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Dialogues

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alberta's piggy bank

investing natural resource wealth

Our Vision

A dynamic and prosperous West in a strong Canada.

Our Mission

A leading source of strategic insight, conducting and communicating non-partisan economic and public policy research of importance to the four western provinces, the territories, and all Canadians.

In 1970, the *One Prairie Province? A Question for Canada* conference was held in Lethbridge, Alberta. Sponsored by the University of Lethbridge and the Lethbridge Herald, the conference received considerable attention from concerned citizens and community leaders. The consensus at the time was that research on the West (including British Columbia and the Canadian North) should be expanded by a new organization.

To fill this need, the Canada West Foundation was established under letters patent on December 31, 1970. The first Canada West Council was elected in June 1973.

Since that time, the Canada West Foundation has established itself as one of Canada's premier research institutes. Non-partisan, accessible research and active citizen engagement are hallmarks of the Canada West Foundation's past, present, and future endeavours. These efforts are rooted in the belief that a strong West makes for a strong Canada.

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letter from the editor

robert roach, director of research
canada west foundation

the future is now

I will be honest with you—I spend everything I earn and save nothing for the future. I know this is a really bad idea, but the future seems far away. I have bills to pay and things to do! I work hard and I want to spend my money today—not 20 or 30 years from now. Hence, I feel somewhat hypocritical arguing that my fellow Albertans and I should resist the temptation to spend the billions of dollars of natural resource revenue the province is collecting on our behalf and, instead, sock most of it away for our collective future. But just as it is extremely foolish for me not save for my personal future (given that, unlike others who are not making enough to live on, I have this option), it is equally foolish for Albertans not to save for their collective future.

This notion of saving a portion of Alberta's natural resource revenue for future use is the theme behind this edition of **Dialogues.** Injecting this notion into a debate dominated by discussion of how to *spend* the surplus created by unusually high prices for oil and natural gas is the primary goal of the Canada West Foundation's **Investing Wisely Project.**

The Project, and the idea of saving for the future that it propagates, rest on the argument that the revenues derived from non-renewable natural resources are *different* from other sources of government revenue such as a tax on income.

When a government collects more income tax revenue from its citizens than it needs, there is a very strong case for giving it back to the people who paid it. The revenues that flow from the oil, gas and bitumen trapped beneath the surface of Alberta, however, are not collected from individual Albertans. Albertans did not work for this money. Albertans benefit from oil and gas wealth, not because they helped generate it, but because they happen to live in Alberta. Rig workers, geologists, engineers, office managers and others employed in the oil patch (and the investors that put up the money) can make this claim (and are rewarded for their efforts by the market), but not Albertans as a group. As a result, the case for "giving back" the extra money is weaker than it may seem at first blush.

This argument, however, is not strong enough to counter the idea of simply taking the excess revenue (and not just the small portion set aside for the recently announced resource rebate program) and cutting a cheque to each Albertan. So what if we didn't earn it? As Albertans, we own the resource and we pay lots of other taxes, so why not just divvy up the surplus amongst us and be done with it?

The answer lies in other factors that differentiate between natural resource revenues and other sources of government income. Perhaps the most important difference is that, unlike the money collected from taxpayers each year by way of income taxes, property taxes, capital gains taxes, sales taxes, corporate taxes (which leave less money in the hands of owners and investors), alcohol taxes, hotel taxes and so on, natural resource revenues are derived from a source of wealth that belongs not only to current Albertans, but to future ones as well.

Albertans have a *duty* to manage the province's bounty of natural resources so that some of it is left for future generations. Simply put, our kids deserve a cut. The best way to carry out this duty is

to take some of the cash generated by the resources—before they run out and while they are fetching a high price—and put it in the bank so future Albertans have access to it in the form of interest earned. The idea is to transform a fleeting source of income into a permanent one. If Albertans spend it all today on programs, tax cuts or dividend cheques, they should do so knowing that they are spending the inheritance of future generations.

But what about the revenues that will flow from the millions of barrels of oil trapped in Alberta's oil sands? Won't this be available to future generations? The problem is that the answer is "maybe it will be, maybe it won't be." We can only *guess* how much public revenue will be derived from the high risk business of oil sands extraction. If history is any guide, it pays to save when you have the chance. Just as I should be saving for my retirement while I have money coming in, so, too, should Albertans be saving for a time when oil and gas revenues may not be what they are today. This brings to mind the now legendary, and colourfully worded, bumper stickers that appeared after a previous boom and bust cycle: "Please Lord, give us another oil boom and we promise not to piss it all away."

It is worth repeating that it is not just children born 20, 50, or 100 years from now that will benefit. The interest earned on an investment fund benefits *current* residents, too. The billions of dollars of interest generated over the years by the Alberta Heritage Savings Trust Fund have been enjoyed by Albertans who made the original investment and by those who live in the province today. It will also be available to future Albertans.

This points to another argument for saving a portion of natural resource revenues (especially when prices are high). This argument arises out of the notorious volatility of oil and gas prices and, in turn, the wild swings (up and down) in the revenues Alberta collects from the oil and gas sector. While it is tempting to spend the money as it comes in—be it on a program like education, on tax cuts, or on dividend cheques—saving some of it has two main advantages: sustainability and predictability. By transforming a depleting and volatile natural resource into a stable and permanent financial resource, a savings strategy provides a relatively stable stream of income that Albertans can use *year after year.* And, like any well-managed savings portfolio, the earnings are likely to exceed the original investment. We can, in other words, get more bang for our buck by investing now and spending the income earned by the principal at a later date.

The goal is powerful and simple: to transform what is likely to be a short-lived resource bonanza into a permanent financial resource, the earnings of which can be used by both current and future generations as they see fit. It is about both sustainability and accountability.

Instead of a short-term tax cut, a permanent one is possible. Instead of issuing dividend cheques only when times are good, cheques could be sent every year for the foreseeable future. Instead of an unsustainable spending spree, programs like health and education could receive additional annual funding. The choices would be up to Albertans, and they would be available regardless of the price of oil and natural gas. This is the beauty of the savings option.

Public opinion data suggest that the Canada West Foundation and the Government of Alberta (which has committed to save some of the current surplus for the future) have an uphill battle to wage in terms of popularizing the savings option. According to a recent Canada West Foundation survey, only 33.5% of Albertans support a savings program. But, it is not always the job of think tanks or governments to follow—sometimes it is necessary to lead.

A NOTE ABOUT OTHER PROVINCES AND THE INVESTING WISELY PROJECT

The Canada West Foundation has a mandate to conduct projects of importance to all four western provinces. So why a project on a fiscal issue in Alberta? Although focused on the unique situation in Alberta (Alberta is the only government that has no official debt and is home to the majority of Canada's oil and gas reserves), because what Albertans decide to do with their wealth is of no small importance to the rest of the region and the rest of the country, the **Investing Wisely Project** is relevant outside Alberta as well as within it. To this end, we have invited a number of authors from outside the province to contribute to this edition of **Dialogues** and to the discussion of how best to manage natural resource revenues.

I will also note here that, contrary to some critics, the idea of Albertans thinking beyond our borders is not tantamount to supporting a new National Energy Program. Albertans are part of a great country and what we do affects our brothers and sisters to the west and east of us. It is up to Albertans as the stewards of the natural resource wealth found within our borders to think regionally and nationally and not just provincially. This does not mean that we *have* to share our wealth (beyond what we already contribute through the tax system), and it certainly does not mean that it should be confiscated by the federal government and redistributed as Ottawa sees fit.

What it means is that Albertans have an opportunity to consider using some of our wealth for ends that extend beyond the province. Alberta's self-interest need not be forgotten in these deliberations. Helping to finance transportation infrastructure in BC with the earnings generated by an investment fund, to name but one example, would help bring Alberta's exports to international markets. Albertans have an opportunity to come up with and debate made-in-Alberta ideas for strategically sharing our wealth. The goal here is not simply to head off externally imposed methods of addressing the fiscal imbalance created by Alberta's good fortune (though this is not a bad thing), but for Albertans to have an informed debate about what to do with our natural resource revenues that includes the idea of sharing some of it with our neighbours.

The **Investing Wisely Project** explores three key issues: 1) the case for saving a portion of Alberta's non-renewable natural resource revenues for future use; 2) creative and strategic ways of using the earnings on the saved revenues to transform the province in positive ways; and 3) Alberta's oil and gas resources in a regional and national context. The project is funded by over 60 foundations, businesses and individuals. The Foundation expresses its sincere thanks for this generous support.

Managing and Protecting Alberta's Petro-Wealth

Peter Holle

Rising world demand for energy in the face of constrained supplies finds Canada's major oil producer, Alberta, in the enviable position of generating huge budget surpluses from burgeoning oil revenues. How should this wealth be managed?

Disproportionate oil wealth can have a downside. The Third World is replete with examples of failed oil states, where the wealth is wasted by ruling elites living in corrupt luxuriance or by a bloated public sector with massive government payrolls and artificially inflated wages and salaries. The inevitable cost is a suffocated private non-oil economy that pays the cost of maintaining inefficient state service monopolies.

Alberta is certainly no Third World basket case, but its rapidly expanding public sector is capturing a rising share of the recent increase in oil wealth. Between 1996-97 and 2005-06, a period during which Alberta's population increased by 17% and inflation ran at 19%, provincial government spending doubled. In 1996-97, Alberta had annual interest payments of $1.5 billion. Today, its interest payments are rapidly approaching zero, yet the savings are going into more program spending. Taken together, the government is spending 44% more per capita than it was a decade ago.

Alberta now spends about the most per capita on public services such as healthcare. Rather than embracing effective and tested reforms, such as injecting competition into the medical marketplace by buying services from competing private suppliers, it chose to put more resources into this expansive public sector monopoly. Public sector wage inflation in Alberta's health sector then spills over into other provinces of more limited means, which then drives calls for more federal funding and subsidies. The same happens for other public services.

As many Albertans will remember, the oil business can fluctuate widely. At some point, much like California which pumped up base spending on its public sector during the dot-com boom of the late 1990s, it is likely that Alberta will once again undergo a painful contraction of the public sector when revenues fall.

The answer to this painful cycle lies in the adoption of what former New Zealand Finance Minister Ruth Richardson calls a fiscal constitution. In 1994, she installed the *Fiscal Responsibility Act,* which required a high level of fiscal transparency in government. She now believes it did not go far enough and recommends the model be improved quantitatively by imposing

an absolute limit on the size of government, and qualitatively by insisting that all government spending achieve the goals it purports to advance.

During a Calgary speech to the Frontier Centre in April, Richardson called for Alberta to introduce competitive structures in its largest spending envelopes—health, education and social services—to ensure that they are accountable, effective and responsive to public needs. "If you're rich," she says, "you can afford to be stupid far longer than when you're poor." She urged Albertans to use the opportunity presented by its resource-based windfall to squeeze underlying inefficiencies and subsidies out of current public spending.

One way to address these concerns is to commit the revenues above population growth and inflation into an Alberta version of the Alaska Permanent Fund.

In her opinion, spending limits are the key and one of her favourite models can be found in Colorado. TABOR, short for that state's Taxpayer Bill of Rights, was embedded in Colorado's constitution by a 1992 referendum. Its stated goal is to "reasonably restrain most [of] the growth of government." It links state spending increases to a simple formula based on population and growth and applies to all government entities in Colorado, including cities. If revenues exceed population increase plus inflation, the funds must be rebated to the public or a vote is held where the politicians ask permission to keep the extra cash.

A study of the law's aftermath, *A Decade of TABOR* (available at www.fcpp.org) details its benefits. The stability and predictability of the tax climate prompted strong economic growth. Private-sector jobs increased at nearly double the rate of government jobs. Instead of starving government, these consequences allowed it to spend more in tandem, at a per capita growth rate of 72% over the decade. Between 1997 and 2001, TABOR's rebate mechanism returned US $3.25 billion in surplus revenues to taxpayers. When other state governments faced recession and collapsed revenues in 2000, Colorado largely sailed through.

Had such a fiscal constitution been operating in Alberta, resource constraints on the public sector would have led to more policy innovation, particularly the introduction of competition into public services. In addition, according to calculations by the Canadian Taxpayers Federation, by limiting spending growth to population increase plus inflation, the province would have had room to eliminate the provincial income tax. Both scenarios scare provinces mired in old policy models and fearful of tax competition.

One way to address these concerns is to commit the revenues above population growth and inflation into an Alberta version of the Alaska Permanent Fund—an endowment fund operated at arm's length from the state government by independent managers who are obliged to follow the "prudent investor rule" of seeking the highest return with no consideration of social or political goals. Averaged over five years, 10.5% of its earnings go directly back to citizens, who exercise direct control over the distribution of the Fund's earnings. If the state government wants to spend more, it must put the matter to a vote. Like the fiscal constitution, this fund is designed explicitly to prevent the excessive capture of oil wealth benefits by politicians and public sector interest groups.

Lastly, Alberta's wealth is exposed to danger from other provinces. Ottawa is facing pressure to increase equalization transfers to "have not" provinces, which discourages investment there and creates provincial-scale welfare traps with uncompetitively high levels of taxation and government spending. Alberta needs to support aggressive reform to equalization. It might commit, for example, to co-investing with the federal government in a one-time buyout of the subsidy stream, whereby debt is transferred to the federal government in exchange for the end of transfer payments.

Oil sands production in northern Alberta. Photo used courtesy of Shell Canada Limited.

In short, to preserve its resource wealth Alberta must make sure it ultimately ends up in the hands of the private, not the public sector.

