

EXECUTIVE SUMMARY

TOWARDS A FISCALLY SUSTAINABLE ALBERTA

A REVIEW OF PROVINCIAL
GOVERNMENT FINANCES



BUSINESS COUNCIL
OF ALBERTA

Policy Paper
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The key to Alberta's fiscal sustainability—addressing Alberta's revenue and expense problems

The Alberta government is facing a monumental fiscal challenge. Compared to the other nine provinces, Alberta spends significantly more per person, while it taxes considerably less. In the past, we have used our resource revenues to cover the difference, but we cannot rely on that continuing in the future. Put simply, our current path is unsustainable. We need to change course because it will only get harder the longer we delay.

These challenges were highlighted in our recent report, *Towards a Fiscally Sustainable Alberta: A Review of Provincial Government Finances*. Our report shows that Alberta had a rapidly deteriorating fiscal situation even before COVID and that, post pandemic recovery, moving to a more sustainable fiscal position requires decisive action in three areas: decreasing spending, increasing revenues and, most importantly, setting the province up for long-term economic growth.

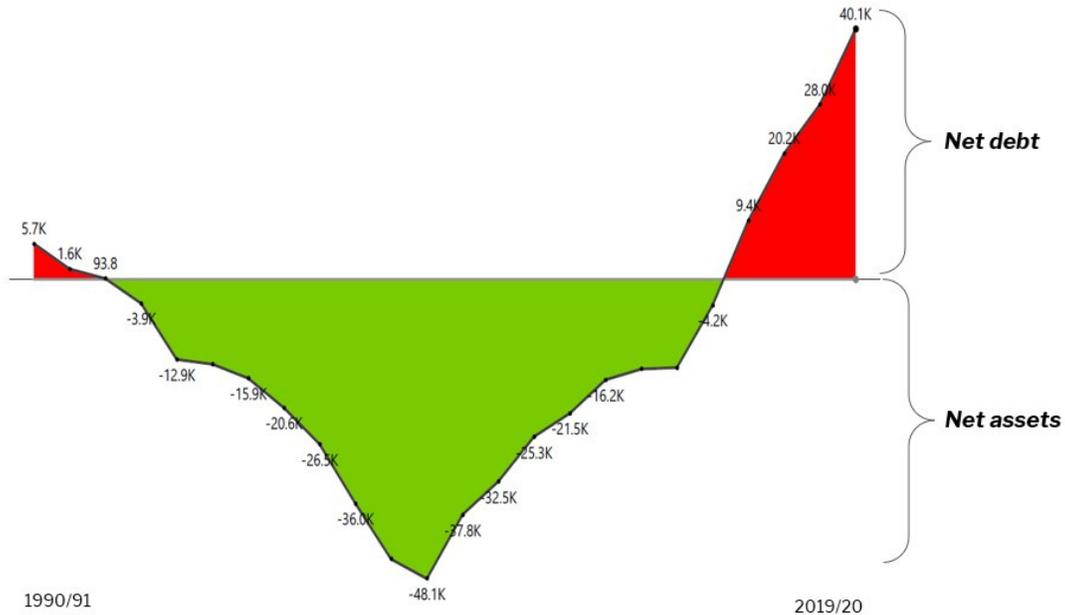
The provincial government is on track to deliver on the first of these steps—reducing expenses. The *MacKinnon Panel on Alberta's Finances* identified areas where Alberta's spending is out of line with other provinces and the government is currently working to implement the Panel's recommendations. Addressing spending is an appropriate step before asking Albertans to pay more taxes. To that end, the most recent budget outlines a plan to hold total non-pandemic spending flat allowing for inflation and population growth to bring Alberta's spending profile more in line with other provinces. It also includes measures to help short-term economic recovery.

Towards fiscal sustainability—summary

- Alberta's current fiscal challenge is great and the trajectory is concerning. Simply put, the province has both a spending and a revenue problem. While in the past resource revenues filled this gap, we cannot count on this continuing into the future.
- Our spending needs to be brought in line with other provinces, but that alone won't be enough. Even after bringing expenses in line, Alberta will still have a deep structural deficit that will keep piling on debt. We also need to increase revenues, and set the province up for long-term economic growth—as a prosperous economy is the real long-term solution to the fiscal challenge.
- Now is not the time for big changes or new taxes, but we do need to start making plans before the problem gets too big.
- Alberta needs a re-imagined revenue model, one that is simple, stable, fair and grows over time. Correctly done, a re-imagined model is not about layering on, but rather could make Alberta more competitive and enhance economic growth.
- Two possible, and well-studied, components of this model are a sales tax and a provincial carbon tax. In combination with offsetting tax cuts and policy changes elsewhere, these measures could improve fiscal sustainability, strengthen the economy, and broaden the tax base.

This paper is a preliminary fiscal sustainability overview. We will be examining options for what such a re-imagined revenue model could look like in subsequent papers.

Alberta's total net financial assets/debt



Source: Alberta Fiscal Plan November 2020, Historical Fiscal Summary.

