

# The Decline of the Other Alberta Advantage: Debt Service Costs in Alberta Are Rising

by Steve Lafleur, Ben Eisen, and Milagros Palacios



## SUMMARY

■ Throughout recent history, Albertans have enjoyed a substantial fiscal advantage other Canadian taxpayers, resulting from the fact that government debt interest payments in Alberta have been far lower than in any other province.

■ For example, in 2007/08, Alberta’s provincial government spent just \$61 per person on debt interest payments. The other nine provinces had to spend between \$521 and \$1,476 per person servicing debt.

■ This fiscal advantage has saved Alberta’s taxpayers billions of dollars each year in the recent past.

■ Alberta’s debt interest payments were so low because the province carried very little debt. Until 2016/17, Alberta was “net debt free,” meaning that its financial assets were greater than its liabilities.

■ In the most recent fiscal years, however, Alberta’s net asset position has flipped from positive to negative and the province is quickly racking up debt.

■ As a result of rapid debt accumulation, the cost of servicing Alberta’s debt is quickly catching up with other provinces. Current projections suggest that by 2020/21, Alberta’s debt service payments per person will exceed British Columbia’s and will be approximately 70 per cent as large as Ontario’s.

■ If Alberta’s pace of debt accumulation continues at a similar rate in subsequent years, Alberta will join Newfoundland & Labrador and Quebec (and possibly Ontario) as the only provinces paying more than \$1,000 per year in per-capita debt interest payments.

# Rising Debt Service Costs in Alberta

## Introduction

Throughout recent history, Alberta enjoyed at least two distinct fiscal advantages over all other Canadian provinces. The first of these was Alberta's famous "tax advantage." In 2015, this advantage was badly eroded by tax increases enacted that year (Eisen, Lafleur, and Palacios, 2017). Alberta's second important fiscal advantage over all other provinces has been its uniquely low annual government debt interest payments. That advantage, too, is now being quickly eroded by the province's rapid accumulation of public debt.

The debt interest advantage Alberta used to have was firmly rooted in its status as Canada's only province with positive net financial assets (i.e., Alberta's government's financial assets exceeded its debts). But the province lost that status in 2016/17. With that loss, and with rapid debt accumulation since then together with much more debt accumulation expected in the years to come, it is forecast that this debt interest advantage will continue to erode substantially in the years ahead. This bulletin examines how annual government debt service payments in Alberta (relative to the provincial population) is rapidly converging with most other provinces, essentially eliminating a fiscal advantage that Alberta's taxpayers have enjoyed for decades.

## What are debt service payments and why do they matter?

While most of the focus around government borrowing is on the size of the deficit and amount of accumulated debt, comparably little discussion focuses on the cost of servicing debt. When governments add debt in a given year (by borrowing—either to make up for deficits or to finance capital spending, all else being

equal), the annual cost of servicing that government debt increases, at least in nominal terms.

Debt servicing costs generally grow both as the principle owed increases<sup>1</sup> and as interest rates rise. This situation is important for taxpayers because rising debt service costs consume scarce resources that would otherwise be available for other priorities. To put the numbers in context, the average Canadian paid \$1,752 to service federal, provincial, and local government debt in 2017 (Lammam et al., 2017). That money could have been used to finance important programs or provide tax relief. Governments with higher debt servicing costs must employ some combination of higher taxes and fewer services to cover those higher costs.

As we will see below, the amount that provincial governments pay for debt servicing varies greatly; historically, Alberta has been in the enviable position of paying a small fraction of what governments in other provinces pay.

