

# What's Changed, By How Much, and What Remains to Be Done? An Analysis of Alberta's Budget



by Steve Lafleur, Ben Eisen, and Milagros Palacios

## SUMMARY

- Since 2008/09, Alberta has run a nearly uninterrupted string of budget deficits. This bulletin analyzes the recently tabled 2019 Alberta budget to assess the extent to which it represents a change of course from the policy approach that has prevailed in recent years.
- We find that with the 2019 budget, the trajectory of government spending and the strategy for deficit reduction do represent a change in policy direction. Whereas nominal program was previously growing every year, the new budget forecasts nominal spending reductions in the years ahead.
- Partly as a result of this change in approach, the government now forecasts that it will return to balance one year faster than under the pre-existing fiscal plan and accumulate less debt in the interim.
- However, from a historical perspective, the spending reductions planned in *Budget 2019* are substantially lower than those introduced in the 1990s by the governments of Roy Romanow, Jean Chretien, and Ralph Klein.
- The four-year time horizon to budget balance does contain risks; historically, successful efforts to eliminate large deficits in Canada have taken place over two or three years. Further, *Budget 2019* does not go very far in restoring Alberta's tax competitiveness, and though the province plans to reduce its reliance on resource revenue, the 2019 budget is only a first step in getting the province off the resource revenue "rollercoaster."

# An Analysis of Alberta's Budget

## Introduction

Changes in government sometimes bring with them major changes to fiscal policy. Other times, policy continuity prevails. In Ontario, for example, one recent analysis showed that the change in government from Premier Kathleen Wynne's Liberals to Doug Ford's Progressive Conservatives has largely been marked by policy continuity on spending growth and deficit reduction (Eisen and Lafleur, 2019).

This study analyzes the recently tabled first budget of the new United Conservative government in Alberta to assess whether or not its fiscal policy has shifted fundamentally from that of its predecessors. It focuses specifically on the province's spending trajectory and approach to deficit reduction. We find that the first UCP budget does change policy direction and establishes a different approach to government spending and deficit reduction than that implemented by its predecessors.

This bulletin also provides historical context by comparing the new Alberta government's approach to fiscal consolidation with that of other governments in Canada over the years. We show that Alberta's planned spending reductions are substantially milder than those enacted during the fiscal consolidations of the 1990s. Finally, we discuss the risks to Alberta's fiscal health that will remain during, and even if, the fiscal plan outlined in the UCP government's first budget is fully implemented.

## The past decade—an era of fiscal complacency

Over the past decade, Alberta's fiscal position has deteriorated dramatically. When it went into the global recession of 2008/09, Alberta's government had an enviable fiscal position

among Canadian provinces. It held \$35 billion in net financial assets making it the only province whose financial assets exceeded its debts.

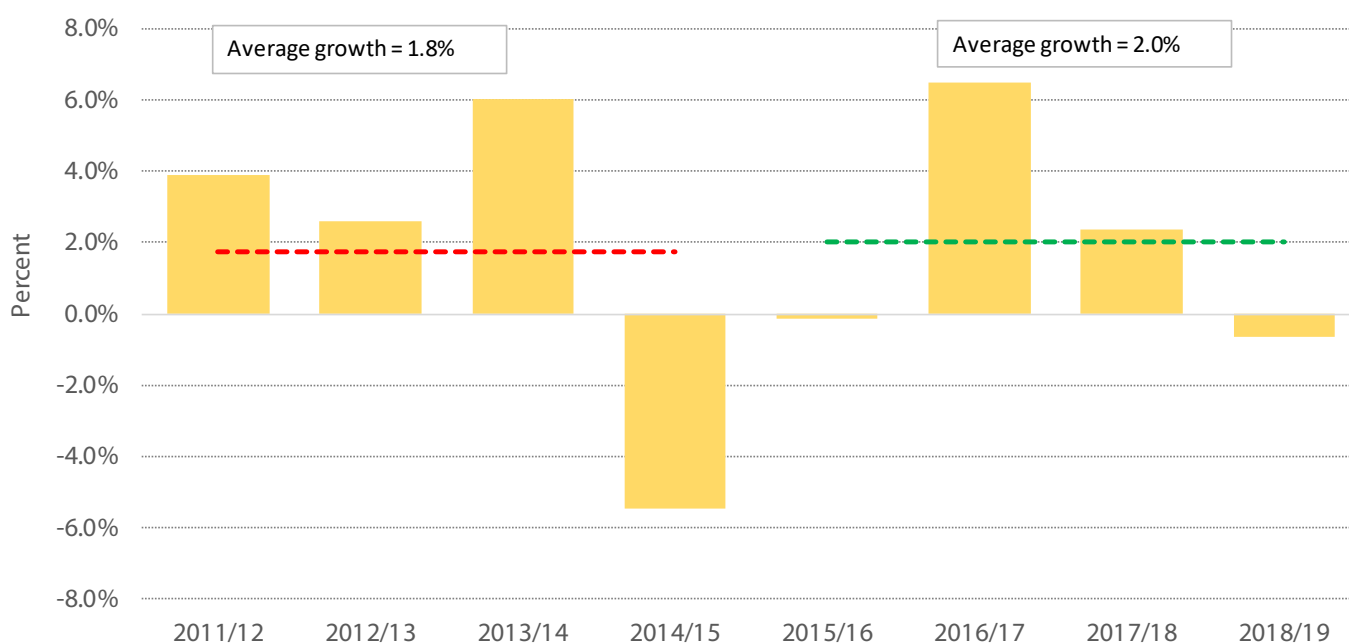
Since then, the province has run a nearly uninterrupted string of operating deficits which have contributed to a rapid erosion of its fiscal position. More specifically, by 2016/17, Alberta's positive net assets were completely depleted, reaching zero. Each year since, the province has accumulated billions of dollars in new debt and its net debt is projected to reach \$37 billion this year. The pace of debt accumulation has raised questions about the sustainability of the province's finances. In fact, a recent report from Canada's Parliamentary Budget Office showed that Alberta's finances are currently unsustainable; in fact, the province will need to make the largest spending reduction (barring tax increases) of any province to achieve sustainability (PBO, 2018).

