A Spending Framework for Alberta

Balancing the Need for Deficit Elimination and Tax Reform

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Executive Summary

This paper calculates the extent of spending reductions that Alberta would need to make over the next three years to eliminate the province's budget deficit by fiscal year 2021/22 while also creating the necessary fiscal room for pro-growth tax relief.

Alberta's fiscal situation has been deteriorating rapidly, with the province going from a $31.7 billion net financial asset position in 2008/09 to having $28.1 billion in net financial debt this fiscal year. This is a total net asset decline of $59.8 billion. All this new debt is leading to higher debt service costs. It is estimated that the province's once negligible debt servicing costs will hit $435 per person by 2018/19, reducing the province's ability to fund important priorities. This highlights the importance of returning to budgetary balance sooner rather than later.

Notwithstanding recent tax increases, Alberta is running large deficits and accumulating debt quickly. Those tax increases have significantly undermined its tax competitiveness and relative attractiveness as an investment destination compared to peer jurisdictions. Until recently, Alberta had the lowest combined top federal-provincial/state statutory personal income tax and corporate income tax rates of any US state or Canadian province. Thanks in part to recent provincial tax increases, Alberta today has the 9th highest top combined PIT rate in Canada and the United States. The provincial government has also increased the province's general corporate income tax and imposed a new carbon levy.

In order for Alberta to meet the dual challenge of restoring its tax competitiveness while also eliminating its large budget deficit, it must make substantial policy reforms and substantial spending reductions. This paper calculates the size of the spending reductions that Alberta needs to make to balance its budget over the next three fiscal years while also creating enough fiscal room for meaningful tax reform and reductions. Specifically, it models the extent of spending reductions that would get Alberta to budget balance by 2021/22 if the province enacted substantial reforms and reductions related to the personal income tax, corporate income tax, carbon pricing mechanisms, and capital gains tax. It finds that to achieve these goals, the provincial government would need to reduce nominal program spending by a total of 10.9 percent over the next three years.

This fiscal consolidation is clearly sizable. However, the paper shows there is historical precedent for consolidations on a similar scale. The spending reductions under the Klein government in the 1990s, for instance, were substantially steeper. Further, the paper provides context on the needed reforms in Alberta by showing that program spending in the province is currently 21.5 percent higher than in British Columbia, a province whose public services in key areas including health and education are currently outperforming Alberta's.

Eliminating the province's substantial budget deficit while also creating room for tax relief and reform will not be easy. However, this study shows that it is possible if the government makes major reforms that substantially reduce provincial government spending in Alberta.

Introduction

Alberta faces severe economic, fiscal, and policy challenges. Between 2014 and 2016 after the fall in commodity prices, provincial GDP declined by nearly 20 percent,[1] while the unemployment rate soared from below 5 percent to 9 percent, before gradually settling down to about 6.5 percent (Alberta, 2019). The number of Albertans receiving unemployment insurance payments remains substantially above pre-recession levels. The province's public finances, which until recently were the envy of the country, are in disarray. Although Alberta's debt burden relative to the size of its economy is still smaller than that of other Canadian provinces, its large yearly budget deficits are quickly closing the gap and Alberta is projected to rack up tens of billions of dollars in new debt in the years ahead. Partly in response to the ballooning budget deficit, in 2015 the Notley government introduced increases to provincial personal and corporate income taxes, substantially undermining the "Alberta tax advantage" that the province had previously enjoyed over other jurisdictions in North America.

The province's regular multi-billion-dollar budget deficits are a potent symbol of the change in Alberta's fortunes; credit rating agencies have pointed to the province's deficits as a primary cause of credit rating downgrades (Bellefontaine, 2017, May 26). The sitting government has explicitly acknowledged that large, persistent budget deficits are a problem and has said that it intends to return to balanced budgets by 2023/24.

Achieving a balanced budget by 2023/24 is in and of itself singularly unambitious. Assuming current revenue forecasts come to pass, realizing that goal would require no nominal spending reductions or real reforms; it would need only some moderation in the pace of the growth in spending compared to what has prevailed in recent years.

A growth-oriented fiscal strategy would go beyond simply spending restraint. Recent Canadian history shows the danger of taking too timid an approach. Apart from the additional debt accumulation that comes from a longer period of deficits, a "go slow" approach to deficit reduction increases the risk that a recession, slowdown, or other unforeseen adverse event will interfere with the fiscal plan and cause yet further delays. Ontario's recent history, in which that province's provincial government set a distant

[1] Author's calculation based on Statistics Canada (2019d).

balanced budget date of 2017/18 in the wake of the 2008/09 recession, provides a powerful example. Due primarily to the slow pace of deficit reduction, Ontario's debt soared in the years following the recession—and in the end, the province did not meet even its unambitious target date, and the province is still in deficit.

On the other hand, the experience of governments from across Canada during the 1990s suggests that fiscal consolidation based on substantial spending reform aimed at rapid deficit reduction have often achieved better fiscal outcomes. A more urgent approach to reforming and reducing provincial government spending with the objective of returning to balance more quickly than the government has currently planned, while also creating the fiscal room for tax relief to restore Alberta's tax advantage, would begin the process of repairing the province's finances and would also encourage growth and investment.

