

Lessons from the Lone Star State: Comparing the Economic Performance of Alberta and Texas

by Steve Lafleur and Milagros Palacios



SUMMARY

■ This bulletin compares the economic and fiscal performance of the Canadian province of Alberta and the American state of Texas in recent years and provides a brief discussion of how different policy choices may be contributing to the divergent outcomes observed.

■ While Alberta suffered a steep recession starting in 2014 followed by a period of tepid economic recovery, Texas's economy has performed substantially better, and has returned to strong economic growth and low unemployment.

■ Despite the severe negative effects of the oil price downturn of 2014, Texas's economy still grew in inflation-adjusted per-person terms in recent years, albeit at the slow annual average rate of 0.2 percent. By comparison, inflation-adjusted per person economic growth in Alberta was meaningfully negative at -2.4 percent annually.

■ Employment growth has also been much stronger over the past three years in Texas than in Alberta, averaging 1.7 percent from 2015 to 2018 compared to 0.6 percent in Alberta.

■ Weak economic performance in Alberta compared to strong results in Texas has contributed to very different fiscal outcomes in the two provinces. Alberta has consistently run large deficits and accumulated substantial debt, whereas Texas has not.

■ While many factors have influenced the divergent economic outcomes between Alberta and Texas, it is noteworthy that during this period the two jurisdictions have taken markedly different approaches to public policy. In Alberta, spending-fueled deficits, increasing taxes, and the perception that its oil and gas investment climate has become unwelcoming have all, to varying extents, hindered Alberta's ability to compete.

Introduction

Prior to the 2014 fall in energy prices and resulting economic downturns in many North American energy producing jurisdictions, the economies of Alberta and Texas enjoyed prolonged periods of robust economic growth. Although both jurisdictions enjoyed strong overall economic growth, job creation, and wage growth during the decade preceding the 2014 downturn in commodity prices, a 2014 Fraser Institute analysis showed that Alberta's fiscal management throughout the boom period was substantially less successful and responsible than Texas's (Eisen et al., 2016). Despite strong economic performance from 2004 to 2014, we showed that Alberta's fiscal position was deteriorating significantly, with worrying implications for the province's fiscal well-being given the sharp economic downturn which was by then underway.

While both of these energy giants enjoyed strong economic growth from 2004 to 2014, the two jurisdictions have been on very different economic trajectories in the years since.

This bulletin compares the economic and fiscal performance of the two jurisdictions in recent years and provides a brief discussion of how different policy choices may be contributing to the divergent outcomes observed. Specifically, we show that while Alberta suffered a steep recession starting in 2014, followed by a period of tepid economic recovery, Texas's economy has performed substantially better, and has returned to strong economic growth and low unemployment. Unsurprisingly given these realities and their pre-existing fiscal trajectories prior to the commodity price downturn, Alberta's fiscal deterioration has accelerated in recent years whereas Texas' finances remain comparatively healthy.

Alberta and Texas have many economic similarities. Both have experienced substantial economic and population growth over the past few decades, and are heavily associated with industries such as cattle and oil and gas. It isn't uncommon for people to refer to Alberta as the "Texas of Canada." As such, the fact that Texas has been able to recover strongly from the recent recession while Alberta has continued to struggle for an entire half-decade deserves careful attention. While some observers attribute nearly all of Alberta's recent struggles to lower commodity prices, Texas' strong economy complicates and to some extent undermines this narrative.

