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A NEW FISCAL FRAMEWORK FOR ALBERTA

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A New Fiscal Framework for Alberta

by Tegan Hill and Joel Emes

Contents

Executive Summary

Alberta's reliance on non-renewable resource revenue has fueled instability in provincial finances for decades. From 2021/22 to 2024/25, resource revenue is projected to average $9.9 billion annually, roughly twice its annual average ($4.9 billion) from 2017/18 to 2020/21. There is a real risk that the provincial government will rely on this rebound in resource revenue to paper over the province's big underlying fiscal problems and continue on the resource revenue "roller coaster". To truly fix Alberta's finances for the long-term, the province needs a fundamentally new path forward.

As recently as the early 2000s, Alberta consistently ran surpluses and enjoyed a net financial asset position. At the same time, relatively high revenue from non-renewable resources ("resource revenue", hereafter) fuelled unsustainable increases in spending. Since 2008/09, a combination of high spending and lower commodity prices has contributed to consistent deficits, which were exacerbated by the decline in oil prices in 2014 and the COVID-induced recession in 2020. In 2020/21, the deficit reached $17.0 billion. Unfortunately, this cycle of public-finance boom and bust has repeated itself more than once.

The current provincial government expects to balance the budget before the end of what would be its second term in 2027; however, it has yet to present a detailed plan. To balance the budget while improving stability in provincial finances for the long term, the provincial government must go beyond spending reductions (and/or tax increases) and fundamentally change how it deals with resource revenue. As recommended in *A New (Old) Fiscal Rule for Non-Renewable Resource Revenue in Alberta* (Hill, Emes, and Clemens, 2021), re-establishing the Alberta Sustainability Fund (ASF) is a necessary first step.

Introduced in 2003, the ASF was one of the most effective policies the provincial government used to address the volatility of resource revenue in the budget. The ASF sets a stable amount of resource revenue that can be spent annually; when actual resource revenue is above the set amount, the excess is saved in the ASF and, when resource revenue is below the set amount, money is withdrawn from ASF to cover the shortfall. In the original ASF, the set amount was based in statutory law, which meant it was relatively easy for governments to drain and eventually, in 2013, eliminate the fund. The rule should instead be constitutional, which will make it more difficult for governments to change.

Hill, Emes, and Clemens (2021) recommend that the set amount be $3.76 billion in 2022/23, adjusted for inflation annually. The ASF balance is to be maintained at 2.9 times the set amount of $3.76 billion, to ensure that sufficient funds are available during periods of low resource revenue to provide the required amount. According to projections, the ASF could be built up by 2023/24.

Assuming any "excess" resource revenue—beyond the set amount and that required to fund the ASF—is included in the budget, the provincial government could moderate growth in nominal program spending to 1.5% over three years to reach balance by

2024/25 while introducing the ASF. The plan would be a big step towards improving fiscal stability for the future, but would still rely somewhat on volatile resource revenue to reach balance. Moreover, the ASF does not prepare the province for a possible permanent decline in resource revenue, which has become increasingly likely given recent regulatory announcements by the federal government that will restrain, if not curtail, energy development in the province.

To achieve this, Alberta should also reintroduce contributions to the Heritage Fund. The Heritage Fund was created in 1976/77 to save a share of the province's resource wealth for the future. The rules around the fund, however—including those requiring contributions—were statutory and therefore easily changed by governments. As a result, no resource revenue contributions have been made since 1986/87.

Contributing "excess" resource revenue to the Heritage Fund, instead of including it in the budget, would ensure Alberta is not relying on volatile resource revenue to reach balance. Hill, Emes, and Clemens (2021) recommend that 25% of all resource revenue should be earmarked for the Heritage Fund once excess resource revenues are sufficient to meet this set contribution rate, which according to projections would be in 2023/24. To balance the budget by 2024/25 while incorporating contributions to both the ASF and the Heritage Fund, nominal program spending must be reduced by 8.4% over three years, or 2.8% (on average) annually.

The plan would undoubtedly require sacrifice. However, it effectively gets Alberta off the resource revenue roller-coaster by better matching ongoing spending with ongoing revenues. Moreover, it prepares the province for the growing likelihood that resource revenue will permanently decline by requiring that a portion of one-time revenue be transformed into a financial asset, which will generate income for the future.

Without fundamentally changing how the government treats resource revenue, Alberta will remain on the resource revenue "roller coaster". Balancing the budget while introducing a new fiscal framework, which includes requiring a share of resource revenue be saved in the Heritage Fund and a predictable level of resource revenue is supported by the ASF, would fix Alberta's finances for the long term.

Introduction

Alberta's resource-driven boom-and-bust cycle has created instability in provincial finances for decades (Hill, Emes, and Clemens, 2021; Kneebone, McKenzie, and Taylor, 2004). As recently as the early 2000s, the province consistently ran surpluses and enjoyed a net financial asset position. At the same time, relatively high non-renewable resource revenue ("resource revenue", hereafter) fuelled unsustainable increases in spending.[1] Since 2008/09, a combination of high spending and lower commodity prices has contributed to consistent deficits, which were exacerbated by the decline in oil prices in 2014 and COVID-induced recession in 2020. In 2020/21, the deficit reached $17.0 billion (Government of Alberta, 2021b). According to numerous reports, Alberta's finances are unsustainable absent a change in policy (Tombe, 2020; PBO, 2021; Fuss and Hill, 2021).

The current provincial government expects to balance the budget before the end of what would be its second term in 2027 (Vacroe, 2021), although it has yet to present a detailed plan. There is a real risk that the provincial government will rely on the recent rebound in resource revenue to paper over the province's underlying fiscal problems and continue on the resource revenue "roller coaster". Moreover, there is no clear plan to prepare the province for a potential permanent decline in resource revenue, which has become increasingly likely given recent regulatory announcements by the federal government that will restrain, if not curtail, energy development in the province (Prime Minister of Canada, 2021; Vasquez-Peddie, 2021). Put simply, Alberta needs a fundamentally new path forward to balance the budget that reduces volatility and lessens our reliance on resource revenue in the longer term.

This study is part of a series aimed at developing a new fiscal framework for Alberta. The first two studies (Hill, Emes, and Clemens, 2021; Hill, Emes, and Lafleur, 2021) recommended a combination of rules that establish a predictable and stable level of resource revenue for the budget and require that a share of resource revenue is saved in the Heritage Fund. With consideration for these recommendations, this study presents two alternative paths to balance the budget as part of a larger plan to fix Alberta's finances for the long term.

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.

Alberta's Current Fiscal Outlook

This section reviews Alberta's current fiscal position and expectations for the immediate future to 2024/25, assuming no tax changes and using government forecasts to the greatest degree possible based on the Mid-Year Fiscal Update and Economic Statement released in the fall of 2021. This analysis examines the operating budget, which refers to the normal annual taxing and spending the provincial government undertakes, and excludes long-term spending, which is included in the province's Capital Plan.[2] This is consistent with how the government reports its financials and deficit position.

