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POLICY BRIEF

Are Today's Working Canadians Saving Enough for Tomorrow's Retirement?

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Highlights

- In the last 30 years, the rate of low income among seniors has fallen to a fifth of its earlier level. But questions remain about the stability of this trend for future cohorts of retirees.
- Two of Canada's three main pillars for retirement income, OAS/GIS and CPP/QPP, provide a foundation on which to build. Evidence on the third pillar, private pensions and registered savings, is decidedly mixed. Evidence on a fourth pillar, housing and other assets, is currently very sparse.
- Canadians have not responded to increases in RRSP contribution limits and are actually saving a smaller proportion of their allowable room today than in 2000.
- Coverage in workplace pensions has declined for men but risen for women, leading to an overall modest increase in the last 30 years.

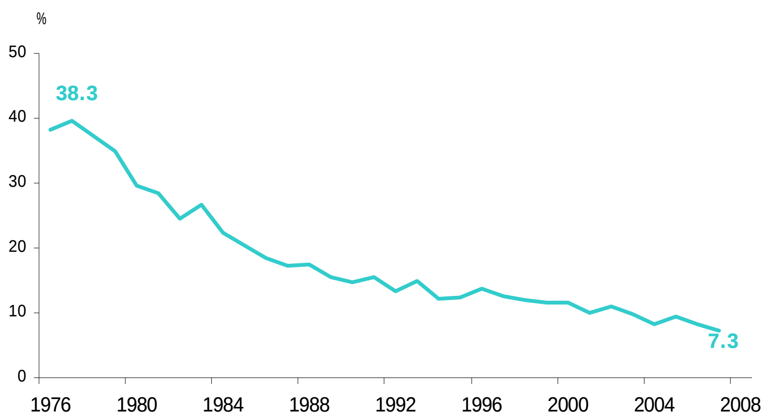
Canada's retirement income system has long been based on three fundamental pillars: seniors' benefits such as Old Age Security (OAS) and the Guaranteed Income Supplement (GIS); mandatory public pensions—notably the Canada Pension Plan (CPP) and Quebec Pension Plan (QPP); and voluntary private savings or workplace pensions. In addition to these, individuals and households build up savings and assets, for example through unregistered assets and housing, which make up a fourth but little-examined pillar.

Today's seniors have incomes substantially higher than seniors 30 years ago and the frequency of low income among today's retirees is less than a fifth of what it was in 1976 (Figure 1). Yet recent studies and reports have raised concerns about the adequacy of Canada's retirement system for the next and future waves of retirees.

Canada

The first two pillars (seniors' benefits and the CPP/QPP) have remained largely stable since the mid-1990s and now make up, on average, more than half of household income for Canadian seniors. Little can currently be said about the fourth pillar given the limited data on assets and net worth. But a number of questions are being raised about how the third pillar is performing: Are Canadians voluntarily setting aside enough for their own retirement through private pensions and registered savings? What is meant by "enough" when it comes to retirement savings? Are Canadians saving all they can within tax rules? Are Canadians saving within employer pension plans? What can we project about future retirement incomes?

Figure 1 - % at or Below Low Income Cut-off (after tax) all households 65+, 1976-2007

