

Research Project #2: Occupational Pension Plans and Retirement Income of Ontarians

Research Paper: Income Security During Retirement in Ontario

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Executive summary

The results outlined in this summary are from a special report made by Statistics Canada, which was commissioned by the OECP to examine the economic welfare of Ontario workers following retirement. More specifically, the report uses a rich source of longitudinal data to track the income levels of workers who had at least \$10,000 in earnings at age 55 over a period of more than 20 years as they enter retirement and provides a number of statistics about the degree of financial well-being enjoyed by workers long after retirement (mainly by focusing on family income after taxes – i.e., family disposable income).

Results indicate that, on average, family income peaks at around age 60, then declines to around age 68, and remains stable thereafter. However, this pattern varies tremendously depending upon where one is located in the income distribution. There is little change, on average, in the income levels of lower income people as they move through retirement, while individuals near the top of the income distribution experience significant declines in income through retirement, on average.

Regarding the role of the various income components, earnings not surprisingly account for the majority of the family income around age 55. This is true for both higher- and lower-income individuals.

By their late 60s, public pensions (including the C/QPP, the OAS and the GIS) accounted for about half of the income among the bottom quintile individuals, and private pensions and RRSPs accounted for only 20%. Among top quintile individuals, public pensions accounted for a small part of total income, while private pensions, investments and capital gains together accounted for about 60%.

More recent cohorts of retirees (say those aged 54 to 56 in 1998) have higher family income levels than their earlier counterparts (say those aged 54 to 56 in 1983) as they enter retirement, largely because of higher levels of private pension benefits received by these more recent cohorts. Whether these increased benefit levels will continue for future cohorts is unknown, because private pension coverage has been falling among younger workers.

A replacement rate is an individual's income at any age, say 65, compared with his income at age 55. Among individuals aged 55 in 1983, median replacement rates started

falling below 1.0 at around age 62, fell to about 0.8 by their late 60s and then remained stable.

However, these results were quite different for low-income and high-income individuals. Among poorer individuals (in the bottom quintile) median replacement rates remained at about 1.0 throughout their retirement. Individuals in the top quintile experienced a larger drop in replacement rates, to around 0.7 by their middle 60s, since they were starting from a much higher income base at age 55.

In addition to variation in replacement rates *across* the income distribution, there is variation in rates *within* income quintiles. Individuals with virtually identical family incomes at age 55 can obviously have very different replacement rates in retirement. Focusing on the middle income quintile, analysis indicates that high replacement rate individuals are distinguished from low replacement rate individuals (from the same income quintile at age 55) by employment earnings early in retirement, plus investment and capital gains, and in later retirement, access to private pension income.

The evidence suggests that there has been little change in the pattern of replacement rates across cohorts. More recent cohorts (e.g., those age 54 to 56 in 1995) appear to have similar patterns of replacement rates as they age as retirees in the 1983 cohort.

In addition to income level and replacement rates, income instability can be an issue for retirees. Income instability can be defined as the amount of year to year variation in income levels for any individual. High levels of income instability can lead to consumption issues in some years, and possibly emotional stress.

With respect to income instability, two main conclusions can be drawn from this report. First, poorer individuals have higher levels of income instability than richer individuals during their late 50s and early 60s, but as the pension income kicks in and stabilizes incomes, the gap in income instability between the rich and poor disappears. Secondly, income instability declines for all groups as they age, largely because of the stabilizing effect of public pension income sources.