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Sustaining Public Pensions in Canada:
a Tale of Two Reforms

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A. Introduction

Confronting (like other industrialized countries) strong demographic and economic pressures that are taxing its capacity to sustain its pension commitments, Canada has implemented fundamental structural changes to its retirement income system. While this paper deals exclusively with reforms to the Canadian system’s two public tiers, less sweeping but still important changes also have been made to the third tier of tax-encouraged private pension provisions – employer-sponsored pension plans and individual retirement savings accounts (known in Canada as Registered Retirement Savings Plans).¹

The first part of the paper deals with changes to the elderly benefit programs that make up the foundation of Canada’s pension system: Significant structural reforms were successfully implemented in the 1980s and 1990s, but a more radical effort at completing that reform process, in the mid-1990s, proved a political failure. On the other hand, the federal and provincial governments together managed to negotiate equally significant reforms to the contributory Canada Pension Plan and Quebec Pension Plan that constitute the second tier of Canada’s retirement income system. The conclusion offers some reasons for the different outcomes of reform.

B. Reform of Elderly Benefits: From Universality to Income-Testing

Canada has a fairly complex collection of income payments for the elderly that constitute the foundation layer of its three-layer pension system. Some elderly benefits are delivered through traditional direct spending programs while others operate through the income tax system. Both the federal and provincial levels of government are involved, though the federal government dominates. The various programs reflect different histories and different purposes and – as a result – exhibit varying and sometimes conflicting designs. While the essential purpose of the country’s elderly benefits are to serve the retirement income system’s anti-poverty objective, they also contribute to the earnings-replacement objective – with resulting tension given the sustainability problems facing a country like Canada with its rapidly aging population, slower economic growth, and serious deficit/debt pressures that only recently have been brought under control.

Canada’s elderly benefits system is comprised of three federal direct spending programs – Old Age Security, the Guaranteed Income Supplement and the Spouse’s Allowance – and two tax-delivered benefits, the age credit (an exemption before 1988) and the pension income credit (a deduction before 1988). Ottawa and the provinces share the cost of the two tax benefits, which reduce both federal and provincial income taxes, so in that sense they are effectively joint federal/provincial programs. Eight of the ten
provinces and the three territories provide income supplements for their low-income seniors, most based on the federal Guaranteed Income Supplement; only Quebec and Prince Edward Island do not have such supplements.

Canada’s elderly benefits system in 1985: universal and unprogressive

Figure 1 shows the distribution of the various federal elderly benefit programs in 1985 – the year prior to a series of significant changes – for single Canadians 65 or older. Old Age Security was a universal program serving all seniors at all income levels, but because its benefits are subject to federal and provincial income taxes, it demonstrated a gradually progressive distribution of benefits – the higher the senior’s income, the smaller the after-tax benefit, and vice-versa. The Guaranteed Income Supplement was (and remains today) a non-taxable program geared to low-income seniors; its high benefit reduction rate of 50 percent (of non-Old Age Security income) ensures that it is targeted to the poor and steeply progressive in its distribution of benefits. (Not shown here is the Spouse’s Allowance, which serves some but not all low-income persons aged 60 to 64 – among the latter, it excludes those who never married or are divorced or separated – is sharply targeted like the Guaranteed Income Supplement). The age tax exemption (for taxfilers 65 or older) excluded the poorest seniors below the taxpaying threshold and was regressive in impact, providing federal and provincial income tax savings that increased with rising marginal tax rates; the income tax system in those days had ten brackets, with marginal tax rates ranging from 6 percent to 34 percent. The pension income deduction allowed taxfilers to deduct from taxable income up to $1,000 in private pension income (from employer-sponsored pension plans and RRSPs) and was, for the same reason as the age exemption, regressive in impact.

These programs had varying, though in some cases similar, rationales. Old Age Security provided a universal foundation for Canada’s retirement income system; it was a ‘demogrant’ paid to all seniors, no matter what their level or sources of income, their economic circumstances or their experience in or not in the paid labour force. Old Age Security played (and still plays) an important role in both of the retirement income system’s basic objectives: With the Guaranteed Income Supplement and the Spouse’s Allowance, it served the anti-poverty objective. But Old Age Security also contributed (and still contributes) to the earnings-replacement objective for seniors at all income levels, though in inverse proportion to income.

The universal nature of Old Age Security was justified as a way for society – through payment of a cash benefit from the state – to recognize the contribution that all elderly women and men, regardless of income, make to Canada. Universalists argue that universal programs like Old Age Security and Family Allowances are required to provide a solid foundation for the social security system, upon which income-targeted programs can be erected; without some social programs that benefit all income groups, so the argument goes, the middle class and well-off Canadians will have no stake in the welfare state and so will be less willing to pay taxes to support programs for the poor. Universal
programs are claimed to be safer from cost cutting because they supposedly enjoy broad public support. The three pillars of the universalist welfare state in Canada — Old Age Security, Family Allowances and medicare (meaning universal public health insurance) — were seen to foster a sense of social solidarity that is a distinctive element of the Canadian national identity (distinct from the US) and to help offset the divisive effects of the country’s regional, ethnic, linguistic and socioeconomic cleavages.

Launched in 1952, Old Age Security furnished a modest benefit that only weakly addressed the anti-poverty objective. The Guaranteed Income Supplement and the Spouse’s Allowance were added in 1966 and 1975, respectively, to bolster Old Age Security’s capacity to ensure a basic income for poor seniors. The new programs improved the elderly benefits system’s anti-poverty capacity, which subsequently was strengthened by several increases to the Guaranteed Income Supplement, over and above the normal annual indexation. However, the income guarantee from the programs fell — and still falls — short of the most commonly used poverty line in Canada. In 2001, Old Age Security and the Guaranteed Income Supplement together paid $11,451 to single seniors, which comes to 60.8 percent of the $18,829 low-income line for one person living in a metropolitan centre of 500,000 or larger; the maximum amount for elderly couples was $18,565 or 78.9 percent of the $23,535 low-income line.

The rationale for the age exemption was that seniors typically must live on less income when they retire — often much less — and so merit some tax relief to improve their disposable income; the ‘societal recognition’ argument used for Old Age Security also was advanced for the age exemption — i.e., that the elderly deserve special treatment in recognition of their long contribution to society and the economy. The pension income deduction, which gave an income tax break to taxfilers with private pension income, was intended to provide an incentive for Canadians to save for their retirement and also to help maintain the purchasing power of (mainly unindexed or only partially indexed) private pensions.

The argument in favour of providing such tax assistance in the form of a deduction from taxable income hinged on the concept of horizontal equity. The age exemption ensured that elderly taxpayers paid proportionately less income taxes than non-elderly taxpayers at the same income level throughout the income range. The non-refundable age credit, which replaced the age exemption in 1988 as part of a general reform of Canada’s income tax system, is a weaker method of achieving the objective of horizontal equity because it is (for all but poor seniors) a flat-rate benefit whose value in terms of income tax savings thus declines proportionately with increasing income. As a result, higher-income elderly taxpayers’ tax advantage over non-aged taxpayers with the same income declines with rising income. The same argument holds for the pension income deduction, which also was converted to a non-refundable credit in 1988.

One of the strengths of Canada’s elderly benefits system is that its three major direct programs — Old Age Security, the Guaranteed Income Supplement and Spouse’s Allowances — are fully indexed quarterly to the cost of living as determined by the
Consumer Price Index. However, the age exemption/credit (along with the rest of the income tax system) was partially deindexed from 1986 through 1999, though full indexation was restored as of 2000. The pension income deduction/credit is not indexed.

In combination these programs created a universal system that was progressive only for the poor and basically flat for all other seniors. Figure 2 shows the distribution of total elderly benefits for a single pensioner in 1985; figures have been converted to constant 2000 dollars to allow comparison to the current system, discussed later. Old Age Security and the Guaranteed Income Supplement combined to provide a maximum benefit of $11,116 for the poorest seniors; eligibility for Guaranteed Income Supplement ended at total income of around $18,000. But above this relatively low income level, total elderly benefits remained virtually flat at around $6,000. The regressive age exemption and pension income deduction offset the progressive taxable Old Age Security, so that in effect gross and net Old Age Security ended up the same. As a result, a senior with an income of $18,000 received $5,866 in elderly benefits - $115 less than the rare individual with an income of $120,000, or seven times as much. The ‘old’ elderly benefits system was universal not only in reach, but in impact as well for all but the poor.

**Conservative government ends universality and advances progressivity: 1986-1991**

The first attempt to change Canada’s elderly benefits system was a political flop. The new Conservative government’s inaugural Budget, in 1985, sought to partially deindex the Old Age Security program; rates would have been adjusted only for the amount of inflation over three percent. Seniors’ interest groups, reminding Canadians of the bad old days before Old Age Security was fully indexed in 1973, stared down the government by winning widespread support from other groups and public sympathy for their cause. Prime Minister Mulroney was embarrassed for the first time in his mandate on national television when castigated by a near-senior named Solange Denis, whose small stature added a David-and-Goliath flavour to the episode, and the media and the government’s critics had a field day.

The partial deindexation proposal was a ham-fisted attempt at cost control of Old Age Security, an increasingly expensive program because of the relentless increase in the number of seniors. If the Conservatives had used the gambit of their Liberals predecessors, who as part of their anti-inflation program partially deindexed Old Age Security but made up the difference for low-income seniors by super-indexing the Guaranteed Income Supplement, they might have got away with partially deindexing Old Age Security by protecting the poor – and still would have managed to reap significant savings.

The Old Age Security debacle was the Conservative government’s sole reversal on pension policy and, for that matter, social policy. The same Budget that failed to partially deindex Old Age Security succeeded in partially deindexing the personal income
tax system: tax brackets, personal exemptions (including the age exemption) and deductions. Partially deindexing the income tax system was an astute revenue-generating move that steadily and surreptitiously eroded the value of exemptions and deductions (hence imposing a hidden annual income tax hike on all taxpayers) and moved some taxpayers into higher tax brackets (it worked best when there were a lot of tax brackets, as there were before tax reform in 1988). The Finance Minister’s inflation-over-three percent formula, which he also applied to child benefits, meant that the value of tax exemptions and deductions as well as Family Allowances automatically lost three percent of their value each year if inflation ran three percent or more or the amount of inflation if the latter were less than three percent. The pension income deduction, which allowed taxfilers to deduct up to $1,000 in private pension income, had been frozen since 1983 and remains so today.

The partial deindexation of tax brackets, exemptions and deductions had three significant effects. First, it imposed a hidden and regressive annual tax increase on taxpayers, including the aged. Second, the measure gradually lowered the income tax threshold each year, adding increasing numbers of low-income Canadians to the income tax rolls each year. Some modest-income seniors had to pay taxes for the first time; the federal taxpaying threshold for single pensioners fell from $9,887 in non-Old Age Security income in 1980 (in constant 1995 dollars) to $6,541 in 1995. Finally, partial deindexation meant that the after-tax value of taxable social benefits – including Old Age Security, the Canada Pension Plan and the Quebec Pension Plan – declined steadily over time as income taxes took an ever-increasing bite. In effect from 1986 though 1999, the policy of partial deindexation reaped substantial cumulative income tax increases [Battle 1998; Poschmann 1998]; full indexation was restored to the income tax system and child benefits only in 2000, when the federal government declared victory over the deficit.

I coined the term ‘social policy by stealth’ to characterize the Conservatives’ style and technique of policy reform [Battle 1990]. Largely through the use of technical changes such as partial deindexation, they imposed hidden increases in federal and provincial income taxes on all taxpayers and an effective annual hike in the Goods and Services Tax (Canada’s version of a value-added tax) for the poor (by weakening the income-tested Goods and Services Tax credit), while at the same time eroding the value of child benefits and federal social transfer payments to the provinces.

The next change to elderly benefits came in 1988, with an income tax reform that broadened the base of taxable income by converting personal exemptions and most deductions to non-refundable tax credits, and lowered tax rates (though not in all cases) and reduced their number from ten to three. The age exemption was $2,640 in 1987, though its value in terms of federal and provincial income tax savings varied according to the taxfiler’s marginal tax rate (there were ten before the 1988 reform). The age exemption was converted to a non-refundable credit of $550, calculated as 17 percent (the lowest marginal tax rate in the new system) of what became known on the income tax return as the ‘age amount’ of $3,236. The increase in the age amount was intended to help compensate for the abolition of the interest income deduction, which had helped
many seniors (including those with relatively modest incomes) who have some income from savings and investments. Non-refundable credits with a ceiling (as is the case for both the age credit and pension income credit) provide equal federal and provincial income tax savings to all taxpayers who qualify for the maximum amount. The change from exemption to non-refundable credit affected seniors differently, depending on their level and sources of income; another factor to be taken into account is the fact that tax rates changed as well (e.g., the top marginal tax rate was reduced from 34 to 29 percent).

