Pension Reform in Canada: An Often Fractious Federation

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PENSION REFORM IN CANADA:
AN OFTEN FRACTIOUS
FEDERATION

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Abstract

The recent recession has turned retirement pensions into an increasingly important issue globally, as concerns rise over both state-run and private pensions. The Canada Pension Plan (CPP), however, is deemed actuarially sound, a consequence of a major reform in the mid-1990s. The CPP, a contributory plan that provides disability and survivor benefits in addition to retirement pensions, operates under a unique set of intergovernmental arrangements. A constitutional amendment in 1964 cleared the way for the federal government to launch the CPP, while Quebec initiated its own plan with parallel benefits and earnings-based contributions. The 11 governments are joint stewards of the CPP and any changes must be supported by two-thirds of the provinces with two-thirds of the population. When actuarial projections for the CPP turned sour in 1995, the federal and provincial governments set aside their strong disagreements on a range of other issues and worked closely together to put the CPP on a sustainable footing; Quebec adopted the same changes. The process was driven not only by the joint nature of the CPP, but by self-imposed rules – adopted 10 years earlier – that would punish a failure to agree with higher contribution rates dictated by the plan’s actuary. The reformed CPP included both higher rates and reduced benefits.

Keywords: Canada; constitution; federal; government; intergovernmental; pensions; pension reform
Introduction

Financial crises typically expose faults that are either hidden or ignored during more buoyant economic times. These days, retirement pensions are among the issues suddenly held up to public scrutiny – and found wanting. Employer-based retirement plans that looked reasonably healthy when stock markets were riding high now carry the pallor of extreme ill health. And governments worldwide are under pressure to produce solutions.

With the focus on employer-sponsored pensions – in both the private and public sector – it has been easy to forget about broader retirement pensions that governments have operated, in one form or another, for decades. Canada is a case in point. At last count, in 2006, only 36 per cent of Canadian employees belonged to some form of workplace pension plan, down from 45 per cent 15 years earlier.

There is a huge divide between public sector workers, 82 per cent of whom are covered, and their private sector counterparts, a scant 24 per cent of whom are covered.¹ The former have little to worry about; they can be certain their employer will be around long enough to pay the promised pension. The latter have more to fear. They are increasingly aware that their own plan is almost certainly under-funded, in that it could not meet all its long-term commitments if it were wound up tomorrow. They also worry that if their employer someday goes bankrupt, then the pension they had counted on – and contributed to – during their working years, might be severely reduced, perhaps even wiped out entirely.

Canadians are lucky in one regard, however. Any Canadian who has ever worked, including the self-employed who have no workplace pension plan at all, is covered either by the Canada Pension Plan (CPP), in all parts of the country save Quebec, or by the parallel Quebec Pension Plan (QPP) in that province. The CPP² is not one of the world’s most generous national pension plans, but it has one huge plus that many of those plans lack: It is financially sound and actuarially sustainable for another 75 years. According to the latest actuarial report, it can meet all of its obligations without any further increase in the contribution rate on employment earnings that workers and their employers now pay.


2. For brevity, all references to the CPP encompass the QPP as well, unless otherwise specified.
Origins of the CPP

The CPP’s road to this benign outlook has been far from smooth, but it represents one of the finest examples of federal-provincial cooperation – one that rests on a unique structure of shared jurisdiction and a very practical approach to problem-solving. The plan was born in 1965 in one of the great public policy battles in Canadian history – a dramatic episode of constitutional conflict in which the governments of Canada and the country’s two biggest provinces, Ontario and Quebec, clashed over competing visions against a backdrop of growing separatist sentiment in Quebec. In its worst moments, some feared the dispute might lead to the breakup of the country.

