Income Security Reform and the Concept of a Guaranteed Annual Income

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Introduction

Substantial public funds are currently committed to the income security of the working-age population through such programs as unemployment insurance, social assistance, and refundable tax credits. Despite the major commitment of public resources, however, the eradication of poverty remains an elusive goal.

Admittedly, reducing poverty is only one of the objectives of the income security system. However, poverty is by far the most pressing issue and, in an environment of increasingly tighter fiscal resources, there is growing pressure for a better method of targeting income transfers to alleviate it.

There is widespread dissatisfaction with the current income security system. Social assistance programs focus on the immediate problem of income need and do little to encourage self-reliance. The system does not emphasize training and improving employability, and the benefit structure discourages work effort and acts as a "welfare trap." A focus on the non-working poor and the neglect of the working poor exacerbate the situation.

Similarly, the current Unemployment Insurance (UI), the costliest of all the income security programs, has been widely criticized on the grounds that it

- contributes to an increase in the duration of unemployment,
- increases the volume of temporary lay-offs,

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- reinforces the concentration of temporary and unstable jobs in high-unemployment and low-wage regions, and
- provides too generous a subsidy to Canadians whose labour-force behaviour is characterized by repeated unstable employment. (Royal Commission on the Economic Union and Development Prospects for Canada 1985, p. 611)

The Guaranteed Annual Income Idea

More than 30 years ago, Milton Friedman proposed the wholesale replacement of existing income security programs with a simple negative income tax (Friedman 1962, pp. 190-195). Under his proposal, households with "negative taxable incomes" (incomes below the level of exemptions and deductions) would pay "negative taxes," that is, they would receive subsidies, at a 50 percent rate. For example, a household of a certain size with exemptions of $8,000 and an income of $6,000 would receive a $1,000 subsidy. The household with no income at all would receive a $4,000 subsidy. The latter amount effectively constitutes an income floor, or a minimum guaranteed annual income, for all households of a given size.

Despite the controversial nature of the specifics of his proposal, the basic concept of a guaranteed annual income (GAI) has received wide-ranging support across the entire ideological spectrum. No other contemporary social policy idea has attracted as much attention or stimulated as much research and intellectual activity. The GAI idea attracted support because it was viewed as a universal plan to eradicate poverty; eliminate the welfare trap that penalizes recipients excessively if they work; redress current inequities toward the working poor, who are largely ignored by traditional welfare programs; and simplify what many have long believed is an unnecessarily complex and expensive administrative system.

During the last 30 years, a variety of schemes has been developed, studied, and proposed. They range from a wholesale replacement of most existing income security programs to incremental changes, such as earnings supplements to strengthen work incentives (as in the case of the Aide aux parents pour leurs revenus de travail [APPORT] program in Quebec).

Some schemes involve the tax system. The original idea of negative income taxes and the federal Child Benefit, which is a refundable tax credit, are two examples. Other schemes, such as the Guaranteed Income Supplement for those 65 and older, involve a separate administration, independent of the income tax system.

Today, the GAI concept implies, not a specific program design, but certain generic attributes. GAI schemes advocate

- household income as the main determinant of the level of benefits,
- a gradual reduction of benefits as earnings increase to encourage self-sufficiency and ensure that individuals are better off working than not working, and
- a simple administration, with minimum intrusion into family affairs and limited or no bureaucratic discretion.

Despite the impressive intellectual activity stimulated by the GAI idea, only modest progress has been achieved in the policy field. There are a number of reasons for this: concerns about the cost of a universal GAI program; political reluctance to introduce a wholesale replacement or radical down-scaling of existing programs, such as UI; uncertainty about potential work incentive effects on the working poor not currently on social assistance; and federal-provincial jurisdictional issues.

However, there is renewed interest in the GAI idea. Increasingly, it is viewed as a means of rationalizing the current system, dealing with the fiscal crisis, and reinforcing work incentives and self-reliance. For example, current proposals by the Ontario government to "abolish the welfare system as we know it in Ontario" involve GAI concepts (Ontario. Ministry of Community and Social Services 1993, p.9).

Study Objectives and Outline

This study is a modest attempt to present the GAI concept in non-technical language in order to provide a better appreciation of its relevance in the current policy environment. It does not attempt to break new ground in this very extensively researched area, nor does it attempt to provide a comprehensive review of the voluminous GAI literature. Instead, the study contains a selective review of key studies and policy initiatives to reveal the potential and challenges of the GAI concept. Also, a simple GAI program is outlined, not to advocate a specific program with all its parameters, but rather, to illustrate the GAI concept with the aid of a concrete example.

The focus of the study is the working-age, low-income population. The elderly population is excluded from the analysis because there is already a *de facto* GAI system for those over 65, consisting of the Old Age Security (OAS) program, the Guaranteed Income Supplement (GIS), and provincial top-ups (such as the GAINS program in Ontario).

First, a profile of the low-income population is presented, with particular attention paid to volatility of income and employability. An overview of the main components of the current income maintenance system follows. The main weaknesses of the system and some recent initiatives to address them are then discussed.

The concept of a GAI is outlined and a selected number of proposals reviewed. Finally, a simple GAI program is considered, which includes rough cost estimates and some discussion of a deficit-neutral implementation strategy involving a reform of the existing UI program.

Profile of the Working-Age Poor

The strength of the case for a GAI depends crucially on the extent to which low-income individuals are employable and, therefore, on the extent to which they can be encouraged to become financially more self-sufficient through a GAI. Here, three particular aspects of the profile of the working-age poor are considered: the extent of poverty among them,the degree of volatility of both their income and their dependency on social assistance, and the extent of their physical employability and employment prospects.

The study findings regarding both the income volatility of the low-income population and their potential employability strengthen the case for a GAI. They demonstrate that there is great potential for encouraging self-sufficiency among social assistance recipients. Furthermore, they show that the population that could benefit from work incentives is not simply those currently on social assistance, but a much broader group at risk of requiring social assistance.

In this section, the following aspects of the study are discussed:

- the definition of poverty lines and the Survey of Consumer Finances, which is the main source of data,
- estimates of the extent of poverty among the working-age population,
- the volatility of both low-income status and reliance on social assistance,
- evidence of the physical employability of the low-income population,
- the marketability of the skills of the low-income population, and
- the main conclusions and the key implications in favour of a GAI program.

Technical Background

Poverty Lines

The definition of poverty lines is a controversial issue. For this analysis, the poor population has been defined according to the Statistics Canada Low-Income Cut-Off (LICO) lines (Table 1). The LICOs are based on household expenditure patterns in 1986 and have been adjusted to 1990, that is, to the cost of living escalation since 1986. Statistics Canada has not endorsed the LICOs as poverty lines; they are used here only to identify low-income family units and study their profile.

Table 1
Statistics Canada's Low-Income Cut-Offs for 1990

	Community Size				
Household size	Cities of 500,000+	100,000-499,999	30,000-99,999	Less than 30,000	Rural areas
1	$14,155	$12,433	$12,146	$11,072	$9,637
2	19,187	16,854	16,464	15,008	13,064
3	24,389	21,421	20,926	19,076	16,605
4	28,081	24,662	24,094	21,964	19,117
5	30,680	26,946	26,324	23,997	20,887
6	33,303	29,248	28,573	26,047	22,672
7+	35,818	31,460	30,734	28,017	24,385

NOTE Based on household expenditure patterns in 1986 and adjusted for cost of living increases to 1990.

SOURCE National Council of Welfare, *Poverty Profile, 1980-1990,* Autumn 1992.

The Survey of Consumer Finances

The analysis of the extent of poverty and the characteristics of poor family units relies extensively on the 1990 Survey of Consumer Finances (SCF). In the final section, the same database is used to simulate the implications of an alternative GAI plan.

The SCF, an annual household survey, is the most comprehensive survey of household characteristics and incomes. It contains detailed information about the demographic and labour market characteristics of the adult Canadian population. Most empirical studies in Canada related to income distribution, poverty, and the simulation of social programs rely on data from the SCF. The survey used here was conducted in April 1991 and contains information about individual incomes in 1990.

The analysis covers single persons — persons not in families — and census families. The latter are families, living together in the same dwelling, consisting of either a husband and wife with or without children who have never married or one parent with one or more children who have never married.[1] Here, the term family unit refers to *both single persons and families.*

Low-income status is defined using Statistics Canada LICO lines. The focus of the analysis is non-elderly family units, i.e., single persons under the age of 65 and census families with the head and spouse, if present, under the age of 65.

There is considerable underreporting or non-reporting of government transfers in the SCF. In particular, there is about 50 percent underreporting of social assistance payments, including non-reporting. As a result, the incidence of poverty and the magnitude of the poverty gap — low-income lines minus actual income — are overstated by the SCF data, while the number of social assistance recipients is understated. However, although the absolute estimates may be biased, relative estimates are still reliable. In other words, while the absolute incidence of poverty is overstated, the relative incidence of poverty by family unit characteristic is valid.

The Extent of Poverty

According to the SCF data, there were approximately 1.8 million non-elderly family units (single persons and census families) with incomes below the Statistics Canada LICO lines in 1990 (Table 2). This represents approximately 3.5 million individuals.

