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SPENDING AND TAXING: THE RECENT RECORD OF WESTERN CANADIAN PROVINCIAL GOVERNMENTS

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1. INTRODUCTION

Serious fiscal deficits developed in provincial budgets of the four western provinces during the 1980s. The impact of falling commodity prices led to provincial unemployment rates that rose relative to the national rate, and to rates of growth in output far below that in national output . Further each province now has to respond to cuts in federal government transfer payments. Policy makers should not be second guessed on the difficult decisions faced during the decade. But it is proper in the following pages to outline general trends in revenues, expenditures, and deficits. This will identify the policy pursued by each province and clarify the future choices following from the realization of these policies.

There were significant differences in the approach followed by each province to deal with the deficits generated by adverse economic circumstances. British Columbia demonstrated substantial expenditure control and kept taxes relatively low. Manitoba accepted that a higher level of public services required higher tax rates and has continued to maintain a level of taxation well above the national average. Both Alberta and Saskatchewan now face serious budgetary problems as a result of levels of public spending well above what is sustainable in the long run. Alberta, in particular, has continued a level of taxation far below the national norm, depending on substantial borrowing while awaiting a hoped for higher real price of energy to produce a needed hike in revenues.

Interpretation of provincial government action is complicated by the fact that during the 1980s provinces engaged in stabilization policy by using higher expenditures and/or reduced tax rates to offset at least in a limited way weakness in private sector expenditures. Stabilization policy dictates government deficits in times of recession and surpluses in boom times, but unfortunately this role is not always easily distinguished from

Table 1.
Real provincial plus local per capita deficits, 1982/3 through 1987/8 in 1981 dollars (and as a percentage of personal income in parentheses)*

Year	Ontario	Manitoba	Sask	Alberta	B. C.
1982/3	–274.3 (–2.2)	–341.8 (–3.1)	–237.4 (–2.1)	–84.3 (–0.6)	–662.5 (–5.1)
1983/4	–248.9 (–1.9)	–329.3 (–3.1)	–193.2 (–1.8)	177.0 (1.4)	–368.7 (–2.9)
1984/5	–162.6 (–1.2)	–269.3 (–2.4)	–415.0 (–3.9)	668.0 (5.2)	–292.2 (–2.3)
1985/6	–335.3 (–2.4)	–350.1 (–3.0)	–664.2 (–6.0)	60.4 (0.5)	–206.8 (–1.6)
1986/7	–123.3 (–0.9)	–306.0 (–2.6)	–294.1 (–2.5)	–1023.8 (–7.7)	–236.8 (–1.9)
1987/8	– 93.2 (–0.6)	–124.3 (–1.0)	–369.6 (–3.2)	–573.8 (–4.4)	–233.1 (–1.8)

*Although final figures are not yet available, sizable deficits continued in each of the western provinces in 1988/9 and 1989/90, ranging in current dollars from over $3 billion in Alberta to less than $400 million British Columbia and Manitoba for the two years combined.

Source: Per capita deficits are calculated from financial data found in the Statistics Canada financial management series as adjusted by Irene Ip of the C.D. Howe Institute. Population data and personal income data are from Statistics Canada, Provincial Economic Accounts: Annual Estimates, 1976-1987 (Ottawa: Ministry of Supply and Services, February 1989). The national CPI index is used as the deflator.

Table 2.
Real per capita financial assets minus financial liabilities consolidated for provincial and local governments, 1981 dollars (figures in parentheses state the debt as a share of personal income)

Fiscal year	Ontario	Manitoba	Sask	Alberta	B. C.
1977	–1939 (–15.3)	–714 (–7.3)	987 (9.5)	1400 (12.5)	–308 (–2.6)
1982	–1906 (–14.9)	–1419 (–12.9)	1201 (10.5)	5108 (37.1)	–32 (–0.2)
1987	–2474 (–17.4)	–3547 (–30.0)	–1299 (–11.1)	2863 (21.6)	–1225 (–9.7)

Source: Same as Table 1.

Debt servicing charges grew with the debt. Although debt contributes to infrastructure and to human capital, it would be an act of faith to assume that the debt of the 1980s raised productivity sufficiently to generate the funds required to service and retire the debt. The debt "burden" has increased substantially. Table 3 shows the growth in debt servicing charges as a share of total provincial and local expenditure from 1977/8 to 1987/8 (and also the growth of debt servicing charges net of interest earned on investments). Alberta is an exception with income from Heritage Savings Trust Fund and other investments more than offsetting increases in debt servicing over this period.

