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Why Is Alberta's Deficit Still So Big?

by Steve Lafleur and Ben Eisen

MAIN CONCLUSIONS

- The Government of Alberta has run nearly uninterrupted deficits since 2008/09 including deficits expected to average over $9 billion annually between 2016/17 and 2018/19.

- Alberta's deficit today is much larger than the deficit the current government inherited (about $6 billion) when it took office in 2015/16.

- Blaming depressed oil prices or fiscal challenges that pre-date the recent recession for the size of Alberta's deficits today is, at best, an oversimplification. Instead, spending choices made over the past three years are an important cause of the persistence of large deficits in Alberta.

- If the current government followed the spending plans laid out in the budget of March 2015, Alberta would have a deficit of just under $3 billion in 2018/19 rather than $8.8 billion.

- Assuming a common revenue forecast, if Alberta's government had kept to the March 2015 spending forecast it would be on pace to shrink the deficit to under $2 billion by 2019/20 rather than nearly $7 billion. It would also be well positioned to balance the budget before its 2023/24 target.

- These spending choices have important implications for Alberta's debt: net debt is forecast to reach nearly $40 billion by 2019/20. Our projections show that under the more restrained spending scenario, debt would be less than half as large—just under $15 billion.

Introduction

In recent years, the health of Alberta's finances has deteriorated significantly, as successive governments have run nearly uninterrupted deficits since 2008/09. The severe drop in oil prices that began in late 2014 and the resulting recession in Alberta exacerbated the province's fiscal challenges, causing annual deficits to swell much larger. The current government expects Alberta's period of large deficits and rapid accumulation of debt to be lengthy as it has no plans for a balanced budget until 2023/24.

The fact that Alberta continues to face large deficits and rapid accumulation of debt today is widely known, but the causes are disputed. The government frequently points to forces outside of its control—the spending choices of previous governments and low oil prices (Morgan, 2017)—as primary causes of the large deficits facing the province today while critics often argue that the current government's own spending choices are an important contributing factor (MacKinnon and Mintz, 2017).

There is no doubt that the current government walked into difficult fiscal circumstances when it took office in 2015: the Notley government inherited a budget deficit of approximately $6 billion. However, nearly three years have passed since the new government took office and, in that time, oil prices have recovered significantly from their lowest point and, although many Albertans are still feeling economic pain, the recession officially ended in 2017 (according to the Alberta Treasury Branch's estimates) and the economy is once again growing (ATB, 2017). Despite these developments, the deficit has grown considerably. In fact, despite strong revenue growth that is forecast to average roughly 5% annually, the government's 2018 budget forecast that Alberta will actually face a larger deficit in 2019/20 than the one the government inherited in 2015/16 (Alberta Finance, 2018).

Given the lack of progress in reducing the deficit and the resulting rapid accumulation of debt, it is important to assess the extent to which these trends are in fact due to factors outside of the government's control or whether they are in large measure the result of decisions about financial management that have been made since the recession hit Alberta. This research bulletin will consider this question, specifically assessing the extent to which spending choices made since the Notley government took office are a contributing factor to the ongoing fiscal challenges in Alberta.

The plan of the publication is as follows. First, we compare the government's actual spending trajectory since 2015/16 to two alternative scenarios, with a particular focus on the planned spending trajectory the government inherited from the budget tabled by the previous government in March, 2015. Next, we show how the province's budget balance would have evolved under two spending scenarios, comparing them to the Notley government's actual spending trajectory. Then, we show how the province's net asset position has in fact evolved compared to what would have happened under the alternative scenarios.

Budgetary balance under three program spending scenarios

When the Notley Government took office in 2015, the budgetary outlook was troubling. Previous governments had run nearly uninterrupted deficits since 2008/09, partly because of rapid growth in spending by successive governments that saw nominal spending increase by approximately 100% in the preceding decade (Lafleur, Palacios, Eisen, and Lammam, 2015). The collapse in resource prices that began in 2014 exacerbated Alberta's fiscal problems. As a result of these and other factors, the Notley government inherited a difficult set of fiscal circumstances and, of particular note, a budget deficit of approximately $6 billion.

Although the fiscal circumstances inherited by the Notley government were difficult, it should be noted that during his brief tenure, Premier Jim Prentice did make notable progress shifting the budgetary trajectory, very nearly freezing nominal program spending. Program spending was cut by 3% in 2014/15, and was slated to grow only by 1.0% in 2015/16 in the Prentice government's March budget. The March budget called for continued spending restraint in subsequent years to begin reducing the province's deficit.

