



C a l g a r y
**Chamber of
Commerce**
in business together

2010 Provincial Pre-Budget Submission

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	3
INTRODUCTION	5
1 MEASURES TO IMPROVE THE PROVINCE’S SHORT-TERM FISCAL POSITION	6
1.1 SUSTAINABILITY FUND WITHDRAWAL POLICY	6
1.2 PROVINCIAL DEFICIT LIMITATION POLICY	7
1.3 SUSTAINABILITY FUND RECAPITALIZATION POLICY	7
1.4 CAPITAL BORROWING POLICY: A SMART DEBT CEILING	8
2 MEASURES TO IMPROVE THE PROVINCE’S COMPETITIVE POSITION	10
2.1 COMPETITIVE AND COST EFFECTIVE HEALTH CARE DELIVERY	10
2.1.1 <i>Fiscal Sustainability of the Health Care System</i>	10
2.1.2 <i>A Competitive Facilities Market</i>	11
2.1.3 <i>Cooperation to Mitigate Cost Escalation</i>	11
2.1.4 <i>Long Term vs. Acute Care</i>	11
2.2 COMPETITIVENESS OF THE OIL AND GAS SECTOR	12
2.3 COMPETITIVENESS OF THE PERSONAL INCOME TAX SYSTEM	14
2.3.1 <i>Increasing the basic personal exemption amount from \$16,775 to \$20,000</i>	15
2.3.2 <i>Lowering the current flat tax rate from 10 to 9 per cent</i>	16
3 MEASURES TO IMPROVE THE PROVINCE’S LONG-TERM FISCAL POSITION	17
3.1 PROVINCIAL EXPENDITURE MANAGEMENT POLICY: A SMART SPENDING BANDWIDTH	17
3.2 PROVINCIAL SAVINGS POLICY: THE ‘VISION 2050’ FRAMEWORK	18
3.2.1 <i>Budgeted Approach to Resource Revenue Savings</i>	19
3.2.2 <i>Unbudgeted (Surplus) Approach to Resource Revenue Savings</i>	21
WORKS CITED	22



Executive Summary

The Calgary Chamber of Commerce represents over 2,300 Calgary based businesses and puts forth the following 2010 pre-budget submission and recommendations to assist the province in developing strategies and managing expenditures over the short and long term, while favourably positioning Alberta for the next economic surge.

1. Measures to Improve the Province's Short-term Fiscal Position

Chamber members identified accessing the *Sustainability Fund* and borrowing for capital spending as actions the provincial government could undertake to balance the budget in the short term.

1.1. Sustainability Fund Withdrawal Policy

It is recommended that the province adopt a *Sustainability Fund* Withdrawal Policy that links withdrawals from the fund to the percentage decline in total provincial revenues. For 2009-10 total provincial revenues are forecasted to decline by 19 per cent. A corresponding withdrawal of 19 per cent from the *Sustainability Fund* would be equivalent to \$3.29 billion. Under this scenario the government would have needed to reduce program spending by \$1.1 billion to balance the budget.

1.2. Provincial Deficit Limitation Policy

It is recommended that the province adopt a Deficit Limitation Policy that:

- Allows deficits only when negative real GDP is forecast and no balance exists in the *Sustainability Fund*; and
- Limits the size of the deficit, as a proportion of total government expenditures, to the percentage decrease in GDP.

1.3. Sustainability Fund Recapitalization Policy

It is recommended that the province adopt a *Sustainability Fund Recapitalization Policy* that, in times of surplus:

- Requires that 10 per cent of annual resource revenue be allocated to the Sustainability Fund (rather than a fixed amount); and
- Sets a formula-based approach for setting the *Sustainability Fund* minimum balance to help ensure sufficient funding exists to cover shortfalls in response to volatile energy prices.

1.4. Capital Borrowing Policy: A Smart Debt Ceiling

It is recommended that the province establish a *Smart Debt Policy* that:

- Includes an exhaustive list of large, one-time capital projects (such as water infrastructure, roads, bridges etc.) as candidate projects for debt financing;
- Establishes a *Smart Debt Ceiling* whereby total debt servicing costs are capped at 0.5 per cent of total provincial revenues;
- Sets amortization terms over the useful life of the debt financed assets – to ensure the beneficiaries (i.e. current and future Albertans) share the costs; and
- Establishes a comprehensive repayment plan, with a focus on ensuring the province's accumulated debt, as estimated in its long-term capital plan, not exceed the *Smart Debt Ceiling*, estimated at \$4.1 billion in 2009 based on an interest rate of 4 per cent.

2. Measures to Improve the Province's Competitive Position

Chamber members identified managing health program expenditures, tax competitiveness and the competitiveness of the oil and gas sector as key provincial budgetary priorities.

2.1. Competitive and Cost Effective Health Care Delivery

It is recommended that the province

- Amend the *Health Care Protection Act* to decrease Ministerial authority over surgical facilities. In doing so, prioritize patient safety by ensuring that Alberta Health Services and the College of Physicians and Surgeons of Alberta collaborate on creating a streamlined regulatory environment.
- Make certain that any legislative change facilitates competition in the surgical facilities market.
- Ensure, where possible, that any legislative change helps create a level playing field for all health care providers by cooperating in the distribution of resources.



- Continue with the reallocation of resources from acute care to long term care.

2.2. Competitiveness of the Oil and Gas Sector

The Alberta government is currently undertaking a review of the competitiveness of Alberta's natural gas and conventional oil sector, and the Calgary Chamber of Commerce commends the Government of Alberta for commissioning the Study.

It is recommended that the province

- Compare Alberta's regime internationally to understand capital deployment alternatives.
- Adjust the royalty regime to recognize that different extraction methods (e.g. enhanced oil recovery, shale gas production, etc.) and the very nature of resource plays (from one off wells to entire scheme developments) result in fundamentally different operations and therefore require alternate fiscal and regulatory frameworks.
- Establish a royalty mechanism for the development of emerging unconventional resources (shale gas, tight oil) and enhanced oil recovery.
- Ensure adequate upside investment return potential to compensate for investment risk, and encourage reinvestment by:
 - Reducing the initial royalty take to allow faster recovery of capital costs.
 - Reducing the steepness of the royalty curve (royalty rate increase as price and production increases) and incorporate cost factors into the royalty structure to account for cost escalations as prices fluctuate.
- Encourage innovation and the development of new recovery and environmental technology through various tax, royalty and/or other incentives.
- Maintain industry and government collaboration in energy research and development to share technological and cost risks (e.g. carbon capture and storage investment partnership).
- Create a permanent and ongoing forum for industry/government dialogue to address emerging issues, ensure understanding of industry investment decision metrics, and explore opportunities to capitalize on emerging resource development.

2.3. Competitiveness of the Personal Income Tax System

It is recommended that the province adopt broad-based tax cuts through either: [1] Increasing the basic personal exemption amount from \$16,775 to \$20,000; or [2] lowering the current flat tax rate from 10 per cent to 9 per cent.

