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Ideas for a More Prosperous Nation

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THE RETIREMENT AGE IN QUEBEC: A WORRYING SITUATION

The aging of the population and the impending mass retirement of the baby boom generation (those born between 1947 and 1966) have been generating plenty of ink lately. These are disturbing phenomena because of the economic and financial problems they risk creating, notably labour shortages and lower economic growth. Another result would be lower growth in government revenues just as requirements and spending levels are pushed higher, especially in the health care sector. The situation is particularly worrying in Quebec, for at least two reasons.

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First, the already acute phenomenon of aging risks becoming more so in the near future. Second, the participation rate of older persons in the labour market is lower in Quebec than elsewhere in North America. In effect, both the average retirement age and the labour force participation rate are lower in Quebec. This Note seeks to understand the causes of this situation and to propose ways of remedying it.

An older population with lower labour market participation

Because of rising life expectancy and lower birth rates, the population has been aging more quickly in Quebec than in the rest of Canada. Between 1981 and 2006, the number of people 65 and over has undergone higher growth in Quebec (see Figure 1), while people under 15, the future labour force, have clearly declined in numbers although they have risen elsewhere.

The higher age groups are also less active in the labour market. The average retirement age is 60.1 in Quebec, compared to the Canadian average of 61.5 and 62 in Ontario. In 1981, the average retirement age stood at about 65 both in Quebec and elsewhere in Canada, which shows that it has fallen more sharply in Quebec.

The labour force participation rate of persons aged 55 to 64 stands at 52% in Quebec and 61% in the rest of Canada.[1] In general terms, there is thus generally a higher proportion of people in Quebec aged 55 and over who have retired from the labour market, whether voluntarily or not, while more people are active and employed in the rest of Canada.

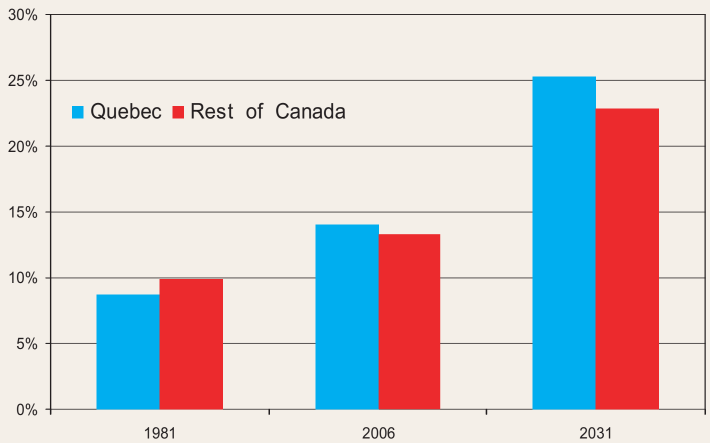
Current and foreseeable effects on economic activity

The low retirement age and low employment rates in Quebec among older persons have a negative impact on economic performance, especially since they are not offset by higher investment and productivity nor by higher employment rates than elsewhere among younger workers – in fact, the contrary is true.

The aging that is already being felt in Quebec also risks becoming more acute in the future. It is estimated that the number of persons 65 and over will rise by nearly 98% between 2006 and 2031 in Quebec, whereas the younger population will

1. The labour force participation rate of persons aged 55 to 64 is the proportion of the labour force in this age group. The labour force consists of persons who are employed as well as unemployed people who are looking for work but do not have jobs. This does not include persons who have already retired or who have ceased looking for work because of discouragement. The employment rate is the number of persons holding jobs as a proportion of the total population. In 2006, the employment rate of persons aged 55 to 64 was 48% in Quebec and 58% in the rest of Canada.

FIGURE 1
Proportion of people 65 and over in relation to the total population (1981-2031)



Source: Statistics Canada, CANSIM Table 051-0001 and Demographic Projections (for projections, the figures correspond to scenario 3 of average population growth).

decline there while rising elsewhere. The proportion of persons 65 and over in the population will thus go from 14% at present to 25% in Quebec in 2031 and to 23% in the rest of Canada.

These observations give reason to expect future labour shortages and lower economic growth. Assuming the same labour force participation rates of each age group as in 2006, which we should mention are above the average of the last 20 years, Quebec's labour force would begin to decline in 2013, with this decline accelerating in subsequent years.[2] Production levels will feel the effects. A Quebec government study has estimated that the average annual growth in real GDP per capita could be just 1.1% between 2020 and 2030, whereas it was 1.6% between 1981 and 2004.

