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CANADA’S RETIREMENT INCOME SYSTEM

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Canada's Retirement Income System
(Background Paper)

Publication No. 2019-40-E

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EXECUTIVE SUMMARY

The purpose of Canada's retirement income system is twofold: to alleviate poverty among seniors and to help seniors who are better off to avoid significant declines in living standards when they retire. This Background Paper outlines the different components of the system, who they target, how much they cost and how they are financed. While there is a general consensus that the retirement income system is a policy success story, a broader discussion of how well the system is meeting its objectives today and what might need to be reformed if the system is to continue to function well into future will be left for another day.

To understand how this collection of programs and policy measures work to support seniors to attain and maintain a decent standard of living requires viewing them as a system. In turn, it is helpful to think of this retirement income system as being composed of three distinct pillars.

The first pillar provides benefits based on age and years of residence in Canada. It includes the Old Age Security (OAS) pension, the Guaranteed Income Supplement (GIS), the Allowance and the Age Credit. Often referred to as the foundation of the system, the first pillar uses a mix of universal and means-tested programs to create a minimum level of income. This ensures that seniors can afford the necessities of life: food, shelter, heating and clothing. The first pillar is financed primarily through general tax revenue.

The second pillar consists of mandatory earnings-related programs: the Canada Pension Plan (CPP) and, in Quebec, the Quebec Pension Plan (QPP). These public pensions are funded primarily through mandatory contributions by employers, employees and the self-employed. As benefits are based upon age and the amount contributed over a person's working career, the second pillar recognizes and supports workers who have spent decades in the labour force.

Third-pillar initiatives are voluntary for employers and/or individuals. They include workplace registered pension plans (RPPs) and private savings (Registered Retirement Savings Plans [RRSPs] and Tax-Free Savings Accounts [TFSAs]). In the third pillar, the federal government incentivizes the working age population to put money aside for retirement through preferential tax treatment. Generally, the third pillar is used most by higher earning Canadians.

Taking the three pillars together, the retirement income system is the federal government's most expensive undertaking. In 2017, OAS/GIS was the single largest budget expenditure, at around $50 billion. Retirement benefits from CPP and QPP totalled over $42 billion. An additional $49 billion of tax expenditures was used to encourage the use of workplace RPPs and private savings. Benefiting millions of Canadian seniors and their families, our retirement income system will continue to grow in significance as Canada's population ages.

The mixed funding model of the three pillars and the measures contained within them has been a source of strength, allowing the system to be both effective and resilient over the years. In the future, it is likely that issues related to the equity and transparency of tax expenditures that support the third pillar (workplace RPPs and private savings) will require more attention. In addition, as the proportion of Canadians with a workplace pension declines, governments will need to take a closer look to ensure retirement income adequacy for middle income earners.

CANADA'S RETIREMENT INCOME SYSTEM

1 INTRODUCTION: AN OVERVIEW OF THE "THREE PILLARS"

Canada's retirement income system is often described as having three pillars. The first pillar provides benefits based on age and years of residence in Canada. It includes the Old Age Security (OAS) pension, the Guaranteed Income Supplement (GIS), the Allowance and the Age Credit.[1] This first pillar is funded largely through general tax revenues and is often understood to be the foundation of the retirement income system.

The second pillar consists of mandatory earnings-related programs: the Canada Pension Plan (CPP) and, in Quebec, the Quebec Pension Plan (QPP). The CPP and QPP are public pensions, funded by mandatory contributions from workers and employers, as well as income from investments made with these contributions. While general tax revenue does not support these pensions, employers and workers are able to deduct contributions from their taxable income.[2]

The third pillar is composed of workplace registered pension plans (RPPs)[3] and private savings (Registered Retirement Savings Plans [RRSPs] and Tax-Free Savings Accounts [TFSAs]). Third-pillar programs are voluntary to employers and/or individuals but they are supported and incentivized by the government through preferential tax treatment, which includes tax exemptions and tax credits.

Table 1 describes the three pillars of the retirement income system. The key elements of these pillars are discussed in greater detail in later sections of this Background Paper.

Table 1 – The Federal Retirement Income System: The Three Pillars

	What Is in This Pillar?	Who Gets It?	How Does It Work?
Pillar One	▪ Old Age Security (OAS) pension	▪ Most Canadians 65 years and over who meet status and residency requirements.	▪ Pillar One provides benefits based on age and years of residence in Canada. ▪ It is financed largely through general tax revenues. ▪ The federal government directly transfers the OAS pension, GIS and the Allowance to individual seniors every month. ▪ The Age Credit is a form of preferential tax treatment called a tax expenditure.
	▪ Guaranteed Income Supplement (GIS)	▪ OAS pension recipients who have a low income.	
	▪ Allowance	▪ Younger spouses (aged 60 to 64) of OAS/GIS recipients.	
	▪ Age Credit	▪ Most Canadians 65 years and over.	

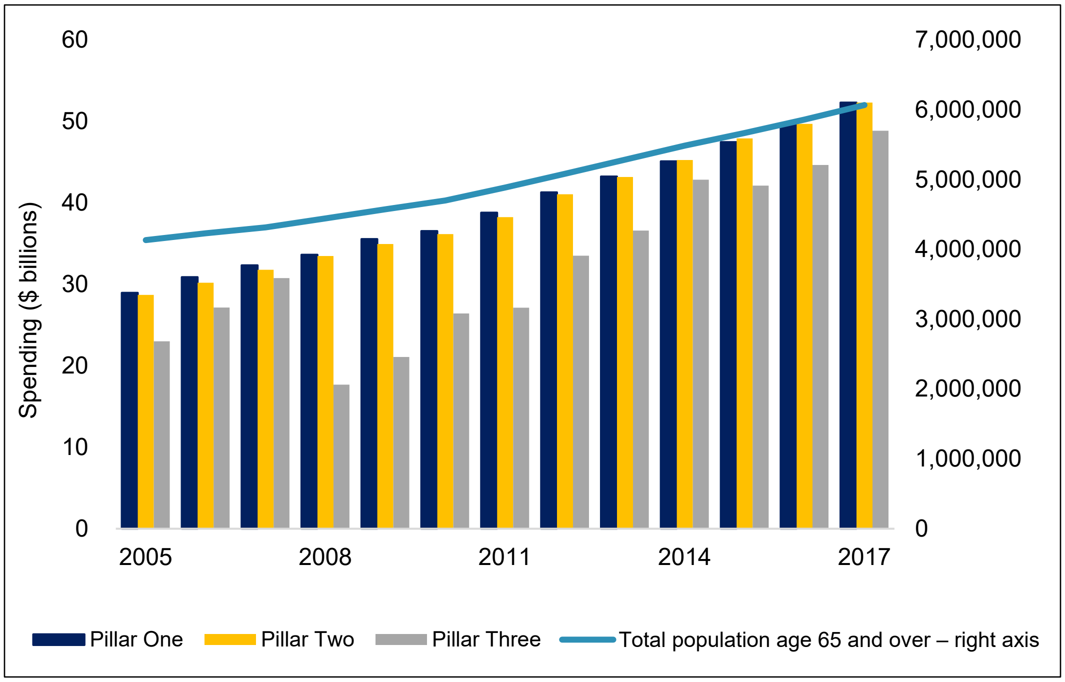
	What Is in This Pillar?	Who Gets It?	How Does It Work?
Pillar Two	▪ Canada Pension Plan (CPP) ▪ Quebec Pension Pan (QPP)	▪ Contributors receive a full retirement pension at age 65, a reduced pension as early as age 60, or an increased pension if retirement is delayed to between the ages of 66 and 70.	▪ Workers, employers and the self-employed all make contributions. There is also income earned from investments made by the Canada Pension Plan Investment Board. ▪ Eligible pensioners receive benefits based on how much they contributed while working. ▪ The federal government administers the CPP. The QPP is administered by the Quebec government.
Pillar Three	▪ Workplace Registered Pension Plans (RPPs)	▪ Workers who have contributed to a plan that has been set up by their employer or union.	▪ These retirement income tools are registered with the federal government for tax purposes but are not administered by the government. ▪ They are voluntary for employers and/or individuals. ▪ Pension plans are established by an employer or union, and both workers and the employer or union contribute. ▪ Contributions to RRSPs and workplace RPPs can be used to reduce taxable income and thus reduce the amount of tax owing. Taxes are paid on pensions and withdrawals during retirement, but often at lower rates than would have been paid during the individual's working years. ▪ TFSA contributions are not tax deductible; however, the interest and other income earned on TFSAs is tax free. ▪ Because the third pillar is financed through preferential tax treatment, there is a cost to the government in the form of tax expenditures.
	▪ Registered Retirement Savings Plans (RRSPs) ▪ Tax-Free Savings Accounts (TFSAs)	▪ People who have opened RRSP or TFSA accounts with financial institutions and have made contributions.	

