Business Council of Alberta

Policy Paper
December 2022

THREE BIG ROCKS

Priorities for Managing Alberta's Future Revenue Surpluses

Report Citation

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About the Business Council of Alberta

The Business Council of Alberta is a non-partisan, for-purpose organization dedicated to building a better Alberta within a more dynamic Canada. Composed of the chief executives and leading entrepreneurs of the province's largest enterprises, Council members are proud to represent the majority of Alberta's private sector investment, job creation, exports, and research and development. The Council is committed to working with leaders and stakeholders across Alberta and Canada in proposing bold and innovative public policy solutions and initiatives that will make life better for Albertans.

Land Acknowledgement

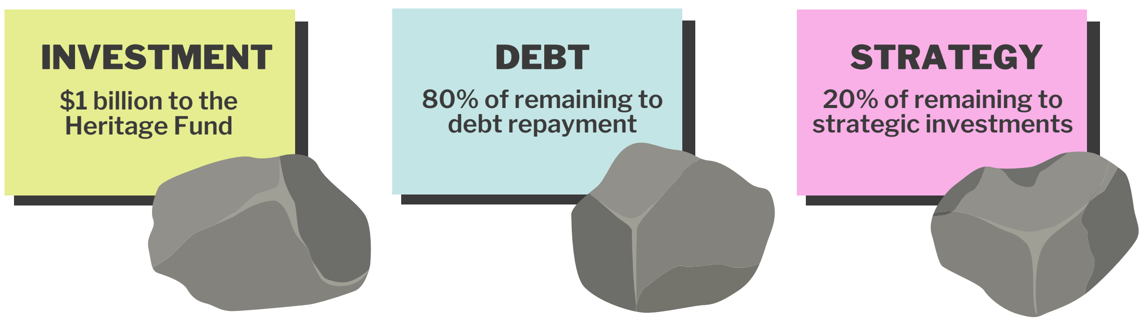
In the spirit of truth, reconciliation, and respect, we honour and acknowledge the lands upon which we live and work as guests, including the traditional territories of the First Nations in Treaties 6, 7, and 8 and the citizens of the Metis Nation of Alberta. We thank the First Peoples of this land, which we now call Alberta, for their generations of stewardship of the land, and we seek to walk together in the spirit of truth and reconciliation to build a shared future for all in Alberta.

This document reflects the views of the Business Council of Alberta based on our own research and on engagement with members and stakeholders. Alberta is a diverse place. In many cases, there are a range of views on an issue within the Council membership. This piece may not necessarily reflect the perspective of all BCA member companies, and should not be read as the position of any one member.

Summary

Albertans are used to the rollercoaster that comes with reliance on non-renewable resource revenues. But even by those standards, times are extreme. The past 24 months have delivered the largest swing in provincial government revenues in Canadian history.

The current environment offers Alberta the opportunity to set itself up for a prosperous future if we use our current revenue windfall thoughtfully and strategically. When it comes to future surpluses, Alberta should prioritize investment, debt, and strategy for the current fiscal year and the next. We call it the **Three Big Rocks Formula.**



Introduction

Alberta is, once again, at the top of the fiscal rollercoaster. Largely because of a massive $28 billion windfall in non-renewable resource revenue, the provincial government announced in its Mid-Year Fiscal Update that it expects to post a $12.3 billion surplus for 2022/23. And even with an anticipated economic slowdown, the province projects surpluses of more than $5 billion in each of the next two years. Those figures could be even higher depending on market and geopolitical conditions.

It would be hard to overstate the magnitude of Alberta's fiscal turnaround in the last two years or the size of the royalty windfall. This fiscal turnaround is the largest in the history of Canada, and Alberta expects to collect more resource revenue this year than it did in the six years from 2015/16 to 2020/21 combined. In fact, resource revenues are expected to be nearly double their previous all-time high of $15 billion in 2005/06.

In the long run, Alberta needs to reduce its reliance on this lucrative but volatile revenue source. Royalties have created enormous benefit for Albertans over the years, but they have also driven instability in provincial public finances for decades, as governments have spent as if the good times would never end. But they did. We've seen booms turn to busts. And with the benefit of hindsight, we wonder how we could have done better when times were good.

We have an opportunity to do something different this time. We can be strategic and thoughtful about how we use this money. We can act prudently but also with vision—by assuming that this might be our last such windfall. In other words, we can use this opportunity to position the province for a competitive and sustainable future when resource royalties may not be as high.

Three Big Rocks is about prioritizing the things that are most important to set our province up for success over the medium to long term and doing those things first. When looking at near-future surpluses, our research shows that the "three big rocks" to put our resources towards are investment, debt, and strategy.

