Canadian and American Saving Rates and the Role of RRSPs

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Les écarts entre les taux d'épargne agrégés canadiens et américains ne semblent pas être attribuables au programme de régimes enregistrés d'épargne-retraite au Canada.

The differences in Canadian and US aggregate savings rates do not appear to be attributable to the Registered Retirement Savings Plan program in Canada.

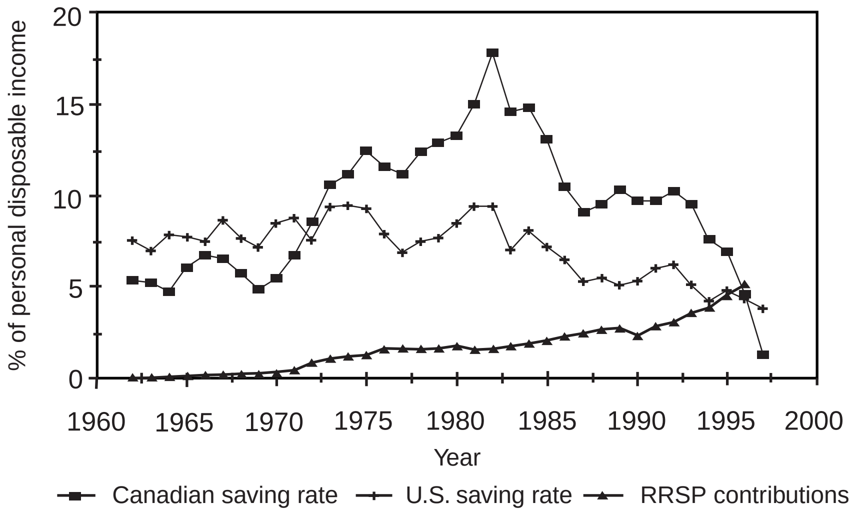
Introduction

Rates of personal saving have long been a concern of policymakers in both Canada and the United States and saving rates in the two countries are inevitably compared. In particular, if the Registered Retirement Savings Plan (RRSP) program leads to increased saving in Canada, as opposed to largely providing tax advantages for saving that would have been made in any case, then it would seem this should be evident in the Canada-US saving rate differential. Indeed Jump and Wilson (1986), Carroll and Summers (1987), Venti and Wise (1995) and Poterba, Venti and Wise (1996), among others, have attributed the jump in the Canadian saving rate in the early 1970s to RRSPs, which at that time had no equivalent in the US (see Figure 1). The purpose of this brief commentary is to show that RRSPs cannot reasonably account for the differences in the aggregate saving rates between the two countries.

Saving Rates and the Components of Saving

Our essential point is made in Figure 1. Note that while the Canadian saving rate did jump in the early seventies, RRSPs had been available in Canada since 1957[1] and contributions increased smoothly from an initial very low level. There is a small but perceptible jump in RRSP saving in the early seventies, probably due to an increase in RRSP contribution limits at that time and an increase in the effective rate of taxation on capital gains, but the increase is not nearly large enough to explain the increase in Canadian savings rates that began in 1969 and

FIGURE 1
Saving Rate and RRSP Contributions, Canada and the United States, 1962-1997



Note: 1997 figures based on the first three quarters.

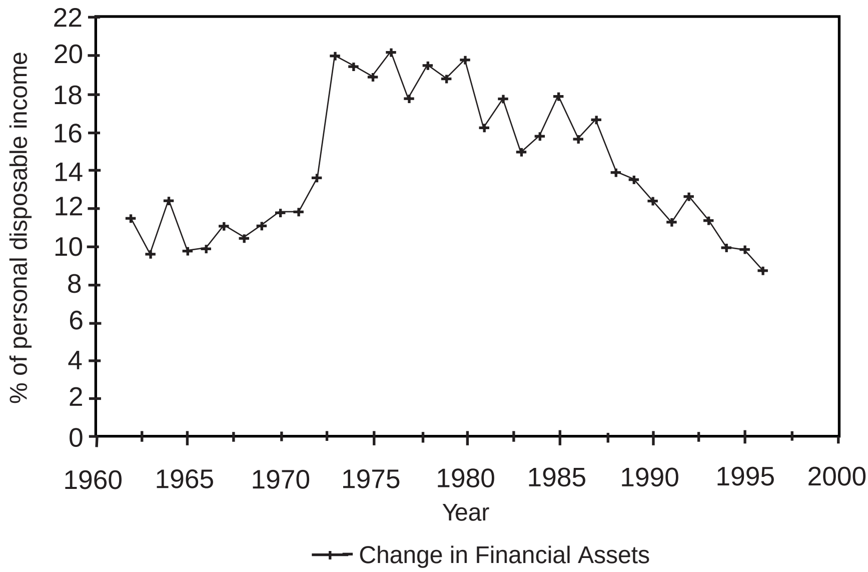
peaked in 1982. Moreover the Canadian savings rate and the Canada-US savings differential fell beginning in 1982 and has declined more sharply in the last few years (to the point that it has been reversed), while RRSP contributions have continued to rise.[2] In sum, RRSP contributions are not well correlated with either the magnitude or timing of changes in Canadian saving rates.[3]

