# Chapter Eight

## NOT JUST ABOUT MONEY: PROVINCIAL BUDGETS AND POLITICAL IDEOLOGY

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The one lesson that emerges is the need to keep trying. No perfection. No millennium. No apocalypse. We must cultivate a skeptical faith, avoid dogma, listen and watch well, and try to clarify and define ends, the better to choose means.
– David S. Landes, *The Wealth and Poverty of Nations*, 1998.

The Klein government was first elected in 1993 in the context of a perceived financial crisis. Government spending, it was claimed, was out of control. The newly elected government said it would get "government out of business" and end wasteful spending. Above all, the Klein government said it would be a sound manager of "the people's money." Today, twelve years later, the premier boasts Alberta is debt free. Is it? What is Alberta's current financial state? What choices has the government made to achieve Alberta's fiscal health? Who have been the winners and losers as a result of these choices?

These are some of the questions I attempt to address in this chapter. I use Statistics Canada Financial Management System (FMS) data to track and compare provincial revenues and expenditures since 1989. I specifically examine changes in Alberta's revenue streams and detail spending in the key areas of health, education, and welfare. Ultimately, I argue the Klein government has pursued policies on both the revenue and expenditure side that have systematically harmed the public sphere and increased overall inequality, while favouring the well off in our society.

To begin, however, the chapter begins with a broad overview of the budget process. My intent is to show that, far from being merely dry numbers, budgets are about political choices that shape societies and impact the life chances of individuals and communities.

### Budgets in Canada: An Overview

Canada has three levels of government---federal, provincial, and local. The local level of government includes municipalities, school boards, hospitals, special agencies, boards, and commissions. Local governments are under the authority of provincial governments and obtain their powers only through provincial delegation. Therefore, these powers vary substantially across the nation. The *Constitution Act* determines the sharing of powers, including spending and taxation between the federal and provincial levels of government. Each jurisdiction produces an annual budget laying out the spending plan and the expected source of funds. Like any budget, the Alberta provincial government's budget is an itemized account of expenditures and revenues for a specific fiscal year. The Alberta government's fiscal year begins April 1 and ends March 31.

For provinces, the outlay side of the budget consists mainly of expenditures on health care and education (K-12 and postsecondary). The next highest level of transfers is to persons in the form of social services, interest payments on government bonds and other liabilities; transfers to local authorities such as municipalities; and transfers and subsidies to corporations. Other expenditures include security (police, fire protection, the judiciary, prisons, etc.). Finally, there are expenditures on communication and transportation (including highways and roads); recreation and culture; the environment; and the running of the institution of the government itself. In Alberta, a relatively large expenditure includes the development of natural resources.

Paying these costs requires revenue – and lots of it. Provincial revenue is acquired from a number of sources: direct taxes (income tax) from individuals and corporations; investment income (including rents from crown lands), profits from crown corporations, and other income generating investments; indirect taxes (consumption taxes); profits from gaming; property taxes; transfers form the federal government; and health premiums. Local governments obtain their revenue largely from transfers from senior levels of government, property taxes on land and buildings, local business permits, and licenses.

## Deficits, Surpluses, and Accumulated Debts/Assets

A government has a balanced budget if total expenditures equal total tax revenues for *the fiscal year*. A budget deficit occurs if that year's expenditures are greater than revenues. Alternatively, the government has a budget surplus if expenditures are less than revenues. In the case of a deficit, financial assets will be diminished or the accumulated debt will grow. Surpluses either add to the accumulated assets or reduce any accumulated debt. As Alberta has simultaneously borrowed in the financial markets creating debt obligations *and* accumulated financial assets in trust funds, the concept of *net debt* is particularly important.

Alberta has always borrowed through the financial markets, thereby incurring debt liabilities, regardless of its overall asset situation. For example, an annual budget deficit is more easily financed by selling securities, such as bonds, in the financial markets. Also, bond issues can fund many long-term projects, such as the building of a dam or a new highway. This is all part of managing the provinces' finances and is not much different than an individual who carries a mortgage on a house while saving by investing in a registered retirement savings account.

Selling bonds to the Canadian private sector is domestic financing. Like any other bond, a government bond is a contract whereby the borrower (the government) agrees to pay back the lender (the buyer of the bond) the amount lent plus some rate of interest after some specified period of time. The provincial government must sell its bonds in the bond market, in competition with bonds sold by businesses and other governments that are trying to borrow funds to finance their investment spending. Government bonds are generally viewed as having a lower risk of default than private sector bonds and therefore usually give the purchaser a lower return than that paid by private bonds. However, if the government is issuing increased amounts of bonds to finance increasing deficits it may have to increase the interest rate paid on the bonds to induce the public to buy new issues. Bonds may also be sold to non-residents in the foreign financial markets. When a government elects to finance its activities through selling financial securities in foreign markets it must also consider the exchange rate, as changes in the rate will affect the value ultimately paid back for the bond.

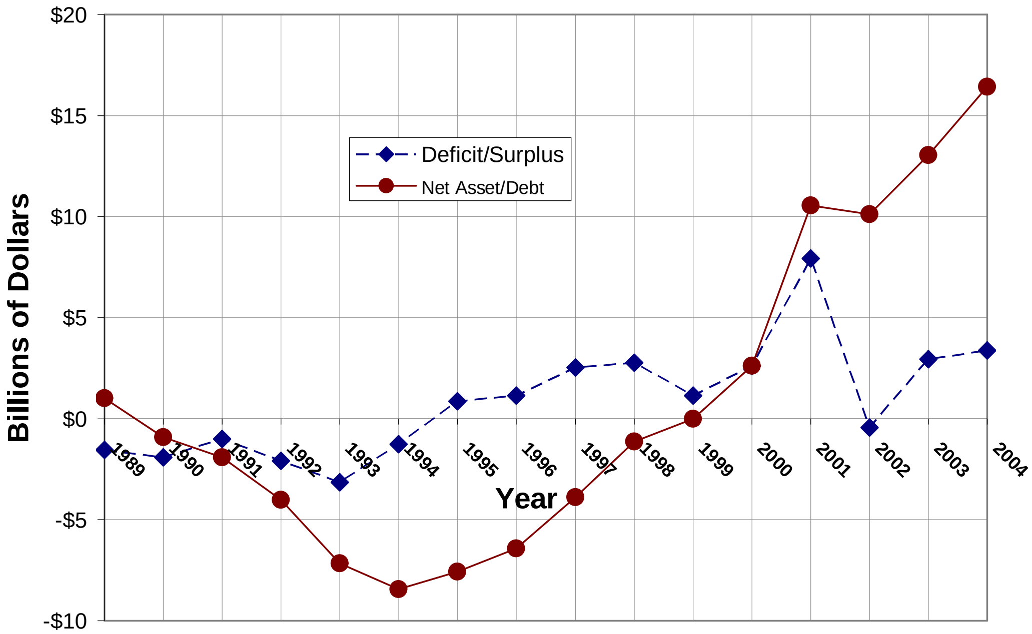
Governments can use a surplus to retire some of the outstanding government debt held by the domestic private sector, can redeem (pay back) debt held by non-residents, or can accumulate financial assets. The Alberta Heritage Fund was accumulated from budget surpluses achieved in the 1980s. This fund was maintained during the deficits that followed in the early 1990s. This is not the only fund holding government assets today, however. More recently, budget surplus funds have been set aside to pay down debt liabilities, such as long term government bonds, as they become due.

