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Old Age Insecurity?

by

**Ken Battle, Sherri Torjman and
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The authors want to thank Caledon Policy Associate Edward Tamagno for his comments and suggestions on drafts of this paper. Ed wrote Caledon's 2007 review of the OAS program, from which some of the recommendations in this paper have been drawn.

ISBN 1-55382-559-4

Published by:

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Table of Contents

Normally cautious Prime Minister Harper has dared to touch the third rail of Canadian politics – the old age pension. Will he succeed when in 1985 his predecessor Brian Mulroney got his political fingers singed suggesting that Old Age Security be only partially indexed, and when a decade later Jean Chrétien retreated for fear that his government's proposed reform of seniors benefits threatened to become too hot to handle?

The pension system

The controversy and confusion over the Prime Minister's and Finance Minister's acknowledgement that their government is studying the long-term sustainability of Old Age Security indicate that there is widespread lack of understanding of the various elements of our pension system. Here, briefly, are its main parts and their purposes.

Canada's retirement income system has two fundamental objectives: The *anti-poverty objective* is intended to ensure that no senior lives in poverty. The *earnings replacement objective* seeks to maintain Canadians' pre-retirement standard of living into retirement.

Over the years, we have built a three-tier retirement income system intended to fulfill the anti-poverty and earnings-replacement objectives.

Old Age Security forms the first tier of Canada's pension system. Often referred to simply as 'the old age pension,' the Old Age Security (OAS) program is the foundation of our retirement income system. Old Age Security is made up of three parts: The basic OAS pension is paid to all Canadians 65 and over except for a small group of affluent seniors.[1] The Guaranteed Income Supplement (GIS) is an income-tested benefit targeted to low-income seniors 65 and over. The Allowance is a payment to low-income seniors aged 60 to 64 whose spouse or common-law partner is eligible for, or currently receiving, Old Age Security and the Guaranteed Income Supplement. The Allowance is also paid to low-income widows and widowers aged 60-64 who have not remarried or entered into a new common-law relationship. Note that the Allowance does not cover persons aged 60 to 64 who had never married or who had divorced or were separated.

The basic Old Age Security pension is by far the largest part of the program, with a projected 5.1 million beneficiaries in 2012 receiving a total of $31.3 billion. The Guaranteed Income Supplement serves 1.8 million low-income seniors and sends out $9.4 billion. There are some 89,000 beneficiaries of the Allowance and their benefits will total $577 million in 2012.

Together, Old Age Security, the Guaranteed Income Supplement and the Allowance aim to prevent poverty in old age. They also help serve the earnings-replacement objective for low- and modest-income seniors.

Old Age Security rates are indexed quarterly. In the first quarter of 2012, for a single senior, the basic Old Age Security is $540 per month and the maximum Guaranteed Income

Supplement is $732 per month, for a monthly total of $1,272. A senior couple gets $1,080 from Old Age Security and a maximum $971 from the Guaranteed Income Supplement, for a monthly payment of $2,051.

The second tier of the pension system is made up of the Canada Pension Plan (CPP) and Quebec Pension Plan (QPP). These universal public programs, funded by employees, employers and the self-employed, help serve the earnings-replacement needs of working Canadians in their retirement. They are especially important to seniors with modest and middle incomes. The maximum Canada Pension Plan and Quebec Pension Plan retirement benefits in 2012 are $986.67 monthly or $11,840 for the year.

The third tier is formed by employer pension plans (Registered Pension Plans or RPPs for short) and individual retirement savings vehicles (mainly Registered Retirement Savings Plans or RRSPs). They are supposed to perform the lion's share of the earnings-replacement needs of middle- and upper-income Canadians in their retirement.

Opinion is mixed on the performance of the various parts of Canada's retirement income system. It is generally agreed that we have made significant progress over the years on the anti-poverty front. The improvements are due mainly to Old Age Security and the Guaranteed Income Supplement (plus income supplements offered in a number of the provinces and territories) as well as the maturation of the Canada and Quebec Pension Plans and the rising participation of women in the labour force, who become eligible for pensions in their own right when they retire.

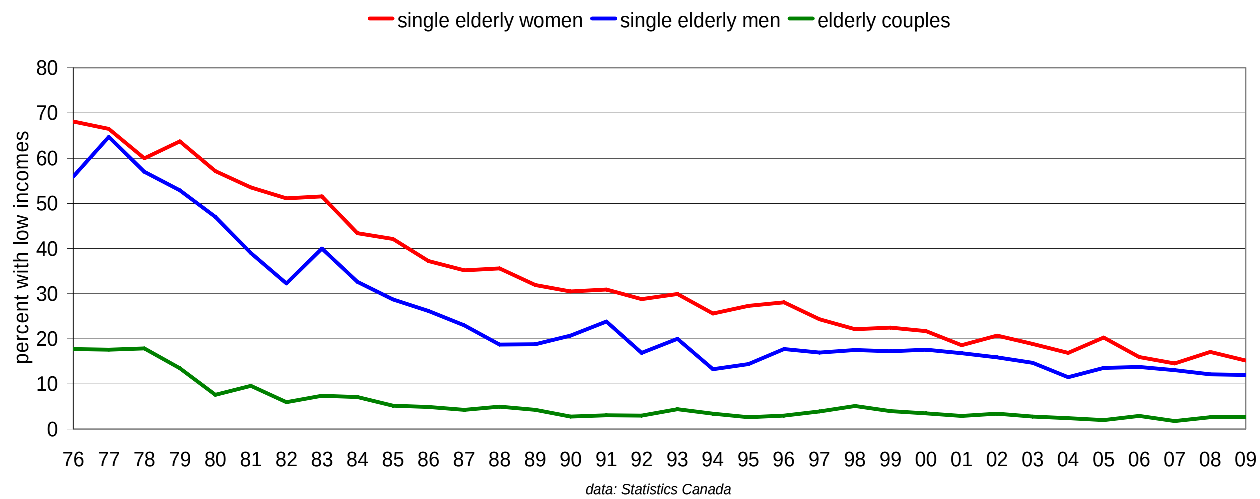
At the same time, though, senior couples have a much lower low-income rate (2.7 percent or 88,000 in 2009) than unattached elderly women (15.2 percent or 140,000) and men (12.0 percent or 46,000).[2] Figure 1 shows the low-income trends. There is still a significant poverty gap for single elderly women and men that Old Age Security and the Guaranteed Income Supplement have yet to fully close, despite improvements in recent years.

Recent research has confirmed concerns that the earnings-replacement function of Canada's pension system will under-perform for many of today's middle-income workers. A pioneering study found that "about half of the late baby boom generation with mid-level earnings in [their] working years can expect at least a 25 percent drop in their living standards by age 70" [Wolfson 2011: 26]. Especially at risk are Canadians who work in the private sector, few of whom have employer pension plans. RRSPs are largely a retirement savings vehicle for the well-off. The weakness of the third tier – which is supposed to play the main role in replacing earnings for middle- and upper-income Canadians – puts pressure on the two public tiers.

The unsustainability argument is unsustainable

The aging of the baby boomers and increasing longevity of seniors have led some observers to the conclusion that Old Age Security will be unsustainable in future years. However, opinions differ as to how to interpret sustainability.

Figure 1
Low income rate, senior couples and single elderly women and men, 1976-2009



Certainly the program's number of recipients and resulting costs are climbing and will increase substantially in coming decades. Figure 2 plots the number of basic Old Age Security beneficiaries from 1966 to 2060. According to the most recent Actuarial Report, they are projected to rise from 4.7 million in 2010 to 6.8 million in 2020, 9.3 million in 2030, 10.5 million in 2040, 11.3 million in 2050 and 12.2 million in 2060. OAS recipients will more than double in numbers between 2012 (5.1 million) and 2040 (10.5 million) [Office of the Chief Actuary 2011b: 24-25].

