

SUBMISSION TO THE GOVERNMENT MLA COMMITTEE ON STRENGTHENING ALBERTA'S ROLE IN CONFEDERATION

February 26, 2004

The Alberta Federation of Labour is pleased to have the opportunity to submit our position on the questions being examined by the MLA Committee on Strengthening Alberta's Role in Confederation.

The AFL is Alberta's largest labour organization, representing almost 120,000 Alberta workers and their families. Our mandate is to participate in public policy debate affecting the lives and wellbeing of working Albertans.

The AFL wishes to comment on two proposals being advocated by "Alberta Agenda" supporters. The third component of their agenda - establishing an Alberta Provincial Police - we leave to other interested parties to discuss. However, the AFL takes the position that Alberta should continue to be serviced by the RCMP. The additional cost burden to Albertans to establish a provincial police force are excessive and the value of such a project is questionable. The RCMP offers high quality police protection to smaller municipalities in Alberta. There is no reason to alter this arrangement.

Attached are two separate briefs addressing the two remaining proposals - Alberta tax administration and an Alberta Pension Plan. We present them separately to maintain clarity about our critique of each.

Respectfully submitted,

ALBERTA FEDERATION OF LABOUR
Executive Council

FACT SHEET

PENSION PLAN RESPONSE

Over the last ten or fifteen years it has been suggested, from time to time, that Alberta might one day consider withdrawing from the Canada Pension Plan (CPP) and establishing its own Alberta Pension Plan (APP). Generally these proposals have come from the political fringes - from individuals or groups with little knowledge of or experience in pension policy issues. Consequently, these suggestions have not led to any much debate or discussion among pension policy professionals.

On November 15th, 2003, however, Premier Klein announced that the Government of Alberta was appointing a committee of MLA's to receive public input on a number of issues in federal-provincial relations, including the possibility of withdrawing from the CPP. The AFL believes there are a number of important objections to any such proposal.

I. Creating an Alberta Pension Plan

A new Alberta Pension Plan would have to overcome a number of serious obstacles in order to provide a retirement benefit similar to the existing Canada Pension Plan. The province doesn't currently have the capacity to collect and maintain the employment information and records needed to support such a plan, nor to collect contributions from each and every wage-earner in the province.

Building such infrastructure or modifying existing public infrastructure (such as the Workers' Compensation Board) to handle these tasks would be expensive and would pose significant technical challenges. It is not at all clear what ends would be served by committing the province to such an investment in order to duplicate services already offered by the CPP.

II. Managing the Alberta Pension Plan

Even if an Alberta Pension Plan were successfully established, it would generate much higher administration costs than the current CPP. Pension administration costs generally show strong economies of scale, as do pension fund investment costs. In other words, large pension plans are much more cost efficient than smaller ones.

An Alberta Pension Plan would be much less cost-efficient than the existing CPP, and again, we ask: what Alberta would accomplish by deliberately choosing an inefficient vehicle for delivering retirement income to its citizens?

III. The Fraser Institute Case for an Alberta Pension Plan

The answer appears to lie in an occasional paper published by the Fraser Institute, entitled "A New Pension Deal for Alberta: A Provincial Alternative to the Canada Pension Plan." This paper, written by William Robson of the C.D. Howe Institute, is linked to the MLA Consultation Committee's website. The study argues that, because of demographic and economic advantages Alberta currently possesses, an Alberta Pension Plan could offer benefits similar to the CPP at a lower cost, allowing Albertans to pay a lower contribution rate without loss of benefits.

CPP is a "Pay-as-You-Go" (or Pay-Go) pension plan. That means the plan doesn't rely heavily on investment earnings to provide benefits, but rather that contributions from current wage-earners pay most of the cost of benefits for current retirees. The actuaries who advise the plan calculate a so-called "steady-state" contribution rate - one which will balance contributions received with benefits paid out over a period of several decades. The Canada Pension Plan

currently provides basic pension coverage for all Canadians except residents of Quebec, who are covered by the Quebec Pension Plan. The QPP offers benefits identical to the CPP and charges the same contribution rates.

