

Saving for the Future:

Fiscal Responsibility
and Budget Discipline in Alberta



Parkland Institute Budget Report 2008



Saving for the Future: Fiscal Responsibility and Budget Discipline in Alberta

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To obtain additional copies of the report or
rights to copy it, please contact:

Parkland Institute, University of Alberta
11045 Saskatchewan Drive
Edmonton, Alberta T6G 2E1
Phone: (780) 492-8558
Fax: (780) 492-8738
Web site: www.ualberta.ca/parkland
E-mail: parkland@ualberta.ca

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About the author

David Thompson is an independent public policy consultant and a Parkland Institute Research Associate. He has postgraduate degrees in law and economics, and has worked in government, the private sector, and the not-for-profit sector.

About the Parkland Institute

Parkland Institute is an Alberta research network that examines public policy issues. We are based in the Faculty of Arts at the University of Alberta and our research network includes members from most of Alberta's academic institutions as well as other organizations involved in public policy research. Parkland Institute was founded in 1996 and its mandate is to:

- conduct research on economic, social, cultural, and political issues facing Albertans and Canadians.
- publish research and provide informed comment on current policy issues to the media and the public.
- sponsor conferences and public forums on issues facing Albertans.
- bring together academic and non-academic communities.

Executive summary

What will our economy look like when our non-renewable resources have dwindled? Where will our government obtain revenues for vital social programs? Will we be able to rely on our own savings, or will we need to go cap-in-hand to Ottawa?

After years of Parkland Institute and others calling for more responsible management of our non-renewable resources, the government struck a Financial Investment and Planning Advisory Commission to study the issue of savings. The Commission has reported to government, but the government has yet to release the Commission's findings or reveal its intentions.

In the current boom the Alberta government has an opportunity to act, but this opportunity will disappear as available resource wealth declines. Now is the time for a responsible approach to saving, investing and benefiting from Alberta's non-renewable resource wealth.

Goals

For many years, the provincial government has single-mindedly focussed on eliminating the financial debt. Now Alberta is in a new reality – a period of surpluses and savings. Yet the government has not adjusted its plans or budgets to reflect this new reality. There is a need for an inclusive social discussion to define appropriate provincial goals that should guide its savings policies. This section of the report draws from the literature and public debate on Alberta's fiscal management to help launch that discussion.

Long-term savings. Albertans own the resources, and the rents arising from their extraction. Rents are the value of the resource when sold, minus costs of production (e.g. exploration, extraction, transport) and a normal, competitive level of profit for the developer. The rents consist of two parts: royalties retained by the owners (the public) and windfall profits (a.k.a. unearned income) taken by the developers.

Alberta's government has a duty to manage rents not just for today's voters, but also for our children and future generations. Non-renewable resources are a form of natural capital – an asset for all Albertans. As they dwindle, we will need to ensure we can still pay for essential public programs.

Unfortunately, Alberta's government treats royalties as if they were ordinary revenues to be spent, instead of assets to be maintained. Royalties have been used to artificially suppress taxes. Indeed, without liquidating our royalties, Alberta's government would have been running deficits for each of the past 20 years, adding up to a total debt of over \$85 billion.

If the government had placed all non-renewable resource royalties in the Heritage Savings Trust Fund after the net debt was eliminated eight years ago, the Fund would be worth \$135 billion (instead of \$16 billion). It would already yield earnings of at least \$7 billion per year, above inflation.

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Fiscal stabilization. The provincial government's addiction to volatile non-renewable resource wealth causes major fluctuations in revenues. And its insistence on never running deficits translates that revenue fluctuation into expenditure fluctuation. In order to stabilize revenues and expenditures, non-renewable resource rents should be removed from general revenues, and replaced with more reliable and predictable revenue streams.

Diversifying the economy. Alberta's economy has been dependent on energy for decades, and continues to be so. This creates a vulnerability to fluctuating global commodity prices, as was experienced by Alberta in the 1980s and '90s. Alberta's non-renewable resource rents should be held and deployed in a manner that helps to diversify its economy.

Economic stabilization. Alberta's economy has a pronounced boom-and-bust cycle, with alternating bouts of unemployment and inflation. The government's procyclical spending exacerbates that cycle. When the business cycle is low, the government cuts spending, thereby throwing people out of work. When the economy is booming, the government spends more, driving up inflation. Government spending can and should do the opposite. Alberta's non-renewable resource rents present an opportunity to spend in a way that mitigates the boom-bust cycle.

Responsible fiscal management. Alberta's government has a history of lowballing budgeted revenues, and declaring "surprise" surpluses that are a surprise to nobody. The government should more honestly manage its non-renewable resource revenues and budgeting, using accurate, even-handed forecasts and making decisions transparently.

The other part of behaving responsibly is behaving ethically. Alberta's energy savings could boost renewable energy development, and pursue other ethical investment goals. Ethical investments often have superior financial performance, and enjoy increasing popular support. Alberta's energy savings should be invested ethically, to obtain social, economic and financial returns for their owners.

Policies arising from the goals

Policies on both sides of the ledger – income and spending – can help achieve our goals.

Income-side policies

Saving our surpluses. For years Alberta's government has spent budgeted and "surprise" surpluses on a range of tax cuts, discretionary spending, and giveaways like the \$400 "Prosperity Bonus" cheques. Instead of reacting to surpluses by dissipating them, government should place 100% of surpluses – budgeted and "surprise" – into the Heritage Savings Trust Fund.

Saving our non-renewable resource rents. Because non-renewable resources will decline, many argue that the rents should be saved. The "Hartwick Rule" of economics holds that in economies dependent on non-renewable resources, ensuring future generations are as well off as we are requires transforming resource stocks into capital that will produce earnings for future generations. Nevertheless, weaning the Alberta government from its addiction to easy money, and replacing it with sustainable revenues, will take time. This report recommends that over a four-year period all non-renewable resource rents be phased out of general revenues and placed in the Heritage Savings Trust Fund.

Increasing Albertans' share of the non-renewable resource rents.

Alberta's government has a duty to maximize the rents it retains for the owners – not to keep a "fair" share, or strike a "balance." However, the government has been giving away much of the rents, and continues to do so under its new Royalties Framework. The idea that industry will pack up and leave if royalties are increased is an empty threat. Clearly it didn't happen after the new Framework was announced, despite dire warnings. This is because risks here are low, and profits are high – recently breaking records on a yearly basis.

Even if retaining rents did push back some investments into the future, this could result in higher overall revenues as oil prices rise, a more orderly pace of development, and a level playing that allows other sectors to secure more investment. Alberta's government should increase its retention of non-renewable resource rents so that within four years Albertans are keeping 100% of rents, and energy corporations are making normal, competitive levels of profit.

Can Alberta backfill the non-renewable resource rents? Removing non-renewable resource rents from general revenues would leave a gap that needs to be filled. The size of the gap would be less than \$8 billion per year, and it turns out that this can readily be filled. Merely adopting a tax system competitive with other provinces would generate \$8 to \$15 billion. An even larger amount could be raised by instituting a carbon tax (or expanding the "non-tax" industrial carbon charge Alberta instituted last year). Whatever strategy the government adopts, replacing the non-renewable resource rents is feasible. Alberta's government should embark on a democratic, transparent process for determining a strategy for doing so.

Wise and ethical fund management. Norway's Petroleum Fund – over 20 times larger than Alberta's Heritage Savings Trust Fund – is managed ethically. And it is unlikely that Albertans would support every profitable investment opportunity regardless of the harm it causes here or elsewhere. Heritage Savings Trust Fund moneys should be invested ethically. And to address "resource envy" a significant portion should be invested in equity holdings outside of the province, including some in renewable energy development.

Spending-side policies

Maintaining the trust. Alberta government policy has decimated the Heritage Savings Trust Fund for the past two decades, wiping out half of its per-capital value and two-thirds of its per-GDP value. Inflation protection has recently been restored, but earnings are still skimmed off. The Heritage Savings Trust Fund should be maintained and expanded: capital should never be removed from it, and earnings should go to inflation-proofing before anything else.

Building a nest egg. As Alberta's non-renewable resource economy shrinks, the government may be unable to raise adequate revenues to support essential programs like health, education, and social assistance – programs that may be in greater need at that time.

“Alberta government policy has decimated the Heritage Savings Trust Fund for the past two decades, wiping out half of its per-capital value and two-thirds of its per-GDP value.”

Alberta’s government should allocate half of Heritage Savings Trust Fund earnings above that needed for inflation-proofing to a new Alberta Permanent Trust. The Permanent Trust would match or supplement government spending in these areas when needed. The government should also commission regular forecasts to determine whether the Permanent Trust will require greater resources.

Orderly spending: responsive, non-partisan, transparent. The government has already established a number of funds: the Medical Research Endowment Fund; the Scholarship Fund; the Energy Innovation Fund; etc. Well-managed arms-length spending can potentially increase transparency, reduce cronyism, and limit bad investing. However, the existing funds operate with a melange of discretion and rules, inviting abuse and limiting transparency. The existing funds should be reconfigured as arms-length foundations, governed by common rules to ensure accountability and transparency, and employed to spend the Heritage Savings Trust Fund earnings not required for inflation-proofing or the Alberta Permanent Fund.

New spending priorities – rationalizing the process. Priorities will shift over time, and the government should regularly review existing foundations against spending needs, as determined by an objective, transparent public process. The government should create new foundations as needs require and resources permit, and shut down those no longer a priority. Having a number of foundations will result in a wide range of grants and recipients, thus contributing to economic diversification.

Countercyclical spending. Removing non-renewable resource rents from general revenues will help reduce procyclical spending. However, our economy could be further stabilized by countercyclical spending policies, e.g. requiring most foundation spending to occur during periods of relatively high unemployment. Other policies could help stabilize Alberta’s economy in the longer term, e.g. developing the renewable energy sector in Alberta.

Sustainability fund and capital account. Given that the non-renewable resource rents would be removed from general revenues, the fiscal shock-absorber provided by the Sustainability Fund is less important. The Sustainability Fund should be replaced by a normal budget cushion of 3.5% of budget, to be funded by ordinary revenues.

Capital spending also can and should play a stabilizing or countercyclical role. The Capital Account should be moved into the Heritage Savings Trust Fund and renamed the Alberta Natural Capital Replacement Foundation, with spending rules as per the other foundations. Immediate-term, urgent spending on our current infrastructure debt can be handled with normal financing as in other provinces, i.e. general revenues and ordinary debt.

Conclusion

Alberta's government can manage its citizens' non-renewable resources rents better. Following the above recommendations would raise the Heritage Savings Trust Fund to over \$200 billion in just ten years. This sum would yield over \$10 billion in earnings above inflation – significantly more than the government's projected royalties.

Alberta's resource revenues have already begun to fall off, and having a solid savings and investment framework is increasingly urgent. The recommendations in this report are achievable. They would help to stabilize the government's finances and make planning, budgeting and program and financial management easier. And they would help diversify the economy, make it more sustainable, and mitigate the boom-bust cycle. Most importantly, these recommendations would help to serve the needs of Albertans – now and in the future.

