Policy approaches to promote private and occupational old-age provision in Canada

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Introduction

This paper has been prepared for the Bertelsmann Foundation as part of a multi-country project examining old-age provision in different nations. The first section will discuss the extent of public provision of old age resources and hence the need for other forms of provision. The second section will concentrate on the two main forms of tax-favoured private provision for old age: registered retirement savings plans and registered pension plans. Section three will briefly discuss financial education while the fourth section will contain some of the authors' perspectives regarding future policy development in this area. Section five provides some references that further describe Canadian institutions, contain Canadian data or contain further research on Canadian public policy in this area.

I. Resources Needed in Old Age

I.1.a) Public Pension Scheme

There are two types of public pensions available in Canada. The first is the Canada Pension Plan (called the Quebec Pension Plan in the province of Quebec as it is administered by that province rather than federally as in the rest of Canada). It is an earnings-related scheme to which all employed persons must contribute. The second is a demogrant called Old Age Security, which may be supplemented for lower-income seniors by additional income-tested benefits known as the Guaranteed Income Supplement.

Canada Pension Plan (CPP)

All persons between the ages of 18 and 70 are required to contribute to the Canada Pension Plan on annual earnings of $3500[1] to $38,300 (2001 limits; lower limit currently frozen, upper limit based on average wages in Canada). The contribution rate is 8.6% in 2001 and is scheduled to rise to 9.9% in 2003 and then remain at that level. Self-employed earners pay the entire contribution of 8.6%; employed earners split the contribution evenly with their employers (4.3% each). When the CPP was introduced in 1966, the contribution rate was 3.6% (1.8% employer/employee). Recent concerns about the solvency of the plan for future generations of earners were met primarily by raising contribution rates and allowing broader investment of accrued funds, rather than by changing the retirement age or reducing current pension payments.

Pension payments under the CPP are based on a contributor's annual earnings and the number of years in which contributions were made. Allowance is made for non-contributory years due to raising children under the age of seven. Currently the maximum monthly pension benefit is $775 or about one-quarter of the monthly average wage, and the average monthly benefit paid is $417. Pension benefits are a fraction of the average Canadian wage in the year in which benefits are taken up, with that fraction depending upon the number of years the individual contributed and her/his level of earnings and hence contributions in those years. Benefits are then adjusted each January to fully reflect increases in the Consumer Price Index.

[1] All money figures are given in Canadian dollars. At market exchange rates, a Canadian dollar is currently valued at about $0.65 U.S. or about 0.72 euros.

CPP pension payments normally begin at age 65. Payments may be started as early as age 60 or as late as age 70. Payments are reduced by .5% for every month prior to age 65 at which CPP is taken up and increased by .5% for every month after age 65 at which CPP is taken up. In the case of early take-up, the claimant must have stopped working or be earning less per month than the maximum CPP monthly benefit. After early take-up, the claimant may earn any level of income, but may not make any CPP contributions on those earnings.

Spouses of CPP pensioners may be entitled to pension benefits at reduced levels after the death of the contributor. "Spouse" for CPP purposes is defined as a legal or common-law spouse, including same-sex. CPP survivor provisions thus incorporate something of a "reverse marriage penalty" in that a survivor who was never a contributor may nonetheless receive CPP pension benefits. The CPP also provides disability payments during a contributor's working life as well as benefits for a spouse and children if the contributor dies before retirement.

Old Age Security/Guaranteed Income Supplement (OAS/GIS)

Old Age Security is a demogrant payable to all Canadian residents age 65 and over, subject only to certain residency requirements. The monthly benefit is currently $436.55 and is reviewed four times a year to reflect Consumer Price Index changes. Partial benefits may be payable to those who do not meet the residency requirements for full benefits.

Since 1989, OAS payments have been "clawed back" for higher-income seniors. Currently, OAS recipients with individual annual net income over $55,309 have their OAS payments reduced by 15% of the exceeding income until payments are fully clawed back at an annual income level of $90,070. Note that OAS payments are made on an individual basis, and thus one member of a couple may have a high income and be subject to the clawback while the other member of the couple may have little income and thus receive full OAS benefits.

Lower-income seniors who receive OAS benefits are entitled to receive the Guaranteed Income Supplement. Maximum monthly payments range from $338 to $519, depending on whether or not the recipient has a spouse and whether that spouse is also an OAS recipient. Benefits are reduced with additional income and are no longer payable when non-OAS annual family income reaches $16,224 for a couple where both are OAS recipients and $30,192 where only one spouse is an OAS recipient.

Lower-income couples in which one spouse is age 65 or over and is thus eligible for OAS benefits may qualify for a benefit called the Allowance for the other spouse if aged 60 to 64. A widow/widower age 60 to 64 who is the survivor of a deceased OAS recipient may also qualify. As with the GIS, the Allowance is subject to reductions based on family non-OAS/GIS income.

The following table summarizes current OAS, GIS and Allowance payments.

Current OAS, GIS and Allowance Payments		
Type of Benefit	**Maximum Monthly Benefit (July-Sept., 2001)**	**Maximum Annual Income (July-Sept., 2001)**
OAS pension	$436.55	Clawback begins at $55,309 annual individual income and is complete at $90,070
GIS benefits	Single Person $518.82 Spouse of non-OAS recipient $518.82 OAS recipient (per spouse) $337.94 Spouse of Allowance recipient $337.94	$12,456 $30,192 (family income) $16,224 (family income) $30,192 (family income)
Allowance	Spouse $774.49 Survivor $855.05	$23,232 (family income) $17,064
Source: Human Resources Development Canada website: www.hrdc.gc.ca/		

The rates at which OAS and GIS benefits are reduced as income rises have been the subject of much controversy. In the case of an unattached OAS recipient, for example, GIS benefits are reduced by $1 for each $2 of other monthly income. Allowance recipients may face benefit reductions of $3 for every $4 of monthly income.

Provincial governments may also provide additional income support to seniors, but the amounts involved are far less than under the federal OAS/GIS program. For example, in Ontario (Canada's most populous province with approximately one-third of Canada's population) monthly supplements for lower-income seniors currently range from $2.50 to $83. With regard to social assistance (welfare), policy is set by the provinces and in Ontario, for example, only those aged 65 and over who do not qualify for OAS are eligible for social assistance.

In 1996 the federal government proposed replacing the present OAS/GIS program and certain tax credits available to seniors with a new income-tested refundable tax credit known as the "Seniors Benefit". The purpose of this proposal was to reduce the cost of the public pension system by denying benefits to more higher-income seniors. This proposal met a large degree of public resistance and was withdrawn. However, the cost of the OAS/GIS program in future years could become a concern of the government if the economy entered a recessionary period and government revenues became more squeezed.

