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E-BRIEF

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What to do About Seniors' Benefits in Canada: The Case for Letting Recipients Take Richer Payments Later

by
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- Letting OAS and GIS recipients delay take-up and rewarding those who do could contain program costs over time in a way that is less stressful to recipients than raising a universal eligibility age, and less discouraging to work and saving than intensifying clawbacks.
- If potential recipients could start at age 65, as they do now, or wait and get benefits that were larger by 0.7 percent per month of delay, they would gain a valuable tool. Those with little income subject to clawbacks and/or unable to work would start at 65 as they do now – they would lose nothing. Those willing and able to wait would forego benefits otherwise available at age 65, but collect more when they do start.
- Because a new cohort turns 65 each year, and the cohorts are getting bigger, such a reform could help Ottawa's bottom line well into the future, alleviating the pressure of aging on government finances and Canada's economy.

The recent polarized reaction to the prospect of changes to Old Age Security (OAS) recalled the debate over Canada and Quebec Pension Plan (C/QPP) reform in the 1990s. Happily, persuasion and adept design got the C/QPP reforms done. A similar success is possible with OAS and the Guaranteed Income Supplement (GIS), especially if policymakers give those programs a key C/QPP feature: letting participants choose when to start their benefits, and reap rewards if they wait.

This is a revised version of an E-brief issued on March 13, 2012, and contains corrected figures on program costs. I thank those who provided comments before and after the original version, and remain responsible for the figures and conclusions presented here.

Rather than replacing work-related earnings as the CPP and QPP do, the OAS and the GIS provide income-tested supports.[1] Maximum OAS payments are about $6,500 annually per person and clawed back at a rate of 15 cents per dollar of taxable income above $69,500.[2] Maximum GIS payments are about $8,800 and $11,700 annually for individuals and couples, respectively, clawed back at 50 cents per dollar of most non-OAS income. Both are funded from general taxation. And with the minor exception of the Allowance – a supplement (with a 75 percent clawback) for low-income spouses or widows of OAS beneficiaries age 60 to 65 – both essentially mark 65 as the onset of old age. Before then, nobody gets the payments or faces clawbacks; afterwards, everybody does.[3]

Demographic changes make age 65 look a less apt marker for old-age dependency than it did when the current benefits for all these programs took shape in the mid-1960s. In 1965, life expectancy at 65 was 16.9 years for women and 13.6 years for men. Recently, the Chief Actuary (OCA 2011a) estimated that it has risen more than one-third for women, at 22.6 years, and almost half for men, at 20.2 years. That, plus a birthrate well below replacement, means the ratio of people age 65 and up to those 18 to 64 will double in 30 years.[4]

By themselves, OAS and GIS seem no major threat to Canada's public finances. As it is, their clawbacks will erode net payments to potential recipients whose incomes grow faster than inflation. And if productivity growth boosts the tax base, growth in gross domestic product (GDP) will help their long-term affordability. The Chief Actuary's latest projections (OCA 2011b) show their combined cost rising from 2.37 percent of GDP in 2011 to 3.16 percent in 2030, then falling to about 2.6 percent in 2050.[5] The 0.79 percentage point increase by 2030 is about $13 billion in today's money. Ottawa could finance that by putting the GST rate back to 7 percent: politically awkward, but economically manageable – if the programs' provisions do not change, if Canada was prepared for aging's other fiscal impacts, and if federal finances were our sole fiscal concern.

OAS and GIS may not be stable, however. The GIS's latest enrichment happened only last July.[6] And if productivity growth does boost workers' incomes, relative living standards of OAS and GIS recipients will drop – a force for ad hoc increases that would inflate their cost.

Moreover, aging will push up the combined draw of healthcare, public education, seniors and family benefit programs more than 4 percentage points of GDP – nearly $70 billion in today's money – by 2030, and nearly

1 The OAS basic amount depends on years of residency and legal status. Canadian residents must be at least 65 years old and have lived in Canada at least 10 years after turning 18 to receive it (Canadians living abroad must have lived in Canada at least 20 years after turning 18). The actual benefit is 1/40th of the full pension for each year of residence in Canada since age 18. Seniors who qualify for partial OAS but also quality for the GIS (mostly low-income seniors who recently immigrated) receive supplementary GIS equal to the difference between their partial OAS and full OAS benefits, the supplementary GIS being clawed back at the same rate as the regular GIS.