So, what happened? In short, rapid spending growth by successive governments. Between 2004/05 and 2014/15, program spending (i.e., all operating spending other than debt service costs) increased nearly 100 percent—almost twice what would have been required to account for the growth in population and inflation. These spending increases led directly to the deficits that began to emerge in 2008/09 (Lafleur and Eisen, 2018). Even during relatively strong economic periods and high oil prices the province ran deficits.

The origins of Alberta's current fiscal challenges pre-date the fall in oil prices that started in late 2014 and triggered one of the worst recessions in the province's history. But strong natural resource revenues in the early years of this decade helped conceal the extent of these problems, keeping annual deficits relatively small.

# An Analysis of Alberta's Budget

Figure 1: Growth in Nominal Per-Person Program Spending (%), 2011/12 to 2018/19



Source: Alberta, Ministry of Finance (2019).

When the recession did hit and revenues fell by 13.9 percent in a single year (from 2014/15 to 2015/16), the extent of Alberta's fiscal problems became much more apparent as large deficits emerged. The province went from having a \$1.1 billion surplus in 2014/15 (its only surplus since 2007/08), to having a budget deficit of \$6.4 billion in 2015/16.

This was the fiscal situation that greeted the Notley government when it took office in early 2015. While it inherited a difficult financial position, the new government's approach to fiscal policy—and specifically to government spending—failed to reduce the budget deficit even as the economy rebounded (albeit tepidly).

While other hard-hit energy jurisdictions such as Saskatchewan and Newfoundland & Labrador implemented nominal program spending reductions, the Notley government essential-

