



# **How Finance Re-Formed Social Policy**

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**Ken Battle and Sherri Torjman**

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## *A Watershed Budget for Social Policy*

The Republican governors of Michigan and Wisconsin are spearheading a movement to fundamentally recast the American welfare state. The major American welfare program – Aid to Families with Dependent Children (AFDC), which is cost-shared by the federal and state governments – and many other federal social programs would be replaced by a system of ‘block grants’ to the state governments. *In return for less money from Washington, the states would have the freedom to design their own welfare systems and to experiment with welfare reforms.*

The Republican majority in the House has passed a bill advancing the block grant concept, which fits comfortably with their ideology and platform of shrinking government. However, the Gingrich Republicans want to do more than simply turn over control of welfare to the states. They also want to shape the brave new world of welfare according to the tough measures proposed in their ‘Contract With America’ – a two-years-and-you’re-cut-off time limit, work-for-welfare requirements and denial of benefits to teenage mothers. In addition to welfare, the Republicans want to block-grant foster care, adoption and other child welfare services as well as the national school lunch program for pregnant women and preschool children.

It may be mere coincidence, but Paul Martin’s 1995 Budget contains a strikingly similar concept. Federal cost-sharing of provincial welfare and social services under the venerable Canada Assistance Plan, as well as existing block-funding of health and post-secondary education under Established Programs Financing, will be rolled into a single ‘block fund.’ The new scheme has been dubbed the Canada Health and Social Transfer (CHST).

*In return for less money from Ottawa, the provinces will have the freedom to design their own welfare systems and to experiment with welfare reforms.*

The Canada Health and Social Transfer is a watershed in the history of Canadian social policy. It will formalize in new legislation what the Mulroney Conservatives initiated in practice through significant though not widely understood changes to the old federal transfer arrangements – a withdrawal of both federal *dollars* and federal *presence* from the provincially-run welfare, social services, post-secondary education and health programs that constitute a significant part of Canada’s social security system.

The Canada Health and Social Transfer should please the proponents of greater provincial power over social policy. They have long argued that the provinces should have the sole say about health and human services that fall within their jurisdiction. They contend that the provinces should be free to experiment and to reform their health and social welfare systems so as to deal with the tough new problems that are overwhelming the capacity of the current programs conceived and constructed in an earlier era. The provinces are ‘closer to the people’ and should not have to deal with interference from the federal government in far-away Ottawa. The decentralists would have us believe that the new federal legislation will usher in a social policy renaissance at the provincial level.

Without question, the Canada Health and Social Transfer will give the provinces greater scope to redesign their health care and human services. However, the future social policy landscape across Canada is sure to become more uneven and more rocky in places.

Some provinces think that the way to reform welfare is to deny assistance to certain

groups or to force them to do sub-minimum wage work in return for their benefits; on the health care front, some provinces would love to reimpose user fees, shrink the range of insured services and privatize part of their health care system. Other provinces with a more progressive bent may want to invest in stronger health and welfare systems, but will lack the money to do so because federal payments under the new Canada Health and Social Transfer will steadily shrink and eventually dry up early in the next century. In times of recession, when welfare caseloads and costs skyrocket, the provinces will be hit hard because the federal government no longer will pay its half of their welfare and social services bills; poorer provinces could be devastated.

The Canada Health and Social Transfer spells the decline and eventual end of federal social transfer payments to the provinces and, with it, the end of medicare and the welfare safety net as we know them. The federal government spent its way into the welfare and health business in the 1950s and 1960s by making the provinces an offer they couldn't refuse – badly-needed cash to help build their social and health systems. In return, the provincial governments had to meet relatively few but very important conditions with respect to their welfare and health care systems. Now Ottawa says it can no longer afford its social transfers to the provinces, and has given notice that it will be cutting back and eventually winding down this important form of financial support. Although the federal government claims it will continue to enforce the five principles of national health insurance – universal, accessible, comprehensive, portable and publicly-administered health care – its capacity to maintain medicare will wane as federal money to the provinces declines.

The 1995 Budget also heralds big changes to the old age pension system. It signals the move towards an income-tested elderly benefit to replace the current collection of income security programs (Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance) and tax breaks for the elderly (the age and pension income credits). This reform was proposed by the Caledon Institute in 1993 and foreshadowed by the decision in last year's federal Budget to income-test the age credit. We applaud the Finance Minister and his government for embarking upon such a sensible, fair and necessary – though potentially controversial – refurbishing of the pension system. Ottawa and the provinces also will be reviewing the Canada Pension Plan, which requires substantial future increases in contributions paid by employees and employers in order to meet rising demands from our aging population. The federal and provincial governments must act now to ensure that the public pension system – which is vital to the economic security of low- and middle-income seniors – remains strong and viable for future generations.

The 1995 federal Budget is a turning point towards a new social policy for Canada. But the Canada Health and Social Transfer, the geared-to-income elderly benefit and the philosophy behind them are not inventions of the 1990s Liberals. The new social policy has its roots in a succession of Conservative Budgets that date back to 1985.

### ***The New Social Policy: The Tory Phase***

Conservative Finance Minister Michael Wilson will be remembered as one of the chief architects of a leaner Canadian welfare state,

with geared-to-income rather than universal child and elderly benefits and a reduced role for the federal government in social policy. Paul Martin is simply finishing the job for him. The continuity between these two powerful cabinet ministers from different parties was furnished by their officials at the Department of Finance, who skillfully designed and engineered the reform of federal social policy.

In successive Budgets, Finance Minister Wilson put in place changes that radically reduced federal transfers for provincial social and health programs and, in the process, put an end to the ‘cooperative federalism’ that built the postwar social security system in Canada. He also made substantial cuts to Unemployment Insurance and abolished federal funding of the program. He harnessed the power of inflation to siphon millions of dollars each year from child benefits and to wring millions more from taxpayers in federal and provincial income taxes – the working poor included. He handed the poor a leaky umbrella in the form of a partially-indexed GST credit that is falling steadily in value each year and thus imposing a growing GST burden on those least able to carry it. He abolished supposedly sacrosanct universal old age pensions and Family Allowances, not with a bang but a clawback.

### *social transfers to the provinces*

The Conservatives’ 1986 Budget limited the indexation of transfer payments to the provinces for health and post-secondary education under Established Programs Financing (EPF) to the annual increase in GNP less two percentage points (the formula used to be the full increase in the GNP). The 1989 Budget reduced the indexation formula by yet another percentage point. The 1990 Budget froze federal

transfers for 1990-91 and 1991-92. The 1991 Budget extended the freeze through 1994-95, after which the GNP-less-three percentage points formula was to resume.

These technical changes to a program that most Canadians have never heard of add up to many billions of dollars worth of cuts in federal social transfers to the provinces, with cash transfers dwindling to zero by the early part of the next century. Not only is this a massive withdrawal of resources, but it means gradually but surely whittling away the fiscal stick by which Ottawa enforces the conditions of the Canada Health Act that maintain Canada’s universal health care system.

Finance Minister Wilson’s 1990 Budget introduced the now infamous ‘cap on CAP’ which set a five percent ceiling on annual increases in federal cost-sharing under the Canada Assistance Plan (CAP) for welfare and social services in Ontario, Alberta and British Columbia. This astute cost-cutting move saved Ottawa an estimated \$5.8 billion from 1990-91 through 1993-94 as the recession drove up welfare caseloads. The cap on CAP decapitated the Canada Assistance Plan, since the federal government never will go back to the era of writing blank cheques for half of whatever the provinces spend on their social welfare systems.

