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C/QPP's uncertain future

by J. Bruce MacDonald

Many Canadians fear for the future of the Canada/Québec Pension Plans (C/QPP). They believe the funds will be exhausted by the time they retire. They do not realize the plan has always operated on a pay-go basis with a contingency fund equal to two years' benefit payments. Implicit in this is a scenario of increasing contributions, which has been planned from the start in 1966, although contributions were not to increase (and did not) for 20 years. In the first years, contributions exceeded benefits paid for reasons that had nothing to do with the plans' actuarial funding. Sophisticated observers fear that the ultimate contribution rates will be higher than Canadians will be willing to pay.

Last year, the Canadian Institute of Actuaries (CIA) appointed a Task Force on Social Security Financing. Coincidentally, at just about the same time, Rob Brown of the University of Waterloo, presented his paper, "The Future of the Canada/Quebec Pension Plans," at the June 1993 CIA meeting. This paper and its discussions were of help to this task force, chaired by Kit Moore. It released its report at the November 1993 CIA meeting.

The rest of this article summarizes the "Report of the Task Force on Social Security Financing."

Contribution rates

The report notes that contribution rates to C/QPP will increase to levels higher than expected, because of significant benefit improvements and the "baby bust" that started in 1960. The combined employer/employee contribution rates to CPP will increase steadily from 5.00% in 1993 to 13.27% in 2035, after which they are fairly level.

Components of the retirement income program

The Old Age Security Pension (OAS), the Guaranteed Income Supplement (GIS), the Spousal Pension Allowance (SPA), and the C/QPP make up the Canadian retirement income program. OAS is a universal demogrant, while GIS and SPA are income tested. OAS is taxed back in whole or in part (the "claw-back") if income exceeds a certain level (currently $53,315). C/QPP are earnings-related and not subject to any income test or claw-back.

C/QPP have several advantages that justify their importance in the retirement income programs. These include

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One of her interesting comments was that Canada should export some health services to the United States. Saying that some procedures could be performed just as well and at much lower cost in some Canadian hospitals than in corresponding U.S. hospitals, she advocated that any excess capacity should be made available to any U.S. residents willing to pay for it.

Bruce Cohen, a journalist with *The Financial Post* of Toronto, was another outside speaker providing valuable insight. He appeared on a panel with CIA members Kit Moore and Rob Brown to discuss the publicity the CIA generated for its "Report of the Task Force on [Canadian] Social Security Financing." (Bruce MacDonald discusses the report more fully in the front-page article of this issue.) Cohen said he had found the report most helpful, and he had been pleasantly surprised that the report's press coverage, resulted in mostly informative and well-balanced articles. He stressed that actuaries should never slacken their efforts to inform the public, and they should remember that the average journalist is comfortable describing immediate crises, not long-term, complex questions.

CIA members spent much of the meeting wrestling with their proposed new consolidated standards of practice. A discussion draft was published in February. In presenting the draft, Ken Clark said he hoped the approval process would be complete by January 1, 1996. Judging by the volume of work to be done and its complexity, this may be optimistic.

In this issue, Editor Mike Cowell reports on the responses to the readership survey last November. I echo his request to readers to keep their responses coming.

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virtually full coverage of the working population, portability of benefits, inflation protection, and low administrative costs.

Comparison with other countries

The report compares the Canadian system to the others in the seven top industrial nations, known as the G-7 countries (United States, Japan, Great Britain, Germany, France, and Italy), plus Australia. Canada's benefit levels usually are somewhat less generous, but about the same as in the United States and Great Britain and much more generous than in Australia. Current contribution rates, however, are much lower than in any of the G-7 countries, all of which have more mature populations than Canada, some with a normal retirement age of 60. The long-term contribution rates in Canada will be comparable to current rates elsewhere.

Rate of return on contributions

The Canadian social security system provides about 45% of the income for elderly single men, about 55% for elderly single women, and about 40% for elderly couples. Private pension plans provide less than 20% of income. Thus, these government plans are an important income source for retired Canadians, with OAS/GIS providing more than C/QPP.

The report considered whether C/QPP was a "good deal" for Canadians. Will Canadians be satisfied with a real rate of return of only 1.5%, when the combined employer/ employee contribution rate exceeds 13%? If the employee contribution ignores the employer contribution, as may well occur, the returns will look much better.

The real problem with C/QPP contribution levels is that Canada is one of the most highly taxed countries in the G-7, with a very high deficit. To reduce it requires higher taxes or reduced government spending.

The estimated cost for Medicare, Unemployment Insurance (UI), Workers' Compensation, OAS/GIS, and C/QPP is 18.6% of GNP. Many of these programs' costs will increase as the population ages. At some point the combination of income tax and social security costs may reduce overall economic activity and employment, thereby reducing the tax revenue available.

