

LABOUR ECONOMIC MONITOR



AUGUST, 2007

Inflation Alert: *Inflation in Alberta is seriously out of control. In June the Consumer Price Index for Alberta was 6.3% higher than one year ago. See the data and analysis starting on page 6.*

Introduction: Public Finance as Smoke and Mirrors

In Ralph Klein's day, the government created budgets using economic assumptions that were consciously biased on the conservative side. For example, oil and gas price forecasts for each budget year were deliberately set below what experts predicted. This somewhat bizarre procedure (why would a government choose to base its economic plans on inaccurate forecasts?) made sense in a twisted ideological way.

The Klein Tories were united in their belief that no government (including themselves) could be trusted to properly handle public money. It was an article of faith that if the government revenues were to rise (for example: through increased oil prices), then the government would just increase spending at the same time. When energy prices fell, however, government would be unwilling or unable to cut spending, so it would begin to run a deficit (the ultimate sin in Klein's world). Since the government couldn't trust itself to budget properly given accurate revenue forecasts, it would instead rely on projections that were biased downwards. This led to the odd spectacle of the government lying to itself about expected revenues every year at budget time, while simultaneously pretending that it didn't know that it was being lied to!

In fact, the real point of the exercise was public opinion. It wasn't government planners that were being held in check by these low revenue estimates – it was public expectations. The Klein government was deeply committed to a political regime of small government and low taxes. Ordinary Albertans, on the other hand, consistently said in opinion polls that they wanted increased resources devoted education and health care, even if this meant taxes would have to increase. Low revenue forecasts were a way to keep public expectations in check.

The whole thing was a political stunt, but it worked well for the government, even though they made no secret of what they were doing. On the contrary, they bragged about it as demonstrating their commitment to “fiscal restraint”. The media never really bothered to examine these policies or explain them to the public, so Albertans were subjected to the same “fiscal shell game” year after year.

Every year at budget time the Tories would announce that there wasn't enough money to fund health care and education at the level the public wanted. And every summer they would announce that in the previous year they had run a large surplus, and that the extra money would be used to pay down the debt. The media would dutifully report the “good news”, and the Tories would start the whole cycle over again. It was an odd way to run a government, but a very good way to get re-elected.

Lately this particular game hasn't been working very well, as many of the government's economic forecasts have been well off the mark. Last year, for example, the budget predicted natural gas prices to be well over 20% higher than they actually turned out to be. This was a significant error, since for each ten cents that the real price falls short of the prediction, Alberta loses about \$100 million in revenues.

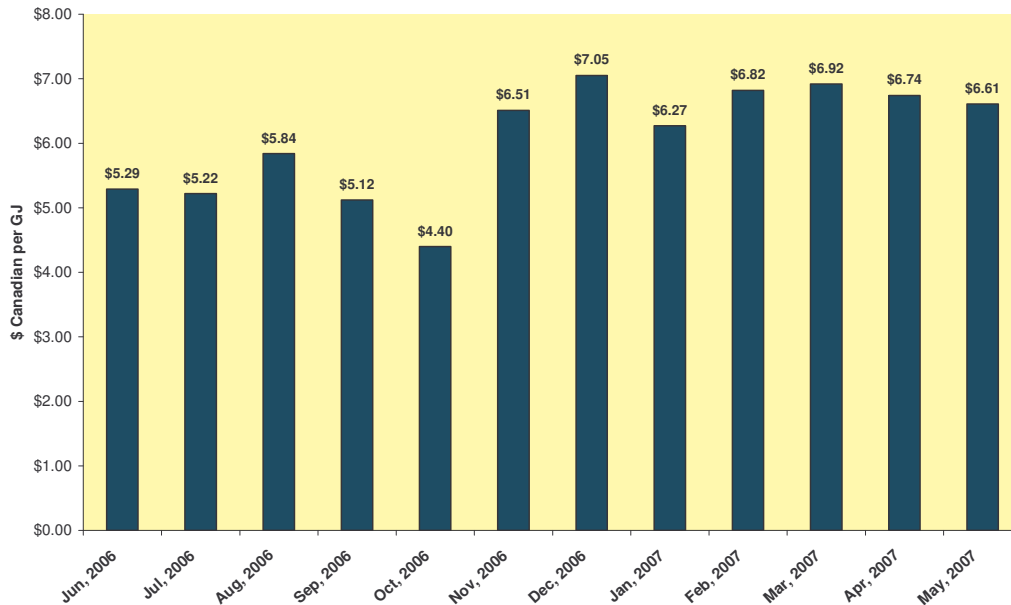
This year's budget doesn't look any better. For example: the Stelmach government has forecast an exchange rate for the Canadian dollar of \$0.86 US (a higher Canadian dollar actually hurts Alberta's finances, because we get so much of our energy revenues paid in US dollars.) For the first three months of the fiscal year, the actual exchange rate has been \$0.91 US. Each one cent US rise in the value of the Canadian dollar costs the government \$123 million in lost revenue.