The Mid-Year Update includes total revenue projections up to 2023/24. Most sources of provincial government own-source revenue, including personal income tax, corporate income tax, and payroll and excise taxes, grow in line with the overall economy (Tombe, 2020; PBO, 2021). For this reason, own-source revenue excluding investment income and resource revenue are projected to grow in line with the province's nominal GDP for 2024/25 based on the Mid-Year Update.[3]

Total investment income includes income transferred from the Heritage Fund and other investments. For 2024/25, investment income from the Heritage Fund is calculated as fund equity at cost in the previous year multiplied by the 10-year average gross return from 2014/15 to 2023/24. Similarly, the 10-year average is used for investment income in 2024/25.

To forecast resource revenue, the provincial government uses a complex formula based on a number of factors such as resource prices, royalty rates, production, and the number of projects in pre-payout or post-payout phases, which is not feasible to replicate based on publicly available data. Further, resource revenue is extremely volatile, which makes forecasting particularly difficult.[4] Because of the limitations of forecasts, this analysis takes the simple approach of adjusting 2023/24 resource revenue by projected oil price and production changes. More specifically, resource revenue for 2024/25 is calculated by multiplying resource revenue in the previous year (2023/24) by the projected percentage change in the WTI price and in total Alberta oil production according to forecasts from the *Annual Report* of the Canada Energy Regulator (2021). This is a reasonable approach as the WTI oil price is closely correlated with resource revenue (Hill, Emes, and Clemens, 2021: fig. 1). Natural gas prices are projected to follow a trajectory similar to that of oil prices.

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2. Note that the annual costs of the Capital Plan are included in the operating budget via amortization costs.
3. Economic projections extend to the 2024 Calendar Year.
4. In 2021/22, for example, resource revenue was projected to be $2.9 billion in the February Budget (Government of Alberta, 2021a) and increased to $10.9 billion by the November Update (Government of Alberta, 2021b).

Revenue from the Canada Social Transfer (CST) grows at an annual rate of 3% in 2024/25. Alberta's Canada Health Transfer (CHT) is estimated using the formula in the Fiscal Arrangements Act.[5] Specifically, Alberta's CHT payment for 2024/25 is based on the 2023/24 per-capita payment adjusted for Canada's three-year rolling GDP and Alberta and Canada's respective population growth for 2024.[6] Equalization payments are assumed to be zero to reflect the province's current status as a non-recipient province. Recent projections reaffirm that Alberta will likely remain a non-recipient province in 2024/25 (Eisen and Emes, 2021). Other transfers from the federal government keep pace with population growth plus inflation in 2024/25 (Tombe, 2020). Population growth and inflation projections come from the Mid-Year Update.

The provincial government has more control over program spending (total spending minus debt-servicing costs). Projections for program spending up to 2023/24 are from the Consolidated Fiscal Summary table, page 3 in the Mid-Year Update. Specifically, program spending is equal to expense (before COVID-19 Recovery Plan, contingency funds, and crude-by-rail provisions) less debt servicing costs.[7] In 2024/25, program spending is grown by expected population growth and inflation from the projected 2023/24 base.

This leads to an important point on COVID-related measures, which have had a significant impact on provincial finances. For instance, the provincial government will spend a projected $5.5 billion in direct, one-time COVID-related measures in 2021/22 (Government of Alberta, 2021b). This temporary spending is much different from ongoing spending in areas such as education. This analysis excludes both COVID-related program spending and revenue in each year in an effort to present a clearer picture of the level of ongoing spending reductions that will be required to balance the budget outside extraordinary events like the COVID pandemic. Specifically, all identifiable COVID-related spending[8] from 2019/20 to 2023/24 and an estimate of federal transfers made for COVID-19 are removed. Federal COVID-19 transfers removed from total revenue consist of the increased CHT in 2021/22, and the difference between estimated federal transfers in Alberta's 2020 budget (Government of Alberta, 2020) and Alberta's Mid-Year Update from 2019/20 to 2023/24. For a similar reason, this analysis excludes crude-by-rail provisions, which are projected to decline from $925 million in 2021/22 to zero by 2022/23. As with COVID-related spending, to include this item would over-state the reductions that will be required in ongoing areas of spending to balance the budget.

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5. *Federal-Provincial Fiscal Arrangements Act*, RSC 1985, c F-8. <https://canlii.ca/t/5553n>, as of Jaunuary, 9, 2022.

6. This analysis does not factor in increased federal transfers included in the Liberal government's recent platform commitments. For example, it does not include the new $4.5 billion Canada Mental Health Transfer promised to the provinces and territories over five years.

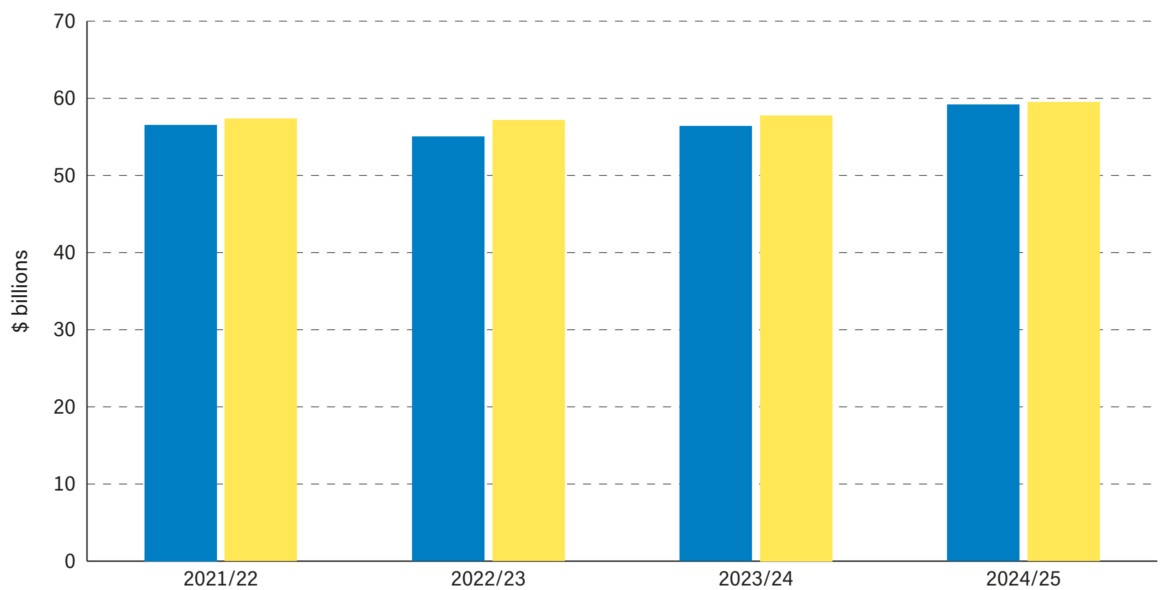
7. While the operating budget excludes the Capital Plan, it includes amortization of the capital budget (line 5) in order to spread capital spending over the lifetime of the assets and capital grants (line 4), which flow to the SUCH sector (schools, universities, colleges, health entities).

