Canada’s Aging Population and Public Policy: 5. The Effects on Employers and Employees

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CANADA’S AGING POPULATION AND PUBLIC POLICY: 5. THE EFFECTS ON EMPLOYERS AND EMPLOYEES

1 INTRODUCTION

In the coming decades, largely because of the aging population, there is likely to be a decline in Canada’s labour force participation rate – the proportion of the population aged 15 years and older that is either working or looking for work. This projected reduction, which assumes no changes to such factors as immigration, could slow the rate of economic growth and the rate of growth in government revenues.

Some analysts believe that employers – and, to some extent, employees – may focus on innovation as well as investments in training as potential solutions to labour supply challenges. Others feel that immigrants and Aboriginal Canadians can play an important role in Canada’s future labour force. Finally, some argue that it will be increasingly important to ensure that older workers can remain in the workforce for as long as they wish and for as long as they are able to work; in this context, tax- and pension-related disincentives to work may be important.

This paper explores the challenges faced by Canadian employers and employees with regard to population aging, as well as possible federal solutions to the challenges. It also identifies selected business opportunities – and possible employment opportunities – arising from the aging population’s demand for goods and services.

2 THE DOMESTIC LABOUR SUPPLY CHALLENGE

According to Statistics Canada, the national labour force is unevenly distributed across age groups, with a disproportionately large cohort of workers close to retirement age. Moreover, projections show that Canada’s working-age population will decrease by 13% from 2009 to 2036; it is not expected to return to 2009 levels until 2061.

3 THE PRODUCTIVITY CHALLENGE

Productivity is defined as output per unit of input; as an illustration, labour productivity can be considered to be a measure of how much work is done per person in a given period of time. Productivity, then, is an important factor in increasing and maintaining living standards. Canada’s productivity is lower than that of its major trading partners, including the United States; in fact, approximately one half of Organisation for Economic Co-operation and Development (OECD) member countries have higher labour productivity than Canada. Since population aging will likely reduce Canada’s rate of economic growth per capita, which is one measure of living standards, it may become increasingly important for labour force participants to
increase their productivity in order to mitigate the adverse effects of population aging on Canada’s living standards.

Hence, if Canadians wish to maintain or increase their standard of living, and if Canada is to remain globally competitive, then Canadian industry, policy makers and other stakeholders could benefit from an examination of the productivity challenge in concert with that of the aging labour force. Focusing on solutions to the challenge may be useful as well.

4 THE CHALLENGE OF TAX- AND PENSION-RELATED DISINCENTIVES TO WORK

Canada’s retirement income system comprises three pillars:

- the publicly funded Old Age Security (OAS), Guaranteed Income Supplement (GIS) and Spouse’s Allowance (SPA) programs;
- a contributory system of pensions covering all employed and self-employed Canadians that comprises the Canada Pension Plan (CPP) and the parallel Quebec Pension Plan (QPP); and
- savings through employer-sponsored registered pension plans (RPPs), registered retirement savings plans (RRSPs) and/or Tax-Free Savings Accounts (TFSAs), all of which are tax-assisted, as well as other investments.

4.1 PUBLICLY FUNDED RETIREMENT INCOME PROGRAMS

4.1.1 OLD AGE SECURITY

The OAS is a monthly taxable benefit available to individuals aged 65 years and older who have been Canadian citizens or legal residents of Canada at some point before applying for benefits and who have lived in Canada for at least 10 years before applying for benefits. The amount of the benefit is updated quarterly to reflect increases in the cost of living as measured by the Consumer Price Index.

At present, individuals can earn up to $3,500 of employment income without affecting the calculation of their OAS benefit. Beyond that amount, for each dollar of net annual income beyond a threshold amount, which is indexed to inflation, the OAS benefit is reduced by $0.15 until the benefit reaches $0.

