A BETTER FUTURE:

FISCAL RECOMMENDATIONS TO POSITION ALBERTA FOR SUCCESS

Todd Hirsch

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A MESSAGE FROM RACHEL NOTLEY

Albertans' priorities are clear.

They want and deserve excellent public healthcare and a top flight public education system. They want a dynamic, innovative and competitive economy. They want a government that is responsive to the cost of living challenges. They want a government that can live within its means.

We can achieve all these things.

But let's be clear, the Government of Alberta relies on Natural Resource Revenues (NRR) to pay for the basics.

We have to think through what that means, and what that means when extraordinary NRR flows into the provincial government coffers. In the summer of 2022, when it was clear that Alberta would realize extraordinary NRR, I proposed that the majority of the surplus should be saved and invested for the future.

I also committed to five key principles that should guide the province's handling of the expected windwall.

Those principles were:

- *Recognizing this revenue is unreliable and simply cannot be used for ordinary operational spending.*
- *Focusing on getting the best return on investment, through consultation with Albertans and financial experts from Alberta and around the world.*
- *Recognizing Alberta will not get off the revenue rollercoaster without real progress on diversifying the economy and creating sustainable, long-term jobs.*
- *Immediate action to help Albertans facing an emergency cost-of-living crisis, one not seen in four decades.*
- *Repairing the damage done to the public healthcare and education systems.*

In the fall of 2022, I asked Todd Hirsch, the former Chief Economist at ATB Financial, to consult with experts and develop recommendations informed by these principles that could help stabilize the province's finances and build a more resilient economy.

At the time this report is being released, we are again witnessing volatility in energy prices.

But what is clear from recent history - with truly historic Natural Resource Revenues (NRR) - is that we need to be strategic. We need a plan. We need long term guidance on the best path forward. We need a better fiscal future.

I am honoured that one of the province's most insightful economists agreed to undertake this project.

His insightful guidance and recommendations are designed to stand the test of time.

I am pleased to share his report with my fellow Albertans.

Rachel Notley

A MESSAGE FROM TODD HIRSCH

Having weathered three years of recession, two major oil price collapses, a 40-year high rate of inflation and a global pandemic, Alberta has had its share of challenges over the past decade. Not only have times been difficult for many Alberta households, the years have been hard on the provincial government's financial situation.

It is said that history doesn't repeat itself, but it does rhyme. And once again, the situation has taken a turn for the better. Stronger resource prices in 2022 – much of that related to geopolitical strife in Europe – has generated yet another windfall of resource income for the province.

The financial surplus expected in fiscal 2022-23 could top $10 billion, more than 20 times what was originally budgeted. Because resource prices could remain high for some time, and because many oilsands projects in Alberta are close to reaching higher royalty payouts, more surpluses could be in store for the coming years.

Of course anything could happen. And it could be happening. Threats of a global recession could drag prices down, reducing or even eliminating those surpluses. There is no certainty.

But we must think about the future. And we must have a plan in place for the future.

Drawing on the wisdom and experience of dozens of expert economists, business leaders, labour leaders and community members, this report provides advice and recommendations on how the provincial government should approach fiscal surpluses.

Rather than allowing reckless and haphazard decisions to squander away surpluses, government should be thoughtful and deliberate.

In the full report that follows, I provide 8 concrete recommendations that can help the Government of Alberta approach its budgeting process and design a thoughtful fiscal strategy.

A strategy that provides guidance for longer term fiscal planning, and that helps build a better fiscal future for Albertans.

I am grateful that Rachel Notely asked me to engage in this project, and I would like to thank the 37 individuals and organizations that participated in the development of this report.

Todd Hirsch

INTRODUCTION

Our friends in Australia may enjoy the description of their homeland as The Lucky Country. But if there was a prize for Luckiest Province within a Lucky Country, it would certainly go to Alberta.

By almost any measure – be it GDP per capita, average income levels, educational attainment or low tax environment – Alberta is among one of the most prosperous places on the planet. Our largest city has repeatedly been recognized as one of the most livable cities on the planet by *The Economist* magazine[1].

A great deal of this prosperity and wealth is due to the enterprising spirit of its people. From Indigenous people to the waves of settlers and immigrants over the decades, Alberta has been built on improbable dreams and audacious aspirations. We work some of the longest and hardest hours in the country. The province's official motto is *Fortis et Liber* – strong and free. But our unofficial motto could well be *Anything is Possible Here!*

Yet luck and good fortune have also played a significant role. The natural endowment of hydrocarbon resources is a sheer accident of geography, to which tremendous human ideas, innovations and creativity have been applied. The financial blessing flowing from our oil and natural gas resources have lifted Alberta to its enviable position.

> ***"From its original Indigenous people to the waves of settlers over decades, Alberta has been built on improbable dreams and audacious aspirations."***

Still, for all the advantages that these bountiful resources have brought, we are falling short on many fronts. Homelessness, child poverty, mental health issues, transportation woes, income disparity, overcrowded schools and hospitals, surgery wait times – there is work to be done.

As well, we have allowed ourselves to become somewhat too financially dependent on oil and gas royalties. As a price-taker with no influence over the energy prices we receive, we are at the mercy of global oil and gas economics. World prices are dictated by forces outside our control. From Saudi princes' power plays to military invasions to global recessions, our provincial finances are in a perpetual state of whipsaw. Every Albertan knows the metaphor of the roller coaster we seem to ride.

Inevitably, that financial roller coaster has resulted in both massive surpluses and massive deficits for Alberta's provincial government.

