# Luxembourg Income Study Working Paper Series

**Working Paper No. 92**

## Canadian Child Benefits: Behavioral Consequences, Income Adequacy and Alternatives

**Shelley Phipps**

**March 1993**

***(scanned copy)***

**Luxembourg Income Study (LIS), asbl**

# Canadian Child Benefits:
# Behavioural Consequences, Income Adequacy and Alternatives

Shelley Phipps
Department of Economics
Dalhousie University
Halifax, Nova Scotia
B3H 3J5
Phone: 902-494-2026
FAX: 902-494-6917

I would like to thank Tom McGuire for research assistance, Peter Burton and Lars Osberg for helpful discussions and the Social Sciences and Humanities Research Council of Canada for financial support.

Abstract

This paper assesses three dimensions of the new Canadian child benefit system. First, evidence is presented to show that the earned-income supplement (EIS) will not increase the labour supply of parents with low earnings. Second, it is argued that the new child benefit system may create substantial lags between a family's loss of income and its receipt of benefit. Third, the paper demonstrates that the level of child benefits is low relative to estimates of the income required to support a child, even at a poverty level standard of living. Moreover, benefits are low in comparison with those received by families in many European countries.

## I. Introduction

With the passing of Bill C-80, the Canadian government has made the most dramatic changes to our system of family benefits since the introduction of Family Allowances in 1945 (Kesselman, 1992). The main objectives of these changes are to increase and target benefits to lower-income families, to supplement the earnings of low-income parents in the work force, to simplify the structure of benefits and to make child benefits more responsive to changes in family needs (Canada, 1992). 'Universal'[1] family allowance benefits, the tax credit for dependant children and the refundable child tax credit have been eliminated. In their place are a basic child benefit and an 'earned-income supplement' for families with low annual earnings (not income)[2]. The basic child benefit is $1,020 per child[3] per year to be taxed back at a rate of 5 percent for families with annual net income above $25,921.[4] The earned income supplement (EIS) is paid at a rate of 8 percent

---

[1] Family Allowances were universal in the sense that every eligible family with children received a monthly cheque in the mail. However, after 1973 family allowances were subject to income tax and after 1989 higher-income families were subject to 'claw-back' of their benefits. Thus, family allowance were no longer universal in the sense that all familes with children received the same net benefit.

[2] 'Earnings' are derived from paid employment; income includes earnings as well as, for example, investment income or government transfers.

[3] Third and subsequent children will receive an additional $75 annually. As well, the benefit will be increased by $213 per child for children under age 7 for whom no child care expenses are claimed.

[4] 'Net income' is very close to the concept of 'taxable income.' Basically, it is income from almost all sources (though not the new basic child benefit) less RRSP and other registered pension contributions, union dues and receipted childcare costs (to a maximum in 1993 of $5000 for children under age 6; $3000 for children 7-14). Notice that with the new system of child benefits, high-income families will not receive recognition for the costs of raising their children -- not even the basic tax credit for dependant children -- unless both parents work for pay and obtain official childcare receipts. (However, childcare is supposed to be an 'employment expense' faced

on household earnings over $3750 to a maximum of $500 per family per year. The EIS is 'clawed back' at a rate of 10 percent on family net income over $20,921 and disappears entirely for family net income over $25,921.

These changes appear to mark a shift in the philosophy underlying our system of child benefits -- away from a European model of social responsibility for all children and toward a US model of efficient delivery of benefits to only some poor children. Kamerman (1980) reports that 'European countries have a long history of acknowledging that children are a major societal resource and that the whole society should share in the costs of rearing them' (p. 24). Universal family allowances did just this, though to a lesser degree after 1989 when higher-income families began to pay back a portion of family allowances (as well as paying income tax on benefits received). Refundable child tax credits delivered benefits to <u>all</u> children in lower-income families while the new earned-income supplement will only be available to <u>some</u> poor children -- poor children whose parents are not labour-market participants will be ineligible.

