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Communiqué

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Remove barriers to working beyond age 65, says C.D. Howe Institute study

Institutional and legal barriers that prevent people from working beyond the normal retirement age of 65 are anachronistic and should be removed, concludes a C.D. Howe Institute Commentary released today. Instead, the study says, the age of retirement should be a matter for workers and their employers to decide without outside influences.

The study, *Flexible Retirement as an Alternative to 65 and Out*, was written by Morley Gunderson, an industrial relations and economics professor at the University of Toronto.

Gunderson argues that many pressures are now emerging in Canada that make flexibility in retirement age increasingly desirable. While the current emphasis is on “early retirement” (before age 65), the demand for “postponed” retirement will grow for a variety of reasons:

- Increases in life expectancy and health are enabling people to participate in the work force longer than they used to.
- The restructuring of the workplace over the past two decades has decreased the percentage of blue-collar jobs, from which many workers both want to retire and can afford to do so. It has simultaneously increased the number of desirable, high-end white-collar jobs that those who occupy them want to keep, and low-wage service jobs that do not pay enough to make retirement financially attractive.
- Changing social patterns mean that, for example, one partner in a two-earner family may not want to retire before the other or that women who left the labor force to raise children may want to build up the number of work years on which pensions will be based.
- Employers increasingly recognize that older workers have knowledge and networks that make them a valuable pool of talent.
- The strain on the public retirement income system will become considerable as the baby boomers turn to it. The financial pressure on the next generation could be eased if individuals are able to work past age 65.

Gunderson points out that many current legal and institutional arrangements inhibit postponed retirement in both subtle and overt ways. They include:

- mandatory retirement policies;
- human rights codes, which generally prohibit discrimination on the basis of age but exempt people over age 65, in part to accommodate mandatory retirement;
- employer pension plans, which often contain features that encourage early retirement and penalize delay;
- the old age security (OAS) and guaranteed income supplement (GIS) programs of the public pension system, both of which have clawbacks that discourage recipients from earning money — the seniors benefit, slated to replace the OAS and GIS, is to involve even stiffer clawbacks;
- the Canada and Quebec Pension Plans, whose early retirement feature, used by the majority of recipients, curbs potential earnings;
- the rules for registered retirement savings plans, which somewhat discourage continued labor force participation;
- the personal income tax system, which includes a tax credit for the elderly that is clawed back, beginning at quite low income levels; and
- disability pensions, which are particularly relevant to the elderly — those awarded by the CPP in particular — may provide work disincentives.

Gunderson acknowledges that good reasons exist for many of these disincentives to postponing retirement. Clawbacks, for example, reduce or preclude transfer payments from going to people with relatively high incomes. But their effect on work and retirement patterns can be perverse. He concludes that policymakers should critically assess the legal and institutional barriers to postponed retirement. In the absence of compelling social reasons to the contrary — reasons that are made explicit and subject to public debate — employees and employers should be free to work out their own agreements on "normal," early, and postponed retirement.

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C.D. Howe Institute
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Communiqué

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Éliminez les obstacles au travail pour les personnes âgées de 65 ans et plus, indique une étude de l'Institut C.D. Howe

Les obstacles institutionnels et juridiques qui empêchent les personnes de travailler passé l'âge normal de la retraite, soit 65 ans, sont anachroniques et devraient être éliminés. Telle est la conclusion d'un Commentaire de l'Institut C.D. Howe publié aujourd'hui. Selon ce document, il devrait incomber aux travailleurs et aux employeurs de décider, sans influence extérieure, du moment de la retraite.

L'étude, intitulée *Flexible Retirement as an Alternative to 65 and Out (Une retraite en souplesse comme alternative à la porte à 65 ans)*, est rédigée par Morley Gunderson, professeur de relations industrielles et d'économie à l'Université de Toronto.

M. Gunderson estime que plusieurs facteurs émergents au Canada contribuent à rendre le concept d'une retraite à un âge plus flexible de plus en plus souhaitable. Bien que l'accent porte plutôt à l'heure actuelle sur une « retraite anticipée » (avant l'âge de 65 ans), la demande d'une retraite différée va s'accroître pour diverses raisons :

- L'espérance de vie accrue et un meilleur état de santé permettent aux individus de continuer à faire partie de la population active plus longtemps qu'avant.
- La restructuration de milieu de travail qu'ont connue les deux dernières décennies a réduit le pourcentage des emplois de col bleu, dont maints travailleurs veulent prendre leur retraite et se la permette financièrement. Elle a du même coup accru le nombre d'emplois de col blanc haut de gamme et recherchés, que les occupants veulent conserver, ainsi que les emplois tertiaires à faible rémunération qui ne paient pas assez pour rendre la retraite intéressante sur le plan financier.
- La structure sociale changeante signifie par exemple, qu'un conjoint d'une famille où les deux travaillent ne voudra peut-être pas prendre sa retraite avant l'autre, ou que les femmes qui ont dû quitter la population active pour élever des enfants voudront peut-être ajouter au nombre d'années de travail sur lesquelles sera calculée leur pension de retraite.
- Les employeurs sont de plus en plus conscients que les travailleurs plus âgés possèdent des connaissances et des réseaux qui les rendent extrêmement précieux.
- Le régime public de revenu de retraite sera soumis à d'énormes pressions au fur et à mesure que la génération des baby-boomers y aura recours. Or, les pressions financières exer-

cées sur la prochaine génération diminueront si l'on offre la possibilité de continuer à travailler après l'âge de soixante-cinq ans.