The first Canadian pension scheme, a modest non-contributory arrangement, was created by an act of the federal parliament in 1927, but it was jointly funded by the federal and provincial governments and administered by the latter, which were considered to have constitutional jurisdiction. The Great Depression of the 1930s induced a greater willingness on the part of the provinces to allow the federal government to introduce new national social programs. In 1940, they unanimously agreed to give Ottawa the power to set up an unemployment insurance plan. Then in 1951, they agreed to another constitutional amendment which made pensions a subject of concurrent jurisdiction, though with the unusual provision that there would be provincial paramountcy in cases of conflict. This amendment allowed the federal government to introduce the Old Age Security Act, which offered a non-contributory pension to anyone 70 and over (later reduced to 65) who had lived in Canada for at least two decades. Having struggled during the Depression to provide such benefits to their people, the provinces, in effect, ceded some of their sovereignty over social policy to prevent a recurrence. By the early 1960s, however, the Old Age Security program (OAS) was widely regarded as insufficient for the needs of the elderly and the major federal political parties all advocated the creation of a broader income-related pension plan that would provide more than retirement pensions alone. Among the additions would be disability and survivor benefits, a feature of the United States Social Security System that many Canadians favoured. Such extras for the non-aged, which the federal Liberal government wanted, were not covered by the 1951 amendment.

Ottawa needed provincial support for a national pension plan and in 1963 began to push the provinces in that direction. Ontario, however, had already moved to expand the private pension system by requiring all but the smallest employers to provide pensions for their employees. Quebec, which was developing its own plan, regarded Ottawa’s plans as an infringement on provincial jurisdiction. In the battle that followed,
the governments first agreed to a constitutional amendment in 1964 that would permit the broader definition of pensions.

After many more months of tense negotiations, they agreed in 1965 to create two plans. The Quebec Pension Plan would operate in Quebec and the Canada Pension Plan in the rest of the country. The aim was to keep the two plans as parallel as possible; they levied the same contribution rate on wages and offered the same benefits. The big difference lay in the treatment of the surpluses that would build during the years when full benefits were being phased in. Quebec established a fund to channel its surplus—really the savings of Quebecers—into a fund that would invest in provincial economic development, while the surpluses in the CPP fund were lent to the provinces at interest rates below the rates they would pay to borrow in financial markets. That solution won provincial support. Ontario, home to almost 40 per cent of Canadians, was further mollified with a *de facto* veto in the amending formula for the CPP; any changes would require the support of the federal government and two-thirds of the provinces with two-thirds of the population. Both plans were launched in 1966.

The policy makers knew that their successors would someday have to raise the contribution rate, which was set at 3.6 per cent of covered earnings, split equally between employers and employees. They had created what were essentially pay-as-you-go pension plans (PAYGO in the lingo of pension experts), each with a fund that amounted to a cushion of only two years worth of benefits. In effect, workers were paying for the pensions of the elderly in the expectation that future generations of workers would pay their pensions after retirement. Actuarial projections suggested that this pattern would hold until the early 1980s.

**Decades of inaction**

For the next two decades, governments regularly enhanced benefits without raising the contribution rate. Indeed, for the first three decades of its existence, financing of the CPP was all too typical of the approach taken by Canada’s federal and provincial governments to fiscal matters in general during that period. In budget-making, they avoided hard, politically unpopular positions that would have been prudent and sustainable, but would have meant higher taxes or lower spending. With the CPP, governments kept putting off the unsavoury task of raising the contribution rate, which was increasingly seen as a payroll tax that acted as a disincentive to job growth. Not until 1987 did they finally impose a new schedule of steadily rising contribution rates; an even steeper rate schedule followed in 1992. In both cases, Ottawa and the 10 provinces followed the amending formula agreed to in 1965 for the CPP, while Quebec kept the QPP in line with it.
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Neither effort, however, solved the CPP’s long-term financing problem – and when it comes to pensions, with their typically 75-year horizon, only the long-term matters. This became depressingly evident in early 1995, when the federal government’s chief actuary, whose job it was to monitor the CPP, reported that without major changes, the plan would “go broke” – as the headline writers loved to put it – by 2013, just as the huge baby-boom generation would begin to retire in large numbers.

Quebec came to a similar conclusion about the QPP. “Go broke” was never a real possibility because the CPP’s own rules included a mechanism to prevent that outcome. Still, the gloomy headlines not only galvanized the governments responsible for the CPP – the plan’s stewards – but also heated up a public debate that had been simmering for several years.