Upon taking office, however, the Notley government discarded the previous government's program-spending plan and replaced it with a significantly different trajectory. Almost immediately the Notley Government restored $624 million in spending that had been trimmed in the March 2015 budget. In its first full budget in 2016 (by which time the revenue outlook had grown still worse), the Notley government released a longer-term budget plan that called for significantly more spending than its predecessor had envisioned. This change in direction has had a substantial impact on the evolution of the government's spending levels in recent years.

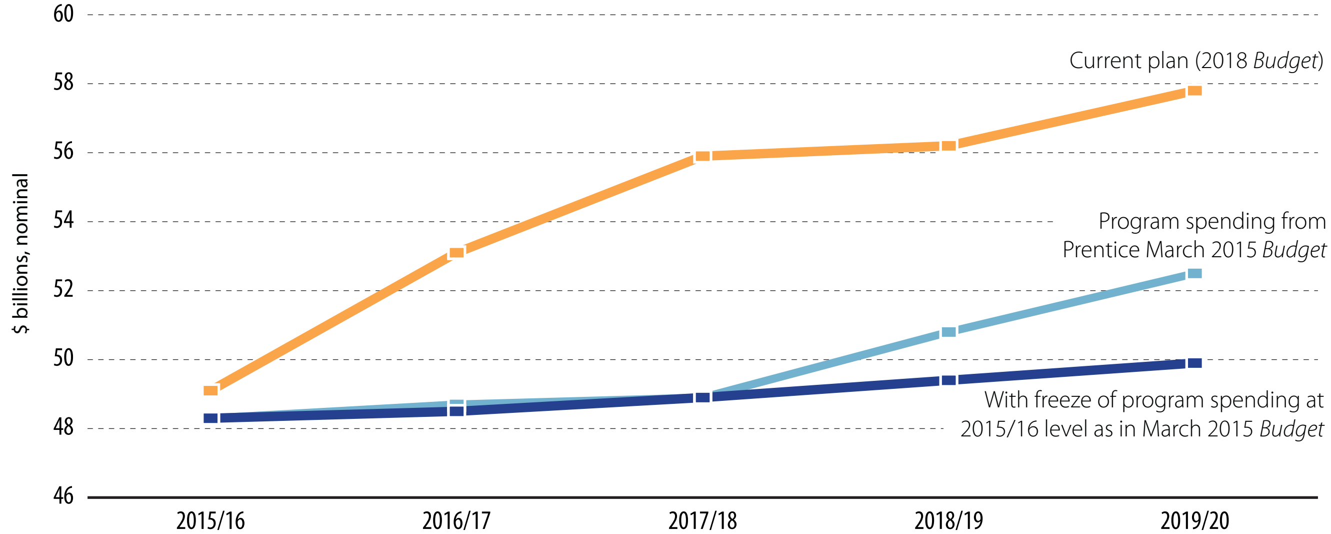
Total spending

Figure 1 shows how total spending in the current government's fiscal plan compares to what was proposed by the Prentice government, as well as how spending levels would have evolved had the Notley government frozen rather than increased program spending upon taking government.[1] For the 2017/18 fiscal year, Alberta's provincial government estimates total spending will be $55.9 billion. This is almost $7.0 billion more than was forecast under the Prentice budget. By 2019/20, total spending is projected to reach $57.8 billion, up nearly $9 billion from 2015/16. That is roughly $5.3 billion more than would have been the case under the Prentice plan for program spending. Had the new government instead decided to introduce a freeze of nominal program spending upon taking office, recognizing the severity of the province's budget shortfall, total spending would have been about $7.9 billion less in 2019/20 than under the current plan.[2]

1 Of course, some areas of government spending are sensitive to the state of the economy and would have increased automatically without any intentional action by the government. Spending on social assistance is the most obvious example. However, the largest areas of government spending (health and education) are not similarly sensitive to the state of the economy. Intentional decisions by the government itself are therefore an important driver of the differences between the Alberta government's actual spending trajectory in recent years and that laid out in the Prentice *Budget* of 2015.

2 The spending freeze scenario only assumes that program spending would have been frozen, as opposed to total spending. This is because the provincial government does not control debt-servicing charges. Freezing total spending would have required either a cut of nominal program spending, or some form of debt reduction. For the sake of simplicity, this scenario simply kept program spending constant, which meant a slight increase in total spending due to the growing cost of debt servicing that would have also prevailed under the spending freeze scenario.