8. The COVID-19 Recovery Plan, contingency funds for disaster and emergency assistance, and contingency for the COVID-19 recovery plan (including unallocated amounts).

Finally, debt-servicing costs for 2024/25 are calculated as total debt multiplied by the implied interest rate (debt services costs in the current year divided by total debt in the previous year) of 2.5% in 2023/24.[9]

Figure 1 shows Alberta's total adjusted—as explained above—nominal spending and nominal revenue from 2021/22 to 2024/25 according to projections. Table 1 contains a summary of Alberta's projected nominal fiscal position from 2021/22 to 2024/25, the ***baseline estimate*** (dashes indicate fields that are not yet relevant to the discussion). In 2021/22, total nominal revenue is projected to be $56.5 billion, while total nominal spending is projected to be $57.4 billion for a deficit of $805 million. Notably, the deficit was initially budgeted to reach $18.2 billion in 2021/22 (Government of Alberta, 2021a). The lower deficit projection largely reflects an unexpected influx in resource revenue of $8.1 billion as per the Mid-Year Update as well as the absence of COVID-related spending and transfers as noted above.

Figure 1: Alberta's projected total revenue and total spending, 2021/22–2024/25, ***baseline***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations …; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

Total nominal revenue and total spending decline in 2022/23. Specifically, projected total nominal revenue declines from $56.5 billion (2021/22) to $55.0 billion (2022/23), which mainly reflects a $1.0 billion decline in projected resource revenue. Total nominal spending declines from $57.4 billion (2021/22) to $57.2 billion (2022/23), which reflects a decline in operating expense and capital grants. Total nominal revenue and

9. COVID-related measures are excluded from total spending and total revenue to give a clearer indication of the level of spending reductions required to balance the budget; however, COVID-related measures are still incorporated into projected debt levels and therefore interest costs.

Table 1: Alberta's projected fiscal summary, ***baseline***, millions (nominal $)

	2021/22	2022/23	2023/24	2024/25
Revenue				
Set amount of Resource Revenue for Budget	—	—	—	—
"Excess" Resource Revenue for Budget	—	—	—	—
Total Resource Revenue for Budget	10,908	9,859	9,231	9,694
Other Revenue	45,641	45,175	47,171	49,473
Total Revenue	56,549	55,034	56,402	59,167
Spending				
Program Spending	54,870	54,226	54,656	56,242
Debt Interest Costs	2,484	2,934	3,127	3,255
Total Spending	57,354	57,160	57,783	59,497
Surplus/Deficit	−805	−2,126	−1,381	−330
Alberta Sustainability Fund				
Contributions	—	—	—	—
Balance	—	—	—	—
Heritage Fund				
Contributions	—	—	—	—
Balance	16,897	17,269	17,614	17,966

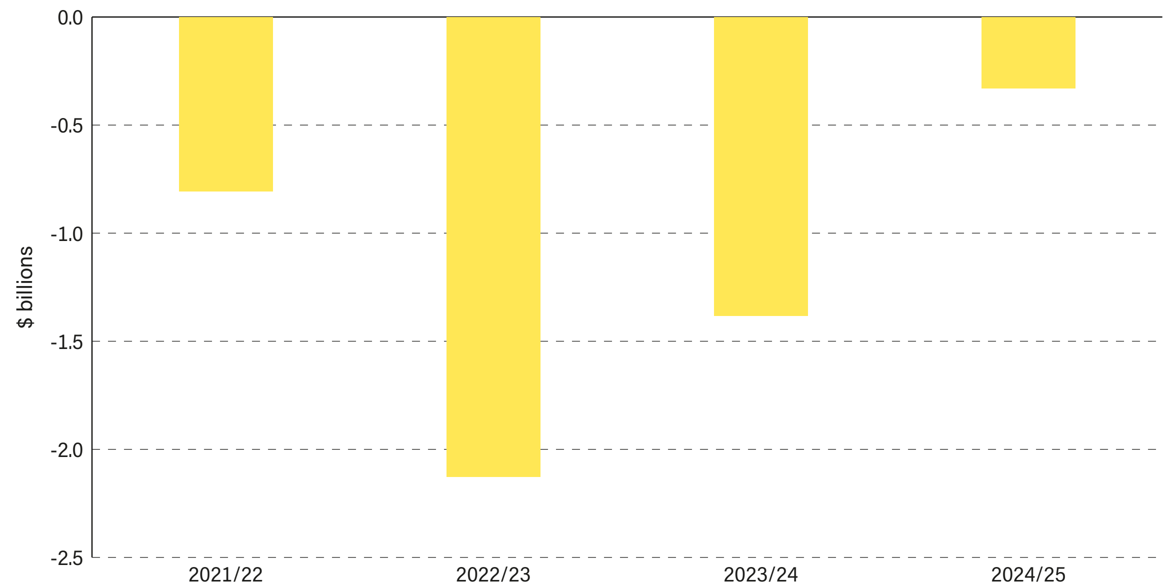
Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

total nominal spending are forecast to increase in 2023/24 and 2024/25. According to projections, the province will continue to incur deficits over the forecast horizon, ranging between $2.1 billion in 2022/23 to $330 million in 2024/25 in nominal terms (figure 2).[10]

There are consequences to the provincial government continuing on its current fiscal trajectory. A string of deficits led Alberta's finances to deteriorate from a net financial asset position of $31.7 billion in 2008/09 to a net debt position of $59.5 billion in 2020/21 in nominal terms (Government of Alberta 2021a, 2021b). As shown in figure 3, Alberta's net debt, which includes debt accumulated via the operating budget as well as through capital spending, will continue to grow. Nominal net debt (total debt minus financial assets) is projected to reach $76.9 billion by 2024/25, equivalent to 18.0% of total provincial gross domestic product (GDP) that year. On per-person basis, that's $16,695 per Albertan. Overall, these projections indicate that Alberta's fiscal position will have deteriorated by approximately $108.6 billion from 2008/09 to 2024/25.

