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LEADING THE WAY OR MISSING THE MARK? THE KLEIN GOVERNMENT'S FISCAL PLAN

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INTRODUCTION

In 1993, Premier Ralph Klein's Progressive Conservative government outlined a Balanced Budget Plan to eliminate the Province of Alberta's substantial deficit within four years. The essence of the plan was to balance the provincial government budget by 1996-97 through a 20 percent reduction in program expenditures without tax increases. Over the three budget years to date, the Klein government has adhered adamantly to its plan despite not insignificant concerns about and protests over the budget cuts. The steadfastness of the government's actions plus the generally broad support for and high level of popularity of the Premier — despite the substantial reductions in all areas of provincial public spending, layoffs, and major restructuring in many parts of the public sector — have given

Mr. Klein and his policies a high level of visibility nationally and even internationally. Especially approving is the business press.

The Klein image has overshadowed many notable deficit fighting policies in other provinces. In fact, in early 1995, six provinces announced budgets that projected a balanced budget for the 1995-96 budget year. Those provinces were British Columbia, Saskatchewan, Manitoba, New Brunswick, Prince Edward Island and Newfoundland. These provinces had struggled with deficits for many years and most had done so without having had the benefit of provincial finances generously supported by ample energy resource revenues nor the presence of a large Heritage

Savings Trust Fund and the revenues it generates. Rather, there had generally been a continuous struggle to balance limited revenues undermined by recession with the expectations of citizen-voters.

Alberta was not among the provinces to project a balanced budget for 1995-96; nor did Ontario, Quebec and Nova Scotia. In Alberta's case, however, large unanticipated revenue gains unexpectedly moved the province to a balanced budget in 1994-95 and lead subsequently to a more conservative treatment of the volatile natural resource and corporate income tax revenues.¹ Despite the pluses on the revenue side, the government projected a consolidated deficit of \$506 millions in 1995-96 and continued with its expenditure reduction plan with the expectation of a balanced budget in 1996-97. Favourable moves in both the revenue and expenditure accounts during 1995-96 resulted in the November 30 projection of the deficit for the year being revised down to only \$45 million and then again revised to a projected surplus of \$573 million in the January 30, 1996 third 1995-96 Quarterly Budget Update.^{2,3}

That Alberta is balancing or on the verge of balancing its provincial budget and six other provinces are balancing their budgets this year, it is timely to ask "How does Alberta compare?". The question is prompted especially by the fact that many Albertans are concerned about deteriorating provincial services, a concern recently focused on health

care. The six provinces that have successfully wrestled with their deficits provide legitimate comparisons as they too have had to strike the balance between services and taxes to their residents and have actually realized the initial balanced budget goal. Where those balanced budget provinces stand in 1995-96 in comparison to Alberta's position when it completes its planned expenditure reductions and actually budgets for a balanced budget in 1996-97 is a natural experiment offering potentially interesting insights.

The following analysis compares the balanced budget positions of the seven provinces. As was projected before by McMillan and Warrack (1995), Alberta's balanced budget expenditure is substantially lower than that in any of the other six balanced budget provinces. This indicates that provincial government expenditures and services in Alberta will be notably less than in the other six provinces. This lower level of service occurs despite the facts that Alberta has the highest fiscal capacity (i.e. has the greatest ability of all the Canadian provinces to fund provincial government) and that taxes in Alberta are the lowest among the seven provinces. Also, balanced budget expenditures in Alberta are well below levels that a simple economic model predicts. Because balanced budget outlays in Alberta are so much lower than those of other, and generally poorer, provinces, it is logical to ask whether Alberta, with its strategy of severely reduced provincial spending, is "leading the way or missing the mark?".

WHERE ALBERTA STARTED FROM IN 1993

Before comparing the balanced budget situations among provinces, it is helpful to understand and appreciate Alberta's fiscal situation as of 1993, the year that the Klein government was elected to office. This review is useful because one legacy of the energy boom years is some persistent, but now unfounded,

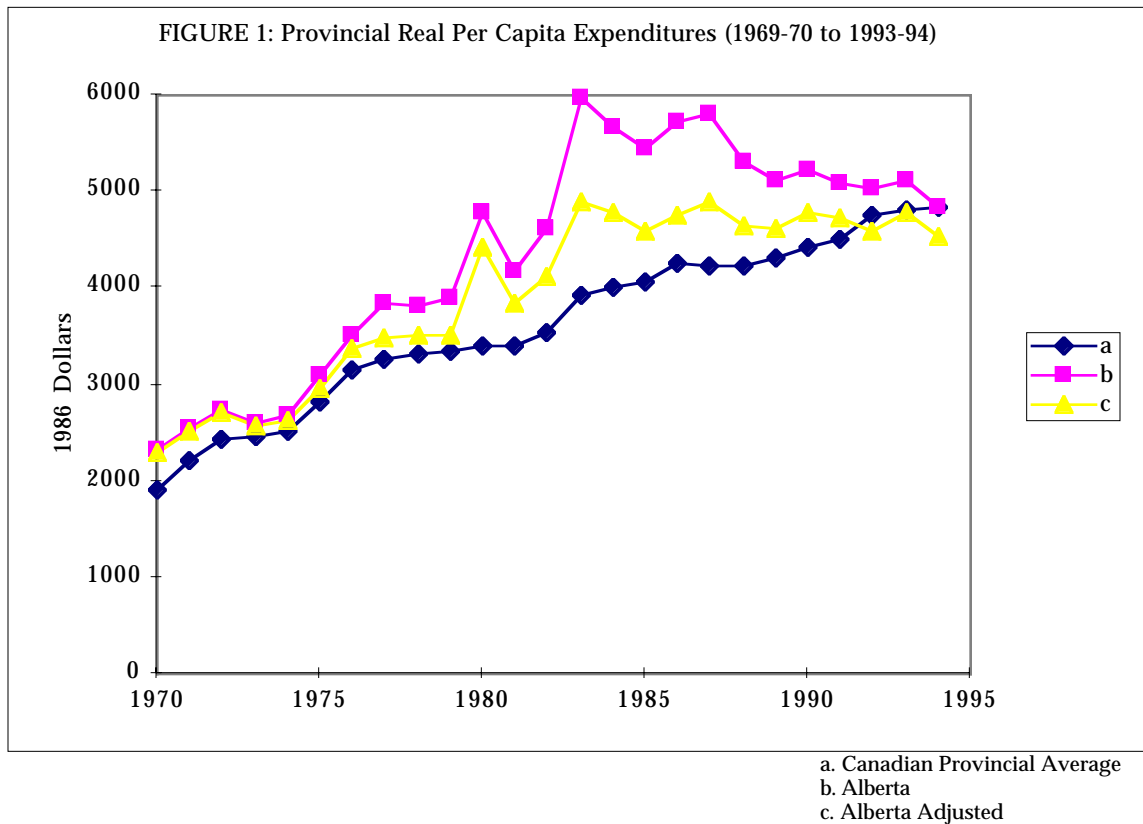
impressions of Alberta's initial and even current fiscal position.

