ALBERTA 360

A Long-Term Fiscal Sustainability Analysis and Reporting Framework is Long Overdue in Alberta

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ONTARIO 360
Policy Solutions for Ontario's Prosperity

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Introduction

With the passage of Alberta's new fiscal framework (the Sustainable Fiscal Planning and Reporting Act[1]) in March 2023, it was disappointing to see Alberta Treasury Board and Finance (TB&F), once again, fail to include long-term fiscal sustainability analysis and reporting within the province's set of legislated fiscal rules.

Current practice, through the Sustainable Fiscal Planning and Reporting Act, still places too much attention on achieving short-term targets, which can be variable and even arbitrary, at the expense of important long-term fiscal sustainability considerations. Continuing to place virtually all the emphasis on short-term fiscal outlooks does a disservice to elected officials who need better information from the Alberta public service to shift thinking towards considering the longer-term consequences of policy decisions.

The OECD defines long-term fiscal sustainability as "the ability of governments to maintain the public finances at a credible and serviceable position over the long-run in light of the prevailing mix of spending and revenue policies and taking into account debt servicing costs and future socio-economic and environmental factors that challenge…budgets."[2] In resource-based economies, concerns over long-term fiscal sustainability are intensified by heavy reliance on resource revenue streams driven by unpredictable and highly volatile commodity prices, the size of oil and gas reserves, and future oil and gas production volumes and costs.

Long-term fiscal sustainability analysis and reporting is thus a critical tool for managing the unique risks associated with a resource-based economy, like Alberta's. Dealing with the volatility of energy revenues requires more robust planning than found through the three- to five-year fiscal outlook. It also needs to be accompanied by more informative risk analysis to help ensure that long-term finances remain on track in the face of commodity price shocks, changing demographic patterns, and the accelerating pace of the energy transition.

[1] Government of Alberta King's Printer. (2023). Sustainable Fiscal Planning and Reporting Act, Statutes of Alberta, 2015, Chapter S-29

[2] OECD. (2013). Strengthening Budget Institutions in OECD Countries: Results of the 2012 OECD Budget Practices and Procedures Survey.

Previous developments on a long-term fiscal sustainability framework

The need for long-term fiscal sustainability analysis and reporting in Alberta has been clearly recognized and articulated, most recently, in 2018, by Alberta's Auditor General's commentary Putting Alberta's Financial Future in Focus[3], of which I served as a primary consultant; in 2019, by the MacKinnon Panel on Alberta Finances[4], of which I served as Executive Director; and various perceptive analyses of Alberta's long-term fiscal future by Trevor Tombe, between 2018 and 2023.

However, despite references to long-term fiscal sustainability in business plans over the years, and even mention of the province's long-term fiscal sustainability as far back as 1994, the evidence shows that robust systems and processes to analyze and report on the province's long-term fiscal sustainability have been slow to develop within TB&F, despite sporadic initiatives undertaken in the past decade and a half.

For example, between 2012 and 2016, the Fiscal Planning and Analysis Branch (FPA) of TB&F developed a long-term (10-year) fiscal model (LTFM) to assess the province's fiscal sustainability. When the results of the LTFM project were presented to senior officials in TB&F, it was noted that "longer-term fiscal projections could help assess the sustainability of public finances by quantifying emerging fiscal pressures and risk; illustrating long-term consequences of the policy 'status quo; and assessing fiscal outcomes under longer-term scenarios of interest to policymakers, such as scenarios for health care expenditure and the energy sector."[5]

However, it does not appear that the LTFM project advanced far beyond the internal reporting of results to senior TB&F officials, and certainly was not mentioned at all publicly. TB&F's recent work on long-term fiscal sustainability analysis and reporting appears to be centered on the preparation of briefing notes to respond to the annual release of the Parliamentary Budget Office (PBO) Fiscal Sustainability Report (FSR). It appears that some senior officials in TB&F have been and continue to be resistant to moving forward with implementing a robust and legislated long-term fiscal sustainability analysis and reporting framework in Alberta. Perhaps it is a fear of disclosing too much information to Albertans on the state of the province's long-term finances in the face of such challenges as an aging population and an accelerating energy transition.

