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Pension Reform and Financial Investment in the United States and Canada

Daniel Béland

SEDAP Research Paper No. 120

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Pension Reform and Financial Investment in the United States and Canada

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Abstract

This paper explores the meshing of pension politics and financial investment in Canada and the U.S. during the 1990s. Drawing on the institutionalist literature, the paper focuses on the relationship between ideas, finance and institutional legacies in the debate over the reform of earnings-related pension schemes (Canada/Quebec Pension Plan and Social Security). In Canada, the existence of a public investment board in the province of Quebec facilitated the advent of state financial investment as part of the 1998 reform of the Canada Pension Plan. In the U.S., policy learning—the process by which experts and state officials evaluate the performance of previously enacted policies—involved mainly a comparison between public and private pension benefits, as the growth of 401(k) and other savings schemes combined with exceptional stock-market performances stimulated financial optimism and legitimized what is commonly known as pension privatization (diverting contributions to individual savings accounts). As opposed to the situation prevailing in Canada, the idea of investing Social Security surpluses in equity faced overwhelming opposition in the U.S., despite the efforts of President Clinton to promote it, notably in his 1999 State of the Union address. Although pension privatization appeared as the most debated policy alternative in that country, the conjunction of divided government, the lack of trust between the President and the Republican majority in Congress, and the absence of short term "fiscal crisis," prevented the enactment of such a reform.

Pension Reform and Financial Investment in the United States and Canada

During the 1990s, the idea of relying on stock-market returns to improve the long-term financial situation of public pension systems gained much ground around the world, particularly after the 1994 publication of the World Bank's report *Averting the Old Age Crisis*. Although stock-market-related pension reforms have proved more common in Latin America and in Eastern Europe than in advanced industrial societies (Brooks), the role of financial investment in pension reform has been widely debated, and, in countries like Canada, Sweden, and New Zealand, concrete steps were taken in the late 1990s to move towards—or to increase the scope of—partial advance funding while investing part of the pension money in equity (Myles and Pierson; Weaver 2003a). Although no reform was enacted in the U.S., financial investment emerged as a key policy issue during President Clinton's second mandate. These trends led sociologist Jill Quadagno to suggest the possible advent of a "capital investment welfare state" (1999).

The expression "capital investment welfare state" should not hide the diversity of policy alternatives associated with financial investment. In the field of pension reform, one can identify at least two essential financial policy alternatives. One, the shift to forced savings, which is known in the U.S. as Social Security privatization, has long been popular among conservatives. Although this approach involves a shift from state-guaranteed, defined-benefit pensions to defined-contribution, individual savings accounts, the term "privatization" is potentially misleading as it may hide the fact that it is the state that establishes *forced* savings through universal, required contributions. Full privatization of mature PAYGO systems constitutes a highly problematic option because of the "double payment" problem (i.e. current workers would need to finance existing pension benefits while saving for their own retirement). In part for that reason, partial privatization—diverting only a fraction of the pension contributions to personal savings accounts—increasingly has been perceived as a more realistic policy option since the 1990s. On the other hand, state investment is a clear alternative to forced savings. Without changing the nature of earnings-related pension benefits, state investment is about moving to partial advanced funding while investing new pension surpluses in equities. If the Chilean pension reform enacted in the early 1980s is a well-known example of privatization, President Clinton's Social Security proposal formulated in the 1999 State of the Union address falls under the state investment category (Béland and Waddan).

This paper explores the meshing of pension politics and financial investment in Canada and the U.S. during the 1990s. More specifically, it focuses on the relationship between finance, policy learning, and institutional legacies in the debate over the reform of earnings-related pension schemes (Canada/Quebec Pension Plan and Social Security). In Canada, where federal civil servants play a crucial role in policy-making and policy learning, Quebec's investment board represented a source of policy learning that facilitated the advent of state financial investment for the entire Canadian earnings-related pension system. Furthermore, the federal decision-making process that derives from the organization of this system favored the exclusion of controversial reform options such as direct benefit cuts (Weaver 1999) and privatization. In the U.S., where policy learning concerns mainly experts located outside the federal bureaucracy, the comparison between the return rates of Social Security and private savings accounts has been used to legitimize Social Security privatization at a time when exceptional stock-market performances stimulated financial optimism. Considering enduring fears about the federal government's economic power, the idea of investing Social Security surpluses in equity faced irresistible opposition in the U.S. despite the efforts of President Clinton to promote it. And, although partial privatization was the most debated policy alternative in that country, the conjunction of divided government, the lack of trust between the President and the Republican majority in Congress, the absence of short term "fiscal crisis," and the conservative failure to gain widespread support from public opinion, prevented the enactment of this reform.

This paper is divided into three parts. The first part formulates a fresh perspective on policy learning and institutional legacies. The second part briefly surveys the two national earnings-related pension systems. The third part studies how the financial logic framed the debate over pension reform in both countries during the 1990s.

Understanding Policy Learning

Since the 1980s, historical institutionalism has been the most debated theoretical approach to welfare state politics. Contrary to societal approaches that focus on economic and social factors, this perspective emphasizes how political institutions, state capacities, and previously enacted policies impact the formation of interests, access to political resources, and political behavior in general (Immergut; Pierson, 1994; Skocpol). To understand national differences concerning reform agendas, political processes, and policy outcomes, this paper draws on two main theoretical insights commonly associated with historical institutionalism: the idea that formal political institutions impact policy-making processes, and the idea that past decisions affect present policy choices through "policy feedback" and "policy learning."

