FROM WELFARE TO WORK IN ONTARIO: STILL THE ROAD LESS TRAVELLED

TD Economics

Special Report

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TD Bank Financial Group

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Executive Summary

A few years ago, TD Bank Financial Group laid out a goal for Canadians: to raise the country's standard of living above U.S. levels within 15 years. In 2002, the bank hosted the TD Forum on Canada's Standard of Living, which brought together Canadians from all walks of life to develop practical suggestions for how to translate the standard of living challenge into reality. And, in support of that goal, TD Economics has produced a series of reports on the issue, focusing on the needs of Canada's urban areas – the locus of economic activity and population growth in the country, and the main battleground where the standard of living challenge will be won or lost.

One issue that has cropped up repeatedly in our research is the importance of developing a more effective and equitable income transfer system – one that does a better job of bringing disadvantaged individuals into the economic mainstream. In 2004, the Toronto City Summit Alliance and St. Christopher House launched a task force devoted to this goal. The Task Force on Modernizing Income Security for Working Age Adults (MISWAA) is seeking to identify failings in the present income security system and lay out a road map for change – objectives that mesh well with the TD standard of living challenge. TD is a member of the MISWAA Task Force and has conducted this background study to assist the Task Force with its deliberations and provide insight into the policy recommendations it is considering.

The argument for focusing on working age adults

Canadian governments have made great strides in recent years in improving the financial security of society's oldest and youngest members. Ongoing enhancements to Old Age Security, the Guaranteed Income Supplement, and the Canada/Quebec Pension Plans have gone a long way toward shoring up the finances of older Canadians, and the 1998 National Child Benefit initiative is doing the same for low-income families with children. But, alongside these gains, there has been a steady erosion in income support for working age adults. In the face of an increasingly challenging labour market environment, marked by stagnant wage growth and an increase in temporary and non-standard work, a reduction in the share of the labour force covered by the federal government's Employment Insurance (EI) program has left unemployed adults with fewer resources to fall back on when they lose their jobs. And, no one has been harder hit than those forced to turn to social assistance, after a decade of cuts to welfare delivered by provincial governments intent on trimming deficits.

The Ontario perspective

That was certainly the case in Ontario, where the Harris government introduced a radical overhaul of the province's welfare system over the 1995-2000 period. One of the key features of that restructuring was the introduction of workfare, an initiative whose stated purpose was to strengthen welfare recipients' attachment to the labour force – and, the inspiration for the program's new moniker, Ontario Works (OW), which it bears today. Consistent with this shift in emphasis, OW recipients were required to "earn" their benefits by participating in community placement or training programs that were meant to function as a bridge into more permanent employment. And, to sharpen the incentive to make this transition, eligibility requirements for welfare were tightened and benefits for the non-disabled were slashed by a sizeable 21.6 per cent.

The government defended the measures on the grounds that they would help nudge more adults off welfare and into workforce, thereby laying the groundwork for a more enduring solution to the problem of poverty. But, while welfare caseloads in Ontario did fall in the ensuing years, a closer look at the data suggests that one of the main drivers of the decline was fewer Ontarians being able to get on welfare – not the intended exodus of welfare recipients into the workforce. In addition, the drop in caseloads has since levelled off, holding steady at around 200,000 households so far this decade. That is all the more striking in view of the fact that welfare allowances in Ontario have fallen substantially, in nominal and real terms, since Ontario Works was launched ten years ago. Based on the usual arguments, this should be serving as an increasingly powerful incentive for OW recipients to find work, to supplement an income that is becoming less adequate with every passing year. Yet, that is not what is happening. As of December 2004, less than 13 per cent of OW recipients had any kind of attachment to the labour force.

Economic arguments for bringing adults into the workforce are compelling

This poor employment outcome is all the more discouraging, given the fundamental soundness of the principle underlying Ontario Works – namely, that people who can work should work. Working has been shown to be one of the surest routes out of poverty for low-income adults, and what is good for individuals is also good for society as a whole. Over the long term, a system that brings more working age adults into the workforce, where they can earn their own income and develop greater economic self-sufficiency, will see welfare costs fall. That, in turn, will free up resources for other things, like lowering personal and corporate income taxes, reducing debt, and financing new investments in health care, child care, education, and research and development – all of which boost productivity and raise living standards for everyone.

Moreover, the costs of not acting are high and rising. Canada's elderly dependency ratio – the ratio of working-age adults relative to adults aged 65 and older – has already declined substantially, and will fall further in the coming years, as the population ages. One of the best strategies for ensuring the long-term health and sustainability of income security programs that Canadians value so highly, like the Canada Pension Plan, Medicare and Old Age Security, is to bring all eligible working age adults into the workforce as soon as possible. This is true across the country, but particularly in Ontario, where changes in the way that income security programs are funded and delivered mean that municipal governments face a serious financial crunch during the next economic downturn. The pinch will be especially painful in Toronto, where the share of the unemployed population receiving EI benefits is well below the national average.

Barriers to work and marginal effective tax rates

Given the obvious symmetry of individual and socio-economic interests served by greater labour force attachment among working age adults, Ontario Works' focus on promoting employment among adults who can work has obvious merit. But, it's equally clear that something has gone awry along the way – and, we needn't look far to find the source of the problem.

The fact is that, even when the real value of welfare allowances is substantially reduced, the structure of most welfare programs gives recipients little financial incentive to get off social assistance. That's because people lose cash and non-cash benefits when they exit welfare, and incur a host of new work-related expenses, that their employment earnings often aren't sufficient to cover. This can leave them no better off, or even worse off, as a result of taking a job. These kinds of 'barriers to work', as they are sometimes called, can contribute to a low-income trap, in which individuals are unable to complete the transition off welfare, despite struggling to make ends meet on what is generally a subsistence income.

It's important to recognize that this is not a problem that can be completely resolved. To keep the income security system affordable, needs-tested benefits like welfare have to be scaled back as recipients' incomes rise. But, the phase-out inevitably raises marginal effective tax rates – *i.e.*, the share of each additional dollar of earned income that is lost to higher taxes and forgone transfer payments and services – limiting the gains that people realize from earning extra income. Still, while the trade-off can't be eliminated, better program design can mitigate some of its worst aspects.

In August 2005, the McGuinty government set out to do just that, by introducing a new set of rules for Ontario Works. In the body of this paper, we look at the impact of those changes on a couple of hypothetical welfare recipients in the province, to see how well the new rules live up to their stated purpose of helping OW clients make a 'permanent and successful transition into the workforce'. On balance, we can't give the total package a high grade. But, it's fair to say that the new rules do largely accomplish what they set out to do – reduce barriers to work – and that most, though not all, of the problems that still afflict the program are directly related to deeper failings in the rest of Canada's income security system.

More clarity needed regarding welfare's proper scope

It's essential to have realistic expectations about what a welfare program can and cannot do. A good place to start is by recognizing that welfare recipients have two separate, but inter-related problems. One has to do with the high marginal effective tax rates they face, which limit the gains they realize from working. The other has to do with the level of their income at any given point along the welfare/work spectrum, which is invariably low, and almost certain to fall short of meeting their needs.

Remedies to the first problem can be sought within the welfare system, but the second requires broader-based solutions. There are two reasons for this. First, if one of the goals of a welfare program for working age adults is to promote work, then it follows logically that the benefits provided ***cannot*** be adequate to meet recipients' needs, because if they were, it would reduce the relative attractiveness of work. Second, the problem of low income is clearly not confined to the welfare system. Many adults today cannot earn enough to feed their families, pay for childcare, and cover a variety of other expenses, despite having a significant attachment to the labour force – and, no association with welfare.

No amount of tinkering with welfare rules can solve the latter problem. Rather, complementary measures are needed to boost after-tax incomes at the low end of the income scale, to reduce the pressure on welfare, as well as to ensure that individuals who cannot or will not access the system have other resources to draw on.

Rating the new Ontario Works

From this perspective, how do the new Ontario Works rules measure up? On the main count of doing more to 'make work pay', the new rules must be seen as an improvement over their predecessors, delivering a measurable reduction in the marginal effective tax rates that OW recipients face as they seek to work their way off welfare. This was one of the principal criticisms of the old system, with welfare recipients facing marginal effective tax rates of 100 per cent or more at most stages along the welfare/work spectrum – giving them virtually no incentive to boost their market income. With a marginal effective tax rate of more than 100 per cent, welfare recipients forfeit ***more*** than one dollar in income and benefits for each additional dollar they earn. It's hard to imagine a more powerful disincentive to leaving welfare for work. Indeed, seen from this angle, the fact that any OW recipients at all seek work speaks to a keen desire to improve their living standards.

The structure of the new earnings exemption introduced in August 2005, which lowers the taxback rate on employment income to 50 per cent from 75-100 per cent, goes a long way toward easing this problem. So, too, does a temporary extension of OW drug and dental benefits for recipients leaving welfare for work. This makes the 'welfare wall' at the OW exit point a little more permeable. Yet, overall, the improvement is still modest. Even with the changes, welfare recipients in Ontario still face marginal effective tax rates of well over 50 per cent. And, while the spike in these rates associated with the loss of the OW drug and dental benefits has been deferred, it has not been eliminated. Once those benefits run out, OW recipients will still sustain a hit to their disposable income of roughly $1,500 – roughly the annual value of the extended health benefits provided by Ontario Works – for earning just a few more dollars of market income.

Pros and cons of lowering taxback rates

Moreover, the reduction in marginal effective tax rates itself does not come without a price. By lowering the taxback rate on employment earnings, the August 2005 rules also raise the earnings threshold at which existing OW clients become ineligible for benefits. This is the basic mechanism of an income-tested benefit – but if the arithmetic is straightforward, evaluating the consequences is not. As a result of the lower taxback rate, most OW recipients will end up with a higher disposable income in the present, because a smaller share of their employment earnings will be clawed back for a given level of market income. But, the flip side of this is that the level of market income they need to attain to exit welfare – sometimes called the 'break-even level' – has been raised.

This is very much a mixed blessing. The reality is that, for the most part, life on welfare is a precarious and demoralizing existence. The rules governing the system are complex and opaque. The application process is cumbersome, and once recipients are approved, they face regular monitoring and supervision by caseworkers. Cash allowances are based on a monthly needs test, which is linked to recipients' earnings, meaning that benefits can vary each month with fluctuations in work income – making planning for the future very difficult. And, harsh restrictions on assets make it difficult to build up a pool of savings.

As a result, hard questions need to be asked about whose interests are really served by restructuring welfare benefits in such a way that recipients' association with the system is prolonged to any degree. As we argue in the body of this paper, the rise in break-even levels for single adults is a price worth paying, because it goes hand in hand with a cash allowance, and thus a disposable income, that is still very low in dollar terms. However, because parents on welfare start with a much higher monthly allowance, the same reduction in the taxback rate on their employment earnings pushes up their break-even levels much higher – so high, in our view, that it works at cross-purposes to the goal of helping families get off assistance.

That said, the fault cannot be laid at welfare's door. The higher break-even levels are necessary, largely because low-income parents have few places to turn for their child care needs – forcing OW to compensate by providing more generous benefits for parents. But, this has ripple effects throughout the system. It diverts more of OW's supports to parents, leaving fewer resources available for single adults at substantially lower levels of income – in many cases, a more obvious 'target market' for welfare.

In drawing attention to this differential treatment of household types within OW, we do not mean to suggest that low-income parents do not deserve help with the cost of raising their children. Rather, our point is that the welfare system is the wrong vehicle for providing this kind of support. Welfare can and should be reformed to improve work incentives for social assistance recipients. But, it was not meant to be a substitute for a broader set of social policies, aimed at meeting needs ranging from assistance with employment, to income supplementation when work doesn't pay enough, to sundry health benefits and child care. When the welfare system is pressed into service in this way, no one is well served by the result.

Comprehensive approach means tackling welfare, and the world beyond

A strategy to improve the income security of all low-income adults will require further modifications to both welfare and non-welfare programs. On the welfare side, the August 2005 Ontario Works rules have helped lower barriers to work for welfare recipients, but there is still room for improvement in other parts of the system.

- **Asset limits:** One area that stands out in particular – and which received no attention with the August 2005 rule changes – is the asset side of the equation. At present, OW clients are permitted to accumulate savings equivalent to only 1-2 months' worth of their monthly cash allowance.

  This is a significant omission, for two reasons. First, in general terms, it is at odds with a growing appreciation in the financial community for the critical role that assets play in cushioning families through temporary disruptions in income. Second, it sits awkwardly with the decision to lower the taxback rate on employment earnings, which raises the earnings threshold at which OW recipients lose their eligibility for assistance. With no commensurate increase in the asset limits, the implication is that recipients have to spend all of the additional income they earn. This suggests that the OW architects have paid insufficient attention to the need to enhance opportunities to save – surely an important corollary to promoting incentives to work.

But, if a clear case can be made for raising asset limits, to give people room to build up enough savings to make abandoning OW's cash and non-cash benefits a viable option, that is the only additional reform that Ontario Works can be expected to make on its own. The remaining flaws in the system arise from situations where welfare has had to expand beyond its natural domain of providing short-term income support into offering broader forms of assistance. As such, these flaws cannot be corrected without supporting changes in the rest of the income security system.

The TD report raises several ideas for consideration that MISWAA Task Force is considering as it proceeds with its efforts to develop a road map for change:

- **A working income supplement and refundable tax credit for low-income Canadians:** One of most pervasive needs is to tackle the problem of poverty among people on and off welfare. Raising welfare allowances to help the former group is not the answer, because it reduces the relative attractiveness of work. And, substantially hiking the minimum wage over and above the increases already planned risks labour market repercussions. Two options that some jurisdictions in Canada have already had success with, albeit on a smaller scale, are a working income supplement and a refundable tax credit for low-income adults.

Neither solution is perfect. There would be a net cost to whichever level of government provided the benefit, and because both measures would need to be income-tested, they would raise marginal effective tax rates over some range of income. But, if properly designed, the two measures collectively would help take some of the pressure off welfare to shore up the financial security of low-income adults. And, they would have the virtue of doing so through anonymous, rules-based programs that are free of the stigma and intrusive administrative oversight that go along with discretionary programs like welfare.

- **Completing the National Child Benefit (NCB) initiative:** The 1998 NCB initiative offers provincial and territorial governments an opportunity to use the federal NCB Supplement as a platform for developing an integrated, income-tested benefit for Canadian children that would eventually replace welfare-based child benefits. Ontario has taken a step in that direction with the introduction of the Ontario Child Care Supplement for Working Families (OCCS), but the program serves only a small segment of the low-income population – namely, low-income families with children under the age of 7. That leaves a healthy chunk of income support for low-income children in Ontario to be paid through the welfare system. As a result, OW has to pay parents a substantially higher allowance than it pays single adults, and this produces a number of distortions in the work incentives and opportunities available to these two household types. Completing the NCB initiative would eliminate the source of these distortions, enhancing OW's ability to function as a temporary income support program that provides genuine and fair work opportunities to all recipients.

- **Employment Insurance (EI) reform:** A decline in the share of the unemployed population covered by the federal government's EI program has left low-income adults with fewer resources to fall back on when they lose their jobs. This has put more pressure on provincial welfare systems, and many have responded by raising entry barriers – chiefly, by imposing disqualification periods during which earnings exemptions that existing clients can claim are denied to new applicants. The result is a growing problem with horizontal inequity, where two households with similar financial profiles end up in very different economic circumstances, because one has access to all the supports of OW and the other doesn't.

It is possible that reforms to EI implemented in the 1990s may have gone too far in raising hours of work requirements, particularly in areas with low unemployment rates. But, there is good reason to believe that the problem is related more to shifts in the composition of the labour force that the present EI system is ill-equipped to deal with. A rising trend toward self-employment, and an increase in the number of recent immigrants who have no prior work experience in Canada – two groups who would have been ineligible for EI benefits even prior to the 1990s rule changes – stand out as obvious examples. Complementary, stand-alone programs might be of some use in addressing this problem, to ensure that individuals who are not eligible for direct unemployment insurance do not also lose out on related services, like assistance with skills development and training. If unemployed adults were better served by EI or related programs, there should be correspondingly less need for provincial governments to keep entry barriers to welfare so high that they risk denying access to people who are legitimate candidates for social assistance.

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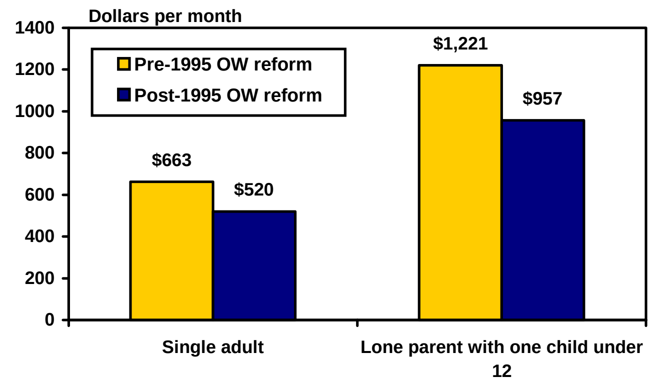
In May 2005, the government of Ontario announced a series of changes to the province's welfare system. The new rules, which took effect in August, represent the first overhaul of welfare in Ontario since the Harris government's radical restructuring of the program in 1995-00. One of the key features of that restructuring was the introduction of workfare, an initiative whose stated purpose was to strengthen welfare recipients' attachment to the labour force – and, the inspiration for the program's new moniker, Ontario Works (OW), which it bears today. Consistent with the shift in emphasis toward work, OW recipients were required to "earn" their monthly benefits by participating in community placement or training programs – an arrangement that was meant to serve as a bridge toward the formation of a more permanent attachment to the labour force. And, to sharpen the incentive to make this transition, the government tightened eligibility requirements for welfare and slashed benefits for the non-disabled by a sizeable 21.6 per cent – making it tougher for new applicants to get on OW, and harder for existing recipients to get by without supplementing their allowance with income from work.

ONTARIO WORKS: BENEFIT RATES*



*Maximum monthly allowance per household type
Source: Ontario Ministry of Community and Social Services

One of the rationales for the introduction of workfare was the notion that efforts to help welfare recipients exit poverty are more likely to succeed over the long term if they are grounded in market-based mechanisms, such as helping people gain access to more and better-paying jobs. But, that argument also hints at the tension at the heart of all welfare programs for working age adults – namely, that decisions about the amount of income support to provide have to be balanced by careful consideration of how this support will affect recipients' motivation to find and main-

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tain employment. The crux of the problem is that measures that give people an incentive to begin working while they're on welfare can have the unintended consequence of creating disincentives for them to leave assistance – mainly because their work earnings aren't sufficient to replace the cash and non-cash benefits they lose and the new work-related expenses they incur when they go off welfare. These kinds of 'barriers to work', as they are sometimes called, can contribute to a low-income trap, in which individuals are unable to complete the transition off welfare, despite struggling to make ends meet on what is generally a subsistence income.

A recognition that Ontario Works still suffers from some of these deficiencies was the main impetus for the reforms implemented in August. In the body of this paper, we'll take a closer look at these changes and study their impact on a couple of hypothetical welfare recipients in Ontario, with a view to determining what problems the new rules solve, and what existing problems they exacerbate or ignore. We'll also suggest some remedies for what we believe still ails the system. But, before jumping headlong into the analysis, it's useful to begin by laying out the dimensions of the problem, to get a clearer picture of what the August 2005 reforms were intended to achieve.

The changing face of welfare in Ontario

In the early decades of the twentieth century, Canadian governments took a hands-off approach to managing the economy. Lacking the tools to do much more (until the introduction of the income tax in 1917), they had little choice but to hope that the economy would prove self-regulating if market forces were allowed to operate freely. The job of caring for the non-institutionalized needy fell to churches and private charities, which provided emergency assistance, generally in the form of goods and services, like food, fuel and clothing. The event that changed all of this was the Great Depression, as the sheer scale of the devastation it wrought revealed the limits of dealing with poverty on an ad hoc basis. And, the programs that governments introduced in response marked the birth of Canada's modern tax and transfer system, including welfare as we know it today – *i.e.*, cash assistance for needy families and individuals.

In Ontario, Premier Mitch Hepburn authorized the first payment of direct cash unemployment relief in 1935, according to the recommendations of the Campbell Advisory Committee on Direct Relief, chaired by Wallace Campbell, General Manager of the Ford Motor Company of Canada. With that step, he also introduced into the policy debate a question that has bedeviled governments ever since they first began providing relief in the form of cash rather than in-kind benefits – namely, what to do about benefit payments when recipients begin to earn income. At the height of the Depression, Campbell's view was that recipients who managed to find work should keep their earnings and use them to try to rebuild their shattered lives. But, as Ontario's economy recovered, subsequent Ministers of Public Welfare shifted their focus toward ensuring that public assistance provided what might be termed a 'hand up' rather than a 'hand out'. This reflected practical considerations about containing program costs, as well as a prevailing view that poverty was in some way related to a defect of character – and, thus, not something the government should be sanctioning through the provision of cash assistance. This belief was evident in the treatment accorded different members of society, with the so-called "deserving poor" (widows, the sick and the disabled) receiving more generous benefits than their "undeserving" counterparts (able-bodied, working age adults). Indeed, single adults in Ontario were ineligible for welfare cash benefits from 1940-1958, and when they did receive them, they were dispatched from assistance post haste, at the first sign of employability.

A lingering discomfort with the idea of able-bodied, working age adults receiving social assistance while working persists today, despite the fact that governments long ago came round to the view that positive work incentives play a critical role in facilitating individuals' transition into the labour force. In Ontario, financial incentives to promote work – such as earnings exemptions that allow welfare recipients to keep a portion of their work income while continuing to receive a reduced monthly benefit – have been a staple of social assistance programs since the 1980s, through Conservative, Liberal, and NDP governments alike. At the same time, policy makers have never lost sight of the need to combine positive work incentives with measures aimed at nudging welfare recipients toward greater self-sufficiency. To a large extent, the history of welfare reform in Ontario for the last twenty-five years is the history of successive governments trying to find a better balance between these 'carrots' and 'sticks'. The reforms that the Harris government launched in 1995, and the changes that the McGuinty government introduced last month, are both very much in this tradition.

Source: John Stapleton and Catherine Laframboise, "The Campbell Report: The Origins of Modern Public Assistance in Ontario," unpublished paper prepared for the Ontario Ministry of Community and Social Services (MCSS), May 2005.

PART ONE:

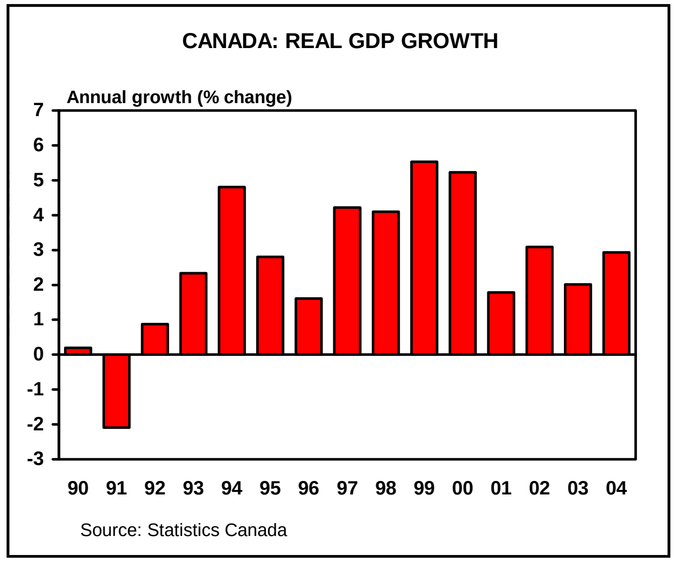
TAKING STOCK OF THE PROBLEM

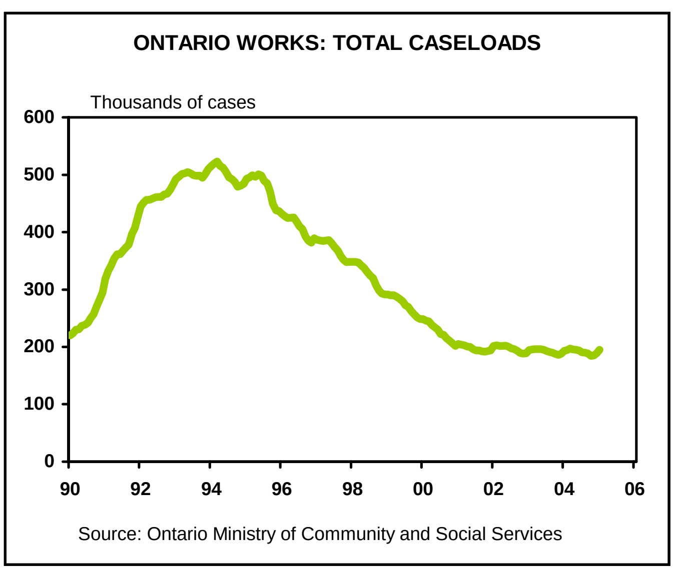
The principal objective of the Harris government's 1995-2000 reforms was to reduce reliance on welfare in Ontario by promoting individuals' ability to find an alternative source of income in the labour market.[1] Taking stock of the results a decade later, it is clear that Ontario Works has been only partially successful in achieving these twin objectives. In a nutshell, although the tide of entrants into OW has been stemmed, the intended exodus of welfare recipients into the workforce, while impressive at first, appears to have lost momentum in recent years.

