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After the Oil Rush: A Blueprint for Alberta's Long-term Happiness

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Albertans could be easily tempted to view the province's abundant natural resources as an unmitigated blessing. The province's economy has grown strongly in the past decade, as the market value of energy resources soared, with significant positive impacts within the province and across the country.

A resource-driven boost to income and wealth, however, can present difficult fiscal challenges. Volatile world energy prices, future economic uncertainty, and political pressure to spend resource revenue quickly can make budget-setting a challenge and pose risks of serious mis-steps.

Of particular concern for Alberta is that high energy prices and rapidly flowing resource revenues mask the province's underlying fiscal position, undercut attempts at spending restraint, and risk leaving the province unprepared, either for market downturns or for an inevitable, eventual slowing of resource production. And Alberta's fiscal institutions, in particular its welter of special funds and trusts, make it difficult for voters to get a clear view of whether and how resource revenue is being saved and spent. Putting in place a framework for coherent spending decisions and clear rules on savings will let Albertans choose more wisely how resource revenues should be balanced between current and future spending demands.

The Current Framework's Problems

Most resource-rich jurisdictions, such as Alaska and Norway, have created consolidated savings funds to manage large resource revenue inflows. Alberta, in contrast, has a primary savings fund, as well as a stabilization fund, two spending funds and a mélange of endowment funds — all intended to help government stabilize revenues and spending (Table 1). An uneasy mix of ministerial discretion and rules of uncertain enforceability govern disbursals from these funds.

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Table 1: *Alberta's Savings Funds*

Fund	Balance	Allocation / Withdrawal Rules
	$billions	
Savings Fund		
Heritage Fund	16.58	By discretion, 1/3 of in-year surpluses above projected surpluses / by discretion.
Stabilization Fund		
Sustainability Fund	7.65	Originally capped at $2.5B, deposits can still be made above this amount. Annual resource revenues above $5.3B (or, the average of the resource revenue forecast for the previous year and the actual resource revenues from two and three years ago) that are not placed in the Heritage Fund or Capital Account are saved in the fund / any resource revenues lower than the amount for fiscal policy purposes can be withdrawn from the fund. Also, funds above the $2.5 billion cap may be withdrawn for spending, or for emergency needs.
Spending Funds		
Debt Retirement Account	1.79	By discretion / pay down remaining debt as it becomes due.
Capital Account	7.78	By discretion, 2/3 of in-year surpluses above projected surpluses / spending on capital projects.
Endowment Funds		
Alberta Heritage Medical Research and Endowment Fund	1.53	By discretion / expenditures principally managed by the fund's board, normally as a percentage of interest income.
Alberta Cancer Prevention Legacy Fund	0.49	Similar to above.
Alberta Heritage Scholarship Fund	0.75	Similar to above.
Alberta Ingenuity Fund*	0.84	Similar to above.
Energy Innovation Fund	0.18	Similar to above.

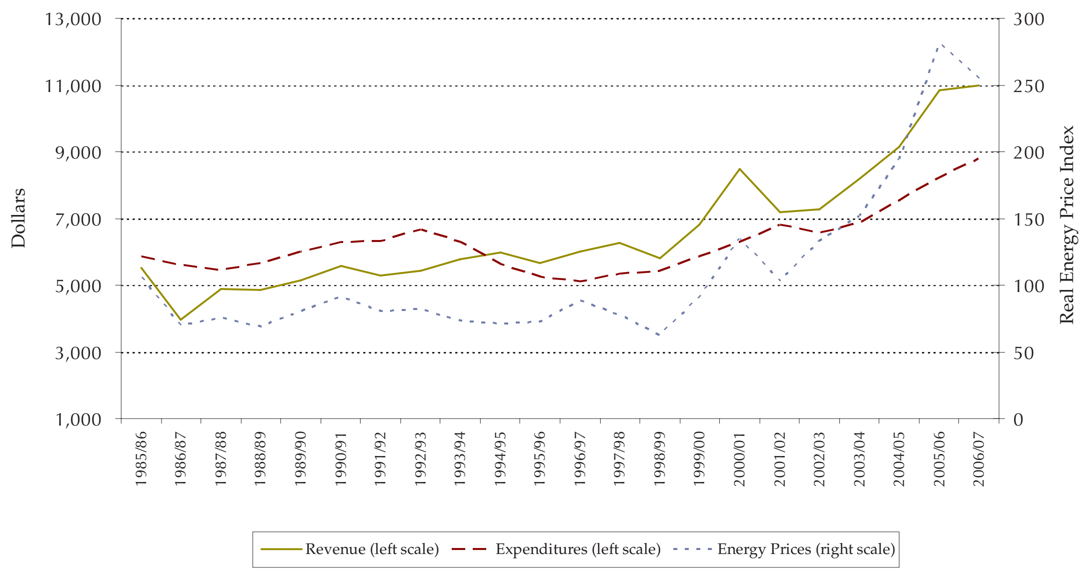
* Formally known as Alberta Heritage Science and Engineering Endowment Fund.

