

# Canada's Past Fiscal Leaders Are Now Fiscal Laggards:

## An Analysis of 2017 Provincial Budgets

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## Contents

Executive summary / iii

Introduction / 1

Historical context: Alberta and Ontario were once Canada's fiscal leaders / 2

From leaders to laggards: Alberta and Ontario  
driving provincial debt accumulation in Canada / 4

Canada's former fiscal laggards now showing the way / 18

Conclusion / 25

References / 26

About the authors / 31

Acknowledgments / 32

Publishing information / 33

Supporting the Fraser Institute / 34

Purpose, funding, & independence / 34

About the Fraser Institute / 35

Editorial Advisory Board / 36



## Executive summary

Around the turn of the 21st century, Alberta and Ontario could both boast of having comparatively sound public finances relative to most other provinces. In recent years, however, serious fiscal problems have emerged in both provinces. Alberta and Ontario were once fiscal leaders in Canada, but they are now among the country's unsuccessful fiscal managers. Meanwhile, several other provinces that at various times have been considered weak fiscal performers are currently pursuing policies that are gradually improving the condition of their public finances. Saskatchewan, Quebec, and British Columbia all currently have in place relatively prudent fiscal plans that minimize debt accumulation and strengthen provincial finances over time. Indeed, several of Canada's historical fiscal laggards have become the country's new leaders.

This paper analyzes the various provincial budgets tabled in 2017 and illustrates the extent to which fiscal leadership in Canada's provinces has changed in recent years. Among other things, it finds that at the provincial level, government debt accumulation in Canada is currently being driven primarily by just two provinces—Alberta and Ontario. These two, which are home to about half of the country's population, are responsible for approximately 74 percent of all new provincial government net debt being added in Canada this year.

Ontario now carries one of the highest per-capita debt burdens in Canada. Furthermore, Ontario continues to add significant new debt each year despite projecting a balanced operating budget this year. In fact, over the next three years, Ontario expects to add \$34.1 billion in new debt—almost exactly the same amount as the \$34.8 billion it added during the last three.

Serious fiscal problems have emerged in recent years in Alberta as well. A significant store of the province's net assets has been erased over the past decade, and it has now joined the rest of the provinces as a net debtor with provincial debts exceeding financial assets. Alberta still enjoys the lowest debt-to-GDP ratio in the country, but the province's long string of budget deficits has begun to significantly undermine this fiscal advantage. What's more, the pace of debt accumulation has accelerated dramatically in recent years, as the province has begun to run some of the largest budget deficits in its history. In fact, the province expects to see its net debt climb

to approximately \$10,000 per person by 2019/20—up from essentially zero as recently as 2015/16.

Although Alberta's debt burden—measured both per person and as a share of GDP—is currently the lowest in Canada, the pace of debt accumulation in Alberta is such that the gap between it and other provinces is rapidly closing and a substantial debt burden is projected to quickly emerge in the province over the next few years.

Despite these fiscal challenges, both Ontario and Alberta have significantly increased spending in their 2017 budgets, and neither has a plan to make meaningful progress slowing their pace of debt accumulation during the life of their current fiscal plans.

On the other hand, Quebec and Saskatchewan, two provinces that have at various points faced severe fiscal problems or been viewed as examples of unsuccessful fiscal management, have in their 2017 budgets taken meaningful steps to address the challenges they face.

Saskatchewan is reducing expenditures and plans to eliminate its deficit in two years (by 2019/20), while Quebec has stopped adding debt entirely and is making meaningful progress in shrinking its debt-to-GDP ratio. The contrast between these two provinces, on the one hand, and Alberta and Ontario, on the other, is clear.

British Columbia, once also a fiscal laggard in the 1990s, has taken the necessary steps that have enabled it to achieve its current status as fiscal leader. But with a change in government in July 2017, questions remain as to whether the province will continue to build on its recent fiscal policy success.

At this point, historical reputations for successful fiscal management seem to bear little relationship to current reality when it comes to keeping deficits and debt in check. On public finances in general, Canada's provinces have been turned upside down, which has important implications for those residing in provinces that have become Canada's new fiscal laggards—and new fiscal leaders.

## Introduction

Around the turn of the 21st century, Alberta and Ontario could both boast of having sound public finances relative to most other provinces. In recent years, however, serious fiscal problems have emerged in both provinces. Alberta and Ontario were once fiscal leaders in Canada, but they are now among the country's unsuccessful fiscal managers. Meanwhile, several other provinces that at various times have been considered weak fiscal performers are currently pursuing policies that are gradually improving the condition of their public finances. Saskatchewan, Quebec, and British Columbia all currently have in place relatively prudent fiscal plans that minimize debt accumulation and strengthen the province's finances over time. Indeed, several of Canada's historical fiscal laggards have become the country's new leaders.

This paper analyzes the various provincial budgets tabled in 2017 and illustrates the extent to which fiscal leadership in Canada's provinces has changed in recent years. The paper is organized as follows. The first section briefly outlines the historical context for Alberta and Ontario's relatively more favourable fiscal position in past years. The next section documents the fiscal problems currently facing Alberta and Ontario, and shows how provincial policy decisions in the 2017 budgets either exacerbate or do virtually nothing to solve these problems. This is followed by a discussion about the positive steps that other provinces in recent budgets have undertaken to put their finances on more solid footing—provinces that at one point or another held reputations for being weak fiscal performers. Although some of these jurisdictions continue to face challenges, the fiscal plans presented in their 2017 budgets take important steps to begin addressing them.

## Historical context: Alberta and Ontario were once Canada’s fiscal leaders

Around the turn of the century, both Alberta and Ontario enjoyed relatively strong public finances within Confederation. As shown in a comprehensive analysis of fiscal policy performance over the period 1998/99 to 2002/03, Alberta and Ontario ranked first and second, respectively, among the provinces and federal government in terms of maintaining competitive taxes, prudent spending, and balanced budgets and debt reduction (Karabegović et al., 2004).<sup>1</sup>

In 2002/03,<sup>2</sup> for example, Alberta stood alone as the only province in a “net asset” position, meaning the government’s financial assets exceeded its debts. All the other provinces maintained a net financial position where government debts exceeded financial assets (this is referred to as “net debt”). At the time, only Saskatchewan and BC carried net debt burdens as a share of their provincial economies that were lighter than Ontario’s. What’s more, in that fiscal year both Alberta and Ontario maintained balanced operating

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1. The analysis by Karabegović et al. (2004) used data on 20 separate indicators of sound fiscal policy to construct an overall index. The provinces and federal government were then ranked according to their index score. The period from 1997/98 to 2003/04 was generally one in which Alberta and Ontario led the provinces on fiscal policy. In their 2002 analysis of fiscal policy performance, which covered data from the period 1997/98 to 2001/02, Karabegović et al. (2002) ranked Alberta and Ontario first and second, respectively. In addition, a later analysis in 2005, covering data from 1999/00 to 2003/04 ranked the two provinces similarly (see Karabegović et al., 2005), although it is important to note that Ontario, while ranking second among the provinces, had an overall index score that had declined in relation to the other provinces, and particularly Alberta.

2. We select the fiscal year 2002/03 as an example because it was the final year in a four-year string of balanced budgets in Ontario, which was followed by budget deficits in the next two years. Starting in 2003/04, Ontario once again began to add significantly to its nominal debt, a trend that would accelerate dramatically starting in 2008/09. In short, 2002/03 is the most recent year during which Ontario could make a reasonable claim that it was on the path to re-establishing its status as a clear fiscal leader within Canada.



budgets. For Ontario, 2002/03 was the province's fourth consecutive balanced budget. For Alberta, it was the ninth straight year without a deficit.<sup>3</sup>

These two provinces were not just running balanced operating budgets—neither was adding debt through capital expenditures either. Ontario's nominal net debt was shrinking slightly, from \$134.4 billion in 1999/00 to \$132.6 billion in 2002/03. Meanwhile, Alberta had eliminated its net debt altogether in 1999/00, and by 2002/03 was in the process of building a significant store of net assets. The province's net asset position stood at \$6.8 billion in 2002/03.

To be sure, Ontario's finances at this moment in history were not in as good a condition as Alberta's. The province had accumulated substantial new debt during the early 1990s, and saw its debt-to-GDP ratio climb from just 12.5 percent in 1989/90 to 26.9 percent in 1993/94. By 2002/03, Ontario had still not yet recovered from this period of rapid debt accumulation and maintained a debt burden that was substantially elevated compared to the prevailing levels of the 1980s. That said, by 2002/03, as a result of essentially stable nominal debt and a growing economy, Ontario's net debt-to-GDP ratio was shrinking steadily, falling from 32.3 percent in 1999/00 to 27.1 percent in 2002/03.