Because the Alberta's economy has been creating jobs at a rate higher than the rest of Canada, many younger Canadians have moved here in search of work. As a result, the province's population is significantly younger than the national average. This constitutes Alberta's demographic advantage, in that fewer Albertans are drawing CPP benefits and a more Albertans are making CPP contributions relative to the overall population of CPP participants.

With a relatively large proportion of its population of working age, Alberta also has the highest labour force participation rate in the country. The participation rate refers to the number of adults either working or actively looking for work. When combined with the province's low unemployment rate and average wages slightly higher than the rest of Canada, this means Alberta has a higher "contribution base" than other jurisdictions covered by the CPP. That means more money flows into the plan in the form of contributions.

Based on the values he estimates for these two factors - Alberta's younger demographic profile and higher contribution base - Robson calculates that an Alberta Pension Plan could offer benefits similar to the CPP supported by a steady-state contribution rate of 8.40%. This is about 1.36% less than the CPP steady-state contribution rate of 9.76%. According to Robson, an Alberta Pension Plan with this contribution rate would save the average contributor about \$320 per year.

IV. Assumptions Underlying the Fraser Institute Study

The actuarial calculations that underlie any pension plan are always based on a series of assumptions about the future of the plan and variables in its demographic and economic environment. Changes in those assumptions can have a very large impact on the projected performance of the plan. In the Fraser Institute paper, Robson examines five variables and assumptions, of which three are especially important:

1. Assumptions about Alberta's demographic advantage.
2. Assumptions about Alberta's economic advantage.
3. Assumptions about start-up and administration costs.

Robson looks at scenarios involving different values for each of these variables and concludes that under all these scenarios the APP maintains a significant cost advantage over the CPP.

In his baseline scenario, for example, Robson assumes values for Alberta's future demographic advantage that are more optimistic than Statistics Canada's population projections. When the more plausible StatsCan projections are used, the cost advantage for the APP falls to 1.01%, a decrease of 0.35%.

In another scenario, Robson uses a more conservative projection of Alberta's future economic advantage. In this instance the cost advantage of the APP is reduced to 1.031%, a decrease of 0.32% from the baseline scenario. Finally, if a higher estimate of costs for the new plan is inserted, the cost advantage of the APP falls by 0.27% to 1.09%.

In each of these scenarios, however, the proposed APP can be sustained by a significantly lower contribution rate than the current Canada Pension Plan. This is the essence of Robson's case for an Alberta Pension Plan.

V. Problems with the Fraser Institute Study (1) Assumptions

Pensions and retirement savings accrue value and disburse benefits over a very long period. An individual's retirement income may accrue through savings or pension contributions for a 35 or 40 year period, after which that same individual may draw their retirement income for another 20 or 30 years. Because of this, actuarial calculations are very sensitive to relatively small changes in underlying assumptions. Those responsible for making decisions about pensions and retirement income have therefore to be extremely conservative in making these assumptions, since an overly optimistic forecast can result in either economic hardship for retirees or escalating pension costs.

Robson's use of demographic and economic assumptions is, in several regards, insufficiently cautious and rests on optimistic projections. He does perform a "sensitivity analysis" - an examination of what would happen to the APP using different assumptions about the future, but the range of values used shows a distinct positive bias.

For example, rather than use Statistics Canada's projection of population trends as the "worst-case scenario" in the analysis of Alberta's demographic advantage, those figures should have been part of the baseline scenario. Stats Can's population forecasts constitute our "best guess" about future demographic trends. Sensitivity analysis of scenarios using projections both more and less optimistic than the baseline case would then have been appropriate.

In the case of Alberta's economic advantage, Robson's analysis uses a range of assumptions that are biased toward optimism. His "worst-case" scenario has Alberta's contribution base declining to the CPP average by the year 2075. While that may seem like a reasonable assumption, it is far from the worst case. After all, by the end of six decades Alberta's supplies of crude oil and natural gas will long since have been exhausted. While we may hope that the province continues to show strong economic growth after that happens, to simply assume it is a poor basis for pension policy decisions.

Even given this positive bias in assumptions, Robson's analysis raises serious questions about the value of an Alberta Pension Plan. For example, each of the negative is examined separately. He doesn't combine all three of his least-favourable assumptions about demographics, the economy, and administration costs (a not unreasonable step given the relative optimism of the

assumptions themselves), and calculate what contribution rate an APP would require under these conditions.