The economic and fiscal performance in Alberta and Texas since 2014

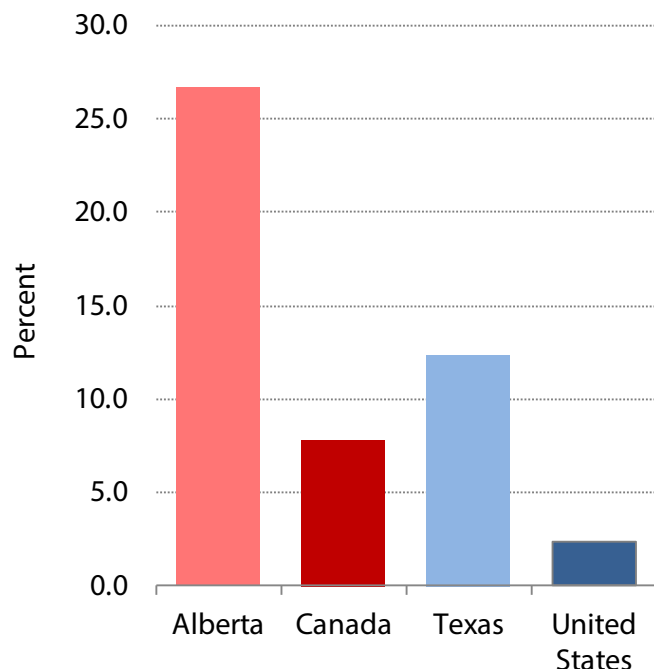
As noted, Alberta is sometimes referred to as the "Texas of Canada," largely because both jurisdictions have large oil and gas sectors. Figure 1 shows that oil and gas is a major contributor to the economies of both jurisdictions. Oil and gas accounted for 26.7 percent of Alberta's economic output in 2018, and 12.4 percent of Texas's. Oil and gas activity in each jurisdiction was much higher than in their respective countries.

From 2004 to 2014 when energy prices were generally high, overall economic performance in both Alberta and Texas was strong, unsurprisingly.¹ However, when in 2014 oil prices fell from their previous highs and remained depressed for years thereafter, the economic trajectories of the two economies diverged starkly. Whereas Alberta suffered a severe recession and tepid recovery, Texas' economy continued to grow—albeit at a slower pace than in the preceding years.

¹ For a detailed comparison of the economic performance of Alberta and Texas during this period, see Eisen, Lafleur, and Emes, 2017.

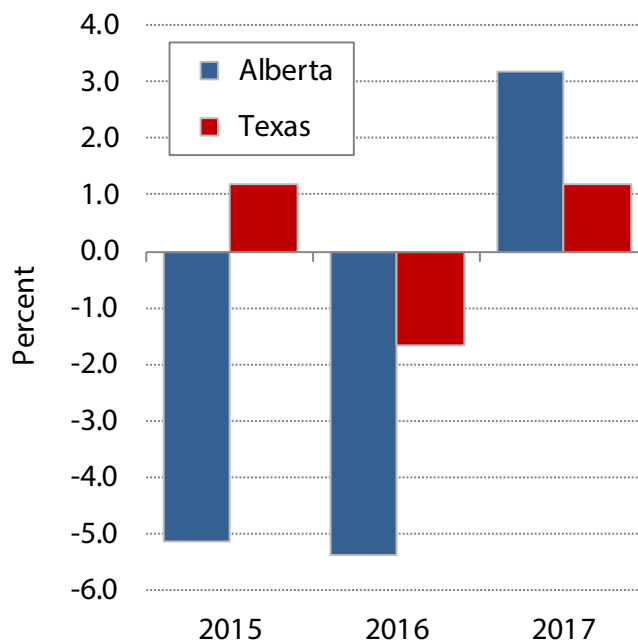
Comparing the Economic Performance of Alberta and Texas

Figure 1: Oil and Gas Activity as a Share of the Economy, 2018



Sources: Statistics Canada, 2019a, 2019b; US Department of Commerce, Bureau of Economic Analysis, 2019.

Figure 2: Real Per-Capita GDP Growth, 2015 to 2017



Sources: Statistics Canada, 2019c, 2019d; US Department of Commerce, Bureau of Economic Analysis, 2019; IMF, 2019.

