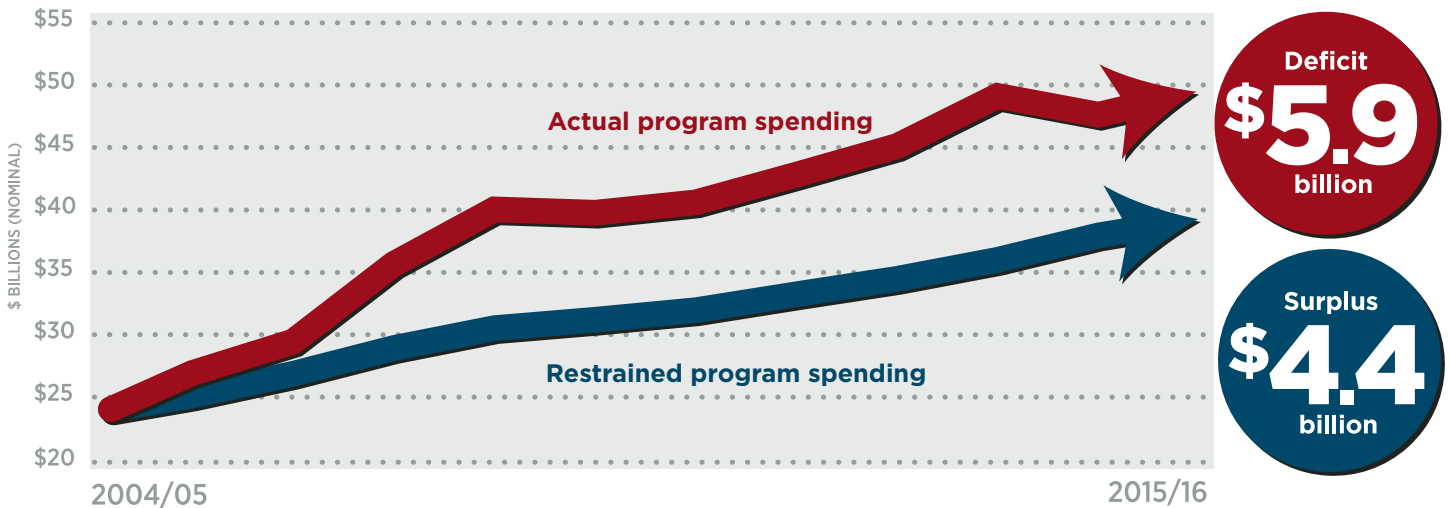


Alberta's Budget Deficit: Why Spending Is to Blame



by Steve Lafleur, Milagros Palacios, Ben Eisen, and Charles Lammam

SUMMARY

- Alberta is headed toward its seventh deficit in eight years and the province is at risk of returning to a net debt position as early as next year.
- A popular narrative holds that the recent fall in oil prices is responsible for the deterioration of Alberta's fiscal position. This view is not supported by the evidence. Instead, the reason Alberta now faces a large budget deficit is spending growth over the past decade.
- Between 2004/05 and 2014/15, government program spending increased by 98.3%, nearly double the rate of inflation plus population

growth (52.1%) and significantly above the rate of economic growth (88.6%) in the province.

- Had the provincial government restrained program spending growth to keep pace with inflation plus population growth since 2004/05, the government would be looking at a \$4.4 billion surplus rather than a deficit of \$5.9 billion for the 2015/16 fiscal year.
- Alternatively, had the provincial government increased program spending at the rate of economic growth since 2004/05, the government could have expected a \$1.9 billion surplus this year.

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Introduction

Alberta's finances used to be the envy of all the provinces, and the backbone of the Alberta Advantage.

That is no longer the case. The province has run seven budget deficits in the last eight fiscal years. In the 2015/16 fiscal year alone, Alberta is currently projected to run a \$5.9 billion deficit, a figure which the finance minister has warned could grow further still.

A popular narrative holds that the recent fall in oil prices is responsible for the deterioration of Alberta's fiscal position. This view is not supported by the evidence. Instead, the reason Alberta now faces a large budget deficit is rapid spending growth over the past decade.