Over the past half decade, the Government of Alberta's criticism of long-term fiscal sustainability analysis and reporting, by such organizations as the Parliamentary Budget Office (PBO), has been that such analysis and reporting does not account for changes in fiscal strategy and policy approaches

[3] Auditor General of Alberta (2018). Putting Alberta's Financial Future in Focus.
[4] Blue Ribbon Panel on Alberta's Finances. (2019). Report and Recommendations.
[5] Alberta Treasury Board and Finance. (FOIP Request #2018-G-0127).

by governments over the next 30 to 50 years, and that it is nothing more than an academic exercise. However, this criticism fails to appreciate the fact that wide-ranging scenario analysis, i.e., comparing the status quo fiscal policy stance versus alternative fiscal policy pathways, is best practice in long-term fiscal sustainability analysis and reporting, globally.

The passage of the Sustainable Fiscal Planning and Reporting Act provides even further justification for long-term fiscal sustainability analysis and reporting within the Alberta government. Stress testing the long-term impact of the new fiscal framework is critical in guiding policy choices. By 2022, it appeared that TB&F had come to at least some realization internally that long-term fiscal sustainability was a vital component of fiscal planning, as TB&F prepared or was presented with some work evaluating the province's long-term fiscal prospects. Unfortunately, this long-term fiscal sustainability work appears to have been withheld from public release.

Global developments show that Alberta is clearly being left far behind when it comes to long-term fiscal sustainability analysis and reporting. As a close follower of developments in long-term fiscal sustainability analysis and reporting over more than two and a half decades, I have watched standards evolve as recognition of long-term fiscal sustainability's importance in the fiscal planning process has grown, worldwide.

International models and best practices

Organizations such as the International Monetary Fund (IMF), the Organization of Economic Cooperation and Development (OECD), and the World Bank have all recognized the importance of and the need for governments to focus on long-term fiscal sustainability as one of the "best practice" elements in financial planning, particularly among resource-rich jurisdictions. The governments of Australia, Australia (New South Wales), New Zealand, Norway, the United Kingdom, the United States, and the Province of Ontario all publicly report on long-term fiscal sustainability.

Norway, Australia, Australia (New South Wales), and New Zealand have achieved a tradition for the comprehensiveness and quality of their long-term fiscal sustainability analyses and reporting, due largely to government support for the reporting mechanisms, the range of long-term fiscal sustainability indicators and measures used, and the relationship between fiscal sustainability and the fiscal rules that utilize the projections. The policy processes in these jurisdictions support long-term fiscal sustainability by explicitly discussing the leading fiscal risks to current and future generations, including health care costs rising from the aging of the population and the benefits and costs of climate change policies and the energy transition. The long-term fiscal sustainability analyses, conducted by Treasury Ministries in Norway, Australia, Australia (New South Wales), and New Zealand, are respected because of a strong government commitment to rigorous long-term fiscal sustainability analysis, the use of this analysis in the consideration of policy options and establishing policy priorities, and the development of fiscal rules with reference to long-term fiscal sustainability.

Alberta's long-term economic and fiscal outlook

There are a number of significant emerging medium- to longer-term risks that will impact Alberta's long-term fiscal sustainability, including the impact of an aging population on government income tax revenues and on spending in health care and other social programs; the impact of the energy transition, including such policies as the 2030 federal Emissions Reduction Plan (ERP), the proposed federal cap on oil and gas emissions, the federal Clean Electricity Regulation, Canada Net Zero 2050, and the Alberta Emissions Reduction and Energy Development Plan (EREP), on corporate taxes, royalties and total government revenues and expenses; the benefits and costs of maintaining and renewing infrastructure; and the impact of international commodity prices, technological change, and market access on energy development.

Demographic change will have a significant impact on Alberta's long-term fiscal outlook. Demographic patterns, such as the age structure of Alberta's population, not only impact GDP growth and government revenues by dampening labour force growth and labour force participation but create spending pressures in such government program areas, as health care.

In 2023, the Conference Board of Canada found that "despite having the country's second-youngest population with a median age of 38.1, Alberta will not be immune to the aging of its population. The share of the population aged 65 and older will increase significantly, growing from 15.4 per cent in 2023 to 18.8 per cent by 2045. The shift in the demographic profile will increase Alberta's dependency ratio (the ratio of the non-working-age population aged 0–14 plus those over 64). The dependency ratio is forecast to increase from 50.0 per cent in 2023 to 54.4 per cent by 2045. This will add further strains on public finances, and the government will be pressed to spend more on pensions and health care, while also collecting less revenue through income taxes."[6] And, by impacting labour force growth and participation, an aging population will also lead to reduced growth in economic output and government revenues. Slower growth in the working age population and a higher number of retirees could reduce employment growth by about 0.5%.per year and slow personal income tax growth by about 2% per year, over the long-term.

