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Alberta's 'Spending Restraint' in Perspective

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Summary

- Despite projected surpluses from 2024/25–2026/27, Alberta is at risk of returning to a budget deficit, due to high spending, when relatively high resource revenue declines.
- Premier Danielle Smith has recognized this risk and signalled that there would be a new approach to provincial finances that relies less heavily on resource revenue, which includes restraining spending by less than inflation and population growth. This "restraint," however, should be considered within the context of the Smith government's spending increases thus far.
- Specifically, while real program spending is projected to decline annually over the next three years, the Smith government plans to spend $30.0 billion more from 2023/24–2026/27 than originally forecast in the 2022 mid-year plan, equivalent to an additional $6,037 per Albertan.
- It's also important to consider the spending plan within the context of the actual level required to stabilize provincial finances (i.e. the spending level that would align stable ongoing government revenue, rather than temporary windfalls). One reasonable way to estimate Alberta's "stable" revenue is to calculate total revenue based on average resource revenue over the last two decades.
- Aligning spending with stable revenue would require significantly more restraint than is shown in Budget 2024. Specifically, program spending would need to be lower by 10.1 percent in 2024/25, 8.7 percent in 2025/26, and 6.8 percent in 2026/27. Notably, if the Smith government simply held to its 2022 mid-year spending plan, spending would be aligned, and in fact, modestly lower than this alternative level that aligns with stable revenue.

Introduction

Alberta is experiencing a boom in resource revenue, which helped swing the province from a period of persistent budget deficits to a surplus in 2021/22. According to Budget 2024, Alberta will continue to run surpluses averaging $1.5 billion from 2024/25–2026/27, however, the province runs a serious risk of incurring deficits when relatively high resource revenue inevitably declines. This is due to a familiar pattern where, during periods of relatively high resource revenue, the provincial government increases spending to unsustainable levels and subsequently incurs budget deficits when relatively high resource revenue falls.[1] For instance, increased government spending during years of relatively high resource revenue in the late 1990s and early 2000s contributed to the most recent string of deficits from 2008/09–2020/21 (excluding 2014/15) when resource revenue declined. That led to $60.1 billion in provincial net debt by 2020/21, and only ended when Alberta experienced a windfall in resource revenue in 2021/22 (DOF, 2023).

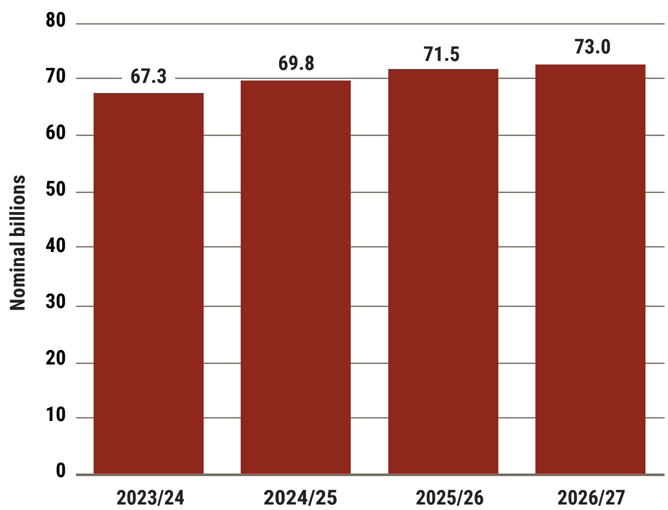
The Smith government recognized the ongoing fiscal risk of deficits and committed to spending restraint ahead of the Budget 2024 (Alberta, 2024a). The intention of this study is to assess the extent to which the Smith government has restrained spending by comparing its original plan in the 2022 Mid-Year Fiscal Update and Economic Statement to the plan in Budget 2024, and provide context to the type of spending restraint that will be necessary to truly stabilize provincial finances.

