

PUTTING THE ALBERTA BUDGET ON A NEW TRAJECTORY

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SUMMARY

Alberta's current NDP government has multiple money problems. Some of those problems arose as a result of the drop in oil prices; others arose because of spending choices the government made. Either way, a course correction is necessary. Otherwise, the burden from this government's building up of debt will be unfairly shifted to the shoulders of future Albertans. This paper examines various measures the government can, and should, employ in both the short and long term to better align spending and revenue.

The NDP's spending choices appear to be based on the precarious assumption that a rebound in oil prices will heal what ails the Alberta economy, as well as on the refusal to significantly reduce spending with almost zero attempt to contain costs. The NDP bases its choices on a black-and-white scenario of either spending or imposing austerity and drastic cutbacks. However, there is a middle ground that would allow the government to maintain services without the quality of those services suffering. These include moderating public sector wages, engaging in better procurement practices, lowering administrative costs, and delivering services and programs more effectively. Alberta is a big spender on health care, but the government could learn much from what other provinces are doing that enables them to spend less while still delivering quality health care.

Alberta's 2017 budget projects deficits of \$10.3 billion this fiscal year, dropping to \$7.2 billion by 2019-2020, and offers no concrete budget-balancing plan. Credit-rating agencies such as Moody's see danger in the NDP budget of a speedily increasing debt burden, long-term deficits and growth in spending that is above inflation levels. The government's projected rise in oil prices, on which it is depending to stabilize the economy, is also considered to be far too rosy.

There are ways out of the gloom. For example, by reducing raises for all public sector workers, unionized or not, the province could save \$1.5 billion over three years. Emulating Ontario, Quebec and British Columbia by applying the brakes to runaway infrastructure spending would save \$4.6 billion over the next three years.

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Public programs and services can be restructured, as has been done in other provinces, to make them more efficient and effective and administrative and procurement costs can be reduced. Reducing Alberta's per capita spending levels to those akin to levels in other large provinces would eventually yield annual savings of \$6.6 billion.

Economic growth won't come from poorly thought-out spending; rather, it will evolve from the creation of a more positive climate for investment. The NDP's carbon tax and its emphasis on more heavily taxing higher income earners do nothing to promote economic growth that could shore up government revenue. Tax reform is key: less economically damaging taxes would improve growth prospects and help close the deficit. Use of the carbon tax should address competitiveness issues through deregulation and cutting business taxes. And for the long term, the government needs a solid plan to balance the budget with specific annual deficit targets.

Common sense, moderation in many things and a firm hand on the fiscal reins will go far towards righting this dangerously listing ship, but the NDP government has to be bold enough to take the initiative. Unrestrained spending is not the answer to any economic predicament.

INTRODUCTION

Spending money is easy for governments. Spending can solve problems, delay difficult decisions and bring tangible benefits to current taxpayers, while the costs – accumulating deficits and debt – are borne by future taxpayers and governments. Relative to other provincial governments, Alberta governments have been big spenders: they have historically increased spending in good times when oil prices have been high, only to face significant deficits during downturns when oil revenues sag. Deficit financing has often been used rather than spending cuts when oil prices plummet in the hope that a rebound in oil prices will restore provincial revenues and balance the budget (Kneebone, 2013).

Thus, it can be argued that the current NDP government's fiscal policies are consistent with the way some past Alberta governments have dealt with the volatility of a boom-and-bust economy. It is also true that when the NDP came to power in 2015 it inherited a very difficult situation: oil prices plunged, the province went into recession and continuing population growth meant additional costs for services. The circumstances were obviously very challenging and running deficits was understandable and unavoidable.

However, what is different this time is the scale of the deficit spending, the riskiness of the assumption that a rebound in oil prices will restore the province's finances and the government's unwillingness to make any significant spending reductions. There is a major difference between running short- or medium-term deficits until a return to balanced budgets can be achieved, and using the challenging fiscal and economic circumstances as a rationale for continued spending, with virtually no attempt to contain costs.

Despite a dramatic drop in revenues, the government justifies its continued spending in various ways. It uses the traditional Keynesian argument that during downturns governments should spend to help stimulate the economy. There is some merit to the idea that when economic growth is slow and interest rates are low, spending on strategic infrastructure is justified if it brings long-term economic benefits to the economy (Sharma, 2017). However, this does not mean governments have a licence to continue to add new spending to Alberta's already high spending levels, as the current government is doing.

The government also presents the public with a stark choice between spending and “austerity,” which Premier Rachel Notley defines as “slashing core services” and “downloading” the province's economic problems “onto families” (Canadian Press, 2016). Yet, reducing spending to help align it with revenues does not necessarily lead to fewer frontline services. Services can be maintained with cost constraint in labour compensation, better procurement practices, lower administrative costs, and delivering services and programs more effectively. This is especially true in a province like Alberta in which data show that public sector spending has been much higher than in other provinces even though outcomes are not better. Clearly, not every dollar spent in Alberta is being spent wisely. Other provinces that do not begin with the same advantages as Alberta have demonstrated some of the choices that can be made to better align spending and revenue.

The government also asserts that by not making significant spending cuts it is protecting Albertans. That may be true today. But the government is taking the easy way out by continuing to spend at high levels, leaving it to future governments to make the difficult but necessary choices. The longer the government continues to run large deficits and accumulate debt, the more painful the choices that future governments will need to make to right the province's fiscal ship.

It is important to begin by analyzing the scale of Alberta's fiscal problem. The size of the current deficits and the growth trajectory of the debt underline the fiscal challenge. However, to put the province's fiscal problem into perspective, it is important to describe the fiscal challenges in terms to which people can relate. For instance, reporting that the province's debt is \$70 billion may beg the question: what does that mean to the average Albertan? To help answer questions of this kind, this paper presents models of what various scenarios mean to Alberta taxpayers.

After analyzing the scale of the problem, the paper will consider some of the policy choices that the Alberta government could make that would begin to align revenue and spending. We do not believe that the deficit can be eliminated in one year but we do feel that more can be done now to reduce the debt build-up, as it will take time to eventually achieve a balanced budget. How these policy choices, most of which have been adopted by other provinces, would affect the deficit will also be projected. As well as taking short- and medium-term measures to better align spending and revenue, the government should present a longer-term plan to balance the budget over a number of years with specific deficit targets for each year.

The Scale of the Fiscal Problem

The 2017 Alberta budget was released on March 16, 2017 and within hours the credit rating agencies pointed to the seriousness of the province's current and future fiscal situation. "Alberta's rapidly rising debt burden, protracted deficits, and above-inflation expense growth" were cited by Moody's credit rating agency as major problems (Moody's, 2017a). The budget projects deficits of \$10.3 billion in 2017-2018, \$9.7 billion in 2018-2019 and \$7.2 billion in 2019-2020, with no concrete plan to balance the budget (Government of Alberta Budget, 2017a, 109). Moody's calculates that Alberta's debt will triple between 2015-2016, when the NDP came to power, and 2019-2020, when the government's electoral mandate ends. It also noted that by 2019-2020, the province's debt burden would approach 150 per cent of revenues (Moody's, 2017b).

It is important to remember that the actual increase in debt – measured as changes in either gross or net financial debt – can be larger than what is indicated by the Alberta government's deficit. Federal and provincial governments in Canada have adopted capital budgets whereby depreciation associated with public capital is deducted as an expense determining the operating budget of the province (capital grants to municipalities are also treated as an expense). A separate capital plan provides the planned capital spending and sources of financing, of which a large share is debt. Thus, if infrastructure spending is more than depreciation charges, debt can be growing faster than deficits. Thus, in 2017-2018, Alberta's budget deficit of \$10.3 billion is smaller than the increase in gross liabilities of \$11.2 billion and net financial liabilities of \$13.6 billion. The amortization charge to the operating budget was \$2.4 billion, but the debt liabilities incurred to fund the capital plan rose by \$6 billion for a net increase in deficits and capital debt financing of \$3.6 billion, largely explaining the growth in net financial debt.