M. Gunderson souligne que de nombreuses dispositions juridiques et institutionnelles interdisent à l'heure actuelle, de manière parfois ouverte, parfois plus subtile, la retraite différée. Il s'agit notamment des suivantes :

- les politiques de retraite obligatoire;
- les codes des droits de la personne, qui interdisent généralement toute discrimination en fonction de l'âge, mais en exonèrent les personnes de plus de 65 ans, en partie pour tenir compte de la retraite obligatoire;
- les régimes de pension des employeurs, qui contiennent souvent des dispositions qui favorisent la retraite anticipée et qui pénalisent tout délai;
- les programmes de sécurité de la vieillesse et de supplément de revenu garanti du régime de pension public, qui contiennent des dispositions de récupération et qui dissuadent les prestataires de gagner de l'argent — la prestation aux personnes âgées, qui doit remplacer ces deux programmes, comportera des dispositions de récupération encore plus strictes;
- le Régime de pension du Canada (RPC) et le Régime de rentes du Québec, et leurs dispositions de retraite anticipée, dont tire parti la majorité des prestataires, réduisent les possibilités de rémunération;
- les règles des régimes enregistrés d'épargne-retraite, qui découragent dans une certaine mesure une participation soutenue à la population active;
- le système d'impôt sur le revenu des particuliers, qui comprend un crédit d'impôt à l'intention des personnes âgées, lequel est récupéré à partir de niveaux de revenus assez modestes;
- les pensions d'invalidité, qui sont particulièrement pertinentes pour les personnes âgées — tout particulièrement celles qui sont octroyées par le RPC — peuvent constituer une contre-incitation au travail.

M. Gunderson admet que plusieurs de ces contre-incitations à différer la retraite ont de bonnes raisons d'être. Les dispositions de récupération, par exemple, réduisent ou empêchent les paiements de transfert d'être remis à des personnes dont les revenus sont relativement élevés. Mais l'effet qu'elles ont sur la structure du travail et de la retraite peut être paradoxal. Il indique dans sa conclusion que les technocrates devraient évaluer d'un œil critique les obstacles juridiques et institutionnels à la retraite différée. Faute de raisons sociales convaincantes du contraire — des raisons qui devraient être rendues explicites et portées au débat public — les employeurs et les employés devraient être libres d'établir leurs propres ententes en matière de retraite « normale », anticipée ou différée.

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Flexible Retirement as an Alternative to 65 and Out

by

Morley Gunderson

The traditional pattern of retirement from the work force — celebrate your sixty-fifth birthday and you are out — is increasingly anachronistic. Recent years have seen much emphasis on encouraging *early* retirement. Pressures are building, however, for permitting Canadians to remain in the work force, part time or full time, *past* age 65 if they so desire.

The age of retirement should ideally be a matter for workers and their employers to decide without outside influences. Yet many programs, public and private, provide incentives for leaving the work force at age 65 or earlier. Good reasons exist for some of these incentives, but they should be critically assessed with an eye to removing institutional and legal barriers to decisions.

Given Canada's aging work force, work that is changing in nature, and pressures on retirement income systems from the baby boomers who are reaching their fifties, such changes may be of paramount importance as Canadians enter the new millennium.

Main Findings of the Commentary

- In Canada today, many pressures are emerging that make flexibility in retirement age increasingly desirable. The current emphasis is on *early* retirement (before age 65), but the demand for *postponed* retirement will grow for a variety of reasons.
- Increases in life expectancy and health are enabling people to participate in the work force longer than they used to.
- The restructuring of the workplace that has taken place during the past two decades has decreased the percentage of blue-collar jobs, from which many workers both want to retire and can afford to do so. Simultaneously have come increases in high-end white-collar jobs, whose occupants often enjoy and want to continue to hold, and in low-wage service jobs, which do not pay enough to make retirement financially attractive.
- Social patterns are fostering delayed retirement. In two-earner families, one partner may not want to retire before the other. Women who left the labor force to raise children may want to build up the number of work years on which pensions will be based.
- Employers are increasingly recognizing that older workers have knowledge and networks that make them a valuable pool of talent.
- The strain on the public retirement income system will be considerable as the baby boomers turn to it. The financial pressure on the next generation can be eased if individuals have the option of continuing to work past age 65.
- Many current legal and institutional arrangements inhibit postponed retirement, sometimes subtly. They include: mandatory retirement policies; human rights codes, which generally prohibit discrimination on the basis of age but exempt people over age 65, in part to accommodate mandatory retirement; employer pension plans, which often contain features that encourage early retirement and penalize delay; the old age security (OAS) and guaranteed income supplement (GIS) programs of the public pension system, both of which have clawbacks that discourage recipients from earning money — the seniors benefit, slated to replace the OAS and GIS, is to involve even stiffer clawbacks; the Canada and Quebec Pension Plans (CPP / QPP), whose early retirement feature, used by the majority of recipients, curbs potential earnings; the rules for registered retirement savings plans (RRSPs), which somewhat discourage continued labor force participation; the personal income tax system, which includes a tax credit for the elderly that is clawed back, beginning at quite low income levels; and disability pensions, which are particularly relevant to the elderly — those awarded by the CPP in particular may provide work disincentives.
- Good reasons exist for many of these disincentives to postponing retirement. Clawbacks, for example, reduce or preclude transfer payments from going to people with relatively high incomes. But their effect on work and retirement patterns can be perverse.
- Policymakers should critically assess the legal and institutional barriers to postponed retirement. In the absence of compelling social reasons to the contrary — reasons that are made explicit and subject to public debate — employees and employers should be free to work out their own agreements on “normal,” early, and postponed retirement.