Putting Alberta's 'spending restraint' in perspective

Despite projected surpluses for 2024/25–2026/27, Alberta is at risk of returning to a budget deficit, due to high spending, when relatively high resource revenues decline (Hill and Palacios, 2024). Premier Smith recognized this risk in her address ahead of Budget 2024 and signalled that there would be a new approach to managing provincial finances that relied less heavily on resource revenue, which included restraining spending by less than inflation and population growth (Alberta, 2024a).[2]

While government "spending restraint" is an important step forward, such "restraint" must be considered within the context of the Smith government's spending decisions thus far.

Figure 1a: Projected program spending, Budget 2024

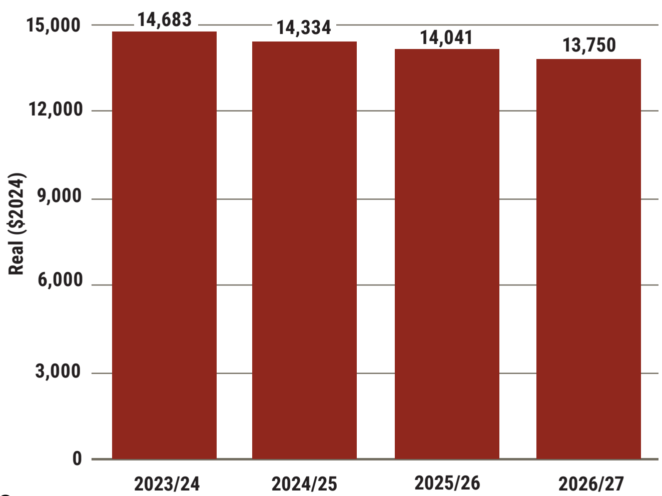


Source:
Alberta (2024b).

1 Alberta's problem with spending and the rise and fall of resource revenue is well documented. For more information, see Hill, Emes and Clemens, 2021; Hill, Eisen, and Palacios, 2021; Eisen, Palacios, Lafleur, and Fuss, 2019; Mackinnon et al., 2019; Ferede, 2018; Kneebone and Wilkins, 2018; and Milke and Palacios, 2015.

2 Put differently, the Smith government has introduced an expenditure based "fiscal rule" in an effort to stabilize provincial finances. A number of other fiscal rules could be used, for example, a limit for the deficit to GDP or debt to GDP ratio (Dahlby, 2021), a limit for interest costs to revenue ratio (the "David Dodge Rule"), or mandatory savings of a portion of resource revenue (Hill, Emes and Clemens, 2021) each come with their own pros and cons; Premier Smith also suggested that a share of resource revenue would be saved in the Heritage Fund so that investment income earned on the fund would eventually be large enough to "eliminate our province's reliance on resource revenues" (Alberta, 2024a).