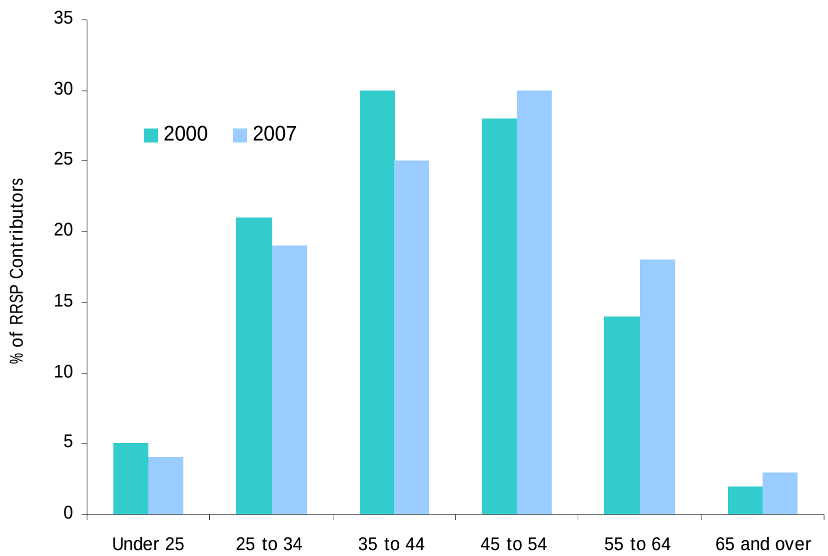


Source: Statistics Canada, CANSIM Table 202-0803

Underuse of RRSPs

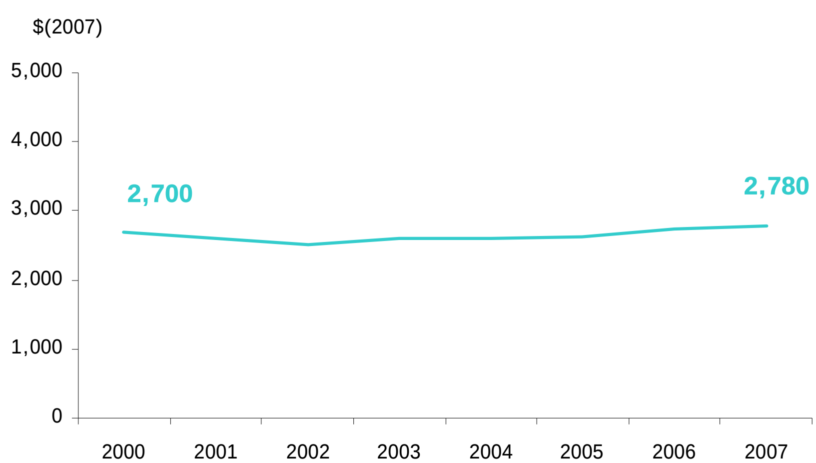
Registered Retirement Savings Plans (RRSPs) enable taxpayers to defer, smooth out, and reduce lifetime taxation by saving for retirement in a registered vehicle, receiving a deduction on current taxable income, and paying tax on withdrawals in retirement when total taxable income is expected to be lower. Compared with 10 years ago, Canadians under age 45 are somewhat less likely to be contributing to an RRSP. At the same time, Canadians aged 45 and older are today more likely than 10 years ago to be setting money aside in an RRSP (Figure 2). Quite apart from suggesting an overall decline in RRSP use, the data suggest Canadians may be postponing their RRSP contributions until later in life. This trend may be related to other life course changes such as prolonged transitions from school to work and a possible extension of working life beyond a traditional age of retirement.

Figure 2 - RRSP Participation by Contributor Age (2000 and 2007)



Source: Statistics Canada, RRSP Contributions, Annual, CANSIM Table 111-039

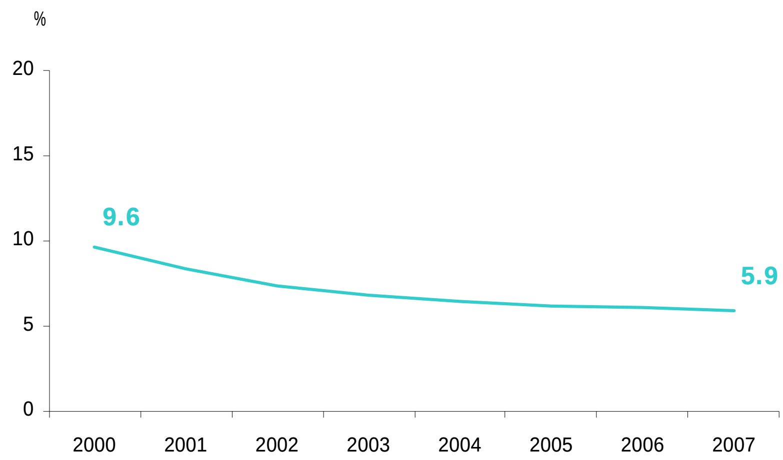
Figure 3 - Median Annual RRSP Contribution ($)



