

Executive Summary

Introduction

This report is the first in the Vision 2020 project series. Vision 2020 is a multi-year project intended to provide insight on how demographic changes may impact Alberta's economic, social and policy landscape and to track how government responds to the challenges that these changes present.

This first report introduces the Vision 2020 project, explains the demographic changes Alberta can expect to see through 2026, and presents the first set of results from the Vision 2020 fiscal projection model.

Research Findings and Conclusions

There is no question that, without much higher immigration levels, much of the developed world will experience population aging as a result of the combination of low fertility rates and increased life expectancy over the coming decades. What is uncertain is whether or not these demographic changes will cause serious fiscal problems for governments.

Government-provided health care in Canada as it is currently organized is expected to produce significant cost increases through 2050, and while Canada's overall sustainability outlook can be considered promising, it is dependent on controlling spending in general and health spending in particular.

Alberta can expect its population to age in coming years and may experience significant spending increases as a result of the interaction of population aging and the age-sex structure of health care costs. Health care spending accounts for a large portion of provincial government spending in Alberta and, in real per capita terms, has been growing faster than GDP for two decades. Generally speaking, provincial government spending in Alberta grew faster than the sum of population growth and inflation by 1.5 per cent per year on average between 1982 and 2001.

In addition to fiscal threats on the spending side of the ledger, Alberta must contend with serious potential threats to its revenue base as natural resource royalties are Alberta's single largest revenue source and long-term projections of production and prices are unreliable.

One of the main purposes of this paper is to present the Vision 2020 fiscal projection model for Alberta. While many scenarios for Alberta indicate that its fiscal policies are sustainable, even using a relatively stringent measure of sustainability, there are projections that indicate that we could be on an unsustainable path. These projections highlight three main risks.

The first risk is real per capita health care costs continuing on their long-term growth pattern. Real per capita health expenditures have increased by 2.2 per cent per year on average between 1980/81 and 2003/04, while real GDP per capita has only grown an average of 1.5 per cent per year between 1982 and 2003. Government efforts to reform health care in Alberta need to recognize that large annual increases in health spending have not solved the fundamental problems in the provision of health care and that it is time to consider all reform options. Without reform, high health spending poses a significant risk to our fiscal future.

The second risk is that natural resource royalty revenues may fall from a moderate level of 3.7 per cent of GDP on average to 2.8 per cent. While the near-term outlook for royalty revenue in Alberta is good, long-term projections are highly uncertain. Resource revenues may continue to accrue, as in recent years, with the help of oil sands production and the possibility of non-conventional natural gas production, but a significant drop in revenue is well within the range of possibilities. Although this revenue source is volatile, there are some actions the government can take on the spending side of the budget to mitigate the negative effects of a possible drop in resource revenues. In addition to controlling health care spending, total spending could be capped at the growth rate of population and inflation combined.

The third risk is that future fiscal surpluses may be “spent” rather than saved. Running surpluses over the near term creates a virtuous circle of increased investment income, which makes deficits less likely to occur and helps avoid “temporary” spending increases that become permanent. Saving surpluses can have a big impact on our future fiscal performance. In the high population growth base scenario, assuming no changes in the current tax system, high revenues allow the excess of financial assets over financial liabilities, or net financial assets, to grow to 27.7 per cent of GDP in 2026 if the government saves the “excess” revenue. If the government does not run surpluses and spends the “excess” revenues instead, net financial assets fall to 0.8 per cent of GDP in 2026. In addition to controlling general spending and reforming health care, the provincial government should budget for surpluses in coming years with the expectation of needing the revenue generated by the assets and possibly the assets themselves to pay for health care spending or offset revenue decreases in other areas.

As a final recommendation, the provincial government make public, their own long-term projections of fiscal balance in Alberta using a range of scenarios (i.e., low royalty revenue, high annual growth rates for health care costs). These projections should become part of the budget process, with revised projections as assumptions about demographic and economic factors are updated.