

# **THE IMPACT OF AGE DISTINCTIONS IN LAW AND POLICY ON TRANSITIONS TO RETIREMENT**

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## **EXECUTIVE SUMMARY**

The impact on the transitions to retirement of various age distinctions in law and policy are examined in a number of areas: age discrimination and human rights legislation; the Charter of Rights and Freedoms; Supreme Court and other court decisions on mandatory retirement; bone fide occupational requirements; employer-sponsored pension plans; public pension plans; private registered retirement savings plans; personal income taxes; disability pensions; income tax credits and supports for disabilities; employment insurance sickness benefits; and social assistance. Mandatory retirement is then singled out for special attention since it best highlights the age distinction in law and policy, as well as the difficult trade-offs and misunderstandings that are involved in this controversial area. Particular attention is paid to the key policy triggers or design and implementation details of the different policy initiatives that can affect the transitions to retirement. The paper concludes with a policy discussion emphasising possible changes to key features of laws and policies that are barriers to flexible transitions to and from retirement and how they and other policies could be altered to facilitate flexible transitions. As well, the policy discussion outlines key policy trade-offs that are involved in such changes and how any adverse effects could perhaps be mitigated. Key recommendations for reform are advanced.

# THE IMPACT OF AGE DISINCTIONS IN LAW AND POLICY ON TRANSITIONS TO RETIREMENT

## INTRODUCTION

There is general agreement that it is desirable to facilitate *transitions* into retirement (and possibly back to the labour force from retirement) as opposed to an all-or-nothing abrupt change into retirement. That abrupt change often occurs as individuals work full-time often intensely and for long hours to maximize their earnings as well as earnings-based pension entitlements just prior to retirement. Then they abruptly retire completely from the labour force. As such, they often move from a state of over-employment to one of under-employment. Negative consequences with respect to health and well-being can be associated with each of those states. Clearly, the individual has not changed from being a potentially productive member of society to an unproductive one “put out to pasture.” Yet the abrupt changes often associated with retirement give that appearance – if not reality.

Such abrupt changes would be acceptable if they were the result of complete voluntary decisions on the part of retirees. But the concept of “voluntary” is elusive when decisions are affected by barriers and constraints, many of which are the by-product (often unintended) of other policies and initiatives that are in place.

The issue is of increased importance from a policy and practical perspective since it is intricately linked to a range of other current and impending issues. The workforce is rapidly aging as the leading-edge of the baby-boom population (born between 1946 and 1965) is now at the age of early retirement and approaching the age of normal retirement. Their expected period of retirement out of the labour force is also longer given the increases in life-expectancy. The large wave of upcoming retirement is expected to give rise to problems of labour and skills

shortages, especially given the loss of accumulated human capital. Concerns arise over the loss of institutional memory and experience as well as mentoring and the need for different mixes of age and experience at the workplace. Those different mixes are likely to provide desirable combinations of lower monitoring costs, firm specific human capital and general human capital from the on-the-job experience of older workers, when combined with new ideas, “fresh blood” and general human capital from education associated with younger workers (Lazear and Freeman 1996). That optimal mix can easily get out of balance when there are dramatic changes in the age structure of the workforce.

At the same time as they are concerned with impending skill shortages, employers also want a more flexible and adaptable workforce, often emphasising part-time work, limited-term contracts, independent self-employed operators, subcontracting and temporary help agencies. Such a “just-in-time” workforce may not be suited to older workers who have accumulated seniority and expected job rights (albeit this may also provide opportunities to bridge transitions into retirement and to return from retirement). Employers are also concerned with possible skill obsolescence associated with technological and computerization, with the potential for a “digital divide” arising between older workers who may be experiencing the technology for the first time and younger workers who experience the technology in every aspect of their lives. Employers also feel pressures from the employer-sponsored pension system and their impending pension obligations from defined-benefit pension plans, especially as such plans are increasingly regulated.

As well, concerns arise over the unfunded liabilities associated with the inter-generational transfers that can be associated with pay-as-you-go systems such as the Canada/Quebec Pension Plan, workers’ compensation, and health care<sup>1</sup>. Such systems work well when there is normal wage and population growth so that the current generation of taxpayers pay for

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<sup>1</sup> Such intergenerational transfers are outlined in Gunderson and Hyatt (2000) and references cited therein.

the expenditures on the older generation in the expectation that they will be “repaid” when the implicit contract will be carried on by subsequent generations. However, as is the current case, when wage growth is stagnant and the population is aging, then the younger but smaller taxpaying base can be saddled with large payroll taxes to pay for the expenditures on the larger but older recipient base. In such circumstances either taxes have to increase (burdening the younger generations) or expenditures have to fall (burdening the older generations). The viability of the social contract associated with such pay-as-you-go systems may be increasingly questioned by the younger generations, especially if they feel that the programs could have been better funded by the older generations that will benefit – given that aging is not exactly an “unforeseen event”. The changing of the social contract will not likely occur in overt fashions but rather through more subtle changes that are already occurring or being contemplated – i.e., raising the age at which public pensions become available, more stringent management of the expenditures of workers’ compensation, and deinstitutionalizing health care to emphasise less expensive home and community care.

Increased emphasis is being placed on human rights and anti-discrimination issues in general and age discrimination in particular. In part, this reflects the greater political pressures associated with the changing demographics of the labour force. Gender discrimination issues were emphasised when women began participating more in the labour force. Discrimination with respect to visible minority status was emphasised when immigration became increasingly diverse and composed of visible minorities. Issues of age discrimination are taking on increased importance given the political pressure from the growing number of “grey panthers” as well as from the fact that they are simply a larger target group.

Perhaps the most visible manifestation of the importance being placed on human rights and age discrimination is the increased emphasis that is being placed on legislative initiatives to ban mandatory retirement (detailed subsequently). This is especially the case given the aging

population and the decline in the more strenuous blue-collar jobs and the growing number of white-collar, knowledge-based jobs that are not physically strenuous and that are often intrinsically interesting.

The purpose of this study is to analyse the barriers and constraints that may inhibit a flexible, voluntary transition into retirement (and perhaps back from retirement) and that, hence, may also have implications for these related policy initiatives. Particular attention is paid to the extent to which age distinctions in law and policy may be *barriers* that inhibit such flexibility.

The study begins by first documenting a number of age distinctions in law and policy that affect transitions into and out of retirement. Mandatory retirement is then singled out for special attention since it best highlights the age distinction in law and policy, as well as the difficult trade-offs and misunderstandings that are involved in this controversial area. Particular attention is paid to the key policy triggers or design and implementation details of the different policy initiatives that can affect the transitions to retirement. The paper concludes with a policy discussion emphasising possible changes to key features of laws and policies that are barriers to flexible transitions to and from retirement and how they and other policies could be altered to facilitate flexible transitions. As well, the policy discussion outlines key policy trade-offs that are involved in such changes and how any adverse effects could perhaps be mitigated. Key recommendations for reform are advanced.