This paper analyzes the extent of the short-term spending reductions Alberta would need to make to return the province's budget to balance over a three-year period—by 2021/22—while also implementing substantial tax reform that would restore Alberta to its former status as one of the most competitive and pro-growth tax regimes in North America. A three-year timeframe is consistent with the history of successful large-scale fiscal consolidations in Canada in the 1990s, which generally took place over a two- to three-year period (Clemens et al., 2017).

Eliminating the budget deficit and creating the fiscal room for tax relief should not be viewed as the end-point for fiscal consolidation in Alberta but, rather, as an important first step. Over the longer term, fiscal policy should be guided by the objective of bringing expenditures more in line with tax revenues and thereby reducing the government's longstanding reliance on non-renewable natural resource revenues to fund operating expenses. This process would end the cyclical emergence of large budget deficits in Alberta during downturns in resource prices and allow the province to resume contributions to the Heritage Fund, ensuring that the fiscal benefits of resource development are shared with future generations. This paper will also briefly discuss a long-term framework for achieving this objective.

The plan of this publication is as follows. The first section reviews Alberta's current fiscal challenges and how we got here. The second highlights the province's declining tax competitiveness, and outlines the steps Alberta would need to take to reclaim its position as close to the top of the pack on key tax rates in Canada and the United States. The third section shows how much spending would need to be cut to make room for tax reform while balancing the budget by 2021/22. The fourth section discusses longer term fiscal goals the province should steer towards after the budget is balanced. A brief conclusion follows.

Background on Alberta's Fiscal Situation

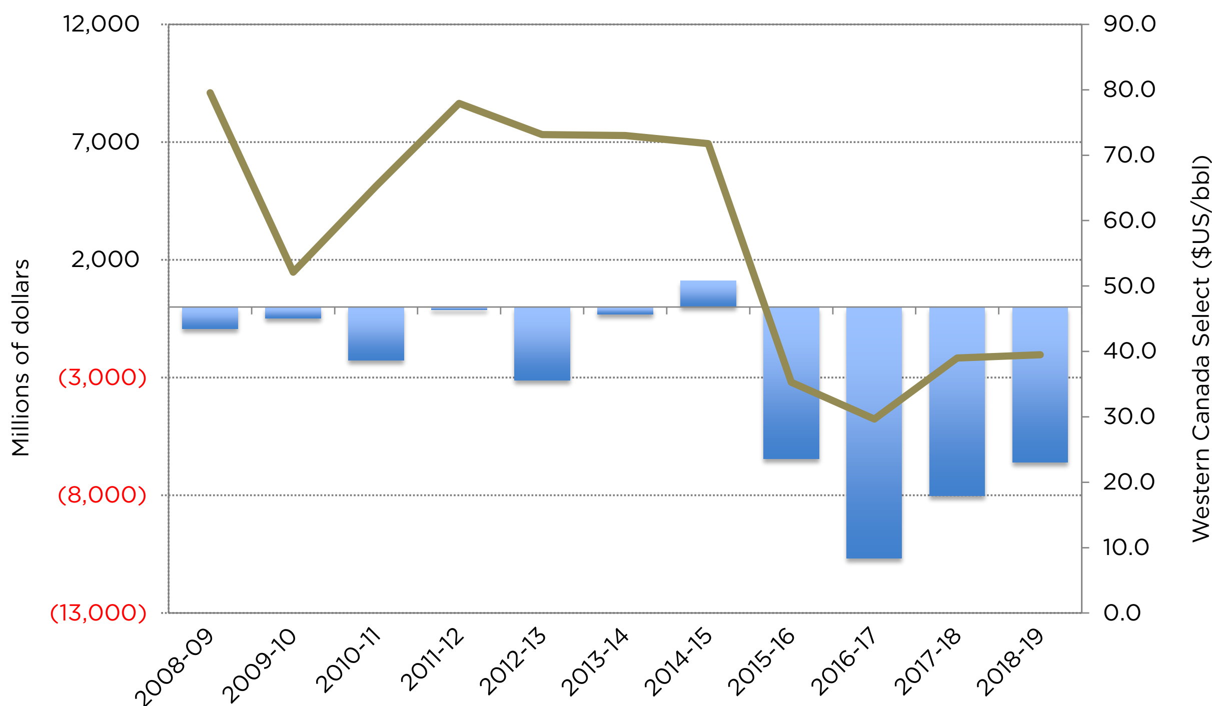
Albertans have endured significant economic pain since the sharp decline in commodity prices in 2014 triggered a major recession in the province that lasted for nearly two years. The decline in oil prices from highs of over $100 per barrel to lows of under $30 per barrel triggered a 19.9 percent decline in provincial GDP and an increase in unemployment rates (which peaked at 9 percent).

