



# TD Economics

## The 2008 Alberta Budget

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### HIGHLIGHTS

- **\$4 billion surplus in FY 07-08**
- **\$1.6 billion targeted for FY 08-09**
- **Spending ramped up to tackle growth pressures**
- **\$1 billion annual health premium tax eliminated**

Powered by the ongoing strength in non-renewable energy markets, Alberta has estimated another impressive budget surplus of just over \$4 billion in FY 07-08, an amount twice that projected in last year's budget. Despite conservative assumptions on oil and gas prices, this solid hand-off has provided more than ample wiggle room to keep spending growing at a sizzling 10% clip in the year ahead, to eliminate the \$1 billion per year health premium tax and, at the same time, still present a healthy surplus of 0.5% of GDP.

#### Surplus of \$4 billion in FY 07-08

Last year, economic growth in Alberta largely unfolded as expected in 2007, with real GDP increasing at roughly half of the prior year's blockbuster 6.6% rate. In contrast, crude oil prices did manage to overshoot the budget plan substantially, averaging some US\$25-per-barrel higher than the budget assumption of about US\$55. As a result, resource royalties managed to tip the scales about \$700 million above plan, while income-tax revenues rolled in about \$1.5 billion higher. Some of the windfall – about \$700 million – was earmarked to new spending.

Heading into FY 08-09, the government's revenue picture had continued to brighten. While the Alberta economy is not immune to the problems in the U.S. economy, crude oil prices have since surged to more than US\$115 per barrel as investors have been lured to commodities as a hedge against a declining U.S. dollar. Natural gas prices have begun the fiscal year above C\$9. In contrast, the government has projected average increases of US\$78 and C\$6.75 for FY 08-09, which implies a hefty drop from current levels. Although some might quibble that the government has been overly cautious, the sheer magnitude of the re-

ALBERTA GOVERNMENT FISCAL POSITION (\$M)				
	Est.	Budget		
	07-08	08-09	09-10	10-11
<b>Revenues</b>	37,757	38,571	37,933	37,988
% change	1.9	2.2	-1.7	0.1
% of GDP	14.4	14.2	12.6	607.8
Resource Revenues	10,956	11,709	10,712	10,044
Other Revenues	26,801	26,862	27,221	27,944
<b>Expenditures</b>	33,726	37,003	37,571	37,789
% change	13.7	9.7	1.5	0.6
% of GDP	12.9	13.6	13.2	12.6
Discretionary Exp.	33,501	36,783	37,373	37,581
Debt-Service	225	220	198	208
% of revenues	0.6	0.6	0.5	0.5
<b>Net Revenues</b>	4,031	1,568	362	199
% of GDP	1.5	0.6	0.1	0.1
<b>Contingency allowance</b>	314	325	340	350
<b>Accum. Debt</b>	-10	-10	-10	-10
% of GDP	0.0	0.0	0.0	-0.2
<b>Net Assets</b>	44,449	45,830	45,971	45,941
<b>Sustainability Fund</b>	7,653	7,653	7,653	7,653

Source: Alberta Finance, Statistics Canada

cent jump, the looming global economic slowdown, the cyclical nature of prices, and the recent increase in investor participation in the energy markets have added layers of uncertainty to the near-term energy outlook. In terms of real GDP growth, the province has assumed a 3% real expansion in 2008, which appears reasonable.

The projection for a modest 2.2% gain in revenues in FY 08-09 assumes relatively flat resource royalties. Under the government's new royalty framework that was announced in the fall and modified earlier this month, royalty payments from the oil and gas sector are projected to increase by \$1.8 billion per year beginning in FY 09-10. This year, the boost will be a smaller \$400 million, since the arrangement only kicks in January 1, 2009.

