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Reforms to Canadian Social Security, 1996-7

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Chapter 9

Reforms to Canadian Social Security, 1996–7

Robert L. Brown

The Canadian Social Security System

The Canadian social security system underwent a series of reforms in 1996–7. These changes were minor and could be viewed as only ‘tweaks’ to the existing system. Proof of this is the ability to describe the Canadian social security system at a general level and not to differentiate whether the description refers to the system before or after the 1996–7 reforms.¹

Government-sponsored retirement income security in Canada comes in three tiers. First, there is Old Age Security (OAS), which is the grandfather of Canadian retirement income security, having first been legislated in 1927. Benefits had been increased on an ad hoc basis over the history of the plan and are now indexed to inflation. At first, benefits were not paid until aged 70 years. Now, all persons in Canada aged 65 years or older who are citizens or legal residents may qualify for either a full or partial OAS pension. In general, those with 40 years of residence after age 18 are eligible for a full pension. Those with fewer than 40 years may receive a partial pension on a prorated basis ($t/40$), provided they have at least 10 years’ residence. OAS benefits are paid out of general tax revenues and are taxable income. The maximum OAS monthly pension as of January 2006 was \$484.63,² or \$5,815.56 per year (at a time when average annual earnings were about \$35,000). The benefit is fully indexed to the consumer price index, with benefit increases taking place quarterly. The importance of OAS in the total income-security package has declined over the past few decades. In 1967, OAS benefits equaled about 21 percent of the average wage. They are now closer to 16 percent.

Before 1989, OAS was universal for those aged 65 years and older, subject only to residence requirements (it was paid on a demogrant basis). No income or asset tests were applied. In 1985, the federal government, debating the merits of the continued universality of OAS benefits, proposed to partially de-index the OAS, adjusting only for cost-of-living increases in excess of 3 percent per annum. At the time the legislation was proposed, the rate of inflation had been close to 9.5 percent for the previous decade, so the intent was to bring about a partial benefit reduction. However,

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inflation in Canada over the past decade has been consistent at around 2 percent per annum, which means the proposed change would have resulted in no benefit increases at all. Regardless, this provision was abandoned in the face of strong opposition from senior citizens groups.

In 1989, however, the government introduced measures to 'claw back' the OAS benefit from recipients with a net income of \$51,765 (\$62,144 in 2006) a year. Seniors have to pay back their OAS benefits at a rate of 15 cents for every dollar that net income exceeds \$62,144. Seniors with net incomes of \$100,914 or more get no OAS pension. This legislation marked the end of the long-standing principle of universality of the OAS. For a while, the clawback incomes (\$62,144 and \$100,914) were not fully indexed but were adjusted to the rate of inflation less than 3 percent. As a result, more and more Canadians faced the clawback each year. Since 2000, the clawback thresholds have been fully indexed to inflation. This clawback of benefits from the wealthy changed OAS from a demogrant benefit to a welfare benefit similar to the Guaranteed Income Supplement (GIS), explained next.³

The second tier of Canadian social security is the GIS. Technically, GIS is a part of the OAS system. It was introduced to the Canadian scheme in 1966 at the time of the inception of the Canada/Quebec Pension Plans (C/QPP, described below). When the C/QPP was introduced, there was a ten-year transition period before retirees could collect a full C/QPP retirement benefit. The GIS was added to OAS as a temporary measure to cover this ten-year transition, providing income-tested benefits for those with no or low C/QPP benefits. However, this 'temporary' add-on is still with us (it is, in fact, expanded) and remains an essential element of the government income security system.

When the GIS was introduced, it provided, in combination with the OAS pension, an income guarantee to single pensioners equal to about 25 percent of the average wage. A pensioner couple was guaranteed an income equal to about half of the average wage. In 1975, the Spouse's Allowance (SA) was added. It is payable to OAS/GIS pensioners' spouses as well as widows and widowers, aged 60–64 years, on an income-tested level. These households are thus guaranteed a minimum income equivalent to that of a GIS pensioner couple.

