Pension Reform in Canada: Lessons for the United States

R. KENT WEAVER*

Canada has, in recent years, faced similar demographic and budgetary pressures on its public pension system to those experienced in the United States. In particular, Canada's contributory, earnings related pension tier, the Canada/Quebec Pension Plan, experienced a funding crisis in the 1990s. However, Canada has made a different set of reform choices than in the United States, and has done a better job in reducing poverty among seniors. This Article reviews recent Canadian reform experiences and outlines several lessons that Canada offers for the United States, including the potential to reduce senior poverty through expanded access to income-tested-benefits, design of "fail-safe" mechanisms for contributory pension tiers, design of tax advantaged retirement savings, and investment practices for current Social Security surpluses.

I. INTRODUCTION

As in most other western industrial countries, combinations of demographic and budgetary pressures have placed reform of public pensions on the Canadian agenda in recent years.[1] Some of the reforms adopted in Canada were similar to those that were enacted in the United States. In particular, Canada has shifted the Canada Pension Plan, the contributory earnings-related pension tier of its pension system, from a pay-as-you-go system to one that is partially-advance funded.

Pension reform in Canada differs from the United States experience in several important ways. First, successive Canadian governments have proposed several retrenchment initiatives in public pension programs over the past twenty years, although their success in actually enacting retrenchment has been mixed. This is quite different from the United States, where major cutbacks in Social Security have not come close to enactment since the 1983 Social Security rescue package. Second, Canada was able to enact huge across-the-board increases in pension payroll taxes in the late 1990s, while payroll taxes have largely been off the U.S. agenda since the early 1980s. Third, unlike the U.S., Canada has never seriously considered a move to individual defined-contribution accounts within the basic government pension system. Canada has, however, built up a very substantial system of voluntary, tax-advantaged individual accounts called Registered Retirement Savings Plans, or RRSPs. Fourth, Canada has in recent years broadened the range of allowable investments for accumulated Canada Pension Plan (CPP) surpluses (the rough equivalent of the Old Age and Survivors Insurance (OASI) Trust Fund). CPP

---

* Georgetown University and the Brookings Institution

[1] For an overview of the Canadian welfare state, see Keith Banting, *The Social Policy Divide*, *in* DEGREES OF FREEDOM: CANADA AND THE UNITED STATES IN A CHANGING WORLD 267–309 (Keith Banting et al. eds., 1997).

surpluses are now invested in a broad array of financial instruments, including domestic and foreign equities. Moreover, Canada has made this policy shift with relatively little controversy. Fifth, Canada has adopted a "fail-safe" structure for its social insurance tier in case of unexpected financial deterioration of the fund that is much stiffer than the equivalent measure in OASI. Sixth, Canada has given increased recognition to the care-giving function in its earnings related pension tier, the Canada Pension Plan. Finally, and perhaps most importantly, Canada has succeeded in lowering its elder poverty rates to levels comparable to those in many of Western Europe's most generous welfare states, while spending about as much of GDP on pensions as the United States.

After examining pressures for policy change in Canada and how those pressures were mediated by program structures and political institutions, this paper examines Canadian experiences in pension reform over the past two decades. The paper then turns to future challenges faced by the Canadian system and potential lessons that the Canadian experience offers for the United States.

II. THE SOCIAL AND DEMOGRAPHIC ENVIRONMENT

Like other advanced industrial countries, Canada has been hammered by a combination of demographic and economic forces that have made it difficult to maintain existing pension policy commitments. Canada's population aged sixty-five and above was only 12.7% of its total population in the year 2000—just a bit above the United States (12.6%), and far below most West European countries.[2] But Canada's elder dependency ratio—the ratio of the population aged sixty-five and higher as a percentage of the working aged population—is expected to grow higher than that of the U.S. in the next few decades. The general problem of the retirement of the "baby boom" generation after 2010 will be exacerbated in Canada by the fact that the onset of the baby boom after World War II was faster and more immediate than in the United States.[3] In addition, fertility rates have fallen much faster and further in Canada than in the United States: from 4.0 children per woman in the late 1950s to around 1.55 (and an even lower 1.45 in Quebec) at the beginning of the twenty-first century.[4] Overall, Canada is expected to undergo a major population aging over the next seventy-five years, and to rely on net immigration for population

---

[2] KEVIN KINSELLA & VICTORIA A. VELKOFF, U.S. DEP'T OF HEALTH AND HUMAN SERVICES, AN AGING WORLD: 2001, at 126 (Nov. 2001), *available at* http://www.census.gov/prod/2001pubs/p95-01-1.pdf (last visited Jan. 15, 2004).

[3] David Walker, *Discussion*, *in* FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS AND ECONOMICS 272 (R. Douglas Arnold et al. eds., 1998).

[4] OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS, OFFICE OF THE CHIEF ACTUARY, ACTUARIAL REPORT (18TH) ON THE CANADA PENSION PLAN AS AT 31 DECEMBER 2000, at 57–58, *available at* http://www.osfi-bsif.gc.ca/eng/office/actuarialreports/pdf/CPP1801.pdf (last visited Jan. 15, 2004).

growth.[5]

If demographic pressures in Canada have mostly affected long-term pension policymaking in Canada, fiscal pressures have been far more immediate. These pressures have been of two related types. The first relates to international competitiveness, where Canada has faced a mixed set of pressures. In several West European countries, payroll tax rates for old age and disability total 15–20% of taxable earnings or even higher, with total social security payroll taxes as high as 40.91% (Germany) and 54.8% (Netherlands) of taxable earnings.[6] These high payroll tax rates have prompted serious concerns from business leaders that high payroll tax rates contribute to making their businesses uncompetitive in the international marketplace. Canada does not have this problem: Canada Pension Plan payroll taxes are relatively low, reaching 5.0% only in 1993, before a rapid rise (described in later sections) to what is supposed to be a permanent 9.9%, split equally between employers and employees, in 2003.[7] This is significantly below the 10.6% tax rate—on a much higher tax base—for OASI in the United States. The picture is quite different for overall tax rates, however: Canada's economy is overwhelmingly dependent on trade with the United States, and total Canadian tax revenues as a percentage of GDP have been six to eight percentage points higher in Canada than in the United States in recent years.[8] The "tax gap" between Canada and its leading trade partner, combined with rapidly rising health expenditures, has created strong overall pressures for austerity in Canadian policymaking.

Deficit pressures have been even more severe, especially since public pensions in Canada are, as we will see below, financed much more from general revenues than in the United States. Canada ran an uninterrupted string of federal budget deficits for a quarter century through 1996–97, with combined federal and provincial/territorial budget deficits peaking at over 10% of GDP in 1984–85 and close to double that level in 1992–93. In 1995–96, the federal government's debt charges were equal to 36% of revenues, and net federal debt stood at 71.2% of GDP, before an improved economy and budget austerity policy led to a dramatic fiscal turnaround in the late

---

[5] In Canada outside Quebec, the population aged sixty-five and above as a percentage of the population aged twenty to sixty-four is expected to rise from 20.3% in 2001 to 28.5% in 2020 and to 42.4% in 2050. *Id.* at 64.

[6] OFFICE OF RESEARCH, EVALUATION AND STATISTICS, SOCIAL SECURITY ADMIN., SOCIAL SECURITY PROGRAMS THROUGHOUT THE WORLD: EUROPE, 2002, at 22–23 (Sept. 2002), *available at* http://www.ssa.gov/policy/docs/progdesc/ssptw/2002-2003/europe/ssptw02euro.pdf (last visited Jan. 15, 2004).

[7] HUMAN RESOURCES DEVELOPMENT CANADA, THE ISP STATS BOOK 2001: STATISTICS RELATED TO INCOME SECURITY PROGRAMS 117, *available at* http://www.hrdc-drhc.gc.ca/isp/studies/trends/statbook/ispstatbook_e.pdf (last visited Jan. 15, 2004).

[8] ORG. FOR ECONOMIC COOPERATION AND DEV., REVENUE STATISTICS 1965–2001 (2002), *available at* http://www.oecd.org/dataoecd/6/63/1962227.pdf (last visited Jan. 15, 2004).

1990s.[9] In short, pension policy over the last two decades of the twentieth century was shaped by fiscal pressures that were severe and sustained.[10]

III. THE INSTITUTIONAL ENVIRONMENT

Because pension reform, and especially pension retrenchment, is generally very unpopular, its political prospects may be mediated in important ways by the structure of political institutions. In general, institutional arrangements that concentrate power, like Westminster-style parliamentary systems, are thought to increase governmental capacity for unpopular loss-imposing actions such as pension retrenchment over arrangements such as the U.S. separation of powers that diffuse power; this effect may be partially offset, however, by the concentration of accountability that accompanies concentration of power.[11]

Canada is a classic Westminster-style parliamentary system with power concentrated heavily in the executive, at least during periods when there is a single party majority government in the Canadian House of Commons. Historically, minority Liberal Party governments dependent for their survival on a progressive or social democratic party to their left were responsible for many important Canadian social policy expansions. But single party majority governments have been the recent norm in Canada. There has been only one nine month period of minority government (in 1979–80) since 1974, and that was under the Progressive Conservatives. Moreover, the Liberal Party has been in power for most of the period since 1963. Other than the 1979–80 minority government, the Progressive Conservatives, the traditional major opposition to the Liberals, held power for only nine years, from 1984–93.

Strong executive power is reinforced by strong party discipline in the House of Commons. In practice, the two traditional major parties have both been centrist "brokerage" parties that tried to appeal across class, ideological, linguistic and regional lines.[12] While the Liberals have had a larger social reform wing and the Progressive Conservatives a larger right wing, there are also many "Business Liberals" and "red Tories." As a result, pension politics has until recently not been a

---

[9] DEPARTMENT OF FINANCE, THE FISCAL BALANCE IN CANADA 18–20 (Aug. 2000), *available at* http://www.fin.gc.ca/fiscbal/fiscbal_e.pdf (last visited Jan. 15, 2004); DEPARTMENT OF FINANCE, THE ECONOMIC AND FISCAL UPDATE Annex 2 (Oct. 30, 2002), *available at* http://www.fin.gc.ca/ec2002/ec02e.pdf (last visited Jan. 15, 2004).

[10] *See, e.g.*, James P. Feehan, *The Federal Debt*, *in* HOW OTTAWA SPENDS 1995–96: MID-LIFE CRISIS 31–58 (Susan D. Phillips ed., 1995).

[11] *See* Leslie A. Pal & R. Kent Weaver, *The Politics of Pain*, and *Conclusions*, *in* THE GOVERNMENT TAKETH AWAY: THE POLITICS OF PAIN IN THE UNITED STATES AND CANADA 1–40, 293–328 (Leslie A. Pal & R. Kent Weaver eds., 2003).