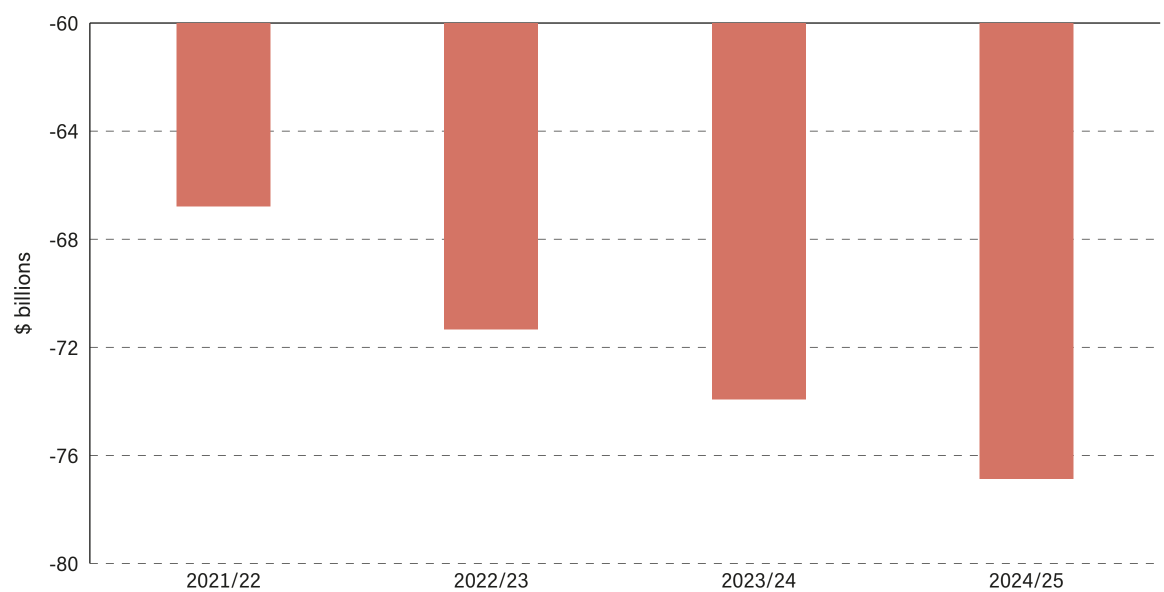
10. The Mid-Year Update projects a smaller deficit in 2022/23 ($3.3 billion) than in 2021/22 ($5.8 billion); however, the deficit is projected to increase after adjusting for COVID-related measures. This is because, while removing COVID-related measures significantly reduces the projected deficit in 2021/22, it does not reduce the projected deficit in 2022/23 to the same degree.

Figure 2: Alberta's projected operating surplus/deficit, 2021/22–2024/25, ***baseline***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

Figure 3: Alberta's net financial debt, 2021/22–2024/25, ***baseline***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

Higher debt will lead to higher debt-servicing payments even if interest rates remain stable. For context, when the province had no net debt in 2008/09, debt-servicing payments cost $58 per Albertan (Lafleur, Eisen, and Palacios, 2018). Debt-servicing payments (nominal) will cost a projected $3.3 billion in 2024/25, which is $707 per Albertan. This expense is projected to consume 5.5% of provincial revenues, more than three-quarters of all corporate income-tax revenue projected to be collected in 2024/25. Recall that projections of interest costs do not include an increase in nominal interest rates, which means there's a real risk of even higher interest costs for the province in the future (Clemens, Palacios, and Fuss, 2021). In other words, these projections are likely conservative.

The expectations for Alberta's finances over the medium term also provides no fiscal room to restore Alberta's Tax Advantage. The previous Alberta tax advantage—a business tax rate of 10%, single-rate personal income-tax system of 10%, and the absence of a provincial sales tax—helped attract people and businesses to the province to support strong economic growth (Eisen, Lafleur, and Palacios, 2017). In 2015, the provincial NDP government introduced tax increases that substantially eroded this advantage: the NDP government raised the business income-tax rate to 12% and replaced the single-rate personal income tax of 10% with five tiers that include a top rate of 15%. In part, the decision to increase tax rates was made in an effort to address the province's ongoing deficits. Instead, deficits increased while Alberta's tax competitiveness declined. The Kenney government has since reduced the corporate income-tax rate from 12% to 8%, but the higher personal income-tax rates remain.

Perhaps the greatest consequence of maintaining the fiscal status quo is that provincial finances will continue to be vulnerable to fluctuations in resource revenue. Over the forecast period, resource revenue will be relatively high (see table 1) averaging a projected $9.9 billion annually from 2021/22 to 2024/25, approximately twice its annual average ($4.9 billion) from 2017/18 to 2020/21. There is a significant risk that the government will rely on a rebound in this source of revenue to temper deficits in the short term and avoid the tough decisions that will be necessary to ensure fiscal stability over the longer term. This is a particularly risky approach given the growing likelihood that fossil-fuel production will be permanently curtailed in the years ahead, whether as result of ongoing regulatory burden or competition from alternative energy sources. Put simply, Alberta needs a plan that mitigates volatility in the budget and prepares for the time that this source of revenue may be permanently reduced in the future.

A Path to a Balanced Budget by 2024/25—Scenario 1

The provincial government needs to take action to balance the budget while preventing the ongoing boom-and-bust cycle in the future. This section outlines a fiscal path that focuses on two primary objectives: balancing the budget in the short term through spending reductions while re-introducing the Alberta Sustainability Fund (ASF).

We have chosen spending reductions rather than tax increases as a method by which to accelerate the timeline for a balanced budget for several reasons. First, spending reductions are found to be an effective and less economically damaging approach to fiscal consolidation than tax increases (Alesina, Barbiero, Favero, Giavazzi, and Paradisi, 2015; Guajardo and Pescatori, 2014). In Canada's own experience in the 1990s, multiple governments successfully eliminated large budget deficits through swift spending reductions and experienced strong economic growth afterwards (Clemens, Palacios, Lau, and Veldhuis, 2017). Moreover, and as has been extensively documented, the root cause of Alberta's fiscal challenges is high spending growth (Eisen, Palacios, Lafleur, Fuss, 2019). Since high spending has been the main cause of Alberta's deficits, it is useful to examine spending reductions in the plan to balance the budget. While it is beyond the scope of this study to determine which areas of spending should be reduced to reach a balanced budget, there are various studies that analyze areas of provincial spending and present opportunities for reform and savings.[11]

A time frame of three years is used to balance the budget in an effort to limit the likelihood that unexpected changes in economic and/or political factors will impede the path to balance.[12] The time frame is also consistent with the successful fiscal consolidations that took place across Canada in the 1990s, when several provinces and the federal government balanced their budgets within two to three years (Clemens, Palacios, Lau, and Veldhuis, 2017). To fix Alberta's finances for the long term, however, the provincial government must go beyond spending reductions and fundamentally change how it deals with resource revenue. As recommended by Hill, Emes, and Clemens (2021), re-establishing the Alberta Sustainability Fund is a necessary first step.

Introduced in 2003, the Alberta Sustainability Fund (ASF) was one of the most effective policies the provincial government used to address the volatility of resource revenue in the budget. The ASF sets a stable amount of resource revenue that can be spent

11. For options for health-care reform, see Bacchus, Clemens, and Jackson, 2017; for K-12 education, see Clemens, Emes, and MacLeod, 2018; and for a review of public-sector compensation, see Palacios, Li, and Lafleur, 2019. For a broad review of areas for reform, see Mackinnon and Mintz, 2017 and Mackinnon, 2019.
12. A shorter time frame is also preferable to build up savings in the Heritage Fund more quickly—as will be discussed in the following section—to prepare for the day when resource revenues may reach a permanent, structural decline.

annually; when actual resource revenue is above the set amount, the excess is saved in the ASF and, when resource revenue is below the set amount, money is withdrawn from ASF to cover the shortfall. Put simply, the fund helps to stabilize and smooth resource revenue over time. In the original ASF, the set amount of resource revenue that could be included in the budget was based in statutory law, which meant it was relatively easy for governments to drain and eventually eliminate the fund in 2013. The rule should instead be constitutional, making it more difficult for governments to change in the future. Hill, Emes, and Clemens (2021) explain how a constitutional rule for the ASF could be implemented.