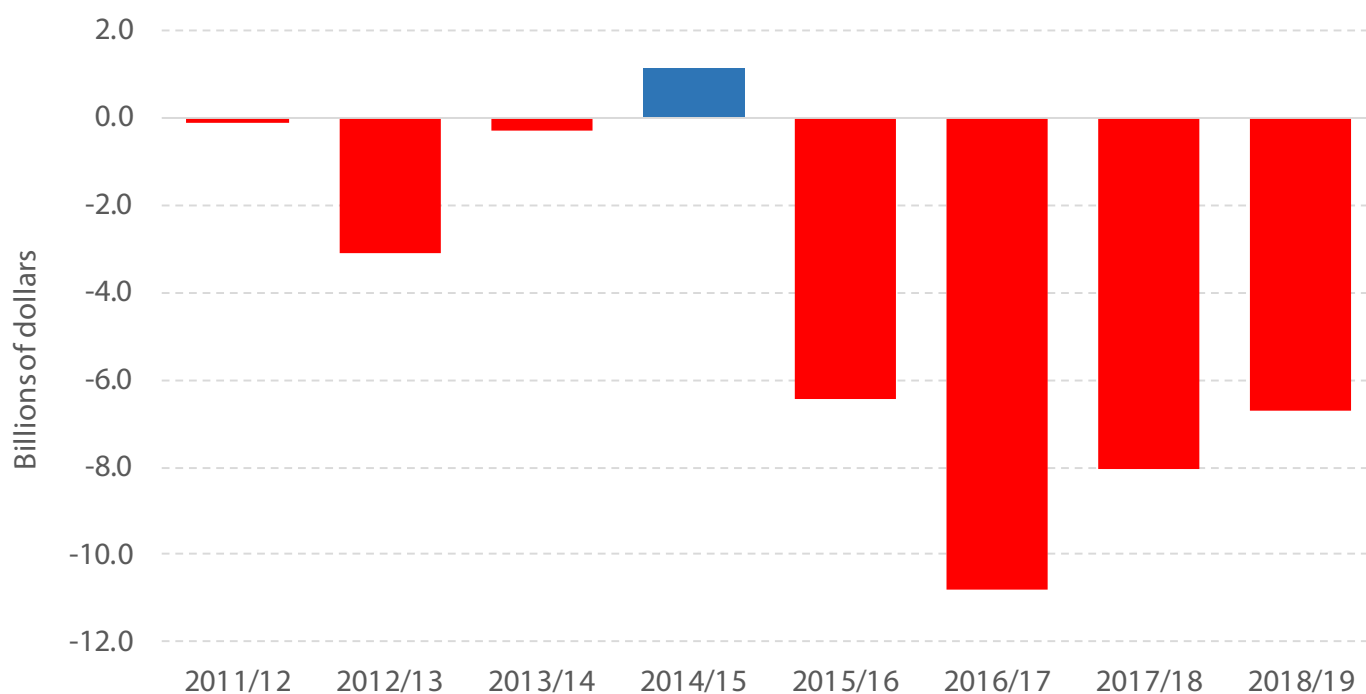
ly carried on the fiscal approach of its immediate predecessors by continuing to increase nominal spending (see figure 1). In fact, during its four years in office, the Notley government increased per-person nominal spending at an average annual rate of 2.0 percent—slightly up from the 1.8 percent average that prevailed in the prior four-year period.<sup>1</sup>

The Notley government did not respond to the sudden fall in revenues that occurred in 2014/15 by implementing nominal spending reductions. In fact, its decision to continue increasing spending despite the sharp revenue decline that occurred in 2015/16 led to a continuous string of large deficits during its term.

<sup>1</sup> Throughout this analysis we use nominal values, which allows for straightforward comparisons to the nominal figures that appear in Alberta's *Budget 2019*.

# An Analysis of Alberta's Budget

Figure 2: Surplus (+)/Deficit (-) (\$ billions), 2011/12 to 2018/19



Source: Alberta, Ministry of Finance (2019).

Figure 2 shows that these deficits ranged from \$6.4 billion to \$10.8 billion. In fact, during the Notley government's final full year in office (2018/19), the province's deficit was almost identical in nominal terms to its first year in office—\$6.7 billion compared to \$6.4 billion.

The link between the continued nominal spending increases following the decline in oil prices that began in late 2014 and the continuation of large deficits throughout the Notley government's term in office is clear. Indeed, one recent analysis shows that if the Notley government had implemented the spending plan it inherited from its predecessor's final budget, the province would be in a position of near budget balance today and the province would have accumulated substantially less debt in recent years (Lafleur and Eisen, 2018).

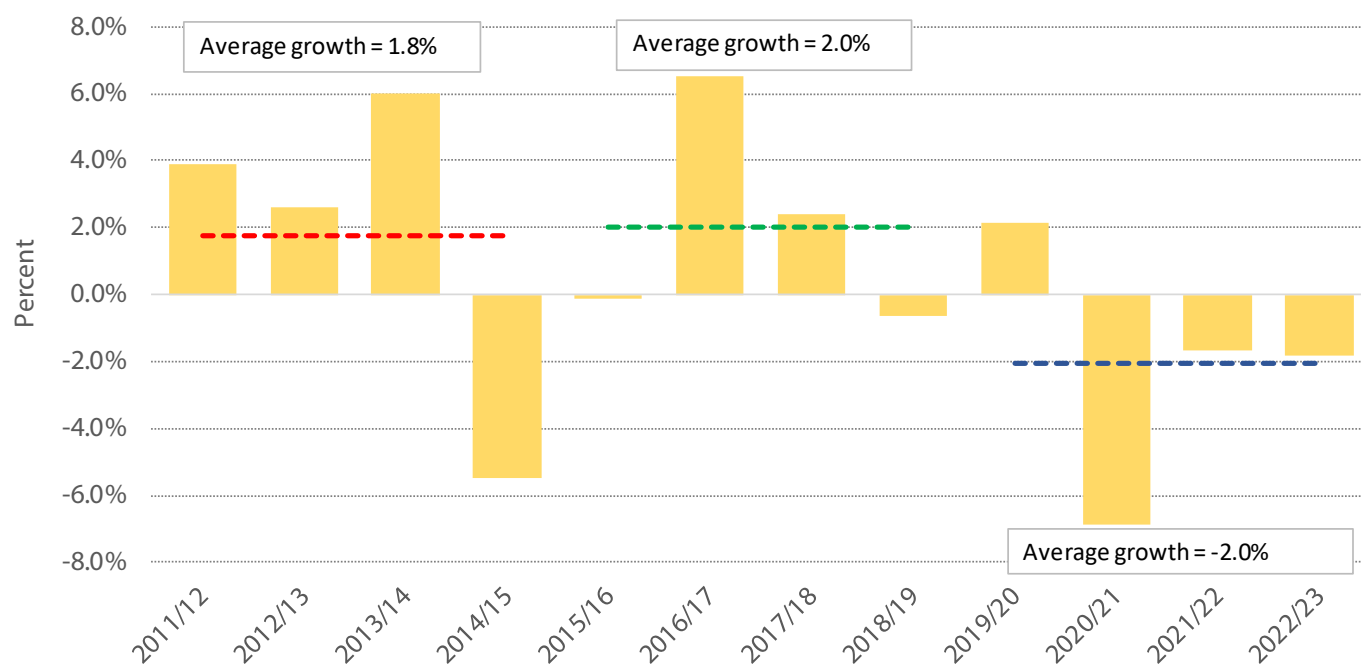
In short, the origins of today's large deficits and fiscal challenges for Alberta lie in the relatively distant past but have been exacerbated by more recent spending decisions. The problems emerged when successive governments grew spending early in the century, but persisted when governments did not respond to the 2015/16 fall in revenues and instead maintained (or slightly increased) the level of spending growth. The upshot was rapidly increasing debt accumulation in the province.

