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OP-ED

EXPANDING THE CPP: MORE COMPLEX THAN AT FIRST GLANCE

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Had I suggested just 15 years ago that we should expand the Canada Pension Plan (CPP) to provide larger benefits on a broader range of wages, I would have been laughed out of town. Pre 1998, the CPP was seen as leaning against death's door. Young Canadians were told not to expect ANY benefits from the CPP when they retired.

However, because of the significant reforms of 1998, the CPP is now healthy for as far as the eye cannot see (the same is not true for the Quebec Pension Plan (QPP), but that is another story). It is so healthy, in fact, that many observers are suggesting that it should be expanded to provide larger benefits.

This could be done in two ways (or a combination thereof). Currently Canadians contribute 9.9 percent percent of wages (split between the worker and the employer) to the CPP on wages over $3500 and up to $48,300 (in 2011: called the Year's Maximum Pensionable Earnings). Benefits accrue at the rate of 25 percent percent of the adjusted (indexed to the Average Wage) average of recorded employment earnings over roughly a forty year period. So, one way to expand the CPP would be to raise the 25 percent percent benefit rate. Another would be to raise the Year's Maximum Pensionable Earnings (the YMPE). Or both.

Sounds pretty straightforward. But it isn't.

Prior to 1996, the contributions Canadians made to the CPP were not large enough to cover the benefits being accrued. In fact, out of today's 9.9 percent contribution rate, a full 4 percent goes to covering past legacy costs (the previous unfunded liability). Thus, it would be possible, if we started a fully-funded CPP today, to do so at a contribution rate of about

5.9 percent. However, if we wish to expand the 25 percent benefit rate only for retirement benefits, and we do not increase any of the ancillary benefits (orphan's, disability, death, etc.) we could fund a new benefit tier with a contribution rate of no more than 5 percent.

This sounds good at first glance, but, in fact, it creates a series of complications. For example, let's say we wish to move from a 25 percent benefit rate to 50 percent. This would require a 14.9 percent contribution up to the YMPE. Double the benefits for 50 percent more cost. Sounds like a good deal.

But think about poorer workers. Having paid a 14.9 percent contribution rate over 40 years, they will now receive a 50 percent CPP benefit when they retire. But this is immediately deducted from their Guaranteed Income Supplement (GIS) at a 50 percent clawback rate and, depending on their province of residency, they could lose another 50 percent from their provincial benefits (e.g., Ontario Guaranteed Annual Income System (GAINS)) for a total 100 percent clawback. That means a 50 percent increase in contributions but no net gain in disposable income from government sources. How many workers would vote for that?

To avoid the impact of the GIS clawback, we could exempt a portion of employment earnings (say up to $30,000 a year) from contributions and benefit accrual. Or, maybe we should leave the benefit ratio at 25 percent but increase the YMPE.

Again, the value of the ancillary benefits is important to this analysis. If, as assumed above, we don't increase ancillary benefits at all, and accepting the current CPP funding formula, then the required contributions would be 9.9 percent up to the YMPE and 5 percent above it. Again, what politician would want to try to win votes with a new system in which poorer workers have a 9.9 percent contribution rate for their first tier benefits and higher income workers only pay 5 percent for their second tier of benefits? This would be a hard sell.

Finally, under any proposal that uses an expanded CPP, the new benefits will not be fully available for 40 years. Until then, only a fraction (t/40) would accrue.

At the end of the day, it takes at least seven provinces with at least 2/3 of the Canadian population to amend the CPP. This includes Quebec. This is not an easy task as can be seen today. To date, the provinces have not seen a proposal for an increased CPP that meets with their approval.

Once one understands the issues more fully, one can see why.

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