An aging Alberta population will put significant pressure on the province's health care system. Seniors require more medical, surgical and residential care services than younger age groups. Despite recent

[6] Conference Board of Canada (2023). Challenges on the Energy and Demographic Fronts: Alberta's Outlook to 2045.

efforts to "bend the health care spending curve", in 2019, the Conference Board of Canada's demographic model of health care "found that health care spending in Alberta would need to increase by an annual average of 5.1 per cent to meet the demand of a growing, and aging, population."[7]

Alberta's population growth, and the impacts of an aging population, will also result in increased demand for infrastructure, such as health care facilities, schools, supportive living facilities, roads, public transit, and water and waste management facilities. The costs associated with maintaining and renewing the province's capital assets will have a significant impact on Alberta's finances, and therefore the province's long-term fiscal sustainability. This risk is compounded by the complexity involved with understanding the current condition of the province's capital assets, and how capital asset and infrastructure needs will change in the future. Alberta Municipalities recently estimated that Alberta had a $30-billion infrastructure deficit.[8]

Finally, another key long-term economic and fiscal challenge is the impact of climate change policy and the pace of the energy transition, symbolized by the federal government's 2030 ERP impact on the Alberta economy and its finances. Preliminary analysis by Alberta Treasury Board and Finance suggests that implementation of the 2030 ERP would see "Alberta's nominal GDP be about $37 billion lower in 2030, than under the base forecast. There would be 80,000 fewer jobs available in 2030, than in the base forecast, resulting in the unemployment rate shifting higher from 5.5 percent to 7.0 percent. Albertans' average incomes would be $138.00 per week lower in 2030. Total exports would be $19 billion less than the base forecast, by 2030. The province's revenues would be between 6 percent to 7 percent, or about $4.2 billion, less than the base forecast by 2030."[9] Earlier this year, TB&F hired the Conference Board of Canada to assist them in quantifying the impacts of 2030 ERP.

The unfolding of such challenges, and the risk factors attached to them, will have a significant impact on the province's long-term fiscal sustainability. It is critical that robust systems and processes for long-term fiscal sustainability analysis and reporting be established to help government decision-makers and Albertans understand and protect the sustainability of public finances, support the efficient allocation of scarce financial resources, and anticipate and respond more effectively to these demographic, economic and fiscal challenges and pressures that are emerging today and into the future.

[7] Conference Board of Canada (2019). Alberta Fiscal Snapshot: Alberta Limits Fiscal Damage but Still Not on a Path to Balance.
[8] Alberta Municipalities (2023). ABMunis in the News: Q1, 2023.
[9] Alberta Treasury Board and Finance (2023). Opportunity Notice: Assessing the Socio-Economic Impacts of Canada's 2030 Emissions Reduction Plan.

The lack of an overall long-term fiscal sustainability analysis and reporting framework means that Albertans do not have all the relevant information needed to understand the long-term impact of federal and provincial policies on the province's financial position to support public debate and accountability. As a result, government cannot clearly demonstrate to Albertans how the policy decisions they are making today on such issues as health care and the energy transition are informed by a robust understanding of future long-term risks.

The contours of a long-term fiscal sustainability framework

It is time for TB&F to finally formalize long-term fiscal sustainability analysis and reporting within government fiscal planning processes and systems, and to enact a legislated requirement for the preparation and release of a long-term fiscal sustainability report, published every three years. The purpose of a long-term fiscal sustainability report would be to evaluate the fiscal impact of key demographic trends and risk factors to the provincial economy and the province's finances, and to provide a framework to assess the long-term fiscal implications of current and future policy decisions. As an example, within the Canadian context, the requirement for a long-range assessment of the Ontario's economic and fiscal environment is found within that province's Fiscal Sustainability, Transparency and Accountability Act.[10]

Alberta's long-term fiscal sustainability framework should be developed with reference to "best practice" in other jurisdictions, with particular attention to the processes and systems being pursued around long-term fiscal sustainability in resource-rich jurisdictions.