As indicated, the SCF data estimate can be treated as a measure of the extent of poverty subject to two qualifications: the definition of poverty is subjective and the LICO lines have not been officially endorsed as poverty lines; and the SCF data overstate the extent of poverty because of underreporting of government transfers.

The incidence of poverty was highest among single mothers (51 percent) followed by single persons (33 percent). However, because single persons are four times as numerous as single mothers, they account for over one-half of all poor family units, while single mothers account for one-in-five poor family units.

According to the SCF, one-in-three poor family units received social assistance in 1990. The actual number is considerably higher because, as mentioned above, there is extensive under- or non-reporting of social assistance payments. Assuming the extent of underreporting or non-reporting is more or less uniform across family unit characteristics, the SCF data provide an interesting insight.

Table 2

Incidence of Low-Income and Social Assistance, by Type of Family Unit, 1990

	All family units	Low-income family units receiving social assistance	Low-income family units not receiving social assistance	All low-income family units
Number of Family Units by Type of Unit and Income Status				
Single persons	2,876,857	277,441	665,696	943,137
Couples/no children	1,614,223	38,289	101,139	139,428
Couples/with children	3,683,482	75,665	248,639	324,304
Single fathers	121,706	10,539	16,457	26,996
Single mothers	672,791	196,160	146,221	342,381
All family units	8,969,059	598,094	1,178,152	1,776,246
Distribution of Family Units by Income Status				
Single persons	100%	10%	23%	33%
Couples/no children	100%	2%	6%	9%
Couples/with children	100%	2%	7%	9%
Single fathers	100%	9%	14%	22%
Single mothers	100%	29%	22%	51%
All family units	100%	7%	13%	20%
Distribution of Income Status by Type of Family Unit				
Single persons	32%	46%	57%	53%
Couples/no children	18%	6%	9%	8%
Couples/with children	41%	13%	21%	18%
Single fathers	1%	2%	1%	2%
Single mothers	8%	33%	12%	19%
All family units	100%	100%	100%	100%

NOTE The term single person refers to individuals not in families, while the term family refers to census families.

SOURCE Survey of Consumer Finances, 1990 incomes.

Low-income single mothers had the highest incidence of reliance on social assistance: three-in-five low-income mothers received social assistance in 1990. The second highest incidence of reliance on social assistance was among low-income single persons, one in three of them received assistance. Single persons accounted for 46 percent of all family units on social assistance, followed by single mothers who accounted for one in three.

Income and Employment Volatility

The low-income population is not static and well-defined. From year to year, large numbers of family units flow into and out of poverty, or onto and off social assistance. This is an important observation from the point of view of designing an effective income security system. It implies that the objective of income security is not simply to help a specific population but, also and more important, to affect in a favourable way the flow of individuals into and out of poverty, or onto and off social assistance.

There is considerable evidence of the income volatility of the low-income population. A recent study by the Economic Council of Canada (1992) provided a unique insight into the income volatility of the low-income population. In particular, the study showed that

> Some 39 percent of those who were in the lowest income quintile in 1982 had climbed to a higher quintile by 1986. Conversely, 40 percent of those who were in the lowest quintile in 1986 had dropped down from a higher quintile that they occupied in 1982. (p. 13)

These numbers do not include those who left a quintile, then returned to it within the five-year period. In fact, the study found dramatic changes in family incomes every year throughout this period.

Similar volatility can be observed with respect to the social assistance population. For example, according to the 1986-87 Labour Market Activity Survey (LMAS), each year one-third of social assistance recipients leave the system. Underlying this volatility is the diversity of circumstances of recipients. Some are on social assistance for a short period as a result of a temporary problem, such as a family break-up, a health problem, or economic recession. Others are caught in a cycle of low-paying intermittent employment, frequent dependency on unemployment insurance, and periodic return to social assistance.

Employability

A principal rationale for a GAI is to improve work incentives among the poor and eliminate the current "welfare trap." The underlying premise is that many of the employable poor are discouraged from achieving greater self-sufficiency because of work disincentives present in social assistance programs. The strength of the case for a GAI, therefore, depends very much on the extent to which the low-income population is employable.

The evidence suggests that most social assistance recipients are employable or at least potentially employable; with appropriate training, income supplementation, and support services, they can be successfully integrated into the labour force and eventually become financially self-sufficient. The following factors indicate that a large proportion of social assistance recipients are employable:

- *The Classification of Social Assistance Recipients.* According to provincial administrative definitions of employability, which differ from province to province, about half of social assistance recipients are classified as employable. However, this proportion may be higher because the classification ignores the number of social assistance recipients who could be integrated into the labour force if appropriate training and other support services were provided.

- *Presence of Earnings.* About two-thirds of all low-income family units had some employment earnings in 1990 (Table 3). Among family units receiving social assistance, 38 percent had some earnings in 1990, a direct indication of the extent of employability among social assistance recipients. Among non-recipient family units, close to 79 percent had some earnings in 1990.

Table 3
Presence of Earnings Among Low-Income, Non-Elderly Family Units, 1990

	Social assistance recipients	Non-social assistance recipients	All low-income families
Single persons	30%	76%	62%
Couples /no children	25%	75%	61%
Couples /with children	65%	92%	86%
Single fathers	46%	72%	62%
Single mothers	41%	76%	56%
All family units	38%	79%	65%

Source Survey of Consumer Finances, 1990 incomes.

Table 4

Distribution of Heads of Low-Income, Non-Elderly Family Units, by Work Experience, 1990

	Social assistance recipients	Non-social assistance recipients	All low-income units
Worked full-time for 50 weeks or more in 1990	5%	28%	20%
Worked less than 50 weeks or part time in 1990	29%	51%	43%
Last worked in previous 4 years	24%	9%	14%
Last worked more than 5 years ago or never worked	43%	12%	22%
All heads of low-income family units	100%	100%	100%

SOURCE Survey of Consumer Finances, 1990 incomes.

- Work Experience of Head of Family Unit. Focusing on the heads of low-income, non-elderly family units, the SCF data show that most individuals either worked in 1990 or had recent work experience. In particular, over one-third of all social assistance recipients worked in 1990, while an additional one-quarter worked in the previous four years (Table 4). Among non-recipients, 80 percent worked in 1990.

Table 5

Distribution of Heads of Low-Income, Non-Elderly Family Units, by Main Activity While Not Working or Looking for Work, 1990

	Social assistance recipients	Non-social assistance recipients	All low-income units
Unable to work	22%	9%	15%
Kept house	38%	18%	27%
Went to school	10%	40%	26%
Retired/idle	15%	18%	17%
Other	15%	15%	15%
All heads of family units	100%	100%	100%

SOURCE Survey of Consumer Finances, 1990 incomes.

- *Reasons for Not Working or Looking for Work* — Only a small percentage of low-income individuals are prevented from working or looking for work because of physical or health reasons. In particular, among heads of families who did not work or looked for work in 1990, only 22 percent of social assistance recipients and 9 percent of non-recipients did not work or look for work because they were unable to do so (Table 5).

Table 6

Distribution of Working Heads of Low-Income, Non-Elderly Family Units, by Full-Year Equivalent Level of Earnings, 1990

	Social assistance recipients	Non-social assistance recipients	All low-income units
Full-time employees			
Under $10,000	49%	38%	40%
$10,000-$19,999	42%	44%	44%
$20,000-$29,999	7%	13%	12%
$30,000 or more	2%	4%	4%
All full-time employees	100%	100%	100%
Part-time employees			
Under $10,000	71%	51%	56%
$10,000-$19,999	21%	39%	35%
$20,000-$29,999	6%	6%	6%
$30,000 or more	2%	4%	3%
All part-time employees	100%	100%	100%

NOTE Full-year equivalent earnings refers to potential earnings if a person worked 52 weeks a year, at his/her usual weekly hours of work.

SOURCE Survey of Consumer Finances, 1990 incomes.

Earnings Prospects

The major obstacle to employment of the low-income population is not physical but economic. Most low-income individuals are prevented from achieving financial self-sufficiency because of low earnings potential, shortage of low-skill jobs, and financial disincentives under existing social assistance programs. The Economic Council of Canada in 1992 concluded that

> Only a small proportion of the population is truly destitute and has virtually no opportunity for achieving some level of self-sufficiency. However, there are many Canadians whose income-earnings prospects are precarious. (p. 18)

An indication of the precarious nature of the earnings of the poor is that the majority of them would be below the poverty line even if they worked all year round. For example, 84 percent of those who worked full-time in 1990 (i.e., 36 or more hours per week) would have earned less than $20,000 even if they worked 52 weeks (Table 6). This means that even if all heads of low-income family units worked year round, most family units would still stay below the poverty line.

Lack of marketable skills leads to inadequate earnings; it also affects the employment prospects of individuals. According to the LMAS data, most social assistance recipients feel that they are prevented from finding employment not because of physical limitations or lack of jobs, but because of inadequate education, or lack of job experience and skills. Social assistance recipients surveyed for the LMAS gave the following responses to questions about the difficulty of looking for work:

- lacked education for available jobs — 52 percent;
- lacked the right skills for available jobs — 51 percent;
- lacked experience for available jobs — 49 percent;
- overall, 70 percent reported at least one of the difficulties cited above;
- by contrast, only 20 percent reported having difficulty finding employment because of a long-term physical condition, mental condition, or health problems.