[12] *See* HAROLD CLARKE ET AL., ABSENT MANDATE: THE POLITICS OF DISCONTENT IN CANADA (3d ed. 1997).

matter in which partisan differences loomed large. That has changed somewhat since the watershed 1993 election, in which the Progressive Conservatives suffered a catastrophic defeat, falling from a majority government to only two seats. Now the apparently hegemonic Liberals face only a much more conservative Canadian Alliance Party (known as the Reform Party until early 2000), a separatist Bloc Québécois, a not-quite-dead Progressive Conservative party, and a weak social democratic New Democratic Party. Leaders of the Canadian Alliance and Progressive Conservative parties agreed in October 2003 to put a merger of the two parties to a vote of their members, but even a merged party is unlikely to alter government in the short run. Although only the Liberals have a realistic prospect of forming a majority government in the near future, that does not mean that they do not have to be cautious: they came close to losing their majority in the House of Commons in the 1997 election, although no other single party won more than twenty percent of the seats.

Canada has a second chamber in its national legislature, the Senate. It is an anachronism, however, because its legitimacy is severely compromised by the fact that its members are appointed by the federal Prime Minister rather than elected. Therefore, the Senate rarely uses its theoretical power to block or seriously amend legislation passed by the House of Commons. It is most likely to do so in the first few years after a turnover in control of the House of Commons, before retirements and deaths of Senators have allowed the Prime Minister to use his appointment power to stack it with Senators loyal to his or her party. The Canadian executive-legislative nexus is, in short, a system in which both the power to impose policy and accountability for governmental actions are concentrated, at least for programs that are entirely within federal jurisdiction.

Another institutional factor that influences the potential for policy change in Canada is the electoral cycle. General elections for the Canadian House of Commons must be called only once every five years, although by tradition, they occur after about four years. These relatively long electoral cycles should afford a substantial window of opportunity for pension retrenchment and other types of loss-imposing actions. This is partially offset, however, by the fact that each of Canada's ten provinces is on its own distinctive electoral cycle: thus if the federal government is concerned about the electoral consequences of its actions on provincial as well as the federal elections, it may be reluctant to take unpopular moves on pensions at almost any time. Ties between federal parties and their provincial counterparts of the same name have weakened in recent years.[13] And some provincial elections are more likely to spark concerns than others. An election in tiny Prince Edward Island is unlikely to spark substantial concern in Ottawa, but the stakes in Quebec provincial elections are

---

[13] Peter McCormick, *Provincial Party Systems, 1945–1993*, *in* CANADIAN PARTIES IN TRANSITION 349–72 (Alain G. Gagnon & A. Brian Tanguay eds., 2d ed.1996); Rand Dyck, *Relations Between Federal and Provincial Parties*, *in* CANADIAN PARTIES IN TRANSITION, *supra*, at 160–89.

potentially much more important. One of the two main party competitors in those contests is the pro-sovereignty Parti Québécois and unpopular moves on pensions may help to elect a PQ government that will hold another referendum on Quebec sovereignty. A Quebec referendum on sovereignty and economic association with Canada was soundly defeated in 1980, but a second referendum lost by only a few thousand votes in 1995. Clearly pension retrenchment or payroll tax increases just before a Quebec provincial election or referendum on Quebec sovereignty is something that a governing party in Ottawa will likely try to avoid.

A third key feature of Canadian political institutions, as the discussion of electoral cycles suggests, is federalism. Canada has only ten provinces, plus three territories. Canadian provinces have strong, constitutionally-protected jurisdictions. Moreover, provincial premiers (the provincial equivalent of prime ministers) are very active on the national political stage as defenders of provincial interests. Overall, the political science literature suggests that federalism tends to inhibit welfare state growth,[14] but the effects clearly are not unidirectional, and depend both on the specifics of program structure and federal arrangements. Three specific hypotheses about federalism (and policy feedbacks) in mature welfare states seem appropriate. First, pension programs that are entirely within provincial jurisdiction, and entirely financed by the provinces/states, are likely to be especially meager, and subject to retrenchment initiatives, as sub-national governments seek to avoid becoming "welfare magnets" in a process that leads to a "race to the bottom." Second, programs that are primarily financed by one level of government but delivered by the other are also likely to be especially vulnerable to cuts, as the financing level of government may feel, if it is pressed by high budget deficits, that it can cut expenditures while the level of government delivering the benefits is likely to incur most of the blame. Finally, pension programs that require changes to be approved by both levels of government are likely to encounter what Fritz Scharpf has labeled the "joint decision trap" and thus be especially impervious to change, especially to retrenchment. As we will see below, neither of the first two conditions currently apply to Canadian pension policy; it is the third feature that has been particularly important in reform of public pensions in Canada.

IV. THE PENSION POLICY ENVIRONMENT

Another critical set of influences mediating the prospects for pension reform are "policy feedbacks"—the policies already in place and the political support coalitions that tend to grow up around and defend them. Canada currently has a public pensions system with three main tiers of cash benefits, rather than the two-tier system in the

---

[14] *See, generally*, KEITH BANTING, THE WELFARE STATE AND CANADIAN FEDERALISM (2d ed. 1987); Paul D. Pierson, *Fragmented Welfare States: Federal Institutions and the Development of Social Policy*, 8 GOVERNANCE 449, 449–78 (1995).

United States.[15] The Canadian federal government inaugurated old-age pensions in 1927, after an election in which pension legislation played a prominent role.[16] The Old Age Pension Act was a system of shared-cost grants to the provinces for means-tested pensions payable at age seventy. Changes in the pension amount and means-test were made in the 1940s, and the provinces were allowed to supplement the pension beginning in 1942.[17] But no fundamental reforms were made until 1951, when a program of universal, federally-financed pensions beginning at age seventy was enacted and accompanied by federal aid for provincial means-tested pensions for those aged sixty-five to sixty-nine.

The resulting system left most Canadian seniors with very inadequate pensions. In the 1963 election campaign the Liberals promised new legislation that would add an earnings-related tier to public pensions on top of the universal pension, now called Old Age Security (OAS). The election produced a Liberal minority government after six years of Conservative rule, and left the balance of power in the House of Commons in the hands of the social-democratic New Democratic Party, the successor to the CCF. A prolonged process of federal-provincial bargaining ensued to allow Ottawa to establish the second major cash tier in Canada's retirement income system—the Canada Pension Plan (CPP), a contributory social insurance plan that pays benefits linked to an individual's contribution history. To make the plan attractive to the provinces, Ottawa agreed to allow the provinces to borrow CPP surpluses as they accrued in the early years of the program. An opting-out clause allowed Quebec to operate the distinct Quebec Pension Plan (QPP), retaining complete control over all investment funds in the QPP.[18] However, contribution rates

---

[15] In Canadian discourse, the quasi-universal OAS and income-tested GIS and the Allowance are all referred to as a single tier or "pillar." In this discussion, I will follow the more conventional practice of separating out universal and income-tested programs as distinct, although integrated tiers. For general background on government pensions in Canada, see NATIONAL COUNCIL OF WELFARE, A PENSION PRIMER (1999); Banting, *supra* note 14.

[16] Ottawa had sold annuities to the public under a 1908 statute, but the program was voluntary and never attracted a large clientele. A Liberal minority government passed pension legislation in the House of Commons in 1926 under heavy pressure from the Progressives and other small parties on the left, but it was blocked by a Conservative majority in the Senate. On the origins of Canadian pension policies, see KENNETH A. BRYDEN, OLD AGE PENSIONS AND POLICY-MAKING IN CANADA (1974) (especially chapters 3 and 4). This discussion draws heavily on Bryden's account.

[17] As Bryden notes, provincial administrative discretion in administering the means-test led to further inter-provincial discrepancies in pensions. *Id.* at 101. *See generally id.* at 81–101 (discussing the implementation of the 1927 Old Age Pensions Act).

[18] Negotiation with the provinces was required because supplementary benefits (e.g., for widows, survivors, and the disabled) were not covered by the 1951 amendment, and thus federal entry required provincial assent to another amendment to the British North America Act. On the negotiations surrounding creation of the Canada Pension Plan, see RICHARD SIMEON, FEDERAL-PROVINCIAL DIPLOMACY: THE MAKING OF RECENT POLICY IN CANADA 43–65 (1972) and Bryden, *supra* note 16, ch. 8.

and eligibility levels in the CPP and QPP have been kept harmonized. The provinces thus resisted benefit increases in the early years of the program because they did not want to have to pay back the funds they had borrowed. Moreover, changes in the arrangement require the approval of a super-majority of the Canadian provinces. As a result, the CPP/QPP has been a more difficult target for either expansionary or contractionary pension initiatives than pension programs within exclusive federal jurisdiction.[19]

The normal retirement age for CPP pensions is sixty-five, but early retirement (with a reduction in benefits) is available from age sixty.[20] Like Social Security in the United States, the CPP provides a higher return to low-wage workers, but using a different mechanism: contributions are not paid on an initial amount of yearly earnings, the year's basic exemption or YBE ($3,500 in 1997). However, those earnings are counted toward benefit entitlement.

The third income-tested tier of Canadian pensions is made up of the Guaranteed Income Supplement (GIS), created in 1965, and an Allowance—now available to spouses and common law partners of OAS pensioners who are age sixty and above, created in 1975. Unlike SSI in the United States, however, there is no asset test for these income-tested benefits. These programs supplement OAS payments to low income senior citizens and their near-senior spouses. OAS, GIS, and SPA are all financed out of general revenues and together provide an income guarantee higher than the Supplemental Security Income floor in the United States—currently about 16% of average wages for OAS alone and 35% for a full OAS and GIS benefit combined.[21] As of 2003, about 37% of OAS pensioners also received at least some GIS payments.[22]

---

[19] Changes in the CPP must be approved by two-thirds of the Canadian provinces having two-thirds of the Canadian population. In practice, Quebec has a veto over major changes as well, since policymakers want to keep the Canadian and Quebec plans closely integrated. *See* Keith Banting, *Institutional Conservatism: Federalism and Pension Reform*, CANADIAN SOCIAL WELFARE POLICY: FEDERAL AND PROVINCIAL DIMENSIONS 48–74 (Jacqueline Ismael ed., 1985).

[20] There is a 6% reduction of benefits for each year below age sixty-five that a person elects early retirement. Individuals can also elect to delay CPP benefits to any point up to age seventy, with a bonus of 6% for each year of delay in benefit take-up. HUMAN RESOURCES DEVELOPMENT CANADA, CANADA PENSION PLAN RETIREMENT PENSION 4–5 (Dec. 2002), *available at* http://www.hrdc-drhc.gc.ca/isp/cpp/retire_e.pdf (last visited Jan. 15, 2004).

