

# Ending Universality: The Case of Child Benefits

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Ce texte évalue la réforme de la prestation fiscale pour enfants implantée en 1993, en utilisant le modèle de simulation de politiques sociales avec données (Social Policy Simulation Model and Database - SPSD/M) développé par Statistiques Canada. L'article montre qu'une faible part des avantages de la réforme est allée aux familles les plus pauvres. Ainsi, à cause de l'interaction entre le régime d'impôt et la prestation, les plus grands bénéficiaires furent les familles à revenu moyen-faible (entre 40,000\$ et 50,000\$). Le texte examine également comment le nouveau supplément au revenu gagné a contribué à accroître l'incitation à participer au marché du travail. Il montre qu'à cause des dispositions fiscales prévalant à cet égard, ce supplément résulte en une augmentation *moyenne* du taux marginal d'imposition. De plus, même lorsque le supplément diminue le taux marginal d'imposition, son effet sur la participation au marché du travail est très minime.

The paper evaluates the 1993 child tax benefit reforms using the Social Policy Simulation Model and Database (SPSD/M) developed by Statistics Canada. The paper argues that few of the benefits of the reform went to the poorest families. Instead, because of the interaction of the tax and benefit system, the greatest net beneficiaries were lower-middle income families in the \$40,000 to \$50,000 income range. The paper also evaluates the effectiveness of the earned income supplement in increasing incentives to participate in the labour market. It argues that, because of tax back provisions, the earned income supplement results, on average, in an *increase* in marginal tax rates for Canadian families. Moreover, even when the earned income supplement decreases marginal tax rates, it will have only the most minimal effects on labour force participation.

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## I Introduction

As of January, 1993, three programs specifically designed to provide support for families with children, family allowances, the non-refundable amount (credit) for dependent children, and the refundable child tax credit, were replaced with a single child tax benefit.

According to the government's White Paper on Child Benefit, the reforms to child benefits had a number of goals, including

targeting limited resources to those families with greatest needs and creating positive work incentives. We begin this paper with a discussion of the goals of child benefit policy, both in general terms, and in terms of the stated government objectives of the 1993 reforms. We then go on to describe child benefits in Canada. Finally, we evaluate the outcome of child benefit reform. Although advocates of the new system claim it is fairer and encourages self-sufficiency (Department of Finance,

1992:136), we conclude that the reform has had limited success in achieving these goals.

The assessment of child tax benefit in this paper is carried out primarily using the Social Policy Simulation Database/Model (SPSD/M) developed by Statistics Canada. This model permits a comparison of the distributional effects of previous and current tax policies, and allows us to untangle the complex interaction of various components of the tax benefit system. We also draw on the results of 10 detailed interviews carried out as part of an on-going research project on family financial management by two of the authors (Woolley and Madill, 1995).

## II Child Benefits – Goals for Policy

With the amalgamation of family allowances, the refundable child credit and the non-refundable child credit, the differing goals of the original programs are easily confounded. In the first part of this section we set out a number of general goals for child benefits which command wide-spread support, and then discuss the specific goals of the 1993 child benefit reforms.

### *General Policy Goals*

There are a number of reasons why almost all developed countries have child tax exemptions, child tax credits, family allowances, or some other form of child benefit.

The first is vertical and horizontal equity. Families with children have, in general, less discretionary income and, therefore, a lower ability to pay taxes than families in comparable economic circumstances without children, so vertical and horizontal equity require that families with children receive some form of tax relief or child benefits.

The second is gender equity. Feminist economists such as Eleanor Rathbone campaigned for family allowances to provide women with an independent source of income (Rathbone, 1986).

The third is alleviation of child poverty.

The original, 1944, motivation for family allowances was 'To aid in ensuring a minimum of well-being for the children of the nation and to help gain for them a closer approach to equality of opportunity in the battle of life' (Governor General's speech, Jan 27, 1944, House of Commons, 1944).

Fourth, child benefits may be part of pro-natalist policy. In Canada, pro-natalist policies have had greatest influence in the design of Quebec's family allowance program.

A fifth function of child benefit policy is income-smoothing (Atkinson, 1993:5). A child benefit policy provides families with support when expenses are high – support paid for by higher taxes during the years before and after child-rearing – and so allows people to more closely match their incomes and their needs over their life cycles. Income-smoothing is particularly important when there exist capital-market imperfections.

Finally, child benefit policies, particularly in Europe, are motivated by social responsibility. Child benefit policies spread the cost of raising children between parents and non-parents, recognizing that raising the next generation is a social responsibility, to be shared by all Canadians.

### *Goals of the Child Tax Benefit*

The goals of the 1993 child benefit reform were fairness, effectiveness, efficiency, simplicity, and responsiveness. The background documents to the child benefit reform did not explore what it means to say that a benefit system is fair, or why a benefit delivered to children in low and middle income families is more 'effectively targeted' than a benefit delivered to all children. Rather the terms fair, effective, and so on are used to justify various aspects of the reform.

Two aspects of the reform are justified in terms of fairness: basing benefits on family income and targeting benefits to low- and modest-income families:

The benefits under the new system will be *more fairly* and *effectively targeted* than under the

current [i.e. pre-reform] system. Benefits will be determined according to family income, so that families at a given income level will be treated the same regardless of the number of earners. The greatest benefit will go the low- and modest-income families (House of Commons, 1992:1:20, emphasis added).

Targeting benefits on 'low and modest-income' families is also justified in terms of effectiveness.

Efficiency goals, especially a concern with negative labour market incentives, justify a third component of the reform. The 1993 child tax benefit reform introduced an earned income supplement designed to 'reinforce the incentives for low-income parents to participate in the work force' (White Paper, 1992:9).

