

Reducing Poverty without Major Pension Reforms: The Canadian Case

(전면적인 연금개혁 없이 빈곤을 감소시키는 방법: 캐나다의 사례)

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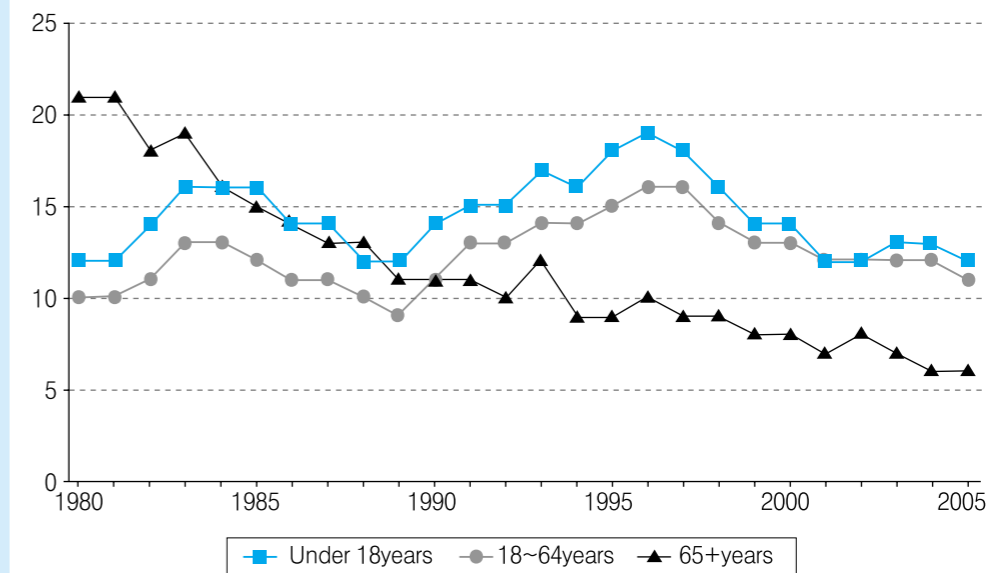
캐나다는 지난 몇십년 간 근본적인 연금 제도의 개혁 없이도 노년층의 빈곤을 크게 감소시켰다. 이는 캐나다의 인구가 노령화되고, 변화된 인생주기가 노년층의 재정적 불확실성을 증가시키고 있는 데 나온 결과이므로 그 의의가 크다. 캐나다의 소득보장시스템은 노년층의 모든 사람들을 대상으로 일반 세입에서 조달되는 정액 연금제도와 소득 비례 연금제도로 이루어져 있다. 두 연금 제도가 개별적으로 보장하는 수준은 높지 않다. 그러나 두 연금제도를 합하면 대부분의 빈곤은 막을 수 있다. 캐나다 정부는 1990년에 세출을 줄이기 위해 정액 연금제도를 개정하려 했지만 대대적인 시민 항의로 인해 개정을 중지할 수밖에 없었다. 인구노령화에 대비하기 위해 같은 시기에 개정된 소득 비례 연금제도의 경우에는, 보험료는 인상되었지만 급여수준은 변하지 않아 급진적인 변화보다는 발전적인 변화에 더 가까웠다. 이 개정은 또한 빠르게 진행되는 인구 노령화에 따른 미래의 위기를 예방하기 위한 체계도 구축하였다. 이로써, 캐나다 국민들은 노년기 연금급여에 대한 확실성을 보장받고, 캐나다는 국민의 높은 지지율과 신뢰를 받는 안정적인 연금 제도를 운영하고 있다.

INTRODUCTION

In the past several decades, Canada has dramatically reduced old-age poverty. A major reason for this achievement is the two pension programs that provide payments to nearly all citizens. However, as notable an accomplishment as poverty reduction among the elderly is that Canada has undertaken no fundamental reforms of the pension programs over the past 40 years. This article examines both the decline of poverty and how it became possible for Canada to refrain from significant reforms.

As shown in Figure 1, below, in 1980 over 20% of those 65 and over lived in poverty. This percentage has steadily declined so that at present only 6% of the elderly are poor. Indeed, the elderly are the group least likely to be poor in Canada today, a complete reversal

FIGURE 1. Low-income rate, by age, 1980~2005(percent)



Note: Based on after-tax Low Income Cut-Offs.
Source: Statistics Canada, Persons in low income, annual(CANSIM Table 202-0802). Ottawa, Statistics Canada, 2007. Available at: www4.rhdsc.gc.ca/indicator.jsp?lang=en&indicatorid=23#MOREON_3

from the situation three decades ago.

