UNIVERSITY OF REGINA Online ISBN 978-0-7731-0716-8
DEPARTMENT OF ECONOMICS Print ISBN 978-0-7731-0717-5

A Call for a New Saskatchewan Heritage Fund?

Dr. Stuart J. Wilson
Jason Penner
Amy Demyen

Department of Economics
University of Regina
Regina, Saskatchewan
Canada S4S 0A2

econ@uregina.ca

October 2012

DISCUSSION PAPER #109

A Call for a New Saskatchewan Heritage Fund?

Wilson SJ, Penner J, Demyen A

Department of Economics
University of Regina
Regina SK S4S 0A2

July 24, 2012

Corresponding author: Stuart Wilson (stuart.wilson@uregina.ca).[1]

During the 2011 Saskatchewan election campaign, the NDP party, under the leadership of Dwain Lingenfelter, proposed a "Bright Futures Fund" modeled after the resource revenue savings funds of Alaska and Norway.[2] Premier Wall has stated that he is not opposed to a savings fund for the long-term future of Saskatchewan, but that the provincial debt should be paid off first.[3] With the Debt Retirement Fund growing to offset the government debt, that time may come soon.

The Blakeney NDP provincial government established a vehicle for the long-term savings of resource revenues, the Saskatchewan Heritage Fund in 1978, but it was terminated in 1992 when the Romanow NDP government took over a debt and deficit-plagued province from the 10-year Devine Progressive Conservative government. Saskatchewan's neighbor to the west has its own Alberta Heritage Savings Trust Fund, established in 1976 by then-Premier Lougheed. But that fund has come under increased scrutiny and attack for being neglected. What lessons can we learn from recent experiences with these types of funds? Should a savings fund be re-established? To explore these issues, we first discuss the current Saskatchewan economic context, then provide an overview of the Alberta and Saskatchewan heritage funds, before returning to the current savings fund debate and descriptions of the Alaskan and Norwegian resource revenue savings funds. We conclude by discussing policy options for Saskatchewan.

Saskatchewan's Recent Boom in Context

Saskatchewan has experienced an economic boom since 2006, with GDP growth averaging 7.5% per year, and population growth averaging 1.3% per year.[4] Over that same period, even though total government spending has increased at a robust rate of 6.0% annually, revenue growth has been more rapid, and the general public debt has decreased from $7.2 billion to $3.8 billion. Much of this renaissance is due to increases in resource prices, the expansion of the resource sector in Saskatchewan, and increased resource revenues.

Figure 1 shows the pattern of Saskatchewan government spending, revenues, deficit, public debt, and total resource revenues, from 1981 to 2011. Of particular interest is the excess spending over revenues that occurred since the 1982 recession up to 1996, which led to the ballooning of the public debt from $176 million, to $8.6 billion. Since then, spending has grown just slightly slower than revenues. In 2009, a major resource revenue surge, more specifically from potash, facilitated a drop in government public debt from $6.8 billion to $4.1 billion. Saskatchewan is currently enjoying a resource-driven economic boom, as are government coffers.

One of the problems with a resource-based economy is price and revenue volatility: oil prices and revenues dropped in the mid-1980s, and potash prices and revenues exhibited a one-year spike in 2009. Governments of resource-based economies should expect economic activity to rise and fall with resource prices, and would do well to insulate themselves from wild swings in government spending: the drop in oil prices in the mid-1980s exacerbated the over-spending problems in both Alberta and Saskatchewan, and contributed to the strong cuts in government spending in the 1990s. To do so, governments need to develop a buffer of savings when resource prices and revenues are considered high, and avoid the temptation to increase government spending during good times. Many governments have short-term rainy-day funds. Governments also need to make long-term plans in cases where their revenues are driven by non-renewable resources, to preserve benefits from resource exploitation and depletion for future generations.

Heritage Funds in Alberta and Saskatchewan

Both Alberta and Saskatchewan developed long-term non-renewable resource revenue savings funds in the late-1970s to sustain long-term economic growth and prosperity. The Alberta Heritage Savings Trust Fund was created in 1976, and the Saskatchewan Heritage Fund followed shortly thereafter in 1978, during a time of high oil prices. However, the design of the two plans changed over time, and in the case of Saskatchewan, so much so that the fund was abandoned in 1992.

