

# Spending Beyond Our Means: Addressing the Root Cause of Alberta's Deficit

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## SUMMARY

■ In May of 2019, Alberta's newly elected United Conservative Party created the Blue Ribbon Panel on Alberta's Finances. The panel's mandate was to develop recommendations to achieve a balanced operating budget without tax increases by 2022/23.

■ This bulletin provides historical and inter-provincial context to help Albertans understand the reasons for the province's large, persistent deficits.

■ Alberta's revenues declined steeply following the downturn in commodity prices that began in late 2014/15 and the subsequent recession. That revenue decline contributed to a series of substantial budget deficits. However, despite the large deficits, the provincial government continued to increase nominal spending, which made the problem worse.

■ The government could have learned from the experiences of other provincial governments that reduced and reformed spending to eliminate large deficits—including the NDP government in Saskatchewan led by former Premier Roy Romanow during the 1990s. Instead, Alberta's government took what had become the status quo approach, and continued to increase spending. Partly because of its policy choices, the province's large deficits have persisted.

■ Alberta's current per-capita spending levels are substantially higher than those in British Columbia, Ontario, and Quebec.

■ Were Alberta's provincial government to reduce program spending by 10.9 percent from 2018/19 levels by 2021/22, it could eliminate the deficit one year ahead of schedule while also creating fiscal room for comprehensive pro-growth tax reform.

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## Introduction

In May of this year, Alberta's newly elected United Conservative Party created the Blue Ribbon Panel on Alberta's Finances. In announcing the panel, the government described its task as "reviewing Alberta's finances" and providing, "a plan to balance the budget by 2022-23, without raising taxes" (Alberta, 2019).

The creation of the panel is in response to a correct understanding that both the province's financial position and its tax competitiveness have deteriorated rapidly. In 2007/08, a little over a decade ago, Alberta could boast of having the healthiest finances in Confederation and a material tax advantage over the other Canadian provinces. The provincial government had run a string of 14 consecutive budget surpluses and enjoyed its position as the only province in a positive net financial asset position—which is to say that its financial assets exceeded its debts (Canada, Department of Finance, 2018).

Since then, Alberta's fiscal position has deteriorated rapidly. Successive governments have run budget deficits in 10 of the past 11 years and Alberta has seen its financial assets plummet from a net financial asset position of \$35.0 billion in 2007/08 to a net debt position forecasted to reach \$37.7 billion this year—a deterioration of \$72.7 billion in the province's net financial asset position over just 12 years (Lafleur and Eisen, 2018).

Alberta's fiscal performance has been particularly damaging over the past five years (2014/15 to 2018/19). While there is no doubt that the substantial downturn in commodity prices have made for an incredibility challenging environment, the previous government's policy direction has made Alberta's difficult fiscal situation markedly worse.

This bulletin assesses government spending in Alberta since 2014/15, the last year Alberta ran a balanced budget, and explores why, despite rebounding revenues, Alberta has made no progress in reducing its deficit. In addition, we give the discussion some context by comparing Alberta's growth trends and current spending levels to those of other large provinces. Finally, we briefly discuss how Alberta could balance its budget and restore tax competitiveness.

## Why have large deficits persisted in Alberta?

In 2014/15 Alberta ran a balanced budget—its first in seven years. Then in late 2014, a large downturn in commodity prices began. It triggered one of the worst recessions in Alberta's history. Provincial revenue fell by 13.9 percent in 2015/16, leaving the province with a \$6.4 billion deficit. The provincial government faced a difficult fiscal situation in 2015.

