CALEDON INSTITUTE OF SOCIAL POLICY

caledon memorandum

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TO: *The Next Prime Minister of Canada*

FROM: *The Caledon Institute of Social Policy*

SUBJECT: *FEDERAL SOCIAL POLICY AGENDA*

The purpose of this memo is to propose some key directions that the Caledon Institute of Social Policy believes your government should pursue in social policy.

Social policy is one of the most important, yet perhaps least understood, aspects of public policy. Despite the fact that social spending amounts to many billions of dollars, most Canadians have little understanding of where these funds are directed and who benefits from them.

While social policy is complex, our message to you is simple.

First, your government must take into account the fact that Ottawa already has made fundamental changes to social programs over the past ten years. Second, profound and long-term shifts in economic, demographic and social conditions are generating heavy and increasing demands on social programs. Third, social spending is rising substantially, at all levels of government. (Despite the overall rise, however, the federal share of social spending actually has dropped, as explained in our report *Opening the Books on Social Spending*.)

In response to the myriad changes to social programs, the growing demands on these programs and increased social spending, the Caledon Institute is calling for an informed and open review of social programs.

Changes to social programs

Over the past decade, the federal government has made many significant – though poorly understood – changes to social programs. These changes are examined in a recent Caledon Institute report entitled *Federal Social Programs: Setting the Record Straight*.

Our analysis found that progressive changes to social programs and tax policy have been undermined consistently by regressive changes. Despite cuts to social programs which benefit poor and middle-income households, the Finance Department has enriched tax breaks by creating the $100,000 lifetime capital gains exemption and by increasing tax deductions for RRSPs and child care expenses that favor well-off taxpayers. These tax breaks cost the federal treasury $17.5 billion in 1989 (the latest year for which published figures are available).

A few of the changes to social programs – e.g., tightening up the rules for Unemployment Insurance – have attracted media attention and provoked public controversy. However, most changes to social programs and the tax system have been finessed through the 'politics of stealth' – arcane measures such as partial indexation and c1awbacks that few Canadians understand and that largely escape media scrutiny. These were introduced with little public information, discussion or debate and have made a mockery of the ideal of democratic government.

For example, universal child and elderly benefits no longer exist as a result of the clawback imposed on old age pensions and family allowances in 1989. Family allowances were replaced entirely in 1993 by an income-tested child tax benefit that will fall steadily in value as the years go by because it is not adequately protected from inflation. The partial indexation of child benefits has cut billions of dollars from these programs since 1985. While the federal government abandoned its commitment to increase the supply of licensed child care spaces, it boosted the regressive child care expense deduction in 1988 and 1993.

Partial indexation of both tax credits and brackets is imposing automatic and hidden tax increases which hit modest- and lower-income taxpayers hardest. The income level at which Canadians begin paying taxes (i.e, the taxpaying threshold) falls every year, catching more and more lower-income households in the tax net.

Limits placed on the indexation formula under Established Programs Financing (EPF) for health and post-secondary education are cutting billions from federal transfers to the provinces. The changes will result in a total federal withdrawal of cash transfers by around 2009 – emasculating Ottawa's ability to enforce the conditions of the Canada Health Act that require universal, accessible and comprehensive health care. The unilateral decision of the federal government to limit its contributions under the Canada Assistance Plan (CAP) to Ontario, Alberta and British Columbia has reduced drastically these provinces' ability to cope with mounting pressures on their welfare and social service budgets.

Pressures on social programs

Powerful economic, demographic and social forces are sustaining and, in some important cases, increasing the demand for social programs.

Economic restructuring, the globalization of trade and the free trade agreement have contributed to dislocation, labour market shifts and high rates of unemployment. Many of the jobs that have been created in recent years pay low wages and are casual or contractual in nature. Most families now require a second wage earner – a fact which increases the need for affordable, quality child care. The changing labour market also spells trouble for future income security as fewer jobs provide associated benefits, such as retirement pension plans and supplementary health and dental care. Despite mass unemployment and underemployment, federal economic policies have focused single-mindedly on controlling inflation and curbing the deficit. The obsession with deficit reduction has taken priority over policies to address Canada's high jobless rate, thereby driving up the demand for Unemployment Insurance and welfare.

The aging of the population is the most profound demographic pressure we face. In 1951, 7.8 percent of the population was 65 or older. By 1991, the proportion had increased to 11.6 percent. Statistics Canada projections put the aged at 18.6 percent of the population by 2021 and 22.7 percent by 2031, respectively. One in five Canadians will be over 65 by early in the next century – a factor which will create unprecedented demand for public pensions, health care and social services.