The new system of child benefits moves towards an 'efficiency' model in several ways. For example, the earned-income supplement has been introduced in an effort to improve the labour-market incentives of parents with low earnings. As well, concern about efficiently targetting family benefit dollars to the most needy households has resulted in the abolition of universal family allowance benefits. This paper assesses the likely success

---

by the parent. It is not intended to recognize the costs involved in the socially important tasks of, for example, feeding and clothing a child.) Thus, for tax purposes, a two-parent family with one child and a joint family net income of $67,000 would be treated identically to a couple without children. According to Kesselman, 1992, this is unprecedented among affluent nations.)

of the new child benefit programme in achieving its efficiency goals. First, Section II of the paper asks whether the earned income supplement is likely to increase hours of paid employment among families with positive but low earnings. Second, since the new child benefit system is intended to avoid the delays many families faced in obtaining their refundable child tax credit, Section III analyses the responsiveness of the new benefits to changes in family income. Finally, Section IV considers the adequacy of benefit levels for the relief of child poverty -- relative to estimates of the 'cost of a child' in Canada, relative to the income shortfalls of poor families with children and relative to benefit levels available in other affluent countries. Section V concludes with a discussion of some alternatives for our system of child benefits and for our fight against child poverty.

## II. Behavioural Consequences

A stated motivation for the earned-income supplement (EIS) is that 'the present child benefit system does nothing to reinforce the incentive to work for low-income working families' (Canada, 1992). Basic economic models of labour-supply behaviour argue that the existence of transfer programmes alters the market opportunities available to individuals and hence the labour-supply choices they make.[5] Thus, the EIS in intended to increase the number of hours individuals with low earnings will choose to work by, effectively, giving them an 8 percent raise. However, the EIS generates different labour-

[5] It should be noted at this point that most simple models of labour supply assume that every worker is free to choose as many hours of paid employment as he or she desires at a wage rate which reflects the worker's productivity level. There is usually no acknowledgement of the possibility that the worker could be involuntarily unemployed or underemployed (working part-time when full-time employment would be the preferred choice).

supply incentives for individuals in different circumstances. It is important to recognize that the EIS will only provide a wage subsidy for some individuals with low earnings. Others will experience a pure income effect or even an implicit tax on earnings. And, even for those individuals receiving an implicit 'raise' as a result of the EIS, econometric evidence indicates that the response to a 'wage change' of the magnitude generated by the EIS will be negligible.

This section considers the four possible effects of the EIS on the labour-supply behaviour of individuals with low earnings. To simplify as well as to make the discussion more concrete, the example of a single mother who can earn $7.50 per hour in the paid labour market is followed throughout this section.[6] (Note that since the EIS is not sensitive to number of children, it doesn't matter how many children she has.)

First, suppose that the single mother does not currently work for pay. Since the EIS is only available (at a rate of 8 percent) on earnings above $3750, she would have to increase labour supply by 501 hours in order to receive her first 60 cent supplement (=0.08 x $7.50). This is surely an implausible response to expect, particularly when the costs of entering the labour market are taken into account (e.g., childcare, clothing, transportation). Even if people have completely free choice about hours of paid employment, it seems unlikely that an individual who didn't participate in the paid labour market without the EIS, will change that decision for an additional 60 cents per hour on hours above 500. However, it is possible that someone currently earning slightly less than the $3750 required to qualify

---

[6] The basic argument is not affected by this presentational choice. Single parents with different wage rates or married couples will face similar incentives.

would attempt to increase hours of paid employment in order to receive the benefit.[7]

Second, suppose the single mother is working 500 hours in the paid labour market and so earns exactly $3750 without the EIS. In this case, each additional hour of employment beyond the current 500 would, with the EIS, earn $8.10 (=$7.50 + 0.08 X $7.50). At the margin, the woman has received an effective 8 percent raise, the largest possible with the earned-income supplement. With this 'wage subsidy,' basic neoclassical theory predicts that an attempt would be made to increase hours of paid employment.[8]

A third situation to consider arises when earnings reach $10,000. At this point the maximum EIS payment of $500 (=0.08 x ($10,000-$3750) is reached. Thus, additional hours of paid employment will effectively be paid at the basic market wage of $7.50 per hour, and in addition, the single mother will receive a 'bonus' $500 of income. In this case, neoclassical economic theory predicts that the individual will attempt to reduce hours of paid employment, if leisure time is a normal good. Basically, the rationale is that when someone has a higher income they have more to spend on things they like. If 'leisure'[9] time is desirable, then more of it will be purchased. Or, looked at another way, suppose the single mother is initially working 2000

---

[7] Recall that to be eligible for the EIS without claw-back, a household cannot have net income above $20,921. To be elgible for any EIS, the household cannot have net income above $25,921. Thus, low-earnings, high-income families would not be eligible for these benefits. However, this is not a common situation.

[8] A wage subsidy is predicted to increase labour supply provided the worker's subsitution effect dominates the income effect (i.e., so long as the labour-supply curve is not backward bending).