The downturn also led to a decline in government revenue, further undermining the health of the province's finances, which were already precarious owing to the spending choices of successive governments. While the revenue downturn stemming from the decline in commodity prices have put pressure on the budget, Alberta's fiscal challenges long pre-date the decline in oil prices. In fact, as figure 1 shows, Alberta has run nearly uninterrupted deficits since the previous recession in 2008-09 despite high oil prices throughout much of that period.

The underlying cause of Alberta's chronic fiscal problems is the failure by successive governments to restrain spending.[2] As previous research has demonstrated, these deficits were driven largely by program spending increases that have been above the combined rate of inflation plus population growth over time. Indeed, between 2004/05 and 2014/15, program spending increased by nearly 100 percent—almost twice what would have been required to keep up with the growth in prices and population (Lafleur et al., 2015). More specifically, during energy booms when revenues climbed quickly, Alberta often increased spending along with revenues. However, it failed to retreat from those elevated levels when revenue growth subsequently slowed or reversed. The period from fiscal years 2003 to 2005 when spending grew by 28.8 percent over just three years is an illustrative example.

[2] The exception to this pattern is a brief period of fiscal restraint beginning with a small nominal program spending cut in 2013/14, culminating in a single balanced budget in 2014/15.

Figure 1: Budget Balance and Oil Prices from 2008/09 to 2018/19

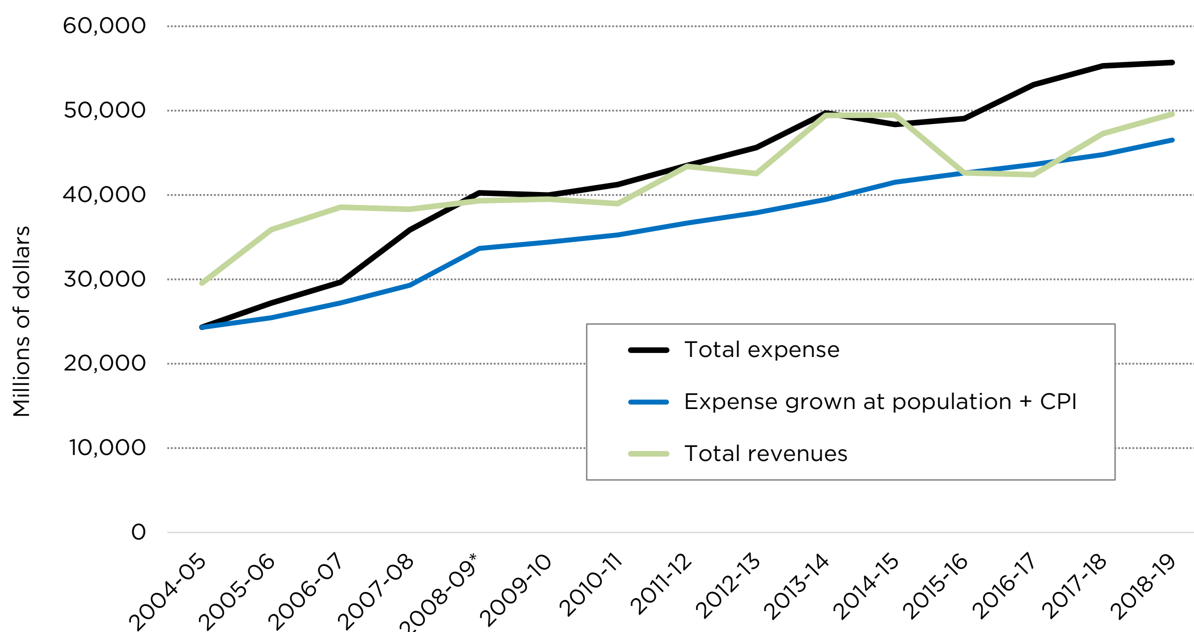


Sources: Alberta (2018); Alberta Finance (2018a, 2018b); Alberta Energy Regulator (2018).

As a result of this rapid spending growth, the province's finances were already in a precarious position when the oil price fall of 2014 occurred, and even larger deficits emerged. Had the provincial government kept spending growth either to the rate of inflation plus population growth, or the rate of economic growth in the decade prior to the 2014 oil price fall, the province would have run surpluses throughout most of the past decade and its level of net assets and its current budget balance would be in a much better position today. More broadly, a study by Kneebone and Wilkins has shown that Alberta's chronic fiscal problems, and specifically its budget volatility, have sprung from its failure to restrain spending in light of the known volatility of the province's resource revenues (Kneebone and Wilkins, 2018).

Figure 2 illustrates these issues graphically. It compares the province's actual spending trajectory since 2004/05 to what would be the case if spending growth had been tied to inflation and population growth. Further, it compares both to provincial government revenue during this period, thus illustrating the fact that the province would have been in

Figure 2: Alberta Revenue, Spending and Constrained Spending



Note: There is a major break in the data between 2007/08 and 2008/09. To account for this we took the spending difference in 2007/08 and applied it to 2008/09 spending and grew this new value by the annual sum of population and inflation growth.

Sources: Canada (2018); Statistics Canada (2019b); Alberta Finance (2018a); Statistics Canada (2019c).