In short, in the early 2000s, Alberta could boast of having the soundest public finances in Confederation, while Ontario appeared on track to repair the damage of a recent run-up in public debt and re-assume its previous status as a low-debt jurisdiction. In this sense, these two traditional engines of the Canadian economy had also, to different degrees and not without caveats, emerged as leaders within Confederation with respect to the successful management of public finances.

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3. Although Alberta was consistently running budget surpluses during this period, policy developments and spending decisions at the provincial level were already beginning to sow the seeds of future fiscal problems. Specifically, after a prolonged period of spending restraint that had restored the province's finances to health, program spending in Alberta ticked up substantially in the earliest years of the decade, beginning a trend that would contribute to the emergence of fiscal problems and the deterioration of the province's net asset position that began in 2008/09. The management of public finances of that time could more comprehensively be described as sound if the province had increased spending at a lower rate and saved a larger fraction of resource revenues. These caveats noted, it's nevertheless clear that in the early 2000s, with consistent balanced budgets and positive net financial assets, Alberta enjoyed the strongest fiscal position of any province.

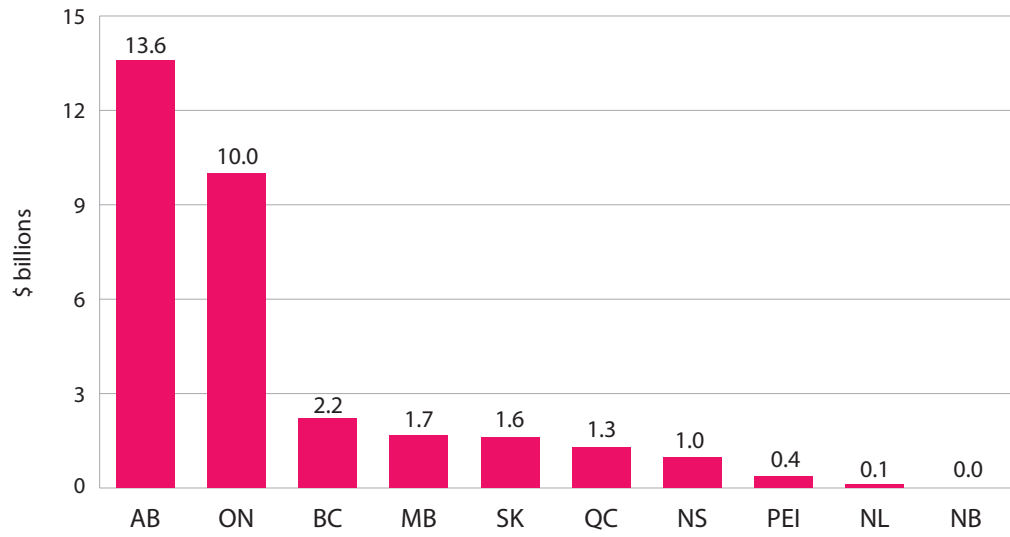
## **From leaders to laggards: Alberta and Ontario driving provincial debt accumulation in Canada**

Fast forward to today. Ontario now carries one of the highest debt burdens in Canada, on a per-capita basis. Furthermore, Ontario continues to add approximately \$10 billion per year in new debt despite projecting balanced operating budgets.

Serious fiscal problems have emerged in Alberta as well in recent years—the province has seen a significant store of net assets erased over the past decade, and has now joined the rest of the provinces as a net debtor with provincial debts exceeding financial assets. Alberta still enjoys the lowest debt-to-GDP ratio in the country but the province’s long string of budget deficits has begun to significantly undermine this fiscal advantage. What’s more, the pace of debt accumulation has accelerated dramatically in recent years, as the province has begun to run some of the largest budget deficits in its history. These large deficits are a function both of the recent downturn in oil prices and resulting decline in resource revenues, as well as unsustainable spending increases by successive provincial governments (Lafleur et al., 2017b). Although Alberta’s debt burden—measured per person and as a share of GDP—remains the lowest in Canada, the pace of debt accumulation in Alberta today is such that the gap between Alberta and other provinces is rapidly closing and a substantial debt burden is projected to emerge quickly over the next few years.

The 2017 government budgets reiterated that both Alberta and Ontario currently face serious fiscal challenges. In the case of Ontario, despite a projected balanced operating budget, that challenge can be summarized as a large and still gradually growing debt load, with no credible plan to tackle the debt burden (Eisen et al., 2017). In Alberta, the challenge can be summarized as a rapid acceleration in the pace of provincial debt accumulation that threatens the province’s fiscal health. Unfortunately, in neither case does the 2017 budget take significant steps to address these challenges.

**Figure 1**  
Change in net debt from 2016/17 to 2017/18



Sources: British Columbia, 2017; Alberta, 2017; Saskatchewan, 2017; Manitoba, 2017; Ontario, 2017; Quebec, 2017; New Brunswick, 2017; Nova Scotia, 2017; Prince Edward Island, 2017; Newfoundland & Labrador, 2017.

**Figure 1** helps illustrate the extent to which Alberta and Ontario are currently driving the accumulation of provincial government debt in Canada. Cumulatively, the ten provinces are expecting to see their net debt increase by \$31.8 billion in 2017/18 relative to the previous year. Of this amount, approximately three quarters of the new debt (\$23.6 billion) will be accumulated by Alberta and Ontario. Alberta expects to add \$13.6 billion to its net debt total this year. Ontario expects to add \$10.0 billion in 2017/18 (note that this is substantially less new debt per capita than Alberta is adding, but it comes on top of a much larger pre-existing stock of debt). No other province expects to add nearly as much new debt—British Columbia is the closest province, and expects to add just \$2.2 billion in new debt in 2017/18,<sup>4</sup> and all other provinces expect to add less than \$2 billion to their net debt totals.

In total, 74 percent of all new provincial debt this year is projected to be added in Alberta and Ontario—two provinces that, collectively, hold approximately one half of Canada's population. These two provinces are largely driving the current era of provincial-level government debt accumulation in Canada. Alberta and Ontario both face significant fiscal challenges but, unfortunately, neither province's recent budget takes meaningful action to address them. This section will discuss each in turn.

<sup>4</sup> This amount is based on BC's 2017 budget tabled in February before the May election. BC is projected to add new net debt in 2017/18 despite a balanced operating budget because the province separates its capital spending from its operating budget for accounting purposes. Although it will stop adding new debt from spending on day-to-day operations such as salaries, programs and income transfers, it will continue adding new debt from spending on long-term projects such as roads and bridges.

## Alberta: Racking up debt quickly

Last year, in 2016/17, Alberta ran an operating budget deficit of \$10.8 billion. For context, this is a larger operating deficit (after adjusting for population and relative to the size of the provincial economy) than was experienced by Ontario during any single year of that province's severe fiscal crunch following the 2008/09 financial crisis (Lafleur et al., 2017a). As a result of this large operating deficit, and a long period of decline in the province's net financial position during the previous decade, Alberta in 2016/17 became a net debt province for the first time since 1999/00. By any measure, 2016/17 was among the worst fiscal years in the province's history.

However, in its 2017 budget, Premier Rachel Notley's government did not present a plan to reform or reduce provincial program spending in an effort to begin shrinking the province's budget deficit and slow down the pace of debt accumulation. Instead, the province's spending plan for 2017/18 called for further spending growth in the coming fiscal year and beyond.

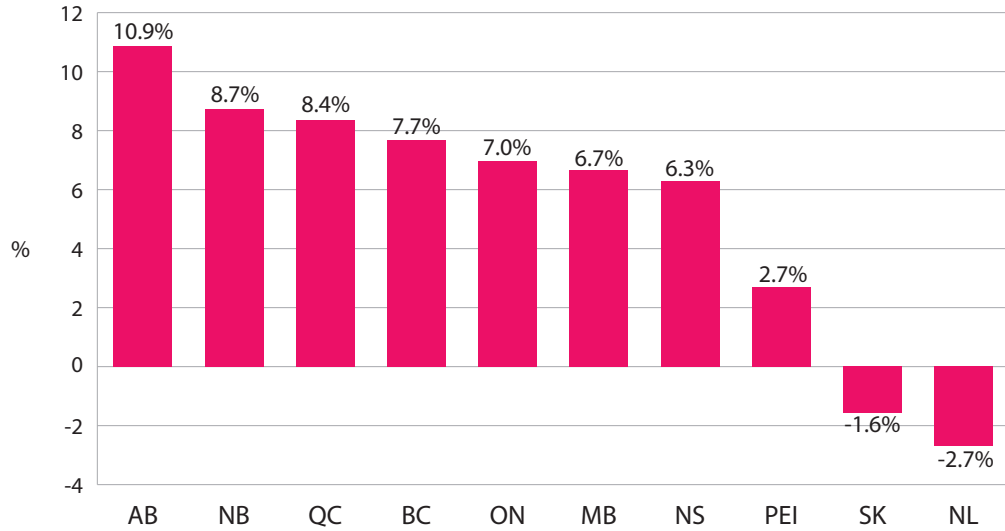
**Figure 2** helps illustrate the extent to which Alberta's spending plan diverges from what is being pursued in other energy-dependent jurisdictions within Canada that have also experienced fiscal shocks. The figure compares total forecasted program spending growth over the two year period from 2015/16 to 2017/18 in all ten provinces.<sup>5</sup> Despite the large deficits and significant debt accumulation in the province, Alberta is actually projected to increase spending by 10.9 percent over the two-year period. This represents the fastest rate of spending growth of any province. By comparison, Saskatchewan and Newfoundland, Canada's other two energy-dependent jurisdictions that have suffered fiscal problems following the decline in oil prices in recent years, are actually in the process of reducing nominal program spending over the same two-year period.

