

**ADVANTAGED NO MORE:
HOW LOW TAXES FLATTENED ALBERTA'S FUTURE**

A report prepared for the Parkland Institute

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INTRODUCTION

Parkland Institute conducts non-partisan research into issues affecting Albertans. In preparation for the Alberta government's upcoming 2002-03 budget, Parkland Institute with the assistance of some of the province's top public policy advisors¹ set out to examine Alberta's current fiscal situation. This paper highlights recent trends affecting provincial revenues and expenditures. On the revenue side, the paper concentrates on the province's recent adoption of the single rate tax (SRT) and increased reliance upon oil and gas royalties for revenues. On the expenditure side, the paper focuses on long-term trends in spending on the "big ticket" items of health, education, and social services.

The paper argues recent government fiscal policies have created an artificial revenue crisis, the result of which has been a second stage crisis involving renewed cuts to valued public services, intensified labour strife, higher costs to average Albertans, and general economic instability. The paper argues that government explanations for the crisis (e.g., that expenditures are out of control) are not substantiated by any existing data and serve only to mislead the public. For this reason, the paper makes several suggestions for improving Alberta's budget process and fiscal accountability.

Finally, the paper calls for a major rethinking of economic policy in Alberta, including the abandonment of the SRT in favour of a more progressive taxation system, repeal of the province's Deficit Elimination Act, and creation of a Revenue Stabilization Fund.

1. REVENUES

On the surface, Alberta would seem to be in an enviable position. The province is rich in oil, gas, and other resources in demand throughout the world, especially the United States, to which Alberta is western Canada's largest exporter (Canada West Foundation, 2001). In turn, based on these exports, Alberta has sported Canada's healthiest economy in recent years, with growing government revenues. Figure 1 (below) shows that in 2001 as energy prices soared across North America, revenues climbed to \$7,761 per capita - \$2,600 per capita higher than in 1993.

¹ The Parkland Institute gratefully acknowledges the assistance of Rod Adachi, Wendy Armstrong, Arlene Chapman, Greg Flanagan, Jason Foster, Tom Fuller, Trevor Harrison, Tim Johnston, Mel McMillan and Dean Neu. We thank also Dave Odynak and Alex Schwarzer for their technical support.

Figure 1: Alberta Revenue Per Capita, 1989-2001

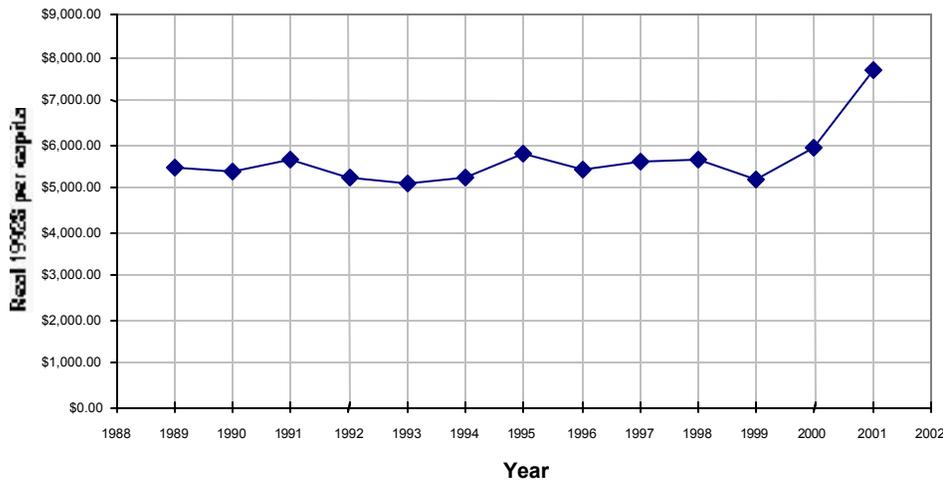


Figure 1² also reveals, however, the long term instability of Alberta’s economy. Between 1989 and 2000, for example, per capita revenues in Alberta fluctuated (in constant 1992 dollars) from a low of \$5,152 in 1993 to a high of \$5,916 in 2000, a difference of nearly \$750 for every person in Alberta. The royalty windfall of 2001 was welcomed, but – as recent government statements attest – provides no basis for sound fiscal planning.

