Once the link with procreative sexuality — is broken, it is not at all clear why the status and benefits of marriage should be restricted to couples involved in sexual relationships.

archy of choices, which, while preferencing one, does not necessarily denigrate the others, but accords them some degree of calibrated respect. It does this in many other areas. Why not in sexual arrangements?"

Sullivan fleshes this out with an analogy to what already happens in families with homosexual members. In such circumstances, he points out, parents are often "disappointed" that their homosexual children are unlikely to carry on the family line, but nevertheless "prefer to see that child find someone to love and live with and share his or her life with."

Quite so. But follow the analogy through. Just as parents who would prefer a heterosexual marriage for their child now endorse the second choice of a loving, but unmarried, homosexual relationship, so it ought to be possible for society at large to prefer heterosexual marriage without disapproving stable homosexual relationships. Indeed, polls suggest that this is precisely how many people actually view the issue. If Sullivan is indeed open to a "hierarchy of choices," why could heterosexual marriage not remain at the top of the hierarchy? If stable, "assimilated" homosexual relations need some form of public sanction, why would a domestic partnership law not be an appropriately "calibrated" response?

In fact, the kind of sexually indifferent partnership law advocated by Ian McClelland solves one of the knotty problems raised by the same-sex marriage movement. To repeat, advocates of same-sex marriage generally want actively homosexual couples to be eligible for legally recognized marriage; they do not propose to extend marriage to relationships that are not sexually based. A long-term household formed by, say, bachelor brothers would not qualify. But once the link with heterosexuality — that is, with procreative sexuality — is broken, it is not at all clear why the status and benefits of marriage should be restricted to couples involved in sexual relationships. Once procreation is removed as a primary purpose of legal status and benefits, any remaining restrictions must be justified by other purposes of marriage, such as the care-giving function. But, as a letter to the *Globe and Mail* once pointed out, if the purpose of spousal benefits is "to foster stability, love and caring for each other," those benefits should be provided to non-sexual as well as sexual partnerships. "Why," asks the writer, should a society that rejects procreation as the chief purpose of spousal benefits, remain "so mesmerized with sex [as] to make a potential for sexual intercourse the criterion for selecting relationships deserving a special legal and economic recognition?" If we wish to encourage people to take care of each other at the level of civil society, rather than depending on the state, why would we provide incentives for such behaviour only to couples who have sex with each other? Why, for example, should a single adult not be able to designate a dependent sibling or even close friend as the recipient of employee benefits or survivor pensions? A sexually indifferent domestic partnership law could easily permit such non-sexual arrangements.

Sexually indifferent domestic partnership laws extend the incentives for civil-society partnerships as widely as possible, without eradicating the traditional status distinction between procreative and non-procreative sex. This should make such partnership laws comparatively attractive to marriage-law traditionalists. Moderate homosexuals might also find them an attractive alternative because they are likely to be more acceptable to the public, and thus more likely to be enacted, than laws targeted to the homosexual community. That such laws will draw fire from radicals on both the left and the right is itself a signal to moderates that they should be considered seriously.

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The vanishing middle

The Ontario low-income tax rate reduction can reach a fair amont up the income scale; some individuals with a number of children receive this reduction and also pay the Ontario high-income surtax.

Alan Macnaughton, Thomas Matthews, and Jeffrey Pittman, Canadian Tax Journal, *December 1998.*

THE BENEFITS OF UNIVERSALITY

This summary of the authors' forthcoming paper in the Canadian Journal of Economics *argues that targeted social programs, which came to dominate Canadian social policy in the 1990s, are both unfair and inefficient. Unfair because if Canadians decide people shouldn't have to bear the entire cost of raising children, having a hip replacement or acquiring an education, their exemption from cost shouldn't vary according to their income. Inefficient because clawbacks add to the effective marginal tax rate faced by the recipients of social programs, thus increasing the distortion of their work, leisure, investment and saving choices.*

Cet article constitue le résumé d'un texte à paraître dans la Revue canadienne d'économique. *Les auteurs estiment à la fois injustes et inefficaces les programmes sociaux ciblés qui ont dominé la politique sociale canadienne au cours des années 1990. Injustes parce que, bien que les Canadiens aient décidé qu'une personne n'avait pas à assumer la totalité des coûts que représentent, par exemple, l'éducation d'enfants, l'implantation d'une hanche artificielle ou l'acquisition d'une formation spécialisée, l'exemption accordée varie selon le revenu de chacun. Inefficaces en ce que les dispositions de récupération s'ajoutent au taux d'imposition marginal en vigueur – ce qui restreint indûment les choix des Canadiens en matière de travail et de loisir, d'investissement et d'épargne.*

Nicholas Rowe and Frances Woolley

Twenty years ago, Canada had a wide range of universal programs, from health care and education to universal transfers to the elderly and to families with children. Growing deficits and increasing demands on government resources, arising, for instance, from widespread child poverty, made universal programs appear unsustainable. Targeting benefits efficiently became the vogue. As Kenneth Boessenkool put it in earlier this year, "One must ask the question: Do we really want to make cash payments to families making $30,000, $50,000 or more? Doing so appears to be very bad social policy."

