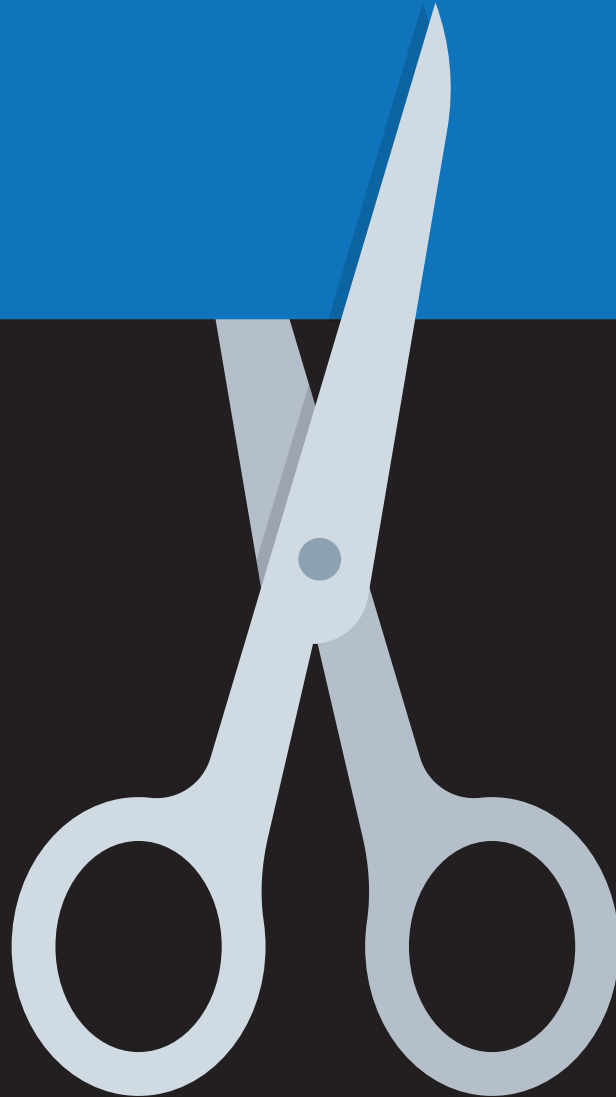


# CUTTING THROUGH THE BLUE RIBBON

A Balanced Look at Alberta's Finances



Bob Ascah, Trevor Harrison and Richard E. Mueller



# CONTENTS

## Cutting Through the Blue Ribbon: A Balanced Look at Alberta's Finances

Bob Ascah, Trevor Harrison and Richard E. Mueller  
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- publish research and provide informed comment on current policy issues to the media and the public.
- sponsor conferences and public forums on issues facing Albertans.
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## Executive Summary

The release of the Janice MacKinnon-chaired Blue Ribbon Panel report by the Kenney government confirms concerns that the panel's limited mandate—to provide advice on balancing the budget, but concentrating only on expenditures, and with no increased taxes—would prohibit a full examination of bigger issues of balance or long-term fiscal sustainability. Due to its intentionally limited scope, the MacKinnon report falls short of providing the government and Albertans with the information necessary to make sound financial decisions about the province's current situation or to plan for the future.

Countering much contained in the MacKinnon report, this report lays out for Albertans a more balanced assessment of the province's finances.

The report shows that Alberta's economy remains strong. Real GDP and GDP per capita growth remain positive. Labour force participation rates, employment rates, and wages remain above the Canadian average. In the long-term, Alberta's economy will likely regress to the Canadian average, resulting from a decline in the price of non-renewable resources, upon which the Alberta economy for too long has been over-reliant. Nearly every concern facing Alberta's finances flows from this dependency.

Alberta does not face a “critical financial situation” resulting from public expenditures. Though caution is warranted, Alberta currently has a manageable debt. This report shows that, compared to Canada and its three largest provinces—Quebec, Ontario, and British Columbia—Alberta's expenditures are not out of line. Public sector wages are commensurate over time with those found in these other jurisdictions for educational services, health care and social assistance, and public administration—the three industries that hold the vast majority of public employees and the ones that are likely to come under the most scrutiny in any cost-saving exercise.

Alberta's real difficulty in balancing the books lies in its anemic tax effort. Alberta's coffers fall consistently short of what is necessary to pay for important public services which Albertans value and expect. In past decades, the revenue hole was filled by non-renewable resource revenues, primarily bitumen, oil, and gas. But those days are gone, and unlikely to return. The hole can only be filled through a mix of various tax measures. Fortunately, Alberta has enormous tax room to meet this need, while still being able to boast a multibillion dollar tax advantage over other Canadian jurisdictions.

There are two ways to balance the books and thus eliminate debt: either through cuts to expenditures or through increases in revenues—or, of course, a balance of both.

The report suggests two remedies for Alberta's fiscal ailments. First, a gradual weaning of Alberta politicians and the public away from resource revenues to fund ongoing expenses through a combination of tax increases to foster revenue stability. Second, in order to fill the revenue void, the adoption specifically of a provincial sales tax, preferably harmonized with the federal GST.

The time is long overdue for a rational, balanced, and fact-based discussion with Albertans about the province's financial circumstances, wrapped neither in celebratory nor "blue" funereal ribbons, just hard truths. Through good fortune, Alberta is a wealthy and much-blessed province, but we can do better. The time is now.



## Introduction

On May 7, 2019, the incoming United Conservative Party (UCP) government of Premier Jason Kenney announced the establishment by the Alberta Department of Treasury Board and Finance of a “blue-ribbon panel” to report on the province’s finances. The panel’s report was delivered on August 15 to Minister of Finance Travis Toews, and released to the public on September 3.

The panel’s chair was Janice MacKinnon, a former Saskatchewan finance minister. Its vice-chair was Michael Percy, a former Alberta MLA and former professor and dean of the University of Alberta’s School of Business. The other panel members were Bev Dahlby, a distinguished fellow and research director of the University of Calgary’s School of Public Policy; Kim Henderson, a principal at Sproat Advertising, and former deputy minister to British Columbia’s premier, cabinet secretary and head of the British Columbia public service, and deputy minister of finance for British Columbia; Jay Ramotar, a former deputy minister of several Alberta public service departments; and Dave Mowat, former president and chief executive officer of ATB Financial.

While the panel’s terms of reference seemed at first broad in tasking the panel to provide “an independent review of the province’s finances,” the details—advice on balancing the budget, but concentrating only on expenditures, and with no increased taxes—immediately suggested the panel’s examination would be something less comprehensive. Critics argued the panel’s mandate meant it would not address bigger issues of balance or long-term fiscal sustainability. Indeed, it seemed intentionally designed from the outset to fall short of providing the government and Albertans with the information necessary to make sound financial decisions about the province’s current situation or to plan for a fiscally sustainable future.

The release of the MacKinnon report bears out these concerns, while raising others. Given the panel’s mandate, its members were constrained to look only at government expenditures. We agree an examination of expenditures to identify potential cost savings is not unwarranted. Contrary to the conclusion of the panel’s report, however, Alberta’s public expenditures are not out of line in the key areas of health and education (in particular) with those in Canada’s other large provinces, when examined in context and over time. Public sector workers, by and large, are not paid more, and in some instances are paid less, than their counterparts elsewhere in Canada.

The inadequacy of the MacKinnon report is revealed most strikingly, however, in its failure to consider Alberta’s lagging revenues. Again, this absence is explained by the panel’s limited mandate, though curiously the

report acknowledges at the outset that revenue volatility is a huge budgeting challenge, noting that “Alberta has a structural budget problem, driven primarily by the volatility of resource revenues” (Blue Ribbon Panel on Alberta’s Finances, 2019: 29). Nonetheless, as our report shows, Alberta’s revenues are woefully insufficient—compared with every other Canadian jurisdiction—to provide the kind of services Alberta’s citizens expect. Alberta’s alleged “tax advantage” has become a severe financial disadvantage.

The MacKinnon report’s failure to provide a comprehensive view of Alberta’s finances spills over into in an alarming depiction of Alberta’s debt situation. While we view it prudent to heed the warning signs, and there is some reason to worry about the debt in the medium-to longer-term, Alberta’s current debt is manageable. The key to addressing the debt, once again, is to deal with the province’s chronic revenue problems.

Alberta’s expenditures (or revenues, for that matter) must not be viewed outside of their material (e.g., changing demographics, economics) and historical context (e.g., resource volatility). Without this context, citizens lack the necessary guidance for sound decision-making. Unfortunately, much of the MacKinnon report appears to be a selective exercise in picking facts to fit a preordained script.

Among the chief concerns raised when the panel was struck was that its primary purpose was political and not one designed to cast a realistic light on Alberta’s financial situation. This concern has been realized. The MacKinnon report’s recommendations constitute a return to the formulae developed in the 1990s which led to offloading of service delivery, lack of capital investment, and a tragic departure of key personnel from the public sector—measures that were driven by ideology and the “need for urgency.”

The problems facing Alberta’s finances are deep and multi-dimensional, and not of recent origin. As such, they are not amenable to simple solutions and quick fixes; indeed, such responses—too frequently engaged in in the past—have contributed to Alberta’s long-term fiscal difficulties.

The authors’ aim in this report is to lay out in clear terms:

- 1) Alberta’s current debt situation and the magnitude and risks it poses;
- 2) the trend lines of Alberta’s finances (including both expenditures and revenues), over time;
- 3) relevant comparisons (where instructive) to other provinces;
- 4) the province’s major sources of financial volatility; and
- 5) the array of remedies open for consideration.

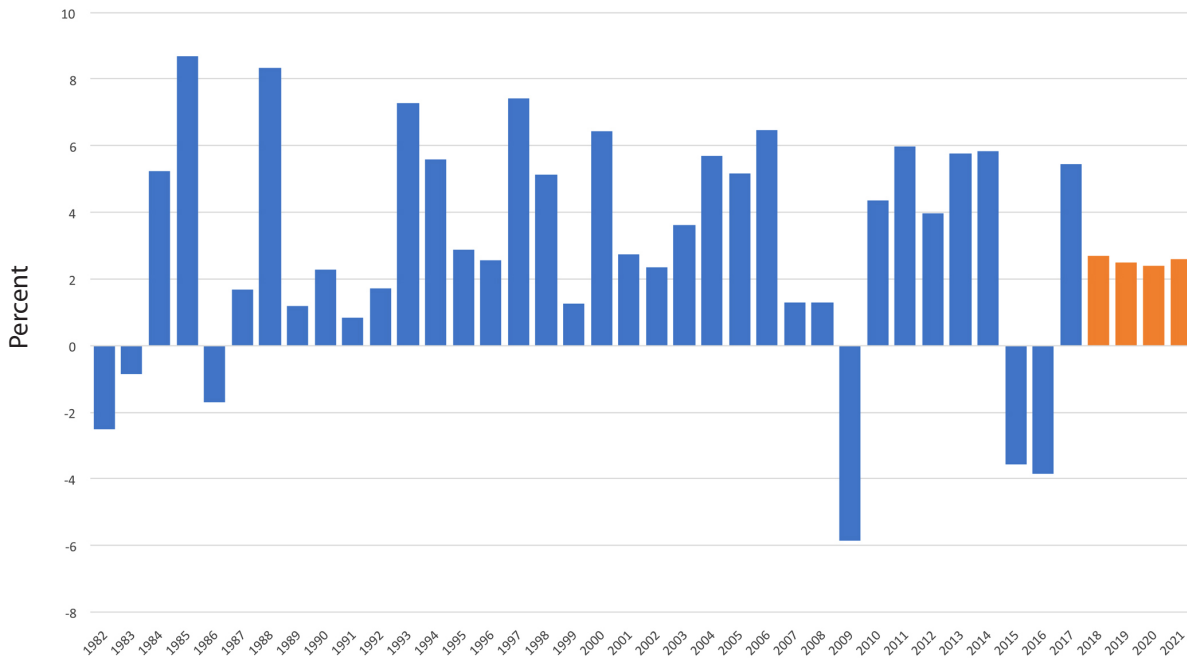
In writing this report, the authors are mindful that the Blue Ribbon Panel is not the first effort by governments to get a handle on Alberta's chronically volatile fiscal circumstances. Among predecessors we count the Financial Review Commission (1993), the Alberta Financial Management Commission (2002), the Premier's Council for Economic Strategy (2011), and the more recent *Report to the Government of Alberta on the Development, Renewal and Financing of the Government's Plan for Spending on Capital Projects to 2019* (2015), better known as the Dodge Report.

As public finances do not exist in a vacuum, but are rather a reflection of the economy as a whole, the report begins with an overview of Alberta's economy.

## 1. Alberta's Economy: How Bad—or How Good—Is it?

Since the energy sector's expansion in the 1970s, Alberta's economy has outperformed the Canadian economy using virtually any measure of economic prosperity: real GDP growth and growth per capita have been higher, GDP per capita levels have grown quickly and are the highest in the country, unemployment rates have been lower, and employment and labour participation rates generally exceed the national average. While the recent economic slowdown dampened what was widely viewed as an overheated—and unsustainable—economy, Alberta is still expected to perform close to national averages on these metrics over the next few years. Alberta's new "normal" will see the province's economy typically match the performance of the Canadian economy; by contrast, the red-hot growth rates and exceptionally low unemployment rates of the past 40-plus years will be anomalous. This section looks at these key economic indicators and compares Alberta's past, current, and projected economic performance to comparable measures for Canada.

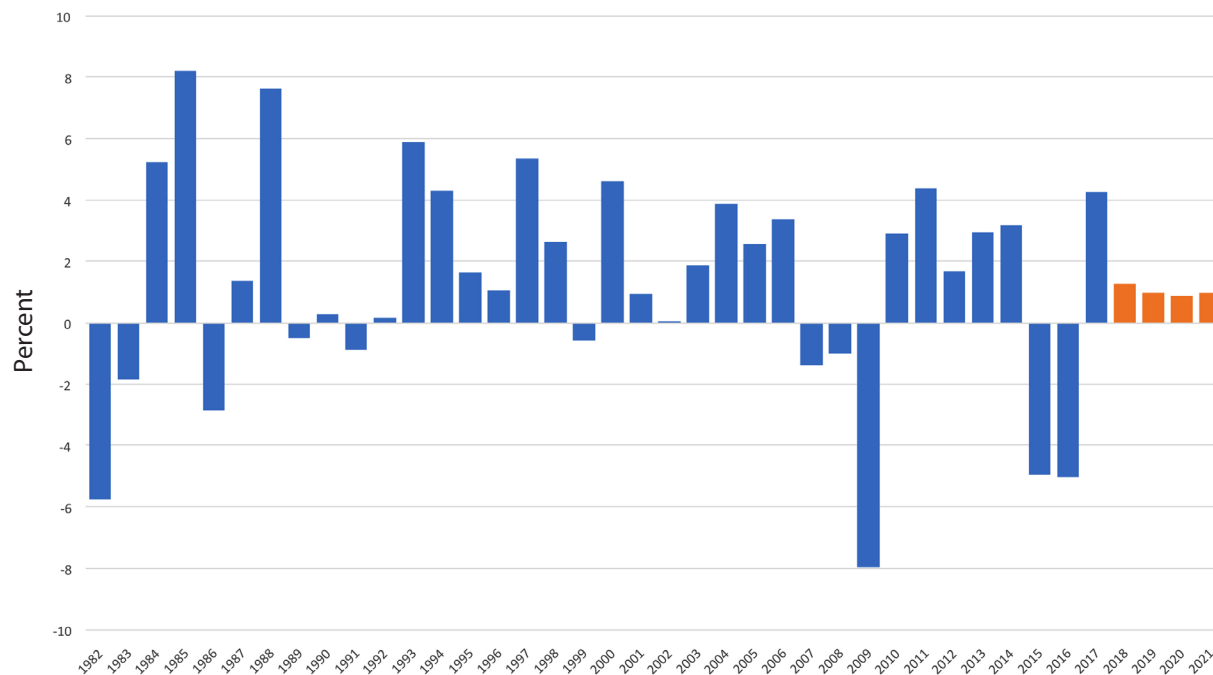
The recent recession in Alberta is not the first time the province has experienced a sustained economic downturn, and looking at the numbers it is easy to be alarmist about the most recent period. Figure 1 shows real GDP growth since 1982 (the earliest data available from Statistics Canada). Over this period, Alberta has had three major recessions. The first, between 1981 and 1983, saw real GDP fall by 3.3 percent; the second in 2009, following the global financial crisis, had real growth decline by 5.8 percent; while the most recent recession saw GDP fall by 7.2 percent in the two years following the collapse of oil prices in 2014. More recent projections from Budget 2018 and its year-end report (GOA, 2018, 2019) show real GDP growth is anticipated to be around 2.5 percent annually from 2019 through 2021, lower than the 3.1 percent average real growth rates over the 1982–2018 period. RBC Economics (2019a, 2019b) is slightly less optimistic, projecting Alberta real GDP growth to be 0.6 percent in 2019 and 2.4 percent in 2020. Still, these projections are overall reasonably positive compared to real GDP growth rate projections for Canada of 1.4 percent in 2019 and 1.8 percent the following year. These closer-to-normal growth rates are to be expected as the Alberta economy moves from a growth phase with heavy investment in the oil and gas sector to a production phase where capital expenditures are significantly lower (Hussey, 2019).

