The Calgary-based oil patch has been through boom and bust cycles before, with significant impacts on Alberta's fiscal frameworks. *Policy* archives photo

The Prentice Pre-election Budget: A Time of Tough Decisions

Jack M. Mintz

As Alberta Premier Jim Prentice points out in this issue of Policy, Alberta has weathered the cycle of boom-and-bust before. But Prentice is, undeniably, facing some difficult fiscal trade-offs as he also lays the political groundwork for an election. Respected economist Jack Mintz, who has played a more official advisory role on fiscal matters in the past, provides a blueprint for how Prentice can navigate the unexpected economic landscape of $50-a-barrel oil.

In late March, the Prentice government will present its first and critical budget, providing an economic manifesto for the next Alberta election. With a 50 per cent decline in oil prices and a potentially $7 billion deficit, the Alberta government will introduce stark measures including revenue increases, spending cuts and debt financing, none of which is popular. This is, however, the price of governing, as some tough decisions must be made.

Albertans are preparing for a fundamental debate about fiscal planning, culminating in an election that is expected to follow after the budget presentation.

Prentice has been clear that Albertans have expected high quality public services and low taxes. To plug the gap between spending and tax revenues, the province has relied on volatile oil and gas natural resource revenues, resulting in booming surpluses or busting deficits.

Spending has been pro-cyclical, aggravating the macro conditions affecting the province. During downturns, the province cuts spending to make up shortfalls. In the good times, spending ramps up in part to make up for earlier tight budgets.

Politicians afraid to cut spending affecting current voters will let deficits ride for a long time hoping that high oil prices will eventually return, putting Alberta in the black. This happened in the Getty years after 1985, as oil prices collapsed, resulting in the highest deficit and debt per capita in the nation by 1993. Ralph Klein cleaned up the books with major spending cuts to eliminate the deficit by 1995, retiring the debt by 2005.

However, once debt was eliminated, the province no longer had a fiscal anchor for planning purposes. Spending ramped up from $7,400 per capita in 2004-05 to $11,000 per capita by 2013-14, the highest per capita level in Canada except for two small provinces, Saskatchewan ($12,000) and Newfoundland & Labrador ($13,300). Alberta was in surplus despite its spending spree, but putting little into saving accounts.

With the collapse in oil prices in late 2008, it was "déjà vu all over again". The Stelmach government, faced with a yawning deficit, did not cut spending much, instead running down net financial assets from $27 billion in 2009 to $9.7 billion by the end of 2013. Even though Saudi Arabia supported the return of oil prices to $90-$100 per barrel after 2010, the Stelmach and succeeding Redford governments failed to stop financial bleeding.

This roller-coaster approach to fiscal planning could have been avoided if the province had built up a substantial endowment over the years, which would provide stable financing with stable distributions from the fund. Peter Lougheed started the trend with the Alberta Heritage Fund and several other funds for long-term investment. Ralph Klein did not put much money into saving funds but in retiring the provincial debt he did pay off the mortgage, which is just as good as saving. Between 1994 and 2007, 30 per cent of natural resource revenues were devoted to saving or debt reduction.

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Various financial planning commissions were appointed over the years, recommending the same message of fiscal discipline and a commitment towards saving. I chaired a fiscal commission in 2007 that argued the same principles. We suggested the province should put aside a portion of revenues into a saving account before deciding on spending and taxes, which could accumulate to $100 billion by 2030. With a four per cent distribution rule, the province would have $4 billion per year to close the gap between revenues and taxes on a stable footing.

That proposal, made at the height of the boom, was overcome by the 2008 financial crisis. However, the Redford government did make a commitment to savings by dedicating a portion of revenues to a saving account, a little-appreciated but important change in fiscal planning. The Prentice government has so far indicated it would retreat to an earlier approach of saving a portion of the surplus after making spending and tax decisions. However, surpluses disappear if spending ramps up or taxes are reduced. This is not a commitment to saving.

Perhaps Albertans don't wish to leave a Norwegian-style fund in the hands of politicians. Some concern has been raised that the fund would be a target for the federal government to raid but defensive arguments can be easily made.