The pursuit of "target efficiency" led to the replacement of family allowances and other universal provisions for children with a targeted child tax benefit, making Canada almost unique internationally in its failure to provide all families with at least some fiscal recognition for the costs of raising children. Target efficiency has also lead to the clawback of Old Age Security payments from better-off Canadians, although a federal initiative to create a targeted seniors benefit was eventually abandoned in the face of strong opposition. Universality in health care has been maintained by the federal government's enforcement of the *Canada Health Act*. However the erosion of transfers to the provinces has blunted the federal government's spending power, and the universality of health care can no longer be taken for granted.

The point we wish to make here is, not that there should be universally provided health insurance, old age security benefits, or child benefits, but rather that if Canadians choose to provide health insurance, benefits to children, or other social programs, universal benefits are more efficient than targeted benefits. Our argument for universality does not depend upon administrative costs, the stigma of targeted benefits, political support for social programs, or any of the many other second-line arguments that have been used to defend universality against the onslaught from the promoters of "target efficiency." Our point is simply that targeted benefits result in a structure of effective marginal tax rates which cannot be justified on either efficiency or equity grounds.

The first thing to realize is that people care about the total tax/benefit package they receive from the government. That is, they care about their "effective taxes," not their taxes or benefits alone. If I pay $10,000 in taxes and receive benefits worth $3,000, my effective taxes are $7,000. *Both* tax policy and social policy involve giving benefits and taking income away. The two are intrinsically linked, and must be considered simultaneously. That this is the case is increasingly being recognized by Canadian policy analysts, such as Bev Dahlby, Tom Wilson and Alan Macnaughton, who have recently documented the size of the tax wedge created by benefit clawbacks.

A second thing to understand is that the efficiency cost of taxation arises from the taxation of income at the margin. What counts is the marginal tax rate. For example, a person with a 40 per cent marginal tax rate who works overtime to earn an extra $100 only gets to keep $60 in disposable income. If he values his time at $61, he turns down the opportunity to work overtime, and an opportunity worth $39 (that is, $100-$61) is thrown away. That $39 forgone opportunity is the welfare, or efficiency, cost of taxation.

These two observations together imply that what distorts economic decisions is the marginal tax rate. A person who loses $40 in benefits for every $100 of extra income they earn faces exactly the same disincentives as one who pays an extra $40 in taxes. Both face a 40 per cent effective marginal tax rate. The "clawback" of benefits raises effective marginal tax rates, creates disincentive effects and distorts economic decisions in exactly the same way taxation does. Indeed, this effect has been documented in recent studies by Alan Macnaughton, Thomas Matthew and Jeffrey Pittman, who found that there were more taxpayers facing effective rates of 45 per cent or more in the bottom tax bracket than in the supposedly "top" 31.32 per cent bracket. A lone parent on social assistance facing a loss of benefits if she works longer hours encounters the same sort of work disincentives as a CEO paying the top rate of income tax. Indeed, because social assistance benefits may be reduced by 80 cents or more for each dollar earned, the lone parent usually faces a higher effective marginal tax rate.

A lone parent on social assistance facing a loss of benefits if she works longer hours encounters the same sort of work disincentives as a chief executive officer paying the top rate of income tax.

We can now see the fallacy in the concept of "target efficiency." Those who argue for targeting say that making benefits universal would be costly to the government, and would mean raising tax rates, which would create disincentives and economic distortions. What they forget is that targeting benefits also raises effective marginal tax rates and creates disincentives and economic distortions.

We define universality to mean that the same benefits are paid to rich and poor alike, and are not taxed back from the rich. In a tax/benefit system with universality, therefore, individuals with the same market income face the same effective marginal tax rate.

With targeted benefits, on the other hand, people receiving benefits face clawbacks, and therefore pay a higher effective marginal tax rate than people with similar incomes who do not receive benefits. Which tax/benefit system is best: one with universality, or one with targeted benefits? The inefficiency of targeted provision can be seen with a simple example. We examine the case of child benefits, although the analysis applies equally well to targeting health care or seniors' benefits.

