national union

pensions backgrounder #2

A Brief History of Pensions in Canada

Part 2 in a Series

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BACKGROUNDER #2

A Brief History of Pensions in Canada

••• Workplace Pensions

The rise of workplace pensions in Canada is very much a 20th century story; however the first pension plan dates back to 1874.

Retirement not an Option for Workers in the 19th Century

During the first half of the 19th century most men worked in farming, crafts or trades and support in old age was provided by their offspring who had taken over the family business or farm. The last third of that century saw manufacturing employment increase at twice the rate of population growth, and these new workers needed to find a different way to provide for their old age. This was also a period when banks, insurance companies and the stock and bond markets were developing many new financial capital instruments for retirement saving. Saving for retirement, however, was not an option most workers could afford and they therefore continued to work until they no longer had the physical capacity to do so.

Railroad Companies First to Introduce Workplace Pensions

This was also a period of widespread labour unrest, with violent strikes and the rise of labour unions. As the 19th century ended, employers faced an aging workforce with potentially diminished capacity. In response, some of the more enlightened employers started providing a variety of benefits for their workers – a response that is often referred to as the beginning of welfare capitalism. These early pension plans were developed based on three different rationales: career, welfare and efficiency.

The first workplace pension plan recorded in Canadian history was a plan that the Hudson's Bay Company had established for certain retiring meritorious officers in 1840. The Ganong Chocolate Factory also offered a pension plan to its management employees in 1855. The railroads were the nation's first large industrial sector to develop pension plans. In 1874 the Grand Trunk Railway Company, a Canadian line, was created only for their management. The plan required employees to join by age 37 and remain at work until at least age 55. The pension deferred part of their wages until retirement, thus 'buying' the loyalty of its workers. By 1900, only federal employees, railway workers and employees of some commercial banks were covered by pension plans.

At first pension plans were justified as a tool to increase workers' loyalty, and to reduce strikes and turnover. As employers found that pensions were not very successful meeting these objectives, they became more interested in the value of mandatory retirement. This was the period of scientific management, when it was thought that older workers (over 45) could not keep up.

Private pension providers at first had little understanding of the actuarial realities of the pension plans they were creating. During the first two decades of this century, most large corporations financed their pensions from operating funds and had no reserves.

First Canadian Private Pension Legislation

The first Canadian legislation that encouraged workers to save for their retirement was the *Canadian Government Annuities Act* of 1908. Its purpose was to encourage Canadians to prepare financially for their retirement through the purchase of a government annuity. The Act allowed for the purchase of various annuities for different amounts and lengths of time. At a specified age, the recipient would begin to receive fixed yearly benefits. The government guaranteed these benefits and assumed all the costs to administer them. The problem, however, was that few Canadians could afford to buy them.

Pensions: Tools for Controlling Workers

After the well-publicized failure of the Morris Packing Company pension plan in 1923, suggestions for reform came from government, consultants and insurance companies, specifically that pension cost should be accrued, funds should be held with an independent fiduciary and workers should be vested.

Reforms were resisted on all three counts. From the beginning, most plans were non-contributory so that employers could terminate them at any time. Actuarial costs were difficult to estimate with most plans because benefits were based on final salaries. Building trust funds was expensive and these might be seen as employee assets. Corporations did not want to turn over funds to another institution when they felt they could better use the funds themselves. Finally, vesting was the least desirable idea, since employers wanted to give pensions to reward only long-serving employees. In general, there was a conflict between the reformers' view of pensions as deferred wages and the corporations' view of pensions as tools for controlling their workforce.

Unions Influence Growth of Workplace Pensions in Postwar Period

During the postwar period, the most important factor that influenced the growth of workplace pensions was the growth of the trade union movement and collective bargaining. First the United Mine Workers and then the CIO unions began pushing for industry-wide standards for pensions in Canada as well as the United States. Their success is measured by the fact that between 1945 and 1960, almost entirely due to union initiatives, pension coverage increased from 19% to 40% of the workforce. This 40% pension coverage rate stayed fairly constant until around 1990 when the rate began to drop to where it is today with only 33.6% of the workforce being covered by a workplace pension.

• • • Canada's Public Pension System

The first substantial involvement by the federal government in the field of income security took place during the decade after the First World War (1920-1930).

The federal involvement was the product of not only a high regard for veterans but also of social unrest, including the Winnipeg General Strike. Returning veterans were not assured work and found a marked contrast between the society's rhetoric and their destitute circumstances.

Old Age Pensions Act, 1927

Survivor and disability pensions were therefore created for war veterans and their families, but there was still a strong and growing need for a national old age pension system. The *Government Annuities Act* of 1908 was not the answer since few people could afford them. So in the 1920s, the issue of government assistance for the elderly was back on the political agenda. In 1924, Parliament appointed a special committee to study the question of pensions.

