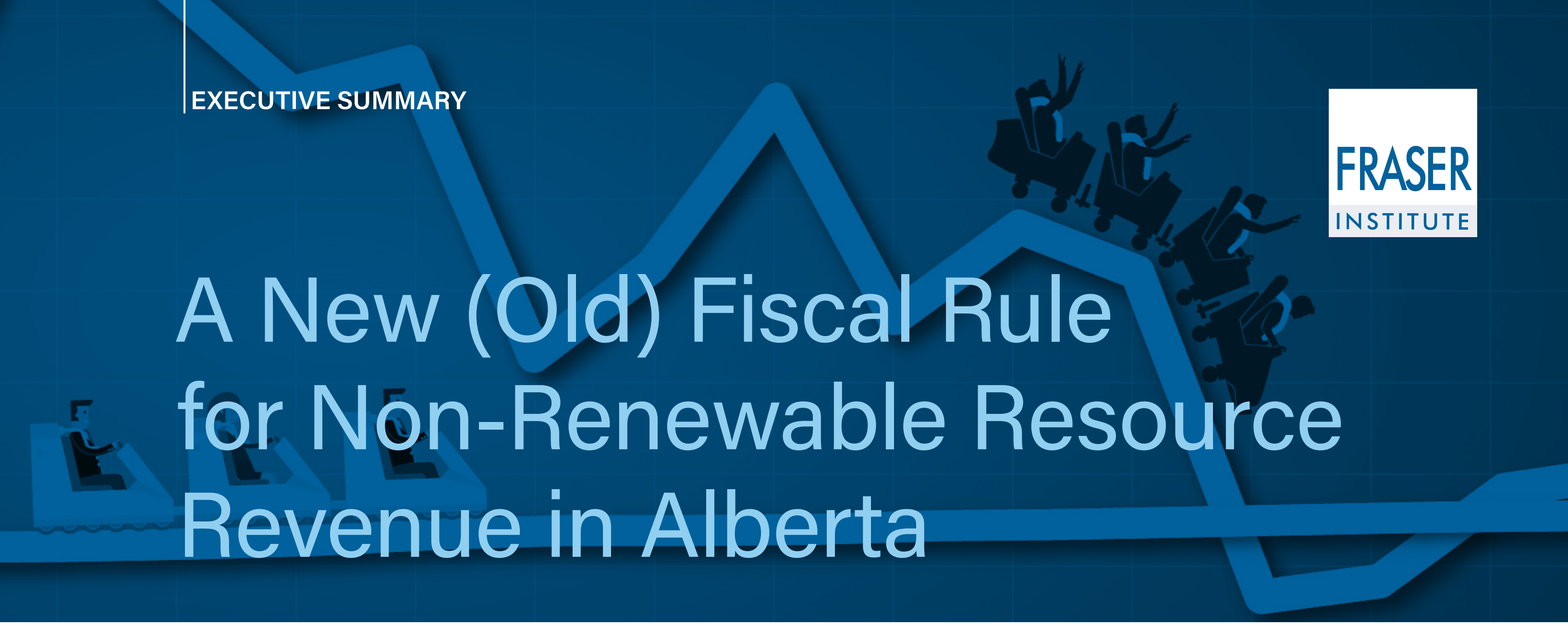


EXECUTIVE SUMMARY

A New (Old) Fiscal Rule for Non-Renewable Resource Revenue in Alberta

by Tegan Hill, Joel Emes, and Jason Clemens

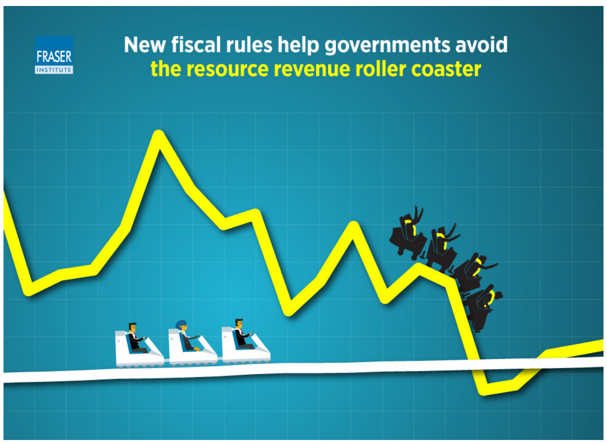
Alberta's government finances are once again in a perilous state with ongoing deficits, mounting debt and near record levels of spending. One of the greatest contributors to Alberta's fiscal instability is the provincial government's treatment of non-renewable resource revenue in the budget. With many expecting a rebound in the energy sector, now is the time to stabilize this volatile source of revenue.