I. WHAT 'DOESN'T WORK' ABOUT ONTARIO WORKS?

There's no denying the fact that there are far fewer people on welfare in Ontario today than there were ten years ago. Caseloads have declined by nearly 60 per cent since the introduction of Ontario Works – from about 450,000 households in October 1995 to just over 198,000 in June of this year, although the bulk of the decline occurred during the 1995-2000 period.[2] At first glance, it may not seem all that surprising that a policy aimed at moving welfare recipients into the workforce found success during the latter half of the 1990s – a period during which the Canadian economy experienced a powerful upswing. After a severe recession in 1990-91 and a limp recovery in 1993-95, real GDP growth in Canada bounced back smartly in the second half of the decade, putting Canada at the top of the G-7 leaderboard for several successive years. And, this robust economic growth fed through into the labour market, sending Canada's unemployment rate tumbling to a 25-year low of 6.9 per cent in 2000 – all in all, not a bad environment in which to be looking for work.

Yet, research by Statistics Canada on welfare dynamics cautions against attributing all of the responsibility for the decline in OW caseloads to a movement off welfare into paid employment. Changes in welfare caseloads reflect movement at both the welfare entry and exit points – *i.e.*, a drop in caseloads could reflect fewer people entering welfare, more people exiting it, or some combination of the two. In a May 2005 report, Ross Finnie, Ian Irvine and Roger Sceviour of Statistics Canada's Analytical Stud-





ies Branch found that, while welfare entry rates fell for all household types in Ontario between 1995 and 1999, trends in exit rates were much more variable. Specifically, exit rates rose sharply for lone parents and couples with children, but fell for single adults and childless couples – making the drop in entry rates the dominant driver of the overall decline in caseloads.[3] Finnie *et al.* did not attempt to disentangle the specific factors driving these changes in entry and exit rates, which would have included macroeconomic conditions, as well as changes in income security policy. However, given that the steep cuts in benefits and reductions in access to welfare associated with the introduction of Ontario Works were phased in during the years covered by their study, it is reasonable to assume that these measures made an important contribution to the decline in caseloads recorded over this period.

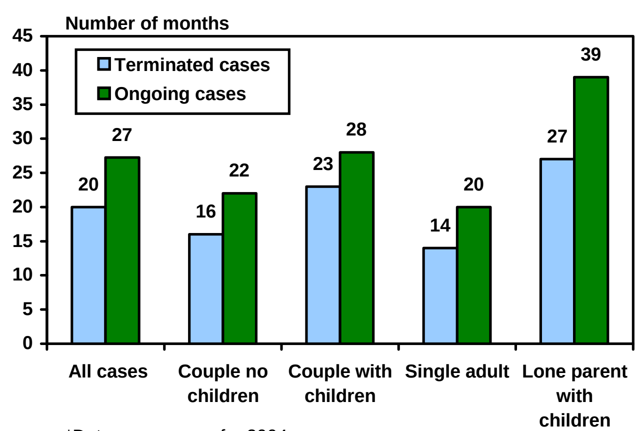
In any case, whatever the respective causes of that decline, it has since fizzled out, with the number of households collecting assistance in Ontario holding steady at just under 200,000 so far this decade. More recent data on entry and exit patterns are not available, making it impossible to know what the precise contribution of each is. However, the overall levelling off in caseloads implies that, at best, exits are merely keeping pace with entries – and, at worst, that they are falling while entries creep back up. Either way, the end result raises questions about whether Ontario Works may have hit some roadblocks in its ability to promote welfare recipients' transition into work.

More evidence along these lines comes from data showing that the duration of dependence on Ontario Works – *i.e.*, the number of months that recipients have been on assistance – remains high. Duration can be tracked in two ways. One is to look at the universe of recipients who have already exited the system; the other is to focus on those who are still collecting benefits. The first measure provides a better picture of the length of time that recipients who ultimately did leave OW spent in the system. What it doesn't capture is the core of individuals who never succeed in making this transition. The unfortunate truth is that there is a certain subset of OW recipients who face unusually high barriers to employment – such as battles with substance abuse, mental health issues, learning disabilities, very low skills development, or long-term caretaking responsibilities for a family member with chronic health problems. While some of these individuals are candidates for OW's sister program, the Ontario Disability Support Program (ODSP), the reality is that many of them remain on OW because of difficulty accessing ODSP.

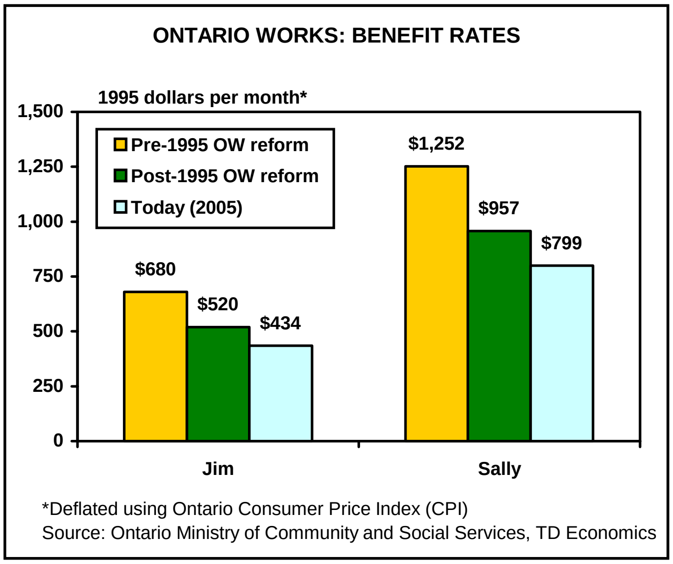
Measuring duration using OW's existing client base will reflect the inclusion of these "hard to serve" individuals, which some would argue overstates the scope of the problem. Still, whichever approach you choose, it's clear that OW recipients are spending a long time on welfare today. As of December 2004, the average duration of dependence on OW for existing clients was 27 months, while the figure for recipients who had exited the system was a still-lofty 20 months. And, that's worrying, because research shows that the longer individuals stay on assistance, the more their skills and experience deteriorate. This undermines their ability to compete in the labour market, making the eventual transition back into work just that much harder. Indeed, it's a rule of thumb in the income security community that two continuous years on welfare can result in an individual becoming "hard to serve". This reference point suggests that, even for those who did make the break with OW, the duration of their dependence on the program – at 20 months – was bumping up against the danger zone.

The stickiness of Ontario Works caseloads is all the more striking in view of the fact that, after the 21.6-per-cent reduction in OW benefits implemented in 1995, benefits were held constant in nominal terms until March of this year, when they were raised by a modest 3 per cent. As a result, OW cash allowances have fallen by another 16.5 per cent in real terms (*i.e.*, adjusted for inflation) over the last ten years, for a total decline of almost 35 per cent relative to the benefit levels that prevailed prior to the in-

DURATION OF DEPENDENCE ON ONTARIO WORKS, 2004*



*Data are average for 2004
Source: Ontario Ministry of Community and Social Services



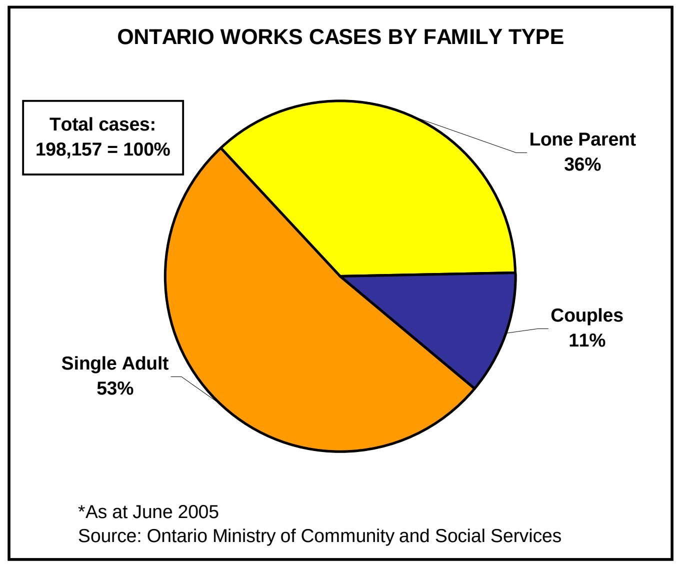
troduction of Ontario Works. Logically, this should be serving as an increasingly potent disincentive to relying on OW as a sole source of income. Yet, that is not what is happening. As of December 2004, less than 13 per cent of recipients had *any* kind of attachment to the labour force, making almost 9 in 10 wholly dependent on OW.

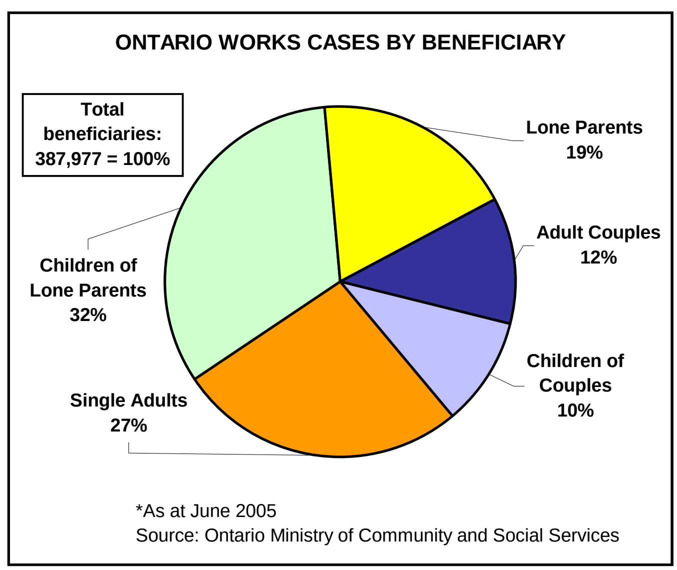
Proponents of a tougher stance on welfare might argue that this attests to the success of workfare – *i.e.*, that the program moved as many recipients as possible into the workforce during the first five years of its existence, and has since managed to keep the floodgates closed. But, taking that view implies that the remaining 221,0800 adults on OW today have either no desire to work, or no capacity to do so, and that seems a rather sweeping condemnation of their prospects. At the very least, an investigation is warranted into whether other factors might be at play.

Who is on OW today?

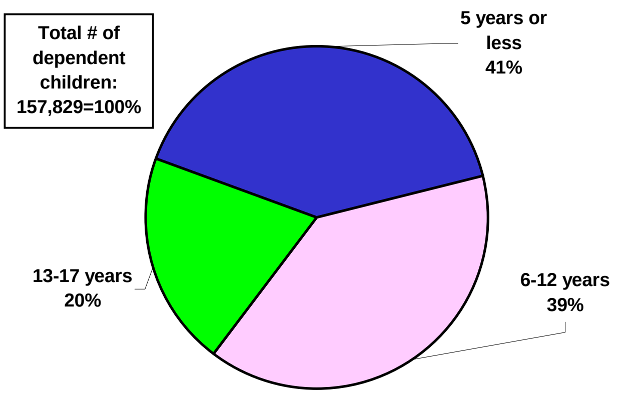
Some demographic groups are more heavily represented than others in the OW universe, both in terms of their reliance on the program and the length of their association with it. A quick look at these groups suggests that there may be some specific obstacles impeding their transition to work. Single adults and lone parents make up the vast majority of the OW population, accounting for almost 90 per cent of the 198,000 households receiving OW today and almost 80 per cent of the program's 388,000 individual beneficiaries. Single adults tend to be a little older, with nearly half of the recipients in this category being 25 to 45 years of age. This group likely includes some of the "hard to serve" individuals referred to above. That is also the conclusion suggested by Finnie *et al.*'s research, which shows that welfare exit rates for single adults declined quite sharply in the 1995-99 period, suggesting that these individuals had a harder time than most in taking advantage of an improving economic climate to find paying work.[4]

Of the lone parent families, 95 per cent are headed by women. These mothers and their children – 80 per cent of whom are twelve years of age or younger – account for more than half of all OW beneficiaries. And, they tend to stay on OW longer, too. As of December 2004, lone parents who had exited OW had been on assistance for 27 months on average, while those still receiving benefits had been doing so for an average of 40 months.



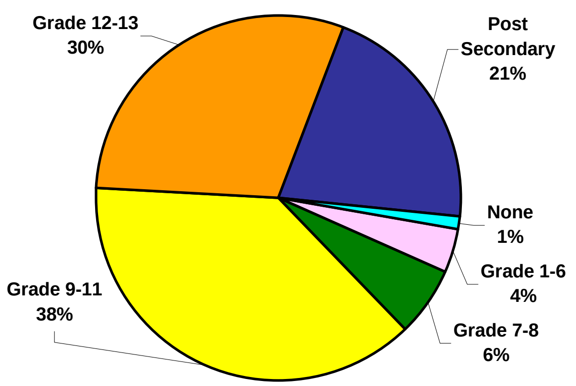


ONTARIO WORKS CASES BY AGE OF CHILDREN



*As at September 2004
Source: Ontario Ministry of Community and Social Services

ONTARIO WORKS CASES BY EDUCATION



*As at September 2004
Source: Ontario Ministry of Community and Social Services

A low level of education is also a defining feature of life on OW. Four out of five households collecting benefits have a high school education at most. And, again, single adults and lone parents are over-represented along this dimension, with half of them having no more than a Grade 11 education.

Yet, while this overview of who is on OW today may point to some particular obstacles that are preventing recipients from working their way *completely* off welfare – *e.g.*, major barriers to work for the so-called "hard to serve" population, insufficient work experience, low skills development, and inadequate child care – it doesn't explain why so few OW recipients are working at all in the first place.

II. MAKING THE CASE FOR WORK

The small number of OW recipients with even a marginal attachment to the labour force is all the more discouraging, given the fundamental soundness of the principle underlying Ontario Works – namely, that people who can work should work. Most readers will likely accept that statement at face value, but it's worth taking a moment to review the argument for promoting employment among working age adults.

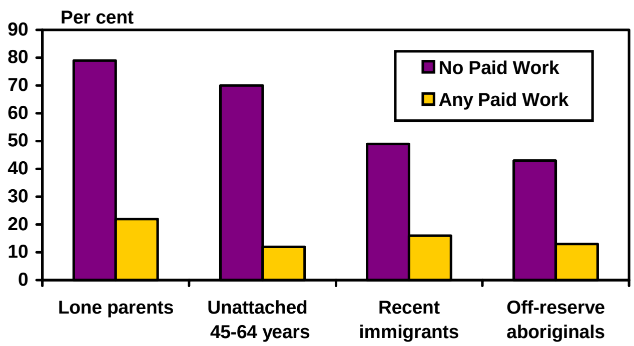
A recent report by Michael Hatfield of Social Development Canada (SDC) documents the critical role that paid employment plays in the dynamics of poverty and income mobility. Assessing the persistence of "low income" among Canadian households – defined as a household having an income below Statistics Canada's after-transfer, after-tax low income cut-off (LICO) over a period of years – Hatfield found that the incidence is relatively low, with only 8 per cent of the population aged 0-59 years experiencing persistent low income over the 1996-2001 period.[5]

Not surprisingly, the problem tends to be concentrated among "high-risk" groups, such as older single adults, lone parents, and recent immigrants to Canada – all households who are over-represented in the Ontario Works universe. But, even among these more vulnerable populations, there is a distinct variation in the persistence of low income, with the key driver being attachment to the labour force. It is not the only factor. For female lone parents, in particular, life events – like marriage, divorce, and the death of a spouse – play a key role in precipitating movements in and out of low income. But, on the whole, Hatfield found that a lack of steady attachment to paid work trumped most other factors in determining the frequency of low income.[6]

It is important to distinguish between work outcomes and low income outcomes. By itself, being employed is not a guarantee that people will not fall into low income. Indeed, researchers at SDC also found that in 2001, 653,000 Canadians were in low income despite having a high work effort throughout the year. But, what this study and others like it do suggest is that few people emerge from low income *without* working.[7] As a result, while employment may not be a sufficient condition to remedy the problem, it does appear to be a necessary condition.

And, to the extent that work is effective in generating upward mobility and combating social exclusion and other ills that are associated with persistent low income, all mem-

LOW-INCOME RATES FOR PERSONS IN HIGH RISK GROUPS, 1998



Source: Research by Constantine Kapsalis and Pierre Tourigny of Human Resources Development Canada and Social Development Canada, cited in Michael Hatfield, "Vulnerability to Persistent Low Income", *Horizons*, Vol. 7, No. 2, Policy Research Initiative, December 2004.

bers of society benefit. A society in which it is considered unacceptable to let people fall through the cracks – simply writing them off as expendable in the transition to a new, knowledge-based economy – will be marked by stronger communities and healthier and happier families. That fits in well with Canadian values – above all, the commitment to building a compassionate and inclusive society in which everyone has a chance to participate.

Promoting employment among working age adults also lays the foundation for a more prosperous future for everyone. Having a pool of adults who are capable of working but who face insurmountable barriers to leaving social assistance is wasteful and inefficient. In addition to being an affront to their personal dignity, the loss of their earning power and their labour reduces the economy's productive potential. At the same time, their ongoing dependence on social assistance is a constant drain on the public purse. If these individuals can be brought into the workforce, they will have a higher income in the present, increasing their capacity to take charge of their own lives and become more self-sufficient in the future.

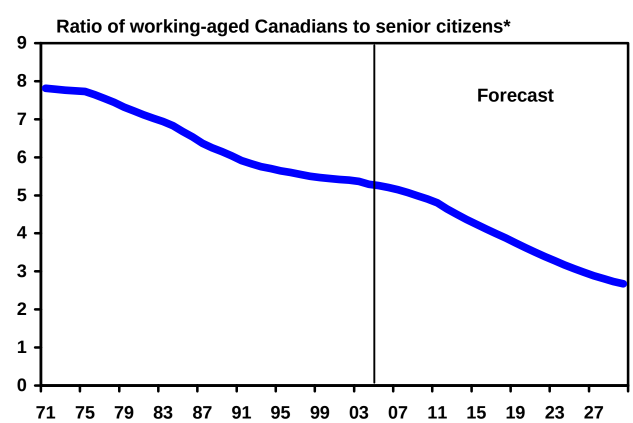
Over the long term, a system that encourages productive participation in society rather than subsidizing non-participation will reduce welfare costs. And, that will free up resources for other things, like lowering personal and corporate income taxes, reducing debt, and financing new investments in health care, child care, education, and research and development – all of which boost productivity and raise living standards for everyone.

Cost of ignoring the problem getting higher – especially in Ontario

Just as important as the gains to be had from promoting greater labour force attachment among working age adults are the costs of failing to do so. These costs are already substantial and will only rise as Canada's population ages. As TD Economics noted in a topic paper last summer, Canada's elderly dependency ratio – *i.e.*, the ratio of working age adults relative to adults aged 65 and older – has declined to five from nearly eight in the 1960s, when most of the social programs that spend disproportionately on seniors were introduced. That ratio is expected to fall even further, to less than three, over the next twenty-five years. In other words, by 2030, there will be fewer than three working-age adults for every individual over the age of 65 drawing on benefits like the Canada Pension Plan, Medicare and Old Age Security.[8] Against that backdrop, the burden of having to support some of these adults on social assistance will weigh even more heavily. Indeed, it is not an overstatement to say that one of the best strategies for ensuring the long-term health and vitality of Canada's income security system is to bring all eligible working age adults into the workforce as soon as possible.

Moreover, while this statement is applicable in every jurisdiction in Canada, it has particular resonance in Ontario and some of its municipalities. In 1996, the Ontario government carried out a "Who Does What" exercise in an attempt to promote more efficient and accountable service delivery in the province. As an outgrowth of this undertaking, a new division of responsibilities for local serv-

OLD AGE DEPENDENCY RATIO



*Those aged 15-64 as a ratio of those aged 65 and older
Source: Statistics Canada, TD Economics

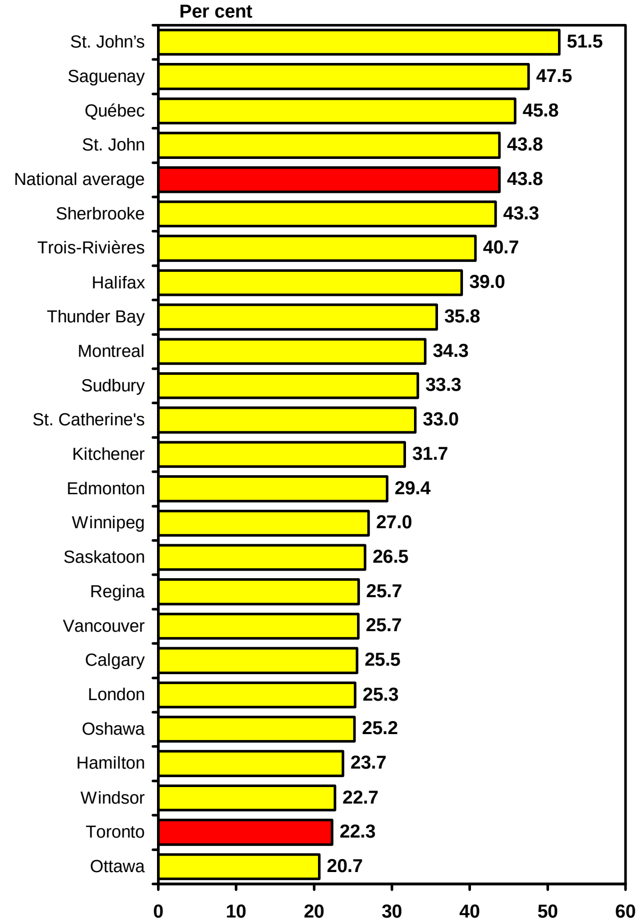
ices in the province was adopted in 1998, called Local Service Realignment (LSR). Under LSR, a cost-sharing agreement was implemented, whereby municipal governments became responsible for a 20-per-cent share of all benefit payments delivered through Ontario Works and the Ontario Disability Support Program, and a 50-per-cent share of both programs' administrative costs.

This arrangement is unique in Canada. And, it represents a significant threat to Ontario municipalities' longer-term stability. In 2002, when the Ontario economy grew by a robust 3.3 per cent, spending on social assistance benefits (*i.e.*, not including administrative costs) clocked in at \$4.6 billion, of which the municipalities' share came to about \$800 million. That represented a sizeable chunk of most cities' budgets in what was a relatively good year for Ontario's economy. This welfare bill will rise when Ontario's economy slows, and municipalities will have few options for covering the additional costs.

TD Economics has written extensively on the challenges that Canadian municipalities face in coping with the myriad responsibilities downloaded to them by the federal and provincial governments in the 1990s – invariably, with no commensurate increase in their ability to raise new revenues to finance these activities. Municipal governments still rely heavily on property taxes, which are very sensitive to fluctuations in the business cycle. So, too, is demand for social assistance and related services. This unfortunate combination means that Ontario municipalities are at risk of experiencing a severe financial crunch during the next economic downturn, with their tax revenues contracting just as their welfare expenditures climb. And, the pinch will be especially painful in cities like Toronto, where a low level of Employment Insurance coverage – 22 per cent of the unemployed, versus a national average of 44 per cent – means that more people are likely to end up relying on social assistance if they lose their jobs. Indeed, this is already evident in the OW caseloads, with the City of Toronto accounting for 33 per cent of all OW cases, as compared with just 22 per cent of Ontario's population.

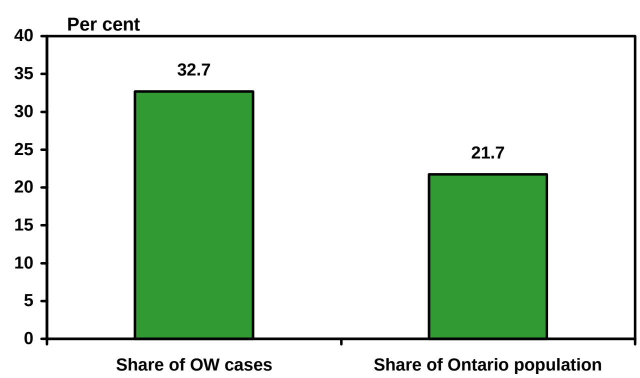
Adding it all up, the message is clear. Preventing the emergence of an economic underclass perpetually dependent on social assistance isn't just a good idea in theory. It's also critically important in practice. And, not just for Ontario. Ontario is Canada's largest province, and Toronto is Canada's largest city. It is in all Canadians' interests to have these key economic engines firing on all cylinders.

PERCENTAGE OF UNEMPLOYED RECEIVING EMPLOYMENT INSURANCE (EI) BENEFITS BY CITY, 2004



Source: Statistics Canada; See also Ken Battle and Michael Mendelson, *A New Architecture for Canada's Income Security System,* The Caledon Institute, April 2005; Richard Shillington, Employment Insurance and Toronto, Tristat Resources, forthcoming.

CITY OF TORONTO:
Share of OW Cases vs. Share of Ontario Population*



*As at March 2004.
Source: Ontario Ministry of Community and Social Services, Statistics Canada

III. BARRIERS TO WORK AND THE "WELFARE WALL"

Given the evident symmetry of individual and socio-economic interests to be served by promoting labour force attachment, Ontario Works' basic premise that working age adults who can work should be employed has obvious merit. But, it's just as clear that something has gone awry in the pursuit of this objective. The low level of monthly benefits that OW pays makes it difficult to argue that the problem is excessively generous welfare allowances that have reduced the relative attractiveness of work. Indeed, for a single adult, $6,432 a year – the maximum allowance for this household type – is less than half the $14,500 that seniors receive, or the $13,000-$15,000 a year that a full-time worker at minimum wage could earn.[9] That can't go far in most jurisdictions, and certainly not in Toronto, where a disproportionate number of OW recipients resides.

