Canadian Centre for Policy Alternatives
December 2011

Pension Breakdown

How The Finance Ministers Bungled Pension Reform

Monica Townson

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ISBN 978-1-926888-88-0

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ACKNOWLEDGEMENTS

My thanks are due to Bruce Campbell, Andrew Jackson and Chris Roberts who read earlier drafts of this paper and offered helpful comments.

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Executive Summary

CANADA'S PENSION CRISIS has been the subject of debate for the past couple of years. More than 11 million Canadian workers don't have a workplace pension plan. And public pension plans — Old Age Security and the Canada Pension Plan — that everyone has, don't provide enough for people to live on in retirement. To make matters worse, most Canadians are not making up for their lack of a pension plan by saving for retirement on their own. Less than one-third of people entitled to contribute to RRSPS actually do so. There is now more than $600 billion in unused RRSP contribution room being carried forward. And 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.

But the government has now introduced a new program which it says will solve the problem. Pooled Registered Pension Plans (PRPPS) — according to the federal finance minister — will make "low-cost private-sector pension plans accessible to millions of Canadians who have up to now not had access to such plans."

Legislation introduced in mid-November will make it possible for employers to offer PRPPS to their employees. The scheme will be run by insurance companies and other financial institutions which will pool the savings of workers whose employers sign up for the program. The financial institutions will run the program on behalf of employers and, of course, will charge fees for doing so. Employers will not have to contribute to the

plan. And workers' savings will be locked in — but apparently they will be allowed to opt out if they want to.

No pension will be guaranteed by this program. In effect, it is yet another voluntary savings scheme that will do nothing to address the pension crisis. Since very few people take advantage of existing voluntary retirement savings schemes, it is not clear why officials are claiming the proposed PRPPs will prove more attractive than the existing programs. So far, the only advantage being promoted for PRPPs is that management fees will be lower than for individual RRSPs, since contributions will be pooled. But, of course, there is no guarantee of lower fees, nor is there any certainty that this would be a big selling point for the plans. It's also worth noting that there is no evidence people are not saving through RRSPs because of high management fees.

Canada does not need yet another voluntary tax-assisted retirement savings program. It needs public pensions that provide all Canadians with a basic guarantee of adequate income that will protect their standard of living in retirement. Expanding the Canada Pension Plan would meet this objective. In fact federal and provincial finance ministers seemed set to take this route when they assembled for their meeting in Alberta in December 2010. But they opted for the PRPP scheme instead.

Improving the replacement rate of CPP retirement benefits would provide better retirement pensions to virtually all Canadians. A relatively modest increase in contribution rates would be required, but that could be phased in over a period of time as the Canadian Labour Congress and others have proposed. The CPP covers all workers — including those who are self-employed — and its benefits would be guaranteed in relation to earnings and years of service; they would be indexed for inflation and fully portable from one job to another. This option would address the two key issues in the pension system causing concern: the lack of coverage of workplace pension plans; and the fact that individuals are not saving for retirement on their own.

As well, an expanded CPP, of course, could reduce federal expenditures on GIS because more people would have adequate retirement incomes. And while the government says CPP contribution rates cannot be increased when there is a "fragile" economy, it's worth noting that when the financing of CPP was changed at the end of the1990s, combined employer/employee CPP contribution rates nearly doubled over a five-year period during which the unemployment rate fell. The combined employer/employee contribution rate rose from 5.6% of covered earnings in 1996 to 9.9% in 2003, where it

remains. During that same period of time, the unemployment rate dropped from 9.6% in 1996 to 7.6% in 2003.

It should also be noted that the PRPPs scheme will do nothing to help the baby boom generation now coming up to retirement. It seems this is the lost generation as far as pension reform is concerned. It has been estimated that roughly one-third of Canadians now in the age group 45 to 64 are likely to end up with incomes that fall short of adequate minimum incomes and/or incomes that will allow them to maintain their standard of living when they retire.

The adequacy of CPP benefits has been an issue for more than 30 years. It is time now for federal and provincial governments to set aside ideology and work together to solve the problem.

How Finance Ministers Bungled Pension Reform

WHATEVER HAPPENED TO pension reform? It seems like only yesterday that politicians and pundits were expressing alarm about Canada's "pension crisis." Turmoil on financial markets was having a devastating impact on workplace pension plans. People who were saving for retirement through RRSPs were finding the value of their investments had dropped so much they were now faced with having to postpone their retirement. And it was revealed that most Canadian workers didn't have a workplace pension plan anyway. Coverage of these plans has dropped from 45% of employees in 1992 to just 39% in 2009. The reality is that 11 million Canadian workers don't have a workplace pension plan. And public pension plans — Old Age Security and the Canada Pension Plan — that everyone has, don't provide enough for people to live on in retirement.

To make matters worse, most Canadians are not making up for their lack of a pension plan by saving for retirement on their own. In 2009, only 31% of those eligible to contribute to an RRSP actually did so. Among people about to retire — that is people in the age group 55 to 64 — the typical person with an RRSP has saved about $55,000. That's enough to provide a monthly income of about $250. There is now more than $600 billion in unused RRSP contribution room being carried forward. And 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."

