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Increase the RRSP Age Limit Again?

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Many Canadians are dealing with a weakened backdrop for their retirement savings, due to the sharp market decline in 2008/09 and the ensuing deep dive in interest rates. One potential reform measure to help address this issue would be to increase the age limit for RRSPs to 75 from 71 currently, or to eliminate the age limit entirely. Such a move would be fully consistent with the aging population and longer life expectancy. As well, it could also help maintain the size of the labour force as the Baby Boom reaches retirement age. A higher participation rate among older workers, with support from a higher RRSP age limit, could help achieve this goal. The main sticking point on boosting the RRSP limit has typically been concern over the fiscal impact of such a change. However, we think that there is reason to believe that, despite modest short-term costs, such changes could be revenue neutral in the long run.

The 2007 Federal budget increased the RRSP age limit from 69 to 71 at an estimated cost of about \$130 mln per year for the first two fiscal years. That's a small cost relative to the overall size of the budget, especially given the perceived economic benefits. Moreover, in the long run, an increase in the RRSP age limit could be revenue neutral. The RRSP is simply a tax deferral tool, so any lost revenue today from the associated tax deduction is eventually made up by higher revenue tomorrow, when those savings are taxed on withdrawal.

Still, there are two ways neutrality might not hold: 1) If the population as a whole pays a lower tax rate upon withdrawal than at the time of the deduction. This is likely the case as incomes tend to be lower late in retirement than during an individual's working years, or earlier in retirement. And, 2) If the cost of funding a higher deficit today is not offset by growth in RRSP assets, to be taxed later. Given today's low government borrowing costs, growth in RRSP assets should be enough to offset the incremental borrowing costs.

The bottom line: Given the aging population, longer life expectancies and need for higher participation rates among older workers, increasing the RRSP age limit makes sense. This can likely be done with a minimal long-run impact on government revenues.

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