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Stasis Amidst Change: Canadian Pension Reform in an Age of Retrenchment

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Stasis Amidst Change: Canadian Pension Reform in an Age of Retrenchment

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Abstract

Faced with aging populations and especially heightened fiscal constraints, large scale pension reforms were implemented in many affluent democracies during the 1990s. Canadian reforms, by contrast, were quite modest and old age security benefits emerged largely unscathed. Drawing on the comparative experience of other OECD nations, we highlight four characteristics of the Canadian pension system and the policy environment to account for this relative stability:(1) the comparatively modest scale of Canadian public sector pension expenditures; (2) relatively greater reliance on general revenue as opposed to payroll taxes to finance these expenditures; (3) the availability of other expenditure targets, notably health care, post-secondary education and social assistance, that could be cut with less political backlash; and (4) a pension design that allocates the public sector share disproportionately to the bottom end of the income distribution, precluding the emergence of the oppositional politics that fueled public debate elsewhere.

Stasis amidst change:
Canadian pension reform in an age of retrenchment

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The ongoing debate on pension reform among policy-makers in East Asian, North American and West European countries has been framed by a conventional discourse depicting a developing demographic time bomb as the elderly population grows in relation to the overall population (Béland and Waddan 2000). Since the 1980s, these demographic fears as well as macro economic constraints related to economic globalisation and regional integration have favoured the enactment of various pension reforms in East Asia, North America and Western Europe.

As in most countries, Canada's national pension system is largely a product of the age of welfare state expansion that extended from the 1950s to the 1970s (see Section I). The result was a public system that might be characterized as a small-scale version of the traditional Swedish design: a universal flat benefit for all seniors (Old Age Security), supplemented by a guaranteed minimum (income-tested) pension (the Guaranteed Income Supplement), and a modest second tier of earnings-related pensions (the Canada and Quebec Pension Plans). Middle and upper-income families supplement these benefits with employment-based pensions (Registered Pension Plans or RPPs) and personal retirement accounts (Registered Retirement Savings Plans or RRSPs). All of these elements were in place by the end of the 1960s.

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Since then, pension reform has emerged as a ‘hot point’ on the legislative agenda in three distinct periods. The period from mid-seventies to the early eighties brought the so-called *Great Pension Debate*, a high profile but ultimately doomed attempt to expand the modest second-tier earnings-related plan to European-like levels. The appropriate points of contrast here are the set of other ‘latecomer’ countries (Myles and Pierson 2001), nations that by 1980 had no (Australia, the Netherlands, New Zealand) or, like Canada, only modest (Denmark, Switzerland) second-tier earnings-related plans by 1980. For all but New Zealand, the 1980s were a period of pension expansion, typically led by organized labour. In these cases, however, expansion took the form of mandatory, typically funded, employer plans. In Canada, mandatory employer pensions were viewed by the reformers as a second best, inferior, solution and were never aggressively pursued. The result was no change.

Talk of expansion was quickly succeeded by the politics of retrenchment and can be divided into two periods: the first under the Conservative government of Brian Mulroney (1984-1993) and the second under Liberal Prime Minister Jean Chrétien (since 1993). In both periods, the universal flat benefit (Old Age Security) was targeted for reform with limited success. Here the appropriate points of contrast are Sweden and Finland. In both countries formerly universal flat rate pension benefits provided to all elderly citizens were ‘clawed back’ (to use the Canadian term) from high income earners by means of a ‘pension test’ (Myles and Quadagno 1997). The Mulroney government succeeded in introducing an ‘income test’ for flat rate pensions in 1989 but as we show below its effects have been decidedly modest. A much more ambitious effort to scale back Old Age Security benefits from middle income seniors in the 1990s (see Battle 1997), in contrast, did not get beyond the proposal stage.

Finally, amidst the usual rhetoric of ‘unsustainability’, the second tier earnings-related scheme (the Canada Pension Plan) was put on the reform agenda in the mid-nineties. The results were equally modest and served mainly to maintain the status quo. Contribution rates were raised to create a surplus to be invested in the equity markets with future revenues used to finance future benefits. This increase in ‘advance funding’ was aimed at maintaining benefit levels while smoothing out the effects of demographic change on contribution rates across successive cohorts of workers. The appropriate points of contrast here are the rather more draconian changes to second-tier earnings-related plans characteristic of many European countries since the early nineties.

In sum, against the comparative backdrop of the other affluent democracies, our main conclusion is that, on the benefit side, relatively little has changed to the basic pension design constructed in the fifties and sixties. Answering the question ‘why not?’, we contend, holds instructive lessons not only for understanding the Canadian case but also for making sense of larger scale reforms elsewhere. An obvious part of the answer is that ‘size matters.’ Like the other Anglo-Saxon countries, Canadian public sector pension expenditures are comparatively modest by international standards (about 5.5 per cent of GDP in the 1990s) and Canadian retirees receive a larger fraction (about 50 per cent) of their incomes from private occupational pensions, personal retirement accounts and other forms of savings. The upshot is that the potential contribution of pension cuts to other policy objectives such as deficit reduction was comparatively modest and, as we highlight in the discussion, governments found more tempting targets in other parts of the social policy matrix.

Less obvious, perhaps, is our claim that the financing mechanism – the composition of the tax budget used to finance public benefits – probably matters more. Unlike most countries that rely mainly on payroll taxes to finance old age pensions, Canada's pension budget is divided more or less evenly between payroll taxes and general revenue financing. High and rising payroll taxes, we argue, create strong incentives (and unusual coalitions) for reform that are comparatively weak in the Canadian context.