## The other "Alberta Advantage": Minimal debt servicing costs

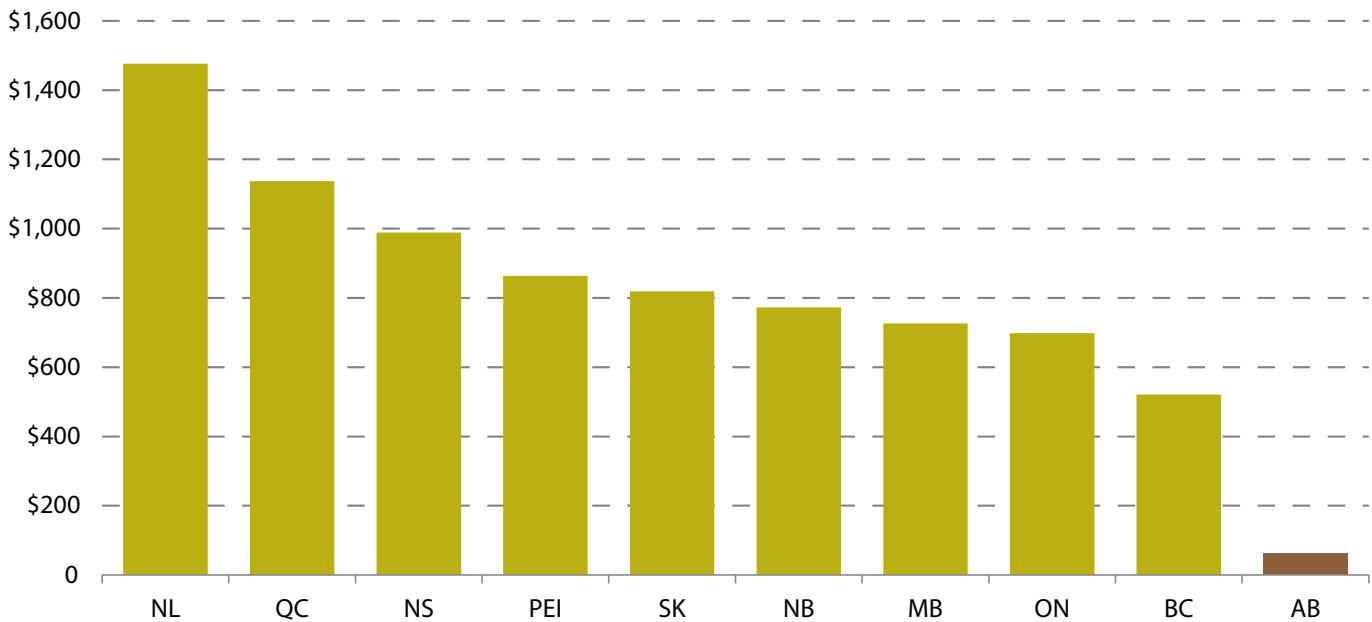
All provincial governments in Canada pay some debt service costs. Until recently, Alberta stood out from the Canadian pack for its extremely low annual debt servicing costs. Figure 1 demonstrates this by comparing per-person debt servicing costs among the provinces (in nominal dollars) for 2007/08. We choose 2007/08 as an illustrative year because it is the year before Alberta's overall asset position began to decline

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<sup>1</sup> There are hypothetical cases, depending on interest rate fluctuations, where a government could accumulate debt but the cost of debt servicing could remain the same or shrink.

# Rising Debt Service Costs in Alberta

**Figure 1: Debt Servicing Charges per Capita (\$ nominal), 2007/08**



Sources: Canada, Department of Finance (2017); Provincial public accounts 2016/17; Statistics Canada, *CANSIM Table 051-0001*; calculations by authors.

and because that year is highly representative of the years surrounding it.

Figure 1 shows that in 2007/08, Alberta spent just \$61 per person on debt service costs. This is far less than any in other province, where per-capita debt service costs ranged from 8.6 to 24.2 times higher than in Alberta.

As noted, the statistics for 2007/08 are illustrative of the low debt interest costs that had prevailed in Alberta for a long time. Per-capita debt service costs for Alberta ranged from \$85 to \$186 every year between 2003/04 and 2015/16 (the last year the province enjoyed a net asset position). In each of these years, all other provinces paid several times more than Alberta to creditors in per-person debt service costs.

Over time, this “fiscal advantage” has saved taxpayers a substantial amount of money. Consider that if Alberta’s debt service costs in 2007/08 had been similar to Saskatchewan’s (\$758 more per capita), Alberta would have had to pay roughly \$2.7 billion more in debt service payments that year—and those funds would then have been unavailable for other purposes. For context, \$2.7 billion is only slightly less than the \$3.1 billion the provincial government spent on social services that year. If Alberta’s per-person debt service costs were similar to Quebec’s that same fiscal year (\$1,077 more), the cost to taxpayers would have been roughly \$3.8 billion dollars higher than was the case – equivalent to more than 40 percent of the provincial education budget in 2007/08. Clearly, Alberta’s status as the jurisdiction with by far the lowest debt service costs has produced a substantial fiscal advantage.