By 2020 the province projects its debt to be \$70 billion. The province's interest costs will be \$1.4 billion this year and increase to \$2.3 billion in two years (Government of Alberta Budget, 2017b, 109). To put these numbers into perspective: the debt burden will be \$16,500 for every man, woman and child in the province. The interest cost for every Albertan will be \$330 in 2017-2018, rising to \$550 in 2019-2020.

However, the size of the debt and related interest costs are premised on optimistic assumptions about the price of oil; hence, these numbers should be considered the best-case scenario.

The Risks:

The credit raters also noted the risks to the province's fiscal forecast. DBRS cited the "uncertain outlook for global commodity prices, limited access to offshore energy markets, ongoing opposition to the construction of new pipelines and the threat of protectionist US trade policies" (DBRS, 2017). Credit rating downgrades also result in higher borrowing costs. Finally, interest rates are at an all-time low, and as the Canadian economy improves, it is likely that the Bank of Canada will increase interest rates.

While the above risks are difficult to quantify, the quantifiable risk cited by Moody's is the province's optimistic assumptions about the price of oil. While the Alberta budget assumes that oil will rise to US\$68 per barrel by 2019-2020, Moody's stated that the \$68 Alberta forecast is "at the upper end or exceeds Moody's own forecast of a medium-term price band of US\$40-60 /barrel" (Moody's, 2017c). Also, current futures' contracts suggest prices could remain well below \$60 until 2020. As shown in Table 1, the federal budget, released March 22, 2017, contains economic forecasts based on surveys of 14 private sector economists. Its assumptions about the price of oil are more pessimistic than those of the Alberta government. Future WTI oil prices are expected to be even lower than the federal March 2017 budget as oil prices have by and large turned to levels below US\$50 per barrel since mid-April 2017 (this would be the high-risk scenario).

The difference in the Alberta and Canadian forecasts is important since every one-dollar drop in the price of oil means \$310 million less in revenue for the Alberta government (additional interest costs to service a higher deficit are included in estimates) (Government of Alberta Budget, 2017c, 38). As illustrated in Table 2, assuming the federal forecast is more accurate than the Alberta one, the Alberta government would have \$310 million less revenue in 2017, which would mean a deficit of \$10.7 billion rather than the projected \$10.3 billion, and \$3.7 billion less revenue in 2019-2020, which would see the 2019-2020 deficit increase from \$7.2 billion to \$11.0 billion.

As a high-risk case, June 2017 trades indicate that future WTI prices will be an even lower oil-price scenario of less than \$50 in the coming three years. If anything, the Alberta government's projected prices are a low-risk scenario.

TABLE 1 WTI CRUDE OIL PRICE (\$US PER BARREL)

	2017	2018	2019
Alberta Government	55	59	68
Government of Canada	54	59	56
Future Prices	47	48	49

Sources: Government of Canada (2017) and Alberta government (2017) and CME as of June 30, 2017 for end of each fiscal year (<http://www.cmegroup.com/trading/energy/crude-oil/light-sweet-crude.html>).

TABLE 2 DEFICITS UNDER VARIOUS PRICE SCENARIOS

	Alberta Forecast (\$ Billion)	Deficits under Federal Forecast (\$ Billion)	Deficits using Future Prices (\$ Billion)
2017-2018	-10.3	-10.7	-12.7
2018-2019	-9.7	-9.8	-13.1
2019-2020	-7.2	-11.0	-13.1
Total	-27.2	-31.5	-38.9

*Based on end of fiscal year (month of March) for each year.

TABLE 3 IMPLICATIONS FOR DEBT

	Alberta Budget Total Liabilities (\$ Billion)	Alberta Budget Total Liabilities Federal projection (\$ Billion)	Alberta Budget Total Liabilities Future Prices (\$ Billion)	Debt Servicing Cost Alberta Budget (\$ Million)	Debt Servicing Cost Using Federal Projected Prices (\$ Million)	Debt Servicing Cost Using Future Prices (\$ Million)
2017-2018	85.7	86.1	88.1	1398	1406	1466
2018-2019	99.5	100.0	105.4	1807	1819	1937
2019-2020	111.6	115.9	123.3	2286	2397	2590
Annual Average				1830	1897	1978

Note: Interest rate forecasts in Alberta were 2.0% for 2017-2018, 2.3% for 2018-2019 and 2.6% for 2019-2020.

If the price of oil is consistent with the federal projection, accumulated deficits will be \$31.5 billion instead of \$27.2 billion over the three fiscal years 2017-2018 to 2019-2020. Thus, the debt would increase by \$4.3 billion, or \$1,000 per Albertan. The extra debt finance would be funded at projected interest rates rising from two per cent in 2017-2018 to 2.6 per cent in 2019-2020. This increase in debt and interest rates would result in an increase in debt-servicing costs (interest expense) in each year, rising from \$1.406 billion in 2017-2018 to \$2.397 billion in 2019-2020 using the federal oil price projection. Interest expense by 2019-2020 would be \$201 million higher than the interest costs projected by the Alberta budget over the three years associated with the extra \$4.3 billion in accumulated deficits. The interest costs borne under the federal projection would be \$67 million annually higher compared to the Alberta budget projection of \$1.83 billion.

If oil prices are more consistent with future prices traded at the Chicago Market Exchange (the high-risk scenario), accumulated deficits will total \$38.9 billion over the next three years, which is \$11.7 billion more than Alberta's projection or \$2,791 for each Albertan. The additional interest cost would be \$167 million annually.

The scale of Alberta's fiscal problem consists of its continued high spending, resulting in significant deficits, escalating debt and higher interest costs. However, there are policy decisions available to the government that could affect its level of spending, the size of its deficits, the growth of debt and interest.

Policy Choices:

The 2017-2018 budget forecasts deficits of \$10.3 billion in 2017-2018, \$9.7 billion in 2018-2019 and \$7.2 billion in 2019-2020 (Government of Alberta Budget, 2017d, 109); however, policy decisions can have a significant impact on these numbers.

A. REDUCING GOVERNMENT SPENDING TO THE AVERAGE SPENDING LEVEL OF COMPARABLE PROVINCES.

Despite Alberta's significant deficits and rising debt, the government proposes to increase spending by 2.2 per cent in 2017-2018 and 2.7 per cent in 2018-2019, which would mean that spending would increase by almost five per cent the next two years (Government of Alberta Budget, 2017e, 18-19). The proposed spending reductions – \$300 million between 2017-2018 and 2019-2020 – are very modest restraint measures with an operating budget of \$45.8 billion (Government of Alberta Budget, 2017f, 7).

Is the Alberta government justified in increasing spending at the proposed levels? To answer the question, it is important to compare Alberta's spending to the spending of Canada's largest provinces, which are comparable since they have populations large enough that there are no concerns about economies of scale in the provision of government goods and services. Table 4 below compares per capita operating spending in British Columbia, Alberta, Ontario and Quebec.

The average spending level of the three other large provinces is \$9233 per capita in 2017-18 compared to Alberta's \$12,409 per capita. Thus, every year Alberta spends \$3175 per capita more than the average per capita spending of comparable provinces. Thus, if Alberta were to develop a plan to bring its per capita spending to levels half closer to the average of comparable provinces, it could eventually reduce its spending by \$6.6 billion annually.

TABLE 4 PER CAPITA SPENDING (IN NOMINAL DOLLARS) BY MAJOR PROVINCES IN CANADA (BASED ON RECENT 2017 BUDGET)

	Alberta	British Columbia	Ontario	Quebec
2017-2018	12,409	9,887	9,163	8,651
2018-2019	12,555	9,856	9,254	8,872
2019-2020	12,580	9,893	9,390	n.a.

Source: RBC Economic Research (2017).

Some policy decisions that could be implemented to reduce the deficit result from the fact that relative to other provinces, Alberta has been a big spender and public sector salary increases have been higher than elsewhere. Indeed, in the past a common complaint of other provinces has been that Alberta public sector salary levels make it difficult for other provinces to compete. The high levels of government spending and high public sector salary settlements have helped put Alberta into deficit, but reducing both can help Alberta move out of deficit.