More tentatively, we make a claim about the 'moral economy' of reform. At the end of the day, all would-be reformers face the challenge of legitimating reforms with their publics by demonstrating that they correspond to some form of popularly held notions of justice or fairness. Many European reforms involved changes to benefit formulas that could readily be defended on the grounds that they involved elimination of inter-personal transfers (e.g. from private to public sector workers) that were indefensible. Large savings could be made by 'rationalizing redistribution' in public sector schemes (Myles and Pierson 2001). In the U.S., the rhetoric of "intergenerational equity" was deployed in (still largely unsuccessful) efforts to cut Social Security. The claim was that scarce transfer dollars that could go to poor families with children were being allocated to relatively affluent, high income, retirees. The Canadian system disproportionately allocates the public sector share to the bottom end of the income distribution (Myles 2000), providing precious little room for such a rhetoric to take hold (Cook et al. 1994).

Finally, and perhaps more importantly, successive Canadian governments found other targets for reform in their pursuit of deficit and debt reduction. During the golden age of expansion, political parties were eager to claim credit for new programs. Retrenchment, in contrast, is generally an exercise in blame avoidance rather than credit claiming (Weaver 1986). Health care, post-secondary education and social assistance provided targets amenable to cost cutting without the associated political backlash likely to follow from significant reductions in pension expenditures.

The emergence of the Canadian pension system

During the 1950s and 1960s, Canada constructed a retirement income system around three tiers: 1) Old Age Security (OAS), a universal, flat-rate pension supplemented by Guaranteed Income Supplement (GIS) that provides a guaranteed income for seniors without additional sources of income, both financed from general revenue;[1] 2) the Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP), that provide a second tier of earning-related public pensions financed from payroll contributions[2]; and 3) private, though tax-subsidized, employer-sponsored Registered Retirement Plans (RPPs) and individual retirement savings accounts called Registered Retirement Savings Plans (RRSPs).

Canada's first national pension legislation, the Old Age Pensions Act (OAP), was enacted in 1927 and provided $20 per month to persons over 70 on a means-tested basis (Bryden

[1] Most of the ten provinces and the three territories also offer benefits that top up the GIS. Considering their modest scale, this paper does not discuss directly the fate of these provincial programs.

[2] The two programs will be referred to together as C/QPP (Canada and Quebec Pension Plans).

1974). In 1951, the Old Age Security Act (OAS) eliminated the means-test and extended the then current benefit of $40 per month to all persons aged 70 and over meeting residency requirements. The Old Age Assistance Act (OAA) extended means-tested benefits to those aged 65-69 and remained in place until 1970 by which time the age of eligibility for the universal pension (OAS) had been reduced to 65.

The Guaranteed Income Supplement (GIS) was established in 1967 as the second component of the pension system's first tier (Bryden, 1974: 130-137; Guest, 1997: 144-145). Though initially intended as a temporary measure until the C/QPP matured, it has remained as a permanent and critical element for providing an income floor for the elderly. Benefits are subject to an income test – benefits are reduced $0.50 for each additional dollar in other income – rather than a means test (i.e. assets are excluded from the test) so that the program functions as guaranteed income (or negative income tax) program.[3] By the mid-1980s the combination of OAS/GIS provided an income floor equal to 50 per cent of average earning for an elderly couple and 31 per cent for a single individual.

Two years earlier, in 1965, legislation to introduce a second tier of earnings-related pensions – the Canada and Quebec Pension Plans – was adopted. This legislation was the outcome of a long bargaining process between the federal government and the ten provinces. As a result of Quebec's campaign for greater provincial autonomy, two

[3] In 1975, a Spouse's Allowance (SPA) was added to the first tier of the federal pension system in order to provide one-pensioner-couples facing economic hardship with more financial support. Like the GIS, the spousal benefit is income-tested; it covers only people aged 60 to 64 who meet residency requirements.

separate but highly coordinated earning-related schemes were created.[4] Financed through contributions from employees, employers and self-employed persons, the C/QPP integrates nearly all employed persons aged between 18 and 70 who make more than a minimum level of earnings during each year. These two social insurance schemes protect the contributors and their families against the loss of income due to retirement, disability and death. The replacement rate of the C/QPP monthly retirement pension represents 25 per cent of a beneficiary's average monthly earnings during his/her contributory life. Together, OAS and the maximum C/QPP benefit replace approximately 40 per cent of earnings for the average wage earner, a modest amount by European and even U.S. standards. Between 1966 and 1970, the eligible age for C/QPP benefits dropped from 68 to 65 and since 1987 actuarially reduced benefits can be accessed at age 60.[5]

From the outset both the CPP and QPP relied on partial funding as a result of the surplus of contributions built up in the early years of the plans. Importantly, however, assets from the QPP trust fund were invested in equities and real estate, to support provincial economic growth and French Canadian entrepreneurship (Thomson 1984) while CPP surpluses were lent to the provinces at preferred rates to subsidize provincial debt. This difference was a direct outcome of the 1960s Quiet Revolution, an attempt to modernize

[4] Benefits from either scheme are based on pension credits accumulated under both, as if only one scheme existed. On the federal/provincial bargaining process leading to the enactment of the C/QPP, see Simeon, 1972 and Bryden, 1974: 129-182.

[5] In Canada during the 1990s, there was no explicit attempt to increase the C/QPP retirement age.

[6] For constitutional reasons, the regulation of private pension plans in Canada is divided among the eleven federal and provincial jurisdictions.

