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## Policy Forum: Delivering Government Grants to Students Through the RESP System—Distributional Implications

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### ABSTRACT

The Canadian learning passport (CLP) proposal put forward in 2011 by the Liberal Party of Canada has interesting distributional implications. Replacing tax-credit-based aid to students with up-front funds through a registered education savings plan (RESP) could get more money to students while they are studying, which is likely one of the lowest-income periods of their lives. As well, the switch to the CLP would spread out student financial assistance based on parental income over a longer period of time, helping to ensure that some additional assistance goes to families that struggle during the period prior to post-secondary entrance, and not only during the study period. Unfortunately, though, current rules under the Canada student loan program (CSLP) would partially undo any attempt to provide increased financial assistance to students from low-income families through the RESP system. This could be ameliorated by changing the treatment of RESP withdrawals under the CSLP—a reform that would be sound policy whether or not a proposal like the CLP is ever introduced.

**KEYWORDS:** HIGHER EDUCATION ■ FINANCING ■ REFORMS ■ POLICY ■ RESP ■ LOANS

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## INTRODUCTION

Canada's system of tax credits for post-secondary education accounts for a large proportion of overall government aid to students. The tuition, education, and textbook tax credits combined cost the federal government \$1.5 billion in the 2009 tax year; the education and textbook tax credits made up about half of that amount.<sup>1</sup> In comparison, the Canada student loan program (CSLP) cost the federal government \$0.8 to \$0.55 billion between 2004-5 and 2007-8, and federal transfers provided directly to post-secondary institutions were \$3.4 billion in 2008-9.<sup>2</sup> Many writers have argued that the tax credits are poorly designed as a means of providing financial aid to post-secondary students.<sup>3</sup> Among the concerns raised are the following:

1. tax credits provide more money to students from better-off families;
2. even conditional on parental income, tax credits disproportionately act as a transfer to individuals with high lifetime incomes; and
3. tax credits tend to provide funds after the time when they are most needed—that is, after the study period has been completed.

During the 2011 election campaign, the Liberal Party of Canada proposed to replace the federal education and textbook tax credits with a new funding program called the Canadian learning passport (CLP). The central idea behind the CLP was to provide financial assistance to post-secondary students through Canada's registered education savings plan (RESP) program rather than through the tax system. The key components of the proposal, as announced, were as follows:<sup>4</sup>

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- 1 Canada, Department of Finance, *Tax Expenditures and Evaluations, 2011* (Ottawa: Department of Finance, 2011).
  - 2 Azim Essaji and Christine Neill, *Tax Expenditures vs. Budgetary Expenditures for Canadian Post-Secondary Education*, LCERPA Economic Research Paper 2010-003 (Waterloo, ON: Wilfrid Laurier University, Laurier Centre for Economic Research & Policy Analysis, November 2010).
  - 3 See Ross Finnie, Alex Usher, and Hans Voostensteyn, "Meeting the Need: A New Architecture for Canada's Student Financial Aid System," in Charles M. Beach, Robin W. Boadway, and R. Marvin McNinn, eds., *Higher Education in Canada* (Kingston, ON: Queen's University, John Deutsch Institute for the Study of Economic Policy, 2005), 495-535; Kirk A. Collins and James B. Davies, *Carrots & Sticks: The Effect of Recent Spending and Tax Changes on the Incentive To Attend University*, C.D. Howe Institute Commentary no. 220 (Toronto: C.D. Howe Institute, October 2005); Alex Usher, *Who Gets What? The Distribution of Government Subsidies for Post-Secondary Education in Canada* (Toronto: Educational Policy Institute, May 2004); Christine Neill, *Canada's Tuition and Education Tax Credits*, Millennium Research Paper no. 30 (Montreal: Canada Millennium Scholarship Foundation, May 2007); and Don Drummond, *Time To Re-Think Financial Assistance for Post-Secondary Education*, TD Economics Special Report (Toronto: TD Economics, March 2008).
  - 4 Liberal Party of Canada, "Michael Ignatieff Announces Canadian Learning Passport," March 29, 2011 ([www.liberal.ca/newsroom/news-release/michael-ignatieff-announces-canadian-learning-passport/](http://www.liberal.ca/newsroom/news-release/michael-ignatieff-announces-canadian-learning-passport/)).

