

Lessons for Ontario and Canada from Forced Retirement Saving Mandates in Australia



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SUMMARY

- Ontario is set to enact a new forced retirement saving mandate through the Ontario Retirement Pension Plan (ORPP), coming into effect January 1, 2017, as the country as a whole continues to debate expanding the Canada Pension Plan (CPP). While it isn't clear that additional compulsory mandates are even needed, this paper argues that if Canadian governments proceed with such initiatives, they should consider Australia's system of individual retirement saving accounts instead of restricting the option to Canada's CPP model.
- This bulletin compares the main features of the Australian and Canadian retirement income systems, primarily focusing on the compulsory saving mandates built into the two systems. The fundamental difference is that Australia's superannuation system is based on individual accounts compared to Canada's collective CPP, upon which the new ORPP will be modelled.
- Australia's defined contribution system, which has much in common with Canada's RRSPs, offers several advantages over the defined benefit CPP and ORPP. For instance, contributions to the superannuation accounts fully vest to the individual and can be bequeathed on death. Superannuation account balances can also be withdrawn without penalty in cases of severe financial hardship, to meet the cost of medical expenses, and in the case of terminal illness.
- Australia's superannuation accounts have limited rules around asset allocation and investment strategy, affording account holders considerable flexibility; individuals may choose a different investment strategy based on their preferences and circumstances.
- Superannuation accounts can avoid some of the underfunding risks associated with partially funded, defined benefit schemes.

Introduction

In recent years, the pension policy debate in Canada has largely centred on proposals to expand the Canada Pension Plan (CPP) and its provincial counterpart, the Quebec Pension Plan (QPP).¹ In Ontario, the provincial government has already introduced legislation for an additional mandatory program on top of the CPP, the Ontario Retirement Pension Plan (ORPP), which is set to come into effect on January 1, 2017.² Much of the mainstream public discussion in Canada about pension policy has focused on whether forced retirement saving mandates should be increased.

Proponents of this position often claim that Canadians aren't saving enough for retirement. This is dubious as research shows the existing retirement system is serving the vast majority of Canadians well (see the appendix for discussion and references). Among the current cohort of retirees, the problem of retirement income inadequacy mainly affects single seniors living alone with minimal work history (Bazel and Mintz, 2014). Neither the new ORPP nor an expanded CPP will help this group in part because contributions continue to be based on earnings. There are important overlooked consequences with both enacting the ORPP and expanding the CPP, including the potential for increased forced government savings to displace voluntary private savings. That is, as governments mandate higher retirement saving contributions (through the ORPP or CPP), Canadians may respond by simply reducing their private savings in vehicles such as Registered Retirement Saving Plans (RRSPs) and

Tax Free Savings Accounts (TFSPAs). In the end, there will be a reshuffling of retirement savings, with more money going to forced savings and less to voluntary savings with perhaps little or no increase in overall savings.

Despite the evidence on retirement income adequacy and the potential for substitution between government and private savings, the Ontario government has committed to enacting a new forced saving mandate. Ontario's decision has national implications because other provinces may follow its lead. And CPP expansion remains a possibility as the issue continues to be debated. Rather than restrict the discussion about additional forced retirement saving mandates to the CPP model, this paper argues that governments (including the Ontario government) should look beyond Canada's borders to models used elsewhere. Australia's compulsory system of individual superannuation accounts provides important insights as that model offers more flexibility and greater choice than the CPP model. If governments are going to pursue an expansion in forced contribution-based pensions (though, as mentioned, evidence shows that such a step is unnecessary), they should consider the Australian model, which has features that may appeal to Canadians if given the choice between it and the new ORPP or an expanded CPP.

There are many reasons to consider the Australian case. The country enacted major pension reform in 1992 and currently stands at the top of international rankings on pension systems.³ In addition, Australia and Canada are re-

¹ All general references to CPP in this paper also apply to the QPP, although the QPP contribution rate is now different as it has been increasing recent years, making its contribution rate higher than the CPP.

² See the Ontario government's latest budget for further details (Ontario, Ministry of Finance, 2015).

³ Australia ranks 1st while Canada ranks 4th on the Mercer Global Pension Index, which measures pension systems based on three components: adequacy, sustainability, and integrity. The three components take various indicators into consideration such as the replacement rates of pension plans, old age dependency ratios, gov-

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markably similar in their political and economic make-up, making them ripe for comparison. Despite their similarities, these countries have taken different approaches to retirement income policy.