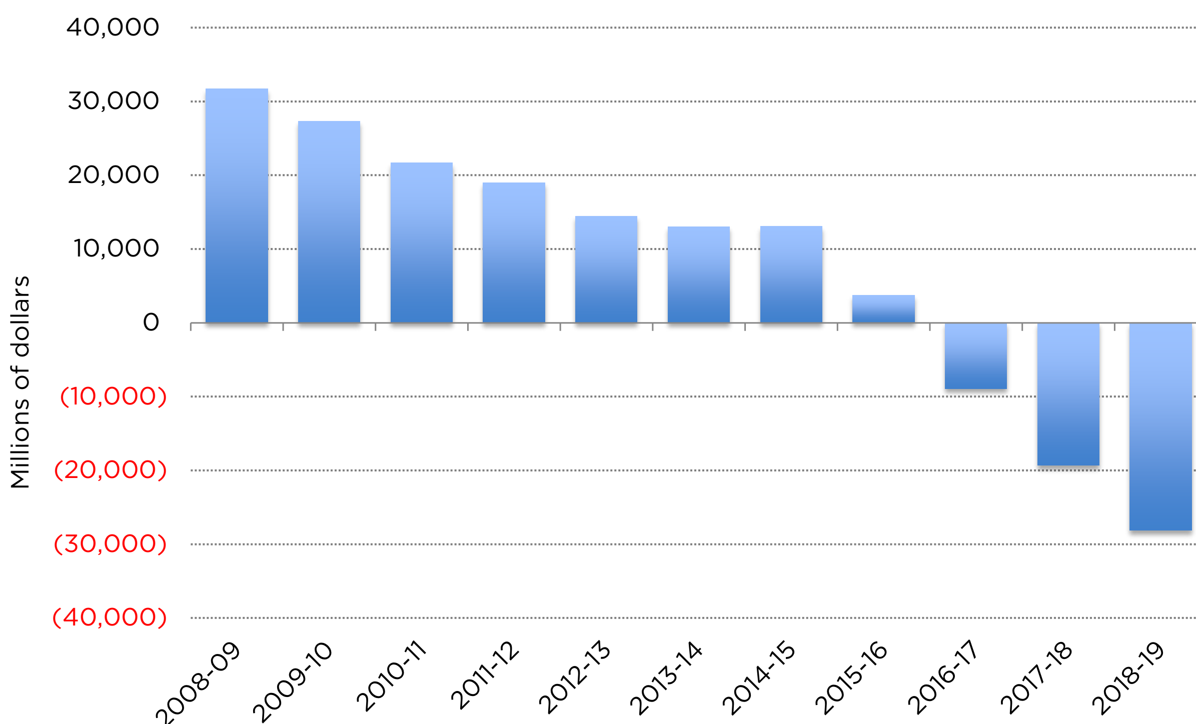
a surplus position in all but two years under the "restrained" spending scenario. In those two years, immediately following the fall in commodity prices, the deficits still would have been negligible.

As it is, the long string of mostly preventable budget deficits, initially caused by a lack of spending restraint and exacerbated by the recent fall in oil prices, has taken a toll on the health of Alberta's public finances.

As figure 3 shows, Alberta had $31.7 billion in net financial assets in 2008/09. After a nearly unbroken string of deficits starting that year, coupled with substantial new debt from capital spending, the government returned to a negative net financial asset position for the first time since 1999/2000 in 2016/17. In 2018/19, Alberta's net debt is expected to reach $28.1 billion. This is a total net asset decline of roughly $60 billion in a single decade.

This rapid pace of debt accumulation is already imposing real costs on Albertans, and those costs are set to grow. Specifically, a growing debt means increased debt service costs, which consumes scarce resources

Figure 3: Alberta's Net Financial Assets from 2008/09 to 2018/19



Sources: Alberta (2018); Alberta Finance (2018a, 2018b).

that become unavailable for other priorities. Annual debt servicing costs for Alberta were negligible as recently as 2008/09, but those costs are expected to reach $435 per person in 2018/19. In total, debt charges have climbed from just $214 million in 2009/10 to a forecasted $1.9 billion in 2018/19 with much more growth expected in subsequent years.

Clearly, Alberta faces serious fiscal challenges that have their roots in spending decisions of successive previous governments as well as the recent downturn in energy prices. However, spending decisions subsequent to the fall in energy prices in 2014 have also contributed to the large deficits and difficult fiscal situation that Alberta finds itself in today.

Despite inheriting a challenging set of fiscal circumstances, the Notley government increased program spending by 13.4 percent in its first two years in office, further driving debt accumulation. The decision to continue increasing spending despite large budget deficits has had important implications for the evolution of Alberta's budget deficit. Despite the fact that provincial revenue has rebounded and is expected to be approximately equal in 2018/19 (in nominal terms) to the pre-recession peak in

2014/15, the government still plans to run multi-billion-dollar operating deficits. Had the Notley government chosen to freeze nominal spending at its 2015/16 levels—even allowing for the spending increases introduced that year—the operating budget would be balanced in 2018/19, and the province would have avoided billions in debt accumulation (unless reduced operating deficits were offset entirely by increased capital spending). If, more modestly, the new government had adhered to the spending plan it inherited from the March 2015 budget of its predecessor, spending growth would have been substantially slower than was in fact the case, and the province would have avoided billions of dollars in new debt in each of the past several years.