1. The federal government would deposit \$1,000 per year (or \$1,500 per year for students from low-income families) into an RESP for any high school student aged 14 to 17.
2. Students enrolled in full-time studies at an accredited post-secondary institution would be allowed to withdraw CLP contributions from their RESP in the amount of up to \$1,000 (or \$1,500) per year for a maximum of four years.<sup>5</sup>
3. CLP withdrawals would be “non-taxable” (although currently withdrawals of any grant portion of RESP funds are taxable at the student’s tax rate).
4. The federal education and textbook tax credits, worth \$558 per year (grant equivalent) for a full-time student, would be eliminated.

This article examines whether the proposed CLP could do better than the education and textbook tax credits from a distributional perspective. Overall, we see some distributional advantages in replacing the tax credits with the CLP. However, interactions with the CSLP may compromise the ability of the CLP or any similar proposal to deliver financial aid to students from lower-income families. Unless this issue is addressed, it does not make sense to attempt to further divert financial aid to lower-income families through the RESP system.

## **ISSUES IN ANALYZING THE DISTRIBUTION OF SUBSIDIES TO POST-SECONDARY EDUCATION**

Any distributional analysis requires decisions to be made regarding the measure of well-being to be used and the unit of analysis; that is, we need to decide on the distribution of what, over what time period, and to whom. In examining the distributional effects of post-secondary subsidies, these decisions are more complicated than usual. The presumed beneficiaries are young adults who are beginning to emerge from dependence on their parents for financial support and are forming new households, but have not yet completed the transition. This is particularly the case for those who continue on to post-secondary education.

We could assume that the students are the primary beneficiaries of the financial aid, and as adults are independent of their parents, in which case we may want to use individual incomes in any distributional analysis. However, current incomes of post-secondary-aged youth probably tell us little about their actual relative well-being. This age group is likely to have the greatest divergence between current income and lifetime income. Youth who drop out of high school and find a full-time job may have a higher current income than most post-secondary students, but the lifetime income of dropouts is likely to be considerably lower. Thus, if we are looking at individual incomes, we probably want to think not about the distributional effects using income in the current year, but rather those effects over the entire lifetime.

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5 Withdrawal of an unspecified “reduced amount” would be permitted for part-time students, though it is unclear whether the four-year time period would then be adjusted. For students enrolled in shorter programs of study (such as a two-year college program), any CLP funds remaining in the RESP could be used to finance further post-secondary studies at a future time.

Typically, studies taking this approach find that subsidies to post-secondary students tend to go to students who themselves will be higher income earners later in life.<sup>6</sup>

It is more common to analyze the distributional effects of post-secondary subsidies using some measure of the income of the household in which the young adult currently resides.<sup>7</sup> A problem with using current household income is that it means that youth who are not currently living with their parents are likely identified as having lower incomes than they would have if they were living with their parents. Since the choice to live separately is likely influenced by post-secondary education choices, this can result in misleading conclusions regarding the progressivity of aid to post-secondary students.<sup>8</sup> Further, many post-secondary financial aid programs explicitly assume that parents will support their children through their post-secondary studies whether or not the student is living with his or her parents. Thus, it is probably more appropriate to use parental income, rather than the income of the household in which a youth is currently resident, as the basis for distributional analysis. It may also be of interest to examine the distributional effects not only based on parental income during the years of post-secondary education, but also based on the youth's income over his or her entire lifetime.

The bulk of reliable distributional analyses of universal subsidies to post-secondary education using current family or parental income find that such subsidies go disproportionately to better-off youth and families.<sup>9</sup> This is because children from higher-income families are more likely to enrol in longer and more expensive post-secondary education programs than children from lower-income families. In Canada, it has been found that youth from the highest-income families have university enrolment rates more than twice those of youth from the lowest-income families.<sup>10</sup>

Most of the distributional analysis presented in this article uses current parental income, or if that is not available, parental income in the most recent year for which it is available, going back no earlier than to students aged 16. We do, however, discuss the distributional implications of using longer-run or lifetime incomes, and of using the individual as a unit of analysis.

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6 See, for example, William R. Johnson, "Are Public Subsidies to Higher Education Regressive?" (2006) 1:3 *Education Finance and Policy* 288-315. Johnson finds that all subsidies to post-secondary education are mildly progressive when the distribution of tax revenues used to fund education is also taken into account. In this article, we do not net out the distributional effects of taxes, since we are concerned with the effects of replacing one "spending" program with another.

7 See, for example, W. Lee Hansen, "Income Distribution Effects of Higher Education" (1970) 60:2 *American Economic Review* 335-40.

8 Joseph A. Pechman, "The Distributional Effects of Public Higher Education in California" (1970) 5:3 *Journal of Human Resources* 361-70.

9 Hansen, *supra* note 7; Usher, *supra* note 3; and Susan Dynarski, "The Behavioral and Distributional Implications of Aid for College" (2002) 92:2 *American Economic Review* 279-85.