Institutionalist scholarship shows that formal political institutions and parliamentary rules structure political behavior and interests in a complex manner. First, political institutions create constraints and opportunities for interest groups involved in policy debates. Concerning the politics of health care reform, for example, Immergut showed that the structure of the Swiss federal system and referendum practices explain why Swiss physicians enjoyed greater political influence than their colleagues in France and Sweden (Immergut). Second, formal political institutions affect the behavior and strategies of elected officials and state bureaucrats. Although the Westminster parliamentary system concentrates power in the hands of the ruling party, for instance, it also increases the number of blame generating situations that emerge when elected officials enact potentially unpopular reforms (Pierson; Pierson and Weaver). Finally, federalism and other forms of political decentralization—as related to institutions like party systems—affect the policy-making process. Antonia Maioni's study of health care reform in Canada and the U.S. during the post-war era supports this. Experimentation at the provincial level increased the pressure on the Canadian government to enact public health insurance in the post-war era. The three above mentioned forms of institutional structuring are frequently related, and it is possible to study them simultaneously.

The second crucial institutional insight for this study is the idea that previously enacted measures directly affect the policy-making process. In the institutionalist literature on social policy, the concept of policy feedback refers to the structuring impact of previously enacted policies on policy-making. Underlying the fact that "policy creates politics," this concept shows how policy-makers have to consider vested interests tied to well-established programs (Skocpol). Policy feedback is frequently related to policy learning, the process by which civil servants, policy experts, and elected officials evaluate the performance of previously enacted policies (Hall; Hansen and King; Heclo). Through the process of policy learning, existing policies affect the perceptions and the strategies of policy-makers, which could impact their decisions.

Yet, the concepts of policy learning and policy feedback should also apply to *private* social benefits, at least in the context of a liberal welfare regime in which employers and financial institutions are significant providers of economic protection (Béland and Hacker; Esping-

Andersen). Loosely regulated through a system of tax incentives (Hacker 2002), private benefits can create specific economic structures and vested interests that policy-makers must take into account when debating potential policy alternatives, even those concerning *public* policy. Overall, this remark underlines the constant interaction between private and public policies in advanced industrial societies.

This example illustrates another crucial aspect of policy learning, which is seldom understood in the existing institutionalist literature: while not always technocratic in nature, it frequently takes the form of a contentious process that involves ideological and political struggles (Hansen and King). Consequently, the evaluation of previously enacted policies could help policy experts and elected officials frame the issues to their advantage. Policy learning and ideological framing are frequently related as they participate in "the social construction of the need to reform" (Cox) and in the justification of specific policy alternatives debated in the political arena.[1]

Cross-national variations in state capacity and political institutions largely explain whose national actors draw policy lessons that may significantly impact policy-making. For example, centralized states such as France rely heavily on civil servants for policy evaluation, while the fragmented U.S. polity stimulates the massive development of think tanks and other learning resources located outside the state apparatus (Weaver, 1989). Although Canada is a federal polity, power at the federal level is far more concentrated than in the U.S., and Canadian civil servants carry much more weight in policy-making processes. Federal bureaucrats also consult regularly with a limited number of provincial and interest group representatives (Montpetit). These cross-national variations explain why it is crucial to focus on civil servants when dealing with Canadian pension reform while, when dealing with the U.S. case, far more attention should be devoted to experts located outside the state—bureaucratic—apparatus. This is especially true of recent years, because the political influence of the U.S. Social Security Administration has declined since the mid-1970s (Berkowitz: 261).

If formal political institutions shed a light on *who* is drawing the lessons that can directly impact policy outcomes, socio-economic assumptions of the policy actors involved generally affect both the *object* of their learning processes and the very nature of the lessons drawn from specific policy experiments. For example, conservative experts located outside the state apparatus may have a greater tendency than civil servants to look extensively at private benefits, especially if they support privatization. Following the same logic, conservatives are inclined to view these benefits in a positive manner as they frequently assume that private benefits are inherently superior to public social programs.

Moreover, policy timing is crucial because economic cycles influence the lessons actors draw from existing policies. For example, the 1970s' stagflation largely shaped the negative evaluation of post-war Keynesian policies that led to their demise and the triumph of economic neo-liberalism under Reagan and Thatcher (Hall). In the case of Social Security privatization, financial cycles impact lessons that can be drawn from a comparison between private and public benefits. Additionally, such cycles affect the agenda setting process because variations in financial outcomes may reduce or increase the apparent "need to reform" public pension programs.[2] If favorable stock-market performances increase the profile of policy alternatives associated with the financial logic, downturns have the opposite effect. Beyond the issue of Social Security privatization, this remark illustrates the relationship between agenda setting, policy learning, and economic cycles in public policy.

Following these remarks, it is possible to classify policy learning processes into two categories: low profile and high-profile leaning. While bureaucratic processes that offer technical guidance to policy-makers frequently maintain a low media and political profile, policy lessons whose main purpose is to convince the population to back a specific policy alternative have a much higher profile. The very objectives of the policy lessons determine their mode of diffusion within and outside a specific policy community. Furthermore, the intended "public" of such lessons will affect the way in which policy experts and elected officials formulate them. Lessons used to frame a specific policy alternative in popular media are likely to take a simplified form that could more readily convince the population that this alternative is the most appropriate one.

Institutional Legacies

Over the years, Canada and the U.S. have developed relatively modest contributory pension schemes supplemented by private benefits covering less than half of the workforce. Beyond these common characteristics, major differences exist between the Canadian and the U.S. earnings-related systems. First, the Canadian system is located on the top of a universal flat pension, which is not the case in the U.S. This largely explains why the Canadian earnings-related system has a lower replacement rate on average than U.S. Social Security, the most massive social program in the U.S. in terms of budget spending (Lynch). Second, the Canadian earnings related program is divided into two distinct, yet highly coordinated, schemes: one for Quebec (QPP: Quebec Pension Plan) and one for the nine other provinces (CPP: Canada Pension Plan). Until recently, only assets from the QPP had been invested in equity, a situation that contrasted with the CPP, whose surpluses were lent to the provinces at preferred rates to subsidize their debt. A look at these contrasting institutional features is essential to the understanding of stock-market politics in both countries.

