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Pension Reform and Old Age Security

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The current economic and financial situation has brought Canada's retirement income system into sharp focus. The value of pension fund investments has dropped so that many workplace pension plans are underfunded — that is they don't have enough money to pay all the promised pensions. Workers may lose their pensions or find they will get only a portion of what was promised if their employer goes under with an underfunded plan. As well, Canadians who have been saving for retirement through RRSPs have found the value of their savings has dropped sharply. And if they are close to retirement age, they may have no time left to wait for the market to bounce back again. They may now be faced with having to go on working because they can no longer afford to retire.

Concern about the viability of the pension system is heightened by the fact that the first wave of baby boomers (Canadians born between 1947 and 1966) has already entered their sixties and their peak retirement years are fast approaching. Public pension programs such as Old Age Security and the Canada Pension Plan provide only a modest income for people when they retire. The expectation has always been that people will supplement public pensions with their own savings or through membership of a pension plan at work. But most Canadians don't have a workplace pension and only a minority — mostly higher-income people — take advantage of tax-assisted private savings through RRSPs. Various provinces have produced reports on workplace pensions; federal-provincial meetings on pensions are under way; and a wide range of proposals for pension reform is now on the table. There are growing calls for a pensions summit at which the various proposals could be discussed by all stakeholders.

To date, much of the emphasis has been on workplace pension plans and private savings. However, it is important to remember that Canada has a three-tier pension system. The basic building block is Old Age Security and the Guaranteed Income Supplement. Taken together, these plans, funded by the federal government, provide a guaranteed annual income for seniors and do not depend on participation in the paid work force. The Canada Pension Plan (or Quebec Pension Plan in Quebec) constitutes the second tier. These plans, funded by contributions from employers and employees, provide earnings-related pensions for people in the paid work force when they retire or become disabled and benefits for the spouses and dependants of disabled or deceased contributors. The third building block consists of private arrangements — workplace pension plans and RRSPs — that receive tax subsidies. There are issues raised in each of the three tiers that need to be addressed. Changes to any part of the system will likely require adjustments to other parts. In the current debate on pension reform, it will be important to make sure that no section of the system is overlooked.

This paper reviews the basic building block of the pension system: Old Age Security and its associated programs of the Guaranteed Income Supplement (GIS) and the Allowance. It discusses measures that could be taken to strengthen this part of the system — particularly in light of the fact that failures in the third tier of the system may place greater stresses on the basic tier to ensure the economic security and dignity of Canadians in retirement.

Old Age Security and the Guaranteed Income Supplement

Old Age Security has been around since the 1920s, but the current Old Age Security Act came into force in 1952, providing for means-tested old age benefits to be paid to seniors at age 70. The Act has been amended many times since then. For instance, the age of eligibility was reduced to 65 in 1965; the Guaranteed Income Supplement was established in 1967; inflation indexing was introduced in 1972; and benefits were extended to same-sex common-law partners in 2000.

There are actually three programs that fall under the Old Age Security Act: the Old Age Security (OAS) benefit itself, the Guaranteed Income Supplement (GIS) and the Allowance. Programs in this first tier of the retirement income system are generally thought of as the anti-poverty part of the program. However, it is also important to note that OAS plays a role in replacing pre-retirement earnings. For example, for someone whose earnings are equivalent to the average wage — roughly $46,300 in 2009 — OAS at $6,203, provides about 13% of pre-retirement earnings. Retirement benefits from the CPP provide another 25% for a total of 38%. It is usually argued that seniors require 70% of their pre-retirement earnings to maintain their standard of living in retirement. That would then leave about 32% of pre-retirement earnings to be provided by workplace pensions or private savings.