As of January 2006, the maximum monthly GIS single-person benefit was \$593.97, or \$7,127.64 a year (at a time when average annual earnings were about \$35,000). For a single pensioner, the maximum GIS is reduced by \$1 for each \$2 of income (other than OAS). For a married couple with both spouses receiving the basic OAS pension, the maximum monthly supplement of each pensioner is reduced by \$1 for every \$4 of the combined monthly income (other than OAS). For a single pensioner, the GIS stops being paid when income reaches \$34,368.

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There is no asset test associated with the GIS, only an income test, which is based on the individual's income tax return from the previous year and is virtually automatic. Citizens do not appear to be stigmatized by the GIS income test. GIS benefits are indexed quarterly to inflation and paid out of general tax revenues; no contributions are required. GIS benefits are nontaxable, although those eligible for GIS would probably not pay much tax anyway. Nearly 80 percent of all single GIS recipients are women (National Council of Welfare 1996*a*: 7).

GIS benefit levels have been increased several times since its inception (over and above the automatic cost-of-living increases), and GIS is now a significant part of the retirement income security system in Canada. However, as income from the C/QPP and private pensions has grown, the proportion of seniors receiving GIS has fallen.

The third tier of retirement income benefits come from the C/QPP. These plans are virtually identical and the description of the CPP that follows will generally be true for the QPP as well, with differences noted.⁴ Workers have full mobility of 'pension credits' and can move seamlessly between the two plans. The QPP has been somewhat more progressive than the CPP over the years, probably because the QPP is easier to amend. For example, the QPP introduced flexible retirement between ages 60 and 70 years (details follow) well before the CPP did.

The C/QPP, first introduced in 1966, are contributory, DB plans. Full benefits were first paid in 1976 (thus requiring only ten years of participation vs today's forty years). While their main benefit is retirement income (70% of cash flow), the plan also pays benefits for disability and death, plus children's, orphans', and survivors' benefits. With 9.9 percent contributions, the C/QPP have operating surpluses (discussed in more detail below).⁵

Contributions to the C/QPP total 9.9 percent of earnings between the year's basic exemption (YBE, equal to \$3,500 constant) and the year's maximum pensionable earnings (YMPE, equal to \$42,100 in 2006), which was originally meant to approximate the average wage and is indexed to the average wage. Contributions are a compulsory 9.9 percent and are shared equally by employers and employees; self-employed make the full contribution. In all cases, the C/QPP contributions receive a tax credit. That is, they are tax deductible but at a defined constant marginal income tax rate applied to all earners. In the CPP, anyone who is retired with CPP retirement benefits does not contribute even if they are earning income, which has not been the case for the QPP since 1998.

The retirement benefit equals 25 percent of a worker's career-average earnings, but with earnings credits indexed to the average wage (more details about this formula are given below). To get this benefit, a worker must have forty years of contributions to the C/QPP. Technically, the

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formula uses the best 85 percent of years of wages between ages 18 and 65 years.⁶ Any years where no contributions are made—years of no labor-force participation or years of earnings below \$3,500—are entered as ‘zeros’, until 40 years are credited. Years before 1966 are not counted, which affects only those now aged 58 years or older. For those who retire early, the formula uses 85 percent of age-of-retirement minus 18, which actually creates a slight subsidy and incentive for early retirement. Special ‘dropout’ years are allowed for years of disability and of child rearing that qualify so long as the years of earnings are ultimately not under ten.

The maximum C/QPP retirement benefit in 2006 was \$844.58 per month, or a maximum of \$10,135 a year, at a time when average annual earnings were about \$35,000. Benefits, which are taxable income, are indexed to the cost-of-living, with annual increases. The benefit is paid as a joint-and-60 percent-survivor benefit. Benefits are paid to those eligible no matter where they reside. There is no income or asset test for the receipt of C/QPP benefits.

The full benefit is payable at age 65. However, the plans allow flexible retirement between ages 60 and 70 years. For both early and late retirement, there is a permanent adjustment in benefits equal to 0.5 percent per month. That is, someone retiring at age 60 years would get 70 percent of a full benefit, while someone retiring at age 70 years would get 130 percent. Years of earnings after age 65 years can be substituted for lower earnings years prior to age 65 years. Between ages 60 and 65 years, the 0.5 percent adjustment is close to being actuarially neutral, but after age 65 years, the 0.5 percent adjustment creates a disincentive to stay in the labor force. Retirement prior to age 65 years requires proof of no labor-force attachment at the time of application, though one can then return to the labor force with no loss of benefits.

