



A New Provincial Savings Framework - Options for Consideration

“VISION 2050”

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SUMMARY OF RECOMMENDATIONS

1. Adopt a schedule that gradually decreases the proportion of budgeted resource revenues by 1 percentage point per year, resulting (in 3 to 4 years) in a 15 per cent target (vs. the current 19-20 per cent). The 'freed up' revenues are directed as additional contributions to the Heritage Fund which, by 2050, would generate over \$4.3 billion in additional annual payments – almost equalling and replacing the value of current budgeted resource revenues.
2. Amend the unbudgeted surplus policy to be more responsive to fluctuations in resource revenues by creating a proportional link to budgeted resource revenues. A policy requiring that 100 per cent of *unbudgeted* surplus revenues in excess of 50 per cent of the *budgeted* resource revenues go into the Heritage Savings and Trust Fund (in addition to the existing 1/3 policy) would generate \$3.25 billion in annual savings, leading to over \$13.6 billion in payments annually by 2050.
3. Raise the priority and capacity of energy innovation research, and signal its importance to the world through the creation of a \$5 billion endowment (the Research in Energy Futures Innovation and Technology (REFIT) fund), as a major step forward in both mitigating future energy, economic and revenue risks, and securing Alberta's prosperity, future and quality of life.



Rationale for Savings

The government's dependence on non-renewable resource revenues for ongoing program and operating expenditures is at greater risk today, and looking forward, than it has been in the past. The government is therefore at greater risk of running deficits, over the next 20-40 years, due to the alignment of significant changes in global and North American environmental regulation and direction, carbon management and elimination demands, and the associated political shifts occurring in Alberta's largest customer/market for petroleum – the United States.

What has served Alberta well as a reliable and invaluable revenue stream, therefore, needs to be reviewed, with consideration of how a proportion of current and medium-term foreseeable resource revenues could be utilized to create a 'hedge', or risk-mitigating, alternative revenue stream that, over time, replaces resource revenues as a base for ongoing government operations, programs and services. Should current global trends continue toward a 'post-carbon' energy future, the creation of this endowment or investment stream would secure Alberta's continued prosperity, opportunity and capacity to serve its citizens.

Context

Since 2002, budgeted resource revenues have represented an average of 19 per cent of total provincial government expenditures. In the absence of non-renewable resource revenues, the government would have been confronted with budgetary deficits every year since 1995.¹

The finite nature of non-renewable resource revenues combined with a potential increase in demand for environmentally friendly energy sources threaten Alberta's position as a prosperous, low-tax jurisdiction that offers an unparalleled quality of life. To address these challenges, the Chamber recommends that government adopt a targeted and strategic approach to financial management that:

1. Mitigates the forward risks of our dependence on carbon-based resource revenues, over time, through the creation of an alternative revenue stream; and
2. Positions the province for continued prosperity in anticipation of increased consumer demand for environmentally friendly energy sources, through targeted research and technology investments.

¹ Alberta Chambers of Commerce and Certified General Accountants Association of Alberta (ACC), 2006:22



1. Mitigating Dependence on Volatile Resource Revenues

The Alberta Chambers of Commerce and Certified General Accountants Association of Alberta, through their Vision 2020 research in 2005/06, estimated that Alberta could save between 30 and 40 per cent of all non-renewable resource revenue per year, and put those monies into the Heritage Fund, without significant cuts in current program spending. Such a large shift in provincial budgeting and budget strategy, however, appears to be of little interest to Albertans struggling under the immediate demands that a fast-growing economy and population.

Recognizing these current and ongoing demands on government, and an expectation to successfully keep pace with, and surmount the province's "growth challenges", the Calgary Chamber has investigated further options, drawing from the principles and findings of the Vision 20/20 Report, that might help to meet a number of critical, but sometimes competing objectives:

- Improve and expand Alberta's infrastructure, in support of future business opportunity and economic activity.
- Provide for the ongoing, long-term maintenance of that infrastructure.
- Support the critical work necessary in finding the optimal, global, technological solution to the present 'carbon waste stream challenge', and in doing so, better secure the future prospects of Alberta's resource and energy industries.
- Set aside a percentage of current resource revenues, and invest in the creation of an alternative revenue stream, so that the province (over time and with a conservative net growth in the assets of the endowment) is secure in a post-carbon environment.