Peter Holle is President of the Frontier Centre for Public Policy, an independent think tank based in Winnipeg (www.fcpp.org).

What do Albertans **Think?**

Loleen **Berdahl**

Do Albertans care about future generations enough to save oil and gas surplus revenue for their use? At first blush, the answer appears to be "no," or at least "not very much."

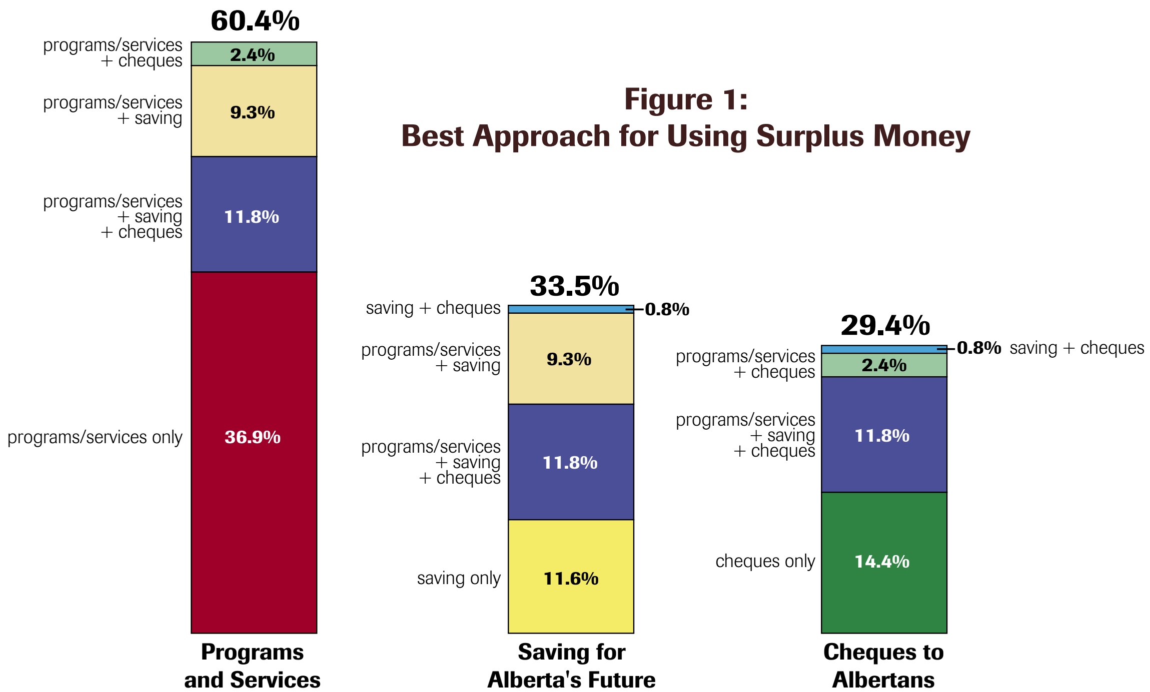
In late September, the Canada West Foundation and the University of Alberta conducted a public opinion survey of 507 adult Albertans. This random cross section of Albertans was asked about the use of the year-end surplus. (For a complete analysis of the survey results, as well as a description of the methodology and survey questions, please see Dr. Harvey Krahn's report, *Save or Spend? Albertans' Preferences Regarding the Year-End Surplus*, available at www.cwf.ca).

When asked how Alberta should spend its money, relatively few of the respondents stated that the money should be saved for the province's future. Instead, Albertans want to see oil and gas surplus revenues used to fund improvements to Alberta's programs and services. When asked to identify what approach to spending money they preferred, six in ten Albertans pointed to program spending, either alone or in combination with savings and/or cheques to individual Albertans, as the best use of the surplus revenues (see Figure 1 below). In contrast, only one-third of Albertans mentioned saving for the province's future, either alone or in combination with program spending and/or cheques to individual Albertans. Clearly, Albertans are more interested in spending the windfall cash now than in saving for a rainy day, for their future grandchildren, or for their grandchildren's grandchildren.

Does this imply that Albertans are selfish, shortsighted, or greedy? I don't think so. Indeed, given the hardships and cutbacks the province endured in the name of debt elimination in the 1990s, a desire for increased program spending should not be surprising. Albertans withstood large cuts in public services, programs and administration, all with the promise of a better tomorrow.

Well, tomorrow has arrived, and Albertans appear to be tired of being one of the wealthiest jurisdictions in North America and still going without. They are tired of medical waiting lists, and news stories about critically ill Alberta babies being sent to Saskatchewan hospitals due to a lack of beds. They are tired of insufficient roads and public infrastructure. They are tired of growing homeless populations,

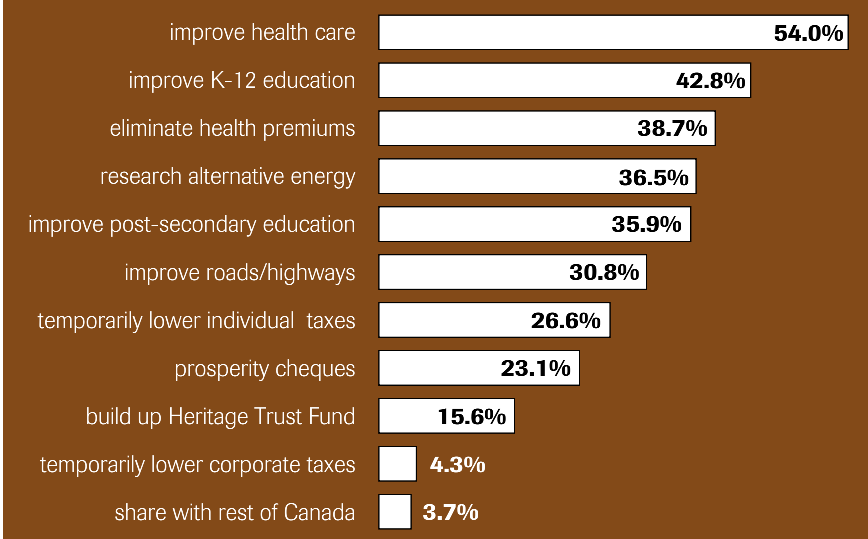
Figure 1:
Best Approach for Using Surplus Money



of continued affordable housing shortages. Albertans cannot be blamed for expecting to lead the country in quality of programs and quality of life, or for wanting the province to be defined by excellence–or, at the very least, adequacy. And they cannot be blamed for wanting to enjoy these spoils now, rather than sometime in the distant future.

For years, public opinion surveys–including the Canada West Foundation's *Looking West Survey* series–have shown that Albertans place high priority on improving programs and services, and that they rank this need ahead of other policy options, such as tax cuts. This suggests a strong desire for widespread improvements in the province's quality of life, ahead of the desire for the individual financial benefits that tax cuts or "prosperity cheques" to Albertans would bring.

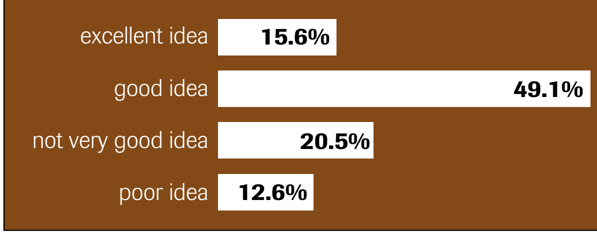
Figure 2: "Excellent" Uses of Surplus Money



The recent Canada West Foundation survey shows continued support for using public money to improve programs and services (see Figure 2). In particular, there is interest in improving health care and education in the province. In contrast, there is less vigorous interest in tax cuts and prosperity cheques (although many Albertans would like to see health care premiums eliminated), and even less interest in building up the Heritage Trust Fund, Alberta's savings account. Simply put, Albertans want to see the oil and gas surplus used to create a better today; they are less interested in socking money away, or in giving it to individual Albertans to help pay off Christmas bills.

But this does not necessarily mean that Albertans are disinterested in ensuring the future wellbeing of the province. Rather than being surprised by the lack of interest in saving for the province's future, I think we should be impressed by the large number of Albertans who do in fact seem open to the idea. After all, few of us have lottery fantasies about prudently investing our winnings. (Luxury homes, elaborate vacations, and big screen TVs, yes; RRSPs no.) Yet despite the natural tendency to value today's wellbeing over a hypothetical tomorrow, and despite the complete lack of debate in the province about building up the Heritage Trust Fund, there is still a strong willingness to pursue this option (see Figure 3). Only one third of Albertans feel that building up the province's savings is a "not very good" or "poor" idea.

Figure 3: Using Surplus Money to Build Up Heritage Trust Fund



This finding suggests that, should the province engage in a larger debate about the use of future surpluses, support for savings is likely to increase. If Albertans were fully informed as to how savings could be used to benefit Alberta's programs, both in the present and in the future, there would likely be greater interest in pursuing this option.

The plans for the 2005 surplus have been made, and debates over these expenditures and investments are, at this time, moot. But, assuming that high oil and gas revenues remain for the years ahead, what should become of future surpluses? There is still considerable time for informed public debate on this topic. Those who favour increased investments should be heartened by the fact that Albertans put savings ahead of individual benefits, and should see the opportunity to increase public support for long-term savings through public information, engagement and education. Who knows–future generations may be able to benefit from Alberta's current riches after all.

Loleen Berdahl is a Senior Researcher with the Canada West Foundation.

CHRIS FAY + BARRY WORBETS

GOING BACK TO THE SOURCE

INVESTING IN NATURAL CAPITAL

Much ink has been spilled over the Alberta Government's recently announced plan to dole out "prosperity cheques" to the residents of Alberta in the coming months. Whatever the merits or pitfalls of this policy announcement, those are now in the past. For the future, it is time to move beyond debate about differences of opinion and look at the bigger picture.

While the Government of Alberta spends its time trying to figure out where to funnel the funds, they are glossing over a very important piece of the puzzle: Alberta's natural assets remain essentially absent from the commentary. Where is the discussion of natural values? Of environmental benefits? Of reinvesting in the very processes that provided us with the "problem" of deciding where to spend a record provincial surplus in the first place?

The most recent Government of Alberta budget pegs total expenditures at $25.8 billion. Of this, $1.7 billion is allocated to postsecondary education, $2.7 billion to social services and some $9.5 billion, or 37% of total expenditure, to the health care system. The budget also earmarks $2.9 billion for Infrastructure & Transportation, a department that will spend a sizeable portion of Alberta's upcoming surplus as well.

Of course, one of the wealthiest jurisdictions in North America should do everything it can to have world-class people, health care and infrastructure. But it should also do everything it can to preserve the power of place that has contributed to the quality of life its residents enjoy today.

The environment consistently ranks as one of the most important issues in surveys of Albertans. However, the investment made by the government in protecting the province's land and preserving Albertans' power of place does not reflect this.

In the 2005 budget, the money allocated to Alberta Environment for "environmental management and stewardship" is $40 million, while Alberta Sustainable Resource Development receives $132 million for "natural resource and public land management," and Alberta Agriculture, Food and Rural Development gets $56 million for "sustainable agriculture."

Comparatively speaking, these numbers do not reflect the value that Alberta receives from its natural environment. Of course, the value of ecological services such as water and air filtration, or of the power of our urban, working and wild landscapes is a lot more difficult to quantify than the return that comes from investing in better universities or a healthier populace. The point is that, in the recent discussion of what to do with the province's surplus, the natural capital variable did not even enter the equation.

A windfall surplus larger than any in the province's history was (and still is) the perfect opportunity to highlight how we should reinvest in Alberta's environment. Yes, the benefits that the oil and gas industry brings to both Alberta and Canada are remarkable; any government in the world would love to be faced with the challenge of how to justly distribute record amounts of revenue. But the effects of the industry on the landscape and the environment are remarkable as well.

Increasing demand for energy is leading to both rapid growth and unparalleled land disturbances in Alberta. The energy industry now fells more trees than the forestry industry on an annual basis. Gas wells are increasingly in conflict with cities and towns. And perhaps most strikingly, the oil sands operations in the northeast corner of Alberta are visible from space.

If Alberta is going to profit from the resources that geography has benefited it with then it must consider reinvesting in the processes that provide these resources. This means linking the discussion about what to do with government revenue to looking at investing back into the land. It means designing public policy and programs that can ameliorate the effects of rapid growth all across Alberta. And it means first and foremost talking about the values and the value that underlie the importance of natural capital.

What could this look like? At its simplest level it involves the provincial government increasing the dialogue on the importance of the land to Alberta. It could mean that infrastructure investments target not only the maintenance and improvement of roads and schools, but of Alberta's public lands and protected spaces as well. It could also mean that more royalty monies are reinvested in the management of our natural assets. Or it could mean a natural capital investment fund, the interest off of which could be used to fund organizations such as water councils or land trusts that are working in non-advocacy roles to protect Alberta's natural capital.

First and foremost, a commitment to Alberta's natural assets and infrastructure requires that the Government of Alberta publicly recognize the benefits that have flowed from the environment, and follow this recognition by contributing back.

Now, more than ever, is the time to focus our attention on the value that Alberta receives from its natural bounty. This is where the real prosperity lies.

Chris Fay is an Intern and Barry Worbets is a Senior Fellow with the Canada West Foundation. Both have been working on the Foundation's Natural Capital Project.

Looming Large

Alberta's Energy Wealth in a National Context

Roger Gibbins

The strategic management of energy wealth is easily the most important challenge that Albertans will face in the years to come. The decisions taken in the next few years, and the public policy trajectory established by those decisions, will quite literally shape Alberta's future for generations to come.

