

Economic Security

A Better Income Security System for All Canadians

Jean-Yves Duclos

Comments:

“An Alternative Proposal on Income Security”
David A. Green

“The Practitioner’s Perspective on Income Security Reform”
Kathy O’Hara and Allen Sutherland

EXECUTIVE SUMMARY

In his chapter on improving economic security in Canada, Jean-Yves Duclos argues, “Canada’s out-of-date system compromises our ability to achieve both a just and a productive society.” Two main policy challenges must be confronted: the sources of modern insecurity and the need to tie economic growth and security. For Canada to prosper, he writes, “all working-age adults should have the ability to contribute to our economy.”

Duclos outlines three basic principles for a better income security system and proposes to replace most elements of the existing tax and transfer system with a universal basic income (BI) to make the system more growth enhancing, more supportive of individual freedoms and capabilities, and more inclusive of those in need of economic security.

Commentator David Green contended that problems of subsistence for people at the very bottom of the income distribution are currently more pressing than issues of security and incentives to work for people higher in the distribution. Cathy O’Hara and Allen Sutherland brought a practitioner’s perspective to their commentary and raised important concerns regarding implementation of Duclos’ bold proposals for reform.



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SCOPE OF THE CHALLENGE

Duclos explains the sources of increased economic insecurity in the context of Canada's changing economic environment: globalization demands greater labour market flexibility and greater productive efficiency, while technological change has increased the relative rewards for highly skilled workers.

Since the end of the 1970s there has been a rise in part-time work, temporary employment and self-employment, known as nonstandard employment. Although this type of employment has stabilized since 1997, it is characterized by a higher risk of unemployment and few, if any, benefits such as pension plans and disability and supplementary health insurance.

Low pay among full-time salaried workers is another source of insecurity. One in six Canadians working full-time currently earns less than \$10 per hour and half of these workers will still be in low-paying jobs in five years' time. Single parents, visible-minority immigrants and the less educated are more likely to be low-paid workers. While there is evidence of labour market rewards for highly skilled workers, Duclos notes, "despite the rise in average educational attainment since 1981, the share of total jobs that pay less than \$10 per hour (in 2001 dollars) has not fallen." Compounding the effects of low pay is a lack of access to employee benefits: only one in ten low-wage workers have access to registered pension plans and insurance, compared to almost 8 in 10 of those who earn \$20 or more per hour.

Also cited as a source of increased insecurity is the shift in pension risk in recent decades — away from employers providing defined-benefit pensions toward employees setting up defined-contribution retirement plans. When combined with the flatness of median wages, the increased duration of unemployment, the fall in the share of employment insurance (EI) recipients among the unemployed and the greater uncertainty of pension benefits, "this increased income volatility adds to the growing concerns about the effects of increased economic insecurity."

The commentators were reluctant to fully accept Duclos' gloomy picture of widespread economic insecurity. According to Green, "There is little evidence of a growing feeling of insecurity among Canadian workers." O'Hara and Sutherland believe that certain aspects of nonstandard employment, such as flexible hours, are making it more acceptable and even desirable for a growing number of individuals.

OPTIONS FOR ADDRESSING THE CHALLENGE

The two pillars of Canada's current income security system are employment insurance and social assistance. In light of the central policy challenge of addressing both growth and security concerns, Duclos finds several flaws in the status quo.

Employment insurance

Duclos asserts that Canada's EI system "has grown into a multipurpose, burdensome social program that is probably doing more harm than good." The work disincentives it creates and the long-term effects on labour market participation mean that EI is poorly designed to address the income insecurity and work support needs of many nonstandard and low-paid workers. Work requirements and maximum duration of benefits vary significantly by region with the effect that only a minority of premium-paying workers who lose their jobs actually receive any benefits. Duclos notes that nationally, EI covers fewer than 40 percent of all the unemployed.

Social assistance

The original expectation for social assistance was that a recipient who managed to find work would simply forgo assistance altogether. But a complex web of cash and in-kind benefits has created a "welfare wall" that imposes large financial disincentives on welfare recipients who take paid employment. This is primarily due to the high effective tax rates caused by claw-back of both cash and in-kind benefits, but the prohibitive limit

on individuals' liquid and fixed assets in order to qualify for social assistance is also problematic. There is also some evidence that social assistance has intergenerational trapping effects.

Training and education

Despite the need to help low-skilled workers adjust to the rapidly changing requirements of today's labour market, effective training and employment support is effectively denied to the many unemployed Canadians who do not meet EI's eligibility rules, such as those in nonstandard employment and many of the working poor.

