Backgrounder A:
The Evolution of Alberta's Fiscal and Savings Policies, 1976 to Present

Overview

Since the energy boom of the mid-1970s, the Province of Alberta has faced significant challenges regarding the allocation of its non-renewable resource revenues and, more broadly, in charting a stable and sustainable fiscal course in an environment of uncertain and volatile resource income. Over the intervening three-and-a-half decades, the province's policy approach to these challenges has changed numerous times, in response to evolving (and, at times, highly volatile) economic and fiscal circumstances.

1976 to 1987

With the rapid growth in energy revenues beginning in the mid-1970s, there was recognition within government of the need to save some of the revenue generated from the sale of non-renewable resources.

As a result, the province established the Heritage Savings Trust Fund in 1976, with a requirement that 30 per cent of the province's non-renewable resource revenues be transferred to the fund each year. In addition to serving a savings function, the mandate of the Heritage Fund allowed up to 25 per cent of the fund's assets to be invested in capital projects. Furthermore, in order to facilitate economic development, the fund established an Alberta Investment Division, which made investments in and loans to Alberta-based corporations.

By the 1985-86 fiscal year, the value of the Heritage Fund had reached $12.7 billion. However, in the early 1980s, fiscal pressures from a major recession brought changes to the policies governing the Heritage Fund. Beginning in 1982, the fund's investment income was included in the province's general revenues, rather than being retained by the fund (over the past three decades, about $30 billion of Heritage Fund income has been transferred to the province's General Revenue Fund (GRF) to support government programs and services). In addition, the share of the province's annual non-renewable resource revenues transferred to the Heritage Fund was reduced from 30 to 15 per cent in 1983, and then eliminated entirely in 1987.

During this period (in 1986), the government also established a Capital Fund to finance a variety of health, post-secondary, and water resources projects. The Capital Fund remained in operation until 1994 when its activities were consolidated within the GRF.

1987 to 1993

Alberta recorded budget deficits every year during this period, part of a run of nine consecutive deficits. The government's focus turned away from savings in the Heritage Fund towards deficit containment – largely on an ad hoc basis through spending restraint, rather than through legislated fiscal rules.

However, these ad hoc policy measures were ultimately unsuccessful in eliminating the budget deficit, and in 1992, the Alberta Government brought forward direct statutory limits on aggregate provincial spending through the *Spending Control Act.*

The act was designed to limit aggregate spending growth to prescribed limits of 2.5 per cent in 1992-93, 2.25 per cent in 1993-94 and 2.0 per cent in 1994-95. However, the *Spending Control Act* had a number of provisions which permitted exclusions to the prescribed spending limits, and was repealed in 1993 with the passage of the *Deficit Elimination Act* (DEA).

1993 to 2003

During this period, the government's focus turned towards eliminating the deficit and the debt. These objectives were met largely through legislated fiscal rules. Several rules-based frameworks were enacted -- most notably, the *Deficit Elimination Act* of 1993, the *Balanced Budget and Debt Retirement Act* of 1995 and the *Fiscal Responsibility Act* of 1999. These frameworks included requirements for balanced budgets, debt retirement, prohibitions on debt (especially operating debt) and restrictions on the amount of non-renewable resource revenue that could be used for budget purposes.

In early 1993, the government established the Alberta Financial Review Commission to review the province's finances and accounting practices. Among other things, the commission recommended that the government follow Generally Accepted Accounting Principles, implement three-year fiscal and business plans, report quarterly to Albertans on the state of the province's finances, and eliminate the deficit. These recommendations were all accepted by the government.

<u>The Deficit Elimination Act, 1993</u>

The *Deficit Elimination Act* (DEA*)* formalized in legislation the government's commitment to eliminate the deficit. The act set annual deficit targets and required the budget to be balanced in four years. Higher-than-budgeted revenue and profits from the sales of assets were required to be used first for reducing the deficit, and then debt. The act required prudent forecasting – resource revenue estimates could not exceed the most recent five year average. The DEA also mandated expanded reporting requirements including quarterly fiscal updates from the Provincial Treasurer.

The government was able balance the budget by 1994-95 (two years earlier than scheduled in the DEA) due to higher than expected resource revenue, larger-than-expected surpluses of funds and agencies, and tightly controlled spending.

The Balanced Budget and Debt Retirement Act, 1995

Once the deficit was eliminated, the government's next priority was to eliminate the net debt. This commitment was legislated through the introduction of the *Balanced Budget and Debt Retirement Act* (BBDRA).