This reduction affects seniors’ retirement incentives through two channels. First, individuals with net income above the threshold amount for that year who choose to work after age 65 pay their federal and provincial/territorial taxes plus an additional 15% because of the reduction in OAS. Secondly, because OAS benefits interact with retirement benefits from the CPP or QPP, each $1 of CPP or QPP income that is received when net income exceeds the threshold amount for the year reduces the recipient’s OAS benefit by $0.15. Consequently, the incentive to work provided through the CPP/QPP actuarial adjustment is 15% smaller for individuals who are entitled to OAS benefits at age 65.
OAS-related disincentives to work affect relatively few seniors, either because individuals work less after age 65 or because few individuals over age 65 have net incomes that are sufficiently high to be affected by the OAS reduction.\(^5\)

### 4.1.2 Guaranteed Income Supplement

The GIS provides a monthly, non-taxable benefit to low-income OAS recipients living in Canada. This benefit is increased quarterly to reflect changes in the Consumer Price Index. Currently, for each $1 of family income, excluding OAS benefits and the first $3,500 of employment income, the GIS benefit is reduced by $0.50. The GIS benefit is reduced to $0 when annual family income exceeds threshold amounts that depend on family status and whether OAS and GIS benefits are being received.\(^6\)

The reduction in GIS benefits that occurs in the presence of family income affects retirement incentives through the same channels previously outlined in relation to OAS benefits. First, employment income received by individuals aged 65 and older that exceeds $3,500 results in a $0.50 reduction in the GIS benefit for every $1 of family income above this amount; this reduction is in addition to the federal and provincial/territorial personal income taxes payable on these earnings.

Secondly, GIS benefits interact with retirement benefits from the CPP and the QPP. At present, each $1 of additional CPP or QPP retirement income that is earned reduces a recipient’s GIS benefit by $0.50. Consequently, the incentive to work provided through the CPP/QPP actuarial adjustment is 50% smaller for individuals who will be entitled to GIS benefits at age 65. These two disincentives to continue to work mainly affect low-income seniors, probably those who would benefit the most from working more years to increase their income in retirement.\(^7\)

### 4.1.3 Spouse’s Allowance

The SPA program provides a monthly non-taxable benefit to the spouse or common-law partner of an individual who is receiving OAS and GIS benefits. To qualify for SPA benefits, the spouse or common-law partner must be aged between 60 and 64 years and must have lived in Canada for at least 10 years since the age of 18. Recognizing that OAS and GIS benefits are reduced when income exceeds certain threshold amounts, the SPA benefit is equal to the sum of the OAS and GIS benefits received by the SPA beneficiary’s spouse or common-law partner.

As with GIS benefits, the SPA benefit is reduced based on family income. Currently, the reduction rate is $0.75 for each $1 on the OAS portion of the SPA benefit and $0.50 for each $1 on the GIS portion of the benefit. The reduction in SPA benefits that occurs in the presence of family income affects retirement incentives through the same channels previously outlined in relation to OAS and GIS benefits. However, the work disincentive effects are stronger because of the 75% reduction in relation to the OAS portion of the SPA benefit. The SPA benefit is reduced to $0 when annual family income exceeds a threshold amount.
4.2 Earnings-Related Pensions

4.2.1 The Canada Pension Plan and the Quebec Pension Plan

The CPP and the QPP are earnings-related pensions funded by contributions made by employers and employees; self-employed persons contribute as both the employer and the employee. The CPP is administered by the federal government, while the QPP is administered by the government of Quebec. In most respects, the two plans are similar. A number of studies have identified three disincentives to continued work associated with the CPP for individuals aged 60 years and older:

- the imbalance in actuarial adjustments that are made when an individual begins to receive retirement benefits;
- the work cessation provision of the CPP; and
- the inability to make CPP contributions while receiving a CPP retirement pension.  

Recent amendments to the CPP will gradually eliminate the disincentives over the 2011 to 2016 period:

- the actuarial adjustments in relation to the receipt of CPP retirement benefits before and after age 65 will be gradually changed to eliminate the imbalance;
- the work cessation test will be eliminated in 2012; and
- starting in 2012, individuals who are receiving CPP retirement benefits will be able to make CPP contributions in order to increase their benefits through the newly created Post-Retirement Benefit.