In short, while spending decisions predating the recession and the fall in oil prices caused the explosion of large budget deficits in Alberta, spending decisions since then have failed to address the problem and have in fact prolonged the problem of large budget deficits and rapid debt accumulation. Moreover, increases to key tax rates have rendered the province less competitive, further adding to Alberta's fiscal woes by reducing economic growth and, by extension, weakening the tax base.

Restoring Tax Competitiveness: An Important Fiscal Objective

Until recently Alberta had the lowest combined top federal-provincial/state statutory personal income tax and corporate income tax rates of any state or province. But three things have changed. First, the Alberta government moved from a single, flat, personal income tax rate of 10 percent to a progressive five-bracket system with a top rate of 15 percent. It also increased its general corporate income tax rate from 10 to 12 percent. Second, the Canadian federal government increased its top personal income tax rate by 4 percentage points. Finally, the US federal government reduced both its personal and corporate income tax rates in 2018. As a result, Alberta now has one of the highest combined top federal-provincial/state statutory personal income tax rates in North America, and its statutory corporate income tax rate is in the middle of the pack (Lafleur, Eisen, Palacios, 2019).[3]

As recent research has discussed, moving back to the old 10 percent single personal and corporate income tax rate won't restore Alberta's former tax advantage. A more ambitious move—to a 6 percent single personal and corporate income tax rate—would bring Alberta into a tie for the lowest combined federal-provincial/state corporate income tax level and move it to within two percentage points of the lowest top personal income tax rate. This step would go a long way towards boosting Alberta's competitiveness, improving incentives to work and invest in the province. Veldhuis, Emes, Taylor, and Clemens (2018), have argued that Alberta could further enhance its attractiveness as an investment destination by reforming its capital gains tax, essentially eliminating the taxation of capital gains in Alberta at the provincial level. Finally, Murphy (2019) has

[3] Alberta's competitive standing on the taxation of corporations is somewhat better when a more comprehensive measure of the Marginal Effective Tax Rate (METR) on new investment is considered. This metric, however, applies only to new investment, and recent policy changes that have lowered the METR in Alberta are temporary, which is a relevant factor in shaping the effect of tax policy on the attractiveness of Alberta as an investment destination.

proposed a comprehensive re-assessment of the provincial government's Climate Leadership Plan (CLP) and associated carbon tax, stating that "the best option is arguably to eliminate carbon pricing at the provincial level altogether."

In establishing a spending plan to return Alberta to budget balance and slow its accumulation of debt, the government could also help contribute to economic growth and investment competitiveness by exercising greater restraint in order to create the fiscal room for comprehensive tax reform such as pursuing the tax reform package described above. Of course, creating this additional fiscal room would require greater spending restraint, a topic to which we turn in the next section.

What Would it Take to Get back to Balance While Creating Room for Tax Reform?

While Alberta currently has no published plan to begin serious deficit elimination measures, its finance minister has repeatedly pledged to balance the budget by 2023/24. But currently the government is not on track to achieve even this modest objective. Figure 4 provides our baseline projection for future provincial government expenditures and revenues through 2023/24 based on the most recent budget information available. By our estimate, the current trajectory, which would set annual program spending growth at 2.4 percent over the next several years, will still result in a budget deficit of $1.6 billion in 2023/24.[4]

The baseline scenario above projects how provincial finances will evolve assuming no deviation from the plans and expectations in recent government fiscal documents. Specifically, this scenario makes no assumptions about tax or other changes, takes government budget and update data at face value, and uses current spending patterns and long-term forecasts to build projections.