Figure 2
Total benefits (OAS, GIS, Allowance) and OAS alone, 1966-2060

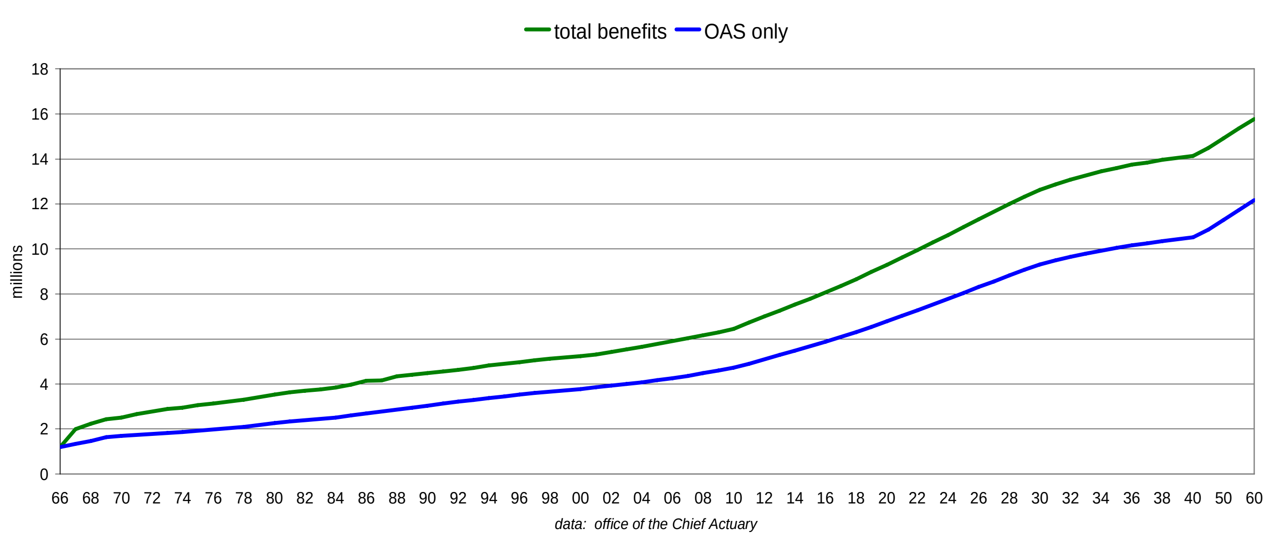
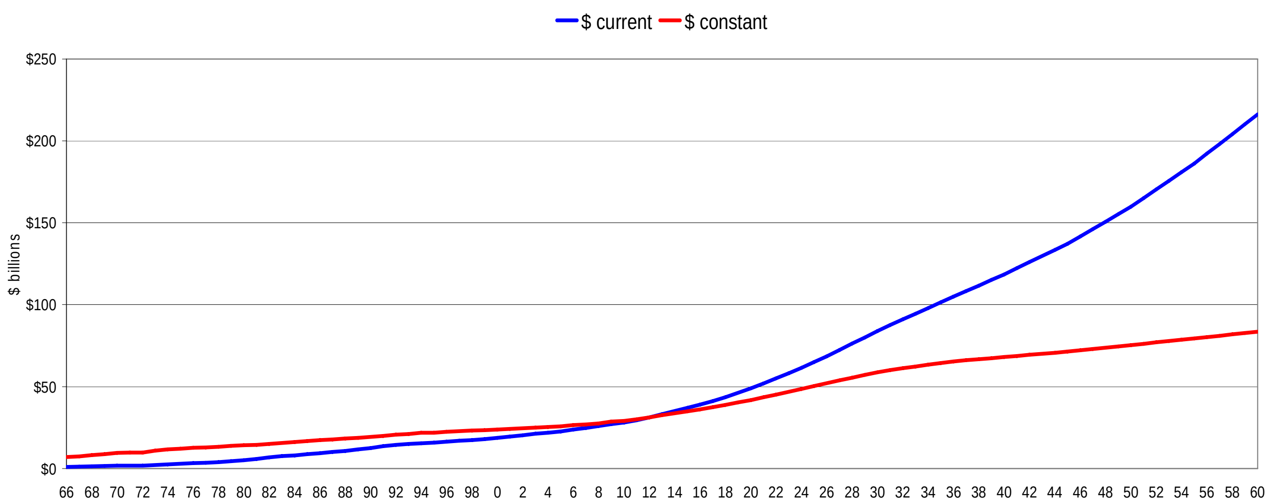


Figure 2 also shows the increasing number of total Old Age Security benefits (i.e., OAS, GIS and the Allowance together). The numbers will rise from 7.0 million in 2012 to 9.3 million in 2020, 12.6 million in 2030, 14.1 million in 2040, 14.9 million in 2050 and 15.8 million in 2060. Between 2012 and 2040, the number of Old Age Security program benefits will double [Office of the Chief Actuary 2011a: 24-25].

As a result, expenditures are on the upswing.[3] Figure 3 shows the trend, looking at the basic OAS pension alone. We show two measures – expenditures in current dollars (the blue line) and in constant 2012 dollars (shown in red). When plotting costs over time, it is essential to convert them to inflation-adjusted constant dollars. The difference between current and constant dollars is significant and widens over time, as illustrated in Figure 3.

Figure 3
Basic Old Age Security pension expenditures, in current and constant (2012) dollars, 1966-2060



data: Office of the Chief Actuary

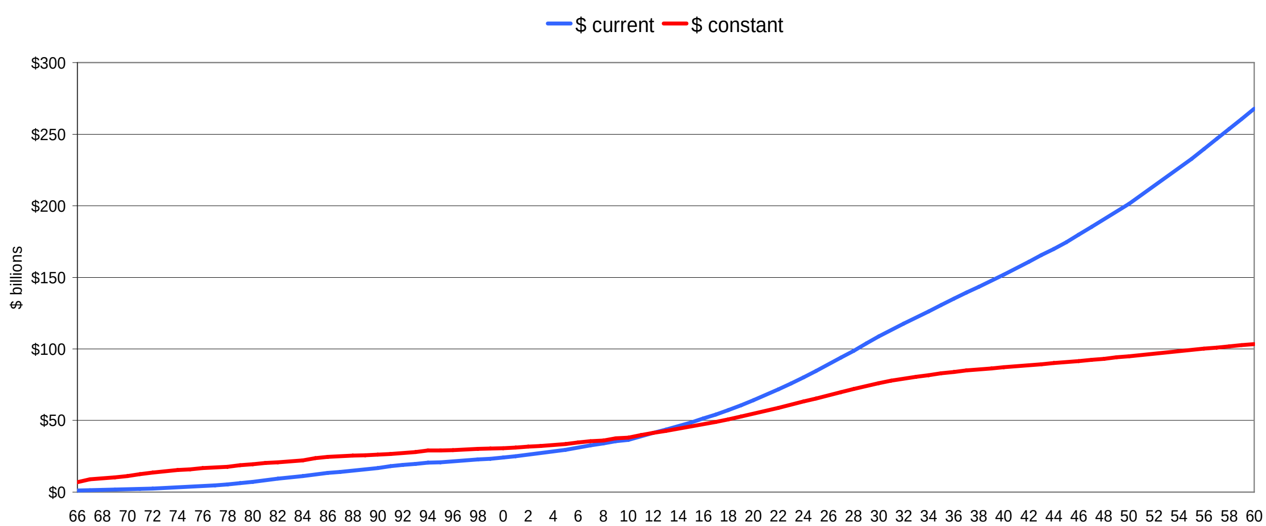
First, the results in current dollars. In 2010, basic Old Age Security pension expenditures amounted to $27.9 billion and are forecast to rise to $49.0 billion in 2020, $84.0 billion in 2030, $118.5 billion in 2040, $159.7 billion in 2050 and $216.1 billion by 2060 [Office of the Chief Actuary 2011a: 13]. According to these figures, OAS costs will triple between 2010 and 2030 – a dramatic hike highlighted by the government and reported in the media.

The trend in terms of constant dollars, however, tells a very significant story. Converted to constant 2012 dollars, basic Old Age Security pension outlay expenditures will increase from $29.1 billion in 2010 to $41.8 billion in 2020, $58.8 billion in 2030, $68.1 billion in 2040, $75.3 billion in 2050 and $83.6 billion in 2060. Between 2010 and 2030, basic Old Age Security pension outlays expressed in constant 2012 dollars will double in value. *So the cost of the basic Old Age Security pension is rising considerably in real terms, but nowhere near as much as when expressed in current dollars.*

The picture is the same plotting total Old Age Security expenditures (i.e., OAS, GIS and Allowance) over time, as illustrated in Figure 4. Total Old Age Security expenditures in current dollars were $36.5 billion in 2010 and are forecast to rise to $64.2 billion in 2020, $108.7 billion in 2030, $151.9 billion in 2040, $201.4 billion in 2050 and $267.8 billion by 2060 [Office of the Chief Actuary 2011a: 13]. According to these figures, total Old Age Security costs will triple between 2010 and 2030 – a big number indeed.