“Following the above recommendations would raise the Heritage Savings Trust Fund to over \$200 billion in just ten years. This sum would yield over \$10 billion in earnings above inflation – significantly more than the government's projected royalties.”

Introduction

What will our economy look like when our non-renewable resources are diminished?

Where will our government obtain revenues for vital social programs?

Will we be able to rely on our own savings, or will we need to go cap-in-hand to Ottawa?

For over three decades Albertans have debated and experimented with different approaches to managing the wealth from exploitation of our non-renewable resources. During booms and busts, the Alberta economy has been defined by the extraction of oil and gas. Our government's policies and the province's public finances have also been shaped by the realities of an oil and gas economy. It is now recognized that the challenges associated with mitigating boom-bust cycles, diversifying our provincial economy, stabilizing provincial revenues, providing public services and meeting future social goals are tied to our management of non-renewable resource wealth.

For years, the Parkland Institute has been an advocate of responsible management of our non-renewable resource wealth. Recently, many other organizations, journalists and political and economic commentators have joined the chorus of those calling for a new approach to greater savings of that wealth.

The government has responded by creating the Financial Investment and Planning Advisory Commission.¹ The Commission has reported to government, but the government has yet to release the Commission's findings publicly or reveal its intentions on savings.

In this report, the Parkland Institute offers a responsible approach to saving, investing and benefiting from Alberta's NRR wealth. Section 1 outlines goals that should drive savings and management policies, including the following:

- **Long-term savings** – ensuring we have financial resources to support a vibrant economy and vital government policies and programs when our non-renewable resource wealth dwindles.
- **Fiscal stabilization** – controlling the fluctuating revenues of government, so that government can budget accurately and govern effectively.
- **Diversification of our economy** – reducing Alberta's dependency on non-renewable resource extraction.

¹ <http://www.finance.gov.ab.ca/fipac/index.html>

- **Economic stabilization** – mitigating the boom-bust cycle.
- **Fiscal management** – ensuring responsible stewardship of our savings.

Section 2 builds on this discussion of goals, and sets out a number of policy changes that could help to achieve those goals. These policy changes fall into two broad areas: the income side and the spending side:

Income side:

- **Saving our surpluses** – saving both budgeted and “surprise” surpluses in the Heritage Savings Trust Fund.
- **Saving our non-renewable resource rents** – putting NRR wealth into the Heritage Savings Trust Fund, rather than liquidating it to finance spending and tax cuts.
- **Increasing Albertans’ share of resource rents** – selling our natural capital for the highest price we can get.
- **Backfilling the resource rents** – re-establishing a sustainable tax system.
- **Sound and ethical fund management** – ensuring our investments yield environmental, social and financial returns to their owners.

Spending side:

- **Maintaining the trust** – preserving and building the Heritage Savings Trust Fund.
- **Building a nest egg** – setting aside some Heritage Savings Trust Fund earnings to provide support for essential government programs when non-renewable resources are diminished.
- **Orderly spending** – spending some Heritage Savings Trust Fund earnings in a way that is non-partisan, merit-based and transparent.
- **Countercyclical spending** – using our spending policies to help flatten, rather than exacerbate, the ups and downs of the business cycle.
- **Sustainability fund and capital account** – budgeting wisely so that ordinary revenues provide a cushion for in-year revenue fluctuations, and intelligently tackling our infrastructure debt.

“Lord please give me another oil boom, and I promise this time I won’t [fritter] it away”

- popular Alberta bumper sticker in the 1980s and ‘90s.

“Our capacity to ensure a prosperous and sustainable future depends on our willingness to make tough decisions today.”

The well-known bumper sticker about not wasting our resource wealth was meant to be humorous. However, we must recognize the seriousness of its message. In the current boom we have a historic opportunity to act, but this opportunity will gradually disappear as our stock of non-renewable fossil fuel resources is depleted. Our capacity to ensure a prosperous and sustainable future depends on our willingness to make tough decisions today. Now is the time for a responsible approach to saving, investing and benefiting from Alberta’s NRR wealth. Quite simply, we have an obligation to take action now for the future.

1. Goals

It is time for Alberta to look forward, to consider what new goals should guide the savings and investment of our non-renewable resource (NRR) wealth. For many years, the Alberta government had single-mindedly focussed on eliminating the province’s financial debt. The massive spending cuts that the government inflicted during the 1990s created infrastructure, social and environmental debts that we are still struggling to pay a decade later.

Alberta is now in a new reality – a period of surpluses and savings. As Parkland pointed out two years ago,² the government has not adjusted its plans or budgets accordingly. As another author put it this year, the government’s “fiscal framework has not been adjusted to reflect this reality.”³

Several goals emerge from the literature and public debate on fiscal management, and these are briefly discussed below. Alberta should also hold a broad, inclusive social discussion – one that is thorough, transparent, non-partisan and involves the broader public in refining our provincial fiscal goals.⁴

Following the discussion of goals, this report will go on to outline policies that would implement and strike a balance between those goals.

- 2 Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” <http://www.ualberta.ca/PARKLAND/research/studies/FiscalDemocracy.pdf> (Parkland Institute, May 2006) at pp. 2, 24-26 (accessed March 10, 2008).
- 3 Ken Boessenkool, “Time for New Budget Rules: A Savings and Surplus Management Act for Alberta” http://www.cwf.ca/V2/files/Time_for_New_Budget_Rules.pdf (Canada West Foundation, January 2008) at p.1 (accessed March 10, 2008).
- 4 It is not enough to rely on input from old “consultative events” or conduct a mail-in public opinion survey, such as the Government’s methodologically-dubious “Public Consultation on a Debt-Free Alberta.” See Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” op.cit. at pp. 28-29.

1.1 Long-term savings

To whom do Alberta’s non-renewable resources belong? Alberta’s Royalty Review Panel stated it succinctly: “Albertans own the resource.”⁵

The provincial government manages the resources on behalf of Albertans, and the government has a duty to manage the common wealth and resources of the province not just for today’s Alberta voters, but also for our children, grandchildren and future generations. A Canadian Taxpayers Federation report characterized the failure to save one-time resource revenues as “theft ... from one generation by another.”⁶ It is the government’s job to steward our resources carefully, and it is the government’s job to distribute their benefits to citizens over time.

Unfortunately, the inevitability of non-renewable resources being used up does not seem to “figure in the government’s current budget planning.”⁷ The Alberta government treats NRR royalties as if they were a revenue item, when it should instead be treating them as an asset and saving them.⁸

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- 5 Alberta Royalty Review Panel, “Our Fair Share” http://www.albertaroyaltyreview.ca/panel/final_report.pdf at p.7 (accessed March 10, 2008).
 - 6 Scott Hennig, “Opportunity (almost) Lost: Why the only option for Alberta is to save” (Canadian Taxpayers Federation, November 2007) at p.6 [http://www.taxpayer.com/pdf/Opportunity_\(almost\)_Lost_-_WEB.pdf](http://www.taxpayer.com/pdf/Opportunity_(almost)_Lost_-_WEB.pdf) (accessed March 12, 2008).
 - 7 Colin Busby, “After the Oil Rush: A Blueprint for Alberta’s Long-Term Happiness” (C.D. Howe Institute February 27, 2008) http://www.cdhowe.org/pdf/ebrief_54.pdf at p. 2 (accessed March 12, 2008).
 - 8 Idem.
 - 9 With the exception of a small number of cases where private land-owners also own subsurface mineral rights. These cases are not the subject of this discussion.
 - 10 Note that energy corporations use a jargon that turns around the meaning of these terms. In industry jargon, “take” is the public share of rents, even though the rents belong to the public in the first place. And “keep” is the share than industry keeps, even though it does not belong to industry.

Terms explained: rents, royalties and windfall profits

Rents are the financial surplus from selling a resource: the price obtained for the product minus the costs of finding, developing, extracting and transporting it and a “normal” level of profit (i.e. a level of profit that assumes a competitive market with other investments).

Resource selling price

– **Costs** (of exploration, development, extraction, transportation, etc.)

– **Profit** (normal, competitive level of profit)

= **Rent**

Rents are comprised of two items: royalties and “windfall profits” (a.k.a. unearned income).

- Royalties are the portion of rent collected on behalf of the owners of the resource when it is sold. In Alberta, the owners are the public.⁹ The public is entitled to 100% of rents.
- Unearned income, or windfall profit, is the portion of rent taken by the firm extracting the resource.¹⁰

Portion of non-renewable resource value		Who pays/gets? ¹¹
Rents {	Royalties	Owner (public) retains
	Unearned ("windfall") profits	Corporations take
Competitive ("normal") profits		Corporations take
Costs of exploration, development, extractions, etc		Owner (public) covers costs

When the Royalty Review Panel issued its report calling on government to increase royalties, energy corporations claimed publicly that they could not afford to pay more (while some privately told investors they could expect a "wall of cash flow.")¹² Some claimed that changing Alberta's royalty framework would drive energy investment out of Alberta. Parkland Institute pointed out that this was an empty threat,¹³ and clearly it has not occurred. And for good reason: the proposed increase in rents was \$2 billion – a small fraction of industry profits. In the end the government failed to even increase public retention of rents by \$2 billion, opting instead for \$1.4 billion over the baseline. However, it is important to recall that even if the Government had raised royalties to the point of retaining 100% of the rents, the corporations would still make a normal, competitive level of profit.

- 11 Taxes are also levied by governments on various transactions.
- 12 Canadian Natural Resources Limited CEO Steve Laut, quoted in David Ebner, "As Big Oil pumps out profit, Alberta's take is shrinking: Is it time to up the ante?" (Globe and Mail, 18 August 2007), pp. B5-6, cited in Gibson, "Selling Albertans Short: Alberta's Royalty Review Panel Fails the Public Interest" (Parkland Institute, October 2007) at p.12 [http://www.ualberta.ca/PARKLAND/research/studies/OilRoyaltyReport\(web\).pdf](http://www.ualberta.ca/PARKLAND/research/studies/OilRoyaltyReport(web).pdf) (accessed March 23, 2008).
- 13 Diana Gibson, "Selling Albertans Short: Alberta's Royalty Review Panel Fails the Public Interest" *ibid*, at pp. 9 & ff.
- 14 The most recent fiscal update notes \$1.7 billion net transfer to capital account, and \$1.9 billion to HSTF and other savings vehicles: Alberta Finance "Third Quarter Fiscal Update 2007-2008" (Alberta Finance, February 19, 2008) http://www.finance.gov.ab.ca/publications/budget/quarterly/2007_3rdq/report.pdf at p.1 (accessed March 12, 2008).
- 15 This does not include cumulative borrowing costs. Data sources: Government of Alberta, "Annual Report 2004-05: Report to Albertans on Budget 2004 – Historical Fiscal Summary, 1986-87 to 2004-05" at p.18 http://www.finance.gov.ab.ca/publications/annual_repts/govt/ganrep05/execsumm.pdf; Government of Alberta 2004-2005 to 2006-2007 Annual Reports http://www.finance.gov.ab.ca/publications/annual_repts/govt/index.html; Alberta Finance, "Budget 2007, Third Quarter Fiscal Update op. cit. (all accessed March 11, 2008).