I.1.b) Housing

According to Statistics Canada, in 1999, 67% of Canadian households headed by a person aged 65 or over owned a principal residence. The median value of these residences was approximately $120,000. Ten percent of these homeowners held mortgages, with a median mortgage debt of $40,000. For purposes of comparison, 73% of households aged 45-54 owned a principal residence and 59% of these homeowners held mortgages, with a median mortgage debt of about $57,000.

I.1.c) Health Care

Medicare in Canada provides medically necessary hospitalization and physician services free of charge. Policy is set and the bulk of funding is provided by the federal government and services are delivered by the provincial governments. Medicare does not provide dental care, prescription drugs, eyeglasses or long-term out-of-hospital care (although some lower-income Canadians can receive a tax credit which offsets all these types of costs). However, as described for example in Crossley et al. (2000), all provinces offer assistance to all seniors for the purchase of prescription drugs, sometimes with lower-income seniors receiving a higher level of assistance. Taking Ontario as an example, most seniors pay the first $100 of their prescriptions each year and after that they pay only $6 per prescription. Low-income seniors do not have to pay the first $100 and pay only $2 per prescription. All provinces also offer some degree of free-of-charge short- and long-term home care which may or may not be income-tested according to the province (Health Canada, 1999).

Currently in Canada, the public sector share of total spending on health care is estimated at 71%. The majority of private spending is on drugs, dental care and vision care. Most private health insurance is employer-provided and insurance expenditures account for about one-third of private health care spending. Some provision is often made by employers to continue private insurance coverage for retired employees but usually at reduced levels of coverage.

It is estimated that 8.1% of Canadians aged 65 and over live in institutions, and the remainder in private households. (See United Nations and Statistics Canada, 1998.) 26% of Canadians aged 65 and over live alone in private households. Nursing homes may be provided by local governments, by charitable organizations, or be privately run. In the case of non-privately run nursing homes, provision is usually made for those who cannot afford the full cost of nursing home care. However, waiting lists for subsidized care can be several years long.

II: Fully funded private, hybrid and occupational pension schemes

Fully funded private and hybrid schemes

There are two main fully funded pension schemes in Canada: Registered Retirement Savings Plans (RRSPs) and Registered Pension Plans (RPPs). RRSPs are set up by individuals and all contributions are by individuals. On the other hand, RPPs are set up by corporations, government or unions for particular groups of employees. Pension plans have been set up for employees since before the First World War while RRSPs date only from 1957. Thus, the RPP system is mature while the RRSP system is not. This is confirmed by some figures on the tax expenditure (or foregone revenue) for 2001 associated with these two plans:

- The non-taxation of the investment income earned within these plans costs the federal government $4.3 billion for RRSPs and $9.3 billion for RPPs. Thus, it is reasonable to assume that the amount invested in RPPs is approximately twice the amount invested in RRSPs.
- The tax deduction for contributions costs the federal government $6.8 billion for RRSPs and $4.0 billion for RPPs. Thus, it is reasonable to assume that the new contributions to RRSPs are more than 50% larger for RRSPs than for RPPs.
- The tax revenue raised by taxing withdrawals is $3.2 billion for RRSPs and $7.1 million for RPPs. Thus, it is reasonable to assume that withdrawals for RRSPs are less than half of withdrawals for RPPs.

In summary, RPPs are currently the most important pension scheme in Canada but RRSPs are growing rapidly. From 1983 to 1993, RRSP assets increased 444%, well above the growth in RPP assets (191%). Over the next two decades, it can be expected that RRSPs will become the dominant scheme.

The two categories, RPPs and RRSPs, are somewhat blurred in that on termination of employment with a particular employer before retirement it is often possible for the employee to transfer his or her financial interest in the RPP into his or her RRSP. Such RRSPs are known as Locked-In Retirement Accounts (LIRAs). The reverse is not possible; money cannot be transferred from an RRSP into an RPP.

Our discussion of fully funded private pension schemes will begin with RRSPs.

Registered Retirement Savings Plans (RRSPs): An overview

The most common personal financial preparation for retirement in Canada is investment in a Registered Retirement Savings Plan or RRSP. According to the Statistics Canada 1999 Survey of Financial Security, about 55% of Canadian households have at least one member with such a plan, although the median household holding is only about $20,000 (average $56,422). The Canadian total holding of $343 billion is about 40% of the financial assets held by Canadian households (not counting the present value of occupational pension schemes, which Statistics Canada does not yet officially value.)

An RRSP may be set up solely by an individual and requires no action of employers. Hence the structure of the plan is the same whether a person is self-employed, employed by a firm without a pension plan or employed by a firm with a pension plan, although in the last case allowable contributions are reduced as described below. Amounts contributed are deductible in computing taxable income for personal income tax purposes. Earnings accumulated within the plan are exempt from current personal income tax but withdrawals are fully taxable. Most kinds of investments may be held within RRSPs including stocks, bonds, mutual funds and mortgages on real property although there are foreign content limits discussed below.

Withdrawals from the plan can be made at any time, subject only to a withholding tax that is counted towards personal income tax due. There is no surcharge for early withdrawal, unlike for similar accounts in the United States. Hence RRSPs are essentially as liquid as the assets they contain. The taxpayer must stop contributions and initiate withdrawals of RRSP funds at age 69, although the withdrawal and hence the tax payments may be spread over time through the use of an annuity or a collapsing income fund known as a registered retirement income fund (RRIF).

Withdrawals from an RRSP will be non-taxable if they are used to purchase a house and the individual is a first-time home buyer. Non-taxable withdrawals are also permitted to finance full-time training or higher education. However, in both cases the amounts withdrawn must be repaid over 10-15 years or the withdrawals will become taxable.

The basic structure of the RRSP program has not changed since its inception in 1957. Individual annual contribution limits are currently calculated by taking the lesser of $13, 500 and 18% of earned income (essentially income that will need to be replaced on retirement, such as wage, salary, business, and professional income) and deducting an estimate of the total firm/employee pension contribution for those who are members of pension plans. (In the case of defined contribution pension plans, this is just the total firm plus employee contribution; in the case of defined benefit plans, the calculation is more complicated but is intended to achieve the same purpose.) Note that as the Canadian personal income tax system is largely set up on an individual basis (with no true joint filing), RRSP contribution limits are based on individual rather than joint income.

Locked In Retirement Accounts or (LIRAs) are a type of RRSP to which employees who have terminated their employment with a particular employer can transfer their financial stake in the employer's pension plan. This allows the employee (rather than the employer) to manage the funds. However there can be no withdrawals from such RRSPs (except in exceptional circumstances) until age 55.

