Alberta

2013-2014 Budget Analysis

Key Findings

- → The budget contains a plan to rebuild the Heritage Fund, which will improve the province's long-term fiscal sustainability. The specific plan is modest in scope, but a welcome development.
- → Taking on new debt to make strategic capital investments makes sense in a low-interest environment but a firm repayment schedule is needed.
- → The budget provides opportunities for the government to improve the value it receives for the money it spends, but includes no clear plans to that effect.
- → The government missed an opportunity to be more aggressive at improving education and skills training.
- → Committing non-renewable resource revenues to build up a Contingency Account is a positive step towards reducing the government's vulnerability to dramatic revenue fluctuations.

The Canada West Foundation is dedicated to building a western Canada in which our children will thrive and prosper. Our focus on provincial and federal government budgets reflects that priority. We are primarily concerned with the long-term directions that governments are setting in their budgets and less preoccupied with year-to-year changes in spending or in fiscal balances.

Detailed Analysis

In its budget preview, the Canada West Foundation identified five steps the Alberta government could take that would lead towards a more prosperous future for all Albertans. Those steps were:

1) New direct investments in the Heritage Fund.
2) Early action to address future labour shortages.
3) Steps to improve value for money in critical government services like health and education.
4) Openness to changing the future tax mix in Alberta.
5) Measures to reduce dependence on resource revenues to fund current spending.

1

Saving for the Future: A Plan to rebuild the Heritage Fund

The Alberta budget includes a two-step plan to rebuild the Heritage Fund. The first step is to re-invest earnings back into the fund. Beginning next year, the province will retain 30% of the Heritage Fund's net income, rising to 100% by 2017/18.

Reinvesting earnings back into the Heritage Fund will allow the fund to grow from an estimated $15.2 billion in 2013/14 to $16.2 billion two years from now. However, as noted in our Budget Preview for Alberta, reinvesting earnings is not the best long-term solution for rebuilding the fund. It would be preferable for a greater share of royalty revenues to be invested directly into the fund and for the earnings from the fund (after inflation-proofing) to go into general revenues.

The second step is that, as noted above, once the Contingency Account reaches $5 billion, future prescribed NRR revenues will be deposited in the Heritage Fund or other endowment funds. The commitment to put new money into the Heritage Fund is a positive development and will help future generations benefit from Alberta's resource wealth.

However, the new investments as outlined in Budget 2013 will be modest into the foreseeable future for two reasons. First, given the prescribed savings rates and the government's projections for NRR growth, the Contingency Account will not reach its $5 billion threshold before 2016/17. As a result, new NRR investments in the Heritage Fund will not begin until at least that year. Second, the amount that will be saved will be modest. Resource revenues in the coming year are expected to reach $7.3 billion. Even if they were to double, the total cash set aside under the current savings plan would be just $1.7 billion.

Nevertheless, the commitment by the Alberta government to set aside resource revenues for the future is welcome. The Canada West Foundation hopes that once the province is on a sounder fiscal footing, the share of funds that are saved will increase.

2

Anticipating Tomorrow's Needs: Acting now to address potential labour shortages

The 2013 budget did not include any new financial commitments to address skills training and labour. In fact, there were modest reductions in operating spending to post-secondary education, innovation and apprenticeship and workforce strategies.

Two key priorities were identified in the business plan for the Enterprise and Advanced Education Ministry to help address potential labour shortages. First, it will implement strategies to engage Aboriginal Albertans and other groups underrepresented in the province's advanced education system. Second, it will develop a new approach to recruiting immigrants to the province, including a targeted domestic and international labour marketing strategy to attract the workers needed to meet Alberta's specific labour challenges.

While the budget did not include an ambitious skills and labour force agenda, these two measures indicate that the province is taking concrete steps to addressing labour market needs.

3

Getting Value for Money: Improving government performance

The 2013 budget did not contain specific measures designed to improve government performance. However, the government did resist the temptation to implement cross-the-board cuts to spending, opting instead for a more targeted and strategic approach to funding its priorities. It also identified a number of areas where a better allocation of resources would result in increased efficiencies.

The Canada West Foundation continues to believe that outcome-based performance measures and study of best practices in other jurisdictions would help the Alberta government ensure that its residents are receiving value for their money. In future budgets, we will watch for additional progress to be made in this area.

4

Changing the Revenue Mix: Considering a sales tax

The Alberta government chose to hold existing taxes steady and not to introduce any new revenue-generating measures in the budget. Consideration of a sales tax was explicitly ruled out.