Recent actuarial valuations of the CPP show that the plan is viable for a seventy-five-year time horizon. Because of less favorable demographics, including lower fertility and immigration, recent QPP actuarial valuations show that, while the QPP is healthy in the short term, there may be a need for future contribution rate increases or benefit decreases. The Y2004 administrative expense ratio for the CPP was 1.6 percent and for the QPP it was 1.2 percent (of one year’s expenditures).

In total, these systems are highly progressive. For the very poor, income/replacement ratios at retirement exceed 200 percent. For someone consistently earning the average wage, the replacement ratio from government-sponsored systems totals about 40 percent. For the very well-to-do with large private savings or pensions, the only government-sponsored income they would receive is the C/QPP. C/QPP retirement benefits equal 25 percent of career-average earnings (indexed to wages) but stop at the

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average wage. As noted above, the maximum C/QPP retirement benefit in 2006 was \$844.58 per month, or \$10,135 a year. Thus, as one moves into higher-income brackets, these C/QPP retirement benefits produce ever lower replacement ratios. GIS and OAS income is also subject to clawback and OAS and C/QPP income is fully taxable when taken. Consequently, this means that there is a huge gap in retirement income security for wealthy Canadians that must be filled with private savings or employer-sponsored private pension plans.

In this regard, the government provides some strong tax incentives to save for retirement. Contributions to retirement savings vehicles are mostly tax deductible for the contributor (whether it is the worker or the employer). Investment income accrues tax free. However, when retirement income is taken, it is taxable in full. In other words, the Canadian retirement savings tax policy treats retirement savings like deferred income.

The limits placed on private saving for retirement have not increased as rapidly as inflation or wages and so are not as liberal as they were when first legislated. Canadians can save up to 18 percent of their wages, to a maximum of \$18,000, if participating in a DC scheme or in an individual account (called a 'registered retirement savings plan'). These limits are on total contributions, worker plus employer. If a DB scheme is used, then the limits are stated as being an annual accrual no larger than 2 percent of wages, with a maximum benefit accrual of \$2,000 per annum. The DC factors are thus nine times that of the DB factors, because, when the legislation was passed in the mid-1980s, an average annuity factor at age 65 years was approximately equal to 9, which made the two options virtually equivalent. The dollar limits above are now indexed to wage growth.

Why Did Social Security Reforms Take Place in 1996-7?

The economic and political climate in 1996 paved the way for reform. In the early 1990s, Canadian governments (both federal and provincial) were running deficits, with the federal deficit peaking in 1993 at \$40 billion. By 1996-7, federal debt totaled \$563 billion, up 50 percent since 1990, or 69 percent of the GDP. Thirty-five percent of federal revenue was being spent on interest on the debt, 36 percent of which was held in foreign hands (Brown 1999: 12). In addition, because both Britain and the USA had lowered personal income tax rates and corporate tax rates, there was pressure on the Canadian government to follow suit. At that time, Canada ranked first among the G-7 nations in terms of direct taxes on individuals (Canadian Institute of Actuaries 1995: 20). Thus, the federal

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TABLE 9-1 Life Expectancy in Canada (1931–96)

Year	At Birth		At Age 65		At Age 75	
	Male	Female	Male	Female	Male	Female
1931	60.0	62.1	13.0	13.7	7.6	8.0
1951	66.3	70.8	13.3	15.0	7.9	8.7
1971	69.3	76.4	13.7	17.5	8.5	10.6
1996	75.4	81.2	16.0	19.9	9.7	12.4

Source: Statistics Canada Life Tables (several years).

government was under extreme pressure to decrease spending. One of the main methods of trimming the federal budget was to decrease the cash flow to, and cost sharing with, the provincial governments. This was particularly evident in health-care delivery (a provincial responsibility cost shared with the federal government).

