The Canadian Income Security System and Economic Well Being

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Much of this material is drawn from the paper Michael Baker and Dwayne Benjamin, “The Evolving Retirement Income System and Economic Security”, April 2006.

While a very general view of well being could be taken, in many studies the emphasis is on income security

Bodie (1990) provides a useful taxonomy of retirement income risk:

- Income replacement inadequacy
- Changes in public IS benefits
- Longevity (and health) uncertainty
- Investment uncertainty
- Inflation risk

Other measures of well being include lifespan, independence, happiness and financial stress.

Empirical Challenges (in addition to data!!)

- Visually there appears to be a correlation between indicators of well being and the development of the IS system
- For example, the poverty rate and labour supply of seniors has declined as the public IS system has expanded.
- This correlation suggests a causal connection, yet there are important challenges to establishing this link.
- The most significant is constructing the counterfactual:
    - For example, to determine the contribution of the IS system to seniors' income we must account for any "crowd out" of employment or savings.

The Public IS System…

The public IS system insures against income inadequacy, longevity risk, investment risk and inflation risk, but clearly not against the risk of changes to the public IS system.

There are very few studies on this topic

… and Income Adequacy

- Baker *et al*. (2005) report non-trivial levels of crowd out, but that the IS system played a significant role in the reduction of "low income". Surprisingly, they do not find a strong link between the IS system and "low consumption".

… and Economic Behaviour

Studies typically relate behaviour to the level of IS wealth and to a measure of the accrual of wealth over time

Estimates of the effect of accrual on retirement behaviour range from significant (Baker et al. 2003) to insignificant (Compton 2001), to a middle ground (e.g., Schirle 2005).

Milligan's (2005) simulations suggest that the interaction of the actuarial adjustment of the CPP/QPP between ages 60 and 70 and the income testing of the GIS leads low income individuals to retire too early.

The View from Abroad

- The weight of the evidence from international studies is that any work disincentives in IS systems do influence the decision to retire.
- The empirical evidence is that effect of these incentives in Canada while significant, are similar to those in the U.S., but much smaller than the effects estimated for counties in Europe (Milligan and Schirle 2005).
- A new literature estimates the effect of public IS systems on outcomes such as living arrangements, happiness, financial stress and health.

The Private System

The RPP system insures against income inadequacy; DB plans provide insurance against longevity risk, investment risk and in some cases, inflation risk

There are no Canadian data that can support the analysis of the impact of the RPPs on measures of welfare or of the behavioural effects of the RPP system so in turn there are no studies of these issues.

Simulations suggest that many RPPs provide strong incentives to retire at specific ages. The welfare implications of these incentives are not explored.

Private Saving

As separate from RPPs, the major public policy in this area is RRSPs

Canadian evidence suggests that the RRSP program encourages participation in the RRSP program. Less clear whether these savings are used in retirement (as opposed to income smoothing at other points in the life-cycle) and whether overall savings are increased.

U.S. evidence is inconclusive, but suggests that total savings is increased (somewhat) by tax-preferred programs.

Targeting of other income security programs may discourage participation of low income individuals in RRSPs

Some recent research (Hurst 2004, Lusardi and Mitchell 2005) suggests a link between poor economic outcomes in retirement and "poor" economic decisions pre-retirement (at much younger ages).

Future Trends

The contribution of the public IS system to economic security may be affected by a number of trends, which include:

1) increases in life expectancy;
2) the end of mandatory retirement;
3) the continually increasing proportion of workers who are foreign born.

The contribution of RPP system to economic security may be affected by a number of trends, which include:

1) the growing importance of DC plans;
2) the rise of non traditional work;
3) the end of mandatory retirement.

Our three pillar system of support (public IS, RPPs and RRSP/private savings) is likely a one pillar system for a significant minority

This is because RPPs are not universal and simulations suggest the behavioural effects of program targeting discourage private saving

Issue: is there are growing dependent client base for public IS that hinders reform?