Simplicity was a further goal of the 1993 child benefit reforms:

The new approach we are adopting will be simpler. The three programs will be consolidated into one program ... This should be less confusing and less time-consuming for Canadian Families (House of Commons, 1992:1:20).

Responsiveness was also explicitly stated as a goal for reform:

The new child tax benefit will also be more responsive to family needs. Changes in family status ... will be reflected in adjustments to monthly payments (House of Commons, 1992:1:21).

It is important to set out fairness, effectiveness, efficiency and the other goals for the 1993 child benefit reform so that we are able to evaluate the reform on its own terms. One of the key conclusions of this paper is that, even evaluated on its own terms, the child benefit reform had significant failings, particularly in terms of the fairness, effectiveness and efficiency objectives.

### III Child Benefits in Canada

The first child tax benefit payments were made in January, 1993. The child tax benefit replaced three other programs; family allowances, refundable child credits, and non-refundable child credits. The details of the old and new programs are shown in Table 1.

The child tax benefit shares a number of features with the programs it replaces. Like the family allowance, it is a monthly payment, paid to 'the parent who primarily fulfils the responsibility for the child's care and upbringing' (Health and Welfare Canada, 1992:1), who is presumed to be the mother. The basic amount of benefits in nominal terms is almost exactly the same under the new program as under the old – the child tax benefit of \$1,020 is equal to the sum of the family allowance (\$419) and the refundable child credit (\$601). The elimination of the non-refundable child credit is, for moderate income families,<sup>1</sup> exactly offset by the fact that the child tax benefit is not taxable, whereas family allowances were. Eligibility for the child tax benefit is assessed in the same way that eligibility for the refundable child credit was determined. Families with a family net income below \$25,921 receive full benefits, after that benefits are reduced by five cents for every dollar of income.

Despite the almost unchanged level of basic benefits, there was a widespread perception that basic benefits increased as a result of the reform, because of the timing of the benefit changes. Child tax benefits recipients saw their monthly cheque rising as soon as the child tax benefit was introduced, in January of 1993. Much of that rise was due to the replacement of the refundable child credit – yet many households would not be aware of the elimination of the refundable child credit until they received (or, rather, failed to receive) their 1993 income tax refund, in the spring of 1994.

**Table 1**  
Old and new child benefit programs

|                       | Family allowance (1992)                                  | Refundable child credit (1992)                                 | Non-refundable child credit (1992)                                                                     | Child tax benefit (1993)                                                                                                                         |
|-----------------------|----------------------------------------------------------|----------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| Recipient             | Mother <sup>a</sup>                                      | Mother <sup>a</sup>                                            | Higher earner                                                                                          | Mother <sup>a</sup>                                                                                                                              |
| Payment               | monthly                                                  | annual tax refund                                              | lower deductions or tax refund                                                                         | monthly                                                                                                                                          |
| Tax                   | taxable                                                  | not taxable                                                    | not taxable                                                                                            | not taxable                                                                                                                                      |
| Benefits              | \$419 per child                                          | \$601 per child, \$213 supplement <sup>b</sup> for 6 and under | \$417 credit, reduces tax owing by \$110 <sup>c</sup> ; \$834 credit for third and additional children | \$1,020 per child, \$213 supplement <sup>b</sup> for 6 and under, \$75 supplement for third and additional children                              |
| Assessment            | equal payment to all families with children; clawed back | based on previous year's income                                |                                                                                                        | benefits adjusted in June, based on previous year                                                                                                |
| Tax back <sup>d</sup> | 15% when higher earner's income exceeds \$53,215         | 5% when family net income exceeds \$25,921                     | none                                                                                                   | 5% when family net income exceeds \$25,921 (2.5% for 1 child families)                                                                           |
| Other                 |                                                          |                                                                |                                                                                                        | earned income supplement of 8% of employment earnings over \$3,750 to a maximum of \$500, reduced at 10% when family net income exceeds \$20,921 |

Notes:

<sup>a</sup> The parent primarily responsible for care of the children, *Income Tax Act* presumes this to be the mother.

<sup>b</sup> Supplement reduced if child care expense deduction is claimed.

<sup>c</sup> Assuming 50% provincial tax rate; including 4.5% federal income surtax.

<sup>d</sup> For example, if the tax back rate is 5%, benefits are reduced by 5 cents for each dollar earned.

Also, although basic benefits did not change, there are a number of features of the reform that deliver benefits to certain groups of families. First, the reform introduces an earned income supplement of up to \$500 for families with at least \$3,750 of employment income and family incomes below \$25,921. Second, the equivalent-to-married amount tax credit for single parents is retained, despite the elimination of other non-refundable tax credits. Third, the child tax benefit tax back rate – 5 per cent for families with two or more children, 2.5 per cent for one-child families – is lower than the previous family allowance tax back rate (15%) or the previous child credit tax back rate for one child families (5%). Fi-

nally, the substitution of a *non-taxable* child tax benefit for a *taxable* family allowance provides tax savings for certain families in the two higher federal income tax brackets.

While some features of the reform deliver benefits to families, other features of the reform make certain families worse off. First, before the reform the non-refundable child credit was not taxed back from even the highest income families. Now that it is included with the child tax benefit it is subject to tax backs. Second, although basic benefits remained unchanged in dollar terms during the reform, inflation reduced the real value of child tax benefits between 1992 and 1993. Third, before the

reform family allowances were only taxed back when one earner's income exceeded \$53,215. Now benefits are taxed back from a much broader group of families.

The complexity of the reform presents two difficulties in terms of its evaluation. First, it is not immediately obvious, for any one family, how the different components of the reform interact, and whether the family is, in the end, better off or worse off. Second, families vary widely in their circumstances. It is necessary to look at a large number of real-life families – not just one or two stylized examples – to find out how many families gained from the reform, how many families lost, and what the gainers and losers looked like in demographic and economic terms. Both of these difficulties can be surmounted by evaluating the child tax benefit reform by using microsimulation.