For all it reveals, Figure 1 also hides an important structural shift in the sources of Alberta government revenues. The biggest shift in government revenues occurred with the government’s introduction of a single rate tax (SRT) system on January 1, 2001. Key features of the SRT included an increase in basic and spousal exemptions to \$12,900 and a single tax rate of 10 percent. Additionally, the tax system was indexed to inflation, while all non-refundable credits were continued.

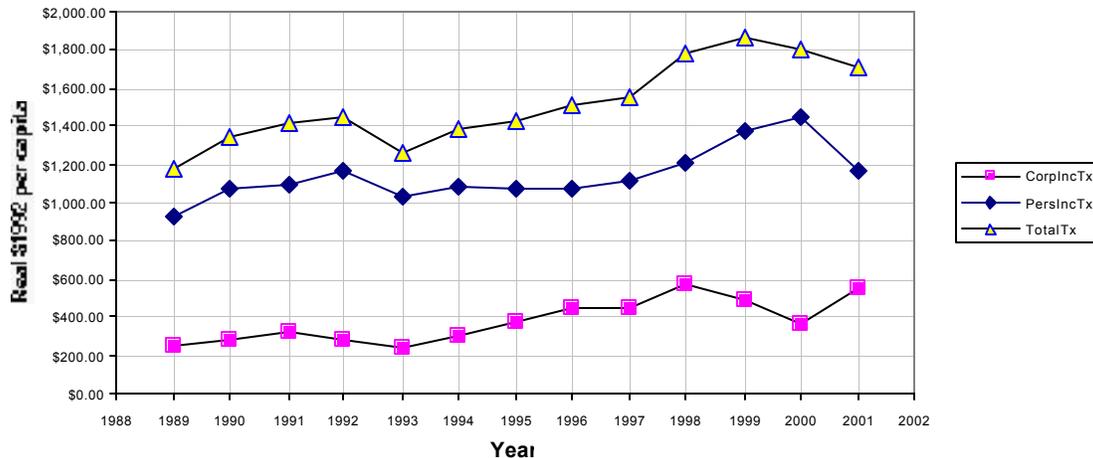
Under Alberta’s previous tax system, real per capita taxes rose steadily throughout the 1990s. In 1989, personal income taxes in Alberta amounted to revenues equivalent to \$927 (in constant dollars) per capita. Thereafter, the amount raised in personal taxes rose steadily to \$1,449 per capita in 2000. Under the new tax system, individual taxes declined in 2001 to \$1,160 per capita. According to the government, the new tax system reduced the amount of money coming into the Alberta Treasury by \$1.1 billion in 2001 alone (Alberta Finance, 2001a), confirming Alberta’s status as having the lowest tax regime in Canada (Canada West Foundation, 2001: 1).

As Figure 2 shows, total taxation revenues in Alberta have declined since 1999, from a high of \$1,862 per capita in 1999 to \$1,713 per capita in 2001. The drop in overall taxation would have been even more dramatic had corporate taxes collected by the

² Unless otherwise identified, all the figures appearing in this paper are calculated from Statistics Canada documents. The documents are (1) Federal and Provincial General Government Revenue/Expenditures: Provincial Government (Dollars – Millions); (2) Estimates of Population, by Age Group and Sex, Canada, Provinces and Territories; Both Sexes; All Ages (Persons); and (3) Consumer Price Index, 1996 Basket Content; Canada; All-Items (Index 1992=100).

government (having dropped in 2000 to \$356 from \$491 the year previous) not spiked again in 2001 to \$553 per capita due to an energy “crisis” in the United States.

Figure 2: Corporate and Individual Income Tax, 1989-2001



At least two things need pointing out regards both Alberta’s ongoing cuts in taxation and adoption of the single (flat) rate tax system (SRT). First, while it is true that all Albertans have formally experienced tax savings as a result of these changes, some have saved more than have others, an occurrence anticipated by critics even before the SRT’s introduction (see Flanagan, 2000). Tables produced by Alberta Finance (2001b: 18-19) show that those earning between \$30,000 and \$60,000 in Alberta pay more proportionately under the flat tax system than do those in tax brackets either below or above them (see also Lawrence, 2001). Put another way, under the new tax system middle income earners pay a greater proportion of Alberta’s individual tax revenues than they did under the old system.

