Executive Summary

An historic opportunity for Alberta

Few jurisdictions around the world have the good fortune to possess natural resource wealth; only a fraction of those manage windfall revenues with prudence. This study casts a glance at Alberta's past spending patterns, present practice, and choices for the future; it also compares trust funds in Alberta, Alaska, and Norway with the aim of learning from those latter jurisdictions. Albertans are familiar with the temptations that accompany windfall resource revenue. Phase III of Vision 2020 aims to broaden the discussion with policymakers, politicians, as well as the general public and the media in order to avoid past errors and to ensure future generations of Albertans also enjoy the Alberta Advantage. The challenge for Alberta is to learn from her own history as regards the Heritage Fund as well as the examples of other, arguably more successful jurisdictions.

FINDINGS: Alberta's fiscal context

- The provincial government has often increased spending beyond inflation and population growth. Alberta's historic government spending pattern is one where government expenditures outpaced inflation and population growth in multiple years by an average of 1.7 per cent annually between 1982 and 2001; expenditures outpaced inflation and population growth by an average of 0.9 per cent annually since 2001.

- In 2004/05, Alberta's per capita spending on programs was the second-highest among the provinces at $7,798; only Newfoundland spent more ($8,250 per person). The average of all provinces was $7,099.

- In Alberta, there is no automatic discipline upon government spending. In contrast, Alaska's legislature is restrained because of the constitutional obligation to place 25 per cent of resource revenues into the Alaska Permanent Fund.

- Until 2005/06, the last transfer to the Heritage Fund occurred in the 1986/87 fiscal year ($216 million). Over the course of the Fund's history, $28.3 billion in Heritage Fund earnings has been transferred to the province's General Revenue account. During that period, Alberta did incur deficits in selected years and upon entering the surplus phase the province did have significant debt to repay. It might be asserted that investments in the Heritage Fund before the present year would have been "a wash" as interest on provincial debt would have cancelled out gains in the Heritage Fund. However, the assumption behind such an assertion is that any and all expenditures during that period were necessary.

- Since Alberta's last deficit year (1994/95), the province collected $76.7 billion in non-renewable natural resource revenue. Average annual non-renewable resource revenue between April 1, 1994 and March 31, 2006 amounted to almost $6.4 billion.

- Since Alberta achieved a surplus position in the General Revenue fund in fiscal 1994/95, $9.8 billion has been transferred out of the Heritage Fund. As of the third quarter for 2005/06, the province inflation-proofed the fund with $258 million, announced another $1 billion deposit and placed $750 million into the Heritage Fund under the auspices of the new Access to Education "sub-fund." Thus, the net injection into the Heritage Fund will be just over $2 billion; the net withdrawal from the Heritage Fund 1995-2006 inclusive amounts to just under $7.8 billion.

- Under Alberta's *Fiscal Responsibility Act* the province may use up to $4.75 billion annually from non-renewable resource revenues for General Revenue Fund expenditures. In practice, the Fiscal Responsibility Act is porous; it cannot effectively limit the province's annual use of resource revenues. *Due to expenditures from various funds, significantly more than just $4.75 billion in non-renewable resource revenues is spent annually.*

- Alberta is heavily reliant on natural resource revenues. With a review of the past twelve years and with conservative assumptions on interest, spending and other tax receipts beyond resource revenue, the province would have faced deficits in five of those twelve years had Alberta's government been limited to earning half of the actual resource revenues that accrued.

FINDINGS: Options

- There are numerous options offered by multiple parties for the Alberta government's windfall resource revenues. A few possibilities suggested by some include more government spending in general, specific expenditures on government-directed investments, additional prosperity dividends, "Harvard"-style endowment funds for universities, multiple new funds as well as additional deposits in the Alberta Heritage Savings Trust Fund, or tax reductions. Some proposals appear to have substantial merit, and some less merit.

FINDINGS: Fund comparisons between Norway, Alaska, and Alberta

- The state of Alaska created the Alaska Permanent Fund in 1976 and first deposited resource revenues one year later. The state government is constitutionally obligated to deposit 25 per cent of all natural resource revenues into the Fund. Norway's parliament deposits *all* revenues from oil production into the Government Petroleum Fund (created in 1990 with the first deposits in 1996).

- Alaska created its trust fund after much previous natural resource wealth was spent mostly on capital projects.