To that end, this paper will present three “big rocks” we believe should be top priorities for the provincial surplus for the current fiscal year and the next: (1) investment in the Heritage Fund, (2) strategic spending, and (3) debt repayment. These priorities were guided by the insights offered by the Business Council of Alberta’s (BCA) members at a working session held in late 2022. They were also informed by past BCA research and principles designed to set up the province for long-term economic success and the input of several fiscal experts.

But before we get to how to use current and future surpluses, a brief background on the challenges and trends in Alberta’s fiscal history follows.

Background

The challenge of volatile resource revenues

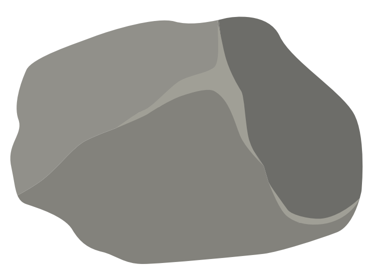
Alberta owes a lot to its natural resources. In addition to attracting investment, creating employment opportunities, and promoting economic growth in the province, our resources generate royalty revenues that provide the Alberta government with a significant source of income not available to most other provinces.

These resource revenues allow the government to spend generously on goods and services while keeping taxes relatively low for Albertans.

This means that the taxes and fees paid by Albertans are typically far less than the cost of services they receive.

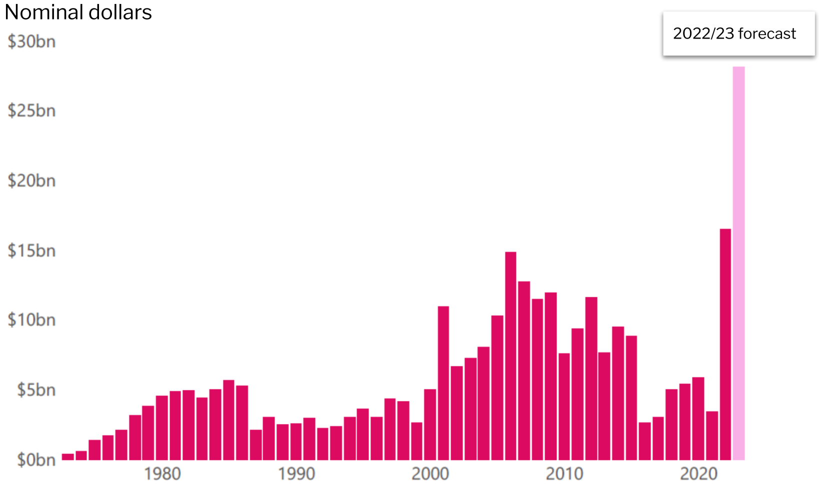
For example, even in the current fiscal year, Albertans paid about $44 billion in taxes and fees (including federal transfers back to the province) but received about $62 billion in program spending, with income from resource revenues covering most of that gap.

However, this system is not without its challenges. For one, the income from resource revenues is highly volatile and can fluctuate wildly from year-to-year. This unpredictability makes long-term budget planning extraordinarily difficult in Alberta.



Alberta's natural resource revenue, 1973-2023

Nominal dollars



Source: Finances of the Nation, 2022-23 Mid-year Fiscal Update and Economic Statement

Not only that, but revenue volatility impacts spending as well. Research shows that the provincial government tends to increase spending when commodity prices and, therefore, resource revenues are high, but typically struggles to curtail spending when prices inevitably drop. This is exactly what happened in 2008 when royalty revenues fell; the province posted consistent deficits until just last year. It was only the combination of eventual spending restraint and a recovery in royalty revenues that turned that situation around.

The current boom: How we got here

As we know too well, the Alberta economy has struggled significantly since the collapse in global oil prices in 2014. After that shock, the province's fiscal position deteriorated rapidly. A constant string of budget deficits took us from a net asset position to a net debt position. By 2020, Alberta's net debt had reached $40 billion.

But in early 2020, things seemed to be finally turning around. Consumer and capital spending were expected to strengthen, and oil production was set to rebound. In that context, Budget 2020 provided a commitment and a pathway to balance the budget by 2022/23.

That, of course, was turned on its head just days later when the realities of the COVID-19 pandemic hit the province.

The economic consequences of the pandemic were enormous. Alberta's fiscal situation rapidly deteriorated as revenues dropped and COVID-related expenses mounted. Collapsing global oil prices at the time only magnified this impact.