Moreover, as calculated by University of Alberta Economist Melville McMillan (Appendix A), whatever meager tax decrease many low and middle income earners obtained as a result of the SRT, this will almost certainly be eliminated under current plans to raise health care premiums in Alberta by a reported 30 percent. The AHI premiums are a regressive tax. The proposed health care premium increase will claw back about 15-35% of the meager tax reduction the SRT brought to middle income taxpayers. We anticipate some subsidy for lower income groups, although the amount is unknown, but not for the middle class. Meanwhile, the tax burden for upper income groups will remain largely untouched.

Second, the Alberta government seems committed to lowering revenues generated from taxation even further. We note, for example, the statement made by Alberta Treasurer Pat Nelson to the *Calgary Herald* on March 27, 2001 that, “The only way taxes are going in this province are down. This government is committed to seeing that Albertans have more money in their pockets.” In particular, as part of its four year plan to reduce business taxes by \$1 billion “subject to affordability” (announced in the 2001 budget,

fiscal plan pages 3 and 19), the government remains intent on dropping business taxes this year by \$275 million (p. 19). It should be noted that this amount exceeds the \$201 million to be generated by the aforementioned rise in health care premiums.

Not all forms of taxation are alike, however. For example, the amount of revenues generated from personal income taxes and consumption taxes is relatively predictable from year to year. By contrast, resource royalties are far less predictable. Alberta has a long history of “boom and bust.” Because it depends on oil and gas royalties now more than before, the Alberta government’s tax changes increase the structural instability underlying the province’s finances.

Government actions since the last budget provide proof. Last year, the Alberta government projected net revenues for 2001-2002 of \$1,091 million. But a drop in oil and gas prices, beginning in the spring of 2001, followed by the terrorist attacks on New York and Washington in September and a mild worldwide recession, quickly led to revised revenue projections and cuts to core program spending (see below). Thus, the government’s third quarter update (February 27, 2002) revised net revenues to \$297 million. This revision meant that Alberta’s economic “cushion” fell from \$817 million to \$18 million, while the amount going to debt repayment dropped from \$613 million to \$18 million.

Keep in mind, this surplus would have been \$1.1 billion larger had the Alberta government not adopted the SRT. In the face of a fiscal crisis of its own making, the Alberta government has (perhaps predictably) argued the need to find new revenue sources. These new sources include an expansion of gambling, which rose from \$770 million in 1998/99 to \$856 million in 1999/00 to \$1 billion in 2000/01 (*Edmonton Journal*, 2001). New sources also include increased cigarette taxes (recently announced), and – as advocated by the Premier’s Advisory Council on Health (2001) - higher health care premiums.

The government’s increasing reliance upon these new sources of revenues is meeting criticisms. There is growing widespread concern, for example, over social problems associated with gambling (Seeley and Seeley, 1998; Azmier, 2000). The Canadian Taxpayers Federation has accurately denounced health care premiums as a tax by another name (*Edmonton Journal*, 2002). Others warn that raising health care premiums may put some businesses at a disadvantage in competing with businesses in other jurisdictions. Finally, there is concern that government fiscal policies in recent years, from premiums to new user fees, are regressive and punitive of those least able to pay (Canadian Association of Retired Persons, 1999).

The government has thus far not heeded these concerns. Having adopted low taxes as an article of ideological faith, the government seems increasingly reliant upon unstable resource royalties or these “new” revenue sources to fund core services or – alternatively – to accept further cuts in spending, including privatization of many services.

2. EXPENDITURES

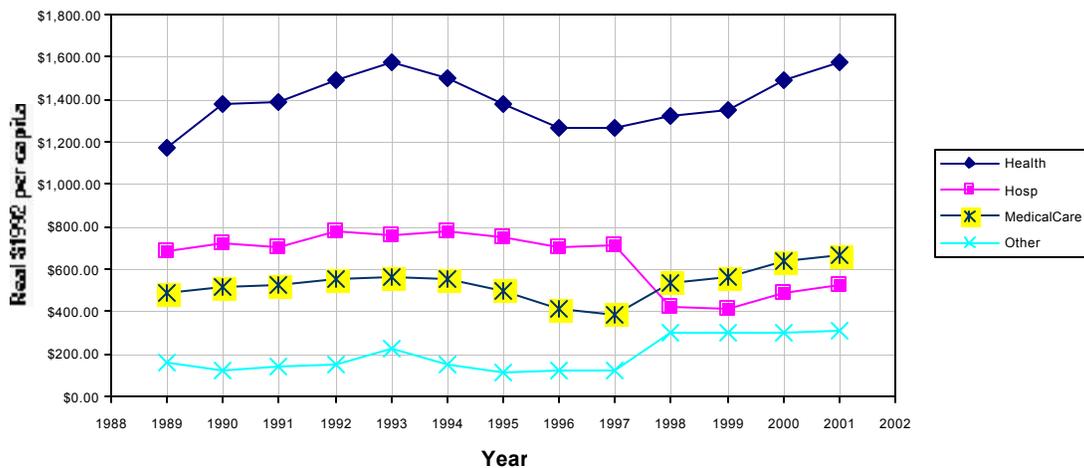
Every year, net migration to Alberta adds roughly the equivalent of a city the size of Red Deer to the province’s population. Thus, even at a time of relatively low inflation (about 2 percent), program costs can also be expected to rise. In order to get an accurate picture of trends in Alberta’s expenditures, these two things – population growth and changes in the cost of living – must be considered.