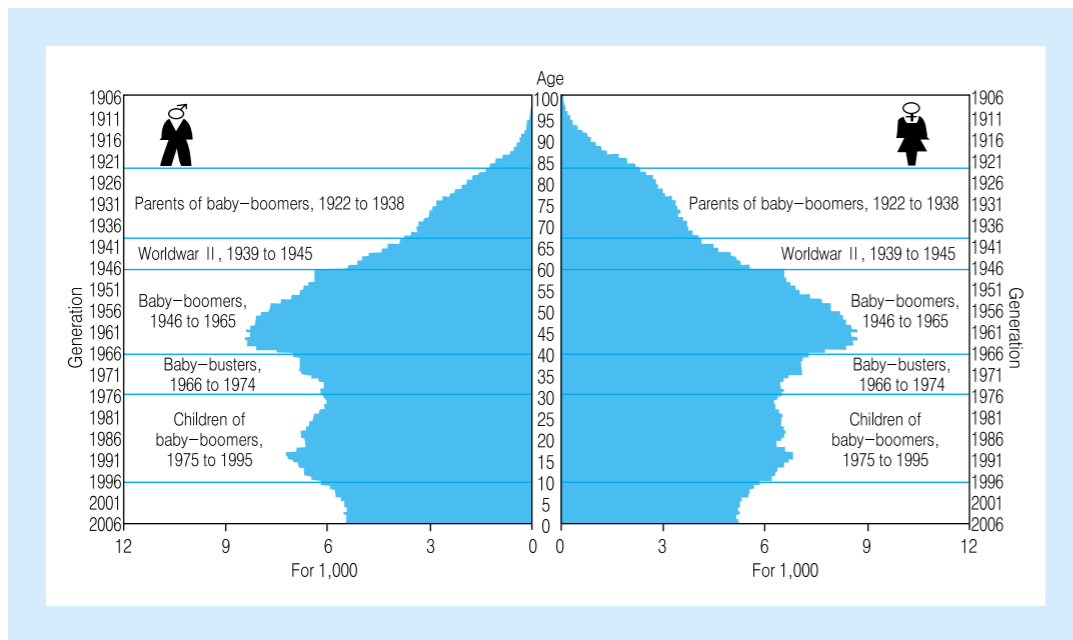
DEMOGRAPHIC CONTEXT

Like many Western developed countries, Canadian public policy, including pension policy is shaped by the large post-World War II baby boom generation. As shown in Figure 2 below, the population is rapidly aging as those born during the baby boom years of 1946-1965

began to reach age 60 in 2006 and become eligible for some public pension benefits.

However, unlike some other nations, Canada remains a country with a high rate of immigration. Indeed, Canada accepts more immigrants per person than just about any nation in the world. In 2006, almost 20% of Canada's population was foreign-born, compared to only 12.5% in the U.S. Annually about 250,000 immigrants come to Canada representing 0.75% of the total population,

Figure 2: Age pyramid of the Canadian population in 2006



Source: Statistics Canada, Census of Population, 2006.

although due to emigration, the net population increase is historically about 0.50% of total population. Although it may be supposed that immigration will alleviate the problem of an aging population, in that young immigrants in the labour force will support an aging society, this is not the case. Immigration has little effect on the age structure, because recent immigrants represent a small part of the total labour force, and at present, have a median age that is not very different from the receiving population. Nevertheless, immigration does prevent an absolute long-

term decline in population, and in the decades to come will keep Canada's population younger than would otherwise be the case.

Three changes in the life cycle have increased the uncertainty that individual faces in predicting their financial and related circumstances in old age. First, in the past thirty years there has been an increase in divorce rates (and re-marriages), later child birth and blended or second families. Second, fertility patterns have altered from past decades. In the 1980s, women in their 30s and older accounted for only 25% of live births, however

by 2006, this proportion had reached 50%. A similar pattern is found for men in that in the 1980s, men in their 30s and older fathered 32% of the babies of first-time mothers, but by 2006, this exceeded 50%. In keeping with world-wide trends, Canada has a fertility – 1.6 births per woman – that is below the replacement rate. This has remained unchanged during the past two decades.

