Child Benefit Reform: A Case Study in Tax-Transfer Integration

Ken Battle*

ABSTRACT

The federal and provincial/territorial governments are undertaking a radical reform of the child benefits tax-transfer system—the national child benefit (NCB)—that has implications for antipoverty policy, social policy generally, and the future of the fragile social union. A series of changes from the 1970s through the early 1990s created a progressive and integrated child benefits system that improved upon the previous system's irrational distribution of benefits. However, child benefit changes in the 1980s were part of Ottawa's antideficit campaign; payments were reduced for middle-income families and removed from upper-income families, abolishing the system's universal base and weakening its capacity to pursue the objective of horizontal equity. Moreover, child benefits contribute to the "welfare wall" because welfare families receive about double the amount of child benefits (they get welfare-provided and federal child benefits) paid to the working poor (who get federal child benefits only). The NCB announced in the 1997 federal budget features a revised federal program, the income-tested Canada child tax benefit (CCTB), that to date has added $2 billion to the previous $5 billion budget to pay for a boost in federal benefits for low-income families, and a modest increase for non-poor families. The provinces' contribution to the NCB involves '"reinvesting" the savings obtained from reduced welfare payments on behalf of children (offsetting the increased federal child benefits) in other programs for low-income families with children, such as provincial income-tested child benefits, wage supplements, child care, early childhood development, and the extension of income-in-kind benefits provided to welfare recipients (for example, supplementary health care) to all lower-income families. A key objective of the NCB is to lower the welfare wall by paying equal child benefits to all low-income families and by investing in other income supports and social services for poor families with children. This paper recommends increasing the investment in the NCB in the coming years to strengthen and rebalance the vertical and horizontal equity objectives, and to solve the problem of the higher marginal tax rates imposed by the CCTB on some working poor families. Changes to the income tax system also are required, however—

* President, Caledon Institute of Social Policy, Ottawa.

first and foremost, the restoration of full indexation of brackets and credits as well as the CCTB.

INTRODUCTION

In 1976, the National Council of Welfare's report *The Hidden Welfare System*[1] introduced to Canadians the concept of tax expenditures hitherto known only to a handful of taxation experts. The catchy title was intended to dramatize the idea that the federal and provincial governments distribute billions of dollars worth of social benefits through the income tax system—in the form of various exemptions, deductions, and credits that reduce tax payable—over and above their better-known "direct" social expenditures such as old age pensions, family allowances, unemployment insurance, and welfare. Though the contention that tax expenditures are just as much social provisions as direct expenditures are was then regarded by some as heretical, over time it has become conventional wisdom. Indeed, after years of pleading by policy analysts (myself included, during my years at the National Council of Welfare), the federal Department of Finance now publishes annual estimates of tax expenditures and recently has been so bold as to add projections.

The sheer cost of such "hidden" spending was a big part of the story—the mid-1970s marking the beginning of rising deficits and the concomitant end of the expansion phase of the post-war welfare state. But *The Hidden Welfare System* and subsequent council reports also made much of the regressive distributional impact of tax expenditures delivered in the form of exemptions and deductions and their contradictory effect to that of progressive direct expenditures such as family allowances and old age pensions. To understand social policies like child and elderly benefits properly, argued the National Council of Welfare, one must analyze the combined impact of both direct and indirect (that is, tax-delivered) benefits. The council's work popularized the concept of the tax-transfer system, which, like tax expenditures, was not well understood at that time, outside of the small circle of government analysts, academics, and "policy wonks." (Note that in this paper I use the term tax-transfer system to include both direct and tax-delivered benefits, not just tax expenditures.)

Since *The Hidden Welfare System* was published, the tax-transfer system has grown and changed considerably. Governments have found the income tax system to be an efficient and effective vehicle for delivering major income security benefits, superior in some respects to traditional direct expenditure programs, especially welfare. The controversial transformation of the Canadian welfare state that began under the Mulroney Conservatives in the mid-1980s and is still unfolding under the Chrétien Liberals has involved significant changes to social tax expenditures as well as more traditional

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[1] National Council of Welfare, *The Hidden Welfare System* (Ottawa: the council, 1976).

direct expenditure programs. The very complexity of the tax-transfer system has proved to be a powerful political asset to governments increasingly concerned about rising deficits and debt financing charges. The income tax system has proved to be a powerful instrument for implementing public policy reform "by stealth"[2]—waging war against the deficit by means of hidden expenditure cuts and revenue increases. In some cases, notably benefits to children and the elderly, changes to the tax-transfer system were attempted (successfully in the case of child benefits, unsuccessfully in the case of elderly benefits) not only in the interest of expenditure restraint but also to pursue a new mix of policy objectives. At a more venal level, replacing the previous mixed direct and tax-expenditure child benefit package with the tax-delivered child tax benefit (CTB) in 1993 allowed the cost-conscious federal government to remove child benefits—which are seeing a substantial expenditure boost under the new national child benefit (NCB)—from the expenditure side of the ledger and hide them on the less politically visible revenue side of the ledger.

In the most recent year for which comprehensive data are available, 1995-96, the federal government spent in total $188 billion on social spending, of which an estimated $38.5 billion, or 20.5 percent, was through various tax expenditures. Yet the diverse collection of direct and tax-delivered benefits remains a mystery to most Canadians and politicians, and is not well understood even by many social policy observers, advocates, and administrators. This insight should come as no surprise to anyone familiar with the Rube Goldberg complexity of Canada's tax-transfer "system."

This paper explores several major issues involving the tax-transfer system by focusing on the child benefits subsystem, though occasionally it also mentions other social provisions. Child benefits are a logical choice for a case study of Canada's tax-transfer system for several reasons. Child benefits over the years have been delivered by means of three main social program vehicles. From their beginning early in the century, child benefits have been embedded in the income tax system; but they also have been paid out through two of the most prominent direct-expenditure social programs, namely family allowances and social assistance (that is, welfare). The child benefits system has undergone a series of changes over the years that touch central nerves in the debate over means and ends in social policy. The unfolding NCB is one of the key current social policy reforms and, in my view, potentially one of the most important advances in the history of the modern (post-modern?) welfare state in Canada, with implications for welfare and income security reform more generally, and for the future of the ever-fragile social union.

Not surprisingly, given the depth and scope of the reform, the NCB has attracted arrows from critics on both left and right, though (also not surprisingly) for different reasons. Social groups have assailed the initiative

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[2] Ken Battle (under the pseudonym Grattan Gray), "Social Policy by Stealth" (1990), vol. 11, no. 2 *Policy Options* 17-29.

for allegedly discriminating against welfare families;[3] the supposedly "new money" in reality only makes up for past losses, and the NCB continues the shell game of stealthy annual cuts as a result of partial deindexation. Incentives-obsessed critics on the right[4] allege that the imposition of high marginal tax rates on some working poor families jeopardizes one of the NCB's key objectives—to encourage low-income families to join and remain in the workforce.

The paper begins by tracing the evolution of the objectives and programs of federal and provincial child benefits. It then discusses some of the forces and events that have driven the current NCB reform. Following a brief description of the NCB agreement between the federal and provincial/territorial governments and the design of the new federal Canada child tax benefit (CCTB), the paper presents some of the key criticisms of the reform made by social advocacy groups. It then discusses a number of policy development issues for the new child benefits system under five headings: marginal tax rates, depth of poverty, adequacy, indexation, and horizontal equity. The conclusion reiterates the main arguments and briefly explores options for further reform.

THE EVOLUTION OF CHILD BENEFITS: TAX-TRANSFER CHANGES IN PURSUIT OF A SHIFTING MIX OF OBJECTIVES

Child benefits were the first-born of Canada's tax-transfer system. Bowing to pressure to acknowledge the fact that tax-paying parents have heavier financial obligations than do childless taxpayers, the minister of finance instituted a children's tax exemption in 1918, the second year of the "temporary" wartime income tax system. By reducing parents' income tax burden, the children's tax exemption served the objective of horizontal equity: to recognize that parents have heavier financial demands than childless couples and single people with the same incomes, such recognition justified as acknowledging the contribution that parents make to society in raising future citizens, workers, and taxpayers. From its outset, then, the federal income tax system did more than just raise revenue; it also pursued a social objective by, in effect, delivering an income benefit to taxpayers deemed worthy of tax relief by virtue of their child-rearing labours.

The tax-delivered children's tax exemption was the sole federal child benefit from 1918 until 1945, when family allowances arrived on the scene. The two programs were quite different in design, purpose, and impact. The children's tax exemption was regressive in its allocation of benefit (the

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[3] See, for example, National Council of Welfare, *Child Benefits: Kids Are Still Hungry* (Ottawa: the council, 1998). Social groups' arguments are stated and assessed in Ken Battle, *The National Child Benefit: Best Thing Since Medicare or New Poor Law?* (Ottawa: Caledon Institute of Social Policy, 1997).

[4] See, for example, Finn Poschmann, "Growing Child Benefit, Growing Tax Rates," *Backgrounder* (Toronto: C.D. Howe Institute, February 17, 1999).

amount increasing with the taxpayer's marginal tax rate); it was claimed largely by men (most taxpayers were men in those days); and it served only a minority of families (because family incomes were much lower in the pre-World War II period, most parents did not pay income tax). In other words, the child benefits system in its infancy pursued horizontal equity only for better-off families, which earned enough to pay income tax. By contrast, family allowances were delivered outside the income tax system; were paid to all mothers on behalf of their children; and were, during their first 28 years, a flat-rate, non-taxable payment of equal value to all families. Family allowances pursued three main objectives: horizontal equity (though for all families, not just the better-off), antipoverty (supplementing the inadequate incomes of poor and modest-income families with children, since wages do not take into account family size), and economic stabilization (putting cash into the hands of mothers and thus helping to increase the consumer demand deemed necessary to smooth the transition from a wartime to a peacetime economy and to help maintain purchasing power in times of economic downturn).

From 1945 to 1978, the federal child benefits system was characterized by what can be called "untargeted universality."[5] Universal family allowances extended coverage to lower-income families, but the child benefits system still did not gear its benefits to need as measured by income. To the contrary, better-off families received larger child benefits because they got income tax savings from the children's tax exemption as well as monthly family allowances, whereas poor and modest-income families received only family allowances.

Federal child benefits began to change direction in the 1970s toward a more progressive (albeit still universal) system. In 1993, family allowances were tripled, fully indexed to the cost of living, and made taxable. On the one hand, these changes were progressive: lower-income families profit most from an increase in child benefits that is protected from inflation (because child benefits constitute a larger proportion of their income); and the after-tax value of taxable family allowances declines with rising marginal tax rates. On the other hand, the children's tax exemption continued in place and cancelled out the progressivity of family allowances. However, the creation of the income-tested refundable child tax credit in 1978 (payable in 1979 for the 1978 tax year) made the federal child benefits system more progressive; the new program was geared to low- and middle-income families but paid its maximum amount to poor families, with a diminishing payment as net family income increased above a set amount (the income threshold). Fully indexed like family allowances, the refundable child tax credit broke new ground because it used the income tax system to deliver benefits to families below the tax-paying threshold. Previously, only families above the tax-paying threshold benefited from tax-delivered child benefits.

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[5] Ken Battle and Michael Mendelson, *Child Benefit Reform in Canada: An Evaluative Framework and Future Directions* (Ottawa: Caledon Institute of Social Policy, 1997), 8.

