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Crisis country case study

Canada

This country case study is one of the studies produced under the *ISSA Crisis Monitor* Project

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The International Social Security Association (ISSA) is the world's leading international organization bringing together national social security administrations and agencies. The ISSA provides information, research, expert advice and platforms for members to build and promote dynamic social security systems and policy worldwide.

The Crisis Country Case Studies are an integral part of the ISSA project to monitor and analyse the impact of the global financial and economic crisis on social security. These studies are based on data and research carried out between June 2009 and the first part of 2010. While every effort has been taken to ensure that the case studies are accurate, the situation in each country is constantly evolving.

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ISSA crisis case study: Canada

Summary

The onset of the crisis precipitated a drop in demand for Canadian exports in 2007 and a recession in 2008. The labour market effect materialized in 2009, when employment fell for the fourth consecutive month in February 2009 bringing total losses since the peak of October 2008, to 295,000. And despite having the most stable banking system and public finances of any developed country, Canada's largest public pension fund (CPP) registered a historically low return of -18.6 per cent for the year ending 31 March 2009.

In response, the government announced an Economic Action Plan in the "Budget 2009" to stimulate the economy through large investments in infrastructure, tax reliefs and social transfers worth USD[1] 48 billion[2]. Social protection measures included: freezing employment insurance rates, strengthening benefits for the employed and unemployed, extending education and unemployment insurance, social housing investments and support for businesses.

While volatile market conditions are creating near-term portfolio declines, they are also providing Canada's social security institutions with long-term investment opportunities. Since Canada's pension funds are not forced to sell assets in adverse market conditions to pay current benefits, they remain well-positioned in future downturns to acquire assets at attractive prices and meet ever increasing social security obligations.

Social security institutions covered

The Department of Human Resources and Skills Development Canada administers pensions and income-tested supplements. Service Canada delivers benefits whilst the Canada Revenue Agency collects contributions.

Overview of the social security system

From modest beginnings in the 1920s, Canada's social security system has evolved into a comprehensive system of universal benefits, social insurance plans, social assistance programmes and a wide array of health and social services funded using mixed approaches.

Federal and provincial governments share responsibility for social security and play an important role in planning, administering, delivering and financing income security, health and social service programmes.

The Department of Human Resources and Social Development administers the first two tiers of Canada's retirement income system:

[1] US-dollar = USD

[2] billion = bn

(1) The Old Age Security (OAS) PAYGO programme which is the cornerstone of the retirement income system and is financed from general tax revenues.

This includes the following benefits:

- Pension
- Guaranteed Income Supplement
- Allowance (which includes survivor's allowance)

(2) The Canada Pension Plan (CPP) which is a compulsory, direct benefit programme partially funded by employee and employer contributions. The programme ensures income support for most employed and self-employed persons against the loss of income due to retirement, disability or death.

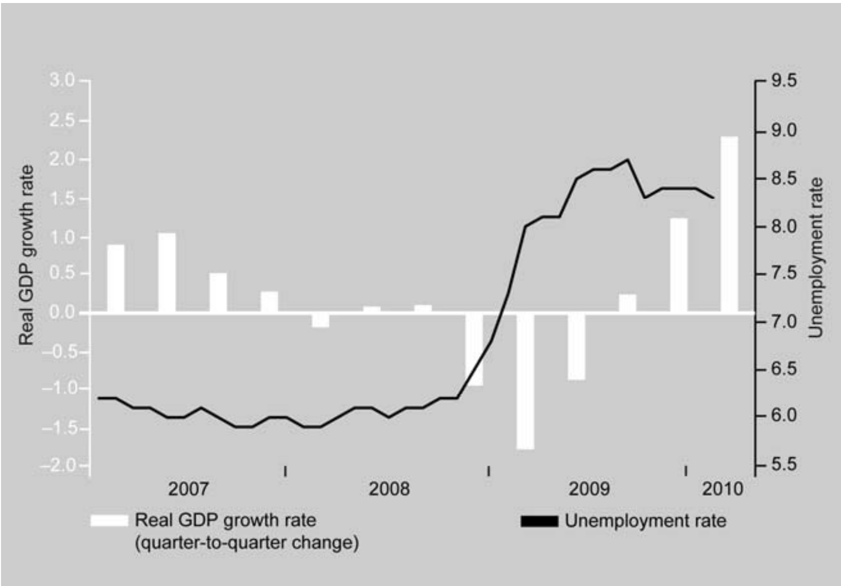
(3) The third level of the retirement income system consists of private pensions and savings (constitutes more than 50 per cent of retirement income in Canada – the highest in the Organisation for Economic Co-operation and Development, (OECD)).