Financial insecurity lay at the root of public concern. The early 1990s featured a brutal recession for Canada: The unemployment rate shot up to almost 12 per cent of the labour force from under 8 per cent, average incomes fell and increasing numbers of Canadians began to worry that when they retired, a monthly pension cheque from the CPP would not be there. At the same time, the federal and provincial governments were running large and persistent deficits that were beginning to unnerve Canadians. In the 1993 federal election, voters decisively dismissed the nine year old Progressive Conservative government and turned the reins over to the Liberals under Jean Chrétien. They also sent to Ottawa a phalanx of very conservative Reform Party MPs, a new party whose popularity was based in no small measure on their promise to eliminate the deficit. Politically, the national mood shifted rapidly from a quarter-century of tolerating deficits to much stronger support for sounder public finances. For Canadians who thought their governments had mismanaged their money, the CPP was – along with budgetary deficits – a key piece of evidence in the indictment.

By mid-decade, governments were ready to grapple with both issues. Only days after the chief actuary sounded his warning about the CPP, federal Finance Minister Paul Martin brought down a tough budget that put the national government on track to return to a budget surplus within, as it turned out, only three years. In this, he was emulating measures already taken in several provinces – notably Saskatchewan and Alberta – to repair their accounts. Martin then turned his attention to the CPP, partly because he and his provincial counterparts had no choice. By earlier agreement, a review of the plan would follow each full new projection from the chief actuary, done every five years. That cycle had begun again, with a 1997 deadline to initiate any changes to the CPP’s contribution rates or benefits.
The CPP and the retirement income system

The CPP (with the QPP) is only one part of Canada’s three-tiered retirement income system. The first tier, Old Age Security, covers almost everyone – even if they have never worked for money; those with very low incomes can also qualify for additional benefits under its companion Guaranteed Income Supplement (GIS) and Spousal Allowance. The second tier consists of public and private contributory plans, based on earnings. Workers contribute a share of their wages and salaries to the compulsory CPP, as do their employers, and can expect a retirement pension equal to about one-quarter of the average industrial wage as a maximum. In addition, the CPP provides disability insurance and survivor benefits that make it more than a simple retirement savings vehicle. Also in the second tier are private plans – employer pensions offered by companies, governments and other organizations. Such registered pension plans qualify for tax relief; contributions are not taxed, nor are the investment income and capital gains earned on the pool of accumulated capital. The third tier consists of private savings, some of which is tax-sheltered through registered retirement savings plans.

Though it is only one of several sources of retirement income – and not even the major source for most Canadians, the CPP (with the QPP) is central to the whole retirement income system. For one thing, workplace pensions have to a considerable extent become integrated with the CPP, making the public plan a cornerstone of the private pension system. Ken Battle, one of Canada’s leading social policy analysts, has described the CPP – by comparison with the much more generous programs available in many European countries – as “a relatively modest earnings-related social insurance program in terms of both its benefits and contributions.” Yet it “constitutes a vital part of the country’s retirement income system, especially for lower- and middle-income working people and their families in general, and women in particular. Canada’s three-tiered retirement income system is for most people effectively a two-tiered system since the third tier of individual savings is largely the preserve of higher-income Canadians. Private pension plan coverage is the exception rather than rule for lower-paid workers, private sector workers and those employed by small or medium-size employers.”


Pressures for reform

The CPP has always been popular with Canadians. It is thus a sensitive issue for the politicians charged with running it. Though established by a federal Act of Parliament and the federal government handles all of its day-to-day administration, the CPP is the single biggest joint venture of the federal and provincial governments. This goes beyond the 1964 constitutional amendment and the 1965 pension deal to a unique set of rules, adopted in 1985 at the time of the first increase in contribution rates, under which all governments bound themselves to an arrangement that limits their own freedom of action. If, after each five-year review, the governments failed to make changes that would satisfy specific actuarial targets, they would have to admit that failure – an embarrassing prospect – by adopting a new schedule of contribution rates based on an actuarial formula. But to reach any agreement, they needed to clear the bar of the double two-thirds amending formula.