This bulletin compares the main features of the Australian and Canadian retirement income systems, primarily focusing on the compulsory saving mandates built into the two systems. Australia's system of individual superannuation accounts offers several advantages over Canada's CPP model, upon which the ORPP will be modelled. (Since Ontario's soon-to-be-enacted pension plan will be largely modelled on the CPP, the CPP's features can effectively be seen as representing those of the ORPP.) The conclusion is that if governments in Canada proceed with additional forced saving mandates, they should broaden the options to include Australia's system of compulsory individual retirement saving accounts.

The next section provides a brief overview and comparison of the retirement income systems in Australia and Canada. The subsequent section focuses specifically on the forced retirement saving mandates in each country, highlighting the advantages and disadvantages of Australia's individual superannuation accounts versus Canada's collective CPP. The final section summarizes the paper's conclusions.

ernment debt, how the pension is funded, government policy and regulations, and the cost of the pension system (see Australian Centre for Financial Studies, 2014). Australia also ranks 1st while Canada ranks 12th on the Allianz Pension Sustainability Index, which evaluates pension systems based on three sub-components: demographics, pension system, and public finances. Seven static parameters and four dynamic parameters are used to measure the burden and the sustainability of the pension system (see Allianz, 2014).

Table 1: The Retirement Income Systems in Australia and Canada

| | Australia | Canada |
|---------------|--|--|
| First Pillar | <ul style="list-style-type: none"> Age Pension | <ul style="list-style-type: none"> Old Age Security Guaranteed Income Supplement |
| Second Pillar | <ul style="list-style-type: none"> Superannuation Guarantee | <ul style="list-style-type: none"> Canada Pension Plan/Quebec Pension Plan |
| Third Pillar | <ul style="list-style-type: none"> Voluntary saving, including via superannuation accounts Other private savings including financial and non-financial assets. | <ul style="list-style-type: none"> Registered Pension Plans Registered Retirement Saving Plans Tax Free Saving Accounts Other private savings including financial and non-financial assets |

Comparing the Australian and Canadian retirement income systems

The Australian and Canadian retirement income systems can be summarized based on the widely used three-pillar classification scheme (see table 1). Both countries employ a formal three-pillar model comprising: (1) a public pension that is not tied to employment and is funded on a pay-as-you-go basis, (2) compulsory employment- and contribution-based saving schemes, and (3) voluntary private saving. The following three subsections briefly discuss each in turn, comparing and contrasting the systems in the two countries. The main characteristics of Australia's three-pillar retirement income system are shown in table 2. This brief comparison of the three pillars sets the stage for the next section, which takes a closer, comparative look at pillar 2 (forced, employment-based, retirement saving mandates), as this pillar offers

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Table 2: Main Features of Australia’s Three Pillar Retirement Income System

| | Pillar 1: Age Pension | Pillar 2: Superannuation Guarantee (SG) | Pillar 3: Voluntary Superannuation* |
|-------------------------|---|--|---|
| Benefit | Income | Lump-sum benefit, which can be converted to income stream | Lump-sum benefit, which can be converted to income stream |
| Level of benefit | Full pension linked to average weekly earnings, subject to income and assets test taper | Dependent on compulsory contributions and investment returns, less taxes and asset management fees | Dependent on voluntary contributions, investment returns less taxes and asset management fees |
| Funding | Funded out of recurrent government expenditure on pay-as-you-go basis | Employer contributions in lieu of wages & benefits | Voluntary personal and employer contributions in excess of SG minimum |
| Coverage | Subject to residency, income and means tests | All employees subject to lower and upper income thresholds | Work tests and contributions caps apply |
| Tax rate | Subject to personal income tax with relief through offsets | Flat 15% on contributions and 15% on earnings, benefits tax-free for those 60 and older | 0-15% on contributions, 15% on earnings, benefits tax-free or those 60 and older |
| Longevity risk | No | Yes, in the absence of lifetime annuity | Yes, in the absence of lifetime annuity |
| Investment risk | No | Yes | Yes |
| Inflation risk | No | Minimal in accumulation stage, post-retirement income stream may have some inflation risk | Minimal in accumulation stage, post-retirement income stream may have some inflation risk |
| Residual value at death | No | Yes | Yes |

Note: * This column excludes other forms of non-superannuation voluntary saving.

Source: Adapted from Australian Government (2010), Retirement Income Strategic Issues Paper, Chapter 2, Australia’s Three Pillar System.

insights for Canada generally and Ontario in particular.

