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**Speaking notes for the Right Honourable Paul Martin P.C., M.P.,
Canada Pension Plan Reforms 10 Years After
Lessons and Prospects**

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Check against delivery

This is an unusual crowd. Not only are you interested in the Canada Pension Plan, you know a lot about it. It's been a decade or so since I faced a roomful of people like this. The big difference now is that there's no requirement that two-thirds of you approve of what I'm about to say – though a majority would be nice.

Let me begin my remarks by congratulating Bill Robson and the C.D. Howe Institute for hosting this conference. A 10th anniversary is a good time for looking back and for looking forward. It's an especially good time in this case because we know today something that we did not know for certain 10 years ago. What we did back in 1997 worked. When we came up with a solution to the CPP's financial problems, we thought it would work, but we couldn't be absolutely sure. Waiting for Susan Peterson to come in to my office with that first actuarial report after the reform, I felt like a Broadway producer waiting for the first reviews on opening night.

As you all know, the review was a good one. And since then, we have had a string of actuarial reports – the latest only a few weeks ago – that said the same thing. The CPP is financially sustainable for as far as the eye can see. We did even better than we thought at the time. We built a global model of how a national pension plan can be made whole and made stable for the generations to come.

And that raises the first question I would like to speak to in this retrospective. Who is the "we" who did this? And the answer is a lot of people.

First, there were the provincial and territorial ministers of finance all of whom stepped up to the plate. This was not an easy time in federal-provincial relations. I suppose it never is, but in those days, we had to face the accumulation of nearly two decades of deep seated federal-provincial financial differences, capped off by the cuts in transfers born of

the 1995 budget. It would have been easy for the provinces to have gone on strike, and some governments certainly thought of it – but their finance ministers did not. They saw the CPP as an issue we could not postpone and they were going to do the job right.

If there were time today I would speak of every minister at that table and of their contribution. I won't do that, but I will mention three as representative of the others.

Ontario felt it bore an unfair burden in the structure of the national employment insurance plan and wanted premiums reduced to offset rising CPP contributions. Ernie Eves could have killed the reform, because Ontario had an effective veto, but when the time came to get the deal done, he got it through Queen's Park.

Janice MacKinnon was constrained by her party's views on a wide range of social issues and indeed Saskatchewan did not support the final arrangement. Nonetheless she was a constructive force for positive change throughout the negotiation and I always had the feeling that if at the end we had needed her province's vote she would have gotten it.

Finally Alberta. Let me simply say that in every federal-provincial negotiation I've been in, there are one or two provincial leaders who step forward and while fighting hard for their provinces perspective, they speak as well for the national interest. Alberta did well for having Jim Dinning at the table, but so did Canada.

Next, I want to mention David Walker, who had been my parliamentary secretary. He had one of the more difficult jobs and did it superbly - that of guiding the public consultations through 18 cities across Canada and keeping them on track.

Certainly the public servants involved in the file at both the federal and provincial governments deserve an enormous amount of credit. When the time came, they were ready with ideas, with options and with the firm determination to get it right. In the federal government, I would have to single out David Dodge, who is one of Canada's great public servants. I think of Munir Sheikh and Bob Hamilton, who spear-headed much of the analysis that went into developing our position. But mostly, I have to thank Susan Peterson and her officials. This was the federal public service at its best and I know the same can be said of the provincial teams who were their counterparts.

One last word about finance ministers and their officials. They are the ones who hold off all those other government departments who want to spend money on projects that are just not affordable. They have to say "no" more often than they can say "yes", and this creates a camaraderie among them that is unique. When I went to the G7 finance ministers' meetings, the attitude always was "We are the only seven sane people in the world."

May I just say, after the CPP negotiation, I would have added the provincial and territorial finance ministers to that list.

With that as a background, let me now set the context for the CPP reforms. When we took office in November 1993, Canada had two major financial problems on its hands. The issues were similar but were viewed very differently. The first issue was that born of deficits and debt. This was sorted out in two budgets – the 95' budget which dealt with the problem, and the 96' budget which confirmed that the new government would stay the course. After that it was only a matter of time before the vicious circle would turn virtuous.