The second reason for the 1996–7 reforms was the growing public concern about the aging of the Canadian population. In 1996 Canada was still a relatively young population, with only 1 person in 8 being aged 65 years or older. However, Canada had a very strong ‘baby-boom/baby-bust’ phenomenon. Because of the rapidly shifting demographics, the ratio of elderly dependents was forecast to rise to one in four by 2036 (Denton, Feaver, and Spencer 1996: 28–30). Overall, Canada was expected to have one of the fastest rising old-age dependency ratios in the period from 1996 to 2036 of any developed nation (Brown 1999: 10). At the same time, Canada was experiencing rapid increases in life expectancy, in common with most Western industrialized nations (see Table 9-1).

The government was concerned about the expected rise in costs of social security that this population ageing would create. In particular, the government presented expected costs for OAS/GIS in total, as shown in Table 9-2.

The final reasons for the timing of the reforms were actuarial in nature. The C/QPP were created in 1966. For the early cohorts of workers, contributions to the plans totaled 3.6 percent of contributory wages between the YBE and the YMPE, split equally between the employer and the employee

TABLE 9-2 Projected Net (After Taxes) Costs of OAS/GIS (\$B)

1996	2001	2011	2030
20.8	24.7	34.4	77.3

Source: Government of Canada (1996b: 34).

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TABLE 9-3 Long-Term Economic Assumptions

	<i>1960s Environment</i>	<i>1990s Environment</i>
Senior dependency ratio (aged 65/20–64)	0.33	0.40
Annual increase in real wages (%)	2	1
Real interest rate (%)	2	4
Cost of social security if PAYGO (%)	11.0	14.5
Cost of social security if fully funded (%)	16.5	7.2

(the self-employed paid the full 3.6%). This contribution rate schedule remained unchanged until the mid-1980s. Even with this low contribution rate, the C/QPP plans were able to build up reserve funds equal to two-years' expenditures. However, by the mid-1980s, the reserve funds were being depleted and were destined for exhaustion by 2016. Further, C/QPP actuarial reports indicated that contribution rates would have to rise to 14.2 percent of contributory wages if no changes were made to the plan (OSFI 1995). At first, the government reacted solely by making gradual ad hoc increases in the contribution rate. By 1997, the combined contribution rate was 6 percent, split between worker and employer.

A report from the Canadian Institute of Actuaries (1996), showing why PAYGO funding was no longer advantageous, proposed that the C/QPP move to 'smarter' funding. The report argued that both economic and demographic variables had changed since the implementation of the C/QPP in 1966. Table 9-3 contains data provided by the actuaries in support of a change in the funding philosophy.⁷ The cost data are for a plan providing a 40 percent replacement rate for someone consistently earning the average wage (fully indexed) or the total of OAS plus C/QPP benefits.

Those familiar with the financing of social security systems will note that in the 1960s, the dependency ratio and the annual increase in real wages favored PAYGO funding with real interest rates at 2 percent per annum. However, by the 1990s, the shift in all three variables created a strong bias toward a more fully funded system.

1996–7 Reforms*Why the Seniors Benefit Failed*

In its budget speech of March 6, 1996, the government announced the most fundamental amendments to social security in Canada since the introduction of the C/QPP in 1966. It proposed that in 2001 a new Seniors Benefit would replace OAS and GIS. The government said that this action was necessary to make this part of the social security system sustainable in the long term.

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Under the proposed Seniors Benefit, those elderly receiving the GIS would receive \$120 more per year. In fact, under the proposed amendments, 75 percent of seniors would have received the same or higher benefits; 16 percent would have received lower benefits; and 9 percent would have received no benefits at all (National Council of Welfare 1996*b*: 17). The new benefit would be nontaxable income and fully indexed to inflation.

The clawback of the Seniors Benefit would have been based on the combined income of spouses—as is the case for GIS. (In contrast, the OAS clawback is based on individual income.) The proposed benefit had two levels of clawback. As personal income rose from \$0 to \$12,520, the Seniors Benefit was to be reduced by 50 cents per dollar of such income. Then the clawback was zero until personal income reached the level of \$25,921, at which point a new 20 percent clawback took hold. This system would have resulted in no benefit being paid once individual income reached \$51,721 or family income reached \$77,521 (vs \$84,484 for an individual and \$168,968 for a couple under the existing OAS/GIS system). All these levels would be indexed, in full, to inflation.