## **AGE DISTINCTIONS IN LAW AND POLICY THAT AFFECT TRANSITIONS TO RETIREMENT**

### **Age Discrimination and Human Rights Legislation<sup>2</sup>**

All jurisdictions in Canada ban age discrimination as part of their human rights codes, with such legislation generally having been established in the early 1980s. This would appear to ban mandatory retirement since it is a policy that specifies a particular age at which the individual must retire from that job if it is covered by mandatory retirement. However, mandatory retirement is effectively allowed in most jurisdictions through two main mechanisms:

- Four jurisdictions (British Columbia, Saskatchewan, Ontario and Newfoundland) have age caps in their human rights codes indicating that the codes do not apply after age 65. The intent of that age cap is to accommodate mandatory retirement. It does mean, however, that persons beyond age 65 do not have the normal protection of their human rights code against age discrimination. As such, the age cap could reduce the ability of individuals to carry on working past age 65 both because it allows mandatory retirement and because it does not provide normal protection against age discrimination.
- Other jurisdictions (federal, Alberta, Quebec, New Brunswick, Nova Scotia and Prince Edward Island) have removed the age cap in their legislation, which would appear to ban mandatory retirement at age 65 or at least make it contestable in the courts. However, these jurisdictions effectively allow mandatory retirement by exempting bone fide retirement or pension plans from age discrimination legislation<sup>3</sup>. This allows mandatory retirement as long as it is part of such a bone fide retirement or pension plan, which is

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<sup>2</sup> Details on the law and jurisprudence in this area are given in Canadian Human Rights Commission (2000), Gillin and Klausen (forthcoming), Gunderson (2003), Ontario Human Rights Commission (2000, 2001) and Zinn and Brethour (1999).

<sup>3</sup> In the federal jurisdiction, the human rights code indicates that mandatory retirement is legal if it occurs at the "normal retirement age for employees performing the same type of work."

invariably the case (as discussed subsequently). As such, these jurisdictions effectively allow mandatory retirement by not making it discriminatory under the human rights code. Only two jurisdictions have an outright ban on mandatory retirement and they do so in different ways.

- Manitoba banned mandatory retirement in 1982 through its human rights code by not having an age cap and not having any exemptions such as for a bone fide retirement or pension plan. This ban on mandatory retirement was confirmed in a Supreme Court of Canada decision in *Winnipeg School District v. Craton* (1985).
- Quebec banned mandatory retirement in 1983 through its employment standards legislation.

The efficacy of the Quebec ban can be questioned, however, because of the decision in *Parent v. The Gazette* (1991). This decision allowed the collective agreement in that organisation to terminate people at age 65 (under the pressure of impending layoffs) because such a termination practice was regarded as an employment guarantee up to the age of 65 and not a practice of mandatory retirement. Presumably if there was not the pressure of impending layoffs, such terminations through a specific age criteria would not be allowed. Effectively, this appears to allow an age specific termination practice under the pressure of layoffs not to be interpreted as mandatory retirement. Alternatively stated, mandatory retirement is allowed but only if it is part of a policy to avoid layoffs of younger workers. Nevertheless, it is a layoff policy based on age and not on a criteria such as reverse seniority. Although not interpreted as mandatory retirement, if it walks like a duck and quacks like a duck .....

The efficacy of the Quebec ban on mandatory retirement can also be questioned by the fact that individuals are allowed to enter into contractual arrangements that involve pre-committing to retire at a specified age in return for other benefits offered. Specifically, universities in Quebec are allowed to have professors who reach age 57 move to half-time

teaching at full-pay for three years providing they agree to retire by age 65. Since mandatory retirement *in general* is a practice whereby individuals pre-commit to retire at a specific age like 65 in return for pension benefits (discussed subsequently) it seems odd to ban the practice in general but allow individuals to pre-commit at age 57 to retire at age 65 in return for a period of half-time teaching at full-pay. If the rationale is that such individuals are protected because they are given a specific benefit in returning to agreeing to retire at a fixed age, this rationale would seem also to hold for regular mandatory retirement policies providing they are accompanied by a pension benefit when individuals retire. The policy of banning mandatory retirement is effectively a policy of not allowing individuals to enter into contractual arrangements that involve mandatory retirement no matter what other benefits (e.g., pensions) may be associated with those arrangements. As such, it seems anomalous to then allow individuals to re-enter into such contractual arrangements simply because they are given some other benefit.

The federal government has also abolished mandatory retirement for its own civil service. This should not be interpreted as a ban on mandatory retirement, however, since it is a practice that any employer can follow. The University of Calgary, for example, has abolished its mandatory retirement policy. The federal jurisdiction itself, as discussed previously, effectively allows mandatory retirement at the “normal retirement age for employees performing the same type of work.”

### **Charter of Rights and Freedoms**

The Federal *Charter of Rights and Freedoms* of 1982 effectively enables provincial and federal legislation (including those that allow mandatory retirement) to be challenged, with the Supreme Court of Canada being the ultimate arbiter. Age discrimination challenges can be brought through the equality provision Section 15(1) which states: “Every individual is equal

before and under the law and has the right to the equal protection and benefit of the law without discrimination, and in particular without discrimination based on race, national or ethnic origin, colour, religion, sex, age [emphasis added], or mental or physical disability.” ... “subject only to reasonable limits prescribed by law as can be demonstrated in a free and democratic society.” This “reasonable limits” or “Section 1” defence effectively allows social trade-offs to be involved. Practices that otherwise are discriminatory are allowed if they are merited based on other demonstrated social purposes – a consideration that has been very important in the mandatory retirement area as discussed in the next section.

### **Supreme Court and Other Decisions on Mandatory Retirement**

The Section 1, or “reasonable limits” defense, effectively was used in the “trilogy” of mandatory retirement cases heard by the Supreme Court of Canada in 1990. In the first case, *McKinney v. University of Guelph*, mandatory retirement was deemed to be discriminatory. However, it was also deemed to be “demonstrably justified in a free and democratic society” under Section 1. This principle has been upheld in two other Supreme Court decisions in 1990: *Harrison v. University of British Columbia* and *Stouffman v. Vancouver General Hospital* as well as in *Dickason v. University of Alberta* in 1992. Zinn and Brethour (1999, p. 3-3) indicate that the Supreme Court effectively determined that the potential social benefits of allowing mandatory retirement outweighed the social cost – that cost being the possible violation of the equality rights of older workers. The potential benefits were largely ones discussed subsequently in this paper under rationales for allowing mandatory retirement. They include such factors as: facilitating employee renewal and opening job and promotion opportunities for youths; facilitate employer planning in areas such as succession planning and age-related benefits; reduce the need for constant evaluation of older workers and facilitate their retiring with dignity; preserve the integrity of pensions; and facilitate deferred compensation schemes.

Subsequent cases, however, have overturned *specific instances* of mandatory retirement, highlighting that the practice could be disallowed under specific circumstances. These cases occurred in British Columbia, which has an age cap in its human rights legislation and thereby does not appear to provide protection against mandatory retirement as constituting age discrimination. In a British Columbia Supreme Court decision in 2000, *McLaren v. Pacific Coast Savings Credit Union*, the mandatory retirement practice of the organization was not allowed to apply to a particular individual since the firm had not effectively communicated the policy to the employee and the employee had never explicitly accepted it as a condition of employment. A British Columbia arbitration board decision (upheld by the Court of Appeal in *Greater Vancouver Regional District Employee's Union v. Greater Vancouver Regional District* in 2001) determined that the social merits of mandatory retirement had to be determined on a case-by-case basis as to whether the social benefits exceeded the social costs. That is, the Supreme Court's trilogy of decisions did not imply that mandatory retirement was *always* "demonstrably justified in a free and democratic society." In this case, the mandatory retirement policy was easier to ban because a collective agreement was in place but it did not explicitly incorporate the mandatory retirement policy. That is, the policy appeared to be one that was more unilaterally imposed by the employer rather than being mutually agreed upon by the employer and the union.