Converted to constant 2012 dollars, total Old Age Security expenditures will increase from $38.0 billion in 2010 to $54.8 billion in 2020, $76.1 billion in 2030, $87.2 billion in 2040, $94.9 billion in 2050 and $103.5 billion in 2060. Between 2010 and 2030, total Old Age Security expenditures will double. *So overall costs of the Old Age Security program are indeed rising considerably in real terms, but not nearly as much as indicated using current dollars.*

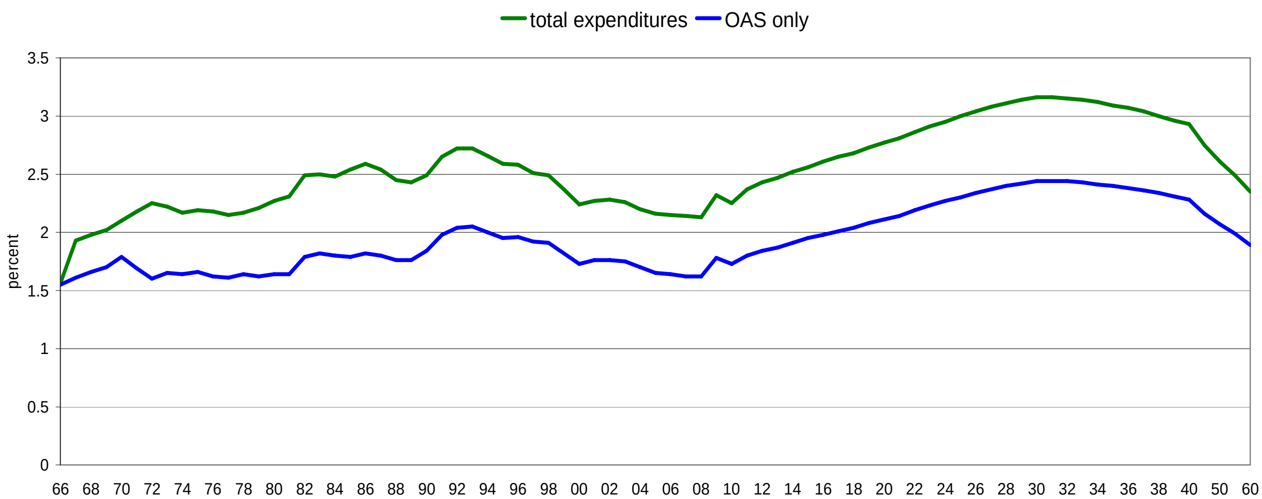
Figure 4
Total Old Age Security (OAS, GIS, Allowance) expenditures, in current and constant (2012) dollars, 1966-2060



Another key indicator is Old Age Security expenditures measured as a percentage of GDP (Gross Domestic Product). Figure 5 shows the results for OAS alone and for OAS, the GIS and the Allowance combined.

Basic Old Age Security pension expenditures amounted to 1.73 percent of GDP in 2010 and will rise to a peak of 2.44 percent in 2030, 2031 and 2032, then fall steadily as the baby boomers die off to 1.89 percent by 2060 (close to today's 1.84 percent). For the Old Age Security program overall (OAS, GIS and the Allowance), expenditures go from 2.25 percent in 2010 to a high of 3.16 percent in 2030 and 2031 and then decline as the baby boom generation dies off to a forecast 2.35 percent in 2060 (not far off this year's 2.43 percent) [Office of the Chief Actuary 2011b: 14].

Figure 5
Total Old Age Security (OAS, GIS, Allowance) and OAS only, expenditures as percentage of GDP, 1966-2060



data: Office of the Chief Actuary

So even at their high point, total Old Age Security expenditures will represent a modest 3.16 percent of GDP, and will fall back to just 2.35 percent of GDP in 2060, which is slightly below today's figure (2.43 percent). These results do not indicate that the cost of Old Age Security is beyond the country's capacity to bear as it increases in the coming two decades.

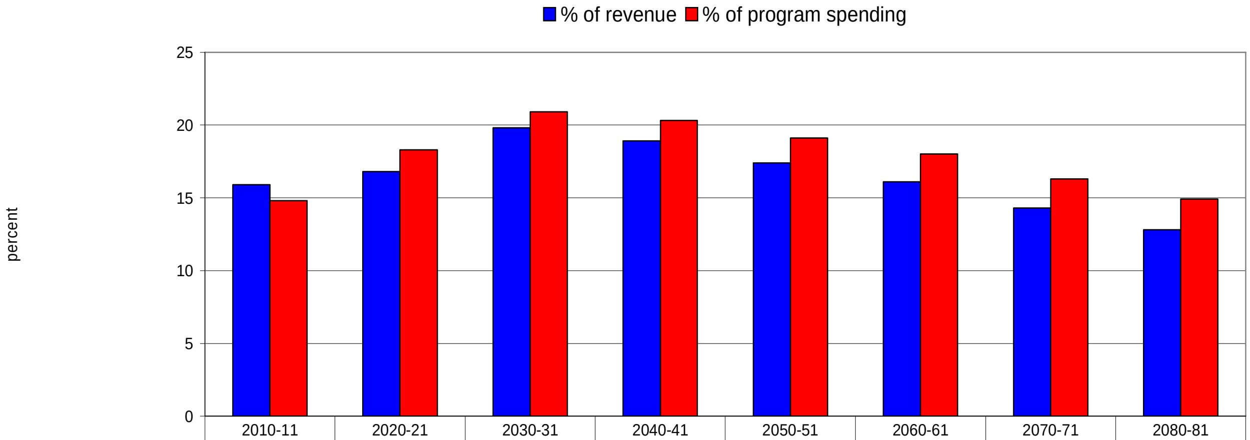
Using several measures, the Parliamentary Budget Officer concurs that Old Age Security is sustainable in fiscal terms. Even assuming that Old Age Security benefits will receive some above cost-of-living increase in future (equal to one-half of the increase in real GDP per capita) to take into account higher living standards in the future, the federal net debt-to-GDP ratio will decline steadily from its current level. Assuming Old Age Security will continue to be indexed only to inflation in future, the federal debt ratio will fall even faster [Matier 2012: iii].

As illustrated by Figure 6, total Old Age Security payments (assuming indexation to inflation) measured as a percentage of revenue will rise from 15.9 percent in 2010-11 to 16.8 percent in 2020-21 and 19.8 percent in 2030-31 and then fall steadily to 18.9 percent in 2040-41, 17.4 percent in 2050-51, 16.1 percent 2060-61, 14.3 percent in 2070-71 and 12.8 percent in 2080-81.

Old Age Security expenditures measured as a percentage of program spending increase from 14.8 percent in 2010-11 to 18.3 percent in 2020-21 and 20.9 percent in 2030-31 and then decline to 20.3 percent in 2040-41, 19.1 percent in 2050-51, 18.0 percent 2060-61, 16.3 percent in 2070-71 and 14.9 percent in 2080-81.

Neither does the future growth of Old Age Security suggest a doomsday scenario if we use employment earnings as the denominator. Expenditures on the Old Age Security program (OAS,

Figure 6
Total Old Age Security (OAS, GIS, Allowance)
as percentage of revenue and of program spending

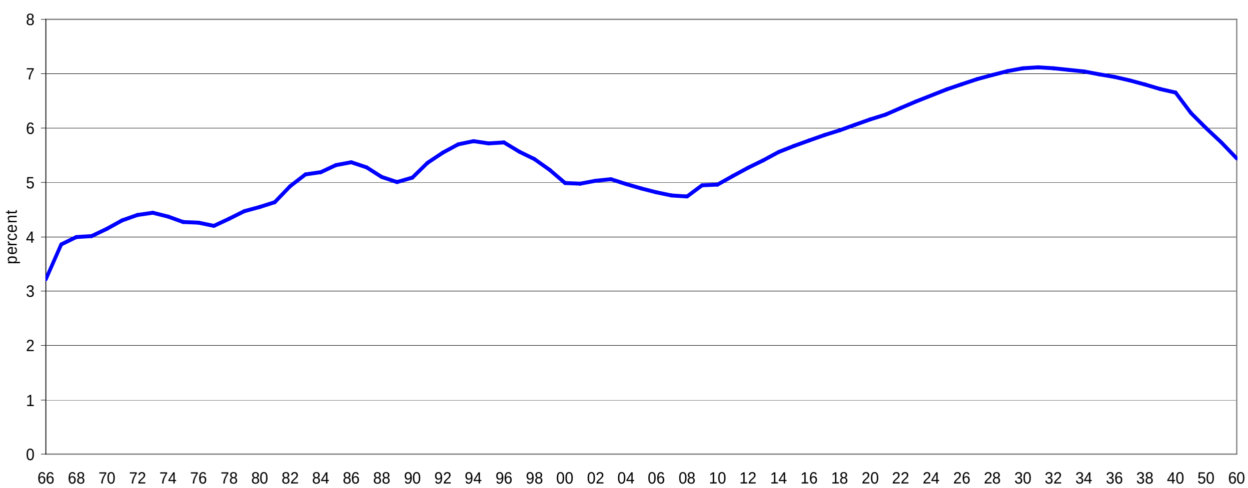


	2010-11	2020-21	2030-31	2040-41	2050-51	2060-61	2070-71	2080-81
% of revenue	15.9	16.8	19.8	18.9	17.4	16.1	14.3	12.8
% of program spending	14.8	18.3	20.9	20.3	19.1	18	16.3	14.9

data: Parliamentary Budget Office

GIS and the Allowance) increased from 3.22 percent in 1966 to 5.76 percent in 1994, declined to 4.74 percent in 2008 and rose again to 5.27 percent this year (2012) and a high of 7.12 percent in 2031, after which they are projected to fall to 5.44 percent by 2060. Figure 7 shows the trend.