First pillar: Publicly funded pensions not tied to employment

Australia’s version of Canada’s first pillar, comprising Old Age Security (OAS) and its related programs, is the Age Pension.⁴ Australia first

introduced the Age Pension in 1909 and originally intended it to be a safety net and poverty alleviation scheme in case other forms of saving failed to provide an adequate standard of living for some individuals in retirement. Australia’s Age Pension is not intended as an income replacement scheme. Access to the Age Pension

⁴ For eligibility details on Australia’s Age Pension, see <http://www.humanservices.gov.au/customer/services/>

centrelink/age-pension. And for Canada’s OAS, see <http://www.servicecanada.gc.ca/eng/services/pensions/oas/pension/index.shtml>.

is subject to an income and assets test. Notably, the assets test excludes the principal residence, although different assets test thresholds apply to homeowners and non-homeowners.⁵ Canada's OAS also has income restrictions; the full benefit is clawed back at a 15% rate after a certain threshold. An extra, non-taxable benefit is also available to low income Canadian seniors through the Guaranteed Income Supplement (GIS), a program linked to OAS.

Age Pension eligibility criteria are sufficiently generous that around 80% of Australians of pensionable age receive a full or partial Age Pension (OECD, 2013). The full pension is set at 27.7% of male total average weekly earnings for singles and 41.8% for couples. This is in contrast to Canada, where the growth in OAS/GIS benefits is tied to price inflation. Wage inflation tends to be higher than price inflation because it includes a real component linked to productivity. Like OAS, the Age Pension benefits are not tied to time in the workforce or pre-retirement earnings. Around 59% of pensioners receive the full pension, with 41% of pensioners having their benefits reduced by the income and assets tests (OECD, 2013). The public pension is self-reported as the main source of income by most Australian retirees over the age of 45 (Australian Bureau of Statistics, 2013).

Under reforms introduced in 2009, Australia will gradually raise the eligibility age for the Age Pension to 67 years by 2023. These changes re-

flect increased longevity and an expectation of increased labour force participation among seniors. It is also seen as a mechanism to contain future Age Pension costs in the federal government's budget. Similar reforms in Canada introduced in June 2012 will also gradually raise the age of eligibility for OAS from 65 to 67, but will not be fully implemented until 2029, six years later than in Australia.⁶

Australia's Age Pensioners enjoy concessional (preferred) prices and discounts for health care, pharmaceuticals, rental assistance, utilities and public transport, making even a partial pension more valuable than implied by the Age Pension rate. These benefits complicate cross-country comparisons of poverty rates among seniors based solely upon earnings replacement rates. Australia's retirees devote considerable effort to arranging their affairs so they can qualify for a partial pension. Although home ownership affects assets test thresholds, the family home otherwise provides a convenient shelter for retirement saving that does not affect pension eligibility. As in Canada, the principal residence is also exempt from capital gains tax.

Second pillar: The Superannuation Guarantee and the CPP

Individual, employment-based, superannuation schemes have a long history in Australia. Superannuation refers to formal arrangements by which Australians save for retirement. Starting in the 1980s, the labour movement sought to extend superannuation benefits to union members as part of a "social wage" that was traded-off against real wage increases through a then centralized system of wage fixing. An important motivation was to improve the standard of liv-

⁵ The income test reduces the fortnightly pension benefit by AU\$0.50 for every dollar above AU\$160 per fortnight for singles and AU\$284 for couples. The assets test reduces pension benefits by AU\$1.50 per fortnight for every AU\$1,000 of assets above AU\$202,000 for singles and AU\$286,500 for couples who own their own home. More generous thresholds apply to those who are not homeowners. A home-owning pensioner couple can still receive a partial pension with up to AU\$1.145 million in assets, although this was lowered to AU\$823,000 in the 2015-16 budget.

⁶ For more discussion on Old Age Security, its related programs, and further reform options, see Clemens et al. (2013).

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ing of workers in retirement by extending participation in superannuation to low and middle income workers. Similarly, CPP was introduced in the 1960s to help Canadians who did not have workplace pension schemes.

In 1992, the Australian Labor government extended superannuation coverage by mandating compulsory employer contributions to employees' superannuation funds (the Superannuation Guarantee or SG). In November 1991, around 78% of employees were already covered by some form of superannuation (Kelly, 2010). The introduction of compulsion extended the coverage of superannuation to around 90% of the workforce. Those left uncovered are the self-employed (in the absence of voluntary contributions) and those who earn less than AU\$450 per month. Contributions are not paid on incomes in excess of AU\$197,720 annually. Effective contribution rates reflect the application of these thresholds. Indeed, the income range for mandatory contributions is much greater in Australia than for Canada's CPP (CA\$3,500 to CA\$52,500 in 2014).