The United States

The modern pension system in the U.S. took shape during the 1930s and in the immediate post-World War II era. It is divided into three main parts: 1) federal old age, survivors, and disability insurance (OASDI)—a centralized earnings-related pension scheme that covers more than 95% of the workforce; 2) Supplemental Security Income (SSI), an income-tested federal assistance program offering modest benefits to needy elderly citizens not entitled to OASDI benefits (less than one million people in 2003); and, 3) tax-subsidized private pension plans that cover less than 40% of the working population and take different forms, from traditional defined-benefit plans to individual savings accounts (Sass).

Enacted in 1935 as part of the Social Security Act, the earnings-related federal pension scheme (OASDI) is the foundation of the U.S. pension system. More generous than its Canadian equivalent, Social Security still offers relatively modest replacement rates. The political need to keep pension contributions low—combined rate of 10.6% in 2003 for old age insurance alone—explains this situation. Less than 40% on average, Social Security replacement rates are in fact progressive in nature. While the replacement rate for poorer workers is more than 50%, for the wealthiest income category it is less than 25%. Since the post-war era, Social Security has remained a popular social program as it integrates the middle class and gives a sense of entitlement superior to apparently less legitimate welfare programs (Quadagno, 1991).

During the mid-1970s, stagflation and the enactment of an overly generous indexation system under the Nixon presidency worsened the actuarial situation of the program. In 1977, Congress enacted legislation that revised the indexation system while raising tax rates in order to prevent fiscal imbalance and restore confidence in Social Security. Six years later, further technical changes were made—for example new payroll tax increases—in order to solve another short-term "fiscal crisis." Furthermore, this legislation made provisions for an increase in retirement age from 65 to 67 that would take place between the years 2000 and 2022 (Light). With the help of subsequent economic growth, the 1983 reform improved the overall fiscal situation of the program: since the mid-1980s, Social Security has moved towards partial advanced funding while accumulating enough reserves to guarantee its short- and mid-term actuarial soundness.[3]

Canada

The Canadian retirement income system took its present shape during the 1960s. It is also divided into three tiers: 1) Old Age Security (OAS), a universal, flat-rate pension enacted in 1951 and supplemented since 1967 by Guaranteed Income Supplement (GIS) providing a guaranteed income for poorer seniors, both financed from general revenue; 2) the Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP), which provide a second tier of earnings-related public pensions financed from payroll contributions (benefits from either scheme are based on pension credits accumulated under both, as if only one scheme existed); and 3) private, though tax-subsidized, employer-sponsored Registered Retirement Plans (RPPs)[4] and individual retirement savings accounts called Registered Retirement Savings Plans (RRSPs).

The earnings related tier—the Canada/Quebec Pension Plan (C/QPP)—was enacted in 1965. This legislation was the result of an extended bargaining process between the federal government and the ten provinces. Because of Quebec's campaign for increased provincial autonomy, two distinct, but coordinated, earnings-related pension schemes were created. Financed through contributions from employers and workers, the C/QPP integrates the large majority of workers aged 18 to 70. Like U.S. Social Security, these two social insurance schemes protect the contributors and their relatives against the loss of income due to retirement, disability, and death. As compared to their U.S. counterpart, however, the C/QPP have a modest replacement rate, as the C/QPP monthly retirement pension represents 25% of a beneficiary's average monthly earnings during his/her contributory life. Between 1966 and 1970, the eligible age for C/QPP benefits dropped from 68 to 65 and, since 1987, actuarially reduced benefits can be accessed at ages as young as 60 (Béland and Myles).

From the outset both the CPP and QPP relied on modest partial funding as a result of the surplus of contributions built up in the early years of the plans. Importantly, however, assets from the QPP trust fund were invested in equities and real estate to support provincial economic growth and French Canadian entrepreneurship (Thomson 1984), while CPP surpluses were lent to the provinces at preferred rates to subsidize provincial debt. This difference was a direct outcome of the 1960s Quiet Revolution, an attempt to modernize Quebec society and to improve the socio-economic status of the province's French-speaking majority. There, an autonomous investment board (*Caisse de dépôt et placement*) was created. Since the late 1960s, the Caisse has invested money from the QPP as well as other provincial insurance and pension funds in bonds, equity, and real estate. The Caisse has since then emerged as the holder of the largest portfolio of Canadian equities, as well as the largest real estate portfolio in the country (Weaver, 2003a).

During the Mulroney era (1984-1993), pension retrenchment became a contentious issue in Canadian politics, yet the debate essentially concerned indirect cutbacks affecting OAS. During that period, no major reform of the C/QPP took place. The modest, indirect OAS cuts enacted then failed to reshape the Canadian public pension system, whose development—like the one of U.S. Social Security—has proved remarkably "path dependent" in recent decades (Béland and Myles).

Policy Learning and Stock-Market Politics

During the second half of the 1990s, the world witnessed three essential trends that influenced the politics of pension reform in Canada and the U.S. First, demographic aging emerged as a major source of concern among citizens and policy-makers alike (Prince). Second, the push for financial investment in the field of pension reform is related to the enduring prominence of market liberalism, which supports the development of personal savings and financial investment (Blackburn). Third, exceptional stock-market performances and the multiplication of tax-sponsored individual accounts created a sense of financial optimism, as the financial sector expanded while affecting an increasing number of individuals (Teles). In spite of these common trends, Canada and the U.S. took two different reform paths during the 1990s. As will be shown below, looking at policy learning processes is crucial to understanding the contrast between the Canadian and the U.S. paths.

United States

Despite the absence of a short-term fiscal crisis, the U.S. witnessed the emergence of a broad movement supporting Social Security privatization during the 1990s. Sketched in the 1970s by conservative economists like Feldstein, the idea of Social Security privatization is far from being new. Since the 1980s, however, many conservatives have pursued what Butler and Germanis labeled a long-term "Leninist strategy" that could gradually undermine the support for Social Security through the multiplication of fiscal measures instrumental to the expansion of the financial logic in the pension domain (Butler and Germanis). In order to achieve their long-term goals, conservative experts and politicians have encouraged the development of private savings schemes that could reduce people's reliance on Social Security while making individuals aware of the apparent financial rewards associated with 401(s)s and other savings schemes (Hacker

2004; Teles). Beyond this support for private schemes, privatizers have popularized two distinct, yet ultimately related, views in an attempt to undermine the support for Social Security and to justify privatization: demographic pessimism and financial optimism. The following analysis focuses on the second view, which is directly related to policy learning and "stock-market politics."

