

Alberta: 2019–20 Budget

A DEMANDING BUT NECESSARY ADJUSTMENT

- The United Conservative Party's first budget (*Budget*) holds few surprises. Delivering on an election commitment, it outlines a path to budget balance by fiscal year 2022–23 (FY23).
- The fiscal deficit is forecast to decline from a FY20 high of \$8.7 bn progressively over the mandate to a surplus in FY23.
- As expected, *Budget* leans heavily exclusively on expenditure restraint, while fully delivering on promised corporate tax cuts. This will underpin an otherwise uncertain business environment, but will render consolidation all the more challenging.
- Alberta's outlook and demographic footprint point to effective real per-capita cuts in the order of 4% per year. Careful navigation in execution of cuts will be essential to the delivery against plan.
- Overall, *Budget* sets off a needed course correction in light of escalating debt levels in Alberta that should help embolden market confidence. Net debt will rise at a slower pace under the budget plan, hitting \$46.3 bn in FY20 rising gradually to \$66.3 bn in FY23.

BALANCING THE BOOKS WITHIN THE MANDATE

The United Conservative Party's maiden budget outlines a path to balance by fiscal year 2022–23 (FY23). As a key platform commitment, this was widely expected. An \$8.7 bn deficit is forecast in FY20 with a gradual erosion of red ink thereafter. Government coffers is expected to be in surplus (\$0.6 bn) by FY23 (chart 1, p.2).

Expenditure restraint will shoulder the brunt of needed consolidation. The plan outlines headline total spending cuts of about 0.3% per annum, concentrated in the public service and transfers to municipalities. The government commits to maintaining some frontline services, a task all the more challenging against the backdrop of a structurally aging population, as well as an expected cyclical uptick in the net inflow of younger Canadians as the economy picks up. Effective real cuts in the order of 4% per capita can be anticipated over the forecast horizon. This is no doubt ambitious, but not as severe as the period of austerity in the mid-1990s in which total spending fell by an average of nearly 7% per year (chart 2, p.2)

Corporate tax cuts will underpin an otherwise uncertain business environment but reduce fiscal headroom. The government had previously announced a reduction in the statutory corporate tax rate progressively from 12% to 8% over the mandate with the first percentage point cut introduced in July. This should boost economic efficiency over the long run, but it will leave a hole in the balance sheets in the short run—foregone revenues are expected to exceed \$2 bn over FY20–23. Meanwhile, deeply ingrained fiscal orthodoxy precluded filling this gap through other measures such as a consumption tax that are deemed technically more efficient revenue-generating mechanisms.

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Updated Fiscal Forecast \$ millions except where noted

	FY19	FY20	
	Final	Bud. 18	Bud. 19
Personal Income Tax	11,874	11,984	11,990
Corporate Income Tax	4,871	5,293	4,177
Carbon Levy	1,324	1,381	0
Other Taxes	5,509	5,890	5,766
Total Tax Revenues	23,578	24,548	21,933
Non-Renewable Resource Revenue	5,429	4,183	6,527
Investment Income	2,349	3,161	2,585
Other Own-Source Revenue	10,255	10,253	9,771
Total Own-Source Revenue	41,611	42,145	40,816
Federal Transfers	8,013	8,470	9,200
Total Revenue	49,624	50,615	50,016
Program Spending	54,554	55,758	54,275
Total Debt Service*	1,781	2,068	2,265
Total Expenditure	56,335	57,826	56,540
Risk Adjustment	0	700	680
Crude-by-rail provision			1,500
Budget Balance	-6,711	-7,911	-8,704
Net Taxpayer-Supported Debt	37,115	--	46,344
Financing Requirements		--	15,101
Annual Change, %			
Tax Revenue	13.6		-7.0
Non-Renewable Resource Revenue	9.0		20.2
Total Own-Source Revenue	4.8		-1.9
Federal Transfers	5.4		14.8
Total Revenue	4.9		0.8
Program Spending	1.2		-0.5
Total Expenditure	1.8		0.4
Memo Items, %			
Own-Source Revenue / GDP	12.0	11.9	11.5
Program Spending / GDP	15.7	15.8	15.4
Consolidated Balance / GDP	-1.9	-2.2	-2.5
Debt Service / Revenue	3.6	4.1	4.5
Net Financial Assets / GDP	10.7	--	13.1

* FY19 net of pension recovery. Source: Alberta Finance; nominal GDP forecasts: Scotiabank Economics.

The cut will widen Alberta's tax advantage. The province's marginal effective corporate tax rate is already among the lowest across Canada. It is similarly more attractive relative to oil-producing states south of the border. Complimentary efforts to attract new and diversified investments, including Alberta-specific capital cost allowances, will be essential to fully leveraging the tax tailwind.

