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NAVIGATION BUTTONS

The pension carrot: Incentives to early retirement

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The Supreme Court of Canada decision of December 6, 1990, upholding the concept of mandatory retirement, has revived the seemingly perennial debate: should 65 be the age at which workers must retire? This ruling, however, may affect few workers. Research shows that few persons would continue working beyond age 65, should mandatory retirement be abolished across Canada. (1)

Indeed, data from several sources indicate that there has been and continues to be a trend towards early retirement in Canada, rather than towards postponement. This is the case for Canadian men especially. The evidence also suggests that an increasing number of early retirements are voluntary, as opposed to mandatory.

What does it mean to be retired?

Retirement is a complex process, unique to each person. Its timing may be determined by personal factors such as work history, financial and physical well-being, leisure interests and family support. It may also be influenced by economic and social conditions such as labour force needs, the state of the economy, health care delivery, social and leisure services and retirement policies. This article does not attempt to specifically define retirement. Rather, it presents two criteria that are accepted by many as retirement indicators: withdrawal from the labour force and replacement of employment income with pension income.

These criteria have some limits in their application. For example, persons who have left the labour force for non-voluntary reasons such as illness or layoff and have given up trying to find other employment may not regard themselves as retired, yet they are not counted in the paid work force. On the other hand, some individuals, retired from a full-time paid position but involved in other paid work - possibly self-employment, possibly part-time - may regard their activity as part of retirement behaviour, even though they are still in the labour force.

Using the concept of a change in a person's main source of income, from employment earnings to pension benefits, as a retirement indicator also has limits. Some people receive income from both employment and pension sources for many years.

Despite their limitations, these criteria are used in this article to demonstrate the trend to early retirement that has evolved in the last 20 years.

How do we determine when a person's retirement is early? In recent decades both employment practices and retirement income programs considered 65 to be the most likely age for individuals to retire. It was most frequently the maximum age to which many employers retained workers. Since 1970 it has been the age of eligibility for Old Age Security benefits and until recently it was the earliest age Canada and Quebec Pension Plan contributors could receive retirement benefits. Also, most employer-sponsored pension plans designate 65 as the normal retirement age. Early retirement, therefore, is defined as retirement before age 65. The focus of this article is the 55 to 64 year-old population.

Fewer men working

The trend toward early retirement seems to be much more pronounced among men than women. The labour force participation rate of men aged 55 to 64 declined steadily over the past two decades, from nearly 85% in 1969 to 65% in 1990. For women in this age group, however, the participation rate actually rose slightly. But, at 36% in 1990, it still remained much lower than the male rate. This slight increase must be considered in the context of the entry of large numbers of women into the labour market during this period and the dramatic increases in the female participation rate at younger ages. These entries seem to have more than offset any early-retirement departures.

Why are older workers, particularly men, leaving the labour force in increasing numbers at younger ages? Poor health and job loss with little possibility of being re-hired cannot adequately explain this trend. In fact, Labour Force Survey information on this growing group identifies voluntary retirement more and more often as the principal reason for leaving. (2)

More pensioners

Having adequate and accessible pension income is cited in a number of studies as the dominant factor in workers' retirement decisions. It has been argued that most individuals would retire earlier if they could afford to do so. (3) In recent years, an increasing number of workers seem to have achieved such a goal.

VIEW ▶ Chart **Taxfilers aged 55 to 64 classified by largest source of income.**

Source: Revenue Canada-Taxation

Note: An additional 9% of taxfilers are unclassified each year.

Personal income tax data reveal that, in the last two decades, pension income has increased in relative importance for taxfilers aged 55 to 64, while income from paid work and self-employment has decreased. Revenue Canada's taxation statistics classify individual taxfilers into specific groups, based on their largest source of income. One group, called pensioners, has its largest source of income from public and private pension arrangements. In 1969 just 3% of taxfilers aged 55 to 64 were identified as pensioners. By 1979 this proportion had increased to 8% and by 1988 it was 18%.

