FISCAL POLICY TRENDS

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COMMENTARY FOR THE PROVINCIAL BUDGET MARCH 22, 2018

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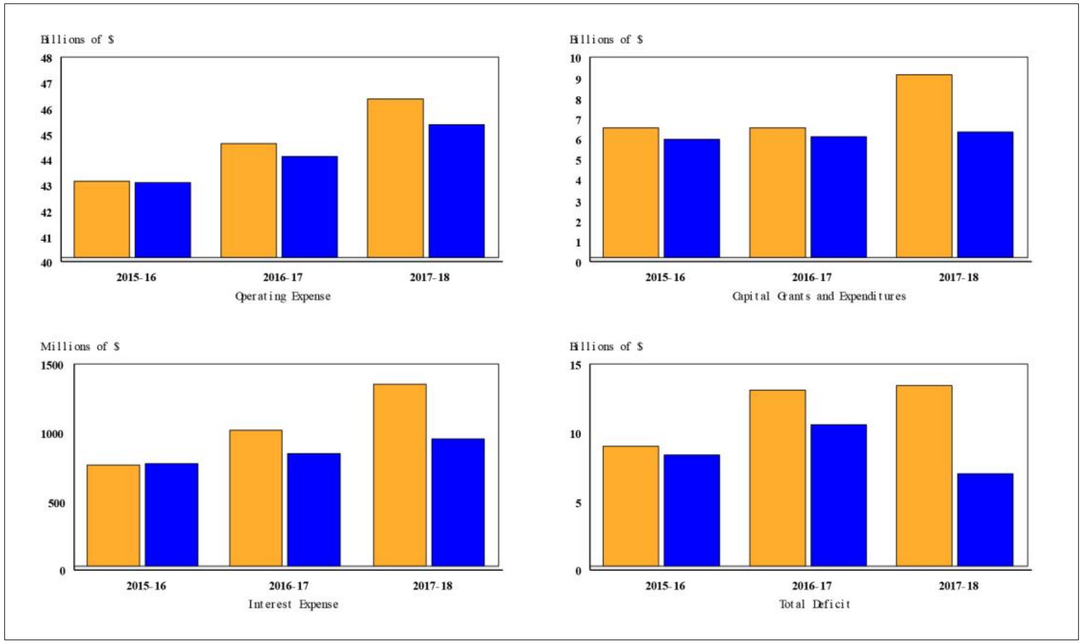
Since the Notley government was elected in May 2015, total government expense has increased 14.3 per cent, well in excess of the growth of population and inflation - 8.9 per cent. Capital spending and grants have increased by a whopping 40 per cent, all of it financed by selling off financial assets and issuing new debt.

> Total debt servicing costs have increased from $776 million to $1.355 billion, an increase of $579 million - larger than the increase in the education budget and second only to the increase in the health care expense.

Since 2015-16, total revenue has increased by 10.3 per cent, despite an $845 million dollar decline in personal and corporate income tax revenues. This reflects the decline in employment, and the erosion of corporate profits caused by the downturn in oil and gas prices. Four revenue sources account for 75 per cent of the increase in total revenues—the carbon levy ($1.012 billion), the increase in bitumen royalties ($1.135 billion), the increase in bonuses and sales of Crown leases, ($374 million) and withdrawal of funds from the Balancing Pool ($771 million). While revenues from the carbon levy revenues will likely increase with the increase in the carbon tax from $20 to $30 per tonne on January 1, 2018, future bitumen royalties and sales of Crown leases are difficult to forecast given the discount on Western Canada Select and uncertainty over pipeline construction. The Balancing Pool entry was a one off entry that will not be repeated in the future. The province's revenue picture is not robust.

Analysis of the Provincial Government's Fiscal Policy:
Actual Versus Constant Real Per Capita Program Spending



The bottom line is that since 2015, with increases in operating and capital spending in excess of revenue growth, the province has run a cumulative fiscal deficit of $24.1 billion, or about $5,500 for every Albertan.

Of course, the NDP government inherited a difficult fiscal situation, brought on by years of imprudent fiscal mismanagement by previous Conservative governments that failed to rein in spending and that ran deficits even in years with rapid economic growth and higher resource revenues.

The NDP government inherited a fiscal Titanic that was clearly headed for collision with the fiscal equivalent of an iceberg. But instead of slowing the Titanic down and maneuvering to safer fiscal waters, the NDP government choose full steam ahead.

To gauge how much the NDP government has contributed to Alberta's fiscal problem, we can compare its policy to a more prudent hypothetical policy of limiting the increase in operating and capital expenditures to the growth in population and inflation. The figure above shows how maintaining real per capita spending at 2014 levels would have affected key fiscal variables over the last three fiscal years. (Actual values in orange and projected values with constant real per capita spending in blue.) Operating expenses would have increased in each year, but they would have been $968 million less than the forecast for 2017-18. More significantly, capital spending and grants would now be $2.8 billion lower. The reduction in spending and the reduced need to borrow to finance deficits would have resulted in a reduction in interest payments on debt of about $400 million this year.

If the Notley government had adopted this modest form of fiscal restraint, the province would have run fiscal deficits over the last three years, but the fiscal gap would have declined and be $6.5 billion lower than forecast for this year.

In summary, the NDP inherited in 2015 a slumping economy and a grave fiscal situation, but instead of adopting a prudent "steady as she goes" plan, it has added to the province's fiscal problem. About one-quarter of the increase in the province's net debt since 2015 can be attributed to the Notley government's decision to increase real per capita government spending.

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