Figure 7
Old Age Security (OAS,GIS, Allowance) expenditures
as percentage of total employment earnings, 1966-2060

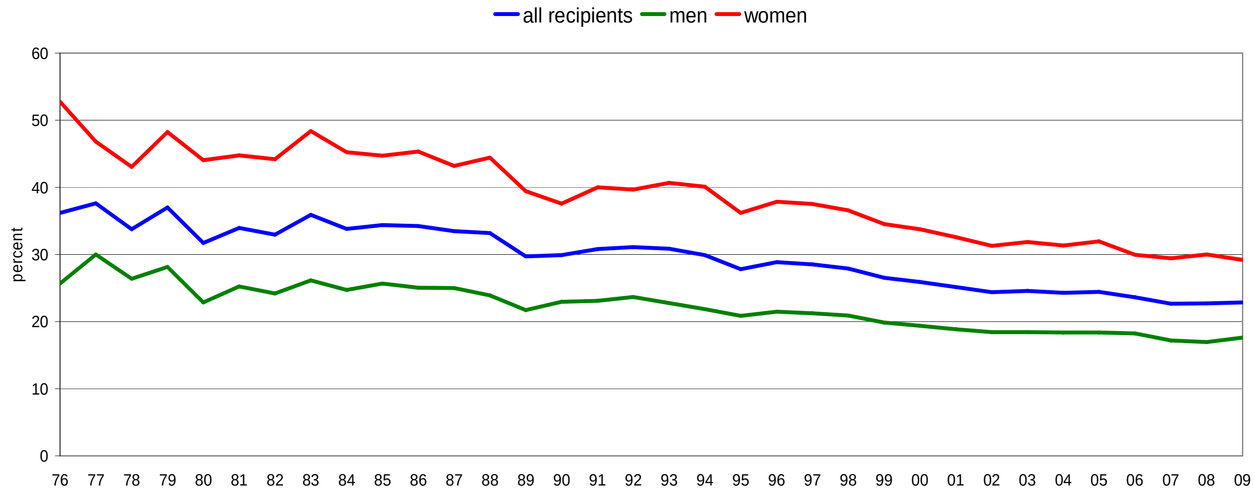


data: Parliamentary Budget Office

Old Age Security in a maturing pension system

The Old Age Security program is the cornerstone of Canada's retirement income system, but its weight within that system has diminished over the years. As shown in Figure 8, Old Age Security benefits (OAS, GIS and the Allowance) fell from 36.2 percent of aggregate income of seniors in 1976 to 22.9 percent in 2009. For women, Old Age Security comprised more than half (52.8 percent) of total income in 1976 but only 29.2 percent in 2009, and 25.7 percent and 17.6 percent for men, respectively. Senior women receive a larger share of income from Old Age Security than men because, on average, women have lower incomes.

Figure 8
Total benefits from Old Age Security and the Guaranteed Income Supplement as percentage of aggregate income of seniors, by sex, 1976-2009



data: Statistics Canada

These trends would suggest that, while it remains a crucial part of the pension system, Old Age Security is not playing an increasingly larger role in that system. To the contrary, it has been contributing a smaller portion of seniors' income at least since the mid-1970s.

The reason for this trend is that other parts of the pension system have been maturing and contributing a larger amount to elderly Canadians' incomes. These other elements include the Canada Pension Plan and Quebec Pension Plan, employer-sponsored pension plans and Registered Retirement Savings Plans. The rising participation of women in the labour force – who become eligible for pensions and benefits in their own right when they retire – has increased women's income and thus helped narrow the gap between the sexes when it comes to Old Age Security's contribution to income.

There is a vital lesson here: Instead of curbing Old Age Security expenditures, such as by increasing the age of eligibility, Ottawa and the provinces should boost the Canada Pension Plan (and Quebec the Quebec Pension Plan), which would reduce reliance on Old Age Security and strengthen the pension system overall.

The elderly are living longer

The increase in the real (after inflation) cost of the Old Age Security program is due not only to the fact that the number of elderly Canadians is growing both in absolute terms and relative to the number of persons of working age. There is another factor: Elderly Canadians are living longer.

In 1952, when the Old Age Security program began, the life expectancy of Canadian men aged 65 was, on average, 13 1/3 years. For Canadian women aged 65, it was about 15 years. For men and women aged 70 in 1952 – at the time, the age of entitlement to OAS – life expectancy was about 10½ and 11½ years, respectively [Dominion Bureau of Statistics 1960]. In other words, a man reaching the age of entitlement to OAS when the program started in 1952 would, on average, receive benefits for about 10½ years and women for about 11½ years.

In 1966, the age of entitlement to Old Age Security began to decrease by one year at a time until it reached 65 – its current level – in 1970. For men, life expectancy at age 65 in 1970 was only a little changed from that in 1952 – about 13¾ years. However, for women it was significantly higher – about 17½ years [Statistics Canada 1974].

The combined effect of lowering the age of entitlement to OAS from 70 to 65 (a decrease of five years) and the increase in life expectancy between 1952 and 1970 (the difference between life expectancy at age 70 in 1952 – as noted, about 10½ years for men and about 11½ years for women – compared with life expectancy at age 65 in 1970 – about 13¾ years for men and about 17½ years for women) meant that men, on reaching the age of entitlement to OAS in 1970, would, on average, receive benefits for about 3¼ years more than their 1952 counterparts, and women for almost six years more.

Now fast forward to 2007, the most recent year for which data are available from Statistics Canada. Life expectancy for men aged 65 in 2007 was 18.3 years, and for women 21.3 years [Milan 2011]. This is a substantial increase since the age of entitlement was set at 65 back in 1970 – for men, over 4½ years, and for women almost four years.

The increase in life expectancy is expected to continue although, as noted by the Office of the Chief Actuary in its most recent actuarial report on the Old Age Security program, “at a slower pace than most recently observed over the 15-year period ending in 2006” [Office of the Chief Actuary 2011b: 14]. The Office of the Chief Actuary estimates that, in 2010, life expectancy for men at age 65 was 18.8 years and for women 21.6 years. In 2050, according to the Office’s estimates, life expectancy at age 65 will be 21.9 years for men and 23.9 years for women [2011b: 65].

The basic conclusion from this data is clear: Canadians reaching age 65 today and in the future can expect to receive benefits for a longer period – in fact, a substantially longer period – than those who reached age 65 in the past.

And this does not tell the whole story. The figures cited above do not take into account likely further increases to life expectancy, after reaching age 65, due to factors such as future improvements in medical technology. When this is taken into account, the Office of the Chief Actuary estimates that life expectancy at age 65 for men and women in 2010 was 20.2 and 22.6 years, respectively [2011b: 66].

