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Fiscal Policy and
Social Democratic Politics

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Saskatchewan stands at a political crossroads. Will its government implement a social democratic agenda defined by enhanced public services and greater redistribution of wealth, or a conservative agenda that constricts the resources available for these purposes? One might assume that the results of November’s provincial election placed Saskatchewan squarely on the social democratic path. If elected, the opposition Saskatchewan Party would undoubtedly have pursued the conservative path. The victory of the NDP leaves the social democratic path open but does not guarantee that it will be followed.

The re-election of the NDP on a more aggressively left-wing campaign with a significantly larger share of the vote may reflect popular support for, or acceptance of, a social democratic agenda. However, the state of Saskatchewan’s finances raises doubt as to whether such an agenda can or will be implemented.

This paper does not review the arguments for and against social democracy. Instead, it assesses the fiscal policy that would be necessary to implement a social democratic agenda given Saskatchewan’s current financial situation. It explains why social democratic values demand increased government expenditure on public services and wealth redistribution, argues that the government of Saskatchewan’s recent tax and royalty reductions diverged from these objectives, examines their effect on provincial revenues and expenditures, and outlines a fiscal policy to balance the provincial budget and implement a social democratic agenda.
Social Democratic Values

Former Saskatchewan Premier Allan Blakeney defines social democracy as “fair share for all in a free society.”¹ This simple phrase encompasses two fundamental political values: equality and freedom. Although both sides of the political spectrum aspire to these two ideals, differing conceptions of equality and freedom define the debate between right and left.

The political right supports equality of opportunity in the sense that all individuals should enjoy the same legal and political rights so that they may compete on even terms. In addition to these basic rights, the left calls for equality of condition, which means reducing economic inequalities between people and ensuring everyone an adequate share of society’s wealth. The right-wing notion of equality of opportunity implies a small government because it requires only that the state protect individual rights and perhaps provide some infrastructure. By contrast, equality of condition requires a much larger government to provide extensive public services and to redistribute wealth.

The right advocates negative freedom or “freedom from the state.”² The left believes that the absence of state restrictions is not enough because, as former federal NDP leader Ed Broadbent puts it, “the vast majority of choices we make to give substance to the abstract notion of freedom require money.”³ While the right-wing notion of negative freedom requires that government activity be sharply limited, the left-wing notion of positive freedom requires that the state use public services to create opportunities and that it redistribute wealth to ensure that everyone has the means to take advantage of them.

This is not to suggest that social democracy has ever been, or should be, defined in terms of complete equality of condition and absolute positive freedom. It is instead to affirm that this ideology seeks to foster greater equality of condition and more positive freedom. For example, Blakeney argues that, even if one does not have “a perfect definition of fair, . . . it is usually very clear the direction we need to go to achieve fairer shares for all.”⁴ One would therefore expect a social democratic agenda to expand public services and to redistribute more wealth with the aim of advancing equality of condition and positive freedom.

Of course, simply increasing the resources devoted to public spending is not an end unto itself. It is important to prioritize potential investments in different public services. It is equally important to determine whether wealth redistribution should focus exclusively on alleviating absolute poverty at the bottom of the income scale or be applied more broadly to reduce inequality across the scale. But, whichever services are deemed most critical and whichever form of redistribution is judged most appropriate, implementing a social democratic agenda must involve expanding public services and redistributing more wealth.
Tax Cuts

The government of Saskatchewan has moved in the opposite direction in recent years by cutting income taxes and resource royalties. The 2000 budget initiated the largest income tax cuts in the province’s history. Over 4 years, income tax rates were reduced by nearly a third. In changing Saskatchewan’s income tax from being a proportion of federal tax to being a direct tax on income, the provincial government also reduced the differentials between rates for different income brackets. It recovered about half the cost of these cuts by applying the sales tax to more goods. Still, these measures were projected to reduce provincial revenues by $240 million in 2003/04. The government has also cut corporate taxes, albeit at much less expense.