3. Measures to Improve the Province's Long-term Fiscal Position

Chamber members identified limiting spending increases to the rates of population and economic growth, and creating a permanent income stream by saving a portion of non-renewable resource revenues to reduce the likelihood of future budget deficits over the long term.

3.1. Provincial Expenditure Management Policy: A Smart Spending Bandwidth

It is recommended that the province adopt a bandwidth approach to government spending, by targeting increases within a range delimited by population and inflation growth, and real GDP and inflation growth. For 2010-11, this range is between 3.4 and 3.5 per cent.

3.2. Provincial Savings Policy: The 'Vision 2050' Framework

It is recommended that the province adopt a plan to decrease budgeted resource revenues as a proportion of total budgeted revenues from 19 per cent (six year average) to no more than 15 per cent during the next three years, and deposit the resulting 'savings' in the *Heritage Savings Trust Fund*. By 2050, the Fund would generate over \$4.3 billion in additional annual payments – almost equalling and replacing the value of current budgeted resource revenues.

It is recommended that the province amend the unbudgeted surplus policy to be more responsive to fluctuations in resource revenues by creating a proportional link to budgeted resource revenues. A policy requiring that 100 per cent of *unbudgeted* surplus revenues in excess of 50 per cent the value of *budgeted* resource revenues go into the *Heritage Savings and Trust Fund* (in addition to the existing 1/3 policy) would generate \$3.25 billion in annual savings, leading to over \$13.6 billion in payments annually by 2050.



Introduction

The Calgary Chamber of Commerce represents over 2,300 Calgary based businesses. On critical and emerging issues in public policy, the Chamber acts as the leading forum for debate, and advocates public policy solutions that improve the business climate on behalf of its members. The Calgary Chamber makes this submission on behalf of its members, the small, medium and large enterprises that are directly impacted by the budgeting, financial management and expenditure decisions of the province.

Given current economic challenges, setting the right conditions for business success is more important than ever. The Calgary Chamber of Commerce, on behalf of its members, has for many years brought forward recommendations on key issues to increase economic opportunities and raise Albertans' standard of living and, in doing so, conducts annual surveys to canvas its membership on the spending and fiscal management priorities of government. In a 2010 pre-budget survey, members identified controlling health and other program spending, the competitiveness of the oil and gas sector, and tax competitiveness as their top priorities:

The structure of this pre-budget submission is based on three objectives to improve the financial and competitive position of the province:

1. Measures to Improve the Province's Short-term Fiscal Position
2. Measures to Improve the Province's Competitive Position
3. Measures to improve the Province's Long-term Fiscal Position

The Calgary Chamber of Commerce makes the following analyses and recommendations to assist the province in developing strategies to balance the budget over the short and long terms, while favourably positioning Alberta for the next economic surge.



1 Measures to Improve the Province's Short-term Fiscal Position

The latest update of the 2009-10 provincial budget forecasts a \$6.9 billion deficit. In a 2010 pre-budget survey, Chamber members identified accessing the *Sustainability Fund* and borrowing for capital spending as actions the provincial government could undertake to balance the budget.

The latest update of the 2009-10 provincial budget forecasts a \$6.9 billion deficit. In a 2010 pre-budget survey, Chamber members identified accessing the *Sustainability Fund* and borrowing for capital spending as actions the provincial government could undertake to balance the budget.

1.1 Sustainability Fund Withdrawal Policy

In 2003, the government created the *Sustainability Fund* under the *Fiscal Responsibility Act* to help “ensure that government spending doesn’t rise and fall with volatile energy prices.” (Alberta Legislative Assembly, 2003:3). Under the *Act*, \$5.3 billion of all non-renewable resource revenues can be used for general government purposes, but any excess must be transferred to the *Sustainability Fund*. If actual non-renewable resource revenue is less than \$5.3 billion in any given year, the difference may be allocated from the Alberta *Sustainability Fund* to the General Revenue Fund.

The Chamber applauds the government’s foresight in establishing the *Sustainability Fund* to protect the province against resource revenue shortfalls resulting from sudden shifts in energy prices. The province is forecasting \$5.56 billion of total resource revenues for 2009-10 – close to a 55 per cent reduction from 2008-09 resource revenues of \$12.3 billion. This decline was a significant shock to the provincial budgetary framework, and the Alberta government plans to withdraw \$4.3 billion from the *Sustainability Fund* to cover the 2009-10 forecasted deficit, which would reduce the Fund’s value to \$13.3 billion by the end of the year (Government of Alberta 2009:1).

While the Chamber recognizes that the intended purpose of the *Sustainability Fund* is to cover revenue shortfalls in times of economic decline, the Chamber also recognizes the importance of prudently managing of the province’s energy wealth and financial reserves to preserve Albertans’ quality of life. The Province’s 2009-10 deficit expenditures of \$4.3 billion represent 24 per cent of the *Sustainability Fund*’s 2009-10 opening balance. At this rate of withdrawal, the fund will be empty before the end of fiscal 2012-13.

The Chamber proposes that the province adopt a *Sustainability Fund Withdrawal Policy* that links the Fund’s rate of depletion to the rate of decline in total provincial revenues. To illustrate, total provincial revenues are forecasted to decline by 19 per cent between fiscal 2008-09 and 2009-10. A corresponding withdrawal of 19 per cent from the *Sustainability Fund* would be equivalent to \$3.29 billion. Under this scenario the government would have needed to reduce program spending by \$1.1 billion to balance the budget – an aggregate spending reduction of nearly 3 per cent.

This proposed withdrawal policy creates a proportionate link between revenue declines and withdrawals from the *Sustainability Fund*, and would provide the province with a responsive and flexible framework for managing withdrawals from the *Sustainability Fund*, enabling the province to gradually transition away from resource revenue dependence in the event of a structural shift in the provincial economy away from oil and gas revenues.

It is recommended that the province adopt a *Sustainability Fund Withdrawal Policy* that links withdrawals from the fund to the percentage decline in total provincial revenues.



1.2 Provincial Deficit Limitation Policy

Maintaining balanced budgets has been a long-standing recommendation of the Calgary Chamber of Commerce. In strong economic times, where real GDP is growing, this is a sensible approach that encourages governments to live within their means and pay down debt where possible. However, the Chamber acknowledges that at certain economic periods, this recommendation may not be the most advantageous for the economy. Severely constraining spending during an economic downturn may prevent government from investing in much needed fiscal stimuli.

Chamber members are clearly concerned with deficits and growing debt. The provincial government has worked diligently to eliminate structural deficits and the provincial debt burden. In the event that government chooses to go into deficit to stimulate the economy during an economic downturn, it is important that Albertans be provided with assurances that the recurring deficits of the past do not become normal practice now and in the future.

Consequently, the Chamber proposes that the provincial government adopt a new deficit limitation policy, which would allow deficits on those extremely rare occasions when GDP growth is negative. The proposed approach would limit the size of the deficit, as a proportion of total government expenditures, to the percentage decrease in GDP, provided that the province does not have the *Sustainability Fund* to draw upon.

