Intelligence MEMOS

From: Glen Hodgson and Charles St-Arnaud

To: Alberta Economy Watchers

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Re: **The Oilpatch is Gushing Money. Where's the Boom?**

Alberta has earned a reputation over many decades for being a boom-bust economy. Strong oil demand and high prices create boom times for jobs, incomes, investment and government revenues, while slowdowns and recessions too often follow weak demand and falling prices.

Now, global oil demand is again rising and prices are high. Even so, more oil-production revenue is not translating into a sustained economic boom for **Alberta**.

The province's economy grew by 4.8 percent in real terms (before **inflation**) in 2021. A budget surplus has financed or paid for Premier Danielle Smith's latest inflation-relief handouts.

While that sounds good, there was no oil boom; this growth is simply part of a pan-Canadian COVID-19 recovery.

Alberta's 2021 growth trailed that of most other provinces and territories, ahead of only Manitoba, Newfoundland and Labrador and Saskatchewan. Growth has since slowed with a weak outlook and a possible recession is projected into 2023.

The reason is that oil producers are eschewing expansion and even seeking to reinvent their business model amid the global push for structural change toward **energy** that produces lower greenhouse gas emissions.

Alberta's oil producers are allocating revenues away from investment and toward payments to investors. Revenue has soared to more than $12 billion a month in 2022 thanks to high prices and record-high production, but this gusher is not translating into strong investment.

The share of producer revenues used for dividends and share buybacks has nearly tripled to 11 percent today, compared to roughly 4 percent in 2014, according to Alberta Central, which serves the province's credit unions, after analyzing financial statements of major oil producers. Most shareholders who benefit are not Albertan, or even Canadian, so financial leakage is limiting overall provincial growth.

Moreover, Alberta-based oil producers are reinvesting much less into their operations than before – $15-billion or 7 percent of producer revenues today, versus $25-billion or 25 percent of revenues at the 2014 price peak. Current investment is largely focused on capital expenditures that improve operating efficiency, not on expanding longer-term oil production capacity.

A few interpretations are possible. The numbers could reflect a temporary adjustment due to the exceptional sudden windfall in oil revenues. This might explain the exceptional dividends and buybacks, but not the sharp drop in oil revenues being allocated to investment, or the shift from capacity building to investing for efficiency.

A second interpretation would focus on specific bottlenecks. Insufficient pipeline capacity for Alberta's oil can discourage investment in new production. Regulatory delays can impair investment appetite. A proposed cap on oil and gas sector emissions would add another layer of uncertainty. These interpretations are reasonable, but do not address the full context.

A more holistic interpretation is that many Canadian oil producers have begun a structural repositioning of their business model, reflecting a global shift toward energy production and use with much lower GHG emissions.

Extracting maximum shareholder value from existing assets and limiting investments in any significant new production, is a rational choice for oil-producing firms operating in a mature industry that faces eventual decline in demand. Value for shareholders and business repositioning become higher priorities than investing in production.

We will only truly know after the fact whether this is the beginning of a pivotal point for Alberta's oil producers. But if it is, there will be many consequences for the provincial economy. The oil-driven boom-bust cycle may end, and patterns of investment, employment and migration, income and growth will all be affected. There will also be national implications – for international trade, investment and capital flows, the value of the loonie and, ultimately, Canada's competitiveness and growth potential.

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To send a comment or leave feedback, email us at blog@cdhowe.org.

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