**Figure 1: Real GDP Growth, Alberta, 1982–2017 (Actual) and 2018–2021 (Projected)**

Source: Authors' calculations from Statistics Canada Table 36-10-0222-01 and GOA (2018, 2019a)

Of course, these numbers really do not mean much in isolation and without adjusting for the size of the provincial population. Figure 2 shows a similar pattern as above but this time with real GDP per capita growth. Again, the pattern is similar to that in Figure 1, but by this measure it appears that recessions are much worse, the result of a lag in people leaving the province following the beginning of an economic downturn and a lag in new people entering the province when the economy again expands (see Mueller, 2019). Here, the recession in the early 1980s resulted in a decline in per capita GDP of 7.5 percent between 1981 and 1983. Between 2006 and 2009 the decline was 10.1 percent, and during the most recent recession the cumulative fall was 9.7 percent between 2014 and 2016. Even in years when real GDP growth was positive (e.g., the early 1990s), GDP per capita growth was at or near zero. Looking forward, figures from Budget 2018 (GOA, 2018) show that real GDP per capita growth is expected to be around 1 percent per year between 2019 and 2021. By 2021, real GDP per capita will be close to its pre-recession peak attained in 2014.

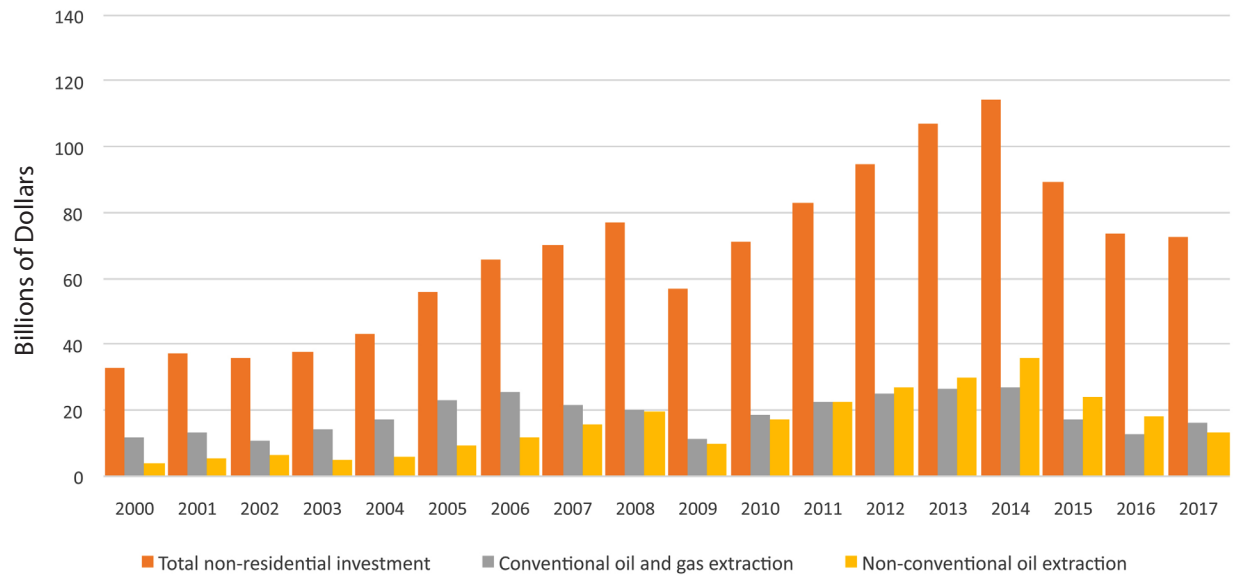
**Figure 2: Real GDP Per Capita Growth, Alberta, 1982–2017 (Actual) and 2018–21 (Projected)**



**Source:** Authors' calculations from Statistics Canada Tables 36-10-0222-01 and 17-10-0005-01, and GOA (2018, 2019a).

The 2015–2016 recession is largely attributable to a decline in fixed non-residential capital formation (capital investment with the exclusion of residential housing), illustrated in Figure 3, which fell from \$115 billion in 2014 to \$74 billion in 2016, a drop of \$41 billion (or 36 percent). This decline follows falling investment in the energy industry, which was more than halved between 2014 and 2016 (i.e., \$63 billion to \$31 billion). To break this down further, investment in the oil sands fell from \$36 billion in 2014 to \$18 billion in 2016, while investment in conventional oil and gas fell from \$27 billion to \$12 billion. Together these declines in oil sands and conventional oil and gas investment amount to \$32 billion, or 79 percent of the total decline of \$41 billion over this period.

**Figure 3: Composition and Level of Non-residential Fixed Capital Formation in Alberta, 2000–2017**  
(billions of dollars)



Source: Statistics Canada Table 36-10-0096-01.

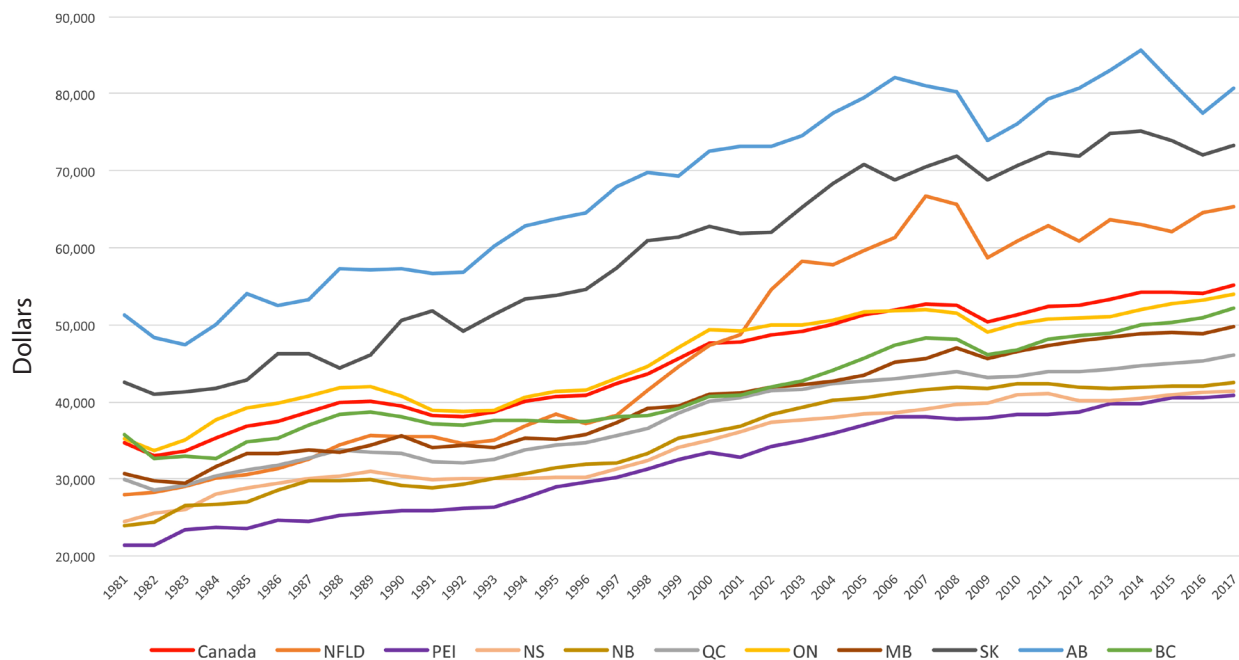
The drop in investment impacted significantly Alberta's economy overall. Nominal GDP contracted from \$376.6 billion in 2014 to \$301.7 billion in 2016, a drop of \$74.9 billion.<sup>1</sup> Thus, 43.1 percent of the decrease in total economic activity during the last recession is directly attributable to the decline in investment in the energy sector, a number that is larger if the indirect effects of this energy sector investment cutback are considered. Indeed, total non-residential gross fixed capital formation fell by \$41.1 billion (as shown in Figure 3 above), or 54.8 percent of the fall in GDP over this two-year period. Furthermore, these investment numbers are not recovering, nor are they expected to recover, to their pre-recession levels. According to McMillan (2018: 4) oil sands investment since 2014 has largely been for the completion of projects, some deferred projects, and to improve efficiencies. While Budget 2018 (GOA, 2018) estimated that there would be a slight increase in investment in conventional oil and gas from 2017 through 2021, investment in the oil sands is expected to remain flat. Thus far, this prediction seems to be meritorious given the year-over-year increase in investment of \$3.3 billion from 2016 to 2017 in conventional oil and gas.

Despite this projected slowdown in real GDP per capita growth, Alberta continues to have the highest GDP per capita in the country, a position it has maintained since at least 1981. Figure 4 shows that in 2017 real GDP per capita in Alberta was \$80,670, some 10 percent higher than per capita GDP in Saskatchewan—the province in second place—and almost double the comparable figure in the three Maritime provinces. Alberta's GDP per

<sup>1</sup> Statistics Canada Table 36-10-0222-01.

capita over the 2000–2017 period was 54 percent higher on average than in Ontario, with Alberta’s primary household incomes (even post-recession) still about 20 percent higher. And although this premium has been reduced, it is expected to remain large and to persist (McMillan, 2018). While the large gap in per capita GDP has largely been due to the massive amounts of investment in Alberta’s energy sector, at least until recently, GDP per capita in the province remains high despite the slowdown in investment. In short, Alberta was—and is—a rich province whose position relative to other provinces will be maintained as long as growth rates equal (or exceed) those of other provinces, an assumption that seems reasonable given the growth projections discussed above.<sup>2</sup>

**Figure 4:** Real GDP Per Capita, Canada and Provinces, 1981–2017 (constant (2012) dollars)



Source: Author’s calculations from Statistics Canada Tables 36-10-0222-01 and 17-10-0005-01.

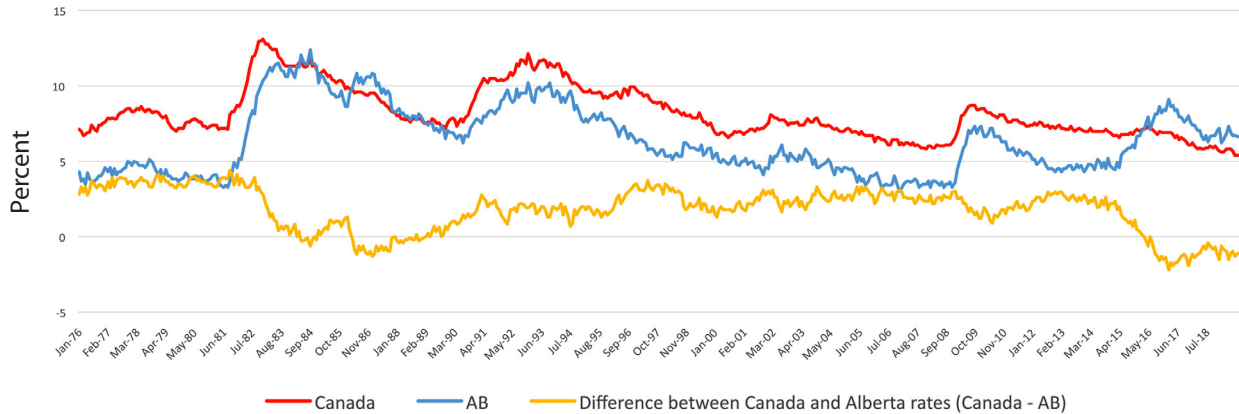
Turning our attention to the labour market, Figure 5 contains data on the unemployment rate from January 1976 to June 2019 for both Canada and Alberta, and the difference between the two. The yellow line below (above) zero indicates that the unemployment rate in Alberta is above (below) the national average. There have been only three sustained periods in these data when the unemployment rate in Alberta equalled or exceeded the national average: in 1984, when the provincial unemployment rate peaked at 0.6 percentage points higher than the national rate; from April 1986 through

<sup>2</sup> For more comparisons of GDP measures between Alberta and other provinces, see McMillan (2019).



December 1988, when there was only one month when the differential in unemployment rates favoured Alberta (September 1988); and the most recent period since January 2016.

**Figure 5: Unemployment Rates, Canada, Alberta and Differences, Ages 15+, January 1976–June 2019**



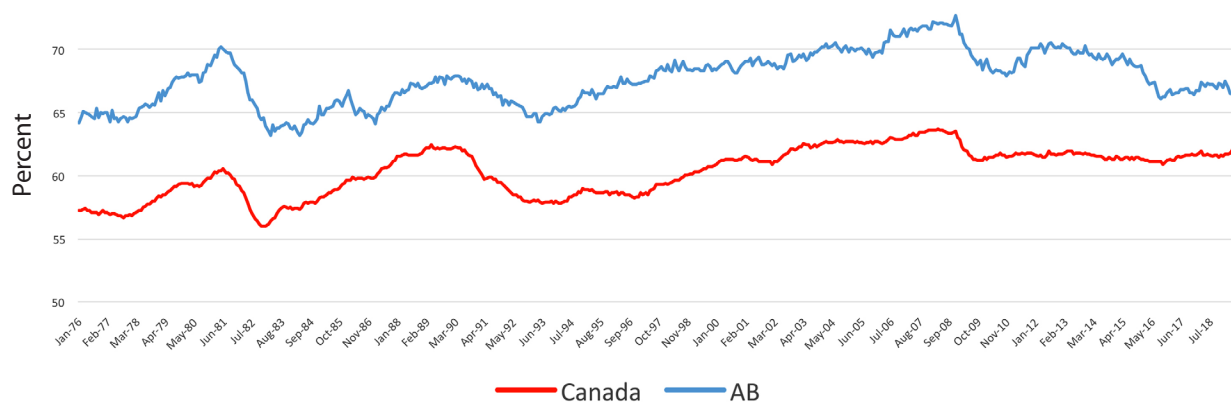
Source: Statistics Canada Table 14-10-0287-01.

While these recent unemployment numbers do not look favourable for Alberta—the rate peaked at 9.1 percent in November 2016—McMillan (2018) points out the unemployment rates from the early 1980s through the mid-1990s tended to be much higher. Figure 5 shows the unemployment rate peaked at 12.4 percent in September 1984, almost double the most recent rate of 6.6 percent in June 2019. Furthermore, Budget 2018 (GOA 2018) forecasted the unemployment rate at 6.8 percent in 2018, followed by 6.2, 5.7 and 5.3 percent, respectively, for 2019 through 2021. Given the actual unemployment rate of 6.7 percent in 2018, these projections seem reasonable, although slightly more optimistic than the 2019 and 2020 projections of 6.8 percent and 6.4 percent, respectively, from RBC Economics (2019b), and still higher than the 5.9 percent and 6.0 percent projected nationally over this same period (RBC Economics 2019a). Thus, while the Alberta unemployment rate has exceeded the national average for the past four years, it has returned to more average levels and is projected to approach the national rates over the next couple of years.

The unemployment rate is but one metric used to gauge the overall health of the labour market. Labour force participation rates, as well as employment rates, are two other complementary measures.

Figure 6 presents the labour force participation rates in Alberta and Canada since 1976. The unemployment rate often disguises actual unemployment since those who have stopped looking for work (i.e., discouraged workers) have dropped out of the labour force and therefore are not included in the unemployment statistics. Here we see that the Alberta rate has exceeded the national average since 1976, with a difference as high as 8.2 percentage points in November 1995. More recently (not shown here), this difference has decreased to about six percentage points, though higher for those in the 55+ age group (about eight percentage points) and recently become lower for those in the 15–24-year-old age group after being higher for most of this period. This latter result is positive for Alberta since it mirrors the increase in education participation rates, as many of those in this age group have returned to school (Mueller, 2019). This may ultimately improve the relatively low education rates in Alberta compared to the rest of the country as the incentives to forego studies in order to work have been reduced. For prime working age individuals (i.e., ages 25 to 54), the labour force participation rates in Alberta and Canada have become similar. While this decline in the participation rate for Albertans is at least in part due to some disguised unemployment, a significant number of Albertans in this age group have chosen—and are able—to retire early.

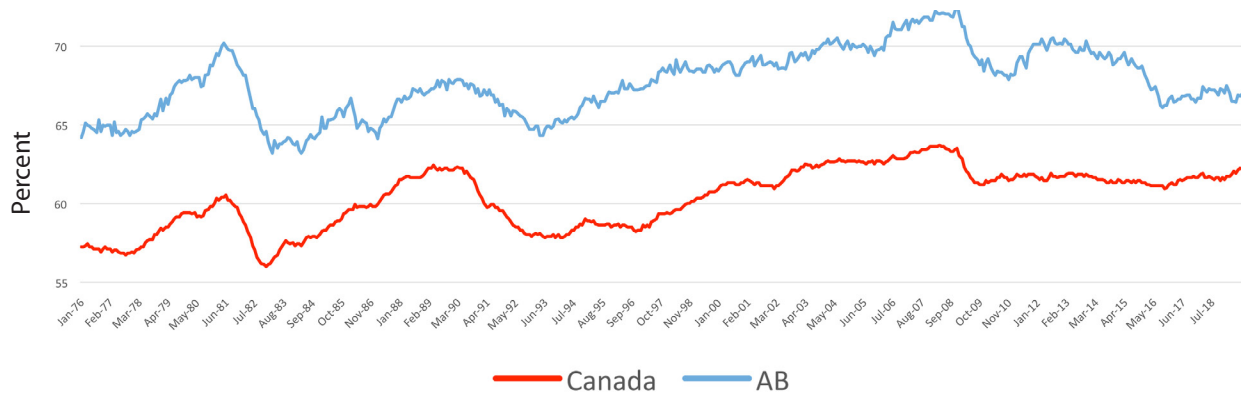
**Figure 6:** Labour Force Participation Rates, Canada and Alberta, Ages 15+, January 1976–June 2019



Source: Statistics Canada Table 14-10-0287-01.