Political advocates like James S. Woodsworth and Abraham A. Heaps argued for a national pension scheme. When his government finally won a majority in 1926, Mackenzie King followed up on his promise to Woodsworth and Heaps by introducing legislation that became the *Old Age Pensions Act* in 1927. The maximum pension was $20 per month or $240 per year. It was available to British subjects aged 70 or over who had lived in Canada for 20 years. It was also restricted to seniors whose income, including the pension benefits, was less than $365 per year (this was determined by a means test). Status Indians were excluded.

Although eligibility was limited, the Act was a modest beginning to nationwide benefits for the poorest elderly. The program gradually included more people, such as blind persons, but eligibility remained limited and seniors had to pass a degrading means test.

The pension became increasingly unpopular when provincial legislation was used to back up the means test. To qualify for assistance, parents had to prove that their children could not support them. Officials even encouraged some elderly parents to sue their children for maintenance. Recipients' eligibility could be withdrawn after they had begun receiving pension payments. Payments were even recovered through claims against the estate of dead recipients.

In 1939, Canada's entry into the Second World War put people back to work and breathed new life into the economy. These good economic times, however, were not as favourable for seniors, whose pensions were devalued because of inflation. The contrast between the prosperous and the aged poor and the memory of the Depression inspired many people to propose a new national system of social security. Political parties, unions, seniors and social interest groups urged the elimination of the means test and the establishment of policies to protect all Canadians from extreme poverty.

Old Age Security Act, 1951

In 1951, THE Constitution was amended to allow the federal government to pass the *Old Age Security Act*. The Act, which took effect in January 1952, established a federally funded pension for all men and women 70 years of age and over, except for Status Indians. The maximum Old Age Security pension was $40 per month or $480 per year. For the first time, Canadian seniors could receive a pension without undergoing a means test. The Old Age Security pension however was not an income replacement measure; it was a safety net that conferred on all seniors who met the residency requirements a basic amount of support.

Private pension plans or savings were supposed to supplement that amount, if possible. However, for most people, retirement meant a drastically reduced standard of living. Even with Old Age Security, the average income for seniors in this period was only around 50% of average industrial wages. Some workers had employment-based pension plans, but they faced several problems: these plans were tied to a particular job, they were not portable, and they usually required very long contributory periods. They were also poor in the area of survivor benefits.

Canada / Quebec Pension Plans, 1966

Responding to the need for a public pension plan that offered portability, a greater measure of income replacement and insurance for families against the death or disability of a breadwinner, Lester Pearson's government introduced the Canada Pension Plan in 1966. This was a compulsory, contributory scheme for salaried and self-employed workers between the ages of 18 and 70. A sister program, the Quebec Pension Plan, was enacted in the same year to cover Quebec workers and their families.

The existence of two plans stemmed from the desire of the Quebec government to retain primacy in the social welfare field in that province and to have control of pension fund reserves for investment in provincial development. The other provinces had the option of establishing their own parallel plans as well, but none did. Ontario had legislated its own plan but never brought it into force, throwing its weight behind the Canada Pension Plan in the national interest. A Canada Pension Plan without either Ontario or Quebec would have faced significant challenges to its credibility and, perhaps, longevity. Development capital for the provinces could be acquired through loans from the Canada Pension Plan surpluses.

Section 94A of the Constitution, added in 1951 to permit the federal government to make laws in relation to old age pensions, was amended. This change permitted the Canada Pension Plan to provide pensions to survivors and disabled persons who were not 'old' and whose pensions would therefore not be old age pensions. The paramountcy clause, which ensured the CPP would not affect any provincial old age pension program, was also retained although its language was slightly modified.

Over the next five years, the eligible age for the Old Age Security pension and the Canada Pension Plan would be lowered to 65. Both pensions would be indexed to offer inflation protection.

Guaranteed Income Supplement, 1967

In the interest of fairness, a Guaranteed Income Supplement (GIS), tied to Old Age Security, was introduced in 1967 as a temporary measure to further reduce poverty amongst seniors. The GIS was part of the Old Age Security program and provided low-income Old Age Security pensioners with additional money. It was income-tested, meaning that as the amount of income increased (to a maximum of $720 a year in 1967 dollars for a single pensioner), the amount of the supplement decreased. It predominantly helped those who would retire before they benefited from the Canada Pension Plan.

Important Changes in the 1970s and 1980s

Throughout the 1970s and 1980s many changes to our public pension system were introduced to help women, low-income workers, disabled people and other groups most vulnerable to poverty. Some important changes:

- Flexible retirement was introduced in 1987, allowing Canada Pension Plan contributors the option of receiving a pension as early as the age of 60.
- The Guaranteed Income Supplement (GIS), introduced in 1967, became permanent.
- The Spouse's Allowance was introduced in 1975 and the Widowed Spouse's Allowance was introduced in 1985.
- Better inflation protection was put in place; from 1973, Old Age Security benefits were indexed quarterly as opposed to annually and indexation was linked to the Consumer Price Index.
- Partial Old Age Security benefits were made available to people who could not meet the residency requirements for a full pension.
- The definition of 'spouse' was added to the Canada Pension Plan and redefined under the Old Age Security program to include both legal and common-law spouses.
- Provisions were made to adjust the CPP / QPP contribution period for parents who left the workforce to raise their children.

