
Reforming Pensions

Why is Change So Hard?

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The Questions

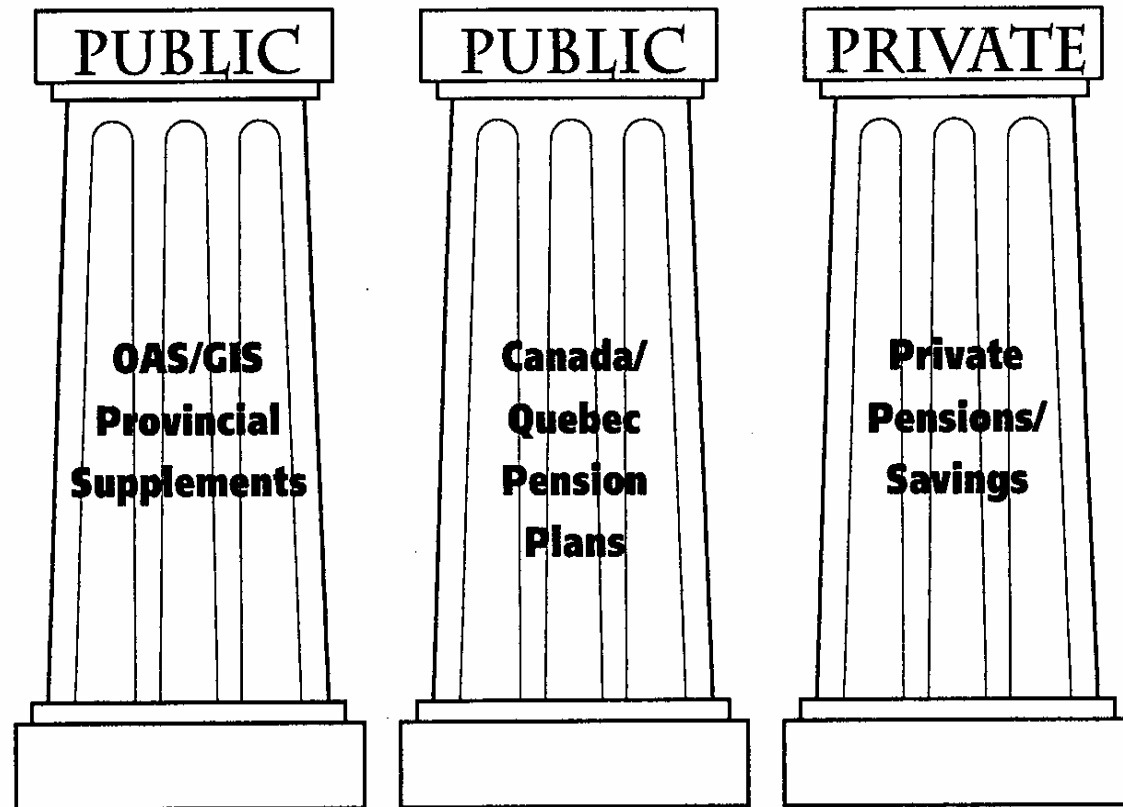
- Why is pension reform difficult?
 - What is Canadian experience?
 - What are the prospects for future changes?
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Why is Change Difficult? Two Theories

- Path dependency
 - History matters
 - Timing and sequence shape long-term outcomes
 - First movers advantage
 - Programs become embedded
 - Institutions, interests, public expectations
 - Change is incremental; bounded by existing framework
 - Change to a new path is difficult
 - Increasing returns
 - Classic case: double funding problem
 - Change requires a major shock
 - Critical junctures and windows of opportunity

 - Institutional complexity
 - Federalism
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Canadian Retirement Income System