# Rising Debt Service Costs in Alberta

**Figure 2: Per Capita Net Debt (\$ nominal), 2007/08**



Sources: Canada, Department of Finance (2017); Provincial public accounts 2016/17; Statistics Canada, *CANSIM Table 051-0001*; calculations by authors.

## Rising government debt is eroding Alberta's other fiscal advantage

We have seen that Alberta's low annual debt service payments have given it a substantial advantage over other jurisdictions in recent history. But why? This fiscal advantage is a function of the fact that Alberta has (and still does) carry less public debt than any other province. But Alberta's fiscal situation is deteriorating rapidly.

Despite the fact that rapid spending growth had already begun to sow the seeds of Alberta's current fiscal challenges, 2007/08 represented the peak of Alberta's net asset position. In 2007/08, not only was Alberta alone among the provinces in having no net debt, but it had a \$35 billion net financial asset position, meaning that it owned \$35 billion more in financial assets than it held in debt.

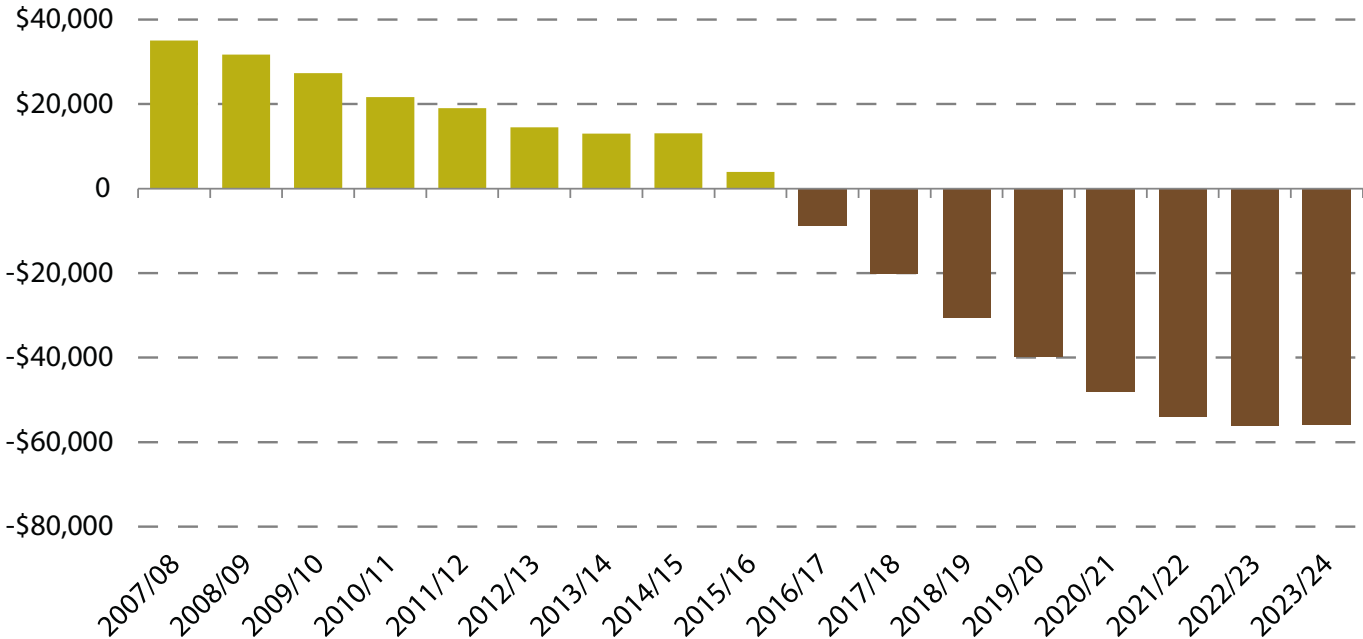
Figure 2, which compares per-capita net debt in every province for the 2007/08 fiscal year, highlights how unusual Alberta's position was.

Figure 2 shows that the government of Alberta had accumulated nearly \$10,000 in financial assets for every Albertan. By contrast, every other province carried net debt, ranging from approximately \$5,000 per person in British Columbia and Saskatchewan, to approximately \$12,000 in Ontario, to \$20,000 in Newfoundland & Labrador.