Following the drop in energy prices in 1986, Alberta struggled to adjust its expenditures to its new, and dramatically reduced, revenues.⁴

Deficits, unknown since the early 1970s, reappeared in much larger magnitude and the provincial (general revenue and capital funds) debt, essentially zero in 1986, rose to over \$15 billion (or \$6000 per capita) at the end of the 1992-93 fiscal year. A \$3.4 billion deficit during the 1992-93 fiscal year focused attention on the province's adverse fiscal circumstances and promoted the Klein government's fiscal strategy.

Per capita provincial expenditures in Alberta grew much more dramatically and greatly exceeded those of other provinces during the energy boom but then declined quite markedly from their 1982-83 peak over the following decade (Figure 1). Alberta's outlays for "resource conservation and industrial development" (much of that reflecting the

province's efforts to diversify and stimulate the economy) diminished most sharply, especially after 1986. Alberta's adjusted expenditure — adjusted for the unusual level of resource conservation and industrial development expenditure in order to make it comparable to that in other provinces — also declined over that period but at a much more modest rate.⁵ Meanwhile, the average level of provincial expenditure in Canada rose relatively steadily. In fact, the two paths crossed by 1991-92. In 1991-92, per capita provincial expenditure in Alberta fell below the Canadian provincial average and has been below since. That is, since 1991-92, Alberta has spent less per capita than the average Canadian province. Alberta is no longer a high spending province and was actually spending less than average at the time that the Klein government came to office.⁶



ALBERTA'S BALANCED BUDGET PLAN

Despite Alberta's below average level of provincial expenditures in 1992-93, the Klein government embarked on a plan to eliminate the deficit and balance the provincial budget within four years without increasing taxes by reducing program expenditures 20 percent.⁷ Some of the changes expected to occur under the plan and their implications are outlined in Table 1.⁸ Although no new taxes were to be introduced, revenues were expected to raise by 8.3 percent by 1996-97 relative to their 1992-93 levels.⁹ Particularly if account is taken of the

revenue cushions, revenues improvements have exceeded expectations. The province's assumption of full responsibility for school finance in 1995 did not change the essence or direction of the plan (although revenue and expenditure figures had to be revised accordingly and throughout to ensure comparability).¹⁰ The province took over responsibility for the funding of schools that had been met by the school boards but, in an offsetting fashion, also took over the school boards' property tax base and tax collections.

Table 1			
Summary of Government of Alberta Balanced Budget Plan and Fiscal Implications (millions of dollars unless otherwise indicated)			
	1992-93	1996-97	Percentage Change 1992 to 1996
Revenue ^a	\$11,470	\$12,425	8.3
Program Expenditures ^a	13,028	10,195	-21.7
Population (thousands) ^b	2,529	2,782	10.0
Expenditures per Capita ^a	5,152	3,665	-28.9
Real Expenditures per Capita (1986\$)	4,022	2,808	-30.2
Operating Deficit ^a	2,777	(510)	-
Consolidated Deficit ^a	3,409	(220)	-
Unmatured Debt ^c	20,181	23,542	+16.7

Notes: a. From Budget '93 Update, Alberta Treasury, September 1993.
 b. Statistics Canada.
 c. Budget '95, Alberta Treasury, February 1995.

Expenditure change is more dramatic under the

plan. Program expenditures were planned to

decrease from \$13.028 billion in 1992-93 to \$10.195 billion; a nominal reduction of 21.7 percent. Not mentioned by the government was that population growth over the four years could be expected to reduce per capita expenditure another 7.2 percent to bring the per capita nominal reduction to 28.9 percent. Price change has a further effect, relatively modest largely as a result of wage and salary scale reductions to public employees, bringing the estimated total effective decline to 30.2 percent. That is, Albertans can expect provincial government services to them to be reduced by about 30 percent as a result of the Klein government's approach to deficit elimination.¹¹

Largely unmentioned is how the province plans to pay down the accumulated tax supported public debt. Elimination of the deficit only keeps the debt from rising further; it makes no provision for paying off the debt. If a plan were adopted to repay the debt over 15 years and the funds for that repayment were to be

realized from further expenditure reductions, expenditures per capita would need to be reduced by 37 percent of their 1992-93 level. That is, once full debt repayment is considered and were it to be met by expenditure reductions, the resulting cutbacks of provincial services would be almost twice as great as the province initially suggested; i.e. by 37 percent, not 20 percent.¹²

Note from this review (a) that Alberta was already spending less than the Canadian provincial average per capita even before the Klein government came to office, (b) that the deficit eliminating expenditure reductions alone will reduce services to the average resident by 30 percent, and (c) repaying provincial debts without raising (or relying upon) additional revenues would require cuts in the order of 37 percent. These are dramatic reductions from an already average level of expenditure and greatly exceed the extent of the cuts as portrayed by the provincial government.