This brief report provides an overview of the state of Alberta's finances, illustrating the severity of the province's fiscal problems. It documents the rapid growth in provincial program spending since fiscal year 2004/05 and shows that program spending growth has significantly outstripped the growth that would have been necessary to offset the effects of population growth and price changes (inflation). It also presents an analysis of how Alberta's fiscal position today would be different if the provincial government had modestly restrained program spending growth over the past 10 years. The last section discusses the implications for present and future policy making.

Alberta's finances today

In the not so distant past, Alberta could boast of having the healthiest finances in Confederation. Spending discipline helped generate large budget surpluses, which in turn allowed for tax relief that helped Alberta become an economic powerhouse. In recent years, however, Alberta's fiscal position has deteriorated significantly.

The large surpluses that the province had enjoyed for many years quickly evaporated and were replaced by regular deficits. In fiscal year 2007/08, Alberta posted a \$2.5 billion surplus (which was itself substantially smaller than the surpluses of immediately preceding years). It would prove to be the last budget surplus Alberta would enjoy until the province finally balanced its books again, for just one year, in 2014/15.

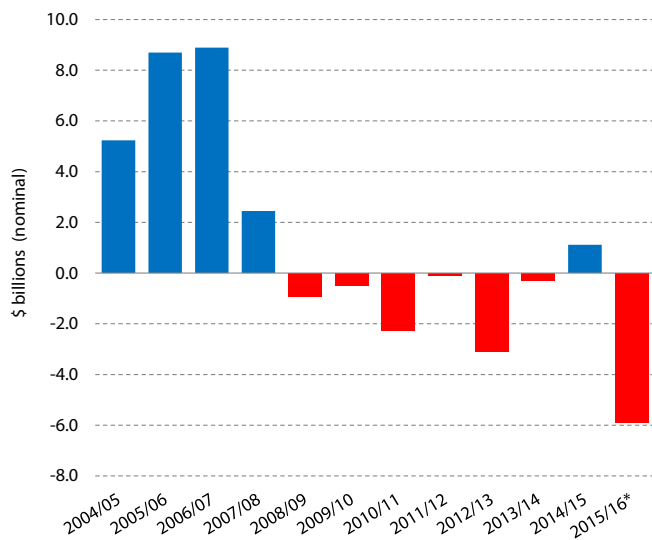
Figure 1 shows the history of Alberta's budget balance between fiscal years 2004/05 and 2015/16. By the end of the current fiscal year (2015/16) the province will have registered deficits in seven of the last eight fiscal years—the one exception being the slim surplus in 2014/15. While the recent decline in oil prices has had an effect on the province's finances, figure 1 clearly shows that deficits have persisted over time, even when economic conditions were relatively strong. For example, the province failed to balance its books between 2010/11 and 2013/14 despite the fact that oil prices averaged over \$90 per barrel and real economic growth averaged 4.6% annually over these years.

Since 2000/01, Alberta has benefited greatly from being in a net asset position (the value of the provincial government's financial assets exceeds the total value of its debt), the product of spending discipline and strong economic performance during the 1990s.¹ However, persis-

¹ Financial assets are the government's financial claims on external organizations and individuals, as well as inventories for resale at the year end. Liabilities represent the government's present obligations to external organizations and individuals arising from transactions or events occurring before the year end (Alberta, 2015e: 35). Net financial assets are arrived at by subtracting liabilities from the assets, and are thus the broadest, most comprehensive measurement of the province's financial "wealth."

