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Strengthening the Foundations of Canada's Pension System:

A Review of the Old Age Security Program

by

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Introduction

Pension systems are established to achieve two fundamental objectives: ensuring a minimum income to seniors (often referred to as poverty alleviation) and assisting seniors to maintain pre-retirement living standards after retirement (usually designated as income replacement).

In order to meet these objectives, Canada has developed a pension system consisting of three pillars:

- The Old Age Security (OAS) program, which provides a minimum income to most Canadian seniors;

- The Canada Pension Plan (CPP), which along with its counterpart program in Quebec, the Quebec Pension Plan (QPP), replaces part of the earnings lost on retirement or in the event of the disability or death of a contributor. Because contributions to, and benefits from, the Canada and Quebec Pension Plans are based only on earnings up to a maximum equal to the average industrial wage, the Plans are especially important to persons with earnings at or below the average in meeting the income-replacement objective; and

- Voluntary tax-assisted mechanisms for retirement savings, in the form of occupational pension plans[1] and individual retirement savings accounts, which provide further means of replacing pre-retirement income, particularly (but not exclusively) for persons with incomes above the average.

During the past five years, to the extent that the pension system has received any attention at all in Canada, the focus has primarily been on occupational pension plans and, in particular, on the funding problems that many defined benefit (DB) schemes have encountered. The Caledon Institute of Social Policy has published several studies examining aspects of these problems [Baldwin 2007a and 2007b; Tamagno 2006a].

There is a widely held, largely implicit assumption that Canada's public pension programs – Old Age Security and the Canada and Quebec Pension Plans – are working well and do not require modification. This assumption is, in large part, based on fact. Canada's public pension programs *are* working well, and they contribute substantially to achieving the two fundamental objectives of the pension system:

- *Poverty alleviation*: Along with the maturation of tax-assisted mechanisms for retirement savings and the increased labour force participation of women during the last quarter century, public pension programs have resulted in a dramatic reduction in poverty among Canadian seniors. In 1980, 21.3 percent of seniors in Canada had incomes below Statistics Canada's after-tax low-income cut-offs.[2] By 2004, this had been reduced to 5.6 percent[3] [Statistics Canada 2007; Tamagno 2006b]. Canada has one of the lowest rates of seniors' poverty among industrialized countries, ranking third lowest behind only Sweden and Finland [Jesuit and Smeeding 2002].

- *Income replacement:* Based on both statistical and anecdotal evidence, most Canadian seniors are able to maintain a standard of living in retirement which is comparable to that which they enjoyed before retirement. For example, in 2005 (the most recent year for which Statistics Canada data is available), senior families consisting of two or more persons[4] had average incomes equal to 67 percent of non-senior families. Among senior men and senior women living alone, the comparable percentages were even higher – 85 percent for men and 87 percent for women [Statistics Canada 2007]. The usual benchmark for maintaining pre-retirement standard of living is a retirement income in the range of 60 to 70 percent of that before retirement.

While the figures just cited provide only a crude measure of income replacement – for example, they are not based on longitudinal data that tracks families and individuals over time, nor do they take account only of seniors' pension income – they nonetheless provide a strong indication that Canada's retirement income system, overall, is meeting its income-replacement objective.

The fact that Canada's public pension programs are working well today does not, however, mean that those programs are as effective as they could be, nor that those programs will necessarily continue to work well in the future. Pension programs are, by their nature, complex in and of themselves. Their complexity is increased by the multitude of ways in which they interact with the economy and society in which they operate. Changes to programs, even seemingly small ones and those made with the best intentions, can have unforeseen and sometimes undesirable consequences. Exogenous factors can likewise have major effects on pension programs, especially if those factors are inadequately evaluated or ignored altogether until their effects trigger alarm bells.

It would, therefore, be a mistake to assume that, because Canada's public pension programs work well today, there is no need to consider modifications to those programs to make them work even better and to equip them to adapt more effectively to the changing social and economic environment in which they operate.

The purpose of this paper, one of two which the Caledon Institute will publish, is to describe and evaluate several possible modifications to the Old Age Security program. A second paper, to be published in 2008, will examine possible changes to the Canada Pension Plan.

The paper starts with a brief, high-level description of the Old Age Security program and the important part it plays in the incomes of Canadian seniors. It then discusses five issues concerning the program that warrant consideration. At the conclusion of the discussion of each issue, the paper gives a recommendation.

An overview of the Old Age Security program

The Old Age Security program is the cornerstone of Canada's pension system. Dating back to 1952, when it replaced an earlier program that began in 1927, OAS is a classic example of the

incremental, pragmatic way in which the Canadian pension system has been built and has evolved over the years.

The original 1952 program consisted only of a modest, universal pension – the basic OAS pension – paid to all persons in Canada aged 70 and over who met the conditions of residence. It is virtually impossible to say whether, in 1952, the primary objective of the basic OAS pension was poverty alleviation or income replacement. Given the high rates of poverty among seniors at the time and the limited coverage of occupational pension plans, it served both purposes.

The basic OAS pension continues to be paid today. However, the benefit, and the program of which it is now only one component, have changed significantly during the past 55 years.

The first major change to the OAS program was enacted in 1965. As part of the legislation establishing the Canada Pension Plan, the age of entitlement to the basic OAS pension was lowered one year at a time, starting in 1966, until it reached its current level of 65 in 1970. Since 65 was also the age of entitlement to a CPP retirement pension, this became the de facto 'normal' retirement age in Canada.

In 1967, in the face of continued high rates of poverty among Canadian seniors, an income-tested benefit, the Guaranteed Income Supplement (GIS), was added to the OAS program. Entitlement to the Supplement followed automatically from entitlement to the basic OAS pension, provided the income of a pensioner or, in the case of a couple, the couple's combined income was sufficiently low. A simple income test was adopted to ensure there would be no stigma to receipt of the Supplement.

The Guaranteed Income Supplement was originally intended to be a temporary benefit, payable only until 1976 when the first full retirement pensions would start to be paid under the Canada and Quebec Pension Plans. However it quickly became clear that, while CPP and QPP retirement pensions would significantly reduce the incidence of low income among seniors, there would still be many seniors in poverty. As a consequence, in 1970 the Supplement was made a permanent part of the OAS program.

The introduction of the Guaranteed Income Supplement in 1967 and the decision in 1970 to make it permanent were major milestones in the evolution of the OAS program. Together, they marked the point at which poverty alleviation became the program's dominant objective.

The primacy of this objective was reinforced in 1975 when a second income-tested benefit, known originally as the Spouse's Allowance and now simply as the Allowance, was added to the OAS program. This benefit was originally payable only to spouses aged 60 to 64 of pensioners eligible to receive the basic OAS pension and the Guaranteed Income Supplement. In effect, it ensured that such couples would have the same minimum guaranteed income as couples both of whose members were eligible for the basic OAS pension and the Supplement. The Spouse's Allowance was extended in 1978, 1979 and 1985 to include widows and widowers aged 60 to 64.

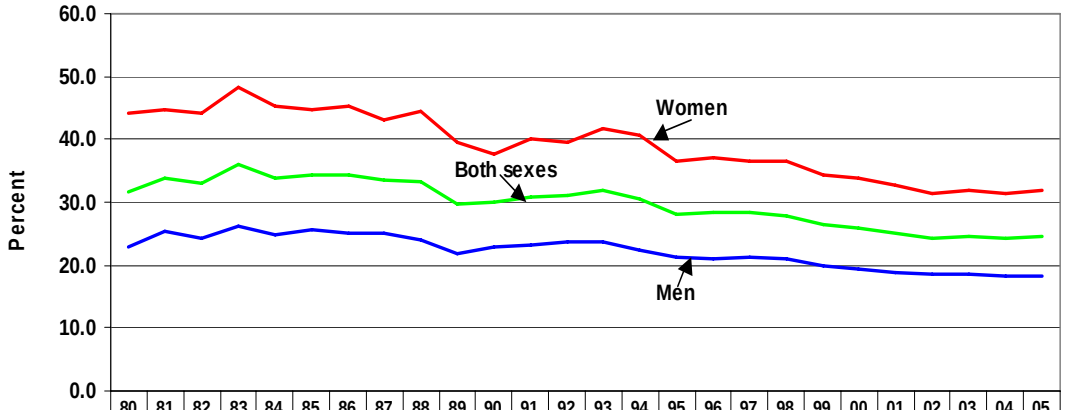
The most recent milestone in the evolution of the OAS program occurred in 1989. It was the introduction of a surtax, popularly called the 'clawback', applicable to high-income recipients of the basic OAS pension. Beneficiaries with high personal incomes – in 2007, those with incomes above a threshold of $63,511[5] – must repay part of their basic OAS pension. The amount of the repayment is equal to 15 percent of the portion of income above the threshold, up to a maximum equal to the entire basic OAS pension. About five percent of all seniors are affected by the clawback, and about two percent of seniors must repay their entire basic OAS pension.

In spite of the relatively small proportion of seniors affected by the clawback, its introduction nonetheless marked the effective end of the basic OAS pension as a universal benefit. The introduction of the clawback also further reinforced poverty alleviation as the principal objective of the OAS program.

For the period October-December 2007, the basic OAS pension is $502.31 a month. The maximum monthly Guaranteed Income Supplement is $634.02 for a single pensioner, and $418.49 for each spouse or partner in a senior couple. As a result, a single pensioner (a senior living alone) is ensured a minimum income of $1,137.33 a month, and a pensioner couple is ensured a minimum monthly income of $1,841.60. All benefits under the Old Age Security program are indexed quarterly, in January, April, July and October, in line with increases in the Consumer Price Index.

