# *Income Support in the Canadian Federation:*

## *International and Interprovincial Comparisons and Future Directions*

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THIS IS A BROAD-BRUSH REVIEW OF INCOME SUPPORT in the Canadian federation, written in the spirit of Ian Stewart, whose versatility and energy far exceed mine, but whose social values and commitment to macroeconomic stabilization and social policy I fully share. There are three sections. In the first section, I place Canada's public expenditure on income support in international perspective. In the second, I highlight the significant variation in spending on income support that exists across Canadian provinces. In the third section, I single out a couple of areas where progress would seem desirable in Canada on the basis of the international and interprovincial context presented in the first two sections. The two areas are old age and family policy.

1 For comments and advice, I am greatly indebted to Keith Banting, John Richards, the two editors, and participants in the CSLS session on *New Directions for Intelligent Government in Canada* at the June 2011 annual meeting of the Canadian Economics Association at the University of Ottawa.

## *Income Support in International Perspective*

Let me begin with the international perspective. The OECD distributes government social expenditure into nine categories: old age, survivors, incapacity, family, unemployment, social assistance and social services, health, housing, and active labour market policies. All areas include in-kind benefits (such as residential care, home help, child care, etc.) as well as cash transfers.[2] In this paper, I take "income support" to mean aggregate national spending in the first six areas. Hence, health, housing, and active labour market policies are excluded from consideration.

To illustrate with Canadian data, "old age" includes the Old Age Security pension, the Guaranteed Income Supplement (GIS), Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) retirement pensions and the regular spouse allowance. "Survivors" comprises the widowed spouses allowance, the surviving spouse's pension, the orphan's benefit and the death benefit. "Incapacity" adds up the disabled contributor's child benefit, the regular disability pension, the veterans' pension, workers' compensation, and Employment Insurance (EI) sickness benefits. "Family" refers to the Canada Child Tax Benefit, EI and Quebec parental leave benefits, and in-kind childcare benefits. "Unemployment" combines regular, fishing, work sharing and older workers adjustment benefits. "Social assistance and social services" bring together the GST/HST tax credits, provincial and municipal social assistance and social services, federal social assistance and social services for registered Indians, and in-kind services for new migrants and refugees.[3]

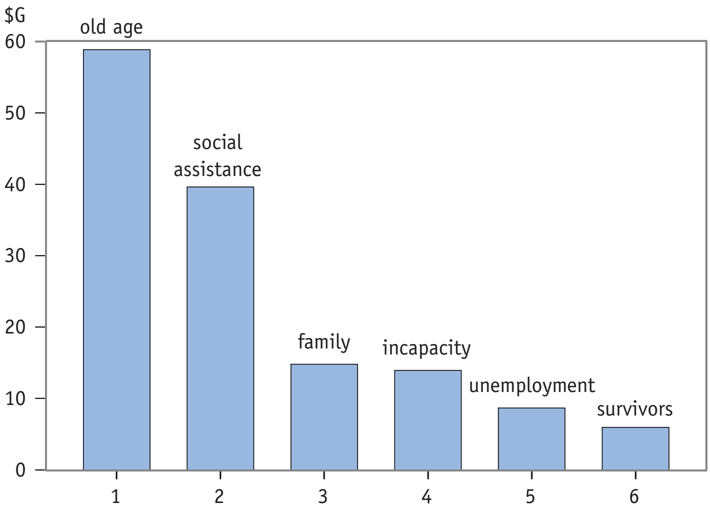
In 2007, for the 22 OECD countries that are listed in Table 1,[4] old age accounted for about 50 per cent of total spending on income support on aver-

2 Refundable tax credits are included in cash transfers, but other elements of income taxation are not.

3 In OECD taxonomy, social assistance and social services is a residual category called "other social policy areas".

4 There are 34 member countries in the OECD. The group of 22 countries in the table excludes those that are either very small (Iceland, Luxemburg), emerging (Chile, Mexico, Turkey), or in transition (Czech Republic, Estonia, Hungary, Israel, Poland, Slovakia, Slovenia). The year 2007 is the last one for which OECD data are currently available. Use of this year therefore avoids the cyclical distortion of 2008-2009. OECD averages are unweighted.

