Reforming the Welfare State: Paying for Canada

by Peter Clutterbuck and Armine Yalnizyan

Canadians are being told that the welfare state is in ruins and that social programs no longer work, as evidenced by the fact that "child poverty is growing, unemployment rates are near record highs and our national debt soars higher every day." (*The Toronto Star*, September 17, 1994)

This is an empty debate as long as it is based on false assumptions about the source of the fiscal crisis, and as long as there is no discussion of the range of options that are, in fact, available to the federal government.

Let us put this exercise into context.

The current drive to reform UI and welfare is being triggered by peripheral concerns: the 3 percent rate of known abuse of welfare, and the 6 percent of the population drawing UI that lives in Newfoundland. The government and the media have promoted the view that the vast majority of those who legitimately *use* these programs are virtually *abusing* them. This focusses social security reform on issues of dependence and fraud, not despair and poverty.

The real fight in this country is about public responsibility, and the public role around shaping economic development. It is a fight about what kind of social security programs we want, about what kind of economy we want, and what kind of public finances would bring this about. In essence, this dialogue is about defining the role of government and its character.

Is the Welfare State Outdated?

Public finances are at the heart of the struggle to redefine the quality and scope of the Canadian welfare state. Ironically, the arena of debate about public finances has been largely closed to the public. In the formulation of budgets and fiscal plans, the Finance Department relies on only one dominant perspective — the way to good nationhood is through the market. Looking at public finances through the lens of the marketplace has led us to prescribe balanced budgets through cutting costs. These costs are equated with social spending.

But Canada's fiscal crisis is *not* the result of an unaffordable system of social programs. Canada has neither over-provided nor over-spent on social programs. Rather, Canada has *under-collected* relative both to the capacity of its citizens and corporations to contribute to the social security of Canadians, and as compared with other industrialized countries.

Source of the Fiscal Crisis

Canada has had a primary expenditures surplus (all federal expenditures except interest paid on the debt) since the 1986–87 fiscal year. Indeed, primary expenditures have been declining every year since 1984, with the exception of the last few brutal years of recession. It is striking that, even under these economic conditions, primary expenditures were lower in 1992 than in 1975. Clearly, government spending is not out of control.

The fiscal crisis originated in under-collection of revenues in the 1970s and was exacerbated by rising debt charges due to the unprecedented interest rates of the 1980s. It did *not* arise from rampant spending on social security, which has remained relatively constant since the mid-1970s, with the exception of the recession periods of the early 1980s and the early 1990s. All other functions of the federal government have fallen dramatically in relation to the size of the economy, with the exception of the service charge on debt.

Rising debt charges on Canada's accumulated debt consume a growing proportion of our public resources. The federal government now spends $41 billion annually — nearly 25 percent of all federal expenditures or 6 percent of our GDP — to service our debt. (See Table 1.)

Table 1

Federal Revenue and Expenditure Patterns as Percentage of GDP, 1986–1992

Year	Total Revenue	Primary (Current) Expenditures	Debt Charges	Total Expenditures
1986	18.1	17.6	5.2	22.8
1987	18.3	17.0	5.0	22.0
1988	18.3	16.2	5.2	21.4
1989	18.3	15.9	5.7	21.6
1990	19.1	16.7	6.2	22.9
1991	19.8	18.0	6.2	24.2
1992	20.8	18.2	5.7	23.9

Source: Canadian Tax Foundation (1993), *The National Finances 1993*. Analysis prepared from data reported in Table 3.6 and Table 3.8.

The False Dilemma: Don't Want Cuts, But Can't Pay

For two decades we have been bombarded with the notion that we pay too much tax. What does the evidence show?

From 1976 to 1985, a majority of advantaged and middle-class Canadians, as well as Canadian corporations, enjoyed a *tax holiday* that resulted in a serious decline in public revenue. This was the initial factor contributing to Canada's current fiscal crisis. For the average Canadian, these tax breaks took the form of full indexation in the personal income tax system and the substantial growth of tax shelters, such as RRSPs. Canada was the only G7 country that experienced such a decline in public revenues.

