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CPP needs more than a ‘modest’ fix to help middle-income retirees

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Federal Finance Minister Jim Flaherty and his provincial counterparts, last December, agreed to consider options for a “modest” expansion of the Canada and Quebec Pension Plans in June, 2013. June has come and gone without this meeting. If and when a meeting does occur, it will likely be behind closed doors, and Canadians will not know what kinds of “modest” expansion options are being discussed. However, if the rare tea leaves provided by finance ministers are any guide, Canadians nearing retirement shouldn’t hold out much hope that these reforms will save the day.

In a study released this week by the Institute for Research on Public Policy (IRPP), I have used Statistics Canada’s Lifepaths model to project both the current retirement income system and some more “out of the box” options for meaningful reform. The projections show that about half of middle-income earners over age 40 today will see a significant decline in their standard of living post-retirement. This may come as a rude awakening for many.

Most pension experts agree with Mr. Flaherty when he says: “Canadians are not saving enough for their retirement.” So what’s the solution? All pension reform scenarios put forward so far assume that any new retirement benefits need to be fully pre-funded. This means it would take nearly half a century for any enhanced benefits to be fully phased-in.

Such a “modest” half-century solution won’t help many Canadians. Clearly more creative thinking is needed. My new analysis provides detailed estimates for a series of options that effectively address the retirement income challenges Canada faces today.

First, and most importantly, the Canadian Pension Plan (CPP) and the Quebec Pension Plan (QPP) remain the best vehicles for reforming the retirement income system. If middle-income Canadians want secure and adequate incomes in retirement, voluntary plans won’t do. They will have to force themselves to save more, and we all know this is unlikely to happen.

The most efficient and effective way for Canadians to save, by far, is to legislate the necessary earnings-based contributions to a broadly-based public fund; in short the CPP/QPP.

If we expand CPP/QPP, then it is important to ensure that the reforms effectively target the problem at hand. Full pre-funding of benefit enhancements has been the universal, though implicit, assumption in all recent discussions – in order to ensure contribution rates remain stable and hence the long-run solvency of the fund.

But full pre-funding is not necessarily the only way to accomplish the twin objectives of plan solvency and rate stability. Increasing the age of pension eligibility, combined with an appropriate increase in the contribution rate to pay for these new benefits, would also produce financial stability. For many Canadians, these contribution rate increases would be smaller than those brought in during the 1990s, which had no obvious adverse effect on Canada’s economy.

Increasing the eligibility age to between 68 and 70 (up from 65 today) would be sufficient to maintain financial stability while expanding and phasing-in new benefits more rapidly – over 20 years rather than nearly a half century. We could increase CPP retirement benefits from 25 to 40 per cent of pre-retirement earnings above $25,550 (half the average wage) and double the range of covered earnings from $51,100 to $102,200 (twice the average wage).

It would also be possible within this framework to adjust benefits for lower-income earners to compensate for their lower-than-average life expectancy and their shorter time drawing retirement benefits. This would address the greater impact of raising the eligibility age on lower income groups.

Trading off a later pension age for enhanced CPP/QPP benefits, phased in over a shorter time horizon, is appealing on many levels. This “grand bargain” would significantly improve retirement incomes, do so sooner, encourage workers to remain in the labour force longer, and provide greater equity across income groups.

Taken together, these changes would reduce by a quarter the proportion of middle-income earners now facing a significant decline in their standard of living post-retirement.

These options are probably not “modest” amongst those long opposed to any CPP/QPP expansion, but they illustrate what is possible, and what is needed, if we are to avoid a wide-spread drop in Canadians’ standards of living post-retirement.

It’s time that our finance ministers finally and meaningfully to address longstanding pension policy issues. Letting Canadians in on the discussions might be a good place to start.

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