Third, although individuals are living longer than before, and are spending fewer years employed. This is because the number of years of formal education has increased, and because the average age of retirement in Canada has decreased since the 1980s from 65 years of age to 61 today. Because workers are entering the labour market later than ever before and leaving relatively early, while living longer, more financial resources for more years of non-employment must be saved for in a comparatively short period. This is particularly the case for women who on average earn lower lifetime income, have less pension and investment income, and will live longer than men.

These three life cycle transformations have diminished the ability of individuals to accurately predict their life course and to forecast their future financial needs, hence diminishing the ability to precisely plan their financial situation in old age. For instance, older individuals may well

have financial commitments, such as young children, that would have been uncommon in previous decades.

These demographic and aging trends, as well as some of the life cycle changes, are not unique to Canada, but exist for most developed countries. Demographic change in Canada is becoming as pronounced as the one in Europe, and it will be more rapid once the large baby-boom generation move more fully into retirement ages in the next decade. In Canada in 1986 just over one in ten people were over 65, but within 50 years, in 2036, a quarter of the population will be over 65. The ratio of the number of people aged 20 to 64 to those aged 65 and over is expected to fall from about 4.7 in 2007 to 2.1 in 2050.

PUBLIC PENSIONS

Unlike many other nations, seniors in Canada draw their retirement income from multiple sources, including private savings and (in some cases) continued employment. The two most important sources, especially those who are middle-class and working class are the two public pension plans: the Old Age Security Program, and the Canada (and Quebec) Pension Plan.

The Old Age Security program is an almost universal, flat-rate pension financed from general tax revenues which provides a modest income beginning at age 65 for all citizens and permanent residents who have lived in Canada for at least 10 years since age 18. The basic maximum yearly payment represents half the income required to remain above the poverty line. Individuals who have lived in Canada for less than 40 years receive a reduced pension, with each year of non-residency reducing the payment by 2.5%. The program is quasi-universal in that individuals with a high net income (above five times the poverty line) do not receive the entire amount, while those with very high income (above eight times the poverty line) do not receive any payment at all.

A component of the Old Age Security program provides additional money, on top of the basic pension to very low-income seniors. This secondary payment is sufficient to (just) bring recipients above the poverty line. The payment is automatically determined, via the tax system income, but not asset-tested.

The second pension regime is composed of two earnings-related pension programs: the Canada Pension Plan and the Quebec Pension Plan. The Quebec Plan is almost identical to the Canada Pension Plan but applies only to those working in the province of Quebec. The

sub-national provincial governments, other than Quebec, share constitutional responsibility for the Canada Pension Plan, with any change to the plan requiring approval from two-thirds of the provinces. The plans are not of the fully-funded type, but are closer to the pay-as-you-go model. Upon retirement, the pension plans provide monthly benefits based on an employee's average earnings, up to certain maximums. The pension is designed to replace about 25 percent of the earnings on which a person's contributions were based. The replacement rate and basic benefits have remained unchanged since the creating of the plans 40 years ago.

With very few exceptions, every person in Canada over 18 who earns more than the basic exempted amount in employment income must pay into the Canada or Quebec Pension Plan. The contribution rate is 4.95% for the worker and the same for the employer, while the self-employed must pay both portions, namely 9.9% of income.

The plans allow for retirement at age 60, unlike the Old Age Security program that is only available at age 65. However, for those accessing the Canada or Quebec pension plans early, payments are reduced permanently by 0.5% for each month prior to age 65. The maximum monthly pension payment at age 65

represents about 75% of income to the poverty line, however the average Canada/Quebec pension plan payment, is about 50% of income to the poverty line.

Nearly all those 65 and over (97%) receive payments from the Old Age Security program. Those who do not would typically be individuals who have not lived in Canada for at least 10 years prior to turning age 65. With regard to the Canada and Quebec Pension Plan, 88% of those 65 and over receive benefits.

The Old Age Security Program accounts for 24% of seniors' total income, while the Canada and Quebec Pension Plan represents 20%. As such, these two public programs are the anchor of income security for older Canadians, and particularly so for those who are working class. Without these programs, poverty levels among the old would increase several fold. It should be noted that the remainder of income for older Canadians is entirely composed of private or optional sources such as occupational and private pensions, other investment income, and employment earnings.