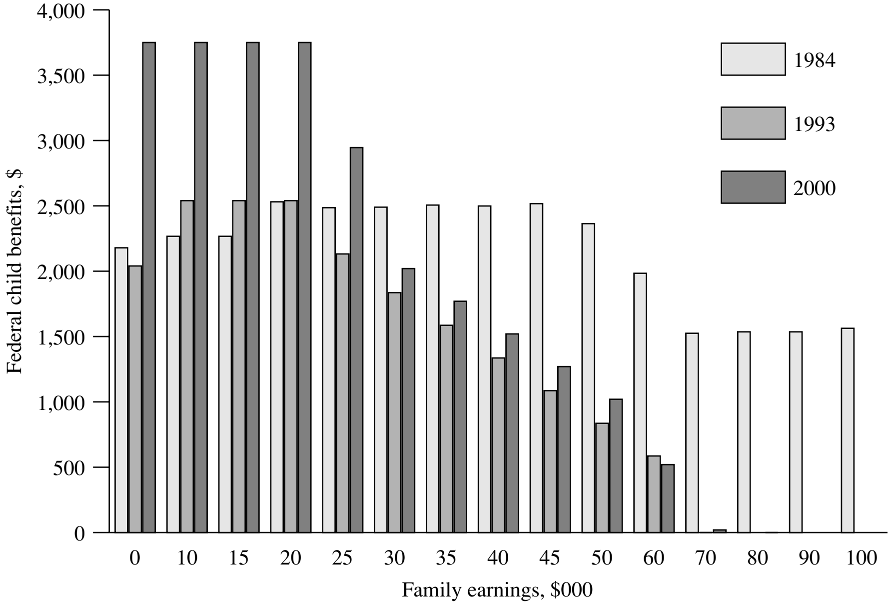
While the late-1970s tax-transfer system for families with children was more progressive albeit also more complicated than before, it remained distributionally irrational. The income-tested children's tax exemption countered the progressivity of taxable, universal family allowances; both distributed their benefits on the basis of individual income. The income-tested refundable child tax credit was progressive but based on net family income. Figure 1 shows the distribution of federal child benefits in 1984, the final year for the trio of family allowances, the refundable child tax credit, and the children's tax exemption. Amounts are expressed in constant 2000 dollars to permit comparison with the income-tested CTB introduced in 1993 as well as the new CCTB as it will be in the year 2000. Under the old system, there was no consistent relationship between the amount of the child benefit and the level of family income: middle-income families got more than the poor, and the poor got not all that much more than the affluent.

The 1980s brought a series of changes that resulted in a more progressive child benefits system, albeit at the expense of universality and the value of payments to modest-income and middle-income families. The children's tax exemption was lowered in 1987 and converted to a non-refundable child tax credit in 1988; almost all eligible families got the same benefit (those that owed less tax than the non-refundable credit got less than the maximum benefit), though poor families below the tax-paying threshold received no benefit. The equivalent-to-married exemption, paid on behalf of the first child in a single-parent family, also was converted to a non-refundable credit. The refundable child tax credit was boosted and a supplementary benefit added for children under age seven. The "sacred trust" of universality was effectively dispatched with the 1989 introduction of a clawback on family allowances to upper-income families, which used the income tax return to remove some or all of the benefits those families had received the previous year.

In 1993, universality officially was buried when the CTB replaced family allowances and the refundable and non-refundable child tax credit. Like the refundable child tax credit, the CTB served low- and middle-income families, and it calculated benefits on a sliding scale based on net family income; the maximum benefit, $1,020 per child per year, was reduced at the rate of 2.5 cents for every dollar of net family income above $25,921 for one child and at 5.0 cents for two or more children. Like family allowances, benefits were paid monthly, though they were not taxable. The CTB included an earnings-based working income supplement for working poor families with children, which paid up to $500 per family annually. For the first time in the history of Canadian child benefits, upper-income families received no child benefit (I am excluding here the child care expense deduction, which is not a child benefit per se).

Another significant structural change came in 1986, when the child benefits system, along with the personal income tax system, was partially deindexed to the amount of inflation over 3 percent. If inflation ran 4 percent, for example, the indexation factor would be only 1 percentage point (not 4 percentage points); if inflation were under 3 percent, there would

Figure 1 Total Federal Child Benefits, Two-Earner Couple with Two Children, by Family Earnings, 1984, 1993, and 2000 (Constant 2000 Dollars)



Source: Caledon Institute of Social Policy.

be no change in program parameters. In real terms, partial deindexation meant that benefits lost 3 percent of their value each year if inflation was over 3 percent, and lost the amount of inflation if that ran below 3 percent. Partial deindexation affected not only the value of child benefits, but also the income threshold for maximum payments in the case of income-tested programs like the refundable child tax credit and its successors, the CTB and the CCTB, as well as the refundable sales tax credit and its successor, the refundable credit for the goods and services tax (GST). Income tax brackets and credits have similarly been partially deindexed since 1986, resulting in annual "stealth tax hikes" and a steady decline in the federal tax-paying threshold.[6]

Figure 1 shows the distribution of the CTB in 1993 for a family with two children, and compares it with the child benefits system in 1984 (family allowances, the children's tax exemption, and the refundable child tax credit) and with the CCTB as it will be in the year 2000. Most lower-income families (except the poorest) saw a small increase in federal child

[6] Ken Battle, *No Taxation Without Indexation* (Ottawa: Caledon Institute of Social Policy, 1998); Finn Poschmann, "Inflated Taxes, Deflated Paycheques," *Commentary* 118 (Toronto: C.D. Howe Institute, December 1998).

benefits under the CTB, though at the expense of middle- and upper-income families, which experienced substantial losses. Expenditure restraint, more than redistribution, drove the changes in the 1980s and early 1990s.

Nonetheless, the CTB represented a significant rationalization and integration of the federal tax-transfer system for children, replacing three programs (one direct and two tax-delivered) with a single program that used the income tax system to calculate eligibility for an amount of benefits, though retaining the family allowances' monthly payment schedule. Because it was based on family income, the new program remedied the previous system's horizontal inequities between families with the same income but different mixes of spousal income, which had been caused by basing two of the three benefits (family allowances and the children's tax exemption) on individual income. From an operational point of view, the CTB built upon the years of successful administration of the refundable child tax credit, the only flaw being the fairly long lag time (as much as 18 months) in responding to changes in family income, a failing that still afflicts the new CCTB.

The CTB marked a shift in the relative weights of the traditional objectives of the child benefits system that occurred over many years. Between the wars, the sole objective was horizontal equity, though not for all families—rather, only for the better-off minority. Family allowances extended child benefits to all families in the spring of 1945, making the horizontal equity objective universal and acknowledging the antipoverty objective. Higher-income families still received the most, however, because they also qualified for income tax relief from the children's tax exemption and because family allowances were not taxable, so the horizontal equity objective received more attention than did the antipoverty objective. The antipoverty objective received more weight in the 1970s, when family allowances were tripled, indexed, and made taxable, and later with the creation of the refundable child tax credit that boosted child benefits for low-income families; horizontal equity was still in the picture, however, because the refundable child tax credit provided partial benefits to middle-income families and because the children's tax exemption still provided a tax break to middle- and upper-income families. Changes in the 1980s further shifted the relative weight of child benefit objectives from horizontal equity toward vertical equity, and the early 1990s brought the CTB aimed mainly at the antipoverty objective, and only weakly pursuing the horizontal equity objective, though only for middle-income families.

The changes to federal child benefits in the 1980s and early 1990s were motivated by a combination of fiscal and philosophical purposes. Substantial funds were siphoned out of the child benefits system as a result of design changes (the abolition of the children's tax exemption and universal family allowances) and the imposition of partial deindexation. Despite increases in benefits for lower-income families, the CTB in its final year (1996) paid out $5.1 billion—$1.5 billion less than the system of family allowances, the children's tax exemption, and the refundable child tax credit had spent in 1984. The federal government rationalized these cost-cutting changes as necessary to make the child benefits system fairer, especially during tough times. Indeed, social advocates had long argued for a fairer system that boosted benefits and paid them in a progressive fashion, though most did not support the abolition of universality or cuts to benefits for non-poor families. Social critics viewed Ottawa's philosophical case—that is, creating a more progressive child benefits system—as a cynical ploy thinly disguising budget cuts, made all the harder to stomach by the Conservatives' absurd claim that family allowances were still universal even after they had imposed the infamous clawback. In reality, family allowances were only temporarily paid to well-off families, since they had to give back part or all of their benefits to Ottawa when they filed their income taxes and became subject to the clawback. But the fact remains that the changes in the 1980s and early 1990s did create a system that was geared more to income, culminating in a rationalized tax transfer (the CTB) that laid the groundwork for a much more radical restructuring of the federal-provincial/territorial child benefits system—though I am getting ahead of myself.

The history of federal child benefits is only part of the story. The provincial and territorial governments also have delivered child benefits for decades, mainly in the form of welfare benefits payable on behalf of children in families receiving social assistance. While such welfare-delivered child benefits range widely in value, as do adult welfare rates, in most provinces they have averaged between $1,200 and $1,800 per child for basic needs (excluding shelter costs). Welfare also can provide additional child-related benefits, including income-in-kind benefits such as supplementary health and dental care and prescription drugs, special allowances (for example, for winter clothing), and shelter subsidies. Such ancillary benefits, when available, vary widely from province to province and sometimes even within provinces. In addition, a few provinces (including Saskatchewan, Manitoba, and Quebec) have offered income-tested child benefits of one kind or another over the years, though only supplementary to their welfare-delivered child benefits.

TAX-TRANSFER DIS-INTEGRATION: IMPETUS FOR RADICAL REFORM OF CHILD BENEFITS

The overall tax-transfer system for families with children—that is, the federal and provincial/territorial programs—has not been integrated in any sense other than sharing the antipoverty objective.

The federal child benefits system has pursued two main objectives—antipoverty and horizontal equity (economic stabilization having gone out of fashion with the demise of Keynesianism in the 1980s and 1990s), though with a shift in emphasis from the latter to the former. With the advent of the CTB in 1993, Ottawa rationalized its previous blend of direct and tax delivery into a single, income-tested, tax-delivered program that, though no longer universal, still served the large majority (8 in 10) of those families with children. The CTB blended the antipoverty objective with a targeted form of horizontal equity (that is, excluding upper-income families with children).

Child benefits delivered through provincial and territorial social assistance systems are a quite different animal. They pursue only the antipoverty objective, and in a different manner than federal child benefits, since welfare benefits *replace* employment earnings whereas federal child benefits always have been intended to *supplement* employment earnings (though in practice they also supplement welfare benefits).

A crucial point often not understood in the Canadian debate over both child and elderly benefits is that such needs-tested welfare differs fundamentally from income-tested and universal social programs; indeed, income-tested benefits are closer to universal benefits than to needs-tested welfare. (I am referring to the ludicrous allegation that the recently withdrawn proposal for a new seniors' benefit would have changed old age security into a form of "welfare" for seniors.) Applicants for social assistance must undergo an intrusive and exhaustive investigation (a needs test) of their incomes, assets, deemed needs, and other personal circumstances; welfare recipients typically are retested frequently and must report any change in their situation. The welfare system is highly discretionary (welfare workers generally have considerable leeway in determining what individual families can receive when it comes to special benefits); it involves a relatively high degree of client-worker interaction; and it continues to lay a high degree of social stigma on its recipients. Welfare is a rules-and-regulations-ridden, highly complex system in which recipients typically are treated in a manner that tends to reinforce their economic powerlessness; recipients sometimes complain that they are treated like criminals or children.

The scope of federal and provincial/territorial child benefits also differs significantly: Whereas federal child benefits have served all or (now) the large majority of families with children, welfare-delivered child benefits go only to low-income families on welfare; they exclude other low-income families such as the working poor and those on employment insurance.

By contrast, income-tested social programs—which number among them the CCTB and its predecessors the CTB and the refundable child tax credit, the refundable GST credit, the guaranteed income supplement, the spouse's allowance, and various provincial refundable credits—involve little or no direct contact between recipients and administrators. They are operated anonymously through the same income tax system that covers Canadians in all income groups and throughout the country. Whether broad-based in terms of their scope (the CTB) or targeted to the poor (the other programs listed above), income-tested benefits bring no social stigma to their recipients. Recipients qualify and requalify for benefits based only on a simple test of their income.

For many years, the federal and provincial/territorial governments delivered their child benefits in two solitudes. Indeed, welfare-delivered child benefits rarely entered into the debate over child benefits, which focused on federal programs. But the confluence of several factors led to a new interest in the 1990s in analyzing federal and provincial child benefits as an overall system (or lack thereof) and led to the far-reaching reform known as the national child benefit (NCB) that was launched in the 1997 federal budget.