Nevertheless, the full potential of the cuts is likely to be held back by broader uncertainty in the energy sector in the near-term. Chronic egress challenges have been a dominant barrier to investor confidence in Alberta's energy sector. Global factors also continue to weigh on the sector's prospects including an environment of heightened global uncertainty and waning growth prospects. In this regard, the budget adopts an appropriately conservative approach to oil price movements and associated revenues that should provide an upside to the outlook.

Much of the economic outlook laid out, notably the pickup in growth anticipated beyond this year, relies on major project activity and capacity enhancements vis-à-vis projects already underway. As such, a more modest-than-projected expansion—and a weaker revenue trajectory—could materialize should major ventures experience delays. However, some upside is presented by long-dormant energy security concerns that were brought to the fore by recent attacks on major Saudi oil facilities. Sentiment toward Canada's oil patch has historically benefitted from such security concerns, and the Province details a higher oil price scenario in the fiscal plan.

Divided political ideologies across federal and provincial parties add to a challenging environment. It will be of mutual interest to find common ground in a dual-track approach to the sustainable development of Canada's energy sector while facilitating broader economic diversification.

Overall, Budget delivers a credible, albeit challenging path to balance that should be well-received by markets. It reverses an unsustainable debt trajectory through ambitious consolidation, while underpinning business activity with sizeable tax cuts. It has chosen a more exigent path (i.e. resting solely on spending cuts, while continuing to resist a common convention of consumption taxes). This should reverse the current boom-bust cycle, but stop shy of preventing the next one. A diversifying economy on the one hand will increasingly provide a larger automatic stabilizer over the business cycle, but it will also reduce the contribution of resource revenues to the government coffers. A structural adjustment will eventually be required.

Nevertheless, the government should be prepared to temporarily adjust its fiscal path should further downside risks materialize. The proposed consolidation path should minimize growth impacts as the economy regains strength, but could create excessive drag in a slowing growth environment. While being mindful of the pace of debt accumulation, the overall net debt level is still low at 13% of GDP.

POLICY AND FISCAL PLANNING DETAILS

For business taxation, the key measure was the previously outlined reduction in the general corporate tax rate—packaged as the *Job Creation Tax Cut*—from 12% last year to 8% on Jan. 1, 2022. The Government anticipates the *Cut* will lift real capital outlays by \$4 bn per year through 2023. To further support business competitiveness in Alberta, the Government will follow several other provinces and parallel federal

Chart 1

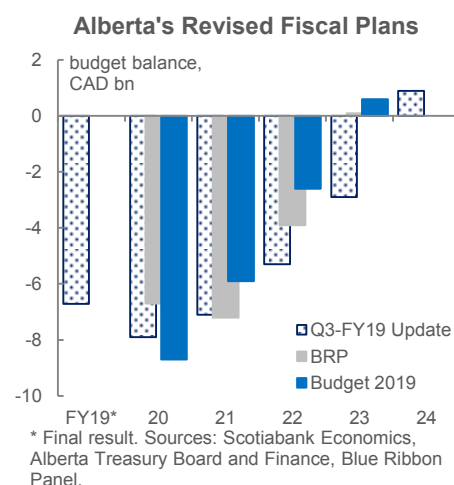


Chart 2

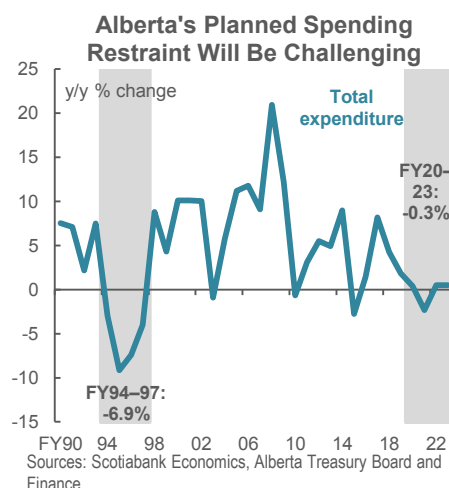
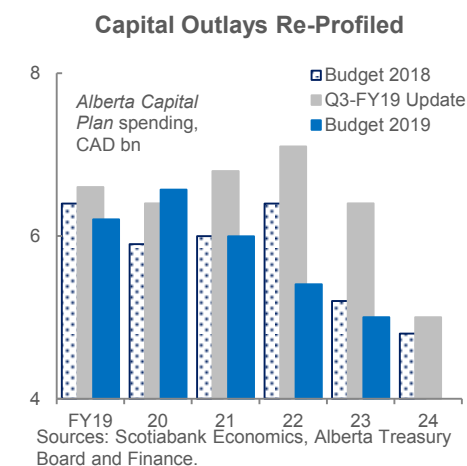


Chart 3



measures that accelerate the rate at which capital outlays can be written off for tax purposes. The Province reiterated its elimination of the previous administration's carbon pricing regime, and pledged to hold the current small business tax rate at 2%.