Figure 7 plots employment rates in Canada and Alberta. These are defined as the number of employed people age 15 and over as a percentage of the total population in the same age group. The pattern here is similar to the previous plot of labour force participation rates, with rates in Alberta always exceeding the national average and with differences approaching 10 percentage points at times. More recently, the difference is about 4.5 percentage points, again showing that Alberta is approaching the national norm.

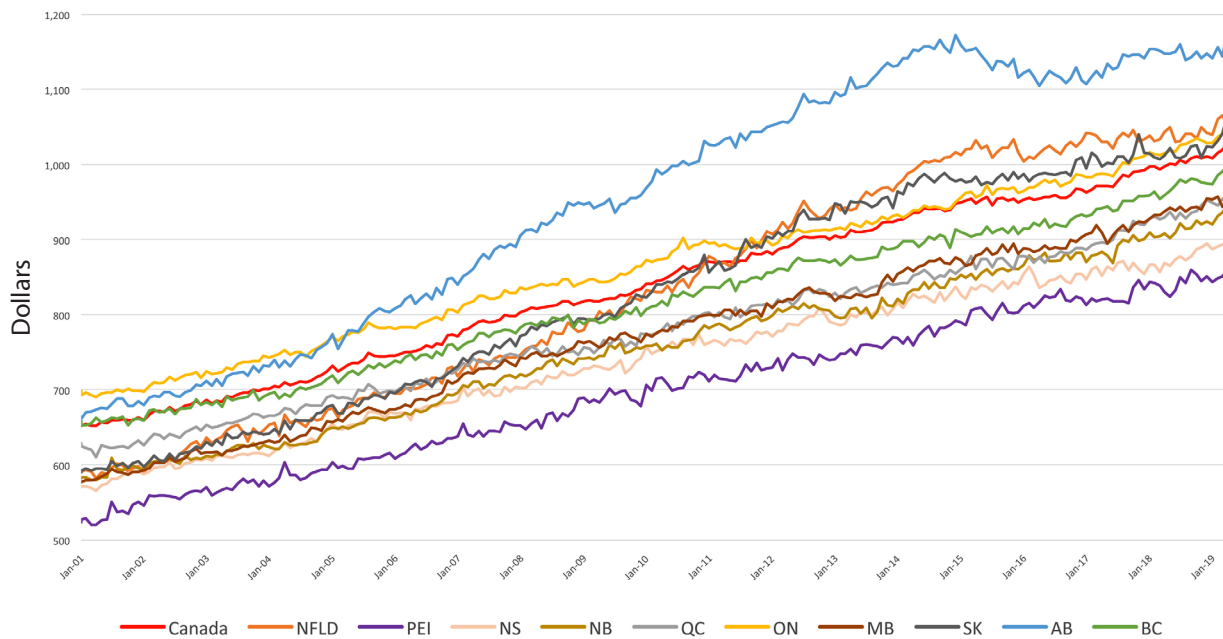
**Figure 7:** Employment Rates, Canada and Alberta, Ages 15+, January 1976–June 2019



Source: Statistics Canada Table 14-10-0287-01.

Finally, Figure 8 shows average weekly earnings in Canada and the provinces. Since the mid-2000s, Alberta has consistently had on average the highest earnings in Canada. Until the recent recession, the gap had continued to widen such that average Alberta earnings exceeded those of the next highest wage province by up to 20 percent. The effects of the recent recession are clearly visible for Alberta, but wages have started to recover and in May 2019 weekly earnings in Alberta were about 10 percent higher than those in Saskatchewan (\$1,182 versus \$1,070, although not shown here), the province with the second-highest weekly earnings. While these earnings increases have not been distributed evenly throughout the Alberta economy, with differences by industry and geographical location, the trend is still upward, albeit moderated, and Alberta is expected to maintain its earnings advantage compared to other provinces (McMillan, 2018).

**Figure 8: Weekly Wages Including Overtime, January 2001–May 2019 (current dollars)**



Source: Statistics Canada Table 14-10-0223-01.

These labour market data, along with the GDP figures, point to an economy which is expected to perform close to (or even exceed, as in the case of earnings) the Canadian economy as a whole and to exceed that of many provinces. This constitutes the new “normal” for Alberta. The overheated economic circumstances of the past are not expected to return at any time in the foreseeable future due to the energy sector having decreased its investments as we move into the less-capital-intensive phase of growth in Alberta. Despite the pain felt by many Albertans as a result of the recent recession, it is important to recognize that the province started from an enviable economic position. As shown through the several measures examined above, while Alberta is moving closer to the national average, the provincial economy as a whole still remains in good economic shape.

Of relevance also to the province’s fiscal future is the matter of climate change (Bank of Canada, 2019). Carbon and other gas emissions caused by anthropogenic forces is creating additional uncertainty about the economic future of fossil fuels. Since the provincial economy and finances are inextricably bound together, at the very least this issue poses very serious risks for future economic growth.

## 2. Alberta's Debt Situation

While the Blue Ribbon Panel's explicit mandate was to balance Alberta's budget through reductions in expenditures and no tax increases, its implicit focus was the province's debt situation. The panel's report provides guidance to the provincial government on spending control.

This section of our report goes beyond the size of the debt to examine the role of debt and how it is measured, specifically by credit rating industries. It also compares the current discourse around debt with how it was constructed and addressed at an earlier period of perceived crisis, in 1993, and questions its political objectives.

To the main issue, as the panel's mandate implicitly suggests: What is the current size of Alberta's debt? According to the consolidated financial statements of the Government of Alberta, Alberta's outstanding public debt stood at \$83 billion on March 31, 2019 (GOA, 2019a: 22, 63-64).<sup>3</sup> However, as Alberta has substantial accounts of accumulated assets—for example, the Heritage Trust fund—which other provinces do not have, the net debt is a more realistic measure of Alberta's outstanding debt.

To many Albertans, accustomed to paying off mortgages, worrying about putting their children through university, and saving for the future, this number might seem alarming, and, as we discuss below, Alberta's debt should raise at least moderate concern. Before addressing this issue, however, it is useful to consider the role of debt in government financing.

The existence of credit or debt enables governments to make financial investments that may assist in future growth, and to provide goods and services to their publics beyond the current level of revenues obtained. For example, Alberta was able to maintain the level of expenditures in the recent past without resorting to tax increases or spending cuts as revenues declined due to the drop in oil prices. Debt financing can continue until lenders are unwilling to lend. Sub-sovereign governments (a term for provinces and states used by credit rating agencies), like Alberta, have access to the globe's deep and liquid capital markets.<sup>4</sup> With such large markets to borrow in, there is a temptation to continue borrowing to operate rather than to raise taxes. Whatever the motivations of political actors (past and present), the reality of readily accessible credit is a critical question for Alberta's fiscal sustainability. Over the last 10 years, historically low interest rates have made long-term borrowing inexpensive and therefore tempting, but this cannot be assumed to continue forever.<sup>5</sup> The growth of debt ultimately presses against the policy flexibility of governments.

<sup>3</sup> Includes liabilities under public-private partnerships of \$2.9 billion.

<sup>4</sup> Go to <https://www.alberta.ca/investor-relations.aspx> for detailed information on the province's investor relations program which includes an Australian Medium Term Note program and a Global Medium Term Note program. The website also contains an investor relations meeting presentation in Paris, London and Edinburgh.

<sup>5</sup> *Report to the Government of Alberta on the Development, Renewal and Financing of the Government's Plan for Spending on Capital Projects to 2019* (i.e., The Dodge Report), p. 38 on the attractiveness of long-term borrowing.

So, should Albertans worry about the size of the provincial debt? In the very short-term, the answer is no. As the previous section of this report showed, Alberta's economy as a whole remains strong and vibrant—a good investment. As credit rating agency reports confirm, the Alberta government has ample liquidity (i.e., cash and short-term investments) to meet its expenditures, to pay interest on its debt, and to repay or refinance maturing debt when due. With high credit ratings, Alberta can continue to borrow billions at foreseeably low rates to meet its financial obligations.<sup>6</sup> The more difficult question is, “How long can the Alberta government go on borrowing without resorting to either tax increases or expenditure cuts, or a combination of both?”

In the medium- to longer-term, Albertans should worry (see also Tombe, 2018). They should worry because as taxpayers, unless the economy grows strongly to produce revenue to keep servicing the debt, sooner rather than later the government will either cut program expenditures or will have to introduce a variety of tax measures to increase revenues. But it is also important to recognize that the problem is not out of control, even in the longer-term. Relative to the situation of the early 1990s, and contrary to some current rhetoric, Alberta's debt is not currently an overwhelming problem.

This appears to be the nuanced view of credit rating agencies as well. Credit rating agencies are sophisticated organizations who provide opinions on the repayment ability of borrowers. Despite all their financial models or simulations, there is no real science to how these agencies develop credit ratings. Agencies occasionally make mistakes, as their ratings on mortgage-backed securities during the recent financial crisis starkly revealed. In short, there is a degree of subjectivity in agency ratings, although published methodologies provide some objective bases for how decisions are reached.

At present, Alberta enjoys a high-quality rating in the A+ to AA range and, as recently as 2015, was rated AAA by some agencies.<sup>7</sup> Financial markets can, however, turn against borrowers—as both the Greek debt crisis and 2007–2009 global financial crises demonstrated—forcing borrowers to pay much higher rates to borrow. This is not a trivial risk, as the 1936 Alberta default demonstrated (Ascah, 1999: 53–80).<sup>8</sup> Similar circumstances faced Saskatchewan in the early 1990s, as the new NDP government sought to repair the province's finances (MacKinnon, 2003: 97–129).

6 See reports from DBRS (2018), Fitch Ratings (2018), Moody's Investor Services (2018), and Standard and Poor's (2018).

7 <https://www.alberta.ca/investor-relations.aspx#toc-3> Moody's (2018) explicitly notes the high likelihood of extraordinary support from the federal government (Moody's, p. 2). According to S&P, “An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.” By contrast, “An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong,” p. 5. Standard & Poor's Ratings Definitions, November 20, 2014. <https://www.spratings.com/documents/20184/86966/Standard+%26+Po or%27s+Ratings+Definitions/fd2a2a96-be56-47b8-9ad2-390f3878d6c6>

8 See also Reinhart and Rogoff (2009).

Concern about Alberta's continued creditworthiness is merited for the following reasons. There are a great number of financial factors beyond the government's control, including, among others: (1) oil prices, which drive royalty revenue, personal and corporate income tax, new vehicle registration revenues, etc., and spending on social services, roads, schools; (2) interest rates, which drive investment income, debt service costs, and valuation of pension fund liabilities; (3) equity market prices, which drive investment income; and (4) loan losses by ATB and the credit union system, whose deposit liabilities are guaranteed by the provincial government. Revenue volatility, discussed below, requires that the provincial government hold more liquid reserves to keep its credit rating, but that very volatility is highlighted as a major credit weakness by all agencies.

Most Albertans with a mortgage have heard the term "debt service coverage ratio." For provincial governments, bondholders want to know the size of the revenue stream from which interest and principal payments will be made. In 2019, Alberta's total revenue totaled \$49.6 billion, while total debt servicing costs were \$1.97 billion, or 4 percent, ostensibly providing plenty of comfort for the lender. With only 4 percent of revenue going to debt servicing, this level of debt is quite manageable.<sup>9</sup>

Another measure often used by financial analysts and economists is the debt-to-GDP ratio. The logic for using this ratio is that the larger the size of an economy, the larger the debt that can be serviced. As noted earlier, Alberta benefits from a very high GDP. In 2018, Alberta's nominal GDP was about \$350 billion, making the gross debt-to-GDP ratio about 24 percent. This amount, relative to other Canadian provinces, is very good.

Still, each province's financial structure, accounting, and economy are very different, adding to the difficulty with which financial analysts must grapple, compelling analysts to adjust the respective debt number. Adding to this complexity are significant differences in how the term "net debt" is defined, depending on what is included and excluded. In Alberta's case, net debt is significantly lower than outstanding debt because of Alberta's significant financial assets, like the Heritage Fund, which could be liquidated to pay debt, if required.

In the province's public accounts, the government presents net debt as the difference between the government's financial assets and its liabilities. Subtracting net cash and portfolio investments<sup>10</sup> from the gross debt produces a net-debt-to-GDP ratio of about 12 percent. Yet another adjustment made by rating agencies is to add unfunded pension liabilities, producing yet another number of 15 percent.

<sup>9</sup> By way of comparison, a bank can foreclose on a property and displace the borrower, but sovereign borrowers typically find a way to renegotiate the debt load. An action may be brought against the province under the *Proceedings of the Crown Act*. Practically, the federal government would step in to guarantee future borrowings. One provision of the *Financial Administration Act* treats debt service payments as statutory payments which means that all payments with respect to debt issuance, including interest and redemption, is automatically paid from the general revenue fund without requiring an annual appropriation. *Financial Administration Act*, s. 67(2).

<sup>10</sup> Portfolio investments include the Heritage Fund and various endowment funds.



Both the measures and the trend are important. In Alberta's case, the increase in these various measures is documented in rating agency reports. For example, DBRS (2018) reports that Alberta's debt-to-GDP ratio grew from 7.1 percent in 2014-15 to 20.7 percent in 2018-19. (Appendix A compares the various agencies' key measures, including the stock of debt itself, variously measured, and the stock of debt as a ratio of GDP, revenue, and interest as a percentage of debt.)

While credit ratings agencies differ in their means of calculating the probability of default of a sub-sovereign borrower like Alberta, the central message across all is that debt is a moderate concern arising from a confluence of two forces: rising debt levels and a decline in revenue, especially from non-renewable resource revenue.

Returning to our earlier question of whether Albertans should worry about the size of the debt, the collective judgments of these credit rating agencies is that they, at least, are "somewhat" concerned about Alberta's rising debt levels. To May 2018, DBRS stated that it had not yet seen evidence from the then-government "to demonstrate meaningful action to address the fiscal imbalance" (DBRS, 2018: 1). All agencies commented on the inherent risk in the concentrated nature of Alberta's single-commodity economy. Another risk identified by both rating agencies are significant contingent liabilities of financial institutions either owned by the provincial government (e.g., ATB (Moody's Investor Services, 2018: 4; Standard and Poor's, 2018: 4)) or whose liabilities the provincial government guarantees (e.g., credit unions (DBRS, 2018: 6)).<sup>11</sup>

## ***2.1 The Discourse of Debt: We Have Been Here Before***

Dealing with Alberta's fiscal situation cannot be separated from the politics surrounding how debt is perceived, debated, and too often exploited. Before and after the April 2019 provincial election, the current government has used language that can only be described as hyperbolic. As we have made clear, Alberta's debt is something to be concerned about going forward. But the rhetoric used to describe the current situation ignores Alberta's enormous fiscal capacity and the long-term structural roots of the problem; to wit, the province's over-reliance over five decades upon non-renewable resource revenues to fund necessary programs. The bottom line? Alberta's finances suffer from a structural problem that can only be solved with a rational long-term plan on how to deal with the predictable booms and busts of a resource-based economy (Wilson, 2002; Ryan, 2003). Unfortunately, Alberta's long history shows a repeated pattern of debt hysteria driving rational fiscal policy off the cliff.

It is instructive, in this regard, to go back to the lead-up to Alberta's

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<sup>11</sup> The reports note that these contingent liabilities are offset by significant financial assets, such as loans, to service the deposit liabilities. DBRS adds (p. 6): "However, given the reliance of Alberta's economy on cyclical industries, such as oil and gas and agriculture, delinquencies can increase substantially during downturns."



1993 election, which brought Ralph Klein the first of his four election victories. Then, as now, the June 1993 election campaign focused on the deterioration in the province's fiscal condition. In December of 1992, treasurer Jim Dinning appointed a nine-person panel—the Financial Review Commission—led by Marshall Williams, the chair of TransAlta Utilities. The panel consisted of five senior accounting partners and three public members, an early version of today's Blue Ribbon Panel. The group was to report publicly to Albertans and to recommend “what actions should be taken to improve the province's management and reporting systems so they may more clearly communicate the province's financial situation to its citizens.” The report “did not propose any solutions to eliminate the province's annual deficit and net debt.”<sup>12</sup> The report addressed major criticisms of the Getty government's budget and accounting policies that were perceived (and were) deficient in timeliness and quality. The Financial Review Commission reported on March 31, 1993, just over three months after its appointment.

The highlights of the commission report stated, “the need for Albertans to support change is urgent.” In its summary, the report duly noted that the annual deficit was serious and getting worse, that the then-current level of spending was unsustainable, that any savings had already been spent, that further borrowing was unsustainable, and that immediate action had to be taken.<sup>13</sup>

The report arrived literally hours after the end of the Red Deer Economic Summit (March 29–30, 1993), organized by the University of Calgary's then-president Norm Wagner and Jim Dinning. Its messages, not surprisingly, resonated with the government's and summit participants' views.

The “Wagner Report,” entitled *Right on the Money: Alberta's Debt and Deficit* (Wagner, 1993), was a workbook prepared for the summit and a summary of its findings. Like the report coming out of the Financial Review Commission, the main message emerging was, “Take action now!” (Wagner, 1993: 34). In turn, the government's response became “A Plan for Change,” the May 1993 budget. The budget was as much a fiscal plan to restore balance as it was an election platform buttressed by a “blue-ribbon” panel and elite consultation process. Both reports set the stage for what was to be a beautifully executed political turnaround strategy in the first meaningful electoral test of the Tories' dynasty since the early 1970s. The outcomes for many Albertans were less salutary.

