

Submission to the Minister of Social Development and Economic Security

RE: Restoration of the Flat Rate Earnings Exemption for Welfare Recipients

By Seth Klein
October 1999

In recent weeks, our office has been asked its opinion about the restoration of the flat rate earnings exemption (FREE) for people receiving social assistance by a number of people within government. It is our understanding that this measure is under consideration and is being actively debated within government.

We have fielded the opinions of our research associates with expertise in this area, consulted with other policy experts across Canada, and drawn upon our own research into income support programs, and submit the following brief for your consideration. It is the CCPA's strong recommendation that the flat rate earnings exemption be, at a minimum, fully restored to its pre-1996 levels (\$100 per month for singles and \$200 per month for couples and families with children).

The following outlines our case for restoring the FREE:

Simply put, welfare rates are too low. After the shelter allowance, single people on social assistance are required to live on \$175 per month, or about \$5.80 per day (less if one's shelter costs exceed the allowance, as is often the case). It is virtually impossible to live on this amount, let alone search for work. With total annual welfare income of \$6,000, single people on social assistance in BC are being asked to live more than \$10,000 below Statistics Canada's low-income cut-off, and more than \$6,500 below SPARC of BC's "Cost of Daily Living" measure. A single parent with one child will receive total welfare income in BC of \$11,784, almost \$10,000 less than the LICO, and \$6,630 less than SPARC's cost of living measure. [1] Moreover, welfare rates in BC have not kept up with the cost of living. According to SPARC, after inflation, the real value of the welfare support allowance for a single person fell 44 per cent between 1982 and 1997. The drop has not been as dramatic for families with children, but they too have seen their welfare support allowances eroded between 10 and 13 per cent.

Under the current regime, people on social assistance with earned income face the highest marginal tax rate in the province, namely, a clawback of 75 per cent. This can hardly be viewed as an incentive to find paid work, and turns the principle of progressive taxation on its head (the wealthy in BC are up in arms about a top marginal tax rate of 52 per cent). Viewed another way, if someone on social assistance finds part-time work at the minimum wage, they are effectively being asked to work for \$1.79 per hour. This extremely high taxback is the real disincentive to work. We would argue that, in addition restoring the FREE, subsequent earnings exemptions should be increased from the current 25%. An ideal model would see the earnings exemption phased in after a flat rate, starting at 75% after the FREE, moving to 50% after an additional \$100 of earned income, then to 25%, and eventually to a zero ceiling once total income is deemed satisfactory.

A flat rate earnings exemption recognizes the fixed costs associated with joining the paid labour force (costs such as transportation, appropriate clothing, tools, supplementary child care,

etc.). In most cases, these costs must be born whenever someone takes on paid work, and cannot realistically be afforded under the 75% clawback. Even a \$100 FREE only poorly meets this objective. We recommend that a higher FREE be established for people with disabilities (we concur with the \$300 recommended by the BC Coalition for People with Disabilities), given the higher fixed costs faced by people with disabilities.

The elimination of the FREE forces people to hide their income. Simply put, it is virtually impossible to make ends meet on current welfare rates. Thus, the elimination of the FREE three years ago has effectively forced many to break the law and seek income top-ups in the informal economy (increasing people's sense of economic insecurity). Forced under the table, welfare recipients are more likely to find themselves in exploitative work situations, unable to find recourse through conventional channels.

Restoring the FREE is cheaper than raising welfare rates. Given the sub-standard level of current welfare rates, when assessing the costs of re-instating the FREE, the government's comparison point should not be the status quo, but rather the costs of increasing general rates. This may seem a cynical argument, but if the government is unwilling to raise basic welfare rates (and for the record, we believe the government should raise rates), restoring the FREE should be viewed as a less costly, but nevertheless helpful and necessary, substitute. An extra \$100, given a monthly living allowance of \$175, would make a real and substantial difference to people's lives. In the case of families, an additional \$200 per month – or \$2,400 per year – represents a much needed top-up for children living in poverty. The FREE should be viewed as part of a long-term strategy aimed at ensuring adequate incomes.

The balance of evidence suggests earnings exemptions make a substantial difference to the health and well-being of welfare recipients, and assist in the transition from welfare to paid work, particularly for single mothers (see below).

Would restoring the FREE entice more people onto the welfare rolls, thereby increasing provincial welfare costs?