This is where the discussion gets complicated and can lead to political confusion. It is important, first off, to distinguish between gross debt, net debt, and outstanding debt liabilities. The most significant of these financial variables is the *net debt*. The net debt is *the sum of outstanding debt liabilities minus the sum of financial assets*. Given the Heritage Fund, the province of Alberta has never in fact had a debt problem. During the 1993 election, the Klein PCs claimed a debt of $37 billion that year. However, the net debt was much smaller and mostly the result of deficits incurred during recessions of the late 1980s and early 1990s. There certainly was a relatively large deficit problem in 1993, but not a significant debt problem. Moreover, these deficits were the result of a serious recession and high interest rates, and did not reflect the underlying strength of Alberta's economy. The Canadian economy was growing in the early 1990s at an average rate of around 5 percent with even stronger growth in Alberta of about 7 percent. The increasing worldwide demand for gas and oil meant Alberta was going to grow significantly in both GDP and in population. Therefore, the deficit would have soon disappeared regardless of what the government did on the expenditure side of the ledger. In consequence, Alberta's net debt was eliminated in 1999.

Alberta still has outstanding debt liabilities reaching out to 2025, however. The accumulation of funds in a special debt retirement account allows the government to offset the value of outstanding liabilities with money assets ready to pay off these securities as they become due. Additional surpluses will be allocated to the government's priorities or added to a new stabilization fund in addition to the Heritage Fund. Graph 8.1 illustrates Alberta's deficits and surpluses, and the relationship between them, and the accumulated debt or asset (1999 on).

**Graph 8.1**

**Surplus/Deficit and Net Asset/Debt**




The Role of Government

Canadians and Albertans often raise – and should raise – questions about the appropriate role of government involvement in the economy in the form of government services, regulations, and controls, and how this involvement is financed. Many people also appropriately question the distribution of government services and programs and the distribution and level of taxes needed to finance these services. On the whole, Canadians have been generous in supporting programs that lessen income disparity and deliver services to all regardless of ability to pay. The overwhelming popular support for government financed Medicare is an example (see Horne, chapter twelve).

What is the purpose of government in a market economy? There is vast literature on this question and it cannot be answered here in any in-depth fashion. Briefly stated, however, private firms in a market economy provide social benefits, but need to make a profit (or at least break even) in the long run. Government functions are far more complex, but government also clearly provides social benefits in excess of costs. Government initiatives correct for failures of the market system, provide protection and security, take on the social risks that individuals cannot anticipate, stabilize the business cycle, and promote fair market competition. Additionally, government should provide vision and leadership, affecting people's notions of value. These roles and functions often clash with pure market outcomes. For instance, while market outcomes often concentrate inequality, government actions can promote equality of opportunity through income redistribution, education, health, and social security.

How one views the role of government in the modern state depends in large part upon one's values. While there are objective questions regarding economic efficiency, much of any discussion of the size and role of government must be normative. Whether the degree of government involvement is too much, just right, or too little is ultimately a political question.

## Business Plans and the Restructuring of Government, 1993-2004

Government expenditure and revenue programs are formulated in the various ministries and departments, reviewed and accepted by the Cabinet, and passed by the Legislature in the form of an annual budget. The planning and budgeting affects over $20 billion per year and involves directly or indirectly thousands of employees in the public sector. It is a political process affected by many different interest groups. The politics of working out compromises among these groups with conflicting objectives takes time and effort. Hence, the provincial treasurer works with virtually every department in government.

During the budget cuts of the mid-1990s in Alberta, the government changed its budgeting process with the implementation of “business plans.” When the Alberta government implemented business plans, it had a number of objectives similar to those found in private business. It wanted to streamline government functions and to focus government service on essentials, to reduce costs, and to improve accountability based on measurable outcomes. The planning framework increased from one year to three years. Initially, financial constraints for each department were predetermined by the overarching policy of cutting expenditures. The initial planning set out the five essential core ‘businesses’ of government: (1) Investing in people and ideas; (2) Building a strong, sustainable and prosperous province; (3) Providing essential services for the health and well-being of Albertans; (4) Maintaining a quality system of roads and highways, telecommunications and utilities; and (5) Providing law, order and good government (Government of Alberta, 1994).

The government document also detailed each department’s initial business plans for the period 1994-97. This business plan set about answering six questions: What are the goals? What are the key functions? What objectives have been set? What will be done to meet the goals? What results do we expect? Who is involved? Each of the 17 ministries developed their own plans in different fashions, but in general each comprised a vision or mission statement, goals, objectives, and strategies. The central motivator underlying each plan was its three-year budget and how it was going to achieve the mandated reduction. The process was to draft working papers in each ministry and in some cases conduct roundtable talks in order to find out from the constituencies just what was a priority, what was desirable, and what could be eliminated, improved upon, or added.

A second round updated the government’s and each department’s business plans to 1997-98 (Government of Alberta, 1995). The government stated the process’ biggest success could be measured by the fact the plans were actually used to guide the actions of the departments and decisions of government; i.e., “They have not become ‘shelf liners.’ The plans have been rethought, modified and changed to respond to changing circumstances and needs.” Round two reduced the core “business” of government to three functions, renamed: People, Prosperity, and Preservation**.** Each department’s primary functions were identified by one of these: “People” included Education, Health, Advanced Education, Career Development, and Family and Social Services. “Prosperity” included Economic Development and Tourism, Agriculture, Food and Rural Development, Energy, Transportation and Utilities, Public Works, Supply, and Services, Labour, and Treasury. “Preservation” included Justice, Municipal Affairs, Environmental Protection, Community Development, and Federal and Intergovernmental Affairs. Business plans in this second round also responded to only four questions: What are the goals? What results are expected? What are the key strategies? What measures will be used to assess progress? The budgets within each plan were not significantly changed; overall spending was to remain at a “sustainable” level. The emphasis, however, was on measuring performance. The government attempted to set performance benchmarks and targets to evaluate programs accurately and intended that the funding of programs would increasingly be tied to the results achieved.

The Alberta government’s use of “business” plans for government programming was not new. A number of federal and provincial ministries and agencies had previously implemented business plans. And, of course, ministries and departments have always had mission statements, identified goals, and budgets to meet. Alberta’s application of the business plan concept to all of government operations, in a comprehensive, systematic, and coordinated way using a three-year planning framework, was unique at the time, however.

What were the implications of government restructuring using business plans? In 1993, the number of government departments was reduced from 23 to 17 (back up to 24 by 2004, including – ironically – a new ministry of Restructuring and Government Efficiency). During the four-year plan, 50 agencies, boards, commissions, and committees were merged or disbanded, 200 plus health and hospital boards were replaced by seventeen regional health authorities (further reduced to nine in 2002), and the number of school boards was reduced from 181 to 57. Some government services were privatized: liquor sales, registry services, property assessments, bailiff actions, labour mediation, employment standards, payroll and accounts payable, and most highway maintenance. In addition, six crown corporations and commercial enterprises were sold. By 1997, twenty-four councils, boards and committees responsible for standards, discipline, and other regulatory functions were delegated to industry and professions. This included the enforcement of building safety codes and occupational health and safety regulations, and the regulation of motor carriers with superior safety records. Other public services delivered to the private sector became self-financing, including the Alberta Tourism Education Council, the Banff Centre, and the Alberta Securities Commission. In addition, the Workers’ Compensation Board became a separate entity outside of direct government control.