Canadian Public Pensions in Comparative Perspective

- **A Mixed System**

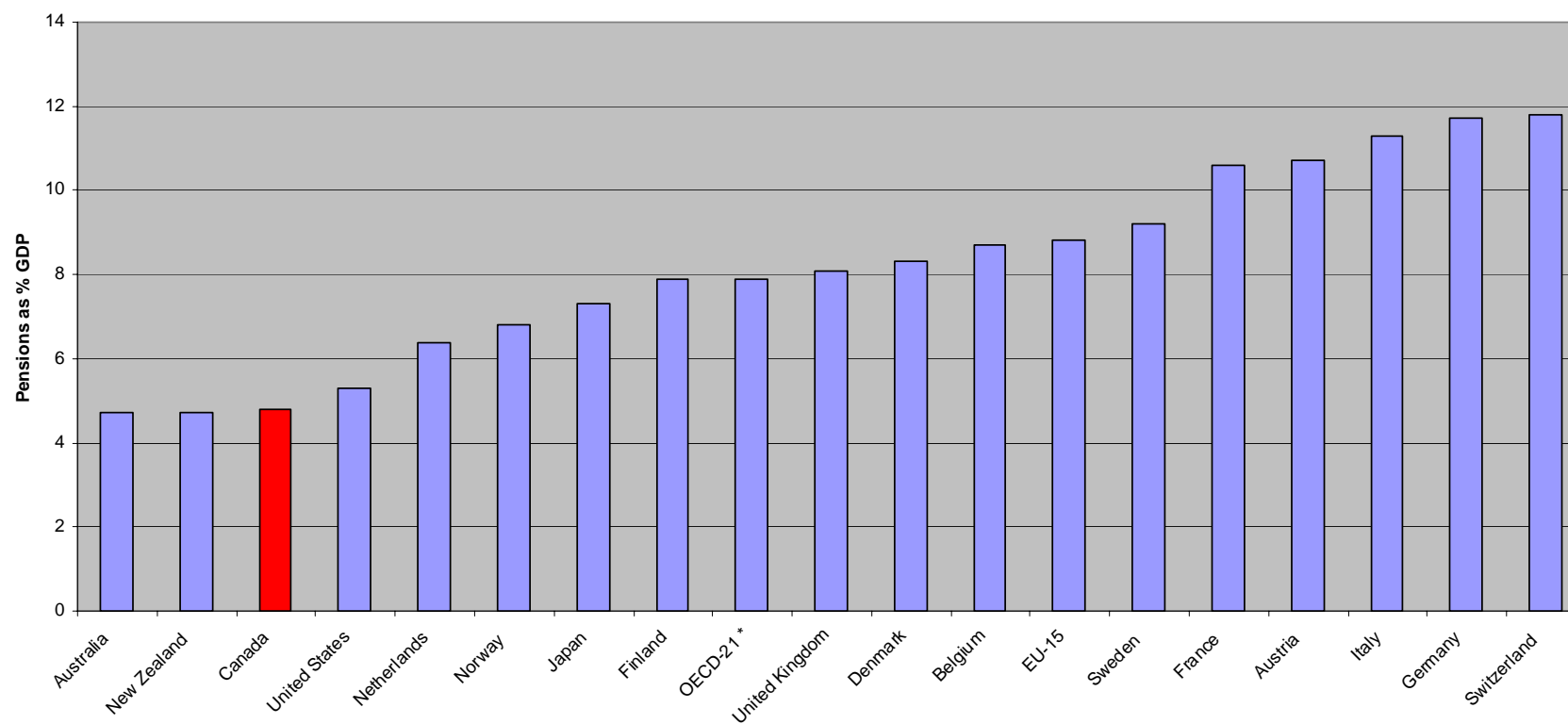
- Public: private division
- Public plans: Beveridge plus Bismarck

- **Expenditure levels**

- Relatively low by international standards
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Public Expenditures of Pensions