Quebec society and to improve the socio-economic status of the province's French-speaking majority.

The third tier of the Canadian pension system was actually the first to emerge. Since the end of the 19th century, Canadian firms and insurance companies have created a variety of private pension plans and personal savings schemes. It is estimated that in 1936**,** enterprise-based pension plans covered less than 10 or 15 per cent of the Canadian paid workforce. Thirty-four years later in 1970, private pensions covered 39.2 per cent of the paid workforce (Bryden 1974, pp. 40-41) a figure that was essentially unchanged by the end of the 1990s (Statistics Canada 2001, p. 16). Since the enactment of the Pension Benefits Act in 1965, both the federal and the ten provincial governments have regulated private pension plans through the registration process and the Income Tax Act. In order to qualify for tax shelter, private pension plans must comply with specific governmental rules concerning coverage and financing.[6] It is worth mentioning that the term Registered Pension Plans (RPPs) refers to employment-based schemes for public as well as private sector workers.

The federal government also plays a decisive regulatory role in the field of personal retirement accounts, which are widespread in Canada. Registered Retirement Savings Plans (RRSPs) were created in 1957 to allow self-employed workers to save for retirement. Actually, all employees can contribute to RRSPs, even if they also participate in employment-based schemes. Employers can also contribute on a group basis to RRSPs for their staff. Upon maturity the assets are commonly used to purchase a life annuity, but two other options are possible. A guaranteed annuity may be purchased, or assets may be placed in a Registered Retirement Income Fund (RRIF), which allow more flexible timing of the withdrawals (Coward 1995, p. 11). In 1999, almost 60 per cent of Canadian families had RRSPs or RRIFs (Registered Retirement Income Funds),[7] with a median value of about $20 000 (Maser and Dufour 2001, p. 14). While coverage by these personal retirement accounts is exceptionally high by international standards (OECD, 2001), the bulk of RRSP assets are held by middle and upper income workers.

From the 'Great Pension Debate' to the politics of retrenchment

The earliest stage of the current Canadian politics of pension reform can be found in the so-called 'Great Pension Debate' of the late 1970s and early 1980s. The debate was launched in 1975 when the Canadian Labour Congress (CLC) advanced a proposal to double C/QPP benefits and contributions. At the time, there was a general consensus concerning the need to increase benefits targeted at low-income elderly (especially elderly women). But the main issue at stake was over the use of the public pension system to ameliorate income security in light of tepid growth in private sector coverage. While labour unions, women's rights groups and social reform lobbies clearly supported a widespread expansion of the C/QPP to meet the needs of Canadian workers, voices within the Canadian business community opposed an increase in payroll contribution rates. From their perspective, the solution to income security problems lay in the growth of private pensions. Moreover, provincial leaders, especially those from Ontario and Quebec, could not agree on the suitable course of reform (Banting 1987). Because the C/QPP had many qualities lacking in private pension plans (indexing, portability, low

[7] RRIFs are tax-deferred investments offered as payout options from RRSPs.

[8] In that province, the Conservative Party was in power from 1943 to 1985.

administrative costs, universal coverage of the labour force), a federal report published in 1980 favoured the public sector option supported by left-wing groups and Quebec's political leaders (Task Force on Retirement Income Policy 1980). The inability of the business sector to reach consensus on a private sector solution also contributed to the ideological success of the public solution. While large firms were willing to accept mandatory private pensions to put an end to the coverage problem, small businesses opposed this option (Myles 1988, p. 46).

In addition to business opposition, proponents of the public sector solution faced the de facto 'veto power' of Ontario, Canada's largest province. Because the federal and provincial governments share constitutional responsibility for this program, Ottawa must reach an agreement with at least two-thirds of the provinces representing two-thirds of the Canadian population before enacting a reform (Battle 1997, p. 538). During the late 1970s and the early 1980s, the pro-business conservative government of Ontario, by far the most populous Canadian province, opposed any attempt to significantly expand the C/QPP.[8] The institutional structure of Canadian federalism at the origin of provincial 'veto power' – combined with the opposition of the business sector – was instrumental in the defeat of left-wing forces supporting a public solution to the 'pension problem' (Banting 1987, pp. 62-69). As we shall see, however, the same constitutional obstacle was a key element restraining serious consideration of cutbacks in the following decade. Despite the many and voluminous reports on the topic, the reform movement began to wither with the onset of recession in 1982.

It is instructive to compare Canada's experience in the 1980s with that of the 'latecomer' countries (Myles and Pierson 2001), nations that had no (Australia, the

Netherlands, New Zealand) or, like Canada, only modest (Denmark, Switzerland) second-tier earnings-related plans by 1980. For all but New Zealand, the 1980s were a period of pension expansion, typically led by organized labour leading to the establishment of mandatory (or quasi-mandatory) employer plans. From the outset, however, Canadian labour and its allies in the reform project rejected this strategy and the result was no change.

The failed assault on 'universality'

The economic recession of 1982 dissipated these reform forces while contributing to a gradual transformation of the Canadian policy agenda. Rising unemployment and a decline in economic activity increased social spending and expanded the federal deficit. The Great Pension Debate ended as fiscal austerity and economic liberalism came to dominate the Canadian political arena. The Conservative Party's widespread victory during the 1984 federal elections concretised this ideological and political shift.[9] During the electoral campaign, soon-to-be Prime Minister Brian Mulroney publicly questioned OAS 'universal coverage', arguing that 'wealthy bankers' wives' should not be receiving OAS benefits. Social movements, old-age organizations and labour unions opposed the idea of targeting OAS benefits, forcing Mulroney to back away.[10] But his promise to fight the federal deficit meant that social programs financed through general revenues such as the OAS had become potential targets for retrenchment (Myles 1988, p. 49)

[9] The Conservatives won 211 of the 282 seats in September 1984.