The problem of a generalized tax holiday was compounded after 1986 when, in addressing revenue problems, the previous government broadened the tax base at the bottom and reduced the rates at the top, resulting in profound inequities in the tax system. These obvious changes have significantly reduced people's will to pay, especially in the light of continued reduction of publicly provided services and benefits.

Corporate contributions have declined most precipitously among all sources of federal tax revenue in the last 20 years. They accounted for only 7 percent of federal revenues in 1992, down from 17 percent in 1975. (They represented 25 percent of all federal revenue in 1995.) In relation to GDP, federal and provincial corporate contributions to public provision in Canada, both in taxes and social security payments, are lower than those in the United States and are the lowest of all G7 countries, including Japan. (See Figure 1.) Apparently, Canadian corporations have some latitude to increase their contribution with no threat to their existing competitive position.

In fact, average Canadians pay less than average Americans for a significantly better society. Relative to the US, average Canadians enjoy access to a universal health care system, an inclusive and well-funded system of public education, and higher levels of support for seniors, the unemployed, and the poor. The cost? Contributions of average Canadians to total government revenue are above those in the US before social security contributions are taken into account. When social security contributions are included, average Americans pay more than average Canadians.

How should we pay for the debt? Cutting social programs to reduce the deficit makes no sense. The crisis of this period is not that we cannot afford to pay for social programs, but that we cannot afford to have an economy that does not work. The objective of reviewing social programs and public finances at this time should be to find fair and logical ways of paying for a system that works.

Enhancing Social Security and Addressing the Deficit

For the past decade, federal politicians have been telling us that there are no alternatives to cutting social entitlements. Canada *does* have national options for addressing the fiscal deficit that do not require us to dismantle the welfare state and erode the foundations of Canadian nationhood. Canadians should expect their federal government to exercise these options and play a key leadership role both domestically and internationally.

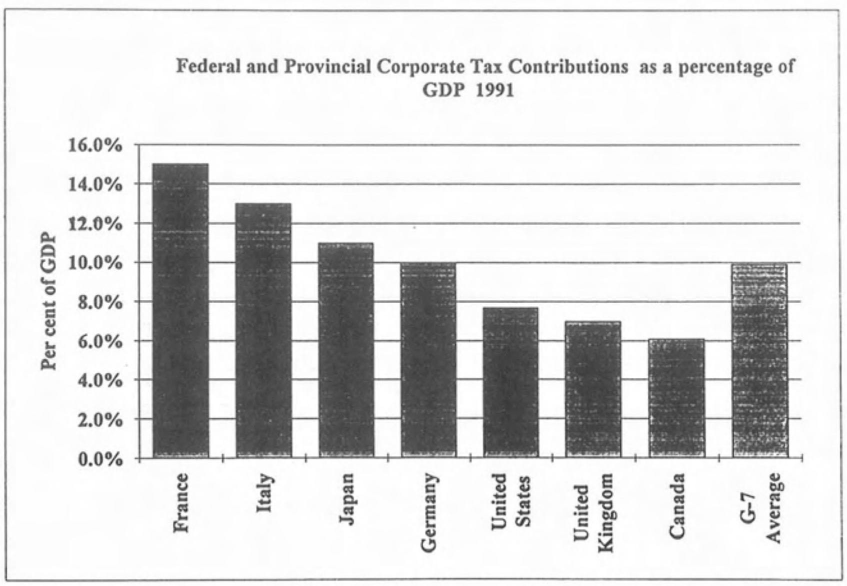
Focus on Getting People Back to Work

The only sustainable mechanism to reduce the deficit and restore financial health to the public and private spheres of society is full employment. A number of possibilities exist to create both more jobs and better jobs.

First, we live in an era of paradox where an unemployment crisis coexists with more and more people working extremely long hours. Establishments that regularly rely on long hours of work — through paid overtime, for example, in heavy manufacturing, and through unpaid overtime, for example, managerial and professional salaried employees — should be required to *reduce*

Continued, see "Reforming the Welfare State" on page 20.

Figure 1



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and redistribute working time to create new job openings.

Second, essential public services — such as providing child care, developing preventive and corrective environmental technologies, supporting community-based health care, and building the training/upgrading infrastructure — should be prime sites of *public investment*, which in turn would generate needed and decently paid work.

