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Reforms to Canadian Social Security 1996-97

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AGENDA

- The Canadian Social Security System
- Why Reforms in 1996/97
- Highlights of Reforms
  - The failed Seniors Benefit
  - Reform of the Canada/Quebec Pension Plans
- Record of the C/QPP Investment Board

Social Security in Canada

Y2005—Average Annual Earnings = $35000

Tier I: Guaranteed Income Supplement (GIS)

- Introduced in 1966 (with C/QPP)
- Meant to be temporary while C/QPP matured
- Since expanded
- Welfare benefits targeted to poor

Guaranteed Income Supplement

- Guarantees single pensioner 25% of average wage
- Guarantees pension couple 50% of average wage
- Reduced 50% for each dollar of income (other than OAS)
- Results in no benefit if single pensioner has income of $32,976

Guaranteed Income Supplement

- Paid out of general tax revenues
- Benefits indexed to inflation
- Benefits non-taxable
- 80% of single recipients are women

Old Age Security (OAS)

- First legislated in 1927
- A demogrant benefit if resident for 40 years since age 18
- If resident < 40 years, pro rata benefit (need ten years residence, minimum)
- Benefit payable at age 65
- Benefits paid from general tax revenues

Old Age Security (OAS)

- Y2005—Benefit = $477 a month or $5724 a year (when average annual earnings = $35,000)
- Benefits indexed to inflation
- Benefits are taxable income

Old Age Security (OAS)

- Benefits now (1989) subject to 15% clawback if income > $60,800 a year
- No benefit if income > $98,800 a year
- These limits are indexed to inflation

Canada/Quebec Pension Plans

- Two plans exist for purely political reasons
- Workers move seamlessly from plan to plan
- Defined-Benefit Contributory Plans
- Started in 1966
- First full benefits in 1976

Canada/Quebec Pension Plans

- Retirement Income = 70% of expenditures
- Other Benefits
  - Disability
  - Death
  - Orphans
  - Survivors

Canada/Quebec Pension Plans

- Contribution = 9.9% of wages between:

  YBE—Year's Basic Exemption = $3500 constant

  and

  YMPE—Year's Maximum Pensionable Earnings

  = $41,100 in 2005
- 9.9% split between worker and employer (4.95% each)
- Self-employed pay 9.9%

Canada/Quebec Pension Plans

- Contributions get tax credit like other (private) retirement savings
- No asset or income test for benefits
- No clawback
- Benefits are taxable income