It is important to note that the main sources of Alberta's current fiscal problems are the decisions of successive past governments to increase spending rapidly during the boom in commodity prices and resource revenues. Specifically, multiple successive governments increased spending faster than either the rate of economic growth or the amount necessary to keep pace with pressures from population growth and inflation (Lafleur et al., 2017b). But when the commodity boom went bust, and resource revenues fell, the Alberta government maintained spending at elevated, unaffordable spending levels.

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5. Spending totals for 2016/17 are somewhat affected by emergency spending for wild-fire relief and an accounting change surrounding the treatment of expenditures related to the phase out of coal power in the province. Considering the two year period from 2015/16 to 2017/18 essentially resolves this issue and therefore presents a more accurate representation of the pace of expenditure growth in Alberta compared to other provinces on day-to-day program spending.

**Figure 2**  
Program spending growth from 2015/16 to 2017/18



Sources: British Columbia, 2017; Alberta, 2017; Saskatchewan, 2016, 2017; Manitoba, 2016, 2017; Ontario, 2017; Quebec, 2017; New Brunswick, 2016, 2017; Nova Scotia, 2016, 2017; Prince Edward Island, 2016, 2017; Newfoundland & Labrador, 2016, 2017.

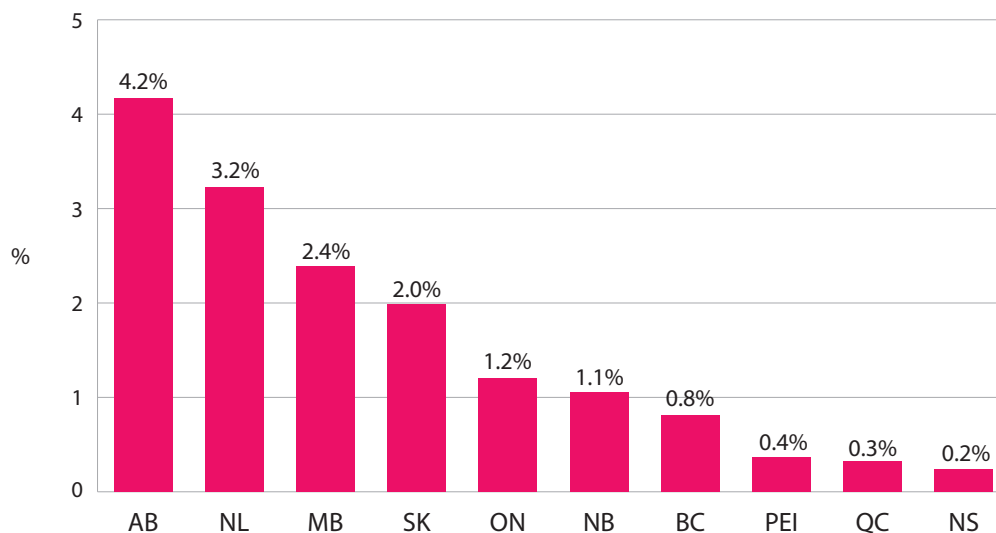
This is not to understate the effect of declining revenues from resource royalties, corporate and personal income taxes, sales taxes, and the like. However, the reality is that deficits were occurring in Alberta even before the commodity price collapse. The province would be running surpluses (or much smaller deficits) had it controlled spending during the boom.

Alberta's 2017 budget signals that Notley's NDP government is making the same mistakes as its Progressive Conservative predecessors, as spending continues to grow briskly—ignoring the root of the problem, which is years of rapid spending growth. Since Alberta is in the process of continuing on the same spending trajectory that helped create its current fiscal problems, it is not surprising that those problems are currently forecasted to persist for the foreseeable future. In its 2017 budget, the Notley government forecasts large and persistent budget deficits, and marked debt accumulation for the rest of its fiscal plan, extending to 2019/20. There is no plan at all to balance the budget. In the current fiscal year (2017/18), the Notley government forecasts a budget deficit of \$10.3 billion and a total of \$13.6 billion in new net debt.<sup>6</sup>

<sup>6</sup> The amount of new net debt exceeds the operating budget deficit because the government separates capital spending on infrastructure from its operating budget, for accounting purposes. Although the government will add new debt from spending on day-to-day operations such as salaries, programs, and income transfers, it will add even more new debt from spending on long-term projects such as roads and bridges.

Alberta's expected debt accumulation for 2017/18 stands out as, by far, the most significant in Canada. **Figure 3** displays forecasted net debt accumulation in each province for 2017/18 relative to the size of each provincial economy. Alberta's additional net debt in 2017/18 represents 4.2 percent of GDP. Newfoundland is a distant second (at 3.2 percent of GDP) while Saskatchewan is lower still at 2.0 percent of GDP. Clearly, Alberta is adding more debt this year relative to the size of its economy than any other province. In fact, despite having just 11 percent of the national population, Alberta is forecasted to be responsible for 43 percent of all new debt that will be added to provincial books in 2017/18.

**Figure 3**  
Change in net debt from 2016/17 to 2017/18 as a share of GDP in 2017

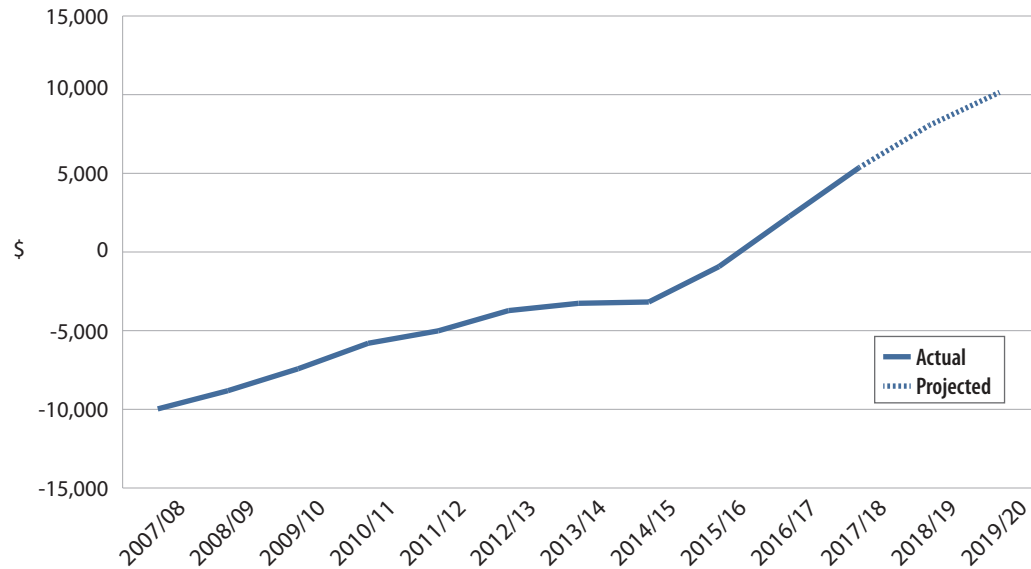


Sources: See figure 1; Statistics Canada, 2017a.

Alberta's fiscal plan calls for little in the way of deficit reduction or a slow-down in the pace of debt accumulation in the years ahead. Operating deficits of \$9.7 billion and \$7.2 billion are planned for the next two fiscal years. The consequence, of course, is a rapid run-up in provincial debt. In fact, Alberta expects to accumulate \$58 billion in new net debt by 2019/20 relative to 2014/15 (Alberta, 2017). This is a remarkable amount of new debt over such a short time period.

For context, **figure 4** illustrates Alberta's level of net debt (and net assets) per Albertan from 2007/08, the year its financial position reached a net asset peak, to 2019/20, the last year projected in the 2017 budget. (Note again the net financial position is calculated as total debt minus financial assets. When positive it means net debt; when negative it means net assets since financial assets exceed debt.) By 2019/20, the Notley government expects to reach a net debt burden of \$10,149 per Albertan. This is a dramatic

**Figure 4**  
**Alberta's net debt (and net assets) per capita from 2007/08 to 2019/20**



Sources: Alberta, 2016-2017; Statistics Canada, 2017b.