Impact of the crisis

The economy and labour market

Despite being economically dependent on its neighbour to the south, Canada did not experience an economic downturn on the scale of the United States (US). Nevertheless, a drop in demand for Canadian exports occurred in 2008 and a sharp decline in raw material prices contributed to a marked slowdown in GDP growth to 0.4 per cent in 2008. This included two quarters in which GDP contracted (i.e. a recession).

Figure 1: ***Monthly unemployment rate and quarterly real GDP growth rate, 2007–2009 and 2010 forecasts (Per cent)***



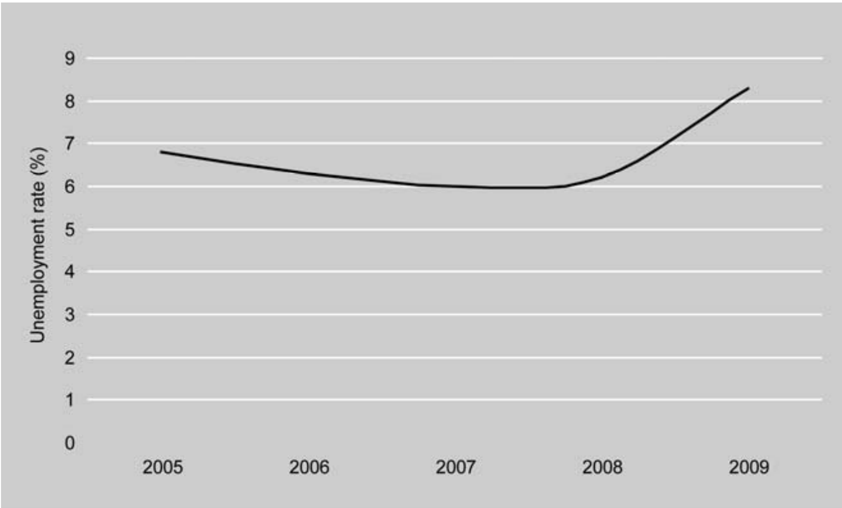
Note: Seasonally adjusted.
Source: ILO (2010).

As can be seen in figure 1 growth did return in the third quarter of 2009 and climbed to 1.2 per cent in the fourth quarter. Yet GDP contracted by 2.6 per cent in 2009 compared with a year earlier (International Labour Office, (ILO, 2010)).

The adverse effect of a downturn on the labour market materialized in 2009 when volatility in job gains and losses was reported. For example, between August and November of 2009 the economy added 137,000 jobs. However, by February 2009, employment fell for the fourth consecutive month bringing total losses since the peak of October 2008 to 295,000. Despite some job gains in part-time work (43,000), youth unemployment increased and by January 2010 it stood at 15.1 per cent, up by 2 per cent from January 2009. As of January 2010, the labour force survey reported an unemployment rate of 8.3 per cent, only marginally lower than the recent peak of 8.6 per cent in October 2009 (Statistics Canada, 2010a).

Figure 2 depicts the sharp increase in unemployment since 2008.

