CALEDON
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commentary

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Tackling Inequality Now*

Thank you to Canada 2020 for having organized this important conversation and for having invited the Caledon Institute to participate in this Future of Canada project.

We are pleased that the significant issue of inequality has made it onto the public radar screen, thanks in large part to the work of Canada 2020, the OECD and many national organizations here at home, including the Conference Board of Canada, the Canadian Labour Congress and the Canadian Centre for Policy Alternatives.

The paper that we prepared for this project briefly discusses the distinct, but interrelated, problems of poverty and inequality. These are obviously complex problems, as the OECD report *Divided We Stand* makes clear. And we couldn't agree more.

Over the past 20 years, the Caledon Institute has made the case for an overarching strategy to tackle poverty and inequality. There is no single solution; there is no magic silver bullet. There never is when it comes to complex problems.

We have argued the need to design a new architecture of income security in order to modernize the current system and tie it more closely and coherently to the labour market. This modernization involves a series of linked changes related to Employment Insurance and welfare, child benefits and adult benefits, earnings supplementation, minimum wages and the disability income system (calling the latter a system is an undeserved compliment). The public pension system also requires substantial strengthening, notably the Guaranteed Income Supplement and the Canada Pension Plan.

We also published *Poverty Policy*, which talks about ten core strategies to tackle poverty and inequality. These interventions include early childhood development and basic education – especially for Aboriginal students.

* *These notes were prepared for the panel on Poverty and Inequality organized by Canada 2020 in Ottawa on January 19, 2012.*

An estimated 60 percent of First Nations on-reserve residents age 20 to 24 still have not completed high school or obtained an alternative diploma or certificate compared to about 16 percent of non-Aboriginal Canadians age 20 to 24. Caledon Senior Scholar Michael Mendelson has proposed the introduction of a *First Nations Education Act*.

We have written about access to post-secondary education in the report *Student Aid Meets Social Assistance*. We have explored the theory and practice of customized training in which specialized training is designed explicitly with the private sector to meet current and emerging market needs.

Over the past ten years, we have helped sponsor Vibrant Communities, a 14-city pan-Canadian learning partnership. The partner communities work with governments, business, voluntary organizations and citizens to test out a wide range of local solutions to reduce poverty. These include social economy businesses, individual development accounts (a new form of asset that helps low-income families save money) and living wage projects involving the private sector.

Finally, we have written at length about the value of social infrastructure in the form of public schools, community centres, libraries, parks and playgrounds. These public assets contribute substantially to the quality of life, as the OECD clearly points out in its *Divided We Stand* report.

All the above are crucial components of an overall national strategy on poverty and inequality. It should involve all orders of government, including municipalities and First Nations.

But clearly the most powerful and immediate intervention for tackling poverty and inequality is the redistributive power of income security programs and a progressive income tax system. While both elements are essential, income security programs have done the heavy lifting over the years in terms of redistribution.

The OECD report *Divided We Stand* argues that the effectiveness of redistributive measures has declined since 2005. The question we need to ask is why?

In our view, these powerful redistributive instruments have become less effective in reducing market inequality than they might otherwise be because the federal government has made some costly and regressive changes. These policy choices have seriously weakened the power of these instruments.

The negative impact of these policy choices has been exacerbated by the recent recession. If anything, redistributive measures should be bolstered in tough economic times to help compensate for the turbulence of the market.

The Canada Child Tax Benefit is a case in point. It is a progressive, broad-based program that delivers benefits to 90 percent of Canadian families with children but provides its greatest assistance to lower- and modest-income households. Child poverty would be substantially higher in the absence of this powerful program.

If there were no federal child benefits, the low-income rate for families with children would have been 15.0 percent in 2008. Instead, the low-income rate for families with children was 9.3 percent. Our proposed improvement to the Canada Child Tax Benefit, discussed below, would reduce that figure further to 8.3 percent.

After a series of important incremental improvements from the Canada Child Tax Benefit's introduction in 1998 until 2007, Ottawa turned its back on years of progress and introduced two regressive schemes – the Universal Child Care Benefit in 2006 and the non-refundable child tax credit in 2007.[1]

These measures added complexity to a well-designed system that had evolved over years of exemplary federal and provincial/territorial collaboration. But these 'new' programs (they are actually retreads from the past) are distributionally perverse – which is incomprehensible, especially in times of so-called 'fiscal restraint.' The Universal Child Care Benefit goes to families at all income levels, rich and poor alike, while the non-refundable child tax credit delivers the same benefit to all families, except for the poor – who get nothing.

The money spent on these measures – some $3.5 billion – does nothing to build a badly-needed child care system in Canada. In fact, the OECD has blown the whistle on our relatively poor performance in this important area.