As they embarked on their review of the CPP in the winter of 1995, then, the governments had a gun to their heads. They faced a major decision and a deadline to make it – at a time when Ottawa and the provinces were fighting each other over a number of issues. Though the two orders of government co-operate on many things, their relationship tends to be fractious on major issues involving money, and there were plenty of those after Martin’s 1995 budget. To balance his own budget, Martin had sharply reduced federal transfer payments to the provinces. This made it much harder for them to make their own ends meet when the economy was still struggling to escape from the 1990-91 recession and the national unemployment rate was still over 9 per cent. Ottawa was also trying to persuade the provinces to harmonize their retail sales taxes with the federal goods and services tax. Some provinces agreed, but only with the encouragement of substantial federal subsidies, which annoyed other provinces. Furthermore, they were at odds over the federal government’s desire to establish a national securities regulator that would supplant the existing provincial bodies, an issue unresolved even today.

In short, while fighting on a number of fronts, they now had to sit down and negotiate changes to a major social program for which both were responsible. Moreover, it was certain that those changes would involve higher contributions, smaller benefits, or both. Any failure to agree would be all too visible, triggering the automatic implementation of a new rate schedule that would drive the contribution rate from its existing level of 5.4 per cent of covered earnings in 1995 to 14.2 per cent in 2030. Martin, who had become finance minister only 15 months earlier, had been startled not only by the lack of confidence financial markets had in the Canadian government after a generation of deficits,
but also by the public’s loss of confidence in the CPP. It was so severe that the young regarded it as “a dead horse … not even worth flogging,” he recalled later. “No one, it seemed, thought we as politicians could muster the will to fix the CPP. … This lack of confidence went to the heart of government, and we could not let that stand.”

In only one sense was the magnitude of the task less daunting than dealing with budget deficits. The CPP is not a budget item for any government. Its finances lie in a separate account, where revenue and spending are clearly tracked and have no impact on the budgets of any government. Other federal provincial disputes over money often involved zero-sum games: More money for Ottawa was less for the provinces; or more money for one province was less for others.

No more tinkering

By December 1995, when finance ministers first sat down together to talk about the CPP, Ottawa was serious and ready to move beyond a position of merely tinkering with rates and benefits and then putting off any structural problems for another five years. Key provincial finance ministers were similarly determined. Ontario’s Ernie Eves, despite his government’s opposition to raising taxes of any kind, was one of the first to acknowledge the need for a higher contribution rate. Alberta’s Jim Dinning was pushing hard for any solution that broke from the business-as-usual history of CPP changes. Both were Progressive Conservatives (with an emphasis on the Conservative), which meant they were political rivals of the federal Liberals.

Other provinces were anxious to protect CPP benefits, notably the four Atlantic Provinces, traditional have-nots, and British Columbia and Saskatchewan, both of whose governments were in the hands of the leftish New Democratic Party. Complicating the scene was the fact that Quebec was governed by the Parti Quebecois, which advocated the province’s separation from Canada. On this matter, however, the PQ government was utterly practical. The QPP needed the same overhaul as the CPP and Quebec was keen to keep it as close to the CPP as possible. Such parallelism, a goal of pension policy from the start, was also good politics: Higher contributions and reduced benefits would be easier to swallow in Quebec if the rest of Canada was doing the same.

Behind the politicians were federal and provincial officials who had toiled in the pension vineyards for years – decades even – and who

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understood deeply just how far short of the mark their previous two reform efforts had fallen. The one in the mid-1980s set the contribution rate on a path of steady annual increases, but also sweetened benefits substantially, so it actually did nothing to put the CPP on sounder footing. There had been a pronounced shift in the early 1990s, when an even steeper contribution rate schedule was coupled with only a minimal expansion of benefits. By then, governments were growing increasingly conscious of their budget deficits and the resulting increase in debt that would burden them well into the future. By the mid-1990s, the officials who worked the pension file were ready for something more dramatic, a more permanent solution to the CPP’s long-term problems.