% GDP



Choosing the Canadian Path

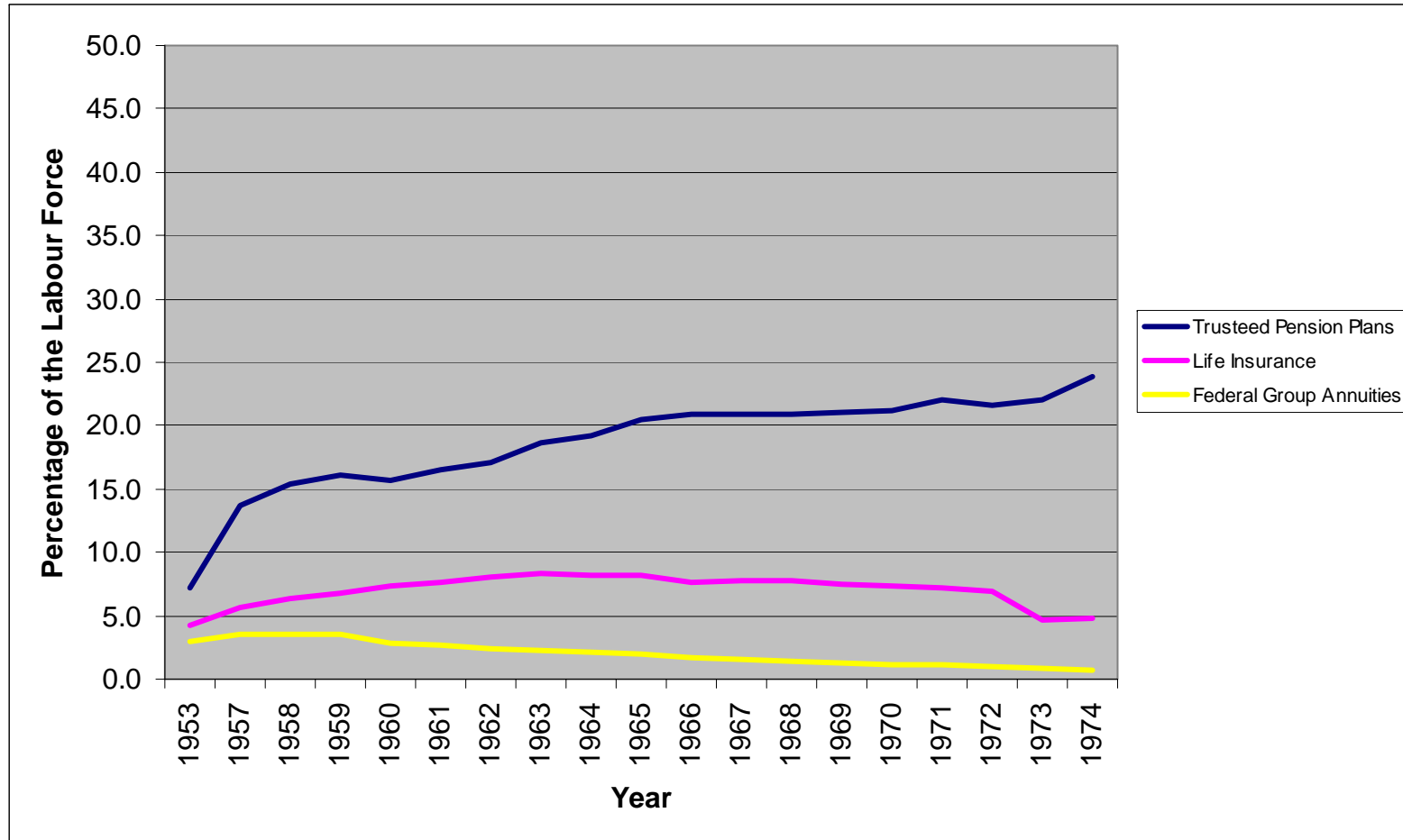
1927-1951

■ First Moves

- Minimal coverage by private pensions in interwar years
 - The First Pillar
 - 1927 Old Age Pensions: means-tested benefits
 - 1951 Old Age Security: universal flat-rate benefit
 - Remaining room in 1950s and early 1960s
 - Retirement income needs of middle income earners
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Early Coverage by Private Pensions

Members of private plans as % of labour force, 1953, 1957-77



Choosing the Canadian Path

1965

- **Adding the Second Pillar: C/QPP**
 - Modest program
 - Leaves considerable room for growth of the third pillar
 - Integration of private pension plans
 - Federal-provincial decision rules constrains growth