As per the recommendation in Hill, Emes, and Clemens (2021), the set amount of resource revenue included in the budget is $3.76 billion in 2022/23, adjusted for inflation annually.[13] The set amount reflects the level that would have stabilized resource revenue over roughly the last commodity cycle from 2000/01 to 2020/21. The ASF balance is to be maintained at 2.9 times the set amount of $3.76 billion, which is $10.9 billion in 2022/23, to ensure that sufficient funds are available during periods of low resource revenue to provide the required $3.76 billion in resource revenue. The high level of resource revenue projected over the next few years will be used to reach the target balance.

Table 2 includes an updated summary of Alberta's projected nominal fiscal position, incorporating the ASF and spending reductions. It is useful to first focus on the revenue side to understand the impact of the ASF. In 2022/23, total revenue for the budget is reduced to $48.9 billion, compared to $55.0 billion in the baseline estimate (table 1). This is because, instead of including all resource revenue in the budget, the set amount of resource revenue is $3.76 billion and the remaining $6.1 billion is contributed to the ASF in 2022/23 (table 2).

As shown in table 2, the set amount of resource revenue (inflation-adjusted) is $3.86 billion in 2023/24. In this year, the ASF is approaching its target balance of $11.2 billion (2.9 times the stable amount of $3.86 billion). This being the case, $5.1 billion is contributed and there is an excess of $276 million. There are two options for the "excess"[14] resource revenue: save it or include it in the budget. The two priorities in this scenario are to balance the budget and re-introduce the ASF; therefore the excess resource revenue is included in the budget to help move towards balance.

In 2024/25, the ASF only requires a $246 million contribution to account for inflation. Total resource revenue included in the budget is $9.5 billion, which is the set amount ($3.94 billion) plus the excess resource revenue ($5.5 billion).

13. As noted in Hill, Emes, and Clemens (2021), more important than the specific stabilized amount of resource revenue ($3.76 billion is used here) is the principle of selecting a stable amount of resource revenue for the budget to be maintained using a fund that is financed during times of high resource revenue and drawn upon during periods of low resource revenue.

14. Hereafter, the term "excess" resource revenue refers to surplus resource revenue above the stable amount and necessary ASF contribution.

Table 2: Alberta's projected fiscal summary, ***Scenario 1***, millions (nominal $)

	2021/22	2022/23	2023/24	2024/25
Revenue				
Set amount of Resource Revenue for Budget	—	3,762	3,860	3,944
"Excess" Resource Revenue for Budget	—	—	276	5,503
Total Resource Revenue for Budget	10,908	3,762	4,136	9,447
Other Revenue	45,641	45,175	47,171	49,473
Total Revenue	56,549	48,937	51,307	58,921
Spending				
Program Spending	54,870	54,211	54,352	55,708
Debt Interest Costs	2,484	2,934	3,127	3,213
Total Spending	57,354	57,145	57,479	58,920
Surplus/Deficit	−805	−8,208	−6,172	0
Alberta Sustainability Fund				
Contributions	—	6,097	5,095	246
Balance	—	6,097	11,193	11,439
Heritage Fund				
Contributions	—	—	—	—
Balance	16,897	17,269	17,614	17,966

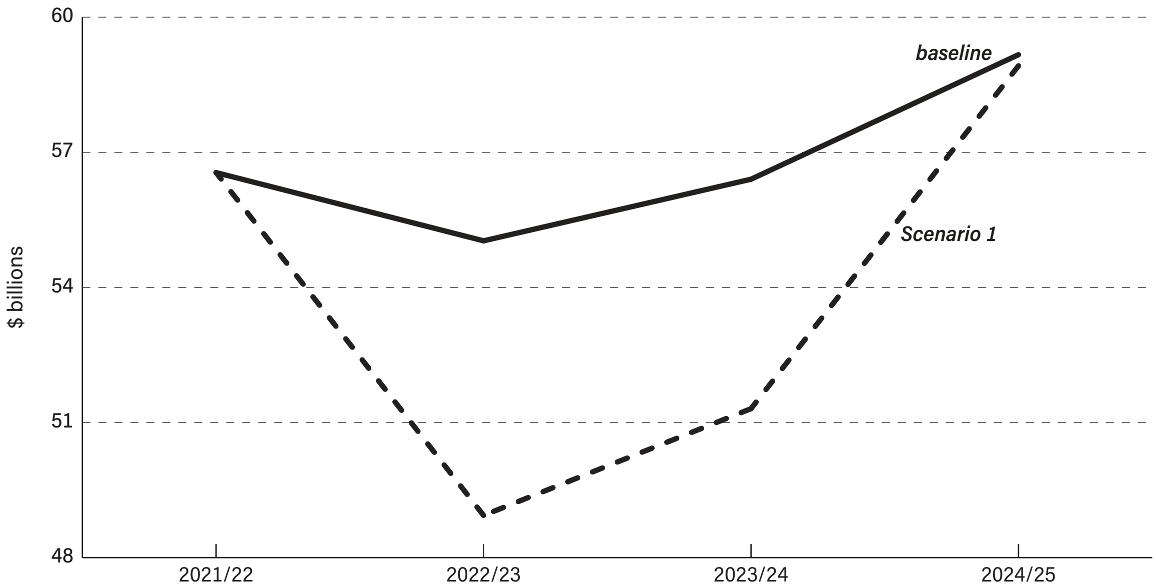
Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

Figure 4 provides some perspective on how the requirement for resource revenues to be earmarked first for the ASF affects revenues available to the provincial government over the period from 2022/23 to 2024/25. Simply put, revenues available to the provincial government are markedly curtailed in 2022/23 and to a lesser extent in 2023/24 to finance savings in the ASF. By 2024/25, the ASF balance is $11.4 billion (table 2). These funds provide stability in the future for periods when actual resource revenues fall below the stable amount set in the budget. Put simply, the ASF will help mitigate the impact of cyclical declines in resource revenue on the budget.

The next step is to review the spending plan that would balance the budget by 2024/25. Figure 5 shows Alberta's total nominal spending under the baseline and under Scenario 1. As shown, total nominal spending increases from $57.4 billion in 2021/22 to $58.9 billion in 2024/25. After adjusting for debt-servicing costs, nominal program spending increases by 1.5% over three years, or 0.5% (on average) annually to reach balance by 2024/25.[15] Although overall spending increases, the plan requires that nominal