Under the proposed system, the federal government expected to see projected savings of \$0.2 billion in 2001, \$2.1 billion in 2011, and \$8.2 billion in 2030 (which is 10.7% of the program cost) (Canada 1996*b*: 34). Voters reacted negatively, or at least apathetically, to what appeared to be very small- and very long-deferred savings in exchange for losing the extremely popular OAS/GIS system.

Analysts of the proposed system criticized the high marginal tax rates that resulted. If the marginal clawback and marginal income taxes were added together, then some seniors would lose 78 cents of every dollar of private income they had after age 65 years. It was argued that these rates would create a significant disincentive to save for retirement.⁸

Another flaw in the Seniors Benefit that led to its being abandoned was that the clawback was based on family income, not individual income, as under OAS. Thus, older women who had never participated in the paid labor force would no longer have any retirement income in their own right. They would lose that aspect of economic autonomy in their spousal relationship and in their community of women who have not been employed. This factor was an important one in the death of the Seniors Benefit proposal and a flaw that the government appeared to have underestimated.

The 1997 Reform of the Canada/Quebec Pension Plans (C/QPP)

On February 14, 1997, the minister of finance announced that the government had an agreement with the provinces to amend the CPP. Similar

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amendments were to be made to the QPP. In introducing the reforms to the Canadian public, the government used arguments of affordability and sustainability as their theme: 'The changes will ensure that the CPP is affordable to future generations and can be sustained in the face of an ageing population, increasing longevity, and the retirement of the baby boom generation' (Canada 1997: 6).

Reforming the CPP is not easy, and radical reforms are unlikely. Under the constitution of Canada, pensions are a provincial responsibility. Changes to the CPP can take place only with the support of two-thirds of the provinces with two-thirds of the total Canadian population (including Quebec).

The 1997 reforms to the C/QPP should be categorized as tweaks to the existing system as opposed to major reforms. In particular, the government made a point of stressing to Canadians that many important aspects of the CPP were not to be changed:

- All retired CPP pensioners or anyone older than 65 years as of December 31, 1997 would not be affected by the proposed changes. Anyone currently receiving CPP disability benefits, survivor benefits, or combined benefits would also not be affected.
- All benefits under the CPP would remain fully indexed to inflation.
- The ages of retirement—early, normal, or late—would remain unchanged.

However, several amendments were announced that decreased the benefits to be paid in the future (by about 9.3% in total), increased the level of funding, and increased the rate of return on any reserve funds.

The first change took place in the area of disability income benefits, enhancing differences between the CPP, and QPP. Between 1966 and 1986, disability income benefits paid by the CPP and the QPP had run very much in parallel. However, starting in 1986, CPP disability income benefits rose sharply relative to those paid by the QPP. In fact, the CPP actuary projected that if these benefits continued at their elevated level, the CPP would exhaust its reserve funds by 2016 (OSFI 1995). In 1985 disability benefits represented 13 percent of all CPP expenditures. By 1995, these benefits had grown to 19.7 percent of overall costs (OSFI 1995). This increase, by itself, would add 1.5 percentage points to the long-term costs of the CPP (Canada 1996*a*: 24).

No one should have been surprised by this increase, however, as the government had liberalized the requirements for these benefits on more than one occasion. In 1987 the length of contributory service required to qualify for disability benefits was shortened (the QPP rules were not changed). Also in 1987, the disability benefit was increased, making it equivalent to the QPP benefits. In 1992 the government lifted the time limit on

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late applications. This change opened the program to many workers who previously had been denied benefits. There was also a campaign to make workers and employers more aware of these changes and CPP disability benefits in general.

Another reason for the growing difference between the CPP and QPP in this benefit category was a change in the adjudication of disability. The CPP introduced some nonmedical factors, including an individual's ability to find work, but rescinded the inclusion of these factors in September 1995. The CPP also recognized several 'new' causes of disability not recognized by the QPP, such as stress, chronic fatigue, and environmental hypersensitivities; the QPP continued to use a more physical case-base for disability. In addition, in the past when workers had to have profound physical disabilities to qualify for the CPP benefits, there was little follow-up to reassess claims for continued disability. The auditor general estimated that this inaction was costing the CPP \$65 million a year in overpayments (Ford 1996: 88). The CPP administration responded by implementing a program of reassessment in May 1993, which helped to decrease continuing disability claims.