Demographic pessimism takes the form of a conventional discourse about a developing demographic time bomb. This pessimistic and deterministic view indicates that population aging will drain enormous fiscal resources away from children and young adults, favoring the multiplication of contentious intergenerational issues. According to the prophets of such "apocalyptic demography" (Prince), social programs for the elderly will create an enormous fiscal burden on the youth as the percentage of the population aged 65 and older increases due to low fertility, longer life expectancy, and the aging of the Baby Boom cohort. In general, such a discourse is used as a political weapon to attack established PAYGO systems and favors the development of personal savings.[5] Associated with the idea of "generational equity," this pessimistic demographic vision became a significant policy issue in the U.S. during the 1980s and 1990s. Frequently, proponents of "apocalyptic demography" describe the elderly as egoistic "greedy geezers" that take scarce fiscal resources away from children and young adults. This negative vision of the elderly supports the idea that current intergenerational transfers are unfair, and that Social Security privatization constitutes the only option available to compensate for the future effects of demographic aging while creating a fairer contract between generations (Béland and Waddan).

Those supporting Social Security privatization during the 1990s also embraced a financial optimism in line with the exceptional performances of the stock markets, as well as the multiplication of 401(k) plans and Individual Retirement Savings Accounts (IRSs). Considering the higher than expected rates of return witnessed during the 1990s, the development of personal savings and defined-benefits schemes in the private sector supported the idea that Social Security privatization represented a positive historical fate coherent with economic rationality and financial progress. Exceptional stock-market performances reinforced the faith in these savings schemes. To convince the public that Social Security privatization would enrich individuals, privatizers emphasized anticipated personal gains related to privatization. In this context, high profile policy learning about the comparative merits of Social Security and private savings schemes appeared as a way to frame the policy debate in a manner that could convince the population and the political elite to support Social Security privatization. While conservative experts did draw lessons from existing private and public pension schemes, they transformed these lessons into an ideological frame grounded in financial optimism and the pursuit of personal gain.

Derived from a unilateral comparative evaluation of private and public pension benefits, this frame can be found in many conservative publications. In a brief conservative book entitled *Common Cents, Common Dreams: A Layman's Guide to Social Security Privatization*, CATO experts Peter Ferrara and Michael Tanner suggest that Social Security is "a bad deal" for workers and that it will be unable to pay benefits to future retirees. As the only genuine alternative to this inefficient bureaucratic system, privatization would enrich workers through higher return rates similar to those of 401(k)s savings accounts. Explicitly using 401(k)s and other savings schemes as the model for Social Security reform, the book articulates demographic pessimism and financial optimism in order to illustrate the superiority of individual savings accounts over PAYGO financing. Clearly targeting the middle class, this book also refers heavily to the Chilean experiment in pension reform (Ferrara and Tanner). Although it is possible to talk about policy learning from the private sector, one must recognize the ideological orientation of this evaluation process, which tends to inflate potential financial rewards while downplaying stock-market risks.

Starting from optimistic economic assumptions, conservative experts drew these specific lessons before sharing them with the population in a highly rhetorical and simplified manner.

U.S. Social Security privatization gradually returned to the federal agenda during the second half of the 1990s. As stated above, the movement in favor of Social Security privatization reflected enduring demographic fears and growing stock-market performances, as well as the efforts of conservative experts and politicians to promote the financial logic through the spreading of high profile, simplified policy lessons. After the defeat of the President's Health Security proposal and the enactment of the 1996 welfare reform, the issue of Social Security privatization gained far more exposure than in the decade following the 1983 Social Security reform (Derthick 2001). The January 1997 publication of the report from the 1994-1996 *Advisory Council on Social Security* contributed to this emergence of Social Security privatization on the federal policy agenda. Failing to reach a consensus about the content of their final report, members of the council formulated three different proposals aimed at solving Social Security's long-term financial problems. For the first time in a federal report, a significant proportion of the members (five out of twelve) supported partial privatization, a policy alternative that became widely debated during the second Clinton mandate.

It is hard to measure the impact of the conservative campaign on public opinion. First, confidence in the future of the current program has sharply declined since the mid-1970s (Cook, Barabas and Page). This trend certainly reflects the massive diffusion of "demographic pessimism" in the U.S. (Skidmore). Second, although Social Security remains popular, enduring demographic fears have led a majority of the population to support more significant changes that could guarantee the long-term solvency of that program. Surveys conducted between 1996 and 2000 showed that a significant majority of the population supported privatization, at least when survey questions did not mention potential risks related to that policy alternative. When risks were considered, however, support for privatization dropped, and most citizens opposed it (Cook, Barabas and Page: 254-255). Although the conservative "Leninist strategy" helped promote Social Security privatization, no widespread consensus over this issue emerged during the 1990s.

Stressing the enduring popularity of the program and the risks associated with Social Security privatization, many academics and politicians—especially Democrats—firmly opposed this policy alternative while drawing their own lessons from the comparison between that program and existing savings schemes. From their perspective, Social Security has contributed to a massive reduction in poverty affecting the elderly. Furthermore, this federal program offers defined-benefit pensions that better protect workers against economic insecurity than defined-contribution savings schemes, which are vulnerable to bad investment choices and stock-market downturns. For those who oppose privatization, this type of reform would transfer unnecessary financial risks onto the shoulders of U.S. workers, especially those living with a lower income. Moreover, Social Security privatization would generate high transition costs derived from the "double payment" problem mentioned above. Even partial privatization proposals would prove difficult to finance without a significant payroll tax increase. Higher administrative costs inherent to individual accounts would also penalize workers, especially low-income ones (Aaron and Reischauer; Ball and Bethell).