The introduction of comprehensive, systematic, and coordinated three-year planning in the public sector was a valuable initiative. Likewise, it was important to ask questions about the appropriate role of government and what services it should provide, and how to improve the efficiency of service delivery. Issues about the purpose and role of government in a modern state need periodically to be addressed. The process of formulating department plans opened these issues up to greater public participation. However, the initial implementation and motivation for business plans was dominated by budget reductions. The underlying philosophy held that spending was too high, not that revenue was too low. Business interests and a neo-conservative philosophy repudiating traditional notions of government involvement in the economy and society dominated consultations in the 1990s. As discussed below, the role of government as stabilizer was abandoned, as regulator was considerably reduced, and as provider of public goods was diminished.

## Balancing the Budget: Alberta's Non-Debate on Deficits and Debt

Government budget policy is the joint result of government spending and tax/revenue policy. Budget policymakers have to consider when and how often the budget should be balanced, when should it be in surplus, and when in deficit. In most jurisdictions, such questions provoke controversy, but not so in Alberta in the mid-1990s. For the Klein government, balancing the budget became a sacred mission. This focus was surely a result of conservative ideology, but (given that the period was predominantly one of solid economic growth) maintaining surpluses was also an appropriate policy from a less ideological fiscal finance perspective.

Premier Klein is one of many politicians, business leaders, and others who believe government budgets should be balanced annually. He has expressed the view that the government budget is the same as the budget of a household or business firm, arguing that households and businesses with budget deficits often go bankrupt. This analogy, however, is misleading. Few families would try to pay the full cost of a new house out of their current yearly income; they borrow against their future expected income in order to facilitate purchasing something that they could not otherwise afford to pay from pres income. Similarly, modern financial management theory supports the idea that firms are better run when they use the extra purchasing power available to them from prudent borrowing against their expected future income, than they are if they try to pay for everything (including their production facilities) using only their present income.

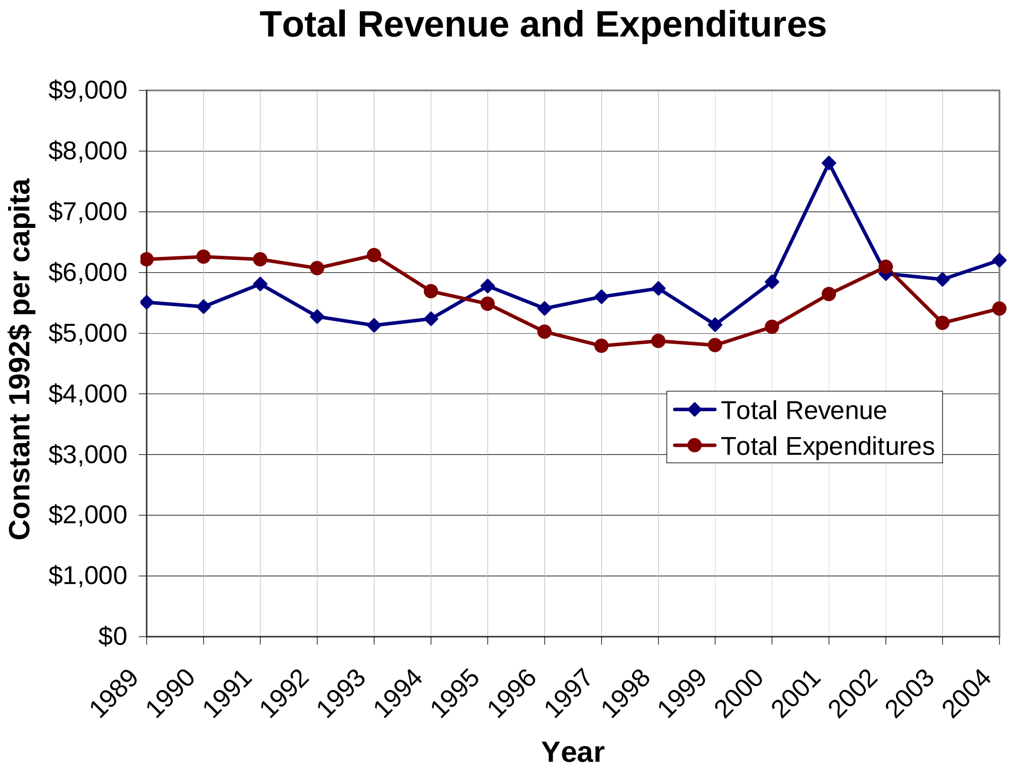
A functional finance point of view contends the goals of economic stabilization and full employment without inflation should come ahead of concerns about balancing the budget. This means the budget may have to run a deficit over a period of several years in order to keep employment high (as the previous Getty government did). Proponents of functional finance (fiscal policy) argue any difficulties associated with ongoing deficits or surpluses far outweigh the benefits of high employment without inflation. Critics of the functional finance approach argue it throws away the fiscal discipline imposed by a balanced budget objective (for a further discussion see Fellows et al., 1997). Generally, however, even critics do not argue for the slavish pursuit of balanced budgets. Rather, they believe they should serve as a rough guideline used to keep inflationary deficit spending under control.

Be that as it may, the Klein government after 1993 set about with obdurate purpose the balancing of Alberta's annual budget. While they may have done so by simply raising revenues, instead they took dead aim at the expenditure side.

## The Focus on Deficit/Debt Elimination

The newly elected the Klein government in 1993 claimed Alberta's financial situation was out of control and reaching a crisis, and that the main culprit was spending on social programs. In fact, government spending was relatively stable from 1989 to 1993 in real per capita dollars as shown in Graph 8.2. The greatest cause of the deficits and debt was the attempt to diversify the economy in a recession through government supported private investment. Ironically, when Klein gained power on a fiscal crisis argument, the economy was beginning the long upswing we have enjoyed over the last decade.

**Graph 8.2**




The Klein government used the “fiscal crisis” to move Alberta's policies and priorities to the right. The subsequent budget plan called for an expenditure reduction of $2.6 billion, or 20 percent, from the level of 1992/93, over a four-year-period. This move was supported by a neo-conservative philosophy advocated in many Western nations, for example, the ideas of Margaret Thatcher and Ronald Reagan. Roger Douglas – instrumental in restructuring New Zealand’s government – visited Alberta and spoke to the Tory caucus early in its mandate, advocating the government move quickly on downsizing before any opposition could organize (see Fuller and Hughes-Fuller, chapter nineteen). (One may note this was hardly good advice if careful deliberation and analysis on policy was desired.) Underlying neo-conservative ideology is the belief that governments cannot deliver services effectively or efficiently. Therefore, governments should be downsized, services privatized, and industry deregulated; once this is done, the “market” can work and the economy will take off.