At the provincial treasury during this period, senior officials were convinced that debt accumulation needed to be arrested. But looking back in history and now examining Alberta's fiscal future, was Alberta's debt situation truly dire? And, if it was dire in 1993, how does it compare with the current so-called crisis?

<sup>12</sup> Financial Review Commission (Williams), p. i.

<sup>13</sup> Williams, Highlights, pp. 5-6.

**Table 1: Debt Measures, 2019 vs. 1993 (billions of dollars)**

		<b>March 31, 2019</b>	<b>March 31, 1993</b>	<b>1993 &gt; 2019?</b>
Financial Assets	(a)	75.7	17.8	
Liabilities	(b)	103.2	29.6	
Net Debt (Public Accounts)	(c)	27.5	11.8	
<b>Debt and liabilities under P3 (Gross Debt)</b>				
Debt and liabilities under P3 (Gross Debt)	(d)	83	20.2	
Portfolio Investments plus Net Cash*	(e)	39.9	8.1	
Net Debt**	(d)-(e) = (g)	43.1	12.1	
Pension liabilities	(h)	9.2	4.8	
Adjusted "Net" Debt	(g)+(h) = (i)	52	17	
Debt servicing costs	(j)	1.97	1.76	
Total Revenue	(k)	49	13	
Nominal GDP 2019	(l)	350	75	
<b>Ratios</b>				
Gross Debt to GDP	(d)/(l)	24%	27%	Y
Net Debt (Public Accounts) to GDP	(c)/(l)	8%	16%	Y
Net Debt to GDP	(g)/(l)	12%	16%	Y
Adjusted "Net" Debt to GDP	(i)/(k)	15%	23%	Y
Debt Service Coverage Ratio	(j)/(k)	4%	13%	Y
Net Debt (Public Accounts) to Revenue	(c)/(k)	56%	89%	Y
Gross Debt to Revenue	(d)/(k)	169%	153%	N
Net Debt to Revenue	(g)/(k)	88%	92%	Y
Adjusted "Net" Debt to Revenue	(i)/(k)	107%	128%	Y

\* Net Cash is cash and equivalent plus accounts receivable less accounts payable and accrued liabilities.

\*\* Net debt subject to Balanced Budget and Debt Retirement Act.

**Source:** Government of Alberta, Consolidated Financial Statements, for fiscal year ending March 31, 2019, p. 22 and Fiscal Plan 2018-19, p. 87. Public Accounts for Alberta, Volume 1, 1992-93. Statistics Canada, Table 384-0001 – Gross domestic product (GDP), income-based, provincial economic accounts, annual.

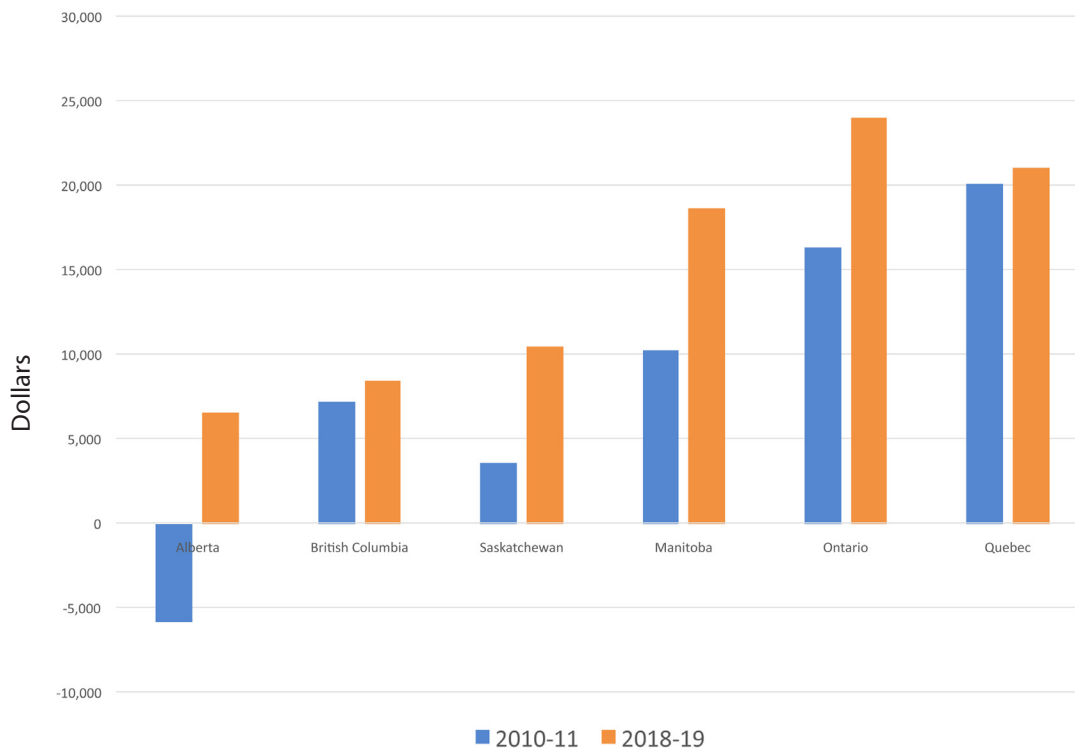
In Table 1, we compare the current fiscal condition of the province with the position back at the end of fiscal 1992-93. This table reveals a couple of key differences between 2019 and 1993. First, the debt service coverage ratio is much lower today (4%) than in 1993 (13%). This is mainly attributable to today's historically low interest rates. Second, debt relative to revenue produces a less clear picture, dependent on the definition of "debt." While revenue is constant in the comparison, the calculation of gross, net, and adjusted net debt are products of many factors, including policy changes with respect to public pension liabilities and accounting policies. Generally, using this measure, the situation in 1993 was worse than today. Finally, in the case of debt as a percentage of GDP, Alberta's situation is slightly better today than in 1993. The third column highlights whether 1993 debt numbers were worse than today, and in all but one instance (Gross Debt to Revenue), they were worse in 1993 than today.

**14** The looming financial crisis for Alberta is not its “spending problem” alone, but also the monstrous environmental liabilities accompanying rapidly dissipating oil wealth. As is becoming evident, the Alberta Energy Regulator (AER) has failed to perform its statutory duty to enforce reclamation obligations. The AER has also vastly understated the estimated cost to rehabilitate oil and gas wells, pipelines, oil sands mines, and tailings ponds (Wadsworth, 2018:13). Given Alberta’s jealous guarding of its constitutional prerogatives and responsibilities from federal “incursions,” how understanding will the federal government be to lowering the industry’s tax load or assisting Alberta in this massive clean-up? While the industry says it will honour these obligations, given the recent examples of regulatory forbearance and the courts enforcing creditors to pay clean-up costs for bankrupt companies, the costs to clean-up orphan wells, oil sands mines, and tailings ponds have yet to be factored into the province’s balance sheet. See, for example, Supreme Court of Canada (2019); Task Force on Climate-Related Financial Disclosures (2017); Task Force on Climate-Related Financial Disclosures (2019).

Were policymakers and politicians wrong in 1993 to sound the debt alarm? With the benefit of hindsight, the alarm seems more justified then, compared to the current situation in Alberta. Certainly, the period of very high interest rates caused great worry, reflected in the very high debt servicing levels at the time. Arguably, today some complacency has set in because the cost of borrowing is low. At the same time, the size of the Heritage Fund has remained static for essentially three decades, and consequently is less of an offset today against the gross outstanding debt than it was in 1993, making the situation then seem more benign.

Is the Kenney government then creating needless alarm about the size of Alberta’s debt? Figure 9 suggests the answer to this question is a nuanced yes. UCP fiscal policy is a follow-on to conservative economic beliefs which deify competition, free markets, and individualism, while denigrating co-operation, community, and a positive role for government. A constant message is that governments are inept, reward the wrong behaviour, and therefore require periodic “down-sizing.” Debt is portrayed in the common-sense manner of how the electorate understands its own financial obligations to make mortgage and daycare payments (“Why can’t governments do the same thing?”).<sup>14</sup>

**Figure 9:** Select Provincial Government Net Debt Per Capita, 2010-11 and 2018-19



Source: RBC Economics, Canadian Federal and Provincial Fiscal Tables, 19 July 2019.

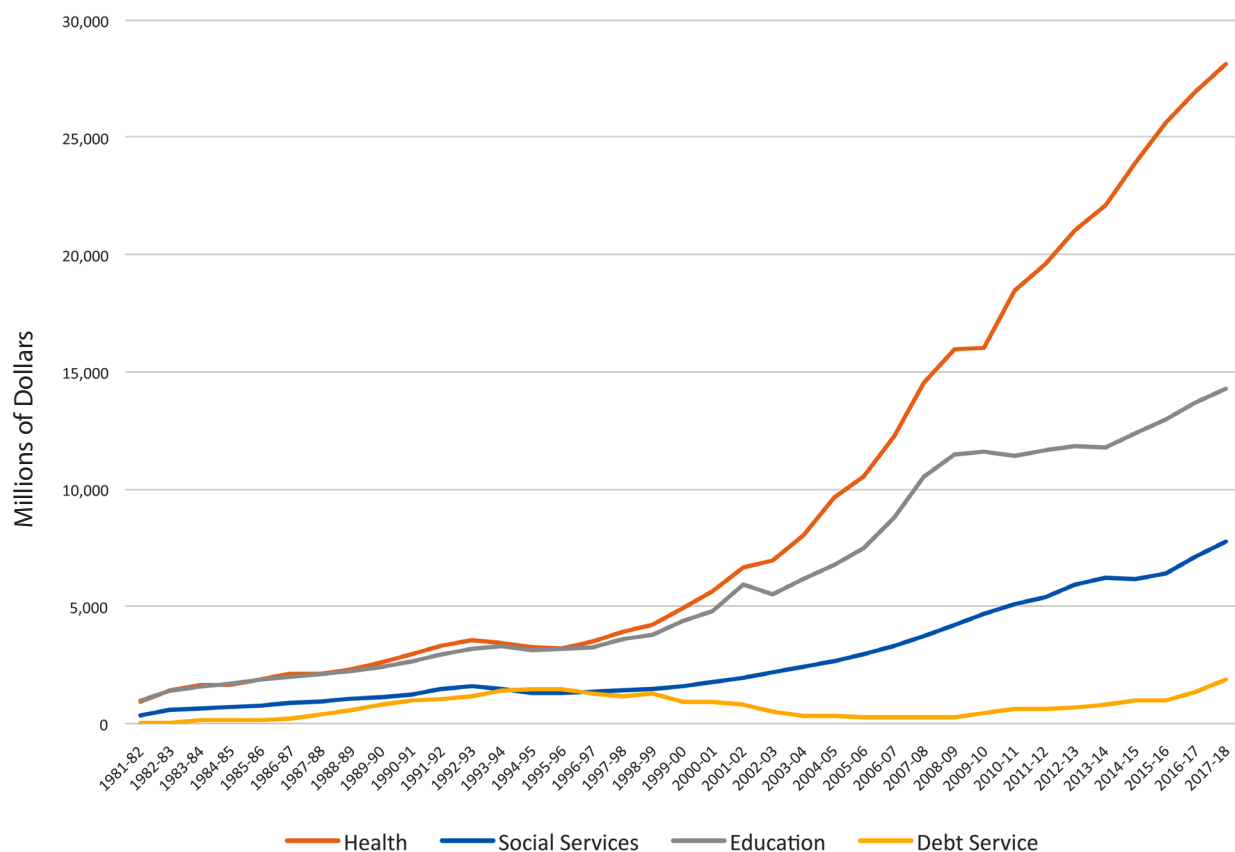
### 3. Alberta’s Expenditures and Revenues

To this point, our analysis shows that, while Alberta’s economy remains solid, its driving force—the energy sector—has been in decline. Given the importance of royalties to fund necessary programs, it should come as no surprise that an imbalance of government revenues and expenditures currently exists.

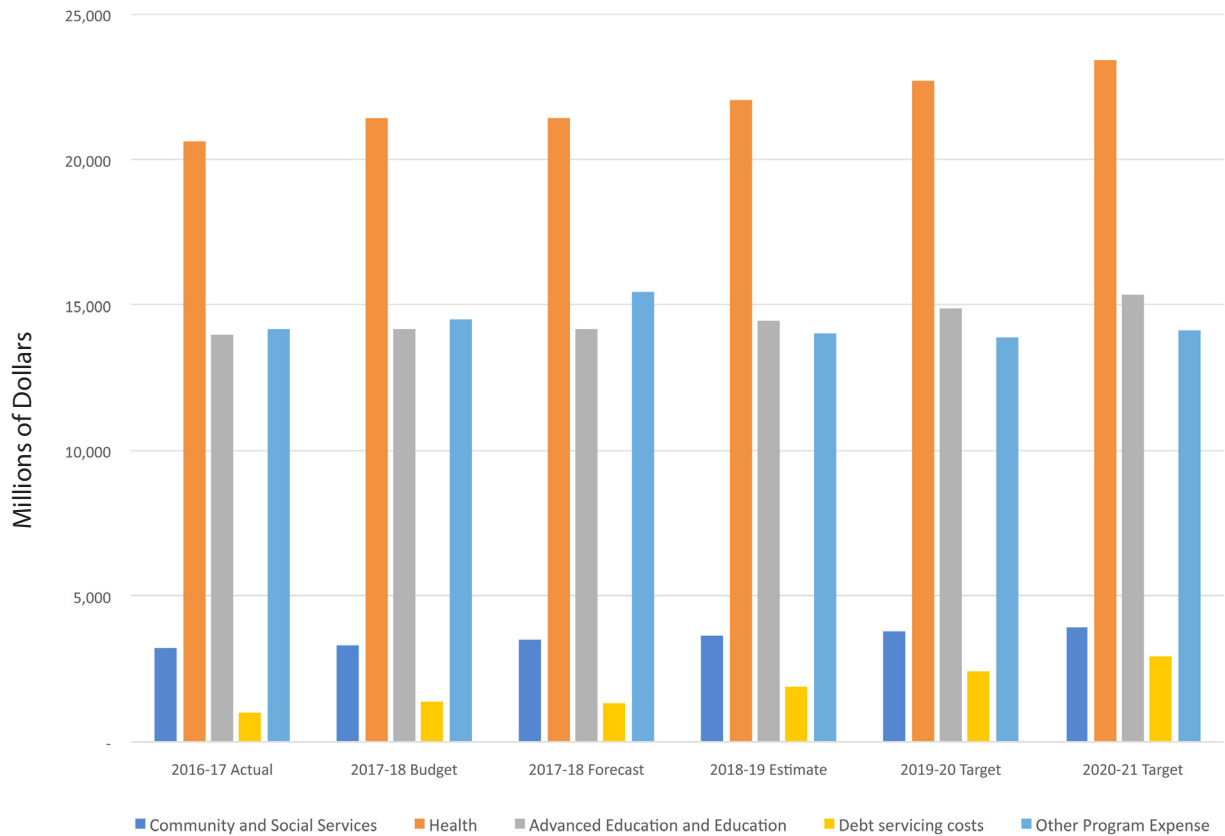
#### 3.1 Expenditures

Health, education, and social services constitute the major areas of expenditure for all provincial governments. Figures 10 and 11 show actual spending in these key areas for Alberta, as well as debt servicing and other expenditures for the period 2016–2020. The figures show that spending on social services has been relatively flat, on education has been marginally higher, and spending on health and debt servicing has increased most. Several reasons may account for these results, among them inflation or an increased demand for some services during the recent recession.

**Figure 10:** Government of Alberta Expenditures, 1981-82–2017-18 (millions of constant (2002) dollars)



Source: Kneebone and Wilkins, 2016, www.policyschool.ca. Alberta (CPI 2002=100) Statistics Canada Table 326-0021 – Consumer Price Index, All items, Annual.