As a result, the causes of this poor employment outcome must be sought elsewhere. And, an obvious focal point is the structural barriers that impede OW recipients from finding work. All too often, people find that they lose income and benefits (*e.g.*, coverage for costly prescription drugs or dental services) as a result of working, and incur new expenses – for everything from transportation and child care, to EI and CPP payroll taxes and union dues – that their market income is not high enough to replace, leaving them no better off, or even worse off, as a result of having taken a job. That doesn't alter the compelling, non-economic incentives that people have to work – a desire for personal and professional development, and the sense of satisfaction that comes from being economically self-sufficient – but it certainly dulls their edge. Unless equally aggressive efforts are made to break down these barriers to work, simply reducing access to welfare and lowering benefits delivers a double blow to low-income individuals, trapping them in a dispiriting cycle of poverty.

The role of marginal effective tax rates

One way of looking at barriers to work is through the lens of marginal effective tax rates. The economic literature is replete with theoretical and empirical studies of how high marginal effective tax rates create disincentives to work, save and invest. However, most of the analysis does not incorporate the impact of the welfare system. Instead, researchers typically focus on other standout examples of high marginal rates, further up the income scale.

What is a marginal effective tax rate?

An individual's marginal tax rate (MTR) measures how much he or she will forfeit – in higher taxes and lost transfer payments and services – out of the next dollar of income earned. MTRs have a powerful effect on the decisions that people make about whether and how much to work, save and invest, because they set the return on these productive activities. Take work, as an example. If earning more income is going to push you into a higher tax bracket, you might choose not to take on extra hours or accept a better-paying job, because you know that you will keep a smaller share of any additional income you earn. In this sense, an increase in your marginal tax rate – or even a high, constant MTR – reduces the value of your labour, and so creates a 'disincentive' to work.

Discussions about marginal tax rates generally focus on the impact of direct taxes, which include personal income taxes, payroll taxes (CPP and EI) and the GST. However, for people at the lower end of the income scale, positive taxation is not the only issue. The loss of income-tested benefits and credits also has to be factored in. To the extent that phasing out a benefit or credit takes away income that people were previously receiving, it has the same effect as a tax. That's why, in trying to get a complete picture of the incentives or disincentives that individuals face with respect to work, the proper focus is their marginal *effective* tax rate (METR). METRs capture the sum of direct taxes and indirect taxes associated with the clawback of income-tested subsidies.

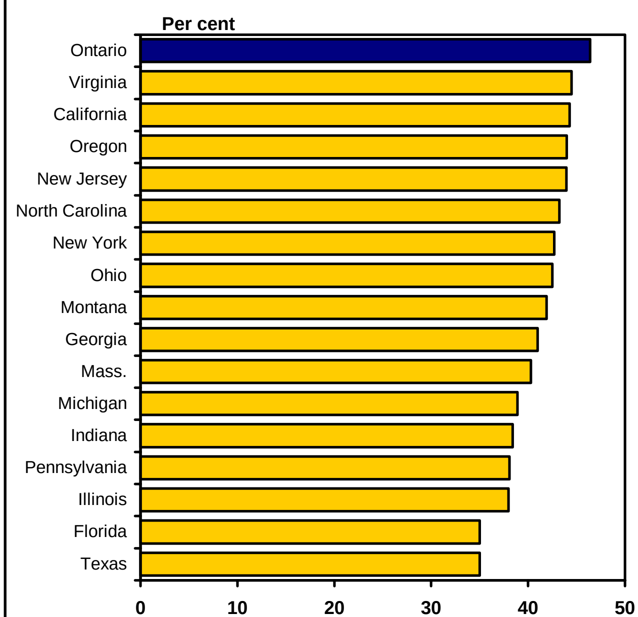
It's important to recognize that higher marginal effective tax rates are the price of keeping an income security system affordable. On the one hand, society has an interest in shoring up the economic security of its lower-income members. On the other hand, to do so cost-effectively, the assistance has to be targeted to those who need it most. That means reducing benefits as recipients' incomes rise. But, inevitably, the phase-out increases METRs at the lower end of the income scale, weakening the incentive to earn more income among precisely those individuals the program was meant to assist. This tension – between providing an adequate level of support and containing program costs – is endemic to all income-tested programs. Ultimately, the design of such programs comes down to an exercise in tinkering with the balance between these competing objectives.

One popular marker is the top combined federal-provincial marginal personal income tax (PIT) rate, which in Canada ranges from a low of 39 per cent in Alberta to a high of 48.6 per cent in Newfoundland and Labrador, with the national average clocking in at 45.1 per cent. A neat way of encapsulating the effect of these rates is to recognize that they make earning additional income roughly a 50/50 proposition for Canada's highest-paid workers, who see nearly half of their incremental earnings eaten up in PIT payments to government.

In Ontario, the top combined marginal PIT rate is 46.4 per cent, and it kicks in at an annual income of just under C$114,000. Studies of Ontario's tax environment frequently draw comparisons with a selection of U.S. states, where top combined federal-state MTRs are lower – ranging from 35 to 45 per cent – and don't kick in until a much higher level of income, of US$320,000 per year or more. Another way of making the same point is to look at relative MTRs at comparable income levels. At current exchange rates, the top income threshold in Ontario of C$114,000 corresponds to an income of roughly US$92,100. At this threshold, U.S. MTRs run from 28 to 37 per cent, putting them 9 to 18 percentage points below Ontario's top rate – often cited as one of the reasons the province's productivity performance continues to lag that in the United States. Having said that, it is important to recognize that the United States is running a sizeable structural budget deficit, as compared with Canada's healthy surplus position. This suggests that the U.S. tax burden may have to rise in the near future to plug the budgetary shortfall. In this sense, the U.S. budget deficit might more correctly be interpreted as a form of deferred taxes. If tax burdens in the U.S. and Canada were adjusted to take account of each country's fiscal stance, the gap would be considerably smaller.

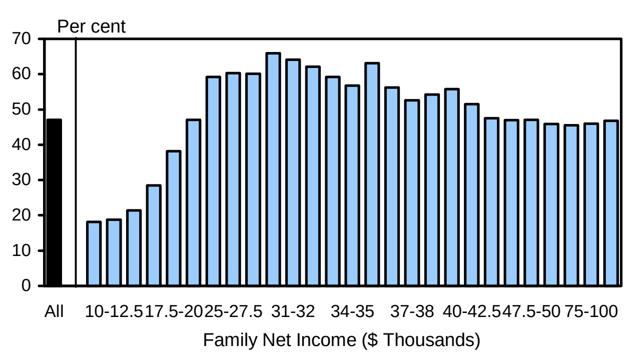
Another focal point in the MTR debate is the impact of income-tested benefits on marginal *effective* tax rates (METRs) at the lower end of the income scale. This is well-trodden ground for the C.D. Howe Institute, which regularly publishes research showing that when the phase-out of income-tested benefits is factored in, METRs for modest-income families (earning $20,000 to $35,000 a year) can soar to more than 60 per cent – well above the top statutory PIT rate. The 'perfect storm' that hits families in this income range reflects the onset of the clawback of benefits under Canada's three largest federal income support programs for non-seniors. Specifically, the phase-out of the National Child Benefit Supplement begins at an annual income of $21,480 per year, with the benefit taxed back at a rate of 12.2 to 32.9 per cent, depending on the number of children in the family. The GST credit is clawed back at a 5-per-cent rate, starting at an annual income of $29,123. And, the Canada Child Tax Benefit is phased out at a 2-4 per cent rate (again, depending on the number of children in the family), starting at an income of $35,595 per

TOP MARGINAL PERSONAL INCOME TAX RATES IN 2005*
For Ontario and Selected U.S. States



*Marginal tax rates include federal and provincial/state taxes and credits, and are calculated for a single wage-earner with no dependents
Source: Government of Ontario, U.S. Federation of Tax Administrators

MARGINAL EFFECTIVE TAX RATES (METR*) BY INCOME FOR CENSUS FAMILIES: ALL PROVINCE AVERAGE



* METR data derived via Statistics Canada's Policy Simulation Database and Model, Release 8.1; calculations exclude welfare benefits (both cash and non-cash); responsibility for the results and interpretation lie with the author. Source: Finn Poschmann, C.D. Howe Institute, August 2005

year. Add in the clawback of the Ontario Child Care Supplement for Working Families (8 per cent, starting at an annual income of $20,000), load all of this onto the combined federal-provincial PIT rate, which in Ontario rises from 22.05 per cent at $20,000 in income per year, to 31.15 per cent at $35,595 a year, and METRs climb into the 45-70 per cent range, making it even harder for modest-income families to reap the benefit of working than it is for their higher-income counterparts.

METRs highest at the welfare/work nexus

Yet, all of this attention to the plight of modest-income and high-income earners in Canada overlooks the fact that individuals at the lowest end of the income scale – those who rely on welfare to make ends meet – face an even bigger set of hurdles. Their situation doesn't feature as prominently in traditional METR analysis, partly because of difficulties associated with measuring the value of the non-cash benefits provided to welfare recipients. To calculate a marginal effective tax rate, it is necessary to be able to measure precisely how much an individual's net payments to government change – *i.e.*, how much they lose in higher taxes and forgone transfer payments – for a given increase in income. For individuals on welfare, this means that a dollar value has to be assigned to the non-cash benefits, which can pose methodological challenges.

Still, even without factoring in the value of these benefits, it is not hard to see that METRs are highest for individuals with one foot in the world of welfare and the other in the world of work. The reason is that no income support program in Canada is phased out at more punitive rates than welfare. A quick glance at the basic parameters of the pre-2005 Ontario Works system reveals the source – and scale – of the problem. To encourage individuals to move off welfare as quickly as possible, the old OW rules imposed a high clawback rate on employment income recipients earned while collecting benefits. The rate structure was tiered, and varied inversely with the length of time individuals had worked while collecting benefits, but the lowest possible rate was 75 per cent. That's already a good deal higher than any of the other METR flashpoints cited above. And, when the loss of the non-

MARGINAL EFFECTIVE TAX RATES ASSOCIATED WITH SELECTED INCOME SECURITY PROGRAMS*

Program	Taxback Rate (%)	Income Threshold Where Clawback: Begins ($)	Income Threshold Where Clawback: Ends ($)
Employment Insurance (EI)	1.95	1	39,000
Canada Pension Plan (CPP)	4.95	3,500	40,500
Ontario Property and Sales Tax Credits (non-seniors)	2.00	4,000	54,000
Ontario Works (pre-August 2005 rules)			
24+ months on OW and earning income	100.00	8,400	18,360
13-24 months on OW and earning income	85.00	9,288	21,018
0-12 months on OW and earning income	75.00	10,800	23,380
Subsidized Day Care (City of Toronto)	27.00	15,288	---
Ontario Basic Reduction	5.63	16,311	35,100
Ontario Child Care Supplement for Working Families (OCCS)	8.00	20,000	36,375
National Child Benefit Supplement (NCBS)		21,480	
1 child	12.20		35,595
2 children	22.80		35,620
3+ children	32.90		35,596
Goods and Services (GST) Credit	5.00	29,618	41,098
Canada Child Tax Benefit (CTB)		35,595	
1 child	2.00		109,145
2 children	4.00		103,070
Child Disability Benefit (CDB)		35,595	
1 child	12.20		51,988
2 children	22.80		53,139
3+ children	32.90		53,832

*All income thresholds and tax rates are based on 2005 values unless otherwise noted. Income thresholds are calculated based on the maximum possible benefit. Source: Government of Canada, Province of Ontario, City of Toronto Children's Services Division, TD Economics.

cash benefits is factored in, METRs can spike to more than 100 per cent. Moreover, this back of the envelope calculation only takes the welfare system in isolation. It doesn't include the effects of positive taxes and the phase-out of other income-tested benefits.

In a 1993 paper published by the Caledon Institute of Social Policy, authors Ken Battle and Sherri Torjman coined the term "welfare wall" to describe the sky-high marginal effective tax rates that welfare recipients face when they enter the workforce.[10] And, it's an apt description. With a marginal effective tax rate of more than 100 per cent, each additional dollar that welfare recipients earn translates into ***more*** than a dollar lost in income and benefits. That doesn't just limit the short-run gains they realize from working – it wipes them out entirely. It's hard to imagine a more powerful disincentive to leaving welfare for work. Indeed, seen from this perspective, the fact that any OW recipients at all continue to seek more and better-paying work speaks to a keen desire to improve their living standards. It also looks uncomfortably like a triumph of hope over experience.

IV. ONTARIO WORKS – AUGUST 2005 VERSION

The changes to OW that were implemented in August 2005 represent an acknowledgement of the fact that the welfare system in Ontario still presents recipients with something of a Hobson's choice when it comes to making decisions about whether and how much to work. That the McGuinty government recognizes this and is committed to addressing the problem is clear from the Backgrounder document it released announcing the changes. Under the heading "Improving Ontario Works", the Backgrounder states that the changes "will encourage Ontario Works clients to move from welfare to employment by providing straightforward incentives and extra support to make a successful and permanent transition to the workforce."[12]

So, how well do the new rules live up to their stated purpose? In the remainder of this paper, we'll lay out the changes to OW that took effect in August of this year and explain how we approached the task of measuring their impact on welfare recipients today. We'll then offer our take on what's better and what's worse in the new OW environment, and why – and, along the way, we'll identify additional measures that we believe would alleviate some of the problems that still afflict the program. The discussion is quite technical in parts. However, a firm grasp of how the OW income-testing process affects marginal effective tax rates is necessary to get a complete picture of how the system raises and lowers barriers to work for welfare recipients. Without an understanding of these dynamics, it's easy to miss the fact that reforms that are meant to break down existing barriers to work can end up erecting new ones in the process. Moreover, while this analysis focuses on welfare in Ontario, many of OW's features are present in other provincial/territorial welfare systems. In that sense, it's fair to say that few jurisdictions in Canada are untouched by the issues the McGuinty government was seeking to address with the August 2005 reforms. By looking at the Ontario example, we hope to provide insight into the larger problem of barriers to work within welfare that will have relevance for other governments across the country.

How is Ontario Works changing?

The new rules fall into three main categories:

- **Earnings exemptions:** Under the pre-2005 Ontario Works rules, welfare recipients' monthly cash allowances were gradually clawed back as their earned income rose. To ensure that the reduction was not dollar for dollar, which would have defeated the purpose of working unless recipients could earn more than the maximum allotment for their household type, two earnings exemptions were applied. The first was a basic, or flat rate earnings exemption, which varied according to household type – *i.e.*, \$143 a month for a single adult, \$275 a month for a lone parent with one child, and so forth. The second was a variable rate exemption, which levied one of three rates, depending on how long an individual had worked while collecting assistance. During the first 12 months (measured as total months over the course of an individual's lifetime, not consecutive months), the rate was 25 per cent; over the next 13-24 months, it was 15 per cent; and, beyond that, it was zero. The reciprocal of these rates represented the portion of an individual's net earnings over and above the amount of the basic exemption that was deducted, or "taxed back", from their monthly cash allowance – *i.e.*, 75 per cent for those in their first 12 months of working while collecting OW, 85 per cent for those in their next 12 months, and 100 per cent thereafter. In the rest of this paper, we will generally refer to the variable earnings exemption rates in terms of their associated taxback rates.

An example helps to illustrate. For a single adult, the current maximum monthly OW allowance is $536. Using the pre-2005 formula and assuming that the individual had simultaneously worked and collected OW for 18 months (putting him in the second variable earnings exemption category), the clawback would be his net earnings, minus the $143 basic exemption, minus another 85 per cent. If this amount were less than $536, the individual would receive the difference as his monthly allotment (*i.e.*, $536 minus the clawback). If it were more than $536, he would be deemed to have surpassed the OW earnings threshold and would receive no assistance.

Under the August 2005 rules, the basic earnings exemption has been eliminated, the variable exemption has been streamlined to a single, lower rate of 50 per cent, and the time limits have been dropped.

Child care earnings exemption: Under the pre-2005 OW rules, parents who were working part-time and had children under 13 years of age could claim an additional earnings exemption worth up to $390 per month per child to help them cover the cost of informal child care. This amount was the last term in the clawback formula. Using the example of a lone parent with one child under 12, the current maximum OW allowance is $865.08. (In fact, it's $987, but the Ontario government deducts 85 per cent of the National Child Benefit Supplement from parents' cash allowance).[11] Using the pre-2005 formula and assuming the parent had already worked while being on OW for 6 months (the first variable earnings exemption category), the clawback would be her net earnings, minus the $275 basic exemption, minus another 75 per cent, minus up to $390. If this amount were less than $865.08, she would get the difference as her monthly allowance (*i.e.*, $865.08 minus the clawback). If it were more, she would be deemed to have exceeded the OW earnings threshold and would receive no assistance.

Under the August 2005 rules, the maximum child care earnings exemption for informal child care has been raised to $600 per month per child. It is available to parents who work full-time or part-time.

- **Health benefits:** In addition to a cash allowance, Ontario Works provides recipients with basic health benefits, such as coverage for prescription drugs, vision care and dental expenses. Under the pre-2005 rules, recipients lost these benefits as soon as their earnings surpassed the OW threshold.

  Under the August 2005 rules, the health benefits have been extended for individuals who are leaving welfare for work for a period of six months or until employer benefits are available. In exceptional cases, benefits could be extended for up to one year.

- **Full-time Employment Benefit (FTEB):** Under the pre-2005 OW rules, recipients were eligible to receive a payment of up to $253 in any 12-month period to help defray expenses associated with starting a new job, changing jobs, or entering a training program.

  Under the August 2005 rules, recipients who begin full-time employment can receive up to $500 in any 12-month period. Recipients who begin part-time work or an employment assistance activity can still receive up to $253 in any 12-month period.

August 2005 Ontario Works Rules: Summary of Changes

Earnings exemptions

- Replacing the current set of flat and graduated exemption rates with a single, easy-to-understand 50 per cent exemption for all earnings.
- Eliminating the punitive two-year limit for the variable earnings exemption. The new, lower 50-per-cent rate now applies to all OW recipients with earnings.
- Raising the maximum amount that working parents with dependent children can deduct for informal child care expenses from $390 to $600 per child per month.

Extended employment health benefit

- Extending basic health benefits such as prescription drugs, vision and dental coverage for a period of six months for recipients who are leaving OW for employment, and up to one year for exceptional cases or until employer benefits are available.

Full-time Employment Benefit (FTEB)

- Providing a new payment of up to $500 to help offset costs related to getting started in a new full-time job.

Source: Ontario Ministry of Community and Social Services

PART TWO:

TEST-DRIVING THE NEW ONTARIO WORKS

V. MEASURING THE IMPACT OF THE NEW RULES

To evaluate the relative merits of the two OW systems, we decided to look at how two hypothetical OW recipients would fare at different stages along the welfare/work spectrum under the old and new rules. We adopted a scenario-based approach, because Ontario Works – and, the broader federal-provincial tax and transfer system of which it is a part – varies dramatically in its treatment of different households, depending on family type and size, income, and a host of other demographic factors. As a result, it is difficult to make high-level generalizations about its impact. Instead, in the interests of accuracy, it is preferable to focus on a few 'sample' individuals who are representative of broad strata of the population and study how the dynamics of the tax and transfer system affect their circumstances under different conditions.

We chose two hypothetical individuals – a 40-year old single and childless adult ("Jim") and a 25-year-old lone parent ("Sally") with a child under the age of 7 – whose demographic profiles match up with those of the top two categories of OW recipients. We studied them in seven different scenarios, representing unique combinations of welfare and work income, and we ran the scenarios under the pre-2005 rules and the August 2005 rules. In each case, our objective was to evaluate both individuals' economic well-being, defined as the sum of their income and benefits (cash and non-cash) after all taxes are paid and all benefits and credits received – an amount we will henceforth refer to as their "disposable income". For the lone parent, the calculation of this measure of disposable income also subtracts child care costs, since the financial benefit a parent derives from working has to be weighed against the additional child care expenses he or she incurs in the process. As a proxy for measuring each individual's incentive to move to the next stage along the welfare/work spectrum, we calculated the marginal effective tax rate they faced, computed as the change in their disposable income between two scenarios as a percentage of the change in their work earnings across these scenarios.

A more complete discussion of the scenarios and the underlying assumptions can be found in the appendix starting on page 34, and detailed results of the scenario runs are presented in Tables A-C, starting on page 37. Readers may find it helpful to refer to this material before proceeding. In the text box above, we summarize the key assumptions and outline four of the seven base case scenarios. These scenarios correspond to key inflection points along the welfare/work spectrum under the old OW rules, and in our view, capture the main problems the McGuinty government was attempting to remedy with the August 2005 changes. Accordingly, they form the core of our analysis.

SCENARIOS

Jim 1 and Sally 1: Individuals are receiving the maximum OW allowance for their household type and are not working.

Jim 2 and Sally 2: (The 'comfort zone'). Individuals are earning the minimum amount of employment income necessary to take advantage of all available OW earnings exemptions, while still retaining the maximum dollar amount of OW cash benefits.

Jim 3 and Sally 3: (The 'break-even point'). Individuals are earning the maximum amount of employment income possible while still retaining $1 of assistance (the condition for remaining eligible for the OW in-kind benefits under the old OW rules).

Jim 4 and Sally 4: Individuals have moved just beyond the break-even point, where their work income exceeds the OW earnings threshold and they have lost all their cash and in-kind benefits.

COMMON ASSUMPTIONS

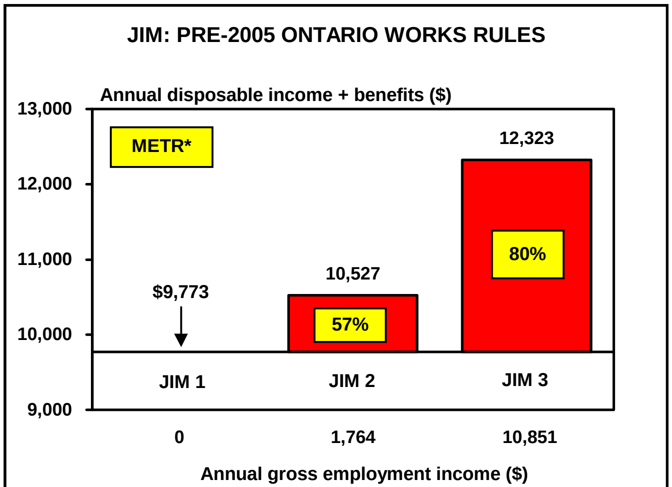
1. All earnings exemptions maximized under pre-2005 OW rules.
2. Maximum amount of OW discretionary cash benefits received where applicable.
3. Child care costs set at $5/hour for informal care.
4. Shelter costs held constant across all scenarios at $335/month for Jim and $600/month for Sally.

Problem #1: Basic earnings exemption plus high variable earnings taxback rates give OW recipients little incentive to work

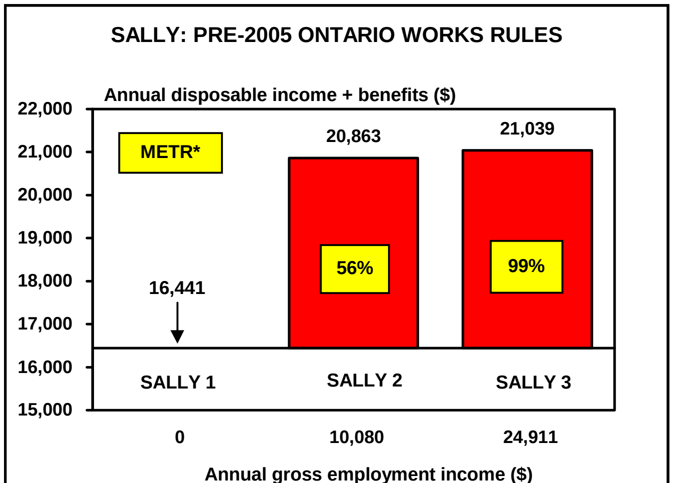
The first thing that jumps out from a comparison of the base case scenarios under the old OW rules is that neither of our hypothetical OW recipients achieves much of an increase in their economic well-being as a result of working. To be sure, as Table A shows, Jim and Sally are both always better off working than relying solely on assistance – *i.e.*, their disposable income (including benefits) is higher in every scenario than in Scenario 1. And, they're better off working more rather than fewer hours – *i.e.*, their disposable income rises steadily from Scenario 1 to Scenario 3. But, the improvement isn't particularly striking, for two reasons. First, the basic earnings exemption allows individuals to shield a fixed dollar amount of income from the OW clawback, regardless of how much they work. Second, the low variable exemptions rates tax back most, if not all, of the income they earn over and above that amount. As a result, a 'comfort zone' is created, where individuals can come close to maximizing their disposable income at a relatively low level of employment earnings. Rather than giving individuals an incentive to boost their market income, the old rules instead encouraged them to remain in the 'comfort zone' in perpetuity, limiting their work hours to the amount necessary to permit them to continue receiving the maximum monthly OW cash allowance.

The transition that showcases this is the one from Scenario 2 to Scenario 3. These scenarios represent the opposite ends of the OW spectrum – *i.e.*, working just enough not to lose any cash benefits (Scenario 2), and working until you're down to your last $1 of assistance (Scenario 3). Under the old rules, Jim and Sally both see an increase in their disposable income as they make this transition, despite the fact that they are getting only $1 of OW in Scenario 3. So, they do have an incentive to make the move, but it's weak, especially for Sally. As the adjacent charts indicate, Jim's annual gross employment income rises by about $9,000 from Scenario 2 to 3, and he is able to keep almost $1,800 of that, or 20 per cent – the inverse of his marginal effective tax rate of 80 per cent. By comparison, Sally's annual gross employment income rises by nearly $15,000 from Scenario 2 to 3, but she keeps only $175 of this, for a METR of close to 100 per cent. The reason is that she has to work more hours, and the resulting increase in her child care costs eats up most of her additional income. For Sally, the combination of losing most of her OW cash benefits *and* having to pay more for child care leaves her disposable income essentially flat, implying that she should be indifferent between the two scenarios.