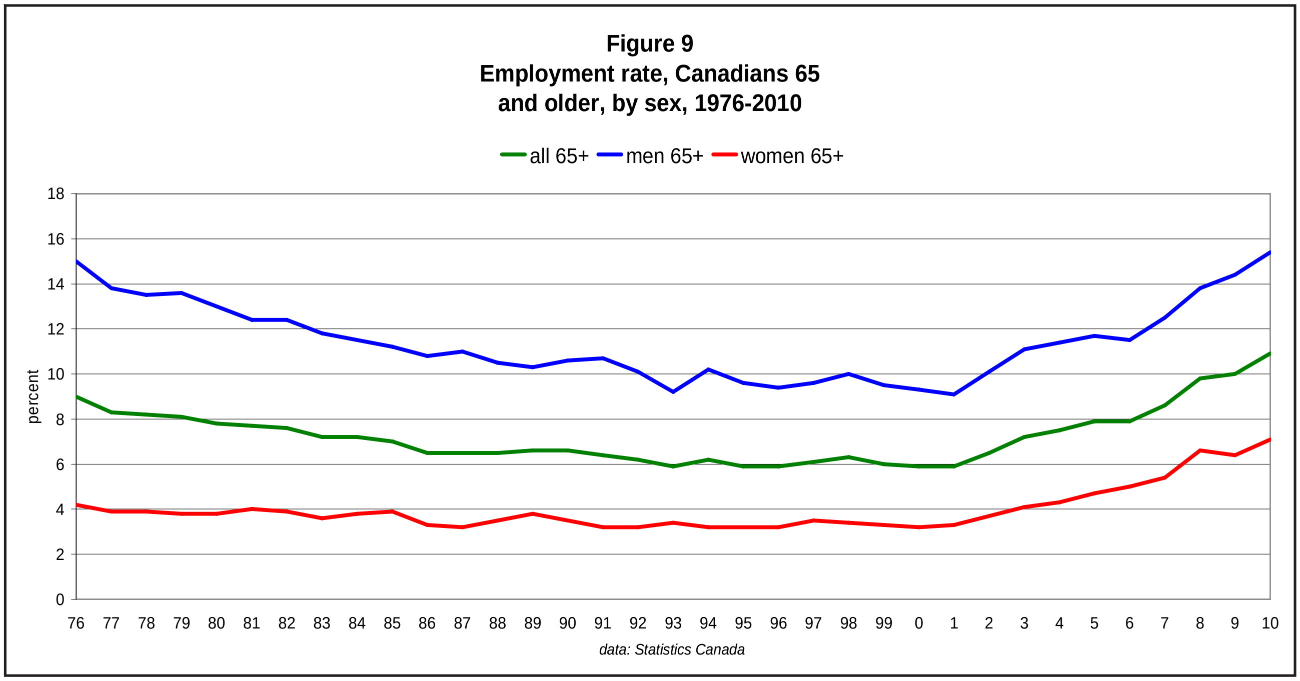
The Office of the Chief Actuary 'best estimate' regarding life expectancy at age 65 in 2050 is 22.6 years for men and 24.6 years for women [2011b: 40]. By our estimates, if the age of entitlement to Old Age Security were increased to age 67 by 2025, Canadian men aged 67 in that year could expect to receive OAS for close to 21 years, and women close to 23 years.

The question of work incentives

Proponents of raising the age of entitlement for Old Age Security – say from 65 to 67 – argue the change would provide a work incentive by encouraging more seniors to remain in the workforce and thus ease anticipated labour shortages (especially skilled and experienced workers) and the rising ratio of workers to retirees. The Chief Actuary predicts that the ratio of the number of Canadians age 20 to 64 to those 65 and older will be halved from 4.4 in 2010 to 2.2 in 2050 [Office of the Chief Actuary 2011b: 10].

"Encourage" may be too positive a word: Raising the age of eligibility for Old Age Security would effectively force many seniors to keep working another two years when they would much prefer to retire, especially if they work in low-paid, tedious or difficult jobs or have no other source of income to tide them over until they reach 67. (We return to this problem later and offer a solution). On the other hand, some better-off seniors might be able to retire earlier even if the age of eligibility for Old Age Security were raised because they do not rely on the program for much of their income (very high-income seniors do not get any OAS anyway because of the income test).

It's not as if older workers are increasingly leaving the workforce. The trend is quite the opposite among seniors and near-seniors, whose employment rate (i.e., the percentage of workers in a given age group) has been increasing during the last decade [Statistics Canada 2010]. Figure 9 shows the employment rate for Canadians 65 and older, which declined from 9.0 percent in 1976 to 5.9 percent in 2001 but rose to 10.9 percent in 2010. Fewer elderly women than men are employed (7.1 percent and 15.4 percent, respectively), but the trend is up for both. Moreover, the gap between women and men has been narrowing; in 1976 women's employment rate was 28.0 percent of men's, but by 2010 women's employment rate had risen to 46.1 percent of men's. The employment rates are higher for older workers under 65: In 2010, 68.0 percent for workers



aged 55-59 and 47.1 percent for those 60-64. Again, some of these elderly and near-elderly women and men work because they need the money, while others do it for love of the job.

Another factor to consider is the problem of unemployment and underemployment among many younger women and men. Some of the jobs of older workers could be done by younger people just beginning their careers.

Old Age Security is the bulwark of the pension system for low-income seniors

Old Age Security is a lesser percentage of the income of retirees on *average* than it was in previous decades, but it remains far and away the most important program for low-income seniors in Canada. The National Seniors Council found that in 2005 low-income single seniors received 77 percent of their income from Old Age Security, the Guaranteed Income Supplement and other income transfers, 17 percent from the Canada Pension Plan or Quebec Pension Plan, and 6 percent from private pensions, earnings and investments. By contrast, single seniors with incomes above the low-income line got 36 percent of their income from Old Age Security, the Guaranteed Income Supplement and other transfers, 25 percent from the Canada or Quebec Pension Plan, 26 percent from private pension plans, 9 percent from investments and the remaining 4 percent from earnings and other sources [National Seniors Council 2009].

The Conservative government has acknowledged the importance of the Guaranteed Income Supplement for low-income seniors in twice making improvements to the benefit. Its maiden 2005 Budget made the first real increase to the Guaranteed Income Supplement since 1984. The raise was a modest $36 for single seniors and $58 for senior couples and was implemented in two instalments – half on January 1, 2006 and the other half on January 1, 2007.

A larger enhancement to the Guaranteed Income Supplement came in the 2011 Budget. The maximum GIS payment for single seniors was increased by $600 and by $840 for couples, starting July 1, 2011.

The maximum increase in the GIS went to the elderly with little or no income other than Old Age Security and the Guaranteed Income Supplement. Single recipients with an annual income (other than Old Age Security and the Guaranteed Income Supplement) of $2,000 or less, and couples with an annual income of $4,000 or less, received the full amount of the increase. Above these income thresholds, the amount of the GIS supplement was gradually reduced and disappeared at an income of $4,400 for singles and $7,360 for couples.

Welcome as these improvements are, we would have focused more of the increase on single elderly women and men because they have a much higher poverty rate than elderly couples.

The poverty gap – the difference between the maximum Old Age Security/Guaranteed Income Supplement and the poverty line – is substantial for single seniors. In 2012, maximum forecast payments from Old Age Security and the Guaranteed Income Supplement total $15,385, which is a hefty $4,133 below the estimated after-tax low income cut-off for metropolitan areas with 500,000 or more residents and $1,121 below the line for large cities of 100,000-499,999.

For elderly couples, whose Old Age Security and Guaranteed Income Supplement amount to a maximum $24,803, their benefits are higher than the low income cut-off for all community sizes (e.g., $1,048 above the poverty line for metropolitan centres and $4,714 above the line in large cities). Keep in mind that most seniors – like most Canadians in general – live in metropolitan areas and large cities.

So poor single seniors who receive only the Old Age Security and the maximum Guaranteed Income Supplement will remain thousands of dollars below the poverty line, while all couples with maximum GIS payments will be substantially above the poverty line.[4]

Reform options

Raising the age of eligibility for Old Age Security is the talk of the town, but there are other possible changes to the program that should be included in the policy debate. And while Old Age Security is a key element of the retirement income system, there is another program that remains unreformed – the Canada Pension Plan.[5] We offer a proposal for expanding the Canada Pension Plan.

raise the age of eligibility for Old Age Security

More and more countries are climbing onto the raise-the-age-of-entitlement escalator. The US passed legislation way back in 1983 to gradually raise the eligibility for Social Security by two months each year for five years, starting 2003, to reach 66 in 2008 and 67 in 2025. The UK is increasing the eligibility age for its state pension from 60 to 65 for women by 2020, and for both sexes from 65 to 68 over 22 years starting 2024. Italy, Finland, Portugal and Sweden have tied their age of eligibility to gains in life expectancy. Other nations that are increasing their age of entitlement for pensions include France, Hungary, Spain, Australia, the Czech Republic, Denmark, the Netherlands, Switzerland, Turkey, Germany and Japan [Denton and Spencer 2010: 5-7].

Our federal government has not yet put forward any formal options for reform, but an increase in Old Age Security eligibility from 65 to 67 years old – with a gradual phase-in period to allow older workers to play by the current rules – is the major idea swirling around the policy community.

Whatever the number of years, raising the age of eligibility is a regressive move that would most hurt low-income seniors: They rely most on Old Age Security for their income and would suffer most if the program was *de facto* cut by reducing the number of years that seniors can receive benefits. Low-income Canadians typically work in non-standard jobs that are low paid, unstable, often part time, tedious or even dangerous, and lacking in employer-provided benefits such as private pensions and supplementary health benefits. When they reach 65, low-income workers see an improvement in their standard of living as they move from the workforce to Old Age Security.

