Forced Savings–*2013 Update*

Economic impacts of raising CPP/QPP retirement benefits and premiums

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The Canada and Quebec Pension Plans (CPP, QPP) are once again being touted as a means by which Canadians can have their retirement savings problems solved for them. Urged by organized labour groups and some academics, a number of governments are now pushing for big changes to the benefits formulas. What they have not brought to light, however, is what it would mean to the funding side of the equation. This report takes a look at one of the current proposals—the so called 10-10-10 Plan—and finds that it would bring employment growth to a halt (with a loss of more than 700,000 person years of employment), limit employee earnings (a 1.5 per cent decline in wage levels) and worsen government fiscal balances (a 2.0 and 1.2 per cent increase in federal and provincial debt-to-GDP ratios respectively).

Background

The CPP and its cousin, the QPP are important threads of the country's retirement income fabric. Though originally meant as a supplementary savings measure, they are seen by some as the panacea in dealing with savings challenges confronting many Canadians. Unfortunately, the proponents of CPP/QPP reforms focus almost entirely on the benefits side of the equation—paying scant attention to the opposite side of the coin. The money has to come from somewhere.

We have seen this attention gap before. In recent years, labour groups umbrellaed under the Canadian Labour Congress (CLC) and the Fédération des travailleurs et travailleuses du Québec (FTQ) asked that pension benefits be

doubled, from 25 per cent of pensionable earnings to 50 per cent and, in the FTQ's case, that the pensionable earnings limit be substantially increased.

CFIB research in 2010, using macro-econometric modeling analysis, found that the net effects of the CLC-FTQ-proposed benefits increases, together with the payroll tax increases on employers and employees necessary to finance them, would dramatically slow down the rate of job growth in the short-run, and measurably erode wage rates in the long run.[1] Under their plan, a doubling of benefits would result in the loss of 1.2 million

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[1] CFIB, Forced Savings, December 2010
http://cfib.ca/a2302e

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person-years of employment over a seven-year period, and permanently lower real wage levels by 2.5%.

The 10-10-10 Proposal

The 10-10-10 proposal is one of the approaches under discussion at federal and provincial government levels is so named because it suggests simultaneously increasing the income replacement rate by **10 percentage** points from 25 to 35 per cent of maximum pensionable earnings (MPE), increasing the MPE limit by **$10,000** from today's $51,100 to $61,100, and phasing-in the changes over a **10-year** period.

Although the 10-10-10 plan is not as hefty as the previous CLC-FTQ proposals, the impacts are likely to be significant nonetheless. The economic impacts can reasonably be estimated by comparing the differences in benefit levels to the CLC-FTQ proposals and then applying them proportionally to the macro-econometric findings of our past study.

Impact on individual premiums

Estimating the impact on premium rates of a 10 per cent increase in the income replacement rate is pretty straight forward. It represents 2/5ths of the increase under the CLC-FTQ proposal (increasing income replacement from 25 per cent to 35 per cent rather than 50 per cent). Given that CLC estimated combined employer and employee CPP premiums would rise from 9.9 per cent to at least 15.4 per cent of MPE levels[2], the 10-10-10 plan would see premium rates rise to about 12.1 per cent of MPE—a 22 per cent increase in premiums expressed in dollar terms (see Figure 1).
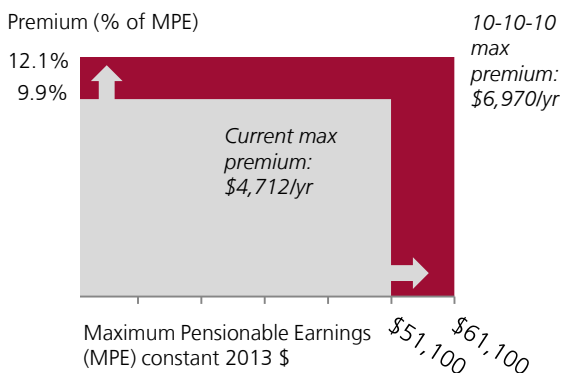
Dollar costs on individuals would depend on income levels, but maximum premiums payable would see an increase from its current $4,712 per year to $6,970 per year[3] once fully phased in—a net combined cost increase for employers and employees of $2,258 per year.