Moreover, the opportunity cost for Jim of boosting his earnings to the OW break-even level is likely higher than our Scenario 3 suggests. We ran our original scenarios using the lowest possible variable earnings taxback rate of 75 per cent, to demonstrate the best possible outcome OW recipients could achieve under the pre-2005 rules. However, OW caseload statistics suggest that most recipients Jim's age (40 years) have worked and collected benefits for more than two years, meaning that they would face the top 100-per-cent rate. As a result, the maximum amount of income that Jim could earn each month before his cash



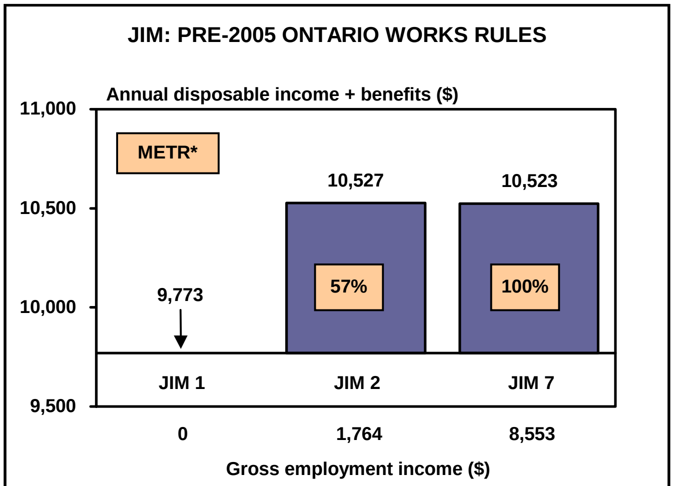
*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table A in summary tables).



*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table A in summary tables).

benefits started getting clawed back would be the basic exemption for a single person – $143. Scenario 7 replicates Jim's break-even point (Scenario 3), but with a 100-per-cent taxback rate. As the chart at the top of the next page shows, under these conditions, his disposable income actually falls relative to Scenario 2, meaning that he is worse off as a result of working more hours.

OW caseload statistics provide some evidence of the powerful disincentive to work embedded in the pre-2005 regime's high variable taxback rates. Prior to 1999, the variable earnings exemption was administered with a single rate of 25 per cent (*i.e.*, a 75-per-cent taxback rate). Between 1998 and 2000, a three-tier, graduated structure was phased in, opening up the possibility that OW recipients could lose more (85 per cent) and eventually all (100



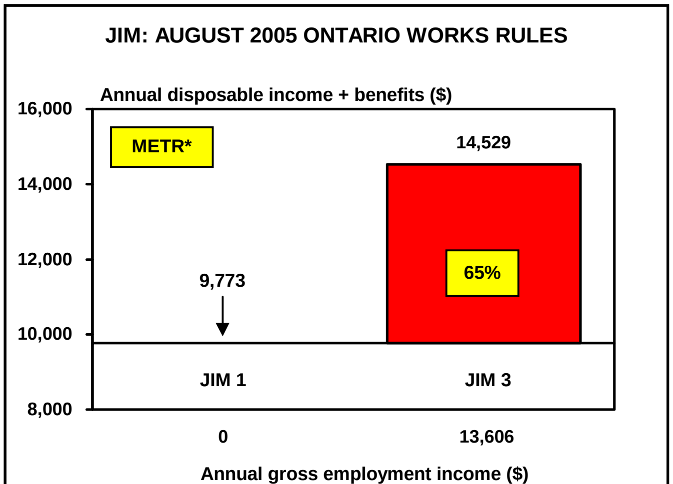
*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table A in summary tables).

per cent) of their earnings in excess of the basic exemption. It is noteworthy that in 1999/2000, almost a quarter of all OW recipients had employment income. That ratio fell steadily in the ensuing years, to 13 per cent in 2004. To be sure, not all of this can be attributed to the introduction of the higher variable taxback rates. The tightening in OW eligibility requirements in 1995 forced many adults who were capable of working off welfare, implying that the "hard to serve" core – those who face particularly steep barriers to work – has come to account for a larger share of the overall OW population. Nevertheless, the punitively high variable earnings taxback rates surely contributed to the decline in labour force participation seen among OW recipients over the last five years.

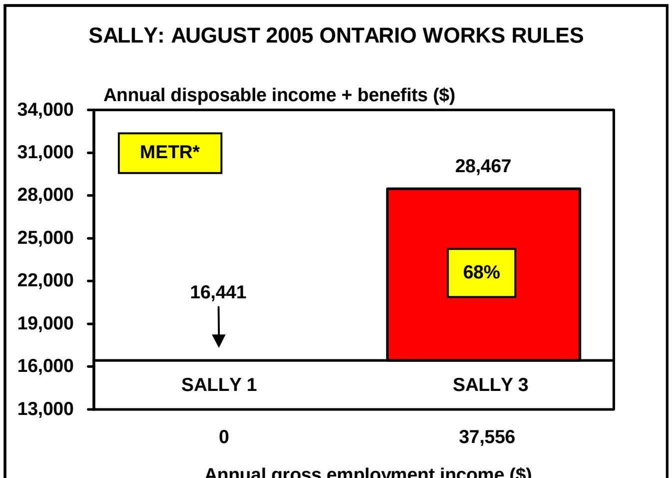
√ August 2005 rules lower high METRs within OW

By getting rid of the basic earnings exemption, the new rules eliminate the 'comfort zone'. And, by replacing the 75-100 per cent variable earnings taxback rates with a single 50-per-cent rate, they reduce the marginal effective tax rates that OW recipients face at each stage along the welfare/work spectrum. The combined effect gives Jim and Sally a greater opportunity – and a stronger incentive – to increase their market income. As the adjacent charts show, the METRs that Jim and Sally face in Scenario 3 relative to Scenario 1 (Scenario 2, the 'comfort zone', has now disappeared) are 30-40 percentage points lower under the new rules. Make no mistake – they're still high, at just under 70 per cent. That's due primarily to the 50-per-cent taxback rate on OW, and secondarily to the hit from rising CPP and EI deductions and personal income taxes that goes along with a higher market income. But, the METRs are lower, which means that OW recipients will see a more pronounced improvement in their economic well-being as their market income rises – evident in the fact that Jim and Sally's disposable income at the Scenario 3 break-even point is higher than it was under the old rules.

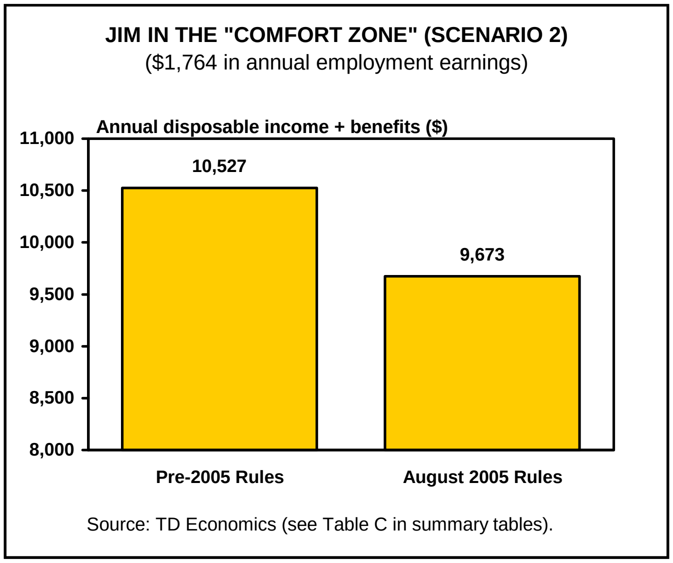
There is an important qualification. At lower levels of employment earnings – *i.e.*, up to and just beyond the old 'comfort zone' – some individuals will be worse off under the new rules. The reason is that, at this level of earnings, the increase in the amount of market income that OW recipients can shield via the lower taxback rate will be less than the amount of the basic earnings exemption they lose. So, for a given level of work earnings, these individuals will see their disposable income fall. While data are not



*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table B in summary tables).



*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table B in summary tables).



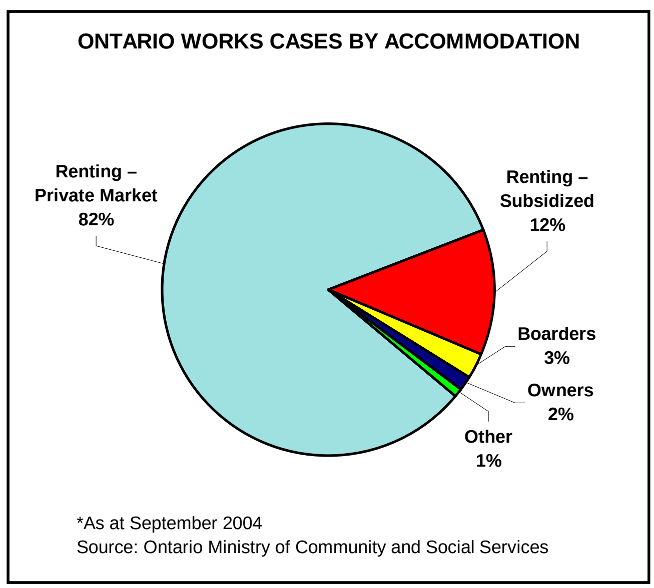
publicly available to show how many OW recipients are clustered around the 'comfort zone', anecdotal evidence suggests that the problem encompasses a meaningful portion of the current population of beneficiaries.[13]

For the most part, these beneficiaries are likely to be single adults – like Jim, as the chart above shows. The reason is that, while parents are also losing the basic earnings exemption, they get offsetting support from two quarters. The first is the increase in the OW child care earnings exemption from $390 to $600 per child per month, which will allow them to shelter another chunk of earnings from the benefit clawback, assuming they have the requisite work hours and child care expenses. The second is the larger-than-usual increase in the National Child Benefit Supplement that was implemented in July 2005 – up a generous 14 per cent for a lone parent with one child.

The reality that some people will be worse off in dollar terms as a result of the new rules suggests that there may be a backlash against the elimination of the basic earnings exemption – not least because of its provenance. The measure was introduced in 1995 to soften the blow of the 21.6-per-cent reduction in benefit rates that accompanied the introduction of workfare. The new basic earnings exemptions were set to match the reduction in benefit levels for each household type – *e.g.*, the monthly allowance for a single individual was lowered from $663 to $520, or by $143, which became the value of the basic exemption for a single adult. The premise was that OW recipients would be able to earn back in labour income what had been cut from their monthly allowance – a 'wedge' of protection

Rent-geared-to-income (RGI) housing: Another brick in the METR wall

Welfare recipients in Ontario would face even higher marginal effective tax rates than our scenarios suggest if they lived in rent-geared-to-income (RGI) housing. The basic premise of this kind of housing is that individuals should not devote more than 30 per cent of their gross income to shelter. The advantage of an arrangement of this sort is that it generally keeps an individual's shelter budget lower than it would be if he or she had to find accommodation in the private market. The disadvantage is that individuals' monthly rent payments usually rise in lockstep with their income, giving them a 100 per cent marginal effective tax rate on this portion of their household budget. As a result, for a given level of earnings, an individual in RGI housing will generally enjoy a higher level of disposable income (ex-shelter) than a similar individual in private housing. But, she will pay a price for this in the form of a higher METR on her work earnings, which will limit the gains she realizes from earning more income. As the adjacent chart demonstrates, the vast majority of OW recipients – fully 82 per cent – rent in the private market, and we structured our scenarios accordingly, keeping rental costs constant as work earnings increase. However, for the 12 per cent of OW recipients in subsidized housing, it is important to recognize that the benefits of a rising market income will be even more elusive.



that gained importance in the ensuing years, as OW benefits failed to rise with inflation. Individuals trying to scrape by at 'comfort zone' levels of earnings are doubtless already struggling to make ends meet, so even a small loss in disposable income from this starting point will be painful. However, while this raises important practical questions about how best to manage the transition to the new rules, from the standpoint of program design, the August 2005 earnings exemption must be seen as an improvement over its predecessors. In the simplest sense, it delivers greater rewards for more work, and that is unambiguously positive with respect to the goal of improving work incentives.

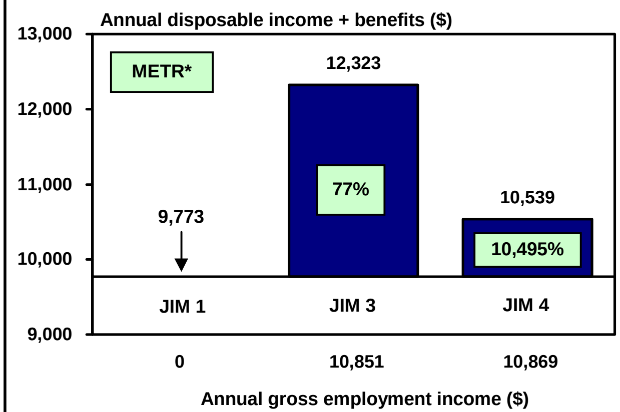
Problem #2: Loss of drug and dental benefits at OW exit point devastating

If the punitively high taxback rates on employment earnings under the pre-2005 OW rules meant that recipients didn't reap much benefit from working, that was still better than the situation they faced when they left welfare. As the adjacent charts show, under the old rules, Jim and Sally saw an outright decline in their disposable income (including benefits) when they lost their last dollar of assistance (Scenario 4), making them unequivocally worse off than when they were working and collecting welfare (Scenario 2 or 3). In other words, under the old rules, OW recipients' best bet was to work AND be on welfare.

The source of the problem at the OW exit point was the loss of the health benefits. Under the old rules, these benefits were not phased out as recipients' incomes rose. Rather, the loss was incurred all at once when they left OW. That's the trade-off of preserving the benefits in full as recipients work their way down to their last $1 of cash assistance – *i.e.*, the benefits don't contribute to the METR problem within welfare, but they erect a virtually insurmountable wall at the exit point. It's the lump sum loss of the drug and dental benefits for a just a few more dollars of earned income that drives the drop in Jim and Sally's disposable income from Scenario 3 to Scenario 4, and the related spike in their METRs to 10,000-15,000 per cent.

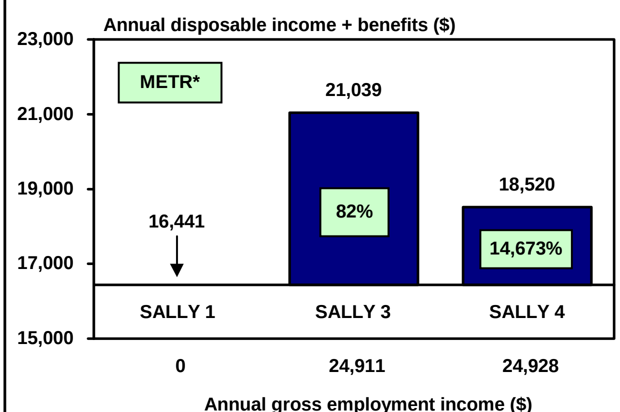
To make these calculations, we had to estimate the dollar value of the OW health benefits. To do so, we worked off the assumption that a reasonable proxy for their value is the cost of replacing this coverage in the private market. Some "Quick Quotes" from the Ontario Blue Cross website suggest that a modest benefit package providing roughly comparable coverage would cost around $130-$140 a

JIM: PRE-2005 ONTARIO WORKS RULES



*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table A in summary tables).

SALLY: PRE-2005 ONTARIO WORKS RULES



*METR: Marginal effective tax rate relative to previous scenario.
Source: TD Economics (see Table A in summary tables).

month for our two hypothetical OW recipients.[14] The relatively high price reflects the fact that individual consumers don't benefit from the economies of scale available in group insurance plans, where employers can spread the risk across more people, thereby lowering premiums. Moreover, as high as the price may seem, it probably understates the true value of the OW health benefits. First, many OW recipients would likely have trouble getting approved for private insurance even if they could bear the cost. Second, and more important, most private health insurance plans don't provide coverage for some of the prescription drugs and dental services that many OW recipients need. For individuals in this situation, leaving welfare can mean going without coverage entirely, making the opportunity cost technically incalculable.

√ *August 2005 rules reduce METRs at OW exit point*

By allowing OW recipients to continue receiving drug and dental benefits for up to a year after they have left welfare, the new rules help lower one of the biggest barriers to work they face. Admittedly, at the end of the extension period, the drug and dental benefits still disappear in one lump sum, meaning that OW recipients will continue to experience a one-time spike in their METRs at this juncture. The extension period doesn't eliminate this problem – it simply pushes it 6-12 months into the future. But, the delay makes a big difference. In an immediate sense, it will allow individuals to complete a course of treatment they have begun. And, more broadly, it gives all OW recipients extra time to replace this vital coverage in the marketplace.

With this move, the Ontario government has restored a provision that was in place for social assistance recipients in the province for almost 20 years under the Family Benefit Allowance (FBA) program, and even longer under the old General Welfare Assistance (GWA) program. Extended health benefits were introduced in 1979 as part of the Work Incentive Program (WIN), a program that provided income supplementation to Family Benefit Allowance recipients who opted out of FBA for full-time work. To facilitate their transition into the labour force, WIN participants were permitted to retain all of the health-related benefits provided to FBA clients for 2 ¼ years. Take-up under WIN was relatively limited, because eligibility for the program was restricted to clients of FBA, which only served lone parents and the disabled. However, under the 1989 Supports to Employment Program (STEP), a form of extended health benefits was made available to recipients of General Welfare Assistance (GWA), the province's welfare program for adults who do not have disabilities. This provision survived until 1998, when it was rescinded as part of the broader retraction of welfare benefits under the mantle of Ontario Works. Prior to 1998, individuals outside the welfare system could also complete a special needs test under a section of GWA known as Special Assistance. A more generous test than the one for general assistance, special assistance often allowed the working poor to continue on in the workplace while receiving extra help, such as a prescription Drug Card. This program feature was also discontinued in 1998.

While the August 2005 OW health benefit extension period isn't as generous as it has been in the past – up to twelve months currently, versus more than two years un-

Timeline of Ontario Social Assistance Programs for Non-Seniors and the Non-Disabled

1920: Mothers' Allowance

- Means-tested program originally introduced for widows with at least two children under 14. Progressively expanded to include all lone parents.
- Provincial-municipal cost-shared agreement initially, amended multiple times over the years.

1956: Unemployment Assistance Act (UA)

- Needs-tested program for Ontario residents only. Repatriation and chargeback system for out of province cases and non-residents. No assistance for employable single adults from 1941-1958.
- 50/50 federal-provincial funding; federal funding open-ended.

1958: General Welfare Assistance (GWA)

- Needs-tested program for persons in need not covered through other categorical programs. For Ontario residents only . Repatriation and chargeback system for out of province cases and non-residents.
- 50/25/25 federal-provincial-municipal funding.

1966: Family Benefits Act (FBA)

- Implemented in response to the introduction the same year of the **Canada Assistance Plan (CAP)**, a federal legislative mechanism for cost-sharing a range of social assistance/social service programs that resulted in a significant expansion of these programs.
- Under CAP, GWA and FBA replaced all existing programs. GWA replaced Unemployment Assistance, and FBA replaced Blind Persons' Allowance, Disabled Persons' Allowance, and Mothers' Allowance.
- 50/30/20 federal-provincial-municipal funding of defined eligible costs; federal cost-sharing based on three conditions: needs-tested benefits, no residency requirement, appeals system in place.

1998: Ontario Works (OW)

- Needs-tested program introduced in 1995, with enabling legislation passed in 1998. All GWA and FBA clients eventually transferred to Ontario Works or the Ontario Disability Support Program (ODSP).
- 80/20 provincial-municipal funding for benefits; 50/50 funding for administrative costs.

Source: Anne Tweddle

der WIN – the reinstatement gives OW recipients a big leg up in their efforts to transition off welfare into work. And, arguably, this is as much as a welfare program can or should be expected to do. After all, if former OW recipients eventually end up without coverage, their situation will be no different from that of many other working adults in Canada who are not covered by an employer-sponsored benefit program. While this may produce undesirable inequities in the labour force, with some individuals bearing a greater insurance cost burden than others, this is a broader social problem, and not one the welfare system can solve.

Moreover, with respect to drug coverage, it's important to recognize that there is already a program in place in Ontario to assist lower-income individuals outside welfare with their prescription drug needs. The Trillium Drug Program offers drug coverage similar to that provided to OW and other recipients (mainly, seniors and ODSP clients) under the Ontario Drug Benefit (ODB) Program, including coverage for so-called catastrophic drugs – a point that is not well understood. Indeed, awareness of the Trillium program itself is low. Part of the reason for the program's relative obscurity is that it has two features that limit its usefulness for low-income individuals – namely, a deductible, and a requirement that recipients pay for their drugs up front, with reimbursement provided later. These elements reduce access to the program for very low-income individuals, who may have an urgent need for a drug, but lack the ready cash to pay for it. The new Ontario Works extended health benefit provides some relief on this front. After the initial six-month period, during which clients who have left OW for work can keep their health benefits in full, benefits can be extended for another six months "in exceptional cases", and Ontario's Ministry of Community and Social Services has indicated that this period could be used to assist with the Trillium deductible for former OW clients' whose employer does not offer a drug plan.

As for dental coverage, a remedy is not as readily apparent. Even within the OW universe, the dental benefits currently provided fall far short of most recipients' needs. While basic preventive, restorative and emergency dental benefits for children and adults with disabilities are mandatory, coverage for non-disabled adults is permissive, with the final decision residing with the individual municipality. And, even when benefits are approved, the dollar amount is often capped. As a result, except in very rare cases, services and procedures that would vastly improve many

Ontario Drug Benefit: Trillium Drug Program

The Trillium Drug Program helps people who have high drug costs in relation to their income. Once an application is approved, the program covers:

- over 3,400 quality-assured prescription drug products
- over 400 limited-use drug products
- some nutritional and diabetic testing products

Ontarians can apply to the Trillium Drug Program if:

- their private insurance does not cover 100 per cent of their prescription drug costs
- they have valid Ontario Health Insurance (OHIP)
- they are not eligible for drug coverage under the Ontario Drug Benefit (ODB) Program

The Trillium Drug Program has a deductible that is based on income and family size. Each year starting August 1st, recipients must pay their drug costs up to their deductible level before they are eligible for drug coverage. The program runs from August 1st of one year to July 31st of the next year, and the deductible is paid in four installments over this period. After each quarter's deductible is paid, a family will receive benefits for that quarter, though they may be asked to pay up to $2 per prescription each time they purchase a covered drug product. Any unpaid deductible in a quarter is added to the next quarter's deductible.

A pro-rated deductible for families who enter the program partway through the program year is also available. New applicants can choose the date on which they wish to be enrolled in the program, and the deductible they pay will be based on the number of days left in the program year. The pro-rating applies only for the first year that a family is enrolled in the program.

Only certain drug costs count towards the Trillium deductible or as program benefits. The drugs must be:

- listed in the ODB Formulary/Comparative Drug Index (Parts III and IX)
- on the Facilitated Access List of HIV/AIDS drugs (Part VI)

Requests for non-ODB drugs must be pre-approved by the ministry before the costs can count towards the Trillium deductible, or as program benefits.

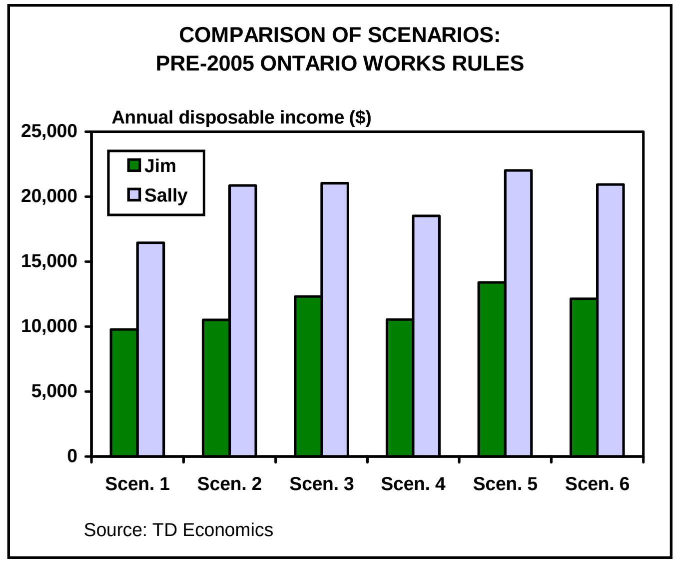
Source: Ontario Ministry of Health and Long-Term Care

OW recipients' chances of getting a job – *e.g.*, dentures, or cosmetic surgery to replace lost teeth – remain permanently out of their reach. In this sense, many OW recipients, working or not, share a problem with other low-income adults in Canada, who don't have access to affordable dental care. Yet, while it is widely recognized that this is not a satisfactory situation, the question of who should pay for these services, and what limitations, if any, should be placed on the range and cost of procedures covered, is a hotly contested issue. Nevertheless, the ongoing failure to address this problem represents a major gap in health care coverage for Canadians.

Problem #3: Gap between benefits for singles and parents distorts work incentives

So far, in looking at barriers to work within OW, we've focused on how the same individual's circumstances change at different levels of employment earnings. In other words, whether we were looking at the transition from one stage to another along the welfare/work spectrum, or assessing how conditions at a particular stage are affected by the introduction of the new OW rules, we've compared Jim with Jim, and Sally with Sally. But, after completing the calculations for both individuals, it's hard not to notice that there is a big gap *between* their situations. As the above chart shows, Jim is considerably worse off financially than Sally in every scenario. And, remember that, except for Scenario 7, which is unique to each individual and so not featured in this chart, scenarios bearing the same number are specified identically. So, the only thing that distinguishes both individuals' circumstances in each case is their household type. As it turns out, this makes a big difference – and, the reasons have implications for work incentives, although it takes a few steps to see the connection.