Welfare was supposed to be a last-resort safety net program that would catch the relatively small number of Canadians who required temporary help to tide them over until they could get back on their feet but who failed to qualify for support from other income security programs such as unemployment (now employment) insurance and workers' compensation. Instead, welfare grew into a front-line program that in the 1980s and 1990s served about 1 in 10 Canadians during the course of a year. Following the recessions of the early 1980s and 1990s, welfare caseloads did not decline in step with falling unemployment, though they have eased somewhat since the mid-1990s as a result of tighter eligibility requirements and some improvement in the employment picture. Moreover, the proportion of recipients deemed to be employable increased significantly. At last count (1996), an estimated two-thirds of low-income, single-parent families received social assistance, as did 36 percent of two-parent families with low incomes; in all, 52 percent of low-income families with children received welfare benefits. Children have come to constitute a shockingly large group in the welfare clientele—more than one-third of all recipients.

There are several reasons for the rise in what governments and right-wing critics characterize as "welfare dependency." The changing labour market coupled with a high rate of marriage breakdown are key: Extensive unemployment and underemployment; the growth of insecure non-standard employment; declining job opportunities for low-skilled and low-educated workers; unindexed minimum wages that have declined in value over the past 30 years; the rising labour force participation of women and Canada's high rate of marriage breakdown, which have increased the demand for child care (still in short supply) to meet the needs of two-earner couples and job-seeking single parents—these factors have made it difficult for many families to earn a living wage and to find and keep a job. Cuts in unemployment/employment insurance have pushed some unemployed families and individuals into the welfare system; in 1997, the new employment insurance program served only 41.7 percent of the unemployed.

After decades of persistent work, social advocates finally managed to put child poverty high on the public policy agenda in the late 1980s and have kept the issue prominent in the 1990s. In 1989, the House of Commons passed an all-party resolution to work toward the elimination of child poverty by the year 2000—an admirable if naive commitment.

Yet child poverty remains high, especially among single-parent families, even with economic recovery. At last count (1997), one in five children lived in low-income families—just under 1.4 million (1,397,000) or 19.8 percent of Canada's children. Compared with 1989, the year that the House of Commons expressed its famous resolve to eliminate poverty by the year 2000, there were 381,000 more low-income children in 1997, and they ran a 4.5 percentage point higher risk of poverty (that is, 19.8 percent were poor in 1997 compared with 15.3 percent in 1989).

The low-income rate for children in one-parent families led by women fell from 65.0 percent in 1996 to 59.5 percent in 1997, though the poverty rate for children in two-parent families remained almost unchanged at 13.1 percent in 1997 (13.0 percent in 1996). Children in single-parent families led by women are five times more likely to be poor than children in two-parent families. The risk of low income among children varies considerably by province above or below the national average of 19.8 percent. Newfoundland had the highest rate of child poverty in 1997, at 22.8 percent, while Prince Edward Island registered the lowest child poverty rate, at 14.9 percent.

The cost factor clearly loomed larger in recent years as an impetus to social policy change. Ottawa and the provinces made large cuts in their social spending, the provincial governments prompted in part by significant federal cutbacks in social transfers to the provinces as well as a series of belt-tightening changes to unemployment/employment insurance. Under the Canada Health and Social Transfer, which replaced the Canada Assistance Plan and Established Programs Financing, the provinces and territories no longer can count on Ottawa to share half the cost of welfare and social services; when the next recession drives welfare caseloads and costs up, they will be on their own.

There has been increasing criticism that social programs are "part of the problem" rather than "part of the solution," to remember the facile platitude of the time. Governments adopted the glib rhetoric of the need to move from "passive" to "active" social programs. "Accountability" and "outcomes evaluation" became commonplace buzzwords among governments interested in "what works and what doesn't work." Soon after the Liberals came to power in 1994, they announced a social security review that conducted extensive public consultations and produced a discussion paper and a series of background documents that explored various avenues for reform.

One policy that received considerable attention in the social security review was child benefits; among the several options for reform was an "integrated child benefit" that would replace the current federal and provincial child benefits. The notion was not new: Proposals for various forms of integrated child benefit (though not always by that name) had been made as far back as Leonard Marsh's path-breaking blueprint for the modern Canadian welfare state in 1943, and later by the Castonguay-Nepveu commission in Quebec in 1971 and the Ontario Social Assistance Review Committee in its 1988 report. I myself undertook the first exploration of costed options for a national integrated child benefit in an appendix to the 1990 Senate committee report on child poverty and in a 1995 report of the Caledon Institute of Social Policy. Caledon went on to play a key role in the social security review and, as adviser to the federal government, in the political and policy development of the NCB.

The substantial cuts in federal social transfers to the provinces that led up to and accompanied the Canada Health and Social Transfer in 1996 embittered relations between the two levels of government. So too did the unilateral nature of the federal actions regarding not only social transfers to the provinces but also severe restrictions to unemployment/employment insurance and the failure to include the provinces as partners in the social security review. Rather than waiting for the federal government to come calling to discuss the possibility of federal-provincial cooperation in devising principles and objectives for the new Canada Health and Social Transfer, the provinces boldly joined together without Ottawa and wrote a report of the Ministerial Council on Social Policy Reform and Renewal, whose key proposal was for an integrated child benefit.

Another galvanizing development was British Columbia's pioneering family bonus, put in place in July 1996. Delivered by Revenue Canada through the federal child benefit apparatus on behalf of the province, the BC family bonus was Canada's first integrated child benefit, replacing welfare benefits on behalf of children with an income-tested benefit paying a maximum of $1,236 per child to all low-income families and partial benefits to modest-income families.

Ottawa, which already had shown an interest in child benefit reform, responded positively and quickly to the provinces' proposal for an integrated child benefit. A federal-provincial working group of officials was established to do the substantive work on the idea, and the 1997 federal budget announced the new NCB.

The concept of an "integrated child benefit," which underlies the NCB, seeks to redress a fundamental "dis-integrative" feature of the federal-provincial/territorial child benefits system: Welfare families with children receive child benefits from two sources—provincial welfare benefits paid on behalf of children, and federal child benefits. Other low-income families, notably the working poor and the poor dependent upon unemployment/employment insurance, for the most part get only federal child benefits. (As noted earlier, a few provinces have offered income-tested child benefits that extend beyond welfare families.) As a result, welfare families receive substantially more cash child benefits than other low-income families, and this advantage is over and above the value of their other income-in-kind benefits, such as supplementary health and dental benefits, shelter allowances, and such special benefits as winter clothing allowances.

Before the introduction of the NCB in July 1998, combined federal-provincial/territorial child benefits ranged from around $2,220 to $2,820 per child in welfare families in most provinces (with another $213 for each child under seven), whereas federal child benefits for children in working poor families were a maximum of $1,520 for one child (the basic $1,020 CTB and the maximum $500 working income supplement), with another $213 for each child under seven for whom the child care expense deduction was not claimed. For two children, the gap between welfare and other low-income families was wider still because the working income supplement was provided on a per family rather than a per child basis, so working poor families received relatively smaller benefits for each additional child. For example, for families with one child under seven and one child over seven, the total child benefits for a welfare family (using a rough average of $1,500 per child for welfare-provided child benefits) amounted to $5,253, which is close to double the $2,753 for other low-income families with children.

The Caledon Institute of Social Policy coined the term “welfare wall” to dramatize the features of the tax-transfer system that can present obstacles to moving from welfare to the workforce.[7] The concept of the welfare wall was taken up by the federal and provincial governments in making the core case for the NCB. Parents who manage to find paid work—the lack of which is another major hurdle to getting off welfare, of course—can risk losing thousands of dollars in welfare-provided child benefits and in-kind welfare benefits, on top of seeing their (typically low) wages reduced by federal and sometimes provincial income taxes, Canada Pension Plan (CPP) contributions, and employment insurance premiums, and facing employment-related expenses such as child care, clothing, and transportation. (Welfare recipients also face a steep reduction rate on their employment earnings, a point discussed later.) Moreover, the federal tax-paying threshold has been declining steadily and substantially because of the imposition of partial deindexation in 1986; some (but not all) provinces attempted to deal with the resultant lowering of the provincial income tax threshold by providing tax relief for the poor. Though employment insurance premiums have been lowered several times over the past several years after previous increases, CPP contributions will increase by 1.8 times between 1996 and 2003 as a result of the switch from pay-as-you-go to partial funding; the impact of this payroll tax increase is regressive because the CPP contribution reaches its maximum at average earnings, and the year’s basic exemption (the earnings level below which contributions are not levied) has been frozen at $3,500, which means that it will decline steadily in real terms year by year. As a result, other aspects of the tax-transfer system—namely, income and payroll tax increases—have contributed to the welfare wall.

National Child Benefit: The Formula

The national child benefit (NCB), a term referring to the combination of federal and provincial/territorial child benefit reform initiatives, seeks to lower the welfare wall in two significant ways. First and foremost, the federal government redesigned (simplified, by dropping the working income supplement) and enriched its child benefit, renamed the Canada child tax benefit (CCTB). The provinces, for their part, are allowed to reduce their welfare-provided child benefits by the amount of the federal child benefit increase, provided that they “reinvest” the resulting savings in other programs and services for low-income families with children; that reinvestment can include income-tested child benefits, earnings supplements, child care and other family support services, employment programs, and the extension

[7] Ken Battle and Sherri Torjman, *The Welfare Wall: The Interaction of the Welfare and Tax Systems* (Ottawa: Caledon Institute of Social Policy, 1993).

of in-kind benefits to the other low-income families (for example, supplementary health care). Over time, government's objective is to raise the CCTB to the point where it (alone or in combination with provincial income-tested child benefits) fully displaces welfare-delivered child benefits (to a target of about $2,500 per child). With this system, all low-income families, regardless of their major sources of income, will receive the same amount of CCTB, whereas with the previous system, larger child benefits were paid to some low-income families (that is, those on social assistance).

The NCB also attempts to lower the welfare wall through the provincial reinvestments in other programs for low-income families with children, such as child care, early childhood development, family supports, the extension of supplementary health and dental care, and income-tested benefits (child benefits and earnings supplements). A key feature of the new social union federalism, of which the NCB is the first substantive example, is the fact that individual provinces decide where and how much to reinvest their welfare savings. To the extent that working poor and other non-welfare, low-income families benefit from these reinvestments, as well as from their increased federal child benefit, such families will be better off than under the old system and will not be penalized for moving from welfare to the workforce.

Ottawa and the provinces have set three objectives for the NCB. It is intended

> to help prevent and reduce the depth of child poverty; to promote attachment to the workforce—resulting in fewer families having to rely on social assistance—by ensuring that families will always be better off as a result of finding work; and to reduce overlap and duplication through closer harmonization of program objectives and benefits and through simplified administration.[8]

In a 1997 Caledon report, *Child Benefit Reform in Canada*: *An Evaluative Framework and Future Directions*, Michael Mendelson and I critically assessed these three objectives.[9] Briefly, we supported the choice of depth rather than incidence of child poverty as an objective. Progress in reducing incidence—difficult to achieve through child benefits alone, especially given their current low level relative to the depth of poverty—easily can be swamped by other factors (especially unemployment), while stronger child benefits realistically can be expected to reduce the depth of poverty among working poor families (and all low-income families, if benefits are increased above the level that would replace welfare child benefits). We argued, however, that it is unrealistic to set the prevention of child poverty as a formal objective of child benefits per se, though other programs (including some in the bundle of provincial "reinvestments" under

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8 Canada, Department of Finance, 1997 Budget, *Working Together Towards a National Child Benefit System*, February 18, 1997, 15.

9 Battle and Mendelson, supra footnote 5.

the NCB) can play a preventive role, such as the broad range of education services (cradle-to-retirement) that invest in human capital and improve employability, programs that seek to help parents balance their work and family responsibilities (especially affordable, quality child care and family-friendly workplace practices), and other family support services. One could well add pro-employment monetary and fiscal policy to the list. We added four objectives to government's three:

1) *Adequacy*. Once the displace-welfare target of $2,500 per child is reached, the fully indexed CCTB should be raised further within the first decade of the 21st century to reach $4,000 maximum per child, which is a low estimate of the cost of raising a child in a low-income family. We also recommended that a study be conducted to come up with more accurate and detailed estimates and that child benefits be improved for modest- and middle-income families, which have seen substantial losses.

2) *Fairness*. The CCTB continues to use net rather than gross family income, which results in unequal treatment of families with the same gross incomes.

3) *The promotion of dignity and independence*. Replacing needs-tested with income-tested tax-delivered child benefits would further this objective.