Since 1992, the compulsory contribution rate in Australia has gradually increased from 3.0% to 9.5% of an eligible employee's ordinary earnings. The current government recently announced that the compulsory contribution rate will remain at 9.5% until June 30, 2021 after which it will increase until it reaches 12.0% on July 1, 2025. There is a history of Australian governments deferring increases in compulsory contribution rates. Since compulsory employer superannuation contributions are paid in lieu of fully taxed wages, the concessional tax rate applied to these contributions reduces the government's income tax take. It remains to be seen whether future governments are prepared to incur the upfront fiscal cost of increased compulsory saving mandates.

The rationale for previous and proposed increases in the SG compulsory contribution rate is to improve retirement saving and reduce future demands on the government's budget from an aging population. The SG can technically achieve income replacement rates of 90% for a median wage earner entering the workforce today and retiring at age 67. This is a generous replacement rate relative to the commonly used benchmark of 70%.⁷

Both compulsory and voluntary contributions to the individual superannuation accounts fully vest to the individual and can be bequeathed on death. Superannuation account balances can also be withdrawn without penalty in cases of severe financial hardship, to meet the cost of medical expenses, and in the case of terminal illness.

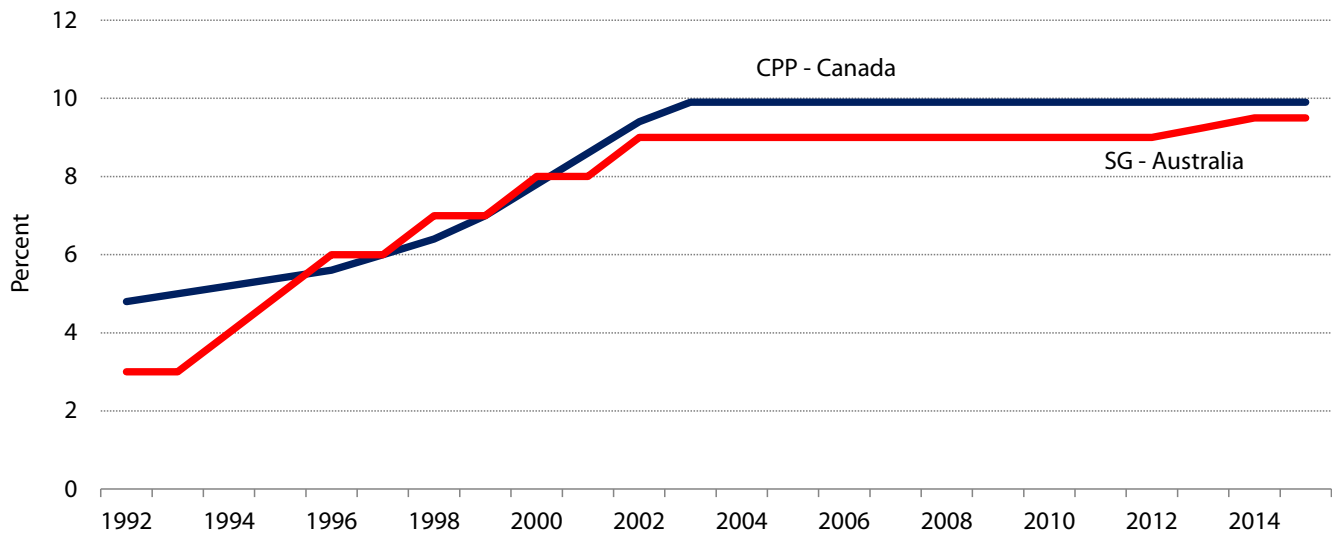
In Canada, CPP benefits are designed to replace about 25% of the pre-retirement earnings on which a person's contributions are based, up to a maximum amount, referred to as the "year's maximum pensionable earnings." Contributions are set at a flat statutory rate of 9.9% for CPP (notionally split between employer and employee contributions) and 10.35% for QPP applied to earnings between CA\$3,500 and CA\$52,500 in 2014 (effective contribution rates reflect these thresholds). Benefits cannot be fully bequeathed⁸ and are pooled so that those who die early subsidize those who live longer, providing built-in longevity insurance (Cross, 2014).

⁷ However, official projections suggest only a modest reduction in future Age Pension eligibility rates, suggesting that Age Pension eligibility requirements may need to be tightened (Australian Government, 2015).

⁸ For details on CPP benefits after death, see <http://www.servicecanada.gc.ca/eng/services/pensions/after-death.shtml>.