This is not to say that the government is in any danger of running a deficit this year, but it does reinforce the impression that the Stelmach Tories don't have a firm grip on the budget process. In a volatile economic climate this can be dangerous, especially given the Tories' irrational fear of any kind of public debt. If the economy does take a sudden downturn that threatens provincial revenues, we can almost certainly count on the Stelmach government to panic and immediately start to cut spending regardless of the long-term consequences.

Energy Prices

The forecast Natural Gas Alberta Reference Price assumed in this year's provincial budget is \$6.75 (Canadian dollars per gigajoule). For the first three months of the fiscal year, the actual average price was only slightly higher, at \$6.68/GJ. While this doesn't leave much of a cushion, we have to remember that the period March – May isn't a period of especially high demand for natural gas. Current prices are down slightly from their peak in December, but are slightly above the average for the last twelve months.

Monthly Natural Gas Reference Prices, Alberta



Although the business press has been muttering recently about volatility in oil markets, the price for benchmark West Texas Intermediate crude oil has remained well above \$50

US/barrel over the last year. This is quite high, considering that the price was below \$20 US/barrel as recently as January 2002.

Monthly Oil Prices
(Benchmark West Texas Intermediate)



Moreover, prices have risen in recent months, and there is no reason to expect, short of a massive melt-down in the American economy, that they will fall in the near future. Indeed, crude oil futures for September through December deliveries are currently trading above \$70 US, which suggest that the markets don't expect oil prices to fall any time soon.

Unemployment

The seasonally adjusted unemployment rate in Alberta has remained very low, and fell to 3.3% in July. Overall employment in the province has risen by 102,600 jobs over the last year, with the biggest gains in the construction and service sectors. One occupational group that has grown sharply is Sales and Service Occupations, which has added about 33,000 jobs in response to booming consumer demand. Unfortunately this latter occupational sector includes a lot of jobs that are lower-paid, and which offer little or no job security. When the economy eventually takes a downturn, this group will be hard hit.

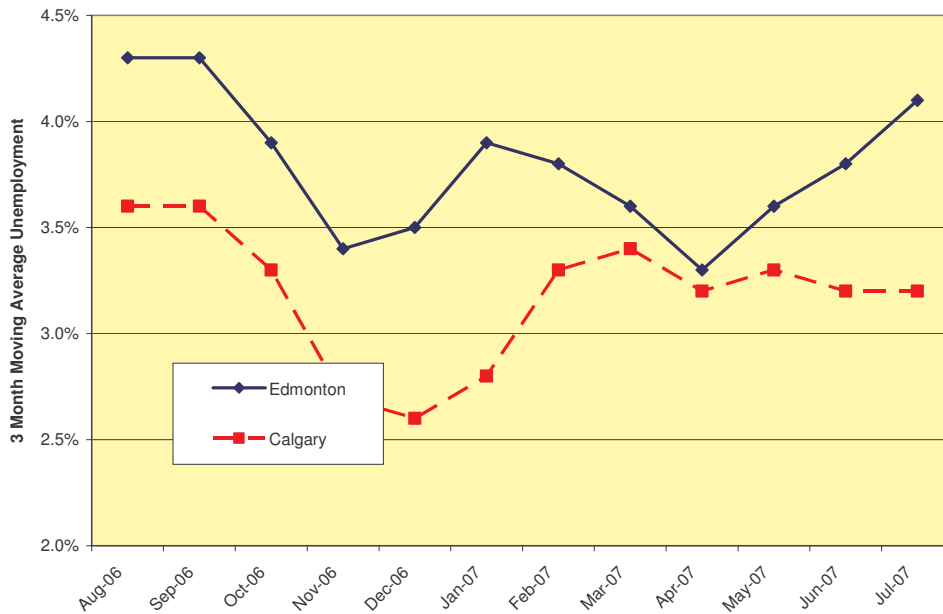
Incidentally: for all of Alberta's reputation as a resource-based economy, the service sector provides almost three times as many jobs in this province as the goods-producing sector.