The Supreme Court of Canada decisions and subsequent decisions suggest the following:

- Mandatory retirement is generally allowed in that its social benefits appear to outweigh its social costs including the possible violation of the equality rights of some individuals.
- Effectively, the banning of mandatory retirement is placed in the hands of the provinces to do so -- likely by changing their human rights code to remove the age 65 cap and not exempt bone fide retirement or pension plans (as in Manitoba) or as part of the

Employment Standards legislation (as in Quebec).

- The viability of mandatory retirement may still be tested on a case-by-case basis as to whether its social benefits exceed its social cost; it may not be a blanket exemption from being considered as age discrimination.
- Mandatory retirement is more likely to be overturned in specific instances if employees are not clearly-informed about the policy by the company, if they do not explicitly accept it as a condition of employment, or if it is not incorporated into the collective agreement where one prevails.

### **Bona Fide Occupational Requirements**

Mandatory retirement at any age can be upheld if it can be shown to be a *bona fide* occupational qualification (BFOQ). This is the case for any age specific legislative requirement. The BFOQ defense for mandatory retirement, as for other practices, is a difficult one for employers to utilize, however, since a number of stringent conditions must be met. In the case of mandatory retirement:

- Mandatory retirement cannot have the unintended by-product of having a disparate impact on older workers, and this cannot be reasonably accommodated on the part of the employer.
- The rule must be made in good faith and intended to ensure adequate performance or safety, especially of co-workers or the public. It cannot exist for some ulterior reason such as to facilitate downsizing.
- Mandatory retirement must be objectively related to performance in that workers who continue working beyond that age are likely to perform more poorly, and this could jeopardize organizational performance especially in ways that could endanger the workers themselves, and particularly their co-workers or the general public.

- It is not feasible to accommodate such persons without undue hardship, for example, by job accommodations or through individual testing. It is for these reasons that the cases have tended to be where public safety is involved as with airline pilots, police, fire fighters and bus drivers<sup>4</sup>.

## **Employer- Sponsored Pension Plans**

Employer-sponsored occupational pension plans can have specific age related aspects that can have important implications for transitions to retirement. Specific age related features include: the normal retirement age (typically 65) at which the pension becomes available; subsidized early retirement provisions (typically age 55) where individuals can retire early and receive their pension with the actuarial adjustment being such that a subsidy is involved for the recipient; subsidized special retirement provisions (typically age 62) where a more extensive subsidy is involved since there is no downward actuarial adjustment to compensate for the fact that the pension is received earlier and for a longer period of time. Also, typically at age 65, postponed retirement provisions typically involve penalties for workers who continue working in that the pension benefits are not adjusted upwards sufficiently, if at all, to account for the fact that they will be received later and for a shorter period of time.

Such age related features have important effects on the compensation profile of older workers<sup>5</sup>. Essentially, they lead to pension benefit accruals (rights to future pension benefits) that start building up after around age 40, with “spikes” or unusual jumps in those accruals at

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<sup>4</sup> Case law on BFOQs is discussed in Ontario Human Rights Commission 2000a.

<sup>5</sup> These features of representative defined benefit pension plans (where the benefits are based on final earnings or a fixed benefit per year of service as discussed below) in Canada and their resulting pattern of pension benefit accruals are discussed and outlined with representative simulations in Pesando and Gunderson (1988) for final-earnings plans and in Pesando, Gunderson and Shum (1992) for flat-benefit plans that dominate the unionized sectors. In final-earnings plans, the pension is based upon years of service and a percent of earnings usually over the final 3 to 5 years e.g., 2% of earnings for each year of service up to a maximum of 35 years, for an earnings replacement rate of 70%. In flat benefit plans, the benefits are fixed for each year of service, e.g., \$30 per month per year of service with a maximum of 35 years of service or \$1050 per month. In defined contribution plans, pension benefits are simply the investment returns to the accumulated contributions made by, or on the behalf of, employees. They are not fixed or defined, but depend upon the investment returns. Other studies are also reviewed in those articles.

the ages of early retirement (typically around age 55) and especially special retirement (typically around age 62). Thereafter the accruals fall off and become negative if people postpone retirement. The negative pension benefit accruals occur because, even though recipients receive the full annual pension benefit that they would have received had they retired, those later annual benefits are not adjusted upwards to compensate for the missing years when benefits were not received. The expected pension benefit accruals can typically average around 20 percent of the individuals wage after age 45. This means that their compensation is significantly backloaded or deferred in that it is coming later in their career. That is, even if their wage profile drops off their total compensation profile may continue to rise. The total compensation is typically around 20 percent higher than the wages for such older workers, highlighting the significant pension costs associated with older workers and an ageing workforce.

The compensation profile that results from the back-loading of pension benefits and the spikes and penalty aspects have important incentive effects that affect the transition into retirement. For example, the back-loading or deferral of compensation in the form of pension benefit accruals can deter unwanted turnover and bond workers to their firms. It can foster honesty and work effort since workers do not want to be dismissed and lose their deferred compensation. It can provide workers with an interest in the financial viability of their firm since bankruptcy can jeopardize their deferred compensation; this in turn can foster co-operative behaviour between employers and employees. Employees can also prefer deferred compensation as a form of future saving.

The spikes in the compensation profile can also have important incentive effects that can affect transitions into retirement<sup>6</sup>. They would discourage quitting prior to the spikes since such premature quitting means that the employee would forgo the subsequent spike. They would

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<sup>6</sup> These incentive effects are documented in Pesando, Gunderson and Hyatt (1992) and references cited therein.

encourage early retirement at the time of the spikes since the recipient then receives this subsidized early retirement benefit. The pension penalties from postponed retirement would also discourage postponed retirement. In general, these features of employer-sponsored pension plans reduce early turnover but encourage early retirement and discourage postponed retirement. In that vein, they are generally not conducive to facilitating transitions to retirement. They encourage all-or-nothing retirement decisions (either early or at the age of normal retirement) and discourage phased retirement. This is furthered by the fact that employees will generally want to work full-time and long hours to maximize their earnings (rather than “phasing down”) so as to augment their earnings-based pension benefit accruals.

Whether these features of private pension plans will change in the near future to help offset impending labour shortages is an interesting and open question. Such features are an element of strategic human resource planning and have been used in the past as ways to downsize and bring in “new blood” by encouraging early retirements. Since the subsidized early retirement features are voluntarily accepted, they are generally regarded as humane ways of downsizing and sustaining job opportunities for younger workers – in effect, a form of voluntary layoffs based on reverse-seniority. Since such pension features were used strategically to affect downsizing, there is no reason *in theory* that their features cannot be changed to encourage retention of older workers to deal with possible skill shortages. The shift from defined benefit plans to defined contribution plans which are more neutral with respect to retirement incentive effects could be occurring in part for that reason, although the increased regulation of defined benefit plans and their uncertainty in a world where lifetime jobs may no longer be prominent are also contributing factors.

## Public Pension Plans

There are also features of the public pension plan systems that (generally unintentionally) discourage transitions into and out of retirement<sup>7</sup>. These are particularly important since they are subject to a degree of policy control, although difficult trade-offs are often involved.

