Alberta Federation of Labour Submission to Financial Management Commission

May 2002

INTRODUCTION

The Alberta Federation of Labour (AFL) would like to thank the Commission for the opportunity to make a written submission and to participate in this important consideration.

The AFL is an umbrella group of Alberta unions, with the mandate to research and communicate on behalf of 120,000 working people and their families who belong to the AFL. Our function is to speak from the perspective of working people, both unionized and non-unionized, in public policy debate in Alberta.

During the past decade, the issue of financial management has been the central hub of political debate in our province. Whether it was the deficit, funding for health care, privatization, unemployment, energy prices or deregulation, the lynch pin for government action has been financial.

As we enter a new phase in Alberta, along with the beginnings of a new millennium, the time is right to re-evaluate the past approaches to financial management. We commend the Commission for examining this important topic.

We will break our submission into four main policy themes.

A. The Bottom Line: Budget Surpluses and Debt

The Alberta government has had the good fortune of strong energy prices in the past few years, allowing them to accumulate successive years of healthy budget surpluses. Those surpluses have been applied to the debt, causing it to drop with surprising speed.

While this is a positive development, it did not happen without a price. Other areas, such as infrastructure, health care and education, did not receive the re-investment possible due to the constraints of the Financial Responsibility Act.

Now that the accumulated debt is projected to be under $6.0 billion, it is time to re-evaluate the priority this item receives.

In short, the Alberta government has slayed the deficit and debt dragon. It is a mere mouse today. We say this not to trivialize six billion dollars, but to create some perspective. The government's annual revenue is now over $20 billion a year. As long as they do not run up renewed deficits, the debt that remains is a small portion of the government's financial picture.

This creates the flexibility to shift financial management to other priorities. We recommend the Fiscal Responsibility Act be eliminated, or at least amended to permit greater flexibility. In particular, we recommend three things.

- First, the government establish a new repayment schedule for the remaining debt, to be paid over 20 years. This would be approximately $150 million each year in principal payments, plus interest. Now that the debt is a manageable size, it should not be trumping other priorities for government.

- Second, establish a fund for unexpected surplus revenue. This fund, a form of stabilization fund, can be used to cushion the province during short term revenue constraints. Given the unpredictable nature of energy prices, this would be a prudent step. An example of how the fund would be used occurred last fall, when the government cut almost $1 billion from departmental funding due to dropping oil prices. Within a few months, oil rebounded and the government found itself on firmer financial footing. The fund could have prevented the shock of the cutbacks without risking a budgetary deficit. Legislation could prescribe the conditions in which a withdrawal from the fund would be justified.

- Third, allow for greater flexibility in the use of unexpected revenue. The current 25/75 split is too restrictive and does not allow the government to react to unforeseen situations. The stabilization fund would eliminate the need for such rigid rules. A more flexible regime would better balance immediate needs with long term financial planning.

B. Public Investments

It is, of course, the job of government to deliver services and programs that the citizens identify as important. The issue of sound fiscal management is related, but separate, from the delivery of these services. It is not the place of this submission or of the Financial Management Commission to consider what services are or are not appropriate for government to deliver.

However, it is within the mandate of the Commission to ensure that money spent on services is done so wisely. This means ensuring a sound system of accountability and transparency so that citizens can know how tax dollars are being spent.

The first thing we need to recognize is that public expenditure is not just "spending". It is an investment in a form of social capital. When we educate a child and give them the skills to be a strong citizen, we are not spending money, we are investing it. When we ensure safe housing for seniors or for low income families, we are investing in a stronger, healthier community. The rate of return for these investments are hard to quantify, but that does not make them less valuable.

Secondly, recent research shows that delivering certain services, such as health care, education and income security through public means actually offers an economic advantage over private delivery. Overall costs are lower and the impact on the economy is higher. We have attached a booklet, "The Other Competitive Advantage", which outlines some of the groundbreaking research in this area. We hope it is useful to the Commission in its deliberations.

The Commission explicitly queries the impact of public sector wages on the province's finances. We wonder why this question is being asked. It seems clearly outside the mandate of a Commission studying the fiscal structure of the Alberta government. Public sector wages and benefits fall into the category of labour relations, and must be determined via fair collective bargaining. A Commission with no attachment to this field and with little familiarity with the issues at hand is not well placed to comment.

For example, the Commission is in no position to determine whether a nurse or a teacher or a doctor is underpaid or overpaid.

The delivery of services comes with a necessary cost of wages and benefits. There is no evidence that public sector wages are out of control. In most occupational categories, public sector workers earn less than their private sector counterpart. This suggests the taxpayer is getting good value for money when it comes to wages.

Second, it should be remembered that money devoted to wages is not entering a black hole never to return. This is money provided to Albertans to perform a task. They use that money to pay bills, purchase goods and services and pay taxes. In other words, the money is immediately returned back into the economy - which is a benefit to the overall Alberta economy.

We recommend:

1. That public expenditures be re-framed as a discussion of investment, and the discussion that ensues address ensuring the best value for our investment.

2. The Alberta government should continue to be committed to delivering services as efficiently and effectively as possible. It should make decisions based on the best available evidence.

3. The government should place a moratorium on moves to contract out or privatize services until the economic and fiscal effect of contracting out can be more fully determined. Past privatization experiences have demonstrated that cost savings are elusive and service improvements non-existent.

4. The Commission should make no recommendation on public sector wages, recognizing that it is an area outside the expertise of the Commission and should be addressed through existing labour relations methods.

