Fiscal Stabilization Policy

Issue

Canada's federal Fiscal Stabilization Program (FSP) is intended to provide protection for provinces whose economies experience economic shocks unrelated to the province's policy actions. However, recent events have shown the program needs updates to meet its own design intents. When Alberta's revenues shrank by $8.8 billion in 2015–16, Alberta received only $250 million from the program due to the $60 per person cap set in 1987, which would be worth at least $133 per person today. To receive that comparatively small amount, Alberta needed to formally apply to the federal finance minister, which puts needless delays and politics between Albertans and financial relief.

Those challenges reveal deeper inadequacies in the 1980s-era program design to meet today's needs. The *focus* of the program on providing relief of particular downturns fails to consider prevention of predictable future costs. The *breadth* of the provincial economy considered by the program does not consider drops in resource revenue as meaningfully as it counts drops in other forms of revenue.

In order to restore and sustain business and skilled worker confidence in Alberta's economy, changes are required to how Alberta is protected by the FSP. In the short-term, FSP needs operational updates to how provinces access and benefit from the program. In the long-term, FSP requires structural changes to reflect and respond to dynamics of today's economy.

Background

Remove the Per-capita Limit

FSP compensates for year-over-year revenue declines due to economic downturns, not for declines due to provincial decisions to reduce taxes. Policy changes made by a province in the rate or in the structure of provincial taxes are factored out when measuring revenue declines. A decline in resource revenues is taken into account only if—and to the extent that—the annual decline exceeds 50 per cent. The maximum payment to a province that makes a claim for a given fiscal year is $60 per person. Provinces may also request an interest-free loan for any amounts in excess of the $60 per person limit, to be recovered over a five-year period. However, the decision of whether to provide such a loan is at the sole discretion of the Minister of Finance.[1]

An oil price crash brought WTI from US$27 per barrel[2] in 1985 to US$14 per barrel in 1986 (US$63 and US$33 per barrel respectively in 2019 dollars), resulting in a drop in Alberta's provincial Non-Renewable Resource Revenues (NRRR) from $4.44 billion in 1985/86, to $1.66 billion in 1986-87 (current dollars). The effects on the broader economy and the provincial budget were magnified, reducing total provincial revenues by 27.7% from $13.29 billion to $9.6 billion (current dollars).

[1] Department of Finance Canada. *Backgrounder: The Fiscal Stabilization Program*. https://www.fin.gc.ca/n16/data/16-027_1-eng.asp

[2] InflationData.com "Historic Crude Oil Prices". https://inflationdata.com/articles/inflation-adjusted-prices/historical-crude-oil-prices-table/

Alberta received an FSP payment of $419 million in 1986-87 ($171 in 1987 dollars for each of Alberta's 2.44 million persons; worth $892 million for the province or $364 per person in 2019 inflation-adjusted dollars). Thereafter, Ottawa imposed a cap of $60 per person in 1987 without inflation indexing.

Owing to an oil price decline from US$86 per barrel WTI in 2014 to US$42 in 2015, Alberta had an FSP claim in 2015-16 for $251 million by the current claim formula, which would be worth $1.6 billion ($1,650 per capita) if the per capita cap was removed, against an NRRR shortfall of $6.16 billion and an overall revenue shortfall of $6.86 billion. Further oil price decline, to US$36 per barrel in 2016, required Alberta to file another FSP claim for 2016-17, which would be valued at $634 million if uncapped, on modest NRRR growth of $316 million, but overall provincial revenue shortfall of $326 million ($77 per person).[3]

Other federal programs that help communities to address unexpected events and disasters[4] are not generally arbitrarily capped at per-capita limits.

<u>Automate FSP Payments</u>

Provinces currently need to apply for FSP payments within 18 months after a fiscal shock has occurred. The federal government has the option to punish provinces for reducing their own-source revenues, even when measures such as reducing corporate tax rates are prudent to stimulating local economies. Although there is a formula prescribed under the *Federal-Provincial Fiscal Arrangements Act*, the federal Minister can decide, for the purpose of calculating FSP payments, how much revenue a province has received from natural resources and other sources.

Ottawa's final determination of Alberta's FSP claims for the 2016-17 fiscal year was delayed until after the October 2019 federal election, to almost 11 financial quarters after the end of the 2016-17 fiscal year. Formula-based assistance from FSP should not depend on provincial or federal political priorities of the day. Time delays add to compounding costs for both governments due to the inability to plan programs and related cash flows, leading to avoidable provincial borrowing or program reductions. In the decades since FSP was established, accurate financial data have become available more quickly due to advances in information technology which allow provincial and federal governments to gather, share, and report financial data at least quarterly.