#### **IV Evaluating Child Benefit Reforms**

This section evaluates the child tax benefit reform both in terms of the general goals of child benefits such as vertical, gender and horizontal equity, and the stated goals of the reform, such as encouraging self-sufficiency. The evaluation of these reforms is carried out using a microsimulation model, the Social Policy Simulation Database/ Model SPSD/M. The first part of this section describes SPSD/M, the remainder takes up a number of different policy goals.

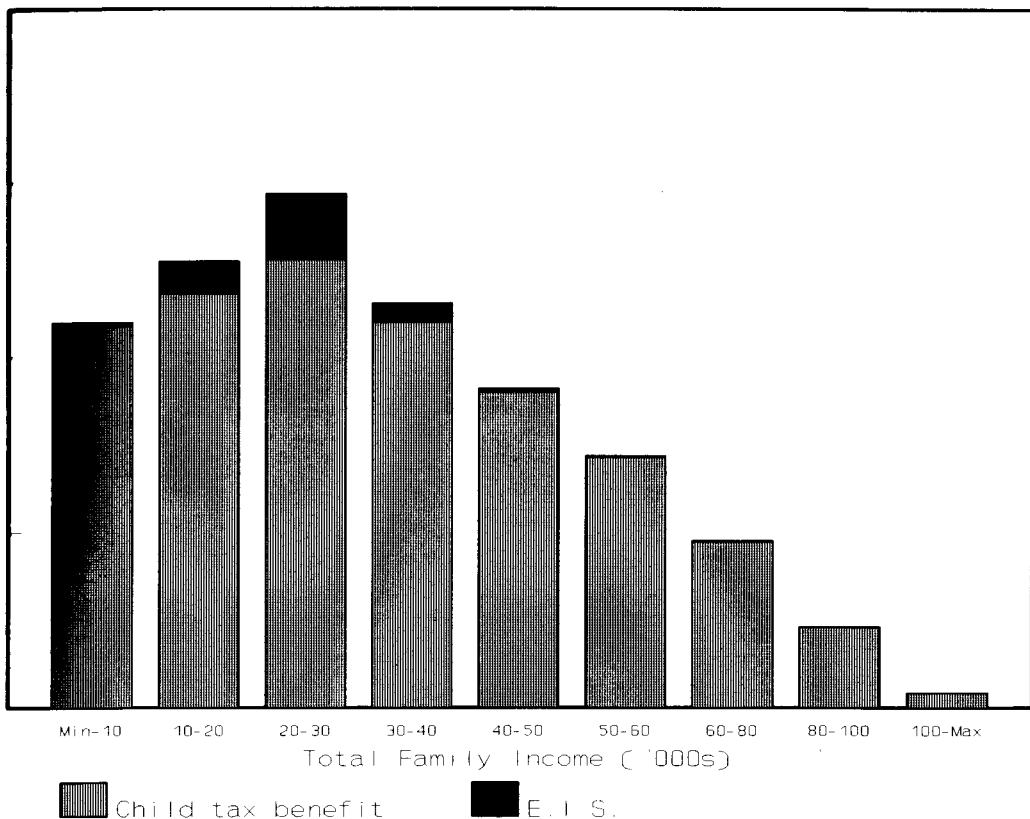
##### *SPSD/M*

The Social Policy Simulation Database/ Model (SPSD/M), developed by Statistics Canada, has two basic components, the database, SPSD, and the model, SPSM. SPSD contains data from taxation records, the survey of consumer finances, the family expenditure survey and unemployment insurance records, which are merged to provide detailed information on individual and family income, expenditures, taxes and transfers. The SPSM calculates taxes and transfers for each individual in the SPSD.

The reliability of the SPSD/M results depends to a large extent upon the type of analysis performed. The analysis in this paper involves primarily income data, and the quality of the income data in SPSD is good, producing reliable results. There are some limitations to the model, the most significant of which is that it does not estimate behavioural responses, for example changes in labour supply, resulting from changes in tax/transfer policies. However given that most Canadian studies find labour supply has a small at most response to changes in marginal tax rates (Phipps, 1993a), and that child tax benefits are only one component of individual and family incomes, there would be very limited benefits to incorporating behavioural responses into the analysis.

In analysing the child tax benefit program, we made a number of modelling decisions. First, we decided to use 1992 as a base case. The introduction of child tax benefit was simulated by replacing the 1992 family allowance/child credits system with the new child tax benefit, while leaving all other tax and transfer parameters at their 1992 level. Second, we based our analysis on real benefit levels. Prices rose between 1992 and 1993, reducing the real value of a given dollar amount of benefits. We have adjusted for the effect of inflation by deflating 1993 child tax benefit values by the consumer price index (CPI).<sup>2</sup> Third, we report the results based on the census family – head, spouse, and never-married children of any age sharing the same dwelling – but indicate when using an economic or nuclear family definition would have produced substantially different results.<sup>3</sup>

Finally, we report results by total income, that is, market income plus transfer payments such as unemployment insurance. There are a number of advantages to using total income. It is a measure of the income directly under the control of families. Moreover, it corresponds to the concept of 'broad income' frequently used in tax incidence studies, facilitating comparison between the results of this study and