[9] Time not spent in the paid labour market is typically viewed as 'leisure time' in neoclassical theory.

hours in the paid labour market and thus earning $15,000. If she will continue to receive the full $500 of EIS so long as she continues to earn at least $10,000, then she can reduce hours of paid employment by about 66 hours (66 x $7.50 = $495) and still retain the same income.

Finally, once the single mother's net income (not earnings) exceeds $20,921 she enters the 'claw-back' zone -- for every additional dollar she earns she will now lose 10 cents of her $500 EIS. Effectively, there is now a 'tax' on her earnings. Alternatively, it is as though she has received a pay cut of 10 percent so that for each hour of paid employment she now nets only 0.90 x $7.50 = $6.75. In this situation, neoclassical theory predicts that she will attempt to reduce the number of hours she supplies to the paid labour market.[10]

Thus, from the perspective of economic theory it is not at all clear that the EIS will 'reinforce the incentive to work.' A theoretical analysis indicates that at least as many negative as positive work incentives are generated. The answer to the question "Will the EIS increase the labour supply of parents with low earnings?" is, in the end, empirical. It will depend on the magnitude of desired changes in labour supply as well as on how many people experience subsidies versus pure income effects or taxes.

First, econometric evidence indicates that most people only want to make very minor, if any adjustments to their hours of work in reponse to changes in their wage rates (such as will be generated by the EIS). The most recent

---

[10] Again, this prediction holds only when labour-supply curves are not backward bending.

estimate of the gross wage elasticity of labour supply[11] for Canadian women, using the best available data, is 0.018 -- and women are traditionally viewed as more responsive to changes in wage rates than men (Osberg and Phipps, 1993). This indicates that from a 1 percent increase in the wage rate, we can expect only a 0.018 percent increase in annual hours of paid employment. Thus, an 8 percent increase in the wage rate would be predicted to increase annual hours by 0.72 hours per year in the example of the single mother who was working 500 hours to earn $3750 in the absence of the EIS.

This result, in line with other current research in labour economics, indicates that we should expect almost no change in annual hours of paid employment as a result of the earned income supplement. Using the largest reasonable post-1980 Canadian estimate of the wage elasticity of labour supply (Stelcner and Breslaw, 1985) together with the full 8 percent increase in the wage appropriate only in the 'subsidy range', predicts an increase of 16 hours per year, assuming employers are willing to expand demand correspondingly. The smallest reasonable estimate (Robinson and Tomes, 1985) predicts that the wage subsidy will reduce annual hours by 34. (See Phipps, 1993 for a survey of estimates of the wage elasticity of labour supply.)

Small estimated elasticities indicate that the reductions in labour supply as a result of the implicit EIS tax predicted by the neoclassical model outlined above will also be small. However, it should be noted that the 10 percent implicit tax exceeds the 8 percent implicit subsidy. Moreover, more people will be affected by the implicit tax and the 'pure income effect' than

---

[11] Economists predict changes in hours (or weeks) of paid employment using 'labour-supply elasticities,' the percentage change in hours of paid employment to be anticipated for a given percentage change in the wage rate. The professional consensus is that the elasticity of labour supply is small. The largest post-1980 estimate is 0.17 -- see Phipps, 1990 for a survey.

will be affected by the subsidy. Estimates using the 1986 Statistics Canada Family Expenditure Survey indicate that only 1.6 percent of families with children have earnings[12] between $3750 and $10,000 as well as net incomes[13] less than $20,921 so that they are in the 'subsidy' range. On the other hand, 3.0 percent of families with children have household earnings above $10,000 and net incomes less than $20,921 so that they experience the 'pure income effect' and 5.5 percent have net incomes in the 'claw-back' range -- a total of 8.5 percent face negative work incentives.[14]

Moreover, limited hours of employment may be a worker's voluntary choice, but they may also be due to insufficient demand for labour services. Many individuals are unable to work as much as they would like because there are shortages of jobs. The 1986 Statistics Canada Labour Market Activities Survey reveals that 18 percent of men (25-55) with some paid employment and 16 percent of women (25-54) with some paid employment were unable to work as much as they would have liked (Osberg and Phipps, 1993). And, lower-income individuals are more likely than others to face quantity-constraints in the labour market (Phipps, 1990). Finally, lack of affordable childcare can be an

---

[12] Household earnings are the sum of wages and salaries and self-employment income for both head and spouse, if applicable. The household 'head' is effectively the higher-income individual.

[13] Net income is approximated as income before tax less RRSP and pension contributions (to a combined maximum of $5500 for 1986), union dues, childcare (to a maximum per child of $2000 for 1986) and less the family allowance payments which were received in 1986 but which would not be received under the new system. 1986 incomes and earnings are then adjusted to 1992 dollars to calculate elibility for EIS tax/subsidy effects.