Since its inception, the Old Age Security program has played a crucial role in the income of Canada's seniors. It continues to play such a role. Figure 1 shows the percentage of the aggregate

Figure 1
Total benefits from the OAS program as a percentage of the aggregate income of seniors, by sex, 1980-2005



	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05
Both sexes	31.7	33.9	33.0	35.9	33.8	34.4	34.2	33.5	33.2	29.7	29.9	30.8	31.1	31.8	30.5	28.2	28.3	28.2	27.9	26.5	25.9	25.1	24.4	24.5	24.3	24.4
Women	44.1	44.8	44.2	48.4	45.2	44.7	45.4	43.2	44.4	39.4	37.6	40.0	39.7	41.7	40.6	36.4	37.2	36.6	36.6	34.5	33.7	32.6	31.3	31.8	31.3	31.9
Men	22.8	25.3	24.2	26.1	24.7	25.7	25.1	25.0	23.9	21.7	22.9	23.1	23.7	23.6	22.3	21.2	21.0	21.3	20.9	19.9	19.4	18.9	18.4	18.4	18.4	18.4

Source: Statistics Canada 2007

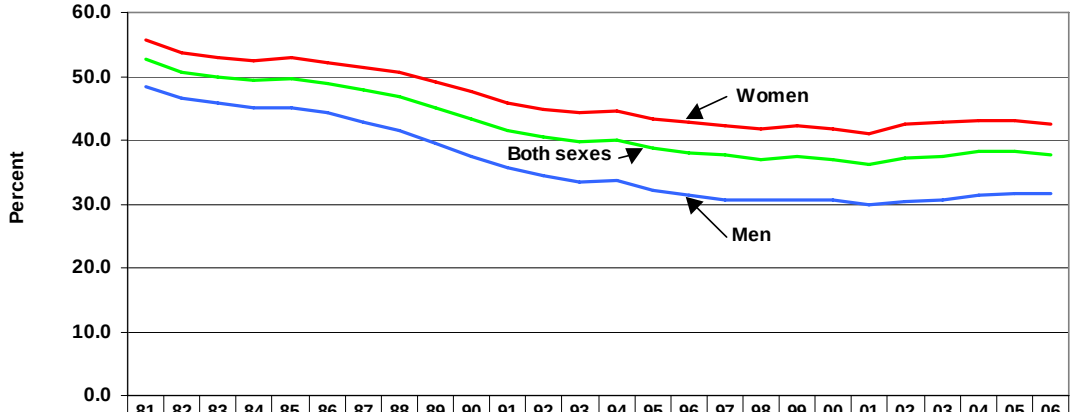
income of seniors that is derived from the OAS program. Data is given for all seniors taken together, and for older men and women separately, for the 25-year period from 1980 to 2005.

In 2005 the OAS program provided one-fourth of the aggregate income of seniors. The program is especially important for senior women, who derive almost one-third of their income from it. For senior men, the comparable amount is less than one-fifth. The greater proportion of income from OAS for senior women is due to the fact that their incomes, on average, are lower than the incomes of senior men. As a result, senior women have greater entitlement to the Guaranteed Income Supplement. This is examined in more detail in Figure 2.

The portion of the income of seniors derived from the OAS program has declined significantly over the past 25 years, from a high of 35.9 percent in 1983 to 24.4 percent in 2005. This has been due primarily to the maturation of the other parts of Canada's pension system – the Canada and Quebec Pension Plans, occupational pension plans, and tax-assisted retirement savings accounts (Registered Retirement Savings Plans, or RRSPs for short). The decline has been most dramatic for senior women, who derived almost half (48.4 percent) of their income from the OAS program in 1983 but less than a third (31.9 percent) in 2005. While senior women continue to lag behind senior men in terms of income, the gap has narrowed.

Figure 2 shows the percentage of seniors, by sex, who receive a Guaranteed Income Supplement in addition to the basic OAS pension. The data is for the period from 1981 to 2006 (figures are for June of each year).

Figure 2
Percent of seniors
who receive the Guaranteed Income Supplement, by sex,
1981-2006



	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06
Both sexes	52.6	50.7	49.9	49.4	49.5	48.9	47.8	46.8	45.2	43.3	41.5	40.4	39.7	39.9	38.7	37.9	37.6	37.0	37.4	37.0	36.2	37.3	37.5	38.1	38.1	37.8
Women	55.7	53.8	52.8	52.5	52.9	52.3	51.4	50.6	49.2	47.5	45.7	44.7	44.2	44.5	43.4	42.7	42.4	41.7	42.2	41.7	40.9	42.6	42.8	43.1	43.1	42.6
Men	48.5	46.6	45.8	45.2	45.0	44.2	42.8	41.5	39.6	37.5	35.6	34.3	33.5	33.6	32.2	31.4	30.5	30.5	30.7	30.5	29.8	30.4	30.6	31.5	31.6	31.5

Source: HRSDC 2007

As already noted, and as confirmed in Figure 2, a greater proportion of senior women receive the Guaranteed Income Supplement than senior men. This has always been the case. In fact, the gender gap in entitlement to GIS has grown over the years, from about seven percent in 1981 to 11 percent in 2006.

Of equal, and perhaps greater, significance, the rates of entitlement to GIS for both men and women have declined over the past quarter century. This reflects the overall higher income of Canada's seniors today than was the case 25 years ago, due to the reasons that have already been cited.

The rates of entitlement of both men and women declined steadily, year over year, from 1981 until the mid-1990s, when they effectively levelled off at about 42 percent for senior women and 30 percent for senior men. Starting in 2002, however, the rates increased a little for both men and women seniors. The increase was largely due to a report published in June 2001 which estimated that some 300,000 low-income seniors in Canada who were eligible for GIS had not applied for the benefit [Shillington 2001].

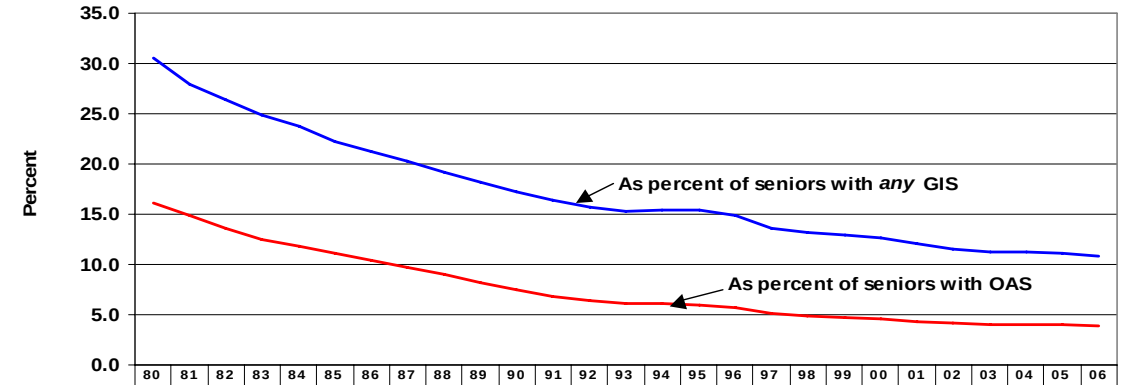
The report received considerable media coverage. In response, the federal department responsible for administering the OAS program – now Human Resources and Social Development Canada (HRSDC) – and the Canada Revenue Agency (CRA) undertook a number of measures to identify seniors who might be eligible for GIS and who had not applied, and to invite them to submit applications. A committee of the House of Commons held hearings on the issue and made recommendations of its own [House of Commons (Canada) 2001]. The result was a substantial number of applications for GIS from seniors who had not previously been in receipt of benefits.

Figure 3 presents an interesting perspective on the poorest of Canada's seniors – those with no income[6] other than the basic OAS pension and the Guaranteed Income Supplement. The bottom line in the chart shows the percentage of such seniors in relation to all seniors (all persons receiving the basic OAS pension), and the top line shows the percentage in relation only to those seniors who receive any GIS (i.e., either a full or a partial benefit).

In 1980, one in six seniors (16.1 percent) relied solely on the Old Age Security program for their income. By 2006, this had declined to one in 25 (3.9 percent). Among seniors entitled to the Supplement, the rate declined over the same period from almost one in three (30.5 percent) to one in nine (10.9 percent). These figures are another indication of how the overall economic security of seniors has improved during the past quarter century.

The improvement is undeniable. However, it is important to keep in mind that, despite the overall improvement, there are still 168,000 seniors in Canada with no income other than that from the OAS program. Moreover, there are 1.6 million seniors – more than a million of them women – whose incomes are so modest that they qualify for partial or full GIS [HRSDC 2007]. In order to qualify for GIS, a single senior must have an annual income of less that $15,240, and a pensioner couple must have a combined annual income of less than $20,112 (in both cases, not taking into account the basic OAS pension).

Figure 3
Percentage of seniors
who receive the full Guaranteed Income Supplement,
1980-2006



	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06
% OAS	16.1	14.8	13.6	12.5	11.8	11.1	10.4	9.7	9.0	8.2	7.5	6.8	6.4	6.1	6.1	6.0	5.6	5.2	4.9	4.8	4.6	4.3	4.1	4.1	4.1	4.0	3.9
% any GIS	30.5	28.0	26.4	24.9	23.7	22.2	21.2	20.2	19.2	18.1	17.2	16.4	15.7	15.3	15.4	15.5	14.8	13.6	13.2	13.0	12.6	12.1	11.5	11.3	11.2	11.1	10.9

Source: HRSDC 2007

Given the central role of Old Age Security in the financial well-being of many of Canada's seniors, it is important that the program's benefits maintain their value over time. As noted previously, benefits are indexed quarterly in line with rises in the cost of living, ensuring that their purchasing power remains constant. However, over long periods of time, wages, and therefore the standard of living of persons of working age, usually increase more rapidly than prices. As a result, if benefits under the OAS program are increased *only* in line with prices, the living standard of the seniors who rely on the program will decline over time in relation to the living standard of other Canadians.

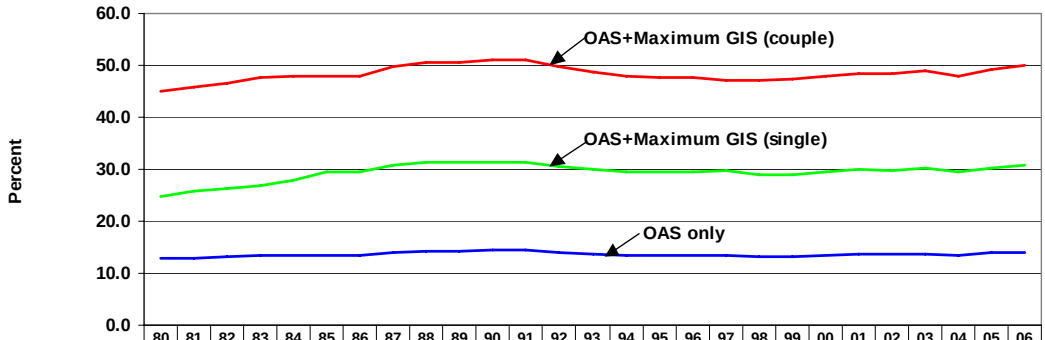
Figure 4 shows the basic OAS pension, and the combined basic OAS pension and the maximum Guaranteed Income Supplement, for a single pensioner and for a pensioner couple, as a percentage of the average wage[7] from 1980 to 2006.