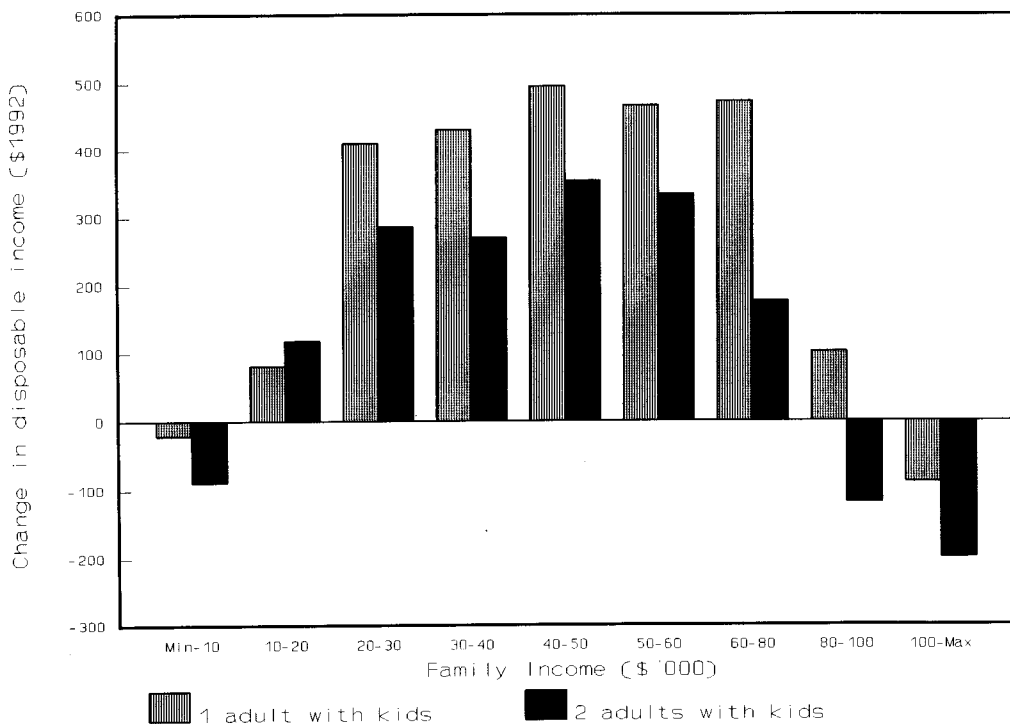
**Figure 1** Average child benefits per child

other research (e.g., Vermaeten, Gillespie and Vermaeten, 1994). Finally, it brings out the cases when the federal government's usage of net income for calculating child tax benefits produces anomalous results.

*Distribution of Gains and Losses*

The White Paper on child tax benefit promised to deliver greater benefits for low and modest-income families. Using SPSPD/M, we estimated the overall distribution of child benefits under the child tax benefit program, and the distributions of gains and losses from the reform of child benefits. Over half (57%) of child tax benefit spending goes to families with incomes between \$20,000 and \$50,000. In part this reflects the large number of Canadian children – 41 per cent – living in moderate income families. It also reflects the design of child tax benefits. Families in the

\$20,000–\$30,000 income range received the highest child tax benefit of any group, an average payment for each child of \$1,281 in child tax benefit and \$188 in earned income supplement, as shown in Figure 1.<sup>4</sup> Child benefits start to decrease as family income rises above \$30,000. This is not surprising, after all child benefits are taxed back when family net income exceeds \$25,921. What is less obvious is why very low income families receive less benefits per child than do families in the \$20,000–\$30,000 income range. One contributing factor is the earned income supplement, which provided an average benefit of only \$10 per family for those with incomes below \$10,000. Another is that families in the \$20,000–\$30,000 income range have, on average, more children than do very low income families, so more often qualify for the special supplement paid for third and addi-



**Figure 2** Gains and Losses

tional children.<sup>5</sup>

One surprising feature of Figure 1 is the relatively high levels of benefit received by families with above average incomes (that is, \$60,000 and above). There are a number of possible explanations for these results. First, the numbers in Figure 1 are based on total income. However most families with incomes above \$60,000 will have substantial deductions for RRSP and other pension contributions, child care expenses, union and professional dues, and so on. If we were to look at net income ranges instead of total income ranges, average child tax benefit per child would fall from \$475 to \$298 in the \$60,000 and \$80,000 income group, and from \$229 to \$71 in the \$80,000 to \$100,000 income group. Second, census family total income includes incomes of older children living at home; incomes which are not taken into account when making child tax credit calculations. Third, child tax benefit calculations are based on the previous year's income, which will in general be different from the current year's income.

Did the move to child tax benefit help low and moderate income families? Figure 2 shows the net gain or loss in disposable income per family – the overall change in child benefits, taxes, and other government transfers – resulting from the introduction of the child tax benefit. Figure 2 brings out the loss in real benefits experienced by the poorest group of families, those with incomes under \$10,000. This loss is primarily due to inflation, which reduced the real value of basic child benefits between 1992 and 1993. Figure 2 also shows the differential effect of the reforms on one- and two-parent families. Single parent families benefit more from the move towards child tax benefit. The retention of the equivalent-to-married amount benefits most single-parent families, while single-parent families with incomes in the \$60,000–\$80,000 range find the child tax benefit tax-back, based on family income, more advantageous than the previous family allowance claw-back based on individual income.

