The Canadian Pension System

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Outline of presentation

- Overview of the pension system
- Is the system meeting its objectives?
- Will the system continue to meet its objectives with an ageing society?
  - Financial sustainability
  - Evolving incomes of seniors
- Conclusions
Overview of the Canadian pension system
Core objectives

- Poverty avoidance: *Ensuring a minimum income to the elderly*

- Income replacement: *Assisting seniors to maintain pre-retirement living standards after retirement*
## Multi-pillared system

<table>
<thead>
<tr>
<th><strong>World Bank model</strong></th>
<th><strong>Canada</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Zero&quot; pillar:</td>
<td>Old Age Security</td>
</tr>
<tr>
<td>Non-contributory, ensures minimal protection</td>
<td></td>
</tr>
<tr>
<td><strong>1st pillar:</strong></td>
<td>Canada/Quebec Pension Plans</td>
</tr>
<tr>
<td>Contributory, earnings-related</td>
<td></td>
</tr>
<tr>
<td><strong>2nd pillar:</strong></td>
<td>---</td>
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<tr>
<td>Mandatory, individual accounts</td>
<td></td>
</tr>
<tr>
<td><strong>3rd pillar:</strong></td>
<td>Registered pension plans, retirement savings plans</td>
</tr>
<tr>
<td>Voluntary arrangements</td>
<td></td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>Universal health care insurance, etc.</td>
</tr>
</tbody>
</table>
Old Age Security

- Objective: Mainly poverty avoidance, but also income replacement for low- and modest-income workers
- Non-contributory
- Financed entirely from general tax revenues
- Entitlement based on age, length of residence in Canada and income
Old Age Security

- **Benefit amounts**
  (July-September 2005, monthly, maximum)
  - Basic pension: CAD\(^{(a)}\) 476.97
  - Supplement (single): 566.87
  - Supplement (married): 369.24

- **Beneficiaries**
  (March 2005)
  - 4.1 M\(^{(b)}\)

- **Cost**
  (2005/06, estimated)
  - CAD 29.7 B\(^{(c)}\)

\[(a)\text{ CAD 1.00} = \text{JYP 92}\quad (b)\text{ M} = \text{Million}\quad (c)\text{ B} = \text{Billion}\]
Canada/Quebec Pension Plans

- **Objective:** Income replacement
- **Cover all employed & self-employed persons in Canada**
  - Quebec Pension Plan (QPP): Employees working in Quebec, self-employed persons residing in Quebec
  - Canada Pension Plan (CPP): All others
- Coordinated through agreements between federal/Quebec governments
Canada/Quebec Pension Plans

- Contributory, social insurance
  - Contribution rate: 9.9%
  - Basic exemption: CAD 3,500
  - Maximum contributory earnings (2005): CAD 41,100

- Partially funded
- Financed entirely by contributions and investment earnings
Canada/Quebec Pension Plans

**Benefit amounts**
(2005, monthly, maximum)

- **Retirement**  
  CAD 828.75
- **Disability**  
  1,010.23
- **Survivor <65**  
  (a) 462.42
- **Survivor 65+**  
  497.25
- **Children**  
  (b) 195.96
- **Death (one-time lump-sum)**  
  2,500.00

(a) For QPP, CAD 410.31-710.37  
(b) For QPP, CAD 62.22
## Canada/Quebec Pension Plans

- **Contributors** (2002) 14.9 M
  - Canada Pension Plan 11.3 M
  - Quebec Pension Plan 3.6 M

- **Beneficiaries** (March 2005) 5.3 M

- **Cost** (2005/06, estimated) CAD 32.8 B
  - Canada Pension Plan CAD 24.9 B
  - Quebec Pension Plan 7.9 B
Tax-assisted retirement savings

- Objective: Income replacement
- Registered pension plans, registered retirement savings plans
- Contributions deductible from taxable income to a limit: 18% of earnings, up to CAD 16,500 (RRSPs, 2005)
- Investment earnings not subject to tax as long as they remain in plan
- Benefits/withdrawals subject to tax
Tax-assisted retirement savings

- Registered pension plans:
  - Contractual arrangements, usually between a company and its employees
  - Voluntary – no private company is required by law to have a pension plan; however, usually mandatory for employees of a company with a plan
  - Regulated by federal and provincial laws
  - Also subject to requirements of the *Income Tax Act*
Tax-assisted retirement savings

- Registered pension plans (2003)
  - Plans (number) 14,376
  - Members (number) 5.5 M
  - Contributions (total) CAD 23.5 B
  - Pensions paid (number) (a) 2.8 M
  - Pensions paid (amount) (a) CAD 41.0 B
  - Assets (total) CAD 794.1 B

(a) Data for 2002
Tax-assisted retirement savings

- Registered retirement savings plans:
  - Individual retirement savings accounts
  - Entirely voluntary
  - Subject to requirements of the *Income Tax Act*
  - Wide range of investment possibilities: mutual funds, guaranteed income certificates, stocks and bonds, etc.
Tax-assisted retirement savings