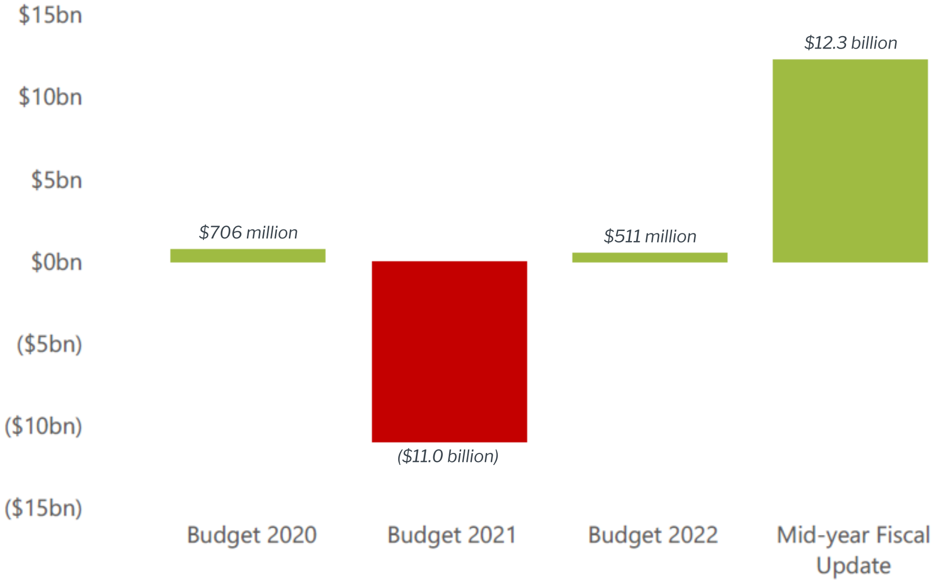
In that context, a balanced budget by 2022/23 was out of the question. What was a forecasted $706 million surplus for 2022/23 in Budget 2020 turned into an $11 billion deficit by Budget 2021.

But, in keeping with Alberta's rollercoaster tradition, the outlook for 2022/23 changed once again—this time for the better. By Budget 2022, that expected $11 billion deficit turned into a projected surplus of $511 million due to elevated oil prices as global supply struggled to meet surging demand.

Since then, global conditions—from underinvestment in energy production to Russia's invasion of Ukraine—have dramatically altered Alberta's short-term fiscal outlook.

The latest projection from the Mid-year Fiscal Update and Economic Statement shows that because of a massive $28 billion windfall in non-renewable resource revenue, the provincial government expects to post a $12.3 billion surplus in 2023—a $23 billion swing in expectations in just 21 months. On a real, per capita basis, this is the largest such swing in Canadian history.

Alberta's anticipated surplus/deficit position for fiscal 2022-23



Source: Budget 2020–February 2020, Budget 2021–February 2021, Budget 2022–February 2022, Mid-year Fiscal Update–November 2022.

While anything can happen—and the last few years have certainly proven that—we can reasonably assume that oil prices will remain somewhat high in the near term, even with the expectation of an economic slowdown or even a recession in 2023.

The Alberta government expects an average WTI price of US$78.50 per barrel next year, well below forecasts by organizations like the US Energy Information Administration (EIA). This is not to suggest that the Alberta government is overly conservative in its assumptions, especially given present market volatility. Rather, even at US$78.50, the province is projecting a $5.6 billion surplus next year. And, should they come to pass, higher oil prices could result in much higher surpluses for the province.

All this to say that unless the province significantly increases spending next year, Alberta can expect large surpluses for the next couple of years—especially since many oil sands projects have reached "payout," transitioning into a higher royalty tier.

However, the most important thing to remember is that this windfall does not represent a fundamental shift in Alberta's fortunes. This is just the fun part of the resource revenue boom and bust cycle.

The Goal

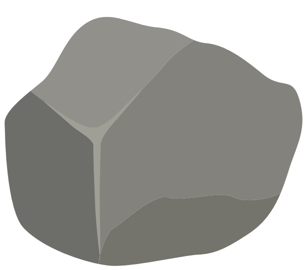
Imperative

Alberta's resource revenue roller coaster makes it extraordinarily difficult to deliver stable government spending and to plan for the future. Revenues are volatile and unpredictable. Large positive swings in revenue can disappear as fast as they arrive, making it impossible to know how much income the provincial government can count on from one year to the next.

As the world moves to decarbonize, demand for fossil fuel-based energy is set to plateau and at some point in the future, fall. This may take decades, and Alberta should compete vigorously for market share during that time, but when it happens, it will have ramifications for Alberta's largest industry and our government finances. In other words, even though we will see commodity cycles again in the coming decades, we should not count on another energy boom coming our way.