10 Miles Corak, Garth Lipps, and John Zhao, *Family Income and Participation in Post-Secondary Education*, Analytical Research Branch Research Paper no. 210 (Ottawa: Statistics Canada, October 2003).

## THE DISTRIBUTIONAL EFFECTS OF REPLACING TAX CREDITS WITH THE CLP

Full details of the education and textbook tax credits can be found in an earlier study by Neill.<sup>11</sup> Here, we briefly outline the key features of the credits before delving into a comparison of their distributional effects with those of the proposed CLP.

The education and textbook tax credits allow a reduction in tax liabilities for any student equal to a fixed monthly dollar value multiplied by the number of months that an individual has spent in post-secondary education, multiplied by the tax credit rate. These credits apply to federal taxes and to provincial taxes, in amounts that differ by province, in all provinces but Quebec. The value of the credits at the federal level in post-tax-dollar terms is currently \$558 for each eight-month academic year spent as a full-time student.

A problem with the tax credits is that they provide funds after most of a student's expenses for a year have been incurred. For a student who begins study in September 2012, for instance, the bulk of fees for the full academic year are paid around October 2012. Students can use education and textbook tax credits accumulated while studying in September to December 2012 to reduce their tax liability in the 2012 tax year. The benefit of these credits will likely be received by the student around March 2013 at the earliest. Credits accumulated for January 2013 to April 2013 will benefit the student no sooner than March 2014, more than a year later. And since the credits are non-refundable, if the student (and his or her parents) does not earn a high enough income to take advantage of the tax credits in the tax year in which they were accumulated, the credits may be of benefit only much later.

Thus, the tax credits tend not to provide additional financial resources to students when they are likely in the lowest income period of their lives and need the money the most. A program, such as the CLP, that could provide money up front would be preferable from the perspective of the distribution of income across an individual student's lifetime.

### Estimates of the Distribution of Tax Credits Relative to the CLP by Current Parental Income

Making use of the simple assumptions that higher-income students are more likely to pursue a post-secondary education,<sup>12</sup> are more likely to attend relatively expensive institutions, and are likely to be enrolled in programs that last longer, Usher<sup>13</sup> estimates that the children from the highest parental income quartile would receive a total benefit, in terms of lower taxes paid, worth on average 68 percent more than children from the lowest parental income quartile.

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11 Neill, *supra* note 3.

12 Corak et al., *supra* note 10.

13 Usher, *supra* note 3.

Figure 1 updates Usher's analysis, using individual-level tax data from the Statistics Canada's longitudinal administrative databank (LAD) to show the percentage of the actual value of education tax credit claims, both full-time and part-time, by equivalent parental income percentile in 2006. (The LAD refers only to the education tax credit; however, the data shown also include claims for the textbook tax credit where relevant.) The figure shows the percentage of total claims of full-time and part-time education tax credits that were made by each percentile of the equivalent parental income distribution. In reading the chart, it should be understood that if tax credits were claimed equally across the income distribution, each income percentile would make exactly 1 percent of the education tax credit claims, meaning that the lines in the chart would be flat across the income distribution at the height of 1 percent. What we find, though, is that claims of the tax credits are roughly twice as high for children of parents with income at the top of the income distribution compared with those at the bottom. Students whose parents' income falls at the 5th percentile of equivalent income account for around 0.7 percent of all education tax credit claims, while students whose parents' income is at the 95th percentile account for almost 1.4 percent of all claims.