- Registered retirement savings plans (2002)
  - Plans (number) N/A
  - Contributors (number) 6.0 M
  - Contributions (total) CAD 27.1 B
  - Benefits paid (number) N/A
  - Benefits paid (amount) CAD 6.3 B
  - Assets (total) CAD 292.5 B
Tax-assisted retirement savings

- Cost of related “tax expenditures”
  (tax foregone because of deductibility of contributions and non-taxability of investment earnings, less tax collected on payments and withdrawals)
  - Registered pension plans (2005, estimated) CAD 10.7 B
  - Registered retirement savings plans (idem) CAD 12.6 B
Is the Canadian pension system meeting its objectives?
Objective: Poverty avoidance

Low-income: Seniors / All Canadians

Source: Statistics Canada
Objective: Poverty avoidance

Low income: International comparisons

<table>
<thead>
<tr>
<th>Country</th>
<th>Percent with low income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>2.7</td>
</tr>
<tr>
<td>Finland</td>
<td>5.2</td>
</tr>
<tr>
<td>Canada</td>
<td>5.3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6.4</td>
</tr>
<tr>
<td>Denmark</td>
<td>6.6</td>
</tr>
<tr>
<td>Germany</td>
<td>7.0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>8.4</td>
</tr>
<tr>
<td>France</td>
<td>9.8</td>
</tr>
<tr>
<td>Austria</td>
<td>10.3</td>
</tr>
<tr>
<td>Italy</td>
<td>12.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>13.7</td>
</tr>
<tr>
<td>Norway</td>
<td>14.5</td>
</tr>
<tr>
<td>Belgium</td>
<td>15.1</td>
</tr>
<tr>
<td>United States</td>
<td>20.7</td>
</tr>
</tbody>
</table>

Source: Luxemburg Income Study Working Papers
Objective: Income replacement

Average income: Seniors / Non-seniors

Source: Statistics Canada
Objective: Income replacement

Replacement rates of public programs (OAS, C/QPP)

<table>
<thead>
<tr>
<th></th>
<th>% of pre-retirement income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single person, half</td>
<td>73%</td>
</tr>
<tr>
<td>average wage</td>
<td></td>
</tr>
<tr>
<td>Couple, one earner,</td>
<td>62%</td>
</tr>
<tr>
<td>half average wage</td>
<td></td>
</tr>
<tr>
<td>Couple, one earner,</td>
<td>111%</td>
</tr>
<tr>
<td>average wage</td>
<td></td>
</tr>
<tr>
<td>Couple, two earners,</td>
<td>62%</td>
</tr>
<tr>
<td>each half average</td>
<td></td>
</tr>
<tr>
<td>wage</td>
<td></td>
</tr>
<tr>
<td>Couple, two earners,</td>
<td>38%</td>
</tr>
<tr>
<td>each average wage</td>
<td></td>
</tr>
</tbody>
</table>

Legend:
- Supplement
- C/QPP
- OAS-Basic
Will the Canadian pension system continue to meet its objectives with an ageing society?
Ageing of Canada’s population

Percentage of population aged 65+

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>13.1</td>
</tr>
<tr>
<td>2010</td>
<td>14.2</td>
</tr>
<tr>
<td>2015</td>
<td>16.2</td>
</tr>
<tr>
<td>2020</td>
<td>18.4</td>
</tr>
<tr>
<td>2025</td>
<td>20.1</td>
</tr>
<tr>
<td>2030</td>
<td>23.0</td>
</tr>
</tbody>
</table>

Source: Office of the Chief Actuary
Ageing of Canada’s population

Ratio of persons 20-64 to persons 65+

Source: Office of the Chief Actuary
Ageing of Canada’s population

Life expectancy at age 65

<table>
<thead>
<tr>
<th>Years</th>
<th>1966</th>
<th>2005</th>
<th>2025</th>
<th>2075</th>
</tr>
</thead>
<tbody>
<tr>
<td>Males</td>
<td>13.8</td>
<td>17.6</td>
<td>19.1</td>
<td>20.9</td>
</tr>
<tr>
<td>Females</td>
<td>16.8</td>
<td>20.8</td>
<td>21.7</td>
<td>23.5</td>
</tr>
</tbody>
</table>

Source: Office of the Chief Actuary
Financial sustainability
Financial sustainability

- Prior to 1997 reform of the financing of the Canada Pension Plan (CPP):
  - Plan was pay-as-you go, with small reserve fund equal to two years’ costs (benefits and administration)
  - Contribution rate was forecast to reach 14.2 percent by 2030
With 1997 reform of CPP financing:

- Plan is partially funded (to reach about 25 percent of total liabilities), with reserve fund to exceed five years’ costs
- Contribution rate will remain at 9.9 percent (“steady-state rate”) for the indefinite future
Financial sustainability