The same applies to social assistance recipients, who do considerably better on Old Age Security than welfare. In 2009, the most recent year for which data is available, provincial welfare incomes for single employable recipients ranged from $6,637 in Nova Scotia to $9,652 in Newfoundland, with most in the $6,000 to $7,000 range [National Council of Welfare 2012]. Contrast welfare incomes to the $14,033 from Old Age Security/Guaranteed Income Supplement in 2009. Making low-income seniors aged 65 and 66 continue to work or stay on welfare for an extra two years is unfair and – in view of our critique of the unsustainability argument – unnecessary.

It gets worse. Low-income seniors generally receive Old Age Security for a shorter time than middle- and upper-income seniors because the poor have the shortest lifespan on average[6] [Tjepkema and Wilkins 2011: 32]. So raising the age of eligibility for benefits would further reduce the number of years that poor seniors can draw Old Age Security.

If the federal government raised the age of entitlement for Old Age Security, this change would produce mixed results for the provinces and territories. It would increase the cost of provincial/territorial social assistance because recipients would have to stay on welfare for an extra two years before they reached the age of entitlement for Old Age Security. On the other hand, most provinces and territories provide income supplements for their low-income seniors who get the federal Guaranteed Income Supplement; the number of such recipients would decline if the provinces and territories followed Ottawa's move to raise the eligibility age for Old Age Security. However, the former factor would outweigh the latter many times over, leaving the provinces and territories with a net increase in costs.

Raising the age for Old Age Security begs many complicated and important questions for *all* programs for the elderly. Would an increased age, say 67, mean that the standard age of retirement for employment pensions would also increase to 67? Would Canadians now be allowed to continue contributing to their registered retirement plans to 67? Would the age for the full Canada Pension Plan be increased to 67 as well? And what about disability plans, both public and private, which now phase out at age 65? Would the age-related provisions in the tax system now also be increased to age 67? And if so, would provinces and territories follow suit in their programs such as seniors' property tax relief? There are literally thousands of changes in both the private and public sector which would need to be considered, some with substantial fiscal and policy implications.

raise the age of eligibility for Old Age Security but protect low-income seniors and near-seniors

If Ottawa decides to raise the age of eligibility for Old Age Security, it should take steps to shield low-income elderly women and men from the impact of the change.

To protect poor seniors, many of whom work in physically difficult or monotonous jobs, for whom postponing retirement would be difficult, and to prevent downloading of costs to the provinces and territories, Ottawa could provide an income-tested benefit for low-income seniors aged 65 and 66. It already has the mechanism in place to do so, in the Allowance. The Allowance for the Survivor could be extended to all low-income single near-seniors (persons aged 60 to 66, if 67 were the age of eligibility for Old Age Security), and the Allowance could be extended to all couples in which both members are 60 to 66. This change would ensure that low-income Canadians aged 65 would receive an income benefit so that they would not have to work two years more should the age of eligibility be raised to 67.

a variable age Old Age Security

An alternative to raising the age of eligibility for seniors is to allow them to choose their own age of entitlement, within limits [Gardner 2012; Mintz 2012]. Old Age Security benefits would be 'actuarially adjusted,' which means that the amount of benefit would vary with the age that beneficiaries choose to begin receiving their payments. Seniors would have the choice of taking their benefit later than the current normal age of 65, as high as say 70, and would get a higher amount for each year they delay going on benefit. Conversely, they could elect to start receiving benefits as low as, say, 60, and the amount of payment would decrease for every year below 65. Of course, an age-variable Old Age Security program that sought to reduce spending could raise the age of normal retirement above the current 65.

This is not a blue-sky proposal: The Canada and Quebec Pension Plans offer an actuarially adjusted benefit, ranging from age 60 to age 70, with the amount depending on the age that recipients choose to start receiving their monthly cheques. The UK also makes such a provision, as do most OECD countries.

A variable age Old Age Security offers some advantages and suits the changing workforce. By providing an incentive for some seniors to keep on working past the age of 65, it might help deal with the problem of labour shortages in some occupations and some parts of the country. A variable age Old Age Security would afford seniors some choice in their personal retirement income plans – rather than forcing them to begin drawing their pension when the government decides. However, with choice can come some tough decisions, especially for lower-income seniors who would have to balance the freedom to leave the workforce earlier with the smaller Old Age Security benefits they would get. Yet, if the variable age option with an increased age for 'full pension' were combined with the extended Allowance benefit proposed above, this could offset losses for low-income seniors while still reducing government costs.

redesign the income test on Old Age Security

The Old Age Security program is made up of three benefits. The basic Old Age Security pension is a taxable benefit, while the Guaranteed Income Supplement and the Allowance are non-taxable income-tested benefits targeted to low-income seniors and near-seniors, respectively.

The basic Old Age Security pension used to be universal, meaning it went to all seniors regardless of their income level. In 1989, the Conservative government tacked an income test – popularly known as the 'clawback' – onto the basic Old Age Security pension to reduce the benefits of upper-income seniors. When introduced, the income test affected seniors with net individual incomes above $50,000 (the income threshold), and declined at the rate of 15 percent (the reduction rate) until it fully reduced Old Age Security benefits once net income reached $72,521.

The Old Age Security clawback was set high enough that it affected relatively few seniors in its early years. The 1989 Budget estimated that it would touch only four percent of Old Age Security recipients at first. The measure saved the federal government only $400 million in 1995-96, which was tiny compared to the total cost of Old Age Security ($16 billion at the time).

But as the partially indexed income threshold for the clawback declined steadily in real terms each year, more and more seniors (at declining income levels) were subject to the clawback and, while they still ended up with partial benefits even after the clawback, the latter effectively took a bigger bite out of their payments. In addition, the income level above which benefits were fully taxed back fell in small but steady steps and so also eroded benefits. The percentage of seniors hit by the clawback had increased to 5.0 percent by 2000 (2 percent were fully clawed back); that figure would have continued to increase over the years – had the federal government not restored full indexation in 2000. In 2012, the clawback kicks in at net individual income of $69,562 and reduces Old Age Security to zero at income of $112,772. Only 6.0 percent of seniors are affected by the income test, and just 2.3 percent receive no Old Age Security.

Lowering the clawback on the basic Old Age Security pension – either by reducing the income threshold or raising the reduction rate or both – would bring more seniors into the income test and reap more savings for the federal government. But at least this would be a progressive measure, affecting better-off seniors and not touching the majority of seniors who have low or average incomes. However, care would have to be taken not to lower the clawback so far that it digs into the large group of middle-income seniors for whom Old Age Security is a significant source of income.

The income test is applied on the net income of individual seniors, not couples. This feature creates unfairness – what economists call ‘horizontal inequity’ – when applied to senior couples. Depending on the division of total income between the spouses, one couple would be affected by the clawback while another couple with the same income would evade it.

Take, for example, the case of two senior couples with the same total net income of $120,000. In one couple, one spouse brings in all of the net income (except Old Age Security, which the other spouse receives) and is subject to the full clawback since his income is above the disappearing point of $112,772; that couple receives $6,480 from Old Age Security. Each spouse in the other couple has income of $60,000, which is below the $69,562 income threshold for the clawback, so its total Old Age Security payments come to $12,963 – double the amount of the other couple.

The solution to this design weakness is to base the Old Age Security income test on the couple’s total, not individual, income – the method used for a number of programs including the Guaranteed Income Supplement and the Allowance as well as the Canada Child Tax Benefit, the refundable GST credit, the Working Income Tax Benefit and provincial/territorial elderly and child benefits. There should be two different income thresholds for the Old Age Security clawback – a higher one for couples than for single seniors [Tamagno 2007: 19].

plug the loophole that allows wealthy seniors in the US and some other countries to evade the clawback on their Old Age Security benefits

The Old Age Security income test has another peculiarity that should be remedied. Because the clawback is in the *Income Tax Act* rather than Old Age Security legislation, it doesn’t apply to wealthy pensioners who live in the United States or in many other countries with which Canada has tax treaties. A Canadian millionaire, who would be entitled to no Old Age Security in Canada, can receive the full benefit if he or she resides in the United States or

Barbados or a host of other countries. The cure to this anomaly is to move the income test to the *Old Age Security Act* [Tamagno 2007: 16].

resurrect the Seniors Benefit: déjà vu all over again?

The 1995 federal Budget stated that the Ministers of Finance and of Human Resources Development would release a paper "on the changes required in the public pension system to ensure its affordability" [Department of Finance Canada 1995: 57-58]. Sound familiar?

The 1995 Budget set forth five "basic principles" for the reform of Old Age Security and the Guaranteed Income Supplement:

- undiminished protection for all seniors "who are less well-off"
- continued full indexation of benefits
- family income-testing of Old Age Security
- greater progressivity of benefits
- control of costs.