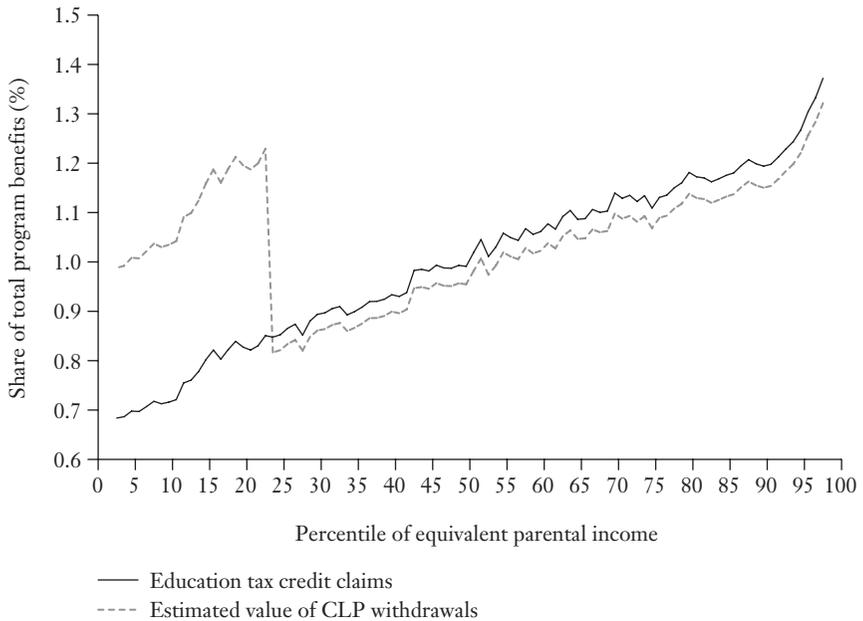
Figure 1 also shows an estimate of the likely distribution of program benefits from the CLP (that is, CLP withdrawals) by equivalent parental income. The estimates assume that participation rates by parental income percentile in the CLP are the same as for the tax credits, that there are no interactions with other student financial aid programs, and that the cutoff for the additional low-income payment is at the 25th percentile of equivalent parental income.<sup>14</sup> The key difference from a distributional point of view is that lower-income families are given an annual grant of \$1,500, rather than \$1,000, for four years, while the education tax credit provides a flat amount that is not dependent on parental income. Youth who were eligible for the \$1,500 grant would capture a share of the benefits of the program that was greater than their share of the population. Nonetheless, youth from families at the top percentiles of the income distribution would likely still receive the largest fraction of the total benefits of the CLP program.

Figure 1 also makes clear the sharp discontinuity introduced by having a stark cutoff for defining low-income status, below which the CLP contribution to an RESP would be \$1,500 rather than \$1,000. This would be mitigated by having the payment depend on income in each of four separate years: since there would likely be some movement around the cutoff, the discontinuity would be less sharp than it would be if all payments were based on income in a single year. But as noted, there

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14 There has been no formal statement as to how the low-income cutoff would be determined. Existing policies that target additional payments to low-income post-secondary students have tended to use a threshold of family income of around \$40,000, depending on family size and province of residence. In what follows, we assume a low-income cutoff at around the 25th percentile of equivalent parental income for families with 18 to 24 year-olds, which is an equivalent income of \$24,600 (corresponding to a total family income of around \$38,000 for a two-parent, one-child family or \$41,000 for a two-parent, two-child family).

**FIGURE 1 Share of Education Tax Credit Claims and Estimated Share of Canadian Learning Passport (CLP) Withdrawals, by Equivalent Parental Income Percentile (Five Percentile Moving Averages)**



Notes: The figure shows the actual share of total government “spending” on tax credits and the estimated share of total spending on the CLP by parental income percentile. An equal distribution by parental income percentile would see each percentile claim 1 percent of the total program benefits. Data on the distribution of tax credits are based on total claims of the education tax credit by 18 to 24 year-olds in 2006, by equivalent parental income percentile, calculated across all youth aged 18 to 24. (The LAD does not provide separate data for the textbook tax credit but includes such claims in the data for education tax credit claims.) Equivalent parental income is calculated by dividing parental income by the square root of (number of adults + 0.4\* number of children). Figures here are moving averages over 5 percentiles. The 25th percentile is an equivalent family income of \$24,600, the 50th percentile is at \$42,400, and the 75th percentile is at \$65,200. An equivalent parental income of \$65,200 corresponds to parental income of \$101,000 for a two-parent, one-child family.

Source: Distribution of tax credit claims is based on 2006 data from Statistics Canada’s longitudinal administrative databank (LAD).

are a number of other programs with similar income cutoffs, which may exacerbate the discontinuity. This should be taken into consideration in determining an appropriate income cutoff.

### Interactions with Other Student Financial Aid Programs

Figure 1 shows that under the assumptions so far, a greater proportion of transfers from the CLP would go to students from lower-income families than is the case for

the tax credit. However, this does not take into account any interaction between the CLP and other financial aid programs for post-secondary students. The estimates presented in figure 1 are consistent with news reports of statements by Liberal Party officials that any withdrawals of CLP payments from an RESP would not be considered as income and would therefore not affect a student's eligibility for financial aid.<sup>15</sup> The estimates are also consistent with the treatment of funding under Quebec's student financial aid program (*aide financière aux études*). However, they are not consistent with the current regulations of the CSLP, the key delivery mechanism for student financial aid in Canada's other provinces.