[14] 7.7 percent of families with children have earnings less than $3750 and have net incomes less than $20,921, the level at which the EIS begins to be 'clawed back.' It is possible that some of these households would increase labour supply in order to obtain the EIS, though as argued above, this seems unlikely. 82.2 percent of families with children have net incomes above $25,921, the level at which EIS is entirely taxed back.

important barrier to paid employment for individuals with young children. The existence of such constraints will further limit the magnitude of behavioural responses we should expect from the earned-income supplement.

In summary, economic theory indicates that the EIS will create positive and negative work incentives; data indicate that more people will be affected by the negative work incentives. However, econometric evidence suggests that changes in labour supply as a result of the EIS will be neglible, both because desired labour supply responses will be small and because many people are unable to alter their hours of work as a result of demand-side constraints. (Demand-side constraints are more likely to be binding for individuals wishing to increase hours of paid employment.)

Analysis thus far has focussed on the effect of the EIS on the supply of hours to the paid labour market as this is the stated motivation for this policy. However, it is important to recognize that the problem of low earnings may not just be a problem of low hours of paid employment. Earnings can also be low as a result of low wages. Statistics Canada Family Expenditure Survey data reveal that many families with low earnings already exhibit significant attachment to the paid labour market. For example, for families with earnings in the 'subsidy' range of the EIS, heads of household had, on average, 18.5 weeks of full-time paid employment and 11.1 weeks of part-time employment for a total of 29.6 weeks. This can be compared with 'high-income' families (i.e., those ineligible for EIS) where household heads had, on average, 45.7 weeks of full-time paid employment and 1.8 weeks of part-time employment for a total of 47.5 weeks. Thus, weeks of employment by heads of household in families eligible for the EIS subsidy were a significant fraction -- 0.62 -- of the average weeks for high-income families, though with

more part-time weeks. Earnings received by heads of household in families eligible for the subsidy, on the other hand, were only 14 percent of the earnings received by heads in high-income households. It is important to remember that low earnings may be due to low wages rather than (in addition to) limited hours of paid employment.

A final extremely important point which should be raised in connection with the earned-income supplement deals with equity rather than behavioural responses. Children in poor families that do not have $3,750 of earned income will not be eligible for the EIS. This is horizontally inequitable from the perspective of the child. That is, similarly poor children are not being treated equally. Since these are to be benefits for children, it is inappropriate to deny one poor child what another might receive as a result of the behaviour of the parents. I would argue that we should not use child benefits in an attempt to modify the labour-market behaviour of parents. This is inequitable from the perspective of the child and, given current econometric evidence, unlikely to be successful. Instead, funds ear-marked for the EIS should be used for all children.

## III. Income Dynamics

The new child benefit scheme is intended to avoid the problem of delays in receipt of funds which characterized the refundable child-tax credit (though not family allowance payments). This was a very real problem for low-income families who must pay bills throughout the year, but who only received the full amount of their refundable credit after tax returns were processed. However, the new system of benefits does not solve this problem. Eligibility for any child benefits will be assessed based on the previous year's income

tax returns (with the old system, families did at least always receive family allowance cheques). Adjustments necessary as a result of changes in income will be made July 1. Suppose an individual loses his or her job on January 1 of 1993 and is without employment throughout the year. Evidence of the drop in income will not be available until April of 1994 -- child benefits will not be adjusted until July of 1994. Thus, the family will wait from January 1, 1993 until July 1, 1994 for the receipt of benefits.[15]

And, economic insecurity is a fact of life for many Canadian families with children. Since 1975, at least 30 percent of new jobs created in most provinces have been part-time jobs. A growing number of jobs are short-term (i.e., lasting less than six months) and a growing number of individuals are self-employed without any employees of their own (e.g., they operate chip wagons). Finally, temporary-help agency work has tripled in the 1980s. These 'non-standard' forms of employment now constitute nearly 30 percent of total employment in Canada (Economic Council, 1990).

Moreover, evidence indicates that changes in income status occur frequently within the period of a year. Results for the U.S. using monthly longitudinal data from the Survey of Income and Progam Participation (SIPP) reveal much more short-run variation in the experience of poverty than can be captured with the sort of data currently available in Canada. The SIPP data indicate substantial fluctuations in income over the course of a year. Thus, while 11 percent of the US population had annual incomes in 1984 less than poverty level, 26 percent were poor in at least one month.[16] The

---

[15] Kesselman, 1992, also makes this point.