[21] In April–June 2003, the maximum OAS monthly rate was $456.08. The maximum Guaranteed Income Supplement was $542.03 for a single person and $353.06 for each person in a married or common law couple where both were pensioners. HUMAN RESOURCES DEVELOPMENT CANADA, INCOME SECURITY PROGRAMS tbls. 1–3, *available at* http://www.hrdc-drhc.gc.ca/isp/oas/tabrates2003.pdf (last visited Jan. 15, 2004); *see also* Mark Sarney & Amy M. Preneta, *The Canada Pension Plan's Experience with Investing Its Portfolio in Equities*, 64 SOC. SEC. BULLETIN NO.2 46, 47 (2001–02).

[22] In April 2003, 3.98 million persons received OAS benefits, 1.46 million received GIS benefits, and another 94.5 thousand received the Allowance. HUMAN RESOURCES DEVELOPMENT

The early programmatic choices made in building Canada's multi-tiered (universal, income-tested, earnings-related) retirement income system limited the range of later options open to politicians—it would now be almost impossible for Canada to start afresh with a dramatically different system of social provision, and almost as hard to delete existing tiers of pensions. For example, targeting inefficiencies in the universal Old Age Security program have long been recognized. But simply abolishing it and relying on the contributory Canada Pension Plan was not an option. Because the CPP was originally designed as a supplement to OAS rather than as a replacement for it, the replacement rate provided by the CPP is very low—roughly 25% of earnings, up to a maximum of about 25% of the average wage. CPP/QPP benefits, like those for OAS, GIS, and Allowance are all indexed for inflation. The Guaranteed Income Supplement was also increased several times on an ad hoc basis, generally in election years, for example, 1979, 1980, and 1984.

As in the U.S., benefits are also delivered to seniors through the tax system, both directly through the Age Credit and Pension Credit (both were tax exemptions and therefore regressive in their impact until 1988), and indirectly, through tax subsidies for contributions to employment-based plans (Registered Retirement Plans, or RRPs) and personal pension plans (Registered Retirement Savings Plans, or RRSPs). RRPs and RRSPs allow contributors to defer taxation on income until they retire; in 2003, individuals could contribute up to 18% of their pre-tax income into RRSPs to a maximum of $13,500.[23] RRSPs differ from their U.S. counterpart 401(k) plans in several ways. In particular, they do not require employer sponsorship and employees can make "catch-up" contributions for years in which they did not hit their contribution ceiling. Canada's tax incentives for retirement saving for both employers and individuals puts Canada in the middle range of OECD countries in private pension fund assets as a percentage of GDP.[24]

RRSPs and RRPs primarily benefit middle and upper-income Canadians who are more likely to have employer-provided pensions and be able to save for retirement.[25] But they comprise a very large share of retirement income; the Canadian government

---

CANADA, CANADA PENSION PLAN OLD AGE SECURITY STATISTICAL BULLETIN 33 (2003), *available at* http://www.hrdc-drhc.gc.ca/isp/studies/trends/monthly/pub0403.pdf (last visited Jan. 15, 2004).

[23] For a brief summary of the complex limits on RRSPs and RRPs, see Jack M. Mintz & Thomas A. Wilson, *Saving the Future: Restoring Fairness to the Taxation of Savings*, C.D. HOWE RESEARCH INSTITUTE COMMENTARY, (Nov. 2002), *available at* http://www.cdhowe.org/pdf/commentary_176.pdf (last visited Jan. 15, 2004).

[24] ORG. FOR ECONOMIC COOPERATION AND DEV., MAINTAINING PROSPERITY IN AN AGING SOCIETY 65 (1998), *available at* http://www.oecd.org/dataoecd/21/43/249142.pdf (last visited Jan. 15, 2004).

[25] A Statistics Canada study on RRSP contributors in the early 1990s found that slightly less than one-third of Canadians used at least 95% of their maximum RRSP contribution room. *See More Canadians Than Expected Take Their RRSPs to the Max*, FINANCIAL POST, Dec. 6, 1995, at 25.

estimates that (excluding the Age and Pension Credits), tax deferred savings through RRPs and RRSPs provided almost 44% of government-sponsored retirement income in 1997, compared with 27.5% for OAS and GIS combined, and 28.8% for the Canada Pension Plan and Quebec Pension Plan.[26]

Overall, Canadian retirement income policies cost about the same percentage of GDP as in the United States. But there are also important differences. First, the Canadian system, as noted above, is financed far more through general revenues (both OAS and GIS) than in the United States. Second, the Canadian retirement income system distributes far more of its resources—about 38%—through the income-tested GIS and Allowance than does its rough U.S. counterpart, the Supplemental Security Income program at only 3%. Third, with a flat–rate universal OAS, a very accessible GIS, and a CPP/QPP with a low replacement and low ceiling, the Canadian retirement income system is much flatter in its benefit distribution than in the United States.

Fourth, the Canadian retirement income system is much more effective at poverty reduction. Timothy Smeeding of Syracuse University has used cross-national data from the Luxembourg Income Study to examine senior poverty rates in nine countries, using 50% of median adjusted household disposable income as the poverty standard. Smeeding found that in 1994, Canada had a higher senior poverty rate than the United States based solely on market income such as earnings and capital income (78.9% and 73.8%, respectively), and nearly equal senior poverty rates 61.6% and 60.2%) when occupational pensions were also taken into account. But adding in Canada's OAS and CPP/QPP lowered senior poverty to only 15.4%, compared to 23.5% of seniors in poverty in the U.S. when the effects of Social Security are included. And GIS lowered Canada's senior poverty rate much further, to only 6.1%, roughly the same level as in Sweden. Social safety net transfers in the U.S. (notably SSI), on the other hand, lowered senior poverty only another 0.8%, to 22.7%.[27]

Finally, the Canadian system is somewhat less successful at promoting the continued engagement of older workers than in the United States. In Canada, the percentage of male workers aged fifty-five to sixty-four who were employed dropped significantly from 72.8% in 1980 to 54.7% in 1996, while the percentage of women in that age group who were employed rose only slightly in the same period, from 32.0% to 34.1%. These 1996 figures are higher than in most West European countries, but 10% and 14% lower than the United States figures for older male and female workers, respectively.[28]

---

[26] GOV'T OF CANADA, SECURING CANADA'S RETIREMENT INCOME SYSTEM 6 (Apr. 1997), *available at* http://dsp-psd.communication.gc.ca/Collection/F2-118-1997E.pdf (last visited Jan. 15, 2004).

[27] TIMOTHY M. SMEEDING, INCOME MAINTENANCE IN OLD AGE: CURRENT STATUS AND FUTURE PROSPECTS FOR RICH COUNTRIES (Oct. 2002) (especially tbl. 4), *available at* http://www.bc.edu/centers/crr/papers/wp_2002–11.pdf (last visited Jan. 15, 2004).

[28] PETER AUER & MARIÀNGELS FORTUNY, AGEING OF THE LABOUR FORCE IN OECD

V. THE INTEREST GROUP ENVIRONMENT

Independent voices on pension policy have been relatively muted in Canada. The Canada Pension Plan, in particular, has been dominated by intergovernmental bargaining rather than by interest group politics—not very surprising given the program's structure and the overall ubiquity of "executive federalism" in shared jurisdiction programs in Canada.

The relative weakness of Canadian seniors' organizations may be due in part to the provision of comprehensive health care services by provincial governments (with subsidies by Ottawa), which has removed one potential source of both senior grievances and selective benefits for members ("medigap" and prescription drug insurance) used by American Association of Retired Persons in the U.S. Canada does have several seniors' organizations, but they have not been a major voice on seniors' issues. The Canadian Association of Retired Persons (CARP), for example, claims a membership of close to 400,000 but its focus has been more on providing discounts and information for members than on issue advocacy.[29] And with a small headquarters staff (around fourteen, including volunteers) based in Toronto, CARP lacks the resources and the expertise needed to be a major player in Ottawa. Other seniors organizations such as One Voice-Seniors Network do have an Ottawa presence, but a tiny one. The Canadian Labour Congress also takes an active interest in pension policy.

Canada's very small think tank community has also taken an active role in recent pension policy debates in Canada.[30] The C.D. Howe Institute, a Toronto-based, business-oriented think tank has published a series of papers criticizing the financing of the Canada Pension plan and the returns that it offers to younger contributors.[31]

COUNTRIES: ECONOMIC AND SOCIAL CONSEQUENCES, § 2(ii) (2000), *available at* http://www.ilo.org/public/english/employment/strat/download/ep2.pdf (last visited Jan. 15, 2004).

[29] *See Give and Take: Meeting Paul Martin*, CARPNEWS, Oct. 1997, *available at* http://www.50plus.com/ArticleFull.cfm?objectid=F5E029DC-DFDF-1103-B62F009027DE53E4&Section=Health&catName= (last visited Jan. 15, 2004), Lillian Morgenthau, *Playing the Numbers Game*, FIFTY PLUS, April 2000, *available at* http:www.50plus.com/ArticleFull.cfm?objectid=8036334D-0B43-11D4-B63E009027DE53E3&Section=CARP&catName= (last visited Jan. 15, 2004). *See also* Judy Creighton, *Seniors Group CARP Fishing for Boomers*, LONDON FREE PRESS, Dec. 16, 1999, at C11.

[30] On Canadian think tanks, *see* DONALD E. ABELSON, DO THINK TANKS MATTER?: ASSESSING THE IMPACT OF PUBLIC POLICY INSTITUTES (2002).

[31] *See, e.g.*, William B.P. Robson, *Ponzi's Pawns: Young Canadians and the Canada Pension Plan*, *in* JOHN B. BURBIDGE ET AL., WHEN WE'RE 65: REFORMING CANADA'S RETIREMENT INCOME SYSTEM (1996), *available at* http://www.cdhowe.org/pdf/Pensions.pdf (last visited Jan. 15, 2004); DAVID W. SLATER & WILLIAM B.P. ROBSON, *Building A Stronger Pillar: The Changing Shape of the Canada Pension Plan*, C.D. HOWE RESEARCH INSTITUTE COMMENTARY (Mar. 1999),

The free-market-focused Fraser Institute has argued for a weakening of RRSP foreign investment restrictions,[32] while the liberal Canadian Centre for Policy Alternatives has criticized privatization proposals.[33] Overall, conservative critiques of public pensions in Canada have been relatively ineffective because (1) the overall political culture in Canada is more supportive of a strong governmental role than in the United States, especially for a welfare state, and (2) although proponents of pension privatization are moderately well-financed and institutionalized, they are not closely allied to a political party that has the political clout to get the issue of pension privatization on the agenda and push it through to adoption.