The second problem was the unsustainable unfunded liability of the CPP – a debt that in fact was greater than the national debt. The big difference between the two issues was not in their magnitude, but in the fact that while the first – the fiscal deficit – was the stuff of headlines, there was virtually none of this in terms of the CPP. Nor was there any pressure from the financial markets, not even after the chief actuary's 1995 report.

This always amazed me!

In fact the only people who persistently talked about the CPP's unsustainable liability were the actuaries and the reason I have long suspected is that while everybody thinks they are an economist, nobody understands what actuaries actually do!

This, the absence of political pressure, is an important point, because what it meant was, when Canada's governments sat down to repair the CPP, they did so not with an eye to the electoral cycle, but to the generational cycle. We had already burdened our children and grandchildren with the fiscal debt. Now they might be facing contribution rates of 14% in return for a retirement benefit equal to 6% plus some insurance against disability and death. This was unacceptable.

There were two other reasons for acting as well. The first was the increasing loss of confidence in the CPP. Indeed many Canadians, especially those in their 20s and 30s, expected no pension at all when they retired. For them, the CPP was a dead horse and one not even worth flogging. This may have been the reason for the lack of political pressure. No one, it seemed, thought we as politicians could muster the will to fix the CPP, so they didn't bother to press hard for changes. This lack of confidence went to the heart of government, and we could not let that stand.

The final reason was one which concerned me more particularly as the federal minister of finance, one which coincided with the "hell or high water" thrust of the deficit fight.

Canada's baby-boomers were going to begin retiring in 2011, which was not that far off. The responsibility for the OAS (Old Age Security) and the GIS (Guaranteed Income Supplement) was entirely that of the federal government alone. If we reached 2011 with large numbers of Canadians potentially falling into financial distress because the CPP had failed them, I knew that the federal government would be on the hook for commensurate financial support. That meant we had to have the strongest balance sheet possible, but it also meant we had to do our best to prevent that long-term disaster from occurring.

In summary, governments had their reasons for reforming the CPP. But there was one overriding reason for doing what we did – a genuine recognition among ministers and officials that it was the right thing to do. It was our answer to the prevailing cynicism about politicians and public servants. We *could* act in the absence of political pressure and we *could* do the right thing for Canadians.

Next – what were the issues? There were many – but two were predominant. The first – rate increases versus benefit cuts as a means of dealing with the funding gap – and the second – fuller funding.

The first provided by far the greatest arena for debate. In terms of the political parties and their respective governments – the Progressive Conservatives sought minimal rate increases, and the NDP minimal benefit cuts – no surprise there.

Apart from ourselves, there were of course two other political parties. Neither was at the negotiating table but both were in Parliament.

The Reform Party of that time was off in its own corner. It tried to stir up support for what they called super-RRSPs. But that proposal went nowhere as it would not have dealt with the CPP's unfunded liability which of course was at the core of the problem we were all attempting to resolve.

The Bloc's position mirrored that of the PQ government in Quebec whose position in turn mirrored our own because it was beset with the similar problems of the Régime-des-Rentes or the Quebec Pension Plan.

In the rates versus benefits debate, the federal government wanted to hold the rate increase to 9.9 percent and make only the benefit cuts needed over time to support that rate.

The main objection to the rate increase was that it would hurt job creation at a time when Canada's unemployment rate was unacceptably high. The battle over benefits was that people having paid into and counting on a retirement pension should not be asked to bear the cost of the negligence of Canada's governments. In the end as we now know, we achieved a reasonable compromise.

There is however one area where we should have made more progress. In this instance, the factor was not one of CPP reform but an important aspect of other social policy. Disability costs had increased sharply in the late 1980s and early 1990s, though we had begun to bring them under control by the time CPP reform was on the table. Some felt that disability benefits should be withdrawn completely from the CPP as one way of reducing the costs of the pension plan.

My position was that we were coming at this from the wrong starting point. It is wrong for a country as rich as Canada not to have a comprehensive system of support for the disabled. We needed then – and need now – a joint federal-provincial program that would ensure as much as possible a level playing field across the country for the disabled, providing enhanced benefits and improved services to everyone who needs them.