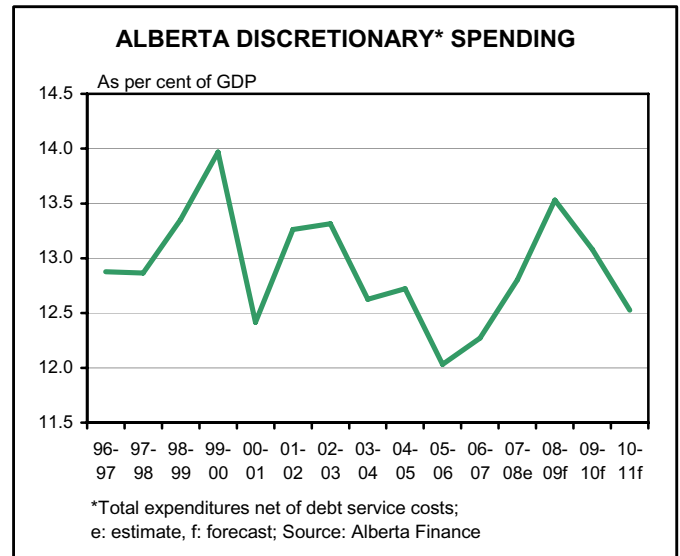
This projected revenue line also builds in the cost of \$1.3 billion in tax measures when fully implemented. In addition to the elimination of health care insurance premi-

ums (effective January 1, 2009), today's budget unveiled an increase in the small business income tax threshold (from \$430,000 to \$500,000 by April 1, 2009), a 4.7% increase in personal tax credits for inflation protection, as well as credits for caregivers and scientific research and development.

Still, it is the spending side that received the most attention. Similar to last year's budget, the key theme of Budget 2008 is keeping up with growth-related pressures in the economy and population growth. And, the government has responded by ramping up operating spending by almost 10% in FY 08-09 (12% if capital investment in government assets is included). This increase represents the 5th straight year that spending has been up 10-12%. While clearly unsustainable, we take some comfort that matching explosive nominal growth in the economy has actually held discretionary outlays as a share of GDP below its peak of 14% in the late 1990s (see chart).

In addition to cautious economic assumptions, the government's budget plan contains other significant protection. If resource royalties fall short of plan or in the event of a disaster, the Sustainability Fund, which carries a balance of more than \$7 billion, can be used to take up the slack. On the flip side, if the government's coffers fare better than expected, additional cash is earmarked one-third to retained to savings and investments, and two-thirds to capital.

As of March 31, 2008, the government's net asset position (excluding pension obligations) climbed to \$52.5 bil-

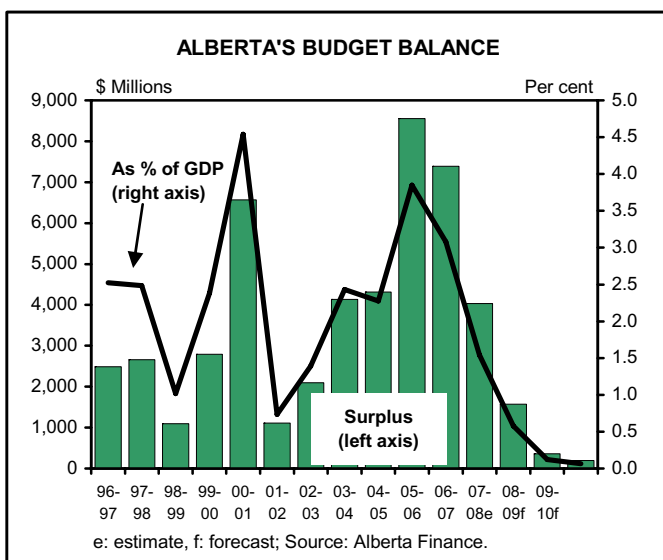


lion from \$48.5 billion in the prior year. Within the asset category, the big increases were recorded by the Heritage Fund and the Capital Account, which both rose by roughly \$1.5 billion, to \$16.4 billion and \$7.5 billion, respectively. Hence, the government continues to make some progress in socking away funds for the future. Still, the further sharp increase in spending in today's budget will continue to put the heat on the government to save an even larger share of current revenues. Later this year, the new Financial Investment and Planning Commission will release a report on the province's savings and investments funds in order to ensure that savings are invested to maximize the long-term benefits for Albertans. In last year's budget, a new Crown corporation – the Alberta Investment Management Corporation – was established to manage the provincial assets.

**The bottom line**

Few governments around the world are in a position to ramp up spending at a double-digit pace, increase their tax advantage on other jurisdictions, and to issue a surplus budget with risks tilted to the upside, but Alberta has done just that. Despite the growing demands for new infrastructure and operating expenditures from across the province, considerable focus will remain on the government's unsustainable spending growth and the need to save a larger share of current revenues for future generations.

*Derek Burleton, AVP & Senior Economist  
416-982-2514*



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