The reform package emerges

Most ministers were ready for stronger medicine. Many were taking tough measures to reduce large budget deficits and had come to think of fiscal probity as their legacy. It was easy to transfer the thinking of deficit elimination to the CPP. A quarter-century of federal and provincial deficits had produced almost $735-billion in government debt, equal to 95 per cent of Canada’s gross domestic product, while three decades of inadequate measures for the CPP had produced a large, unfunded liability – about $550-billion – in the form of pension promises made with no money set aside to meet them. The finance ministers were moving to reduce the debt burden on future generations. Now they were ready to reduce the burden that would arise when the much smaller baby-bust cohort, the one that followed the baby-boom generation, would be expected to finance their parents’ CPP benefits as well as their own.

The federal team sketched out a plan that played well to this sentiment. The schedule of contribution rate increases would become even steeper (no change there from what they had done previously) and benefits would be cut (a very big change). But the contribution rate could be capped in relatively short order at a level well below the projected 14.2 per cent rate that so spooked Canadians. Revenue would exceed the cost of benefits for another quarter-century and the growing accumulation of annual surpluses would be managed by a professional investment organization at arm’s length from governments. Though utterly logical – indeed, almost an inevitable outgrowth of any decision to expand the size of the fund – this new investment policy was a radical departure from the practice of the first three decades of the CPP.

For the participating provinces, the CPP fund’s assets had been a convenient and cheap source of financing during a period marked by provincial government deficits. But the fund was already dwindling and had now been a source of new borrowing for several years. Quebec, which had invested the QPP’s surplus funds from the beginning, natu-
rally had no direct interest in this issue. It needed only to pay attention to the debate on contributions and benefits and stand ready to offer advice on investment questions based on its own experience.

While the ministers were ready for a major overhaul of the CPP, they realized that the public was not. Canadians were deeply worried about the outlook for the CPP but had not begun to think hard about the dimensions of the problem, let alone debate the kind of measures needed to fix it. The ministers’ solution at the December 1995 meeting – to launch a series of public consultations – looked like the usual delaying tactic of politicians trying to avoid a tough decision. It was not. It became a key element in the success of the eventual reform.

A blandly titled consultations paper – *An Information Paper for Consultations on the Canada Pension Plan* – forced the public debate to focus hard on CPP reform. It set out a rationale for the reform itself, conveyed a sense of urgency about resolving the issue, provided a detailed list of the choices at hand and gave a clear sense of the governments’ preferred outcome. Canadians were being asked what they wanted, but the debate was circumscribed by the issues and options set out in the paper. Released in February 1996, it set in motion a road trip of public consultations that covered 18 cities over two months.

The *Information Paper* warned that while the CPP was “a vital part of Canada’s retirement income system,” its cost was rising faster than expected when the plan was created and would “escalate dramatically” when baby-boomers begin to retire.

The core of the argument occupied only four paragraphs:

1) The basic challenge facing Canadians today is one of fairness and equity. If no changes are made to the CPP and the way it is financed, our children and grandchildren will be asked to pay two to three times more than we are paying for the same pensions from the CPP. For the past 30 years, we have not paid our way. Even today, we are not paying our way. Today’s CPP pensioners have paid much less than their benefits are worth. In contrast, future generations will be asked to pay considerably more than their benefits are worth.

2) Will they be able to do so? Will they be willing to do so?

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7. Ibid., p. 3
3) To ensure the sustainability of the CPP, steps must be taken to be as fair to future generations as possible.

4) The Government of Canada and the Governments of the provinces are joint stewards of the Canada Pension Plan. They believe that all reasonable steps should be taken now to ensure that future generations are not faced with unreasonable burdens. They do not believe that Canadians wish to be faced with this problem yet again at the next review of the CPP in five years' time. If the problems of the CPP are faced squarely now, fairness can be restored, and the CPP can be sustained not only for today's seniors, but for tomorrow's as well.8

It was a tight summary of the CPP's financial problems that blended crisis, urgency and optimism. The essential message: Big problems loom, but "reasonable" steps now can prevent "unreasonable" burdens in the future; a solution exists that is fair to all; and if we adopt it now, we can resolve the issue. The paper laid out plainly the broad course that governments wanted to follow:

- The financing of the CPP can be strengthened by ensuring that today's working Canadians pay a fairer share of CPP costs. Raising contributions more quickly now would ease some of the contribution burden that will otherwise be passed on to future generations of workers. This would not only be fairer across generations – it would also make the CPP more sustainable for future participants.