Another example: The Working Income Tax Benefit was introduced in 2007 in order to supplement low earnings. It is a sound and welcome measure in theory but currently too modest in amount to make a substantial dent in poverty and inequality.

Caledon argued the need to improve the Benefit's adequacy and its design in terms of moving the reach of benefits higher up the income scale. The 2009 Budget did, in fact, make several improvements but, unfortunately, these were still too modest to harness the Working Income Tax Benefit's full potential power.

Employment Insurance is a third illustration. Changes introduced in the 1990s have drastically reduced eligibility. Fewer than half of the unemployed have been eligible for regular Employment Insurance benefits since 2003. Caledon has proposed a new *temporary income program* that would help jobless Canadians in financial need who don't qualify for EI, preventing them from falling into the morass of welfare.

The income tax system used to be more progressive but it too has lost some of its redistributive muscle. The top federal income tax rate saw a marked decline from 43 percent in 1981 to 29 percent in 2010. Ottawa introduced income splitting of pension income and plans to do the same for families with children – two regressive and expensive tax breaks that do nothing to tackle inequality and poverty.

Improving the redistributive system in Canada in no way minimizes the need for investments in basic education, post-secondary education and continual upskilling. A broad-ranging human capital agenda is required for a healthy society and for creating the wealth that supports these redistributive instruments.

But investments in human capital development, while crucial, take time to effect. In the meantime, there are literally hundreds of thousands of households choosing between paying the rent and feeding the kids (in the trenchant words of Mel Hurtig). We can do something right now to reduce poverty and inequality.

For those of you thinking that it is far easier said than done in an era of fiscal restraint, you are correct. We have written at length about current expenditure that could be far better spent. There are public dollars that could be redirected if we really wanted to make our redistributive system more effective. Here are just two examples.

Ottawa currently spends about $3.5 billion a year on the Universal Child Care Benefit and the non-refundable child tax credit. Given the flaws earlier described with these two measures, we believe that they should be scrapped and the resulting savings used to boost the Canada Child Tax Benefit.

In 2008, Caledon proposed a bigger and better Canada Child Tax Benefit at $5,000 for the first child – up from the current maximum $3,485. That increase would have cost about $4 billion at that time. Instead, Ottawa found $3.5 billion in new money for two poorly-designed child benefits that fail to target families most in need.

Second example: An estimated $50 billion is spent every year on a plethora of non-refundable tax credits.

We are not saying to do away with all these credits. What we *are* saying is that this is a lot of public expenditure with very little scrutiny. These tax credits tend to pass virtually unnoticed – unlike expenditure programs that get far more attention. We need to ask some serious questions about bang for the buck. Who is benefiting from these measures and what is the best way to meet a social goal?

These non-refundable credits provide substantial tax breaks to non-poor households, including the wealthy, while excluding the poor. There is a huge 'hidden welfare system' in Canada, to borrow a phrase coined by the National Council of Welfare back in the 1970s.

The children's fitness tax credit introduced in 2007 delivers its primary assistance to higher-income families rather than lower-income families that would benefit far more from this assistance. The $115 million spent on this one measure alone would be better invested in public infrastructure – the parks, playgrounds, arenas and local community centres that would benefit an entire neighbourhood, city or region.

So Canada's policy choices in recent years clearly have reduced the power of its redistributive measures. Neither are these choices enabling the public infrastructure investments that the OECD itself has described as significant in reducing inequality – and improving overall quality of life.

A wide range of linked strategies – educational upgrading, upskilling, technological innovation, better jobs, living wages and public infrastructure – are all essential for addressing poverty and inequality. Educational upgrading and upskilling, in particular, are crucial components that help tackle the problem at its very heart.

But equally important are two powerful measures – the Canada Child Tax Benefit and the Working Income Tax Benefit – which could land a solid punch on poverty and inequality – right now.

Endnote

1. The maximum Canada Child Tax Benefit payment for the first child rose from $1,625 in its first year (July 1998 to June 1989) to $2,632 for July 2003-

June 2004 and reached $3,271 for July 2007-June 2008. The maximum benefit for a second child went from $1,425 for July 1988-June 1989 to $2,423 for July 2003-June 2004 to $3,041 for July 2007-June 2008, and for the third and each additional child from $1,425 to $2,427 to $3,046 over the same period. Expressed in inflation-adjusted 2007 dollars, the maximum Canada Child Tax Benefit for the first child was $1,974 in 1997, the year before the National Child Benefit reform began. By July 2007, it had reached $3,271 – a substantial $1,297 or 65.7 percent real increase over 1997.

2. The share of the unemployed eligible for Employment Insurance declined from 48.0 percent of the unemployed in 2003 to 42.9 percent in 2008, but increased to 49.8 percent in 2009, falling again to 44.4 percent in 2010.

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