The traditional notion that people retire from the work force at age 65 is increasingly anachronistic. In a recent article on reforming Canada's retirement income system, economist Thomas J. Courchene argues:

> [W]e have to rethink the range of policies that tend to assume the elderly will not be in the labor force. Perhaps a bill of rights and privileges for the elderly is going too far, but we must remove features such as age discrimination and our willingness to embed confiscatory or near-confiscatory tax-back rates in their income support programs.

Overall, he says:

> [W]e have to balance our concern over the looming intergenerational transfer with a companion view that treats the elderly as an invaluable social asset. One wonders if the politics of pension reform ... might become more "doable" if they were accompanied by a set of policies designed to ensure that the elderly can continue to participate fully in Canadian economic, social, political and cultural life.[1]

This suggestion is the point of departure for this *Commentary*, which focuses on the barriers, often posed by well-intended social policies, that inhibit the continued labor force participation of older workers.

I begin with a discussion of the emerging pressures for more flexible and phased retirement that would facilitate the continued labor force participation of older workers. Then I outline institutional and legal barriers that discourage continued labor force participation, and I close with some policy implications. The emphasis is on the tradeoffs involved and on the need for more critical thinking and debate in this important area of social policy (see Box 1).

I pay particular attention to the inevitable dilemma of programs that try to target assistance to those most in need without having it spill over into the hands of the non-needy. In general, such targeting requires generous benefits to those with no earnings and claw backs of benefits as earnings increase. This approach reduces work incentives, but having a small clawback to preserve them means that benefits go to the non-needy.

Throughout the paper, I critically assess two widespread views: the lump-of-labor fallacy that assumes that every job held by an older worker is one less job available for a younger worker; and the lack of concern over policies that adversely affect the incentives of older workers to continue working.

My purpose is to encourage flexible retirement by removing distortions that often unintentionally bias individuals' decisions. Although flexibility for *both* early and late retirement is desirable, the focus here is on policies that discourage workers from continuing to participate in the labor force if they so choose, since it is such barriers that create the biggest distortions.

Emerging Pressures

Current attention on retirement policy tends to focus on issues of early retirement, in part to accommodate the downsizing that has been occurring. As well, people in the baby boom's leading edge are now entering their fifties, the age at which they are making decisions about early retirement. Soon, however, that group will be entering their sixties, when issues of normal and postponed retirement will be coming to the fore.

Simultaneously, other pressures will be making "normal" retirement — celebrate your sixty- fifth birthday and you're out — an increasingly anachronistic phenomenon. Substantial numbers may want to delay retirement and continue to participate in the labor force, perhaps on a part-time basis.

Many of the factors that will be involved in this social change are already becoming evi-

> **Box 1: *No Right Answers... Only Right Questions***
>
> "Short of the potential breakup of the country, the reform of the retirement income system is probably the most daunting policy challenge on the horizon. Its dimensions are staggering: it is essentially a cradle-to-grave issue; it embodies implicit social contracts; it is a jurisdictional quagmire and it is underpinned by every conceivable equity issue. There are no right answers in this area."[a]
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> *a* Thomas J. Courchene, "Generation X vs. Generation XS: Reflections on the Way Ahead," in Keith G. Banting and Robin Boadway, eds., *Reform of Retirement Income Policy: International and Canadian Perspectives* (Kingston, Ont.: Queen's University, School of Policy Studies, 1997), p. 330.

dent. They include longer average life spans; the shift to white-collar jobs and nonstandard employment (for example, part-time work, self-employment, limited-term contracts, and work through temporary help agencies); changes in the employment patterns of couples and women; employers' growing recognition of the value of older workers; and a desire to reduce the strain on the public purse as the baby boomers leave the work force.

Demographics

Although the aging work force has higher and higher percentage of members at risk of death or incapacity, increased life expectancy means that people may be able to continue to participate in the labor market for a longer period of time. Improved health means that they are physically able to do so.

By 2021, life expectancy for a 65-year-old, for example, is expected to have increased by about five years since 1966, when the Canada and Quebec Pension Plans (CPP / QPP) were first established.[2] One implication is that in 2021 a persons who has worked to the age of 70 and not drawn CPP / QPP benefits until then can expect to receive those benefits for the same number of years as a person who retired in 1966 at age 65 and drew CPP / QPP benefits.

The aging of the work force also means that the median union voter is more likely to pressure unions for protection against age discrimination and perhaps to negotiate for delayed and flexible retirement options.

The Restructured Workplace

These demographic factors are augmented by continent-wide restructuring from blue-collar jobs in manufacturing to white-collar jobs at both the high end of the occupational distribution (professional, administrative, and managerial positions) and the low end (low-wage jobs, especially in sales and services).

Retirement from traditional blue-collar jobs is attractive because the work is often onerous and physically demanding. Furthermore, such jobs are often reasonably well paid, so their holders can afford to retire, especially because many have an employer-provided defined- benefit pension plan — one that may encourage early retirement and penalize delayed retirement.

In contrast, high-end white-collar jobs may invite postponed retirement because they are not physically demanding and they are often intrinsically interesting — one's vocation is often one's vacation. Although these jobs are frequently associated with a higher income, making retirement savings possible, those higher earnings also make retirement more costly in that individuals have to forgo considerable sums when if they retire.