Figure 1b: Per-person program spending, Budget 2024

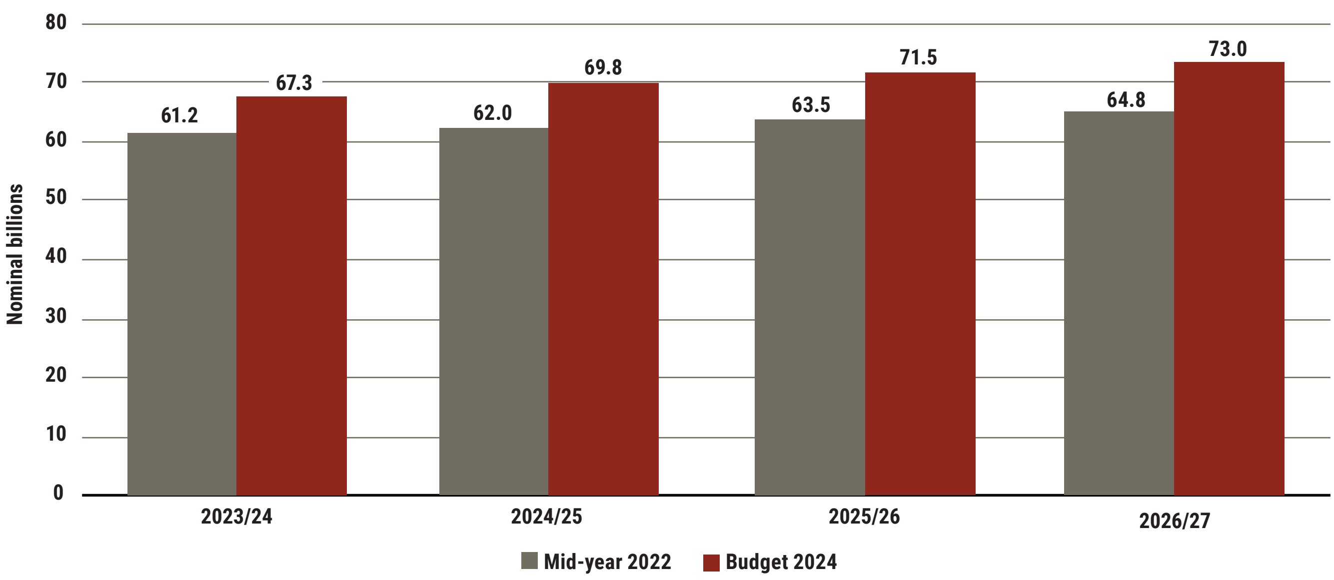


Source:
Alberta (2024b).

As shown in Figure 1a, according to Budget 2024, nominal program spending (excluding debt interest costs) is projected to increase from $67.3 billion in 2023/24 to $73.0 billion in 2026/27. After adjusting for inflation and population growth, however, real ($2024) per-person program spending is projected to decline annually from $14,683 in 2023/24, to $14,334 in 2024/25, $14,041 in 2025/26 and $13,750 in 2026/27 (see Figure 1b). This reflects a real per-person annual decline of 2.4 percent in 2024/25, 2.0 percent in 2025/26, and 2.1 percent in 2026/27, which is aligned with the Smith government's commitment to increase spending by less than inflation and population growth.

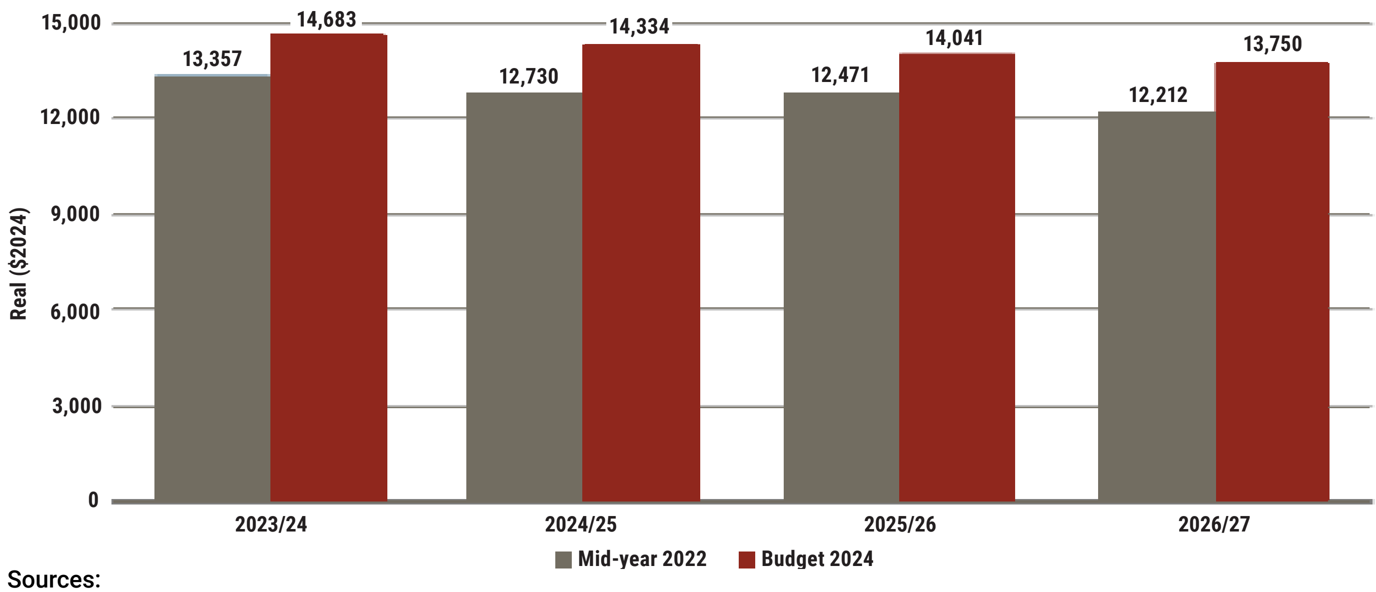
As shown in Figure 2a, however, when the Budget 2024 spending plan is compared to the Smith government's 2022 mid-year "original plan," it is clear that spending has increased in every year from 2023/24–2026/27. As the 2022 mid-year plan only includes projections to 2024/25, program spending is increased by the growth rate in Budget 2024 for 2025/26 and 2026/27, which is 2.4 and 2.1 percent, respectively. More specifically, compared to the 2022 mid-year plan, nominal program spending is projected to be higher by $6.1 billion in 2023/24, $7.8 billion in 2024/25, $8.0 billion in 2025/26, and $8.2 billion in 2026/27. In other words, the Smith government expects to spend $30.0 billion more over four fiscal years than originally planned in the 2022 mid-year forecast.[3]

