

## **From pleasure to terror: Why unexpected money is a problem for the poor**

***The purpose of this commentary is to build support for assets based approaches to poverty reduction such as those proposed by Social Enterprise Development Innovations (SEDI) in the context of Learn\$ave and St. Christopher House in its Registered Development Savings Plan (RDSP) proposals.***

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### **The Experiment**

I would like you to consider a short ‘thought experiment’. You are called to the phone from a busy meeting. Your attempts to inquire from staff as to the identity of the caller are unsuccessful. Somewhat annoyed, you testily repeat your name to the caller and ask how you can help her.

The caller identifies herself as a worker from a charity draw you entered and had forgotten. She informs you that you have won the second prize of \$8,000 tax-free. She would like to know how you would like to arrange to be paid. You begin to smile despite your best efforts to remain irritated by the interruption. You involuntarily begin speculating how you will spend the funds. This is definitively going to be a good day.

Most people would have much the same reaction. Winning a nice bit of cash or getting a windfall from an unexpected source is a pleasurable event.

### **From Pleasure to Terror**

But this is not the case for a significant portion of the poor. Benefits from a variety of government sources that go to the poor are almost always income tested and often tested for assets and need. The staff who run these programs closely monitor them. A minor<sup>1</sup> windfall, instead of being a happy event, often strikes terror into the heart of the poor.

On a personal note, I have talked to scores of welfare and disability support recipients over the past two years who have seen receipt of unexpected money as a real problem. In these instances, the money seems to come in about four different forms:

- A small unexpected inheritance
- A lottery or gaming win
- A lump sum back payment from another benefit program; or
- A payout from a compensation scheme

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<sup>1</sup> I use ‘minor’ to mean any amount that will be insufficient to meet an average person’s income requirements in Canada for a year.

## **The Feeding Frenzy**

Depending on the source, the benefit programs that are designed to take income, need, and assets into account are mandated to either stop or curtail their payments. They often stop payment at the moment that the poor person receives the money. For example, a single lump sum windfall of \$8,000 reported to benefit program administrators can have the following cumulative effect on a low-income adult:

- All social services payments paid on behalf of all family members including children come to a halt sometimes days before their delivery
- Eligibility for required prescription drugs for all family members including children are cancelled within weeks of reporting the windfall, regardless of how much of the prescription remains at the time of cancellation
- Eligibility for dental benefits are cancelled for all family members including children within a month, regardless of the course of any treatment
- Rent-geared-to-income rents rise
- Child care fees increase; and
- Legal fees covered through legal aid cost more.

Later on, over the course of the year, depending on the source of the income, income taxes could rise while GST credits, Property and Sales Tax Credits, and National Child Benefit Supplements may be reduced. Since few of these programs coordinate the way in which they treat income, it is possible within a very short time, to lose more (in the form of benefit loss) than the original value of the windfall.

## **Climbing out of the maze**

No wonder that the initial pleasure turns to terror, especially for those who have already been through the experience. What's worse is that once benefit programs are cancelled or reduced, it is often difficult to reinstate them. Proof that the money has been spent (or otherwise disposed of) is required and different programs require different levels of proof.

In addition, varying treatment of different forms of income can result in a level of complexity that would only be understandable by a small group of experts. The outcome for the poor is a level of uncertainty that mitigates against sound money management strategies.

## **Some good news**

But there is also some good news nested within the complexity. Most government benefit programs exempt various forms of income and assets. Most exempt one-time compensation programs such as the Hepatitis C program as well as payments made to individuals for pain and suffering. Many programs do not reduce their own benefits when someone receives a lump sum payment from another program.

The other good news is that most welfare-based programs (i.e. income needs, and assets tested programs) have a clause that allows windfalls from certain sources to go towards items that benefit the person. The rub is that these programs usually have rules that require the funds to be spent quickly. Most poor people oblige, leading to what most of us know as the 'welfare-induced spending spree'.