4.2.2 Registered Pension Plans

Prior to 2008, the Income Tax Act (ITA) contained provisions that prohibited employees from accruing pension benefits under a defined benefit RPP while, at the same time, receiving a pension from that RPP or from another employer’s or a related employer’s RPP. These provisions prevented employers from offering phased retirement programs that would permit older workers to continue working while receiving a partial pension and accruing further pension benefits from their part-time work. They also prevented employers from paying a partial pension to older workers to increase the remuneration from full-time work while that worker continued to accrue pension benefits.

In recent years, work incentives for older workers have been improved through two legislative amendments related to provisions that prohibited employers from offering phased RPP benefits. In 2007, the ITA was amended to allow employers to offer qualifying employees up to 60% of the annual amount of the defined benefit pension to which they are entitled while accruing additional pension benefits. In addition, the Pension Benefits Standards Act, 1985 was amended to accommodate phased retirement in federally regulated pension plans.
Since phased retirement is not required for employer-sponsored RPPs and since employers in the public and private sectors can choose the employees who will be eligible for phased retirement benefits, the impact of recent legislative changes on the labour market participation of older Canadians will depend on the extent to which employers choose to offer phased retirement in the coming years.

4.3 Private Savings Arrangements

4.3.1 Registered Retirement Savings Plans
Initially designed as a retirement savings vehicle, an RRSP allows an individual to accumulate tax-sheltered savings until age 71. While RRSP contributions are tax-deductible, withdrawals of contributions and investment returns are considered to be taxable income that is taxed at regular federal and provincial/territorial personal income tax rates. Once an RRSP-holder reaches age 71, he or she is no longer allowed to make RRSP contributions and must choose either to withdraw the full value of his or her RRSP assets and pay taxes on that amount or to convert his or her RRSP into either a registered retirement income fund or an annuity. Regardless of the option that is chosen, prescribed minimum amounts must be withdrawn each year and are taxed at regular personal income tax rates.

Given the progressivity of the personal income tax system, with higher marginal tax rates for individuals having higher levels of income, the requirement to begin withdrawals at age 71 creates a disincentive to continue working after that age.

4.3.2 Tax-Free Savings Accounts
The TFSA was introduced in 2009 as a type of savings account that allows an individual to earn tax-free investment returns. TFSA contributions are not tax-deductible, but the contributions and the investment returns are exempt from tax when withdrawn. Since neither investment returns in a TFSA nor withdrawals from it affect eligibility for federal income-tested OAS, GIS or SPA benefits, seniors can withdraw funds from their TFSA with no adverse impact on these benefits. Thus, the tax-related disincentives to work described earlier in relation to federal income-tested benefits is partially offset. However, this offsetting effect is relatively small since, at this time, TFSA savings represent only a small part of seniors’ retirement income. As well, it should be noted that TFSA savings can be used for any purpose; their use is not limited to retirement income.

5 The Retirement Income-Related Solution
Recent amendments to the CPP, the ITA and the Pension Benefits Standards Act, 1985, as well as the introduction of TFSA, have improved the incentives for older workers to continue to work. However, these workers still face some disincentives to work associated with the OAS, the GIS and the SPA programs, as well as the requirement to start withdrawing RRSP savings at age 71. Eliminating or reducing these disincentives could encourage older workers to remain in the workforce and hence mitigate the adverse effects of population aging on the nation’s rate of economic growth and government finances.
As noted earlier, there are some disincentives to work related to the OAS. One way to reduce these disincentives to work would be to increase the amount of exempted employment income in the calculation of the OAS benefit. Disincentives to work could also be reduced by lowering the OAS reduction rate or increasing the net income threshold above which the reduction applies.

One means by which to reduce or eliminate the disincentives to work associated with the GIS program would be to increase or exempt the amount of employment income of a GIS recipient from the income measure used in the GIS reduction calculation. Another option would be to calculate the GIS reduction rate using the CPP or QPP retirement benefit entitlement from age 60 rather than the actual CPP or QPP income. Other options include reducing the GIS reduction rate or increasing the family income threshold above which the reduction applies.

Disincentives to work connected with SPA benefits could be reduced by increasing the amount of exempted employment income in the calculation of the OAS and GIS benefits, reducing the SPA reduction rate, or increasing the family income threshold above which the reduction applies.

