RAE DAYS IN ALBERTA
The Notley Government at Two Years

AUGUST 2017

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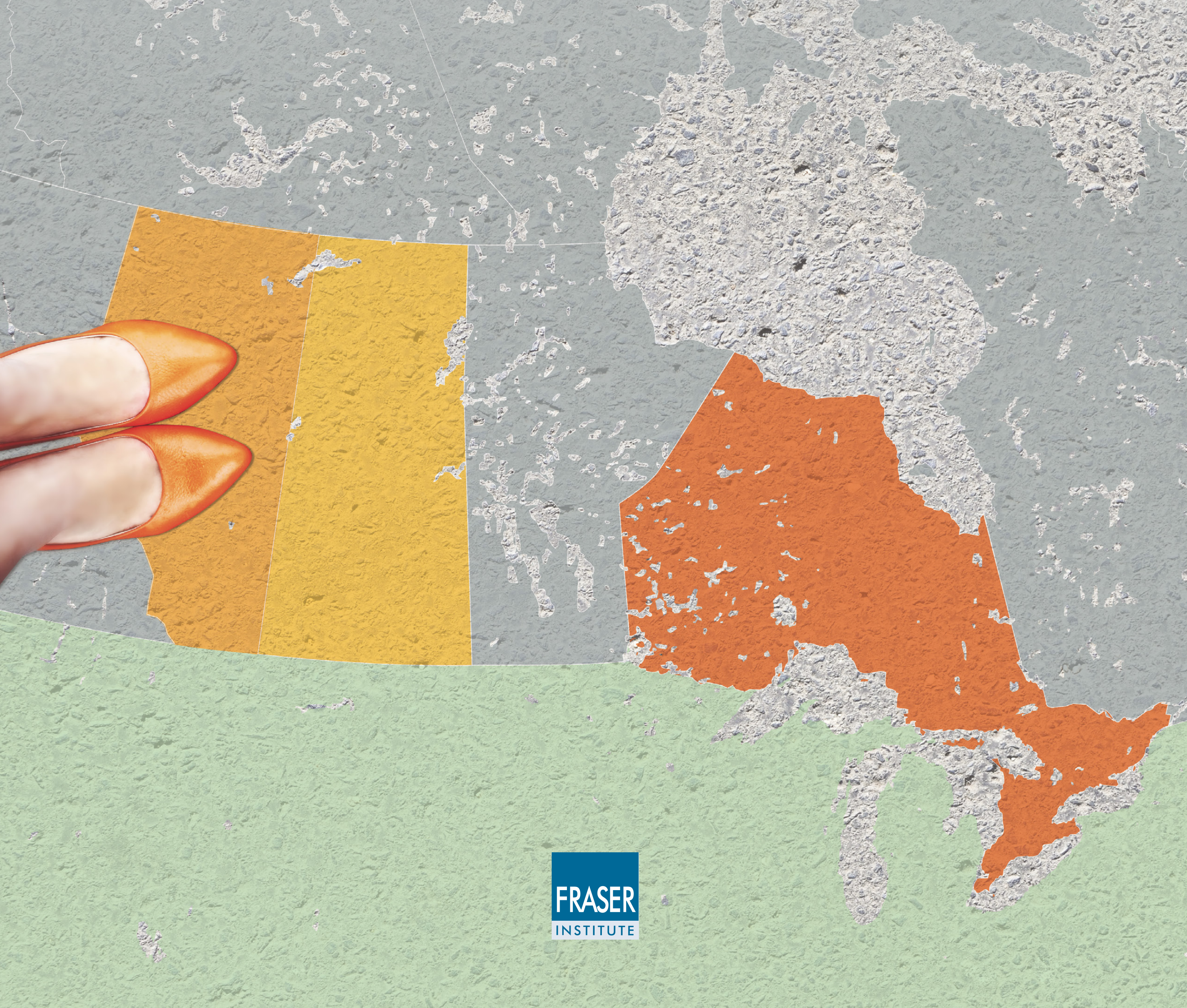

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Executive Summary

When Premier Notley took office two years ago in Alberta, her new government faced severe fiscal challenges. The province had a large and growing budget deficit and was headed towards net debt status for the first time in approximately 15 years.

It was impossible to predict in advance with any degree of confidence how Premier Notley would confront these challenges. Canadian history shows us that political labels are not a reliable predictor of a new government's approach to fiscal policy. All of Canada's major parties have produced governments that have pursued sound approaches to fiscal management. Similarly, all have produced governments that were far less successful in this area.

When Premier Notley took office, there were at least two broad historical models of NDP fiscal management from which she could have drawn. One of these was the Bob Rae model of higher spending and increased taxes. The other was the Roy Romanow model from Saskatchewan characterized by spending discipline. Both premiers inherited daunting fiscal challenges and big deficits in the early 1990s, but took markedly different approaches to addressing those challenges, and these approaches produced vastly different outcomes.

Two years into her government, it is clear that Premier Notley is following the example and model set by Bob Rae in Ontario during the early 1990s. For example, during his first two years in office, Premier Rae increased program spending in Ontario by approximately 16 percent. Premier Notley has taken a very similar path, increasing program spending by 11 percent during her first two years in office. These policy choices contrast sharply with those made by Roy Romanow's government in Saskatchewan, which reduced spending in nominal terms during its initial years in office and then essentially held nominal spending flat through the rest of its first mandate.