Currently, the majority of NRR royalties end up in the general revenue fund and are spent by the government on programs and on artificially suppressing taxes. Of nearly \$11 billion in NRR royalties projected by the government for the 2007/2008 fiscal year, only about \$3.6 billion will be put into savings.¹⁴

Put differently, if we subtract out the NRR royalties from general revenues, the government would have been running deficits averaging over \$4 billion per year over the past 20 years. Instead of the reported net surplus over that time of \$33 billion, there would be a net debt of over \$85 billion.¹⁵

“... if we subtract out the NRR royalties from general revenues, the government would have been running deficits averaging over \$4 billion per year over the past 20 years. Instead of the reported net surplus over that time of \$33 billion, there would be a net debt of over \$85 billion.”

“Royalties in particular are not so much revenue as they are the result of converting an asset from one form to another—from a physical asset (oil or gas in the ground like the baker’s oven) to a financial asset (royalty payments, like the proceeds from the sale of an oven). ... Another way to look at this is to consider other tax revenues as income statement transactions while non-renewable resource royalties should be treated as a balance sheet transaction.

In this context, the fact that only 8.6% of non-renewable resources in Alberta from 1977 to 2005 went into the Heritage Savings Trust Fund while over 90% went into general revenues is problematic. While admittedly some of the more recent non-renewable resource revenues assisted in the payment of provincial debt, the fact that resource revenues were treated no different than other tax revenues for most of this period is troubling.”¹⁶

The current high levels of economic activity associated with resource extraction constitute a benefit to Albertans today. However, non-renewable resources, by definition, will be depleted and rates of extraction will subside. And once they are gone, they are gone forever, along with the economic activity they provide.

The last several generations have seen improvements in their average material standard of living. However, it is more than conceivable that when the resource has dwindled, that improvement will stop or reverse.

The reality is that Alberta’s supplies of conventional fossil fuels are already falling. Extraction is rapidly shifting to unconventional sources which cost more – both financially and environmentally – and have lower per-unit potential for profits and royalties.¹⁷ As a result, the associated benefits – both economic and fiscal – of NRR extraction will dwindle. Those benefits will need to be replaced with others, such as financial investments that we make today and that pay out in future.

We need a vibrant economy in the future, not just today. One commentator stated that we need to “maintain Albertans’ standard of living long after the energy reserves are depleted.”¹⁸ It may actually be impossible to maintain our current energy-intensive lifestyles when reserves are depleted, but we will need to maintain fiscal resources that will allow us to ensure an equivalent quality of life for Albertans.

¹⁶ Ken Boessenkool, “Time for New Budget Rules: A Savings and Surplus Management Act for Alberta” op. cit. at p.5 (accessed March 10, 2008).

¹⁷ Colin Busby, “After the Oil Rush: A Blueprint for Alberta’s Long-Term Happiness” op. cit. at p.3 (accessed March 12, 2008).

¹⁸ Calgary Chamber of Commerce, “Submission to the Alberta Government Financial Investment Planning and Advisory Commission” (October 31, 2007) at p.10 [http://www.calgarychamber.com/abcalcoc/doc.nsf/files/B7FA58234EFB99F98725738B006818C5/\\$file/CalgaryChamberFIPAC-Submission.pdf](http://www.calgarychamber.com/abcalcoc/doc.nsf/files/B7FA58234EFB99F98725738B006818C5/$file/CalgaryChamberFIPAC-Submission.pdf) (accessed March 10, 2008).

- **Goal:** *Alberta's non-renewable natural resource rents should be saved instead of being spent.*

19 The government stated "The province's net asset (net debt) position is the difference between its financial assets and total liabilities, excluding pension obligations. ... Alberta's net debt was eliminated in the 1999-00 fiscal year." Government of Alberta, 2000-2001 Annual Report, under "Alberta's Net Assets (Net Debt) (at fiscal year end March 31), cited in Parkland Committee on Alberta Finances, "Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta" op. cit. at pp. 37 (note 34).

20 The net debt was not eliminated in 2005, but rather in the 1999/2000 fiscal year, when financial assets exceeded liabilities. In 2005, despite the "debt elimination" fanfare (which had a familiar ring), the Government merely allocated some of its existing net financial assets to an account designated to pay individual debt instruments as they came due – more an accounting trick than elimination of the debt. See Parkland Committee on Alberta Finances, "Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta" op.cit. at pp. 15-16.

21 Yearly NRR royalties: Government of Alberta, "Annual Report 2004-05: Report to Albertans on Budget 2004 – Historical Fiscal Summary, 1986-87 to 2004-05" at p.18 http://www.finance.gov.ab.ca/publications/annual_repts/govt/ganrep05/execsumm.pdf; Government of Alberta 2004-2005 to 2006-2007 Annual Reports op. cit; Alberta Finance, "Budget 2007, Third Quarter Fiscal Update op. cit. (all accessed March 11, 2008). 5.1% growth rate as per Alberta Finance "Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures" http://www.finance.gov.ab.ca/publications/budget/budget2007/heritage.html#goals_strategies (accessed March 23, 2008).

22 Alberta Finance projects 5.1% growth above CPI, compared to 13% in the previous year (and slight increased projected for future years) "Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures" op. cit.

What would the Heritage Savings Trust Fund be worth today if Alberta's government had saved?

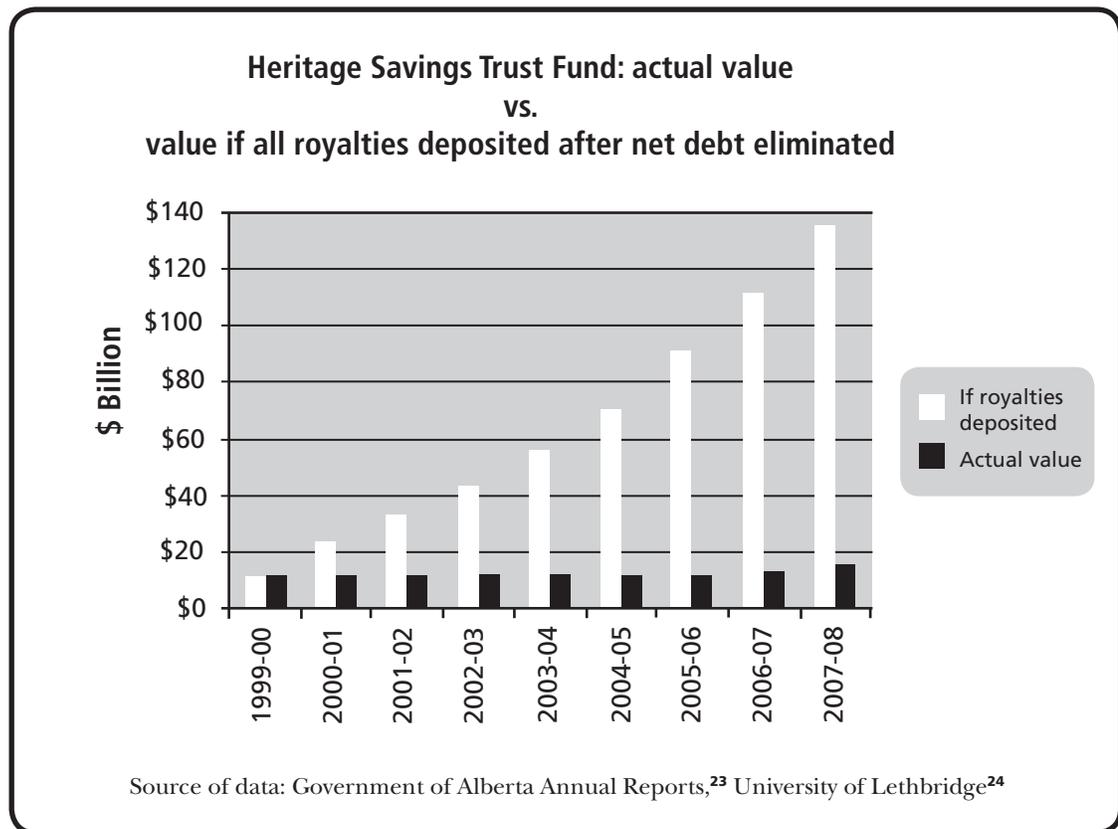
For years the Alberta government has been spending our non-renewable resource rents on ordinary program spending and tax cuts. Arguably, some of those rents may have been used to reduce the debt, but it is impossible to say with certainty, as money in general revenues is not normally earmarked. However, the debt could also have been paid down with ordinary revenues. And if the government had not engaged in massive and unsustainable tax cuts it could have paid down the debt without touching NRR royalties.

In any event, the government was net debt free in 1999-2000, as it indeed declared that year,¹⁹ when its financial assets first exceeded its liabilities.²⁰ At that time, the value of the Heritage Savings Trust Fund was approximately \$12 billion. Since then, the government has taken in approximately \$80 billion in non-renewable resource royalties. With conservative growth assumptions, if those royalties had been placed in the Fund, it would be worth \$135 billion today.²¹

What would \$135 billion be earning for Albertans today? Using the government's conservative growth projections²² for 2007-2008, a principal of \$135 billion would yield almost \$7 billion above the amount required for inflation protection. Using last year's actual growth rate, the yield would be \$17.5 billion above inflation – far higher than current non-renewable resource royalties.

In other words, if Alberta's government had decided to spend normal revenues after the debt was gone instead of liquidating our natural capital, Alberta would have a steady, permanent revenue source of several billion dollars per year.

Unfortunately for Albertans, their government failed to act on that opportunity. However, as will be shown below, we can still make up for lost time.



23 Government of Alberta, "Annual Report 2004-05: Report to Albertans on Budget 2004 – Historical Fiscal Summary, 1986-87 to 2004-05" op. cit. at p.18; Government of Alberta 2004-2005 to 2006-2007 Annual Reports op. cit.; Alberta Finance, "Budget 2007, Third Quarter Fiscal Update op. cit.

24 CPI for Alberta at <http://www.uleth.ca/analysis/CPI/PDF/alberta.pdf> (accessed March 23, 2008).

25 Norges Bank Investment Management, Norway Government Petroleum Fund Annual Report 1998 – The Government Petroleum Fund http://www.norges-bank.no/Pages/Report___47774.aspx (accessed April 3, 2008).

26 Quoted in Jason Fekete and Chris Varcoe, "How much cash should we stash away?" (Calgary Herald, Aug 12, 2007) <http://www.canada.com/edmontonjournal/news/sundayreader/story.html?id=cbbd036a-541a-4551-a91b-2408a5a40506> (accessed March 26, 2008)

"The Petroleum Fund constitutes a buffer against fluctuations in revenues from petroleum activities, and a tool for dealing with the long-term challenges to state finances which will present themselves when petroleum activities decline."

- Norway Government Petroleum Fund, Annual Report 1998²⁵

"Compared to Alaska and Norway, Alberta has mishandled its resource revenue planning."