At the other end of the occupational distribution, the low-paying service jobs often do not yield sufficient income to enable workers to afford to retire, and they tend not to provide pension plans. The nature of the work may also be conducive to continued labor force activity, especially on a part-time basis, albeit often with poor wages and working conditions.

In essence, the jobs associated with normal and early retirement are becoming less common and being replaced by ones at the polar ends of the occupational distribution that are associated with continued labor force participation, albeit for different reasons.

The growth of nonstandard employment is also fostering nonstandard retirement patterns. Also, the stagnant real wages that have prevailed in Canada since the mid-1970s mean that many individuals cannot afford to retire. This problem is augmented by the substantial income losses suffered by many workers who have been displaced from their traditional jobs.

Changes in Employment Patterns

The past two or three decades have seen abrupt changes in labor market activity in Canada. The potential adjustment problems auger for a flexible approach to retirement, which is further fostered by the growing diversity of the workforce in general, especially the increased number of women in the labor force and the associated dominance of the two-earner family.

In many families, problems arise in coordinating the retirement times of the husband and wife; neither wants to retire until both do.

Moreover women who have returned to the labor force after periods of childraising may want to continue working, rather than retiring, to make up for their time out of the labor force, especially if they have started a new career or are seeking to build up seniority-based pension benefits.

The Value of Older Workers

Pressure for more flexible retirement policies, including postponed retirement, is also coming from employers. The downsizing of the 1980s and 1990s has been associated with early retirement as an adjustment mechanism. There is growing recognition, however, that this device has firms losing invaluable persons with organizational-specific knowledge and networks. The baby — in this case, the aging baby — may have been thrown out with the bathwater.

As well, labor shortages are often predicted to emerge for the period around the year 2010, when baby boomers are likely to be retiring in large numbers.[3] In the event of such shortages, older workers could obviously be an important pool of talent, especially if flexible work meets their needs for flexible retirement. This possibility may, in fact, encourage employers to remove incentives for early retirement and even to introduce incentives to delay it.

The Strained Retirement Income System

Pressure to enable workers to continue in the labor force will also come from the need to relieve the financial strain on the retirement-income system. That strain can be reduced only by some combination of increased taxes, increasing deficits, and reducing expenditures.

Higher taxes or deficits are facing increased resistance, however, especially since only a relatively small number of Canadians will be available to pay for them as the large baby boom population leaves the work force. Expenditures can be reduced by raising the age of entitlement to benefits,[4] reducing benefits, or clawing back benefits on the basis of income testing. All such reductions are more palatable if individuals are not unnecessarily constrained from continuing to earn an income by participating in the labor force.

A more basic consideration may also be at play here. In pay-as-you-go pension systems, such as the CPP / QPP, the current generation of taxpayers pay for the retirement benefits of their elders in the expectation that future generations will pay for their retirement benefits. But with productivity and real wages stagnant and the baby-boom “bulge” about to retire and impose a burden on a smaller cohort of taxpayers, such systems are unlikely to be sustainable.

The problem is complicated by the fact that the baby boomers' pension payouts will be accompanied by extensive public health care expenditures for the aged, as well as by other intergenerational unfunded liabilities that are passed on to future generations through other systems' such as workers' compensation.[5]

Quite simply, younger generations understandably may not honor the intergenerational social contract we have foisted off on them through the unfunded liabilities of pay-as-you-go schemes, especially since those liabilities will not have been unanticipated and we could have planned for and financed them ourselves accordingly (see Box 2). It will soon be our children's turn to turn the tables on us and rightly say, "You have behaved irresponsibly and now should face the natural consequences of your actions!" In such circumstances, it may be important — indeed necessary — for those who want to continue working to have the option of doing so.

Conclusion

Clearly, these diverse pressures suggest the increasing need for flexibility in retirement patterns, a move away from assuming that every adult (at least every male adult) will work full time until age 65 and then completely retire. One size no longer fits all — if it ever did — and distorting individuals' retirement preferences can lead to welfare losses. The key is flexibility. What is needed is a system that enables older people to keep on working if they want to.

The current emphasis tends to be on *early* retirement. This may be sensible if early retirement is voluntary and meets the preferences and needs of both employers and employees. However, the pressures discussed here highlight a likely growing demand for *postponed* retirement on the part of many. What will be required is flexibility for *both* early and postponed retirement to meet the increasingly heterogeneous needs of both employers and employees.

As a minimum, it is imperative to examine the constraints that exist in current legal and institutional arrangements and that inhibit private parties from working out their own best retirement arrangements. Thus, the emphasis in the remainder of this *Commentary* is on identifying those constraints and how they might be altered to facilitate continued labor force participation on a full-time or part-time basis. Most of these constraints serve other legitimate purposes so difficult tradeoffs will be involved. Nevertheless, delineating the constraints and tradeoffs will facilitate informed discussion.

Constraints on Continued Participation

A wide range of institutional and legal constraints discourage, often subtly and unintentionally, the continued labor force participation of older workers. These include mandatory retirement policies, age limits in human rights codes, employer pension plans, public pension plans, registered retirement savings plans (RRSPs), personal income taxes, and disability pensions.

Mandatory Retirement

Mandatory retirement policies in firms' personnel policies or in collective agreements can obviously inhibit older people from continued participation in the labor market. Of course, such policies do not *stop* a person from working elsewhere; they simply specify that the existing contractual arrangement is over, invariably in return for a pension. (Indeed, individuals affected by mandatory retirement are sometimes hired back by the same organization, usually under a different contractual arrangement.)