5

Reducing Volatility: Treating non-renewable resources differently

The Alberta budget contained measures that will help the province reduce its vulnerability to dramatic fluctuations in non-renewable resource revenues (NRR).

The province introduced a new Contingency Account to replace the nearly-depleted Sustainability Fund. The Contingency Account serves the same basic purpose as its predecessor – to insulate the province against sudden revenue shortfalls. Specifically, it will be used to cover any deficit in the province's operating balance.

The Contingency Account will have a targeted balance of 15% of provincial operating revenue, currently estimated to be about $5.6 billion. To build the account to $5 billion, the province will set aside a certain amount of NRR funds every year, beginning in 2014/15:

→ 5% of the first $10 billion in NRR;
→ 25% of the next $5 billion; and
→ 50% of any amount over $15 billion.

Once the Contingency Account reaches $5 billion, the NRR funds set aside will be allocated to the Heritage Fund or a provincial endowment. To get the rest of the way to the 15% target, the government will use future budget surpluses. If the province needs to draw upon the Contingency Account, it must replenish that account through the allocation of future surpluses and not the set-aside NRR funds.

The Contingency Account is an improvement over the Sustainability Fund. The former includes a plan to replenish itself whenever funds are removed and has a clear target size (15% of operating revenue) that grows in value alongside the size of the government. In addition, to build a pool of cash, the new account will siphon off a fixed share of NRR regardless of the province's net financial position. That share of NRR will not be considered "operational" revenue by the government.

The Contingency Account will not eliminate Alberta's dependence on resource revenues to fund current expenditures. However, a well-maintained financial buffer will smooth out year-over-year revenue volatility, making it easier for the province to develop and implement long-term strategic plans for building a prosperous economy.

Other Measures

The budget did not include specific measures in several of the areas highlighted by the Canada West Foundation in its budget preview, but there were two areas we did not identify where the Alberta government did take important steps.

First, in spite of an operational spending freeze, the government increased funding for international relations by 22%. The money is intended to help Alberta deliver its International Strategy and open new foreign offices in locations like India and Singapore. The province also allocated some new funds to pursue market access gains for specific goods, such as forest products.

International trade and market access are critical to the Alberta economy. Such steps to improve trade and trade relations are necessary to secure the province's long-term prosperity.

Second, even though it means taking on new debt, the provincial government is continuing to make strategic investments in infrastructure. The Canada West Foundation has noted in its previous research that there is a strong link between public infrastructure investment and long-term economic growth. Debt is an appropriate mechanism for such investments (especially in a low-interest-rate environment) because infrastructure has both present and future value. However, a firm repayment schedule is needed so as not to unduly burden future generations.

The issue of taking on new debt to finance capital investment also speaks to the larger debate about the proper revenue mix in Alberta. Low-interest debt financing might make sense today but it may not be the best option available, especially in a future where borrowing costs are higher. The Canada West Foundation would welcome a broader discussion within the province about the right mix of revenue and debt to fund future strategic investments in Alberta.

Alberta Budget by the Numbers

Presentation

The Alberta government has dramatically altered the way that it presents the budget. Instead of a single consolidated document, it presented a budget with three distinct plans: an operational plan, a capital plan and a savings plan. The operations plan includes the government's day-to-day spending in areas like health care, education and social services. It does not, however, include spending on new building or equipment in those areas – those expenditures are accounted for in the capital plan. Money set aside for the Heritage Fund or the Contingency Account is included in the savings plan.

While there is certainly value in separating operations from capital – many governments follow such a fund-based accounting approach – the new format obfuscates the bottom line and makes it more difficult to make accurate comparisons of revenues and expenditures with those of previous years. In changing the presentation, the government could have included a fiscal summary that combines operations, capital and planned savings into one table and shown more clearly how its new approach relates to the previous format.

Revenues and expenditures

The government faced a significant shortfall in resource revenues in 2012/13, largely because of lower-than-expected oil prices and the wide differential between western Canadian heavy oil prices and North American benchmark rates. Last year, the province had budgeted for resource revenues to be $11.2 billion in 2012/13 and $13.4 billion in 2013/14. Those expectations have been scaled back considerably. In the 2013 budget, the government expects 2012/13 resource revenues to come in at $7.2 billion and to remain at about the same level in the coming year.