The 1996 federal Budget followed up with a proposed Seniors Benefit that would replace not only Old Age Security and the Guaranteed Income Supplement, but also the age and pension income tax credits. The new integrated elderly benefit was, true to the government's word, designed according to the five principles for reform.

The proposed Seniors Benefit distributionally resembled the Guaranteed Income Supplement placed on top of the basic Old Age Security pension. The Seniors Benefit would pay $120 more than the then maximum Old Age Security/Guaranteed Income Supplement for both singles and couples, providing an income guarantee of a maximum $11,420 for single seniors and $18,440 for elderly couples in 2001. (Note that the Allowance would continue as a stand-alone program, albeit modestly increased by the same $120 a year.) The Seniors Benefit proposal promised a fully-indexed benefit and income threshold.

The Seniors Benefit proposal included 'grandfathering' rules intended to ensure that no senior or near-senior would lose benefits as a result of the switch to the new system – which would not have taken effect until 2001. All Canadians age 60 by December 31, 1995, would have been able to choose either the Seniors Benefit or the old system – whichever provided the better benefit – for the rest of their lives.

The Seniors Benefit would have paid the majority of elderly Canadians either more than or the same as they get under the current system: Three in four elderly households would have received more or the same. Senior households with incomes under $40,000 – about the average income for couples and more than double the average income for single seniors at the time – would have been better off or no worse off under the new program. Some couples in the $40,000-$50,000 income range would have received somewhat more and some less, depending on the income mix of the spouses. Couples with income over $45,000 (above the $40,000 average income) would have got less, and those above $78,000 (almost double the average income) no longer would have received elderly benefits. Nine in ten single aged women would have come out ahead under the Seniors Benefit [Battle 2003: 13].

The controversy over the Seniors Benefit doubtless sent its name to the public policy closet for a long long time. But the essence of the reform – integrating current elderly benefits into a single, family income-tested program with a progressive design – still makes sense and would usefully be revisited in a public debate over pension reform.

fiddle the indexation formula

Governments in the past have tried – with considerable success – to trim spending by partially indexing or not indexing programs – 'social policy by stealth.' In its first (1985) Budget, the Mulroney government tried to partially index Old Age Security (which had been fully indexed to inflation since 1973) by adjusting benefits only to the amount of inflation over three percent. Led by seniors' groups, a political firestorm broke out and the government backed down.

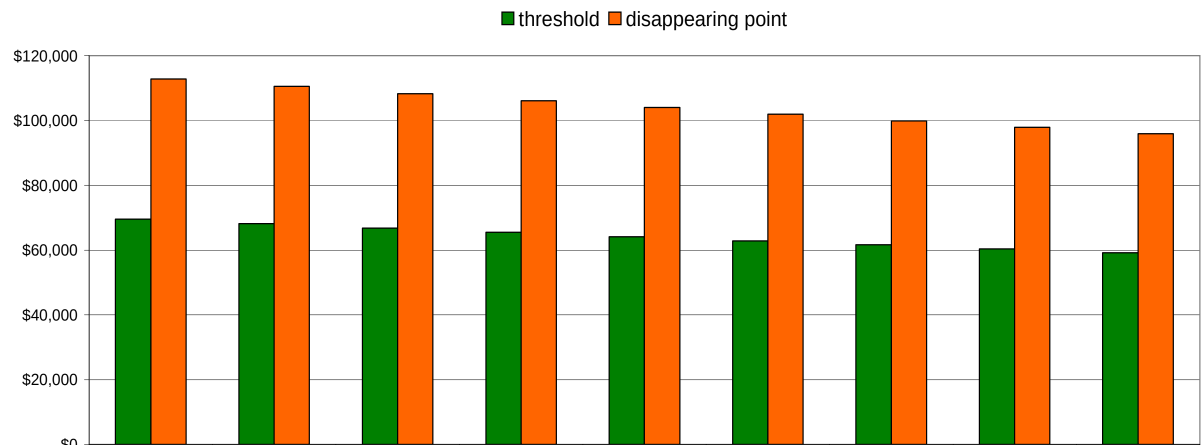
However, for various periods over the years, stealthy changes to indexation of major benefits and taxes have been imposed and reaped enormous savings to governments by effectively reducing benefits and increasing income taxes. Partial indexation was applied to child benefits, the personal income tax system and the refundable GST credit. The pension income credit is not indexed, though it was doubled in 2006 to make up for lost ground (which it did more than enough). The clawback on Old Age Security, introduced in 1989, was partially indexed until 2000, when – along with the personal income tax system and child benefits – it was fully indexed.

With the exception of the botched attempt to partially index Old Age Security in 1985, Ottawa got away with its partial indexation of child benefits, the personal income tax system, the refundable GST credit and the clawback on Old Age Security – largely because few Canadians understand this instrument of stealth. Partially indexing the income test on Old Age Security would reduce both the income threshold above which the clawback applies and the income level above which Old Age Security is fully removed. A partially indexed clawback would catch increasing numbers of seniors and siphon more and more money from the program each year. The clawback would catch even more seniors if it were simply not indexed at all. Figure 10 shows how not indexing the income test on Old Age Security would operate over a 10-year period.

It might seem tempting to compromise indexation given the federal government's desire to trim Old Age Security spending. Let's hope they resist and pursue the politics of transparency, not stealth.

There are less nefarious ways of cutting benefits by changing the indexation formula. The Old Age Security program is indexed to the cost of living on a quarterly basis. If, like most social programs, Old Age Security were indexed only once a year, rates could be raised less because, under the current quarterly indexation schedule, spikes in the cost of living are reflected

Figure 10
Clawback on Old Age Security, no indexation, in constant 2012 dollars, 2012-2020



	2012	2013	2014	2015	2016	2017	2018	2019	2020
threshold	69562	68171	66807	65471	64162	62879	61621	60389	59181
disappearing point	112772	110517	108306	106140	104017	101937	99898	97900	95942

in the indexation amount. We mention this just as a heads-up: Caledon is not advocating ending quarterly indexation of Old Age Security rates. Given the steadily rising population of Old Age Security beneficiaries, even small changes in benefits can result in large savings.

Statistics Canada is scrutinizing its cost of living measure, the Consumer Price Index (CPI), which is used to index income programs, including Old Age Security. Some economists contend that the current CPI overestimates the rise in the cost of living. Statistic Canada officials admit that one kind of measurement bias can add as much as 0.2 percentage points to the Con-sumer Price Index. That may not seem such a big deal, but it could have a significant effect because the Consumer Price Index is used to index a wide range of income programs, cost-of-living adjustments, child support payments and wage settlements. Correcting a 0.2 percentage point overestimate would reduce Old Age Security outlays by some $72 million the first year, $144 million the second year and $216 million in the third year [Chase and Grant 2012]. Statistics Canada is working to improve its method of measuring the cost of living, which monitors the prices of a basket of around 600 goods and services.

bolster the Guaranteed Income Supplement

The basic Old Age Security pension and Guaranteed Income Supplement are the most important source of income for poor seniors and have played a key part in the long-term progress against poverty. But the low income rate remains much higher for single seniors than couples, and there is a substantial gap for single seniors between OAS/GIS and the poverty line.

Last year's Budget significantly enhanced the Guaranteed Income Supplement for both singles and couples. We urge Ottawa to focus future increases on the Guaranteed Income Supplement for single seniors, who are most in need. To help pay for improvements to the Guaranteed Income Supplement, Ottawa should scrap a costly and regressive tax expenditure called 'pension income splitting.'

The 2006 Budget announced a new tax break called 'pension income splitting' whereby couples that previously paid tax on each spouse's individual income, like other taxpayer couples, can now split their income from private pensions and RRSPs so that each pays tax on half of private pension income. Couples in which one spouse (typically the man) has all the private pension income – the traditional one-income couple – are the biggest winners since the higher-income spouse now pays tax at a lower rate. Pension income splitting does absolutely nothing to help single seniors or the poorest elderly couples that pay no tax. Many senior couples are enjoying a tax reduction, but the measure is regressive – the higher their income, the larger the tax savings. And the tax break is costly – an estimated $925 million in 2011 [Department of Finance Canada 2012]. Increasing the Guaranteed Income Supplement for single seniors by $1,000 would cost around $976 million – close to the $925 million cost of pension income splitting.

strengthen the Canada Pension Plan and Quebec Pension Plan

The focus on Old Age Security is important, but it threatens to deflect attention from the key to pension reform – boosting the Canada and Quebec Pension Plans.