Box 2: *The Fragility of the Social Contract in Pay-As-You-Go Systems*

A number of commentators have highlighted the fragile nature of the social contract in pay-as-you-go systems such as the CPP.

"Can we in good faith tell the next generation that beyond servicing the debt that we ran up, they are responsible for funding the entire intergenerational unfunded CPP liability, in addition to providing their own savings?....The credibility issue will become exacerbated and, with it, the increased potential for reneging and opting-out."[a]

"It is irresponsible of today's adults to try to impose the CPP on today's children and unrealistic to think that, when those children reach adulthood, they will accept the attempt if it is made."[b]

"The security of public pensions is ultimately linked to the willingness of future generations to provide pensions that are promised to today's workers. This willingness will depend on two considerations: first, the share of national income required to meet the pension obligations, which depends on the level of national income and the ratio of pensioners to workers; and, second, the perceived likelihood that the pension system will be perpetuated , so that future generations of Canadians will be supported in turn during their own retirement. In other words, the viability of today's pensions depends on both long-term economic conditions and future generations's acceptance of the "rules of the game" established by the current generation."[c]

"The 'pension crisis' thus reflects the concern that the next generation of workers may choose not to honour the rules of the game established by the current generation, since the next generation will be treated less favorably."[d]

"[T]he Ponzi game — dependent as it is on confidence that future entrants will be willing to pay the benefits of those already in — is on the verge of breaking down....[T]he idea that payments to the CPP are 'contributions' is increasingly inappropriate — they are becoming a straightforward tax. And as the burden of the tax grows, more and more workers will resist paying it, by avoidance or evasion, or by exerting political pressure to reform the system."[e]

a Thomas J. Courchene, "Generation X vs. Generation XS: Reflections on the Way Ahead," in Keith G. Banting and Robin Boadway, eds., *Reform of Retirement Income Policy: International and Canadian Perspectives* (Kingston, Ont.: Queen's University, School of Policy Studies, 1997), pp. 330, 331.

b William B.P. Robson, "Ponzi's Pawns: Young Canadians and the Canada Pension Plan," in John Burbidge et al., *When We're 65: Reforming Canada's Retirement Income System*, The Social Policy Challenge 13 (Toronto: C.D. Howe Institute, 1996), p. 55.

c James E. Pesando, *From Tax Grab to Retirement Saving: The Case for Privatizing the CPP*, C.D. Howe Institute Commentary 93 (Toronto: C.D. Howe Institute, June 1997), p. 6.

d Morley Gunderson, Douglas Hyatt, and James E. Pesando, "Public Pension Plans in Canada and the United States" (paper presented at the Upjohn Institute Conference on Employee Benefits, Labor Costs, and Labor Markets in Canada and the United States, Kalamazoo, Mich., 1996), p. 13.

e William B.P. Robson, *Putting Some Gold in the Golden Years: Fixing the Canada Pension Plan*, C.D. Howe Institute Com-

Obviously, banning mandatory retirement — as has been done in the United States — would enable some people to continue working in the same job in the same organization. Nevertheless, that remedy would have other repercussions. Presumably, mandatory retirement exists for some mutually beneficial reason;[6] it is, after all, most prevalent in situations in which workers have a reasonable degree of bargaining power (generally "good" jobs with a collective agreement, a pension arrangement, and a degree of long-term commitment). Employers and employees may agree to mandatory retirement to facilitate worksharing, open promotion and job opportunities for younger workers, and facilitate deferred compensation.

Since mandatory retirement is generally a mutually agreed-on personnel policy, state intervention to ban it or even to raise the age at which it can prevail should not be undertaken without some well-defined rationale as to why private parties or their agents should not be allowed to make such arrangements. In the absence of such explicit rationales, allowing the parties to enter into contractual arrangements that involve mandatory retirement seems sensible.

Human Rights Codes

Human rights codes generally prohibit discrimination on the basis of age but then exempt people from coverage if they are under a minimum age or over age 65. The upper limit is designed to enable employers to have certain age-related policies, such as mandatory retirement, without their being regarded as constituting age discrimination. But one result is that Canadians who have reached age 65 are effectively unprotected from general age discrimination in the workplace.

The extent to which this lack of protection discourages some individuals from continued employment is unknown. But it has the potential to be an important factor since, if age discrimination is prevalent, it is likely most prevalent against older people. Furthermore, for those who have left their original job because of mandatory retirement, such protection could be important if they do search for a new job.

Removing the upper limit is certainly a policy that merits more consideration not only to facilitate continued employment but also to provide normal protection against age discrimination. It is contradictory to say that one cannot discriminate against older persons... unless they are over 65! If policymakers are concerned that removing the ceiling would *de facto* ban mandatory retirement policies, they could exempt such policies if they are *bone fide* (for example, if they are clearly part of a mutually agreed-on practice as evidenced by being part of a collective agreement or an occupational pension plan.)

Employer Pension Plans

Employer pension plans often contain features that both encourage employees to retire early and penalize those who delay retirement beyond the normal retirement age, typically 65.[7]

Plans often contain subsidized features for early retirement at specific ages whereby the benefits are not actuarially adjusted to fully offset the fact that those who retire early receive the pension sooner and for a longer period of time. Such features can give rise to substantial pension benefit accruals or “spikes” at certain ages, creating a strong monetary incentive to retire early. And final-earnings plans can discourage gradual retirement by basing benefits on the last three to five years of work.