Sources: Table prepared by the authors using information obtained from Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020; Government of Canada, *Old Age Security pension*; Government of Canada, *Registered Retirement Savings Plan (RRSP)*; Government of Canada, *The Tax-Free Savings Account*; and Employment and Social Development Canada, *Annual report of the Canada Pension Plan for fiscal year 2017 to 2018*.

1.1 SIZE AND COST OF THE RETIREMENT INCOME SYSTEM

In 2005, the total cost of the retirement income system was estimated at over $80 billion. By 2017, expenditures exceeded $153 billion. Although per person spending has increased, the increases in costs are largely a function of population aging. In 2005, the population aged 65 years and over was estimated at 4.2 million, and by 2017, it was estimated at just over 6.1 million.[4] Figure 1 illustrates federal spending for each of the three pillars of the retirement income system from 2005 to 2017. It also illustrates the growth of the senior population over this period.

Figure 1 – Federal Spending on the Three Pillars of the Retirement Income System and Population Aged 65 and Over, 2005–2017



Note: Program expenditure estimates for pillars one and two are for the population aged 65 and over. Estimates are generated using tax data and are for the calendar year. Pillar One estimates include Department of Finance Canada estimates of the Age Credit. Pillar Two estimates are generated from tax data but also include Department of Finance Canada estimates on the tax expenditures related to Canada Pension Plan/Quebec Pension Plan deductions.

Sources: Figure prepared by the authors using data obtained from Statistics Canada, "Table 11-10-0039-01: Tax filers and dependants, seniors with income by sources of income and age" (database), accessed 29 June 2020; and Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020.

The first pillar – the OAS Program – is the foundation of the retirement income system. Between 2005 and 2017, OAS program spending combined with Age Credit tax expenditure rose from around $29 billion to exceed $52 billion, representing an 80% increase in spending.[5]

The second pillar – CPP and QPP – is related to workforce participation and is designed to replace earnings in retirement. Spending levels on CPP and QPP are similar to the first pillar when the tax treatment of contributions is considered. In 2005, federal spending was estimated at $29 billion. This increased to $52 billion in 2017, representing an 80% increase over the period.[6]

The third pillar – workplace RPPs and private savings – is the most volatile. Between 2005 and 2017, the tax expenditures that supported this pillar ranged from a low of around $18 billion during the 2008 recession to almost $49 billion in 2017. The variability is a function of what is happening in financial markets and in the larger economy.[7]

1.2 ROLE OF EACH PILLAR

The characteristics of each pillar, the ways in which they are supported (i.e., general tax revenues, mandatory employee/employer contributions and tax expenditures) and the distributional effects of this financing will be discussed in more detail below. While each pillar plays a significant role in supporting the system as a whole, it should be noted that individual seniors likely do not receive equal support from each pillar.

For example, under the first pillar, OAS pensions are taxed back for seniors with high income. In 2017, the maximum annual income to be eligible to receive the OAS pension was about $119,000. It is estimated in that year that over 500,000 seniors had their OAS pension clawed back to various degrees. Around 200,000 of those seniors had high enough incomes that they were not eligible to receive any support from the first pillar.[8] Under the second pillar, the maximum CPP/QPP benefit in 2018 was around $1,100 per month, amounting to just over $13,000 per year. However, the average CPP/QPP retirement benefit paid out was significantly lower, at around $570 per month, or about $6,800 per year.[9] Finally, many seniors receive little-to-no support from the third pillar. Indeed, in 2016, 16% of seniors living in families and 36% of seniors living alone (over 1.2 million seniors) did not have any registered retirement assets (workplace RPPs, RRSPs or TFSAs).[10]

2 PILLAR ONE: THE FOUNDATION OF THE SYSTEM

2.1 OLD AGE SECURITY PROGRAM

The OAS pension is a monthly payment available to most Canadians who are 65 years of age and over and meet the status and residency requirements. Its objective is to ensure a minimum income for seniors and to mitigate income disruptions at retirement. It was the first universal pension for Canadians, and no means test was required. The benefit was introduced in 1952, and at that time, the maximum annual benefit was $480 per year.[11] By 2019, the maximum benefit exceeded $7,000 per year. In fiscal year 2018–2019, OAS pension expenditures exceeded $40 billion.[12] The total number of OAS pensioners that year was approximately 6.3 million.[13]