When this is done, we see that overall government expenditures in nearly every area have remained flat over the long term. It is only by taking a very short term view (concentrating on the period following the cuts ending in the mid-1990s) that government expenditures might seem – as sometimes claimed – to be skyrocketing out of control. This section of our paper deals with the three core areas of government expenses: health, education, and social services.

2.1 Health

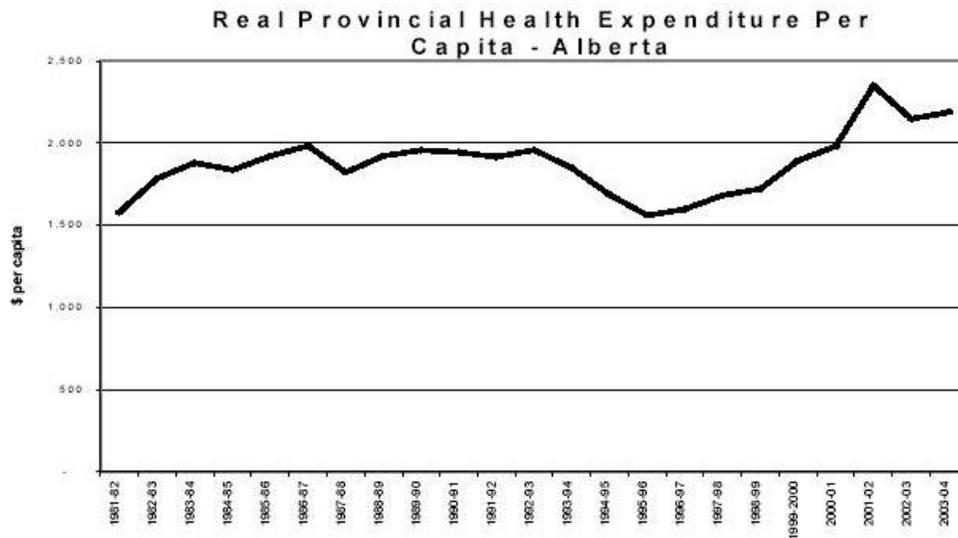
The recently released Report by the Premier’s Advisory Council on Health (a.k.a., the Mazankowski Report) (2001: 27) argues “spending on health has increased by an average of 10 percent a year since 1996.” Figure 3 shows this statement presents only a partial truth. In fact, real spending per capita on health care in Alberta in 2001 is identical to spending in 1993 (\$1,571 vs. \$1,575).

Figure 3: Health Expenditures in Alberta, 1989-2001



Moreover, the data shown in Figure 3 is borne out by a similar graph contained in the recent report prepared by the Premier’s Advisory Council on Health (2001). The context paper accompanying the report, entitled “Is Alberta’s health system sustainable,” presents on page 3 a graph nearly identical with the exception of an extrapolation into the future of what are otherwise supposed to be “real” expenditures. The Advisory Council’s graph is reproduced here for comparison (Figure 4).

Figure 4



Source: Alberta Finance, September 2001

Returning to our Figure 3, we see that hospital costs have been declining (presumably as a result of the shutting down of some hospitals in Alberta in the mid-1990s), while medical care and assorted “other” costs have been rising. Again, however, overall public costs have been contained. The report of the Premier’s Advisory Council (2001: 5) makes clear public health care costs in Alberta in fact have “flat lined” and are below the Canadian average (5.3 percent of GDP vs. 6.6 percent for Canada in 2000 as a whole). The same report (p. 11) also shows Canada’s total spending on health care (9.3 percent of GDP in 1997) is about average for all western industrial countries, but well below that of the United States (13.6 percent of GDP in 1997). Despite this, the government recently has implied a desire to withdraw further from public spending on health care, through delisting of services, privatization, and raising health care premiums.