AN INTERPROVINCIAL COMPARISON OF BALANCED BUDGET EXPENDITURES

In part because of the recession and weak recovery of the 1990s, provincial government deficits have been the norm over the past decade. During the ten years preceding 1995-96, only one-half of the provinces had even one surplus and only two provinces had more than one; British Columbia (three in succession from 1987-89 to 1989-90) and Alberta (1985-86 and 1994-95). No province reported a surplus over the 1989-90 to 1994-95 period (except Alberta in 1994-95 when windfall revenues turned a budgeted deficit into a surplus).¹³ All provinces have been struggling with their finances. It was only in 1995-96 that six provinces budgeted for surpluses; British Columbia, Saskatchewan, Manitoba, New Brunswick, Prince Edward Island and Newfoundland; and a seventh, Alberta, belatedly joins the group with its third quarter budget revisions. Given that there are now seven provinces projecting balanced budgets this year, it is interesting to compare their balanced budget plans. Is the

outcome of the Klein government deficit elimination strategy different from that of the other provinces? And, if it is greatly different, is it likely to be sustainable?

The budgeted per capita program expenditures for 1995-96 for the six balanced budget provinces are reported in Table 2. These figures are calculated from the spring 1995 budget documents of those provinces.¹⁴ Figures are for program expenditures; that is, operating and capital expenditures excluding interest cost on the provincial debt. Program expenditures represent the outlays to provide goods and services to provincial residents. Also reported are Alberta's planned program expenditures for 1996-97; the province's first planned balanced budget year.¹⁵ Because resource conservation and economic development expenditures have been unusually high in Alberta in the past, an RCID adjusted value of Alberta's expenditure is

also shown. The adjustment introduced with respect to these six provinces at this time is a relatively modest \$208 per capita reduction to

make the Alberta figure comparable to those of the other provinces.

Province	Program Expenditure		Health
	full provincial funding of schools	schools partially funded by local school districts	
BC	\$5178		\$1808
Sask		\$4258	1532
Man		4264	1640
NB	4869		1568
PEI	5061		_c
Nfld	5146		1376
Alta (1996-97) ^b	4250	3723	1233
Alta (RCID adj) ^d	4042	3515	-

- Notes:
- a. For the six provinces projecting balanced budgets in their 1995-96 budgets.
 - b. Planned expenditure in 1996-97, the planned balanced budget year.
 - c. PEI combines health and social services.
 - d. Alberta's program expenditure reduced by \$208 for extraordinary resource conservation and industrial development (RCID) outlays.

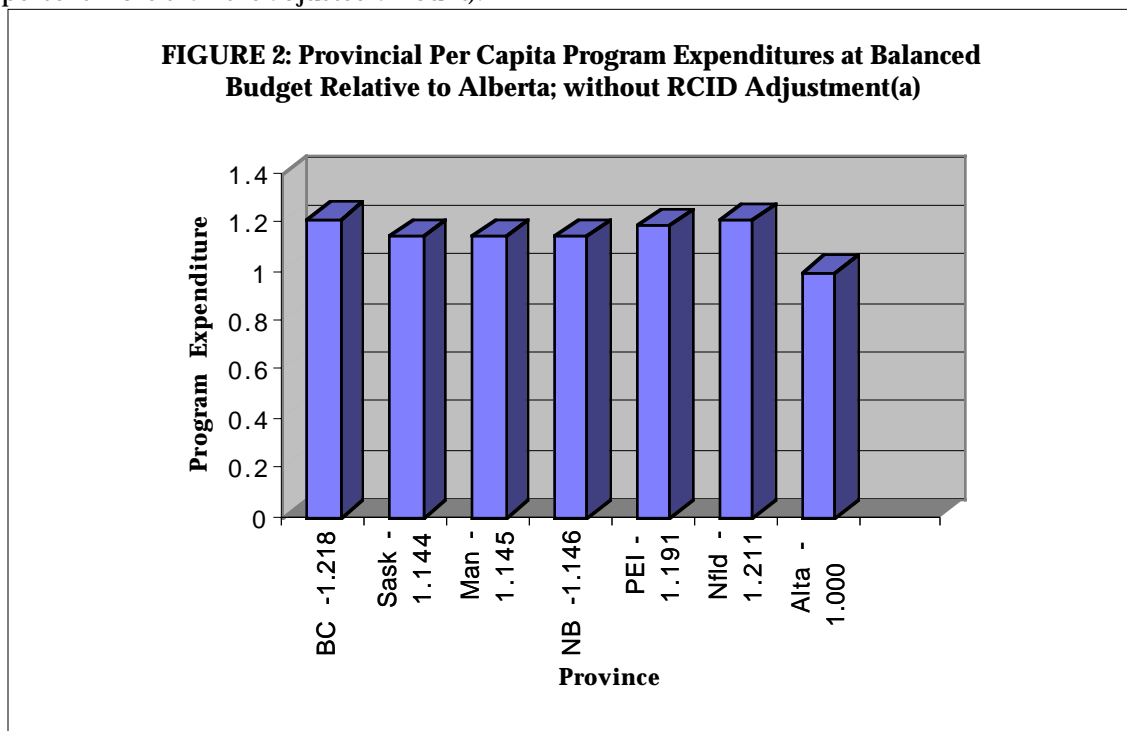
Provincial government responsibilities are not identical in all provinces so per capita expenditures are not directly comparable across all provinces. The major difference is that, as of 1995-96, five provinces fully fund schooling while in Saskatchewan and Manitoba school financing is shared with local school boards. In Saskatchewan and Manitoba, local school boards receive support from the province but also raise taxes to fund their own expenditures for schooling. In the other provinces, the local