4) *Economic stabilization*. This objective resurrects a traditional but lost objective of child benefits, as noted earlier.

The NCB is being phased in over several years. At the federal level, in 1997 the working income supplement was changed from a per-family payment (with a maximum of $500) to a per-child payment (with a maximum of $605 for the first child, $405 for the second child, and $330 for the third and each additional child).

Effective July 1998, the CCTB replaced the CTB (and its working income supplement) and paid a maximum of $1,625 for the first child and $1,425 for each additional child (the old $75 supplement for the third and each additional child was retained). Increases were concentrated on families below net income of $25,921, and families above that level continued to receive the same child benefits as before (though, as before, the value falls to inflation each year because of the continuation of partial deindexation).

In July 1999, the maximum CCTB goes up to $1,805 for one child and $1,605 for each additional child, and the net family income threshold at which the increased benefits to poor families are phased out rises to $27,750.

In July 2000, the maximum increases to $1,975 for one child and to $1,775 for each additional child. The net family income threshold at which increased benefits to low-income families ends rises to $29,590 (where the second income tax threshold begins).

Figure 2 illustrates how the CCTB operates, as of July 2000 when the second instalment will be fully implemented. To further confuse matters, Ottawa has chosen to divide the CCTB into two parts; while conceptually precise, this decision makes explaining the program to non-specialists a real chore. The base CCTB is a maximum of $1,020 per child and phases out at the rate of 2.5 percent for one child and 5.0 percent for two children when net family income exceeds $29,590 in 2000. The national child benefit supplement (NCB-S) is the increased benefit for low-income families; in 2000, it will reach a maximum of $955 for the first child and $755 for each additional child, phasing out above net family income of $20,921 at the rate of 11.0 percent for one child, 19.7 percent for two children, and 27.5 percent for larger families, to end at $29,590. Together, the base CCTB and NCB-S will amount to a maximum payment of $1,975 for one child and $1,775 for each additional child as of July 2000.

To date, the federal government has augmented its child benefits expenditures from $5 billion to $7 billion (as of 2000)—a substantial $2 billion or 40 percent increase. While such sums are still not inconsequential, as Ottawa begins to creep cautiously into the light of the post-deficit day, the money must be seen in context. It only partly reverses the past cuts; in 1984, the federal child benefits budget was about $8 billion (in constant 2000 dollars). The federal government spends twice as much on the tax deductions for RRSP and RPP contributions (an estimated $15 billion in 2000) as it does on the CCTB.

The provinces have reinvested their welfare savings in a range of programs for low-income families with children, as agreed in the political (not legislative) agreement that constitutes their NCB partnership with the federal government. Some have concentrated on one or a few initiatives, while others have undertaken several. Two provinces, New Brunswick and Newfoundland, chose not to reduce welfare payments on behalf of children by the increase in federal child benefits, since their welfare wall is lower than elsewhere because their welfare benefits are considerably lower. Those provinces have, however, allocated additional funds of their own to other programs and services for low-income families with children, as have a few provinces that did reduce welfare benefits on behalf of children (that is, provinces that added money to the federally created savings).

CRITICISMS OF THE NCB FROM SOCIAL ADVOCACY GROUPS

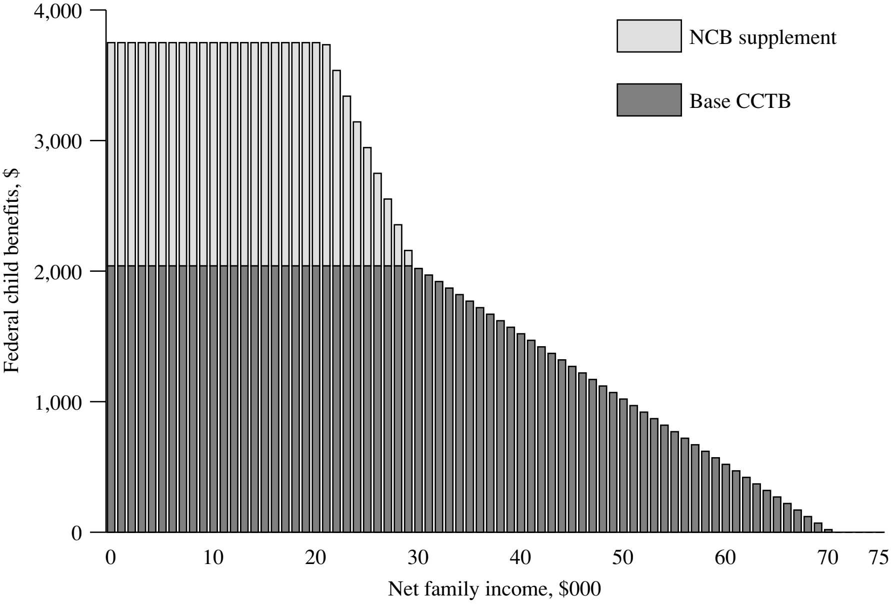
Social groups and academics generally reacted to the announcement of the NCB with either open hostility or a Doubting-Thomas, I'll-believe-it-when-I-see-it attitude.[10] In this time of social policy cuts in the guise of reform, this negative reaction should come as no surprise. I have discussed these criticisms of the NCB at length elsewhere,[11] so here will just state and respond to some of the key concerns.

The most damning allegation against the NCB is that it "discriminates against welfare families, the poorest of the poor." Coming as it does after

10 See papers by Douglas Durst, Karen Swift and Michael Birmingham, Jane Pulkingham, Gordon Ternowetsky, and Pete Hudson in Douglas Durst, ed., *Canada's National Child Benefit: Phoenix or Fizzle?* (Halifax: Fernwood Publishing, 1999).

11 Battle, supra footnote 3. See also Battle and Mendelson, supra footnote 5.

Figure 2 Federal Child Tax Benefit, Families with Two Children, 2000



Source: Caledon Institute of Social Policy.

several years of overt or covert cuts to welfare benefits, and increasing efforts on the part of most provinces to "encourage" welfare recipients into the workforce through various means (such as workfare in Ontario, and tightening eligibility rules), the NCB is stepping onto rough ground. Welfare families, which have suffered erosion of their incomes in every province in recent years, will see no increase in their child benefits, but rather simply an increase in the proportion coming from Ottawa and a concomitant decline in the share from provincial welfare.

By contrast, the working poor and other low-income families not on social assistance will enjoy an increase in their child benefits. The National Council of Welfare led the charge, claiming that the majority of poor families with children are on welfare; the council estimates that only 17 percent of poor single-parent families and 59 percent of poor two-parent families will see a real increase in their child benefits as a result of the first instalment of the CCTB.[12]

This criticism misses—or rejects—the whole point of the reform (in its current stage), which is to equalize child benefits for all low-income families by raising the child benefits of non-welfare, low-income families to the level of child benefits paid to welfare families. Contrary to what

[12] National Council of Welfare, supra footnote 3, at 9.

some critics allege, welfare families will indeed receive increased federal child benefits (under the CCTB), though their welfare-delivered child benefits will be reduced accordingly. A key issue here is money: If Ottawa had gone with a big-bang approach (as proposed in Caledon's 1995 report) rather than the incremental phase-in approach, and had put enough money on the table, it could not only have displaced welfare-delivered child benefits but also raised the level of the new CCTB high enough to exceed the previous amount of federal-provincial child benefits payable to welfare families. While welfare families still would have seen a smaller increase in child benefits than the working poor and other non-welfare poor families, at least welfare families would have been better off than before. Of course, the critics could still accuse the NCB of discriminating against welfare families, even with a real increase in child benefits. In that case, the onus would be on the critics to explain why they think one group of low-income families with children (those on social assistance) should receive more child benefits than other poor families, notably the working poor.

Caledon's position is that the federal government should accelerate its investment to reach the $2,500 displace-welfare target by the year 2000—a politically significant year in view of the 1989 Commons' resolution against child poverty. It would cost about another $1 billion to achieve that level. Then Ottawa should extend increases to middle-income families and boost benefits to the poor to reach $4,000 by 2010 at the latest. I cannot offer cost estimates here, since they will depend on the design of such a mature child benefit system, especially on how much it would increase benefits for non-poor families.

Even without an increase in child benefits for welfare families, it can be argued that they will be better off under the NCB than they were before. Welfare is a highly stigmatizing program, prone to cuts on the part of the provinces. A get-tough-on-welfare plank was a prominent part of the election platform of Ontario's Conservative government, and it followed through with a draconian 21.6 percent cut in welfare for most recipients in October 1995. Income-tested social programs, by contrast, have seen some increases in benefit rates for lower-income recipients (for example, the guaranteed income supplement and the refundable child tax credit in the 1980s, and the CCTB in the 1990s), though child benefits and the refundable GST credit remain infected with the partial deindexation virus that erodes their value. The CCTB is likely to see further increases in the coming years and, we hope, a restoration of full indexation.

To borrow a term from pension terminology, the CCTB is a "portable" benefit that accompanies families no matter what their primary income source: welfare families no longer will lose child benefits if they move to the workforce, and working poor families will continue to receive their child benefits from the federal government even if they move to welfare or employment insurance. If they improve their earnings, families will continue to receive the CCTB—though in a smaller amount, depending on their income—quite high up the income scale. In 2000, the CCTB for a family with one or two children will end at net family income of $70,390, which (especially if converted to gross income, which is higher) is above the average family income of $67,000 as of 1997 for a two-parent family.

Welfare families receive the CCTB, without stigma, just like the majority of Canadian families. Payment is automatic and painless, involving little or no contact with government officials. Moreover, some welfare families will benefit from some of the provincial reinvestments (not all of which are focused on the working poor), though more so if they move into the workforce, of course.

Social groups also have criticized the federal government for not putting enough money on the table and for continuing to hobble the CCTB with the curse of partial deindexation. Caledon concurs fully with these criticisms.

Although the social groups' negative view of the NCB is understandable, it is nonetheless lamentable. The NCB holds out the promise of being more than just a restructuring and enhancement of child benefits. By removing a large group (children) from welfare caseloads, it marks a major step forward in the essential task of dismantling the welfare system and replacing it with more effective and humane programs. The NCB also serves as the poster child for the social union. It could become a model for other badly needed federal and provincial/territorial initiatives against poverty and unemployment.

POLICY DEVELOPMENT ISSUES FOR THE NEW CHILD BENEFIT SYSTEM

Marginal Tax Rates

Economists tend to scrutinize the tax-transfer system through the monocle of marginal tax rates. There are emerging concerns among some economists[13] that the NCB could shoot itself in the foot, as it were, by imposing usurious marginal tax rates that sap the work ethic of the very people it is supposed to help. (Strictly speaking, "marginal tax rates" refers to income and payroll taxes, while "effective marginal tax rates" includes the de facto tax rates imposed by income-tested social programs' reduction rates; here, however, I use the term marginal tax rate to mean effective marginal tax rate, as is common practice.)

While there is no doubt that the CCTB has resulted in high marginal tax rates for some working poor families (those in the range of $20,921-$25,921 net family income), its actual impact on their labour market behaviour remains an open question. More important, social initiatives such as the NCB should not be judged by marginal tax rates alone: the impact of the new child benefit on the depth of poverty and disposable income, and the potentially positive labour attachment effects of its earnings supplementation role, must also be thrown into the witches' brew of the policy wonks. But the marginal tax rate debate highlights one of the conundrums of the geometry of the tax-transfer system: Targeted income programs

[13] See supra footnote 4.

invariably raise marginal tax rates, and the problem grows the more we try to boost maximum benefits for low-income recipients—unless money is no object. But money is an object, even in post-deficit Canada. The alternatives to income-tested programs—universal programs or no programs—are, however, worse.

The CTB introduced in 1993 retained the same low reduction rate of the 1978-1992 refundable child tax credit upon which it was modelled—2.5 percent for one child and 5.0 percent for two or more children on net family income above the threshold, which in 1997 stood at $25,921. The working income supplement for working poor families imposed a somewhat higher phase-in and phase-out (it phased in at the rate of 8 percent of earnings above $3,750 and phased out at 10 percent of net family income over $20,921).

