



**Don't Panic:**  
**How a Careful and Caring Provincial Budget**  
**Can Help Steer Albertans through**  
**the Global Economic Storm**

**Alberta Federation of Labour**

**Pre-Budget Brief**

**Submitted to the Honourable Lloyd Snelgrove**

**November 3, 2009**

## Introduction

We would like to begin by thanking the Government of Alberta for this opportunity to discuss the economic and fiscal issues that confront the province. The Alberta Federation of Labour represents 140,000 working Albertans living all across the province, and we believe the input of front-line workers must be considered when public policy is being formulated.

The AFL is also pleased to note that the Government is leaving open a wide range of policy options, ruling out only a provincial sales tax. We share the Government's aversion to sales taxes, which we view as a regressive form of taxation that essentially discriminates against lower income earners.

## The Problem and the Context

As originally presented in the Budget Discussion of June 2009, the problem to be addressed was the fiscal divergence confronting the Government of Alberta. Simply put: the province has committed itself to a program of increased infrastructure spending, but now finds itself confronted with diminished revenue as a result of the ongoing economic downturn and low prices for oil and natural gas.

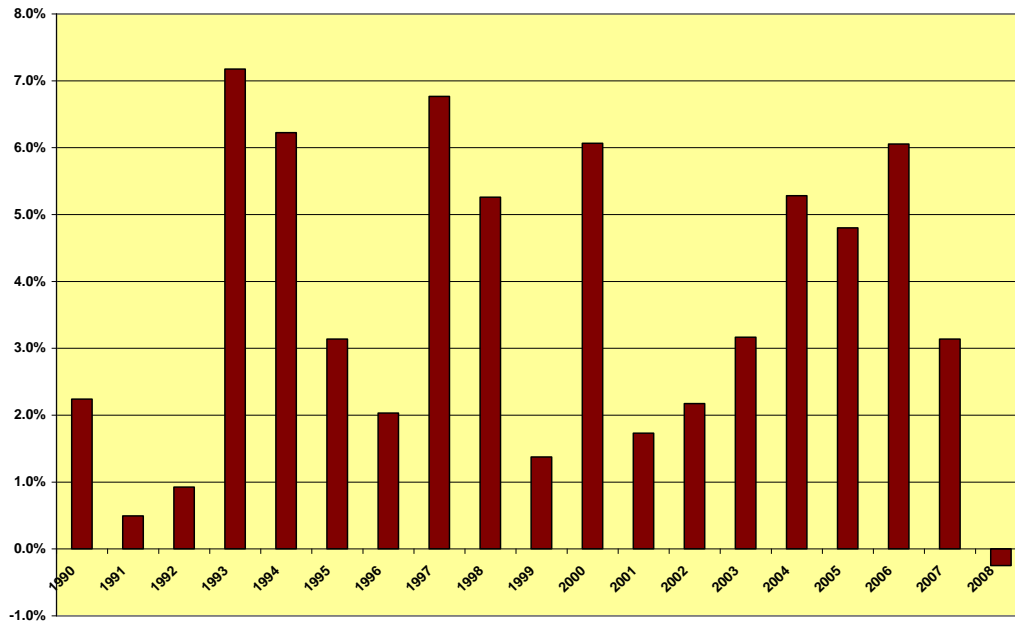
Discussions of government debt and deficits often produce two responses, characterizing the problem as either "a revenue problem" or "a spending problem". All too often, these opinions are advanced with little, if any, supporting evidence. It seems to the AFL that the appropriate way to begin our submission is by examining the economic and fiscal environment, both in its current state, and historically.