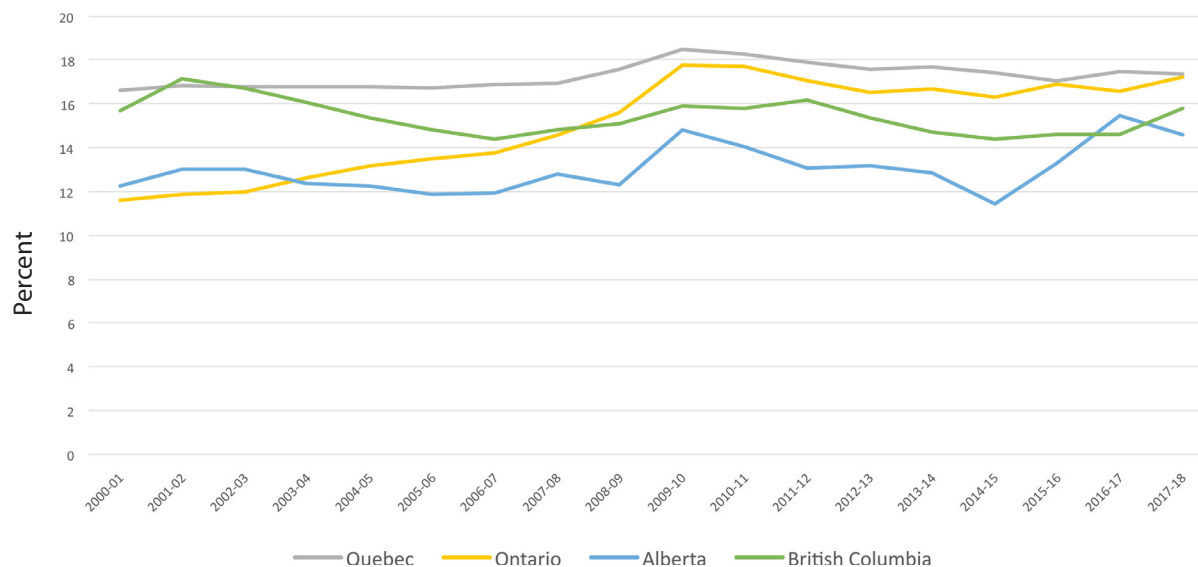
**Figure 11: Government of Alberta Expenditures, 2016–17–2020–21 Target (millions of dollars)**

Source: Budget 2018-19, Statement of Operations, p. 139

How do Alberta's expenditures compare with other major Canadian provinces? Figure 12 summarizes the position of Alberta vis-à-vis the three largest provinces in terms of the relative size of program expenditures compared to the size of the provincial economy for the fiscal years 2000-01 through 2017-18.<sup>15</sup> For almost of all this period Alberta has had the lowest relative program expenditures. The impact of the recent economic slowdown and the increase in total expenditures since 2014 are obvious, but even taking this into account Alberta is still below all three comparator provinces in the most recent fiscal year. In short, Alberta is not the spendthrift province it is often portrayed as being.

<sup>15</sup> Similar comparisons using total expenditures show a similar pattern, but with the gap between Alberta and Quebec and Ontario is larger, the result of lower relative debt services payments in Alberta.

**Figure 12:** Provincial Program Expenditures as a Percent of GDP, 2000-01–2017-18



Source: Authors' calculations from Statistics Canada Table 36-10-0222-01 and Kneebone and Wilkins (2019).

Still, as outlined above, Alberta does have a growing, if moderate, debt. The current government has implied that public sector wages are a central cause of its increased debt. A paper written by the Blue Ribbon Panel's chair, Janice MacKinnon, and the University of Calgary's Jack Mintz (2017) similarly argues that public sector workers in Alberta in 2016 were overpaid relative to comparable public sector workers in Canada's three largest provinces. Palacios, et al. (2018), in a report written for the Fraser Institute, use data from 2017 and estimate that Alberta's public sector workers were paid a wage premium relative to their counterparts in the private sector. A limitation of both reports is the focus on a single year of data that is not necessarily representative of longer-term trends. In 2016, the Alberta economy was still in recession and private sector wages were declining while the economy only started to recover in 2017, but earnings did not. Furthermore, the then-Notley government pursued countercyclical policies during the recession which included maintaining (and indeed expanding) the public sector, though only in proportion to population growth. In other words, 2016 and 2017 are arguably years that are not representative of the longer-term relative position of Alberta's public sector. Similarly, the Alberta economy experienced larger-than-average rates of inflation over the period since 2000, thus using nominal earnings comparisons between provinces yield distorted results (although comparisons within provinces would not be affected).

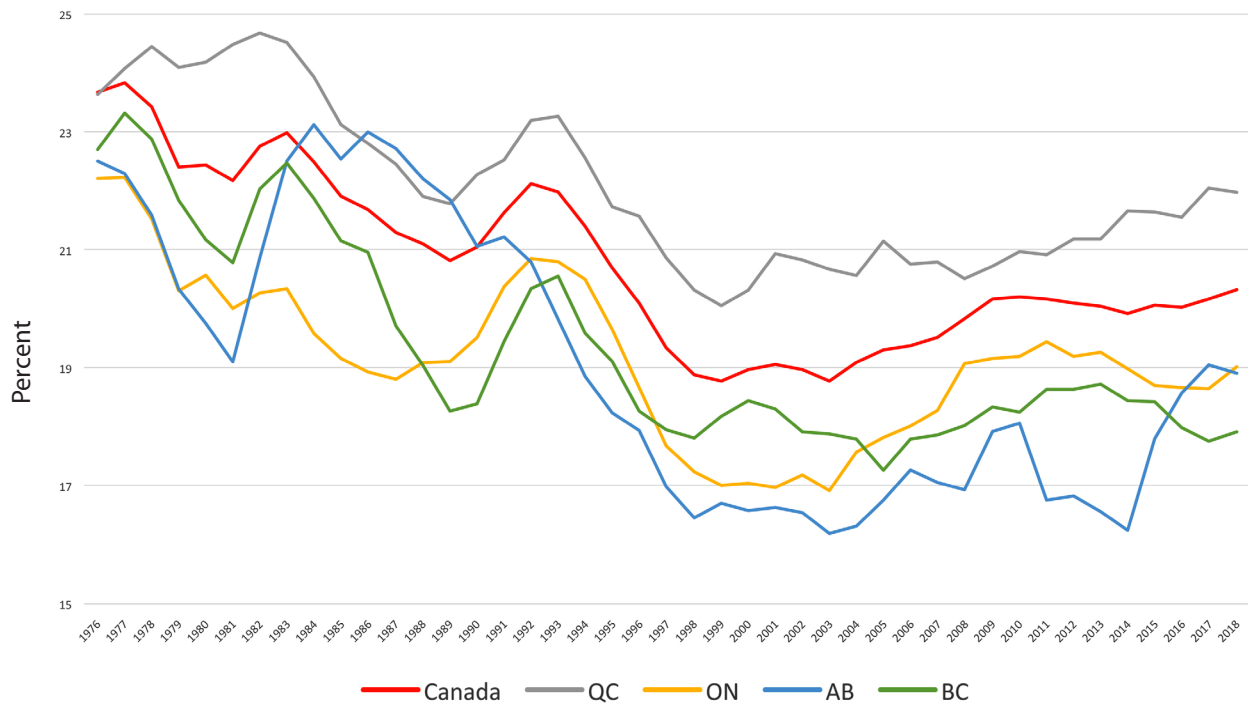
Recent calculations by economist Richard Mueller (forthcoming), using similar comparisons to those in MacKinnon and Mintz (2017) show that when a longer-term perspective is considered, neither the size of the public sector in Alberta, nor the real weekly earnings of public sector employees, seem out-of-line with Canada nor its three largest provinces.

**16** Total employment includes all paid employees, the self-employed and a few unpaid family workers. Using only paid employees, the trends shown here are similar. As a percentage of the population, the share of public sector employees in Alberta is about the same in 2018 as it was in 1976, and currently is the same as the Canadian average. See Mueller (forthcoming) for details.

**17** Between 1992 (the year that Ralph Klein became premier) and 2000, the number of public sector employees in Alberta decreased from 266,200 to 262,400 (a drop of 1.4 percent) while the number of private sector employees increased from 793,000 to 1,036,900 (an increase of 30.8 percent). Over the same period the population of Alberta increased from 2.63 million to 3 million (an increase of 14.1 percent). Authors' calculations from Statistics Canada Tables 10-14-0027-01 and 17-10-0005-01.

Figure 13 shows that as a share of total employment, the size of the public sector has decreased since 1976 in all jurisdictions.<sup>16</sup> For Alberta, the cuts to public sector employment during the Klein government (from the mid-1990s) are evident. Digging deeper, however, these same data show that the number of public employees fell by very little over the course of the 1990s, rather the expansion of private sector employment was responsible for this dramatic decline. Of course, the expansion of the population over this period meant in per capita terms the number of public sector employees fell, contributing to the “sting” of the Klein government’s cutbacks felt by Albertans.<sup>17</sup> The increase in the relative size of the public sector since 2014 is also evident, but again this is due to both to the decline in private sector numbers and increases in public sector employees.

**Figure 13: Public Sector Employees as a Percent of Total Employment, 1976–2018**



Source: Mueller (forthcoming) using data from Statistics Canada Table 14-10-0027-01.

MacKinnon and Mintz (2017) use three industries as their definition of the public sector: educational services, health care and social assistance, and public administration. This is not unreasonable since in Alberta in 2016 some 87.1 percent of all public sector employees were in one of these three industries. However, not all workers in the first two sectors are public employees; 91.5 percent of educational services workers were public employees, as well as 57.9 percent of those in health care and social assistance. The remainder in each case were in the private sector. All public administration workers are—by definition—public employees, but not all of these work for the province, rather only about 35.5 percent did in 2016, with the remainder employed at the federal (21.6 percent) and local (42.3 percent) levels of public administration.<sup>18</sup>

These distinctions are important since the provincial government only has direct or indirect control in determining the employment conditions for a subset of the employees in these three industries. Still, to make the data comparable between studies, we will stay with the MacKinnon and Mintz (2017) definition and disaggregate the public sector into the three industries largely (or exclusively in the case of public administration) populated by public employees. We also use real weekly earnings for each of these three industries and make comparisons with the other provinces over a longer period of time (since 2001).

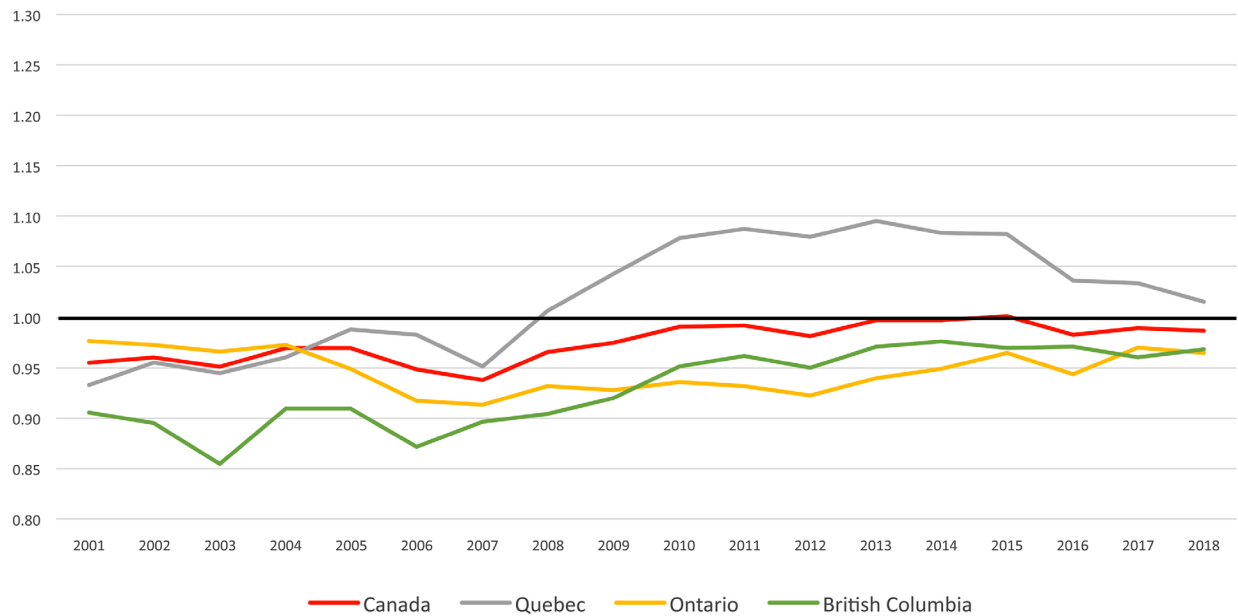
Figures 14, 15, and 16 present these comparisons. In each figure, numbers greater than one indicate that relative real earnings in Alberta are higher than in the comparator jurisdiction while numbers less than one indicate that real earnings in Alberta are lower than the comparator jurisdiction (i.e., real earnings in Alberta divided by real earnings in the comparator jurisdiction).

In the educational services industry, we do see real weekly earnings growth in Alberta compared to all other jurisdictions (Figure 14), although the relative real earnings differences are much smaller. For example, the largest wage differential is 10 percent (relative to Quebec in 2013). Compared to all of Canada as well as Ontario and British Columbia, the differential is never positive. In 2018, there is practically no difference between Alberta and its comparators.

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<sup>18</sup> These numbers do not add to 100 percent since there are a few individuals (less than one percent) that work in Indigenous or international administration who are included in (and thus slightly inflate) the total public administration numbers.



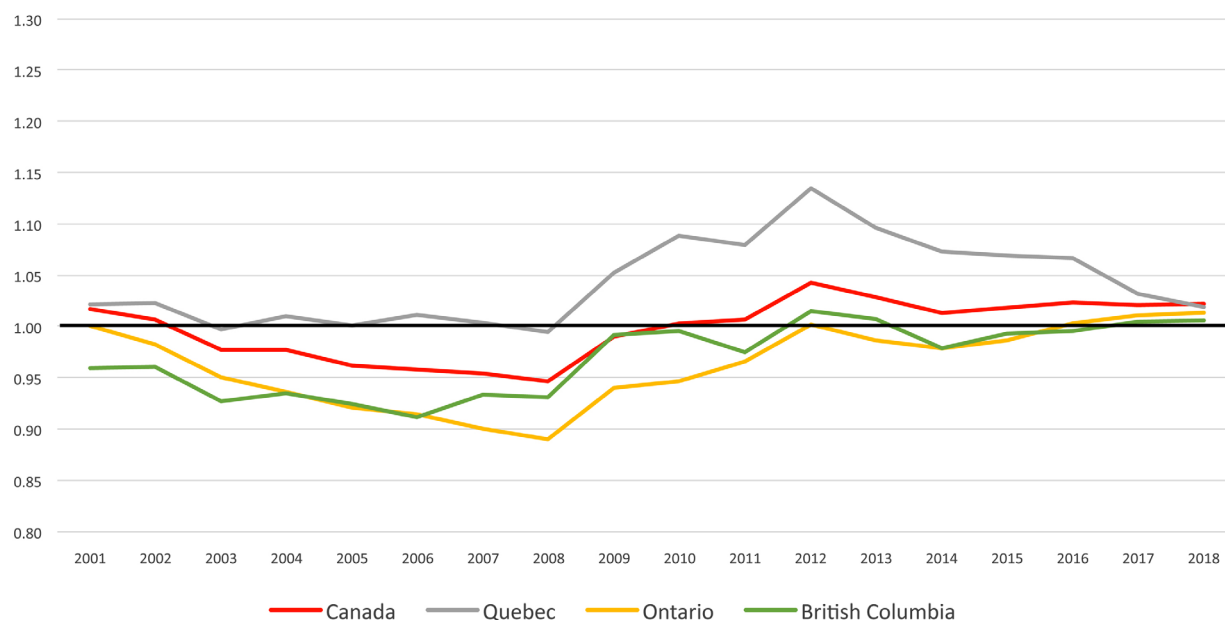
**Figure 14:** Relative Real Weekly Earnings (Including OT) in Alberta, Educational Services, 2001–2018

Source: Mueller (forthcoming) using data from Statistics Canada Tables 14-10-0204-01 and 18-10-0005-01.

Turning our attention to the health care and social assistance industry in Figure 15,<sup>19</sup> we see that relative real weekly earnings in Alberta tend to have the smallest differential with Ontario and the largest differential with Quebec, at least until recently when the Alberta advantage is only 1 to 2 percent. Here we see comparatively low relative earnings in Alberta in the early 2000s, followed by growth after 2008, and then a stable and minimal differential since 2012 with Canada, Ontario, and British Columbia. As in the previous case, by 2018 there is essentially no difference between Alberta and the other jurisdictions.

<sup>19</sup> The health care sector and social assistance industry in these data contain very few physicians. Physicians are almost always members of professional corporations where data on earnings are not available.

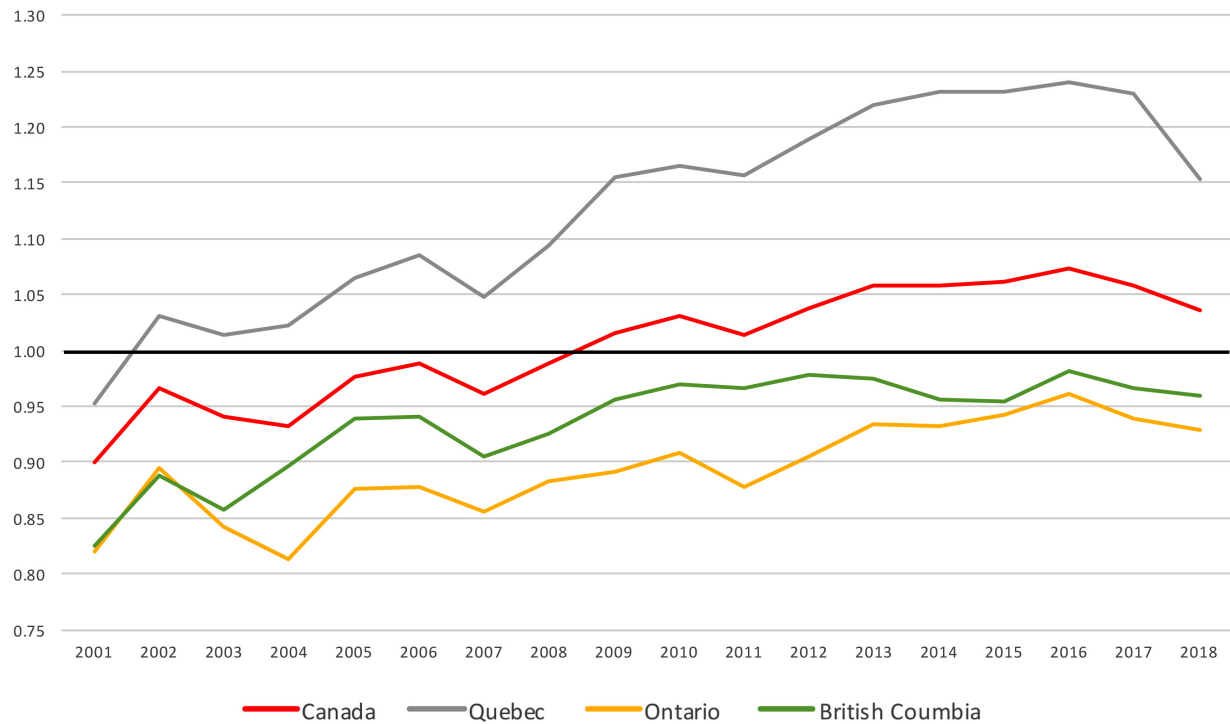
**Figure 15: Relative Real Weekly Earnings (Including OT) in Alberta, Health Care and Social Assistance, 2001–2018**



Source: Mueller (forthcoming) using data from Statistics Canada Tables 14-10-0204-01 and 18-10-0005-01

Figure 16 addresses the relative real earnings differentials in the provincial public administration industry. Again, we include only provincial administration since employment conditions here are in the purview of the provincial governments.<sup>20</sup> Here the outcome is similar, with real earnings higher relative to the Canadian average since 2008, but still only 4 percent higher in 2018. This pattern is driven by the high real earnings relative to Quebec, and this must be balanced with the fact that real earnings were never at or above those in Ontario and British Columbia throughout the entire period.