Figure 2: ***Unemployment, 2005–2009 (Per cent)***



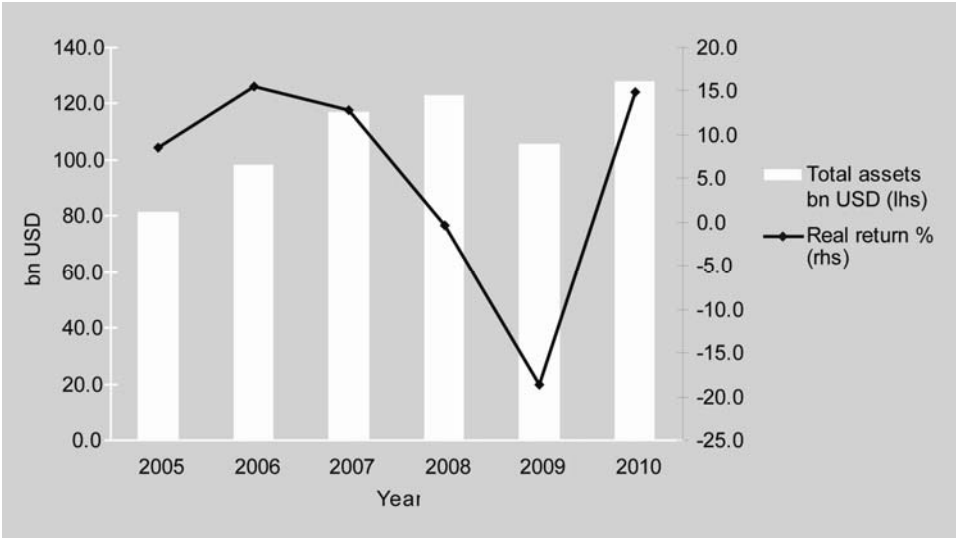
Source: EIU (2010).

Investment performance

As a result of having portfolios exposed to equities and other volatile asset classes, pension funds suffered considerable losses in 2008. The value of the Canada Pension Plan (CPP) fund declined by USD7 billion (return of -6.7 per cent) for the quarter ending 31 December 2008 (CPPIB, 2009).

The Fund experienced an historic low in the fiscal year 2009 registering a return of -18.6 per cent (see figure 3). However, the CPP Fund bounced back strongly in the fiscal year 2010 with a return of 15 per cent and total assets of USD123 billion.

Figure 3: ***CPP annual fiscal year summary, 2005–2010***



Source: CPPIB (2010).

Individual registered retirements saving plans were also badly hit and occupational pension plans are experiencing significant deficits. According to the CPP Investment Board, this will cause more employers to convert to defined contribution plans, whilst also increasing the likelihood of bankruptcy (CPPIB, 2009).

Administrative capacity

According to the Department of Finance, successful reforms in 1997 (e.g. the establishment of a professionally managed investment board) strengthened the government's ability to meet social security obligations. According to the Chief Actuary of Canada's 2007 report, CPP contributions are expected to exceed annual benefits paid through to the end of 2019, providing from 2010 a ten-year period before a portion of the investment income is needed to pay benefits. "Self-sustaining" provisions also automatically increase contribution rates and freeze benefits if ministers cannot reach a consensus on how to sustain the CPP (Canada Department of Finance, 1997).

Moreover, improvements to the administrative capacity of Service Canada were gradually introduced to speed up the processing and payment of benefits via hiring additional staff, and extending opening hours of unemployment insurance call centres.

Responses to the crisis

Budget 2009

In early 2009, Canada's Minister of Finance Jim Flaherty unveiled Budget 2009 – a temporary Economic Action Plan aimed at stimulating the economy through large investments in infrastructure, tax reliefs and social transfers. Over the next two years, the total stimulus will maintain approximately 265,000 jobs and surpass USD48 billion or 3.2 per cent of GDP (Canada Department of Finance, 2009a).