In the 1980s, Canada went through an extended period when prices rose more rapidly than wages. As a result, benefits under the Old Age Security program, which are indexed to prices, increased as a percentage of the average annual wage. For a single pensioner receiving the basic OAS pension and the maximum Guaranteed Income Supplement, the increase was from 24.9 percent in 1980 to 31.4 percent in 1990-1991. For a pensioner couple receiving the maximum GIS, it was from 44.9 percent in 1980 to 51 percent in 1991.

Since 1991, wages generally (although not always) have increased somewhat more than prices, with the result that benefits under the OAS program drifted downwards as a percentage of the average wage. The decrease from 1991 to 2004 was relatively small (for a single pensioner, from 31.4 percent to 29.5 percent, and for a pensioner couple from 51 percent to 47.8 percent).

However, for seniors with incomes so modest that they qualify for GIS, any decrease can have a material negative effect on their standard of living.

Figure 4
OAS and OAS+GIS as a percent of the average wage, 1980-2006



	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06
OAS only	13.0	12.9	13.1	13.4	13.5	13.5	13.5	14.0	14.3	14.3	14.4	14.4	14.0	13.7	13.5	13.4	13.5	13.5	13.3	13.3	13.5	13.7	13.6	13.8	13.5	13.9	13.9
OAS+Max GIS (single)	24.9	25.8	26.2	26.8	27.8	29.6	29.5	30.7	31.2	31.2	31.4	31.4	30.6	30.0	29.6	29.4	29.5	29.6	29.1	29.0	29.6	29.9	29.9	30.2	29.5	30.4	30.9
OAS+Max GIS (couple)	44.9	45.8	46.5	47.5	48.0	48.0	47.8	49.7	50.6	50.6	50.9	51.0	49.7	48.7	47.9	47.7	47.8	47.0	47.1	47.3	47.9	48.5	48.4	48.9	47.8	49.3	50.1

Source: Author's calculations, based on data from HRSDC 2007

In the 2005 Budget, the federal Minister of Finance acknowledged this fact and announced an increase to the Guaranteed Income Supplement (i.e., a *real* increase, in addition to the ongoing indexation according to prices). The monthly increase was $36 for, single seniors, and $58 for senior couples. It was implemented in two instalments – half on January 1, 2006, and the other half on January 1, 2007 [Finance Canada 2005]. The increase is reflected in the data in Figure 4 and largely accounts for the increase in the level of OAS/GIS benefits as a percentage of annual wages from 2005 to 2006.

The Old Age Security program is financed entirely out of the general tax revenues of the federal government. With Canada's rapidly ageing population, it is particularly important both that the program continue to provide a viable minimum income to Canadian seniors and that its costs not place an unreasonable burden on Canada's future resources.

Under the *Public Pensions Reporting Act*, the Chief Actuary of the federal Office of the Superintendent of Financial Institutions (OSFI) is required to conduct an actuarial valuation of the Old Age Security program every three years. The valuation report, after submission to the responsible Minister (now the Minister of Human Resources and Social Development), must be tabled in Parliament and becomes a public document.

The most recent valuation report of the Old Age Security program was as on December 31, 2003 and was tabled in Parliament in May 2005 [OCA 2005]. Its conclusions are encouraging.

In spite of the fact that the number of OAS beneficiaries is expected to more than double from 4.1 million in 2004 to 8.9 million by 2030, and the fact that the program's total expenditures are expected to almost quadruple from $28 billion in 2004 to $110 billion in 2030, the costs of the OAS program as a percentage of Canada's Gross Domestic Product (GDP) are projected to increase by less than one percentage point, from 2.3 percent in 2004 to 3.2 percent in 2030. A percentage point of GDP is a substantial amount measured in dollars, but it ought to present no serious problem to either federal finances or the Canadian economy.

The next actuarial valuation of the OAS program, as at December 31, 2006, is currently in preparation. It will be tabled in Parliament in late spring of 2008. It seems reasonable to believe that its principal findings will not be significantly different from those of the previous report.

Issues concerning the Old Age Security program

The basic structure of the Old Age Security program – its 'architecture' – is sound and requires no modification. There are, however, specific aspects of the program that ought to be examined. These include the clawback and persons living outside Canada, the clawback and couples, the Guaranteed Income Supplement and immigrants to Canada, and the Allowance and single persons aged 60-64. The issue of work incentives and the OAS program also warrants examination.

The clawback and persons living outside Canada

As a public policy measure, the clawback, introduced in 1989 by a Conservative government, was a logical step in the evolution of the OAS program. The continued payment of the basic OAS pension to the best-off among Canada's seniors, who could hardly claim a need for the benefit, made progressively less and less sense when the primary purpose of the OAS program had become poverty alleviation. The case for reducing benefits to the wealthiest seniors was buttressed by the fact of an ageing population and the resulting increase in the cost of public pension programs in general. Moreover, there was the reality of the large deficits that the federal government was running at the time.

However, the government of the day was faced with a political dilemma. A few years before, it had made an ill-conceived effort to reduce the real (inflation-adjusted) value of the pensions of all seniors by proposing to limit the indexation of OAS benefits to the annual increase in prices above three percent. Seniors had mounted a vigorous lobby campaign against this blatantly unfair proposal, which would have particularly hurt low- and modest-income seniors. In the course of the campaign, the government, and the Prime Minister personally, had been publicly embarrassed. In the end, the government was forced to withdraw its proposal to partially de-index OAS benefits.

When the same government was contemplating the introduction of the clawback in 1989, it was keenly aware of the failure of its previous effort to limit the cost of the OAS program. A second failure and, worse yet, a second embarrassment had to be avoided. There was concern that limiting entitlement to pensions in any way, even to the wealthiest seniors, could leave the government open to criticism that it was attacking one of the supposedly sacred cows of Canadian social policy, the universal OAS pension.

The government's solution to its dilemma was what Battle [1990] has called 'social policy by stealth'. Instead of making the clawback part of the OAS program, it was legislated in the *Income Tax Act*. This approach allowed the government to claim, with technical accuracy, that the basic OAS pension continued to be a 'universal' benefit, in the sense that everyone who met the conditions of age and residence would still receive it. The clawback would only take effect at the time an OAS beneficiary filed her or his annual tax return. Those with incomes above the threshold would have to 'repay' part or all of the pension as part of their tax settlement.

The solution worked, in that the government was able to legislate its proposed clawback with relative ease. However, a problem soon emerged. Since the clawback was legislated under the *Income Tax Act*, it could apply only to seniors who were required to file a Canadian income tax return – those deemed residents of Canada for tax purposes. Although the vast majority of OAS beneficiaries were (and still are) Canadian residents for tax purposes, not all were (or are today). In particular, OAS beneficiaries who lived outside Canada, including those who were outside the country for more than half the year, were not usually considered residents of Canada for tax purposes. Therefore, they were not subject to the clawback. And, while most of these out-of-country retirees were not wealthy, they included some who, if they had remained in Canada, *would* have been subject to the clawback.

It is not known whether the Conservative government that brought in the clawback knew about the loophole. If they did, they turned a blind eye to it. Not so, however, the Liberal government that was elected in 1993.

The 1995 federal Budget announced that:

> effective July 1996, OAS recipients who are no longer resident in Canada will have to file a statement of their world-wide income in order to receive OAS benefits. Currently, non-residents with incomes above $53,215 (the clawback threshold at that time) escape the high-income recovery (a euphemism for the clawback) [Finance Canada 1995].

At about the same time as the 'outside-Canada' clawback (known in government websites and publications as the 'OAS recovery tax') was implemented, the *Income Tax Act* was amended to levy a 25 percent withholding tax on OAS, CPP and QPP benefits paid to persons residing outside Canada. Under the withholding tax, 25 percent of the benefit was no longer to be paid to the beneficiary but, instead, would be remitted directly to the federal tax authorities. The 25 percent withholding rate approximately equalled the combined federal and provincial income tax that a resident of Canada would have to pay on her/his OAS, CPP and QPP pensions (which are considered as

taxable income for purposes of income tax) if she or he were in the lowest marginal tax bracket. By virtue of an existing provision of the *Income Tax Act*, persons subject to the new withholding tax whose overall income was low were able to apply to the Canadian tax authorities for a reduction in the withholding rate. Depending on the amount of their income, the reduction could bring the applicable withholding rate down to zero.

Taken together, the outside-Canada clawback and the new withholding tax were supposed to ensure that a person residing in another country and receiving benefits under Canada's public pension programs would no longer be treated more favourably than a person in similar financial circumstances living in Canada. By almost any measure, this would have been a reasonable and fair outcome.

However, there was a problem in implementing the plan. It was the result of provisions in some of Canada's bilateral tax treaties, designed in part to eliminate double taxation.

One of the situations in which double taxation often occurs is when a person living in one country receives income, such as a pension, from another. In such circumstances, tax treaties spell out the negotiated rules under which one country or the other can tax the income in question.[8] A provision commonly found in tax treaties is to place a maximum on the withholding rate that can be applied by the country from which the income comes (in the case of a public pension, by the country paying the benefit).

Canada's tax treaties in the mid 1990s – just as Canada's tax treaties today – contained a dizzying array of different, and seemingly inconsistent, approaches to the taxation of public pensions and the allowable maximum withholding rates. Some tax treaties said nothing at all about public pensions, thus permitting the two parties (Canada and the other country) to do what they want regarding withholding tax on pensions. Other treaties did not allow Canada to withhold any tax at all on the Canadian public pensions paid to persons living in the other country.[9] Yet other tax treaties allowed Canada to withhold tax on public pensions, but at a rate lower than the 25 percent prescribed in the *Income Tax Act*. (The provisions of a tax treaty trump the provisions of the *Income Tax Act*. If a tax treaty sets a maximum withholding rate less than 25 percent, it is the treaty's maximum rate, and not the 25 percent rate of the *Income Tax Act*, that applies to benefits paid to persons living in the other country.) In the treaties setting maximum withholding rates less than 25 percent, the most common maximum rate was 15 percent.