The **Alberta Heritage Savings Trust Fund** (AHSTF) was created in 1976 by the Lougheed government, and has the following objectives:

1. *To save for the future;*
2. *To strengthen and diversify Alberta's economy; and,*
3. *To improve the quality of life in Alberta.*[5]

The fund was initially endowed with $2.2 billion, and was to receive thirty percent of resource revenues. In the early stages of the fund, its equity increased through the share of resource revenues and increasing income from fund investments. The fund provided investment capital for Crown Corporations and the private sector, and provided loans to other provincial governments. The fund also made capital expenditures that were not intended to generate a financial return, but instead, to generate long-lasting economic and social returns. Examples of these expenditures include those for education (the Alberta Heritage Scholarship Fund), agriculture projects (the Reforestation Nursery Enhancement Program), and research facilities (the Alberta Heritage Foundation for Medical Research, and the Alberta Oil Sands Technology and Research Authority).[6]

The fund was initially built up on the strength of high oil prices and revenues, but the 1980 National Energy Program and the 1982 recession led to slower growth in resource revenues and an increase in provincial government support for the energy industry.[7] By 1984, all investment income of the fund was diverted to the General Revenue Fund and the share of resource revenues to the fund declined to 15%. Then, in 1986, oil prices and revenues collapsed, and with continued high spending growth, the Albertan government began an eight-year journey into deficit spending. By 1988, the AHSTF no longer received any share of resource revenues. The Progressive Conservative Government was re-elected in 1993, under the leadership of Ralph Klein, with the goal to eliminate the deficit which had increased to twenty percent of spending. The view was that revenues were not the problem, but instead it was unrestrained spending that led to the government debt and deficit problem. Budgets were slashed by twenty percent. The deficit was eliminated by 1995, and then the government embarked on a debt reduction plan, with the goal to eliminate the debt within twenty-five years.[8] Alberta was able to eliminate its net debt position in 2001. **Figure 2** shows Alberta government spending, revenues, and resource revenues over the 1981 to 2009 period.

As of 1996, no capital expenditures have been made through the AHSTF, and the fund has since continued to simply generate additional revenue (investment income), for the Alberta government to use as general revenues. Even after the elimination of deficits in 1995 and the surge in resource revenues in the 2000s, the Alberta Heritage Savings Trust Fund did not experience a change in policy to receive injections of resource revenues as it had in the past. Since 1986, fund equity has only grown by $1.5 billion in nominal terms, even with special injections of $3.9 billion from 2006 to 2008 that effectively offset investment losses in 2003 and 2009. AHSTF developments are depicted in **Figure 3** (Revenues), and in **Figure 4** (Expenditures and Equity).

The **Saskatchewan Heritage Fund** (SHF) was introduced by the Blakeney government in 1978. The fund was established with three main purposes:

1. *To invest part of non-renewable resources revenues into income-producing assets to ensure that future generations can benefit from resource development in Saskatchewan;*
2. *To create stability in the consolidated fund which is responsible for the government's day-to-day spending. This would ensure that the consolidated fund did not depend on the revenues from non-renewable resources as those revenues can be volatile and unpredictable, and;*
3. *To ensure legislative control over the expenditures and investments of non-renewable resources revenues by having them subject to legislative approval.*[9]

The fund was initially endowed with $465 million from its predecessors, the Energy and Resource Development Fund, and the Special Investment Account. Unlike the AHSTF, all non-renewable resource revenues were to be deposited into the fund, but up to eighty percent of these revenues could be transferred to the General Revenue Fund. Up to twenty percent of revenues could be used for provincial development initiatives. Revenues from oil, natural gas, potash, uranium and coal generated the bulk of non-renewable resource revenues, amounting to half of a billion dollars in fiscal year 1978-79. Of that amount, $308 million (61%) was transferred into the Consolidated Fund, $32 million (8%) was used to provide grants for petroleum and natural gas exploration, and $16 million (3%) was earmarked for provincial development expenditures. The remainder increased fund equity in that year, primarily in the form of long-term investments in Saskatchewan's Crown Corporations.[10] The Crowns would be the predominant recipient of SHF investment over time.