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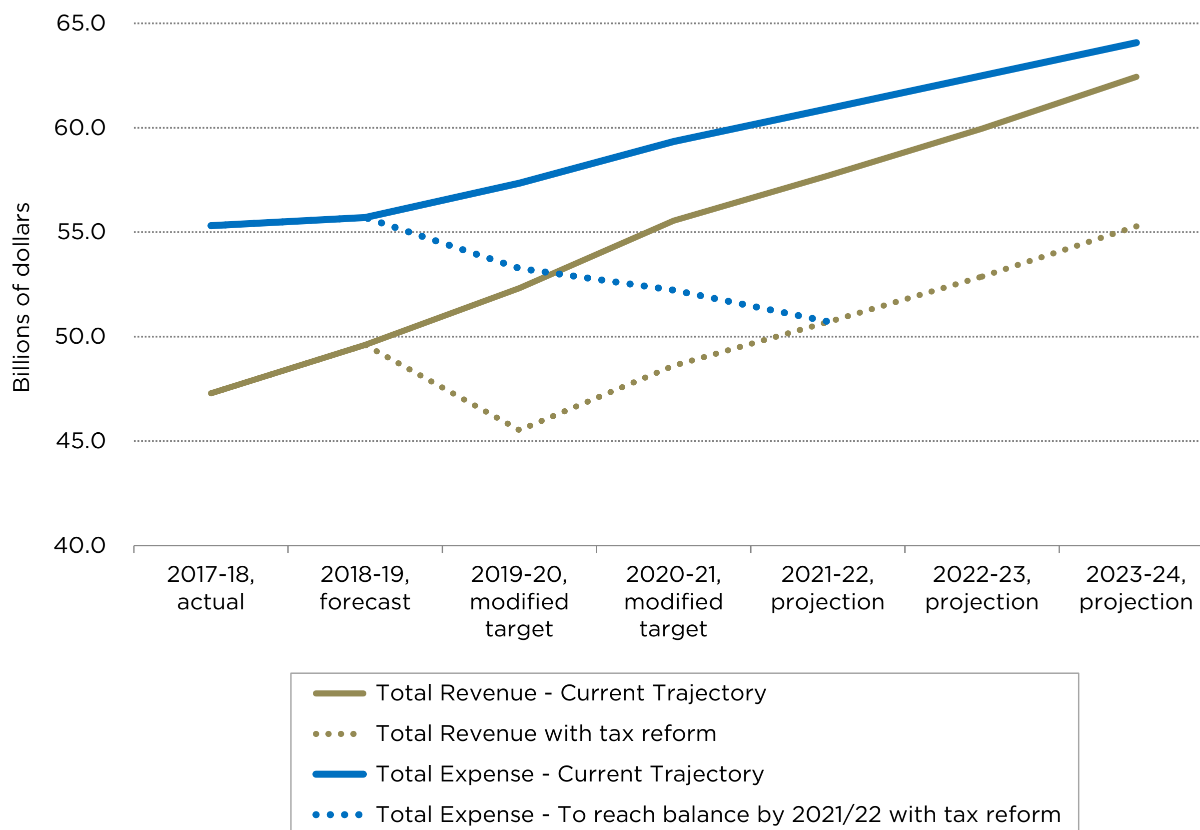
[4] The model we present in this paper is built from the historical fiscal summary in Alberta's 2017/18 annual report (Alberta, 2018), the 2018 budget (Alberta Finance, 2018a), and the most recent quarterly report (Alberta Finance, 2018b). Projections beyond 2020/21 are typically made using recent growth rates calculated from the 2018 budget but some (most notably personal and corporate income tax revenue) are grown using nominal GDP. In all our figures, 2017/18 values are actual, 2018/19 values are from the 2nd quarter update, 2019/20 and 2020/21 values are from the 2018 budget but have been modified to account for the updated 2018/19 values, and 2021/22 through 2023/24 values are from our projection. More specifically, "current trajectory" values through 2020/21 shown in figure 4 are drawn from government documents so reflect the assumptions underlying Alberta's 2018 budget and the second quarter update. Our projections from 2021/22 through 2023/24 mainly use the growth rates over the latest three years from the 2018 budget. Notable exceptions are personal and corporate income taxes, which are assumed to grow at the rate of nominal GDP, and federal transfers, which have specific calculation formulas.

Figure 4: Alberta Revenue and Expense, 2017/18 to 2023/24, Base and Alternate Scenarios



Sources: Alberta (2018); Alberta Finance (2018a, 2018b); authors' projections.

However, as described above, current projections would mean continued reliance on higher personal and business tax rates, and therefore assumes no action to restore Alberta's tax advantage in the years ahead. By relying on a prolonged path to balance, it would also result in substantial debt accumulation and increased debt interest payments in the years ahead (Lafleur et al., 2018). For instance, Lafleur et al., 2018 showed that with a balanced budget target date of 2023/24, the province would accumulate a net debt of $62 billion by the time of balance. That paper forecasted that a target date of 2021/22 would leave Alberta with a debt load of $48 billion at the time of balance—$14 billion less than under the government's current target date (Lafleur et al., 2018). Clearly, a faster move to

balance would enable Alberta to accumulate less debt (all else equal) in the years ahead, helping to slow the growth of debt interest payments.

As discussed previously, plans to balance budgets based on slowing the rate of growth of spending and waiting for revenues to catch up have a spotty record in recent Canadian history at best. Further, research from Alesina et al. (2014) suggests that the current government's failure to reduce spending at the same time that it is increasing taxes in an effort to address the deficit is problematic. This research shows that fiscal consolidations based on tax increases are generally substantially more economically harmful than consolidations based on expenditure reductions.

Alberta would need to implement greater spending restraint[5] were it to pursue a fiscal strategy that included comprehensive tax reform, such as the single-rate 6 percent personal and business tax structure described in Lafleur et al. (2018) along with the capital gains reform proposed by Veldhuis et al. (2018), and were it to reform the province's approach to carbon pricing as proposed in Murphy (2019)[6] while also targeting a three-year deficit elimination process (consistent with the experience of successful consolidations in the 1990s). In fact, as figure 4 shows, under a scenario with tax reforms and reductions as described above, total revenue would be forecasted to be $50.7 billion in 2021/22. To eliminate that deficit entirely and achieve balance in 2021/22 with a comprehensive tax reform package such as described above, the province would need to reduce nominal program spending (all spending apart from debt interest payments) by a total of 10.9 percent from 2018/19 levels.[7] This would, of course, represent a meaningful fiscal consolidation. For context, nominal program spending was reduced by more than 20 percent during the fiscal consolidations of the early 1990s. As such, the spending reductions required to achieve balance today, even with tax reform, would be somewhat smaller than those implemented in the 1990s. Figure 4[8] illustrates

[5] Lafleur et al., 2018, includes a detailed description of how the fiscal impact of the PIT and CIT reforms shown in this model were estimated.