On tax policy, the Alberta NDP is again closely following the approach taken by Bob Rae's government during the early 1990s, which increased a number of different taxes on Ontarians. Similarly, the Alberta NDP under Premier Notley has increased taxes repeatedly. Significant tax increases include those to the personal income tax and the corporate income tax, as well as a broadening of the province's carbon levy, which is scheduled to see further increases in the future.

When it comes to fiscal outcomes, Premier Notley also appears to be on track for a record that looks much more like Premier Rae's than Premier Romanow's. Premier Romanow reduced spending and was able to eliminate a large deficit in just three years. By contrast, Premier Rae ran large deficits throughout his term in office. According to Alberta's most recent fiscal plan, Premier Notley's NDP government expects to run large deficits in every year of its mandate, thereby following Bob Rae's example.

In a study published by the Fraser Institute two years ago, we wrote:

> As Premier Notley and her cabinet work to develop their fiscal policy strategy, they would be well-advised to follow the model of New Democratic governance provided by their neighbours in Saskatchewan during the early 1990s. If, instead, they emulate the Ontario NDP model for the same time period, the result will likely be increased spending, higher taxes, unsustainable deficits, and reduced prosperity for Albertans in the years ahead.

Two years later, it is clear that the Notley government has indeed chosen to reject the Romanow model in favour of the Rae model. Unfortunately, but predictably, the Rae policy approach is producing similar fiscal outcomes in Alberta today as it did in Ontario during the 1990s. Albertans will continue to feel the consequences of these decisions and outcomes for many years to come.

Introduction

Two years ago, the Fraser Institute published a paper entitled *Fiscal Policy Lessons for Alberta from Other NDP Governments*. The study showed that political labels are not a reliable predictor of a new government's approach to fiscal policy. Indeed, all of Canada's major parties have produced governments that have at various times pursued successful and unsuccessful approaches to fiscal management. Specifically, the paper showed that historically there are at least two broad models of NDP fiscal management both from the early 1990s. One of these is characterized by higher levels of government spending, higher tax rates, and deficits, as embodied by the government of Premier Bob Rae in Ontario. The other is the model of spending discipline and a tight focus on balanced budgets as demonstrated by Roy Romanow in Saskatchewan.

Fiscal Policy Lessons for Alberta was published approximately one month after Premier Notley's government was sworn into office in Edmonton. At the time, it was an open question which of the two models Premier Notley would follow. Now, halfway through the Alberta NDP's term in office, the answer to that question has become clear—Premier Notley's government has rejected the Romanow approach and embraced an approach to fiscal management that is strikingly similar to Bob Rae's. This short study reviews the two models of NDP governance represented by Rae and Romanow, and demonstrates the extent to which Premier Notley's government is mirroring the ultimately unsuccessful fiscal strategies of Ontario Premier Rae's government from the early 1990's.

Rae or Romanow? Two Distinct Models of NDP Governance[1]

Premier Rachel Notley's New Democratic Party in Alberta took office facing severe fiscal challenges. A steep decline in energy prices and rapid growth in government spending by her predecessors meant that Alberta's first NDP government inherited a bleak income statement. The province faced a large budget deficit along with the prospect of returning to "net debt" status (a situation in which total debts exceed financial assets) for the first time since the turn of the century.

In a research study published shortly after the Notley government took office, we showed that while the new government had walked into an unenviable predicament, the fiscal choices it would make in the year ahead could either substantially mitigate or exacerbate the damage that would be done to the province's fiscal position. Specifically, we wrote:

> The question is whether the new Notley government will succeed at reforming and restraining provincial spending, eliminating the budget deficit, and restoring a sound approach to financial management to Alberta's provincial government while maintaining the tax advantage Alberta enjoys over competing jurisdictions. (Eisen et al., 2015)

At the time, the answers to these questions were not foregone conclusions. It certainly would not have been possible to answer them simply by noting the political stripe of Ms. Notley's new government. Recent Canadian history clearly shows that political labels are an unreliable indicator of whether or not a particular government will pursue sound fiscal policy. The evidence suggests that all of Canada's major political parties

[1] Eisen et al., 2015, provides a more detailed account of the fiscal records of the Romanow and Rae governments. This section summarizes key findings of that research to provide context for the subsequent comparative analysis of Premier Notley's record in Alberta.

are capable of producing governments that deliver either prudent financial management or economically harmful fiscal policies.[2]

Similarly, it would not have been possible to predict the success or failure of Ms. Notley's approach to fiscal policy simply by examining the NDP's campaign platform and rhetoric from 2015. Canada's history shows us that in order to respond to serious challenges facing their jurisdictions, governments often respond to changing circumstances and embrace policy approaches that are quite different from those implied in their campaign rhetoric.

Jean Chrétien's 1993 campaign based on the *Red Book*, for example, was replete with commitments for increased spending and government intervention. Instead, in the mid-1990s his government oversaw a major program review, spending reductions, and a successful deficit elimination program that helped establish a foundation for tax relief and other pro-growth policy changes that continue to benefit Canada to this day (Clemens et al., 2017).