Figure 1

Impact of 10-10-10 proposal on CPP premiums

Premium (% of MPE)

12.1%
9.9%

10-10-10 max premium: $6,970/yr

Current max premium: $4,712/yr

Maximum Pensionable Earnings (MPE) constant 2013 $ $51,100 $61,100

The impacts on participants in the Quebec Pension Plan would be about the same as for CPP contributors, but from a higher base premium rate, owing to the fund's poorer performance through the recession, forcing premiums higher by almost one percentage point compared to the CPP.[4] In all, maximum annual premiums in Quebec would increase from about $5,410 per year to an estimated $7,668 under the 10-10-10 plan (see Figure 2).

Figure 2

Impact of 10-10-10 proposal on QPP premiums

Premium (% of MPE)

13.3%
10.8%

10-10-10 max premium: $7,668/yr

Current max premium: $5,410/yr

Maximum Pensionable Earnings (MPE) constant 2013 $ $51,100 $61,100

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[2] Various CLC documents estimate the higher premium rates to range between 15.4 and 15.9 per cent. The following 2009 report is the most conservative. http://www.canadianlabour.ca/sites/default/files/pdfs/Pension-Policy-Paper-2009-EN.pdf, pg. 11

[3] in constant 2013 dollars

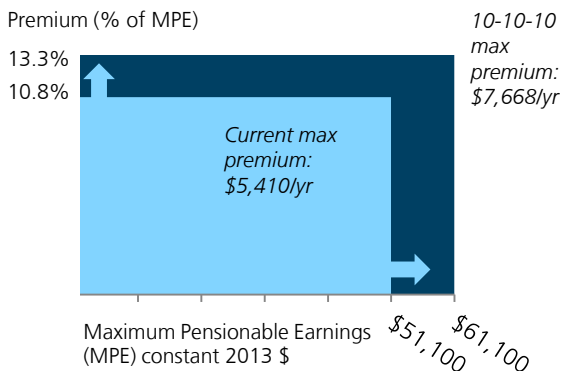[4] In its 2011 Budget, The Government of Quebec scheduled a series of premium increases, pushing rates up from 9.9 per cent in 2011 to 10.8 per cent by 2017. Benefits, however, would not change. For the purposes of this study, we use the 10.8 per cent rate as the base for additional rate increases associated with the 10-10-10 proposal.

Impact on total premiums collected

Understanding the implications of an upward $10,000 adjustment in maximum pensionable earnings requires an estimate of how much in premiums and employment income is gathered in Canada annually among those earning above $51,100. Those earning more than $61,100 would be paying the maximum additional premiums, while those in the $51,100 to $61,100 income group would pay a portion of the maximum. Based on most recent taxation statistics (2010) from the Canada Revenue Agency[5] we estimate the higher MPE would increase the CPP/QPP premium revenues collected by about 11 per cent.

These two impacts on rates and MPE have a compounding effect on total premiums. The 22 per cent increase in premiums rates, simultaneously set against the 11 per cent increase in payable amounts from a higher MPE yields a net increase of almost 36% in total premiums revenue per year (see Table 1).

Table 1.

CPP, QPP reform proposals: effects on premiums

	Current (2013)	CLC (CPP)	FTQ (QPP)	10-10-10 (CPP&QPP)
Yearly maximum pensionable earnings (constant 2013$)	$51,100	$51,100	$67,500	$61,100
Premiums rate %ch. over current	-	55.6%	55.6%	22.2%
$ Premiums %ch from growth of MPE*	-	-	15.0%	11.0%
Total CPP, QPP $ premium %ch.	-	55.6%	78.9%	35.8%

* CFIB estimate based on income distributions from CRA T1 Preliminary Statistics tables

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[5] Canada Revenue Agency, *Preliminary 2010 T1 Income Statistics.* http://www.cra-arc.gc.ca/gncy/stts/gb10/pst/ntrm/menu-eng.html

In comparison, the CLC proposal would have increased total premiums by almost 56 per cent (In Quebec, the FTQ-proposed increase would have been much larger due to the bigger jump to the MPE). It is reasonable to assume, therefore, that the 10-10-10 proposal carries almost two-thirds the total Dollar impacts as the previous CLC proposal (35.8/55.6).
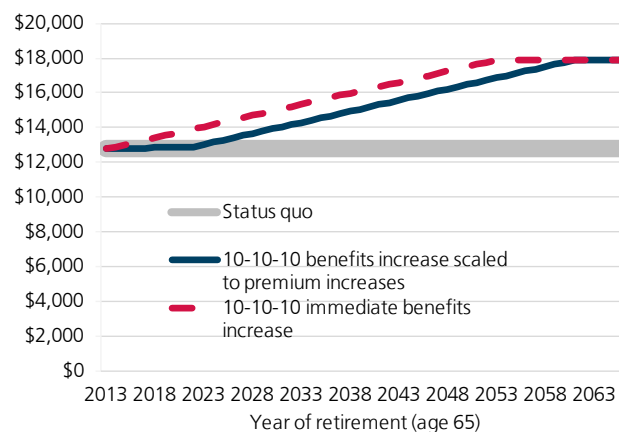
Impact on benefits