- Principal elements of 1997 reform:
  - Rapid increase to 9.9 percent contribution rate
  - New investment strategy – creation of the Canada Pension Plan Investment Board
  - Freezing of the basic exemption at the 1997 level of CAD 3,500
### Financial sustainability

**Increase in the contribution rate**

<table>
<thead>
<tr>
<th>Year</th>
<th>Pre-reform</th>
<th>Post-reform</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>5.85</td>
<td>6.0</td>
<td>+0.15</td>
</tr>
<tr>
<td>1998</td>
<td>6.10</td>
<td>6.4</td>
<td>+0.30</td>
</tr>
<tr>
<td>1999</td>
<td>6.35</td>
<td>7.0</td>
<td>+0.65</td>
</tr>
<tr>
<td>2000</td>
<td>6.60</td>
<td>7.8</td>
<td>+1.20</td>
</tr>
<tr>
<td>2001</td>
<td>6.85</td>
<td>8.6</td>
<td>+1.75</td>
</tr>
<tr>
<td>2002</td>
<td>7.10</td>
<td>9.4</td>
<td>+2.30</td>
</tr>
<tr>
<td>2003</td>
<td>7.35</td>
<td>9.9</td>
<td>+2.55</td>
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</tbody>
</table>
## Financial sustainability

### Increase in the contribution rate

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<tr>
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<td>7.60</td>
<td>9.9</td>
<td>+2.30</td>
</tr>
<tr>
<td>2005</td>
<td>7.85</td>
<td>9.9</td>
<td>+2.05</td>
</tr>
<tr>
<td>2006</td>
<td>8.10</td>
<td>9.9</td>
<td>+1.80</td>
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<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
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<tr>
<td>2016</td>
<td>10.1</td>
<td>9.9</td>
<td>-0.20</td>
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<td>...</td>
<td>...</td>
</tr>
<tr>
<td>2030</td>
<td>14.2</td>
<td>9.9</td>
<td>-4.30</td>
</tr>
</tbody>
</table>
Financial sustainability

- New investment strategy:
  - **Objective:** Increase the average annual real rate of return on the reserve fund to 4.1 percent
  - **Approach:** Diversify the assets in the reserve fund to resemble those of occupational (“private” or employer-sponsored) pension plans
Financial sustainability

- New investment strategy:
  - Mechanism: Create an independent ("arms’ length") agency – the Canada Pension Plan Investment Board – with a mandate to invest the reserve fund
Financial sustainability

- Design and operation of the Canada Pension Plan Investment Board based on three principles:
  - Independence from political interference in investment decisions
  - Accountability to stakeholders (contributors, pensioners, governments)
  - Transparency
Financial sustainability

Canada Pension Plan: Income vs expenditures

Source: Office of the Chief Actuary
Financial sustainability

Public pensions as a percentage of Gross Domestic Product (GDP)

Source: Office of the Chief Actuary, Régie des Rentes du Québec
Evolving incomes of seniors
Evolving incomes of seniors

Sources of income (percentage), 2001

Source: Statistics Canada
Evolving incomes of seniors

Average income

<table>
<thead>
<tr>
<th>Year</th>
<th>All</th>
<th>Men</th>
<th>Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>17,324</td>
<td></td>
<td></td>
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<td>17,324</td>
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<td></td>
</tr>
<tr>
<td>2000</td>
<td>18,671</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>18,671</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Evolving incomes of seniors from 1991 to 2001:

- **All**
  - 1991: 17,324
  - 2001: 18,671
  - **Change:** +7.8%

- **Men**
  - 1991: 27,486
  - 2001: 28,330
  - **Change:** +3.1%

- **Women**
  - 1991: 17,324
  - 2001: 18,671
  - **Change:** +7.8%

Source: Statistics Canada

CAD, constant 2001
Evolving incomes of seniors

Sources of income (total amount)

Source: Statistics Canada
Evolving incomes of seniors

Sources of income (percentage)

<table>
<thead>
<tr>
<th>Year</th>
<th>Other</th>
<th>Employment</th>
<th>Investments</th>
<th>Private pensions</th>
<th>C/QPP</th>
<th>OAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>30.5</td>
<td>16.6</td>
<td>26.2</td>
<td>18.8</td>
<td>30.5</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>28.0</td>
<td>19.7</td>
<td>30.3</td>
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<td>26.2</td>
<td>16.6</td>
</tr>
</tbody>
</table>

Source: Statistics Canada
Conclusions
Conclusions

Overall,

- The Canadian pension system is meeting its core objectives of poverty avoidance and income replacement.
- The system will continue to meet its objectives, and the incomes of seniors will continue to increase in real (after inflation) terms.
Conclusions

- The Canadian pension system is financially sustainable over the long term.
- However, problems remain (e.g. low income among some seniors, some disincentives to continued work) and require on-going policy attention.