In that context, the imperative to be thoughtful, strategic, and sensible about how to use the windfall is more important than ever before. We need to get off the resource revenue roller coaster and create a fiscal path for Alberta that is more stable and sustainable in the long term.

Few other places in North America have the means and opportunity to set themselves up for a bright future in the way Alberta can. We just need to plan and execute.



What not to do

Increase operational spending

Aside from COVID-related spending, the Alberta government has been in a period of relative austerity over the last four years. As noted in the 2022 provincial budget, regular operational spending in Alberta has increased by just 3.6% since 2018/19. That increase is less than population growth and inflation over that period—what we call the smart spending band—meaning that program spending has been falling on a real per capita basis.

This has been a conscious policy decision by the Alberta government—largely in response to the recommendations of the MacKinnon Panel on Alberta's Finances. The MacKinnon Panel report, published in 2019, noted that Alberta spends more on a per capita basis than other peer provinces (Ontario, Quebec, and British Columbia), but Albertans did not receive demonstrably superior services or outcomes. Since that report was published, the government has worked to bring spending in line with those three other provinces as its fiscal anchor. This fiscal restraint has played a role in Alberta's improved financial position today.

With Alberta's finances dramatically improved, there are good reasons to increase operational spending, especially in health care and education. Alberta's population is aging and will require more health care services, adding pressure to an already-strained public health care system. Furthermore, we need to ensure Alberta provides exceptional-quality educational opportunities for everyone in the province; highly skilled talent is critically important to build Alberta's economy of the future.

There are pressures to spend in other areas as well, whether it be on mental health, homelessness and addiction supports, municipal infrastructure, or even wages in the senior public service. Wages for senior officials had been frozen for six years and only began to increase again this year, by around 1.5% annually. This stagnation affects the province's ability to attract and retain top talent to leadership positions in government.

While important, each one of these line items creates an ongoing, annual spending obligation for the province. In contrast, Alberta's current revenue windfall is almost certainly temporary. So, while there are good reasons to consider some increases to program spending, those conversations must be held outside of discussions about how to use Alberta's revenue windfall.

To ensure that windfall revenues are not used to finance ongoing government activity, operational spending growth should be capped at the rate of population growth plus inflation for the next two years.

It should be noted that this guardrail will result in a notable increase in operational spending in the coming years. Not only is inflation unusually high, but Alberta's population is growing quickly due to positive net in-migration from other provinces and Canada's higher national immigration targets.

RECOMMENDATION

The provincial government should not use its current revenue windfall to fund increases in ongoing operational spending beyond accounting for inflation and population growth. Rather, the government should limit total program spending growth over the next two years to the smart spending band—no more than the rate of population growth plus inflation.

Bonus cheques to Albertans

The last resource windfall in Alberta was in 2005/06. At the time, rising commodity prices resulted in an unexpected $15 billion in resource revenues, leading to an $8.7 billion surplus—more than five times initial projections.

Then-Premier Ralph Klein returned a portion of the surplus to Albertans through a one-time $400 Resource Rebate cheque—colloquially known as "Ralph Bucks." These bonus cheques cost $1.3 billion, or 15% of the province's surplus. The remainder of the surplus was allocated to the Heritage Fund and other endowments ($2.7 billion), the Sustainability Fund ($1.1 billion), and the Capital Account for future capital projects ($3.6 billion).

While Ralph Bucks were initially popular with most Albertans, the program soon drew criticism for its lack of vision for the province. In one 2005 poll, 54% of Calgarians opposed Ralph Bucks and instead wanted the money invested in health, education, welfare, or infrastructure such as roads and police. In Edmonton, 48% of people favoured the government keeping the money for public services.

After oil prices crashed in 2008 and the government started running consistent deficits, there was further consensus that rebating surplus money back to Albertans was not the appropriate way to deal with resource revenue windfalls. Instead, Albertans wanted the money to have been used to smooth the path or alleviate the pain that comes when boom times turn to bust.

RECOMMENDATION

With the exception of modest, temporary, and targeted supports to help households cope with inflation, the provincial government should not spend its current revenue windfall on making direct cash payments to Albertans.

Affordability Action Plan

It's important to contrast the idea of "Ralph Bucks" with recent announcements by Premier Smith and the Government of Alberta that, among other supports, include $600 cash payments over six months to seniors and families with children. On the surface, the two are similar in that they involve money sent directly to Albertans. However, the current transfers are intended for a specific purpose—to help Albertans cope with the highest inflation we've seen in a generation. While one could argue about aspects of the program's design and who qualifies for payments, it is intended to address a specific economic problem rather than what was effectively a dividend payment through the use of targeted and limited funding.