For example, if GDP is forecast to contract by 1 per cent, the deficit should be a maximum of 1 per cent of total government expenditures. When there is GDP growth, government would not be permitted to run a deficit. TD Economics estimates that Alberta GDP will decline by 2.3 per cent in 2009 (TD Economics 2009:6). This permits a deficit of \$848 million based on 2009-10 provincial expenditure estimates of \$36.9 billion.

This approach enables government to stimulate the economy during tough economic times, while ensuring deficits are eliminated during periods of economic growth.

It is recommended that the province adopt a *Deficit Limitation Policy* that:

- Allows deficits only when negative real GDP is forecast and no balance exists in the *Sustainability Fund*; and
- Limits the size of the deficit, as a proportion of total government expenditures, to the percentage decrease in GDP.

1.3 Sustainability Fund Recapitalization Policy

The Chamber recognizes the importance of protecting the province from the volatility of our natural resource dependence as well as funding capital projects to help manage our growth pressures, and endorses the concept of the *Sustainability Fund*. However, the Chamber also recognizes and supports the need for a principled approach to the fiscal management of our resource revenues.

The uncertainty surrounding world energy markets creates challenges for governments in anticipating future resource revenues. According to the *Fiscal Responsibility Act*, when resource revenues exceed \$5.3 billion, at least \$2.5 billion must be held in the *Sustainability Fund* in anticipation of emergencies, disasters, rebates, First Nation settlements and budget shortfalls.

However, such an arbitrary threshold is not necessarily responsive to market conditions and future revenue shortfalls. Rather than establishing a minimum threshold for the Fund, the



Chamber recommends that the government adopt a formula-based approach for setting the *Sustainability Fund* minimum balance, in part, based on economic forecasting techniques. A formula based approach will help ensure sufficient funding exists to cover budget shortfalls in response to volatile energy prices and economic trends that impact Alberta's resource revenues.

It is estimated that the proportion of resource revenue required for government to meet long-term spending obligations between 2001 and 2005 was 55 per cent (Kneebone, 2005:37).¹ The Chamber, therefore, recommends that government adopt a 10 per cent proportion (rather than absolute) rule for annual resource revenue allocations to the *Sustainability Fund* during periods of economic growth.

The *Fiscal Responsibility Act* has been amended in each of the last three years, with the government spending limit increasing from \$3.5 billion in 2003-04 to \$5.3 billion in 2006-07. In addition to adopting a formula based approach for establishing Fund allocations and thresholds, and in accordance with a principled approach to savings and investment, any subsequent threshold and allocation changes to the *Sustainability Fund* should be subject to consultation with the Board of the Alberta Investment Management Corporation.

It is recommended that the province adopt a *Sustainability Fund Recapitalization Policy* that, in times of surplus:

- Requires that 10 per cent of annual resource revenue be allocated to the Sustainability Fund (rather than a fixed amount); and
- Sets a formula-based approach for setting the *Sustainability Fund* minimum balance to help ensure sufficient funding exists to cover budget shortfalls due to volatile energy prices.

1.4 Capital Borrowing Policy: A Smart Debt Ceiling

Over the past decade Alberta has come to pride itself as a debt-free province. However, with the focus on debt reduction and program cuts in the 1990s, maintaining and building the province's infrastructure was easily ignored, as infrastructure assets have life spans that exceed political terms and the immediate effects of deferred infrastructure maintenance and investment in new infrastructure are less noticeable in the short term.

Consequently, the government is continually faced with a choice of what kind of debt is preferred: financial debt or infrastructure debt. Government has chosen infrastructure debt over the last 10-20 years and are now faced with crumbling roads, broken sewers, below grade highways, weakened bridges and traffic congestion. The lack of investment over the past 15 years accumulated into an infrastructure debt estimated at \$7 billion in 2005 (Government of Alberta 2008).

A number of factors have aligned to make debt financing of major infrastructure projects an attractive option.

- Alberta is considered a safe place for investment and has a AAA credit rating.
- The economic downturn has forced central banks to lower both short and long term interest rates to record low levels
- The province holds a significant amount of capital in its various savings vehicles, many of which have the potential to earn a rate of return greater than the rates the province would be charged on infrastructure related loans.

¹ It should be noted the proportion of resource revenue required for government to meet long-term spending obligations increased from 44 per cent between 1995 – 2000, to 55 per cent between 2000 and 2005 (Kneebone 2006:42), an indication that a 55 per cent government dependence benchmark is a generous assumption.



- The cancellation and delay of many large private projects has loosened the market for both labour and goods, thus decreasing the total cost of construction.

Though the term 'debt' has a particularly negative connotation in Alberta, there are times when debt is a wise choice. By investing during a period of negative growth the province can mitigate the worst of the economic downturn by providing jobs to workers and income to businesses, while positioning itself to reap the benefits of infrastructure investment. According to Statistics Canada, between 1962 and 2006 roughly one-half of the total private sector growth in multifactor productivity was the result of growth in public infrastructure (Gu and MacDonald 2009:7). In Alberta, a 1% increase in municipal infrastructure spending alone leads to a 2.4% increase in provincial GDP (Vander Ploeg with Brunnen 2003:33).

The key challenge for government is to develop and adopt a principled and disciplined debt financing framework, one that involves choosing the right projects at the right time, while mitigating the risk of structural deficits and debt – this is known as *Smart Debt*.

Smart debt is a valid form of infrastructure financing but should only be used in conjunction with a few broad parameters on how and when to borrow. It must be understood that debt and leveraging of any kind introduces risks that are ultimately borne by Albertans. Government, as the "custodian" of the wealth of the province and its future generations, must apply a high standard of prudence when making investment and financing decisions. Typically, there are four guidelines associated with smart debt (Vander Ploeg with Brunnen 2004:25):

- Only a few capital projects are well-suited for tax-supported debt financing. These include large one-time projects with long asset lives that can leverage additional financing elsewhere (e.g. water pipelines, sewer and roads etc). Operationally intensive capital assets such as hospitals or educational institutions, whose operating costs sometimes exceed the capital costs, are not suitable candidates for smart debt;
- Smart debt programs require a definition of a sustainable level of borrowing or some notion of optimal debt relative to future revenues and anticipated growth – to prevent unsustainable and out of control borrowing. In 2009 a total debt servicing cost cap of 0.5 per cent of total provincial revenues would provide \$4.1 billion worth of additional financing (assuming an interest rate of 4 per cent), which represents 59 per cent of the province's 2009-10 budgeted capital expenditures (Government of Alberta 2009b:6);
- Pursuing smart debt policies requires setting out guidelines regarding debt structure and amortization – projects should be financed over the useful life of the asset rather than based on arbitrary time lines or lowest cost financing. In this way, the project is better managed and monitored, and future generations who benefit also share in the costs; and
- Smart debt plans recognize that debt only finances infrastructure, and that the debt must be funded. Before issuing debt, the province must draw up a comprehensive repayment plan.