Economist Michael Wolfson, formerly assistant chief statistician of Canada and now Canada Research Chair in Population Health Modeling/Populomics at the Faculty of Medicine at the University of Ottawa, estimates that half of all Canadians born between 1945 and 1970 who have average career earnings between $35,000 and $80,000 are facing a drop of at least 25% in their post-retirement standard of living.[1] He also takes issue with the claim that the problem facing Canada's retirement income system is primarily "inadequate saving discipline." Instead, Wolfson says:

> What some may see as a lack of willingness to save for the long-term future, others will see as inadequacy in other parts of the retirement income system, such as the unduly poor returns offered in markets for private saving and annuities; the regulation of workplace pensions, which some see as discouraging employers from offering any plans in the first place, let alone high quality plans; the structure of tax incentives for retirement saving which are tilted toward the wealthy; and the inadequate size of Canada's public pensions, which has been evident for decades"[2]

In a paper written for the federal and provincial finance ministers, pension expert Bob Baldwin estimated that roughly one-third of Canadians now in the age group 45 to 64 are likely to end up with incomes that fall short of adequate minimum incomes and/or incomes that will allow them to maintain their standard of living when they retire.[3] What will they do then? They may have to go on working — if their health permits them to. Or they may have to fall back on those first tier programs in Canada's retirement income system especially the Guaranteed Income Supplement.

In a sense, this is the "lost generation" when it comes to retirement income. Pension reform should be addressing their needs in particular. Almost certainly we can expect poverty rates among seniors to start going up again unless something is done.

For those who do have workplace pension plans, we've seen an ongoing switch to defined contribution plans — especially the increasing tendency of employers to put new hires into DC plans while older employees continue in a long-standing defined benefit plan.

The switch to defined contribution plans lets employers off the hook because they no longer have to guarantee promised pension benefits. This was an issue in recent labour disputes at Canada Post and Air Canada. It's a process that will eventually lead to ever wider discrepancies in pension

security between younger and older workers — and maybe to increasing resentment on the part of younger workers.

Statistics Canada reports that 75% of workers who belonged to a registered pension plan in 2009 were in a defined benefit plan. But the agency also said that the rate of participation in these plans has declined constantly from more than 85% a decade earlier. Membership in defined contribution plans accounted for 16% of all pension plans members at the beginning of 2010. More than 85% of defined contribution members were in the private sector.[4] Only 4.5 million Canadian workers now have a defined benefit plan — that's about 26 % of all Canadian workers — where they are guaranteed a retirement pension related to their earnings and years of service.[5] And defined benefit plans are in an ever more acute crisis as a result of recent corrections in equity markets and the fall in interest rates to ultra low levels.

With the baby boom generation about to enter retirement, it certainly seemed like a crisis. In fact, the provincial premiers were so concerned about it that at a meeting of the Council of the Federation in 2009, they urged the federal finance minister to plan for a national summit on pensions to be held in 2010. They wanted to bring all the stakeholders together to decide what could be done to reform the pension system and make sure that future seniors would have adequate retirement incomes Urgent action was called for, they said.

Their concerns fell on deaf ears. Urgent action was not taken. Instead, the federal government produced reports denying there was a crisis. Current seniors were doing pretty well, they said. There was no need to worry — although it was admitted that "not all working Canadians are saving enough to obtain the same level of consumption in their retirement as in working years."[6]

Critics pointed out that the prosperity of current seniors — in itself arguable — was no guide to the financial security of future seniors. For example, coverage of workplace pension plans had dropped significantly since today's seniors were in the work force; unlike current seniors who probably spent a working life in secure jobs with the same employer, job security was no longer guaranteed during the careers of workers who will soon be retiring; many of them had experienced patterns of temporary or precarious jobs with no benefits and little opportunity to save for retirement; periods of high unemployment and economic instability had also taken their toll.

Following the 2007/08 meltdown of financial markets and the impact on workplace pensions, several provinces set up pension committees to consider the "pension crisis" and make recommendations for change in the rules

governing workplace pension plans. Such changes, of course, only affect the minority of Canadian workers who have a workplace pension plan. In the meantime, federal and provincial finance ministers continued to meet regularly to discuss pension reform.

A range of proposals to reform the pension system had been made by various experts and organizations — a key proposal being an expansion of the Canada Pension Plan. The Canadian Labour Congress called for a doubling of CPP retirement benefits to be phased in over a period of time and there seemed to be widespread public support for some variation of this option. A modest increase in contribution rates would be required — likely about 0.43% of pensionable earnings each year for seven years. This proposal would mean increasing the replacement rate of CPP retirement benefits from 25% of covered earnings to 50% of average adjusted pensionable earnings. The worker contribution (matched by the same percentage of wages contributed by the employer) was estimated to rise from 4.95 % of covered earnings in 2010 to 7.95% by 2016. Combined employer/employee contributions would then be 15.9% of earnings up to the YMPE. The Year's Maximum Pensionable Earnings (YMPE) is roughly equivalent to the average wage. (It should be noted that a doubling of benefits does not require a doubling of contribution rates since part of the current premium is used to bring down the previous unfunded liability, whereas an expansion of benefits would be fully pre-funded).

It was also noted that the CPP covers all workers — including those who are self-employed — and that its benefits would be guaranteed in relation to earnings and years of service; they would be indexed for inflation and fully portable from one job to another. This option would address the two key issues in the pension system causing concern: the lack of coverage of workplace pension plans; and the fact that individuals are not saving for retirement on their own.

Expectations were high that federal and provincial finance ministers would finally take action on pension reform at their meeting in Alberta in December 2010 and it was widely believed they would favour CPP expansion. But that idea has now been shelved in favour of a private sector solution in which employers will be able to offer defined contribution pension plans run by financial institutions such as insurance companies. Insurance companies had lobbied hard for this option for the past couple of years.