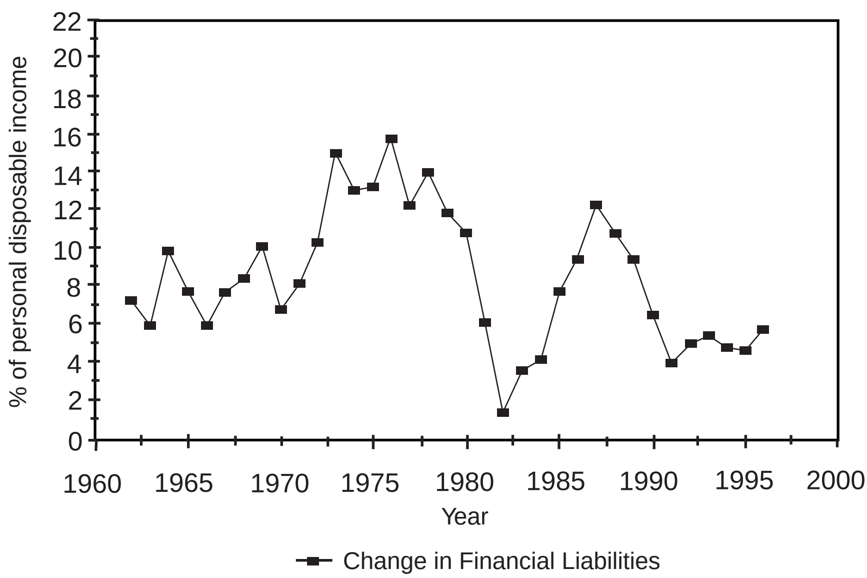
Even within the standard economic theory paradigm of individual optimization, it is not unambiguous that the availability of RRSPs should increase saving. RRSPs do encourage saving by allowing an individual to defer taxation on contributions until a year when marginal tax rates may be lower and, probably more important, by allowing tax-free compounding on assets within the plan. However the effect is not unambiguous both because the responsiveness of saving to higher interest rates is ambiguous (in effect individuals may find that higher returns mean they do not need to save as much) and because given a certain government revenue requirement, the tax advantages of RRSPs must be paid for by higher tax rates elsewhere. (See Ragan 1994 for a theoretical exploration of this latter issue.) Finally it is possible that some individuals will realize that any formal, financial saving for the future will affect their returns when older from such means-tested programs as the Guaranteed Income Supplement or the proposed Seniors Benefit and hence such individuals will not participate in the RRSP program at all.[4]

As a final point, we draw upon an insightful analysis by Clift (1988) and consider two components of Canadian saving that account for much of its variation: the change in financial assets and the change in financial liabilities. From Figure 2, it can be seen that the reduction in liabilities accounts for the 1982 peak in Canadian saving seen in Figure 1: this was due to an increase in the rate of mortgage paydown probably triggered by the very high interest

FIGURE 2

Change in Financial Assets and Liabilities as a Percentage of Personal Disposable Income, 1962-1996





rates at the time. The incentive to pay down mortgages was lower in the United States, because mortgage interest is "deductible" in the US federal income tax system.