The 2009-12 provincial Capital Plan released with Budget 2009 contains a three-year commitment of \$23.2 billion - \$1.1 billion of which will be directly borrowed each year for the next three years to support capital spending (Government of Alberta 2009c:91). As at March 31, 2009, the province's accumulated debt totaled \$1.16 billion (Government of Alberta 2009b:7) – an amount well within the proposed *Smart Debt Ceiling* of \$4.1 billion identified by the Chamber.

However, if the province were to continue this trend over the next three years (as delineated in the 2009-12 Capital Plan) total accumulated provincial debt would equal \$3.36 billion – an amount perilously close to the Chamber's proposed smart debt ceiling. Consequently, it is imperative that the province continue to monitor the growth of its accumulated debt, and ensure that no additional significant debt is planned or accumulated beyond its 2009-12 Capital Plan, unless there is room in the proposed smart debt ceiling.



It is Recommended that the province establish a *Smart Debt Policy* that:

- Includes an exhaustive list of large, one-time capital projects (such as water infrastructure, roads, bridges etc.) as candidate projects for debt financing;
- Establishes a *Smart Debt Ceiling* whereby total debt servicing costs are capped at 0.5 per cent of total provincial revenues;
- Sets amortization terms over the useful life of the debt financed assets – to ensure the beneficiaries (i.e. current and future Albertans) share the costs; and
- Establishes a comprehensive repayment plan, with a focus on ensuring the province's accumulated debt, as estimated in its long-term capital plan, not exceed the *Smart Debt Ceiling*, estimated at \$4.1 billion in 2009 based on an interest rate of 4 per cent.

2 Measures to Improve the Province's Competitive Position

Chamber members identified managing health program expenditures, tax competitiveness and the competitiveness of the oil and gas sector as key 2010 provincial budgetary and financial management priorities.

2.1 Competitive and Cost Effective Health Care Delivery

Chamber members identified managing health care spending and delivery as their top 2010 provincial fiscal management priority. Health care expenditures represented 35 per cent of total provincial expenditures in the 2009-10 provincial budget. This proposal focuses on reforms to both health care delivery and health care financing.

2.1.1 Fiscal Sustainability of the Health Care System

Public health care encompasses an increasing proportion of the provincial budget. Alberta Health and Wellness real per capita expenditures have increased by nearly 75 per cent in the last 10 years. With Ministry allocations increasing by approximately 8 per cent in 2008/09 alone, health care now comprises 34 per cent of the province's budget (\$12.7 billion). Alberta already spends the most per capita on health care of any province in Canada but seems to have turned a corner with a spending reduction of 2.1% for 2009-2010. However, Alberta Health Services will be carrying a \$1 billion dollar deficit moving forward, and received a 6.5 per cent increase in its funding allocation for 2009-2010 (Government of Alberta, 2009a).

Research conducted by the Alberta Chambers of Commerce and Certified General Accountants Association of Alberta finds that real per capita health expenditures in Alberta increased by 2.2 per cent per year on average between 1980/81 and 2003/04, while real GDP per capita only grew an average of 1.5 per cent per year between 1982 and 2003 (Alberta Chambers of Commerce and Certified General Accountants of Alberta 2004).

The Alberta Chambers of Commerce recognizes that more spending on health care is not the solution. In a 2008 survey of Calgary and Edmonton Chamber members, 70 per cent of respondents agreed that current health care spending is unsustainable. The looming demographic shift will continue to put pressure on the health care system, since the amount spent per patient increases with age.



It is essential that government, private industry, and the health care community collaborate to build a health care system that offers a competitive advantage, fiscal sustainability, and fosters and supports a healthy population.

2.1.2 A Competitive Facilities Market

Competition encourages technological, clinical, and systemic innovation and productivity enhancements that improve the overall sustainability and accessibility of our system. The current legislative framework inhibits competition by functioning as a barrier for entry into the facilities market. Other systems that are not covered by the *Health Care Protection Act* (HCPA), like diagnostic services and long term care facilities, have experienced success in attracting private capital and encouraging competition. As part of any legislative reform, the Chamber recommends that the Government of Alberta adjust the current legislative framework to encourage competition among public and private providers, both for-profit and non-profit.

The amended legislative framework can facilitate competition in a number of ways: [1] by ensuring that contracts are structured in the same fashion as commercial contracts, with duties and obligations distributed more evenly between the two parties; [2] by facilitating different funding methodologies that encourage competitive internal markets like patient focused funding; and [3] by decreasing Ministerial authority over non-hospital surgical facilities (NHSFs) and the associated red tape when contracting with AHS.

2.1.3 Cooperation to Mitigate Cost Escalation

While enhancing competition, it is important to keep in mind that all providers are operating under the same system and should cooperate in distributing resources especially when for-profit and non-profit facilities are contracted to provide publicly funded care.

For example, because AHS purchases pharmaceuticals for system wide application it can take advantage of bulk purchases and discounted rates. Previously, under the Calgary Health Region, ophthalmological centres could purchase extraordinary pharmaceuticals at rates set by the Region for publicly funded patient care. This allowed for-profit and non-profit providers to address complex cases, of which there may have been 10 or fewer per year, without having to purchase 1000 units (the minimum order) of pharmaceuticals the vast majority of which would go to waste. Since the transition, these providers have not been able to purchase from AHS resulting in significant and unneeded cost escalation, and decreasing system-wide efficiency. Any cost-savings achieved by an equal distribution of resources, pharmaceutical and otherwise, among for-profit and non-profit providers could be captured by AHS thus reducing system wide costs and increasing sustainability.

In principle, the whole system should benefit from the economies of scale generated by AHS. If and when the AHS is able to negotiate joint/ equal procurement agreements with non-AHS providers, the entire system should benefit through reduced costs.

2.1.4 Long Term vs. Acute Care

For some time the level of patients requiring long term care in the community but occupying acute care hospital beds has been rising. In Calgary, over 190 patients in acute care are waiting for community living spaces. AHS has recognized the need to adapt to the changing needs of Alberta's health system by launching its *Community and Acute Care Strategy* which will open up spaces in the community, while also freeing capacity for other uses in hospitals. As acute care spaces require four or five times more funding than long term care spaces, the strategy will help save an estimated \$35 million to \$50 million annually.



The Chamber applauds this common sense strategy, which reflects the kind of thinking that is needed for Alberta to maintain a sustainable health care system.

It is recommended that the province

- Amend the *Health Care Protection Act* to decrease Ministerial authority over surgical facilities. In doing so, prioritize patient safety by ensuring that Alberta Health Services and the College of Physicians and Surgeons of Alberta collaborate on creating a streamlined regulatory environment.
- Make certain that any legislative change facilitates competition in the surgical facilities market.
- Ensure, where possible, that any legislative change helps create a level playing field for all health care providers by cooperating in the distribution of resources.
- Continue with the reallocation of resources from acute care to long term care.

