

REDUCING GOVERNANCE RISK

Lessons that corporate human resources departments need to learn from pension managers.



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IN A WORLD WHERE WORKERS ARE SCARCER AND MORE ECONOMICALLY SECURE, THE ART OF KEEPING PEOPLE HAPPILY AND PRODUCTIVELY EMPLOYED WILL BE MORE VALUABLE.

Canada is aging and growth in our traditional working-age population is decelerating sharply—that much is well-known. The adverse implications of this change for economic growth and investment returns, however, are less familiar. For the country and its pension plans, capitalizing on unexploited opportunities to make work more rewarding will

likely prove a better route to prosperity than eking out a few more basis points of investment returns.

An older workforce presents a challenge, as well as an opportunity, for pension managers. They will have to tell management and labour that high investment returns will not bail out bad employment and compensation decisions. They must stress the need for innovation in compensation packages and work arrangements that will keep workers happy and productive for longer employment lives. And, as befits professionals accustomed to taking the long view, they must start soon and make their case often.

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Unfortunately, the current arm's-length relationship between pension governance and other human resource functions hampers the use of pension experts' insights in employment contract design. Reducing governance risk, so that the pension plan is an integral part of a package that encourages work rather than an afterthought that covers for a package that fails to do so, should be a priority for all concerned.

A workhorse model of economics that distinguishes three critical supports to long-run income growth makes

clear the problems arising from a slower-growing workforce. Over the next 40 years, labour's contribution to income growth seems set to fall sharply, from the 1.1% annually recorded from 1976 to 2002, to only 0.2% annually. That change alone could lower annual growth in real incomes from the 2.9% recorded since 1976 to 1.9%. Allowing for possible adverse interactions between aging and the two key inputs—the capital accumulated by saving, and productivity growth—suggests that total annual real income growth could be as low as 1.3%. That would be a tough environment in which to find the high real returns many pension plans need to fund their liabilities.

The message from this calculation—that we need to keep Canadians on the job, especially the older Canadians who will loom so large in tomorrow's potential workforce—applies to individual pension plans as much as to the economy as a whole. In an environment of 2% real wage growth and, say, 4% real returns, raising replacement ratios through higher investment returns is proportionately twice as hard as achieving it through lengthening working life. Yet our system forces pension managers to focus on the former task rather than exploiting the opportunities available from smarter employment contracts.

Human resource departments that resist advice from pension managers on approaches to encouraging work from older employees must confront several facts. Most striking of all, the actual number of older workers on the job is exploding. Organizations that employ these people are gearing up for the workforce of the future. Those that are not should ponder whether their failure to keep up will blunt their competitive edge.

The earlier we start encouraging older Canadians to stay on the job, making contributions to pension plans and generating the incomes those plans need to pay benefits in the future, the better the long-term outlook will be. ■