The universal *Old Age Security* (OAS) is a flat benefit paid to all Canadians who have met a pre-specified age requirement of 65 as well as a length of residency requirement. Since 1990 it has a 15 percent clawback after net income of slightly over \$50,000 per individual; that is, OAS payments are reduced by 15 cents on each dollar of additional income after the threshold. Such a clawback is added to the normal marginal income tax rate, which is in the neighbourhood of 50 percent for such individuals so that the effective marginal tax rate can be around 65 percent. Since such individuals' effectively only keep 35 cents on the dollar, their incentive to remain in the labour force or return from retirement is clearly reduced. Reducing or removing the clawback should facilitate transitions to retirement, albeit at the expense of a trade-off of allowing transfer payments to go to higher income individuals.

An income-tested *Spouse's Pension Allowance* also exists in OAS, given to persons age 60 to 64 who are widows, widowers or spouses of current OAS pensioners. As with regular OAS, clawbacks<sup>8</sup> exist ranging from 25 to 75 percent, with the SPA being completely clawed back for couples with earnings of slightly over \$20,000. As with OAS, the clawbacks can also discourage transitions from retirement to the labour force, especially given the high implicit tax rates and the low threshold level of income after which it applies.

A federal income-tested *Guaranteed Income Supplement* (GIS) also exists for low-income persons on OAS. As with OAS and the Spouse Allowance, the GIS is also subject to a clawback

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<sup>7</sup> These features are discussed in Burbidge et. al (1996), Gunderson (1998, 2004) and Gunderson, Hyatt and Pesando (2000) and references cited therein.

<sup>8</sup> Clawbacks involve reducing benefit payouts as the recipient earns more income so, in effect, the benefits are "clawed-back". For example, if benefits are reduced by 50 cents for every dollar earned, then a clawback of 50 percent prevails.

rate – in this case, of 50 percent. Such a clawback clearly reduces the incentive to participate in the labour market.

*Provincial supplementary benefits* can also augment the federal GIS. The magnitude of the supplements is based on income. In Ontario, for example, the *Guaranteed Annual Income System* (GAINS) provides a small annual supplement to single retirees on GIS, with a claw-back rate of 50 percent, the same as OAS. The combination of the 50 percent clawback on OAS and the same clawback on GIS means an effective clawback rate of 100 percent. Clearly this eliminates any monetary incentive to continued labour force participation.

*The Canada Pension Plan (CPP)* provides an earnings-based pension, normally payable at age 65. The regular CPP does not have a clawback. However, *early retirement benefits under CPP* are payable as early as age 60. The benefit adjustments are such that they involve a subsidy for early retirement. As well, to receive the early retirement benefit the recipient must "substantially cease working", which is interpreted as earning less than approximately one-quarter of the average industrial wage. This constraint is particularly important since the majority of recipients access the early retirement features of CPP. Clearly, the "substantially cease working" requirement is a barrier to continued labour force participation.

*Delayed receipt of CPP* is also possible. If the person delays receipt up until the age of 70, their subsequent pension is adjusted upwards to compensate for the fact that it is received later and for a shorter period of time. However, the adjustment is not "actuarially fair" but involves a penalty for postponed retirement. After the age of 70 there is no actuarial adjustment so that persons who delay receipt would forgo their CPP pension. Clearly, the delayed retirement features of CPP discourage continued labour force activity and encourage complete retirement rather than transitions to retirement.

## **Private Registered Retirement Savings Plans**

Registered Retirement Savings Plans (RRSPs) are essentially a form of earnings-based, tax-deferred savings. As such, when they are "cashed-in" normally beginning at age 65, the income is taxable and this could put the recipient in a higher marginal tax bracket and hence discourage any incentive to return to work. More importantly, individuals are not allowed to contribute to RRSPs after the age of 69, effectively eliminating that benefit of continued labor market work. They must also begin to access their RRSP benefits at that time, thereby increasing the likelihood that any additional labour market earnings would put such individuals in a higher marginal tax bracket. This in turn would reduce their monetary incentive to work.

Clearly, RRSPs can reduce the incentive to return to work by placing people in higher marginal tax brackets if they return when they begin to access their benefits at age 65. This is augmented by the fact that at age 69 they must access their plans and can no longer contribute. RRSPs may also discourage transitions to retirement because any reduction of earnings prior to retirement associated with phasing into retirement could reduce the contributions and hence the leveraging associated with those contributions. While eliminating RRSP regulations requiring access and prohibiting contributions would mitigate this issue, it would be "regressive" in that it would disproportionately benefit higher income persons since they 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**

An age-specific tax credit for persons age 65 and older exists in the personal income tax system. Since 1995, a clawback of 15 percent also exists for income levels beyond a threshold of approximately \$25,000. As stated by Dickinson (1996 p. 176): "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". Clearly in

such circumstances, the monetary incentive to remain in the labour market is reduced and transitions to retirement discouraged.

### **Disability Pensions<sup>9</sup>**

A complicated and wide range of disability programs exists in Canada. While they apply to persons of all ages, they are particularly relevant for older workers given that slightly over 40 percent of persons age 65 and over self-report themselves as disabled (Cossette and Duclos, 2002).

The effect of disability programs on the transitions to retirement will be even more important in the future as larger proportions of the population move into the age group when they are more likely to be disabled and to engage in transitions to retirement.

Disability pensions exist in the workers' compensation systems of each Canadian jurisdiction for persons injured at work and who have a permanent partial disability. Compensation is typically 85 to 90 percent of lost earnings so that persons who return to work increase their income by only 10 to 15 percent, perhaps even less after work related expenses and since the workers' compensation disability benefits are not taxable. Empirical evidence confirms this theoretical expectation.<sup>10</sup>

The Canada/Quebec Pension Plan (C/QPP), which is normally for retirement pensions for persons when they reach age 65, also has a disability component (C/QPP-D) which provides disability benefits for work or non- work related disabilities that are severe and prolonged. That disability component has grown substantially in recent years and now accounts for almost 20 percent of total C/QPP expenditures. Persons under the age of 65 are eligible providing they had been employed and contributed to the general C/QPP plan and they have contributed to the

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<sup>9</sup> Descriptions of the different disability programs are given in Gunderson, Gildner and King (1997), HRDC (1998, 1999) and Torjman (2002).

<sup>10</sup> Butler, Johnson and Baldwin (1995) and Hyatt (1996).

plan in four of the last six years, or any four years if they have less than a six-year contributory period under the C/QPP.

The disability pension benefit consists of a lump-sum or fixed benefit that is independent of earnings and an earnings-related component that is 75 percent of the retirement pension the disabled claimant would have received under regular CPP retirement benefits (based on their earnings history). These two components are about equal in magnitude accounting for about 95 percent of C/QPP-D expenditures, with the remaining five percent being a fixed benefit for dependent children (Campolieti 2001, p. 424). When the recipient reaches age 65 they shift to normal retirement benefits under regular CPP. Approximately half of the CPP-D recipients shift to regular CPP with the other half dying before that age. Less than 1 percent of CPP-D cases respectively are reassessed as no longer having a disability or they voluntarily return to work.

The lack of voluntarily returning to work likely reflects the severity of the disability under CPP-D. However, some may reflect the lack of a monetary incentive to do so since those who return to work lose all of their C/QPP-D benefits, which effectively implies a 100 percent clawback on earnings, and perhaps more if they lose other assistance. Empirical evidence generally suggests that incentives that result from CPP-D do discourage the return to work.<sup>11</sup> As well, less stringent screening and case management increases the numbers on the disability rolls, especially in the case of disabilities that are hard-to-diagnose, with these factors generally regarded as more important than the benefit generosity in explaining the growth of the disability rolls over time.<sup>12</sup>

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<sup>11</sup> Canadian studies include Campolieti (2001b), Gruber (2000) and Maki (1993) although Campolieti (forthcoming) finds the impact to be statistically insignificant. There is an even more extensive US literature on the effect of the Social Security Disability Insurance (SSDI) and needs-based Supplemental Security Income (SSI) programs. That literature has led to considerable debate over the magnitude of the effect although most studies suggest that higher benefit replacement rates as well as less stringent screening and case management induce non-participation in the labour force. Such studies are reviewed in Bound and Burkhauser (1999) and Haveman and Wolfe (2000). The estimates of Parsons (1980, 1982) and Slade (1984) suggest all of the decline in the labour force participation of older men over the 1970s in the US can be accounted for by the more generous benefits of SSDI and SSI.