**Chart 1**
**Breakdown of Spending on Income Support into Six Categories, Canada, 2007**




Source: OECD.

age, family and incapacity 15 per cent each, unemployment and survivors 7 per cent each, and social assistance and social services 5 per cent.[5] Chart 1 breaks down Canada's expenditure on income support into these six categories. The OECD estimates that Canada spent $142 billion in income support in 2007, equivalent to 9.3 per cent of nominal GDP. Together, old age and social assistance and services accounted for 69 per cent of the total, followed in decreasing order by family, incapacity, unemployment, and survivors.

How does the Canadian income support/GDP ratio compare to those of other OECD countries? Canada is among the small spenders. As Table 1 indicates, in 2007 Canada was near the bottom of 22 OECD countries in terms of spending on income support. Canada ranked 20th out of 22 OECD countries, with only the United States and Korea lower. The United Kingdom, New

5 Canada is an outlier here, with 28 per cent of its spending on income support attributed to social assistance and social services in 2007. Most likely, the OECD found it impossible to distribute provincial and municipal social services properly across the other five areas, and so left them in this residual category.

Zealand, Ireland, and Australia were ranked slightly above Canada. Sweden, France, Austria, Belgium Denmark, Finland, Italy and Germany were the top eight spenders.

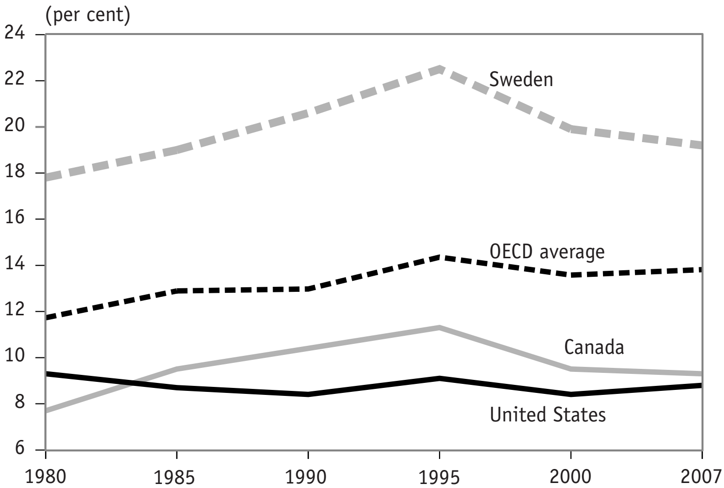
**Table 1**
**Expenditure on Income Support in 22 OECD Countries, 2007, (per cent of GDP)**

| Rank | Country | Exp./GDP |
|---|---|---|
| 1 | France | 19.3 |
| 2 | Sweden | 19.2 |
| 3 | Austria | 18.8 |
| 4 | Belgium | 17.7 |
| 5 | Denmark | 17.6 |
| 6 | Finland | 17.6 |
| 7 | Italy | 17.6 |
| 8 | Germany | 16.1 |
| 9 | Portugal | 15.4 |
| 10 | Greece | 14.9 |
| 11 | Spain | 14.5 |
| 12 | Norway | 14.4 |
| 13 | Netherlands | 12.6 |
| 14 | Japan | 12.3 |
| 15 | Switzerland | 12.3 |
| 16 | United Kingdom | 11.9 |
| 17 | New Zeland | 10.1 |
| 18 | Ireland | 9.7 |
| 19 | Australia | 9.6 |
| **20** | **Canada** | **9.3** |
| 21 | United States | 8.8 |
| 22 | South Korea | 4.1 |
| | *Unweighted Average* | *13.8* |

Source: OECD.Stat databank.

**Chart 2**

**Government Expenditure on Income Support in Sweden, Canada, United States and OECD Average, 1980-2007 (per cent of GDP)**




Note: The OECD average is the unweighted average of same 22 countries as in Table 1.
Source: OECD.Stat Databank.