The Chamber, through its annual budget submissions and submission to Financial Investment Planning and Advisory Commission, has consistently recommended that government commit to investing a long-term average of 35 per cent of non-renewable resource revenues in the Heritage Savings and Trust Fund, and that the Fund be structured as a true "trust", in which the net income earned on the capital invested is added to the fund, rather than transferred into general revenues. This is an ambitious but challenging objective to achieve, given that an average of 49.9 per cent of total resource revenues were unbudgeted since 2002 (Figure 1).²

Consequently, as a first principle, any savings framework or strategy needs to incorporate both budgeted and unbudgeted revenues in its approach.

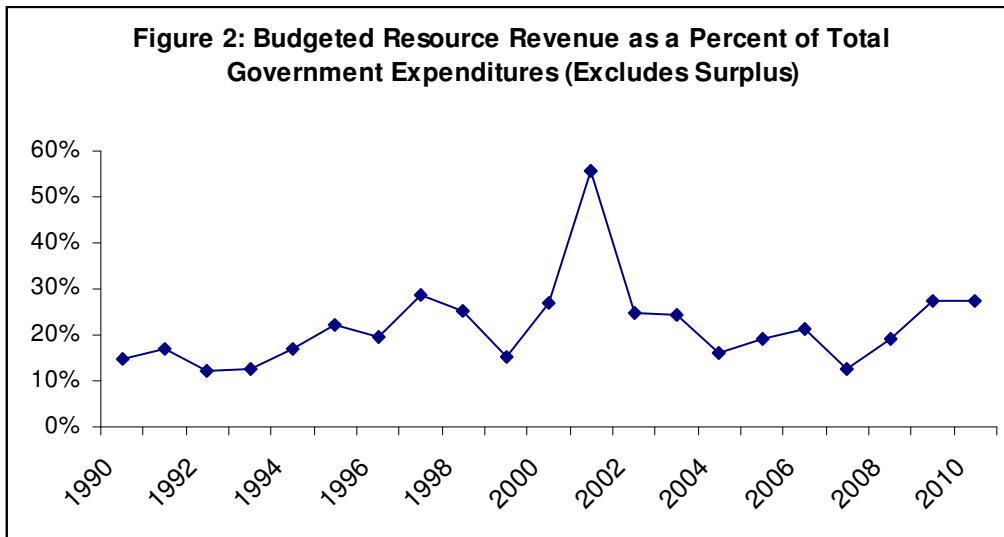
Total Revenue	30.2
Total Expenses	25.3
Resource revenue	9.8
Surplus Resource Revenue	4.9
Surplus as a Proportion of Total Resource Revenues	49.9%
Budgeted Resource Revenues (Total Minus Surplus)	4.9
Budgeted Resource Revenues as a % of Total Expenses	19.3%

² According to Alberta Finance, only budget numbers for 2001-02 forward are fully comparable.



A. Budgeted Approach to Resource Revenue Savings

Since 2002, budgeted resource revenues have represented an average of 19 per cent of total provincial government expenditures (Figure 1). To adopt a more sustainable approach to government expenditures, the Chamber recommends that government gradually decrease this proportion to no more than 15 per cent, and deposit the resulting ‘savings’ in the *Heritage Savings Trust Fund*, with net revenues reinvested back into the fund.



From an implementation standpoint, government could adopt a schedule that seeks to decrease this 19 per cent budgeted revenue proportion gradually, by 1 percentage point in the first year, an additional percentage point in the second year and an additional 2 percentage points in the third year, resulting in the 15 per cent target, which would continue in perpetuity.³ The approach facilitates the creation of a savings ‘delta’ over time, and increases contributions to the Fund, without drastic disruptions or dislocations in forward budgeting, while leaving the government with revenues to meet more immediate needs and demands, as outlined in the previous page.

Assuming a 3-year phase in, and with average annual budgeted resource revenues at \$4.9 billion (since 2002), this approach would generate \$336 million in ‘savings’ (additional contributions to the Fund) next year, \$589 million the following year, and \$1.1 billion in year three and in each year thereafter (Figure 3). Using a conservative 4 per cent real rate of return, and assuming that net revenues are reinvested, by 2050 the increased capital in the Fund would generate over \$4.3 billion in payments annually – almost equalling, and thereby almost replacing the value of current budgeted resource revenue, positioning Albertans and their government for prosperity and security in perpetuity. This figure is achievable, without having yet considered the effect of additional contributions to the Fund from unanticipated, and unbudgeted surpluses.