### *Unemployment Insurance*

The Finance Minister pulled the plug on federal funding for Unemployment Insurance (Ottawa used to pay for regionally extended benefits, fishermen’s benefits and benefits for people in training and *job* creation projects), leaving employers and employees to foot the entire bill – and requiring premium hikes in 1990, 1991 and 1992. Unemployment Insurance

underwent two rounds of belt-tightening under the Tories. In 1990, the government increased the number of weeks worked in order to qualify for benefits, reduced the maximum duration of benefits and imposed heavier penalties on workers who quit their jobs without just cause. In 1993, UI benefits were reduced from 60 to 57 percent of insurable earnings and people who quit their jobs without just cause were denied benefits.

### *pensions*

Old Age Security benefits are subject to federal and provincial income taxes, which means that higher-income pensioners in fact end up with smaller after-tax benefits than those with lower incomes. In 1989, the Finance Minister announced a surtax on Old Age Security benefits, better known as the ‘clawback.’ Seniors with net incomes above a ‘threshold’ (\$50,000 in net income in 1989) now had to pay – in addition to their regular federal and provincial income taxes – 15 cents of their Old Age Security benefit. High-income seniors have to pay back all of the old age pension that they got the year before, which is a pretty inefficient way to operate a social program.

The clawback on Old Age Security affected only four percent of seniors when it was introduced in 1989, since relatively few elderly Canadians had incomes above \$50,000 and the measure was phased in one-third at a time over three years; only starting in 1991 did the clawback remove all the old age pension from high-income seniors. In 1994, the clawback applied to pensioners with net incomes of \$53,215 or higher, and removed the full Old Age Security benefit from those with net incomes above \$84,195. These may appear to be relatively high incomes, and are seemingly higher than they were in 1989.

However, the Tories were careful to only partially index the \$50,000 trigger level for the clawback, to the amount of inflation over three percent. As a result, the threshold is declining steadily in real terms each year and thus hitting more and more seniors at lower and lower income levels. In effect, the Finance Department capitalized on the fact that few seniors would comprehend the need to convert the \$50,000 threshold to inflation-adjusted dollars, or have at hand the formula required to make the conversion; recall that the same stealthy trick was played on Canadian parents, whose child benefits are eroding in value each year.

Between 1989 and 1995, the clawback on Old Age Security fell from \$50,000 to \$45,620 (in constant 1989 dollars) and the income level above which the entire old age pension must be paid back declined from \$76,332 to \$72,211. By 2000, the clawback will affect seniors with incomes over an estimated \$41,400, and the income level above which they have to repay their full Old Age Security will be down to \$65,532. If the current system were kept in place, by 2020 the clawback would hit seniors with incomes of just \$27,861 and would remove the full old age pension from those with incomes of \$44,100 or more. (These figures are expressed in inflation-adjusted 1989 dollars to allow comparison to the 1989 amounts.)

Another failing of the clawback is that it treats some upper-income households unfairly compared to other upper-income households with a different mix of incomes. For example, in 1995 a senior with a net income of \$85,000 must repay all of his or her Old Age Security benefits through the clawback. An elderly couple in which one spouse has an income of, say, \$50,000 and the other spouse makes \$35,000 – for a total income of \$85,000, the same as the single senior – is untouched by the

clawback and so keeps both spouses' Old Age Security benefits, subject of course to normal income taxation. This unfair treatment arises because the clawback on Old Age Security is based on individual, not family, income. Other income security programs, such as the Child Tax Benefit, the refundable GST credit and the Guaranteed Income Supplement for seniors, avoid this problem because they are based on family income.

The main weaknesses of the clawback on Old Age Security are its deliberate tactic of deceiving seniors by means of lack of full indexation, its individual income base and the fact that some high-income seniors living abroad can evade the clawback because they hide their non-Canadian income. Caledon has been highly critical of the clawback for these reasons. However, we support the concept of income-testing old age pensions on the basis of family income: In 1993, Caledon proposed a radical redesign of elderly benefits that would replace the current federal income security programs and federal/provincial tax breaks for the aged – Old Age Security, the Guaranteed Income Supplement, the Spouse's Allowance and the age and pension income credits – with a single, geared-to-income program that would provide fully-indexed benefits to low- and modest-income seniors. In effect, our scheme would constitute a guaranteed income for elderly Canadians.

### *child benefits*

Child benefits also underwent significant changes under the Conservatives. The children's tax exemption was replaced by a non-refundable credit; the refundable child tax credit was increased; and the entire system was partially de-indexed in order to shave millions of dollars each year from its budget, using the insidious power of inflation to gradually erode the value of benefits.

In 1993, the three major child benefit programs – Family Allowances, the non-refundable child tax credit and the refundable child tax credit – were combined into a single Child Tax Benefit that operates like the old refundable child tax credit, though it is paid monthly like the old Family Allowance. The Child Tax Benefit pays a maximum of \$1,020 per child per year, plus an additional \$213 for each child age 6 and under and \$75 per year for the third and each additional child in a family. Maximum benefits go to families with net incomes under \$25,921. Families with modest and middle incomes get a partial benefit that gets smaller as incomes get bigger, and upper-income families (e.g., \$75,241 and above in the case of families with two children under age 7) get nothing. The Child Tax Benefit also provides a Working Income Supplement of up to \$500 per family for working poor families with children. Neither the Child Tax Benefit nor its income threshold for maximum payments (\$25,921) is fully protected against inflation, which means that the value of benefits is declining steadily and the income level for maximum payments is being pushed farther and farther below the poverty line each year.

The Tories put an end to 75 years of tax assistance for families with children and 48 years of universal Family Allowances. Upper-income families with children now receive no tax break or cash benefit to recognize their child-rearing costs and responsibilities. Canada stands alone in the industrialized world in treating high-income taxpayers with children the same as high-income taxpayers with no children to support.

### *the tax system*

Tax policy and social policy are intertwined. The Tories made fundamental changes to the tax system.



The little-admired Goods and Services Tax (GST) at least provided some measure of protection for low-income Canadians in the form of a refundable credit for adults and children intended to offset any increase in taxes that occurred when the old federal sales tax was replaced by the GST; however, the GST credit does not fully remove the GST burden. Unfortunately, the credits and their income threshold (the same \$25,921 as for the Child Tax Benefit) are only partially indexed, to the amount of inflation over three percent, which means both a declining income level for maximum credits and an erosion in the value of the credits. As a result, the Tories imposed a rising GST burden each year on the one group in society that can least bear it – the poor. The Liberal government has kept the flawed GST credit in place.

The Conservatives also lowered the marginal tax rate for upper-income taxpayers and enriched several tax breaks that most benefit the well-off: They introduced a \$100,000 lifetime capital gains exemption, increased the child care expense deduction, substantially boosted the tax deduction limit for contributions to RRSPs (only affluent Canadians benefited from this change) and removed the limit on the tax deduction for contributions to Registered Pension Plans. On the other hand, they took an important step in the direction of a fairer income tax system when they replaced personal exemptions and most deductions with non-refundable credits, which generally provide equal or similar tax savings to claimants in different income groups. They also expanded the range of disabilities eligible for the disability credit and increased its value, which helped taxpayers with disabilities (though not the many Canadians with disabilities who are too poor to pay income tax).