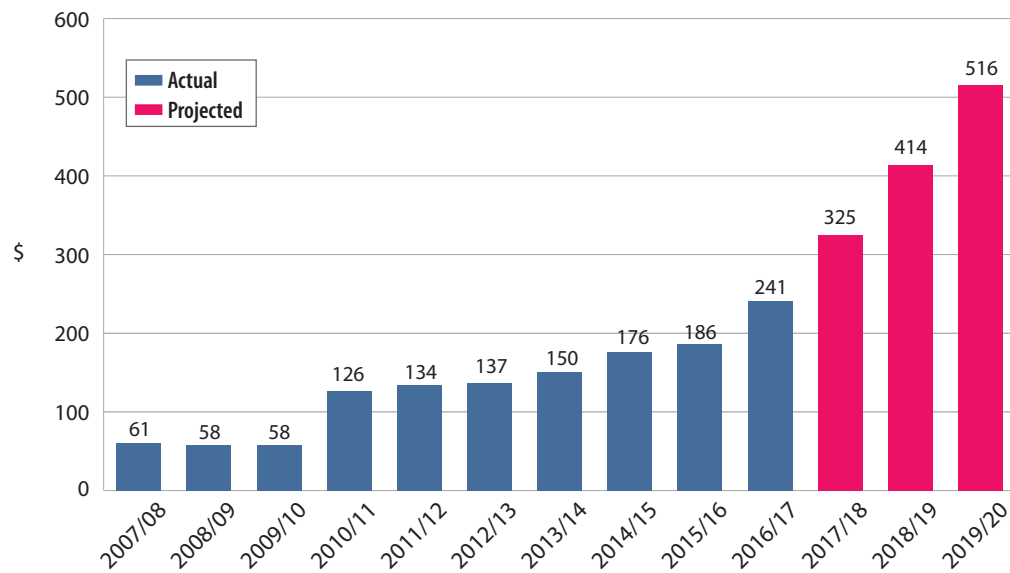
Note: The net financial position is calculated as total debt minus financial assets; when positive it means net debt; when negative it means net assets since financial assets exceed debt.

swing compared to the situation in 2007/08, when each Albertan enjoyed \$9,973 in net assets (as government financial assets exceeded debts).

Of course, it is true that Alberta entered the current period of rapid debt accumulation with no net debt at all, while every other province carried significant net debt. That historical situation greatly benefitted the current government, as it is required to spend far fewer tax dollars on servicing the debt each year through interest payments than any other province (Lamman et al., 2017). However, debt servicing costs are rising quickly, growing from \$214 million in 2007/08 to \$1.4 billion in 2017/18. They are projected to reach \$2.3 billion by 2019/20. **Figure 5** presents Alberta's annual debt servicing costs over this period on a per-person basis. It shows debt servicing costs in Alberta are rising quickly, placing a bigger burden on Albertan taxpayers.

With significant debt accumulation planned in the future, Alberta's net debt per person, which is currently lower than other provinces, is expected to increase quickly and catch up to other provinces. By 2019/20, the Alberta government forecasts its net debt per capita will be larger than British Columbia's and nearly as large as Saskatchewan's currently is. In that same year, Alberta's net debt per capita is forecasted to be 63 percent as large as Nova Scotia's. Finally, Alberta's per-capita debt burden in 2019/20 is forecasted to be 44 percent as large as Ontario's, the second most indebted province in the country per capita behind only Newfoundland. Put differently, just four short years removed from net debt-free status, Alberta will have narrowed the gap in

**Figure 5**  
**Alberta's debt servicing costs per capita from 2007/08 to 2019/20**



Sources: Alberta, 2016-2017; Statistics Canada, 2017b.

terms of per-capita indebtedness between itself and high-debt jurisdictions such as the Maritime provinces and Ontario.<sup>7</sup>

A further concern is that these troubling forecasts of rapid debt accumulation are based on optimistic revenue forecasts. In short, Alberta's fiscal projections rely on future oil prices that are substantially higher than future markets expect (Tombe, 2017). If these rosy revenue forecasts do not come to pass, the province's budget deficits will likely be even larger and the pace of debt accumulation even more significant than is now forecasted. The same is true if the government spends more than is currently planned.

In summary, in 2015/16 Alberta was the only province in a net asset position, as financial assets exceeded debts. However, the province is now racking up debt much faster than any other province and is driving nearly half of all provincial-level debt accumulation in the country. As a result, the gap in indebtedness between Alberta and other provinces is expected to close very quickly over the next four years, even if optimistic revenue projections come to pass. If they do not, Alberta's fiscal situation will deteriorate even more quickly. Clearly, while Alberta has historically been one of Canada's strongest fiscal performers, the opposite is true today, particularly when considering the future fiscal path of the province.

7. Alberta's debt-to-GDP ratio is also climbing quickly. Over just four years from 2015/16 to 2019/20, Alberta's net debt-to-GDP ratio is forecasted to climb by 12.6 percentage points. This is an average of 3.2 percentage points per year. If the province continues to accumulate debt at this rate, the gap between Alberta and other provinces on this measure will also shrink quickly.



## Ontario: Adding to a substantial debt burden

Ontario, like Alberta, once enjoyed a reputation for sound public finances. In recent years, however, rapid provincial debt accumulation has returned to the province and the progress made during the late 1990s and early 2000s in restoring its reputation for successful financial management has been undone.<sup>8</sup> To be sure, Ontario's fiscal challenges today are somewhat different from Alberta's. Specifically, whereas Alberta's challenge is a period of very rapid debt accumulation that threatens the health of provincial finances, Ontario's challenge is that it already carries a significant debt load that it continues to add to each year. Ontario's debt-to-GDP ratio, which is currently hovering near its historic high, is not expected to fall significantly in the years ahead (Eisen et al., 2017). Despite positive spin surrounding the province's potential balanced operating budget in 2017/18, Ontario's 2017 budget did not take significant steps to address its large stock of public debt. Instead, due to high levels of debt-financed capital spending not fully accounted for in the operating budget and continued growth in debt service payments, the province's nominal debt load will continue to grow in the years ahead.<sup>9</sup>

Ontario's status as a highly indebted province is of relatively recent vintage. In 2002/03, it was Canada's seventh most indebted province relative to the size of provincial GDP. Only Saskatchewan, BC, and Alberta had smaller debt burdens. Since that time, however, Ontario has added a substantial amount of new debt. In fact, one recent analysis showed that despite

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8. During the early 1990s, Ontario ran up significant public debt. This was a marked change from the state of affairs during most of the 1980s, when the province enjoyed relatively sound public finances and the provincial debt burden was comparatively small. By the early 2000s, Ontario was in the process of restoring a reputation for sound management of the public purse. In 2002/03, the province tabled its fourth consecutive balanced budget, the province's nominal debt load essentially stopped growing, and the provincial debt-to-GDP ratio was shrinking steadily. In short, there was reason to be optimistic that the period of rapid debt accumulation of the 1990s would eventually come to be seen as a historical anomaly, and that Ontario would return to being a low-debt province.

9. Some argue that borrowing is an appropriate way to finance public sector infrastructure through capital spending. An analysis of this argument is beyond the scope of this paper. However, it is first important to note that in the case of Alberta the vast majority of planned new debt in the years ahead is expected to result in operating budget deficits. Further, in Ontario, much of the new debt accumulated in the province in recent years has also been to finance operations rather than capital (Wen, 2016). This heightened debt load, resulting largely from operating expenditures, has raised questions about the province's ability to finance its capital plan by adding even more debt without incurring significant fiscal risks—a reality cited by at least one credit agency in explaining a recent credit downgrade. Finally, we will note that the view that it is always appropriate to finance capital expenditures through debt is by no means universally held. For an example, see Dahlby and Smart (2015), which suggests that only a fraction of public sector investment should be debt financed.

having approximately 40 percent of the country's population, Ontario was responsible for more than half (56 percent) of all provincial debt accumulation in Canada between 2003/04 and 2015/16. On a per-capita basis and relative to the size of provincial GDP, Ontario added more debt than any other province in Canada during this period (Eisen et al., 2016a). Consider that in 2002/03, Ontario held 43.2 percent of all provincial government debt in Canada.<sup>10</sup> In 2017/18, that share stands at 48.2 percent.

As a result, Ontario has gone from being roughly in the middle of the pack to being one of the most indebted provinces in Canada. In 2017/18, Ontario's debt-to-GDP ratio is the fourth highest in the country, behind Newfoundland and Quebec and nearly tied with New Brunswick. **Figure 6a** shows that on a per-capita basis, Ontario's debt burden is the third largest in Canada, behind only Newfoundland and nearly identical to but very slightly smaller than Quebec's. It is a remarkable development that Ontario's net debt per person is now almost exactly as large that of Quebec, a province which (as will be discussed) has long held a reputation as the poster child of bad fiscal management in Canada.