10-10-10 reform proponents' description of 40-per-cent increases in benefit levels no doubt captures the public's attention. Unfortunately it also creates erroneous expectations. Based on proponents' messaging, casual observers could be forgiven for thinking that all new retirees would be immediately entitled to 40% increases in benefits. One should be concerned that even some current beneficiaries may think they would get a hike in payments.

In reality, because the system has to remain funded, the flow of benefits would only gradually trickle back to future beneficiaries. Assuming the new system would take effect immediately, the only people to receive the full 40-per-cent increase in benefits would be those who would be retiring after the year 2053—after putting in a full career of paying in at the higher premium rates (see Figure 3).

Figure 3.

Average annual CPP-QPP benefits* for those at or above the MPE their entire careers

Status quo

10-10-10 benefits increase scaled to premium increases

10-10-10 immediate benefits increase

Year of retirement (age 65)

* Constant 2013$. For simplicity, other adjustments that contribute to actual benefits calculations have been excluded.

Indeed, 2063 should be the full-benefit retirement date because of the 10-year phase-in of premium increases. The profile of benefits to retirees between now and then, therefore, looks considerably less generous than what they might expect.

For example, under 10-10-10 reforms, a 65-year-old applying for CPP-QPP in 2013 would still receive a maximum inflation-adjusted $12,775 annual benefit for the remainder of their life. A 65-year old in 2025 would receive maximum lifetime benefits of $14,308 per year (or $13,273 if benefits are scaled to the phasing-in of premiums).

The benefits are essentially no different than what one would receive if they were able to put the same premium amounts (employer and employee contributions) into a bank account and then pull the money out evenly over a 20-year period (the average remaining life expectancy of those reaching the age of 65). For example, a 45-year-old putting the equivalent of the premium increases away at a 2-per-cent real rate of return until age 65 would be able to withdraw $498 (in equivalent 2013$) annually until age 85—the same level of incremental CPP-QPP benefits associated with the 10-10-10 proposal.

Economic impacts from net 10-10-10 CPP/QPP reforms

Our previous study relied on a detailed macro-econometric modelling of premium and benefits increases, conducted through the University of Toronto's Policy and Economic Analysis Program. The simulation took into effect the phasing-in of premiums and the spin-offs associated with changes to incomes and payroll taxes. The study found a net loss of 1.2 million person years of employment in the early years of the simulation, followed by about a 2.5 per cent drop in wage levels, as the unemployed gradually started settling for lower incomes in exchange for employment.

Reapplying the macro-econometric results on the 10-10-10 assumptions, we think it is reasonable to gather a ballpark estimate simply by applying the 'two-thirds' ratio to the previous estimates.[6] The

policy reform, therefore, would constrain economic growth in the first ten years of the policy change. Employment growth, in particular, would be cut by approximately 700,000-to-750,000 person years of employment through the two decades following implementation.

Expressed another way, the premium increases would bring employment growth to a virtual standstill seven to eight years into the reform (see Figure 4). Employment levels would recover, reabsorbing the unemployed, but only after wage levels are bid downward by about 1.5 per cent.

Figure 4.

10-10-10* CPP, QPP reform proposal: effects on annual employment growth
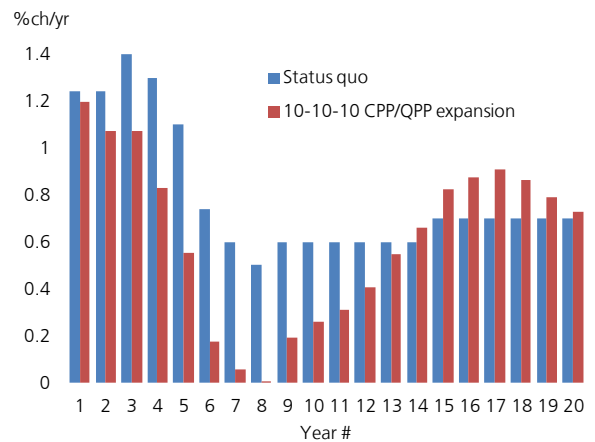
*CFIB Economics projections, based on current economic outlook and a pension reform scenario adjusted to a 10-year implementation. Assumes phasing-in of premium changes begin in 2013