VI. Problems with the Fraser Institute Study (2) Policy Issues

Pension policy decisions have to rest on a foundation of rigorous and objective analysis, but they also reflect political and ethical judgments. The Fraser Institute Study is correct in stating that Alberta's demographics and economy give it an advantage in pension costs relative to the other parts of Canada covered by the CPP, although it overstates how great that advantage is and how long it is likely to last. There is a whole other aspect to this issue, however - one the study doesn't consider.

If Alberta were to leave the Canada Pension Plan, it would be to the detriment of other Canadians participating in the CPP. If Alberta's substantial contribution base were split off from the rest of the CPP, the "steady-state" contribution for that plan would almost certainly have to rise. Albertans would essentially be saying that they were not prepared to bear any responsibility for the retirement incomes of people in other parts of Canada. There is no evidence that working Albertans wish to say anything of the kind.

On the contrary, Albertans are bound to our fellow Canadians by ties of history, culture, and kinship. Breaking away from the CPP to establish a separate Alberta Pension Plan is not a merely technical matter, with problems that can be resolved by a reciprocal agreement between the two plans. Insofar as the CPP reflects Alberta's place in Confederation, it is emblematic of our willingness to assume the obligations of citizenship, and to share in social insurance programs like the CPP.

Many working Albertans have come to this province from elsewhere in Canada, pursuing work and financial independence. They left behind them parents, relatives and friends. Many of our children will grow up, get an education, and find work in another province. Working Albertans have no desire to abandon their families, their friends, or their fellow citizens. Indeed, they want to see the CPP strengthened and improved.

VII. Problems with the Fraser Institute Study (3) Other Agendas

The Fraser Institute study raises two issues that aren't directly relevant to the feasibility of an Alberta Pension Plan. The first of these is the structure of the CPP benefit.

The Canada Pension Plan provides a defined benefit - a specific amount of income based on years worked and salary received - and this benefit is fully indexed to inflation. These are both important features, since they provide a solid base of retirement income that cannot be lost to bad investments or inflation. Insofar as the CPP is intended to provide a "foundation" income for the retired, it is well-designed and does its job admirably. Any attempt to change the basic design of the plan would run the risk of creating a serious income problem for many seniors.

Political opponents of the CPP want to see it converted from a defined benefit plan to a compulsory individual savings plan. Robson refers to such a possibility at three different points (twice on page five, once on page seven) in his paper, and it is clear that he, personally, favours such a conversion. If the elimination of the defined benefit of the CPP is part of the motivation for creating an Alberta Pension Plan, then the public should be informed and given balanced information on the strengths and weaknesses of the two kinds of retirement savings.

Another reason given by Robson (p.5) for addressing the feasibility of an Alberta Pension Plan is to strengthen the province's negotiating position vis-à-vis the federal government. This is a disturbing proposal, since it subjects pension policy issues to a different, more political agenda. Robson makes cryptic reference to Alberta's "objectives within the CPP," but does not clarify what those objectives might be, and the Government of Alberta has never clearly explained its goals in the area of pension policy.

VIII. Conclusion

The proposal to leave the Canada Pension Plan and establish a new Alberta Pension Plan is ill-conceived. Regardless of Alberta's current economic and demographic "advantages," there is no compelling technical case for the APP. All defined benefit pension plans and most social programs contain some elements of cross-subsidization (what Robson calls a "tax"). This insurance or risk-pooling aspect of pension plans is not a flaw - it is a strength.

If the Government of Alberta wants to promote an Alberta Pension Plan in order to convert to a compulsory individual savings plan model, it should plainly state its intent, and give the public a chance to have an informed discussion on the issue.

If, on the other hand, the Government of Alberta wants to strengthen its hand in federal/provincial bargaining on a number of issues, it shouldn't involve pension plan design and the retirement income that we as Canadians have agreed to provide for our seniors.

The Alberta Pension Plan is at best a sadly misguided pension policy initiative, and at worst a political red herring. The Alberta Federation of Labour urges the MLA Committee to seek out balanced information on the Canada Pension Plan, and to reject the proposal for a separate Alberta Pension Plan.