B. INFRASTRUCTURE SPENDING COULD BE MORE MODERATE.

As mentioned above, operating spending does not include all of capital spending. While it was argued that infrastructure spending was too little in Alberta in the past, the comparison was based on public spending as a share of GDP, where the latter includes the rents from the resource industries, which are exceptionally high in Alberta, thereby over-estimating the supposed shortfall (McMillan, 2015).

Infrastructure spending should be based on demands and population size – it is far from clear that Alberta needs to spend far more per capita on infrastructure compared to other major provinces, which have similar, if not older, infrastructure (Table 6). Alberta has had a fast growing population in the past, which creates demand for infrastructure, although it has recently slowed. However, on a per capita basis, public infrastructure spending has been much higher than in other provinces. On a per capita basis, public infrastructure spending in Alberta by all levels of government was substantially higher than in British Columbia, Ontario and Quebec (Table 5) from 2010-2015.

TABLE 5 ALL GOVERNMENT SPENDING ON INFRASTRUCTURE PER PERSON IN SELECTED PROVINCES, 2010-2015 (CHAINED, 2007 DOLLARS)

	Quebec	Ontario	Alberta	British Columbia
2010	1,957	2,236	2,910	1,844
2011	1,915	1,946	2,756	1,448
2012	1,818	1,825	2,733	1,602
2013	1,711	1,721	2,499	1,443
2014	1,511	1,702	2,130	1,502
2015	1,564	1,697	2,482	1,539

Source: Calculations from Statistics Canada, CANSIM Table 310005.

TABLE 6 AVERAGE AGE IN YEARS OF PUBLIC INFRASTRUCTURE BY PROVINCE AND TYPE OF INFRASTRUCTURE

	Highways and roads	Bridges and overpasses	Water supply	Wastewater treatment	Sewer systems	Total
Quebec	15.2	31	18.5	19.1	18.1	17.2
Ontario	13.9	24.1	13.1	16.9	18.3	15.4
Alberta	14.4	23	14	17.7	16.3	15.6
British Columbia	15.8	23	11.4	17.2	16.9	16.3

Source: From Mychele Gagnon, Valerie Gaudreault and Donald Overton, "Age of Public Infrastructure:

A Provincial Perspective," Analytical Paper, Statistics Canada (2008), p. 26, Table 1.

TABLE 7 CAPITAL SPENDING PER CAPITA (IN NOMINAL DOLLARS) BY MAJOR PROVINCES IN CANADA (BASED ON THE RECENT 2017 BUDGET)

Year	Alberta	British Columbia	Ontario	Quebec
2017-2018	1,918	2,022	1,450	1,153
2018-2019	1,658	1,890	1,250	1,201
2019-2020	1,728	1,851	1,379	1,201

Note: Alberta capital plan excludes self-financed capital plan by the school, university, college and hospital sector (SUCH sector).

- a. For Ontario, 2017-2018 figures are from the Ontario Budget 2017-2018, for 2018-2019 and 2019-2020 from the Ministry of Infrastructure Update
- b. Data for Quebec are from the Budget 2017-2018
- c. Data for B.C. are from the Budget 2017-2018

Source: Budget 2017, various provinces.

Provinces, however, can differ in their allocation of infrastructure spending among the three levels of government. Focusing only on the provincial expenditure on capital in the upcoming three years (that excludes the SUCH sector), Alberta will be spending more per capita than the other three provinces except British Columbia (Table 7). If Alberta were to spend the same infrastructure per capita as the average of the three provinces, the savings in capital spending would be \$4.6 billion over three years, thereby reducing debt-financing requirements.

C. PUBLIC SECTOR COMPENSATION COULD BE MORE STRONGLY RESTRAINED TO REDUCE DEFICITS

Public sector compensation constitutes 55.8 per cent of operating spending and is the single biggest government expense. In 2017-2018 the government will spend \$26.1 billion on public sector compensation, including teachers, doctors and nurses (Government of Alberta, 2017g, 21). Thus, whether public sector compensation increases, stays flat or decreases will have a major impact on the scale of Alberta's fiscal problem. Other provinces facing fiscal challenges provide examples of how restraint in public sector compensation can be achieved and the significant fiscal benefits of doing so.

The Alberta government has already acted to restrain the salaries of non-union employees by freezing the salaries of senior officials, managers and other out-of-scope workers at 2015 levels until 2018 (*Edmonton Journal*, 2016). It has also reviewed compensation in agencies, boards and commissions to make it consistent with the broader public service (Government of Alberta, 2017h, 23). The government has also restrained compensation increases for doctors, a topic that will be addressed later in this paper. However, most public sector workers are unionized, and an unprecedented number of contracts have expired or are set to expire within the next year. If the government were willing to impose salary settlements on other employees, why would it not expect similar salary restraint from its unionized employees?

Relative to other comparable provinces, public sector salaries in Alberta are relatively high. As shown in Table 8, wages per employee are higher in Alberta compared to Quebec and British Columbia, leaving aside pension and other benefits. While the estimated weekly wage earnings are based on total compensation per employee rather than per working hour, Table 8 indicates that Alberta provides higher compensation than the three other largest provinces in Canada.¹ Alberta could have saved around \$2.1 billion in 2016, if public sector salary levels were the same as the average of the three biggest provinces (British Columbia, Ontario and Quebec).

It is often argued that Alberta compensation is relatively high due to income paid to skilled workers in the province, thereby pushing up salaries in Alberta. However, competition for teachers, health workers and public administration is most influenced by demands for public sector workers

by federal and provincial governments. When Alberta salaries are above levels found in other provinces, it creates pressures on other provinces to raise public salaries to keep their best workers.

TABLE 8 PUBLIC SECTOR EMPLOYMENT AND COMPENSATION IN 2016

Public Sector	Quebec	Ontario	Alberta	British Columbia
Public Sector Employment ('000s)	899	1,430	418	486
Average Weekly Earnings				
Educational services	\$940	\$1,066	\$1,063	\$981
Health care and social assistance	\$812	\$891	\$944	\$850
Public administration	\$1,119	\$1,285	\$1,345	\$1,239
Public Sector Employee Average Weekly Earnings*	\$957	\$1,081	\$1,117	\$1,023

Note:

- i. Public sector employment includes people employed in educational services, health care and social assistance, provincial and territorial public administration and local, municipal and regional public administration.
- ii. Average weekly earnings data are based on gross payroll before deductions. *Average earnings for public sector employees are the average wages earned by employees in educational services, health care and social assistance and public administration (based on NAICS code). Benefits are not included.

Source: Authors' calculations based on Statistics Canada, CANSIM 18302-00.

Alberta Finance Minister Joe Ceci stated regarding unionized employees: "I don't want to presuppose what will happen at those bargaining tables because that's really for those tables."² By taking the position that bargaining or public arbitration should determine public sector salary levels for unionized employees, Ceci is making a decision that could be costly for taxpayers. Other provinces, like Nova Scotia and Manitoba, have shown fiscal leadership by establishing processes limiting the compensation of all public sector employees.

A common misconception is that governments can only reduce public sector salaries of unionized employees if the unions agree. The misconception stems from a landmark Supreme Court of Canada decision in 2007 in which the court ruled that section 2(d) of the *Charter of Rights and Freedoms*, which guarantees freedom of association, protects collective bargaining rights (SCC, 2007, 27).

The 2007 ruling resulted from specific facts that are important to understanding the decision's limitations. The case involved Bill 2, legislation passed by the British Columbia government to address sustainability issues in the health sector that overturned several provisions of an existing agreement, and was introduced and passed by the legislature in just three days. The Supreme Court decision focused on the process: by rushing the legislation through and failing to consult with the unions, the government interfered with the collective bargaining process (Fudge, 2008, 25-48).

A 2015 Supreme Court ruling revealed the limitations of the 2007 decision, in a case where the federal government rolled back previously agreed-to wages for the RCMP. In this case, the Court dismissed the appeal and concluded that the wage rollback was not an infringement of collective bargaining (SCR, 2015a).