A significant and unfair tax change made in Finance Minister Wilson's first (1985) Budget that has gone virtually unnoticed was

the partial indexation of tax brackets, exemptions and credits. This retreat from full indexation results in a hidden and automatic income tax hike each year for all taxpayers, including the working poor and modest-income Canadians. It also causes a gradual lowering of the income tax threshold – i.e., the income level above which taxes kick in – which has fallen from \$9,772 in 1980 (in constant 1994 dollars) to a shamefully low \$6,541 in 1994 for a single person. The Liberals have left this sorry page of the Tory legacy intact.

### *social policy by stealth*

Just as significant as *what* the Conservatives did to social and tax policy was *how* they did it. They relied on 'social policy by stealth': the use of arcane and poorly understood technical changes to programs, such as partial deindexation and clawbacks, which were imposed on the Canadian people without their knowledge or consent. Major changes to social programs, such as the removal of universal old age pensions and Family Allowances and the massive cuts in social transfer payments to the provinces, were made with no advance notice and little effective public debate. Whatever one thinks of the substance of the Tory record – we support some of their changes, such as the end of universal child and elderly benefits, the creation of the Child Tax Benefit and the conversion of tax exemptions and most deductions to credits – their style of policy-making was reprehensible and undemocratic.

Another important development under the Tories was the ascendancy of the Minister of Finance and his officials in social policy. Traditionally, power over federal social policy had been shared between the Ministers of Health and Welfare, and Finance. This made sense, since social programs constitute a large – and

growing – portion of federal spending. However, the influence of the Department of Finance on social policy increased during the 1970s, when it effectively pulled the plug on the Minister of Health and Welfare’s Social Security Review because its proposal to create an income supplementation plan for the working poor was deemed to be too costly. During the Wilson era, Finance came to rule decisively over social policy-making, outflanking and overshadowing Health and Welfare.

### *The New Social Policy: The Liberal Phase*

It may seem premature to pass judgment on the Liberal record on social policy before they have completed their second year in office. However, the changes they have made to date and those announced in the 1995 Budget would indicate that the Liberals are basically following the Conservative road toward the new social policy – with a diminished role for the federal government, more power to the provinces, cuts to UI, greater variability in provincial social welfare systems and the continuation of inflation-induced reductions in child benefits and GST credits and hidden increases in income taxes.

#### *no more stealth?*

The Liberals set out determined to usher in a new era of public policy. The federal government would be more open and responsive to the public, and would conduct a thorough review not only of the purposes and design of its many programs but also how it delivers them.

Finance Minister Martin’s 1994 Budget speech vowed an end to the Conservative “tactics of stealth.” Lloyd Axworthy, the new Minister of Human Resources Development (a

superministry created by the Conservatives just before they left office) launched a highly-public Social Security Review that was to consider sweeping reforms to a large chunk of federal social expenditures – Unemployment Insurance, training and other ‘employment development services,’ child benefits and federal transfers to the provinces for welfare, social services and postsecondary education. Axworthy appointed a Task Force to advise him on the preparation of an ‘Action Plan’ on social security reform, subsequently – and significantly – downgraded to a ‘Discussion Paper.’ The new Standing Committee on Human Resources Development was given the important job of canvassing Canadians for their views on the arguments and ideas presented in the Discussion Paper; the Committee subsequently traveled to 24 cities across the country and received more than 1,250 briefs from organizations and individuals before delivering its own report to the House of Commons in January of 1995.

The Finance Minister’s first (1994) Budget immediately cast a long shadow over the Social Security Review. He introduced major changes to Unemployment Insurance and the age credit and announced substantial cuts to federal social transfers to the provinces – all before the Social Security Review even got off the ground. Unlike his Conservative predecessors, who acted first and rationalized their decisions after the fact, Finance Minister Martin made it clear from the outset that he would be much more than a silent partner to Lloyd Axworthy in reforming social programs.

Although much has been made by some commentators of Lloyd Axworthy’s step into the shadows while Paul Martin took centre stage in the months leading up to the 1995 Budget, in fact it was abundantly clear from the outset that social policy reform was to march smartly to the tune of the government’s antideficit cam-

paign. The Finance Minister's 1994 Budget set "firm ... savings parameters" for the Social Security Review in terms of changes to Unemployment Insurance and transfer payments to the provinces, and stated that these were minimal cost-cutting goals.

The Liberals' changes to social policy have been relatively upfront, though they have gone much farther than indicated in the *Red Book* and – with the new Canada Health and Social Transfer – than suggested in either the Discussion Paper on Social Security Reform or the Human Resources Development Committee's Report on the same subject. They say they will consult the public on changes to old age pensions, though they did not do so when they income-tested the age credit or changed the schedule for increases in the tax deduction limits for RRSPs and Registered Pension Plans. Significantly, the government has retained key elements of the Tories' legacy of social policy by stealth – the partial indexation of child benefits, the tax system, the GST credit and federal social transfers to the provinces.

### *social transfers to the provinces*

Social transfers to the provinces and territories were significantly cut by the Tories. The Liberals' first (1994) Budget went further and gave Canadians a preview of what was in store in the draconian 1995 Budget.

In return for re-establishing "fiscal parameters and a predictable funding environment," the 1994 Budget announced there would be additional cuts to social transfers to the provinces. Entitlements to the provinces under the Canada Assistance Plan and the post-secondary education part of Established Programs Financing – or their successors – were to be no higher in 1996-97 than they were in 1993-94.

Clearly, even if "no higher" meant "the same" and not "lower" (the Budget was careful not to preclude the latter), in real terms this would mean a cut since transfers would have increased under the old system. The 1994 Budget projected savings to the federal treasury from these restraint measures of at least \$466 million in 1995-96 and \$1.5 billion in 1996-97. Significantly, "if social security reform fails to achieve these savings by 1996-97, alternative measures to take effect in 1996-97 will be implemented to ensure that the savings are realized."

The 1995 Budget went farther than the 1994 Budget had foreshadowed. The Canada Assistance Plan, which since its creation in 1966 has allowed the federal government to share half the cost of provincial welfare and social services – and in 1990 was hamstrung by the Tories' 'cap on CAP' – will be dismantled. Ottawa also will wind up Established Programs Financing, the 1977 legislation which provides a federal block grant to the provinces for health and post-secondary education. In their place will be the new Canada Health and Social Transfer (CHST) – a single mega-block fund for provincial health and human services that will allow the provinces to spend their federal money where and how they see fit.

The new Canada Health and Social Transfer will arrive with even deeper cuts than proposed in last year's Budget. When it is put in place in 1996-97, the CHST will pay the provinces \$26.9 billion – \$2.5 billion less than the \$29.4 billion that would have been spent under the present system (CAP and EPF). In its second year, 1997-98, the CHST will transfer \$25.1 billion – \$4.5 billion less than the \$29.6 billion the provinces would have received under the old regime. These reductions amount to 8.5 percent for 1996-97 and 15.2 percent for 1997-98, and total a hefty \$7.0 billion.

The Canada Health and Social Transfer will continue the current approach whereby Ottawa divides its social transfer ('entitlement') into two parts – cash transfers and 'tax points' (i.e., the income tax power that the federal government gave up to the provinces when it introduced EPF back in 1977 and which it still counts as part of its transfers to the provinces). In 1994-95, the total entitlement under EPF/CAP was \$29.4 billion, made up of \$17.3 billion in cash transfers (59 percent of the total) and \$12.1 billion in tax points (41 percent of the total); in 1996-97, the total entitlement under the new Canada Health and Social Transfer will have fallen to \$26.9 billion, of which \$12.9 billion will be in the form of cash transfers (48 percent of the total) and the remaining \$14.0 billion (52 percent) in tax points. The cash portion of the total entitlement will fall from 59 percent in 1994-95 to 48 percent by 1996-97. While the total entitlement in 1996-97 will be 9 percent lower than in 1994-95, the cash portion will fall by a much larger 25 percent during the same period.