Canada/Quebec Pension Plans

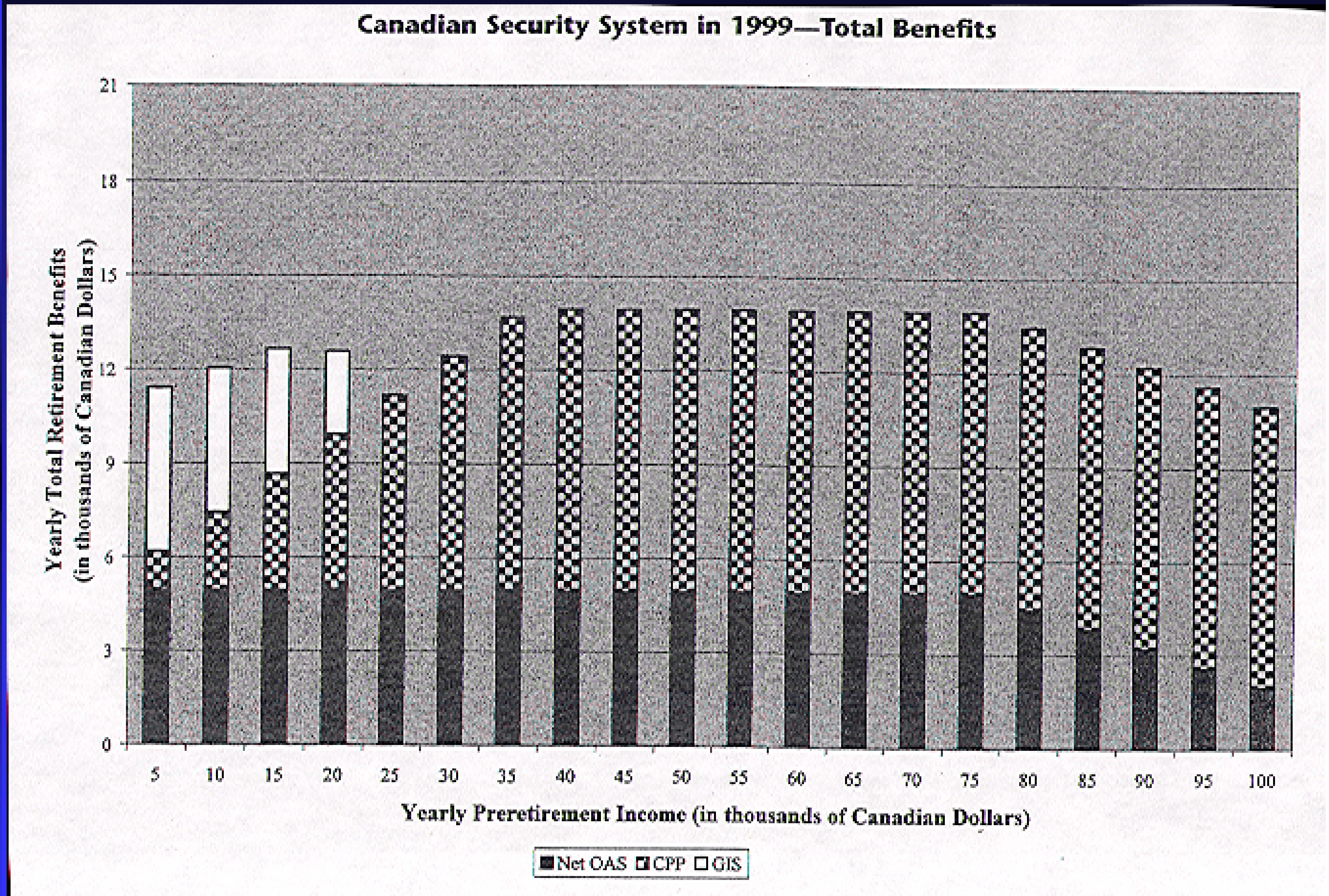
- Retirement Benefit = 25% of wage-indexed Career Earnings over best 40 years between age 18 and 65
- Qualified years of Disability or Child Rearing can be dropped out (of 40)
- Max C/QPP benefit (2005) = $829 a month or $9945 a year (when average earnings are $35,000)
- Benefits indexed to cost of living post-retirement
- Benefit is Joint and 60% Survivor