The only actual legislated amendment to the CPP disability income benefits in the 1997 reforms was the increase of the contribution period for eligibility. Instead of requiring contributions in only two of the past three years, the amendment required contributions in four of the past six years. All other changes affected the adjudication guidelines. The change in the eligibility requirement and the more intense review of existing files have brought the CPP disability expenses back into balance with those experienced by the QPP.

Another change, designed to reduce benefits, was made in the method used to determine retirement pensions and other earnings-related benefits, such as survivor's benefits. Prior to the amendments, these benefits were determined based on the contributor's average career earnings updated to the average of the YMPE in the past three years before calculation. This formula was changed to the average of the YMPE in the past five years before calculation, a change that made the C/QPP more like the average pension in the private sector. More private-sector pensions base retirement benefits on a final five-year formula than on a final three-year formula.

The next benefit change was the value of the CPP death benefit. Before amendment, this benefit was equal to 6 months of retirement benefits, to a maximum of 10 percent of the YMPE. In 1997, the YMPE was \$35,800, so the maximum death benefit then was \$3,580. However, the 1997 reforms set a new maximum of \$2,500, which does not adjust to inflation.

A more subtle change was made in the way contributions to the C/QPP are made. Before amendment, workers contributed only on wages between

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the YBE and the YMPE; the YBE was equal to 10 percent of the YMPE. In 1997 the YMPE was \$35,800, so the YBE was \$3,500 (rounded down). Under the reforms, the YBE was then frozen at \$3,500. This adjustment is actually an important feature of the C/QPP (and somewhat ingenious), which makes the plans more progressive. Consider a worker who earns \$30,000 in a given year. That worker contributes only on earnings between \$3,500 and \$30,000 (a maximum of \$26,500). However, the worker earns benefits on the full \$30,000 for that year. More importantly, someone who earns \$3,600 contributes on a base of \$100 (and the employer matches this small contribution), but accrues benefits on \$3,600. For those earning less than \$3,500, no benefit accrual occurs in that year. Over time, the progressiveness of the frozen YBE will erode due to inflation. It is highly doubtful, however, that more than a handful of Canadians ever understood or appreciated this reality. In addition, more Canadians now earn years of benefit accruals.

This amendment also made the C/QPP more like contributory private pension plans—the majority of private pension plans in Canada require employee contributions—since with private plans, workers contribute on all of their earnings.

It should be noted that while the official C/QPP contribution rate today is 9.9 percent, because of the YBE, no one actually contributes 9.9 percent of their entire C/QPP base earnings. To make a fair comparison to a private pension plan, this needs to be understood. With the 2006 YMPE being \$42,100, maximum worker/employer contributions are \$1,910.70. For a self-employed person, the maximum contribution is \$3,821.40.

The 1997 CPP reforms also introduced an automatic stabilizing principle. The CPP is supposed to continue in existence, with the benefits described previously, financed by a 9.9 percent contribution rate. If the CPP actuary shows that the present benefits are not sustainable at the 9.9 percent contribution rate, then two things happen. First, the contribution rate moves half of the distance to the necessary long-term contribution rate as determined by the CPP actuary. At the same time, benefits are de-indexed to bring them slowly down in value until the new (slightly higher) contribution rate is in balance with the new (slightly lower) benefit structure. Thus, sustainability is guaranteed and is achieved by (equal) adjustments to both benefits and contributions.

The final amendment to the C/QPP was the rapid ramping up of contributions with a resultant rapid increase in the reserve funds. In the early existence of the C/QPP, the reserve funds held were equal to about two years' worth of total expenditures. Contribution rates were increased linearly to 9.9 percent in total by 2003 (from 6% in 1997). These extra contributions, over what would have been needed on a PAYGO basis, will create reserve funds equal to five years of expenditures. Stated another way,

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by 2017 CPP assets will equal 20 percent of its liabilities (i.e. it will be 20% funded).

Until 1997, the CPP reserve funds were lent to the provincial governments, who paid federal long-term bond rates on this debt. The new reserve funds are invested by the independent Canada Pension Plan Investment Board (CPPIB). As an aside, the QPP reserve funds had always been invested widely in private-sector assets by the Caisse de depot et placement du Quebec. The CPPIB can invest in a highly diversified portfolio with the objective of achieving higher rates of return than under the pre-reform provincial-bond arrangement. The CPPIB is subject to broadly the same investment rules as other pension funds in the private sector.