³ An alternative to a three-year phased in reduction to 15 per cent is to reduce by 1 percentage point per year over a 4-year period.



	Annual Savings (Billions)	Budgeted Resource Revenues as a % of Total Expenses
Average Budgeted Resource Revenues (2002- 2008)	4.9	19.3
Year 1	0.336	18
Year 2	0.589	17
Year 3	1.095	15
Year N	1.095	15

B. Unbudgeted (Surplus) Approach to Resource Revenue Savings

Unbudgeted resource revenues have represented, on average, 49.9 per cent of total resource revenues since 2002. The province has an established policy of allocating one third of unbudgeted resource revenues to savings, and two thirds to capital and maintenance.

The Chamber recommends that a critical objective of any provincial savings framework be to save more revenues in times of prosperity, particularly unbudgeted revenues, as these do not adversely impact existing, budgeted programming and service commitments. However, the Chamber also recognizes the need for government to be equipped and able to respond to unanticipated growth pressures that accompany unbudgeted revenues, as discussed above.

Consequently, the Chamber recommends that government look at amending its unbudgeted surplus policy to be more responsive to unbudgeted revenue fluctuations by creating a proportional link to budgeted resource revenues. For example, that unbudgeted surplus policy could require 100 per cent of *unbudgeted* surplus revenues in excess of 50 per cent of the *budgeted* resource revenues, go into the Heritage Savings and Trust Fund, in addition to the existing 1/3 policy, which would continue to apply to the first 50 per cent of unbudgeted surplus revenues (Figure 4).

	Revenues (Billions)	Savings (Billions)
Average Total Resource Revenues (2002 - 2008)	9.8	
Surplus Resource Revenues as a Proportion of Total Resource Revenues	49.9%	
Proportion Subject to 100 per cent Savings (50% of the 49.9%)	25%	\$2.44
Proportion Subject to Existing Savings Policy (33% of 50% of 49.9%)	25%	\$0.806
Total Annual Surplus Savings		\$3.25

Unlike the budgeted resource revenue approach, the implementation of this proposed unbudgeted revenue strategy does not require a phased implementation. With an average of 49.9 per cent of resource revenues being unbudgeted since 2002, the suggested unbudgeted savings policy could generate \$3.25 billion in annual savings, leading to over \$13.6 billion in payments annually by 2050, again assuming a 4 per cent real interest rate, with net revenue reinvested.



2. Transitioning the Economy from Carbon Intensive to Carbon Smart – a Special Purpose Endowment within the Heritage Fund

The challenge of managing our carbon-based economy, and carbon footprint represents a tremendous business opportunity – to create the ‘Silicon Valley’ of climate change innovation, centred in Alberta. If achieved, it would position the province as a global leader in carbon capture and storage and clean coal, with the potential to export these technologies worldwide.

In the 1980s, the Alberta government partnered with industry to invest \$2 billion in oil sands research through the *Alberta Oil Sands Technology Research Authority*. This investment helped bring technology to market that lowered the costs of producing synthetic crude, making oil sands development feasible.

While the Alberta Government continues to support energy research through, for example, the \$200 million dollar Energy Innovation Fund established in 2006, R&D investment in the industry today is still only about one-third what it was 20 years ago.⁴

Alberta’s prosperity is based on resource wealth and the energy sector, which makes up 42 per cent of the economy. Consequently, a Special Purpose Endowment fund should be established to attract the best and brightest researchers on energy related issues, including alternative energy sources, and carbon management technologies – our generation’s great technological challenge – securing Alberta’s position as the world’s leading energy producer in the 21st Century.

By raising the priority and capacity of energy innovation research, and signaling its importance to the world through the creation of a \$5 billion endowment (the Research in Energy Futures Innovation and Technology (REFIT) fund), a major step forward results in both mitigating future energy, economic and revenue risks, and securing Alberta’s prosperity, future and quality of life.

⁴ Institute for Sustainable Energy, Environment and Economy (ISEEE). (2006). *Energy and the Alberta Economy: Past and Future Impacts and Implications*. Calgary: Robert L. Mansell and Ron Schlenker.