## **The spending spree: a public policy choice**

It is hard to imagine a policy and a set of outcomes more at odds with public sentiment than the welfare-induced spending spree. So how did we get there? The simple answer is that there are inherent unresolved conflicts between meeting need, spending government resources wisely, and supporting immediate vs. long-term self-sufficiency.

On the one hand, the public tends to see poverty as an individual deficit that the poor ought to overcome, hopefully with a minimum of help. The public also supports the goal of self-sufficiency at the same time that it believes that programs for the poor should only be available as long as they are required. So far so good.

But the public also believes that policy outcomes should be positive when worthy goals conflict. The spending spree that is induced by welfare rules is an example of a negative outcome that has no support in any quarter but is regarded by some as the regrettable but necessary outcome of the arithmetic of inevitable social policy tradeoffs.

## **Some alternatives to the spending spree**

But it doesn't have to be like this. There are several things that can be done that allow poor people to retain a windfall (and use it wisely) while maintaining the integrity of the income and asset sensitive elements of benefit programs for the poor.

The first is to allow people to keep the money in a special account to be used wisely later on in life or to provide for retirement income. Social Enterprise Development Innovations (SEDI) has advocated for the adoption of Individual Development Accounts (IDA's) and is now testing (along with the federal government), the Learn\$ave project, an IDA specifically aimed at savings for future education. Minor windfalls often help participants stay the course in terms of monthly savings requirements.

St. Christopher House (a community based multi-service agency in Toronto) has advocated for the establishment of a special registered savings account called a Registered Development Savings Plan (RDSP). Under this approach to windfalls, savings would be put aside, free from taxes, to be spent on worthwhile items when required at a later date. The RDSP construct is a form of Tax Prepaid Savings Plan (TPSP) originally formulated by Jonathan Kesselmann and Finn Poschmann for the C. D. Howe Institute.

A second approach would be to allow a much longer time frame to dispose of windfalls in a way that avoids a spending spree induced by the sudden and catastrophic loss of a variety of benefits. It's one thing to lose benefits from a variety of sources all at once. It is quite another thing to lose them suddenly and virtually without notice or regard for crucial drug or dental treatment therapies being provided (as often as not to a child). It is worse to lose them with the prospect of losing even more later on.

A third approach is to view self-sufficiency as a goal more likely achieved through policies that plan for it in the medium to long term rather than to suddenly impose it for a short period. Research conducted in the United States has indicated that persons who leave welfare but who attain and keep resources are half as likely to return to welfare than their counterparts with few or no resources.<sup>2</sup> This may mean less Draconian policies may save more money than they cost.

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<sup>2</sup> Pamela Loprest, Who Returns to Welfare? Urban Institute, <http://www.urban.org/> September 2002

The following chart juxtaposes suggested new approaches against the current policies and their objectives

| <b>Social Policy Objectives</b>      | <b>Current 'Windfall' Policies</b>   | <b>Possible New 'Windfall' Policy</b>   |
|--------------------------------------|--|---|
| 1. Meeting Need                      | Provide benefits where no other resources are available.<br>When other resources available, use immediately until consumed.            | Build assets and savings for use at best possible time in short to longer term.<br>Develop rules to ensure resources spent wisely.                            |
| 2. Using Government Resources Wisely | Ensure only those in greatest need obtain assistance. Cut assistance when other resources available. Short term certain savings result | Allow longer period to deploy windfalls.<br>Base policies on assumption that self-sufficiency is a long term goal not achieved through immediate benefit loss |
| 3. Self-sufficiency                  | Immediate short term   | Longer term approach  |

### **Conclusion**

Welfare induced spending sprees and sudden multiple program reductions are not inevitable. It is worth the effort to attempt to convince a sceptical public that:

- In exchange for social programs that spend a few more short term dollars while
- Continuing to assist people who have received a minor windfall

It is in the public interest to wisely use government and the personal resources of poor people on longer-term self-sufficiency plans.

They would avoid spending sprees that may produce savings greater than those achieved through immediate and catastrophic disentanglement to benefits.

If some of these changes are made, perhaps a minor windfall will bring a smile to the face of anyone (the way it should).