II.a) Importance of RRSPs

There are no provisions that allow Canadians to contribute to RRSPs instead of participating in the publicly funded Canada Pension Plan (CPP). However, since the income replacement rate of the CPP plan is low, many individuals will wish to have additional income in retirement and hence RRSPs as well as occupational pensions are important. Perhaps the greatest importance of RRSPs is that they give tax shelter comparable to a pension plan to individuals who are self-employed, who work in jobs without pension plans or who have high mobility across employers and hence never vest within a single pension plan. However in terms of public policy, because RRSP contribution is completely a matter of individual choice, many individuals still have zero assets upon retirement and therefore receive the maximum public benefits. Unlike direct public provision, there is no evidence that the RRSP program has significantly decreased poverty in the older population.

While as noted above, about 55% of Canadian households hold RRSPs with a median value among holders of only $20,000, this does understate their quantitative importance. As noted in the overview of the Statistics Canada financial survey (Statistics Canada, 2001) about 67% of Canadians aged 55-64 hold RRSPs with median holding $50,000 (average $97,000). As noted in that same overview, RRSP holdings are growing sharply and in 1999 were 6.4 times larger (in real terms) than in the previous survey in 1984 as compared to a growth factor of 1.8 for total assets (not including the present value of registered pension plans, which as noted, have not yet been valued).

II. b) Regulation

RRSPs are not subject to pension standards legislation. RRSPs are creatures of tax law, which in Canada is generally the responsibility of the federal government. Therefore, the rules governing them are administered by Canada's tax administration authority, the Canada Customs and Revenue Agency.

The financial assets held within RRSPs are subject to the usual regulations applying to those assets. Thus, it is necessary to examine the type of assets held within RRSPs. While the data are imperfect, it appears that about 70% of RRSPs are deposits of some form with a financial institution. These are often (but need not be) interest-bearing financial instruments and can qualify for government-provided deposit insurance. Those financial instruments based on equities as well as the 30% of RRSPs that are self-directed (a portfolio of assets held through a financial firm but managed by the individual) have no guarantee of principal. The financial institutions themselves are regulated by the Office of the Superintendent of Financial Institutions, Canada.

Certain credit unions and other non-bank financial institutions which operate only within a single province are provincially regulated. An example of a provincial regulator is the Financial Services Commission of Ontario.

II. c) Tax treatment of other assets relative to RRSPs

The tax advantages of RRSP saving are considerable when compared to non-RRSP saving. The main advantage is the deferral of taxation until the funds are withdrawn from the RRSP. However, there is some disadvantage in that withdrawals from RRSPs are fully taxable regardless of the type of income used to fund the RRSP withdrawal, while dividends and capital gains received outside RRSPs are less than 100% taxable.   Capital gains are only 50% taxable if earned outside RRSPs. The situation with dividends is more complicated in that dividends from Canadian corporations are subject to a gross-up and tax credit system which results in the proportion taxable being approximately two-thirds for upper-income investors. However, on balance the deferral advantage of not paying tax until the funds are withdrawn from the RRSP normally overwhelms the problem of the income being 100% taxable.

There are also other tax-favoured plans less widely used and typically less generous than RRSPs. These include deferred profit sharing plans and educational savings plans.

In some cases personal housing equity can also be more attractive than RRSP saving because capital gains in owner-occupied housing are not taxable. However in Canada, the interest incurred on housing debt (as well as other kinds of interest not counted as related to the purchase of income-earning assets) is not tax deductible. There is no provision for taxation of imputed rents for owner-occupiers. Income from rents net of expenses receives no special tax advantage.

The interest on borrowing to contribute to RRSPs is not tax deductible (unlike interest incurred in borrowing to purchase investments held outside RRSPs).

II.1: The accumulation phase

II. 1.a) Target groups

RRSPs are fully available to all those who earn labour or real-estate rental income, including those who are self-employed. However the maximum annual contribution of $13,500 is achieved by those with incomes of $75,000 so the greater an individual's income is in excess of $75,000, the less an RRSP plan can contribute to the retirement income replacement rate. On the other hand, the RRSP plan tends to be of greater benefit to high income individuals because their tax savings (particularly through the allowance of tax-free accumulation) tend to be larger. Also, as described below, the spousal RRSP provision confers some advantage on married households with a large differential in spousal incomes.

As noted, contributions are voluntary and there is evidence that RRSPs are used more by individuals who also use other saving vehicles: in particular, RRSP participation is higher among those with occupational pensions than among those without occupational pensions. There is no minimum age for RRSP contributions but those past age 69 must stop contributing and begin withdrawing.

II.1.b) Government-provided incentives

RRSP contribution is completely voluntary and there is no mandated provision. Hence the decision to contribute may depend on the individual's perception of her/his other sources of income in retirement. Canadian taxpayers receive regular information on their Canada Pension Plan contributions from the federal government. The federal government also gives an estimate of retirement pension at age 65 if earnings "continue at this level".

Financial institutions must provide regular information on the status of their RRSPs. Employers must provide regular information on the accrual of pension plan rights. Most employer statements for defined benefit pension plans also give an estimate of future pensions. However, since in all cases the actual real value of any pension paid in the future depends heavily on assumptions about the future, it is not clear that this information is completely digested by its recipients.

As has been noted, one tax incentive associated with RRSP contribution is the deduction of the contribution from current taxable income. This may defer taxable income to retirement, when the marginal tax rate may be lower. (Note however that substantial RRSP withdrawals are made by individuals before retirement, often during a period of low individual income.) The second tax incentive (and one that is typically greater for lifelong contributors to RRSPs) is the tax-free accumulation of investment income within the RRSP.

As also has been noted, individual annual contribution limits are currently calculated by taking the lesser of $13,500 and 18% of earned income (essentially wage, salary or real-estate rental income) and deducting an estimate of the total firm/employee pension contribution for those who are members of pension plans. (In the case of defined contribution pension plans, this is just the total firm plus employee contribution; in the case of defined benefit plans, the calculation is more complicated but is intended to achieve the same purpose.)

The amount of earned income which is relevant to the contribution limit is that earned in the previous calendar year. Thus, contribution limits for 2001 are affected by earned income for 2000. The purpose of this time delay is to allow the government to mail out annual notices on the maximum contribution allowed for that year. Some observers believe that these notices increase contributions because they provide a personalized reminder about the possibility of investing in RRSPs.

The RRSP program has four more special incentives that affect contribution. First, an individual can carry forward unused RRSP contribution room without limit. (The 1999 value of this carryforward exceeds $200 billion.) Second, while the provision is seldom used, once a contribution is made it can be deducted from taxable income in any future year. Third, an individual is allowed to have a cumulative RRSP overcontribution of $2,000 in order to allow for small errors in exceeding the maximum contribution limits. Fourth, instead of making a contribution to her/his own RRSP plan, an individual can make it to that of her/his spouse so that when it is withdrawn (after certain time limits), it will be taxed at the spouse’s presumably lower marginal tax rate.