## *Budget 2019: A change in approach?*

Changes in government sometimes bring with them major changes to fiscal policy. Other times, policy continuity prevails (Eisen and Lafleur, 2019). Jason Kenney's UCP government re-

# An Analysis of Alberta's Budget

Figure 3: Growth in Nominal Per-Person Program Spending (%), 2011/12 - 2022/23



Source: Alberta, Ministry of Finance (2019).

cently tabled its initial budget and it appears that the former is the case in this instance—that the government is embracing an approach to public spending and deficit reduction that is different from its immediate predecessor.

The new budget's targets for program spending per capita offer the clearest evidence of a policy shift. Figure 3 extends the time-series (annual per-person spending growth) from figure 1 to include the projected annual per-person spending changes forecasted in *Budget 2019*.

Figure 3 shows three periods—the four years prior to the Notley government's time in office, the four years during its time in office, and the four-year period forecasted in *Budget 2019*'s fiscal plan. It shows, as noted earlier, that from 2011/12 to 2015/16 nominal per-person spend-

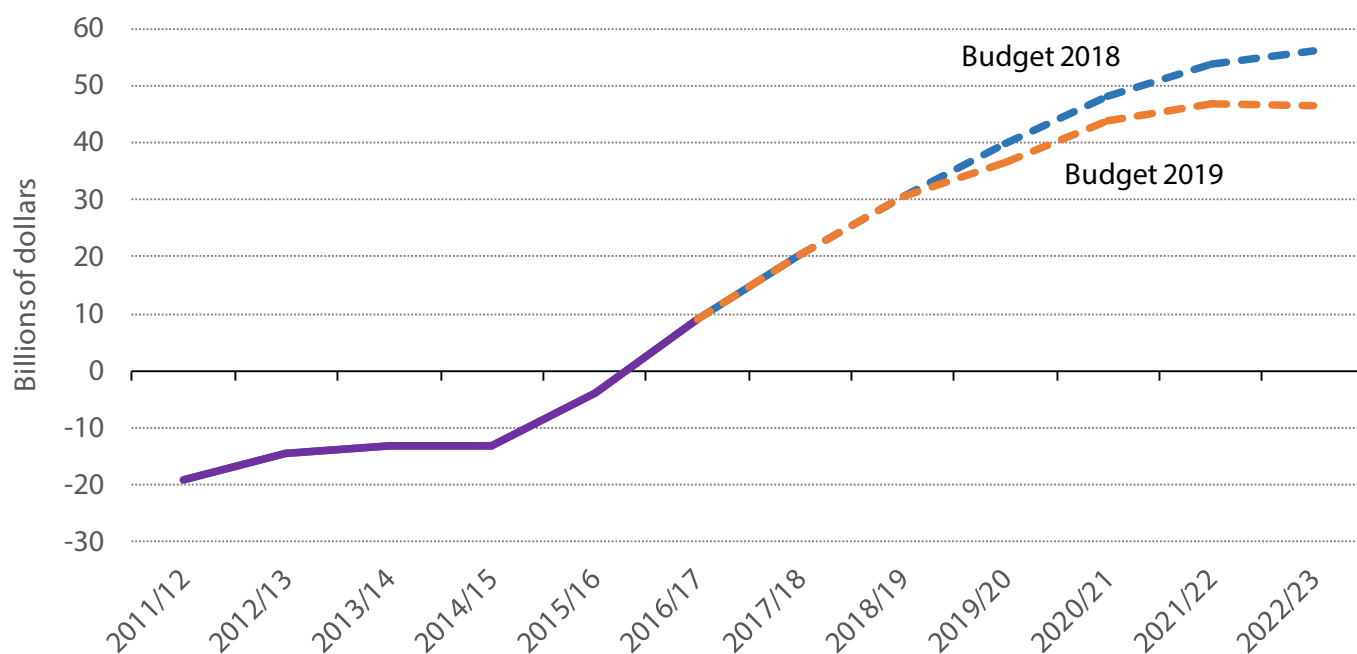
ing increased at an average annual rate of 1.8 percent. Then during the Notley government's time in office (2015/16 to 2018/19) nominal per-person spending increased at an average annual rate of 2.0 percent. *Budget 2019* forecasts that nominal per-person spending will drop from 2019/20 for the next 4 fiscal years, averaging -2.0 percent annually.