The core question that animated this report is a simple one: *What should Alberta do with its surpluses?* While the question is simple, the nuances and ramifications are immensely complex.

This is not the first time this question has been tackled. However, in 2023, Alberta's situation is different.

Never before has there been as urgent a need to diversify our economy, and take the global stage in solving some of the world's most vexing problems.

This report is the culmination of three dozen formal interviews, consultations with industry and labour leaders, and conversations with economists and academics on how Alberta should consider its budgeting process, and allocate surplus revenue in years when income exceeds expenses.

[1] The Economist magazine, 22 JUNE 2022. https://www.economist.com/graphic-detail/2022/06/22/the-worlds-most-liveable-cities

FISCAL CONTEXT

When thinking about the fiscal surplus in Alberta, it is impossible to ignore the overall fiscal framework that underpins all revenue collection and income, and total spending and other expenses. After all, if the government decided to simply spend every dollar of revenue and income that is collected, there would be no surplus at all.

Surpluses in Alberta are typically driven by extraordinary (and sometimes unanticipated) resource income – and in this province, that is almost entirely from oil and natural gas. When global and continental prices spike, a windfall of royalty cash gushes into the provincial treasury.

The reality is, significant surpluses in Alberta are driven by resource income, not over taxation.

This is an important point. Provincial revenue from taxation, the major source of overall income, is drawn from current economic activity. However, income derived from natural resources is not revenue at all: it is the sale of an asset that is being converted from one form (ie., hydrocarbon molecules in the ground), into another (i.e., money).

“Income derived from natural resources is not revenue at all: it is the sale of an assest that is being converted from one form (i.e., hydrocarbon molecules in the ground), into another (i.e., money).”

To use everyday household finances again as a metaphor, taxation revenue is like the regular paycheques earned by the family’s breadwinners; resource income is like the sale of the family’s antique collection or heirloom jewels, or maybe parceling off and selling bits of the family farm. They are completely different forms of income, and therefore should be considered differently as to how we spend it.

These occasional resource-fueled surpluses are both blessings and curses – although most would agree that it’s heavy on the blessing. The challenge with surpluses is that, unless there is a governance plan in place before a surplus occurs, it can easily be squandered. And that can leave citizens frustrated in hindsight. Many Albertans will remember the famous bumper sticker of the 1980s: “Please God grant us another boom and we promise not to piss it all away!”

The squandering of windfall surpluses is symptomatic of an electoral structure where elected officials are rewarded for short-term thinking. This is not an indictment on politicians or voters at all – it is a four-year election cycle that rewards short-term spending, sometimes hindering long term vision.
This is why it is so important to have a long-term plan in place for allocating surplus revenue, and to the extent that it is possible, not waver from the principles and structure of the plan.

That said, it is important to be realistic about what even the largest imaginable surpluses can and cannot achieve. The list of concerns faced by Albertans in 2023 outlined in the introduction to this report – homelessness, child poverty, mental health issues, transportation woes, income disparity, overcrowded schools and hospitals, surgery wait times – cannot be solved with the magic wand of surplus dollars. All of these issues are larger, longer term challenges that governments both present and future need to address. Surplus dollars may be able to move the needle on some of these issues, but it is not realistic to expect that they be solved or eliminated simply by pouring one-time amounts of money onto the problem.

“We simply cannot allow yet another financial boom without applying wise and careful consideration to how we manage it.”

THE INTERVIEWS

Over the months of November and December 2022, and January 2023, a series of 37 formal, one-on-one interviews were conducted. There were also written submissions, and countless other informal conversations (i.e., various citizens who were simply interested in this project and had some thoughts to share). In the case of the formal, recorded interviews, each participant was asked a simple – yet complex – question: "What should Alberta do with its surpluses, not just this fiscal year, but on an ongoing basis?"

The interviews were lively, with no shortage of ideas and thoughts. Many of the recommendations fell in line with the particular area of interest represented by the interviewees. That was expected, and even though some of the ideas put forward were predictable, they were no less useful and insightful.

It was notable that throughout the interviews, many participants had concrete proposals that government should consider, irrespective of the size of the surplus. This pattern of advice led, in particular, to Recommendation # 4 in this report.

Major Interview Themes:

There was a vast array of ideas and recommendations for what should be done with the surpluses, but there were a few consistent themes that arose:

- **Invest for the Future:** there was a strong and compelling sense that whatever is done with the surplus, we must always think about how it will support the future of Alberta's economy.
- **Diversify the economy:** in addition to the idea of being future-oriented, there was also a desire that the surplus help diversify the economy in the near-term as well.
- **Universal direct cash payments to Albertans not favoured:** although there was some suggestion that rebate cheques/direct cash payments targeted to low-income and most vulnerable might be considered, there was almost no appetite for a general rebate cheque to Albertans.
- **Balanced approach:** with few exceptions, interviewees generally encouraged a balanced approach to dealing with the surplus: some to debt repayment/savings, and some to address current pressing needs.
- **Don't lock in operational spending:** many of the interviewees - though not all - cautioned that whatever is done with surplus dollars, it should not lock the government into higher operational spending in the future (which may not see a surplus). For example, increasing teachers' salaries may be a laudable goal, but extraordinary surplus dollars should not be directed towards this.
- **Move towards a sustainable fiscal framework:** a strong theme emerged that surplus dollars should, in some way, be used to redesign the overall fiscal framework of the province. Specifically, we should move towards less reliance on natural resource income and get off the metaphorical boom-and-bust rollercoaster.
- **Intergenerational equity:** many participants noted that resource income belongs both to current and future Albertans, so whatever is done with surplus dollars should consider the needs and interests of future generations.