Social democratic values imply the use of a progressive tax system to raise revenues for public programs and to redistribute wealth by taxing large incomes at a substantially higher rate than small ones. But reducing the differences between the rates applied to different tax brackets made provincial income taxes less progressive. Because the poor must spend a larger share of their incomes on consumption than the rich, expanding the sales tax also reduced the progressivity of Saskatchewan’s tax system.

Certainly, the government’s tax reforms included some progressive measures such as increasing tax credits, eliminating the 2% flat tax, and introducing partial sales tax rebates. These changes would be commendable had they not been made in the context of reducing the differences between tax brackets and shifting much of the tax burden from income to consumption.

Although there are different ways of measuring progressivity, most supporters and opponents of the government’s policy agree that it made the tax system less progressive. There is no doubt whatsoever that the benefits of these reforms increase—both in absolute dollars and as a proportion of income—as one moves up the income scale. Because the poor must spend a larger share of their incomes on consumption than the rich, expanding the sales tax also reduced the progressivity of Saskatchewan’s tax system.
These tax changes were promoted and defended on the basis that they would propel economic growth and employment in Saskatchewan, or at least stem the migration of people and business out of the province. The debate about whether, or how much, tax rates influence prosperity and out-migration needs not be repeated here. Since the tax reforms introduced in 2000 were not fully implemented until the end of 2003, and since their effects cannot be separated from those of other changing factors, whether they achieved their stated objective of “creating growth and opportunity” remains an open question.7

Royalty Reductions

In addition to cutting taxes, the government has greatly decreased resource royalties. In effect, it has reduced the price that firms must pay the province to exploit its reserves of non-renewable resources. When the Calvert government cut oil and gas royalties recently, it suggested that lower royalties would stimulate so much additional economic activity as to increase provincial revenues. While there is no doubt that lower royalties have expanded the petroleum sector by making new investment in it more profitable, it is wildly optimistic to believe that they will augment provincial revenues.

Figures from the Mineral Statistics Yearbook, expressed in constant 2000 dollars, paint a much different picture. Between 1975 and 1982, Saskatchewan’s oil and gas sales averaged $1,705 million per year. During this period, the Blakeney government collected an average of $848 million per year in oil and gas royalties. Between 1983 and 1991, oil and gas sales amounted to $2,387 million per year, and the Devine government collected an annual average of $640 million in royalties. Between 1992 and 2000, sales were $3,264 million per year, and the Romanow government collected only $567 million per year in royalties. As a percentage of sales, royalties were lowered from 50% under Blakeney to 27% under Devine, to 17% under Romanow.8

These figures show that dramatic reductions in provincial royalty rates have facilitated a massive expansion of Saskatchewan’s oil and gas sector over the past quarter-century. However, this growth has not increased provincial oil and gas revenues. On the contrary, lower royalty rates have meant significantly lower royalty revenues.
...the number of jobs created in the petroleum industry by forgoing royalty revenues will be limited by the fact that its operations employ very few people relative to the capital invested, and are largely headquartered outside the province. Collecting these revenues and transferring them to other areas of Saskatchewan’s economy would have created many more jobs.

In effect, Saskatchewan people financed industry expansion during the Devine and Romanow periods by forgoing millions of dollars of royalty revenues every year. The Calvert government’s royalty reductions will increase this transfer of funds from the people of Saskatchewan to oil companies. While increased profits will generate additional corporate tax revenue, it will be only a fraction of lost royalty revenue since corporate tax rates are much lower than royalty rates.

The provincial government also argues that increased industry activity will create many jobs in Saskatchewan. However, the number of jobs created in the petroleum industry by forgoing royalty revenues will be limited by the fact that its operations employ very few people relative to the capital invested, and are largely headquartered outside the province. Collecting these revenues and transferring them to other areas of Saskatchewan’s economy would have created many more jobs. Reducing royalties is therefore likely to eliminate more jobs than it creates.9

Furthermore, the economic activity created by lower royalties is tied to the emission of more greenhouse gas. In implementing the Kyoto Accord, the government of Canada will tax or restrict greenhouse-gas emissions, creating a regime under which it would be more appropriate to increase royalties with the aim of extracting more revenue from a reduced volume of oil and gas production. In this context, one wonders why the provincial government has embarked on an economic development strategy of increasing Saskatchewan’s fossil-fuel output and the associated emissions.

