BEYOND ALBERTA'S PROSPERITY DIVIDEND: A WESTERN ACCORD TO POOL RESOURCE WEALTH

Todd Hirsch

Alberta's good fiscal fortune may be partly a result of good management in eliminating the deficit, but good fortune has allowed it to eliminate its provincial debt and return what Premier Ralph Klein calls the "prosperity dividend" in the form of cheques to be mailed to taxpayers. But the province's good fortune has also created a headache Klein didn't bargain for — a horizontal imbalance between the fiscal capacity of it and the other provinces. "Regardless of how Alberta chooses to deal with its surpluses," writes Todd Hirsch of the Canada West Foundation, "the other provinces are going to find it hard to compete." Hirsch suggests a western energy accord by which the four western provinces would pool their diversified and abundant resources for the good of the region, and the country.

Sans doute la bonne fortune de l'Alberta vient-elle en partie d'une saine gestion budgétaire, mais elle a permis de supprimer la dette provinciale et de verser aux contribuables albertains ce que le premier ministre Ralph Klein appelle les « dividendes de la prospérité ». Mais cette bonne fortune a aussi causé à Ralph Klein des maux de tête imprévus, sous la forme d'un déséquilibre fiscal horizontal qui révèle un écart important entre les capacités fiscales albertaines et celles des autres provinces. « Quoi que l'Alberta fasse de ses surplus, note Todd Hirsch, de la Canada West Foundation, les autres provinces auront du mal à lui faire concurrence. » L'auteur propose un Accord énergétique de l'Ouest prévoyant la mise en commun des abondantes ressources énergétiques des quatre provinces concernées. Dans l'intérêt de la région… et du pays.

Entering its second century as a province of Confederation, Alberta has been enjoying a special place in the national spotlight. The government has paid off its debt — the only province that has done so. No other province is even close (see table 1). Central Canadian publications such as *Saturday Night*, *Maclean's* and *The Globe and Mail* have featured articles on Alberta's growing financial clout. Ontario Premier Dalton McGuinty called it "the elephant in the room" at the recent premiers' meeting. And Alberta Premier Ralph Klein has advised the federal government to keep its hands off Alberta's money.

The province's debt-free status isn't the end of the story. The Alberta government is expecting to run a sizable surplus, too, estimated by the private sector to be in the neighbourhood of $7 billion and $8 billion in the 2005-06 fiscal year. That alone is creating ripples of excitement within the province. Now that the province is debt-free and running surpluses rivaling those of the entire federal government, surplus cash can be invested, spent, or used to lower taxes in Alberta. Ralph Klein even announced in September that everyone in Alberta will be sent a cheque in the mail — the "prosperity dividend" as it is called — from the expected surplus resource revenue.

A reasonable question to ask is *why*, exactly, is Alberta the only debt free province? How did it manage to amass this kind of wealth?

Is it totally an accident of geography? Can Alberta's enviable position be fully due to the fact that the province sits atop massive oil and gas resources? Other provinces, namely Saskatchewan and Newfoundland, benefit from high oil prices too, yet they are two of the most heavily indebted jurisdictions on a per capita basis. And while Alberta's energy reserves are much greater, Saskatchewan and Newfoundland have only grown more indebted over the years.

Can Klein be credited for his resolve and determination in eliminating the deficit in the 1990s? After all, if he and his government had not been so focused on deficit and debt elimination, it is likely that spending would have increased in a fashion reminiscent of previous Progressive Conservative administrations in the 1970s and 1980s. The method by which the government achieved deficit elimination (i.e. a 20 percent reduction in spending in most areas) can be questioned, but the government's resolve cannot.

The debt-free status and the massive resource-driven surplus may also be creating a headache for Klein that he didn't bargain for. The problem with this surplus — and the additional surpluses that the province is likely to enjoy in the foreseeable future — is the imbalance it creates between Alberta and the rest of Canada. No other province is even close to being in the same position.

Is Alberta debt free because of the province's low tax environment and positive business climate? The argument can be made that without such a favourable tax regime and royalty structure, Alberta's massive oil, gas and oil sands resources would still be largely untapped.