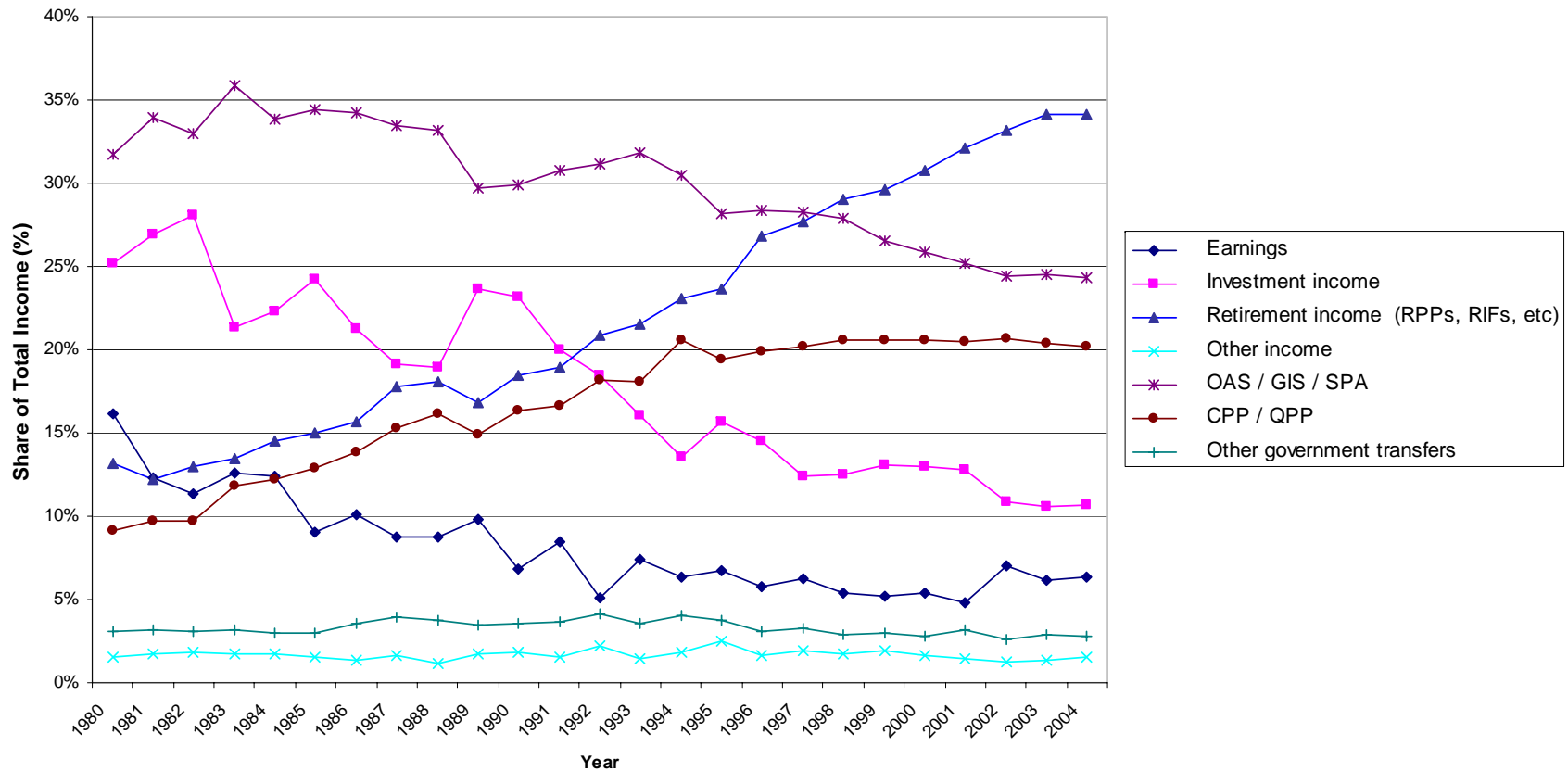
 - **Restructuring the First Pillar: GIS**
 - Unanticipated consequences
 - Growth as a result of electoral politics
 - Constraint on expansion of private pensions
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Staying on the Path at Critical Junctures

- The Great Pensions Debate (1970s)
 - Defeat of proposal to double the C/QPP
 - Enhancing Private Instruments (1980s-1990s)
 - Rejection of mandatory coverage
 - Enhancements of regulations on RPPs and RRSPs
 - Erosion of RPP / growth of RRSPs
 - The Politics of Retrenchment (late 1990s)
 - C/QPP: stabilization through a new funding model
 - Seniors Benefit rejected
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Underlying Change in Retirement Income

Income Sources as % of total income, 1980-2004



New Paths in the Future?

Shocks and Windows of Opportunity?