In brief, depending in which country an OAS beneficiary resided and the provisions of Canada's tax treaty (if any) with that country, the applicable withholding rate might be as low as zero or as high as 25 percent. This remains the case today.

In terms of applying the outside-Canada clawback, the problem was not the lack of consistency in the withholding rate applicable from one country to another, however strange this inconsistency might seem to an outside observer. The crazy-quilt of withholding rates could be (and has been) rationalized by government officials who argue that each tax treaty is unique and the result of highly complex (and secret) negotiations involving a variety of trade-offs (taxing pensions, for example, in exchange for taxing capital gains).

The problem in terms of applying the outside-Canada clawback was that *any* limitation in a tax treaty on Canada's right to impose a withholding tax on the Canadian public pensions paid to residents of another country meant that the clawback could not apply (and, to this day, does not apply) to persons residing in that country.[10]

The reason for this outcome is that the outside-Canada clawback was, and still is, part of the Canadian income tax system and, in the usual meaning of the term 'withholding' in international tax treaties, the clawback constituted, and still constitutes, a 'withholding tax.' As a result, in the case of a country with which Canada's tax treaty does not allow Canada to levy any withholding tax on its public pensions, the outside-Canada clawback cannot apply to OAS beneficiaries residing in that country because Canada gave up the right to impose such a withholding tax when it signed the treaty. And in the case of a country with which Canada's tax treaty sets a maximum rate of withholding, the general rate of withholding applicable to public pensions paid to residents of that country is already equal to the maximum withholding rate allowed under the tax treaty, so the additional 15 percent clawback rate would exceed the allowable maximum.

In short, the objective sought through the introduction of the outside-Canada clawback would not, and *could* not, be achieved in regard to persons living in many countries because of the provisions of Canada's tax treaties with those countries. One of those countries was the United States, where about half of all out-of-country OAS beneficiaries lived.

Under the provisions of the Canada-United States tax treaty[11] in force at the time the clawback and the withholding tax were introduced, only the country of residence, and not the paying country, could tax the public pensions that each country paid to persons living in the other.[12] As a result, Canada could tax US social security benefits received by residents of Canada, but it could not withhold tax on OAS, CPP and QPP benefits paid to residents of the United States. On a reciprocal basis, the United States could tax the OAS, CPP and QPP benefits received by US residents, but it could not withhold tax on US social security pensions paid to residents of Canada.

This provision of the tax treaty was, in fact, greatly to Canada's advantage. The aggregate amount of US social security pensions paid to residents of Canada was far greater than the aggregate amount of OAS, CPP and QPP pensions paid to residents of the United States, and this remains the case today. For example, in 2005 (the most recent year for which US data is available), the total annual amount of US social security pensions paid to residents of Canada was about $600 million (in Canadian dollars) [SSA 2006]. In the same year, the total amount of Canadian OAS and CPP benefits paid to residents of the United States came to $287 million [HRSDC 2006], less than half as much.

These figures may seem counterintuitive. When Canadians think of retirement, an image that often comes to mind is that of 'snowbirds' basking in the warm sun of Florida or California. Why would American seniors want to come to the cold climes of Canada?

The answer, simply put, is that most of the beneficiaries of US social security pensions living in Canada are not Americans who have chosen to come to Canada to retire (although there are some). The great majority are Canadians who have spent part, or in some cases most, of their working lives in the United States. They are especially numerous in border areas such as the Windsor-Sarnia corridor, where large numbers of Canadians commute each day to work to the United States.

Officials of the federal Finance department, which is responsible for the negotiation of Canada's tax treaties as part of its overall responsibility for setting tax policy, were, not surprisingly, aware of the provision of the Canada-United States tax treaty that would have prevented the application of the outside-Canada clawback to OAS beneficiaries living in the United States. As it turned out, at the same time as the 'outside Canada' clawback was proposed, those officials and their counterparts at the US Department of the Treasury were in the course of negotiating amendments to the Canada-United States tax treaty.

At the negotiations, as was later learned, the Canadian side proposed changing the provisions of the tax treaty regarding the taxation of public pensions: instead of allowing only the country of residence to tax those benefits, only the paying country should tax the benefits in the future. Before making this proposal, the Finance department did not ask the federal department paying OAS and CPP pensions (at the time, Human Resources Development Canada) about the respective flows of benefits between Canada and the United States. As Finance officials later admitted privately (but never publicly), they simply *assumed* that more Canadians must retire in the United States than Americans retire in Canada, so they also assumed that the change would be financially in Canada's favour. As the figures cited above show, this 'analysis' was badly flawed.

The US side accepted the Canadian proposal. Whether the US negotiators knew that the United States would be the big winner as a result of the change will probably never be known for sure. It is known, however, that, unlike their Canadian interlocutors, the US negotiators consulted the social security experts at the US Social Security Administration before agreeing to the proposal.

The amendments to the Canada-United States tax treaty were signed on 17 March 1995. At about the same time, articles curiously appeared in several newspapers reporting that wealthy Canadian OAS beneficiaries who had retired to Florida were escaping the outside-Canada clawback because of the (pre-amendment) tax treaty. These articles conveniently allowed the Finance department to reply that it had anticipated the problem and solved it through the amendments to the tax treaty.

The amendments came into force on January 1, 1996, and the negative consequences for Canadian beneficiaries of US social security pensions quickly became evident. The United States imposed an effective 25.5 percent withholding tax on its social security benefits paid to residents of Canada. Canadian residents who were also American citizens could get part or all of the withheld US tax back, depending on their overall income, when they filed their annual US tax returns (which the United States requires its citizens to file annually irrespective whether they live in or outside the United States). However, for Canadians living in Canada who were not US citizens – 'non-resident aliens' in the US terminology – there was no possibility of any refund at all of the withheld US tax. In the dry

bureaucratic language of an explanation put out by the US Department of the Treasury, the withheld US tax was "a final payment of tax and Canadian recipients of U.S. social security benefits, regardless of their level of income, may not elect to be taxed in the United States on a net basis at graduated rate."[13] This was very different from Canadian tax policy (explained earlier) that allowed anyone residing in the United States and receiving Canadian pensions to obtain a refund of part or all of the Canadian tax withheld on those pensions if their incomes were sufficiently low.

Canadian recipients of US social security pensions quickly started to write and call their MPs to protest the drop in their pensions. It did not take long for the Finance department to realize that it had made a mistake.

Canada approached the United States and proposed negotiations to amend again the Canada-United States tax treaty in order to reverse the changes that had just been made to the taxation of public pensions. The United States agreed. On 29 July 1997 the Canada-United States tax treaty was amended yet again, this time to reverse the 1995 amendments regarding the taxation of public pensions. Under the 1997 amendments, which applied retroactively to 1 January 1996, taxation of public pensions was, once again, the exclusive right of the country of residence – the *status quo ante* preceding the ill-conceived (from Canada's perspective) 1995 amendments.[14] Needless to say, the United States, in agreeing to Canada's proposal regarding the taxation of public pensions, undoubtedly asked for something in return – something in the United States' interest that Canada might not otherwise have conceded. What Canada conceded to the United States and the financial cost to Canada of those concessions have never been made public.

To announce the signing of the 1997 amendments to the Canada-United States tax treaty, the Finance department put out a press release saying that the amendments "will deliver significant tax relief to thousands of lower-income Canadians who receive US social security benefits … They will pay Canadian tax instead of the flat, non-refundable US withholding tax they now pay" [Finance Canada 1997]. Not surprisingly, the press release did not mention the messy fact that this 'good news' was to correct a mistake that the Finance department had made in the first place.

The end result of this long and complex story is that, today, someone who meets the age and residence requirements for a basic OAS pension, irrespective of how much income she or he has, and even if that income would otherwise disqualify him or her from receiving that pension in Canada, can nonetheless receive the pension if he or she resides in the United States.

This is certainly a bizarre situation, and the United States is not the only country where it can occur. There are a long list of others: Argentina, Australia, Bangladesh, Barbados, Bulgaria, Côte d'Ivoire, Cyprus, Dominican Republic, Ecuador, Finland, Germany, Hungary, Ireland, Israel, Italy, Kenya, Malaysia, Malta, Mexico, New Zealand, Norway, Papua New Guinea, Peru, Poland, Portugal, Senegal, Romania, Spain, Sri Lanka, Tanzania, Trinidad and Tobago, the United Kingdom, Zambia and Zimbabwe.[15]

It would be interesting to hear an explanation from the federal Finance department of why, for example, someone living in Finland or Norway should receive a basic OAS pension without regard to

her or his income, but not someone living next door in Denmark or Sweden. Or why Bangladesh and Sri Lanka but not India.

This illogical and unfair situation is the result of the decision taken by the government of the day in 1989 when the clawback was introduced, and tacitly confirmed by the government that followed it, to make the clawback part of the income tax system rather than putting it where it belongs, in the OAS program. If the clawback were in the OAS program, it would apply equally everywhere in the world.

Recommendation 1:

The high-income clawback on the basic OAS pension should be taken out of the *Income Tax Act* and made part of the *Old Age Security Act* so that it will apply equally to all OAS beneficiaries residing outside Canada.

The clawback and couples

The inconsistent application of the clawback to persons living outside Canada was not the only unfairness resulting from the decision to make the clawback part of the income tax system. Another is the way the clawback affects couples with the same total income but different splits of that income between the two spouses or partners.

Take an example of two senior couples, each with a total income in 2007 of $110,000 (excluding the basic OAS pensions of the spouses or partners). In couple A one spouse or partner receives all the income, while in couple B each spouse or partner receives half ($55,000).

As noted earlier in this paper, the threshold at which the clawback starts to apply in 2007 is $63,511. If an OAS beneficiary has a personal income above this threshold, her or his basic OAS pension is reduced by 15 percent of the excess, up to the full amount of the pension. A straightforward mathematical calculation, taking into account the value of the OAS pension and the 15 percent reduction rate, shows that no basic OAS pension is payable for 2007 to someone with a personal income greater than $102,865.