Figure 2a: Projected program spending, Budget 2024 and 2022 mid-year



Sources:
Alberta (2022 and 2024b); calculations by authors.

Figure 2b: Per-person program spending, Budget 2024 vs 2022 mid-year



Sources:
Alberta (2022 and 2024b); calculations by authors.

Figure 2b compares real ($2024) projected per-person program spending in the 2022 mid-year plan and Budget 2024.[4] Data for inflation and population are based on Budget 2024 projections. As shown, real per-person program spending is projected to be higher than originally planned in every year from 2023/24–2026/27. Specifically, the Smith government is projected to spend $1,326 more per person in 2023/24, $1,603 more per person in 2024/25, $1,571 more per person in 2025/26, and $1,538 more per person in 2026/27. In total, the Smith government plans to spend $6,037 more per Albertan over four fiscal years.

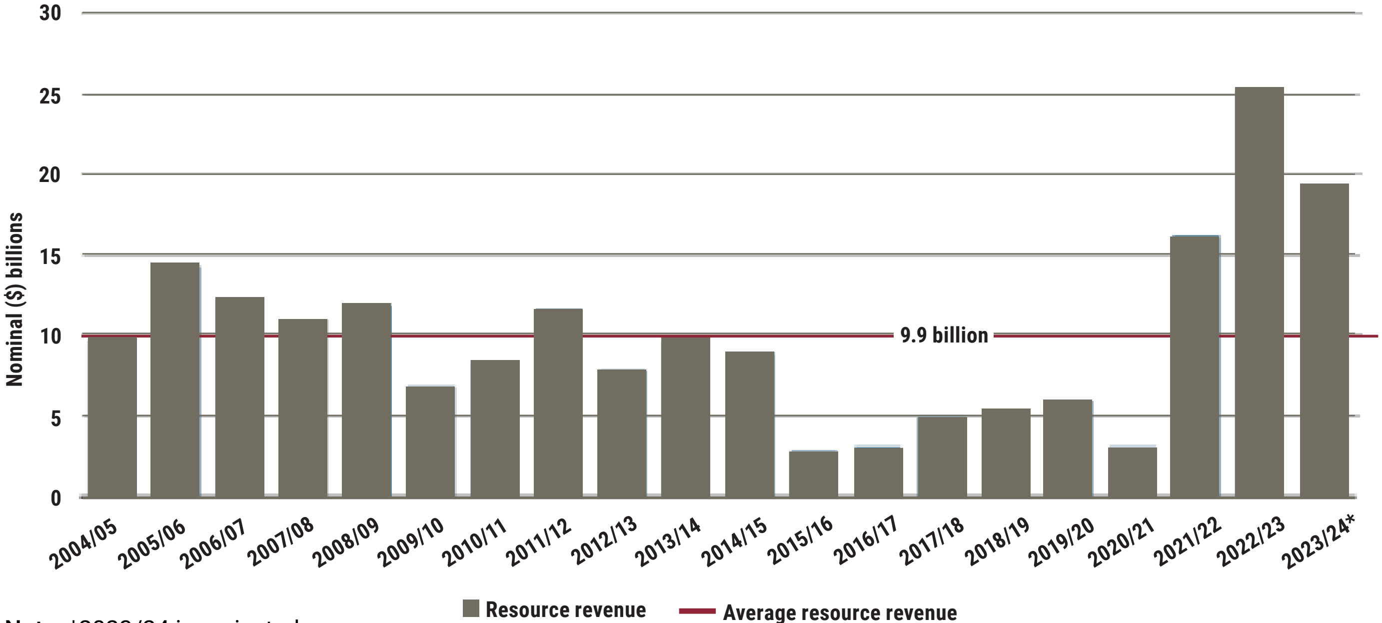
This is important context, as significant spending increases since 2022 mid-year affect the base level of spending in 2023/24 that the "restraint" is based on. Recall, nominal program spending in 2023/24 increased by $6.1 billion from a projected $61.2 billion in the 2022 mid-year plan to a projected $67.3 billion in Budget 2024. For perspective, if nominal program spending in 2023/24 came in at the same level as the 2022 mid-year plan, and increased by the rate of growth (3.8 percent) projected in Budget 2024, nominal program spending would be $6.3 billion lower in 2024/25 than projected in Budget 2024. On a per-person basis, if real program spending in 2023/24 was the same as the 2022 mid-year plan, and fell 2.4 percent, as projected in Budget 2024, real program spending would be $1,294 lower in 2024/25 than projected in Budget 2024.