Although they argued that modest reforms could adequately guarantee the long-term fiscal soundness of Social Security, some defenders of the program found it politically difficult to resist the financial logic. Considering the actual stock-market performances, politically savvy pension experts such as Robert Ball promoted a financial alternative to partial privatization: the investment of Social Security surpluses in equity. In his book *Straight Talk about Social Security*, this former commissioner of the Social Security Administration explicitly opposes risky privatization and the apparently cautious reliance on stock returns to improve the long-term fiscal soundness of the program (Ball and Bethell: 20). Increasing national savings and direct investment would preserve security associated with defined-benefit pension plans, while improving the long-term fiscal balance of the program. Drawing on existing financial optimism, Ball and other liberal authors (Aaron and Reischauer) depicted the direct investment of Social Security surpluses as a low-risk stock-market alternative to partial privatization.

Most Congressmen took a cautious stance towards the policy alternatives formulated by proponents and adversaries of Social Security privatization. Labeled as the "third rail of American politics" (touch it and you die), Social Security is a source of major electoral risks, and even politicians interested in privatizing the program stated that they actually wanted to "save Social Security." Rarely the object of explicit attacks, this program nevertheless constituted a blame-generating issue for Republicans who faced a Democratic President repeatedly accusing them of plotting against Social Security. Nevertheless, the multiplication of Congressional hearings on Social Security after 1995 showed that partial privatization became a persistent issue on the federal policy agenda during the second half of the 1990s.[6] Yet enduring electoral risks and the President's reluctance to strike a deal with Republicans on partial privatization made talk about Social Security privatization a safer political option than concrete legislative action. This is especially true in the context of a divided government, which gives the President an institutional "veto point." Moreover, higher economic growth than expected increased Social Security revenues, which had the effect of improving the long-term actuarial forecast (Weaver 2003b).[7]

Finally, President Clinton clearly rejected partial privatization and attempted to capitalize on the popularity of Social Security to prevent the Republican majorities in Congress from enacting massive tax cuts. During the 1998 State of the Union address, he recommended using federal surpluses to "Save Social Security," a clear attempt to shift current legislative debates away from Republican tax cut proposals related to the coming of federal fiscal surpluses. During the two last years of his Presidency, Clinton made numerous public references to Social Security reform,[8] just as Social Security reform proposals multiplied in Congress (Derthick 2001: 206).[9]

Considering the optimistic financial mood prevailing at the time, Clinton explicitly embraced the financial logic in his 1999 State of the Union address. Opposing partial privatization, he supported the creation of savings accounts *alongside* the existing PAYGO-system. Following Robert Ball and other liberal pension experts, the President also embraced the idea of investing part of Social Security surpluses in equity: "I propose that we commit 60 percent of the budget surplus for the next 15 years to Social Security, investing a small portion in the private sector just as any private or state government pension would do." (Clinton) Unfortunately for the President, who probably saw Social Security reform as a key legacy-building issue, conservatives strongly opposed this type of investment. After the President first talked about investing part of Social Security surpluses in equity, American Enterprise Institute senior fellow James Glassman formulated a traditional conservative objection against state investment in equity: "having Washington become a major shareholder in U.S. corporations presents terrible dangers and could undermine the system of free enterprise itself." (Glassman) A most respected economist, the Chairman of the Federal Reserved Bank, Alan Greenspan, attacked state investment on the same ground (Greenspan cited in Glassman). Greenspan reiterated his opposition immediately after the 1999 State of the Union (Dionne). Simultaneously, influential voices within and outside the financial sector criticized direct state investment as a measure that could favor the "'politicization' of the stock-market system" (Fitzgerald). State investment exacerbated existing fears of "big government," which were not associated with the idea of Social Security privatization. And although state investment could have increased the demand for equities, partial privatization—a potentially greater source of equities demand—appeared as a more attractive reform option to most representatives of the financial industry. This is especially true since growing federal budget surpluses could have helped cover the transition costs associated with partial privatization.[10]

Because of these conservative reservations about state investment, and the political tensions created by the impeachment debate, President Clinton failed to strike a deal with Congress over Social Security reform, and no legislation was enacted before the 2000 presidential election.[11] Although Clinton's 1999 Social Security proposal went nowhere, the President at least had the satisfaction of having prevented partial privatization from gaining more ground in an era of financial optimism. Immediately following the 2000 federal elections, President George W. Bush appointed a commission on Social Security reform (*Strengthening Social Security and Creating Wealth for all Americans*) that cautiously supported partial privatization. Unfortunately for privatizers, the debate over tax cuts and the terrorist attacks of September 11, 2001 relegated Social Security to the periphery of the federal policy agenda. Massive financial downturns related to this tragic event also underlined the vulnerability of tax-sponsored savings plans related to the idea of partial privatization and the financial logic itself (Kuttner). The decline of financial optimism undermined the short-term political support for partial privatization.

Canada

Usually less central to Canadian political debates than health care reform, the C/QPP surged on the national policy agenda in the mid-1990s. As in other nations, new actuarial provisions created fears about the long-term financial sustainability of this earnings-related pension system. The publication of the Fifteenth Actuarial Report of the CPP in 1995 exacerbated these fears. As a result of economic downturn, as well as a notable increase in disability benefits, this report projected a higher payroll tax schedule than forecasted by the previous actuarial report. In the absence of a significant alteration of the current tax schedule, by the year 2015 the CPP's revenues would prove insufficient to pay all the pension benefits under the existing payroll tax schedule (Battle: 537).[12]

This report created a window of opportunity for conservative writers and politicians supporting the privatization of the CPP. As in the U.S., demographic fears were exploited to justify path-departing reforms. In a brochure issued in 1997, for example, the right-wing Reform Party suggested that incremental reforms cannot guarantee the long-term financial integrity of the CPP, and that this program is "the worst investment imaginable for our youth." Mobilizing a U.S.-style individualistic rhetoric to legitimize privatization, they argued that Canadians "should be given a CHOICE to stay in the CPP, or to redirect premiums to their own personal retirement account." (Reform Party) The expansion of private—tax assisted—savings schemes provided another argument in favor of privatization, as financial investment appeared more profitable than social insurance. Alberta's conservative government of Ralph Klein and some Canadian think tanks also backed privatization (Townson).