RECOMMENDATIONS

The recommendations in this report are divided into two parts:

> **Part A** includes four recommendations that are particularly relevant for a jurisdiction like Alberta that is reliant on non-renewable resource revenues. This set of recommendations is designed to provide considered advice to guide decision makers in their fiscal decision making.
>
> **Part B** includes another four recommendations in relation to budgeting and steps a government should take in order to be prepared to deal with situations of fiscal surplus driven by strong natural resource revenues.

It is my hope that these recommendations will serve any government well, and help Albertans think about the future before us.

Recommendations - Part A

Recommendation #1: Government should assign a fixed amount of non-renewable resource revenues (adjusted annually for inflation) that will be apportioned for base budgeting purposes.

This recommendation is a reflection of what was discussed earlier: that is, income from natural resource royalties are not, in fact, income. They are the conversion of an asset in one form (physical molecules) into another (dollars).

For years, the Government of Alberta has converted physical molecules into dollars, and then transferred those dollars to the government's General Revenue Fund (GRF). Despite being a misnomer, this is what the Government of Alberta refers to as non-renewable resource revenues (NRR). In the current fiscal year, the government estimates it will bring in a historic $28.1 billion in NRR. As Marcia Nelson, the former Deputy Minister of Executive Council, noted early in the interview process: "What to do with the surplus has to start with why we have a surplus. That's non-renewable resource revenues".

It is not surprising that many of the interviewees proposed that the government set aside a fixed amount of non-renewable resource revenues (NRR) that it should allocate for base budgeting purposes, and then stick to it.

University of Calgary economist Blake Shaffer put it well when he acknowledged that we need to set aside some amount of NRR that will go into general revenues every year to help cover the provinces' regular operating expenses, but the goal in the long-run should be to operate without them.

In the more immediate term, if we are going to set aside a fixed amount of NRR the question is how much. On this question, there was no consensus opinion among. But it was made clear that in a post-payout royalty environment, where NRR is expected to be high, government should establish a fixed amount that can be used for base budgeting purposes. Any incremental amount above that threshold should be considered real surplus dollars.

This recommendation, along with others in the report, is key to constraining and moderating growth in government spending. Absent this approach, when NRR are very high, it is far too easy for governments to lock in higher rates of spending.

This first recommendation is not new in its origin. In the past, various provincial governments have attempted to limit a dollar value maximum of NRR that can flow into general revenues.

The problem historically with this approach is that it lacked permanence. As the provincial economy grows, more people live in Alberta, and inflation takes hold, that fixed amount needs to be adjusted. Hence the caveat built into this recommendation: that the fixed amount be adjusted annually for inflation, including population growth.

Determining the appropriate amount of NRR that can go towards base budgeting is a question for government, and beyond the scope of this report. While the amount matters, what is more important, as another former Deputy Minister of Executive Council Richard Dicerni noted, is that this approach becomes "institutionalized."

Recommendation #2: Government should consult with Albertans, and consciously determine a goal and purpose for the Alberta Heritage Savings Trust Fund.

When the Alberta Heritage Savings Trust Fund (AHSTF) was established in the 1970s, it was done to protect Alberta from a time when our oil resources would be depleted. It became known as "the rainy day fund."

Since that time, and with no deliberate decision making or thought, the AHSTF has evolved into an inflation protected income fund. Each year, the fund generates a return. The base asset amount is indexed to inflation (so the real value of the asset base remains constant) and any surplus is redirected to general revenues.

Transfers to the General Revenue Fund

2021/22: $2.128 billion
2020/21: $1.208 billion
2019/20: $1.471 billion
2018/19: $1.071 billion
2017/18: $1.557 billion

Many participants in the interviews recommended saving at least some of the surplus in the AHSTF. But a broader key question needs to be addressed: What is the purpose of the Heritage Fund and what are we saving for?

It is therefore recommended that the government commission a study, and consult broadly with Albertans, on the future of the AHSTF. The end result would be a specific purpose for the fund, and set strict parameters around how and when the funds (or income derived from it) are to be used.

If we do start investing significantly more dollars into the AHSTF, as per the recommendations of this report, then we need to answer the question directly: what are we saving for?

What about Norway?

Norway's sovereign wealth fund (formally named the Government Pension Fund Global) is often raised as an example for Alberta. The aim of the Nordic country's fund is to ensure responsible and long-term management of revenue from the nation's oil and gas resources, so that this wealth benefits both current and future generations.

According to the Norges Bank Investment Management: "In 1990, the Norwegian parliament passed legislation to support this, creating what is now the Government Pension Fund Global, and the first money was deposited in the fund in 1996. As the name suggests, it was decided that the fund should only be invested abroad. Oil revenue has been very important for Norway, but one day the oil will run out. The aim of the fund is to ensure that we use this money responsibly, think long-term and so safeguard the future of the Norwegian economy."[2]

What Norway has done with its oil and gas revenue is admirable, but what works for Norway is not necessarily the best model for Alberta.

The fund is presently valued at approximately 12.5 trillion NOK ($1.7 trillion Canadian dollars).

The comparison between Norway's wealth fund and Alberta's own Heritage Savings Trust Fund was made repeatedly by several participants in the formal interviews. However, most of those who raised the Norwegian example understand the limits to the comparison.