Ontario's rising debt burden has had real implications for provincial taxpayers—debt service payments are consuming an ever-growing share of provincial revenues in Ontario. In fact, debt service payments are currently the fastest growing major category of spending in the provincial budget. And the province now spends approximately \$1 billion per month on servicing the debt, which is more than it spends on funding for the province's system of colleges and universities (Lammam et al., 2017).

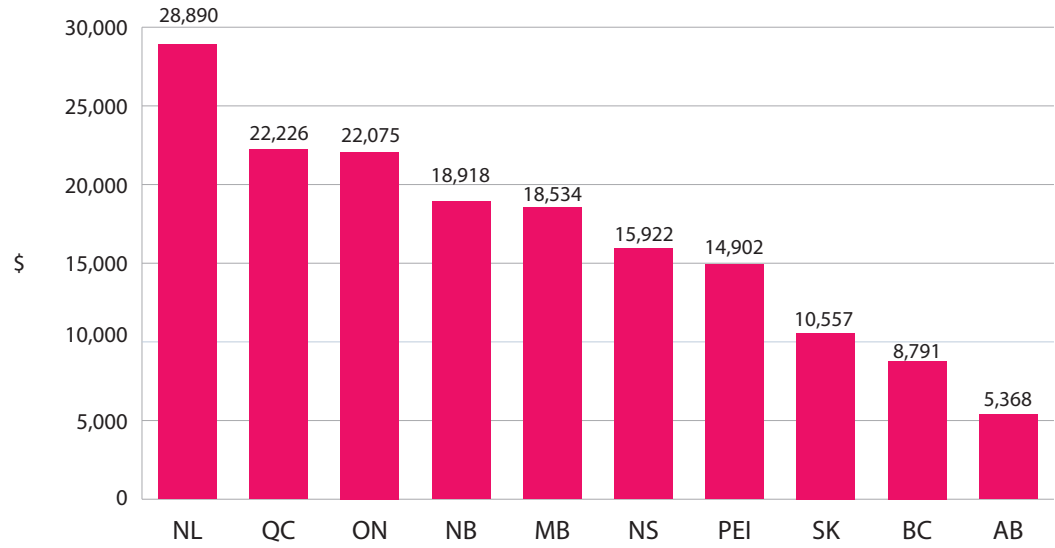
While Ontario faces substantial fiscal challenges, the 2017 provincial budget unfortunately did not take significant steps to address these challenges. Like Alberta, Ontario's fiscal challenges in recent years emerged because the provincial government, over a lengthy period of time, increased program spending at a faster rate than the economy was growing and at a faster rate than would have been necessary to keep pace with pressures from inflation and population growth (Eisen et al., 2016b).

In the most recent years, however, Ontario did finally begin to make some progress in the direction of program spending restraint, holding program spending growth to an average annual rate of 1.7 percent between 2011/12 and 2016/17. (For perspective, program spending in Ontario grew by 6.9 percent annually, on average, over the period 2003/04 to 2010/11. That is four times the average from 2011/12 to 2016/17.) Recent spending restraint, coupled with very strong revenue growth, allowed the provincial government to finally project a balanced operating budget in 2017/18 and slow down the

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<sup>10</sup> In 2002/03, Alberta was in a net asset position. If Alberta's net assets are included in the calculation, Ontario held 44.1 percent of all provincial government debt in that year.

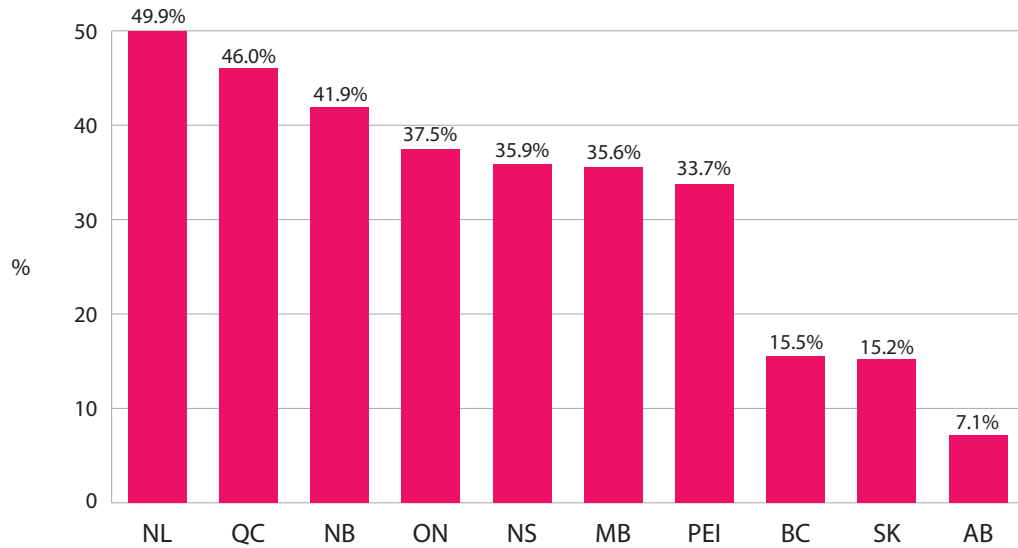
**Figure 6a**  
**Net debt per capita by province, 2017/18**



Sources: See figure 1; Statistics Canada, 2017b.

Note: PEI population estimate dates from 2016.

**Figure 6b**  
**Net debt as a percentage of GDP by province, 2017/18**



Sources: See figure 1; Statistics Canada, 2017a.

rate of debt accumulation compared to what prevailed during the period immediately following the 2008/09 recession.<sup>11</sup>

These developments would have been rightly viewed as small first steps in repairing the province's finances, which had been badly battered by the recession and rapid spending growth of preceding years. The province nonetheless retains an elevated debt burden, and much more work remains to be done to restore Ontario's fiscal health. Instead, upon finally projecting a balanced operating budget for 2017/18, Premier Kathleen Wynne's government in this year's budget reverted to the freer-spending approach that contributed to Ontario's fiscal problems to begin with. Specifically, Ontario's 2017 budget calls for a program spending increase this year of 4.8 percent—significantly more than would be required to keep pace with combined pressures from population growth and inflation (3.1 percent) (Ontario, 2017). **Figure 7** highlights the substantial increase in provincial government program spending forecasted for 2017/18 in this year's budget compared to the years of relative restraint going back to 2011/12.

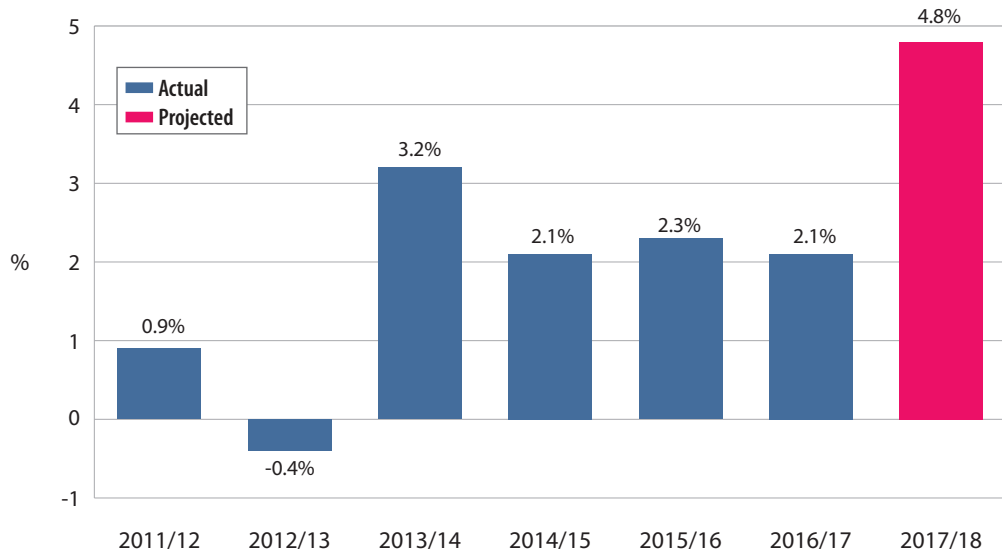
Partly as a result of the government's abandonment of spending restraint, as well as an ambitious capital spending program that will be financed through debt, the provincial government will continue adding substantial new debt in the years ahead. As noted, strong revenue growth and comparative spending restraint from 2011/12 onwards helped at least slow down the pace of debt accumulation in Ontario. This limited progress in terms of slowing the pace of debt accumulation has, however, been halted by the plans outlined in the 2017 budget.