Most likely it is a combination of many of these factors, but undeniably the single most important factor contributing to Alberta's debt-free status is the province's enormous energy resource endowments and, even more so, the fact that prices for both crude oil and natural gas have been rising dramatically. Both the size of the endowments and the prices are completely beyond the efforts or control of Klein, his government, or the people of Alberta. It is mostly sheer good fortune.

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Fiscal imbalances in Canada are identified as being either *vertical imbalances* (i.e., an imbalance between the federal and provincial governments in their expenditures and revenues) or *horizontal imbalances* (i.e., imbalances between the relative fiscal capacities of the provinces). While there is strong evidence to suggest that a vertical imbalance currently exists in Canada, it is the horizontal imbalance between the provinces that is the focus of this article.

Constitutionally, the royalties accruing from natural resource extraction belong to the people of the province, and in that respect it is the provincial governments that act as the guardians. Royalty revenue is collected by the provincial governments and is directed into general revenues. How the royalty revenue is spent is entirely the decision of the province.

It is the issue of ownership of natural resources within the Constitution that holds the seeds of potential discontent among the provinces. Issues of equity regarding natural resource wealth are bound to come up. Is it "fair" that so many oil and gas deposits are found within the borders of Alberta but not in most other provinces? Is it "fair" that crude oil prices soar while prices for other resources languish? Is it unreasonable to suggest that natural resources belong to all Canadians, not just citizens of the province in which they are found? Certainly, if the *British North America Act* were being written today — with the knowledge of the problems being created by unbalanced resource endowments — natural resource ownership would most likely remain with the federal government.

The last time the problem of soaring energy prices and the resulting financial inequity created between the provinces arose, the federal government introduced the National Energy Program (NEP). While the program did not seek to extract cash from the royalty revenues directly (which *would not* have been allowed under the Constitution), it *did* impose price controls, foreign investment regulations, and a series of income and export

TABLE 1. NET DEBT OF PROVINCIAL GOVERNMENTS AS OF MARCH 31, 2004

Provinces	Net debt ($ millions)	Change in net debt over 2003 (%)	Per capita ($)
Newfoundland and Labrador	10,995	15.6	21,226
Prince Edward Island	1,291	12.3	9,355
Nova Scotia	11,835	-0.4	12,631
New Brunswick	5,909	-0.2	7,868
Quebec	97,647	2.4	12,973
Ontario	108,703	5.9	8,804
Manitoba	11,338	11.0	9,707
Saskatchewan	10,134	2.6	10,185
Alberta	-14,345	n.a.	-4,497
British Columbia	21,255	5.6	5,081

Source: Statistics Canada, *The Daily*, September 12, 2005.
1. This table is derived using the Financial Management System.

taxes directed at the energy sector (which *were* allowed under the Constitution). In the minds of Ottawa, it was simply doing something to address the imbalances caused by (at the time) record oil prices.

This year marks the 25th anniversary of the NEP. People outside the West have likely long since forgotten about the NEP, but it hasn't been forgotten in Alberta. The program crippled the oil and gas sector. It is firmly entrenched in the province's psyche, a chapter of biblical proportions in Alberta's history.

Fast-forward to 2005. A replica of the original NEP is unlikely; but some other scheme is surely plausible. Suggestions range from a tax on energy exports to the US (as retaliation for the softwood lumber dispute) to some sort of carbon tax to address our Kyoto obligations. Ottawa could even increase corporate income tax rates on oil and gas companies. Eventually, the fiscal imbalance will become so great that Ottawa will be forced to come up with something.

Other provinces, too, have been quietly worrying about the implications of such an imbalance. Regardless of how Alberta chooses to deal with its surpluses, the other provinces are going to find it hard to compete. Lowering taxes even further will increase the outflow of people and companies from Saskatchewan to Alberta. Increasing health care spending will exacerbate the shortage of doctors in Ontario. Investing heavily in post-secondary education will make attracting students and academic staff more challenging for all other provinces.

They have not been too numerous or loud so far, but there are suggestions being bandied about the rest of Canada that Ottawa should do something to address the vertical imbalance. For example, a city councillor from Timmins, Ontario, called on Ottawa to reactivate the National Energy Program.

