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Fiscal Pulse

Expanding the Canada Pension Plan

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An agreement in principle has been reached by eight Provinces for a comprehensive expansion of Canada's social security system, the Canada Pension Plan (CPP), phased in over seven years from 2019 to 2025. Ottawa and Ontario have indicated a tight July 15, 2016, deadline for approval by at least seven Provinces representing the required two-thirds of the national population. The discussion below is based upon information available immediately following the Finance Ministers' meeting.

The proposed CPP expansion allows Ontario to begin to unwind its Ontario Retirement Pension Plan (ORPP), scheduled for implementation from 2018 to 2021. The CPP enhancement is expected to preserve a more coherent national retirement saving framework and a more level playing field for private-sector business expansion. The comprehensive enhancement of a portable CPP should help to address previously noted retirement savings gaps, but will alter households' saving allocations.

The Proposed CPP Changes Are Significant

The CPP benefit will be raised from one-quarter to one-third of pensionable earnings. For example, for an individual with constant earnings of about $50,000 over his working life, the annual CPP benefit would climb from $12,500 to almost $16,700, a yearly increase of over $4,000.

Maximum pensionable earnings, presently $54,900 for 2016, will continue to be indexed annually for inflation, and then rise by 14% in 2024 and again in 2025 to an approximate target of about $82,700.

Employer/employee CPP premiums, currently 4.95% of maximum pensionable earnings less the $3,500 annual basic exemption, will rise by one percentage point for both employers and employees over the five years from 2019 to 2023 to cover the larger benefit share. The proposed increase in the combined CPP premium rate from 9.9% to 11.9% compares with the upswing from 6.0% in 1997 to 9.9% in 2003, after the steady upward trend as of 1987 from the original combined rate of 1.80%.

Over 2024-2025, annual premiums will climb with the increase in maximum pensionable earnings. This rise will be muted if an individual's annual employment earnings are substantively less than $82,700. Over the next nine years to 2025, the proposed escalation in maximum pensionable earnings, capturing the effects of indexation to inflation and the policy change, is roughly 50%.

How Affordable is the CPP expansion?

The proposed CPP benefit changes will be paid out gradually as they are funded, avoiding an additional intergenerational shift in the financing burden.

For lower-income Canadians, to help offset the impact of higher CPP contributions, the federal *Working Income Tax Benefit* will be adjusted.

For higher-income Canadians, the additional CPP premium will receive more favourable tax treatment as an allowable deduction similar to an RRSP contribution. The existing amount of CPP premiums will continue to be treated as a tax credit based on the lowest personal income tax rate.

One consequence of an expanded CPP will be reduced saving in other retirement vehicles. Individuals are likely to set aside less for private-sector savings instruments such as *Registered Retirement Savings Plans* or *Tax-Free Savings Accounts,* while employers possibly scale back contributions to their employee pension plans.

A key objective of the relatively lengthy seven-year phase-in is to provide time for employers and workers to adjust to the new regime. Other options discussed before yesterday's meeting had included a more targeted approach that addressed specific retirement savings gaps such as workers without sufficient workplace pension plans.

Manitoba and Quebec, the two Provinces not proceeding with the agreement-in-principle, are still expected to remain part of the CPP expansion discussions going forward. The latter, during future consultations on the Quebec Pension Plan (QPP), is expected to urge a modest expansion, with one possible option new premiums exempting income from the current $3,500 threshold to $27,000. The QPP employer/employee contribution rate is 5.325% for 2016, with the planned increase from 4.95% in 2011 to 5.40% in 2017 nearly completed. For those without employer pension coverage, Quebec has implemented its *Voluntary Retirement Savings Plan*, modeled on Ottawa's *Pooled Registered Pension Plan*.

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