CALEDON INSTITUTE OF SOCIAL POLICY

caledon commentary

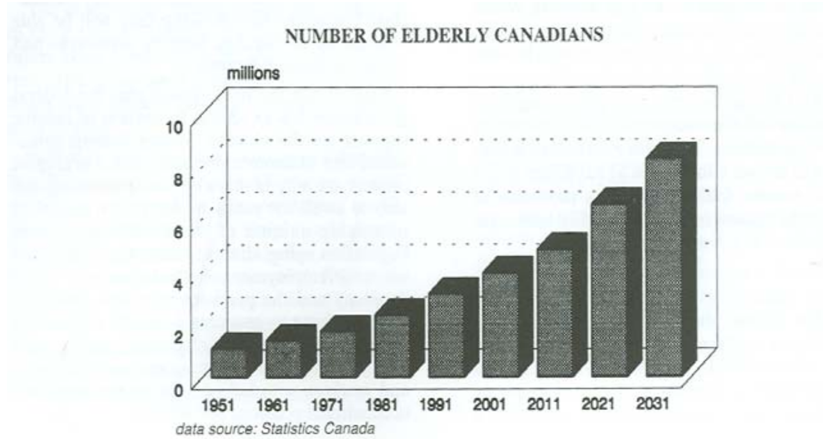
October 1993 ISBN # 1-894159-39-X

Thinking the Unthinkable: A Targeted, Not Universal, Old Age Pension*

In 1989, the federal government effectively abolished universal child and elderly benefits by taxing back all of the family allowances and Old Age Security benefits from upper-income parents and pensioners by means of the 'clawback.' In 1993, Ottawa went even further: it formally ended universal child benefits by eliminating family allowances and replacing that program (along with the refundable and non-refundable child tax credits) with a new child tax benefit geared to low- and middle-income families.

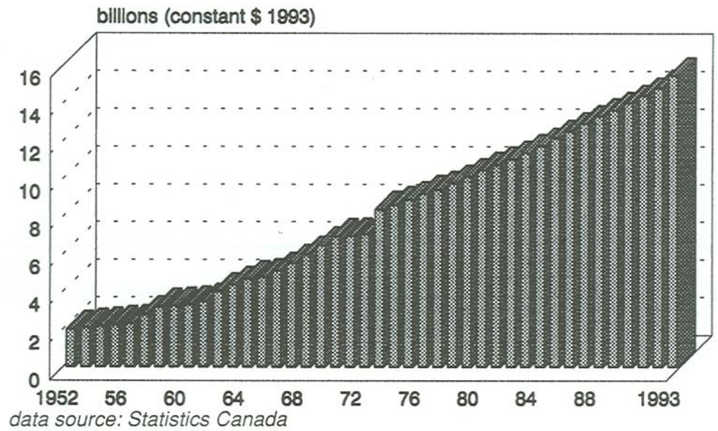
The new superministry of Human Resources and Labour should do the same to the Old Age Security (OAS) program. It should replace OAS and the various other income security and tax benefits for the aged with a single program targeted to low- and modest-income seniors. (These benefits should not be confused with the Canada and Quebec Pension Plans, to which all Canadians in the paid labour force contribute and which would be untouched by this proposal.)

Number of Elderly Canadians



Published in edited form as "How to subsidize tomorrow's seniors" in Commentary Page, The *Globe and Mail*, July 29, 1993.

Old Age Security Payments



In 1951, during the baby boom, only 1.1 mil-lion Canadians (7.8 percent of the population) were 65 and older. By 1991, when the baby boomers were reaching middle age, the elderly had increased to 3.2 million or 11.6 percent of the population. Recent projections from Statistics Canada put the aged at 6.6 million or 18.6 percent of Canadians in 2021 and 8.3 million or 22.7 percent by 2031, when the baby boomers of the late 1940s and early 1950s – who will live longer on average than previous generations of the elderly – will become the seniors boom of the early decades of the 21st century.

The relentless increase in the number of seniors is the single most important cause of rising social spending. The largest income security program for the aged is Old Age Security, which is paid out to all Canadians 65 and older, though a portion of the cost is recovered through income taxes and the clawback. In its first fiscal year, 1952-53, Old Age Security paid out just under $2 billion (in inflation-adjusted 1993 dollars) to 671,240 pensioners. This year (1993-94) the program will deliver a forecasted $15.0 billion to 3.3 million seniors. Old Age Security payments in 2036 could amount to a staggering $38 billion (in 1993 dollars) to 8.6 million recipients.