The short answer is, we just don't know. Expert opinion is divided on this question, in large measure because the answer depends on other factors (such as the state of the labour market) and the unique characteristics of the welfare system (such as the availability of employment support programs), all of which vary greatly between jurisdictions. Most likely, the impact of a FREE on welfare caseloads and costs, whether positive or negative, would be marginal. In the absence of clear data one way or the other, the burden of proof should rest with the Ministry to demonstrate that the costs of restoring the FREE are prohibitive.

One reason to view this question optimistically is that, to its credit, the BC government now extends the Family Bonus and Healthy Kids program (covering dental and vision care costs) to low-income families whose incomes derive mainly from the paid workforce. This represents a significant change since the last time a FREE existed, and makes comparisons with the pre-1996 period problematic. To the extent that many or most people claiming earnings exemptions are single parents (and the data suggests this is so), the Family Bonus and Healthy Kids programs make the "benefits" of staying on welfare less "enticing," given that these benefits are now extended to the working poor as well.

Some research contends earnings exemptions make welfare more attractive, thereby extending the period of time some people will spend on welfare and enticing new clients onto the welfare rolls. This research tends to be from the U.S., it is based mainly on some selective experiments

using negative income taxes, and emerges from a time when welfare rates were, in general, more generous and accessible, putting into question its applicability to the current BC context.

Others maintain that, if done right, a flat rate earnings exemption would help people move from welfare to paid employment. Specifically, if there is a waiting period before a FREE can be claimed (as is the case in BC, where a three month waiting period applies), if there is a ceiling placed on the overall amount that may be claimed as an earnings exemption, and most importantly, if a FREE exists in combination with other forms of employment support (such as high-quality and accessible child care, transportation subsidies, training and education, and a higher minimum wage), there is little reason to believe re-instating the FREE would lead to increased welfare caseloads.

Intuitively, the latter position in this debate seems the stronger. Adding \$100-\$200 dollars to welfare incomes still leaves those on social assistance with an overall income that can hardly be called attractive. Conversely, encouraging people to take on part-time work (which the FREE does) gives people access to improved work experience, new employment contacts, an improved sense of self-sufficiency, and added self-confidence, thereby improving the likelihood of leaving the welfare rolls.

These arguments have resulted in many Canadian provinces instituting flat rate earnings exemptions. PEI, Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, Saskatchewan, and Alberta all have FREES. The FREE systems in place in New Brunswick, Quebec, Ontario and Alberta are all more generous than that which existed in BC even before the FREE was eliminated. [2]

There is now compelling research evidence that earnings exemptions help in the transition to work. A recent British study, entitled "Lone Parent Families: Routes to Social Inclusion," argues that income earnings exemptions are an important incentive for getting single mothers into paid work. A report published last year by the U.S.-based National Centre for Children in Poverty concludes: "While earlier research raised concerns that financial incentives could reduce recipients' work effort, more recent findings indicate that incentives are helping some families improve their income, obtain jobs, and escape poverty without increasing welfare receipt." [3] A 1999 study by Blank, Card and Robins reports, "Evidence also indicates that combining financial incentive programs with job search and job support services can increase both employment and income gains... programs with enhanced earnings disregards also suggest that these programs increase employment." [4] Finally, in late 1996, the Vancouver-based Workfare Hurts One and All coalition conducted hearings into the changes brought about with the introduction of BC Benefits. Some recipients reported having to quit their jobs when the FREE was eliminated, claiming they could no longer afford the fixed costs associated with working.

Ultimately, even if a FREE does result in increased costs to the government, this does not represent sufficient cause not to restore the FREE. The additional income is badly needed, making re-instatement the right thing to do.

In conclusion, the CCPA strongly recommends that the government fully restore the flat rate earnings exemption (and consider raising the FREE to \$200 for singles and \$300 for families), ideally in combination with an increase in the benefits rate and further enhancement of employment support programs.

Endnotes:

1. Michael Goldberg, "Widening the Gap: A Comparison Between the Cost of Daily Living and Income Assistance Rates (BC Benefits) in British Columbia," Vancouver: Social Planning and Research Council of BC, May 1997.
2. National Council of Welfare, "Welfare Incomes 1996," Ottawa: NCW, Winter 1997-98.
3. Ellen Berrey, "Financial Incentives Can be Key to Moving Families Off Welfare and Raising Income, Research Reveals" *The Research Forum on Children, Families, and the New Federalism* (published by the National Centre for Children in Poverty at Columbia University), Vol. 1, No. 3 (Sept. 1998).
4. Rebecca M. Blank, David Card, and Philip K. Robins, "Financial Incentives for Increasing Work and Income Among Low-Income Families," Joint Centre for Poverty Research, Working Paper #1, February 1999.