The Régie des rentes du Québec (Quebec pension board) estimates that the number of beneficiaries (and thus in essence of new retirees) will rise 19% by 2011 and 90% by 2030. These retirements represent a loss of experienced labour that is not offset by the arrival of new workers and will put pressures on pension plans.

These forecasts are obviously based on a number of hypotheses. Economic performance – measured in particular by job creation in an economy – and demographic growth are interdependent. There is thus reason to hope that the demographic scenario could be more favourable if correct policies and incentives encourage greater economic growth, which would bring higher immigration levels and would avoid an exodus of workers.

The causes of the problem and ways of solving it

A number of factors can explain the low retirement age, in terms of both work supply and work demand. We can look, for instance, at income levels, personal tax rates, weaker job creation, higher unionization rates and, of course, personal factors. However, factors related directly to retirement plans often make it relatively unrewarding to continue working compared to retirement at an early age. Current measures in pension plan laws and tax laws, which were modified in the 1980s to facilitate early retirement from the labour market, are largely responsible for this state of affairs.

A pension paid before the official retirement age of 65 (referred to as the "normal" age) is generally cut back by a certain amount. In public plans, the reduction is 0.5% per month preceding the 65th birthday. There is also an increase of 0.5% per month following this date, up to age 70. According to the Chief Actuary of Canada, the current system is unfair to people who retire later and too generous to those who retire early.[3] Moreover, in the case of private plans, measures in the law state that the reduction rate applied to early retirement must never penalize beneficiaries financially in the long term (in practice, they will be penalized only if they exceed the average life expectancy).

Unlike persons in phased retirement (a program enabling employees to work reduced hours before the normal retirement age), people who retire early and who are enrolled in a private pension plan can receive bridge benefits, a "bonus" that brings early retirement income to a level comparable to that at normal retirement age. These measures, combined with taxation, mean that early retirement often pays better than working. This is especially true of part-time work,

2. TD Bank, *Converting Quebec's Strengths into Prosperity*, April 10, 2007, http://www.td.com/economics/special/db0407_que.pdf.
3. Senate Standing Committee on Banking, Trade and Commerce, *The Demographic Time Bomb: Mitigating the Effects of Demographic Change in Canada*, June 2006, http://www.parl.gc.ca/39/1/parlbus/commbus/senate/com-e/bank-e/rep-e/rep03jun06-e.htm.

TABLE 1 : Additional work income starting at age 60 compared to early retirement

	Early retirement at age 60	Phased retirement (3 days a week of work from age 60 to 63)	Full-time work from age 60 to 63	Phased retirement with changes to the law	Full-time work with changes to the law
Present value of net future income	$402,318	$417,852	$452,737	$445,115	$466,803
Additional net income compared to early retirement	-	$4.32/hour	$8.40/hour	$11.89/hour	$10.75/hour

Source: Quebec Department of Finance, *op. cit.*, Note 5. Changes to the law correspond to scenario 3 (see the document to learn about the hypotheses used).

an option that could be quite interesting for older persons. It is estimated, for example, that a typical 60-year-old worker enrolled in a private defined benefit pension plan and earning an hourly rate of $28.85 would receive additional net income of $4.32 (after taxes and other deductions) per hour worked in phased retirement and $8.40 working full time, compared to complete early retirement (see Table 1).[4]

As a result, phased retirement measures are used quite seldom in Quebec: between 1991 and 2001, 81% of retirees left the labour market completely, compared to 19% who retired gradually.[5] To make work pay better than retirement, especially early retirement, a number of concrete measures can be considered. Two of them look especially interesting. One is to increase incentives for retiring later and/or reduce the advantages of retiring early. The other is to push back the normal retirement age.

Current measures in pension plan laws often make it relatively unrewarding to continue working compared to retirement at an early age.

Raising incentives for retirement at a later age

To make work pay better than retirement and to correct the existing imbalance that favours early retirement, one idea is to raise payments for later retirement as suggested by the Quebec government (the Quebec pension board would raise payments by 0.7% per month after age 65 rather than the current 0.5%).[6] In this way, workers who choose to retire after the normal age would no longer be penalized, except for those who die earlier than the average life expectancy. A reverse approach could involve applying a higher rate of reduction to benefits for persons who retire before age 65; this would reduce the system's costs (and thus contributions) rather than increasing them.

