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Putting the boom to work for future generations

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Saskatchewan will soon unveil the province's first- quarter financial performance. What news might this report hold?

Owing mostly to strong commodity prices, over the last five years Saskatchewan's revenues averaged about \$1 billion above budgeted expectations. And prices have since shifted even higher, so it would not be out of line for the province to have a \$2-billion revenue overshoot by the end of this fiscal year. Is that a reason for concern?

Saskatchewan is the second-largest oil producer in Canada, and with unconventional heavy oil reserves estimated at 25 billion barrels, and assuming 2006 rates of conventional production, Saskatchewan would be in the oil business until 2168.

Non-renewable resource revenues, however, are finite, volatile and uncertain. The main challenge is to properly deploy them over time. On one hand, Saskatchewan will likely undergo a large growth period as resource production expands, with fiscal emphasis shifting to spending today. On the other hand, resource extraction is the permanent conversion of finite resource assets into financial ones, so revenue should be set aside for future generations to allocate.

Sound fiscal planning should aim to balance current needs with those of future generations.

Alberta has three important lessons to lend its eastern neighbour. First, fiscal planners should focus on spending restraint. Second, large amounts of revenues should be saved. And finally, the budget process should be kept as transparent as possible.

Why? A common failing for resource-based regions is that when faced with rising commodity prices, policymakers allow government spending to increase unrestrainedly.

The oil price spike of the late '70s and early '80s shows the importance of fiscal discipline. After years of increasing public expenditures with rising commodity prices, Alberta -- much like Saskatchewan at the time -- suddenly found itself in a significant deficit position: negative \$4 billion in 1986/87. Soon after, the province made large cuts to public programs; a painful readjustment premier Getty once referred to as "trying to turn the Queen Mary."

Now, global demand and prices are unpredictable, meaning a significant source of Saskatchewan's future government revenues is uncertain. Financing regular program spending from volatile resource revenues could put the province into a fiscal hole.

To overcome a similar problem, Alberta's budget planners, in addition to establishing a no-deficit policy, set limits on the amount of resource revenues available for spending: no more than the lower of a five-year moving average and a fixed dollar benchmark. Any excess resource revenues went to pay down the debt, with the intent of keeping windfalls away from any potential new spending initiatives. This worked -- temporarily, until consistently high resource revenues rendered the moving average obsolete, pushing budget makers to raise the fixed benchmark even higher.

Saskatchewan's current fiscal rules require no deficits, and that half of all surpluses go to the Growth and Financial Security Fund, with the other half dedicated to the Debt Retirement Fund. These rules fall short, because they allow resource-financed spending to rise over the course of the fiscal year. Spending over and above planned spending increases has grown by 3.5 percent on average over the last ten years. Cumulative overruns over the period came in at \$2.3 billion.

A better plan would limit the amount of spending that could be financed from resource revenues at the outset. For example, a forward-looking rule would allow the province to set a benchmark level for resource-revenue spending, to be scheduled over the projected life-cycle of resource extraction. If revenues came in above this level, they would be saved, and if below target, spending would temporarily be financed by borrowing. When properly designed, fiscal rules help to curb spending growth in a depoliticized framework.

Saskatchewan should also focus on saving a large portion of resource wealth. When resources expire, the principal benefit will be the interest revenue earned on savings. Factors beyond Saskatchewan's control, such as foreign government policy and the possibility of obsolescence, further bolster the case for being prepared, by amassing savings or paying down the \$6-billion net provincial debt.

In considering the scope for saving, Saskatchewan taxpayers should know that Alberta's primary savings fund, the Heritage Fund, now amounts to only 11 per cent of total resource revenues collected over the last 30 years.

The final key lesson is to keep the fiscal process transparent. A welter of special government savings funds, for example, presently obscures Alberta's true fiscal position. And an uneasy mix of withdrawal rules makes the source of government spending difficult to trace.

Saskatchewan's fiscal planners should avoid growing a similar garden of funds. The province's \$1.6-billion Growth Fund for development amalgamated the previous infrastructure and fiscal stabilization fund -- that is a step in the right direction. However, discretionary transfers from the fund to the budget have the potential to offset deposits.

In future, Saskatchewan will likely need to expand the scope of the Growth Fund to store more of the province's resource riches. Without the proper rules for deposits and fund management, and, without a strong public commitment, such a fund could serve to destabilize fiscal policy more than help it.

High commodity prices make now an opportune time for Saskatchewan to initiate a prosperous cycle of growth and development. Managing resource revenues requires prudent leadership that balances immediate pressures with the interests of future generations. Saving, fiscal restraint and transparency are the key ingredients for Saskatchewan to develop a long-term plan for becoming and remaining a wealthy and productive province.

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