VIEWPOINT

Montreal Economic Institute

Ideas for a More Prosperous Nation

A new paradigm for retirement

by Yves Guérard | April 2012

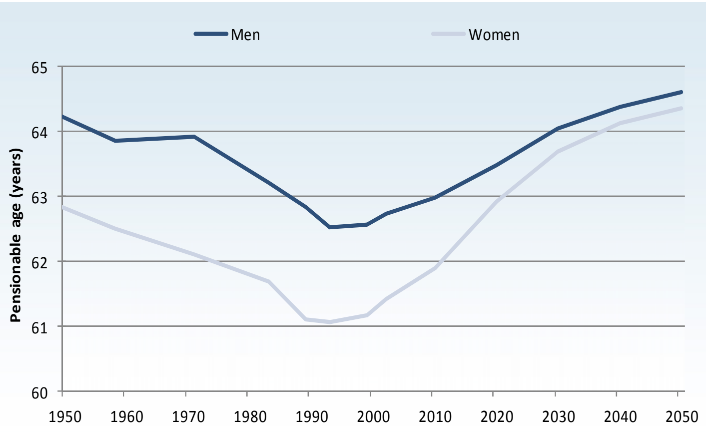
In its 2012-2013 Budget, the Canadian government announced its intention to gradually raise the age of eligibility for Old Age Security benefits from 65 to 67. Future generations will surely come to see this as a timid adjustment measure. If life expectancy keeps rising as expected, government policies in this area will need to be guided by a new paradigm for retirement.

A historical anomaly

When it came into force in 1952, the Old Age Security program was reserved for people 70 years of age and over. It is only in the late 1960s that the age of eligibility for retirement benefits was lowered to 65.[1] This decision represents a historical anomaly, as it makes little sense from the perspective of public finance for the age of eligibility to fall while life expectancy is rising.

And indeed, throughout this period, life expectancy has kept on rising. In 1951, a man who had reached the age of 65 could expect to live another 13 years, and a woman 15 years.[2] Today, they can expect to live another 18 and 22 years respectively.[3]

Figure 1
Average age of eligibility for public pension benefits in OECD countries (1950-2050)



Source: OECD, *Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries*, 2011, Figure 1.6.

Canada was not the only country to lower the age of eligibility for Old Age Security while life expectancies were rising. The average age of eligibility for similar programs in OECD countries began to fall in the 1950s, reaching all-time lows in the 1990s. As can be seen in Figure 1, reforms recently enacted in several countries will be inching it back up to 65 in coming decades. Already, Germany, Australia, Denmark and the United States have begun raising the age of eligibility to 67, while it will reach 68 in the United Kingdom in the year 2046.

The most important resource

Human resources are without a doubt a country's most important resources since all others (raw materials, technology, capital) can be purchased or borrowed from abroad. A country cannot become more prosperous by paying a greater number of its citizens not to work.

An argument often raised against keeping older workers on the labour market is that they take up jobs that could be filled by younger workers, which increases youth unemployment. However, this perception is contradicted by reality. As shown in Figure 2, there is a strong correlation within OECD countries between the employment rate for workers aged 55 to 64 and the rate for workers aged 15 to

1. Canadian Museum of Civilization, *The History of Canada's Public Pensions*, July 2010.
2. Office of the Superintendent of Financial Institutions Canada, *Striking a Balance - Annual Report 2005-2006*, 2006, p. 62. Note that life expectancy at birth and life expectancy at age 65 are different.
3. Statistics Canada, CANSIM Table No. 102-0512.

24. Where the employment rate is high for older workers, it is also high for younger workers, and when it is low for the one, it is low for the other as well.

This correlation can be explained by the fact that just like for the economy in general, employment is not a fixed "pie" that we must all share. What one group gets, others need not do without. On the contrary, an economy where the experience and skills of older workers are exploited will tend to be a more dynamic and prosperous one. Since the "pie" gets bigger, younger workers also benefit.

Rethinking the linear retirement model

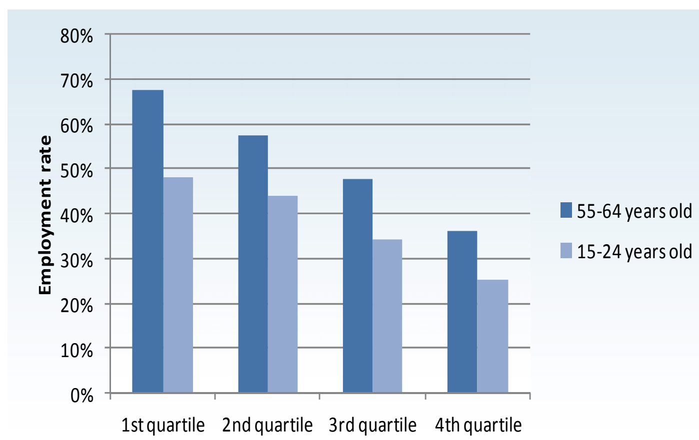
If life expectancy continues to increase as expected, a fixed age of eligibility for public pension benefits is likely to become increasingly expensive for governments. As disparities in the fiscal contribution demanded from each generation widen, it will also come to be seen as an issue of fairness that there be an appropriate sharing of the benefits and burdens of increasing longevity.

Instead of reforming public pension plans every generation or so, a dynamic approach stipulating that age of eligibility is to increase automatically with life expectancy might be perceived as fairer and would be easier to implement politically.

At the same time, cumulative increases in longevity will require a deep rethinking of the current linear model of retirement in a way that is more respectful of personal aspirations. Already, more than half of Canadians intend to work beyond the age of 65, either part-time (34%) or full-time (20%).[4] In the future, phased retirement is likely to become the norm. It would certainly be a win-win solution for everyone if workers were able to plan for a longer working life for more free time before retirement—free time that could be used for personal development, participation in community activities, leisure and more quality time with family.

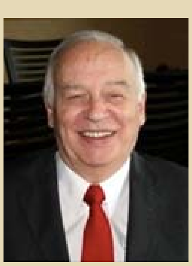
Efforts are already being made by governments and businesses to introduce greater worker flexibility, especially for parents. Other steps can be taken along the same lines, such as providing continuing education and training that would help people remain fully productive longer. The generalization of this approach will represent a major cultural change and will be one of our main challenges in the coming decades.

Figure 2
Employment rates in OECD countries: older and younger workers (2010)



Source: OECD and author's calculations. The 34 countries were divided into quartiles based on the employment rates of workers aged 55-64.

4. Sun Life Financial, *Canadian Unretirement™ Index Report*, 2012, p. 5 (survey conducted with 3,700 working Canadians from 30 to 65 years of age).



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