Alberta is projected to run a deficit of $10.8 billion in 2016/17. This will be the province’s 8th deficit in nine years. The province is expected to return to a net debt position this year for the first time since 2000/2001.

While the sharp decline in oil prices since 2014 is often blamed for the province’s fiscal challenges, the evidence does not support this view. Instead, the primary reason for the deterioration of Alberta’s finances in recent years is rapid program spending growth.

Between 2004/05 and 2015/16, program spending increased by an average rate of 7.1% per year while revenues increased at an average annual rate of 4.6%. During the same period, spending increased at nearly double the combined rate of inflation plus population growth.

Had the government increased spending more modestly at the rate necessary to keep up with inflation plus population growth, the province would have run surpluses in every year examined, rather than 8 deficits in 9 years.

The early evidence suggests the new government in Edmonton is repeating the mistakes of its predecessors.

In its first full year in control of the budget, the new government is projected to increase program spending by 7.5% this year (or 5.4% excluding unplanned emergency spending associated with the wildfires in Fort McMurray).

If the government oversees more spending growth in the years ahead, it will exacerbate Alberta’s fiscal problems, contributing to further increases in debt and delaying a return to balanced budgets. A better course is to acknowledge the source of the problem—spending—and take corrective action.

SUMMARY

Alberta is projected to run a deficit of $10.8 billion in 2016/17. This will be the province’s 8th deficit in nine years. The province is expected to return to a net debt position this year for the first time since 2000/2001.

While the sharp decline in oil prices since 2014 is often blamed for the province’s fiscal challenges, the evidence does not support this view. Instead, the primary reason for the deterioration of Alberta’s finances in recent years is rapid program spending growth.

Between 2004/05 and 2015/16, program spending increased by an average rate of 7.1% per year while revenues increased at an average annual rate of 4.6%. During the same period, spending increased at nearly double the combined rate of inflation plus population growth.

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Introduction

Alberta currently faces significant fiscal challenges. The province is projected to run a budget deficit of $10.8 billion this year and accumulate tens of billions of dollars in debt in the years ahead.

However, the causes of these fiscal challenges are misunderstood. The government, for instance, frequently asserts that the recent drop in oil prices is responsible for Alberta's fiscal problems. This is, at very best, an oversimplification.

While there is no doubt that the recent plunge in commodity prices beginning in late 2014 has been harmful to Alberta's public finances, the provincial government's reliance on deficit spending to fund its operations predates the onset of the commodity price slump. In fact, Alberta has run a budget deficit every year except for one since 2008/09, with the result being a significant deterioration in the province's financial position that began long before the current oil price slump.

The reality is that the primary cause of the fiscal challenges Alberta faces today is rapid program spending growth by successive governments starting more than a decade ago. Indeed, successive Alberta governments spent like the good times would never end. But when they inevitably did end, spending remained at a level that revenues could not support.

In the spring of 2015, a new NDP government was elected in the province. It inherited the fiscal problems that had been created by the rapid spending growth implemented by its predecessors. Then those fiscal problems were exacerbated by the fall in commodity prices. But instead of acknowledging the true cause of Alberta's fiscal problems and taking corrective action, the Notley government continues to foist blame entirely on the decline in natural resource revenues.¹ In fact, the Notley government has doubled down on the failed approach of its predecessors by increasing the rate of per-capita spending growth above that which prevailed between 2009/10 and 2015/16.

This bulletin begins with an overview of Alberta's finances, focusing on how rapid program spending growth since 2004/05 has contributed to the province's current fiscal problems. It then specifically examines the fiscal choices that have been made by the new provincial government since it took office, with a particular focus on projections for the fiscal year 2016/17 (the government's only year in full control of the province's finances) before concluding.

Alberta's current finances

At the turn of the millennium, Alberta could boast of having the healthiest finances in Confederation. Disciplined spending during the mid-1990s helped generate substantial surpluses which allowed for tax relief in the early 2000s that helped drive strong economic growth in the province. In recent years, however, Alberta's finances have deteriorated significantly.

In fiscal year 2007/08, Alberta posted a $2.5 billion surplus. This was the province’s 14th consecutive operating surplus. However, in the following years, the surpluses that the province had enjoyed evaporated and were replaced by regular deficits; the provincial government now consistently spends more than the revenues it collects each year. In fact, the surplus of 2007/08 was the last operating budget sur-

¹ For example, see the premier's comments in Bennett (2016).
plus Alberta would enjoy until the province finally balanced its books again, for just one year, in 2014/15.