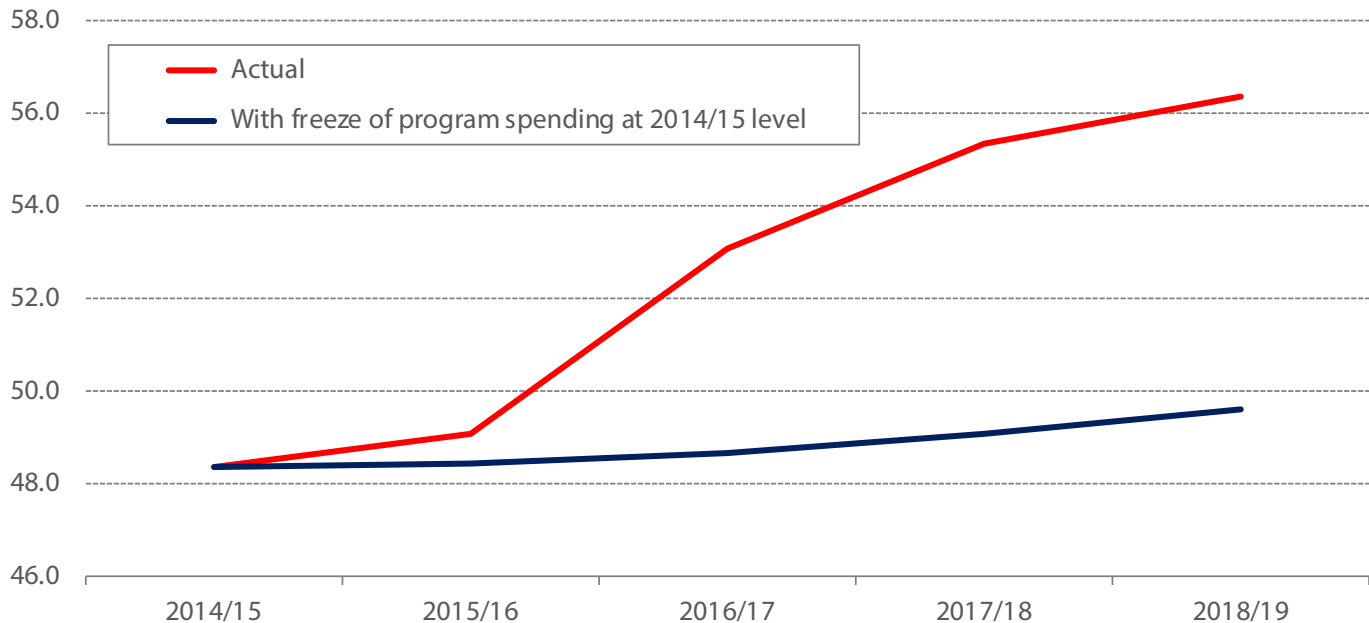
Nearly five years have passed since the start of the commodity price fall. Oil prices have recovered significantly from their lowest point and, although many Albertans are still feeling economic pain, the recession officially ended in 2017 and since then, the economy has been growing—albeit slowly and unevenly (ATB, 2019a).

Despite these developments, however, the province has made no progress over the past five years in reducing its deficit, which in 2018/19 was \$6.7 billion. This despite reasonably strong revenue growth, which has averaged 5.0 percent in nominal terms annually since the steep decline in 2015/16 (including the projection for this year).

One important cause of Alberta's failure to shrink its deficit in recent years is rooted in its failure in the years since 2014/15 to restrain

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Figure 1: Total Spending—Actual vs. with a Freeze of Program Spending at 2014/15 Level (\$ billions)



Sources: Canada, Department of Finance (2018); Alberta Treasury Board and Finance (2019b); calculations by authors.

spending so it is commensurate with the fiscal challenge facing the province.

The government could have learned from the experiences of other provincial governments that reduced and reformed spending to eliminate large deficits—including the NDP government in Saskatchewan led by former Premier Roy Romanow during the 1990s. Instead, Alberta's government took what had become the status quo approach and continued to increase spending, which exacerbated the province's fiscal challenges beyond what they would have been had it either reformed and reduced spending or, alternatively, held nominal spending constant.