Canadian governments can establish and impose salary settlements on unionized employees, but they have to show respect for the collective bargaining process. Legislation recently introduced in Manitoba outlines the process. The legislation explains the need for restraint: public sector compensation must "reflect the fiscal situation of the province, [be] consistent with the principles of responsible fiscal management, and protect the sustainability of public services" (SCR, 2015b, 1). The legislation also commits to respecting collective bargaining. Then, it establishes a framework that specifies the public sector salary levels for each year over the next four years. The legislative mandate applies to all provincial employees, including employees of government and government agencies, health organizations, school districts and post-secondary institutions.

In 2015, Nova Scotia introduced similar legislation and when negotiations with the teachers broke down and there was a strike, the government passed legislation that imposed the mandated salary levels on the teachers (Government of Nova Scotia, 2015 and 2017).

If Alberta were to follow this process, then, the government would have to consult with the unions about the fiscal situation, pass legislation establishing a bargaining mandate and continue to bargain collectively. In establishing the appropriate mandate, factors that should be considered include: the high level of Alberta public sector salaries, the dramatic drop in government revenue and the fact that since 2015 thousands of Albertans in the private sector have lost their jobs or had their compensation reduced. A reasonable mandate might be: minus two per cent in year 1, zero in year 2 and zero in year 3.

The goal would be to reach a negotiated settlement; however, the legislative mandate would prevail if the issue went to arbitration. That is, arbitrators could not award higher settlements. Such a mandate would result in savings of two per cent on the \$26.1 billion cost of public sector compensation, an annual savings of \$510 million.

If, however, the Alberta government continues with its current approach of allowing the salary settlement to be decided at the bargaining tables, without establishing a legislative framework for the final settlement, it will be exposing the province to a major financial risk. A settlement might be reached that is above zero, which will increase the deficit since no salary increases are built into the budget. Alternatively, as is often the case, the issue might be sent to arbitration, where ability to pay is not a factor in the settlement awarded. A settlement consistent with the Alberta Consumer Price Index might well be the result. The Alberta budget pegs the Consumer Price Index at 1.9 per cent in 2017-2018 and two per cent for the next two years. Hence, the province could see the costs of public sector compensation increase by two per cent a year for three years or a six per cent increase over three years. A six per cent increase in the public sector compensation cost of \$26.1 billion would increase the deficit and debt by \$1.5 billion.

The government's handling of public sector bargaining will be a major factor in the province's fiscal future. Reducing public sector compensation would be a difficult decision for the government, but it would help to trim the deficit. Alternatively, increasing public sector salaries will add to an already sizeable deficit.³

D. REDUCING SPENDING BY RESTRUCTURING AND REFORMING PROGRAMS

There are other ways to reduce spending beyond restraining increases in public sector compensation. When the issue of its ongoing spending is raised, the Alberta government portrays its fiscal choices as either cutting spending that will negatively affect basic services or increasing spending and protecting services. In fact, there is another and better option: restructuring programs and the way services are delivered to get more value for the tax dollars spent. Other provinces provide better services at a lower cost and Alberta should learn from these jurisdictions.

Take the example of health care. Relative to the other three major Canadian provinces, Alberta spends significantly more per capita on health care.

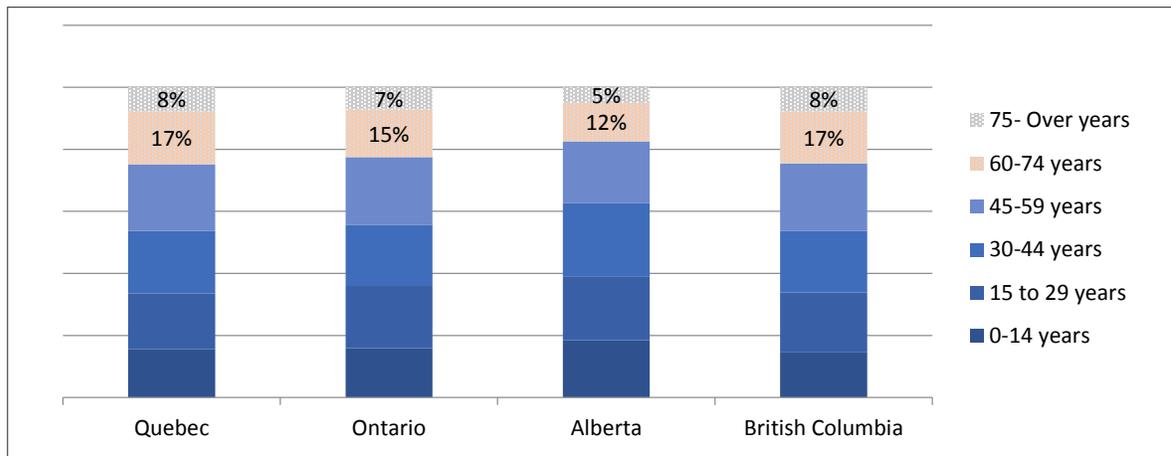
Health-Care Spending Per Capita:

- Alberta: \$6,995
- British Columbia: \$6,214
- Ontario: \$6,144
- Quebec: \$5,882⁴

Alberta spends \$6,995 per capita on health care, which is \$915 more than the average of the other three large provinces. What this means is that each year Alberta spends \$3.8 billion more than the average of Ontario, British Columbia and Quebec on health care.

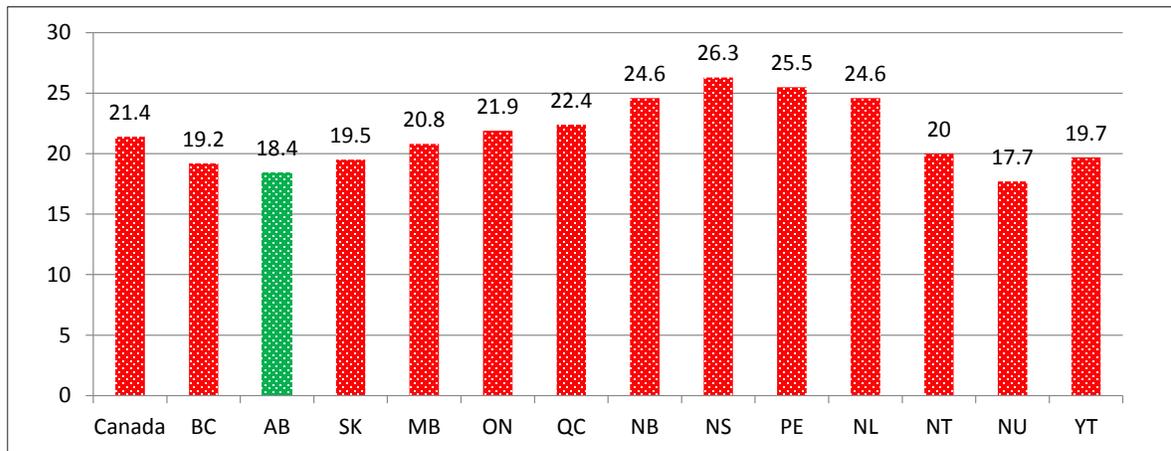
Are there reasons why Alberta's health-care costs should be higher than other provinces? In fact, the opposite is true. An older population is one factor that increases health-care costs. Relative to comparator provinces, Alberta has a younger population and the smallest share of individuals over 60 (see Figure 1). The median age in Alberta in 2016 was 36.6 years. As illustrated in Figure 2, moreover, relative to other provinces Alberta has a healthier population, measured by the prevalence of key chronic illnesses.

FIGURE 1 SHARE OF 60 AND OLDER IN ALBERTA POPULATION



Source: Statistics Canada (2017).

FIGURE 2 PREVALENCE OF CHRONIC DISEASES ACROSS PROVINCES IN CANADA



Note: Percentage of population (age 20+) with at least one major chronic disease (cancer, diabetes, cardiovascular diseases, chronic respiratory diseases).

Source: Canadian Chronic Disease Surveillance System.

Thus, if anything, Alberta's health-care costs should be lower, not higher, than provinces like British Columbia.