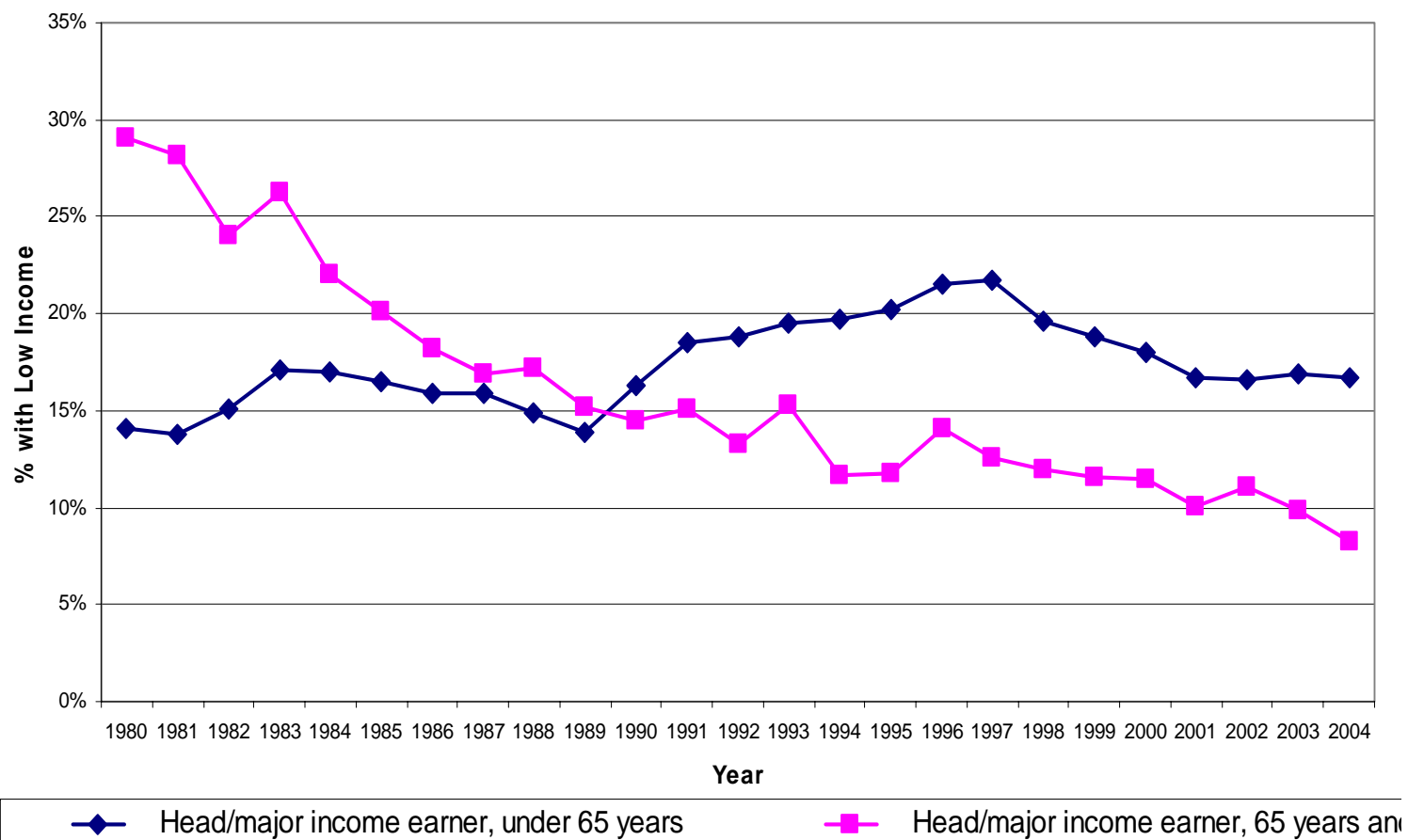
- Exogenous shocks on the horizon?
 - Fiscal pressures manageable
 - Political flexibility of hybrid model
 - Limited scope for intergenerational warfare?
 - Prospects for Further Incremental Change
 - Possible shifts in the balance among the pillars
 - Weakening of some pillars?
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Pillar One: Future of OAS/GIS

- Income Support for the Poor
 - Low income elderly dependent on public programs
 - 80% of retirement income of low-income elderly
 - High replacement rates for low-income elderly
 - 80-100 %
 - Dramatic reduction in poverty rate

 - Future vulnerabilities?
 - Strong anti-poverty role politically unchallengeable
 - Demographic pressures
 - Indexed to prices, not wages
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Poverty Among the Elderly, 1980 - 2004



Poverty Among the Elderly in Comparative Perspective

(2000 or near year)

Country	Elderly Poverty %	Child Poverty %	Inequality (gini)
Canada	7.8	16.3	.277
Denmark	6.6	8.7	.236
Germany	11.6	6.8	.264
Italy	5.6	16.6	.290
Norway	11.9	3.4	.231
Sweden	7.7	4.2	.229
U.K.	20.9	15.4	.336
U.S.	24.7	21.9	.338