Poverty is a moving target. Family unit incomes change significantly even over short periods. For low-income family units on social assistance for a short period, the policy issue is how to influence the dynamics of labour market flows (e.g., introducing work incentives through a GAI program, discouraging quits, and encouraging job search). Low-income family units that stay longer on social assistance may require both the work incentives of a GAI and additional employment services to enhance employability.

The high volatility of the social assistance population implies that over an extended time, many low-wage earners are likely to become recipients. This means that a policy to successfully contain the number of social assistance recipients cannot focus only on those currently in the program. It has also to address the broader group at risk of becoming recipients, namely low-wage earners.

Most social assistance recipients are potentially employable and are currently employed or have had some attachment to the labour force in the recent past. Most of them can be encouraged to seek full-time employment with incentives created through a GAI program and appropriate employment services, such as job information centres, referrals, placements, and counselling.

A GAI program would be most effective if it were complemented by a wide range of employment services. Work incentives under a GAI program are a necessary condition for encouraging self-sufficiency. For many low-income individuals such work incentives would be enough to minimize reliance on social assistance. However, for others, especially those who have been trapped in the welfare system for an extended period, additional help would be required. This might include job referral services, work experience projects, career training, day care for dependent children, counselling, and life skill training.

The Current System

A full appreciation of the potential of a GAI requires an understanding of the serious flaws of traditional approaches to income security. This chapter provides a brief description of the main income security programs for the working-age population, their main weaknesses, and recent efforts to reform them.

At the heart of the interest in a GAI is the growing dissatisfaction with the current income security system. It is becoming increasingly difficult to sustain the status quo, especially in an environment of fiscal crisis. In a nutshell, the three main concerns about the current income security system are

- the existence of a "welfare trap" that discourages self-sufficiency and contributes to the perpetuation of poverty,
- the seemingly uncontrollable growth of welfare costs and the increased strain on debt-burdened federal and provincial governments, and

- the presence of an unnecessarily complex system that is costly to administer, often poorly targeted to the needy, and inequitable to such groups as the working poor.

The idea of a GAI has reemerged precisely as a response to the above concerns about the current income security system. The essence of a GAI is to move away from universal income transfers toward more targeted programs. The savings resulting from greater selectivity can then be used to finance an income support system that encourages self-sufficiency and shifts resources from passive income support toward active programs to improve employability, such as educational upgrading and training.

Following an overview of the main income transfer programs that benefit the non-elderly, low-income population, the main limitations of the current system, with a particular focus on the work disincentives of social assistance programs, are discussed. As well, a number of recent initiatives designed to address the issue of work disincentives under social assistance are outlined.

Overview of the Current System

The main programs that benefit the non-elderly, low-income population are family allowances and child tax credits, unemployment insurance, and social assistance. Beginning in 1993, family allowance and child tax credits were integrated into the Child Benefit program, which is discussed in more detail later in this section. The level of spending on these four major income transfer programs between 1980-81 and 1992-93 is shown in Table 7.

Child Benefits (to the end of 1992)

- *Family Allowance* — about $35 per child was paid monthly to all Canadian families with children under age 18. Family Allowances were taxable and benefits were "clawed-back" from higher income families.

- *Child Credit* — a non-refundable annual tax credit of $71 per child age 18 or under was provided against income taxes owed. The tax credit was double after the second child.

Table 7

Major Income Transfers, 1980-81 to 1992-93

($ million)

	Family Allowances	Federal Child Tax Credit	Unemployment Insurance	Federal/ Provincial Social Assistance	Total Major Transfers	Personal Income	Major Transfers/ Personal Income
1980-81	1,851	1,013	4,559	2,838	10,261	249,710	4.1%
1981-82	2,020	1,069	5,399	3,272	11,760	289,361	4.1%
1982-83	2,231	1,514	9,708	4,155	17,608	311,783	5.6%
1983-84	2,327	1,447	9,931	4,927	18,632	331,717	5.6%
1984-85	2,418	1,494	10,171	5,522	19,605	359,624	5.5%
1985-86	2,501	1,484	10,127	5,880	19,992	386,973	5.2%
1986-87	2,534	1,573	10,640	6,124	20,871	414,873	5.0%
1987-88	2,564	1,639	10,577	6,394	21,174	451,230	4.7%
1988-89	2,606	1,968	10,979	6,826	22,379	494,698	4.5%
1989-90	2,654	2,064	11,818	7,146	23,682	536,234	4.4%
1990-91	2,736	2,110	14,468	8,883	28,197	565,253	5.0%
1991-92	2,821	2,326	18,435	10,500	34,082	576,128	5.9%
1992-93	2,189	na	19,238	13,000	na	na	na

NOTES The Family Allowances and Child Tax Credit programs were replaced by the Child Benefit in January 1993. For Personal Income, calendar-year data have been converted to fiscal-year data.

SOURCES Major Income Transfers: Health and Welfare Canada, *Social Security Statistics: Canada and Provinces, 1993.* Provincial payments to individuals under social assistance for 1991-92 and 1992-93 are not readily available. Estimates provided here are based on rough calculations.
Personal Income: Department of Finance, Reference Tables, August 1993.

- *Refundable Child Tax Credit* — a refundable tax credit of up to $601 a year was provided for each child age 18 or under.

In addition, the GST refundable credits, while relatively small, have components for children and adults.

Unemployment Insurance (as of 1993)

Unemployment Insurance, the main program protecting individuals from the financial hardship of unemployment while looking for a new job, is Canada's largest income security program. According to the federal budget, $19.2 billion of benefits were paid in fiscal year 1992-93.

UI was radically changed in 1971 and it now covers about 95 percent of all paid workers in Canada. Since 1971, the program has repeatedly been amended to tighten its eligibility criteria and to lower the rate of benefits. The most recent thrust is toward shifting from "passive" income support to "active" training and reemployment initiatives.

To qualify for benefits, a person must be actively searching for employment and in the previous two weeks must have had a minimum of 10 to 20 weeks of insurable earnings, depending on the regional unemployment rate. Claimants may receive benefits for 17 to 50 weeks, depending on their weeks of insurable earnings and the regional unemployment rate. The weekly benefit payments are 57 percent of insurable earnings, up to a maximum of $426 per week in 1992.

In addition, UI pays special benefits, which include maternity and parental leave and sickness. Under section 26 of the *Unemployment Insurance Act*, claimants may receive benefits while attending training courses or participating in job creation projects.

Social Assistance

Social Assistance is Canada's social security system's program of "last resort." According to the constitution, each province is responsible for the design, administration, and delivery of its own social assistance program. Consequently, there is considerable variation in the design and level of benefits from province to province.

The federal government contributes to the financing of social assistance through the Canada Assistance Plan (CAP), which covers 50 percent of approved costs of social assistance programs. The federal contribution to social assistance under CAP in fiscal year 1992-93 was $6.3 billion.

> Since 1990, the federal contribution to provinces that do not receive Equalization Payments (Ontario, Alberta, and British Columbia) has been capped at 5 percent annual growth. This has substantially reduced the share of social assistance spending funded by the federal government. For example, "Federal transfers to Ontario ... shrank from 50 percent of social assistance costs in 1989-90 to 28 percent in 1992-93." (Ontario. Ministry of Community and Social Services 1993, p. 8)

Generally speaking, social assistance may be granted to any person in need. The needs test takes into account the budgetary requirements and the income and assets available to the applicant and other members of the applicant's household to meet such requirements. The majority of social assistance recipients tend to be either disabled, unemployed employable persons, or single parents.

Benefits include income payments for shelter costs, food, clothing and other necessities. A wide range of other benefits or services are also provided to meet specific needs, such as dental care or prescription drugs, or to improve employability, such as training or daycare (Table 8).

Table 8

Maximum Social Assistance Benefits, by Type of Household, 1992

Province	Single Employable	Single parent & one child	Couple & two children
Newfoundland	4,301	11,198	12,119
Prince Edward Island	7,872	10,920	16,303
Nova Scotia	5,904	10,368	12,432
New Brunswick	3,048	8,304	9,318
Quebec	5,994	10,623	13,050
Ontario	8,186	14,817	19,396
Manitoba	6,906	10,618	17,741
Saskatchewan	5,375	10,311	14,683
Alberta	5,640	10,104	15,696
British Columbia	6,308	11,373	14,389
Average	5,953	10,864	14,513

NOTE Benefits include the basic living allowance and the maximum shelter allowance. Benefits do not include any special needs allowances or other government transfers, e.g., family allowances, the child tax credit, child related benefits, sales tax/GST credits, and provincial tax credits.

SOURCE National Council of Welfare, *Welfare Incomes 1992*, Spring 1993.

In most cases, income other than earnings leads to a dollar-for-dollar reduction in social assistance benefits. The treatment of earnings under the various provincial systems is summarized in Table 9. The table is a simplification of a rather complex system and provides only a broad impression of how the system operates. As a general rule, provinces tax back most of the earnings after allowance is made for work related expenses and a certain allowable exemption.

Table 9

Treatment of Earnings

Under Provincial Social Assistance Programs, 1992

Newfoundland

50% of net earnings up to $80 per month for single and $200 per month for families is exempt. Net earnings above the exemption level are taxed back at 100%. Net earnings exclude work-related costs (such as UI, CPP and union premiums, income taxes, transportation costs, required special equipment or clothing, babysitting).