The CSLP provides assistance to post-secondary students based on an assessment of their costs of living (including tuition fees) relative to the funds they have available for their education. Students receive a combination of loans and grants equal to their living costs less their available financial resources, up to a maximum dollar value. This dollar value differs by province, but for Ontario is currently \$12,240. For a dependent student—that is, a post-secondary student who graduated from high school less than four years earlier—the available financial resources include an expected contribution from the student's parents, which increases with parental disposable income.<sup>16</sup> Beyond a certain threshold, 100 percent of a student's employment earnings during the academic term and 80 percent of earnings during any non-study term (typically the summer) are also included in the financial resources available for education.

In the CSLP as currently configured, RESP withdrawals are considered to be resources available for education. However, it is not entirely clear whether RESP withdrawals count toward the expected parental contribution or toward student income. In some provinces, withdrawals are treated differently depending on whether they come from parental RESP contributions, accumulated income, or government contributions. For the most part, though, the CSLP treats funds drawn from an RESP as part of the expected parental contribution, and for now we examine the implications of treating a CLP withdrawal as such.

Under standard CSLP rules, if the amount withdrawn from a student's RESP in a given year is less than the total expected parental contribution, the financial aid allocated to the student is unaffected. However, if the amount withdrawn is higher than the expected parental contribution, then each additional dollar withdrawn from an RESP is considered to be an additional voluntary parental contribution, which reduces total eligibility for financial aid by one dollar—a 100 percent benefit

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15 CBC News, "Ignatieff Calls Student Aid Plan Revolutionary," March 29, 2011 ([www.cbc.ca/news/politics/canadavotes2011/story/2011/03/29/cv-liberal-eduplan.html](http://www.cbc.ca/news/politics/canadavotes2011/story/2011/03/29/cv-liberal-eduplan.html)).

16 The calculation of disposable income under the CSLP takes after-tax income then subtracts an amount required to achieve a moderate standard of living (which depends on family size and province of residence). A proportion of income above that level is considered to be available to help fund the post-secondary education of any children.

clawback rate.<sup>17</sup> What this means for the distributional consequences of the CLP is complicated, and depends not only on parental income, but also on a student's assessed need, which is mostly determined by tuition fees, other compulsory fees, and living arrangements. The treatment of RESP withdrawals also varies to some extent by province.

Table 1 shows, for Ontario, how the move from the education and textbook tax credits to the CLP would affect (1) the funds available to the student in each academic year of study and (2) the overall net effect on lifetime income per academic year of study. We assume here that the tax credits would not be available during the academic year, and that the student would withdraw \$1,000 from his or her RESP at the beginning of the academic year.

The table sets out five cases (labelled A through E) representing differences in a student's eligibility for financial aid and in the expected parental contribution. It is not possible to place exact figures on the parental income ranges over which each of these cases applies, since these depend on the province of residence, family size, number of family members currently in post-secondary education, and a range of other factors. We can, though, provide some broad characterizations that help to show the distributional effects.

Case A corresponds to students from families whose parental incomes are high enough that they are expected to be able to fully meet the costs of post-secondary education for their children, so that those children are not eligible for assistance under the CSLP. For a two-parent, one-earner, one-child family living in Ontario,

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17 Although this policy on RESP withdrawals is well known among administrators, it is difficult to find it stated in publicly available documents. The 2009 evaluation of the Canada education savings grant and the Canada learning bond notes that attention should be paid to "[t]he extent to which RESPs interact with the Canada Student Loans Program. It may be the case that more parental savings through RESPs leads [sic] to fewer loans and grants under the Canada Student Loans Program, implying that the financial situation of students might remain unchanged, which could limit the impact of RESPs on access": Human Resources and Skills Development Canada, *Formative Evaluation of the Additional Canada Education Savings Grant and Canada Learning Bond: Final Report* (Ottawa: Human Resources and Skills Development Canada, Strategic Policy and Research Branch, November 2009), at 52. There are official statements of the policy in student loan handbooks issued by the governments of Saskatchewan (Saskatchewan, *Student Loan Handbook 2011-2012* (Regina: Student Financial Assistance Branch, 2011) ([www.aeei.gov.sk.ca/student-loan-handbook-2011-12](http://www.aeei.gov.sk.ca/student-loan-handbook-2011-12))) and British Columbia (British Columbia, Ministry of Advanced Education, *StudentAidBC: Policy Manual 2011/2012* (Victoria: Ministry of Advanced Education, 2011) ([www.aved.gov.bc.ca/studentaidbc/school-officials/docs/policy\\_manual\\_11\\_12.pdf](http://www.aved.gov.bc.ca/studentaidbc/school-officials/docs/policy_manual_11_12.pdf))). New Brunswick's guide (New Brunswick, Department of Post-Secondary Education, Training and Labour, *Information Guide and Application 2011-2012: Student Financial Assistance for Full-Time Post-Secondary Students in New Brunswick* (Fredericton: Department of Post-Secondary Education, Training and Labour, 2011) ([www.studentaid.gnb.ca/pdf/guide-11-12-e.pdf](http://www.studentaid.gnb.ca/pdf/guide-11-12-e.pdf))) states that all funds in an RESP (not just the amount withdrawn) are treated as a parental contribution, with a similar effect on available aid. Alberta may become an exception, having recently announced plans to remove the expected parental contribution.