[10] Immediately after the election, his Finance Minister reopened the debate on universality, but Mulroney was forced to repudiate him publicly to neutralize public outcry.

In May 1985, approximately nine months after the election, the Conservatives launched the first serious retrenchment attempt in the field of pension reform. Rather than abolish universal flat rate benefits, the first Budget proposed the 'partial deindexation' of family allowances and OAS.[11] These indirect cutbacks were aimed at saving the federal treasury approximately four billion dollars or so over the next five years as a result of the gradual erosion of benefits. Unfortunately for Brian Mulroney and Finance Minister Michael Wilson, the 'partial deindexation' issue created a true 'political tempest' across the country. In addition to labour unions and anti-poverty groups, old-age organizations participated actively in the two-month long campaign that would finally force the conservative government to discard the 'partial deindexation' proposal. The mass media also played a decisive role in that campaign. A famous televised encounter between the tall Prime Minister and a petite but vocal French Canadian woman named Solange Denis**,** became a national symbol of the conflict between 'greedy politicians' and the 'deprived elderly', and in this instance the politicians backed down. While this episode was then perceived as proof of the emerging power of a powerful 'grey lobby' in Canada, the 1985 debate appears more as an exception than as a new 'iron rule' of Canadian politics (Battle 1997, p. 530). Far less vocal and well organized than its US counterpart, the Canadian 'grey lobby' has never played a truly central role in pension politics since that time.[12]

[11] According to the plan, OAS benefits would only increase by the amount that inflation surpasses 3 per cent. 'If inflation were 3% or higher a year, then OAS benefits would automatically loose 3% of their value. Even if inflation were less than 3%, benefits would decline by the amount of inflation (e.g. an inflation rate of 2% would reduce the value of OAS by 2%).' (Battle, 1997: 530-531)

[12] For a comparative outlook on the Canadian grey lobby, see Pratt, 1997.

The defeat of 'partial indexation' probably convinced conservative politicians that 'visible' cutbacks in established social programs was a source of excessive 'political risks.'[13] During the second half of the 1980s, the Conservative government did in fact turn to a blame-avoidance strategy aimed at reducing 'political risks' related to retrenchment while ending universality 'through the back door.'[14] In 1989, the Conservatives successfully implemented a 'clawback' of OAS benefits from very high-income seniors that was largely ignored by the media. Benefits for individuals with incomes greater than $51 765 were reduced by 15 per cent for every dollar of income above the threshold with all benefits disappearing at approximately $89 000 per year. However, the cut-off point ($51 765) where the clawback would come into effect was only indexed to inflation in excess of 3 per cent so that in real terms a growing share of seniors could be affected with the passage of time. Since the huge majority of the elderly were unaffected and few politicians or journalists understood the longer-term implications of the reform, the clawback came to be identified as 'social policy by stealth' (Battle 1990).

Low inflation and slow income growth during the 1990s, however, meant that by 2001, less than 5 per cent of all seniors were affected by the income test introduced in 1989. In 2000, full indexation was restored with the result that future savings from the

[13] In the Canadian parliamentary system, the strong centralization of power creates a high level of autonomy that could exacerbate political risks related to pension reform (Pierson and Weaver, 1993)

[14] This strategy, which was also mobilized in other social policy areas, was labelled as 'social policy by stealth' by Kent Battle (Battle, 1990; 1997). See also Myles and Pierson, 1998.

clawback will only occur as a result of a significant increase in the numbers of very high-income retirees.

The rise and fall of Seniors Benefits

After some reluctance, the Liberals moved forward on pension reform in 1995. With the 'war on the deficit' and demographic fears as a background, the 1995 Budget formulated five principles for the reform of public pensions (1995 Budget cited in Battle 1997, p. 539):

1. undiminished protection for less well-off seniors;
2. continued full indexation to protect seniors from inflation;
3. provision of OAS benefits on the basis of family income;
4. greater progressivity of benefits by income level; and
5. control of program costs.

Far from departing from the Conservative agenda, these design criteria reinforced the logic of pension reform that emerged during the second half of the 1980s, the effective abolition of universal flat rate pensions.

[15] The same strategy has been used in the US concerning the gradual change in retirement age enacted as part of the 1983 amendments to the Social Security Act (Light, 1995).

Targeting was still highly controversial in 1995, but the Liberals made sure to avoid the mistake of the first Mulroney government, which was to call into question full indexation of benefits. The spectre of Solange Denis's colourful encounter with Brian Mulroney was a source of 'political learning' for elected politicians interested in reducing political risks related to pension reform (Caragata 1995).

In 1996, the Liberals unveiled a new reform project far more explicit than the OAS 'reform by stealth' enacted in 1989. The government proposed to replace both OAS and GIS programs with a new Seniors Benefit that would integrate the two in a single income-tested scheme. Generally speaking, low and even middle-income families would benefit from the new scheme and high-income retirees would bear the brunt of reform. For example, a family receiving \$20 000 per year on top of the Seniors Benefit would gain \$500 per year under the new system. But families with \$50 000 per year of other retirement income would lose more than \$4000 per year as a result of the new legislation (Geddes 1998, p. 13). Unlike the 1989 clawback that was calculated on the basis of individual income, the clawback implicit in the new Seniors Benefit was to be based on family income, thus impacting a much larger pool of retirees.