OAS benefits

The OAS benefit is a flat rate benefit indexed for inflation and adjusted every three months. The maximum monthly benefit for July to September 2009 is $516.96 or $6,203 a year. The benefit is taxable. As well, benefits paid to higher-income individuals are subject to a "clawback". Individuals whose net income in 2009 exceeds $66,335 will find part of their OAS benefit will be withheld. Amounts withheld from the benefit are gradually increased as income rises so that individuals whose net income exceeds $107,692 in 2009 would not receive OAS at all. Like the tax system as a whole, the clawback threshold is indexed for inflation and is adjusted every year. It should be noted that since the income tax system is based on individuals, the OAS clawback is based on individual income. In other words, calculation of a clawback for a married woman does not take into account the income of her husband or partner. And because it does not depend on participation in paid employment, effectively OAS provides a pension benefit to women who have not worked outside their homes.

Old Age Security is an important source of income for today's seniors — particularly for women. In 2007, for example, women aged 65 or older received almost 21% of their income from OAS; OAS provided 15% of the income of men aged 65 or older in the same year [Townson 2009:37].

The Guaranteed Income Supplement (GIS)

The Guaranteed Income Supplement is an income-tested benefit payable monthly to lower-income seniors who are also receiving OAS and who have little or no other income. Individuals must apply for GIS benefits, which are based on income (excluding OAS) from the year before. The benefit is indexed quarterly but is not taxable. Separate rates apply to single individuals and to couples. For married or common-law partners — including same-sex partners — eligibility depends on the income of the couple. The maximum monthly benefit for a single individual in the July-September 2009 quarter is $652.51. Eligibility ceases once income apart from OAS reaches $15,672. The maximum monthly benefits in the same quarter for each spouse or partner in a couple is $430.90 and no GIS is paid where the income of the couple reaches $20,688. For single individuals, the GIS benefit is reduced by $1 for each $2 of additional income over and above OAS. For couples, benefits for each pensioner are reduced by $1 for each $4 of additional joint income apart from OAS. Different rules apply when one spouse of the couple is a pensioner and the other is not.

The federal government has made ad hoc increases to the GIS from time to time — most recently in the 2005 budget, when it was announced monthly GIS benefits for singles would be increased by $36 and by $58 a month for couples by January 2007 [Finance Canada 2005: Chapter 3].

The Allowance

Although it falls under the Old Age Security Act, the Allowance is a monthly benefit paid to low-income near seniors in the age group 60–64. Amounts are income-tested and are equivalent to OAS and GIS combined for those who qualify. However, the benefit discriminates on the basis of marital status. Only low-income people aged 60–64 who are married to a low-income pensioner or who are widows/widowers who have not remarried are entitled to benefits. Low-income people aged 60–64 who are single, divorced or separated, or married to someone who has not yet reached age 65 are excluded from the program.

Issues of concern with OAS and GIS

There are several issues of concern with the programs in the first tier of the pensions system:

- Benefit levels are low;
- Immigrants are disadvantaged;
- Indexing to prices will result in a growing gap between seniors and the rest of the population in future; and
- The Allowance program discriminates on the basis of marital status

Adequacy of benefits

Benefit levels in the first tier of the retirement income system are too low. For example, the maximum annual income a single individual could receive from OAS and GIS combined in the July-September 2009 quarter) is about $14,000. However, Statistics Canada's 2008 after-tax low-income cut-off for a single individual in a major urban area with a population of 500,000 or over was $18,373. Even for smaller urban areas in 2008, the after-tax LICO was above $14,000 [Statistics Canada 2009: 19]

For a couple with no other sources of income apart from OAS, the maximum annual benefit they could receive from OAS and GIS combined in the July-September 2009 quarter was about $22,748. While this amount was above the 2008 after-tax LICO for two persons living in smaller urban areas, it was close to the after-tax LICO for a larger city. For example, the after-tax LICO for a two-person family living in a major urban area with a population of 500,000 or more in 2008 was $22,361 [Statistics Canada 2009: 19].

Most provinces pay top-up benefits to low-income seniors who are receiving GIS, but the amounts of these benefits tend to be small. There are also tax credits, such as the GST credit and the age credit, given to seniors through the tax system. But the fact that 14% of senior women on their own have incomes below the after-tax LICO even after taking all these programs into account indicates an urgent need to address their low incomes. An increase in the GIS for singles could address this problem.

