

CSLS

“Is the Retirement Income System Meeting the Needs of Canadians?”

Presentation to CSLS Seminar

By

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Criteria for Judging Retirement Income Systems

Income adequacy

- Minimum incomes*
- Earnings replacement (maintenance of living standards)*
- Relative incomes
- Predictability (stability of) incomes

Financing

- Affordability
- Sustainability
- Intergenerational fairness

Focus of prepared remarks*

Three Pillars

- 1: OAS + GIS
- 2: C/QPP
- 3: RPPs + RRSPs

Incomes of Today's Elderly: Amounts

- Late 20th century was a time of huge improvement in elderly incomes
 - Strong real income growth: 79%/55% singles/couples (1976 – 2007)
 - Equalizing tendency: P95 to P5: couples after tax: 9:1, late 1970s; 4:1 mid 1990s; 5:1 mid 2000s
 - Relative income growth (after tax, equalized by family size): 70% in late 1970s; 85% in mid 1990s; 80% mid 2000s
 - Poverty rates decline: 35% in late 1970s; 3% in mid 1990s; 5% in mid 2000s
 - Strong earnings replacement:
 - LMP conclude that @ age 71, 21% have a replacement rate below 60%; quintile 3 - 25%; quintile 5 - 30% (start point age 54-56 in 1983)
 - Consistent with GSS self-assessment: 20% of retirees say they are worse off
- Much of the improvement by the mid 1990s
- Reflects programs and economic, financial and labour market circumstances

Incomes of Today's Elderly: Sources

Trend since 1970s

- Declining sources: earnings and investment
 - Stable source: OAS/GIS
 - Increasing sources: C/QPP and 3rd Pillar
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- C/QPP stable since mid 1990s while 3rd pillar continues to grow
 - Some increase in earnings in 2000s

Within elderly

- 3 pillars are important in deciles 1 through 9
- Pillars 1 and 2 important in the bottom half of the distributions
- Pillar 3 important in the middle and upper deciles

Women: income gap closing with glacial speed; less from earnings related sources (C/QPP and RPPs)

Immigrants (all): gap small but sources differ: more from earnings and investment

Incomes of the Future Elderly: Minimum Incomes

- Rapid decrease by any measure: one of lowest in OECD
- Debate about concept, measure and head count
 - o Concentration around measures
- Subsets of concern
 - o Recent immigrants, single women and seniors with dependents: Veall
- Future value of OAS/GIS if real wages grow (OCA assumes 1.3% per annum)
- Equivalence of single/couple guarantees
 - o Couples guarantee is 1.6 times singles; equivalence equals 1.4
- GIS incentive effects

Incomes of the Future Elderly: Earnings Replacement

Place in the context of pension reform discussions

Pension Reform Debates: A Chronology

Late '06 and early '07: 4 provinces (Alberta, British Columbia, Ontario and Nova Scotia) create 3 inquiries to study RPP issues; Alberta and BC have joint inquiry

- Reflect concerns about the regulatory law and declining portion of the workforce in RPPs
- Canada and Quebec have less formal inquiries

Report in late '08 and early '09

- Call for significant regulatory reform (+ some tax and bankruptcy changes)
- Two reports call for the creation of provincial pension plans to deal with declining coverage and other problems

May '09, at F/P/T meeting of finance ministers some provinces call for joint federal provincial action to address declining coverage

- Mintz hired to oversee federal studies of coverage and future income adequacy
- Baldwin produces study for Ontario

December '09, F/P/T finance ministers agree to more study

Pension Reform Debates: Nature of the Reform Proposals (Part 1)

Focus on earnings replacement in the future

- Exceptions: reform packages and Tom Kent
- Underlying concerns
 - o Declining coverage
 - o Scale and governance of RPPs
 - o Security of RPP benefits
 - o Administrative costs of RRSPs
 - o Employers as delivery platforms

Earnings replacement: within a voluntary framework

- Regulatory (provincial inquiries) and tax changes (CD Howe papers and Horner) + new institutional choices

Earnings replacement: beyond the “purely” voluntary: proposals under discussion

- Create new auto-enrolment schemes with strong DC elements (provincial plans, Ambachtsheer’s CSPP proposal)
- Expand the CPP: BC options that reflect CLC, FSNA and CARP

Pension Reform Debates: Nature of the Reform Proposals (Part 2)

Earnings replacement: beyond the “purely” voluntary: points in common

Scepticism about voluntary outcomes; focus on earnings replacement;
future service only; and, acceptance of full pre-funding

Desire to use the CPP administrative/investment platform

Earnings replacement: beyond the “purely” voluntary: points of difference

Instruments: CPP expansion (BR and YMPE) vs new instruments

Earnings coverage: Low end: YBE to multiple; High end: AWS to multiple

Benefit design: CPP: (largely) DB; Others: (largely) DC

Degree of compulsion: Auto-enrolment; Compulsory

Relationship to existing RPPs: Displace; Wrap-around

Employed versus self-employed: Treat the same; Treat differently

Pension Reform Debate: Earnings Replacement

Widely shared conclusions found in Mintz report:

“The first conclusion from the research is that Canadians are by and large doing relatively well in ensuring they have adequate savings for retirement.”

“There is, however, some evidence that not all working Canadians are saving enough to obtain the same level of consumption in their retirement as in their working years.”

Mintz says 20% at risk, drawing on Horner.