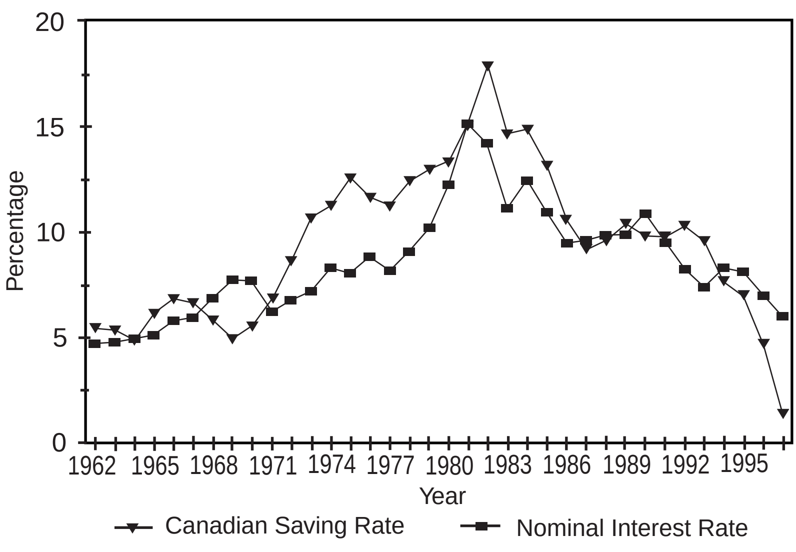
Turning to assets, the graph reveals that despite the increase in RRSP contributions, since the early 1970s the rate of Canadian asset accumulation as a percentage of personal disposal income has steadily and almost smoothly declined. Again there is no evidence of an effect attributable to RRSPs, which are part of this category. More generally, as shown in Figure 3, what seems remarkable is how closely Canadian nominal interest rates track Canadian saving rates, but that is beyond the scope of this commentary — our emphasis is simply that RRSP contributions seem to have little to do with the variation in Canadian saving.

Conclusions

The RRSP program serves many purposes in the Canadian personal income tax system, for example, by providing an important measure of horizontal equity for those with no or limited private pensions and providing "income-averaging" for those whose incomes vary widely. However, changes in the RRSP program or in RRSP contribution rates do not appear to explain the savings gap between Canada and the United States during the 1970s, 1980s, and the early 1990s, a gap which has since been reversed despite continued growth in aggregate RRSP contributions.

Figure 3

Canadian Saving Rates and Nominal Interest Rates, 1962-1997



Notes:
1. Saving rates are as a percentage of personal disposable income.
2. Interest rates are those on five-to-ten-year Government of Canada bonds.
3. 1997 figures are based on the first three quarters.

NOTES

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[1]Organizations such as the Canadian Medical Association immediately set up plans to take advantage of the RRSP program (Moreton 1957).

[2]In the United States, tax-favoured saving (particularly in 401(k) plans, which must be set up by the employer) has increased substantially in recent years over quite low levels in the 1980s. While the most recent official data are for 1993, Shoven and Wise (1998) guess that such saving was up to about $100 billion in 1997 (or about 40 percent of US personal saving). Nonetheless growth in US tax-favoured saving relative to Canadian RRSP saving is not nearly rapid enough to account for the recent reversal of the Canada-US saving gap.

[3]Moreover, there is little evidence that changes in RRSP contribution limits have had much effect on RRSP contribution rates or saving rates. While Burbidge, Fretz and Veall (1997) investigate this in some detail using both aggregate data and data from the Family Expenditure Survey, again the basic point is clear from Figure 1, where it is difficult to discern any effects from substantial increases in limits in 1976 and 1986. While the higher limits in the 1990s may have had some effect, almost all growth in the program has come from increased numbers of participants with the average contribution relatively constant in real terms and well under the limit.

Sabelhaus (1997) also argues that the higher saving rates in Canada in the 1970s and the 1980s are not a consequence of the RRSP program but are largely a consequence of relatively low provision of public and private pensions at higher incomes, as for example US Social Security pays more to high-income retirees than does the Canadian public pension system. It is not clear how this proposal accounts for the recent plunge in Canadian saving.

[4]Empirically, while individuals with RRSPs save more than individuals without RRSPs, this could simply be that individuals who are "savers" by nature use RRSPs as a (tax-favoured) vehicle for holding their savings. Burbidge, Fretz and Veall (1997) also find that about one-fifth of RRSP contributions are RRSP rollovers for termination benefits or pension transfers and hence do not reflect an individual's saving decision as typically conceived.

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