Social protection measures include:

(1) Tax relief and freezing employment insurance (EI) rates

- USD19 billion in personal income tax relief;
- freezing premium rates at USD1.73 per USD100 for both 2009 and 2010 – their lowest level since 1982;
- reducing the required minimum Registered Retirement Income Fund withdrawal for 2008 by 25 per cent. This provided one-time tax relief of USD193 million to seniors;
- USD144 of annual tax savings for low- and middle-income seniors through a USD964 increase to the Age Credit amount.

(2) Strengthening benefits for the employed and unemployed

- Five additional weeks of unemployment benefits or up to USD2,154 million more as extra support while unemployed persons are looking for work;
- extending work-sharing agreements by 14 weeks to a maximum of 52 weeks so that more Canadians can continue working;
- extending the Wage Earner Protection Programme to cover severance and termination pay to eligible workers impacted by employers' bankruptcy.

(3) Extending education and unemployment insurance

A total USD8 billion was set aside for the Canada Skills and Transition Strategy, which includes extra support for Canadians most affected by the crisis. Programmes include:

- USD482 million over two years to support the needs of individuals who do not qualify for EI training, such as the self-employed or the long-term unemployed;
- USD53 million over two years to help young Canadians find summer jobs;
- support for older workers and their families with an additional USD58 million over three years for the Targeted Initiative for Older Workers;
- USD38.5 million a year to launch the Apprenticeship Completion Grant;
- USD96 million for the Aboriginal Skills and Employment Partnership (ASEP) initiative (expected to support 6,000 jobs).

(4) Social housing investments

USD7.5 billion on building or renovating social housing to both create jobs and improve the quality and energy efficiency of 200,000 social housing units.

This includes:

- A renovation tax credit providing an estimated 4.6 million low-income earners, seniors, persons with disabilities and Aboriginal Canadians funding for energy retrofits;
- USD385 million allocated over two years to building and renovating affordable housing in Aboriginal Canadian communities;

(5) Supporting businesses and communities

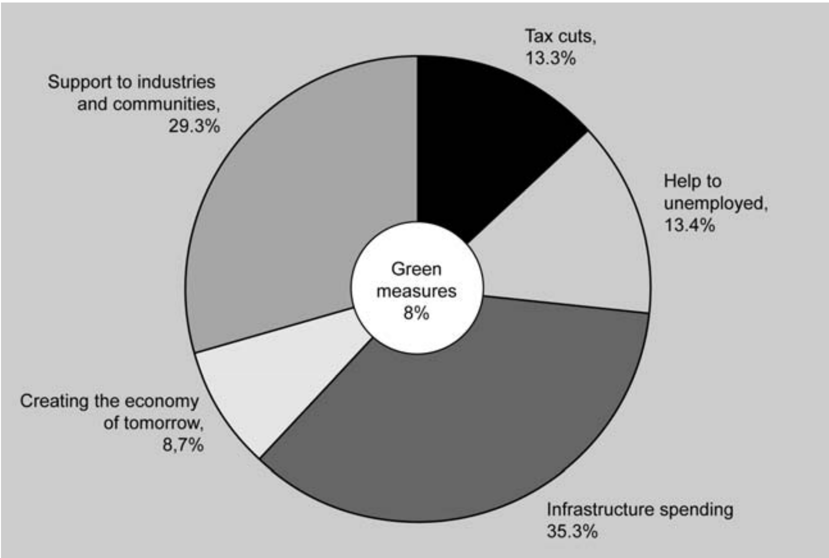
USD7.2 billion in support for sectors, regions and communities. This includes targeted funding for the auto, forestry and manufacturing sectors, as well as support for clean energy.

Budget 2010

The stimulus for 2010–11 includes:

- USD3 billion in personal income tax relief;
- Over USD3.8 billion in additional benefits, training opportunities and employment insurance premium relief to help unemployed Canadians;
- USD7.4 billion in infrastructure stimulus to create jobs;
- USD1.8 billion to create the economy of tomorrow (support jobs, skills development, clean energy and eliminating tariffs on machinery);
- USD2 billion to support industries and communities.