Put simply, the Smith government's plan for spending restraint will be less effective in reducing overall spending and stabilizing provincial finances due to significant increases since the 2022 mid-year plan.

3 Spending funded by dedicated revenues, including from federal transfers, SUCH revenues and fees, energy industry levies, AIMCo charges, and other earmarked funds, are included in this analysis although they may not technically reflect an "unplanned" spending increase. While incorporating the exact impact of dedicated revenues on spending is challenging, it is clear that the impact would not significantly alter the overall finding that spending has increased meaningfully since the 2022 mid-year update.

4 The inflation and population projections were somewhat higher in the Budget 2024 compared to the 2022 mid-year plan. More specifically, inflation increased from a projected 3.3 percent (2023/24) and 2.2 percent (2024/25) in 2022 mid-year to a projected 3.3 percent (2023/24) and 2.5 percent (2024/25) in the Budget 2024. Population growth increased from a projected 2.2 percent (2023/24) and 1.8 percent (2024/25) in 2022 mid-year to 4.1 percent (2023/24) and 3.7 percent (2024/25) in the Budget 2024.

Figure 3: Resource revenue from 2004/05 to 2023/24



Note: *2023/24 is projected
Source: Alberta (2024b).

Level of spending required to align with stable revenue

The Smith government's planned spending restraint is less significant when taken in the context of spending increases since the 2022 mid-year plan. However, an important question remains: What level of spending is actually needed to stabilize provincial finances?