So why did Alberta go from running large surpluses to running consistent deficits? A popular narrative holds that Alberta's fiscal challenges have been caused by the recent sharp decline in oil prices that began in late 2014. However, as figure 1 shows, Alberta's string of deficits began before the decline in oil prices. Indeed, the province ran five straight deficits between 2009/10 and 2013/14, a period during which oil prices were generally strong and the economy was performing well. For example, between 2010/11 and 2013/14, oil prices averaged over $90 per barrel (in nominal US dollars) and real per capita economic growth averaged 3.1% annually, but the province continued to run deficits. The province finally did run one operating surplus budget in 2014/15 (not coincidentally, during the only year in the period during which spending was actually reduced), before returning to deficit spending the following year. This means that the province has run budget deficits in seven of the past eight fiscal years.

This long string of budget deficits contributed to a substantial erosion in the health of the province's finances. In the years prior to this string of deficits, Alberta benefited greatly from being in a substantial net asset position, which means that the value of the provincial government's financial assets exceeded the total value of its debt. This state of affairs was the product of spending discipline and strong economic performance during the 1990s. However, the persistent deficits documented above contributed to a significant decline in Alberta's net financial assets in recent years. Figure 2 shows the steep drop that has occurred in the province's net asset position since 2008/09, when the province first began to run deficits. Alberta's net assets reached a high of $35.0 billion in 2007/08, but fell quickly to $3.9 billion in 2015/16. This represents a remarkable decline of $31.1 billion in just eight years and, as a result, the province will now return to a net debt position (debts will exceed financial assets) in 2016/17, a point to which we return later in this bulletin.

How did we get here? Alberta's spending record

The preceding section documented the fact that Alberta now faces significant fiscal challenges in the form of persistent budget deficits and eroding net assets. These are important fiscal challenges because they limit the government's fiscal flexibility, whether it is to make the province more competitive (through lowering taxes, for example), deal with fiscal shocks, or to spend on key government programs that Albertans value. In addition, the decline in net assets during periods when oil prices were high represents a lost opportunity to save substantially for the future through the Heritage Trust Fund, which could have done much more to share the benefits of recent resource royalties with future generations. Finally, as the provincial debt grows in the years ahead, it will create a financial burden that will be passed along to future generations of Albertans who will be responsible for servicing and repaying it, which can also create uncertainty and instability in the economy due to the potential for tax increases to repay past deficits.

But why have these problems emerged? The decline in commodity prices (especially oil) that began in late 2014 is frequently claimed to be the sole cause but, as we have seen, Alberta's persistent deficits and the decline in net financial assets significantly pre-dates the downturn in oil prices. Certainly, the recession and
decline in resource revenues for the provincial government have exacerbated Alberta’s fiscal challenges, but these factors are not the fundamental cause of the difficulties. Instead, the evidence suggests that sustained spending growth over the past decade is the reason for Alberta’s fiscal challenges. Indeed, the real issue is that successive governments imprudently managed spending during the good times, when the economy was growing robustly and resource revenues were increasing rapidly, and left spending at unaffordable levels when the boom went bust.

The reason Alberta was regularly running budget deficits beginning in 2008/09, even though energy prices and provincial revenues were high in most of those years, is because the provincial government was in the midst of a prolonged period of rapid spending growth.

This reality can be demonstrated by comparing the program spending growth rate to the revenue growth rate and other key economic indicators in recent years. Specifically, we examine the period between 2004/05 and 2015/16. We use 2004/05 as the baseline year for this analysis because by then, real per-capita program spending in Alberta had already returned to the levels seen in the early 1990s, prior to the spending reforms implemented by Premier Klein’s government. Put another way, by 2004/05, Alberta’s era of fiscal consolidation was long over and the province was once again spending as much per person as it did before the spending reductions of the early 1990s (Milke, 2014).
Between 2004/05 and 2015/16, provincial revenue growth was reasonably strong, averaging 4.6% annually. Provincial program spending (all spending excluding debt service payments), however, increased much faster—at an average annual rate of 7.1%. While the provincial government managed to run large surpluses between 2004/05 and 2006/07, the significant increase in program spending levels proved unsustainable and large deficits emerged in subsequent years.