At first glance, the reason for the gap is obvious – namely, Sally has expenses as a parent that Jim doesn't bear. You would expect the income security system to make provision for this, and it does, through welfare and non-welfare channels. Outside of welfare, the personal income tax system offers a child care expense deduction that lowers parents' taxable income, as well as federal and provincial non-refundable tax credits for dependent children that reduce the tax payable on that income. Parents also receive income-tested benefits from the federal and provincial governments, including the federal National Child Benefit and the GST credit (not strictly a child benefit, but



the payout is higher for families with children), and in Ontario, the Ontario Child Care Supplement for Working Families. On the welfare side of the equation, most provincial welfare programs pay higher benefits to families with children. In the case of OW, that 'premium' takes the form of a higher base monthly allowance, a higher basic earnings exemption (under the pre-2005 rules only), and an additional earnings exemption for child care expenses.

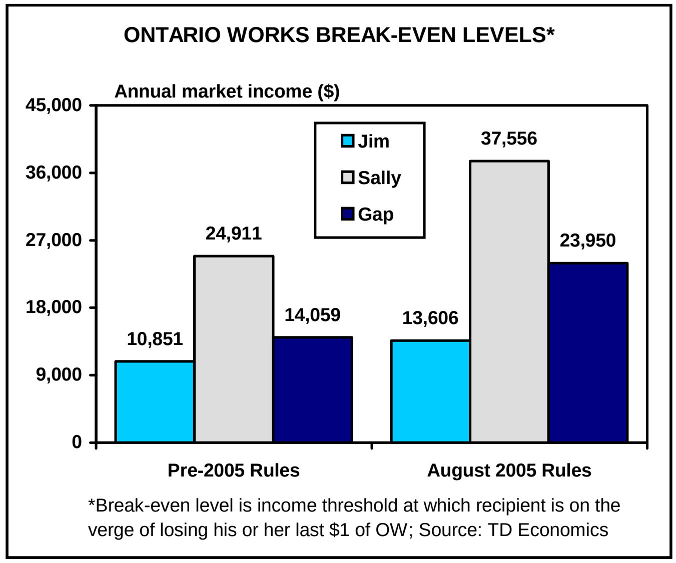
So, the discrepancy between Jim and Sally's economic circumstances reflects choices about the relative treatment of singles and parents at all levels of the income security system – not just welfare. But, what's interesting about the OW dimension is that it has a direct bearing on work incentives. The reason is that the value of the benefit package drives the amount of employment income that OW recipients can earn, which in turn influences their ability to find and maintain a well-paying job. This isn't about work incentives in the narrow sense of marginal effective tax rates, but it is about work incentives understood more broadly as the spectrum of opportunities and supports that individuals can draw on as they seek to form an attachment to the labour force. In a nutshell, Jim's lower monthly OW allowance curtails his work options by capping the amount of market income he can earn at a lower level than Sally. And, his less generous earnings exemptions mean that he reaches that ceiling faster, because he has fewer opportunities to shield his market income from the OW clawback. The combined effect circumscribes his ability to find the kind of work that might enable him to get off welfare once and for all.

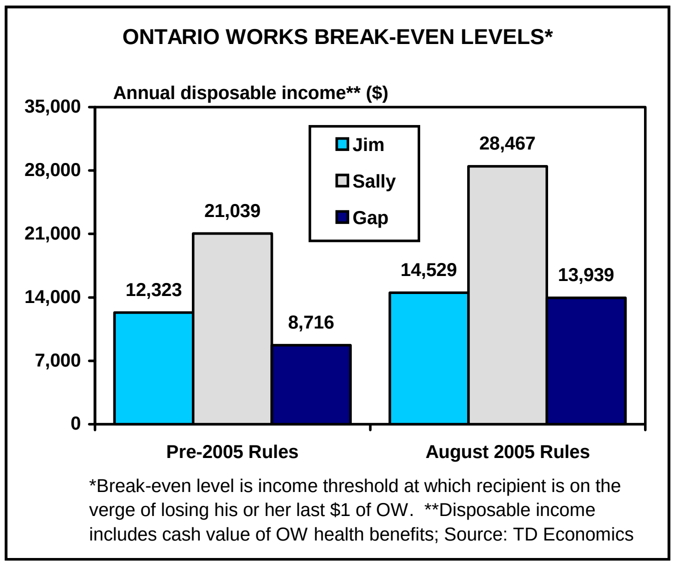
✗ *August 2005 rules worsen gap between single adults and lone parents*

The new OW rules make the gap between singles and parents much larger. The key is the interaction between two of the main elements of the OW benefit structure. As we explained in our discussion of Problem #1, the lower taxback rate on employment earnings under the new rules eases the high marginal effective tax rates that welfare recipients face as they move into the workforce. All other things being equal, this should improve work incentives for all welfare recipients – and, it does. But, the rewards don't flow equally to all households, because all other things are not equal in the OW universe. The benefit package for parents is worth more than the one for single adults, and it's the value of this package that sets the parameters for the OW clawback. When the lower taxback rate is overlaid on top of it, and the higher child care earnings exemption is tacked on, it magnifies the gap between the amount of market income the two household types can earn.

To see this, it's necessary to understand the role that benefit levels and recovery rates (AKA taxback rates) play in a needs-tested program like Ontario Works. The taxback rate determines how rapidly a benefit is clawed back as a recipient's income rises – *i.e.*, it defines the marginal effective tax rate the individual faces. The dollar amount of the benefit, in conjunction with the taxback rate, determines the program's break-even point – *i.e.*, the level of income at which the benefit finally runs out. This point is sometimes referred to as the 'escape level', to convey the idea that the individual is exiting the program, and thus 'escaping' the higher marginal effective tax rates associated with it. Reducing taxback rates to keep METRs low extends the range of income over which recipients can collect benefits. That enlarges the pool of people who are eligible for the program, thereby increasing its cost.

In the OW context, lowering the earnings taxback rate to 50 per cent pushes up Jim and Sally's break-even levels, but because Sally's starting point is higher – *i.e.*, a richer benefit package – her break-even level rises by a lot more. This is true despite the fact that the August 2005 rules eliminate one element of the premium she enjoyed under the old system – namely, the basic earnings exemption, which was set at $275 a month for a lone parent with one child, versus $143 for a single adult. The loss of this exemption is more than offset by the combined effect of the lower taxback rate on earnings and the increase in the





child care earnings exemption (from $390 to $600 per child per month) under the new rules. A comparison of break-even levels under the two OW regimes makes this very clear.

Under the pre-2005 rules, Jim bumps up against his OW earnings threshold at $10,850 in annual employment earnings, whereas Sally doesn't reach this point until she's earning close to $25,000 a year – a gap of just over $14,000. Under the new rules, Jim's break-even level rises to about $13,500, but Sally's soars to $37,500, for a gap of $24,000. These break-even levels are based on market income rather than disposable income, which is the traditional measure of economic well-being. But, the market income benchmarks are important, because they determine the quality (wage) or quantity (hours) of work that individuals can achieve before losing their eligibility for OW. In any case, there is also a pronounced discrepancy on a disposable income basis. Under the old rules, Jim and Sally's market income break-even levels correspond to annual disposable incomes (including benefits) of $12,300 and $21,000, respectively, for a gap of about $8,700. Under the new rules, Jim breaks even at a disposable income of $14,500, which gives him about $2,200 more per year, but the comparable level for Sally is $28,500 – about $7,500 more per year for her, for a premium of nearly $14,000 relative to Jim.

However you measure it, Sally's higher break-even levels allow her to retain all of the supports of OW to a much higher level of market income than Jim, giving her a better opportunity to form a lasting attachment to the labour force. That was true under the old rules, but it's even more true after the August 2005 changes. In other words, while both household types see an improvement in their circumstances, lone parents are 'more better off' than single adults.

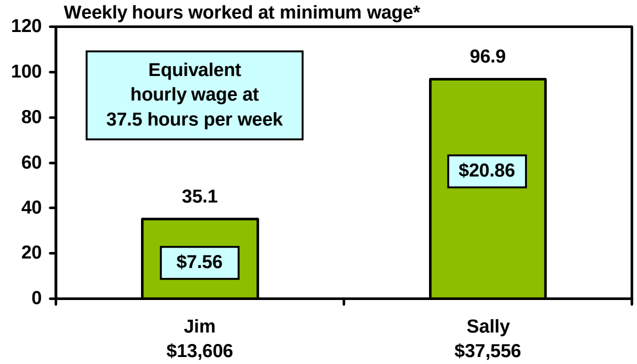
There's nothing wrong with that, if that's where the need is greatest. But, it's hard to make a case that it is. Indeed, if anyone is part of welfare's 'target market', it is surely Jim, with a maximum allowable market income of less than $11,000 a year under the old rules. That would suggest that directing additional welfare resources toward single adults like him would deliver the biggest 'bang for the buck', particularly given the paucity of support these individuals get from the rest of the income security system. But, that's not how the new OW rules will play out.

Absence of good child care options has far-reaching implications

This initial conclusion is likely to spark a reaction from both ends of the political spectrum. People on the right – particularly those who favour a leaner welfare system – will be troubled by the implications of the break-even analysis, which indicates that a two-person household earning nearly $40,000 a year could still be collecting OW benefits. As a result, a number of lone-parent families whose earnings previously put them above the OW threshold will now be eligible to receive benefits, increasing program spending on households who don't seem to be obvious candidates for assistance. At the same time, people on the left, especially children's advocates, will be loath to accept what this implies – namely, that OW benefits for parents could somehow be construed as being too generous.

There are a couple of things to keep in mind with respect to both anticipated objections. First, it's important to remember what the break-even levels signify. They simply show what a household *could* earn, in theory, without losing its eligibility for assistance. For starters, a household at this income level would be receiving only $1 a month in OW, so it would hardly be a significant drain on the program's resources. More to the point, while the break-even levels convey important information about the overall structure of work incentives under OW, they don't have anything to say about how common instances of recipients earning this amount of income will be. In fact, they are likely to be very rare. To earn the break-even income for her household type, our lone parent would have to work nearly 100 hours a week at minimum wage, or find a full-time job that pays more than $20 an hour. The first is impossible, and statistics on average hourly wages earned by OW recipients suggest the second is highly unlikely.

AUGUST 2005 ONTARIO WORKS RULES: Hours Worked at Break-Even Market Income



*Ontario minimum wage of $7.45/hour. See Table B in Appendix for detailed calculations. Source: TD Economics

But, there's an even more profound issue that must be acknowledged here, and that's the fact that the gap between break-even levels for singles and parents arises from primarily one source – namely, the need to help parents cover their child care costs when they enter the workforce. This is part of the reason OW pays parents a higher base monthly allowance, and it's the only rationale for the additional – and now higher – monthly child care earnings exemption. In large part, OW is effectively standing in for the lack of affordable and accessible child care in Canada. Like the issue of drug and dental benefits, this problem is not confined to the welfare system, but it plays out in very pernicious ways there.

Forcing OW to bear the full brunt of the child care burden at the lower end of the income scale produces a welfare system that conflates child care subsidies with work incentives to the detriment of both. It is clearly not the best way to help families with their child care needs – *i.e.*, via benefits and earnings exemptions that change each month depending on a parent's income, delivered through a heavily rules-based program with a high degree of stigma attached to it. At the same time, this 'welfarization' of child care creates a paradoxical situation within OW. It is very much a mixed blessing for parents. They do receive additional support, but at the price of a substantial increase in their break-even levels, which means that they have to earn a great deal more income before they fully escape welfare and its associated high marginal effective tax rates and restrictions on asset accumulation. Moreover, by virtue of staying in the system for longer, they become a disproportionate draw on OW's resources, siphoning away funds that might more usefully be directed to other household types. The end result is an overly complex structure of benefits that undermines Ontario Works' ability to function as a temporary income support program that provides genuine and fair work opportunities for all recipients.

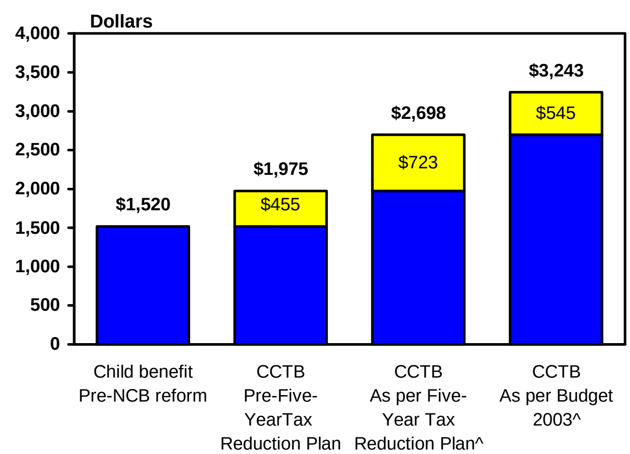
A call to complete the NCB initiative

It's worth noting that there is already a program in place to help remedy some of the problems associated with paying child benefits through the welfare system. That program is the National Child Benefit (NCB), a joint federal-provincial-territorial initiative launched in 1998 as part of a strategy to combat child poverty in Canada. One of the NCB's primary goals – reiterated each year in the annual *National Child Benefit Progress Report* – is to "reduce the role of social assistance in providing basic children's income support", thereby alleviating one of the main contributors to the high marginal effective tax rates that families on welfare face as they increase their work earnings.[15]

The NCB has two components – the base Canada Child Tax Benefit (CCTB) and the National Child Benefit Supplement (NCBS). The CCTB is targeted to low- and middle-income families with children, and the NCBS provides additional assistance beyond the CCTB base benefit to low-income families with children. The NCB Supplement is funded according to a reinvestment-recovery model, whereby provinces and territories are encouraged to offset or 'recover' the amount of the federal supplement against the child benefits they pay through social assistance, and 'reinvest' those savings in non-welfare-based benefits and programs for children. In its 2003 budget, the federal government laid out a schedule of annual increases to the CCTB and the NCBS through 2007. The expectation of the program's designers was that once the annual increases in the supplement brought it up to the level of the child benefits paid through welfare, provincial and territorial governments would be able to eliminate those benefits. Welfare would then become an income support program for adults only, with the federal CCTB-NCBS and its provincial/territorial counterparts constituting new, fully portable, income-tested child benefits that parents could retain as they moved from welfare into work.

The recovery-reinvestment aspect of the NCBS has been the cause of much controversy and the source of much misunderstanding. In particular, it is quite common within the income security advocacy community to hear calls to "end the NCBS clawback", the implication being that, by reducing child welfare payments by the amount of the supplement, provincial and territorial governments are somehow diverting money away from low-income families. This is not the case. What the offset actually represents is a transfer of funds out of welfare and into programs that provide similar forms of assistance for all low-income children. This offers real advantages. Having a separate platform for child benefits reduces the level of earnings that parents need to achieve to exit welfare, enabling them to escape the system sooner – and, with no net loss in the support they receive for their children along the way. In fairness, it is not surprising that there has been confusion and mistrust over this issue. Provinces and territories have a great deal of latitude in deciding how to make use

ENHANCEMENTS OF FEDERAL CHILD BENEFITS SINCE CREATION OF NCB SUPPLEMENT
(First Child - age 7 and over - for the 2007 benefit year)*



*Additional Canada Child Tax Benefit (CCTB) for children under 7 years of age not included; ^ Projection: Source: Federal government, TD Economics

COMPONENTS OF CANADA CHILD TAX BENEFIT: MAXIMUM AMOUNTS ($)	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E
Base Benefit										
Basic amount per child	1,020	1,020	1,104	1,117	1,151	1,169	1,208	1,228	1,253	1,278
Additional benefit for 3rd child+	75	75	77	78	80	82	84	86	88	89
Additional benefit for children under 7	213	213	219	221	228	232	239	243	248	253
NCB Supplement										
First child	605	785	977	1,255	1,293	1,463	1,511	1,722	1,941	1,980
Second child	405	585	771	1,055	1,087	1,254	1,295	1,502	1,717	1,751
Third child and subsequent children	330	510	694	980	1,009	1,176	1,215	1,420	1,633	1,666
Total CCTB Benefit - Child 7 and over										
First child	1,625	1,805	2,081	2,372	2444	2,632	2,719	2,950	3,194	3,258
Second child	1,425	1,605	1,875	2,172	2238	2,423	2,503	2,730	2,970	3,029
Third child and subsequent children	1,425	1,605	1,875	2,175	2240	2,427	2,507	2,734	2,974	3,033
Total CCTB Benefit - Child 7 and under										
First child	1,838	2,018	2,300	2,593	2,672	2,864	2,958	3,193	3,442	3,511
Second child	1,638	1,818	2,094	2,393	2,466	2,655	2,742	2,973	3,217	3,282
Third child and subsequent children	1,638	1,818	2,094	2,396	2,468	2,659	2,746	2,977	3,222	3,286

Figures for 1998-2005 are actuals; figures for 2006-07 reflect 2-per-cent indexation for inflation, plus $185 increase in NCB Supplement in 2006, as laid out in federal government's 2003 Budget Plan, Annex 9, page 322; figures for 2004-07 differ slightly from those shown in 2003 Budget Plan due to deviations in inflation from those projected at time of budget. Source: Canada Revenue Agency, Federal government, TD Economics

of the funds generated from the NCBS offset, and the result has been a very uneven application of the model across the country. This has made it difficult to judge whether provinces and territories are living up to their responsibility to re-invest all of the savings in new programs for children, as well as to assess the success of these programs in reducing child poverty.

If a criticism can be levelled at Ontario's approach to implementing the NCB initiative, it is that the main re-investment vehicle for NCBS funds is the Ontario Child Care Supplement for Working Families (OCCS) – a supplement that goes only to working families, and only those with children under the age of 7. As such, it is a much less comprehensive program than some of its provincial counterparts. For example, under the aegis of the NCB initiative, Saskatchewan, British Columbia, Nova Scotia and Newfoundland and Labrador all restructured their social assistance programs, using the savings from the NCBS, along with additional provincial monies, to create new CCTB-integrated, income-tested child benefit programs that are separate from welfare. Saskatchewan and B.C. offset the annual increments in the NCBS against their child benefits, such that each year's increase results in new funds being available for reinvestment in NCB spin-offs – like earned income supplements for low-income working parents (see text box on next page). Nova Scotia and Newfoundland and Labrador pass on the annual increase in the NCBS to families in full, keeping their reinvestment funds fixed at the value of the child benefits they previously paid through social assistance.[16] But, in each case, the new benefits provide assistance to all low-income families, whether their parents are on welfare or not. In essence, these benefits are NCBS "clones", with eligibility criteria that are sufficiently similar to those governing the NCBS to permit the effective integration of the benefits. As such, the programs are much closer in spirit to the intent of the NCB initiative, which was to help provinces and territories remove children from welfare entirely. By contrast, in Ontario, only working families with very young children receive OCCS, making the benefit quite a distant cousin to the NCBS – impeding integration, and leaving a hefty chunk of income support for low-income children in Ontario to be paid through the welfare system.

In looking at the problems posed by funding income security for children through the welfare system, the NCB's main focus was on lowering the barriers to work faced by parents trying to transition off welfare into the labour force. The remedy it offers – taking children out of welfare – certainly does that. But, it does much more. It also eliminates the source of the numerous distortions that we identified in our discussion of Problem #3, all of which flow directly from the provision of child benefits through welfare – another compelling reason for governments to press on with the completion of the NCB initiative.[17]

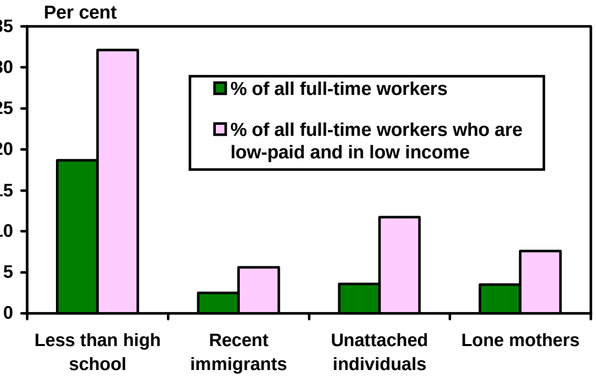
WHEN WORK ISN'T ENOUGH: CONFRONTING THE PROBLEM OF ADEQUACY

What's lurking beneath the discussion about the gap between welfare benefits for singles and parents is a deeper question about what constitutes an adequate level of income. In fact, this is a controversial issue in the income security community, with limited consensus on how to define 'adequacy'. But, what is clear is that, if the primary goal of a welfare program for working age adults is to encourage them to move into the workforce, then the benefit package should not be adequate.

The difficulty is that, as we noted earlier, working is no guarantee of an adequate standard of living in Canada. The reasons range from the stagnant growth in real median wages recorded over the last two decades, to a decline in the quality of employment, with temporary and non-standard work on the rise, and non-wage benefits, like participation in employee health insurance and registered pension plans, on the wane. A recent report from Statistics Canada reveals that the share of the Canadian population that is working in a low-paying job and in 'low income' – like the share that is in persistent low income more generally – is relatively low, at 5 per cent. But, it's much higher in certain subsets of the population, including those with less than a high school education (8.4 per cent), recent immigrants (12 per cent), lone mothers (13 per cent), and single adults (18.1 per cent).[1] Given that work has been shown to be one of the surest routes out of low income – and given that this is often used to justify ratcheting back welfare benefits for working age adults – the phenomenon of working poverty, particularly amongst those working full-time, is troubling.

It's also not an easy problem to fix. As we've argued, raising welfare rates isn't the answer, partly because it reduces the relative attractiveness of work. But, it goes much deeper than that. The welfare system was never meant to be a source of long-term financial support for the employed – mainly because, when welfare programs were first conceived, there was no thought that employment earnings might be insufficient to produce an adequate income. As a result, welfare is poorly suited to remedying the problem of low income among working adults. This is clear from the way that welfare benefits are structured. For one thing, they make no provision for most of the work-related expenses that adults encounter when they try to establish an attachment to the labour force, such as the cost of transportation, CPP and EI payroll taxes, union dues and the like. And, when they do – as with child care – it generally creates a host of other problems in the process. More fundamentally,

SELECTED FULL-TIME WORKERS WHO ARE LOW-PAID AND IN LOW INCOME, 2000



Source: René Morissette and Garnett Picot, "Low-paid work and economically vulnerable families over the last two decades," Statistics Canada, April 2005, Table 13, page 36.

welfare benefits are needs-tested, which means that they are based on family size and structure, but the labour market pays a uniform wage, regardless of a worker's household situation. There's nothing inherently wrong with either approach, but when they intersect – which occurs because welfare benefits are scaled back by work earnings, usually from the first dollar of income earned – it exacerbates problems with income inadequacy in a way that undermines work incentives.

What this illustrates is that the problem of low income among working adults is crying out for more labour-market friendly solutions that are less confiscatory than welfare at low levels of income. In our view, one measure that meets this description is an earned income supplement. Earned income supplements typically kick in only after individuals have established a moderate attachment to the workforce. They then increase with earnings up to a certain point – say, the average number of hours worked by minimum wage earners – and taper off thereafter. What these supplements do is address cases of labour market failure, where wages are too low or hours of work insufficient to generate an adequate income. They accomplish this by paying a benefit that rises over an initial range of income. This reduces marginal effective tax rates across that zone, strengthening the incentive to pursue work at levels of income where individuals might otherwise be tempted to substitute social assistance for employment, because they cannot make ends meet on their work earnings. In the simplest terms, welfare re-

WHEN WORK ISN'T ENOUGH:
CONFRONTING THE PROBLEM OF ADEQUACY *(continued)*

duces the amount of money that people receive as soon as they start working, whereas earned income supplements increase people's income up to a pre-determined level of earnings – helping them get over the initial hump of entering the labour force.

A common criticism of earned income supplements is that they reduce the pressure on businesses to pay a 'living wage'. But, the fact is that, for most employers, considerations of this sort likely form a very small part of the wage-setting process. Ultimately, firms pay wages based on what they think the market will bear, within the parameters set by minimum wage restrictions. There are already minimum wage laws in effect in every jurisdiction in Canada, and in Ontario, the provincial government has laid out a series of planned increases over the next two years. We are not advocating deferring these increases. But, additional, too-rapid hikes in the minimum wage over and above those already scheduled could have labour market repercussions.

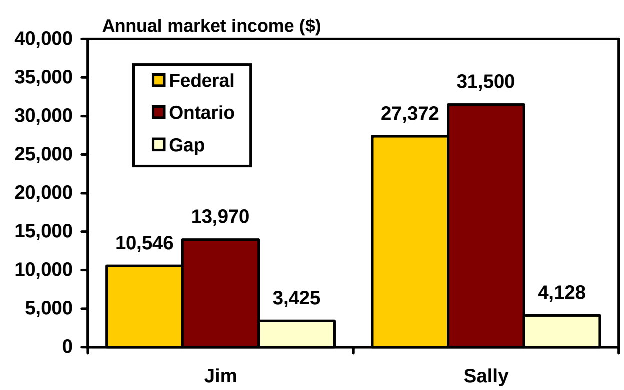
Moreover, it's important to distinguish between low-paid workers and those in low income. While low-wage work plays a significant role in explaining low income among the employed, it is not the only determinant. As research by Statistics Canada referenced elsewhere in this publication illustrates, other factors, like family type, are also important drivers. The question policy makers need to ask themselves is whether they want to help workers with low earnings independently of their family economic situation, or help workers who live in poverty.[2] In our view, the latter group is the appropriate focus. And, we believe their plight would be more usefully addressed by a working income supplement linked to family earnings than by further hikes in the minimum wage.