If it is implemented, this change in spending trajectory will soon have a meaningful impact on overall spending levels in Alberta. *Budget 2018* (the former government's final budget) forecast that program spending would reach \$56.9 billion in 2020/21 (the final year of the fiscal plan for which program spending is shown). *Budget 2019*, by comparison, forecasts spending in that year of \$53.4 billion, a \$3.5 billion difference. Put another way, the fiscal plan from *Budget 2018*



# An Analysis of Alberta's Budget

Figure 4: Net Debt (\$ billions), Budget 2018 vs. Budget 2019, 2011/12 - 2022/23



Sources: Alberta, Ministry of Finance (2018 and 2019).

called for program spending levels in 2020/21 that were 6.0 percent higher than the levels forecast in *Budget 2019*. *Budget 2019* marks the start of a clear change in future spending.

Largely as a result of this changed spending plan, the province is on a faster course to balance its budget than it was with *Budget 2018*, which called for a return to balance in 2023/24. *Budget 2019* forecasts a return to balance one year earlier—by 2022/23.

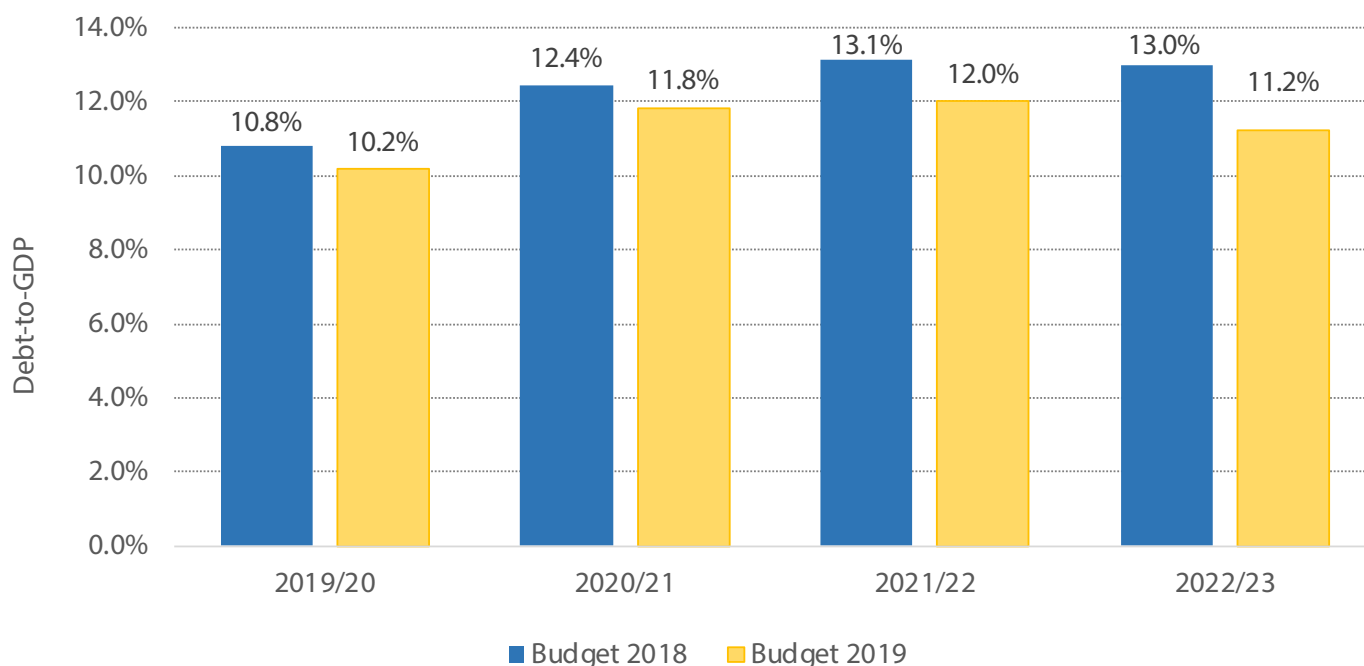
The faster return to budget balance is expected to result in slowing debt accumulation. As figure 4 shows, *Budget 2018* forecast that provincial net debt would reach \$56.2 billion in 2022/23. *Budget 2019* forecasts that net provincial debt that year will be \$46.4 billion.