But there is more to the grim prognosis than the cuts alone would suggest. If – as seems almost certain – the new Canada Health and Social Transfer is only partially indexed, the dissipation of federal cash transfers to the provinces that was started by the Mulroney government will continue. Assuming the new Canada Health and Social Transfer is partially indexed using the established GNP-less-three percent formula and also adjusted for changes in provincial population, then Caledon estimates that federal cash transfers under the CHST will disappear by 2011-12 (Scenario 1 in the graph). The federal cash would end two years sooner, in 2009-2010, if the CHST did not adjust for provincial population growth (Scenario 2). If the federal government were simply to freeze its entitlement at its starting level of \$26.9 billion and provide no annual adjustment, then the

end to cash transfers would come in 2006-07 (Scenario 3). **Note: The 1996 Budget committed Ottawa to a cash floor, preventing these scenarios – at least for the next 5 years (see graphs at the end of this paper).**

The projected date for the end of federal cash transfers under the CHST varies to some extent from one province to another depending upon several factors – the relative size of cash transfers as a percentage of total entitlements, the growth of provincial revenues and change in population. Using the assumptions of the first scenario in the previous paragraph, federal cash transfers would end in Quebec in 2005-06; under the second scenario, in 2004-05; and in 2002-03 under the third scenario. The end arrives sooner in Quebec than other provinces because federal cash transfers are a smaller proportion of entitlements (only 46.5 percent in 1994-95, compared to 57.5 percent nationally) since that province chose to take part of its CAP transfer in the form of tax points (known as the 'abatement'). Using the same assumptions, in Ontario federal cash payments under the CHST would end in 2013-14 under the first scenario, 2010-11 under the second scenario and 2006-07 under the third scenario. The latest the cash would run out is in the Northwest Territories – 2019-20 under the first scenario. Projecting the demise of federal cash to individual provinces and territories is complicated by the fact that provinces' revenue yields vary, and are hard to predict 20-odd years into the future

The precise date when federal cash ends, which will depend on such factors as the adjustment formula chosen for the Canada Health and Social Transfer, the performance of provincial tax revenues and growth in GDP, is in any event academic: The rapid diminution of federal transfer payments surely will cripple if not kill federal influence over provincial health and human services years before the money runs out.

The three provinces which have been subject to the cap on CAP since 1990 – Ontario, Alberta and British Columbia – will get no redress for their past losses. The new Canada Health and Social Transfer will allocate its transfers among the provinces in 1996-97 in the same proportion as they receive under combined CAP and EPF transfers in 1995-96. The most recent estimates from the Ontario government put that province's cumulative loss from the cap on CAP at \$7.7 billion from 1990-91 through 1994-95; Ottawa now shares only 29 percent of Ontario's welfare and social service costs rather than its traditional 50 percent. Ontario estimates its losses in 1994-95 alone from the cap on CAP to be \$1.7 billion, with another \$2.9 billion cut resulting from the various limits placed on EPF in recent years.

What about national standards? The Budget's rhetoric is strong on health care, weak when it comes to welfare and social services, and silent concerning post-secondary education. But reality is another matter altogether.

The Canada Health Act attaches five important conditions to federal payments to the provinces that maintain our national health care system: Publicly insured health care in all provinces and territories must be universal (covering all legal residents of the province who are eligible for coverage after no more than three months of residence); accessible (provincial health plans must provide reasonable access to necessary hospital and physician care without financial or other barriers); comprehensive (covering all medically necessary services performed by doctors or in hospitals); portable (people who are temporarily absent from their home province or territory or have moved to another province must be able to receive medical treatment in another province without having to pay out of their own pocket); and publicly administered (on a non-profit basis by a public

authority accountable to the provincial government). The only way that Ottawa can continue to enforce the conditions of the Canada Health Act is by withholding dollars for non-compliance with the Act. This leverage will disappear as the dollars disappear. Despite the fact that the Finance Minister publicly swore his allegiance to the Canada Health Act, there is no protection for medicare without federal dollars; the dollars provide the enforcement clout.

As far as welfare is concerned, only one of the existing requirements of the Canada Assistance Plan was explicitly attached to the new Canada Health and Social Transfer. Provinces cannot impose minimum residency requirements for welfare.

The Budget was loudly silent on the two other important conditions of the Canada Assistance Plan. The first is the all-important requirement that income assistance be provided to all people in need, regardless of the cause of that need: CAP requires the provinces to provide an income safety net that is open to all who need it, whatever the reason and whatever their 'category' – e.g., 'single employable,' 'disabled,' 'single parent.' The loss of CAP invariably will mean the loss of that protection. Provinces will be free to provide financial assistance to whichever 'deserving' applicants they so choose.

The third condition of CAP is that provinces must put in place an appeals system to allow welfare recipients to question decisions made with respect to their cases. Will some provinces decide to dismantle or weaken their welfare appeals procedures? Only time will tell, though presumably in post-CAP Canada they could do so if they wish. But even if they keep their welfare appeal systems, under the brave new world of the Canada Health and Social Transfer, provinces will be able to deny benefits to certain categories of people or to attach

conditions – such as work-for-welfare – to the receipt of benefits. The appeals system will be of no help to needy people that some provinces may decide to define as ineligible for welfare.

Nothing was said about conditions for post-secondary education because the existing system (EPF) imposes no requirements of any kind on how the provinces spend their money in this sector.

As far as social services are concerned, CAP funds for this important sphere of social policy come with few strings attached. Cost-shared social services must be delivered to persons deemed to be in need or likely to be in need – though this is more an eligibility criterion than a standard of service. However, CAP does not identify any benchmarks for the quality of social services.

The Finance Minister chose his remaining words very carefully on the critical matter of national standards. The Minister of Human Resources Development “will invite all provincial governments to work together on developing, through mutual consent, a set of shared principles and objectives that could underlie the new transfer. In this way, all governments could reaffirm their commitment to the social well-being of Canadians.” Note the use of the conditional “*could underlie*.”

It seems unlikely that the new block-funding arrangement will impose more conditions on the provinces regarding welfare than the few that already exist, or any conditions at all on social services (which have almost no conditions under the present arrangement). After all, one of the main arguments for scrapping CAP and moving to the CHST is to give the provinces more freedom to design and deliver their social programs as they see fit. The best we can hope for is that Ottawa and the provinces

succeed in creating a system of voluntary compliance with the “shared principles and objectives” for welfare and social services. Ideally, the two levels of government could work out some standards of adequacy and quality for welfare and social services, though that probably is wishful thinking on our part. This is nothing to sneeze at; but there is a world of difference between enforceable conditions on the one hand, and lofty principles and fine objectives on the other.

The loss of enforceable conditions is not the only threat to the future of welfare and social services. Just as troubling are the implications of the new mega-block CHST for welfare and social services as the years go by and federal funds decline, made all the worse by the ruinous results of recessions. It is not difficult to imagine what might happen as federal funds gradually dry up and the provinces come to terms with their new-found freedom.