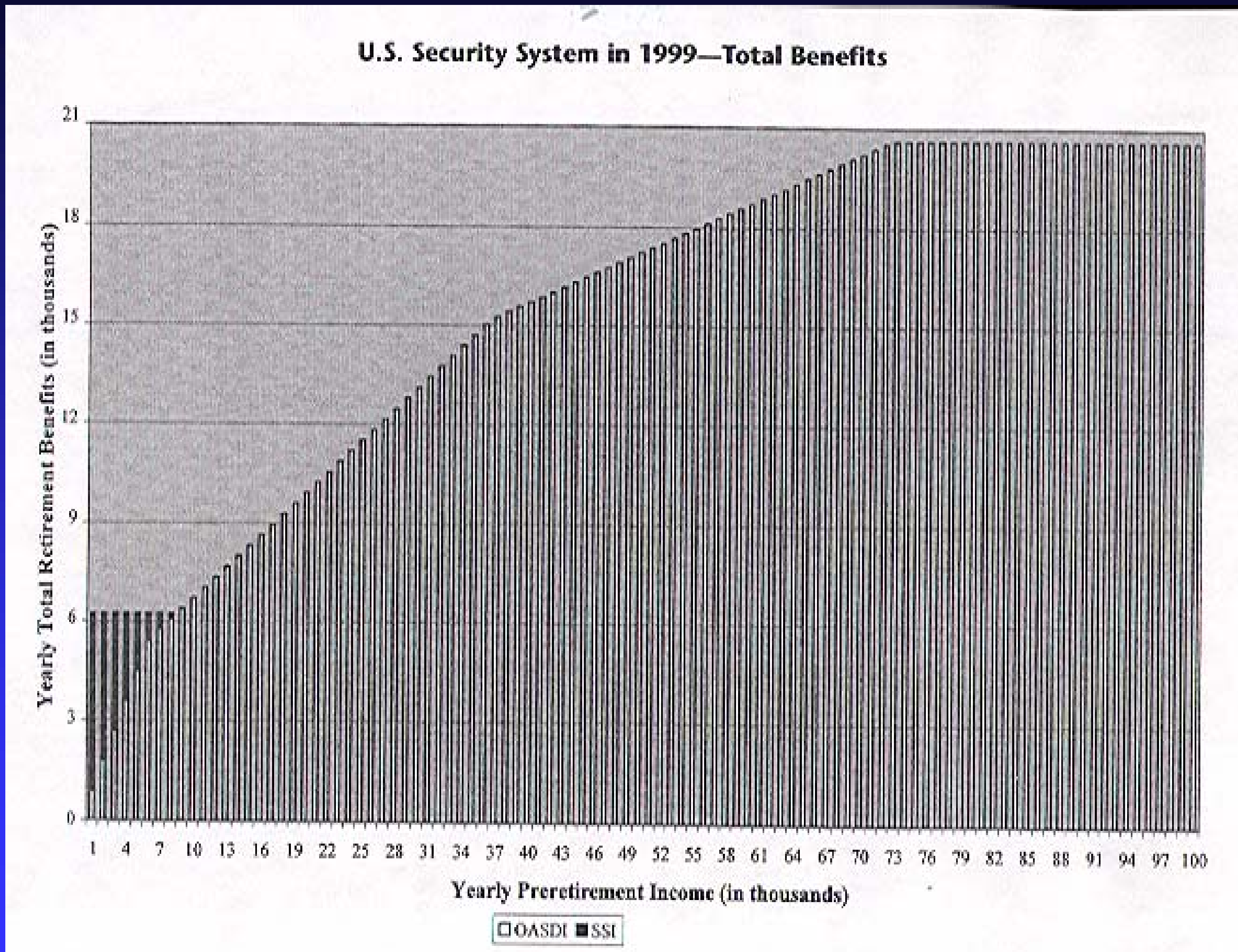
Canada/Quebec Pension Plans

- Normal Retirement age = 65
- Can retire between age 60 and 70
- Lose or gain ½% per month early or late
- Results in a 70% benefit at age 60 and a 130% benefit at age 70
- Retiring prior to 65 requires being out of the labor-force