- Roger Gibbins, Canada West Foundation, 2007²⁶

1.2 Fiscal stabilization

The Parkland Institute has frequently pointed out that the provincial government's addiction to NRR royalties results in unpredictable fluctuations in general revenues:

“The wildly swinging revenues of the Alberta government are the result of its policy decision to cut sustainable taxes, and rely instead on increasing yet unsustainable rents from selling off the public's fossil fuels.”²⁷

This problem – addiction to NRR rents causing fluctuating general revenues – has also been noted in reports published by others.²⁸ The Calgary Chamber of Commerce called it an “unsustainable and unhealthy dependence on volatile revenue sources.”²⁹

Furthermore, fluctuating revenues tend to result in fluctuating expenditures. This is a direct result of the decision by the government to avoid fiscal deficits: when revenues are low, spending is cut, and later on (e.g. now) the government plays catch up.³⁰ As Michael Percy, Dean of the University of Alberta's School of Business, puts it, “The current means of ensuring balanced budgets also means that revenue volatility is transmitted directly into expenditure volatility.”³¹

Spending at the top of the business cycle also wastes revenues, as costs are higher. University of Alberta economist Paul Boothe notes that, at such times, increased government spending doesn't buy more capital so much as it buys more expensive capital.³²

Alberta's government needs stable general revenues in order to deliver its programs and services efficiently, and to plan rationally for the future.

- **Goal:** *In order to increase the stability of provincial general revenues and expenditures, and to facilitate orderly delivery of programs and services, Alberta's volatile NRR rents should be kept separate from the general revenue fund. The government should be relying on more predictable and less volatile revenue streams in its general revenues.*

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- ²⁷ Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” op. cit. at p. 1.
- ²⁸ E.g. Ken Boessenkool, “Time for new budget rules: A Savings and Surplus Management Act for Alberta” op. cit. at p.5 (accessed March 10, 2008).
- ²⁹ Calgary Chamber of Commerce, “2008 Provincial Pre-Budget Submission” (Nov 2007) at p.8 [http://www.calgarychamber.com/abcalcoc/doc.nsf/files/1552BF6DD2DB76E8872573A6005E4208/\\$file/Chamber_Provincial_Pre-Budget-Final_2008.pdf](http://www.calgarychamber.com/abcalcoc/doc.nsf/files/1552BF6DD2DB76E8872573A6005E4208/$file/Chamber_Provincial_Pre-Budget-Final_2008.pdf) (accessed March 26, 2008).
- ³⁰ Colin Busby, “After the Oil Rush: A Blueprint for Alberta's Long-Term Happiness” op. cit. at p.3 (accessed March 12, 2008).
- ³¹ Cited in Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” op. cit. at p. 18. To some extent, Alberta's government has gotten around its own balanced budget rule by creating a number of exceptions to the rule, and by creating foundations that soak up revenue in fat years and spend in lean years.
- ³² Cited by Todd Hirsh, “Will Alberta's economy crush Steady Eddie?” (Globe and Mail, December 5, 2006), at Canada West Foundation http://www.cwf.ca/V2/cnt/oped_hirsch_120506.php (accessed March 11, 2008).

1.3 Diversifying our economy

Alberta's economy is energy-dependent, and in the past the province has felt the pain of drops in international energy prices. It is a case study of economic vulnerability to volatile commodity prices. And in addition to being vulnerable to volatility in commodity markets, "resource dependent economies are more vulnerable to disruptions from trade disputes."³³

A healthy economy, in contrast, is one that is not dominated by a single sector. Diversity creates resilience to economic shock; the economy won't be decimated when a single sector (e.g. NRR extraction) declines.

Concerns about Alberta's failure to diversify its economy are not new.³⁴ Indeed, diversification was among the original three goals of the Heritage Savings Trust Fund (HSTF) when it was established in 1976:

"to save for the future, to strengthen or diversify the economy, and to improve the quality of life of Albertans."³⁵

Thirty years later, Alberta's economy is still heavily reliant on NRR extraction.³⁶ The economy would wither if NRR extraction were to end today, and we know for a fact that NRR extraction rates will decline in the future. The government should ensure that, when that happens, Alberta's economy will be sufficiently diversified to be self-sustaining.

- **Goal:** *NRR rents should be deployed in a manner that helps support and facilitate diversification of the economy.*

1.4 Economic stabilization

Not only do the Alberta government's finances fluctuate significantly, the entire economy has a pronounced boom-and-bust cycle. This can and does lead to serious problems for Albertans, including periods of high unemployment and crashes in housing values, and periods of high inflation and runaway housing costs.

Unfortunately, the government's spending practices exacerbate rather than mitigate that cycle. When the business cycle is low, Alberta's government has tended to cut spending, throwing more people out of work and deepening the bust. When the economy is booming, Alberta's government tends to spend more money, adding fuel to

³³ Western Economic Diversification Canada, "2007-2008 Report on Plans and Priorities" http://www.tbs-sct.gc.ca/rpp/0708/wed-deo/wed-deo_e.pdf at p. 8 (accessed March 10, 2008).

³⁴ E.g. S. E. Drugge, T. S. Veeman, "Industrial Diversification in Alberta: Some Problems and Policies" Canadian Public Policy / Analyse de Politiques, Vol. 6, Supplement: The Alberta Heritage Savings Trust Fund: An Overview of the Issues / (Feb., 1980), pp. 221-228.

³⁵ Alberta Finance, "Heritage Fund: Historical Timeline" <http://www.finance.gov.ab.ca/business/ahstf/history.html> (accessed March 10, 2008).

³⁶ Taking into account the sector's impact on other industries, such as transportation and manufacturing, the energy sector accounted for more than a third of provincial GDP as of 2003 (i.e. prior to the record growth of the sector in the last five years). Alberta Finance, "Budget and Fiscal Planning September 18, 2007, Economic Spotlight: Energy and the Alberta Economy" http://www.finance.gov.ab.ca/aboutalberta/spotlights/2007_0918_energy_and_ab_economy.pdf (accessed April 2, 2008).

the fire and driving up costs further (and making the next bust even deeper).

Worse still, Alberta's balanced budget law, to an extent, locks in a procyclical spending pattern. By prohibiting government from running a deficit, balanced budget laws require spending cuts just when government spending would help boost an ailing economy. This in turn requires extra catch-up spending when revenues are high and the economy is already overheated.

It doesn't need to be this way: "[c]ounter-cyclical spending is how governments with a long-term vision can help smooth out the highs and lows of the economic cycle."³⁷ By spending more when the economy is in a lull, government can boost the economy, and it can also save taxpayers' money by buying when it doesn't have to pay top dollar. When the economy is booming, government can ease off on spending and take some of the pressure off of an overheated economy. The earnings generated by Alberta's NRR wealth present an opportunity to spend in a way that mitigates the boom-bust cycle.

- **Goal:** *NRR rents should be managed in such a way as to mitigate the boom-bust economic cycle.*

1.5 Responsible fiscal management

Alberta's government has a long history of lowballing revenue figures, especially revenues from NRR exploitation. It then routinely declares "surprise" surpluses, which in reality are a surprise to nobody.³⁸ This is not responsible fiscal management.

- **Goal:** *Provincial NRR rents and budgeting should be managed honestly and transparently.*

Alberta's government also has an opportunity with its savings to boost renewable energy development (e.g. wind, solar) across Alberta and Canada. Directing our investments toward renewable energy and other ethical investment opportunities can pay off in many ways, including financially, since ethical investments can financially outperform regular investments. The Jantzi Social Index "has outperformed the S&P/TSX 60 since its inception in January 2000," and the American Domini 400 Social Index "has outperformed the benchmark S&P 500 since its inception in 1990."³⁹

³⁷ Diana Gibson, "Taming the Tempest: An Alternate Development Strategy for Alberta" <http://www.ualberta.ca/PARKLAND/research/studies/TamingTempestWeb.pdf> (Parkland Institute, May 2007) at p.40 (accessed March 11, 2008).

³⁸ Parkland Committee on Alberta Finances, "Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta" op. cit. at p.1.

³⁹ Rosemary McCracken, "Ethical investing 'makes social and financial sense'" (Edmonton Journal, Dec 13, 2008) <http://www.canada.com/edmontonjournal/story.html?id=2f925a97-b1c1-4524-8242-87f56cda6166> (accessed March 17, 2008).

Furthermore, public support for ethical investing has grown, as demonstrated by something more compelling than public opinion polls: people are putting their money where their mouths are. Ethical investing has grown enormously in Canada, rising from \$65.5 billion to over \$503 billion in the two years leading up to June 2006, and now accounting for fully 20% of all assets under management in Canada.⁴⁰

- **Goal:** *Alberta's NRR savings should be invested ethically, obtaining social, environmental and financial returns for their owners.*

1.6 Conclusion

It is important that we articulate goals that will guide our decision-making on fiscal policies, and that these goals be relevant for the times we live in. The goals discussed above provide an initial guide for moving forward to establish policies for NRR savings, and for spending the earnings of those savings. Section 2 relies on these goals and begins to outline policy changes for Alberta's management of NRR rents.

⁴⁰ idem.

2. Policies arising from the goals

The provincial government needs to implement new fiscal policies on both the income and spending side of the ledger. Spending policies should prioritize protection of the capital and earnings, and assist in stabilizing and diversifying our economy. These points and others are discussed in greater detail below.

2.1 Income-side policies

On the income side, Alberta's policy direction should be to save our (temporary) revenues – both budget surpluses and NRR rents – to the maximum extent possible. We should also be managing those savings both wisely and ethically.

2.1.1 Saving our surpluses

For several years, Alberta's government has been making new spending announcements during the fiscal year. "Surprise surpluses," which were a surprise to nobody and simply result from low-balling NRR royalties in the budget, regularly resulted in an embarrassment of riches. The government needed to spend these surpluses, and did so through tax cuts, discretionary spending and giveaways like the \$400 "Prosperity Bonus" cheques (a.k.a. Ralphbucks).

However, revisiting the budget on an ongoing basis throughout the year is not fiscally responsible. The budget is a one-year financial plan (not a quarterly plan or a rolling plan) and it should be treated as such.

The government has taken some baby steps toward reducing the impact on the budget of "surprise surpluses," currently allocating 1/3 of "surprise surpluses" to savings.⁴¹ However, 2/3 goes to capital spending, and this savings policy does not apply to surpluses forecast in the budget. This simply creates an incentive to bypass the savings rule by increasing the size of the forecast surplus.

The government needs to fully eliminate the impact of surprise surpluses on the budget and eliminate the incentive to bypass the savings rule.

⁴¹ Alberta Finance, "Budget 2007: Managing Our Growth – Fiscal Plan 2007-2010" at p.11 <http://www.finance.gov.ab.ca/publications/budget/budget2007/fiscal.pdf> (accessed March 25, 2008).