These suggestions are already causing defensive postures in Alberta, epitomized by Klein's "hands off our money" attitude. But the "prosperity dividend" cheques for Albertans seem unlikely to win Alberta any sympathy outside the province.

CP Photo

From cowtown to boomtown: the Calgary skyline reflects its growth, and all of Alberta's, driven by oil and gas revenues. Energy royalties have enabled the Klein government to pay off the provincial debt, top up the Heritage Fund to $12 billion and declare a "prosperity dividend" to be returned to taxpayers.

Support for Alberta or western Canada separating from Canada is still very weak, likely in the single-digits of popular opinion among Albertans. It is even lower in the other western provinces. However, there is a tension evident among many Albertans and other westerners that their patience is reaching a limit. Any policy action imposed by the federal government that is perceived as a cash-grab on Alberta's energy revenues could easily be "the last straw" for many Albertans. The conditions are perfect for a constitutional storm — gallons of fuel poured on to the faint-but-smoldering embers of Alberta separatists.

The word *crisis* should be reserved for extreme events, such as the devastation brought on by hurricane Katrina or the Asian tsunami disaster. In this respect, it would be incorrect to identify the current situation of energy supply and demand in Canada as anything close to an "energy crisis." Even the power outage in Ontario in the summer of 2003, while a major and costly inconvenience, was not a true crisis.

Nonetheless, the supply and demand of all types of energy sources in Canada has been growing increasingly tight over the past few years. Electricity costs are rising in most jurisdictions. Gasoline prices spiked to well over $1.20 in the summer of 2005. Commodity prices for natural gas, coal, crude oil, and uranium have increased strongly and are not expected to return to their previous levels any time soon.

Crude oil prices have been rising because of factors exogenous to the Canadian economy, such as geopolitical tensions in the Middle East, surging demand from China and India, and fear of a long-term decline in global supply. Similarly, natural gas prices (which are determined on the North American continent, not globally) have been driven largely by demand in the US.

Electricity is a special case in Canada, particularly in Ontario where partial deregulation and then a reversal of policy has led to insufficient investment in new power generation. Electrical power in Ontario is highly integrated with the US power grid, and large amounts of power move both ways across the Canada-US border. But brown-outs, possible black-outs, and advisories to use less electrical power are increasingly common in Ontario. New sources of low-cost, reliable electrical power are needed.

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The economic costs of rising energy prices and (even worse) interruptions of supply are mounting. It is possible that if crude oil prices remain high or rise further still, the US and Central Canada could suffer slower economic growth or even experience recession.

Canada's "two birds" currently ruffling their feathers, then, are: 1) the potential for a national unity crisis, precipitated by a horizontal imbalance of financial resources among the provinces, and 2) a growing shortage of power and escalating prices for traditional sources of energy, which are threatening economic growth.

There is a stone that could help to address both of these problems. (The proverbial "killing two birds with one stone" is a limited allegory in this instance, since it is not expected that this proposal would actually "kill" the problems of national unity or energy shortages. It would, at most, only help to lessen the pressures of both.)

The government of Alberta could initiate a western energy accord — an agreement with the other three western provincial governments to create a pool of energy revenue, the purpose of which would be to:

1. increase energy output nationally by tapping more deeply into the West's vast energy resources;
2. position western Canada as the world leader in developing alternative, clean and renewable forms of energy and power generation; and
3. strategically market western Canada's energy — conventional and alternate forms of energy — throughout the globe.

It could be Alberta's golden opportunity to step up to bat and show leadership within the country. Instead of the angry bumper-sticker slogan "The West Wants In," the new catch phrase of western political sentiment could be "Here's what we're doing? Are you with us or not?"

The unique feature of this accord is that it would not be limited to Alberta's oil and gas. It would include all of western Canada's energy resource — Manitoba's vast hydro power, Saskatchewan's powerhouse uranium deposits, British Columbia's coal and (yet to be developed) offshore oil, and even arctic gas. It should also include fledgling industries such as wind, solar, bio-mass, and hydrogen sources of energy. They may not all be economically viable today, but they are likely to be someday.