This is why the Canada West Foundation has been so actively engaged in the debate over how best to handle not just current surpluses, but how best to handle the non-renewable natural resource revenues from which those surpluses stem.

However, the management of Alberta's energy wealth is not only an important matter for Albertans, for the decisions taken within Alberta will have regional and national effects; Alberta simply looms too large in the regional and national economies.

As a consequence, the internal debate within Alberta will necessarily spark a national debate; this is both inevitable and appropriate. There is a clear national stake with respect to what happens in Alberta.

These two debates—the Alberta and national debates—will be closely entangled. Decisions made within Alberta will set the terms for, and tone of, the national debate. Whether Alberta's energy wealth will be *seen* as a national asset or a national problem will be determined in large part by the decisions that Albertans make.

In order to think this issue through, let's begin by considering the magnitude of Alberta's opportunity, and therefore Canada's challenge. To provide one perspective, Alberta's forthcoming surplus for 2005/06 is currently estimated to be in the range of $8-9 billion. However, this estimate is just a single snap shot; what we need is a somewhat longer perspective. Here it is useful to consider two ***scenarios.***

The first is what I would call the gravity scenario, or as Premier Ralph Klein says, what goes up must come down. In this scenario, Alberta's current bounty is not expected to last; it will be little more than a short-term blip in the regional and national economies. Proponents of this scenario cite a number of important arguments.

> It is not just a question of how best to handle current surpluses, but how best to handle the non-renewable natural resource revenues from which those surpluses stem.

First, past experience, sometimes bitter past experience, drives home the boom and bust nature of a natural resource-based economy; the Premier is right—gravity works. What goes up comes down, and often with a loud crash.

Second, Alberta's conventional oil and gas reserves are starting to decline, and with that ongoing decline will come a decline in energy wealth.

Third, although a large number of oil sands plants are coming on stream, their production and capital costs are such that the royalty returns to the provincial government will be much smaller than the returns from conventional oil and gas reserves.

Fourth, the "Age of Oil" is coming to an end as the world moves towards alternative and more sustainable energy sources.

The argument, therefore, is that Alberta's current prosperity is transitory, and thus the impact on the regional and national economies should be short-term and relatively light.

As a consequence, in this scenario "Alberta envy" should not be a significant problem for the federal government. If Ottawa just waits, the "Alberta problem" will solve itself as energy prices fall. Alberta envy will evaporate as energy prices tank.

This is not a scenario that should be quickly dismissed. If it does prevail, if what goes up does indeed come down, then the national political system has little to worry about. Canadians will be able to handle the temporary dislocation, and Alberta envy will not generate any serious political response.

It should also be noted, however, that this first scenario suggests that Albertans will have little opportunity to strengthen and transform their own economy, to ensure sustainable communities and prosperity. Camelot may have come and gone before we can even get the chance to cash our prosperity cheques.

Consider, though, a second scenario. Imagine for a moment that, at least for the medium-term, we will not see a return

to low energy prices. Imagine that the recent escalation persists, and indeed, imagine that prices may even continue to rise. Imagine oil prices not at $30 or $40 a barrel, but at $70, $80 or $90 a barrel.

The proponents of this scenario also advance some compelling arguments.

First, given the growth of the Chinese and Indian economies, the global demand for energy resources is unlikely to fall, and in fact will probably rise.

Second, energy supplies are unlikely to increase, and thus the basic demand/supply projection is for increasing rather than decreasing energy costs. If demand grows and supplies are at best flat, prices will increase.

Third, global security concerns will heighten the attractiveness of Alberta energy sources, and the prices paid for Alberta energy. Here I would argue that the odds of a tranquil international security environment are long at best.

Fourth, the general terms of international trade appear to be shifting towards the resource sector and away from the manufacturing sector, a trend that should accelerate a westward drift in the Canadian economy. There is nothing manufactured today in southern Ontario that can't be made somewhere else better and more cheaply tomorrow, whereas the resource base of western Canada cannot be outsourced. Wealth that lies beneath the surface is simply less mobile than is wealth resting on the increasingly frail foundations of a manufacturing economy.

Fifth, although conventional energy reserves may be in decline, Alberta has truly vast reserves with respect to the oil sands, coal bed methane, tight gas and coal.

And finally, although the shift from carbon-based energy sources to alternative energy sources is underway, this shift will not happen over night. The shift will take several decades.

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Add to all of this the fact that the Alberta provincial government is debt free, and you are looking at a formidable and quite likely sustainable Alberta Advantage.

Given this, there is a reasonable chance that Alberta's current prosperity will not be a blip. Instead, it may foreshadow a structural realignment of the Canadian economy. It is quite possible that huge Alberta budget surpluses will roll on, and on, and on.

Now, I am not an economist. However, if I had to bet between the first and second scenarios, if I had to predict $20 a barrel oil or $80 a barrel oil, I would bet on the second scenario and higher energy prices.

If this second scenario does happen, then we have tremendous opportunities in Alberta. However, the national government also faces a much more difficult challenge as Canadians adjust to permanently higher energy prices, to the structural change in the national economy, and to the accumulation of energy wealth within Alberta.

How, then, might Ottawa respond? Perhaps the most important point I want to make is that the response of the federal government will be largely determined by how Albertans decide to handle the influx of energy wealth.

Consider, then, a few things that Alberta might do to set the stage for the national debate.

First, we could significantly cut taxes, thus creating a tax haven within the federation. However, dramatic steps in this direction will pose serious problems for our provincial neighbours, and for the national government. The pressure on the federal government to "do something" would increase.

Second, Alberta could significantly increase public expenditures, thus creating pressures on our neighbours as public sector salaries increase, as we cherry-pick the best and the brightest from around the country. Again, the pressure on the federal government to "do something" would increase.

Third, Alberta could give away the surplus in the form of ongoing prosperity dividends. In this case, Alberta envy would surge. We would be painting a very large target on our chests if other Canadians come to believe that the high prices they are paying for fuel flow directly into the pockets of individual Albertans.

Or, Alberta could invest the surplus funds to ensure greater intergenerational equity, to strengthen our communities, to strengthen innovation and creativity within the province, but in ways that would benefit all Canadians.

This is why the Canada West Foundation is devoting so much time to the development of an investment strategy for Alberta. The stakes are enormous.

An investment strategy will not eliminate Alberta envy. However, it would make Alberta's wealth less of a target because Canadians would be more likely to see that wealth as a national asset. If we invest in medical research, in wellness projects, in sustainable energy, in educational opportunities for Canadians and foreign students, then we not only strengthen the Alberta economy for the long run, but also reduce the external threat.

Now it is important to stress, of course, that Albertans already do contribute substantially to the national community and government through the taxes they pay. Albertans get substantially less back through federal government services than they pay out in federal taxes.

Albertans often cite the equalization program as evidence they are carrying their financial load within the federation. However, the equalization system is based only on the transfer of individual wealth; a lawyer making $80,000 a year in St. John's pays just as much into the equalization program as does a Calgary lawyer making $80,000.

The equalization formula does not address the public wealth that is being accumulated by the provincial government.

I also want to stress that pondering a political response from the national government is not engaging in paranoia; it is simply recognizing that the Canadian government may be as responsive to the 90% of the population that lives outside Alberta as it will be to the 10% who live inside. Perhaps even more so!

My basic point is that Albertans, by the decisions they make, can moderate or exacerbate the strain on the regional and national economies. If we are smart and strategic, we can ensure that Alberta's energy wealth is indeed seen as a national asset, and we can do this without prompting any national raid on the provincial treasury.

This can be done, but not if we just stumble forward, with our fingers crossed and our eyes shut. If there was ever a time for Albertans to be smart and strategic, it is now.

The decisions we make with respect to the management of energy wealth will have huge consequences for Alberta, for the West, and for Canada. Let's get it right. The opportunity is there to seize.

Dr. Roger Gibbins is President and CEO of the Canada West Foundation.
This article is based on a speech given by Dr. Gibbins to the Canadian Club in Calgary on September 28, 2005.

What is your vision for the future of western Canada?

The Canada West Foundation has launched a western Canadian student essay contest with $5,000 available in prize money.

the NEXT West

Generational Transformations

Students in the four western Canadian provinces (age 17-30) are invited to share their thoughts on the future of the region.

How do you see the West changing?

What role do you see for yourself in the West of the future?

What is YOUR vision for the future of western Canada?

Young western Canadian residents (age 17-30) attending (or planning to attend) a post-secondary institution in 2006 are eligible to earn prizes by submitting an essay before March 1, 2006.

To learn more, visit the Canada West Foundation's NEXT West Generation website at: **www.cwf.ca/nextwest**.

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Why leave to **tomorrow** what you can do **today**?

Why the Alberta Heritage Foundation for Medical Research is a Model for Investing Wisely

Kari Roberts

A debate is raging in Alberta today over how best to manage our provincial surplus and natural resource revenue. How should Albertans enjoy the fruits of our good judgment and bountiful natural resources, and still plan for tomorrow? Perhaps we need only look to our recent past for guidance.

The Alberta Heritage Foundation for Medical Research (AHFMR) was established by Peter Lougheed's government in 1980 to fund biomedical and health research at Alberta's universities, affiliated institutions, and other medical and technology-related institutions. Its goal was to improve the long-term health of Albertans by investing in cutting edge medical research in Alberta to benefit and sustain future generations of Albertans. The Foundation began with an initial endowment of $300 million from the Government of Alberta and sustains itself on the interest accrued from this initial investment. Rather than a one-time cash injection of funds, the AHFMR is permanent and self-sustaining; the principal is invested and managed for the purposes of generating the highest return for minimal risk. The AHFMR currently totals approximately 900 million dollars, with approximately 50 million dollars spent each year on funding research programs. The fund generates a respectable degree of annual revenue, but requires no additional expenditure of government funds, although the Klein government did announce plans earlier this year to inject another $500 million over three years to top up the Fund—an affirmation of the success of the Foundation to date, according to its President and CEO, Dr. Kevin Keough.

Since its inception, the AHFMR has contributed more than $780 million to the scientific community and has received international attention and commendation for its contributions to biomedical research excellence. It currently supports over 200 senior researchers and over 300 researchers-in-training.

To underscore its commitment to excellence in research, technology, and service provision, the AHFMR invests in medical research of the highest caliber, consistent with international standards, ensures responsible allocation and management of financial resources, and collaborates with research organizations, the private sector and other granting agencies.

To safeguard and sustain this dynamic research initiative, the autonomy and independence of the AHFMR must be ensured; it remains unimpeded by changing political climates or economic circumstances within the province. This ensures responsible stewardship and garners the respect and trust of Albertans.

The Fund operates independently from the provincial government and is governed by a board of trustees. The Foundation operates in partnership with the federal government and its various institutes of health research, as well as provincial regional health authorities and the Universities of Alberta, Calgary, and Lethbridge.

Among the countless noteworthy initiatives the Foundation has supported are: Dr. Patrick Lee's discovery of the reovirus in 1998, which may be effective in combating certain forms of cancer; Dr. Raymond Rajotte's diabetes research; and Biomira's cancer vaccine research. The Foundation has also sponsored studies on, among other things, research ethics, bone and joint research, heart and stroke research, spinal cord research, and research on sleep disorders, mental illness, gambling addictions and health care service delivery in Alberta—projects that place Alberta researchers on the leading edge of medical research in Canada and internationally.

University of Calgary President and AHFMR Trustee, Dr. Harvey Weingarten, credits the Foundation for helping to attract and retain quality researchers in Alberta. It has helped Alberta's universities reputationally and it has enabled cutting edge research that is admired both nationally and globally. Weingarten notes that it has enabled health care research in Alberta to exceed what might otherwise be expected from a relatively small province of only three million people.

In the words of the visionary Dr. Joe Martin, born in Alberta, Dean of Medicine at Harvard University, and a co-founder of the AHFMR—"the Foundation revolutionized the opportunities for Alberta to recruit outstanding scientists from around the world, to establish world-class research centers with the equipment and tools required to do specialized research, and resulted in the two main universities becoming recognized internationally for their research contributions. Without AHFMR, it is unlikely any of this would have happened."

Investment in the AHFMR showed the kind of leadership and strategic thinking that is not only possible, but necessary. The AHFMR attracts researchers of the highest caliber to Alberta institutions and it has heightened the reputation of Alberta's research facilities. It has taken on a life of its own as an investment whose dividends are innumerable.

It is this kind of proactive thinking that Alberta is currently well placed to repeat. Health services are one of the key priorities of Albertans and an investment in the future is one of the best legacies we can hope to design—and it is within our grasp. Alberta has the potential to be a leader in western Canada.

Perhaps wisdom can be found in the words of Abraham Lincoln who said, "we cannot escape the responsibility of tomorrow by evading it today."

The Alberta Heritage Foundation for Medical Research serves as an excellent example of the degree of ingenuity and wisdom that Albertans have shown in the past, and which, perhaps, represents only the tip of the iceberg in terms of what we could do if we put our heads together, prioritize, and invest strategically in our future—perhaps in areas such as renewable energy or wellness. If we do, our future is guaranteed to be bright, healthy, and sustainable. Let's ensure for decades to come that Alberta remains one of the best places in Canada—and in the world—to live.

Dr. Kari Roberts is a Policy Analyst with the Canada West Foundation.

the elephant in the room
the view from saskatchewan

Ian Peach

Pierre Trudeau once famously described Canada-US relations as being like sleeping with an elephant—one is inevitably affected by every twitch and grunt. For Saskatchewan today, Alberta is the elephant.