So as to target the entire ($850 million) increase in child benefits on low-income families, the first phase of the CCTB (which took effect in July 1998) imposed a substantially higher reduction rate[14] on the NCB-S (the increase over the base benefit of $1,020) for families with one to three children[15] and net family income of between $20,921 and $25,921, while keeping the previous 2.5/5.0 percent reduction rate on the base child benefit ($1,020) on net family income above $25,921. That higher reduction rate boosted overall marginal tax rates for families with net income between $20,921 and $25,921. For example, an Ontario family with two children and earnings of $23,000 saw its marginal tax rate rise from 34.7 percent to 44.9 percent with the introduction of the CCTB in 1998.

In considering how to implement the second phase of the CCTB, which added another $850 million to the budget, the federal government took into consideration the effect of different options on marginal tax rates. If Ottawa had simply continued on the identical track as the first phase and again concentrated the entire $850 million increase on families below $25,921, even higher reduction rates on families between $20,921 and $25,921 would have been necessary. One such "all-to-the-poor" option would have increased the maximum CCTB from $1,625 for the first child (and $1,425 for subsequent children) by $410, to $2,035 ($1,835), but would have required a reduction rate increase on the NCB-S from 12.1 percent to 20.3 percent for one child, from 20.2 percent to 36.6 percent for two children, and from 26.8 percent to 48.6 percent for larger families. The result would have been increases of 15 to 16 percentage points in marginal tax rates for families in the $20,921 to $25,921 range. For example, an Ontario family with two children and earnings of $25,000 saw its marginal tax rate rise from 40.1 percent under the CTB to 49.5 percent under the first

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[14] The reduction rates imposed were 12.1 percent for one child, 20.2 percent for two children, and 26.8 percent for three or more children.

[15] For families with more than three children, the upper income limit rose—to $27,150 for those with four children, $28,380 for those with five children, $29,160 for those with six children, and $1,230 more for each additional child.

phase of the CCTB, and it would have jumped to 64.6 percent under this all-to-the-poor option for the second phase.

Instead, Ottawa chose a "most-to-the-poor" option for the second phase of the Canada child tax benefit (CCTB2), which slightly reduced marginal tax rates for the hard-hit $20,921 to $25,921 families, though at the expense of increased marginal tax rates (and child benefits) for families with net incomes between $25,921 and $29,590 (the latter being the taxable income threshold where the second—26 percent—income tax bracket kicks in). The reduction rate on the NCB-S is being lowered slightly for most families, from 12.1 percent in CCTB1 to 11.0 percent in CCTB2 for one child, and from 20.6 percent to 20.1 percent for two children, though it will rise a bit from 26.8 percent to 27.6 percent for larger families. However, the net family income threshold where the NCB-S phases out is being raised from $25,921 to $29,590. Note that these are the figures for 2000; CCTB2 is being phased in over two years (that is, July 1999 and July 2000).

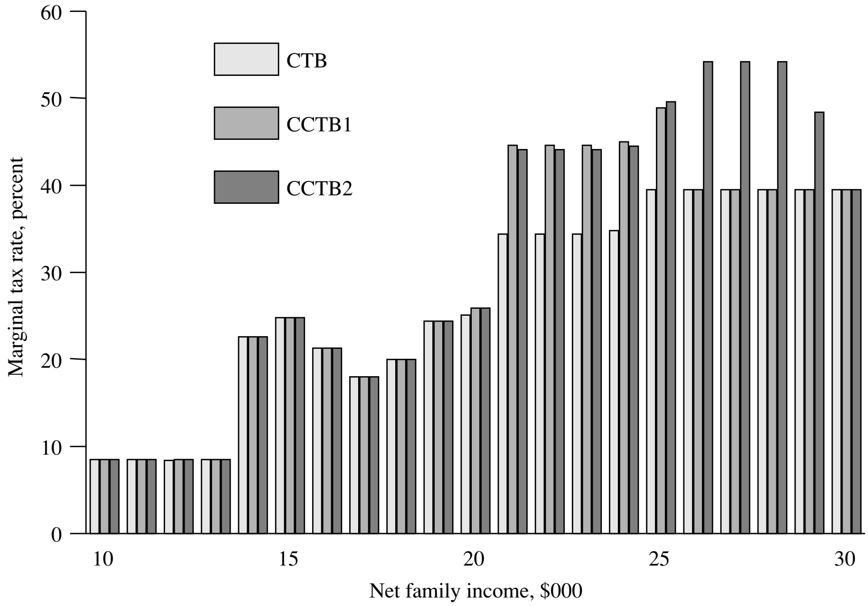
The design chosen for the second phase of the CCTB raises marginal tax rates for families between $25,921 and $29,590 by about 15 percentage points. Figure 3 shows the results. For example, a family with a net income of $27,000 will see its marginal tax rate rise from 39.5 percent under CTB and CCTB1 to 54.2 percent under CCTB2. If the federal government had opted for an all-to-the-poor design for CCTB2, however, the marginal tax rate of a family with a net income of $23,000 would have risen from 44.6 percent under CCTB1 to 61.0 percent under CCTB2; instead, its marginal tax rate will ease slightly under the actual CCTB2 design, from 44.6 percent to 44.1 percent, thanks to the lower NCB-S reduction rate.

While CCTB2 shifts higher marginal tax rates up the income range (that is, from $20,921-$25,921 families to $25,921-$29,590 families), an all-to-the-poor option would have increased marginal tax rates on the former families even higher than the actual increase for the latter families. Figure 4 illustrates the impact of the two CCTB2 options on marginal tax rates.

In return for higher marginal tax rates, families in the $25,921 to $29,590 range will receive more child benefits, since they will become eligible for the NCB-S portion of the CCTB. They also will benefit from another change announced in the 1999 budget: the net family income threshold above which the base ($1,020 maximum) CCTB is reduced (by 2.5 percent of net family income for one child and 5.0 percent for two or more children) will increase from $25,921 to $29,590 as of July 2000. Child benefit gains range from $713 for a two-child family at $26,000 to $272 at $29,000.

Raising the threshold for the base CCTB will have two effects: it will bestow small increases (for example, $184 for two children) on modest- and middle-income families, and it will raise the disappearing point—that is, the net family income threshold at which eligibility for partial benefits ends—from $66,721 to $70,390 for a family with one or two children. Though small, this change marks an important first step in the necessary

Figure 3 Marginal Tax Rates, Two-Earner Couples with Two Children, Ontario, CCTB2 Versus CCTB1 and CTB

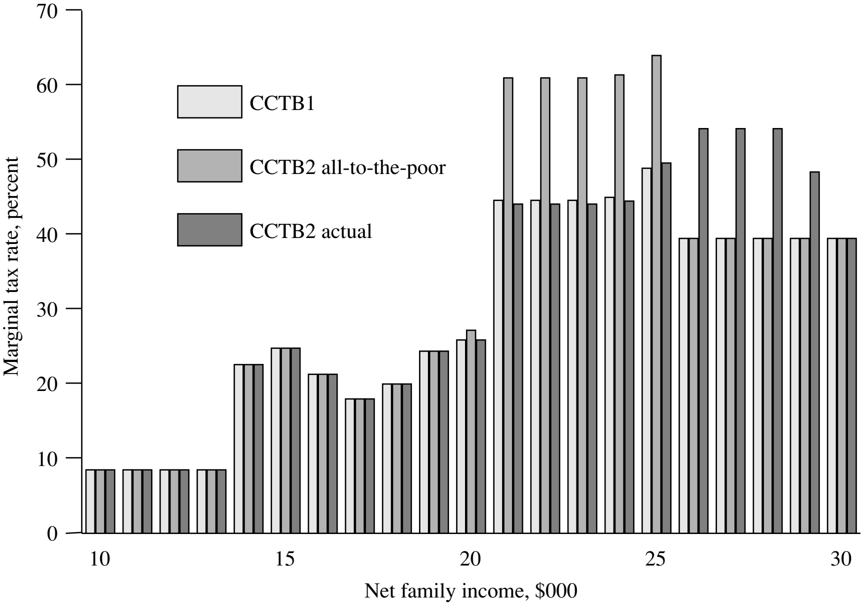


Source: Caledon Institute of Social Policy.

task of restoring child benefits for non-poor families, which have suffered an erosion of their benefits over the years.

The marginal tax rate picture looks much worse if one includes the very high reduction rate on welfare for earnings above the modest allowable amount (both of which vary from province to province). In Ontario, for instance, welfare is reduced at the rate of 75 percent of employment earnings, less a small amount of exempted earnings ($346 a month). Theoretically, working poor families with two children in Ontario could be eligible for partial welfare benefits as high as $25,000. The result can be extremely high overall marginal tax rates if a working poor family receives a welfare top-up. But I stress the word *theoretically*: In Ontario, at least, the province has tightened up on welfare regulations and their administration in recent years to the point where few if any working poor families receive welfare as a de facto earnings supplement. Moreover, welfare is such a stigmatizing program that, even if small benefits were made available to low-income working families, many would not apply in any case. It is an important empirical question as to how many working poor families actually receive welfare top-ups in each province and territory. Until such information is made available on an updated basis—a Caledon recommendation—we should be wary of assuming welfare top-ups in marginal tax rate calculations, especially for the purposes of analyzing child benefits and assessing different options.

Figure 4 Marginal Tax Rates, Two-Earner Couples with Two Children, Ontario, CCTB2 Actual Versus CCTB2 All-to-the-Poor Option



Source: Caledon Institute of Social Policy.

Another empirical question—how great are the alleged work disincentive effects of high marginal tax rates?—also merits study, preferably through qualitative research (ideally, longitudinal surveys) that can delve into the complex factors that can influence families' decisions regarding paid work (such as the choice of full-time or part-time work, welfare over work, or overtime). Marginal tax rates for low- and modest-income families in particular have increased over the years with the creation of income-tested tax benefits (for example, the refundable GST credit, federal and some provincial child benefits, income tax reductions, and provincial refundable tax credits) and as a result of partial deindexation of income tax brackets (bracket creep). Though no one would argue that high marginal tax rates are a good thing, higher-than-otherwise marginal tax rates are a necessary evil if we want to target income assistance on people deemed to be most in need, and if money is tight. Moreover, the alleged impact of marginal tax rates on labour market behaviour resulting from the more sharply reduced child benefits for low-income families is open to question.

Higher marginal tax rates resulting from increases in the CCTB reduction rate cannot affect labour market behaviour if they are invisible. I find it hard to believe that any but a handful of families—those, perhaps, that avidly scour the federal budget for details of the latest CCTB instalment so that they can update the tax-transfer model running on their home computers—have any idea of the impact of federal child benefits on their marginal tax rates. For one thing, there is a long time lag (up to 18 months) between the assessment of income and the payment of child benefits. The net family income definition used by the CCTB also makes it difficult for families to figure out their child benefits; in any case, the CCTB is calculated automatically for them by the federal government. Families are much more likely to have a sense of their average tax rate (visible to them from the difference between their gross and net pay), not their marginal tax rate. Surely no one is arguing that working poor families will reduce their work effort because they are unhappy at paying a minority of their earnings to government.

Labour market behaviour is affected by various factors, among which marginal tax rates are but one consideration. For example, the availability of affordable child care and the fierce desire of many Canadians—especially the thousands of working poor and modest-income employed parents—to work and not rely on welfare are two such factors. Some people work because they like the social aspects of the workplace, or the challenge of work, or for any number of non-monetary reasons. It seems implausible to me that higher marginal tax rates on working poor families resulting from the CCTB—even if families understood the implications, which is doubtful—would result in parents deciding to quit their jobs or to move from full-time to part-time work. At most, conceivably, some might decide it is not worth their while to work overtime, though even this effect may be a stretch for families struggling to make ends meet, for whom every dollar counts.

While I am not accusing marginal tax rate obsessors of stereotyping the poor, we should be aware that their concern can be linked to the time-dishonoured "culture-of-poverty" school that views poverty as a self-perpetuating, intergenerationally transmitted social pathology in which deviant attitudes and values on the part of the poor dig them deeper into poverty. One element of the culture-of-poverty way of thinking—a paradigm that goes as far back as Elizabethan England—is that the poor tend to cluster on the leisure end of the work/leisure calculus. Hence the concern that public policy act as an incentive to work, or at least not act as a deterrent to work. The centuries-old "principle of less eligibility" holds that social support must be set lower than the wages of the lowest-paid workers. According to the culture-of-poverty school—which I reject, so as not to be quoted out of context here—excessive marginal tax rates are even more worrisome given the poor's propensity to avoid work.