**Figure 8** illustrates this fact by showing how much debt Ontario has added in each year since 2008/09, including the government's forecasts through to the end of its fiscal plan in 2019/20. It shows that after a relative slowdown in the amount of annual debt accumulated each year in 2016/17, the Ontario government intended for the pace of debt accumulation to begin accelerating again in the future. In 2016/17, Ontario added \$7.3 billion in new debt. The 2017 budget forecasts that in 2017/18, that number will rise to \$10.0 billion, climbing higher still in each of the next two fiscal years. Over the past three years, Ontario's net debt has increased by a total of \$34.7 billion. Over the next three fiscal years (2017/18 to 2019/20), the government expects to add almost exactly the same amount of debt—\$34.1 billion.

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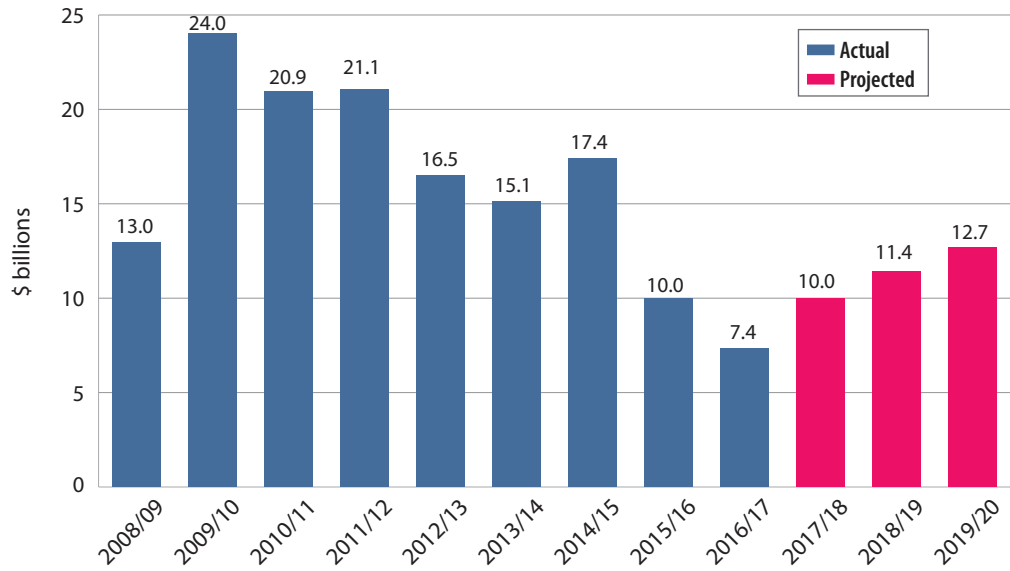
11. A number of factors contributed to rapid revenue growth in Ontario at the time. This included significant growth in fiscal transfers from the federal government (Eisen et al, 2016), robust growth in the housing market of the Greater Toronto Area (FAO, 2017a), and one-time infusions of revenue through asset sales.

**Figure 7**  
Annual program spending growth in Ontario from 2011/12 to 2017/18



Source: Ontario, 2017.

**Figure 8**  
New net debt added each year in Ontario from 2008/09 to 2019/20



Source: Ontario, 2017.

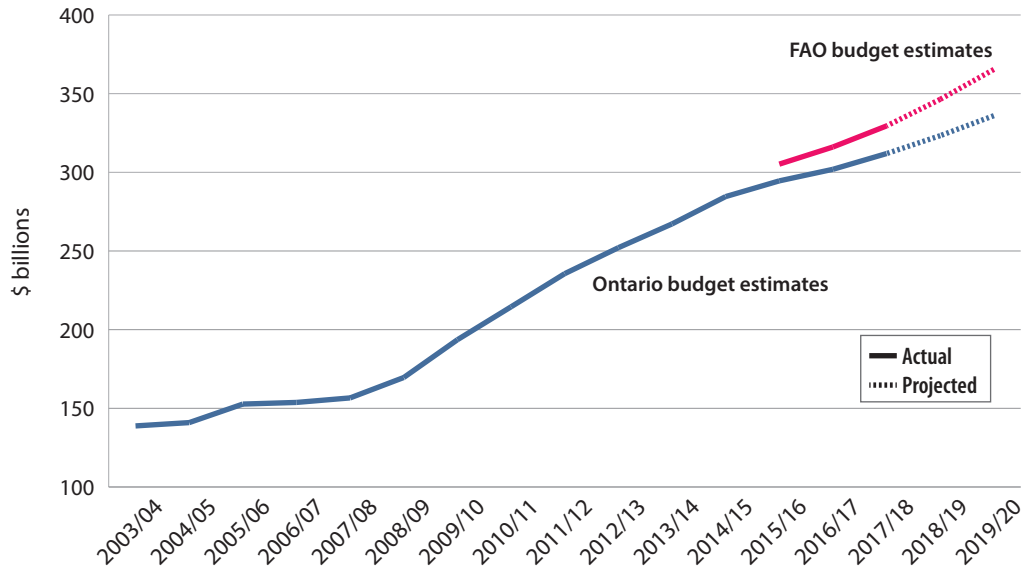
Instead of viewing the arrival of a balanced operating budget in 2017/18 as a first step in addressing the province's fiscal woes, Ontario's provincial government appears poised to accelerate its debt accumulation. Spending has ticked back up substantially, and the province's limited progress in terms of slowing the pace of debt accumulation has been completely halted. As a result, Ontario's net debt, which has grown so dramatically over the past 15 years, will continue climbing in the years ahead.

**Figure 9** shows that Ontario's net debt is forecasted to climb from \$312 billion this year to \$336 billion in 2019/20. Using slightly different accounting methods and assumptions about government spending and revenue, the province's Financial Accountability Office (FAO) forecasts that provincial debt will climb even higher—to \$390 billion by 2021/22. Figure 9 shows the FAO's forecast side-by-side with the government's projections. Using either projection, it is clear that Ontario's nominal net debt will continue to grow significantly in the coming years. As a result, the province's own forecasts show minimal progress in reducing the province's debt-to-GDP ratio (currently hovering near its historic high) in the near future.

One consequence of this continued debt accumulation is rising annual interest payments to service the debt, which will consume resources that would otherwise be available for other priorities. Furthermore, the province's large debt burden may discourage investment in the province, as the prospect of future taxes to service and/or repay the debt raises uncertainty and diminishes Ontario's attractiveness as a destination for skilled workers and investment. Finally, Ontario's finances will remain vulnerable in the foreseeable future to another fiscal shock or recession, which could very well drive the province's debt-to-GDP ratio back up to or above its pre-recession peak if it were to strike while the province is still maintaining an elevated debt burden.

In short, it is concerning that Ontario continues to add substantially over time to an already historically high debt burden. Whereas Alberta's problem is fundamentally one of rapid debt accumulation, Ontario's problem is a somewhat slower but still significant debt accumulation coming on top of an existing substantial debt burden. While Ontario's problems are different from Alberta's, what the two provinces have in common is that their 2017 budgets did not take significant steps to address the specific challenges that they face. As a result, the large debt load already being carried by Ontario taxpayers will continue to grow and eventually be passed along as a burden on future generations.

**Figure 9**  
**Net debt: Ontario government vs. FAO forecasts**



Sources Ontario, 2012, 2017; FAO, 2017b.

## Canada's former fiscal laggards now showing the way

### *Hopeful signs in Saskatchewan, Quebec, and BC*

It is worrying that the traditional economic engines of Canada, Alberta and Ontario, are currently failing to address the fiscal challenges they face. However, there are more hopeful signs from provinces that have historically held poor reputations for fiscal management. Such provinces, including Quebec, Saskatchewan, and British Columbia, tabled budgets for 2017 that show encouraging signs for their fiscal futures. To be sure, some of these jurisdictions (especially Quebec and Saskatchewan) continue to face real fiscal challenges. However, their 2017 budgets present plans to begin to or continue addressing the challenges they face. Although imperfect in some respects, these plans at least represent recognition that serious fiscal challenges exist and offer a meaningful response to those challenges. Unfortunately, this is more than can be said for either Alberta or Ontario.

This section briefly discusses important aspects of provincial budgets in each of these jurisdictions that suggest the country's former fiscal laggards have now become, in important respects, fiscal leaders within Confederation.

### **Saskatchewan**

Saskatchewan's fiscal history includes some dark chapters. Notably, during the very early 1990s, the province saw its debt-to-GDP ratio spike by more than 10 percentage points in just one year, and found itself on the brink of insolvency. Although many jurisdictions across Canada faced fiscal challenges around that period, Saskatchewan's were among the worst in the country (Drummond, 2011).

However, in the early 1990s it was Saskatchewan, one of the most fiscally distressed provinces in Canada, that led the way in implementing spending reductions and program reforms that would eventually help serve as models for many other provinces. Roy Romanow's government in the 1990s helped change Saskatchewan's reputation by being the first in the country to seriously



tackle its deficit and debt problems by significantly reducing program spending and ultimately eliminating a daunting budget deficit in just three years.