2.2 Competitiveness of the Oil and Gas Sector

Chamber members identified the competitiveness of the oil and gas industry as a top Alberta government priority for 2010. Alberta's oil and gas sector represents a fundamental component of the broader provincial economy. It is estimated that 42 per cent of provincial GDP is derived from the oil and gas sector, with approximately 15 per cent (\$23 billion) as a result of direct mining and oil and gas activity (Mansell 2006). The remainder of this contribution is attributable to downstream economic activity resulting from the oil and gas sector – both indirectly (through increased demand for geological, drilling, accounting and technological services) and through induced activity (such as increased consumption and investment associated with higher incomes and profits).

New analysis from the Canadian Energy Research Institute (CERI) forecasts that over the next 25 years oil & gas activities in Alberta will create a total GDP impact of \$2.9 trillion within Canada, providing total federal tax revenues of \$311 billion and \$189 billion in Alberta. Incremental employment gains are estimated to be 13,750 thousand person years within Alberta, and an additional 4,780 thousand person years across the country (reaching a total of 18,530 per thousand person years). In addition, oil & gas activity is expected to result in \$12 billion in royalties per year to the Government of Alberta. The study indicates a three-fold return to the Canadian economy for oil & gas investment in Alberta (CERI 2009). These government revenues and economic growth prospects could be jeopardized by a fiscal and regulatory regime that is uncompetitive.

The Alberta government is currently undertaking a review of the competitiveness of Alberta's natural gas and conventional oil sector, and the Calgary Chamber of Commerce commends the Government of Alberta for commissioning the Study. It has the potential to position the province more competitively to capitalize on its tremendous resource endowment, while restoring industry and investor confidence in the process.

At the heart of the Study is the opportunity to articulate a long-term vision of energy development in the province and create a forward-focused, stable, fiscal and regulatory regime that is globally competitive and responsive to technological change. The key outcome is attracting investment, creating jobs and ensuring economic prosperity for all Albertans.

To continue to build this prosperity the fiscal and regulatory review must position the province as a global leader in attracting capital and recognize the changing nature of the Western Canada Sedimentary Basin (WCSB) towards 'resource plays' (large unconventional oil & gas deposits that are regionally intensive) and enhanced oil recovery.

Important elements of a fiscal and regulatory regime to deliver efficient oil & gas production in an increasingly carbon-constrained environment should include:

- Securing a Return on Investment (ROI) for investors that reflects the level of risk taken.
- Ensuring predictability and stability to instill trust and confidence for investors.
- Providing economic incentives for the development of the widest range of energy opportunities available and fostering technological innovation and investment in R & D, with particular emphasis on reducing greenhouse gas emissions during production.
- Recognizing that different extraction methods (e.g. enhanced oil recovery, shale gas production, etc.) and the very nature of resource plays (from one off wells to entire scheme developments) result in fundamentally different operations and therefore require alternate fiscal and regulatory frameworks.
- Making improvement of the regulatory process a major ongoing priority with the goals of minimizing the regulatory burden and eliminating duplication and increasing collaboration between regulatory bodies to achieve outcome based assessments.
- Ensuring producers, large and small, are treated equitably.
- Fostering continuous improvement in environmental management.
- Providing responsive and equitable economic rent from resource development for Albertans.
- Providing an ongoing forum for constructive dialogue with industry to capitalize on emerging opportunities and encourage greater understanding of the impacts of any proposed regime changes.

The Chamber recognizes that a parallel stream of regulatory review analysis is currently underway. It is extremely important that such a review takes place within the context of the key points above as this is an important component of overall competitiveness. Other variables include access to resources, geology, commodity prices, political climate, currency exchange rates, financial capital mobility and labour costs. These factors should be important considerations in developing the final regime.

Success of the Study also means establishing and maintaining a positive and trusting working relationship between the Department of Energy and industry, as the major joint stakeholders in maximizing the potential of Alberta's energy resources. Improved dialogue leads to better understanding of industry investment decisions and impacts of fiscal and regulatory decisions.

The Calgary Chamber of Commerce puts forth the following recommendations in several key areas.

It is recommended that the province

- Compare Alberta's regime internationally to understand capital deployment alternatives.
- Adjust the royalty regime to recognize that different extraction methods (e.g. enhanced oil recovery, shale gas production, etc.) and the very nature of resource plays (from one off wells to entire scheme developments) result in fundamentally different operations and therefore require alternate fiscal and regulatory frameworks.
- Establish a royalty mechanism for the development of emerging unconventional resources (shale gas, tight oil) and enhanced oil recovery.
- Ensure adequate upside investment return potential to compensate for investment risk, and encourage reinvestment by:
 - Reducing the initial royalty take to allow faster recovery of capital costs.
 - Reducing the steepness of the royalty curve (royalty rate increase as price and production increases) and incorporate cost factors into the royalty structure to account for cost escalations as prices fluctuate.
- Encourage innovation and the development of new recovery and environmental technology through various tax, royalty and/or other incentives.



- Maintain industry and government collaboration in energy research and development to share technological and cost risks (e.g. carbon capture and storage investment partnership).
- Create a permanent and ongoing forum for industry/government dialogue to address emerging issues, ensure understanding of industry investment decision metrics, and explore opportunities to capitalize on emerging resource development.

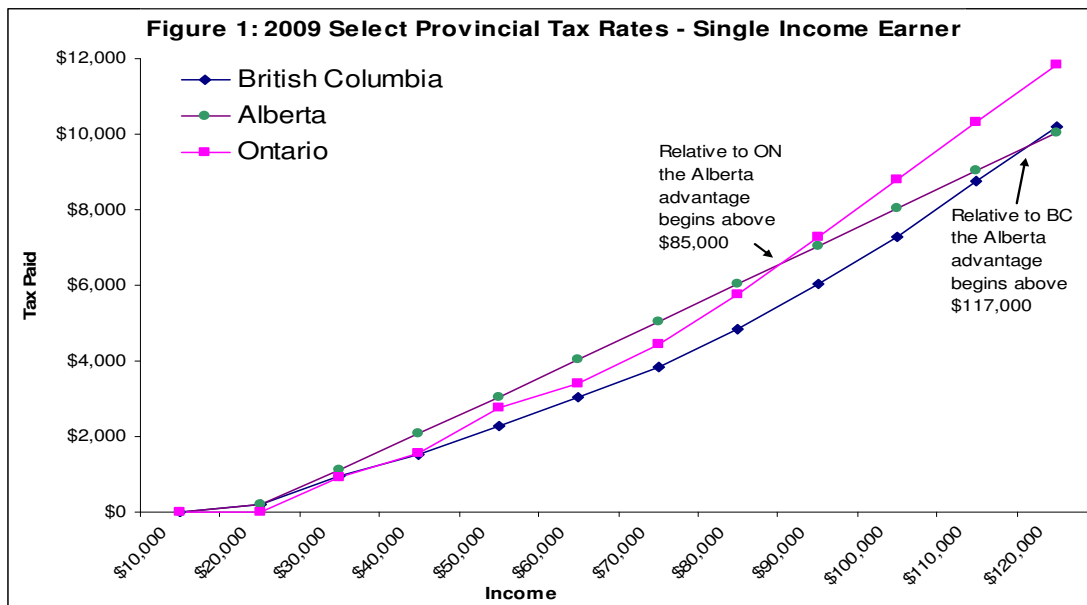
2.3 Competitiveness of the Personal Income Tax System