Immigrants are disadvantaged

To qualify for an OAS benefit, a person must be a Canadian citizen or legal resident on the day preceding the application's approval and must have lived in Canada for at least 10 years after age 18. Full benefits are paid only to those who have lived in Canada for 40 years after age 18. (There are some exceptions to this rule—for example, for people who were 25 or older on July 1, 1977). Those who don't meet these residency requirements may receive a partial OAS benefit equivalent to 1/40th of a full monthly benefit for each full year lived in Canada after the person's 18th birthday.

As a result of these requirements, many immigrants cannot qualify for full benefits. However, it should be noted that low-income immigrants who cannot qualify for full OAS may be able to receive an enhanced GIS to make up for this. While this provision may help low-income immigrants who have not been in Canada long enough to qualify for a full OAS benefit, it should be noted that high rates of low income among some groups—particularly among older women on their own—are calculated after taking into account taxes and transfers. In other words, even after receiving the benefit of government programs, high numbers of these women are left in low income.

Canada has Social Security agreements with many countries that allow immigrants from those countries to improve their access to Canada's public pensions by including years when they contributed to social security programs in their countries of origin. However, Canada generally does not have agreements with the major immigrant source countries in Southeast Asia from which most recent immigrants come. In any case, many of these countries do not have well-developed social security or pension systems.

Indexing is problematic

Benefits in the first pillar of the retirement income system — as well as retirement pensions from the CPP — are indexed for inflation using the Consumer Price Index (CPI). Inflation indexing is particularly important for women elders because, on average, they will spend longer in retirement than their male counterparts so they need to be protected from erosion of the real value of their benefits over time.

However, over the longer-term, wages tend to increase faster than prices. As a result, seniors in the future will likely find themselves falling further and further behind the rest of the population in their standard of living. In fact, some European countries — for example, Germany — have changed their pension indexing systems recently, indexing them to prices rather than wages specifically as a way to save money [Fédération Européenne des Retraites et Personnes Agées 2004: 4].

Discrimination in the Allowance program

As noted earlier, the Allowance program discriminates on the basis of marital status. Although a case was brought under the Charter of Rights and the federal court agreed the program was discriminatory, it ruled it would be too expensive to extend the program to everyone who qualified on the basis of income regardless of marital status

The argument was also made that if marital status limitations in the program were to be eliminated it would effectively mean reducing the retirement age (or more correctly, the age of eligibility for public pensions) from age 65 to age 60. Such a move would be unlikely to find favour with policy makers who are currently trying to persuade individuals to postpone retirement and go on working. However, it is noteworthy that CPP benefits can be claimed as early as age 60 and that most people claim their CPP retirement pensions before age 65.

Policy makers have two options: the Allowance and Allowance to the Survivor could be phased out completely and the savings redirected to improving OAS and GIS benefits for seniors aged 65 and older; or the program could be extended to include all low-income persons aged 60 to 64, regardless of marital status. Since the CPP retirement pension is available at age 60, it would make sense to eliminate the marital status limitation in the Allowance programs and make benefits available to all low-income persons aged 60 to 64, regardless of marital status.

The future of OAS/GIS

Almost 4.6 million people currently receive Old Age Security (OAS). About 36% of OAS recipients or 1.5 million people also receive some GIS, but only 4% or 164,000 of all OAS recipients receive the full GIS benefit. For the 2009–2010 fiscal year, the costs of these programs, financed from the general tax revenues of the federal government, were projected to be $36.2 billion, of which OAS was projected to cost $27.6 billion.

However, the most recent actuarial report for the Old Age Security programs (as at December 31, 2006) estimates the number of seniors receiving OAS will more than double over the next 20 years reaching over nine million by 2030 as the baby boom generation moves into retirement. [Office of the Chief Actuary 2008: 16]. The report also predicted the number of GIS beneficiaries would increase to 2.8 million by 2030. But the Chief Actuary said the percentage increase is less than for the basic pension due to the expected decline in recipient rates for these benefits over the same period. In fact, the projections indicate the percentage of seniors receiving GIS would decline from about 36% in 2007 to 30% in 2030 [Office of the Chief Actuary 2008: 25].