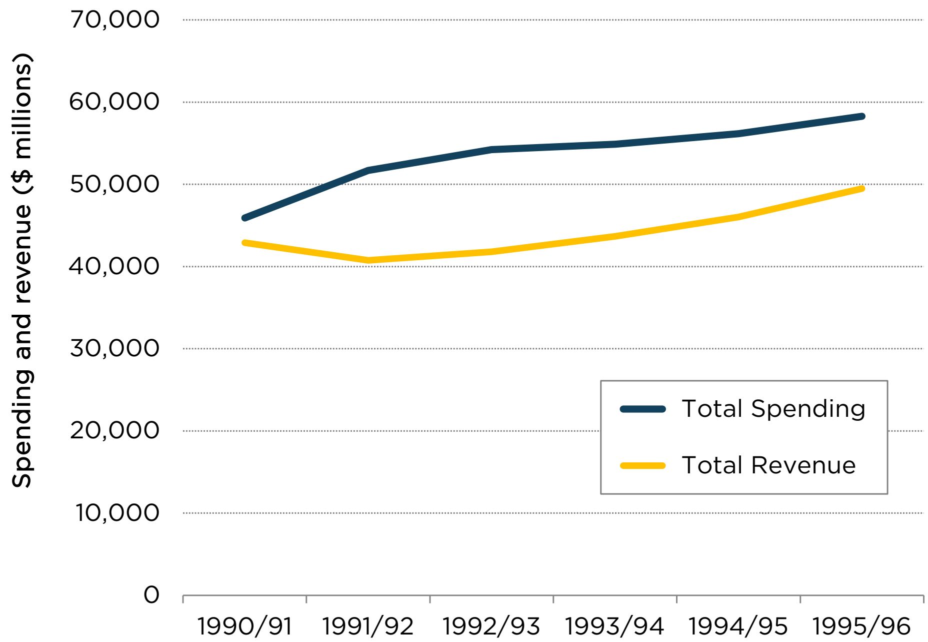
In our 2015 study, we specifically examined the history of provincial NDP governments, showing that there are at least two different NDP governance models that the then newly elected Notley government could follow. These models are that of Roy Romanow's government in Saskatchewan from the early 1990s, and Bob Rae's government from Ontario in the same time period.

Both historical models had important lessons and implications for Alberta as Notley's government took power. During the early 1990s, both Saskatchewan and Ontario faced severe fiscal crunches, with big deficits, rapid debt accumulation, and resulting credit downgrades—just as Alberta is facing now. In short, both Bob Rae and Roy Romanow inherited situations not unlike the one that Premier Notley's government walked into in 2015, but the earlier premiers took very different approaches to addressing the challenges they faced.

In Ontario, Bob Rae's government responded to the recession and big deficits it inherited by dramatically ramping up spending—by a total of 16 percent in its first two years in office. In subsequent years, the NDP finally arrested the growth in program spending but did not enact significant spending reforms or reductions. Furthermore, although spending growth slowed in the later years of the Rae government's mandate, rapid increases in debt service charges put further upward pressure on total spending, contributing to sustained deficits. Figure 1 illustrates how the growth in total spending (driven largely by program spending growth in the early years and by increased debt service charges in the later years)

[2] For a discussion with examples, see Eisen et al, 2015. For a more detailed analysis of the same phenomenon, see Clemens et al, 2017.

Figure 1: Ontario Total Spending and Total Revenue, 1990-1995



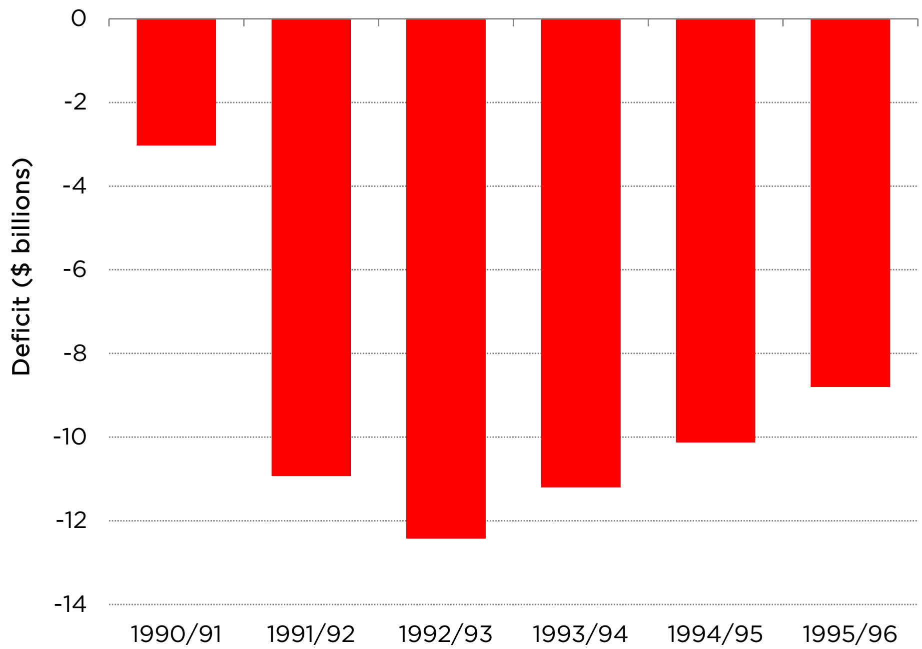
Source: Kneebone and Wilkins, 2016.

led to the emergence of a large gap between spending and revenue that persisted after the end of the recession in the early 1990s.