Although the age credit does not vary in value as much as the age exemption it replaced, and is not regressive overall, it is worth less than the maximum for low-income seniors with little tax liability. For elderly taxfilers with incomes low enough that they do not require the full amount of the age credit to reduce their taxes to zero, the age credit is worth the amount of their basic federal tax. The age credit is worth its maximum amount for elderly taxfilers who still owe taxes after factoring in the age credit. Married spouses whose incomes are not high enough to require the full age credit can transfer the unused portion to their spouse, up to the maximum amount.

The federal Conservative government also converted the $1,000 pension income deduction to a non-refundable credit worth up to $170 (17 percent of $1,000) in federal income tax savings and, on average, $94 in provincial income tax savings, for a combined federal/provincial income tax savings of $264, though of course taxfilers with less than $1,000 in private pension income receive a smaller tax break. Under the old pension income deduction, the maximum federal/provincial tax savings varied from $93 to a claimant in the lowest tax bracket in 1987 (with taxable income under $1,295) to $527 for a taxfiler in the highest tax bracket (with taxable income over $62,160). Like the age credit, any unused portion of the pension income credit can be transferred from the lower-income spouse to the higher-income spouse.

Although the federal government restored full indexation to the income tax system in 2000, most credits (including the age credit) were not compensated for past losses. The reindexed age credit in 2000 was worth $600 in federal tax savings and about $300 in provincial income tax savings, for a total maximum tax savings of $900. But it had never been partially deindexed, it would have been worth $736 in federal income tax savings and some $368 in average provincial income tax savings, for a total $1,104. Most seniors paid $204 more in income taxes in 2000 than if the age credit had not been partially deindexed. The pension income credit is not indexed at all, not even partially, so its value has declined even more than the age credit over time. If the pension income credit had been fully indexed, in 2000 it would have been worth a maximum $341 in federal/average provincial income tax savings rather than its actual $255.

Universality died not with a bang but a ‘clawback’ in 1989. The Finance Minister announced that Old Age Security recipients with net incomes over $50,000 (the ‘threshold’) would have to repay 15 cents of their Old Age Security for every dollar of income above the threshold, over and above their normal federal and provincial income taxes; to complicate matters further, the amount of the clawback is treated as a deduction.
(Actually, it took until 1991 for the full clawback to come into effect and universality to disappear, because the change was phased in one-third at a time over three years.) Once net income exceeded a certain point – $72,521 when the clawback was introduced – seniors would have to pay back at income tax time all of the Old Age Security they had received the year before, which struck me at the time as a peculiar way to run a social program. During this bizarre Alice-in-Wonderland episode in Canadian social policy, the federal government continued to send out monthly Old Age Security cheques to all Canadians 65 or older but required upper-income seniors to pay back part or all of their benefits the next spring on their income tax return. Ottawa claimed that the program was still “universal,” but in effect it imposed an *ex post facto* income test through a weird administrative mechanism that I argued at the time meant that well-off seniors effectively got an interest-free loan (i.e., the temporary use of their monthly Old Age Security payments) for one year.

The beauty of the clawback from the federal government’s point of view is that it is a prime example of social policy by stealth – a technical measure so arcane and complex that few Canadians outside of a handful of social policy wonks and seniors’ groups understood what was going. Another stealthy feature is that the clawback was partially deindexed, which means that it fell steadily each year in value, reaching more and more seniors and recouping an ever-increasing amount of money for the federal treasury as the gap between gross and net Old Age Security expenditures widens. In a report I wrote while Director of the National Council of Welfare, I calculated that a 35 year-old Canadian earning $40,000 when the clawback was announced in 1989 (the average male worker earned $39,000 that year) would end up at age 65 with only one-quarter of his/her Old Age Security benefits (an estimated $1,001) after taxes and clawback, as opposed to 60 percent ($2,358) under the old system when benefits were subject to normal taxation but no clawback [National Council of Welfare 1989: 16-19].

The Old Age Security clawback was set high enough that it affected relatively few seniors in its early years. The 1989 Budget estimated that it would touch only four percent of Old Age Security recipients at first. The measure saved the federal government only $400 million in 1995-96, which was tiny compared to the total cost of Old Age Security ($16 billion). But as the partially deindexed income threshold for the clawback declined steadily in real terms each year, more and more seniors (at declining income levels) were subject to the clawback and, while they still ended up with partial benefits even after the clawback, the latter effectively took a bigger bite out of their payments. In addition, the income level above which benefits were fully taxed back fell in small but steady steps and so also eroded benefits. The percentage of seniors hit by the clawback had increased to five percent by 2000; that figure would have continued to increase over the years – had the Liberals not restored full indexation as of 2000.

The clawback on Old Age Security and Family Allowances was a milestone in the history of Canadian social policy, even if the clawback on Old Age Security affected relatively few seniors at first (more families were hit). The clawback marked the end of the universal foundation of the child and elderly benefits systems, one of the ‘sacred
principles’ of the universalist welfare state. In 1993, the Mulroney government went all the way with Family Allowances and replaced that universal program, along with the refundable and non-refundable child tax credits, with a single family income-tested Child Tax Benefit [Battle and Mendelson 2001].

The Conservative government paved the way for further changes to elderly and child benefits under the Liberals. The Conservatives established the direction, substance and mechanisms of change and bequeathed to their Liberal successors the political momentum for further reform. The political climate for pension reform – and public policy generally – changed significantly under the Conservatives. Canada – like many other countries – struggled with the collision between pay-as-you-go public pension programs and demographic and economic pressures, and with the growing strains on the welfare state in general. In Canada, the politics of stealth and the federal government’s successful campaign to convince the public of the need to quell the deficit and slow the mounting debt the deficit enabled it to make paradigm-shifting changes to the welfare state with relative political ease. Seniors, women’s and social groups railed just as vigorously against the clawback on Old Age Security and Family Allowances as they had about the attempt to partially de-index Old Age, but to no avail. This time, the government stood firm. By the end of the Conservatives’ second and final term, Family Allowances were extinct and universal Old Age Security was gone in all but name.

More income-testing under the Liberals: 1994-1996

The Liberal government inherited from the Conservatives and left intact the well-oiled and powerful machinery of stealth – partial indexation of the personal income tax system, of the refundable GST credit, of federal social transfers to the provinces and of child benefits – which invisibly grew revenues and shrunk social benefits. The Liberals made additional incremental changes to elderly benefits that followed the Conservative direction, though these proved far less controversial – until the attempt at more radical reform through the Seniors Benefit, recounted below.

The Liberals’ inaugural (1994) Budget income-tested the age credit. Only taxfilers with net incomes under the then threshold of $25,921 can claim the maximum age credit. The credit is reduced at the rate of 15 percent of income above the threshold (the same reduction rate as the clawback), which means that it disappeared once a senior’s net income exceeded $49,134. Since lower-income seniors cannot qualify for the full age credit, the latter indicates an up-flat-down distributional pattern. Income-testing the age credit saved the federal government an estimated $300 million a year when fully phased in by 1996-97 [Department of Finance Canada, 1994: 43].

The 1995 Budget made two changes to elderly benefits. To correct an inequity and plug a revenue leak, seniors who live outside of Canada have to report their worldwide income (i.e., their income from all sources, inside and outside Canada) in order to receive Old Age Security benefits; up to this point, they have not been required
to report either their Canadian or non-Canadian income and so have not been subject to the clawback. However, there is a hole in the dike: Elderly Canadians living in the United States avoid the clawback because the income-testing mechanism is administered not through the Old Age Security program but through the income tax system, which imposes a limit on the amount of Canadian income tax that can be collected from Canadians living in the US.

Effective July 1996, Old Age Security was income-tested before rather than after the fact, based on seniors’ incomes for the previous year as reported on their tax form. This change completed the conversion of Old Age Security from a universal to income-tested program, since upper-income seniors were no longer eligible for benefits. However, Ottawa seems to want to continue pretending that the program is universal, since high-income seniors are informed that the government has taxed back their old age pension (even though they never see the money).

Distribution of elderly benefits: 1985 versus 2000

Figure 3 shows the amount and distribution of elderly benefits for a single senior under the current system (for 2000), after the various changes made by the Conservative and Liberal governments. Old Age Security is progressive and phases out a relatively high ($88,000) income. The Guaranteed Income Supplement is the same steeply-targeted program as it was in 1985. The age credit is moderately income-tested, phasing out at around $50,000, while the pension income credit is the only benefit available to upper-income seniors (providing they have private pension income, which is a safe bet).

Figure 2 compares elderly benefits under the old (1985) and current (as of 2000) systems. Only poor seniors are in the same position now as they were under the old system, since they receive the same total benefit from Old Age Security and Guaranteed Income Supplement; the various changes to Old Age Security do not affect the poor and Guaranteed Income Supplement remains unchanged both in design and value of benefits. However, the majority of seniors, with modest, average or high incomes, have experienced a significant decline in their elderly benefits, though the cuts are distributed in a progressive fashion. Figure 4 shows the dollar change in benefits between 1985 and 2000, which is progressive up to $90,000 (very few single seniors have income so high). However the loss measured as a percentage of income (see Figure 5) is more irrational, with ups and downs that bear no consistent relationship to income (e.g., losses amounted to 5.4 percent of income for seniors at $17,000 and $64,000).

Today’s elderly benefits system distributes its benefits in a much more progressive fashion than it used to, but progressivity has come at a price for most seniors – lower benefits for all but the poor. There have been no increases in benefits since the 1984 increase in the Guaranteed Income Supplement for single pensioners. The reforms in the 1980s and early 1990s created a progressive but also leaner elderly benefits system with a
built-in Achilles heel in the form of partial indexation of the clawback on Old Age Security and the age credit and the non-indexation of the pension income credit.

While significant progress was made in achieving the objective of vertical equity, Canada’s elderly benefits suffered from a different form of inequity – horizontal inequity. The existing ‘system’ (if that is not too generous a term) employs an irrational array of income tests.

Old Age Security and the age credit are income-tested on an individual basis. The pension income credit also is income-tested on an individual basis; it is not available to people with private pension income who are below the taxpaying threshold, though relatively few would fall in this category. But the Guaranteed Income Supplement and Spouse’s Allowance are income-tested on the combined income of both spouses – i.e., family as opposed to individual income.

The result of these mixed income tests is that elderly couples with the same income can receive different amounts of elderly benefits, depending on each spouse’s share of family income. Throughout most of the income range, what can be termed ‘two-income couples’ receive more benefits than do ‘one-income couples.’

One-income couples have the advantage over two-income couples at the low and high ends of the income spectrum. In the extreme case, an elderly spouse with little or no income other than Old Age Security, but living with a wealthy spouse, could receive the maximum Old Age Security (paying no income tax and not subject to the income test). By contrast, elderly single people or couples with even quite modest incomes end up with less after-tax Old Age Security because they are in taxpaying range and must pay tax on their benefits.

**Ill-fated attempt at more radical reform: the Seniors Benefit**

The 1995 Budget stated that the Ministers of Finance and of Human Resources Development would release a paper “on the changes required in the public pension system to ensure its affordability” [Department of Finance Canada 1995: 57-58]. The Budget set forth five “basic principles” for the reform of Old Age Security and Guaranteed Income Supplement: undiminished protection for all seniors “who are less well-off”, continued full indexation of benefits, family income-testing of Old Age Security, greater progressivity of benefits, and control of costs.

The 1996 Budget followed up with a proposed Seniors Benefit that would replace Old Age Security, the Guaranteed Income Supplement, and the age and pension income tax credits. The new integrated elderly benefit was, true to the government’s word, designed according to the five principles for reform, though as we will see the reform’s critics objected strenuously to some of the principles and their embodiment in the Seniors Benefit proposal.
Incidentally, the reader should know that I originally proposed an integrated elderly benefit and did some work behind the scenes with the Departments of Finance and Human Resources Development Canada on the Seniors Benefit. Nonetheless, I have tried to give a balanced account in this paper of the controversy that swirled around the reform. While my design differed in that it would have paid a larger maximum benefit and imposed a lower reduction rate, the essence of my proposal — a more targeted, family income-tested integrated elderly benefit — figured fully in the federal government’s Seniors Benefit proposal.