**TABLE 1** Effect of the Canadian Learning Passport Taking into Account Interactions with the Canada Student Loan Program (CSLP)<sup>a</sup>

Case	Net effect on funds available (per 8-month study period)	Net effect on lifetime income (per 8-month study period)
	<i>dollars</i>	
A ■ Not eligible for CSLP aid	+1,000	+442
B ■ Eligible for CSLP ■ Loan does not cover all need	+1,000	+442
C ■ Eligible for CSLP ■ Loan covers all assessed need ■ Expected parental contribution greater than RESP withdrawals	+1,000	+442
D ■ Eligible for CSLP ■ Loan covers all assessed need ■ Expected parental contribution less than RESP withdrawals ■ Has high overall need (reductions in financial aid come primarily from grants)	0	-558
E ■ Eligible for CSLP ■ Loan covers all assessed need ■ Expected parental contribution less than RESP withdrawals ■ Has low overall need (reductions in financial aid come primarily from loans)	0	-558 in tuition credits but student debt \$1,000 lower

<sup>a</sup> Assuming full-time enrolment for eight months a year for no more than four years, with registered education savings plan withdrawals of \$1,000 in each academic year.

this corresponds to parental income of around \$175,000. For larger families, the cutoff would be higher. In this case, eliminating the tax credit would result in a \$558 reduction in income after the study period, while the CLP would provide an additional \$1,000 during the study period, for a net lifetime income benefit of \$442 per academic year (assuming a four-year program).

Case B shows the effects for students who receive the maximum possible student loan because their overall costs are very high relative to their available resources. This category includes students whose parents have lower incomes, and students who have high costs because they are enrolled in a relatively costly program and/or they live away from home during the academic year. An example might be a student from a two-parent, one-earner family living in Ontario, with family income under \$100,000, where the student is enrolled at a university and living away from home. For such students, an additional \$1,000 in RESP withdrawals would not change their student aid eligibility, unless it reduced assessed need to below the maximum aid limit.

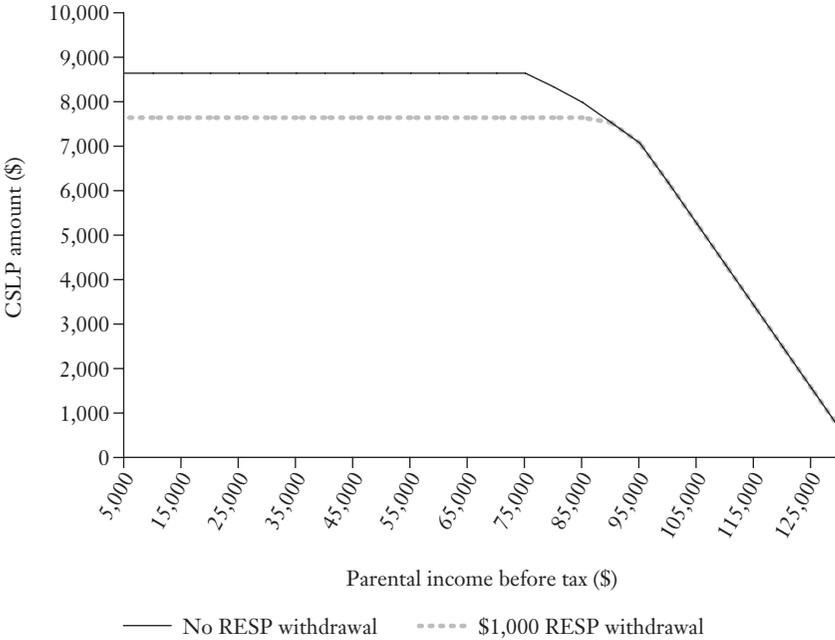
The same is true for case C, which includes anyone for whom the expected parental contribution under the CSLP is greater than withdrawals from an RESP. For Ontario, expected parental contributions are above \$1,000 for a two-parent, single-earner, one-child household with gross parental income above \$90,000. This gross-income cutoff would be lower for a household with two parents who both earned an income, since they would have lower tax liabilities and therefore higher disposable incomes.