The Rae government did attempt to grapple with its large budget deficit primarily by implementing a raft of tax increases. However, this strategy proved unsuccessful and Ontario's deficit remained stubbornly large throughout Premier Rae's tenure, resulting in a rapid run-up in provincial debt. As figure 2 shows, between 1992 and 1995, Premier Rae's government ran deficits every year ranging from roughly $9 to $12 billion. These deficits were substantial relative to provincial GDP, ranging from 3 percent to just over 4 percent of GDP each year. Primarily as a result of this string of deficits, the province's net debt relative to GDP climbed from 15 percent in 1990 to almost 30 percent by 1996.

Roy Romanow's NDP government in Saskatchewan, on the other hand, offers a completely different model of New Democratic Party fiscal management. Roy Romanow's government took office at a perilous moment in the province's fiscal history (MacKinnon, 2003). In fact, Saskatchewan's fiscal position at the start of its consolidation period was even worse than Ontario's at the time. Annual deficits were large, the provincial debt was rising quickly, interest payments were escalating, and

Figure 2: Ontario Surplus or Deficit, 1990/91 – 1995/96



Source: Kneebone and Wilkins, 2016.

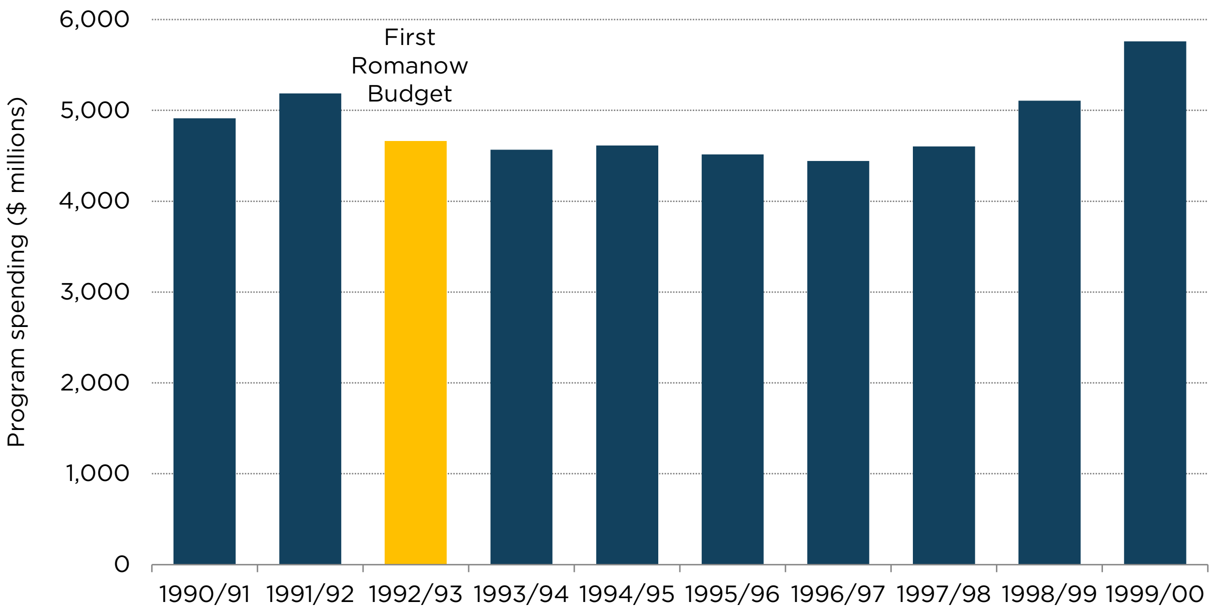
the province was at the brink of insolvency—so much so that contingency plans were created in the event the province wasn't able to raise money in foreign bond markets (Drummond, 2011: ch 2).

In response to its fiscal crisis, the Romanow government delivered one of the most fiscally prudent and successful periods of governance in recent decades. Premier Romanow enacted substantial spending cuts. He immediately reduced spending by approximately 10 percent, and then maintained nominal spending at this lower level for the next half decade (despite an increasing population and cost pressure from inflation).

Figure 3 shows the extent and speed of Romanow's spending reductions during the early 1990s. The initial spending reductions and subsequent restraint meant that in 1998/99, program spending was still, in nominal terms, lower than it was in 1991/92 when the Romanow government was elected.