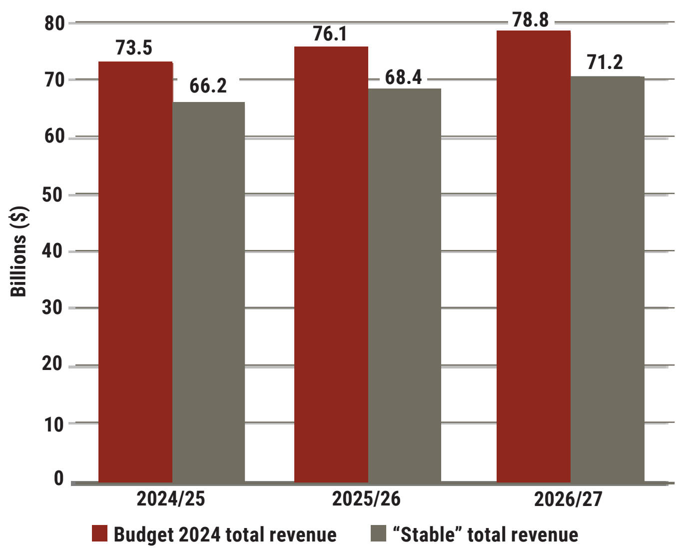
The key to stabilizing provincial finances and mitigating Alberta's ongoing boom-and-bust cycle is to align government spending more closely with stable ongoing government revenue, rather than temporary windfalls. As per Hill and Palacios (2024), one reasonable way to estimate Alberta's stable level of government revenue is to calculate total revenue based on average resource revenue[5] over the last two decades. It is a useful approximation of the stable amount of resource revenue the province could expect to collect annually over the long-term.[6]

Figure 3 shows nominal resource revenue over the last 20 years, including average resource revenue over the same period. Nominal resource revenue averaged $9.9 billion from 2004/05–2023/24, which represents the stable annual amount of resource

5 Other sources of government revenue, such as corporate income tax, fluctuate along with resource revenue, however, empirical analysis finds the impact is mainly associated with an increase in resource revenue rather than a decline in resource revenue (Ferede, 2018). Similarly, other budget components are not shown to have a statistically significant response to a decline in resource revenue (Ferede, 2018).

6 Many oil and gas facilities have transitioned to post-payout status, which will typically result in higher revenue at given price levels compared to the past. This suggests a historical average may underestimate the potential "stable" level of resource revenue, however, the "stable" level of resource revenue used here is roughly aligned with the provincial governments own "low scenario" projection, which estimates that if oil prices fall below the base forecast in Budget 2024 (see Table 1: scenario impacts) tax and resource revenues would be $8.6 billion lower in 2024/25, $7.7 billion lower in 2025/26 and $6.8 billion lower in 2026/27. Using the average estimated here, stable revenue is $7.4 billion lower in 2024/25, $7.7 billion lower in 2025/26, and $7.6 billion lower in 2026/27 (see Table 1). Despite a shift in Alberta's oil and gas sector, the average over the last two decades is a reasonable estimate of stable revenue.

Figure 4: Budget 2024 total revenue vs "stable" total revenue from 2024/25–2026/27



Sources:
Alberta (2022 and 2024b); calculations by authors.

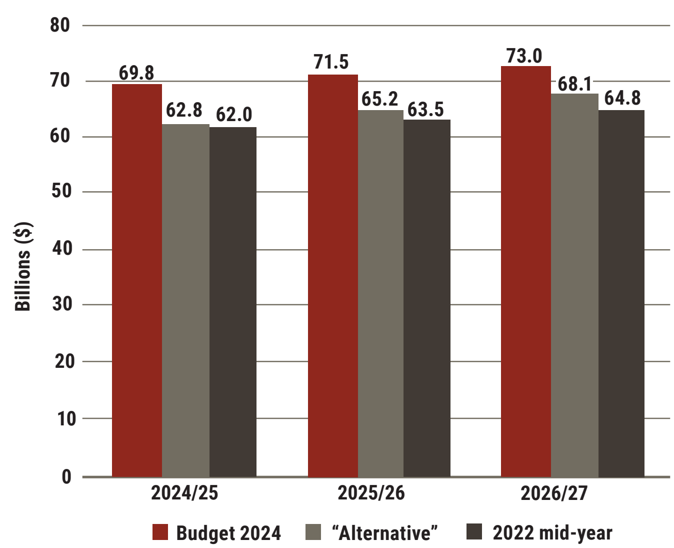
revenue the province could reasonably expect over the long-term. After adjusting for inflation, the stable amount of resource revenue would be $10.1 billion in 2025/26 and $10.4 billion in 2026/27.

Figure 4 compares total projected government revenue in Budget 2024 to total government revenue calculated with average resource revenue from 2024/25–2026/27. The latter will be referred to as "stable" total revenue hereafter.