Figure 4: ***Canada's Economic Action Plan (Budget 2009 and 2010)***



Note: Federal stimulus measures only (does not include provincial).
Source: ILO (2010).

Lessons learned

Though economically dependent on the US, Canada's response to the crisis was different. One key difference concerns the use of tax reliefs (which constituted a third of the total US stimulus package). As can be seen above in figure 4, tax relief in Canada plays a much smaller role (13.3 per cent of the total stimulus package). Evidence on Canada from the 1981–82 and 1990–91 recessions points to a very strong correlation between net spending on the unemployment insurance system and economic performance (Dungan and Murphy, 1995). What commentators from widely referenced studies found and what the government has come to learn is that unemployment benefit spending and targeted community and business support is more powerful as an economic stabilizer than tax measures.

Nonetheless, literature on social security and the crisis has also been critical of the government's apparent failure to increase the resistance of the pension system to financial shocks (Course, 2010). It is clear that pensions have been put under stress, yet from a long-term perspective the largest Canadian pension plan (CPP) remains healthy.

Interestingly, the adverse effects of the crisis have in fact put the CPP Investment Board in the spotlight and the public can closely scrutinize their ability to stabilize the contribution rate (i.e. to strengthen the contribution-benefit connection, ensure intergenerational fairness and strengthen financial discipline) and to minimize the contribution rate by optimizing pension financing by considering the relation between the rate of return on investments and the rate of increase in wages. The current partial funding approach (employee and employer contributions) for the CPP is claimed by the Chief Actuary of Canada to be optimal in terms of withstanding economic and financial fluctuations (ISSA, 2010b). Under a disciplined risk/return analytical framework the government successfully manages to retain a pension system with a high degree of long-term security and predictability for the individual.

Furthermore, a valuable lesson the government has learned concerns a common feature in times of crises when seniority rules often mean that youth are the first to be laid off. In recognition of this, the March 2010 federal budget set aside USD105 million over three years for youth-training programmes to enhance the country's labour supply and combat the effects of an ageing population (ISSA, 2010a).

Conclusion

The onset of the crisis precipitated a recession in 2008, increases in unemployment in 2009 and pension fund losses (return of -18.6 per cent) in 2009. Yet taking a long-term perspective on the latter, the 2007 report from the Chief Actuary of Canada projects that the CPP is sustainable over a 75-year projection period due to steady net inflows and because investment income is not required to help pay pensions until 2020.

In response to the crisis the Canadian government announced Budget 2009 and 2010 which earmarks USD48 billion to stimulate the economy through large investments in infrastructure, tax reliefs and social transfers. Though a large outlay, Canada's public finances are the most comfortable among G7 countries and the deficit in 2009/10 was the first after 12 years of surpluses.

According to Statistics Canada, GDP grew at an annual rate of 6.1 per cent in the first quarter of 2010 and the gain of 108,700 jobs in April 2010 was the biggest one-month rise on record and the fourth monthly advance in a row (Statistics Canada, 2010b). Much to the dismay of Canadians though, this has not caused the unemployment rate to fall because the vast majority (95 per cent) of jobs created were part-time and an increasing number of people previously dropped out of the workforce due to poor prospects of finding a job. While unemployment is forecast to remain stable at about 8.5 per cent, concerns exist about a potential pullback in consumer spending (the key source of demand) and renewed turmoil sparked by the Euro zone sovereign debt crisis.

However, while current market conditions are creating near-term portfolio declines, they are also providing Canada's social security institutions with long-term investment opportunities. Since the CPP is not forced to sell assets in adverse market conditions to pay current benefits, it remains well-positioned in future downturns to acquire assets at attractive prices and meet social security obligations (Canada Department of Finance, 2009b).

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