Finally, *more private sector job creation should be expected during a recovery*. This is only likely to occur, however, if:

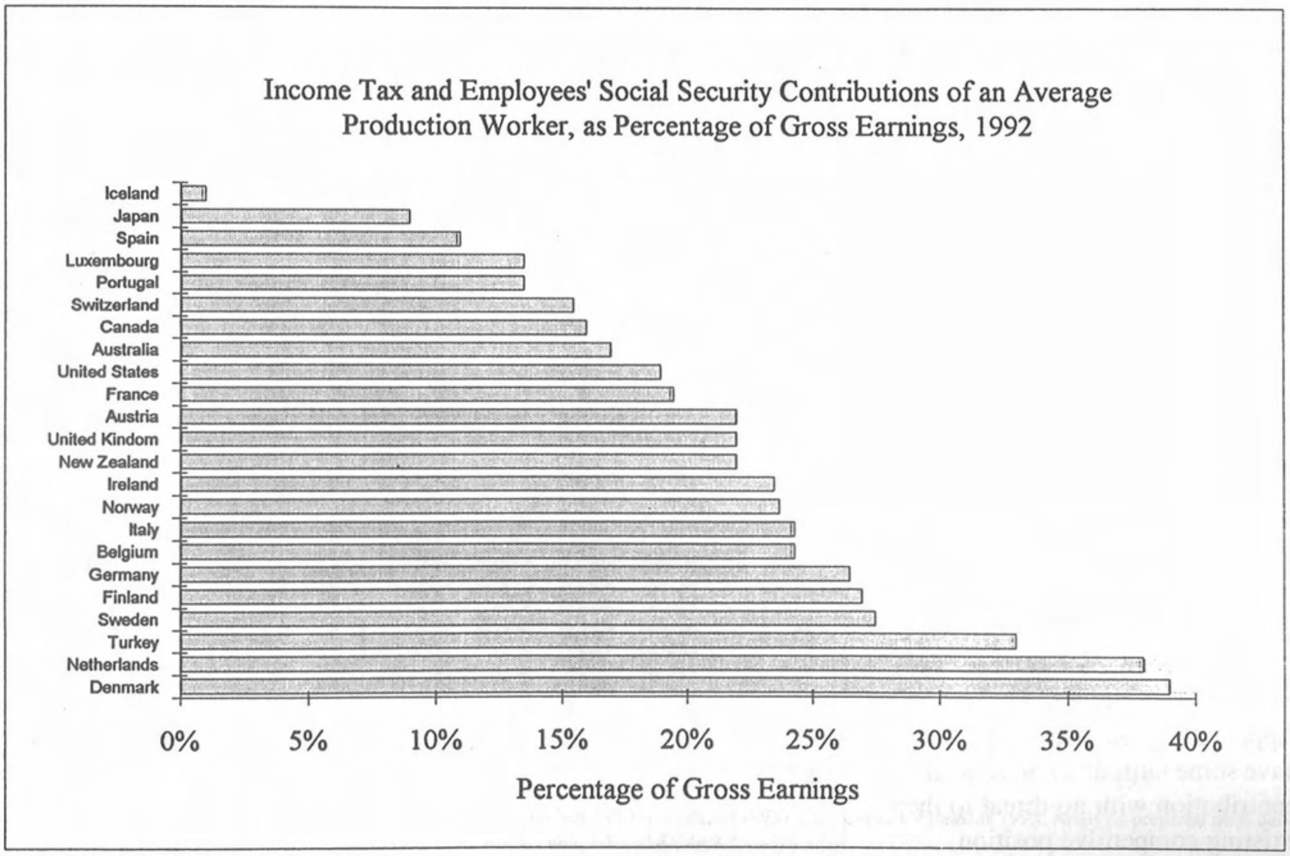
1. *more of our savings are returned from offshore*, so they are made available for productive investment here, and
2. *more domestic consumption is supplied through domestic production* rather than imports.