Rolling the money intended for welfare and social services into a larger block fund along with health care and post-secondary education is almost as bad as providing no money at all for welfare and social services. They will get lost in the mix and will never have the importance accorded to services intended for the general population. Already the poor cousin of social policy, welfare and social services will rank consistently at the bottom of the priority list.

Some people would argue that this is how it should be – that programs which do not have high Gallup Poll approval do not deserve public funding. This is a dangerous and appalling presumption; it means that programs for people who are poor or vulnerable no longer will be deemed worthy of public support. Canadians who do not require income assistance will not want to fund it for those who do. Canadians

who are well-off will buy their own social services as they do now – nannies for their children, counselling in the event of marital or family problems, and private caregivers for elderly parents. There will be no desire to purchase these services on behalf of others.

Another strength of CAP is that it provides matching funds to the provinces. By virtue of the fact that costs are shared with Ottawa, the provincial governments must make the initial contribution to welfare and social services. While this may be difficult for most ‘have-not’ provinces, at least the arrangement requires some degree of provincial commitment. The new Canada Health and Social Transfer guarantees only a fixed amount of *federal* money that, moreover, will dwindle over the years: What the provinces put into their health and social programs will depend upon their fiscal capacity and political predilection.

A block fund is much more palatable to the provinces than cost-shared arrangements which ‘tie their hands.’ Provinces can take the money and run. And that is precisely the problem. The monies intended for human services could be used, at the end of the day, for whatever purposes the provinces desire. If the federal funds go out with no stipulations attached to their use, these dollars are no different than equalization payments which are intended simply to compensate for fiscal imbalances. There must be some way of ensuring that transfers intended for services to people are not transferred to some other purpose.

The loss of CAP also means the loss of built-in cyclical protection. When provincial costs rise in the face of higher welfare caseloads resulting from recessions, federal costs rise as well because Ottawa pays half the tab, no matter how large the bill. This makes sense in that

welfare caseloads and costs are linked directly to economic performance; they go up with high unemployment because they are intended to act as safety nets in the event of high joblessness. Federal cost-sharing over the past three decades helped provinces respond to the economic troughs which forced their costs to rise, and helped cushion the effects of recessions on Canada’s economy by providing at least a minimal income for people with nowhere else to turn. CAP is an important instrument of federal economic policy as well as social policy.

The next time we enter a recession, provinces will have to cope with the pressures of rising welfare caseloads entirely on their own: There will be no assured federal offset to compensate for higher costs. At best, provinces will cut welfare benefits; at worst, provinces will cut off welfare recipients. Their other alternative – to raise provincial taxes, most of which are regressive consumption and property taxes – is almost as undesirable from a fairness point of view and politically unlikely given tax fatigue on the part of the electorate and the policy of a number of provincial governments not to hike taxes.

To make matters worse, recent and anticipated changes to UI inevitably will add to welfare caseloads because some unemployed workers no longer will qualify for UI and so will have to turn to welfare instead. At the very time that the provinces will face the loss of 50-50 cost-sharing and steadily diminishing federal transfer payments, they also will have to contend with the fallout of measures to tighten up UI.

Most Canadians are unaware of the fact that provincial welfare programs provide essential goods and services to help people with disabilities and many elderly persons live independently in communities. Without these supports,

there likely would be hundreds or even thousands of citizens who would require an institutional setting because they are simply unable to live on their own.

The Canada Assistance Plan provides for two major types of aid: basic assistance and special assistance. *Basic assistance* refers to the financial aid that provinces provide in the form of welfare payments. Basic assistance covers essential items including food, clothing, shelter and utilities; some provinces provide a small clothing or personal allowance as part of their basic assistance package. *Special assistance*, by contrast, helps offset the costs associated with seeking employment, or with disability- or health-related needs. The latter include, for example, wheelchairs, prosthetic equipment, special eyeglasses, hearing aids, medications, medically prescribed diets, homemaker services and attendant services. Special assistance may be provided in the form of a cash payment, the actual item or a service.

Persons with disabilities may qualify for basic and/or special assistance depending upon their needs and the special assistance that happens to be available in their respective jurisdiction. Much of the help provided through welfare systems is delivered as ‘income-in-kind,’ such as technical aids and equipment. In fact, welfare systems play a quasi-health role by paying for and supplying many of the goods and services that are not supported under medicare.

The loss of the CAP legislative base and rapidly dwindling dollars from the human services sector will mean the loss of many special assistance goods and services – the very items that help maintain the elderly and persons with disabilities in communities and out of costly nursing homes and institutions.

### ***Human Resources Investment Fund***

The Budget was so bold as to make the unannounced announcement that several programs financed through the Consolidated Revenue Fund will be combined into a Human Resources Investment Fund which will “focus on actively helping unemployed people find and keep jobs, combating child poverty and providing assistance to those who need help most.” One generally expects a new ‘fund’ to come with dollars attached. This fund will likely come with dollars detached. Because there will be no new money for any of the government’s stated objectives, it is difficult to imagine that the fund will serve any purpose other than creative financing.

The Human Resources Investment Fund may simply act as a vehicle for combining the developmental uses of Unemployment Insurance (training and other employment programs funded by employer and employee premiums) and the Canadian Jobs Strategy or CJS (funded through general tax revenues) under one roof – and then shrinking the size of the house by reducing the CJS monies. There could be very little government contribution to the new fund; employers and employees will basically pick up the tab for employability enhancement initiatives, as they now have to for UI benefits. So the ‘fund’ could be a cover for cuts.

Another possibility is that Ottawa will use the fund to pay for the Working Income Supplement, which currently provides up to \$500 a year to working poor families with children, under the Child Tax Benefit. The federal Discussion Paper included an option to double the Working Income Supplement, which could be financed by cutting the Child Tax Benefit paid to upper middle-income families. But improvements to the Working Income Sup-



plement instead could be paid out of the new Human Resources Investment Fund, in effect using employer and employee contributions to help “combat poverty.” An added bonus is that the federal government could trim its own budget by shifting part of the cost of the Child Tax Benefit onto employers and employees, as it did with UI in 1990.

### *Unemployment Insurance*

The Liberals cinched the UI belt even tighter than did the Tories. The 1994 Budget announced that, as of July 1994, employees have to work a minimum of 12 weeks to be eligible for UI if they live in a region with an unemployment rate of 13 percent or higher; before, the minimum qualifying period was only 10 weeks (for a regional jobless rate of 16 percent or more). Unchanged is the feature that the lower the unemployment rate in a claimant’s region, the longer he or she must work to qualify for UI, ranging from 12 weeks for a regional unemployment rate of 13 percent or higher to 20 weeks for a regional unemployment rate of six percent or less.

Also changed was the method of calculating the maximum length of time that UI beneficiaries can draw benefits, which depends on two factors – how long they worked before they lost their job and the unemployment rate in their region. Before the 1994 Budget, recipients could collect benefits for up to 35 weeks, depending on how long they worked; this was reduced to 32 weeks. And whereas previously, they could draw benefits for up to 32 weeks depending on the regional unemployment rate, the maximum is now 26 weeks. The Budget did not alter the maximum length of time that someone can remain on UI, which is 50 weeks.