To minimize the risk of political backlash among the wealthiest segment of the elderly population, Finance Minister Paul Martin stressed that current OAS/GIS beneficiaries would not be affected by the reform. Later, this commitment was expanded to 'apply to everyone age 60 and over as of December 31, 1995, as well as their spouses, regardless of their age.' (Government of Canada, 1996a)[15]

Despite these efforts at blame avoidance, organized groups representing not only the elderly but also professional associations and investment firms slowly united against the proposal. At the beginning of 1997, the Retirement Income Coalition sealed an alliance between 21 of these groups, including the Canadian Teachers' Federation, the Investment Dealers Association and the Canadian Association of Retired Persons. This new coalition generated considerable media attention on the potentially negative impact of the reform on savings behaviour (Geddes 1998). As Reform Party MP Keith Martin (1997) argued:

This new Seniors' Benefit is obviously not much of a benefit at all, but a seniors tax. It penalizes those who have sacrificed and saved for their retirements. Ultimately, it will make more people dependent on taxpayer-funded, low return, government controlled pensions instead of enabling people to earn a more lucrative pension through their investments, such as RRSP's.

From this perspective, the Seniors Benefit would discourage personal savings and encourage 'welfare dependency.'

At the other end of the political spectrum, women's organizations and NDP officials also criticized the Seniors Benefits. The NDP leader, Alexa McDonough, summarized widespread feminist concerns about the proposed scheme: 'Senior women currently receive the OAS directly, but the Seniors Benefit Program will be calculated on a couple's combined income. Older women may lose their Seniors Benefit based on the income of their spouse, threatening their financial independence.' (McDonough 1997) Considering that the Bloc Québécois and most social reform organizations also rejected the Seniors Benefit, political support for this measure appeared weak.

Facing considerable pressure from social movements, the Retirement Income Coalition and opposition parties, the liberal government finally withdrew the controversial reform proposal, more than two years before it was to take effect. Referring to renewed economic prosperity and a shrinking federal deficit, Finance Minister Paul Martin found an elegant way to justify his retreat:

> The reform of the OAS/GIS was launched at a time when our choices were restricted by the overwhelming constraint of a $38 billion deficit and, as importantly, a debt-to-GDP ratio that had risen virtually uninterrupted since the mid-1970s. Because of these two very real fiscal factors, the proposal made in 1995 represented the best choice available at the time. That being said, any choice that depended on taking money out of the retirement income system was far from ideal. Three years later, our prospects have changed for the better and a much wider set of choices is now available. (Martin 1998)

Now that the federal government was expecting long-term fiscal surpluses, the idea that future retirees had to make significant economic sacrifices in the name of fiscal austerity was difficult to justify.

The fall of the Seniors Benefit proposal is related to a strategic mistake of the liberal government. Instead of relying on hidden fiscal changes that silently affect wealthier beneficiaries, Paul Martin launched a highly visible reform project that attracted too much attention to neutralize the political risks associated with the politics of retrenchment. Despite their decision to postpone the implementation of the Seniors Benefit and their commitment to indexation and social redistribution, the proposal attracted widespread media attention to a reform project that upset key interest groups and a significant fraction of the population. Moreover, unpopular budget cuts enacted between 1995 and 1997 in other policy areas such as unemployment insurance and fiscal transfers to provincial governments reduced the political 'security margin' of the government in the field of pension retrenchment.[16] Hence, while OAS became a target for reform under two political regimes, at the end of the day little was changed.

The politics of consultation: reforming the Canada Pension Plan

In 1995, the publication of the Fiftieth Actuarial Report of the CPP suddenly pushed this program to the centre of the Canadian policy agenda. Due to a significant increase in disability benefits and the impact of the economic recession, this report projected a higher schedule for future contributions than anticipated by the previous actuarial report. Without a significant change in the current schedule of contribution rates, by the year 2015, the CPP would no longer collect enough revenues to pay all the benefits (Battle 1997, p. 537).[17]

While the Reform Party and conservative think tanks such as the CD Howe Institute responded with proposals to replace the public pay-as-you-go system with private sector alternatives, the governing Liberals launched a consultative process aimed at reforming the program in an incremental manner. This consultative turn in pension reform is related to a key institutional feature of the CPP noted earlier: since the federal and provincial governments share constitutional responsibility for this program, Ottawa must reach an agreement with at least two-thirds of the provinces with two-thirds of the population before enacting a reform (Battle 1997, p. 538).

[16] On these related retrenchment efforts, see Banting, 1997; Rice and Prince, 2000: 110-129.

[17] Between 1966 and 1986, a contribution rate of only 3.6 per cent prevailed. In 1993, such a rate had risen to 5 per cent (Emery and Rongve, 1999: 69).

After a first round of consultation, the Department of Finance drafted a joint report that evaluated the long-term financial situation of the CPP while setting the agenda for a consensual reform. Published in February 1996, this Information Paper for Consultations on the Canada Pension Plan (Federal/Provincial/Territorial CPP Consultations Secretariat 1996) formed the basis of public consultations on the CPP that were held across Canada in 1996. The consultations were part of the statutory review of the CPP carried out by the federal and provincial governments. Meanwhile, Quebec conducted its own public consultations within the province concerning the QPP (Government of Canada, 1996b). In November of the same year, the federal and provincial governments published a joint statement to frame the principles that would guide the elaboration of the next CPP reform. Among the nine principles outlined in the statement, two were especially significant:

4. The CPP must be affordable and sustainable for future generations. This requires fuller funding and a contribution rate no higher than the already legislated future rate of 10.1 per cent. In deciding how quickly to move to this rate, governments must take economic and fiscal impacts into account.