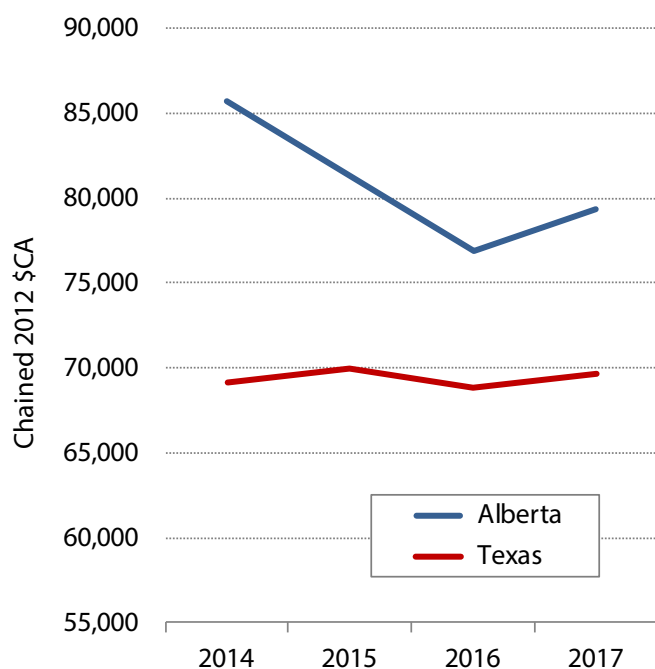
Figure 2 shows real per-capita GDP growth by year from 2015 to 2017 (the years following the commodity price decline that began in late 2014) to capture the changes in the economic fortunes of the two jurisdictions once the collapse of global oil prices took its toll. Real per-capita GDP in Alberta shrunk by more than five percent in both 2015 and 2016. While growth resumed in 2017, the GDP shrinkage was a major setback for Alberta's economy. By contrast, real per-capita GDP actually grew by more than one percent in Texas in 2015 and shrunk by less than two percent in 2016 before returning to growth in 2017.

While Alberta did finally enjoy a year of stronger growth in 2017, it was not nearly enough to offset the stronger growth in Texas in the pre-

ceding years. As a result, despite the severe negative effects of the oil price downturn of 2014, Texas's economy still grew in inflation-adjusted per-person terms over this three-year period, albeit at the slow annual average rate of 0.2 percent. By comparison, inflation-adjusted per-person economic growth in Alberta was meaningfully negative at -2.4 percent annually.

The result of this stronger performance in Texas in recent years has been a substantial convergence between the two jurisdictions in their real GDP per capita; in 2014, it had been markedly higher in Alberta than Texas. As figure 3 shows, in 2014, real GDP per person in Alberta was \$16,467 higher than in Texas. By 2016, this gap was cut more than in half—to \$8,071 before rebounding back to \$9,702 in 2017.

Figure 3: Real Per-Capita GDP, 2014–2017

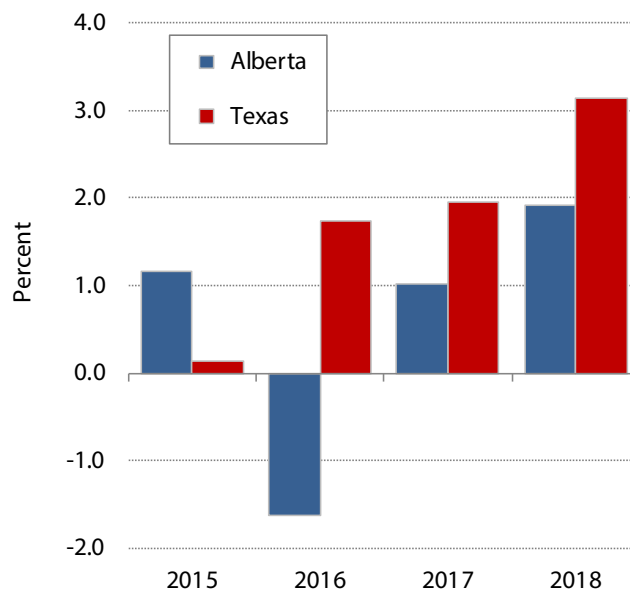


Sources: Statistics Canada, 2019c, 2019d; US Department of Commerce, Bureau of Economic Analysis, 2019; IMF, 2019.

