



**CANADA'S PENSION SYSTEM IN AN
INTERNATIONAL PERSPECTIVE**

RETIREMENT INCOME AND MIDDLE-INCOME CANADIANS

QUEEN'S INTERNATIONAL INSTITUTE ON SOCIAL POLICY

20 AUGUST 2014

Hervé Boulhol
Senior Economist (Pensions and Population Ageing)
Directorate for Employment, Labour and Social Affairs

***Canada's old-age pension system in
an international perspective***

- Three-pillar system is generally working well
- Old-age poverty is relatively low
- Average income of senior people is relatively high
- The system offers a well-diversified stream of retirement income
- The financial sustainability of the pension system is better than in most OECD countries
- Pension system relies more heavily than most on private and optional saving plans
- There are some concerns about the income adequacy of about 15 to 30% of future retirees (in the middle-income part of the distribution)
- The current structure of private schemes might generate inefficiencies
- Recent progress in the policy framework, but additional steps might be needed

2

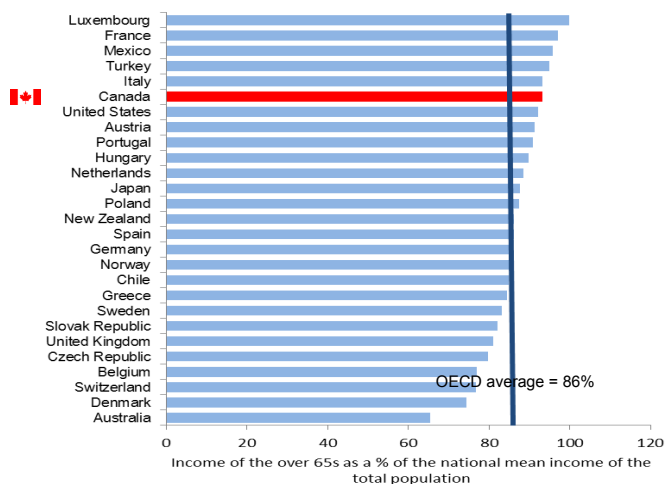
A three-pillar system that is generally working well

- First pillar of the pension system (OAS, GIS) is an effective safety net
- The second pillar, public and mandatory, provides a relatively small protection above average earnings (target replacement rate equals 25% up to roughly the average wage)
- The third pillar, private and voluntary, plays a bigger role than elsewhere, but coverage is low for middle-income earners (Antolin, 2008). Concerns due to declining coverage in a context of increasing longevity

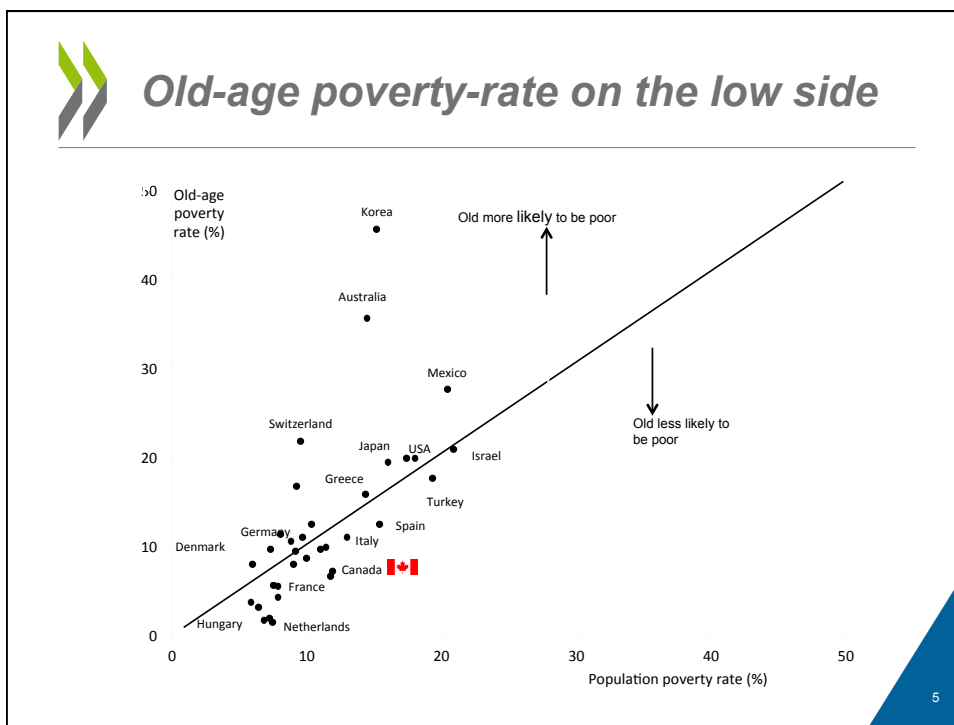
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Average income of the over 65s is relatively high