As identified earlier, the requirement to begin RRSP withdrawals at age 71 creates a disincentive to continue working after that age. Individuals who are able and would like to continue working after age 71 could be discouraged from doing so when they realize that employment income, in addition to their RRSP withdrawals and other pension income, increases their marginal income tax rate. This work disincentive could be reduced by increasing the age at which an individual must withdraw his or her RRSP savings or convert them to a registered retirement income fund or annuity.

6 THE INNOVATION SOLUTION

Innovation is a key driver of productivity growth in advanced economies. In Canada, lagging labour productivity growth is said to be the result of the business sector’s weak innovation performance.14

According to the OECD:

[a]n innovation is the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organisational method in business practices, workplace organisation or external relations.15

Innovation can lead to improved productivity, lower costs and increased output, all of which can add to an organization’s profitability, as well as to an economy’s growth. Thus, given the benefits of innovation, and recognizing aging and productivity concerns in a number of countries, employers and employees can aim to be more innovative. Governments can help in this regard by introducing policies that encourage business investment in research and development (R&D) and in other activities that lead to innovation.16
Gross expenditures on R&D (GERD)\(^{17}\) is a measure used for international comparisons of innovation investment. Figure 1 shows Canada’s GERD as a percentage of gross domestic product (GDP), or “GERD Intensity,” and compares it with that of other OECD countries. The data reveal that Canada lags behind its international competitors in the area of R&D investment.

**Figure 1 – Gross Expenditure on Research and Development as a Percentage of Gross Domestic Product, Canada and Organisation for Economic Co-operation and Development Countries, 2000–2008**

Furthermore, Canada is not competitive with regard to business enterprise expenditure on R&D (BERD), which is an indicator of private-sector innovation investment. For example, Canada’s BERD as a percentage of GDP for 2009 was 1.00%, below the OECD average of 1.62%.\(^{18}\)

Innovative workplace behaviour is one way in which to address the productivity challenge. Another option to enhance productivity is ensuring proper compensation incentives. As the workforce gets older, the factors that motivate its participants to achieve high workplace performance may change; consequently, firms may wish to reconsider the incentives they have in place to encourage productivity. For example, those older workers who no longer have mortgage payments may value time off more than they do additional salary, or a more flexible work schedule rather than time off. Firms that consider the needs, wants and abilities of their employees, and act accordingly, may have better success in attracting, retaining and motivating employees.

### 7 THE TRAINING SOLUTION

As another possible solution to demographic challenges, Canadian firms may consider implementing training programs for their workers so that workers of all ages can be more productive.
Several reports have stressed the importance of ongoing training for the Canadian labour force. For instance, one of the recommendations of the 2008 Expert Panel on Older Workers was:

[that the federal government work with provincial and territorial governments to promote the value, benefits and importance to individuals and employers of increasing the levels of training and literacy, both in the workplace and through other programs, and to also promote the need for continuous learning throughout individuals’ working lives.]

Furthermore, new training for employees could also address ways in which to encourage them to become more innovative. In fact, given that the recent global financial crisis appears to have delayed the retirement of a portion of the older cohort, firms that provide training for these workers may receive better-than-expected returns on such investments, as these workers may be working longer than planned.

8 THE IMMIGRATION SOLUTION

It has been suggested that immigration to Canada could enhance labour force growth, reduce the proportion of older people in the Canadian population, address skilled worker shortages, spur innovation and increase productivity. However, most researchers conclude that immigration is only part of the solution and that policy challenges have to be overcome in order to maximize the full contribution immigration could make.

Canada received 280,681 new permanent residents in 2010, approximately 0.8% of the Canadian population. For the past 25 years, Canada has maintained immigration levels averaging between 225,000 and 250,000 immigrants per year, or 0.6 to 0.9% of the Canadian population. Since the mid-1990s, net migration has been the main source of population growth in Canada.

The C.D. Howe Institute estimates that immigration would have to increase by 2.5 times to offset the impact of low past fertility on workforce growth. The authors also construct a model targeting only immigrants aged 20–24 years and find that Canada would have to admit an average of 1.7 million of these immigrants annually to try to alter the old age dependency ratio (the number of people 65 years of age or older for every 100 people of working age, considered to be 15 to 64 years old). The study concludes that increasing the immigration to the levels required is an unlikely policy response. Factors such as job prospects, availability of housing and schools, settlement services and supportive public opinion are taken into account when the government sets the immigration levels.