For the people in the province who are part of mainstream society, life in Saskatchewan these days is better than it has been in a very long time, and better than in much of the country. Most famously, Saskatchewan has achieved the coveted status of a "have" province. As well, the rate of growth in the province's real GDP was 3.5% in 2004 and 4.5% in 2003, a rate which allows our wealth to double in less than a generation, and has been the highest in Canada for the last two years.

Yet the political discourse in the province is dominated by comparisons to Alberta, rather than the rest of Canada. As one might imagine, the competition with, and demands to emulate, Alberta represent a challenge to policy-makers that they simply cannot overcome. Due to accidents of geology and the way in which the Northwest Territories was divided in 1905, Alberta rests on a huge volume of hydrocarbons. While Saskatchewan benefits from significant natural resource endowments, Alberta has almost eight times our oil reserves and almost fourteen times our natural gas reserves. From natural resources flow wealth, jobs, and tax revenues, and from tax revenues flows the capacity to do the very things that can create destructive interprovincial competition.

While Saskatchewan is the most influenced by Alberta, Alberta's wealth is sufficiently outstripping that of other provinces that the rest of the country is starting to wonder about the equity of the "Alberta Advantage." Thus, not only is it in the interest of Saskatchewan (or Ontario, or Quebec, or other provinces) to ensure that Alberta's resource revenues are managed with one eye on the intergovernmental environment, it is in Alberta's interest. If the Alberta government were to use its wealth to, for example, raise salaries for such important public sector workers as nurses and teachers to a point that would make it impossible for other governments to compete for those much-needed workers, the pressure to expropriate Alberta's windfall for the benefit of the country as a whole could become more than the federal government could (or at least would be prepared to) resist. The intergovernmental conflict created by such a response could well be as serious as in the days of the despised National Energy Program.

To prevent this, Alberta needs to be an active participant in intergovernmental discussions of fiscal federalism. Rather than simply resisting any national initiatives, Alberta should be trying to generate a provincial consensus on the equitable sharing of Canada's resource wealth and presenting to the federal government "an offer they cannot refuse." Further, with the existence of the Council of the Federation and, though a creature of the federal government, the Experts Panel on Equalization and Territorial Formula Financing, the vehicles exist for Alberta to take on such a leadership role in the federation.

Redesigning the equalization program so that it actually achieves its constitutionally mandated objective of providing provinces with the capacity to provide reasonably comparable levels of services at reasonably comparable levels of taxation would seem to be the key to this exercise. It is also likely that an Alberta government committed to proposing changes to the equalization program that would make it stable, predictable, and equitable would find a ready ally in the Government of Saskatchewan. However, a policy of intergovernmental isolationism (or "we're taking our bucks and going home") will not serve Alberta's long-term interest.

Within Alberta, the province must be careful not to succumb to the temptation of doing with its wealth that which is easy, rather than that which is rational and sustainable when the hydrocarbon revenue windfall eventually ends. Temporary benefits have a way of creating unsustainable expectations. If a benefit is built on a good policy rationale that will reap its own benefits for society, a government will be able to sustain public support for it when the hard times come and tough choices have to be made. An initiative designed simply to seek a quick political advantage can leave a government in the difficult position of taking away, at a later date, benefits that are not policy priorities, but which have created a dependency among the beneficiaries. Doubtless, there are many opportunities for public expenditures in Alberta that will achieve important public policy outcomes; that is for the people of Alberta, not an observer from Saskatchewan, to decide.

In many ways, public policy decisions become harder when money is available than when it is not, because the infinite number of ideas for how to spend the newfound wealth will inevitably outstrip the money available from even the biggest boom. Thus, both intergovernmentally and within the province, this period will test the mettle of the Alberta government. The people and Government of Saskatchewan will have a particular interest in the outcome, as the actions of this elephant so directly and significantly affect the political discourse of Saskatchewan.

Ian Peach is the Director of the Saskatchewan Institute of Public Policy (www.uregina.ca/sipp).

GETTING BACK ON TRACK

Revisiting the Heritage Fund

Casey G. Vander Ploeg

The 1973 OPEC crisis and the resulting run-up in oil and gas prices presented the Peter Lougheed government with an enviable problem—what to do with a string of multi-billion dollar royalty windfalls? Rather than flying by the seat of its pants, the Lougheed government seized the day by drawing a blueprint for the future. At the heart of this plan was the Alberta Heritage Savings Trust Fund, created on May 19, 1976.

The idea was simplicity itself. The Heritage Fund would claim 30% of all provincial oil and gas royalties and the interest earned by the fund (less approved capital projects) would be re-invested, unleashing the magic of compound interest on the assets. By the end of 1976, $2.2 billion had been placed in the fund and $88 million in interest had been earned—all of it walled off from general revenues to fuel a vision for the province that went beyond the immediate concerns of the day.

The objectives of the Heritage Fund were to provide a source of long-term investment income given the inevitable decline of a depleting resource, to diversify the Alberta economy by ensuring new opportunities for Albertans, and to invest in projects that would provide long-term social and economic benefits for all Albertans—both present and future.

Lougheed had the right idea. Setting aside 30% still leaves the remaining 70% to fund a lower tax regime and also "invest" in important areas like health and education. But more important, Lougheed understood that Alberta's endowment of oil and gas is special—something that should not be frittered away. Alberta's oil and gas resources belong to all Albertans—both the current generation and the ones to come. Selling the resource today and consuming the entire fiscal windfall without leaving behind a financial asset for future generations, is grossly unfair.

In 1976, Albertans accepted this logic. By 1982, however, world oil markets began to soften and a nasty recession gripped the province. In March 1983, income from the Fund was diverted to general government expenditures and the Fund's royalty contribution was scaled back to 15%. The bad news continued. In 1986, the softer price for oil went completely south, taking provincial government oil and gas revenues with it—non-renewable resource royalties for the province fell by 60% in the span of one year.

When the fiscal joy of huge budget surpluses mutated into the fiscal terror of huge budget deficits, Albertans lost their nerve. The Heritage Fund was capped—all oil and gas revenues, along with the Fund's annual earnings, began flowing into general revenue to finance Alberta's low tax regime and prop up current expenditures.

Ever since, the Heritage Fund has been kicked around pretty hard. The assets still remain at close to $12 billion, but the real value is only a shadow of its former self. Fund assets have been effectively halved—assets that used to represent 95% of all Alberta government program spending in 1987 represent only 47% today. Worse, a recent Canada West Foundation poll shows that only one in ten Albertans favour higher than average oil and gas revenues going to the Fund.

Yet, Albertans should reflect on the many advantages that have flowed from the Heritage Fund. When the provincial economy went sour, the Fund allowed the province to borrow from its own savings. When interest rates hit 22% in the early 1980s, the Fund financed interest shielding programs for small business and those desperate to hold onto the family farm. From 1983 to 2005, almost $24 billion in interest income generated by Heritage Fund investments was used to fund these things, as well as health care and education. That is $24 billion in taxes that Albertans did not have to pay.

There are few second chances in life, but Alberta has been graced with one. Once again, Alberta has won the lottery. When you win the lottery, you first pay off your bills and credit cards. Alberta has done that—the province is debt free. When you win the lottery, you buy some nice things. Alberta has done that—we have the highest health and education spending in the country. When you win the lottery, you hand out some gifts. Alberta has done that—bonus cheque anyone?

But when you win the lottery, you also save. Is Alberta doing enough of that? From 1976/77 to 2004/05, the province collected $122.9 billion in oil and gas royalties. Yet, only $10.6 billion was ever saved in the Heritage Fund. The rest—$112.3 billion or 91.4%—has gone to general revenue to support government spending.

Albertans need to revisit the purposes and principles behind the Heritage Fund. In the 1980s, a bumper sticker appeared on the backside of half-tons across the province. It read something like this: "Please give us another oil boom and we promise not to …[urinate]… it away this time."

The idea behind the Heritage Fund is to prevent exactly that kind of regret. The bumper sticker is prophetic. Let's heed the prophecy.

Casey Vander Ploeg is a Senior Policy Analyst with the Canada West Foundation.

Petroleum and the Norwegian Economy

Svein Gjedrem

Let me start by reminding you of the importance of the petroleum sector to the Norwegian economy. In 2004, it accounted for 20% of total GDP and almost half of Norway's total exports. Due to spillover effects, investment in the petroleum sector affects the activity level both offshore and in mainland Norway.

Oil gives us an economic base that is not available to many other countries. But it also presents us with considerable challenges.

Our petroleum resources are part of our national wealth. When oil is extracted and sold, natural assets are transformed into financial wealth. Norway's national wealth belongs not only to our generation, but also to future generations, and government policy takes this into account. When exercising fiscal discipline, the Norwegian authorities are seeking to ensure that our petroleum wealth is distributed equitably across generations.

Second, the size of the cash flow from petroleum activities varies. Considerable fluctuations in demand in the Norwegian economy, which amplify cyclical fluctuations, would be the result if petroleum revenues were to be used as they accrue.

Third, the use of petroleum revenues has an impact on competitiveness in Norwegian business and industry. A high level and substantial variations in the use of petroleum revenues would have a negative impact on internationally exposed industries.

The establishment of the Government Petroleum Fund and the guidelines for the use of petroleum revenues are intended to meet these challenges. The Petroleum Fund serves as a buffer between current petroleum revenues and the use of these revenues in the Norwegian economy. In this way, the economy is shielded from fluctuations in prices and extraction rates in the petroleum sector. Petroleum revenues may be gradually phased into the Norwegian economy.

The Fund is also a savings fund that allows petroleum wealth to be distributed across generations. The objectives are best achieved by investing the Petroleum Fund outside the Norwegian economy. The Act relating to the Government Petroleum Fund stipulates that all central government revenues from petroleum operations shall be transferred to the Petroleum Fund and that the Fund's capital may only be spent over the central government budget. The Act prohibits using the Fund's capital in any other way.

Once a year, the government authorities decide in accordance with the Act how much of the Fund may reasonably be used. All use of central government funds is thus subject to the same assessment and alternative uses must be weighed against one another. The background material for the Act relating to the Petroleum Fund clearly indicates that the Fund shall not be a second central government budget and, by implication, shall not be used for investment or spending that have not received priority in the budget.

The Storting (Norwegian parliament) has approved a fiscal guideline for the use of petroleum revenues. It states that, in general, petroleum revenue spending shall be limited to 4%, or the expected annual real return on the Petroleum Fund over time. This fiscal rule shall ensure that the use of revenues in the Norwegian economy is at a level that can be sustained over time.

The usefulness of a fiscal guideline is that it gives weight to long-term considerations when addressing day-to-day economic policy challenges. The fiscal rule stabilizes enterprises' expectations concerning competitiveness and the krone exchange rate, thus preventing abrupt and pronounced swings in the structure of the economy. If the government authorities disregard the rule, enterprises will lose an important reference. A policy rule can make matters worse if economic agents have drawn up long-term plans on a faulty basis.

The fiscal rule for the budget states that the government can use 4% of the Fund over time. This year, around 6% of the Fund is being used. The deviation partly reflects an unexpected shortfall in tax revenues from the non-oil economy in recent years. The government budget deficit is the difference between total revenues and total expenditure. They each account for about half of total GDP in Norway. Even small deviations from expenditure and revenue projections can have a major impact on the deficit. Exchange rate changes will also lead to fluctuations in the value of the Petroleum Fund. For these reasons alone, the use of petroleum revenues may in periods deviate from the 4% rule. Spending was also increased in response to the economic downturn in 2003.

Norway's history as an oil nation goes back to the end of the 1960s. At the beginning of the oil age in Norway, the relationship between the use of petroleum revenues and changes in industry structure was highlighted.

However, since then, competitiveness in the business sector in Norway has deteriorated both due to high wage growth and in later years an appreciation of the krone against our trading partners. Costs rose sharply from the mid-1960s to the mid-1970s. In subsequent years, costs have varied around this higher level.

So far this year, competitiveness in Norway's manufacturing industry has been about 5.5% weaker than the average for the period 1970-2004. Over the past 30 years, manufacturing has been scaled back in waves. A substantial decline occurred in the period 1977 to 1984 and from 1987 to 1992. The last wave occurred around the turn of the millennium. Manufacturing employment decreased by close to 55,000 persons from 1998 to 2004.

There are many studies in international literature that point to the pitfalls facing a country that suddenly discovers large natural resources. Certainly, the Norwegian manufacturing sector has undergone substantial changes over the past 30 years. On the other hand, this period has also been marked by substantial productivity gains in parts of the sheltered sector, for example in retail trade and the banking sector. Petroleum activities have contributed to technological developments in the shipbuilding industry and the offshore sector.

After a period, we will be able to cover a smaller share of our imports using current petroleum revenues and by drawing on the Petroleum Fund. Competitiveness will then have to be improved. It may have to be brought back to around the level prevailing at the end of the 1960s prior to Norway's emergence as an oil nation. Rough estimates suggest that the real exchange rate that ensures balance in the external account when petroleum wealth no longer has the same significant role in the economy is more in line with the real exchange rate that we started with before petroleum extraction began.

In conclusion, the Petroleum Fund and the fiscal rule shield the economy from fluctuations in oil prices and extraction rates. With an inflation target, inflationary pressures are steered using the interest rate, while the value of the krone fluctuates. Consequently, when decisions on the use of petroleum revenues are taken, weight must not only be given to long-term considerations and the distribution of wealth across generations, but also to developments in the real exchange rate and the competitiveness of the exposed sector over the short and medium term.

This article is an abridged version of a speech by Svein Gjedrem at Alfred Berg ABN AMRO's Nordic Energy Conference, 30 August 2005. Svein Gjedrem is the Governor of Norges Bank.