Clearly, overall economic performance as measured by gross domestic product growth has been much stronger in Texas than in Alberta in recent years, resulting in significant convergence in real per capita GDP. We will now turn to examine employment data.

The diverging fortunes of the two jurisdictions is also illustrated in the substantial difference in their employment growth rates in recent years. Throughout the 2004 to 2014 period, Alberta generally enjoyed stronger employment growth than Texas. In recent years, however, this trend has been reversed. As figure 4 shows, total employment growth has been much stronger over the past three years in Texas than in Alberta, averaging 1.7 percent in Texas from 2015 to 2018 compared to 0.6 percent in Alberta. Notably, Texas hasn't seen a year of negative employment growth over the past four years, despite the sharp decline in oil and gas prices.

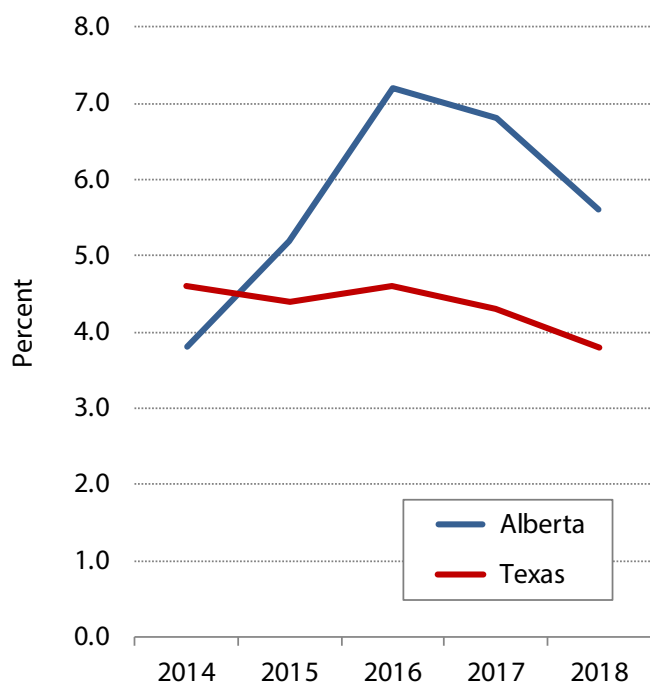
Figure 4: Total Employment Growth, 2015–2018



Sources: Statistics Canada, 2019e; US Department of Labor, Bureau of Labor Statistics, 2000-2017, 2019; calculations by authors.

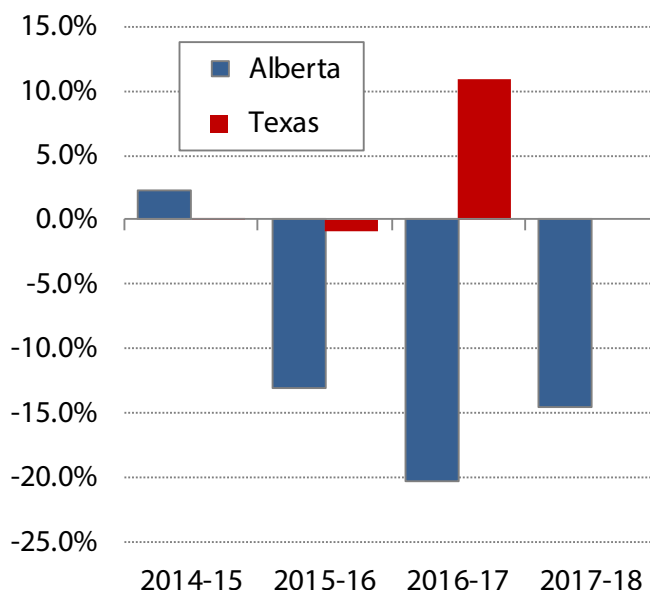
Figure 5 makes evident the impact of the diverging employment growth levels; it shows the annual unemployment rate in the two provinces between 2014 and 2018. Throughout the 2004 to 2014 period, Alberta consistently enjoyed a lower unemployment rate than Texas. Once again, this situation has been reversed in recent years. While the unemployment rate in Alberta was just 3.8 percent in 2014 (compared to the also low rate of 4.6 percent in Texas), that rate rose by 1.4 percentage points in 2015 while the unemployment rate in Texas fell by 0.2 percentage points, giving Texas the lower rate. Subsequently Alberta's unemployment rate jumped to 7.2 percent for 2016, peaking at roughly 9.1 percent in November of 2016. By comparison, in Texas, the full-year unemployment rate stayed below 5 percent during this period, suggesting a much healthier labour market.

