How Feasible is an Alberta Pension Plan?

by William Robson

Ask young Canadians what kind of deal they expect from the Canada Pension Plan, and most will say "bad." On one level, this response seems odd. The 1998 reform package that raised the CPP's contribution rate to 9.9 percent and trimmed future benefits did put the plan on a more sustainable path. Last year, the Chief Actuary's *Nineteenth Actuarial Report on the Canada Pension Plan as at 31 December 2000* estimated the CPP's "steady-state" contribution rate—the rate that would make the ratio of the plan's assets to its expenditures the same in the year 2063 as it will be in 2013—at 9.76 percent, lower than the 9.9 percent rate now scheduled. So why would people worry about the CPP?

They might have looked at similar government-run pension plans elsewhere in the world. That experience is glum: repeated hikes in contributions and adjustments in benefits, and occasional outright investment disasters.

Or they might simply have looked at the CPP itself. When people fund their own pensions, they can improve their benefits by working longer, saving more, and investing for higher returns. Pool people in a CPP-like plan that is only partly funded, and the fastest route to richer benefits for any participant is to work the plan so that other, usually later, participants pay for them—which is how the CPP got into trouble in the past. Worse, looking forward, a partially-funded, pooled plan presents a temptation for governments whose industrial policy ambitions are outrunning their tax revenues. In short, the political tensions that originally made the CPP a bad deal for younger workers are still with us. Give a fiscally profligate federal government the right combination of provincial allies, and the next round could undo the 1998 reforms, leading to future rounds of contribution hikes and benefit cuts.

Happily, the citizens of one province in this game hold a strong hand. Because Canada's constitution gives the provinces primacy in pension-related matters, and because Quebec preferred to set up its own QPP rather than participate in the CPP, the legislation establishing the CPP provides for any province to withdraw from the plan. For Alberta, a separate deal is especially attractive.

Albertans of working age are likelier to work, and earn higher incomes on aver-

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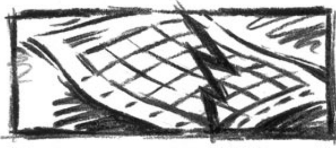

age, than their counterparts elsewhere in Canada. And because Alberta's population is younger than that of other provinces, Albertans of all ages tend, on average, to draw less heavily on CPP benefits than their counterparts elsewhere. That means that Alberta could establish a separate Alberta Pension Plan (APP) providing the same benefits as the CPP at substantially lower cost.

How much less an APP might cost depends, as does the CPP's current contribution rate, on the assumptions made in calculating it. Yet even a fairly conservative projection suggests that the margin between the two plans would be large.

In a recently-released Fraser Institute Public Policy Source, *A New Pension Deal for Alberta*, I use the latest actuarial reports on the CPP as a baseline from which to project the future evolution of an APP that pays the same benefits. In general, my projections assume that Alberta's demographic and economic advantages over the rest of the CPP-participating provinces disappear over the 75-year projection period the chief actuary uses in evaluating the CPP's prospects. I adopt a fairly pessimistic view of the possible administrative costs of an APP. Even so, a steady-state contribution rate for the APP, calculated on an identical basis to that of the CPP, works out to 8.40 percent, some 1.36 percentage points below the 9.76 percent CPP rate the Chief Actuary calculated in the *Nineteenth Actuarial Report*.

The margin between the steady-state rates of an APP and the CPP is, of course, sensitive to the assumptions underlying the projections. Alberta's initial advantages are so big, however, that only ludicrous and utterly unprecedented demographic and economic reversals, and administrative costs many times larger than those of the CPP, would close the gap. And, of course, not all the risks are negative. If Alberta's demographic and economic advantages persist, and if an APP can contain disability expenses as effectively as the QPP has done in Quebec, an APP's contribution rate could be closer to 2 percentage points below the CPP rate.

From an economic perspective, these margins understate the advantages of a lower APP rate. Because the CPP is

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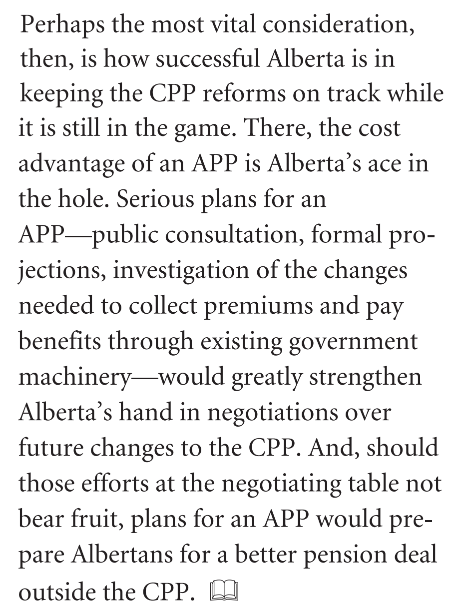
stacked against young Canadians, it charges more than an equivalent package of benefits would cost in a funded plan. For a young worker entering the CPP, about 4 percentage points worth of its premiums feels like a tax—a tax that some will work underground, abroad, or not at all, to avoid. For those people, an APP charging 1.36 percentage points less would be like a one-third cut in the CPP payroll tax.

And from the perspective of an ordinary Albertan, an APP's lower cost means a big pay-off. Expressed relative to Alberta's projected contribution base in 2003, an APP charging 1.36 percentage points less than the CPP would reduce aggregate premiums paid by Albertans by some $520 million annually. That is $330 per contributor in today's money. A young worker who invested that saving every year, allowing for rising earnings over time and compounding at the CPP's projected rate of return, would have around $115,000 after 40 years—a nice kitty to add to the pension the APP would provide.

These numbers, attractive as they are, do not determine by themselves whether Alberta should deal itself out of the CPP. Much else enters the calculation—how much confidence Albertans would have in an APP's promises compared to those of the CPP, for example, and how cooperative or otherwise Ottawa and the other provinces would be in the event Alberta left. The longer Alberta waits, moreover, the more the funds accumulating in the CPP will raise the stakes in a potential battle over Alberta's fair share. And, of course, many Albertans would regard leaving the CPP as a blow against their partners in Confederation, a wound they have little desire to inflict.



Perhaps the most vital consideration, then, is how successful Alberta is in keeping the CPP reforms on track while it is still in the game. There, the cost advantage of an APP is Alberta's ace in the hole. Serious plans for an APP—public consultation, formal projections, investigation of the changes needed to collect premiums and pay benefits through existing government machinery—would greatly strengthen Alberta's hand in negotiations over future changes to the CPP. And, should those efforts at the negotiating table not bear fruit, plans for an APP would prepare Albertans for a better pension deal outside the CPP.