Figure 1: Total spending ($ billions) under three spending scenarios, 2015/16–2019/20



Sources: Alberta Finance, 2015, 2017, 2018; calculations by authors.

Annual balance

Given these differences, it is not surprising that the Notley government's decision to discard the Prentice budget's planned spending trajectory and instead to proceed with significant spending increases during its time in office have had a significant impact on the evolution of the province's budget balance. Figure 2 shows how these program-spending trajectories would have affected the province's budgetary balance.[3] We compare all three program-spending scenarios with the latest revenue projections from Alberta Finance to estimate how each approach would have affected the budgetary balance in the years examined.[4]

The government has stated that it plans to continue running deficits until 2023/24. Figure 2 shows that the government faces a deficit of $8.8 billion this year. It also shows that under the March 2015 spending plan, all else equal, the deficit would be much smaller today.[5] Under this scenario, the deficit would be just under $3 billion today. In other words, the government's decision to discard the Prentice government's spending trajectory and significantly increase spending instead during its first three years in office has increased the size of this year's deficit by approximately $5.8 billion.

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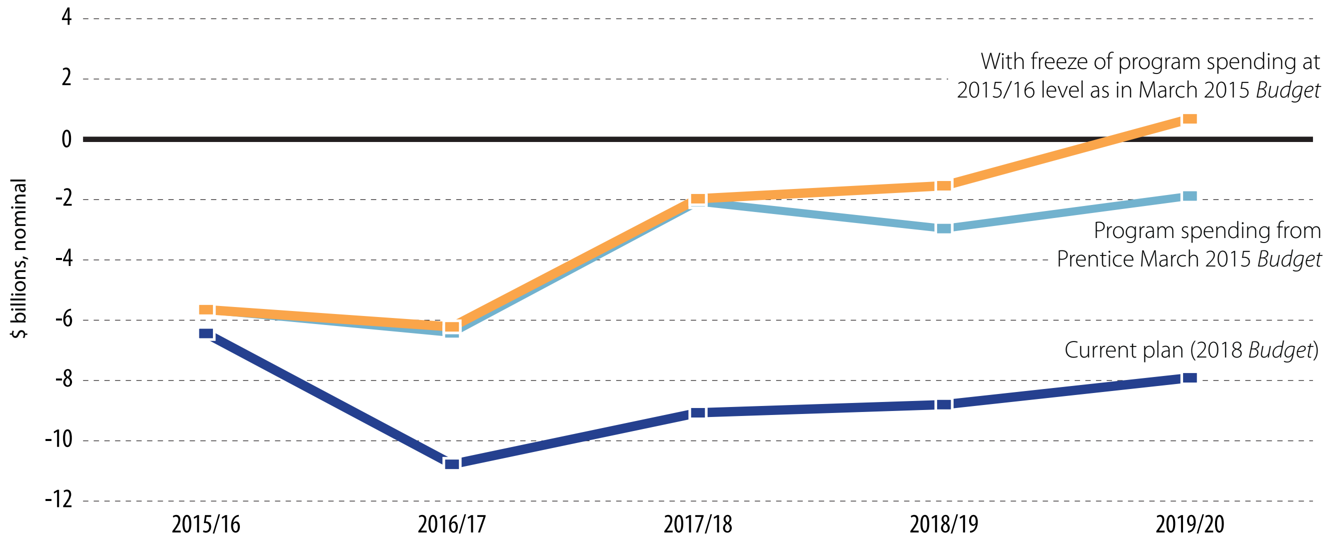
3 These projections make a simplifying assumption that debt-service payments are the same in all three scenarios and so does not reflect the fact that the higher-spending scenarios would result in higher debt-service costs. In the short term, the resulting differences on total spending are small and, therefore, would not exert a large influence on the results.

4 The projected deficit is arrived at by comparing all three of the spending scenarios from figure 1 with the latest revenue forecasts from Alberta Finance (2017, 2018).

5 Our forecast relies on a common revenue forecast drawn from the most recent Alberta fiscal update. It should be noted that the province's revenue outlook has actually deteriorated somewhat from what was expected under the Prentice budget. This is important because it shows that the expansion in planned spending since the Prentice budget is not the result of additional resources becoming available thanks to tax increases or other factors that have improved the province's revenue outlook. The reality is that the Prentice budget was based on a more optimistic revenue scenario than has actually come to pass.

Figure 2: Annual balance ($ billions) under three spending scenarios, 2015/16–2019/20



Sources: Alberta Finance, 2015, 2017, 2018; calculations by authors.

