Boom-and bust Alberta needs stabilization fund

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ABSTRACT

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FULL TEXT

The government of Alberta's revenue volatility turns ordered plans topsy-turvy. Highly variable revenues make it difficult for the government to achieve a sustainable level of spending. Instead, Alberta's spending tends to follow a boom-and-bust pattern -- expenditures rise when oil and gas prices are high and abate when prices fall.

The rapid expansion of programs and capital spending during revenue booms stretches the capacity of the government to provide services and monitor spending, which can lead to waste and inefficiency. During a revenue collapse, spending cuts are often across the board rather than focused on the projects and services with the lowest benefit. Large spending cuts precipitated by a fall in revenues may also damage the morale and capacity of the public sector, leading to a further deterioration in the provision of public services.

The variability of government revenues is driven principally by the energy-sector component of revenues. Resource revenues form the largest component of Alberta's own-source revenues -- just over 30 per cent on average over the past 30 years -- and are four times more volatile than revenues from income taxes.

What can be done to get off the revenue roller-coaster? Some have recently suggested that Alberta could stabilize revenues with the introduction of a sales tax. However, the revenue collected from this type of tax is not likely to be big enough to have an appreciable effect on overall revenue volatility, given the large magnitude and variability of resource revenues.

Although the existing Alberta Sustainability Fund, created in 2003-04, is intended to stabilize revenues, it has several shortcomings. Rules for fund contributions and wit hdrawals have changed frequently. As a consequence, contributions and withdrawals are, effectively, at the discretion of the government.

This means that when revenues are booming, it is possible for the government to expand spending rapidly rather than make deposits to the fund.

In 2009, the Sustainability Fund was worth $17 billion but, according to the 2010-11 Alberta budget, its value is set to fall to $3 billion in 2013, at which point its stabilizing role will be minimal and its future prospects uncertain.

Despite these shortcomings, the Sustainability Fund could easily be revamped to create a better stabilization fund. The government could do this by committing to deposit a fixed percentage of resource revenues in the stabilization fund each year, while withdrawing a fixed percentage of the assets in the fund to support current spending. A stabilization fund of this type would reduce the volatility of the revenue available for current spending since a proportion of the most volatile component of revenue, resource revenue, is automatically deposited in the fund. Also, withdrawals would be based on the stock of assets in the fund, which depend on contributions from all previous years. Since this stock is unlikely to change much from year to year, withdrawals from the fund would be quite stable.

The establishment of a stabilization fund would require a startup period during which contributions to the fund exceed withdrawals, so a portion of resource revenues would not be available to fund current expenditures. To avoid a large rise in taxes or fall in expenditures during this period, the proportion of resource revenues contributed to the fund could be gradually increased to a target level. With this type of gradual transition, the net proportion of resource revenues saved would be similar to the share actually saved between 1995 and 2005. Further, once the fund is fully in place, withdrawals from the fund would, on average, equal contributions, and no further net saving would be required. Using data for the past 30 years, we calculate that, if the government had deposited 75 per cent of Alberta's resource revenues in a fund of this type and withdrawn 10 per cent of the assets from the fund each year, the volatility of revenues would have fallen by more than half.

While the main benefit of this stabilization fund is that government revenues would no longer follow a boom-and-bust pattern, another advantage is that revenue uncertainty would be reduced. This is because a large part of revenues would be in the form of withdrawals from the stabilization fund, and the sizes of these withdrawals are known since they are based on past contributions. Less uncertainty would facilitate the planning of program expenditures that are sustainable over the long term.

In contrast to the Alberta Heritage Savings Trust Fund, which is focused on the more distant goal of intergenerational equity, a revamped Sustainability Fund would have a short-term goal with more immediate benefits -- the stabilization of revenues to support stable expenditures. This would appeal to the many Albertans who have experienced the costs of boom-and-bust government spending. Further, a stabilization fund with fixed contribution and withdrawal rates would be simple and transparent and could easily be monitored by the voters of Alberta.

For too long, Alberta's government revenues have been driven largely by volatile global oil and gas prices. An effective stabilization fund could help the province get off the revenue roller-coaster.

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DETAILS

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