Figure 5 shows that this change in the trajectory of the net debt would stop the increase in the province's debt-to-GDP ratio (a key measure of fiscal sustainability) – and that the ratio will begin to decline in the years ahead. Specifically, *Budget 2018* forecast that the debt-to-GDP ratio would reach 13.0 percent in 2022/23. By comparison, *Budget 2019* forecasts net debt as a share of GDP to peak at 12.0 percent in 2021/22 before falling to 11.2 percent in 2022/23.

The scale of this change is small relative to the net debt-to-GDP ratio declines during the 1990s, but it nonetheless forecasts an encouraging directional change for the province. If it follows the plans laid out in *Budget 2019*, Alberta will return to balance faster and accumulate less debt than had been forecast in *Budget 2018*.

# An Analysis of Alberta's Budget

Figure 5: Net Debt-to-GDP Ratio, Budget 2018 vs. Budget 2019



Sources: Alberta, Ministry of Finance (2018 and 2019).

## Historical context for the scale of spending reductions

The data presented in the preceding section show that with *Budget 2019* Alberta is embracing nominal per capita spending reductions, which marks a meaningful change of course in Alberta's approach to public spending.

Despite this change in policy direction, the forecast spending reductions in *Budget 2019* are mild compared to those that past governments across Canada have implemented to eliminate budget deficits. This section provides historical context for assessing the scale of the *Budget 2019* spending reductions relative to significant attempts at fiscal consolidation in the 1990s. This review suggests that Alberta's current approach to spending reduction and fiscal con-

solidation are dramatically less aggressive than efforts in the 1990s.

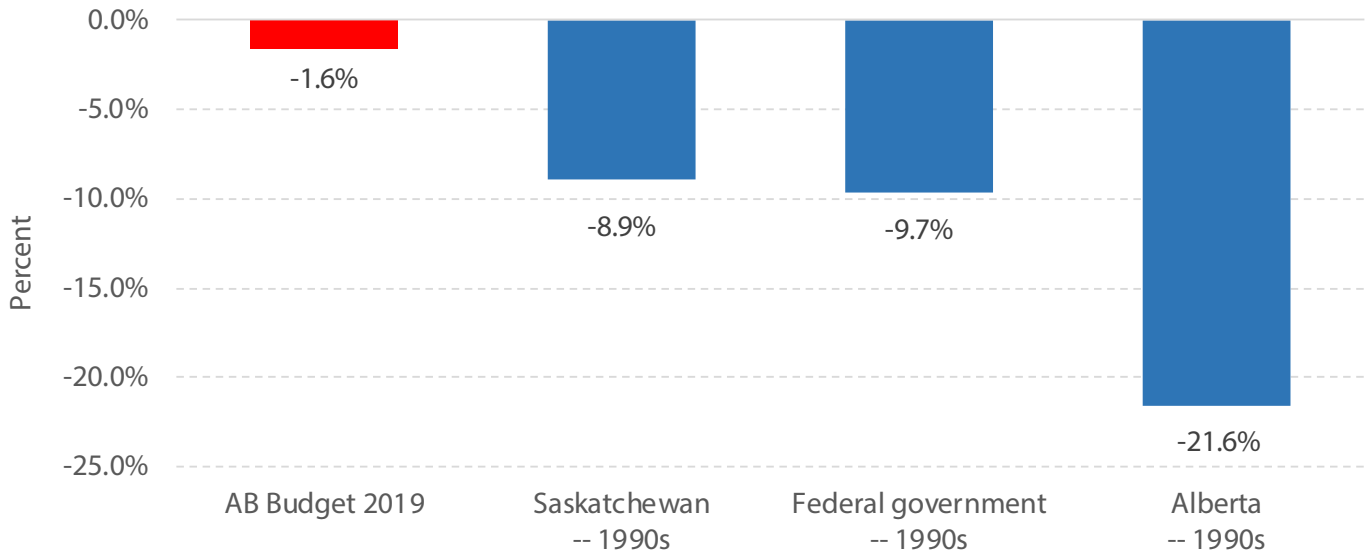
In fact, all of the fiscal consolidation efforts of the 1990s at both the federal level and in the nine provinces that reduced spending and eliminated their deficits (which in several cases were much larger relative to GDP than Alberta's current deficit) were faster than is envisioned in Alberta today—two to three years in each case (Clemens et al., 2017).