How has income support evolved internationally over time? Chart 2 shows that, as a group, advanced countries increased their effort in supporting incomes until the mid-1990s. Since then, the average effort has remained on a plateau around 14 per cent of GDP. The chart singles out one of the top spenders (Sweden) as well as two small spenders (Canada and the United States). In the United States, spending on income support as percentage of GDP has been low (9 per cent of GDP), but basically trendless, throughout the 1980-2007 period. The trend was upward until the mid-1990s in Sweden (up to 22 per cent of GDP) and in Canada (up to 11 per cent of GDP). Since then, it has declined somewhat in these two countries. After 1995, Canada and Sweden both recovered from long and painful recessions and introduced programmatic changes. In Canada, unemployment insurance at the federal level and social assistance in provinces were main targets of reform.

It is instructive to compare government expenditure in Sweden, Canada and the United States by income support category. The OECD estimates that in

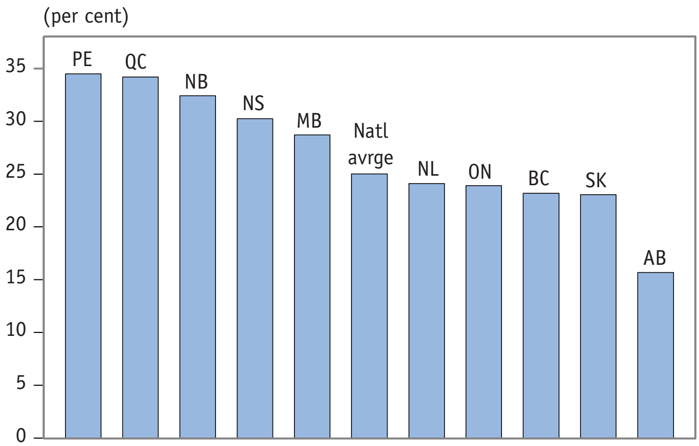
2007 the amounts spent for old age were 9 per cent of GDP in Sweden, 3.8 per cent in Canada and 3.2 per cent in the United States.[6] Sweden's greater effort is due partly to the share of its 65-and-over population being 40 per cent larger than in Canada and the United States, and partly to more generous pensions and an extensive network of residential care facilities and home-help services. Despite spending only 40 per cent as much as Sweden for old age, Canada has targeted the low-income elderly successfully, thanks mainly to the GIS. Another area where Sweden spends a much greater fraction of its GDP than the United States or Canada is incapacity-related income support. Disability pensions, paid sick leaves and in-kind residential care and home help are all more developed in Sweden. Family benefits are also larger in that country, not because family allowances are higher, but because parental leaves are more extended and generous and there is universal low-fee childcare. Access to generous unemployment insurance benefits is also easier in Sweden, but continuation of benefits beyond a certain point is generally conditional on participation in an active labour market program.

## *Income Support in Interprovincial Perspective*

Is there a connection between the degree of income support offered by a country as a whole and its status as a federation or a unitary state? Political decentralization could affect the *average level* of the income support/GDP ratio or the *dispersion* of this ratio across component states. Simple regression analysis of the data provides no evidence of a significant positive or negative correlation between the average country-level of the income support/GDP ratio and the fact of being a federation, which I assume to be the case for 8 of the 22 countries (Australia, Belgium, Canada, Denmark, Austria, Spain, Swit-

6 The official OECD estimate for old age support in the United States is 5.3 per cent of GDP. However, this figure includes the retirement pensions federal, state and local public employees receive from their employers over and above their Social Security pensions. Removing this item from the U.S. estimate to make it comparable to the Swedish and Canadian estimates gives 3.2 per cent of GDP.