The ministers proposed a voluntary savings scheme to be operated by insurance companies and other financial institutions and known as a Pooled Registered Pension Plan (PRPP). It was described by the federal fi-

nance minister as "a major breakthrough for the Canadian Pension Market," which would make "low-cost private-sector pension plans accessible to millions of Canadians who have up to now not had access to such plans."[7] The ministers agreed their officials would continue to work on a "modest expansion" of the CPP, but meanwhile, they said they would engage with key stakeholders "to ensure the framework for these new plans will meet the needs of employees, employers and those financial institutions that may offer the arrangements."

The decision not to proceed with CPP expansion at this time took many observers by surprise. So much so that the Canadian Labour Congress launched an Access to Information request to try to find out who had torpedoed the attempt to expand the public system. In June 2010, federal and provincial finance ministers and premiers had indicated they would support an expansion of the CPP and there was widespread support from other groups such as the Canadian Federation of Municipalities. Changes to the CPP require the consent of two-thirds of the provinces having two-thirds of the population. Quebec has a vote on CPP changes even though it operates it own plan — the Quebec Pension Plan — for residents of Quebec.

While Quebec had apparently objected to CPP expansion — presumably because it did not want to have to implement a similar doubling of the QPP — it would appear, that Alberta was the key hold-out. Ted Morton, who was the Alberta finance minister at the time, had made no secret of his hostility to the CPP. He had been a long-time opponent of the CPP. In fact, as a Reform Party MLA with Stephen Harper, who was then president of the National Citizens Coalition, Morton co-authored the Alberta Letter which called on Alberta to reassert its constitutional power and take more direct control of its own future.[8] Among specific actions, they called for Alberta to withdraw from the CPP and set up its own Alberta Pension Plan.[9]

Pooled Registered Pension Plans

FEDERAL FINANCE MINISTER Jim Flaherty claimed with the introduction of PRPPs, "many employees of small- and medium-sized businesses and self-employed workers will now have access to a private pension plan for the very first time." According to the Finance Department, "PRPPs will make it more attractive for employers, particularly SMEs, to offer pension plans to their employees because a third-party administrator [the financial institution or insurance company] will take on most of the responsibilities that employers bear in existing pension plans." The proposal had been developed and heavily promoted by the Canadian Life and Health Insurance Association, the corporate-funded C.D. Howe Institute and others.

Background documentation from the Finance Department also implies that pooling contributions will enable financial institutions to offer plans at lower management costs than existing products. It would appear that lower costs are intended to make the plans attractive to investors.

The federal government introduced the *Pooled Registered Pension Plans Act* on November 17, 2011 (Bill C-25) claiming it would "make saving for retirement easier for millions of Canadians." The government said provincial enabling legislation will need to be introduced for the framework to become fully operative.[10] The plan is apparently aimed at the self-employed and employees of companies — particularly small businesses — that do not offer a

pension plan. The government did not mention that these individuals currently have access to RRSPs and TFSAs as ways of saving for retirement.

While details remain to be worked out, it is intended that insurance companies and banks will operate a kind of national savings scheme — pooling the savings of those who sign up in a defined contribution type of plan. Employers will be able to sign up their employees for the scheme (self-employed workers will be able to register too) but will not be required to contribute to the plan. Employers will select a plan for their employees, but they will also apparently be able to chose to stop offering the plan if they wish. According to Bill C-25, employee contributions to PRPPs will be locked in. The administrator of the plan (the financial institution) will decide the contribution rates.[11]

The federal government will modify the tax rules to accommodate PRPPs. It says tax rules for PRPPs are being developed and will be released in draft for comments shortly. The tax rules will apply to both federally and provincially regulated PRPPs.[12]

Like other defined contribution plans, amounts contributed to the PRPP will represent a percentage of the employee's salary and will be invested by the insurance company or financial institution, which will, of course, charge fees to run the program. PRPPs will be regulated by pension regulatory authorities so rules could vary from one province to another. Other issues remain to be resolved. For example, how will the proposed system deal with high job mobility within the SME world?

But Flaherty's statement was misleading on several counts. Access to the so-called "private pension plan" will depend on whether or not employers decide to opt into the scheme. There will be no requirement for them to do so — although since the proposed plans will be regulated by the provinces, a province could decide to make PRPPs mandatory for employers under their jurisdiction. For instance, any employer without a workplace pension plan could then be required to offer a PRPP, with automatic enrolment for its employees, who might be allowed voluntarily to opt out. However, many observers feel it's unlikely the plans will be made mandatory since employers will likely resist such a move.

A recent survey in Quebec, for example, found that 54% of Quebec's SMEs (small and medium enterprises) do not offer pension plans or other forms of contribution to employees' retirement plans and that 93% of this number do not intend to do so in the next three years in spite of incentives offered by the Quebec government to encourage experienced workers to remain in the workforce.[13]

As well, what will be offered is not a "pension plan" but a savings scheme. Employees and self-employed workers already have access to RRSPs and to Tax-Free Savings Accounts (TFSAs) through which they can save for retirement. (Self-employed workers are covered by the CPP). As we noted earlier, very few take advantage of RRSPs and a recent survey from ING DIRECT noted that only 41% of Canadians have a TFSA and almost half of those earn $100,000 a year or more. Only 24% of those surveyed said they used the TFSA for retirement savings.[14]

The proposed PRPPs simply offer yet another voluntary savings vehicle that will not guarantee any particular pension at all. Since very few people take advantage of existing voluntary retirement savings schemes, it is not clear why officials are claiming the proposed PRPPs will prove more attractive than the existing programs. So far, the only advantage being promoted for PRPPs is that management fees will be lower than for individual RRSPs, since contributions will be pooled. But, of course, there is no guarantee of lower fees, nor is there any certainty that this would be a big selling point for the plans. It's also worth noting that there is no evidence people are not saving through RRSPs because of high management fees.