As figure 6 shows, *Budget 2019* calls for a peak-to-trough spending reduction in program spending of 1.6 per cent between 2019/20 and 2022/23.

Starting with Alberta's own history, this spending reduction is much smaller than that budgeted by Progressive Conservative Premier

# An Analysis of Alberta's Budget

Figure 6: Total Change in Program Spending (%), Alberta Budget 2019 vs. Past Deficit Reduction Efforts



Note: The data for Saskatchewan correspond to the actual values from 1991/92 to 1993/94.

Sources: Alberta, Ministry of Finance (1993 and 2019); Canada, Department of Finance (1995); Canada, Department of Finance (2019); calculations by authors.

Ralph Klein in the 1990s when he cut spending by 21.6 percent and eliminated a significantly larger deficit (relative to GDP) in three years.

Ambitious spending consolidations in the 1990s were by no means the exclusive purview of Progressive Conservative governments. In that era, governments of all political stripes reduced spending much more dramatically than the cuts now being implemented in Alberta. Jean Chrétien's Liberal federal government reduced program spending from peak-to-trough by 9.7 percent, successfully eliminating a budget deficit that was more than 5 percent of Canada's GDP over the course of three years.

Also in the 1990s, Roy Romanow's NDP government in Saskatchewan made substantially greater spending reductions than those forecast in Alberta's *Budget 2019*. The Romanow

budget reduced provincial spending by 8.9 percent and in so doing eliminated in three years a budget deficit that was equal to 3.9 percent of provincial GDP.

The more aggressive spending and deficit reduction efforts of the 1990s predictably had a larger impact on the debt-to-GDP ratios in the jurisdictions that enacted them than is forecast in Alberta. As noted earlier, Alberta's *Budget 2019* calls for the debt-to-GDP ratio to peak in 2021/22 before falling slightly the following year. The debt-to-GDP reductions in the 1990s were much more substantial in all three of the jurisdictions discussed. In Alberta under Ralph Klein, the debt-to-GDP ratio fell from 10.1 percent in 1993/94 to 0.1 percent in 1998/99. In subsequent years, with the province's net debt eliminated, the province's net assets grew. In Saskatchewan, debt-to-GDP fell from a peak



# An Analysis of Alberta's Budget

of 33.6 percent in 1993/94 to 20.5 percent in 2000/01. Finally, the federal debt-to-GDP ratio fell from 66.6 percent in 1995/96 to 53.6 percent in 1999, and continued to fall steadily in the following years until the recession of 2008. All of these debt-to-GDP reductions are much larger than what Alberta envisions for the years ahead in *Budget 2019*. Further, the governments in question pushed for faster deficit elimination—two or three years, depending on the case—than Alberta has planned in *Budget 2019*, which forecasts a four-year path to balance.

## Discussion: Risks and next steps

*Budget 2019* changes Alberta's spending trajectory and its approach to deficit reduction. However, *Budget 2019* is the first step Alberta must take to repair its finances, not the end of the process. There are several risks in the budget's fiscal plan. Further, even if it is fully implemented, Alberta's finances will not be fully restored to sustainability if the province does return to balance in 2022/23.

One key risk in the 2019 budget plan comes from its relatively lengthy four-year path back to balance. As noted earlier, the fiscal consolidations of the 1990s all took place more quickly—over two to three years. Because the province is taking longer to balance its budget, the province will accumulate more debt than it would were it to take less time to do so. Further, that longer path extends the amount of time that the province's deficit elimination plan is subject to revenue risks, such as an economic slowdown or another downturn in oil prices. It also extends the time during which the government will need to remain committed to spending targets and may therefore entail political risks as the government will have to remain committed to spending restraint as the next provincial election approaches.

A further risk associated with Alberta's *Budget 2019* is that even if fully implemented and the government returns to a balanced operating budget in 2022/23, the province will still be reliant on non-renewable natural resource revenues to fund programs. The government's path to balance relies not just on a recovery in natural resource revenues, but an increase in the share of provincial revenue that comes from this volatile source. *Budget 2019* forecasts that by the time the government returns to balance, non-renewable resource revenue will represent 14.9 percent of all provincial revenues.