Source: Alberta Budget Documents.

When the world energy price changes, Alberta faces volatile inflows of money. Consequently, shifts in world energy markets tend to drag Alberta's fiscal policy along with them (Figure 1). Windfalls in oil revenues lead to increases in program spending — and this has been Alberta's experience (Busby and Robson 2008). In the last five years, total spending increased above *planned* spending growth by an average of 6.3 percent annually. Not surprisingly, overall spending in the last 10 years has nearly doubled.

Furthermore, the implications of an aging population and the fact that resources are finite are inevitabilities that do not figure in the government's current budget planning. So while non-conventional resources, such as the oil sands and coal-bed methane, have a promising future, conventional reserves of crude oil and natural gas are falling, and the transition to less profitable resources

Figure 1: *Per Capita Revenues, Expenditures and Energy Prices (1986 to 2007)*



Sources: Alberta Budget Documents; Statistics Canada CANSIM.

is likely to result in lower government revenues (Mansell and Schlenker 2006). Furthermore, factors such as increasing labour costs, environmental costs, or the development of alternative energy sources, could lead to declining resource revenue, putting the government in a precarious fiscal position.

What to Do?

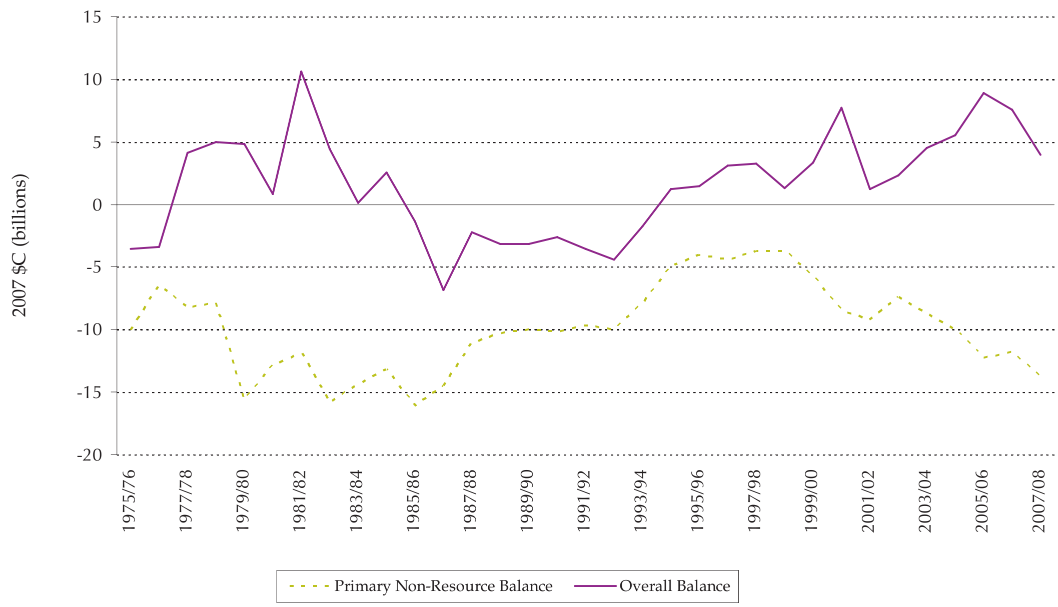
A single fund and a coherent set of rules for saving and spending would help Alberta's government do a better job of managing fiscal planning.

An important component of any fiscal framework is the distinction between wealth and income. Presently, Alberta counts resource revenue and interest on savings as current income. Interest earnings indeed belong in the current income category — but resource royalty revenue does not, because it represents a conversion of the province's resource assets into financial ones. In the interest of facilitating fiscal priority setting, resource revenue should be allocated directly to the Heritage Fund.