Turning to the example, in the case of couple A, one spouse or partner – the person with the $110,000 income – is entitled to no basic OAS pension, while the other spouse or partner is entitled to the full pension. As a result, for the couple taken together, their combined annual income in 2007 from the OAS program will be about $5,900. In the case of couple B, on the other hand, both spouses or partners have an income of $55,000, which is below the clawback's threshold level of

$63,511. Therefore both will qualify for the basic OAS pension, and couple B's combined annual income from the OAS program will be about $11,800 – double that of couple A.

Why are two couples with the same total income treated in such significantly different ways?

The cause of the difference in treatment is easy to identify. It is due to the fact that the clawback is based on *individual* income, not a couple's *combined* income. This, in turn, is essentially due to the fact that the clawback is part of the income tax system rather than the OAS program.

In the OAS program, the entitlement of spouses or partners to income-tested benefits – the Guaranteed Income Supplement and the Allowance – is determined by the combined income of the couple. This reflects the common-sense observation that spouses or partners share living expenses between them, so their entitlement to income-tested benefits should take account of the combined income of the couple.

In the income tax system, on the other hand, tax liability is based, generally speaking, on individual income (although there are several adjustments to a taxfiler's tax liability that take account, for example, of a dependant spouse or partner and the other person's own income). Basing a person's income tax on his or her individual income, and not on a couple's combined income – an 'individual return' system rather than a 'joint return' system, as is found in the United States and some other countries – is, in fact, one of the longstanding principles of the Canadian income tax system. Joint returns have been considered several times in the past in Canada, but they have always been rejected because of their undesirable consequences.[16]

Since the clawback is part of the income tax system, there is some justification for basing it on individual income and not, for couples, on the couple's combined income.

However, as the previous section of this paper has shown, making the OAS clawback part of the income tax system was a matter of political expediency – providing a pretext for claiming that the basic OAS pension was still a 'universal' benefit even though it clearly had ceased to be such. There was no policy or administrative reason preventing the clawback from being made part of the OAS program. In fact, in addition to the anomalies described in the previous section of this paper on the application of the clawback to persons living outside Canada, there is a cogent rationale, from the perspective of transparency alone, for putting the clawback into the OAS program. And if the clawback were to be put in the OAS program, there would be no justification for continuing to base it, in the case of couples, on individual income rather than the couple's combined income.

One possible argument that might be raised against basing the clawback on a couple's combined income warrants consideration. It arose in 1996 when the government of the day proposed replacing the basic OAS pension and the Guaranteed Income Supplement (along with the age credit in the income tax system) with a more sharply targeted 'Senior's Benefit.' The proposed benefit would have provided the same or a higher amount (compared to the existing programs) to all low- and most moderate-income seniors. However, fewer seniors with above-average incomes would have been

entitled to benefits, and the amount of the Senior's Benefit for couples would have been based on the couple's combined income [Finance Canada 1996].

A vocal coalition of interest groups argued against the proposed Senior's Benefit because of its use of a couple's combined income to determine the entitlement of each spouse or partner [Battle 2003]. They invoked the hypothetical case of beleaguered senior women who, while married to or living with a wealthy spouse or partner, had no access to the family's resources and could count only on the basic OAS pension as their sole source of independent spending money. Undoubtedly there were, and still are, some women in such regrettable relationships (perhaps some senior men as well). However, there was no reason to suppose that their number was substantial, nor was any evidence whatsoever produced to demonstrate the number. Moreover, even if the problem existed in some cases, why should it be dealt with through the pension system and not, for example, under family law?

The issue of basing a couple's entitlement to the Senior's Benefit on the couple's combined income was not the only criticism that eventually doomed the proposal. In any case, the proposed Senior's Benefit was not implemented, and there is no reason to revive it today. However, the question remains relevant whether, in the case of a couple, an income test – in particular the income test for applying the OAS clawback – should be based on each spouse or partner's income or the combined income of the couple.

In fact, the issue is even more relevant today because of the change to the income tax system, announced by the federal Minister of Finance on October 31, 2006, allowing couples to split pension income between them when determining each spouse or partner's tax liability [Finance Canada 2006].

The Caledon Institute has published an analysis demonstrating the grossly unfair results of splitting pension income – results that include large windfall gains (in the form of reduced taxes) to the wealthiest senior couples, meagre tax savings for the vast majority of middle-income senior couples, and nothing at all to single seniors and to senior couples with incomes too low to put them in the tax-paying range [Tamagno and Battle 2006]. However, large tax savings are not the only windfall that fortunate, wealthy senior couples realize from splitting pension income. Some get another: entitlement to the basic OAS pension which one spouse or partner would otherwise not receive because of the clawback.

The reason is quite straightforward. Let's return to the example of couple A at the start of this section – the couple with an income of $110,00 (excluding the basis OAS pension) in which all the income is received by one spouse or partner and none by the other. Suppose that all the income in question is pension income eligible for splitting.

Without pension-income splitting, as has already been shown, the higher-income spouse or partner is entitled to no basic OAS pension because of the clawback. However, with pension-income splitting, each spouse or partner has only $55,000 of income – below the clawback's threshold – so they are both entitled to the basic OAS pension. The result is an additional $5,900 a year for couples that are already among the wealthiest of Canadian seniors.

Basing the clawback for a member of a couple on his or her individual income, and not the combined income of the couple, results in basic unfairness. Pension-income splitting only makes the unfairness all the worse.

Recommendation 2:

The high-income clawback on the basic OAS pension should be modified so that, for pensioners in couples, it is based on the combined income of the spouses or partners. A distinct income threshold for couples – higher than that for single pensioners – should be established (for example, $90,000 although a detailed analysis would be required to determine the actual level, taking account of the relative living costs of single seniors and senior couples).

Recommendation 3:

The savings realized through the change to the high-income clawback (recommendation 2), along with the savings from moving the clawback from the *Income Tax Act* to the *Old Age Security Act* (recommendation 1), should be reinvested by increasing the Supplement for the lowest-income seniors who are most in need.

The Guaranteed Income Supplement and immigrants to Canada

Until 1977, the basic OAS pension was an all-or-nothing benefit – either a person was entitled to the full pension, or she/he was entitled to no pension at all. This situation changed on July 1, 1977 when new rules for calculating the basic pension came into effect.

Under the new rules, 40 years of residence in Canada after reaching age 18 are required for entitlement to the full basic OAS pension. Someone with less than 40 years of residence, but with enough years to meet the minimum requirements set out in the *Old Age Security Act* (10 years of residence for a person living in Canada, 20 years for a person living outside Canada),[17] is entitled only to a partial pension. The partial basic pension is calculated at the rate of 1/40th of the full pension for each year of residence in Canada after age 18. Notwithstanding the new rules, full pensions, based on the eligibility rules applicable immediately prior to July 1, 1977, can still be paid to persons who were aged 25 or more and who resided in Canada on the day the new rules came into force.[18]

When partial OAS pensions were introduced, no change was made to the amount of Guaranteed Income Supplement to which persons receiving only partial pensions were entitled. This meant that the minimum income guaranteed to such persons from the partial OAS pension and the maximum Supplement was *less* than the income guaranteed to persons entitled to the full basic OAS pension. The persons most affected were new immigrants to Canada who arrived in Canada after 1 July 1977.[19] However, since new immigrants were, for the most part, still many years away from reaching the age of entitlement to a pension, the problem would not substantially manifest itself for many years to come.

Nonetheless, there were calls to address the situation of low- and modest-income seniors entitled only to a partial OAS pension. In 1984, with Canada heading into a general election and with a bill under consideration in Parliament to increase the maximum rate of the Guaranteed Income Supplement (along with other improvements to the OAS program), the government of the day acted. A provision was added to the bill that dealt specifically with the situation of persons entitled only to a partial OAS pension. For such a person, the maximum rate of Supplement payable (subject to the same income test applicable to all Supplement beneficiaries) would be increased by an amount equal to the difference between the full basic OAS pension and the partial pension to which he or she was entitled. This provision, and the bill of which it was part, were given speedy approval by Parliament.

The 'top-up' to the Guaranteed Income Supplement – sometimes referred to as the 'super GIS' – was a fair and reasonable measure. It ensured that there would not be two categories of low- and modest-income seniors – those entitled to the full income guarantee of the OAS program and those entitled to only a partial guarantee. However, a complication soon arose. It was the result of some of Canada's social security agreements[20] taken in conjunction with the provisions of Canada's immigration law regarding family reunification – in particular, the provisions allowing residents of Canada to 'sponsor' elderly parents living outside Canada to join their children in Canada.

Social security agreements protect the pension rights of persons who move between countries. From a Canadian perspective, agreements ensure, in particular, that immigrants to Canada will be entitled to any pensions they earned in other countries in which they lived and worked before coming to Canada. As a country overwhelmingly of immigrants, social security agreements are very important for Canada and bring in large amounts of foreign pensions to Canadian residents.

One of the means by which social security agreements protect the pension rights of immigrants is through 'totalizing'. Most countries' social security laws require a minimum period of contribution or residence before a person is entitled to a pension (for example, the requirement of at least 10 years of residence in Canada for entitlement to a basic OAS pension). An immigrant to Canada may have lived in another country or contributed to its social security system for a number of years, but not for the minimum period required for entitlement to a pension from the other country. Through totalizing, the other country adds together ('totalizes') periods under its social security scheme and periods in Canada – generally speaking, periods of residence under the *Old Age Security Act* and periods of contribution to the CPP[21] – to meet the minimum requirement for its pensions. On a reciprocal basis,

Canada does the same to determine entitlement to a Canadian OAS or CPP pension. Once each country determines entitlement to its pension through totalizing, it calculates the amount of benefit it will pay exclusively on the basis of the periods actually spent under its social security system.

Under all the social security agreements Canada had concluded in 1984 except for one,[22] periods of residence after reaching age 18 in the other country were totalized with periods of residence in Canada after that age to determine eligibility for a basic OAS pension. With as little as one year of residence in Canada – provided that the age and other requirements for an OAS pension were met – a person could, and still can, become eligible for an OAS pension. In such a case, the pension is calculated at the rate of 1/40th of a full pension for each complete year of residence in Canada after age 18. In other words, each complete year of residence in Canada gives entitlement to 1/40th of an OAS pension – at the present time, $12.56 a month. Once a pension starts to be paid, additional periods of residence in Canada *cannot* be used to increase the amount of the pension. However, even more importantly, under the OAS Act as it stood until 1996 once a basic OAS pension started to be paid – even a small pension equal to 1/40th of the full benefit – the pensioner became eligible for the Supplement, including the super-GIS.

