# FISCAL POLICY TRENDS

March 2018

## THE PATH TO BALANCE OR THE ROAD TO RUIN?

By Bev Dahlby

The NDP government's plan to balance the provincial budget by 2023-24 is based on drastically cutting capital spending and on optimistic revenue projections.

In order to show that these are the key elements of the "Path to Balance", we need to know how interest payments on debt, total operating expenditures, and the cash deficits will evolve under the government's plan, but these key fiscal variables are not reported in the budget documents. Fortunately, it is possible to estimate them in order to reveal more clearly the fiscal implications of the government's plan. In Table 1, we have added some of these key fiscal variables to the table on page 86 of the budget. The series and figures that we have added are indicated in italics. In particular, we have added the provincial government's cash surplus or deficit, which determines the amount of borrowing that the government has to undertake each year to finance the gap between its revenues and its operating expenditures, capital expenditures, and interest payments on debt. The cash deficit can be inferred from the increase in the province's net financial debt. The increase in interest payments on debt can be calculated based on the increase in debt and the interest rate implicit in the government's calculation of the growth in interest payments for the years 2017-18 to 2020-21. Given the government's projected revenues and capital expenditures, and our estimate of the interest payments on debt, we can infer total operating expenditures in each year. We have also added an estimate of amortization, inventory consumption, and disposal loss.

Table 1: Government Expenditures Under the "The Path To Balance" Plan

| $ Billions | 2017-18 Forecast | 2018-19 Estimate | 2019-20 Targets | 2020-21 Targets | 2021-22 Projection | 2022-23 Projection | 2023-24 Projection |
|---|---|---|---|---|---|---|---|
| **Revenue** | 46.9 | 47.9 | 50.6 | 53.8 | 57.8 | 62.3 | 66.3 |
| **Operating Expense** | 46.4 | 47.8 | 49.1 | 50.3 | 52.0 | 53.8 | 55.6 |
| ***Amortization / inventory consumption / disposal loss*** | 3.4 | *3.4* | *3.6* | *3.7* | *3.8* | *3.9* | *4.0* |
| ***Interest on Debt*** | 1.4 | *1.9* | *2.4* | *2.9* | *3.4* | *3.7* | *3.8* |
| **Total Expense** | 55.9 | 56.2 | 57.8 | 59.8 | 62.2 | 63.7 | 65.5 |
| ***Risk Adjustment*** | 0 | -0.5 | -0.7 | -1.0 | *0.1* | *0.0* | *-0.1* |
| **Surplus (Deficit)** | (9.1) | (8.8) | (7.9) | (7.0) | (4.3) | (1.4) | 0.7 |
| | | | | | | | |
| **Capital Plan** | 9.2 | 6.4 | 5.9 | 6.0 | 6.4 | 5.2 | 4.8 |
| | | | | | | | |
| **Revenue** | 46.9 | 47.9 | 50.6 | 53.8 | 57.8 | 62.3 | 66.3 |
| ***Operating Expenditures*** | *47.7* | *49.8* | *51.6* | *53.3* | *53.7* | *55.7* | *57.5* |
| **Capital Expenditures** | 9.2 | 6.4 | 5.9 | 6.0 | 6.4 | 5.2 | 4.8 |
| ***Interest on Debt*** | 1.4 | 1.9 | 2.4 | 2.9 | *3.4* | *3.7* | *3.8* |
| ***Total Expenditures*** | *58.3* | *58.1* | *59.9* | *62.2* | *63.5* | *64.6* | *66.1* |
| ***Cash Surplus (Deficit)*** | *-11.4* | *-10.2* | *-9.3* | *-8.4* | *-5.7* | *-2.3* | *0.2* |
| | | | | | | | |
| **Net Financial Debt** | 20.3 | 30.5 | 39.8 | 48.2 | 53.9 | 56.2 | 56.0 |
| | | | | | | | |
| **Index of Real Per Capita Operating Expenditures** | 100 | 100.7 | 100.9 | 100.7 | 98.0 | 98.1 | 97.7 |
| **Index of Real Per Capita Capital Expenditures** | 100 | 67.5 | 60.2 | 59.1 | 60.9 | 47.7 | 42.5 |

Source: Albert Fiscal Plan 2018-21, page 86 with additional data added by the author in italics.