The Norwegian Storting adopted the Act relating to the Government Petroleum Fund in 1990. The Ministry of Finance is responsible for the management of the Fund, and has delegated responsibility for the operational management of the Fund to Norges Bank. The capital in the Fund is invested in foreign financial instruments (bonds, equities, money market instruments and derivatives). The Fund's value is approximately $US 195 billion.

Visit www.norges-bank.no for more information.

Extending
the Alberta Advantage

Scott Hennig

The Alberta Advantage is the phrase widely used by the Alberta government to remind Albertans that our oil wealth has created great opportunity. Often that opportunity is portrayed simply as an ability for Albertans to find work and earn a comfortable living in a low-tax environment with generous government services. Yet the true Alberta Advantage should, and can be, much greater.

As custodian of Albertans' natural resource revenues, the Alberta government should be acting to extend the Alberta Advantage well beyond the day our derricks pump dry. The Alberta Advantage is more than receiving a one-time prosperity bonus. The Alberta Advantage is more than not paying a sales tax. The Alberta Advantage should be about creating long-term prosperity for future generations. And Alberta should be pursing its long-term “Advantage” unapologetically.

Most recently, capitalizing on our “Advantage” has meant more government spending. The Alberta government has increased spending by 88% since 1996. This number continues to outpace both our inflation rate and our population growth. Had the Alberta government held the line on spending increases, Albertans would have been debt-free years ago, and well on our way to establishing long, sustainable prosperity.

Albertans have told their government, time after time in surveys like “Talk it up, talk it out,” and “It’s your money,” once our debt is paid off, they want personal tax cuts. It’s not that Albertans are greedy, they just believe, rightfully so, that they know better than the government how to spend their own money.

The government already saw the wisdom of paying off our debt. Being debt-free now saves Albertans nearly $1.5 billion each year in debt servicing costs. Those savings should be passed on to Albertans. $1.5 billion could eliminate the health care premium tax, the 3% sales tax on insurance, and even give a small bump to the Basic Personal Exemption. This would save most families over $1,000 a year in taxes.

But the question thrown back to the Canadian Taxpayers Federation when we plead with the government to control spending and cut taxes, is how can we afford to cut taxes with one-time dollars?

Simply put: save it.

To answer this question of how to afford tax cuts with one-time dollars, the Canadian Taxpayers Federation commissioned a study by Dr. Jean-Francois Wen of the University of Calgary in 2001. Dr. Wen was asked if it would be possible for Alberta to build up the Heritage Fund and then use the interest to eliminate personal income taxes. Remarkably, Dr. Wen discovered it would not be difficult at all, especially with a little bit of political will.

Dr. Wen determined if the government held the line on spending increases starting in 2000, and dedicated 50% of all resource revenues to the Alberta Heritage Savings Trust Fund (AHSTF), along with retaining all of the interest generated by the Fund, Alberta could eliminate personal income taxes by 2015. Furthermore, his study was based on oil priced at $18/barrel and natural gas at $2.35/mcf and increasing only at the rate of inflation. As we have seen this year, with oil over $60/barrel and natural gas over $11/mcf, the time-line suggested by Dr. Wen in 2001 could be substantially ramped up.

If the Alberta government had followed Dr. Wen’s advice and invested half of all royalty revenues starting in 2001 as well as retaining the interest generated by the fund, we would already have over $35 billion in the AHSTF and be well on our way towards the $55 billion target and elimination of personal income taxes. Moreover, Dr. Wen determined if resource prices stayed at 2000 levels, our debt could have been eliminated in 2002 and income taxes could have been eliminated in 2005.

Obviously, the Alberta government squandered an excellent opportunity to truly repay Albertans for their years of penny-pinching. But it’s not too late to ensure we don’t fully—as Brian Mulroney might say—“piss away” another oil boom. But to do so, the Alberta government is going to have to put the reigns on their recent wild spending spree and make a firm commitment to cut taxes by saving our royalty revenues.

Many naysayers have suggested building up a large Heritage Fund will only create a target for the federal government to swoop in and steal our money with the National Energy Program version 2.0. Yet these people have obviously failed to notice the huge target already painted squarely on Alberta’s forehead.

Alberta is the only province without a sales tax. Alberta is the only province to be debt free. Alberta is the only province with a $12 billion savings account. Alberta has the highest per capita spending and the lowest taxes. Alberta already has some of the highest paid nurses, teachers and doctors. It stands to reason many of our neighbours and the federal government are going to be looking at us with envy.

Some of these same naysayers have suggested the government continue its current defensive action of spending it as fast as it comes in. That's simply not working; it's only feeding our addiction to spending.

Yet, no matter what Alberta does, whether it is having the largest Heritage Fund, the lowest taxes, the highest paid public sector workers, or the best funded social programs, someone is going to be jealous. If the federal government is bound and determined to covet our oil wealth, no strategy aimed at hiding it or spending it will work.

Imagine if you got a promotion at work and could now afford that fancy sports car you have always dreamt about. Immediately after driving your brand new sports car off the lot, would you smash out the head lights, dent up the doors and scratch up the paint job just so that your neighbours wouldn't be jealous? No, of course you wouldn't. Now why would anyone expect Alberta to do the same?

Alberta has an unprecedented opportunity to create a lasting Alberta Advantage. Nothing, not even the possibility of a jealous federal government should stop us from making it a reality.

Scott Hennig is the Alberta Director of the Canadian Taxpayers Federation (www.taxpayer.com).

Alberta's Natural Resource Revenue

Todd Hirsch

How to Avoid a Potential National Unity Crisis

Surging prices for crude oil and natural gas have led to an unprecedented cash windfall for the province of Alberta. Royalties from the extraction of these resources has helped the province pay off its entire debt about 20 years ahead of schedule. Furthermore, the debt-free province is looking forward to a surplus in 2005-06 in the range of $8-$10 billion. The Klein government has been busy coming up with proposals for how to manage this natural resource surplus—among their ideas is a $400 "Prosperity Dividend" cheque for each and every citizen of the province. It's good times in Alberta.

But the massive resource-driven surplus may also be creating a headache for Mr. Klein that he didn't bargain for. The problem with this surplus—and the additional surpluses that the province is likely to enjoy in the foreseeable future—is the imbalance it creates between Alberta and the rest of Canada.

Regardless of how Alberta chooses to deal with its cash—lower taxes, increase program spending, or stash it away in long-term investments—the other provinces are going to find it hard to compete. It won't be long before another province or the federal government finally says "Enough! Something has to be done."

The last time the problem of soaring energy prices came up, the federal government introduced the National Energy Program (NEP). While the program did not seek to extract cash from the royalty revenues directly, it did impose price controls, foreign investment regulations, and a series of income and export taxes directed at the energy sector. In the minds of Ottawa, it was simply doing something to address the imbalances caused by (at the time) record oil prices.

People outside the West have likely long since forgotten about the NEP, but it hasn't been forgotten in Alberta. The program crippled the oil and gas sector. It is firmly entrenched in the province's psyche, an epic chapter of biblical proportions in Alberta's history.

So what is it going to be this time? A replica of the original NEP is unlikely, but some other scheme is surely plausible. Suggestions range from a tax on energy exports to the US (as retaliation for the softwood lumber dispute) to some sort of carbon tax to address Kyoto obligations. Ottawa could even increase corporate income tax rates on oil and gas companies.

Eventually, the fiscal imbalance could become so great that Ottawa may be forced into a corner. It appears that the conditions are perfect for a constitutional storm—a gallon of fuel poured onto the faint-but-smoldering embers of Alberta separatists.

It need not be so. In fact, this could be Alberta's golden opportunity, a chance to stand up and show leadership within the country. Instead of "The West Wants In," the new catch phrase of western political sentiment could be "Here's what we're doing, are you with us or not?"

With part of its massive resource-driven surpluses, Alberta could initiate a **Western Energy Accord**—an agreement with the other three western provinces to create a pool of energy revenue, invest in the West's energy resources, and strategically market western Canada's energy to a global market.

The catch is that this Accord will not be limited to Alberta's oil and gas. It will include all of western Canada's energy resources—Manitoba's vast hydro power, Saskatchewan's uranium deposits, BC's coal and (yet to be developed) offshore oil, even arctic gas. It should also include fledgling industries such as wind, solar, bio-mass, and hydrogen sources of energy. They may not all be economically viable today, but they are likely to be someday.

Through the Accord, a portion of the cash derived from energy resources would be pooled and redistributed among the western provinces for re-investment in major energy projects. For example, a portion of Alberta's oil royalty money could help finance the construction of a major hydro dam in Manitoba, including the billions required for transmission lines to Ontario. The hydro revenues could help fund other energy projects back in Alberta, such as research and development in coalbed methane. Revenue from southeastern BC's coal deposits could help Saskatchewan invest in wind power research or enhanced recovery of crude oil. Energy revenue from Saskatchewan would in turn help fund energy projects elsewhere in the West, and so on.

Marketing western Canada's energy for export would also be a central goal of the Accord. China's surging economy is thirsty for oil; the US is hungry for all types of energy: gas, oil, hydro electricity, uranium. The premiers of the western provinces would have the ability to sell the US on a comprehensive package of energy solutions from a safe, politically stable and geographically linked source. Strategically, it is a much stronger approach than each province marketing its energy individually.

Of course, there would be major hurdles to overcome. For one thing, it would require a complex pooling of revenue from resources that are both in the private sector (oil and gas) and the public sector (provincially-owned hydro utilities). There would be endless debate as to what constitutes a viable emerging source of energy ("Why should Manitoba's hydro money be funneled into tidal energy research?"). There would also be the question of arctic gas, an enormous resource that would naturally tie into western Canada's gas distribution system, but is under Ottawa's jurisdiction. But with enough determination and cooperation, these hurdles can be cleared.

In the short-run, Alberta may have the most to lose with this idea. But in the long-run, it has the most to gain. The province is blessed with hydrocarbon resources and prices are currently high. And while things look good in the foreseeable future, the party can't last forever. By forging an energy accord that includes all of western Canada's energy resources—many of which are clean and renewable—Alberta would greatly strengthen its own long-term energy position.

Alberta has all of the cards in its hand at the moment. By initiating a Western Energy Accord it would not only show a great deal of goodwill to its provincial neighbours, it would deflect criticism and envy directed its way by other governments struggling to balance their budgets. It's a preemptive strike.

Ontario and the rest of the country—once they see how the Western Energy Accord works for the benefit of all provinces and the region—will see the benefits of such a program. They've got energy resources, too: nuclear in Ontario, hydro in Quebec and Newfoundland, gas and coal in Nova Scotia. In terms of the Energy Accord, the new bumper-sticker slogan will be "The East Wants In."

Energy resources will continue to create wealth and improve our standard of living. Canada will be strengthened. And it will all start with Alberta.

Todd Hirsch is Chief Economist at the Canada West Foundation.

The mixed blessing of natural resources

Brian Lee Crowley

Look at the countries with vibrant economies. Few have a large natural resource endowment. In fact, many with high per capita incomes—Japan, Denmark, Switzerland, Germany, France—are resource poor. The same is true within countries. In the United States, resource-rich Texas and Louisiana have low per capita incomes compared with resource-poor Connecticut and Massachusetts.

Even countries that should benefit from huge increases in the value of their natural resources often find their blessings extremely well disguised. Mexico and Nigeria both went bust in the 1980s after oil price rises hugely increased the value of their resources. Jeffrey Sachs, one of the world's leading economists, notes that it is a generally accepted fact of economic development that "resource abundant economies [tend] to lag behind resource scarce ones."

What these states and countries find—like many lottery winners—is that it is hard to spend a windfall wisely. You must not just consume the proceeds. But investing them is tricky—markets may have difficulty coping with a sudden inflow of capital, and there may be too few projects fully justified by cost-benefit analyses and normal rates of return.

So, time and time again, the public sector has expanded to spend the resource rents. Or, to put it in former Alberta Treasurer Jim Dinning's more colourful language, *revenue causes spending.* Lavish spending programs are often for consumption, through welfare spending, or wasteful public works, such as schools and highways in politically sensitive constituencies. And once the public spending gets going, it's hard to stop, despite the fact that non-renewable natural resource revenues are also non-*reliable* revenues.

That's one of the catches around natural resource revenues. Government spending is highly reliable. When governments spend money, it tends to be in regular and long-term commitments. They hire teachers or restaurant inspectors or surgeons or museum administrators. Those people expect to be paid every year, year in, year out. They expect annual pay increases, improved working conditions, fringe benefits and pensions. And once you hire them, you have to put them somewhere, so you need buildings as well as electricity, heat, cleaning and other services.

And of course these employees are highly unionized and their contracts are quite inflexible. They are likely to be quite stoney-faced at the bargaining table if the government pleads low natural resource prices as a budget constraint. On the other hand, if prices (and therefore government revenues) are high, they certainly expect "their share."

Natural resource revenues represent the sale of our natural capital assets. You're selling a natural endowment that belongs to everyone within the jurisdiction, including those who are not yet born.

That's why it is always a fatal mistake to treat natural resource revenues as if they were just like income or sales or excise taxes. Spending commitments made when prices are high are a nightmare for governments when prices fall. Unless resource rich governments act carefully and deliberately, they simply sow the seeds of miserable and draconian budget cuts when the inevitable price collapse comes. Within the past few years we've seen oil go to $15 a barrel (and lower) and as high as $70, natural gas has been $2, $7, and everything in between.

