Alberta Federation of Labour

THE “KENNEY RECESSION”

Proposed UCP cuts would hurt economy worse than oil price crash

> **"The recommendations of the Blue Ribbon Panel on Alberta's Finances would put Alberta on a short path to economic recession"**

Jason Kenney was elected in Alberta on the promise of economic prosperity and job growth.

This promise remains a cornerstone of the UCP government and is desperately needed by Alberta families who may still be struggling from the economic hardships caused by the worldwide drop in oil prices. The recently released MacKinnon report has been characterized as a blueprint for the Kenney government's delivery on that promise. It is not. The MacKinnon report presents recommendations which, if implemented, will result in substantial additional economic hardship for Alberta families as it imposes a generationally significant and radical dismantling of public services upon which Albertans depend.

The recommendations of the Blue Ribbon Panel on Alberta's Finances would put Alberta on a short path to economic recession. Its analysis is fundamentally flawed. And its recommendations completely ignore their impact on the Alberta economy and the quality of life of Albertans. The government's response to date gives no indication that it either recognizes these problems or takes them seriously. Indeed, the only response from the government so far would make the impact of the recommended changes even more extreme.

The MacKinnon recommendations do not promote the interests of Albertans in building a prosperous economy and enhancing their quality of life. Instead, the recommendations promote an ideology of a smaller and less effective government that only serves the interest of the wealthy elite.

This is the choice facing the Kenney government. Kenney could choose to follow the MacKinnon recommendations and implement an ideological agenda that results in greater job loss for Alberta. Or, Kenney could choose to help keep more Albertans working and protect the public services that help families thrive as Alberta responsibly deals with its economic situation.

In summary, if Kenney chooses the MacKinnon recommendations, he is choosing a road map that will hurt Alberta's economy, workers and communities. You simply cannot cut a key part of Alberta's economy without risking the province tipping into a self-inflicted recession.

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The MacKinnon report is a road map to broken promises

In our analysis we go through four different scenarios to estimate the consequences for the Alberta economy of implementing the MacKinnon recommendations. As drastic as the impact of the MacKinnon report’s recommendations appear on the surface, the underlying reality is much more extreme.

In its preliminary response to the MacKinnon report, the government has already upped the ante, calling for the inclusion of a budgetary revenue contingency allowance in its deficit elimination program, a move that would effectively force a cut in program expenditures beyond even those recommended by MacKinnon.

More troubling, however, is that the MacKinnon report’s deficit elimination plan rests on inexplicably high and economically implausible assumptions about the rate of growth of Alberta government revenue in the second half of the four-year deficit elimination plan. In overestimating the rate of growth of revenue by 3% (three percentage points) in each of the last two years of the planning period, the report essentially hides a further 6% reduction in public services spending that would be required to reach its recommended budget balance targets.

In the most likely scenario, adjusting the report’s inexplicable revenue projections and taking into account the government’s announced preference for an immediate revenue contingency allowance, and allowing for population growth and inflation, the MacKinnon recommendations would mean cuts in public services of 20.2% over 4 years. These cuts would result in a cumulative negative impact on GDP of 4.8% and a loss of just under 114,000 jobs.

Historically, Albertans’ investment in public services has helped ensure that families survive tough financial times. The public service is in fact a pivotal part of Alberta’s economy. During the last oil and gas recession in Alberta, where we saw roughly 50,000 jobs lost in the private sector, employment in the public sector helped mitigate the effects of the recession for many families. For many families, public sector employment and support from public services meant that bills could still be paid on time, that children could still participate in community activities, and that families could stay and thrive in Alberta. If public sector employment and public services had been cut at the same time as private sector job loss was happening, many of Alberta families would have had no income and the economic recession would have been dramatically worse.

Scenario Analysis

In this report, we analyze the impacts on economic activity and employment over the next four years of the fiscal scenarios implied by:

1. The MacKinnon recommendations, as set out in the report, including its four-year deficit elimination target and its revenue forecast.

