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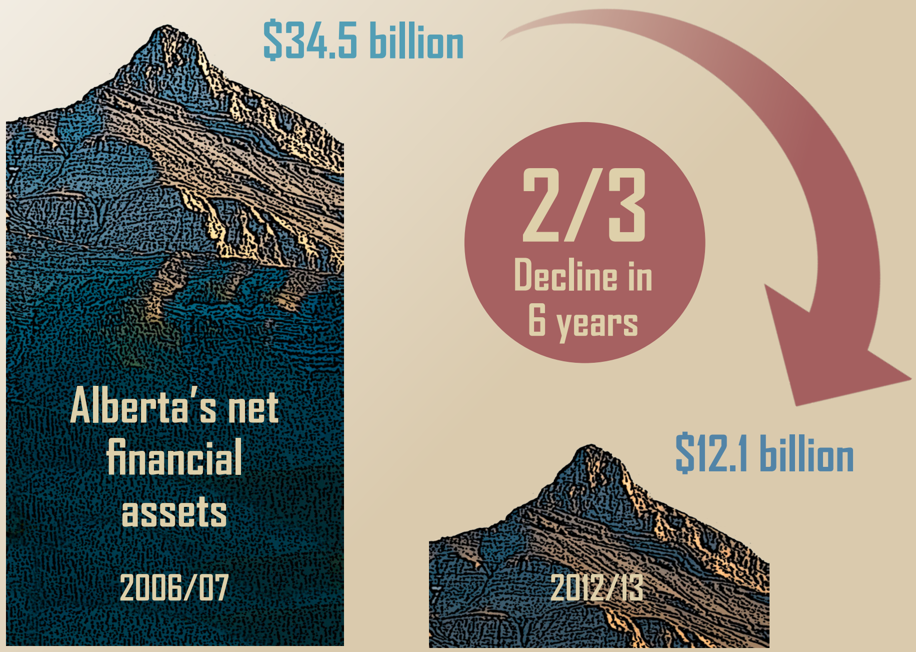
Alberta's double-dip decline in financial assets

by Mark Milke



Main Conclusions

- In just six years, the value of Alberta's net financial assets—the broadest, most comprehensive measurement of Alberta's financial "wealth"—has dropped by about two-thirds (65 percent), from $34.5 billion in the 2006/07 fiscal year to $12.1 billion in 2012/13, a six-year, $22.4-billion decline.

- The recent decline mimics how Alberta's net financial assets plunged by $36.2 billion between 1984/85 and 1993/94, from $15.3 billion in net assets to a net debt of $20.1 billion.

- Arresting the present decline in Alberta's net financial assets has not been helped by historically high per-capita program spending. In 2012/13, such spending was $2,861 higher per person in real terms relative to the turn of the century. (This spending is not linked to flood relief, as this study ends with the last fiscal year, March 31, 2013, before the recent floods.)

- The decline looks set to accelerate with recently announced borrowing and provincial spending on flood relief.

- The common sense implication and recommendation is that *the reality of spending beyond the province's current means* must *be acknowledged and acted upon.*

- With the exception of extraordinary flood costs, "normal" per-capita program spending must be restrained and pared sooner rather than later, and/or program spending held to a rate of growth below that of government revenues generally.

Alberta's finances in the context of recent events

In its March 2013 budget, the government of Alberta forecast yet another deficit year for the then-upcoming 2013/14 fiscal year. Should the province's forecast be accurate, the current budget year will be the sixth straight year that Alberta has not balanced the books (Alberta, 2013a: 130-131; 2013b: 22). That forecast occurred before the floods that affected Calgary, High River, and other parts of southern Alberta in June 2013, and which will only add to the "red ink" already forecast by the province of Alberta. Additional deficit financing appears inevitable given that the provincial government promised to ensure that "[n]o eligible homeowner with flood damage will go without financial support." Also, the province pledged that if the cost of repairs is greater than the cost of rebuilding a home, then the provincial treasury would "provide support for a complete rebuild of homes, as well as additional funding in the form of interest-free loans for business" (Alberta, 2013c; 2013d).

This study examines provincial government finances up to March 31, 2013—the end of the most recent fiscal year and before the recent floods. While spending on home and other restoration expenses will exacerbate provincial red ink, it is clear from the data that the already-substantial decline in Alberta's net financial assets was set to continue regardless. That was due both to provincial own-source revenues that are down (in inflation-adjusted terms) from their all-time high in 2006/07 (Milke, 2013: 7) but also because of near all-time high spending which has continued despite that drop in revenues. After noting the decline in net financial assets—the focus of this analysis—I will address both realities, as I have done in previous studies (Milke, 2011, 2012, 2013).