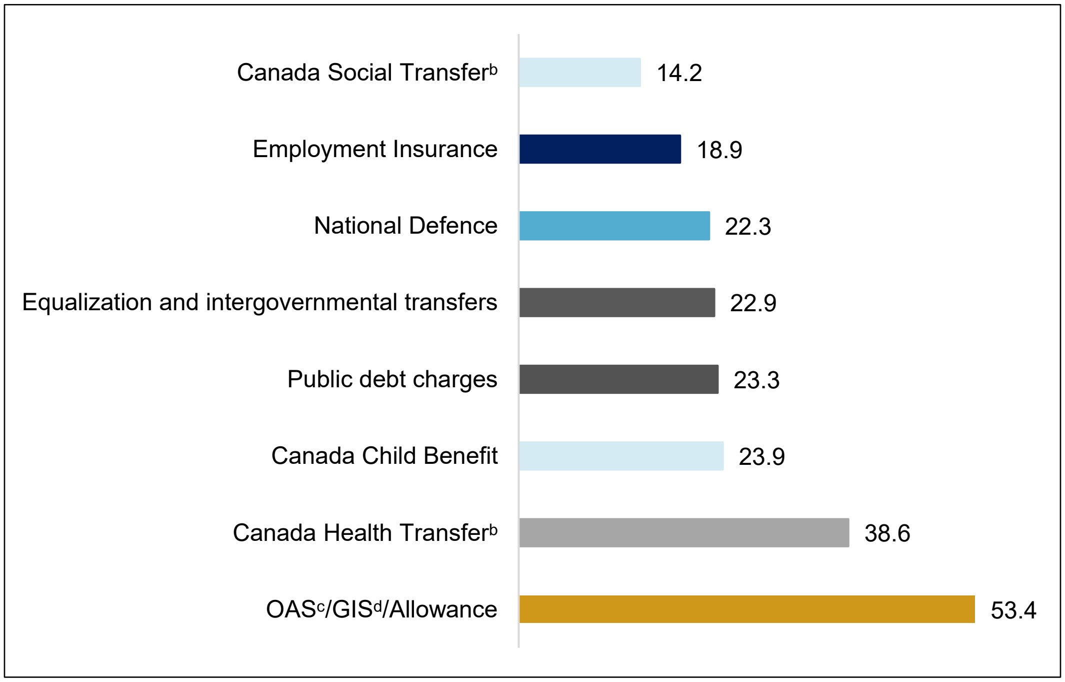
The GIS is a monthly non-taxable benefit provided to OAS pension recipients who have a low income and are living in Canada. The benefit has always been means tested and targets seniors with the lowest incomes. It was introduced in 1967 as a temporary measure to further reduce poverty among seniors.[14] In fiscal year 2018–2019, GIS expenditures exceeded $12 billion.[15] An average of 2 million seniors (about 33% of OAS pensioners) received GIS payments in addition to their monthly OAS pension. In order to receive GIS, these seniors were reporting annual incomes below roughly $18,000 for single seniors and $24,000 for couples.[16]

The Allowance was introduced in 1975. It is a benefit available to low-income individuals aged 60 to 64 who are the spouse or common-law partner of a GIS recipient. The Allowance acts like a bridge to help households with a younger spouse before they are eligible for OAS and GIS. Like GIS, it is a targeted means-tested benefit. There is also an Allowance Survivor benefit available to people whose spouse or common-law partner has died.[17]

Together, the OAS pension, GIS and the Allowance effectively function as a minimum income floor that ensures that low-income seniors have a minimum or basic income guarantee. In 2019, the minimum guarantee was around $18,000 for single seniors and $26,000 for couples.[18] This minimum income floor is funded through general tax revenues. This type of financing is often referred to as pay-as-you-go because taxes currently being paid are paying for benefits currently being received.[19]

Figure 2 illustrates first pillar (OAS/GIS/Allowance) spending in the larger context of total budgeted federal spending in fiscal year 2018–2019. At over $53 billion, it represents the largest single government transfer. Put into context, during the same year, the Canada Health Transfer was $38.6 billion, fiscal arrangements with the provinces (Equalization) around $23 billion, children's benefits were $23.9 billion and the Canada Social Transfer was $14.2 billion. Total budgeted federal spending for 2018–2019 was around $346 billion.[20]

Figure 2 – Federal Budgetary Expenditures, 2018–2019 ($ billions)[a]



Notes:
a. Federal budgetary expenditures are for the government's fiscal year beginning 1 April 2018 and ending 31 March 2019.
b. Both the Canada Health Transfer and the Canada Social Transfer are transferred to provincial and territorial governments.
c. Old Age Security.
d. Guaranteed Income Supplement.

Source: Figure prepared by the authors using data obtained from Government of Canada, "Consolidated statement of revenues and expenses," in "Section 1 – Summary tables and Appendices," *Public Accounts of Canada 2019: Volume II – Details of Expenses and Revenues*, 2019.

2.2 AGE CREDIT

The Age Credit is a tax credit that reduces the tax burden borne by Canadian seniors. This type of preferential tax treatment is often referred to as a tax expenditure or government spending that is delivered through the tax system. Tax expenditures are discussed in greater detail in section 4 of this paper.

The credit is provided to individuals aged 65 and over. In 2019, it had a maximum value of around $1,125. It is income tested, meaning the credit amount is reduced by 15% of net income in excess of an annually indexed threshold amount ($37,790 for 2019). The credit is completely phased out at a high-income threshold ($87,750 in 2019). Any unused portion of the credit may be transferred to a spouse or common-law partner.[21] In 2019, the tax expenditure associated with the Age Credit was estimated to be $3.8 billion.

3 PILLAR TWO: MANDATORY EARNINGS-RELATED PROGRAMS

3.1 CANADA PENSION PLAN AND QUEBEC PENSION PLAN

The CPP and the QPP are public pensions funded through mandatory contributions by employers and employees, those who are self-employed and the revenue earned on investments. The QPP is administered by the Government of Quebec, and Quebec residents participate in this parallel program instead of the CPP.[22]

These pension plans were established in the 1960s to respond to the fact that many Canadians experienced a drastically reduced standard of living in when they retired. At that time, there was growing support for an employment-based pension plan that would be portable from job to job. Eligibility is based on age, and payments are based on the amount contributed over a person's working career. In addition to retirement benefits, the CPP and QPP include disability benefits, a survivor's pension, children's benefits and a death benefit. These benefits are designed to provide a modest replacement income.[23]

3.2 THE CANADA PENSION PLAN OVER TIME

When it was introduced in 1966, the CPP was designed as a pay-as-you-go program, similar to the way in which the OAS program currently operates. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense at the time given population growth, rapid wage growth and the labour force participation rate, as well as the low rates of return on investments.