Although oil and gas royalties are most significant, the provincial government has also reduced royalties on other resources. In 2002, for example, “the government brought in a ten-year royalty tax holiday for new gold and base metal mines.”10 In other words, it has committed to give away Saskatchewan’s finite gold reserves for a decade to promote the limited activity required for their extraction.
Royalty reductions increase resource production and the short-term economic activity associated with it, but reduce the return that Saskatchewan people receive for the exhaustion of their non-renewable resources and accelerate the depletion of Saskatchewan’s natural environment. In doing so, they place business interests ahead of the public interest and run contrary to social democratic values.

Foreign events have driven the world price of oil to well above U.S.$ 30 per barrel since 2002. Because investment and production decisions for this period were made on the expectation that oil would be worth about U.S.$ 20 per barrel, this large price increase has created huge windfall profits in Saskatchewan’s petroleum industry. Arguably, such profits should accrue to the people who own this resource rather than to the companies that extract it.

Following this rationale, the Blakeney government greatly increased royalty rates in response to similar price shocks in the 1970s. Because royalties are set as percentages of price, some of the present windfall is accruing to the provincial government by default. But since the Calvert government took no positive action to collect a greater portion of this windfall, most of it is landing in the oil industry’s hands. In fact, as is mentioned above, the Calvert government chose to reduce royalty rates further during this time of unexpectedly high prices. Current oil prices, and the huge windfall profits they imply, cry out for a more activist resource policy and higher royalties in Saskatchewan.

Royalties and Equalization

Cabinet ministers in the Romanow and Calvert governments have deflected calls for higher royalties by suggesting that any gains in resource revenues would be offset by lost equalization revenues. Perhaps because this suggestion is misleading, no one has set it out in writing. In a recent and highly publicized paper, economist Thomas Courchene criticized the effect of Canada’s present equalization system on Saskatchewan’s oil and gas revenues. The equalization formula employs a “five-province standard,” consisting of British Columbia, Saskatchewan, Manitoba, Ontario, and Quebec. Saskatchewan produces by far the most oil
In addition to collecting greater resource revenues from a somewhat smaller volume of resource extraction, higher royalty rates could allow Saskatchewan to retain more equalization revenues. . . . the interaction of equalization payments and resource production provides a further rationale for higher royalties, not an argument against them.

However, provinces gain or lose equalization due to the size of their tax bases not due to the amount of revenue they choose to collect from these bases. (If equalization were just inversely related to own-source revenue, provinces would have little incentive to collect own-source revenue.) For each of the 33 bases covered by equalization, a province gains (or loses) an amount equal to the “national average tax rate” for that base multiplied by the difference between the average base of the five-province standard and its own base.

Thus, Saskatchewan loses equalization primarily due to the value of its resource base, not due to the rate at which it taxes this base. However, the rate it applies could affect the size of its base. If Saskatchewan significantly increased its oil royalties, the national average tax rate for oil would rise only marginally (because this average is dominated by Alberta’s royalty rates) but its oil production would contract somewhat (because some marginal production would be made unprofitable). Under the equalization formula, a marginally higher national average tax rate and somewhat less oil production would mean a smaller oil tax base and hence a smaller loss of equalization for Saskatchewan.

In addition to collecting greater resource revenues from a somewhat smaller volume of resource extraction, higher royalty rates could allow Saskatchewan to retain more equalization revenues. Whether or not the government of Saskatchewan chooses to raise royalties, it should, of course, lobby the government of Canada to limit the energy-related offsets imposed through equalization. However, the interaction of equalization payments and resource production provides a further rationale for higher royalties, not an argument against them.
Forgone Revenues

Overzealous tax and royalty cuts have contributed to a substantial gap between revenues and expenditures, which has been filled by depleting the Fiscal Stabilization Fund (FSF). This Fund was created in 2000 from the retained earnings of Saskatchewan’s Liquor and Gaming Authority and was intended to absorb small provincial surpluses and deficits, maintaining its value at about 5% of provincial revenues. It is now being drawn down so rapidly that the Department of Finance estimates that the FSF will disappear in the 2004/05 fiscal year. Only by exhausting its limited financial reserves has the government (temporarily) prevented its tax and royalty cuts from reducing public expenditures. However, the fact remains that every dollar forgone through lower taxes and royalties is a dollar not available for public services or wealth redistribution.