Employees ultimately bear the full burden of payroll tax increases, but the implications don't stop there. The combined loss of employment in the short term, and lower wage levels in the longer term would also have substantial impacts on federal and provincial budget balances. By year seven or eight, when one might hope budgets would be balanced at both levels of government, the CPP-QPP reform would instead mean they would be running combined deficits on the scale of $10 billion. Impacts would gradually fade, but even by the end of the 20-year projection horizon, respective federal and provincial debt-to-GDP ratios

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[6] The original simulations assumed a 7-year phase-in of premium changes. A 10-year phase-in would have the

same long-run impacts, but have slightly dampened and delayed annual impacts.

would still be 2.0 per cent and 1.2 per cent higher than they otherwise would have been.

The net implications on the economy are complex. The impacts flow through all the other economic pathways, including price levels, interest rates, investment and trade balances. See the Appendix for a more detailed view on how these other variables may be affected.

For simplicity, our economic modelling incorporates the CPP-QPP benefits increases as if they would be paid out immediately at the maximum amounts (shown by the dashed line in Figure 3). It would be more appropriate, though, to work from an assumption that benefits be scaled to the phasing–in of premiums. The latter approach would ensure that benefits are kept proportional to contributions and that older workers' future benefits are not subsidized by younger workers' earnings. The economic impacts arising from additional benefits in the hands of retirees therefore, are overstated in this model—hence understating the net negative impacts once the premium increases are factored in.

As with the past analysis, the net impacts are dependent on the level of behavioural changes to savings profiles over time. For employees, we expect higher CPP/QPP premiums would likely be offset by lower savings in other retirement vehicles such as RRSPs, TFSAs or the planned PRPPs.

For them, the impacts are purely intertemporal— their own income is being deferred from current years to future years.

The economic impacts on the employer portion of premiums, however, are more significant. The increased cost of labour from higher premiums would result in lower job creation as employers adjust the structure of their staffing—because there would be no commensurate increase in relative workforce productivity due to these measures. It is only when wage levels are bid downward to reabsorb unemployed workers that employment levels would return to normal.

Conclusions

The macro-econometric simulations show what happens with a transfer of current spending power from today's wage earners to tomorrow's retirees. We looked specifically at the 10-10-10 proposal, but any combination of premium rate increases and maximum pensionable earnings levels would have proportional effects. The impacts all even out after 40 years or so, but nonetheless, the interim impacts are substantial. In particular, it is payrolls and governments' fiscal profiles that suffer the most in the interim—leading to the question of whether such reforms are appropriate for an economy currently operating well below potential.

Appendix:

Economic Impacts: Increase in employer and employee CPP/QPP premiums, income replacement to 35% of $61,100 MPE

Summary of Macro-econometric Projection**

(Percentage difference from base case levels; * Indicates change in levels)