Why the decline in financial assets matters

In the past, the provincial government has occasionally pointed to the province's financial assets as an accomplishment. In a June 2012 news release, the provincial government trumpeted how Alberta is the only province "in a net financial position" (Alberta 2012a). It would be strange for Alberta's government to have noted that position and yet to ignore the now annual and chronic decline in such assets, or merely to compare itself with other provinces. A more apt comparison is to other resource-rich jurisdictions such as Alaska and Norway—and to what those two jurisdictions have done to boost their resource funds while Alberta's fund has virtually stalled (Milke, 2006; Gibbins and Roach, 2006; Alberta, 2007; Murphy and Clemens, 2013.)

In addition, the province of Alberta has made clear that it intends to try and save more in the coming years. In Budget 2013, Finance Minister Doug Horner said it was important that "before you spend on anything, put some [money] away to save first." He then announced the province would deposit $297 million into the Alberta Heritage Savings Trust Fund in 2013/14 (Alberta, 2013c: 9-10). However, in the same budget, the province made clear it intended to borrow substantially for capital expenditures (Alberta, 2013e: 18). Budget documents indicate that $11.6 billion in direct borrowing will occur for the purposes of infrastructure (Alberta, 2013f: 11). The intent to save and yet the intent to borrow means the latter negates the former. That, and the province's occasional pointing to the province's net financial assets as an accomplishment, mean the province's net financial assets warrant an ongoing look.

Here, critics will likely retort that borrowing for capital expenditures is different and perhaps prudent to some extent, since the benefits of that capital spread across many years into the future. Future taxpayers, the argument goes, should thus share in the pain. However, as noted in a previous report (Milke, 2013), the province could have avoided debt financing even for capital expenditures by simply adhering to a population-growth-plus-inflation scenario since the mid-2000s on program spending, an action that would have created room for capital spending out of current revenues. There was and is nothing particularly prudent about letting program spending spiral out of control.

The six-year 65 percent decline in net financial assets

In 2006/07, Alberta's net financial assets stood at an all-time high of $34.5 billion, but they have since declined to $12.1 billion as of 2012/13 (all figures in inflation-adjusted 2012 dollars). That is a $22.4 billion decline in real terms, or 65 percent in six years (**figure 1** and citations).

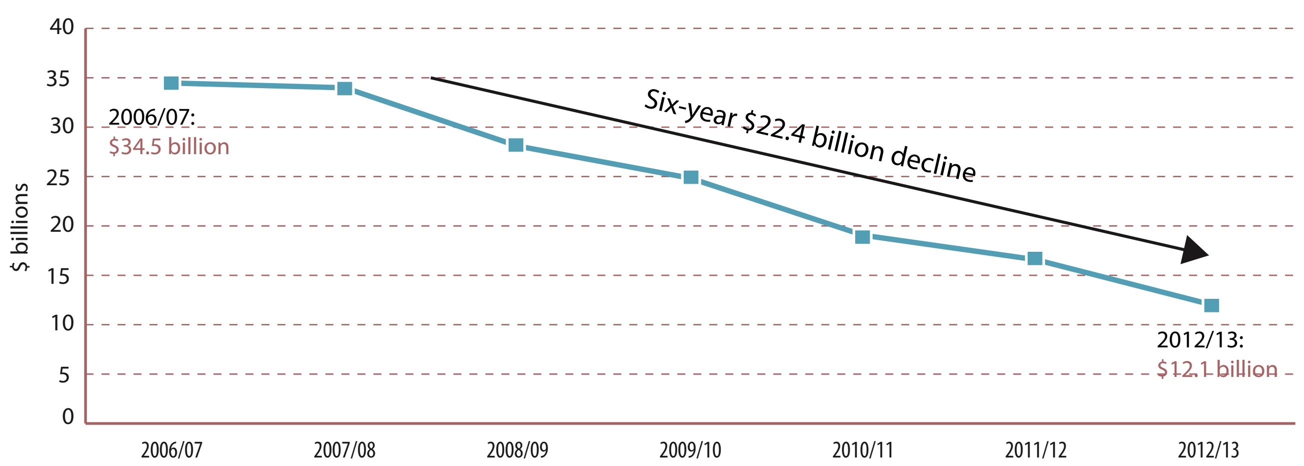
We've been here before

Alberta has been down this road before, in the mid-1980s to early 1990s, when the province also had net financial assets, boasted about it, and yet quickly saw that advantage over other provinces ebb away, with net assets eventually turning into net liabilities. At present, the provincial government is treading down the same path, making the same policy choices, and repeating the same mistakes.

