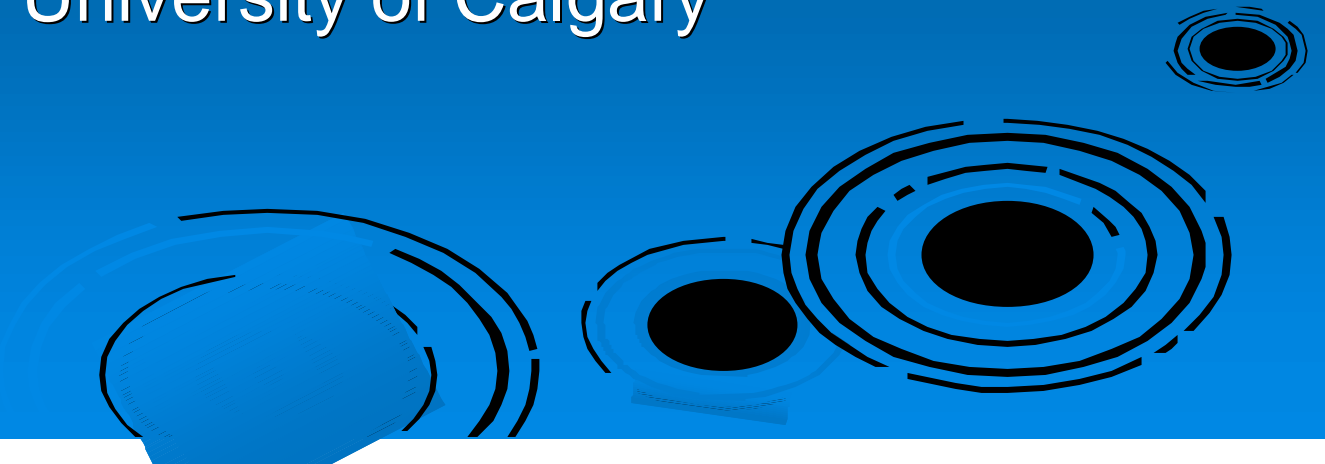


The Feasibility of a 50% Saving Rule for Alberta

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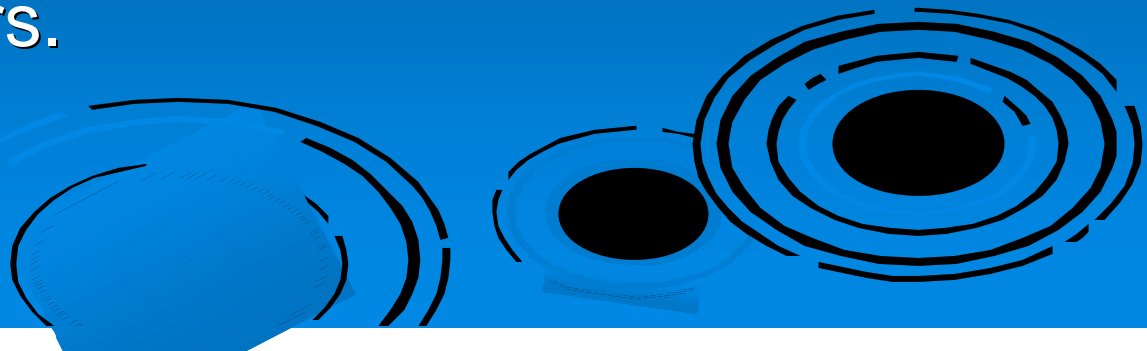
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The Issue

- Saving a substantial portion of the revenue collected from the sale of a non-renewable resource is good economics. But can it be made good politics so that the good economics can become actual policy?
- Why is this difficult to do? The more it chooses to save, the higher will tax rates need to be and/or the less generous will current spending need to be.
- Saving therefore requires a political commitment to protect future taxpayers against the interests of current voters.



The Issue

- Question: Can the government afford to commit to saving 50% of the non-renewable resource revenue it collects without requiring draconian cuts to current programs or increases in current tax rates?
- In coming to grips with this issue, the first problem is that non-renewable resource revenue is volatile. This makes any commitment to saving problematic.



The Issue

- An Example: Suppose
 - Spending = \$25 billion
 - Tax Revenue = \$20 billion
 - A gap between Spending and Tax Revenue of \$5 billion
 - Suppose Resource Revenue = \$10 billion
- To avoid a deficit, \$5 billion of resource revenue must be used to cover spending. That leaves \$5 billion (50%) of resource revenue to be saved
- But if Resource Revenue is only \$5 billion, saving = \$0 (0%)

The Issue

- The example illustrates that the commitment to save 50% of non-renewable resource revenue must be a commitment to do so over the long-term. It is not possible to commit to save 50% of non-renewable resource revenue each and every year.
- If we can obtain a picture of long-term spending commitments and the long-term revenue effects of current tax rates, we get an idea of the long-term gap between spending and tax revenue.
- This gives us an idea of how large must be the amount of resource revenue committed to deficit-avoidance and so how much is available for saving.