Alberta Unemployment Rate (Seasonally Adjusted)



Calgary’s labour market remains extremely tight (3.2% unemployment), but the last three months have seen some slackening in Edmonton. With a seasonally adjusted unemployment rate of just 4.1% however, Edmonton’s job market remains very strong.

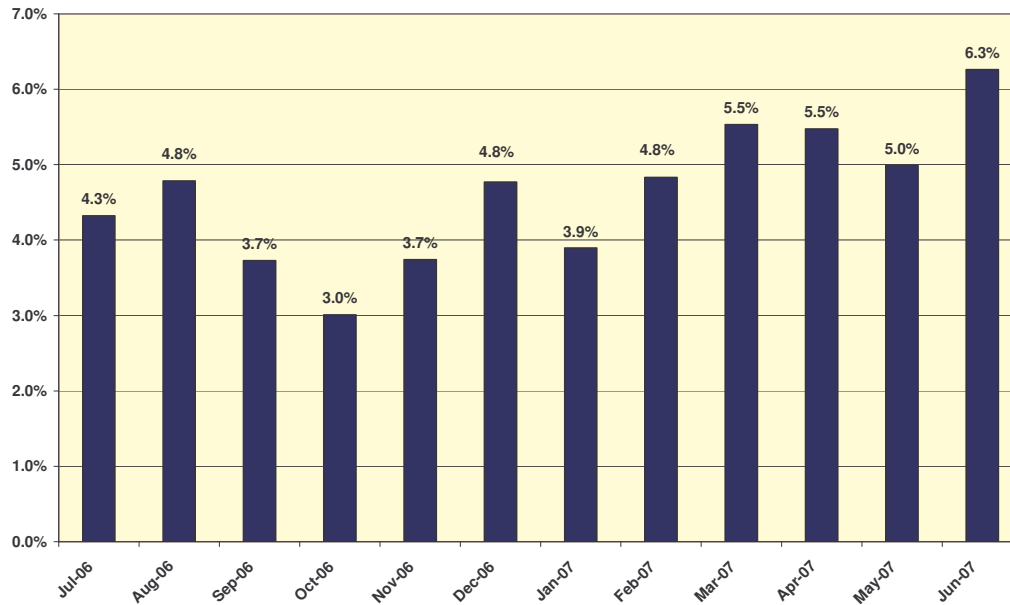
Regional Unemployment Rates, Edmonton and Calgary



Inflation

A high rate of inflation has been the dark side of Alberta's economic boom for a long time now. For most of the last decade, inflation in Alberta has been much higher than the national average, and this has eaten away most of the wage gains made by working Albertans.

Annual Inflation Rate, Alberta



This trend has become stronger in recent months. The nation-wide rate of inflation in June was 2.2%, but in Alberta the CPI increased by a whopping 6.3% over June, 2006. For the last four months the year-over-year inflation rate in Alberta has been 5% or higher. In fact, for the first six months of 2007 the average inflation rate has been 5.2%, and it has been rising in recent months.

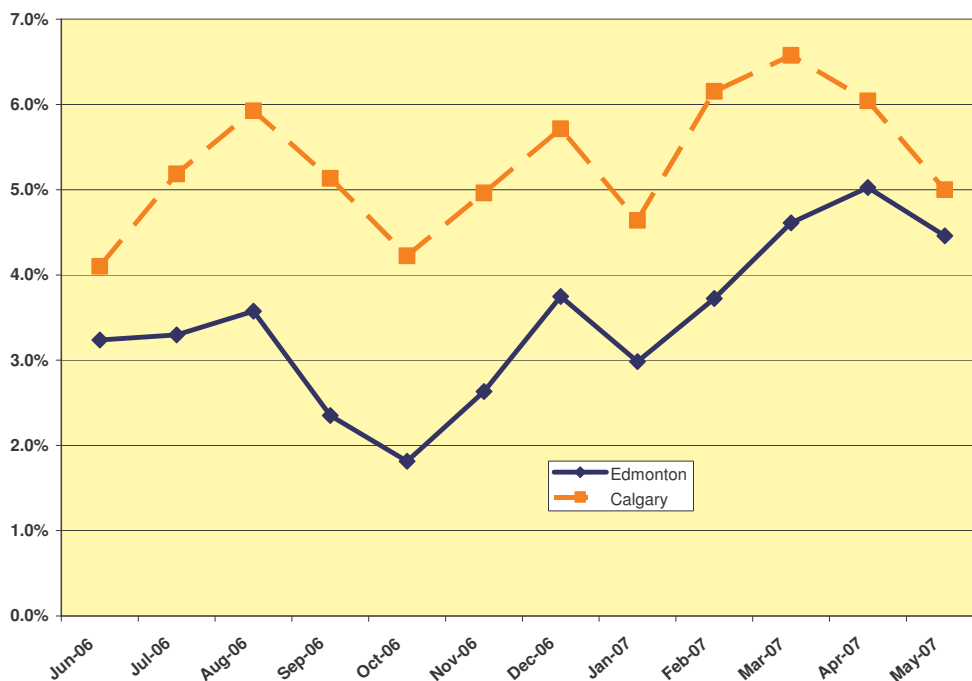
There are two things that could bring about a slowdown in inflation. The first is a slowing of economic growth in the province. This seems unlikely, unless there is a major recession in the rest of North America. The second is an intervention by the Bank of Canada, in the form of an interest rate hike. This too seems unlikely, since inflation at the national level is 2.2% (well within the Bank's guidelines), and higher interest rates could pose a problem for financial markets already suffering from the crisis in the US sub-prime mortgage sector.