Cases A through C indicate that any student from a family with income above \$90,000, or from a family with a more modest income who attended university full-time and lived away from home, would benefit from a switch from tax credits to the CLP.

In cases D and E, however, the switch could reduce the net financial aid to post-secondary students. In both cases, the total aid available to the student is less than the maximum amount available under the CSLP, and the total parental contribution is less than the RESP withdrawal. In both of these cases, a \$1,000 RESP withdrawal would trigger a \$1,000 reduction in total aid provided under the CSLP. Thus, the CLP would not actually result in any increase in financial resources available during the study period. The difference between the two cases depends on the value of the total aid package for which a student is eligible under the CSLP. In Ontario (and most, but not all, other provinces), those with a relatively low net need receive all their payments in the form of repayable assistance, while those with a high net need receive some portion of their payments in the form of non-repayable assistance. Case E corresponds to the situation of a student with a low net need (less than \$7,300 per academic year in the case of Ontario) who consequently receives all of his or her financial aid in the form of repayable assistance (loans). In this case, a student who withdraws \$1,000 from an RESP receives \$1,000 less in loans, and so has some benefits in the form of lower student loan repayments after graduation. A single child of two parents with a combined income of under \$90,000 who attended a college program and lived at home in Ontario would fall under this case. Case D corresponds to a somewhat higher net need situation—for instance, a single child of two parents with family income below \$90,000 who attends college and lives away from home, or who attends university and lives at home. For such students, an RESP withdrawal of \$1,000 would trigger a \$1,000 reduction in financial aid, but this time from non-repayable assistance. Thus, the switch from tax credits to the CLP would have no effect on net resources available during the academic year, and would mean a lifetime income loss of \$558 per academic year owing to the loss of the education and textbook tax credits.

Figure 2 shows the relationship between the total financial aid for which a student is eligible under the CSLP and parental income, based on an assumed case of an Ontario university student paying \$6,000 in tuition fees who is living at home with two parents, only one of whom earns an income (indicated on the horizontal axis). It shows that CSLP amounts are not affected by RESP withdrawals for students with relatively high-income parents, but decline dollar for dollar for students with relatively low-income parents.

**FIGURE 2 Estimated Canada Student Loan Program (CSLP) Amount**



Note: This scenario corresponds roughly to the case of a single university student in a two-parent, one-child family, who is living at home in Ontario. In this case, all of the reduced CSLP amount is in the form of non-repayable assistance (that is, grant equivalents), because of the Ontario student opportunity grant. For lower total CSLP amounts (under \$7,300), and for some other provinces, the reductions in overall financial assistance would come predominantly from lower repayable assistance (that is, loans).

The only students who fall into case D or E are those at the lower end of the parental income distribution, since only those students have low or zero expected parental contributions to the funding of their post-secondary education. Further, the net effects at the low end of the parental income distribution are the same regardless of the value of RESP withdrawals. For any student receiving aid under the CSLP at less than the maximum value, a larger government grant via an RESP and therefore a larger RESP withdrawal would not increase study period financial resources, and could reduce total lifetime income for students in some provinces.

As noted earlier, it is possible that CLP withdrawals may be treated as income to the student rather than as a parental contribution. In that case, the clawback rate would likely be 80 percent rather than 100 percent, but this clawback would affect all students receiving aid, not just those with smaller expected parental contributions. In addition, under this treatment of CLP withdrawals, students with lower-income parents—particularly those students who earned more through work during the summer months—could be worse off in terms of total lifetime income under the CLP

than under the existing tax credits. And again, students with parents whose incomes were high enough that the students were not receiving aid under the CSLP would unambiguously benefit.

### **What If Some Students Do Not Have an RESP?**

The CLP proposal relies on the notion that all high school students aged 14 to 17 will have an RESP in their name. It seems reasonable to assume that if parents realize that \$1,000 or \$1,500 per year will be deposited in an RESP for their child from age 14 to age 17, they will ensure that they take advantage of the opportunity. However, there is some evidence that this may not occur. Since 2004, the government has offered the Canada learning bond program, which provides an initial grant of \$500 for any child in a low-income family on the opening of an RESP, and another \$100 for each year in which the family continues to have a low income, whether or not the parents make any additional contributions. The program provides a lifetime maximum of \$2,000 in government grants for a child if the RESP is opened at birth (excluding any interest earned on those contributions). Nonetheless, by 2008, only around 15 percent of eligible children had ever received a grant under this program. In part, this may be because the program was relatively new at that point, having begun only four years earlier. But this was a dramatically lower takeup rate than the 36 percent rate for the RESP/Canada education savings grant system overall in 2007, and it is consistent with evidence that children from lower-income families are less likely to have an RESP.<sup>18</sup> If lower-income families remain much less likely to open an RESP, then providing targeted assistance via the RESP system will not succeed.