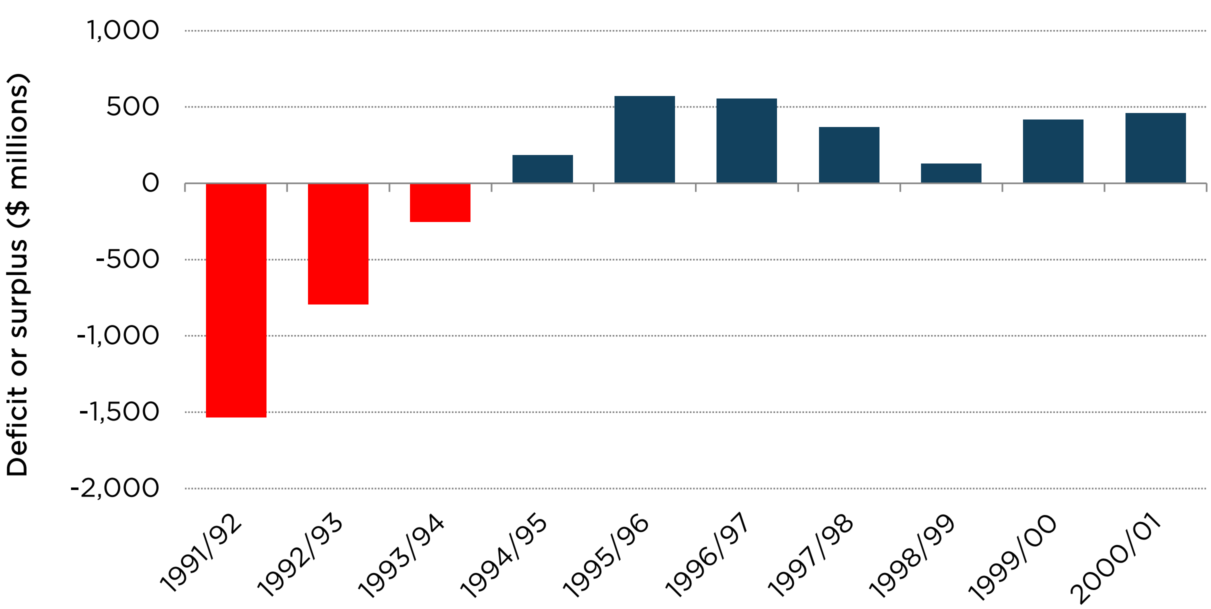
Roy Romanow's government relied on a wide range of tactics to bring spending under control and slay the deficit. In its first budget, it enacted policies that eliminated 20 government programs entirely and reduced public sector employment in the province by approximately 3 percent (Crowley et al., 2011). Simultaneously, it cut spending on social assistance by transforming its approach to welfare policy and thereby

Figure 3: Saskatchewan Program Spending, 1990/91 – 1999/00



Source: Department of Finance, 2016.

Figure 4: Saskatchewan Deficit or Surplus, 1991/92 – 2000/01



Source: Department of Finance, 2016.

encouraging social assistance recipients to re-enter the labour market (Drummond, 2011).

As figure 4 shows, Premier Romanow's decisive cuts to spending allowed his government to eliminate its budget deficit in just three years. The province's spending reductions and subsequent restraint were sufficient to enable the province to continue running budget surpluses throughout the rest of the 1990s.

This deficit elimination and falling debt burden in the following years created fiscal room for later tax reform and reduction, which in turn laid the foundation for the relative prosperity the province enjoyed for the next two decades.

In short, the NDP government in Saskatchewan in the 1990s used strategic spending reductions (along with some tax increases which were later undone, as will be discussed in more detail later in this paper) followed by a lengthy period of spending restraint. This tactic proved to be a prudent approach to public spending in an era of daunting fiscal challenges. The outcomes were impressive. The government quickly eliminated its large budget deficit, then set the conditions for important tax reforms and reduced spending on government debt interest payments, both of which benefited the province for many years to come.

Alberta Rejects Romanow's Approach, Follows Rae's Example

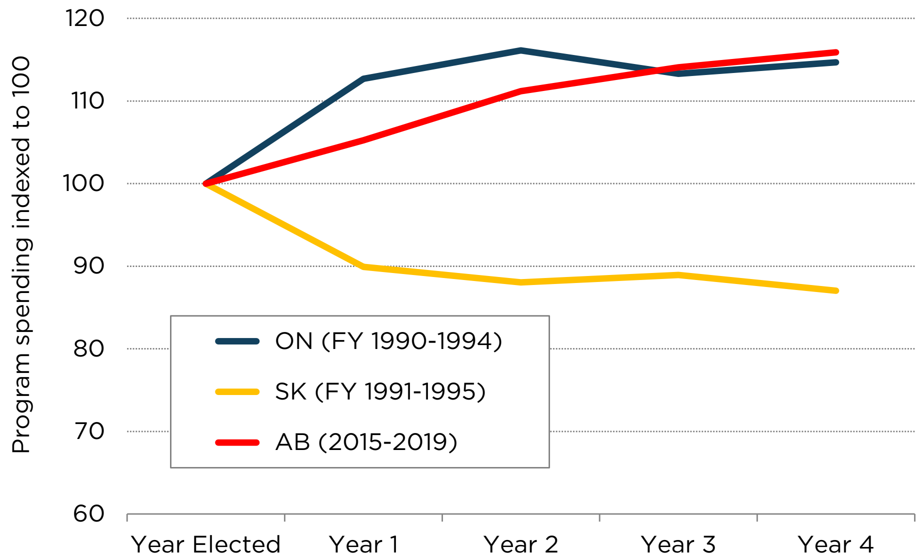
Comparing spending trajectories—Notley mirrors Rae