	Yr-1	Yr-2	Yr-3	Yr-4	Yr-5	Yr-6	Yr-7	Yr-8	Yr-9	Yr-10
Real Gross Domestic Product	-0.08	-0.28	-0.48	-0.64	-0.70	-0.68	-0.62	-0.44	-0.11	0.19
Real GDP (Change in $2009 Bill)	-1.4	-4.6	-8.3	-11.3	-12.7	-12.7	-11.9	-8.6	-2.2	3.8
Expenditure on Personal Consumption	-0.11	-0.39	-0.75	-1.05	-1.25	-1.34	-1.36	-1.22	-0.92	-0.57
Expenditure by Governments	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01
Investment Expenditure	-0.07	-0.20	-0.31	-0.39	-0.39	-0.29	-0.17	0.12	0.69	1.18
Residential Construction	-0.12	-0.37	-0.69	-1.07	-1.27	-1.22	-1.00	-0.30	0.89	1.84
Non-Residential Construction	-0.06	-0.13	-0.14	-0.11	-0.03	0.06	0.11	0.21	0.42	0.57
Machinery and Equipment	-0.01	-0.06	-0.01	0.10	0.19	0.32	0.36	0.40	0.71	1.12
Exports	-0.01	-0.03	-0.07	-0.11	-0.12	-0.10	-0.06	0.01	0.10	0.21
Imports	0.01	-0.05	-0.17	-0.32	-0.48	-0.60	-0.68	-0.75	-0.73	-0.59
Gross Domestic Product	0.03	0.01	-0.06	-0.15	-0.25	-0.37	-0.53	-0.71	-0.77	-0.77
Implicit Deflator for GDP	0.11	0.28	0.43	0.50	0.46	0.32	0.10	-0.26	-0.66	-0.95
GDP Deflator - Inflation Rate	0.12	0.17	0.15	0.07	-0.04	-0.15	-0.22	-0.37	-0.40	-0.30
Unemployment Rate	0.05	0.17	0.31	0.42	0.48	0.47	0.44	0.33	0.15	-0.04
Employment	-0.06	-0.24	-0.48	-0.68	-0.79	-0.82	-0.78	-0.64	-0.37	-0.06
Employment (Ch in '000) *	-11.5	-43.3	-85.3	-123.2	-146.0	-151.4	-146.2	-121.5	-69.2	-10.9
Labour Force	-0.01	-0.06	-0.14	-0.23	-0.29	-0.32	-0.32	-0.29	-0.21	-0.10
Participation Rate *	-0.01	-0.04	-0.10	-0.15	-0.19	-0.21	-0.21	-0.19	-0.14	-0.06
Finance Co. 90-Day Paper Rate *	-0.01	-0.07	-0.12	-0.14	-0.15	-0.14	-0.15	-0.19	-0.22	-0.20
Industrial Bond Rate *	-0.01	-0.08	-0.12	-0.14	-0.15	-0.14	-0.15	-0.20	-0.22	-0.20
Consumer Price Index	0.12	0.31	0.47	0.56	0.54	0.41	0.23	-0.12	-0.50	-0.78
CPI - Inflation Rate *	0.13	0.19	0.17	0.09	-0.02	-0.13	-0.19	-0.35	-0.39	-0.29
Average Annual Wages and Salaries	0.05	0.09	0.10	0.02	-0.19	-0.50	-0.86	-1.30	-1.68	-1.95
Real Annual Wages per Employee	-0.08	-0.22	-0.37	-0.53	-0.72	-0.91	-1.08	-1.18	-1.19	-1.18
Productivity Change (GDP/Employee)	-0.01	-0.03	-0.01	0.04	0.10	0.14	0.16	0.21	0.26	0.24
Capital Stock	0.00	-0.01	-0.01	-0.02	-0.01	0.01	0.04	0.07	0.11	0.19
Exchange Rate (US $/Cdn $)	0.00	-0.06	-0.13	-0.19	-0.26	-0.26	-0.19	-0.13	-0.06	0.00
Balance on Current Account ($ Mill) *	71	440	1141	1998	2967	3949	4944	5945	6476	6333
Consolidated Government Balance ($ Mill) *	1113	1262	770	417	792	2114	4014	4662	7412	10876
Federal Gov't Balance (NA Basis) ($ Mill) *	-401	-1376	-2766	-4246	-5554	-6593	-7460	-7370	-6193	-4576
Ratio: Federal Debt to GDP (%) *	0.0	0.1	0.2	0.4	0.6	1.0	1.3	1.6	1.9	2.0
Prov'l Gov't Balance (NA Basis) ($ Mill) *	-448	-1449	-2770	-4080	-5140	-5858	-6312	-5894	-4569	-2904
Ratio: Provincial Debt to GDP (%) *	0.0	0.1	0.2	0.4	0.6	0.9	1.2	1.4	1.5	1.7
Personal Savings Rate (%) *	-0.1	-0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.0
Nominal After-Tax Corporate Profits	-0.2	-0.3	-0.3	-0.1	0.0	-0.1	-0.4	-0.3	-0.2	-0.3
Real Personal Disposable Income	-0.2	-0.5	-0.8	-1.0	-1.2	-1.3	-1.3	-1.2	-0.9	-0.6

Economic Impacts: (cont'd)

Summary of Macro-econometric Projection**

(Percentage difference from base case levels; * Indicates change in levels)