Yet perhaps the most striking result in

**Table 2**

Gain < loss > from introduction of CPI adjusted child tax benefit

| Census families with children under 18, by census family income group | Total family income (in thousands of dollars) |      |       |       |       |       |       |       |        |       | All |
|-----------------------------------------------------------------------|-----------------------------------------------|------|-------|-------|-------|-------|-------|-------|--------|-------|-----|
|                                                                       | Quantity                                      | <10  | 10-20 | 20-30 | 30-40 | 40-50 | 50-60 | 60-80 | 80-100 | >100  |     |
| Unit count ('000)                                                     | 62                                            | 292  | 466   | 540   | 546   | 504   | 680   | 299   | 261    | 3650  |     |
| Pre-reform benefits (average per family)                              |                                               |      |       |       |       |       |       |       |        |       |     |
| Ref. child credit                                                     | 1089                                          | 1105 | 1224  | 1036  | 637   | 340   | 121   | 53    | 8      | 586   |     |
| Non-ref child credit                                                  | 61                                            | 78   | 116   | 137   | 143   | 147   | 143   | 135   | 127    | 131   |     |
| Family allowance                                                      | 578                                           | 637  | 732   | 764   | 771   | 782   | 772   | 760   | 747    | 750   |     |
| FA clawback                                                           | 0                                             | 0    | 0     | 0     | 0     | 21    | 144   | 313   | 623    | 100   |     |
| Post-reform child benefits (average per family)                       |                                               |      |       |       |       |       |       |       |        |       |     |
| Child tax benefit                                                     | 1631                                          | 1855 | 2247  | 2013  | 1661  | 1346  | 880   | 406   | 75     | 1398  |     |
| E.I.S.                                                                | 15                                            | 148  | 329   | 100   | 21    | 7     | 5     | 2     | 1      | 74    |     |
| Average change in                                                     |                                               |      |       |       |       |       |       |       |        |       |     |
| Child transfers*                                                      | -37                                           | 113  | 292   | 213   | 253   | 225   | -13   | -407  | -680   | 62    |     |
| Sales tax credit                                                      | -1                                            | -1   | 1     | 28    | 13    | 3     | 1     | 1     | 0      | 7     |     |
| All transfer income                                                   | -35                                           | 115  | 299   | 247   | 271   | 230   | -12   | -406  | -679   | 52.76 |     |
| Federal income tax                                                    | 0                                             | -5   | -6    | -10   | -29   | -35   | -12   | 24    | 101    | -5    |     |
| Provincial income tax                                                 | 0                                             | -1   | -14   | -40   | -68   | -66   | -44   | -16   | 38     | -34   |     |
| FA clawback                                                           | 0                                             | 0    | 0     | 0     | 0     | -21   | -144  | -313  | -623   | -100  |     |
| Average change in disposable income                                   | -35                                           | 121  | 319   | 297   | 368   | 352   | 189   | -101  | -195   | 210   |     |

\* Excludes change in FA Clawback.

Figure 2 is that the greatest gains are experienced by families in the \$40,000–\$50,000 income group. Table 2, which breaks down the average change in disposable income into its component parts, shows why the net benefits of the reform went disproportionately to these middle income families. The greatest increase in child transfers does, indeed, go to families in the \$20,000–\$30,000 income range. However, because family allowances were included in taxable income, but child tax benefits are not, families in the \$40,000–\$50,000 income range experienced a \$97 reduction in federal and provincial income taxes. The income taxes of lower income families were reduced too, but by much less: families in the \$20,000–\$30,000 income range saw their taxes fall by only \$20. Because the marginal tax rate for families in the \$40,000–\$50,000 income range is higher than that faced by lower income families, the substitution of *non-taxable* child tax credits for *taxable* family allowances is of much greater benefit.

Table 2 can be read in a number of other ways. The first part of the table shows how benefits were distributed before the reform, the second part of the table shows the post-reform distribution of benefits. The final part of the table shows how the changes in benefits interact with other parts of the tax/transfer system, particularly federal and provincial income taxes. Table 2 demonstrates how much the final impact of program changes depends upon the interaction of various components of the tax/benefit system, and the usefulness of micro-simulation models for tracing through the effects of benefit changes.

The child tax benefit was designed to be 'effectively targeted to low and modest income families'. However, the greatest beneficiaries from the reform – on a per child or per family basis, taking economic or census families – are those with total family incomes in the \$40,000–\$50,000 range. It is certainly a struggle to raise a family on an income between \$40,000 and \$50,000, but it is an even greater struggle

to raise a family on a lower income. If the aim of the child tax benefit was to target resources to those families in greatest need, it has been only a qualified success.

The main conclusion to be drawn from this analysis that the move to child tax benefit had an ambiguous effect on vertical equity. On the one hand, most of the losers from the change were concentrated in the higher end of the income distribution, and substantial gains were experienced by single parent families, suggesting that the change enhanced vertical equity. On the other hand, the lowest income groups lost ground in real terms, suggesting that there is potential for a greater increase in vertical equity than actually realized.

### *Horizontal Equity*

Horizontal equity refers to the principle that equals should be treated equally by the tax system. For the purposes of this paper, we will concentrate on the tax treatment of families and individuals with equal incomes. Is it fair?

One of the often criticized (see, for example, Kesselman, 1990) anomalies associated with family allowances was that, because the claw-back was based on individual income, a one-earner family with a net income of \$60,000 would repay part of their family allowance, yet a family with two earners, each with a net income of \$50,000, would repay none of their family allowance. Under child tax benefit, because the repayment is based on family income, this situation does not arise. Is horizontal equity increased? On the one hand, because families with equal incomes are treated equally, it seems obvious that horizontal equity is improved. The improvement in the situation of single parents with incomes in the \$50,000–\$60,000 range is particularly welcome. These are families who have all the costs associated with not having a parent in the home borne by two income families at a similar income level, yet had to pay back part of their family allowances, while two income families with similar family incomes generally did not.

Yet there are two reasons for thinking that the child tax benefit does not completely achieve horizontal equity. First, a *family's* income is an imperfect measure of the income available to women and children within the family. The limited data available for Canada (Woolley and Marshall, 1993) indicate that family members do not have equal access to family income. Less than 50 per cent of couples report that incomes are placed into a 'common fund which each member can draw on as needed' (see also Phipps and Burton, 1993, for related evidence). There is a real possibility of what Rowntree (cited in Pahl, 1989) has called 'secondary poverty' – women and children experiencing deprivation in middle or high income households because they do not have access to the 'breadwinner's' income. Because family income is an imperfect measure of the neediness of individual family members there is a case to be made for payments on behalf of children at all levels of family income, even if these payments are included in the family's taxable income, or partially repaid in some other way.