- Norway is a sovereign nation with its own currency;
- it is not part of a confederation in the same way Alberta exists within Canada;
- Norwegians pay a 25 per cent VAT, compared with Albertans who pay a 5 per cent GST and no provincial sales tax at all; and
- the history and social context of Norway is entirely different from Alberta.

In short, what Norway has done with its oil and gas revenue is admirable (and perhaps Albertans are a bit jealous). Still, what works for Norway is not necessarily the best model for Alberta.

As one interviewee put it, "Had Alberta amassed a pot of money even a fraction of the size of Norway's, it would put an enormous target on us within Canada."

Nonetheless, even with these differences in mind, most of the interviewees (and perhaps most Albertans in general) regard Norway's example and think *"Gee, we really should have saved more over the years."*

[2]Norges Bank Investment Management website https://www.nbim.no/en/

Recommendation #3: In the absence of a constructive and thoughtful plan, debt repayment should be the default option for all surplus funds.

As David Dodge, former Governor of the Bank of Canada, put it in one of the interviews: “Paying off debt should be the default; but it is not the best choice.”

This statement is provocative, yet insightful. And it should be viewed in context. With Alberta’s low net-debt to GDP ratio, we should be strategic.

Simply put, we are not at the mercy of bond holders on Bay Street or Wall Street, as was the case with Saskatchewan in the late 1980s and early 1990s. We have choices.

We must acknowledge that debt repayment may not in fact have the highest rate of return (interest earned on savings has historically been higher than what is paid in debt interest), but it is risk-free.

Hence the recommendation above.

However, this recommendation applies only in the absence of a plan.

Through the consultations and interviews with stakeholders, much of the advice centered around the priorities of Albertans. In addition to debt repayment, other priorities include capital expenditure and infrastructure, economic diversification and resiliency, social spending and the “Care Economy,” education, and enabling the energy sector to thrive in a net-zero carbon future.

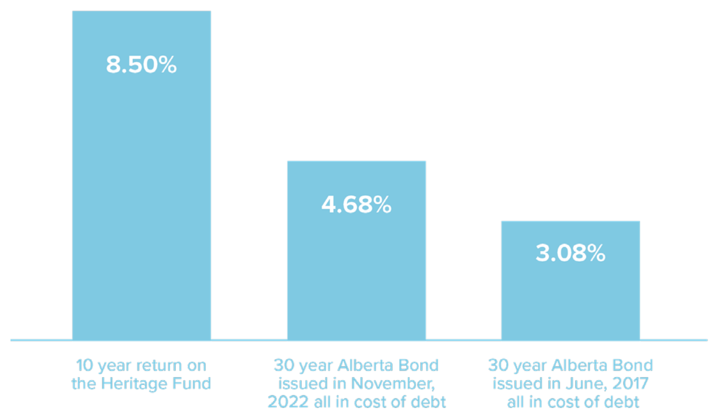
The bottom line on this recommendation is that debt repayment is the default option in the absence of a plan. But we should not be caught once again without a plan that is more reflective of Albertans priorities, and generates a higher long term return.

Discussion: Repaying Debt? Or Save for the Future?

There is an interesting question regarding the balance between debt repayment and savings. From an accounting perspective, the two are immediately equivalent – both lower debt and greater savings count in the same direction when assessing the overall financial balance sheet of the province. For example, a bond rating agency would look at the overall financial balance sheet of the province, including debt and financial assets.

Historical returns have been higher from savings than debt repayment over the long term. Some of the interviewees – particularly those in academia or economics – did not recommend complete debt elimination as a laudable goal. If interest payments on the debt are less than the interest earned on financial savings, it makes no sense to apply any dollars to debt repayment. All dollars, under this logic, would go towards savings.

However, at the time this report was written, the gap between savings and earning interest vs. debt repayment and forgone interest payments has narrowed. If past performance remains a good barometer of future performance, then savings should continue to be prioritized. It’s just basic math. But if the gap continues to narrow, then as University of Calgary Economist Trevor Tombe points out, the risk-free option (debt repayment) becomes more compelling.



Almost every interviewee recommended that at least some of the surplus dollars should go to debt repayment or savings. A few of them went so far as to suggest that all surplus revenue go towards savings, and that the other priorities [i.e., health, education, climate, food security] be dealt with as priorities within the regular budget. How to deal with these issues is addressed in subsequent recommendations in this report.

What is clear from my discussions with Albertans is that we need a plan.

If we are going to save, then we should know what we are saving for (see Recommendation #2). And if government has no plan, then the default should be to pay off debt (see Recommendation #3).

There is a final element to this discussion. While debt repayment may not always be the most financially advantageous choice, it may be the best psychologically for Albertans. Even if the debt is never repaid entirely (and there is no reason why it needs to be), Albertans may simply derive confidence and pride that our debt obligations are lessening. In this respect, as a collective goal, there may be some serious justification for steady debt repayment.

Recommendation #4: The Government of Alberta should maintain the outer bound maximum net debt/GDP ratio of 30 per cent as a fiscal anchor.

Jurisdictions like Alberta that are reliant for budgeting purposes on non-renewable resource revenues must accept that those revenues are volatile. In this context, and relative to other provinces, it is only reasonable that Alberta carries a lower level of net debt to GDP than other provinces.

When challenging times arise, like a major oil price collapse, we need room for public debt to act as a shock absorber. If that fiscal room does not exist, the only option available to government would be a significant increase in taxes or a significant decrease in government spending. Either of those options would likely make a bad situation worse.