Like its Albertan counterpart, the SHF had the objective to fund provincial development expenditures that may not provide a defined financial return, but instead would generate an economic and social return to the province. In its first year, the SHF provided funding for the University of Saskatchewan's Engineering and Veterinary College building projects, the Buffalo Narrows Airport, and the Moose Jaw Wild Animal Park, among other projects. In later years, the SHF funded projects including the Saskatchewan Technical Institute expansion, the restoration of Saskatchewan House, northern highways and development roads, and community capital projects.[11]

Oil and other resource revenues grew to almost $800 million by 1982, and the newly-elected Progressive Conservative government, led by Grant Devine, enacted a series of changes to the Heritage Fund. The limit of revenues that could flow into the Consolidated Fund was abolished, as was the limit of revenues that could fund provincial development. The government established an Agricultural Lands division to finance farm purchases by residents, and curtailed the diversion of Heritage Fund revenues into Crown Corporation investment and loans. However, Saskatchewan was affected by the same shocks that affected Alberta: the NEP, the 1982 recession, and the 1986 oil price collapse. SHF revenues were increased by special investment income in the form of dividends drawn from Crown Corporations. SHF revenues are shown in **Figure 5**.

During the 1980s, the province experienced excessive growth in spending. Saskatchewan government expenditures were growing at a pace that surpassed growth in revenues, and the provincial debt increased. For the 1982-83 fiscal year, the share of SHF revenues that were transferred to the Consolidated Fund surpassed the 80% mark, and rose to 88% in 1985-86. With the dramatic drop in resource revenues in the mid-1980s, revenues available to be transferred into the Consolidated Fund also fell. As a consequence of these developments, the share devoted to provincial development expenditure dropped from a high of 6.4% in 1981-82, to nil by 1986-87. SHF Expenditures are shown in **Figure 6**.

Following ten years of consecutive budget deficits, the 1992 fiscal year government deficit amounted to $600 million, and the public debt surpassed $8.1 billion. With the government teetering on bankruptcy, the newly-elected NDP government, led by Roy Romanow, terminated the Saskatchewan Heritage Fund, by absorbing its balances into the Consolidated Fund, effective April 1, 1992. The majority of those balances were investments in, and loans to, the Crown Corporations, with a substantial amount as a short-term receivable from the Consolidated Fund. These balances are depicted in **Figure 7**.

Renewed Heritage Fund Debate

With the recent experience of high resource revenues, surpluses, and falling debt in Saskatchewan, the question of re-instating a heritage fund in some form has been posed. At the same time, the Alberta government has come under attack for its spending habits and reluctance to save resource revenues for the future. Their net debt was essentially eliminated in 2000. Since then, Alberta experienced another resource boom, but has neglected the AHSTF, which has not received any resource revenue deposits since 1988.

In 2009, Emery and Kneebone wondered if the Alberta government would remember its experience in the 1980s and 1990s, present sustainable budgets that did not rely so much on resource revenues, and enact a plan to save during resource price and revenue booms. In 2011, Emery and Kneebone reiterated their arguments and showed that the Alberta government further increased spending and added tax cuts in 2009 when energy revenues declined. The Alberta fiscal situation is currently one in which the gap between spending and tax revenues is rising and has surpassed the value of energy revenues: the government is heavily reliant on energy revenues that have recently fallen and is poised to see its wealth decline by $13 billion by 2014.[12] The Alberta Government has been accused of neglecting the AHSTF and allowing the fund to stagnate while resource revenue trust funds in Alaska and Norway have continued to grow.[13]

In a similar vein, Saskatchewan needs to decide how it wants to handle its non-renewable resource boom in the coming years. Saskatchewan's past experience with a heritage fund was hindered by general government overspending, and in its short history, was essentially used as a vehicle to channel resource revenues to the crowns as loans, and into the general revenue fund – no financial savings strategy was employed. Will Saskatchewan neglect to save for the future, or will it develop a savings fund, as proposed by the Saskatchewan NDP party, and modeled after those of Alaska and Norway? To consider that question, we will now briefly explore the funds of these two countries and their differences.

The **Alaska Permanent Fund** (APF) has grown from its inception in 1976, to its current value of 40 billion US$. However, the APF is quite different from the funds of Alberta and Saskatchewan. The Alaskan government is constitutionally mandated to place twenty-five percent of non-renewable resource-related revenues automatically into the fund. Unlike in Alberta or Saskatchewan, a change to this policy would require voter approval, rather than the whim of the governing party. The APF is managed at arms-length without political influence, and is well-diversified.[14] The AHSTF is managed by the provincial treasurer and an investment committee, and since 1996, has undergone a transition to become more diversified and to hold more market-based financial investments. This is compared to the SHF practice of holding predominantly crown corporation debt and receivables from the government's general revenue fund. In addition, APF proceeds may only be used to increase the capital of the fund (including inflation-proofing) which are used to sustain the fund for future generations, or used to payout dividends to eligible Alaskan residents. As of 2011, half of the fund's cumulative income ($19.6 B) had been paid out to residents, and half had been reinvested for future generations.[15] The government derives no direct benefit from the fund to help cushion government revenues and spending during poor economic times – instead it has a stabilization fund, the Constitutional Budget Reserve Fund.[16]