Total annual expenditures on the Old Age Security programs were expected to increase to $110 billion by 2030, at which point the spending would represent 3.1% of Gross Domestic Product, compared with 2.2% in 2007. But the Chief Actuary also noted that because benefits are indexed to inflation, which is assumed to be lower than the rate of growth in both the GDP and the income of new retirees, the amount of income-tested benefits is also reduced. Over the long term, he says, "the effect of price indexation of benefits predominates and results in the reduction of the ratio of expenditures to GDP to a level of 2.7% by 2050" [Office of the Chief Actuary 2008: 16].

It is also important to note that if the CPP were expanded to provide more generous pensions—as is now being suggested by various organizations—expenditures on GIS would be reduced accordingly because fewer people would qualify. However, it should be noted that because CPP is an earnings replacement program, those with low earnings will receive low CPP retirement benefits, even if the CPP replacement rate is doubled from the current 25% of covered earnings to 50% as is now being proposed. For instance, women's low earnings mean their CPP pensions are also very low. The average monthly CPP retirement pension paid to women who retired in May 2009 was only $391.29, compared with an average $564.23 for men. The maximum monthly CPP retirement pension in 2009 is $908.75. Even if improvements are made to the CPP (the earnings-related part of the retirement income system) increases in OAS/GIS will still be needed.

The federal government and the basic guarantee

Since the programs in the first pillar of the retirement income system are funded by the federal government, that government alone can make changes to these programs. As we noted earlier, from time to time it has implemented ad hoc increases in the GIS.

But in the 1996 federal budget, it proposed much more radical changes. In fact the government announced it planned to replace the existing OAS and GIS benefits with an income-tested "Seniors Benefit" in 2001. While the proposed benefit was to be tax-free, the income test was to be based on family income. In other words, unlike the existing OAS, a woman's right to benefits under the new program would have been dependent on the income of her spouse or partner. The proposal generated widespread criticism from women's groups who said it would undermine women's economic autonomy. The financial community was also opposed, arguing the new benefits would discourage seniors from saving for retirement because small amounts of personal savings would have meant disqualification from receiving the Seniors Benefit. In the end, the proposal was abandoned.

Does the program discourage personal savings?

It has been argued that the high tax-back rate of the GIS discourages personal savings. Since every $2 of income over and above OAS reduces GIS benefits by $1, people who have been able to save small amounts through an RRSP, for example, may simply find these amounts will disentitle them from receiving a GIS benefit when they reach retirement age. One way of addressing this problem might be to allow higher amounts of income before cutting back on GIS benefits. In fact, the government moved to make this change last year when it increased the GIS earnings exemption to $3,500 from $500. It said approximately 100,000 working seniors who collect GIS or the Allowance would benefit. For instance, a single pensioner earning $3,500 or more will be able to keep an additional $1,500 in GIS benefits. The change came into effect on July 1, 2008.

Another possibility would be to increase the age credit, given through the tax system to those aged 65 or older, for GIS recipients [Shillington 2003: 7]. The age credit is a federal tax credit based on individual income available for taxpayers aged 65 or older. For 2009, the credit is worth a maximum of about $961 in federal tax savings. Provinces offer additional credit amounts which can be used to offset any taxes owing. While such tax credits are not worth anything to individuals who do not owe any taxes, Shillington notes that about half of GIS recipients pay income tax. He suggests "fixing the overlap between that taxation and the GIS receipt would go a good way toward fixing the savings disincentive" [Shillington 2003:7]. In other words, an increased tax credit could be used by GIS recipients to offset additional taxes they may have to pay on their RRSP savings.