Further details about PRPPs remain to be developed, although the federal finance minister has apparently been consulting with interested parties. Some observers believe the scheme will not be operational for at least a couple of years. Yet the federal government declared this arrangement would provide pensions to those who do not currently have them (more than 60% of the work force).

Meanwhile, the federal government and provincial finance ministers are apparently still considering "modest" enhancements to the CPP and will be meeting again in Victoria in mid- December 2011. The NDP and the CLC are still pursuing the idea of CPP expansion, but not much was heard of these developments during the recent election campaign and the federal budget had virtually nothing to say about pensions other than a proposal for a very small increase in the GIS.

Barriers to CPP Expansion

THE CANADA PENSION Plan covers virtually all workers in Canada, whether employees or self-employed. Even those who do not themselves contribute to the plan may still receive benefits from it — for example, women who do not work outside the home may share in their spouse's retirement pension when both reach retirement age; they may be entitled to surviving spouse benefits if their contributor partner dies or becomes disabled; and they may be allocated a share of pension credits if the marriage or common-law relationship ends. As well, benefits are indexed for inflation.

But benefits were deliberately set at a modest level when the plan was established in the expectation that individuals would be able to supplement CPP benefits with their own saving or through membership in a workplace pension plan. It is perhaps interesting to note that strong opposition to a more generous CPP replacement rate was also mounted by the insurance industry when the plan was established in 1966. The industry claimed private pensions (which they would provide) would supplement the public plans to provide adequate retirement incomes to Canadians.

This time around, the industry claimed a "private sector solution is the best approach for Canada." And they argued that pension coverage could be expanded by amending pension legislation so non-affiliated employers and the self-employed could band together in a single multi-employer pen-

sion plan "so they can benefit from economies of scale that a large pension provider can deliver."

Since coverage of the CPP is practically universal, the easiest way to improve retirement incomes for future seniors would be simply to increase the benefits from the CPP. Retirement benefits from the public plans of OAS and CPP would then provide a much better benefit for those with modest incomes. For someone earning an average wage — currently around $48,300 a year — public pensions would then replace about 64% of pre-retirement earnings: 14% from Old Age Security and 50% from the CPP. A replacement rate at this level would ensure that retirees whose earnings before retirement had been around the average wage are able to maintain their pre-retirement standard of living in retirement. Higher income workers would still be at liberty to supplement these benefits with their own savings or through membership of a workplace pension plan.

Replacement rates of Canada's public pension system are much lower than average replacement rates of OECD countries. For those earning more than 60% of the average wage, Canada's public pension system (OAS, GIS, and the CPP/QPP) replaces about 25% of earnings as opposed to the OECD average of 55% at 1.5 times the average wage, and 20% as opposed to 50% at twice the average wage.[15] For workers earning above the average wage, Canada's replacement rates are below those provided by the U.S. Social Security program: 25% as opposed to 32% at 1.5 times the average wage and 20% as opposed to 29% at twice the average wage.[16] According to Horner, Canada relies more on employer-sponsored plans and individual saving than other countries do.

It is also important to note that OAS is indexed to the consumer price index and over the longer-term wages increase faster than prices. As a result, the real value of OAS benefits will decline significantly over time and seniors will find themselves falling further and further behind the rest of the population. In its Alternative Federal Budget, for example, the Canadian Centre for Policy Alternatives has recommended that OAS be indexed to wages rather than to prices.

Current CPP retirement benefits are designed to replace up to 25% of the worker's average annual lifetime earnings (adjusted to reflect current dollars) up to a maximum. The CLC proposal would be to double the replacement rate to 50% of earnings leaving the maximum limit in place.

Expanding the CPP in this way is not a new idea. In fact, it has been around for at least 30 years. A national Task Force on Retirement Income Policy, which produced a landmark report on the retirement income system

in 1980, concluded that: "…a powerful case can be made for expanding the C/QPP"[17] And at a national pensions conference held in Ottawa in 1981, the CLC also advocated doubling the CPP replacement rate.

But expanding the CPP has been opposed for a variety of reasons, as outlined below.

Ideological Arguments: "The Nanny State"

A key argument against expanding the public pension system is based on ideological grounds. The foundation for the CPP is a pooling of risks and resources among all citizens so that all are guaranteed a basic income in retirement. It is a social program based on collective action. But in the tradition of "rugged individualism" a neoliberal approach prescribes that individuals should be responsible for themselves. They can sink or swim in a free market system.

Margaret Thatcher famously proclaimed that "there is no such thing as society." "There are individual men and women," she said "and there are families. And no government can do anything except through people, and people must look to themselves first."[18] When it comes to retirement saving, the neoliberal approach is also that people must look after themselves. Government may play a minimal role in picking up the pieces for some of those who fail to do so, through programs such as the Guaranteed Income Supplement. In rejecting CPP expansion, the federal and provincial finance ministers have opted for the individualism, "free market" approach.