A corresponding decline took place in the proportion of taxfilers whose largest source of income was from paid work or self-employment. This group decreased from 88% of all 55 to 64 year-old taxfilers in 1969 to 69% in 1979 and 58% in 1988. These increases in the proportion of taxfilers classified as pensioners and decreases in the proportion identified as employees or self-employed workers were similar for men and women.

Some caution may be called for on the use of the data classifying taxfilers as pensioners. Retirees are excluded from this classification if the largest share of their total income is from sources other than pension plans, such as investments or rental property. In fact, 9% of all 1969 and 14% of all 1979 and 1988 taxfilers aged 55 to 64 were identified as investors and property owners. While about 600,000 of the 1.9 million taxfilers in this age group reported pension benefits on their 1988 tax returns, only 350,000 were identified as pensioners.

VIEW ▶ Chart **Taxfilers aged 60 to 64 with income from pension programs and employment.**

Source: Revenue Canada-Taxation

Note: In addition to retirement pensions, C/QPP and private pension benefits include disability and survivors' pensions.

A review of all taxfilers reporting pension income shows that the percentage reporting such benefits on their tax returns increased more quickly during the 1980s than in the 1970s. Also, this percentage is considerably higher for the 60 to 64 year-old group than for those aged 55 to 59.

In 1979, 21% of taxfilers aged 60 to 64 reported payments from employer-sponsored pension plans

(RPPs) and annuity contracts, and 13% had Canada and Quebec Pension Plan (C/QPP) benefits. By 1988, however, 30% of this group had RPP and annuity income and nearly 45% received C/QPP benefits. Conversely, the proportion of these taxfilers reporting income from paid work and self-employment decreased, from 70% in 1979 to 58% in 1988.

A further limit on the use of Revenue Canada's taxation statistics is the impact of non-taxfilers. The proportion of the population aged 55 to 64 that did not file a tax return has decreased considerably in the last two decades. When measured in terms of the proportion of the total population aged 55 to 64, the growth in pension beneficiaries, as revealed in the tax data, is even more pronounced. (See *Taxation statistics* for further details.)

Despite the limitations inherent in these data, there is evidence of changes in the relative importance of various income sources for a growing number of older taxfilers, both men and women. These changes, combined with a drop in male labour force participation, show that there has been a trend to early retirement in Canada.

Incentives and responses

A number of factors have contributed to the declining labour force participation rates for men and the changes in sources of income for men and women aged 55 to 64. Long-term developments, as well as some recent innovations, have increased voluntary early retirement opportunities, unheard of not many years ago.

In the long term, there have been dramatic improvements in pension accumulations by Canadian workers and advancements in the timing of access to these benefits. These developments, evident in all three earnings-related pension programs - the Canada and Quebec Pension Plans (C/QPP), employer-sponsored pension plans (RPPs) and registered retirement savings plans (RRSPs) - are the result of legislative changes and voluntary responses to new opportunities. (4)

In the last 10 years some employers have provided incentives for early retirement on an ad hoc basis to cushion the negative effects of "downsizing" their work forces. (5)

Tremendous impacts of the C/QPP

The Canada and Quebec Pension Plans may have been the greatest factors in the trend to early retirement in the last decade. Implemented in 1966, the maturing of these programs during the 1970s and 1980s produced generous pension equities for workers and the introduction of "flexible retirement" in 1984 (QPP) and 1987 (CPP) permitted access to these benefits as early as age 60. (6) Full indexation of benefits was first introduced in 1974 and, after a phase-in period, full accrued benefits were first paid out in 1976. Worker response to this early retirement opportunity was dramatic. In 1984, three out of every four persons receiving QPP retirement pensions for the first time were between the ages of 60 and 64.

Similarly, two-thirds of new CPP beneficiaries in 1987 were aged 60 to 64.