Granted, a larger share of future Old Age Security pensions will be recovered than at present. The income threshold at which the clawback begins – a threshold only partly protected from inflation – will decline steadily, and will remove benefits from an increasing number of middle-income seniors in future. Caledon's recent report, *Federal Social Programs: Setting the Record Straight*, esti-mated that the income threshold for the clawback on Old Age Security will have fallen from $50,000 in 1989 to $23,000 (in inflation-adjusted 1989 dollars) by 2020 and will take back the entire old age pension from seniors with incomes above $49,000.

But this is no reason to stick with the status quo of a pretend-universal old age pension. The political optics of burgeoning public pension costs are bad. Because social expenditures are reported in gross terms, rather than after-tax and after-clawback, future increases in Old Age Security payouts will appear even greater than they actually are. The clawback is bad public policy not because it reduces costs – we need to do that – but because it deceives many middle-class Canadians into thinking they will be able to count on an Old Age Security pension as part of their retirement income.

Cost is not the only reason that the federal government has to reform its system of income support for the elderly. Strong demographic, social and economic pressures are working in concert not only to drive up social spending, but also to swell the ranks of the future poor – an increasing number of whom will be elderly. Population aging, divorce, mass unemployment and underemployment, the turbulent new world economy and the persistence of low-paid jobs are conspiring to condemn a sizable segment of Canadian society to poverty in old age because existing public pension programs are inadequate and workers with below-average earnings lack occupational pensions and RRSPs.

We must act now to take the steps necessary to strengthen public pensions so that they will be able to assure a decent basic income to future elderly Canadians in need.

The answer is not simply to rescind the clawback and return to the pre-1989 era of a truly universal old age pension. Canada no longer can afford to pay Old Age Security to every senior regardless of income. We have to scrap OAS itself, as part of a wholesale restructuring of income support for the elderly, in a manner that will protect – indeed improve – benefits guaranteed to lower-income seniors who are wholly or mainly dependent on government assistance.

There is a lot of money that can be put on the table in designing a new income security system for the elderly. Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance together total $20 billion. The income tax system also pays out significant benefits to the aged and to taxpayers who are saving for their retirement. The age credit is worth about $1 billion and the pension income credit another $250 million. Much more costly tax breaks are the deductions for contributions to Registered Pension Plans ($3.6 billion) and RRSPs ($2.8 billion), which totaled $6.4 billion in 1989, the latest year for which the Finance Department has published data. The cost of the RRSP deduction will be much higher when the figures for 1993 are made public, since the ceiling for RRSPs is being raised substantially. The tax deductions for RPPs and RRSPs benefit upper-income Canadians most, who least need state assistance to feather their retirement nests.

The objective of reform should not simply be to rejig this $27 billion-plus spending, since future costs would keep escalating out of control. The program I propose would restrain future costs, since it would be targeted to seniors most in need.

Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance, as well as the age credit and the pension income credit, should be replaced by a single, adequate, income-tested program (along the lines of a larger Guaranteed Income Supplement). This new program would pay its maximum benefit to low and modest-income persons aged 60 and older, with partial and diminishing benefits available to middle-income seniors. Both benefits and the income threshold must be fully indexed to the cost of living.

The choice of the benefit rate, the income threshold for maximum benefits and the income level at which partial benefits end would be a crucial and tough decision. Projections as to future private pension income (from occupational pension plans and RRSPs) available to seniors at different income levels must be taken into account in designing the new program. It would have to determine what constitutes a decent income floor for the aged. And the new scheme would have to be phased in gradually so as not to hurt Canadians near or in retirement.

While no government would dare to abolish tax assistance for contributions to private pension plans and RRSPs, at least these deductions (which pay their largest benefits to upper-income taxpayers) could be converted to credits, which are less costly and fairer (they would pay the same maximum amount to all claimants, regardless of their income).

In line with the new "politics of inclusion," extensive public consultation would be essential for such a bold and controversial reform.

Ken Battle

The Caledon Institute of Social Policy
1600 Scott Street, Suite 620
Ottawa, Ontario, Canada
K1Y 4N7

Phone: (613) 729-3340
Fax: (613) 729-3896
E-mail: caledon@caledoninst.org
Website: www.caledoninst.org