Canada would gain from less pro-cyclical macro-economic planning in Alberta so that booms are not accompanied by spending spurts and busts aggravated by spending cuts. Alberta also faces significant health and pension unfunded liabilities associated with an aging population as well as natural resource revenues failing to keep up with a growing economy. Other resource-rich provinces should also establish similar funds, a trend set by Alberta.

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Whether the Prentice government will deal successfully with long-term financial planning in the upcoming budget is unclear. With a massive deficit that will continue for several years to come, Alberta has a big short-run problem. Prentice has already signaled a balanced approach with $2 billion in revenue increases, $2 billion in spending cuts and the balance in debt financing, perhaps staged over three years.

However, good planning should consider not just the short-run but

putting in policies that could have beneficial long-run consequences. Spending should emphasize investments in physical and human capital. Tax reform should put more emphasis on taxes less harmful to the economy.

Alberta's health system, accounting for two-fifths of program expenditures, has provided mediocre performance at relatively high cost. Similar to Ontario, Alberta could push for measures that would create more competition in the public-funded system, such as developing further primary care and clinics offering specialized services. The province could reform its purchasing of services by adopting a better auctioning approach to make contracting-out prices more competitive.

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Similarly, education reforms are possible. Alberta's average undergraduate tuition fees for full time students ($5,730 in 2014-15) are one of the lowest in Canada compared to Ontario ($7,539). When students cover a bigger portion of education costs, students demand better teaching. Education efficiencies can be achieved by better use of school buildings over a year.

The largest spending faced by Alberta is employee compensation, including academic, school and health sectors. Although some argument can be made that salaries are generally high in Alberta as in the private sector, Alberta competes in the Canadian market for public servants, doctors and teachers. Studies have shown that compensation levels, somewhat above the rest of Canada about a decade ago, are now well above public sector salaries in other provinces today. Certainly, one can expect Alberta to reduce labour costs that ultimately account for over half the budget.

Meanwhile, infrastructure spending is critical for long-term growth but greater reliance on user fees should be made to improve efficiencies, whether at the provincial or municipal levels. Major highway expansions, including ring roads and the Fort McMurray-Edmonton highway, should be financed by tolls to price congestion as well as achieve a better distribution of the population in an urban area.

And then there are taxes. The province should not just increase revenues but keep in mind long-term growth prospects. With the "flat" tax of 10 percent on personal incomes above $17,500, Alberta has been able to attract skilled labour, making it less necessary to offer high compensation for private or public workers. The corporate income tax at 10 per cent puts Alberta in the middle of the pack of OECD countries in terms of competitiveness even though it is the lowest in Canada. Yet, a greater tax advantage that could help diversify the economy can be realized by relying less excessively on income taxes.

Certainly, some room exists to raise existing consumption taxes on tobacco, cigarettes and fuel. A re-instated health premium related to the cost of Medicare and providing for better registration control could be considered. Other user fees related to infrastructure, as mentioned above, would be appropriate from a long-run perspective. Unfortunately, these levies hit low-income Albertans the hardest—the province could use some of the new revenue to provide a refundable low-income tax credit to help the poor.

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Premier Prentice has already ruled out a general sales tax in Alberta, which is perhaps a pity. Compared to other tax hikes, even the health premium, this is by far the best option in the long run. An Alberta sales tax of two per cent harmonized with the federal GST would raise $2 billion dollars at very little administrative or compliance cost, since it is just changing the rate of an existing tax. Almost 10 per cent of the revenues would be collected from visitors and non-resident workers. Alberta could also make a case for one-time federal transition payment that could be as much as $1.2 billion. With a higher rate, Prentice could lower personal taxes by expanding the exemption as well as introduce a refundable low-income tax credit.

Albertans are strongly opposed to a sales tax. However, as recent polls have shown, a personal tax increase or new Alberta health premium receive less than 20 per cent support, not much more favourable than a sales tax. Perhaps this reflects that Albertans are generally against any tax increase and believe that spending cuts are the best way to achieve a balanced budget.

Whatever happens, this blockbuster budget could put the province on a new path for long-term growth with a better fiscal plan. Let's see what the political process will produce. P

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