Economist Gary Tompkins suggests that the FSF muddied the trade-off between cutting taxes and funding public programs: “The myth of the balanced budget may allow the government to persuade us that both goals have been and can be accomplished. Would a government facing a $225 million deficit [2002/03 budget estimate] have continued with the personal income tax reductions given demands for higher funding?”

Third quarter estimates indicate that the government will withdraw $464 million from the FSF in 2003/04. The exhaustion of the FSF will therefore leave the government facing a deficit of half a billion dollars in 2004/05 unless corrective action is taken.

Public discussion of this looming deficit has been dominated by the notion that the provincial government has a “spending problem.” But nominal spending increases since the late 1990s must be understood in the context of deep spending cuts in the early 1990s. The government of Saskatchewan balanced the provincial budget by laying-off healthcare workers, running down medical equipment, not maintaining highways properly, and allowing schools and municipal infrastructure to erode. Such measures may have been necessary responses to a fiscal crisis, but they were certainly not sustainable: healthcare workers had to be rehired, worn-out equipment had to be replaced, highways had to be repaired, and other infrastructure had to be kept up.

To a large extent, the provincial budget was balanced by deferring public expenditures that had to be made at some point. Cutbacks in the past necessitate increased provincial spending in the present. Unfortunately, the government of Saskatchewan has delivered unprecedented tax and royalty cuts, depriving itself of the revenue needed to fund these inevitable increases.
In 2003/04, the government’s personal tax cuts cost it about $240 million. The annual cost of reduced royalties is similarly in the hundreds of millions of dollars.\textsuperscript{20} Saskatchewan’s half-billion-dollar deficit is thus attributable to tax cuts costing a quarter of a billion dollars and royalty reductions costing at least a quarter of a billion more.

New Democrats condemned the Devine government for creating an imbalance between revenues and expenditures by cutting taxes and royalties. In the 1999 and 2003 elections, the NDP warned that the Saskatchewan Party would probably do the same thing if handed the reins of power. Unfortunately, the Calvert government’s own fiscal policy has followed much the same pattern.

A major argument to justify tax and royalty reductions is that they were needed to maintain Saskatchewan’s competitive position despite their cost. It is certainly true that Saskatchewan must keep the magnitude and progressivity of its taxes within the same ballpark as other Canadian provinces, as it has always done. However, our province need not match the lowest standard set by Alberta, as the government of Saskatchewan has attempted to do. In any case, tax competition against Alberta is an unaffordable economic strategy.

Similarly, the royalty regimes of other jurisdictions affect Saskatchewan’s ability to extract revenue from its resource sector. However, the historical record shows that Saskatchewan was successful in maintaining its oil and gas royalties well above Alberta’s for years, and Saskatchewan faces very little competition with respect to the other major resources it produces. In any case, the evidence suggests that this province’s current fossil-fuel royalties are effectively below Alberta’s.\textsuperscript{21} The Romanow and Calvert governments cut taxes and royalties more than may have been necessary to keep Saskatchewan competitive.
Reduced Expenditures

By dramatically cutting income taxes and resource royalties, the government has significantly reduced the funds available to finance improved public services or increased wealth redistribution. The first publicly visible signs of this trend were the temporary hiring freeze on the civil service, the sudden merger of several government departments, and other disruptive ad hoc measures near the end of the 2001/02 fiscal year.