Until recently, employer pension plans also often had penalties for delaying retirement beyond some age (say, 65). The penalties were often subtle in that no actuarial adjustments were made to offset the delayed receipt of the pension and members were often not allowed to continue to accrue service credits. But those penalties could be substantial. Typically, they were in the range of 20 percent of earnings — often higher — for workers in the five-year period after the age of normal retirement. Obviously, such penalties reduced the monetary incentive to continued employment beyond the usual age.

Rightly or wrongly, such features have generally been disallowed as a result of recent pension reforms. Now the main deterrent to continued employment is giving up the option of taking a subsidized early retirement package by continuing to work with the same employer.

Public Pension Plan Features

The public pension system in Canada currently has three main components: the universal old age security (OAS); the guaranteed income supplement (GIS), which is income tested; and the CPP/QPP for those with labor market earnings. All these programs have features that penalize and therefore discourage continued labor force participation.[8] So does the seniors benefit, which is to replace the OAS and GIS in 2001.

Old Age Security

OAS, which is part of the social safety net, is a universal demogrant or fixed benefit of approximately $4,800 annually paid to all Canadians who have reached age 65 and meet a length-of-residence requirement.

OAS payments are taxable but, in 1990, the federal government introduced an additional clawback rate of 15 percent after net income of $52,000 per individual; that is, for every dollar of income over $52,000, the OAS benefit is reduced by 15 cents.

Adding this clawback rate of 15 percent to a marginal income tax rate of 50 percent implies an effective marginal tax rate of 57.5 percent. That is, of every extra dollar earned, tax-payers in this high bracket keep approximately 42.5 cents. The purpose of the clawback is to reduce the transfer payments going to higher-income individuals, but the effective marginal tax rates they face can clearly discourage continued labor market participation and thereby reduce governments' revenues from the income tax on labor market earnings.

The OAS also has an income-tested spouse's pension allowance payable to individuals ages 60 to 64 who are widows, widowers, or spouses of current OAS pensioners. The maximum annual allowance is approximately $6,800 for widows and widowers and $6,200 for spouses. A complicated set of clawbacks apply; they range from 25 to 75 percent, with the payment being completely clawed back for couples with income of approximately $21,000.

Since the spouse's allowance is reduced as income increases, it too can discourage the labor force participation of older persons.

Guaranteed Income Supplement

The GIS is an additional safety-net program provided to recipients of the basic OAS pension who have little or no other income. Its purpose is to provide minimum living standards for the elderly who have no alternative source of income.

The maximum GIS payment is approximately $5,500 annually for single persons and $7,200 for married couples. Those benefits are not taxable. The GIS is, however, subject to a clawback rate of 50 percent; that is, the benefit is reduced by 50 cents for every extra dollar of income.

Many provinces also augment the federal GIS with their own supplements, in amounts based on income. Ontario's guaranteed annual income system (GAINS), for example, provides an additional $1,000 annually to single retirees on GIS.

GAINS has a clawback rate of 50 percent. Since the GIS is already stacked on top of OAS payments and each of the supplementary programs has a clawback of 50 percent, GAINS recipients face an effective tax rate of 100 percent. That is, for every dollar of income they earn in the labor market, they forgo 50 cents of GIS and 50 cents of GAINS. Clearly, such claw-backs eliminate any monetary incentive to continued labor force participation.

The Seniors Benefit

As noted, the proposed new seniors benefit program, to come into effect in 2001, is to replace the universal OAS pension and the low-income GIS supplement.[9] The maximum seniors benefit is planned at $11,420 for singles and $18,440 for couples.

Those amounts are to be subject to a clawback of 50 percent for every dollar of earned income until they are reduced to $5,150 per senior. They are then to be subject to a 20 percent clawback for family incomes over approximately $26,000 per year (in 2001 dollars) so that the payment will be completely clawed back at an annual income of $52,000 for an individual or $78,000 for a couple.

As illustrated in Table 1, such clawbacks can imply very high effective tax rates when combined with the tax rates under the personal income tax system. For a single person or family with income of only $28,000, the effective marginal tax rate would be 46 percent. For a single person with income of $40,000, the effective tax rate would be 62 percent, and for a one-income couple with income of $74,000, it would be 73 percent. Clearly, these marginal rates could provide a strong disincentive to continued labor market participation — and to saving for retirement (at least in ways that will yield taxable income). One result would be to reduce the tax revenues that would otherwise be generated by continued labor market participation.

The Canada and Quebec Pension Plans

The CPP / QPP provide earnings-based pensions, normally payable at age 65. The maximum annual payment is approximately $8,300, or one-quarter of the average industrial wage.

A CPP / QPP payout received at age 65 or later does not entail any clawbacks, although the amount is subject to income tax and may therefore raise the marginal income tax rate of a recipient who continues to work.

The early retirement feature of the CPP / QPP can, however, create a substantial disincentive to continued labor market participation. Under that feature, added in 1987, bene-fits can be payable as early as age 60. The amount is permanently reduced by 0.5 percent for every month an individual is short of his or her sixty-fifth birthday, but the small size of the adjustment does not offset the additional period of benefit. In effect, the arrangement provides a subsidy for early retirement.

More important, the recipient must “substantially cease working,” which is interpreted as earning less than the maximum benefit payable at age 65. This “no work” requirement affects substantial numbers since the majority of recipients access CPP / QPP benefits between the ages of 60 and 64.

