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The integration of child tax credits and welfare: Evidence from the Canadian National Child Benefit program ☆

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Abstract

In 1998, the Canadian government introduced a new child tax credit. The innovation in the program was its integration with social assistance (welfare). Some provinces agreed to subtract the new federally-paid benefits from provincially-paid social assistance, partially lowering the welfare wall. Other provinces did not integrate benefits, providing a quasi-experimental framework for estimation. We find large changes in social assistance take-up and employment in provinces that provided the labour market incentives to do so. In our sample, the integration of benefits can account for between 19 and 27% of the decline in social assistance receipt between 1997 and 2000.

Keywords: Tax credits; National child benefit; Welfare; Maternal employment; Child benefits

1. Introduction

Policies such as the Earned Income Tax Credit (EITC) and the Medicaid Health Insurance Program in the US have targeted low-income families with children as priority recipients of government assistance. In Canada, the Canada Child Tax Benefit and the National Child Benefit

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(NCB) have similarly been designed to provide assistance primarily for families with children. Along with the goal of providing assistance to these families, both the EITC and the NCB have also been designed to encourage parents to participate in the labour force, with the long-term objective of helping these families provide for themselves instead of receiving transfers.

This type of 'welfare to work' tax credit typically focuses on the working poor, rather than the very poorest in society. Some of this emphasis derives from a concern about the efficiency cost of transfers to the poor.[2] While the poorest may be the most deserving, the loss of output generated by making transfers to them could exceed the value to society of the redistribution. Other motivations for these policies include broader measures of the costs of large transfers to non-workers, such as the effects of long-run dependency and stigmatization.[3]

Recently, Saez (2002) has shown that earnings subsidies to the working poor are preferred to direct transfers to the poorest when the extensive labour market margin is more elastic. The result comes from the high marginal tax rates that accompany direct transfers, as the high tax-back rates serve to discourage any labour market participation among recipients. One of the important goals for empirical researchers, therefore, is to examine the magnitude of the extensive participation responses to labour market policies.

Most of the empirical literature has examined the labour market effects of the EITC in the United States. Because the EITC is a federal program, these studies have tended to rely on variation in the program over time (Eissa and Liebman, 1996; Meyer and Rosenbaum, 2001), or on variation within the program across families (Eissa and Hoynes, 2004; Dickert et al., 1995). Hotz and Scholz (2003) summarize the findings from these and other studies and draw the following broad conclusions: The EITC positively affects labour force participation of single-parent households and these effects are substantial. The EITC has a modest negative effect on labour force participation for secondary workers in two-parent families. Finally the EITC has a negative effect on hours worked for those already in the labour force, although the negative hours effect, in the aggregate, is smaller than the participation effect.

Research on European working tax credits is more limited. In the United Kingdom, Bingley and Walker (1997) find that the Family Credit increased part-time work, while Blundell et al. (2000) simulate the effects of the Working Family Tax Credit (WFTC), uncovering positive work effects for single mothers but negative effects for married women. Several other European countries have introduced, or have plans to introduce, similar measures. Immervoll et al. (in press) describe the pan-European landscape and simulate the effects of in-work versus universal benefits, concluding that universal benefits are only preferred if the government has a very large taste for redistribution.

In our paper, we examine the labour market effects of the National Child Benefit program in Canada. The unique feature of the NCB relative to policies in other countries is its integration with social assistance (welfare) payments. Some provinces agreed to subtract the federally-paid National Child Benefit Supplement benefits from provincially-provided social assistance payments. This structure allowed former welfare recipients to carry part of their total social assistance payments with them into the work force, effectively lowering the 'welfare wall' of high tax rates that faces welfare recipients. Other provinces chose not to deduct the new federal benefit from recipients' social assistance cheques, meaning that the National Child Benefit did not directly

[2] See Immervoll et al. (in press) for an extensive discussion of the efficiency–equity tradeoff in the context of child benefits.

[3] Ventry (2000) provides a detailed history of the political and economic debates that have accompanied the introduction and growth of the EITC in the United States.