**the design**

The federal government’s proposed Seniors Benefit employed the same two-step, family income-tested design as my proposal, combining a Guaranteed Income Supplement-style component (with the same steep 50 percent reduction rate as the current Guaranteed Income Supplement) and an Old Age Security-like component (with a $25,921 threshold and a 20 percent reduction rate). We differed only on the amount of the maximum benefit and the reduction rate for the Old Age Security component. The Seniors Benefit would pay $120 more than the current maximum Old Age Security/Guaranteed Income Supplement for both singles and couples, providing an income guarantee of $11,420 for single seniors and $18,440 for elderly couples in 2001. (Note that the Spouse’s Allowance would continue as a stand-alone program, albeit modestly increased by the same $120 a year.) The Caledon (i.e., my) option would add $300 to the maximum benefit for single seniors ($11,600) and $500 for elderly couples ($18,820), expressed in the same 2001 terms as the Seniors Benefit. Where the two designs differed most was in the reduction rate for the Old Age Security component — mine was 12.5 percent as opposed to the Seniors Benefit’s 20 percent. As a result, the Seniors Benefit would have disappeared at a lower income level than my proposal — for single seniors, at $51,721 (versus $67,201 for my option) and $77,521 (versus $108,481 for mine) in 2001. However, the large majority of elderly Canadians, who have low or modest incomes, would have received much the same from the Seniors Benefit as from my option.

The Seniors Benefit proposal promised a fully-indexed benefit and income threshold. This was a welcome improvement over the elderly benefits system of the day, with its partially deindexed Old Age Security clawback threshold and age credit, and unindexed pension income credit.

The Seniors Benefit proposal included ‘grandfathering’ rules intended to ensure that no senior or near-senior would lose benefits as a result of the switch to the new system — which would not have taken effect until 2001. All Canadians age 60 by December 31, 1995 would have been able to choose either the Seniors Benefit or the old system — whichever provides the better benefit — for the rest of their lives.
The Seniors Benefit, like Caledon’s proposal, would have paid the majority of seniors either more than or the same as they get under the current system: Three in four elderly households would have received more or the same. Elderly households with incomes under $40,000 – about the average income for couples and more than double the average income for single seniors at the time – would have been better off or no worse off under the new program. Some couples in the $40,000-$50,000 income range would have received somewhat more and some will get less, depending on the income mix of the spouses. Couples with income over $45,000 (above the $40,000 average income) would have got less, and those above $78,000 (almost double the average income) no longer would have received elderly benefits. Nine in ten single aged women would have come out ahead under the Seniors Benefit.

Figures 6 (single seniors) and 7 (elderly couples) illustrate the distribution of benefits under the existing system and the proposed Seniors Benefit. Clearly, the new system would be more progressive, though mainly by its greater targeting at the upper half of the income spectrum than through increases at the lower end, which were very modest. Note that the picture is somewhat different for one-income as opposed to two-income couples; while they receive exactly the same from the Seniors Benefit, the current system pays them different amounts at different income levels. As a result, the ‘winner/loser’ profile is somewhat different for one- and two-income families.

Figure 8 iii shows that, for single people, the proposed Seniors Benefit would deliver gains ranging from $120 for the poorest seniors to $632 for those with other income of $25,000 (by ‘other income,’ we mean income from sources other than elderly benefits – e.g., from the Canada and Quebec Pension Plans, individual retirement savings vehicles, employer-sponsored pensions plans, employment earnings, earnings on investments, rental income). The larger dollar increases for modest- and middle-income seniors compared to low-income seniors indicates not a flaw in the Seniors Benefit design, but rather the irrationality of the current system of elderly benefits, which is not smoothly progressive.

A more informative way of looking at the changes, though, comes by expressing the gains and losses relative to recipients’ income. Figure 9 shows that gains for single seniors range from 0.9 percent at $20,000 in other income to 3.0 percent at $10,000 in other income, while losses go from 0.3 percent at other income of $80,000 and $90,000 (low since the few seniors in this stratosphere of income receive only the pension income credit at present, so there is relatively little to lose under the Seniors Benefit) to 5.6 percent at $50,000.

Figures 10 and 11 show the dollar and percentage-of-income changes, respectively, for one-income elderly couples (i.e., those in which one spouse has all the income except for the other spouse’s Old Age Security). Gains range from $120 at the lower end to $869 at $25,000 in other income, while losses are from $289 for couples with $35,000 in other income to $5,592 for those at $80,000. Measured as a percentage of other income, gains range from 1.2 percent at $10,000 to 3.5 percent at $25,000, while
losses vary from .8 percent for couples with $35,000 in other income to 6.2 percent for those at $60,000. Figures 12 (dollar changes) and 13 (percentage of income changes) indicate that the numbers differ but the overall picture is much the same for two-income couples (in this example, the spouses earn 60 and 40 percent of combined other income). Gains range from 1.2 percent for couples with $10,000 in outside income to 3.0 percent for those at $25,000, while losses go from .9 percent at $30,000 to 8.9 percent at $80,000.

It is important to put these micro results in the macro perspective of the distribution of income among Canada’s elderly population, which – despite improvements over time – remains quite compressed at the lower end. In 1995, two-thirds of single seniors had incomes under $20,000 and 63 percent of elderly couples were under $40,000. So it comes as no surprise that, as noted above, the majority of elderly Canadians would be better off or no worse off under the proposed Seniors Benefit, while those with low or modest incomes – among whom single elderly women are heavily concentrated – would be somewhat better off.

**the attacks**

The Seniors Benefit ran into strong criticism from both the left and right of the political spectrum – attacks that were allowed to mount as the federal government did little to either defend or implement its proposal. The reform eventually was withdrawn in late July of 1998 – two-and-a-half years after its introduction in the March 1996 federal Budget – when Parliament was in recess and many Canadians on holiday. The proposed reform was attacked on two main fronts – its use of a family income test and its alleged damage to incentives for private saving for retirement – though there were other complaints as well.

**the family income test: ‘poor wives with rich husbands’**

In their fight against the Seniors Benefit, women’s groups advanced what I dubbed the ‘poor wives with rich husbands’ argument. According to this line of reasoning, even in some wealthy families, elderly women have little or no income of their own other than Old Age Security. They are completely dependent on their husbands, “even though [they have] no legal claim to that income”[Shifrin 1996]. The Seniors Benefit would have removed the only independent source of income for these poor wives with rich husbands. It has been argued that some men block wives’ access to family income, especially in cases where there is spousal abuse; not sharing family income is seen as a form of abuse in itself, and “economic abuse” can take the form of a husband forcing his wife to ask for money, giving her an allowance, taking her money away and not letting her know about, or have access to, family income [Women and Taxation Working Group 1992; Townson 1997: 9]. Canadian Pensioners Concerned, a seniors lobby group, protested that “women should not be subjected to this kind of indignity” [Canadian Pensioners Concerned].
Homemakers in affluent families are not the only women who would lose in the change to a family income-tested Old Age Security. So also could some women who worked in the paid labour force part time or full time for wages and so qualified for the Canada or Quebec Pension Plan (and perhaps even an employer-sponsored private pension). If their (typically lower) retirement income and their husband’s (usually higher) retirement income raised the couple above the income threshold for Old Age Security, such women could lose part or all of their Old Age Security. Of course, the same holds for the man, unless his income is high enough that it disqualified him for Old Age Security under the existing system.

What to make of these criticisms? While the Seniors Benefit rationalized its family income test as solving the horizontal equity failing of the current elderly benefits system, there is more to the issue than that – and it goes to the heart of competing philosophies of social policy.

Family income-testing rests on the assumption that the family is an economic unit as well as a social and emotional partnership – that its members pool their resources and share their financial needs – and thus is an appropriate vehicle for delivering social benefits geared to need. The Guaranteed Income Supplement, for example, assumes that low-income aged couples are deserving of assistance based on their level of total income, and that the contribution of each spouse to that income is not a relevant factor. Family income-testing of social programs can be seen as subscribing to the traditional marriage vow – in sickness and in health, for better or worse. Canada makes considerable use of family income-testing, including the Guaranteed Income Supplement, Spouse’s Allowance, Canada Child Tax Benefit and income-tested provincial child benefits and earnings supplements, and the refundable Goods and Services Tax credit.

The ‘poor wives with rich husbands’ argument raises the question as to whether social programs should be asked to try to solve the problem of income sharing between spouses. At a time of rising expenditures on the aged and a federal government committed to reigning in the deficit and debt, is it justifiable to keep paying out elderly benefits to affluent families that amounted to a tiny portion of well-off couples’ incomes while so many Canadians – below and above the age of 65 – live thousands of dollars below the poverty line? For every ‘poor wife with a rich husband’ who would no longer receive Old Age Security, more than 50 lower-income single elderly women will receive a higher benefit.

Another argument in favour of basing the Seniors Benefit on family as opposed to individual income is that this approach would help achieve a more progressive distribution of benefits (one of the federal government’s five principles pension reform). A family income-tested benefit can better target benefits to seniors below the threshold for maximum payments than an individually income-tested program with the same threshold. The existing income test on Old Age Security, which is based on individual income, means that a single senior or an elderly spouse with most of a couple’s income will get lower benefits if his or her income is above the threshold, which was $53,215 in
net income at the time of the Seniors Benefit. However, an aged senior couple with total income of $53,215 made up of two smaller incomes escapes the income test. If the income test were based on the spouses’ combined income, it would capture such two-income couples and thus both save the federal treasury more money and produce a more progressive distribution of benefits. A family income-tested elderly benefit will always be more progressive than an individually income-tested program paying comparable benefits because it will deliver less to many two-income senior couples than they would get from the latter.

killing universality – again

A related criticism of the Seniors Benefit is that it would put another nail in the coffin of universality, going even farther than the clawback in reducing or denying benefits to better-off seniors. Canada’s largest labour union, the Canadian Labour Congress, contended that a family income test would transform a long-standing entitlement into what amounts to a form of social assistance or “state charity,” severely damaging the retirement income system overall. [Canadian Labour Congress 1995: 6].

According to this school of thought, Old Age Security was intended to provide a foundation to the retirement income system that should cover every single elderly Canadian. Universal social programs like Old Age Security and Family Allowances were said to recognize the contribution that all seniors and parents, respectively, make to society, regardless of their income or economic circumstances. Universal benefits have been “earned through years of participation (and tax paying) in Canadian society” [Baldwin 1996]. Universal social programs are said to foster a sense of social solidarity and support for the welfare state and for Canada, crossing class, regional, ethnic and linguistic lines. Universal Old Age Security established a right for all elderly women and men; the program ensured that every senior received a basic retirement benefit of his/her own [Coalition of Seniors for Social Equity 1995:6]. Universal programs like Old Age Security are touted as avoiding the stigma that comes with means-tested programs like welfare, since everyone benefits regardless of socioeconomic class or income level. Universal programs also are claimed to be more secure than selective programs with a smaller constituency, especially those geared to the poor. And without universal social programs, broad public support for the welfare state generally – including programs for the poor – will weaken, in the end hurting the poor as well.

However, this universalist creed had grown long in the tooth by the time that the Seniors Benefit was proposed and was based on some dubious assumptions. The allegation that a family income-tested Seniors Benefit would amount to a form of ‘welfare’ is based on a lack of understanding of the difference between income-testing and needs-testing in social policy, which many people typically and wrongly lump together under the rubric ‘mean-testing.’ An income-tested program is based on a simple and anonymous test of level of income as measured by the income tax system or on some other application form. A needs-tested program, like welfare (the popular term in Canada for last-resort income assistance), involves a complex, intrusive and detailed investigation
and assessment of applicants’ resources, assets, family composition, age of children, employability and other indicators of need, as well as periodic re-tests to ensure there have been no changes in welfare recipients’ circumstances. There is a world of difference between an income-tested program, like Guaranteed Income Supplement or the Canada Child Tax Benefit, and needs-tested welfare; in fact, universal and income-tested programs are much closer than are income-tested and needs-tested programs. The argument that income-tested programs are stigmatizing or marginalizing, like needs-tested welfare, is nonsense.