- To strengthen CPP financing would require both fuller funding and a new investment policy. Together with benefit reductions, these actions could help to keep future contribution rates from rising to levels which may be beyond the capacity and willingness of future generations to pay.9

A trio of measures – higher contribution rates, benefit cuts and a bigger investment fund with a new investment policy – would prevent excessive increases in future premiums, ensuring both fairness and sustainability. The contribution rate would rise quickly from the current 5.6 per cent "to a higher level which can then be maintained without further increases. This contribution rate would cover the costs of each contributor’s own benefits, plus a share of the burden that has

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8. Ibid., p. 4
9. Ibid., p. 27
built up because both current and past contributors have paid far less than their benefits are worth. This rate can be called the ‘steady-state’ contribution rate.” That in turn would lead to fuller funding and a reserve fund containing not two years of benefits, the existing target, but six years of benefits. A fund that big could earn enough money to “help pay for an increased share of CPP benefits” and that, in turn, “would make a major contribution to lowering contribution rates in the future.” The paper also set out a range of possible cuts to benefits that would cement the CPP’s financial future.

“A paradigm shift”

The paper narrowed the debate. After years in which discussion and proposals had wandered all over the map, “there was a paradigm shift,” as pension consultant Keith Ambachtsheer put it. The political right attacked the paper for not scrapping the CPP altogether and replacing it with individual retirement accounts; the left argued that it created a fake “crisis” and failed to propose a further expansion of benefits. But for the most part, it was seen as a good effort. “It was short, but there was real meat to it,” as Ken Battle of the Caledon Institute put it.

The consultations team, rather than simply listen to a string of presentations, brought together groups with disparate viewpoints to sit down for half-day discussions of the issue. “Each hearing was balanced by having protagonists and antagonists at the same table,” recalled one federal official who sat through most of the sessions. “It was a round table – not one after the other. This was key.”

By the time the finance ministers met again in June 1996 in Fredericton, they had a 92-page account summarizing the public feedback. For the policy-makers who wanted strong action, the report was a gift. Overwhelmingly, those consulted wanted the CPP preserved and protected because of its key role in the retirement income system. “Canadians want the plan’s current problems fixed quickly and fixed for good. The majority of Canadians participating in the consultations urged governments to put the CPP on a sound financial footing now.”

10. Ibid. Further technical details on steady-state financing were spelled out in Annex C, beginning on p. 55 of the Information Paper.


More to the point, people were willing to pay higher premiums (as long as they did not go too high) and accept smaller benefits (as long as they did not shrink too much). Crucially, Canadians were willing to see CPP surpluses handed over to pension fund managers to invest in financial markets, as long as they were kept at arm’s-length from governments and political influence.

The ministers released the report to the public but did nothing more because a key province was missing. British Columbia’s minister had lost her seat in a general election a couple of weeks previously and her successor was appointed too late to make it to the meeting on the other side of the country.

Most of the 11 governments around the table were content with the broad direction of the talks, but there were divisions – hardly surprising in light of the political parties represented. Progressive Conservatives held power in Ontario, Alberta and Manitoba; Liberals in Nova Scotia, New Brunswick, Newfoundland and Prince Edward Island; New Democrats in British Columbia and Saskatchewan; and the Parti Québécois from Quebec. As far as Paul Martin was concerned, “we had all the views around the table.”14 The only party in the federal Parliament not in the CPP meetings, aside from the PQ’s federal surrogate, the Bloc Québécois, was the Reform Party – but no government in the land was paying any attention to its call to scrap the CPP. Alberta and Ontario were the hawks, insisting on a more permanent solution to the CPP’s chronic financial woes. The poorer Atlantic Provinces worried about the impact on their residents of paying higher premiums for smaller benefits, while the two provinces with NDP governments – reflecting the views of the left in general – were skeptical that the problems were so deep that any radical solution was needed at all. Quebec, whose pension plan had the same weaknesses as the CPP, would join the emerging consensus as long as it worked to the province’s advantage.