Future availability

A recent survey indicated that less than 30% of Canadians believed that C/QPP benefits would be available to everyone at retirement. However, 60% expect to rely on social security and private pension plans after retirement. Yet only about 45% of working Canadians are members of private pension plans. Only about 35% contribute to a Registered Retirement Savings Plan, a tax-assisted form of retirement savings. Of this 35%, many are sole proprietors or partners (which include most professionals such as doctors, lawyers, and accountants) who cannot, under Canadian tax laws, establish a pension plan.

Increased contribution rates necessary

Large increases in contribution rates will be necessary to maintain the status quo for C/QPP. The scheduled increases are gradual, and in no one year should be great enough to produce a public outcry. With reduced wage increases, however, they will be much more noticeable than in earlier years. A large increase in UI rates two years ago caused no great outcry; benefit cutbacks resulted in more complaints. With the many objections to the substantial increase in 1994 UI rates, the level of contributions finally may have reached the stage where a tax revolt may be brewing.

The report points out that most social security schemes are financed on a pay-go basis, and it rejects full funding for

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social security. It correctly points out that if the fund were in government bonds, it merely redirects part of the cost from identified contributions to income tax.

The pragmatic objection is that full actuarial funding would lead to even greater increases in contribution rates than are now proposed.

Suggested changes

The report suggests four possible changes to C/QPP that would reduce costs:

1. **YBE** — No contributions are being made on the first 10% of maximum covered earnings, known as the Year's Basic Exemption (YBE), which was $3,400 in 1994. If earnings are below the YBE, no contributions are made nor benefits earned. If earnings are above the YBE, no contributions are made on this tranche, but benefits are earned. This was done to reduce administration and to subsidize lower income workers. The result is that part-time workers don't receive benefits, and it has created inequities between workers earning just over and under the YBE.

The report suggested the YBE be eliminated. This could reduce ultimate contribution rates by up to 2%. The change would be highly regressive, as it would result in a 17-fold increase for a worker earning only $200 more than the YBE, while the increase would be only 11% for someone with maximum covered earnings. Obviously, such a change would have to be phased in.

2. **Contributory period** — Currently, the 15% of years with lowest earnings can be dropped out in calculating benefits. Ultimately the maximum contributory period will be 47 years, from 18 to 65, so full benefits will require contributions for only 40 years. This provision makes sense, because many individuals do not start working until they reach their twenties or they have periods of unemployment. Consideration, however, could be given to changing the drop-out period to 10%.

The treatment of early retirement is more important. In this event, the contributory period stops at the date of early retirement. Thus at age 60 the maximum contributory period will ultimately be only 42 years, so a full pension can be earned after only 35.7 years of contributions. If 40 years of contributions were required for a full pension, it could reduce the cost by .5%. Early retirement pensions are reduced by .5% for each month between the date of early retirement and age 65.

3. **Survivor's benefits** — With more two-income families and financial autonomy of spouses, the report suggested current survivor's benefits are, in large part, redundant. In 1992, survivor's benefits amounted to 14% of all CPP benefits paid. The report's only suggestion for change was to replace the current survivor's benefit with a temporary pension if death occurs before age 65 and to transfer 50% of the deceased's earnings to a surviving spouse based on years of cohabitation.

4. **Retirement age** — The normal retirement age is now 65 under all programs. The report suggested the normal retirement age be raised to 70 by increasing the retirement age by either two or three months every year, beginning in 1994. This ultimately would reduce the combined costs of C/QPP, OAS, and GIS by about 4.5% of contributory earnings and of CPP by itself by almost 3%. Economic conditions today encourage early retirement. The report suggests, however, that by the time the baby boomers have retired, incentives for delayed retirement may have become the norm.

Public discussions beginning

The report should make a valuable contribution to the public discussion of C/QPP changes. Three actuaries, two of whom are over age 60, told me they think drastic action to reduce the level of benefits is needed. Another actuary, in a letter to the Toronto *Globe & Mail,* wrote that the current problems were brought on by the "profligacy" of the current generation of seniors by spending more than they took in on retirement programs and by tax reductions for savings programs. (No mention was made of education, health care, or infrastructure.) He suggests those who are too young to collect will refuse to pay for the financial excesses of the previous generation and will tell seniors that they are on their own. He compares this to dealing with out-of-control children and calls it "tough love."

J. Bruce MacDonald, retired, does some consulting work for the Senior Citizens Secretariat of Nova Scotia.

IN MEMORIAM

James G. Bruce	FSA 1946, MAAA 1965	**Kenneth G. Gustafson**	FSA 1978, MAAA 1970, MSPA 1980
Rebecca Burell	ASA 1979, MAAA 1982	**James F. McJohn**	FSA 1978, MAAA 1979, FCA 1986
Peter L. Durbin	ASA 1970, FIA 1969		
Joseph T. Gannon	FSA 1936, MAAA 1965	**Thomas D. Pitts**	FSA 1971, FCIA 1971