**OTTAWA’S $285-BILLION PENSION PROMISES: FINANCIAL POST OP-ED**

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By Alexandre Laurin and William Robson

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Suppose a Canadian not employed by the federal government wanted to set aside a nest egg that would provide retirement income like that promised to a federal employee. He or she would invest in a security that is backed by taxpayers and indexed to inflation. Such a security exists: the federal government’s real return bond (RRB). The amount this person would need to put aside to achieve his or her goal — leaving aside retail costs and ignoring for the moment the tax limits on individual saving that would obstruct the project — would be a function of the yield on the RRB.

On March 31, 2011, the RRB yield was not the 4.2% return assumed in the statements of Ottawa’s new pension accruals, but a mere 1.15%. At that yield, the nest egg required to pay Ottawa’s pension promises would not have been the government’s reported $213-billion but $285-billion.

These colossal numbers reflect a gross unfairness in Canada’s pension system. Sensitivities to rates of return provided in the Chief Actuary’s most recent valuations of the main federal plans — those for the public service, the RCMP and the Canadian Forces — suggest that the annual saving rates needed to achieve equivalent tax-backed, indexed pensions at the RRB yield on March 31, 2011, would have been 38%, 46% and 46% of pay respectively. And those calculations take no account of the fact that the opportunities for tax-deferred saving federal employees get inside their defined-benefit (DB) plans are not available to savers in defined-contribution plans or RRSPs. For them, limited to saving of up to 18% of earnings and capped in the low $20,000s, the pretax saving effort would need to be much greater.

Unhappily, those Canadians who must prepare for retirement in a much less congenial environment are also on the hook for the growing unfunded liability in the federal plans. So this look at Ottawa’s pensions suggests three types of reforms to improve Canada’s retirement-income system.

In the medium term, the benefit structure of these plans needs changing. Final-salary-based DB plans with early retirement incentives distort labour markets in many ways; career-average-salary plans make more sense. Some flexibility on the benefit side to share risks between the sponsor and the participants has become common in other public-sector plans in Canada. Such a target-benefit structure would also make sense for federal plans.

Since current low yields on low-risk securities, and the RRB particularly, affect everyone trying to achieve a comfortable retirement, these calculations also highlight the desirability of increasing the tax-deferred saving room available to the rest of the population to match that given to Ottawa’s employees. One route to that goal would be establishing a uniform, lifetime limit for accumulated retirement wealth for all Canadians.

The third reform is to ensure that, whatever the rate at which federal pension entitlements are accruing, actual money is flowing into the plans to match those entitlements — by raising contribution rates and putting the additional cash into existing or new arm’s-length funds. Even if much of that extra cash ends up funding purchases of federal bonds and other debt instruments, the need to pay the full cost of federal compensation in cash will be a powerful discipline, as will the need for federal debt issues to compete with other potential investments for the fund managers. To let this unfunded obligation expand is unconscionable — all the more so to the extent that tax and other laws limit non-federal employees’ opportunities to build retirement wealth, some of which may be needed to bail out the federal plans.

Fair-value reporting of Ottawa’s pension obligations highlights three imperatives. Over time, federal plan benefits need rationalization. Meanwhile, private-sector employees need much more generous treatment in their own quests for secure retirements. And higher contributions should boost the actual assets held by federal-employee pension plans, to protect Canadian taxpayers from the double whammy of unexpectedly low retirement incomes and unexpectedly high taxes as they bail out the plans of their more fortunate former government-employee compatriots.
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Alexandre Laurin is the C.D. Howe Institute’s associate director of research and William B.P. Robson is CEO. Excerpted from*[*Ottawa’s Pension Gap: The Growing and Underreported Cost of Federal Employee Pensions*](http://www.cdhowe.org/pdf/ebrief_127.pdf)*.*