The universalists’ claim that universal programs which benefit a broad swath of the population are more secure than income-targeted programs looks pretty feeble, now that the federal government has done away with two of the most popular and well-known social programs – Old Age Security and Family Allowances! The political ease with which the Conservatives knocked down the walls of universality was extraordinary. Stealth played a significant role in the demise of universality, but social advocates had little success in mobilizing seniors or parents, let alone the general public, in the way they had back in the 1985 defeat of partial indexation of Old Age Security. Moreover, the empirical evidence for Canada indicates that universal social programs are more rather than less susceptible to cuts or demolition than are income-tested programs; indeed, universal programs’ budgets have been raided to help establish and improve income-tested programs.

*the earnings-replacement case against the Seniors Benefit*

Another argument made for restoring the universal Old Age Security and against income-testing the program (whether on an individual or family basis) is that it is intended to contribute to the earnings-replacement objective of the retirement income system [Baldwin 1995b:14]. Old Age Security provides a base on which to build other sources of pension income – Canada Pension Plan/Quebec Pension Plan, employer pension plans, Registered Retirement Savings Plans (RRSPs) and other forms of savings – necessary to maintain a reasonable standard of living in retirement for non-poor seniors, including the affluent. Granted, Old Age Security also makes a vital contribution to achieving the anti-poverty objective, along with the income-tested Guaranteed Income Supplement and Spouse’s Allowance programs. But the 1991 move to an individually income-tested Old Age Security, and the prospect of going all the way to a family income-tested program, was damned as jeopardizing Old Age Security’s earnings-replacement role and forcing a lamentable shift in emphasis from the earnings-replacement to the anti-poverty objective. One prominent feminist economist accused the 1995 Budget of “effectively eliminating [Old Age Security’s] role in income-replacement and converting it to a strictly anti-poverty program” [Townson 1995: 3].

This issue is of course a judgment call, and opinions varied. But the losses to better-off elderly Canadians – especially the small group of well-off seniors – under the Seniors Benefit would be relatively modest when expressed as a percentage of overall income, as discussed earlier. Figures 9, 11 and 13 show that losses are relatively small in
proportionate terms and would affect a minority of seniors. One could, perhaps, make a case that seniors with upper-middle incomes would be hardest hit whereas those at the top end would barely notice the change since they receive little or virtually nothing (save the pension income credit) under the existing system. However, the current elderly benefits system accounts for a small and (until the restoration of full indexation of the threshold for the income test on Old Age Security in 2000) diminishing share of the income of affluent seniors, so further losses from the Seniors Benefit would seem to have little appreciable impact on their economic status.

‘an attack on the middle class’

The media in Canada tend to uncritically parrot the views of critics of government, and the Seniors Benefit was no exception. The reform was characterized by two prominent newspapers as an ‘attack on the middle class’ [Simpson; McCarthy]. Elderly couples with incomes under $40,000 would be better off or no worse off after the reform; couples between $40,000 and $50,000 would get somewhat more or less; and those above $45,000 would receive less. But this criticism fails to understand that seniors have much lower average incomes than non-seniors. When the Seniors Benefit was proposed in 1996, the average income of elderly couples was only $41,234, compared to $62,078 for non-elderly couples. Single aged women averaged only $20,990 and single elderly men $26,160.

failure to make a compelling case for reform: the contentious issue of sustainability

A number of critics complained – rightly so, in my view – that the federal government failed to follow through on its earlier commitments to release a comprehensive and multi-dimensional public discussion document that would inform and solicit public views on different routes to reform. Instead, the proposal for the Seniors Benefit was presented in the 1996 Budget and came fully dressed, with all the design features filled in. There were not even variants on the favoured design, let alone other approaches put forward.

Two issues in particular sparked criticism. The federal government presented fairly rudimentary estimates of winner/loser profiles, especially in terms of the gender impact of the proposal (e.g., it did not provide estimates as to the number of married women suffering losses), and failed even to provide the most basic data required to assess the scheme – estimates of the value (overall and by individual component) of elderly benefits under the current system.

The second point of attack involved the federal government’s rather peremptory treatment of its core case for reform: the need to control costs and make the public pension system sustainable and affordable in future as Canada’s population ages and the baby boomers grow old. The discussion paper presenting the Seniors Benefit pretty much assumed its key case for reform, offering little in the way of evidence other than a scant couple of pages (in large type at that). A few paragraphs identified demographic
pressures (rising life expectancy, decline in birth rate and aging of baby boomers resulting in rising pension costs and associated worsening dependency ratios). A few sentences fingered slower economic growth (in productivity and average wages, which will reduce the capacity of working Canadians to fund rising public pension costs). With this, the federal government concluded that public pensions’ large and growing share of government spending, exacerbated by the pressures of an aging population on health and social services costs, could crowd out spending on other important policies.

One leading pension expert at the Canadian Labour Congress faulted the Seniors Benefit paper for failing to consider other important indicators, such as the capacity of the economy to sustain rising public pension costs in future, and questioned its claim that expenditures on public pension programs will increase faster than our ability to pay for them [Baldwin 1996]. He noted that the most recent Actuarial Report at the time forecast that Old Age Security expenditures would grow from $21 billion in 1995 to $119 billion in 2030 – which looks like a huge (467 percent) increase, except that the 2030 projection would amount to only $35 billion in real (inflation-adjusted 1995 dollars) or 67 percent more in real terms. Elderly benefit spending as a percentage of total earnings would rise from 4.19 percent in 1995 to a projected 5.59 percent in 2030 – hardly catastrophic, and projected to decline thereafter. The 1995 federal Budget stated that spending on Old Age Security and the Canada Pension Plan would increase from 5.3 percent of national income in 1993 to more than 8 percent by 2030. Yet these estimates fail to take into account the taxation of Old Age Security and Canada Pension Plan benefits, which reduce costs. If the aged population is expected to double, why would these expenditures increase by only 50 percent? One unspoken factor is that if wages grow by more than inflation, then Old Age Security will decline relative to national income and wages and salaries. Moreover, a figure of 8 percent for 2030 is less than current national average expenditure on public pensions in the OECD.

The issue of sustainability is crucial and warrants more discussion.

There is a difference between what a program costs and whether it is affordable. The former is a pretty straightforward accounting-cum-demographic projection exercise. Combined spending on Old Age Security, the Guaranteed Income Supplement and the Spouse’s Allowance has risen steadily since the program began in 1952 and will continue to increase apace at least until 2100, the highest year for which actuarial projections are available [Office of the Superintendent of Financial Institutions 1999]. In constant 2002 dollars, expenditures on the three federal programs went from $2.5 billion in 1952 to $24.8 billion in 2000 and will reach a projected $58.8 billion in 2035 and $334 billion by 2100. The actual cost to government will be somewhat less than the formal projections, which are based on gross payouts; since benefits are subject to income tax and an income test; during the 1986-1999 partial deindexation period, partial deindexation of the personal income tax system took a growing bite out of taxable Old Age Security benefits and steadily lowering the real level of the income test and so recovered increasing amounts over time. But even in net terms, demographic pressures will keep pushing up Old Age Security costs for the projectable future.
The affordability of Old Age Security, the Canada and Quebec Pension Plans and other major social programs (e.g., medicare and social services) under pressure from the aging population is a much more contentious issue that involves at least as much political as economic judgment. One widely-used measure, the social expenditures -to-GDP ratio, shows the expected increase over time; combined expenditures on Old Age Security, the Guaranteed Income Supplement and the Spouse’s Allowance rose from 1.3 percent of GDP in 1952 to a projected 2.5 percent today (2002). But does this mean that Old Age Security will be ‘unaffordable’ in future?

Projections of the elderly benefits-to-GDP ratio suggest that that the sky will not fall. From its current 2.5 percent of GDP, total spending on Old Age Security, the Guaranteed Income Supplement and the Spouse’s Allowance is projected to peak at 3.3 percent in 2030 but then decline precipitously to 1.8 percent by 2100 (see Figure 14). Indeed, the rate of increase in elderly benefits costs actually decelerated in the 1990s because of a slowdown in the rate of increase of the elderly population; the Great Depression and World War Two produced relatively small cohorts (that are now aging) compared to the baby boom generation that followed [Desjardins and Dumas 1993: 19].

Neither does the future growth of Old Age Security suggest a doomsday scenario if we use employment earnings as our denominator. The Chief Actuary has projected that expenditures on elderly benefits will decline from 5.7 percent of total employment earnings in 1995 to 5.2 percent in 2010 because earnings will increase at a somewhat faster rate than elderly benefits expenditures. The elderly benefits-to-earnings ratio then will rise with the aging of the baby boom generation to peak at 7.1 percent in 2030, after which it will fall to a projected 3.9 percent by the year 2100 [Office of the Superintendent of Financial Institutions 1999].

On the other hand, certain labour market developments of the 1980s and 1990s – such as the growth of nonstandard jobs, relatively high unemployment and underemployment, tough job prospects for young Canadians without postsecondary education, displacement of middle managers, disappearing blue-collar jobs in the traditional manufacturing sector and wage polarization – will have an impact on the pension system of the future. Many of today’s unemployed, underemployed and nonstandard workers will have little if any private pension income when they retire, leaving them mainly or wholly dependent on public pension programs. Trends in the coverage of employer pension plans are not encouraging: The proportion of paid employees in employer pension plans was lower in 1999 (40.7 percent) than 1983 (45.4 percent) because the declining coverage of men more than offset the improved coverage of women from 1983 to 1993 and because women’s coverage has since fallen to 39.3 percent in 1993. The fact that private pension coverage of the whole labour force (i.e., adding in self-employed Canadians who are not eligible for private pension membership) has declined from 36.0 percent in 1983 to 33.4 in 1999 is also significant in view of the rise in self-employment. These labour market and employer pension coverage trends, combined with substantial growth of the elderly population, will place heavy pressure on
the public pension system in the coming decades, including Old Age Security, Guaranteed Income Supplement and the Spouses’ Allowance.

Moreover, as the federal government argued, population aging is increasing not just elderly benefits costs. The Canada and Quebec Pension Plans, health care and social services also are caught in the demographic meat-grinder. The Canadian Institute of Actuaries used the Office of the Superintendent of Financial Institutions to forecast Old Age Security, Canada /Quebec pension Plan and medicare expenditures for seniors, which will rise from a total 8.5 percent of GDP in 1995 to 14.8 percent by 2030 [Canadian Institute of Actuaries 1995: 19].

There is a political argument that could have been made in favour of a more income-targeted elderly benefits system. Some younger Canadians see themselves as getting a raw deal on the intergenerational equity index. They are dubious that the welfare state will be able to afford to pay them public pensions when they retire, yet their income and payroll taxes (if they are lucky enough to have job) go to support today’s aged and may have to increase in future to pay for the baby boomers’ pensions, health care and social services. To the extent that the government could have sold its Seniors Benefit as sustainable and fair, it may have helped restore confidence in and generate public support for the public pension system overall.

However, when he unveiled his Seniors Benefit proposal, the Finance Minister did not have his gaze fixed on improving elderly benefits-to-GDP and benefits-to-earnings ratios in the middle of the 21st century. Instead, he and his Cabinet colleagues saw rising elderly benefits expenditures taking a growing share of federal program spending, in the process making it harder to reduce the deficit and slow the debt, let alone contemplate desirable improvements to other social programs such as child benefits. While partial indexation of the personal income tax system and the income test on Old Age Security would ease somewhat the rising real cost of elderly benefits, the 1995 Budget’s principle of ‘control of program costs’ clearly signalled that Ottawa wanted to save some money out of reform. Otherwise, why take the political risks involved?

Ironically, just a few years later, the same Finance Minister did a flip-flop and killed the Seniors Benefit, arguing that improvements in Canada’s fiscal and economic situation and impending reforms to the Canada Pension Plan and Quebec Pension Plan (discussed later in this paper) had largely resolved the sustainability issue and ended the need to make reforms that would take money out of the retirement income system. But there was more politics than economics in the decision to withdraw the proposal to reform elderly benefits. I will return to this point in the conclusion of the paper when I compare the reasons for the failure of the Seniors Benefit and the success of the changes to the Canada Pension Plan.

marginal tax rate
While labour, aged and women’s lobby groups raged against the Seniors Benefit’s purported sins against universality and women’s right to a pension, another major attack came from those on the right. The private pension industry selling individual retirement savings plans argued that the higher (20 percent) reduction rate on the Old Age Security-equivalent part of the Seniors Benefit would discourage Canadians from saving for their retirement in Registered Retirement Savings Plans, Canada’s tax-assisted individual retirement savings vehicle. This line of criticism was fuelled by analysis from right-wing think tanks and spread like wildfire through the financial advice columns in Canada’s major newspapers. The private pension lobby most certainly made its views known loudly in the corridors of power in Ottawa, notably the all-powerful Department of Finance which authored the Seniors Benefit.