boards make very little or no financial contribution to school finances but are there to manage the funds provided by the province. To distinguish these two situations, program expenditures are reported in two columns separated by the nature of school financing. Expenditures for Alberta are reported in each. Alberta expenditures can be reported easily for each because Alberta only converted from provincial-local shared financial responsibility for schools to full provincial

funding of schools as of 1995-96.

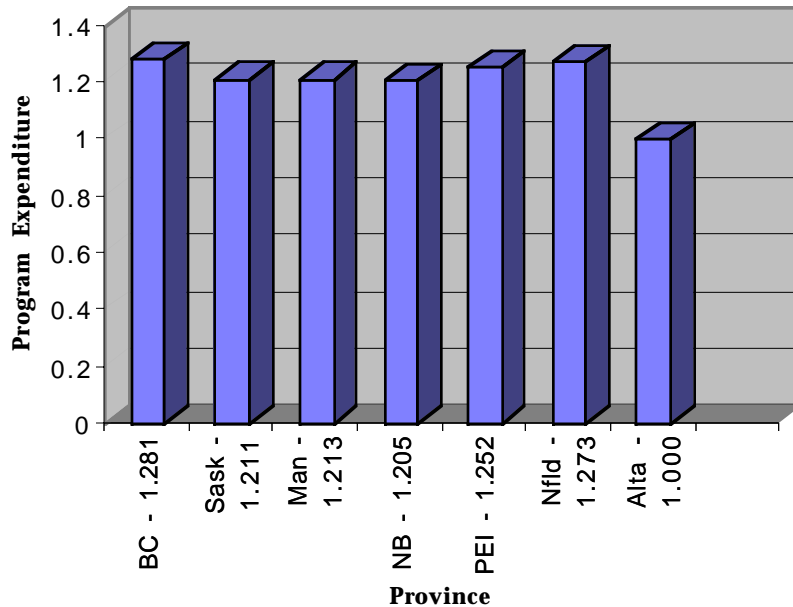
The balanced budget per capita program expenditures are much lower in Alberta than in the six other balanced budget provinces. For the four provinces which fully fund schooling, per capita expenditures average \$5063 in contrast to \$4250 unadjusted and \$4042 adjusted in Alberta. This is a \$813 or \$1021 difference depending upon which figure is selected. In Saskatchewan and Manitoba, expenditures are about \$4261 per capita while Alberta's is \$3723 (or \$3515 if adjusted). With respect to those two provinces, the difference is \$538 or \$746 if adjusted. Relative to Alberta, the four full funding provinces have chosen to spend 19.1 percent more (25.3 percent more relative to the adjusted value) while Saskatchewan and Manitoba chose to spend 14.5 percent more (and 21.2 percent more than the adjusted amount).

The level of per capita program spending by province relative to Alberta's is shown in Figures 2 and 3. Figure 2 shows expenditures relative to Alberta's unadjusted amount (\$4250). Spending in the other six provinces ranges from 1.144 to 1.218 times the level in Alberta. Saskatchewan, Manitoba and New Brunswick are similar at about 14.5 percent above Alberta's while British Columbia, Prince Edward Island and Newfoundland are about 20 percent higher. Because there is reason to believe that RCID adjusted figures may be more comparable, Figure 3 shows the per capita program expenditure levels of the other provinces relative to Alberta's. There, spending ranges from 20.5 percent greater in New Brunswick to 28.1 percent more in British Columbia.



Note: (a) Alberta for 1996-97. Other provinces for 1995-96

FIGURE 3: Provincial Per Capita Program Expenditures at Balanced Budget Relative to Alberta; with RCID Adjustment(a)

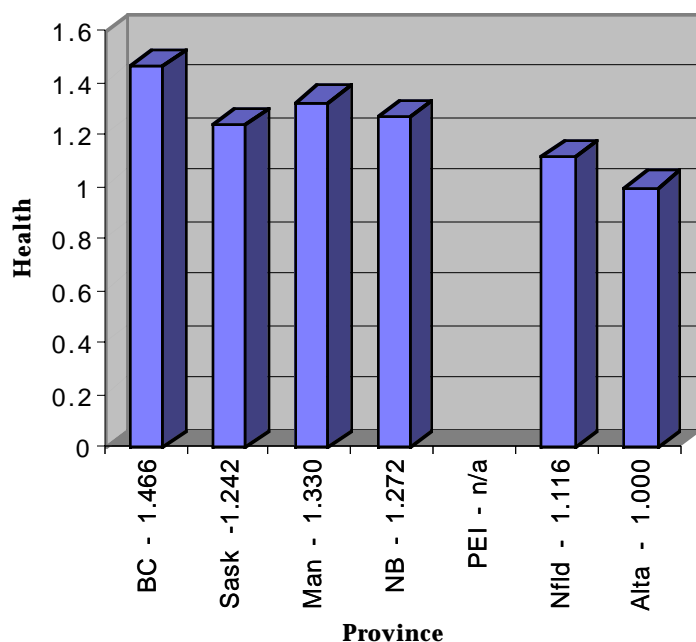


Note: (a) Alberta for 1996-97. Other provinces for 1995-96

It would be interesting to compare also various categories of provincial expenditures; e.g., those for schooling, health, advanced education, social welfare, etc. Unfortunately, the budget documents do not allow sufficient separation of the data to do that.¹⁶ It is possible, however, to get a comparison of expenditures on health care.¹⁷ The per capita outlays for health care are reported in Table 2 for all provinces but Prince Edward Island which combines health and social service expenditures in its budget. Also, there is no logic for an RCID adjustment to Alberta's