<sup>20</sup> If addressing all public administration employees in Alberta, the differentials are somewhat smaller, largely the result of federal public administration employees, who tend to be paid much less in Alberta than in other jurisdictions. Local public administration employees in Alberta, by contrast, tend to have substantial relative earnings premiums (higher than those for provincial administration employees), but these are not enough to overcome the earnings penalty for federal administration employees in the overall tally. See Mueller (forthcoming) for details.

**Figure 16:** Relative Real Weekly Earnings (Including OT) in Alberta, Provincial Public Administration, 2001–2018

Source: Mueller (forthcoming) using data from Statistics Canada Tables 14-10-0204-01 and 18-10-0005-01.

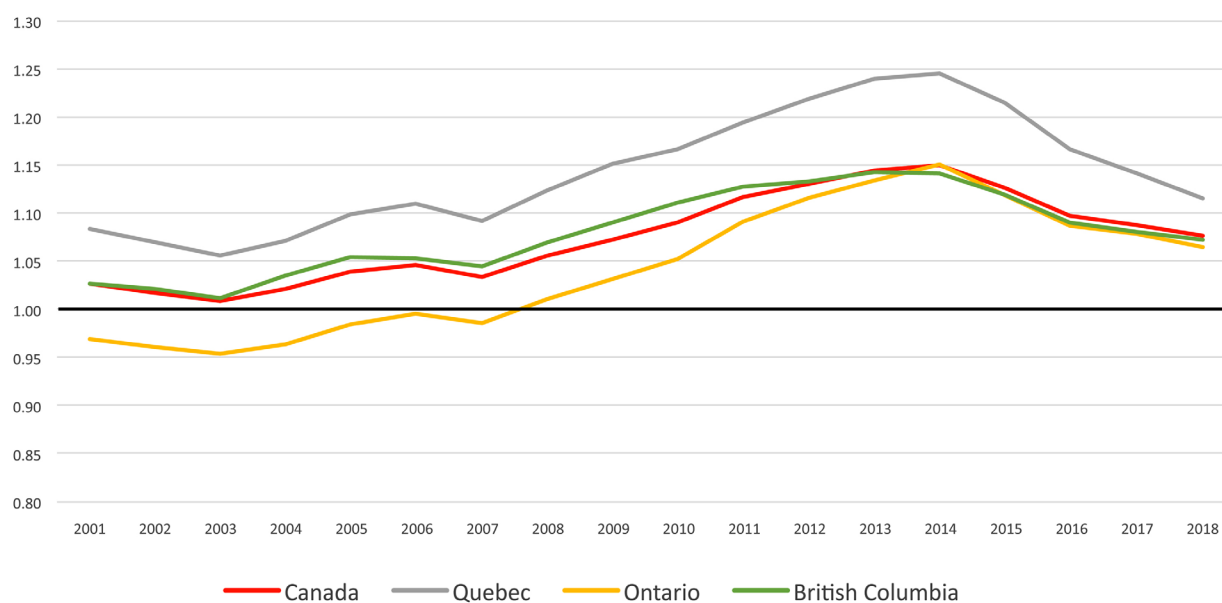
Of course, earnings in any jurisdiction are not set in a vacuum. With the private sector in Alberta (and in the other jurisdictions) comprising close to 80 percent of all employment, the relative earnings in this sector are important in determining the ability of the public sector to attract and retain employees, something that must be done with relatively attractive employment packages. While there are differences in occupations within the private and public sectors which may hinder movement between the sectors (and hence the need for competition between sectors), there is enough overlap that compensation in one sector will certainly have an impact on the other; while a teacher (or professor) may have problems switching sectors, the same cannot be said of, for example, accountants or administrative support.

Any earnings convergence between public and private sector employees could happen directly, as clearly defined occupations are prevalent in both sectors and hence competition could be fierce for employees. Or it could happen indirectly, as there is a general increase in wages and inflation which put upward pressure on wages throughout the economy. This is likely what occurred in Alberta in the period leading up to the 2014 fall in energy prices, as economic growth was strong, unemployment rates low, and the labour market adjusted (at least in part) by hiring tens of thousands of temporary

foreign workers and commuters from other provinces, young people delayed (or abandoned) their post-secondary education, and older workers were encouraged to postpone retirement. As such, it is necessary to also look at the overall relative real earnings trends in the Alberta economy.

Figure 17 shows the economy-wide differences in real weekly earnings from 2001 through 2018, the same period of analysis as above. As in the three figures above, numbers greater than one indicate that relative real earnings in Alberta are higher than in the comparator jurisdiction. Here relative wages are higher for workers in Alberta in each year compared to all provinces but Ontario, where relative real earnings in Alberta have exceeded those in that province since 2008. The earnings differentials peaked in 2014 and have declined since but remain seven to eight percentage points higher than Canada, Ontario, and British Columbia, and 12 percent higher than in Quebec. While the public sector industries in Alberta (see above) had relative earnings penalties at the beginning of the 2000s and then earnings at par more recently, overall earnings in Alberta have consistently been much higher over this period.

**Figure 17: Relative Real Weekly Earnings (Including OT) in Alberta, All Industries, 2001–2018**



Source: Mueller (forthcoming) using data from Statistics Canada Tables 14-10-0204-01 and 18-10-0005-01.

By looking at a longer-term perspective and controlling for differences in inflation in each jurisdiction, it does not appear that the public sector in Alberta is much different than its comparators, either in terms of its size nor in terms of earnings. This is important since any reductions in public sector numbers or earnings could lead to morale problems, the loss of government

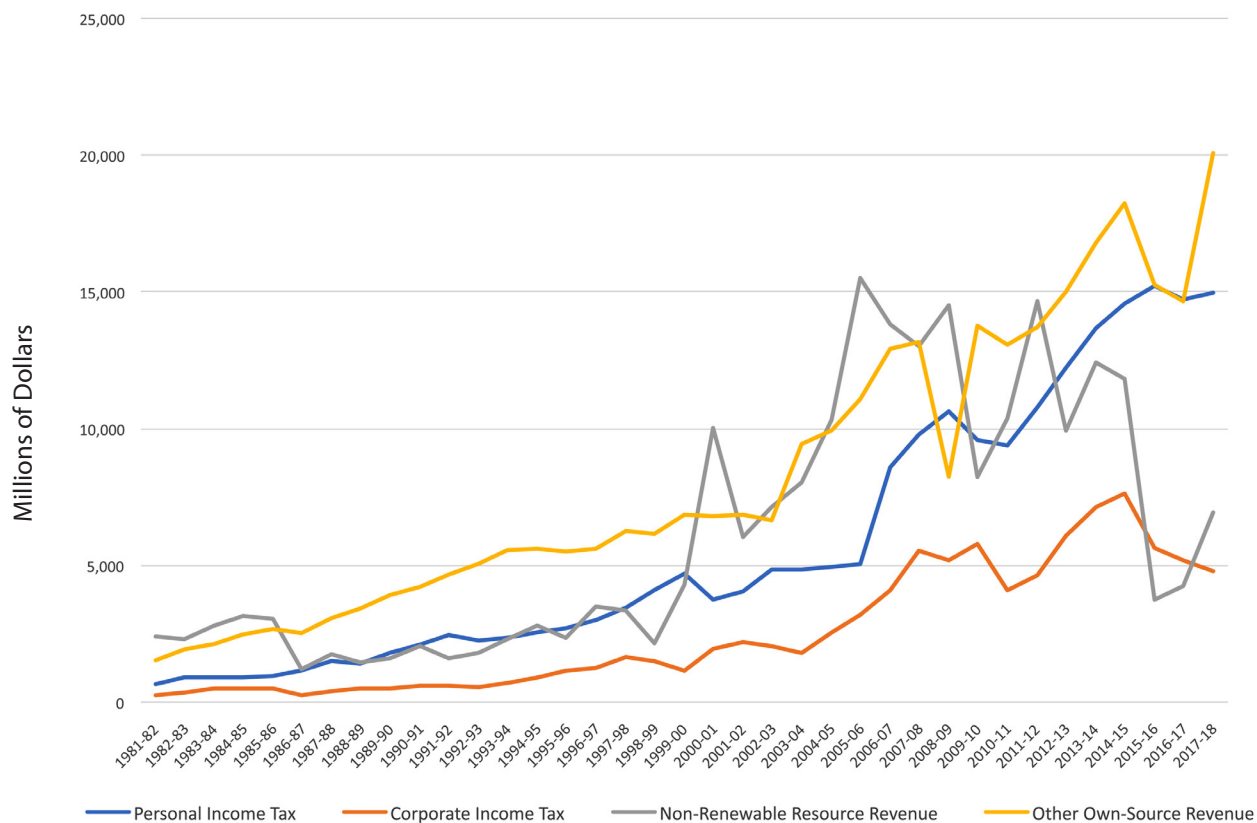
services, and the loss of public sector workers to the private sector or to other provinces. MacKinnon and Mintz (2017) argued that Alberta could have saved around \$2.1 billion in 2016 if public sector salaries were at the same level as the unweighted average of those in Quebec, Ontario, and British Columbia. But Alberta was and remains a high-wage province and its public sector must be competitive. To suggest that billions could be trimmed from the Alberta budget through public sector cuts seems overly optimistic.

### **3.2 Revenues**

Government deficits or surpluses are the arithmetic result of subtracting expenditures from revenues. In this section, we examine variations in key revenue sources for the Alberta government over an extended fiscal period. Figure 18 details the components of Alberta revenues for the period 1965-66 to 2018-19. As shown, Alberta's main revenues are derived from four primary sources: personal income tax, corporate income tax, non-renewable resource revenues (NRRR), and other own-source revenues (a collection of many different sources of revenue, the largest being investment income, which can range from zero to nearly \$4 billion, along with other revenue sources, including lottery and liquor sales, motor vehicle licenses, and the carbon levy).

What jumps out from this inflation-adjusted data series is the very wide fluctuations in non-renewable resource revenue. This constitutes a long-standing, structural problem of Alberta's finances. Historically, resource revenue has constituted the largest source of revenue fluctuating between nearly 50 percent of own-source revenue (total revenue less federal transfers) to lows of under 10 percent. This variation is particularly pronounced at three times during this 40-year period. First, beginning in 1985-86, there was a dramatic drop in resource revenue persisting until about 2000. Beginning in the early 2000s, and continuing through that decade (until the 2008 financial crisis), provincial coffers overflowed, mainly due to natural gas royalties. Dropping after the financial crisis, oil prices recovered, but natural gas prices collapsed due to the hydraulic fracking boom in the United States. Commencing in the autumn of 2014, falling oil prices have driven a hole in the province's revenue outlook. Personal income tax now counts as the single largest revenue source.

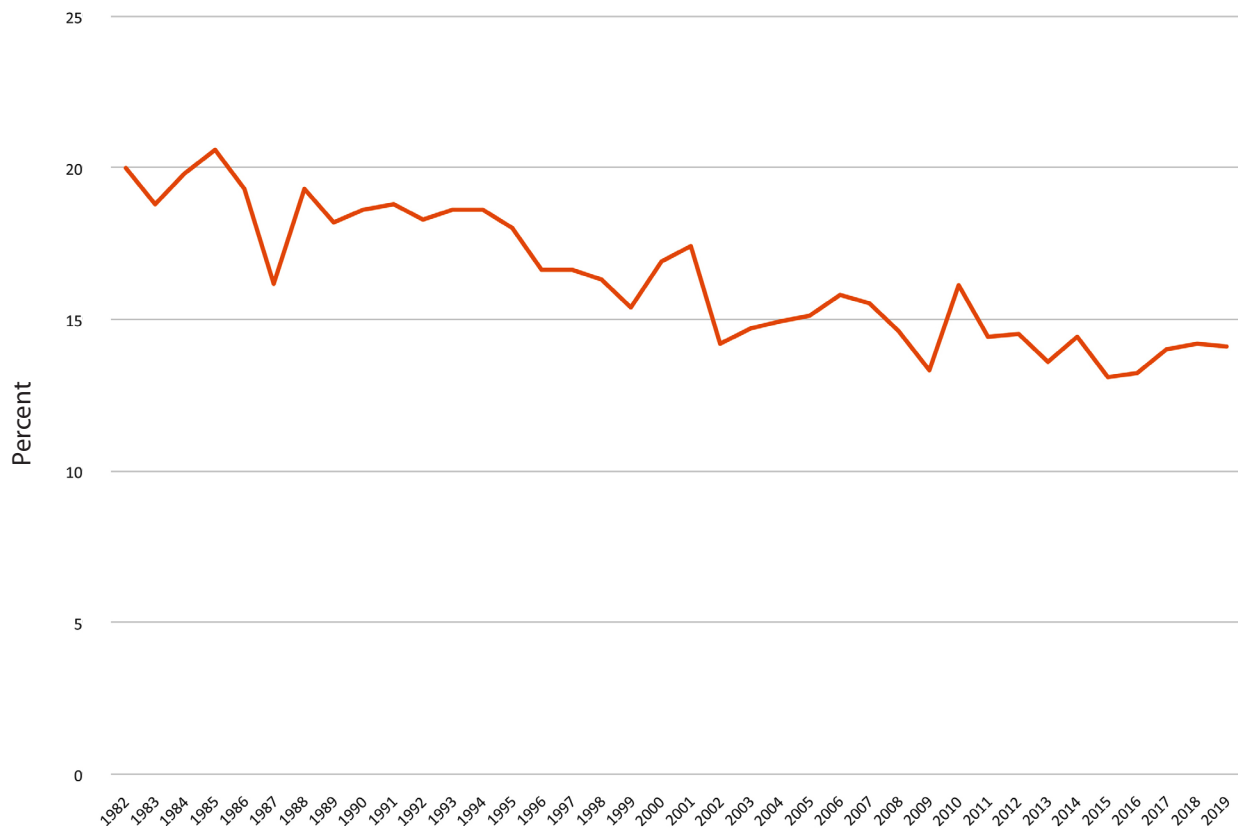
**Figure 18:** Alberta Government Major Revenue Sources, 1981-82–2017-18 (millions of constant (2002) dollars)



Source: Kneebone and Wilkins, 2016, www.policyschool.ca. Alberta (CPI 2002=100) Statistics Canada Table 326-0021 – Consumer Price Index, All items, Annual.

**21** With respect to personal taxation, the table on page 135 of Budget 2018, shows the relative tax advantage of four types of families with incomes of \$35,000 rising to \$200,000. Without considering Alberta's absence of a sales tax, with the one exception of Quebec's treatment of low-income families, Alberta's personal tax advantage ranges from \$1,031 vis-a-vis BC (highest income) to \$16,950 for Quebec (highest income). Alberta's personal income tax regime is highly competitive, arguably more than generous, to attract workers into the province. In addition, Alberta's gasoline taxes are lowest in Canada although, up until the carbon tax was abolished by the UCP, Alberta businesses and residents faced a carbon tax at similar levels to BC. The corporate income tax rate in Alberta, prior to a staged reduction announced in May 2019, was identical at 12 per cent with the three Western provinces in 2018 but slightly higher than Ontario (11.5) and Quebec (11.7). The small business tax rate of 2 per cent is consistent with BC and Saskatchewan, higher than Manitoba (0), but lower than Ontario (3.5) and Quebec (8). This analysis again suggests that, when contrasted with competitor provinces, Alberta is the most competitive jurisdiction in the country.