The current government's spending choices have important implications not only for the size of this year's deficit, but also for the timeline on which the government is likely to return to balance. Had the government retained the program-spending plans from the March 2015 *Budget*, we forecast that it would be in position to post a much smaller deficit in 2019/20. Assuming our current revenue projections hold, we project the deficit would have been roughly $1.9 billion rather than $7.9 billion. In other words, as a result of spending choices the current government is making, Alberta will likely face a deficit nearly $6 billion larger than had it adhered to the spending plan it inherited. Had the new government gone one step further and frozen nominal program spending, it would be on pace to run a modest surplus by 2019/20, assuming current revenue projections.

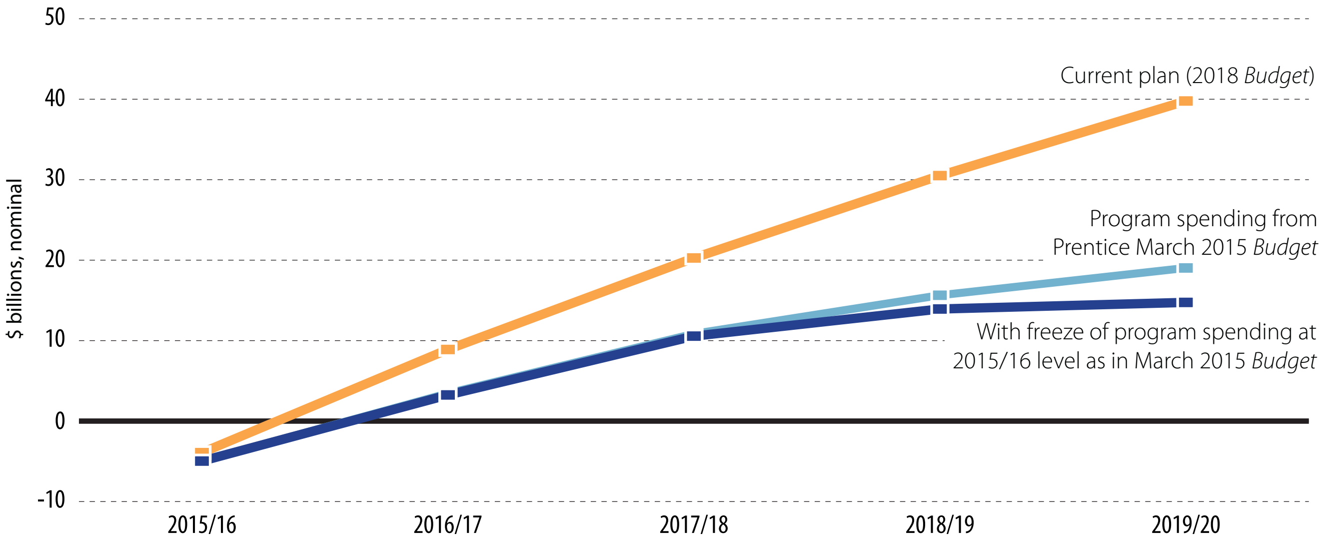
As this section has shown, the Notley government's decision to increase spending over that planned in the budget it inherited is largely responsible for the large budget deficits facing Alberta today and also for the fact the province is not expected to return to a balanced budget for many years. If the government had adhered to the planned spending trajectory it inherited from its predecessor, holding all else equal, the deficit today would be approximately $3 billion in 2018/19 instead of $8.8 billion and the province would be on track to run a small deficit of under $2 billion by 2019/20.

The impact of spending choices on provincial debt

Net debt

By the end of current budget projections (2019/20), the provincial government will have run nearly uninterrupted deficits for over a decade. This is taking a substantial toll on the provincial government's finances. In 2008/09, the provincial government had $31.7 billion in net financial assets (in other words, –$31.7 billion in net debt). As figure 3 shows, by 2015/16 the province's net debt levels were still negative, but the government's net financial assets had fallen by $27.8 billion dollars in less than a decade. By 2016/17, the provincial government returned to a net debt position.

Figure 3: Net debt ($ billions) under three spending scenarios, 2015/16–2019/20



Sources: Alberta Finance, 2015, 2017, 2018; calculations by authors.

But, the new government's spending plans have significantly increased the pace at which debt is accumulating. Alberta is on track to reach $30.5 billion in net debt this year and nearly $40.0 billion in 2019/20. Figure 3 shows that this outcome was avoidable. In fact, if the government had adhered to the spending trajectory it inherited, the debt would have been held to under $20 billion by 2019/20. Under the current plan, provincial debt in 2019/20 is expected to be more than twice as much as would have been the case under the Prentice program-spending plan, assuming current revenue estimates hold. Net debt is expected to be nearly three times as much by 2019/20 as it would have been had nominal program spending been frozen at the level the Notley government inherited.