Table 1 shows the difference between the effective marginal tax rates faced by a single earner with two children and a single earner with no children. The figures are based on the child tax benefit rates announced in the most recent federal budget, and are calculated using a simplified version of Canada's current income tax system. In some income ranges, people with children experience an effective marginal tax rate almost twice that of those without children. Put another way, middle income people with children face a very progressive tax schedule, which emphasizes poverty reduction, coupled with high effective marginal tax rates. Their rates reach 45 per cent at an income of $20,000 per year. People without children face a much flatter tax schedule. They don't hit a 45 per cent effective marginal tax rate until their income reaches $70,000 per year, more than twice an average Canadian's earnings. Moreover, the rate schedule shown in Table 1 is actually an improvement over the current system. At present, a two-child family faces a tax-back rate of 26.8 per cent in the $20,921 to $25,921 income range, creating an effective marginal tax rate approximately double the statutory rate, even before payroll taxes, Employment Insurance and Canada/Quebec Pension Plan premiums, are taken into account, not to mention the effects of other targeted programs, such as the GST rebate.

Table 1
Simplified effect of child benefit tax back, single earner family, 2000 benefit levels

Income between ($)	Combined federal-provincial tax rate	Benefit tax back rate	Effective marginal tax rate	
			With children	No children
0 - 12,000	0	0	0	0
12,000 -20,000	25	0	25	25
20,000 - 30,000	25	20	45	25
30,000 - 60,000	40	5	45	40
60,000 - 70,000	45	5	50	45
70,000 +	45	0	45	45

Statutory tax rate calculated assuming provincial taxes are 50 per cent of federal taxes. Actual provincial taxes may be higher or lower.

A government aiming to maximize social welfare must balance efficiency considerations, which argue for low tax rates, with equity considerations, which argue for the higher tax rates needed to finance redistributive social programs. We do not know — we suspect no one knows — what an optimal tax rate schedule would look like. But it seems very unlikely that either efficiency or equity requires radically different tax schedules for Canadians with and without dependent children.

The equity argument for targeting benefits is that it is unfair to pay benefits to those who are not deserving of them. As Ken Boessenkool said, "Do we really want to make cash payments to families making $30,000, $50,000 or more?" There are three problems with this argument. First, if benefits are targeted, then benefits for poor children are effectively paid for by higher taxes on other children, as can be seen in Table 1. This is exactly what happened when Canada's child tax benefit was first introduced. Fighting the problem of child poverty by taking money away from other families with children hardly seems fair.

Second, targeting benefits compromises the horizontal equity of the tax benefit system. Consider two people, both earning $70,000 a year, one of whom needs a hip replacement and the other does not. Though neither is "needy" in any absolute sense, the first is clearly more needy than the second. By providing universal health insurance, the Canadian government equalizes their discretionary incomes, so they both have the same amount to spend on the good things in life. If caring for children creates a need that Canadians consider worthy of tax recognition — and we suspect this is the case — then that recognition should go to all parents, regardless of their labour market skills or choices.

Third, direct payments to the care-giving parent can achieve goals that deductions or non-refundable credits cannot. Refundable credits or cash payments provide an independent source of income to stay-at-home parents, whereas deductions are only of value to those already earning enough to pay income tax. A recent study by Shelly Lundberg, Robert Pollak and Terry Wales found that, when Britain replaced the child deduction with a child benefit paid directly to mothers, family expenditure patterns changed measurably, with more income being spent on, for example children's clothing.

If equity arguments don't justify targeted programs, what about the "target efficiency" argument against universal benefits, namely that paying benefits to all families makes it difficult to increase payments to those least well off without enormous budgetary expense and, as a corollary, higher taxes? Increasing payments to poor families with children increases the progressivity of the tax system, and necessarily requires higher marginal tax rates. With universality, those higher tax rates are shared between those with children and those without. With targeted benefits, the higher tax rates are only experienced by families with children.

In general, universal benefits, which create a single effective marginal tax rate, are superior to targeted benefits, which lower effective tax rates for some and raise effective tax rates for others. The reason is, as any textbook in public finance will show, that the efficiency losses from taxation increase with the square of the marginal tax rate. For example, if the efficiency costs of a 10 per cent tax are 10 per cent of revenue raised, the efficiency costs of a 20 per cent tax will be 40 per cent of revenue raised, all else being equal. This means that the efficiency gain from reducing taxes on people with children from, say, 45 per cent to 35 per cent, is greater than the efficiency costs of raising tax rates on similarly situated people without children from perhaps 25 to 35 per cent. Moreover, because families with children are in the minority, reducing the current 20 per cent tax back rate faced by modest income families to 10 or 5 per cent would require only a small — perhaps three or four per cent — increase in overall tax rates over the same income range.