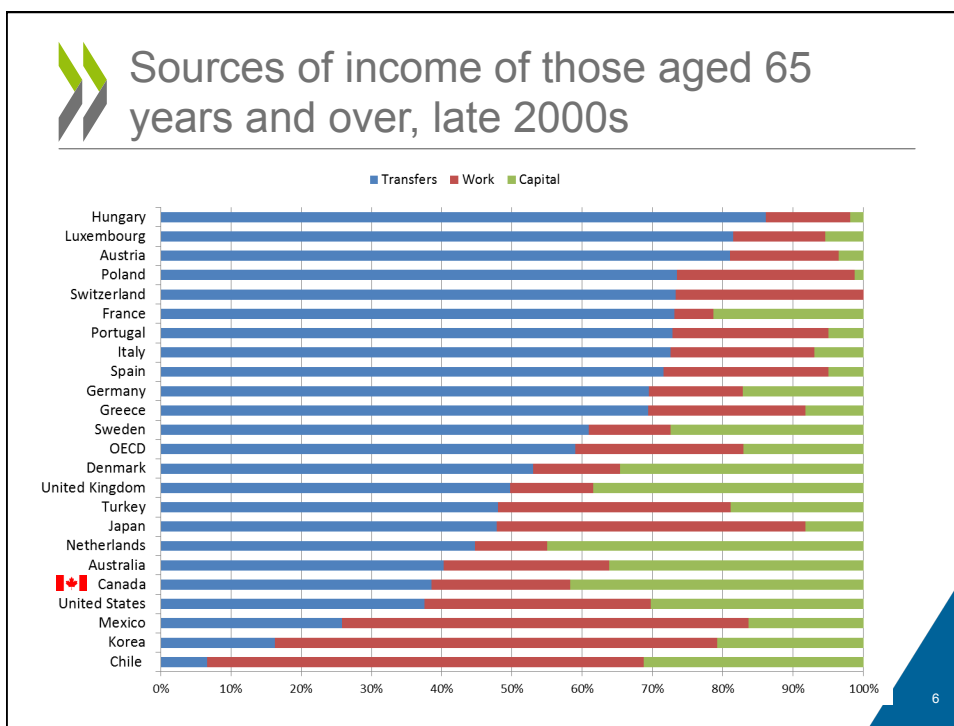
Relative income of the over 65s, late 2000s



4



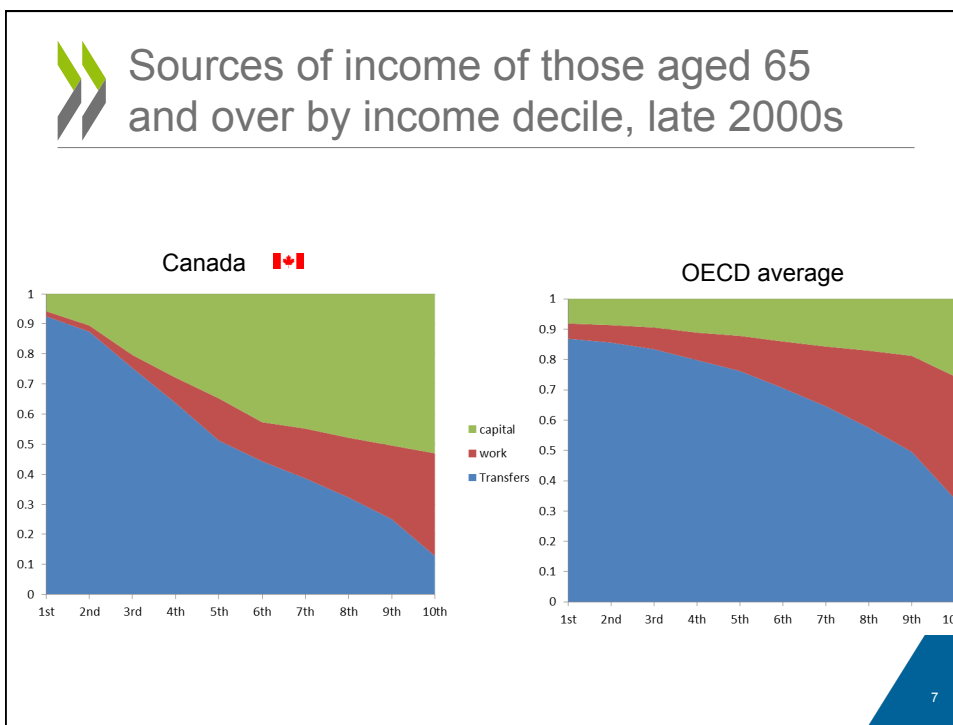
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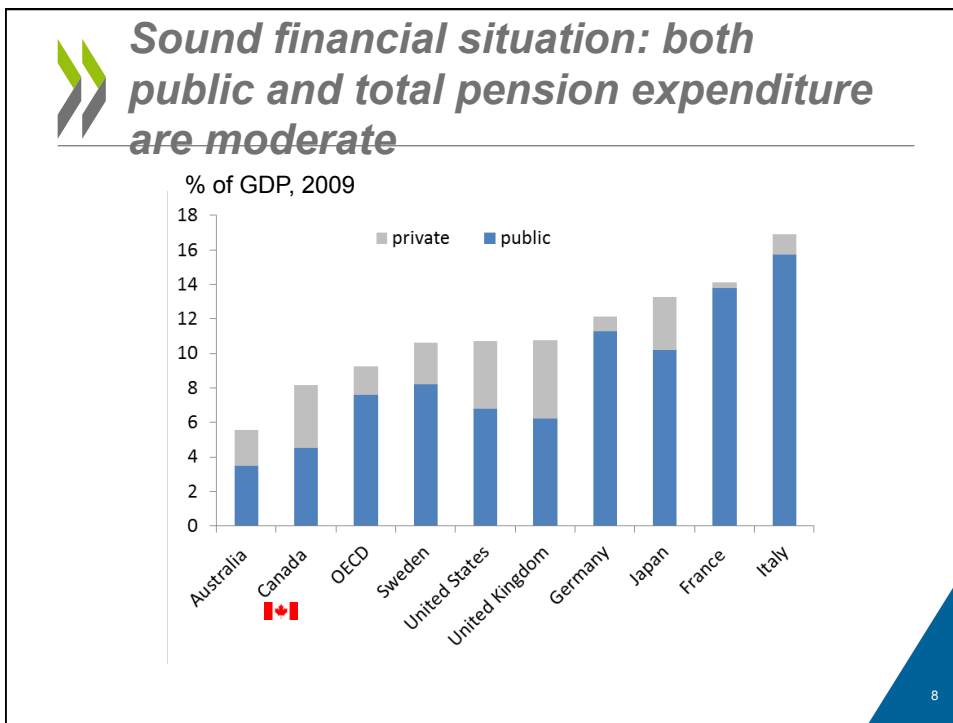
Sources of income of those aged 65 and over by income decile, late 2000s