In 2008/09, however, Alberta began a string of budget deficits that has gone nearly uninterrupted since. Those budget deficits, along with significant debt-financed capital spending, have caused a rapid erosion in the province's fiscal position. Figure 3 shows the deterioration in Alberta's financial assets since 2007/08.

# Rising Debt Service Costs in Alberta

**Figure 3: Alberta’s Net Financial Assets (+)/Debt (-) (\$ millions), 2007/08 to 2023/24**



Note: Data are not fully comparable due mainly to various changes to accounting standards. Major breaks in the series include 2008-09 to 2016-17: SUCH sector included on “line-by-line” basis (revenue, expense, assets and liabilities reported in revenue, expense, assets and liabilities).

Sources: Canada, Department of Finance, 2017; Alberta Finance, 2017; Alberta, Finance, 2018.

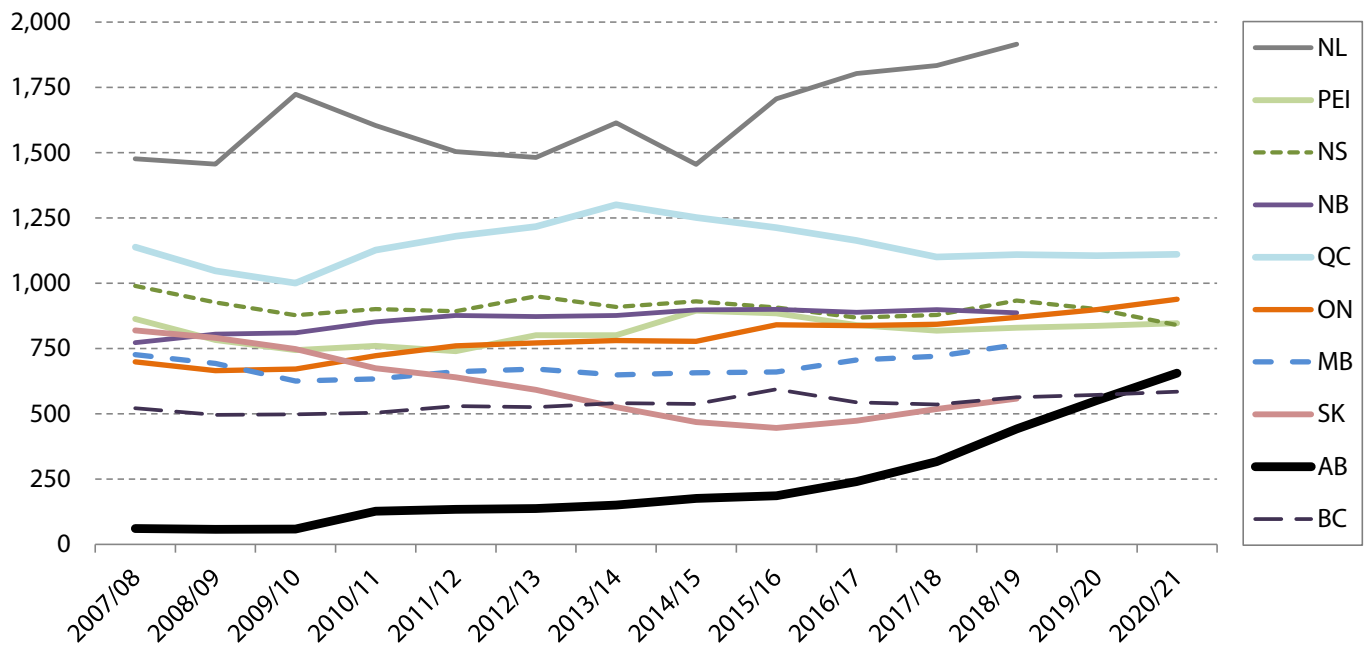
Within a nine year period, the government drew down all of its net assets and in 2016/17 returned to a net debt position. The government forecasts that debt will already have climbed to over \$30 billion by the end of this fiscal year (2018/19). Despite the fact that the recent recession is over, the government plans for net debt to continue climbing quickly, reaching \$56 billion in 2023/24. Combined with the deterioration already experienced, that would be a decrease of roughly \$91 billion dollars in the province’s net assets in 15 years. This has led to, and will continue to lead to, a substantial increase the province’s debt servicing costs.