Between 2004/05 and 2015/16, spending growth not only exceeded revenue growth, it also exceeded key economic indicators. For example, while program spending increased at an average annual rate of 7.1%, the combined rate of population growth and inflation during this period was just 4.4%. This meant that the per-person value of government spending, adjusted for inflation, was increasing markedly during this period. During the same period, nominal economic growth averaged 5.9% annually. Figure 3 graphically presents these comparisons.

Note that the rate of spending growth throughout this period was not uniform and during the very last years of the period slowed significantly. We will return to this point in the next section. However, taken as a whole, the 2004/05-2015/16 period was characterized by rapid spending growth.

Between 2004/05 and 2015/16, program spending in Alberta doubled, growing from $24.0 billion to $48.2 billion, an increase of 100.5%. By comparison, if spending had been increased in line with inflation plus population growth, it would have been $38.9 billion in 2015/16—$9.2 billion lower than was in fact the case.

To put this difference in perspective, the province’s budget deficit in 2015/16 was $6.4 billion. This means that if the province had increased spending more modestly since 2004/05, the province would actually have run a significant surplus last year instead of a deficit, notwithstanding the fall in commodity prices that began in late 2014. In fact, the province would have run a budget surplus in every year dur-
This period under this scenario of slower spending growth. This reality emphasizes that Alberta is not doomed to the boom-and-bust cycle of public finances, with large deficits developing whenever oil prices fall. Better control of spending during the good times would have allowed the province to better prepare for the inevitable bust.²

Furthermore, if we were to extend the analysis to include projections for the current fiscal year (2016/17) using the government’s own projections, we would find that under the scenario with spending growth held to the rate of inflation plus population, provincial spending this year would be $11.7 billion lower than is in Alberta during recent years when energy prices were high and, as a result, is currently in the midst of a long string of surpluses and has a much brighter fiscal outlook than Alberta (Eisen et al., 2016).

² For an example of a jurisdiction that has put this approach into practice, consider Texas, which exercised markedly greater spending restraint than

Notes:
(i) Program spending is defined as total spending minus debt charges. Program spending includes pension provision expenses (i.e. annual change in unfunded pension liabilities).
(ii) Data from 2004/05 to 2007/08: SUCH sector included on “net equity” basis (net revenue included in revenue and net assets included in assets).
(iii) Data from 2008/09 to 2015/16: SUCH sector included on “line-by-line” basis (revenue, spending, assets and liabilities reported in revenue, spending, assets and liabilities).
Sources: Alberta Finance; Statistics Canada; calculations by authors.
fact expected to be the case. So based on current forecasts, Alberta would still be running a modest surplus this year instead of a $10.8 billion deficit if the provincial government had increased spending in this way since 2004/05.

In short, the persistence of budget deficits documented above and the rapid deterioration of the province’s financial position were entirely avoidable. With different spending choices and, specifically, by linking spending growth to the rate of population growth plus inflation, the province could have run surpluses throughout the past decade and seen its net financial position improve rather than deteriorate. Under this scenario, the province would have been dramatically better positioned to cope with the fiscal shocks that accompanied the decline in oil prices and resource royalties in recent years.

The consequence of these avoidable deficits in recent years is that the province is forecasted this year to return to a net debt position (its debts will exceed its financial assets) for the first time since 2000/01. The debt accumulated in the years ahead will be passed along to be serviced and/or repaid through the tax dollars of future generations of Albertans, an issue to which this paper turns in the next section.

In short, the primary cause of the fiscal challenges Albertans face today is rapid spending growth by successive governments in the province. While it is convenient for some to blame today’s low oil prices for the province’s deficits and the province’s projected return to net-debtor status this year, the reality is these outcomes could have been avoided with a different approach to the management of public expenditures. This is something the current government must acknowledge and take corrective action to address.

### Doubling down on a failed approach

When the new NDP government was elected in the spring of 2015, it inherited the fiscal challenges described in the preceding section. When the new government came to power, it was an open question whether it would continue down the path of its predecessors and keep rapidly growing its spending. There is historical precedent for a newly elected provincial NDP government to successfully solve the fiscal problems left to it by its Progressive Conservative predecessors. This is exactly what occurred in Saskatchewan during the 1990s under the premiership of Roy Romanow (Eisen et al., 2015).