7



Sound financial situation: both public and total pension expenditure are moderate



8



Sound financial situation

- In comparison to many OECD countries, Canada spends a smaller share of its total revenues on pension (public and total)
- It will be facing similar ageing challenges: low albeit improving (until 2009) fertility rates, substantial gains in life expectancy, potentially lower capital returns
- Canada is in a relatively favourable situation in terms of the financial sustainability of the pension system, leaving more space to tackle ageing issues (and possibly on top of it to increase contributions)

9



OECD projections of theoretical replacement rates

Key assumptions:

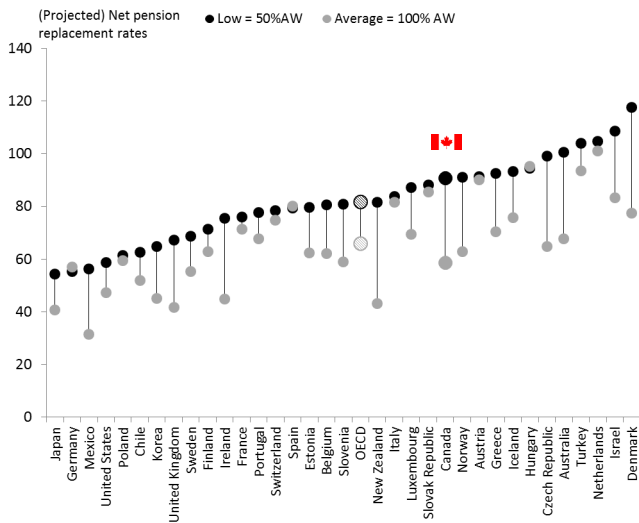
- Full career for a worker entering the labour market at age 20 in 2012
- First-pillar benefits are indexed to earnings
- Real annual return on financial assets is 3.5%
- For Canada, private pension schemes are assumed to be defined-contribution with an 8.5% contribution rate

(this is a tricky assumption: total private contributions have been equal to 8-9% of total compensations, but coverage is about 50% and varies a lot as a function of age and income)