When considering the historical record of total expenditures and revenue data in Alberta as shown in Graph 8.2 it can be seen that revenues have increased while expenditures have declined over the whole period under Ralph Klein’s premiership.

The determination to eliminate debt has seemed the singular objective of Ralph Klein's Progressive Conservatives government since first elected in 1993. This obsessive focus has considerable biased the government's policies. Table 8.1 shows the relative outcome of this policy dominance. In 1993, Alberta had per capita revenues $237 greater than the mean of the other provinces, while expenditures were $589 per capita greater. By 2004, however, after suffering large cuts in expenditure while revenues continued to rise through the late 1990s, the difference in per capita revenue had grown to $1,486 while the per capita expenditure had fallen to only $42 greater than the mean for all other Canadians. Although per capita revenues are vastly greater in Alberta, the Klein revolution has resulted in only average Canadian expenditures on social goods for Albertans.

**Table 8.1**

| **1993** | *Current$* | *All Prov Mean* | *Difference* | *Prov Mean excl AB* | *Difference* |
|---|---|---|---|---|---|
| TR/capita | $5,198 | $4,983 | $215 | $4,961 | $237 |
| TE/capita | $6,373 | $5,839 | $534 | $5,784 | $589 |
| | | | | | |
| **2004** | *Current$* | *All Prov Mean* | *Difference* | *Prov Mean excl AB* | *Difference* |
| TR/capita | $8,268 | $6,930 | $1,338 | $6,783 | $1,486 |
| TE/capita | $7,207 | $7,169 | $37 | $7,165 | $42 |

Another way to consider the Alberta government's philosophy is illustrated in Table 8.2. Many provinces and the Federal government have grown out of their deficit problems over the decade 1993-2003 by restricting expenditure growth while the economy, as measured by the gross domestic product (GDP), has grown. The economic growth has been most dramatic in Alberta and yet expenditures were cut and the percentage of GDP spent in public domain has plummeted.

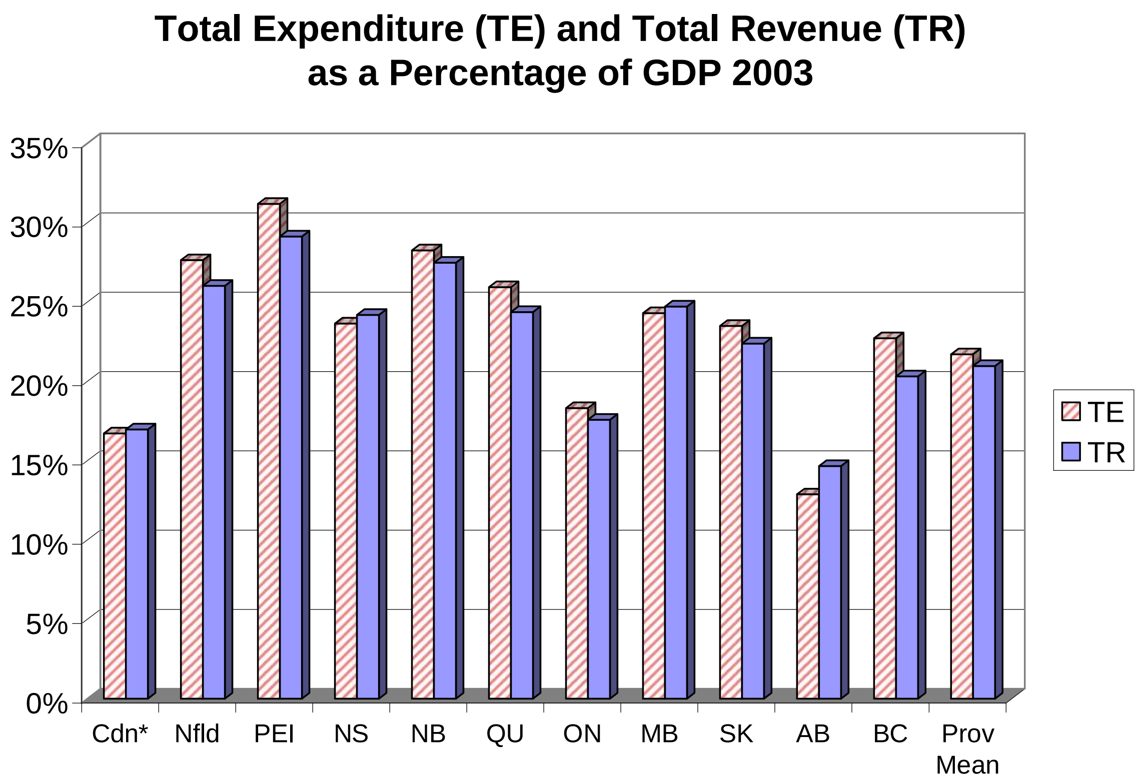
**Table 8.2**

| **Year** | **Cdn** | **Nfld** | **PEI** | **NS** | **NB** | **Que** | **ON** | **MN** | **SK** | **AB** | **BC** | **ProvMean** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **1993** | 25% | 44% | 36% | 32% | 35% | 30% | 25% | 30% | 29% | 22% | 24% | 27% |
| **2003** | 17% | 28% | 31% | 24% | 28% | 26% | 18% | 24% | 23% | 13% | 23% | 22% |

Expenditures

Government purchases of goods and services are expenditures for currently produced goods and services, and are parts of the nation's income. Transfer payments are government expenditures in the form of money payments to households, firms, or other levels of government that do not contribute to the current production of goods and services, because the government does not receive any good or service in return. One way to indicate the size of government is to compare the expenditures of government to the province's income or GDP. Graph 8.3 shows provincial government expenditures and revenues for 2003 as a percentage of GDP. Note the figure also shows the provincial means. On the basis of income (GDP), Alberta both collects the smallest amount of revenue and spends (13 percent compared to the provincial mean of 22 percent) the least of any government in Canada.