Prince Edward Island

The first $50 of net earnings per month for single and $100 for families is exempt. Above the exemption level, net earnings are taxed back at 90%. Net earnings exclude UI, CPP, income taxes, pension contributions, and other deductions that are a condition of receiving wages.

Nova Scotia

The first $100 of gross earnings per month for single and $200 for families is exempt. Above the exemption level, gross earnings are taxed back at 75%.

New Brunswick

The first $150 of gross earnings per month for single and $200 for families is exempt. Above the exemption level, gross earnings are taxed back at 100%. Net earnings excludes non-voluntary deductions (income taxes, UI, CPP, etc.).

Quebec

Under the Financial Support Program, $100 of net earnings per month is exempt. Net earnings exclude non-voluntary contributions. For clients of the Work and Employment Incentives Program, the exemption level varies according to the client's participation in training and related programs. Above the exemption level, net earnings are taxed back at 100%. Families with children can receive earnings supplementation under the APPORT program, which reduces the effective tax-back rate below 100%. (APPORT is discussed below in the section on recent policy initiatives.)

Ontario

Under the provincial STEP program, $160 of net earnings per month for single and $175 for families is exempt. Net earnings exclude work-related costs. Above the exemption level, net earnings are taxed back at 75%. The taxed back amount, however, is reduced by the amount of eligible child care costs.

Manitoba

Under the provincial Work Incentives provision, the earnings exemption is the greatest of (i) $50 per month; (ii) 70 cents per hour worked; or (iii) 30% of gross earnings. An amount equal to work-related expenses is also exempt. Effectively, the incremental tax-back rate on earnings is 70%.

Table 9 — Treatment of Earnings
Under Provincial Social Assistance Programs, 1992 *continued*

Saskatchewan
Net earnings exclude involuntary deductions and actual work-related costs may be included in the budgetary requirements. The monthly exemption ranges from $25 plus 20% of net earnings (up to a maximum $75) for single, to $125 plus 20% of net earnings (up to a maximum of $250) for families with five or more members. Effectively, the incremental tax-back rate is 80% up to a certain level, and then 100%.

Alberta
Monthly net earnings are taxed back as follows:

a) earnings up to $115 .... 0%
b) $116 to $200 .... 50%
c) $201 to $300 .... 75%
d) over $300 .... 90%

British Columbia
The monthly exemption level is $100 for single and $200 for families. Earnings above the exemption level are taxed back at 75%.

Weaknesses of the Current System

There is a growing consensus that the income security system is ineffective and too costly. The main criticisms of each of the above programs are described in turn.

Child Benefits

The main concern about child benefits prior to 1993, particularly Family Allowances, was that benefits were not sufficiently targeted to low-income families. At the centre of the debate was the issue of universality versus selectivity. The proponents of universality argued that Family Allowances were a matter of "horizontal" equity — within the same income bracket there is a need for income redistribution from families without children to families with children because of the difference in financial needs due to the presence of children. Family Allowances were also viewed as a means of life-cycle redistribution, the mirror program to public pensions, part of the broad "social contract."

The proponents of selectivity argued that the most critical social issue is poverty and, given the current fiscal crisis, the only practical way to address the problem of poverty is to re-target existing funds. The selectivity view has won some support: changes under the former federal government, primarily with respect to child benefits, were in the direction of a better targeting of benefits to the low-income population.

Unemployment Insurance (as of 1993)

Unemployment Insurance has received by far the largest share of criticism. At the heart of the debate is whether UI is an insurance program or simply an arbitrary income redistribution program.

The critics complain that it is possible to qualify for as many as 39 weeks of benefits by working as few as ten weeks in a year. In many cases, there is no risk of unemployment but instead a virtual certainty, as is the case for seasonal workers who return to UI for income support on a regular basis. The main criticisms that have been raised against the current UI program are

- Most of the money is spent on passive income support, rather than on improving the employability of the unemployed. There is growing evidence that a significant part of unemployment is structural. For example, the job vacancy rate corresponding to different levels of unemployment has been growing. Also, according to the Labour Market Activity Survey, well over half of all unemployed feel that they have difficulty finding work because they lack the education, skills, or experience required for available jobs.

- UI contributes to higher unemployment by prolonging unproductive job search; by making seasonal jobs more attractive; and by encouraging the participation in the labour force of marginal workers who may not be interested in full-time, year-round work.

- The overwhelming share of benefits (about 90 percent according to the Survey of Consumer Finances) does not go to low-income families (Table 10). It is also difficult to rationalize benefits on the basis of insurance because the insured eventuality often occurs with a predictable regularity.

Table 10
Incidence of UI Benefits, 1990

	Low-income family units	High-income family units	All family units
Total number	1,776,246	7,192,813	8,969,059
Number of recipients	321,483	1,903,765	2,225,248
Percent of all recipients	14.4%	85.6%	100.0%
Percentage incidence	18.1%	26.5%	24.8%
Average amount	$3,760	$4,924	$4,755
Total amount ($million)	$1,209	$9,373	$10,582
Percent of total amount	11.4%	88.6%	100.0%

SOURCE Survey of Consumer Finances, 1991 (1990 income, census households).

Social Assistance

Social assistance recipients are often economically inactive not because of absolute physical limitations, but because of inadequacies in the social assistance system. Many recipients lack adequate technical and life skills and require training to qualify even for entry-level jobs. However, most resources are devoted to passive income support and little is done to build marketable skills. As a major recent consultation report concluded

> ... most barriers to training for Social Assistance Recipients arise from poor program design, rather than from any inherent difficulties of social assistance recipients. (Canadian Labour Market and Productivity Centre 1990, p. 110)

The problem of the lack of emphasis on training is compounded by a structure of social assistance benefits that creates a poverty trap and fosters dependency. Once on social assistance, the high rate of tax-back of earned income and the loss of social benefits can make it unattractive for recipients to take low-wage, entry-level jobs.

Social assistance programs have been criticized for their almost exclusive focus on providing financial assistance and their limited involvement in assessing the future prospects of clients and assisting them to regain self-sufficiency. The system does little to help people exit the longer term benefits stream and, often, it unwittingly sets up obstacles to individual initiative. The following characteristics specifically limit social assistance programs:

- *A Narrow Definition of Employability* — The current employable/unemployable distinction prevents a significant number of social assistance recipients from participating in training programs. For example, people with disabilities are generally labelled as unemployable even though many of them want to work and are capable of working. As a result, a significant portion of social assistance recipients are unable to access training opportunities.

- *An Inadequate Focus on Training* — The narrow definition problem is compounded by the fact that a disproportionately small amount of resources are devoted to long-term training and complementary employment services to improve the marketability of recipients. Often, training programs for social assistance recipients

  - are not widely available;
  - are short term;
  - are not closely linked to shortages and potential employment opportunities in the local labour market;
  - focus on the requirements of a specific job and place limited emphasis on skills that can be transferred from job to job;
  - do not address basic weaknesses, such as inadequate literacy, numeracy, life skills, communication skills, and transferable technical skills.

- *Disincentives to Employment* — Under existing social assistance programs, there is often little or no incentive to participate in the labour force because employment at low wages results in small or no benefits to the recipient. Income testing of supplementation, rent, and other subsidies means that each dollar of earnings may result in an almost equivalent, and some times greater, reduction in the disposable income of the recipient, creating a "welfare trap." Work disincentives can be compounded by the "stacking" of tax-back rates from different programs. Unless different programs (such as income support, subsidized daycare, or subsidized housing) are properly harmonized, it is possible for a certain range of earnings to have an overall tax-back rate above 100 percent.

Recent Policy Initiatives (as of 1992)

Recent changes in the major income transfer programs include the replacement of Family Allowance and child tax credits by the Child Benefit program; the shift of UI funds toward training under the Labour Force Development Strategy (LFDS); and provincial initiatives to strengthen work incentives, such as APPORT, Quebec's Parental Wage Assistance Program.

The Child Benefit Program

The most important recent development in income transfer programs has been the introduction of the Child Benefit program, an example of the integration of social program payments into the income tax system. The new program, which integrated Family Allowances and child tax credits into a single refundable tax credit, is intended to

- increase and target benefits — total federal child assistance is greater and increased benefits are directed to low- and modest-income families,
- supplement earnings — the child tax benefit includes an earned income supplement that provides additional support for low-income parents in the workforce, and
- consolidate benefits — the program replaced Family allowances, the non-refundable child tax credit, and the refundable child tax credit with a uniform refundable tax credit.

The Child Benefit consists of a Basic Benefit and an Earned Income Supplement. For example, a family with two children receives a Basic Benefit of $2,040 annually. Above $25,921 of net family income, the Basic Benefit is taxed back at 5 percent. The amount of the Earned Income Supplement is calculated to be 8 percent of the annual earnings above the first $3,750, to a maximum supplement of $500. Above $20,921 of net family income, the supplement is taxed back at 10 percent.

The earnings supplement component is modelled after the APPORT program, although the level of supplementation is significantly lower. The main attraction of the Child Benefit is the rationalization and better targeting of several programs.