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Figure 1: Compulsory Contribution Rates, Second Pillar Pension Schemes (%), 1992 to 2015



Notes:

- The Superannuation Guarantee contribution rate for each year is the rate as of July 1 in that year.
- The CPP contribution rate is the combined employee-employer rate.

Source: Lammam et al (2013), table 1; Australian Prudential Regulation Authority.

It is notable that both the Australian and Canadian second pillar compulsory contribution rates were increased to approximately the same percentage of earnings during the 1990s and early 2000s (see figure 1). Canada's 1997 reforms raised the CPP contribution rate to make the program less of a pay-as-you-go scheme, whereas Australia's second tier system has always been fully funded. Statutory compulsory contribution rates are similar in both countries (currently 9.9% for CPP and 9.5% for Australia's SG). In both countries, there are proposals to further increase the compulsory contribution rates based on the assumption of widespread under-saving for retirement (in Ontario, the provincial government is moving ahead with a new compulsory program, the ORPP, imposing a 3.8% contribution rate on annual earnings up to \$90,000). However, as discussed in the appendix, a more comprehensive view of saving behaviour does not support the notion of a widespread under-saving problem.

In Australia, compulsory employer and voluntary employee contributions to the superannuation accounts are both taxed at a concessional flat rate of 15% up to an annual cap of AU\$30,000 (AU\$35,000 for those aged over 50), above which normal marginal income tax rates apply.⁹ This compares to a top marginal tax rate in the 2014-15 fiscal year of 49% (including Medicare and "Temporary Deficit Reduction" levies). Concessional tax treatment provides an incentive for additional voluntary contributions into the superannuation accounts in addition to compulsory contributions from employers.

Investment income earned in Australian superannuation accounts is taxable. The Australian system is unusual internationally in taxing fund earnings and this is a widely criticized feature of the system. Superannuation fund earnings

⁹ Post-tax contributions can be made up to AU\$180,000.

are taxed at a notional 15% flat rate, although effective tax rates vary.

Superannuation benefits and fund assets supporting a retirement income stream are tax free if taken after the age of 60 up to an annual cap of AU\$185,000 and taxed at a rate of 17% (including Medicare levy) above that threshold. Benefits can be taken as a lump sum or as an income stream through an annuity to provide a guaranteed stream of retirement income. This is different from Canada's RRSP and RPP programs, where contributions are tax deductible and earnings in the plans are accumulated tax free but withdrawals are taxed at normal income tax rates.

Australians can begin withdrawing from their retirement savings account at age 55, though the income is subject to personal income tax. The option to withdraw from the accounts early has contributed to low levels of post-retirement participation in the labour force, so the government is now transitioning to a minimum retirement age of 60 by 2025.

Third pillar: Voluntary saving

Voluntary saving is an important source of self-provision for retirement; it occurs through both financial and non-financial assets, including housing, business equity, and consumer durables that yield a stream of services through retirement. As Cross (2014) notes in the Canadian context, voluntary saving is an under-appreciated and under-recognised form of provision for retirement and plays an important role in supplementing current and prospective retirement income streams from public and compulsory pension schemes.

In Australia, the second tier of compulsory superannuation accounts serves as a vehicle for additional voluntary, concessionally taxed con-

tributions (up to a cap) over and above those mandated by the SG. This provides Australians with considerable flexibility in how they save for retirement. The compulsory contribution rate sets a minimum saving rate, but does not preclude additional saving through this vehicle.

Canada's third pillar includes saving vehicles such as Registered Pension Plans (RPPs), Registered Retirement Savings Plans (RRSPs), and Tax Free Savings Accounts (TFSA). RPP schemes are somewhat similar to Australia's superannuation accounts in so far as they are (although not necessarily) funded by employers in the context of collective bargaining arrangements. Plans can be defined benefit, defined contribution, or hybrids. Employee and employer contributions are tax deductible. Contributions and earnings are tax exempt, but not benefits. In 2013, there were 18,236 registered pension plans with over six million members in Canada, around one-third of the country's labour force (Statistics Canada, 2014).

RRSPs are also similar to Australian superannuation accounts in that they are defined contribution plans that are available for voluntary contributions by employees under the age of 70. Up to 18% of earnings can be contributed subject to an annual maximum. Like RPPs, contributions are tax deductible and investment earnings are tax free, but withdrawals are fully taxed. Funds can be used to purchase an annuity or transferred to a Registered Retirement Income Fund (RRIF). Earnings within the assets of the RRIF before they are disbursed are tax free, but assets are subject to a minimum prescribed drawn-down each year. There were nearly six million RRSP contributors contributing over CA\$37 billion in 2013 (Statistics Canada, 2015).