Defenders of the provincial government argue that, while some revenue has been forgone and some adjustments have been made, social democratic projects are still being financed. In the months preceding the 2003 election, the government of Saskatchewan announced $46 million over 4 years, in partnership with the federal government, for the Centenary Affordable Housing Program, $2.7 million over 6 years for the Indigenous Peoples Health Research Centre, $3.2 million to improve social assistance and employment opportunities for people with disabilities, and $13.4 million over 4 years, in partnership with the government of Canada, for additional childcare spaces.22

All of these initiatives are well intentioned and will do some good, but they must be placed in perspective. The few million dollars spread over several years—in conjunction with the federal government—for social democratic initiatives pale in comparison to the hundreds of millions forgone every year by Saskatchewan alone through low taxes and royalties. Had the government not cut taxes and royalties, it would have the funds to make substantial new investments in public services and wealth redistribution.

Of course there are bright spots in the government’s operating-expenditure budget of almost $6 billion. Clearly, Saskatchewan’s provincial expenditures are doing much good. The same can be said of public spending in every province. The real question is whether the government increases or decreases the proportion of provincial resources devoted to public purposes. This can be measured by examining provincial expenditures as a proportion of provincial Gross Domestic Product (GDP). After having greatly reduced provincial spending relative
to GDP in balancing the budget, the Romanow government began to restore it between fiscal year 1996/97 and 1998/99. But after this point, the Romanow and Calvert governments again consistently decreased expenditures as a share of GDP. Had the government simply maintained its revenues as a constant share of GDP rather than reducing them, its financial problems would not have emerged.

But where does Saskatchewan stand with respect to other Canadian provinces? If the NDP is more committed to public services and wealth redistribution than other major political parties, one would expect Saskatchewan—one of only two provinces governed by the NDP—to have comparatively high provincial expenditures as a proportion of GDP. In fact, Statistics Canada figures for the last fiscal year (2002/03) show that Saskatchewan’s provincial expenditures were the third lowest among the 10 provinces, relative to GDP. The only provinces that spent proportionally less than Saskatchewan were the two that then had intensely neo-conservative governments, Alberta and Ontario.

The view that Saskatchewan’s public spending is out of control is often supported with figures showing rising provincial expenditures in current dollars, which take no account of inflation and economic growth. Examining spending relative to GDP clearly dispels this view.

Another common refrain is that rapidly rising healthcare costs are pushing Saskatchewan into deficit and encroaching on other expenditures. While controlling health spending is an important priority, this issue has been blown out of proportion. Healthcare costs are growing more rapidly as a share of provincial spending than they are as a share of the economy because provincial spending is being reduced relative to the size of the economy. These increased spending demands would be less ominous in the context of a budget growing at the same rate as the economy, or faster. Again, the underlying problem is that deliberate decisions have been made that reduce the portion of Saskatchewan’s GDP available for provincial spending, both over time and relative to other provinces.
Local governments can compensate for this lack of provincial spending only to a limited extent, if they have the political will to do so at all. For example, the shortage of provincial funding for municipalities and school boards has forced them to increase property taxes in Saskatchewan to nearly the highest level in Canada simply to maintain basic local services. Since low-income homeowners must pay about 10% of their incomes in property taxes, while high-income homeowners pay less than 2%, this is an extremely regressive way to raise revenue.25 The burden of property taxes also falls disproportionately on senior citizens and rural residents. Reductions in progressive provincial taxes and royalties have thus decreased provincial expenditures relative to GDP and increased regressive local taxes.

The notion of “pragmatism” is frequently invoked to explain apparent deviations from social democracy. But what does this concept mean? To this author, it means being flexible about the mechanisms used to advance one’s political values and willing to make compromises in advancing those values. It does not imply or justify implementing policies contrary to one’s political values.

The Romanow and Calvert governments opted to cut Saskatchewan’s income taxes and decrease the return that Saskatchewan people receive for the depletion of their non-renewable resources, thereby reducing the proportion of Saskatchewan’s economy available for public services and wealth redistribution. These decisions do not advance social democracy by unorthodox methods or at a compromised pace. They constitute a movement away from social democratic values.