VIEW ▶ Chart **New C/QPP retirement beneficiaries.**

Sources: Health and Welfare Canada and Régie des rentes du Québec

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New opportunities in RPPs

In recent years greater retirement benefits from employer-sponsored pension plans (RPPs) have become payable to a larger number of workers at an earlier age. Not only has the rate of participation in these plans increased in the last 30 years, but the average rate of accrual of retirement benefits has also increased. Membership grew from about 19% of all Canadians 18 to 64 years of age in 1960 to 30% in 1980 and has remained at that level since (Table 1). Furthermore, regulatory pension legislation implemented during the 1960s and 1970s encouraged increased savings under RPPs through more stringent vesting requirements. (7) Other RPP provisions, introduced by employers voluntarily or because of union pressures, resulted in improved benefits as well; for example, the increased incidence of indexation and the provision of a bridging benefit for workers retiring before age 65. (8)

VIEW ▶ Table 1 **Participants in the C/QPP, RPPs and RRSPs, selected years**

Sources: Intercensal population estimates, Pension Plans in Canada database, Revenue Canada-Taxation, Health and Welfare Canada and Régie des rentes du Québec

Note: Very few workers aged 65 and older contribute to the C/QPP and RPPs. RRSP contributions are permitted up to the end of the year the taxfiler reaches 71 years of age.

Besides improvements in pension accrual opportunities, more liberal retirement provisions have been introduced in RPPs in the last two decades, granting participants earlier access to their pensions. Age 65 is most frequently stipulated in the plans as the normal retirement age. However, nearly all RPPs provide for early retirement, permitting employees to retire well before age 65, sometimes on a reduced pension, sometimes (after meeting certain minimum conditions) with a full accrued benefit. (9)

Since 1970, the availability of early retirement with and without reduction in benefits has increased. For example, the proportion of RPP members with an option to retire early on a reduced pension grew from 87% of the 2.8 million RPP members in 1970 to 98% of the 5 million members in 1989. Even more

noteworthy, 77% of the 1989 members could choose such early retirement without employer approval, while only 35% of 1970 RPP members had this freedom. Early retirement without reduction in benefits was also much less available in 1970 than in 1989. While only 19% of the 1970 members were provided with this opportunity, in 1989 nearly 55% had this option. (10)

Dramatic growth in RRSPs

Participation in registered retirement savings plans and the amounts contributed to these plans have increased dramatically over the last 30 years. In 1970, 14 years after the introduction of RRSPs, only 2% of the population aged 18 to 70 contributed to these plans. By 1988, however, 22% of this group participated. At the same time, average contributions grew from $900 per contributor in 1970 to nearly $2,800 in 1988. These increases were partially the result of the periodic raising of the maximum contribution level, as well as the opportunity provided in the legislation to roll over certain lump-sum and periodic payments into RRSPs without paying income taxes on these amounts. (11)

Sources of income of the older population

How many workers were able to take advantage of these retirement savings opportunities? Certainly not all. A large number had no opportunity to participate in RPPs or RRSPs and, for many, even C/QPP accruals were limited. For these workers, insufficient income may have precluded retirement before age 65. There is evidence, however, that the availability of these programs did result in early retirement for an increasing number of workers, especially in the last 10 years.

Total assessed income (excluding capital gains) for the Canadian tax-filing population aged 55 to 64 increased from $22.6 billion in 1979 to $50 billion in 1988 (a growth of 121% in current dollars and 24% in constant dollars). Income from employment (both paid work and self-employment) remained by far the largest source in 1988 (67%), though it had decreased in relative importance. Aggregate pension income for this group increased from 6% of total assessed income in 1979 to 13% in 1988.

VIEW ▶ Chart **Sources of income for taxfilers aged 60 to 64.**

Source: Revenue Canada-Taxation

Note: Other income includes unemployment insurance benefits, investment and rental income and other miscellaneous income, but excludes capital gains.

This increased reliance on pension income is most evident among men aged 60 to 64. The proportion of total income received from pension arrangements, both public and private, grew from 8% in 1979 to

nearly 21% in 1988. Aggregate pension income was nearly six times greater in 1988 than in 1979, while employment income merely doubled over this period.

Prospects for the near future

There is no indication that the recent trend to earlier retirement will be reversed or even halted in the near future. C/QPP early retirement opportunities will remain attractive to many workers. Also, a number of developments in pension legislation, whose effects have not yet been felt, may contribute to the advancement of retirement.