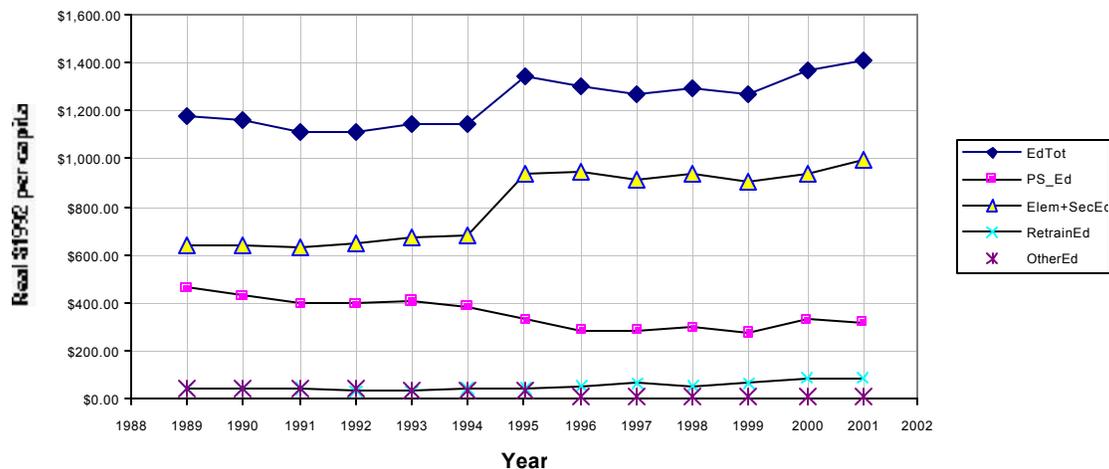
Will plans for revamping Alberta’s health care system, as detailed in the Premier’s Council report harm the health of lower income Albertans? Will these plans encourage large, private sector monopolies to enter the health care field in Alberta? Will the increase in health care premiums harm Alberta’s favourable business environment? The data presented here cannot answer these questions. It does suggest, however, that government plans are based on a false premise regarding past trends in health care spending, that Alberta’s health care situation has been misdiagnosed and ill-thought out remedies have been suggested. In turn, this makes us leery of government expenditure projections that seem intended to create an illusion of future crisis rather than to inform and engage the public in debate.

2.2 Education

Figure 5 (below) shows overall education costs in Alberta. It also breaks down education costs by type: post-secondary, elementary and secondary, retraining, and “other.”

At first, the graph appears to suggest direct education spending by the Alberta government has risen substantially since 1989, with a particular “spike” in 1994-95. It must be remembered, however, that after 1994 the Alberta government took away, assuming for itself, taxing authority from local school boards and so paid a larger portion of education out of general revenues. When this shift in funding is accounted for, real per capita education costs overall and real costs at the elementary and secondary educational levels have remained nearly static since 1989.³

Figure 5: Education Expenditures in Alberta, 1989-2001



In another sense, however, we should not be surprised if education funding overall at the K-12 levels were increasing. For example, efforts to integrate special needs children into classrooms in recent years might be expected to require more resources.

More striking is the steady decline in post-secondary funding over the years, and most particularly since 1994. In 1989, per capita funding on post-secondary education was \$459 (in constant dollars). By 1994, it had declined to \$388. In 2001, it stood at \$317.