The former governor of the Bank of Canada, David Dodge, has condemned an expanded CPP as "a nanny state solution" that "does not allow for individuals' preferences in how they want to live out their golden years." The implication of his comments seems to be that if some people choose not to save for retirement — that's their choice and it should be no concern of anyone else. However, it is worth pointing out that the government may still be on the hook for those people whose retirement income is inadequate because they will qualify for GIS, which is funded from the tax revenues of the federal government.

An expanded CPP, of course, could reduce federal expenditures on GIS because more people would have adequate retirement incomes. It is also worth pointing out here that the cost of the GIS program may increase significantly if more people start using TFSAS to save for retirement. Withdrawals from TFSAS are not taxable and do not count as income for the pur-

poses of GIS eligibility. As a result, people who hold these accounts could accumulate large amounts of money and still qualify for GIS. Horner suggests if the use of TFSAs increases, the proportion of seniors who pay income tax will decline from over 50% to about 25% and the cost of the GIS program could rise by 84%.[19]

However, it should also be noted that, even with an expanded CPP, OAS and GIS will still be needed to supplement the retirement incomes of those who had low earnings in their pre-retirement years. For example, while the maximum CPP monthly retirement benefit for people who retire at age 65 in 2011 is $960, the average monthly benefit being paid to women who retired at 65 in September 2011 was only $486.26 while the average monthly benefit being paid to men who retired at age 65 in the same month was $649.21.[20]

According to Jonathan Kesselman, Canada Research Chair in Public Finance at Simon Fraser University's School of Public Policy,

> …while individual choice is attractive in principle, in practice a significant proportion of Canadian workers are making poor choices in both savings and investment decisions that do not serve their own longer-term best interests, The burgeoning discipline of "behavioural economics" is rapidly displacing the traditional theory of the individual as an omniscient, rational decision maker: lifetime savings and investing decisions are a perfect example of this shift. Moreover, phenomena such as adverse selection and the Samaritan's Dilemma[21] suggest that mandatory coverage in a relatively rigid public pension scheme can actually yield more economically efficient and cost-effective outcomes than can unconstrained individuals in private markets.[22]

A number of different proposals have been out forward as "solutions" to the pension problem. But virtually all of them — including the PRPP proposal — rely on voluntary contributions to some form of pension plan. The Liberal party, for example, is now suggesting the creation of a supplemental account to the existing CPP. Individuals would be allowed to top up their CPP benefits by making additional contributions to the plan on a voluntary basis. The problem with this proposal, of course, is that — apart from anything else — contributions would be voluntary and, as we have seen, voluntary contributions don't work when the objective is to achieve widespread or universal coverage.

The NDP apparently also supports a voluntary contribution option. While its party platform commits to working for a doubling of CPP benefits, it also says it would work with the provinces to build in the flexibility for workers

and their employers to make voluntary contributions to their "individual public pension accounts".

As Kesselman notes, "pro-choice and pro-market rhetoric need to confront empirical reality about how individuals actually behave in their savings and investment decisions and about the real-world operation of particular markets."[23]

"Payroll Taxes" and the "Fragile Economy"

CPP legislation now requires that any change/increase in benefits be fully funded in advance. A doubling of benefits would therefore mean that contribution rates would have to be increased to fund the benefits. The CLC proposal suggests phasing in the required contribution increase over a period of seven years. But it would take 40 years for these increases to provide full funding for a doubling of benefits. However, benefits could be increased gradually during the phase-in period so contributors would be able to get gradual increases in their pensions.

But the argument has been made that CPP contributions are payroll taxes and increasing payroll taxes in a period when the economy is "fragile" would result in lost jobs. Because expanding the CPP replacement rate would result in higher contributions, this has been used as an argument to reject CPP expansion.

Employer contributions to the CPP could be viewed as pension plan contributions in the same way as employer contributions to workplace pension plans or group RRSPs. Employment Insurance contributions, on the other hand, may correctly be considered payroll taxes since these contributions form part of government revenues and the EI fund is part of the government accounts. In fact, the federal government has used surpluses in the EI account to reduce the federal deficit. CPP contributions, on the other hand, do not form part of government revenues. They are directed to the CPP Investment Fund and are used solely to pay benefits.

As to whether increasing CPP contribution rates would discourage employers from hiring, evidence indicates the contrary. In the late 1990s, as part of a comprehensive review of the CPP, the government decided to increase contribution rates significantly over a brief period of time and to allocate excess contribution revenue to the newly-established CPP Investment Fund. Beginning in 1997, CPP contributions nearly doubled over a five-year period during which the unemployment rate fell. The combined employer/

employee contributions rate rose from 5.6% of covered earnings in 1996 to 6.0% in 1997, 6.4% in 1998, 7.0% in 1999, 7.8% in 2000, 8.6% in 2001, 9.4% in 2002 and 9.9% in 2003, where it remains. During that same period of time, the unemployment rate dropped from 9.6% in 1996 to 7.6% in 2003.

A Blanket CPP Expansion Would Force Lower-Paid Workers To Save More Than They Need

While the usual rule of thumb is that individuals need income that replaces about 60% to 70% of their pre-retirement earnings to maintain their standard of living in retirement, observers note that lower-income workers receive close to full replacement from the existing retirement income system. For example, OAS and CPP may be combined with provincial top-ups to provide full replacement for these workers — generally those earning less than half the national average wage and salary — about $24,150 in 2011.