Moreover, budgets should report Alberta's long-run fiscal position. One approach, employed by other commodity-based jurisdictions, offers part of a model: their budgets emphasize the "primary non-resource balance." This is the overall budget balance, less all resource revenues (including royalties and personal and corporate taxes derived from the resource sector) and net interest income, as a key indicator of long-run fiscal sustainability (Barnett and Ossowski 2003).

The primary non-resource balance gives an improved measure of fiscal policy. A falling non-resource balance demonstrates either increases in spending or

Figure 2: *Primary Non-Resource Balance and Overall Balance (1977 to 2008)*



Note: The portion of resource revenues that comes from tax revenue is solved for using a narrow measure of the oil and gas sector in Alberta. This takes into account only the direct effects of the sector as measured by GDP per industry. Broader measures based on I/O models would take into account the indirect effects of this sector and likely result in higher figures. See Alberta Finance (2007) for a complete discussion.

Sources: Boothe (1995); various Alberta Government Documents; and author's calculations.

a decline in non-resource revenue collections. A volatile balance signals a lack of fiscal discipline (Figure 2). Alberta's primary non-resource balance was low in the mid-1970s, despite budget surpluses, followed by a recovery in the early 1990s, only to have receded since then in the shadow of overall budget surpluses.

In 2003, the Alberta government created the Sustainability Fund — presently valued at $7.7 billion — to protect the budget from possible future revenue shortfalls. Over just a few years, however, persistently low energy prices could empty the fund, unless public spending's inertia were redirected.[1] For example, the primary non-resource deficit in fiscal year 2007/08 is approximately $13.8 billion. Large primary deficits are not an immediate reason for panic, but when resource reserves or revenues begin to fall the deficit may become unsustainable. To make a primary non-resource deficit sustainable, oil and gas revenues should be converted into savings, so that interest income and future, staged drawdowns can help fund future program spending. Thereafter, the primary non-resource balance becomes the target of fiscal policy.

With a fiscal framework in hand, we can coherently tackle the question of how much to save, or, in other words, how large intergenerational transfers

1 Former premier Donald Getty referred to the challenge of reversing public spending as "trying to turn the Queen Mary."

among Albertans should be. In doing so, budgetmakers should forecast, as best they can, very long-run resource revenues. Then, an appropriate level of fixed transfers can be determined. Spending limits would be clearly drawn to distribute resource wealth smoothly over time — where excess revenues are saved and invested — helping to stabilize the economy. Thus, the primary non-resource balance would be targeted to reach a fixed level that can be maintained once resources are exhausted. Preliminary results from upcoming work[2] suggest that if transfers were made on the basis of constant real per capita spending from resource wealth, approximately $2,300 per Alberta resident could be allocated each year, sustainably, from the savings fund to the program-spending budget. These levels would adjust as new information became available, and the rules could be revised to suit Albertan's needs and values.

Next Steps

With reforms in the 1990s, Albertans facilitated their current prosperity by correcting a fiscal mess. Maintaining that success, however, requires a three-part program for fiscal reform. First, existing savings funds and trusts should be collapsed to one long-lived fund. Second, fiscal planning and budgetmaking should refocus on the primary non-resource balance, to gain a clearer view of what spending is sustainable, given available non-resource revenues, and what is not. Finally, with these reforms in place, Albertans should choose the pace at which they want to draw down their resource heritage, so that future generations may share in the revenues from current resource extraction.

Today, as in the 1970s and 1980s, Alberta's fiscal framework lacks a meaningful anchor. When resource revenues become a less significant source of income, public spending plans will have to be ratcheted down to match the sum of the available tax base and scheduled drawdowns from the province's savings fund. In the interim, planners' attention should move from the budget balance to the primary non-resource balance — placing annual budgets in a long-term context. This will give budgetmakers the framework for choosing meaningful fiscal policy and, in turn, give voters the ability to hold their government to task. Sound policy chosen today will help maintain Alberta's prosperity for future generations, guaranteeing them, at a minimum, the same living standard that Albertans currently enjoy.

2 Shiell, Leslie, and Colin Busby. Forthcoming. *Running Down the Inheritance?* C.D. Howe Institute Commentary.

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