The Canada Pension Plan Investment Board

The CPPIB began operations in April 1998, with a mandate to invest in the best interests of CPP contributors and beneficiaries and to maximize long-term returns without undue risk of loss. The benchmark used to evaluate their investment outcomes is the achievement of real returns, after inflation, that exceed the return on a portfolio of government real-return bonds nine years out of ten.

By December 2005, the CPP portfolio had grown to \$92.5 billion, and the CPPIB expects to be managing \$200 billion by 2016. The rate of return in fiscal year 2004–5 was 8.5 percent, versus 17.6 percent the previous year. Over the five-year period, 2000–4 inclusive, the CPP reserve fund earned a real (inflation-adjusted) rate of return of 4.48 percent. The last CPP actuarial report shows that the CPP was more than solvent over a 75-year horizon assuming investment returns of 4.1 percent real, as one of more than a dozen variables.

As of December 31, 2005, 56.6 percent of the CPP assets were publicly traded stocks; 29.7 percent were government bonds (a legacy from the previous fund investments); 8.4 percent were real-return assets; 4.3 percent were private equity; and 1.0 percent were cash and money market securities. Going forward the CPPIB intends to diversify the portfolio more broadly by increasing the holdings in real estate, infrastructure, and other real-return assets.

Based on the latest CPP actuarial report (OSFI 2004), CPP contributions are expected to exceed benefits until 2022, providing a sixteen-year period before any portion of the investment income is needed to help pay CPP benefits.

The CPPIB and the government have worked very hard to guarantee that the CPPIB will remain independent from political pressure and to provide

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strong evidence of ethical governance. To date, the CPPIB has been well received by the public.

Conclusion

The C/QPP reforms of 1997 can be viewed as tweaks to the system as opposed to massive change. Most of the amendments were subtle and not fully understood by the average Canadian citizen. These reforms were made without apparent opposition, which is somewhat surprising given that contribution rates were raised from 6 to 9.9 percent over a short 6-year period.

The failure of the Seniors Benefit in 1996 and the causes of its demise are an interesting study. The failure was political, not actuarial. The government failed to understand how popular the OAS was and how emotional the response would be to proposed reforms given the very small- and long-deferred savings that were projected to result.

The Canadian social security system today provides Canadians with a high level of income security while leaving ample room for individual savings and investments (see Brown and Prus 2004). The reforms of 1997 have meant that the CPP now rests on a healthy foundation. Indeed, the latest CPP actuarial report shows that this system is sustainable for at least the next seventy-five years.⁹ In summary, there seems to be wide acceptance of Canada's current social security system among Canadian voters.

Notes

¹ For an excellent summary of the 1996–7 reforms, see Belánd and Myles (2005).

² Unless otherwise indicated, monetary units are Canadian dollars.

³ For information about the OAS, go to www.sdc.gc.ca/en/gateways/nav/top_nav/program/isp.shtml

⁴ For information on the Canada Pension Plan, go to www.sdc.gc.ca/asp/gateway.asp?hr=en/isp/cpp/cpptoc.shtml&hs=cpr. For information on the Quebec Pension Plan, go to www.rrq.gouv.qc.ca/en/

⁵ For full information on all of these benefits, go to <http://www.sdc.gc.ca/en/isp/pub/factsheets/rates.shtml>

⁶ Note that 0.85(65-18) is 40 years.

⁷ To read the CPP actuarial reports, go to www.osfi-bsif.gc.ca/osfi/index_e.aspx?DetailID=499. To read the QPP actuarial reports, go to www.rrq.gouv.qc.ca/en/programmes/regime_rentes/analyse_actuarielle_sommaire.htm

⁸ For more information on the impact of clawbacks on labor force participation, retirement saving, and decisions to retire, see Baker (2002), Baker, Gruber, and Milligan (2003a, 2003b), Shillington (2003), Milligan (2005), and Mintz et al. (2005).

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⁹ The QPP is not as healthy because of higher dependency ratios expected in the future in that province.

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