The main line of this argument held that the increase in the reduction rate (from 15 percent of individual income for the Old Age Security clawback to 20 percent of family income under the Seniors Benefit), coupled with the decrease in the threshold at which it is applied (from $53,215 under the Old Age Security clawback to $25,921 under the Seniors Benefit), would increase effective marginal tax rates for many seniors, including those with modest incomes (by adding to existing marginal income tax rates and income-tested social program taxbacks). Hence, claimed the critics, the Seniors Benefit would discourage non-elderly Canadians from saving for their retirement in Registered Retirement Savings Plans (tax-assisted individual savings vehicles) since allegedly much of such savings effectively would be lost to government (through federal and provincial income taxes and losses in elderly benefits) when they reach 65.

One dissenting economist, who worked with a seniors lobby, criticized the critics and his fellow economists after reviewing their claims and undertaking his own analysis of the proposed reform: “For the most part, the articles and papers that have been published have been seriously lacking in depth and accuracy of analysis and have drawn quite incorrect conclusions” [Patterson 1997:1].

His study (which is far too detailed and involved to recount here) found that effective marginal tax rates after the Seniors Benefit would rise for some elderly Canadians but fall for others (mainly low- and high-income seniors). Using Patterson’s calculations, Figure 15 shows effective marginal tax rates for single seniors under the current and proposed elderly benefits systems. The increases generally would be less than portrayed by the critics (in the 11-15 percent range for the typically middle-income seniors who would see higher effective marginal tax rates, not 20 percent as alleged), once the effect of other contributors to effective marginal tax rates (e.g., the income-tested age credit, the income test on Old Age Security and its taxability) are factored into the calculation. In any case, his analysis found that investing in tax-encouraged RRSPs would remain advantageous over other forms of investments for most Canadians if the Seniors Benefit were implemented; the longer the investment period, the greater the advantage.
Estimates from the federal Department of Finance support this position. Using the example of an individual earning $50,000 before retirement, the Department estimated that his after-tax retirement income would amount to $28,653 if he saved in Registered Retirement Savings Plans (assuming a rate of about 9 percent), which afford the advantage that accumulating contributions and investment earnings are free from income tax until they are converted to retirement income; more than half of that income would derive from RRSPs, with the rest from public pensions (the proposed Seniors Benefit and Canada Pension Plan). The same individual investing instead in other forms of investments would retire on $21,177 after-tax income, with only about one-third coming from savings. A non-saver would end up with just $15,385, from public pensions [Department of Finance Canada 1997].

For a criticism that claims to be rooted in ‘rational economic behaviour,’ the marginal tax rage (as I have dubbed it) criticism seems lacking in rationality itself. Patterson [1997] argues that:

…it is fairly difficult for most people to predict accurately what their level of income in retirement will be. For someone to forego the tax advantages of investing in RRSPs on the assumption that at retirement he or she will face a 20 percentage point increase in effective taxation would be quite risky. If the person should become unemployed or for some other reason not meet his or her income expectations in retirement a very significant tax advantage will be missed, resulting in serious hardship.

One can stand the marginal tax rage criticism on its head and argue (as Patterson and I both do) that the widely-disseminated fears about cuts in or vulnerability of public pensions (i.e., elderly benefits and the Canada Pension Plan) could well encourage people to save more on their own for their retirement to make up for anticipated losses in government pensions. Patterson also speculates that, to the extent the Seniors Benefit would reduce future spending (compared to what the current system would costs), “overall tax rates should be reduced and this would increase savings” [Patterson 1997:13]. The flaw in this argument is that government always will find ways to spend tax money (though, for other reasons, both levels of government in recent years have substantially reduce their income taxes, mainly to make up for past increases).

**a revised design**

The Department of Finance responded to some, but not all, of the criticisms and had worked out a compromise design when the Finance Minister pulled the political plug on the exercise and withdrew the reform. Essentially, the revised version was closer to my own proposal for an integrated elderly benefit published before the government’s Seniors Benefit proposal.
The modest increase in maximum benefits (only $120) would have been sweetened, albeit modestly. The reform would have been phased in over a longer period to respond to those who would argue that the proposed grandparenting rules would create a ‘notch’ problem (i.e., a divide between similar-aged Canadians who would receive different benefits because the older group would be allowed to continue receiving the level of benefits under the old system if it were advantageous to them (i.e., to better-off seniors). A gender analysis would have been commissioned to provide more information on the impact of the reform. The biggest change would be lowering the contentious 20 percent reduction rate on the Old Age Security-equivalent portion of the Seniors Benefit, to assuage the marginal tax ragers from the investment community. However, there would be no backing down on the family income test that was essential to the concept of the reform – and, hence, no allaying of the attacks from women’s and seniors groups.

Politics killed the reform

Initially, the Seniors Benefit seemed to be cleverly crafted, packaged and sold to seniors and the public. In their coverage of the 1996 Budget, the newspapers showed a photo of Finance Minister Paul Martin with his arm around the shoulders and hand in the hand of a smiling 73 year-old woman. She was Solange Denis, the erstwhile Joan of Ark of the fight against partial deindexation of Old Age Security back in 1985. It seems likely that the reform – particularly in its amended form – could have been successfully sold to the public and implemented if Ottawa chose to proceed.

But the forces of opposition gathered steam and the Seniors Benefit ran into strong criticism from both the left and right of the political spectrum, while the public remained largely indifferent (though not necessarily opposed to the idea) in the absence of a concerted selling campaign from the federal government. The noise from the marginal tax ragers and universalists did not fall on wholly deaf ears of Members of Parliament, especially the many Liberal members of the ruling party and its women’s caucus who were nervous about going into the next election with a potentially hot political potato in their platform.

Ironically, the Seniors Benefit’s chief rationale – the sustainability argument – was a major factor in its demise. The reform would have garnered no major savings when implemented and, even in the long term (which is never-never land for politicians), would have saved only an estimated 10.7 percent of net program expenditures in its original form. The revised design – with its more generous grandparenting provisions, increase in maximum benefits and lower reduction rate – would have produced somewhat smaller savings than the original design. And with the end of its tough anti-deficit program in sight, the political climate for deficit-driven reforms was changing – back to a status quo stance, which much better suited the political style of the Prime Minister. The Finance Minister’s July 29, 1998, press release announcing the withdrawal of the Seniors Benefit cited to Canada’s improving fiscal and economic health as reasons for not proceeding with the reform; the federal deficit was under control, the debt-to-GDP ratio
was on the way down, productivity and investment were improving, and prospects for long-term economic growth were deemed to be “very positive” [Department of Finance Canada 1998].

The demise of the Seniors Benefit also was linked by the federal government to the success of its other major pension reform, financing and benefit changes to the Canada Pension Plan (discussed below). In 1995, when it launched the Seniors Benefit, Ottawa projected that the total cost of public pensions (i.e., elderly benefits and the Canada and Quebec Pension Plans) would rise from by three percentage points relative to GDP by 2030 (from 5 percent to 8 percent of GDP) – two percentage points being attributed to the “spending pressures associated with the CPP and QPP.” However, the implementation of a series of reforms to the Canada Pension Plan and Quebec Pension Plan was claimed to solve their problems and thus “the source of two-thirds of the long-term cost pressures has been addressed” [Department of Finance Canada 1998].

the elderly benefits system today

The government’s retreat on the Seniors Benefit means that Canada’s elderly benefits system today remains a hodge-podge of poorly-fitting pieces, with all but one of the flaws discussed earlier that provided the design rationale for the Seniors Benefit. The mix of individual and family income tests creates horizontal inequities among families with the same income but different spousal contributions to that income. The Seniors Benefit would have increased (modestly, admittedly) payments to poor and modest-income seniors, improving benefits for nine in ten single women (who still experience a high risk of poverty). Instead, the level of maximum benefits remains the same as it has been for many years: The last real (i.e., above-inflation adjustment) increase to federal elderly benefits — to the income-tested Guaranteed Income Supplement — was under the Trudeau government, way back in 1984. While the system is income-tested, in fact it is not highly targeted like many income-tested social programs; rather, it is better characterized as quasi-universal, as only five percent of the highest-income seniors are subject to the income test (and only two percent get nothing, while three percent still retain some benefits). And when we factor in the fact that many well-off seniors receive the pension income credit, then for them the system is actually universal.

The major improvement is that the Liberals finally restored full indexation to the federal tax/transfer system, effective 2000, as a fundamental feature of its broad-based income tax cuts. However, they did not fully restore tax credits and thresholds to their original value. And while the threshold for the income test on Old Age Security was fully indexed, thus rising from $53,215 in 1999 to $53,960 for 2000, the latter amount is worth only $42,540 in 1989 dollars (as opposed to it original $50,000 level in 1989). This means that the threshold fell by $7,460 in constant dollars — a sizable 14.9 percent decline — between 1989 and 2000 as a result of partial de-indexation. Nonetheless, the restoration of full indexation is a major improvement in Canadian tax/transfer policy, since it halts the stealthy slide in the value of a number of important tax benefits,
including those for seniors (with the exception of the pension income credit, which remains unindexed), and solidifies ongoing increases to the Canada Child Tax Benefit.

C. Reform of Contributory Public Pensions: Refinancing the Canada Pension Plan

The story of the reform of the Canada Pension Plan – Canada’s earnings-related, contributory public pension program that forms the second tier of its three-tier retirement income system – is a striking and instructive contrast to the reform of the first tier of elderly benefits, which as we explained above underwent significant reforms that paved the way for but fell short of the final stage of an integrated, family income-tested benefit. Whereas the path to reforming elderly benefits proved to be a political minefield, the road to the reform of the Canada Pension Plan proved to be comparatively smooth and straight. Yet the changes to Canada’s contributory pension program were at least as significant in both policy and political terms as the unfinished transformation of elderly benefits.

Two of the fundamental characteristics of Canada are its dual French-English heritage and its decentralized federalism, which are embodied in its social security system (I use the term in its broad sense to mean social provision generally, no just pensions), including the pension system. As noted earlier, most provinces provide income-tested supplements for their low-income seniors. The federal government operates the Canada Pension Plan that covers all employees and the self-employed throughout the country except for Quebec, whose provincial government operates the Quebec Pension Plan. However, the two plans are virtually identical in design and are implementing the same financing reforms; thus the financing changes to the Canada Pension Plan discussed below apply to the Quebec Pension Plan as well. The other important factor is that the Canada Pension Plan is a national social program (much like medicare, Canada’s public health care system) jointly managed by the federal, provincial and territorial governments; reforming the plan requires the agreement of two-thirds of the provinces with two-thirds of the population.

a modest but vital part of Canada’s pension system

The Canada Pension Plan is a relatively modest earnings-related social insurance program in terms of both its benefits and contribution (the term the plan uses for premiums). In 2002, the maximum retirement benefit is $788.75 a month or $9,465 for the year, payable to those who earned over their lifetime about average earnings or more, and average payments are of course less because this Canadians with below-average earnings receive less than the maximum. In February 2002, the average retirement pension was $440.38 or $5,285 for the year, which works out to just 55.8 percent of the maximum payment. The modest earnings-replacement power of the Canada/Quebec Pension Plan – only one-quarter of earnings up the average – originates in a political compromise when the programs were created to preserve a major role for private pension and individuals savings plans.
While contribution rates are rising rapidly over the short term, as explained below, in 2002 the maximum amount for employees was $1,673 (calculated as 25 percent of the amount of a contributor’s earnings between the Yearly Basic Exemption of $3,500 and the Year’s Maximum Pensionable Earnings of $39,100 which is roughly average earnings; self-employed Canadians pay double this amount, or a maximum of $3,346. Some relief is offered by the income tax system, which provides a nonrefundable tax credit worth 17 percent of Canada Pension Plan contributions; adding in provincial income tax savings, on average contributors end up paying about three-quarters of their gross amount (e.g., about $1,255 for employees earning the average wage or more).