2 The OAS is a taxable transfer payment, included in taxable income for calculating the OAS clawback, which reduces the benefit to zero when taxable income surpasses $112,800. The combined federal/provincial tax rate is about 35 percent over the affected range, making the net increase in effective tax rates from the clawback a little less than 10 cents per dollar of non-OAS income.

3 The OAS basic pension started in 1952 and the GIS in 1967. OAS eligibility started at age 70, and transitioned to 65 between 1965 and 1969.

4 No plausible changes in immigration can appreciably modify this trend (Banerjee and Robson 2009).

5 The full cost also includes the much smaller Allowance program and administrative costs, but the OAS and GIS payments drive the changes.

6 The *Supporting Vulnerable Seniors and Strengthening Canada's Economy Act* added a new benefit top-up to the GIS and the Allowance targeted to very low income seniors.

7 percentage points – some $113 billion in today's money – by 2050 (Robson 2010). Add regular government debt, government-employee pensions and benefits, and contingent liabilities related to government financial institutions, environmental cleanup and other exposures, and the tab could preempt the growth in living standards today's youngsters might otherwise hope for as they grow up.

Finally, provincial governments will bear most of aging's fiscal burden. Ottawa's relative tax take should shrink, not grow, to help the provinces meet this challenge without gutting key programs such as infrastructure and education.

Such larger-picture considerations prompted the late-1990s C/QPP reforms. Trimming and partially prefunding their benefits forestalled the multi-decade payroll tax escalation otherwise in prospect. The reforms also initiated regular reviews of their financial status, which recently changed a key feature: their actuarial adjustments.

C/QPP benefits do not start automatically at age 65. Participants can take them as early as age 60 and as late as age 70, and those who wait get more. In the past, early take-up lowered payments by 0.5 percent for every month before age 65, and late take-up increased them similarly. To respond to adverse demographic and economic circumstances by encouraging later take-up, the adjustment factors are changing. By 2016, early take-up will lower payments 0.6 percent per month before age 65 and raise them 0.7 percent per month after it.[7]

Letting OAS and GIS recipients delay take-up and rewarding those who do could contain program costs over time in a way that is less stressful to recipients than raising a universal eligibility age, and less discouraging to work and saving than intensifying clawbacks. What if potential recipients could start at age 65, as they do now, or wait and get benefits that were larger by 0.7 percent per month of delay? Seniors would gain a valuable tool. Those with little income subject to clawbacks and/or unable to work would start at 65 as they do now – they would lose nothing. Those willing and able to wait would forego benefits otherwise available at age 65, but collect more when they do start.