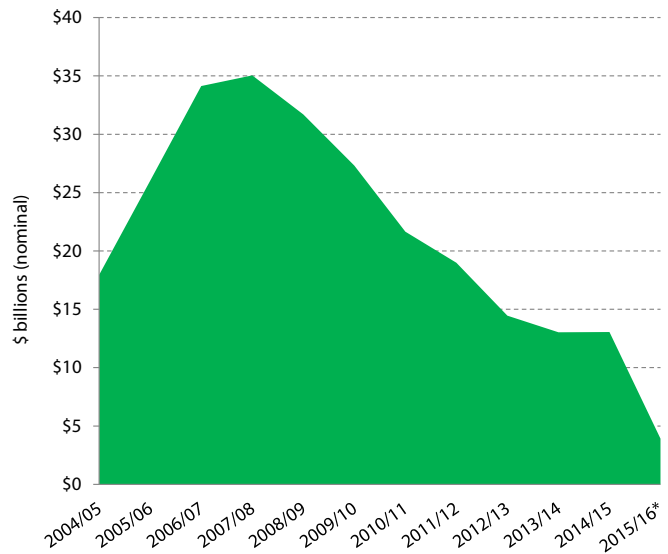
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**Figure 1: Budget balance (\$ billions)
2004/05 – 2015/16**



*2015/16 projection from the First Quarter Fiscal Update. Sources: Alberta, Annual Reports (various years); Alberta (2015a).

**Figure 2: Net Financial Assets (\$ billions)
2004/05 – 2015/16**



*2015/16 projection from the First Quarter Fiscal Update. Sources: Alberta, Annual Reports (various years); Alberta (2015a).

tent deficits over the past eight years have led to a significant decline in Alberta's net financial assets. Figure 2 shows a steep drop in the province's net assets since 2008/09, when Alberta first began to run deficits—from a high of \$35.0 billion in 2007/08 to a forecasted \$3.9 billion in this fiscal year (2015/16). Alberta now is at risk of returning to a net debt position for the first time in over 15 years.

Alberta's spending record

In seven of the past eight years, Alberta has run deficits, even though its economy has enjoyed relatively robust growth rates. While government revenue is expected to fall by 10.4% this year (2015/16), it will still remain over \$6.0 bil-

Note that none of the above includes capital assets, but does include pension liabilities.

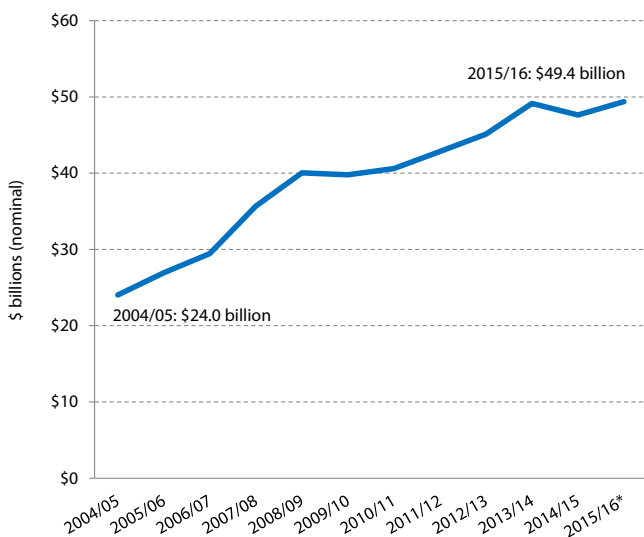
lion (15.7%) higher than pre-recession levels (2007/08). The real reason the Alberta government has—and continues—to run deficits lies on the other side of the ledger, its spending.

Figure 3 shows the substantial increase in provincial program spending (total spending minus interest payments on the debt) since 2004/05. Over the course of a decade (from 2004/05 to 2014/15), program spending increased at an average annual rate of 7.3% and nearly doubled from \$24.0 billion to \$47.6 billion. The provincial government expects program spending to increase another \$1.7 billion in 2015/16, reaching \$49.4 billion.

Alberta's dramatic run-up in program spending during this period can best be put into perspective by comparing program spending increases to other economic benchmarks, the growth in the economy (GDP), and the combined ef-

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Figure 3: Program spending (\$ billions) 2004/05 – 2015/16



*2015/16 projection from the First Quarter Fiscal Update.