What should we do instead?

If increasing spending without bounds or rebating money back to Albertans is not the right approach, what is? How should Alberta spend its current resource revenue windfall?

There is no objective right answer. Myriad options are available to government, each with its own pros and cons. The "right" answer depends on the goal we are trying to achieve and the values underpinning that goal.

Based on our research and consultation with BCA members, we propose that goal should be the following:

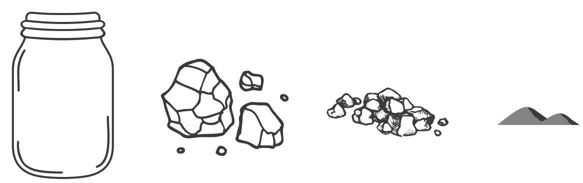
Use the revenue windfall to position Alberta for a more prosperous and fiscally sustainable future.

More specifically, we believe the surplus is best used when it is guided by the following principles:

- **Future-focused:** It should set the province up for a stronger long-term fiscal state
- **Strategic:** It should promote competitiveness, economic opportunity, and investment
- **Equitable:** It should maximize the benefit for future generations
- **Clear:** The plan should be easy to communicate to Albertans to encourage broad buy-in

In short, the best use of the surplus is one that recognizes that it is the result of a temporary surge in revenue from the one-time sale of Alberta's non-renewable resources.

Just like filling a jar with rocks, pebbles, and sand, we need to set the top priorities and get those things—those big rocks—in first.



We've likely all heard versions of the story. If you want to fill a jar with rocks, pebbles, and sand, there are two ways. You could put in the sand and pebbles first and would find you don't have enough room for the big rocks. To fill a jar with all these items—Alberta's needs—we need to first put the big rocks in, followed by the pebbles, and then the sand.

Alberta's surpluses should therefore be used with an eye to the future: to generate an ongoing revenue stream (either through investment income or foregone interest payments from debt reduction) or to bolster economic competitiveness, and prosperity for all Albertans through strategic investments. The objective is to ensure the province has the means to sustainably provide the highest quality services to Albertans for generations to come.

Evaluation of Priorities

Our proposed model for Alberta's surpluses for fiscal 2022/23 and 2023/24 is the **Three Big Rocks Formula:**

- Rock 1: $1 billion to Alberta's Heritage Savings Trust Fund annually

And with the remaining surplus:

- Rock 2: 80% toward debt repayment
- Rock 3: 20% toward a fund for future strategic investments

The provincial government is projecting a surplus of $12.3 billion for 2022/23 and $5.6 billion for 2023/24. We believe the government should deploy those surplus funds towards the above three priorities over those two fiscal years.

Indeed, the provincial government has already signalled that debt repayment is a priority. In the province's First Quarter Fiscal Update, the government under Premier Kenney announced that, in concert with extra cash from the previous year, it would allocate $13.4 billion towards this goal in 2022/23. The Smith government maintained that commitment in its Mid-Year Fiscal Update.

However, with oil prices fluctuating and additional spending announced to help Albertans cope with high inflation, the final surplus this year is still unknown. We believe there is an opportunity to add our other two "big rocks" to provincial government priorities and, by so doing, further position Alberta for a sustainable fiscal future.

After the 2023/24 fiscal year, we believe economic conditions in Alberta and globally will have changed enough to warrant a re-evaluation and potential rebalancing of these priorities, although the three categories will likely remain. In the meantime, by using the surplus strategically in these three areas, we believe the province will be set up to prosper in the long term.

Debt Repayment

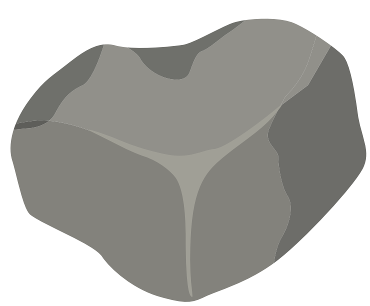
The second item in the formula, but the most important in terms of total expected investment, is debt repayment. It would be fair to call this the most significant priority of the Three Big Rocks Formula under current conditions.

Background

For this year and the next, the top priority should be for the provincial government to pay down its outstanding debt.

To be clear, government debt (and the deficits that create debt) is not inherently bad. Deficit spending may be needed to help Albertans through challenging times (think immediate COVID response), jump-start a struggling economy (think of COVID recovery spending), or finance large projects that yield long-term benefits.