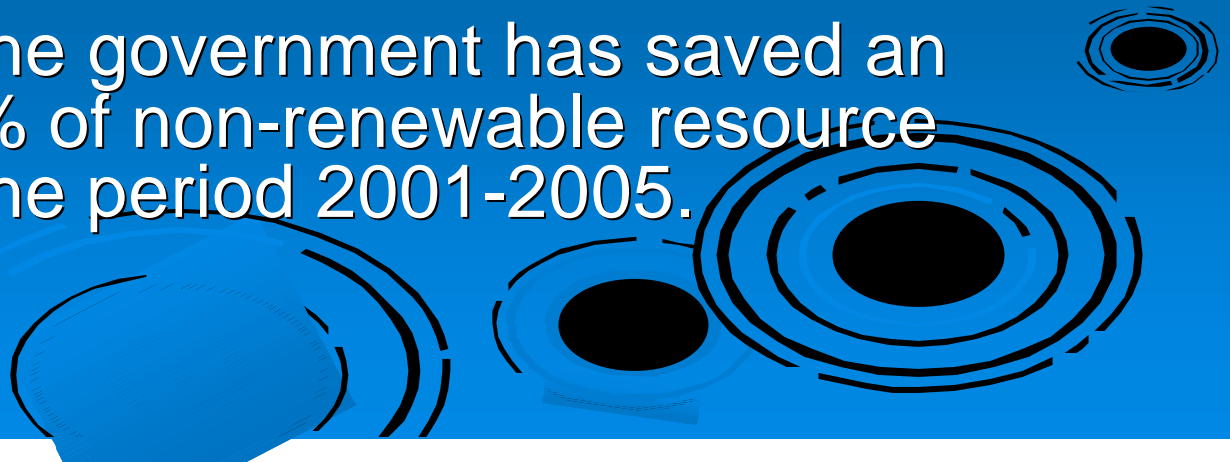


How Has the Government Done?

- In the decade prior to the budgetary reforms introduced by the Klein government in 1994, the provincial government's long-term spending commitments and tax revenues were such that it was able to save none of the non-renewable resource revenue it collected.
- The gap between spending and tax revenue was so large that resource revenue was unable to bridge the difference.
- The result was string of large deficits, mounting debt, and crowding out of program spending by interest payments on debt.

How Has the Government Done?

- Budget reforms after 1994 closed the gap between long-term spending and tax revenue sufficiently that the government was in a position to save an average of 56% of non-renewable resource revenue over the period 1995-2000.
- Over the period 2001-2005, the gap between spending and tax revenue has widened due to tax cuts and re-investments in health and education.
- Nonetheless, the government has saved an average of 45% of non-renewable resource revenue over the period 2001-2005.

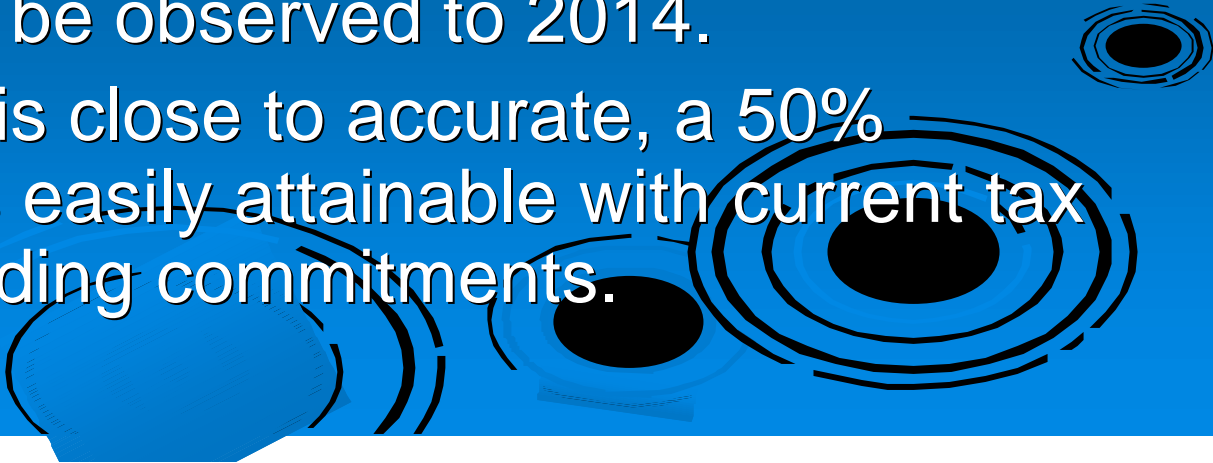


How has the Government Done?

- The recent past certainly suggests that a commitment to save 50% of non-renewable resource revenue is feasible without the need for large tax rate increases or cuts to programs.
- The government has established spending commitments and set tax rates at levels that currently allow it to hit the 50% saving target.
- The current government has shown the political commitment to protect the interests of future taxpayers.



How will the Government do in the Future?

- But, there are clouds on the horizon;
 - Health care costs are increasing rapidly. This will widen the gap between spending and tax revenue and so make saving more difficult.
 - Are the current prices of oil and natural gas exceptional or the new norm?
 - The AEUB recently published a forecast suggesting current prices for oil and natural gas will continue to be observed to 2014.
 - If that forecast is close to accurate, a 50% saving target is easily attainable with current tax rates and spending commitments.
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How will the Government do in the Future?

➤ More clouds;

- Will the government be able to resist the urge to splurge? To its credit, it has imposed rules designed to limit its dependence on non-renewable resource revenue. The current rule requires that the government base its spending on no more than \$4.75 billion of non-renewable resource revenue. The rest must be saved.
- Unfortunately, the rule is decidedly *ad hoc*. It has changed every year for the past 3 years in a way that reduces saving.
- A commitment to spending control is an integral part of any commitment to saving. Recent signs that the government has abandoned 3-year business plans in favour of “flying by the seat of Ralph’s pants” spending decisions are not encouraging.

Conclusion

- *A Hard Rain's A-Gonna Fall* when non-renewable resources are depleted and we have not saved sufficiently for that day.
 - The citizens of Alberta need a clear and irrevocable commitment from their government to prepare for that day. My analysis of the government's future spending and revenue prospects suggests this would not be a politically expensive commitment.
 - The government has yet to make that commitment. Until it does, Alberta's future is uncertain.
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