	Yr-11	Yr-12	Yr-13	Yr-14	Yr-15	Yr-16	Yr-17	Yr-18	Yr-19	Yr-20
Real Gross Domestic Product	0.34	0.40	0.37	0.28	0.17	0.13	0.14	0.14	0.15	0.20
Real GDP (Change in $2009 Bill)	7.0	8.4	8.0	6.0	3.7	3.0	3.3	3.4	3.7	5.0
Expenditure on Personal Consumption	-0.32	-0.22	-0.22	-0.27	-0.34	-0.36	-0.32	-0.24	-0.17	-0.10
Expenditure by Governments	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01
Investment Expenditure	1.38	1.48	1.49	1.31	1.04	0.93	0.92	0.83	0.74	0.80
Residential Construction	2.39	2.75	2.66	2.07	1.39	1.03	0.84	0.62	0.63	0.91
Non-Residential Construction	0.56	0.53	0.53	0.50	0.46	0.49	0.54	0.51	0.45	0.46
Machinery and Equipment	1.18	1.15	1.30	1.36	1.26	1.24	1.35	1.31	1.07	0.98
Exports	0.32	0.39	0.42	0.41	0.38	0.34	0.31	0.28	0.26	0.24
Imports	-0.45	-0.35	-0.27	-0.21	-0.21	-0.21	-0.18	-0.13	-0.10	-0.06
Gross Domestic Product	-0.77	-0.74	-0.69	-0.68	-0.69	-0.65	-0.58	-0.53	-0.48	-0.39
Implicit Deflator for GDP	-1.11	-1.13	-1.06	-0.95	-0.85	-0.78	-0.72	-0.68	-0.63	-0.59
GDP Deflator - Inflation Rate	-0.16	-0.03	0.07	0.12	0.10	0.08	0.06	0.05	0.05	0.05
Unemployment Rate	-0.14	-0.17	-0.14	-0.08	-0.01	0.01	0.01	0.00	-0.01	-0.02
Employment	0.15	0.24	0.23	0.16	0.06	0.00	-0.01	0.00	0.01	0.03
Employment (Ch in '000) *	28.2	45.1	44.6	30.9	12.2	0.4	-1.3	-0.2	0.8	5.5
Labour Force	-0.01	0.06	0.08	0.07	0.05	0.02	0.01	0.00	0.00	0.01
Participation Rate *	0.00	0.04	0.05	0.05	0.03	0.01	0.00	0.00	0.00	0.00
Finance Co. 90-Day Paper Rate *	-0.24	-0.30	-0.33	-0.32	-0.31	-0.30	-0.26	-0.23	-0.23	-0.24
Industrial Bond Rate *	-0.24	-0.31	-0.33	-0.32	-0.32	-0.30	-0.26	-0.23	-0.24	-0.25
Consumer Price Index	-0.93	-0.95	-0.87	-0.77	-0.67	-0.60	-0.55	-0.50	-0.46	-0.42
CPI - Inflation Rate *	-0.15	-0.02	0.07	0.11	0.10	0.07	0.05	0.05	0.04	0.04
Average Annual Wages and Salaries	-2.07	-2.06	-1.97	-1.88	-1.80	-1.74	-1.68	-1.63	-1.58	-1.50
Real Annual Wages per Employee	-1.16	-1.14	-1.11	-1.12	-1.14	-1.14	-1.14	-1.13	-1.12	-1.09
Productivity Change (GDP/Employee)	0.19	0.16	0.14	0.12	0.10	0.13	0.15	0.14	0.15	0.17
Capital Stock	0.28	0.35	0.42	0.49	0.55	0.59	0.63	0.68	0.70	0.70
Exchange Rate (US $/Cdn $)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Balance on Current Account ($ Mill) *	6377	6674	6780	6777	7038	7296	7090	6750	6718	6566
Consolidated Government Balance ($ Mill) *	13471	14889	15060	14078	12574	11651	11438	11284	11192	11548
Federal Gov't Balance (NA Basis) ($ Mill) *	-3297	-2483	-2244	-2573	-3150	-3398	-3277	-3093	-2809	-2227
Ratio: Federal Debt to GDP (%) *	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.0
Prov'l Gov't Balance (NA Basis) ($ Mill) *	-1622	-864	-625	-814	-1130	-1129	-760	-268	297	1040
Ratio: Provincial Debt to GDP (%) *	1.7	1.6	1.6	1.5	1.5	1.5	1.5	1.4	1.4	1.2
Personal Savings Rate (%) *	-0.1	-0.1	-0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Nominal After-Tax Corporate Profits	-0.6	-0.6	-0.6	-0.6	-0.6	-0.3	-0.1	-0.1	-0.1	0.2
Real Personal Disposable Income	-0.5	-0.5	-0.5	-0.5	-0.5	-0.4	-0.3	-0.3	-0.2	-0.1

**Source: CFIB Economics projections, based on FOCUS Model – Policy and Economic Analysis Program – 2010 simulation conducted for CFIB.
Note: Simulation assumes 7-year phase-in of CPP-QPP premium changes. A 10-year phase-in would result in basically the same long-run impacts, but somewhat dampen and delay timing of the annual impacts.