Source: Statistics Canada, RRSP Contributions, Annual, CANSIM Table 111-039

The last 10 years have seen the annual contribution limits increase (in constant 2010 dollars) from $16,400 in 2000 to $22,000 in 2010. Actual contribution room depends on several factors, such as income, registered pension contributions, and room carried over from previous years. However, RRSP contributions have remained flat over the same period (Figure 3). Compared with how much they could be saving (measured by RRSP room), Canadians are actually saving less – down from 9.6 percent of available contribution room in 2000 to 5.9 percent in 2007 (Figure 4).

Figure 4 - Proportion of RRSP Room used by Contributors (%)

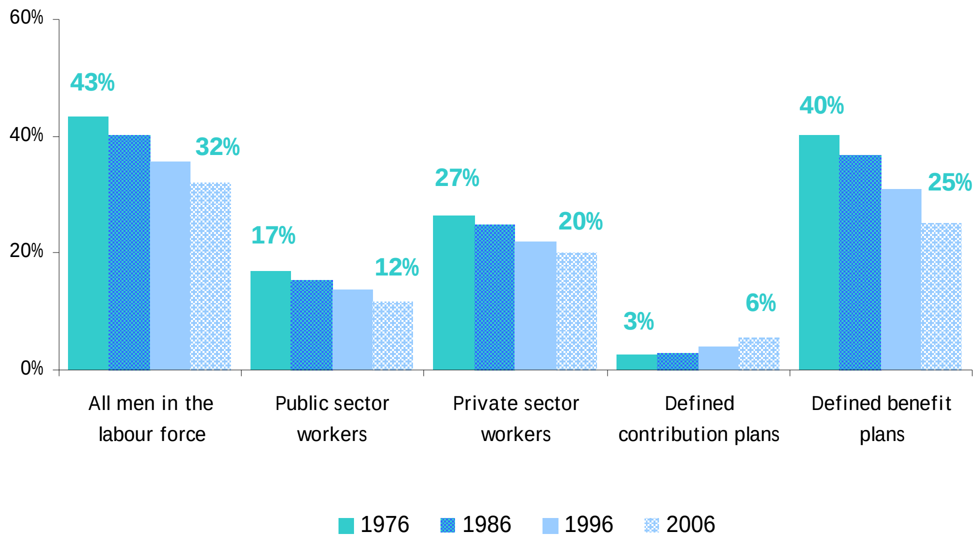


Source: Statistics Canada, RRSP Contributions, Annual, CANSIM Table 111-039

Coverage in Employer-Sponsored Plans

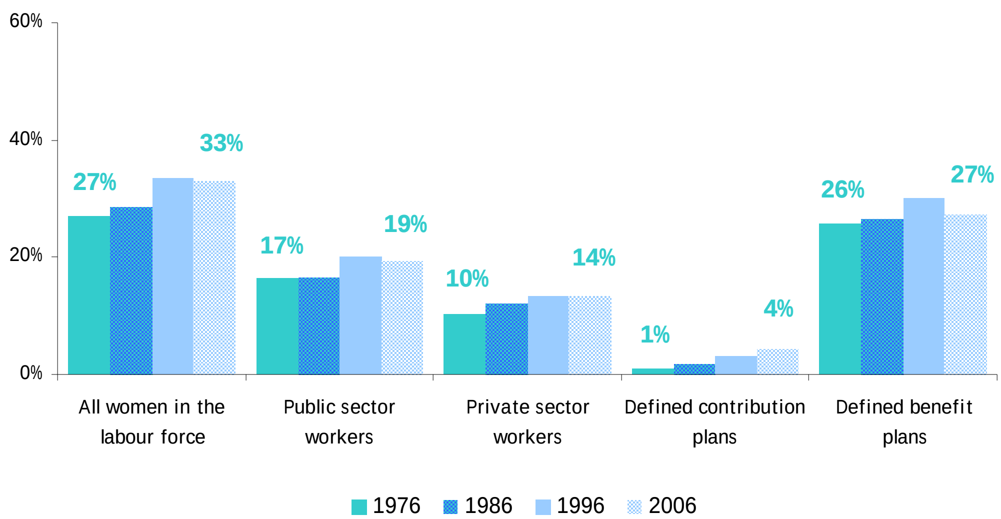
Other countries (such as the United States and the United Kingdom) have seen sharp declines in pension coverage rates. Some recent media attention has also raised concern about coverage in pensions for Canadian workers. Given that income from private pensions accounts for nearly half of median income among Canadian seniors, a major decrease in coverage rates could spell future trouble. However, the proportion of the workforce with a workplace pension was just 37 percent in 1976 and is down only 5 percentage points to 32 percent today. The patterns for men and women have gone in nearly opposite directions in the last 30 years so that overall coverage levels are now equal. Moreover, men have experienced a decline in defined benefit plan coverage such that women are now more likely than men to be members of a defined benefit pension (Figures 5 and 6). Among