Perhaps the most important think tank player in Canadian pension policy has been the Caledon Institute of Social Policy, a tiny (less than five person professional staff) Ottawa-based think tank. Caledon's head, Ken Battle, was for many years director of the National Council of Welfare, a quasi-independent advisory body to the federal government. Battle was increasingly critical of the Mulroney government's social policies, and in 1992 obtained foundation start-up funding to provide a more independent social policy voice through the Caledon Institute. After the return of the Liberal Party to power in 1993, Battle enjoyed very good access to Finance Minister Paul Martin, just as the paramountcy of deficit reduction was making Martin by far the leading player in social policy generally and pension politics in particular.

VI. INITIAL PENSION RETRENCHMENT INITIATIVES

Several efforts to reduce pension costs in Canada took place in the 1980s.[34] In late 1984, the new Progressive Conservative government headed by Brian Mulroney considered cutting Canada's universal demogrant programs—Old Age Security and Family Allowances—as a way to reduce the country's huge budget deficit and target resources on the needy. The government ultimately retreated from an attack on universality without ever articulating a clear proposal, and Mulroney backed himself further into a fiscal corner by pledging to maintain universality.[35]

---

available at http://www.cdhowe.org/pdf/rob-10.pdf (last visited Jan. 15, 2004).

[32] *See* JASON CLEMENS ET AL., FRASER INSTITUTE, THE 20% FOREIGN PROPERTY RULE: INCREASING RISK AND DECREASING RETURNS ON RRSPS AND RRPS (1999).

[33] *See, e.g.*, MONICA TOWNSON, PENSIONS UNDER ATTACK: WHAT'S BEHIND THE PUSH TO PRIVATIZE PENSIONS (2001).

[34] For an overview of changes in Canadian pension programs, see generally Ken Battle, *A New Old Age Pension*, *in* KEITH G. BANTING & ROBIN BOADWAY, REFORM OF RETIREMENT INCOME POLICY: INTERNATIONAL AND CANADIAN PERSPECTIVES 135, 146–47 (1997); See Michael J. Prince, *Lowering the Boom on the Boomers: Replacing Old Age Security with the New Seniors Benefit and Reforming the Canada Pension Plan*, *in* HOW OTTAWA SPENDS 1997– 98, SEEING RED: A LIBERAL REPORT CARD (Gene Swimmer ed., 1997).

[35] *See* DAVID BERCUSON, ET AL., SACRED TRUST?: BRIAN MULRONEY AND THE CONSERVATIVE PARTY IN POWER 93–120 (1986).

The following year, under continuing intense budget pressures the Conservative government took a different approach to cutting social spending, using indexing as its vehicle. The government proposed adjusting Old Age Security (as well as Family Allowances and income tax brackets) only for inflation in excess of 3%. Full indexing of the Guaranteed Income Supplement was to be maintained, but since the latter is an add-on to OAS, low-income seniors would also have their benefits cut. The proposal prompted intense criticism not only from opposition parties and senior citizens' organizations but also from the Quebec National Assembly (which unanimously passed a resolution asking the federal government to reconsider), Conservative provincial premiers in the Maritime provinces, and even many representatives of the business community. Within a month, the Mulroney government was in full retreat, announcing that full indexing of Old Age Security (but not Family Allowances and the personal income tax system) would be continued.[36]

After winning re-election in 1988, the Mulroney government again sought savings from the Old Age Security program. The government's April 1989 budget announced a special tax (known as a "clawback") of 15% on Canada's universal demogrants (OAS payments and family allowances) for upper income families and individuals, phased in over three years. When fully phased in, the clawback would initially affect only 4.3% of the elderly population, with 1.8% of OAS recipients losing their OAS benefit entirely.[37] But because the thresholds at which the clawback begins are only partially indexed (to inflation over 3%, with the potential for additional adjustments on an ad hoc basis), the clawback gradually affected more pensioners. Although social policy advocates strongly criticized the erosion of universality implicit in the clawback, the government held firm, aided by the disarray of the opposition parties (both the Liberals and the New Democrats were in the midst of searches for new leaders) as well as the complexity and selectivity of the proposals, which made it difficult for opponents to mobilize opposition.[38]

A. *Pension Reform in the Chrétien Years*

The Conservative government headed by Brian Mulroney was extraordinarily

---

[36] The Mulroney government did succeed with a similar reform on two more modest (and far less visible fronts)—in converting both the age and pension tax deductions to non-refundable credits in 1988. The former was only partially indexed and the latter was not indexed at all, cutting their real value over time. *See* Prince, *supra* note 34, at 214.

[37] The "clawback" rate of 15% on OAS payments initially phased in beginning at a net income of $50,000, with all OAS benefits taxed back at an income level of $76,332. *See* DEPT. OF FINANCE, BUDGET PAPERS 9–12 (Apr. 27, 1989); NAT'L COUNCIL OF WELFARE, THE 1989 BUDGET AND SOCIAL POLICY 15–20 (Sept. 1989). By 1995, the clawback began at a net income above $53,215, with all OAS income taxed back at income of $85,893. NAT'L COUNCIL OF WELFARE, A PENSION PRIMER 4 (1996).

[38] *See* Grattan Gray, *Social Policy by Stealth*, 11 POL'Y OPTIONS POLITIQUES 17–29 (Mar. 1990); Battle, *supra* note 34, at 146–47.

unpopular in its last years in office. Mulroney stepped down shortly before the 1993 election, and under his successor, Kim Campbell, the Conservatives suffered a crushing defeat, winning only 2 of 301 seats in the House of Commons. The Liberal government headed by Prime Minister Jean Chrétien that came to power after the 1993 election was elected on a platform that stressed job creation and made no mention of pension retrenchment. Once elected, however, the new government devoted most of its attention to deficit reduction, propelled primarily by a fear that without major deficit reduction, the financial markets would effectively declare Canada bankrupt.[39] Much of the burden of deficit reduction was borne by reduced transfers to the provinces in the areas of post-secondary education, social assistance to the poor and (especially) health: sectors where the provinces actually delivered services and hence would have to make the tough decisions—and presumably incur most of the political blame—resulting from the federal budget cuts.[40] But this option was not available in the pensions sector, where the federal government financed and administered benefits directly (except for the Quebec Pension Plan).

Government initiatives were heavily constrained by the political calendar. A Quebec provincial election was anticipated in the fall of 1994, and if (as expected) the Parti Quebecois won, a referendum on Quebec sovereignty would occur within a year after that—and another federal election presumably in 1997. That left a very narrow window of opportunity—after the Quebec referendum but as far as possible away from the next federal election—for any pension retrenchment initiative. Finance Minister Paul Martin sought Cabinet approval for a restructuring of OAS and GIS to be included in the 1995 budget, just half a year before the expected Quebec referendum.[41] Prime Minister Chrétien forced the finance minister to back down on including pension reform in his 1995 budget, but promised that he could include it the following year.[42]

The pension reform announced in the 1996 budget constituted a major restructuring of OAS and GIS. The two programs were to be replaced in the year 2001 by a single integrated "Seniors Benefit"; pension and old age tax credits were to

---

[39] On this period, see EDWARD GREENSPON & ANTHONY WILSON-SMITH, DOUBLE VISION: THE INSIDE STORY OF THE LIBERALS IN POWER (1996).

[40] *See* Leon Muszynski, *Social Policy and Canadian Federalism: What Are the Pressures for Change?*, *in* NEW TRENDS IN CANADIAN FEDERALISM 288–318 (François Rocher & Miriam Smith eds., 1995); Miriam Smith, *Retrenching the Sacred Trust: Medicare and Canadian Federalism*, *in* NEW TRENDS IN CANADIAN FEDERALISM 319–37 (François Rocher & Miriam Smith eds., 1995); Allan M. Maslove, *The Canada Health and Social Transfer: Forcing Issues*, *in* HOW OTTAWA SPENDS, 1996–1997: LIFE UNDER THE KNIFE, 283–301 (Gene Swimmer ed., 1996).

[41] *See* Prince, *supra* note 34, at 211–34; Greenspon, *supra* note 39 (especially ch. 16).

[42] Edward Greenspon, *Martin Chose Lesser of Two Evils*, GLOBE & MAIL, July 29, 1998, at A4. The 1995 Budget did enunciate a set of five principles to be followed in pension reform initiatives, however, including maintenance of benefits for low-income seniors, full indexation of benefits, using family income in income testing OAS, increased benefit progressivity, and cost control. Battle, *supra* note 34, at 151–71.

be eliminated at the same time. The basic effect of the changes would have been to start phasing out pension benefits (except the CPP/QPP) at lower income levels, and at a faster rate, than under the current system.[43] The result was to be lower pension benefits for middle and upper-income seniors and their elimination for a larger group than those affected by the current OAS "clawback." The changes were supposed to produce substantial savings for the federal government—$200 million in its first year and $2.1 billion a year by 2011.[44] By the year 2030, the new Seniors Benefit was expected to save 10% (about $7 billion) over the cost of the existing programs.[45] The political palatability of the proposal was increased by some changes made in the plan in the weeks before it was unveiled: existing senior citizens—and those over age sixty as well—would remain under the existing system as long as they lived if they chose not to switch to the new system. The government claimed that 75% of senior citizens (and 90% of single senior women, who tend to have the lowest incomes) would be as well off or better off than under the old system.[46] Thus the government sacrificed immediate budget savings for increased political viability for the proposals and their long-term savings. In short, the Seniors Benefit proposal contained numerous elements—significant lead time before going into effect, a lengthy phase-in, "grandfathering" of the aged and near-aged, and minimal sweetening of benefits for the lowest income seniors—designed to diffuse opposition and political blame. Inclusion in the budget both lowered the proposals' visibility and made them almost immune from attack or amendment procedurally. Moreover, the amendments were highly technical and complex, involving interacting effects of several programs, making it impossible for the average voter to understand.

The measures nevertheless did prove very controversial, and the Chrétien government did not take the opportunity to impose the measures immediately as part of its 1996 budget legislation. Action was first postponed until after the spring 1997 federal election.[47] This long delay gave ample opportunity for interest group opposition to emerge to the Seniors Benefit. Women's groups criticized the fact that benefits were to be based on family income rather than individual income, meaning steep cuts in benefits for women whose husbands had substantial income but had little of their own. Business groups, retirement planners, and even the Canadian Institute of

---

[43] Effects would be particularly strong for couples, since the Seniors Benefit would be calculated on the basis of family income rather than individual income. For an overview, see NAT'L COUNCIL OF WELFARE, A GUIDE TO THE PROPOSED SENIORS BENEFIT (1996).

[44] *Id.* at 23.

[45] Shawn McCarthy, *Martin Backs Off Seniors Plan*, GLOBE & MAIL, July 29, 1998, at A1 [hereinafter McCarthy, *Martin*].

[46] DEPARTMENT OF FINANCE, BUDGET PLAN 1997, BUILDING A FUTURE FOR CANADIANS 117 (Feb. 18, 1997).