health care spending. Per capita health care spending is higher in the other five provinces than in Alberta. Alberta plans to spend \$1233 per capita while the five province average is \$1579 or 28 percent more. There is more variation in the levels of health care spending among the other provinces than was the case for total spending. Newfoundland is at the low end at 1.116 times Alberta's while British Columbia is at the high end at 1.466 times Alberta's level. The provincial levels relative to Alberta's spending are shown in Figure 4.

FIGURE 4: Provincial Per Capita Health Expenditures at Balanced Budget Relative to Alberta(a)



Note: (a) Alberta for 1996-97. Other provinces for 1995-96

A REVIEW OF PROVINCIAL REVENUES

It is reasonable to ask whether Alberta's low level of spending results from a low or greatly diminished fiscal capacity. The short answer is that it does not. Indeed the fiscal capacity of the Alberta provincial government is the highest of all provinces. Table 3 summarizes the situation as of 1993-94.¹⁸ Because of the importance of natural resource revenue and earnings on provincial investments in Alberta's budget, taxes accounted for only 40.3 percent of provincial revenues in Alberta while they were the source of 61.4 percent of revenues across all provinces. Furthermore, taxes paid per person were \$2195 in Alberta as opposed to the all province average of \$3396. That is, taxes in Alberta were \$1200 less per person. Largely

because of the resource base, the fiscal capacity of Alberta is 33 percent larger than the national average; i.e. Alberta can raise the average per capita revenues with only 75 percent of the average province's effort. Indeed, Alberta's tax effort that year was 75 percent of the average. Only Alberta, British Columbia and Ontario have above average fiscal capacities and the other two are at the more modest levels of 1.10 and 1.08 respectively. These three provinces are commonly referred to as the three "have" provinces. Clearly, Alberta does not spend less because it is a have not province.

<p style="text-align: center;">Table 3</p> <p style="text-align: center;">Provincial Taxes and Fiscal Capacity, 1993-94</p>		
	All Provinces	Alberta
Taxes as a % of total revenues	61.4%	40.3%
Taxes paid per capita	\$3396	\$2195
Tax capacity	1.00	1.33
Tax effort	1.00	0.75

Note: See McMillan and Warrack (1995).

Although it is impossible to update the above information to 1995-96, Table 4 below reports information on the expected sources of provincial government 1995-96 revenues for the seven provinces studied here. Federal transfers to the provinces, especially the three "have" provinces, have diminished since 1993-94 as the federal government has made further efforts to reduce its own deficit. Still, the "have not" provinces (i.e. the seven which receive equalization payments from the federal government, five of which represented here), expect to obtain between 25 and 40 percent of their total revenue from federal transfers. Taxes are the main source of own-source revenues but natural resource revenues are important in British Columbia, Saskatchewan and Alberta and also investment income in Alberta. Alberta expects to receive about 30 percent of its total revenue from natural resource and investment income. Taxes are

expected to raise 46.7 percent of Alberta's total revenue. Only in Prince Edward Island is the percentage (slightly) lower. However, in every other province including Prince Edward Island, the projected taxes paid per person are higher than in Alberta. For the five "have not" provinces here, the per capita taxes are close to \$2600 in contrast to the \$2240 expected in Alberta despite the higher incomes there. The per capita tax revenue expected in British Columbia, the only other "have" province in this group, is \$3438. Ontario and Quebec are also high tax provinces. Although Alberta may have come to depend somewhat more on own-source revenues, and on taxes and other revenues within its own sources, taxes remain very low relative to incomes and the province's overall fiscal capacity very high.¹⁹ There is no deficiency in the ability to pay for provincial services to restrain provincial expenditures.

<p style="text-align: center;">Table 4</p> <p style="text-align: center;">Sources of Provincial Revenue, 1995-96 Budgets, (Percent)^a</p>	
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	Taxes	Natural Resource Revenues	Investment Income	Other Own-source	Transfers	Total ^b
BC	62.8 (\$3438) ^c	12.1	0.5	13.1	11.5	100.0
Sask	51.7 (\$2665)	10.1	1.5	9.8	26.8	100.0
Man	53.2 (\$2611)	0.9	-	13.2	32.7	100.0
NB	48.1 (\$2781)	1.1	7.1	7.9	35.8	100.0
PEI	44.1 (\$2641)	-	6.9	8.5	40.6	100.0
Nfld	51.0 (\$2562)	1.0	-	7.7	40.3	100.0
Alberta	46.7 (\$2240)	16.9	12.4	15.5	8.5	100.0

- Notes: a. As budgeted for 1995-96.
b. Rows may not sum due to rounding.
c. Per capita taxes are shown in the brackets.

PREDICTING PROVINCIAL EXPENDITURES

The planned balanced budget level of provincial expenditures seems odd; unusually low given that past expenditures, incomes and general provincial fiscal capacity are high. A way to examine the comparability of provincial expenditures is to determine whether they can be explained with an economic model and whether the actual expenditures and those predicted by the model correspond. That exercise is reported on in this section.

A simple economic model is used. The limited amount of data available prevent more elaborate specifications. The dependent variable to be explained is Y where
Y = provincial program expenditure in the balanced budget

provinces in balanced budget years.