C. Capital expenditures

Financing for construction and maintenance of roads, buildings and other capital assets is a challenge for all entities, both public and private. The initial cost outlays are large, and can have a serious impact on the budget. However, the good news is that the lifespan of such projects is long, many decades in some cases. This presents the option of financing the cost of the construction over longer periods.

Just as a family purchases a long-term mortgage for their home, government's should not be adverse from arranging specific, limited loans for the purposes of one-time capital costs (e.g. construction or renovation of a building, construction or major upgrade of a road). A family chooses a mortgage, even though they will pay a substantial amount in interest, for one of two reasons. First, the purchase may not be possible otherwise. Second, by amortizing the costs of the capital expenditure over 15 to 30 years, it lessens the cash flow concerns, freeing up money in the short term for other necessities, such as food, transportation or child rearing.

In a time of tight fiscal constraint, financing capital expenditures is difficult for government. Many needed projects languish, awaiting the proper cash flow. Others go ahead but at the expense of reduced funding available for other needs, such as health care, education or other services.

Borrowing for capital investment is a common strategy. Every major private sector corporation borrows money to finance construction or other capital costs. It is seen as good business sense. This type of business strategy should be available to governments as well.

In recent years, many governments have explored Public Private Partnerships (PPPs) to solve this difficulty. The PPP could be for the construction of a facility, and operation remains with the government, or it could be for operation as well. PPPs have two major flaws, however. First, the risk is borne entirely by the government partner, as the private partner is usually provided a guaranteed rate of return. Unforeseen costs and hidden costs are borne by the public sector partner.

Second, PPPs tend to be more expensive than direct financing by government. The reason is simple - by adding a partner to the project, that partner requires a rate of return. This increases the overall costs of the project. If the private sector partner seeks financing from a financial institution to fund their upfront expenditures, their borrowing costs will be higher than if the government had sought the financing themselves. As preferred creditors, government's can leverage their superior position to achieve lower interest rates than a private corporation.

There is a third problem with PPPs, one that is less calculable in terms of money, but is equally important in terms of democracy. The issue is accountability. When hundreds of thousands and possibly millions of tax dollars are at stake, Albertans have a right to achieve clear and transparent lines of accountability. When implemented elsewhere, PPPs have failed this key test. Who is accountable for what is a murky area in PPPs and an accurate and full accounting of how tax dollars are spent is also difficult to achieve.

If a government spends the money, the spending becomes part of the public record and receives overview from the auditing system in place. If the private partner outlays originally, then is repaid over time by the government, then that spending is not accountable to the tax payer and cannot be audited by the Auditor General. This should give Albertans cause for hesitation.

We recommend two actions in the area of capital expenditures:

1. Amend the Fiscal Responsibility Act to allow for borrowing to finance specific, one-time capital expenditures such as road or building construction.

2. Reject the option of PPPs. If government is to undertake a capital project, the financing of that project should be wholly public to ensure clearer accountability.

D. Revenues

A discussion of finances would not be complete without consideration of revenue sources. Obviously a government requires necessary revenues to finance its priority operations. That revenue should be collected in the most efficient manner possible and in the fairest manner possible.

The government recently hiked health care premiums by 30%, to $44 and $88 a month. This premium is an inefficient and unfair way to raise revenue. First, because it must be collected separate from the income tax system, a distinct administrative infrastructure must be created to ensure its collection. And with that comes added costs. Plus there is the additional costs of uncollected debts, which must be written off each year.

Aside from being an inefficient way to raise revenue, health care premiums are unfair. As a flat tax, those with lower incomes pay a disproportionate amount of the burden. Premiums are also a form of taxation on employers - as many employers pay a portion or all of an employee's premiums. Shifting the revenue to fairer sources would relieve the burden on low income earners and businesses.

Admittedly revenue lost from premiums would need to be made up somewhere else. One area to examine is the area of oil royalties. Alberta royalty rates are one-half what they were under Peter Lougheed. They are 60% less than Alaska. There is no economic evidence showing that low royalties increase oil exploration, and that a moderate increase in royalty rates would cause a slowing of oil activity.

To the contrary, evidence from Alaska and Norway demonstrate that higher royalties enhance the overall economy, as more revenue is directed efficiently to government, allowing for lowering of taxes in other, less efficient and less fair areas.

If Alberta raised our royalties to the level of Alaska, we would bring in $2.0 billion more per year. This would more than erase any loss from the elimination of health premiums.

The final consideration is the flat tax. There should be a thorough examination of the economic impact of imposing a flat tax, and if found negligible or negative, it should be phased out and the government should return to a progressive, tiered tax system. The flat tax was implemented without study and without an analysis of its economic impact. This impact needs to be tested before such a momentous shift can be permitted to permanently alter how revenue is raised in Alberta.

Our recommendations for revenue include:

1. Eliminate health care premiums. They are an inefficient, costly and unfair way to raise revenue.

2. Increase oil royalties to the level of Alaska. This would bring in substantial additional revenue very efficiently without adverse effects on the economy.

3. Review and assess the impact of the flat tax. If found to have no or negative effect on the economy and on average Albertans, it should be eliminated.

CONCLUSION

When choosing future directions for Alberta's financial management, we urge the Commission to proceed with care and due attention. All actions should be thoroughly researched and well-grounded in the real life impact on average Albertans. Theories and academic conclusions are useful guides, but we first and foremost must use the average working Albertan as the yardstick with which we measure the desirability of any policy.

The days of single minded commitment to deficit reduction are gone. Now the issues are diverse. Therefore our response must be diversified and focused on solving real problems, not pretend ones.

The AFL thanks the Commission for the opportunity to make a submission. We wish the best of luck in your deliberations.

Respectfully submitted,

ALBERTA FEDERATION OF LABOUR