[16] And, more than 60 percent of these individuals did not have enough assets to cover even a short spell of low income.

substantial lag in the calculation of entitlement to any child benefits under the new system will leave many families in hardship.

The easiest way to ensure that families receive support when it is needed is to make a universal monthly payment. This ensures that support is always available for poor children as soon as it is needed. To maintain the same budgetary consequences as the proposed child benefit scheme in the most vertically equitable manner, income taxes can be increased. In this way, revenues would be obtained from all individuals who can afford to pay (including but not limited to higher-income individuals with children). Alternatively, universal benefits received by higher-income families could be subject to a special claw-back, as currently. This is a less desirable approach since treating income from family allowances differently from other forms of income is neither logical nor fair.

## IV. Adequacy of Proposed Benefit Levels

An important question to ask about the new child benefits is whether or not they have been set at the appropriate level. This section of the paper addresses the question of adequacy from three perspectives. First, how do benefit levels correspond with estimates of the income required to support a child in Canada today? Second, are they adequate in terms of alleviating the poverty experienced by low-income families with children? Finally, how do benefit levels compare with those received by families with children in other affluent nations?

IV.1 The Adequacy of Benefits Relative to Estimates of the Cost of Supporting a Child

Table 1 presents child benefits for sample families with different earnings and numbers of children (Canada, 1992). Table 2 presents estimates of the amount of income families use, directly and indirectly, for their children.[17] (These estimates include income required for indirect child costs such as extra living space, heating costs, and transportation costs as well as income required for direct child costs such as children's food and clothing.) The amount of income devoted to children obviously varies with the income of the family. Thus, for the purposes of assessing the adequacy of the new child benefits, two sets of estimates are considered. The first set measure the income which a family living at its appropriate poverty line would use for children. This surely provides a lower bound on the income required to support a child in Canada. The second set of estimates measure the income which a family with average income (for families with children) would devote to children. This provides an estimate of the 'average' income cost of a child in Canada. Notice that the cost of a child is higher in single-parent households which are less able to take advantage of 'economies of scale' in sharing together and because single parents have less time available for 'production' within the home (Phipps, 1992).

A comparison of estimates of income needs with benefit levels indicates that the new benefit levels (including earned income supplements) are substantially less than estimates of the income required to support a child (or children) in Canada today, even at a poverty level standard of living.

---

[17] These estimates are derived using an Engel methodology similar to that employed by Statistics Canada in the derivation of the Low-Income Cut-offs. See Phipps, 1992 for details.

For a couple with one child, the maximum possible child benefit of $1520 (including EIS) constitutes only 39 percent of the income required to support a child at poverty level; the maximum benefit constitutes only 17 percent of the income a two-parent, one-child family with average before-tax income ($50,000) would use (directly and indirectly) on behalf of the child.[18]

IV.2 The Adequacy of Benefits Relative to Family Poverty Gaps

Proposed benefit levels are also inadequate for the purpose of bringing the incomes of poor families with children up to poverty level (see Table 2). In 1990 dollars, poor families with one child had, on average, incomes which were $7939 below their Statistics Canada poverty line; poor families with two children had incomes which were $8519 below their poverty line; single parents with one child had incomes which were $7824 below their poverty line. A poor single parent with one child and earnings less than $3750 would receive child benefits of $1020 -- approximately 1/8 of the amount required to eliminate the poverty gap. A working poor couple with two children and earnings of $15,000 fare better. They would receive benefits (including the full EIS) totalling $2540 -- 1/3 of the amount required to eliminate the poverty gap. Still, even when child benefits are targetted to lower-income Canadian families with children, the level of benefits is inadequate for the purposes of eliminating child poverty.

---

[18] Of course, a family with average income of $50,000 would only receive a benefit of $418. I compare the maximum benefit, which would only be received by a lower-income family, with the income which would be used for the child in an average Canadian family to provide a way of assessing the adequacy of the benefit levels.

IV.3 The Adequacy of Benefits Relative to International Standards

A final way of assessing the adequacy of the new child benefits is to compare them with average benefit levels available in other affluent countries as calculated using microdata from the Luxembourg Income Study.[19] These estimates are reported in Table 3. To make the international comparisons, average child benefits for each country are reported as a percentage of average after-tax and transfer income for that country. This indicates the magnitude of child benefits relative to each country's ability to pay, given existing standards of living.

First, since the US does not provide any child benefits, ours naturally appear generous by comparison. (Some poor children in the US do receive transfers through the Aid for Families with Dependant Children programme, similar to Canadian social assistance. There is no programme specifically designed to pay benefits to all children, or even to all poor children (Kamerman and Kahn, 1988)).