Alberta currently has a strong balance sheet, and lowest net debt/GDP in the country, at 9.9 per cent. In a period of what is expected to be surplus budgets, or at least balanced budgets, that ratio will decline as the economy grows. Moreover, as Peter Tertzakian rightly pointed out in one of interviews, since our debt principal is fixed, the current period of higher inflation will drive nominal GDP higher, further improving the ratio.

Net Debt/GDP

Alberta: 9.9%
British Columbia: 13.0%
Saskatchewan: 14.6%
Manitoba: 33.6%
Ontario 39.0%
Quebec: 36.0%
New Brunswick: 26.7%
Nova Scotia: 33.5%
P.E.I 28.4%
Nfld & Labrador: 38.4%

Source: BMO Capital Markets - February 2023)

In the first budget following the onset of the pandemic, as the province was awash in red ink, the government established an outer maximum debt/GDP ratio of 30 per cent as a fiscal anchor. That was a reasonable decision to help guide budget planning, and this report recommends it be maintained.

Recommendations - Part B

What I Heard and Targeted Advice

With only one or two exceptions, most interviewees had thoughtful advice on addressing immediate needs facing the province and setting it up for long-term success. It was common in most interviews that, despite the core question animating this report, participants were concerned that the province has incredible potential that is not being realized, and some targeted investments in these areas could go a long way.

Put simply, a discussion centered on the surplus inevitably led many interviewees to focus on spending priorities for the province.

When asking participants to prioritize which areas of public spending they see as most critical, the answers were – predictably – vast and diverse. However most of the recommended priorities can be grouped into a few broad categories:

1. Healthcare

In the wake of the pandemic, the challenges of health care system in Alberta has been brought into sharp focus. From primary to acute care, and from long-term care to mental wellness, none of this appears to be working to the satisfaction of citizens. It is well beyond the scope of this report to make recommendations for how the system can be made to work, but interviewees repeatedly mentioned how greater financial support could be part of the solution.

2. Quality of Life and the "Care Economy"

The general quality of life in Alberta needs attention. While the province already offers an exceptional quality of life, we must not take that for granted. Investment and reinvestment in arts and culture, sporting facilities, parks and recreation, festivals and social enterprises were mentioned several times. The ability to attract and retain top talent makes focusing on these areas an economic necessity.

A few interviewees spoke passionately about the "care economy" – including everything from home care, early childhood care, community support, life-long learning and seniors' care. These account for roughly 12.6 per cent of the economy as measured by the GDP.[3] Similar to the quality of life argument, attention to the "care economy" will be essential for attracting and retaining people to Alberta. People will move to where everyone – from infants to seniors – are properly cared for.

[3]https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610043402
And also The Care economy. https://thecareeconomy.ca/wp-content/uploads/2021/09/The-Care-Economy.-Data-Room_-Labour-Day_Sept-2021-.pdf

Interviewees also spoke passionately about the people who work in the care economy. The Alberta Federation of Labour noted that many frontline public sector workers have not had a meaningful raise in years, which is extraordinarily difficult in a period of high inflation. Likewise, the Calgary Chamber of Commerce, through our formal interview and in their 2023 Alberta Election Platform, noted that nonprofits and voluntary agencies should be supported "with an immediate increase of 10 per cent to all current operating agreements. Further, commit to indexing all granting programs to inflation."

3. Education, training and skills development

When considering government spending as investments in the future, few areas match education. We are only as good as we are smart, skilled and prepared for a rapidly changing economic environment. What worked for education in the 20th century (which placed a great deal of emphasis on university education and a single career path) is inadequate in the 21st century. Today and in the future, workers will be required to shift career paths, develop new skills throughout their lives and constantly be pivoting as economic opportunities come and go.

On top of academic and vocational programs, there was a strong voice for micro-credentialing and skills development outside of a typical three- or four-year program within a post-secondary institution.

4. Environment, renewable energy and climate change mitigation

Alberta's strength has always been around energy – notably hydrocarbons. And we've been a world leader in extraction and exports of energy to the world. Yet increasingly, the world has a conflicted relationship with hydrocarbons. On one hand, there is undisputed evidence that carbon emissions have done damage to the planet – and time is rapidly running out for us to do something about it. But on the other hand, the world needs energy. And at present, there are no practical ways to sufficiently meet the world's energy needs without hydrocarbons.

> ***Renewable energy, clean energy technology and low-or zero-net carbon energy is what the world needs - and quickly.***

This is a golden opportunity for Alberta to become a global leader. Renewable energy, clean energy technology and low- or zero-net carbon energy is what the world needs – and quickly. Building on our strengths in geology and engineering, and our bountiful solar, wind and geothermal resources, Alberta has excellent potential to provide the world with 21st century energy solutions. To get there, however, requires greater public investment.

5. Agriculture and Food Security

Along with energy, Alberta's other traditional strength has been agriculture. From the 1870s, when explorer and geographer John Palliser described the area now known as Alberta as being entirely unsuitable for agriculture, to the 21st century when Alberta is now a world leader in dryland farming technique and production, we have come a long way.

Building on this strength was seen as a priority area. Food security – around the world and here at home – is rapidly becoming a grave concern. High quality and nutritious food at affordable prices is an area of opportunity for Alberta. This could include diversifying our agricultural production towards more plant-based proteins as well as more locally grown produce and vegetables.

Investments in industrial agri-food zones and improved infrastructure for transportation could be two practical ways to enhance Alberta's agri-food production.