II.c) Volume of required/subsidized contributions to this scheme

As noted, RRSP contributions are not subsidized but there are tax incentives and contribution limits. The dollar ceilings have not been raised with inflation for almost ten years. The most recent federal budget stated that the ceilings would be raised to $15,500 by 2005 but offered no immediate increase in the ceiling. However the 18% of earned income provision is naturally geared to increases in nominal incomes.

II.1.d) Providers

Providers of RRSP plans must be licensed financial institutions such as banks, trust companies, insurance companies or investment management companies. Self-directed plans must also be held through such a financial institution. As mentioned, financial institutions are generally under the regulation of the Office of the Superintendent of Financial Institutions. The choice of financial provider is completely open. There is considerable advertising every year, particularly around the end-of-February deadline (after which RRSP contributions cannot be deducted in the calculation of the preceding year's taxable income) to try to attract new contributions. It is a relatively simple matter to shift an existing RRSP from one provider to another. One individual may hold RRSPs with any number of providers simultaneously.

II.1.f) Permitted financial products

As noted, stocks, bonds, mutual funds, mortgages on real property and other financial instruments can be held within RRSPs. However, normally 70% of the content must be deemed Canadian, a limit that is relaxed for investors in certain kinds of tax-favoured venture capital investments. This 70% rule puts no effective limit on investing in Canadian funds that use derivatives based on foreign financial instruments. There is no limit on "riskiness" and indeed as was just noted, there is a small advantage to holding some amount of relatively risky venture capital fund instruments. There is also no limit on charges by the financial provider although the provider must furnish certain information annually both to the individual and the tax authority.

If an RRSP holder dies and the named beneficiary in the RRSP contract is the holder's spouse or common-law partner, the balance in the deceased's RRSP is transferred on a tax-free basis to the beneficiary's RRSP and only becomes taxable when that person withdraws it. If the beneficiary is a dependent child, the amount is taxable to the child, although it can often be spread over a period of years. If the beneficiary is not in these two categories, the accumulated balance in the RRSP is taxable in the last tax return of the deceased even though the funds in the RRSP have been paid to the named beneficiary. If there is no named beneficiary, the balance in the RRSP is taxable in the last tax return of the deceased.

II.1.g) Ensuring retirees can rely on assets in old age

With respect to RRSPs, there is sufficient individual decision-making that there is no absolute guarantee that the principal will survive until old age. In the cases of RRSP deposits in government-insured deposit-taking institutions or in government bonds, there is a government guarantee.

RRSP holdings are not immune to the demands of creditors and generally cannot be held out of bankruptcy proceedings. However, they cannot be specifically pledged as collateral. RRSPs (including LIRAs) are viewed as common property on the dissolution of marriage.

II. 2: The withdrawal phase

II.2.a) Withdrawal

Withdrawal from a regular RRSP is permitted at any time. However, in order to prevent tax deferral and indefinite accumulation, after age 69 withdrawal must begin either through an annuity or a RRIF. Under a RRIF, the minimum withdrawal schedule for a RRIF is specified by law and ranges from 5% of holdings at age 70 to 20% of holdings at age 94 or any year thereafter. There is no limit on maximum withdrawals.

LIRAs do not permit withdrawals, although after age 55 the person may convert the LIRA to a Life Income Fund (or, in some provinces, a Life Retirement Income Fund). These vehicles carry the same minimum withdrawals as a regular RRIF but also have maximum withdrawals. Furthermore, some provinces require conversion to a life annuity at age 80.

Under recent amendments to Ontario pension standards legislation, access to funds from a LIRA, a Life Income Fund or a Life Retirement Income Fund may also be permitted in certain situations of financial hardship: low-income ($25,000 annually or less), risk of eviction from a home or rented residence, need for rent deposits to rent a residence, expenses for medical treatment, or expenses for home renovation needed for certain medical conditions.

II.2.b) Incentives

The incentive for RRSP withdrawal through either an annuity or RRIF is that it extends the tax-deferral advantage and may lower the marginal tax rate paid by a taxpayer. However, in some cases, a taxpayer already paying the maximum marginal tax rate (including the clawback rates discussed in Section I) may benefit by withdrawing everything and then reverting to a lower marginal tax rate in subsequent years. The most common financial advice is to use a RRIF rather than an annuity because it provides greater flexibility.

II.2.c) Permitted design of annuities

There are also some restrictions on the annuities that can be purchased from an RRSP. For example, the annuity need not be a life annuity but must provide benefits up to age 90. To avoid infinite tax deferral, it cannot guarantee benefits for a term that exceeds 90 minus the lesser of the individual's age and the age of her/his spouse. It may or may not be a joint annuity with the individual's spouse. Indexation is not required, and in fact indexed annuities are no longer sold in Canada because of a lack of market interest. There are no special restrictions on the permitted criteria in calculating such annuities save those that would conflict with the Canadian charter of rights. Currently age, gender and any available health measures may be used.

II.2.d) Reduction of public benefits

As described in Section I, there is an income-tested element of old age assistance (the Guaranteed Income Supplement) that is sharply reduced by the receipt of any income including the Canada Pension Plan, RRIF or annuity income or occupational pensions. In addition, the basic old age entitlement (Old Age Security) is also "clawed back" as such income is received, albeit at a much slower rate than the GIS clawback and only for those with relatively high incomes. Nonetheless there is no doubt that the contributory CPP plan, RRSPs and occupational pensions all contribute to the reduction of means-tested public benefits. The architects of these means-tested plans would probably argue that they were in part temporary measures designed to bridge the period in which these other forms of contributory schemes would become more prevalent, at least for some of the older population.

II.3) Experience

It is so clear that RRSPs primarily are used by higher-income individuals that there has been relatively little formal evidence presented on the topic. However, Fretz and Veall (2000) for example use a 1992 survey to confirm that those who contributed to both an RRSP and an occupational pension plan in that year had both mean and median incomes well in excess of double those who contributed to neither. The contrast was almost as sharp comparing noncontributors to those who contributed to either an RRSP or an occupational plan alone. Compared to noncontributors, contributors to RRSPs and occupational pension plans also tended to have higher investment income and increasing rather than decreasing financial assets.

The effect of the schemes on private savings is as controversial in Canada as it is elsewhere. It has been argued (Carroll and Summers, 1987) that higher savings rates in Canada compared to the United States in the 1970s were attributable to RRSPs in Canada encouraging saving (while the U.S. then had only small provisions that were comparable). But savings rates in Canada have since plunged, even more sharply than they have in the United States. Research by Veall (2001) suggests that the RRSP savings effects do not appear to be sensitive to changes in marginal tax rates and hence after-tax returns, but this does not rule out an overall saving effect.

