Alberta: 2020–21 Budget

SUMMARY

- The United Conservative Party has tabled its second budget just four months after presenting its inaugural fiscal plan last October.

- Today’s budget is broadly consistent with a path to balance by fiscal year 2022–23 (FY23) from an expected deficit of $7.5 bn in FY20.

- But the outlook has arguably shifted substantially. Budget forecasts were finalized in mid-January before the coronavirus outbreak was evident, with WTI oil prices dropping by over US$10/bbl since then. This represents a risk to the anticipated economic recovery in 2020.

- Nevertheless, the government remains firm in its resolve to balance its books. Budget 2020–21 largely expands on previously announced expenditure restraint measures.

- The fiscal plan delivers a needed course correction in light of escalating—albeit still relatively low—debt levels as the accumulation of net debt should decelerate substantially.

- Should further risks materialize, flexibility could be warranted to calibrate the pace of consolidation to evolving economic circumstances in the context of a credible medium-term path to fiscal balance.

OUR TAKE

A medium-term fiscal consolidation plan was warranted in Alberta. While overall debt levels are still modest—and the lowest across the country as a share of its economy—the trajectory was on an unsustainable path following two successive commodity shocks. The government’s fiscal plan provides a credible path to balance that should reverse this trend and erode debt levels over time. The gradual pace and composition of consolidation should not substantially compromise growth as the economy regains steam.

However, the government should be prepared to temporarily adjust its fiscal path should further downside risks materialize. In particular, the coronavirus outbreak (COVID-19) will likely impact economic activity in the first half of the year at least with consequential effects on oil prices before a rebound could be expected. With pockets of persistent weakness in Alberta’s labour markets already, a reduction in public expenditures could compound drag in a slowing economy including through confidence channels. In this context, there could be a solid case for greater active labour market policies that directly target affected workers. In the near term, this may add to the bottom line but could reinforce the recovery over the medium term.

The government has chosen a more exigent route to consolidation by relying exclusively on expenditure restraint, while simultaneously cutting corporate taxes. Meanwhile, it continues to resist a more common convention of broadening its revenue base through consumption taxes. The
current plan should reverse the current boom-bust cycle, but will likely stop shy of preventing the next one as the broader economic diversification plan, and in turn revenue diversification, will take time. Meanwhile, the longer-term trend of revenue erosion as a share of the economy will be difficult to reverse (chart 2).

**ECONOMIC OUTLOOK**

Alberta’s economy faces a fragile recovery. The rebound had already been anaemic when the United Conservative Party took office last Fall following back-to-back oil shocks. Despite a recovery in global oil prices and easing egress challenges over the course of 2019, economic activity nevertheless has lagged historic patterns (chart 3). Nevertheless, forecasters had earlier called for a solid rebound in 2020. In this context, the government set out its inaugural fiscal path last October with prudent assumptions regarding global oil prices.

**Much has changed in four months.** While oil markets largely played in the Province’s favour for much of 2019 with accelerating global prices and a narrowing differential, the unexpected emergence of the coronavirus (COVID-19) outbreak in early 2020 quickly eroded these gains (chart 4). Prudent assumptions at the time of the October budget are proving prescient for FY20, though they are arguably optimistic looking ahead to 2020. This budget is predicated on a solid economic recovery of 2.5% real GDP growth in 2020 up from an estimated 0.3% last year.

**Budget forecasts were made in mid-January prior to the COVID-19 outbreak.** Since then, WTI oil prices have dropped by more than US$10/bbl. The outbreak will dampen global growth this year with a particularly pronounced effect upon the first half of the year, after which one could cautiously expect a moderate rebound. Needless to say, the trajectory of COVID-19—and importantly its impact on oil markets—places substantial and disproportionate uncertainty on Alberta’s economic and fiscal outlook this year that could potentially push out a full recovery to 2021.

**The political landscape has also shifted.** Whereas a Federal minority government had just been elected back in October on a platform of responsible resource sector development, aspirational plans are proving more difficult in reality. Recent rail disruptions related to the LNG pipeline development in British Columbia underscore that federal approval may be necessary but insufficient, while the last-minute withdrawal of Teck’s project application convolutes all of the above. Political, geographical and ancestral ideologies impede rational dialogue on a common and sustainable economic path forward. Irrespective of fault, these developments have elevated the uncertainty around Alberta’s—and Canada’s—economic growth outlook.

These uncertainties could dwarf other positive developments for Alberta in the near term. An acceleration of crude-by-rail volumes earlier this year could partially offset global oil price climbs via narrower differentials. The Trans Mountain pipeline expansion has passed one more hurdle with the recent Supreme Court dismissal that should help alleviate egress challenges over the medium term. Investment activity outside the oil and gas sector also holds promise, including in petrochemical production and telecommunications prospects.

**THE FISCAL PLAN**

Budget 2020 reaffirms the government’s commitment to balance its books. The path to balance is largely consistent with the earlier plan set out in October. Deficit
spending is expected to peak in FY20 at $7.5 bn on total revenues of $51 bn. This is slightly smaller than the anticipated $8.7 bn deficit at the time of the October budget but largely reflects the release of contingencies and provisions. A gradual erosion in deficit spending is then forecast through FY23 when it is expected to post its first surplus of $700 mn. The incremental withdrawal of deficit spending would amount to about 0.2% of GDP in FY21, 1% in FY22 and 0.5% in FY23.