What this exercise reveals is that under the government's fiscal plan operating expenditures are projected to increase by 20 percent from $46.9 billion in 2017-18 to $66.3 billion in 2023-24, while interest payment on debt will shoot up from $1.4 billion to $3.8 billion, an increase of $2.4 billion.

The increase in operating expenditures contrasts with the steep decline in capital expenditures, which are projected by the government to be cut almost in half by 2023-24. As shown in the Table 1, operating expenditures, adjusted for inflation and population growth, are projected to decline by 2.3 percent over the next six years, while real per capita capital expenditures are projected to decline by 57.5 percent. It is clear that on the spending side the government is relying of cutting investment in public infrastructure while basically maintaining the level of health, education, and other public services.

The NDP government had ramped up capital spending from the already high levels of the previous Conservative governments, so cutting back on capital spending is undoubtedly warranted.

Table 2: Fiscal Metrics with a Prudent Revenue Projection

| $ Billions | 2017-18 Forecast | 2018-19 Estimate | 2019-20 Targets | 2020-21 Targets | 2021-22 Projection | 2022-23 Projection | 2023-24 Projection |
|---|---|---|---|---|---|---|---|
| *Revenue* | 46.9 | 47.9 | *50.0* | *52.8* | *55.9* | *59.0* | *61.9* |
| Operating Expense | 46.37 | 47.8 | 49.1 | 50.3 | 52 | 53.8 | 55.6 |
| *Amortization / inventory consumption / disposal loss* | *3.4* | *3.4* | *3.6* | *3.7* | *3.8* | *3.9* | *4.0* |
| Interest on Debt | 1.4 | 1.9 | 2.4 | 2.9 | 3.4 | 3.9 | 4.2 |
| Total Expense | 55.9 | 56.2 | 57.8 | 59.8 | 62.2 | 63.7 | 65.5 |
| Risk Adjustment | 0 | -0.5 | -0.7 | -1 | 0.1 | 0 | -0.1 |
| Surplus (Deficit) | -9.1 | -8.8 | -8.5 | -8.0 | -6.2 | -4.7 | -3.7 |
| | | | | | | | |
| Revenue | 46.9 | 47.9 | 50.0 | 52.8 | 55.9 | 59.0 | 61.9 |
| *Operating Expenditures* | *47.7* | *49.8* | *51.6* | *53.3* | *53.8* | *55.9* | *57.7* |
| Capital Expenditures | 9.2 | 6.4 | 5.9 | 6 | 6.4 | 5.2 | 4.8 |
| *Interest on Debt* | 1.4 | 1.9 | *2.4* | *2.9* | *3.4* | *3.9* | *4.2* |
| *Total Expenditures* | *58.267* | *58.1* | *59.9* | *62.2* | *63.5* | *64.6* | *66.1* |
| *Cash Deficit* | -11.367 | -10.2 | *-9.9* | *-9.4* | *-7.7* | *-6.0* | *-4.7* |
| | | | | | | | |
| *Net Financial Debt* | *20.3* | *30.5* | *40.4* | *49.9* | *57.6* | *63.6* | *68.3* |

Whether focusing the real spending cuts almost exclusively on capital spending will imperil the long term health of the economy is a topic that we will have to return to another day.