Canadians can also make contributions to Tax-Free Savings Accounts with after-income-tax

money. The contributions generate tax-free investment income and withdrawals that do not effect OAS/GIS entitlements. The previous annual contribution maximum was CA\$5,500 but the federal government's 2015 budget proposed an increase to CA\$10,000 per year. About 31% of taxpayers have such accounts (Cross, 2014). Australia lacks a comparable third pillar savings vehicle to Canada's TFSAs.

Canada already has private pension saving vehicles similar to Australia's superannuation accounts that provide incentives for voluntary saving for retirement. In fact, Canada's RRSPs have some advantages over Australia's superannuation accounts in that contributions are strictly voluntary and earnings within the account are tax-free, whereas in Australia, only benefits are tax free and even then are subject to limits.

A comparative look at forced retirement saving mandates in Australia and Canada: Individual accounts (defined contribution) vs. collective plans (defined benefit)

Australia's pillar 2—compulsory individual retirement saving accounts—holds a lesson for Canada. With Ontario already moving ahead with its own, new, forced saving scheme, and the national debate about expanding CPP continuing, a closer look at the comparative advantages and disadvantages of Australia's approach is informative. If governments are going to expand forced contribution-based pension schemes, despite being unnecessary, they should consider the Australian model, which has features that may appeal to Canadians if given the choice over the new ORPP or an expanded CPP.

Flexibility

Australia's individual superannuation accounts have distinct advantages over the collective CPP model. For instance, the Australian accounts have limited rules around asset allocation and investment strategy, affording considerable flexibility to account holders; individuals may choose a different investment strategy based on their preferences and circumstances. The Australian plan is also flexible enough to allow funds to be withdrawn from the accounts prior to retirement for medical emergencies or financial hardship. Any balance in the accounts can be fully transferred in a lump sum to a dependent tax-free upon death. These important benefits are not available through the CPP model. In addition, all contributions and earnings in the Australian accounts accrue to the individual, which contrasts sharply with the collective CPP model.

Investment risk

Australia's individual retirement saving accounts are defined contribution plans—not defined benefit plans—which means the level of retirement benefits is less certain, and will depend upon how the investments perform. While defined benefit pensions such as the CPP offer protection against longevity risk and fluctuations in financial market returns, they are subject to the risk of under-funding and government rule changes, such as increased contribution rates or reduced benefit payments. Investment risks to beneficiaries are thus not completely eliminated through the CPP, as poor investment returns and under-funding could lead to changes in contribution rates and benefits, for which there is already recent historical precedent.

Australia's defined contribution approach avoids the under-funding risks associated with partially funded defined benefit schemes. Canada's CPP model concentrates investment risk in a single, public-sector asset manager, whereas in Australia, investment risks in relation to compulsory contributions are more diversified. In Australia, the investment risk to compulsory contributions is better spread over multiple private sector fund managers, including individual self-managed funds, rather than being concentrated in a single public sector fund. These risks are effectively shared with Australian taxpayers through the tax system and the eligibility requirements for the public Age Pension. A growing trend in Australia is the use of self-managed superannuation funds covering a single individual or household, giving investors increased flexibility and reduced asset management costs. However, smaller self-managed funds can incur high operating expense ratios due to fixed compliance and administrative expenses (Australian Taxation Office, 2013).

It is worth noting that the Canadian Pension Plan Investment Board (CPPIB), the entity charged with investing CPP contributions, pursues active rather than passive investment strategies and this increases asset management costs (Cross and Emes, 2014). As Andrew Coyne notes, the CPPIB's recent investment performance slightly underperformed its benchmark, and similar returns could be achieved at lower cost through a passive investment strategy (*National Post*, 2014, Jun. 25). *The Economist* (2012) notes that the large size of Canada's public sector pension funds can be an obstacle to the effective implementation of an active investment strategy. Although the CPPIB uses external asset managers, the process for selecting these managers still represents a concentration of

investment risk.¹⁰ A public sector asset manager such as the CPPIB pursuing active investment strategies represents a concentration of investment risk that is avoided through Australia's system. While a large public sector asset manager can potentially achieve economies of scale, these scale economies are offset by the use of active investment strategies, which yield higher returns only by taking on greater risk.