In 1997, major reforms were introduced. It was recognized that the pay-as-you-go approach would not be sustainable in the longer term. Legislative amendments were introduced to raise the level of funding. Contribution rates were increased, and the growth rate of benefits over the long term was reduced. In addition, contributions not needed to pay benefits immediately were to be invested in the financial markets through a newly created investment board, the Canada Pension Plan Investment Board.[24]

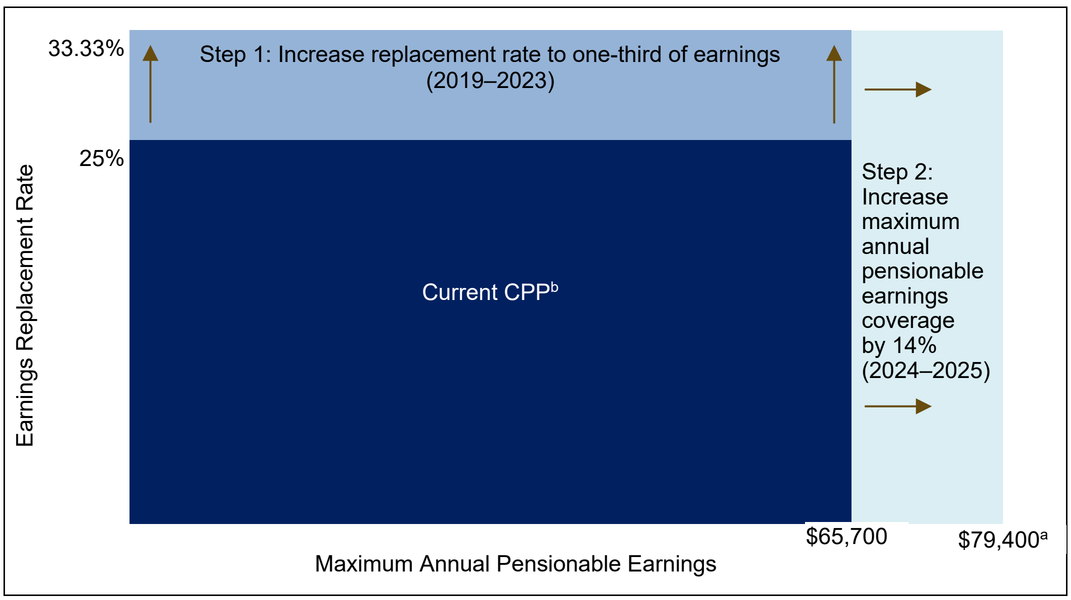
These legislative reforms transformed the CPP from pay-as-you-go to a steady-state model. This means that contributions will not need to increase dramatically to support a growing number of retirees. In addition, the amendments included provisions that ensured that any increases in benefits or new benefits provided under the CPP would be fully funded. In other words, any changes must follow the principle of intergenerational equity, making sure that each generation "gets what it gives" or pays for the benefits it will end up receiving. The CPP is reviewed every three years to ensure that funding requirements are being met.[25]

3.3 EXPANDING THE CANADA PENSION PLAN

Benefits under the CPP are designed to replace a fixed proportion of a person's average annual earnings from their working career, subject to an annual earnings ceiling. In 2016, the government enacted legislation to enhance the CPP by increasing the percentage of earnings that will be replaced and by increasing the maximum amount of annual earnings that will be covered, beginning in 2019.[26] By increasing both the replacement rate and the level of maximum pensionable earnings, the second pillar will be able to support more of the weight of the retirement income system.

The CPP expansion is illustrated in Figure 3. It shows the two-stage process for CPP enhancement, which includes both an increase to the maximum earnings replacement rate and an increase in the maximum annual pensionable earnings.

Figure 3 – Design of the Canada Pension Plan Expansion



Notes:

a. Over 2024 and 2025, the maximum annual pensionable earnings will be increased by 14% in addition to the usual rate-of-inflation increases. The estimated earnings limit will increase from $65,700 in 2023 to $67,700 in 2024 then to $79,400 in 2025.

b. Canada Pension Plan.

Source: Figure prepared by the authors using data obtained from Canada Revenue Agency, "The Canada Pension Plan enhancement – Businesses, individuals and self-employed: what it means for you," Backgrounder.

Up until 2019, CPP replaced one-quarter of a contributor's average annual earnings. Over the medium term, the CPP pension will aim to replace about one-third of a contributor's annual earnings. To achieve this, the contribution rate paid by workers and employers will increase between 2019 and 2023. The degree to which a retiree can receive the higher pension rate will depend on how long they paid the higher contribution rate. Current retirees will continue to receive pensions at the older rates.

Put concretely, in 2018, employee and employer CPP contributions were each 4.95% of pensionable earnings. CPP expansion increases this rate gradually. In 2019, the employee and employer contributions rose to 5.10%. It is estimated that employer and employee contributions will need to increase to 5.95% by 2023 so that contributions will be able to fully cover the cost of a 33.33% earnings replacement rate.

But this is only half the story. The maximum level of pensionable earnings is also increasing. Traditionally, the maximum pensionable earnings level has risen more or less at the rate of inflation. In 2018, this maximum was $55,900, and in 2019, it rose to $57,400. As part of the CPP enhancement, this maximum level of pensionable earnings will rise higher than the rate of inflation for two years (from 2024 to 2025). The CPP expansion projects to increase the yearly maximum pensionable earnings to approximately $79,400 in 2025. This change to the earnings ceiling will have no effect on lower-income workers. Higher-income workers, however, will pay more in contributions and will in turn receive higher pension payments in retirement.[27]

In February 2018, the government of Quebec implemented enhancements to the QPP similar to those of the CPP. It introduced higher retirement pensions (the rate at which income is replaced will gradually increase from 25% to 33.33%), a gradual increase in the contribution rate from 2019 to 2025, as well as an increase to the maximum annual pensionable earnings as of 2024.[28]

4 PILLAR THREE: WORKPLACE REGISTERED PENSION PLANS AND PRIVATE SAVINGS

The third pillar of the retirement income system consists of workplace RPPs and private savings (RRSPs and TFSAs). These retirement savings vehicles are not mandatory government pension programs; however, the government does offer incentives through the tax system to encourage Canadians to use these plans and accounts to save for retirement. Because workplace RPPs, RRSPs and TFSAs are financed through preferential tax treatment, there is a tax expenditure cost associated with them.[29]

The government does acknowledge that the tax system can be an effective way to implement a policy objective. Yet using tax incentives to encourage people to save for retirement "deviates from the core function of the tax system, at the cost of lower tax revenues."[30] In addition, tax expenditures decrease the administrative efficiency by increasing the complexity of the system. Longer forms are required. More effort on the part of taxpayers is needed to understand the system. Tax expenditures can also conflict with the neutrality of the system. Certain tax credits and deductions advantage certain types of behaviour of certain taxpayers. For example, pension splitting advantages married seniors, while many seniors are single (i.e., never married, divorced or widowed).[31]

4.1 WORKPLACE REGISTERED PENSION PLANS, REGISTERED RETIREMENT SAVINGS PLANS AND TAX-FREE SAVINGS ACCOUNTS

Workplace RPPs are employer or union-sponsored plans that allow both workers and employers to contribute. These plans receive preferential tax treatment in that workers can deduct their contributions from their taxable income to reduce the amount of tax owing. When the worker begins to draw a monthly pension, this amount is then taxable, albeit often at a lower tax rate than when the individual was working.[32]

RRSPs are retirement savings plans offered by financial institutions in which contributions can be used to reduce income tax owing. Any investment income or interest earned in the RRSP is usually exempt from tax as long as the funds remain in the plan. Contributors pay tax when funds are withdrawn.[33]

