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Is the Piggybank Broken? — We don't really know

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Brian Lee Crowley, Financial Post

Finance Minister Jim Flaherty has just announced that the proposal to expand the current Canada Pension Plan, with higher premiums and higher benefit levels, has been shelved in favour of working with the private sector to improve Canadians' retirement options. We should all heave a sigh of relief. The Big CPP reform was always a solution in search of a problem.

People are concerned that the recent recession devastated some people's retirement savings, and it is a legitimate concern. But it is hardly the first time downturns have resulted in disappointing retirement expectations for some. So we need to ask whether the recession revealed the way we run pensions in Canada to be unsound, or simply caused stress here, as in so many other areas.

Turns out there is nothing wrong with the way we run pensions in Canada, and much that is right. Only two major OECD countries, France and Germany, have pension systems that give their average retiree a higher percentage of average pre-retirement disposable income. Other allegedly generous countries, such as the Netherlands, Sweden and even the U.S., with their much more generous state schemes, end up giving retirees less income, relative to average population disposable income, than Canada's impressive 91%. Performance like this is no sign of a failing system.

Moreover, it is by no means clear that Canadians will now lack sufficient retirement income to live independently and with dignity. Poverty among Canadian seniors is among the lowest in the OECD, so our retirement system is not failing the least well off. And the wealthy are generally retiring comfortably. So if there's a problem, it lies in the middle.

There is evidence that some people in the middle-income range are not saving enough to generate the 60% to 70% of pre-retirement income generally considered suitable for a comfortable post-work life. But we don't know a great deal about these people or their circumstances.

For example, this shortfall for a minority in the middle may be due to poor data in Canada that do not capture all possible sources of retirement income and therefore may be misleading. Also, some middle-and high-incom e Canadians may need less than 60% of their pre-retirement income for an adequate lifestyle; the OECD suggests 50% replacement is sufficient for those who earned more than $90,000 in Canada. Given these uncertainties, and our incomplete knowledge of how the recovery will proceed, it is too early to make major policy changes with uncertain long-term effects.

As for those who suggested we needed to constrain Canadians to save more through the Big CPP, such as the trade unionists occupying Finance Minister Jim Flaherty's Whitby constituency office to protest his decision, they failed to make their case. If more forced saving were the solution to the narrow problem we've identified, you'd expect Canadians who participate in registered pension plans to have higher retirement incomes than those who do not. Inconveniently for the Big-CPP advocates, they do not.

So before we decide governments have to do anything drastic, we should wait and see whether Canadians react rationally to the discovery that returns on retirement savings are lower than they had hoped by changing their behaviour, increasing their savings further or reducing expenses prudently. As a rule, Canadians do respond sensibly to such changes in their financial situation and make choices appropriate for their circumstances.

They now have an impressive array of vehicles available to help them in that regard. RRSPs are actually quite widely used in Canada, with age and income taken into account. And the removal of the foreign-property rule allows Canadians to diversify their investments and hence their risk more than ever before. The introduction of the tax-free saving account has added an important new saving vehicle whose impact we cannot begin to measure.

There is still work to be done, calmly and incrementally, to improve "risk pooling" in the existing pension system. Retirement plans are intended to protect people against the risk of catastrophically inadequate post-work income, and rightly so. The way they do this is to combine individual people's retirement savings into a large pool and invest it in diverse ways. The virtue of this approach is that even if some specific investments turn out badly, the general rate of return is high enough to furnish everyone with a decent standard of retirement living. The danger is that risk can be pooled in ways that undermine personal and corporate and government responsibility and accountability. We should look hard for ways to remove incentives for the wrong kind of risk pooling.

It is possible there is a minority that is not being well-served by this otherwise robust system, but we don't even know yet if that is the case. Let's find out before making ill-informed reforms to a system that has served Canadians well.

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