The government believes immigration is needed to provide a new labour supply for certain skill shortages. Citizenship and Immigration Canada offers the Federal Skilled Worker Program and Canadian Experience Class to address national structural labour market needs, and the Quebec skilled worker and provincial nominee programs respond to regional labour market gaps. The federal government has also admitted growing numbers of temporary foreign workers, which indicates that employers have been unable to find Canadians willing or able to fill open positions.
Data on the extent to which immigrants contribute to the host country’s innovation and productivity are limited. However, the Conference Board of Canada has found that immigration has a positive impact on innovation at many levels; it asserts that immigrants represent a high proportion of those who are recognized for achievements in research and the arts, that they improve innovation in Canadian businesses and that they expand Canada’s trade relations.24

Despite the research suggesting that immigration may be a viable policy response to skilled labour shortages and lagging innovation, policy challenges have to be overcome to capitalize on this possibility. One such challenge, within the economic class of immigration, is getting the right match between immigrant skills and labour market shortages. Research shows that there is a correlation between skilled worker selection criteria and immigrant success in the labour market.25 Translating these research findings into immigration programs is a continual learning process. For instance, the Canadian Experience Class, which provides a route to permanent residence for highly skilled temporary foreign workers, was developed based on the economic success experienced by immigrants who had previously worked in Canada. Whether skilled workers should be selected on their general human capital or experience in particular occupations is being tested now as a result of changes to selection introduced in 2008.

Another challenge lies in using the immigrant labour force to its greatest potential. Immigrants report a number of barriers to economic integration, including lack of Canadian experience and lack of connections in the job market, as well as the non-recognition of foreign credentials and experience.26 Finally, Canada’s immigration program serves multiple purposes, including family reunification and provision of asylum to those in need of protection; while also potential economic contributors, these new immigrants are not selected on economic grounds.

9 THE ABORIGINAL LABOUR FORCE SOLUTION

Aboriginal people are a potentially significant domestic source of labour that could offset some of the demographic pressures of Canada’s aging labour market.27 Although Aboriginal Canadians are currently under-represented in the labour force, proposals to address Canada’s tightening labour market have tended to place more attention on retaining older workers and attracting immigrant workers than on increasing Aboriginal labour force participation rates. Research suggests, however, that between 2001 and 2026, an estimated 600,000 Aboriginal youth will reach the age of labour force participation.28 Ensuring that Aboriginal entrants into the labour force can fill labour market requirements in the coming decades is therefore important, not only for Canada’s prosperity, but also for the economic and social well-being of Aboriginal communities.

With a median age of 27 years, the Aboriginal population is much younger and is growing faster than the non-Aboriginal population, whose median age is 40 years.29 Owing to its younger age profile and higher relative growth rate, the Aboriginal population could account for at least 12.7% of labour force growth and 11.3% of employment growth between 2006 and 2026.30 Integrating the Aboriginal population into the workforce, however, will depend on successfully raising Aboriginal
participation rates. Despite some recent improvements in Aboriginal labour market activity, substantial gaps in employment rates between Aboriginal and non-Aboriginal people remain. In 2006, the employment rate for core working-age Aboriginal people (25–64 years) was 65.8%, compared with 81.6% for non-Aboriginal people.

Today, Aboriginal people represent roughly 3% of the Canadian working-age labour force, and are projected to account for about 5% of the total labour force population by 2026. While the absolute impact on the size of the overall workforce may be modest, it is nevertheless significant, particularly in certain provinces and regions. The potential contribution of Aboriginal people to the Canadian economy is perhaps most important in Manitoba, Saskatchewan and the North, where Aboriginal people comprise a sizeable share of the population. In Manitoba, for example, 28% of the population between 15 and 29 years of age will be Aboriginal by 2026, and Aboriginal people are expected to account for approximately half of labour force and employment growth from 2006 to 2026. Similarly, in Saskatchewan, it is projected that 36% of the population will be Aboriginal by 2026, and that Aboriginal people will account for all labour force and employment growth in the province, as it is expected that non-Aboriginal employment and labour force growth will decline over the period.