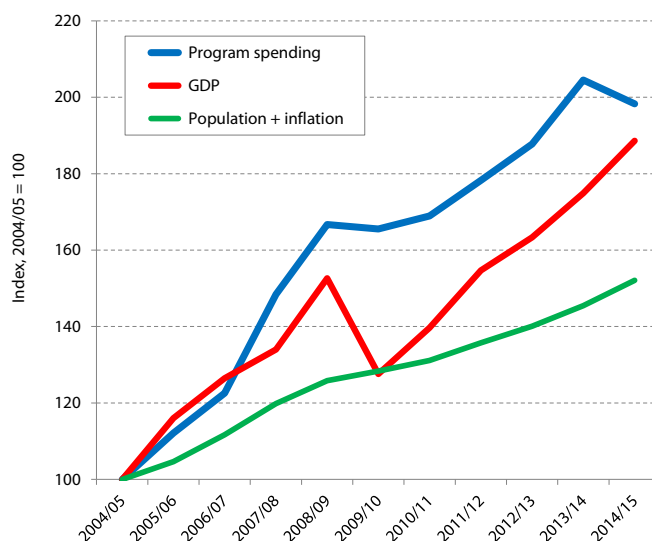
Notes:

- (1) Program spending is defined as total spending minus debt charges.
- (2) Program spending is presented on a Consolidated Financial Statements (CFS) basis, which includes school boards, universities and colleges, and health entities (the SUCH sector) and the Alberta Innovates corporations.
- (3) Program spending for 2015/16 were estimated using the 2015/16 First Quarter Fiscal Update and Economic Statement.

Sources: Alberta, Annual Reports (various years); Alberta (2015a).

fects of population growth and price changes (see figure 4). Alberta's program spending increased by 98.3% in the decade from 2004/05 to 2014/15, nearly double the growth in population and inflation (52.1%) and significantly above the pace of economic growth (88.6%).

Figure 4: Index comparing growth in Alberta's program spending, GDP, population and inflation 2004/05 – 2014/15



Note:

Inflation is measured by changes in Statistics Canada's consumer price index (CPI).

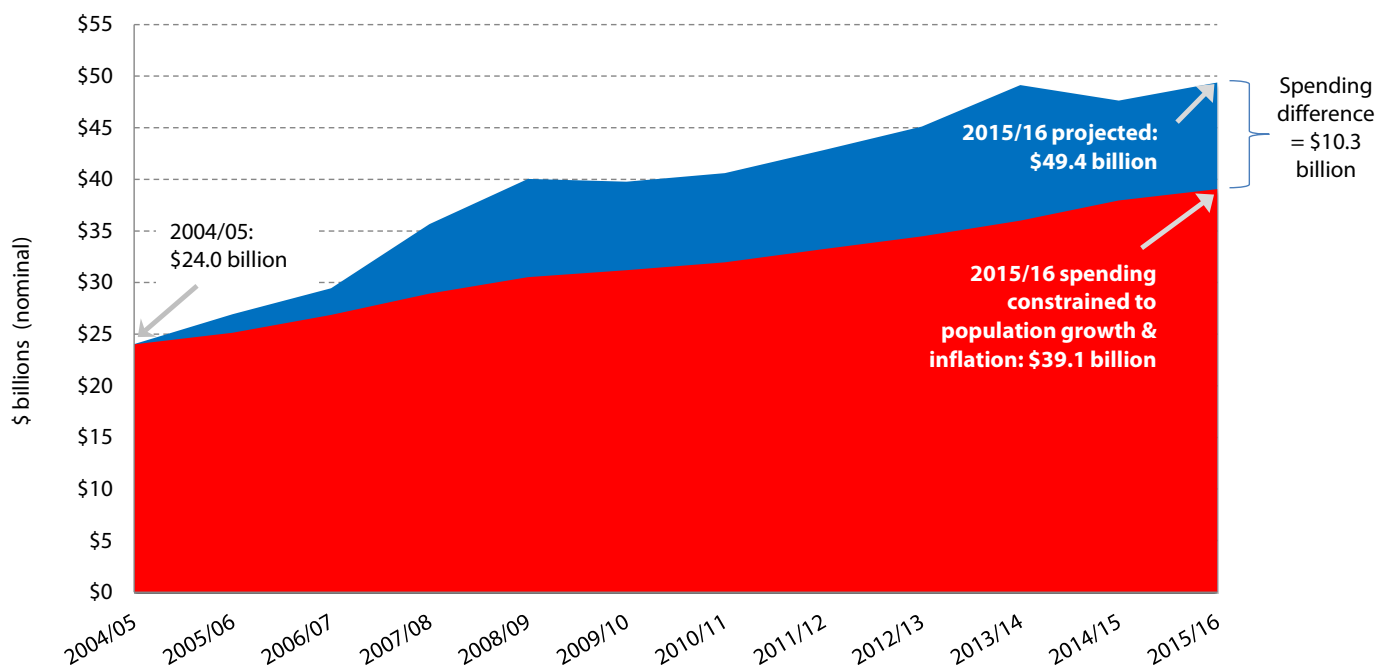
Sources: Alberta, Annual Reports (various years); Alberta (2015a); Statistics Canada (2014a, 2014b, and 2015); calculations by authors.