Like both Bob Rae and Roy Romanow, Rachel Notley entered office facing severe fiscal challenges that were not of her government's making. The deficit for the 2015/16 fiscal year during which Notley's government took power wound up to be $6.4 billion. What's more, sustained spending growth by a series of Premier Notley's predecessors helped drive a substantial deterioration in the province's fiscal condition in the years prior to Premier Notley's election. In 2007/08, Alberta's financial assets exceeded its debts by $39.4 billion. In 2015/16, thanks primarily to a lengthy period of unsustainable spending growth, Alberta's net asset position had fallen to $3.9 billion (Lafleur et al., 2017), a decline of $35.5 billion in just eight years. The province was on track to soon become a "net debtor," and indeed, when the Notley government took power, was already on course to acquire substantial net debt in the following years (Lafleur at al., 2016).

When we published *Fiscal Policy Lessons for Alberta's New Government from other NDP Governments,* it was an open question which of the two paths—Rae's or Romanow's—that Premier Notley's government would follow in an effort to respond to the challenges facing it. Now, halfway through the government's term in office, the answer is perfectly clear. Premier Notley has rejected the path of spending discipline and deficit reduction embodied by Roy Romanow and embraced an approach to fiscal policy that is strikingly similar to Bob Rae's in Ontario in the early 1990s, both with respect to policy decisions and fiscal outcomes.

A comparison of the spending trajectories in the two jurisdictions provides the first and most striking similarity between Premier Notley's government and that of Premier Rae. Figure 5 compares Alberta's current spending plan, including its forecast for future years, to the spending pur-

Figure 5: Indexed Nominal Program Spending under NDP Governments



Sources: Kneebone and Wilkins, 2016; Alberta, 2017; Department of Finance, 2016.

sued by Premier Rae's government in the 1990s.[3] To make these two different times and places comparable, we have indexed program spending in each jurisdiction, setting program spending in the year during which each government took office at 100. So for example, an index value of 105 for a given year represents a 5 percent increase in nominal spending compared to the level in the year that the government in question took office.

As figure 5 illustrates, Alberta's latest budget forecasts that this year it expects to spend 11.2 percent more than the provincial government was spending in 2015/16, the year it took office. The government plans to continue increasing spending (albeit at a slower rate) for the rest of its fiscal plan, finishing its fourth year in office with spending levels that will have increased by 15.9 percent over the level it inherited.

[3] In each case, the figure begins in the year during which the NDP was elected. The years shown for Ontario are therefore 1990/91 to 1995/96, in Saskatchewan 1991/92 to 1995/96, and in Alberta 2015/2016 to 2019/20 (with the government's budget projections used for later years). In each case, the baseline year is the one during which the NDP was elected.

The Alberta government's plan to continue ratcheting up spending despite a big budget deficit is similar to what occurred in Ontario during the early 1990s. Over its first two years in office, the Rae government increased spending by 16.1 percent, slightly more than the Alberta government plans to in its first two years in office. In the second half of its mandate, having seen the province's credit rating downgraded and facing the possibility of additional downgrades, the Rae government began exercising some limited spending restraint (Kneebone, 1994: 159). By the end of its term, the Rae government had increased program spending by 14.7 percent over and above the level it inherited, a slightly smaller spending increase than the Notley government is currently forecasting.

For contrast, figure 5 also provides the spending trajectory of Roy Romanow's government. It shows a substantial spending reduction over the first two years in office, followed by continued restraint in subsequent years. As a result, after four years, the Romanow government was still spending, in nominal terms, less money annually than was the case when it took office.

Tax increases

An analysis of each government's approach to tax policy illustrates another way that Premier Notley's government is following the Bob Rae blueprint. As it refused to cut spending, the Rae government's deficit reduction strategy was focused entirely on a relentless array of tax increases. Personal income taxes, corporate taxes, capital taxes on financial institutions, various excise taxes, and many other taxes and levies were increased under the Rae government.

The tax hikes were intended to increase revenue to offset some of the spending increases and restrain growth in the deficit, but they may have partially undermined this objective by dampening economic growth in the province. Several of the taxes that were raised, such as taxes on corporate capital and personal income, are among the most harmful in common use in advanced economies (Clemens, 2007). What's more, the increases to these taxes under Bob Rae's government were imposed on top of other increases to the same taxes that had been implemented by the preceding Liberal minority government. This compounded their harmful economic effects (Clemens et al., 2003).

Similarly, Premier Notley has attempted to grapple with her government's big deficit by refusing to rein in spending, and instead has implemented a raft of significant tax increases. Premier Notley has eliminated Alberta's single rate personal income tax system, replacing it with a progressive income tax with five distinct tax brackets. The top personal income tax rate has been increased from 10 percent to 15 percent. The province has also significantly increased its corporate income tax rate, raising it from 10 percent, the lowest rate in the country, to a middle-of-the-pack 12 percent. Cumulatively, these tax increases have in many respects spelled the end of Alberta's historic "tax advantage" over other Canadian jurisdictions (Eisen et al., 2017).