Since these comments were made, the government has introduced tax-free savings accounts (TFSAs) which allow individuals to contribute up to $5,000 a year to a TFSA. No tax deduction is given for the contribution, but amounts withdrawn are not taxable. In effect, investment earnings on these accounts are tax-free. TFSAs have been promoted as a way to encourage lower-income people to save and still be eligible for programs like GIS when they retire.

Building a stronger foundation

Strengthening the first tier of the retirement income system requires that the maximum amount of OAS and GIS combined should be increased at least to bring it up to the after-tax low-income cut-off for single individuals. As noted earlier, the 2005 and 2006 federal budgets increased GIS benefits by 7%, but this amounted to just $39 a month for individuals and $58 a month for couples. And the 2008 federal budget allowed GIS recipients to earn more in paid employment without triggering a reduction in benefits. The Alternative Federal Budget of the Canadian Centre for Policy Alternatives proposed an increase in GIS benefits of 15%, which it calculated would cost approximately $1.2 billion. But it also pointed out that since GIS is targeted to low-income individuals, an increase in the benefit could be an ideal way to stimulate the economy because these individuals would be likely to spend the extra amounts.

More radical proposals have also been made. For example, in a recent *Globe and Mail* article, Tom Kent, who served as principal assistant to Lester Pearson and played a leading role in the development of the retirement income system in the 1960s, advocated increasing the amount of OAS from the current $6,000 a year to $10,000. He also suggested a bonus of $100 a month for each month after the person's 65th birthday that they continued working. Delaying retirement to age 70 would result in OAS of $16,000 a year. The proposal, he said, would achieve a double objective of restoring confidence in the retirement income system and making people less eager to retire because later retirement would be rewarded with "a gratifying larger pension."

The proposal is not unlike a measure introduced in the UK in April 2005 that allows people to put off claiming their state pension and rewards them with a higher pension when they eventually claim it, or the option of a lump sum payment instead, based on the amount of the normal weekly state pension they would have received, plus interest added each week and compounded.

Kent also noted that as yet, no improvement in public pensions is on the political agenda. "Instead," he says, "the government is increasing its subsidization of private pensions." He argues that subsidization of private pensions should be "cut to a fraction of its current level, with the tax savings put to fair encouragement of productive work" [Kent 2009].

The federal government estimates that the net cost of tax assistance to RRSPs in 2005 was $9.3 billion. This was projected to rise to $12.1 billion by 2010. The net cost of tax subsidies to registered pension plans in 2005 was $13.3 billion, projected to increase to $16.8 billion by 2010. (Net cost is the cost in lost tax revenue of deductions for contributions and the non-taxation of investment income minus the revenue gained by taxation of withdrawals from these plans). [Finance Canada 2008: 19]. It is perhaps significant that the net cost in lost tax revenues of tax subsidies to registered pension plans and RRSPs in 2010, at $28.9 billion, is greater than the total cost of OAS benefits, estimated at $27.6 billion for the 2009–2010 fiscal year [Service Canada 2009].

Pension reform should reconsider the high cost of taxpayer subsidies to the third tier of the retirement income system. Only 38% of employed Canadians have a workplace pension. It is also important to note that most Canadians who are entitled to contribute to an RRSP fail to do so. In many cases it would appear many of those eligible to contribute can't afford to do so. Statistics Canada reports that 88% of taxfilers were eligible to contribute to an RRSP in 2006, but only 31% actually made contributions. They used only 7% of the total contribution room available to them [Statistics Canada 2007]. In other words there is now almost $500 billion in unused RRSP contribution room being carried forward.

A reduction of the tax subsidies to the third tier of the retirement income system, as suggested by Tom Kent and others, would free up funds to improve benefits in the first tier of the system.

Action needed now

Pension reforms now being contemplated must take into account all three tiers of Canada's retirement income system. Some key changes to the first tier of the system could be implemented quickly—others might be phased in over a period of time. Action needs to be taken on the following:

- Increase GIS for single individuals;

• Index OAS/GIS to wages instead of to prices;

• Modify the residency requirements for OAS to make it easier for immigrants to qualify for benefits;

• Remove discriminatory provisions from the Allowance program.

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