8. CPP funds must be invested in the best interests of plan members, and maintain a proper balance between returns and investment risk. Governance structures must be created to ensure sound fund management (Government of Canada, 1996c).

While the first of these principles reflects a strong emphasis on 'economic competitiveness', the second one is the product of a policy learning process related to the existence of the Caisse de dépôt et placement du Québec, a provincial investment board that has invested QPP's money in equity since the 1960s. The relative financial 'success' of this provincial scheme paved the way to the investment of CPP surplus funds in equities by providing the federal and other provincial governments with a positive precedent.[18]

Finance Minister Paul Martin finally presented the draft of the new CPP legislation in February 1997. Following the principles formulated a year before in the Information Paper for Consultations on the Canada Pension Plan, it was decided to increase combined employer and employee contributions to the CPP from 5.6 to 9.9 per cent by 2003 in order to build up a larger reserve fund.[19] The fund was then equivalent in value to about two years of benefits and was projected to decline. As a result of reform, it is now scheduled to grow to five years of benefits with the surplus invested in a diversified portfolio of securities ‘to earn higher returns and help pay the benefits as Canada’s population ages’ (Martin, Paul 1997). In order to invest the reserve fund, a CPP Investment Board was created. This new organization is governed by a board of directors and is managed by investment professionals from the private sector. By 31 March 2001, the CPP Investment Board ‘had 7.2 billion dollars invested in Canadian and foreign equities and by 2011’ the board ‘expects to be managing at least $130 billion in a diversified investment portfolio.’ (CPP Investment Board 2001)

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[18] During the first half of the 1980s, however, the Caisse de dépôt et placement faced criticism and suspicion from the business community and the federal government, which considered this investment board as a mere political tool of nationalism (Brooks and Tanguay, 1985). More recently, authors such as Pierre Arbour have criticized what they considered as the excessive ‘economic power’ of the *Caisse* (Arbour, 1993; 2002).

[19] The government of Quebec enacted the same schedule of contribution increases to harmonize them with the federal one.

Finally enacted in January 1998, Bill C-2 included other minor modifications aimed at improving the long-term financial situation of the CPP. For example, the annual basic exemption was frozen at $3500 so that the portion of income subject to contributions will increase faster than inflation (Government of Canada 1997). Moreover, 'retirement pensions will be calculated on the 5-year average of the Year's Maximum Pensionable Earnings at the time, instead of the 3-year average.' (Martin, Paul 1997) Disability pensions were also subject to some cost-control measures. To boost public confidence in the program, contributors will receive annual reports on their CPP accounts and the federal-provincial reviews will be conducted every three years, rather than five years. Far from radically breaking from the historical path of the program, the 1997 reform reaffirmed the contributory nature of the C/QPP. Moreover, significant (and unpopular) reforms such as an increase in retirement age were excluded from the reformers' agenda.

It is worth mentioning that the privatisation of the CPP has never been considered as a serious option by Canadian policy-makers. Despite the rhetoric emanating from the conservative Canadian Alliance party and Alberta's Conservative party (for example: Martin 1995), pressures to move from social insurance to individual savings accounts are far more diffuse in Canada than in the United States. Despite that fact that neo-liberal economists and politicians have exploited the demographic fears associated with population ageing, public support for the CPP remains strong (Townson 2001, p. 195). The 1998 CPP reform reduced these fears by improving the system's financial balance and recent stock market instability (especially in the aftermath of the 2001 terrorist attacks) has been detrimental to the emergence of a large movement favouring pension privatisation (Chevreau 2002).

Beyond this relative lack of support for privatisation, federal policies enacted during the 1980s favoured greater reliance on personal savings and private pension schemes. Conservative**,** as well as Liberal governments**,** significantly increased the level of tax assistance during the 1980s and 1990s to provide greater incentives for Canadians to save money for their retirement (Battle 1997, p. 525). These reforms concerned both RRSPs and RPPs. Moreover, 'tax assistance limits were made fairer and more flexible.' (Pearse 2001, p. 214)

In spite of these reforms, only 39.1 per cent of the paid workforce participated in an enterprise-based pension plan in 1998 (Statistics Canada 2001, p. 16) Poorly covered by RPPs, low-income families save little for retirement: 'The large majority of family units with no private pension assets had lower employment incomes. Considering only those economic family units with a major income recipient between 25 and 64, just over 70 per cent of families of two or more with no pension savings had earnings of less than $30,000.' (Maser and Dufour 2001, p. 5) In this context, the public pension system represents the main source of economic support for low-income elderly and has brought old age poverty to now very low levels (Myles 2000). While some scholars have argued that even minor erosion of universality would affect the political support for state-financed pensions, it seems that the OAS and GIS programs have a strong political basis in Canadian society.

Discussion

Although the window of retrenchment was opened on several occasions in the past two decades, the design put in place in the 1950s and 1960s has thus far survived relatively intact. The famous ‘clawback’ of OAS benefits introduced in 1989 might have resulted in serious long-term erosion of benefits for middle-income seniors since the threshold for the income test was partially deindexed. But that door was effectively shut with the return to full indexing under the Liberals in 2000. The main result of the 1997 reform of the Canada Pension Plan was to raise contribution rates to stabilize the system. None of this was because benign spirits were directing social policy reform. Under pressure from rising deficits, both the Conservatives under Brian Mulroney and the Liberals under Jean Chrétien spent a great deal of energy, and not a little political capital, in efforts to reduce social spending. The Chrétien government was particularly successful in this venture. Though both governments flirted with large-scale pension reform, old age benefits emerged relatively unscathed. Why so?