However, our analysis shows that spending cuts alone will not be enough. Reducing Alberta's expenditures to be in line with other provinces will only cover a fraction of the fiscal gap. So Albertans must decide: do they want to cut expenses further and risk service delivery and quality of life, or do they want to generate some additional revenue to cover the deficit? We argue that Albertans should consider a re-imagined revenue model that could create greater stability, competitiveness and equity.

How did we get to where we are today?

The story of Alberta's budget challenges begins with our natural resource wealth. The energy sector in Alberta has made an extraordinary contribution to the provincial—and national—economies. It has attracted hundreds of billions of dollars in investment and it drives Canada's exports. It has created thousands of high-paying jobs for Albertans and delivered billions of dollars in royalty revenues to the provincial government.

Those resource revenues made Alberta the envy of all other provinces. Our historic "Alberta Advantage" meant that residents earned attractive wages and paid relatively low taxes. That combination made Alberta a magnet—attracting people from across Canada and around the world to seek a better life in our province.

But from a government finances standpoint, those benefits also created two challenges. The first problem is that resource revenues allowed a persistent gap to form between the taxes Albertans were paying and the amount that successive provincial governments were spending. This is not a value statement about the size of government or any particular political party; a low-tax, low-spend government is not necessarily better than a high-tax, high-spend government. The problem is that for decades, Albertans grew accustomed to a low-tax, high-spend government. Resource revenues initially filled that gap, but over time, as resource revenues have declined, debt has come to take its place.

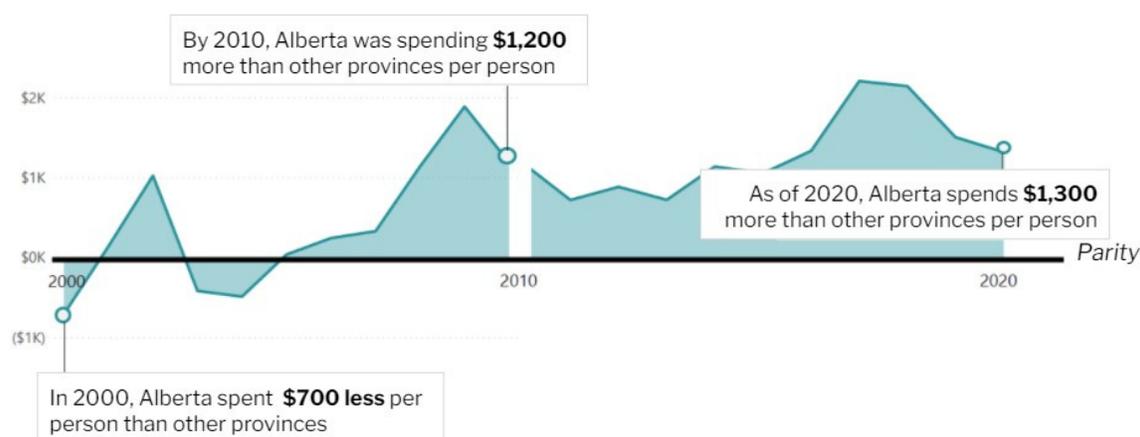
The second problem is that high resource revenues didn't just allow past Alberta governments to spend more, they created the pressure to spend more. Whenever the province received a financial windfall from high oil prices, within a year or two, there tended to be a corresponding uptick in government spending. Over time, this meant that on a per-person basis, the Alberta government was spending far more than most other provinces.

Ultimately, as a result, Alberta has both a revenue and an expense problem.

In a nutshell, the Alberta government spends more per person than most other provinces and taxes less. Based on 2019/20 data, government spending in Alberta is about 11% higher per person compared to the average of the other nine provinces; and at the same time, the province collects about 7% less revenue per person.

On the spending side, Alberta has done reasonably well at containing growth over the last decade; notwithstanding a spike around 2016, per capita spending increases were the third lowest of any province. But the problem isn't the last 10 years, it was the decade before that. In 2000, the Alberta government spent about \$700 less per person than the average in other provinces. By 2010, however, it was spending \$1,100 more per person. That gap has more or less persisted ever since.

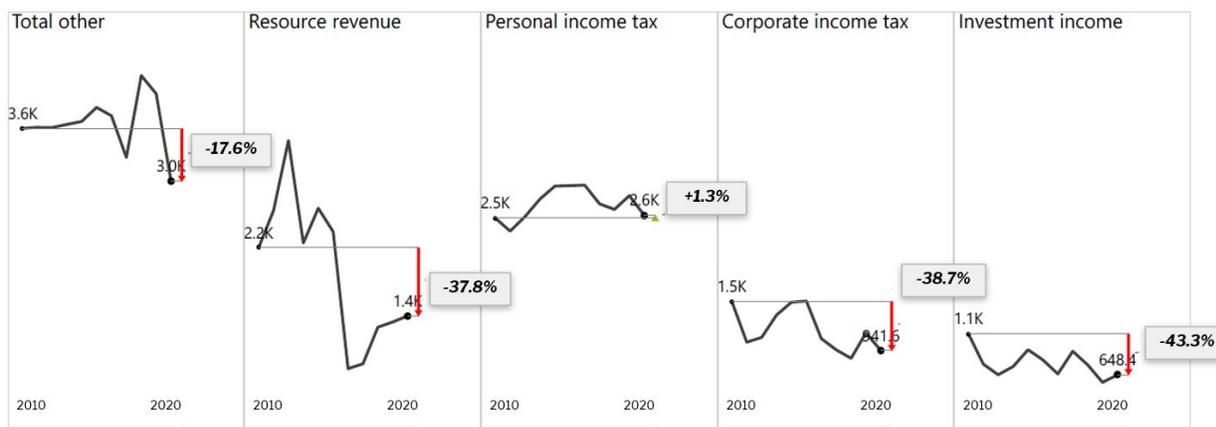
Alberta per capita spending premium relative to the rest of Canada