Alberta has shown very strong economic growth over the last two decades, with positive changes in real GDP every year until 2008. During this period, and especially in the last five years, Alberta was "in the midst of the strongest period of economic growth ever recorded by any province in Canada's history".<sup>1</sup>

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<sup>1</sup> Cross, Philip and Bowlby, Geoff, *The Alberta economic juggernaut: The boom on the rose*, Statistics Canada, Canadian Economic Observer, Sept. 2006, p.3.1

Chart #1, Real GDP Growth, Alberta



This strong economic performance was reflected in the province's labour market: Alberta consistently had extremely low unemployment rates, often the lowest in the country. This was especially impressive, because the two primary elements underlying the supply side of the labour market – population growth and the labour force participation rate, were also consistently the highest in the country, and almost without precedent in Canadian history. This meant the number of people ready to work in the province was growing very rapidly, yet the number of unemployed Albertans remained at very low levels. Put simply: the provincial economy was a job-making machine.

This strong performance, however, always rested on a relatively narrow foundation, as the real source of growth in the economy was the energy industry – especially oil sands and the construction of oil sands facilities. As the September, 2006 Statistics Canada article cited above puts it:

*Alberta's employment is unique in Canada in several ways. It had the largest share of jobs in the goods-producing sector at 27.3% in 2005, reflecting the size of its mining and construction industries. The large presence of these industries is also reflected in the preponderance of men holding jobs: at 76.1% in 2005, it was easily the highest in Canada...*

*Not too surprisingly, job growth since 2002 has been led by mining (including oil and gas), which has jumped by 30,000 (or 33%) over the last three years (and 71% since 1999). As a result, it is now the sixth largest employer in the province, up from 12<sup>th</sup> in 1999... Together with a 19,000 increase in construction, these two*

*industries accounted for nearly half of all job growth since 2002. This does not include the side-effects of the energy boom on industries such as finance, business services and transportation (up 35,000 since 2002).<sup>2</sup>*

The risks inherent in such a narrow economic base are obvious, especially when that base is a resource industry, subject to the volatility of global commodity markets. Economic diversification of the Alberta has been a goal of many provincial governments over the years, but our economy remains as dependent on energy prices as it was three decades ago (if not even more so).

It should also be noted that despite this extremely tight labour market, real wages in Alberta remained stagnant for much of this period. It was only in 2008 that average hourly wages in the province began to rise at a rate that exceeded inflation, and in constant dollar terms they never got back to their peak level that was reached in 1999. Despite the widespread discussion of a provincial shortage of skilled (and later, unskilled) labour, these shortages (which served to justify the province's extensive reliance on temporary foreign workers) were not enough to exert significant upward pressure on the wages of hourly paid workers. At the same time, the social wage – the package of services provided by the public sector – decreased in response to government spending cuts.

In net terms, then, many wage-earning Albertans reaped little in the way of economic benefit from the province's booming economy. With that boom now at an end, they face difficult times indeed. The provincial labour market is in serious decline: in August 2009, about 21,000 fewer Albertans were employed than in January 2008, while the number of unemployed in the province more than doubled from 78,300 in October 2008 to 158,000 in August 2009.

## **Provincial Government Finances**

In Budget 2009, the Government forecast a deficit of \$4.7 billion for the fiscal year 2009-10. It was this prediction, and the prospect of further deficits in upcoming years, that led to the current consultation.<sup>3</sup> The First Quarter Fiscal Update, issued in August, increased that forecast to deficit of \$6.9 billion, making the objective of fiscal sustainability even more urgent.

In addressing this issue, the AFL believes that we should begin by trying to answer the question posed earlier in this brief: Does the Government of Alberta have a revenue problem or a spending problem? This question has been the focus of intense political debate in the province over the last two decades, although the debate has generally consisted of simple assertions, with a notable absence of hard evidence. This is unfortunate, since discussions based on fixed ideological positions, rather than on facts, tend to be unproductive. What, then, are the relevant facts regarding the finances of the Government of Alberta?