The argument is then made that including these workers in a mandatory increase in CPP replacement rates would pose an undue burden in that they would be required to pay higher CPP contributions for retirement income they don't really "need." In other words, low earners and the self employed may be forced to save more than they need to.

The question could be dealt with by creating a second tier of the CPP that provides an additional benefit rate of 25% of earnings in excess of half the average wage. Bob Baldwin suggests a 25% replacement rate on earnings up to half the average wage; a 50% replacement rate on earnings from half the average wage to the average wage; and a 25% replacement rate on earnings from the average wage to twice the average wage. In other words, middle-income earners would get a higher replacement rate than those at lower earnings levels.[24] And contribution rates for those at the lowest earnings level would not have to be increased.

Economist Keith Horner, formerly with the tax policy division of the federal finance department, proposes a two-tier benefit structure with a replacement rate of 40% for earnings between the existing YBE and the existing YMPE and a new 25% benefit rate for earnings between the existing YMPE and twice that figure.

Michael Wolfson proposes an increased replacement rate of 40% (not 50% as the CLC proposes) but starting only on earnings above half the current YMPE — roughly equivalent to the average wage. However, the 40% replacement rate would be extended up to twice the current YMPE. He con-

cludes that his proposal, which he calls the "wedge" option, provides a greater increase in average replacement rates at middle and higher pre-retirement earnings, while the doubling option has relatively greater impact at the middle range of earnings.[25]

Doubling CPP Benefits Would Take Too Long To Implement

In 1997, major changes were made in the way the CPP is funded. As noted earlier, contribution rates were increased significantly over a relatively brief period of time and surplus revenue not needed to pay current benefits was directed to the newly-established CPP Investment Fund. At the same time, various other changes were made. In the agreement outlining the changes, under the heading "Stewardship and Accountability" the government made the following statement:

> There must be improved stewardship of the CPP to avoid again putting the sustainability of the CPP at risk. Economic and demographic realities have changed significantly over the years without adequate response. Enrichments to benefits have repeatedly been made without proper adjustments to contributions.[26]

A key provision of the new legislation was that any future benefits improvements will be fully funded. In the context of the proposed increase in the replacement rate of CPP benefits, this means contribution rates would have to be increased to fully fund the change before contributors would be able to receive a doubling of benefits. It is estimated this process would take about 40 years, although benefits could be increased gradually as higher contribution rates generate the necessary revenue to fund them.

Workers who retire before making increased contributions for the full 40-year period would still be entitled to enhanced benefits. For example, the CLC calculates that with its proposed plan (which would retain the current maximum earnings level on which contributions will be paid) a worker who is now 38 years old and works full-time from now until retirement at age 65 — 27 years of expanded contributions — would earn a monthly CPP payment of about $1,293. Without labour's plan, the same worker's monthly payment would be only $646. With the CLC plan, a worker who is 48 years old and works full-time from now until retirement at age 65 — 17 years of expanded contributions — would earn a monthly CPP payment of

about $814. Without labour's plan, the same worker's monthly CPP payment would be only about $407. It should be noted that these amounts are in addition to whatever a worker has already saved through CPP contributions since age 18, if any, and they show the effect of labour's plan on future retirement income.[27]

These calculations assume that none of these workers draws a CPP pension before age 65 and will make contributions based on annual earnings equivalent to $48,300 in 2011 (which is the maximum pensionable earnings for 2011).

Intergenerational Fairness and Phasing In of Benefit Increases

As we have noted, the requirement that any benefit changes in the CPP must be fully pre-funded has resulted in a 40-year phase-in period before contributors could receive a benefit of twice the current replacement rate. The full impact of the proposed change is therefore not going to be experienced until workers who are currently in their twenties get set for retirement. The proposal will have little impact on the baby boomers and Generation X-ers[28] who are now entering retirement.

Michael Wolfson points out that virtually all of the public discussion and the major documents produced by the provinces accept without question the presumption that any expansion of mandatory pensions must be gradually phased in. But he also notes that the introduction of the CPP/QPP in 1966 included a very rapid phase-in, as well as the "windfall" introduction of the GIS/SPA program for those seniors then in the most straitened financial circumstances.

According to Wolfson:

> Implicitly, the thinking at that time was that any pension "promises" by the then working- age generation to itself in later years when it had retired should be accompanied by a set of transfers to the contemporaneous population of seniors. This was a reflection of a kind of intergenerational golden rule that the working-age generation should not do unto (promise) itself any more than it was prepared to do for its parents' generation[29]

However, while intergenerational transfers do not seem to have figured much in the current pension policy discourse, Wolfson says is would be possible to limit the size of intergenerational transfers and at the same time

have a more rapid phase-in of benefits. Increasing the contribution rate beyond the 5.2% used in his analysis would generate a surplus that could be used to phase in CPP/QPP benefit increases more rapidly, he says. But he suggests difficult political judgments would be involved. As well, making the pension reform more beneficial for politically relevant age groups (say, those currently over age 50) by more rapid phase-in, while keeping the system fully pre-funded, would require a larger increase in the contribution rate.

He notes there would be legitimate concerns about the impact on today's fragile economy of increases in "payroll taxes" (CPP contributions) both from a fully-funded enlargement of the CPP/QPP and from a more rapid phase-in that is also fully pre-funded. But Wolfson suggests it would be entirely possible to combine a CPP/QPP payroll tax increase with an increase in the Working Income Tax Benefit (WITB), for example. Although this combination would admittedly (and implicitly) shift more pension financing to general tax revenues, the WITB increase could be designed to offset all or a substantial portion of any payroll tax increase on lower- and lower-middle-income earners.