Explanatory variables are:

X_1 = personal income,

X_2 = non-tax provincial government revenues (federal grants, natural resource revenues, investment income),

X_3 = interest on the provincial public debt.

All variables are in per capita constant (1986) dollars. The data are (i) the values of these variables in 1995-96 for the six provinces which planned to balance their budgets in that fiscal year and as projected to be for Alberta in 1996-97 (the end year of its fiscal plan and its first planned balanced budget year) and (ii), to expand the data base, the values for the seven

provinces in the last year that each reported a balanced budget (prior to 1994-95). Budget data were used for the latest year and Statistics Canada provincial public finance data for the prior balanced budget year.²⁰ To make Saskatchewan's and Manitoba's expenditure data comparable to those of the other provinces which fully fund schooling, the average per capita level of local school taxes in each province was added to the province's expenditure value. No adjustment was made for the higher level of RCID expenditure in Alberta. Ordinary least squares regressions were run on this data.

The choice of variables is conventional and easy to explain. Per capita program expenditures, the dependant variable, is the variable of interest. Many studies have been undertaken to explain government spending. A consistently important explanatory variable, often the most important, is per capita income. Hence, it is included here. Intergovernmental grants are also usually included and are also usually important. Because of the importance of natural resource and interest income to several provinces, these revenue sources are also included because, like intergovernmental transfers, they too provide revenue that is not taxed from or charged directly to the resident.²¹ Because of the limited number of

observations and the potential parallel treatment by provincial governments of revenues from these sources, grant, resource and interest income is combined. Servicing the public debt is a first call on provincial revenues and diminishes the availability of funds to support program expenditures. Hence, interest payments on the public debt is also included as an explanatory variable. Academic studies suggest a variety of other variables and many more sophisticated specifications but the lack of data constrain this model to a relatively simple form.

The predicted expenditure values from two estimated regressions are reported in Table 5. In the case of regression A, the regression was run on all 14 observations. As shown in the note, the regression explains a relatively high 84.8 percent of the interprovincial variation in per capita spending. The coefficients of the income and non-tax provincial revenue variables have the expected positive effect on expenditures, are of reasonable magnitude and are significantly different from zero. The interest cost variable performs poorly with an unexpected positive sign on the coefficient but that coefficient is not significantly different from zero.²²

Table 5					
Actual and Predicted Per Capita Provincial Program Expenditures, 1995-96					
	Actual	Regression A ^a		Regression B ^b	
		Predicted	Deviation (Actual-Predicted)	Predicted	Deviation (Actual-Predicted)
BC	\$5178	\$4759	\$419	\$5099	\$79
Sask	4738 ^c	4703	35	4862	-124
Man	4548 ^c	4689	-141	4895	-347
NB	4869	4773	96	4873	-4
PEI	5061	5287	-226	5367	-306
Nfld	5146	4705	441	4776	370
Alta (1996-97)	4250	5297	-1047	5640	-1390

- Notes:
- The estimated equation for A (on 14 observations) is:

$$Y = 719.99 + 0.0933X_1 + 0.7697X_2 + 0.1101X_3 \quad R^2 = 0.848$$
 (1.284) (2.928) (6.358) (0.255)
 where t statistics are shown in brackets
 - The estimated equation for B (on 13 observations; Alberta 1996-97 omitted) is:

$$Y = 175.46 + 0.1367X_1 + 0.7326X_2 + 0.2050X_3 \quad R^2 = 0.962$$
 (0.567) (7.384) (11.55) (0.908)
 - Adjusted to include local school taxes.

The reasonably good fit of the equation is reflected in the predicted values. For all provinces but Alberta, the predicted values are quite similar to the actual values. Some of the estimates are above and some are below but, other than that for Alberta, the largest deviation is 8.6 percent of the actual value. Alberta's predicted balanced budget level of expenditure (that for 1996-97) is \$5297 but the planned and expected level is \$4250. That is, Alberta's balanced budget spending is \$1047 per

person, or 24.6 percent, less than that predicted by the economic model.

Regression B provides alternative results. In this case, the same model is regressed on 13 observations. Because Alberta's level of expenditure is so much different from that of the other provinces in 1996-97, that observation is deleted. Without Alberta, this regression should give a better prediction of the levels of spending in the other provinces and also of

what it would be in Alberta if the Alberta behaviour paralleled that in the six other balanced budget provinces.

As expected, regression B fits the data better. It explains over 96 percent of the variation in provincial per capita expenditures. The coefficients of the income and non-tax revenue variables are even more significant than before although the interest cost variable performs no better than previously. For the six balanced budget provinces together, the predicted levels of spending deviate less from the actual than those from regression A. The average deviation is \$205 from the average expenditure of \$4923, or 4.2 percent. For Alberta, however, the predicted spending is, at \$5640, larger than before and the deviation is likewise larger at \$1390. Essentially, if provincial expenditures in Alberta were determined by the same

economic model as that which successfully explains spending in the other balanced budget provinces, spending is predicted to be \$1390 per capita, or 32.7 percent, higher.²³

The econometric model indicates that Alberta is behaving unlike other provinces that have managed to balance their budgets in pursuing and attaining its deficit elimination objectives. It appears to have selected a level of provincial per capita spending that is between 25 and 33 percent less than is expected of a province with its (high) level of per capita income and large non-tax sources of provincial revenues. Note too that no provision has been made here for the still somewhat larger level of RCID outlays in Alberta. To do so would make the variance in the level of Alberta's expenditures even greater.