Canadian Federalism and the Politics of Blame Avoidance[20]

The designer’s of the original Canadian union envisioned a strong central government and under the British North America Act of 1867 assigned all major powers to the central government, leaving what were then considered ‘residual’ powers related to health, education and welfare (social assistance for the poor) to the provinces. Nevertheless, in the post-war decades Ottawa took the lead in reforming all three areas. The Canada Assistance Plan (CAP) established in 1966 created a cost-sharing agreement by which Ottawa assumed half the cost of provincial welfare and social services that met specified conditions. The central governments role in health and post-secondary education was consolidated in 1977 under Established Program Financing (EPF) that provided a federal

[20] On blame avoidance, see Weaver, 1986.

block grant to the provinces to finance these programs. Although Ottawa established basic ground rules for their delivery, the final mix of services and benefits in all three areas remained under provincial jurisdiction (Rice and Prince 2000).

Divided jurisdiction with regard to both the CAP (social assistance) and EPF (health and post-secondary education) proved to be a mixed blessing for Ottawa. As these programs were expanding, Ottawa received little political credit since the services and benefits they provided were delivered under provincial brand names. In a period of retrenchment, however, Ottawa was able to retreat from all three areas by cutting transfers to the provinces, leaving provincial governments to take the blame, for subsequent reductions in services and benefits. In 1995, The Liberals dismantled both the CAP and EPF, replacing them with the Canada Health and Social Transfer (CHST) leading to ‘savings’ of 8.5 and 15.2 percent (or about $7 billion) in the first two years of its existence (Battle 1998, p. 330).

In contrast, OAS and GIS are purely federal programs and, in the case of the CPP, divided jurisdiction created a decisive check against any serious consideration of large-scale cutbacks. Reform of the CPP requires the consent of two thirds of the provinces containing two thirds of the population. The Province of Quebec made it clear that it would oppose any significant benefit cuts as would Saskatchewan and British Columbia, then ruled by the social democratic New Democratic Party, effectively removing that option from the political agenda.

The Politics of the ‘New Economy’

As elsewhere, Canadian social politics in the 1990s were influenced by policy models associated with the *Third Way*, a new buzzword that captures the common elements of a still inchoate paradigm assigning welfare functions to families, markets and states. The 'old' welfare state, constructed between the 1930s and the 1970s, emphasized protecting people *from the market. Third Way* solutions, by contrast, emphasize programs that both provide incentives for and help people to succeed *in the market*. In addition to, and sometimes instead of, the welfare state's traditional mandate of 'civilizing capitalism,' *Third Wayism* assigns responsibility for "nurturing capitalism" (Battle 2001) to welfare states. During the 1990s, the major targets for Canadian *Third Way* reforms were unemployment insurance and child benefits. In the case of the former, changes in eligibility rules greatly reduced coverage rates among the unemployed. In contrast, income-tested child benefits for the 'working poor' were greatly expanded to enhance work incentives, a path also followed in the U.K. and the U.S.

Pension policy and population aging get on the radar screen of *Third Way* advocates when they are widely perceived to be reducing employment levels either by encouraging early retirement or by driving up payroll taxes. Neither feature has figured prominently in Canadian policy debates.

Because of its modest scale, changes to the age of eligibility for CPP pensions are unlikely to have large effects on retirement behaviour except among lower income earners, creating obvious equity problems. Such a result would be perverse for macroeconomic as well as for distributive reasons. The largest gains to the economy are to be had if the most productive workers (the healthy, well educated, and presumably better paid) remain in employment longer. Reform can have a potentially perverse effect if changes to retirement incentives in public sector plans mainly produce higher retirement ages among low wage, low productivity workers.

To induce large changes in retirement ages among middle and upper income wage-earners in the Canadian context would require extensive regulation of the age at which workers can access private sources of retirement wealth (RPPs, RSSPs), on the one hand, and, on the other, reforms that eliminate incentives that now *bias* retirement decisions in favour of more retirement and less employment. Early retirement incentives and defined benefit formulae that discourage continued employment are examples. But until now, there has been precious little pressure on Canadian policy-makers to pursue such an agenda and little likelihood of reaching the political consensus required for reform if they did. Current and projected ratios of retirees to workers while higher in Canada than in the U.S. are well below typical European levels (OECD, 2001, p. 79).

The major pressure for pension reform in OECD countries is a product of high and rising payroll taxes to meet current and future pension expenditures. The payroll tax is a flat tax, often with a wage ceiling that makes it regressive. Unlike income taxes, there are no exemptions and no allowances for family size. Low-wage workers and especially younger families with children typically bear a disproportionate share of the cost as a result. These effects are compounded to the extent that high payroll taxes discourage employment, especially at the lower end of the labour market where the social safety net, minimum wages, or industrial relations systems make it difficult for employers to pass such costs on to employees.

Because of their impact on wage costs (for employers) and the real take-home pay of less skilled and younger workers, the threat of high and rising payroll taxes has provided a potent incentive for the formation of somewhat unexpected coalitions of business and labour favouring pension reform in many countries (Myles and Pierson 2000). Since low-wage workers and especially younger families with children typically bear a disproportionate share of the cost, union leaders really do face a trade-off between their retired and working-age constituents if, as projected in Germany for example, payroll taxes were to rise from 22 to 38 percent of payroll in the coming decades.