- **Recommendation:** *Effective immediately, the Alberta government should be placing 100% of its surpluses – both budgeted surpluses and "surprise" surpluses – into the Heritage Savings Trust Fund.*

This fiscal discipline would force the government to prepare its budget with greater attention to detail. It would also remove the problem of an “embarrassment of riches,” which seems to be encouraging the government to find ways to spend money during the fiscal year.

2.1.2 Saving our non-renewable resource rents

Planned and unplanned surpluses are not the only funds that should be deposited into savings. It should never be forgotten that once non-renewable resources are extracted, they are gone forever. If we spend NRR rents, our collective wealth is reduced and our natural endowment is gone. As noted by Jack Mintz, Chair of the government’s own Financial Investment and Planning Advisory Committee, it is necessary to save now “at this time of prosperity, in order to make sure Alberta is prosperous for years to come. Alberta can’t live forever off its natural resources.”⁴²

Other governments in Canada manage their budgets without enormous rents derived from selling off the family silver. Alberta should be capable of doing the same. A CD Howe report recently stated that “oil and gas revenues should be converted into savings.”⁴³ The Canadian Taxpayers Federation recommends that NRR rents should eventually be completely phased out of Alberta’s general revenue stream.⁴⁴

The idea of saving NRR capital and living off the earnings also has solid economic support. Over 30 years ago, leading resource economist John Hartwick published a seminal article in the *American Economic Review*. Hartwick determined that in an economy dependent on non-renewable resources, for future generations to be at least as well-off as the current generation the declining resource stock must be transformed into capital that will produce a steady stream of earnings for future generations. Hartwick’s Rule, as it has come to be known, is that “government must save all of the ‘economic rents’ generated by the resource.”⁴⁵

At the same time, removing NRR rents from the general revenue stream and replacing them with more stable revenues will help to serve the goal of reducing fluctuations in general revenues.

Breaking the addiction to the easy money will be difficult. NRR rents would need to be phased out of general revenues, as giving them up cold-turkey would create serious fiscal problems for the government.

42 Quoted in Jason Fekete, “Alberta must save riches; Heritage Fund not properly managed, panel says” (Calgary Herald, Jan 21, 2008) <http://www.canada.com/calgaryherald/news/story.html?id=592da320-62e5-4088-a067-99b94f1f96c9&k=91297> (accessed March 12, 2008).

43 Colin Busby, “After the Oil Rush: A Blueprint for Alberta’s Long-Term Happiness” op. cit. at p. 4 (accessed March 12, 2008).

44 Scott Hennig, “Opportunity (almost) Lost: Why the only option for Alberta is to save” op. cit. at p.4.

45 Ronald D. Kneebone, Kenneth J. McKenzie, M. Scott Taylor, “Living on Borrowed Time: Alberta at the Crossroads” (Institute for Advanced Policy Research, October 2004) <http://www.ucalgary.ca/iaprfiles/policy/briefs/iapr-pb-0401.pdf> at p.3 (accessed March 13, 2008). Emphasis added.

However, there is not much time to lose. The government is predicting a significant decline in NRR revenues, and this decline has apparently already begun.⁴⁶

Balancing the need to wean government from dependence on NRR rents with minimizing economic disruption, we propose a four-year transition period. See table below.

- **Recommendation:** *Alberta's government should phase out the practice of taking NRR rents into its general revenues, and within four years should be placing 100% of its NRR rents into the Heritage Savings Trust Fund.*

Weaning government from NRR rents

Year	NRR rents destined for general revenue
2007-2008	\$7.4 billion*
2008-2009	75% of rents that would be collected under 2007-2008 system
2009-2010	50% of rents that would be collected under 2007-2008 system
2010-2011	25% of rents that would be collected under 2007-2008 system
2011-2012	0% of rents

* current projected level of rents not saved.⁴⁷

“Being a responsible agent requires the Alberta government to strike the best deal it can on behalf of its citizens. Not a ‘fair’ deal or a ‘balanced’ deal, but the best deal.”

2.1.3 Increasing Albertans’ share of NRR rents

As noted earlier, Alberta’s non-renewable resources belong to Albertans, as do the rents that are derived from extracting and selling those resources. The government is the agent of the owners; it doesn’t own the resources, and nor do the energy corporations.

Being a responsible agent requires the Alberta government to strike the best deal it can on behalf of its citizens. Not a “fair” deal or a “balanced” deal, but the best deal. Alberta’s government has a duty, as the agent of the owners, to maximize the royalties it collects on their behalf.

What is the maximum amount of royalties that can be collected? As noted earlier, the rents are the financial surplus available over and above the costs and a normal level of profit involved in extracting and selling resources. In other words, an energy corporation can still make normal (i.e. competitive) levels of profit on investments when government retains all the rents.

⁴⁶ Alberta Finance, “Budget Documents 2007: Revenue Outlook” http://www.finance.gov.ab.ca/publications/budget/budget2007/fiscal.html#revenue_outlook (accessed March 23, 2008).

⁴⁷ \$11-3.6 billion = \$7.4 billion. Alberta Finance, “Budget 2007, Third Quarter Fiscal Update” http://www.finance.alberta.ca/publications/budget/quarterly/2007_3rdq/report.pdf (Alberta Finance, February 19, 2008) at p. 2 (accessed March 11, 2008).

The provincial government does not collect 100% of rents. Indeed, it appears to be letting a lot of rents go. In 2007, Canada's four biggest oil companies made record profits – \$11.75 billion – exceeding their previous record set the previous year.⁴⁸ And in 2008, because of increasing tar sands production and record high oil prices, it is expected that total oil extraction industry profits in Canada will increase by almost 18% to new record of nearly \$23 billion.⁴⁹

At the same time, Alberta's economy is overheated, with chronic labour and materials shortages and a made-in-Alberta inflation problem. The pace of tar sands development is too high, a fact made clear when everyone from environmental groups to oil patch companies⁵⁰ are asking the government to suspend new tar sand leases.

It is not necessary for energy corporations make record, windfall profits. It is adequate for those companies to make normal, competitive levels of profit, in other words, the same profits made in other industries.

Some would argue that retaining the rents for Albertans could delay future investments in the sector, as multinational corporations seek higher rents in other jurisdictions. However,⁵¹ it is important to note that other jurisdictions are also increasing their royalties and fewer jurisdictions are allowing foreign multinational corporations access to their resources. Furthermore, Alberta is a politically stable jurisdiction with lower political investment risks. With tar sands development, which have now overtaken conventional oil and are set to triple in the next several years, we already know where the oil is located (i.e. exploration risks are zero). Thus, the likely impact on relocating planned investments will be considerably less than some firms threaten, a conclusion borne out by the blasé response of the equity markets to the Alberta government's recent royalty increase.⁵²

However, even if retaining rents for Albertans did delay future investments in the sector, it is difficult to conclude that this would be an entirely negative outcome. In a world of peak oil, energy is becoming much more expensive,⁵³ and shifting some of the development from the present to the future may actually result in higher overall revenues. And with more Albertans than not supporting an outright suspension on new tar sands developments,⁵⁴ a slowdown in some investments seems a relatively moderate step. Finally, balancing the investor returns available to various industries in Alberta would help to diversify the economy, as other industries will then be able to attract investor dollars normally sapped by the tar sands' "wall of cash flow."

48 Shaun Polczer, "Record profits for Canada's four biggest oil companies" (Vancouver Sun, February 12, 2007) <http://www.canada.com/vancouvernews/business/story.html?id=09a35987-fa58-4a96-a298-9c7a13191619&p=1> (accessed March 17, 2008).

49 Conference Board of Canada, "Canada's Oil Extraction Industry to Enjoy Another Year of Record Profits" (Conference Board of Canada, February 17, 2008) <http://www.conferenceboard.ca/press/2008/cios-oil-winter08.asp> (accessed March 17, 2008).

50 CBC News, "Companies call for oilsands development freeze" <http://www.cbc.ca/canada/calgary/story/2008/02/25/oilsands-moratorium.html> (accessed March 25, 2008).

51 For the following points, see Diana Gibson, "Selling Albertans Short: Alberta's Royalty Review Panel Fails the Public Interest" op. cit. at p.9 & ff.

52 Gary Norris, "Oil stocks shrug off Alberta royalty hike" (Toronto Star October 26, 2007) <http://www.thestar.com/Business/article/270830> (accessed March 26, 2008).

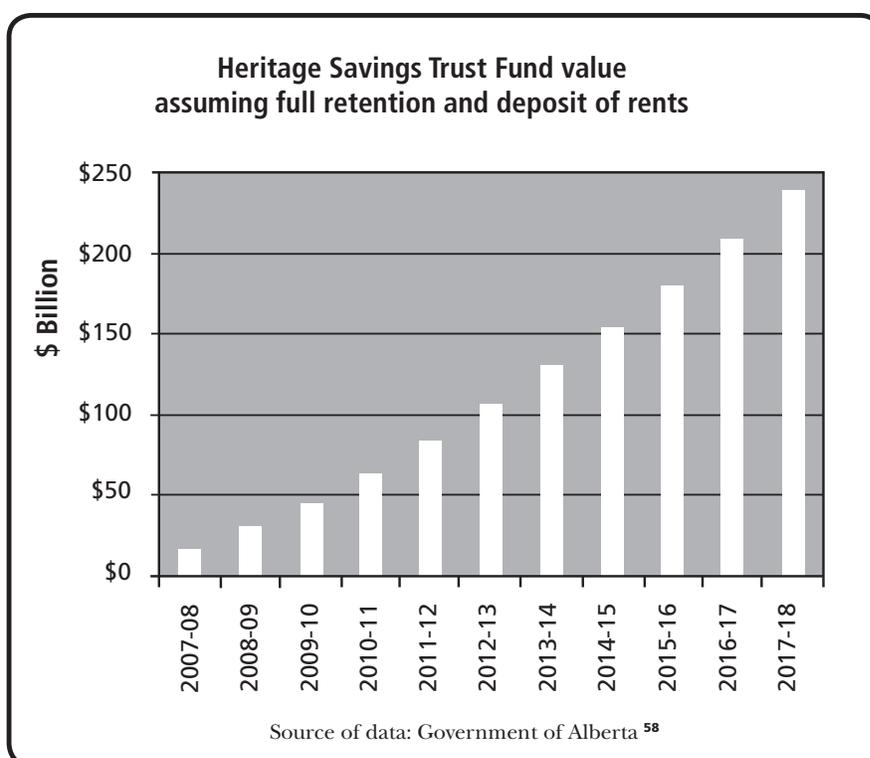
53 Jon Harding "Jeff Rubin pegs oil at US\$150 within five years" (National Post, Jan 11, 2008) http://www.nationalpost.com/todays_paper/Story.html?id=230926 (accessed March 26, 2008).

54 "48% supported a suspension of new projects versus 40% who did not." Mike De Souza, "Canadians warming to emissions cap: poll" (National Post, March 25, 2008) <http://www.nationalpost.com/story.html?id=398559> (accessed March 26, 2008).

