, after the family's 1999 earnings and net income are reported on the 1999 tax return. Indeed, she would not feel the full OCCSWF impact until June 2001, 29 months after she increased her work hours.

Saskatchewan deals with the responsiveness problem by gearing its SES to monthly, rather than annual, earnings. A Saskatchewan family in the position outlined above would receive an SES increase in February 1999, just one month after the increase in work hours.

Thus, in terms of encouraging work attachment, Saskatchewan's 30 percent SES incentive rate for low monthly earnings may well be more effective than Ontario's 40 percent OCCSWF incentive rate because the SES is a rapid-response benefit that can be recalculated monthly. However, the downside is that the speed with which the 25 percent SES taxback on modest earnings kicks in may discourage work effort more than the delayed effect of the 8 percent OCCSWF taxback.

Saskatchewan's rapid-response SES is similar to the Working Families Tax Credit (WFTC) introduced by the UK government in its 1998 budget. However, the United Kingdom is going one step further by integrating the WFTC into its tax withholding system so that benefits can be delivered along with regular paycheques (United Kingdom 1998).[17]

In a perfect world for policy analysis, the question of how best to deliver an earnings supplement would be based on empirical estimates of compliance and administration costs and of how families at different income ranges respond to immediate and lagged earnings supplements and taxbacks. In the real world, however, the necessary empirical estimates are entirely lacking (the case with the compliance costs of applying for family benefits) or vary widely from one researcher to another (the case with the labor supply's response to tax rates). As a result, governments often have to make decisions based on "guesstimates" of the pros and cons of different options. In this case, Ontario, Saskatchewan, and British Columbia faced the same problem — to find the best way to deliver an earnings supplement — and came up with three different solutions.

## The Treatment of the Self-Employed

How to treat self-employed workers is another difficult decision for designers of earnings supplements. Saskatchewan uses a separate definition of earnings to restrict the self-employed from SES eligibility, probably because of concerns that they could manipulate their income to take advantage of the SES bonus for families with low earnings. For example, the incomes of self-employed farmers can fluctuate widely from year to year with local weather and world market conditions. As a result, a farmer with a high average income over a long period of years can experience a year in which he or she earns a very low taxable income. This kind of income volatility is prevalent in many other owner-operated businesses, too. If the tax rate on low income earned in a bad year is significantly lower than the tax rate on higher income in a good year, the self-employed have an incentive to bunch discretionary business expenses into good years and to crowd sales into bad years to the extent that the timing of some expenses and sales can be controlled.

To avoid this potential problem, Saskatchewan designates 40 percent of gross receipts as self-employed earnings for SES purposes. There is no allowance for specific business expenses. The mechanism ensures that farmers with large operations and substantial gross receipts will not qualify for the SES in bad years when their net earnings are low.

In contrast, neither Ontario nor British Columbia has taken any steps to restrict the self-employed from qualifying for their earned-income supplements. The OCCSWF gives self-employed parents a strong incentive to push their net earnings in a bad year up to $10,100 so that they can collect the maximum OCCSWF of $1,020 per child. Self-employed parents timing their expenses and sales to increase annual earnings to the OCCSWF maximum threshold would be rewarded for tax planning rather than work effort. The same problem arises in British Columbia, although not to the same degree because of the lower level of the BCEIB.