Unemployment Insurance (as of 1992)

The most important recent development with respect to the UI program has been the introduction of the Labour Force Development Strategy. The impetus for the LFDS came from the realization that while training and education are increasingly more critical to labour market adjustment and competitiveness, public resources are largely devoted to passive income maintenance.

The LFDS, an important initiative in the evolution of the UI program, shifted resources from passive income maintenance into active training and other employability enhancement programs. In addition to placing more emphasis on training and reemployment, the LFDS also launched a more inclusive process involving business, labour, the educational community, and equity groups with the goal of improving training effort throughout the private sector. Part of the increased UI funding for training was directed to social assistance recipients, while additional funding was directed to individuals at risk of relying on social assistance.

The focus on training is a crucial complement to the increase of work incentives. To be effective in integrating individuals into the labour market, public programs must combine both training and work incentives. In that sense, one could make the argument that a logical extension of the LFDS would be to shift more UI funding into work incentives, in the form of an earnings supplement or a GAI program.

Social Assistance

An important prerequisite to the success of any employability initiative is to ensure that work effort receives adequate financial reward. Unless wages are adequate and net earnings significant, most attempts to train or facilitate integration into the labour market are likely to fail.

There are two broad approaches to address the issue of financial incentives. Several previous studies (including the Macdonald Commission) have taken the approach that the entire system of income transfers and taxes needs to be revamped. However, because of the magnitude of the change required, such approaches have never been implemented.

The alternative approach is to introduce small practical incremental changes to redress some of the existing imbalances in the complex system of federal-provincial-municipal income security programs.

An interesting initiative that falls under the latter approach is Quebec's APPORT program. It offers incentives for the working poor to stay in the labour market while at the same time, by offsetting part of the high tax-back rates of social assistance, encouraging social assistance recipients to seek employment. More specifically, the program is targeted to both social assistance recipients and the working poor and its stated objectives are

- to keep low-wage earners with dependent children in the labour market, and

- to encourage social assistance recipients with dependent children to enter the labour force.

A simplified overview of the APPORT program is presented in order to describe the main character of the program, rather than to provide a precise description of its features.

The APPORT program is designed to supplement the earnings of single parents or couples with children. To qualify for benefits in any given month, an individual must have at least $150 of earnings. Benefits start when annualized earnings exceed $3,445.

As long as the annualized earnings (i.e., average monthly earnings times 12) are less than the level of income needs ($11,730 in our example), the parent receives 45 cents for each additional dollar of earnings over the initial annual figure $3,445. Once the annualized earnings exceed the level of needs, for each additional dollar earnings APPORT benefits are reduced by 42 cents. One can distinguish two cases:

- *Individuals Without Social Assistance* — In this case, individuals have a strong incentive to bring their earnings up to the level of needs; beyond that point they face a 42 percent tax-back rate; however, this rate is lower than the 50 percent tax-back rate often advocated in the literature as a reasonable limit and it is considerably lower than the traditional 100 percent rate under social assistance.

- *Individuals With Social Assistance* — In this case, the 45 percent subsidy effectively reduces the 100 percent tax-back rate of social assistance to 55 percent. The work incentive is not as strong as for those not receiving social assistance; however, it is a more reasonable rate than the 100 percent rate under social assistance: when earnings exceed the level of needs, both groups of individuals are treated the same.

APPORT offers an interesting way of addressing some of the major weaknesses of the current income security system. It does this in an incremental fashion, rather than by the more drastic approach of revamping the whole gamut of subsidies, tax credits, and taxes.

However, there are a number of issues. The most important is the low take-up of the program. There are only about 17,000 recipient families, 40 percent of which also receive social assistance. This is far below the number of eligible working poor in Quebec. Therefore, although the design of the program is quite attractive, its effectiveness is seriously limited by the fact that it reaches only a small percentage of its intended target population. This may be attributed to the fact that it is a new program and it has not been adequately publicized.

Another issue concerns adjustment payments at the end of the year. Because the earnings of the working poor are quite volatile, it is difficult to avoid making under- or overpayments. To avoid the difficulty of collecting overpayments, monthly payments are set equal to 75 percent of entitlements, with balances paid at the end of the year. However, even with a 25 percent hold-back, it is not uncommon to have to request recipients to refund part of the benefits.

Several summary points of this overview of the current income security system are particularly relevant to this discussion of a GAI plan. The system in place is characterized by an excessive focus on passive income support, a weak link between entitlements and social insurance or income redistribution principles, and serious work disincentives as a result of prohibitive tax-back rates.

Recent changes, both at the federal and provincial level, indicate a growing awareness and willingness to respond to the need to break the welfare trap. For example, the Child Benefit program improved the targeting of benefits and introduced a modest earnings supplement through the income tax system. The LFDS questioned the allocation of public funds between passive income maintenance and active employability initiatives. Following up on the recommendations of the Macdonald Commission, it proposed a broader definition of active policies, which would include work incentives. The Quebec experiment, although modest, provides an example of the kind of programs that can be employed to break the welfare trap. These three reforms show the direction that the income security system needs to take to achieve a better coherence between income maintenance policies and labour market policies.

Despite recent reforms in income security programs, many fundamental problems remain. The current social assistance system is still too complex, involving a maze of ill-understood programs. Recipients are penalized for working through substantial reductions in benefits, while the working poor receive little or no assistance.

The Child Benefit program has rationalized the child benefit part of income security. However, the program only begins the reforms necessary to the income security system. UI is still a costly program, with benefits poorly targeted to those with a major attachment to the labour force or in financial need, and an insufficient focus on improving the employability prospects of the unemployed.

The idea of a Guaranteed Annual Income (GAI) is increasingly being seen as a way to rationalize the existing income security system. Some of the recent policy initiatives have moved income security in this direction; however, a strong case can be made for replacing many of the current income transfers with a comprehensive GAI program.

The Guaranteed Annual Income Concept

During the past two decades, a large number of GAI schemes have been proposed by governments, policy institutions, academics, and social advocates. The main objective of the following very selective review of some of these proposals is to describe the essential elements of a GAI concept and to provide an appreciation of its strengths and the challenges that must be overcome to implement it. This section also includes a non-technical discussion of the potential impact of a GAI program on work incentives.

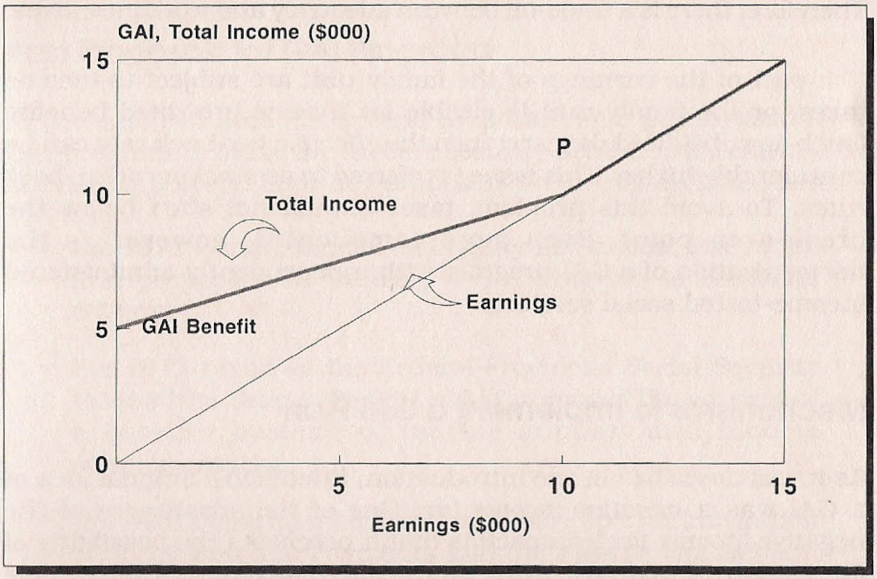
Basic Aspects

The following description, in simple terms, of the concept of a GAI, and the discussion of some basic issues and alternative methods of implementation is not intended to cover the full range of issues, but rather to provide an appreciation of the fundamental aspects of a GAI program.

In the simplified example of a GAI program presented graphically in Chart 1, the maximum benefit per household is $5,000, and is referred to as the *minimum guaranteed income level* (G). In practice, G relates to the size of the household. Also, coverage can be universal or it can be limited to certain types of households, such as households with dependent children.

Chart 1

A Simplified GAI Program



The *level of benefits* (B) is reduced only partially in the presence of earnings so that there is an incentive for the recipient to work. In the case of two-adult households, earnings typically refer to the combined earnings of the two spouses. In the example here, the benefit reduction rate, referred to as the *tax-back rate* (r), is assumed to be 50 percent. At any given level of earnings, therefore, the level of benefits is given by the following formula:

$$B = G - r^*E$$

In the above example, at $10,000 of earnings, the level of benefits becomes zero. This level of earnings is referred to as the *break-even point* (P). It relates to the minimum guaranteed level and the tax-back rate through the following formula:

$$P = G/r$$

This equation indicates the *fundamental trade-off* among the three basic parameters of a GAI program: in order to keep the break-even point (and therefore the size of the eligible population) constant, a decrease in the tax-back rate to improve work incentives requires a reduction in the minimum guaranteed income level as well. Therefore, there is a trade-off between adequacy and work incentives.