6. Technology and Innovation

Technology has played a pivotal role shaping the modern digital world, and as the years progress will become more ingrained in both the lives of individuals and the way industry operates. Technology and innovation's impact are industry agnostic, ranging from using AI to improve drug discovery, or satellite images used to improve agriculture management, and is often looked at as the only way to meet the targets to address climate change.

Not only does technology play a critical role in progressing Alberta's core industries, including energy, renewables, life sciences, health care, agriculture, food, and construction, it also creates a more diverse and resilient economy.

In recent years, Alberta has seen rapid growth in the number of companies operating, people employed, and dollars invested in the technology sector. With Alberta's young, highly educated workforce and entrepreneurial spirit, this is a unique opportunity to build on the momentum to further diversify the economy, make global impact with home grown innovation, and position Alberta as a major tech and innovation hub.

The Big Issue: What about Diversifying the Economy?

Jurisdictions like Alberta that are reliant for budgeting purposes on non-renewable resource revenues must accept that those revenues are volatile. In this context, and relative to other provinces, it is only reasonable that Alberta carries a lower level of net debt to GDP than other provinces.

One of the guiding principles of allocating surplus dollars, and indeed a major theme in most of the interviews, was the goal of diversifying Alberta's economy.

This question has bedeviled Alberta for generations. Since the days of Premier Peter Lougheed, diversification of our economy away from such an enormous reliance on oil and gas was imperative. Talk of diversification, however, comes and goes. It tends to ebb when oil and gas prices are doing well and the economy is firing at capacity. But the inevitable downturns that follow are marked by much hand-wringing about diversifying the economy.

Yet diversity in and of itself should not be our ultimate goal. Economically, the most diverse province in Canada is arguably Manitoba – it has a uniquely balanced economy including agriculture, hydroelectric energy, manufacturing, services and government. Yet it is not typically held up as an example of an ideal economy.

Rather, our goal in Alberta should be prosperity, stability and dynamism. A diversified economy alone is not a sufficient element to get us there.

The six priority areas listed above:

- Healthcare,
- Quality of life and the "care economy",
- Education, training and skills development,
- Environment, renewable energy and climate change mitigation,
- Agriculture and food security, and
- Technology and Innovation

will not only automatically help diversify our economy, but they will also enhance the other elements we desire: prosperity, stability and dynamism.

A world-leading healthcare system, a high quality of life and excellent care for every citizen will draw people to the province, making us a magnet for skills and talent.

An educated and skilled workforce will boost productivity and innovation, both of which are essential to the dynamic economy we desire.

Globally recognized research and development in renewable energy and clean tech will draw investment dollars from around the world, enhancing our productivity and adding to diversity.

Building on our strengths in agriculture, agri-foods and life sciences will also diversify and stabilize our economy, and help provide solutions to a world in which food security is a growing problem.

In short, diversifying the economy is not an easy task, nor is it the end goal. But by focussing on these six priority areas, we will not only find our economy more diversified, but also more prosperous, stable and dynamic.

> ***Economic diversity in and of itself should not be our ultimate goal. Our goal should be prosperity, stability, and dynamism. A diversified economy alone is insufficient.***

Recommendation #5: The government should establish a strong, credible and sustainable financial plan that will guide both revenues and expenditures.

Before we can even start to consider surplus dollars, we need to have a strong budget plan in place. Without a budget plan that takes into account credible assumptions on revenue and expenditures, the surplus is really just as much or as little as the government of the day chooses. It is arbitrary.

Albertans deserve better than arbitrary.

Through a strong commitment to the priorities of citizens on issues such as healthcare, education and quality of life, the government should decide what truly needs to be done, and then find the money to do it.

Combined with Recommendation #1 (a limit of total revenue to come from resource income), the surplus would no longer be arbitrarily set by spending patterns (either increases or decreases). Rather, the surpluses would be set almost entirely by resource prices – the value of our physical assets converted into dollars.

Clearly, this is the broadest recommendation in the report. But likewise, it is perhaps the most important.

If the interviews are any barometer, as reflected in the summary in Part B of this report, there are untold needs and opportunities for the province. Addressing those strategic priorities should not simply be driven by the fact that we are currently experiencing high levels of non-renewable resource revenues.

Perhaps more importantly, if government meets the mark, sets aside a fixed amount of non-renewable resource revenues for base budgeting purposes and then has a credible plan to fund the difference, we can have a serious discussion about the surplus. Because only at that point, will we have determined what we really mean by a surplus.

With that in mind, it's time to return to the original question posed: How should Alberta allocate surplus revenues?

Recommendation #6: Alberta Treasury Board and Finance should maintain an updated model on the return on investment (ROI) in three areas: debt repayment, savings and capital investments in physical assets.

Without timely and accurate information on the expected ROI of various financial priorities, the government cannot be expected to make the best decisions.

For example, with access to an evergreen list of capital projects that are execution ready and their associated ROI, the government would be better able to make judicious decisions around capital expenditures, versus savings, versus debt repayment.

This recommendation is not an easy task, and would require considerable work by Treasury Board and Finance.

Consider the complexity, by way of example. As noted in an Alberta's Future research paper on "Bridging the Digital Divide", increasing rural broadband connectivity might reasonably increase GDP by $4 billion, and create roughly 18,000 jobs over five years. This would require a significant investment by government, but the direct financial benefits (i.e. the ROI) would not entirely accrue to government immediately. Families and businesses would necessarily benefit, and positive externalities would accrue, but this requires longer term thinking (and economic modeling).

Simply put, investments by the government is a complex undertaking, but if recent history is any guide, Albertans need better information on the expected value of those investments.