CONCLUSIONS AND IMPLICATIONS

Like many other provinces, Alberta has struggled to eliminate seemingly persistent deficits. In its efforts to restore a balanced budget, the Klein government spelled out a clear and demanding fiscal program and held to that plan. That program has resulted in large, and implies some further, reductions in the expenditures providing provincial goods and services to Alberta residents. The magnitude of the reductions and the levels sought stand out in contrast to those found in the six other provinces that have managed to balance their budgets as of 1995-96. Alberta is unique and anomalous as being the richest province (having high personal incomes and the highest fiscal capacity of any provincial government) while providing the lowest level of provincial public services in Canada.

The comparison of provincial per capita expenditures among the balanced budget provinces demonstrates the unusually (relatively and absolutely) low level of spending in Alberta. Alberta spends at least 15 percent less per person than the lowest spending "have not" provinces and more like 20 to 25

percent less than the balanced budget provinces overall when provincial expenditures are placed in more fully comparable terms. The differences are even more dramatic when health care expenditures are considered separately.²⁴

A low provincial fiscal capacity does not explain Alberta's low level of expenditure. Indeed, Alberta's tax and other provincial revenue bases are the largest of any province and exceed those of the average province by 33 percent. Per capita taxes in Alberta remain the lowest in the country.

Provincial government expenditures can be explained well by economic factors. An econometric model of provincial per capita spending estimated on data for the seven balanced budget provinces predicts a much higher level of spending for Alberta than exists and will provide at the end of the province's deficit elimination program at the end of next year. Alberta's fiscal behaviour is strikingly at odds with the economic model that explains well the performance of the other provinces

that have already eliminated their deficits.

Is Alberta leading the way? If so, it would seem that the other provinces that have already managed to balance their budgets are not following. More importantly, the people in those other provinces and who are now living with the results of those difficult choices do not seem inclined to follow. While one can point to the dramatic expenditure cuts planned and begun by the new Harris government in Ontario, the Ontario government is (unlike Alberta's) a very long way from achieving its fiscal objectives. In addition, the Harris government seems to have undertaken a more difficult challenge. One may also note the large federal deficit and debt burden and that the federal government's efforts to bring those under control will effectively raise the apparent cost of government to Canadian taxpayers. This development has the potential to turn citizens further against government spending and taxes generally. This is certainly a valid consideration. It could mean, for example, that federal transfers to the provinces are reduced further (e.g., as with the shift to the Canada Health and Social Transfer) and that the provinces are called upon to finance a larger share of programs or simply do more from their own sources. To assume that Alberta is ahead in this possible game, however, is to assume that Alberta will react to such reductions in transfers much differently than other provinces. That is unlikely.

Alberta has made dramatic reductions in its level of provincial spending and has brought it to an exceptionally low level; by a considerable measure, the lowest per capita in Canada. These cuts have not come without cost. Many citizens are concerned about the quality of the services which result. Perhaps too, the premier also has some modest political concerns. In his January 29 provincially televised speech, Premier Klein spoke of 1996 being a year of "assessment and evaluation" and a year of "transition and monitoring". Following up previous references to "reinvestment", he spoke of "investing in programs". In announcing some expenditure concessions, he provided examples of investing; restoring kindergarten funding to

400 hours from 240 (at a likely cost of about \$18.7 million), funding to connect all schools to the Internet, \$11.4 million to reduce surgery backlogs, and \$6.3 towards highway twinning. The next day the Minister of Education announced that school funding would be increased by a total of \$88 million in 1996-97. Previous to the premier's speech, concessions had been minimal. Most notable was that in response to a strike by hospital laundry workers in Calgary, the government claims to have deferred \$93 million in the last round of cuts to regional health authorities (and the unannounced cuts said to have been planned for the following two years).²⁵

Amounts like \$88 million and \$93 million sound large. Even if they materialize, their impact upon the total fiscal picture, however, is relatively small. Together, they amount to \$65 per person. At the very most, this represents less than ten percent of the difference in funding between Alberta and the other six balanced budget provinces. Even if the total of the \$282 million cuts that have been scheduled for 1996-97 were cancelled, that amounts to \$101 per person. Best estimates suggest that this would still leave Alberta expenditures \$780 below the average of the other six balanced budget provinces; i.e. at 84 percent of the average; and about \$500 per capita below any other province. Thus, concessions to the planned expenditure cuts even well beyond those yet suggested would do little to help shift Alberta from the basement of Canadian provincial government services. Furthermore, it is uncertain whether the latest pronouncements will actually result in either reduced cuts or real additional funding overall. The Klein government's deficit reduction strategy would have been better implemented in the late 1980s, when the deficits began and spending was high, than in the early 1990s. Indeed, one could reasonably look further back, and say that it might have been the right policy but a decade too late. Despite the laudable and ubiquitous efforts to get more for the public dollar, the expenditure cuts in Alberta have eroded, often substantially, public services and deferred needed public investment. The citizens of Alberta, and other budget balancing provinces, will need experience to assess fully the

adequacy of the services that are now being (or are about to be) provided and their willingness to pay for those, or some other level of, services. The existing levels and patterns certainly cannot be considered an equilibrium. However, for Alberta, the exceptionally low level of provincial expenditures and services in the fiscally most affluent province in Canada presents a striking anomaly. Albertans will have to make their choices and it is likely to take some time to assess fully the alternatives. While politics certainly matters, all the economic indicators reviewed here suggest that

there are many forces promoting some significant upward adjustment in provincial spending within a few years. If Albertans are actually being presented with more than an a politically convenient illusion of a relaxation of expenditure restraint/reduction, the beginning of that shift may just be starting to emerge.²⁶ In conclusion then, the evidence suggests that, despite the press and the sell, the Klein government's deficit elimination program is "missing the mark" more than "leading the way".

FOOTNOTES

My thanks to Bruce Makila for his valuable research assistance.