### *Manitoba*

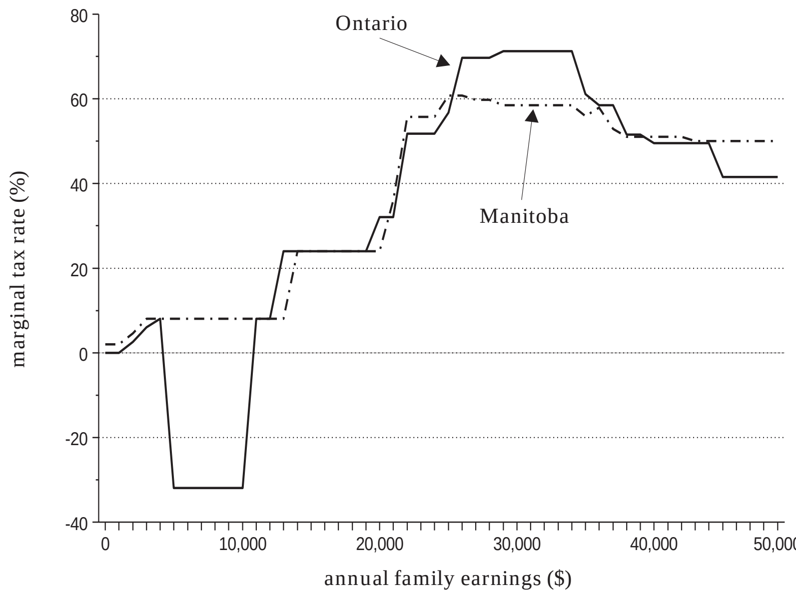
Like most other provinces, Manitoba deducts the federal NCB Supplement from welfare entitlements. But instead of creating a provincial supplement with these NCB-related welfare savings, Manitoba is using them to fund a range of noncash services for low-income families with children. Thus, Manitoba families on welfare do not benefit from the NCB beyond a reduction in the earnings levels at which families exit welfare and get over the welfare wall of high MTRs.

Low-income Manitoba families benefit directly from the NCB only if they are not on welfare and their earnings fall in the ranges over which the federal CCTB has risen, as shown in Figure 1. Unlike Ontario and Saskatchewan, Manitoba has not introduced an earned-income supplement.[18] For low-income Manitoba families not on welfare, the NCB gains from the federal CCTB changes are much lower than gains for comparable families in Ontario and Saskatchewan.

Manitoba evidently placed a lower priority on immediate poverty reduction. However, by opting against an earned-income supplement, it avoided the increase in MTRs that Saskatchewan and Ontario are imposing on families earning just enough to be ineligible for welfare.

Figure 6 compares post-NCB MTRs for one-earner couples not on welfare with two children under age seven in Ontario and Manitoba. The OCCSWF ensures that Ontario families with earnings below $10,100 enjoy a large MTR advantage over their Manitoba counterparts. Ontario families enjoy an MTR advantage on earnings of between $15,000 and $26,425. The CRISP taxback and provincial income tax start at lower income levels in Manitoba than do the OCCSWF and provincial income tax in Ontario. However, once Ontario income tax kicks in, families earning between $26,425 and about $40,000 are subject to a higher MTR than are their Manitoba counterparts. Even though the provincial income tax rate is much lower in Ontario than in Manitoba, the OCCSWF taxback pushes MTRs many Ontario families face above the levels similar families face in Manitoba.

**Figure 6: *Marginal Tax Rates for Families in Manitoba and Ontario After the Introduction of the National Child Benefit***




Note: The family is defined here as a one-earner couple with two preschool children. Earnings from work are assumed to be the only source of income.

Source: Author's calculations.

## *Poverty Prevention*

Rather than pursue immediate poverty reduction, Manitoba opted for a "Children First" strategy aimed at preventing child poverty in the long term. According to the Manitoba government,

> [t]his strategy recognizes that children should have first call on resources, and services need to be coordinated, community based and child centred... [and] based...on the principles of prevention and early intervention designed to improve the long term outcomes for Manitoba's children....The new...programs targeted to high-risk families will help more children develop into healthy and productive adults and break the cycle of poverty. (Quoted in Canada 1998b.)

Almost half of Manitoba's 1998–99 NCB funding goes to early intervention, literacy, preschool, and nutrition programs aimed at improving the lifetime prospects of children being raised in disadvantaged circumstances. Such programs do not generate MTRs because targeting is not based on family income, but on other family or neighborhood characteristics that suggest that young children are being raised in disadvantaged circumstances. However, one-third of Manitoba's NCB funding does go to income-tested child care subsidies, which add to MTRs for those families that have access to subsidies and incomes in the subsidy-reduction zone.

## The NCB and Federal-Provincial Overlap

So far, I have not commented on the third NCB objective: to reduce overlap and duplication between Canadian and provincial-territorial programs. Federal-provincial overlap has joined bureaucratic red tape as a bogeyman for governments to declare war on.