The method of calculating the level of UI benefits was changed to introduce a form of needs test. The Conservatives had reduced the amount of UI benefits from 60 percent to 57 percent of insurable earnings for all recipients as of April 4, 1993. The Liberals went back to the two-tier arrangement that had been in place between 1971 and 1976 in order to provide more assistance to low-income UI recipients with dependents to support. UI recipients who earn half of maximum insurable earnings or less (\$390 a week or \$20,280 a year in 1994) and who have dependents now get 60 percent of their average insurable earnings – back up to where it was before the Tories lowered it in 1993. However, the remaining 85 percent of UI claimants had their benefits reduced further from 57 percent to 55 percent of their average insurable earnings. The maximum UI benefit for recipients with low earnings and dependents increased from \$222 a week to \$234 a week; the maximum benefit for other recipients (i.e., the benefit for those with the maximum insurable earnings or more) fell from \$445 a week to \$429 a week.

The 1994 Budget projected savings from these UI changes totaling \$5.5 billion over three years – \$725 million in 1994-95, \$2.4 billion in 1995-96 and \$2.4 billion in 1996-97. The UI premium rate, which would have risen to 3.3 percent of insurable earnings for 1995 under the old scheme, was lowered to its 1993 level 3.0 percent of insurable earnings. These changes were billed as “interim measures” until the Social Security Review came up with proposals to reform UI, with “further significant reductions in ... expenditures” to take effect by 1996-97.

The 1995 Budget handed Lloyd Axworthy additional specifications for his forthcoming

reform of Unemployment Insurance, with new legislation planned for the autumn of 1995 and the changes to take effect no later than July 1, 1996. "Funds will be channeled from those aspects of the benefit structure that create dependence and stifle the economic energy of the country to investments in people to make them more employable." Presumably this means more badly-needed resources for employment development services. But it also means that UI will be tightened up once again, by increasing the qualifying period and, possibly, reducing the maximum duration of benefits as well as the level of benefits. The latter might be accomplished by introducing a stepped benefit structure, whereby recipients' level of benefits decline if they use the program frequently. UI expenditures are to be at least 10 percent less – a forecast \$700 million – as a result of Axworthy's reforms and an expected improvement in the jobless rate: The unemployment rate already fell from 11.2 percent in 1993 to 10.4 percent in 1994 and is projected to decline further to 9.5 percent in 1995 and 9.4 percent in 1996.

Employee and employer premiums will be kept at their current level 3.0 percent of insurable earnings for employees and 4.2 percent for employers. The combination of no reduction in UI premiums and the improving economic situation is expected to move the UI Account from a \$6 billion deficit in 1993 to a \$5 billion surplus by the end of 1996. Ottawa wants to maintain the UI Account surplus at this level to help offset the need for future increases in premiums when the next recession hits.

The 1994 Budget cut a projected \$5.5 billion from UI from 1994-95 through 1996-97. The 1995 Budget calls for another \$700 million (at least) in savings for 1996-97. The total reduction in UI expenditures, then, will amount to at least \$6.2 billion under the Liberal government.

## *pensions*

The 1994 Budget also took a small but firm step on the rocky road to pension reform. It imposed an income test on the age credit, which reduces the federal income taxes of elderly taxpayers by up to \$592 a year and their provincial income taxes by, on average, \$343 for a total average tax savings of \$935. The maximum age credit now is available only to elderly taxfilers with net incomes under \$25,921 (the same income threshold as for the Child Tax Benefit and refundable GST credit); it is reduced by 15 cents for every dollar of net income above \$25,921, which means that seniors with net incomes over \$49,100 no longer qualify for any age credit.

The 1995 Budget took two more steps toward a geared-to-income old age pension. It said that the government wants to apply a family income test to Old Age Security, while maintaining the income-tested Guaranteed Income Supplement and full indexation of all benefits. It also announced that, starting in July of 1996, the clawback on Old Age Security will be applied before cheques are sent out to seniors, on the basis of last year's income, rather than after the fact (through the income tax form) as is now the case. Unchanged for now are the threshold for the clawback, which is \$53,215; seniors with net incomes between \$53,215 and \$84,195 pay a partial clawback that still leaves them with some Old Age Security benefits, but those with net incomes above \$84,195 do not qualify for any old age pension. Old Age Security recipients who do not live in Canada will be required to file a statement of their total income (including sources outside Canada) to ascertain if they are subject to the clawback; at present, high-income non-residents receive favorable treatment because they can avoid the clawback.

The Caledon Institute supports these measures because they respond to our 1993 proposal that Old Age Security, the Guaranteed Income Supplement, the Spouse's Allowance, and the pension and age credits be replaced by a single geared-to-income benefit for poor and modest-income seniors – a super-GIS, in effect. Old Age Security costs are the single and steadiest cause of rising social spending. The aging of the population, coupled with the growth of low-wage jobs and insecure employment, will add up to a large increase in the number of lower-income pensioners in the decades to come. The shift to a single geared-to-income elderly benefit foreshadowed in the 1995 Budget will save billions of dollars in future increases in Old Age Security expenditures, though even with these changes the aging of the population still will push up pension and health care costs. Reform of elderly benefits is essential if Canada is to maintain an adequate level of basic income support for the rising ranks of low-income seniors in the next century.

The 1995 Budget also reminded Canadians that the federal and provincial finance ministers will convene this autumn to conduct their regular five-year review of the financing of the Canada Pension Plan. Contributions from employers and employees are being gradually increased to handle rising claims on the Canada Pension Plan and the Quebec Pension Plan. The recent recession and an increase in the number of people receiving disability benefits have forced an upward revision of projections of future contribution rates. As a result, the finance ministers will discuss ways to deal with this pressure – such as a more rapid increase in contribution rates than previously planned and, possibly, a reduction in benefits.

### *child care and child benefits*

The Human Resources Investment Fund may also be used to house the dollars that had been set aside for child care – conspicuous in this year's Budget by its absence. The Liberal *Red Book* committed the government to expand child care in Canada by 50,000 new quality child care spaces in each year that follows a year of three percent economic growth, up to a total of 150,000 spaces. This election promise was backed up by dollar allocations for child care in the 1994 Budget which had designated \$120 million in additional funds for 1995-96 and \$240 million more in 1996-97.

The line for the child care allocation seems to have slipped off the ledger sheet in Mr. Martin's most recent Budget. If child care gets any funding at all, it will not be in the manner envisaged in the *Red Book* or in the context of building an infrastructure of service for all Canadians. Rather, it probably will be merely an adjunct to a given individual's employability enhancement program. Perhaps the Liberals still plan to invest in a child care system at some point; they simply could not proceed with a good news announcement at a time when the credit rating constituency was demanding a bad news Budget.

The Budget introduced no measures to reduce child poverty, such as improvements to the Child Tax Benefit. This is a travesty, given that the government could easily have found some money in the billions spent on tax breaks for high-income Canadians that it chose not to touch. At the very least, the federal government could have stopped the erosion in the value of the Child Tax Benefit by restoring full indexation to benefits and the income threshold.

## *the tax system*

The 1994 Budget trimmed and slimmed several tax breaks in the personal and corporate income tax systems. It closed down one of the worst of the Tories' tax changes – the creation of a \$100,000 lifetime capital gains exemption. This was a phenomenally regressive tax break that even some financial journalists and tax experts deemed devoid of merit. As noted above, the 1994 Budget income-tested the age credit. Employer-paid private group life insurance premiums under \$25,000 worth of coverage used to be exempt from taxation; now, employees will have to pay income tax on the full amount of such coverage. Changes to the business income tax included reducing the deduction for meals and entertainment, eliminating the preferential tax rate used by large corporations and cutting regional investment tax credits. These and other tax measures will yield an estimated \$3.5 billion in additional revenue from 1994-95 through 1996-97.