Personal taxation policy was anchored by two measures. The first is the Alberta Child and Family Benefit (ACFB), which replaces the existing Alberta Family Employment Tax Credit and Alberta Child Benefit. The ACFB includes an annual base component that ranges from \$1,330 for families with one child to \$3,325 for families with four or more children, as well as an additional component for working families. Families must earn at least \$2,760 to qualify for the latter, while both components are phased out at higher net income levels. The Province will also pause 2019 and 2020 tax year indexation of non-refundable tax credits and tax bracket thresholds, resuming indexation "once economic and fiscal conditions can support it."

The key plank on the expenditure side of the ledger was a pledge to hold nominal health care spending constant throughout the forecast horizon. The Government intends to release a detailed plan to reduce surgical wait times in next year's budget. For education, it will keep K-12 spending flat while lowering post-secondary funding by an average of 3.1% per annum during FY20–23. Expenditures on advanced education will be based on a model that allocates funds on the basis of educational system performance and job creation, set to be introduced in FY21.

Consistent with the recommendations of the *Blue Ribbon Panel* on Alberta's finances released last month, the Province will scale back infrastructure outlays under its *Capital Plan*. Key to planned reductions are more modest transfers to municipalities, the past generosity of which was cited as a reason for cost pressures at the Provincial level. The key initiative in this respect appears to be a shift of the \$3 bn funding allocated for Edmonton and Calgary LRT ventures to beyond FY23; FY20–23 Capital Plan outlays are forecast to come in a cumulative \$3.7 bn lower than outlined as of the Q3-FY19 fiscal update (chart 3, p.2). The Province will leverage federal infrastructure funding to provide a partial offset.

Budget also outlines controls on the size of the public sector service and its compensation. A reduction of some 764 full-time equivalent positions is forecast in FY20, with reductions through FY23 expected to occur primarily via attrition. No increases in compensation are planned from FY20 to FY23 for any of the major government agencies.

The fiscal blueprint builds a \$1.5 bn contingency amount—intended to reduce the costs to taxpayers vis-à-vis Alberta's crude-by-rail program—in FY20. It estimates that the program will cost taxpayers at least \$1.8 bn without recalibration, and pledged to explore options to increase market access without burdening taxpayers. It will honour existing agreements under the Petrochemicals Diversification Plan and extend the royalty credit regime to incent new investment, but remove capital grants for the Petrochemical Feedstock Infrastructure Program and Partial Upgrading Program.

Provincial borrowing requirements are expected to total \$15.1 bn in FY20, rise modestly to \$15.3 bn in FY21, and average about \$12.4 bn over FY22–23. More than 60% of borrowing is forecast to consist of new financing during FY20–23, with a share nearer 70% this fiscal year. Long-term debt is expected to constitute the bulk of borrowing over the planning horizon. Consistent with previous practice, the Government will target 30–40% issuance in foreign markets, build liquid benchmark bonds, and issue debt in multiple terms to maturity out to 30 years.

Net taxpayer-supported debt is forecast to reach \$46.3 bn this fiscal year, rising steadily to \$66.3 bn by FY23. As a share of nominal GDP, the value is expected to be just north of 13% in FY20, and increase gradually towards a rate approaching 20% by FY23. To reduce borrowing needs and associated costs, the Government will consolidate a range of regulated funds and reduce its annual cash reserve from \$5 bn to \$4 bn.

Borrowing Requirements (millions of dollars)		2019-20 Estimate	2020-21 Target	2021-22 Target	2022-23 Target
Government	New financing	9,579	9,058	6,201	6,233
	Refinancing	3,899	3,071	3,679	3,274
	Total	13,478	12,129	9,880	9,507
Provincial corporations	New financing	247	658	838	1,084
	Refinancing	568	2,027	1,242	1,856
	Total	815	2,685	2,080	2,940
Government business enterprises	New financing	608	250	311	153
	Refinancing	200	200	-	-
	Total	808	450	311	153
Total borrowing requirements	New financing	10,434	9,966	7,350	7,470
	Refinancing	4,667	5,298	4,921	5,128
	Total	15,101	15,264	12,271	12,600

Sources: Scotiabank Economics, Alberta Treasury Board and Finance.

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