In the Chamber's 2010 pre-budget survey, members identified tax competitiveness as a high priority for government to improve the business environment. Through generous personal exemption thresholds and child tax credits, Alberta's personal income tax system is one of the most advantageous in Canada for families with children. The withdrawal of Alberta health care premiums (though the Chamber believes that a such reduction would have been better targeted through the personal income tax system) was also of great benefit to all Albertans. While the Chamber appreciates the government's commitment to families, in order for Alberta to improve the business climate and encourage economic growth, the province's personal income tax regime for individuals needs to be more competitive relative to neighbouring jurisdictions.

Both British Columbia and Ontario adjusted their tax margins this year by raising the thresholds to the lower margins and raising their basic personal deductions. Ontario also lowered its lowest tax rate from 6.05 per cent to 5.05 per cent. All these changes resulted in a reduction in Alberta's personal income tax competitiveness for single income earners (Figure 5).² Last year Albertans paid less tax than Ontarians on taxable income over \$80,000, now Albertans are better off only after taxable income of \$85,000. B.C. has further widened its gap with Alberta, losing its advantage only after the \$117,000 threshold.

From a tax-to-earnings perspective, Alberta is, therefore, less competitive than both British Columbia and Ontario for the majority of individual income earners. With a recovery from the global financial crisis in sight, a continued commitment to personal income tax competitiveness would send a signal to the rest of Canada, and North America that Alberta is ready for the next boom.

² BC imposes a carbon tax, a health care premium and a sales tax, while Ontario imposes a health care premium and a sales tax.



Source: Statistics Canada, Alberta Finance

Alberta is the only Canadian jurisdiction that applies a proportional flat income tax rate for all income levels – ensuring fair treatment regardless of income. At the same time, Alberta also boasts the highest basic personal exemption amount (\$16,775) and, therefore, exhibits one of the most progressive average tax rates in the country (as income increases, the average tax rate also increases).

To preserve the favourable distributional attributes of Alberta’s personal income tax regime while improving upon our competitive position relative to British Columbia and Ontario, the Chamber is calling for personal tax reductions.

It is recommended that the province adopt broad-based tax cuts through one of two methods:

- [1] Increasing the basic personal exemption amount from \$16,775 to \$20,000; or
- [2] Lowering the current flat tax rate from 10 per cent to 9 per cent.

2.3.1 Increasing the basic personal exemption amount from \$16,775 to \$20,000

Increasing the basic personal exemption amount to \$20,000 will improve our competitive position relative to BC and Ontario by narrowing the Alberta-BC tax gap for all personal income levels, and reclaiming the Alberta advantage outright for income levels up to \$30,000 and taxable income above \$110,000 (Table 1). The Alberta-BC tax differential would decrease from \$1,208 to \$786 for taxable income of \$70,000.

Raising the personal exemption amount would improve the progressiveness of Alberta’s tax regime by increasing average taxes with income. The benefits of this option would accrue largely to lower income earners in Alberta, especially employees in the service and hospitality industries.

With the total number of people employed in Alberta estimated at 2,134,000 (Statistics Canada 2009), the Chamber calculates that this proposed change would cost government \$688 million, or 2.3 per cent of 2009-10 budgeted government revenues.



Taxable Income Level	Existing Income Taxes			Proposed Alberta	
	Ontario	British Columbia	Alberta	Option 1 Increasing Basic Personal Amount to \$20,000	Option 2 Decreasing Flat Tax to 9%
\$10,000	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$20,000	\$0.00	\$195.89	\$206.23	\$0.00	\$240.84
\$30,000	\$924.06	\$951.09	\$1,139.43	\$816.93	\$1,080.72
\$40,000	\$1,574.55	\$1,536.39	\$2,072.63	\$1,750.13	\$1,920.60
\$50,000	\$2,748.63	\$2,288.59	\$3,037.46	\$2,714.96	\$2,789.01
\$60,000	\$3,386.80	\$3,058.59	\$4,037.46	\$3,714.96	\$3,689.01
\$70,000	\$4,421.92	\$3,828.59	\$5,037.46	\$4,714.96	\$4,589.01
\$80,000	\$5,759.99	\$4,838.47	\$6,037.46	\$5,714.96	\$5,489.01
\$90,000	\$7,277.75	\$6,031.42	\$7,037.46	\$6,714.96	\$6,389.01
\$100,000	\$8,795.51	\$7,270.35	\$8,037.46	\$7,714.96	\$7,289.01
\$110,000	\$10,313.27	\$8,740.35	\$9,037.46	\$8,714.96	\$8,189.01
\$120,000	\$11,831.03	\$10,210.35	\$10,037.46	\$9,714.96	\$9,089.01

Bold text indicates a favourable tax burden relative to British Columbia and Ontario.

2.3.2 Lowering the current flat tax rate from 10 to 9 per cent

Lowering the current flat tax rate would similarly improve Alberta's competitive position relative to B.C. and Ontario for all income levels. However, the benefit will accrue largely to higher income earners (Table 1). Under this option, Alberta regains its competitive income tax position over BC for taxable incomes just above \$100,000, and the Alberta-BC tax differential would decrease from a high of \$1,209 to \$505 for an income of \$70,000. It is important to nurture a competitive tax environment and encourage high income earners to continue to invest and generate wealth in the Alberta economy through competitive tax rates.

The Chamber estimates that this proposed change would cost government \$803 million, representing approximately 2.71 per cent of 2009-10 government revenues based on personal income tax revenues of \$8,027 billion, as outlined in government's 2009 First Quarter Fiscal Update (Alberta Finance 2009:5).



3 Measures to Improve the Province's Long-Term Fiscal Position

Chamber members identified limiting spending increases to population and economic growth; and creating a permanent income stream by saving a portion of non-renewable resource revenues as measures the provincial government could undertake to reduce the likelihood of future budget deficits over the long term.

3.1 Provincial Expenditure Management Policy: A Smart Spending Bandwidth

Chamber members identified controlling program spending as a top priority for government to reduce the likelihood of future budget deficits. On average, however, provincial government expenditures have increased beyond the rate of inflation and population growth since 1982 and, in Budget 2008, increased by a further 13.5 per cent – well above the combined rate of inflation and population growth of six per cent for that year. Per capita government spending in Alberta is the highest of any provincial government (Canadian Taxpayers Federation 2008:10).