Nonetheless, the Canada Pension Plan constitutes a vital part of the country’s retirement income system, especially for lower- and middle-income working people and their families in general, and women in particular. Canada’s three-tiered pension system is for most people effectively a two-tiered system since the third, private tier is largely the preserve of higher-income Canadians. Private pension plan coverage is the exception rather than rule for lower-paid workers, private sector workers and those employed by small or medium-size employers. Although the gap in coverage between women and men has narrowed somewhat over the years, the fact remains that most women (67 percent of the female labour force) and indeed most men (66 percent of the male labour force) do not belong to occupational pension plans. Moreover, the majority of women and below-average earners of both sex contribute little if anything to RRSPs (tax-encouraged private retirement savings vehicles).

While in theory, women can look forward to some private retirement income if they are surviving spouses, in practice this option is not open because the majority of men do not belong to employer pension plans either. In any case, most retirement pensions and survivor benefits from employer pension plans are not fully indexed to protect them from inflation, so even women who are fortunate enough to have private pensions of their own and/or survivor benefits from their husbands’ plans in most cases will see this source of retirement income erode as they grow older. Canadians with below-average earnings – among whom most women are still overrepresented – must look to the public parts of the pension system – Old Age Security, the Guaranteed Income Supplement, the Spouse’s Allowance and the Canada and Quebec Pension Plans – as the chief source of their retirement income.

We noted earlier that the trend in private pension coverage is not encouraging. The proportion of paid employees in employer pension plans was lower in 1999 (40.7 percent) than 1983 (45.4 percent) because the declining coverage of men more than offset the improved coverage of women from 1983 to 1993 and because women’s coverage has since fallen to 39.3 percent in 1993. Private pension coverage of the whole labour force (i.e., adding in self-employed Canadians who are not eligible for private pension membership) has declined from 36.0 percent in 1983 to 33.4 in 1999. Developments in the labour market do not bode well for the private pensions prospects of either women or men. Employment creation is concentrated among small employers, which regard
occupational pension plans as an additional labour cost that would reduce their competitiveness. Many of the new jobs being created are ‘nonstandard’ – including contractual, part-time, multiple and self-employment – and do not offer employer pension plans. Governments and large corporations – the main providers of private pension plans – imposed downsizing in the 1990s. Private pension coverage of women in future could begin to slide (it already shows sign thereof), as it has for men in recent years, since women are more likely than men to work in the growing sector of non-standard jobs.

The Canada and Quebec Pension Plans offer a number of features which outclass private pension plans and are especially beneficial to below-average earners in general and women in particular. The C/QPP covers every employee and every self-employed Canadian for every job – part-time or full-time, for any size and type of employer, in every part of the country – throughout her or his years in the paid labour force. Benefits are portable and accompany contributors throughout their careers. The C/QPP allows a portion of years of low or no earnings (e.g., due to unemployment, disability, school attendance), as well as time spent raising children under age 7, to be excluded from the calculation of average lifetime earnings. It is a defined benefit pension plan, assuring a retirement benefit calculated as a percentage of average lifetime earnings – unlike private pension plans and RRSPs, most of which are defined contribution plans that provide no guaranteed benefit. The C/QPP provides for equal division of pension benefits between spouses at death, retirement or divorce, and actuarially adjusted pensions as early as 60 and as late as 70. It also offers important ancillary benefits, including disability, survivor, death, orphans and children’s benefits. Benefits are fully indexed to inflation, unlike most private pension plans, and pensionable earnings from previous years are indexed when calculating the amount of retirement pension. The CPP is also cheap to run because of its non-profit nature and economy of scale; administrative expenses for the 1999-2000 fiscal year were $336 million or 1.8 percent of total benefit payments of $18.8 billion.

The C/QPP’s importance has grown over the years as increasing numbers of women have joined the paid labour force. The percentage of female taxfilers 65 or older reporting income from the C/QPP increased from 52.8 percent in 1981 to 85.3 percent in 2002, narrowing the gap with men (whose share went from 83.8 percent to 94.5 percent over the same period).

pressures for reform

Pension reform is by no means a new concern in Canada. The country undertook a high-profile ‘Great Pension Debate’ in the early 1980s that brought together policy players from across the nation and the political and interest group spectrum. The debate dealt with a wide range of issues, and sparked considerable dissension on the best route to reform. Some wanted to expand the pension system, either by boosting the Canada/Quebec Pension Plan’s earnings-replacement capacity (the favoured option of labour, the New Democratic Party, most seniors and social groups and the left generally)
or by mandating universal coverage of private pension or retirement savings plans (advocated by the private pension industry – surprise, surprise – and the Ontario Royal Commission on the Status of Pensions). Others (e.g., the corporate sector, the federal Department of Finance and most provincial governments) preferred evolutionary improvements in the various existing public and private provisions. But there was general consensus that Canada’s pension system, despite its phenomenal growth since the war, still was not adequately achieving its two fundamental objectives – guaranteeing seniors a basic income, and ensuring adequate maintenance of living standards in retirement. These are the anti-poverty and earnings-replacement objectives, and remain the core purposes of the retirement income system.

The evolutionists won out over the expansionists, and the Great Pension Debate of the early 1980s marked the end of the postwar growth trajectory of the pension system and the Canadian welfare state overall. The following years brought modest improvements to the Guaranteed Income Supplement, the Spouse’s Allowance, the Canada and Quebec Pension Plans, and government pension standards legislation regulating occupational pension plans. The tax deduction limits for RRSP contributions were increased as well.

By the 1990s, concerns over the anti-poverty and earnings-replacement performance of the pension system had given way to fears that the existing system – whatever its failings in achieving these traditional objectives – would not be able to withstand the growing pressures that threatened the financial and political sustainability of public pensions.

In February 1996, the federal and provincial/territorial governments released a public discussion report on the Canada Pension Plan that, like Ottawa’s companion March 1996 Budget paper proposing the Seniors Benefit, founded the case for reform on sustainability. We discussed the basic demographic, fiscal and economic factors above in our analysis of the Seniors Benefit, so will not repeat them here.

The CPP reform paper went further and added a focus on why changed economic conditions favoured a shift from pay-go to partial financing. These arguments no doubt will be familiar to non-Canadian readers. When the Canada Pension Plan was created in the mid-1960s, healthy growth in wages and salaries and in the labour force meant that total contributions could handle rising pension outlays without necessitating significant increases in contribution rates (which were very low for the plan’s first 20 years). Real interest rates were low, which mitigated against opting for a financing arrangement that would grow a large fund to help pay for benefits. But by the 1990s, real interest rates had risen significantly (from around 2 percent in the 1960s to more than 6 percent in the 1990s), while wages and salary growth had weakened due to slower growth in labour productivity and in the labour force. Another pressure arose from benefit enhancements over the years – full indexation of benefit, payment of survivor benefits to widowers as well as widows, dropping retirement and earnings tests, adding the child-rearing dropout provision, more generous disability benefits and relaxed minimum contributory
requirements, and allowing recipients of survivor benefits to keep these benefits when they remarried.

The political climate exerted added pressure on Canadian governments to act: Public apprehension about the future of the public pension system were fuelled by critics on the right, who claimed that Canadians are neither willing nor able to afford the rising cost of the program. The critics seized upon the most recent Actuarial Report’s finding that CPP benefits would cost more than forecast in the previous Report due to an unexpected increase in disability claims and the adverse effect of the recession on contributions. The media were quick to seize on the Report as ‘proof’ that the CPP was ‘going broke’, since it projected that payouts would exceed contributions by the year 2015 if the current schedule of contribution rates established during the last (1990) federal-provincial review were kept in place. Alarms also were been raised that the CPP has ‘unfunded liabilities’ going on $500 billion, adding to fears that plan could not meet its promised pension obligations.

The accusations that the CPP would ‘go bankrupt’, had ‘unfunded liabilities’ in the hundreds of billions of dollars and ‘will not be there’ for the baby boom generation and/or its children were fallacious and based on a lack of understanding of the purpose and design of the plan. The CPP is a social insurance plan, not a private pension plan. It was designed as a ‘pay-as-you-go’ public pension program in which current contributions are used to pay for current pensions; employees’ and employers’ contributions do not go into a fund that is invested and that will eventually pay for their pensions in the manner of occupational pension plans. Granted, during its first two decades, CPP contributions (although at a very low rate of 3.6 percent of contributory earnings (1.8 percent from employees and 1.8 percent from employers) exceeded pension payouts. This resulted from a political compromise that secured Quebec’s agreement to allow Ottawa to establish the CPP; Quebec wanted even higher contribution rates for the QPP to develop a fund for investing in the province’s economic development. So the CPP built up a ‘partial fund’ from the surplus contributions that was lent to the provinces at interest rates payable on long-term Government of Canada bonds, which offer somewhat more favourable terms than are available to the provinces from capital markets.

The CPP cannot go broke because the federal government, with provincial agreement, agreed in 1985 to establish a long-term schedule of contribution rates – 25 years initially but increased by five years every quinquennial review – that was reviewed every five years (since reduced to three years) to ensure that they are sufficient to pay for pensions as well as to finance a small contingency fund. Between 1966 and 1986, contribution rates remained fixed at 3.6 percent of contributory earnings (split half and half between employees and employers). Starting in 1987, contribution rates were increased very gradually, to 3.8 percent of contributory earnings (1.9 percent for employees and 1.9 percent for employers); by 1995, they had risen to 5.4 percent of contributory earnings (2.7 percent for employees and 2.7 percent for employers).
Some naysayers – most prominently English-speaking Canada’s most influential news paper, the Globe and Mail, and the opposition Reform Party – said governments should forget fixing the Canada Pension Plan and instead replace it with some form of mandatory RRSP (i.e., individual retirement savings plan). The scrap-the-CPP faction was able to advance its cause by exploiting the fears and ignorance of the Canadian public, who have little understanding of the purposes, workings and advantages of the CPP and are highly susceptible to fear-mongering about its future in a time of cutbacks to social programs and lack of confidence in governments generally. A Gallup poll found that the majority of Canadians were not confident they will receive Old Age Security and Canada/Quebec Pension Plan benefits; the doubters numbered 71 percent of interviewees aged 18-29, 77 percent of those 30-39, 71 percent of those 40-49 and 53 percent of those 50-64, though only 15 percent of persons 65 and older [Gallup Poll 1994].

The extremist option of abolishing the CPP was never on the political table and not even mentioned in the public discussion paper. Even if the federal government wanted to take the enormous political risk and contend with the incredible transition problems of winding down a 30-year-old program that has promised many billions of dollars worth of pensions to the entire Canadian workforce which pays into the plan, it probably would not be able to do so because of opposition from at least some of the provinces. Two-thirds of the provinces with two-thirds of the population must agree to changes in the CPP; it is doubtful whether enough provinces would agree to scrap the plan. While the conservative governments of Ontario and Alberta might be open to anti-CPP arguments, it is unlikely that they would win support from enough provinces to axe the plan. At a meeting of federal and provincial finance ministers, Quebec objected to the options of reducing CPP benefits by 10 percent and increasing the age of eligibility for full retirement benefits from 65 to 67 (the QPP is parallel to the CPP, and Quebec has a vote in changes to the CPP since they would be expected to be carried over to the QPP), so it seems unlikely that Quebec would agree to the CPP’s abolition. Parliament must approve changes to the CPP; there certainly would be opposition to abolishing the CPP from most Liberals as well as the Bloc Quebecois and the NDP, though the Reform Party favoured replacing the CPP with super-RRSPs).

On the other hand, the federal government was under pressure from the business community to slow the future increase in CPP contribution rates, on the grounds that such payroll tax hikes would hurt their competitive position vis-à-vis other countries. It is fashionable in government policy-making circles to decry payroll taxes such as CPP contributions and UI premiums as a ‘tax on jobs’ that discourage employers from expanding their workforce [Government of Canada 1994:42]. Though in reality employers pass most of their payroll tax costs down to employees in the form of lower wages and to customers in higher prices, the fact remains that the corporate sector in Canada wields a powerful political pressure on government. Working Canadians face an even heavier burden from Canada Pension Plan contribution rates than most of them realize since they effectively pay for employers’ share. Already saddled with substantial overt and covert increases in their federal and provincial income taxes, how would
Canadians react to the prospect of every-increasing contributions until well into the 21st century?