2. The recommendations, under scenario #1, adjusted to provide for the revenue-side contingency announced by the Minister of Finance in his response to MacKinnon. To take that into account, we have assumed contingencies of 0.25% in 2020-21, 0.50% in 2021-22 and 0.75% in 2022-23.

3. Implementation of the fiscal target in scenario #1, but with the revenue forecast increases for 2021-22 and 2022-23 reduced from 7.0% and 7.3%, respectively to a more reasonable assumption of revenue growth. Based onan expected rate of nominal growth in the Alberta economy consistent with recent experience and with longer-term forecasts for the Canadian economy, and assuming that revenue grows at the rate of growth of GDP, we foresee revenue growth of 3.8% and 4.0% in 2021-22 and 2033-23, respectively. [1]

4. Scenario #3 with its adjusted revenue forecast along with the revenue-side contingency modelled in scenario #2.

In each case, the impacts are measured relative to a base case in which per capita public services spending in the 2018-19 fiscal year is maintained, after adjusting for inflation, for the next four years. Each scenario assumes that the deficit reduction path recommended in the MacKinnon report will be maintained. For each of the scenarios, we rely on the MacKinnon report's revenue estimates for 2019-20 and 2020-21, which take into account the government's promised elimination of the carbon levy and the proposed reduction in the corporate tax from 12% to 8%. In making our reference projection – maintenance of real, per capita, public spending at the 2018-19 level -- we adopted the inflation forecasts in the MacKinnon report and assumed that Alberta's population would grow at the rates projected in the 2018-19 budget, 1.5% in three of the four years and 1.6% in one of the four years.

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Differences in expenditures relative to the base case were estimated to have a multiplier effect of 1.8 times – 1.0 times as a direct effect, and 0.8 times as an indirect effect. This assumed multiplier effect is extremely conservative. Depending on the category of public spending, macroeconomic multipliers for public spending would normally fall in the 1.75 to 2.5 range. Accounting for "leakage" of the secondary impact into other jurisdictions – estimated to be 20% -- the total multiplier impact in Alberta was estimated to be 1.64 times. [2]

1.Specifically, the rate of growth of the Alberta economy is forecast to grow at a real rate of 2% in each of 2021-22 and 2022-23, plus the rate of inflation forecast in the MacKinnon report. This forecast for economic growth is consistent with recent experience and the report's forecasts for 2019-20 and 2020-21 of 3.8% and 2.8%, respectively.

2.These estimates will tend to understate the negative effect of a deficit elimination program because, to simplify the calculations, they do not take into account the knock-on effect of the reduction in growth rates caused by the deficit reduction plan itself on the baseline assumptions for economic growth that underlie the revenue projections. The reduction in growth caused by the public services cuts would have a negative effect on revenue and thus, given a deficit elimination target, drive even greater reductions in public services spending with their own negative economic impacts.

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Employment impacts were estimated by applying the direct operating expenditure impact as a percentage to estimated total provincial public sector employment and to employment in the postsecondary education sector adjusted to reflect the fact that provincially controlled resources account for only approximately 65% of the revenue base for post-secondary institutions.[3]

Total employment effects on the private sector were estimated by applying the estimated GDP impact to total provincial employment, and thus reflects the estimated multiplier effects on GDP of the expenditure and tax changes considered in the analysis.[4] To estimate the impact on private sector employment, the public sector employment impact determined above was subtracted from the estimated total employment effects determined above.

Scenario #1 – the MacKinnon report

Scenario #1 models the fiscal and economic impact of the recommendations from the MacKinnon report, adopting all of its economic assumptions and revenue projections, and its proposed pathway to a balanced budget by fiscal year 2022-23. The report proposes a 1.2% cut in spending over a four-year period but does not account for population growth and inflation. Compared to the reference case where real per capital project spending is maintained at 2018-19 levels, the overall cuts recommended by MacKinnon cumulate to 13.5% by 2022-23. This magnitude of cut would reduce GDP cumulatively by 3.2% after 4 years. These cuts would also mean 32,500 public sector jobs lost as well as 41,500 private sector jobs for a total of 74,000 jobs lost from Alberta.