However, persistent deficits (and therefore rising debt) create debt servicing payment obligations which, if they grow too large, can crowd out spending on important goods and services, like healthcare, education, or infrastructure. This is especially an issue in a period of rising interest rates. **In 2022/23, Alberta will spend $2.7 billion servicing its debt. This is not pocket change; it is about half the amount we spend on post-secondary education across the province every year.**



Assessment

By reducing its overall debt, Alberta will pay less to service that which remains. University of Calgary Economist Dr. Trevor Tombe found that for every $1 billion in debt reduction, Albertans save about $30-40 million in debt servicing costs—money that can be redirected toward other things like education, health and capital investment.

Of course, this decision comes at a cost—the revenue foregone by not investing it instead. Historically, the Heritage Fund has returned an average of 8.9% per year. So, a dollar of debt repayment saves, on average, three or four cents, while a dollar invested earns, on average, more than double that amount—almost nine cents.

However, this general long-term trend is unlikely to hold true in the next year or two. For one, as interest rates climb, the cost of servicing existing debt increases, meaning the financial benefit of repaying that debt is higher as well. And second, slower economic growth and the risk of a national or global recession in 2023 will likely result in continued lower returns on equity investments. In this context, the savings associated with debt repayment will likely exceed the income from savings in the short term.

In many ways, the allocation of money between debt repayment and investment in the Heritage Fund (or any other savings vehicle) is merely an accounting exercise with the same result—additional freed-up cash. However, debt repayment may have an advantage because it could make it more difficult for future governments to overspend—at least for as long as the budget remains in balance. A large investment or contingency fund is cash on the balance sheet that could appear to be readily available to spend without affecting the budget balance. But allocating funds to debt repayment means that future governments will either need to go into deficit or raise taxes to finance new spending. Neither option is preventable, but both come with political costs that are not as obvious when governments are spending cash they have on hand.

Economic Theory

The return on investment, however, does not always exceed the cost savings of debt repayment. According to economic theory, the reason equity investments usually provide higher returns than bonds is because they are riskier. The difference in return between the two is the implied cost of that risk. Once that is accounted for, there is no theoretical difference between debt repayment and investment.

Debt repayment offers other advantages as well. For one, it creates the fiscal room that might be needed one day to recover from a recession or withstand a pandemic. It can also improve the province's credit rating and lower future interest payments.

There is also an intergenerational equity argument. Large or growing debt today is the promise of tax increases or spending cuts tomorrow. For that reason, paying down current debt reduces the burden on future generations.

And finally, there is an intuitive simplicity to debt repayment that will likely receive broad-based support from Albertans across the province. Even if investing the money were to yield a higher return, there is a psychological comfort that comes from debt repayment: paying off your credit card may provide more mental relief than maintaining a balance on it and prioritizing a growing investment portfolio. Perhaps, for this reason, **years of research and polling have demonstrated that balanced budgets, low government debt, and fiscal prudence are core values for Albertans.**

RECOMMENDATION

Following a $1 billion investment in the Heritage Fund, in 2022/23 and 2023/24, the provincial government should allocate 80% of the remaining surplus to debt repayment.

PRINCIPLE	ASSESSMENT	
Future-focused: It should set the province up for a stronger long-term fiscal state	✓	It creates fiscal resilience, future spending capacity, and frees up money that would otherwise be spent on debt servicing costs.
Strategic: It should promote competitiveness, economic opportunity, and investment	○	While not directly strategic, debt repayment creates the flexibility to be strategic going forward.
Equitable: It should maximize the benefit for future generations	✓	Future generations will not be left with high debt-servicing costs that erode their spending capacity.
Clear: The plan should be easy to communicate to Albertans to encourage broad buy-in	✓	The value of paying down provincial debt is easily understood and broadly supported by Albertans.

Strategic One-Time Spending

Background

The second priority should be for the provincial government to use some of its revenue windfall for major one-time investments in strategic initiatives that position Alberta for long-term economic success.

The world is changing in big ways. Digitization, automation, and artificial intelligence are changing the nature of work and the skills needed to do them. Countries around the world are decarbonizing and looking for new sources of low-emissions energy, and investors are increasingly shifting capital toward low-carbon opportunities. Populations are aging, urbanizing, and becoming more diverse. And lastly, productivity growth is increasingly expected to be driven by innovation, highlighting the growing importance of investing in research and development, technology, and business scaling.

These realities are not unique to Alberta. Other jurisdictions around the world are dealing with the same global trends and forces. What is perhaps unique to Alberta is that the province is in a better position to adapt to and capitalize from them.