[47] *See* Shawn McCarthy & Edward Greenspon, *Ottawa Girds for Pension War*, GLOBE & MAIL, Sept. 8, 1997, at A1, A4; Laura Eggertson, *Martin Defends Premium Hike for CPP Security*, TORONTO STAR, Oct. 29, 1997, at A5.

Actuaries argued that the Seniors Benefits contained severe disincentives for retirement savings because middle income seniors would lose twenty cents of the Seniors Benefit for every dollar of income that they pulled from Registered Retirement Savings Plans. Senior citizens could end up with higher marginal tax rates after retirement than before—rates over 70%.[48]

Even more important than interest group opposition was a growing public awareness that the federal budget was headed toward a surplus. Polls conducted for the government showed that there was little public support for cutting pension benefits in the absence of a budget crisis.[49] A deal with the provinces to stabilize the financing of the Canada Pension Plan (discussed below) also undercut the financial urgency of implementing the Seniors Benefit. The political ambitions of Finance Minister Paul Martin did not bode well for the proposed reform either. Martin was widely seen as the leading candidate to succeed Jean Chrétien as leader of the Liberal Party and offending senior citizens and other groups arrayed against the Seniors Benefit was not a very good way to boost his prospects. By spring of 1998, the Finance Ministry was outlining alternatives to the Seniors Benefit for Martin.[50] At the end of July, Martin announced that he was simply canceling it altogether.[51] Another, less visible change that predominantly affected upper income Canadians did move forward—a cut and then seven year freeze in contribution limits for RRSPs announced in Martin's 1995 and 1996 budgets. These changes were expected to cut the income level to which retirement savings could be tax sheltered from roughly two and one-half to two times the average industrial wage.[52]

B. *Reforming the CPP*

Throughout each of these rounds of retrenchment in the universal Old Age Security program, the Canada/Quebec Pension Plan remained largely unaddressed—but not for lack of problems. The CPP shared with the U.S. Social Security system a

---

[48] McCarthy, *Martin*, *supra* note 45, at A1; Alan Toulin, *Martin Scraps Seniors Benefit Plan*, NATIONAL POST, July 29, 1998, at A1; Sean Durkan, *Martin Kills Plan to Cut Pensions*, EDMONTON SUN, July 29, 1998, at 24; *see also* Prince, *supra* note 34, at 226–29.

[49] Shawn McCarthy, *Ottawa Finds Little Support for New Seniors Plan*, GLOBE & MAIL, June 30, 1998, at A3 [hereinafter McCarthy, *Ottawa*].

[50] *See* Eric Beauchesne, *Martin Ignored Bureaucrats' Advice on Adjusting Pension Plans*, NATIONAL POST, May 17, 1999, at A7.

[51] McCarthy, *Martin*, *supra* note 45.

[52] The 1996 budget also lowered the age at which RRSPs must be closed and withdrawals begun from seventy-one to sixty-nine. Overall, the changes were expected to generate an additional $45 million in revenue in the 1997–98 tax year and $180 million the following year. *See* Bruce Cohen, *Top RRSP Contribution Limit Slated for Cutback in '96*, FINANCIAL POST, Feb. 28, 1995, at B7; Jonathan Chevreau, *RRSP Changes Worry Fund Firms*, FINANCIAL POST, Mar. 7, 1996, at B8; Kristin Goff, *RRSP Contribution Level Frozen for Seven Years*, OTTAWA CITIZEN, Mar. 7, 1996, at A4.

deteriorating financial condition, shaped in part by declining economic and demographic conditions, a number of benefit enhancements enacted in the 1970s, and a dramatic increase in take up of disability benefits in the 1980s and 1990s.[53] As a result, cash flow from contributions (i.e., contributions minus expenditures) turned consistently negative beginning in 1983. In 1993, overall CPP assets began to turn negative (i.e., contributions plus interest payments were no longer adequate to pay benefits), meaning that the provinces were beginning to have to repay the principle that they had borrowed from the CPP at favorable rates.[54]

Despite these financial problems, the difficulty of securing provincial assent helped to keep CPP cutbacks from even getting on the agenda; it does not pay to go out in front on an issue where resolution in the absence of a crisis is very doubtful, and where it is almost certain that at least some provincial ministers as well as the federal opposition parties would use the occasion to denounce the federal government in a high-profile setting.[55] Getting agreement on payroll tax increases was difficult, too: they remained flat at 3.6% (shared equally by employers and employees) from 1966 through 1986. Moreover, things were expected to grow steadily worse in the future; the CPP's Chief Actuary estimated in 1995 that the CPP trust fund would be exhausted by the year 2015, and that with an empty trust fund, the contribution rate needed to finance contributions on a pay-as-you-go basis would have to reach 14.2% by the year 2030.[56] As in the United States, critics also warned that the CPP, as currently constituted, was also grossly unfair to younger workers, and thus ultimately politically unsustainable.[57] Projections for the Quebec Pension Plan were similarly

---

[53] Benefit enhancements included full indexation of benefits (rather than just for inflation over 2%) in 1975, dropping retirement and earnings tests for persons aged sixty-five to sixty-nine in 1975, and the addition of a child-rearing drop-out provision in 1978. Overall, these benefit enhancements were estimated to add costs of 2.4% of contributory earnings to the program. FEDERAL/PROVINCIAL/TERRITORIAL CPP CONSULTATIONS SECRETARIAT, DEPARTMENT OF FINANCE, AN INFORMATION PAPER FOR CONSULTATIONS ON THE CANADA PENSION PLAN Ch. 3 (1996).

[54] *See* OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS, OFFICE OF THE CHIEF ACTUARY, ACTUARIAL REPORT (17TH) ON THE CANADA PENSION PLAN AS AT 31 DECEMBER 1997, at tbl. II.1 (1997) [hereinafter CHIEF ACTUARY (17TH)]. Assets in the trust fund continued to increase through the end of 1992 because of investment earnings, falling each year after that. *Id.*

[55] On Ottawa's reluctance to proceed in the face of opposition from provincial governments in the 1996–97 round of CPP reform, see Edward Greenspon, *Martin Won't Push Changes to Pension Plan*, GLOBE & MAIL, Oct. 3, 1996, at A4.

[56] *See* OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS, OFFICE OF THE CHIEF ACTUARY, ACTUARIAL REPORT (16TH) ON THE CANADA PENSION PLAN AS AT SEPTEMBER 1997, at 3 (1997), *available at* http://www.osfi-bsif.gc.ca/eng/office/actuarialreports/pdf/cpp16e.pdf (last visited Jan. 15, 2004) [hereinafter CHIEF ACTUARY (16TH).

[57] *See, e.g.*, William Robson, *The Coming Revolt Against the CPP*, GLOBE & MAIL, Dec. 6, 1996, at A23; *See also*, William Robson, *Ponzi's Pawns: Young Canadians and the Canada Pension Plan*, *in* WHEN WE'RE 65: REFORMING CANADA'S RETIREMENT INCOME SYSTEM (John Richards & William G. Watson eds., 1996).

bleak.[58]

Declining trust fund balances, eroding public confidence in the CPP, and growing awareness that a failure to address the CPP's problems quickly would lead to soaring contribution rates in the future finally led to an initiative by Ottawa in 1995 to alter the program.[59] Initially, much of the effort was devoted to a behind the scenes effort led by the Federal Finance Ministry to bring their counterparts in the provincial capitals on board for the need for change.

Ottawa and eight of ten provinces reached agreement in 1997 on a package of CPP changes that distributed pain among all parties.[60] Unlike the planned Seniors Benefit, the Liberal government did not back off from these changes, and they went into effect in 1998.[61]

The most visible change in the CPP rescue package—and the one with the

---

[58] *See* RÉGIE DES RENTES DU QUÉBEC, FOR YOU AND YOUR CHILDREN: GUARANTEEING THE FUTURE OF THE QUÉBEC PENSION PLAN 21, app. 2 (Sheila Boudreault et al. trans., 1996), *available at* http://www.rrq.gouv.qc.ca/an/services/publications/rrq_livvert_en.pdf (last visited Jan. 15, 2004) (estimating that to maintain current benefits, contribution rates would have to rise 0.4% per year from 1997 to 2001 and 0.25% per year thereafter until it reached a stable rate of 13% in the year 2023).

[59] *See* HUMAN RESOURCES DEVELOPMENT CANADA, DEPT. OF FINANCE CANADA, AN INFORMATION PAPER FOR CONSULTATIONS ON THE CANADA PENSION PLAN 17 (1996), *available at* http://www.cpp.rpc.ca/maindoc/cppe.pdf (last visited Jan. 15, 2004) [hereinafter HUMAN RESOURCES DEVELOPMENT CANADA, INFORMATION PAPER]. On this period, see also Michael J. Prince, *Taking Stock: Governance Practices and Portfolio Performance of the Canada Pension Plan Investment Board, in* HOW OTTAWA SPENDS 2003–2004: REGIME CHANGE AND POLICY SHIFT 134–54 (G. Bruce Doern ed., 2003).

[60] *See* HUMAN RESOURCES DEVELOPMENT CANADA, DEPT. OF FINANCE CANADA, SECURING THE CANADA PENSION PLAN: AGREEMENT ON PROPOSED CHANGES TO THE CPP 5 (1997), *available at* http://www.cpp-rpc.ca/sec/secure.pdf (last visited Jan. 15, 2004) [hereinafter HUMAN RESOURCES DEVELOPMENT CANADA, AGREEMENT]. The provinces of British Columbia and Saskatchewan, both governed by the left-of-center New Democratic Party, backed an alternative proposal that would have raised the ceiling on the CPP tax base, resulting in a substantial tax increase for middle and upper-income workers. On the British Columbia government's proposal for an increase in the tax base, see Andrew Petter, *How to Save the Canada Pension Plan*, GLOBE & MAIL, Oct. 3, 1996, at A21 (expressing the view of Petter, prior Finance Minister of British Columbia); Barrie McKenna, *Provinces Block CPP Reform*, GLOBE & MAIL, Oct. 5, 1996, at A1.