These conditions can be met respectively by:

1. returning foreign investment thresholds for pension/retirement plans to 1989 levels (10 percent instead of the current 20 percent), thereby re-routing about $25 billion back for investment in Canada, and
2. identifying key sectors of the economy as vital to the national interest (as has been the case for the defence industry) and setting domestic production targets in these sectors (e.g., heavy machinery related to resource-extraction, technology associated with hydroelectricity, pharmaceuticals, etc.).

Canadian taxpayers spend 25 cents of every tax dollar to service the $41 billion federal debt. An increasing proportion of that money (8.6 percent in 1983 to 23.6 percent in 1992) simply leaves the country in the form of interest to foreigners who hold our debt. Reviewing these expenditures is at least as important as reviewing expenditures on social programs. A variety of mechanisms could be weighed, from renegotiating the yields from bonds, to introducing interest rate controls, to relying more heavily on long-term, strictly domestic instruments such as Canada Savings Bonds (which can only be held by residents and have historically been the prime mechanism for financing Canadian debt). Since the financial community has long been alerting us to the dangers of debt "crisis," they should be required to finance part of it. Canadian banks and other large bondholders could be required to take marginally lower returns as part of the belt-tightening exercise that the government has required of the unemployed and working poor for the past three years.

Figure 2



Generate Tax Reforms that Address Both Equity and Adequacy Concerns

Many studies show that the federal deficit started in the mid-1970s due to an under-collection of tax revenues, not overspending. Is there room for higher taxation? Who should bear these increases? These questions raise issues of both equity (who should contribute and how much?) and adequacy (what amounts are required for what levels of benefits and for whom?). (See Figure 2.)

Tax expenditures such as retirement savings exemptions, protected family trusts, and business corporate tax exemptions are perhaps more of a drain on public finances at a time of deficit crisis than social spending. In these cases, significant public revenues are "spent" on those who least need public support. As one example, the startlingly generous RRSP contribution limits could be reviewed as a possible source for financing the debt. The current ceiling for RRSP contributions is $12,500, a limit wildly beyond the $2,567 claimed on average by 4 million Canadians in 1990, representing only 22 percent of tax filers, and causing the federal government to forfeit about $4 billion in revenues. A further $10 billion was forfeited through registered pension plans. The decision about how much of that could be retrieved is political, not economic.

Tax deferrals and exemptions should also be reviewed. For example, the amount of federal taxes deferred by corporations due to fast write-offs for capital investment totalled about $3 billion in 1972. By the early 1990s, corporations had deferred almost $40 billion in federal taxes — roughly equivalent to the nation's debt servicing charges. If this is a fiscal *crisis*, it is reasonable to expect a review and reduction of such tax holidays.

The personal income tax system should also be reviewed regarding the rates of taxation, the numbers of tax brackets and their thresholds. Note that, between 1987 and 1989, the number of tax brackets fell from 10 to 3, with the top marginal rate of tax dropping from 36 to 29 percent while the bottom was boosted from about 7 to 17 percent. Alternative sources, such as inheritance taxes or altering regulations regarding family trusts and/or capital gains exemptions, should be examined.

Conclusion

Public finances are at the heart of the struggle to redefine the quality and scope of the Canadian welfare state. Ironically, the arena of debate about public finances has been largely closed to the public. In the formulation of budgets and fiscal plans, the Finance Department relies on only one dominant perspective — the way to good nationhood is through the market. Looking at public finances through the lens of the marketplace has led us to prescribe balanced budgets through cutting costs. These costs are virtually equated with social spending.

What is missing in the spending cuts "debate" are the connections between revenue and security, and between collection and provision. The capacity to finance social need exists when people know what they are paying for, and when increased contributions result in enhanced — not decreased — supports and services.

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Canada Watch
Practical and Authoritative Analysis of Key National Issues

Volume 3, Number 2
October 1994

Production
WordsWorth Communications

Canada Watch is produced jointly by the York University Centre for Public Law and Public Policy: Phone (416) 736-5515, Fax (416) 736-5546 and the Robarts Centre for Canadian Studies of York University: Phone (416) 736-5499, Fax (416) 736-5739.

ISSN 1191-7733

Subscription Information
Canada Watch is published eight times per year. Subscription rates effective this issue are as follows:

Institutions	$75.00
Individuals	$35.00
Students	$20.00

(Outside Canada add $10.00)

Printed in Canada