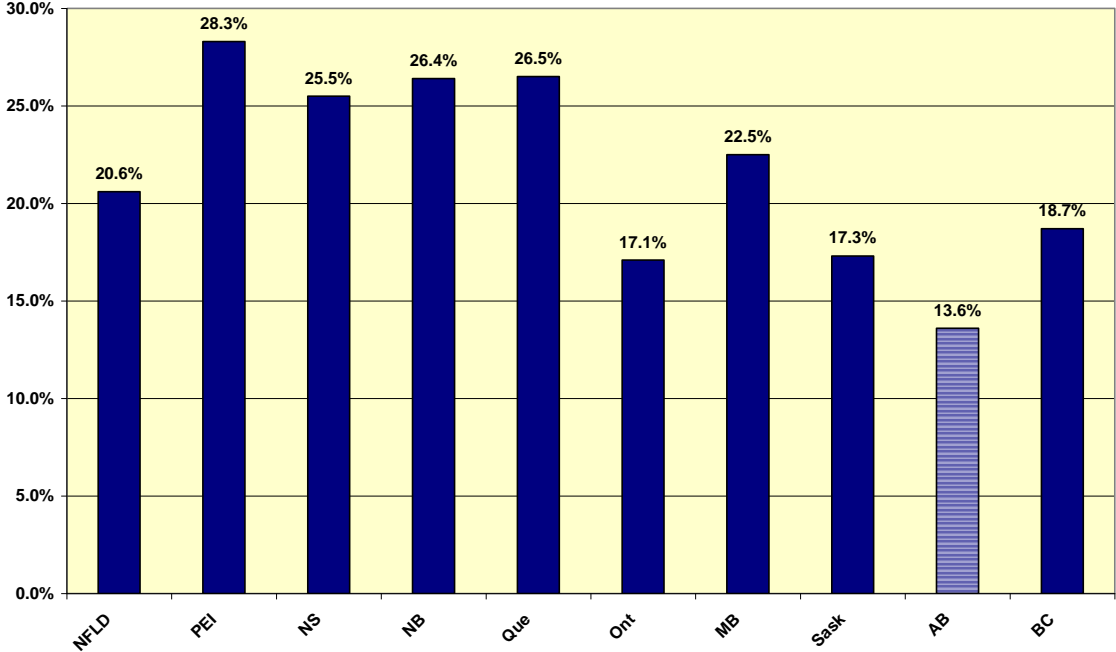
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<sup>2</sup> Ibid, p.3.7

<sup>3</sup> Budget 2009, *Building On Our Strength*, p.87.

The following chart shows, for all ten provinces, provincial government revenues as a percentage of provincial GDP. It answers the question: what portion of the wealth generated by each provincial economy is collected by the government and used to fund public services?

**Chart #2, Provincial Government Revenue vs GDP**



As we can see, compared to the rest of Canada, Alberta devotes relatively little of its GDP to providing public services.