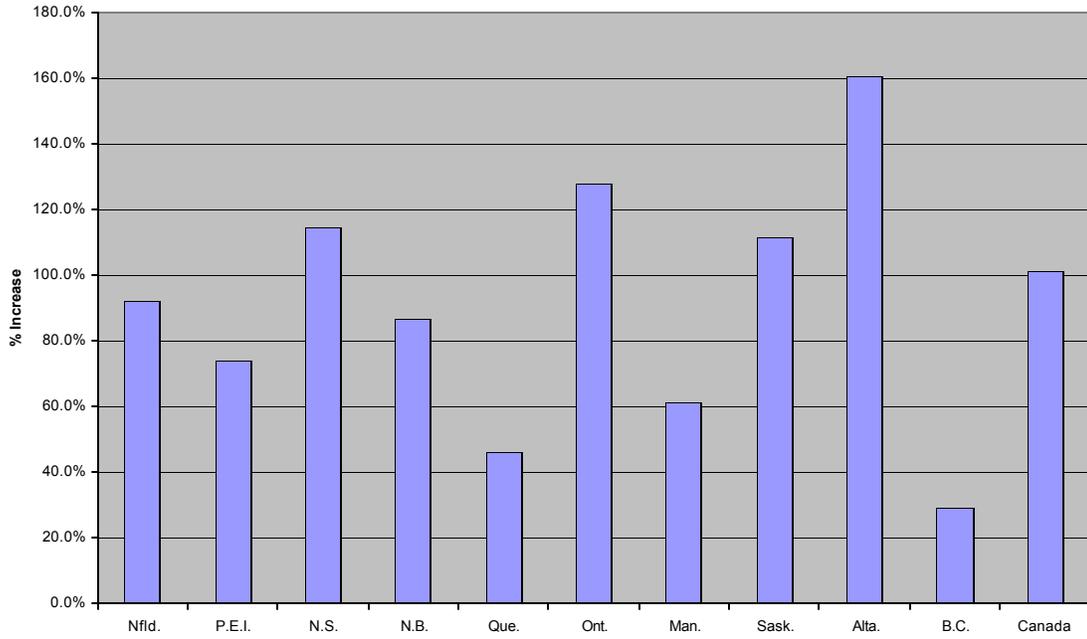
The decline in public post-secondary spending reflects real increases in university tuition fees in recent years. As Figure 7 (below) shows, over the last decade the cost of a Bachelor of Arts degree has increased in Alberta far more than in the other provinces.

This finding seems at odds with public statements frequently made by Alberta’s political and business leaders. Higher education is widely touted as a vital necessity for creating a modern, knowledge-based economy. The data presented here does not definitively contest these statements. It does suggest, however, that the government does not view higher education as a vital area for public expenditures. Increasingly, the costs of higher education are being “privatized” – that is, being transferred to students and their families. Alternatively (or perhaps additionally), one may infer that the government views education as something that can be “externalized” to other jurisdictions, with Alberta

³ For figures on school property taxes and expenditures on basic and advanced education, see “historical consolidated fiscal summary, 1984-85 to 2003-04,” in Alberta Finance 2001a).

reaping the economic benefits of students educated elsewhere – a conclusion hardly cheery for Alberta parents and their children.

**Figure 6: Percent Increase In Tuition Fees - Undergraduate Arts Degree
1991-92 to 2001-02**



Source: Derived from Statistics Canada, 2001: 8.

In any case, given Alberta's large tuition increases, it is not surprising that Alberta ranks seventh among provinces in the percentage of young people (aged 25 - 29) with university degrees (Figure 7).

Figure 7: Percentage of Population With University Degrees (ages 25 - 29)

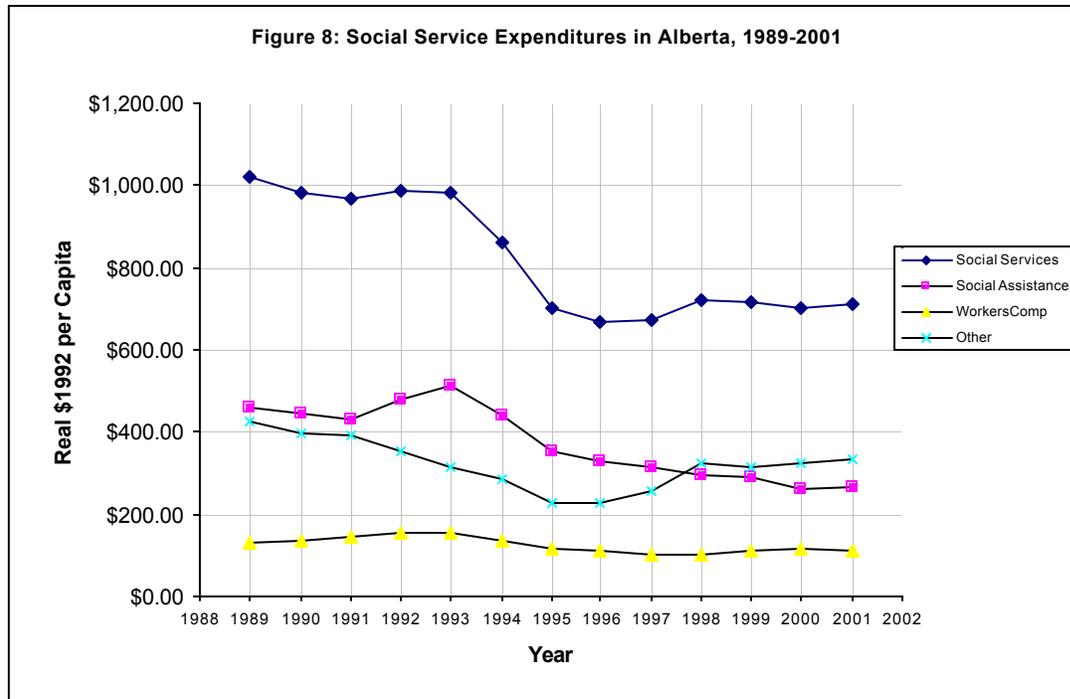
Year	Canada	Alberta	Alberta's Rank
1990	17%	15%	5 th
1998	26%	22%	7 th