- 55 Note that this report does not advocate or endorse the planned extent or pace of development in Alberta's tar sands. For an analysis of policy reasons for slowing tar sands development, See Diana Gibson, "Taming the Tempest: An Alternate Development Strategy for Alberta" <http://www.ualberta.ca/PARKLAND/research/studies/TamingTempestWeb.pdf> (Parkland Institute, May 2007) (accessed March 11, 2008).
- 56 Alberta Finance projects CPI of 4% and Heritage Fund growth of 5.1% above CPI "Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures" http://www.finance.gov.ab.ca/publications/budget/budget2007/heritage.html#goals_strategies (accessed March 23, 2008). And the Government of Alberta states that its new royalties rate will bring in \$1.4 billion more than current baseline projections at 2010, based on the same assumptions as the Review Panel, "The New Royalty Framework" http://www.energy.gov.ab.ca/Org/Publications/royalty_Oct25.pdf at p.13 (accessed March 24, 2008), and this report conservatively assumes the same increment at 2016. Alberta Royalty Review Panel projects revenues at 2010 and 2016, and notes that on the order of 50% of rents are retained currently, "Our Fair Share" op. cit. at pp.17 and 7 respectively.
- 57 Alberta Finance projects Heritage Fund growth of 5.1% above CPI "Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures" http://www.finance.gov.ab.ca/publications/budget/budget2007/heritage.html#goals_strategies (accessed March 23, 2008).
- 58 Alberta Finance projects Heritage Fund growth of 5.1% above CPI "Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures" op. cit.
- 59 Federal oil and gas tax subsidies alone have been at \$1.4 billion per year: EcoJustice Canada, "A Petition to the Auditor General of Canada," (November 2007) at para.16 http://www.ecojustice.ca/media-centre/media-release-files/oilgas_petition_nov14_2007.pdf (accessed March 26, 2008).
- 60 Pembina Institute, "Government Spending on Canada's Oil and Gas Industry" (Jan 2005) at p.3 <http://www.climateactionnetwork.ca/e/resources/publications/can/public-money-oil-gas-sm.pdf> (accessed March 26, 2008).

However, the most important point is that the rents – which belong to Albertans – would stay with Albertans, instead of going to shareholders who mainly live outside of Alberta. They could then be used to ensure a sustainable and sustaining economy in the future.

Using Alberta government figures and assumptions,⁵⁵ if the government were to retain all of the NRR rents Albertans are entitled to and deposit them in the HSTF, the Fund could grow to around \$240 billion within ten years.⁵⁶ Assets at this level would easily yield \$12 billion over inflation per year⁵⁷ – far more than currently projected royalties.



- **Recommendation:** *The Government of Alberta should increase its retention of non-renewable resource rents such that within four years Albertans are retaining 100% of rents, and energy corporations are making normal, competitive profit levels.*

The fossil fuel sector annually receives federal government subsidies estimated in the billion dollar.⁵⁹ And provincially the sector likely receives significant subsidies, but the amount is impossible to determine as it appears that Alberta's government is not even tracking its subsidies.⁶⁰ Continuing subsidies to the industry would, quite simply, undermine the collection of NRR rents. It would tempt

“Alberta’s government has significantly reduced taxes over the years. The only reason it has had a balanced budget is because the government has been liquidating the public’s natural capital and bringing NRR royalties into general revenues.”

an industry-sympathetic government to do an end-run around the rent retention maximization rule. In addition, massive subsidies to the fossil fuel industry encourage greater production and greater environmental harm (in addition to introducing distortions in the economy).

- **Recommendation:** *The Government of Alberta should immediately stop subsidies to the fossil fuel sector and should work with other orders of government to eliminate other subsidies.*

2.1.4 Can Alberta backfill the NRR rents?

As noted above, ending the practice of converting NRR capital to revenue will leave a gap in the general revenue fund, which will need to be backfilled with other sources.⁶¹ Approximately how much backfilling would be required, and is it feasible to do so?

This backfilling requirement would be phased in over time, as the NRR rents are phased out of general revenues (see above), meaning the full amount of NRR royalties would need to be backfilled by 2011-2012. NRR royalties under the current regime are projected to decline to approximately \$8.6 billion by 2009-2010,⁶² and further thereafter. By 2011-2012, they would likely be lower than \$8 billion.

Additionally, we would not necessarily need to backfill the entire amount. The government is already directing some amount of royalties into savings (albeit a relatively small amount, so those sums would not need to be backfilled in order to increase to 100% savings. For example, the government will be saving approximately \$3.6 billion this year.⁶³

In any event, backfilling even an amount on the order of \$8 billion is feasible.

Alberta’s government has significantly reduced taxes over the years. The only reason it has had a balanced budget is because the government has been liquidating the public’s natural capital and bringing NRR royalties into general revenues.

If Alberta restored some of its artificially suppressed taxes it would raise billions of dollars in revenues. Indeed, the Alberta government itself calculates that if Alberta had a tax system similar to that of other provinces, it would raise an extra \$8-\$15 billion in revenues.⁶⁴ This suggests that \$8 billion could be raised without severe economic disruption.

⁶¹ It would be the height of foolishness to repeat the disastrous spending cuts that took place in the 1990s – spending cuts that hurt the economy and created infrastructure debts we are still paying for today in 2008.

⁶² The Royalties Review Panel projected baseline NRR royalties at \$7.2 billion by 2010, and the Government’s new Royalties Framework would add \$1.4 billion in royalties at that time. Alberta Finance, “Budget 2007 Revenue Outlook” http://www.finance.gov.ab.ca/publications/budget/budget2007/fiscal.html#revenue_outlook (accessed March 12, 2008).

⁶³ The Third Quarter Fiscal Update 2007-2008 notes \$1.7 billion net transfer to capital account, and \$1.9 billion to HSTF and other savings vehicles http://www.finance.gov.ab.ca/publications/budget/quarterly/2007_3rdq/report.pdf at p.1 (accessed March 12, 2008).

⁶⁴ Alberta Finance, “Budget Documents 2007, Alberta Advantage” http://www.finance.gov.ab.ca/publications/budget/budget2007/abadv.html#albertas_tax (accessed March 12, 2008).

To take another comparison, a study by M.K. Jaccard and Associates found that a carbon tax could raise \$50 billion per year nationally.⁶⁵ Given that Alberta causes 31% of Canada's greenhouse gas emissions⁶⁶ (despite having just 10% of the population), Alberta could raise perhaps double the \$8 billion figure through a carbon tax. (Despite publicly opposing the idea of a carbon tax, Alberta's government has already instituted a small industrial carbon charge that it declines to label as a "tax."⁶⁷)

This report does not make a recommendation that Alberta should bring its tax system in line with those of other provinces, nor does it recommend the institution of a comprehensive carbon tax. The point of these examples is to illustrate that the backfilling required to replace NRR royalties is achievable through available revenue sources, and the middle of a boom is a good time to be raising taxes, as doing so will take some of the inflationary pressure out of the economy.

In the end, it will be up to the government of Alberta to determine how best to backfill those NRR revenues. The reinstatement of progressive income taxes and the restoration of tax rates for large corporations should be on the table. Ultimately, a democratic and transparent process should be used to determine the appropriate backfilling strategy.

- **Recommendation:** *Alberta's government should conduct transparent, independent consultations with the public and hold open and full legislative committee debates with outside expert witnesses before determining what forms of sustainable revenue it should use to backfill NRR royalties.*

And finally, it is worth noting that, whether or not the government acts on recommendations to take NRR rents out of its general revenue stream, time and the finite nature of the resource will do it for them. Our NRR rents eventually will dwindle and if the government fails to act it will have far less in savings to cushion that shock when the time comes.

2.1.5 Sound and ethical fund management

The foundations in the Heritage Savings Trust Fund (HSTF) need to be managed responsibly and transparently. Standard fund management practices will ensure that returns are maximized within any operating constraints. And on this point, it is unlikely that Albertans – the owners of the HSTF – would support every single profitable investment opportunity regardless of the harm it might cause to people here and elsewhere. Alberta's HSTF should be invested ethically.

65 Nic Rivers and Dave Sawyer, "Pricing Carbon, Saving Green: A carbon price to lower emissions, taxes and barriers to green technology" http://www.davidsuzuki.org/files/reports/Pricing_Carbon_saving_green_eng.pdf, at p.8 (accessed March 12, 2008).

66 Environment Canada, Envirozine Issue 37:3 "Provincial and Territorial Greenhouse Gas Emissions" http://www.ec.gc.ca/EnviroZine/English/issues/37/feature3_e.cfm (accessed March 12, 2008).

67 Don Braid "Go figure -- a carbon tax crafted right here at home" (Calgary Herald, March 09, 2007) <http://www.canada.com/calgaryherald/columnists/story.html?id=8c3c9760-7cbe-4fab-b00c-1c77243903b6> (accessed March 12, 2008).

- **Recommendation:** *Alberta's Heritage Savings Trust Fund should invest its holdings in accordance with rigorous ethical investing standards and practices.*

Alberta would not be alone in requiring its NRR rent savings to do be ethically invested. Norway's Petroleum Fund – over 20 times larger than Alberta's Heritage Savings Trust Fund – operates under ethics guidelines, regularly votes on shareholder resolutions and has excluded many companies from investment, including Wal-Mart and weapons-makers Boeing and Honeywell International.⁶⁸

A portion of HSTF investments should be used to boost the renewable energy sector. Given that our fossil fuels will decline, equity investment in the renewable sector may also provide significant financial payoffs in the long term. Such investments would also help to reduce Alberta's greenhouse gas emissions in the long-term and could perhaps count toward reductions under the Kyoto Protocol.

Furthermore, investing in renewables sector can send a message to the rest of Canada that Alberta's energy wealth is helping to improve Canada's future. "Resource envy"⁶⁹ is a very real issue, and squirreling the money away in a number of different investment vehicles, as the government has done, will not address concerns about interprovincial wealth imbalances. Investing the capital wisely, across Canada, would help.

68 Norges Bank Investment Management Annual Report 2007: Government Pension Fund Global – Ownership and Ethics <http://www.norges-bank.no/Upload/NBIM/Reports/2007%20Part4.pdf> at p.56 (accessed March 17, 2008). See also Norway Ministry of Finance, "Ethical Guidelines for the Government Pension Fund – Global" <http://www.regjeringen.no/en/dep/fin/Selected-topics/andre/Ethical-Guidelines-for-the-Government-Pension-Fund---Global-.html?id=446948> (accessed March 24, 2008).

69 "Resource envy:" Melville McMillan, "Investing for Alberta's Future: Improving the Use of Non-Renewable Resource Revenue in a Resource Rich Province", chapter 6 in Roger Gibbins and Robert Roach (eds) *Seizing Today And Tomorrow: An Investment Strategy for Alberta's Future* (Canada West Foundation, Calgary 2006) at p. 79 <http://www.cwf.ca/V2/files/Seizing%20Today.pdf> (accessed March 26, 2008)

- **Recommendation:** *A significant portion of the Heritage Savings Trust Fund investments should be directed to equity holdings in renewable energy development in Alberta, Canada and internationally. This portion should be determined by an independent, rigorous assessment of how much investment that sector is capable of efficiently absorbing, and the need to reduce risk by investment diversification.*

“... the Fund sits at just \$16.6 billion, and with the government still skimming off earnings, it will not grow significantly. By way of contrast, Norway’s Petroleum Fund, established in 1990, is now worth approximately \$390 billion.”