Some critics also argued that younger workers – who face a hard time in the tough new labour market – would not be willing to pay the increasing contribution rates required to pay for their baby boom parents’ CPP benefits when they retire. The politically frightening spectre of ‘intergenerational conflict’ was another scare tactic exploited by the CPP’s opponents. At best, many young Canadians viewed the Canada Pension Plan as a bad deal for them compared to their parents; at worst, they believed unfounded but widely-believed claims that ‘the Canada Pension Plan will not be there for them’ when they retire.

routes to reform

The discussion paper issued by the federal, provincial and territorial governments stated that the CPP needed significant redesign if it were to remain economically and politically sustainable as the baby boom generation moves into old age. The paper proposed two major routes to reform – a fundamental change in the financing of the CPP, and reductions in CPP benefits.

The main financing proposal would shift the CPP from pay-go to partial funding by accelerating the contribution rate to achieve a ‘steady-state’ rate within six to eight years. The larger fund that would accumulate could be managed by means of a market-savvy investment strategy that would earn a higher rate of return through smart management in diverse equities and thus allow future contribution rates to be lower than they would otherwise be under the present system. An additional financing option was to freeze, reduce or eliminate the Year’s Basic Exemption (the earnings level – set at 10 percent of the Year’s Maximum Pensionable Earnings – below which contributions are not levied).

Benefit reductions could be achieved through a variety of means, including: lowering the earnings-replacement rate, partial deindexation, tightening the dropout provision, increasing the age of eligibility, eliminating the death benefit, and tightening the administration and some design features of the disability benefit. A combination of both approaches seems to be the government’s unstated but favoured option, since benefit reductions could bring down the steady-state contribution rate somewhat.

the makings of a consensus

The Canada Pension Plan’s traditional supporters – labour, social groups (including women’s, seniors, disability rights and anti-poverty groups) and the left in general – argued that governments had not made a convincing case that the plan is facing a crisis of sustainability. The latest Actuarial Report at the time had projected that
combined contribution rates under the CPP would have to increase from their current 5.4 percent of pensionable earnings to 12.6 percent in 2020, 14.2 percent in 2040 and 14.4 percent in 2100 [Office of the Superintendent of Financial Institutions 1995:7]. The question is: are such contribution rates ‘too high’ or ‘insupportable’? The critics claimed that governments and business did not even bother making the case: They simply assumed that the higher CPP contribution rates were out of the question both for employees and employers, who apparently would balk at carrying such a heavy payroll tax burden. Other industrialized countries already operate their social insurance pension plans with contributions around the level forecast for the worst years in Canada, 2030-2050. CPP contribution rates were increasing gradually, to allow employers and employees to adjust. Some on the left also rejected the assumption that high real interest rates and sluggish wage and economic growth would continue forever.

Not surprisingly, the Canada Pension Plan’s defenders vociferously opposed proposals to reduce benefits. Most of the discussion paper’s options to reduce benefits would hit women harder than men because women earn less, have lower average pensions and live longer than men. Weakening the already modest CPP would reverberate throughout the retirement income system and would hurt Canadians who rely on the program for an important source of retirement income.

Interestingly enough, though, some experts from the financial community who favoured a move to partial funding or some variant thereof (e.g., the Canadian Institute of Actuaries’ ‘conditional funding’ concept, a sort of flexible funding arrangement ranging from pay-go to full funding depending upon real interest rates), did not support significant reductions in CPP benefits, though some of these experts would tighten one or two. None of the financial community presenters at an experts forum co-hosted by the federal Department of Finance and the Caledon Institute of Social Policy supported the proposal to reduce the earnings-replacement rate, for example, and some of the CPP reform ‘hawks’ opposed such proposals to reduce benefits as partial indexation as well as the financing option of freezing, reducing or eliminating the Year’s Basic Exemption.

On the other hand, the CPP ‘doves’ were not universally opposed to partial funding. Although there were doubts concerning the economic advantages of partial funding, some CPP defenders appeared to consider steady-state financing an acceptable political compromise, if that would restore public confidence in the viability and intergenerational fairness of the program. In other words, the CPP doves seemed soft on partial funding.

The public consultations generated widespread support for maintaining the Canada Pension Plan as a public program. Though the views of the many and varied groups and individuals that appeared before the consultation travelling roadshow obviously differed on specific options for reform, generally speaking there was opposition to major benefit reductions and support for a change from pay-go to partial financing.
the deal

The emerging consensus from public and expert consultations suited the federal governments’ purposes ends handily and in 1997 it negotiated a deal with the provincial/territorial governments that went heavy on financing changes and relatively lightly on benefit reductions.

partial financing

Under the pay-go system, contributions had been increasing gradually each year since 1986 and would have had to rise considerably in future to meet the increasing demands on the Canada Pension Plan resulting from factors such as population aging, rising life expectancy, slow wage growth, past benefit improvements and rising disability expenditures (though the latter factor proved to be temporary since steps had been taken to tighten eligibility and trim expenditures). The combined (worker/employer) contribution rate was projected to increase two-and-a-half times between 1996 (5.6 percent of contributory earnings) and 2030 (14.2 percent of contributory earnings) under pay-go financing. The year 2030 is a sort of doomsday date when all of Canada’s baby boom generation will be elderly.

The federal and provincial governments’ deal moved the Canada Pension Plan to ‘partial funding.’ (Note that Quebec made the same changes to the Quebec Pension Plan). Canada Pension Plan contributions are increasing substantially over seven years (from 1997 through 2003), but then will level off once they achieve the so-called ‘steady-state’ rate of 9.9 percent of contributory earnings (again, split equally between employees and employers) – with no further increases thereafter.

Contributions will exceed expenditures, thus building up a fund; the steady-state contribution rate is designed to accumulate a fund equal to about five years’ worth of benefits over the next 20 years. The larger fund is being invested more broadly than under the current system, which has invested mainly in 20-year non-marketable provincial securities and charged the provinces the federal long-term bond rate. The Canada Pension Plan surplus is being invested in the market in a diversified portfolio of assets, following the practice of large employer pension funds in Canada and other countries. Provinces still can borrow from the Canada Pension Plan, though at the same rate of interest as they pay for their market borrowings after a phase-in period. Earnings on the investments are supposed to help reduce future contribution rates over what they would otherwise be. The Canada Pension Plan fund is managed by the Canada Pension Plan Investment Board, which operates at arms’ length from government accountable to the public and governments.

While it is still early days for the Canada Pension Plan Investment Board, so far so good. Its rate of return was 5.0 percent in 1998-1999 and 40.1 percent in 1999-2000, the latter reflecting the fact that the TSE 300 Index (the basis for the passive investment of 80 percent of the Board’s assets) enjoyed one of the highest increases among major
exchanges in industrialized nations, rising 45.5 percent. But the Board warned that the 1999-2000 performance was a happy anomaly; according to the President and CEO, “as we broaden our asset allocation base, the volatility of our portfolio will decline, as will the likelihood of achieving such outstanding results again” [Canada Pension Plan Investment Board 2000]. His words proved prophetic: With the following year’s turbulence in world markets, the rate of return fell to minus 9.4 percent in fiscal 2000-2001. The Board’s annualized rate of return since making its first investment in March 1999 is 14.8 percent. The Board projects its assets will grow steadily over the next ten years to exceed $130 billion by 2011 and is “confident that the total portfolio will produce returns that will meet or exceed those expected by the Chief Actuary and our long-term return target.” [Canada Pension Plan Investment Board 2001.] An excellent account of the mandate, structure and early performance of the CPP Investment Board is presented in Edward Tamagno’s 2001 report *Investing Social Security Funds: Principles and Considerations*, published by the Caledon Institute of Social Policy.

As to the sustainability of the steady-state contribution rate, the most recent Canada Pension Plan Actuarial Report concluded that it “is sufficient to pay for future expenditures and to accumulate assets worth $141 billion (i.e., 4.2 times the annual expenditures) in 2010. In 2050 the assets are projected to be $1,506 billion or 5.6 times the annual expenditures” The Actuarial Report concludes that “the Plan is sustainable over the long term, as it is projected that there will be more cash inflows than outflows over the entire projection period. The pool of assets generated over the projection period [to 2075] makes it possible for the Plan to absorb almost any unforeseen economic or demographic fluctuations, which other would have to be reflected in the contribution rate [Actuarial Report on the Canada Pension Plan 2001:11].

stealth: freezing the Year’s Basic Exemption

The other financing change is a freeze of the Year’s Basic Exemption, which had been wage-indexed. In 1997, the Year’s Basic Exemption was $3,500, calculated as 10 percent of the $35,800 Year’s Maximum Pensionable Earnings (the latter remains wage-indexed). By freezing the Year’s Basic Exemption, which will fall in value each year, the base of contributory earnings will increase (i.e., more earnings will be subject to Canada Pension Plan contributions) and thus future contribution rates can be lower than otherwise necessary. The Caledon Institute calculated that the $3,500 Year’s Basic Exemption will be worth $2,722 in 2003 and $822 in 2030 (in constant 1997 dollars). The federal government has estimated that, by freezing the Year’s Basic Exemption, by 2030 the (pay-go) rate would be reduced by 1.63 percentage points.

So freezing the Years’ Basic Exemption – a stealthy change that few Canadians will recognize or understand – proved irresistible to governments concerned about reducing future contribution rates. By comparison, the rapid ramp-up in contributions over the next several years will be very visible and perhaps difficult politically – though recent reductions in federal and provincial income taxes and Employment Insurance premiums will soften the blow.
The Year’s Basic Exemption offers (offered is a more accurate term, since it will decline in future) two advantages to contributors with below-average earnings. First, it reduces their contributory burden because the first $3,500 of earnings are exempt. Second, retirement pensions are calculated on the full range of earnings up to the Year’s Maximum Pensionable Earnings, not the narrower band of earnings (between the Year’s Basic Exemption and the Year’s Maximum Pensionable Earnings) on which contributions are paid. As a result, Canadians who earn below the average wage receive relatively more Canada Pension Plan retirement benefits in relation to their contributions than those who earn the average wage or higher.

The move to partial funding and the freeze on the Year’s Basic Exemption will impose a heavier burden on Canadians with below-average earnings than on those in the higher ($50,000-and-up) range. For example, a $20,000 employee’s net (i.e., after-tax credit) contributions will rise from $337 or 1.7 percent of earnings in 1996 to $625 or 3.1 percent of earnings in 2003, the year that the steady-state rate will be reached. A $50,000 employee’s net contributions will increase from $652 or 1.3 percent of earnings in 1996 to $1,181 or 2.4 percent of earnings in 2003. (All dollar figures are in inflation-adjusted 1996 amounts.)

Measuring the net increase in contributions (2003 versus 1996) as a percentage of earnings, the result ranges from a high of 1.6 percent for those earning just $6,000 to 1.5 percent for those earning $35,000 (roughly average earnings) and then declines with increasing income to just 0.5 percent of earnings for employees earning $100,000. The distributional pattern is identical for the self-employed − a growing group in the labour force − except that their increased burden is twice that of employees.

Women and younger workers will be hardest hit in relative terms during the seven-year transition to partial funding since they cluster at the lower end of the earnings spectrum. Among female Canada Pension Plan contributors, 79 percent earn less than the Year’s Maximum Pensionable Earnings (i.e. about the average) and 43 percent earn less than half the average. The large majority of young contributors earn below the average.

On the other hand, Canadians with low or modest employment earnings stand to benefit most in the longer term from the financing changes. The steady-state contribution rate will reach 9.9 percent in 2003, and then is supposed to remain level, whereas the pay-go rate would have kept increasing. After 2016, the pay-go rate would exceed the partial funding rate and rise year after year.

Moreover, partial funding is intended to restore public confidence in the long-term viability of the Canada Pension Plan − a pension program that is crucial to low- and modest-income Canadians, who rarely work for employers offering private pension plans or save much if anything in individual retirement savings plan. The growth of a Canada Pension Plan fund that will be invested broadly in the market should appeal to the many Canadians who either do not understand or accept the pay-go system in which there was
nothing more than a small contingency reserve. The baby boom generation in effect will be paying for part of its own pensions and Generations X, Y and Z will pay lower contributions than they would under the old (pay-go) system, which should to some extent address the issue of the Canada Pension Plan’s alleged intergenerational unfairness.