Source: Confederation of Alberta Faculty Associations, 2001: 2.

Will Alberta's high tuition fees and relatively low post-secondary educational levels result, over time, in a low - wage workforce? If so, this "education gap" may in time prove to be a competitive disadvantage for Alberta.

2.3 Welfare and Children's Services

In the mid-1990s, the federal government and provincial governments embarked on several measures to deal with deficits and accumulating debts. These measures varied from jurisdiction to jurisdiction, but frequently relied upon a combination of program cuts and tax increases. Alberta was somewhat singular in relying upon a “one hand clapping” approach of massive cuts to government programs. Social services experienced particularly large cuts at this time. A report by the Canada West Foundation (1998: 12) shows that between 1992/93 and 1994/95, welfare expenditures in Alberta declined by 22.1 percent compared with 8.1 percent in health and 6.6 percent in education. Between March 1993 and April 1997, social allowance caseloads decreased by more than 60 percent from 94,087 to 39,506 (Canada West Foundation, 1997), while welfare rates for those remaining were significantly reduced. Not incidentally, in the minds of many, child protection caseloads rose dramatically during this period (Edmonton Social Planning Council, 1998). Today, welfare allowance rates remain low, child protection caseloads continue to grow (up 1,337 to 15,032 in 2001 [Alberta College of Social Workers, 2002]), homelessness is now common, and food banks – a temporary measure started in the early 1980s – have become permanent features of Alberta's urban landscape. Yet, while health and education have seen recent increases in spending, bringing them up to pre-cut levels, social service expenditures remain far below the 1993 level (Figure 8). It is hard not to conclude that social services are a neglected domain, the people who rely on its services forgotten people.



In August 2001, Alberta Children’s Services had its budget reduced by 1percent, a total of \$6.5 million. ACS already had a projected deficit at the time of \$32 million. These deficits are occurring at the same time as Alberta’s population is growing and caseload sizes in the province also are increasing

3. REPORTING AND ACCOUNTABILITY

Financial markets have recently been stunned by revelations of loose accounting practices involving formerly large companies such as Enron and Corel. Similar concerns have been expressed regarding the awarding of federal contracts to private firms and – in a case with remarkable parallels to Alberta – Ontario’s Auditor General in the case of a contract made with a private health care clinic in that province (*Ottawa Citizen*, 2002).

These recent events highlight concerns we have with Alberta’s current budget process. Alberta’s finances today are generally more transparent than in the early 1990s. There remains much to be done, however. This is not the place to fully examine Alberta’s budgetary processes, but we want to highlight two chief concerns.

Our first concerns follows on the heels of the report of Ontario’s Auditor General (cited above) and an emerging literature on the need for sound accounting practices in the awarding by government of private contracts (see Globerman and Vining 1996). It is not clear the Alberta government has in place the necessary mechanisms for monitoring and assessing the benefits of private contracting. Neither is it clear the government has in place adequate means of ensuring competitiveness in the awarding of contracts.

A second related concern deals with reporting. Private companies are not required to report in the same way as public agencies and departments. But how are Albertans to know they have received value for their dollar? This problem highlights a particular difficulty with current plans to expand private contracting in the public service.