Key elements of a long-term fiscal sustainability analysis and reporting framework for Alberta should be:

- Establishing robust systems and processes within government to analyze and report on the medium- to long-term fiscal impacts of Alberta's demographic, economic and fiscal risks, and challenges, as well as the medium- to long-term impacts of government policies;
- Requiring that internal decision memos on public policy proposals, such as Ministers' Reports (MRs), include an analysis of the impact of policy options on the province's long-term fiscal sustainability;
- Establishing a definitive time horizon (10-years or longer) for long-term fiscal sustainability analysis and reporting within government;
- Preparing and publicly releasing a comprehensive long-term fiscal sustainability report at least once every three years, and providing useful information on long-term fiscal sustainability that is understandable to Albertans;
- Establishing a statutory or legal requirement for long-term fiscal sustainability reporting in the province's new fiscal framework (the Sustainable Fiscal Planning and Reporting Act) as a show of government commitment to managing future long-term risks and challenges in a prudent manner;

[10] Government of Ontario, King's Printer, (2023). Fiscal Sustainability, Transparency and Accountability Act, 2019, S.O. 2019, c. 7, Sched. 30.

- Clearly presenting the methodology, key demographic, economic and fiscal assumptions, and data sources for long-term fiscal sustainability analysis and reporting to Albertans;
- Providing information to Albertans on how long-term fiscal sustainability models are built and used to assess long-term fiscal sustainability; and
- Establishing clear accountability mechanisms for long-term fiscal sustainability analysis and reporting, including accountability to Cabinet, Treasury Board Committee, the Legislative Assembly, and Legislative Assembly Standing Committees.

Analyzing and reporting on long-term fiscal sustainability helps government decision-makers and Albertans to better understand the size and nature of risks and their implications for public finances. Being better aware of risks allows governments to take steps to limit their exposure to commodity price shock and demographic changes, such as an aging population. And better understanding of fiscal risks, greater transparency, and effective risk management practices help improve fiscal policy credibility in Alberta.

The OECD Council of Budgetary Governance identifies as one of the ten principles of good budgetary governance the need "to identify, assess and manage prudently longer-term sustainability and other fiscal risks, through applying mechanisms to promote the resilience of budgetary plans and to mitigate the potential impact of fiscal risks, and thereby promoting a stable development of public finances; clearly identifying, classifying by type, explaining and, as far as possible, quantifying fiscal risks, including contingent liabilities, so as to inform consideration and debate about the appropriate fiscal policy course adopted in the budget; making explicit the mechanisms for managing these risks and reporting in the context of the annual budget; and publishing a report on long-term sustainability of the public finances, regularly enough to make an effective contribution to public and political discussion on this subject, with the presentation and consideration of its policy messages – both near-term and longer-term – in the budgetary context".[11]

As pointed out by Trevor Tombe, "managing public finances in Alberta is a challenge. The province confronts significant volatility in its economy and its natural resource revenues Fiscal policy decisions not anchored in a clear long-term goal expose Alberta to significant risks The importance of long-term planning is even more important today as Alberta, like other provinces, is in the process of a significant demographic transition to an older population Alberta needs a renewed approach to its public finances. Long-term planning that considers both the slow moving (but entirely foreseeable) consequence of population aging and the faster moving changes in resource revenue volatility can improve provincial fiscal policy."[12]

[11] OECD. (2015). Recommendation of the Council on Budgetary Governance.
[12] Trevor Tombe. (2021). Fiscal Planning and Sustainability in Alberta.

If TB&F is truly committed to restoring Alberta's leadership role in global financial transparency and accountability, it should follow the OECD Council of Budgetary Governance principles and the lead of other jurisdictions by finally including long-term fiscal sustainability analysis and reporting as a critical element in the province's new fiscal framework. Frankly, the time for a long-term fiscal sustainability analysis and reporting framework in Alberta is long overdue.

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Lennie Kaplan spent over two decades in the Alberta Public Service, including as a senior manager in the Fiscal and Economic Policy Division of the Ministry of Treasury Board and Finance, where he worked on examining best practices in long-term fiscal sustainability analysis and reporting in other jurisdictions. Mr. Kaplan also served as the chief consultant to the Office of Alberta's Auditor General on its 2018 commentary, "Putting Alberta's Financial Future in Focus," and as Executive Director to the MacKinnon Panel on Alberta's Finances in 2019.

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