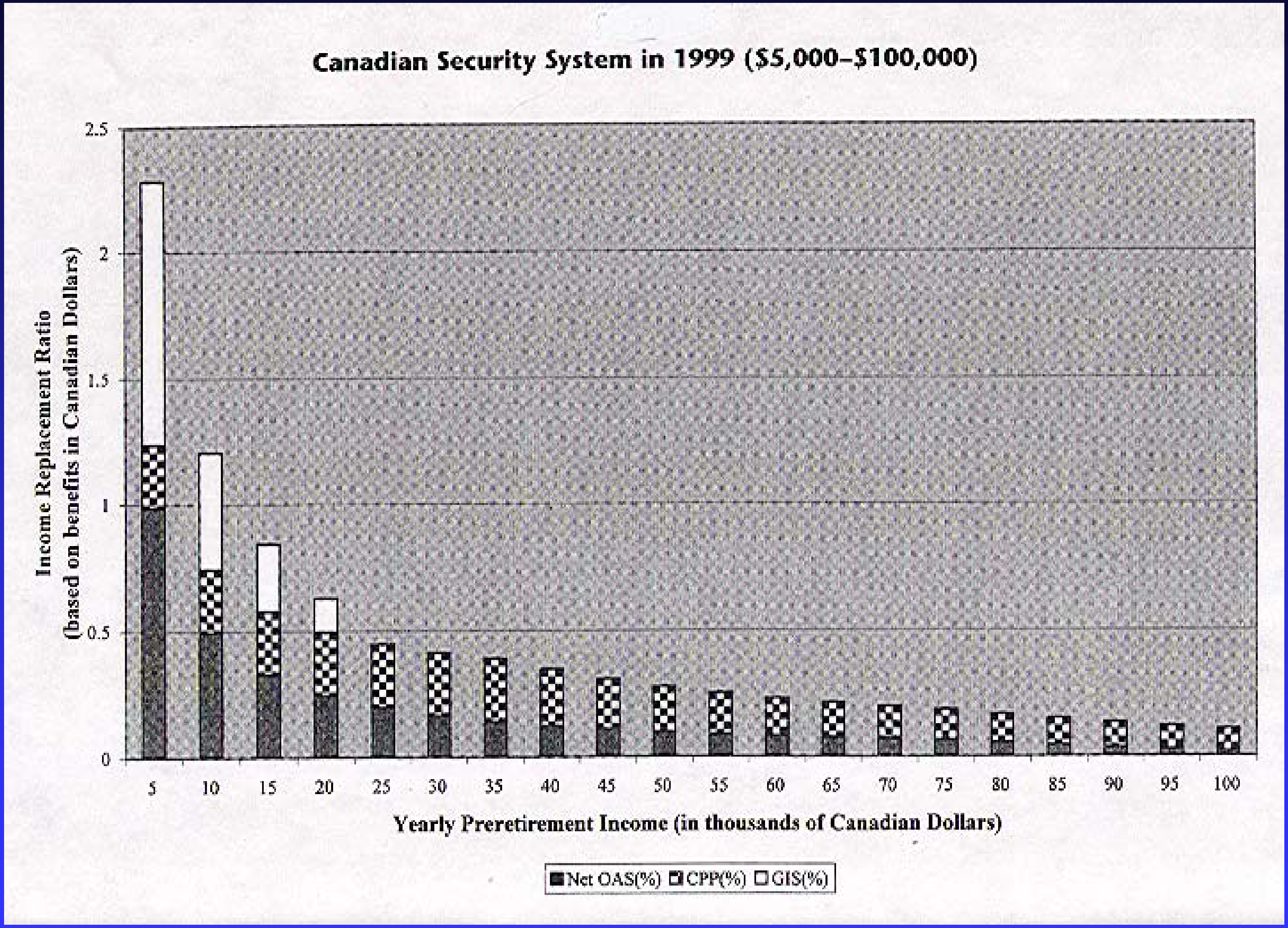
Canada/Quebec Pension Plans

- CPP: 9.9% contribution rate good for 75 years
- QPP: Not so clear because of lower fertility and immigration