[61] *But see* Laura Eggertson, *Pension Changes Pass Hurdle in Senate*, TORONTO STAR, Dec. 17, 1997, at A7. The CPP legislation did run into opposition in Canada's unelected (and therefore usually docile) second chamber, the Senate. Conservative Senators threatened to delay consideration of the bill past the end of 1997, meaning that payroll tax increases scheduled for January 1, 1998 could not be implemented as scheduled. In exchange for getting speedy passage of the legislation, Finance Minister Paul Martin agreed to delay implementation of provisions of the new legislation dealing with the CPP Investment Board until March 31, 1998, giving the Senate Committee on Banking, Trade and Commerce an opportunity to hold a series of hearings on the CPP Investment Board, the proposed Seniors Benefit and RRSPs, and issue a report on the Investment Board. *See id.*

biggest fiscal impact—was in payroll taxes.[62] Tax rates on employers and employees will rise from 5.85% to 9.90% (shared equally between the two) over a six year period to finance a move away from pay-as-you-go toward partial advance funding of the CPP. As critics on the political right pointed out, this represents a 70% increase in the tax rate. In exchange, Ottawa bowed to provincial demands for a cut in the Unemployment Insurance payroll tax, which was running large surpluses.[63]

The CPP payroll tax increase is more rapid than the ones already scheduled under the statute then in effect, but politicians sold it as a measure that would prevent payroll taxes from having to go as high as previously projected if the CPP contribution rate was not changed quickly. Moreover, the initial tax increase was not scheduled to be felt until 1998, after the next federal election.[64] In addition to higher rates, the amount of earnings of low-income workers that is exempt from the CPP payroll tax was frozen at the 1997 level ($3,500), rather than being indexed for inflation as was the previous practice. Overall, changes in contributions, combined with higher returns that were projected to result from diversifying CPP investments away from provincial bonds, were expected to lower the required stable contribution rate by 2.9% of payroll.[65]

Cuts in CPP retirement benefits were, not surprisingly, made much harder for beneficiaries to discern and understand. In consultation documents, bureaucrats suggested a number of options for cutbacks, including an explicit 10% cut (from 25% to 22.5%) in replacement rates and increases in the normal and earliest retirement ages.[66] But in a 1996 discussion paper, the Quebec government rejected making most of the cuts with the largest potential savings—including retirement age increases, cuts in the replacement rate, and cuts in indexation—in the Quebec Pension Plan.[67] In theory, Ottawa could have implemented major benefit cuts in the CPP anyway if

---

[62] On the fiscal impact of the 1997 changes, see DAVID W. SLATER & WILLIAM B.P. ROBSON, BUILDING A STRONGER PILLAR: THE CHANGING SHAPE OF THE CANADA PENSION PLAN 5–6 (C.D. Howe Inst., Commentary No.123, 1999), *available at* http://www.cdhowe.org/pdf/rob-10.pdf (last visited Jan. 15, 2004).

[63] *See* McKenna, *supra* note 60.

[64] *See* Derek Ferguson, *73% Premium Increases to Save Pension: Martin*, TORONTO STAR, Sept. 26, 1997 at A1. In fact, the initial tax increase—from 5.85% to 6.0% of payroll—was retroactive to January 1997, but was not to be paid until income tax time in the spring of 1998. *Id.* For a schedule of prior and revised payroll tax rates, see HUMAN RESOURCES DEVELOPMENT CANADA, AGREEMENT, *supra* note 60, at 6–7.

[65] The increased contribution rate and accelerated payroll tax increase together were expected to result in 1.5% reduction in contribution rates; the effects of these two provisions are difficult to separate because they interact—a higher contribution rate provides greater surpluses in the near-term that can then be invested at higher rates. The freezing of the YBE was expected to result in a reduction of 1.4% in the stable contribution rate. *See* CHIEF ACTUARY (16TH), *supra* note 56, at 5.

[66] For a list of proposals and estimates of their likely savings, see HUMAN RESOURCES DEVELOPMENT CANADA, INFORMATION PAPER, *supra* note 59, at 43.

[67] RÉGIE DES RENTES DU QUÉBEC, *supra* note 58.

Quebec either went along or was outvoted by other provinces. But a strong desire on the part of all participants to keep the CPP and QPP closely integrated meant that the benefit cuts opposed by Quebec were effectively off the table for both the CPP and QPP once Quebec decided to oppose them. Thus the scope for change on the benefit side was dramatically reduced.

In the final reform package adopted by Parliament, just over one quarter of the reduction in the overall projected long-term 4.0% of payroll in the CPP/QPP contribution rate required to achieve long-term funding stability came on the benefit side. Benefit cuts in the CPP were made largely through technical changes to formulas that are almost incomprehensible to most beneficiaries.[68] Cuts were also made in disability benefits. Reflecting the familiar principle of "grandfathering" current retirees in order to lower political opposition from the group with the most intense interest, this group was protected from CPP benefit cuts.

Little noticed at the time the legislation was passed, but potentially of great importance in the longer run, the new CPP legislation also put in place a new "default" or fail-safe procedure for ensuring the long-term financial viability of the CPP. In the future, the chief actuary for the CPP was to prepare estimates of the long-term financial sustainability of the Plan. Over the next year, Ministers from Ottawa and the provinces are supposed to agree on any needed changes to keep the plan viable; if they do not agree, contribution rates will increase automatically to meet half of the anticipated deficiency (phased in over three years) and indexation of the CPP will be frozen for the next three years.[69] This procedure could be overridden by Cabinet order, but it would take affirmative action to do so. Thus the new statute creates a "clean hands" default procedure that allows losses to be imposed on beneficiaries and contributors without politicians having to do anything—although the concentration of accountability in Canada's Westminster political system means that it will be difficult for a future Cabinet to avoid blame by refusing to cancel contribution increases and indexation freezes.

As might be expected, the role given to the CPP Chief Actuary's report in triggering painful increases in contribution rates and indexation freezes have indeed made those reports the subjects of political contention. Shortly before the first Chief Actuary's report was due under the new law, the Chief Actuary was fired. The fired

---

[68] For example, the years of (un-indexed) earnings prior to retirement on which initial retirement benefits are calculated was increased from three to five. This affects the maximum pension benefit, since these earnings amounts used in initial benefit calculations are not indexed for inflation or changes in average earnings. If this policy had been in effect in 1997, the maximum pension benefit would have been twelve dollars a month lower. HUMAN RESOURCES DEVELOPMENT CANADA, AGREEMENT, *supra* note 60, at 14. For a summary of the financial impact of the benefit changes in the 1997 CPP reform package, see CHIEF ACTUARY (17TH), *supra* note 54, at 6–8.

[69] *See* Canada Pension Plan, R.S.C., ch. C-8, §§ 113–15 (1991); Canada Pension Plan Investment Board Act, R.S.C., ch. C-40, §§ 94–96; SLATER & ROBSON, *supra* note 62, at 6–7.

Chief Actuary, Bernard Dussault, charged that he had been pressured by Finance Ministry officials to change his assumptions after preliminary estimates suggested that a small (0.1% of payroll) increase in the contribution rate would be needed to keep the CPP solvent in the long term. The Chrétien government argued strongly that Dussault's firing had nothing to do with his conclusions.[70] The consultant commissioned to complete Dussault's report—using a set of assumptions that were questioned by some critics as too optimistic—produced a report showing that the system was in fact slightly (0.1% of payroll) over-financed.[71] But provincial officials expressed fears that manipulation of the Chief Actuary's findings could mean that they were not getting accurate information about the financial status of the CPP.[72]

VII. CPP INVESTMENT PRACTICES

Along with increases in payroll taxes and a new fail-safe mechanism, the 1997 CPP reform also contained some significant elements of restructuring in the form of changes in CPP investment practices. Provinces will eventually have to pay higher rates on borrowings from the CPP.[73] More importantly, current CPP surpluses generated by higher payroll taxes are being invested in a broader range of securities, including equities, with these investments managed by an independent board.

This change in investment practices moves the CPP closer to the practices of the Quebec Pension Plan, which has long invested in a diverse set of assets through the Caisse de dépôt et placement du Québec (CDP), a unique Quebec institution that invests not only QPP funds, but also for Quebec public sector employee pension funds, public insurance funds, agricultural marketing boards and other Quebec financial institutions.[74] Indeed, Canada's Finance Minister, Paul Martin, explicitly acknowledged the Caisse as a positive model for the CPP.[75]

---

[70] *See* Laura Eggertson, *Firing of CPP Watchdog to Be Probed*, TORONTO STAR, Sept. 23, 1998; Ian Jack, *Don't Embarrass Martin: Fired Actuary Says Boss Twice Asked Him to Alter CPP Numbers*, NATIONAL POST, Oct. 1, 1998, at 3; Ian Jack, *Actuary Was Asked to Look at 'Alternative' CPP Analysis*, NATIONAL POST, Dec. 3, 1998 at A1; Ian Jack, *Federal Auditor Plans to Keep Sharp Eye on CPP*, NATIONAL POST, Jan. 8, 1999, at C3.

[71] CHIEF ACTUARY (17TH), *supra* note 54. For a critique of the assumptions used in the report, see SLATER & ROBSON, *supra* note 62.

[72] Ian Jack, *Provinces 'Concerned' at CPP Actuary's Firing*, NATIONAL POST, Oct. 3, 1998, at 7.

[73] Provinces will have to pay their own market rate of interest rather than Ottawa's, but they were given the option of rolling over their current CPP borrowings for another twenty-year term. *See* HUMAN RESOURCES DEVELOPMENT CANADA, AGREEMENT, *supra* note 60, at 13.

[74] For a list of CDP depositors, see CAISSE DE DÉPÔT ET PLACEMENT DU QUÉBEC, 35TH OPERATIONS REPORT 2001 at 10–11, *available at* http://sofinov.lacaisse.com/pdf/RA-2001-a.pdf (last visited Jan. 15, 2004).

[75] Martin said, "I have always been an apostle of the Caisse de dépôt and I think having a Canadian Caisse de dépôt to manage the savings of Canadians is very important." Ferguson, *supra*

Although the Caisse served as a model for the new Canada Pension Plan Investment Board (CPPIB) in some ways, it is very different from its Quebec counterpart in its mandate, size, and relationship to its sponsoring government. The Caisse has, since its founding in 1966, been closely linked to the Quebec government. Indeed, it is the linchpin of what has been called "Quebec, Inc.," a tight alliance of the Quebec government and Quebec francophone business leaders.[76] Governance procedures for the CPPIB, on the other hand, are intended to keep government at arm's length. The legislation establishing the Board set up a complicated appointment procedure for CPPIB's Board of Directors that gives primary responsibility to the Federal Minister of Finance, but utilizes a federal-provincial nominating committee, and requires consultation with provincial finance ministers.[77] Staggered terms of three years for the Board give it some additional protection from government interference.[78] Current members of the federal and provincial legislatures and employees of both levels of government are barred from membership on the Board.[79] The CPPIB Board does not have reserved seats for "social partners" (business and labor) but its authorizing statute does call for the Board's directors, like most other institutions associated with the Canadian government, to represent Canada's geographic diversity.[80] In the short history of the CPPIB, appointees to the Board have generally had financial sector experience rather than political or governmental experience.[81] The Board chooses CPPIB's President, who serves as CEO (government has no role in the selection). John McNaughton, the only person to hold

---

note 64.

[76] *See* PIERRE ARBOUR, QUEBEC INC. AND THE TEMPTATION OF STATE CAPITALISM (Madeleine Hebert trans., 1994) (critiquing the tight alliance between government and business).