Source: *Finances of the Nation*—Nominal total expenditure. "Rest of Canada" is calculated as the sum of all provinces except Alberta. Own calculation, adjusted for inflation and population size with data from Statistics Canada

On the revenue side, the problem is twofold. One is that resource revenues are not only highly volatile from one year to the next (which makes budgeting extraordinarily difficult), but they have been trending downward over time. And second, a sluggish economy has severely dampened growth in taxes and other revenue sources. As a result, Alberta's per capita government revenues have actually decreased by an average of about 1% per year over the last 10 years. By comparison, they have grown by about the same amount every year in all other provinces.

Alberta per capita revenue by source



Source: Alberta Fiscal Plan 2009 and November 2020, Historical Fiscal Summary. Fiscal years are denoted by fiscal year end (e.g. 2020 represents the 2019/20 fiscal year). Own calculation, adjusted for inflation and population size with data from Statistics Canada.

This combination of spending growth and declining revenues is why our fiscal situation has deteriorated so much over the last decade.

What can we do?

The bigger issue is not how we got to where we are today but where we're headed. A transitioning economy spells an uncertain future for resource royalties—even if they strengthen in the short term, it would be inadvisable to assume they will remain that way. Moreover, a rapidly aging population will both increase health care costs and lower income tax growth. Meanwhile, education and skills training are increasingly vital in a technology-driven and knowledge-based economy, and for a transitioning energy sector.

These and other trends will place upward pressure on spending, while eroding the revenue base with which to finance those expenditures. Research from the [University of Calgary](#) shows that, given these demographic and economic trends, if Alberta were to focus on one side of the ledger alone to balance the budget, it would require increasing taxes by 34% or cutting spending by 27% (relative to 2019/20) to close our fiscal gap.

As noted above, the provincial government is already moving on the expenditure side of the ledger by implementing the MacKinnon Panel's recommendations. The key will be to do so in such a way that preserves, or even enhances, the quality and accessibility of government services—especially health care and education.

Bringing our expenses down and delivering value for money is a necessary first step but it won't be enough. Based on the government's most recent budget projections, even once spending is in line with other provinces, Alberta will still have a \$7.5 billion budget shortfall. And that's before considering the long-term economic and fiscal trends described above.

This is why Alberta needs to explore options for a re-imagined revenue model—one that is simple, fair and stable; and one that enhances Alberta's economic competitiveness. We agree with the provincial government that now is not the time to introduce new taxes. However, given our fiscal outlook, now is precisely the time to begin a conversation about what to do once the economic recovery is well underway.

What should this re-imagined revenue model look like? Our guiding principles are that any new revenue model must:

- Put the province in a stronger long-term sustainable fiscal state;
- Optimize the value of government services to Albertans;
- Reflect the principles of competitiveness, simplicity, fairness, and stability;
- Limit unintended consequences that inhibit economic growth or social well-being; and
- Enable greater prosperity generation after generation.

Two specific options worth exploring are a provincial harmonized sales tax and repatriating the provincial carbon tax. To be clear, these would not be new additive taxes; they would be components of a broader tax reform package that would include lowering other more harmful taxes lowered (income taxes, for example), strategic investments, or other measures consistent with the principles listed above.

These are not easy options to consider. For many Albertans, the absence of a sales tax is a defining characteristic of this province. Implementing such a tax would require a province-wide referendum. As for the carbon tax, the current government cancelled its version of the tax and is fighting the constitutionality of the federally imposed replacement at the Supreme Court. Action on a carbon tax must wait until that court case is resolved.

But these are not reasons to avoid the conversation. Well-designed, an improved revenue model could work in service of the most important of the three budget levers: economic growth. Albertans face the lowest tax burden in Canada. We can explore new revenue options without compromising our competitive advantage. That's why the options need to be studied carefully, and why, as Albertans we need to talk about it.

The challenge is to get the details right. Alberta needs to forge a path forward based on providing high-quality government services at reasonable tax rates; positioning Albertans to succeed in a transitioning economy; and attracting investment and economic growth. In the coming months, the Business Council of Alberta will be taking a closer look at the revenue model options for the province to help put us on a path to fiscal sustainability and economic prosperity.

More Information

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