Through the accord, a portion of the cash derived from energy resources would be pooled and redistributed among the western provinces for reinvestment in major energy projects. For example, a portion of Alberta's oil royalty could help finance the construction of a major hydro dam in Manitoba, including the billions required for transmission lines to Ontario. The hydro revenues could help fund other energy projects back in Alberta, such as research and development in coalbed methane.

Revenue from southeastern BC's coal deposits could help Saskatchewan invest in wind power research or enhanced recovery of crude oil. Energy revenue from Saskatchewan would in turn help fund energy projects elsewhere in the West, and so on.

The agreement should also see major investments into research and development in fledgling energy industries such as wind, solar, tidal, bio-mass, and hydrogen cell energy. They may not all be economically viable today, but they are likely to be someday. Alberta and the West have a chance to be world leaders in clean, renewable energy research.

Marketing western Canada's energy for export would also be a central goal of the accord. China's surging economy is thirsty for oil; the US is hungry for all types of energy: gas, oil, hydro-electricity, uranium. The premiers of the western provinces would be able to sell the US on a comprehensive package of energy solutions from a safe, politically stable and geographically linked source. Strategically, it is a much stronger approach than each province marketing its energy individually.

Of course, the accord would have major hurdles to overcome. For one thing, it would require a complex pooling of revenue from resources that are managed both by the private sector (oil and gas) and the public sector (provincially owned hydro utilities).

Other questions would need to be answered. How much would each province be required to commit to the fund? What rules would guide how the money is spent? How do you extract economic rent fairly from the wide variety of natural resources and their mix of public and private ownership?

There could also be endless debate as to what constitutes a viable emerging source of energy (e.g.,"Why should Manitoba's hydro money be funnelled into tidal energy research?"). There would also be the question of Arctic gas, an enormous resource that would naturally tie into western Canada's gas distribution system, but is under Ottawa's jurisdiction.

But with enough determination and cooperation, all of these hurdles can be cleared. Political leadership and a long-term vision for what the West — and Canada — can become is what is truly needed to make a western energy accord happen. What this country does not need is for Ottawa to initiate an NEP *redux*. It would cripple the country's energy sector and further alienate and infuriate Albertans. An Alberta-led western energy accord would demonstrate that energy supply and provincial imbalances can be addressed through a positive, cooperative policy.

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Such an agreement would be most workable and practical if it remained an accord among the four western provinces. This is in no way meant to purposely exclude other provinces from the agreement. Rather, it is to simplify the negotiations and to recognize the geographic proximity that binds many of the West's energy resources. However, the point of the agreement would also be to demonstrate to the rest of the country what can be achieved through cooperation, rather than turf protection.

Once the accord has proven its value, it would be a logical next-step to eventually invite other provinces to join. For example, once Ontario sees the benefits of such an energy accord, it may choose to enter. All of the other provinces have some form of energy resources, too: nuclear in Ontario and New Brunswick, hydro in Quebec and Newfoundland, gas and coal in Nova Scotia, etc. The accord could be the most effective nation-building policy Canada has enjoyed in quite some time.

Most appealing, all of the provinces have a long-term interest in developing clean, renewable forms of energy. The pool of energy revenue would be available for investing in research projects in all of the member provinces.

In the short run, Alberta may have the most to lose with this idea. But in the long run, it has the most to gain. The province is blessed with hydrocarbon resources and prices are currently high. And while things look good in the foreseeable future, the party can't last for ever. By forging an energy accord that includes all of western Canada's energy resources — including the research and development in clean and renewable resources — Alberta would greatly strengthen its own long-term energy position.

Alberta has strong cards in its hand at the moment. By initiating a western energy accord it would not only show a great deal of goodwill to its provincial neighbours, it would deflect criticism and envy directed its way by other governments struggling to balance their budgets. It would be a pre-emptive strike.

Energy resources will continue to create wealth and improve our standard of living. National unity will be strengthened. The energy supply will increase. Canada will become the world leader in development alternate forms of energy. And it will all start with Alberta.

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