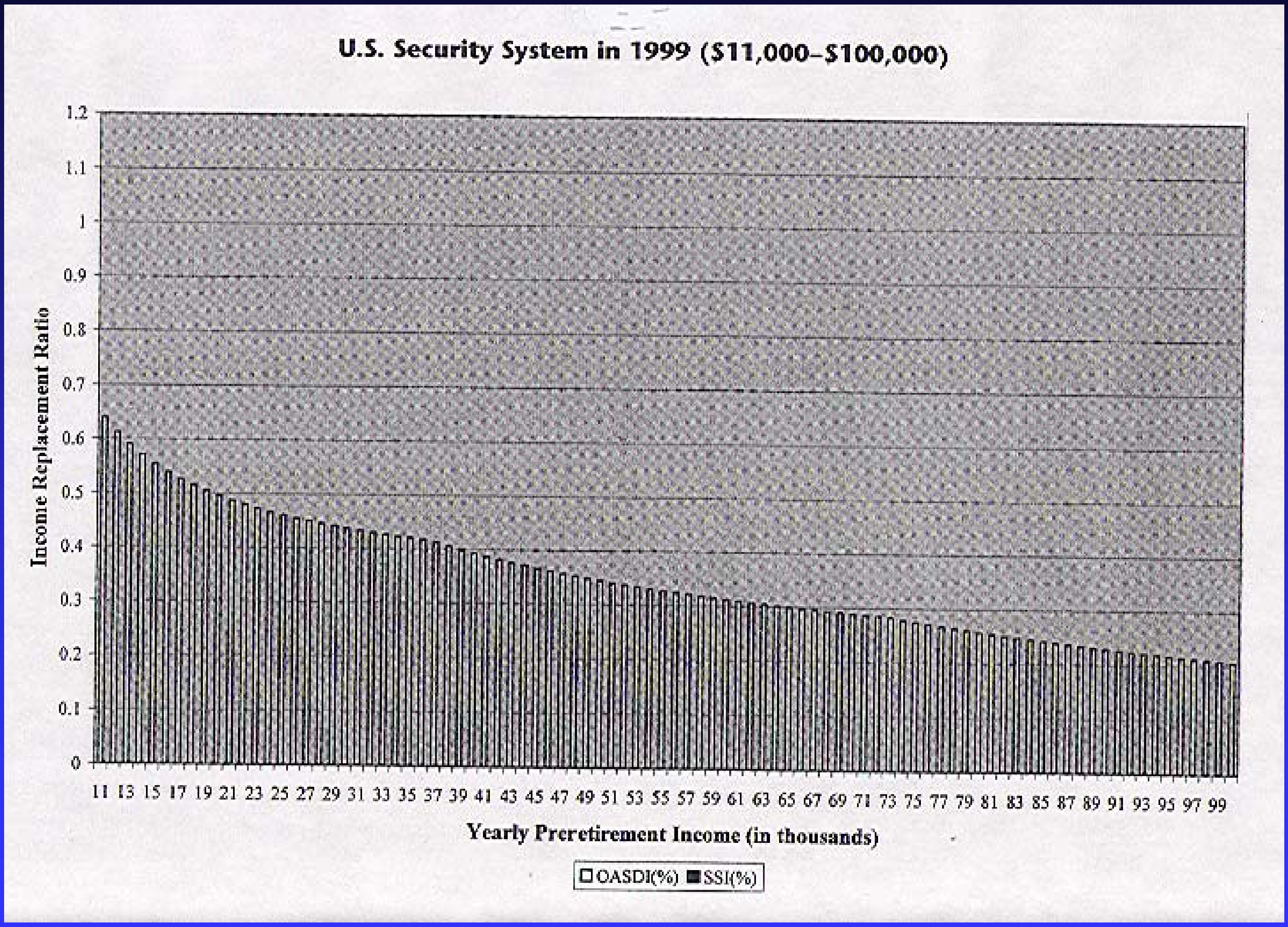

Canadian Security System in 1999—Total Benefits
Yearly Total Retirement Benefits (in thousands of Canadian Dollars)
21
18
15
12
9
6
3
0
5 10 15 20 25 30 35 40 45 50 55 60 65 70 75 80 85 90 95 100
Yearly Preretirement Income (in thousands of Canadian Dollars)
Net OAS CPP GIS



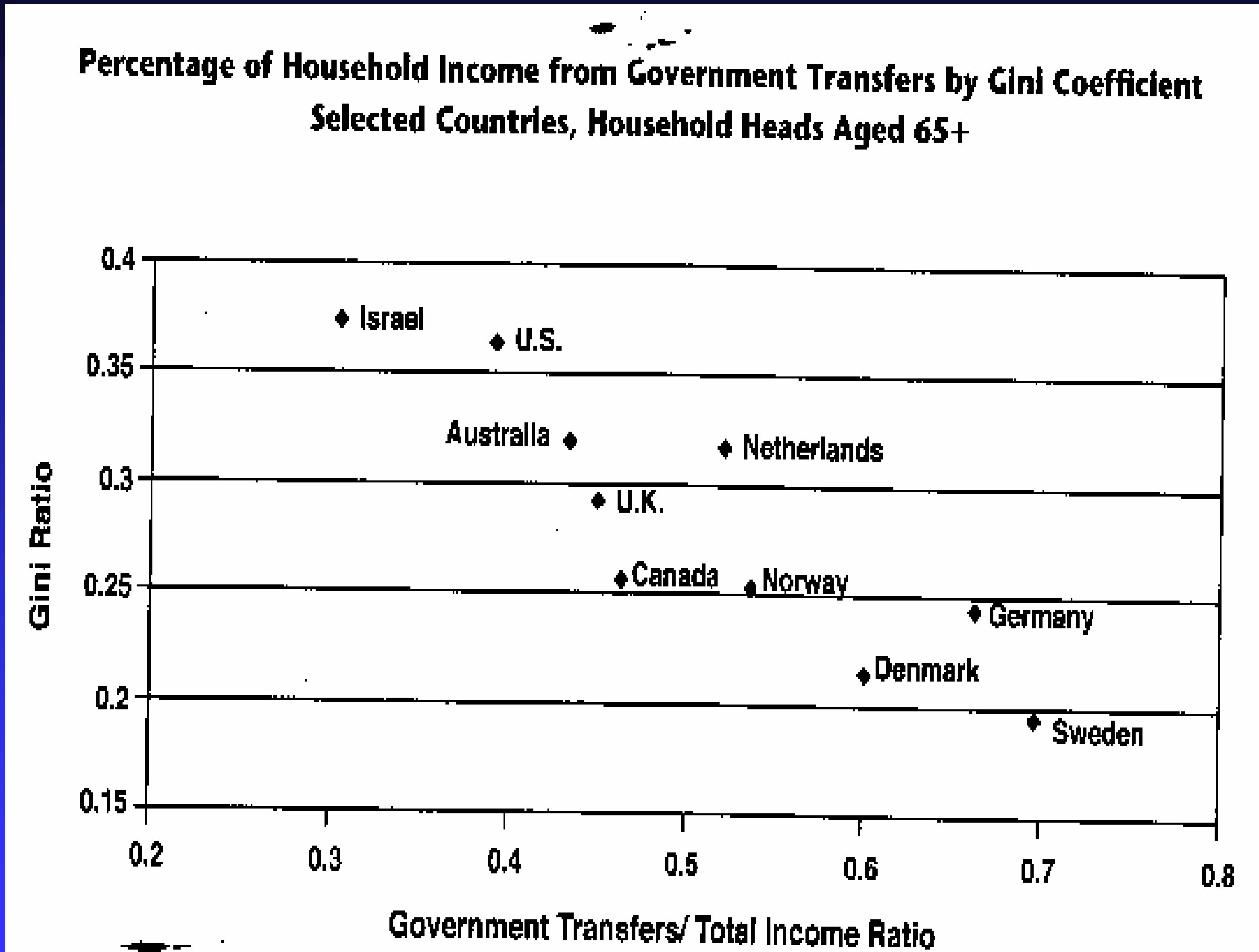
U.S. Security System in 1999—Total Benefits
Yearly Total Retirement Benefits (in thousands)
21
18
15
12
9
6
3
0
1 4 7 10 13 16 19 22 25 28 31 34 37 40 43 46 49 52 55 58 61 64 67 70 73 76 79 82 85 88 91 94 97 100
Yearly Preretirement Income (in thousands)
OASDI SSI