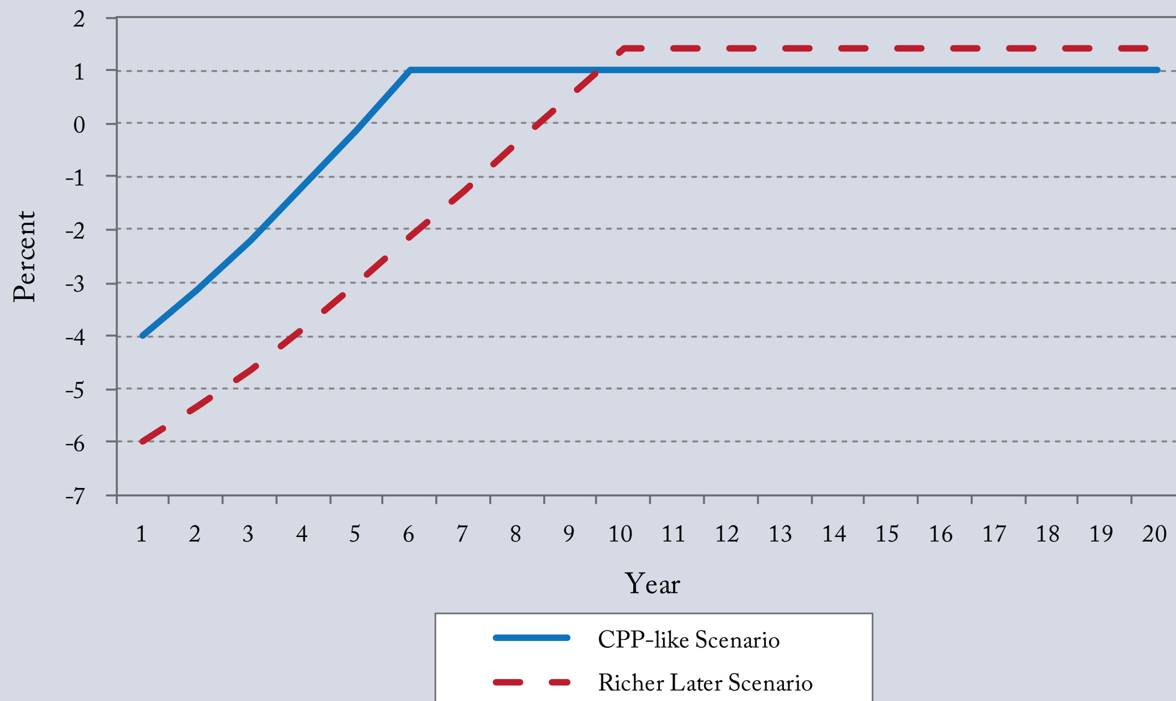
Three Scenarios

Such a change would help Ottawa's bottom line in the near term. For a "CPP-like Scenario," suppose take-up of actuarially adjusted OAS and GIS roughly resembled that of the CPP, with 96.0 percent of each age cohort starting their benefits at age 65, and 0.8 percent of the rest starting successively at 66, 67, 68, 69 and 70.[8] The impact on that cohort's payouts would be as shown by the solid line in Figure 1. That figure also shows a "Richer Later Scenario – the dashed line – in which benefits rise 0.8 percent per month of delay and 94 percent of each cohort starts at 65, with 0.6 percent of the rest starting at each successive age until all are collecting by 75. In any variation, the savings from people delaying take-up in each cohort will initially outweigh the larger payments once benefits commence, with those larger payments pushing total average payouts to that cohort above the baseline later on.

7 The schedules for the changes are not identical: the CPP changes started earlier and are more gradual.

8 As noted in the text, CPP benefits are actually available as early as age 60. By age 65, 96 percent of those eligible have started – a fact reflected in the model. Actual take-up rates after that are slightly skewed toward older age brackets (OCA 2010), so this stylized scenario allows for the fact that the population of OAS/GIS recipients contains more people whose incomes and life expectancies might incline them toward earlier take-up than is the case for the CPP. How quickly new take-up would respond to the incentive to delay is hard to say, but the high public profile of the change might spur many soon-to-be-seniors, especially those facing clawbacks and/or with access to financial advice, to consider delaying.