RPP legislation

Recently implemented federal and provincial regulations prohibiting stringent eligibility requirements in employer-sponsored pension plans should generate increases in RPP participation. (12) Also, substantial growth in the accrual of pension benefits at both the individual and aggregate levels will become evident in the next few years as a result of strict vesting and locking-in requirements. (13)

Legislation mandating early retirement provisions has been extended to cover more and more RPPs in the last 5 years. The minimum legislative requirement, that is the opportunity to retire 10 years before the specified normal retirement age, was provided for in plans covering about 90% of all members by January 1, 1990. This provision will thus be available to a growing number of older workers.

New RRSP opportunities

New legislation, coming into effect in the 1991 tax year, increases the opportunity to contribute to RRSPs for a large number of individuals. The ceilings on contributions have been lifted dramatically and a new seven-year carry-forward provision has been introduced. The latter will permit individuals to make up contribution opportunities missed during years of low income or unusual financial obligations. (14)

Conclusion

The observations presented in this article may imply that the trend towards early retirement in the last two decades reflects a conscious decision, on the part of many workers, to retire early. This is not the case. Retirement planning is far from universal (see Lowe, 1991). For many, early retirement may be the result of circumstances rather than a planned event. Many workers still enter into retirement with inadequate resources.

As the changing labour force participation rates indicate, more and more men aged 55 to 64 are leaving the paid work force. The tax data show that the incidence and amounts of payments from pension programs for both men and women in this age group have increased. These developments are to some

degree a consequence of changing conditions in retirement programs, of increased opportunities for retirement savings and of the maturing of programs established years ago.

It is difficult to predict to what extent early retirement will be an issue in the years to come. The long-range view of an aging population and of a possible increase in labour demand may have a significant impact on retirement in the future. (15) However, bearing in mind the responses to the early retirement opportunities introduced in the C/QPP and in RPPs in the 1980s, it can be safely assumed that the trend to early retirement will continue for some years.

Taxation statistics

The Revenue Canada taxation statistics sample file is used in this study. A weakness of this file is the incidence of non-taxfilers. In 1969 just 63% of the 55 to 64 population filed returns. By 1979 this share had increased to 74% and in 1988 it was 82%. While the proportion of the male population in this age group filing tax returns increased only slightly (from 87% in 1969 to 94% in 1988), the percentage for women grew dramatically, from 38% to 70%. Only those individuals with a tax liability are required to file returns. However, in order to obtain certain grants and allowances, such as federal sales tax credits, child tax credits and provincial tax credits, the filing of a tax return is essential. The growth in the filing rate can be attributed to a large extent to the introduction of these tax credits.

Public pension income is the income reported by taxfilers as received from the Canada and Quebec Pension Plans (C/QPP) only. Old Age Security benefits, payable at age 65 or older, are not relevant here. Excluded also are non-taxable sources of income such as Spousal Allowance payments. These benefits (nearly $483 million in the 1987-88 fiscal year) are paid to low-income 60 to 64 year-old individuals, who meet Health and Welfare Canada requirements. There were 139,000 such recipients in 1987-88.

Private pension income includes employer-sponsored pension plan (RPP) benefits and annuity payments from registered retirement savings plans (RRSPs), deferred profit sharing plans (DPSPs) and registered retirement income funds (RRIFs) plus the income portion of general annuities. Lump-sum RRSP withdrawals are excluded.

The number of pension beneficiaries is inflated to some extent, since not all received retirement pensions. Payments from RPPs and especially the C/QPP include supplementary benefits, such as disability and survivors' pensions. In fact, nearly all of the 1979 and about one-half of the 1988 female C/QPP beneficiaries aged 60 to 64 had received survivor pensions, rather than retirement benefits.

For details on the Revenue Canada sample file consult the publication*Taxation Statistics 1990* or call

Revenue Canada at (613) 957-8398.

