**Think Like a Canadian Economist**

**Episode 9. Canada Pension Plan**

**VIDEO SCRIPT**

Canada’s model for public pensions is relatively simple, at least at its core. Essentially, there are two parts – a pension that depends on your career earnings – that’s the Canada Pension Plan or Quebec Pension Plan, depending on where you live, and a pension that depends on your income while retired – that’s the Old Age Security pension and related supplements. The government also supports private savings, largely with incentives in the tax system.

The Canada and Quebec Pension Plans – though run separately, are nearly identical and work well together.

While you are working, you pay premiums. Generally, these are collected by your employer and submitted to the government for you. No contributions are made on the first $3500 earned in a year, known as the Year’s Basic Exemption. And no contributions are made on any income over the year’s maximum pensionable earnings – which was $53,600 in 2015.

If you over-paid during the year, you’ll get your money back at tax time.

After age 60, you can start collecting your pension. How is this calculated? It depends on when you decide to start collecting the pension and whether you keep working and making contributions, but here’s the basic scenario.

First, we line up what you earned every year since you were 18 years old, up to age 65. If you haven’t reached 65 yet, that will include some zeros.

We drop out any years where you were the primary caregiver of your young child and had low earnings.

We also drop out some years where you were disabled and unable to earn income.

And then we usually drop out a few years when your earnings were lowest.

From the years that are left, we only consider the earnings up to that maximum amount you paid CPP premiums on. Then we can work out an average career earnings. The formulas involved will account for inflation since you were 18.

If you start-up your pension at exactly age 65, you can plan on getting 25% of your covered annual earnings from CPP or QPP – paid out in monthly installments – for the rest of your life.

In 2015, the maximum monthly payment for someone initiating their benefits at age 65 was $1065. In January 2015, the average amount for new beneficiaries at age 65 was $619 [$618.59].

If you decide to take that earlier than age 65, the monthly benefit will be smaller, to account for the fact that you get to receive it longer than someone who starts at age 65.

If you decide to take up CPP after age 65, you can get a larger monthly benefit, accounting for the fact that you will not get to receive it as long.

Notably, survivor benefits will be available to a spouse. However, if your spouse also contributed to CPP and has their own pension, their survivor benefit from your pension will be smaller for it.

Why do we have the Canada and Quebec Pension Plans?

Some people think that we should simply leave it up to individuals to save for themselves, and if they don’t, so be it. Why interfere? Why would we want a national program for retirement savings?

Economists usually start by looking for a market failure when deciding whether policy is needed.

People can turn to the annuities market. You can buy annuities that offer lifetime monthly payments. However, the market fails to provide good pricing because of what we call adverse selection.

People would like to purchase annuities at a fair price. However, those with longer expected lifespans are more likely to seek out such annuities and those with short lifespans are less likely to purchase annuities. Since insurance companies have less information than you do about your health and life expectancy, they price everything with an expectation you’ll probably live longer than you’d claim – making the price unattractive to many people.

Aside from that, people just fail to make good decisions sometimes. Hindsight may 20-20, but decisions to spend instead of save aren’t reversible. For those who choose to save, the options aren’t simple and mistakes are easily made.

We might also consider that when people don’t save for themselves, and many don’t even if they could, they will rely more heavily on the social safety net that we’ve created for seniors. It might simply be prudent to require individuals to save some basic amount so that the next generation is not left responsible.

Follow us on twitter @tlcecon, and visit our website for more videos.

**Suggested Reading and References**

Current CPP payment amounts are published by Service Canada: <http://www.servicecanada.gc.ca/eng/services/pensions/cpp/payments/>

Current OAS and GIS amounts are published by Service Canada: <http://www.servicecanada.gc.ca/eng/services/pensions/oas/payments/index.shtml>

Milligan, K. and T. Schirle. 2014. "Simulated Replacement Rates for CPP Reform Options." The School of Public Policy SPP Research Papers, Volume 7, Issue 7, March 2014.

Schirle, T. 2013. "Senior poverty in Canada: A decomposition analysis." *Canadian Public Policy*, Vol. 39(4) 517-540.

Laurin, A., K. Milligan and T. Schirle. 2012. "Comparing nest eggs: how CPP reform affects retirement choices." C.D. Howe Institute Commentary No. 352, May 2012.

Milligan, K. and T. Schirle. 2008. "Improving the Labour Market Incentives in Canada's Public Pensions "   *Canadian Public Policy* Vol. 34, no.3 (September 2008) pp. 281-304.