**Graph 8.3**



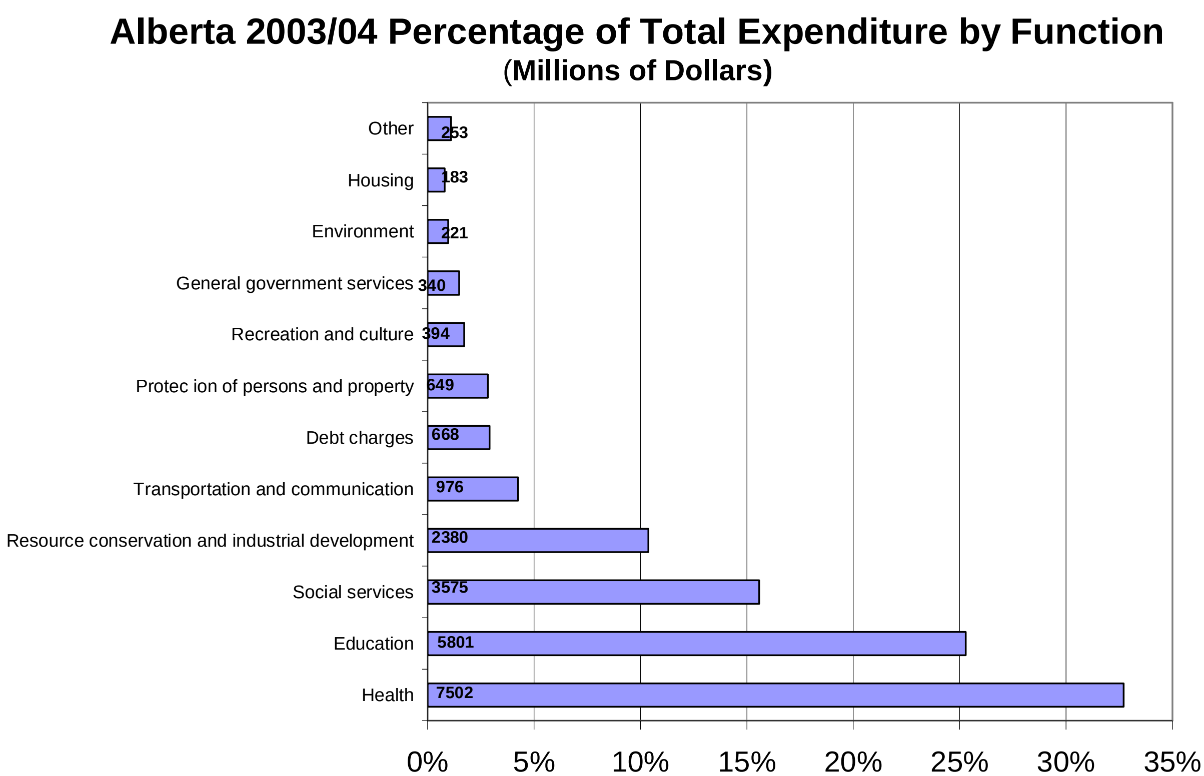

I have given here a broad summary of Alberta's revenues and expenditures since 1989. But where does Alberta's money go? That is, what kinds of things does the province spend upon? And where does it get most of its revenues to spend? The next sections of this chapter answer these questions.

## An Overview of Alberta's Expenditures

The major expenditure categories are included in Graph 8.4, which shows the current 2003-04 pattern of expenditures in Alberta (actual expenditures noted). Statistics Canada Financial Management System (FMS) data are used as these are collected by government function and do not vary as departments change across jurisdictions or over time (Statistics Canada 2004). The data in the graphs following (8.5-8.7) show the changes of expenditures over time and, therefore, are calculated in constant 1992 dollars using CPI data (Statistics Canada 1996) in order to eliminate the effects of inflation from the comparison over the years. The data are also calculated on a per capita basis as the population has changed considerably over this time period and calculations of public service expenditures should be a function of the number of persons affected. The data indicate the general pattern of decline in expenditures from 1993 until the later 1990s. Health, Education, Social Services, and Transportation and Communication, the four biggest departments confirm this pattern. Debt (gross) charges do not include (subtract) interest earned on financial assets. This "expenditure" is somewhat misleading as Alberta has earned considerable interest income on its financial assets. However, as expected debt charges peaked in 1995 and have then continuously declined as the gross debt was paid down. Expenditures on the environment peaked in 1995 and have been declining gradually throughout. Protection ranged above $200 per capita in the early 1990s falling in 1994 and remaining in $150-170 range throughout the last ten years.

The Resource Conservation expenditure item is of particular interest. This item in the past included financing a wide array of industrial projects to diversify and boost a sagging economy. Examples include NovaTel, Alberta Special Waste Management System, Gainers Meat Packers, the Lloydminster upgrader, and the Magnesium Company of Canada. Most of these enterprises eventually went bankrupt at a total cost to the province equal to the accumulated deficits. Resource conservation expenditures fell dramatically with the implementation of the Klein government's view that "government should not be in the business of picking business winners." However, this expenditure item has continued to grow again since 1998 reaching two-thirds of its 1993 maximum in 2004.

**Graph 8.4**



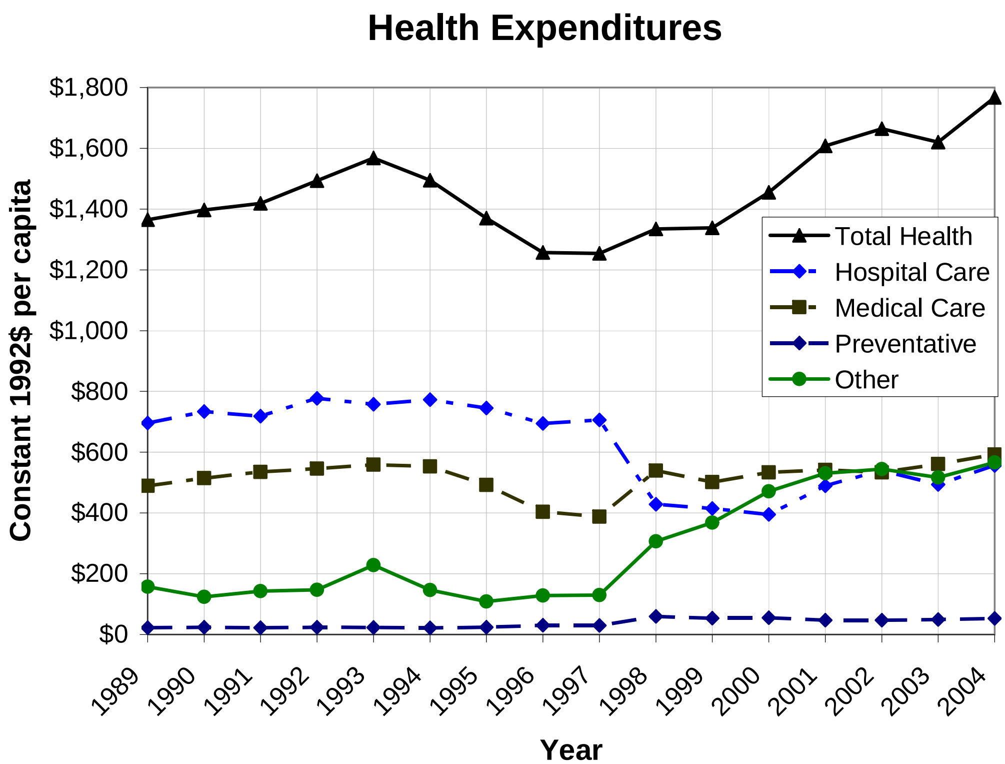

As Graph 8.4 shows, health, education, and social services are for Alberta – as all provinces – the major expenditure categories. For this reason, the next sections of this chapter focus on these.

## Health Expenditures

Graph 8.5 (below) shows health care expenditures in Alberta from 1989 to 2003.
A couple of things should be noted about the overall trend in spending. First, the cost of health care increased rapidly up to 1993. This is partly due to the fact our population is aging and, as the proportion of elderly people increases, the cost per capita of medical care also increases. A more important factor, however, is that health care is a normal good, therefore, as our incomes have risen, we have wanted more and better health care. In turn, as the needs and demand for

health care increase, so the costs to the government of providing Medicare also increase. It should be noted the cost of health care in the United States, where it is mainly provided by the private sector, has risen even more rapidly than in Canada during this period.