There is scant evidence that the NCB has reduced federal-provincial overlap in any meaningful sense. Most families on welfare continue to receive provincial welfare benefits and federal CCTB benefits. True, the portion of their provincial welfare benefit related to children has declined or even been eliminated, while the federal CCTB has increased. But from the point of view of most families on welfare there has been no real change. And for governments there have been no significant administrative savings. Families on welfare are still receiving the same level of income from two monthly cheques delivered by two bureaucracies: the federal CCTB administration and provincial welfare agencies.

The federal NCB Supplement removed from the welfare caseload a small number of families with earnings close to the pre-NCB welfare exit levels. These are the only families to experience a practical reduction in the compliance costs of dealing with different levels of government. In the first NCB year, the administrative savings for provincial governments from this small reduction in welfare recipients were offset by the costs of changing procedures, forms, and computer programs to handle the deduction of federal NCBS payments from welfare entitlements.

The introduction of provincial family benefits has increased the number of families not on welfare who are receiving monthly payments from both levels of government. In some provinces, administrative and compliance costs have been minimized by integrating delivery of provincial benefits with the federal CCTB. In Ontario and Saskatchewan, however, families apply for and receive their provincial earned-income supplement separately from their federal benefits.

Whether or not delivery is integrated, if there is any income range in which the taxbacks on provincial and federal benefits overlap, the inevitable result is high MTRs in that range. Provinces can avoid the problem of overlapping taxbacks if they use NCB funds to finance services for which families are eligible on the basis of characteristics other than income.

For example, school nutrition and literacy programs can be delivered to all families in neighborhoods or communities identified as disadvantaged.[19] Early-intervention services can be provided to new parents identified as at risk of having problems on the basis of home visits by trained child-welfare workers (see Gadd 1997 for a description of Hawaii's program).

If the provinces used their NCB funds to develop these types of programs, there could be a real reduction in federal-provincial overlap. With the NCB Supplement, the federal government now has an increased role providing the income floor of cash benefits for low-income families. The provinces could complement the supplement by specializing in programs aimed at breaking the cycle of poverty.

## Where to From Here? Some Policy Proposals

The increases in the NCB Supplement to take effect in July 1999 and July 2000 will generate another $300 million or so in welfare savings for the eight provinces deducting the federal benefit from welfare entitlements. New Brunswick and Newfoundland, which allowed families on welfare to keep the July 1998 NCB Supplement increase, will have to decide whether to continue this policy in July 1999. The other provinces will have to decide whether to use additional NCB-related welfare savings to raise their own income-tested family benefits or to invest in early-prevention programs.

Table 6 shows post-NCB MTRs for one-earner families with two children under age seven in the five provinces under study. In each province, MTRs exceed 50 percent for families earning between $20,921 — the point at which the NCB Supplement taxback begins — and $35,000. (When annual income passes $35,000, the MTR drops as various thresholds are reached, such as the $37,400 ceiling for CPP premiums and the $39,000 ceiling for EI premiums.)

Some working families with relatively modest incomes now face higher MTRs than families on welfare. Saskatchewan families face a 91 percent MTR on earnings of between $17,500 and $22,980. Ontario and BC families

**Table 6:** ***Marginal Tax Rates for One-Earner Couples with Two Children, Selected Provinces***

| | Family Earnings | | | | | |
|---|---|---|---|---|---|---|
| | **\$20,921 –\$25,921** | **\$25,922 –\$29,590** | **\$30,000** | **\$35,000** | **\$40,000** | **\$50,000** |
| | *(percent)* | | | | | |
| New Brunswick | 61.3 | 61.3 | 56.0 | 56.0 | 46.6 | 46.6 |
| Ontario | 51.7 | 69.7 | 71.2 | 61.1 | 49.5 | 41.5 |
| Manitoba | 55.7 | 59.7 | 58.5 | 58.5 | 51.0 | 50.0 |
| Saskatchewan | 66.4[a] | 62.4 | 56.4 | 56.4 | 46.9 | 49.1 |
| British Columbia | 66.1 | 50.9 | 69.4 | 53.4 | 43.9 | 43.9 |

[a] The MTR is 91.4 for incomes between \$20,921 and \$22,980, at which point the taxback on the Saskatchewan Employment Supplement ends.