previous generations, women have been at greater risk of poverty in old age, largely due to weaker labour force participation rates and very limited access to employer registered pension plans (RPPs) or the CPP. For future retirees, gender differences in risks may be less important than differences among workers with and without workplace pensions, or differences among members of plans with defined benefits for employees and those with defined contributions from employers.

Figure 5 - Proportion of Adult Males in the Labour Force with a Workplace Pension by Sector and Pension Type (1976 to 2006)



Source: Statistics Canada, Labour Force Survey, CANSIM Table 292-002

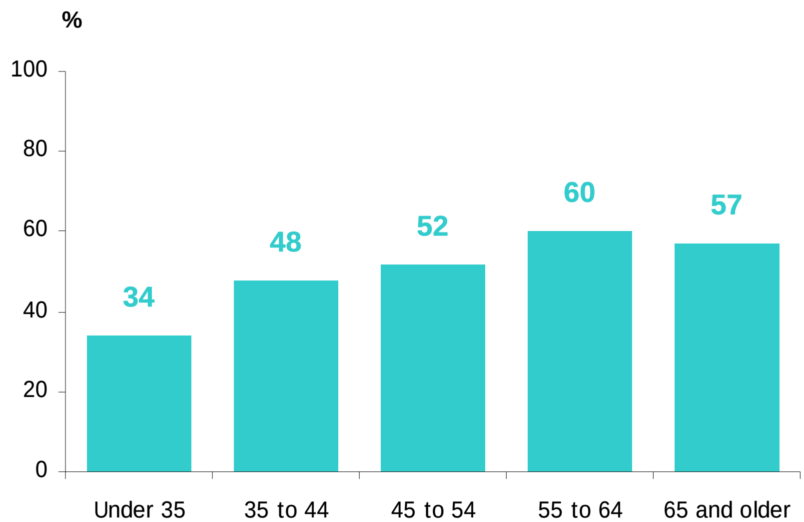
Figure 6 - Proportion of Adult Women in the Labour Force with a Workplace Pension by Sector and Pension Type (1976 to 2006)



Source: Statistics Canada, Labour Force Survey, CANSIM Table 292-002

Some of the changing patterns can likely be explained through larger labour market shifts and conversion to defined contribution plans among some private sector employers. Age also appears to play a role as participation in an employer-sponsored plan does rise with age (Figure 7). On an individual basis, only a minority of workers in Canada have a workplace pension but the proportion is higher when we look at households, most of which are composed of couples where both partners are part of the labour force. To the extent that this pattern may reflect the needs and preferences of older workers, an aging population (coupled with greater bargaining power for workers in tightening labour markets), it is possible that employer pensions will remain reasonably common in Canada, even if they never cover all or even the large majority of the workforce.