**Graph 8.5**




The second thing to note from Graph 8.5 is that expenditures on health in Alberta were drastically cut in the mid-1990s by more than 20 but soon began climbing (slowly) again as the provincial government set about – under public pressure – repairing some of the damage caused by the earlier cuts. (To give one example, the ratio of hospital beds per thousand population fell from a high of 4.3 to 1.7 when the best estimate of a necessary and efficient number was 2.4.) By 2004, overall health care expenditures per capita had risen to a level higher than the previous peak in 1993. At the same time, we should not lose sight of the fact that a large amount of money was removed from the system during the interim years (Flanagan, 1998).

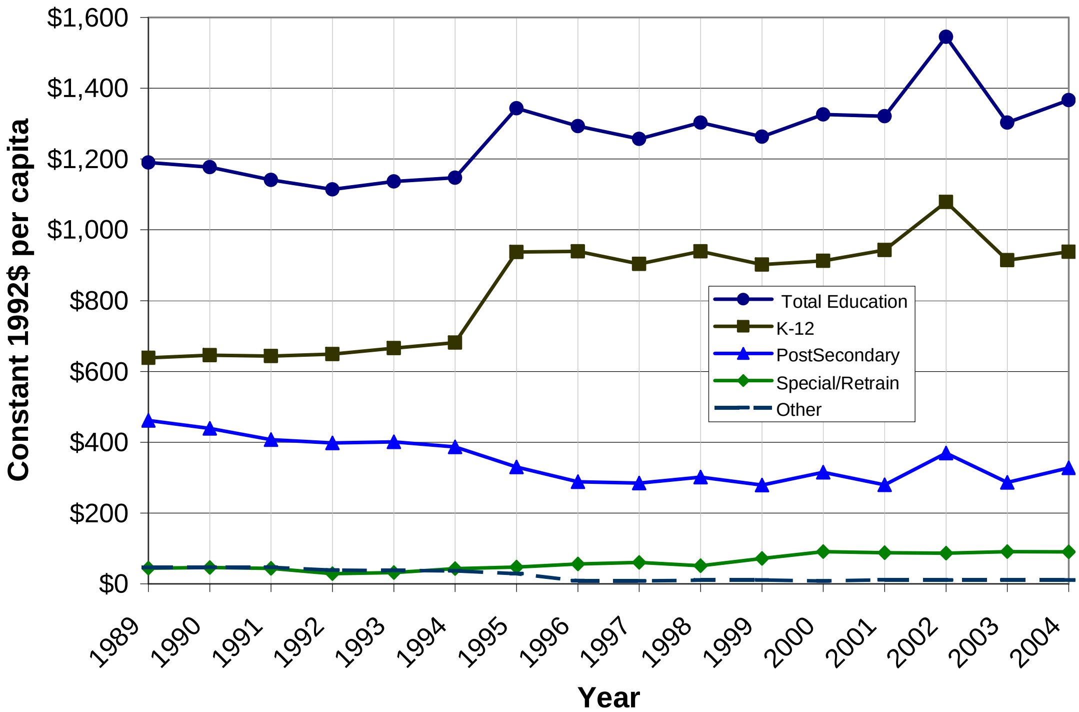
Third, we should note that, despite the increase in expenditures, the trend line since 1989 does not suggest a system in financial crisis. This conclusion contrasts with a number of studies, commissions, and reports on the state of health care – the Kirby Report, the Romanow Commission, and the Mazankowski Report, to name a few – that have created alarm (Flanagan, 2002). The figures are particularly at variance with the rhetoric of the Alberta government which has fostered the impression that health care costs, driven by new technology, drugs and an aging population, are spiraling out of control and as a consequence fundamental changes are needed in how we pay for health services. The fact is, Canada's proportion of GDP spent on health care has not been increasing. Our system costs 50 percent less than the American system and slightly more than European (2-tier) systems, while serving proportionally more people with more services. Canada's health-care system is a mixture of public and private bodies, institutions, and individuals (in Alberta about 75 percent of all expenditures are public).

The fourth point to be noted from Graph 8.5 is that the main driver of increased costs are not hospital, medical, or preventive care, but rather a set of elements comprising the "Other" category. This "includes outlays on clinics for the treatment of retarded or emotionally disturbed persons and on laboratory and diagnostic services, grants to health oriented organizations, and expenditures on other health-related services such as health department administration, health statistics, staff training and other services of health establishments (e.g., hospitals and other health and social service institutions), ambulance services, medical rehabilitation and indemnities to injured persons and their dependants which cannot be allocated to the other sub-functions. Also included are outlays on protection of health and health inspection, and expenditures of ancillary enterprises of health and social services institutions. Included are the Canada Health Transfer (CHT) payments" (Statistics Canada, 2004).

### Education Expenditures

Graph 8.6 shows education expenditures in Alberta from 1989 to 2003. The Statistics Canada series, from which the figures are taken, is misleading to a degree. After coming to power in 1993, the Klein government cut education to the same degree – 20 percent – as other public services. The graph shows, however, a spike in spending in 1994-95 for both K-12 and education spending overall. This is explained by the government's taking over the property tax from municipalities in 1994 and adding this revenue to its expenditure stream. In effect, the government was able to claim real spending on its part by taking over the spending previously done by municipalities. At the K-12 level, there was an additional one-time spike in spending in 2002, but overall spending on in this area has remained fairly constant (in per capita real dollars) since 1995.