Notes

Note 1
In the December 6, 1990, judgement, The Hon. Mr. Justice G. La Forest noted that "estimates of workers who would voluntarily elect to work beyond the age of 65 vary from 0.1 to 0.4 per cent of the labour force" (*McKinney v. University of Guelph*, p. 67).

Note 2
This trend was observed in a study by E.B. Akyeampong published in *The labour force* (1987). A number of other studies (including L.S. Osberg, *Is it retirement or unemployment?: constrained labour supply and induced "retirement" among older workers* (1990)), have downgraded the importance of voluntary retirement as a cause for diminishing labour force participation. However, even if the incidence of voluntary retirement is inflated, its importance seems to have increased over the long term.

Note 3
See B.D. McPherson,*Aging as a social process: an introduction to individual and population aging* (1983); A.L. Gustman and O.S. Mitchell, *National bureau of economic research* (1990); and "Retirement attitudes, plans and behaviour" by G.S. Lowe in this issue.

Note 4
The other major retirement program in Canada, the Old Age Security/Guaranteed Income Supplement (OAS/GIS) system, is not relevant here, since its benefits are payable at age 65 only. For a detailed description of the retirement income system in Canada and definitions of the above program see "Women approaching retirement" by D. Galarneau in this issue.

Note 5
Various incentives were used to encourage employees to retire early. For an example of such activity, consult L. Taylor, *Benefits Canada* (1990), on the staff reduction programs of eight Canadian companies in 1982 and 1983. It shows that one-third (more than 2,200) of the eligible employees in these companies took advantage of the incentives offered.

Note 6
Contributors aged 60 to 64, who "have wholly or substantially ceased pensionable employment", can apply for and receive a retirement pension, reduced to take into account the earlier-than-age-65 start. A contributor is considered to have substantially ceased pensionable employment if his or her earnings

(annualized from employment or self-employment do not exceed the maximum retirement pension payable at age 65 for the year the pension is claimed ($7,258 in 1991). The reduction is 0.5% for each month (6% per year) that the early retirement precedes the member's 65th birthday. (See Health and Welfare, *Overview: the income security programs of Health and Welfare Canada* (1990).)

The early retirement benefit may be beneficial to the member in the long term, particularly in the case of an earlier than normal death. The aggregate life-time benefits (fully indexed) might be greater with the early start. The worker's accrued pension, dependent on amounts contributed during the contributory period, will not be affected by the shortening of this period through early retirement. Also, the pension accrual rate declines once the member becomes eligibile for early retirement benefit (age 60) and the expense of making contributions is avoided. There is a cost to continuing to work, which did not exist previously previously.

Note 7

The term "vesting" traditionally referred to the employees' rights to employer contributions on termination of employment after a minimum period of participation in the RPP (possibly in conjunction with a minimum age). It also has come to infer that the vested benefits be used for future retirement income purposes only and that a minimum share of the accrued benefits be borne by the employer. The minimum legislative requirements have been made more and more stringent over the years. For further details see Statistics Canada, *Pension plans in Canada, 1988* (1990).

Note 8

In 1970 only 7% of RPP members had some form of automatic indexing, usually limited to a maximum increase of 2% per year. By 1989 more than a third of the RPP members had such indexing and 35% of these individuals were in plans that provided for indexing based on the full upward movement of the Consumer Price Index. Many employers, without such automatic provisions in their RPP, provide ad hoc improvements to their retirees on a regular basis, either voluntarily or as a result of union-negotiated agreements. (See William M. Mercer Limited, *The Mercer bulletin* (1984 and 1988).)

An RPP bridging benefit provides workers, retiring before age 65, with a higher pension until they reach 65, after which a lower RPP benefit is compensated for by C/QPP and OAS benefits. The extent of this practice is not known. However, two-thirds of RPP members are in plans that have some form of C/QPP integration. For many of these plans a full benefit is provided for the retirement period before age 65 (for example, 2% of earnings for each year of service) with a reduced benefit coming into effect at age 65 (possibly 1.3% of C/QPP pensionable earnings and 2% on the balance of earnings for each year of service).