The Notley government followed up these tax increases with a significant expansion and broadening of the province's carbon levy. Research shows that an important downside of a carbon tax is found in the way it interacts with other harmful taxes like the corporate income tax and personal income tax. In short, the research shows that carbon taxes can make the economic damage caused by other economically inefficient taxes even worse (McKenzie, 2016). In Alberta, this means that the economic damage caused by the personal and corporate income tax increases of 2015 will likely be made even worse as the carbon tax increases over time.[4] Like Premier Rae, Premier Notley is embracing a deficit reduction strategy based largely on tax increases despite the evidence that suggests that such an approach will dampen economic growth and undermine recovery.

Table 1 illustrates the similarity between the Notley and Rae governments by providing a selection (not comprehensive) of some of the most important tax increases implemented by the two governments.[5]

Clearly, in the face of large budget deficits the Notley government has followed the Rae government's lead by focusing on tax rate increases instead of spending reductions early in its tenure. The difference between the Rae government and the Romanow government on tax is not quite as stark as it is on public spending, discussed in the preceding section. Roy Romanow's government, though it did reduce spending, also introduced some tax increases. Romanow referred to this combination of spending cuts and tax increases as "The Saskatchewan Way." However, although under Premier Romanow the government did raise taxes, the restrained approach to spending and resulting return to surpluses created fiscal conditions that allowed for the tax reforms of the late 1990s and early 2000s, which significantly reformed and reduced provincial taxes.

While all three NDP governments did introduce some tax increases, the Romanow government stands out for not relying on tax hikes as the

[4] Also see Green, 2017, for a further analysis of the economic impact of Alberta's broadened carbon levy.

[5] For a comprehensive review of all of the tax increases implemented in Ontario between 1985-2002, which includes the Rae government as well as several years before and after its time in power, see Clemens et al., 2003, Appendix A: 63.

Table 1: Summary of Tax Increases Implemented by the Ontario NDP and the Alberta NDP Governments

Ontario NDP Tax Increase Summary	Alberta NDP Tax Increase Summary
• Increased surtaxes on provincial income tax payable in excess of $10, 000 (1991 and 1992)	• Single-rate personal income tax rate eliminated. Replaced with a five-bracket system.
• Gasoline, diesel fuel, and tobacco increased (1991 and 1992)	• Top personal income tax rate raised from 10 to 15 percent
• Surtax of 3.7 percent applied to small business income above $200, 000 (1991)	• Corporate income tax rate increased from 10 to 12 percent.
• Capital tax for financial institutions increased (1991 and 1992)	• Carbon levy broadened, scheduled for annual increases.
• Various personal income tax rates (PIT) increased repeatedly	• Increased various excise taxes
• New tiered system of income surtaxes applied to personal income tax (1992)	
• Corporate minimum tax created	

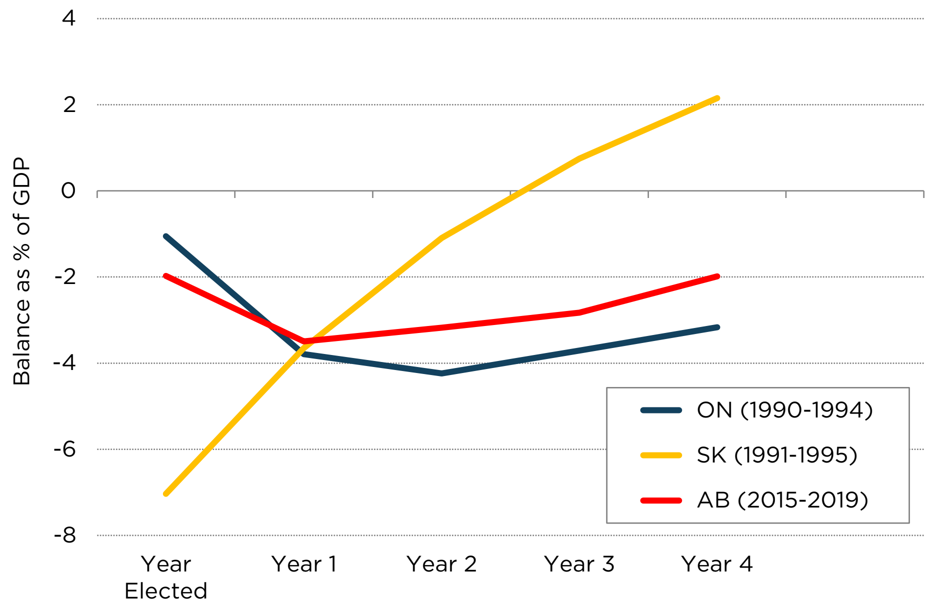
centerpiece of its deficit-management strategy. The Rae government pursued tax increases alone without spending cuts, and in this respect, Premier Notley's government is clearly following the Rae government's example from early 1990s Ontario.