Figure 5: Unemployment Rate, 2014–2018



Sources: Statistics Canada, 2019e; US Department of Labor, Bureau of Labor Statistics, 2000-2017, 2019.

Figure 6: Provincial and State Surplus/Deficit as a Percentage of Total Government Spending



Sources: Canada, Department of Finance, 2018; Urban Institute, 2019; US Census Bureau, 2015-2017.

Weak economic performance in Alberta compared to Texas has contributed to very different fiscal outcomes in the two jurisdictions. Part of this is the result of government spending choices, which will be discussed in the next section. First, however, we will simply note the markedly different fiscal outcomes in the two jurisdictions. Figure 6 shows the fiscal balance in both jurisdictions every year since 2014/15 relative to GDP (figures are unavailable for Texas in the final fiscal year). It shows that while large deficits have emerged in Alberta, in Texas they have not. While Texas has maintained a very nearly balanced budget every year since the recession (and produced a significant surplus in 2016/17), Alberta has seen large deficits emerge, topping out at approximately 20 percent of GDP in 2016/17.

Predictably, large deficits have led to substantial debt accumulation in Alberta, which has not occurred in Texas. Alberta's net asset position has deteriorated by over \$40 billion since the 2014/15 fiscal year, whereas Texas has experienced no similar rapid accumulation of debt. As the forthcoming section shows, the cause of this outcome is a combination of both policy choices and differences in economic performance.

As we have seen, Texas's economy has substantially outperformed Alberta's in the years following the 2014 commodity price decline whether it is measured in terms of overall economic growth, employment data, or fiscal outcomes. Texas's better performance significantly complicates the narrative that the severity of Alberta's economic problems are entirely the result of the downturn in oil prices. The next

section considers how divergent policy trajectories in the two jurisdictions may be contributing to these results.

Diverging policy trajectories

The economic divergences noted in this report aren't driven by any single cause. While there are similarities between the economies of Alberta and Texas, there are also differences. For instance, as noted above, oil and gas plays a bigger role in Alberta's economy than it does in Texas. Moreover, different sources of oil destined for different markets receive different prices. Relatedly, a lack of pipeline capacity has exacerbated the price differential between Western Canadian Select (WCS) and West Texas Intermediate (WTI) oil, while also producing significant uncertainty for oil producers in Alberta. The price differential that Alberta faces has also hindered the province's economic performance. Notwithstanding these external factors, it is also clear that the two jurisdictions have taken markedly different approaches to public policy in recent years—and substantial evidence shows that policy choices can play a significant role in influencing economic performance. This section examines the different public policy approaches that the two have taken in recent years.

In tax policy there has been noticeable policy divergence. Texas has no state-level personal or corporate income tax, though it does have an inefficient gross receipts tax. Nevertheless, until recently, Alberta's combined provincial/state and federal corporate and top personal income tax rates were lower than in Texas. However, recent developments have erased this advantage.