Future patterns of labour force participation by Aboriginal peoples are likely to rely on higher educational attainment rates and on occupational training. In 2006, about 50% of the on-reserve registered Indian population aged 25–34 did not have a high school diploma, compared with 10% of the non-Aboriginal population. The potential impact on the Canadian economy of improved levels of education among Aboriginal people is considerable. A 2009 report estimates that if Aboriginal educational outcomes “reach 2001 non-Aboriginal levels by 2026, all levels of the Canadian government will incur an increase in total tax revenue of $3.5 billion in 2026 (in 2006 dollars).” Given that education is a principal driver of employment and labour force participation, improving educational outcomes will be critical for young Aboriginal people entering the labour market, as well as for Canadian productivity generally as the Aboriginal share of the labour force grows.

10 THE BOOMER CONSUMER

Though the aging population will present a number of labour supply challenges to Canadian companies, it may also provide companies with new business opportunities and provide potential workers with new sources of employment. Given their large presence in the population, baby boomers have commanded much marketing attention throughout their lives; their senior years are likely to be no different. Some firms have already created products for this large cohort of consumers approaching their senior years, including special automobile insurance plans for motorists over the age of 50, tailored health insurance plans, new home-equity financing options, specially designed vacation packages, and retirement living properties and communities. Canadian companies that can address the needs and wants of aging boomers may benefit from lucrative business opportunities for years to come, while providing employment for workers of all ages.
11 CONCLUSION

An aging workforce, impending labour shortages and increased competition for skilled labour are creating challenges for Canadian businesses. Some believe that the federal government should work closely with its provincial/territorial counterparts, along with other stakeholders, to ensure that these challenges are addressed before they become detrimental to Canada’s economic prosperity. Policies that support innovation, immigration, a strengthened Aboriginal workforce, training, and the removal of tax- and pension-related disincentives to work could help Canada’s future economic prosperity.

NOTES

1. This paper is one of seven in the Library of Parliament series “Canada’s Aging Population and Public Policy.” The other publications are:

1. Note that, at one time, mandatory retirement provisions existed. However, legislatures across Canada have repealed provisions stipulating mandatory retirement. Today, all jurisdictions in Canada have either prohibited mandatory retirement or permit it only when there is a bona fide occupational requirement restricting employment to those in a certain age group due to issues such as safety or the physical nature of the job. In June 2011, the federal government announced that it would bring forward legislation to eliminate mandatory retirement for federally regulated employees unless justified by a specific bona fide occupational requirement.


3. Ibid. Also, it should be noted that these labour supply challenges will be mitigated by immigration, more intensive use of the existing workforce, etc.

4. Organisation for Economic Co-operation and Development [OECD], Labour productivity levels in the total economy, database.


6. Service Canada, Old Age Security Payment Amounts, April to June 2012.


11. Ibid.


16. Also important to improving productivity are investments in machinery and equipment; these types of investments are considered to be another area in which Canadian businesses lag behind their American counterparts.

17. GERD is defined as “the total intramural expenditure on R&D performed on a national territory during a given period. GERD includes R&D performed within a country and funded from abroad but excludes payments for R&D performed abroad,” This definition is used by OECD member countries and by Statistics Canada. See OECD, *Frascati Manual: Proposed Standard Practice for Surveys on Research and Experimental Development*, 6th ed., 2002, p. 121.

18. OECD, “Business Enterprise Expenditure on R&D (BERD) as a Percentage of GDP,” *Main Science and Technology Indicators Database*.


21. Statistics Canada (June 2010).


31. On this point, see, for example, Glen Hodgson, “Sustaining the Canadian Labour Force: Alternatives to Immigration,” *Executive Action*, Conference Board of Canada, August 2010. Hodgson argues that raising the participation rate of Aboriginal people in 2006 to the national average would add approximately 46,000 workers to the Canadian workforce, and while this would represent a welcome gain, it would not be significant relative to the overall size of the workforce.


34. Ibid., p. 16.

35. Ibid.