In 1984/85, the province possessed net financial assets of $15.3 billion (all figures in inflation-adjusted 2012 dollars). Thus, in 1985, Alberta Treasurer Lou Hyndman noted the net asset position of the general revenue fund as well as the positive balance in the Alberta Heritage Savings and Trust Fund (AHSTF).[1] "There are few governments in the world that can match the financial strength of the Province of

1 The official title of finance ministers in Alberta before 1993 was Treasurer.

Figure 1: Decline in Alberta's net financial assets, 2006/07–2012/13



Note: Inflation-adjusted 2012 dollars. Includes pension liabilities.

Sources: Alberta, 2001: 88; Alberta, 2013b: 22; inflation calculations by Milagros Palacios using Statistics Canada data (2012a).

Alberta," said Hyndman in his March 1985 budget speech (Alberta, 1985: 12).

However, a drop in oil prices (and thus in provincial government revenues) and per-capita program spending above available revenues, akin to today's levels, created deficits which eventually led to Alberta having a net debt (by 1991/92). In the course of nine years, between 1984/85 and 1993/94, Alberta went from having net financial assets to having net financial debt of $20.9 billion. The decline in inflation-adjusted dollars was $36.2 billion, or a 236 percent drop—a 236 percent drop because the province went from net financial assets to net debt over that nine-year period (**figure 2**) (Alberta, 2011: 88; Statistics Canada, 2012a).

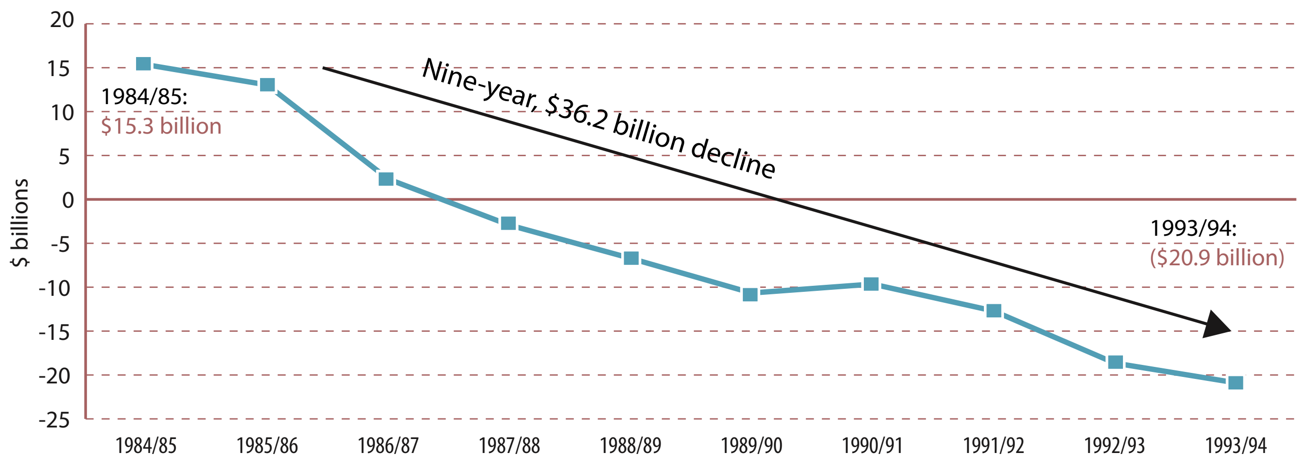
Alberta's double-dip decline in financial assets

On an average annual basis, and accounting for inflation, the recent six-year decline is similar in dollar terms to the average annual decline Alberta experienced in the last decline in financial assets: just over $3.7 billion on average over the 2006/07–2012/13 period compared to an annual decline of just over $4.0 billion in the 1984/85–1993/94 decline.

When compared in percentage terms, the annual average decline is less dramatic, with a 16 percent annual average decline compared to a 66 percent annual average decline in the earlier nine-year period (the 66% possible because the province declined into net financial *debt*) (**table 1**).[2]

2 Note that in both periods the annual average percentages result from substantially large percentage declines in some years even if the dollar amount is less severe. For example, if net assets decline from $3 billion to $1 billion in one year, that is a $2 billion and 67 percent decline; if the next year saw a $900 million decline from $1 billion this would represent a larger 90 percent decline, though the dollar decline—$900 million—is not as large as the dollar drop in the previous year.