We must not lose sight of the fact that the NCB will increase child benefits and thus disposable income for working poor families—and that this increase will be visible to them, unlike marginal tax rates. Moreover, provincial reinvestments in other programs and services also will benefit the working poor in particular. While this is an open question that should be central to evaluation, I would hope that lowering the welfare wall as a result of the development of a strong NCB likely will have a more positive impact on employment behaviour than would the work-disincentive effects of higher marginal tax rates.

The NCB offers a wonderful opportunity for research into the dynamics of poverty and of labour market behaviour. Qualitative, in-depth research, preferably longitudinal, is required to explore the real impact of marginal tax rates and other factors that enter into the employment equation.

Depth of Poverty

During the first stage of the development of the NCB, in most provinces only the working poor and other low-income families not on welfare will experience a reduction in their depth of poverty. Two exceptions are New Brunswick and Newfoundland, which (for the first instalment of the CCTB, at least) are passing the increased federal child benefits through to welfare families and not reducing welfare accordingly.

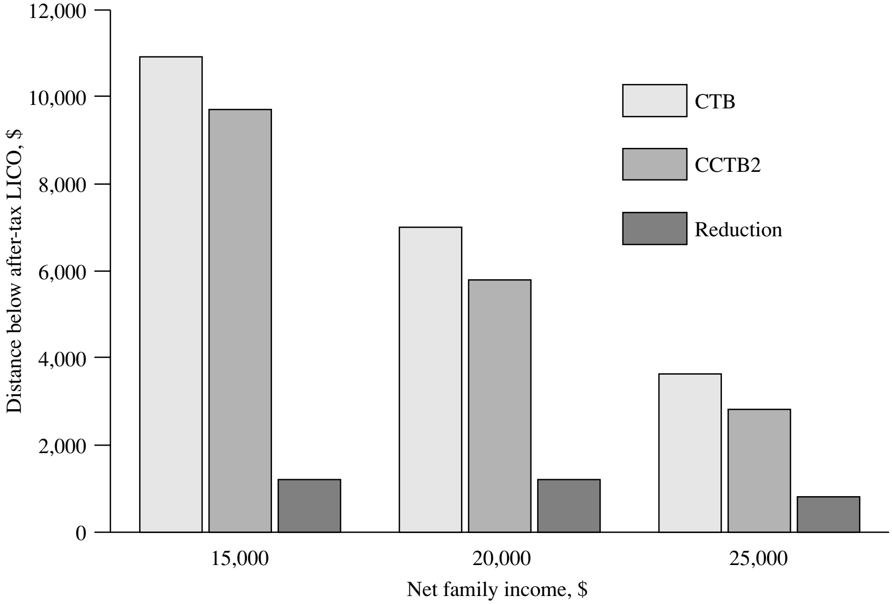
Unless one uses an extremely low poverty line, it is unrealistic to expect the NCB to make a large dent in the depth of poverty for most low-income families in this first stage (that is, as it progresses toward the $2,500 displace-welfare target). The average depth of poverty for two-parent low-income families was $10,057 at last count (1997), so even a $2,500 maximum CCTB could not fully close the poverty gap. Moreover, child benefits cannot be expected to raise adults as well as children above the poverty line.

Figure 5 shows the poverty gap—that is, the distance below the after-tax low-income cut-off (LICO) for a metropolitan centre—for Ontario families with two children under the CTB and the CCTB (in 2000). The after-tax LICO is an estimated $28,782 for 2000. A family earning $15,000 would have a disposable income of $17,858 under the CTB, which is $10,924 below the after-tax LICO. The CCTB will raise its disposable income to $19,068, reducing the poverty gap to $9,714. The $20,000 family's depth of poverty will fall by the same $1,210 because of increased child benefits, raising its disposable income from $21,774 to $22,984 and lowering the poverty gap from $7,008 to $5,798. The $25,000 family's disposable income will increase by $814 from $25,145 to $25,959, shaving its poverty gap from $3,637 to $2,823. The following table compares these numbers, again showing the CCTB2 reducing the poverty gap at all three income levels.

	Net family income		
	$15,000	$20,000	$25,000
		dollars	
Poverty gap			
with CTB	10,924	7,008	3,637
with CCTB2	9,714	5,798	2,823
Reduction	1,210	1,210	814

Figure 6 illustrates the increase in child benefits comparing the CCTB with the CTB. Increases range from $1,210 for two children in low-income families with net incomes below $20,921 to $184 for those above $29,590. Figure 7 shows the increase in child benefits between CCTB2 and CTB as a percentage of net family income; gains range from a substantial 12

Figure 5 Poverty Gap: Distance Below the After-Tax LICO, for Two-Earner Couples with Two Children, Ontario, CCTB2 Versus CTB, 2000



Source: Caledon Institute of Social Policy.

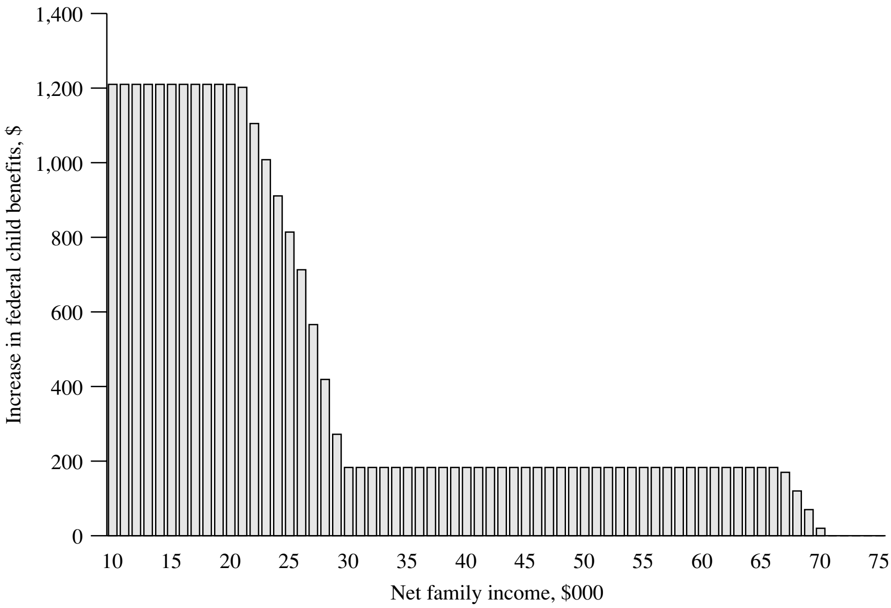
percent for families with $10,000 net income to less than 1 percent for those with net incomes of $29,000 or above. Figure 8 shows, for Ontario, the percentage change in disposable income as a result of the increase in child benefits under the CCTB2, ranging from 9 percent at $10,000 net income to under 1 percent for families with $29,000 and more.

Adequacy

The first two instalments of the CCTB have gone a considerable distance toward the $2,500 displace-welfare goal, though another increase will be required to reach that target. Figure 9 compares the maximum federal child benefit for one child, under both the CTB and the CCTB as it will be in 2000, with the $2,500 and $4,000 targets.

Once child benefits are equalized for all low-income families, by providing a maximum $2,500 per child, then Caledon and other social policy groups have recommended that the foundation be raised to around $4,000 maximum per child, which would go a long way toward meeting the costs of raising children for low-income families and would establish an income floor for families with children analogous to (though not as generous as) the de facto guaranteed income afforded by elderly benefits (old age security, the guaranteed income supplement, and the spouse's allowance).

Figure 6 Increase in Federal Child Benefits, for Families with Two Children, CCTB2 Versus CTB



Source: Caledon Institute of Social Policy.

However, boosting the maximum benefit poses design problems even thornier than those already experienced in terms of reduction rates and costs, as noted above.

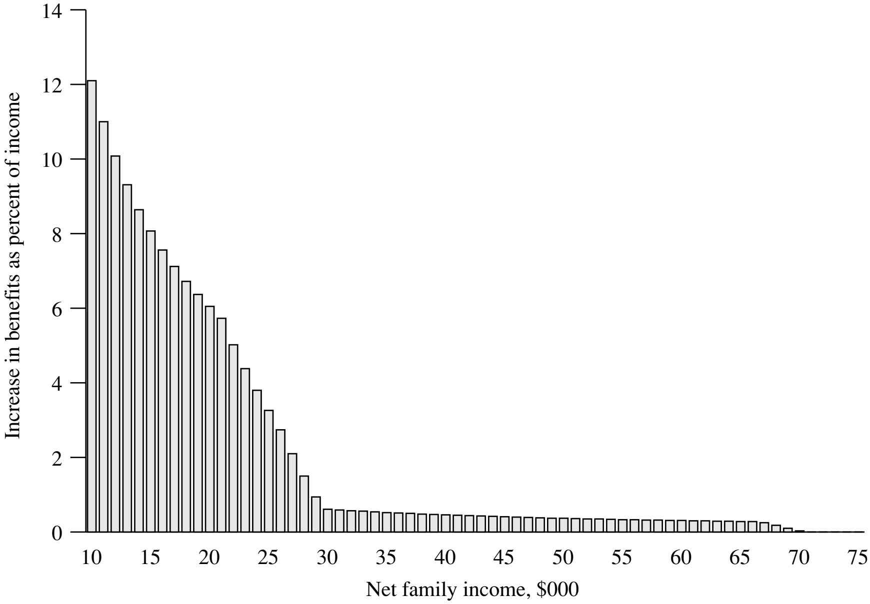
Indexation

An adequate child benefit must be fully indexed, in terms of both the benefit and thresholds. The federal child benefits system has been partially deindexed since 1986, along with the personal income tax system; the refundable GST credit also is partially deindexed.

I have characterized partial deindexation as a public policy designer virus injected into the tax-transfer system by the federal government stealthily to raise income taxes and the GST and reduce child benefit expenditures.[16] Not only does partial deindexation result in bracket creep, which hits some taxpayers, it also erodes the value of credits, which affects all taxpayers. Partial deindexation imposes on all taxpayers inflation-imposed, hidden income tax hikes each year, and draws increasing numbers of poor working Canadians into the tax net as the tax-paying threshold falls further below the poverty line. Ottawa will pay for more than half

[16] Battle, supra footnote 6.

Figure 7 Increase in Federal Child Benefits, as a Percent of Net Family Income, for Families with Two Children, CCTB2 Versus CTB



Source: Caledon Institute of Social Policy.

the cost of the next year's cuts to income tax announced in the 1999 budget by means of stealth tax increases.[17]

Partial deindexation has pernicious effects on child benefits, steadily lowering not only their value but also the income threshold for maximum benefits. Over time, the entire child benefits system becomes increasingly compressed down the income spectrum: fewer low-income families receive maximum payments, which are themselves lower; as the disappearing point declines, fewer middle-income families qualify for (lower) partial benefits. Although the recent increases in child benefits for low-income families have managed to more than offset the losses due to deindexation, non-poor families have born the full force of the corrosive power of partial deindexation. The unfortunate result is a widening gap between the CCTB for poor families and that for non-poor families. Fortunately, the 1999 federal budget made a modest but significant beginning in restoring child benefits for non-poor families. But provincial and territorial child benefits—those provided through welfare as well as those through income testing—are not indexed.