There nonetheless is almost no policy debate concerning the existence of RRSPs. We believe that this is partly because the plans have such widespread use, partly because they provide a "pension-like" tax shelter to the self-employed and those without pension funds and partly because they provide a measure that permits tax-smoothing for those with volatile incomes (by contributing in year in which the marginal tax rate is high and withdrawing in a year in which the marginal tax rate is low). Some critics have suggested that RRSP contribution cash limits not be increased from the current $13,500, presumably because they believe the program unfairly benefits those with higher incomes. Similarly it has been suggested that rather than RRSP contributions being deducted from taxable income (which confers a greater benefit to those in higher income tax brackets), an equal-value tax credit be available to any individual who contributes to an RRSP.

In the future operation of RRSPs, besides the issue of increasing contribution limits, there may be pressure to provide more generous tax treatment of withdrawals, particularly withdrawals for purposes considered "worthy". A rough estimate is that only considering funds already contributed to RRSPs, the present value to the federal and provincial governments of the tax payments that will be triggered upon withdrawal is in excess of $100 billion, or more than the annual yield of both provincial and federal personal income taxes.

Registered Pension Plans (RPPs): An Overview

As described in the introduction to Section II, RPPs have been set up by corporations, government or unions for particular groups of employees since before the First World War. Thus, the RPP system is mature and provides more than double the amount of pension income currently provided by RRSPs.

The tax incentives for RPPs are similar to those for RPPs: a deduction for contributions, no taxation on income earned within the plan, and withdrawals are fully taxable.

Money-purchase RPPs are similar to RRSPs in the financial limits to contribution. On the other hand, defined-benefit RPPs are subject to very different limits in that there is no limit on contributions; instead this is a limit on the maximum pension that can be paid, and the contribution limits are derived actuarially from that.

A notable aspect of the Canadian system is that there is an attempt to ensure that the amount of tax-assisted retirement savings which can be achieved through an RPP is approximately the same as that which can be achieved through an RRSP. On balance, these rules are fairly effective. RPPs, unlike RRSPs, are regulated by pension standards legislation in addition to tax law. Thus, a major difference between RRSPs and RPPs is that all RPPs, both money-purchase and defined-benefit, are locked-in until retirement.

No company is forced to set up an RPP, and no employee is forced by law to join an RPP. However, it is common for employers to make joining the RPP a condition of employment, at least for workers above age 35 or with more than five years of service.

II.a) Importance of RPPs

Of the $95 billion in pension income in 1998, 25.1% came from OAS/GIS, 25.2% came from the CPP, and 49.8% came from RRSPs and RPPs. Of this last amount, more than two-thirds came from RPPs. Thus, RPPs are the largest single source of pension income.

Just over one-third of the labour force (35% to 37%) belonged to RPPs during the period from 1983 to 1993. Despite the stability of the share of the labour force which contributes to RPPs, the amount of assets in RPPs grew 191% from 1983 to 1993 (in nominal terms).

As discussed below in Section IV under the section entitled “Replacement Rates”, public pensions replace more than 100% of income for many low-income workers.

Thus, membership in RPPs is much less common among low-income workers than among middle- and upper-income workers.

A Financial Executives Institute Canada survey of pension plans (see Robertson and Archibald, 1998) revealed, not surprisingly, that high-income workers are much more dependent on RPPs for earnings replacement than low-income workers. For example, consider an individual 65 years of age with 35 years of service. If he or she makes $35,400 annually, OAS, CPP and RPP combined provide a replacement ratio of 84%, and that replacement ratio would drop steeply to 44% if the public plans were not included. On the other hand, for a worker earning $106,200 annually, the three plans provide 65% replacement, and that would drop only slightly to 53% if the public plans were not included.

II. b) Regulation

RPPs are restricted in their actions by both tax law and pension standards legislation. In Canada, tax law is generally the responsibility of the federal government. Therefore, the tax rules governing them are administered by Canada's tax administration authority, the Canada Customs and Revenue Agency.

The relevant pension standards legislation may be either federal or provincial. The federal government, through the Pension Benefits Standards Act and the pension supervisory authority that administers it, the Office of the Superintendent of Financial Institutions, regulates pension plans that cover employees who are subject to federal employment standards. Federal employment standards apply primarily to people who work in the banking, communication or transportation industries or who work in the three northern territories. The provincial governments, through their own pension laws and supervisory authorities, regulate all other pension plans. All provinces except Prince Edward Island have pension laws in effect. In all, there are 10 different sets of pension standards laws in Canada with 10 different pension supervisory authorities. In Ontario, the largest province, the Financial Services Commission of Ontario is the supervisory authority.

Fortunately, there is a large degree of harmonization of pension standards laws across these jurisdictions. Also, since much of the legislation specifies minimum standards, it is often possible for a pension sponsor to comply with laws in all jurisdictions by choosing pension terms which abide by the laws of the jurisdiction with the strictest standard (e.g., in vesting and locking-in minimum requirements).

The financial assets held within RPPs are subject to the usual regulations applying to those assets, as discussed above in connection with RRSPs. According to 1997 Statistics Canada figures, 44% of RPP assets are invested in equities and 37% is in fixed-income investments. The foreign investment limit of 30% mentioned above concerning RRSPs also applies to RPPs.

II. c) Tax treatment of other assets relative to RRSPs

The tax advantages of RPP saving are similar to those discussed above for RRSP saving. Employer contributions to RPPs are not taxable to employees. This tax treatment is equivalent to making them taxable to employees and then allowing a deduction to the employee for these contributions made on his or her behalf. Thus, effectively RPPs are treated the same as RRSPs: contributions are deductible, earnings within the plan are not taxed, and withdrawals are taxable.

II.1: The accumulation phase

II. 1.a) Target groups

The target group for RPPs is all employees. No employees are excluded from belonging to RPPs, although tax law does not allow contributions after age 69. On the other hand, self-employed people cannot be part of an RPP.

An employer is not required to provide an RPP for its employees. However, when an RPP does exist, pension standards legislation generally requires that every full-time employee who belongs to the class of employees for whom the plan was established must be allowed to join the plan. Employers generally go beyond this requirement and allow employees to join the plan as soon as they start employment.

RPPs are voluntary in the sense that there is no legal requirement that employees belong to the employer's plan. However, employers with RPPs may make it a condition of employment that the employee join the RPP. This type of condition occurs in both unionized workplaces (as part of the collective agreement) and in non-unionized workplaces. A common rule imposed by employers is that employees need not join the RPP until they are 35 years old or until they have completed five years of service. However, when a new pension plan is being implemented, it is usually considered impossible (or even illegal) to make the plan compulsory for the then-present employees, since it was not a condition of employment when they were hired.