There are some conceivable circumstances where the inconsistent tax treatment of those with and without children would make economic sense. First, suppose that people with dependent children respond less to economic incentives than people without children. Suppose, in other words, they have a less elastic labour supply and so the amount they choose to work is less affected by high marginal tax rates. If this were true, it would make sense to make them face a higher effective marginal tax rate than people without children, because the distortions and efficiency losses would be less in their case. Yet all empirical evidence suggests that women with children under 16, the primary group receiving child benefits, have *higher* labour supply elasticities than other population groups, which suggests that they should be subject to particularly low, not particularly high, marginal tax rates. Indeed, labour supply elasticity considerations argue for lowering marginal tax rates on women by giving *increasing* child benefits with income. This could be accomplished through a child deduction, or French-style system, which allows income splitting between parents and children.

Second, suppose that paying benefits to those in need created a "moral hazard" problem. For example, Canada's universal health insurance may cause overuse of medical resources as people visit doctors unnecessarily or fail to take adequate care of themselves. If true, this would mean that everybody should have to pay some portion of the cost of health care. But the only way to justify abandoning universality would be to argue that this moral hazard problem is more severe for the rich than for the poor, so that the rich should co-pay, but the poor should receive universal coverage. This is scarcely plausible for health care, and even less plausible for children.

Many debates about tax and benefit policy are in fact debates about the relative importance of equity and efficiency. For example, a policy of increasing taxes to pay for higher welfare benefits would buy more (vertical) equity at the expense of reduced efficiency, due to disincentive effects. But going from targeted benefits to universality improves both equity and efficiency. We think of it as "parallel equity." In our view, the difference in tax/benefit treatment between those with and without children, between the sick and the healthy, between the young and the old, should be the same at every income level. Similarly, the efficiency benefits of universality are subtle. We are not talking about lowering effective marginal tax rates for everyone, which would promote efficiency but reduce vertical equity. Instead we are talking about equalizing effective marginal tax rates between those who do and those who do not need medical care, support for their old age, or recognition of the costs of dependent children. Once this is understood, universality deserves support from all ranges of the traditional political spectrum — from those who emphasize equity to those who emphasize efficiency. Many public policies are advertised by their supporters as being "win-win." Universality really is.

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Favourite StatsCan headlines

FARMERS LOSING INTEREST IN FIELD PEAS

Statstics Canada, The Daily, *23 March 1999.*

DON'T SELL HYDRO SHORT

The Ontario government thinks Ontario Hydro's assets are worth just $17.1 billion, compared to its debt of $38 billion. In fact, Hydro's value may be as high as $51.2 billion, depending on the outcome of a three to five year program to increase the efficiency of its nuclear plants. Before selling off much of the province's electricity industry to foreign multinationals, who, motivated only by profit, would raise electricity prices to their level in neighbouring US states, the government should wait to see the results of the efficiency drive.

Le gouvernement ontarien croit que les actifs d'Hydro Ontario ne valent que 17,1 milliards $ alors que la dette de cette dernière s'élève à 38 milliards. En fait, selon les résultats que produira le programme mis en place par le gouvernement pour accroître l'efficacité de ses centrales nucléaires et s'étendant sur une période de trois à cinq ans, la société d'État pourrait valoir jusqu'à 51,2 milliards $. Le gouvernement ontarien devrait donc attendre de mesurer les résultats de ces efforts, avant de vendre une part importante de l'industrie électrique de la province à des multinationales étrangères. Ne cherchant que le seul profit, celles-ci auraient tôt fait de hausser les tarifs d'électricité au niveau de ceux que l'on pratique dans les états américains voisins.

M.J. Gordon

With the passage of the *Energy Competition Act* in 1998, the Harris government has begun the process of privatizing Ontario Hydro and deregulating the energy industry in Ontario. Its hope in doing so is that the proceeds from the sale will cover Hydro's $38 billion debt, for which the province has a contingent liability, and that electric power rates will not be increased.

Fortunately, the process of privatization and deregulation has only just begun — "fortunately" because there is no way in which the government's hopes can be realized. The cost to the people of Ontario of completing the process may well prove to be enormous. Hydro's plants would be sold at prices far below their value, so that as much as half of its $38 billion debt could become a direct liability of the province. The substitution of private ownership for a crown monopoly would end Hydro's exemption from NAFTA's procurement rules and see ownership of the industry pass to foreign multinational corporations.

With deregulation and foreign ownership, profitability would become the sole criterion for investment and pricing decisions. Reserve capacity would disappear and the reliability of service would decline. The price of electricity is at least 40 per cent higher in the states that border on Ontario, and the profit motive would eliminate that difference by raising the price in Ontario, not lowering it south of the border.

Anyone who looks on these predictions as baseless speculation should consider what has already taken place. The Ontario Financing Authority under the minister of finance has drawn up a financial plan for the privatization of Hydro. The Market Design Committee under the energy minister has created the "design" for a competitive market to replace the crown monopoly.