## Chart 3
## Total Nonfederal Government Expenditure as a Percentage of Provincial GDP, 10 Canadian Provinces, 2007




Source: Statistics Canada.

zerland and the United States).[7] More sophisticated multivariate explorations tend to conclude that political decentralization does affect income support negatively.[8]

Be that as it may, federations obviously have the theoretical potential for allowing greater dispersion of income support across their component states. The actual outcome depends on how constitutional powers are shared, how large and how differentiated federal transfers are across states, how decentralized the power of taxation is, and to what extent it is actually exploited. Charts

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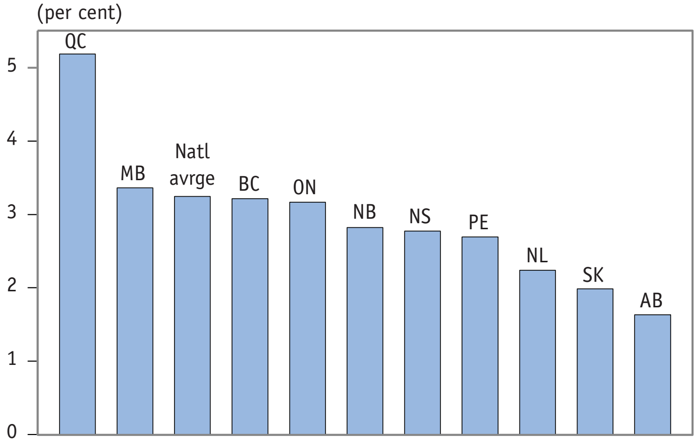
7 The result is:

$$INCSUPP/GDP_i = 14.1 - 0.7{*}FEDERATION_i, \quad R^2 = 0.01 ,$$
$$\qquad\qquad (1.1) \quad (1.7)$$

where $INCSUPP/GDP_i$ = 2007 income support/GDP ratio in country i, $FEDERATION_i$ = 1 if country i is a federation and 0 otherwise (i = 1, 2,..., 22), R = correlation coefficient, and standard errors are in parentheses. The non-significance of the correlation holds whether Spain is considered to be a federation or not, and whether the United States is included in the sample or not.

8 See, for instance, Swank (2002). Swank further argues that globalization has not contributed to the retrenchment of developed welfare states.

**Chart 4**
**Provincial and Local Expenditure on Social Assistance, Workers'Compensation and Other Social Services as Percentage of Provincial GDP, 10 Canadian Provinces, 2007**




Source: Statistics Canada (Financial Management System)..

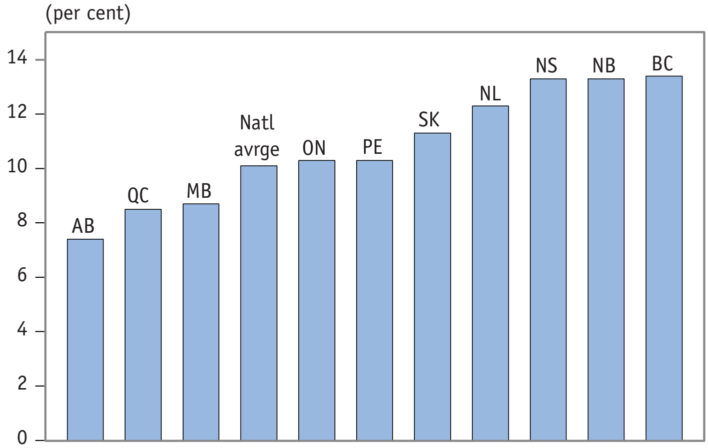
3 and 4 respectively indicate how variable total nonfederal expenditure and income support spending were across Canadian provinces in 2007.

Chart 3 first pictures interprovincial differences in total nonfederal expenditure. All current and capital expenditures of provincial and local governments and Canada and Quebec Pension Plans are included in this aggregate, not only expenditure on income support.[9] The range goes from 16 per cent of GDP in Alberta to 34 per cent in Prince Edward Island. This variance is large.[10] The chart also underlines the important fact that total nonfederal spending/GDP ratios in the three Maritime Provinces and Quebec significantly exceed the

9 For interprovincial comparisons to be valid, either CPP/QPP spending should be included in the total expenditure of every province, or it should be excluded everywhere. The first of these two options is retained here. This has an impact of the heights of the bars in Chart 3, but a negligible effect on their dispersion across provinces, which is the object of scrutiny.

10 The dispersion of government spending/GDP ratios across provinces is magnified somewhat by per capita GDP being very low in Prince Edward Island and very high in Alberta. Nevertheless, the dispersion remains large even if one takes this into account.