Delayed receipt of the CPP / QPP is also possible until the age of 70. The benefit adjustment, however, provides a penalty for late retirement in that the income from postponed benefits does not fully compensate for the fact that the pension will start later than the usual age and continue for a shorter period of time.

After age 70, there is no actuarial adjustment so individuals who delay receipt forgo their CPP / QPP benefits. Obviously, most people take the pension.

Registered Retirement Savings Plans

RRSPs constitute an additional component of the private pension system. The plans are earnings based in the sense that individuals are allowed a tax-deductible contribution of up to 18 percent of their previous year’s income, subject to a maximum and an offset for contributions made through an employer-sponsored occupational pension plan. The maximum contribution is $13,500 through 2003 and slated to rise to $15,500 by 2005.

Such plans are essentially tax-deferred private savings accounts. When they are cashed in (normally beginning at age 65), the income is taxable; therefore, additional earnings can combine with RRSP receipts to place recipients in a higher marginal tax bracket.

Furthermore, individuals are not allowed to contribute to RRSPs after age 69, effectively eliminating that benefit of continued labor market participation. At that time, they must also begin to draw their RRSPs down (or convert them to annuities), thereby increasing the likelihood that any augmentation of their labor market earnings will push them into a higher marginal tax bracket.

Clearly, the RRSP regulations can somewhat discourage continued labor force participation.

Table 1: *Effective Marginal Tax Rates under the New Seniors Benefit*

	Annual Income	Personal Income Tax Rate	Seniors Benefit Clawback	Effective Marginal Tax Rate
	(dollars)		*(percent)*	
Single senior	28,000	26	20	46
One-income couple	28,000	26	20	45
Single senior	40,000	42	20	62
One-income couple	74,000	53	20	73

Note: The numbers here have been rounded and averaged since the personal income tax rate will vary slightly across provinces.

Sources: David W. Slater, *The Pension Squeeze: The Impact of the March 1996 Federal Budget*, C.D. Howe Institute Commentary 87 (Toronto: C.D. Howe Institute, February 1997), p. 10; Canada, *The Seniors Benefit: Securing the Future* (Ottawa, March 6, 1996), charts 3, 4.

Yet eliminating such rules would disproportionately benefit higher-income persons since they are the ones who tend to use and benefit most from RRSPs because of their higher marginal tax rates at the time of deposit relative to withdrawal.

Personal Income Taxes

The personal income tax system has a tax credit for individuals 65 years of age and older. In 1995, a clawback of 15 percent was introduced for income levels of approximately $25,000. As one commentator states:

> With the GIS benefit reduction, combined with federal-provincial income taxes, a taxpaying GIS recipient can face a combined marginal tax rate between 70 and 80 percent, depending on the provincial tax rate.[10]

Disability Pensions

Disability pensions can, in theory, create powerful incentives to reduce the labor force participation of older workers. Individuals who are injured at work can receive permanent partial disability benefits through workers' compensation schemes. In systems that compensate on the bases of wage loss, the typical benefit is 85 to 90 percent of lost income. Clearly, income replacement at this level can greatly reduce the monetary incentive to return to work; an individual who does so increases his or her income by only 10 to 15 percent (perhaps less since the benefits are not taxable) and may incur work-related expenses.

In practice, knowing the actual importance of such motivations is difficult. Empirical evidence suggests, however, that they do reduce the incentive to return to work.[11]

Since the monetary incentives to return to work are weak, administrators often apply pressures in such forms as deeming individuals capable of earning income or requiring employers to reasonably accommodate the return to work of injured workers. In general, only catastrophically impaired workers are deemed completely unemployable, and they are unlikely to be able to return to work irrespective of the lack of monetary incentives. Most injured workers either obtain a lower-paying job or are deemed capable of doing such work, and it is difficult to determine the extent they may be deterred from obtaining a higher-paying job because of the lack of monetary incentives.

In theory, the high implicit clawback rates are important; in practice, it is difficult to know how important.

For nonwork-related disabilities that are severe and prolonged, the CPP / QPP also provide benefits for persons under age 65 as long as they have contributed to the relevant fund for four of the six years before suffering incapacity.

These disability pensions, which are a combination of flat benefit and compensation for wage loss, have increased substantially in recent years; by 1994, they had soared to 19 percent of CPP expenditures.[12] The explanation for this rapid rise attracts considerable controversy. It has been attributed in part to lax administration and the shifting of recipients from more stringent provincial workers' compensation programs to the federal CPP disability program.[13] Interestingly, the disability benefits did not increase substantially in Quebec, where workers' compensation and the QPP are under the same jurisdiction and hence there are no fiscal benefits in transferring claims from one to the other.

To the extent that the CPP / QPP disability component is abused, it clearly reduces the incentive to participate in the labor market. Since disability is obviously a more relevant issue for older workers, it can disproportionately affect their labor market behavior. This situation is exacerbated by the high effective tax rates they may face from the clawbacks on their other benefits if they earn labor market income.

Policy Implications

Clearly, a wide range of the features of Canada's legal system, private and public pensions, and income maintenance schemes discourage the continued labor force participation of older workers. In most cases, these features are not "carrots" that provide rewards to persons who retire (as is often the case with early retirement programs) but "sticks" that remove legislative protection from or provide penalties to those who continue to work. The penalties are usually not direct; rather, they come in more subtle forms, such as clawbacks or reduced eligibility for benefits. But implicit taxes that involve forgone benefits are no less onerous than explicit taxes — they are simply less transparent.