In the years following the adoption of the 'super GIS' in 1984, administrators of the OAS program started noticing something unusual. In the case of some of the countries with which Canada had concluded social security agreements, there were disproportionately many persons who became entitled to very small OAS pensions – usually, in fact, pensions equal to only 1/40th of the full pension – and who had little or no other income, thus making them entitled to large amounts of Guaranteed Income Supplement.

The reason soon became apparent. It had to do with the provisions regarding family reunification under Canada's immigration law.

Under the immigration law of the day, as under the law today, residents of Canada can 'sponsor' family members, such as elderly parents or grandparents, to become immigrants to Canada. These sponsored immigrants do not have to meet the requirements of the point system used to determine whether most persons wishing to immigrate to Canada are allowed to come. However, the person in Canada who is sponsoring the family member – the child or grandchild, for example – must sign an 'undertaking' to provide support for the sponsored immigrant for a prescribed period of time. This period can be as long as 10 years, although it is now usually for a shorter period.

The family reunification provisions of the immigration law are based on well justified, humanitarian principles. The vast majority of sponsors take their sponsorship undertakings seriously and provide full support for the persons they have sponsored. However, not all do. Often (probably in most instances) when this happens, it is for reasons beyond the sponsor's control, such as loss of a job, illness, or other legitimate cause. But in some cases, it is deliberate and made in the knowledge that Canada's social safety net will step in and provide financial support to the sponsored immigrant.

Although sponsorship undertakings were drafted by lawyers and clothed in legal language, they were, in fact, unenforceable, for all intents and purposes, if the sponsor failed to provide the promised

support to the sponsored immigrant. At least that was the case in the 1980s and 1990s. Whether it is still the case today is beyond the scope of this paper to determine. As well, even if the sponsorship undertakings were enforceable, they could not be binding on the sponsored immigrant (the parent or grandparent) because the sponsored immigrant was not a signatory to the undertaking. In particular, the sponsorship undertaking could not be used to prevent the sponsored immigrant from receiving the Guaranteed Income Supplement or provincial or territorial social assistance.

The number of elderly sponsored immigrants who came from some of the countries with which Canada had concluded social security agreements and who qualified, as a result of those agreements, for the super-GIS, often at the maximum rate, after one year in Canada was too large to be purely coincidental.

By the mid-1990s federal officials decided that action needed to be taken to stop what appeared to be the abuse, by some, of the combined effects of the 'super GIS', the totalizing provisions of some of Canada's social security agreements, and the sponsorship provisions of Canadian immigration law. A working group consisting of officials of four department – Citizenship and Immigration, Finance, Human Resources Development and Justice – was formed to examine options. Finance Canada effectively had the lead, although not officially.

The working group developed two options, both of which required amending the *Old Age Security Act*. One option was to disallow sponsored immigrants from receipt of any Guaranteed Income Supplement during the period of the sponsorship undertaking. The other option was to require at least 10 years of residence in Canada after age 18 in order to receive a 'full' Supplement, and to prorate the Supplement to anyone who, as a result of a social security agreement, qualified for a partial OAS pension on the basis of less than 10 years' residence.

The first option – disallowing the Guaranteed Income Supplement during the period when a sponsorship undertaking was in force – clearly addressed the specific issue at hand. The only question was what to do if a sponsor, for reasons beyond his or her control, could no longer carry out the commitment to provide support to the sponsored immigrant. The interdepartmental working group concluded that this issue could be resolved through regulations allowing receipt of the Supplement, even during periods when a sponsorship undertaking was still in force, if prescribed circumstances set out in regulations applied.

The second option – requiring at least 10 years of residence in Canada before becoming entitled to a full Guaranteed Income Supplement, and prorating the Supplement for those with less than 10 years – was considerably more draconian because it affected everyone, whether a sponsored immigrant or not. To make the second option somewhat less draconian, the working group concluded that, if the option were adopted, additional years of residence after a partial Supplement started to be paid should be taken into account in determining the portion to which a beneficiary would be entitled in future years. If, for example, someone first became entitled to a Supplement with only seven years of residence, he or she would be entitled to only 7/10^{ths} of the full Supplement. However, after an additional year of residence in Canada, the entitlement would increase to 8/10^{ths}, etc.

In the end, the federal Finance department unilaterally decided on the measure that would be implemented. The decision was announced in the March 1996 federal Budget [Finance Canada 1996]. Finance's decision was not a choice of one option or the other. Its decision was to implement both options. The 1996 Budget announced that the new rules would apply to all persons arriving in Canada after Budget day (March 6, 1996). For persons already in Canada on that date and already in receipt of the Guaranteed Income Supplement, the old rules would continue to apply for as long as they remained eligible for the Supplement. As well, the old rules would apply to persons already in Canada on March 6, 1996 who were not yet eligible for the Supplement but who might be in the future, but only until December 30, 2000.

Through the Budget announcement, the issue of the apparent abuse of the 'super GIS' had been fixed. However, this was only done by reintroducing a variant of the same problem that had led to the introduction of the 'super GIS' in 1984 – the creation of two categories of low- and modest-income seniors, those entitled to the full income-guarantee of the OAS program and those entitled to only a partial guarantee.

Moreover, the regulations that were adopted to prescribe the circumstances under which a sponsored immigrant could be entitled to a (partial) Supplement were, and remain, rigid and severely limited. During the period of the sponsorship undertaking, a sponsored immigrant can be entitled to a (partial) Supplement *only* if one of four situations occurs: the sponsor dies, the sponsor is convicted of a criminal act involving the immigrant (that is, assault and battery), the sponsor is declared legally bankrupt, or the sponsor is imprisoned for a term of more than six months. In any other case – for example, if the sponsor loses his or her job, or becomes severely ill or disabled and can no longer work, or has to reduce working time to look after an ill family member, or whatever else – the sponsored immigrant cannot be entitled to the Guaranteed Income Supplement. The Minister responsible for the OAS program – the Minister of Human Resources and Social Development – has no discretion whatsoever to make an exception, no matter the circumstances. The sponsored immigrant's only option is provincial or territorial social assistance, provided she or he qualifies.

There is no straightforward solution to the problem that has just been described. If the 1996 rules remain in place, at the least the Minister of Human Resources and Social Development should be given discretion to make exceptions in evident cases of hardship. This would still, however, leave the issue of two classes of low- and modest-income seniors. Resolving this issue would mean revisiting the 1996 rules for entitlement to the Supplement. It also would likely mean examining the continued relevance of the requirement of at least 10 years of residence in Canada before becoming entitled to a basic OAS pension. The latter, in particular, would be a very major change to the OAS program with far-reaching cost implications.

Recommendation 4:

A parliamentary committee should examine the rules currently in place regarding entitlement to the basic OAS pension and the Guaranteed Income Supplement of persons who have lived in Canada for less than 10 years. The objective of the study should be to recommend the changes, if any, required to make the rules more equitable.

The Allowance and single persons aged 60-64

The evolution of the Allowance in the OAS program provides an instructive example of the gaps that can sometimes result from an incremental approach to program development.

As noted in the overview of the OAS program at the start of this paper, the Allowance (known at the time as the Spouse's Allowance) was introduced in 1975. Two years earlier, in 1973, the federal government had launched a far-reaching review of Canada's income security system. Although the review covered all aspects of income security ('social security', as it was referred to at the time), its principal focus was families with children and persons of working age. Since programs for the income security needs of these Canadians were primarily in provincial jurisdiction, the review involved the provinces as key players.

In its first two years, the social security review went well. In fact, there seemed to be an emerging federal/provincial consensus in favour of a significant reform of the structure – the 'architecture' – of Canada's income security system. The consensus centered around a concept that became known as 'support and supplementation,' which would replace provincial social assistance and extend benefits to the 'working poor.' By 1975, although 'support and supplementation' was still only a general concept with no specifics, there was nonetheless optimism that it would result in a new, concrete program.

In the period in which the social security review was being carried out, the rates of low income among seniors and near-seniors were high. This was especially the case for couples in which one spouse was a pensioner while the other spouse was not yet 65. The spouse aged less than 65 was often a wife who was not in the paid labour force and who had few, if any, prospects for employment. Without income from some other source, such a couple could scarcely get by on the older spouse's basic OAS pension and Guaranteed Income Supplement. Many had to turn to provincial social assistance.

In introducing the (Spouse's) Allowance in 1975, the federal government was, in effect,anticipating the adoption of 'support and supplementation,' which was widely expected to

become an operating program within a couple of years. By making the Allowance part of the OAS program, the federal government was assuming the costs of income security for a significant number of near-seniors (spouses aged 60 to 64 of pensioners) and relieving the provinces of a part of their related social assistance expenditures.

Not long after the Allowance began, it became clear that federal/provincial consensus on 'support and supplementation' would not be possible. However, the federal government could hardly terminate the Allowance, on which many couples had become dependent for their subsistence and which provided benefits at a higher level, generally speaking, than provincial social assistance. In fact, terminating the Allowance was never an option. It had become a permanent part of the OAS program.

It did not take long before a fundamental design problem of the Allowance became evident. The entitlement of the younger spouse – the spouse aged 60 to 64 – to the Allowance was dependent on the entitlement of the older spouse to the basic OAS pension and the Guaranteed Income Supplement. If the older spouse died before the younger spouse reached age 65, the younger spouse was no longer eligible for an Allowance. Each month hundreds of grieving spouses who has just lost their husband or wife were told that they had also lost their Allowance. From both a humanitarian and a political perspective, such a situation was unacceptable.

The federal government's initial response was an unsatisfactory half-measure. In November 1978, the *Old Age Security Act* was amended to allow continuation of the payment of the Allowance for six months following the death of the older spouse. Grieving low-income widows and widowers were not cut off immediately on the death of their spouse; they had a six-month grace period before being cut off.