The current levels of inflation erode wages very rapidly, and make contract negotiations extremely difficult. Settlements already reached, which seemed excellent at the time they were negotiated, are now resulting in a loss of real wages. At the same time, employers, government and the media are starting to talk about the need to "hold the line" on wage increases, in order to prevent further inflation.

This is simply nonsense. Inflation in Alberta is not being driven by wage increases, but by high petroleum prices, rapid growth, and an acute housing shortage. The average price of a single-family dwelling in Edmonton has more than doubled in the last four years, from \$186,000 in 2003 to \$417,000 this summer. Rents are following the same pattern, and hundreds of Albertans are being threatened with eviction from their homes as landlords convert to condos in order to cash in on the housing shortage.

In this context, calls for wage restraint make no sense whatsoever. What are Alberta workers supposed to do – hold their wages down and live in tents? Is this the “Alberta Advantage” that the government is so proud of?

Annual Inflation Rates, Edmonton and Calgary



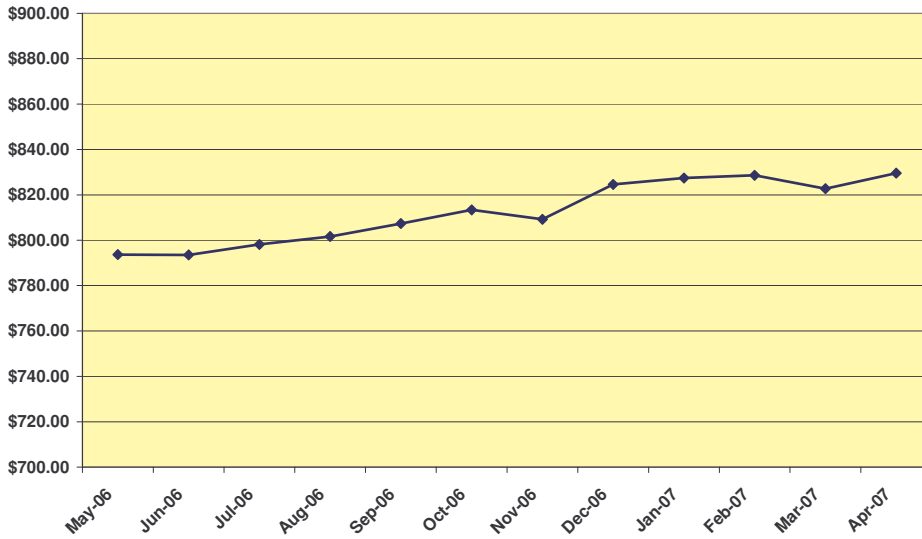
Inflation in Edmonton and Calgary is slightly lower than in the rest of the province. This probably reflects the fact that the north-east part of the province is the real epicenter of the boom. Rates in the cities, however, are still unacceptably high.

In the budget that came out just this spring, Alberta Finance predicted inflation for this year of just 2.8%. It's hard to see how they arrived at this ridiculous figure: Alberta's record on inflation over the last few years is clear, and predicting that an economic boom will continue but that inflation will decline is voodoo economics at its worst.