2.2 Spending-side policies

The recommendations above would produce substantial savings, and those savings in turn will generate significant earnings. The protection of both the capital and the earnings should be a high priority, and any spending should be aimed at stabilizing and diversifying our economy.

2.2.1 Maintaining the trust

The value of the HSTF has been decimated in the last two decades. Contributions were not made, inflation protection was removed and \$30 billion in earnings was skimmed off and placed into general revenues.⁷⁰ The result has been the erosion of the “Fund’s real per-capita value from \$6,000 in 1988 to \$2,800 today.”⁷¹ As a percentage of Alberta’s GDP, the Fund shrank from 21% in 1987 to just 7% in 2004.⁷²

Although inflation protection has recently been restored and modest deposits have been made, the Fund sits at just \$16.6 billion, and with the government still skimming off earnings, it will not grow significantly. By way of contrast, Norway’s Petroleum Fund, established in 1990, is now worth approximately \$390 billion.⁷³

It is possible to keep our non-renewable resource rent as capital; it does not need to be liquidated and made into revenue. The HSTF needs to be treated as it was intended to be: Alberta’s primary vehicle for savings, not a cash cow.

- **Recommendation:** *Capital should never be removed from the Heritage Savings Trust Fund.*
- **Recommendation:** *Earnings from the Heritage Savings Trust Fund should be used to inflation-proof the value of the Fund against annual inflation before any are put to other uses.*

The growth in the HSTF this fiscal year has been projected at 5.1% above inflation, and last year’s actual growth was 13% above inflation.⁷⁴ Thus inflation-proofing will still leave earnings to be allocated and managed. At the current size of the HSTF, the amounts involved would be on the order of \$1 billion per year, or about 3% of the budget. As we shall see below, in the future the amount involved could be several billion dollars.

70 Alberta Finance, “Heritage Fund Frequently Asked Questions: What happens to the investment income earned by the Heritage Fund?” <http://www.finance.gov.ab.ca/business/ahstf/faqs.html> (accessed March 13, 2008).

71 Melville McMillan “Investing for Alberta’s Future: Improving the Use of Non-Renewable Resource Revenue in a Resource Rich Province”, chapter 6 in Roger Gibbins and Robert Roach (eds) *Seizing Today And Tomorrow: An Investment Strategy for Alberta’s Future* (Canada West Foundation, Calgary 2006) at p. 79 <http://www.cwvf.ca/V2/files/Seizing%20Today.pdf> (accessed March 26, 2008)

72 Ronald D. Kneebone, Kenneth J. McKenzie, M. Scott Taylor, “Living on Borrowed Time: Alberta at the Crossroads” op. cit. at p.6.

73 Recently renamed the Government Pension Fund. Estimated value based on December 2007 valuation at 2,019 billion NOK, cited by Sovereign Wealth Institute <http://swfinstitute.org/fund/norway.php> and exchange rate of 1CAD = 5.17555 NOK <http://www.xe.com/ucc/convert.cgi> (both accessed March 13, 2008).

74 Alberta Finance notes 13% growth above CPI for the HSTF last year, and projects 5.1% above CPI this year, and slightly higher levels in future years. “Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures” op. cit.

2.2.2 Building a nest egg

In the short term, Alberta's government should be paying for normal program spending using normal, sustainable revenue sources, as other provinces do. In the long term, when Alberta's NRR-based economy has shrunk, the government may be unable to raise normal revenues needed to support program spending. (Note that this is different from being unwilling to raise those revenues, which has been the case in the past such as with the simultaneous spending and tax cuts of the 1990s).

Health, education, and social assistance⁷⁵ are currently the largest spending areas in the budget,⁷⁶ and when the NRR-based economy has shrunk, it is likely that spending needs in these essential areas⁷⁷ will stay high or even increase. At the same time, government revenues from NRR rents will be declining. Thus it would be prudent to set aside some HSTF earnings in a special trust for that time. The earnings could be used to match or supplement government spending in these areas.

- **Recommendation:** *Alberta's government should allocate a portion (initially half) of all Heritage Savings Trust Fund earnings above inflation to a new Alberta Permanent Trust within the Fund. The mandate of the Trust would be to save for future unmet spending needs on education, health care and social assistance.*
- **Recommendation:** *The Alberta Permanent Trust should only release funds to match or supplement government spending when the economy is in a long-term state of decline due to permanent reductions in NRR exploitation.⁷⁸*

Ideally, the growth in the Alberta Permanent Trust will be sufficient to sustain a decent standard of public program delivery for Albertans when it is needed. However, it is possible that it will be too small.

- **Recommendation:** *The government should regularly commission independent, long-term projections of NRR inventories, extraction rates, prices, rents available and the future balance of the Alberta Permanent Trust, as well as economic activity, sustainable tax revenues and program spending needs in an era of much-reduced NRR activity.*
- **Recommendation:** *If forecast long-term Alberta Permanent Trust spending needs exceeds forecast ability to pay, the proportion of Heritage Savings Trust Fund earnings allocated to the Permanent Trust should be increased to the point where it can meet its future needs.*

75 Social assistance: seniors and community supports; children's services; income supports; affordable housing; etc.

76 See Alberta Finance, "Third Quarter Fiscal Update 2007-2008" op. cit. at p.5.

77 Arguably there also will be a need for higher spending in other areas at that time, e.g. environment. The process for establishing new foundations (see below) aims to address needs identified in the future.

78 A number of objective, legislated formulas could work to determine when spending could commence, but any would need to incorporate both: (a) a long-term economic decline (e.g. GDP growth below a certain level); and (b) a long-term decline in revenues available to government.

2.2.3 Orderly spending: responsive, non-partisan, transparent

As noted above, the Alberta Permanent Trust would absorb a portion (initially half) of HSTF earnings above inflation, in order to build a nest egg for essential public programs when the NRR economy declines. The other half could be made available for other spending areas in the meantime.

The government of Alberta has already established a number of funds that can accept surpluses and NRR royalties and spend money. Funds established to date by the government include the Medical Research Endowment Fund, the Science and Engineering Research Endowment Fund, the Scholarship Fund, the Alberta Cancer Prevention Legacy Fund, the Energy Innovation Fund and the Climate Change and Emissions Management Fund.⁷⁹ (The Sustainability Fund and Capital Account are discussed separately below.)

By their very names, such funds appear to have worthy aims, and in theory, having well-managed arms-length institutions spend money can potentially increase transparency, reduce cronyism and limit bad investing.

However, this “melange” of different funds has an “uneasy mix of ministerial discretion and rules of uncertain enforceability govern[ing] disbursements.”⁸⁰ As one example, the Advanced Education Minister made spending commitments of tens of millions of dollars from the Access to the Future Fund when neither the spending regulations nor the Advisory Panel had been established under the legislation.⁸¹ Such “flexibility” can make it difficult for the public to track spending decisions, let alone understand how they were made. It also leaves more room for politicians to spend on pet causes and to direct spending decisions in order to buy votes.

Transforming the funds into arms-length public foundations could make spending more transparent, build public trust and increase accountability. A common set of rules and methods for spending would “help Alberta’s government do a better job of managing fiscal planning.”⁸²

“One important reason for establishing the [Petroleum] Fund was to make the use of petroleum revenues in the central government budget easily visible.”

- Norway Government Petroleum Fund, Annual Report 1998⁸³

⁷⁹ See Alberta Finance, “Third Quarter Fiscal Update 2007-2008” op. cit. at p.11.

⁸⁰ Colin Busby, “After the Oil Rush: A Blueprint for Alberta’s Long-Term Happiness” op. cit. at p. 1 (accessed March 12, 2008).

⁸¹ Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” op. cit. at pp. 21.

⁸² Colin Busby, “After the Oil Rush: A Blueprint for Alberta’s Long-Term Happiness” op. cit. at p. 3 (accessed March 12, 2008).

⁸³ Norges Bank Investment Management, Norway Government Petroleum Fund Annual Report 1998 – The Government Petroleum Fund http://www.norges-bank.no/Pages/Report_47774.aspx (accessed April 3, 2008).

While the normal government budget process would directly manage non-NRR government revenues and spending, the foundations structure could, with the right rules in place, manage the spending of some of the HSTF earnings (those not destined for inflation proofing or the Alberta Permanent Fund).

- **Recommendation:** *The existing funds should be re-configured as arms-length public foundations.*
- **Recommendation:** *Heritage Savings Trust Fund earnings above those required for inflation-proofing and the Alberta Permanent Fund (“spending-eligible earnings”) should be spent by the public foundations.*
- **Recommendation:** *Legislation should be passed establishing common rules and methods for spending by the public foundations, and requiring any government interventions to be authorized by the legislature.*

Grantmaking organizations – charitable and research-oriented, in Canada and abroad – have devised time-tested, transparent, lean and efficient methods⁸⁴ for distributing funds to projects with demonstrated need and promise of success. These methods can be applied to the public foundations.

- **Recommendation:** *Foundation spending should be done according to rules modelled on proven, efficient grant-making practices, including:*
 1. Spending decisions should be in response to written funding applications.
 2. Spending decisions should be governed by a Board of Directors (with limited terms, and selected by an all-party committee of the legislature)
 3. Spending decisions should be published and should refer explicitly to terms of reference that guide decisions.
 4. Spending levels should be planned over time to enable each foundation to grow to targeted levels of assets (to be determined by need in the granting area).
 5. The Auditor General should review annual foundation spending, and achievement of goals stated in their terms of reference.

⁸⁴ For example, see Calgary Foundation “Frequently Asked Questions” http://www.thecalgaryfoundation.org/documents/TCFFAQs_Jan2507.pdf (accessed April 2, 2008).

Spending in this manner would create a needed “demand for savings” as potential applicants hope to maintain or increase the level of savings made available to the foundations. This would replace the “demand for spending” that is created when government spends from general revenues.⁸⁵

The legislature would of course have the power to control any potential abuses and would provide a democratic backdrop for the foundations. In a sense, the foundations would be a control mechanism, interposed between politicians and the HSTF earnings, forcing greater transparency and objectivity in decision-making about Albertans’ wealth.

Finally, there is a need to make sure that spending from the foundations does not simply replace regular program spending by government, thus enabling a return to unsustainable, vote-grubbing tax cuts. However, it is difficult to track program spending from year-to-year, as government ministries are re-organized and their budgets changed.

- **Recommendation:** *the Government should be required to justify any significant program spending cuts, and specifically to show that they were not enabled by foundation spending.*

2.2.4 New spending priorities – rationalizing the process

As noted above, the various funds created to date appear to have worthy aims, and new foundations should be developed as social goals are identified and evolve. There should be a transparent, non-partisan, democratic process for deciding which foundations Alberta will need in future.

