Abolish RRSPs?

Yes: Financial benefits to contributors

come from others who typically have lower incomes

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The Ottawa Citizen, January 30, 1997

If you have turned on your television in the last six weeks, you know we are now deep into the annual RRSP advertising blitz. The ads do very well in getting across the idea that Registered Retirement Savings Plans bring big financial benefits. And they do.

But although individual Canadians clearly benefit from contributing to RRSPs, it is not at all obvious that RRSPs are good for the country as a whole.

They don't solve the problems they were designed to solve and, more importantly, they generate undesirable side-effects, the most serious being the redistribution of income in the "wrong" direction—away from low-income people and toward higher-income people.

In effect, the financial benefits contributors reap are paid for by other people who typically have lower incomes.

More saving, more growth

Many people see the widespread use of RRSPs as a way to increase Canada's low saving rate. Low saving rates are a problem because less saving means less accumulation of physical capital, such as machines and factories, and that reduces economic growth.

Those who see RRSPs as a means of increasing saving blame the current shortage on the current tax system, which discourages saving by taxing income from interest and capital gains. By deferring taxes from the year in which income is earned to the year in which it is spent, the RRSP allows savings to accumulate tax-free, thus eliminating the anti-saving bias to the tax system.

So say RRSP supporters, at least. The problem with their argument is that it only tells half the story. If we are concerned about Canada's rate of economic growth, and if we think more saving is the solution, what matters is *national* saving not private saving. National saving is equal to the saving of business firms and households plus the combined saving of our various governments.

Although RRSPs increase private saving, they almost certainly reduce government saving by a larger amount. By reducing government tax revenues—by $13.6 billion in 1992 alone—RRSPs raise government borrowing and thus reduce government saving.

Much available evidence, both from the U.S. and Canada, suggests that, when individuals contribute to RRSPs (or IRAs in the U.S.), they spend some of the tax rebate generated by the

RRSP contribution. This means that private saving rises by less than the full amount of the tax rebate. But this tax rebate is exactly equal to the reduction in government saving. Thus, private saving rises by less than the fall in government saving and so, in their overall effect, RRSPs *reduce* national saving. If you are concerned about Canada's saving and economic growth, you should favor eliminating RRSPs, not expanding them.

Less drain on the public purse?

Another common argument for RRSPs is that they provide an incentive for individuals to save more for their retirement, thereby reducing the drain on the public purse for retirement income-support programs, such as Old Age Security and the Guaranteed Income Supplement.

The trouble with this argument is that the people who typically contribute to RRSPs are not the same people who are likely to require income assistance when retired. In 1992, for example, the average after-tax income of households contributing to RRSPs was over $50,000. Low-income households are greatly under-represented among RRSP contributors. This isn't surprising, of course. Low-income people typically aren't high savers, for the simple reason that saving is a luxury when paycheques barely cover the basic necessities of life.

Perverse redistribution

RRSPs overwhelmingly are used by middle- and upper-income people and tend not to be used at all by low-income people. But the tax benefits contributors receive must come from somewhere—there really never is a free lunch. When the RRSP-generated tax rebates go through, governments must borrow more, spend less, or raise other taxes. Whichever they choose, the pain tends to be spread over people from all income groups.

So who finances the benefits to those middle- and upper-income RRSP contributors? Low-income people—people who receive no RRSP benefits but end up paying some of the costs.

With this in mind, it is difficult to view RRSPs as a desirable component of an overall tax system designed to redistribute income from those who have plenty to those who have little.

What to do?

RRSPs do very little, if any, good for the country as a whole. And they redistribute income in the wrong direction. Given this, here is my three-part proposal for reform.

First, abolish the special tax status of RRSPs (and of similarly "registered" employer-sponsored pension plans. Existing RRSPs could be folded into RRIFs (Registered Retirement Income Funds) and drained within, say, 10 years.

Second, in order to reduce the current tax bias against saving, reduce income-tax rates across the board and, at the same time, broaden the base and raise the rate on GST. (Reducing the bias against saving was much of the motivation for the GST in the first place.)

Third, so that no government sees my proposal as an opportunity for a tax grab, design these tax changes so that total tax revenue remains the same.

This three-part proposal may strike many people as drastic. This is hardly surprising since it would make many current RRSP contributors—including myself—worse off. But the economy as a whole would be better off, and we would be doing more to back up the claims that we really are a kinder and gentler nation.

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