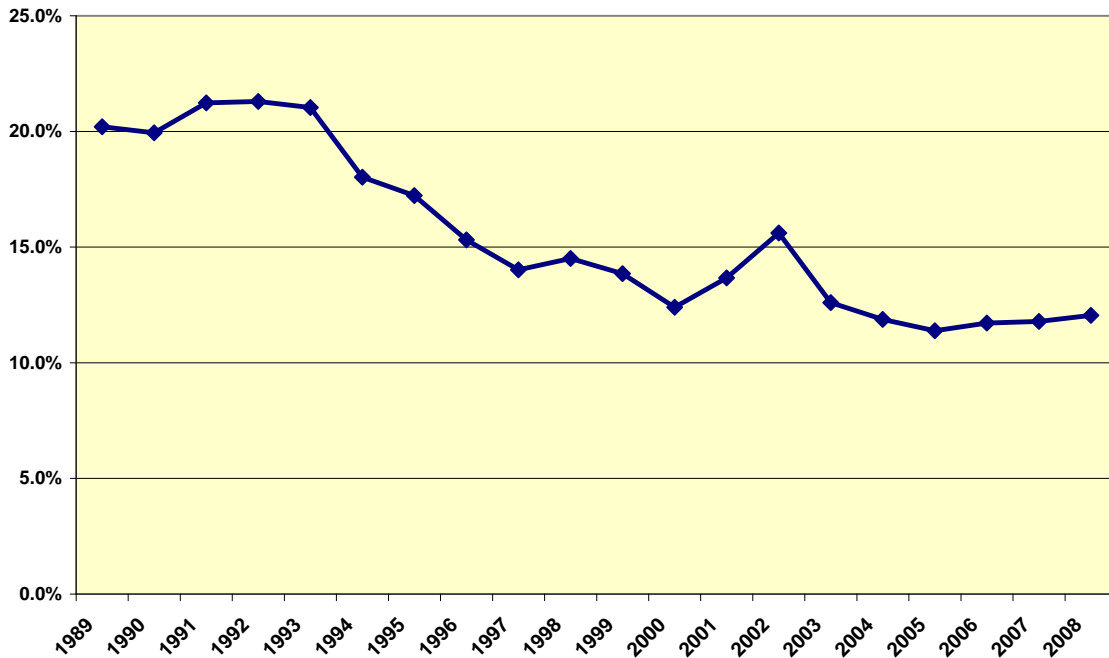
This is not to argue that the Government of Alberta ought necessarily to collect and spend any particular proportion of our province’s GDP - any such target would be arbitrary and unjustifiable. What the above evidence does suggest, however, is that the Government has options – it has fiscal “room to maneuver”. The current deficit and the prospect of fiscal shortfalls over the medium term do not mean that Alberta has to cut public services without regard for the consequences.

**Background**

The story of how Alberta arrived at its current problems is fairly straightforward. For decades the province has used the revenues derived from energy resource royalties to subsidize low provincial taxes. In the 1990s, the Klein government elevated this to the level of a principle, and labeled it “The Alberta Advantage”, but this practice of revenue substitution in fact had a long history.

In the late 1980s, the province was using resources revenue to subsidize lower taxes than other provinces, while maintaining comparable levels of spending on public services. Declining energy prices, however, reduced the viability of this approach, and led to a series of deficits. In 1992, Ralph Klein became Premier of Alberta, and implemented sweeping cuts to public services in the name of deficit and debt elimination.

**Chart #3, AB Gov't. Spending as % of GDP**



The cuts had a significant negative effect on the provincial economy. Real wages declined sharply, in both the public and private sector. In 1994 and 1995, in fact, while nominal hourly wages in Canada as a whole rose only slowly, held in check by the “jobless recovery” from the recent recession, in Alberta they actually declined. In addition, the cuts reduced services and the “social wage” to average working Albertans.

These negative trends were, to some extent, masked by the effect of increasing energy prices in the ensuing years. The government quickly began running fiscal surpluses, and the provincial net debt was eliminated in 1998.