Albertans spend more tax dollars on health care, but are they getting better outcomes? Again, the opposite is true. A Conference Board of Canada study compared the health outcomes of Canada's provinces and territories and 15 peer countries. The best Canadian health-care system was British Columbia's, which ranked third, behind only Switzerland and Sweden. Alberta ranked 13th, even though it spends \$781 more per capita than British Columbia (Conference Board of Canada, 2015).

What about wait times for care? How long do Albertans wait relative to other Canadians from referral from a general practitioner to receipt of treatment? In 2016 Albertans waited 22.9 weeks for treatment, above the Canadian average of 20 weeks. In contrast, in Ontario, which spends less per capita on health care, the wait is only 15.6 weeks, (Saskatchewan is close behind at 16.6 weeks) (Barua and Ren, 2016).

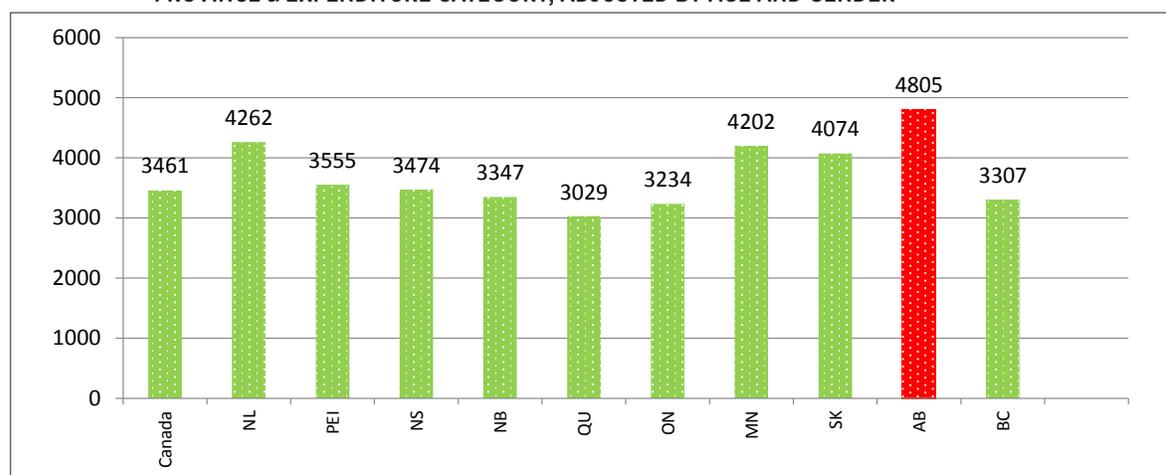
In short, provinces like Ontario and British Columbia spend less on health care, even though their populations are older and less healthy, but they have better outcomes.

Despite its already high levels of spending on health care and the fact that health consumes more than 40 per cent of the Alberta budget, the 2017-2018 budget increases health spending by five per cent over the 2016-2017 spending level. Rather than merely increasing spending, the Alberta government should consider what provinces like Ontario and British Columbia have done to make their health-care systems more effective and affordable.

While the Alberta government has taken some steps to improve health care (Alberta Health, 2016a) the changes made in British Columbia and Ontario have been much more comprehensive (British Columbia Health, 2014a; McGrail and Evans, 2015a, 271-296; Ontario Health, 2012a). Both provinces focused on efficiency and effectiveness and used outcomes to determine health-care funding decisions. For example, British Columbia used the Lean process improvements to make its system more efficient and linked staff performance reviews to success in achieving the stated goals. The provinces also linked hospital funding to outcomes -- better patient care and reduced wait times -- and to activities performed (British Columbia Health, 2014b; Deber and Allin, 2012; McGrail and Evans, 2015b, 271-296; Ontario Health, 2012b).

Hospitals are the biggest expense in health care and the most expensive place to treat patients: one study compared the average daily cost of a hospital bed (\$842), with the daily cost of a long-term care bed (\$126) and home care (\$42) (CLHIA, 2012, 4). Also, patients are exposed to the risk of infections in hospitals and often patients with specific conditions can be more appropriately cared for elsewhere. Both British Columbia and Ontario introduced reforms to provide high levels of care in the community, so that patients did not have to go to hospitals. For example, in British Columbia primary and community care were integrated and programs and services targeted to specific groups, such as the frail elderly or those with chronic conditions, with the goal of “keeping people out of acute care and long-term facility-based care” (McGrail and Evans, 2015c, 284). As a result, as shown in Figure 3, British Columbia and Ontario spend significantly less on hospitals than Alberta, whose per capita spending on hospitals is the highest in Canada.

FIGURE 3 CURRENT PROVINCIAL GOVERNMENT HEALTH-CARE EXPENDITURE PER ADJUSTED CAPITA 2015, BY PROVINCE & EXPENDITURE CATEGORY, ADJUSTED BY AGE AND GENDER



Source: Alberta Health Services (2016).

While the Alberta government has taken some steps to shift care from hospitals to community and home care and to reduce hospital stays, the measures fall well short of the actions taken by British Columbia and particularly Ontario. Reducing hospital use means having a high quality primary care system where people can access care easily, quickly and in an integrated way. As Table 9 shows, Alberta scores very poorly on these metrics:

TABLE 9 RESIDENTS' OPINIONS ON ACCESS TO PRIMARY CARE IN MAJOR PROVINCES (PERCENTAGE OF RESPONDENTS, 2013-2014)

	Have a Regular Doctor	Same/Next Day Appointment	Ease in Finding After-Hour Care	Same-Day Answer to Phone Call
Quebec	75%	40%	32%	75%
Ontario	91%	42%	42%	65%
Alberta	80%	36%	33%	58%
British Columbia	85%	46%	44%	67%

Source: Government of Alberta (2016).

Relative to comparator provinces, Alberta ranks last or second to last in access to primary care as measured by key indicators (having a regular doctor, same/next day appointment, ease of finding after-hours care and same-day answers to phone calls).

As depicted in Table 10, among the comparator provinces Alberta was ranked middle of the pack or worse across five of the six care co-ordination metrics. If patients cannot easily access health-care services in the community, then more of them end up in costly emergency rooms or their conditions deteriorate and they have to be hospitalized.

TABLE 10 RESIDENTS' OPINION ON CARE CO-ORDINATION METRICS IN MAJOR PROVINCES (PERCENTAGE OF RESPONDENTS, 2013-2014)

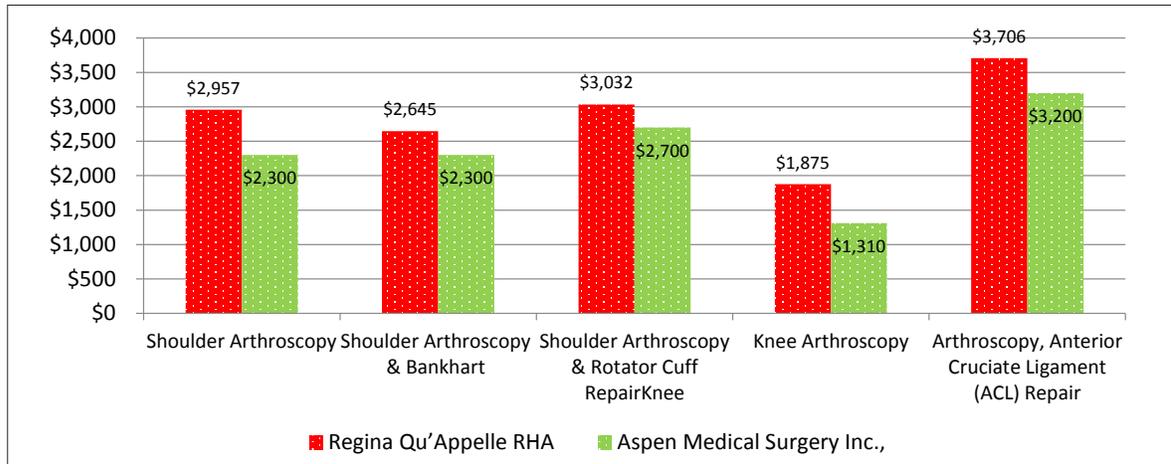
Co-ordination Metrics	Quebec	Ontario	Alberta	British Columbia
No Conflicting Information from Different Doctors	91%	82%	80%	84%
Access to Medical Test Results	49%	33%	32%	44%
Doctors Informed about Visit to Emergency Department	48%	68%	66%	63%
Doctors Seem Knowledgeable about Medical History	61%	62%	54%	57%
Doctor Spending Enough Time with Patients	49%	54%	54%	57%
Doctors Sharing in Decision-Making With Patients	50%	64%	60%	63%

Source: Government of Alberta (2016).