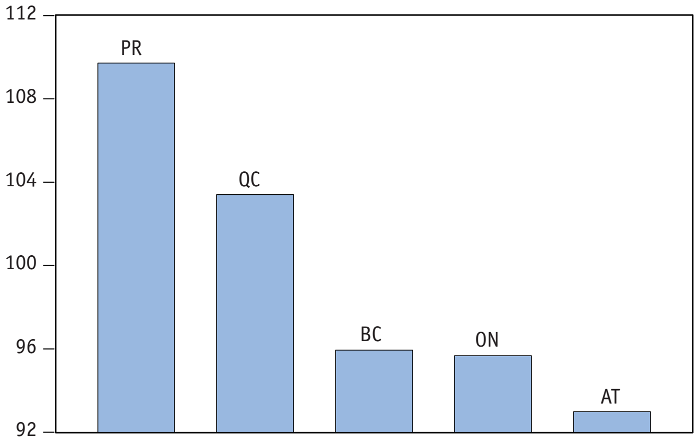
**Chart 5**
**Absolute Poverty Rate, 10 provinces, 2007**
(percentage of population in households whose after-tax income does not allow them to purchase a modest basket of goods and services)




Source: Human Resources and Skills Development Canada.

national average. It is well-known that these four provinces receive federal equalization payments. These federal transfers represent a larger fraction of their provincial GDP than is the case for provinces that do not receive equalization payments. Table 2 further shows that the contribution of above-average federal transfers to above-average nonfederal spending/GDP ratios is much larger in the Maritimes than in Quebec. In 2007, 96 per cent of the high nonfederal spending/GDP ratio in the Maritimes came from above-average federal transfers. In contrast, Quebec financed its above-average nonfederal spending/GDP ratio largely through above-average own-source taxation. Only 16 per cent came from above-average federal transfers.

**Chart 6**
**After-Tax Purchasing Power of Individuals in Economic Families with Two Persons or More Belonging to the Lowest Regional Quintile of Adjusted Family Income, 2007**
(national average=100)




Source: Human Resources and Skills Development Canada.

**Table 2**
**Contributions of Above-average Federal Transfers and Above-average Own-source Taxation to Above-average Nonfederal Spending in the Maritime Provinces and Quebec, 2007**
(percentages of GDP)

| Contribution from: | Maritime Provinces | Quebec |
|---|---|---|
| Above-average federal transfers (%) | 96 | 16 |
| Above-average own-source taxation (%) | 4 | 84 |
| Total (%) | 100 | 100 |

Note: The Maritime Provinces include Prince Edward Island, Nova Scotia and New Brunswick. “Own-source taxation” includes straight tax revenue, income from government enterprises, and borrowing (which amounts to postponed future own-source taxation).
Source: Calculations based on Statistics Canada’s *Provincial and Territorial Economic Accounts: Data Tables*, Cat. no. 13-018-X (CANSIM table 384-0004), November 2010.

Chart 4 turns to interprovincial differences in income support spending. It shows that the Quebec exception carries into this area. While most provinces spent about 3 per cent of their GDP on nonfederal income support in 2007, the percentage in Quebec was 5 per cent, which is $6 billion more than if it had conformed to the national average. Manitoba is also somewhat above average at almost 3.5 per cent, and Alberta is below average at 2 per cent. Do these interprovincial differences in income support lead to concrete results in terms of lower poverty rates? There is no fool-proof evidence. I only have two suggestive observations to draw from absolute poverty rates and the position of the lowest disposable income quintile across regions of Canada.

Absolute poverty should be low if the province is very rich, does not have conspicuously large pockets of deep poverty, and/or provides solid support to low incomes. It can be seen in Chart 5 that, in 2007 again, absolute poverty is low in rich Alberta, and is held down by income support spending in Quebec and Manitoba.[11] At the other end, the challenging problem of high poverty in British Columbia emerges clearly.