The Caledon Institute of Social Policy advocates a redesign of the income tax credit for contributions to the Canada Pension Plan to ease the rapidly rising burden of Canada Pension Plan contribution increases on plan members with below-average earnings. Instead of the current (federal) rate of 17 percent of contributions for all Canada Pension Plan contributors, Caledon proposes that the tax credit vary inversely according to income: Lower-wage workers would receive relatively more tax relief to ease their CPP contributions than higher-wage earners. Such a reform to the tax credit for Canada Pension Plan contributions is particularly important for the self-employed, who carry double the burden.

Boosting the tax credit for poor and modest-income contributors would increase the cost of the Canada Pension Plan tax credit to the federal and provincial governments and in effect transfer part of the cost of rising Canada Pension Plan contributions from labour force participants to taxpayers. However, the tax expenditure for Canada Pension Plan contributions will increase anyway under partial funding, though over the longer term not as much as under pay-go financing. The extra cost required to beef up the tax credit for Canada Pension Plan contributors with below-average earnings is in our view well worth the price.

stealth: benefit reductions

CPP benefits did not escape completely. Ottawa and the provinces agreed to a stealthy trimming of benefits through technical modifications that affect future pensioners and that few people would understand. Although these changes shaved the value of retirement benefits slightly (by 1.7 percent), the losses will hurt lower-income pensioners and their survivors hardest in relative terms.

Changes have been made to the way in which benefits are to be calculated for both retirement pensions and the earnings-related portions of the disability and survivor benefits. Benefits were based on the average Year’s Maximum Pensionable Earnings (YMPE) for the last three years, but in future will be calculated on an average for the last five years. While this change may be more consistent with the majority of private plans, it will reduce benefits for most workers because wages usually reach their peak at the end of a person’s working life. The overall average based on a five-year span typically will be lower than an overall average based on a three-year span, which generally includes the highest level of earnings.

Several changes were made to the disability benefit. Eligibility for this benefit has required that contributions be made in two of the past three years or five of the past 10
years; this is being lengthened to four of the past six years. Disability benefits no longer will be paid to estates, and Canadians already receiving early retirement benefits will not be eligible for disability benefits. The administration of the benefit will be tightened through more frequent reassessments and new appeal procedures.

The way in which retirement benefits are calculated for disability beneficiaries also is being modified. These pensions used to be based on the YMPE when the recipient turned 65 and then indexed to prices. The retirement benefit for disability beneficiaries now will be based on the YMPE at the time of disablement (regardless of when this occurred) and subsequent price indexing. In addition, disability benefits will no longer be paid to estates, and recipients of an early retirement benefit will no longer be eligible for disability benefits.

Prior to the Finance Minister’s announcement, the combined survivor-disability benefits were based on a ceiling equivalent to the maximum retirement pension plus the larger of the two flat-rate components of the survivor and disability benefits. The new ceiling is now one maximum disability pension. There has been no change to the ceiling of the combined survivor-retirement benefits.

The death benefit was not withdrawn but its value has been reduced from its former level of six months of retirement benefits to a maximum of $3,580 with wage indexation to six months of retirement benefits to a maximum of $2,500 with no indexation, so it will shrink steadily in future.

**D. Conclusion**

The federal government successfully implemented structural changes to the several elderly benefit programs that make up the foundation tier of the country’s pension system, but was unable to complete that program of reform by creating a single, integrated, family income-tested Seniors Benefit. Yet as part of the same reform process it successfully managed to make equally significant changes to the Canada Pension Plan which, along with the parallel Quebec Pension Plan, makes up the second tier of the pension system.

Why half-way reform on the one hand and all-the-way reform on the other? Sustainability – the watchword of both reform efforts – is as much a political as economic concept in the real world of policy-making.

The short-term political risks posed to the federal government by an unprecedented combination of attacks on its Seniors Benefit proposal from interest groups on both the left and right outweighed the potential benefits of the reform, which in fiscal terms (i.e., slowing the steamroller of relentlessly rising spending) were trivial in the short term, small in the medium term and significant though still modest in the long term. Moreover, the fiscal gains would have been even less under the revised option that
was designed to allay some of the criticisms levelled against it, since it would have increased maximum benefits and softened the reduction rate.

The Seniors Benefit was born during Canada’s tough anti-deficit years. The political optics of a reform that promised to slow relentlessly rising expenditures while at the same time improving benefits for those in greater need were attractive to a Liberal government struggling to combine its traditional social justice concerns with a tough fiscal stance. Yet when the light at the end of the deficit tunnel began to grow brighter, the reform – with its attendant political risks – began to look less compelling. Why take a risk – especially with a federal election in the offing, memories of past debacles in old age pension reform and the fear of gray power – when the fiscal imperative seemed weaker and the voices of the critics contrasted with a public that probably did not grasp the issues at hand?

The attacks from the critics were amplified by media that, with rare exceptions, thrive on criticizing government and do not understand the most basic concepts in public policy. Yet the case against the Seniors Benefit was, in my opinion, generally weak – some of the arguments were preposterous – and easily could have been countered by a forceful federal response together with the revised design that would have shown Ottawa’s willingness to respond to criticism. There is reason to believe that a well-crafted public education campaign could have sold the reform to the Canadian public, which has shown itself to be supportive of changes that create fairer, more progressive social programs – and apprehensive about the future sustainability of the pension system and social program generally. But, in the end, the certainty of the risks – including internal opposition from the Liberal caucus, especially the women’s caucus – won out over the more questionable political gains.

Some might argue that Ottawa’s cold feet on the Seniors Benefit stemmed as well from the Prime Minister’s pledge to his fellow Quebeckers (to counter criticism from the separatists) that his government would not cut old age pensions. But I think this issue also could have been handled with clear public information on the distributional impact of the new system and the fact that Quebec – with its relatively high rate of elderly poverty and absence of a provincial income supplement for its poor seniors – would have gained more than most provinces from the improvement in elderly benefits for lower-income seniors.

Unlike the stealthily wrought changes to the elderly benefits system in the 1980s that were not understood by the public, the media and even some interest groups, the Seniors Benefit was a relatively transparent reform proposal that had to undergo the glare of close scrutiny. By contrast, the regressive changes to the Canada Pension Plan – the heavier burden of contribution increases on lower-income Canadians and the small but stealthy benefit trimming – received scant criticism and did not cause governments any political pain.
Another factor that separated the two reforms was that the Seniors Benefit’s commitment to progressive distribution of benefits and family income-testing as opposed to demogrants proved controversial because it questioned core principles of the universalist model of the welfare state that shaped the development of social policy in Canada during the 1950s, 1960s and 1970s. The Seniors Benefit, like the Child Tax Benefit that preceded it and the Canada Child Tax Benefit that followed, were inspired by what I have termed a ‘post-welfare state’ approach to social policy that, while firmly committed to the fundamental ends of social provision, calls for structural reforms to the means by which those ends are pursued in the light of profound changes in the economy and society [Battle 2001]. Most civil society groups in Canada remain wedded to the universalist philosophy and suspicious of, if not hostile toward, the emerging post-welfare state. The reforms to the Canada Pension Plan and Quebec Pension Plan, on the other hand, evidenced governments’ continuing commitment to the philosophy and practice of social insurance that constitutes a core element of the universalist model – and is fully carried over in the post-welfare state approach.

Ironically, perhaps, the political failure of the Seniors Benefit was linked to the success of the reforms to the Canada Pension Plan. Attributing the lion’s share of the sustainability problem to rising Canada Pension Plan outlays, the federal government claimed that its fix for the CPP lessened the need to adopt (potentially controversial) reforms to slow rising elderly benefits spending.

The pressures to reform the Canada Pension Plan were far heavier than those to complete the transformation of elderly benefits that had occurred slowly and with little public or media comprehension during the 1980s and early 1990s. While privatization was never on the table – no Canadian government would dare even think out loud about so radical and potentially dangerous a change to the country’s pension system – the federal and provincial governments faced sizeable political risk if they failed to convince an apprehensive public that ‘the Canada Pension Plan will be there for them in future. The national nature of the Canada Pension Plan was another factor that likely helped the cause of reform: The federal and provincial governments share responsibility for the program, even though it is delivered by the federal government, and shared as well the attendant political risks of a perceived failure to act to ‘save’ the programs for future generations.

Adding weight to the reform was the need to maintain parallelism between the Quebec Pension Plan and Canada Pension Plan: Quebec, despite its fractious relations with Ottawa, was on the same road to partial financing (indeed, had advocated partial financing from the beginning of the plans in the mid-1960s to create a fund for public investment).

The selling case for reforming the financing of the Canada Pension Plan was not hard to make: The ‘money in the bank’ imagery inherent to partial funding appealed to Canadians and most interest groups who – though supportive of the CPP – were susceptible to the privateers’ warnings that the plan was in fiscal peril.
While the issue of the differential impact of the Seniors Benefit and Canada Pension Plan reforms on Canadians at different income levels never reached public attention to become a political issue, the CPP changes are easier on better-off Canadians and harder on those with below-average incomes, whereas the opposite would have been the case for the Seniors Benefit. The more rapid ramp-up of Canada Pension Plan contributions and the freeze on the Year’s Basic Exemption are regressive, as are the relatively hidden reductions in benefits. While Canadians doubtless will notice the significant increase in their contributions during the shift to partial funding, this increase is relatively painless for upper-middle-income and well-off contributors and is mitigated by sizable cuts to federal and provincial income taxes (which in dollar terms are regressive).

The public consultations had indicated broad opposition to significant cuts to Canada Pension Plan benefits, but the governments’ reform package did make changes that would trim future benefits a bit and reap some not insignificant savings as a result. Opposition to these benefit reductions was easily avoided by stealth: Few Canadians would grasp the nature and impact of the changes, which were highly technical.

Pension reform is an unfinished business. Canada’s federal and provincial governments are studying other possible changes to the Canada Pension Plan, including providing partial pensions, reforming survivor benefits, mandatory splitting of pension credits during marriage and extending coverage up the income scale by raising the limit on pensionable earnings above its current level of the average wage. As to elderly benefits, it seems unlikely that substantive changes of the scale of the Seniors Benefit will be resurrected any time soon given that the current Liberal government and its Conservative predecessor both got their fingers burned playing with the fire of pension politics.

References


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1 Federal and provincial standards governing occupational pension plans were strengthened. In most jurisdictions, vesting now must occur after no more than two years of membership; plan members become entitled to their employers’ pension contributions made on their behalf. Pension contributions must be locked-in, meaning that plan members cannot get at their employee and employer contributions until they retire. Private plans must provide survivor benefits, though unfortunately spouses can elect to waive this provision, and accumulated private pension benefits must be divided between divorcing spouses.

Employers providing pension plans must extend coverage to all full-time employees in an occupational group covered by the plan after two continuous years of employment and to their part-time workers, subject to certain conditions (in most jurisdictions, part-time workers become eligible if they have earned at least 35 percent of the average wage as measured by the YMPE after two consecutive years of employment). Plan sponsors must allow early retirement using actuarially reduced pensions. Portability provisions were improved; plan members who change jobs can transfer their accumulated pension contributions to their new employer’s plan if one exists, to a locked-in RRSP or to an annuity that pays benefits upon retirement.

However, there are no requirements regarding the critical feature of indexation, one of the strong points of the Canada and Quebec Pension Plans. Although there has been some improvement in inflation protection over the years thanks in large part to the efforts of trade unions, less than half of occupational pension plan members were in plans that provide some form of indexation to protect pensions from the ravages that even low rates of inflation can cause over a number of years (especially given the fact that average life expectancy is increasing); only 14.1 percent of plan members enjoyed full indexation to the cost of living.

Though the large majority of private pension plan members still belong to defined benefit plans, there is a trend away from defined benefit plans, which promise a retirement benefit based on a formula that takes into account years of service and average or recent earnings, to defined contribution plans in which the pension depends upon the amount of contributions and investment earnings built up over the years; defined benefit plans provide an important element of security that defined contribution plans (which are essentially savings plans) cannot.

II In this case ‘family’ means the combined income of the spouses; income from other family members is not included.

III Figures 8 through 13 are based on data from the National Council of Welfare, with additional calculations by the author. See National Council of Welfare 1996.

IV I have borrowed the phrase “slowing the steamroller” from Terrance Hunsley, who applied it originally to child benefits. See Hunsley 1990.