Private retirement plans are also required by law to offer the possibility of early retirement from age 55 onward without penalizing the beneficiary in the long term. Bringing greater flexibility into private plans in setting the minimum age at which retirement can be taken or applying penalties for early retirement could have a significant effect in encouraging workers to remain on the job a little longer (after all, the minimum retirement age for the public Quebec Pension Plan is 60).

A measure contained in the last federal budget,[7] also aimed at increasing the advantages of later retirement, would eliminate the prohibition on receiving a salary and payments from a private retirement plan at the same time. Workers could continue contributing to the plan based on their full-time salaries. The Quebec government is also proposing that workers no longer be obliged to stop working or go into a phased retirement agreement to be entitled to their pensions from the public system. A number of European countries have moved in this direction. In Germany, workers aged 55 or over can cut their work week by half and receive a partial pension. Since 1998, the Swedish government has allowed persons 61 or over to work and receive a pension at the same time.

4. Quebec Department of Finance, *Promoting Phased Retirement* (2007-2008 Budget), February 2007, p. 64, http://www.budget.finances.gouv.qc.ca/budget/2007-2008/en/pdf/PhasedRetirement.pdf. These data assume a three-day work week between ages 60 and 63.
5. Régie des rentes du Québec, *Transition travail-retraite*, November 2005, p. 19, http://www.rrq.gouv.qc.ca/en/services/etudes_statistiques/travail_retraite.htm.
6. Régie des rentes du Québec, *Adapter le régime de rentes aux nouvelles réalités du Québec*, 2003, p. 29, http://www.rrq.gouv.qc.ca/fr/services/Publications/ConsPub2003.pdf.
7. Canada Department of Finance, *Budget 2007 (Annex 5: Tax Measures)*, March 19, 2007, http://www.budget.gc.ca/2007/bp/bpa5ae.html.

These measures represent a step in the right direction but are not sufficient in themselves. The Quebec Department of Finance estimated that similar but more generous measures favouring phased retirement in private defined benefit plans would result in seven out of ten participants aged 55 to 65 staying at work a year longer. From age 60 onward, the proportion of workers choosing early retirement would fall from 78% to 63%.[8] A study from the Canadian government calculated that, to maintain the same labour force participation rate in 2025 as exists today, the average retirement age would have to go up by two years.[9]

Raising the normal retirement age seems all the more justified in view of the general increase in life expectancy and improved health among the elderly. In Quebec, when public pension plans were instituted in 1966, people 65 or over represented 6% of the total population, and a 65-year-old male could expect to live another 13.6 years. Today, people 65 or over account for 14% of the total population, and the average male can expect to live 17.3 years beyond his 65th birthday. A person who retires at age 55 after working 30 years will spend almost as many years in retirement as on the labour market (not counting years at school).

Pushing back the normal retirement age from 65 to 67

Another more radical solution would be to push back the normal retirement age, a solution adopted in the United States and more recently in Germany. In the United States, the threshold will rise gradually from 65 to 67 between 2001 and 2027 (the minimum retirement age has been 62 for several decades). In Germany, the normal retirement age, currently 65, will rise starting in 2012, reaching 67 in 2029. In the United Kingdom, the normal retirement age for women, currently 60, will be raised to the same level as that for men (age 65) between 2010 and 2020.

To maintain the same labour force participation rate in 2025 as exists today, the average retirement age would have to go up by two years.

Conclusion

These measures present practical, simple and relatively inexpensive ways of achieving a solution. They can ideally be combined with other measures that provide for greater work flexibility and take account of the situation of older low-income workers. Such measures could help encourage continuing education by means of tax credits or education savings plans for adults and an increase in work-related refundable tax credits beyond age 60, as with the work premium. Whatever measures are chosen, it is important to fix the current situation as soon as possible before its effects worsen.

8. Quebec Department of Finance, *op. cit.*, Note 4, p. 64.
9. Policy Research Initiative, *Encouraging Choice in Work and Retirement: Project Report*, October 2005, http://www.recherchepolitique.gc.ca/doclib/Encour_Choice_E.pdf.

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