Figure 1 shows the increase in total government spending since 2014/15. It also shows how total spending levels would have evolved had the

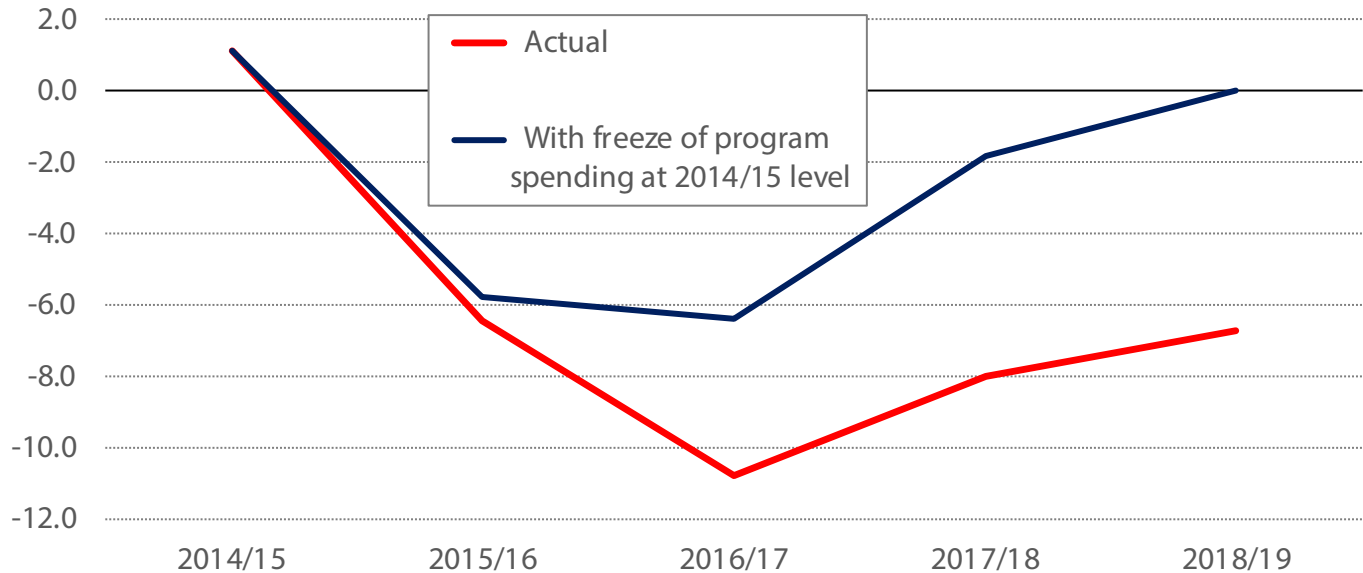
newly elected government responded to the large deficits it inherited by freezing program spending. All told, the provincial government increased nominal program spending by 14.1 percent between 2014/15 and 2018/19. In short, instead of responding to the province's large deficits by reducing and reforming provincial spending, or even holding nominal spending flat in an effort to shrink the deficit over time, the government carried on with significant nominal spending increases.

Its spending growth has caused Alberta's deficits in recent years to be substantially larger than they would have been had the approach to spending been different.

Other policy approaches were available. If the province had followed Roy Romanow's example in Saskatchewan, for example, or Ralph Klein's

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Figure 2: Annual Budget Balance (\$ billions) Under Two Program Spending Scenarios, 2014/15 – 2018/19



Sources: Canada, Department of Finance (2018); Alberta Treasury Board and Finance (2019b); calculations by authors.

in Alberta during the 1990s, it could have quickly eliminated the deficit. Even had it taken the more modest step of holding nominal spending flat in response to the large deficit, the fiscal outcomes would have been far better than they are.

Specifically, instead of peaking at \$10.8 billion in 2016/17, Alberta's deficit would have peaked at \$6.4 billion in that year. Indeed, as figure 2 shows, Alberta would have run much smaller deficits throughout recent history under this scenario—and, in fact, it would have balanced its budget last year instead of having a \$6.7 billion deficit.<sup>1</sup>

<sup>1</sup> This analysis makes two simplifying assumptions: first it does not account for reduced spending on debt interest costs from smaller deficits; second, it assumes no change to government revenue as a re-