If part of the earnings of the family unit are subject to income taxes, or the family unit is eligible for income pro-rated benefits (such as subsidized daycare) then the effective tax-back rate can be considerably higher. This issue is referred to as *stacking of tax-back rates*. To avoid this problem, taxes should not start below the break-even point. Even more complicated, however, is the harmonization of a GAI program with independently administered income-tested social services.

Mechanisms to Implement a GAI Plan

As it was described in the introduction, Friedman's original idea of a GAI was a *negative income tax*. One of the advantages of the negative income tax approach is that it precludes the possibility of an overlap of tax-back rates and positive income tax rates. One particular form of a negative income tax, which is increasingly being utilized in Canada, is a *refundable tax credit*. Under this option, family units receive a credit against taxes owed, or if no taxes are owed, a cash payment. The value of the tax credit depends on the level of income. Payments can be made when an income tax return is submitted, or periodically throughout the year based on the level of income in the previous year.

Administratively and constitutionally, refundable tax credits are the simplest mechanism to improve the income security system, which explains their growing popularity in Canada. At the same time, a major limitation of tax credits is their lack of responsiveness to changes in current income. So far this has not been a major issue because of the small level of benefits paid through refundable tax credits and the low tax-back rate.[2] However, this will become a more serious concern if tax credits become a major component of the income support system.

There is a wide range of alternative options. For example, one option is to replace the entire income support system under social assistance with a single GAI program. Another is to leave basic income support to the provinces and introduce a federal second-tier program of earnings supplementation, either through tax credits or through the UI system. A number of specific proposals are considered in the next section.

Past Proposals for GAI Programs

In the past two decades, several proposals were put forward for a GAI program to make the income security system more effective in alleviating poverty. Four key proposals are briefly reviewed here:

- the 1971 Senate Report on Poverty in Canada, one of the first proposals for utilizing a GAI program to eradicate poverty;
- the 1973 report of the Federal-Provincial Social Security Review (the Orange Paper), which proposed the concept of a two-tier system, of income support and income supplementation;
- the 1978 Department of Finance White Paper on Integration of Social Program Payments into the Income Tax System, which was the precursor to the use of refundable tax credits as a part of the income security system; and
- the 1985 report of the Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission), which advocated a much more far-reaching overhaul of the income security system. It recommended eliminating universal programs, tightening UI,

and shifting the resulting savings into the funding of a Universal Income Security Program and active reemployment policies.

The Senate Report

The key elements of the Senate Report on Poverty proposal were the following:

- the GAI will be a federal program, covering all Canadians;
- the Basic Allowance Rates will be set initially at 70 percent of the poverty lines, defined in relation to the average standard of living and estimated using a method similar to the one Statistics Canada employs to determine the low-income cut-off lines;
- the tax-back rate will be set at 70 percent;
- the GAI will be divorced from the provision of social services, which will remain a provincial responsibility and cost-shared with the federal government under CAP;
- universal programs, such as Old Age Security and Family Allowance will be repealed;
- no one will receive less money under the GAI than is currently the case under other federal programs; and
- the income tax exemptions levels will be raised so that no Canadian whose income is below the poverty line will pay any taxes.

The Senate proposal focused on adequacy, rather than on work incentives. The 70 percent tax-back rate is fairly high, not much better than what is already in place in many provinces. Also, under the plan, social services would be operated by a different jurisdiction, presumably employing separate income-tested fees, thus raising the prospect of stacking tax-back rates. Finally, it is not realistic to propose that no one receive less money in federal transfers under a GAI than they are currently receiving. The current fiscal reality calls for more selectivity and a shift of resources from those with higher incomes to those with lower incomes.

The Orange Paper

The federal government outlined the basic elements of a GAI program in its 1973 Working Paper on Social Security in Canada. Like the

Senate report, the Orange Paper focused on adequacy; its opening paragraph states

> The central, though by no means the sole, objective of social security in Canada is an acceptable basic income for all Canadians — whether that income comes through employment, if a person is able to work, or through pensions or allowances if a person is unable or not expected to work. For a basic income is essential if a person is to live in decency and in dignity. (Government of Canada 1973, p. 4)

The Orange Paper proposed a two-tier GAI program, consisting of an income supplementation tier and an income support tier.

> Income Supplementation Recommendation: That the income of those who are working but whose incomes are inadequate by reason of family size ... or by reason of the nature of their employment (low-paying self-employment or intermittent or partial employment) should be supplemented under a single, general income supplementation plan, with built-in work incentives. (p. 30)
>
> Income Support Recommendation: That a guaranteed income should be available to people whose incomes are insufficient because they are unable or are not expected to work, namely the retired or disabled, single parent families, and people who are not presently employable by reason of a combination of factors such as age, lack of skills, or length of time out of the labour market. The guaranteed income will be paid in the form of an additional income supplement over and above the general income supplementation available... (p. 32)

The White Paper

The Department of Finance discussion paper entitled "Integration of Social Payments into the Income Tax System" made a case for using the income tax system to implement social programs, including income supplementation.

The main instrument proposed, the refundable tax credit, has several advantages:

- simplicity
- low administration costs
- integration with income taxes (it avoids stacking income tax and tax-back rates)

- a high take-up rate among the targeted population
- it avoids the thorny constitutional issue of who has jurisdiction over GAI

The mechanism of the refundable tax credit is increasingly being used in Canada to rationalize the income security system. The most recent example is the integration of several types of benefits into the refundable Child Benefit tax credit.

As the White Paper acknowledged, however, the main weakness of refundable tax credits is the lagged response of benefits to changes in the income situation of the recipient.

> ... at present there does not exist a neat system whereby each Canadian individual or family receives a number of regular monthly transfer payments and makes a regular monthly tax payment. Thus it is not possible to offset the two flows. The move towards a tax/transfer system may therefore have some costs in terms of the ability to aim programs at intended beneficiaries. (Canada. Department of Finance 1978, p. 33)

The Macdonald Report

One of the main recommendations of the Macdonald Commission was

> ...an option which delivers a relatively low guarantee level, but which also has a lower reduction rate combined with a special 'top-up' for those who cannot be expected to work, will produce a more desirable combination of income support and work incentives [relative to a uniform GAI program]. Such an option would not provide a payment high enough to encourage employable people to rely wholly on it, and it would not tax back benefits on earnings at a rate high enough to discourage the earning of income. We prefer to describe such a package as a 'Universal Income Security Program' (UISP). (Royal Commission on the Economic Union and Development Prospects for Canada 1985, p. 795)

The Commission recommended (pp. 824-25) that the UISP replace existing federal tax and transfer programs including

- GIS (but not OAS)
- Family Allowances
- Child Tax Credits
- married exemptions

- child exemptions
- federal contributions to social assistance programs
- federal social housing programs

The Macdonald Commission's proposal is similar in some respects to that proposed in the Orange Paper. However, the Macdonald Commission is more comprehensive because it also called for a tightening of the UI program. In particular, it recommended that "the UISP should be put in place at the same time as the broad UI reforms described above" (p. 825).

The Issue of Work Incentives

One of the stumbling blocks to the implementation of a GAI program is the potential work disincentive effects on those currently not on social assistance. A GAI program is expected to improve work incentives among social assistance recipients by effectively lowering the tax-back rate on their earnings. However, it is also expected to have some potential work disincentive effects among the working poor not on social assistance.

According to standard labour supply theory, a GAI program is expected to reduce the work effort of the working poor not currently on social assistance because of the presence of two effects: an "income" and a "substitution" effect. Although the two effects act simultaneously, for the sake of simplicity of presentation, let us assume that they act in sequence.

- *The Income Effect* — Suppose that, based on its current income, the household qualifies for $4,000 of GAI payments annually. Let us assume that initially there is no reaction to the introduction of the GAI and that the members of the household continue working the same hours and receive the same amount of earnings. The added $4,000 of income is allocated between consumer goods, paying off debts, and savings.

  However, one type of consumer good, in a broad sense, is "leisure." Leisure is an economic jargon for time spent on such things as housekeeping, looking after one's own children, or simply resting and having a good time. The standard theory predicts that the typical household will "spend" part of the added income on leisure.

Let us assume that some members of the household decide to work less and that, as a result, the household earnings are reduced by $1,000. This reduction in work effort and earnings is referred to as the "income effect."

- *The Substitution Effect* — Let us assume the tax-back rate of the GAI program is 50 percent. The $1,000 reduction in earnings will result in a $500 increase in GAI which will offset half of the loss in earnings. In fact, each additional one dollar decrease in earnings results in only a 50 cent decrease in household income.

  If the household was not paying any income taxes prior to the introduction of the GAI, the 50 percent tax-back rate means that the benefit of added work is much lower with the GAI. To put it differently, the cost of leisure in terms of lost income is much lower.

  Suppose that, faced with the 50 percent "penalty," the members of the household decide to reduce their work further and, as a result, household earnings are reduced by an additional $2,000. This further decrease in work effort and earnings is referred to as the "substitution effect."[3]

In the above example, the income and the substitution effects of the GAI lead to a $3,000 reduction in household earnings. As a result, the household has $1,500 less in total income and the cost of the GAI program is $1,500 higher, compared to the situation if there had been no change in work effort.