10

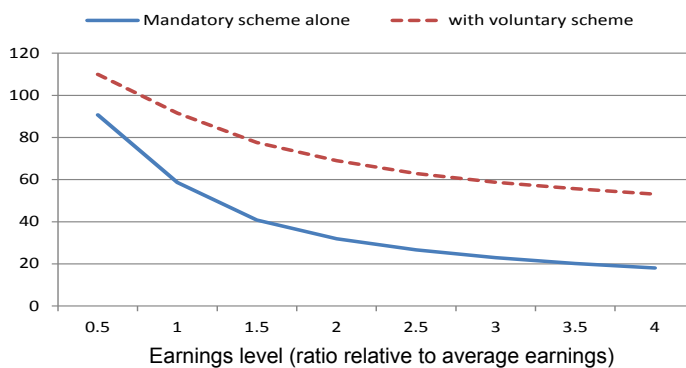


Theoretical net replacement rates from mandatory schemes



Low earners relying on the public system and workers who subscribe to private schemes would have relatively high replacement rates


Net replacement rates (%), by earnings level





Middle-income workers not covered by a private scheme would have low replacement rates

Net replacement rates (%) for three earning levels (ratio of average earnings)


	Public alone			Total mandatory			Total with voluntary		
	0.5	1	1.5	0.5	1	1.5	0.5	1	1.5
Australia	..	..	..	100.5	67.7	54.3	100.5	67.7	54.3
 Canada	90.7	58.6	40.8	90.7	58.6	40.8	110.0	91.5	77.6
France	75.9	71.4	60.9	75.9	71.4	60.9	75.9	71.4	60.9
Germany	55.9	55.3	54.4	55.9	55.3	54.4	77.2	76.4	75.2
Italy	78.0	78.2	77.9	78.0	78.2	77.9	78.0	78.2	77.9
Japan	54.3	40.8	35.7	54.3	40.8	35.7	54.3	40.8	35.7
Mexico	..	..	..	56.2	31.5	31.3	56.2	31.5	31.3
Netherlands	..	..	..	104.8	101.1	97.2	104.8	101.1	97.2
New Zealand	83.0	43.5	30.6	83.0	43.5	30.6	97.5	58.7	46.6
Sweden	..	..	..	68.8	55.3	72.9	68.8	55.3	72.9
United Kingdom	61.7	38.0	27.2	61.7	38.0	27.2	100.3	78.1	68.9
United States	56.2	44.8	40.4	56.2	44.8	40.4	99.1	88.9	86.2
OECD34	65.7	48.7	42.6	79.4	64.1	58.3	100.1	79.5	71.4

13



Coverage of private pension schemes

Coverage of private pension schemes by type of plan, 2011

	Mandatory / Quasi-mandatory	Voluntary		
		Occupational	Personal	Total
Australia	68.5	n.a.	19.9	19.9
 Canada	n.a.	33.4	32.8	about 50
France	n.a.	16.5	5.4	..
Germany	n.a.	56.4	35.2	71.3
Italy	n.a.	7.5	6.9	14.0
Japan	..	..	..	..
Mexico	59.5	1.9	n.a.	1.9
Sweden	about 100	n.a.	27.1	27.1
United Kingdom	n.a.	30.0	11.1	43.3
United States	n.a.	41.6	22.0	47.1

14



Three main issues

1. Indexation of the first pillar to inflation might weaken protection over time if wage growth becomes more dynamic
2. The insufficient coverage of (young and) middle-income workers by private pension schemes could threaten adequacy.
3. The current framework of private pensions is likely to generate inefficiencies

15



Towards a better coverage of middle-income workers?

If the goal is to increase coverage for a specific group of workers:

- If people do not choose to participate and if that is considered as detrimental to them, an additional quasi-mandatory part is needed (mandatory or at least subject to auto-enrolment with good incentives, see NZL and UK)
- Whether this additional part should be DB or DC is not discussed here. Both have their strengths and weaknesses.
- The reduced flexibility would have some downsides of course
- Canada has a well diversified system, however, one might wonder what is the objective of the public DB scheme and whether its parameters (low target benefit rate and only up to a low threshold) are consistent with those objectives given the risk of insufficient coverage by private schemes
- The contribution parameters of a new scheme should be defined to target middle-income earners (wage floor and wage ceiling leading to new contributions, somewhere between roughly 0.8 and 2 average wages)

16



Towards a better coverage of middle-income workers?

If the goal is to increase coverage, and if the chosen option is to strengthen private schemes, some questions need to be addressed.

- The new scheme should be designed in a way that:
 - ensure portability and is not an obstacle to labour mobility. Current occupational DB schemes (and maybe DC too) limit labour mobility
 - limit administrative / management cost. There is some evidence that current administrative costs are too high (esp. RRSPs)

Achieving this would be greatly helped by the introduction at the federal level of pooled instruments offering limited investment options. The PRPP proposition is important and goes in the right direction. It will improve efficiency, but will depend on implementations; so far it is not necessarily well targeted to improve coverage of middle-income earners

- Individual longevity risks
- Higher employment of senior workers might be part of a comprehensive strategy to boost pension adequacy for middle-income earners (age eligibility to benefit from CPP / QPP without penalty might be increased and tax incentives might be improved for middle incomes)



Canada's employment for senior workers is not high