During the 1990s, however, the movement in favor of privatization was less prominent in Canada than in the U.S. Four factors explain this situation. First, conservative think tanks and libertarian ideas carry less weight in Canada than in the U.S. (Abelson), especially since the emergence of regionalist parties like the Reform Party and the Bloc Québécois has favored the durable electoral dominance of the moderate Liberal Party in power since 1993. Second, because the Reform Party essentially remained a regional party carrying the traditional Western Canadian grievances towards the federal government, this party's crusade echoed less in central and Eastern Canada. And since only the Alberta government strongly supported privatization, this option remained marginal within provincial policy circles. Fourthly, privatization—as much as direct cuts in benefits—represented an especially unpopular policy alternative in Quebec, a province that has an implicit "veto point" in the reform of earnings-related pension schemes.

Because the pressure not to alienate Quebec voters became stronger than ever after the 1995 referendum when separation almost triumphed, privatization became implicitly related to "national unity" issues.[13]

Rejecting privatization, the Liberal government launched a consultative process in order to reform the program in an incremental and consensual manner. A key institutional logic mentioned above made this consultative process necessary: because the federal and provincial governments share constitutional responsibility for the C/QPP, Ottawa had to reach an agreement with at least two-thirds of the provinces with two-thirds of the population prior to enacting a reform (Banting; Battle: 538).

After consulting the ten provinces, the Department of Finance formulated a joint report evaluating the long-term financial situation of the CPP while setting the agenda for a consensual reform. Published in February 1996, this report (Federal/Provincial/Territorial CPP Consultations Secretariat 1996) constituted the starting point of public consultations on the CPP that were held across Canada that year. The consultations formed a key element of the statutory review of the CPP undertaken by the federal and provincial governments (Government of Canada, 1996a).[14] During this time, voices supporting privatization remained marginal, and representatives of the Alberta government failed to convince the other provinces to support that option (Townson).

In November 1996, the federal and provincial governments issued a joint statement to organize the principles that would frame the elaboration of the next CPP reform. Two of the nine principles outlined in the statement seemed particularly significant: "4. The CPP must be affordable and sustainable for future generations. (…); 8. CPP funds must be invested in the best interests of plan members, and maintain a proper balance between returns and investment risk." (Government of Canada, 1996b) These two principles illustrate the double logic of the future C/QPP reform. First, greater partial advance funding resulting from rapid payroll tax increases would reduce the need for bolder tax hikes in the long run. Second, and more interestingly, the subsequent principle reflects policy learning towards Quebec's Caisse. This organization appeared as a natural source of policy lessons because the Caisse is tied to the QPP, a program identical to CPP with the exception of the investment formula. Because federal policy-makers were questioning the investment formula of the CPP, learning from the Caisse seemed obvious. Furthermore, as a former businessman living in Montreal, Finance Minister Paul Martin knew the Caisse well, and he certainly had informal contacts with people involved with this organization. As mentioned above, the Caisse has been investing QPP money in equity and real estate since the late 1960s.

In the mid-1990s, exceptional stock-market performances boosted the Caisse's financial returns. A few statistics illustrate this logic. While the Caisse's total return averaged 10.2% between 1987 and 1996, it amounted 15.6% during that last year (Caisse de dépôt et placement). Like other Canadian pension funds, the Caisse appeared increasingly successful. The relative financial "success" of this provincial investment board implicitly paved the way to the investment of CPP surplus funds in equities by providing the federal and other provincial governments with a positive financial precedent.[15] The Caisse's three-decade-long experience in financial investment showed that a public pension fund, if properly managed, could achieve higher rates of return than the current CPP. During the review process, federal policy-makers consulted with the Caisse's officials, as well as with representatives of other Canadian public investment funds—especially Ontario Municipal Employers Retirement System (OMERS) and Ontario Teachers' Pension Fund (Foster; Walker). Representatives of the private financial sector, who were divided over the issue of state investment, were also consulted. Overall, the Caisse's existence certainly facilitated the enactment of the CPP Investment Board, because the Caisse represented a financially successful public investment fund related to the Canadian public pension system through the QPP.

Yet, the CPP Investment Board emerged as a slightly different organization than the Caisse (Weaver, 2003a). On the one hand, policy-makers involved in the CPP reform formally rejected the idea of assigning a secondary investment objective to the new federal board. For this reason, the new CPP Investment Board would only have a single objective, similar to the one of most private pension funds: generating the highest returns possible without undue risks for plan members (Salgo). The decision to reject economic development as a second possible investment objective can be related to policy learning from the Caisse's experience. During private discussions with federal civil servants, Caisse's officials actually warned them about the political risks associated with the existence of a double investment mandate. Many provincial leaders and civil society representatives also expressed their opposition to "social investment" during the CPP consultation process (Foster; Federal/Provincial/Territorial CPP Consultations Secretariat 1996; Walker). Rejecting Quebec-style economic nationalism, the state investment model that triumphed in the Rest of Canada (ROC) during the late 1990s aimed exclusively at increasing financial returns.[16] Giving full investment power to private managers represented the best way to generate higher returns without creating major political controversies traditionally associated with the Caisse.