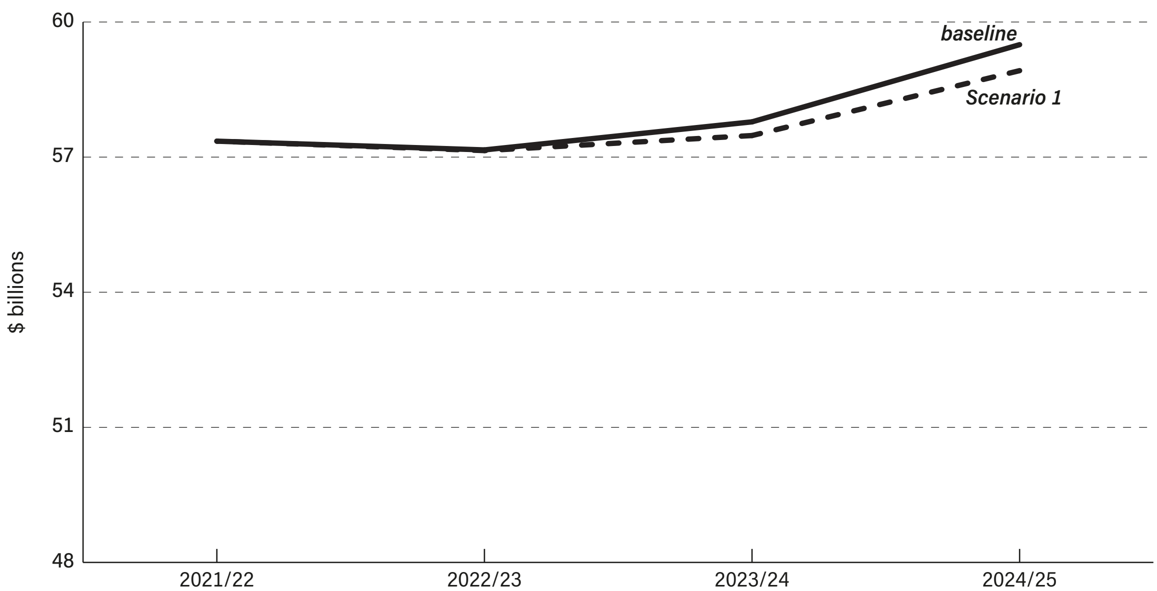
15. In real per-capita terms ($2023), this is approximately a 3.1% annual reduction (on average) over three years.

Figure 4: Alberta's total revenue, 2021/22–2024/25, ***baseline***, ***Scenario 1***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

Figure 5: Alberta's total spending, 2021/22–2024/25, ***baseline***, ***Scenario 1***, nominal ($ billions)

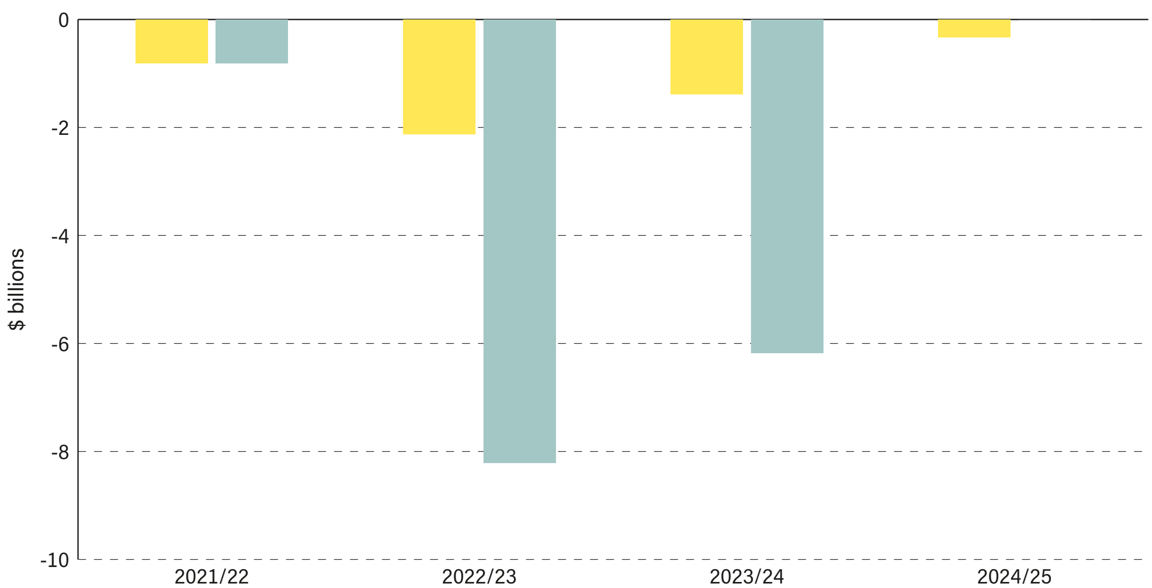


Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

program spending be 0.5% lower (on average) annually than currently projected spending levels from 2022/23 to 2024/25. The introduction of the ASF causes a drop in total revenue, which necessitates lower levels of program spending.[16] Moreover, operating deficits will be larger in 2022/23 and 2023/24 in Scenario 1 compared to the baseline before reaching balance in 2024/25 (figure 6). Overall, the plan requires some sacrifice up front to help restore stability to the budget.

The plan presented in this section accomplishes two important objectives: it builds up the ASF by 2023/24 and balances the budget by 2024/25. However, it permits resource revenue beyond the set amount to be included in the budget, which means it still relies somewhat on volatile resource revenue to reach balance. Put differently, spending levels are not fully reduced to match revenue levels (including the stable amount of resource revenue for the budget) should excess resource revenue be unavailable.

Figure 6: Alberta's projected operating surplus/deficit, 2021/22–2024/25, ***baseline*** and ***Scenario 1***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

16. For context, program spending would be permitted to grow by 2.0% over three years to balance the budget by 2024/25 with no contributions to the ASF.

An Alternative Path to a Balanced Budget by 2024/25—Scenario 2

To truly get Alberta off the resource revenue roller-coaster, and prepare for a potential structural decline in resource revenue over the longer term, what is needed is an alternative path that re-introduces the ASF and achieves a balanced budget while contributing excess resource revenue to Alberta's Heritage Fund.

The Heritage Fund was created in 1976/77 to save a share of the province's resource wealth to provide benefits to Albertans in the future. The rules around the fund, however,—including those requiring contributions—were statutory and therefore easily changed by governments. As a result, no resource-revenue contributions have been made since 1986/87 and the provincial government has deposited just 4.9% of total resource revenue to the fund over its lifetime.

Contributing excess resource revenue to the Heritage Fund, as opposed to including it in the budget, will ensure Alberta is not relying on volatile resource revenue[17] to balance the budget. As per the recommendation by Hill, Emes, and Clemens (2021), 25% of all resource revenue should be earmarked for the Heritage Fund once excess resource revenues are sufficient to meet this set contribution rate.[18] This will help reduce the pressure for future governments to increase spending when resource revenues are relatively high to help prevent the run-up of unsustainably high spending that has routinely led Alberta to deficits in the past. Moreover, contributions to the Heritage Fund will transform a share of one-time resource revenue into a financial asset that generates a permanent stream of income for the province over time.[19]

Table 3 includes an updated summary of Alberta's projected nominal fiscal position, incorporating the ASF, spending reductions, and contributions to the Heritage Fund. Consider first the revenue side to understand the impact of reallocating excess resource revenue from the budget to the Heritage Fund. Figure 7 shows Alberta's total nominal revenue under the baseline, Scenario 1, and Scenario 2. In 2022/23, total revenue is

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17. This is a particular risk given the recent regulatory announcements by the federal government. Importantly, price increases for West Texas Intermediate (WTI) do not necessarily translate to price increases for Western Canadian Select (WCS) because of the WCS discount, which has recently increased (Johnston, 2021). The increasing regulatory burden faced by oil and gas producers in Canada may blunt some of the benefit of price increases in Alberta.
18. Hill, Emes, and Clemens (2021) recommend the rule be constitutional, which is more difficult to change than a statutory rule, and therefore more robust over time. See Hill, Emes, and Clemens (2021) for more information on how such a rule could be implemented.
19. See Hill, Emes, and Lafleur (2021) for more information on the Heritage Fund and potential use of its earnings, which include eventually using a share to replace resource revenue in the budget if/when resource revenues reach a structural decline.