Scenario #2 – the MacKinnon report, including a phase-in of the recommended revenue contingency over the last three years of the deficit elimination period

In the government's response to MacKinnon, it indicated an intent to go beyond the recommended cuts by including a revenue contingency in its budget projections. While the government acknowledged that this change would result in greater cuts than those recommended by MacKinnon, it did not reveal any specifics. In this analysis, we modelled the MacKinnon report's recommendation for a three-year phase-in of a revenue contingency allowance beginning after the budget is balanced, but implemented over the final three years of the deficit phase-out period. Revenue estimates were reduced by 0.25% for 2020-21, 0.50% for 2021-22 and 0.75% for 2022-23. Program spending levels were then adjusted downwards to produce the same path towards deficit elimination as recommended in the MacKinnon report.

3. Note that the implicit assumption here is that expenditure reductions will result in a proportional reduction in employment. Given that employment costs make up a disproportionate share of variable expenditures, this assumption would likely lead to a conservative – lower than likely – estimate of employment impacts.
4. Note the implicit assumption here that the employment-intensity of GDP remains constant.

In this scenario, nominal spending cuts (i.e. not adjusted for inflation and population growth) would be 2.9% over four years. Adjusted for inflation and population growth on the same basis as in scenario #1, the cuts climb to 14.7%. GDP drops by 3.4% over the four-year period. These cuts would result in 35,750 public sector jobs lost and 45,500 private sector jobs lost for a total of 81,250 jobs lost.

Scenario #3 – adjusting for MacKinnon's overestimate of revenue in 2021-22 and 2022-23.

The MacKinnon report forecasts Alberta's revenue includes the elimination of the carbon levy and Kenney's promise to reduce corporate taxes from 12% to 8%. However, the final two years of the forecast predict significant increases in government revenue – 7.3% in 2021-22 and 7.0% in 2022-23. There is no support for an assumed revenue increase of this magnitude in the economic assumptions cited in the report. These increases are both surprising and inexplicable, especially given the more normal assumption that revenue would increase at the same rate as provincial GDP.

The following table compares the percentage increases in revenue assumed in the MacKinnon report with the rate of increase in GDP assumed in the base case in the report.[5]

SUMMARY COMPARISON -- REVENUE AND GDP GROWTH

Year	GDP	Revenue	Notes
2019-20	3.85%	0.60%	Reflects implementation of tax changes
2020-21	2.82%	-0.40%	Reflects implementation of tax changes
2021-22	5.27%	7.04%	Not explained by economic assumptions
2022-23	5.54%	7.33%	Not explained by economic assumptions

Not only is the relationship assumed between GDP growth and revenue growth unjustifiable, the rates of growth in GDP assumed in the report's base case are far outside the mainstream of growth expectations for the intermediate future. Although there are (conveniently) no public forecasts for Alberta against which these assumptions can be tested, the fact that these assumptions would require the rate of real economic growth to more-than-triple from 2020-21 to 2021-22 and 2022-23, to more than 3% is sufficient basis to question their validity.

Consistent with recent experience in Alberta and in Canada as a whole and with the general medium-term view of growth rate prospects, in this analysis we assume a real rate of growth of 2%. Coupled with the MacKinnon report's forecast for inflation of 1.8% and 2% in 2021-22 and 2022-23, respectively. This yields assumed GDP growth rates and corresponding revenue growth rates for 2021-22 and 2022-23 of 3.8% and 4.0%, respectively.

As with scenario #2, we then adjusted projected program expenditures to match the report's deficit elimination pathway over four years. Without adjusting for inflation and population growth, the cut in program spending would be 8.6%. After adjusting for inflation and population growth, cuts in this scenario amount to 19.1%.