The impact of a GAI on the working poor has been extensively investigated, primarily in the U.S. It has been studied by using both cross-sectional data as well as experimental data from pilot studies in selected communities. Although there is significant variation in the findings of the various studies, there appears to be some consensus. In particular, it would appear that in most cases, a GAI program has a very limited negative effect on the work behaviour of adult males, but a more noticeable negative effect on the work behaviour of female spouses.

Results from the Manitoba Income experiment (Mincome), which is the only Canadian experiment, seem to indicate a relatively lower negative response. In particular,

> The results from Mincome may be compared to those from four U.S. experiments. The labour supply response from Mincome is lower than any of the U.S. results for men and married women, although similar results obtained from the Gary (Indiana) experiment for single female heads. The Mincome results imply a labour supply response of 0.8 to 1.6 percent for men compared to a combined response of 5 percent from the U.S. experiments; a response of 2.4 to 3 percent for married women compared to 21 percent in the United States; and a response of 3.8 to 5.3 percent for single female heads compared to 13.2 percent in the United States. In short much smaller responses. (Hum and Simpson 1991, pp. xiv-xv)

The traditional view, based primarily on U.S. experimental and non-experimental studies, is that the negative effect of a GAI on the working poor is more significant than its positive effect on social assistance recipients. However, this is less likely to be the case in Canada for two reasons. First, work disincentives tend to be relatively more serious in the Canadian income security system than in the U.S. system and, therefore, the scope for work incentives among social assistance recipients is relatively greater. For example, the generosity of unemployment insurance and social assistance benefits to unemployed individuals is three times higher in Canada than in the U.S. (Elmeskov 1993, p. 88). Second, the working poor (not on social assistance) face higher income tax rates in Canada. Consequently, the introduction of the same GAI scheme in the two countries would cause a relatively smaller increase in the combined tax-back and income tax rates in Canada than it would in the U.S.

Given that the negative impact of a GAI program on the working poor is likely to be very small and that there is extensive scope for a positive impact among social assistance recipients, it is probably fair to conclude that the introduction of a GAI is not likely to have an overall negative effect on the Canadian labour force. Indeed, there are reasons to be optimistic about the impact of a GAI program on work incentives. Much of the theory and empirical evidence is based on static analysis. However, the volatility of the social assistance population provides some reason to believe that a GAI may have the beneficial effect of reducing the tendency of the working poor to resort to social assistance. In other words, although the static labour supply theory may be right in predicting a reduction (albeit small) in the hours of work among the working poor not currently on social assistance, over a longer period the impact on the labour supply could even be positive among the working poor. This would result from raising the incomes of the working poor significantly above those on social assistance and making it relatively less attractive for them to fall back on social assistance. In the longer run, the decreased reliance on social assistance would result in a greater attachment to the labour force and enhanced employability. Also, to the extent that a GAI is funded through UI cuts, it may have further positive work incentives.

As this discussion indicates, there has certainly been no shortage of GAI proposals in Canada over the last 20 years. Frequently, they have been motivated by the desire to improve the income support to the poor. However, other important considerations, which are becoming increasingly more important, include the desire to

- extend benefits to the relatively neglected working poor,
- improve work incentives and increase self-sufficiency among the low-income population, and
- reduce the overall cost of the income-support system by better targeting of income transfers to the low-income population.

The most difficult challenge facing governments is to overcome public resistance to changing existing programs, primarily the UI program. Without a major reform of existing programs, it is unlikely, in the current fiscal environment, that even a modest GAI program could be implemented. There are several other issues to be considered, ranging from federal-provincial jurisdictional issues to the necessary complementary reform of the income tax system to facilitate harmonization between a GAI program and income taxes. However, by far the most serious stumbling block to a GAI program is public resistance to changes in existing programs.

Guaranteed Annual Income Options

A simple GAI program is described here to illustrate several aspects of the GAI concept. The treatment is selective and does not deal with all the potential implications of a GAI program. Nevertheless, estimates of the number of beneficiaries and the cost of the program if it had been implemented in 1993 are provided and UI changes to implement a GAI program in a deficit-neutral way discussed. Alternative implementation mechanisms are considered as is the issue of federal-provincial cooperation and the role of the private sector.

A Simple Guaranteed Annual Income Proposal

The national GAI program outlined here is designed to supplement the earnings of the working poor. Its objective is to assure that individuals with significant hours of work are always better off working than on social assistance. The goal is to address the existing discrimination against the working poor and to make it more attractive for low-income households to leave social assistance or stay off social assistance.

Under the proposed program, households would be guaranteed a minimum annual income depending on the number of persons in the family. The minimum annual income in 1993 is set somewhat higher than the lowest provincial social assistance benefit levels in 1992. The maximum GAI benefits in 1993 would have ranged from $5,000 for a single person to $12,000 for a couple with two or more children (Table 11).

Table 11

GAI Benefit Schedule, 1993

	Number of persons in the family			
	1	2	3	4 or more
Maximum GAI	5,000	8,000	10,000	12,000
Tax-back rate	50%	50%	50%	50%
Break-even point	10,000	16,000	20,000	24,000
Household income	GAI benefit			
0	5,000	8,000	10,000	12,000
2,000	4,000	7,000	9,000	11,000
4,000	3,000	6,000	8,000	10,000
6,000	2,000	5,000	7,000	9,000
8,000	1,000	4,000	6,000	8,000
10,000	0	3,000	5,000	7,000
12,000	0	2,000	4,000	6,000
14,000	0	1,000	3,000	5,000
16,000	0	0	2,000	4,000
18,000	0	0	1,000	3,000
20,000	0	0	0	2,000
22,000	0	0	0	1,000
24,000	0	0	0	0
26,000	0	0	0	0
28,000	0	0	0	0
30,000	0	0	0	0

NOTE GAI benefits are calculated as follows: at zero income, families receive the maximum benefit; when families have income from earnings or other sources, the GAI benefit is taxed back at 50%.

For each dollar of income from earnings or other sources, GAI benefits would be reduced by 50 cents (as under the federal GIS program for older Canadians). For example, a single parent with two children and no other source of income would have received in 1993 the maximum $10,000 that applies to this family size. The same single parent with $12,000 of earnings would have received $4,000 in GAI benefits (i.e., $10,000 minus 0.50 times $12,000). UI benefits are treated like earnings, while income from social assistance is not taxed back at all.

The GAI program would replace traditional social assistance payments. However, the provinces could still supplement the federal GAI program. The GAI program could be treated as the "first tier" and individual provinces could add a "second tier" through social assistance. For example, a province could top up the national benefits with additional benefits for those unable or not expected to work. Such top-up programs could work like the GAINS program in Ontario.

This is an example of a two-tier approach, such as the one proposed by the Orange Paper in 1973 (Canada. Department of National Health and Welfare 1973), of income support through traditional social assistance for those not working; and income supplementation through a GAI program for those working but not having adequate income. The type of GAI employed is also consistent with the concept outlined in the recent Ontario document *Turning Point* (Ontario. Ministry of Community and Social Services 1993).

The maximum GAI benefits would be roughly equivalent to the maximum social assistance benefits in several provinces. For example, in the case of couples with two children the maximum GAI benefits would be roughly equivalent to the maximum social assistance benefits in Newfoundland, Nova Scotia, and New Brunswick.

The tax-back rate is significantly lower than provincial social assistance tax-back rates to provide a work incentive for social assistance recipients. The working poor not on social assistance would be faced with a 50 percent GAI tax-back rate. As discussed earlier, the combination of higher income because of GAI and the new tax-back rate could create some work disincentives among this group of individuals.

However, the overall extent of work disincentives would likely be minimal — especially taking into account that many GAI recipients would also be likely recipients for social assistance and that the GAI plan would make the work option more attractive relative to social assistance.

The particular benefit structure presented here was deliberately chosen to minimize the possibility of an overlap between GAI benefits and income tax payments. An increase of the minimum guaranteed income levels, or a lowering of the tax-back rate would require a reform of the income tax system to avoid stacking GAI tax-back rates and income tax rates. Such a reform could be fairly involved and costly.

Simulation Results

The 1991 Survey of Consumer Finances (1990 incomes) were used to simulate the number of beneficiaries and the cost of the simple GAI program if it were implemented in 1993. The basis of the analysis is census family units where neither the head nor the spouse (if present) is 65 or older.

The results of the simulation are reported in Table 12. They show that in 1993 about 1.6 million households would have qualified for GAI payments. The average benefit would have ranged from $2,977 for single individuals to $5,144 for families with four or more members, with the total benefits being approximately $6.3 billion. Since the GAI would have replaced part of existing social assistance payments, there would have been about $3.1 billion saved in federal and provincial social assistance costs. As a result, the net cost of the GAI program in 1993 would have been about $3.2 billion.