As shown, Alberta's total nominal revenue is projected at $73.5 billion in 2024/25, $76.1 billion in 2025/26, and $78.8 billion in 2026/27, which includes historically high resource revenue averaging $17.7 billion over the period (see Table 1). In contrast, stable total revenue is $66.2 billion in 2024/25, $68.4 billion in 2025/26, and $71.2 billion in 2026/27. Put differently, compared to total projected revenue in Budget 2024, stable revenue is lower by $7.4 billion (11.2 percent) in 2024/25, $7.7 billion (11.3 percent) in 2025/26, and $7.6 billion (10.6 percent) in 2026/27. If the provincial government truly wishes to reduce Alberta's reliance on volatile resource revenue and avoid large deficits when historically high resource revenues decline, it should aim to align spending with this stable level of revenue.

Figure 5 compares projected program spending in Budget 2024 to "alternative" program spending that would align with stable revenue from 2024/25–2026/27. Recall, program spending is projected to be $69.8 billion in 2024/25, $71.5 billion in 2025/26, and $73.0 billion in 2026/27 in Budget 2024. After factoring in debt interest costs, which are projected to range from $3.1 billion to $3.4 billion annually, total nominal spending is a projected $73.2 billion in 2024/25, $74.6 billion in 2025/26, and $76.2 billion in 2026/27 (Table 1). In contrast, "alternative" program spending is $62.8 billion in 2024/25, $65.2 billion in 2025/26, and $68.1 billion in 2026/27.[7] As shown in Table 1, that is the level of program spending that, after adjusting for debt interest costs (assumed constant, for simplicity), would equate total spending with stable total revenue of $66.2 billion in 2024/25, $68.4 billion in 2025/26, and $71.2 billion in 2026/27.

Figure 5: Projected program spending, Budget 2024 vs "alternative" vs 2022 mid-year, 2024/25 to 2026/27



Sources:
Alberta (2024b); calculations by authors.

Table 1: Fiscal summary, Budget 2024 and "alternative" plan, nominal ($) millions

	2024/25	2025/26	2026/27
BUDGET 2024			
TOTAL REVENUE	73,537	76,051	78,816
RESOURCE REVENUE	17,315	17,839	17,939
TOTAL SPENDING	73,170	74,614	76,176
PROGRAM SPENDING	69,805	71,493	73,002
DEBT INTEREST COSTS	3,365	3,121	3,174
BUDGETARY BALANCE (SURPLUS/DEFICIT)	**367**	**1,437**	**2,640**
"ALTERNATIVE" PLAN			
"STABLE" TOTAL REVENUE (AVERAGE RESOURCE REVENUE)	66,151	68,359	71,248
RESOURCE REVENUE	9,929	10,147	10,371
TOTAL SPENDING	66,151	68,359	71,248
PROGRAM SPENDING	62,786	65,238	68,074
DEBT INTEREST COSTS	3,365	3,121	3,174
REVISED BUDGETARY BALANCE	**7,386**	**7,692**	**7,568**

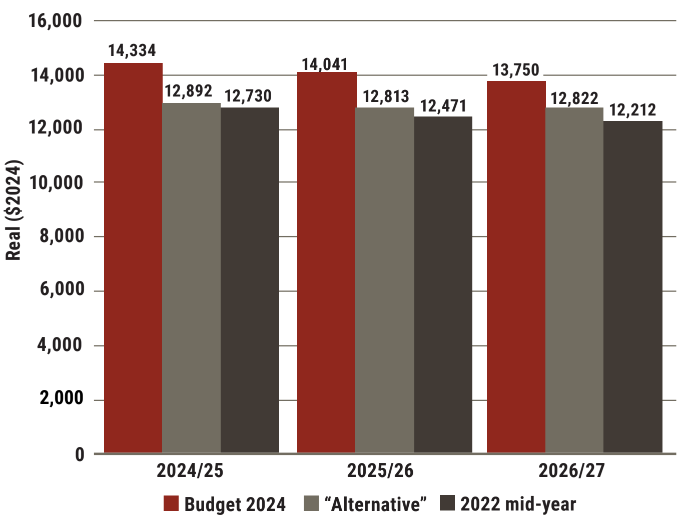
Sources:
Alberta (2024b); calculations by authors.