This recommendation, in part, helps to constrain government action when in times of surplus. It is too easy, when times are good, to make bad bets. Transparency in the value (i.e. ROI) on government investments will help make better decisions.

It is clear that our economy is changing, and we need to adapt. The AFL, for example, has put forward an industrial blueprint to take advantage of emerging technologies and establish new industries. In the past, Premier Lougheed employed such an approach, where government would de-risk new technologies and industries, with an eye to capturing future returns. As government's around the world engage more actively with industrial policy, it is critical that government has the means and capability to actively assess risk and get the best return for taxpayers.

Having Treasury Board and Finance publish, annually with Budget, their ROI model on the tradeoff between debt repayment vs. savings vs. capital investment would be a good start to make sure we invest surplus dollars wisely.

Recommendation #7: In years when total revenues and resource income exceeds expenditures, apply a fixed formula for how these surplus dollars should be allocated.

In conjunction with Recommendation #1 (a limit on total from resource income for base budgeting purposes) and Recommendation # 4 (a strong, credible and sustainable budgeting plan), in certain years we can expect resource income to produce a surplus.

Rather than being caught off guard – as governments in the past have been again and again – it is recommended that all surplus dollars be allocated according to a fixed formula.

The bottom line on this recommendation is that — if adopted — Albertans can be assured that we won't "piss away another boom".

Some amount of surpluses should go to X, Y and Z, respectively.

The idea of applying a fixed formula to surpluses came up frequently in the interviews. Gary Mar, President and CEO of the Canada West Foundation, nicely summed up the collective wisdom of the interviewees that a fixed formula for allocating surpluses both constrains government action (for the good) while being helpful as democratic tool to engage with the public.

Many of the interviewees had recommendations on what that fixed formula should be.

I provide my own thoughts in the discussion below.

Fixed Formulas for the Surplus

How to apply a fixed formula for the surplus? There was no shortage of ideas. Below is a sampling.

Calgary Chamber of Commerce Proposal

- 30% to Debt Reduction
- 40% to Alberta Heritage Savings Trust Fund
- 20% to Long Term Strategic One Time Investments
- 10% to Affordability Measures

Business Council of Alberta Proposal

- First $1 billion to Alberta Heritage Savings Trust Fund
- Remaining 80% to Debt Repayment
- Remaining 20% to Strategic Investments

Hirsch Proposal

- 40% to Debt Repay/Savings/Capital Investment (per Recommendation #6)
- 40% to Endowments (per Recommendation #8)
- 20% to Immediate and Emerging Priorities

As the sampling shows, there is a wide variety of advice with what should be done with the surplus.

My formulation of surplus allocation was slightly different from some of the formal submissions that have been made public. But it is important. A 20 per cent cap on spending towards Immediate and Emerging Priorities is critical. In times of extraordinary non-renewable resource revenues - hence winning the lottery - governments will inevitably need to spend something to meet to democratic priorities.

This is reasonable. It's human nature. But my advice is to institutionalize and constrain that desire to spend for short term rewards.

No Albertan who won the lottery wouldn't spend some amount to address their immediate wants — a better vehicle, a kitchen renovation, fixing the roof, etc. And in a democracy, government must be attentive to citizens' needs. But government is also morally obligated to think long-term.

My allocation formula is designed to address that pragmatic balance. Let's be honest with ourselves about the possible, and save the bulk of our lottery/surplus winnings. But let's also be clear about the emergent needs facing the province:

In 2022, inflation pressures were a major concern to most Alberta households. And in the case of low-income and vulnerable people, inflation was at times the difference between providing food or paying the heating bills.

However, inflation was not a priority in 2020. In that year, issues related to COVID-19 (such as lost income, support to businesses and mental health issues related to social isolation) would have been more pressing concerns.

In 2023, the ever-worsening crisis in health care, particularly emergency wait times and surgery wait times may be the most pressing issue facing Albertans.

New and unpredictable priorities will invariably arise in subsequent years.

The 20 per cent allocation to immediate and emergent priorities reflects the unpredictability of the world in which we live. And it will give the government of the day some flexibility to address these needs in a timely manner, all the while not disrupting the long-term goals and priorities reflected in the ministries. The caveat with the dollars allocated to this pool is that none of this spending should lock the government into operational spending in the future.

Recommendation #8: A portion of the surplus should go into fixed endowments, to benefit Albertans in perpetuity.

Alberta already has a long and steady tradition of setting aside funds in endowments, each with a specific goal. At present there are three major endowments:

Alberta Heritage Fund for Medical Research:	**$2.034 billion**
Alberta Heritage Sciences and Engineering Research:	**$1.218 billion**
Alberta Heritage Scholarships	**$1.388 billion**

Through the interviews, what became clear is that many participants wanted increases in the base budget of the Alberta government for truly legitimate purposes.

At the same time, one of the core themes of the interviews was that surplus dollars should not be used to increase core operating spending.

The solution is endowments. Money set aside, inflation proofed, that would target priority initiatives and fund them in perpetuity. This is the mechanism to get off the boom and bust roller coaster, at least for some areas of the Government of Alberta's budget.

The animating idea is that the dollars earned through the endowments do not replace existing strategies and priorities, but rather enhance them.

We would be clear on the limitations and benefits of this approach.

The major drawback to the endowment approach is that it allows only a fraction of the surplus dollars to be put to work immediately. For example, a $1 billion allocation from a surplus of $10 billion into, say, a Foundation for Technology and Innovation would yield approximately $50-$100 million in new dollars to be allocated between several ministries, and countless projects. This is a small sum in immediate dollars.