### The cost of servicing Alberta’s debt

The elimination of Alberta’s net assets described above, and especially the rapid increase in debt that is now occurring and is expected to continue to occur in the years ahead, are quickly causing Alberta’s “other” fiscal advantage—minimal debt service payments—to disappear. Already in 2018/19, Alberta’s government expects its per-person debt service payments to reach \$442. This is only about \$120 less than the per-person debt service costs in BC and Saskatchewan. By contrast, in 2007/08, the gap was more than four times as large. Alberta’s per-capita debt service payments are still the lowest in Canada, but the size of the advantage has diminished substantially.

# Rising Debt Service Costs in Alberta

**Figure 4: Alberta's per-Capita Debt Servicing Costs (\$ nominal), 2007/08 to 2020/21**



Note: Data are not fully comparable due mainly to various changes to accounting standards. Major breaks in the series include 2008-09 to 2016-17: SUCH sector included on “line-by-line” basis (revenue, expense, assets and liabilities reported in revenue, expense, assets and liabilities).

Sources: Canada, Department of Finance, 2017; Provincial public accounts 2016/17; Provincial budgets 2018; Statistics Canada, CANSIM Table 051-0001 and 052-0005; calculations by authors.

The forecast is that Alberta’s debt service payments fiscal advantage will continue to be eroded in the years ahead—and, in fact, will disappear entirely relative to at least two provinces. Figure 4 shows the evolution in debt service payments per province since 2007/08 (ending in the last year for which each provincial government provides projections).<sup>2</sup> At the begin-

ning of the period, Alberta (black line) clearly stands alone with the lowest interest payments per person. By the end of the projection, in 2020/21, Alberta (at \$655 per person) is expected to exceed debt service levels in British Columbia and Saskatchewan in their last year reported, and will likely be closing in on several other provinces where per-capita debt service charges are essentially stable.

<sup>2</sup> Because forecasts for Saskatchewan, Manitoba, New Brunswick, and Newfoundland & Labrador are not currently available up to 2020/21, we have provided data up until the last year for which estimates are available. While that means the comparisons are not ideal, their inclusion nevertheless highlights that Alberta’s debt servicing costs are catching up

Remarkably, by 2020/21, Alberta’s per-capita interest payments on government debt are expected to be approximately 70 percent as large

rapidly to most provinces other than Newfoundland & Labrador.



# Rising Debt Service Costs in Alberta

as those for highly indebted Ontario. That year, debt service payments per person in Alberta are expected to be 59 percent as high as in Quebec—a province that is in the early stages of a long process of repairing its finances after decades of fiscal mismanagement.

Figure 4 shows that just three fiscal years from now, Alberta's per-person debt servicing costs are set to surpass at least two provinces and be within striking range of several others. In short, Alberta's status as a province with uniquely low debt service costs will be long gone.

In subsequent years, the forecast is for the situation to worsen further. Given that Alberta's government still intends to run a \$7 billion deficit in 2020/21, these costs will continue to increase at least until the budget is balanced in 2023/24, and perhaps longer depending on interest rates and borrowing for capital spending.

If the government does indeed continue to increase debt at anything resembling the current pace, Alberta will continue to close the remaining per-capita debt service payments gap with the most indebted provinces. Between 2017/18 and 2020/21, Alberta's debt service payments are forecasted to increase by approximately \$100 per year per person. If the government continues at a similar pace in the subsequent years, Alberta will shortly join Newfoundland & Labrador and Quebec as the only provinces paying more than \$1,000 per year in per capita debt payments.<sup>3</sup>

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<sup>3</sup> After a brief slowdown, Ontario's net debt per person has once again began to increase more quickly and as a result it, too, may soon join the group of provinces paying more than \$1,000 per resident per year in debt payments.

## Conclusion

Although Alberta's formerly unambiguous tax advantage compared to other states and provinces was eroded in recent years, its minimal debt service costs flowing from the province's "net debt free" status still provided the province with a second distinct fiscal advantage. With less money diverted to debt service payments, more was available for other priorities. However, the yearly per-capita debt service payments gap between Alberta and most other provinces is shrinking quickly, which will make it harder for future governments to achieve balanced budgets and provide Albertans with public services and tax relief.

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# Rising Debt Service Costs in Alberta



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