[77] *See* EDWARD TAMAGNO, INVESTING SOCIAL SECURITY FUNDS: PRINCIPLES AND CONSIDERATIONS 5–6 (2001), *available at* http://www.caledoninst.org/tomagno.pdf (last visited Jan. 15, 2004). The federal finance minister appoints the chair of a nominating committee, which also has members appointed by the government of each province participating in the CPPIB. The nominating committee makes recommendations for Board appointments and reappointments to the Federal Minister of Finance, who makes final decisions in consultation with the provinces. The official nomination is made by Order-in Council of the federal cabinet. *Id.* at 6.

[78] Board members can be appointed for a total of three successive terms, or nine years. *Id.* at 15 n.3.

[79] Canada Pension Plan Investment Board Act, R.S.C., ch. 40, § 10(9)(e)–(f) (1997).

[80] *Id.* at § 10(4).

[81] One CPPIB board member is a former MP who had responsibility for federal-provincial consultations in the period leading up to the 1997 CPP reform. Experience in financial services is not a prerequisite for service as a CCIPB director, but the authorizing statute does call for the Minister of Finance, in making nominations, to the Board, to "have regard to the desirability of . . . having on the board of directors a sufficient number of directors with proven financial ability or relevant work experience such that the Board will be able to effectively achieve its objectives." *Id.*

the post, is the recently-retired head of a major Canadian investment firm. The staff of CPPIB is small—under forty people—and is expected to remain so. The CPPIB and senior management have decided that the organization should operate as a "virtual corporation" relying heavily on outside managers and investment partners to handle most portfolio management.[82]

The CPPIB is supposed to achieve a "maximum rate of return, without undue risk of loss."[83] But the CPPIB's mandate does not include additional industrial policy or social policy objectives. Many features of the CPPIB governance structures were set precisely to limit movement away from an exclusive focus on maximizing returns with reasonable risk. However, the CPPIB, like the Caisse and individual RRSPs, is subject to limits on the percentage of non-Canadian assets that they can hold. These limits mirror those for RRSPs, a rough equivalent to American 401(k) plans. Originally those limits were set at 20% of total assets. When the RRSP limit on foreign assets was raised to 30%, the Caisse and CPPIB levels were raised as well.

To diversify the overall portfolio of the CPP—initially composed entirely of provincial bonds—the CPPIB from the outset decided that it would invest all of the funds transferred to it in equities. The CPPIB does have important limitations on its investment allocations, however. In addition to the 30% limit on foreign assets, CPPIB is also prohibited from holding, directly or indirectly, more than 30% of the voting shares of any company. Other restrictions on the Board are intended to limit its exposure both to particular types of investments (e.g., real estate and natural resources) and in particular firms or projects.[84] The CPPIB's authorizing legislation also requires the consent of two-thirds of provinces participating in the CPP, with a population of at least two-thirds of the total population of participating provinces, to consent to any change in the Board's investment regulations.[85] Thus, it is unlikely that any plausible combination of future governments would be able to shift CPPIB's focus toward industrial or social policy objectives.

The CPPIB has been given both more tasks and more freedom over its relatively short life-span. Initially, the CPPIB was required to manage all of its Canadian equities portfolio passively by "substantially replicating" the Toronto Stock Exchange (TSE) 300. The requirement for passive investing was later reduced to half of the

---

[82] CANADA PENSION PLAN INVESTMENT BOARD, 2000 ANNUAL REPORT 5–6 (2000).

[83] R.S.C., ch. 40, § 5(b).

[84] Section 11 of the Board's investment regulations limit it to having no more than 10% of its assets in the securities of any group of affiliated persons or organizations. In addition, CPPIB cannot have more than 5% of its assets in any single "real property or Canadian resource propert[y]," hold more than 15% of its assets in all Canadian resource properties, or more than a total of 25% of its assets in all real property and Canadian resource properties. Canada Pension Plan Investment Board Regulations, *at* http://laws.justice.gc.ca/en/C-8.3/SOR-99-190/41771.html (last visited Jan. 15, 2004).

[85] Canada Pension Plan Investment Board Act, R.S.C., ch. 40, § 53 (1997).

Canadian equities portfolio and eliminated entirely in the fall of 2001.[86] In the summer of 2002, the government announced its intention to hand over management of CPP's bond portfolio to the Investment Board as well.[87]

Saying that domestic investment standards have been relatively depoliticized does not mean that they have been problem-free, however. Implementing these standards in the relatively small Canadian equities market has created problems. The original mandate of the CPPIB to invest 80% of its funds passively in Canadian equities quickly came into conflict with its mandate to limit exposure to one firm; at the height of the telecommunications boom in the late 1990s, Northern Telecom reached almost one-third of the total value of the TSE 300 index, so the CPPIB began using a "TSE 299" to limit its financial exposure to Northern Telecom.[88] More generally, the CPPIB has expressed concern that relatively large (by Canadian standards) inflows of $6 to $8 billion per annum expected from CPP payroll taxes over the next few years could contribute to a bidding up of Canadian equity prices as well as inadequate diversification of assets—betting too much on the performance of the Canadian economy—under current investment rules.[89]

At the end of March 2003, just over 30% of all CPP assets were invested in public and private equity—primarily the former.[90] But the CPPIB has recently begun to implement a policy to actively invest up to half of its Canadian equity assets, while keeping costs low.[91] It has also begun working in partnership with merchant banks and other pension funds to take advantage of venture capital opportunities while spreading risks and minimizing its exposure to political flak by taking minority stakes in funds managed by other parties.[92] By the end of the 2002 fiscal year, 3.2% of CPP's assets were invested in these vehicles, and the Board has declared its intention to invest up to 10% of total CPP assets in private equity with another 5% in real estate, natural resource development projects and other private market assets.[93] While

---

[86] Eric Beauchesne, *Ottawa Ends Restrictions on CPP Investment Board's Stock Leeway*, FINANCIAL POST, Oct. 4, 2001, at D6; *Regulations Amending the Canada Pension Plan Investment Board Regulations*, 135 THE CANADA GAZETTE, *Part 1*, 39 at 3747–749 (2001).

[87] Greg Quinn, *Manley Sets Up Company to Handle CPP Bond Investments*, FINANCIAL POST, June 7, 2002, at FP8.

[88] Barry Critchley, *MacNaughton's CPP Odyssey*, NATIONAL POST, Feb. 8, 2001, at D03; Dianne Maley, *CPP Chief Has Some Explaining to Do*, TORONTO STAR, Nov. 13, 2001, at C11.

[89] CANADA PENSION PLAN INVESTMENT BOARD, 2002 ANNUAL REPORT 7 (2002).

[90] CANADA PENSION PLAN INVESTMENT BOARD, 2003 ANNUAL REPORT 14 (2003).

[91] *See* CANADA PENSION PLAN INVESTMENT BOARD, 2002 ANNUAL REPORT 1 (2002) (reporting the fiscal year 2001–02 CPPIB costs were 9 cents per $100 of assets).

[92] On the evolution of the Canada Pension Plan Investment Board's investment strategy, see CANADA PENSION PLAN INVESTMENT BOARD, 2001 ANNUAL REPORT (2001); News Release, CPP Investment Board, Canada Pension Plan Investment Board Announces Its First Private Equity Investments (Aug. 21, 2001).

[93] *See* CANADA PENSION PLAN INVESTMENT BOARD, 2002 ANNUAL REPORT 9 (2002).

there are no legal or regulatory requirements that CPPIB's private market investments be skewed toward Canada, the Board's vice-president for private market investments has stated that CPPIB is ' "making a special effort to find the best opportunities at home before venturing too far abroad.' "[94]

The CPPIB has also taken a very cautious stand on social and environmental investment criteria. In April 2002, the Board adopted a Social Investing Policy statement that argued that (1) its "statutory mandate and fiduciary duty are based exclusively on investment considerations," (2) responsible corporate behavior in fact usually contributes positively to investment returns in the long run, and (3) the religious, ethical, social, and other views of Canadians are so diverse that they could not possibly be reflected in the Board's investment decisions.[95] Therefore, although the Board would "generally support corporate policies and practices . . . that would result in the disclosure of information that could assist investors in assessing whether corporate behavior was contributing to or detracting from long-term investment returns," it would not use non-investment criteria to screen in or out any investments.[96] Instead, it would consider for investment "the securities of any issuer engaged in a business that is lawful in Canada" and "the securities of issuers in any country with which Canada maintains normal financial trade, and investment relations."[97]

In the absence of screening in or out specific investments, CPPIB's other major mechanism for expressing social or environmental concerns relates to voting its shares. Once again, CPPIB has taken a largely passive approach, delegating its voting rights to external fund managers in most situations.[98]

The CPPIB's investment performance has reflected the roller-coaster ride of equity prices in recent years. In the Board's first few years of operation, CPPIB enjoyed very strong returns, followed by a terrible 2000–2001 fiscal year, in which the fund had a negative 9.4% return on investments, a modest positive return of 3.4% in 2001–2002, and a disastrous return of negative 21.1% in 2002–2003.[99] Overall, the CPPIB has lost money on its investments since its inception, because the inflow of

---

[94] News Release, Investment Board, CPP Investment Board Commits Half-Billion Dollars to Canadian Venture Capital (June 19, 2002) (quoting Mark Weisdorf, Vice President for Private Market Investments).

[95] CANADA PENSION PLAN INVESTMENT BOARD, SOCIAL INVESTING POLICY 1–2 (2003).

[96] *Id.* at 2.

[97] *Id.*

[98] Delegation to external managers is contingent on the CPPIB "[i]nvestment committee's prior review and acceptance of such external managers' voting philosophies and a summary of significant policies . . . ." Directions to the external manager may be given where the external manager seeks direction or where CPPIB "management does not agree with the voting intentions of an External manager, and such External Manager has agreed to be directed." CANADA PENSION PLAN INVESTMENT BOARD, INVESTMENT STATEMENT 18 (2002).

[99] CANADA PENSION PLAN INVESTMENT BOARD, 2003 ANNUAL REPORT 15 (2003).

funds as CPP payroll taxes rose meant that many more funds were at risk in the last few years of operations than in earlier years.

VIII. TOWARD MORE FUNDAMENTAL REFORM?

The reforms to the CPP enacted in 1997 have not escaped political criticism. On the political left, the New Democratic Party (NDP) has criticized investment of CPP funds in equities as a reckless move that endangered the retirement security of Canadian seniors.[100] NDP legislators have also called for an "ethical investment screen" for the CPPIB, excluding investments such as tobacco companies and firms that invest in Sudan.[101] Political conservatives in Canada also remain dissatisfied with the 1997 CPP reform package, arguing that it will produce an inadequate return on contributions for future generations of contributors.