Second, considering only family income ignores differences between two-earner and one-earner families. Two earner families have greater work-related expenses. Families with one spouse working full-time in the home receive great benefits from that spouse's household production. It is not at all obvious that two-earner and one-earner families with the same total income have the same ability to pay taxes.

A third horizontal equity issue relates to the treatment of childless families and families with children at comparable income levels. It is entirely possible for a family with a net family income of \$67,000 and two school-age children to be paying exactly the same taxes as a family without children at an equal income level. If one regards children as a private consumption good, analogous to, say, a yacht, this is perfectly reasonable. Moreover, the families without child benefits do have above average incomes. Why should there be another

tax break for the rich? Yet, as was argued in section I, the important comparison to make is between families with and without children at the same level. If families with children have less discretionary income and a lower ability to pay taxes, there should be some recognition of this fact in the tax/transfer system.

### *Gender Equity*

Feminist economists such as Eleanor Rathbone (1986) fought for family allowances on the grounds that they would provide women with some limited measure of financial independence. Yet the rationale given in political debates for paying family allowances to women is not a feminist one. Rather, family allowances are paid to women because the *Income Tax Act* presumes (unless it is demonstrated otherwise) that the mother is the parent who primarily fulfils the responsibility for the child's care and upbringing. Implicit are the assumptions that women are responsible for purchasing food and other necessities for their children, and that women are more likely to spend money on these necessities than are men.

There is a certain amount of evidence that women are more likely to spend income on their children. Most is drawn from studies of developing nations (see Hodinott and Haddad, 1993, for a survey), however, recent work by Phipps and Burton (1993) provides similar evidence for Canada.

Our own research, in which we conducted a series of in-depth interviews<sup>6</sup> with couples to discover how they managed their family finances, found that men and women have different spending priorities, yet may be unaware of their differences. In our small sample we found some limited support for the hypothesis that women are more likely to spend income on their children. For example in one couple the man, when asked how he would use a \$1,200 income windfall, replied that he would put it in the house (i.e. save it), whereas the woman said that she would prefer to spend

it on the children. At the same time, it may be possible that some men are not aware of their wife's own personal needs. For example, one man thought his wife would like to use a \$1,200 windfall to save for their daughter's education; her own preference was a dishwasher, washer and dryer. Men and women do have differing spending priorities, and more research is needed to understand these differences.

What about the early feminists' hypothesis, that family allowances provide women with an independent source of income? In our own research we addressed this question in a variety of ways. First, we asked women 'Do you feel differently about money you get from family allowance compared with money you receive from your usual sources of income'. All those who answered the question replied 'no'. Second, we asked those who received more in child tax benefit than in family allowance: 'What did you do with the extra money?' The responses - 'pay bills,' 'it evaporates,' 'just put into bank,' 'use for kids needs,' 'use it as an income source, food for baby' - indicate two things. First, women do not seem to view child tax benefit as a source of independence or empowerment. Second, the intent of child tax benefit, that it be spent on children, is recognized by women, and they feel an obligation to spend the income for their children's or their family's benefit. Finally, we traced the child tax benefit cheque through the household. In approximately half the couples studied the cheque was deposited into a joint chequing account along with other sources of income, in the other half the cheque was deposited in the women's own account. However, in the majority of the cases where it went into the women's account, the woman was working, therefore had independent income anyway.

In conclusion, child tax benefit is of limited success in achieving gender equity goals. It is not enough to make a difference, its very name indicates that it is for children not women, and it seems to disappear in the family finances. If gender equity goals require payments for women, the pay-

ments need to be large enough to make a difference in women's lives.

### *Efficiency - Labour Supply*

The child tax benefit program is unusual in that one element of the program, the earned income supplement, is ostensibly designed to 'reinforce the incentives for low-income parents to participate in the workforce' (White Paper, 1992:9). The earned income supplement increases by 8 cents for every dollar of annual earnings over \$3,750, up to a maximum supplement of \$500, and is reduced by 10 per cent of family net income over \$20,921.

The earned income supplement is designed to lower marginal tax rates (that is, the amount of a dollar's additional earnings that goes in taxes or transfer reductions) for individuals when the family's earned income is between \$3,750 and \$10,000. As the earned income supplement is clawed back, marginal tax rates are raised, specifically for individuals with family net incomes between \$20,920 and \$25,920.

One issue in assessing the effects on work incentives is how many people will experience a decrease in marginal tax rates and how many will experience an increase. To answer that question, we simulated the effects of increasing family annual earnings by \$100 on the amount of earned income supplement received using SPSD/M. We targeted our analysis on those low income families that are potential earned income supplement (EIS) recipients, that is, 778,000 families who either received EIS, or would receive it given an extra \$100 in annual earnings. Of this EIS target group only 169,000, or 22 per cent, face a decrease in their marginal tax rate<sup>7</sup> as a result of the supplement. For these families the amount of supplement received increases as earnings increase, reinforcing incentives to participate in the work force. A much greater number, 282,000, or 36 per cent of potential recipients, face a decrease in their earned income supplement when earnings increase. The EIS actually discourages labour force participation for this group.

The greatest single group of recipients, 326,000 or 42 per cent, receive the full supplement, and have unchanged incentives for labour force participation. Overall, the average marginal tax rate faced by individuals rose from 34.9 per cent to 35.3 per cent as a result of the change. The reduction in the earned income supplement occurs at a denser part of the income distribution than the increase.

Although the earned income supplement results in a rise in average marginal tax rates overall, perhaps the policy can be justified on the basis of the special incentives it provides the very poor to enter the labour force. A careful examination of the program, however, suggests that it is a seriously flawed method of encouraging self-sufficiency. First, using SPSD/M we have found that it is an expensive way of reinforcing work incentives. It is true that the majority of social assistance recipients would find that their supplement increased if their earnings increased, reinforcing their work incentives. However, if one examines the expenditures on the EIS, it becomes apparent that over half of the total amount spent goes to individuals with either a full or a decreasing EIS.