Graph 8.6
**Education Expenditures**

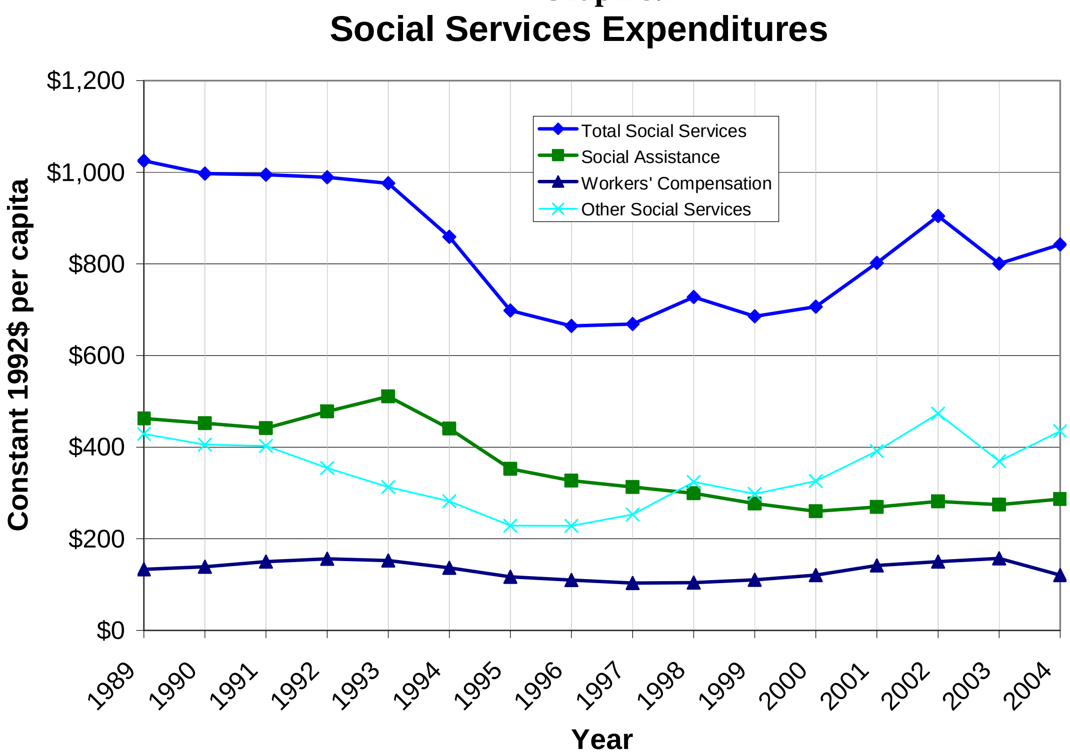



Spending on post-secondary tells a slightly different picture. Over the last three decades, the proportion of Canadians undertaking post-secondary education has increased dramatically and so has the cost. This is due in part to the fact that education, like health care, is a normal good. But increased attendance (and attendant costs) is mainly the result of a need to be better educated in today's technologically more sophisticated society. The question is: Who should pay for post-secondary schooling? Is higher education a benefit only to the individual student, so that they should pay? Or does it benefit society overall, so that the costs should come primarily from public coffers? What should be the mix of individual and public expenditures? The figures in Graph 8.6 make clear that postsecondary support from the Alberta government has continued to decline since 1994, the costs offset by increased tuition fees (see Titley, chapter fifteen).

Social Services Expenditures

Social Service expenditures are illustrated in Graph 8.7 (below). In percentage terms, this area of expenditures was the one most drastically reduced in the mid 1990s. Unlike Health, Social Services, particularly social assistance, have continued to decline and today remain at low levels (see Lafrance, chapter sixteen; and Black and Stanford, chapter seventeen). To the degree this reflects a growing economy with increased work opportunities, this decline might be viewed as positive. However, much of the decline is due to stagnant social assistant rates that have not included cost of living increases. Additionally, it reflects the government’s attitude to low income and no income Albertans. The expansion of homeless shelter and food bank use attests to inadequacy of current social assistance and other social services. The re-elected Klein government of 2004 has indicated it will begin to address this issue. We may hope this will be the case.

**Graph 8.7**



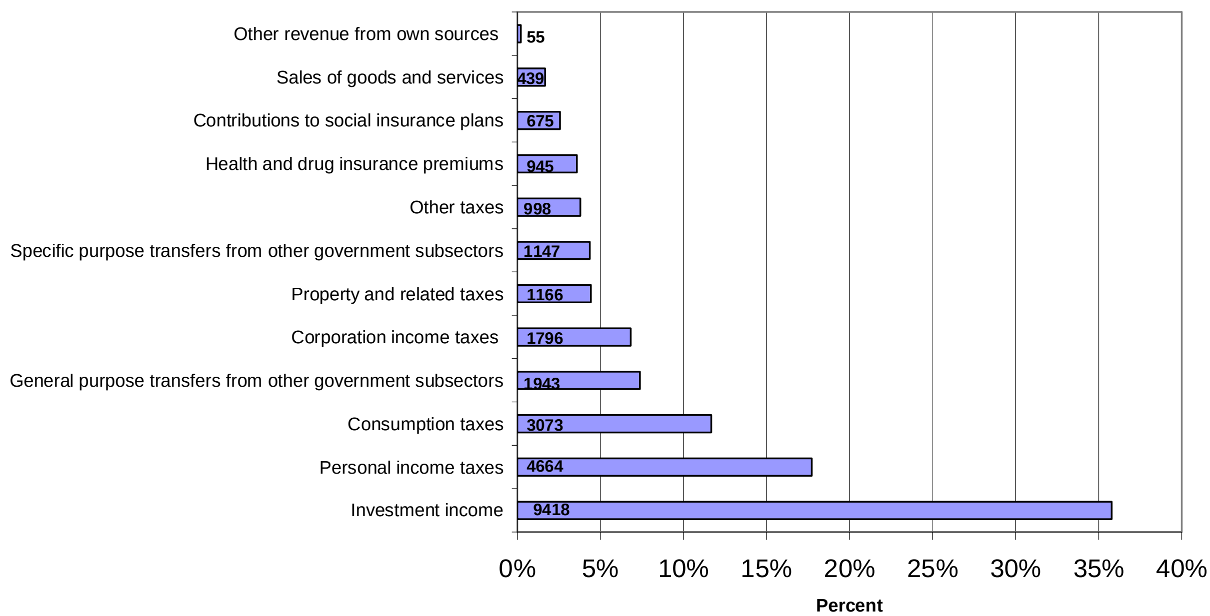

An Overview of Alberta's Revenues

Graph 8.8 shows Alberta's major sources of revenue for the current period 2003-04. Subsequent graphs again show how the revenues have changed over time using constant (1992) per capita expenditures. The largest source of revenue is investment income. This item includes gas and oil royalties, the major source, as well as any interest on financial assets or other revenue-generating assets. Despite the large amount of revenue coming from oil and gas royalties, Alberta royalty rates have received considerable criticism as being too low in comparison with places such as Alaska and Norway (Pembina, 2004).