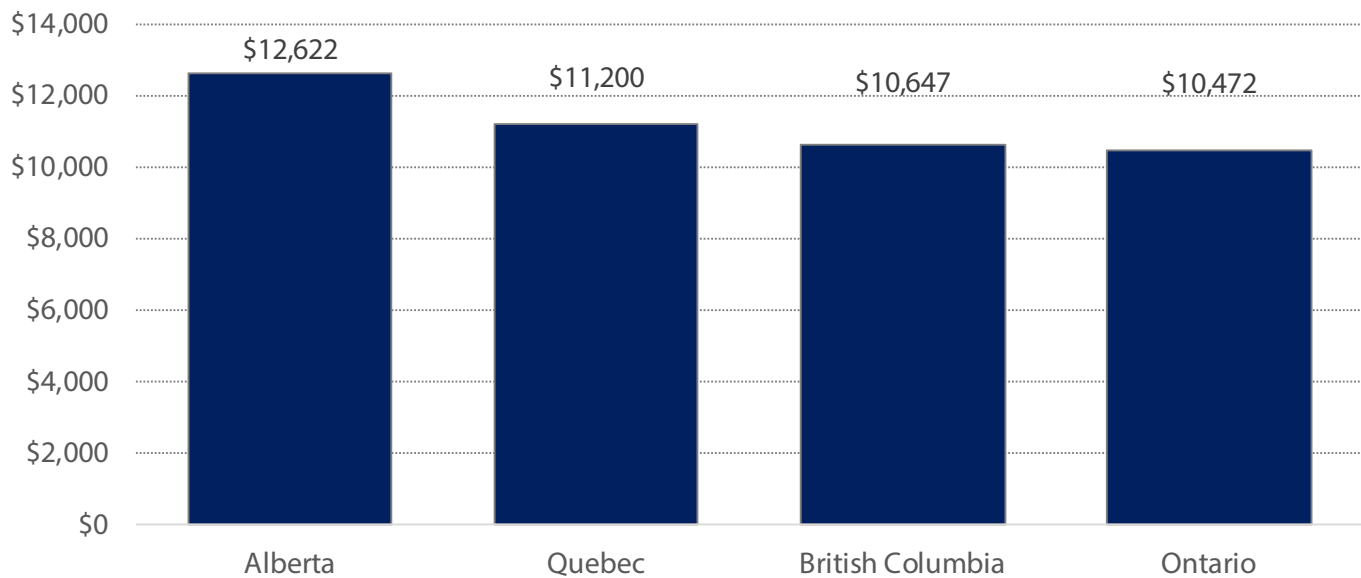
The government's failure to curb spending since 2014/15 has had profound implications for the province's fiscal health. Specifically, because of the large deficits in recent years (along with significant new debt from capital spending), the province is forecasting that its net debt will reach \$37.7 billion this year. By contrast, a recent analysis shows that if the government had kept nominal program spending flat, and if all else were held equal, the province's debt burden this year would be just over \$10 billion (Eisen, Lafleur, and Palacios, 2018).

sult of different spending choices by the provincial government.



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Figure 3: Per Capita Program Spending (2018/19)



Note: Quebec data excludes abatements.

Sources: Canada, Department of Finance (2018); Alberta Treasury Board and Finance (2019b); Statistics Canada (2019a); calculations by authors.

## Interprovincial context: Comparing Alberta's spending to that in the other large provinces

The preceding section showed that if the Alberta government had held nominal spending flat beginning in 2014/15, the province would have had a balanced budget last year. Instead, the government decided to continue increasing spending despite the large deficits it faced, which has contributed to the size of Alberta's recent deficits.

