



2010 ALBERTA CHAMBERS OF COMMERCE RESOLUTION Capital Borrowing Policy: A Smart Debt Ceiling

Issue

The provincial infrastructure network underpins Alberta's economy, and is critical to our ability to efficiently provide services and transport people and goods within the province and beyond. Over the past decade Alberta has come to pride itself as a low debt province. However, with the focus on debt reduction and program cuts in the 1990s, maintaining and building the province's infrastructure network was easily ignored. This is because 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 this lack of investment has accumulated into an infrastructure debt estimated at \$7 billion in 2005.¹

Principled Borrowing for Capital Infrastructure Projects

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

- 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, with the potential to earn a rate of return greater than the rates the province would be charged on infrastructure related loans.
- 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

¹Government of Alberta 2008. 20-Year Strategic Capital Plan.



infrastructure.² In Alberta, a 1% increase in municipal infrastructure spending alone leads to a 2.4% increase in provincial GDP.³

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

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:⁴

- 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 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. For fiscal 2010-11 a total debt servicing cost cap of 0.5 per cent of total provincial revenues for capital projects would provide \$4.25 billion worth of additional financing (assuming an interest rate of 4 per cent). This represents 59 per cent of the province's 2010-11 budgeted capital expenditures;⁵
- 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.

² Gu and MacDonald. 2009. *The Impact of Public Infrastructure on Canadian Multifactor Productivity Estimates*. Statistics Canada.

³ Vander Ploeg, Casey with Brunnen, Ben. 2003. *A Capital Question: Infrastructure in Western Canada's Big Six*. Canada West Foundation, Calgary. October

⁴ Vander Ploeg, Casey with Brunnen, Ben. 2004. *No Time to Be Timid: Addressing Infrastructure Deficits in the Western Big Six*. Canada West Foundation, Calgary. February.

⁵ Government of Alberta. 2010. *Budget 2010 Striking the Right Balance*. February



The 2010-13 provincial Capital Plan released with Budget 2010 contains a three-year commitment of \$20.1 billion - \$1.1 billion of which will be directly borrowed this year to support capital spending⁶. As at March 31, 2010, the province's forecasted accumulated debt will total \$1.1 billion⁷ – an amount well within the proposed *Smart Debt Ceiling* of \$4.25 billion identified by the Alberta Chambers. It is imperative, however that the province continue to monitor the growth of its accumulated debt to ensure it does not accumulate unsustainable debt levels, as has been the experience of decades past. This can be achieved through a binding repayment plan that mitigates this risk.

Recommendations

The Alberta Chambers of Commerce recommends that the Government of Alberta:

- 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 capital debt servicing costs are capped at 0.5 per cent of total provincial revenues (based on a three year moving average);
- 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 \$4.25 billion in 2010-11 based on an interest rate of 4 per cent).

⁶ Government of Alberta. 2010. 2010-13 Capital Plan. p111

⁷ Government of Alberta. 2010. budget 2010 Fiscal Plan Tables. p80