While, it is clear that the government's plan to balance the budget by 2023-24 is based on cutting capital spending, while preserving current services, it is also based on optimistic assumptions about the growth revenues, especially non-renewable resource revenues, which are projected to increase from $4.5 billion in 2017-18 to $10.4 billion in 2023-24. In order to gauge how vulnerable the NDP's fiscal plan is to the projected growth in resource revenue, we have modelled a lower revenue growth scenario in which total revenues grow at the same rate as the nominal GDP growth projected by the government. In other words, in this scenario provincial revenues will growth after 2018-19 at the same rate that the province's economy grows, and it will

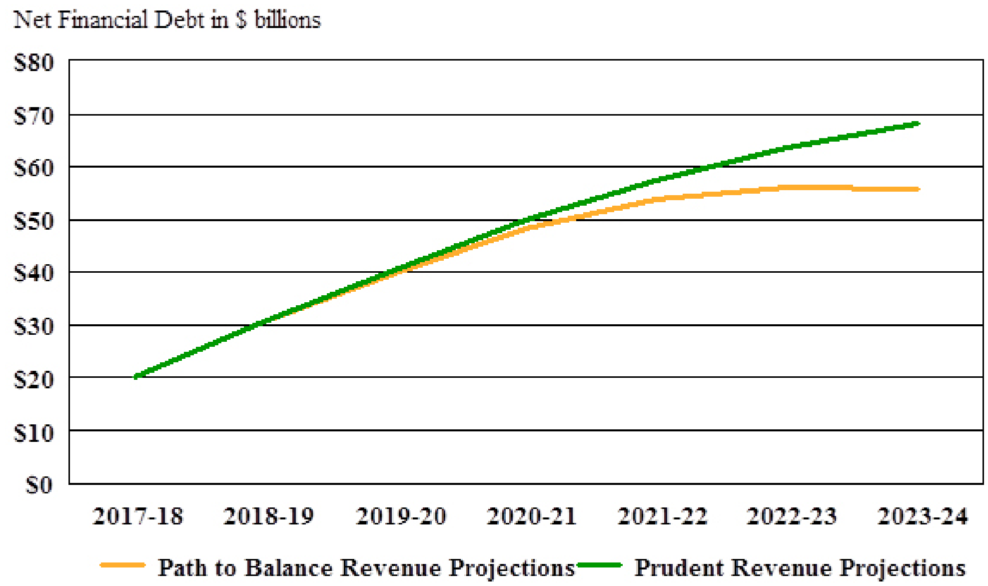

**The School of Public Policy**
University of Calgary Downtown Campus
906 8th Avenue S.W., 5th Floor
Calgary, Alberta T2P 1H9

not get the extra boost from higher oil prices or pipeline capacity that underlies the government's projected resource revenue increases. We could call this a prudent revenue growth scenario.

Table 2 shows the impact on the province's finances of a prudent revenue growth scenario, while maintaining the projected operating and capital expenditures that are in the government's fiscal plan. First, note that with the prudent revenue projection, total revenues are only slightly lower in 2019-20 and 2020-21, but the revenues are significantly lower in the following two years and $4.4 billion dollars lower in 2013-24. Given the lower revenues and the same operating and capital expenditures, the operating deficits and the cash deficits of the province are higher than under the government's projections. This leads to a higher net financial debt $68.3 billion, higher interest payments of $4.2 billion in 2023-24, and the government's budget remains in deficit. Figure 1 shows that under the prudent revenue projections, the province's net financial debt will still be increasing at a rapid pace in 2023-24, rather than leveling off as the government has projected.

The prudent revenue scenario shows how vulnerable the government's "Path to Balance" plan is to the vagaries of oil prices, pipeline construction and the absence of other negative shocks to the economy.

Figure 1: The Province's Net Financial Debt under Alternative Revenue Projections




Over the next six years, many fear that the national and global economies could suffer downturns because of financial market disruptions and trade wars. Slower economic growth or higher interest rates would cause an even greater divergence from fiscal balance in 2023-24. A more responsible fiscal plan would have used more cautious projections of future revenues to determine the spending restraint that is necessary to balance the budget in 2023-24, and it would commit the government to saving any improvement in resource revenues in the Alberta Heritage Savings Trust Fund or a newly created revenue stabilization fund.



**The School of Public Policy**
University of Calgary Downtown Campus
906 8th Avenue S.W., 5th Floor
Calgary, Alberta T2P 1H9