Existing pitfalls lead Duclos to propose three basic principles for a better income security system in Canada:

- ▼ **Tying growth and security:** A better system could boost economic performance by encouraging Canadians to make investments — in entrepreneurship and physical and human capital, for instance — that foster growth.
- ▼ **Enhancing capability and responsibility:** A modern system should also recognize the importance of designing policies to “make work pay,” and providing opportunities for enhancing skills and building financial assets. At the same time, individuals should be expected and encouraged to assume personal responsibility for engagement in the workforce and in community life.
- ▼ **Promoting inclusion and equity:** All Canadians, regardless of their attachment to the labour market, should be eligible, ensuring vertical equity by providing the greatest benefits to the least advantaged, and horizontal equity by treating individuals with similar means equally.

A modern economic security system should recognize the importance of making work pay and provide opportunities for enhancing skills and building financial assets.

THREE POLICY PROPOSALS TO ADDRESS THE ECONOMIC SECURITY CHALLENGE

- ▼ **Create a universal basic income.** Similar in structure to the Canada Child Tax Benefit, the universal BI would provide cash payments to all working-age individuals, with the amount declining with rising levels of income. This would replace most existing social assistance and income support programs, though some in-kind benefits would be extended to the working poor in order to reduce the “welfare wall.”
- ▼ **Base employment insurance contribution and benefit levels on experience ratings.** Duclos argues that EI has strayed from a true insurance program and proposes using experience ratings to calibrate contribution rates and benefit levels, so that firms that lay off fewer workers pay lower premiums, and workers who make fewer and less frequent claims receive higher benefits.
- ▼ **Promoting accumulation of human capital and financial assets.** The current social assistance system penalizes accumulation of financial assets and provides insufficient training and development opportunities for the poor. Duclos proposes to remove assets from social assistance means tests, improve incentives for low-income individuals to contribute to RRSPs and implement a voucher system for training programs.

PREFERRED POLICIES

Based on his assessment of the scope of the challenge, Duclos proposes a suite of related policies, and emphasizes that the effectiveness of any one would be reinforced by implementation of the others.

Universal basic income (BI)

Duclos' main proposal is to replace all tax transfers, allowances and social assistance with a basic income transfer, which would be available to all working-age Canadians but whose net value would decline with rising levels of income. Unlike the current EI program, BI would be available for an unlimited period of time and would be noncontributory (funded out of general revenues). It would be federally financed and administered through the personal income tax

system, and thus be more vertically and horizontally equitable. In-kind supports such as supplementary health, dental care and prescription drugs, currently available only to welfare recipients, would be extended to the working poor.

A reformed EI

Duclos proposes to simplify the existing system and base it more firmly on insurance principles: a contributory program providing wage replacement based on individual unemployment and contributory record. Because a reformed EI would operate on a strict insurance basis, it would finance itself over time as contributions equalize benefits. An overriding objective of reform would be to facilitate the transition to full-year employment by reducing incentives for seasonal/temporary work. A second effect would be the elimination of the *ex ante* implicit region-based redistributive elements of the current program.

Promoting and protecting assets

Initiatives to enhance assets, notably through training vouchers and incentives for financial asset building and protection, would provide individuals with the capacity and freedom to build their human and financial capital in the form of skills development and savings.

The commentators expressed considerable skepticism with regard to Duclos' first two proposals, which would involve comprehensive changes in income security systems. In his comments, Green expressed a preference for in-kind transfers (such as drug treatment programs and food banks) over a BI scheme, noting that the latter assumes individuals are capable of taking full advantage of the money they receive and the real freedom it might provide. In Green's view, the most pressing issue with regard to economic insecurity is the plight of the homeless, who face multiple barriers to employment and would not be able to make informed decisions on how to use the BI to their best advantage.

O'Hara and Sutherland were critical of Duclos' silence on the difficult issues of program design, financing and division of jurisdictional responsibilities that must be tackled when contemplating significant social policy change. They were also concerned that fiscal constraints would not permit a sufficiently generous basic income for the poorest Canadians.

CONCLUSION

Duclos contends that his policy suite will make Canada's income security system more growth enhancing, more supportive of individual freedoms and capabilities, and more inclusive of those in need of economic security and support. Most importantly, streamlining the tax and transfer system and using the liberated resources for a universal basic income would yield an increase in income for most people at the bottom of the income distribution. Even though the commentators expressed doubts with regard to the political feasibility of implementing such bold reforms, there was general agreement on the underlying principles, suggesting that Duclos' proposals are good ideas whose time has not yet come.

THE CANADIAN PRIORITIES AGENDA

The IRPP's Canadian Priorities Agenda project is designed to initiate a broad-based and informed public debate on policy choices and priorities for Canada over the medium term. Research papers by some of Canada's foremost scholars examine the most effective ways to address the following eight broad policy challenges:

- Human capital
- Climate change
- Natural capital
- Population aging
- Economic security
- Health outcomes
- Productivity
- Trade and globalization

Based on the results of this research, six judges, among Canada's top policy thinkers, each crafted from the eight papers a policy package of the specific recommendations that in his or her view will best enhance the economic and social well-being of Canadians.