- In 1988, Aboriginal people earning income on reserves were allowed to contribute to the Canada Pension Plan and receive benefits from it for the first time.
- In 2000, all Old Age Security and Canada Pension Plan benefits and obligations were extended to same-sex, common-law relationships.

Uproar Over Mulroney Government's Proposal to End Indexation, 1985

There were also regressive changes to our public pension system introduced in the 1980s. The Mulroney Conservative government came to power in the mid 1980s espousing neo-conservatism (or neo-liberalism) in the same 'wave' which elected Thatcher in the UK and Reagan in the U.S. Regarding social programs, the message was that spending had to be restrained, and "benefits targeted to those in need".

In the May 1985 budget, Minister of Finance Michael Wilson declared that "social programs must be changed so that benefits are targeted to those in need". He announced that Old Age Security would no longer automatically increase in dollar terms against the first 3% increase in the Consumer Price Index (CPI) annually.

The OAS de-indexation announcement provoked an uproar from the seniors' lobby. On June 19, Mulroney encountered a group of seniors protesting outside the Centre Block on Parliament Hill, in the rain. He thought he could sweet-talk them. But with the TV cameras rolling nearby, one senior, Solange Denis, directly challenged the PM: "You lied to us! You got us to vote for you, and then good-bye Charlie Brown!"

This proved to be a public relations disaster for the government. Eight days later, with Denis sitting in the public gallery, Wilson rose in the House of Commons to announce the government was flip-flopping and withdrawing the partial de-indexation for the OAS.

The labour movement learned an important lesson from this episode – that Canadians are justifiably worried about their retirement security and that politicians who seek to reduce retirement benefits are potentially vulnerable to union opposition and popular mobilization.

An End to Universality of OAS, 1989

The universality of the Old Age Security ended in 1989, with that year's federal budget 'clawback'. The budget declared that seniors had to repay 15¢ of their pension for every dollar of net income earned over a certain threshold. The threshold was $53,215. Seniors received their monthly

OAS cheque as before, but next spring at tax time the funding was 'clawed back' from the seniors affected when they filed their income tax form.

But the threshold level where the clawback kicked in was only partially indexed against inflation – indexing continued only at inflation rates above 3%, as with the 1985 reform (see above). This meant that over time, the threshold level declined in real terms.

The Liberal government reformed this program in July 1996 to provide that henceforward, eligibility for it was determined before the benefit was paid out, based on last year's income tax return. Benefits for affluent seniors are reduced before the monthly cheques are sent out, rather than being taxed back after the seniors have received their cheques.

Benefits are now paid out net of the clawback amount, based on the previous year's income tax return. Now affluent seniors do not receive any nominal funding at all. At least under the Tories' clawback, affluent seniors got a nominal benefit on a monthly basis, before it was clawed back when the seniors filed their income tax return. So the Tories maintained at least the pretence of universality; the Liberals eliminated even that.

The Tories' (partially indexed) clawback ended the universality of the OAS because it was now allocated on the basis of income. Their strategy for selling it to the public was to emphasize that it only affected the wealthiest 4.3% of the seniors' population: why should they get a government benefit? But because of the partial de-indexing, a growing number of seniors could expect to be affected (depending on the inflation rate). Thus, the clawback was another example of the 'politics by stealth' strategy, coupled with seductive rhetoric about the reasonableness of 'targeting' programs.

Changes to CPP to Guarantee Sustainability, 1998

The sustainability of Canada's public pensions grew into an important political issue in the 1990s. Life expectancy was increasing and seniors were making up a greater share of the population. At the same time, the number of workers contributing to the Canada Pension Plan (CPP) was decreasing. Many people were concerned that pensions would not be there for them when they retired.

In response to this growing concern, the Government of Canada and the provinces agreed to make changes to the CPP in 1998. Canada Pension Plan contribution rates were increased. The Canada Pension Plan Investment Board (CPPIB) was established to invest funds not immediately needed for benefits. The administration and calculation of benefits changed.

These changes put the CPP on solid financial ground. Despite the aging population, the Canada Pension Plan will continue to be available for future generations. As of December 2006, the CPP reserve fund now stood at $110.8 billion. The CPP reserve fund is expected to grow to $147 billion by 2010 and to more than $200 billion a decade from now. Based on actuarial projections, CPP contributions are expected to exceed benefits paid until 2022, providing a 16-year period before a portion of the investment income from the CPP reserve fund is needed to help pay CPP benefits. By the year 2010, CPP is expected to be the largest pension plan in the world.

The Martin Government took steps to try and protect the CPPIB from a progressive pension investment agenda by banning it from considering 'social' and 'political' issues. They also refused to appoint any representatives from the labour movement – in marked contrast to the situation in Quebec where a senior labour movement representative sits on the investment board of the QPP. Over time, the size of the CPP fund and the fact that its beneficiaries include all working Canadians may well mean that the Federal Government will have to engage with a progressive union agenda.

Public Pensions are Here to Stay

Although seniors will make up an increasing proportion of our population, Canada's public pensions are secure and will continue to support many future generations.