A complementary measure that would help address the problem of low income more broadly – *i.e.*, among working and non-working adults alike – would be a new refundable tax credit for low income working age adults, styled on Ontario's property and sales tax credits. As a glance at the tables in the appendix will confirm, Ontario's refundable property and sales tax credits play a key role in reducing our hypothetical OW recipients' net provincial tax burden. That's also clear from the adjacent chart, which shows the level of income at which each individual's federal PIT liability (net of the GST credit, the only offset at the federal level) and Ontario PIT liability (net of property and sales tax credits) kick in. Sally's thresholds are higher, because of the child-related tax credits and deductions she can claim, but for both individuals, the provincial burden is clearly lower.

That would suggest that the federal government is the obvious candidate to deliver one or both of the proposed new benefits. Further supporting that argument is the steady stream of federal budget surpluses racked up in recent years – clearly, the resources are there. It should be noted that the federal government has already taken steps to reduce the PIT burden for lower-income Canadians through a schedule of planned increases (through 2009) in the basic personal amount laid out in this year's federal budget. But, providing a new credit at the federal level would open up an opportunity to collapse existing federal and provincial refundable credits – including the GST credit – into a single program, streamlining the tax system in a way that better serves the needs of all low-income Canadians.

Another design issue to consider is how the new benefits would interact with social assistance. There are already several earned income supplements in existence in Canada, administered at the provincial/territorial level – Ontario's OCCS is one example, and there are similar programs in Saskatchewan, British Columbia, Nunavut and the Northwest Territories. These programs were all created with funds freed up under the NCB initiative, so benefits are not deducted from welfare payments in these jurisdictions, because welfare rates have already been adjusted downward via the 'recovery' of the NCB Supplement. In other words, if the earned income supple-

FEDERAL/PROVINCIAL PIT TRESHOLDS*



*Personal income tax (PIT) liabilities are net of welfare payments so calculations are not affected by OW rule change. Federal calculations include GST credit; Ontario calculations include Ontario property and sales tax credits. Source TD Economics

WHEN WORK ISN'T ENOUGH:
CONFRONTING THE PROBLEM OF ADEQUACY *(continued)*

ment benefit were offset against welfare as well, this would result in a double clawback of funds intended to support low-income individuals. However, because the aforementioned provincial/territorial programs are NCB spin-offs, they only pay benefits to low-income families with children. As a result, they're effectively child benefits, delivered in the form of an earned income supplement. A new working income supplement for all low-income adults, regardless of their family type, would help fill a gap in the income security net. And, together with a new refundable tax credit – which would also go to all low-income adults – it could be partially offset against social assistance. The goal would be to deliver net gains in income at the lower end of the spectrum, with the gains designed to peak at the point where individuals are working enough that they are likely to have formed a permanent attachment to the labour force.

Because the working income supplement and refundable tax credit that we propose would both have to be income-tested, they will contribute to raising marginal effective tax rates over some range of income. And, that means that another key concern will be to minimize the overlap with other income-tested programs – *i.e.*, for example, by ensuring that the supplement and the refundable tax credit phase out fully before a 'perfect storm' of clawbacks that begins at roughly $20,000 in annual income. It will not be a simple task, but it is one well worth undertaking, because collectively, both measures would provide a much-needed boost to the financial security of low-income, working age adults. And, they would have the added virtue of doing so through anonymous, rules-based programs that are free of the stigma and intrusive administrative oversight associated with a discretionary program like welfare.

1. René Morissette and Garnett Picot, "Low-paid work and economically vulnerable families over the last two decades," Analytical Studies Branch Research Paper Series, Ottawa: Statistics Canada, April 2005, Table 11, pages 33-34.

2. For this clear and concise formulation of the problem, I am indebted to Dominique Fleury of Social Development Canada, who, with several of her colleagues, has written extensively on the subject of low-paid work, low income and working poverty (see References).

Problem #4: Earnings disqualification period creates inequity between individuals inside and outside OW

There's another problem to consider with the new OW rules, and while it isn't strictly about marginal effective tax rates, it does have to do with relative work incentives – this time, between individuals inside and outside of welfare. The bulk of this paper has focused on the obstacles that OW recipients face to getting OFF welfare in Ontario. But, as it turns out, it's also extremely difficult to get ON welfare. And, that creates what is often termed a problem of 'horizontal inequity' at the lower end of the income scale. This refers to a situation where households with an otherwise similar or identical financial profile find themselves in very different economic circumstances, owing to their differential access to OW supports.

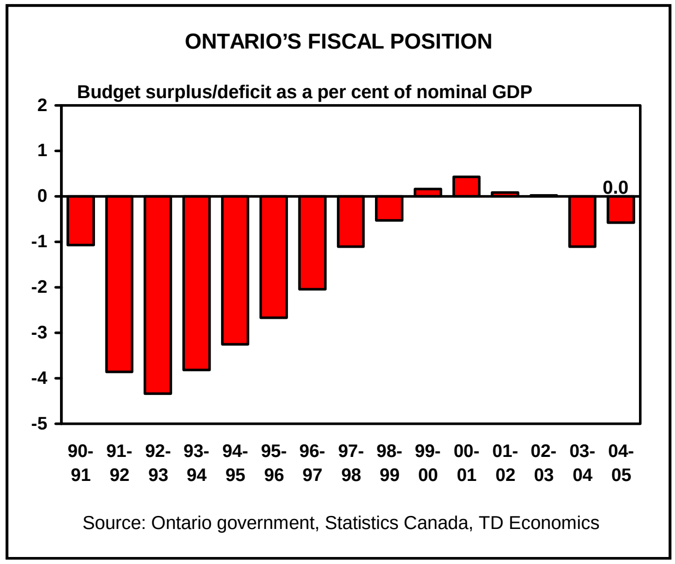
Ontario Works is a needs-tested program, and the test has two components – one pertaining to assets and the other to income. We'll discuss the asset test in the next section. The income test is the formula that we have referred to throughout this paper – *i.e.*, the formula for calculating the portion of a recipient's earnings that will be deducted from their monthly OW cash allowance. All OW recipients, current and prospective, are subject to a monthly needs test to determine whether their assets or their income have exceeded the prescribed limits for their household type. But, while the asset test is applied equally to current and prospective recipients, the income test for new applicants is assessed without the OW earnings exemptions for the first three months. In other words, if a new applicant to OW has some income from other sources, the formula for calculating the share that will be clawed back from his allowance – which, in turn, doubles as the test of his eligibility – is based on his total income.

The earnings disqualification period is one of the main entry barriers to OW, and it's not hard to see how it leads to situations of horizontal inequity. As a result of the differential application of the income test, two individuals who are earning the same market income, and who are identical in every way except for the length of their association with OW, can end up with a different disposable income. At best, a new applicant will receive a lower monthly allowance than an existing OW recipient, because 100 per cent of his earnings will be deducted from his allowance during the first three months, versus only 50 per cent for the existing client. At worst, if his market income is higher than the relevant OW threshold before the earnings exemptions are applied, he will be denied access to the system and all its cash and non-cash benefits.

In the extreme, this can introduce a perverse new incentive into the mix for individuals whose market income exceeds the "raw" OW earnings threshold, but who still can't make ends meet. While they might need only a fraction of the full OW allowance to close the gap, that option isn't open to them. Instead, their best bet is to hope that they get laid off from their jobs so that they can go on OW full-time. (Note that the trigger must be a lay-off – individuals who quit their jobs are not eligible for OW.) Then, once they're safely ensconced in the program, they can re-enter the labour force and work their way back up to the income they had before, and hopefully beyond.

In some respects, the earnings disqualification period is an object lesson in the perils of tinkering with individual elements of a needs-tested program. The measure was introduced by the Rae government in 1992, to address a growing imbalance between the number of employed adults joining Ontario's welfare system and the number leaving welfare for the workforce. The ratio had tilted in favour of the former, increasing the cost of welfare at a time when the province's finances were under strain – indeed, Ontario's budget deficit peaked at a sizeable 4.3 per cent of GDP in fiscal 1992/93. The speculation then was that the appeal of welfare lay in the drug and dental benefits granted to recipients – a reasonable enough inference, given what our analysis shows about the high barriers to work associated with the potential loss of these benefits. The government's response was the earnings disqualification period. It was meant to discourage individuals with adequate incomes from entering the welfare system simply to capture the non-cash benefits – and by extension, to limit the number of additional low-income workers who would be pulled into the system, only to become embroiled in all of its associated incentive problems. But, what is clear in retrospect is that this measure – which, fundamentally, sought to promote equity by conserving welfare resources for those most in need – ended up by creating the conditions for another form of inequity.

The earnings disqualification period also provides another perspective on the decline in OW caseloads in Ontario since the launch of workfare. If part of the reason for that decline is that legitimate candidates for assistance



are being denied access because of the asymmetric application of eligibility criteria, this is hardly cause for cheer. Rather, it raises the spectre of one group of individuals being sheltered from the worst aspects of poverty at the price of the growing exclusion and isolation of another.

August 2005 rules worsen gap between individuals inside and outside welfare

The August 2005 OW rules worsen the problem of horizontal inequity – and, no charts or tables are needed to demonstrate why. What our discussion of Problems #1-3 reveals is that, for the most part, individuals who are currently receiving OW benefits will be better off under the new rules. Not fully, and not always equally, to be sure, but on balance, the lower taxback rate on earnings and the temporary extension of the drug and dental benefits will improve most recipients' circumstances. However, the new rules leave the earnings disqualification period intact. It already creates a gap between the income supports and work incentives available to those on and off welfare, so if it's true that existing OW clients are better off under the new rules, it must also be true that the disparity between those on and off welfare has widened.

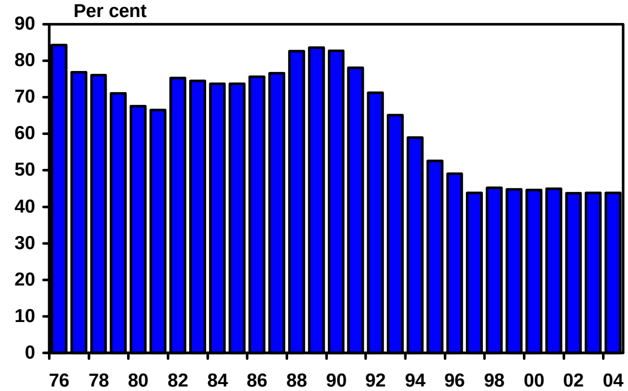
In making this point, our intention is not to suggest that it would be desirable to increase the number of people on welfare in Ontario. The issue here is equity, not ease of access. Simply put, if an income is deemed low enough for one person to be in need of Ontario Works benefits, then a similar individual with the same income should not be denied assistance.

That said, it's important to recognize that a major contributing factor to this problem is the declining share of unemployed adults receiving benefits under the federal Employment Insurance (EI) program. This is due partly to changes the federal government introduced in the 1990s to reduce the size and cost of EI. These changes included a dramatic tightening in eligibility requirements for the program, a sharp reduction in the level and maximum duration of benefits, and an increasing diversion of the program's funds toward training and labour market development programs.[18] But, perhaps an even more important driver is the shift in the composition of the labour force that has occurred over the last ten or fifteen years.

In this respect, the top chart in the adjacent column, which shows the number of people receiving regular EI benefits (B) as a percentage of the entire unemployed population (U) – commonly known as the B/U ratio – likely overstates the degree to which EI coverage of the unemployed has declined. The main reason is that the denominator of the ratio (all unemployed) includes people with no prior work experience, as well as those who left a job voluntarily – for example, to go back to school. As such, they are not part of the population that EI is intended to capture – *i.e.*, people who have lost a job unexpectedly and need temporary financial assistance while they look for other work or try to upgrade their skills. A study prepared by Human Resources Development Canada, which administers the EI program, concluded that somewhat less than half of the drop in the so-called B/U ratio between 1990 and 1997 could be attributed to the changes in the program implemented during this period, while the rest of the decline was due to changes in the labour market.[19]

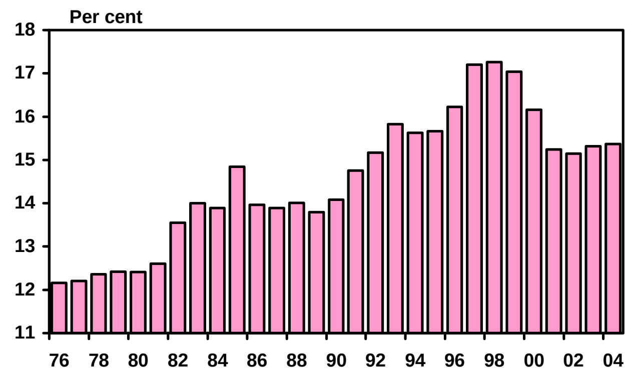
To see how labour market changes have affected EI coverage, it is useful to review the eligibility criteria for EI. To receive EI benefits, contributors to the program must have lost their job through no fault of their own – for example, because they were laid off – and they must have worked the required number of insurable hours for their region over the previous 52 weeks.[20] Data from the Labour Force Survey Historical Review indicate that, between 1989 and 2004, the share of the unemployed (on an annual average basis) who were laid off from a job fell from 49.4 per cent to 38.4 per cent. By contrast, the share who were not in the labour force at all prior to becoming unemployed rose from 28.5 per cent to 44.5 per cent.[21] That shift alone would have resulted in a significant drop in the proportion of unemployed who qualified for EI, even in the absence of the program restrictions that were introduced in the 1990s. Similarly, the percentage of Canadians who are self-employed, or who do contract work – two more disqualifying factors for EI – has increased in recent decades. The combined impact of these factors on eligibility for EI among the unemployed is evident in the latest EI Coverage Survey, which reveals that more than 80 per cent of EI contributors who had a recent job separation that met the program's criteria were paid benefits. At the same time, of all unemployed EI contributors who were laid off from their last job, only 10.5 per cent were denied benefits on the grounds of insufficient hours of insurable employment.[22]

PER CENT OF UNEMPLOYED RECEIVING REGULAR EMPLOYMENT INSURANCE (EI) BENEFITS



Source: Statistics Canada

SELF-EMPLOYMENT AS SHARE OF TOTAL EMPLOYMENT*



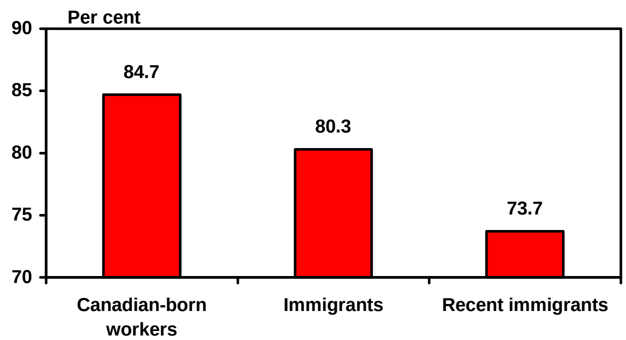
*Self-employed as a share of total employed, all classes of workers and all industries (NAICS basis).
Source: Statistics Canada, Labour Force Survey

CANADIAN IMMIGRATION:
Per Cent of Total by Destination*

Ontario	**57.4**
Toronto	46.4
Ottawa-Gatineau	2.7
Hamilton	1.6
Windsor	1.4
Kitchener	1.3
London	1.1

* average of 2001-02 and 2002-03
Source: Statistics Canada

UNEMPLOYED POPULATION WITH RECENTJOB SEPARATIONS THAT QUALIFY UNDER EI RULES



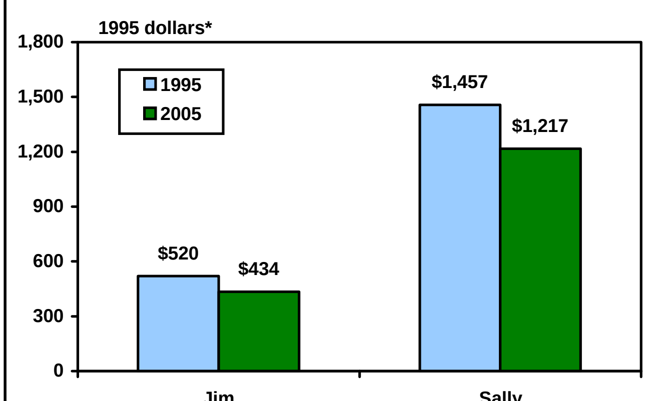
Source: Statistics Canada, *2003 Employment Insurance Coverage Survey*, referenced in *2004 Employment Insurance Monitoring and Assessment Report*, Ottawa: Human Resources and Skills Development Canada (HRSDC), 2005, p.59.

What these figures show is that changes in the make-up of Canada's labour force have made the EI program much less responsive to the needs of low-income workers today. To take just one example, the increase in the percentage of unemployed with no prior workforce attachment likely reflects demographic trends, like the rising number of immigrants in Canada, who tend to have more limited work experience – at least in this country. That surely helps explain the unusually low level of EI coverage in Toronto (recall the chart on page 8), where a majority of recent immigrants to Canada settle. The implication is that, while EI appears to be doing a good job of serving its core clientèle – paying unemployment insurance benefits to 4 in 5 eligible workers – changing labour market realities have left a growing share of the labour force uninsurable under the program. That suggests that a complementary set of programs is urgently needed to plug the gap – not least so that Ontario Works and other provincial/territorial welfare programs do not end up having to double as employment insurance and training programs. Indeed, one might argue that, by allowing the universe of EI-eligible recipients to shrink the way it has, the federal government has left provincial/territorial governments with little choice but to introduce a degree of horizontal inequity at the low end of the income scale – to stem the pressure on welfare from the growing pool of unemployed who have nowhere else to turn for assistance.

Problem #5: OW asset limits are too low

There's one final problem to address with the August 2005 OW rules. Like the one with the earnings disqualification period, this problem is more an error of omission than commission, but it is no less serious for it. We referred in the previous section to the asset dimension of the OW needs test. It is relatively straightforward. A ceiling is set on the dollar amount of liquid assets that OW recipients can hold, and if they exceed this limit – which is currently $536 for a single adult, and $1,487 for a lone parent with one child – they lose their eligibility for welfare. The OW asset limits were reduced sharply in 1995 as part of the broader retraction of benefits that occurred in conjunction with the introduction of Ontario Works. And, like the cash benefits, the asset limits were held constant in nominal terms until March of this year, when they, too, were raised by 3 per cent. As a result, throughout a period when Canadian households more generally have been encouraged to boost their savings, OW recipients have faced a steadily diminishing ability to do so, as the purchasing power of the assets they are permitted to accumulate has been eroded by inflation.

ONTARIO WORKS: ASSET LIMITS



*Deflated using Ontario Consumer Price Index (CPI).
Source: Ontario Ministry of Community and Social Services, TD Economics

✕ *August 2005 rules ignore barriers to work created by harsh restrictions on saving*

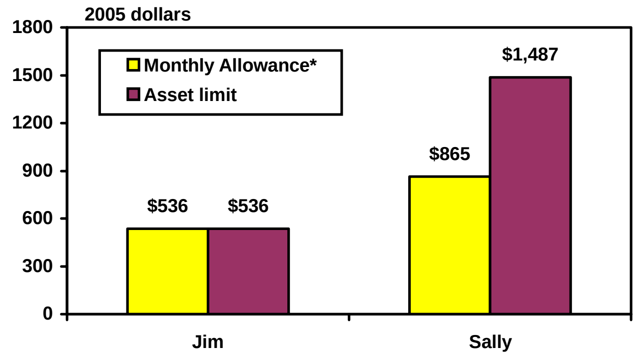
The new OW rules make no change to the current asset limits, and that seems a rather important oversight, for two reasons. We've focused primarily on the income dimension of the OW needs test in this paper, because it is directly linked to employment earnings and so has a clearer impact on work incentives. But, the asset limits can create an important barrier to exiting welfare in their own right, inasmuch as they impede individuals from accumulating a sizeable enough nest egg to make abandoning OW's cash and non-cash benefits a viable option.

In fact, the concept of asset limits in general has come in for more criticism in recent years, as income security advocates have become more aware of the limitations of welfare programs aimed solely at providing income for current consumption. In this respect, they have been spurred on by broader trends within the financial community toward a greater appreciation for the role that assets can play in enhancing financial security.

On that score, it's interesting to note that one of the most rudimentary principles in household budgeting is that individuals should maintain savings equivalent to at least three months of salary, as a guard against a temporary disruption in their earnings. Seen from this angle, OW's asset limits – which amount to one month's worth of cash benefits for a single adult, and less than two months' worth for a lone parent with one child – look indefensibly low. In effect, they force current and prospective recipients alike to take what amounts to a vow of poverty to maintain their eligibility for OW – which is surely counter-productive to the ultimate goal of reducing their reliance on welfare.

Moreover, the decision to leave the asset limits unchanged sits awkwardly with the other two major elements of the August 2005 reform – namely, the lower taxback rate on earnings and the higher child care earnings exemption – both of which raise the acceptable income thresholds for OW recipients. The higher earnings thresholds make it possible for welfare recipients to boost their market income without losing their OW benefits. But, with no commensurate increase in the asset limits, the implication is that they have to spend all of the additional income. The irony is particularly evident in the case of the lone parent with one child, whose market income break-even level rises to just over $35,000 per annum under the August 2005 rules. The notion that a parent could earn this much income, yet not save more than $1,500 is simply not believable. While this bias toward consumption was surely not the government's intention, it is the result of these twin decisions – namely, that individuals have a greater incentive to work, but a weaker incentive to save. The architects of the new OW system got the first half right, but by ignoring the asset side of the equation, they've undercut much of the benefit, by preventing welfare recipients from using some of their increased earnings to build up a reserve fund for the future.

ONTARIO WORKS: MONTHLY ALLOWANCES vs. ASSET LIMITS



*Monthly allowance shown is maximum for each household type; maximum allowance for Sally is shown net of the NCB Supplement
Source: Ontario Ministry of Community and Social Services

CONCLUSION

Part of what we set out to do in this paper was to evaluate the merits of the new Ontario Works rules that were implemented in August of this year. Specifically, we were interested in assessing how they compared with the rules that had been in place since the Harris government began overhauling welfare ten years ago – what problems they solve, what new problems they create, and what problems they leave unaddressed. On balance, we can't give the final result a high grade, but it's important to recognize that these latest changes – like most of their predecessors – are ultimately aimed at wrestling with a problem that cannot be completely resolved. Higher marginal effective tax rates and the barriers to work that they create go hand in hand with income-tested benefits. There is no way around this. The most that can be accomplished is to modulate the mix, in order to achieve a better balance between improving work incentives and containing program costs.

From that perspective, the new OW rules do deserve credit on the main count of doing more to 'make work pay'. This was one of the principal criticisms of the old system, with welfare recipients facing marginal effective tax rates of 100 per cent or more at most stages along the welfare/work spectrum, giving them virtually no incentive to boost their market income. The structure of the new earnings exemption, which lowers the taxback rate on employment income, goes a long way toward easing this problem, as does the temporary extension of the drug and dental benefits, which makes the welfare wall at the point of exit from OW a little more permeable. Together, these measures do enhance OW recipients' ability to complete the transition from welfare to work.

At the same time, by leaving certain elements of the old system untouched – the gap between benefits for singles and parents, the earnings disqualification period for new OW applicants, and the asset limits for all recipients – the new rules worsen some existing problems. And, overall, the effect contributes to a less efficient allocation of OW resources, by concentrating resources on smaller groups of relatively less needy individuals.

Of the three, the least defensible – and the one that is most within Ontario Works' power to change – are the tough limits on assets. Retaining these limits at their current, low (and non-indexed) levels reflects a failure to recognize that enhancing opportunities to save is a critically important corollary to promoting incentives to work.

However, as we have argued, the other two elements have their roots in deeper dilemmas. As a result, if identifying these flaws implies that more work needs to be done to 'fine tune' Ontario Works, it is equally important to acknowledge that the flaws are a direct result of weaknesses in the rest of Canada's income security system, which has not kept up with a changing economy. Shifts in the structure of the labour market and in the composition of the labour force have resulted in a shrinking portion of the unemployed population being eligible for federal Employment Insurance benefits, leaving working adults with fewer resources to fall back on when they lose their jobs. At the same time, the poor quality and non-standard nature of many of the jobs that are being created today – which pay low wages and offer no health or pension benefits – have increased the economic insecurity of Canadians who do work, while the lack of affordable child care has restricted others' ability to find work in the first place – particularly the heads of lone-parent households, who account for an ever larger share of the population. And, in today's knowledge-based economy, being out of the workforce for even a short time requires more upgrading of skills and training than ever to make a successful re-entry.

These kinds of holes in the income security system have left too many Canadians with nowhere to turn but welfare. In a sense, Ontario Works and other provincial/territorial welfare systems have been turned into "providers of first resort" for too many people and too many things – for a path into work, for more income when work doesn't pay enough, for sundry health benefits, and for child care. And, not surprisingly, welfare programs have responded to this surfeit of demands on their systems by raising entry barriers, with the result that a growing number of low-income adults are at risk of falling through the cracks.

Welfare was meant to be a program of *last* resort for households needing short-term income support during a temporary shock. It was not intended to be a substitute for a broader set of well-defined social policies. As a result, any criticism of Ontario Works today has to be tempered by a recognition of the degree to which the program has been forced to paper over too many cracks in the rest of the income security system. While OW might benefit from further reforms, these should be contemplated only in conjunction with broader changes to Canada's income security apparatus, to enable the system as a whole to function more efficiently in guarding against the emergence of a low-income trap.