5. Note that the MacKinnon report's base case forecast for real economic growth, for years in which there is an overlap, is substantially higher than that of ATB Financial (ATB). For 2019, the MacKinnon forecast is 1.0%, ATB's is 0.7%. For 2020, MacKinnon's forecast is 2.6%; ATB's is 1.6%. For 2021, MacKinnon's forecast is 2.8%; ATB's is 1.8%. Source: ATB, Alberta Economic Outlook, May 2019.

Over four years GDP would be reduced by 4.5%. Job losses would total 107,000 with 47,250 being lost in the public sector and 59,750 jobs being lost in the private sector.

Scenario #4 – GDP linked revenue growth in 2021-22 and 2022-23 and implementation of contingency

This scenario combines the variations from the MacKinnon report in scenario #2 and scenario #3. That is, it limits forecast revenue growth in 2021-22 and 2022-23 to a realistic rate of growth of GDP in those years and assumes that a revenue contingency of 1.25% will be phased in over the final three years of the balanced budget plan. This is the most likely scenario considering the government's reaction to the MacKinnon recommendations.

In this scenario, nominal program expenditures are cut by 9.9% over four years. Adjusted for inflation and population growth, the effective cut is estimated to be 20.2%. The negative impact on GDP over the four years cumulates to 4.8%. Public sector employment drops by 50,000. Indirect private sector job losses are estimated at 63,500. Total employment is down by 113,500.

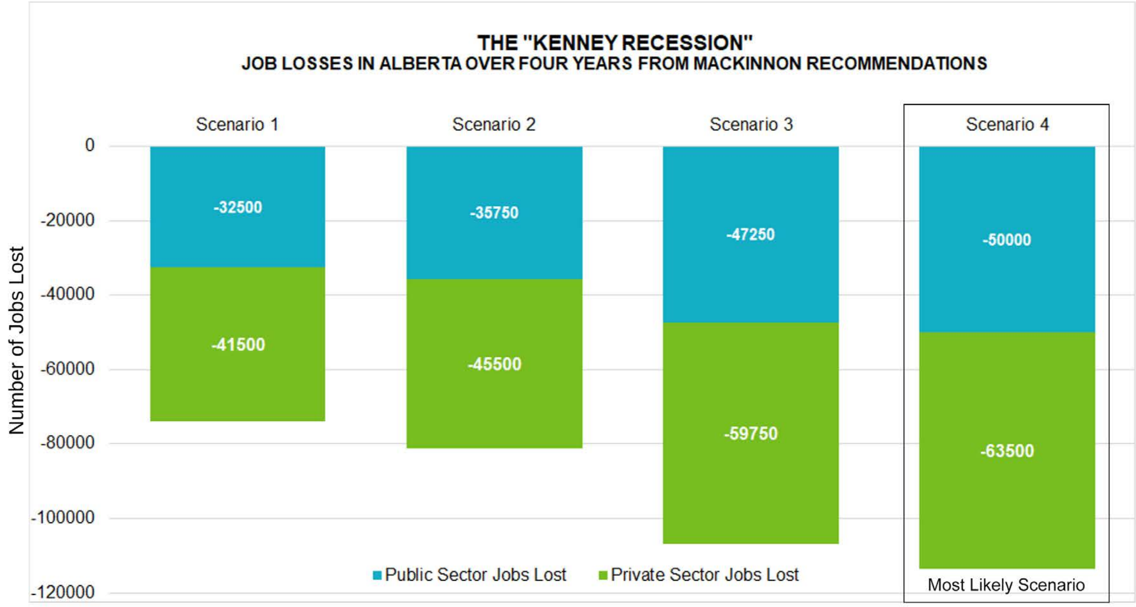
The impact of these cuts on GDP would put the province's economy into recession territory dropping real growth to 0.2% in fiscal 2020-21, 0.4% in fiscal 2021-22 and 0.4% in 2022-23.[6]

The MacKinnon report is right about one thing. Alberta has a problem. But it is not primarily an expenditure problem. It is a revenue problem. For decades, the province has relied on buoyant resource revenues to underwrite the so-called "Alberta Advantage" – the lowest personal and corporate taxes in Canada. The harsh reality is that with resource revenues expected to remain in their current range for the indefinite future, Alberta can no longer afford the "Alberta Advantage." It is the fiscal elephant in the room. And ignoring that fiscal elephant is a greater threat to the Alberta economy than even the 2015 collapse in oil and gas prices.