Wolfson concludes that various ideas about intergenerational fairness (discussed in detail in his paper) "may provide routes for contemplating pension reform options that have so far been off limits, but need not imperil intergenerational fairness more broadly and appropriately conceived, and that will allow improvements in net replacement rates to be phased in more quickly."[30]

Bob Baldwin also notes that even though proponents of expanding the CPP may have spent little time explaining their support for full funding, it was often associated with intergenerational fairness: each generation pays its own way. However, he also states that prefunding does not resolve all issues of intergenerational equity. "There is ample room for discussion of how the concept of intergenerational equity should be put into effect," he says.[31]

Baldwin also suggests that prefunding may unnecessarily constrain the phasing-in of an expansion. He points out:

> In the expansion, like the CPP's original introduction (when individuals already in the workforce received full benefits without contributing for a full career), were to provide improved benefits for periods of employment both before and after the new benefits are introduced, then full prefunding would require additional contributions for a time from workers already in the labour force to cover the cost of those improved benefits for earlier periods of employment. More importantly…prefunding is likely to introduce some degree of contribution rate volatility. A volatile CPP contribution rate could have perverse employment effects[32]

Phasing In and the Baby Boom Generation

It must be emphasized that the requirement of prefunding and the resulting phasing in of an expanded CPP will do little or nothing to help the baby boom generation which is now entering retirement. The generally-accepted definition of the "boomers" is that the term refers to those who were born in the period between 1947 and 1966.[33] The leading edge of the boomer generation will be retiring in 2012 — assuming they retire at age 65. The younger boomers will reach age 65 around 2031, so they could benefit from an expanded CPP since they would have another 20 years (from 2011) in which to contribute to the CPP at higher rates, although there would not be enough time for them to receive replacement rates that are double those now in effect. If governments accept CPP expansion as the best way to provide adequate incomes for this generation, it is clear they would have to consider seriously some way of accelerating the phase-in of higher benefits.

So far, government concern about the adequacy of retirement incomes for the next generation of seniors has not been in evidence. For instance, it is noteworthy that the government's proposal for PRPPs leaves the baby boom generation with only 20 years (from 2011 to 2031) in which to save for retirement — assuming they retire at age 65. While we do not yet know what limits on PRPP contributions will be imposed, it is highly unlikely that the boomers currently without a pension plan or much in the way of retirement savings could accumulate enough savings to supplement their benefits from the public programs and provide themselves with an adequate retirement income in such a brief period of time.

By way of example, the joint committee of officials from Alberta and British Columbia which reviewed pensions in the two provinces recommended an "ABC Plan" which could cover employees who currently do not belong to a workplace pension plan. The proposed plan, which was similar to the proposed PRPP, was to be a mandatory defined contribution plan with a three-tier contribution rate schedule. Employers and employees could choose to contribute 3%, 6% or 9% of earnings up to a limit. In response to the proposed plan, the Alberta Federation of Labour, which had the proposal evaluated by an actuarial firm, described the two lower rates as "utterly inadequate." Even the 9% rate, it said, "might prove inadequate in a period of low market returns and low interest rates."[34]

Taking Action Now

SO FAR THERE is no clear evidence the government is committed to changes to the retirement income system that would guarantee an adequate basic pension income to all Canadians. Following the announcement of PRPPs, the federal finance minister said officials are continuing to work on a "modest expansion" of the CPP, but no details were given. It is possible further details may be forthcoming when finance ministers meet again in mid-December. But given the requirement for pre-funding, discussed above, it is unlikely changes will be made in the CPP that would help those Canadians who are now close to retirement and who are facing a significant drop in income when they leave paid employment.

In addition, it appears pension reform is no longer a priority for federal and provincial governments. The federal finance minister's November 2011 economic statement made no mention of pensions other than to state that growth in benefits for seniors, which include Old Age Security and the Guaranteed Income Supplement, is expected to average almost 6% annually over the planning period due to an increase in the population of seniors, the changing demographic profile of seniors and consumer price inflation, to which benefits are fully indexed. In its pursuit of a budget balance, the government also said it will not cut transfers to persons, including those to seniors.[35]

While the federal government has claimed its proposal for PRPPs will provide pensions for the millions of Canadian workers who currently do not have access to a workplace pension plan, it is clear the proposal will

do nothing for those millions of Canadians who are now approaching retirement with inadequate retirement savings. Their only option, it appears, will be for them to continue working — always assuming their health will allow it — until they can afford to retire. In fact, there is evidence this is already happening.

A recent study from Statistics Canada indicates the employment rate of individuals aged 55 or over has grown noticeably. The agency says that an indicator of the retirement decisions of Canadians shows a significant increase in delayed retirement starting in the mid-1990s. In 2008, for example, a 50-year old Canadian could expect to be working for 16 years, compared with 14 years in 1977.[36] Particularly noteworthy, according to this study, are increases in the employment rate in recent years of both women and men aged 55 and over.