In the past, the provincial government has had some success with strategic investments when not politically driven. For example, in the early 1970s, the government established the Alberta Oil Sands Technology and Research Authority (AOSTRA)—a Crown Corporation tasked with unlocking Alberta's vast oilsands resources and enhancing recovery of conventional oil deposits. The government invested over $1.4 billion in innovation, and AOSTRA developed technologies (e.g., stream-assisted gravity drainage) that changed the industry, and Alberta's economic future, forever. More recently, the Alberta Enterprise Corporation (AEC) has enabled a number of Alberta success stories in tech through its sector leadership and expertise, deal flow, and model of ensuring venture capital firms are based in the province.

That said, not all government-led strategic investments have been successful. Indeed, there have been more failures than successes over the years. But that doesn't mean governments cannot invest in a way that positively shapes future economic growth. Rather, it highlights the difference between opportunity and execution.

Assessment

Alberta's fiscal windfall creates an opportunity to respond to the trends and forces shaping the economy of the future. We can use the surplus to stake out a leadership role in solving major global challenges or adapting to the changing world around us.

Building on BCA's recommendations in Define the Decade, Alberta could use its revenue windfall to build the infrastructure needed to enable future economic opportunity—things like province-wide high-speed broadband access, or developing an integrated economic corridor stretching from Fort McMurray to Medicine Hat and Lethbridge.

Alberta could also use the surplus to invest in areas of emerging opportunity where the province is well-positioned to succeed: a world-leading hub of low-carbon energy investment and innovation; helping Alberta become a world leader in carbon capture, utilization, and storage (CCUS) or other emissions reduction technologies; taking on a leading role in using ag-tech to enhance sustainability; or becoming the next hotspot for biomedical technology.

While BCA is not in a position to recommend precisely how funds should be deployed, we know that any strategic government investments, whether in infrastructure or technology, must be made with an eye to the future. This is not about building a few new roads or supporting one particular company. It is about using Alberta's revenue windfall to create the conditions needed for future economic success and prosperity for all Albertans.

There are many ways that windfalls could be deployed towards strategic one-time investments. Ideally, decisions on how to allocate these funds should be made at arms-length from government. And to the extent possible, they should be business-led, technology- and sector-neutral, and have a focus on creating opportunities for the province in the digital, low-carbon, innovative economy of the future.

One example might be to create an Alberta Mission Agency as BCA recommended in Define the Decade.

That said, there are pitfalls to avoid. As suggested earlier, AOSTRA and AEC aside, governments typically have a poor record when it comes to "picking winners." All too often, economic development strategies and targeted government investments fall short of expectations or even miss the mark entirely. The goal behind setting aside money for strategic investment is not to create a government agency that decides where money should flow. Instead, it is to enable the private sector to innovate, invest, grow, and develop solutions for the world's most challenging problems.

And finally, strategic investments should be structured in a way that avoids significant ongoing operational spending to support them. Every new road requires repair and upkeep. Care should be taken to prioritize meaningful investments or supports that have the potential to generate long-term economic benefits.

It will take time to create a body capable of determining where strategic investment funds should be allocated. In the meantime, the Alberta government should begin building a pool of capital to be disbursed by that body. The bottom line is that the province's current revenue windfall provides an opportunity to invest in Alberta's long-term economic success. That opportunity should not be ignored.

RECOMMENDATION

Following a $1 billion investment in the Heritage Fund, in 2022/23 and 2023/24, the provincial government should allocate 20% of the remaining surplus to an arms' length fund for strategic investments in Alberta's future.

PRINCIPLE		ASSESSMENT
Future-focused: It should set the province up for a stronger long-term fiscal state	✓	It sets a bold course to secure Alberta's economic future.
Strategic: It should promote competitiveness, economic opportunity, and investment	✓	It is outcomes-based and rooted in Alberta's existing strengths in entrepreneurship and innovation.
Equitable: It should maximize the benefit for future generations	✓	It does not create ongoing spending obligations for the province while creating future opportunity in new areas.
Clear: The plan should be easy to communicate to Albertans to encourage broad buy-in	✓	It builds on Alberta's legacy of government and industry collaboration to advance economic prosperity.

Invest in the Heritage Savings Trust Fund

Background

The third priority should be for the provincial government to make significant investments in the Heritage Savings Trust Fund.

The Heritage Fund is Alberta's primary long-term savings vehicle, established in 1976 to save a portion of Alberta's natural resource revenue for future generations.