7 To be clear, this is likely the maximum level of program spending that should be permitted. Indeed, it may also be argued that spending should align with non-resource revenue, which would indicate even more significant spending reductions are required.

As shown in Figure 5, aligning spending with stable revenue would require sacrifice as program spending must be reduced significantly compared to Budget 2024. More specifically, compared to Budget 2024, alternative program spending is $7.0 billion lower (10.1 per cent) in 2024/25, $6.3 billion lower (8.7 percent) in 2025/26, and $4.9 billion lower (6.8 per cent) in 2026/27. In real ($2024) per-person terms, "alternative" spending would be $1,441 lower in 2024/25, $1,228 lower in 2025/26, and $928 lower in 2026/27 (Figure 6).

For perspective, it's once again helpful to consider spending within the context of the 2022 mid-year update. As such, Figure 5 also includes projected program spending in the 2022 mid-year plan. As in the previous section, for the 2022 mid-year plan, program spending is increased by the growth rate in Budget 2024 for 2025/26 and 2026/27. As discussed, "alternative" program spending is lower than projected program spending in Budget 2024, however, compared to the 2022 mid-year plan, it is $789 million higher in 2024/25, $1.7 billion higher in 2025/26 and $3.2 billion higher in 2026/27. In real ($2024) per-person terms, compared to the 2022 mid-year plan, program spending in the "alternative" plan is $162 higher in 2024/25, $342 higher in 2025/26 and $610 higher in 2026/27 (Figure 6). In other words, if the Smith government had simply held to its 2022 mid-year spending plan, spending would be aligned, and in fact, modestly lower than the level required to match stable levels of revenue.

Figure 6: Projected per-person program spending, Budget 2024 vs "alternative" vs 2022 mid-year



Sources:
Alberta (2022 and 2024b); calculations by authors.

It's worth noting, as shown in Table 1, that if program spending was at the "alternative" level and total projected revenue in Budget 2024 materializes, Alberta would incur significantly larger budget surpluses from 2024/25–2026/27. While it is beyond the scope of this bulletin to discuss in detail what should be done with such surpluses, it's clear that they could be used to further stabilize provincial finances.

The Smith government, for instance, has committed to allocating surplus cash to the repayment of provincial debt and/or savings in the Heritage Fund (Alberta, 2024b)[8]. Economists have similarly advised that surpluses be saved in the Heritage Fund (Tombe, 2022), which would help the Smith government reach its target of building up the fund so that its annual earnings can eventually replace resource revenue in the budget. Surpluses could also be saved in a rainy-day account to be withdrawn to help support the budget during periods of relatively low resource revenue (Hill and Palacios, 2023). Any of these approaches would help stabilize provincial finances.

Overall, this analysis provides important perspective on the level of required spending restraint. While it would call for sacrifice, if the Smith government simply held to its 2022 mid-year plan, spending would be aligned with stable revenue and Alberta's risk of incurring a budget deficit when

8 According to the Smith government's fiscal framework, surpluses may also be used to support one-time spending initiatives.

relatively high resource revenues decline would be significantly reduced.

Conclusion

In an effort to stabilize provincial finances, the Smith government has committed to increasing program spending by less than inflation and population growth. This is an important step forward. However, due to a significant increase in spending since the original 2022 mid-year plan, this restraint will likely be insufficient to avoid deficits when Alberta's historically high resource revenue inevitably declines. To truly stabilize provincial finances, the Smith government must align spending with ongoing, stable levels of government revenue, rather than temporary windfalls.

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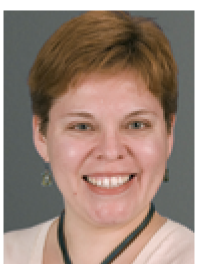

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