For men, this is a reversal of a previous trend in which the employment rate of those 55 and over dropped from 45.4% to 29.8% from 1976 to 1996. By 2010, it had risen to 39.4%. Men aged 65 to 69 showed the most pronounced change as their employment rate almost doubled between 2000 and 2010. The employment rate of men aged 60 to 64 also increased significantly. For women, the upward trend in the employment rate began in earnest in 1996, increasing to 64.1% in 2010, while the employment rate for women aged 60 to 64 almost doubled, from 21.5% to 41.4%.

The authors of this study suggest the increase starting in the mid-1990s in the employment rate of men aged 55 to 69 may indicate delayed retirement. The increase in the employment rate of women is likely the result of two trends: delayed retirement and the arrival of cohorts with higher employment rates, StatsCan says.[37]

Can we expect further action on pension reform? Expansion of the CPP by increasing the replacement rate of retirement benefits would address the problems with the current system that we have identified. It would provide a mandatory defined benefit pension to virtually all Canadians giving them a basic retirement income that for modest and middle-income earners would preserve their standard of living in retirement.

The government's PRPP proposal does not do this. It does not guarantee a pension — benefits would depend on selection of investments and stock market performance; participation would depend on an employer deciding to take part in the program. Unlike the CPP, there would be no benefits for dependents; there would be no accommodation for periods when an individual could not contribute, such as the child-rearing drop-out and the general drop-out in the CPP; there would be no inflation protection; and the

costs of operating the scheme would be significantly higher than the costs of operating the CPP.

Although various concerns have been raised about CPP expansion, there are many ways of addressing these concerns as we have outlined above. And there is a range of options to choose from which would achieve the key reform objectives. What is required now is a strong commitment to consider the various options and to take action. But that, in turn, requires a political decision to make meaningful pension reform a priority and so far, there is no indication the Harper government is willing to take the leadership and persuade the provinces to agree.

Federal and provincial governments were able to work together to make major changes to the CPP in 1996, when contributions rates were increased and the CPP Investment Board was established. Bruce Little's 2008 book *Fixing the Future: How Canada's Usually Fractious Governments Worked Together to Rescue the Canada Pension Plan*[38] documents the history of those negotiations and their eventual success. In a foreword to the book, Keith Ambachtsheer, a well-known pension expert, makes this statement:

> ...successful reform involves a great deal more than just technical prowess. The political and human elements of the CPP reform story are equally important and compelling. The difficulty many politicians have thinking beyond four-year election cycles has been well documented. On top of that, Canada is a federation, implying that any acceptable solution also required maintaining a delicate balance between federal and provincial powers. Then there is the inevitable 'ego' factor. Some of the personalities in the CPP reform story thought themselves larger than life, and behaved that way. Yet, despite all these formidable obstacles, Canada's politicians were able to reach a consensus that CPP reform was essential, and that they were willing to spend political capital on taking the reform message to a skeptical electorate.[39]

Ambachtsheeer, who is the Director of the Rotman International Centre for Pension Management at the University of Toronto, goes on to say that this remarkable achievement required meeting two conditions: the reform package had to be both understandable and credible; and Canadians had to be treated as adults in how the reform message was conveyed to them.

Little himself concludes at all too often, politicians have trouble seeing beyond the next election, and long-term problems fester until they become crises that are far more difficult to resolve than they would have been if they had been tackled earlier.[40]

The adequacy of CPP benefits has been an issue for more than 30 years. It is time now for federal and provincial governments to set aside ideology and work together to solve the problem. Canada does not need yet another voluntary tax-assisted retirement savings program. It needs public pensions that provide all Canadians with a basic guarantee of adequate income that will protect their standard of living in retirement.

Notes

1 Wolfson 2011.

2 Wolfson 2011:6.

3 Baldwin (2009)

4 Statistics Canada 2011

5 Statistics Canada at http://www40.statcan.gc.ca/101/cst01/famil118a-eng.htm

Accessed November 15, 2011

6 Mintz,J. (2009)

7 Department of Finance Canada (2010) "Ensuring a strong retirement system, support for provinces and territories while moving towards budget balance." Kananaskis, Alberta, December 20, 2010.

8 Ted Morton web site at http://www.tedmorton.ca/bio.html

9 See also Townson (2000) pp. 168–177.

Little(2008

10 Canada, Department of Finance 2011.

11 Bill C-25 # 45 & 47.

12 Ibid

13 *Benefits Canada* October 31, 2011.

14 ING Direct at http://www.ingdirect.ca/en/aboutus/whoweare/whatwereupto/PR_2011–01-05.html

January 5, 2011

15 Horner 2011: 12

16 Ibid

17 Task Force on Retirement Income Policy 1979: vol.1, 243.

18 http://briandeer.com/social/thatcher-society.htm

Accessed October 15, 2011.

19 Horner 2011:11

20 HRSDC 2011

21 The phenomenon of a public program that seeks to help people but actually worsening their dependency through disincentives is known as the Samaritan's Dilemma.

22 Kesselman 2010: 29

23 Ibid p. 5

24 Baldwin 2010.

25 Wolfson 2011: 20.

26 Canada, Human Resources Development 1997: 17.

27 Canadian Labour Congress (2010)

28 "Generation X" includes people born in the 1960s up to about 1982

29 Wolfson 2011:21

30 Wolfson 2011:23

31 Baldwin 2010.

32 Ibid.

33 Foot 1996: 18.

34 Alberta Federation of Labour 2008: 5

35 Department of Finance 2011b: 16 & 46.

36 Carriere and Galarneau 2011:3.

37 Ibid p. 7

38 Little 2008

39 Ibid p. x

40 Ibid 311

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