There are also day procedures that do not have to be performed in expensive hospitals, but can be delivered effectively in clinics that specialize in specific procedures. Whether or not private clinics can be used to reduce costs depends on good contract negotiations by the purchaser. A recent study of the use of private clinics by previous Alberta governments pointed out the shortcomings of the process for choosing and funding private clinics. For instance, political interference has been a problem. When private companies failed to win a government tender process, they publicly challenged the results; the minister of health intervened and the losing tenderers were also given contracts (Duckett, 2014, 316-318).

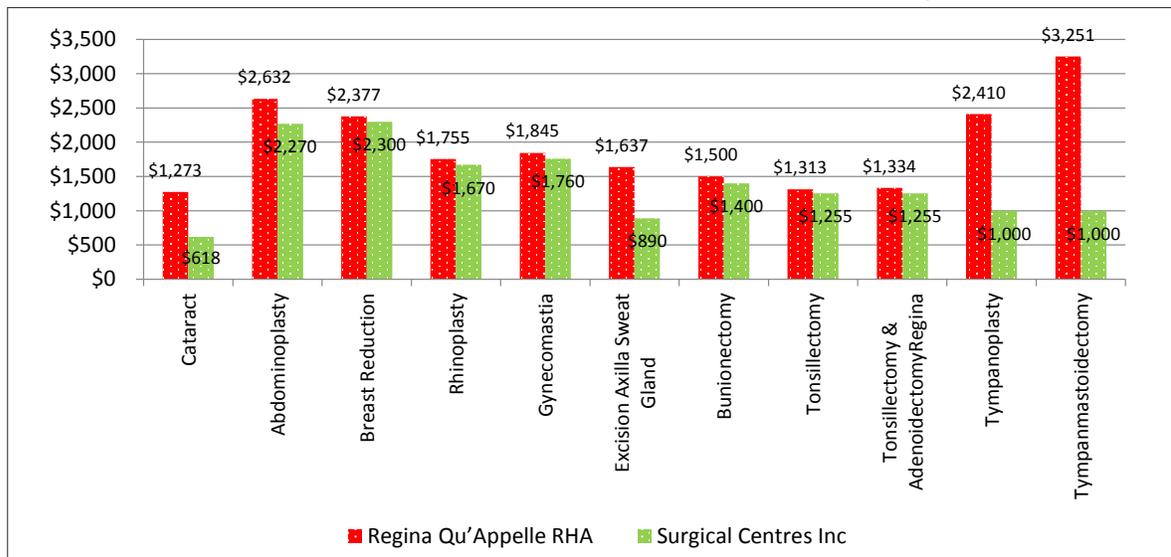
In 2010, the Saskatchewan government moved 34 day procedures from hospitals to private clinics, as part of its strategy to reduce wait times. The government was transparent about the process for choosing the companies, the costing process, the principles and standards that would be applied and the importance of complying with the Canada Health Act. As shown in Figures 4, 5, 6 and 7, performing the 34 procedures in the clinics was 26 per cent less expensive than performing them in hospitals.

FIGURE 4 COST PER CASE AT REGINA QU'APPELLE RHA AND ASPEN MEDICAL SURGERY INC., 2012



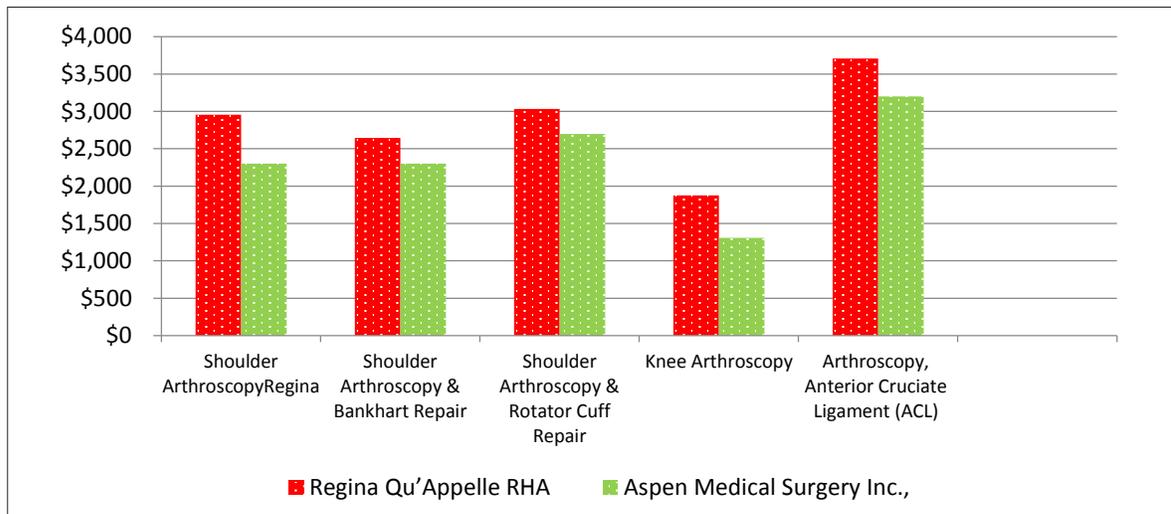
Source: Janice MacKinnon, "Health Care Reform From the Cradle of Medicare," Macdonald-Laurier Institute Publication, Ottawa, (January 2013): 9-10.

FIGURE 5 COST PER CASE AT REGINA QU'APPELLE RHA AND SURGICAL CENTRES INC., 2012



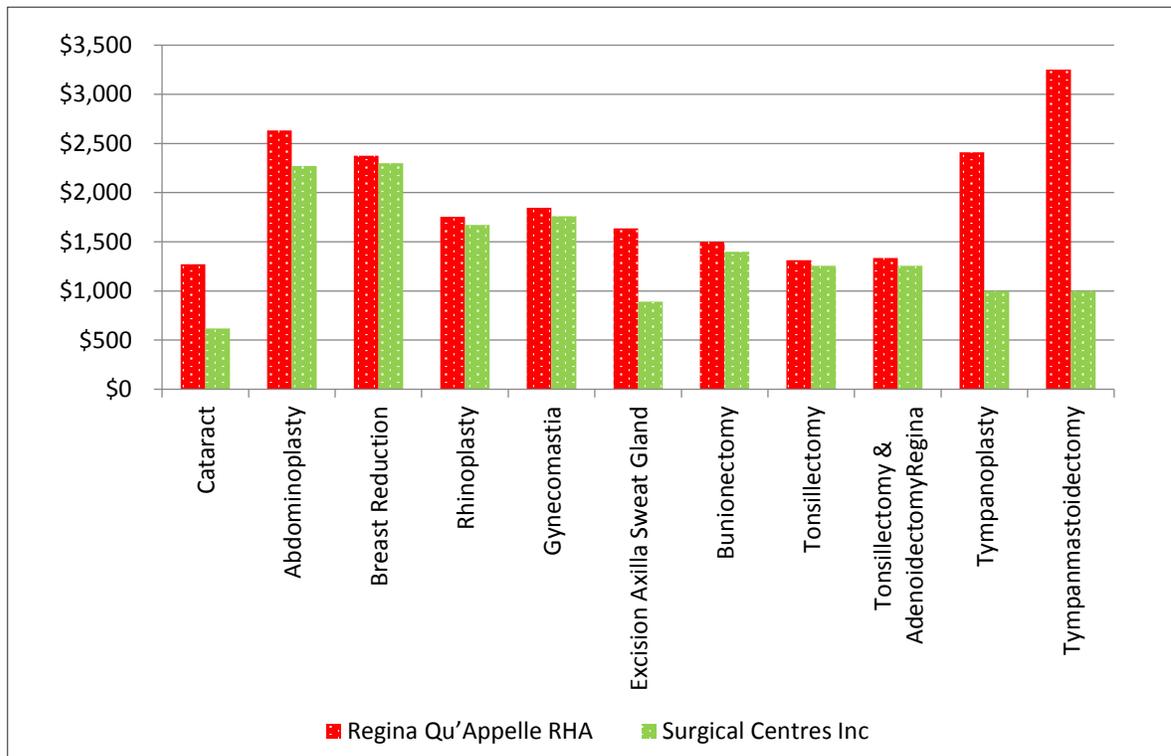
Source: Janice MacKinnon, "Health Care Reform From the Cradle of Medicare," Macdonald-Laurier Institute Publication, Ottawa, (January 2013): 9-10.