SUMMARY AND RECOMMENDATIONS

Alberta remains the envy of many provinces. This pre-budget report points to some worrying trends, however. Boom and bust have long been a recurring theme in Alberta. In 1971, the Alberta Tories under Peter Lougheed were elected largely on a promise of diversifying the economy. This promise of diversification was renewed following the economic recession that hit the province in the mid-1980s, and led (for example) to development of the provinces forestry industry. Today, Alberta's fiscal health should not be as dependent upon resource royalties as in the past. And, yet, within a matter of months following last year's budget the province's fiscal situation underwent a massive sea change. Once more, programs were cut and the euphoric dreams of (for example) eliminating health care premiums were replaced by the exact opposite.

The problem lies not in Albertans themselves but in the single star of "low" and even "extraordinary low" taxes that the Alberta government has hitched itself to in recent years believing they are necessarily an advantage. This false assumption reached its peak with the implementation in 2001 of the government's single rate tax that cost the Alberta Treasury \$1.1 billion. The illusion that an extraordinary low tax regime could be maintained while simultaneously maintaining services comparable to those in other provinces was made possible only by a temporary boom in resource royalties. The subsequent decline of oil and gas revenues in 2001 destroyed this illusion and has created a crisis.

While the current fiscal crisis is very much of the government's own making, it nonetheless holds risks for Alberta's real advantages: Medicare (Canada's advantage as a whole), excellent education systems (at both the K-12 and post-secondary levels), safe streets, affordable housing, and social harmony. What is so good about low taxes if important services suffer? What do low taxes mean to people if they must immediately turn around and spend their "savings" – and perhaps even more money - on necessary services provided in the private marketplace? In pursuing lower and lower taxes as an end in themselves, the government has put the future prosperity of Alberta at risk.

With this in mind, Parkland Institute recommends the Alberta government immediately adopt the following fiscal and economic measures:

- that it drop the flat tax rate system adopted in 2001 in favour of a return to a progressive rate structure on taxable income, while maintaining the higher level of basic and spousal exemptions adopted in 2001⁴;

⁴ University of Alberta economist Brad Reid has recently voiced similar concerns regarding Alberta's tax cuts.

- that Alberta's Deficit Elimination Act be repealed⁵, replaced by five year averaging to ensure no net debt additions over a five year period.
- that a Revenue Stabilization Fund be established;
- that health care premiums be eliminated entirely, with health care funded solely out of general government revenues;
- that economists and accountants independent of the oil and gas industry conduct a full review of the province's royalty rates in comparison with other similar jurisdictions (e.g., Alaska, Norway) to determine whether Albertans are obtaining a fair price for their non-renewable resources, and that an annual report be presented to the Legislature on Alberta's royalty rates;
- that privatization of services by the Alberta government be halted until a Task Force under the auspices of Alberta's Auditor General determines that the proper mechanisms and procedures are in place to ensure competition, monitoring, and compliance by contracting agencies and organizations;
- that there be a revitalization of public services through new hiring in the fields of education, health, and social services.

⁵ Don Drummond, chief economist of TD Economics, and Mary Webb, senior economist at Scotiabank, have recently spoken out against Ontario's policy of never running a deficit.

Appendix A

Net Tax Savings of Typical Alberta Households from the Move to Alberta's Single Rate Tax and Increased Health Insurance Premiums				
Single Person				
Annual Income Example ^a	Alberta 2001 PIT Saving (1)	Increased AHI Premium (29.4%) ^b (2)	Net Saving (1 – 2)	Percentage of PIT Saving Lost due to AHI Increase
(1) \$11,800.	\$137.	\$120.	\$17.	87.9
(10) 20,000.	413.	120.	293.	29.1
(7) 36,000.	336.	120.	216.	35.7
(2) 46,000.	525.	120.	405.	22.9
(3) 72,000.	1067.	120.	947.	11.2
(4) 90,300.	1773.	120.	1653.	6.8
(15) 120,000.	9246.	120.	9126.	1.3
Single Earner Family				
(2) \$26,700.	\$1065.	\$240.	\$825.	22.5
(4) 30,000.	1095.	240.	855.	21.9
(1) 60,000.	1599.	240.	1359.	15.0
(8) 83,000.	2840.	240.	2600.	8.5
(6) 250,000	9519.	240.	9279.	2.5

- a. Examples from “Typical Albertan Profiles and Tax Saving Examples” (see www.treas.gov.ab.ca/business/tax_personal/profiles_savings_examples.html). Number refers to specific example.
- b. Assumes increases of \$10 per month for singles and \$20 per month for families as projected in the Edmonton Journal, March 15, 2002.

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