Standing Committee on Finance (FINA)
Subject Matter of Bill C-26, an Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act, and the Income Tax Act.
Meeting: November 16, 2016, 3:30-5:45 pm.

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Speaking Notes

Thank you for the opportunity to speak with you today. I will take this opportunity to flag some general concerns I have with Bill C-26, with a focus on individuals with low earnings.

Over the past few years, several researchers have expressed concerns that an expansion of the CPP’s existing structure, alongside the provisions for the Guaranteed Income Supplement, would imply a very low rate of return on contributions for individuals who entered retirement with low average earnings.

The planned changes to CPP and the Income Tax Act, as set out in Bill C-26, take some steps to mitigate those concerns.

First, an expansion of the Working Income Tax Benefit is included in this Bill. Most importantly, this will help some individuals with the lowest earnings cover their additional CPP contributions. This has several other benefits.

• As a method of pre-funding retirement income through the current generation’s tax revenues, rather than relying on other programs funded by future generations, we reduce intergenerational transfers. I like this approach. I wish we had forced it on the baby boomers 30 years ago.
• The proposed changes will enhance work incentives among our lowest earners.
• The changes offer broader support to those with disabilities with a noticeable expansion to the WITB disability supplement
• And using the WITB involves a simple expansion of an existing policy. I see the appeal there.
• However, I don’t think it’s the best approach.
I will state my concerns with using the WITB to refund CPP contributions.
First, I think we need to design policy in ways that support and promote gender equity. WITB eligibility depends on a couple’s earnings, not just the individual’s. Also, only one spouse can claim the benefit. This means the after-tax-and-benefit wage rate of a secondary earner—which is typically wives—will depend in part on the decisions of their spouse and their ability to negotiate with their spouse. I think that whenever practical and possible, such policies should be based on individual earnings.

Second, the WITB is not directly and visibly linked to CPP. As such, the link between this expansion of the WITB to additional CPP contributions will not be clearly visible to workers, and we want that link to be as clear as possible to minimize any negative effects on the labour market. Moreover, without a clear link to CPP it is easy for future governments to forget the importance of this provision.

Third, the WITB only covers the lowest-earners. A single person earning around $20,000 per year would not be eligible.

Fourth, the WITB expansion is only designed to cover the employee’s new contribution at 1%, not the employer’s additional 1%. We expect wage bargaining to result in employees absorbing nearly the full cost of the additional contributions.

The second part of planned changes that I think is important for understanding the contributions of low earners is the lack of drop-out provisions. Existing drop-out provisions—for years with young children, low earnings, or disability—work to subsidize labour market interruptions. However, the drop-out provisions then sever that important link between contributions and benefits. Also, if those years dropped included some low earnings, the contributions made when earnings are low effectively offer a zero return. My understanding is we have not entirely done away with the cross-subsidies in that we are only counting a person’s best 40 years when calculating their benefits. As such, workers will continue to have some low-earning years in which their earnings and contributions are dropped from the contribution period and are not directly linked to a benefit.

Thinking beyond my focus on low earners, I would like to highlight concerns with the survivor benefit formulas. It is my understanding that the provisions that define a maximum combined retirement and survivor benefit remain in the new formula. Moreover, benefit eligibility does not depend on whether retirees have a spouse that would receive survivor benefits. This differs from
many employer pension plans that offer reduced monthly benefits to pensioners who keep the option to have survivor benefits available. The prevailing CPP survivor provisions weaken the link between one’s contributions and one’s benefits as it creates a transfer from unmarried retirees and couples with strong work histories toward couples characterized as single-earner couples.

If given the opportunity to make recommendations, I would focus on two things:

• First, continue with efforts to clearly link individual contributions and benefits, avoiding inter- and intra-generational transfers in CPP. Such transfers can be more transparently and effectively developed in other programs.

• Second, administer the refund of CPP contributions to low-earners separately from the WITB and define eligibility by individual earnings. This should be administered through the tax system to minimize administrative costs. The refund of CPP contributions should be clearly visible to those receiving it.

Thank you for your attention, I’m happy to take any questions you might have.
Informal notes regarding issues I think can lead to interesting conversations:

Below are some general thoughts in response to questions I have been asked in the past. The answers are not complete, require full statements of evidence, and generally require the caveats that economists are well known for. Such complete answers require more time than I have been afforded.

1. Do we want to have drop-out provisions for children and disability?

I am inclined to say no. I say this primarily because I think there are benefits in the labour market to having the clearest link possible between individuals’ CPP contributions and their retirement benefit. I also prefer programs that have clearly defined goals.