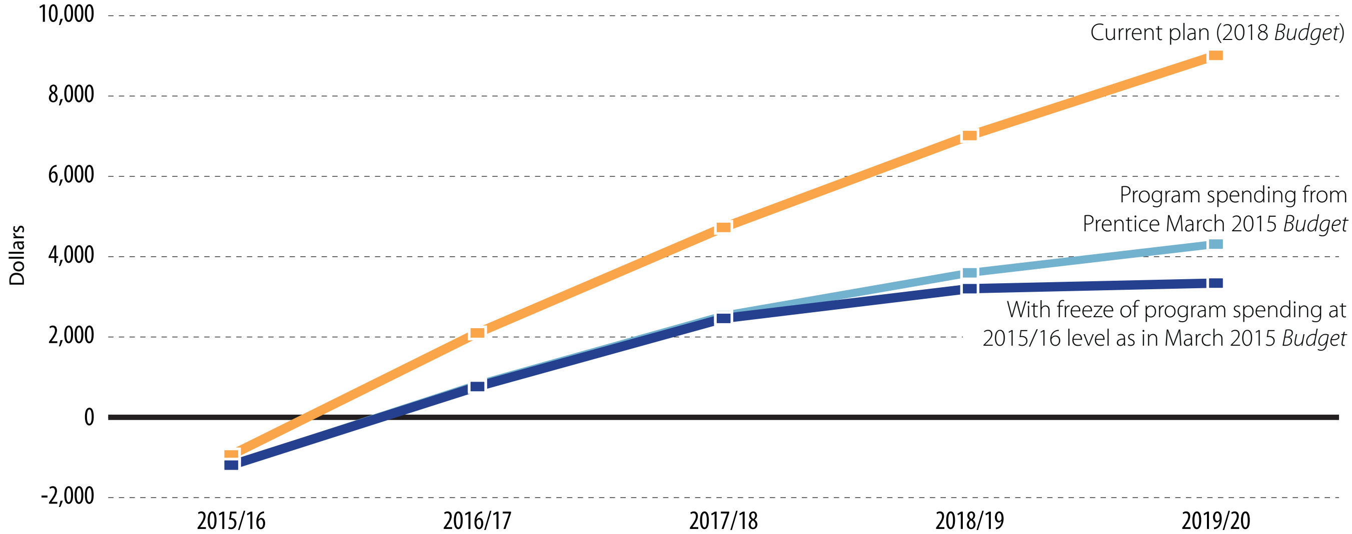
Net debt per person

To put the impact of debt accumulation into context, figure 4 shows the amount of net debt per person under the three scenarios laid out above. Under the Prentice program-spending plan, we forecast net debt per capita would have reached roughly $4,300 per person by 2019/20. That is less than half of the roughly $9,000 in per-capita debt that is in fact expected to occur. Under the scenario with a freeze of nominal program spending, per-capita debt would have been just over one third what it is currently projected to be by 2019/20.