<sup>12</sup> Canadian studies of the impact of screening and case management include Campolieti (2002, 2003), Campolieti and Lavis (2000), with US studies including Autor and Duggan (2003), Gruber and Kubik (1997), Kreider (1999) and Stapleton, Coleman, Dietrich and Livermore (1998) and references cited therein.

As well, there is evidence of substitution across programs; that is, as program becomes more generous or easier to access, individuals substitute into that program and away from ones that are less generous or less easy to access<sup>13</sup>.

While program participants clearly respond in their labour force participation decisions to the incentives of the programs, they also respond to the incentives and job opportunities available in the labour market. That is, if economic and business cycle conditions are good and job opportunities plentiful and reasonably well-paying, individuals will voluntarily leave the rolls of disability income support programs<sup>14</sup>. In fact, some empirical evidence for Canada in workers' compensation systems suggests that the "carrot" of higher wage opportunities are likely to have a stronger impact on inducing a return-to-work decision than the "stick" of reducing program benefits (Hyatt 1996).

To the extent that improved job opportunities reduce the likelihood of being on income support programs, then the impending labour shortages associated with the upcoming retirement of the baby-boom population should enhance their job and employment opportunities. This can have the dual benefit of providing more options for phased-retirement and return-to-work opportunities and reducing the incentive to be on income support programs.

### **Income Tax Credits and Supports for Disabilities**

A wide range of income tax credits and support programs also exist for persons on disability, the main ones being the Medical Expense Tax Credit for medical expenses from disability, the Disability Tax Credit and Non-Taxation of Veteran's Disability Benefits.<sup>15</sup> The

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<sup>13</sup> Evidence of program substitution in Canada is found in Fortin and Lanoie (1992), Robson (1996) and Campolieti and Krashinsky (2003), with references to US studies cited therein.

<sup>14</sup> Evidence on the impact of favorable economic conditions and job opportunities is provided in Campolieti 2003, Campolieti and Lavis 2000 and HRDC 1996a, p.62 for Canada, and in Autor and Duggan 2003, Black, Daniel and Sanders 2002, Burkhauser and Daly 1996, Lando, Coate and Kraus 1979 and Stapleton, Coleman, Dietrich and Livermore 1998 for the US, although such evidence is not found in Kreider and Riphahn 2000.

<sup>15</sup> The disability-related tax programs in Canada are discussed in Canada, House of Commons (1993), Fawcett and Shillington (1996), Prince (2001a) and Canada, Finance Canada (1998).

value of these tax supports have increased substantially through the introduction of new programs, the enrichment or expanded eligibility of existing programs, and the conversion from deductions to credits for many programs. To the extent that engaging in paid employment or returning to work could reduce the likelihood of being eligible for such tax support, they may also discourage transitions into phased retirement.

### **Employment Insurance Sickness Benefits**

The employment insurance system in Canada also has a sickness benefit component for persons who are incapable of work by reason of illness, injury or quarantine. The benefit replacement rate is 55 % of weekly insurable earnings subject to a maximum and payable only for a maximum of 15 weeks and with a two-week waiting period during which any income earned would be deducted from subsequent benefits. The low replacement rate, short duration period and two-week waiting period likely will mean that this program would have no substantial impact on the work decision and hence transitions into phased retirement.

### **Social Assistance**

Social assistance or welfare is means tested (i.e., based on needs relative to income) and generally available as a system of "last-resort". While it is potentially available for all persons in need, almost 30% of social assistance cases are headed by a disabled person. If persons on social assistance return to work, their social assistance is typically "clawed-back" or reduced by 75 cents or more for every dollar earned. That is, they face an implicit tax rate of 75% or more and even higher if they incur work related expenses or also lose in-kind benefits such as prescription drug benefits and special disability-related allowances. As such, to the extent that there is any discretion in their work decision, older workers on social assistance would have little monetary incentive to engage in paid employment or to return to such employment as part of a transition to retirement.

Clearly, there is a wide array of age distinctions in law and policy that can affect transitions to retirement. Most (probably unintentionally) discouraged phased transitions and encourage the extreme of full-time extensive work or no work at all. In the case of many of the income support programs, difficult trade-offs are involved since the income support is provided for obvious reasons and yet the greater generosity of the support and easier access to it, both in theory and in practice, reduces the incentive to engage in paid employment including phased transitions to retirement.

## **MANDATORY RETIREMENT**

The age specific policy that is receiving the most attention is the one of banning mandatory retirement. Such a ban has been endorsed by the Prime Minister, the Governor of the Bank of Canada, the previous Conservative government in Ontario and the current Liberal government in Ontario as well as the Ontario Human Rights Commission. That interest will likely increase if labour shortages arise from the impending retirements and as the older population becomes a larger political force. At first glance, banning mandatory retirement appears a “no-brainer” since mandatory retirement, where it exists, requires individuals to leave their job at the specific mandatory retirement age, usually at the specific age of 65. Nevertheless, as with so many policies, it is “not as simple as it seems” and can involve “throwing the baby out with the bathwater”.<sup>16</sup> Given the increased policy interest, and the complexity of the matter, it is singled out here for special treatment.

The legal status of mandatory retirement through Human Rights codes, Supreme Court decisions, case law and arbitral decisions has been outlined previously in this article. The

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<sup>16</sup> These are respectively the subtitles in Gunderson (forthcoming and 2004). That latter article also indicated (p. 1) “The debate over whether to ban mandatory retirement is one of the most misunderstood debates today in the area of

remainder of this section will deal with other dimensions: its meaning and prevalence; evidence on the extent to which people would prefer to work past the mandatory retirement age; its associated characteristics and the implications of those characteristics for arguments for banning mandatory retirement; rationales for allowing mandatory retirement; expected impact of banning mandatory retirement, including impact on other groups such as youths, women and immigrants; evidence on the actual impact of banning mandatory retirement; relevance of US experience where mandatory retirement has been banned but where features of the public and private pension system are different; and intergenerational issues especially with respect to youth employment, promotions and mentoring as well as inter-temporal life-cycle decision making as part of personnel practices, private contracting and collective bargaining.

### **Meaning of Mandatory Retirement**

Where mandatory retirement exists it is part of a company personnel policy or collective agreement, generally associated with the pension plan as part of that policy or agreement. The provision specifies that the existing employment arrangement is terminated at a specific age (usually 65). If the person is hired back by the organisation it can be under a new contractual arrangement (e.g., part-time or consulting arrangement or limited-term contract). There is also nothing preventing the private parties from mutually agreeing to continue the existing arrangement, unless they have pre-committed not to do so (sometimes termed automatic retirement). The individual, of course, is not required to retire from the labour force, only from that particular contractual arrangement.