In 1998, the provincial government of Alberta called for a new round of CPP reform, which might include moving some current benefits outside the CPP structure, individual accounts, and possibly some form of opt-out for employers who provide benefit plans as generous as those in the CPP.[102] Alberta's then-Treasurer (the equivalent of Finance Minister), Stockwell Day, even broached the possibility of Alberta leaving the CPP and setting up its own plan on the Quebec model as a "last resort" to prod his federal and provincial counterparts into taking further action on CPP reform. This was likely an idle threat, since it would require Alberta to come up with an estimated $45 billion (Cdn.) to pay for its share of the unfunded CPP liability that the CPP's new Chief Actuary estimated at around $430 billion (Cdn.).[103] Day's strong position against any further CPP payroll tax increases, and in favor of considering an increase in the retirement age and some benefit cuts, suggests that the future of CPP politics may look increasingly like that in the United States, both in terms of the range of options on the table and the procedural tendency toward stalemate.[104] But the very different default procedure in place in Canada still makes payroll tax increases more likely than they are south of the thirty-ninth parallel.

Pressure for additional CPP change has also come from the Canadian Alliance (until early 2000, the Reform Party), the Official Opposition in the federal House of Commons. Reform/Alliance has called for replacing the CPP with mandatory private

---

[100] Jeff Sallot, *McDonough Blasts Grits Over Pensions*, GLOBE & MAIL (Toronto), Oct. 27, 2000, at A7.

[101] Eric Beauchesne, *Talisman Fattens CPP*, CALGARY HERALD, June 27, 2000, at C1.

[102] *See* STOCKWELL DAY, DEP'T OF TREASURY, GOVERNMENT OF ALBERTA, NEXT STEPS TO CPP REFORM (1998); DEP'T OF TREASURY, GOVERNMENT OF ALBERTA, BUDGET 99: THE RIGHT BALANCE 195–98 (1999).

[103] Sean Durkan, *Alberta Ready to Quit CPP*, EDMONTON JOURNAL, June 16, 1998, at 7.

[104] Jill Mahoney, *Alberta Issues Warning Over CPP*, GLOBE & MAIL (Toronto), Jan. 23, 1999, at A4; *Federal Willingness to Reform CPP Impresses Alberta's Day*, LETHBRIDGE HERALD, Jan. 23, 1999, at 5.

pensions, and more recently for an opt-out from the CPP to individual pensions based on the British model.[105] And with the change from Reform to the Alliance, Alberta's Stockwell Day briefly became the leader of the new party. But neither Alberta nor Reform/Alliance has spelled out how it would handle the "double payment problem" if younger workers withdrew in large numbers from the CPP. In any case, the Canadian Alliance does not have significant leverage to get its proposals on the agenda given that it holds little more than a fifth of the seats in Canada's House of Commons, with little prospect of winning power, alone or in coalition, in the foreseeable future.[106]

IX. ACCOMPLISHMENTS AND CHALLENGES

The variety of programs that comprise countries' retirement income systems can be evaluated on a multiplicity of criteria. These range from the adequacy of benefits, to equity in linkage of contributions to benefits, to whether the system encourages or discourages work by those approaching and passing standard retirement age, to its affordability and political sustainability.

A report card incorporating these multiple criteria suggests an overall fairly high set of marks for Canada. In terms of pension adequacy, Canada has been able to retain a pension system that is substantially more redistributive, and more poverty reducing, than the United States. The CPP reforms of the late 1990s have also put the funding of the contributory tier of Canada's pension system on a firm financial footing at least for the medium term, with significant surpluses anticipated in the short-term. Neither the surpluses themselves nor the investment practices for those surpluses have stirred substantial political controversy.

Important challenges also remain in Canada's pension system. One continuing source of conflict is the foreign investment rules for the CPP/QPP and Registered Retirement Savings Plans and Registered Pension Plans. Elimination of the 30% limitation on foreign investment has been endorsed by a powerful coalition of the country's largest pension funds, including the Caisse de depot in Quebec and the British Columbia, Ontario Teachers, and Ontario Municipal Employee funds. The funds argue that current rules make it difficult for them to spread risk adequately, and some large funds (although not the CPPIB) have begun to use derivatives as a mechanism to get around the 30% limitation.[107] The freezing of income limits on tax-

---

[105] REFORM PARTY OF CANADA, BLUE SHEET: PRINCIPLES AND POLICIES OF THE REFORM PARTY OF CANADA (1998), Neville Nankivell, *Reforms New Strategy Reopens Serious Debate About CPP's Future*, FINANCIAL POST, June 6, 1998, at 21.

[106] On the limited political prospects of the Alliance, see, e.g., NEIL NEVITTE ET AL., UNSTEADY STATE: THE 1997 CANADIAN FEDERAL ELECTION, Ch. 8 (Don Mills ed., 2000); FARON ELLIS, *The More things Chan... The Alliance Campaign*, *in* THE CANADIAN ELECTION OF 2000, 59–89 (John H. Pammett and Christopher Doman eds., 2001).

[107] *See, e.g.*, Ian Jack & John Greenwood, *Bid to End 30% Cap Gains Steam*, NATIONAL

advantaged retirement savings since the mid-1990s also sparks continuing controversy.[108] Some consideration may also be given to creating multiple funds as the total size of the CPP grows larger and its current bond portfolio matures and becomes available for reallocation.[109]

Substantial concerns also remain over the signals sent to workers on retirement decisions.[110] Eligibility for CPP/QPP benefits beginning at age 60 sends a clear signal that retirement at this age is sanctioned by public policy. Mandatory retirement policies, which are not prohibited by the Canadian Human Rights Act (so long as they apply to the "normal retirement age" in a particular occupation), and are permitted in six Canadian provinces as of 1993, are another policy that discourages a longer working life in an aging workforce.[111]

Finally, there are concerns about the incentives and signals sent in the Canadian system for retirement savings. In particular, lower income Canadians who save modest amounts in RRSPs but remain eligible for the Guaranteed Income Supplement (GIS) are likely to lose most of their savings due to the 50% benefit reduction rate in GIS for those with incomes (including RRSP withdrawals). For GIS recipients who pay income taxes (about half of GIS recipients) the effective marginal tax rate can be 75%, and for those who also receive income-tested benefits such as meals on wheels or home care, the effective marginal tax rate can be over 100%.[112] The problem of designing retirement savings incentives for low and moderate earners as part of an overall retirement income system that combines income adequacy, affordability, equity and savings incentives at all earning levels is not a problem that is unique to Canada, of course—it is a serious issue in the United States and many other countries as well.

POST, Feb. 6, 2002, at FP1; Jeff Sanford, *Power to the Pensions*, NATIONAL POST BUSINESS MAGAZINE, Nov. 1, 2001, at 33.

[108] *See, e.g.*, Oliver Bertin and Carolyn Leitch, *Ottawa Urged to Boost RRSP Contribution Limit*, GLOBE & MAIL, (Toronto) Dec. 20, 2002, at B12.

[109] CAN. SENATE COMM. ON BANKING TRADE AND COMMERCE, THE CANADA PENSION PLAN INVESTMENT BOARD: GETTING IT RIGHT, REPORT (1998) (recommending that multiple funds be considered during each comprehensive triennial review of the CPP by federal and provincial prime ministers).

[110] On the impact of current policies, see Baker, M., J. Gruber, and K. Milligan, *The Retirement Incentive Effects of Canada's Income Security Programs*, 36 CANADIAN J. ECON. 261, at 261–73 (2003).

[111] *See* HUMAN RESOURCES DEVELOPMENT CANADA, LEGISLATIVE FRAMEWORK: MANDATORY RETIREMENT, *at* http://labour.hrdc-drhc.gc.ca/worklife/aw-retirement-legislative-02-en.cfm (last visited Jan. 15, 2004).

[112] Richard Shillington, *New Poverty Traps: Means-Testing and Modest-Income Seniors*, Toronto C.D. Howe Inst. Backgrounder No. 65, 2–5 (Apr. 2003).

X. LESSONS FOR THE UNITED STATES

The Canadian experience in reforming its pension system offers several lessons applicable to the United States debate on Social Security reform.

The area where Canada offers perhaps the most fruitful lessons for the United States is one that concerns ways to offer effective poverty-reduction for the elderly at a relatively low cost. Canada's combination of a quasi-universal Old Age Security program that is clawed back for upper-income seniors and an earnings-related CPP/QPP with modest replacement rates and income ceilings means that upper-income seniors receive relatively modest benefits. But the key to Canada's low senior poverty rates is the GIS, which combines effective targeting and easy accessibility, leading to high take-up rates. Three attributes of the GIS are key to achieving this outcome: one-time application, the absence of an assets test, and automatic recertification through the income tax mechanism. The GIS is, thus, far less intrusive and stigmatizing than the SSI program in the United States.

A second potential lesson that Canada offers the United States is in the design of a stiffer fail-safe device for Social Security expenditures that combines a lengthy time horizon for financial viability projections, a series of "default" policy changes split between payroll tax increases and indexation freezes that go into effect in the absence of an agreement between politicians, and an action-forcing mechanism that allows politicians to devise an alternative to default changes within a specified period of time.

A third area where the United States can learn from Canada concerns weakening the link between employer sponsorship and individual retirement savings accounts in 401(k) accounts and their equivalents for non-profit and governmental employees. The Canadian experience with RRSPs suggests both advantages and complications in such an approach. There are clearly important complications involving setting an overall ceiling on tax-advantaged savings when an employer is also making contributions to a defined benefit or defined contribution pension plan on an employee's behalf, but most of these issues also arise under the current U.S. system. And the Canadian system has several advantages, notably, greater access for workers whose employers do not offer an employer-sponsored plan and the possibility of making "catch-up" contributions based on past years' unused contribution room.

A fourth Canadian lesson for the U.S. concerns broadening the range of Social Security trust fund investments. The Canadian experience with the CPPIB suggests that the political risks of such investments can be lowered by employing a clear mandate to emphasize commercial returns with moderate risk, putting in place procedures to have an autonomous, insulated board, heavy initial use of indexed investments, substantial reliance on contracting out for fund management, partnering with private sector investment funds, and a gradual move to more active investment policies. As noted above, several conditions in Canada that facilitated a move to collective investment in equities included a broad consensus on the need to increase

trust fund returns to address a long-term funding shortfall; the example of the QPP investment strategy; the difficulty of integrating an individual accounts scheme with the QPP; and the weak institutional leverage of conservative political forces in resisting such a reform. Only the first of these conditions exists in the United States. The U.S. may eventually follow the Canadian path on collective equity investment of trust fund surpluses, especially if conservatives decide that moving to individual accounts is not politically feasible and can be reassured about insulation of those accounts from government interference. But, the road to that decision will be much rockier in the U.S. than it was in Canada.