- Alberta — the first jurisdiction to create a trust fund in 1976 and which immediately deposited revenues into the same — ceased contributions in 1987 and only resumed deposits into the fund in the 2005/06 fiscal year.

- The principal in the Alaska Permanent Fund is constitutionally protected and cannot be withdrawn by the state legislature or used for other purposes than that noted in the applicable constitutional amendment. Alberta and Norway have no such constitutional protection of fund principal.

Executive Summary Table: Fund comparisons

	Alberta Heritage Savings Trust Fund	Alaska Permanent Fund	Government Petroleum Fund (Norway)
Total value (In $ Cdn)	$14.6 billion	$37.5 billion (U.S. $32.239 billion)	$223 billion (NOK 1,281 billion)
Per capita (In $ Cdn)	$4,483	$59,805	$48,145
Inflation-proofing required?	Yes	Yes	No
Fund has constitutional status?	No	Yes	No
Legislative requirement for annual resource revenue deposits?	No	Yes (25 per cent)	Yes (100 per cent)
Year created/first year in which resource revenue deposited	1976/ 1976	1976/ 1977	1990/ 1996

As of December 31, 2005 for Alberta and Alaska. Norway figures are as of November 30, 2005. All comparisons in $Cdn. Sources: Annual reports and quarterly updates from Alaska Permanent Fund, Petroleum Fund (Norway), Alberta Heritage Fund. Alberta figures include Third Quarter update *and* February 2006 announcement of an intended $1 billion deposit for Heritage Fund before the end of the fiscal year.

Recommendations

Recommendation One:

- **Alberta's annual per capita spending should not exceed population growth and inflation.**

  Rationale: The province may act prudently now or be forced to rein in future spending in the manner it did in the early to mid-1990s. *Prudent spending is the foundation for future choices*: tax relief, the avoidance of a deficit because of an economic downturn or decline in resource prices, or emergency spending on unforeseen catastrophes. The ability to set aside resource revenue in the Heritage Fund is directly linked to restraint on the expenditure side of the ledger.

Recommendation Two:

- **The province should deposit between 30 per cent and 40 per cent of all non-renewable resource revenues in the Heritage Fund annually.**

  Rationale: In its original incarnation in 1976/77, 30 per cent of non-renewable resource revenues were directed into the Heritage Fund. The Fund also retained all earnings.

  Annual set-asides are feasible. Alberta no longer has debt interest payments beyond those scheduled to be re-paid with set-aside funds for that purpose. Debt interest equates to 15 per cent of all resource revenues collected during the twelve surplus years (April 1, 1994 – March 31, 2006). An additional 15 per cent or 25 per cent portion for a total set-aside of 30 per cent or 40 per cent is thus feasible. Even under a 40 per cent plan, *the province would still spend 60 per cent of non-renewable natural resource revenue every year*.

  If Alberta set aside 30 per cent of such revenues annually — based on average resource revenues between 1994 and 2006 ($6.4 billion) — the annual contribution to the Heritage Fund would be over $1.9 billion each year. If Alberta set aside 40 per cent of all such revenues annually, the annual contribution to the Heritage Fund would be approximately $2.55 billion each year.

  In Phase I of Alberta Vision 2020, Emes (2004) projected a number of scenarios for revenues, expenditures and surpluses/deficits over the next 20 years. One possible scenario replicated here in Phase III projects annual surpluses of between $3.35 billion to $6.88 billion between 2006 and 2026. Given the Emes' projection, annual deposits of 30 to 40 per cent of annual resource revenues are feasible.

Recommendation Three:

- **The province should consider transfers of additional resource revenue into the Heritage Fund (beyond the recommended percentages) in the manner of the state of Alaska.**

  Rationale*:* If natural resource prices remain high, there is an opportunity to more quickly secure the Alberta Advantage for future generations. If the province does not deposit additional windfalls into the Heritage Fund, the more likely default course will be additional spending above (the combined effect of) population growth and inflation. Such extra expenditures are not sustainable in the medium to long-term.

Recommendation Four:

- **The province should not issue dividend cheques in the short to medium-term. While the 2006 dividend cheques were popular, such payouts place the dividend "cart" before the principal "horse."**

  Rationale: Dividend cheques in Alberta should be the result of overflowing earnings in the Alberta Heritage Savings Trust Fund — not at the expense of necessary infusions of principal, which are crucial to build up the Fund.