The half-measure had an appropriately short half-life. In October 1979, the recently elected minority government introduced another change to the *Old Age Security Act*, this time to extend the Allowance until the widow or widower reached age 65 (provided that the conditions of the income test continued to be met).[23]

The 1979 amendment resolved the problem of terminating the Allowance in the case of the death of the older spouse before the younger spouse had reached age 65. However it created a new problem. A person aged 60-64 who became widowed while married (or living common-law) with someone entitled to the Guaranteed Income Supplement was entitled to an Allowance until age 65 if her or his income was sufficiently low. However, a person in the same age group and with the same income who became widowed *before* her/his spouse was entitled to a Supplement did not qualify for an Allowance.

This new problem was resolved in 1985 with a further amendment to the *Old Age Security Act*. Under this amendment, all widows and widowers aged 60 to 64, irrespective of when their spouses died, qualified for the Allowance if they met the requirements of the income test.

The 1985 extension of the Allowance ensured consistent treatment of all widows and widowers aged 60 to 64. It was, therefore, a decided improvement to what had been the case before. However the Allowance still was not available to persons aged 60 to 64 who had never married or who had divorced or were separated. These persons are still not eligible for an Allowance today.

The constitutionality of the limitation on eligibility for the Allowance has been challenged in the courts. The Federal Court of Canada (FCC), in both its trial and appeals divisions, found that the limitation is discriminatory, in contravention of subsection 15(1) of the *Canadian Charter of Rights and Freedoms*. In its decision, the Appeal Court of the FCC noted:

> There may be many grounds on which one could criticize Parliament, having established the spouse's allowance for some but not all persons between the ages of sixty and sixty-five, for drawing the line where it did ... Any low income person in one of the excluded categories might fairly complain that their financial need is the same as that of a person entitled to an allowance [FCC 2002: paragraph 24].

However, the court went on to say that the discrimination is justified under section 1 of the *Charter*, which allows "such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society." In the court's opinion, "the *Charter* does not require Parliament, upon undertaking an old age pension scheme, to provide the same benefit to everyone" [FCC 2002: paragraph 25].

Simply put, the Federal Court said that the limitation on eligibility for the Allowance is a political issue which Parliament, and not the courts, must decide.

Extending the Allowance to all persons aged 60 to 64, irrespective of their marital status, would ensure equitable treatment of all near-seniors. The cost in the current year of such an extension would likely be $1.5 billion.[24]

One and a half billion dollars is a large amount. But it must be considered in context. In his economic statement given on 30 October 2007, the federal Finance Minister announced a one percent reduction in the Goods and Services Tax (GST) which will cost the government, in the form of foregone revenues, $6 billion in fiscal year 2008-09, increasing to $7.1 billion in 2112-13 [Finance Canada 2007]. The GST reduction has not been supported by a single reputable economist. The vast amount that the government is proposing to forego through the GST reduction is four times what would be needed to extend the Allowance to all persons aged 60-64 who meet the income test. In fact, the funds could be used both to extend the Allowance and to improve benefits to families with children through an increase in the Canada Child Tax Benefit, as the Caledon Institute recommends in a paper soon to be published [Battle 2007]. This would be a far better use of resources than what the government has proposed.

While an extension of the Allowance is certainly affordable over the short and medium term, it cannot be assumed, with Canada's ageing population, that the costs would continue to be affordable in the long term. In addition, not enough is known about the financial situation of the group of persons in question – near-seniors aged 60 to 64 who are neither married (or in a partnership) nor widowed – to assess the relative priority of extending the Allowance to them as opposed to any other social expenditure the federal government could consider.

Further study and analysis are required before action can be taken on this issue.

Recommendation 5:

The Office of the Chief Actuary should be requested to prepare an estimate of the cost over the next 50 years of extending the Allowance to all persons aged 60 to 64. Concurrently, Human Resources and Social Development Canada should be requested to prepare an analysis of the financial situation of the persons aged 60 to 64 who are not now eligible for the Allowance. Once the estimate and analysis are completed, a parliamentary committee should examine the conclusions and make recommendations as to the changes, if any, that should be made to the Allowance.

Work incentives

The ageing of Canada's population presents a widerange of challenges for the formulation of suitable public policies. This is especially the case in regard to pension policy.

As noted earlier in this paper, the Office of the Chief Actuary has projected that the number of beneficiaries of the Old Age Security program will double in the period from 2004 to 2030, from $4.1 million to $8.9 million [OCA 2005]. The same projections forecast that the ratio of workers to retirees will fall over this period from 4.8 in 2004 (about 5:1) to 2.4 in 2030, half the 2004 ratio. By any measure, this is a profound change, with far-reaching consequences.

Some experts have predicted that Canada will experience serious labour shortages in the coming years because of the ageing of its population. Other experts suggest that future labour shortages, while possibly significant in some sectors, will not be dire for the Canadian economy overall. It is beyond the scope of this paper to assess the different arguments. What is, however, clear is that a prudent approach to policy formulation should involve identifying and analyzing existing measures that might unnecessarily encourage early withdrawal from the labour force, especially for

'knowledge workers' whose expertise and experience are essential for maintaining Canada's competitive advantage in a globalized marketplace.

In June 2006, the Standing Committee on Banking, Trade and Commerce of Canada's Senate published a report that examined the implications for Canada's economy of an ageing population. The report, titled (somewhat melodramatically) *The Demographic Time Bomb*: *Mitigating the Effects of Demographic Change in Canada* [Senate (Canada) 2006], recommended ways to lessen the negative effects. The recommendations included some concerning the Old Age Security program. Given the prestigious source of the recommendations, these warrant consideration.

The Senate Committee made three recommendations concerning the OAS program: The federal government [should] amend the *Old Age Security Act* to:

- allow receipt of Old Age Security benefits to be deferred, with appropriate actuarial adjustments
- exempt a portion of employment earnings from the clawback provision associated with the Guaranteed Income Supplement program
- ensure that the amount and the timing of the Spouses Allowance does [sic] not represent a disincentive to the labour force participation of recipients [Senate (Canada) 2006: 24].

Each of the recommendations needs to be considered individually.

➪ *Allow receipt of Old Age Security benefits to be deferred, with appropriate actuarial adjustments*

The phrase 'Old Age Security benefits' almost certainly refers to the basic OAS pension. But what, exactly, is the work disincentive of the existing basic OAS pension? And what, exactly, would be the advantage of allowing deferral of receipt of the pension 'with appropriate actuarial adjustments' – presumably meaning an increase in the amount of the pension if the start of payment is postponed beyond reaching age 65?

The basic OAS pension is payable at age 65 irrespective of whether a person is or is not still working. In fact, employment status is completely irrelevant either for determining eligibility for the pension or when calculating its amount. It is difficult to see, therefore, on a *prima facie* basis how there can be any work disincentive at all to receipt of the pension.

Only one argument supporting the purported work disincentive seems possible: Because the basic OAS pension is included in income for purposes of the *Income Tax Act*, the pension could be taxed at a higher marginal tax rate for someone with income from employment than for someone with no such income.

But this is simply the logical consequence of a progressive income tax system. And the 'disincentive', if one exists at all, would only affect the relatively few affluent seniors with income from employment so substantial in amount as to put them in a high tax bracket.

Allowing deferral of the start of receipt of the basic OAS pension with a corresponding actuarial increase would overwhelmingly benefit the small group of seniors who have such substantial amounts of income from employment that they are subject to the clawback. These individuals could postpone the start of receipt of the pension until they cease working or reduce their working hours. Then they would get the best of both worlds – avoiding the clawback while they receive substantial income from employment, and getting an increased pension when they cease working or reduce their hours of work.

From a public policy perspective – and especially from the perspective of a program whose objective is poverty alleviation – such an outcome is entirely perverse. The Senate Committee's first recommendation regarding OAS is without merit.

- *Exempt a portion of employment earnings from the clawback provision associated with the Guaranteed Income Supplement program*

Provincial and territorial social assistance schemes usually have a provision that exempts a portion of earnings from employment from a reduction in benefits. This recommendation of the Senate Committee suggests that a similar exemption should be extended to the Guaranteed Income Supplement. In other words, a part of a pensioner's employment earnings, if the pensioner has any such income at all, would not be taken into account in calculating the amount of GIS – that is, it would be exempt from what the Committee's report refers to, misleadingly, as the 'clawback'.

The vagueness of the Senate Committee's recommendation – exempting 'a portion of employment earnings', but without specifying the actual amount – makes it difficult to asses the cost of the proposal. However, the cost would almost certainly be large. The question is only how large. For every $1,000 in exempt employment earnings, the cost in the form of higher GIS expenditures will be in the range of $55 to $110 million, by the author's estimates. An exemption of, say, $3,000 will, as a result, mean an annual cost of $115 to $330 million.

How many of the poorest of seniors – those most in need of increased assistance – will benefit from such an expenditure? Probably not many, since most have little or no capacity to work. And what kind of jobs will be created? Without prejudice to a large and popular fast-food chain or to a very successful retailer, these will be mostly 'McJobs' and 'WalJobs' – low paying, with few if any benefits. Is this really what Canada wants for its seniors? And is there any justification for spending large amounts of public funds to, in effect, subsidize such companies?

The Senate Committee's second recommendation regarding OAS is undoubtedly well intentioned, but it suffers from an inadequate analysis of its consequences.

- *Ensure that the amount and the timing of the Spouses Allowance does* [sic] *not represent a disincentive to the labour force participation of recipients*

This third recommendation of the Senate Committee is simply mystifying. It is so vaguely worded that it cannot be understood in any practical, operational terms.

One way of ensuring that 'the amount and the timing' of a benefit do 'not represent a disincentive to the labour force participation of recipients' would be only to pay the benefit to those deemed 'worthy' through a demeaning needs test such as those used in the Elizabethan *Poor Laws*. Clearly this is not what the Senate Committee had in mind. Unfortunately, the Committee's recommendation does not tell us what they had in mind.

The third recommendation of the Senate Committee does not warrant further consideration.

Recommendation 6:

Work incentives, or the purported disincentives to work identified by the Senate Committee on Banking, Trade and Commerce in its report titled *The Demographic Time Bomb: Mitigating the Effects of Demographic Change in Canada*, are not relevant to the Old Age Security program. Implementation of the Committee's recommendations regarding the OAS program would result in substantial and unwarranted additional expenditures.