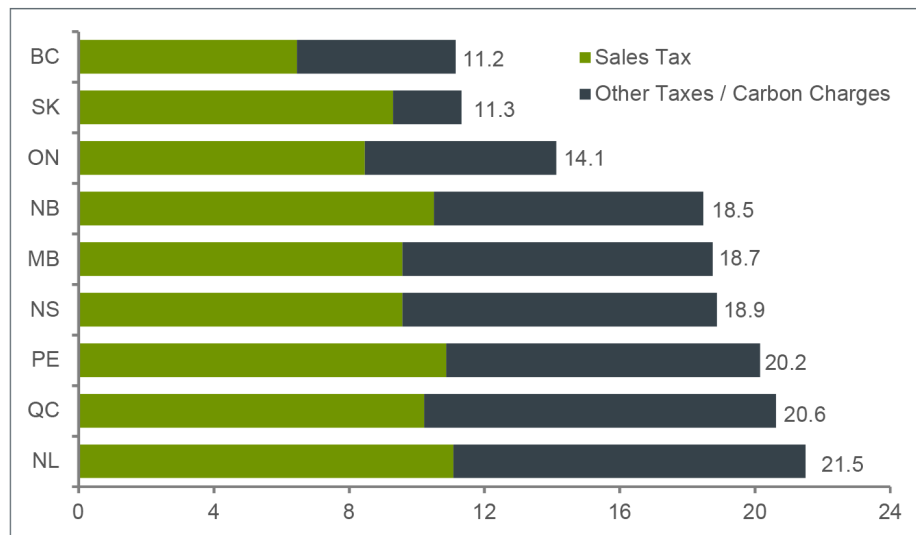
Figure 19, taken from RBC Economics, illustrates the Alberta government's revenue as a share of GDP. It shows, since the beginning of the period, that revenue as a share of GDP started a persistent, if unsteady, decline in the early 1980s, though it has been modestly stable since 2009, ranging between 12 percent and 15 percent of GDP. This declining trend accelerated in the mid-1990s with then-premier Klein's proclamation of the "Alberta Advantage." A central feature of then-government policy was to drop personal and corporate income taxes to attract investment and create jobs, a strategy invoked again by the current UCP government.<sup>21</sup> An associated feature in the plan was the generic royalty regime which offered developers "teaser" royalty rates to invest in Alberta's oil sands.

**Figure 19:** Government of Alberta Revenues as a Percent of GDP, 1982–2019

Source: RBC Economics, Research, Canadian Federal and Provincial Fiscal Tables, 19 July 2019

Alberta's vaunted "tax advantage" has been heavily featured in Alberta budgets over the past two decades. The bar graph from Budget 2018, reproduced in Figure 20, shows the revenue the Alberta government foregoes to retain this competitive tax advantage. Relative to our two closest neighbours, the Alberta treasury would gain an additional \$11 billion in revenue if Alberta had the same tax system and carbon charges as these two provinces. The main difference, of dubious advantage, is the absence of a sales tax. This absence represents a massive revenue loss of approximately \$7 billion when contrasted with British Columbia. This is not the only area where a tax difference exists, however. On the personal tax side, Alberta has the highest income tax exemption level and the second-lowest marginal tax rate for high income earners in Canada (GOA, 2018: 136).

**Figure 20: Alberta’s Tax Advantage, 2018-19 (billions of dollars)**



**Source:** Alberta Treasury Board and Finance

- This graph shows the total additional provincial tax and carbon charges that individuals and businesses would pay if Alberta had the same tax system and carbon charges as other provinces. This information reflects tax rates for other provinces known as of March 9, 2018. A minimum carbon charge of \$20/tonne is assumed in 2019 for all provinces according to the federal government’s carbon pricing plan. This comparison includes personal and corporate income tax, sales tax, fuel tax, carbon charges, tobacco tax, health premiums, payroll tax, liquor tax and markups, land transfer tax and other minor taxes.

**Source:** Budget 2018: Fiscal Plan (GOA, 2018: 125).

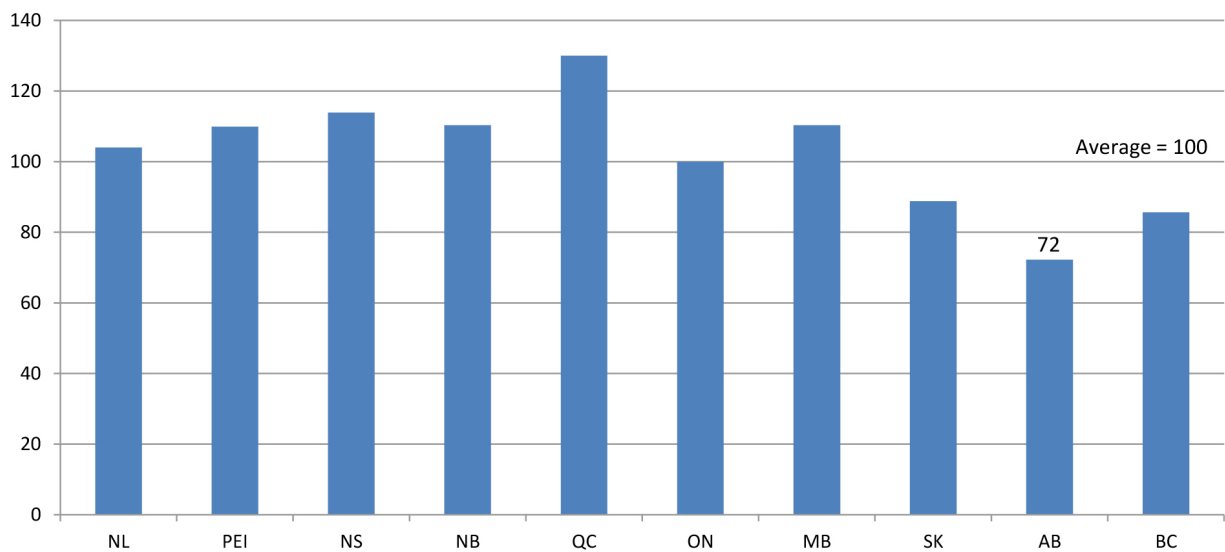
Is the so-called Alberta Tax Advantage a good thing in terms of the long-term sustainability of the province’s fiscal regime? The Premier’s Council on Economic Strategy expressed a different perspective on the question in 2011:

The true Alberta advantage is not the ability to create a low-tax environment by underwriting a significant proportion of government services with funds received from the sale of energy assets. Rather, the advantage lies in our opportunity to use the proceeds from our natural resource wealth—in combination with our highly educated and skilled people—to intentionally invest in shaping an economy that is much less dependent on natural resources. The practice of spending this converted capital as if it were ordinary income deprives Albertans of the opportunity to intentionally shape our future (Premier’s Council for Economic Strategy, 2011: 96).



Figure 21 considers the Alberta advantage as demonstrated on the basis of “relative tax effort.” Alberta’s tax effort—defined as “the ratio of the actual tax collection to the predicted tax revenue” (IGI Global, 2019)—is 72 percent of the provincial average. Alberta’s provincial neighbours are also “tax friendly,” but the figure indicates Alberta has additional tax room to maneuver either on a short-term basis, until the budget is balanced, or over the long-term. Note that non-renewable resource revenues are excluded. If Alberta had not relied upon resource revenues and instead taxed at or near the average rates of other jurisdictions, resource revenues could have been placed in the Heritage Trust Fund. Instead, the real value of the fund has been allowed to erode.

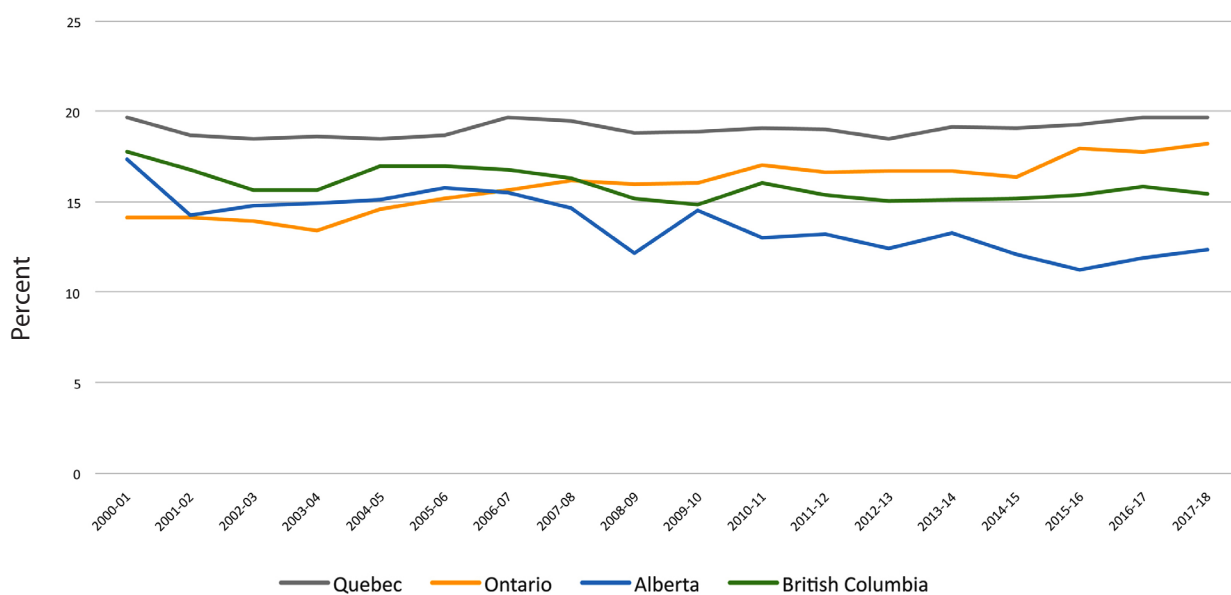
**Figure 21:** Relative Tax Efforts of Provincial Governments, 2016-17  
(average=100, resource revenues excluded)



Source: Trevor Tombe (2018) from McMillan (2018b).

Alberta’s rather meagre tax effort is not of recent vintage. Figure 22 outlines the relative position of Alberta in terms of total revenues as a percent of GDP for the fiscal years 2000-01 through 2017-18. Throughout this period, Alberta generally has the smallest relative provincial revenue stream of the four largest provinces (even when non-renewable resource revenues were high) and, not surprisingly, the gap widened during the recession.<sup>22</sup>

**Figure 22:** Provincial Revenue as a Percent of GDP, 2000-01–2017-18



Source: Authors’ calculations from Statistics Canada Table 36-10-0222-01 and Kneebone and Wilkins (2019).

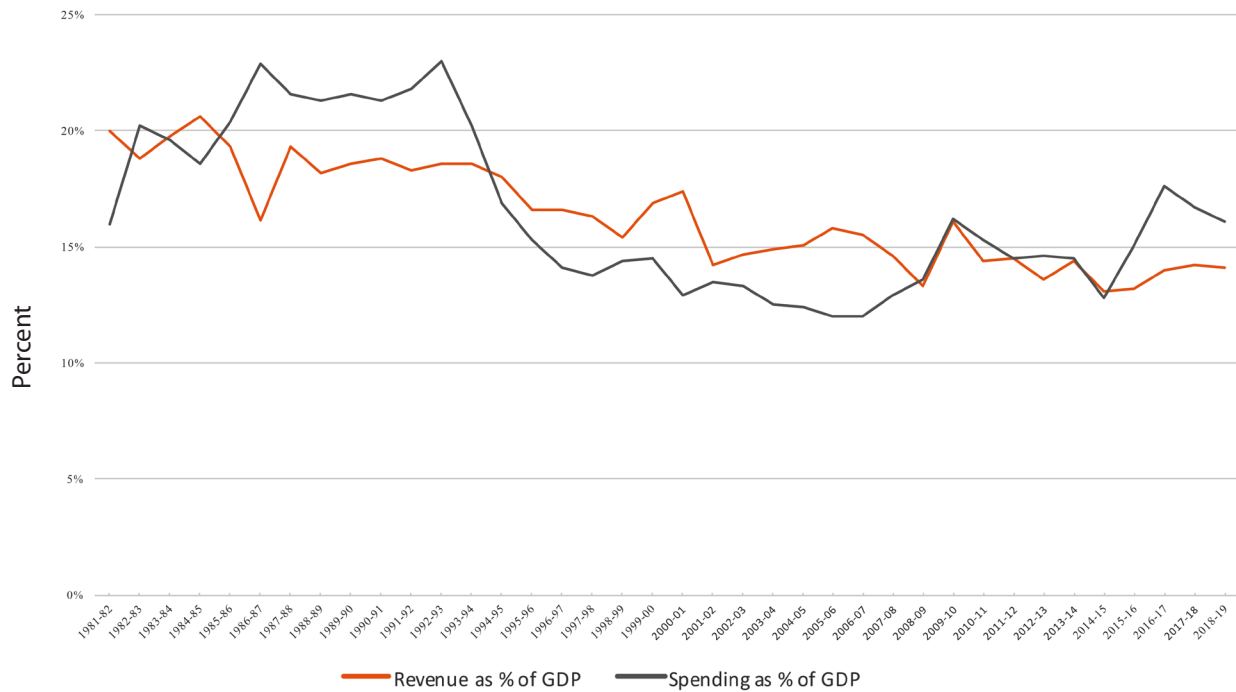
We expect this trend towards declining government tax revenues to continue as the UCP has announced the elimination of the carbon tax and a staged lowering of the corporate income tax from 12 percent down to 8 percent by 2022. The government believes lower corporate taxes will encourage investment and economic growth in the medium- to long-term. However, in the immediate—and perhaps even long-term—reductions in the corporate tax also means lower revenue, making it more difficult for the government to achieve fiscal balance, absent very severe restraint in both operating and capital spending. Adding to Alberta’s already weakened tax effort is the *Royalty Guarantee Act* that locks in existing royalty rates for 10 years to remain competitive with other jurisdictions (GOA, 2019c) and a \$23-million tax reduction program to struggling shallow gas well and pipeline companies (GOA, 2019d).

<sup>22</sup> McMillan (2019) adds to this debate, showing that in 2016-17 not only did Alberta’s total provincial revenue lag that of other provinces as a percentage of GDP (as shown in Figure 22), but also in terms of dollars per capita: Alberta provincial revenue per capita was \$9,893 compared to \$9,915 in Ontario, \$10,682 in British Columbia and \$12,207 in Quebec.

### 3.3 Alberta Revenues and Expenditures: A Question of Balance

The deliberate policy to keep taxes low has been a constant throughout the past two decades. The NDP government continued this policy, although some minor changes to higher marginal rates were made. This policy choice presents an interesting experiment in comparative fiscal performance over past 40 years. As shown in Figure 23, the resulting experiment has produced two periods of debt build-up and one period of debt repayment.

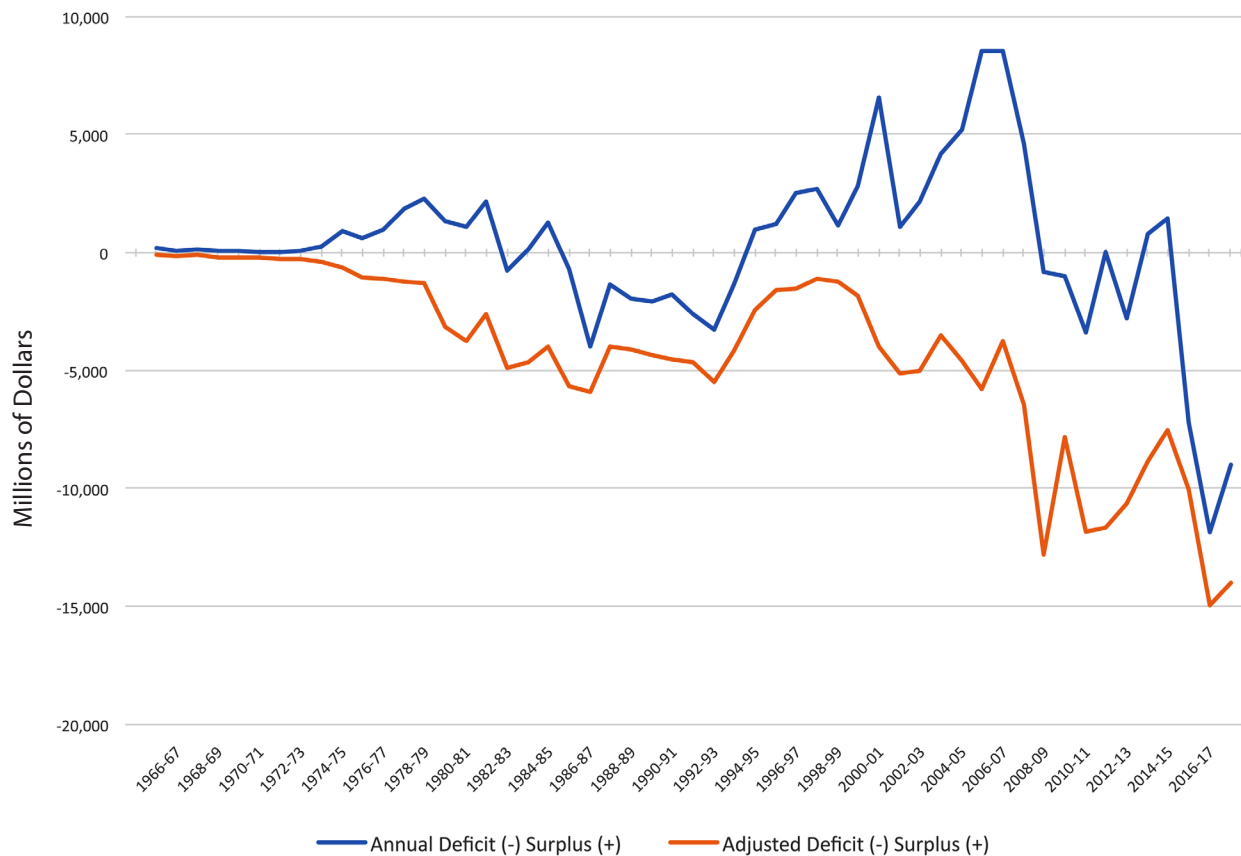
**Figure 23:** Expenditures and Revenues as a Percent of GDP, Alberta, 1981-82–2018-19



Source: RBC Economics, Research, Canadian Federal and Provincial Fiscal Tables, 19 July 2019.