The TFSA is also available from financial institutions and it allows individuals to set money aside tax-free throughout their lifetime. Contributions to a TFSA are not deductible for income tax purposes; however, income earned in the account (such as interest, dividends and capital gains) is generally tax-free.[34]

4.2 ADDITIONAL TAX CREDITS AND TAX EXEMPTIONS THAT SUPPORT WORKPLACE REGISTERED PENSION PLANS

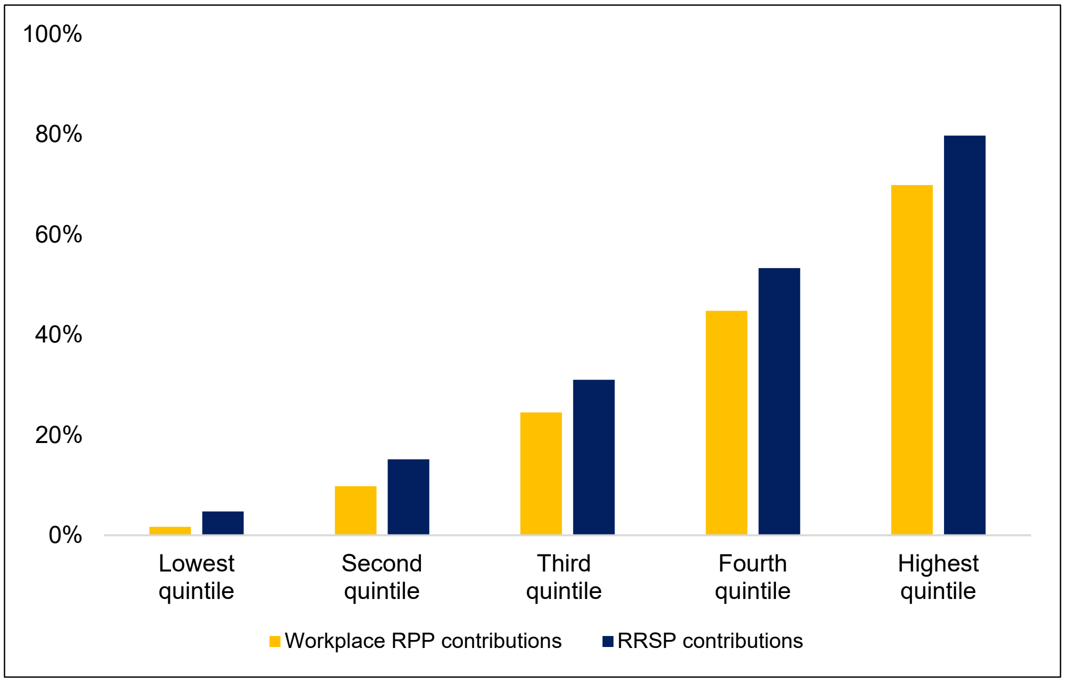
The Government of Canada also identifies the Pension Income Credit and pension income splitting as tax expenditures benefiting seniors.[35] The Pension Income Credit allows those with eligible workplace RPP, superannuation or annuity income to claim up to $2,000 per year. The value of the credit is calculated by applying the lowest personal income tax rate to the first $2,000 of eligible pension income. Any unused portion of the credit may be transferred to a spouse or common-law partner. It is a non-refundable credit meaning an individual can only claim the benefit if they have tax owing. Pension income splitting allows a spouse to give up to 50% of eligible registered pension income to their spouse for tax purposes. Canadian residents receiving income that qualifies for the Pension Income Credit can access this preferential tax treatment.[36]

4.3 WHO BENEFITS FROM RETIREMENT SAVINGS INCENTIVES OFFERED THROUGH THE TAX SYSTEM?

4.3.1 Workplace Registered Pension Plans, Registered Retirement Savings Plans and Tax-Free Savings Accounts

Higher income families disproportionately benefit from tax expenditures that encourage retirement savings. This distributional impact is most apparent in the case of RRSPs. Figures 4a and 4b illustrate RRSP and workplace RPP contributions by after-tax family income, represented in quintiles. Each quintile contains 20% of all families, and families are arranged from the 20% of families with the lowest income to the 20% with the highest income. Thus, families in the highest quintile have after-tax incomes higher than 80% of the population.

Figure 4a – Proportion of Families that Made Workplace Registered Pension Plan (RPP) or Registered Retirement Savings Plan (RRSP) Contributions, by After-Tax Family Income Quintile, 2015

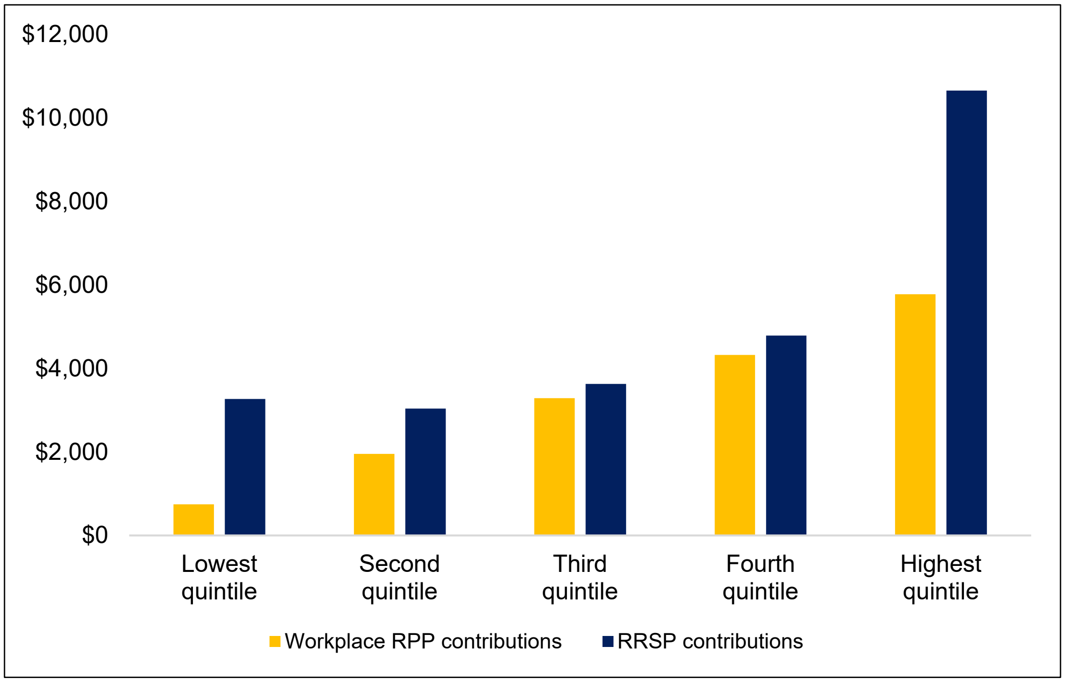


Note: The first quintile reflects the lowest after-tax family income; the fifth quintile represents the highest after-tax family income. After-tax family quintile amounts are, from lowest to highest: under $24,982; between $24,982 and $43,158; between $43,159 and $65,624; between $65,625 and $100,040; and over $100,040.