- **Recommendation:** *The government should annually review existing foundations against the priorities needs of Alberta and Albertans, as determined by an objective, transparent, non-partisan process that includes meaningful stakeholder and public consultation.*
- **Recommendation:** *Based on the review, the Government should create new foundations at a careful pace over time as Heritage Savings Trust Fund earnings permit and close foundations that are no longer a priority.*

The existence of a number of different foundations will result in a wide range of investments, thereby supporting the goal of economic diversification. Instead of one or two large economic diversification pursuits, which history shows can result in boondoggles and pork-

⁸⁵ Demand for savings idea: Ken Boessenkool, “Time for New Budget Rules: A Savings and Surplus Management Act for Alberta” op. cit at pp. 6-7.

“... following the recommendations in this report would result in the Heritage Savings Trust Fund growing to over \$200 billion in just ten years. This sum would yield over \$10 billion in earnings above inflation – significantly more than the government’s projected royalties at that time.”

barrelling, the economy will be stimulated by a number of smaller injections of investment, each according to demonstrated need.

Certainly, enabling spending by foundations over time would diminish the pool of savings available in the future. As a result, the government should be performing regular, realistic projections to ensure that Albertans’ nest egg will be adequate to address future needs. But even assuming that the foundations spend all their earnings right away, following the recommendations in this report would result in the Heritage Savings Trust Fund growing to over \$200 billion in just ten years.⁸⁶ This sum would yield over \$10 billion in earnings above inflation – significantly more than the government’s projected royalties at that time.

2.2.5 Countercyclical spending

Other recommendations in this report would help to mitigate the boom-bust cycle. For instance, taking NRR rents out of the general revenue stream will eliminate part of the incentive behind pro-cyclical government spending. And to some extent, the government’s existing funds and accounts already enable countercyclical spending through the accumulation of revenues in fat years and spending in lean years (thereby to an extent bypassing the “balanced budget law”).⁸⁷

However, more can be done through requiring that a formal countercyclical spending policy apply to the foundations. The bulk of spending from the foundations should be conducted low in the business cycle in order to provide economic stimulus. When the business cycle is high, spending should be lower in order to relieve inflationary pressure.

- **Recommendation:** *Include in the spending rules for foundations the direction that the majority of their spending over time is to take place during periods of relatively high unemployment.*⁸⁸

However, such spending needs to be carefully controlled. For instance, shorter-term projects should be given preference, as they will not be disrupted by stop-and-go funding and the ensuing higher costs, as has been the case in the past due to Alberta government pro-cyclical spending.⁸⁹

⁸⁶ Alberta Finance projects CPI of 4% “Budget Documents 2007: Heritage Fund Business Plan 2007-2010 – Goals, Strategies and Performance Measures” op. cit. Government of Alberta assumes same baseline royalties as the Royalty Review Panel, “The New Royalty Framework” op. cit at p.13, and this report conservatively assumes the same increment at 2016. Alberta Royalty Review Panel projects revenues at 2010 and 2016, and notes that on the order of 50% of rents are retained currently, “Our Fair Share” op.cit. at pp.17 and 7 respectively.

⁸⁷ Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” op. cit. at pp. 19-20.

⁸⁸ Defining high or low unemployment could be done in relation to Alberta historical and future projected levels, average current Canadian or North American unemployment levels, or a combination. Foundation spending, according to a legislated formula, would be ramped up as unemployment increases, and reduced as unemployment subsides. Such countercyclical spending would not deplete funds, as they would continue to be protected from capital withdrawal, to be inflation-proofed, and to absorb NRR rents.

⁸⁹ Parkland Committee on Alberta Finances, “Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta” op. cit. at p. 19.

Some of the spending of the foundations should be directed toward reducing Alberta's reliance on the fossil fuel sector and building a strong renewable energy sector for the future. This could also be used to help to address legitimate concerns about provincial wealth imbalances across Canada.

- **Recommendation:** *Apply a sustainability lens to the review of any funding proposed for physical infrastructure (e.g. encouraging urban densification and sustainable transportation, rather than sprawl and road-building)*
- **Recommendation:** *Create a foundation aimed at developing the renewable energy sector in Alberta and across Canada, for example through procurement, price subsidies and R&D grants.*

In addition to rule-based countercyclical spending from foundations, spending on social programs has a countercyclical impact. When the economy is down, more people receive financial assistance from government, and by spending that money they stimulate the economy. When the economy is up, less financial assistance is required and the economy receives less stimulation. Unfortunately, Alberta slashed social assistance spending in the 1990s, which exacerbated the downturn in the economy. These programs should be expanded. Alberta – given its massive wealth and high GDP – should be able to assist the less fortunate at least as well as any other province in Canada, if not better.

2.2.6 Sustainability Fund and Capital Account

The Sustainability Fund, initially capped at \$2.5 billion, has now grown to over \$7.6 billion and the Capital Account has now grown to over \$7.7 billion.⁹⁰ Together they are almost as big as the HSTF.

A primary purpose of the Sustainability Fund was as an economic shock-absorber – to compensate for revenues that are above or below budget within a given year.⁹¹ Given that this report recommends removal of the most volatile revenue stream – NRR rents – from general revenues, there would be less need for such a massive shock absorber. A prudent financial cushion in the budget can provide adequate protection from revenue fluctuation, and revenues other than NRR rents should provide that cushion.

⁹⁰ Alberta Finance, "Third Quarter Fiscal Update 2007-2008" http://www.finance.alberta.ca/publications/budget/quarterly/2007_3rdq/report.pdf (Alberta Finance, February 19, 2008) at p. 7 (accessed March 11, 2008).

⁹¹ It has also been used to finance \$400 "Prosperity Bonus" cheques (aka "Ralphbucks") to Alberta residents, and can be used to pay for gas rebates, forest recovery, etc. When assets are over \$2.5 billion, it can be used for any purpose.

- **Recommendation:** *The Sustainability Fund should be closed, and its assets placed into the Heritage Savings Trust Fund.*
- **Recommendation:** *The annual budget cushion should be raised from 1% to its original level of 3.5%.*

Capital spending also can and should, to the extent possible, play a stabilizing or countercyclical role.

- **Recommendation:** *The Capital Account should be moved into the Heritage Savings Trust fund and be renamed the Alberta Natural Capital Replacement Foundation, with prescribed rules and methods of spending as per the other foundations.*

It is important to recognize that there is currently a large public infrastructure debt caused by years of government cuts and under spending. Some of this infrastructure debt will need to be addressed right now, despite the fact that we are in the midst of a boom. These urgent projects can be funded through a combination of general revenues and debt financing as they are in other provinces.⁹²

Projects that prove not to be urgent priorities can be funded by the Alberta Natural Capital Replacement Foundation when the economy cools down. Funding capital projects during a lull in the business cycle will mean we can better afford them and afford more of them. It also will provide stimulation of the economy at a time when it is needed.

⁹² Despite the public anti-debt rhetoric common among Alberta's political and media elite, debt is a perfectly legitimate capital financing tool of government, just as it is for business and individuals. See remarks of Roger Gibbins reported in the Calgary Herald Feb 10, 2002, cited in Parkland Committee on Alberta Finances, "Fiscal Surplus, Democratic Deficit: Budgeting and Government Finance in Alberta" op. cit. at p.18

3. Conclusions and key recommendations

Alberta's government can manage its citizens' non-renewable resources rents better. It can keep more of them, instead of giving them away to oil corporations. It can steward them carefully so we will have more savings in the future, when the flow of those rents dwindles. In the meantime, it can manage them more productively and more ethically. The rents, like the resources themselves, belong to Albertans and the government owes it to Albertans to more carefully manage their property.

The recommendations made in this report are all achievable. In terms of government finance, they would help to stabilize revenues and make planning, budgeting and program and financial management easier. In terms of the economy, these recommendations would help to diversify it, sustain it and mitigate the boom-bust cycle.

Government can and should do further detailed research to guide the implementation of these recommendations, but such research should not be used as an excuse for inaction. Albertans understand the need to save; this is why they have RRSPs and savings accounts. Albertans expect no less from their government.

Below are some key recommendations emerging from the analysis in this report. Additional recommendations are included in relevant sections of the text above.

Income-side policies

- **Recommendation:** *Effective immediately, the Alberta government should be placing 100% of its surpluses – both budgeted surpluses and “surprise” surpluses – into the Heritage Savings Trust Fund.*
- **Recommendation:** *Alberta's government should phase out the practice of taking NRR rents into its general revenues, and within four years should be placing 100% of its NRR rents into the Heritage Savings Trust Fund.*
- **Recommendation:** *The Government of Alberta should increase its retention of non-renewable resource rents such that within four years Albertans are retaining 100% of rents, and energy corporations are making normal, competitive profit levels.*
- **Recommendation:** *The Government of Alberta should immediately stop subsidies to the fossil fuel sector and should work with other orders of government to eliminate other subsidies.*

- **Recommendation:** *Alberta's Heritage Savings Trust Fund should invest its holdings in accordance with rigorous ethical investing standards and practices.*
- **Recommendation:** *A significant portion of the Heritage Savings Trust Fund investments should be directed to equity holdings in renewable energy development in Alberta, Canada and internationally. This portion should be determined by an independent, rigorous assessment of how much investment that sector is capable of efficiently absorbing, and the need to reduce risk by investment diversification.*

Spending-side policies

- **Recommendation:** *Capital should never be removed from the Heritage Savings Trust Fund.*
- **Recommendation:** *Earnings from the Heritage Savings Trust Fund should be used to inflation-proof the value of the Fund against annual inflation before any are put to other uses.*
- **Recommendation:** *Alberta's government should allocate a portion (initially half) of all Heritage Savings Trust Fund earnings above inflation to a new Alberta Permanent Trust within the Fund. The mandate of the Trust would be to save for future unmet spending needs on education, health care and social assistance.*
- **Recommendation:** *Heritage Savings Trust Fund earnings above those required for inflation-proofing and the Alberta Permanent Fund ("spending-eligible earnings") should be spent by the public foundations.*
- **Recommendation:** *Legislation should be passed establishing common rules and methods for spending by the public foundations, and requiring any government interventions to be authorized by the legislature.*
- **Recommendation:** *The government should annually review existing foundations against the priorities needs of Alberta and Albertans, as determined by an objective, transparent, non-partisan process that includes meaningful stakeholder and public consultation.*
- **Recommendation:** *Include in the spending rules for foundations the direction that the majority of their spending over time is to take place during periods of relatively high unemployment.*
- **Recommendation:** *Create a foundation aimed at developing the renewable energy sector in Alberta and across Canada, for example through procurement, price subsidies and R&D grants.*

- **Recommendation:** *The Sustainability Fund should be closed, and its assets placed into the Heritage Savings Trust Fund.*
- **Recommendation:** *The annual budget cushion should be raised from 1% to its original level of 3.5%.*



PARKLAND
INSTITUTE

11045 Saskatchewan Drive,
Edmonton, Alberta
T6G 2E1
Phone: (780) 492-8558
Email: parkland@ualberta.ca
Website: www.ualberta.ca/parkland

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