That's not all. Ordinary taxes simply take a slice off infinitely renewable economic activity. But natural resource revenues represent the sale of our natural capital assets. Sell it and it's gone forever, and what you're selling is a natural endowment that belongs to everyone within the jurisdiction, including those who are not yet born. It must not be squandered on ordinary consumption. It must be treated as capital, and reinvested, so as to confer benefits over a long period of time.

This is a hard lesson for many people to grasp, especially when they are bedazzled by the billions of dollars in temporarily-high revenues they see flowing into the coffers of energy-rich jurisdictions like Alberta and Newfoundland. But all of these calls for new long-term spending commitments just show how hard it is for people to get their heads around natural resource royalty revenue, which is unlike ordinary tax revenues.

One way to see the difference is to think in terms of a private household. Suppose you own a nice little house, and you decide to sell in order to move into a better neighbourhood. But before you find the new house you want, you get mesmerized by the big whack of cash the sale of your old home put in your hand. Suddenly you have visions of all the things you've deprived yourself of over the years being within your grasp.

You buy that new car, those new clothes, you take the cruise you've always wanted, you take your friends out to fancy dinners. You live high. For a while.

Then reality catches up to you. Your real income can't support this extravagance, which has only been made possible because you've been spending your assets. Now not only can you not afford to keep the new car and your fancy lifestyle, but your standard of living will be lower than it was before, because you no longer have the capital to invest in the new house, and you have to go back to renting. In other words, spending that has to be repeated year after year after year, like mortgages, groceries and the like, should only be paid out of streams of income that are also repeated year after year, like wages or interest on investments.

That's the difference between assets and income. The assets generate income. But if you spend the assets on ordinary consumption, both the asset and the income it could generate get used up.

Natural resource revenues should thus be used exclusively for two things. One is debt reduction. When you are heavily indebted, it makes sense to sell some assets to relieve the pressure of interest payments and free your income up for more productive purposes.

The other use is heritage or legacy funds. These are *not* "rainy day funds," which simply cause everyone to break out their umbrellas. We should be required by law to invest the capital, and only spend the income it generates. That smoothes out the huge fluctuations in natural resource revenues, while creating an asset that can be invested in things that confer long-term benefits, like genuine infrastructure, medical research, and top flight facilities for our schools, colleges and universities.

The moral of the story? Being resource rich is like so many things: easy to do badly and very very hard to do well.

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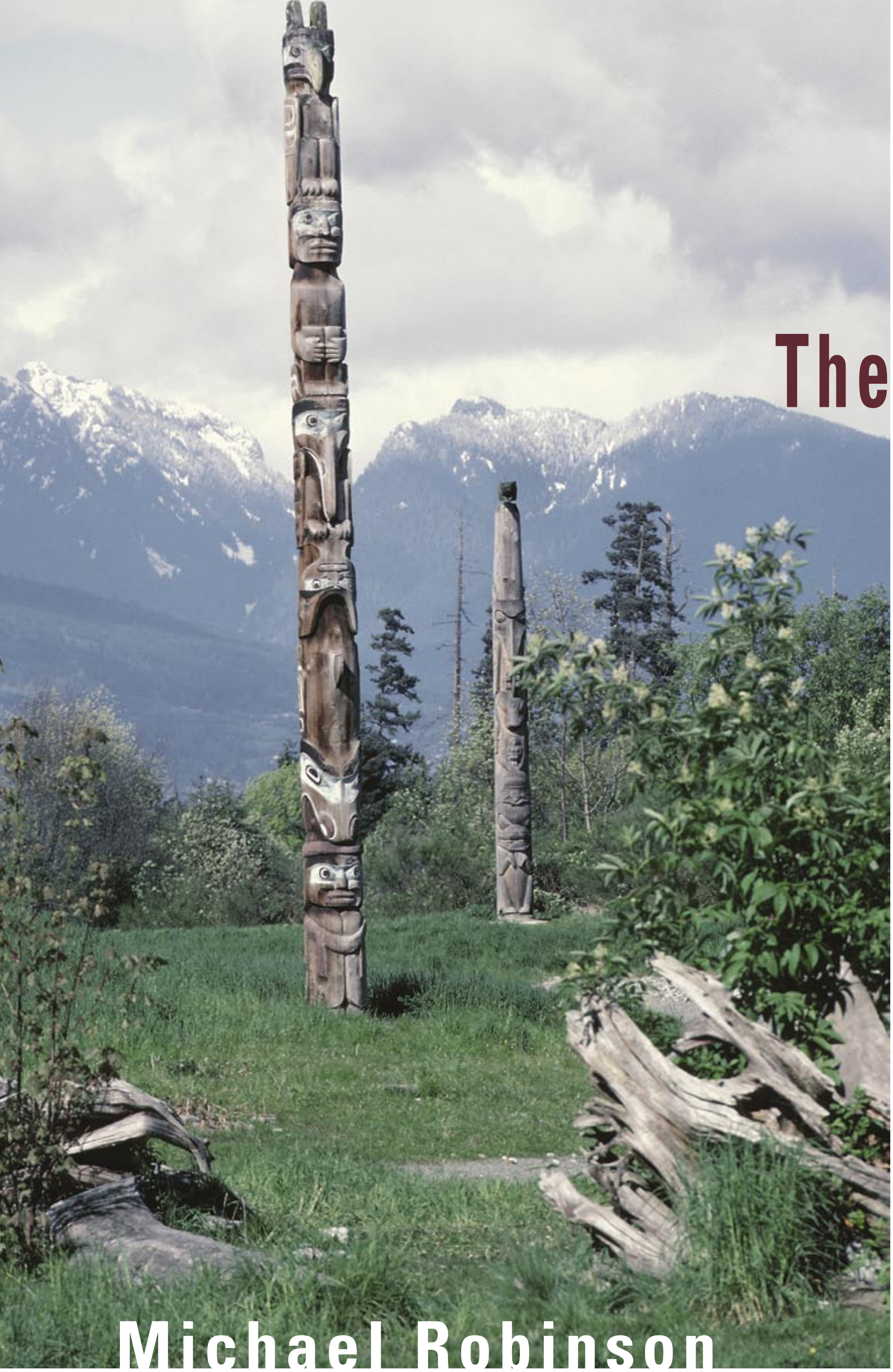


The Gwaii Trust

A Model for Albertans?

Michael Robinson

Haida Gwaii (once commonly referred to as the Queen Charlotte Islands) off British Columbia's northwest coast has been the ancestral home of the Haida for the past ten thousand years, and more recently has accommodated the needs and desires of about 3,000 non-Haida "outsiders."

For most of the past hundred years Haida Gwaii was home to a thriving commercial fishing and logging industry. Starting in the 1970s both of these economic sectors began to wind down as wild salmon were over-fished, and old growth forest over-cut.

In the 1980s, the Haida became increasingly angry with the non-sustainable pace of resource extraction, and in 1985, a political standoff took place at Lyell Island as Haida elders blockaded a logging road in a classic act of Canadian civil disobedience. The resulting film footage of octogenarian chinni's and nonnis (grandfathers and grandmothers) being hauled away in RCMP Suburbans caused a national outcry, and worldwide attention was focused on the Haida's land title dispute, and the consequences of clear-cut logging in the west coast rainforest. As a direct result, in 1988 Canada designated the area (the South Moresby archipelago) a National Park Reserve—now known as Gwaii Haanas.

This designation knocked about 500 loggers out of work, and instantaneously provided the residents of Haida Gwaii with a world-class eco and cultural tourism opportunity. To compensate the residents and mollify the loggers, Canada offered to create an Accord and a Community Development Fund. The federal government asked the Council of the Haida Nation and the Residents' Planning Advisory Committee to create a nonprofit society to operate a perpetual trust fund. The Gwaii Trust was formed in September 1994, after six years of difficult work required to overcome legislative hostilities and initial cross-cultural differences between Haida and non-Haida residents. This year it celebrates its first ten years of operations providing environmentally sustainable social and economic benefits to Haida Gwaii.

Initially capitalized with a principal of $38.2 million, the Gwaii Trust today has a market value of $70 million. From its inception, it has been annually inflation-proofed based on the Consumer Price Index, and the inflation-proofed current value (some $48 million) can never be touched, allocated, or expended. The average draw on the fund by the Gwaii Trust Board is 5%. Current draws of $3.5 million (utilizing post-inflation-proofing interest and dividends) pay for about $500,000 in administrative costs, and the rest, $3 million, is allocated to fund authorized programs in the Gwaii Trust Business Plan. The Gwaii Trust's investment strategy is based on the premise of only investing in bonds (65% of the portfolio), and equities (35%) that provide sufficient security and demonstrate a proven corporate record of socially-responsible investing.

The Gwaii Trust creates a new Business Plan every five years, and does so with the direct input of all seven Island communities, and the hands-on involvement of the Gwaii Trust Board of Directors. The Board has four elected non-Haida representatives, four Council of the Haida Nation (CHN) appointees, and a CHN appointed chairperson. The Business Plan clearly lays out funding priorities for the Islands and is driven by a consensual desire to create a sustainable "Islands community." The central goal in this process is the quality of life and common good of all residents of Haida Gwaii. Over the past decade of operations, the Gwaii Trust has allocated $25 million to this goal.

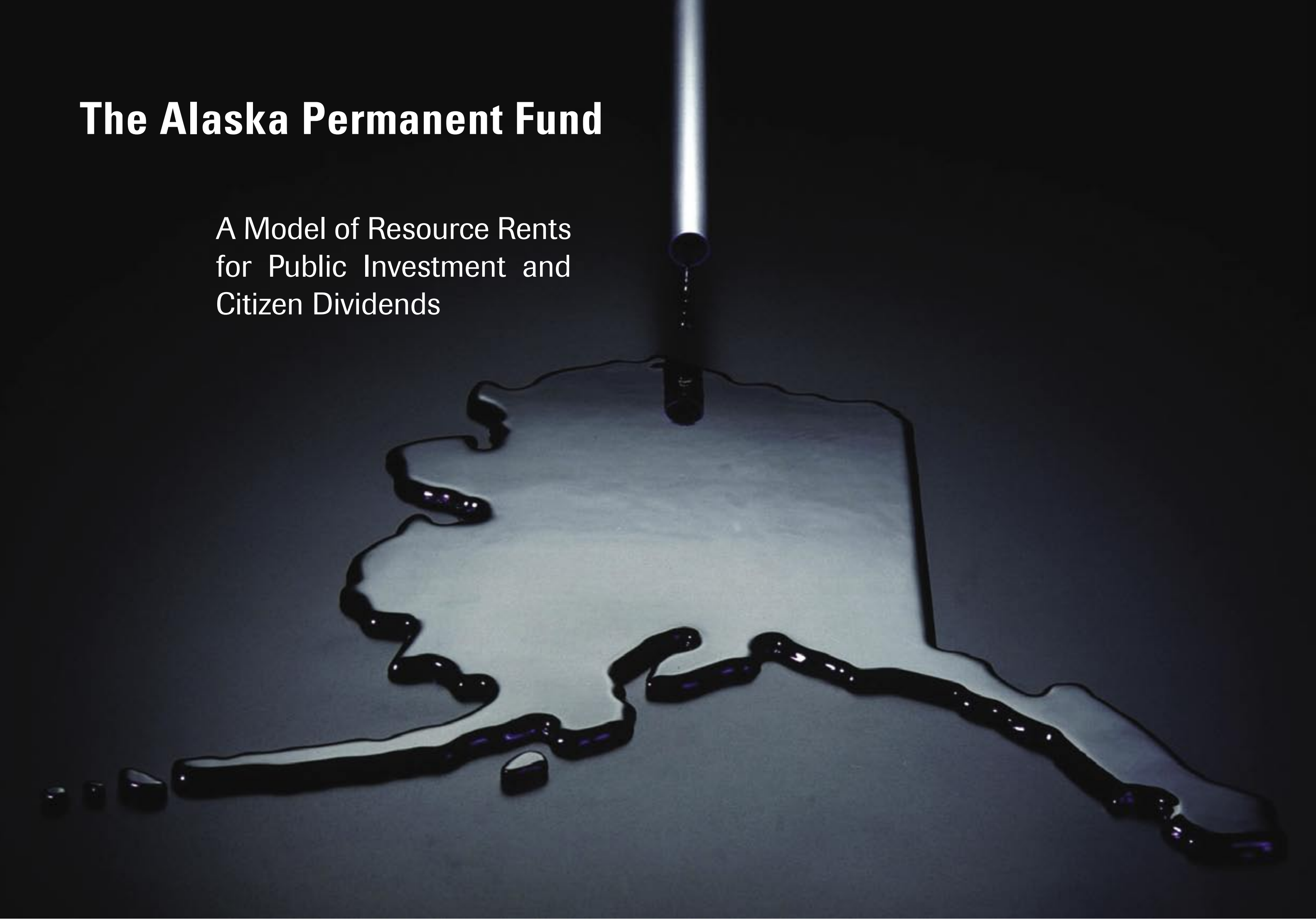
The *Major Contributions Program, New Legacy Program,* and *Culture as it Relates to Tourism Program* have funded water and sewer upgrades, landfill modernization, fire truck and ambulance purchases, tourist campgrounds and trail systems, health centre construction and renovations, and cultural, educational and municipal governance offices. The *Healthy Humans Program* supports spiritual healing projects, and pilot projects dealing with medical and holistic health issues. The *Arts Program* grants $50,000 per year to artists in a competitive application process, and a bundle of *Education Programs* provide $329,000 to scholarships, bursaries, grants, post-secondary education tours and special education projects.