AVOIDING REFORMS

Given the importance of the two public

pensions, what explains their effectiveness especially since they have remained largely unaltered for decades? First, the long history (dating to the 1950s) and its almost universal coverage means that governments must overcome strong opposition to any reforms to the Old Age Security Program. In both the 1980s and 1990s the government sought to decrease benefits, in a variety of ways (such as partial de-indexation, and replacing the Program with a tax-based program for poor elderly) but was forced to retreat in the face of opposition, including mass protests. The only substantive reform occurred in the late 1980s when the program was made quasi-universal by limiting benefits to those of very high income. This was not a dramatic reform as at present only five percent of seniors are affected by the income test, so that the program does remain almost universal in character.

That the Old Age Program is modest also means that it is not a major target of groups calling for a smaller role of the state, while its almost universal nature means it has powerful appeal for all citizens of all ages. After all, it is the only guaranteed means to avoid utter poverty.

The Canada and Quebec Pension Plan has undergone one major reform – in the mid-1990s – to deal with the aging population, but

the reform left unchanged the benefits paid in retirement. In other words, the reform was the least dramatic one possible in that decreases in benefits paid, increases in retirement ages and other unpopular measures were avoided. The central change was a sharp rise in contribution rates, from 5.85 per cent in 1997 to 9.9 per cent in the year 2003 (and then kept at that level).

The reform also sought to secure the financing of the Canada Pension Plan for the foreseeable future. In that regard, a steady-state funding provision was implemented to replace the original pay-as-you-go financing. As a result, a reserve of assets equivalent over time to about five and a half years of benefit expenditures or about 25 per cent of plan liabilities has been established. To operationalize the reserve, the Canada Pension Plan Investment Board was established (along the lines of a similar board that had been part of the Quebec Pension Plan for decades). The investment fund has grown quickly from a legacy portfolio of more than \$35 billion in government securities to what is now a broadly diversified portfolio of more than \$140 billion. The objective of the reserve is to ensure that the Canada Pension Plan is able to make payments when the bulk of the baby-boom generation has retired.

Second, an incremental full funding policy was put into place which requires that changes to the Canada Pension Plan that increase benefits or add new benefits to be fully funded. This prevents the expansion of benefits from occurring without concomitant funds in place. Both of these mechanisms were introduced to improve fairness and across generations. The move to steady-state funding eases some of the contribution burden on future generations. Under full funding, each generation that receives benefit enrichments is more likely to pay for them, rather than passing costs to future generations.

Third, a default mechanism was legislated that determines the steps that will take effect if calculations show the Canada Pension Plan is not sustainable. If politicians cannot reach a consensus on reforms, an increase in the contribution rate will automatically be phased in over three years, and benefits will be frozen. This is to ensure that politicians deal with shortfall in funding quickly or face these programmed, rather than face these politically unpopular mechanisms. Additionally, the default provisions mean that the Canada Pension Fund cannot fall into a deficit for any long period of time.

CONCLUSIONS

Canada's old age income support system, established in its current form during the 1950s and 1960s, is anchored by two public pension plans. The Old Age Security program provides a tax-financed universal flat-rate pension for nearly all those aged 65 and older. The program, also financed from general tax revenues, has an income supplement those whose income would otherwise be below the poverty line. The Canada and Quebec Pension Plans provide earnings-related public pensions financed from contributions from workers and employers. Neither program is particularly generous; however, working in tandem they have almost eliminated old-age poverty in Canada.

Policy makers have generally sought to leave the two programs untouched, and if tempted to reform them has been quickly rebuffed by citizens who see these programs as the bedrock of their retirement planning. The aging of the population may place new strains on both programs, and may trigger pressure for reforms. As such, policy-makers and citizens – who are ultimately the beneficiaries of, and contributors to, the plans – must

remain vigilant.

With regard to the Old Age Security program, the ratio of expenditures to the gross domestic product will increase from 2.2% at present to a high of 3.1% in 2030 as the number of beneficiaries for the basic pension more than doubles over the next 25 years. Actuarial projections for the Canada Pension Plan show that despite substantial increase in benefits paid as a result of an aging population, the Plan is expected to be able to meet its obligations for the next 75 years. Nevertheless, increases in longevity as well as uncertain investment returns may compel difficult adjustments to be considered.

Fortunately, the past 40 years illustrate that Canadians have preferred relatively minor evolutionary, rather than revolutionary, reforms. Additionally, the strong preference of decision-makers and citizens has been for reforms that leave benefits unchanged. This stability has allowed citizens to make long-term plans, while ensuring the credibility and sustainability of the programs. At the same time, this incremental approach to pension policy has contributed to a decline in old age poverty rates. [GSST](#)