Only if that was implemented could I have supported re-examining the relationship between disability benefits and the CPP. I felt, as did others, that the national disability program had to be in place first. Unfortunately time did not allow for this to happen, and it is one of the great regrets of my life that we were not able to make more progress towards a truly national disability program built by both orders of government. It's time to revive that idea and do the job properly.

The second big issue in the 1990s was over fuller funding. More accurately, the key debate was not about the need for fuller funding per se, but about how the investment fund that would result from fuller funding would be managed. The higher contribution rate would generate upfront temporary surpluses and we had to come up with a way to invest that money properly. And properly, in the opinion of all of us, meant at arm's length from government – and a very long arm at that – because these surpluses would belong not to the current generation or to its governments but to future generations who would depend on them for their pensions.

This is important to understand. The fact is the CPP's large fund has no real surpluses. Every penny is already earmarked to pay the retirement and other benefits to Canadians over the next 75 years.

I had expected some ministers to object to the idea of a fund that would be invested in financial markets rather than being lent to the provinces, but there were very few such objections. The main fear was that a federal government might try to raid the fund at some future time to suit its own purposes.

In response I recall telling my provincial counterparts that Ottawa wouldn't be able to do so because whatever we did would require the support of two-thirds of the provinces with two-thirds of the population. And if the unmentionable ever did happen – if the provinces connived with the federal government to scoop the cash – the political furor that would ensue would not be a ripple, it would be a tsunami.

Furthermore, we put in place as many hurdles as possible to make that even more difficult – the most important of which was to remove the temptation, by taking the pool of capital away from government clutches, and putting it into the hands of a board (the Canada Pension Plan Investment Board) whose directors were appointed through an appropriately complex process that ensured their independence. We then gave the board an unequivocally clear mandate – that of maximizing the fund's investment return without taking an undue risk of loss. There were to be no other ancillary goals or objectives. The mandate could not have been simpler - do the best job for CPP members.

For the board to focus on that one objective and no other, it had to be isolated from political pressure. If it were not so isolated, it would eventually run off in as many diverse directions as there were diverse political pressures brought to bear on it. Clearly, that would mean that the next generation would have found itself once again paying for their parents needs' at the expense of their own.

In short by establishing the board's mandate as we did, we recognized that that the integrity of the fund itself and the independence of the board were linked. Together they constituted the best way to ensure that governments would not repeat the mistakes of the past, ie: they would not engage in intergenerational inequity.

In summary, we knew the question of the board's independence was crucial and we knew we had to get it right. I believe we did!

I'd like to take this moment to congratulate the board itself, its chairperson Gail Cook-Bennett and the management team under its two successive CEO's – John MacNaughton and David Denison.

Both because of my earlier business and subsequent political career I am not a stranger to the financial industry and I am impressed by how they have made transparency and good behavior part of their trademark. It's all too easy for big players to become arrogant. They have avoided any tendency in that direction.

Building from scratch as they have done could not have been easy, nor has overseeing the evolution from passive to active investor been without its moments. They have discharged their responsibility to their fellow Canadians, most of whom are as yet unborn, with great skill and have fulfilled the hopes we placed in them. In short they have built the brand and are known around the world as a strong player.

Well, that just about brings us up to date. The question now is where do we go from here? With your permission let me raise two issues.

First, a decade ago, concerned about the potentially disproportionate influence of the fund in financial markets, we discussed whether or not to limit its size. We were about to unleash an elephant in Canadian capital markets and some felt that we might have to make provisions for splitting the fund in two. In the end, we decided to leave that issue to our successors who would have better facts in hand.

This was the right decision. Ten years ago, the foreign property rule limited a pension fund's foreign holdings to 20 percent. Subsequently we raised the FPR and in 2004, Ralph Goodale did away with it altogether, so that today all of Canada's pension funds are free to operate on a global scale. With \$121-billion in assets, the CPP might be an elephant in relation to Canada's financial markets, but it's a much smaller beast in world terms which is the scale by which it now must be judged.

For example, China recently set up a \$200-billion fund at the snap of a finger. Abu Dhabi has a fund of \$875-billion. Singapore is at \$438 billion, Norway \$367-billion and Kuwait \$213-billion. And the U.S. has a number of pension funds – CALPERS, for instance – that are much larger than the CPP.