Now, 25 years later, history is in some respects repeating itself. Saskatchewan, along with other energy producing provinces (Newfoundland and Alberta), is facing a significant fiscal crunch, with large deficits and significant debt accumulation. However, unlike Alberta, in its 2017 budget, Saskatchewan's government put forward a plan to curtail public spending and meaningfully shrink projected budget deficits.

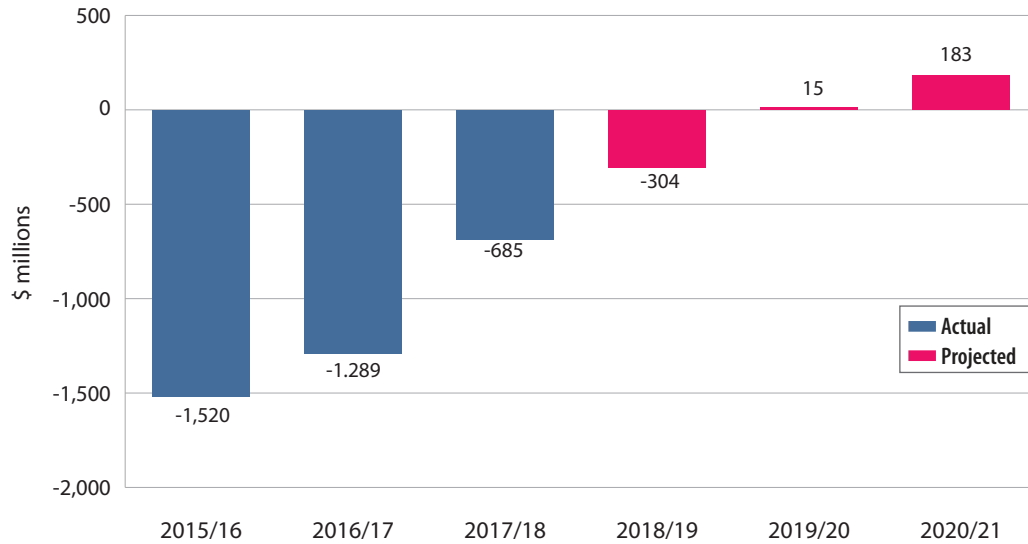
While Alberta has continued to increase spending despite its large budget deficit, Saskatchewan's 2017 budget plans for a reduction in nominal government program spending this year. Specifically, it calls for spending to be trimmed by 1.8 percent from 2016 levels. Considering that it would require a nominal spending increase of 2.4 percent to offset combined pressures from population growth and inflation, the 1.8 percent nominal reduction represents a significant reduction in inflation-adjusted per-person provincial spending in the province.

Cumulatively, over the two year period from 2015/16 to 2017/18, Saskatchewan's fiscal plan calls for a nominal spending reduction of 1.6 percent. This compares to a 10.9 percent nominal increase in neighbouring Alberta. Clearly, the two provinces are taking very different approaches to dealing with the budget deficits they now face—deficits partly rooted in a commodity price downturn that has affected both provinces.

Partly as a result of these different spending choices, Saskatchewan is on track to shrink and eliminate its budget deficit over the next few years, whereas Alberta's deficit is barely expected to shrink throughout the life of the government's fiscal plan. **Figure 10** shows Saskatchewan's projected deficit reduction for the coming years. In 2016/17, Saskatchewan ran a budget deficit of \$1.3 billion. In its 2017 budget, Saskatchewan forecasts that this year it will cut its deficit approximately in half, to \$685 million. Premier Brad Wall's fiscal plan calls for the deficit to be halved again the following year to \$304 million before being eliminated entirely in 2019/20.

To be clear, Saskatchewan's fiscal plan is just that—a plan. The hard work of implementing it will require making difficult choices that result in savings within departments and programs. Saskatchewan's fiscal plan calls for minimal increases in nominal spending in the years ahead, and cost pressures from inflation and population growth will make it more challenging to keep nominal spending levels from creeping up—which would endanger the government's deficit forecasts. Achieving this important objective of restraining nominal spending growth will require the government to find savings within departments and programs, which likely must include real discipline on government wages and salaries. This work remains to be done, but the government's successful adherence to spending restraint in 2016/17 and in its 2017 budget makes its commitment to future spending restraint more credible.

**Figure 10**  
Budget deficits (and surpluses) in Saskatchewan from 2015/16 to 2020/21



Source: Saskatchewan, 2016, 2017.

Further, the government's fiscal plan (like Alberta's) makes optimistic assumptions with respect to resource revenues. Deficit reduction targets will be jeopardized if these do not come to pass (Eisen and Lafleur, 2017). Despite these caveats, Saskatchewan's 2017 budget laid out a generally realistic and relatively swift path to balance which could protect future generations of Saskatchewanians from the type of rapid debt accumulation that is anticipated in Alberta in the years ahead.

Saskatchewan undoubtedly continues to feel real economic pain and faces fiscal challenges as a result of the downturn in commodity prices that began in 2014. However, its 2017 budget reflects an understanding that deficits and persistently growing debt are serious problems that require a prompt and bold response in the form of sustained spending restraint. This approach stands in contrast with Alberta, which has continued to increase spending steadily in recent years despite large budget deficits.

## Quebec

Quebec has historically held an undistinguished reputation in the area of fiscal management within Canada. The province has maintained a larger debt burden than any other province in many years, and has at various points in its history made running large deficits a routine matter of course.

However, in recent years, Quebec's reputation has begun to change. Under Premier Philippe Couillard, the province has embraced a more prudent

approach to fiscal management that is beginning to address the daunting fiscal challenges facing the province. In its 2017 budget, Quebec's provincial government continued the successful policy agenda of recent years, which has led to consecutive balanced budgets and a cessation of debt accumulation. As an added bonus, the fiscal room created by these developments is opening the door to some welcome (albeit modest) tax relief, which is sorely needed to help enhance the province's tax competitiveness.

Quebec's fiscal situation a few years ago in some ways mirrored Ontario's. Both provinces emerged from the 2008/09 recession with large debt burdens and significant budget deficits. While Ontario's immediate budget deficits were larger, Quebec faced the larger debt burden both per capita and relative to the size of provincial GDP. Over the past few years, however, Quebec was able to eliminate its operating deficit much more quickly than Ontario, returning to a balanced budget in 2015/16. In 2017/18, Quebec tabled its third consecutive balanced budget.

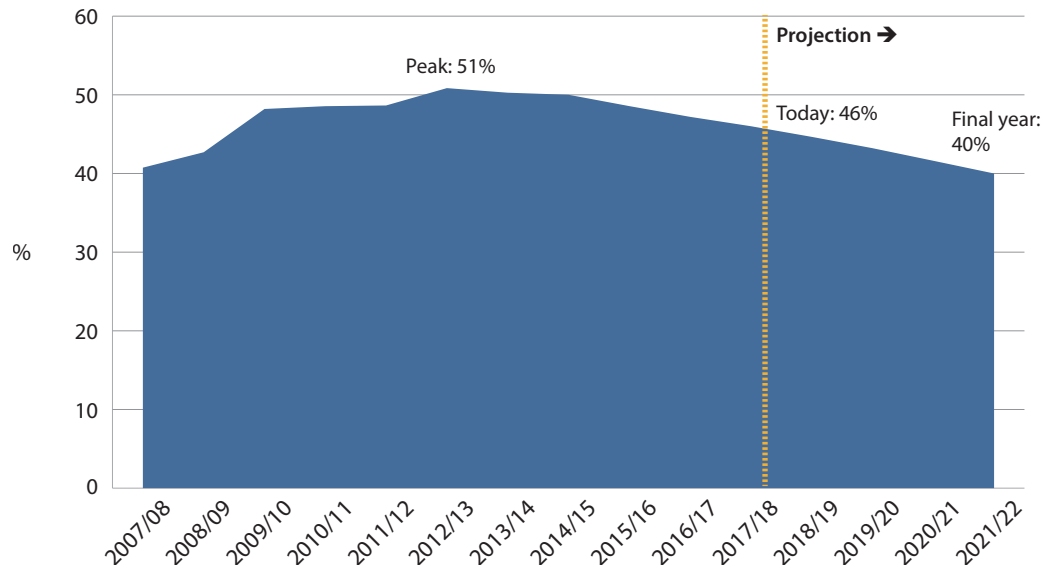
Importantly, whereas Ontario continues to add new debt despite having a balanced operating budget, public debt accumulation in Quebec has ceased altogether in recent years. In 2014/15, Quebec's net debt stood at \$185.7 billion. In 2017/18, provincial debt is forecasted to be \$186.5 billion. In short, there has been virtually no new debt added to the province's books over the past three years. Over the next four years, the province expects its nominal net debt to shrink slightly, to \$183.7 billion. This cessation of debt accumulation in Quebec contrasts sharply with projections for Ontario which, as we have seen, expects to add approximately \$34.1 billion in new debt over the next three fiscal years.