An exception to federal-provincial acrimony

The Fredericton meeting highlighted one of the most unusual features of the effort to overhaul the CPP. The contrast between the ministers’ steady, low-key work on the CPP and their ferocious battles over other issues is quite striking – amazingly so to any student of federal-provincial relations in the 1990’s, when combat was common. The finance ministers fought vigorously over other items on the agenda – harmonization of federal and provincial sales taxes and complaints about how Ottawa’s

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major spending programs were allocated across the country. Saskatchewan’s finance minister, Janice MacKinnon, later recalled Fredericton as “one of the nastiest meetings I’ve ever been in,” but she put her finger on what seems to have been a crucial point. Disagreements on other issues rarely spilled over into the CPP negotiations. Though the federal government’s 1995 budget cuts did much to “poison the well” of federal-provincial relations, the CPP was “not seen as a battleground” because the politics of it were quite different and its reform had no direct budgetary implications for the provinces. Ottawa would get blamed for any shortcomings in the reform – either for the higher contribution rates or reduced benefits – but the provinces, which took most of the political flak for the federal cuts in transfer payments after the 1995 budget, “would not be out in front on the CPP.” There was a nobler sentiment operating as well. All finance ministers prided themselves on being united in their determination to get their fiscal houses in order, “so we couldn’t let the CPP just sit there. We had the capacity to do [the reform],” MacKinnon said. “Our contribution as finance ministers was to leave Canada with better finances.”

Despite the apparent amity over the CPP in Fredericton, there was plenty of work – and plenty of bumps – ahead. Federal officials spent the summer putting meat on the bones of the proposed new investment policy, talking to experts in financial markets, the pension industry and at the Caisse de Dépôt et Placements du Quebec, which managed the QPP’s surplus funds. On this, as on most issues, the federal government did most of the work, for the simple reason that most provinces had little expertise on pension issues and few resources to throw at the file. Even in some of the bigger provinces, the CPP was what one official called a “side-of-the-desk” file, hauled out only when a review was at hand. They were mainly content to toss in ideas then let the federal team develop proposals to which the provinces could respond. Federal officials, for their part, worked to keep their provincial counterparts informed of what they were doing – both formally and informally.

When the ministers next met in October 1996 in Ottawa, the wheels had apparently come off the CPP bandwagon. British Columbia’s new finance minister, Andrew Petter, produced an entirely new approach to CPP reform that won no fans among other ministers, while Ontario’s Ernie Eves dug in his heels on the issue of Employment Insurance premiums. EI premiums and CPP contributions were both widely regarded as payroll taxes that discouraged job creation. Eves wanted the federal government to commit itself to a steady reduction in EI premiums that would largely offset any increase in the CPP contribution rate. Martin was just as stubborn. Even though his own officials supported a faster reduction in EI premiums, Martin was not keen to
cede control over the wholly federal EI, whose surpluses were a key contributor to his balanced budget strategy, to smooth the path for a joint federal-provincial program like the CPP.

Getting a deal

The only positive outcome from the meeting was an endorsement by ministers of a statement of principles they would follow in reforming the CPP. The principles effectively spelled out the package outlined in the *Information Paper* and now fleshed out through months of talks by officials – “steady-state” funding of the CPP through higher contributions and reduced benefits, with an arm’s length organization to invest the surpluses that would grow steadily until the baby-boomers began to retire in large numbers around 2020. Clearly, a deal was there for the taking if the federal government could satisfy Ontario, with its all-important veto, on the question of EI. Quebec, normally a vocal player on such issues, maintained a low profile throughout. It had released its own information paper and held its own public consultations, and as the talks progressed, it was evident that the proposed increases in contribution rates and reductions in benefits largely reflected its own preferences. The new investment policy, which would not apply in Quebec, was of little concern to the provincial government. If anything, it was evidence that Quebec had taken the right approach from the beginning three decades earlier.