Table 3: Alberta's projected fiscal summary, ***Scenario 2***, millions (nominal $)

	2021/22	2022/23	2023/24	2024/25
Revenue				
Set amount of Resource Revenue for Budget	—	3,762	3,860	3,944
"Excess" Resource Revenue for Budget	—	—	—	—
Total Resource Revenue for Budget	10,908	3,762	3,860	3,944
Other Revenue	45,641	45,175	47,171	49,504
Total Revenue	56,549	48,937	51,031	53,449
Spending				
Program Spending	54,870	52,386	50,703	50,234
Debt Interest Costs	2,484	2,934	3,127	3,215
Total Spending	57,354	55,320	53,830	53,449
Surplus/Deficit	−805	−6,383	−2,799	0
Alberta Sustainability Fund				
Contributions	—	6,097	5,095	246
Balance	—	6,097	11,193	11,439
Heritage Fund				
Contributions	—	—	276	5,503
Balance	16,897	17,269	17,890	23,751

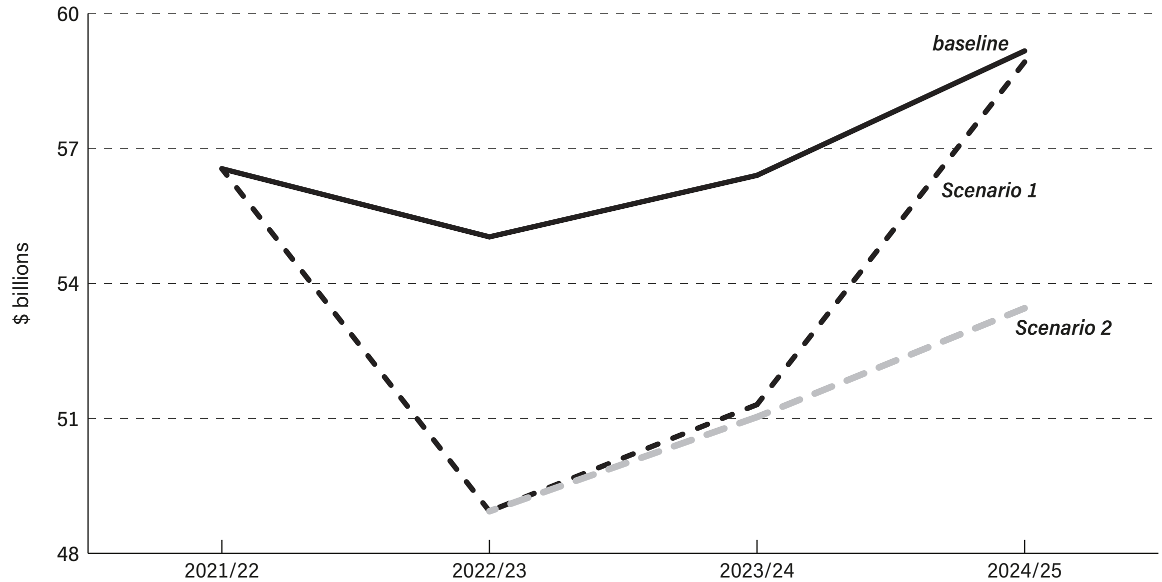
Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations …; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

$48.9 billion, the same as in Scenario 1. This is because, as in Scenario 1, the set amount of resource revenue included in the budget is $3.76 billion and the $6.1 billion excess resource revenue is saved in the ASF. The ASF has not yet reached its target balance ($10.9 billion).

By 2023/24, the ASF is approaching its target balance of $11.2 billion, which is 2.9 times the stable amount of $3.86 billion. In this case, $5.1 billion is contributed to the ASF and there is an excess of $276 million—again, the same as Scenario 1 (table 2). Instead of including the excess $276 million in the budget, however, it is saved in the Heritage Fund. As shown in figure 7, this results in lower total nominal revenue in Scenario 2 than in Scenario 1 for 2023/24. Importantly, the excess resource revenue in 2023/24 signals that there is now more than sufficient resource revenue to fund the stable amount for the budget and maintain the ASF. Put simply, the provincial finances are in a position to introduce mandatory contributions to the Heritage Fund.

In Scenario 2, the rule for contributions to the Heritage Fund is officially implemented in 2024/25 with 25% of all resource revenue ($2.4 billion) immediately earmarked for the Heritage Fund. In 2024/25, the set amount of resource revenue included in the budget is $3.94 billion. The ASF only requires a $246-million contribution to

Figure 7: Alberta's total revenue, 2021/22–2024/25, ***baseline*, *Scenario 1, and Scenario 2***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

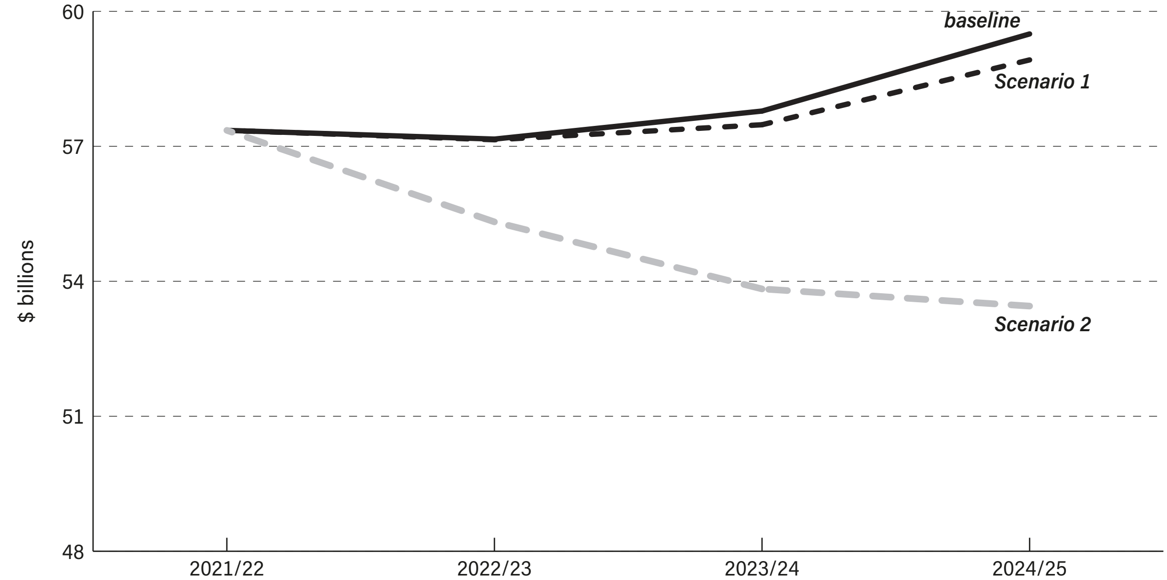
account for inflation, leaving $3.1 billion in excess resource revenue, which is also saved in the Heritage Fund for a total contribution of $5.5 billion in 2024/25 (table 3). The result is that in 2024/25 total revenues available to the province are $53.4 billion rather than the currently projected $59.2 billion (table 1). At the same time, the Heritage Fund is built up to $23.8 billion by 2024/25, compared to $18.0 billion in the baseline and Scenario 1.