There is no government policy that requires individuals to retire at a specific age. Government policy either allows mandatory retirement as part of such contractual arrangements or prohibits such contractual arrangements (as currently is the case in Manitoba and Quebec, as discussed). It is important to keep this perspective in mind since it reminds us that a policy

initiative to ban mandatory retirement is to ban the private parties from entering into such contractual arrangements under any circumstances. Even though banning mandatory retirement is usually couched in terms of the “pro choice” option (i.e., allowing people to retire at their chosen date of retirement) it is not the pro-choice option in the sense that it does not allow the private parties the choice to make such pre-commitments under any circumstances. In that vein, allowing mandatory retirement is the pro-choice option in that it allows people to enter into such contractual arrangements perhaps as part of a collective agreement or in return for a pension plan. Banning mandatory retirement effectively bans such private contracting.

This also reminds us that it is distinctly possible to be in favour of abolishing a mandatory retirement policy at your particular organization but to be “pro choice” in the sense of being in favour of allowing it to be part of your organization’s policies if, for example, it is negotiated in the collective agreement or part of the pension plan. This is analogous to being individually against abortion, but “pro choice.”

Governments, of course, often ban private parties from many contractual arrangements even amongst “consenting parties”. This is the case with prostitution (in many but not all countries), indentured service (where individuals agree to work for an employer for a specified period of time in return for having their passage to the New World paid by the employer) and child labour. At other times, however, the state sanctions and upholds contractual arrangements that involve pre-commitments at periods of our life that can constrain our flexibility and freedom in later periods. This is the case with marriage contracts and with mortgages or bank loans that have to be repaid. Generally when governments sanction such contracts they require them to be clearly laid out and entered into without coercion. The question then is: Is mandatory retirement more like prostitution and indentured service or more like a marriage or loan contract? Understanding the conditions under which mandatory retirement exists facilitates an informed answer to that question.

## Prevalence and Constraining Influence of Mandatory Retirement

Approximately half of the Canadian workforce is in jobs that involve mandatory retirement<sup>17</sup>. This does not mean that half of the workforce ultimately will be involuntarily constrained by mandatory retirement in that they would like to work longer once they arrive at that age. Some may quit, be dismissed, take early retirement, continue working with the same or another employer, or die. Others may prefer that retirement date especially since it tends to occur at the same age as the receipt of private and public pensions. Calculations based on the numbers who indicated they retired because of mandatory retirement but did so involuntarily in that they would like to have continued working suggest that only about one-third of one percent to two percent of the workforce is involuntarily constrained by mandatory retirement (Gunderson 2004, p.2). There appears to be reasonable agreement in the literature that this number is small.

Statistical studies that examine the changes in labour force participation and employment in Canadian jurisdictions after mandatory retirement was banned also tend to conclude that the impact of the ban has been small or insignificant, although those studies recognize that it is difficult to control for all of the other factors that affect the labour force participation decision.<sup>18</sup> In essence, most individuals appear to want to retire at or before the mandatory retirement age in any case, so abolishing mandatory retirement is not likely to have a substantial impact. U.S. studies tend to arrive at similar conclusions for the workforce in general, likely because the substantial clawbacks that exist in public and private pension systems discourage postponed retirement<sup>19</sup>. The relevance of those studies for Canada, however, may be questioned on the grounds that the public C/QPP does not have such

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<sup>17</sup> See Pesando and Gunderson (1988, p. 33), Gomez, Gunderson and Luchak (2002, p. 411), Gunderson (forthcoming) and Hewitt (2004) as well as references cited therein.

<sup>18</sup> Reid (1988) and Shannon and Grierson (2004) based on the bans in Quebec and Manitoba.

<sup>19</sup> Burkhauser and Quinn (1983), Fields and Mitchell (1984) and Neumark and Stock (1999).

clawbacks and pension penalties for postponed retirement in private plans have been banned in a number of Canadian jurisdictions (Pesando and Gunderson 1988, p. 255).

Gomez, Gunderson and Luchak (2003) document a dramatic reversal in the pattern of labour force participation rates of persons age 65 and older between Canada and the U.S., with that reversal occurring in 1986, the year that mandatory retirement was banned in the U.S. Prior to 1986, the labour force participation of older workers declined in a similar fashion in both countries, but in 1986 that decline reversed itself in the U.S. (when mandatory retirement was banned) but continued to decline in Canada (where mandatory retirement was generally not banned). As well, this divergent pattern occurred only for older persons; for other age groups the patterns did not diverge. While other factors may influence these divergent retirement patterns, they indicate that mandatory retirement was associated with a reversal of the downward trend in labour force participation in the US – a trend that continued in Canada where mandatory retirement was generally not banned. As well, U.S. studies have indicated that the ban on mandatory retirement did have a more substantial impact on postponing the retirement decision of university professors in that country<sup>20</sup>. This may reflect a combination of the characteristics of such jobs or the predominance of defined contribution pension plans where there are no substantial pension penalties to postponed retirement.

### **Characteristics of Jobs Subject to Mandatory Retirement**

Jobs subject to mandatory retirement tend to have the characteristics associated with “good jobs” such as<sup>21</sup>:

- higher wages
- long-term stable employment relations

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<sup>20</sup> Ashenfelter and Card (2003) and Clark, Ghent and Kreps (2001).

<sup>21</sup> See Gunderson and Pesando (1988, p. 33), Gomez, Gunderson and Luchak (2002) and Pesando and Gunderson (1988) for a discussion of the characteristics of jobs subject to mandatory retirement as well as the sources and references cited therein.

- pension and retirement plans including generous early retirement provisions
- the protection of a collective agreement or a formal personnel policy
- higher lifetime earnings and pensions such that the person is very unlikely to be in poverty when they retire.

This is important since it reminds us that mandatory retirement policies generally occur as part of private contracting between mutually consenting parties that can reasonably be regarded as “consenting adults”. When this is not so, as some of the previously discussed case law indicated, then mandatory retirement has been overturned in specific cases. Furthermore, mandatory retirement is generally associated with specific quid pro quos such as pensions and early retirement provisions. It is not a policy foisted on disadvantaged workers by opportunistic employers engaging in age discrimination.

### **Implications of Associated Characteristics for Banning Mandatory Retirement**

The previous discussed characteristics of mandatory retirement have important implications for many of the arguments advanced in favour of banning mandatory retirement.

The strongest argument in favour of banning mandatory retirement is that it constitutes age discrimination since it requires workers to retire at a pre-specified retirement age. The fact that it is a mutually agreed upon arrangement by persons with generally reasonable individual or collective bargaining power and associated with other quid pro quos in the employment package, casts doubt on this argument. Furthermore, mandatory retirement is an *inter-temporal* agreement whereby individuals early in their career pre-commit *themselves* to be bound later in their career, presumably in return for the other quid pro quos such as increased employment and promotion opportunities when they were younger and pension benefits when they retire. If they are engaging in age discrimination, they are discriminating against *themselves* in the

future. This is different from other forms of discrimination where majority groups may benefit by discriminating against minorities and hence where legal protection may be merited.

It is the case that individuals may make mistakes because they are poorly informed or behave irrationally in entering into such inter-temporal contractual arrangements.<sup>22</sup> That is, they may accept mandatory retirement provisions because of the job and promotion opportunities it provides when they are younger, but regret that decision when they are subject to the constraint when older, even if it provides them with benefits at that time such as generous early and normal retirement pensions. Such “mistakes”, however, can be made in any inter-temporal contracting arrangements, however, such as with marriage contracts or mortgages. As well, they can be made in both ways – by people who enter into such arrangements and by those who do not and later regret that they did not get married or buy a house. Governments do not “protect people from themselves” by prohibiting such contractual arrangements. The appropriate policy response would seem to be to require that all agents are fully informed about the arrangements they make, perhaps even by explicitly requiring that they sign a statement indicating they are fully aware of any mandatory retirement provision.