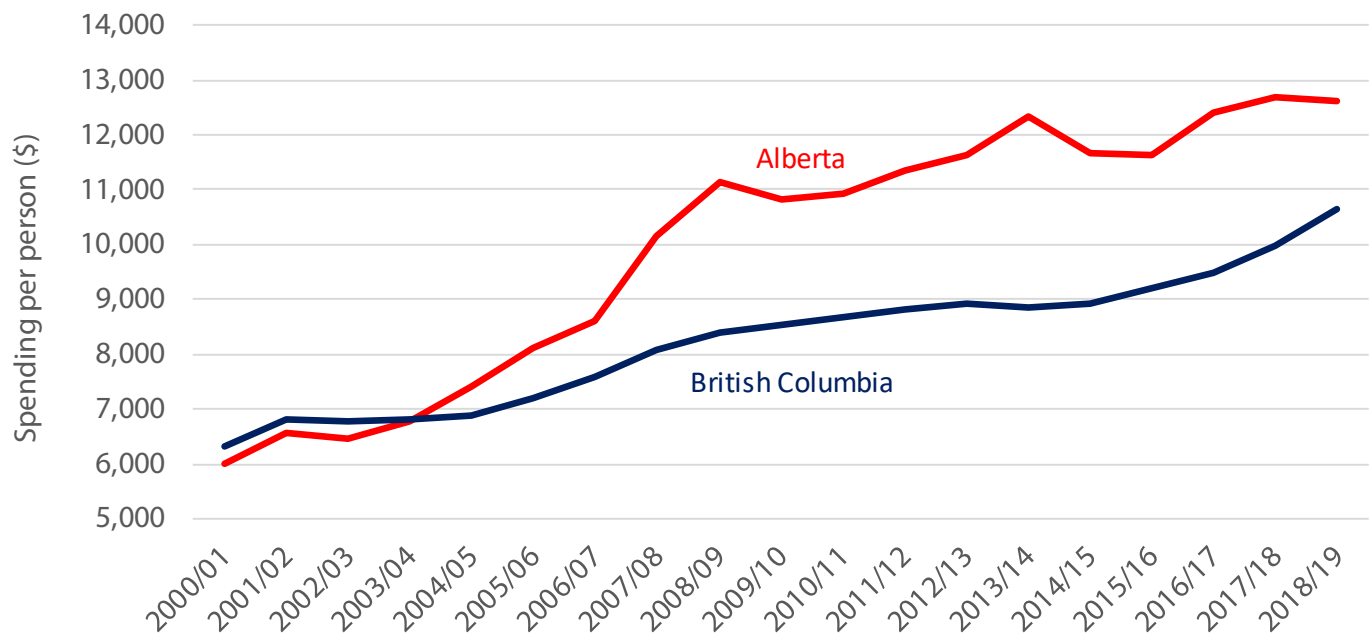
But how feasible is it to hold or reduce program spending? In considering that question, it is illustrative to compare Alberta's current program spending (adjusted for population) to that in the other three large provinces. In 2018/19, Alberta's per-person program spending was substan-

tially higher than in Quebec, British Columbia, and Ontario.<sup>2</sup> For example, in 2018/19 Alberta's per person spending (\$12,622) was 18.5 percent higher than that in British Columbia (\$10,647). Figure 3 illustrates this and also shows per-

<sup>2</sup> Each province allocates responsibility for service delivery differently between the provincial and local governments, and so it is theoretically possible that low per-person program spending levels at the provincial level in a given province could be driven partly or entirely by greater devolution of responsibilities to municipalities. To ensure this factor was not a primary driver of the results, we compared per-person consolidated provincial/local spending in the four large provinces. On this metric as well, per-person spending in Alberta was substantially higher than in the other three large provinces.

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Figure 4: Per-Person Program Spending in Alberta and BC, 2000/01 to 2018/19



Sources: Canada, Department of Finance (2018); Alberta Treasury Board and Finance (2019b); Statistics Canada (2019a); calculations by authors.

person spending levels in Ontario and Quebec,<sup>3</sup> both of which spend substantially less per person than does Alberta.

Alberta's much higher per-person spending relative to, for example, British Columbia, is a relatively recent phenomenon. In fact, figure 4 shows that in 2000/2001, the BC government was spending \$6,303 per person in that year while Alberta's government was spend-

ing \$5,988. Since then, much faster spending growth in Alberta has drastically changed the complexion of this comparison.

More specifically, while nominal per-person program spending increased by 110.8 percent in Alberta between 2000/01 and 2018/19, it grew much less—by 68.9 percent—in British Columbia over the same period. So elevated spending levels in Alberta relative to BC is not a deeply-rooted historical phenomenon; rather, it is the result of each making different spending choices over the past two decades.

This section has shown that Alberta has the highest per-person program spending level of the four large provinces—by far. Further, there is no evidence that this spending has given Albertans better public services than British Co-

<sup>3</sup> Quebec has assumed responsibility for certain areas that in other provinces are under federal control. Quebec receives an “abatment” from Ottawa to compensate for these extra costs. When this abatment is subtracted from government spending in Quebec it, in effect, subtracts the financial costs of these responsibilities, allowing direct comparison with other provinces.

