Alberta ready to defy boom bust cycles of the past: TD Economics

CALGARY - Are Alberta's boom-times setting the economy up for a classic bust? TD Economics says no in a report released today at the Calgary Economic Development's Economic Outlook luncheon. (www.td.com/economics).

There are a number of "flashing warning signs" such as the decline in natural gas prices and drilling output levels, as well as slower growth in home and consumer goods sales, but TD economists Don Drummond and Derek Burleton consider the "odds of a hard landing to be one in four." They cite the massive surge in oil sands investments and related activities as a key driver for the province's ongoing expansion.

Specifically, the report states the Alberta economy will yield another solid advance in real GDP of 4.3 percent in 2007. In the Calgary Edmonton Corridor – Alberta's main economic engine -- growth is estimated to surpass 5 percent. Over the coming years (2008-09), projected growth rates will moderate to 2.5-3 percent, largely due to the dampening forces on demand stemming from rising labor, producer and infrastructure costs. While this equates a sub-par performance, it is far from the bust scenario that has followed past periods of euphoria.

Growth has been good…
Indicative of Alberta's stellar growth is the emergence of medium-sized urban centres. During the past five years, seven of Canada's 15 fastest growing centres (10,000-100,000 population) were located in Alberta: Okotoks, Wood Buffalo, Grande Prairie, Red Deer, Canmore, Medicine Hat and Lethbridge. Notably five of these centres were outside the Calgary Edmonton Corridor.

in the Calgary Edmonton Corridor
The Calgary Edmonton Corridor is emblematic of the boom's benefits. Among 19 large North American urban centres, this region ranked 4th in terms of job creation and enjoyed the lowest unemployment rate (3.5 percent in 2006) in Canada. This region could build upon its enviable standard of living position, as measured by GDP per capita. With the purchasing power of US$57,000 in 2005, individuals in the Corridor surpassed the American average by US$15,000, and are ranked second among OECD countries after Luxembourg in terms of prosperity.

and across Canada
Some Canadians outside of Alberta look at the province's recent drive to prosperity with envy and are even critical that Alberta's gains have hurt the rest of Canada by raising overall costs and, in turn, leading to a tighter monetary policy setting than would otherwise be the case.

The TD report, however, points out the tremendous spin-off benefits on the rest of Canada. For instance, it notes a study that estimates 60 percent of the total output and employment benefits from oil sands development will migrate to other parts of Canada through higher demand for manufacturing goods, such as steel. Alberta's above average income level finances redistribution in Canada and helps to keep taxes down lower in the other provinces. Indeed, the net contribution of Alberta residents to federal coffers is about $9 billion per year, or almost $3000 in per-capita terms.

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But prosperity comes with a price tag
There are some negative consequences to the economic boom. Labour market shortages abound, partly spurred by an increasing number of baby boomers heading into retirement. This will likely curtail economic growth. Shortages are also found in housing and materials' across the province. Prices are rising fast and enormous strains have been placed on infrastructure and the environment.

For instance, the vacancy rates for lower end rental units in the Edmonton market declined from 5-6 percent to 1-1.5 percent in 2006, pushing up rents sharply. Homelessness has soared – up approximately 20 percent in 2006. In Calgary, estimates of the number of homeless show a near five-fold increase over the past decade. Smaller markets in the Corridor are now experiencing similar shortages of affordable housing.

Governments at work
Governments have worked hard to keep up with the demands for new infrastructure and public services. Accommodating growth has been particularly apparent at the provincial level, where revenues have poured in on the back of a rising resource and non-resource. Indeed the government's overall discretionary spending has forged ahead at 12 percent per year since fiscal 2004-05. However in some cases this is like throwing fuel on a fire. In the construction industry, the burst of public capital spending has competed head-to-head with private projects, driving up materials and labour costs.

This unfortunate outcome illustrates the difficult challenge facing policy makers in Alberta. Public consultations have done little to clarify the future direction. For every Albertan that has called for restraint, at least one has supported immediate measures to alleviate service and infrastructure deficiencies in the province. There is no easy solution, but in some cases spending should be moderated in order to avoid exacerbating the rise in costs.

Down the road
The report states that Alberta is in a strong position for future prosperity, citing for instance that the price of oil is likely to remain elevated. Moreover the strength of the oil patch has allowed Alberta to establish a competitive overall tax environment, which should support growth in other industries.

But some important challenges remain that will need to be addressed to ensure sustained prosperity for all Albertans. Challenges cited in the report include:

Advancing diversification
The oil and gas industry now represents 19 percent of the province's GDP, down from 23 percent in 2001. This bodes well for the province as it is less dependent on fluctuating oil and gas prices. The province must ensure diversification continues around a thriving oil and gas sector. Yet, if not managed carefully, a number of recent policy decisions could impact the sector's long-term viability, including changes to royalty and tax programs as well as the environment. The provincial government's response to the Royalty Review Panel's report will also have significant implications.

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The most powerful way to foster diversification is to continue with Alberta's past formula of creating a winning business climate, including further improvements to the province's tax competitiveness at both the personal and corporate levels.

These measures should be complemented by actions to spur trade opportunities and reduce regulation. The 2006 Trade Investment Labour Mobility Agreement (TILMA) between B.C. and Alberta is in its early stages. Continued efforts to cement the details and to bring other provinces on board could provide significant rewards to Alberta's exporters.

Climate change
It is widely considered that a price of $30 per tonne of greenhouse gas emissions is the minimum to achieve meaningful reductions. This would translate into an extra $3 per barrel of oil, which could substantially change the economics of production. But the National Roundtable on the Economy and Environment has estimated that in order to achieve a 45 per cent reduction in emissions by 2050 – in line with stated federal objectives – the carbon price would ultimately need to be at least $200 per tonne, or $20 per barrel (in 2003 dollars). This underscores the urgency of accelerating initiatives to achieve energy efficiencies in the oil patch.

Skilled labour shortages
While the Corridor is home to one of the most highly-skilled workforces in the world, only 43 percent of high school students move on to Post Secondary Education – the lowest rate in Canada. Although high school drop out rates had been following a downward track they remain above the national average. This suggests Alberta's high average education attainment is being supported by inter-provincial migration of educated workers.

Heritage Fund
If non-renewable resource revenues decline in the future – which is a real risk – an inadequate savings endowment to fund services would imply higher taxes, reduced public services and a lower standard of living. This is why reviving the Heritage Fund is a smart policy decision. The fund has grown by $5 billion since 2003, to $17 billion. In total, the government's endowments add up to about $40 billion.

An independent assessment of the current investment strategy and recommended changes that would maximize the returns is a smart step forward. It is hoped that Alberta draws lessons from Norway's Petroleum Fund, which boasts $200 billion in assets. For instance, moving forward it would be wise to diversify investments to markets outside of Alberta as well as Canada. This will mitigate the problem of too much capital chasing relatively fixed resources, resulting in the inefficient allocation of resources.

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According to Mr. Drummond: “The promise of oil sands projects, combined with assets such as a young, educated population and an excellent business climate, bodes well for the region. Yet Alberta needs to focus on addressing some of its vulnerabilities – most which stem from the pressures that flow from a burgeoning economy – in order to lay the seeds for prosperity well into the future. Progress has been made, but more needs to be done to ensure the province sustains its enviable economic position.”

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