Social forces have increased the pressures on social programs. The high rate of marriage breakdown and inadequate support payments create poverty for many single-parent mothers and their children. Persons with disabilities may require income assistance, housing and personal supports to live independently. Many families are struggling with problems of abuse and neglect.

Rising social spending

Despite the significant cuts made to social programs over the past ten years, overall social spending has risen substantially in real terms. The trends in total social spending by all levels of government as well as the specific components of this expenditure are explored in a Caledon Institute report entitled *Opening the Books on Social Spending*. The findings of that study are chastening.

In the 1960-61 fiscal year, all levels of government together paid out $18 billion (in inflation-adjusted 1993 dollars) on income security, social insurance, social service, health and employment programs, which amounted to 8.3 percent of the Gross Domestic Product. By 1980-81, total public social spending had risen to $79.4 billion or 14.7 percent of GDP. The 1980s brought phenomenal growth in social expenditures. By 1990-91, total social spending had climbed to $127.7 billion or 18.4 percent of GDP.

A primary cause of the growth in social spending is the rising cost of income security programs for the aged and the near-aged. Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance together paid out $16.2 billion in benefits in 1984-85 (in inflation-adjusted 1993 dollars). By 1993-94, the total will escalate to $20.2 billion or 25 percent more in real terms than in 1984-85. The growing number of retired Canadians and their dependents who qualify for the Canada Pension Plan, together with improvements to that program, also are pushing up social spending. Canada Pension Plan spending will more than double from $6 billion in 1984-85 to an estimated $14.5 billion in 1993-94.

Recession is the second major pressure on social spending. Declining unemployment in the mid-1980s kept Unemployment Insurance expenditures fairly flat – between $13 and $14 billion. But the current recession has driven the jobless rate up again to over 11 percent. Despite two rounds of cuts to Unemployment Insurance, UI costs will rise to more than $19 billion in 1993-94. Federal cost-sharing of welfare and social programs under the Canada Assistance Plan remained at just over $5 billion in the mid-1980s but will increase to $7.2 billion in 1993-94. Recession-driven unemployment is responsible for burgeoning welfare costs despite the cut in federal contributions to Ontario, Alberta and British Columbia.

By contrast, spending in two other major areas of social policy – child benefits and EPF – has fallen. In 1984-85, the two largest child benefit programs (family allowances and the refundable child tax credit) cost $5.3 billion in 1993 dollars; the price tag for the new child tax benefit that replaced these programs (and the non-refundable child tax credit) will be $4.5 billion in 1993-94. The reduction is not due to a decline in the numbers of eligible children but rather to a drop in the value of benefits as a result of partial indexation introduced in 1986. In 1984-85, Ottawa transferred $11.3 billion in cash payments to the provinces for health and post-secondary education; cuts imposed through partial indexation of the financing formula will reduce that amount to $9.4 billion by 1993-94.

Informed and open review of social programs

i. a fresh look

Critics calling for cuts often know little about social programs and the pressures that are driving up social spending. They tend to favor simplistic solutions that would reduce benefits, restrict access to programs or offload the costs onto other levels of government or individuals.

Social-spending slashers often take a narrow view of social programs. For example, in the days when we still had universal family allowances (i.e., before the clawback was implemented fully in 1991), they argued that it is wasteful to spend money on wealthy families (the 'banker's wife' example). Yet the same critics typically ignored the children's tax exemption and the child care expense deduction – two tax-delivered social programs that paid the largest benefit to affluent families, bankers included.

There is also a tendency to expect too much of social programs and to forget that these programs struggle to deal with problems that arise in the economy and in society. Unemployment Insurance is a classic example. If Unemployment Insurance costs are skyrocketing, the simplistic answer is to cut benefits and tighten up access to the program. Yet the primary causes of rising UI rolls are high unemployment and the growth of unstable jobs.

In short, social policy is a complex and poorly-understood field, and the current challenges it faces are daunting. Canada badly needs open, informed public discussion on social programs – based on facts, serious analysis and reflection rather than the ideological baggage, rhetoric and myths that characterize the current 'debate' on social policy.

We propose a moratorium on changes to social programs and the income tax system until a comprehensive, in-depth review of these programs has been conducted. Such a review must ensure full participation of all interested parties including key federal departments, other levels of government, business, labour, social policy and service agencies, and consumer organizations.