This ratio is relatively low compared to some recent years. As recently as 2005/06, non-renewable resource revenues made up 40 percent of all provincial revenues. Nevertheless, there are significant risks associated with relying on natural resource revenues as a significant source of funding for provincial programs because these revenues are very volatile—much more so than tax revenue. Indeed, the large increase in the size of the budget deficit that occurred in 2015/16 was the immediate result of a fall in resource revenues from 18.1 percent of all revenue in 2014/15 to 6.5 percent in 2015/16.

The government's current plan for a return to balance relies on natural resource revenues climbing back up to within 3.2 percentage points of where they were in 2014/15 (when this figure stood at 18.1 percent). As such, even if all goes to plan as envisioned in *Budget 2019*, provincial finances will at that point be almost as vulnerable to an oil price shock as they were in the year prior to the recent recession. The large deficits and rapid debt accumulation of recent years illustrates the risks associated with such a position.

It is important for the province to reduce its reliance on natural resource revenues over

# An Analysis of Alberta's Budget

time because doing so reduces the volatility of its funding sources. In addition, relying on the depletion of an asset stock such as non-renewable natural resources to fund current programs limits the province's ability to save resource revenues for future (and current) generations, so raises questions about inter-generational equity.

A final concern with *Budget 2019's* plan for a return to balance is that it continues to rely on additional revenue from the increases to personal income tax rates that have been implemented in recent years. These tax increases are economically damaging. While Alberta's personal income tax (PIT) rate was once the very lowest in North America, that competitive position has been eroded badly in recent years (Lafleur, Eisen, and Palacios, 2019); *Budget 2019* does not address this issue. In fact, the 2019 budget introduces a subtle further PIT increase by de-indexing provincial tax brackets, thus leading to gradual tax increases as nominal incomes rise even if real incomes remain flat.

The province's tax competitiveness has been undermined not only by provincial PIT increases in recent years, but also by federal PIT rate increases and by recent tax reforms in the United States. As a result of these changes, Alberta has gone from having the lowest top PIT rate (combined federal and sub-national) in Canada or the United States to being in the higher half of jurisdictions on this indicator of tax competitiveness (Lafleur, Eisen, and Palacios, 2019). Partly due to this change in Alberta's competitive position (along with the fact that high PIT rates are an economically inefficient revenue source, meaning that they produce significant economic harm per dollar raised), the tax increases described above will reduce economic growth in coming years.

A recent analysis examined what level of spending reductions would be required to achieve balance on the same timeline as several of the consolidations in the 1990s (over three years instead of the four planned in *Budget 2019*), while enhancing Alberta's competitive position with respect to several taxes including the personal income tax, corporate income taxes, and the taxation of capital gains. This analysis showed that a nominal spending reduction of 10.9 percent over three years would achieve these objectives (Eisen, Clemens, and Veldhuis, 2018). Such a reduction in provincial spending would be similar in scale to those enacted by Saskatchewan and the federal government during the 1990s, but substantially smaller than that enacted in Alberta during the same period.

Given the analysis above, *Budget 2019* carries considerable fiscal risk. Even if it is fully implemented, it is only the start of a longer process of bringing stability and sustainability to provincial finances. Further spending reductions or long term fiscal restraint will be necessary to make Alberta's finances sustainable while reducing the province's reliance on natural resource revenues and enhancing its tax competitiveness. Even if the government's fiscal plan in *Budget 2019* is fully implemented, much more work remains to be done.

## Conclusion

*Budget 2019* suggests that Alberta's provincial government has altered its approach to fiscal policy following the recent change in government. This is in contrast to Ontario. Its *Budget 2019* indicates that that province's approach to public spending and deficit reduction will maintain policy continuity rather than embrace change.

Alberta's *Budget 2019* takes a more active approach to deficit reduction than that taken by

# An Analysis of Alberta's Budget

the government's predecessors. Specifically, it implements meaningful nominal per-person spending reductions, which will more quickly eliminate the deficit and reduce future debt accumulation.

The spending reductions outlined in Budget 2019 are mild compared to those implemented across Canada in the 1990s by governments of all political stripes and, at four years, the path to deficit elimination is longer in Alberta's Budget 2019 than was implemented during that era. Partly as a result of these moderate spending reductions, Budget 2019's fiscal plan has risks. The four-year path to balance brings political and economic risks to the fiscal plan, while the deficit reduction strategy requires natural resource revenue to rebound such that the province in 2022/23 is nearly as reliant on resource revenue as it was in 2014/15 just before the current era of large deficits began.

As such, *Budget 2019* is just a first step in what will be the long process of repairing Alberta's finances. The province will need to undertake further fiscal consolidation and spending restraint to complete the process of bringing stability and sustainability to Alberta's finances.

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