Child-related drop-out provisions:

More generally, I think Canadians need to have the difficult conversation about how we support parents who stay home full time with their young children while other parents work for pay while also managing their child’s care. Important to this conversation is that today’s experience and demographics of stay-at-home parents are very different than 40 years ago when child-related drop-out provisions were introduced, and will probably be different 40 years from now. We currently offer subsidies through a patchwork of programs, tax credits, survivor benefits, and so on. In the case of EI we only offer support if people have a work history. Through CPP we only highly value the efforts of at-home parents who later have strong attachment to the labour force. If there is a goal with such subsidies, I’d prefer it to be clearly stated and transparently accounted for. I think this issue is beyond this committee’s current study.

Consider the original purpose and implications of the child-rearing provisions. In the 1970s the majority mothers with young children would have stayed out of the labour force. The child-related provisions would have applied to families quite broadly. In this context, we could think of the child-related drop-out provisions as representing a transfer from husbands to their wives to compensate them for the value of home production. I would have supported that policy in that context.

Move forward 40 years. Today, the experience for mothers is quite different and more diverse, and the nature of this transfer is quite different. To fix ideas, consider a good friend of mine and myself. We both love being mothers. We are well educated, have good job opportunities and employed spouses. We do not rely on formal childcare. I love my job and chose to return to work full time when my daughter was quite young. My friend liked her job, but would hate organizing herself and her family around her job, and chose to remain home for a few years. Both of us have made optimal choices in my view.

In this 2016 context consider the child-related drop-out provisions. We are no longer simply thinking of husbands transferring income to their wives to recognize the value of home production. We are now thinking of transfers from one family to another to subsidize one way of organizing our families and not another. Questioning the merits of this policy
 leads to very difficult conversations, since all mothers—and some fathers—are often made to feel defensive of their own choices. I won’t attempt to settle this here, but the value and nature of the child-related drop-out provisions and resulting transfers have shifted over the past four decades.

Disability provisions:

I think Canadians agree we need a good range of supports for workers with diverse abilities. I noted Bill C-26 includes an expansion of upper thresholds for the WITB disability supplement; it is not clear to me the expansion is large enough. CPP disability benefit payments will account for the additional contributions to CPP. I would be interested in studying the option of making CPP contributions on a disabled individual’s behalf from general tax revenues during the time a person is disabled – ie. prefunding the retirement income – to fund the disability-related drop-out provisions. Given the CPP-D works as a long-term disability insurance program, I tend to view this differently than other drop-out provisions—this is insurance rather than a transfer. Given the nature of CPP-D eligibility, in that it requires one to have a severe and prolonged condition to qualify, I would speak with those in OSFI and ESDC to obtain estimates of that cost.

2. What does the US do?

In the U.S., the upper threshold for pensionable earnings is US$118,500. A non-linear retirement benefit formula is applied to the average earnings so that the top portion receives a 15% replacement rate; the middle portion is 32%; the bottom portion is 90%.

WITB has the EITC as its comparator, which is a much larger program.

3. Why not improve voluntary options as an alternative to expanding CPP?

Why not rely on improving incentives or expansions of existing savings vehicles? The simple answer is that these have not worked in the past. We are not concerned here with people running out of TFSA room. We are concerned with people who simply do not save. They have not saved despite the strong financial/tax incentives already offered to do so. Marginal changes to these programs might increase savings among savers, but are unlikely to push the non-savers into an appropriate level of savings.

4. Isn’t the identified gap in retirement savings incredibly small?

It is small, but large enough to pay attention in my opinion. The motivating gap is characterized as middle-income families that do not have access to an employer-based pension plan. Within this group there are many families that have income replacement rates below 40%; many of these will rely on GIS in retirement. There is a paper by Grant Schellenberg and Yuri Ostrovsky that parses this out nicely.

But we need to recognize the statistics we have seen represent the situation of recent and near-retirees. The baby boomers are the wealthiest generation entering retirement in Canadian history. This is both in terms of their access to employment-based
pensions (especially defined benefit pensions) and the housing wealth they hold. It is not clear what the situation of retirees 40-50 years from now will be and I think that is the group this CPP expansion is really targeting.

5. *When thinking about gender equity, why not assume people share resources equally within a household and focus on a family unit?*

   It is reasonable to assume household members share resources. They also achieve economies of scale by forming relationships relative to those that do not. (For example, rent on an apartment appropriate for a couple is not normally twice the rent of an apartment for one person.) I think this is important to consider when developing poverty strategies.

   However, we have several studies that offer evidence that members of a family do not share all resources equally, nor do they have identical preferences for how to use their resources. Shelly Lundberg has some nice work in this area.

   I recommend reading the Canadian Tax Foundation’s upcoming book *100 Years of Canadian Income Taxation*. It will include a nice chapter looking at gender equity in taxation. For more sources, Frances Woolley offers a nice overview on the Worthwhile Canadian Initiative blog. I would seek out Elisabeth Gugl as one of Canada’s leading experts on this.

