

Intelligence MEMOS



From: Lennie Kaplan
To: Alberta Budget Observers
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Re: **ALBERTA NEEDS COMPREHENSIVE BUDGET STRESS TESTING**

Alberta's revenue forecasting prowess is back in the spotlight as the province faces potential [budget deficits](#) over the next two fiscal years. Alberta has several revenue sources, most notably non-renewable resource revenues and corporate income taxes, that are significantly affected by commodity price swings. A one-dollar change in the price of a barrel of oil moves provincial revenue up or down \$640 million, presenting a forecasting risk unique in Canada.

And revenue forecasts have been spectacularly [wrong](#) the last two fiscal years; off by \$24.6 billion in 2021-22 and \$13.5 billion in 2022/23. This erodes both credibility and public confidence provincial budget and quarterly update numbers.

What can be done?

Discipline around [budgeting](#) the use of non-renewable natural resource revenue is one step. And budget stress testing and revenue and expense at risk analysis is another. This relatively new forecasting best practice is being [used](#) in a number of U.S. states, including big ones like California and Pennsylvania along with Montana, Idaho and Wyoming. State budget stress tests measure the effects of various hypothetical economic scenarios on long-term revenue and expense estimates. These scenarios are then compared to a realistic baseline to measure potential revenue and expense at risk.

Utah is one of the best at this [stress testing analysis](#), according to many observers. In 2016, the Utah Office of the Legislative Fiscal Analyst (LFA) and the Governor's Office of Planning and Budget conducted their first stress testing exercise. This resulted in a 2018 [bill](#) that required the LFA to conduct state budget stress testing every three years. These have helped the state develop a fiscal sustainability toolkit with options to close budget shortfalls caused by recessions, reports [PEW Charitable Trusts](#). These include various revenue increases, spending cuts, and reserves.

Alberta has had its own best-practice assessments of budget forecasting. In 2015, as a senior manager in Alberta Treasury Board and Finance, after a best practice review, I recommended that Alberta's budget documents provide further detail on the range of plausible revenue outcomes/scenarios (high, baseline and low) and to incorporate wider use of stress testing and revenue at risk analyses, disclosing the results in the budget documents. Unfortunately, the Alberta government did not adopt this recommendation for another four years.

In 2019, on the request of the [MacKinnon Panel on Alberta's Finances](#), Alberta Treasury Board and Finance prepared three fiscal and economic scenarios for panel members: a status quo scenario, a continued constrained market access scenario, and a global recession scenario, examining the impacts of each on a balance sheet basis, including revenues by source, surplus/(deficit), fiscal and capital plan debt, and net financial debt. As part of its deliberations, the MacKinnon panel [recommended](#) regular releases of alternative fiscal and economic scenarios to assess key fiscal and economic risks and offer a formal analysis of Alberta's exposure to external factors.

[Budget 2019](#) marked the first public release of a formal assessment of the risks to the economic and tax revenue and resource revenue outlooks through low oil price, high oil price, and no market access scenarios. [Budget 2021](#), presented only high and low scenarios, with an attempt to expand the analysis by including the balance sheet impact, including the annual deficit and the net financial debt. However, [Budget 2022](#) and [Budget 2023](#), removed discussion of the balance sheet impact.

The Alberta government can and should do better by expanding its budget stress test and revenue and expense at risk analysis reporting in Budget 2024 and beyond.

Here are five recommendations:

- The Alberta government should prepare and publicly release a formal, comprehensive and annual budget stress test report in its budget documents.
- The annual budget stress test report should examine a range of budget scenarios, including low revenue, high revenue, energy transition policies, and global recession scenarios.
- It should examine the impact of each scenario on revenues by source, expenses by function, surplus/(deficit), net financial assets/(debt) and fiscal and capital plan debt.
- A discussion and analysis section should be included, examining the economic and fiscal outlook over 10-years, as a means of assessing long-term fiscal sustainability.
- The requirement for the preparation and public release of a comprehensive annual budget stress test report should be legislated within Alberta's fiscal framework.

Lennie Kaplan is a former senior manager in the fiscal and economic policy division of Alberta's Ministry of Treasury Board and Finance, and was Executive Director to the MacKinnon Report on Alberta's Finances. He recently retired from his position as Executive Director of Research at the Canadian Energy Centre.

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