A Social Democratic Agenda

Implementing a policy agenda based on social democratic values requires increased expenditures on public services and wealth redistribution. If the government of Saskatchewan chooses to balance the provincial budget by cutting spending back to match revenues depressed by tax and royalty cuts, it will not be able to make such expenditures. Balancing the budget through a combination of spending cuts and revenue increases could be presented as a reasonable compromise. However, it would have the effect of further reducing the already low proportion of GDP devoted to provincial spending and thereby deprive the government of the resources needed to carry out any semblance of a social democratic agenda.
...significant expenditure reductions will simply complete a classic conservative fiscal strategy: cut taxes, create a deficit, and use it to justify cutting spending. This pattern makes sense if one’s goal is to reduce the role of government in society to foster equality of opportunity and negative freedom, but the NDP is ostensibly committed to greater equality of condition and positive freedom. Harbouring an intangible commitment to left-wing social policy while implementing right-wing fiscal policy does not serve these values.

If the government of Saskatchewan wishes to carry out a social democratic agenda, it must make up the revenue shortfall that created the present deficit. Although several revenue sources are worthy of attention, only higher income taxes and resource royalties have the potential to balance the budget without further constricting public expenditures. Income taxes can be structured to raise funds overwhelmingly from those most able to pay. Resource royalties can ensure the people of Saskatchewan an adequate return on the depletion of their non-renewable resources. To expand public services and redistribute more wealth, the provincial government must adopt a fiscal policy that reverses its recent reductions in income taxes and resource royalties, and instead collects more revenue through these mechanisms.
ENDNOTES


3 Ibid., xvii.


5 The chartered accountants who proposed the government’s tax reforms estimated that, in 2003/2004, the income tax cuts would cost $427 million and the sales tax expansion would raise $187 million. Jack Vicq, Charlie Baldock, and Shelley Brown, *Final Report and Recommendations of the Saskatchewan Personal Income Tax Review Committee* (Regina: Government of Saskatchewan, 1999). However, the reforms implemented by the government differed slightly from those proposed by the accountants.


9 Ibid., 12-15.


12 The author thanks Dr. Thomas Courchene and Dr. Robin Boadway, both of Queen’s University, for reviewing a draft of this section for its accuracy in describing the equalization system and its implications. Of course, the author takes full responsibility for any errors or omissions.

13 Although this claim has not appeared in writing, the author has heard more than one cabinet minister make it. Others also report receiving this response to calls for higher royalties.


20 Vicq, Baldock, and Brown, *Final Report and Recommendations*, 39 (Table 11) and Weir, *Oil and Gas Royalties*, 27.

21 Statistics Canada data on provincial royalties and the value of production cited in Weir, *Oil and Gas Royalties*, 1, 19-20, and 28. In addition to this evidence, Canadian Association of Petroleum Producers data shows that, in 2001, before the Calvert government’s royalty cuts, Alberta produced 1.7 times as much crude oil as Saskatchewan, but collected twice as much in crude oil royalties and taxes. Similarly, Alberta produced 17 times as much natural gas as Saskatchewan, but collected 31 times as much in gas and byproduct royalties and taxes. “Mining Week,” page H7.


23 Jason Clemens, Joel Emes, and Nadeem Esmail, *Saskatchewan Prosperity: Taking the Next Step* (Vancouver: Fraser Institute, 2002), 40-42 (especially Figure 6, which shows consolidated provincial-local expenditure as a percentage of Saskatchewan’s GDP.)

24 As a share of 2002 GDP, consolidated 2002/2003 provincial expenditures were 31.1% in Newfoundland and Labrador, 31.7% in P. E. I., 27.6% in Nova Scotia, 30.0% in New Brunswick, 26.9% in Quebec, 17.3% in Ontario, 25.9% in Manitoba, 23.0% in Saskatchewan, 15.7% in Alberta, and 24.2% in British Columbia. The author calculated these percentages using the “Consolidated provincial government, revenue and expenditures, provinces and territories” and “Gross domestic product, expenditure-based, provinces and territories” data available at www.statscan.ca.