**Graph 8.8**

**Alberta 2003/04 Percentage of Total Revenue by Source**

**(Millions of Dollars)**



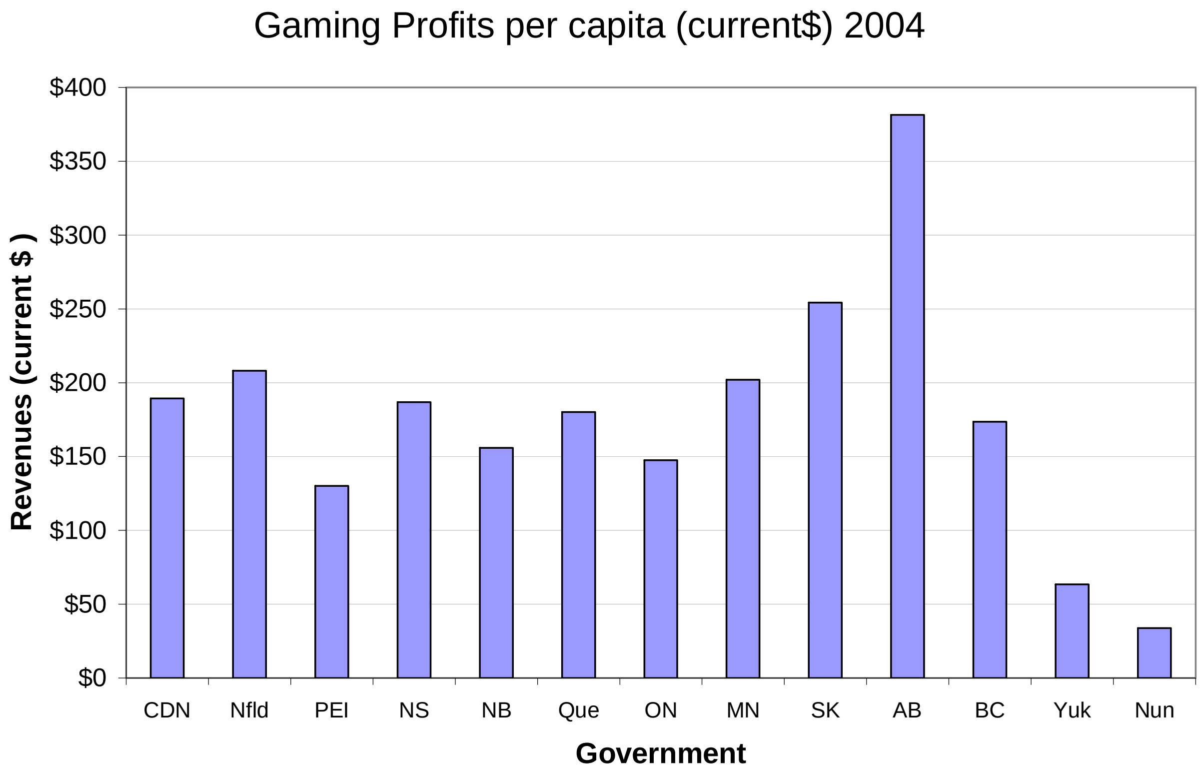

Income tax (including corporate and personal taxes) is the second largest source of revenue. These revenues increased until 1999, based largely on the same tax rates and reflecting increased economic activity during this period. After 1999, however, although the economy was still expanding, actual tax revenue tapered off with the introduction of reduced tax rates and tax reforms (introduced in 2000) that “flattening” the taxable rate on personal incomes. The new tax system meant personal income tax revenue in Alberta fell by almost $1 billion in 2000, as seen in Graph 8.9. Changes, such as those made around Alberta’s tax system show clearly that government budgets are about making social choices (see Sidebar).

**Graph 8.9**


Consumption taxes (excluding gaming) are the third largest source of revenue. Consumption taxes include cigarette, alcohol, gasoline, and other excise taxes on goods. The revenues from this source have climbed steadily both as a result of increased rates and an expanded population and economy.

Property taxes are the next largest source of revenue, followed by gaming. The growing importance of gaming revenues to the Alberta government revenue should be noted, now substantially larger in Alberta than in any other provinces (see Graph 8.10 below).

**Graph 8.10**




The last sources of Alberta government revenue are health care premiums (Alberta is one of only three provinces that collect premiums) and federal transfers.

Alberta's budgetary decision-making since 1993 can be summed up as follows. The province has adopted a low tax/low expenditure policy. The Klein government advances several arguments in adopting these policies. What is important to understand, however, is that the choices are not made separate from a set of philosophical arguments, for example, the nature of human motivation or the kind of relationship that should exist between people and government. The effect of these policies is real. Corporations and the very wealthiest in Alberta have done very well by these choices. By contrast, though the tax changes introduced in 2000 had some benefit for Alberta's lowest income earners, the overall impact of these budget decisions has not been favourable to either the poor or the middle class (Flanagan, 2000). In part, this is because these budget policies have encouraged personal wealth seeking at the cost of the larger commons. Alberta's budgets since 1993 have not spoken of a collective vision of people working together to build a prosperous and sustainable future; rather, they have bellowed the narrow interests of unfettered individualism at the expense of the public good and the present at the expense of Alberta's future.

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SIDEBAR: A Short Primer on Taxes

A tax can be proportional, regressive, or progressive. A tax where the average tax rate increases with income is progressive; and a tax rate where the average tax rate falls as income increases is regressive; and if the average tax rate remains the same over all income levels the tax is proportional.

Many economists (including Adam Smith in the *Wealth of Nations*) favour progressive taxes. In part, this is because progressive taxes are simply fairer as the tax burden falls on those most able to pay. Progressive taxes are also fairer in the sense that people's income depends not only on their own efforts, but the social circumstances they find themselves in, as well as outright luck at birth and beyond. Finally, from a strictly macro-economic perspective, a progressive tax structure enhances the effectiveness of the tax system as a built-in stabilizer by automatically increasing tax withdrawals more than proportionally as GDP rises and by reducing such withdrawals more than proportionally as GDP falls. Increasing withdrawals during an inflationary expansion has a dampening effect on the economy. Conversely, decreasing withdrawals during a recession tends to buoy up spending.

Against these long-held arguments, then Alberta Provincial Treasurer Stockwell Day in 1999 presented at Budget with “A New Tax Plan for Albertans.” The plan introduced three major changes to Alberta’s income tax: a major tax cut with a substantial reduction in income tax revenues; the first step in decoupling Alberta from federal income tax administration; and, the most controversial, a flattening of the income tax structure – the so-called “flat-tax.”

Day gave many reasons for these tax changes. First, he argued a reduction in taxes would actually stimulate economic growth, thus increasing in the aggregate the amount of taxation revenue to fund public services. Second, he argued low taxes – the lowest taxes in Canada (and the United States!) – would encourage business investment and attract skilled people to the province, further stimulating the economy. Third, he argued from a philosophical perspective that individuals should be able to make their own choices as to their priorities. Fourth, he argued low taxes would encourage people to work and invest. And, fifth, he argued the new tax system would be simpler and fairer.

Ralph Klein’s government is the first to enact a “flat” income tax in Canada. The new Income Tax Act, implemented in 2000, radically restructured taxation in Alberta by coupling taxes with a tax reduction where everyone obtained at least some tax relief. The new single rate tax relieves the working poor of paying tax. But it also shifts the tax burden away from the wealthy to middle-income earners. Although not a proportional tax, it flattens the tax structure and reduces the tax systems progressivity. As this tax change makes the first move in decoupling Alberta from the federal tax structure, it also moves Alberta closer to introducing a pure expenditure tax, accompanied by eliminating taxes on investment income.

A single-rate tax such as the new Alberta tax has a constant marginal tax rate (10.5 percent). A single rate tax (linear tax) would be proportional if it applied to all levels of income. However, if there is a significant income exemption level, the average tax rate will increase with income. The Alberta tax is in reality a two-rate tax, zero percent on the first $13,500 and 10.5 percent on higher income. Although the exemption level makes this tax progressive, it is a much “flatter” tax than the 1999 system where Alberta’s income tax was 44 percent of the federal tax levied.

Although a flat tax does not eliminate the opportunity to redistribute income, it does eliminate the automatic redistributive aspects of a more progressive income tax as well as the stabilization function. Additionally, people earning no income receive no benefit from a reduction in tax rates.

Ultimately the test of this tax change is fairness. The new tax clearly moves the tax burden from the wealthier to the middle-income group. Fairness for flat or proportional tax advocates suggests equality is achieved by having everyone subject to the same tax rate and to bear the tax burden proportionally. A flat tax does not change the income distribution before and after taxes are levied. Some consider this fair because they believe markets distribute income based on how hard people work, save and invest. In contrast, the support for progressive taxation emphasizes different individual circumstances suggesting that ability to pay is what is most important. Poor people should be exempt from tax while the rest should contribute a greater percentage to taxes as income rises. After tax income is more equal under a progressive tax system, helping restrict concentration of economic and political power.