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APPENDIX: SCENARIOS & ASSUMPTIONS

As we explain in the main text, we have used a scenario-based approach to analyze the impact of the pre-2005 and August 2005 Ontario Works (OW) rules on the work incentives faced by two hypothetical welfare recipients in Ontario. Several things must be acknowledged at the outset about this approach. First, our hypothetical individuals are fictional characters – any resemblance to persons living or dead is coincidental. Second, in developing these scenarios, we have been guided by the nature of the research question we posed, which was how individuals' economic well-being changes at different levels of employment income. This means that gross employment earnings have to be treated as the driver of each scenario. This should not be interpreted to mean that we believe individuals can or would target a specific level of employment earnings to achieve a particular mix of market/welfare income and tax benefits and credits. Indeed, the opposite is usually the case. In reality, most OW recipients who work juggle several part-time jobs, meaning that their work hours, and therefore their earnings, vary from one month to the next. Since welfare allotments are re-assessed every month, recipients' cash benefits can change monthly. Indeed, it's not uncommon for people who are near the OW employment earnings threshold to drop off welfare one month, only to regain their eligibility the next.

More generally, our scenarios do not presume to present a definitive picture of the economic circumstances in which like households would find themselves. Rather, they are an analytical tool that we developed in order to test the limits of the two sets of OW rules and tease out the structure of work incentives embedded in each. With those caveats in mind, we provide below a detailed description of the scenarios and the assumptions common to each. This is followed by an explanation of how to read the summary tables that appear after the appendix, where the complete results of our analysis are presented.

SCENARIOS:

We studied two hypothetical individuals – a 40-year-old single, unattached adult (Jim) and a 25-year-old single parent with a 4-year old child (Sally) – in six scenarios, specified to capture key decision points along the welfare/work spectrum under the pre-2005 OW rules. The scenarios are organized as follows:

- **Jim 1** and **Sally 1:** The individuals are receiving the maximum Ontario Works allotment for their household type and are not working at all.
- **Jim 2** and **Sally 2:** The "comfort zone" scenarios, so-called because they identify the minimum level of employment earnings needed for the individual to realize all Ontario Works earnings exemptions available under the pre-2005 regime, while retaining the maximum dollar amount of Ontario Works cash benefits.
- **Jim 3** and **Sally 3:** The "break-even" scenarios, so-called because they pinpoint the maximum amount of employment earnings the individual can receive and still retain $1 of assistance (the condition for remaining eligible for the Ontario Works in-kind benefits under the pre-2005 rules).
- **Jim 4** and **Sally 4:** The individuals earn just enough additional employment income to put them over the Ontario Works limit as specified under the pre-2005 rules, causing them to lose all of their OW cash and in-kind benefits.
- **Jim 5** and **Sally 5:** The individuals earn enough additional employment income to make them better off than they were when they were still partially on assistance. This is defined as $1,000 more in disposable income relative to their "break-even" point (Scenario 3).
- **Jim 6 and Sally 6:** As we discuss in the text, our scenarios reveal that the federal personal income tax (PIT) burden kicks in at much lower level of income than the Ontario PIT burden. Scenario 6 identifies the level of employment earnings at which both individuals first start paying federal PIT.

ASSUMPTIONS:

- **Ontario Works:** In scenarios where the individuals are earning employment income and receiving OW benefits, we assume that they maximize all possible OW ***earnings exemptions***. Under the pre-2005 rules, this means that an assumption has to be made about which of the three variable earnings exemptions to use. We apply the highest possible exemption rate of 25 per cent (available to recipients who have worked while collecting OW benefits for 12 months or less), to show the best possible outcome an OW recipient could achieve. Conversely, this can be understood as the lowest possible earnings taxback rate of 75 per cent.
- **Jim 7:** Scenario 7 shows Jim's break-even point (Scenario 3) at the 0-per-cent variable earnings exemption rate (*i.e.*, the 100-per-cent taxback rate) – a more realistic assumption for an OW recipient his age, who is likely to have worked while collecting benefits for 25 months or more.

  We also assume that Sally is able to maximize the OW ***child care earnings exemption*** ($390 per month per child under the pre-2005 rules, and $600 per month per child under the August 2005 rules) – *i.e.*, we assume that she works enough to incur at least this sum in child care expenses every month.

  A variety of other ***cash benefits*** are available to OW recipients. We include: Participation Allowance for workfare, Employment and Training Start-Up Assistance (re-named Other Employment and Employment Assistance Activities Benefit under the August 2005 rules), Full-time Employment Benefit (a new benefit introduced in August 2005) and Up Front Child Care (all meant to facilitate the transition into work), as well as the Winter Clothing and Back to School allowances (to assist with the cost of raising children). Where relevant, we assume that individuals receive the maximum benefit.

- **Child care expenses (Sally only):** Child care costs are a key input in the lone-parent scenarios – partly because they have to be offset against employment earnings to derive an accurate measure of the parent's disposable income, but also because they affect the relationship between gross employment earnings and disposable income via their impact on a variety of child-related income tax deductions and OW earnings exemptions. Two assumptions have to be made here – one about the hourly cost of care, and the other about the number of hours of care provided.

  In the six base case scenarios, we assume that Sally does not have access to subsidized child care. We made this assumption partly because of the scarcity of licensed, subsidized day care spaces in Ontario, but also because the spaces that are available generally offer full-time care during business hours only. As such, they are not likely to be of much use to individuals working irregular hours – the reality for most OW recipients. Instead, we assume that Sally pays $5/hour for child care to an unlicensed provider (*e.g.*, a family member or neighbour). This estimate was based on anecdotal evidence about the cost of informal daycare in a private home.

  As for the hours of care required, this is not an independent assumption, but rather a function of the level of employment earnings assumed in each scenario, which in turn determines the number of hours worked. The hours of care assumption can be derived in two ways. The first is to calculate the number of hours the individual would have to work to achieve that scenario's designated level of employment earnings if she were earning minimum wage. The second is to calculate the hourly wage the individual would need to earn if she were to achieve that level of employment earnings while working no more than full-time (defined as 37.5 hours/week). Both sets of calculations are reflected in the summary tables.

  As this pertains to the assumption about child care costs in each scenario, we cap Sally's workweek at 37.5 hours. If she can reach a scenario's designated level of employment earnings by working less than this amount at minimum wage, we accept the minimum wage condition and set her child care costs at $5/hour times this number of hours. If not, we allow her wage to rise to the level necessary to meet the 37.5-hour workweek limit. Her child care costs are then set at $812.50 per month ($5/hour * 37.5 hours/week * 4.33 weeks/month). While this wage increase may seem unrealistic, an alternate interpretation could be that Sally works more than 37.5 hours/week in several lower-paying jobs and/or is able to obtain additional child care at a lower cost (*e.g.*, on a barter basis).

- **Sally 7:** Scenario 7 shows Sally's break-even point (Scenario 3) assuming she has access to a subsidized daycare space. The child care costs in this scenario are based on the City of Toronto's fee schedule. These fees rise at a 27-per-cent rate above a certain income threshold. As a result, at lower levels of income, a parent with subsidized daycare will have a higher disposable income than one paying for private care. However, she will face a higher marginal effective tax rate as her earnings rise, reflecting the 27-per-cent taxback associated with the increase in her daycare fees.

- **Personal income tax (PIT) payroll deductions:** In scenarios where the individuals are earning employment income, payroll income tax deductions are set at zero. This is done to avoid having to make additional assumptions about how much payroll tax to deduct from each individual's paycheck. The Canada Customs and Revenue Agency's Payroll Deductions Tables assess federal and provincial income tax on the basis of total earnings, which reflects an assumption that all earnings come from a single source (*i.e.*, one job). However, most OW recipients work at more than one job, and this will result in lower payroll tax deductions, both because the implied tax rate is lower at lower earnings levels, and because there is an earnings floor beneath which no payroll tax is deducted. We make no PIT deductions from gross employment earnings and allow each individual's tax liability to be captured through their tax return.

- **Shelter:** We assume that both individuals live in private rental market housing rather than subsidized housing. As with the choice of hypothetical individuals, this assumption was guided by OW caseload statistics, which show that a majority of recipients rent in the private market. Rent costs for each individual are held constant across all scenarios in order to isolate the effects on disposable income of changes in employment earnings.

SUMMARY TABLES:

There are six tables summarizing the results of our scenarios under the pre-2005 and August 2005 Ontario Works rules:

- Table A shows the base case scenarios under the pre-2005 rules.
- Table B shows the base case scenarios under the August 2005 rules.
- Table C combines the employment income levels from the original scenarios (pre-2005 rules) with the August 2005 OW rules. This table isolates the impact of the new OW rules for a given level of employment earnings.

Several things should be noted when reviewing the tables:

- Scenario 1 is the same under the pre-2005 and August 2005 OW regimes, because the new OW rules only affect individuals with employment earnings *and* OW benefits. In

Scenario 1, both individuals are relying solely on OW – *i.e.*, they have no employment earnings.

- Scenario 2 disappears under the August 2005 rules, because, as we discuss in the main text, these rules eliminate the conditions for the "comfort zone". As this pertains to the summary tables, Scenario 2 is left blank in Table B, which repeats this base case scenario under the August 2005 rules. However, it is featured in Table C, to demonstrate how the August 2005 rules would affect an individual's disposable income if he or she were still earning a pre-2005 "comfort zone" level of market income.
- Scenario 6 shows the level of market income at which both individuals start paying federal income tax. Because OW payments are not taxable, the new rules have no effect on this threshold – *i.e.*, Scenario 6 occurs at the same level of market income under the pre-2005 and August 2005 rules. We show this by leaving Scenario 6 blank in Table B and capturing the effect of the new rules – which do alter disposable income in this scenario – in Table C. In effect, Scenario 6 is the same in Table B and Table C, because the only difference between the two tables is the level of market income in each scenario, which does not change.
- Scenario 7 does not exist for Jim under the August 2005 rules, because it shows the effects of the 100-per-cent taxback rate, which is eliminated under the new rules. However, as with Scenario 2, which also disappears under the new rules, we feature Scenario 7 in Table C, to demonstrate how the August 2005 rules would affect Jim's disposable income if he were still at this level of market income.
- The August 2005 rules introduce a new Full-time Employment (FTEB), which provides a one-time payment of up to $500 per 12-month period for expenses related to starting a full-time job. This benefit is a complement to the pre-2005 OW rules' Employment/Training Start-Up Benefit (featured in Table A), which has been re-named Other Employment and Employment Assistance Activities Benefit, and which provides a one-time payment of up to $253 per 12-month period to help offset costs related to starting a new part-time job or employment assistance activity. The two benefits are alternatives to each other – OW recipients can receive only one, depending on whether they are starting full-time or part-time work. The August 2005 rules define the condition for full-time employment as 30 hours or more of work per week. In Tables B and C, in scenarios where Jim and Sally are still on OW, the benefit shown is whichever one corresponds to the number of hours they work in that scenario at minimum wage – *i.e.*, if their workweek exceeds 30 hours, they receive the $500 FTEB; if they work less than 30 hours, they receive the $253 benefit. There is no distinction in Sally's case, because in all of the scenarios shown in Tables B and C, she works more than 30 hours per week, and so receives the $500 benefit in every scenario where she is on OW. However, in Table C, which shows Jim at his pre-August 2005 earnings levels, his workweek falls short of 30 hours in those scenarios where he is on OW, so he receives the $253 start-up benefit.
- The most difficult thing to demonstrate in our scenarios is the loss of the OW drug and dental benefits under the new rules. The reason is that our scenarios measure the impact of changes in employment earnings on disposable income, and under the new rules, the loss of the drug and dental benefits has effectively become time-dependent rather than income-dependent. As a result, it is tricky to know where to insert this 'event' along the earnings spectrum. We consider one possible alternative in Table B, by re-inserting the drug and dental benefits into Scenario 4 (previously, the scenario where these benefits were lost) but continuing to leave them out of Scenario 5. Thus, Scenario 5 in Table B becomes the scenario that shows the loss of these benefits.

  It must be noted that this has a peculiar effect on the marginal effective tax rates (METRs) for each scenario, listed at the bottom of each column in the table. Putting the benefits back into Scenario 4 lowers the METRs for this scenario from the 10,000-15,000 per cent range seen in the original scenarios (Table A) to 2,000-5,000 per cent (Table B). Meanwhile, the METRs in Scenario 5, which ranged from 30-35 per cent in Table A (old rules) rise to 65-70 per cent in Table B (new rules). It is important not to read too much into these variations. In each case, part of the difference is accounted for by the fact that the loss of the OW drug and dental benefits is being defrayed over different ranges of employment earnings. This is a limitation more generally of the METRs we have calculated. While each one is valid for the particular transition to which it refers, as a group, they are not strictly comparable with each other, because they are not calculated across equal increments of income (*e.g.*, $1, $10 or $100). That is how a formal tax model would generate an METR series, and it would produce many more data points than we have. Accordingly, in the text, we refer only periodically to METRs, and instead focus primarily on the absolute change in individuals' disposable income across different scenarios.

Table A. Jim – Pre-2005 Ontario Works Rules
Base Case Scenarios (as described in Appendix)

	Jim 1	Jim 2	Jim 3	Jim 4	Jim 5	Jim 6	Jim 7
Gross annual employment earnings:	0.00	1764.00	10851.48	10868.64	15000.00	8568.00	8552.88
Annual Canada Pension Plan (CPP) deduction:	0.00	0.00	363.90	364.75	569.25	250.87	250.12
Annual Employment Insurance (EI) deduction:	0.00	34.40	211.60	211.94	292.50	167.08	166.78
Net annual empl. earnings (AKA "take home pay"):	0.00	1729.60	10275.98	10291.95	14138.25	8150.06	8135.98
Equivalent monthly earnings:	**0.00**	**144.13**	**856.33**	**857.66**	**1178.19**	**679.17**	**678.00**
Equivalent weekly hours at $7.45:	0.00	4.55	28.01	28.06	38.72	22.12	22.08
Equivalent wage at 37.5 hours per week:	0.00	0.98	6.03	6.04	8.33	4.76	4.75
Ontario Works (OW) monthly cash benefits:							
Basic Needs:	201.00	201.00	201.00	201.00	201.00	201.00	201.00
Shelter Allowance:	335.00	335.00	335.00	335.00	335.00	335.00	335.00
Statutory OW entitlement:	**536.00**	**536.00**	**536.00**	**536.00**	**536.00**	**536.00**	**536.00**
Basic earnings exemption:	143.00	143.00	143.00	143.00	143.00	143.00	143.00
Variable earnings exemption (@25%):	0.00	0.28	178.33	178.67	258.80	134.04	0.00
Minus chargeable net employment earnings:	**0.00**	**0.85**	**535.00**	**536.00**	**776.39**	**402.13**	**535.00**
Ontario Works received:	**536.00**	**535.15**	**1.00**	**0.00**	**0.00**	**133.87**	**1.00**
Total monthly pre-tax cash income:	**536.00**	**679.28**	**857.33**	**857.67**	**1178.19**	**813.04**	**679.00**
Annual federal/provincial income tax:							
Federal income tax:	0.00	0.00	(340.48)	(343.03)	(958.44)	(0.33)	0.00
GST credit:	227.00	243.18	296.73	296.83	347.00	282.95	250.76
Ontario income tax:	0.00	0.00	0.00	0.00	(347.01)	0.00	0.00
Ontario property & sales tax credits:	381.76	346.68	293.13	293.03	210.40	306.91	339.10
Total annual after-tax cash income:	**7040.76**	**8741.26**	**10537.38**	**10538.82**	**13390.20**	**10346.05**	**8737.86**
Annual Ontario Works in-kind/additional cash benefits:							
Imputed Blue Cross benefit:	1532.28	1532.28	1532.28	0.00	0.00	1532.28	1532.28
Participation Allowance (for workfare project):	1200.00	0.00	0.00	0.00	0.00	0.00	0.00
One-time Employment./Training Start-up Assistance:	0.00	253.00	253.00	0.00	0.00	253.00	253.00
Total in-kind/additional cash benefits:	**2732.28**	**1785.28**	**1785.28**	**0.00**	**0.00**	**1785.28**	**1785.28**
Total annual income + in-kind benefits:	**9773.04**	**10526.54**	**12322.66**	**10538.82**	**13390.20**	**12131.33**	**10523.14**
Relative to previous scenario:							
Change in annual employment earnings:	---	1764.00	9087.48	17.16	4131.36	---	---
Change in annual income + in-kind benefits:	---	753.50	1796.12	(1783.84)	2851.38	---	---
Marginal tax rate:	---	**57.3**	**80.2**	**10495.4**	**31.0**	---	---
Relative to original (Jim 1) scenario:							
Change in annual employment earnings:	---	---	10851.48	10868.64	15000.00	8568.00	8552.88
Change in annual income + in-kind benefits:	---	---	2549.62	765.78	3617.16	2358.29	750.10
Marginal tax rate:	---	---	**76.5**	**93.0**	**75.9**	**72.5**	**91.2**
Alternative comparisons:				**vs. Jim 2**	**vs. Jim 3**		**vs. Jim 2**
Change in annual employment earnings:	---	---	---	9104.64	4148.5	---	6788.9
Change in annual income + in-kind benefits:	---	---	---	12.28	1067.5	---	(3.4)
Marginal tax rate:	---	---	---	**99.9**	**74.3**	---	**100.1**

Table A. Sally – Pre-2005 Ontario Works Rules
Base Case Scenarios (as described in Appendix)

	Sally 1	Sally 2	Sally 3	Sally 4	Sally 5	Sally 6	Sally 7
Gross annual employment earnings:	0.00	10080.00	24910.80	24928.08	30300.00	23520.00	19855.08
Annual Canada Pension Plan (CPP) deduction:	0.00	325.71	1059.83	1060.69	1326.60	990.99	809.58
Annual Employment Insurance (EI) deduction:	0.00	196.56	485.76	486.10	590.85	458.64	387.17
Net annual empl. earnings (AKA "take home pay"):	0.00	9557.73	23365.20	23381.29	28382.55	22070.37	18658.33
Equivalent monthly earnings:	**0.00**	**796.48**	**1947.10**	**1948.44**	**2365.21**	**1839.20**	**1554.86**
Equivalent weekly hours at $7.45:	0.00	26.02	64.30	64.35	78.21	60.71	51.25
Equivalent wage at 37.5 hours per week:	0.00	5.60	13.84	13.85	16.83	13.07	11.03
Ontario Works (OW) monthly cash benefits:							
Basic Needs:	460.00	460.00	460.00	460.00	460.00	460.00	460.00
Shelter Allowance:	527.00	527.00	527.00	527.00	527.00	527.00	527.00
Statutory OW entitlement:	**987.00**	**987.00**	**987.00**	**987.00**	**987.00**	**987.00**	**987.00**
Minus NCBS clawback:	121.92	121.92	121.92	121.92	121.92	121.92	121.92
Maximum OW entitlement:	**865.08**	**865.08**	**865.08**	**865.08**	**865.08**	**865.08**	**865.08**
Basic earnings exemption:	275.00	275.00	275.00	275.00	275.00	275.00	275.00
Variable earnings exemption (@25%):	0.00	130.37	418.03	418.36	522.55	391.05	319.97
Child care earnings exemption:	0.00	390.00	390.00	390.00	390.00	390.00	95.81
Minus chargeable net employment earnings:	**0.00**	**1.11**	**864.08**	**865.08**	**1177.66**	**783.15**	**864.08**
Ontario Works received:	**865.08**	**863.97**	**1.00**	**0.00**	**0.00**	**81.93**	**1.00**
Federal income security monthly cash benefits:							
Base Child Tax Benefit (CTB):	102.33	102.33	102.33	102.33	102.33	102.33	102.33
CTB supplement :	20.25	0.00	0.00	0.00	0.00	0.00	0.00
Total CTB benefit:	**122.58**	**102.33**	**102.33**	**102.33**	**102.33**	**102.33**	**102.33**
National Child Benefit Supplement (NCBS):	143.50	143.50	143.50	143.50	125.00	143.50	143.50
Total CCTB benefits:	**266.08**	**245.83**	**245.83**	**245.83**	**227.33**	**245.83**	**245.83**
Provincial income security monthly cash benefits:							
Ontario Child Care Supplement (OCCS):	0.00	109.17	109.17	109.17	87.17	109.17	109.17
Total monthly pre-tax cash income:	**1131.16**	**2015.45**	**2303.11**	**2303.44**	**2679.71**	**2276.13**	**1910.86**
Annual federal/provincial income tax:							
Federal income tax:	0.00	0.00	(207.71)	(210.29)	(1010.49)	(0.54)	(390.65)
GST credit:	574.00	574.00	574.00	574.00	574.00	574.00	574.00
Ontario income tax:	0.00	0.00	0.00	0.00	(99.00)	0.00	0.00
Ontario property & sales tax credits:	416.38	349.45	265.54	265.44	158.00	273.94	249.65
Total annual after-tax cash income:	**14564.34**	**25108.84**	**28269.09**	**28270.44**	**31779.02**	**28160.95**	**23363.29**
Annual Ontario Works in-kind/additional cash benefits:							
Imputed Blue Cross benefit:	1702.56	1702.56	1702.56	0.00	0.00	1702.56	1702.56
One-time Winter Clothing Allowance:	105.00	105.00	105.00	0.00	0.00	105.00	105.00
One-time Back to School Allowance:	69.00	69.00	69.00	0.00	0.00	69.00	69.00
One-time Employment/Training Start-up Assistance:	0.00	253.00	253.00	0.00	0.00	253.00	253.00
One-Time Up Front Child Care Allowance:	0.00	390.00	390.00	0.00	0.00	390.00	95.81
Total in-kind/additional cash benefits:	**1876.56**	**2519.56**	**2519.56**	**0.00**	**0.00**	**2519.56**	**2225.37**
Total annual income + in-kind benefits:	16440.90	27628.40	30788.65	28270.44	31779.02	30680.51	25588.67
Annual child care expenses:	0.00	6765.10	9750.00	9750.00	9750.00	9750.00	1149.75
Annual after-tax, after-child care income + benefits:	**16440.90**	**20863.30**	**21038.65**	**18520.44**	**22029.02**	**20930.51**	**24438.92**
Relative to previous scenario:							
Change in annual employment earnings:	---	10080.00	14830.80	17.28	5371.92	---	---
Change in annual after-tax, after-child care income + benefits:	---	4422.40	175.35	(2518.21)	3508.58	---	---
Marginal tax rate:	---	**56.1**	**98.8**	**14673.0**	**34.7**	---	---
Relative to original (Sally 1) scenario:							
Change in annual employment earnings:	---	---	24910.80	24928.08	30300.00	23520.00	19855.08
Change in annual after-tax, after-child care income + benefits:	---	---	4597.75	2079.54	5588.12	4489.61	7998.02
Marginal tax rate:	---	---	**81.5**	**91.7**	**81.6**	**80.9**	**59.7**
Alternative comparisons:			**vs. Sally 7**	**vs. Sally 2**	**vs. Sally 3**		**vs. Sally 2**
Change in annual employment earnings:	---	---	5055.72	14848.08	5389.2	---	9775.08
Change in annual after-tax, after-child care income + benefits:	---	---	(3400.26)	(2342.85)	990.4	---	3575.62
Marginal tax rate:	---	---	**167.3**	**115.8**	**81.6**	---	**63.4**

Table B. Jim – August 2005 Ontario Works Rules
Scenarios as in Table A.

	Jim 1	Jim 2	Jim 3	Jim 4	Jim 5	Jim 6	Jim 7
Gross annual employment earnings:	0.00		13605.60	13631.40	18000.00		
Annual Canada Pension Plan (CPP) deduction:	0.00		500.23	501.50	717.75		
Annual Employment Insurance (EI) deduction:	0.00		265.31	265.81	351.00		
Net annual empl. earnings (AKA "take home pay"):	0.00	Comfort	12840.06	12864.08	16931.25	No change	100%
Equivalent monthly earnings:	**0.00**	zone	**1070.01**	**1072.01**	**1410.94**	relative to	Ontario
Equivalent weekly hours at $7.45:	0.00	scenario	35.12	35.19	46.46	Table A	Works
Equivalent wage at 37.5 hours per week:	0.00	does not	7.56	7.57	10.00	because	taxback
		exist				personal	on
Ontario Works (OW) monthly cash benefits:		because				income tax	employment
Basic Needs:	201.00	basic	201.00	201.00	201.00	liability	earnings
Shelter Allowance:	335.00	earnings	335.00	335.00	335.00	not	not
Statutory OW entitlement:	**536.00**	exemption	**536.00**	**536.00**	**536.00**	affected	relevant
Basic earnings exemption:	0.00	has been	0.00	0.00	0.00	by OW	under
Variable earnings exemption (@50%):	0.00	eliminated.	535.00	536.00	705.47	allowance.	new OW
Minus chargeable net employment earnings:	**0.00**		**535.00**	**536.00**	**705.47**		regime.
Ontario Works received:	**536.00**		**1.00**	**0.00**	**0.00**		
Total monthly pre-tax cash income:	**536.00**		**1071.00**	**1072.01**	**1410.94**		
Annual federal/provincial income tax:							
Federal income tax:	0.00		(750.73)	(754.57)	(1405.32)		
GST credit:	227.00		347.00	347.00	347.00		
Ontario income tax:	0.00		(189.93)	(192.84)	(528.48)		
Ontario property & sales tax credits:	381.76		238.05	237.77	150.40		
Total annual after-tax cash income:	**7040.76**		**12496.42**	**12501.44**	**15494.85**		
Annual Ontario Works in-kind/cash additional benefits:							
Imputed Blue Cross benefit:	1532.28		1532.28	1532.28	0.00		
Employment Related Expenses (old Participation Allowance):	1200.00		0.00	0.00	0.00		
Employment Assistance/Full-time Employment Benefit (FTEB):	0.00		500.00	0.00	0.00		
Total in-kind/additional cash benefits:	**2732.28**		**2032.28**	**1532.28**	**0.00**		
Total annual income + in-kind benefits:	**9773.04**		**14528.70**	**14033.72**	**15494.85**		
Relative to previous scenario:							
Change in annual employment earnings:	All figures		---	25.80	4368.60		
Change in annual income + in-kind benefits:	same as in		---	(494.97)	1461.12		
Marginal tax rate:	original		---	**2018.5**	**66.6**		
	Jim 1 in						
Relative to original (Jim 1) scenario:	Table A						
Change in annual employment earnings:	(Pre-2005 rules).		13605.60	13631.40	18000.00		
Change in annual income + in-kind benefits:			4755.66	4260.68	5721.81		
Marginal tax rate:	New OW		**65.0**	**68.7**	**68.2**		
	rules have						
Alternative comparisons:	no impact				**vs. Jim 3**		
Change in annual employment earnings:	because		---	---	4394.4		
Change in annual income + in-kind benefits:	Jim 1 has no		---	---	966.1		
Marginal tax rate:	work earnings.		---	---	**78.0**		

Table B. Sally – August 2005 Ontario Works Rules
Scenarios as in Table A.