The dilemma is that many of the clawbacks exist for a reason: to reduce payments to persons who have other sources of income and hence to facilitate targeting more benefits to those most in need. The tradeoff is that clawbacks, when added to marginal income tax rates, can lead to confiscatory total tax rates.

If the rationale for such high effective tax rates and lack of legislative protection is to discourage work on the part of older Canadians, this point should be explicitly stated and subject to debate.

Some may argue that the disincentives are necessary to facilitate deferred compensation and to open up job and promotion opportunities for younger workers. The later argument, however, is subject to the lump-of-labor fallacy

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that assumes that the economy has a fixed number of jobs and any occupied by an older person is one less for a younger person. Al-though there may be some tradeoffs, such argu- ments should be subject to the same scrutiny that is merited by the old claim that any job occupied by a woman is one less job for a man.

The barriers that exist to discourage the continued labor force participation of older workers may not have been so important in the old world of work characterized by a male-dominated, blue-collar work force that may not have wanted to continue to work after age 65. That world is changing, however. Al-though some individuals are still in that situation, the work force is increasingly heterogeneous with different preferences and needs. Some people want normal retirement, others early retirement, and others postponed retirement.

In the absence of compelling social reasons to the contrary — reasons that are made explicit and subject to public debate — public policy should facilitate variation in the retirement decisions of private parties. At the very least, it should be neutral and not discourage any particular set of choices. The emphasis should be on removing the legal and institutional barriers that inhibit the private parties from working out their own best arrangements.

The desire of some workers to continue to participate in the labor market and of their employers to have them continue is as legitimate as the desire of others for early retirement. Thus, policymakers should critically assess the legal and institutional barriers that can inhibit not only early retirement but also postponed retirement. The aging work force, the changing nature of work, and the pressures on our retirement income systems suggests that these issues may be of paramount importance as we enter the new millennium.

Notes

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1 Thomas J. Courchene, "Generation X vs. Generation XS: Reflections on the Way Ahead," in Keith G. Banting and Robin Boadway, eds., *Reform of Retirement Income Policy: International and Canadian Perspectives* (Kingston, Ont.: Queen's University, School of Policy Studies, 1997), pp. 313, 314.

2 Robert L. Brown, "Achieving Stability and Equity with Paygo Funding," *Policy Options*, September 1995, p. 21. Since 1966, expected life span at age 65 has already risen by about 2.0 years for men and 2.5 years for women.

3 See Newman Lam, Michael J. Prince, and James Cutt, "Restoring the Canada Pension Plan: Simulating the Future and Stimulating the Social Policy Debate," in John B. Burbidge et al., *When We're 65: Reforming Canada's Retirement Income System*, The Social Policy Challenge 13 (Toronto: C.D. Howe Institute, 1996), p. 159.

4 Proposals to rein in CPP benefits, for example, include "raising the eligible age for normal retirement benefits to 70 over time, and scaling back benefits accruing in the future to 60 percent of today's level." See William B.P. Robson, *Putting Some Gold in the Golden Years: Fixing the Canada Pension Plan*, C.D. Howe Institute Commentary 76 (Toronto: C.D. Howe Institute, January 1996), p. 1. Support for raising the age of entitlement is also given in Lam, Prince, and Cutt, "Restoring the Canada Pension Plan," p. 158.

5 See Morley Gunderson and Douglas Hyatt, "Intergenerational Considerations of Workers' Compensation Unfunded Liability," in Miles Corak, ed., *Government Finances and Generational Equity* (Ottawa: Statistics Canada and Department of Human Resources Development, 1998).

6 See Morley Gunderson and James E. Pesando, "The Case for Allowing Mandatory Retirement," *Canadian Public Policy* 14 (March 1988): 32–39.

7 James E. Pesando and Morley Gunderson, "Retirement Incentives Contained in Occupational Pension Plans and Implications for the Mandatory Retirement Debate," *Canadian Journal of Economics* 21 (May 1988): 244–264.

8 Such features are discussed in John B. Burbidge, "Public Pensions in Canada," in Burbidge et al., *When We're 65*; and Morley Gunderson, Douglas Hyatt, and James E. Pesando, "Public Pension Plans in the United States and Canada" (paper presented at Upjohn Institute Conference on Employee Benefits, Labor Costs, and Labor Markets in Canada and the United States, Kalamazoo, Mich., 1996). The illustrative dollar values used here are not exact since they are rounded and the sources may not contain the very latest figures.

9 For discussions of the seniors benefit, see David W. Slater, *The Pension Squeeze: The Impact of the March 1996 Federal Budget*, C.D. Howe Institute Commentary 87 (Toronto: C.D. Howe Institute, February 1997); James E. Pesando, *From Tax Grab to Retirement Saving: The Case for Privatizing the CPP*, C.D. Howe Institute Commentary 93 (Toronto: C.D. Howe Institute, June 1997); and Canada, *The Seniors Benefit: Securing the Future* (Ottawa, March 6, 1996).

10 Paul Dickinson, "Six Common Misperceptions about the Canada Pension Plan," in Burbidge et al., *When We're 65*, p. 180.

11 For Canadian evidence and a review of other studies, see Douglas Hyatt, "Work Disincentives of Workers' Compensation Permanent Partial Disability Benefits: Evidence for Canada," *Canadian Journal of Economics* 29 (May 1996): 289–308.

12 Dickinson, "Six Common Misperceptions about the Canada Pension Plan," p. 176.

13 Robson, *Putting Some Gold in the Golden Years*, p. 17.

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