However, Canadian child benefits are less generous than those received in any other country studied. The average Canadian child benefit received before 1983 was only 2.5 percent of average family disposable income. This compares most closely with Australia, where average child benefits constituted

---

[19] The Luxembourg Income Study is a set of internationally comparable microdata sets, housed in Luxembourg, but easily accessible to remote users via the EARN/BITNET system. See Smeeding, et al., 1985, for a detailed description of this data source. The LIS dataset for Australia is the 1985 - 86 Income and Housing Survey (7,560 observations); the dataset for Canada is the 1987 Survey of Consumer Finance (10,999 observations); the dataset for France is the 1984 Income Survey of Taxes (12,693); the dataset for Germany is the 1984 German Panel Survey (5,174 observations); the dataset for the Netherlands is the 1987 Survey of Income and Program Users (12,693 observations); the dataset for Sweden is the 1987 Swedish Income Distribution Survey (9,421 observations); the dataset for the UK is the 1986 Family Expenditure Survey (7178 observations).

3.3 percent of average family disposable income.[20] For couples with one child, benefit levels were very similar for the two countries. The divergence occurs as a result of the more generous benefits paid to larger Australian households.

Child benefits as a percentage of average after-tax and transfer income are much lower in Canada than in several European countries. While Canadian child benefits constituted only 2.5 percent of after-tax income, average child benefits were 11.9 percent of after-tax income in France, 4.8 percent in Germany, 8.5 percent in the Netherlands, 9.7 percent in Sweden and 7.6 in the UK. Forecasts are that the new Canadian child benefit system will pay out $400 million dollars more than the old child benefit system. Even so, Canadian child benefits do not appear generous relative to those received by families with children in Europe. Government estimates (Canada, 1992) indicate that the average benefit to be received by Canadian families will be $1260 (including the value of the 'equivalent-to-married exemption for single parents).[21] This constitutes only 3.0 percent of average Canadian after-tax income -- substantially less than the value of child benefits received by European families with children.

Finally, it should be noted that the average child benefits reported in Table 3 do not indicate the full package of benefits available to families with children in some European countries. For example, France and Germany offer free (or very low-cost) childcare for children from about age three

---

[20] Evans (1992) reports that the child benefit system in Australia has recently been revised and is currently significantly more generous than the Canadian.

[21] Numbers reported for the other countries (and for Canada pre-1993) do not include the value of non-refundable child tax credits or dependant child exemptions. The US, for example, has a dependant child exemption.

until they begin formal schooling. France, Germany and the Sweden provide income-tested housing allowances for families with children (Kamerman and Kahn, 1988).

Even with the increased targetting of child benefit dollars, the level of child benefits to be received by poor Canadian families is low relative to need and by international standards. Benefit levels would have to be increased by as much as eight times their present values just to bring some families up to the poverty threshold. Thus, the new child benefits will not go far toward the goal of reducing child poverty in Canada. And, it is important that Canadians recognize that child poverty is a more serious problem in Canada than in many other affluent societies. 15.5 percent of Canadian children lived in poor families in 1981. While 22.4 percent of US children and 15.9 percent of Australian children lived in poor families, only 4.9 percent of (then West) German children, 4.8 percent of Norwegian children, 5.0 percent of Swedish children, and 7.8 percent of Swiss children lived in poor families. Moreover, <u>all</u> Canadian public transfers leave poor families with incomes which, on average, are still 15 percent less than poverty level (25 percent less for single parents). This is, again, in marked contrast with the situation in other affluent nations. For example, public transfers received by poor families in Germany, Norway and the UK raised incomes (roughly) to poverty level (Smeeding, Torrey and Rein, 1988).[22]

Why are some countries more successful at reducing child poverty than we are in Canada? Child allowances, while important, are far from the only significant factor. For example, Smeeding, Torrey and Rein (1988) conclude:

---

[22]Calculated using the Survey of Consumer Finance 1987 in $1990.

> Despite their presumably more effective targeting, countries that rely on means testing seem politically unable or unwilling to raise benefits high enough to be as effective in moving children out of poverty as universal and social insurance approaches (p. 116).