	Sally 1	Sally 2	Sally 3	Sally 4	Sally 5	Sally 6	Sally 7
Gross annual employment earnings:	0.00		37556.04	37581.72	45930.00		30080.64
Annual Canada Pension Plan (CPP) deduction:	0.00		1685.77	1687.05	1861.20		1315.74
Annual Employment Insurance (EI) deduction:	0.00		732.34	732.84	895.64		586.57
Net annual empl. earnings (AKA "take home pay"):	0.00	Comfort	35137.92	35161.83	43173.17	No change	28178.33
Equivalent monthly earnings:	**0.00**	zone	**2928.16**	**2930.15**	**3597.76**	relative to	**2348.19**
Equivalent weekly hours at $7.45:	0.00	scenario	96.94	97.01	118.56	Table A	77.65
Equivalent wage at 37.5 hours per week:	0.00	does not	20.86	20.88	25.52	because	16.71
		exist				personal	
Ontario Works (OW) monthly cash benefits:		because				income tax	
Basic Needs:	460.00	basic	460.00	460.00	460.00	liability	460.00
Shelter Allowance:	527.00	earnings	527.00	527.00	527.00	not	527.00
Statutory OW entitlement:	**987.00**	exemption	**987.00**	**987.00**	**987.00**	affected	**987.00**
Minus NCBS clawback:	121.92	has been	121.92	121.92	121.92	by OW	121.92
Maximum OW entitlement:	**865.08**	eliminated.	**865.08**	**865.08**	**865.08**	allowance.	**865.08**
Basic earnings exemption:	0.00		0.00	0.00	0.00		0.00
Variable earnings exemption (@50%):	0.00		1464.08	1465.08	1798.88		1174.10
Child care earnings exemption:	0.00		600.00	600.00	600.00		310.01
Minus chargeable net employment earnings:	0.00		864.08	865.08	1198.88		864.08
Ontario Works received:	**865.08**		**1.00**	**0.00**	**0.00**		**1.00**
Federal income security monthly cash benefits:							
Base Child Tax Benefit (CTB):	102.33		102.33	102.33	102.33		102.33
CTB supplement :	20.25		0.00	0.00	0.00		0.00
Total CTB benefit:	**122.58**		**102.33**	**102.33**	**96.78**		**102.33**
National Child Benefit Supplement (NCBS):	143.50		51.10	50.97	0.00		93.76
Total CCTB benefits:	**266.08**		**153.44**	**153.30**	**96.78**		**196.09**
Provincial income security monthly cash benefits:							
Ontario Child Care Supplement (OCCS):	0.00		38.71	38.62	0.00		66.68
Total monthly pre-tax cash income:	1131.16		3121.31	3122.08	3694.54		2611.97
Annual federal/provincial income tax:							
Federal income tax:	0.00		(2091.35)	(2095.17)	(3577.09)		(1502.59)
GST credit:	574.00		526.50	525.81	108.40		574.00
Ontario income tax:	0.00		(662.81)	(665.71)	(1649.06)		(217.56)
Ontario property & sales tax credits:	416.38		12.64	12.36	0.00		96.55
Total annual after-tax cash income:	14564.34		35240.71	35242.22	39216.72		30294.00
Annual Ontario Works in-kind/cash additional benefits:							
Imputed Blue Cross benefit:	1702.56		1702.56	1702.56	0.00		1702.56
One-time Winter Clothing Allowance:	105.00		105.00	0.00	0.00		105.00
One-time Back to School Allowance:	69.00		69.00	0.00	0.00		69.00
Employment Assistance/Full-time Employment Benefit (FTEB):	0.00		500.00	0.00	0.00		500.00
One-Time Up Front Child Care Allowance:	0.00		600.00	0.00	0.00		310.01
Total in-kind/additional cash benefits:	**1876.56**		**2976.56**	**1702.56**	**0.00**		**2686.57**
Total annual income + in-kind benefits:	16440.90		38217.27	36944.78	39216.72		32980.57
Annual child care expenses:	0.00		9750.00	9750.00	9750.00		3720.15
Annual after-tax, after-child care income + benefits:	**16440.90**		**28467.27**	**27194.78**	**29466.72**		**29260.42**
Relative to previous scenario:	All figures						
Change in annual employment earnings:	same as in		---	25.68	8348.28		---
Change in annual after-tax, after-child care income + benefits:	original		---	(1272.50)	2271.94		---
Marginal tax rate:	Sally 1 in		**---**	**5055.2**	**72.8**		**---**
	Table A						
Relative to original (Sally 1) scenario:	(pre-2005						
Change in annual employment earnings:	OW rules).		37556.04	37581.72	45930.00		30080.64
Change in annual after-tax, after-child care income + benefits:			12026.37	10753.88	13025.82		12819.52
Marginal tax rate:	New OW		**68.0**	**71.4**	**71.6**		**57.4**
	rules have						
Alternative comparisons:	no impact		**vs. Sally 7**		**vs. Sally 3**		
Change in annual employment earnings:	because		7475.40	---	8374.0		---
Change in annual after-tax, after-child care income + benefits:	Sally 1 has no		(793.15)	---	999.4		---
Marginal tax rate:	work earnings.		**110.6**	**---**	**88.1**		**---**

Table C. Jim – August 2005 Ontario Works Rules
Employment Earnings as in Table A.

	Jim 1	Jim 2	Jim 3	Jim 4	Jim 5	Jim 6 & 7
Gross annual employment earnings:	0.00	1764.00	10851.48	10868.64	15000.00	8560.00
Annual Canada Pension Plan (CPP) deduction:	0.00	0.00	363.90	364.75	569.25	250.47
Annual Employment Insurance (EI) deduction:	0.00	34.40	211.60	211.94	292.50	166.92
Net annual empl. earnings (AKA "take home pay"):	0.00	1729.60	10275.98	10291.95	14138.25	8142.61
Equivalent monthly earnings:	**0.00**	**144.13**	**856.33**	**857.66**	**1178.19**	**678.55**
Equivalent weekly hours at $7.45:	0.00	4.55	28.01	28.06	38.72	22.10
Equivalent wage at 37.5 hours per week:	0.00	0.98	6.03	6.04	8.33	4.76
Ontario Works (OW) monthly cash benefits:						
Basic Needs:	201.00	201.00	201.00	201.00	201.00	201.00
Shelter Allowance:	335.00	335.00	335.00	335.00	335.00	335.00
Statutory OW entitlement:	**536.00**	**536.00**	**536.00**	**536.00**	**536.00**	**536.00**
Basic earnings exemption:	0.00	0.00	0.00	0.00	0.00	0.00
Variable earnings exemption (@50%):	0.00	72.07	428.17	428.83	589.09	339.28
Minus chargeable net employment earnings:	**0.00**	**72.07**	**428.17**	**428.83**	**589.09**	**339.28**
Ontario Works received:	**536.00**	**463.93**	**107.83**	**107.17**	**0.00**	**196.72**
Total monthly pre-tax cash income:	**536.00**	**608.07**	**964.17**	**964.83**	**1178.19**	**875.28**
Annual federal/provincial income tax:						
Federal income tax:	0.00	0.00	(340.48)	(343.03)	(958.44)	0.00
GST credit:	227.00	227.00	322.37	322.55	347.00	297.87
Ontario income tax:	0.00	0.00	0.00	0.00	(347.01)	0.00
Ontario property & sales tax credits:	381.76	363.78	267.49	267.31	210.40	291.99
Total annual after-tax cash income:	**7040.76**	**7887.58**	**11819.37**	**11824.80**	**13390.20**	**11093.17**
Annual Ontario Works in-kind/cash additional benefits:						
Imputed Blue Cross benefit:	1532.28	1532.28	1532.28	1532.28	0.00	1532.28
Employment Related Expenses (old Participation Allowance):	1200.00	0.00	0.00	0.00	0.00	0.00
Employment Assistance/Full-time Employment Benefit (FTEB):	0.00	253.00	253.00	253.00	0.00	253.00
Total in-kind/additional cash benefits:	**2732.28**	**1785.28**	**1785.28**	**1785.28**	**0.00**	**1785.28**
Total annual income + in-kind benefits:	**9773.04**	**9672.86**	**13604.65**	**13610.08**	**13390.20**	**12878.45**
Relative to previous scenario:						
Change in annual employment earnings:	All figures	1764.00	9087.48	17.16	4131.36	---
Change in annual income + in-kind benefits:	same as in	(100.18)	3931.80	5.43	(219.89)	---
Marginal tax rate:	original	**105.7**	**56.73**	**68.3**	**105.3**	---
	Jim 1 in					
Relative to original (Jim 1) scenario:	Table A					
Change in annual employment earnings:	(Pre-2005 rules).	---	10851.48	10868.64	15000.00	8560.00
Change in annual income + in-kind benefits:		---	3831.61	3837.04	3617.16	3105.41
Marginal tax rate:	New OW	---	**64.7**	**64.7**	**75.9**	**63.7**
	rules have					
Alternative comparisons:	no impact			**vs. Jim2**	**vs. Jim3**	**vs. Jim2**
Change in annual employment earnings:	because	---	---	9104.64	4148.5	6796.0
Change in annual income + in-kind benefits:	Jim 1 has no	---	---	3937.23	(214.5)	3205.6
Marginal tax rate:	work earnings.	---	---	**56.8**	**105.2**	**52.8**

Table C. Sally – August 2005 Ontario Works Rules
Employment Earnings as in Table A.

	Sally 1	Sally 2	Sally 3	Sally 4	Sally 5	Sally 6	Sally 7
Gross annual employment earnings:	0.00	10080.00	24910.00	24928.00	30300.00	23520.00	19855.08
Annual Canada Pension Plan (CPP) deduction:	0.00	325.71	1059.80	1060.69	1326.60	990.99	809.58
Annual Employment Insurance (EI) deduction:	0.00	196.56	485.74	486.10	590.85	458.64	387.17
Net annual empl. earnings (AKA "take home pay"):	0.00	9557.73	23364.46	23381.22	28382.55	22070.37	18658.33
Equivalent monthly earnings:	**0.00**	**796.48**	**1947.04**	**1948.43**	**2365.21**	**1839.20**	**1554.86**
Equivalent weekly hours at $7.45:	0.00	26.02	64.30	64.35	78.21	60.71	51.25
Equivalent wage at 37.5 hours per week:	0.00	5.60	13.84	13.85	16.83	13.07	11.03
Ontario Works (OW) monthly cash benefits:							
Basic Needs:	460.00	460.00	460.00	460.00	460.00	460.00	460.00
Shelter Allowance:	527.00	527.00	527.00	527.00	527.00	527.00	527.00
Statutory OW entitlement:	**987.00**	**987.00**	**987.00**	**987.00**	**987.00**	**987.00**	**987.00**
Minus NCBS clawback:	121.92	121.92	121.92	121.92	121.92	121.92	121.92
Maximum OW entitlement:	**865.08**	**865.08**	**865.08**	**865.08**	**865.08**	**865.08**	**865.08**
Basic earnings exemption:	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Variable earnings exemption (@50%):	0.00	398.24	973.52	974.22	1182.61	919.60	777.43
Child care earnings exemption:	0.00	563.76	600.00	600.00	600.00	600.00	95.81
Minus chargeable net employment earnings:	0.00	0.00	373.52	374.22	582.61	319.60	681.62
Ontario Works received:	**865.08**	**865.08**	**491.56**	**490.86**	**282.47**	**545.48**	**183.46**
Federal income security monthly cash benefits:							
Base Child Tax Benefit (CTB):	102.33	102.33	102.33	102.33	102.33	102.33	102.33
CTB supplement :	20.25	0.00	0.00	0.00	0.00	0.00	0.00
Total CTB benefit:	**122.58**	**102.33**	**102.33**	**102.33**	**102.33**	**102.33**	**102.33**
National Child Benefit Supplement (NCBS):	143.50	143.50	119.82	119.73	90.53	127.38	143.50
Total CCTB benefits:	**266.08**	**245.83**	**222.16**	**222.06**	**192.87**	**229.71**	**245.83**
Provincial income security monthly cash benefits:							
Ontario Child Care Supplement (OCCS):	0.00	109.17	83.78	83.71	64.57	88.73	103.12
Total monthly pre-tax cash income:	1131.16	2016.56	2744.53	2745.07	2905.12	2703.12	2087.28
Annual federal/provincial income tax:							
Federal income tax:	0.00	0.00	(207.59)	(210.27)	(1010.49)	(0.54)	(390.65)
GST credit:	574.00	574.00	574.00	574.00	574.00	574.00	574.00
Ontario income tax:	0.00	0.00	0.00	0.00	(99.00)	0.00	0.00
Ontario property & sales tax credits:	416.38	349.18	147.83	147.63	90.21	162.68	205.86
Total annual after-tax cash income:	14564.34	25121.87	33448.62	33452.18	34416.20	33173.56	25436.53
Annual Ontario Works in-kind/cash additional benefits:							
Imputed Blue Cross benefit:	1702.56	1702.56	1702.56	1702.56	1702.56	1702.56	1702.56
One-time Winter Clothing Allowance:	105.00	105.00	105.00	105.00	105.00	105.00	105.00
One-time Back to School Allowance:	69.00	69.00	69.00	69.00	69.00	69.00	69.00
Employment Assistance/Full-time Employment Benefit (FTEB):	0.00	500.00	500.00	500.00	500.00	500.00	500.00
One-Time Up Front Child Care Allowance:	0.00	563.76	600.00	600.00	600.00	600.00	95.81
Total in-kind/additional cash benefits:	**1876.56**	**2940.32**	**2976.56**	**2976.56**	**2976.56**	**2976.56**	**2472.37**
Total annual income + in-kind benefits:	16440.90	28062.19	36425.18	36428.74	37392.76	36150.12	27908.91
Annual child care expenses:	0.00	6765.10	9750.00	9750.00	9750.00	9750.00	1149.75
Annual after-tax, after-child care income + benefits:	**16440.90**	**21297.09**	**26675.18**	**26678.74**	**27642.76**	**26400.12**	**26759.16**
Relative to previous scenario:	All figures						
Change in annual employment earnings:	same as in	10080.00	14830.00	18.00	5372.00	---	---
Change in annual after-tax, after-child care income + benefits:	original	4856.19	5378.09	3.56	964.02	---	---
Marginal tax rate:	Sally 1 in	**51.8**	**63.7**	**80.2**	**82.1**	---	**---**
	Table A						
Relative to original (Sally 1) scenario:	(pre-2005						
Change in annual employment earnings:	OW rules).	---	24910.00	24928.00	30300.00	23520.00	19855.08
Change in annual after-tax, after-child care income + benefits:		---	10234.28	10237.84	11201.86	9959.22	10318.26
Marginal tax rate:	New OW	**---**	**58.9**	**58.9**	**63.0**	**57.7**	**48.0**
	rules have						
Alternative comparisons:	no impact		**vs. Sally 7**	**vs. Sally 2**	**vs. Sally 3**		**vs. Sally 2**
Change in annual employment earnings:	because	---	5054.92	14848.00	5390.0	---	9775.08
Change in annual after-tax, after-child care income + benefits:	Sally 1 has no	---	(83.98)	5381.65	967.6	---	5462.07
Marginal tax rate:	work earnings.	**---**	**101.7**	**63.8**	**82.0**	**---**	**44.1**

GLOSSARY OF TERMS

Break-even level	Income threshold at which a benefit or allowance ceases to be paid (term applies to any income-tested program; in context of welfare, sometimes referred to as 'escape level', to denote exit point from program)
B/U ratio	Unemployed individuals receiving regular EI benefits (B) as a proportion of all unemployed individuals (U) (term applies to coverage of unemployed population under federal Employment Insurance program)
CAP	Canada Assistance Plan (federal)
CCTB	Canada Child Tax Benefit (federal)
CDB	Child Disability Benefit (federal)
Comfort zone	Income threshold at which individual is earning minimum amount of income necessary to take advantage of all available Ontario Works earnings exemptions while still retaining the maximum dollar amount of OW cash benefits (term applies only to Ontario Works program)
CPP	Canada Pension Plan (federal)
EI	Employment Insurance Program (federal)
FBA	Family Benefit Allowance (Ontario)
FTEB	Full-time Employment Benefit (Ontario – part of Ontario Works)
GAINS-A	Guaranteed Annual Income System for the Aged (Ontario)
GIS	Guaranteed Income Supplement (federal)
GST credit	Goods and Services Tax Credit (federal)
GWA	General Welfare Assistance (Ontario)
Hard to serve	Welfare recipients facing multiple barriers to income (also referred to as 'hard to employ' or 'multi-barriered')
METR	Marginal Effective Tax Rate
MTR	Marginal Tax Rate
NCB	National Child Benefit Initiative (federal-provincial-territorial)
NCBS	National Child Benefit Supplement (federal)
OAS	Old Age Security (federal)
OCCS	Ontario Child Care Supplement for Working Families (Ontario)
ODB	Ontario Drug Benefit
ODSP	Ontario Disability Support Program (Ontario)
OW	Ontario Works (Ontario)
PIT	Personal Income Tax
RGI housing	Rent Geared to Income Housing
STEP	Supports to Employment Program (Ontario – part of social assistance)
UA	Unemployment Assistance Act (Ontario)
WIN	Work Incentive Program (Ontario – for FBA participants)

ENDNOTES

1. In fact, the new Ontario Works system took shape gradually, through a series of reforms that were phased in over a period of years. The Harris government made the initial announcements about workfare in 1995-1996, the supporting legal apparatus was introduced in May 1998, and additional changes to the structure of benefits were made in 1998, 1999 and 2000. For the sake of simplicity, we will refer in this paper to the full set of reforms introduced over this period as the pre-2005 OW rules or the old Ontario Works (OW) rules.

2. These figures do not include beneficiaries of the Ontario Disability Support Program (ODSP), which has seen a rise in caseloads over this period.

3. Ross Finnie, Ian Irvine and Roger Sceviour, "Social Assistance Use in Canada: National and Provincial Trends in Incidence, Entry and Exit," Analytical Studies Branch Research Paper Series, Ottawa: Statistics Canada, May 2005, Tables A4 and A5, pp. 39-40.

4. *Ibid*., p. 18.

5. Michael Hatfield, "Vulnerability to Persistent Low Income," *Horizons*, Vol. 7 No. 2, Ottawa: Policy Research Initiative, December 2004.

6. *Ibid.*

7. Dominique Fleury and Myriam Fortin, "Canada's Working Poor," *Horizons*, Vol. 7 No. 2, Ottawa: Policy Research Initiative, December 2004. See also Ron Saunders, "Low-Paid Workers in Canada: Does a Rising Tide Lift All Boats?," Ottawa: Canadian Policy Research Networks, March 2005.

8. Eric Lascelles, "2030 Vision – A Long-term Economic Forecast for Canada," TD Economics, July 14, 2004.

9. The $14,500 figure represents the income that is paid to low-income seniors through the federal Old Age Security (OAS) and Guaranteed Income Supplement (GIS) programs, the province of Ontario's Guaranteed Annual Income System for the Aged (GAINS-A), and a variety of refundable tax credits for seniors.

10. Ken Battle and Sherri Torjman, "The Welfare Wall: Reforming the Welfare and Tax Systems," Ottawa: Caledon Institute of Social Policy, 1993; Ken Battle and Sherri Torjman, "The Welfare Wall: The Interaction of the Welfare and Tax Systems," Ottawa: Caledon Institute of Social Policy, 1993.

11. The National Child Benefit Supplement (NCBS) is a component of the National Child Benefit (NCB) program, a federal-provincial-territorial initiative that was launched in 1998 as part of a strategy to combat child poverty in Canada. The NCB supplement is a federal payment targeted specifically to low-income families with children, and it was introduced for the express purpose of helping reduce the barriers to work that parents on social assistance face as a result of having their welfare-based child benefits clawed back as their market income rises. The supplement was intended to achieve this by providing a platform for the development of an integrated income-tested benefit for Canadian children that would eventually replace welfare-based child benefits entirely. To get to that endpoint, provinces and territories were encouraged to reduce the value of the child benefits they deliver through social assistance by the amount of the NCBS and re-invest the savings in non-welfare-based programs for low-income families with children. (For a more detailed treatment of this 'recovery-reinvestment' aspect of the NCBS, see the discussion in the main text on pages 23-25.)

    Provinces and territories have a good deal of flexibility in deciding how to implement the NCB initiative. In the years since the program was introduced, a number of different approaches to adjusting social assistance and child benefits have evolved. In Ontario, the provincial government treats the NCBS as income, which it deducts from parents' welfare allowances – although, since 2004, the annual increments in the NCBS, which are delivered every July, have not been included in the chargeback. As a result, as of this year's increase in the NCBS, the taxback against Ontario Works amounted to 85 per cent of the NCBS's total value. Using the example of a lone parent with one child under the age of 12, the statutory maximum OW allowance of $987 per month is reduced by $121.97, or 85 per cent of $143.50 (the monthly value of the NCBS as of July 2005). The actual maximum OW allowance for a lone parent with one child who receives the full NCB Supplement is thus $865.08. The Ontario government re-invests the savings generated by the NCBS offset in several programs, but the largest by far is the Ontario Child Care Supplement for Working Families (OCCS), which provides income support to working families with children under the age of 7.

The above information was obtained from *The National Child Benefit Progress Report: 2003*, published March 2005 and available at http://www.nationalchildbenefit.ca.

12. Ontario Ministry of Community and Social Services, "McGuinty Government Breaks Down Barriers To Help People Move From Welfare To Work," press release, May 17, 2005. Text can be seen at: http://www.cfcs.gov.on.ca/CFCS/en/newsRoom/newsReleases/050517.htm. Also see Ontario Ministry of Community and Social Services, "Improving Ontario Works," Backgrounder, May 17, 2005. Text can be seen at: http://www.cfcs.gov.on.ca/CFCS/en/newsRoom/backgrounders/050517.htm.

13. Social Services, Region of Waterloo, "Recommendation to Province Concerning Earnings Exemptions for Ontario Works Recipients," Report SS-05-033, June 14, 2005; Thunder Bay District Social Services Administration Board, "Ontario Works Bulletin 2005-05, Changes to Employment and Informal Child Care Benefits," Report No. 2005-19, June 2, 2005; Community Services, Niagara Region, "Provincial Announcements to Change the Social Assistance Program, May 19, 2005," COM 62-2005, July 11, 2005.

14. See the Ontario Blue Cross website, at: https://www.useblue.com/asp/secure/bluechoice_quote.asp.

15. *National Child Benefit Progress Report: 2003*, p. 4.

16. *Ibid.*, p. 15, and *National Child Benefit Progress Report: 2003*, Appendix 2, "Provincial, Territorial and First Nations NCB Reinvestments and Investments, pp. 35-39 (Newfoundland and Labrador), pp. 43-45 (Nova Scotia), pp. 54-56 (Saskatchewan) and pp. 61-65 (British Columbia).

17. For more on the NCB initiative and the advantages of creating a separate platform for child benefits, see the following publications: Adil Sayeed, "Improving the National Child Benefit: Matching Deeds with Intentions," *C.D. Howe Institute Commentary 125,* Toronto: C.D. Howe Institute, May 1999; John Stapleton, "*Transitions* Revisited: Implementing the Vision," Ottawa: Caledon Institute of Social Policy, September 2004; Daily Bread Food Bank, "Rebuilding Lives: Taking Children off Social Assistance and Encouraging Their Parents to Work," Toronto: Daily Bread Food Bank, 2005.

18. Michael Mendelson and Ken Battle, "A 'New Architecture' for Canada's Adult Benefit System," Ottawa: Caledon Institute of Social Policy, April 2005. See also Richard Shillington, "Employment Insurance and Toronto," Tristat Resources, forthcoming.

19. Human Resources Development Canada (HRDC), "An Analysis of Employment Insurance Benefit Coverage, Applied Research Branch, Ottawa: HRDC, October 1998, referenced in The Canada Employment Insurance Commission, "Impacts and Effectiveness of the Employment Insurance Program," Chapter 5, *2004 Employment Insurance Monitoring and Assessment Report*, Ottawa: Human Resources and Skills Development Canada (HRSDC), 2005, p.56. Report can be viewed at http://www.hrsdc.gc.ca/en/ei/reports/eimar_2004.shtml.

20. Government of Canada, Human Resources and Skills Development (HRSD), Employment Insurance (EI) website, at http://www.hrsdc.gc.ca/en/gateways/nav/top_nav/program/ei.shtml.

21. Statistics Canada, "Labour Force Survey Historical Review: 1976-2004", Ottawa: Statistics Canada, 2004, Table 2-7.

22. Statistics Canada, "Employment Insurance Coverage Survey", *The Daily*, Ottawa: Statistics Canada, June 22, 2005, p. 7-9.

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