Chart 6 in turn shows that after-tax purchasing power of the lowest income quintile also varies significantly across Canadian regions, with the Prairies and Quebec again doing significantly better than the national average.[12] Quebec's commitment to social policy has been made concrete by a number of measures that have been adopted after 1995: the Prescription Drug Insurance Plan, the Reduced-Contribution Educational Childcare Program, the Child Assistance Measure, the Work Premium, the Parental Insurance Plan, pay equity legislation, and a policy of maintaining the minimum wage around 47 per cent of the average wage. The province's effort to step up the fight against poverty was

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11 The absolute poverty rates reported in Chart 5 are from Human Resources and Skills Development Canada, *Low Income in Canada: 2000-2007, Using the Market Basket Measure*, Final Report, Publication SP-909-07-09E, August 2009, Tables 8a to 8j.

12 Average regional after-tax incomes of families in the first quintile (adjusted for family size) are from Statistics Canada, *Income in Canada 2009*, Cat. no. 75-202-X (CANSIM table 202-0706), June 2011. Statistics Canada calculates these from its Survey of Labour and Income Dynamics (SLID). I further adjust the numbers by the relevant inter-city indexes of consumer retail prices based on Statistics Canada, *The Consumer Price Index*, Cat. no. 62-0001-X (CANSIM table 326-0015), March 2009.

enshrined in its 2002 Act to Combat Poverty and Social Exclusion. This has helped focus political discussion and has generated obligations for government in the area of anti-poverty policy.

## *Two areas where progress could be made*

Based on the international and interprovincial comparisons I have presented, I want to conclude by singling out two areas where intelligent government could find new directions for income support in Canada. They pertain to old age and family. I have a few remarks to offer on old age policy, and a larger set of observations on family policy.

In the old age area, there does not seem to be a need for a broad-based increase in government cash benefits. But an important challenge arises from the incipient explosion of demand for residential care and home help. The rising pressure originates from population aging. According to Statistics Canada's medium-growth scenario,[13] by 2035 the 65-and-over population will be twice as large as today, and by mid-century the 85-and-over population will be four times as large as today. In addition to putting our healthcare system to severe test, this will lead to a sharp increase in older Canadians' needs for residential care and home help services.

In this respect, two key developments are, first, that the boomers have two to three times fewer children than current and past older Canadians to take care of them when their physical and mental condition deteriorates; and second, that 85 years old is an age beyond which more than half of persons suffer from severe chronic ailments such as Alzheimer's disease. These two trends will likely lead to an explosion of demand for long-term residential and home care. Access to this kind of continuing care will be beyond the financial means of a large fraction of the elderly, and they will naturally turn to government as the last-resort provider. It is with this explosion of demand in mind that the Canadian Medical Association recently came to emphasize the need for expanding the number of long-term care facilities (CMA, 2010). This may or may not be the best or the only solution, but

13 According to Statistics Canada's "M4 medium-growth projection scenario", the 65-and-over population will increase from 5.0 million in 2011 to 10.2 million in 2035, and the 85-and-over population from 675,000 in 2011 to 2,850,000 in 2050 (CANSIM Table 052-0005).

there is clearly an urgent need to recognize the problem and to discuss intelligent policy alternatives.

On family, the most important finding of recent decades is that early childhood plays a fundamental role in the building of human capital for the life cycle. Neurology emphasizes three brain phenomena in the first few years of life: the interconnection of neurons or synaptogenesis; the development of myelin; and the expansion of glial cells. Psychology has found that brain development responds to the kinds of environment to which young children are subjected, and that traumas in early childhood can cause damage that is often difficult to repair afterwards. As for economists, they have calculated that returns from investment in early childhood are very large (Cunha *et al.*, 2011, and Almond and Currie, 2011). The benefit-cost ratio for this type of investment has been estimated to be many times as large as the corresponding ratios for investment in primary, secondary and college education.