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lumbians receive.<sup>4</sup> This suggests that there is room for meaningful savings in Alberta's budget.

## Discussion: Balancing the budget while restoring tax competitiveness

This bulletin has shown that the provincial government's decision to continue increasing spending in recent years has contributed to the persistence and size of Alberta's deficits. Specifically, we have shown that if the provincial government had held nominal spending at 2014/15 levels in response to the substantial downturn in revenues, it would have balanced the budget in 2018/19. As it stands, Alberta still has per-person spending levels that are substantially higher than those of any of the other large provinces and it continues to face a multi-billion-dollar deficit.

The most promising solution to Alberta's fiscal challenges is to reform and reduce provincial spending.<sup>5</sup> An earlier study showed that by doing so, Alberta's new government could eliminate the budget deficit by 2021/22 (one year ahead of the blue ribbon panel's mandated target date), while also creating fiscal room for significant growth-enhancing tax relief (Eisen, Emes, and Lafleur, 2019).

More specifically, the government would need to reduce nominal program spending by 10.9 percent from 2018/19 levels by 2021/22 in or-

der to achieve balance in that year while creating room for comprehensive tax reform.<sup>6</sup>

There is good reason for setting the target date for deficit elimination for 2021/22 instead of 2022/23. Specifically, Canadian history suggests that the shorter timeline would enhance the prospects of the consolidation plan actually achieving its balanced budget goal. Indeed, most successful efforts in recent Canadian history aimed at eliminating large deficits (particularly during the mid-1990s) took place over a two- to three-year period (Clemens et al., 2017). Longer-term plans have a less impressive track record as they are subject to a variety of economic and political risks over that longer period.

Further, it is important for the blue ribbon panel to recognize that beyond balancing the budget, the government's approach to spending in the years ahead should also recognize the need to create fiscal room to allow for a comprehensive restoration of the once famous "Alberta tax advantage," which has been almost entirely lost in recent years.<sup>7</sup> Tax increases at the provincial level in Alberta and at the federal level in Canada combined with tax reductions in the United States have badly undermined Alberta's competitiveness. For example, Alberta has gone

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<sup>4</sup> For comparisons of health care and education performance in the two provinces, for example, see (Eisen, Clemens, and Veldhuis, 2019).

<sup>5</sup> For a detailed discussion of several policy options that could help achieve such spending reductions and/or improve the quality of public services in the province, see Eisen, Clemens, and Veldhuis (2019)

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<sup>6</sup> More specifically, this spending reduction would be sufficient to reduce the province's personal income and corporate income tax rates to 6 percent while also eliminating the provincial share of capital gains taxation and eliminating the province's carbon tax as described in Murphy (2019).

<sup>7</sup> The new government has already taken one important step in this process by announcing a gradual reduction of the province's corporate income tax rate from 12 to 8 percent over a four-year period. However, given the scale of the policy changes in Alberta and elsewhere in recent years, significant additional tax reform will be required to comprehensively restore Alberta's tax advantage.

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from having the lowest top marginal personal income tax rate in either Canada or the United States in 2014 to having the tenth highest top marginal rate in either country in 2018 (Lafleur, Eisen, and Palacios, 2019).

## Conclusion

This bulletin has shown that continued spending growth since the recession that began in 2014/15 has contributed to Alberta's persistent deficits today. Further, it has shown that per-person spending in Alberta is substantially higher than in the other large provinces.

Reducing nominal program spending by 10.9 percent over three years would be sufficient to eliminate the deficit while creating fiscal room for tax relief. This would represent a substantial fiscal consolidation. It would not, however, be unprecedented in Alberta's history.<sup>8</sup> Further, the advantages of pursuing such an approach to government spending would be many, as it would eliminate the deficit, drastically slow the accumulation of debt, and create the fiscal room for tax reform and relief to restore the recently lost "Alberta Tax Advantage."

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<sup>8</sup> For context, during the Klein reforms of the mid-1990s, nominal spending fell by more than 20 percent.

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