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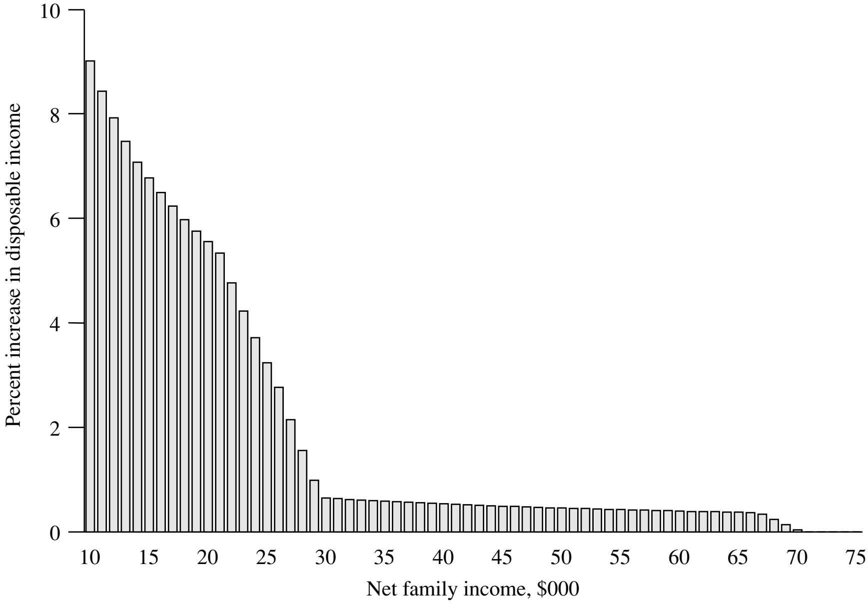
[17] Ken Battle, Sherri Torjman, and Michael Mendelson, *The Social Fundamentals* (Ottawa: Caledon Institute of Social Policy, 1999).

Figure 8 Percentage Increase in Disposable Income, Two-Earner Couples with Two Children, Ontario, CCTB2 Versus CTB



Source: Caledon Institute of Social Policy.

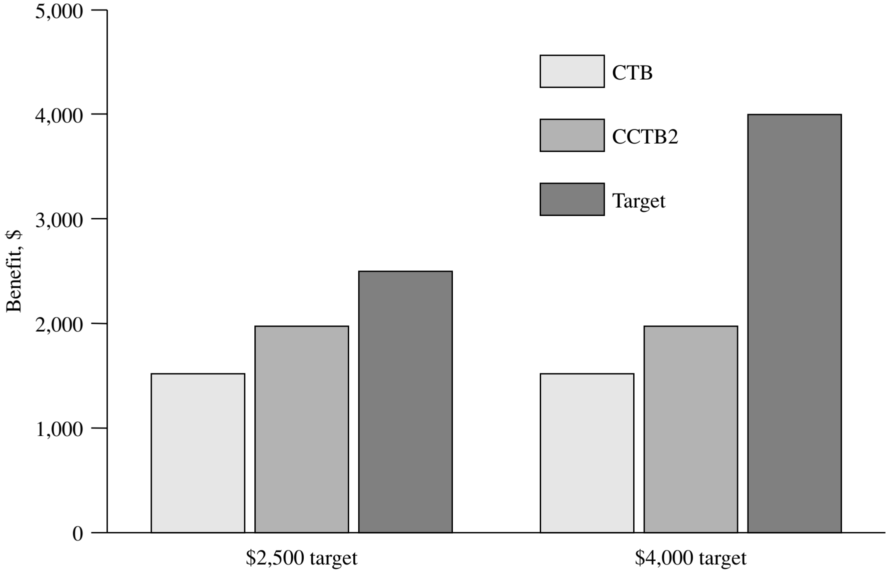
One of the most outrageous tax changes is the partial deindexation of the refundable GST credit, a tax-delivered benefit intended to partly offset the impact of the regressive GST on low-income Canadians. The compression effect is the same for the GST credit as for child benefits: each year, fewer modest-income families and individuals qualify for partial GST credit, and fewer receive the maximum amount of tax relief. Figure 10 shows how the partial deindexation of the GST credit and its threshold is causing a shift in regressivity down the income spectrum. Every year, as the value of their GST credit declines, low-income Canadians pay more net GST—the only group in society to face such a regressive tax increase.

Horizontal Equity

The issue of horizontal equity arises in the NCB reform in several ways.

First, equalizing child benefits for all low-income families will achieve horizontal equity within the population of poor families with children, since the previous system paid larger child benefits to some low-income families (those on welfare) than to others (the working poor). Of course, paying equal child benefits to all poor families also will recognize the heavier financial burden on them than on low-income childless couples and single people—although this aspect of horizontal equity is not usually raised. Once we reach the $2,500 target and start moving up to the $4,000

Figure 9 Maximum Federal Child Benefits for One Child, Compared with the $2,500 and $4,000 Targets, CCTB2 Versus CTB



Source: Caledon Institute of Social Policy.

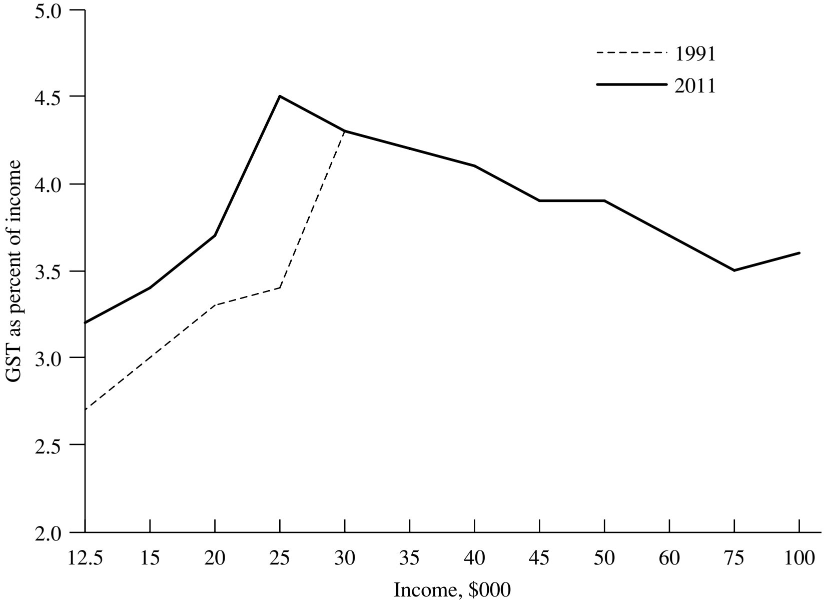
goal (thus raising child benefits for welfare families as well), this improvement in vertical equity also will improve the child benefit's horizontal equity performance among the low-income population.

The horizontal equity issue normally arises in relation to non-poor families. Some critics decry the fact that Canada—alone among industrialized nations—no longer pays child benefits to upper-income families. (I am not here counting as a child benefit the child care expense deduction, which delivers its largest benefit to affluent families with receipted child care expenses; note also that Quebec continues to provide a universal child benefit). Partial deindexation lowers the disappearing point for partial child benefits and thus increases the group of higher-income families not eligible for assistance.

But horizontal equity for middle-income families with children also has been eroded steadily as a result of changes to child benefits in the 1980s—eliminating the children's tax exemption, abolishing family allowances, and partially deindexing child benefits. Indeed, in relative terms, middle-income families have been harder hit than affluent families by the various changes.

The increase in the CCTB for non-poor families announced in the 1999 budget and the resulting small rise in the disappearing point should encourage those who worry about horizontal equity for non-poor families. The

Figure 10 Net (After Tax Credit) GST as Percent of Income, for Single Canadians, by Income, 1991 and 2011



Source: Caledon Institute of Social Policy.

measure is only a modest first step, however, and does not nearly make up for past losses.

Yet another horizontal issue involves the relative tax-transfer treatment of one-income and two-income families, a hot issue that flared up once again recently with the Reform Party's focus on the matter and the Alberta income tax reforms that will increase the spousal credit. Briefly, the critics contend that most one-income families pay higher income taxes than two-income families with the same family income, because of the higher marginal tax rate of the one-income taxpayer and the fact that many two-income families with children can claim the child care expense deduction. Others retort that the child care expense deduction recognizes a major cost of earning a living, and offer calculations to show that two-income families typically end up with lower disposable income than one-income families because of work-related expenses and payroll taxes.[18]

I do not propose to dive into these perilous waters here, except to point out that the development of a stronger child benefit system, which boosts benefits for low- and middle-income families will to some limited extent address the one-income versus two-income problem, in the sense that (most) one-income families will receive more financial recognition of

[18] Canada, "Response of the Government of Canada to the Communication of Beverly Smith to the United Nations Commission on the Status of Women," 1999.

their child-rearing labours: all families with the same (net) income receive the same CCTB, regardless of the parents' mix of income. Of course, there are flies in this ointment too. A more generous child benefit cannot reduce the gap that the critics allege exists in the tax-transfer treatment of one-income and two-income families. Nor will a larger CCTB improve matters for upper-income, one-income families, unless further steps are taken to raise the disappearing point or (not my policy priority) restore universality. And because the CCTB is based on net family income, two-income families can deduct child care expenses and thus qualify for larger child benefits than they otherwise would receive; one-income families cannot use this deduction, though they can reduce their net income for child benefit purposes through other means (for example, RRSP and RPP deductions) that are also available to two-income families.

A final horizontal equity issue arises from the CCTB's use of net rather than gross family income to calculate eligibility for and amount of payments, following the practice established in 1978 for the refundable child tax credit and followed ever since for other income-tested programs, such as the refundable GST credit, the CTB, and emerging provincial income-tested child benefits. The net income definition allows the deduction from gross income of a variety of items, including child care expenses, contributions to RPPs and RRSPs, union and professional dues, attendant care expenses, certain employment expenses, carrying charges and interest expenses, business investment losses, moving expenses, and investments in oil, gas, and mining ventures. Horizontal inequity can arise because families with the same total (gross) income receive different amounts of child benefits depending on how much they are able to deduct to reduce their net income for CCTB purposes. Vertical inequities also can occur when upper-income families end up with similar amounts of child benefit as middle-income families, and some non-poor families may qualify for the same benefits as low-income families. Caledon has estimated that the first instalment of the CCTB paid out $4.1 billion, or 69 percent of its total $5.9 billion, to families with over $25,000 on the basis of net family income, but would have spent only $2.6 billion on families with over $25,000 on the basis of gross income.[19]

CONCLUSION

The NCB will make a significant structural advance toward a more integrated tax-transfer system for families with children. After years of evolution accelerated in the 1980s and 1990s by the antideficit campaign, federal child benefits finally have been integrated into a single program. But the more radical form of integration is the plan to have the federal child benefit, over the next few years, gradually absorb the provincial/territorial child benefits delivered through the welfare system. All low-income families with children will receive equal benefits from a non-stigmatizing,

[19] Battle and Mendelson, supra footnote 5, at 75.

tax-delivered program that also serves the large majority of non-poor families with children.

Federal benefits for low-income families have increased significantly since the introduction of family allowances at the end of World War II. Figure 11 shows the trend between the years 1946 and 2000. In 1946 (the first full year of family allowances), benefits for two children ages 5 and 10 (family allowances varied by children's ages in the early period) amounted to $1,437 in constant (2000) dollars. They declined in the 1950s and 1960s because they were not indexed, except informally to federal election campaigns. They increased sharply in 1971 with the tripling of family allowances, and in 1979 with the advent of the refundable child tax credit. Between 1993 and 1997, working poor families received a larger benefit (under the CTB's working income supplement), but the CCTB provides equal federal benefits to all low-income families. By 2000, federal child benefits will total $3,963—almost three times their 1946 value.

The changes to child benefits since the 1980s have been controversial, especially the new NCB. The antipoverty objective has been enhanced at the expense of the traditional horizontal equity objective, as child benefits have been reduced for middle-income families and removed from upper-income families. Along with that of universal old age security, the demise of universal family allowances kicked two of the three main legs out from under the universalist welfare state (medicare remaining, barely). The equalization of child benefits among low-income families to deal with the problem of the welfare wall means that welfare families will see no real increase in their child benefits for several years, until after the $2,500 maximum per child is attained, although I have argued that welfare families stand to benefit in any case as their child benefit income moves from politically vulnerable provincial welfare to the more secure, broad-based federal CCTB. Some critics do not trust that the provinces will wisely reinvest their savings from federally induced welfare reductions into other programs for low-income families, especially since the provinces have very wide leeway as to where and how to spend. Some see the NCB's emphasis on removing barriers to work as a rhetorical smokescreen for forcing welfare recipients into the workforce, though I would reply that the provinces can do so anyway with the elimination of the Canada Assistance Plan by the Canada Health and Social Transfer. Ottawa's decision to maintain partial deindexation under the new CCTB undermines the policy and political integrity of the reform; low-income families in effect are climbing up a down escalator, while middle-income families are seeing their benefits falling steadily, and the entire system is being compressed down the income scale.