Wages

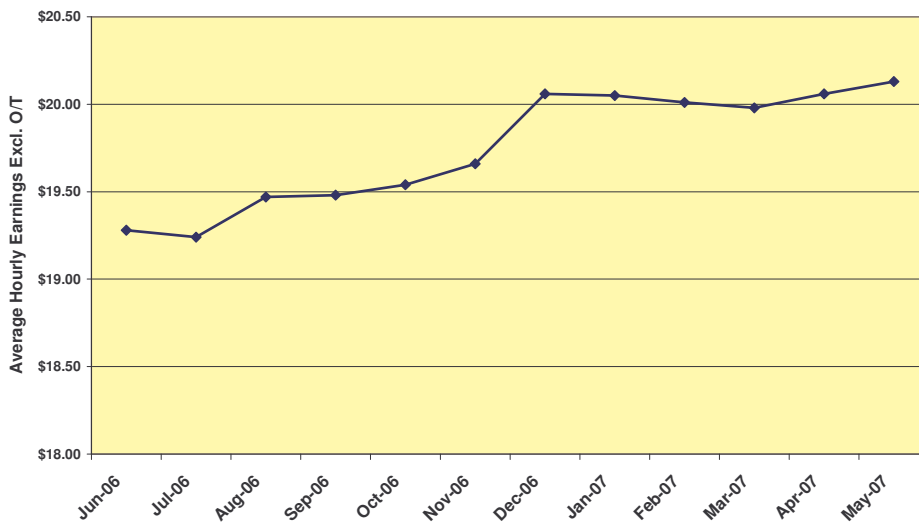
Wages in Alberta continue to rise, but at a rate that fails to keep up with inflation. Weekly earnings over the first four months of this year averaged 4.8% higher than the same period in 2006.

Alberta Average Weekly Earnings



Hourly wages in the January – June period were 5.0% higher than in 2006.

Average Hourly Earnings, Hourly Paid Employees Alberta

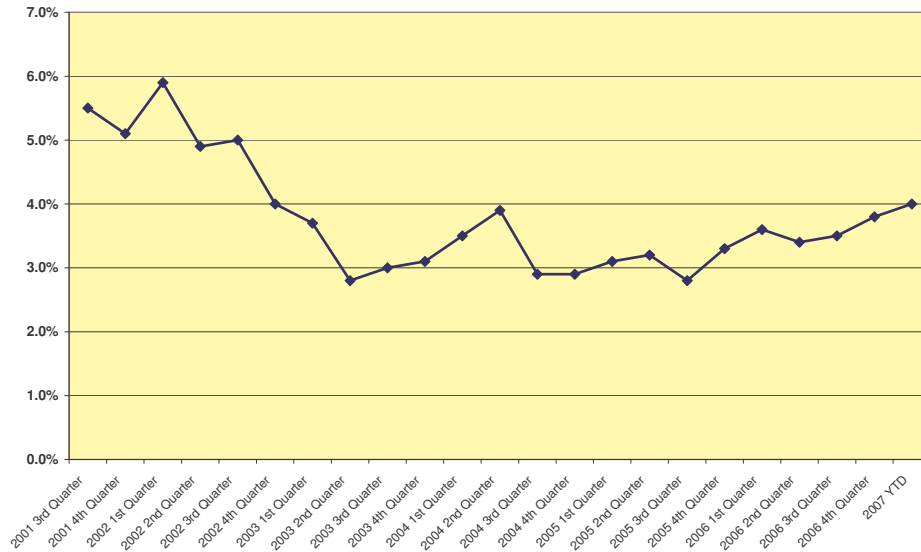


No analysis or comment is required to explain the above information. The facts are plain: in the middle of the greatest economic boom in the province's history, workers in Alberta are seeing their real wages actually decline because of high rates of inflation.

Wage Settlements

Overall wage settlements reported in the first two quarters of 2007 averaged 4.0%. Alberta Employment, Immigration and Industry hasn't yet incorporated the results of recent agreements, such as the province wide settlement won by the United Nurses of Alberta, so the total number of agreements reported and workers covered is too small (as it was in the last edition of *Labour Economic Monitor*) to allow meaningful analysis by industrial sectors.

Collective Bargaining Wage Settlement Rates



So far this year, Employment, Immigration and Industry is reporting just 23 private sector settlements, covering 2,400 workers and averaging wage increases of 5.5%. Public sector settlements reported include 32 agreements covering 9,400 workers with wage increases of 3.6%.

As unions and their members adjust to the most recent inflation figures (and assuming the inflation trend continues), we can expect bargaining to become more intense, with the possibility of more frequent strikes and lockouts.

Conclusion

Runaway inflation remains the main problem confronting workers and unions in Alberta today. For a more detailed discussion of its impact on wages, try to attend this September's conference "*Treading Water: Workers, Wages and the Boom.*" Information on the conference can be obtained from the AFL or the Parkland Institute.