Unfortunately, the Notley government has not addressed the deficit by reforming and reducing spending as Romanow did, but has instead doubled down on the approach of prior governments by rapidly growing government spending. In fact, in 2016/17 (the first year for which the new government can reasonably be attributed full fiscal responsibility), the government is forecasted to increase spending at a significantly faster rate than has prevailed in recent years.3

Over the entire 2004/05–2015/16 period, program spending in Alberta grew rapidly. However, as noted above, it did not rise uniformly in this period. In fact, in the very last years of the period, the provincial government had finally begun to reduce the rate of program spending to more moderate levels.

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3 In fact, Alberta’s eroding fiscal position is being used as partial justification to for the new government to raise a host of taxes, making the province less competitive. This despite academic research that shows that tax hikes are ineffective at closing budget deficits; rather, they impose more economic harm that spending cuts (Alesina et al., 2016).
Consider that in the three years prior to 2016/17, provincial program spending increased at an average annual rate of 2.3%. While the slowdown in the spending growth rate was not sufficient to solve the fiscal problems caused by the rapid spending increases of the preceding years, it was a step in the right spending restraint direction. However, 2016/17 is expected to see a reversal of the trend and spending is currently projected to increase by 7.5% this year.

Some of this spending growth was necessitated by the emergency response to the wildfires in Fort McMurray. However, even if we remove the $1.03 billion in additional disaster spending this year that was unplanned for in the 2016/17 budget, the government is still planning to increase spending by approximately 5.4% this year. This is approximately double the average rate of spending growth that prevailed in the previous three years. Furthermore, it is nearly double the expected 3.0% combined rate of inflation plus population growth in 2016/17.

In short, in its first year with full control over provincial finances, Alberta’s new NDP government has continued down the same path as its predecessors, making the same decision to increase spending at a significantly higher rate than the combined rate of inflation plus population. The new government is not learning the lessons from history, but is instead repeating the same mistakes from previous Progressive Conservative governments.

The decision to increase spending significantly in 2016/17 will contribute to the rapid run-up in provincial debt that is expected to occur in the years ahead, and should therefore be considered in that light. As noted in the preceding section, Alberta has seen its net financial assets deteriorate rapidly in recent years, falling from $35 billion in net assets in 2007/08 to just $3.9 billion in 2015/16. In 2016/17, for the first time since 2000/01, Alberta will once again be in a net debt position. Figure 5 illustrates this fact, showing the projected growth in Alberta’s net financial debt over the next several years, as stated in the province’s 2016 budget.

Alberta’s debt is forecasted to increase by a little more than $10 billion per year throughout the remainder of the government’s fiscal forecast, reaching $33.2 billion in 2018/19. For context, that’s approximately $7,600 in (net) debt per Albertan that is expected to be accumulated just over three years.
When it took office in 2015, the Notley government inherited serious fiscal problems that were caused by the spending decisions of its predecessors and exacerbated by the collapse of oil prices in late 2014. The government cannot reasonably be held responsible for all of these problems. However, it is responsible for solving them. The government’s decision to significantly increase the rate of spending growth beyond what has prevailed in recent years, despite the province’s fiscal challenges, is an important contributing factor to the expected run-up in debt shown in figure 5. If the government oversees more spending growth in the years ahead, it will exacerbate the fiscal problems documented here, contributing to further increases in debt and delaying a return to balanced budgets. A better course is to acknowledge the source of the problem—spending—and take corrective action.

Conclusion

Alberta faces significant fiscal challenges. This paper has shown that these challenges were created by rapid program spending increases since 2004/05 in excess of what would have been required to account for the combined rate of inflation plus population growth.

There is no doubt that the current provincial government inherited significant fiscal problems. Rather than taking steps to reform and reduce spending to address these problems, however, the government has exacerbated them since coming to power. It has repeated the mistakes of its predecessors by increasing provincial program spending at a significantly faster rate than would have been necessary to offset the effects of population growth and inflation. In fact, in its first year in full control of the provincial budget, and despite the stark fiscal realities facing Alberta, the new government has doubled down by significantly increasing the rate of spending growth than what had prevailed in the years immediately before it took office.

The approach of rapid spending growth has caused Alberta’s fiscal problems in the first place, and those problems are unlikely to be solved if the new government continues down this course. If it seeks to repair Alberta’s damaged finances, the government first must recognize that the primary source of the problem is spending growth, not low oil prices, and then move quickly to strike at the root of this problem by reforming and reducing provincial spending.

References


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