There is a lot of work yet to be done if the NCB is to realize its full potential. Once the replace-welfare $2,500 target is realized, benefits must be raised substantially (we have suggested a provisional goal of $4,000) to improve the incomes of all poor families with children and take a real whack at the poverty gap. Full indexation must be restored. Ottawa could think about providing larger benefits to younger children (beyond the current small $213 supplement for children under seven for whom the

Figure 11 Federal Child Benefits for Two Children, Ages 5 and 10, in Low-Income Families, 1946-2000

Source: Caledon Institute of Social Policy.

child care expense deduction is not claimed). The issue of net versus gross family income definition could be reviewed and adjustments made as deemed necessary to the income definition and benefit structure. Another important issue is the problem of the lack of responsiveness of income-tested child benefits to fluctuations in income, though one obvious answer—testing income more often than once a year—poses problems for Revenue Canada; currently, income change resulting from marriage breakdown is recognized within-year by special application, but not so for other reasons (such as the unemployment of a parent). The BC family bonus solves this problem by providing temporary welfare until the tax system catches up with the income change and adjusts (or provides) the bonus. Interestingly, in focus group research, Caledon found that recipients of the BC bonus opposed the notion of a more frequent test of income to deal with the responsiveness issue because it smacked too much of the despised welfare system that some of them had encountered.

The de facto guaranteed income provided by the elderly benefits system, which has contributed to the remarkable reduction in the extent and depth of poverty among seniors, is an encouraging example, though it would be naive to expect child benefits alone to pack quite as potent an antipoverty punch for low-income families. A strong child benefits system is a necessary but not sufficient solution to family poverty. That is a problem that is deeply rooted in our economy and society and thus requires a wide range of public and private solutions, both preventive and remedial.

While the task of developing a mature CCTB poses a daunting challenge in terms of both cost and design, a satisfactory resolution to the marginal tax rate conundrum lies in bolstering both the antipoverty and the horizontal equity objectives. The higher the maximum benefit for low-income families, the steeper must be the reduction rate in order to constrain costs; but such a highly targeted approach would result in even more punishing marginal tax rates for working poor and modest-income families. Moreover, the child benefit system distributionally would resemble a ski jump, with an even wider gap between the benefits paid to poor and non-poor families than under the current system.

One option would be to restore the non-refundable child tax credit to provide a universal base to the child benefits system, which could be pictured as a "targeted-with-a-tail" model. That fix, however, would do nothing to resolve the marginal tax rate and distributional ski-jump problems. Moreover, paying upper-income families a token benefit that represents a drop in their bucket of income still costs money. One could delve even further back in history and dust off the old children's tax exemption, which would reinject some regressivity into the child benefit system and give social groups something more to rail against.

The other extreme would be to return to the golden age of universality and pay the CCTB to all families. That approach would pretty much solve the marginal tax rate problem (that part of which is due to income-tested child benefits) because payments would be taxed under the normal income tax system, like family allowances, though some families would be pushed into higher tax brackets as a result. But a universal child tax benefit does not present a pretty picture distributionally, given the 1988 tax reforms that created three broad tax brackets; the net (after income tax) distribution of child benefits would resemble a series of plateaus, with families at opposite ends of each tax bracket receiving the same amount of benefits even though their incomes differed considerably. Moreover, the costs of such a system would be huge, even with taxable benefits, given our goal of a $4,000 per child benefit.

All right then, how about paying the CCTB to every family and then recovering part of the cost through the tax system according to a sliding scale schedule that creates a smoothly progressive distribution? Well, that is what was done under the clawback on family allowances that was imposed between 1989 and 1992 (though it was applied only to families with above-average incomes and removed benefits completely only from well-off families); that would result in a huge shell game in which enormous sums were transferred to and from families—hardly a recipe for a politically sustainable social program. In any case, such a universal-cum-clawback model still would increase marginal tax rates even if the taxation occurred after as opposed to before the payment of benefits.

Yet another way out of the marginal tax rate dilemma is not to pay child benefits. That is a "we had to bomb the village in order to save it" approach that few Canadians would take seriously.

I think there are two solutions to the marginal tax rate issue. One involves child benefits, the other the income tax system.

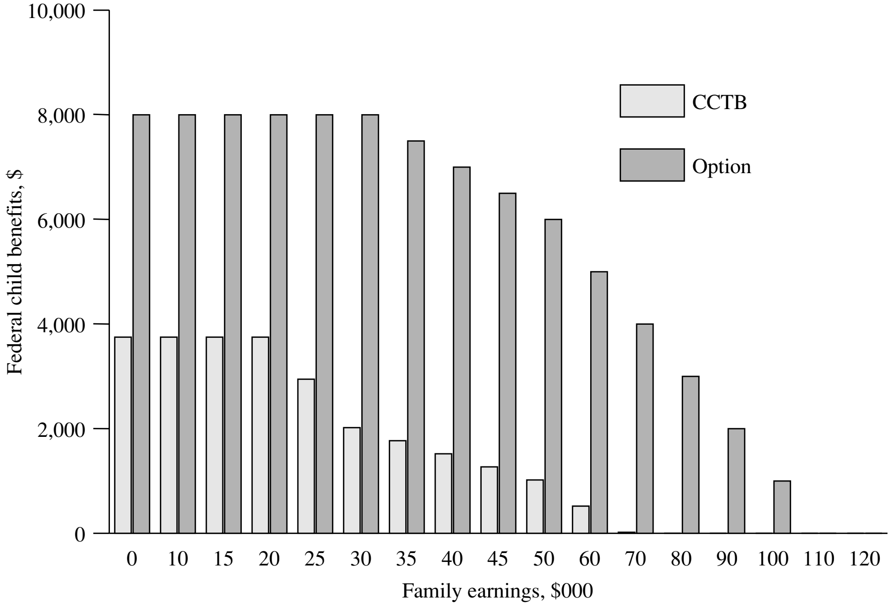
A mature child benefit will have to extend substantial increases beyond low-income families into modest- and middle-income territory; the second instalment of the CCTB announced in the 1999 federal budget already moves in that direction, however tentatively. Marginal tax rates for lower-income families could be significantly reduced by replacing the current two-tier reduction rate (a high rate for the NCB-S, a low rate for the base CCTB) with a single reduction rate whose amount lies between the present two rates.

For the sake of illustrative argument (I have not costed this particular configuration yet), let us suppose a \$4,000 maximum CCTB with a reduction rate of, say, 10 percent above a threshold of \$30,000 in net family income. Figure 12 compares the distribution and amount of child benefits under this “big-bang” option with that under the current CTB (as of 2000). All but very high-income families would see a sizable increase in their child benefits; the disappearing point would rise to \$110,000, effectively restoring universality for all but a small group of well-off families. If purists insisted, we could stick a tail onto the program in the form of a minimum payment, thus extending child benefits to rich families and stemming the dangerously declining birth rate among the wealthy due to the lack of horizontal equity. For Ontario, marginal tax rates (shown in figure 13) would be lower for families earning under \$30,000 and higher for recipient families above \$30,000 (but not all that much higher). The worst cases would be families earning \$35,000, whose marginal tax rate would rise from 44.7 percent to 49.7 percent; those earning \$50,000, whose marginal tax rate would increase from 47.4 percent to 52.4 percent; and families earning \$100,000, whose marginal tax rates would go from 40.5 percent to 50.5 percent. Not only are these higher marginal tax rates not in the “dangerous” range (50 percent seems to be an acceptable limit among marginal tax rate devotees), but also families would realize, in return, a significant increase in their income from child benefits—for example, \$5,730 for the \$30,000 family, \$4,980 for the \$50,000 family, and \$1,000 for the \$100,000 family.

Granted, this big-bang model would be much more costly than the current, more targeted approach. Variations on the theme could make the program less expensive. For example, the income threshold for maximum benefits could be lowered somewhat; marginal tax rates for working poor families above the threshold would be higher than under the big-bang option illustrated, but still lower than they are now. A less-generous maximum CCTB obviously would reduce costs substantially, though that option would weaken its crucial antipoverty effect and also lessen its horizontal equity performance. Whatever the exact parameters chosen, a big-bang child model would enhance both the antipoverty and the horizontal equity objectives of the child benefits system.

Financing a big-bang child benefit would require what would appear to be problematic actions: either taking some money away from other government

Figure 12 Total Federal Child Benefits for Two-Earner Couple with Two Children, by Family Earnings, CCTB and "Big-Bang" Option (Constant 2000 Dollars)

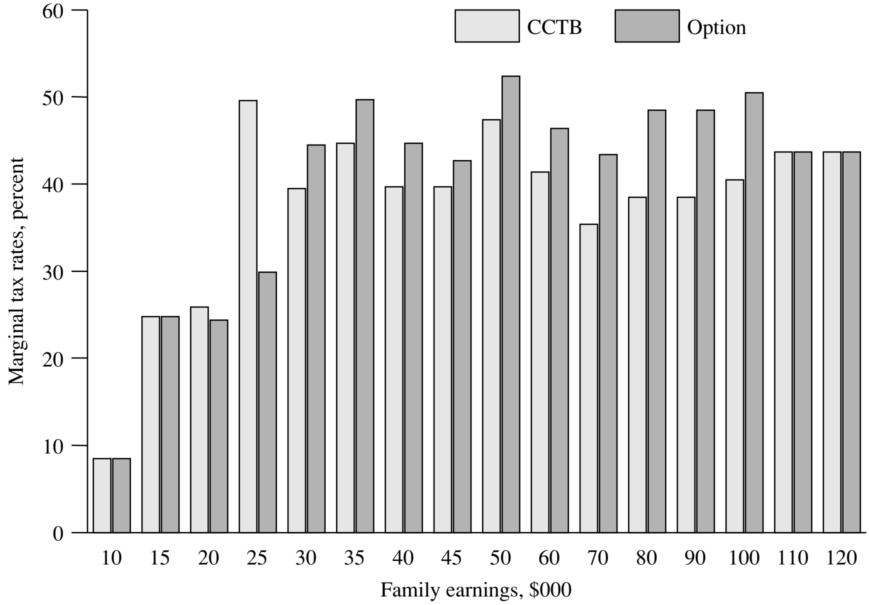


Source: Caledon Institute of Social Policy.

expenditures or (the horror, the horror) raising tax revenues. The latter might not be quite as quixotic as it appears if Ottawa kept to its course of partial deindexation and maintaining a large surplus in the employment insurance account. The choice of financing methods would affect, in turn, the net distributional impact of a larger CCTB, though the exact consequences would be hard to determine. In other words, one way or another, families with children would help pay for their larger child benefits (through reductions in other public programs they use or through tax increases, overt or covert). Of course, that happens already with all government programs and services, and analysts rarely if ever attempt such a deep calculation.

The other, perhaps more immediate, solution to the marginal tax rate issue involves the income tax system in which the CCTB resides. The restoration of full indexation of the personal income tax system is the first order of business, in order to stem bracket creep, the downward trend in the tax-paying threshold, the regressive impact of hidden annual income tax hikes, and the erosion of the refundable GST credit and its threshold (which, among other things, imposes its reduction rate lower down the income scale each year). Income tax rates could be reduced (the most costly option), more tax brackets reinserted, or the existing tax brackets at least raised (that would be especially important if partial deindexation were left in place). An Alberta-style flat tax rate, if low enough,

Figure 13 Marginal Tax Rates for Two-Earner Couples in Ontario with Two Children, by Family Earnings, CCTB and "Big-Bang" Option



Source: Caledon Institute of Social Policy.

obviously would appeal to some. Regardless of what is done on the tax rate and bracket side, the refundable GST credit should be integrated with the CCTB to avoid notches in marginal tax rates.

The prospect of more provinces following Alberta's lead and tailoring their own income tax systems adds another layer of complexity and uncertainty to the tax-transfer picture. One promising sign on the child benefit front is that integration is already occurring under the NCB: provinces that have opted for their own income-tested child benefits have designed them to work in tandem with the CCTB, and indeed (except for Quebec) are using Revenue Canada to deliver their benefits.

The NCB has been touted by its supporters as the biggest social policy innovation in a generation, as the first big step toward a broader restructuring of other elements of the tax-transfer system (especially welfare and employment insurance), and as a best-practices example of how governments should run the new social union. Whether it will measure up to these claims depends in many ways upon the current federal minister of finance and his immediate successors.