By European and even U.S. standards, however, current and future payroll tax levels for pensions in Canada are quite modest, reflecting the modest scale of the C/QPP, one the one hand, and on the other greater reliance on general revenue financing (for OAS/GIS). In the mid-nineties, prior to reform, the payroll contribution rate for CPP was 5.6 per cent (compared to 12.4 per cent in the U.S.) and was projected to peak at 14.2 per cent in the next century, a level already exceeded by most European countries. The 1997 CPP reform accelerated contribution rates early in to create a capital pool the revenues from which will be used to finance future benefits. The aim was to reduce future increases. After reform, the maximum projected rate for future wage-earners is a modest 9.8 per cent.

The Moral Economy of Pension Reform

During the 1980s and 1990s, a remarkable shift in policy debate occurred in a number of countries. Whereas in the 1960s the common assumption in old age policy debates was that the elderly were ‘too poor,’ by the 1980s the claim that the elderly were ‘too rich’ was heard with growing frequency. In the United States, the rapid fall of poverty rates among the elderly relative to children brought themes of ‘intergenerational equity’ to the fore (Preston 1984) together with charges against the elderly of being 'greedy geezers.' Although 'population aging' is often perceived through the pessimistic lens of 'apocalyptic demography' (Prince 2000), the issue of 'intergenerational equity' has been far less prominent in Canada than in the United States (Marmor et al. 1994). This difference, we think, has a real material base.

As elsewhere, average incomes among Canadian seniors did rise sharply from the 1970s to the 1990s and low-income rates among Canadian seniors measured by the usual international standard (persons with adjusted incomes less than 50 per cent of the median) are among the lowest in the OECD, even when compared to egalitarian Sweden (Hauser 1997; Smeeding & Sullivan 1998).[21] But it was difficult to make the claim that the elderly were becoming 'too rich' (Table 1). In 1980, about 40 per cent of all elderly persons were in the bottom quintile, twice the rate for the population as a whole. By 1995, just over 17 per cent of the elderly were in the bottom quintile, somewhat below the level of 20 per cent for the entire population. However, approximately 80 per cent of the shift out of the bottom quintile reflected movement into the second and third quintiles and little increase in the proportion of seniors in the top two quintiles. While the risk of poverty fell dramatically over the period, it was difficult to sustain the case that retirees were becoming 'too rich'.

Table 1: The Distribution of the Population 65+ By Income Quintile, 1980-95

		1980	1990	1995	Change, 1980-95
Quintile	Bottom	39.7	25.2	17.5	-22.2
	2nd	22.1	29.7	32.5	10.5
	3rd	12.2	16.2	20.0	7.8
	4th	13.3	14.9	16.0	2.7
	Top	12.8	13.9	14.0	1.2
Total: all quintiles		100.0	100.0	100.0	

Source: Myles (2000) calculated from Statistics Canada, Survey of Consumer Finances

The reason for this outcome is that in combination OAS/GIS, the C/QPP and related transfers function much like an enriched flat benefit system on a pre-tax basis and post-

[21] By the usual international standard, low-income rates among Canadian seniors had fallen to about 5 per cent in 1994 compared to a U.S. rate in excess of 20 per cent. And among the population 70+, Canada's low-income rate was below that of Sweden, the usual 'winner' in the international league tables on poverty reduction (Smeeding & Sullivan, 1998).

tax the overall impact is highly redistributive. This result is highlighted in Table 2 where we show average (equivalence adjusted) income transfers from all public plans by source and age-specific income quintiles for the population 65+ in 1995.[22] Total pre-tax transfers (column 5) of between eleven and twelve thousand dollars or approximately 50 percent of the average equivalence adjusted disposable income ($23 000) of all persons 65+ is more or less identical across all income levels.

Table 2: Distribution of Adjusted Transfers and Taxes by Income Quintile

Quintile	(1) C/QPP	(2) OAS/GIS	(3) Other Transfers	(4) Taxes	(5) Total Transfers (pre-tax)	(6) Net Transfers (post-tax)
Bottom	2482	7886	928	-181	11 296	11 115
Second	4610	7158	800	-406	12 568	12 162
Third	4990	5875	1154	-1546	12 019	10 473
Fourth	5187	5494	1268	-3701	11 949	8 248
Top	5358	5248	1350	-12249	11 956	-293

Source: Myles (2000) calculated from Statistics Canada, Survey of Consumer Finances

Conclusion

Since early eighties, the universal flat benefit (Old Age Security) system was targeted for reform on two occasions but with limited success while the 1997 CPP reform served primarily to maintain the status quo. In order to understand why Canadian policy-makers enacted reforms that seem so modest from a comparative perspective, we showed that an essential part of the answer is that ‘size matters’. Because of the modest level of pension-related public expenditures in Canada, the potential contribution of pension cuts to deficit reduction was comparatively limited. In this context, both Liberal and Conservative governments found more attractive targets in other areas of state intervention, especially those areas in which the federal government could transfer political risks to provincial leaders. As importantly, limited reliance on payroll taxes to finance the public system created few incentives for the emergence of the reform coalitions that have been

[22] All incomes are adjusted with an equivalence scale to take account of differences in family size.

characteristic of the high payroll tax countries. Finally, the actual distribution of public sector benefits left little room for a moral assault on public pensions by conservative intellectuals and politicians. The upshot is that in Canada public pensions have been a point of relative stability in a world of welfare state change.

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