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Old Age Security: Can We Afford It?

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Old Age Security is the basic building block of Canada's retirement income system. It is a flat rate monthly benefit that goes to everyone at age 65, provided they meet certain residency requirements. Canadians build on that foundation, saving for their retirement with benefits from the Canada or Quebec Pension Plan, a workplace pension if they're lucky enough to have one, and private savings.

But now Prime Minster Harper says OAS is unsustainable. According to the Prime Minister, the program will not be able to accommodate the retirement of the baby boom generation over the next 20 years, so something must be done. Although details were sketchy at first, Harper now admits he is planning to raise the age of eligibility for OAS from 65 to 67.

Pension experts don't agree with him. In a 2010 paper on Canada's pension system, commissioned by the Department of Finance for the federal and provincial finance ministers' Research Working Group headed by Jack Mintz, Edward Whitehouse, who leads the pensions team in the Social Policy Division of the OECD, said that "long-term projections show that the public retirement income system is financially sustainable." He concluded "There is no pressing financial or fiscal need to increase pension ages in the foreseeable future."

How OAS Works

- OAS is a flat rate benefit, currently $540.12 a month that goes to individuals at age 65 provided they meet the residency requirement. There is no requirement to stop working in order to receive OAS.
- To get benefits at all, you must have lived in Canada for 10 years after age 18. To get full benefits, you must have lived here for at least 40 years after age 18. Those who can't meet the 40-year requirement get a pro-rated benefit, depending on how long they've lived here. However, low-income immigrants who are not getting the full OAS may qualify for an enhanced GIS.
- OAS is paid to individuals and does not depend on participation in paid employment nor on the income of a spouse or

partner. As a result, women who have not worked outside the home receive a benefit in their own name without reference to the income of a spouse or partner.

- OAS is clawed back from individuals whose income exceeds $69,562 (at 2012 rates). Once income reaches $122,772, the entire amount of the OAS benefit is subject to the clawback. The amount clawed back is deducted at source. Like the rest of the tax system, clawback incomes are adjusted each year for inflation.

The Guaranteed Income Supplement

- GIS is an income-tested benefit payable to low income pensioners who are getting OAS. If the age of eligibility for OAS is changed, low-income seniors presumably will have to wait until age 67 to claim GIS.
- In 2011, 34% of all OAS beneficiaries received some GIS.
- There are different GIS rates for singles and spouses in a couple, depending on family income. The maximum benefit in the first quarter of 2012 for the spouse of an OAS pensioner is $485.61 a month. The maximum GIS for a single individual is $732.36 a month.
- Both OAS and GIS are funded from the tax revenues of the federal government and are adjusted for inflation quarterly using the consumer price index.
- Income from OAS is taxable; GIS benefits are not taxable.

Is OAS Unsustainable? Here Are the Facts

- The number of OAS beneficiaries is expected to almost double over the next 20 years, growing from 4.7 million in 2010 to 9.3 million in 2030 as the baby boomers retire,
- Total annual expenditures of OAS (and the Guaranteed Income Supplement) are projected to increase from $36.5 billion in 2010 to $48.3 billion in 2015 and to $108 billion by 2030. But these costs reflect inflation. There is no indication of what the cost would be in 2012 dollars.
- Set in the context of the total resources of the economy (the Gross Domestic Product) OAS/GIS spending will go from 2.3% of GDP in 2010 to 3.1% in 2030. That's an increase of less than 1 percentage point of GDP. The ratio of expenditures to GDP is then projected to drop from 3.1% in 2030 to 2.6% 2050.
- According to some estimates, health care costs will increase from 12% of the economy to 18% of GDP in 2031.
- Canada allocates a much smaller percentage of its total GDP to public pensions than most European countries — as well as the United States — do. Italy, for example, spends 14% of its economy on public pensions.
- It is not clear what the Prime Minister means by "sustainable." Observers say a sustainable fiscal structure is one in which the government debt is not growing faster than the economy. In other words, the government's debt burden — the ratio of debt to GDP — is either stable or falling. They also note the Prime Minister and the Finance Minister frequently claim that Canada's debt-to-GDP ratio is the lowest in the G-7.