Canadian Security System in 1999 ($5,000–$100,000)
Income Replacement Ratio (based on benefits in Canadian Dollars)
Yearly Preretirement Income (in thousands of Canadian Dollars)
0
0.5
1
1.5
2
2.5
5
10
15
20
25
30
35
40
45
50
55
60
65
70
75
80
85
90
95
100
Net OAS(%)
CPP(%)
GIS(%)



U.S. Security System in 1999 ($11,000–$100,000)
Income Replacement Ratio
1.2
1.1
1
0.9
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
11 13 15 17 19 21 23 25 27 29 31 33 35 37 39 41 43 45 47 49 51 53 55 57 59 61 63 65 67 69 71 73 75 77 79 81 83 85 87 89 91 93 95 97 99
Yearly Preretirement Income (in thousands)
OASDI(%) SSI(%)


Percentage of Household Income from Government Transfers by Gini Coefficient
Selected Countries, Household Heads Aged 65+
Gini Ratio
0.4
0.35
0.3
0.25
0.2
0.15
Israel
U.S.
Australia
Netherlands
U.K.
Canada
Norway
Germany
Denmark
Sweden
0.2
0.3
0.4
0.5
0.6
0.7
0.8
Government Transfers/ Total Income Ratio

CANADIAN SOCIAL SECURITY:

Lots of room for Individual Savings

(with tax incentives)

Reasons for Reforms in 1996/97

Political

- Late 1980's/early1990's—huge government deficits
- Plus pressure (from US influence) to lower taxes
- Many programs were being cut
- Seniors were to share in the "pain"