Figure 7 - Proportion of Canadian Families with Employer-paid Pension Assets by Age of Head of Household (2005)



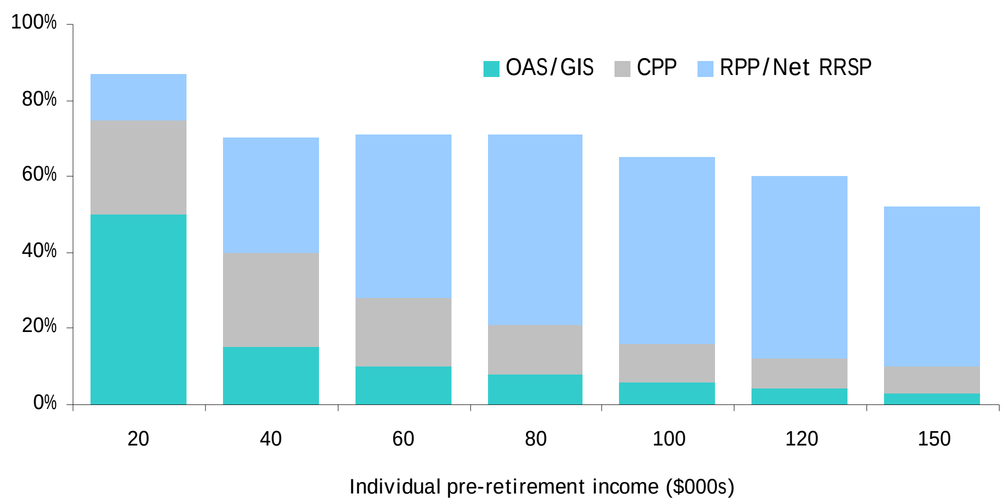
Source: Statistics Canada, Survey of Financial Security

What can we Forecast about the Future Adequacy of Retirement Incomes in Canada?

One way to project the future adequacy of retirement savings is to look at the proportion of income in working years that would be replaced by combining retirement income from the three main pillars: seniors' benefits (OAS/GIS), mandatory public pensions (CPP/QPP), and voluntary private savings or workplace pensions. It's important to note that these projections cannot take into account non-registered financial assets or the value of housing equity that can be important sources of financial security in retirement. As reported by a expert panel to the Minister of Finance (Mintz, 2009), projected replacement rates (given current savings rates, pension contributions, and CPP entitlements) show a wide range of variation: from as low as just over 50 percent to nearly 90 percent of pre-retirement income (Figure 8).

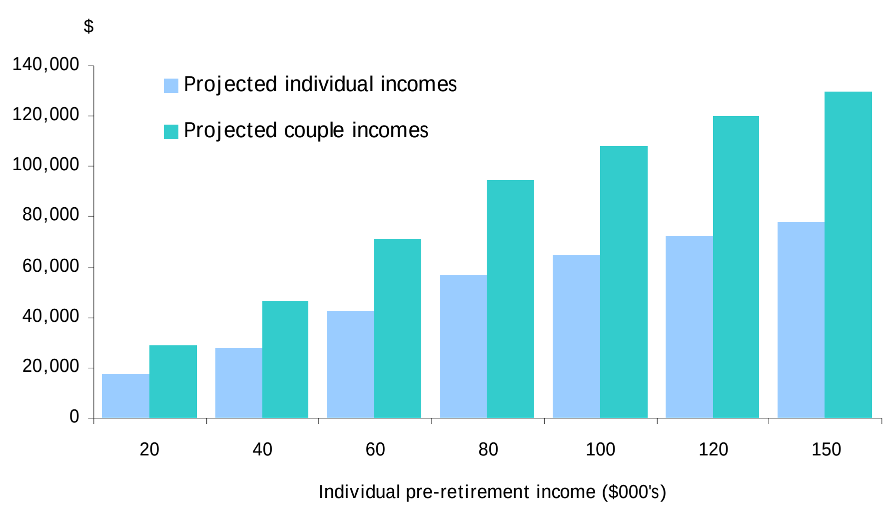
But when these figures are converted into dollar amounts for individuals and couples, the distribution looks quite different (Figure 9, over). Across the pre-retirement income categories, only singles earning an average of $20,000 or less per year in their working life would be expected to have a retirement income below the after-tax low income cut-off (the LICO was $18,373 in 2008 for singles in medium or large cities). Meanwhile, all singles earning an average of $60,000 or more would have enough income to put them in the richest half of seniors by today's standards. Furthermore, presuming that patterns in male to female earnings of couples stay about the same (an assumption that may not hold as women today outpace men in post-secondary education), all couples would have enough retirement income to keep them out of poverty. Even looking at singles with the lowest projected replacement rates (50 percent - among those earning an average of $150,000 per year), these would still be expected to have nearly $80,000 in individual income for retirement. Among couples, the model predicts an even higher retirement income of $130,000, despite a low replacement rate, relative to working life income.