Figure 24 provides a different look at how the province's fiscal picture would appear without non-renewable resource revenues. The blue line shows actual surpluses or deficits, while the orange line shows what the surpluses and deficits would have been in the absence of any non-renewable resource revenues. It is truly remarkable that when resource revenue is excluded, Alberta did not achieve a surplus in any fiscal year since 1965. Thus, it is incumbent that Alberta governments look at other sources of revenue to tap as the future of fossil fuel extraction grows dimmer.

**Figure 24:** Alberta Annual Deficit/Surplus and Adjusted Deficit/Surplus, 1965-66–2017-18 (millions of dollars)



Source: Kneebone and Wilkins, 2016, [www.policyschool.ca](http://www.policyschool.ca).

These two figures raise an important question: “Does the Alberta government have adequate revenue sources to meet its spending commitments on a fiscally sustainable basis?” (See sidebar on next page.)

The unequivocal answer is no.

The volatility of Alberta’s principal revenue sources (non-renewable resource revenues, personal and corporate income taxes) are highly correlated to swings in energy prices. As oil and natural gas prices rise and capital investment is induced and more employment created, major revenues grow but other social and infrastructure costs also grow. When the energy sector goes into one of its periodic down cycles, there is no revenue replacing lost royalties or falling or stagnating personal and corporate income taxes. This happens as the need for many government services and counter-cyclical spending to maintain aggregate economic demand both increase. This is Alberta’s perennial—and deep—fiscal challenge.

## The elements of a sustainable fiscal policy

- Competitive, meaning that tax rates, payroll, sales and other taxes, including municipal and education tax levels are comparable with those of its chief competitors for investment and people. "Competitor jurisdictions" are Western Canadian provinces, Ontario, and Quebec. This can be measured by the relative tax effort (Figures 20 and 21 above).
- Competitive, meaning that government programs are not noticeably "richer" than those offered by competitor jurisdictions—both capital and operating.
- Competitive also means salary levels in the public sector that are not significantly different than competitor jurisdictions.
- Fair, meaning that revenue policy is balanced between corporations and individuals and that tax and royalty policies are perceived by the public as fair.
- Minimize variability in both spending and revenue functions.
- Fiscal balance is maintained so that borrowing is required only when the economy is in recession. Spending is adjusted to reflect population growth, technological changes, recessions, and continuous improvement in the quality of public services.
- Comprehensible. With frequent changes to the accounting entity, accounting policies, and frequent use of separate regulated funds, Alberta's finances are difficult to understand even for the initiate (Kneebone and Wilkins, 2018).

## 4. Conclusion and Recommendations

This report's starting point was the Alberta government's establishment in May 2019 of the Janice MacKinnon-chaired Blue Ribbon Panel to examine the province's finances. Like many others, we were concerned the panel's limited mandate would prohibit a full examination of bigger issues of balance or long-term fiscal sustainability. With the release of the MacKinnon report, our concerns have proved justified.

Contrary to the MacKinnon report's findings, our report shows that Alberta's economy, though still coming out of the recent recession, remains strong. Real GDP and real GDP per capita growth remain positive. Labour force participation rates, employment rates, and wages remain above the Canadian average. In the long-term, however, Alberta's economy will likely regress to the Canadian average. This is the new normal. There is no mystery behind the cause of this change; it is the result of a decline in the price of non-renewable resources, upon which the Alberta economy for too long has been over-reliant. Non-renewable resources will remain an important part of the Alberta economy for the foreseeable future, but are today challenged by lower-priced alternatives elsewhere and by changes on the consumer side sparked by concerns over climate change. The way forward is not for Alberta to sink deeper into a non-renewable resource trap, but to begin the hard work of diversifying its economy away from such dependency.

Nearly every concern facing Alberta's finances flows from this dependency. Alberta today has a manageable debt; indeed, one that other provinces might envy (see Figure 9 on page 21). Still, as flagged by credit rating agencies, there are warning signs. It is prudent that governments heed such warnings, but it is also prudent to not give way to, or encourage, needless panic. Debt may sometimes be necessary, even beneficial when put to good use. In the present instance, the best evidence shows that Alberta's debt is manageable. But caution is warranted, as we have pointed out, with regard to changes in the overall economy and to potentially large environmental liabilities down the road.

There are two ways to balance the books and thus eliminate debt: either through cuts to expenditures or through increases in revenues—or, of course, a balance of both. This report has shown throughout that, compared to Canada and its three largest provinces—Quebec, Ontario, and British Columbia—Alberta's expenditures are not out of line. For example, public sector wages—a favourite target of government cuts—are commensurate over time with those found in these other jurisdictions for the areas of educational services, health care and social assistance workers, and public administration.

Alberta's real difficulty in balancing the books lies in its anemic tax effort. Alberta's tax revenue with its current tax policy consistently falls short of that needed to pay for the important public services that Albertans value and expect. In past decades, the revenue shortfall was filled by the revenue obtained from non-renewable resource royalties, primarily oil and gas. But those days are gone, and are unlikely to return. The hole that has been dug can only be filled through a mix of various tax measures. Fortunately, as this report shows, Alberta has enormous tax room to meet this need, and still be able to boast a multibillion dollar "Alberta Advantage."

What, then, is to be done? Successive government-commissioned reports have urged decision-makers to save more of the resource wealth or to obtain a higher share of rent from the Crown's ownership (Alberta Financial Management Commission, 2002: 48-53; Premier's Council for Economic Strategy, 2011: 94-103; Alberta Royalty Review Panel, 2007: 34). These recommendations were politically naïve in the sense that political decision-making is short-term in nature. In any case, the current political environment would seem inhospitable to revisiting the resource revenue agreements as a potential option.

The Klein revolution of the early 1990s was necessitated in part by strong exogenous forces (financial market concerns and a systemic threat to Canadian government finances). While there is indeed evidence to suggest fiscal circumstances are moving in an ominous direction for the country as a whole, the existence of cheap money makes the external pressures appear less urgent. Given this factor, it is incumbent on the Alberta government to ensure that its diagnosis of the problem is correct; that its diagnosticians do not prescribe bloodletting to save a patient already suffering from anemia; to first, as the doctor says, do no harm. Stepping beyond metaphor, if the malady is only partially the result of spending, this suggests a fuller examination is required if Alberta's financial structure is to be made stable, competitive, and fair in the long-run.

Our diagnosis suggests the revenue side of the ledger is the primary ailment plaguing Alberta's fiscal order. And, indeed, the MacKinnon report (p. 20) acknowledges that volatility of resource revenue is the main driver of Alberta's structural budget problem. Two prescriptions are readily apparent.

First, a start must be made to wean Alberta politicians and the public off the 100 percent use of highly volatile resource revenue to fund ongoing expenses. This could be done over a period of five to 10 years to allow for an adjustment to the reality that sustainable finance requires that Alberta wean itself off financing its programs through non-renewable resource revenue. In effect, households do not use annual bonuses to pay for their groceries and rent. The key point is not that Alberta will go back to savings, but rather

go back to paying “its own way” through a combination of tax increases to foster revenue stability—thus assuring expenditure stability, and finally recognizing that the oil and gas industry is a sunset industry.

Second, in order to fill the revenue void, Alberta must improve its tax effort. There are various means of doing this. Our recommendation, echoed by many economists and policymakers over several years, is that Alberta adopt a provincial sales tax. A key advantage of a provincial sales tax is that the marginal cost of public funds of a dollar from a sales tax is much lower than from other taxes (Ferede and Dahlby, 2016). In addition, the sales tax, properly structured, is a stable source growing with consumption—a tax base that is more immune from energy price volatility (Ferede, 2013). Further, such a tax on consumption, if harmonized with the federal GST would minimize compliance issues for business, and minimize administrative costs. The tax could be set at a level below its nearest neighbours (i.e., British Columbia’s provincial sales tax is at 7 percent and Saskatchewan’s is 6 percent). Such a tax set at, say, 4 percent would bring in an additional \$4 billion per year, depending, of course, on other changes such as increases in Alberta’s personal exemption removing more low-income individuals and families from tax rolls; in any case, assisting those who require the most income assistance. In addition, we envisage the provincial sales tax would be offset for low-income earners with a tax credit administered by the federal government. While a sales tax is not a panacea for Alberta’s fiscal woes—other tax measures that would be fair and equitable should also be considered—such a consumption tax would reduce the vulnerability of Alberta’s public programs to the wild swings of borrowing, expenditure cutting, then rapidly increasing spending.

The causes of Alberta’s failure to face up to its fiscal problems are many, but chief among them is a failure of political leadership. The time is long overdue for a rational, balanced, and fact-based discussion with Albertans about the province’s financial circumstances, wrapped neither in celebratory nor “blue” funereal ribbons, just hard truths. Through good fortune, Alberta is a wealthy and much-blessed province, but we can do better. The time is now.



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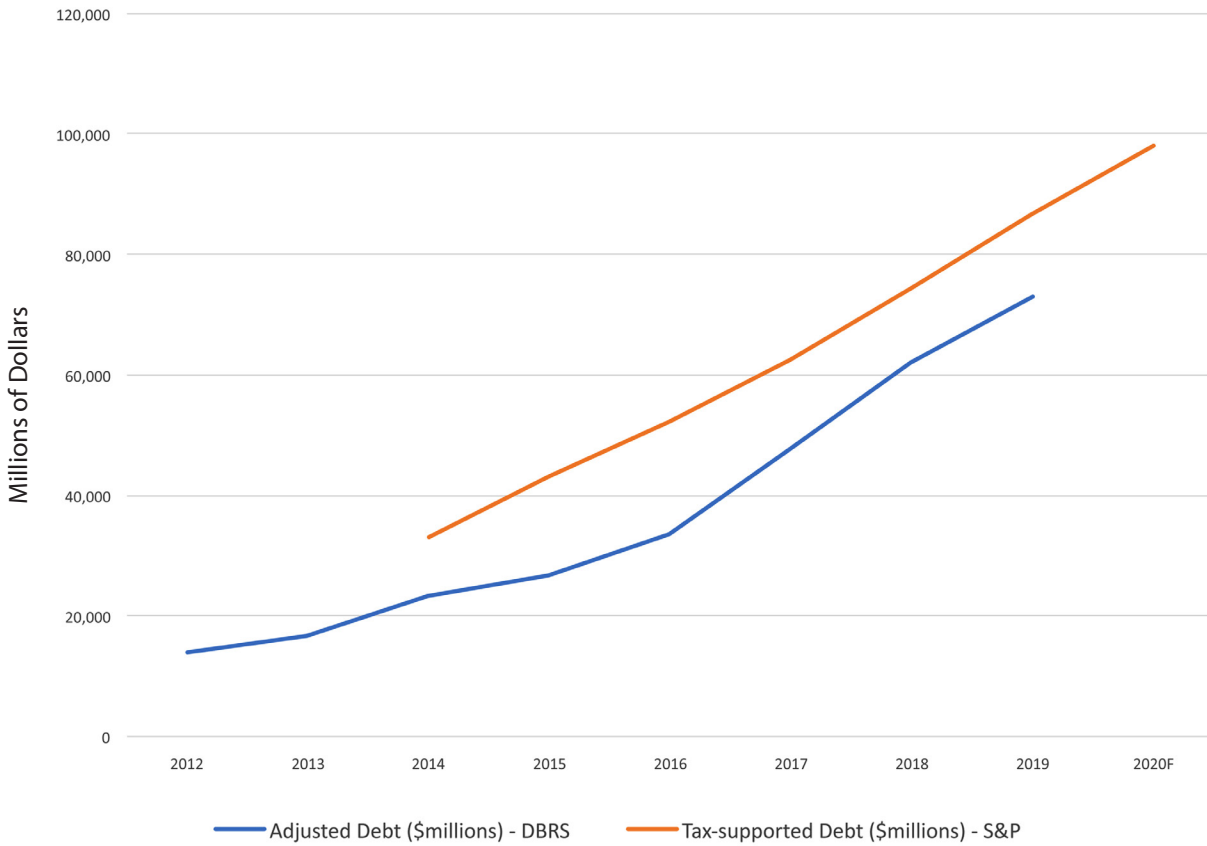
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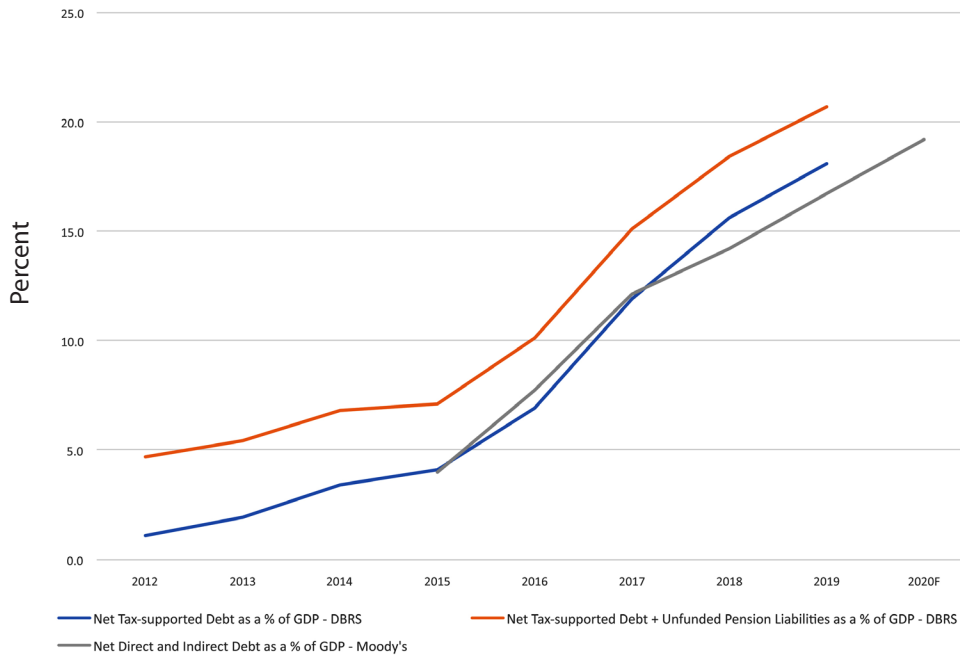
## Appendix A: Alberta's Debt As Measured by Various Credit Rating Agencies

**Figure A.1:** Debt Measures, DBRS and S&P, For Alberta, Various Fiscal Years (millions of dollars)



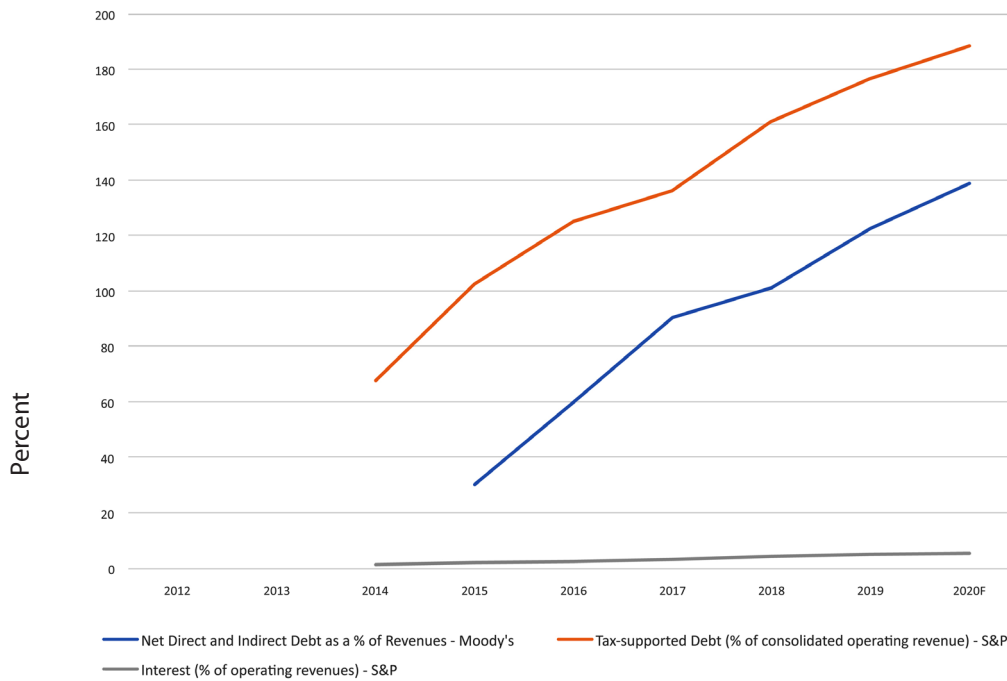
Source: DBRS, Standard & Poor's, 2018.

**Figure A.2: Debt-to-GDP Measures, DBRS and Moody's, For Alberta, Various Fiscal Years**



Source: DBRS, Moody's, 2018.

**Figure A.3: Debt Measures – Debt as Percent of Revenues and Interest as Percent of Debt, Moody's and S&P, For Alberta, Various Fiscal Years**



Source: Moody's, Standard & Poor's, 2018.





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