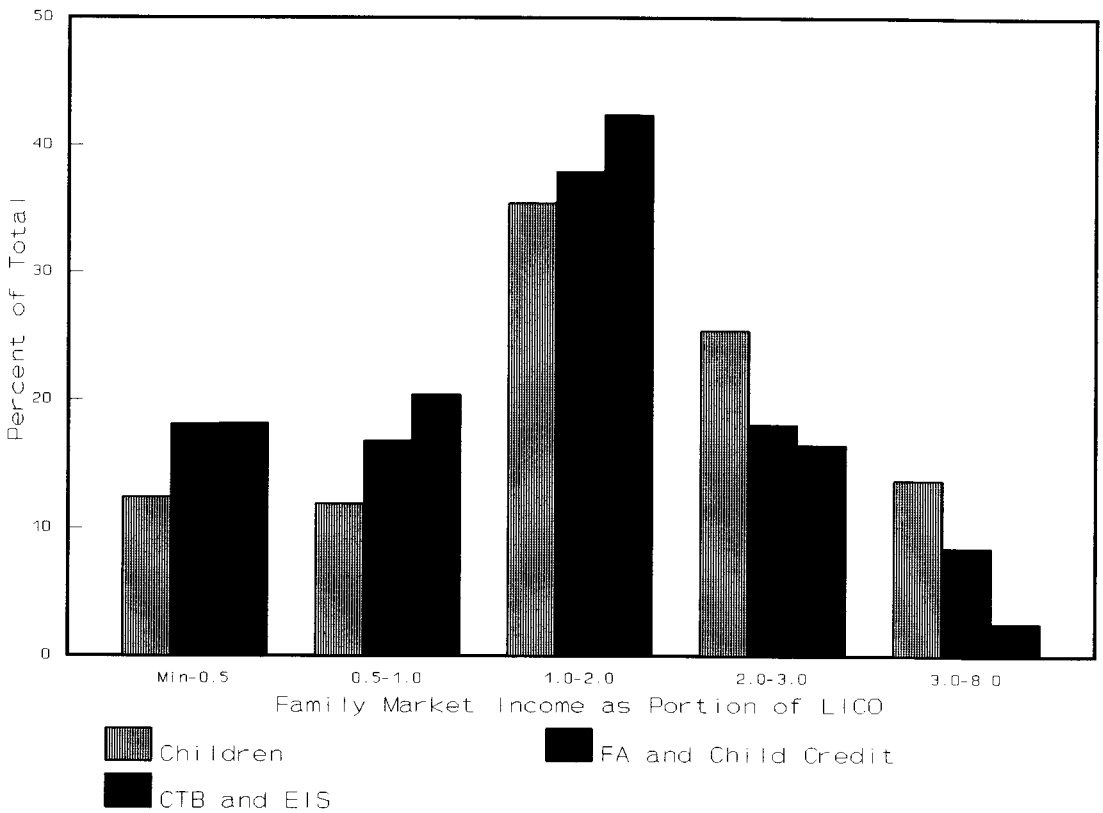
Second, as Shelley Phipps has pointed out (House of Commons, 1992), even when the earned income supplement has maximum impact it produces a trivial effect on earnings. For example, a single mother earning \$3,750 by working 500 hours a year for \$7.50 per hour would, according to the best available evidence, increase her work time from 500 hours per year to about 501 hours as a result of the EIS. Third, any effect of the EIS on labour force participation is dampened, if not extinguished completely, by the six- to 18-month time lag between a change in earnings and an increase in the EIS. Fourth, because the maximum EIS is reached at such a low income level, the positive incentives it provides are experienced primarily by people working part-time or part of the year. Is part-year or part-time work really what policy-makers were aiming to encourage?

Finally, the EIS ignores the dynamics of family decision-making. There is an inconsistency in much economic thought, both at a theoretical and at a policy level. The decision-making unit is for some purposes taken to be the individual, and for other purposes taken to be the family. Economic analysis of labour supply decisions generally considers each individual making a labour supply decision based on his or her own marginal tax rate. It is not at all obvious that an increase in the child tax benefit received by mothers will have the same effect on fathers'/husbands'/partners' labour supply as would an equivalent increase in their own wages. Nor is it obvious that the EIS was intended to encourage mothers to enter the labour force.

There is some question why any government would institute a program that seems guaranteed to fail to meet its stated aim, that is, to reinforce low income working families' incentive to work (White Paper, 1992:4). One plausible explanation is that the EIS is not designed to increase labour force participation at all. Its real aim is simply to provide increased income to poor families with children. Families without earnings are excluded from the program because if the full \$500 EIS was available to all families some provincial governments would reduce social assistance levels correspondingly. Low income families would be little better off, and a provincial spending responsibility would have been taken over by the federal government.

In summary, the available evidence suggests that the EIS will do little to achieve efficiency goals. Indeed, there is some questions as to why *child* benefits should be used to alter *adult's* work behaviour. If there are disincentives for employment stemming from the structure of social assistance programs, incentives for work effort might be more effective if integrated with these programs.

*Targeting – Efficiency and Effectiveness*  
A second way in which the word 'efficiency' is used in the context of child benefits is



**Figure 3** Distribution of children, child benefits

what could be called ‘targeting efficiency’ – an efficient program is, by this definition, one that delivers benefits to those in need.