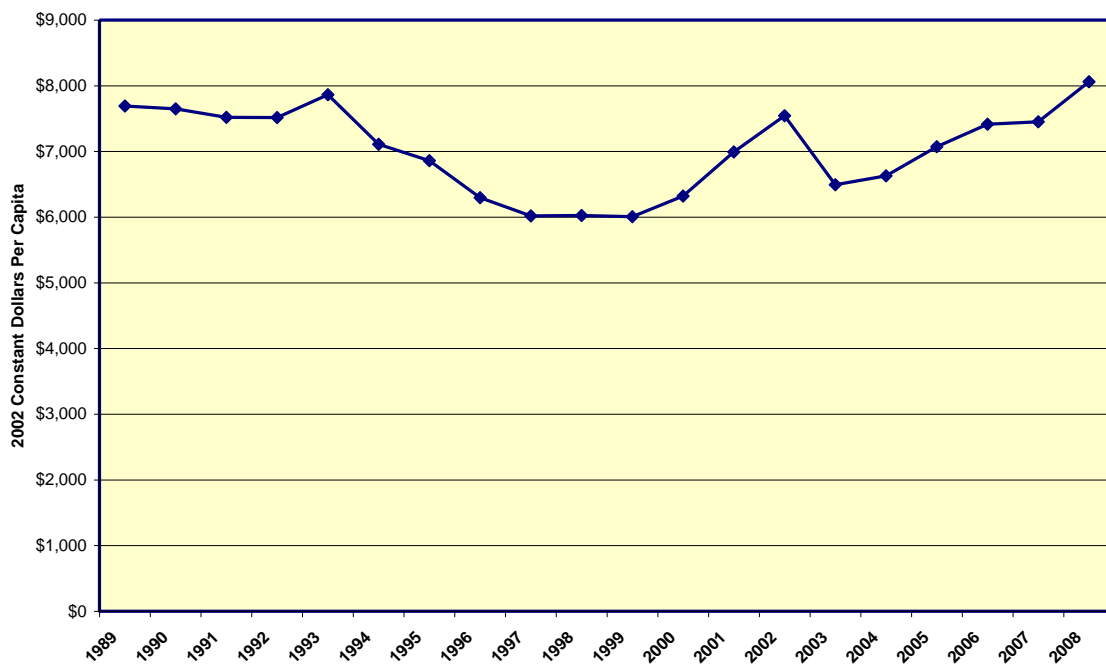
By the middle of the next decade, however, government and the public alike had become aware of a substantial “infrastructure deficit”. By insisting on across-the-board cuts, then making the suppression of public spending an article of faith, the Klein government had failed to maintain the infrastructure necessary to support growth in a modern economy. New schools, hospitals, public buildings and roads weren’t built, while existing facilities cut maintenance budgets to the bone. This left the succeeding government of Premier Ed Stelmach with little choice but to undertake large-scale investment in the repair and construction of public roads

and facilities. It was at this juncture, unfortunately, that the current recession occurred, and crude oil and natural gas prices declined sharply,

The impact on government finances has been serious, indeed. Budget 2009 forecast that natural resource revenue in fiscal year 2008-09 would amount to over \$12 billion, over one third of total government revenues for that period. In 2009-10, however, the Budget predicted these revenues to fall to just \$5.9 billion, and the First Quarter Fiscal Update revised this prediction downward to just \$3.8 billion. For a government so heavily dependant on resource royalties, having these revenues drop by more than 75% in just one year poses obvious problems.

Given the above, it is beyond dispute that the Government of Alberta faces a serious revenue problem. In fairness, however, we should also ask if public spending is a major contributor to our current fiscal woes.

**Chart #4, Real Per Capita Government Spending, Alberta**



The evidence does not suggest that government spending poses a threat to provincial finances. As the above chart indicates, real per capita spending in Alberta declined sharply in the 1990s, and rose only gradually in the last five years. The relatively sharp increase for the year 2008 reflects the government's decision to reinvest in badly needed public infrastructure. Such spending is necessary: allowing this infrastructure to further deteriorate would be a disservice to the public, and a hindrance to economic growth.

## **Policy Responses**

The government stated in its June 2009 presentation that “There are no preconceived notions of what will be done and everything is on the table except a provincial sales tax.” In the light of the above information, what should the Government of Alberta do?

### **I. Maintain Infrastructure Investment**

Any attempt to make significant cuts to capital investment in infrastructure projects would be ineffective in the short run and detrimental to the province’s future. The Klein government left an infrastructure deficit that has the potential to damage prospects for economic growth. Curtailing reinvestment at this time would leave this problem unaddressed, and would allow this “deficit” to grow even larger.