Figure 2: What happened last time: Alberta's net financial assets, 1984/85–1993/94



Note: Inflation-adjusted 2012 dollars. Includes pension liabilities.

Sources: Alberta, 2001: 88; inflation calculations by Milagros Palacios using Statistics Canada data (2012a).

Table 1: Comparison of Alberta's net financial assets in two periods of decline

	Total decline $ millions, inflation adjusted	Annual average decline $ millions, inflation adjusted	Total decline %	Annual average decline %
2006/07 to 2012/13: the 6-year decline	-22,376	-3,729	-65	-16
1984/85 to 1993/94: the 9-year decline	-36,234	-4,026	-236	-66

Source: Alberta, 2001: 88; Alberta, 2013b: 2; inflation calculations by Milagros Palacios using Statistics Canada data.

The decline in Alberta's net financial assets in greater context

It might be argued that a decline in Alberta's net financial assets is to be expected. After all, Alberta and the entire world experienced a recession in 2008/09. Thus, financial assets such as the Alberta Heritage Savings Trust Fund (AHSTF), with half of its holdings in equities, would have been expected to decline in value (as it did, and it has yet to fully recover even in nominal terms never mind in real terms) (Alberta, 2012b: 5, 20; Alberta, 2013g: 20). It might also be argued that the value of province's Sustainability Fund, created to provide the General Revenue Fund with a cash infusion when revenues are weaker and/or spending higher, would inevitably decline.

However, Alberta's recession ended in mid-2009 and the province has yet incurred deficits in every subsequent year—six consecutive years—and thus had added to the decline in Alberta's net financial assets (Alberta, 2013b: 22). Critically, the decline in Alberta's financial assets and the further intent to borrow must be placed in the context of where the province has been on spending, and the effect such spending had on choices available to government.

In its June 2013 review of the final budget numbers for 2012/13 fiscal year, the government once again laid the blame for Alberta's "red ink" finances solely on revenue declines and on "discounts faced by Alberta producers," the gap between what Alberta oil (especially bitumen) normally fetches on world markets and actual prices in 2012/13 fiscal year (Alberta, 2013b: iii). Nowhere in the entire 130-page document did the government point to historically high per-capita program spending as part of the problem in failed attempts to balance the province's books, or to how such spending helped along the dramatic decline in Alberta's financial assets.[3] The sole focus on the revenue side of the province's equation has been the pattern since at least the 2008/09 recession (Milke, 2011: 14-22); and it matters, as there are two sides to the ledger.

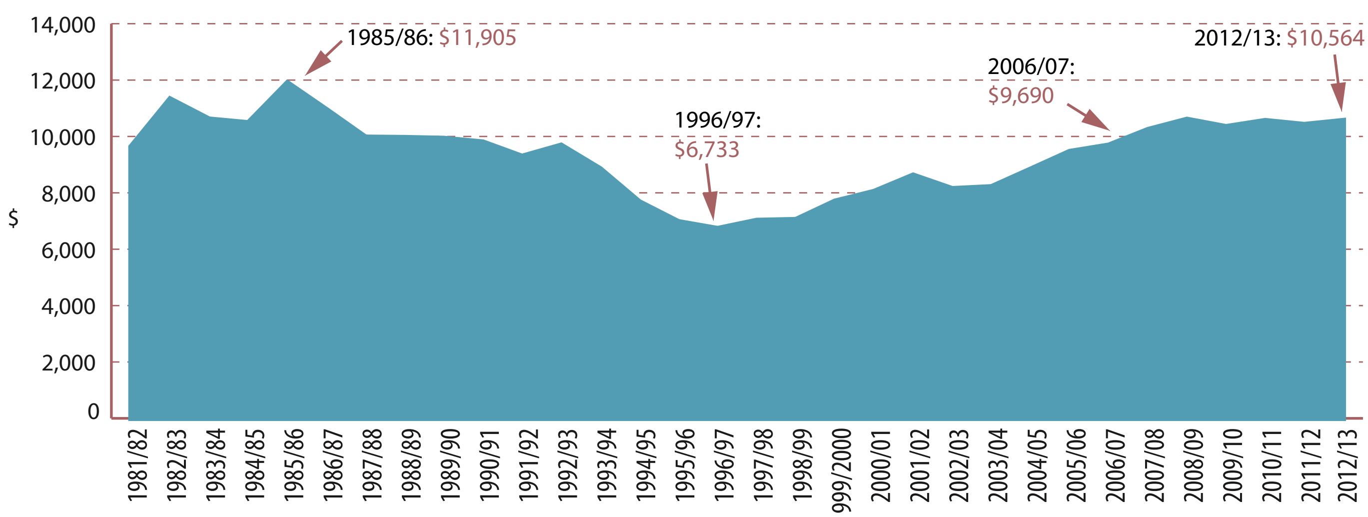
3 In Alberta, "net financial assets" include major funds such as the Alberta Heritage Savings Trust Fund, the Sustainability Fund, and other funds including endowments. Liabilities include accumulated debt, pension liabilities, and other accounts payable (Alberta, 2012b: 109, 130). Net financial assets are arrived at by subtracting liabilities from the assets, and are thus the broadest, most comprehensive measurement of the province's financial assets. Note that none of the above includes capital assets but it does include pension liabilities.