On the other hand, federal policy-makers made sure that no government official would sit on the CPP Investment Board, a decision meant to increase its autonomy. Policy-makers also designed complex appointment procedures for the CPP Investment Board that would reinforce its autonomy from the federal state while allowing each province to have a stake in the nomination process.[17] This decision contrasts with the current organization of the Caisse, which allows high ranked civil servants to sit on the board of directors. Although the Caisse is officially autonomous from the provincial government, the presence of civil servants on the board, and the fact that the government appoints all its members, undermine the organization's independence. In fact, the "Caisse CEOs have generally had close ties to the provincial governing party." (Weaver, 2003a) During the 1980s, the Caisse did face criticism and suspicion from the business community and federal officials who perceived this increasingly powerful investment board (already one of Canada's most important financial institutions) as a mere political tool in the hands of Quebec's nationalist leaders (Brooks and Tanguay).[18] More recently, authors, such as Pierre Arbour, have criticized what they consider politically motivated investments that ultimately generated significant financial losses (1993; 2002).[19] The presence of top provincial civil servants on the board of directors did not help to dissipate doubts about the Caisse's political autonomy. And when investment performances are not perceived as satisfactory, members of the opposition depict the government as responsible for this situation.[20] While pushing the Caisse to adopt a more cautious investment strategy, these attacks made federal policy-makers particularly aware of the political risks associated with direct state investment in stock markets. Yet as the Caisse's returns jumped in the mid-1990s, it became increasingly tempting to create a similar investment board for the ROC that would generate significantly higher returns than existing provincial bonds while improving the CPP's long-term financial health. Because the Caisse had a spotty reputation within the English-speaking Canadian business community, however, federal officials strategically limited references to this organization in their public statements (Walker). For political reasons, policy learning about the Caisse remained a low-profile exercise.

Quebec's experience illustrated the financial rewards of state financial investment as well as the political uncertainties associated with it. Justified by cautious financial pragmatism that contrasts with the rhetoric of U.S. privatizers, the decision to invest CPP surpluses in equity while creating a fully independent investment board exclusively centered on financial returns—as opposed to economic development—thus seems at least partially grounded in feedback effects from Quebec's long-term financial experiment. Warning voices emanating from academic and financial circles (Lindgren) also made the need for political independence in state investment more pressing.[21]

Although lessons drawn from Quebec's experience seemed ambiguous, dominant economic assumptions supporting the financial logic and exceptional stock-market performances made this policy alternative look irresistible. The Caisse and the other Canadian pension funds were generating superior returns while feeding the stock markets. Because current stock-market performances reinforced the domination of the financial logic, policy learning about the Caisse and other pension funds was rooted in the then dominant financial logic, which transformed potential obstacles to state investment as solvable technical matters, not great economic and political threats.[22]

In February 1997, Finance Minister Paul Martin presented the draft of the new CPP legislation. It proposed to increase combined employer and employee payroll taxes to the CPP from 5.6 to 9.9% by 2003, in order to build up a larger reserve fund and avoid more massive tax hikes in the long run. This provision followed the principles formulated a year before in the *Information Paper for Consultations on the Canada Pension Plan*. In 1997, the fund had a value equivalent to about two years of benefits, and that was expected to decline in the future. As a result of the final legislation enacted in January 1998 (Bill C-2), the CPP trust fund is scheduled to grow to five years of benefits, with the reserves invested in a diversified portfolio of securities "to earn higher returns and help pay the benefits as Canada's population ages" (Martin). With the purpose of investing a portion of the reserve fund, the legislation created the CPP Investment Board, an autonomous organization governed by a board of directors. As mentioned above, only independent professionals from the private sector make the investment choices. Although the main goal of the CPP Investment Board is to generate high returns, the existence of a 20% limit on foreign investment—later increased to 30%—constitutes a significant institutional constraint that reduces the freedom of these financial professionals. Moreover, most of the CPP fund is still invested in fixed-income assets such as federal and provincial bonds. Finally, since the CPP mostly operates as a PAYGO system, state investment cannot directly jeopardize pension entitlements because the program still operates on a defined-benefit basis.

Yet state financial investment is not the only aspect of the 1998 CPP reform. In addition to modest, indirect retrenchment and measures dealing specifically with disability insurance, the new legislation stated that contributors should receive annual reports on their CPP accounts. Moreover, the traditional federal-provincial reviews should be carried out every three years, rather than five years. In general, this reform reaffirmed the contributory nature of the C/QPP while excluding potentially unpopular policy alternatives such as partial privatization or retirement age increase. Although modest, the reform improved the long-term actuarial balance of the system, which reported a surplus fund of more than 53 billion dollars in 2003.

State financial investment certainly represents the most original feature of the CPP reform. Investment began in fiscal year 1999, and by the end of March 2001, the CPP Investment Board "had 7.2 billion dollars invested in Canadian and foreign equities and by 2011" the board "expects to be managing at least $130 billion in a diversified investment portfolio" (CPP Investment Board 2001). During the two first years of CPP investment, portfolio returns reached 5.0% (1999) and 40.1% (2000) respectively. However, these excellent returns would rapidly evaporate as CPP equity investment began shortly before stock performances started to deteriorate. In the year that ended on March 31, 2001, the CPP lost 852 million dollars CDN, which represents negative returns on equity of 9.4%. Although the situation improved in 2002 with positive returns of 3.4%, the 2003 financial year proved catastrophic for the CPP investment board. During that fiscal year, which ended on March 21, 2003, the Board reported negative returns of 21.1% on assets of $17.5 billion CDN (CPP Investment Board 2003). Since investment began, annual returns averaged only 3.6%. Investment performances of Quebec's Caisse also proved deceiving in the early 2000s (Arbour, 2002).

In Canada, members of the parliamentary opposition have recently criticized the investment choices of the two public investment boards. Although the enactment of Bill C-3 in 2003 actually increased the amount of money managed by the CPP Investment Board, this organization still faces skepticism that only higher returns could truly dissipate in the long run.[23] The political status of this organization—as well as the one of the Caisse—is thus related to national and international stock-market performances. If the decline in stock-market returns further undermined the popularity of privatization in Canada (Chevreau), this trend also complicated the launching of the CPP Investment Board. Nevertheless, this organization has not yet been victim of a genuine "legitimacy crisis" that could seriously undermine its future. So far, no significant political movement aimed at ending CPP investment in equities has emerged in the Canadian political landscape.