FIGURE 6 COST PER CASE AT REGINA QU'APPELLE RHA AND ASPEN MEDICAL SURGERY INC., 2012



Source: Janice MacKinnon, "Health Care Reform From the Cradle of Medicare," Macdonald-Laurier Institute Publication, Ottawa, (January 2013): 9-10.

FIGURE 7 COST PER CASE AT REGINA QU'APPELLE RHA AND SURGICAL CENTRES INC., 2012



Source: Janice MacKinnon, "Health Care Reform From the Cradle of Medicare," Macdonald-Laurier Institute Publication, Ottawa, (January 2013): 9-10.

Another major health-care cost is physicians' salaries (Grant and Hurley, 2013). Alberta's physicians' salaries are 23 per cent higher than in comparable provinces (KPMG, 2016, 11). The Alberta government recently signed an agreement with physicians to moderate cost increases and reform service delivery (Alberta Health, 2016b). However, other provinces have made more progress in implementing alternatives to the fee-for-service compensation model (Table 11). Alberta has done the least of all provinces to reform its compensation model. Alternative compensation platforms in care have been on the rise since 1999-2000 but adoption in Alberta has been the lowest.

TABLE 11 ALTERNATIVE PAYMENT PLANS (APP) AS A PERCENTAGE OF ALL CLINICAL PAYMENTS

	2004-2005	2013-14
Quebec	23.7%	22.89%
Ontario	16.73%	36.80%
Alberta	10.77%	13.87%
British Columbia	16.73%	18.77%

Source: KPMG

Another way to reduce health-care compensation costs is to allow other professionals like nurse practitioners to perform services previously reserved for physicians and to have less costly health-care professionals, like licensed practical nurses (LPN), perform some duties currently assigned to registered nurses. While Alberta has more highly paid doctors and nurses than comparable provinces, it has fewer LPNs (Alberta Health Services, 2016, 4).

The Alberta government could also reduce health-care costs by improving procurement policies for purchasing services for clinics' drugs and medical supplies. The auctioning system plays an important role in determining these overall costs. For example, Alberta introduced a new approach for procuring cataract operation services by a competitive auction with a global service fee, which would result in cost savings. It was withdrawn even though the existing system did not minimize costs (Dranove, Capps and Dafny, 2009). Working with other provinces such as Ontario, Quebec and British Columbia, greater negotiation power could be exerted to reduce drug prices in Alberta. These are just some examples as to the possible opportunities for ways health costs could be reduced without affecting frontline services.

Thus, as Canada's biggest spending province, Alberta has lots of scope to reduce spending by restraining salary settlements and restructuring other services like health care to get more value from tax dollars being spent. When other provinces are delivering better services for less money, then the case for reforming the ways services are delivered and programs managed more effectively is compelling.

ECONOMIC GROWTH AND TAXATION

Another way to reduce deficits is to promote economic growth, thereby enhancing government revenue. Growing the economy depends on specific growth-oriented measures like the right tax mix, but also on creating a positive environment for investment.

In the 1990s, the Saskatchewan NDP government of former premier Roy Romanow relied on economic growth as one prong of its strategy to balance the budget. As an NDP government, it was important to create the right climate for business investment. The government's economic development plan involved establishing a competitive tax regime, reducing red tape, providing an educated, skilled workforce and appropriate infrastructure, and establishing several public-private partnerships. Traditional NDP policy supported raising taxes on business and high-income earners in the name of tax fairness. However, raising corporate and personal income taxes discouraged investment and economic development. Hence, to achieve its goal to promote economic growth, the government lowered business taxes and royalties and reduced income taxes for high-income earners. In 1995, when the government balanced its budget, economic growth was a significant factor in enhancing government revenue (MacKinnon, 2003, 75-79).

In contrast, the Alberta NDP has raised taxes for larger businesses and high-income earners, increased environmental and other regulations, imposed a carbon tax, significantly increased the minimum wage and has run large deficits, raising the prospect of future tax increases to balance the budget. Taken as a package, the message to potential investors is that doing business in Alberta

is becoming more difficult and more expensive. Hence, changing some of these measures and creating a more positive investment climate would promote more economic growth and enhance government revenue.

Besides curtailing spending increases including labour compensation, taxation could also be considered as an opportunity to reduce the deficit. The common view is to increase taxes to help close the gap – and there is some logic to increasing those taxes that do little harm to the economy in terms of economic growth and competitiveness. However, tax reform creates an opportunity for the economy to grow if levies, most harmful to the economy, are replaced by less harmful taxes, resulting in better growth.

For each dollar of tax raised, an additional cost is imposed on the economy by discouraging work effort, investment or risk-taking. This economic cost is the “dead-weight loss” of taxation and is indicative of the loss in the value of consumption or production resulting from tax distortions. Adding this dead-weight loss to the cost of raising a dollar of taxes is referred to as the marginal cost of taxation. Additionally, if administrative and compliance costs were added to the marginal cost of taxation, which are more difficult to measure, the overall cost is even higher. Thus, the cost of taxation is not just one dollar being raised but also the economic and administrative/compliance costs associated with each dollar of tax revenue.

Economists have come to similar qualitative conclusions. The highest marginal cost of taxation is associated with corporate taxation, stamp duties and real estate transfer taxes (Alberta has a very small land transfer tax, which is more like a registration fee), followed by personal income taxes and payroll taxes. Consumption taxes tend to have the lowest marginal cost of taxation. A reduction in business taxes offset by a rise in consumption taxes would improve the economy. The best-known work is by Bev Dahlby (2012) who has estimated the marginal cost of funds for Canada and individual provinces. The Alberta results are quite striking. The marginal cost of taxation is \$81.61 for corporate taxation, \$1.44 for personal income taxes and one dollar for an Alberta HST. Bazel and Mintz (2013) show that an eight per cent Alberta GST rate coupled with \$8 billion reductions in personal and corporate income taxes could maintain revenues and be distributional-neutral as well as reduce both economic and compliance/administrative costs. Overall, the Alberta economy would grow faster, leading to a reduction in deficits. Dahlby and Ferde (2012, 563-94) show that a one-point reduction in the corporate income tax rate would increase the GDP annual growth rate by 0.1 to 0.2 percentage points, which would have a dramatic impact over time on per capita incomes and help close the deficit as a result.

Alberta’s tax treatment of investments in manufacturing industries is particularly unfavourable in Canada – it has no tax advantage at all, as shown in Table 12. While the province has tried to push for diversification, it has an upward battle with a business tax structure that discriminates against some service industries and is uncompetitive in manufacturing within Canada, never mind other countries (Bazel and Mintz, 2016).

TABLE 12 EFFECTIVE TAX RATES ON NEW INVESTMENT BY PROVINCE AND INDUSTRY 2017.