To be sure, as chronicled in my study earlier this year, in inflation-adjusted terms, resource revenues to the province hit a peak in 2005/06, and while they have recovered somewhat they have never again reached that peak. Similarly, the province's total own-source revenues hit a peak in 2006/07, have since recovered, but have not hit another all-time high. But, as noted, had the province since 2005/06 (the peak year for resource revenues) kept program spending growth within the confines of inflation plus population growth, the province would have spent $22.1 billion less in total program spending between 2005/06 and 2012/13. It would have reported a balanced budget in every single year since 2005/06, including during the recession (Milke, 2013).

Thus, even with revenues falling, the province could have shown a rosier financial picture than it did, but it would have had to control program spending more tightly. For the purposes of this paper, arresting the present decline in Alberta's net financial assets has not been helped by per-capita program spending that is $2,861 higher per person in real terms relative to the turn of the century, and $874 higher per person relative to 2006/07—the year when Alberta's own-source revenues were at their peak (Milke, 2013: 6). While the province seems to have moderated any additional program spending growth beyond population growth and inflation in the last several years, its per-capita program spending in 2013/13 was still at near-record highs, at $10,564 per person, a level exceeded only in 2008/09 at $10,607 per person.

Moreover, in historical context, such per capita spending levels were only exceeded in the early to mid-1980s when per-capita program spending hit a high of $11,905 in 1985/86 (in inflation-adjusted, i.e. real 2012 dollars) (Canada, 2000, 2010; Alberta, 2013b; Statistics Canada, 2012a, 2012b). Despite having (relatively) held the line on per-person program spending since 2008/09, the province of Alberta has "held the

Figure 3: Alberta per-capita program spending, 1982–2013



Note: Inflation-adjusted 2012 dollars. Fiscal years ending March 31.

Sources: Canada, 2000, 2010; Alberta, 2013b; Statistics Canada, 2012a, 2012b; inflation calculations by Milagros Palacios using Statistics Canada data.

line" at elevated spending levels, historically speaking, and this at a time when resources revenues are nowhere near their boom-time peaks (Milke, 2013).

How the province might have curbed spending: lessons for the future

As for how the province might have spent less during that period, several answers are available, found in past choices, and which are relevant to future budget choices yet to be made by the provincial government. It seems clear much of the above-inflation, above-population growth in spending can be traced to the public sector and how it has swallowed extra revenues available to the province.

In early 2012, Kenneth Boessenkool and Ben Eisen found that, since 2000, increases in public sector compensation costs consumed "95 percent of the increase in provincial revenues over the past decade." They concluded that public sector wages previously at par with such wages across the country "are now higher (in many cases very substantially) across all public sector categories)" (Boessenkool and Eisen, 2012: 1). One might argue that the labour market is different in Alberta and necessitates higher wages for government employees and the broad public sector vis-à-vis other provinces. However, while that may be true in some limited cases—if the government competes with the private sector for engineers, for example—there is an average wage premium right across the entire public sector.

As noted by my colleagues Amela Karabegovic and Jason Clemens earlier this year, public sector workers located in Alberta enjoyed, on average, a 10 percent wage premium over private sector colleagues, based on Labour Force Survey data from Statistics Canada and once factors such as education, length of time in the workforce, and other relevant factors were controlled for (Karabegovic and Clemens, 2013).[4]

In addition, such factors matter because there are other costs associated with the public sector, and factors which are more unique to that sector. My colleagues also found that public sector workers retire two years earlier on average than private sector workers, and that public sector workers in Alberta also are more likely to be covered by a registered pension plan—81 percent in the public sector compared to just 21 percent in the private sector (Karabegovic and Clemens, 2013: 18).