The moral of the Gwaii Trust story is that a nonprofit society board comprised of elected and appointed representatives, and constrained by the BC *Trustee Act* and constitutionally mandated investment policies and procedures, can effectively, fairly and efficiently contribute to the common good while simultaneously inflation-proofing and growing the trust fund. The Gwaii Trust combines the best of Haida and non-Haida world views on values for sustainability of cultural and ecological diversity, and the creation of a post-industrial sustainable economy. Think of it as a model for post-oil Alberta.

Michael Robinson is a Gwaii Trust Business Plan Facilitator and President of the Glenbow Museum in Calgary. For more information on the Gwaii Trust, visit: www.gwaiitrust.com

The Alaska Permanent Fund

A Model of Resource Rents for Public Investment and Citizen Dividends



Alanna Hartzok

Wars are often fought over the ownership and control of land and natural resources. Inequitable ownership and wasteful, unsustainable use of the earth's resources are root causes of both the unjust wealth gap between the rich and the poor and the depletion and collapse of our natural resource base.

If you were a third grade student in the state of Alaska, one day in school you would play a game called Jennifer's Dilemma. The game tells the story of a little girl who has discovered a box of valuable coins. Her dilemma is deciding what to do with an unexpectedly large amount of money. It is a way for young children to learn about their own yearly windfall fortunes from the Alaska Permanent Fund. In the year 2000, each Alaskan received a dividend check for nearly $2,000.

The Alaska Permanent Fund is a case study in a new concept of the role of government—that of an agent to equitably distribute resource rents to the people, thereby securing democratic common heritage rights to land and natural resources.

Purchased from Russia in 1867, Alaska became the 49th state in 1959. Under the Alaska Constitution (Article VIII. Section 2. General Authority) all the natural resources of Alaska belong to the state to be used, developed and conserved for the maximum benefit of the people. Ten years after statehood the first Prudhoe Bay oil lease sale yielded $900 million from oil companies for the right to drill oil on 164 tracts of state-owned land. Compared to the 1968 total state budget of $112 million, this was a huge windfall.

By legislative consensus, the original $900 million was spent to provide for basic community needs such as water and sewer systems, schools, airports, health and other social services.

Although the oil fields were proving to be the largest in North America, Alaskans came to agree that a portion of this wealth should be saved for the future when the oil runs out. In 1976 voters approved a constitutional amendment, proposed by Governor Jay Hammond and modified by the legislature, which stated that at least 25% of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue-sharing payments, and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments.

The Alaska Permanent Fund was thus established as a state institution with the task of responsibly administering and conserving oil and other resource royalties for the citizenry.

There are two parts to the Fund: principal and income. The principal is invested permanently and cannot be spent without a vote of the people. Fund income can be spent, decisions as to its use being made each year by the legislature and the Governor.

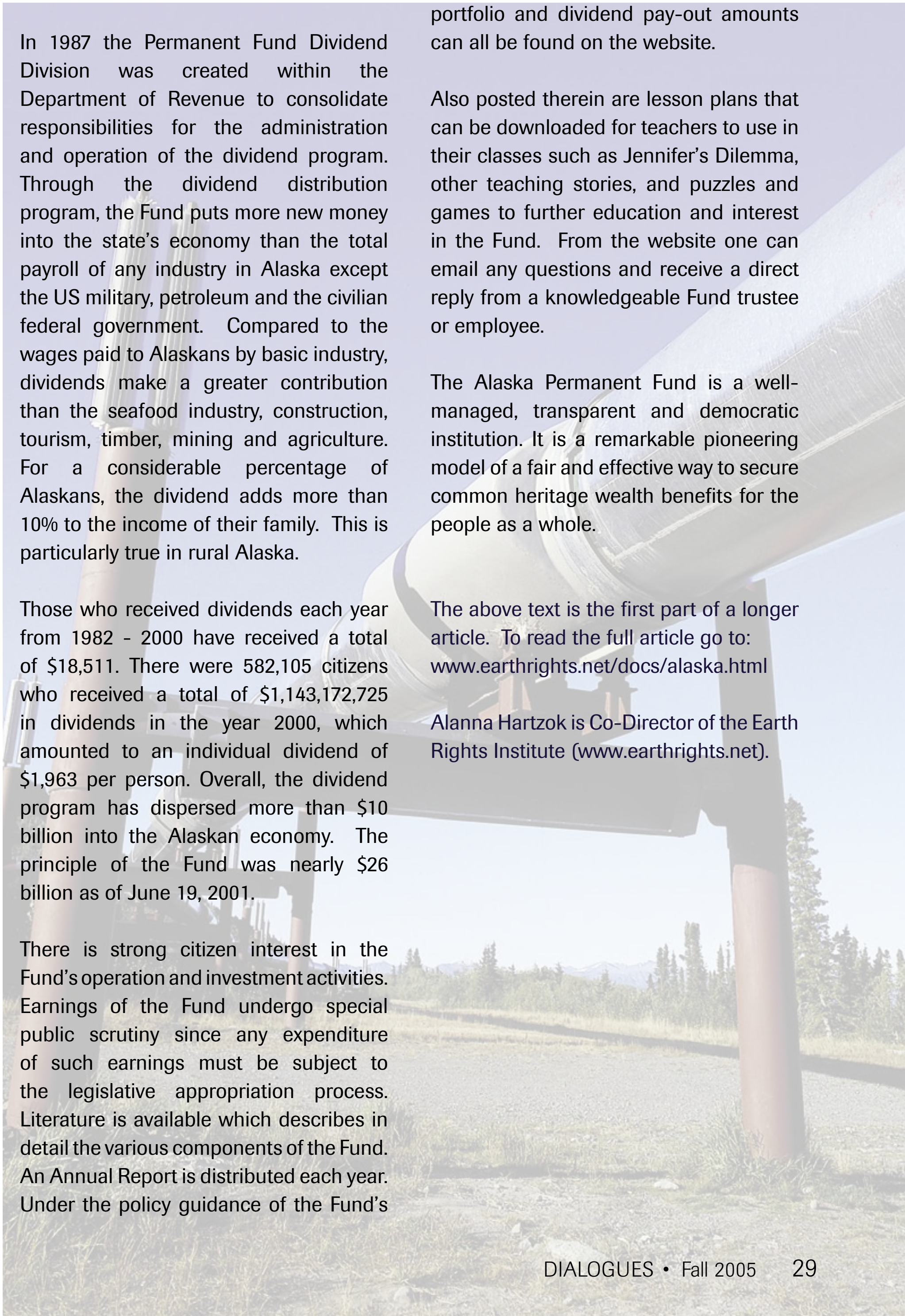
The Fund was established as an inviolate trust, meaning that the principal of the Fund is to be invested in perpetuity. The Fund thereby transforms non-renewable oil wealth into a renewable source of wealth for future generations of Alaskans.

Oil started flowing through the Trans-Alaska Pipeline in 1977, at the time the world's largest privately financed construction project. In February of that year, the Fund received its first deposit of dedicated oil revenue of $734,000.

All income from the Permanent Fund was to be deposited in the state general fund unless otherwise provided by law. What to do with the earnings generated and how they would best benefit the present generation of Alaskans engaged Alaskans in debate for the two decades following the establishment of the Fund.

Like Jennifer with her box of coins, the dilemma was what to do with the growing income from the Fund. Would it best be saved for the future or managed as a development bank for Alaska's economy? After a four year debate the Alaska State Legislature decided in 1980 in favour of a savings trust for the future. The Alaska Permanent Fund Corporation was created to manage the assets of the Fund.

The same year the Legislature also created the Permanent Fund Dividend Program, retroactive to January 1, 1979, to distribute a portion of the income of the Permanent Fund each year to eligible Alaskans as a dividend payment. By the end of 1982, after a couple years of wrangling with the US Supreme Court over constitutional details, all residents of Alaska—every woman, man and child—who applied for and who were found eligible (must be at least one-year resident) received their first dividend, which was $1,000. This was the historic beginning of an annual program paying to Alaskan citizens a fair and equal share of the wealth from publicly owned resources.



In 1987 the Permanent Fund Dividend Division was created within the Department of Revenue to consolidate responsibilities for the administration and operation of the dividend program. Through the dividend distribution program, the Fund puts more new money into the state's economy than the total payroll of any industry in Alaska except the US military, petroleum and the civilian federal government. Compared to the wages paid to Alaskans by basic industry, dividends make a greater contribution than the seafood industry, construction, tourism, timber, mining and agriculture. For a considerable percentage of Alaskans, the dividend adds more than 10% to the income of their family. This is particularly true in rural Alaska.

Those who received dividends each year from 1982 - 2000 have received a total of $18,511. There were 582,105 citizens who received a total of $1,143,172,725 in dividends in the year 2000, which amounted to an individual dividend of $1,963 per person. Overall, the dividend program has dispersed more than $10 billion into the Alaskan economy. The principle of the Fund was nearly $26 billion as of June 19, 2001.

There is strong citizen interest in the Fund's operation and investment activities. Earnings of the Fund undergo special public scrutiny since any expenditure of such earnings must be subject to the legislative appropriation process. Literature is available which describes in detail the various components of the Fund. An Annual Report is distributed each year. Under the policy guidance of the Fund's six trustees and the executive director and staff selected to execute it, there has developed an extensive accountability program and open meetings with opportunity for citizen participation.

The Alaska Permanent Fund Corporation website (www.apfc.org) keeps current all investment and distribution activities of the Fund. The history of the development of the Fund, its incorporation, details concerning its management, along with up-to-date information on the Fund portfolio and dividend pay-out amounts can all be found on the website.

Also posted therein are lesson plans that can be downloaded for teachers to use in their classes such as Jennifer's Dilemma, other teaching stories, and puzzles and games to further education and interest in the Fund. From the website one can email any questions and receive a direct reply from a knowledgeable Fund trustee or employee.

The Alaska Permanent Fund is a well-managed, transparent and democratic institution. It is a remarkable pioneering model of a fair and effective way to secure common heritage wealth benefits for the people as a whole.

The above text is the first part of a longer article. To read the full article go to: www.earthrights.net/docs/alaska.html

Alanna Hartzok is Co-Director of the Earth Rights Institute (www.earthrights.net).

Political Will is Critical

Ron Kneebone

Governments which collect large sums from the sale of non-renewable resources typically face conflicting demands. On the one hand is the voting public which observes large amounts of revenue accruing from the sale of non-renewable resources and demands lower taxes and/or more generous government spending. On the other hand are analysts who emphasize to those governments the need for them to save at least some part of non-renewable resource revenue so that this wealth can be shared with future generations.

The Canada West Foundation has recently raised that other hand in its publication *Investing Wisely: An Investment Strategy for Creative Leadership.* The Foundation recommends that the provincial government save 50% of the revenue it earns on non-renewable resources. But is a 50% savings target feasible?

The Government of Alberta collects royalties and other revenues based on the sale of non-renewable natural resources, particularly oil and natural gas. This money comprises a sizable fraction of total provincial revenue and enables the government to finance program expenditures without imposing anything more than moderate rates of income and excise taxes on Alberta taxpayers. Unfortunately, resource revenue tends to be quite volatile. It is this volatility that makes the proposed commitment to a 50% saving rule problematic.

Consider the following hypothetical situation. Assume that the Alberta government has committed to spending $3.5 billion more than it collects in tax revenue. Thus, to meet its no-deficit commitment, the government must commit $3.5 billion of the resource revenue it collects to finance spending and maintain a balanced budget. If resource revenue comes in at $7 billion, $3.5 billion (50% of resource revenues) can be saved. If resource revenue is just $4 billion, meeting the no-deficit commitment means that only $0.5 billion (12.5%) of resource revenue is available to be saved.

The government could, of course, meet the suggested 50% saving commitment in years where resource revenue is low by increasing tax rates or reducing spending on health, education, or social services. But it is bad economic, social, and even political policy to make frequent changes to tax rates and to levels of government spending.

Given this, can we expect resource revenues to be large enough to provide enough revenue to simultaneously balance the budget and satisfy a 50% saving rate? In addition, because having enough resource revenue to meet the 50% rule does not guarantee that the government of the day will actually save the money, what options exist to constrain a government in this way? Keep in mind that the Alberta government has deposited less than 10% of resource revenue into the Alberta Heritage Savings and Trust Fund since its inception in 1976. Whether Albertans can impose on their government budgetary rules, procedures, and commitments that will generate a 50% saving rate is therefore also part of the question of feasibility.

If we use the most recent 5-year period (2001-2005) as a rough guide of what might be the future value of the gap between long-term spending and long-term revenue, then an average of $4.5 billion of resource revenue will be needed to balance the budget (controlling for the ups and downs of economic cycles). Given this, saving 50% of resource revenues will require that resource revenues average $9.0 billion per year. That is a little more than the average amount of resource revenue collected over the 2001-2005 period ($8.3 billion) but well over twice the average amount collected in the 6-year period prior to that ($3.5 billion).