Reasons for Reforms in 1996/97

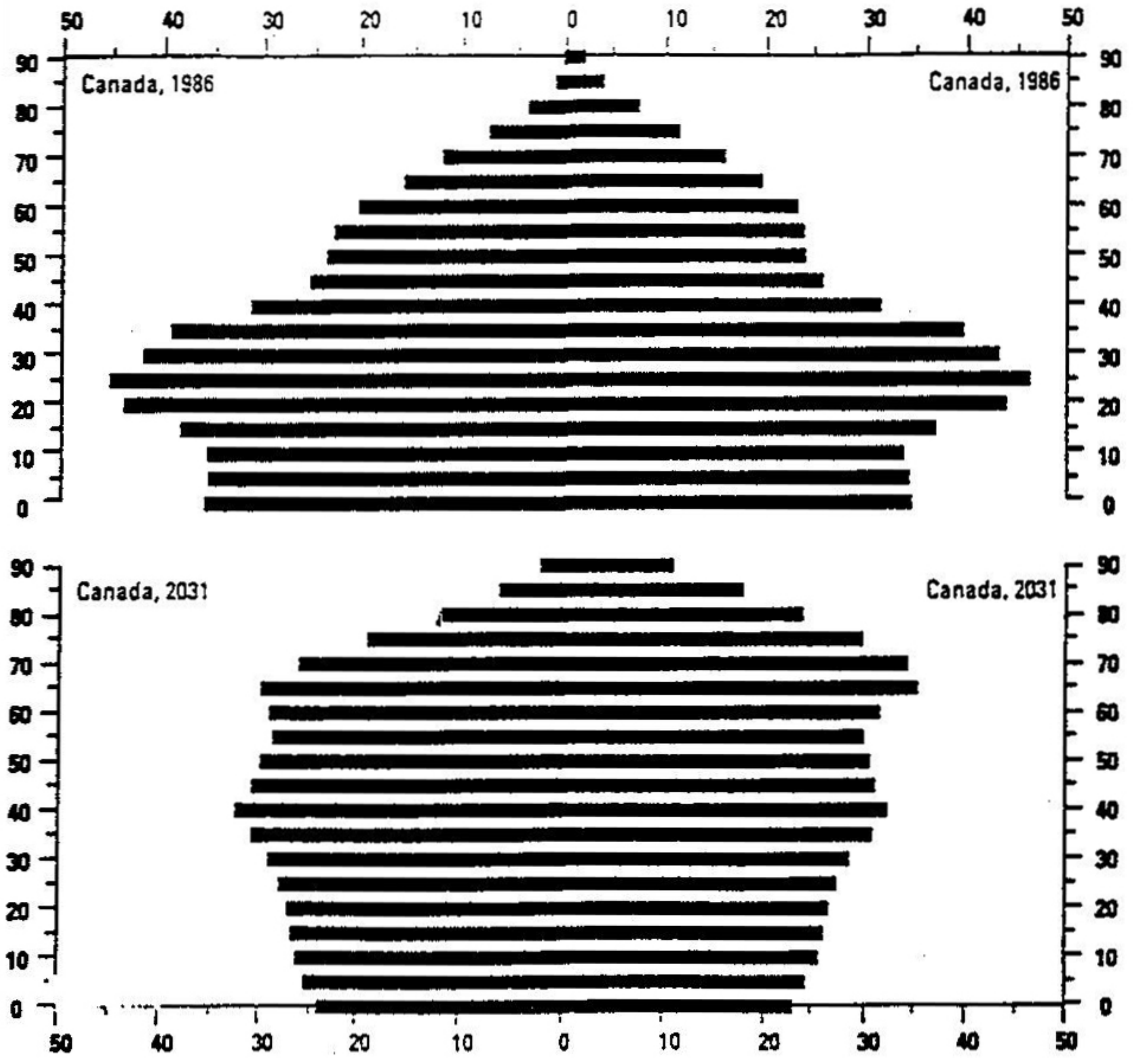
Demographic

- Rapid population aging
- Improved Life Expectancy
- Strong Baby Boom/Bust

TABLE 2
LIFE EXPECTANCY IN CANADA

Year	At Birth		At Age 65	
	Male	Female	Male	Female
1931	60.0	62.1	13.0	13.7
1951	66.3	70.8	13.3	15.0
1971	69.3	76.4	13.7	17.4
1991	74.6	80.9	15.7	19.9

Changes in the Age Structure



Reasons for Reforms in 1996/97

- C/QPP had been run close to a PAYGO plan
- Contributions in 1997 were 6%
- Under pure PAYGO, contributions would have to rise to 14.2%

Long-Term Economic Assumptions

	1960's	1990's
Senior Dependency Ratio (Age 65/20-64)	0.33	0.40
Annual Real Wage Increase	2%	1%
Real Interest Rate	2%	4%
Cost of C/QPP PAYGO	11.0%	14.5%
Cost of C/QPP Funded	16.5%	7.2%

The Seniors Benefit—Why It Failed

- Designed to combine OAS + GIS
- With earlier and sharper clawbacks
- Poorest recipients would have received $120 a year more
- Clawback would be based on combined income of spouses (as GIS is today)
- But, today, OAS is clawed back based on individual income (important to female spouses)

The Seniors Benefit—Why It Failed

- Future savings were small (10% of total program by 2030)
- Resulted in high marginal “tax” rates (income tax + clawback = 78% for some)
- Female spouses lost income autonomy
- This was very important
- Seniors Benefit allowed to die

1997 Reform of the Canada/Quebec Pension Plans

- Small “tweak” amendments
- Most key attributes unchanged
- Total plan costs lowered 9.3%
  - Disability Income made harder to get (benefit had grown to 20% of plan expenditures; target was 13%)
  - Retirement Benefit wage indexing base changed from average YMPE over last 3 years to 5-year final YMPE
  - Death Benefit frozen at max $2500 (not indexed)
  - Year’s Basic Exemption (YBE) frozen at $3500

Freezing of YBE make C/QPP less progressive

- Someone earning $3600 in 2005 contributes on $100 ($3600 - $3500) but benefit accrual is on $3600
- Someone earning $30,000 in 2005 contributes on $26,500 and earns benefit accruals on $30,000
- Not well understood (if at all)

Canada Pension Plan Investment Board (CPPIB)

- C/QPP Contribution rate rose from 6% total in 1997 to 9.9% in 2003 (split between worker and employer)
- Will create investable funds equal to 20% of plans total liabilities by 2017 (or 5 years of expenditures)

Canada Pension Plan Investment Board (CPPIB)

- Started in 1998
- Arms length from government
- By June 2005, had $87B (Cdn) in assets
- Expects $200B in 10 years
- Over 5 years (2000-04), earned 4.48% over inflation
- CPP valuation assumes 4.1% real return

Canada Pension Plan Investment Board (CPPIB)