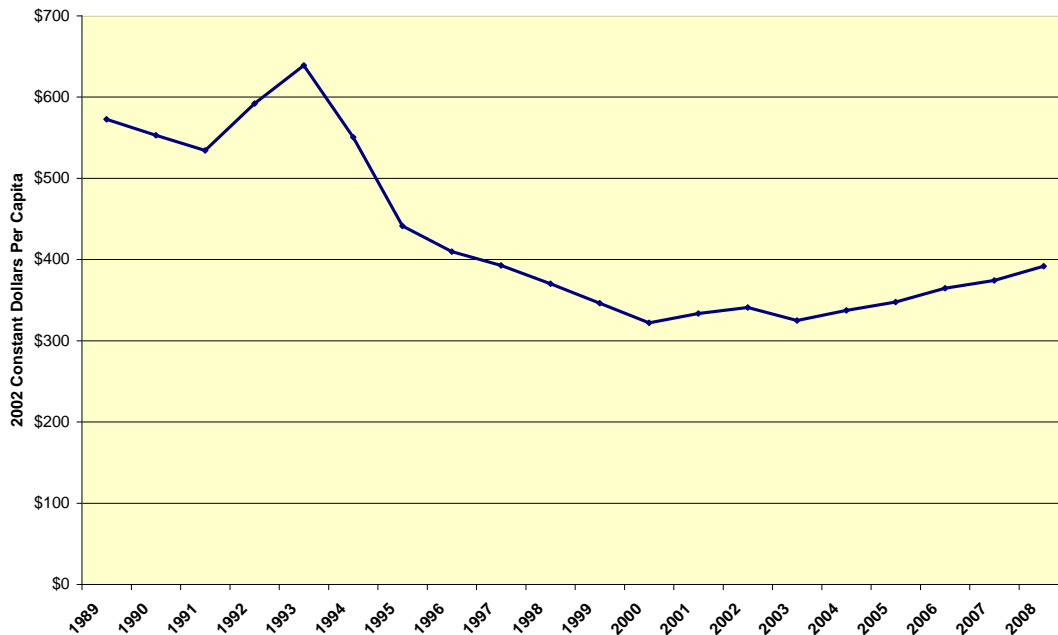
Even worse, such cutbacks in the middle of a recession would be “pro-cyclical” – they would serve to further depress the economy by reducing investment flows in the public sector. In the long run, of course, an inadequate provincial infrastructure will reduce private sector investment.

### **II. Maintain Program Spending**

In times of fiscal stringency, governments frequently try to cut program spending. The Government of Alberta should resist the temptation to do so for several reasons:

- After fifteen years of spending cuts, spending restraint, and continual restructuring, the idea that there is any “fat” left in the public service defies common sense. On the contrary, the same Statistics Canada review cited earlier points out that Alberta has the lowest percentage of its workforce employed in public administration of any province in Canada.
- Such cuts would harm the Alberta public, especially those most at risk in difficult economic times. Over the last two decades, as levels of economic inequality in the province have risen dramatically, and the number of homeless people on our streets has multiplied, real per capita spending on Social Assistance in our province has dropped by almost a third.

**Chart #5, Real Per Capita Social Assistance Spending, Alberta**



- Education and Health Care are critical components of the province's future. With an ageing population, our already overtaxed Health Care system is stressed almost to the breaking point. Further cuts and/or restructuring will put the health of Albertans at risk. In a province that is going to have to make the transition from resource extraction to a knowledge-based economy, education cuts are a recipe for long-term decline.
- As in the case of infrastructure investment, cuts to program spending would be pro-cyclical, and would further depress the provincial labour market.

### **III. Stop Subsidizing the Energy Industry**

In late 2008, in response to the collapse in energy prices and in an effort to spur activity and create jobs in the oil patch, the Alberta Government announced new transitional royalty rates for conventional oil or natural gas wells. Nearly all of the \$2 billion per year that the Stelmach government had promised to collect in additional royalties and fees from energy sector was given back in a vain effort to stimulate the sector.