Some have expressed concern that the package negotiated by the employer and the employee (or bargaining agent) that involves mandatory retirement is an arrangement that generally reflects uneven bargaining power. Most employers present the package as a fait accompli and therefore there is no real negotiating room or choice on the part of the employee. “Take it or leave it” is not really a choice along the same lines as a mortgage or marriage agreement, especially if a number of workplaces have the same policy and older workers have less mobility and fewer options (although the same can be said of older persons in marriages where there may be uneven bargaining power!). Even getting employees to sign an

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<sup>22</sup> This argument is articulated in Kesselman (2004) and Krashinsky (1988).

acknowledgement does not give much of a choice since they are generally not allowed to agree to individual arrangements such as forgoing pensions in return for working longer.

This is a legitimate concern, but uneven bargaining power and the “take it or leave it” option can lead to a variety of outcomes that favour employers including lower wages and poorer working conditions in general. There is little reason to single out mandatory retirement as the egregious element to ban in that package, especially when it is associated with other desirable aspects such as pensions. Individual workers invariably have elements in their job that they must accept as part of the package (e.g., hours of work that do not match their preferences or fringe benefits they do not value but “pay” for by lower wages). Nevertheless, when enough individual workers have preferences that do not match with what employers are providing (or even what most of their co-workers want) then employers have an incentive to try to be more flexible in those arrangements. This is occurring, for example, through more flexible worktime arrangements such as flexitime, as well as flexible fringe benefit packages such as cafeteria benefit packages whereby employers choose amongst an array of fringe benefits. There is nothing stopping employers from being more flexible in the area of mandatory retirement, for example, by eliminating the practice, or allowing some employees to continue working with appropriate pension adjustments, or reducing any other disincentives that may discourage people from continued employment. Even if employers possess more bargaining power they still have an incentive to attract and retain employees. Furthermore, as indicated previously, the “uneven bargaining power” argument is weakened somewhat by the fact that this is one area where employees generally do have reasonable individual or collective bargaining power as evidenced by the fact that mandatory retirement is generally associated with “good jobs” and other quid pro quos in the employment package. Concern over uneven bargaining power should focus more on the “bad jobs” that have bad outcomes in all dimensions.

Mandatory retirement has also been criticized on the grounds that it may create an “attitudinal barrier” against older workers as a result of which workers approaching the age of mandatory retirement are strongly “encouraged” to retire even though they may prefer to work longer. This can occur, but the argument presented in this paper is that such pressure will be even stronger if mandatory retirement is banned since employers will be less likely to “wait it out” until the mandatory retirement age in the case of poor performers. As a result, there will also be more dismissals of older workers and monitoring and assessment of their performance to defend against unjust dismissal claims. The whole “retirement with dignity” argument in favour of allowing mandatory retirement was to minimize these issues.

Some have expressed concern that unions may not be adequately representing the interests of older workers when they negotiate mandatory retirement (Kesselman 2004, forthcoming). This is always a possibility but surely the risk is low given that the aging workforce that is pressuring the political process should also be pressuring democratically elected union officials if they felt, for example, that agreeing to mandatory retirement was not worth the associated quid pro quos such as the income security of a pension. Certainly it is the case that not all work rules and collective agreement provisions benefit all workers equally. But governments do not ban child related fringe benefits such as childcare and parental leave, for example, because some workers do not have children. Furthermore, if unions are egregious in not representing the interests of particular individuals, then such individuals have recourse to complaints under “duty of fair representation procedures.” Leaving it up to the private parties to negotiate such arrangement ensures that the various trade-offs amongst different constituencies of workers are considered and are required to confront the equally compelling concerns of employers with respect to such factors as costs and competitiveness.

Banning mandatory retirement has also been supported on the grounds this will lead to savings in age-related social programs and reduce the impending labour shortages associated

with the retiring baby-boom population if workers continue working. But few are likely to continue working. As stated by Shannon and Grierson (2004, p. 550): “Banning mandatory retirement in the jurisdictions where it remains illegal is unlikely to do much to alleviate possible future skill shortages or to be much aid in financing health care or public pension programs”.

As well, for there to be a cost-saving, the benefit payouts in such programs must be reduced if people continue to work. But this is not the case under current C/QPP in Canada unless clawbacks are introduced or the age of entitlement is increased as occurred in the US. Nor is it automatically the case in private employer-sponsored pension plans since those jurisdictions that have banned mandatory retirement in Canada have also banned such pension penalties (Pesando and Gunderson, 1988, p. 259). If these are rationales for banning mandatory retirement, then they should be stated more explicitly as part of the debate<sup>23</sup> since support for such a ban may be tempered if it was more widely known that it might lead to reductions in public and private pension benefits. This is in fact the very concern of the trade union movement in this area<sup>24</sup>.

Banning mandatory retirement is also rationalized as a means to reduce impending labour shortages. However, again, this will occur only if large numbers continue working which is not likely to be the case (see the previous cite of Shannon and Grierson). Furthermore, employers themselves may abolish the practice if it fosters labour shortages. If it is part of the collective agreement they may have to give something else in return (such as no pension penalties for those who continue working) but this is part-and-parcel of the normal process of collective bargaining in having confront the trade-offs that are involved in such decisions

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<sup>23</sup> Kesselman (2004, forthcoming) does explicitly link a ban on mandatory retirement to possible increases in the age of entitlement for tax-funded programs for older persons, and the Bank of Canada Governor David Dodge in his support for a ban on mandatory retirement did indicate: “The federal government should re-consider automatically handing out Canada Pension Plan benefits to Canadians at age 65.” *Globe and Mail* (April 21, 2004).

<sup>24</sup> This is evidenced, for example, by statements from Buzz Hargrove, head of the CAW and by Wayne Samuelson, President of the Ontario Federation of Labour *Macleans* (May 24, 2004, p. 70).

Banning mandatory retirement is sometimes rationalized as a policy to alleviate poverty amongst older workers if retiring pushes them into poverty (Croll, 1979, p. 26; McDonald 1995, p. 451). The previous description of the characteristics of jobs with mandatory retirement indicates that this is not the case; in fact, the opposite is more likely to be true especially if a ban on mandatory retirement leads to a reduction in private and public pension income. Disadvantaged older workers who end up in poverty are invariably *not* likely to be in the “good jobs” that involve mandatory retirement.

Banning mandatory retirement is also rationalize on the grounds that such a ban may enable groups like women and immigrants to accumulate income pension benefits based on years of service<sup>25</sup>. This can be the case and empirical evidence supporting this contention for women is provided in Pesando, Gunderson and McLaren (1991). Nevertheless, this is part-and-parcel of the more general set of consequences from accumulating less labour market experience. A wide range of other benefits such as those from C/QPP are based on years of contribution because of the belief that payouts should be based on contributions. Other benefits such as layoff protection are based on seniority. In such circumstances, it is not clear why mandatory retirement should be singled out as the culprit in this area. As well, the impact may be dissipating as the labour force participation of females is now approaching that of males. It is also the case that women and immigrants may benefit by the job and promotion opportunities as well as the opportunities for firms to meet employment equity objectives to the extent that those who retire because of mandatory retirement tend to be white males.