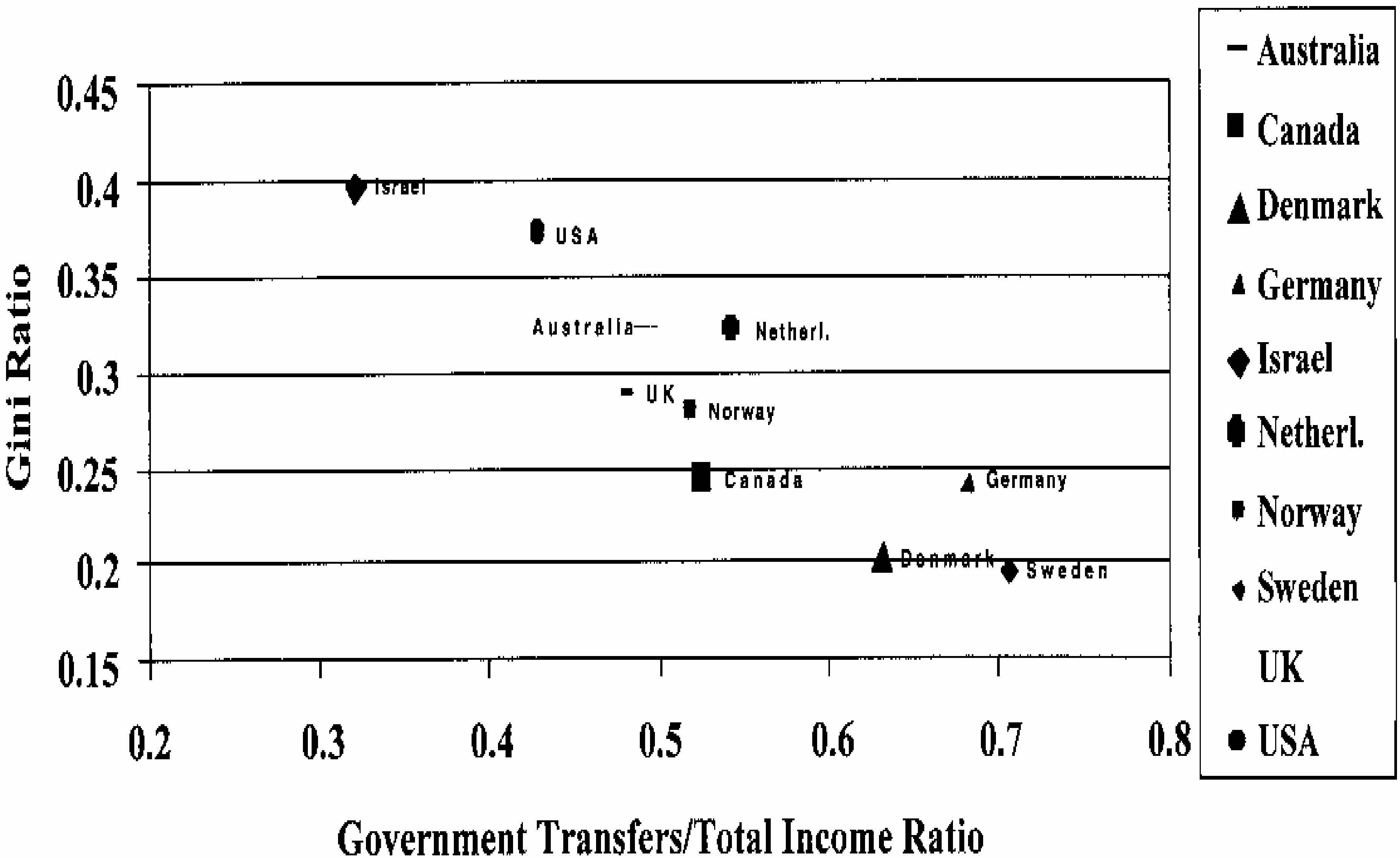
- Assets
  - 55% publicly traded stocks
  - 33% government bonds (legacy)
  - 4% real return assets
  - 4% private equity

Canada Pension Plan Investment Board (CPPIB)

- Goal is to maximize returns without undue risk of loss
- Has been independent of government influence

Conclusion

Figure 1 Percentage of Household Income from Government Transfers by Gini Coefficient, for Selected Countries, Household Heads Aged 65+.



Conclusion

- High level of security with lots of room for private retirement savings plan (tax incented)
- CPP is healthy
- QPP less so (lower fertility/immigration)
- Wide acceptance of reformed C/QPP
- But lessons to be learned from failed Seniors Benefit