In the past, Alberta has benefited significantly from the development of its natural resources. Non-renewable resource revenues have contributed an average of more than 30 per cent of total provincial government revenues since 2001, and were as high as 40 per cent in 2005-06. The government's continued reliance on non-renewable resource revenue for current consumption creates an unsustainable and unhealthy dependence on volatile revenue sources, and distorts incentives to maintain or improve efficiencies in program delivery. Unfortunately, reality hit home this year as resource revenues declined nearly 70 per cent putting Alberta in a deficit position.

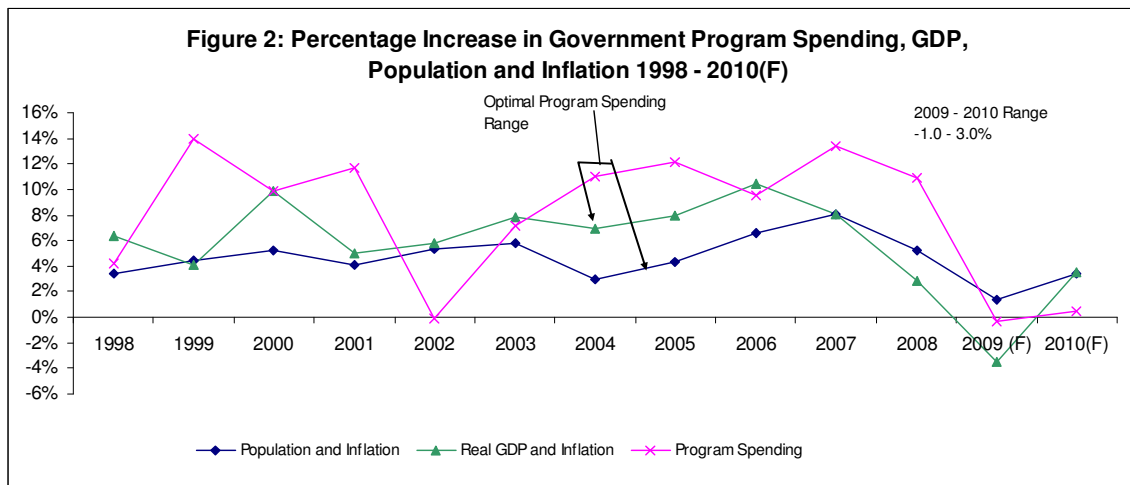
While the Calgary Chamber of Commerce recognizes the importance of maintaining and expanding Alberta's infrastructure to cope with high levels of growth, the message from Calgary business is clear: government needs to control spending. In the past two decades the government and the people of Alberta made the necessary sacrifices to eliminate the provincial deficit and debt. In these uncertain economic times, Alberta's debt-free status provides a steadfast Alberta advantage, and the government should continue to make every effort to avoid deficit spending in the future.

The Chamber, therefore, encourages government to adopt a more sustainable and prudent approach to program expenditures.

It is recommended that the province adopt a bandwidth approach to government spending, by targeting increases within a range delimited by population and inflation growth, and real GDP and inflation growth. For 2010-11, this range is between 3.4 and 3.5 per cent.

This is an ambitious objective, as program expenditures more than tripled the higher end of the bandwidth in 2008-2009, though the Government of Alberta is projected to spend within the bandwidth in 2009 (-1.1 per cent) and 2010 (.05 per cent) (Figure 2).³ It is, however, an objective worth achieving, as nearly 88 per cent of Chamber members indicated that the provincial government should manage spending by basing yearly increases on population and economic growth. In light of the large increases in program expenses during the last few years, and the priority of not slipping into deficit spending, the Chamber would support a move by government to spend below the bandwidth level over the next two years.

³Real GDP plus CPI inflation is used rather than nominal GDP because nominal GDP presents too volatile a target for government budgeting purposes.



Source: Alberta Finance and Statistics Canada

3.2 Provincial Savings Policy: The ‘Vision 2050’ Framework

The government’s dependence on non-renewable resource revenues for ongoing program and operating expenditures is at greater risk today, and looking forward, than it has been in the past. The government is therefore at greater risk of running deficits over the next 20-40 years.

What has served Alberta well as a reliable revenue stream needs to be reviewed, with consideration of how current and medium-term resource revenues could be utilized to create a risk-mitigating alternative revenue stream. Over time, this stream would replace resource revenues as a base for ongoing government operations. Should current global trends continue toward a ‘post-carbon’ energy future, the creation of this endowment or investment stream would secure Alberta’s continued prosperity, opportunity and capacity to serve its citizens.

Since 2002, budgeted resource revenues have represented an average of 19 per cent of total provincial government expenditures. In the absence of non-renewable resource revenues, the government would have been confronted with budgetary deficits every year since 1995 (Alberta Chambers of Commerce 2006:22).

The finite nature of non-renewable resource revenues combined with a potential increase in demand for environmentally-friendly energy sources threaten Alberta’s position as a prosperous, low-tax jurisdiction that offers an unparalleled quality of life. To address these challenges, the Chamber recommends that government adopt a targeted and strategic approach to financial management that mitigates the forward risks of our dependence on carbon-based resource revenues, over time, through the creation of an alternative revenue stream.

The Alberta Chambers of Commerce and Certified General Accountants Association of Alberta, through their *Vision 2020* research in 2005-06, estimate that Alberta could save between 30 and 40 per cent of all non-renewable resource revenue per year, and put those monies into the *Heritage Savings and Trust Fund*, without significant cuts in current program spending. Such a large shift in provincial budgeting and budget strategy, however, appears to be of little interest to Albertans struggling with the current economic uncertainty.

Recognizing these immediate and ongoing demands on government, the Calgary Chamber has investigated further options, drawing from the principles and findings of the *Vision 2020* report, which might help to meet a number of critical, but sometimes competing objectives:



- Improve and expand Alberta’s infrastructure, in support of future business opportunity and economic activity;
- Provide for the ongoing, long-term maintenance of that infrastructure; and
- Set aside a percentage of current resource revenues, and invest in the creation of an alternative revenue stream, so that the province (over time and with a conservative net growth in the assets of the endowment) reduces its dependence on volatile commodities.