Expenditure constraint will continue to drive consolidation. Operating costs are expected to be cut by 2.5% over three years motivated by a desire to strengthen the quality and efficiency of social services in line with best-performing peers. As announced in October, this is to be achieved by holding nominal health care and primary education spending constant (with substantial reallocation within these sectors), while reducing secondary education by about 3% per annum by shifting to a performance model. The budget announces public sector staffing costs will also be cut by about 2% over three years.

The fiscal path also relies on a rebound in revenues. Total revenue forecasts for FY20 have been revised up modestly to $50.9 bn for FY20 (about 2.5% growth over last year) and are then expected to decline modestly in FY21 by about 2.5% before rebounding by an average of 7.8% over the following two years, driven by income taxes, bitumen royalties and federal transfers. Revenues are historically highly volatile and are particularly sensitive to oil prices. For instance, a dollar drop in WTI oil price assumptions or a dollar increase in the WTI-WCS differential would each add more than $300 mn to the deficit. The budget restates its case for a retroactive federal ‘equalization rebate’ of $2.4 bn but does not incorporate this into its fiscal plan.

Earlier-announced corporate tax cuts will reduce fiscal flexibility over the budget horizon. The second of four 1-ppt cuts came into effect on January 1, 2020 bringing the statutory corporate rate to 10%—the lowest across Canada and oil-producing states in the US. The rate will be progressively reduced to 8% by 2022. While it is too early to see effects of these tax cuts, the 2018 federal investment incentives have not moved the dial substantially on marginal capital outlays in Alberta suggesting that other factors dominate investment decisions presently though the budget estimates the measure will boost real GDP growth annually by 0.3–0.4 ppts annually between 2020 and 2023. Meanwhile, it is expected to forego annual revenues in the order of $600 mn.

Consolidation will face a variety of headwinds. Planned spending restraint is not as austere as the mid-1990s that saw annual spending cuts upwards of 7%, but strengthening oil prices during this period spurred strong economic activity (chart 5). An aging population also adds pressure to social systems. Negotiations with teachers’ unions and the medical association are already off to a confrontational start. That said, the fiscal plan largely offers a common-sense Realpolitik approach to consolidation: introduce a credible fiscal plan early in the electoral cycle, provide a gradual path to consolidation that is least harmful to growth, and protect critical front-line services that will most directly impact citizens. This bodes well for successful execution.

Arguably the biggest risk to the fiscal plan is that it falls out of step with economic developments. Planned spending restraint is well-calibrated to a recovering economy, but a weakening economy can amplify fiscal multipliers, further widening the output gap, and ultimately threatening a precarious rebound. Labour
market indicators in Alberta are showing persistent softness (chart 6), suggesting some flexibility in the pace and composition of the consolidation path could be warranted. In particular, active labour market policies that directly target affected workers could mitigate against the risk that consolidation contributes to a broad-based slowdown. Budget 2020 acknowledges this with its long-term Blueprint for Jobs, but shorter-term, stimulative and targeted job action may be warranted either through provincial or federal channels.

Otherwise, Budget 2020 lays out sound structural policies that should strengthen Alberta’s economy over the medium term. This includes its agenda to advance economic diversification that is arguably drowned out in the debate around natural resource development. The government acknowledges that competitiveness extends beyond a tax advantage with its agenda to reduce red tape. It also demonstrates leadership in driving down interprovincial trade and labour mobility barriers with the lowest non-geographic trade barriers among Canadian provinces according to the IMF.

The Province will also modestly increase its capital spending plans. It plans to invest $6.4 bn in average annual spending over the next three years for roads, bridges and LRTs with priority given to projects that enable future private sector investment. This represents $772 mn in new incremental capital funding over this period (chart 7).

DEBT AND BORROWING

Provincial borrowing requirements are expected to rise to $15.8 bn in FY21 before hovering around $11.5 bn in subsequent years. Borrowing requirements for FY20 at $10.6 bn were scaled back by $4.5 bn relative to Budget 2019 as a result of a slightly lower deficit, the closure of regulated funds announced in Budget 2019, and improvements to cash management. New financing requirements account for approximately 60% of borrowing needs between FY21–23 with long-term debt accounting for the bulk of borrowing over the horizon.

Alberta’s taxpayer-supported debt will continue to rise, albeit more slowly. Taxpayer-supported debt outstanding is forecast at $76.9 bn for FY21 (21.3% of GDP and 153% of revenues). Net financial liabilities are projected to be $43.6 billion at year’s end. In relative terms, it will be over 12% of GDP and about 87% of revenues, while debt service costs represent about 4.1% of total estimated revenues.

**Borrowing Requirements (millions of dollars)**

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<td>2,027</td>
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<td>New financing</td>
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<td><strong>Total</strong></td>
<td>672</td>
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<td><strong>Total borrowing requirements</strong></td>
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<td>15,791</td>
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Sources: Scotiabank Economics, Alberta Finance.
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