3. GROWTH IN PUBLIC SPENDING

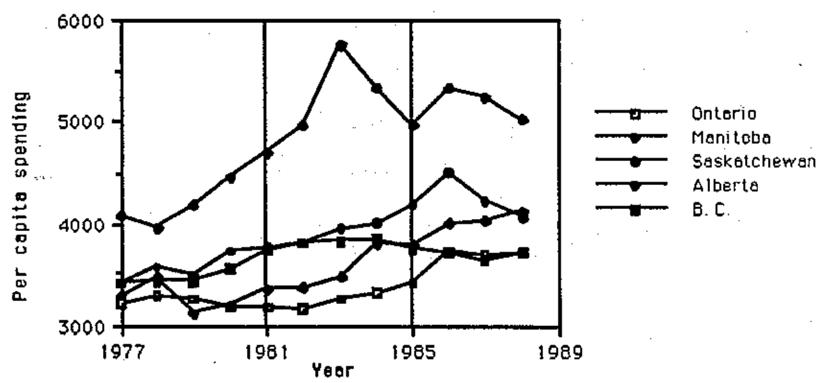
With buoyant commodity prices, the level of per capita public spending after allowance for inflation grew rapidly in British Columbia, Alberta, and Saskatchewan through 1982/83, and at close to an 8 per cent annual rate in Alberta (see Table 4). This growth is reflected in Figure 3 which shows real per capita expenditure by local and provincial governments for the western provinces and Ontario in 1981 dollars. Following 1982/3, where growth had been fastest it became slowest, and vice versa. Figure 4 shows that from 1982 to 1986, local and provincial government expenditures as a share of personal income rose to varying degrees in all of the provinces. The rise was particularly rapid in Saskatchewan.

Table 4. Growth rates in provincial and local real per capita expenditure and real per capita tax* revenues, 1977/8 - 1982/3 and 1982/8 - 1987/8

	76/7–82/3		82/3–87/8	
	Expend	Taxes	Expend	Taxes
Ontario	–0.2	.0.5	2.2	4.8
Manitoba	0.0	–1.6	2.8	7.2
Sask	2.0	0.7	0.5	1.5
Alberta	7.8	2.0	–2.7	1.3
B. C.	2.2	– 1.9	–0.7	0.7

*Tax revenues exclude non-renewable resource revenues, investment income, and other non-tax revenues.
Source: Same as Table 1

Figure 3: Provincial and Local Government Per Capita Spending, 1977-88 (1981$)



4. TAX EFFORT AND FISCAL CAPACITY

Scissors for deficit cutting have two blades, at least one of which must be very sharp. Even low levels of expenditures may be unmanageable if the tax blade is too dull. And at the other extreme high levels of public expenditure may be manageable if there is a sharp tax blade. Manitoba supports a higher level of public spending with a willingness to pay higher taxes, yet it has not avoided large deficits. British Columbia, even with relatively low expenditures, prefers deficits to tax levels at the national average. Saskatchewan has been running large deficits with higher than average expenditures and average tax rates. Albertans live in a world of supranormal expenditure levels and subnormal tax rates made possible by resource revenue and relatively low net provincial debt.

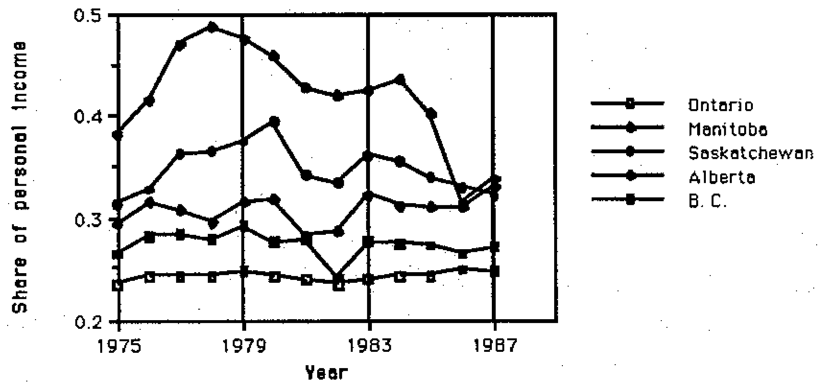
Tax effort indices are widely used to show the extent to which governments actually tap available revenue sources. An index of 100 indicates that a province uses tax rates that are, on average, equivalent to the average rates for all provinces. It does not mean that any particular revenue source is used at an average rate. The "tax effort index" reported for each province in 1988 in Table 6 indicates that Alberta's tax rates are, on average, 77 per cent of the national norm. Manitoba, in contrast, imposes tax rates that are 113 per cent of the national average. Further evidence of this limited tax effort by Alberta is seen in Figure 5 in which local and provincial tax revenues are stated as a share of personal income. Although Alberta sharply increased taxes in fiscal 1988, tax effort remained significantly below that in other provinces. Figure 6, showing real per capita tax revenues, indicates post-1981 increases for all provinces but British Columbia, and points up how the tax policy it adopted differed from that of other western provinces.

Table 6. Indices of tax effort (a), and provincial-local fiscal capacity for all own-source revenue (b), *plus* the federal equalization transfer (c), *plus* all federal transfers (d).