6. *Won’t increasing CPP contributions merely reduce private savings?*

   To some extent this is true, but not 1-for-1. Look for evidence in the research of Derek Messacar. He found a $1 increase in RPP contributions reduced RRSP contributions by $0.55. So there is an overall increase in savings. For workers who do not save much voluntarily, a $1 increase in RPP contributions raised savings by $0.95.


7. *Won’t this payroll tax result in serious job loss? Won’t this affect young people most?*

   There are different types of payroll taxes. Generally, we think of a payroll tax increasing the costs of hiring workers, and reducing the take-home pay of workers, which would ultimately result in lower levels of employment. We are less concerned with whether an employer or the employee is legally responsible for remitting the tax.

   But a payroll tax that is directly linked to a benefit is different. As long as workers value that benefit, they will think of it as part of the total wage and benefit package offered them for every hour they work. Put simply, they are willing to fully absorb the cost of obtaining those benefits, the benefits improve their incentives to work more, and no loss of employment results. In theory this is fairly straightforward. We have some empirical evidence to back this up (for example by Jonathan Gruber).

   If employers and employees did not have time to negotiate their wage contracts, I might be more concerned about short-term losses of employment. However, the CPP Act provisions prevented any rushed reforms and the earliest changes are for 2019.

   I note that economists tend to approach survey results, particularly those for which respondents have clear incentives to exaggerate their planned behavior, with extreme caution. We prefer evidence based on observed responses to real policy changes.
8. How disconnected are current CPP contributions and benefits?

For consideration:

a. The basic retirement benefit under CPP is 25% of average monthly pensionable earnings. Early or later take-up is adjusted in a way that is nearly actuarially fair.

b. The formula for determining said average earnings is not simple – see Section 48 and 49 of the CPP Act
   i. Contribution period age 18-60 (if applying at age 60)
   ii. Remove time associated with disability
   iii. Remove time with young children (48(2))
   iv. Remove 17% of low earnings periods if remaining history is long enough (48(4))
   v. Take an average of earnings that remain and multiply that 25%

This results in a situation where two individuals with very different contribution histories may receive the same monthly benefit at age 60.

9. Who are the low-earners we’re talking about?

It is practical for us to define contributions by current earnings. Benefits are defined by an average of earnings over one’s lifetime. When individuals have low lifetime earnings they are likely to receive GIS after age 65.

Low average earnings may reflect:

- Persistent low earnings with high labour market attachment
- Some periods of absence from the labour market combined with low earnings
- Large number of periods of absence from the labour market combined with high earnings
- And many other scenarios you might imagine

We know that roughly one third of seniors will receive at least some GIS benefits.

We know that many individuals with low average earnings will not receive GIS benefits because GIS eligibility depends on family income.

We know that many individuals with low current earnings will not have low average earnings. For example, this may be due to temporary absences from the labour market, or simply being new to the labour market.

In my opinion the case can be made for assisting all low-earners with their additional CPP contributions, not just those we expect are going to have low average earnings.
1. [12] Section 18.1 (1) Year’s Additional Maximum Pensionable Earnings-- to be 1.14 *2025 YMPE
   a. Equivalent to moving current YMPE of $54,900 to $62,586, which would be rounded up to $62,600
2. [20] Alters section 44 to refer to “base” contributions as distinct from the new enhanced portion.
3. [21] Changes 46(1) defining the basic monthly retirement pension:
   a. 25% of average monthly pensionable earnings (for the existing CPP)
   b. 8.33% of first additional monthly pensionable earnings (up to YMPE)
   c. 33.33% of their second additional monthly pensionable earnings (up to YAMPE)
4. [22] Adds 48.1 and 48.2 to the act, which implies there are not the same drop-out provisions with respect to the calculation of average earnings in the enhanced portion of the benefits
5. [31] Refers to the disability benefit formula (section 56) as it relates to one’s earnings history. The new amounts are covered.
6. [32] Refers to survivor benefits (section 58) as it relates to the contributor’s earnings history. The new amounts are covered. Section 58(2)(c) requires more careful more review on my part to clarify the formula for clawbacks to survivors who also have a retirement pension.
7. [33] Refers to the post-retirement benefit. New amounts are covered.
8. [69(1)] Is referring to changes in Income Tax Act for WITB, where section 122.7 defines key parameters. Bill C-26 raises the 2019 subsidy rate from 25% to 26%, and raises the maximum benefit accordingly (which depends on family status). It also reduces the reduction (clawback) rate on WITB, from 15% to 14%, on income above the upper threshold, which appears to remain unadjusted. Similar adjustments are made to the disability supplement, except that we appear to raise the upper thresholds for clawbacks. The upper thresholds are adjusted in section 117.1(1) of the Act, as amended in Bill C-26 [67].