Alberta leaving the Canada Pension Plan (CPP) and creating its own Alberta Pension Plan (APP) has been discussed for many years, and has resurfaced as the newly elected Premier of Alberta has said there is a compelling case for creating an APP, and launched a formal study.

The case for creating an APP is straightforward – at least on the surface – but far from a slam dunk.

Base benefits – benefits that were in place before the creation of additional benefits that are now being phased-in – are the major component of the CPP. They are financed primarily by a direct transfer of income from working age contributors to retired beneficiaries. The higher the ratio of contributors to beneficiaries, the lower the contribution rate. A relatively youthful population will have a relatively low contribution rate and an older population will have a high contribution rate.

Because Alberta is relatively young, it is argued that Alberta could create an APP that would be similar to the CPP in its benefit provisions and financing with a lower contribution rate. The contribution rate for base benefits in an APP could be roughly two percentage points or more below the CPP rate of 9.9 percent. So convinced are some prominent Albertans of this line of argument that the advantage of a separate APP has been called a slam dunk.

If Alberta could be sure of staying forever young, this argument would have merit. As always however, there is uncertainty about the future and in Alberta’s case there is real uncertainty about its ability to remain forever young.

Globally, age structures are determined by basic demographic factors: the number of children born per adult female (the fertility rate) and the length of time that people live beyond birth or other specific ages like retirement age. But Alberta’s youthfulness is not based on these demographic factors. Fertility rates and life expectancies in Alberta are very similar to those for Canada as a whole. What distinguishes Alberta is its receipt of a very large inflow of young interprovincial migrants whose move to Alberta has been driven by a strong oil and gas industry.

This source of youthfulness faces a serious challenge as we look to the future. The downward global pressure on the use of carbon-based energy is inexorable and its adverse effects will be felt most acutely by high-cost producers. Stagnation or even contraction of oil and gas production in Alberta are likely to bring with them a significant decline in inbound migration and undermine Alberta’s relatively youthful status and its lower-cost APP benefits.

Quebec provides a cautionary tale on this kind of demographic gamble. At the time it decided to create a separate QPP, it was a relatively youthful province. That is no longer the case and the QPP contribution rate for base benefits is higher than the CPP rate.

It is also worth noting two things that produce an overstatement of the potential advantage of an APP. Some analyses that promote the advantage of an APP focus exclusively on the base benefits and ignore the newly created additional CPP benefits.

Alberta’s demographic advantage is basically irrelevant to the additional benefits because they are to be fully funded with invested contributions and returns. Cost advantages for the additional benefits will be determined by the rates of return garnered by the CPP Investment Board and the Alberta fund manager, AIMCO. AIMCO has a very good track record as an investment manager. But it will still be relatively small compared to CPPIB even after an equitable asset transfer from the CPPIB. So it isn’t clear AIMCO would have any advantage over the CPPIB in generating the returns necessary to sustain the additional benefits.

Some analyses also tend to assume that administrative costs for the APP will be at the same level as for the CPP. This is very unlikely given the economies of scale that exist in pension administration. Startup costs will be substantial. Alberta will have to create a capacity to collect contributions, calculate and pay benefits, maintain earnings records and adjudicate disputes. The government will have to add APP-related analytical capacity.

All things considered, the creation of a separate APP looks less like a slam dunk than a three-point shot from midcourt.

From: Bob Baldwin

To: Albertans Pondering a New Pension Plan

Date: November 29, 2019

Re: THE ALBERTA PENSION PLAN IS NO SLAM DUNK