Here Are Some Other Considerations

- OAS benefits are indexed for inflation, based on price increases. But over the long term, wages increase faster than prices so seniors will find themselves falling further and further behind the rest of the population. For the federal government, which finances the benefits from tax revenues, price indexing keeps a lid on costs. The Chief Actuary says "the fact that benefits are indexed to inflation as opposed to wages and that new retirees incomes are expected to grow drive the cost of the program down over the long term."
- Pushing in the opposite direction is the impact of Tax-Free Savings Accounts (TFSAs) introduced by the government in 2009. These plans allow people to contribute up to $5,000 a year to savings accounts and income earned is excluded from income tests that determine eligibility for GIS. Government spending on GIS will therefore increase accordingly. In 2050, for instance, it's estimated that 32% of pensioners will be eligible for GIS. If the impact of TFSAs is excluded, it would be 26%. It is expected that the effect of TFSAs would lead to an increase of $4.2 billion or 12% in GIS expenditures by 2050.
- Seniors do not stop paying taxes when they retire. They continue to pay income taxes, as well as other taxes such

as property tax, sales tax and GST. As higher-income seniors receive their pensions and withdraw funds from their RRSPs and other investments, they will pay income taxes on these amounts which can be used to fund OAS and other programs.

- Increasing the benefits provided by the Canada Pension Plan — a move which has widespread public support — would ease the pressure on GIS over the long term. Modest increases in contribution rates for employers and employees could be phased in gradually over a period of several years so that benefits can be improved.

Do Seniors Need OAS?

- OAS benefits constitute a significant percentage of income for many seniors. According to one estimate, OAS and GIS combined make up 36% of the income of seniors. For low-income seniors, it's between two-thirds and three-quarters.
- OAS alone represents about 29% of the income of women aged 65–69 and 19% of the income of men aged 65–69.
- About 16% of older women on their own have incomes below the low-income cut-off. It is estimated that public transfers (mainly OAS and GIS) constitute 77% of the total income of unattached low-income seniors.
- And what about all those wealthy seniors who "don't need" OAS? Just 6% of seniors were subject to the clawback in 2010. For 2012, the clawback kicks in at income of $69,562. While benefits are phased out gradually as income rises, anyone whose income is above $112,772 will lose the entire amount of OAS benefits. In other words, if only 6% of seniors were having their benefits taken away, that's the percentage of potential OAS recipients who might be considered "high income."

Increasing the Age Of Eligibility: Working Longer

- Increasing the age of eligibility for OAS would have the biggest impact on lower-income earners who would be forced to go on working for another two years until eligible for their benefits. Higher income earners are more likely to have other sources of retirement income so they probably have more choice of when to retire.
- Would people be able to go on working if the government increases the age of eligibility for OAS from 65 to 67 or even older? That would depend on the state of their health. Individuals in high stress jobs or work that requires heavy physical activity may not be able to continue working for longer.
- Working longer will also depend on the attitudes of employers to older workers. Individuals in their late sixties may well face discrimination in employment and difficulty in finding jobs.

Offloading to the Provinces

- Most provinces have top-up programs that provide benefits to low-income seniors receiving GIS. If the age of eligibility for OAS/GIS is changed to 67 instead of 65, will provinces be expected to change the age of eligibility for their programs as well? There is no indication that the federal government has discussed any of this with the provinces.
- Those unable to continue in paid employment past 65, but ineligible for OAS or GIS until age 67 may then have to rely on provincial programs such as social assistance. Raising the age of eligibility could therefore also offload on to the provinces some of the costs associated with low-income seniors in their late sixties.

Cutting OAS For Younger Workers

- Federal government ministers have said changes to OAS will not affect current seniors or those who are close to retirement. We can therefore assume those who will be affected by possible cuts or changes in the OAS program will be individuals currently aged under 45 to 50. These are the very same workers who are affected by other developments in the retirement income system — in particular the practice of employers who have defined benefit pension plans switching to defined contribution plans that don't promise any particular retirement pension, or putting new hires into defined contribution plans while older workers remain in existing defined benefit plans.

Fixing the Retirement Income System

- More than 11 million Canadian workers do not have a workplace pension plan. Less than one-third of individuals entitled to contribute to an RRSP actually do so.
- The Canadian Institute of Actuaries says only about one-third of Canadian households are currently saving at levels that will generate sufficient income to cover their non-discretionary expenses in retirement.
- Federal government tax subsidies for pension income splitting and contributions to pension plans and RRSPs currently cost $23 billion a year. That's after allowing for tax revenues it receives by taxing withdrawals from these plans.
- OAS benefits represent about 14% of pre-retirement earnings for someone earning at the average wage. The CPP provides about 25%. It is generally considered that retirement income should replace about 60% to 70% of pre-retirement earnings for retirees to maintain their standard of living in retirement.
- Reducing the role of OAS in replacing pre-retirement earnings will mean workers will have to save additional amounts on their own — something many have been unable to do.
- This is the worst possible time to be considering cutting back on the basic benefit that provides the foundation for the retirement income of all Canadians. It could well reverse the progress Canada has made in reducing the poverty of older Canadians.

Sources

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