Source: Author's calculations.

earning about \$30,000 face MTRs of 71 percent and 69 percent, respectively. For these families, the net gains from working longer hours or finding a better-paying job are negligible. If the provinces use their NCB-generated welfare windfall to raise family benefits and their associated taxback rates, more and more working families with modest incomes will face welfare-style MTR walls of 70 percent or higher.

Historical evidence indicates that the greatest reductions in poverty and human misery result from technological progress and productivity growth. Recognizing this fact, Canadian government leaders at all levels frequently refer to the need to build a technologically advanced, growth-oriented economy (see any federal or provincial budget speech of the past few years). Raising the MTRs facing low-income families with children even higher would not be consistent with this objective.

With little room left for more income testing of benefits, the provinces should put their upcoming welfare savings into programs that try to address the causes of poverty. Among the many possible spending areas that could give children growing up in disadvantaged circumstances a fighting chance in life are prenatal care to reduce the incidence of low-birthweight babies, parent training programs, intensive support for new parents identified as having problems, "head-start" programs for preschool children, intensive literacy programs for young children and parents, school nutrition for children in disadvantaged neighborhoods, and programs for troubled teenagers.

Of course, governments are already active in these areas, but such programs have so far taken a back seat to cash benefits. For example, Ontario allocated 80 percent of NCB-related welfare savings to the new OCCSWF benefit, and only 20 percent to locally delivered service programs for families with children. This order of priority should be reversed. The bulk of future NCB funds should go to programs aimed at improving the lifetime prospects of children who grow up in disadvantaged circumstances.[20]

The premise of such an approach is that well-targeted service programs could be of more help to children who are in difficulty than cash benefits for low-income families. Results from Statistics Canada's National Longitudinal Survey of Children and Youth show that children ages 6 to 11 in low-income families are indeed more likely than other children to experience problems such as aggression, hyperactivity, and depression (Statistics Canada 1998b). These childhood problems can contribute to below-average performance in school and higher dropout rates at later ages, which, in turn, can constrain employment and income prospects in adulthood. In short, there may well be a cycle of poverty in which children from low-income families grow up to head low-income families themselves.

The question, however, is whether income transfers are the best way to address these problems. Statistics Canada reports that "preliminary analysis of survey findings suggests that higher frequencies of behavioral, relationship, and scholastic problems tend to persist, at least in the short term, for children moving out of lower-income" (ibid.). Other factors, such as parenting style, are more highly correlated with childhood behavioral problems than with family income. In the words of University of New Brunswick Professor Douglas Willms:

> The difficult thing is that if you look at all children in low-income families, a large percentage of them do very well. So, when you try to target just low-income families, you don't hit all the vulnerable children. (Quoted in Philip 1998.)

Admittedly, the jury is still out on whether childhood intervention programs have any lasting effects. (See, for example, Currie and Thomas [1997] for a discussion of the conflicting evidence on whether or not children who participate in the much-heralded Head Start program in the United States reap lasting benefits.) In many cases, arguments based on anecdotal evidence about the merits of such programs are based on faith that such well-intentioned efforts must be doing some good.

Provincial governments, therefore, must choose between income-tested cash benefits and childhood intervention programs based on imperfect information. Governments know that income-tested cash benefits increase disposable incomes for low-income families. They know that earnings supplements can reduce work disincentives for families with no or very low earnings. But they also know that families with incomes in the taxback zones face increased disincentives.

It is not possible to quantify these effects on family well-being and work attachment. The effects of childhood intervention programs are even more difficult to predict. Thus, the perfect policy analysis balance sheet weighing the two approaches does not exist.

My recommendation that provinces focus on childhood intervention programs ultimately rests on a hope that a new approach to the problem of poverty will work better than the existing approach. Income redistribution has been the underlying theme of Canadian postwar social policy. The proportion of Canadians with low incomes has indeed fallen since measurements were first taken in the 1960s, particularly among the elderly. But poverty is far from being eliminated: 16 percent of all families with children were on welfare in

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Adil Sayeed, the author of this issue, is a public policy consultant. The text was copy edited by Lenore d'Anjou and prepared for publication by Wendy Longsworth and Barry A. Norris.