Though the deadline of year-end 1996 for a CPP deal was missed, the federal government made a final successful effort to win Ontario’s approval in February 1997, settling the EI issue with a classic wink-and-nod. Martin would never admit to any linkage, but he announced the next annual cut in EI premiums shortly after the CPP package was made public – a full nine months earlier than normal. The NDP governments in British Columbia and Saskatchewan withheld their support, but eight provinces with more than 83 per cent of the population had signed on, comfortably over the double two-thirds threshold. Parliament passed the necessary legislation by the end of 1997, after which federal officials wrote the requisite regulations, ran them by their provincial counterparts and put them in place in April 1998.

One more piece of joint federal-provincial action was needed. The deal had established the Canada Pension Plan Investment Board as a professional pension fund manager at arm’s length from government. Importantly, the CPPIB mandate was defined to invest solely in the

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15. EI premiums continued to fall in subsequent years as the CPP contribution rate rose.
interest of plan members – maximum returns with minimum risk. Ottawa and the nine provinces in the CPP explicitly rejected Quebec’s long-standing approach of using the fund for economic development purposes. Appointment of the first directors for the new board reflected the arm’s-length governance principle. A joint nominating committee delivered a list of 30 potential directors to the finance ministers. Because the empowering legislation was federal, the appointments had to be made by the federal government, but Martin consulted with each of the provinces – dickering over both the number of directors to come from each region and the names of the appointees themselves, almost all of whom had extensive investment experience. The first directors were named in October 1998 and the CPPIB received its first transfer of funds to invest in March 1999.

Why it worked

The reform worked for several reasons. Joint jurisdiction over pensions forced the governments to work together, as did the sheer popularity of the CPP among Canadians. The voting formula, despite its apparently onerous requirement for the double two-thirds majority support, probably worked to the advantage of the reformers. British Columbia and Saskatchewan could safely vote no – thus appeasing their leftist supporters who wanted more – without jeopardizing the whole package. Indeed, one B.C. official said later that he would have endorsed the reform if his vote had been the deciding one.

The federal government could agree to what was in effect a side-deal to win Ontario’s support. In Quebec, where a 1995 referendum had narrowly rejected a form of sovereignty, the provincial government could get what it needed to shore up the QPP while remaining on the sidelines of a national Canadian debate. There was no discussion of jurisdictional issues or the CPP’s peculiar voting rules for such a major reform. Those questions had been settled in 1965; no one even questioned them. Their sole concern was the financial sustainability of the CPP. Beyond that was a serendipitous combination of good luck, good people, a good package and good communications. By the luck of the calendar, CPP reform was pushed onto the agenda just when the public was ready for the tough medicine needed to repair the plan’s finances.

The politicians, seized with the desire to leave a legacy of sound finances, were ready for bold steps and their officials were ready with sound ideas for just such measures. The fact that the pension arrangements were off-budget also helped in that the CPP was isolated from the never-ending federal-provincial disputes over money. Together, they produced a package that Canadians could accept – one that was fair across generations and comprised a mix of contribution rate
increases and benefit cuts (the ratio was three-to-one) that Canadians liked. Finally, they communicated their intent clearly through the consultation process; Canadians got a chance to discuss the issues and largely came to the same conclusions as their governments on the correct solution.

These days, in the aftermath of the financial crisis, the pension debate – revolving as it does largely around the solvency of employer pensions – is much different. There is room for joint action, but most of the initiative is now coming from the provinces, which have sole jurisdiction over most private pension plans in the country. Ontario, Nova Scotia, British Columbia and Alberta, the latter two working jointly, have all launched initiatives to reform employer-based pensions.

At the same time, there is considerable debate over expanding the CPP itself or creating a Canada Supplementary Pension Plan, through which small employers could offer their workers a pension scheme that is now beyond their capacity. Once more, Ottawa and the provinces are reaching for some form of joint action and have set up the Federal-Provincial Working Group on Pension Reform, though the sense of crisis that characterized the mid-1990s reforms is missing and there is no deadline for action. Whether the latest effort produces solutions to match the success of the 1997 reform of the CPP remains to be seen.