Bolstering the Guaranteed Income Supplement and preserving the basic Old Age Security benefit are necessary to strengthen the retirement income system's anti-poverty goal. The second major weakness in the pension system is the decline in *earnings replacement capacity* that is supposed to be provided by its second and third tiers. There are two problems – the overly modest design of the second tier's Canada Pension Plan and Quebec Pension Plan, and low and declining coverage of the third tier's employer-sponsored pension plans and RRSPs.

When the Canada and Quebec Pension Plans were created in the mid-1960s, they were deliberately designed to pay relatively modest benefits. The maximum retirement amount is only one-quarter of average earnings, for a maximum payment of just $11,840 in 2012. Private pensions and individual savings were intended to provide most of retirement income for middle- and upper-income pensioners.

Fewer than one in four private sector employees have a pension plan compared to nearly nine in ten within the public sector. Eighty-two percent of employees working for very large employers (500 or more workers) are in private pension plans compared to only 26 percent of those working for employers with 100 to 499 workers and a mere 2 percent in small workplaces with fewer than 50 employees. Coverage of RRSPs is also poor – only 24.3 percent of tax filers contributed to an RRSP in 2009.

In response to these problems related to adequacy, coverage and security, the federal Finance Minister worked with his provincial/territorial counterparts to craft a retirement income strategy. They debated a wide range of proposals, including improvements to the Canada Pension Plan and introducing a supplementary plan. Finance Minister Flaherty initially appeared to favour improving the Canada Pension Plan, but some provinces were opposed. At a meeting in December 2010, the federal and provincial/territorial Finance Ministers agreed instead to a voluntary plan. Dubbed Pooled Registered Pension Plans (PRPPs), these vehicles were touted in the 2011 Budget as a way "to provide Canadians with a new, low-cost, accessible vehicle to meet their retirement objectives" [Minister of Finance 2011: 112]. The new measure is now being implemented.

The problem is that Canada already has in place a voluntary supplementary system of pensions – Registered Retirement Savings Plans (RRSPs). These vehicles are used mainly by taxpayers in upper-income levels who have the money at hand and enjoy a hefty tax break in return for their contribution. The challenges facing modest- and middle-income retirees will remain unresolved.

Caledon proposes that the retirement income system be secured through major improvements to the Canada Pension Plan. The CPP is one of the nation's most important social programs and stands as an exemplary model in the world of a fair, solid and secure earnings-financed retirement income plan.

We have proposed that the earnings replacement rate rise by 1.5 times from its current 25 percent to 37.5 percent of Yearly Maximum Pensionable Earnings. We also would raise the Year's Maximum Pensionable Earnings by 1.5 times, from its current $50,100 to $75,150. This change would be of particular assistance to middle-income earners, especially those who work in the private sector and therefore are unlikely to enjoy coverage of employer-provided pension plans. Right now, the value of their Canada Pension Plan benefits is effectively capped at one-quarter the average wage, which means that the earnings of these workers are not being adequately replaced. A forthcoming Caledon report will include estimates of the contribution rate increases required to pay for this proposal.

Conclusion

Raising the age of eligibility for Old Age Security has become a hot-button issue. But politicians, bureaucrats, the media, policy experts and the general public should also be debating other possible changes to Old Age Security. And despite all the fuss over Old Age Security, a more important reform is to strengthen the Canada Pension Plan. Ottawa and the provinces should go back to the reform table and expand the Canada Pension Plan.

- We do not support the idea of raising the age of entitlement for Old Age Security because we see no convincing evidence to support the case that the program is not sustainable. Increasing the eligibility age would hit lower-income seniors – the working poor and those on welfare – hardest and would increase inequality.

- However, if the federal government goes ahead and increases the age of eligibility from 65 to 67, as now seems to be in the works, then it should protect the poor by extending the Allowance to cover low-income persons aged 65 and 66, including both couples and single persons.

- Instead of raising the age of eligibility for all seniors, the federal government should take a page from the Canada and Quebec Pension Plans and explore the possibility of an 'actuarially adjusted' age requirement, whereby seniors can elect to receive their Old Age Security earlier (at a reduced amount) than the normal age or later (at an increased amount) – say as low as 60 and as high as 70, keeping the existing 65 normal age. This same model can be used with a higher normal age of retirement, such as 67, while protecting low-income seniors by extending the Allowance to those who elect to begin collecting Old Age Security at age 65.

- Ottawa should base the Old Age Security income test ('clawback') on the couple's income, not that of each individual spouse. There should be a higher income threshold for couples than single seniors. If the federal government wants to slow the growth of its basic Old Age Security expenditures, it could lower the income thresholds for the income test and/or increase the reduction rate. The income thresholds must remain fully indexed. To plug the loophole that allows millionaires in the US and some other countries evade the clawback and get a full Old Age Security benefit, the income test should be moved from the *Income Tax Act* to the *Old Age Security Act*.

- To take the previous proposal a step further, Ottawa could dust off its 1986 proposal for a Seniors Benefit that would integrate Old Age Security, the Guaranteed Income Supplement, the age credit and the pension income credit into a single, fully indexed benefit based on family income. Under the original proposal, lower-income seniors would see an increase in benefits and upper-income seniors a loss. The Seniors Benefit used a progressive, geared-to-income design which still makes a lot of sense.

- In the name of fiscal restraint, past governments have for various periods partially indexed major programs and the personal income tax system, in the process reaping billions of dollars in increased tax revenue and spending reductions. Now that taxes and most programs are again fully indexed, care should be taken to keep them that way. The clawback on Old Age Security must remain fully indexed. Old Age Security is fully indexed on a quarterly basis (i.e., every three months); changing this to the more usual annual adjustment could affect benefits. The same holds for Statistics Canada's ongoing review of the Consumer Price Index, the basis of indexation to the cost of living. These seemingly arcane technical matters could translate into invisible but not insignificant reductions of Old Age Security benefits in future. The federal government should inform Canadians on these important matters.

- The Conservative government has increased the Guaranteed Income Supplement twice. Future improvements should be targeted to single seniors, who face a higher rate of low income than couples and whose elderly benefits still leave the poorest among them thousands of dollars below the poverty line. Ottawa should scrap the regressive and expensive ($925 million) pension income splitting tax expenditure to help pay for improvements to the Guaranteed Income Supplement.

- The key to improving Canada's pension system is to boost the Canada and Quebec Pension Plans' earnings replacement capacity, which would reduce the pressure on the Old Age Security program's Guaranteed Income Supplement and the Allowance. We propose that the Canada Pension Plan's earnings replacement rate rise by 1.5 times from its current 25 percent to 37.5 percent of Yearly Maximum Pensionable Earnings. We also would raise the Year's Maximum Pensionable Earnings by 1.5 times, from its current $50,100 to $75,150. These changes would be of particular assistance to middle-income earners, especially those who work in the private sector and therefore are unlikely to be covered by employer-provided pension plans. A forthcoming Caledon paper will propose increases in the contribution rate required to pay for this proposal.

Momentous changes to the foundation of Canada's retirement income should be done through a public process animated by a clearly-written reform paper that puts forth arguments, options and costs. The Chrétien government promised just that for its proposed Seniors Benefit but then changed its mind and, in a Budget, delivered a fully-formed program with no options or alternatives. The Seniors Benefit made sound policy sense but was not properly handled politically and died – not with a bang but a whimper.

The Harper government appears to be heading down the same possibly perilous path. Journalist Heather Scoffield writes that "government sources now say the budget will lay out a path forward, rather than launch a national conversation or policy paper on proposed changes" [Scoffield 2012]. While the Conservatives have a majority and can impose their will, they still could get their fingers burned if they follow a my-way-only approach.

Endnotes

1. For people living in Canada, they must be 65 years or older; living in Canada and be a Canadian citizen or a legal resident at the time their pension application is approved; and must have lived in Canada for at least 10 years after turning 18. For people living outside Canada, they must be 65 or older; have been a Canadian citizen or a legal resident of Canada the day before they left Canada; and have lived in Canada for at least 20 years after turning 18.

2. Low-income estimates for 2009 are from Statistics Canada using after-tax low income cut-offs.

3. The federal government recoups about 20 percent of its outlays through taxing the basic Old Age Security pension.

4. A number of the provinces/territories offer income supplements to their low-income seniors.

5. The Quebec Pension Plan is very similar to the Canada Pension Plan. We hope that Quebec too would expand its Quebec Pension Plan.

6. Men in the lowest income quintile, at age 25 live, on average, 48.2 more years or 73.2 years in all, while those in the highest income group, at age 25, live an average of 55.3 more years or 80.3 years in all – 7.1 years more than the poor. Women in the lowest income group, at age 25, live 55 more years or 80 years in all, in contrast to 59.9 years for women in the highest income quintile or 84.9 years in all – 4.9 years more than the poor.

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