The changes came in three stages. First, the Notley government ended Alberta's single-rate 10 percent personal income tax system, replacing it with a five-bracket system with a top rate

of 15 percent. The Notley government also increased the province's general corporate income tax rate to 12 percent. Second, Canada's federal government increased the top federal personal income tax bracket from 29 percent to 33 percent. Finally, the US federal government recently slashed its general corporate income tax rate from 35 percent to 21 percent and reduced the top personal income tax bracket to 37 percent. That meant the combined corporate income tax rate of 27 percent in Alberta was 6 percentage points higher than in Texas (though, as noted, there is also a gross receipts tax in Texas). The new government in Edmonton has legislated a gradual four percentage-point corporate income tax rate cut, eventually bringing that gap to 2 points (before accounting for Texas' gross receipts tax). So while Alberta's strong advantage on corporate income tax rates has vanished, the province is on schedule to roughly pull even on this front.

The discrepancy on personal income taxes is even starker. Alberta's top personal income tax rate is now 48 percent—nearly half of every dollar earned over \$150,000. By contrast, the top rate in Texas is 37 percent, and it doesn't apply until after \$300,000 of income earned (roughly CA\$400,000). Texas residents would only pay 24 percent in income tax on their next dollar of income at the equivalent of \$150,000, and between 32 and 35 percent until they reach the top bracket.

Combined with the federal government's creation of a new top tax bracket, the five percentage-point increase in the top marginal tax rate in Alberta has transformed that province's personal income tax competitiveness. Indeed, the province has gone from having the lowest combined rate in Canada or the United States to having one of the highest rates, at 48 percent. Texas, meanwhile, remains highly competitive

in this area, having introduced no similar increases, and continues to have a top combined rate of 37 percent—tied for the lowest in Canada or the United States.

These increases to the personal and corporate income tax rates have had an adverse impact throughout Alberta's economy, particularly in the critically important oil and gas sector. Indeed, the tax increases have been recognized as one factor that has reduced the province's competitiveness and perceived attractiveness as an investment destination (Stedman and Green, 2018). However, since 2015, the Alberta government has implemented a number of other policy changes with implications for the oil and gas industry. They include a cap on GHG emissions from oil sands production, new regulations in the sector, and a royalty review that ultimately left the existing royalty structure in place but may have contributed to uncertainty at the time (Green and Jackson, 2016).

The combined result of these policy changes was a marked decrease in the perceived attractiveness of Alberta's oil and gas sector amongst investors. This is evidenced by Alberta's fall in recent years in the Policy Perception Index (PPI) in the Fraser Institute's Annual *Global Petroleum Survey*. The PPI measures investor perception of the attractiveness of the policy environment for investment in various jurisdictions. In the most recent index, Alberta's score was 67.83 (out of 100 possible points), placing the province in 43rd place out of 80 jurisdictions measured. This represents a nearly 20-point drop from 2014. By comparison, Texas earned a score of 100 in the most recent index (Stedman and Green, 2018). Clearly, many investors believe that as an investment destination in the oil and gas sector, Alberta's attractiveness has declined in recent years, while Texas's has not.

The policy trajectories of the two jurisdictions also diverge in their approaches to public spending, deficits, and debt. As noted earlier, Alberta has run large deficits and incurred substantial new debt in recent years, whereas Texas has not. This is not simply a function of the sharper economic downturn in Alberta—government spending choices have also played an important role. Indeed, Alberta's approach to public spending has been generally undisciplined for over a decade, and that trend has continued in recent years.²