Intergenerational equity

Australia's individual accounts not only avoid the potential under-funding problem in collective defined benefit plans, but by virtue of being a defined contribution plan, they also minimize intergenerational inequities. Consider that the benefits of current CPP retirees are partially funded by a younger cohort of workers, raising concerns about fairness between generations. For older cohorts of contributors, the CPP offers a higher rate of return (in terms of benefits relative to contributions). According to the Office of the Chief Actuary, someone born in 1980 could expect a 2.3% annual real rate of return on their CPP contributions (Canada, OSFI, 2013). For someone born in 1950, the rate of return is considerably higher at 4.2%. And according to a 2014 study by Godbout et al., a major reason why the rate of return is so much lower for younger generations is that contribution rates have increased without an equivalent increase in benefits. In 1986, the total con-

¹⁰ Australia's sovereign wealth fund, the Future Fund, which manages a portfolio of assets on behalf of the government and is designed to pre-fund some public sector employee pension liabilities, also pursues costly active investment strategies. The Future Fund's cumulative total return since it commenced operations in 2006 underperformed its target return of CPI inflation plus 4.5% until 2014 (see Future Fund, *Portfolio Update*, September 30, 2014). The higher rates of return seen more recently have only been achieved by taking on increased investment risk through an increased allocation to equities and "alternative" investment strategies such as hedge funds.

tribution rate was 3.6%, growing steadily to the current rate of 9.9% in 2003. According to a report released by an interprovincial committee of government ministers, the current contribution rate would only need to be 6% if a higher rate wasn't required to correct the under-funding left by the low rates of older cohorts (Steering Committee, 2010). Put differently, the rate of return from CPP for today's youth is lower to compensate for the higher returns provided to the older generation. There is no guarantee that further program reforms won't reduce the rate of return for future CPP beneficiaries.

Pitfalls with the Australian model

The Australian system of superannuation accounts is not perfect and there are pitfalls worth noting.¹¹ For one thing, the Australian market for longevity insurance is under-developed, but this problem can be addressed by requiring superannuation benefits to be paid as annuities or income products that include some longevity insurance. The recent Australian Financial System Inquiry has made recommendations to this effect (Australian Government, Treasury, 2014).

Another pitfall is that the availability of tax-free retirement benefits from superannuation accounts at age 60, in combination with the Age Pension means test, creates incentives for early retirement and early dissipation of retirement benefits to maximize pension eligibility. Just over half of retirees take their superannuation benefits wholly or partly as a lump-sum (Australian Bureau of Statistics, 2013). Households

may change their labour supply decisions based on the accumulation of retirement savings, so that mandated contributions induce earlier retirement, which is at odds with the public policy objective of increasing labour force participation among older age groups. The average retirement age in Australia is around 60, and post-retirement-age labour force participation rates are low by international standards (Chomik and Piggott, 2012). It has been proposed that the eligibility age for tax-free superannuation benefits should be raised to that of the Age Pension to increase labour force participation among those approaching retirement age and to reduce incentives for early dissipation of retirement benefits. As noted, it has also been suggested that retirement benefits should be subject to mandatory annuitization (income streams) to prevent early dissipation of retirement benefits in the form of lump sum payments (Bateman and Kingston, 2010).

Australia's compulsory superannuation system has also been criticized for high fund management costs—an implication of reduced competition, which flows from compulsion. Costs are above those found in overseas pension systems of similar size (Minifie, 2014), although this should be traded-off against reduced public pension spending relative to GDP (3.5% of GDP in Australia compared to 4.5% for Canada) (OECD, 2013). If the current level of compulsory employer contributions to superannuation were financed out of the federal budget, the size of government in Australia would be around five percentage points larger as a share of GDP (see Daley and McGannon, 2014).¹²

¹¹ As discussed earlier, the tax treatment of superannuation contributions and earnings in Australia is unusual internationally and not ideal. However, this is more a pitfall of the tax system than superannuation *per se*, which is a separate topic. Canada can learn from superannuation independent of taxation arrangements used in Australia for such accounts.

¹² Some have suggested that compulsory superannuation contributions should be attributed to the size of government, since they are a restriction on the use of household income. However, given that the contributions are individually-vested, privately managed, and only change the timing of consumption and reduce future public pension

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Australian superannuation policies usually have an insurance component and a relatively high share of asset allocation to equities that raises costs relative to other countries. Some pension systems do not include an insurance component and have higher allocations to cash and bonds that are cheaper to manage than equities. Compulsory contributions also create a captive market for saving via superannuation, reducing competition from alternative saving vehicles. Competition between superannuation funds is further reduced by the role of collective employment agreements in determining the choice of fund. Many collective employment agreements favour industry-based fund managers with ties to the trade union movement.