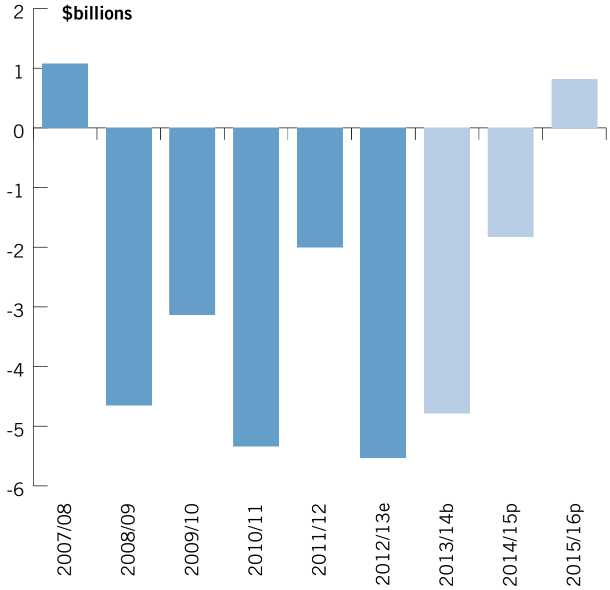
In response to this revenue shortfall, the government froze overall operational spending. There were small increases in health care, K-12 education and a few other areas, offset by decreases in post-secondary education, agricultural support and environment and sustainable resource development.

Deficit and debt

Without a consolidated summary, it is difficult to understand the precise nature or size of the combined budget balance. However, the data show that the Alberta government's net financial asset position fell by $5.5 billion in 2012/13 and will deteriorate by another $4.8 billion in the coming year. This figure captures operations, capital, amounts going to savings and changes in other financial assets and liabilities, including unfunded pension liabilities.

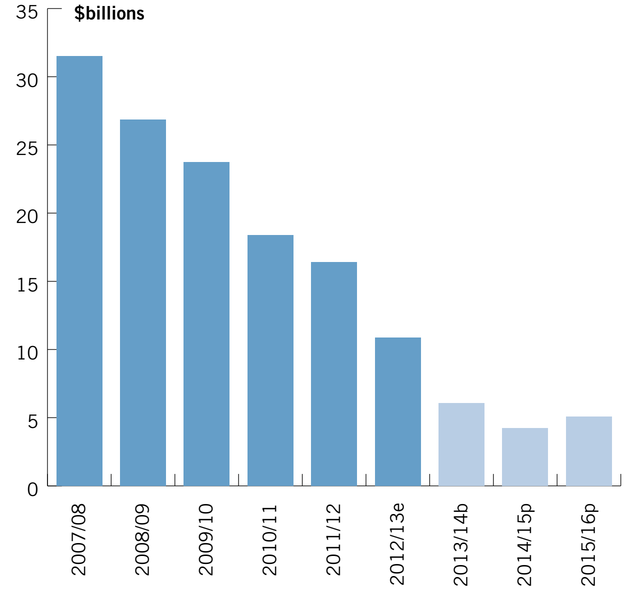
Each year of deficit reduces the Alberta government's net asset position. Alberta's net debt (financial liabilities less financial assets) was eliminated in 2000/01 and by 2007/08, its net financial assets reached a high of $31.5 billion. With successive deficits since 2008/09, Alberta's net asset position will fall to $6.1 billion in 2013/14.

Provincial Budget Balances
(Change in Net Financial Asset Position)



Source: Canada West Foundation calculations using data from the Alberta 2013 budget
Note: e=estimated, b=budgeted, p=projected

Provincial Net Debt
(Net financial asset position)



Source: Canada West Foundation calculations using data from the Alberta 2013 budget
Note: e=estimated, b=budgeted, p=projected

Future Targets

The province expects to move to a positive net financial asset (surplus) position by 2015/16. It projects a $1.8 billion shortfall in 2014/15 and an $821 million increase in net financial assets for the following year. To accomplish this turn-around the province is counting on revenues to grow by $6.5 billion, operational expenses to grow by only $1.5 billion, and annual capital expense to fall by $0.5 billion. In short, the province expects revenues to grow in excess of total expenditures over the next three years, thus close the deficit.

This budget analysis was prepared by Canada West Foundation Senior Economist Michael Holden. The opinions expressed in this report are those of the author and are not necessarily those of the Canada West Foundation's Board of Directors, funders or advisors.

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CANADA WEST FOUNDATION
900, 105 – 12 Avenue SE
Calgary, Alberta, Canada T2G 1A1

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