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March 1997. Meanwhile, the MTR barriers that help keep working families from moving into higher income brackets persist; as I have shown, for many families with children and incomes up to $35,000, MTRs now exceed 50 percent.

Earnings supplements and income-tested child benefits dress income redistribution in more politically acceptable form than welfare does, but they do not solve the MTR problem. Rather than continue down the redistribution road to higher MTRs, the provinces should put their $300 million or so in welfare savings from the upcoming NCB Supplement increases into programs aimed at turning around the lives of children growing up in disadvantaged circumstances.[21]

## Notes

I thank Kenneth Boessenkool, Jack Mintz, John Richards, and William Robson for comments on earlier drafts of this paper, Elizabeth d'Anjou for copyediting, and Barry Norris for supervising the publication process. Special thanks go to Finn Poschmann for his comments on the drafts and help during the publication process. I am responsible for any errors or omissions.

*1* The figure of $750 million is an estimate derived as follows: Together, all provinces and territories except Quebec reported a total of $331.4 million in potential welfare savings (Canada 1998a). Quebec accounts for just under one-quarter of the national population; assuming Quebec's welfare savings per capita are similar to other provinces' savings, Quebec would add another $110 million or so to the national total. (See the end of "The Analytical Framework" section for more discussion of Quebec's role in the NCB.)

Provincial welfare savings depend on the maximum federal NCB Supplement, since most families on welfare have annual incomes below the $20,921 threshold for NCB Supplement income testing. For families with two children, the NCB Supplement will rise in July 2000 to $1,710, or about 70 percent higher than the maximum of $1,010 that was in place when the NCB took effect in July 1998. Thus, annual provincial welfare savings should ultimately be about $750 million, or 70 percent higher than the initial estimate of $440 million.

*2* Both provinces are also making their own independent NCB contributions by raising spending on programs such as child care subsidies. They are financing this spending with general budgetary resources rather than federally generated welfare savings. Other provinces have also raised their spending on family programs by more than their NCB-related welfare savings.

*3* Situation C requires some further explanation. A single parent supporting two children on a $25,000 salary could not walk into an Ontario government office, apply for welfare, and walk out with a cheque. Welfare eligibility is based on a needs test that assesses both income and assets, and most people with full-time jobs would fail this test. However, if a jobless family meets the needs test for welfare, the family may remain eligible for partial benefits when the parent returns to work. A jobless Ontario single parent with two children whose assets were low enough to meet the welfare needs test could have remained eligible for a small welfare benefit prior to the NCB even after finding a job paying a $25,000 salary.

*4* Alternatively, and perhaps more realistically, imagine a job offer of a 28-hour weekly shift at the Ontario minimum wage of $6.85 per hour, which also works out to an annual salary of about $10,000.

*5* I have included only the employee portion of EI and CPP premiums. There is evidence that employees ultimately bear the burden of the employer's share of payroll premiums in the form of lower wages than would be paid in the absence of employer premiums. However, this long-run effect does not likely enter into the MTR calculation for an employee considering an offer to increase earnings with a higher-wage job or a shift with longer hours. There is an opposing argument to remove EI and CPP premiums from MTR calculations if employees value the benefit entitlements that accrue from paying these premiums. This argument would apply if employees perceived an actuarially fair link between expected EI and CPP benefits and the premiums that they pay. Yet very few Canadians view EI as just like private insurance and CPP as just like a private pension. Therefore, it is reasonable to include the employee portions of CPP and EI in MTR calculations.

*6* To then get to annual earnings of $25,000 in situation C, our minimum-wage worker in the alternative situation would have to be offered a raise in both hours of work and hourly wage.

*7* In this particular example, the average tax rate on earnings from $10,000 to $25,000 would be the parent's chief financial consideration when deciding between weekly work shifts of 16 hours or 40 hours. In general, the average tax rate — the weighted average of MTRs — on a large chunk of income or on total income influences major decisions such as whether to work at all, or whether to work part time or full time. The MTR on additional income influences incremental decisions such as whether to work overtime or whether to pursue a promotion or a better-paying job.