Net debt as percentage of GDP

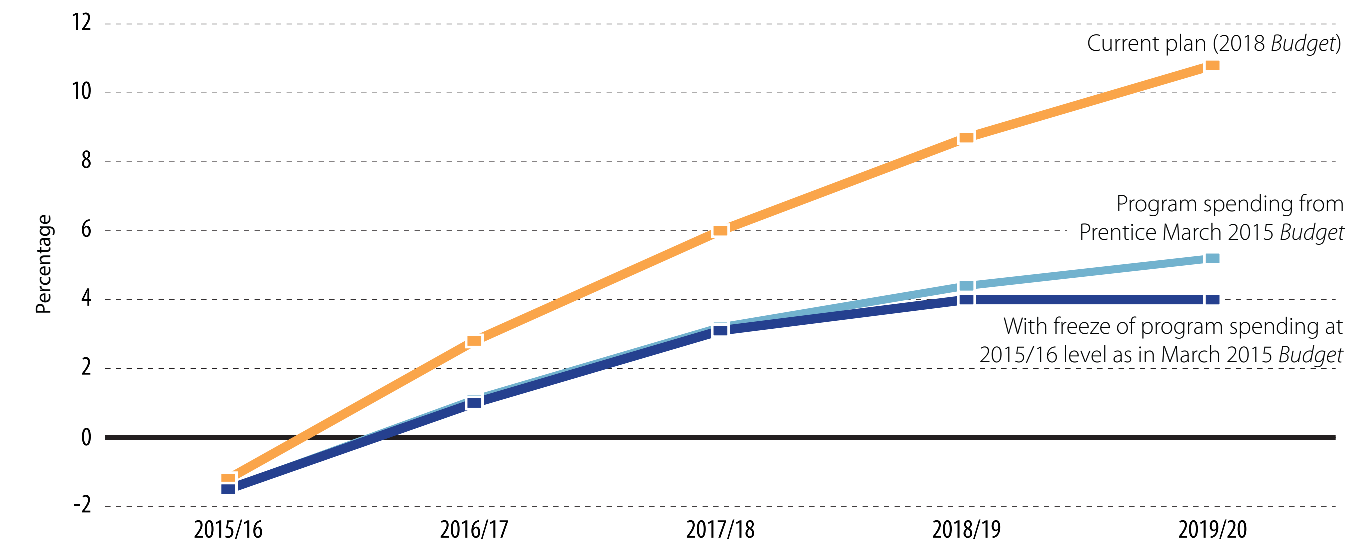
Finally, figure 5 shows net debt as a percentage of GDP under the three spending scenarios. This is a preferred metric for economists judging the sustainability of government debt levels. In 2015/16, the percentage was negative since the provincial government had no net debt. The current trajectory is much different than the two alternative spending scenarios: under the Prentice program spending scenario, net debt as a percentage of GDP would be projected to reach 5.2% by 2019/20. Under the scenario of a freeze of nominal program spending it would have been lower still, 4.0%. But, because of the spending increases introduced by the current government, net debt is projected to reach 10.8% of GDP by 2019/20, nearly three times as much as under the scenario using a freeze of nominal program spending.

Figure 4: Net debt per capita ($) under three spending scenarios, 2015/16–2019/20



Sources: Alberta Finance, 2015, 2017, 2018; Statistics Canada, 2017a, 2017b; calculations by authors.

Figure 5: Net debt as a percentage of GDP under three spending scenarios, 2015/16–2019/20



Sources: Alberta Finance, 2015, 2017, 2018; Statistics Canada, 2017f; calculations by authors.

For context, this means that Alberta will have gone from $35 billion in net assets to rapidly approaching debt levels in British Columbia and Saskatchewan in the span of just over a decade (RBC Economics, 2017). While that will still be around one third of the levels in Manitoba and Ontario, the trajectory is worrying given than the province still anticipates deficits until 2023/24.

This rapid increase in provincial debt will contribute to increased spending on servicing the debt in the years ahead: debt-service payments are expected to climb to over $2.4 billion by 2019/20. This represents tax revenue that will be used to pay government bond holders rather than fund programs. The rapid increase in provincial debt also means that the province is more vulnerable to future fiscal shocks. In the event of another global recession, for instance, the province would likely experience further revenue losses, leading to even deeper recessions and more rapid accumulation of debt. This makes repairing the province's finances now all the more urgent.

In summary, the spending choices laid out in the previous section are having a substantial impact on debt accumulation in Alberta. The province's debt-to-GDP ratio is projected to be more than twice as high as it would have been had the government simply stuck to the program-spending plans it inherited.

Conclusion

The Notley Government inherited a difficult financial situation after more than a decade of rapidly increasing government spending. While it would be unfair to assign to this government responsibility for the challenges it inherited, our analysis has shown that the spending choices the government has made since taking office are an important reason that Alberta continues to face large deficits today and is not on track to achieve a balanced budget in the foreseeable future. Holding all else equal, had the Notley government adhered to the program spending trajectory laid out in the March 2015 *Budget*, the deficit would be just under $3 billion this year and under $2 billion in 2019/20. Had the government taken a step further, recognizing the continual deterioration of the fiscal situation, by implementing a freeze on nominal program spending at the level set by the March 2015 *Budget*, it would be on track for a small surplus by 2019/20. As this publication shows, the spending choices made by this government have exacerbated provincial deficits, and will likely result in more than double the amount of net debt by 2019/20 than would have been the case under the program spending outlined by Premier Prentice in the March 2015 *Budget*, and nearly three times as much as would have been the case had the new government implemented a freeze of nominal program spending upon taking office. In short, the substantial run-up in provincial debt projected to take place between 2015/16 and 2019/20 is largely a function of the current government's spending choices rather than an inevitable consequence of the decline in resource prices.

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About this Publication

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