2017	Agriculture	Forestry	Electrical Power, Gas & Water	Construction	Manufacturing	Wholesale Trade	Retail Trade	Transportation and Storage	Communications	Other services	Aggregate
Canada**	18.0%	15.3%	18.9%	23.7%	15.8%	23.5%	24.2%	17.9%	22.4%	24.7%	20.3%
Newfoundland	12.2%	-4.8%	18.5%	24.9%	-6.0%	25.3%	25.5%	17.1%	21.3%	23.7%	11.4%
Prince Edward Island	1.6%	-23.1%	19.2%	25.8%	-36.7%	26.4%	26.5%	21.4%	21.4%	26.4%	13.9%
Nova Scotia	13.3%	3.1%	19.2%	25.8%	2.1%	26.2%	26.5%	18.0%	22.2%	24.8%	18.7%
New Brunswick	3.5%	-6.5%	17.7%	24.0%	-6.3%	24.4%	24.6%	17.9%	20.5%	22.9%	12.9%
Quebec	16.9%	12.6%	16.2%	22.1%	14.5%	22.6%	22.8%	15.2%	18.9%	23.2%	18.2%
Ontario	16.7%	15.6%	15.8%	21.7%	17.1%	21.9%	22.4%	15.8%	18.6%	22.1%	19.0%
Manitoba	23.5%	12.1%	29.0%	30.5%	11.3%	28.6%	29.4%	25.1%	34.6%	35.6%	26.1%
Saskatchewan	22.1%	17.9%	26.9%	28.5%	19.0%	28.7%	28.3%	21.6%	34.3%	32.4%	24.2%
Alberta	17.2%	17.1%	16.3%	22.2%	20.0%	22.6%	22.8%	14.9%	19.0%	21.6%	19.1%
British Columbia	22.1%	22.9%	27.6%	29.5%	22.8%	27.9%	28.6%	23.1%	34.5%	33.0%	27.7%

Source: School of Public Policy, University of Calgary.

Alberta's corporate income tax rate of 12 per cent is higher than Saskatchewan, Ontario and Quebec, encouraging companies to shift profits to other provinces (and internationally). Alberta taxes capital investments more heavily than Quebec and the four Atlantic Provinces (the latter due to the federal Atlantic Investment Tax Credit) and similar to Ontario, the latter having a much larger market and labour pool. Alberta's more favourable taxation of capital compared to other western provinces results from retail sales taxes on capital purchases in British Columbia, Saskatchewan and Manitoba. Oil and gas investments in Alberta are more heavily taxed than in other provinces, except for Saskatchewan (Crisan and Mintz, 2017).

When deficits are large, as in Alberta's case, tax reductions are less affordable. However, tax reform is possible. The current carbon tax levy has resulted in a significant new source of revenue that is being used to provide subsidies and a demogrant to low- and middle-income households. A small-business corporate tax cut of two points is also funded, which has less impact on growth since growing small businesses could eventually be facing higher taxes once they become profitable enough.

Overall, tax increases for business in Alberta have risen in recent years. The effective tax rate on medium and large businesses in manufacturing and services has increased from 17.0 in 2014 to 19.1 per cent today due to a higher Alberta corporate tax rate by two points. Carbon levies have also increased business costs. For example, in the forest sector, non-labour costs have risen 2.8 per cent or 16 per cent of gross profit margins (Venkatachalam and Mintz, 2017).

A tax reform could therefore have significant impacts on growth opportunities for the province. Some of the expected carbon levies (\$1.9 billion in 2018-2019) could have been used to reduce corporate income tax rates instead of providing subsidies. Personal income tax rates for lower middle-income classes could have been reduced to encourage work and saving rather than a demogrant that had little behavioural impact.⁵

To the extent that taxes are increased to reduce the deficit, it is obvious that the best choice is one that does the least harm to growth. That again is consumption taxation. The carbon tax is partly a tax on consumption but it is also a tax on business hiring and investment by raising energy prices and overall business costs.

Similar to taxation, regulations are another cost imposed on businesses and households that should be carefully reviewed. Regulations such as those related to safety and environmental degradation provide important benefits even though they might have associated costs. However, some regulations can be very expensive in achieving objectives, including unintended consequences. For

example, the Ecofiscal Commission (2017) has identified several carbon-related policies such as ethanol requirements in gasoline, subsidies for electric vehicles and possibly renewable standards as having a relatively high implicit carbon price compared to other potential policies. Other policies, including minimum wage hikes, higher property taxes and new labour regulations affect business competitiveness with few other policies to compensate for higher business costs.

Thus, in the short and medium term, policies could be adopted that would not compromise public services but would significantly narrow the gap between Alberta spending and revenue. The government should also establish a fiscal plan – with specific deficit targets for each year – to balance the budget over the longer term. Such a plan would impose fiscal discipline on the government since it would be accountable to the public for meeting its yearly deficit targets and it would signal the importance of returning to a balanced budget.

CONCLUSIONS

Alberta's fiscal picture is considerably worse compared to budget forecasts if oil prices are expected to be lower than projected by the 2017 Alberta budget. A medium-risk scenario is for deficits to be \$4.3 billion more over the next three years if the federal budget price forecasts were used (medium risk). It would increase by \$11.7 billion if future WTI oil prices as traded through the Chicago Mercantile Exchange were used for the next three years (high-risk scenario).

We argue that greater effort must be made to reduce Alberta's public deficits without compromising frontline services for the public. Otherwise, provincial debt, relatively low at this point, will reach levels that will leave a large mortgage to future taxpayers as well as a growing interest expense that will need to be funded by taxes. A reduction in deficits could be achieved by:

- Reducing compensation increases for all workers, not just non-unionized public employees, for a potential savings of \$1.5 billion over three years;
- An infrastructure plan more consistent with other provinces such as British Columbia, Ontario and Quebec, providing savings of \$4.6 billion over three years;
- Reform of public services to deliver programs and services more efficiently and to reduce administrative and procurement costs, and to reduce public spending per capita in Alberta to levels similar to other large provinces, eventually yielding \$6.6 billion in annual savings;
- Creating a more positive climate for investment to promote economic growth and enhance government revenue;
- A tax and regulatory reform to improve economic growth. A tax reform would shift from more to less economically damaging taxes and help reduce the deficit through more growth. Carbon levies should be used more to address competitiveness issues by reducing business taxes and deregulation;
- A plan to balance the budget over the long term with specific deficit targets for each year.

There is no reason why the Alberta government could not take a stronger position to reduce deficits. As the economy begins to repair itself with improved North American and global economic growth, a priority will be to bring revenues more in line with expenses while ensuring that the province can achieve stronger growth, given its challenges to the energy industry. There is no free lunch. Spending constraint and pro-growth tax and regulatory reforms would help repair the fiscal gap between revenues and spending.

ENDNOTES

- ¹ Taking into account gender, age, marital status, education, tenure, occupation and other factors, a recent study suggests that Alberta's public workers earned a 7.9 per cent wage premium over private sector workers in 2015. See C. Lamman, M. Palacios, F. Ren, and J. Clemons, "Comparing Government and Private Sector Compensation in Alberta, 2017," Fraser Institute, Vancouver, British Columbia, 2017. Available at <https://www.fraserinstitute.org/studies/comparing-government-and-private-sector-compensation-in-alberta-2017>. See also K. Boessenkool and B. Eisen, "Public Sector Wage Growth in Alberta," *SPP Research Papers*, 5(1), 2012 that showed that the build-up in public sector salaries in Alberta relative to other provinces is not a new phenomenon.
- ² Ibid.
- ³ It should be noted that in April 2017 an agreement covering the period September 2016 to Aug. 31, 2018 was reached with the teachers that provided for no salary increase (although \$75 million in new funding was provided for a classroom improvement fund); however, the agreement cannot be seen as establishing a template for other collective agreements since the teachers will benefit from any increases negotiated by other public sector unions. Janet French, *Edmonton Journal*, April 27, 2017.
- ⁴ Canadian Institute of Health Information, Health Database, in Alberta Health Services, Physician Services Analysis, KPMG slides, February 2016.
- ⁵ Actually, a demogrant increases a household's personal income, thereby encouraging more leisure (and less work) and more consumption (and less saving). Given the demogrant was an offset for carbon taxes, the overall negative impact of carbon taxes on consumption and saving would be blunted. Nonetheless, personal tax rate reductions would have a stronger impact in encouraging work and saving.

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