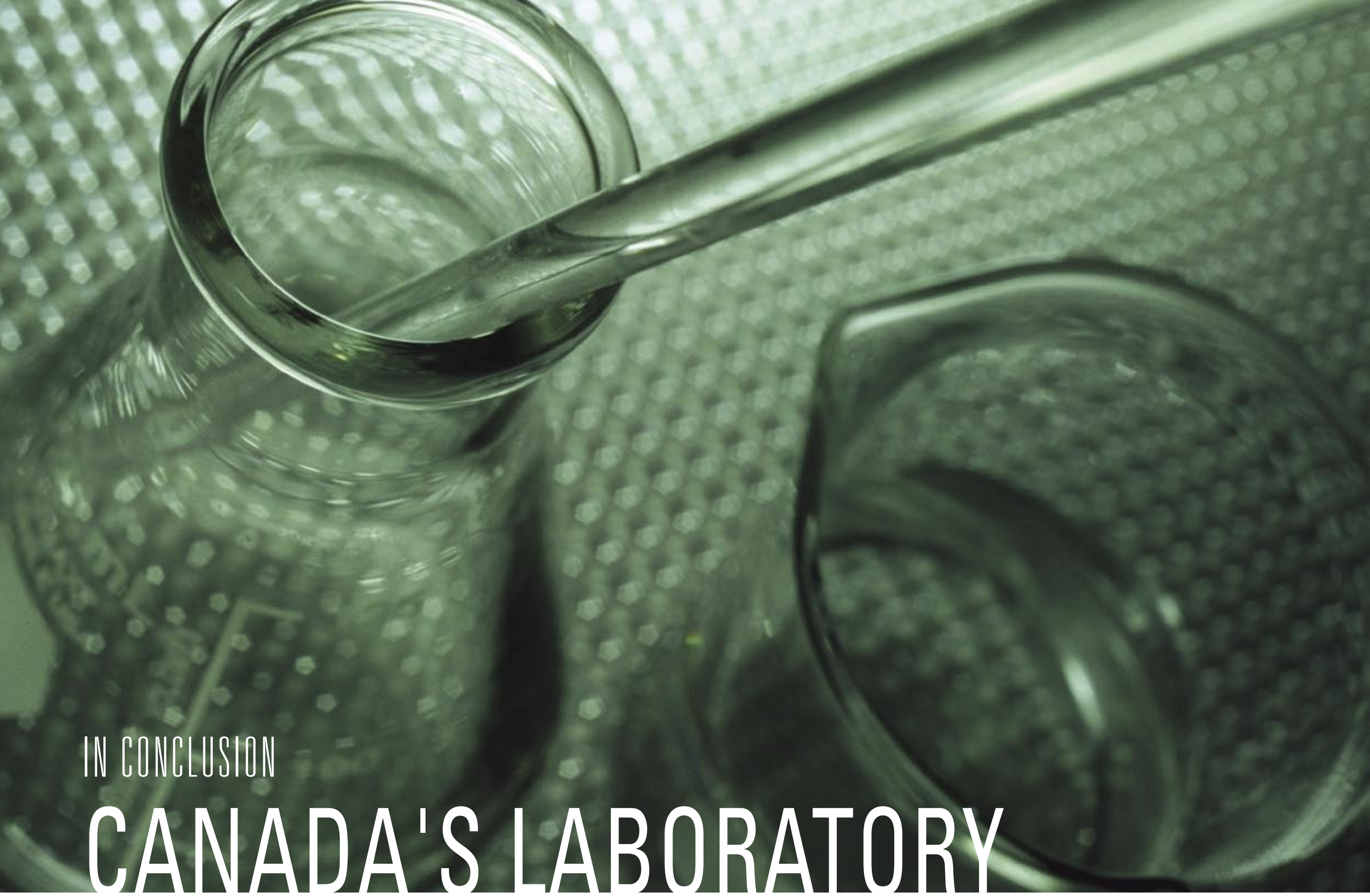
Is, then, the 50% rule feasible? If we presume that the government remains committed to maintaining a level of government services comparable to what is currently enjoyed, and if we presume that it remains committed to maintaining current tax rates, then the answer to the question rests on the future direction of resource revenues.

If resource revenues remain close to what they have been recently, the 50% rule is feasible without large changes being required of current tax rates and current spending levels. If resource revenues return to the more moderate levels of 1995-2000, meeting the 50% rule will demand a roll-back of previously passed tax cuts, a renewed and vigorous effort at expenditure control, or some combination of the two.

Recently, the Alberta Energy and Utilities Board released its forecast for energy prices for 2005-2014. The AEUB reports that it expects both oil and natural gas prices to remain high for the foreseeable future. This forecast suggests that the government of Alberta has a unique opportunity to not only continue to provide high quality government services at relatively low tax rates but to also save 50% of resource income to benefit future taxpayers. If the AEUB is correct, the economic conditions required for this to happen are in place. All that is required now is the political will to make it happen.

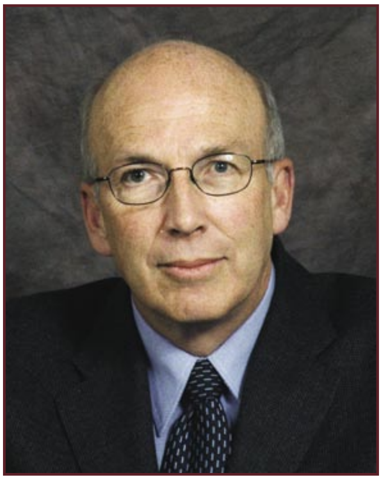
If saving a significant percentage of resource revenues is deemed important to Alberta's future, how can citizens ensure that their politicians will make these difficult choices? One way is to bind them to budgeting rules which make saving of resource revenues a priority rather than an after-thought. Without a binding rule that places a priority on saving, governments will tend to avoid the difficult choices that are required to ensure that future generations of Albertans will share in the benefits of the resource endowment the current generation of Albertans enjoy.

Dr. Ronald Kneebone is a Professor in the University of Calgary Department of Economics and Institute for Advanced Policy Research.



IN CONCLUSION

CANADA'S LABORATORY



DR. ROGER GIBBINS
President and CEO
Canada West Foundation

A good way to start an argument in Alberta today is to suggest that the province's energy wealth should be a topic of national conversation. There is an understandable wariness about a national discussion that could lead to proposals on how Alberta's energy wealth might be redistributed. Constitutional protections notwithstanding, Albertans have an instinctive and historically well-grounded fear of national initiatives directed at natural resource wealth. Placing the adjective "national" in front of policy initiatives makes Albertans run for cover.

I would argue, however, that a national debate on energy wealth is not only unavoidable but welcome. If nothing else, it sets a high bar for Albertans themselves, challenging them to make the most of their natural resource endowment.

There is a need to ventilate and enrich the internal debate within Alberta, to bring a wide range of perspectives to bear on the province's awesome potential. In this context and others, the Canada West Foundation endeavours to serve as a catalyst for informed public policy debate. To this end, *Dialogues* seeks to inform a provincial and national debate on the management of natural resource wealth, and on the transformative power of that wealth.

Albertans, I would argue, have nothing to fear from an expanded debate, and a great deal to gain.

Part of the reason for a national debate stems from the fact that Alberta's wealth will unquestionably have significant regional and national effects. Although only 10% of

Canadians live in Alberta, the provincial economy is large enough to influence both its neighbours and the country at large. For example, what happens in Alberta with respect to tax rates and public sector salaries, with respect to human, social and natural capital, will have effects well beyond Alberta's borders.

Alberta's energy wealth is like a large stone thrown into the pools of the regional and national economies. There will be ripples, even waves, to which other jurisdictions will have to react.

Direct economic effects, however, are not all that might ripple out into the regional and national communities. The more important effects in the years ahead are likely to come from the public policy leadership that Alberta may be able to provide.

It is important to stress here that Alberta's current prosperity exemplifies, albeit in an exaggerated form, a much broader national trend. It is hard to pick up a newspaper without running across stories about Canada's strong economic performance. Unemployment rates are lower than they have been for 25 years, levels of economic growth hold up well to international comparisons, and public finances have improved dramatically from the more dismal performance of the 1990s. Deficit financing has been reduced and often eliminated, and many governments, including the Government of Canada, are running healthy surpluses.

As a result, Canadians at large (and particularly those living in the four western provinces) are moving from the politics of constraint to the politics of prosperity. In this new environment, there is much to learn as Albertans confront truly pan-Canadian challenges and opportunities.

Part of our national conversation, of course, will address the perennial debate between the comparative advantages of lower taxes or enhanced public programs. This debate will never be finally resolved in Alberta or elsewhere—it simply represents the inherent tension between the appeals of private and public wealth.

The Alberta situation can contribute more directly and constructively to a critically important national debate on the role of public policies in promoting wealth creation and, therefore, sustainable economic prosperity. Canadians should be watching carefully as Albertans experiment with public policies designed to ensure sustainable economic prosperity in a global environment characterized by steadily increasing competition.

In the years ahead, Albertans will be struggling with public policy challenges that all Canadians will face:

What is the appropriate balance between economic prosperity and environmental protection—can they be recast as truly two faces of the same coin?

The bitumen found in northern Alberta puts the province second (Saudi Arabia is first) on the list of the world's largest oil reserves (there are179 billion barrels of established oil reserves in Alberta). Photo used courtesy of Suncor Energy Inc.

How can we foster urban environments that will serve as magnets for footloose human talent around the world?

How can we invest in human capital in ways that can effectively address looming skills shortages?

Can we find the means by which Aboriginal peoples can participate fully and equally in economic prosperity?

What mix of tax reform and public policy initiatives best promotes innovation and research, and thus sustainable economic prosperity and quality of life?

How can governments facilitate the gradual transition away from a carbon-based economy?

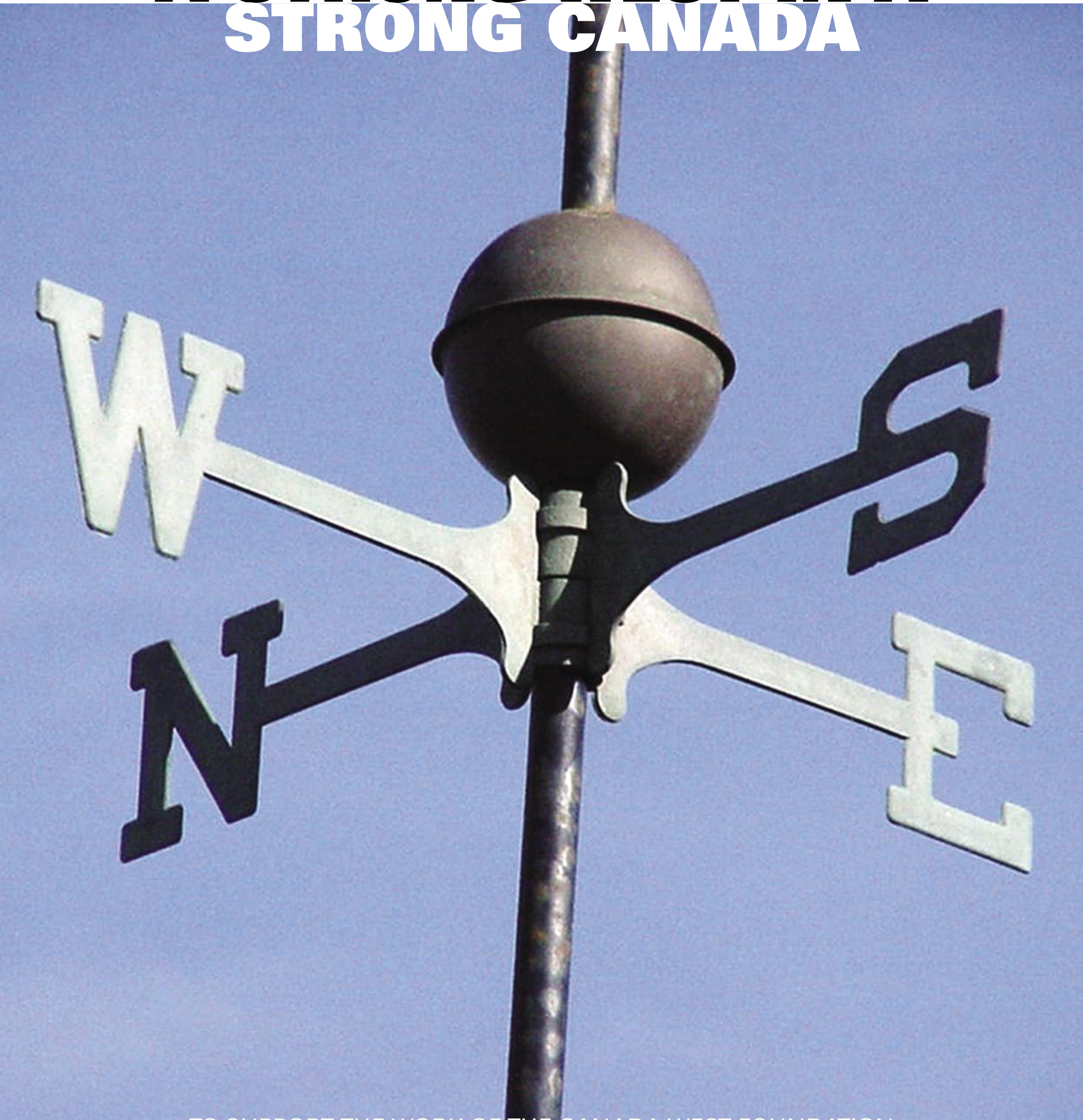
Alberta is the public policy hothouse within which these and other public policy challenges will be addressed.

Today, the slogan on Alberta license plates is "Wild Rose Country." Tomorrow, perhaps, it will be "Canada's Laboratory." Alberta has a priceless opportunity to experiment, not simply because it has the financial wherewithal, but because the province can afford to fail. Albertans can be risk takers, and can be so to the advantage of all Canadians.

Let's hope, then, that the Alberta "laboratory" helps improve public policy performance across the country as Canadians grapple with the return of economic prosperity.

Albertans have a wonderful opportunity for national leadership where it truly counts—leadership in creativity and ideas. Let's all hope that Albertans rise to this challenge. If they succeed, we all succeed. If they fail, we all fail.

A STRONG WEST IN A STRONG CANADA



TO SUPPORT THE WORK OF THE CANADA WEST FOUNDATION

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