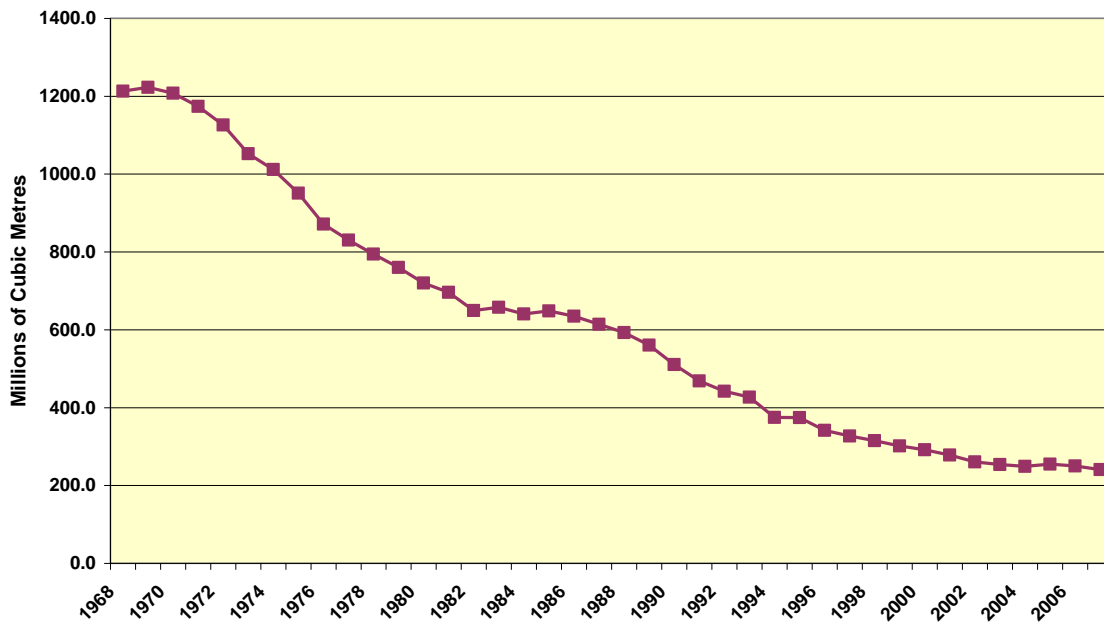
This response is typical: previous Alberta governments (notably the Getty government of the mid 1980s) have sought to prop up the oil and gas exploration industry during downturns by offering royalty holidays, incentives and outright handouts. Such actions (then and now) have cost the province billions of dollars: however, they have never resulted in any significant employment gains. Investment and jobs only return to the energy sector when global prices increase. In other words, price – not the amount that the Alberta government charges or

doesn't charge in royalties – has always been the key determinant in energy-related job creation.

Massive subsidies to the energy sector also make little sense because they don't do anything to change the fact that Alberta's conventional oil and gas sectors are mature industries which have entered into an inevitable and irreversible period of decline.

Put simply: Alberta is running out of conventional crude oil – reserves peaked in 1970, and have declined steadily ever since.

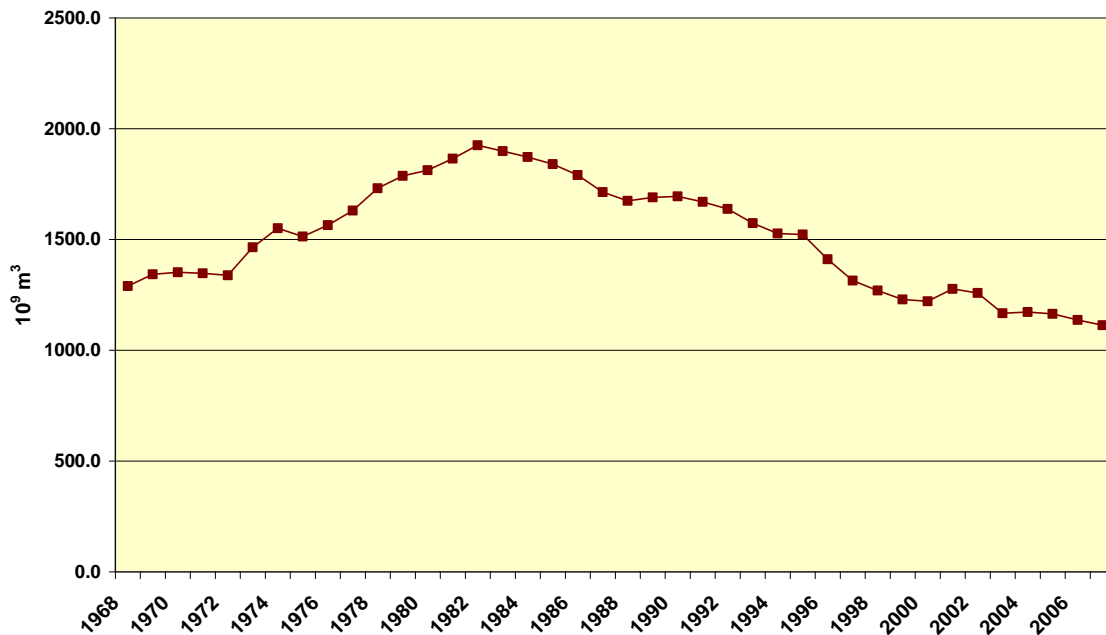
**Chart # 6, Conventional Crude Oil Reserves  
Alberta, 1968 - 2007**