II.1.b) Government-provided incentives

Pension standards legislation in all jurisdictions in Canada requires that employers and pension plan sponsors provide to employees the following comprehensive information about the RPP:

- a written explanation of the plan's terms and conditions and the member's rights and duties;
- on termination of membership in the plan (including retirement), a written statement of the value of the member's contributions, pension entitlements, death benefits and transfer options;
- an annual statement showing the employee's accrued pension benefits, and the funded position of the pension plan
- access to the full text of the plan as well as actuarial reports, annual information returns and financial statements of the plan.

Many employers have gone beyond these requirements to actively market the features of the plan as a strategy to retain employees.

A goal of tax policy since the late 1980s is to ensure that the total amount of tax-assisted savings for retirement is the same regardless of whether the saving is entirely through RPPs, entirely through RRSPs, or through a combination of the two. However, this is implemented somewhat differently for defined-benefit and money-purchase RPPs.

For money-purchase plans, the aggregate limit on combined employer and employee contributions is 18% of employee earnings, subject to a dollar cap of $13,500 for 2001. This is scheduled to rise to $14,500 in 2004 and $15,500 in 2005, and after 2005 is to be indexed to the average wage. However, increases in these limits have been deferred several times, and these increases could be no exception.

For defined-benefit plans, the limit is imposed not on amounts that can be contributed to the plan but instead on the maximum pension that can be received on retirement. Contributions to fund that pension are then left to be actuarially determined. Generally speaking, the maximum defined benefit is calculated as 2% of the employee's income, usually an average of the employee's income for the last 3 to 5 years, times the number of years of service. The maximum pension is the number of years of service multiplied by the lesser of 2% of the employee's income and $1,722 per year and cannot exceed $60,728 annually. This is known as the "pension cap". To receive the maximum pension an employee would have to earn employment income of $86,111.

Every year, an RPP must calculate for each of its members the current-year equivalent of the pension to be received in the future. This amount is called the "pension adjustment", and it reduces the amount of money the employee can contribute to an RRSP below the normal limit of the lesser of $13,500 and 18% of earned income. Thus an employee who has a pension plan which is less generous than the permitted maximum may also contribute to an RRSP.

The pension adjustment of a money-purchase plan is simply the sum of the employer and employee contributions. For defined-benefit plans, the pension adjustment is calculated from the amount of pension promised in the future by applying a set of assumptions. The key assumption is the "factor of 9", which assumes that $9 saved as a lump-sum in a person's working life will generate an annual pension income of $1 per year in the future.

An employee who terminates employment with a particular employer may not actually receive as much pension benefit in the future as assumed in calculating the pension adjustment. In particular, an employee who has served less than two years will typically receive only his or her own contributions back. Thus employees who terminate employment before retirement may be entitled to a "past service pension adjustment" which restores some of the RRSP contribution room taken away through the pension adjustment.

The pension cap has not been raised since 1976; in relation to the average wage, it has declined by more than 70% since that time. During that time RRSP limits have remained relatively constant relative to the average wage, so there is now rough equality between the two methods of saving for retirement.

Although equality between saving through RPPs and RRSPs is generally fairly close to being achieved, there are significant problems:

- there is no RPP equivalent to the spousal RRSP, which allows withdrawals to be taxed to the spouse of the contributor rather than to the contributor;
- RPPs are subject to “lock-in” requirements under pension standards legislation preventing withdrawal prior to retirement, while RRSPs are not;
- the pension cap allows higher pension to be paid through a defined-benefit RPP than is generally possible through an RRSP or a money-purchase RPP (equality would require a $15,500 annual limit for these plans instead of the current $13,500); and
- many aspects of pension plan design are not taken into account in the factor of 9, so individuals who belong to defined-benefit pension plans with significant ancillary benefits (indexing, early retirement benefits, etc.) are effectively allowed a much higher contribution limit than other individuals.

Most observers agree that equality between the two methods of saving for retirement is a desirable goal. Thus, the issue is not whether the pension cap alone should be raised but whether the pension cap and RRSP limits should jointly be raised.

II.1.c) Volume of required/subsidized contributions to this scheme

The dollar limits to contributions have been discussed in II.1.b) above.

There are no rules specifying any minimum percentage of benefits or contributions that must be paid for by the employee. In fact, legislation requires that the employee cannot pay for more than 50% of RPP benefits. To implement this “50% rule”, a calculation is done for each employee at retirement and any excess payments by the employee are refunded.

A wide variety of arrangements are seen in practice. Plans involving equal contributions by employee and employer are common, but employer-pay-all plans are also frequently seen. Some evidence that employers pay on average more than half of benefits is provided by a survey of money-purchase plans by the Financial Executives Institute Canada; the mean percentage of basic salary contributed by employers vs. employees is 3.5%vs. 2.7% respectively for incomes up to about $35,000, and 4.6% vs. 3.5% above that.

II.1.d) Nondiscrimination regulations

These are very limited in Canada. As noted in II.1.a) above, when an RPP does exist, pension standards legislation generally requires that every full-time employee who belongs to the class of employees for whom the plan was established must be allowed to join the plan. It is permissible to have different pension plans for different classes of employees and to have to pension benefits vary widely among them. It is even possible to create a one-person pension plan for the company president with enriched pension benefits. However, the terms and conditions of the plan cannot differ according to the gender of the member.

II.1.e) Providers

Pension standards legislation requires that the employer or pension plan sponsor appoint a custodian to hold the investments for the benefit of plan members and execute any trades of securities. The trustee cannot be the employer.

The investment decisions of the RPP may be made by employees of the plan sponsor or by an investment manager. The investment manager need not be a bank or insurance company and in fact is often an investment counselling firm. For money-purchase plans, it is also possible for employees to be given the right to choose the investments held on their behalf. Few RPPs permit this degree of employee choice, however; a more usual choice would be an asset-allocation choice of proportions in equity vs. debt.

II.1.f) Permitted financial products

Pension standards legislation does not generally regulate the specific classes of investments allowed but instead imposes a "prudent portfolio" rule and a "prudent person" rule. Under the "prudent portfolio" rule, a pension plan sponsor must: establish a written investment policy, respect certain quantity restrictions on investments, such as that a maximum 10% of the book value of plan assets may be invested in one entity (except for government issues or insured deposits); and act in consideration of the overall context of the overall investment portfolio, without undue risk of loss and with a reasonable expectation of a fair return. The "prudent person" rule also requires that the people involved in making investment decisions for the plan must exercise the care, diligence and skill in the investment of the funds that a person of ordinary prudence would exercise in dealing with the property of another person. Penalties apply to persons who make investment decisions which do not respect these rules.