The estimates presented here are very rough. Overall, the simulation results overstate the number of beneficiaries and the cost of the GAI program, for at least two main reasons. First, about half of social assistance benefits are not reported in the SCF. As a result, the number of eligible households and the level of benefits are overstated. Second, all eligible family units are assumed to receive their GAI entitlements. In reality, the take-up rate would likely be below 100 percent.[4]

Table 12
Simulation of a Simple GAI Program, 1993

	Persons in census family unit				All
	1	2	3	4 plus	families
GAI incidence					
All census family units (000)	2,877	2,047	1,505	2,539	8,969
Eligible census family units (000)	777	329	213	278	1,597
Incidence of GAI (%)	27%	16%	14%	11%	18%
Gross GAI cost					
Eligible census family units (000)	777	329	213	278	1,597
Average GAI per census family unit ($)	2,977	4,426	5,107	5,144	3,937
Total gross GAI payments ($ million)	2,312	1,457	1,088	1,430	6,287
Net GAI cost					
Family units better off with GAI (000)	548	215	147	219	1,129
Average GAI minus social assistance ($)	2,235	2,957	3,361	3,745	2,812
Total net GAI payments ($ million)	1,226	635	493	818	3,173

NOTE The simulation results are based on the Survey of Consumer Finances 1991 (1990 incomes; census families). The estimates are crude for at least three main reasons:
(a) 1990 incomes are used to simulate the cost of the program in 1993,
(b) it is not taken into account that about 50% of social assistance benefits are not reported in the SCF, and
(c) no allowance was made for potential work incentive or disincentive effects.
On balance, the above simulation results most likely overstate the potential number of eligible households and the net cost of the program.

Deficit-Neutral Financing

Despite all the uncertainties of the cost simulation, there is little doubt that the cost of implementing a GAI is substantial. In the current fiscal environment, the only realistic way to finance a GAI would be by realizing savings elsewhere in the income security system.

Part of the federal costs of implementing a GAI plan could be offset by reducing payments to the provinces under CAP. The amount of reduction could reflect the amount of savings accruing to provincial social assistance programs because of the introduction of the GAI first tier.

The net federal cost of the GAI plan outlined here could be as high as $3.2 billion. Deficit-neutral financing would require changes in existing federal income security programs. The UI program

Table 13

Cost Savings from Changes in UI in 1993-94

Based on Recommendations by the Macdonald Commission

UI Change	Expected Savings
Reducing the benefit rate for all types of UI benefits from the current 57% to 50%	$2.6 billion
Increasing the minimum entrance requirement to 20 weeks	$3.0 billion
Paying a maximum of one week of benefits for each week of insured employment	$1.7 billion
Combine savings in regular benefits as a result of all above changes	$6.7 billion
Savings as a percentage of total regular benefits	40%

NOTE Calculations are based on rough assumptions applied to statistics contained in the Statistics Canada publication "Unemployment Insurance Statistics" (Catalogue 73-001).

provides the opportunity for the largest savings. According to the 1993-94 Estimates, the cost of UI is expected to be $20.8 billion, of which regular benefits will account for $16.5 billion.

Implementing some of the recommendations of the Macdonald Commission, discussed above, could result in $6.5 billion of savings, or about 40 percent of the total UI benefits (Table 13). These savings would be more than enough to finance the GAI plan outlined here. In fact, such savings could finance a more ambitious GAI plan. They could also finance additional employability improvement programs, such as classroom training, apprenticeship training, and work experience initiatives. (Note: Some parts of these cuts have been implemented since this paper was written; the savings would be less than those indicated in Table 13.)

Alternative GAI Implementation Mechanisms

The same schedule of benefits and tax-back rates could be implemented through alternative mechanisms. In choosing the most appropriate vehicle, the considerations represented by the following questions must be taken into account:

- Will the GAI reach most of the eligible population?/What will the take-up rate be?
- Will it be simple and economical to administer?
- How will the recipients respond to changes in their income level?
- Will adjustments for underpayments and, more importantly, overpayments be necessary?

A national GAI plan could be implemented integrated with the social assistance system, the UI system, or the tax credit system.

Integration with the Social Assistance System — Under this option, CAP could fund 100 percent of the national GAI plan, subject to certain national conditions. Other social assistance programs could continue to receive federal funding under CAP but at lower matching rates.

With this delivery mechanism, benefits could be very responsive to short-term changes in the income position of the recipient. On the other hand, the mechanism has several disadvantages. The stigma often associated with social assistance could become attached to the benefits and social assistance does not reach a large part of the low-income population, namely the working poor.

Integration with the UI System — Canada Employment Centres (CECs) could administer a GAI plan as an extension of the UI system. The provinces could top-up benefits, especially for the unemployable or those not expected to work. These top-ups could work like the Ontario GAINS top-up to the federal Guaranteed Income Supplement for the older population. The provinces would continue to be responsible for short-term/emergency assistance and for the delivery of social services.

There would be less stigma attached to it than there would be to the social assistance mechanism and, consequently, there would be a relatively higher take-up rate. Also, this mechanism would be more appropriate for reaching out beyond the traditional social assistance clientele. As well, if the GAI plan were visibly link to the UI fund, it might get business-labour support, especially if business and labour wanted to influence how the fund is used. This could occur, for example, through the Canadian Labour Force Development Board.

On the other hand, bringing social assistance recipients within the UI system could tempt the government to finance the GAI through employer and employee UI premiums. This could discourage employers from creating jobs and it would be a regressive way of financing the GAI program.

Integration with the Tax Credit System — A GAI plan could be administered in the form of a refundable tax credit program such as the federal Child Benefit. Although this option would likely achieve the highest take-up rate and lowest stigma, it would require a more elaborate administrative design than current refundable tax credit programs. Because of its scale, it would be important to make the GAI tax credit more responsive to short-term changes in household income than is the case with existing refundable tax credits.

The main conclusion arising from this examination of GAI options is that a GAI program is feasible. The cost of the example presented here, although substantial, would still be but a fraction of the potential savings from changes to the UI program along the lines proposed by the Macdonald Commission. (These savings have been significantly reduced by recent UI cuts, but there would still be substantial savings.)

Using UI funds to reinforce work incentives is a critical element in the overall strategy of shifting from passive income support to active measures to improve employability. Work incentives and training are necessary complements to any serious attempt to break the cycle of recurrent reliance on social assistance. Such a major change in the income security system would require cooperation between federal and provincial governments. It would also benefit from business and labour support.

Federal-Provincial-Private Sector Cooperation

The successful implementation of a GAI would require first and foremost the close cooperation of the federal and provincial governments. A certain degree of harmonization of benefit rates and tax-back rates would be required to assure that the main objective of a GAI — the elimination of the welfare trap — is not undermined by the lack of cooperation between the two levels of government.

A clear distinction of responsibilities would be a very effective way to achieve the required harmonization. For example, the federal government could be responsible for the first tier and the provinces could be responsible for short-term assistance and top-ups to the federal program. The role of business and labour would also be very important, at least in the initial phase of implementation.

Cooperation among governments, business, labour, and equity groups would be very critical for the success of a GAI program. In the past, many interesting proposals have been put forward but they have always encountered difficulties when federal-provincial negotiations got under way. With the increased assertiveness of business and labour, the issue of cooperation becomes even more critical. A realistic way to move ahead in this area would involve a broad consultation exercise, similar to the one orchestrated by the Canadian Labour Market and Productivity Centre following the launching of the Labour Force Development Strategy in 1988.

An overhaul of the income security system is long overdue. This study indicates that a GAI could be the centrepiece of such a reform.

Two key observations from this study which strengthen the case for a GAI program are

- poverty is a moving target and a program to contain the number of social assistance recipients must address both those currently receiving assistance and low-wage earners, who are at risk of becoming recipients; and

- only a small percentage of the low-income population is truly destitute with no opportunity to achieve some level of self-sufficiency.

The GAI program described in the study could be implemented in a number of ways and financed from savings achieved through changes in existing programs. (While existing programs have been cut back since this paper was written, and the details of the changes required to finance a UI would be different, the basic point that a GAI could be financed through savings in existing programs remains valid.) It could encourage self-sufficiency among social assistance recipients and make income transfers more equitable with respect to the working poor. Under the current system the working poor receive very limited support. This is not equitable and creates work disincentives by encouraging low-income earners to move to social assistance rather than to work to become self-sufficient.

Studies, primarily U.S. studies based on static analyses, of the impact of a GAI plan on work incentives have indicated a negative effect among the working poor. However, the effect tends to be small and there are reasons to believe a GAI program would have a smaller effect on work incentives in the Canadian labour force. Given the employment volatility of the social assistance population, a GAI plan may have a long-term positive effect on work incentives among the working poor.

Work incentives and training are necessary complements to any serious attempt to break the cycle of recurrent reliance on social assistance. The introduction of a GAI plan could play a critical role in facilitating the shift from passive income support to active measures to improve the employability of both social assistance recipients and the working poor.

Notes

1. Often those conducting poverty studies base their analysis on the economic family definition rather than the census family definition. The economic family definition includes all related individuals living in the same dwelling. The census family definition was chosen here because it is more appropriate for implementing a GAI in the form of a refundable tax credit, like the Child Benefit program.

2. A low tax-back rate means that variation in income from year to year leads to small changes in benefits. Consequently, there is no need for major reconciliation of payments.

3. The above description of the substitution effect is an over-simplification. A more accurate description involves advanced economic concepts such as "indifference curves" and "utility maximization." For a more technical treatment of the topic, see Gunderson and Riddell (1988).

4. Interesting in this respect is the experience of Quebec with respect to its APPORT earnings supplement. The take-up rate for the program is considerably lower than 100 percent.

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