Source: Figure prepared by the authors using data obtained from Statistics Canada, *The Social Policy Simulation Database and Model (SPSD/M)* (database), accessed 29 June 2020.

Families in the highest quintile accounted for over two-thirds of all RRSP contributions.[37] Not only are people in high-income families more likely to contribute to an RRSP, they are also more likely to make larger contributions. In 2015, 80% of families in the highest quintile contributed to an RRSP. On average, they contributed $10,650 during that year.

Figure 4b – Average Workplace Registered Pension Plan (RPP) and Registered Retirement Savings Plan (RRSP) Contributions per Contributing Family, by After-Tax Family Income Quintile, 2015



Note: The first quintile reflects the lowest after-tax family income; the fifth quintile represents the highest after-tax family income. After-tax family quintile amounts are, from lowest to highest: under $24,982; between $24,982 and $43,158; between $43,159 and $65,624; between $65,625 and $100,040; and over $100,040.

Source: Figure prepared by the authors using data obtained from Statistics Canada, *The Social Policy Simulation Database and Model (SPSD/M)* (database), accessed 29 June 2020.

In contrast, families in the lowest quintile accounted for around 1% of all contributions in 2015. This is because less than 5% of the lowest-earning families contributed to an RRSP, and of those who did, the average contribution was about $3,270, less than one-third of the average contribution by the highest-earning families.

Figure 5 illustrates the total amount of RRSP contributions by after-tax family income quintile for the 2015 tax year. It shows the compounding effect of people in high-income families being more likely to contribute to an RRSP also being more likely to make larger contributions.

Figure 5 – Estimated Registered Retirement Savings Plan Contributions by After-Tax Family Income Quintile, 2015

Note: The first quintile reflects the lowest after-tax family income; the fifth quintile represents the highest after-tax family income. After-tax family quintile amounts are, from lowest to highest: under $24,982; between $24,982 and $43,158; between $43,159 and $65,624; between $65,625 and $100,040; and over $100,040.

Source: Figure prepared by the authors using data obtained from Statistics Canada, *The Social Policy Simulation Database and Model (SPSD/M)* (database), accessed 29 June 2020.

Recent research from the Parliamentary Budget Officer (PBO) tells a similar story for the TFSAs: the benefits of TFSAs – higher levels of savings combined with lower taxes – are more are likely to accrue to high-wealth households. A study released by the PBO projects that, by 2060, TFSA benefits to families in the highest quintile of wealth will be twice those going to families in the median quintile and 10 times those going to families in the lowest quintile. As noted by the PBO, these benefits come at the expense of forgone government revenues.[38]

The disparities with respect to the distribution of benefits in the case of workplace RPPs are not quite as extreme as those of RRSPs and TFSAs. However, figures 4a and 4b illustrate that contributions to workplace RPPs similarly increase by income quintile. These distributional trends remain when controlling for age (i.e., only considering families with a member aged 45–54 years old).

Most families in the highest income quintile (70%) contributed to a workplace RPP in 2015. The average contribution was $5,776. Almost no lowest-income quintile families contributed to a workplace RPP (2%), and when they did, these contributions were substantially lower than other quintiles ($745). This is not surprising given that higher paying jobs are more likely to come with pensions, and that the dollar amount of pension contributions increases with salary level.

Perhaps the more important insight from the data is that 63% of people who made contributions to a workplace RPP also made an RRSP contribution, while only 26% of people without any workplace RPP contributions contributed to an RRSP. It suggests that RRSPs may not be an effective substitute for people who are not able to participate in a workplace RPP.

4.3.2 Pension Income Splitting

In 2015, it is estimated that only 20% of seniors benefiting from pension income splitting belonged to families with after-tax income family incomes of less than $53,000. In addition, 40% of those benefiting had after-tax family incomes greater than $88,000. Moreover, as with RRSPs, there is also a compounding effect. Families with after-tax incomes greater than $88,000 accounted for almost half of the value of total pension income–splitting deductions.[39]

5 DELIVERING INCOME SECURITY: HOW IS PROGRAM SPENDING DIFFERENT FROM TAX EXPENDITURES?

The government delivers the retirement income system through two principal instruments:

- program spending (direct transfers to individuals: OAS pensions, GIS, CPP and QPP pensions); and
- tax expenditures (these include tax deductions for workplace RPPs, RRSPs and CPP and QPP contributions, preferential tax treatment for pension income and TFSAs, and the Age Credit).

Information related to OAS and CPP/QPP program spending is accessible to anyone with an Internet connection. Employment and Social Development Canada (ESDC), Treasury Board of Canada, the Office of Superintendent of Financial Institutions and the Office of the Chief Actuary regularly publish data, statistics and detailed reports on program costs and the population receiving benefits. In addition, the *Financial Administration Act* requires ESDC to conduct a review the relevance and effectiveness of these programs every five years.[40]

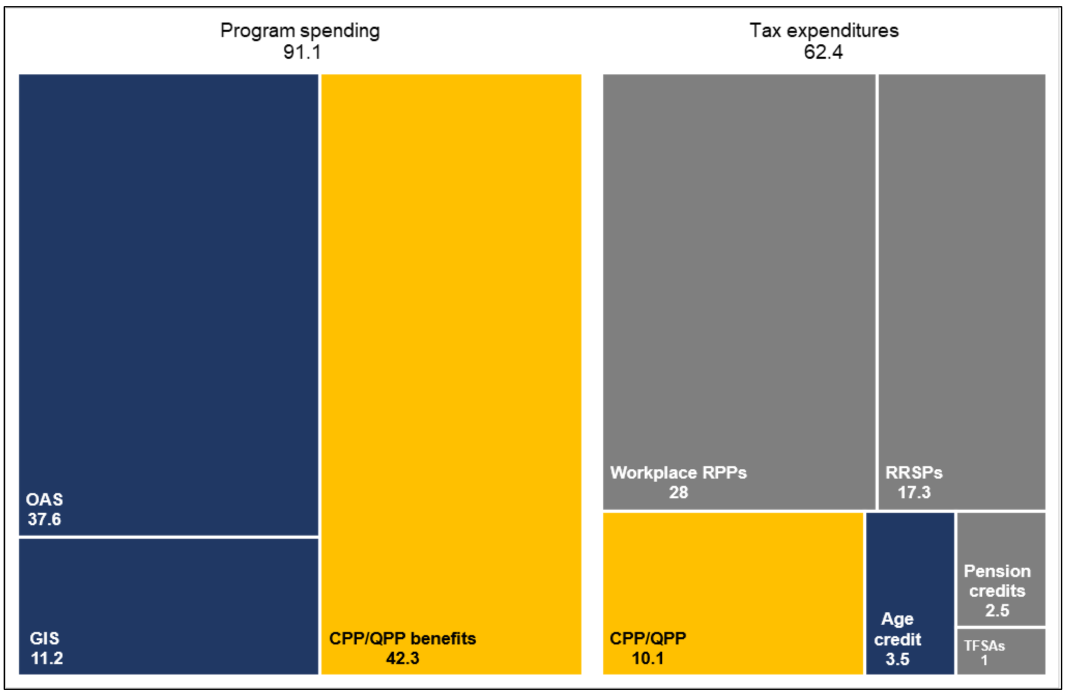
In contrast, information related to the tax expenditures that support workplace RPPs, RRSPs, and TFSAs, pension income splitting (even to a certain extent the tax expenditures that support worker contributions to CPP and QPP) is more difficult to find, especially with respect to the population that accesses and benefits from these tax expenditures.