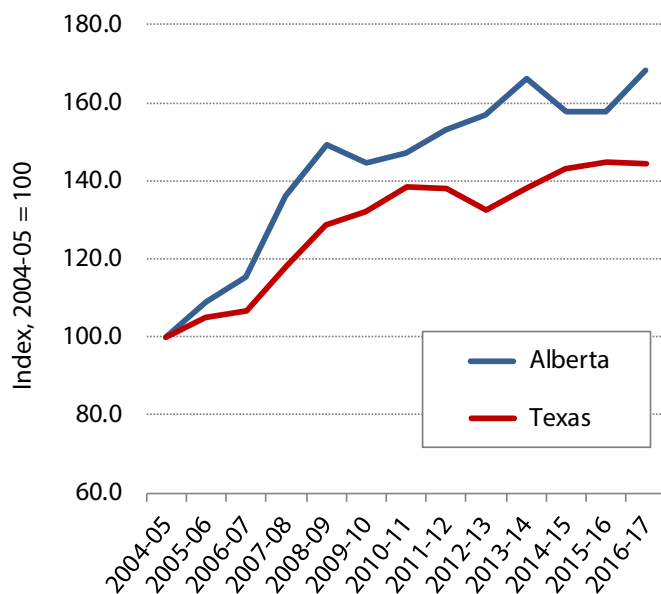
Alberta's government spending since 2014-15 contrasts starkly with that of Texas (figure 7). Since 2014, despite the severe fiscal challenges facing the province, nominal per-capita spending in Alberta increased by 6.8 percent between 2014/15 and 2016/17. By contrast, Texas has taken a much different approach to public spending in response to the energy price downturn, essentially holding spending flat since 2014-15. Indeed, between 2014-15 and 2016-17 (the last year of available data), per-person spending in Texas increased by just \$58 (compared to an increase of \$805 per person in Alberta).

As Figure 7 shows, this divergent approach to government spending predates the recession. It shows that per-capita total government spending in Texas increasing by 44 percent between 2004-05 and 2016-17, while during the same period, it increased by 68 percent in Alberta.

This spending divergence explains much of the difference in the fiscal situations of the two jurisdictions. The different policy choices have had important and immediate consequences for the jurisdictions. Specifically, debt ser-

² See Lafleur et al (2015) for a discussion of Alberta's spending trajectory since 2004/05.

Figure 7: Per-Capita Total Government Spending (2004–05 = 100)



Sources: Canada, Department of Finance, 2018; Statistics Canada, 2019d; Urban Institute, 2019; US Department of Commerce, Bureau of Economic Analysis, 2019; US Census Bureau, 2015-2017; IMF, 2019; calculations by authors.

vices payments in Alberta have begun to increase quickly in recent years, placing further strain on the government's budget and diverting money that would otherwise be available for other purposes. Further, Alberta's growing debt load raises the spectre of possible future tax increases to service the debt—a factor that could further discourage investment in the province.

The two very different approaches to government spending in recent years, particularly since the oil price downturn of 2014-15, represents another important policy difference between Alberta and Texas—one that has had important implications for fiscal outcomes in the two jurisdictions, as discussed earlier.

In short, while many factors have influenced the divergent economic outcomes in Alberta and Texas, the two jurisdictions have taken markedly different approaches to public policy in recent years. Spending-fueled deficits, increasing taxes, and the perception that Alberta's oil and gas investment climate has become less welcoming have all, to varying extents, hindered Alberta's ability to compete at a time where the province can least afford to have unaccommodating public policy.

Conclusion

Alberta and Texas have a lot in common. For decades, each has been an important driver of economic growth in their respective countries, and each has been a magnet for internal (and international migration). This was particularly evident during the 2004 to 2014 oil boom. Unfortunately for Alberta, the two economies have gone in different directions since then.

While the collapse in oil prices was harmful to the Texan economy, the state avoided a large increase in unemployment and has maintained positive (albeit muted) inflation-adjusted economic growth in recent years. By contrast, Alberta's economy has floundered since the oil price decline and fiscal and economic performance have suffered greatly over the past few years. While external factors have certainly played an important role in this decline, internal policies such as higher taxes and regulatory barriers to building pipelines have also hindered Alberta's growth prospects. Texas's superior performance relative to Alberta in recent years complicates the narrative that Alberta's struggles are entirely attributable to external forces beyond government control. Texas's success underscores the importance of maintaining a pro-growth policy environment.

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