The review should assess the objectives and purposes of social programs in light of changing economic, demographic and social pressures. In response to demands that arise primarily from the economy, the review should explore labour market policies and programs, Uunemployment Insurance, the welfare system and tax/transfer integration. With respect to demographic trends, there should be a careful assessment of public and private pensions as well as health care reform and community-based personal supports. Social pressures demand consideration of programs such as child care, child benefits and child support. The review also should consider the fiscal arrangements that permit federal transfers to the provinces for health and post-secondary education under Established Programs Financing and for welfare and social programs under the Canada Assistance Plan.

ii. key themes

Whether or not you decide to undertake a formal review, the following themes should guide your social policy agenda.

The federal government should reaffirm its traditional role of leadership in social policy. Special effort will be required to repair the strained federal-provincial relations that have resulted, in large part, from Ottawa's unilateral decisions to offload transfers for social programs. Federal-provincial cooperation was crucial in building Canada's social programs; it is required once again to effect their reform.

Social programs should be recognized explicitly as a vital part of Canada's economic and social fabric rather than being portrayed as a financial drain. Moreover, social programs cannot on their own solve poverty, unemployment and other fundamental problems. We need economic and social policies that will reduce high and chronic unemployment, create decent jobs and equip Canadians with the educational and technical skills required to compete in a global economy. The current vogue for 'active social programs' means nothing unless there are real job opportunities. Moreover, social and economic policies must be better integrated to reduce the pressures on existing programs and to generate the tax revenues needed to finance employment-related and social programs.

Your government should examine the inordinate power that the Finance Department has assumed in the development and implementation of social policy. Moreover, the veil of secrecy under which it has been allowed to operate – e.g., producing budgets which provide little or no information on the nature, cost and distributional impact of its policy measures – should be lifted immediately. There should be full and open accounting of social expenditures – both direct costs and tax expenditures.

Finally, any proposed changes to social programs or to the tax system should examine and assess how these changes will affect the poor.

iii. specific issues

In addition to the general themes, there are several specific areas that we believe should be priority issues for your government.

The aging of the population, combined with the growth of the low-wage sector of the labour market, will result in a massive increase in the number of elderly poor unless steps are taken to reform the pension system and to increase the proportion of decently-paid jobs.

The clawback on Old Age Security is a pernicious measure that will reduce or remove old age pensions from more and more middle-income Canadians. It will deceive them into thinking that they have a pension when they retire. One option for pension reform is to replace Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance with a single, fully-indexed income-tested program – in short, a larger Guaranteed Income Supplement – for low and modest-income people ages 60 and older. Such a plan would have to be phased in so as not to hurt those in or near retirement.

Tax programs related to the pension system are costly and should be reassessed. The age credit could be dropped and the resulting savings used to help finance the program proposed above. Tax deductions for RRSPs and Registered Pension Plans could be converted to non-refundable credits. Because credits are deducted from tax payable, they are worth more in relative terms to persons with low incomes. As a general rule, costly and regressive tax expenditures should be limited or scrapped entirely.

Programs for low-income families should be improved. Your government should consider the possibility of working with the provinces to develop an integrated child benefit and low-income tax credit that would replace the child tax benefit, refundable GST credit, provincial refundable tax credits and welfare payments for children. The new credit would increase child benefits for low-income families as well as reduce the income and consumption tax burden on poor households. The federal government also should work with the provinces, business and child care organizations to address the need for high quality, affordable child care.

Ottawa should stem the erosion of EPF transfers to maintain its capacity to uphold the Canada Health Act. Your government should renew its commitment to high quality health care and, in so doing, should never permit experimentation with user fees. In addition, Ottawa should lift the cap on CAP until it is able to negotiate with the provinces an acceptable and adequate cost-sharing arrangement for welfare and social programs.

iv. Caledon review

Over the next few years, the Caledon Institute of Social Policy will be conducting an independent review of social programs. We recently completed in-depth studies of social spending and of federal changes to social programs. We have begun to explore options for pension reform. We are examining fiscal federalism and possible changes to federal-provincial fiscal arrangements. We have analyzed the interaction of the welfare and tax/transfer systems in Ontario, in particular, and have modelled numerous options for reforming these systems. Our other areas of work include labour market and employment initiatives, income security programs and social services, such as child care and personal supports for the elderly and persons with disabilities.

The Caledon Institute looks forward to engaging your government in an open and informed debate on social policy. We look forward as well to helping you rebuild, strengthen and reaffirm the federal commitment to and national leadership for Canada's social programs.

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