Pillar Two: Future of C/QPP

- C/QPP relatively secure
 - New funding model put in place in 1990s
 - Minimal resistance to significant contribution increases
 - Protection from joint federal-provincial control
 - Expert consensus on sustainability
 - Future vulnerability?
 - Lack of public faith in sustainability
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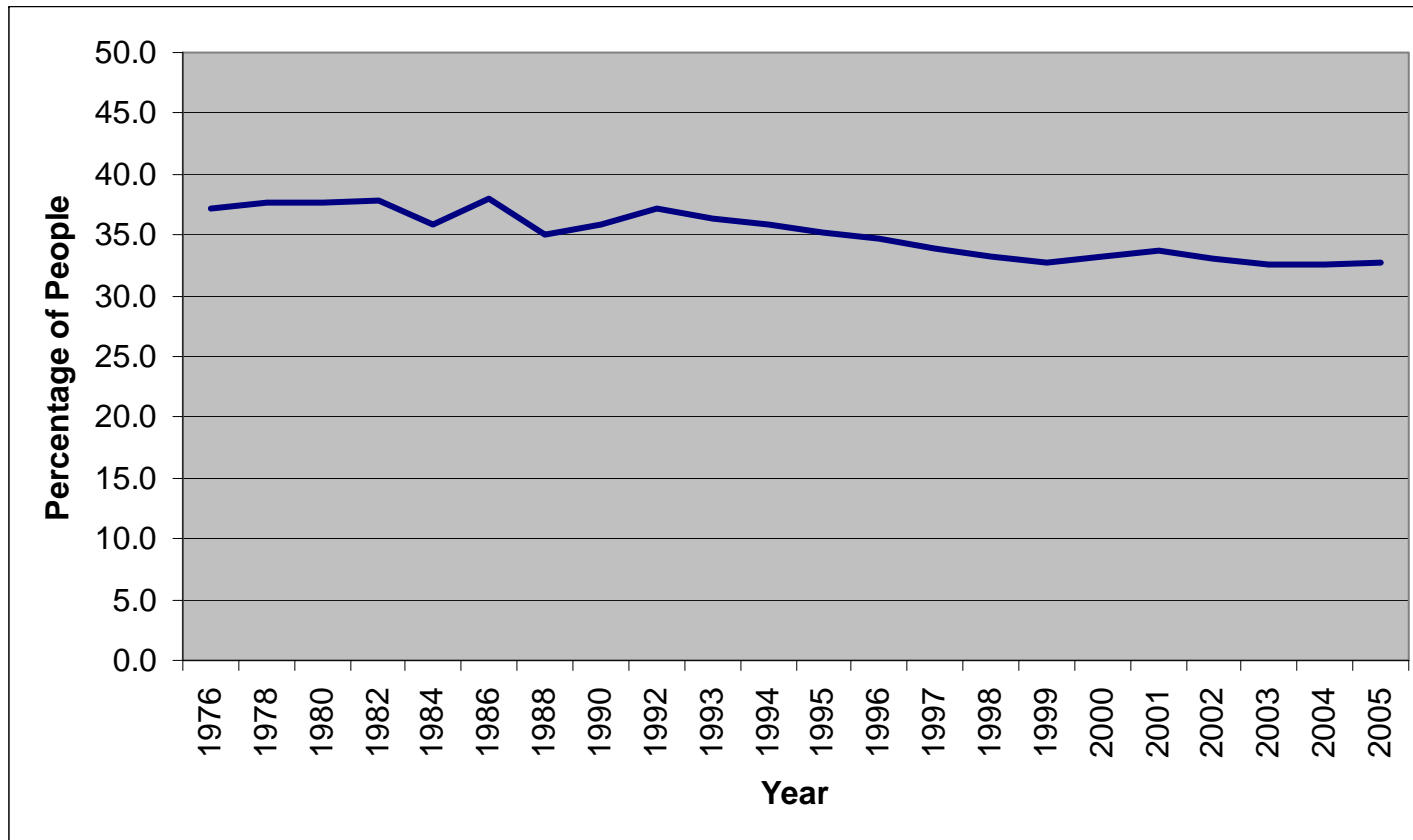
Pillar Three: Future of RPPs and RRSPs

■ Vulnerabilities

- Erosion of RPPs
 - Coverage decline mitigated by RRSP growth
 - Unequal distribution as a political liability?
 - Shifting Risks
 - DB → DC plans
 - Unpredictable returns: will the money last?
 - Under-funding / termination
 - Improbability of “pension revolution” (mandatory coverage)
 - Path dependency: space pre-empted by the GIS
 - Federalism
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Coverage of Registered Pension Plans

RPP members as % of labour force



Conclusions

Dramatic Change Remains Unlikely

- Retirement income system on its path
 - Reflects decisions made between 1927 and 1965
 - Exogenous shocks?
 - Hard to see shocks that will push it onto a different path
 - Expect the unexpected?
 - Continued incremental change
 - Shifts in the balance among the pillars
 - Greatest risks faced by the third pillar
 - Proposals to expand public provision?
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