Alberta's non-renewable resource revenue (NRR), adjusted for inflation, has ranged from as low as $1.6 billion in 1970/71 to as high as $19.0 billion in 2005/06. This volatility is reflected in NRR as a share of provincial revenue, which has been as high as 77.4% (1979/80) and as a low as 6.5% (2015/16). NRR is expected to be just 4.7% of total revenue in 2020/21—its lowest on record.

Despite this volatility, the Alberta government normally includes all non-renewable resource revenue in its budget. In times of high NRR, the provincial government faces pressure to increase spending, which is premised on continuing high NRR. Consider that when NRR started increasing in the late 1990s, the province increased per-person spending (adjusted for inflation) from $8,012 in 1999/00 to $12,740 by 2008/09, an increase of 59.0%. When the inevitable happens and non-renewable resource revenue declines, the province faces spending levels that are unsustainable without large-scale deficits and mounting debt. Since 2009/10, amid a decade-long, general decline in NRR, the province ran a deficit in every year except 2013/14 and recorded a total accumulated deficit of $64.3 billion (up to 2019/20). This cycle of public finance boom and bust has repeated itself more than once.

Lessons on improving the rules governing the treatment of non-renewable resource revenue can be drawn from Alberta's own history as well as the performance of the Alaska Permanent Fund. The first lesson is that a portion of NRR should be saved. Part of the province's problem is that it effectively liquidates its non-renewable resource assets by using all of the NRR—by its nature one-time revenue—in general revenues to finance ongoing spending. In 1976/77, the province required that 30% of NRR be saved in the Heritage Fund. The problem with the province's initial approach was that this requirement to save a portion of NRR was a statutory law, which subsequent legislatures could easily change, and did. Following a decline in NRR in 1982/83, the government reduced the rate to 15%. Following a second collapse of oil prices in 1986/87, the province eliminated the requirement to save any portion of NRR. Overall, no contributions were made to the Heritage Fund in 30 of the 44 years of its existence and the province has deposited just 4.9% of total NRR to the fund over its lifetime.

The Alaska Permanent Fund provides important insights. Alaska requires at least 25% of all mineral revenue be deposited annually based on a constitutional rule, which is more difficult to change than a statutory rule and more robust over time. The implications of Alaska's approach for Alberta are significant. Consider that Alberta's Heritage Fund could have a balance of $91.6 billion as of 2019/20 instead of the actual $16.2 billion had it followed rules similar to those used in Alaska. The first step in achieving a sounder approach to NRR is requiring a portion to be saved each year in the Heritage Fund.

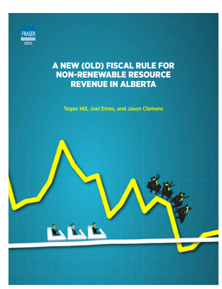


Contributions to the Heritage Fund alone, however, do not change the volatility of non-renewable resource revenue in the provincial budget. To address this volatility, the provincial government has experimented with a number of mechanisms. One of the most effective was the Alberta Sustainability Fund (ASF) introduced in 2003 but eliminated in 2013. The idea behind the ASF was to save a portion of NRR during times of higher NRR so that it could be drawn on during times of low revenue from non-renewable resources, thus stabilizing the level of NRR included in the budget. Again, the statutory nature of the the ASF, however, meant that the rules guiding the fund were easily changed, ignored, and eventually eliminated.

A renewed Alberta Sustainability Fund is recommended based on a stabilized level of NRR of $2.3 billion (adjusted by inflation annually), which is the ten-year average of NRR between 1990/91 and 1999/00. More important than the specific stabilized amount of NRR, however, is the principal of selecting a stable amount of NRR for the budget to be maintained using a fund that is financed during times of high NRR and drawn upon during periods of low NRR. Once the ASF is fully funded, any additional NRR would be contributed to the Heritage Fund.

The new rules governing the Heritage Fund and the new Alberta Sustainability Fund should be constitutional in nature to make them more difficult to change in the future. To achieve this, the province would first present the ideas to the public through a referendum—a procedure that in itself provides value by educating Albertans on the benefits of such an approach and garnering public support. Assuming the proposal is passed, the Alberta government would then pass legislation recognizing the rules. This legislation would then be presented to the federal House of Commons and Senate for recognition, resulting in a change pertaining to Alberta in the national Constitution.

The combination of rules requiring a share of NRR to be saved in the Heritage Fund and a predictable level of NRR supported by a sustainability fund would provide a more stable framework for Alberta's treatment of non-renewable resource revenue and temper its fiscal booms and busts.



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