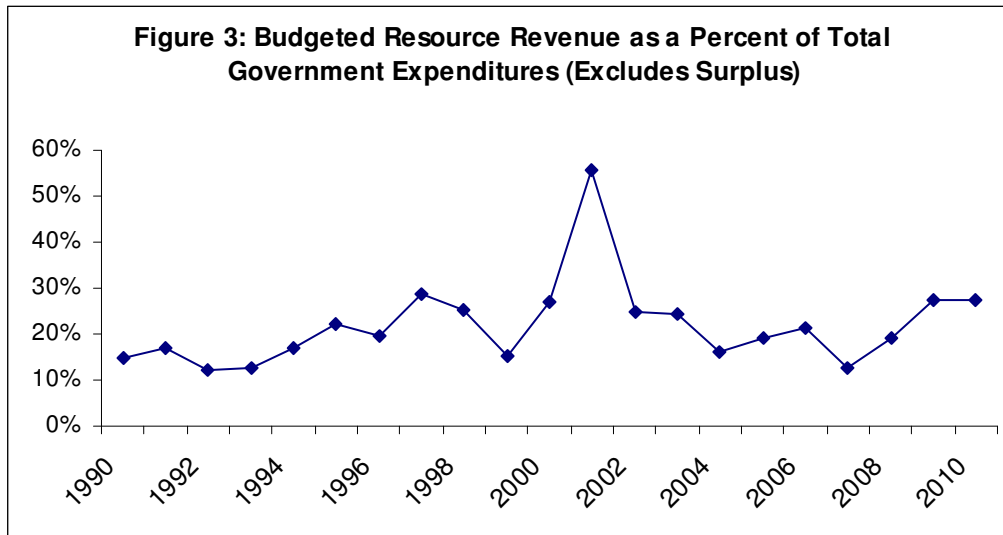
The Chamber, through its annual budget submissions and submission to the Financial Investment Planning and Advisory Commission, has consistently recommended that government commit to investing a long-term average of 35 per cent of non-renewable resource revenues in the Heritage Savings Trust Fund, and that the Fund be structured as a “true” trust, in which the net income earned on the capital invested is added to the fund, rather than transferred into general revenues. This is an ambitious but challenging objective to achieve, given that an average of 49.9 per cent of total resource revenues was unbudgeted since 2002 (Figure 1).⁴ Consequently, as a first principle, any savings framework or strategy needs to incorporate both budgeted and unbudgeted revenues in its approach.

Total Revenue	30.2
Total Expenses	25.3
Resource revenue	9.8
Surplus Resource Revenue	4.9
Surplus as a Proportion of Total Resource Revenues	49.9%
Budgeted Resource Revenues (Total Minus Surplus)	4.9
Budgeted Resource Revenues as a % of Total Expenses	19.3%

3.2.1 Budgeted Approach to Resource Revenue Savings

Since 2002, budgeted resource revenues have represented an average of 19 per cent of total provincial government expenditures (Figure 3). To adopt a more sustainable approach to government expenditures, the Chamber recommends that government gradually decrease this proportion to no more than 15 per cent, and deposit the resulting ‘savings’ in the Heritage Savings Trust Fund, with net revenues retained in the Fund.

⁴ According to Alberta Finance, only budget numbers for 2001-02 forward are fully comparable.



From an implementation standpoint, government could adopt a schedule that seeks to decrease this 19 per cent budgeted revenue proportion gradually, by 1 percentage point in the first year, an additional percentage point in the second year and an additional 2 percentage points in the third year, resulting in the 15 per cent target, which would continue in perpetuity.⁵ The approach facilitates the creation of a savings ‘delta’ over time, and increases contributions to the Heritage Savings Trust Fund, without drastic disruptions or dislocations in forward budgeting, while leaving the government with revenues to meet more immediate needs and demands, as outlined in the previous page.

Assuming a three-year phase-in, and with average annual budgeted resource revenues at \$4.9 billion (since 2002), this approach would generate \$336 million in ‘savings’ (additional contributions to the Fund) next year, \$589 million the following year, and \$1.1 billion in year three and in each year thereafter (Table 3). In a 2009 pre-budget survey, 89 per cent of members identify that government should invest resource revenues to create a permanent income fund. Using a conservative 4 per cent real rate of return, and assuming that net revenues are reinvested, by 2050 the increased capital in the Heritage Savings Trust Fund would generate over \$4.3 billion in payments annually – almost equalling, and thereby almost replacing the value of current budgeted resource revenue, positioning Albertans and their government for prosperity and security in perpetuity. This figure is achievable, without having yet considered the effect of additional contributions to the Heritage Savings Trust Fund from unanticipated and unbudgeted surpluses.

	Annual Savings (Billions)	Budgeted Resource Revenues as a % of Total Expenses
Average Budgeted Resource Revenues (2002- 2008)	4.9	19.3
Year 1	0.336	18
Year 2	0.589	17
Year 3	1.095	15
Year N	1.095	15

⁵ An alternative to a three-year phased in reduction to 15 per cent is to reduce by 1 percentage point per year over a 4-year period.



It is recommended that the province adopt a schedule to decrease budgeted resource revenues as a proportion of total budgeted revenues from 19 per cent (six year average) to no more than 15 per cent during the next three years, and deposit the resulting ‘savings’ in the *Heritage Savings Trust Fund*. By 2050, the Fund would generate over \$4.3 billion in additional annual payments – almost equalling and replacing the value of current budgeted resource revenues.

3.2.2 *Unbudgeted (Surplus) Approach to Resource Revenue Savings*

Unbudgeted resource revenues have represented, on average, 49.9 per cent of total resource revenues since 2002. The province has an established policy of allocating one third of unbudgeted resource revenues to savings, and two thirds to capital and maintenance.

The Chamber recommends that a critical objective of any provincial savings framework should be to save more revenues in times of prosperity, particularly unbudgeted revenues, as these do not adversely impact existing, budgeted programs and service commitments. However, the Chamber also recognizes the need for government to be equipped and able to respond to unanticipated growth pressures that accompany unbudgeted revenues.

Consequently, the Chamber recommends that government look at amending its unbudgeted surplus policy to be more responsive to unbudgeted revenue fluctuations by creating a proportional link to budgeted resource revenues. For example, that unbudgeted surplus policy could require 100 per cent of *unbudgeted* surplus revenues in excess of 50 per cent of the value of *budgeted* resource revenues, go into the Heritage Savings Trust Fund, in addition to the existing 1/3 policy, which would continue to apply to the first 50 per cent of unbudgeted surplus revenues (Table 4).

Table 4: Unbudgeted (Surplus) Savings Framework		
	Revenues (Billions)	Savings (Billions)
Average Total Resource Revenues (2002 - 2008)	9.8	
Surplus Resource Revenues as a Proportion of Total Resource Revenues	49.9%	
Proportion Subject to 100 per cent Savings (50% of the 49.9%)	25%	\$2.44
Proportion Subject to Existing Savings Policy (33% of 50% of 49.9%)	25%	\$0.806
Total Annual Surplus Savings		\$3.25

Unlike the budgeted resource revenue approach, the implementation of this proposed unbudgeted revenue strategy does not require a phased implementation. With an average of 49.9 per cent of resource revenues being unbudgeted since 2002, the suggested unbudgeted savings policy could generate \$3.25 billion in annual savings, leading to over \$13.6 billion in payments annually by 2050, again assuming a 4 per cent real interest rate, with net revenue reinvested.

It is recommended that the province amend the unbudgeted surplus policy to be more responsive to fluctuations in resource revenues by creating a proportional link to budgeted resource revenues. A policy requiring that 100 per cent of *unbudgeted* surplus revenues in excess of 50 per cent the value of *budgeted* resource revenues go into the *Heritage Savings and Trust Fund* (in addition to the existing 1/3 policy) would generate \$3.25 billion in annual savings, leading to over \$13.6 billion in payments annually by 2050.



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