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Addressing the Need for Comprehensive Fiscal Reform in Alberta

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Background

Troughs in the business cycle, financial market shocks, volatile commodity prices, cost escalations driven by demographic trends, pressures to accommodate growth while faced with infrastructure deficits, the inevitability of carbon taxes and swings between budget surpluses and deficits are strong and repetitive signals of the need for a comprehensive reform of the fiscal regime in Alberta.

The system of financing the provision of public goods and services in Alberta (and Canadian jurisdictions in general) was developed at a time when labour intensive agriculture was the mainstay of the economy and when the majority of the population was dispersed over geographically large rural areas. In sharp contrast, the economy is now dominated by capital intensive resource, industrial, commercial and business service activities that are concentrated in and around a very few large metropolitan agglomerations.

Over the years there have been a series of minor modifications to the tax regime in the province but as recent fiscal performance demonstrates, the changes have not kept pace with the needs of the current reality.

Stabilizing Government Revenues

Two recent studies, *Vision 20/20 - Saving for the future Alberta Advantage* (Alberta Chambers of Commerce, March 2006) and *Preserving Prosperity – Challenging Alberta to Save* (Alberta Financial Investment and Planning Advisory Commission, December 2007), are among many reports and studies that clearly demonstrate the need for the Government of Alberta to reduce its reliance on royalties as a major source of general revenues by shifting to a revenue generating savings strategy. The volatility of commodity prices and the non-renewable nature of the resources are obvious arguments for breaking the dependence on royalties. Examples in other resource based jurisdictions have demonstrated how Alberta could stabilize its revenues with a well planned diversion of royalties into a permanent endowment fund that stabilizes public finances.

Reforming the Tax Regime

Numerous other studies, reports and examples have demonstrated how our current system of taxation is no longer optimal from an economic competitiveness, productivity and even quality of life perspective. Although the recommended strategies for achieving an optimal tax mix may vary by author and organization there is consensus on the need for change. The Canada West Foundation in *Ready for Takeoff: Bold Tax Policy Moves for a More Competitive Western Canada, October 2009*, offers some guiding principles for reform: Maximize efficiency and equity by building a broadly competitive tax climate; Broaden the tax base wherever possible and practicable; As the tax base is broadened, lower the rate of tax; Simplify all taxes to increase visibility and transparency and lower costs for business and government; Change the tax mix to rely on “economically-friendly” taxes as opposed to “economically-damaging” taxes and; Lower taxes on savings and investment.

Funding Health Care

In addition to reinforcing the need for stable revenues and a savings plan, the Alberta Chambers of Commerce in the Phase I Report of the Vision 20/20 project, *Demographic Impacts on Albert's Provincial Budget – Fiscal Projections Through 2026, September 2004*, clearly shows how without reform, high health spending poses a significant risk to our fiscal future.

In addition to diligently scoping out and utilizing alternative and more efficient methods of delivering quality health care to Albertans, the government must adapt its budgeting process to accommodate cost increases necessitated by superior technologies and real demand shifts due to changing demographics .

Funding Municipalities

The report *Vision 20/20: Population and Fiscal Stresses in Alberta Municipalities, Alberta Chambers of Commerce, September 2005*, confirms the long standing issue that many Alberta communities face long-term challenges related to population changes and infrastructure finance. At risk communities include those where recent and ongoing population growth is outpacing infrastructure financing, management and delivery capability and those where declining economic activity and population outflows are contributing to fiscal challenges. Other reports and studies highlight the inadequacy of the property tax (one of the few sources of revenue available to municipalities) to address those fiscal issues mainly because of that tax's lagged response to growth and inability to deal with infrastructure deficits without politically unacceptable large rate increases. The bottom line is that municipalities need a sustainable source of funding that is responsive to economic changes.

In most cases municipalities in Alberta (and elsewhere) have shifted a significantly higher burden of the property tax burden onto the non-voting i.e. non-residential business segment of property owners. Property tax rate differentials in the range of

4 non-residential points to 1 residential are not uncommon and often negate tax reductions at the provincial or federal level that are intended to improve competitiveness and productivity. Clearly, “robbing Peter to pay Paul” results in a myriad of demand for service distortions and is not a sustainable system of financing municipal operations and infrastructure.

Accounting for Carbon Taxation

An unfortunate wild card in the maze of needed fiscal reforms is an unavoidable carbon tax system that will inevitably be imposed by international agreement and which for the most part will be out of the control of the provincial or even federal governments. At best, the Alberta Government will need to be fully engaged in negotiations with the Government of Canada to ensure that whatever system is adopted does not unfairly impact Alberta businesses or result in wealth transfers out of Alberta jurisdictions that are in most need of investments to mitigate emissions and the potentially negative impact of carbon taxes.

Recommendation:

1. That the Government of Alberta improve the long-term competitiveness, productivity and quality of life in Alberta by embarking on an immediate and comprehensive reform of the fiscal system that at minimum includes changes that;
 - 1.1. Stabilize provincial revenues by diverting royalty revenues into an endowment fund at a rate that, within a period of 15 years, will increase the size of the fund to a point where investment earnings from the fund can totally replace royalties as a source of general revenue.
 - 1.2. Increase provincial revenues and reduce tax rates by broadening the tax bases through an elimination of tax exemptions while still protecting low and fixed income groups with income tested refunds and rebates.
 - 1.3. Improve Alberta’s competitiveness and productivity with a simplified mix of provincial and municipal tax tools that shifts the tax burden from production and wealth generation (investments and income) to consumption and discretionary spending.
 - 1.4. Create a sustainable funding model for health care in Alberta by allocating health budgets wherein growth and cost estimates are based on realistic demographic projections and actuarial data.
 - 1.5. Establish sustainable funding for municipalities by providing provincial transfers and grants that are aligned with municipal budget cycles and are based on a fixed proportion of predictable and growth sensitive taxes and fees that are sufficient to support municipal operations without local tax increases that exceed inflation.

- 1.6. Attract and retain more value-added activity in the Province by establishing a more equitable distribution of the local tax burden through an elimination of provisions allowing municipalities to apply differential property tax rates to residential and non-residential classes of property owners.
- 1.7. In partnership with the Federal Government create a nationally harmonized carbon tax and credit system that applies equally to all areas and sectors of the economy and that does not result in regional wealth transfers.