### **Longer-Run Distributional Considerations**

Recently, increasing attention has been given to the notion that the link between participation in post-secondary education and family income is in part the result of the cumulative effects of low income during childhood and adolescence. Most existing aid programs for post-secondary students provide assistance entirely on the basis of parental income during the period of post-secondary studies. If longer-run factors are important, such programs may be providing more support than needed to students from families who experience a temporary period of low income, and less than needed to students whose families experience a temporary period of high income, while the student is of post-secondary age.

Since the proposed CLP provides differential grant amounts based on parental income in the years leading up to post-secondary education, it may bring the financing system closer to providing assistance in amounts that depend on the income of a family over a child's lifetime. This is more consistent with the general principle behind programs like the RESP that are designed to encourage saving for post-secondary

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18 Kevin Milligan, *Tax Preferences for Education Saving: Are RESPs Effective?* C.D. Howe Institute Commentary no. 174 (Toronto: C.D. Howe Institute, November 2002).

education. The CLP would then provide some additional support for families trying to accumulate savings to pay for post-secondary education during low-income years prior to their children's completion of high school. However, this benefit of the CLP is negated if the additional grants paid into an RESP during low-income years prior to post-secondary enrolment are clawed back from financial aid while a student is enrolled in post-secondary education.

Despite the emergent focus on lifetime income, there is evidence that children of families that receive large negative income shocks around the time that they would be eligible to enter post-secondary education do have lower university enrolment rates than would otherwise be expected.<sup>19</sup> It would therefore probably be unwise to convert all financial aid to post-secondary students into a form that depends on lifetime opportunities to accumulate saving, and ignores contemporaneous family income altogether.

## CONCLUSION

The existing education and textbook tax credits are widely agreed to be a poor approach to delivering financial aid to post-secondary students. The payments do not come when students most need them, and since they are a block grant to post-secondary education, which is more heavily used by children from higher-income families, they tend to provide additional funds to families that are already relatively well off. A switch to the CLP, with a higher payment to students from low-income families, would therefore seem to be an improvement from a distributional perspective.

However, that conclusion depends on (1) the measure of well-being that is used to evaluate the distributional effects and (2) whether interactions with other programs—in particular, the CSLP—are taken into account. Table 2 summarizes the broad conclusions of this article.

The main concern we have is that any attempt to use the RESP system to deliver financial aid that is more heavily weighted to lower-income students cannot succeed as long as the treatment of RESP withdrawals under the CSLP is so disadvantageous to youth from lower-income households. The current rules make it difficult to reliably deliver an increase in resources to low-income students through the RESP system. This is true not only for the proposed CLP but also for existing programs that provide additional grants or higher matching contribution rates on contributions to RESPs for children from low-income families. There is a strong case for revising the treatment of RESP withdrawals under the CSLP immediately, but this will certainly need to be done if a program like the CLP is to provide the benefits intended for students from less well-off families.

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19 Michael B. Coelli, "Parental Job Loss and the Education Enrollment of Youth" (2011) 18:1 *Labour Economics* 25-35.

**TABLE 2 Overall Conclusions Regarding Distributional Effects of the Canadian Learning Passport (CLP) Relative to Tax Credits**

Measure of well-being	Distributional effects	Explanation
Current individual income	Positive	Increases income available to students when they most need it—during their study period—and so improves the distribution of students' income over their lifetime.
Individual lifetime income	Slightly negative	Like any universal subsidy to post-secondary education, provides additional funds to those who undertake some post-secondary study and who tend to have higher lifetime incomes than those who do not.
Current parental income	Unclear	The \$1,500 payment per year for children from lower-income families makes the CLP more progressive than the flat payments under the tax credit system, but the interactions with the Canada student loan program (CSLP) may more than undo this benefit. Unambiguously positive only if this quirk of the CSLP is eliminated, and if children from lower-income families all have a registered education savings plan in which funds can be deposited.
Average parental income during childhood/adolescence	Positive?	Increases the extent to which post-secondary education is subsidized not on the basis of parental income during the period of post-secondary studies, but during the entire period of childhood. This may be a more effective measure of parental resources, and it is also strongly correlated with children's educational achievement.