[6] As noted above, Murphy proposes multiple possible reforms for consideration, from a renovation of the CLP that would make its carbon pricing mechanism consistent with economic best practices to the outright elimination of provincial level carbon pricing. For the purposes of this paper, we model the removal of revenue from the new carbon levy introduced under the CLP.

[7] This aggregate reduction reflects a 2.3 percent reduction in 2019/20 to immediately remove expenditures associated with the CLP such as rebates to households, which would presumably be discontinued in the event of CLP repeal, plus a 3.0 percent reduction in remaining nominal spending in each of 2019/20, 2020/21 and 2021/22.

[8] Figure 4 illustrates the total spending trajectory (including interest payments) that would be achieved by implementing the reductions in program spending described in

the spending trajectory that would be required to achieve the objectives described above.

The history of past fiscal consolidations in Canada suggest a greater likelihood of success if spending reductions were to be "front loaded," with spending reforms resulting in nominal reductions implemented immediately.[9] This is reflected in the scenario shown in figure 4, which depicts a program spending decline of 5.3 percent in 2019/20, followed by further spending reductions of 3.0 percent in each of the next two years.

An aggregate nominal spending reduction of 10.9 percent over a three-year period would mean an even larger decrease in inflation-adjusted per-person spending. Specifically, it would represent a 20.3 percent reduction in real spending per capita.

This would, of course, represent a substantial fiscal consolidation. Such reductions, however, should be considered in context. Specifically, per-person program spending in Alberta was 21.5 percent higher than in neighbouring British Columbia in 2017/18 (Canada, 2018; Statistics Canada, 2019a). Spending consolidation of the magnitude described here would therefore have the effect of bringing Alberta's per-person spending levels approximately into line with British Columbia,[10] a jurisdiction whose health care and education systems, for example, generally outperform Alberta's.[11] Further, this timeline is consistent with that employed in past successful fiscal consolidation efforts in recent Canadian history (Clemens el al., 2017). Finally, Alesina's research on the output effects of different approaches to fiscal consolidation suggests that any adverse short-term effects on output would be substantially less than would be the case if the government attempted to shrink the deficit through further tax increases (Alesina et al., 2014).

Further, it is important to note that the elimination of carbon pricing in Alberta would necessarily be accompanied by the elimination of substantial related spending—for example, on the lump-sum rebates sent to households. Indeed, the government's recently introduced Carbon Leader-

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the text. As such, the pace of reduction shown in figure 4 is slightly less than what is described in the text.

[9] For a comprehensive discussion of successful fiscal reforms in the 1990s that followed this trajectory, see *End of the Chretien Consensus*, by Clemens, Lau, Palacios, and Veldhuis (2017).

[10] This makes the simplifying assumption of approximately flat inflation-adjusted per-person spending in British Columbia over the next three years.

[11] For a discussion of the comparative performance of BC's and Alberta's education systems, see Clemens, Emes, and Macleod (2018). For a recent discussion of the performance of Alberta's health care system, see Barua, Clemens, and Jackson (2019).

ship Plan (CLP) was originally designed to be deficit-neutral (although over time revenues have in fact slightly outstripped expenditures). If the carbon levy were to be repealed, there would be substantial "low hanging fruit" for offsetting expenditure reductions through the cancellation of related rebates and program spending. Ontario provides an illustrative example. That province recently repealed its cap-and-trade program and the resulting revenue loss was offset by the cancellation of related spending.

In short, it is possible for the government to achieve its existing objective of budget balance by 2023/24 with nominal spending increases over time—if spending is successfully constrained and if forecasted revenue growth materializes (Lafleur et al., 2018). However, the objective of reaching balance two years earlier while also making fiscal room for comprehensive tax reform would require substantial fiscal consolidation. More specifically, reaching that goal would require a nominal spending reduction of 10.9 percent over the next three fiscal years (a substantial consolidation, but still considerably less than was achieved in the fiscal consolidation of the 1990s), which would bring spending in Alberta closer into line with neighbouring British Columbia.

The spending trajectory presented above would allow Alberta to achieve a balanced budget with tax relief by 2021/22. This outcome is markedly different from the province's current fiscal plan which calls for balance in 2023/24 without tax relief. There are, of course, many outcomes and possible trajectories in between these two, all of which would result in different levels of debt and more or less room for tax relief. For a detailed discussion of how a wide range of different spending scenarios would affect Alberta's debt accumulation (without an accompanying discussion of the benefits of tax relief as discussed here), see Lafleur et al. (2018).