*8* The Canadian Council on Social Development bases this figure on data collected from the provinces by Human Resources Development Canada.

*9* See Canadian Council on Social Development (1996)) for data showing that two-earner couples outnumber one-earner couples by two to one. However, the proportions of two-earner couples and one-earner couples are much closer in the bottom 40 percent of the family income distribution, the relevant range for concerns about high MTRs. See Statistics Canada (1997.) I am indebted to Kenneth Boessenkool for this point.

*10* One obvious difference between one- and two-earner couples is that both halves of the latter are unlikely to experience extended unemployment at the same time and fall onto welfare.

*11* The NCB itself has not reduced the welfare exit point in British Columbia. That province is deducting the

NCB Supplement from the BC Family Bonus, which is similar to the federal CCTB and goes to low-income families whether or not they are on welfare. When the Family Bonus was introduced in 1996, benefits were adjusted to leave families on welfare no better off. Thus, the bonus had already reduced the earnings levels at which BC families exited from welfare. New Brunswick, on the other hand, did not adjust welfare benefits when it introduced its Family Benefit.

*12* In its 1996 budget, New Brunswick did introduce two benefits for low-income families with children, the $250 per child Family Benefit and the $250 per family Working Income Supplement. These new benefits are not financed by NCB funds. Alberta also introduced a Working Income Supplement for families with children prior to the NCB.

*13* Some families with very low, or even no, earnings are not on welfare. For example, farmers and other self-employed parents can earn little or no income in a bad year, but still be ineligible for welfare because of the value of their assets. I return to the self-employment issue in a later section.

*14* Ontario did introduce an income-tested Child Care Tax Credit (OCCTC) in 1997 before the NCB took effect. The OCCTC has now been subsumed by the OCCSWF. Only families claiming the income tax deduction for child care expenses were eligible for the OCCTC. In my examples, child care expenses are assumed to be zero. For such families, the OCCSWF is an entirely new benefit. It should be noted, however, that net gains are not as large for OCCSWF recipients who were also eligible for the OCCTC.

*15* In the interests of simplicity, I have excluded the net effect on the MTR of the interaction between the welfare taxback and NCB taxbacks in Figure 3. Changes in MTRs for families on welfare in the two provinces differ from those shown in the figure, but the general pattern of lower MTRs for families with earnings below $10,000 holds for families on welfare.

*16* There are some exceptions. The tax cut has eliminated some families from the Ontario tax rolls. These families do have lower MTRs even if they face the OCCSWF taxback.

*17* Britain's WFTC is similar to New Zealand's Guaranteed Minimum Family Income plan, introduced in 1987. The latter's benefits were initially integrated into tax withholdings, but this arrangement was canceled after employers complained about increased compliance costs. It will be interesting to see whether Britain fares better with the WFTC.

*18* Well in advance of the NCB, Manitoba established its income-tested Child Related Income Support Plan (CRISP). While not specifically earnings related, the CRISP, which is still in effect, is similar to an earned-income supplement in the sense that it is paid to low-income families not on welfare.

*19* One objection to restricting services to specific neighborhoods is that low-income families in other neighborhoods would not be eligible. However, family income may not always be the best measure of need for family services. Evidence for this proposition can be found in Corak (1998), which links employment and investment incomes of young adults in 1994 back to the incomes of their parents 12 years earlier. Corak concludes that children in low-income families living in neighborhoods with "positive peer groups, greater possibilities for supportive relationships with adults outside the home, or a richer set of job contacts and role models" earn higher incomes as adults than those who grew up in low-income families in bad neighborhoods.

*20* One hopeful sign is the announcement in the 1998 Ontario Throne Speech of the appointment of Dr. J. Fraser Mustard to prepare a report on Ontario's strategy for children. Dr. Mustard is a leading proponent of early intervention programs for young children in disadvantaged circumstances (see Mustard 1995). For more discussion of early childhood development and the potential for intervention policies, see also Mayer (1997).

*21* I recognize that higher MTRs are the unavoidable cost of social welfare. I am not so opposed to taxation that I favor eliminating welfare. For the record, I believe that the best approach would be to combine universal transfers with a flat tax applied to a broad income base.

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