The BBDRA required the province's $8.3 billion net debt, excluding pension liabilities, to be eliminated in 25 years. The requirement for a balanced budget remained in place. All surpluses had to go to net debt reduction, and payment of at least $100 million was required each year. Prudent revenue forecasting continued – the budget forecast for both resource revenue and corporate income tax had to be the lower of the five-year average of actual revenue or 90 per cent of the government's forecast of expected revenue.

Strong revenue growth and controlled spending helped eliminate net debt within four years of the BBDRA's passage.

Government Accountability Act, 1995

This period also saw the government move forward with legislated improvements to fiscal planning and reporting through the passage of the *Government Accountability Act* (GAA) in 1995.

The GAA established such practices as three-year consolidated fiscal plans ('the budget'); three-year business plans by all government ministries; government and ministry annual reporting; and an increased focus on performance and results reporting through *Measuring Up*.

Alberta Heritage Savings Trust Fund Act, 1996

In 1995-96, the government consulted with Albertans about the future of the Heritage Fund. Albertans indicated that they wanted to keep the Fund for future generations and focus on generating better returns on long-term investments.

As a result, in 1996, legislative changes (*the Alberta Heritage Savings Trust Fund Act*) narrowed the mandate of the Heritage Fund to one focused on maximizing financial returns. The government stopped funding Alberta capital projects and economic development activities from the fund. In addition, the new legislation allowed the fund to retain some of its investment income for the purpose of inflation protection.

Fiscal Responsibility Act, 1999

The *Fiscal Responsibility Act* (FRA) was enacted in 1999 to deal with the remaining accumulated debt. Under the FRA, the accumulated debt had to be paid off in 25 years, and the requirement for a balanced budget was maintained.

Budgets were required to include an economic cushion equal to 3.5 per cent of revenue, to protect against weaker than expected revenue and/or emergencies and disasters. Seventy-five per cent of the economic cushion had to be allocated to pay down debt, and the remaining 25 per cent was to be allocated to a contingency reserve. If revenue was higher than budget estimates, the additional surplus was to be allocated in the same manner as the economic cushion.

2003 to 2009

In 2002, the government established the Alberta Financial Management Commission to recommend changes to the fiscal framework, to reflect the new realities of increased revenue volatility, both in-year (i.e., within a given fiscal year) and year-to-year. Among its recommendations, the commission recommended new mechanisms for short-term fiscal risk management and improvements to capital budgeting practices.

The government responded to the commission by establishing an Alberta Sustainability Fund to protect the fiscal plan from revenue volatility and to fund emergencies and disasters. For budgeting purposes, non-renewable resource revenue was capped at $3.5 billion per year (increasing to $5.3 billion by 2009), and excess amounts were deposited in the Sustainability Fund. The economic cushion was reduced to 1 per cent of forecast revenue (from 3.5 per cent). The requirements for balanced budgets and debt retirement were retained.

As well, a Capital Account was created to provide an additional source of funding for capital projects. Funds allocated to the Capital Account could be used to fund projects in future years, and capital funding could be carried over from one year to the next.

The accounting treatment of capital investment also changed. Capital expenditures on government-owned assets were no longer immediately and fully charged to the bottom line in the current fiscal year; instead, the expense was now amortized over the expected life of the asset, consistent with the Public Sector Accounting Board standard on the accounting treatment of capital assets.

2009 to the present

The global recession which began in 2008 required additional adjustments to Alberta's fiscal policies and legislated fiscal framework. The fiscal framework adopted in 2003 was focused on establishing limitations during times of revenue growth. The magnitude of the recession's fiscal effects (which included a $6.9 billion decline in projected non-renewable resource revenue for 2008-09 in the span of just nine months) required a revised fiscal framework, featuring greater flexibility.

Among the significant changes introduced through the *Fiscal Responsibility Act, 2009* were the following: the assets of the Capital Account were transferred to the Sustainability Fund, budget deficits were now permitted (if there were sufficient funds available in the Sustainability Fund to offset them) and limitations on the amount of non-renewable resource revenues that could be used for budget purposes were eliminated.

Both prior to and after 2009, the act permitted borrowing for capital purposes. This facilitated the development of public private partnerships (P3s), as they contain a borrowing component. After 2009, the Government of Alberta also undertook direct borrowing for capital purposes, signaling interest in a three year borrowing program of $3.3 billion. However, subsequent improvements in the fiscal situation resulted in only $1.5 billion actually being borrowed.

In fiscal year 2011-12 the Government also began borrowing on behalf of Alberta Treasury Branches and the Alberta Capital Finance Authority (as has been the practice with Alberta Financial Services Corporation). This allowed these entities to take advantage of the Government of Alberta's AAA credit rating.