Figure 1: Change in OAS and GIS Payments to One Cohort from Reform

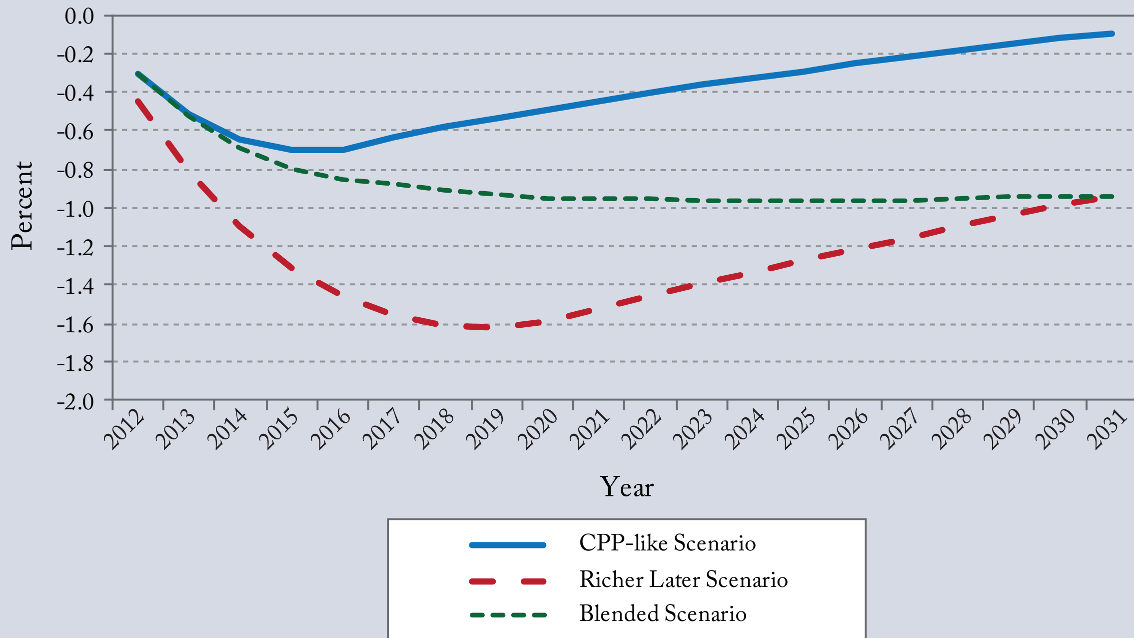


Source: Author's calculations as described in the text.

Because a new cohort turns 65 each year, and the cohorts are getting bigger, such a change would help Ottawa's bottom line well into the future. Figure 2 shows the results of modeling successive cohorts over 20 years as though a reform along these lines to OAS and GIS took place in 2012, using mortality rates and cohort sizes from the Chief Actuary (OCA 2011a).[9] The solid line shows the CPP-like Scenario: the impact of later take-up by part of each new cohort lowers payouts to people reaching age 65 after the reform by about 0.5 percent for the first decade, and the increasing share of those new seniors in the total seniors population keeps total payments lower throughout the period. The dashed line shows the Richer Later Scenario in which the impact of later take-up is much greater – although that scenario is far less likely near-term, since OAS/GIS recipients, on average, will not likely start benefits later than CPP recipients.

9 The simulations assume that Allowance payments do not change. They also assume that administrative costs do not change, which is not realistic: while modern information and payments technology, and integration of income supports with the personal tax system, should limit the ongoing increase in administration costs involved with the new system, launching it would involve upfront costs.

Figure 2: Change in Seniors' Benefits from Reforms: Stylized Scenarios



Note: Total program costs include all OAS, GIS and Allowance payments to all recipients, plus administrative costs.
Source: Author's calculations as described in the text using mortality, cohort size and program cost data from OCA (2011a, 2011b).

More plausible are a reform and response initially resembling the CPP-like Scenario, but with subsequent changes such as modified actuarial adjustments, better health, later retirement and changing norms, inducing a take-up pattern more like the Richer Later Scenario over time. So Figure 2 also shows a "Blended Scenario" with modest initial savings but larger impacts as both demography and behavior change, with the impact (as in the Richer Later Scenario) amounting to about 1.0 percent of program costs by 2031.

This stylized model treats everyone eligible for OAS and GIS as identical, which they are not – people will defer take-up or not as suits them, not the federal government, so initial savings may be smaller than these estimates. However, this exercise also omits benefits – notably the impact of longer work and higher saving on GDP and the tax base by those who defer.[10] Because ability to tailor take-up to individual and family circumstances has real value to recipients, moreover, some restraint in future growth of base amounts, particularly for the OAS, could be part of the package.

10 Many provincial seniors' benefits piggyback on GIS eligibility (Curry 2012). If delaying GIS receipt affected those programs, most potential recipients would have a further incentive to start at age 65, but provinces might add their own adjustment factors, potentially reducing other costs that otherwise make aging a fiscal problem.

The C/QPP reforms put Canada in the forefront of countries that have shored up their social security programs against demographic pressure. That success, and the fact that the CPP and QPP have made actuarial adjustments familiar to many Canadians,[11] should encourage Ottawa to boost OAS and GIS payments by, say, 0.7 percent per month for those who delay take-up. Raising the age of receipt is less gentle; hiking clawbacks more economically damaging. Letting Canadians choose when to take their benefits and rewarding later receipt looks a better course.

11 Actuarial adjustments is familiar enough to have been suggested by several other commentators, including Vettese (2011) and Mintz (2012). As far as the author is aware, however, this is the first specific proposal for an adjustment and attempt to model its potential effects.

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