One way of defining the needy is in terms of Statistics Canada’s Low Income Cut-Off (LICO) – an income level which varies according to family size and area of residence. Figure 3 shows the percentage of children living in families with market income (earnings plus investment income) less than half the LICO, up to the LICO, and so on, and compares this with the distribution of total spending under the old (family allowance and child credits) and new (child tax benefit and EIS) child benefit regimes. Figure 3 illustrates a number of findings. First, the child tax benefit does almost nothing to shift benefits towards families with very low earnings. The move to child tax benefit shifted resources away from higher income families and towards poor and moderate income families, leaving the

very poor no better off than before. The re-design of the child tax benefit reflects a decision to target more resources to working poor, rather than very poor, families.

The term effectiveness is used to describe the extent to which a program reduces the incidence and depth of poverty (Economic Council of Canada, 1992). The move to (CPI adjusted) child tax benefit reduced the number of families with low incomes by 10,000. The change was not, however, revenue neutral. In fact, 90 per cent of the reduction in poverty is due to the increased resources devoted to child tax benefit. A revenue neutral reform would have reduced the number of families in poverty by less than 1,000. In conclusion, while the child tax benefit appears to be slightly more effective in reducing the incidence of poverty than child credits, the change is fairly minor.

### *Responsiveness and Administrative Simplicity*

The child tax benefit is designed to be 'responsive to family needs'. There are two ways in which a benefit may be responsive. First, a benefit may be responsive by changing quickly in response to changes in needs. However, the only changes in needs to which child tax benefit responds quickly are changes in family composition, for example, the birth of a child. Changes in income are not reflected in child tax benefit payments for six to 18 months, as payments are adjusted once a year, in June, on the basis of the previous year's earnings.

This limited responsiveness hampers the effectiveness of child tax benefit in creating incentives for self-sufficiency or fighting poverty. The Economic Council of Canada (1992) found that 27.5 per cent of those who are poor in any given year escape poverty the following year. Among those who became poor in a given year, 49 per cent escaped for the following year. The poor are a moving target, which cannot be hit with a high degree of accuracy after a six- to 18-month time lag.

A second sense in which a benefit may be responsive is in timeliness of delivery. There is some anecdotal evidence<sup>8</sup> to suggest that low-income women found the child tax credit, which was received once a year, much less useful in meeting daily needs than a monthly payment. In this sense, the child tax benefit is superior to the child credits it replaced. At the same time, however, other recipients found that a single lump-sum payment could be more easily saved or used for major purchases.

The child tax benefit is generally superior in terms of administrative simplicity. Family benefits are administered in one program, instead of three. Furthermore, child tax benefit only needs to be applied once, when a child is born or enters the country, rather than annually, as was the case for the refundable and non-refundable child credits. However, the child tax benefit, because it is administered through the income tax system, requires individuals to

file income tax returns, which may reduce the take-up of benefit, particularly for groups such as the functionally illiterate or homeless.

### *Conclusions and Future Directions for Policy*

Universal social programs are coming under increasing scrutiny in Canada. As government budgets are squeezed, there is increasing pressure to redirect resources from those who are seen as less needy to those who are more needy. Yet, in reality, ending universal child benefits delivered few benefits to very poor families, despite the fact that the reform was explicitly designed to 'give the greatest benefit to low and modest income families'. Because of the interaction of old and new child benefits with other elements of the tax transfer system, the greatest gains in disposable income were experienced by families with incomes in the \$40,000-\$50,000 range. Furthermore, the move away from universal benefits inevitably left some parents without benefits, and without any social recognition of their contribution to society as parents, or their lower ability to pay taxes.

The child tax benefit program has other drawbacks. One is the severe limitations of the Earned Income Supplement in creating incentives for labour force participation. By providing incentives to work in a thin part of the income distribution, but taxing back those incentives at a thicker part of the income distribution, the earned income supplement leads to an overall increase in marginal tax rates.

Yet having said all of this, is there a case for reforming child benefits yet again? There are problems with the existing child benefit program: it fails to make major progress against child poverty, it is not responsive to changes in family income, and it fails to provide support for all families with children. Moreover, there are alternatives to the existing child benefit programs such as more generous basic levels of benefits or restoration of some basic universal benefit.

At the same time, there are reasons to be cautious about bringing child benefits back into the forefront of the policy agenda. First, it is not clear that there is political will on the part of the government, or pressure from the public, to find additional funding for child benefits through increased taxes. Increased child benefits could come at the expense of social support for single people, elderly individuals, or working parents, in the form of a reduced child care expense deduction. Second, an improvement in the situation of the very poor requires co-operation from provincial governments, who are responsible for social assistance programs. It is not clear that this will be forthcoming. In summary, although the child tax benefit reform is flawed, there are serious obstacles to further improvements in child benefit programs.

## Notes

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\*\* Formerly known as Judith Marshall.

- 1 Where the high earner's income is below \$29,590, so he pays federal income tax at the basic rate of 17%.
- 2 We chose a broadly-based price index since most goods housing, transportation, food, and home entertainment are consumed by both children and adults. Also increases in the price of non-child goods, such as tobacco, may be reflected in the amount a family spends on children.
- 3 The economic family is a group of individuals living together who are all related by blood, marriage, or adoption and share the same dwelling. A nuclear family is a head, spouse, and children under the age of 18.
- 4 Average benefit levels are calculated by dividing total benefits received by families with children under 18 by the number of families with children under 18. All values are in 1992 dollars. The value of the child care expense deduction is held at its 1992 level, and family income is defined as total income, including market income and government transfer payments.
- 5 For example, the average number of children per

family is 1.36 in families with incomes under \$10,000 and 1.83 for families in the \$30,000 to \$40,000 income range.

- 6 We used structured, in-person, interviews. Husband and wife were interviewed together and then separately (the questions discussed in this paper were asked during the individual interviews).
- 7 These marginal tax rates are calculated as the portion of an extra \$100 of employment income paid in taxes (all taxes except commodity taxes).
- 8 Suzanne Peters, personal communication.

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