Tax law imposes a requirement that no more than 30% of the book value of the pension fund can be invested in foreign property. This foreign property rule applies equally to RPPs and RRSPs. Tax law also requires an RPP cannot invest in shares of the employer unless those shares are publicly-traded.

II.1.g) Ensuring retirees can rely on assets in old age

Pension standards legislation in most jurisdictions requires that pension rights vest after two years of service. However, Alberta has a five-year vesting requirement. The pension rights which vest are whatever is provided under the terms of the pension plan, which may or may not be indexed to inflation. Generally, very few private-sector plans are indexed to inflation, although indexing to the Consumer Price Index is common in public-sector RPPs.

These time limits are also the times at which the member's contributions become locked-in and cannot be taken as cash on termination of employment. Instead, the amounts are either taken as an immediate or deferrred pension or are transferred into a LIRA. Withdrawals from LIRAs are discussed in connection with RRSPs, since they are a type of RRSP.

Pension plan rights are not subject to distribution in bankruptcy proceedings, nor can they be pledged as collateral for loans. Pension plan rights may be split on the dissolution of a marital or common-law relationship, however.

For defined-benefit RPPs, the employer or pension plan sponsor is financially liable to meet the pension plan's payment obligations if the pension fund has insufficient assets. If the sponsor is insolvent, one jurisdiction – Ontario – provides for a guarantee fund (the Pension Benefits Guarantee Fund) that will attempt to cover the shortfall.

Ontario, like other jurisdictions, imposes funding requirements on pension plans that generally have been adequate to insure that pensions are fully funded and the guarantee fund is not needed. However, there is a "too big to fail" clause which allows corporations with over $500 million of assets to provide for less than full funding of certain types of pension obligations. Currently, there are concerns that one such corporation in financial trouble might cause a big draw on the guarantee fund.

II. 2: The withdrawal phase

II.2.a) Withdrawal

The only means of withdrawal of funds from an RPP is the payment of funds under a life annuity. According to pension standards legislation, guarantee periods are allowed, but a term-certain annuity is not allowed. Annuities must also be of the joint-and-last-survivor type with a minimum 60% payment to the survivor if the employee has a spouse or common-law partner at the time the payments begin. These requirements can be lifted if the spouse or common-law partner agrees in writing. The annuity may provide for automatic percentage increases or it may be indexed to actual inflation, but neither form of indexing is required by law and few pensions provide it.

Pension law does not specify a mandatory starting time for pension payments. However, tax law requires that payments must start before the end of the calendar year in which the employee turns 69. Most pension plans specify that pension payments must start within the few months following the normal retirement date under the pension plan unless the member continues working for the employer after that time.

Tax law allows RPPs to provide for an unreduced pension on retirement as early as age 60 or when the age plus the number of years of service totals 80 or more.

Funds in an RPP may also be transferred to an RRSP under certain conditions. Portability requirements in pension standards legislation require that if the termination of employment is earlier than age 55, the employee must be given the choice of transferring the funds to a LIRA (which is a type of RRSP). Certain employers allow this transfer after this time, even including the time of retirement. The withdrawal options available under a LIRA are discussed in connection with RRSPs above.

II.2.b) Need for annuitization

As discussed in the previous section, the only means of withdrawal of funds from an RPP is the payment of funds under a life annuity.

II.2.c) Permitted design of annuities

This is discussed in section II.2.a) above.

II.2.d) Reduction of public benefits

As described in Section I and further in connection with the similar section for RRSPs, there is an income-tested element of old age assistance (the Guaranteed Income Supplement) that is sharply reduced by the receipt of any income including income from an RPP. In addition, the basic old age entitlement (Old Age Security) is also "clawed back" as such income is received, albeit at a much slower rate than the GIS clawback and only for those with relatively high incomes. Nonetheless there is no doubt that RPP income contributes to the reduction of means-tested public benefits.

II.3) Experience

The relevant section on RRSPs above discusses RPPs also.

One current issue that has not been resolved is the ownership of pension plan surplus. Can it be withdrawn by employers to meet current cash needs? On wind-up or termination of the pension plan, can it be withdrawn by the employer or must it be used to finance enhancements of benefits to employees? These issues are unsettled and are the subject of current consultations with the pension regulatory authority in Ontario.

III Financial Education Policies

III.I.1 Financial Education Programs

Financial Literacy Programs

There are no compulsory financial education programs in Canada. Education in Canada is the responsibility of the provincial governments and thus there is no national policy on financial education. Each province may offer some courses involving financial literacy at the high school or higher education level, but these are not a mandatory part of a student's education. In Ontario for example, non-compulsory guidelines have been issued this year for two high school economics courses which involve financial education to some degree. (See Public District School Board Writing Partnership, 2001.) The course aimed at students who will go on to higher education may involve a student selecting an investment portfolio and the course for students who will enter the workplace after high school may involve a student's theoretical purchase of a major asset such as an automobile.

Retirement Income Planning/Education Programs

As with financial literacy programs, there are no compulsory retirement income planning programs. The high school course guidelines outlined above do not specifically consider retirement planning. Large-sized corporations may make financial and retirement planning programs available to their staff, particularly to downsized or retiring employees, but they are not required to do so.

Given the popularity of the RRSP program in Canada, many financial companies offer free-of-charge seminars on RRSP investment and other retirement planning issues. These seminars are not regulated in any way and may be viewed more as a sales promotion device than as an education service. There is also much written on RRSPs in the press and there are numerous books authored by qualified professionals available on RRSPs and retirement planning for the interested consumer.

III.I.2 Research on Financial Education and Old-Age Income Planning Issues

Since there is so little that could be called "financial education" in Canada, research on financial education issues is similarly lacking. The majority of Canadians learn about financial and retirement issues through the media or through the numerous books available. Excellent quality publications in this area may be found (examples listed in Part V) but of course the difficulty for the less-than-expert consumer is to distinguish these volumes from the proliferation of less reliable, "get rich quick" offerings on the market.

IV: Personal Assessment

Time Trends in Expenditure

In 1978, Canada's retirement income system was heavily tilted towards government demogrants: of the $29.2 billion in pension income, 52.2% came from OAS/GIS, 16.9% came from the CPP, and 30.9% came from RRSPs and RPPs. With the increasing maturity of the CPP, RRSPs and RPPs, by 1998 there was both tremendous growth in the total amount of pension income and a big change in the shares: of the $95 billion in pension income, 25.1% came from OAS/GIS, 25.2% came from the CPP, and 49.8% came from RRSPs and RPPs.