The 1995 Budget dealt far larger spending cuts than tax increases. Its tax changes will raise an additional \$3.7 billion between 1995-96 and 1997-98, as opposed to \$25.3 billion in savings from cuts to government programs and bureaucracies. The most lucrative of the tax increases was regressive – a 1.5 cents per litre hike in the federal excise tax on gasoline, which will raise \$1.5 billion over the next three fiscal years. By contrast, the increase announced in the tax rate on large corporations will yield a total of \$460 million; the corporate surtax will go up to bring in another \$350 million; and a temporary increase in the capital tax levied on Canada's profit-starved banks and other large deposit-taking financial institutions will garner a deficit-crunching \$100 million.

The Budget's changes to tax assistance for retirement savings were a cop-out. The

Finance Minister could have substantially reduced the tax deduction limit for contributions to Registered Pension Plans and RRSPs or changed the deduction to a credit. Such changes would not affect modest-income and middle-income taxpayers but would reduce (though not eliminate) generous and costly tax breaks for the well-off. Instead, he merely reduced the maximum tax deduction for contributions to RRSPs from \$14,500 in 1995 to \$13,500 for 1996 and 1997, after which the limit will rise by \$1,000 a year to reach \$15,500 in 1999; it will be indexed in the years to follow. Taxpayers are presently allowed to over-contribute up to \$8,000 in their RRSP accounts without penalty; as of 1996, this amount will be reduced to \$2,000 in 1996. The tax deduction limit for contributions to money purchased pension plans will be lowered from \$14,500 in 1995 to \$13,500 for 1996, but then will rise by \$1,000 a year to reach \$15,500 on 1998, and indexed thereafter. The maximum limit for the deduction of contributions to defined benefit pension plans will be frozen through 1998 and then indexed in 1999.

These changes to tax breaks for retirement savings will save the federal treasury \$15 million in 1995-96, \$95 million in 1996-97 and \$160 million in 1997-98. To put this in perspective, the latest estimates from the Department of Finance show that the federal government spent \$8.7 billion on the tax deductions for contributions to Registered Pension Plans and RRSPs in 1992.

High tax deduction limits for retirement savings translate into many millions of dollars in tax breaks to upper-income Canadians who least need a subsidy from government to save for their (already) golden years. When the tax deduction limit for RRSP contributions reaches \$15,500 in 1999, only taxpayers who earn \$86,000 or more will be able to claim the

maximum deduction, which will save them about \$7,100 in federal and average provincial income taxes – six times what Ottawa pays in Child Tax Benefit for a poor child.

## **Conclusion**

Aside from the forward-looking pension proposals, it is no exaggeration to say that the Liberals brought in a Budget that harks back half a century to a time when the federal government played a much smaller role *vis-a-vis* the provinces and when charity and the private market played a much more prominent role in social policy. The future of Canadian social policy may well resemble the past more than the present.

The Tories tried to make the poor go away by rewriting the definition of poverty. The Reform Party proposes a Brady-Bunch approach to social policy in which we send them back home to their families.

The Liberal response is to get out of the business; it simply isn't profitable. This no doubt will please the international financiers in Tokyo, New York and London – but raises serious questions as to why we have a federal government and its role with respect to its own citizens, particularly the most vulnerable. The future of Canada's income safety net for the poor and its health care system for everyone is being traded off in the frenzy to please the Wall Street men in suits – who chalk up the numbers on a ledger but have absolutely no interest in the well-being of people, especially poor Canadians.

These are difficult political times and Ottawa is seeking ways of 'renewing' itself and its relationship with the provinces – especially

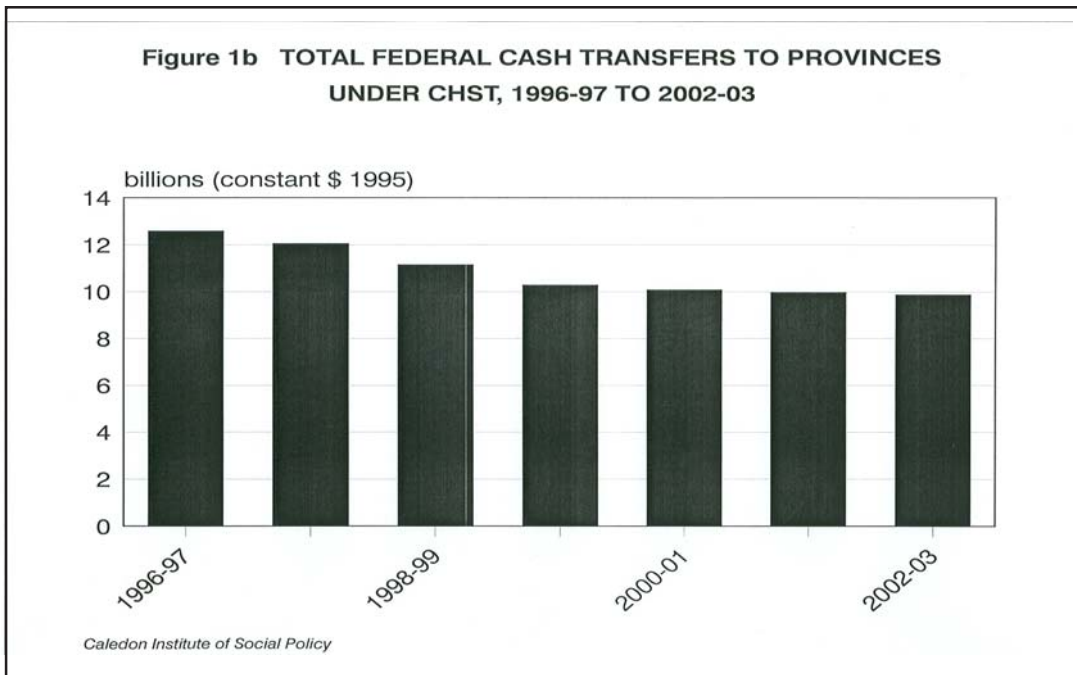
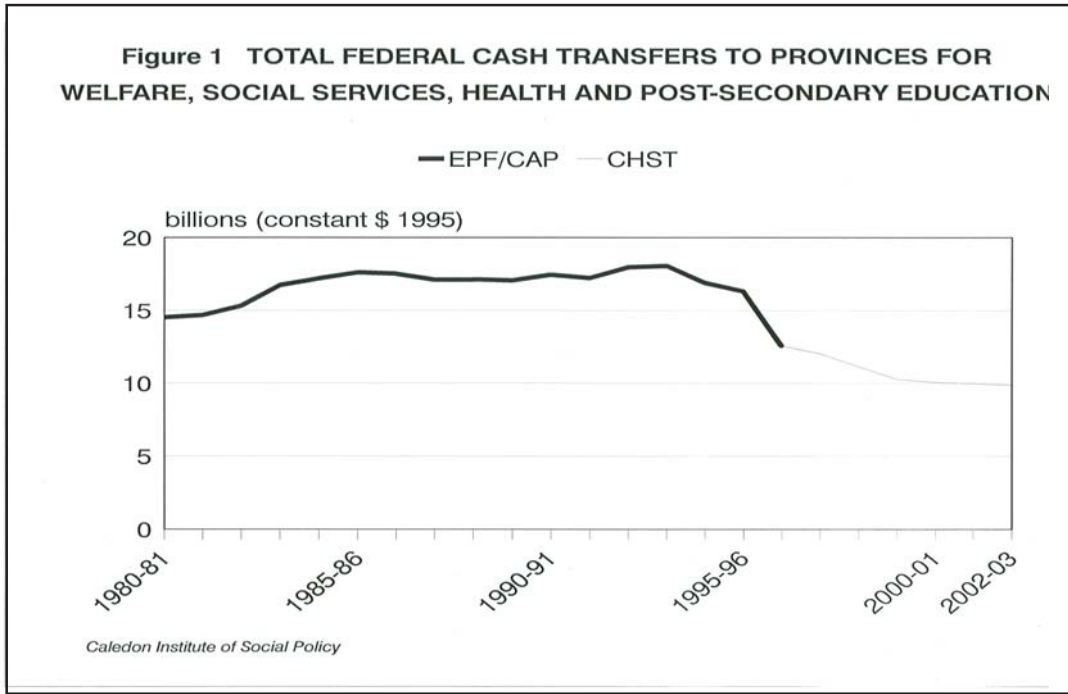
in light of an impending referendum in Quebec which threatens to break up the country. But to conclude that the federal role in shaping the basic social contours of this country is *passee* is terribly wrong. In a world which values creativity, innovation and initiative, it is all the more important that these 'thousand points of light' are bound together by a common set of principles. Yet the Budget promised only that the Canada Health and Social Transfer *could* – not *would* – have a set of associated principles and objectives, and it does not even mention conditions.