Because it has stopped adding debt, economic growth in Quebec is allowing the province to make significant progress in reducing its debt-to-GDP ratio, which peaked at 50.9 percent in 2012/13. The province's fiscal plan calls for that ratio to shrink to 40 percent by 2021/22. This forecast depends on no new debt being added in the years ahead—a forecast that is made credible by the fact that the province has already eliminated its reliance on new debt to finance operating expenditures and capital projects over the past three years.

**Figure 11** shows Quebec's progress in reducing its debt-to-GDP ratio to date, and its forecast through to the end of its current fiscal plan. Taxpayers in Quebec are already enjoying some of the benefits of this debt reduction, as the share of provincial revenue that must go to debt service payments has been shrinking over time. Specifically, the share has fallen from a recent peak of 11.4 percent in 2013/14 to 9.3 percent in 2017/18. The share of provincial revenue required to service provincial debt is forecasted to fall slightly to 9.1 percent between now and the end of the government's fiscal plan.

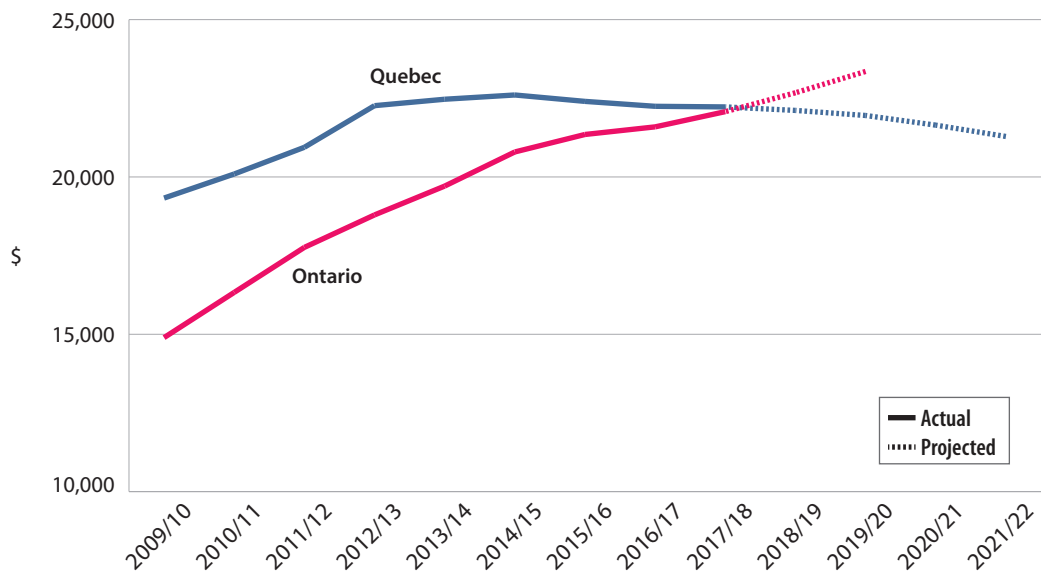
Clearly, Quebec's 2017 budget plan differs substantially from Ontario's. A clear way to illustrate this fact is to examine changes in the two province's

**Figure 11**  
Debt-to-GDP ratio in Quebec from 2007/08 to 2021/22



Sources: Quebec, 2017; Statistics Canada, 2017a.

**Figure 12**  
Net debt per capita in Ontario and Quebec from 2009/10 to 2021/22



Sources: Ontario, 2017; Quebec, 2017; Statistics Canada, 2017b.

net debt burdens per capita in recent years. In 2009/10, Quebec's net debt per capita was \$4,435 larger than Ontario's. Since then, the gap between the two provinces has steadily shrunk to the point that in 2017/18, Ontario's net debt per capita will be almost identical to Quebec's. It is a striking statement about the reversal of fortunes for the two provinces. The average Ontarian now carries almost exactly as much provincial government debt as the average Quebecer. **Figure 12** illustrates this new reality.

Quebec, like Saskatchewan, continues to face real fiscal challenges. None of this is to suggest that the province's fiscal problems have been solved. However, Quebec differs from Ontario and Alberta in that it has presented in its 2017 budget a credible, realistic plan which, if implemented, will help the province make significant progress in addressing its fiscal challenges. Long held up as an exemplar of fiscal mismanagement within Canada, Quebec is now serving as an example for Ontario about the benefits of sustained balanced budgets and limited debt accumulation over time.

## British Columbia

British Columbia, like Saskatchewan and Quebec, has a tainted recent fiscal history. The 1990s in BC are often called its "lost decade," as the province fared poorly on most measures of economic success (Clemens and Emes, 2001). A dramatic turnaround in fiscal policy took hold following the election of Premier Gordon Campbell in 2001, as the province decreased the size of government with targeted spending cuts and restraint, which allowed for multiple rounds of significant, incentive-improving personal and business tax rate cuts. These major tax cuts improved the competitiveness of BC's investment climate and ultimately led to higher levels of investment and faster rates of economic growth (Dahlby and Ferede, 2008).<sup>12</sup> While the 2000s were generally a period where BC performed well on fiscal policy relative to other provinces (Lammam et al., 2010), the province began to increase its debt burden in 2008/09 as it financed many large capital projects with borrowed money. The resulting increase in the debt burden as a share of GDP peaked in 2012/13 and has fallen ever since.

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12. Along with tax relief, the provincial government also substantially reduced the cost of red tape by reducing the number of regulations by more than one-third. It also began a process of regulatory harmonization with Alberta which culminated in the Trade, Investment, and Labour Mobility Agreement (TILMA) and has now evolved into the New West Partnership Trade Agreement including Saskatchewan and Manitoba. The government also undertook a number of steps to improve labour market regulations, including the reinstatement of the secret ballot voting requirement for union certification.

Today, BC in many ways stands out as a province with relatively sound fiscal policies. The 2017 provincial budget proposed BC's fifth consecutive balanced operating budget.<sup>13</sup> As several other provinces struggle with large and persistent deficits, BC has taken a more prudent approach to managing provincial finances. As a result, BC's net debt per person is currently second lowest in the country (see figure 6) and based on the 2017 budget plan, BC could soon become the least indebted province on this measure if Alberta continues down its current path of large and persistent deficits. BC's relatively strong fiscal management allowed former Premier Christy Clark's government to announce significant tax relief in its February 2017 budget, although the type of tax cuts announced did not provide the best possible bang for the buck with respect to economic growth (Lammam et al., 2017).

However, in May, following the February budget, BC had a provincial election. There was much uncertainty in the months after the election about who would actually govern the province given the results, which saw the BC Liberals fall short of a majority. In July 2017, an NDP minority government was officially formed with the support of the Green Party, which means BC's February budget will no longer serve as the basis for the provincial government's long-term fiscal plan. Ultimately, the direction of fiscal policy going forward will depend on the next budget plan passed by the legislature. This leaves BC at a critical juncture, leaving open the question about whether the province will continue and build on its recent fiscal policy success.

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13. However, it is important to note that despite forecasting multiple balanced operating budgets over the fiscal plan, BC's net debt is expected to rise from \$40 billion in 2016/17 to \$46 billion by 2019/20.

## Conclusion

Many Canadian provinces are currently grappling with significant public finance challenges. In this review of 2017 budget plans, however, some provinces are taking meaningful steps to address these challenges in the short term while others are not, putting off hard decisions for another day.

Specifically, Ontario and especially Alberta, which once boasted comparatively sound public finances, are failing to take decisive action to address the challenges they face. Ontario continues to add debt to its large existing burden, and now exceeds Quebec with respect to net debt per capita. Meanwhile, Alberta, which until recently was not a net debtor (as provincial financial assets exceeded its debts), is adding debt faster than any other province in the country and closing the gap quickly in terms of indebtedness with other Canadian jurisdictions. Both Ontario and Alberta have increased spending in their 2017 budgets, and neither province has a plan to make meaningful progress in terms of slowing their pace of debt accumulation during the life of their current fiscal plans.

On the other hand, Quebec and Saskatchewan, two provinces that have at various points faced severe fiscal problems or been viewed as examples of unsuccessful fiscal management, have in their 2017 budgets taken meaningful steps to address the very real challenges they face. Saskatchewan is reducing expenditures and plans to eliminate its deficit within a few years, while Quebec has stopped adding debt entirely and is making meaningful progress in terms of shrinking its debt-to-GDP ratio over time. The contrast between these provinces, on the one hand, and Alberta and Ontario, on the other, is clear. BC, once a fiscal laggard in the 1990s, has taken important steps to achieve its current status as leader. But with a change in government in July 2017, questions remain as to whether the province will continue and build on its recent fiscal policy success going forward.

At this moment, historical reputations for successful fiscal management seem to bear little relationship to reality when it comes to keeping deficits and debt in check. When it comes to public finances, Canada's provinces have been turned upside down, with important implications for residents of Canada's new fiscal laggards as well as its new leaders.

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