Figure 8 - Estimated Replacement Rates, all Individuals



Source: Mintz (2009)

Figure 9 - Projected Annual Retirement Incomes based on 2006 Data



Source: Calculations based on data in Mintz (2009) and Statistics Canada CANSIM Tables 111-0021 and 202-0202

Box 1: What can Studies of Typical Cases tell us about Individual Canadians?

Results generated using models, as in the figures above, are based on aggregate data so do not predict the actual replacement rates or retirement incomes of individual Canadians. In other words, they are based on prototypes meant to represent averages while in reality few if any individual Canadians will fit the prototype. But the findings from the models are not inconsistent with other studies that use individual tax data. For example, Ostrovsky and Schellenberg (2009) find that replacement rates from seniors' benefits and public pensions are higher among seniors with lower pre-retirement incomes. They also find that total replacement rates, also taking into account income from RRSPs, voluntary pensions, and other market sources, ranged between 120 percent and 65 percent for men and between 170 percent and 90 percent for women. Generally the replacement rates were inversely related to pre-retirement income but not consistently so, especially for women. Interestingly, the authors find that membership in a private pension is not correlated with retirement income replacement rates: among women, replacement rates were generally higher for women with a private pension but the opposite was true among men. What this suggests is that more complex models are needed to accurately predict the future adequacy of retirement incomes in Canada. And again, it's important to note what replacement rates (whether high or low) mean in terms of real dollars: for example, even for those with the highest total replacement rates the net result is a projected retirement income that can be as low as $12,000 annually.

Where are the Risks for Future Retirement Incomes in Canada?

Most Canadians retire with a partner and share their retirement savings and incomes. Will couples in the future be better or worse off compared with their parents and grandparents? Now that Canadians are postponing their RRSP contributions, will they fast-track their savings or postpone their retirement? And in either case, will they have enough to make up for lost time? Will Canadians switch jobs to gain better access to pension benefits as they get older and what could this mean for their retirement outcomes? In the face of tightening labour supply, will employees have more power to ask for more generous or more responsive pension benefits? What does "adequacy" mean to Canadians for retirement savings now and into the future? What resources will households need to pay for future retirement costs of older age including housing, drug costs, and personal care over longer life spans? How can we take into account the financial and fixed assets outside of pensions and registered savings as part of retirement portfolios? What options will future Canadian retirees have for mobilizing their financial and fixed assets and how might intergenerational income and asset flows and bequests shape outcomes?

There are myriad questions still to be examined. While new and ongoing data is required to answer some of these questions, research and analysis can also benefit from considering both the adequacy of savings for retirement (including unregistered assets) as well as the agency of the individual or household; in other words, the choices and constraints that can shape the ability of individuals and households to make decisions regarding their own retirement planning. This dimension can change over a lifetime and can be suddenly and dramatically affected by external events or institutional changes. Adequacy will, of course remain an essential dimension of retirement income policy. At the same time, real outcomes are also shaped by ability to take action and make choices.

References

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