While government accounting best practices do take the reporting of tax expenditures into account, it is often difficult to compare tax expenditures with program spending, even when they may serve a similar purpose. There is also no requirement that they be evaluated. Moreover, unlike all other public expenditures, there is not currently an established process for parliamentarians to review tax expenditures.[41]

Finally, it is noted that private members' legislation is not allowed to call for new program spending without Royal Recommendation.[42] However, private members' legislation that proposes a new tax expenditure by imposing or increasing an exemption from taxation is allowed.[43] As a result, tax expenditures can be an attractive policy tool for sponsors of private members' bills.

Figure 6 provides another snapshot of the financing of Canada's retirement income system. It compares program spending with tax expenditures. In 2017, the cost of program spending on OAS, GIS, CPP and QPP exceeded $91 billion. That same year, the cost of tax expenditures related to seniors was estimated to exceed $62 billion.[44]

Figure 6 – Program Spending and Tax Expenditures that Support the Retirement Income System, 2017 ($ billions)



Note: The first pillar is shown in dark blue, the second pillar in yellow, and the third pillar is grey. Pension credits include the Pension Income Credit and pension income splitting. While the Quebec Pension Plan (QPP) is not administered by the federal government, it acts as a substitute for the Canada Pension Plan (CPP) for residents of Quebec. In order to consider the costs of retirement nationally, QPP is included. Tax expenditure related to CPP/QPP refers to only the federal tax treatment of contributions to these programs.

Sources: Figure prepared by the authors using data obtained from Statistics Canada, "Table 11-10-0039-01: Tax filers and dependants, seniors with income by source of income and age" (database), accessed 29 June 2020; and Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020.

6 CONCLUSION

Canada's retirement income system, with its three pillars and mixed funding approaches, has proven remarkably resilient over the years. Ensuring that benefits are adequate while respecting intergenerational fairness and sustainability will always be challenging. Much of the cost of the retirement income system is borne by working-age Canadians, and the financial significance of the system can limit government funds available for programs that benefit younger Canadians. Yet the system offers policymakers a range of tools that can be used to address these challenges and adapt to changing conditions.

Moving forward, it is likely that issues related to the equity and transparency of tax expenditures that support the third pillar (workplace RPPs and private savings) will require more attention. In addition, as the proportion of Canadians with a workplace pension declines, governments may need to take a closer look at future retirement income adequacy for middle income earners.[45]

NOTES

1. The Allowance includes the Allowance and Allowance for the Survivor. While the Age Credit is not part of the Old Age Security [OAS] program, it is included in the first pillar because it is a nearly universal tax credit for people over the age of 65 and is not dependent on the person having made contributions.
2. The Quebec Pension Plan [QPP] is the Province of Quebec's version of the Canada Pension Plan [CPP]. It is managed by Caisse de dépôt et placement du Québec [CDPQ]. The Canada Pension Plan statute permits provinces to opt out of the CPP if they develop a similar contributory program that provides retirement and supplementary benefits. In 1966, Quebec introduced the QPP as a sister program to the CPP. It has the same contributory scheme and provides retirement, disability and survivor benefits. See CDPQ, *About CDPQ*. The tax treatment of CPP/QPP contributions is a tax expenditure. See section 5.
3. "A registered pension plan (RPP) is an arrangement by an employer or a union to provide pensions to retired employees in the form of periodic payments." For more information, see Government of Canada, *About Registered Pension Plans (RPPs)*.
4. Statistics Canada, "Table 17-10-0005-01: Population estimates on July 1st, by age and sex" (database), accessed 29 June 2020.
5. Statistics Canada, "Table 11-10-0039-01: Tax filers and dependants, seniors with income by source of income and age" (database), accessed 29 June 2020 (OAS expenditure estimates do not include the Allowance); and Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020, p. 37. These figures have not been adjusted for inflation.
6. Statistics Canada, "Table 11-10-0039-01: Tax filers and dependants, seniors with income by source of income and age" (database), accessed 29 June 2020; and Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020, p. 38. Statistics Canada publishes income by source of income data from both CPP and QPP benefits. It does not publish this data disaggregated. These figures have not been adjusted for inflation.
7. Statistics Canada, "Table 11-10-0039-01: Tax filers and dependants, seniors with income by source of income and age" (database), accessed 29 June 2020; and Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020, pp. 36–37. See also Government of Canada, *Old Age Security pension*.

8. Note that this pillar also includes the tax expenditure associated with the Age Credit. The OAS pension recovery tax requires seniors whose net world income exceeds a certain threshold ($77,580 in 2019) to repay part or all of their OAS pension. The Age Credit is not available to seniors who exceed a certain net income threshold ($87,750 in 2019). See Government of Canada, *Old Age Security pension recovery tax*; Government of Canada, *Line 30100 – Age amount*; and Statistics Canada "Table 11-10-0039-01: Tax filers and dependants, seniors with income by source of income and age" (database), accessed 29 June 2020.

9. Employment and Social Development Canada [ESDC], *Annual report of the Canada Pension Plan for fiscal year 2017 to 2018*.

10. Statistics Canada, "Table 11-10-0016-01: Survey of Financial Security (SFS), assets and debts held by economic family type, by age group, Canada, provinces and selected census metropolitan areas (CMAs) (× 1,000,000)" (database), accessed 15 October 2019.

11. Canadian Museum of History, "1952–1967: Reducing Poverty," *The History of Canada's Public Pensions*.

12. Government of Canada, "Expenditures under statutory authorities," in "Section 3 – Revenues, expenses and accumulated deficit for the year ended March 31," *Public Accounts of Canada 2019: Volume I – Summary Report and Consolidated Financial Statements*, 2019.

13. ESDC, "Old Age Security pension," *Evaluation of the Old Age Security program: Phase 2*.

14. Canadian Museum of History, "1952–1967: Reducing Poverty," *The History of Canada's Public Pensions*.

15. Government of Canada, "Expenditures under statutory authorities," in "Section 3 – Revenues, expenses and accumulated deficit for the year ended March 31," *Public Accounts of Canada 2019: Volume I – Summary Report and Consolidated Financial Statements*, 2019.