Tax assistance is less costly than providing public pension income. It is estimated that retirement income provided through RPPs and RRSPs costs the government less than half the cost of directly providing the same amount of pension income through OAS/GIS.

Replacement Rates

A typical calculation of replacement rates is in Banting and Boadway (1996, p. 7). Their graph shows that *public program* post-retirement income is about 80% of *all* pre-retirement income for a single person household earning about $20,000, the lowest income they consider. For a single-earner two-person household at that income range, the public program replacement rate is 110%. Considering that in retirement the expenses associated with a job are removed, that some products (public transit, prescription drugs, some entertainment expenses) are provided at a discount to senior citizens and that even the lower-income older population may have some assets and private sources of income, it is clear that for many in Canada, reaching a sufficient age to enter the public programs is one way to exit poverty. Indeed Canadian poverty rates in the older population are very low: Smeeding (2001) uses one measure to calculate them as 5.3% compared to 7% for Germany, 13.7% in the United Kingdom and 20.7% in the United States. In Smeeding's table only Finland and Sweden are clearly superior. However, overall poverty rates in Canada are relatively high at 11.9%, still much lower than the U.S. at 16.9% but far in excess of Germany's rate of 7.5%.

But the Banting and Boadway table also shows that public program replacement rates fall sharply with income: public programs benefit those with low incomes much more than they benefit those with high incomes. For those in the bottom income quintile of the older population, about two-thirds of their income is OAS/GIS (that is noncontributory public transfers) and just under one-fifth is from the public contributory pension plan (CPP). For the top quintile, less than one-fifth of income comes from both sources combined. The calculations of Sabelhaus (1997) show that the tilt of such programs towards the assistance of low-income elderly is much larger in Canada than in the United States.

The recent Statistics Canada survey (1999, 2001) finds that the median net worth is about $227,000 for economic families of two or more headed by 55-64 year olds and $202,000 for similar economic families headed by those 65 and over. This does not seem a large drop. For unattached individuals, median net worth for those

65 and over is $85,000, actually higher than median net worth for those 55-64 of $53,000. The results of Lin (2000) provide much of the answer: her evidence is that even making adjustments for higher mortality, mean and median saving rates *for individuals in all income quartiles* <u>*rise*</u> *after age* 65, sometimes with a lag of two or three years. While income falls, expenditure falls more. She finds that while many types of expenditure fall during the retirement period (especially alcohol, tobacco, private transportation and restaurant meals), gift-giving and charitable contributions increase markedly.

The overall picture which emerges is that the financial position of those in households in which there has been a retirement from a low-income position on average does not decline and probably improves. The situation is much more mixed at higher levels of income although the increase in saving rates at all income quartiles and the increase in gift-giving and charitable contributions is suggestive that the financial position of many such households does not decline.

Tax Changes

The pace of tax changes has been slow and it is our opinion that the frequency of changes in tax/benefit programs has not been a serious deterrent to saving. There are three relatively recent episodes worth mentioning.

First, Canada had a major period of tax reform in the late 1980s. The changes had very little effect on the low-income older population. Very high income members of the older population probably benefited by a reduction in marginal tax rates. However, an offsetting effect was the introduction of the clawback of the OAS for higher income individuals discussed in Section I.

Second, as mentioned in Section I, in the mid-1990s, the government proposed a plan called the “Seniors Benefit” to change the structure of the OAS/GIS noncontributory transfers to the older population. The designed changes would have had very little effect on the low-income older population but would have cut the benefits for high-income seniors, particularly those in couples with asymmetric incomes. No change was proposed for existing recipients or for those within five years of retirement. These proposed changes were subsequently withdrawn.

Third, as it became clear the contributory Canada Pension Plan was not actuarially sound, the government simply introduced a package that was essentially an increase in payroll taxes, paid by both employers and employees. Changes in the benefit structure were extremely minor. These changes have been almost noncontroversial.

In sum, the pace of change has been slow. The guiding principles of any change appear to have been that (1) no significant change should be imposed on existing recipients, except perhaps those at higher incomes (2) even with respect to future recipients, any reductions should only affect those at higher incomes.

The most significant pressure for change at the present time is to increase the $13,500 dollar cap on RRSP contributions to the $15,500 level needed to achieve equality in the amount of retirement saving permitted under defined-benefit RPPs.

There is also pressure to increase the pension cap, which has not been increased for 25 years despite considerable inflation eroding its value. Presumably the dollar limit on RRSP contributions would be increased beyond $15,500 in tandem with this increase so as to preserve equality between the amounts of tax-assisted savings permitted under different vehicles. The issue about raising these limits has arisen partly because many middle-level managers are now affected by them, and partly due to comparison with the US tax system, which offers far more generous retirement savings limits than Canada does (particularly for defined-benefit pension plans).

Another significant area of pressure is to increase the types of situations in which RRSP funds can be withdrawn without tax. Schemes have already been introduced to allow this for first-time home purchase and to go back to school. There seems to be little basis on which to hold the line to these two purposes, and further pressure can be expected for other worthy financial needs. Ultimately, the RRSP may become an all-purpose savings plan rather than a plan which provides for retirement income.

General Assessment

Perhaps the greatest Canadian public policy accomplishment of the last fifty years has been the reduction of the rate of old age poverty. Using the numbers of Banting and Boadway (1996, p. 7), an old age poverty rate of over 40% (about double the total population poverty rate) in 1969 had been reduced by the 1990s to about 5% (about half the total population poverty rate). Noncontributory transfer programs were the key to this change, in particular the introduction of the GIS scheme for the low-income elderly.

However, the cost of these programs was reduced by the high rate of clawback, particularly for the GIS, so that strong work disincentives have been created. There are also strong saving disincentives, but these are probably less important because the low-income population typically has a low rate of saving in any case.

We think there are two issues which are critical. First, because of the aging of the population, without changes the cost of the OAS/GIS program will rise, perhaps doubling in real terms over the next 25 years. Because occupational pension coverage is low in Canada and registered retirement saving plans are typically owned by higher income individuals, it is unlikely that saving from those sources will reduce the public obligations under the means-tested GIS. One way to reduce GIS costs will be to require compulsory saving of some sort, either through the Canada Pension Plan or through Registered Retirement Savings Plans. The government would still have to make contributions for those with insufficient income. But the transition arrangement would be key: it is easy to imagine that such a scheme could be introduced in such a way that would increase rather than reduce public costs.

Second, the Canadian system has not indexed its age parameters to longevity. One of the reasons for the greater expense associated with public programs is the wonderful news that people are living longer. However Denton and Spencer (2000) point out that centering the public system on age 65 will become more and more inappropriate (and expensive) as the number of years of both life and healthy life increase.

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