It is important to remember that children are poor because their parents have inadequate incomes. Thus, if we truly wish to reduce child poverty, we must make changes in policies which increase parents' incomes. These include:

a) improve employment opportunities for parents (e.g., pursue a full-employment policy). Simulation results which I have conducted indicate that if all heads of household in Atlantic Canada (aged less than 65) were able to obtain as many weeks of full-time employment as heads of household receive, on average, in Ontario (41.13 weeks), the probability of poverty would fall 19 percentage points (from 31 percent to 22 percent) (Phipps, 1991).

b) increase social assistance and unemployment insurance payments to help protect families from both the long- and short-term hardships associated with an ever-changing labour market.

c) provide state guarantees of minimum child support payments (such as are provided in Austria, Denmark, Finland, France, Israel, the Netherlands, Norway, Sweden and Germany(Kamerman and Kahn, 1988).

d) provide affordable/available childcare and equal pay for women.

## V. Conclusions

The earned-income supplement component (EIS) of the new Canadian child-benefit system will not be an effective means of increasing the labour supply of parents with low earnings. First, the scheme generates negative work incentives for more workers than it creates positive incentives. Second, recent econometric evidence indicates that labour supply is not very responsive to implicit changes in wages such as will be generated by the EIS. Third, many workers will be unable to work more hours in the paid labour market because, in a high-unemployment economy, there are no more hours available to them. Finally, it is inappropriate that funds intended to help children should be used in an attempt to modify the work behaviour of their parents. Thus, it is recommended that the EIS component of the new child benefit system be dropped.

The new child benefit system is not more responsive to changes in income experienced by families with children. For example, a family suffering a drop in income in January of one year will not be entitled to <u>any</u> benefits until a year and a half later. This problem could be eliminated without altering the budgetary commitment to child benefits by replacing both the basic child benefit and the earned-income supplement with a universal payment made monthly and 'clawed back' at tax time, as currently. An even more equitable and logical approach, with the same budgetary commitment, would simply be to treat the child benefits as taxable income like any other and to increase income taxes for all households, with and without children.

Finally, since a major motivation for the revisions to the Canadian system of child benefits is to 'help families who need help the most,' this paper addresses the issue of benefit adequacy. Results indicate that child

benefits are low relative to estimates of the income required to support a child, even at a poverty standard of living. They are low relative to the income required to raise the incomes of poor households to poverty level. And, they are low relative to benefits available in European countries.

In the final analysis, if we wish to 'help families who need help the most' and to reduce or even (hopefully) eliminate child poverty in Canada, we are unlikely to do this using child benefits alone unless benefit levels are increased by as much as eight times their current levels. Since children are poor when their parents have low incomes, policies which increase parental incomes are critical for the reduction of child poverty. Such policies include improving employment opportunities for parents (e.g., through the pursuit of full employment), increasing the level of social assistance and unemployment insurance benefits, providing state guarantees of minimum child support payments and equal pay for women.

# Bibliography

Canada. 1992. The Child Benefit: A White Paper on Canada's New Integrated Child Tax Benefit, Ottawa.

Economic Council of Canada. 1990. "Good Jobs, Bad Jobs: Employment in the Service Economy."

Evans, Patricia M. 1992. "Tackling Child Poverty: A Comparison of Australian and Canadian Initiatives", mimeo.

Kamerman, S.B. 1980. "Child care and family benefits: policies of six industrialized countries." Monthly Labor Review, 103(11), 23-28.

Kamerman, Sheila B. and Kahn, Alfred J., 1988. "Social Policy and Children in the United States and Europe" Ch. 14 in J.L. Palmer, T. Smeeding and B.B. Torrey (eds.) The Vulnerable, Washington: The Urban Institute Press.

Kesselman, Jonathan, 1992. "The Child Tax Benefit: Simple, Fair, Responsive?" mimeo.

Osberg, Lars and Phipps, Shelley, 1993. "Large-Sample Estimates of Labour Supply: Results with Quantity Constraints", Oxford Economic Papers, forthcoming.

Phipps, S. 1992. The Cost of Children in One- and Two-Parent Families: Consequences for the Equitable Design of Child Support Payments, mimeo.

Phipps, Shelley A. 1993. "Does Unemployment Insurance Increase Unemployment", paper presented at the conference "Unemployment: What is to be done?" Laurentian University, Sudbury, Ontario, March 26-27, 1993.

Phipps, S. 1990. "The Impact of the Unemployment Insurance Reform of 1990 on Single Earners", Canadian Public Policy, 16:3, 252-261.

Phipps, S. 1991. "Regional Differences in the Incidence of Poverty in Canada" The Canadian Journal of Regional Science, 14:1, 47-72.

Robinson, Chris and Nigel Tomes, 1985. "More on the labour supply of Canadian women," The Canadian Journal of Economics, 18:1, 156-163.