SUMMARY COMPARISON OF SCENARIOS

Scenario	Employment loss over 4 years			GDP impact	Impact on public service	
	Public sector	Private sector	Total	4-year cumulative	Nominal	Adjusted for inflation and population growth
#1 MacKinnon report	32,500	41,500	74,000	3.2%	1.2%	13.5%
#2 MacKinnon report with revenue contingency	35,750	45,500	81,250	-3.4%	2.9%	14.7%
#3 MacKinnon report with revenue forecast revision	47,250	59,750	107,000	-4.5%	8.6%	19.1%
#4 Scenarios #2 and #3 combined	50,000	63,500	113,500	-4.8%	9.9%	20.2%

6. For example, in 2020, if the less optimistic forecast of Alberta Treasury Branches of 1.6% real growth rather than the 2.6% assumed in the MacKinnon report, the province would likely slip into recession during fiscal year 2020-21. Even a modest departure from the assumed long-term real growth rate of 2.0% -- a possibility that has to be given careful consideration given the uncertainty in the current global economy – would, combined with the impact of the deficit elimination plan, push the province into recession.



The "Kenney Recession" is a choice

The "Kenney Recession" will be unique compared to other hardships Alberta has had to endure. While previous recessions have been caused by external market forces that are largely beyond the control of the Alberta government and independent of its policy choices, the hardship caused by this government's ill-considered deficit elimination strategy will be entirely self-inflicted. The loss of 50,000 jobs during the oil price crash from 2014 to 2017 will pale in comparison to the estimated 113,500 jobs that would be lost in Alberta if the Kenney government goes ahead with cuts of the magnitude being considered. The reality is that the self-inflicted "Kenney Recession" job loss could be worse than the economic crisis caused by the drop in worldwide oil prices.

A large portion of the provincial deficit forecasted for 2022-23 is self-inflicted, created by the current government through large corporate tax cuts that have no strings attached to ensure Alberta receives any benefit. Rather, Kenney is forcing Albertans to take a drastic and unnecessary cut to public services so that large profitable corporations can pay less in taxes.

These kinds of cuts are not required to manage Alberta's current fiscal deficit. Rather, the cuts are designed to achieve Kenney's ideological objective of shrinking the size of government and dramatically reducing public services that Albertans rely on. The public services that help ensure Albertan's can remain healthy and active in our communities and local economy. The same public services that ensure our children receive a quality education. The public services that are a vital safety net that Albertans turn to when they are in need the most.

> "Kenney is forcing Albertans to take a drastic and unnecessary cut to public services so that large profitable corporations can pay less in taxes."

This is not a modest cut and it is certainly not just a wage freeze. The impact on public services in Alberta would be catastrophic. The economic impact of these cuts would be equally dramatic.

This Alberta Federation of Labour report was created in consultation with Hugh Mackenzie.

About Hugh Mackenzie

Hugh Mackenzie is principal in an economic consulting business, Hugh Mackenzie and Associates, based in Toronto. In that capacity, he conducts research projects on economic and public policy and provides specialized support to unions and employee organizations in collective bargaining.

He has worked for over 35 years in a variety of capacities related to public policy development in the trade union movement, the private sector, and at all three levels of government and was part of the Alberta Premier’s Advisory Committee on the Economy.

He is a graduate of the University of Western Ontario and holds a Master's degree in economics (public finance) from the University of Wisconsin (Madison).

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