Size bestows economies of scale that are enormously valuable in the world of international investment. It is not just that the opportunities are big. But increasingly, pension funds and other pools of capital are forming partnerships around specific investments because no pension fund wants too much exposure to a single venture. And the blunt fact is that if you are not a major player by world standards, you'll never get close to the opportunities at the table.

The second issue I'd like to raise is whether the reasons for the board's mandate and its governance structure have stood the test of time. My view is that they have! Indeed the reasons have become even stronger.

I had long been a proponent of a separate CPP fund holding real market assets. I had been an admirer of the Government of Singapore's funds and of Québec's Caisse de dépôt. But I recognized as well that worries about potential political interference were more than valid. For this reason we required not only the highest return-risk ratio, but as

well a strong governance model with a solid commitment to transparency and accountability.

Over the intervening years, this view has only strengthened. Why – two things.

The first is that Canadians now have more confidence that the CPP will be there for them when they retire than they did a decade ago, but this confidence is still short of a level that reflects the actions we took. At first, I thought this was just a hangover from the past – old myths die hard – but I'm told that it's more than that, for when Canadians hear of all the measures taken through the Board to protect the CPP's assets from being scooped up by governments, confidence in the CPP goes up dramatically. I believe increasing this level of confidence is important.

The second reason reflects something that was not an issue a decade ago, but is very much an issue today. That, of course, is the question of sovereign wealth funds. The world has changed greatly in the past 10 years. As mentioned earlier there are now many more state-owned or state-controlled funds roaming the world searching out investment opportunities. Already, we are seeing strong reactions to these entities and talk of legislation to control their activities.

I believe that governments around the world – when they act – should establish a very clear line of demarcation between funds that are primarily agents of government policy and funds that are pure return seekers. I expect that governments will begin to put restrictions on those that fall into the first category, but I would hope, they will largely exempt funds in the second group. To that end it will be essential for the Canada Pension Plan to be seen as independent of government control. And the best way to be *seen* as independent is to *be* independent.

There is another aspect to this issue as well. The CPP board began its existence as a passive investor, which meant its investments were tied to market indexes. Governments subsequently loosened the requirements so that it could become an active investor. That was a good decision. But it means the board must be vigilant when actions are taken that could create the kind of broader problems that might undermine its independence.

Thus, if the pension plan's share of an individual company's equity is big enough to give it a significant influence over the company's decisions, it could become a target of the people who oppose those decisions. For example, the board could be part of a takeover bid that pits region against region within Canada if jobs are to be cut or if a head office is to be moved.

Another example is that the Canada Pension Plan could be a partner in a takeover bid that might place at risk Canadian control of a Canadian company – a transaction that on its own would lead to increased scrutiny. The independence of the board's investment

decision-making must not be compromised, so it is incumbent on the directors to constantly consider how they would handle this added scrutiny and pressure.

In short the board now and the board in the future must recognize that they are the best safeguard of their own independence. If they work to maintain Canadians' confidence in their activities, they can avoid the potential pitfalls, as indeed they did when they refrained from accepting the federal government's recent offer of transferring some of its surplus to the fund.

And on that – let me bring these remarks to a close.

Compared with a decade ago, Canada today is in so much better shape than we were. It's hard to believe how far we have come in so short a time. In the middle 1990s, we were obsessed with deficits and debt in our fiscal accounts and in our pension accounts. Today, we are the only G7 country with fiscal surpluses and one of only two with a national pension plan that is financially secure.

But the job is not done; indeed, it will never be done. China and India have joined the United States, Europe and Japan as major economic players. Canada with only 33-million people will have to be quick off the mark to prosper in this new world. To do so we must give new definition to the concept of an "entrepreneurial nation," the kind of definition that comes from a confidence that we can take on much bigger players and win, a confidence born of sound national finances, good education and healthcare; the kind of confidence that comes when Canadians know that their retirement dollars are well managed and will be there when they need them; the kind of confidence that comes when Canadians know that their governments – federal and provincial alike – can solve major problems in a way that serves their interests.

What we did in the mid 1990s and what has been done since, was and is an important accomplishment of which we can be proud. We have built a pension plan and an investment fund that the world envies. Let's keep it that way.

Thank you.

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