<u>Prevent Need for Future Claims</u>

The current FSP predominantly addresses symptoms of a fiscal shock, not its causes. Provinces can spend FSP payments in any ways that they prefer, including repaying loans required to operate programs during deficits, without a requirement to improve conditions that exposed the province to fiscal shock in the first place. The *focus* of FSP on providing *relief* from effects of particular shocks fails to consider *prevention* of predictable future shocks and their costs. In Alberta, there is broad consensus that diversifying our economy is necessary to reduce fiscal shocks resulting from volatile oil markets.

Federal policy has previously included investments to address and prevent downstream impacts from economic shocks that can be anticipated, including $3.5 billion Ontario auto bailouts in 2008-2010[5],

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[3] Bev Dahlby (2019). *Reforming the Federal Fiscal Stabilization Program.* University of Calgary School of Public Policy.

[4] Public Safety Canada. *Disaster Assistance Programs - List of all federal programs*. https://www.publicsafety.gc.ca/cnt/mrgnc-mngmnt/rcvr-dsstrs/dsstr-ssstnc-prgrms/dsstr-ssstnc-prgrms-ll-en.aspx

$372 million Bombardier bailout in 2017[6], $1.6 billion energy industry bailout in 2018[7], and the $4.5 billion Trans Mountain Pipeline purchase[8] in 2019 plus billions more in construction costs.

In other areas where governments protect against unexpected events, governments: buy out floodplains to ensure that homes do not get re-flooded; invest in traffic control devices and upgrades to make highway intersections safer; and require developers to design and construct buildings that are resilient against extreme weather.

Treat Resource Revenues Fairly

The *breadth* of a provincial economy considered by FSP does not consider drops in resource revenue as meaningfully as it counts drops in other forms of revenue. The fiscal stabilization program is intended to protect all provinces, but it discriminates against resource-dependent provinces of Alberta, Saskatchewan, and Newfoundland and Labrador, while favouring manufacturing economies of Ontario and Quebec. A decline in resource revenues is taken into account only if—and to the extent that—the annual decline exceeds 50 per cent.

Provinces are exposed to different economic shocks than the federal government. The federal government can pool the fiscal risks that individual provincial governments face. Lack of insurance coverage for significant loss of natural resource revenues in one province harms all provinces by diminishing each province's future capacity to support the federal government and other provinces. It is important to share risk between natural resource provinces and the rest of Canada because those economies may act counter-cyclical to each other.

The Alberta Chambers of Commerce recommends the Government of Canada:

1. Remove the per capita cap from calculation of Fiscal Stabilization Program payments;

2. Provide an automatic and immediate upfront non-discretionary minimum portion of a province's total FSP payment under transparent and unambiguous terms, followed by remaining portions requiring ministerial discretion on a defined schedule so that managers of provincial programs can plan effectively; and

3. Revise FSP to ensure that it adequately insures resource-dependent provinces, when:

    The annual decline in a province's resource revenues exceeds 50 per cent:

        Maintaining the current policy of considering and compensating for 50 per cent of annual decline in resource revenues;

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[5] Globe and Mail (April 7, 2015). "Canadian taxpayers lose $3.5-billion on 2009 bailout of auto firms" https://www.theglobeandmail.com/report-on-business/canadian-taxpayers-lose-35-billion-on-2009-bailout-of-auto-firms/article23828543/

[6] CBC (Feb. 7, 2017). "Federal government to give $372.5M in loans to Bombardier" https://www.cbc.ca/news/canada/montreal/bombardier-announcement-feds-1.3971263

[7] CBC (Nov. 18, 2019). "1 year on, most oil-and-gas bailout money has moved, federal government says" https://www.cbc.ca/news/canada/edmonton/oilsands-bailout-money-alberta-ottawa-1.5363218

[8] CBC (May 29. 2018). "Liberals to buy Trans Mountain pipeline for $4.5B to ensure expansion is built" https://www.cbc.ca/news/politics/liberals-trans-mountain-pipeline-kinder-morgan-1.4681911

Additionally, compensating for the remaining 50 per cent of a province's annual resource revenue decline by providing funds restricted to investments in a province's non-resource industrial sectors; and,

When the annual decline in a province's resource revenues does not exceed 50 per cent:

Compensating for the entirety of a province's annual resource revenue decline by providing funds restricted to investments in a province's non-resource industrial sectors.

Further, the Alberta Chambers of Commerce recommends that the Alberta government:

1. Invest a significant portion of future FSP funds received toward policies that: enable Alberta to take proactive leadership to diversify Alberta's economy, build capacity of Alberta firms to scale up and scale out, attract export-oriented industries to Alberta, strengthen Alberta's assets and workforce, and increase all Albertans' quality of life.