Ruggles, Patricia and William Roberton, 1989. "Longitudinal Measures of Poverty: Accounting for Income and Assets over Time", Review of Income and Wealth, 35:3, 225-282.

Smeeding, T., G. Schmaus, S. Allegrezza, 1985. An Introduction to LIS, Luxembourg Income Study, Working Paper #1.

Smeeding, T., Torrey, B.B. and Rein, M. 1988, "Patterns of Income and Poverty: The Economic Status of Children and the Elderly in Eight Countries", in

The Vulnerable, Palmer, J.L., T. Smeeding and B.B. Torrey (eds.), Washington: The Urban Institute Press.

Statistics Canada, 1986. The Family Expenditure Survey.

Stelcner, Morton and Breslaw, Jan. 1985. "Income Taxes and the Labor Supply of Married Women in Quebec", Southern Economic Journal, 51:4, 1053-72.

Wolfson, M.C. and J.M. Evans, 1990. "Statistics Canada's Low Income Cut-offs: Methodological Concerns and Possibilities", Statistics Canada, Analytical Studies Branch, Research Paper Series.

Table 1

Child Benefits by Family Income,
Family Type and Number of Children

| Family Income | One Child | Two Children | Three Children |
|---|---|---|---|
| 0 | $1,020 | $2,040 | $3,135 |
| $10,000 | $1,520 | $2,540 | $3,635 |
| $20,000 | $1,520 | $2,540 | $3,635 |
| $30,000 | $918 | $1,836 | $2,931 |
| $40,000 | $668 | $1,336 | $2,431 |
| $50,000 | $418 | $836 | $1,931 |
| $60,000 | $168 | $336 | $1,431 |
| $75,000 | 0 | 0 | $681 |
| $100,000 | 0 | 0 | 0 |

[1] This table assumes families are claiming the childcare expense deduction. Families not claiming this deduction will receive an additional $213 annually for each child under seven. Taxable single parents are also entitled to claim the 'equivalent-to-married' credit for one child. For taxable single parents this will, on average, have a value of $1,445 in reduced federal and provincial taxes.

Source: Canada, 1992.

Table 2

Income Requirements for Children[1]
and Poverty Gaps for Canadian Families with Children

| | Couples | | | Single Parent |
|---|---|---|---|---|
| | One Child | Two Children | Three Children | One Child |
| Income required to support a child at a 1990 poverty level standard of living[2] | $3879 | $5715 | $7592 | $5715 |
| Income required to support a child at the average standard of living for Canadian families with children ($50,000) | $9016 | $11,538 | $14,029 | $16,887 |
| Average Family Poverty Gaps[3] | $7939 | $8519 | $7364 | $7824 |

[1] Phipps, 1992. Income requirements are expressed in 1990 dollars.

[2] The relevant poverty lines are $21,510 for couples with 1 child, $24,765 for couples with 2 children, $27,058 for couples with 3 children; $16,922 for a single parent with 1 child. These values are in 1990 dollars and are averages across all levels of urbanization. See Wolfson and Evans 1990, p. 15. Mean income for all families with children is $49,612, calculated using the 1986 Statistics Canada Family Expenditure Survey, and converted to 1990 dollars.

[3] Average family poverty gaps are calculated as the average amount by which the incomes of poor families fall short of the poverty line. These poverty gaps are calculated using the 1987 Survey of Consumer Finance and adjusted to 1990 dollars.

Table 3

An International Comparison of Average Child Benefit Levels[1]

| | All Families with Children | Couples | | | Single Parent |
|---|---|---|---|---|---|
| | | One Child | Two Children | Three Children | One Child |
| Australia[2] | 3.3% | 1.3% | 3.3% | 6.3% | 1.3% |
| France | 11.9% | 3.2% | 10.5% | 31.4% | 5.5% |
| Germany | 4.8% | 2.7% | 5.2% | 13.6% | 2.7% |
| Netherlands | 8.5% | 3.5% | 9.4% | 17.1% | 3.4% |
| Sweden | 9.7% | 4.8% | 10.8% | 21.8% | 5.0% |
| UK | 7.6% | 3.8% | 8.1% | 13.4% | 5.0% |
| US | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Canada - pre 1993[3] | 2.5% | 1.3% | 2.6% | 4.7% | 1.4% |

[1] Calculated using the Luxembourg Income Study. Average child benefits are reported as a fraction of average family income for each country.

[2] The Australian system of child benefits has recently been completely redesigned. See Evans, 1992.

[3] Child benefits in this case refer to family allowances and refundable child tax credits. The value of the non-refundable child tax credit is not included -- this is true for all countries.