At its outset, 30% of the province's annual non-renewable resource revenue was committed to the Fund. However, because of challenging economic conditions, investment in the Fund slowed and, by 1987, stopped completely. Since then, the Fund has been largely neglected, as the government transferred net earnings to general revenue and prioritized debt repayment over investment in the Fund. At present, the Fund is worth about $18 billion. However, studies show that if the government had only invested in it just enough to keep up with inflation, it would be worth about twice what it is today.

More recently, the Alberta government has taken modest action to build the Heritage Fund. Pending legislative amendments, the government committed to retaining and re-investing all of the Fund's earnings rather than transferring the investment income to general revenue. Furthermore, in the August 2022 First Quarter Fiscal Update and Economic Statement, the province announced that it would use a small portion of the 2022/23 surplus to make a $1.7 billion deposit into the Fund. While that amount is relatively modest, it would have represented the single largest transfer into the Heritage Fund since its inception. The Smith government, however, changed tack, choosing to forego transferring any of the surplus to the Heritage Fund and, instead, set aside $5.8 billion for allocation between debt repayment and savings at a future date.

Assessment

The Heritage Fund is often called Alberta's "rainy day" fund. However, this characterization is misleading. The purpose of the Fund was not to collect money to have on hand to spend when times were tough; it was to save some of Alberta's non-renewable resource revenue for future generations.

The idea was to create a permanent revenue stream from what amounts to the one-time sale of an asset (a barrel of oil). Once a (non-renewable) barrel is sold, it's gone and cannot be sold again—unlike, for example, personal income, which can be taxed every year. So, by saving and investing royalty revenues in the Heritage Fund, Alberta can turn that asset sale into a revenue stream because the investment earns a yearly return. These returns are generally more stable than resource revenues themselves. And more importantly, they allow future generations of Albertans to also benefit from our resource wealth.

In normal economic circumstances, this would be BCA's highest priority. However, we are not in normal economic circumstances. As mentioned above, while the Fund has historically provided a higher rate of return compared to the cost savings associated with debt repayment, that is unlikely to be true in the immediate term. As such, we believe debt repayment should be prioritized in this environment of rising interest rates and slowing economic growth.

That said, it remains prudent to save resource revenues, rebuilding the value of the Heritage Fund for future generations of Albertans and preparing for when resource revenues are not as high. For that reason, we believe that the government should commit to making modest but fixed annual investments in the Heritage Fund this year and next. In addition to making some modest progress on saving for the future, doing so will signal to Albertans that the government is committed to preserving some of our wealth for future generations.

Looking beyond a two-year time horizon, when inflation subsides, the economy recovers, and substantial progress has been made on debt repayment, investing future surpluses in the Heritage Fund should be Alberta's highest priority.

RECOMMENDATION

In addition to re-investing fund earnings, the provincial government should invest $1 billion in the Heritage Fund in 2022/23 and 2023/24. If significant surpluses persist after 2023/24, the amount invested in the Fund should be increased.

PRINCIPLE		ASSESSMENT
Future-focused: It should set the province up for a stronger long-term fiscal state	✓	It starts the process of rebuilding the value of the Fund, creating a reliable and permanent future revenue stream.
Strategic: It should promote competitiveness, economic opportunity, and investment	✗	It does not directly promote competitiveness, economic opportunity, or investment.
Equitable: It should maximize the benefit for future generations	✓	It saves a portion of non-renewable resource revenue for future generations.
Clear: The plan should be easy to communicate to Albertans to encourage broad buy-in	✓	A $1 billion annual transfer demonstrates a concerted commitment to the Fund while balancing more pressing priorities.

Conclusion

Alberta is in a position where global forces are expected to keep oil and gas prices elevated, meaning that, so long as spending remains in check, the province will likely see large surpluses for the next couple of years.

When it comes to allocating those surpluses, we believe that debt reduction should be Alberta's highest priority this year and next, with smaller amounts earmarked for creating a fund for future strategic investments and for building up the Heritage Fund.

Should large surpluses persist beyond that point, the three big rocks will likely remain, but the allocation proposed in this paper should be re-evaluated and likely adjusted to prioritize long-term savings so that future generations of Albertans benefit from today's resource wealth.

It is important to remember that Alberta's fiscal windfall is just that—a windfall. It does not represent a fundamental shift in the province's fiscal fortunes. Resource royalties will continue to be volatile and uncertain, and their long-term future is unclear as global fossil fuel demand is expected to fall in the coming decades.

These realities highlight the importance of solving the province's longer-term problem: how to transition to a more stable and sustainable revenue model. The Business Council of Alberta will study this issue as part of our 2023 research agenda. Put simply, Alberta must find a way off the resource revenue roller coaster. The good news is that our current fiscal upswing means we can begin exploring that challenge from a position of strength.

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