These large numbers are more digestible if we consider the average growth rate of these metrics during the 10-year period in question. During this period, program spending grew at an average annual rate of 7.3% compared to an average increase in population and prices of 4.7% and economic growth of 6.9%.

The increase in provincial program spending over the past 10 years has been dramatic; the rise has been faster than the underlying economy and faster still than what would have been necessary to offset population growth and inflation. The consequence has been the deterioration of the province's finances.

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Figure 5: Actual Alberta program spending versus spending constrained to population growth and inflation, 2004/05 – 2015/16



Notes:

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- (3) Program spending for 2015/16 were estimated using the 2015/16 First Quarter Fiscal Update and Economic Statement.

Sources: Alberta, Annual Reports (various years); Alberta (2015a); Statistics Canada (2014a and 2015); calculations by authors.

Alberta's finances with spending restraint

The province's descent into deficit spending, as documented above, was entirely avoidable. Here we show what Alberta's fiscal balance would look like today had the provincial government spent responsibly for the past 11 years.

Figure 5 compares actual program spending since 2004/05 along with the projected program spending increase for 2015/16, to what program spending would have been had the provincial government limited program spend-

ing increases to the combination of inflation plus population growth over the period. It shows that since 2006/07, provincial program spending in Alberta has been dramatically higher than would have been the case if the government had held program spending to the rate of inflation plus population growth. Specifically, had program spending increased at the same rate as population growth and inflation (an average of less than 4.5% a year), the Alberta government would currently be forecasting program spending \$39.1 billion for the 2015/16 year instead of the \$49.4 billion it actually plans to spend.

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Put differently, had the Alberta government *increased* its program spending more prudently (averaging just over 4.5% a year) over the past 11 years, current program spending would be \$10.3 billion lower in 2015/16 than it is projected to be, nearly double the 2015/16 forecasted deficit of \$5.9 billion. That means that in the current fiscal year and notwithstanding the recent slump in the price of oil, instead of the \$5.9 billion deficit that it is now projected to run, the province would have run a surplus of \$4.4 billion.

Alternatively, the province could have expected a \$1.9 billion surplus had the provincial government tied program spending increases to GDP growth.

Where to from here?

While Alberta's new provincial government is not at fault for most of the problems documented in this paper, it is nonetheless responsible for solving them. It is therefore concerning that the new government has already taken actions that will see spending increase further and thereby increase the already daunting projected budget deficit it inherited.

During its first weeks in office, the Alberta government announced \$624 million in new spending in a supplementary spending bill. In total, the first quarter fiscal update delivered in August shows that program spending is now projected to be \$1.4 billion higher than was projected in the previous government's March budget. The deficit is projected to now be \$5.9 billion, which is approximately 18% larger than the \$5 billion deficit projected by the previous government in the March budget. This further increase in spending and the resulting increase in the deficit are discouraging, and will be fiscally problematic if they are an early indication of the approach to fiscal policy the new government will take.

The red ink in Alberta stems from poor fiscal policy, not external forces. To solve the problem, the government needs to strike at its root, which is spending growth.

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