Conclusion

The above discussion about policy learning and institutional legacies explored the meshing of pension politics and financial investment in the 1990s. During that decade, the debates over financial investment and pension reform took very different shape in Canada and in the U.S. The idea of privatization remained marginal in Canada, a situation that contrasts with the scope of the U.S. debate over that issue. The federal decision-making process associated with C/QPP reform largely contributed to the *a priori* exclusion of highly controversial policy alternatives such as privatization. In the U.S., partial privatization appeared as a more debated policy option than state investment: the one that finally triumphed in Canada, a country in which one of the provinces had invested earnings-related pension contributions in equity since the late 1960s. In contrast to the Canadian experience, U.S. policy learning in the field of financial investment mostly concerned a comparison between Social Security and private savings schemes, as the growth of 401(k) and other savings schemes legitimized financial optimism and, ultimately, privatization. Comparing rates of return of Social Security and private pension schemes made sense for conservatives because 401(k) constituted an explicit model for privatization. Considering the weight of divided government, the lack of trust between the President and Congress, and the absence of short-term "fiscal crisis" and the mixed results of the conservative campaign to convince public opinion to support privatization, no major reform occurred.

In the future, students of pension reform could further explore the relationship between social learning, decision-making structures, and financial investment. This paper provides some general insights about these crucial issues. As shown above, social learning deals with both public and private provisions, and it does not always take the form of an apparently detached bureaucratic process. In fact, policy lessons can have a high profile and serve as framing tools aimed at convincing the population to support a specific policy alternative. Moreover, current stock-market performance affects the way in which policy-makers perceive the functioning of existing pension schemes. But because this performance is unstable, timing is crucial as stock-market downturns may reduce the support for the financial logic at the center of both pension privatization and state investment. The future of the emerging "capital investment welfare state" will thus depend largely on stock-market performance and the capacity of experts and policy-makers to draw credible lessons from existing private and public pension schemes.

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Endnotes

[1] On framing, see Powell, Bronco and Williamson, 1996.

[2] John W. Kingdon's theory rightly underlines the role of economic conjunctures in agenda setting.

[3] According to the 2003 report of the Board of Trustees, the Social Security trust fund is "expected to become exhausted in 2041, 3 years later than projected in last year's report." (Board of Trustees)

[4] In 1998, 39.1% of the workforce participated in an employer-sponsored plan (Statistics Canada: 16).

[5] U.S. demographic prospects seem favorable when compared to other advanced industrial nations. The percentage of the U.S. population over 60 should increase from 16.4% in 1995 to 28% in 2040. In Canada, the percentage of population over 60 should rise from 16.2% in 1995 to 32.4% in 2040: World Bank, 1999.

[6] In 1994, only one congressional hearing on the future of Social Security was held. In 1997, Congress held ten different hearings dealing directly with that issue. After a small decline in 1998, the number of Social Security hearings increased to 18 in 1999 (Cook, Barabas and Page).

[7] According to the official actuarial forecast of the Social Security Administration, the anticipated trust fund "exhaustion" moved further away—from 2029 in 1997 to 2034 in 1999.

[8] The number of presidential addresses in which Social Security is mentioned jumped from 48 in 1997 to 225 in 1998 and 230 in 1999 (Cook, Barabas and Page: 241).

[9] An example of partial privatization proposal is the bill presented in the spring of 1998 by Senators John Breaux (D-LA) and Judd Gregg (R-NH).

[10] In addition to making direct political contributions, many banks and financial services firms financed think tanks, research projects, and public-policy forums that promoted Social Security privatization. Yet by 1999, the support for Social Security privatization within the financial industry had already faded as concrete legislative proposals showed the administrative problems associated with this policy alternative (Darby and Celarier).

[11] The White House staff spent thousands of hours in total during the last two years of Clinton's second mandate dealing with various Social Security proposals (Burman).

[12] For a critique of the report's assumptions, see Emery, 1996.

[13] An anonymous federal civil servant shaped this insight with the author.

[14] Simultaneously, Quebec conducted its own pension consultations within the province.

[15] The original investment target for the CPP Investment Board (4% above the rate of inflation) "is based on rates of return in the Quebec Pension Plan." (Drover: 97) Many newspaper papers published during the CPP reform process referred to the Caisse's experience when discussing the idea of state financial investment (for example: Nankivell, 1997).

[16] The Caisse has modified its practices since the 1980s to favor higher returns and invest outside Quebec's economy. In 2000, the *Caisse* managed about $125 billion CDN in assets. Almost 50% of these assets were in Canadian and foreign equities (Sarney and Preneta).

[17] Since it relies heavily on outside managers, the CPP Investment Board has a far more modest staff than the Caisse: less than thirty employees against more than 500 (Weaver, 2003a).

[18] Traditional federal concerns about the Caisse dealt with economic nationalism, not financial investment *per se*.

[19] These attacks reflected concerns emanating from business interests. In Quebec, the left largely supports the Caisse, which is perceived as a tool for French-Canadian economic development. In English-speaking Canada, the left expresses doubts about state financial investment and the functioning of the CPP Investment Board, which lacks a "social investment" component (Nystrom).

[20] For example: *Journal des débats*, 36[e] législature, 2[e] session, November 27, 2002.

[21] In October 1997, however, a Toronto-based conservative think tank, the CD Howe Institute, published a report supporting the proposed CPP Investment Board while welcoming its institutional autonomy from the federal government (Slater). Overall, representatives of the Canadian financial industry seemed less worried about direct state investment than their U.S. counterparts. As privatization remained off the Canadian federal legislative agenda, state investment represented another method for using the public pension system in order to generate new demands for equities. The fact that the CPP Investment Board would rely heavily on expertise emanating from the financial industry constituted an additional reward for the private sector.

[22] Informal discussions with several federal officials confirmed this intuition.

[23] For example: *Edited Hansard*, 37th Parliament, 2nd Session, October 23, 2003: 1650.

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