Fiscal outcomes

The different fiscal policy choices documented above produced markedly different fiscal outcomes, the consequences of which continue to be felt in Ontario and Saskatchewan. It is clear that Premier Notley's approach to fiscal policy is producing fiscal outcomes that are much more like those experienced under Bob Rae in Ontario than what occurred in Saskatchewan under Roy Romanow. This is perhaps unsurprising, given the similar approaches to fiscal policy that Notley and Rae have taken.

Figure 6 clearly demonstrates how one crucial fiscal outcome (the annual operating balance) under Premier Notley is closely mirroring the outcome in Bob Rae's Ontario, and not Roy Romanow's Saskatchewan. Figure 6 shows the budget balance (deficit or surplus) for each jurisdiction relative to the size of provincial GDP during each year of the NDP govern-

Figure 6: Provincial Budget Balances as Share of GDP under Various NDP Governments



Sources: Kneebone and Wilkins, 2016; Department of Finance, 2016; Statistics Canada (n.d.).

ment's first term in office. For Alberta, the government's forecasts are used for later years of its fiscal plan.

As figure 6 shows, thanks to the spending reductions documented in an earlier section of this report, Roy Romanow's government quickly reduced the large budget deficit it inherited, eliminating it in just three years—two years ahead of its own schedule. By contrast, Ontario continued to run large deficits of approximately 3 percent of GDP or higher throughout Rae's term in office. Of course, many factors influence budget deficits including economic growth and transfer payments from the federal government. Nevertheless, the different approaches to public spending were major contributors to these divergent outcomes.

Figure 6 also demonstrates that Alberta's fiscal outcomes are far more like Bob Rae's than Roy Romanow's. Over the course of its first two years in office, Alberta's deficit has grown from 2.0 percent of GDP in 2015 to 3.2 percent of GDP in 2017. In the following two years, the government forecasts some reduction in the size of deficits relative to GDP. However, these forecasts still show that the province's budget deficit will be just as large at the end of the government's term as they were at the beginning.[6] Whereas Premier Romanow's approach to fiscal policy resulted in significant deficit reduction, Premier Notley's fiscal outcomes are more like Bob Rae's in that they will include sizeable budget deficits throughout her term in office.

As a result of its large budget deficits, Ontario's debt-to-GDP ratio continued to climb throughout Premier Rae's term in office. By contrast, this ratio stabilized under Premier Romanow in Saskatchewan, and began to fall during the later years of his term.

Unfortunately, Alberta is following the Rae government's trajectory on this indicator as well. Alberta, which just last year became a net-debt province for the first time since 2000/01, forecasts that its debt-to-GDP ratio will climb to 11.4 percent by 2019/20. This represents approximately $10,000 in new debt per Albertan, acquired over the course of just four years.

These data suggest that Premier Notley has not only pursued a fiscal policy approach that is reminiscent of that pursued by Bob Rae in the 1990s, but this approach is also producing fiscal outcomes that closely mirror those of the Rae government.

[6] Note that many experts consider the government's deficit forecast for the later years of its term to be optimistic. The government's forecasts rely on robust revenue growth, driven by forecasts on oil prices that are relatively optimistic compared to futures markets. If these forecasts do not come to pass, Alberta's budget deficits will be even larger than the government currently forecasts in the later years of the Notley government's first term.

Conclusion

Two years ago, it was still an open question which approach to fiscal policy Premier Notley's new government would take. The province was facing a severe fiscal crunch, and the option remained very much available for the new government to adapt to the difficult circumstances in which they found themselves and pursue a disciplined, frugal approach to fiscal management based on the Roy Romanow model from Saskatchewan.

At the time, it was clear that the implications of the choice for Alberta's fiscal and economic future were important. We wrote:

> As Premier Notley and her cabinet work to develop their fiscal policy strategy, they would be well-advised to follow the model of New Democratic governance provided by their neighbours in Saskatchewan during the early 1990s. If, instead, they emulate the Ontario NDP model for the same time period, the result will likely be increased spending, higher taxes, unsustainable deficits, and reduced prosperity for Albertans in the years ahead.

Two years later, it is clear that the Notley government has chosen to follow the Rae model rather than the Romanow model. Unfortunately, but predictably, the Rae policy blueprint is producing similar fiscal outcomes in Alberta today as it did in Ontario 25 years ago. Albertans will continue to feel the consequences of these decisions and outcomes for many years to come.

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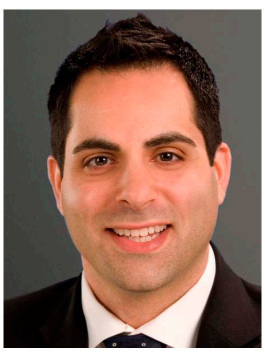

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Acknowledgments

The authors would like to thank Steve Lafleur, David Watson, and Jason Clemens for their assistance with this study, and the unidentified reviewers for their comments and insights. Any remaining errors or oversights are the sole responsibility of the authors. As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.

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Date of issue

July 2017

ISBN

978-0-88975-455-3

Citation

Eisen, Ben, and Charles Lammam (2017). *Rae Days in Alberta: The Notely Government at Two Years*. Fraser Institute. <http://www.fraserinstitute.org>.

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