Admittedly, there is nothing inherently creative about the federal government. It is the provinces – not Ottawa – which have taken the lead in terms of innovation and creativity with respect to human services; the example of Saskatchewan's pioneering of medicare is frequently cited as proof. This should come as no surprise, given the fact that provinces have constitutional responsibility for health and social services.

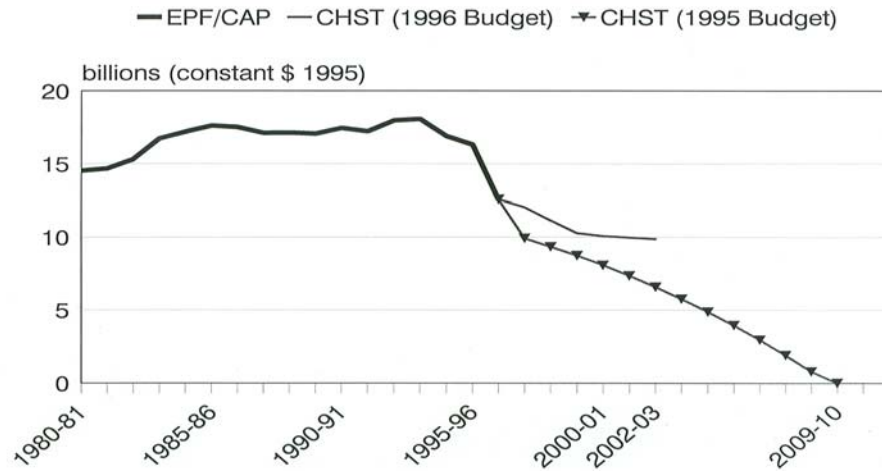
But we should also remember that medicare would never have spread from Saskatchewan to the rest of Canada without federal financial assistance and leadership. Moreover, it has become all too clear in recent years that some provinces are committed to high-quality human services while other provinces are simply ideologically opposed. The each-household-for-itself mentality has taken hold in certain parts of the country. The problem is not diversity; the problem is diversity in the absence of national principles and basic standards which ensure that being a Canadian brings certain rights of citizenship, regardless of province of residence.

The 1995 federal Budget represents a fundamental turning point in Canadian social policy. It was the Liberals who created the foundation of our social security system in the 1950s, 1960s and 1970s. It was the Conservatives who fundamentally weakened that foundation in the 1980s by putting federal trans-

fer payments to the provinces on a down escalator. It is now the Liberals of the 1990s who are shaking that foundation to the core – making it smaller and extracting the federal cement that holds the essential building blocks in place.

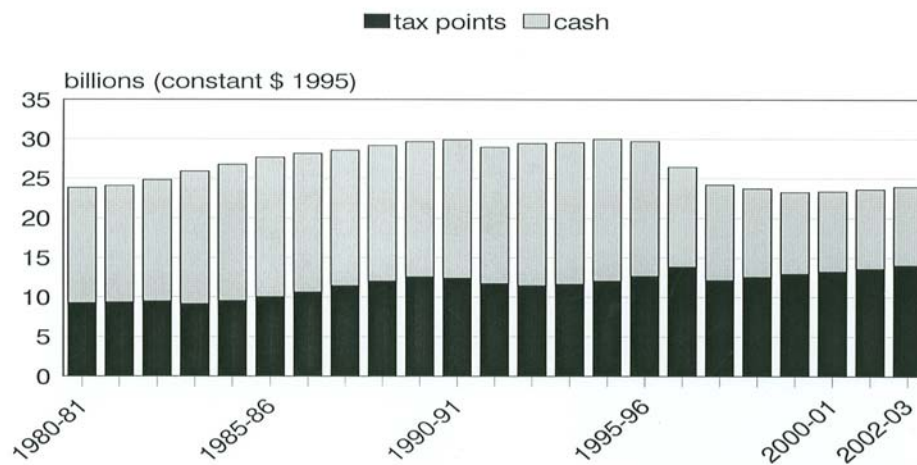


**Figure 2 TOTAL FEDERAL CASH TRANSFERS TO PROVINCES FOR WELFARE, SOCIAL SERVICES, HEALTH AND POST-SECONDARY EDUCATION**



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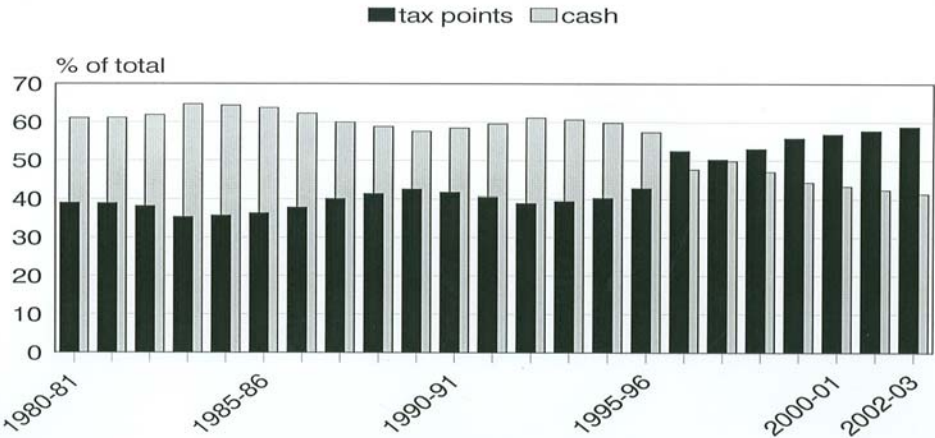
**Figure 3 TOTAL FEDERAL CASH TRANSFERS TO PROVINCES FOR WELFARE, SOCIAL SERVICES, HEALTH AND POST-SECONDARY EDUCATION**



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**Figure 4 TOTAL FEDERAL CASH TRANSFERS TO PROVINCES FOR WELFARE, SOCIAL SERVICES, HEALTH AND POST-SECONDARY EDUCATION**



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