The major advantage of this approach is that dollars flow in perpetuity. A one time investment could yield economic diversification projections forever, helping to create a new economic base for the province.

A discerning reader of this report might well ask how this recommendation aligns with Recommendation #2 related to the Alberta Heritage Savings Trust Fund. To those inquisitive minds, the answer is straightforward. In the AHSTF, we have an enormous existing pool of capital. We need to decide what to do with it. There are many good ideas, including the default, steady state, approach. But others ideas might transform the Heritage Fund into something entirely different. We need to disentangle, as a province, what is in front of us (i.e. use of potential surpluses), and what we are doing with our surpluses accumulated saved from the past (i.e. the Heritage Fund).

CONCLUSION

Years of recession. Two major oil price collapses. A global pandemic. Generational high inflation.

It's been tough. But Albertans are resilient.

Now, well into 2023, the fiscal fortunes of Alberta have changed, with no deliberate action from government. We have once again been blessed by extraordinary surpluses, driven by luck and fortune, and high energy prices.

We are at the proverbial top of the roller coaster.

As we look to the future, we can not simply assume that the government (fiscally) or Albertans (personally) will continue to benefit for generations to come.

Now is the time to be smart about how we deal with this generational opportunity.

For more than two decades, I had the privilege to be ATB's Chief Economist and witnessed first hand the ingenuity of Albertans.

While not a formal recommendation in this report, I recommend betting on the people of Alberta.

Attract the best to our province. Invest in our talent. And reap the rewards, in the terms of a life long dividend they will surely provide.

At the outset, my task was to consult on how best to allocate surplus dollars arriving into the provincial treasury, subject to the widely accepted principles that Rachel Notley laid out.

Those conversations led me down a path that I hope will likewise be widely accepted. Recommendations that are informed by sound economic principles, and are practically useful to the government that forms in later 2023.

I would like to thank my fellow Albertans for their insightful thoughts that led to the generation of this report.

While the recommendations are mine, I know our province is in good hands when we listen to Albertans, and let them paint the canvas of opportunity.

I hope these recommendations help frame that canvas, and set the province up for success.

Todd Hirsch

RECOMMENDATION SUMMARY

Recommendation #1:
Government should assign a fixed amount of non-renewable resource revenues (adjusted annually for inflation) that will be apportioned for base budgeting purposes.

Recommendation #2:
Government should consult with Albertans, and consciously determine a goal and purpose for the Alberta Heritage Savings Trust Fund.

Recommendation #3:
In the absence of a constructive and thoughtful plan, debt repayment should be the default option for all surplus funds.

Recommendation #4:
The Government of Alberta should maintain the outer bound maximum net debt/GDP ratio of 30 per cent as a fiscal anchor.

Recommendation # 5:
The government should establish a strong, credible and sustainable financial plan that will guide both revenues and expenditures.

Recommendation #6:
Alberta Treasury Board and Finance should maintain an updated model on the return on investment (ROI) in three areas: debt repayment, savings and capital investments in physical assets.

Recommendation #7:
In years when total revenues and resource income exceeds expenditures, apply a fixed formula for how these surplus dollars should be allocated.

Recommendation #8:
A portion of the surplus should go into fixed endowments, to benefit Albertans in perpetuity.

ORGANIZATIONS AND INDIVIDUALS INTERVIEWED

David Dodge - Economist
Marcia Nelson - Deputy Minister of Executive Council (Retired)
Richard Dicerni - Deputy Minister of Executive Council (Retired)
Trevor Toombe - Economist
Blake Schaffer - Economist
Ron Kneebone - Economist
Chris Ragan - Economist
Mike Moffat - Economist
Peter Tertzakian - Economist
Armine Yalnizyan - Economist
Angella MacEwen - Economist
Gil McGowan - Alberta Federation of Labour
Karen Kuprys - Alberta Federation of Labour
MC Beander - Alberta Federation of Labour
Terry Parker - Building Trades of Alberta
Cyndi Bester - Lethbridge Chamber of Commerce
Deborah Yedlin - Calgary Chamber of Commerce
Ruhee Ismail-Teja - Calgary Chamber of Commerce
Mike Holden - Business Council of Alberta
Emma Dizon - Business Council of Alberta
Annie Dormouth - Canadian Federation of Independent Business
Andrew Sennyha - Canadian Federation of Independent Business
Lisa Baiton - Canadian Association of Petroleum Producers
Tara Payment - Canadian Association of Petroleum Producers
Brad Parry - Calgary Economic Development
Geri Anderson - Calgary Economic Development
Ben Dachis - C.D. Howe Institute
Charles De Land - C.D. Howe Institute
G Kent Fellows - C.D. Howe Institute
Alex Laurin - C.D. Howe Institute
Courtney Mo - Momentum
Karen Ball - Calgary Chamber of Voluntary Organizations
Patti Pon - Calgary Arts Development
Marc Desormeaux - Economist
Jim Stanford - Economist
Mark Anielski - Economist on behalf of Treaty 8
Jared Dziuba - Oil and Gas Equity Research
Chris Severson-Baker - Pembina Institute
Simon Dyer - Pembina Institute
Gary Mar - Canada West Foundation
Ricardo Acuna - Parkland Institute
Joseph Doucet - Dean and Professor
Kathy Heron - Alberta Municipalities
Charles St. Arnaud - Alberta Central Credit Unions
Gary Hart - CEO Altalink