A series of major Australian government reviews have offered recommendations in this regard. The 1997 Wallis Inquiry into the Australian Financial System recommended the introduction of choice-of-fund legislation, which was not implemented until July 2005. However, collective employment agreements still override individual choice-of-fund for many workers. The recent 2014 Financial System Inquiry again recommended that all employees be given a choice of fund for compulsory contributions to improve competition and efficiency in superannuation (Australian Government, Treasury, 2014). Reforms flowing from the 2010 Cooper Review of Superannuation are expected to see a rationalization of superannuation products and administration, as well as increased use of lower cost default funds on an opt-out basis. This is expected to lower costs and increase long-term retirement benefits for fund members (Australian Government, 2010).

eligibility, it is more appropriate to view these contributions as a reduction in the size of government relative to a counter-factual in which these contributions are paid out of the budget to fund retirement incomes.

Australia's second pillar system could certainly be improved through increased choice of fund for those subject to collective employment agreements, streamlined administration and governance, as well as improved taxation arrangements. Recent and prospective reforms to superannuation have aimed to improve the system's efficiency and competitiveness, although taxation arrangements remain sub-optimal (Kirchner, 2012). While compulsion is part of Australia's second pillar, it is not essential to its operation and improved taxation arrangements would provide incentives for additional voluntary contributions that could substitute for compulsory employer contributions. The basic features of Australia's second pillar superannuation system remain an attractive alternative to the Canadian model of compulsory contributions to the CPP and potentially the ORPP.

Conclusion

This paper examined the Australian retirement income system with a focus on the forced, employment-based saving mandate in order to draw lessons for Canada in general, and Ontario in particular. While Australia's system of individual superannuation accounts is not without drawbacks, the general model has several advantages over Canada's collective CPP and ORPP models. Rather than restrict the option of new, forced retirement saving mandates to the CPP model, this paper argues that governments (including the Ontario government) could look beyond Canada's borders to compulsory models used elsewhere. Australia's system of individual accounts offers important insights because it has many advantages in terms of increased flexibility and choice not available in Canada's CPP model. If governments are going to pursue an expansion in forced contribution-based pensions (despite being unnecessary), they

should consider the Australian model, which has features that may appeal to Canadians if given the choice over the new ORPP or an expanded CPP.

Appendix: The dubious case for additional compulsory retirement saving mandates

The growing interest in additional compulsory saving mandates is motivated by a concern that Canadians might not be saving adequately for retirement. However, as Philip Cross (2014) demonstrates, a comprehensive perspective of saving behaviour does not support this view. A major review of Canada's retirement income system overseen by Professor Jack Mintz also came to this conclusion (see also McKinsey & Company, 2014). Further, according to pension expert Malcolm Hamilton (2015), the assumptions underpinning the claim that "few middle-income [Canadians] have sufficient retirement savings," are incorrect. Specifically, Hamilton notes that the widely cited household savings rate and 70% income replacement rate benchmark are not reliable guides to the adequacy of retirement saving. To the contrary, some analysts have found that many Canadian households are likely over-saving (Vettese, 2013).

By requiring further compulsory retirement savings, government actions could lead to substitution between mandated and voluntary saving, which may leave the household no better off. Indeed, the scope for substitution between mandated and voluntary saving vehicles limits the extent to which public policy can effectively compel higher saving rates. The net effect by age and income groups depends on the specific forced saving parameters. Voluntary saving allows households to better choose how and to what extent they smooth their consumption

over time. For more discussion on the life-cycle theory, see Vaillancourt et al. (2015), who found that past increases in mandatory CPP contributions were followed by decreases in the private savings rate of Canadian households. Their results suggest that for every one dollar increase in CPP contributions, the average Canadian household reduced private savings by around one dollar. The drop in private savings was stronger among younger (under 30) and mid-career households (ages 30-49) and weaker among Canadians approaching retirement (ages 50-64). It was also more dramatic among lower- and middle-income households than those with higher incomes. In Australia, official modelling by the federal Treasury typically assumes a 30% private saving offset to compulsory employer superannuation contributions.

Households already have a strong incentive to provide an adequate standard of living for themselves in retirement. The availability of non-employment-based publicly-funded pensions, such as Old Age Security, is often thought to give rise to moral hazard in retirement provision. This, in turn, can generate a negative fiscal externality for taxpayers who are then compelled to underwrite living standards in retirement for undersavers. Compulsory saving mandates rely on this fiscal externality argument to justify intervention in relation to private saving decisions that would otherwise only burden the individual saver. However, as Homburg (2000) shows, correcting this fiscal externality through compulsory saving schemes tied to employee earnings creates an even more costly labour market distortion. This result holds under fairly general conditions.

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