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<sup>25</sup> Gillin and Klassen (2000) and Klassen and Gillen (1999, p. 261, 268).

## RATIONALES FOR ALLOWING MANDATORY RETIREMENT

A variety of rationales have been offered for why the private parties may agree to contractual arrangements that involve the constraint of mandatory retirement.<sup>26</sup> These include that fact that mandatory retirement may:

- Facilitate employee renewal and the job and promotion opportunities for others including youths and employment equity groups, especially in situations where the number of positions in an organisation is relatively fixed
- Facilitate employer planning in areas such as succession and age-related benefits such as pensions and health and disability plans
- Facilitate employee planning for retirement in terms of retirement saving and preparing for possible transitions into retirement
- Reduce the need to terminate older workers with poor performance but who may be accommodated given a known retirement date, hence enabling retiring with dignity
- Reduce the need for constant monitoring and evaluation of older workers to prepare for age discrimination and unjust dismissal claims
- Provide a termination date for back-loaded or deferred compensation systems in longer-term employment relationships whereby individuals are overpaid relative to their productivity when they are older in return for having been underpaid relative to their productivity when younger<sup>27</sup> (Lazear 1979). Deferred compensation, in turn, can provide numerous benefits to both employers and their employees<sup>28</sup>.

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<sup>26</sup> These rationales for mandatory retirement are outlined, for example, in Gunderson (1983, forthcoming), Gunderson and Pesando (1980, 1988) and Gomez, Gunderson and Luchak (2004).

<sup>27</sup> This rationale for mandatory retirement was first advanced by Lazear (1979). Evidence of deferred wages is outlined in that study and in later reviews by Kotlikoff and Gokhale (1992), Lazear (1999) and Prendergast (1999).

<sup>28</sup> The benefits to both employers and employees of deferred compensation are outlined in many of the previously

From a public policy perspective, the main rationale for allowing mandatory retirement is that it is a private contractual arrangement mutually agreed upon between employers and employees with a reasonable degree of individual and collective bargaining power. It is a practice that can confer benefits to both employers and employees. Even if the benefits disproportionately go to employers, and employees would prefer not to have the policy by itself – and it is by no means obvious that this is the case – it simply means that employers would have to compensate employees for this “unattractive” work arrangement. Pension benefits at the time the constraint applies and reduced monitoring and evaluation may be a form of that compensation that makes the *package* attractive to employees in general.

From the perspective of public policy, the relevant question is not: are you for or against an age-based constraint like mandatory retirement? Rather, it is are you for or against allowing the private parties to enter into arrangements like mandatory retirement that may constrain their flexibility at a specific age in the future in return for other benefits? Prohibiting private parties from entering into such arrangements should only be done in egregious circumstances – circumstances that are not characteristic of the jobs that involve mandatory retirement.

## **POLICY DISCUSSION**

A wide array of laws and policies involve age criteria, many of which can be often unintended but significant barriers to transitions into phased retirement. Changing the age criteria to reduce such barriers is increasingly attracting policy attention given the aging workforce, the desirability of allowing voluntary phased transitions to retirement and the impending labour shortages. In some instances, however, the age criteria can exist for good

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mentioned articles that discuss the rationale for mandatory retirement to sustain deferred compensation.

reasons. As such, changing the policy can involve important trade-offs that must be understood.

Laws and policies with age specific aspects have been outlined previously in this paper. They are summarized here with suggested changes that could reduce the barriers to phased retirement.

- The age cap of 65 still exists in the human rights code of some jurisdictions that exists to accommodate mandatory retirement but that means that persons over the age of 65 do not have the normal protection against age discrimination. Eliminating that age cap would extend the normal age protection of the code which is desirable, but also it would effectively eliminate mandatory retirement (which, as argued here, is undesirable). As such, eliminating the age cap but exempting mandatory retirement when accompanied by a bone fide retirement plan and/ or collective agreement would be desirable.
- Private employer-sponsored occupational pension plans typically specify a normal retirement age of 65, but they also often have subsidized early retirement provisions at age 55 and even more extensively subsidized special retirement provisions at age 62. Those features should be left up to the private parties to negotiate or change as the labour market pressures themselves change. If employers fear labour shortages, or if the need for downsizing dissipates, such incentives for early retirement may be eliminated.
- Public pensions have a number of features that discourage postponed retirement and continued work:
  - Old Age Security (OAS) at age 65 is universally provided but with a 15% clawback.
  - An income-tested Spouse Allowance as part of OAS exists at age 60-64 for widows, widowers or spouses of OAS pensioners, with clawbacks ranging from 25 to 100 percent.

- A Guaranteed Income Supplement exists for low-income persons on OAS with a clawback of 50 percent.
- Provincial supplementary benefits have a clawback of 50 percent, which can combine with the OAS clawback to yield a total clawback of 100 percent.
- C/QPP is normally payable at age 65 with no clawback, but with subsidized early retirement provisions at age 60 that require the recipient to “substantially cease working” and with delayed receipt possibilities beyond 65 with actuarial penalties especially after age 70.

Eliminating or reducing the clawbacks and actuarial and other penalties to continued employment would encourage continued work but at a cost to the funds and, in some instances, at the cost of providing transfers to high-income persons. The clawbacks obviously exist for a reason. Nevertheless, their effect on reducing the incentive to continued employment may not be fully appreciated and hence they merit re-examination.

- Private Registered Retirement Plans do not allow contributions passed age 70. Again, this may merit re-examination.
- A personal income tax credit exists at age 65 with a 15 percent clawback after an income threshold. While the clawback is small, it may merit re-examination especially when the sum of a series of small clawbacks can add up.
- Disability benefits and pensions can be particularly important for older persons given their high rate of disability. Such programs include:
  - Workers’ compensation that can have effective clawbacks of 85 to 90 percent in wage loss systems.
  - Canada Pension Plan – Disability component with effective clawbacks or around 100 percent.

- Income tax credits for disability expenses that can be jeopardized by returning to work.
- Social Assistance that can have effective clawbacks of 100 percent.

Such high clawbacks merit reconsideration for all workers, not just older workers, given the disincentives they provide to returning to work.

Clearly there is a wide array of programs that provide important sources of income support for older persons. However, they can also reduce transitions to retirement through various means: clawing back transfer income if labour market income is earned; sometimes by imposing requirements to cease working to be eligible; subsidizing complete early retirement; and penalizing postponed retirement. More attention is merited on determining whether these design features unduly restrict transitions to retirement.

Mandatory retirement is the most overt age-specific policy. Banning it, however, involves prohibiting the private parties (who generally have reasonable individual or collective bargaining power) from voluntarily entering into such an age-specific contract even if it is mutually beneficial and associated with a wide range of benefits for both parties. As such, the sensible policy option in this area would be to:

- Ban mandatory retirement by removing the age cap in human rights codes when they still have them, so that the normal protection against age discrimination exists for such older workers.
- Exempt bone fide retirement or pension plans from the ban so that mandatory retirement is effectively allowed since it invariably is associated with retirement and pension plans.
- Consider also exempting bone fide collective agreements so that unions are allowed to negotiate mandatory retirement, thereby allowing it if there is the protection of a collective agreement.

- Where is its allowed consider requiring employees to “sign off” that they are aware of its features.

Those two steps – altering various pension and tax-transfer programs so that they do not unduly restrict transitions to retirement, and removing the age cap in human rights codes to provide protection against age discrimination, but effectively allowing mandatory retirement under certain conditions – would go a long way to facilitate transitions to retirement.

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