Horner for Mintz: % saving enough for 90% consumption level in retirement (@65) by earnings level: all types of household

Low	97
Modest	72
Middle	71
High	68
All	78

Horner expresses the view that RRSP saving is not offsetting the impact of declining RPP participation

Mintz expresses scepticism about the importance of RPP participation and cites Schellenberg and Ostrovsky

Pension Reform Debates: Comment on Earnings Replacement

Historical paradox: declining coverage and growing 3rd pillar income

- Offsetting influences
 - o Increased RRSP use through mid 1990s
 - o Increased emp/pop ratio
 - o Individual versus family coverage
 - o Regulatory reform

Horner, results are similar to other attempts to quantify, but like most attempts to quantify is:

- Highly stylized (deterministic modeling)
- Suppresses view of uncertainty (modality matters)
- Assumes stable institutional and economic environment

Adverse elements in the environment

- Declining coverage without continuing effect of offsets
 - o Increased RRSP use; increasing employment to population ratio; coverage at family level; regulatory change
- Growing ratio of retirement period to working life
- Narrowing gap between investment returns and wage growth
- Maturing RPPs (pensioner/total liabilities; liabilities/payroll)
- Value of OAS/GIS

Substitution or complementary nature of RPP and other wealth

- Needs research
- NB both normative and descriptive/analytical dimensions to the substitution question (note tax support presumes stacking and no other wealth reduction)
- Do pensions as opposed to retirement savings matter; degree of certainty/predictability

Pension Reform Debates: CPP Reform Alternatives (BC Paper plus Alternative 4)

Status quo (SQ): BR is 25%; YMPE=AWS

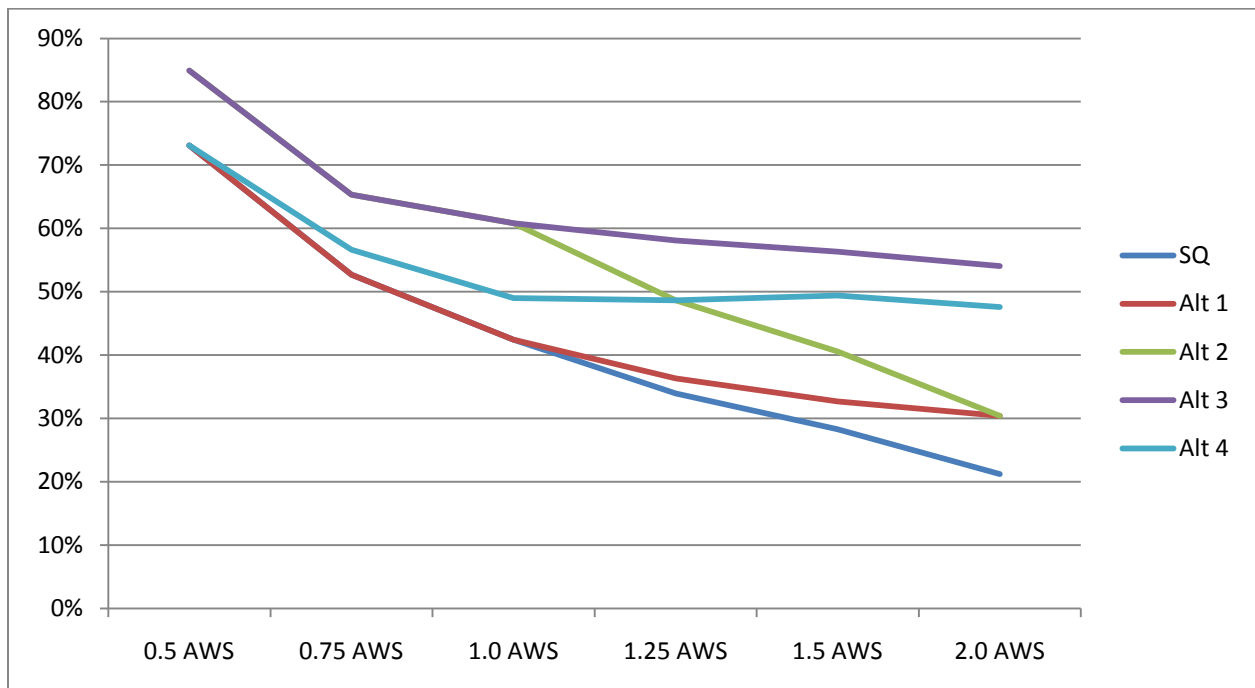
Alternative 1: BR is 25%; YMPE= 2 x AWS

Alternative 2: BR is 50%; YMPE = AWS

Alternative 3: BR is 50%; YMPE = 2 x AWS

Alternative 4: SQ + tier 2 with BR is 25% and contributory earnings of 0.5 AWS to 2.0 x AWS

Pension Reform Debates: Stylized Impacts of CPP Expansion



Pension Reform Debates: Some Concluding Thoughts

Big (Obvious) Unresolved Issues

- Degree of need (range of opinions)
- Appropriate role of compulsion

Somewhat less obvious

- Flexibility of CPP platform
- Choice of benefit design (beyond DB and DC)
- Implications of fully pre-funding CPP
 - o Contribution rate volatility
 - o Investment program

Mintz summary report and related research studies: www.fin.gc.ca

Ontario (Baldwin) report: www.gov.on.ca