Note 9

Most early retirement opportunities in RPPs require a reduction in the accrued benefit, either on an actuarial basis or by some fixed percentage, to compensate for the longer benefit period. In addition, some plans provide early retirement opportunities without reduction in the accrued benefit (also called special retirement provisions). This form of early retirement does entail some additional condition(s),

such as a minimum number of years of service. For example, the employee must be at least 55 years old and have 30 years of service or age plus service must equal at least 85.

The early retirement provision without reduction and even one with a reduction of less than the actuarial equivalent includes an implicit subsidy. Few workers are aware of this, however, and it can be assumed that the earlier access, not the increased value of aggregate benefits, provides the incentive to retire early. For further explanation of the disincentives to continue work after eligibility for early retirement, consult J.E. Pesando and M. Gunderson,*Retirement incentives contained in occupational pension plans and their implications for the mandatory retirement debate* (1987); or L.J. Kotlikoff and D.A. Wise,*The wage carrot and the pension stick: retirement benefits and labour force participation* (1989).

Note 10
This increase in the right to early retirement is partially the result of changes in regulatory pension legislation of the federal government and of some provinces in recent years. For further details see Statistics Canada, *Pension plans in Canada, 1988*, p. 43.

Note 11
Average contributions actually declined in constant dollars. A rationale for this is provided in "Women approaching retirement" D. Galarneau in this issue. For further details on RRSPs, consult H. Frenken, *Perspectives on labour and income* (Winter 1990).

Note 12
By 1990 nearly 90% of RPPs were subject to legislation that prohibited stringent eligibility requirements for new employees. Since these former restrictions precluded the participation of many workers from their employers' RPP, their disallowance should increase membership.

Note 13
By January 1, 1990, more than 70% of RPP members had full vesting after two years of participation in the RPP. Furthermore, benefits accrued after the effective date of the legislation could no longer be forfeited on termination of employment. These benefits now have to remain in the pension fund to provide for a deferred pension or they can be transferred into a locked-in RRSP. In the past, many workers reached retirement age with little or no pension accrual, despite membership in a number of RPPs during their careers.

Note 14
Also, prior to 1989, RRSPs could not be converted into annuity income or registered retirement income funds until after the participant reached age 60. That restriction has been lifted and such payments from RRSPs can now start at any time. For a detailed explanation of the 1991 changes to the Income Tax Act and analysis of its effects on taxfilers, consult H. Frenken,*Perspectives on labour and income* (Winter 1990), pp. 16-17.

Note 15

We may learn from the experience of developed countries that have an older population than Canada. Some countries - The United Kingdom, Sweden, Norway, Ireland - with low growth in their working-age populations are showing signs of a slowing down in the trend towards early retirement (see Organisation for Economic Co-operation and Development, *OECD employment outlook* (1990).

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Source

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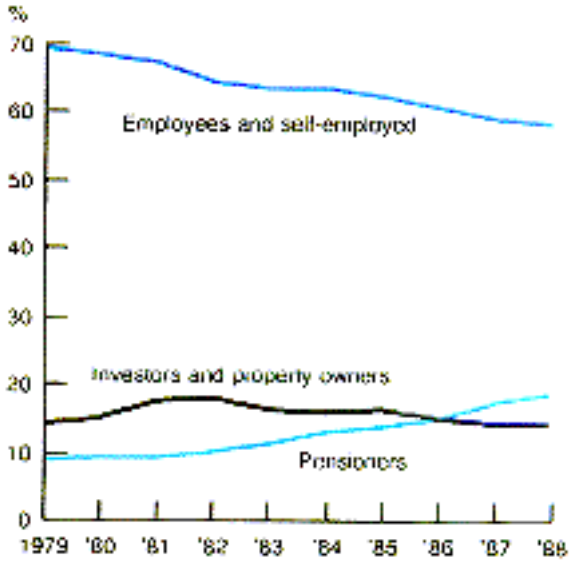
Taxfilers aged 55 to 64 classified by largest source of income