Importantly, for those who look towards future budgets, such plans are normally of the defined benefit variety and thus can require additional and special contributions from taxpayers.[5] In the past, increasing liabilities have had consequences. For example, in 2002/03, the province made what was supposed to be a "one-time" payment of $60-million towards what is known as the "pre-1992" Teachers' Pension Plan (the Teachers' Pension Plan is in two separate entities—pre and post-1992) (Alberta, 2003: 42). However, in 2009/10, the Alberta government paid another $1.2 billion in a special payment towards the unfunded pre-1992 shortfall in the Teachers' Pension Plan (Alberta, 2010: 61).

4 Note that the wage premium is an average across the entire public sector in Alberta—federal, provincial and municipal. Figures for just provincial public sector workers were not available from Statistics Canada.

5 In Alberta, of those who have a registered pension plans, 97 percent of public sector plans are defined benefit plans, whereas just 43 percent of private sector plans are defined benefit plans (Karabegovic and Clemens, 2013: 18).

More generally, in the province's 2012 budget forecast, unfunded pension liabilities were just under $10 billion for fiscal 2012 (Alberta, 2011: 88). Actual pension liabilities were recorded at $10.3 billion for that year and $10.6 billion for the 2013 fiscal year (Alberta, 2013b: 22). Similarly, such pension liabilities are now forecast to increase to $10.8 billion for the 2013/14 fiscal year—another $200 million decline in Alberta's financial assets if the province is accurate in its current forecast (Alberta, 2013a: 136).

Such figures matter, as program spending is difficult to rein in given that a substantial portion of it is tied closely to wages, salaries, benefits, and pensions in the broad public sector, which are often negotiated on a multi-year basis. In Alberta, the province has not estimated the cost of compensation (wages, salaries, benefits, and pensions) in the entire (broader) public sector as a percentage of program spending. However, we can gain some insight into the probable weight that public sector compensation imposes on overall spending by looking at Ontario. The Commission on the Reform of Ontario's Public Services recently noted that "labour costs account for about half of all Ontario government program spending" across the broader public sector (Ontario, 2012: 52). Therefore, assuming some comparability between provinces with respect to the portion of spending consumed by compensation, roughly half of Alberta's program spending could be comprised of public sector worker pay and benefits. If the province is to arrest the decline in its net financial assets, it must turn its attention to the wide public sector.

Conclusions and recommendations

The diversion of past revenues to the pay of public sector workers has meant that insofar as the province spent above inflation and above population growth on programs, less money was available for capital spending (absent additional borrowing); in addition, it also meant money was unavailable for building up the Alberta Heritage Savings Trust Fund, a priority addressed in another Fraser Institute paper earlier this year (Murphy and Clemens, 2013) and a stated priority of the provincial government (Alberta, 2013c: 9-10).

The public sector wage premium and associated benefits such as pensions, vacation days, and the like, all of which form part of total compensation, and the diversion of almost all additional tax revenues since 2000 to the public sector, have been in part responsible for the reappearance of deficits in the midst of the 2008/09 recession and ever since (Alberta, 2013b: 22). That meant when revenues to the province declined, limited choices were available to the province, as its per-capita program spending was already at elevated levels when compared with historical norms.

Thus, it became axiomatic that red-ink deficits, and now borrowing for capital purposes, would lead to a steep decline in net financial assets absent any early, post-recession efforts to rein in such spending, an effort that was absent. The result is that Alberta's net financial assets have already declined by 65 percent since 2006/07, mimicking a previous decline in Alberta's financial condition that began in the mid-1980s and lasted until the mid-1990s.

Looking forward, absent a determined effort to bring down per-capita program spending in real terms, and given the already-announced deficit for 2013/14, spending on flood relief, and intended capital borrowing, the sharp decline in Alberta's net financial assets will continue, and at an annual rate that so far has replicated the 1980s-1990s decline.

The common sense implication and recommendation is that *the reality of spending beyond the province's current means* must *be acknowledged and acted upon*.

While, in its 2013 budget, the province announced measures to freeze what it now terms "operational spending", it still intends to run a deficit for 2013/14. Also, given its announced commitments on expenditures on flood-related costs, the province must view its current per-capita program spending in the context of historic norms—and the spending is significantly higher than such norms.

The policy implication is that with the exception of extraordinary flood costs, "normal" per capita program spending must be restrained and pared sooner rather than later, and/or program spending held to a rate of growth below that of government revenues generally.

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