The next step is to review the spending plan required to balance the budget by 2024/25 while incorporating both the ASF and Heritage Fund contributions. Figure 8 shows Alberta's total nominal spending under the baseline, Scenario 1, and Scenario 2. In Scenario 2, total nominal spending must be reduced from $57.4 billion in 2021/22 to $53.4 billion in 2024/25 to balance the budget that year. This requires a reduction in nominal program spending of 8.4% over three years, or 2.8% (on average) annually.[20] Figure 9 shows the balance of Alberta's projected operating budget from 2021/22 to 2024/25 under the baseline, Scenario 1, and Scenario 2. As in Scenario 1, the province will incur larger deficits in 2022/23 and 2023/24 than in the baseline scenario.

The plan presented in this section will require sacrifice, namely, significant spending reductions over the next three years. However, the plan re-introduces the ASF and balances the budget without relying on excess resource revenue. Put simply, it gets Alberta off the resource revenue roller-coaster by better matching ongoing spending with ongoing revenues including a more stable level of resource revenue. The

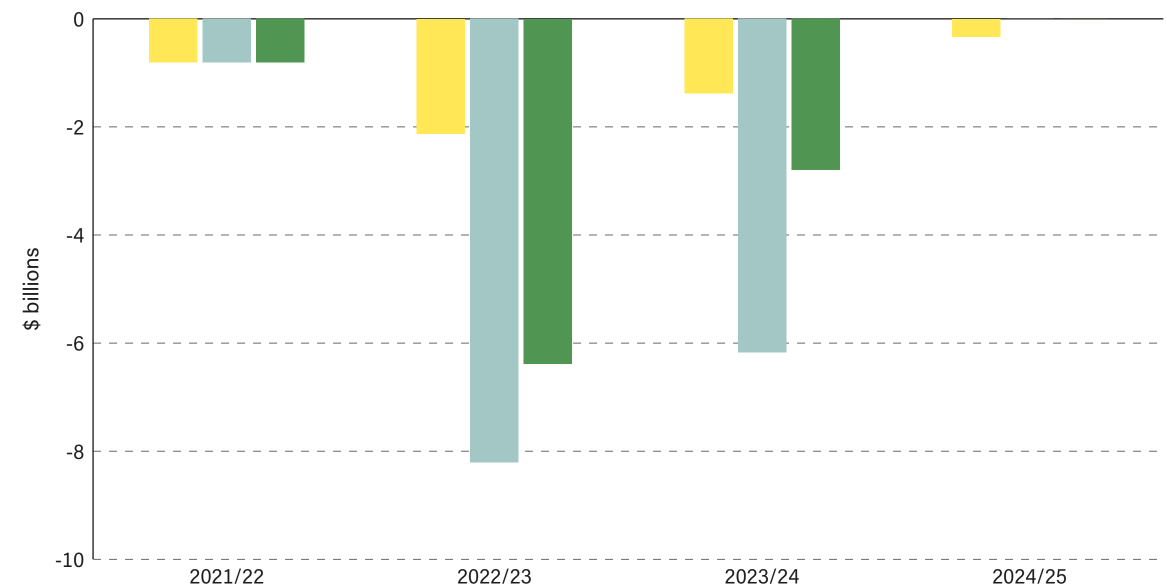
20. In real per-capita terms ($2023), this is approximately a 6.1% annual reduction (on average) over three years.

Figure 8: Alberta's total spending, 2021/22–2024/25, ***baseline***, ***Scenario 1***, and ***Scenario 2***, nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

Figure 9: Alberta's projected operating surplus/deficit, 2021/22–2024/25, ***baseline*** , ***Scenario 1*** , and ***Scenario 1*** , nominal ($ billions)



Sources: Alberta Heritage Savings Trust Fund, 2013–2021; Canada Energy Regulator, 2021; Fraser Institute, 2021: Calculations ...; Gov't of Canada, 2021; Gov't of Alberta, 2021a, 2021b; Parliamentary Budget Office, 2021; Statistics Canada: table 17-10-0005-01; table 17-10-0057-01; table 36-10-0221-01.

plan also prepares the province for the growing likelihood that resource revenue will permanently decline by introducing a requirement that a portion of one-time revenue be saved and transformed into a financial asset that generates income for the future. There are obviously a host of factors that contribute to the specific calculations presented thus far, including the time horizon for a balanced budget as well as the stable amount of resource revenue provided to the budget and thus the required size of the ASF. The key, however, is the principal goal of re-introducing the ASF, balancing the budget, and eventually requiring a portion of resource revenues be contributed to the Heritage Fund.

Top Priority after Achieving a Balanced Budget

Once the budget is balanced, the provincial government will have the opportunity to use surplus funds to address other priorities. Assuming the provincial government takes the approach presented in Scenario 2 (that is, the constitutional rule for the Heritage Fund has been introduced), it is recommended that the government prioritize reducing personal income taxes. Restoring Alberta's tax competitiveness through reductions in personal income-tax rates would help to encourage economic growth in the province. Ferede (2021) demonstrated how the top statutory income-tax rate of 15% could be gradually reduced to 10% over four years, while having a relatively small impact on government revenues in the context of the many economic benefits the rate reduction could bring.

Conclusion

If no action is taken by the provincial government, Alberta's finances will remain vulnerable to fluctuations in resource revenue. This study presents two alternative paths that balance the budget by 2024/25 and help stabilize Alberta's finances for the long-term. As shown in Scenario 1, the provincial government could moderate growth in nominal program spending to 1.5% over three years to balance the budget by 2024/25 while re-introducing the Alberta Sustainability Fund. The ASF—which sets a stable amount of resource revenue for the budget—is key to creating a new fiscal framework that helps prevent the ongoing boom-and-bust cycle in provincial finances. The plan, however, still relies on volatile resource revenue to some degree. To truly free Alberta from the resource revenue roller-coaster, program spending must be reduced by 8.4% over three years, which would be sufficient to balance the budget by 2024/25 while re-introducing the ASF and renewing contributions to the Heritage Fund. This plan would not only get Alberta off the resource revenue roller-coaster by better matching ongoing spending with ongoing revenue, but it would help prepare for the increasing likelihood that resource revenue will permanently decline by saving a share of resource revenue for the future.

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