1. In 1994-95, windfall revenues of \$1.3 billion made the major contribution towards converting a projected \$1.55 billion consolidated deficit into a forecasted \$110 billion surplus. (However, despite the consolidated surplus, program and debt servicing expenditures of \$14.42 billion in 1994-95 still exceeded general revenue of \$13.95 by \$470 million.) For 1995-96, the Budget introduced a \$391 million resource revenue and corporate income tax "cushion" which removed that amount from budgeted revenues leaving a budgeted \$506 million consolidated deficit. See the Alberta Budget '95 document.
2. As of the January 30 revision, general revenues are (for the first time) expected to exceed program and debt servicing costs; \$13.97 versus \$13.72 billion.
3. For the second year in a row, there has been over a one billion dollar adjustment (or error) in the projected deficit resulting in a change in the consolidated account from a projected deficit to a surplus.
4. Natural resource revenues to the province fell 50 percent within one year and, in per capita real dollar terms, have declined somewhat further since.
5. A detailed explanation of the adjustment made to arrive at the Alberta adjusted real per capita expenditure in Figure 1 can be found in McMillan and Warrack (1995).
6. Even unadjusted per capita expenditures, i.e. including the much smaller but still well above average level of resource conservation and industrial development outlays (reflecting now primarily the additional costs to Alberta of managing the province's substantial natural resources) fell below the Canadian provincial average by 1993-94.
7. Program expenditures exclude payments of interest on the public debt and so reflect outlays providing provincially supplied goods and services to provincial residents.
8. For further detail see McMillan and Warrack (1995).
9. Higher health insurance premiums and additional user fees are not considered new taxes by the Alberta government.
10. See Budget '95 for the appropriately revised plan.
11. This estimate of the real per capita expenditure reduction is somewhat larger than that given in McMillan and Warrack (1995) because more recent, and somewhat larger (now 2.782 million), Statistics Canada estimates of the Alberta 1996 population are used for the calculations.
12. The province does have a Debt Retirement Plan to reduce the province's "net" debt over 25 years beginning in 1997-98. Net debt was initially defined to be \$8.6 billion but the unplanned 1994-95 and the expected 1995-96 surpluses have led to that being revised to \$6.8 billion. In contrast, the outstanding debt of the general revenue fund was \$19.95 billion as of March 31, 1995. If the province does have a plan to address the larger tax supported debt, recent developments suggest that it may be to balance future budgets on the basis of conservative estimates and use unbudgeted "extra" revenues to pay down the accumulated debt.
13. See Statistics Canada (1992 and 1995).
14. Because provincial accounting systems are not identical, figures from the budget documents may not always be entirely consistent and so may not be fully comparable. However, given the aggregated nature of the majority of this data (i.e. total program expenditure), the variations should be small.
15. Although Alberta is now projecting a surplus for 1995-96, no significant deviations from its balanced budget expenditure plan (i.e. that for 1996-97) have been announced to date.

16. The Statistics Canada Financial Management Series reports interprovincially comparable data in sufficient detail to do that. That data is not yet available.
17. There is some concern though that the budgetary data for health care may not provide as reliable interprovincial comparisons as the aggregated total program expenditure data. However, the relative values compare closely with unofficial, unpublished numbers from federal sources.
18. See McMillan and Warrack (1995) for further detail.
19. In the January 30 Alberta budget update, increased natural resource revenues and corporate income taxes contributed about equally to the unplanned growth in total revenue. As a result, the Alberta most recent values of the percentages in Table 4 for natural resource revenues increase to 18.9 percent and that for taxes to 47 percent.
20. See Statistics Canada (1992 and 1995). Because Newfoundland has not had a balanced budget by Financial Management Series accounting for many years, 1989-90 was selected as its previous balanced budget year since the deficit that year was a modest \$6.1 million.
21. It is common to find that non-tax revenue (usually intergovernmental grants) is treated differently by the recipient government than that from tax sources. More than would normally be expected is spent and less than expected goes towards tax relief. As shall be seen below, recent suggestions coming from the Klein government as a result of the newly projected budget surpluses illustrates the point. There appears to be a greater willingness to consider deferring further expenditure reductions or restoring expenditures when the funds become available from increased natural resource revenues than would be the case if that same policy were financed by higher taxes revenues from individuals (and especially so if higher tax rates were required).
22. Adding the unemployment rate results in the coefficient of interest having the expected negative sign but neither coefficient is significant. Other specifications were tried but they offered no improvement.
23. Various other specifications and variations in the data were explored but none improved or notably changed the results from those reported in Table 5.
24. Unfounded impressions of Alberta's fiscal position were mentioned earlier. A good illustration of the persistent erroneous fiscal myths about Alberta's government finances appears in the January 31, Globe and Mail. There, Scott Feschuk, in his Business West column states that "Today, Alberta's program expenditures rank around the national average in per capita terms." Unfortunately, Mr Feschuk, among others, has failed to realize that the Klein government began its program cuts at per capita expenditure levels about equal to those in the other provinces and by now has reduced expenditures to levels substantially below those of any province in Canada.
25. The health authorities were scheduled for \$58 million in cuts in 1996-97. Even at \$93 million in total, the concession was minimal in that it amounts to \$33 per capita in health spending which is already the lowest in Canada and about \$350 per capita less than the average of that in the six other balanced budget provinces. That is, deferring the cut represents a "gain" of less than ten percent of the underfunding relative to the average in those provinces. Health spending would need to be increased 28 percent to reach that average. Nonetheless, this plus some short term employment guarantees quelled the strike which had garnered a surprising amount of public support in its protest against the Klein government's policies.
26. It is difficult to discern just what the ultimate and total impact of various budget changes are until the end of year numbers are available and then, ideally, on a financial management basis.

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