In the past 15 years, Quebec has adopted a Scandinavian-type family policy that has been explicitly motivated by these pieces of evidence from neurology, psychology and economics. The Quebec package includes three programs. First, since 1997 full-day kindergarten (the *école maternelle*) has been offered to all 5-year-olds. Second, since 2000 an Educational Childcare (EC) program has been offered to all children aged 0 to 4, initially at a reduced fee of $5 a day and then at $7 since 2004, mainly through regulated early childhood centres (*centres de la petite enfance*) and family-based child care. Before- and after-school programs have also been made available at $7 a day to all primary-school children. Third, since 2006 the province's Parental Insurance Plan has taken over administration of Employment Insurance parental leave benefits and has significantly enhanced their level and duration. The three stated goals of Quebec's Educational Childcare Act are to "foster the development and well-being of children, provide them with equality of opportunity, and help parents reconcile their parental and professional responsibilities." Access to these programs is universal.

Quebec's $7-a-day EC program currently covers 50 per cent of all pre-school children at an annual cost to the provincial government of $10,000 per subsidized place.[14] However, the favourable tax revenue feedback to provincial and federal treasuries is so large that the reduced-fee program has been estimated to more than pay for itself. The reason that the tax feedback is so large is that the EC program has been hugely popular.[15] Three recent micro-econometric studies have suggested that it has had a major impact on mothers' employment rates.[16] Based on these studies, Luc Godbout, Suzie St-Cerny and I have calculated that by 2008 Quebec's EC program was responsible for increases of 3.8 per cent in women's aggregate employment and 1.7 per cent in provincial GDP. A corollary of this finding is that every $1 of provincial spending on EC generated $1.50 of additional tax revenue, including $1.05 for the provincial government and $0.45 for the federal government (Fortin *et al.*, 2011).

Now, purely economic benefits are neither necessary nor sufficient for any government program to be a good program. Quebec's EC program clearly helps parents "reconcile their parental and professional responsibilities", but it no doubt can still be improved in "fostering the development and well-being of children and providing them with equality of opportunity". Recent studies of resources, organization and outcomes in early childhood centres suggest that future efforts in Quebec should focus on enhancing the general quality of EC services, particularly through improved training of personnel (see Japel *et al.*, 2005). In general, it is to be expected that disadvantaged children would on average benefit more from EC programs than children from more advantaged backgrounds.[17] Fortunately, so far low-income working families participate in Quebec's EC program nearly as much as middle- and high-income working families (66 per cent vs. 74 per cent) (Institut de la Statistique du Québec,

14 In the rest of Canada, the percentage of pre-school children in regulated care was 21 per cent in 2008. See Beach *et al.* (2009), Section 3, Table 9.

15 In 2009, 92 per cent of users of centre- and family-based regulated childcare said that the EC program fully matched their preferences. See Institut de la statistique du Québec (2011), Table 6.8.

16 They are: Baker *et al.* (2008), Lefebvre *et al.* (2009), ; Lefebvre *et al.* (2011).

17 Evidence for this proposition abounds. For Canada, see Baker (2011).

2011, Table 6.1). In addition, Quebec offers special programs that target the needs of children whose families are on social assistance.

An important question for Canada is therefore whether other parts of the country should follow the universal, Scandinavian-type family policy Quebec has adopted, or whether they should stick to EC programs that are purely targeted at the at-risk children. My view is that Canada does not need to choose between universality and targeting, but that it can have both at a bargain price. If universality generates more tax revenue than expenditure, then with federal-provincial cooperation the difference can be used to finance the high-quality targeted interventions that are deemed most useful.

Furthermore, I see a number of reasons why a universal EC program is desirable per se. First, the Quebec experience indicates that families strongly prefer the current reduced-fee, regulated universal EC system over the traditional system, even with equivalent income tax deductions or credits.[18] Second, a universal EC program allows greater interaction between children from middle- to high-income families and those from lower-income families. This contributes to class rapprochement in the long run. Third, the message a universal EC program *cum* a parental leave program gives to young middle-class families is that they do obtain something tangible in return for the taxes they pay. This could help stabilize political support for social policy in general.

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18 Quebec parents can always choose to send their children to an unsubsidized private provider of childcare services outside of the universal EC program. Finances Quebec indicates that, for family incomes up to $125,000, the net after-tax daily cost is about the same in an unsubsidized space in private daycare as a subsidized facility (source: www.budget.finances.gouv.qc.ca/Budget/outils/garde_fr.asp). However, only 5 per cent of families with children in daycare choose the unsubsidized option.

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