	Tax Effort Index (1988)		Fiscal Capacity Indexes (1988/89)	
	(a)	(b)	(c)	(d)
Newfoundland	102	61.8	92.8	95.1
Prince Edward Island	95	65.0	92.8	95.0
Nova Scotia	92	76.6	92.8	94.4
New Brunswick	95	72.2	92.8	96.2
Quebec	120	86.8	92.8	93.5
Ontario	98	108.7	101.9	100.3
Manitoba	113	81.7	92.8	94.7
Saskatchewan	103	90.2	92.8	95.3
Alberta	77	137.0	128.4	125.9
British Columbia	95	104.5	98.0	99.9

Source: Tax effort indices have been calculated by David Perry of the Canadian Tax Foundation, based on data provided by the Department of Finance in April 1989. Fiscal Capacity Indices are from "Historical Summary of Provincial Indices of Fiscal Capacity, 1972-73 to 1988-89" (Ottawa: Department of Finance, March 31, 1989), mimeo.

Figure 7: Provincial and Local Government Revenue as a Share of Personal Income, 1975-87

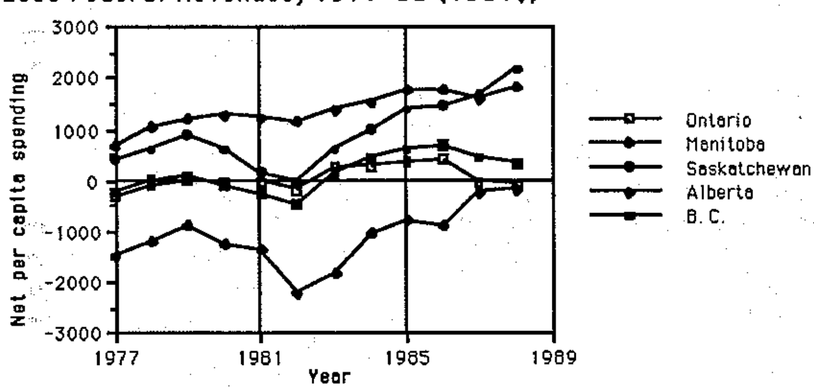


Finally, it may be helpful to refer to some public discussion of Alberta which is frequently referred to as a particularly high tax province based upon the evidence in Figure 7. When non-tax revenues - including land sales and royalties derived from nonrenewable resources, investment income from trust funds, and transfers from the federal government - are added to tax revenues, government revenues in Alberta have been a large share of income relative to that in other provinces. Hence, under the assumption that various of these non-tax revenues belong to individuals but are taxed away, it is possible to conclude that Alberta is a high tax province. Even in such a case, tax effort indices will indicate that Alberta, relative to other provinces, raises more revenue with less effort.

5. Federal Infusions or Drains

The federal government drains money out of each province through taxation. It injects money back into every province through direct expenditures and transfer payments. Some win and some lose. Table 7 expresses the net drain (-) or injection (+) that has occurred in each of the western provinces from 1982/3 through 1987/8 as a percentage of personal income. And Figure 8 presents the annual per capita figures in 1981 dollars.

Figure 8: Real Per Capita Federal Expenditures Less Federal Revenues, 1977-88 (1981$)



rents is in the hands of individuals, and is transferable, rather than in the hands of provincial governments. Individuals would then decide how much of the additional income they would contribute, through higher taxes, to support public expenditures. It is likely that public spending would be lower than under current methods of capturing resource rents. Governments, because they are much shorter lived than individuals, may have a greater propensity to spend (rather than save) when they realize windfall gains, such as those resulting from higher energy prices. Cutbacks from once established high levels of spending are particularly difficult. Larger deficits in the 1980s has been one result. Another approach to the problem is improved national income accounting. Accounts which do not reflect growth in income or in government revenues upon the conversion of non-renewable resource wealth/assets to financial wealth/assets may help to improve spending and tax decisions.[2]

Third, tax room for dealing with deficits varies among the western provinces. Alberta has considerable freedom on the tax side to at least partially deal with its deficit. In 1988, Alberta's "tax effort" was 77 per cent of the national average while its "fiscal capacity" from own-source revenues was 137 per cent of the national average. At least for the time being, with average tax rates Alberta can finance a substantially higher than average expenditure level. Saskatchewan's tax effort is 5 per cent above the national norm; fiscal capacity, even after transfers, is at 95 per cent of the national norm. Although further tax increases may be possible, reduced expenditure will probably play the biggest role in the deficit reduction process. Manitoba, with a tax effort that is 13 per cent above the average, may find that tax room is limited in an environment of growing tax competition. However, with a clear preference for a higher level of public goods, even Manitoba may increase taxes to reduce the deficit. British Columbia, with tax rates 5 per cent below the norm, appears to have flexibility to raise taxes if it chooses to avoid further cuts in an already relatively low level of public spending.

ENDNOTES

1. These figures do not include transfers such as occurred from Alberta to other parts of Canada when energy prices were held down by the federal government.
2. This topic is being developed in a separate paper by the author. When adjusted for depletion of the non-renewable resource base, figures for GDP and current government revenues differ significantly from those under current accounting procedures.