It is beyond the scope of this paper to discuss how specific reforms could be implemented to achieve these objectives. However, several recent studies have examined the room for savings and possible spending reforms in several areas of provincial spending including public sector compensation (Lafleur et al., 2018), health care (Barua et al., 2019), and education (Clemens et al., 2018). The reforms outlined in these studies provide specific advice on how short-term fiscal consolidation could be achieved while also pointing to public management principles that can help restrain spending growth in the longer-term, an objective to which this paper will now briefly turn.

Longer-Term Fiscal Goals: Reducing Reliance on Resource Revenues and Repairing the Heritage Fund

To this point, we have discussed the degree of spending restraint that would be necessary to eliminate the budget deficit in the short-term while simultaneously creating fiscal room to allow for pro-growth tax relief. Specifically, we have shown that achieving these objectives would require the provincial government to decrease nominal program spending by 10.9 percent over the next three years.

These objectives may seem ambitious, but balancing the budget while restoring Alberta's competitive tax advantage in the short term should be viewed not as the end goal, but as a starting point from which to address the province's larger fiscal problems. It is beyond the scope of this paper to discuss long-term fiscal policy at length, but this short discussion points out some of the problems that will remain to be considered and solved once the immediate and time-sensitive challenges are overcome.

Historically, there is at least one powerful example of an Albertan government setting a meaningful fiscal target, reaching it, and then lapsing into unfocused and undisciplined spending which contributed to the development of future fiscal problems. This example is found in the later years of the Klein government. It completed a successful fiscal consolidation that eliminated the deficit and achieved the goal of making the province "debt free" in terms of net financial assets, but then struggled to maintain fiscal discipline thereafter. Once these highly publicized goals were achieved, fiscal discipline lapsed, spending growth accelerated, and the seeds of the current fiscal challenge were sown. In this light, and given the severity of Alberta's long-term fiscal challenge, it is crucial that any short-term consolidation aimed at deficit elimination be viewed as a first step in a longer process of restoring Alberta's finances to long-term sustainability.

Alberta's fiscal challenges developed over a long time and, even with focused consolidation and policy reform, they will not be solved overnight. For example, even if an Alberta government were to eliminate the

deficit and implement tax relief by pursuing the spending plan described above, the province would still be heavily reliant on volatile natural resource revenues to fund day-to-day operating expenditures and Alberta's provincial finances would still be vulnerable to future downturns in commodity prices. Further, under this scenario, resource revenue would not be available for the province to resume deposits to the Heritage Fund, an important tool that should be used to spread the fiscal benefit of resource development over time for the benefit of future generations. There are many models for saving natural resource revenues and smoothing out budget volatility that Alberta could consider for achieving these important objectives (see Clemens and Murphy, 2013). The sooner Alberta is able to eliminate its large budget deficit, the sooner it can begin considering options for optimizing the long-term benefits of the province's natural resource wealth.

A brief consideration of these long-term issues helps highlight the need for longer term reforms to Alberta's fiscal framework once the budget is balanced. Budgetary balance should be followed by the implementation of a longer-term strategy for spending restraint shaped by the objective of building a sustainable, low-debt, pro-growth fiscal framework that reduces the province's reliance on resource revenue to fund current programs and resumes deposits to the Heritage Fund. The urgency of establishing such a framework as quickly as possible is heightened by economic and demographic challenges that will be more difficult to address in the presence of a large debt. Given that Alberta's governments have struggled to resist the temptation to ride the "resource revenue rollercoaster" over the course of decades, and have frequently increased spending dramatically during booms but failed to commensurately reduce spending during downturns, the province may be an especially strong candidate for legally binding Tax and Expenditure Limitations (TELs) which place legal restrictions on the pace of spending growth.[12]

Alberta's fiscal challenges, including its substantial budget deficit and continued reliance on resource revenues to fund current programs, were created over a long period and it will take time to address them. The spending reductions described in the preceding chapters, which could produce a balanced budget with tax relief in the short term, should be viewed as a starting point in a longer process of repairing Alberta's finances, and not be viewed as the end point.

[12] For a discussion of possible advantages resulting from TELs as well as the necessary characteristics and features that allow TELs to be successful, see Clemens, Fox, Karabegovic, LeRoy, and Veldhuis, 2003.

Conclusion

Albertans have experienced significant economic challenges in recent years. While external forces have presented major short term challenges, poor fiscal policy, including perpetual deficits and tax increases, have presented the province with longer-term problems.

While the province's chronic deficits may be seen as an excuse not to reduce personal and corporate income taxes to more competitive levels, this paper has shown that it is possible to both balance the budget and introduce transformative pro-growth tax reform. Achieving these two goals simultaneously won't be easy, but it can be done if the provincial government is willing to undertake meaningful reductions in provincial spending in the years ahead. This approach, if followed up by a long-term commitment to spending restraint to reduce reliance on natural resource revenues, is a framework for Alberta to eliminate its provincial budget deficit, enact tax reform, and create a fiscally sustainable, pro-growth policy environment.

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