Concluding observations

The Old Age Security program is one of the foundations of the inter-generational social contract that binds younger and older Canadians together in a shared commitment to ensuring that all of Canada's seniors, who have contributed so much to building this country and to giving us the high standard of living that most of us enjoy today, will be able to live their retirement years in dignity.

The OAS program is sound. It is fundamentally well designed, and it largely succeeds in achieving its objective of poverty alleviation. However, there are some specific aspects of the OAS program that could, and should, be improved. This report has described these, examining both how they came to be introduced into the program and how they can be corrected.

There can be a tendency with a program as successful as Old Age Security to take it for granted. There is the old adage that 'the squeaky wheel gets the grease.' The OAS program doesn't 'squeak'. Moreover, it is not glamorous, so it doesn't get much attention in the media or in discussions of public policy.

However, we should not take the Old Age Security program for granted. It is far too important to Canada, and to Canadians, for us to do so. Because the Old Age Security program works well does not mean that it cannot work even better. We owe nothing less to our seniors.

List of abbreviations and acronyms

CPP	Canada Pension Plan
CRA	Canada Revenue Agency
DB	Defined benefit
FCC	Federal Court of Canada
GAINS	Guaranteed Annual Income for Seniors
GDP	Gross Domestic Product
GIS	Guaranteed Income Supplement
GST	Goods and Services Tax
HRSDC	Human Resources and Social Development Canada
IRPP	Institute for Research in Public Policy
OAS	Old Age Security
OCA	Office of the Chief Actuary (Canada)
OSFI	Office of the Superintendent of Financial Institutions (Canada)
QPP	Quebec Pension Plan
RRSP	Registered Retirement Savings Plan
SSA	Social Security Administration (United States)
YMPE	Year's Maximum Pensionable Earnings

Endnotes

1. Occupational pension plans are sometimes referred to as employer-sponsored pension plans, workplace pension plans, private pension plans, or, in Canada, registered pension plans.

2. Low income cut-offs (LICOs) convey the income level at which a family may be in straitened circumstances because it has to spend a greater proportion of its income on necessities than the average family of the same size. Specifically, the threshold is defined as the income below which a family is likely to spend 20 percentage points more of its income on food, shelter and clothing than the average family. There are separate cut-offs for seven sizes of family – from unattached individuals to families of seven or more persons – and for five community sizes – from rural areas to urban areas with a population of more than 500,000 [Statistics Canada 2007].

3. In 2005, the low-income rate among seniors rose somewhat, to 6.1 percent [Statistics Canada 2007]

4. A 'senior family' is an economic family in which the person with the highest income is aged 65 or more. An economic family is a group of two or more persons who live in the same dwelling and who are related to each other by blood, marriage, common law or adoption.

5. A note for readers outside Canada: Whenever the word 'dollar' and the dollar sign ($) appear in this paper, they refer to the Canadian dollar. At the time of writing, the Canadian dollar is worth about 1.05 United States dollars (USD 1.05); it is worth about 72 Euro cents (EUR 0.72).

6. The term 'income' is defined in the *Old Age Security Act* to have the same meaning as in the federal *Income Tax Act*, subject to specific exclusions prescribed in the OAS Act such as the basic OAS pension. 'Income', in this technical sense, does not include the 'top-up' income-tested benefits which most provinces and territories pay to seniors with very little or no income. In the province of Ontario, for example, the GAINS program (Guaranteed Annual Income for Seniors) provides up to $83 a month to such seniors who are eligible for the federal Guaranteed Income Supplement. The GAINS benefit is paid in addition to the basic OAS pension and the GIS.

7. In developing the data shown in Figure 4, 'average income' for the years 1986 to 2006 means the Year's Maximum Pensionable Earnings (YMPE), which is the maximum amount of earnings from employment and self-employment taken into account under the Canada Pension Plan. The YMPE is approximately equal to Statistics Canada's 'composite average' annual wage. In the period from 1980 to 1985, the YMPE was less than the composite average. Therefore, for the years 1980 to 1985 inclusive, the average wage was estimated on the basis of the YMPE in 1986, adjusted by the Bank of Canada's 'inflation calculator' available on the Bank's website (http://www.bankofcanada.ca/en/rates/inflation_calc.html, accessed on November 3, 2007).

8. A tax treaty sometimes allows both countries to tax certain forms of income, including in some treaties pensions. In such a case, however, the treaty generally allows a person to claim the tax paid in one country as a credit when calculating the tax due to the other country. This provision effectively eliminates double taxation of the same income.

9. In such cases, the treaty, on a reciprocal basis, does not allow the other country to withhold any tax on the public pensions it pays to residents of Canada. Similarly, if a treaty sets a withholding rate on Canadian pensions of less than 25 percent, the same withholding rate usually applies to the other country's pensions.

10. In theory, the outside-Canada clawback could apply if the maximum withholding rate specified in a tax treaty were 40 percent or more. In practice, no country would accept a withholding rate in a tax treaty higher than 25 percent and, as Canada's tax treaties demonstrate, many countries insist on a withholding rate less than 25 percent.

11. The official title of the treaty is *Convention Between Canada and the United States of America With Respect to Taxes on Income and Capital*.

12. The provisions of the Canada-United States tax treaty were somewhat more complex: if a person living in one country received a public pension benefit from the other country, the country of residence could tax *half* of the benefit. The other half was entirely tax free.

13. http://www.treas.gov/offices/tax-policy/library/tecanada.pdf, accessed on November 3, 2007.

14. The 1997 amendments restored the *status quo ante* in the sense that only the country of residence, and not the paying country, could tax the benefits in question. The percentage of the benefits that could be taxed by the country of residence, however, was changed. Before 1996, the country of residence could tax half of the public pension paid by the other country. Under the 1997 amendments, different rules, still in effect today, apply for Canada and the United

States. Under these rules, Canada can tax 85 percent of the US social security benefits received by a resident of Canada. The remaining 15 percent are tax free. The United States, on the other hand, can tax the full amount of any Canadian pension as long as the pension would be taxable in Canada.

15. http://www.cra-arc.gc.ca/tax/nonresidents/individuals/seniors_oasri-e.html, accessed on November 3, 2007. The outside-Canada clawback also does not apply to Brazilian nationals residing in Brazil and to OAS beneficiaries residing in the Philippines whose Canadian pensions total less than $5,000 a year.

16. For example, in a joint-return system, a married mother who goes back to the labour force when her children reach school age would have her income added to that of her husband for tax purposes, and her income would be taxed at the husband's highest marginal tax rate. This approach would usually result in a much higher effective rate of tax on the wife's income than in a system, like Canada's, of individual returns. In other words, it would impose an economic penalty on mothers for returning to the paid labour market.

17. In addition to the minimum period of residence described, a person must also be aged 65 or more. As well, if the person is living in Canada, he or she must be in the country legally on the day before the pension starts to be paid; if a person is living outside Canada, she or he must have been in Canada legally on the day the person left Canada.

18. A full basic OAS pension can also be paid in accordance with the rules applicable before July 1, 1977 to a person who was outside Canada and aged 25 or more on that date, provided that either (i) the person possessed a valid Canadian immigrant visa on July 1, 1977 or (ii) she or he had resided in Canada at a previous time but after having reached age 18.

19. Although new immigrants to Canada were overwhelmingly the ones affected, they were not the only ones. For example, a Canadian citizen who had spent less than 40 years in Canada between the ages of 18 and 65 was also affected, unless she or he was entitled to a full OAS pension under the rules in effect prior toJuly 1, 1977.

0. The 1977 amendments to the *Old Age Security Act* that brought in the new rules for calculating partial OAS pensions also allowed, for the first time, the inclusion of the OAS programs in social security agreements. In fact, one of the principal reasons (perhaps *the* principal reason) for introducing partial OAS pensions was to make it possible for Canada to conclude such agreements. Prior to the adoption of the new rules, no country would conclude a social security agreement with Canada because other countries insisted that agreements had to cover both the OAS program and the CPP. Once the *Old Age Security Act* allowed the inclusion of OAS in social security agreements, many countries expressed their interest in agreements with Canada.

21. Constitutionally, the federal government can include the Quebec Pension Plan in one of Canada's social security agreements only if the government of Quebec were to ask it to do so. In practical political terms, it is difficult to imagine the government of Quebec requesting Ottawa to do this. All of Canada's social security agreements contain a provision permitting the conclusion of 'understandings' (in French, 'ententes') between the other country and provinces of Canada in regard to any aspect of social security that, in Canada, is within provincial jurisdiction. The province of Quebec has concluded several understandings that include the Quebec Pension Plan.

22. The single exception was Canada's social security agreement with the United States. The United States would not accept periods of residence in Canada when totalizing to determine eligibility for US social security pensions; they would only accept periods of contribution to the CPP. On a reciprocal basis, Canada, under the agreement, does not accept periods of residence in the United States when totalizing to determine eligibility for OAS benefits, only periods of contribution to the US social security system can be used.

23. The Allowance paid to a widow or widower ceased if the person remarried, unless, of course, the new spouse was a pensioner in receipt of the Guaranteed Income Supplement and the couple's combined income qualified them for a Supplement and an Allowance.

24. Estimate prepared for the Caledon Institute by Andrew Mitchell of Thinking Cap Consulting using Statistics Canada's Social Policy Simulation Database and Model (SPSD/M). The SPSD/M is a tool designed to analyze the financial interactions of governments and individuals in Canada. It allows the assessment of the cost implications or income redistributive effects of changes in the personal taxation and cash transfer system. The SPSD/M is a non-confidential, statistically representative database of individuals in their family contexts, with enough information on each individual to compute taxes paid to and cash transfers received from government. The database was constructed by combining individual administrative data from personal income tax returns and unemployment insurance claimant histories with survey data on family incomes and on expenditure patterns. The database has been constructed in such a way as to provide a statistically representative sample of Canadians. The SPSD/M is a micro-simulation model which calculates taxes and transfers for individuals and families. These calculations are performed for everyone on the SPSD/M and then aggregated to obtain estimates. The estimated cost of extending the Allowance that appears in this study is based on the SPSD/M. The assumptions and calculations underlying the simulation results were prepared by Edward Tamagno and Andrew Mitchell, and the responsibility for the use and interpretation of these data is entirely that of the authors.

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