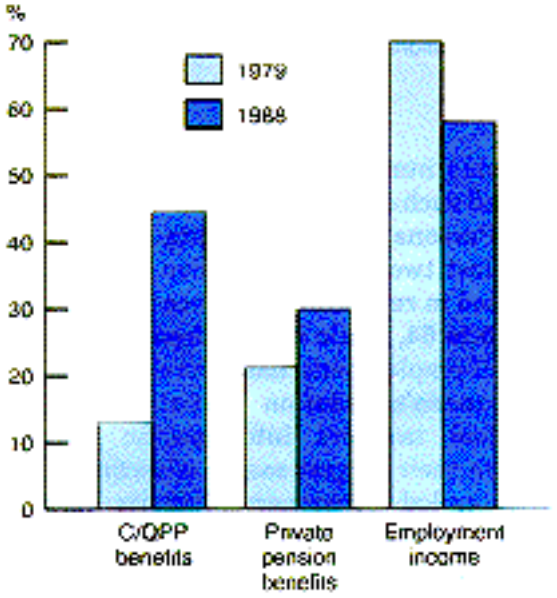
While the proportion of older taxfilers classified as employees and self-employed persons has decreased, the proportion classified as pensioners has grown.



Source: Revenue Canada-Taxation
Note: An additional 9% of taxfilers are unclassified each year.

Taxfilers aged 60 to 64 with income from pension programs and employment

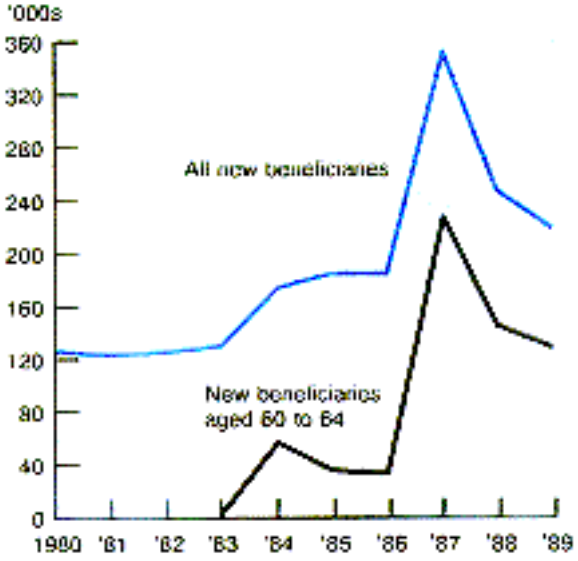
The share of 60 to 64 year-old taxfilers reporting benefits from pension programs has grown extensively.



Source: Revenue Canada-Taxation
Note: In addition to retirement pensions, C/QPP and private pension benefits include disability and survivors' pensions.

New C/QPP retirement beneficiaries

The introduction of early-retirement opportunities in the Quebec Pension Plan in 1984 and the Canada Pension Plan in 1987 generated dramatic increases in the number of new applications for benefits.



Sources: Health and Welfare Canada and Régie des rentes du Québec

Table 1

Participants in the C/QPP, RPPs and RRSPs, selected years

Year	C/QPP participants		RPP participants		RRSP participants	
	Number	% of total population 18 to 64	Number	% of total population 18 to 64	Number	% of total population 18 to 70
	‘000		‘000		‘000	
1960	...	...	1,815	19	..	..
1970	8,716	73	2,822	24	249	2
1980	10,943	74	4,475	30	1,916	12
1988	12,640	77	4,845	29	3,802	22

Sources: Intercensal population estimates, Pension Plans in Canada database, Revenue Canada-Taxation, Health and Welfare Canada and Régie des rentes du Québec

Note: Very few workers aged 65 and older contribute to the C/QPP and RPPs. RRSP contributions are permitted up to the end of the year the taxfiler reaches 71 years of age.

Sources of income for taxfilers aged 60 to 64

Reliance on employment earnings decreased during the 1980s, while pension income increased in importance.

Source: Revenue Canada-Taxation
Note: Other income includes unemployment insurance benefits, investment and rental income and other miscellaneous income, but excludes capital gains.