16. ESDC, "Guaranteed Income Supplement," *Evaluation of the Old Age Security program: Phase 2*.

17. Government of Canada, *Allowance for people aged 60 to 64 – Overview*; and ESDC, "The Allowances: Allowance (spousal) and the Allowance for the Survivor," *Evaluation of the Old Age Security program: Phase 2*.

18. Government of Canada, *Guaranteed Income Supplement: How much could you receive*; and ESDC, *Evaluation of the Old Age Security program: Phase 2*.

19. Canadian Museum of History, "1952–1967: Reducing Poverty," *The History of Canada's Public Pensions*; Bob Baldwin, *Canada's Retirement Income System: A Reform Agenda*, Discussion paper, Experts Panel on Income Security, Council on Aging of Ottawa, June 2019, p. 18; and ESDC, *Evaluation of the Old Age Security program: Phase 2*.

20. Government of Canada, "Consolidated statement of revenues and expenses," in "Section 1 – Summary tables and Appendices," *Public Accounts of Canada 2019: Volume II – Details of Expenses and Revenues*, 2019. Note that the Canada Pension Plan is a separate account and is not included in this consolidated statement.

21. Government of Canada, *Line 30100 – Age amount*. See also Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020, p. 37.

22. Further information on the QPP can be found at Retraite Québec, *The Québec Pension Plan*; and Retraite Québec, *Historical notes*.

23. Canadian Museum of History, "1952–1967: Reducing Poverty," *The History of Canada's Public Pensions*.

24. Canadian Museum of History, "1990–2000: Pensions On Solid Ground," *The History of Canada's Public Pensions*.

25. Funding is stabilized at a level equal to about six years of expenditures until 2030, then gradually grows to about seven years.

26. See *An Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act*, S.C. 2016, c. 14.

27. Government of Canada, *Canada Pension Plan enhancement*.

28. Retraite Québec, *Significant changes to the Québec Pension Plan*.

29. Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020, pp. 36–37.

30. Ibid., p. 6.

31. Jason Jacques, *Federal Tax Expenditures: Use, Reporting and Review*, Office of the Parliamentary Budget Officer [PBO], 1 June 2011.

32. Government of Canada, *Line 20700 – Registered pension plan (RPP) deduction*; Jean-Claude Ménard, Chief Actuary, Office of the Chief Actuary, Office of the Superintendent of Financial Institutions [OSFI], "Sustainability of the Canada Pension Plan," Presentation to the Institute for Governance of Private and Public Organizations, Montréal, 5 April 2019, p. 3; and Allen Buckley, "Do Tax-Qualified Plans Still Make Sense?," *Journal of Pension Benefits*, Vol. 18, No. 3, 2011, pp. 60–61.

33. Government of Canada, *Registered Retirement Savings Plan (RRSP)*; and Government of Canada, *Line 20800 – RRSP deduction*.

34. Government of Canada, *The Tax-Free Savings Account*.

35. Government of Canada, *Line 31400 – Pension income amount*; Government of Canada, *Pension income splitting*; and Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2020*, 2020, p. 36. Note that the Department of Finance Canada also identifies non-taxation of Guaranteed Income Supplement [GIS] and Allowance benefits and the Home Accessibility Tax Credit as tax expenditures benefiting seniors. (The cost of non-taxation of GIS and Allowance benefits and the Home Accessibility Tax Credit expenditures was estimated to be $230 million in 2017.) Since the non-taxation of GIS and Allowance benefits and the Home Accessibility Tax Credit are an order of magnitude less than other tax expenditures that benefit seniors, they are not discussed at length in this Background Paper.

36. Government of Canada, *Pension income splitting*.

37. In this instance, "family" refers to a group of two or more persons who live in the same dwelling as an economic unit and are related to each other by blood, marriage, common-law union, adoption or a foster relationship. An individual who does not live with family members is also considered to be a family for this definition.

38. Trevor Shaw, *The Tax-Free Savings Account*, PBO, 24 February 2015. See also Richard Shillington, *Are Low-Income Savers Still in the Lurch? TFSAs at 10 Years*, Institute for Research on Public Policy, 9 April 2019.

39. Based on the authors' calculations using data obtained from Statistics Canada, *The Social Policy Simulation Database and Model (SPSD/M)* (database), 29 June 2020. The model is programmed to optimize pension splitting between members of census families with pension income. It consistently overestimates the number of families taking the deduction and thus the total amount transferred. The SPSD/M estimates that in almost 25% of cases, only between 1% and 5% of the individual's pension would be transferred to a spouse. This suggests that tax filers either: 1) do not know about the deduction; or 2) decide the deduction may be more trouble than it is worth. This further supports arguments that tax expenditures can conflict with the neutrality of the tax system by increasing its complexity and conferring an advantage on certain types of behaviour. See Jacques (2011), p. 2.

40. See *Financial Administration Act*, R.S.C. 1985, c. F-11, s. 42.1(1); Government of Canada, *Public Accounts of Canada 2019: Volume I – Summary Report and Consolidated Financial Statements*, 2019; ESDC, "Fiscal year 2017 to 2018 at a glance," *Annual report of the Canada Pension Plan for fiscal year 2017 to 2018*; Office of the Chief Actuary, OSFI, *14th Actuarial Report on the Old Age Security Program as at 31 December 2015*, 8 June 2017; and Jacques (2011).

41. Office of the Auditor General of Canada, "The information provided by the Department of Finance Canada on tax-based expenditures does not adequately support parliamentary oversight," *Tax-Based Expenditures*, Report 3 in *2015 Spring Reports of the Auditor General of Canada*, 2015.

42. Robin MacKay, "Parliamentary Rules Concerning Private Members' Bills," *Canadian Parliamentary Review*, Vol. 41, No. 3, Autumn 2018. The author writes:

> [S]ection 54 of the *Constitution Act, 1867* has been summarized by Eugene Forsey in the following terms: "It [the cabinet] has the sole power to prepare and introduce bills providing for the expenditure of public money." This is known as the Royal Recommendation as the purpose behind the appropriation of public funds is recommended to the House of Commons by Message of the Governor General.

43. Eugene A. Forsey, *How Canadians Govern Themselves*, 9th ed., Library of Parliament, Ottawa, 2016, p. 6. See also Senate, *Rules of the Senate of Canada*, October 2020, Rule 10-7; House of Commons, *Standing Orders of the House of Commons – Consolidated version as of April 20, 2020*, Standing Order 79(1); and House of Commons, "Private Members' Business," *Our Procedure*.

44. Note that tax expenditures are reported according to the tax year or calendar year.

45. OSFI, *Registered Pension Plans (RPP) and Other Types of Savings Plans – Coverage in Canada*; and Keith Ambachtsheer and Michael Nicin, *Improving Canada's Retirement Income System: A Discussion Paper on Setting Priorities*, National Institute of Aging, February 2020. See also Baldwin (2019).