For the natural gas industry, reserves peaked in the early 1980s, and the current market regime of low prices is unlikely to change in the near future. This is particularly unfortunate, since natural gas royalties have been a major source of revenue for the province in recent years, but it's also one more reason not to further diminish this revenue flow by reducing royalties.

**Chart # 7, Natural Gas Reserves, Alberta**

(Standardized @ 37.4 MJ/m<sup>3</sup>)



The conventional oil and gas industry in Alberta is in a state of permanent decline. No serious observer expects large new reserves to be discovered, and subsidizing these industries through royalty reductions is throwing good money after bad.

#### **IV. Begin a Comprehensive Review of the Provincial Taxation System**

Raising taxes in the middle of a recession is inadvisable, but the current government finds itself in a financial squeeze created by previous governments. The “flat” personal income tax, and the entire low-tax regime billed as the “Alberta Advantage” leave the province’s finances at the mercy of volatile global energy markets, while hollowing out the government’s fiscal capacity. It is urgent that Alberta begin a process of tax reform, with changes implemented as economic conditions permit.

### **Conclusion**

The Alberta Federation of Labour thanks Alberta Finance for the opportunity to take part in this consultation.

We recognize that the Government of Alberta finds itself in a difficult situation, confronting a recession driven by global economic forces, while dealing with fiscal constraints created by previous provincial governments.

We believe that it is time for the province to take a fundamental change in direction – one which will provide a sound fiscal base for future economic growth and prosperity in Alberta.

The first and most important step in this process of change is for the government to recognize the need to take a new approach to collecting revenue – one that doesn't rely disproportionately on energy revenue and doesn't leave the province so vulnerable to inevitable changes in energy prices.

The second important step that we believe the government needs to take is to recognize that deep cuts to public services and public spending are not the answer. Recent history has shown that knee-jerk cuts imposed as a result of short-term revenue problems only serve to create long-term problems for both the economy and future governments. By imposing deep public sector spending cuts during a recession, governments also runs the risk of making the recession longer, deeper and more painful than it needs to be.

With all this in mind, the Alberta Federation of Labour urges the government to maintain levels of spending on both infrastructure and services, even if it means using all of the "rainy day" money set aside in the Sustainability Fund – and even if it means a return to more traditional deficit financing over the short term. Once the recession is over, the province can then begin talking about eliminating deficits – but in the meantime, no drastic measures should be taken to weaken the one sector of the economy (the public sector) that is doing more than other sectors to keep Alberta families afloat during these difficult economic times.

No other province in Canada – and perhaps no other jurisdiction in North America – is better positioned financially to ride out the recession than Alberta. By taking advantage of our debt-free status and our savings – and by maintaining, or even increasing, levels of public spending while times are tough – we can help individuals Albertans and their families stay employed while at the same time building the infrastructure and services we need to emerge from the recession stronger than ever.