The **Norway Pension Fund Global** (NPFG), formerly the Government Petroleum Fund, was established in 1990 to preserve oil wealth for future generations. It is managed by Norges Bank Investment Management, an arm of the Norwegian Central Bank, under the supervision of the Ministry of Finance. It is well-diversified, with wide-ranging global interests in equities, fixed income products, and real estate. Over the years since 1996, the first year of a government surplus since the fund's inception, the fund has continuously grown with annual petroleum revenue inflows and investment income, from a value of 46.3 billion kroner, to 3.31 trillion kroner in 2011 (563 billion C$ at that time). The fund even grew in 2008 by over 250 billion kroner, when disastrous investment returns measured in international currencies were offset by the depreciation of the krone and historically high oil revenue deposits (384 billion kroner).[17] The NPFG is fully integrated into the annual budget process, with the government setting the oil revenue transfers, unlike the case for the APF as explained above, where the government is mandated to divert 25% of resource revenues into the fund. However, Norway has succeeded in restraining government spending so as to grow the fund through continual injections of oil revenues, and reinvestment of income, something the Alberta government has failed to do.

Saskatchewan Fund Policy Options

What then should Saskatchewan do differently with its resource revenues? The primary objectives of the SHF still have merit, and bear repeating here:

1. *To invest part of non-renewable resources revenues into income-producing assets to ensure that future generations can benefit from resource development in Saskatchewan;*
2. *To create stability in the consolidated fund which is responsible for the government's day-to-day spending. This would ensure that the consolidated fund did not depend on the revenues from non-renewable resources as those revenues can be volatile and unpredictable, and;*
3. *To ensure legislative control over the expenditures and investments of non-renewable resources revenues by having them subject to legislative approval.*[18]

To meet the objective of budgeting stability (objective 2), the government has its own rainy-day fund, the Growth and Financial Security Fund (GFSF), which was projected to hold $709 million at the end of the 2011-12 fiscal year. With forecast government public debt at $3.8 billion, and total spending of $11.0 billion at the 2012 fiscal year-end, the GFSF is projected to hold a balance equal to 18.6% of the government public debt, and 6.4% of total spending. Funds from the GFSF, $325 million, were used to pay down government public debt during the 2011-12 fiscal year. The government expects to build up this fund again over the coming years to achieve a balance of $1 billion by 2016, while keeping the public debt constant at $3.8 billion.[19] This fund should continue to be used to address short-term government revenue cycles, with inevitable resource boom and bust cycles. The government should define an optimal strategy of accumulation and de-cumulation of fund balances, as well as a target balance for the fund, and provide more transparency in the operation of this fund for the future.

As for the first objective, the government does not currently have dedicated long-term savings funds for financial wealth accumulation: the SHF was terminated in 1992 and has yet to be replaced. It has been pursuing long-term savings through debt reduction, and once the debt is retired, it would be wise to use resource revenues to also develop an investment fund of income-producing assets to benefit future generations. The Alaskan, Norwegian and Albertan funds are all well-diversified. A Saskatchewan fund should not restrict itself to the crowns.

The government will also have to setup the guidelines for such a fund so that legislative control and approval (objective 3) do not supersede the first objective. The Saskatchewan government should define a policy of contributions, desired growth, and use of the fund over time. Alberta has essentially pushed aside and neglected its heritage trust fund as a long-term savings vehicle for Alberta. However, the two cited models for a new Saskatchewan fund, the APF and the NPFG, have continued to meet their original objectives. The Alaskan government is mandated to inject resource revenues into the fund to keep the APF relevant and its short-term Constitutional Budget Reserve Fund allows it to weather short-term economic and resource storms. The Norwegian government has integrated its fund into the budgeting process, but has continuously kept its long-term commitment to inject revenues into the fund. These two models work because of the commitment, either internally enforced or constitutionally mandated, of the government to maintain their long-term savings objectives. Both the Albertan and Saskatchewan governments abandoned those commitments in the 1980s, and have not since renewed them.

There are two related issues that need to be addressed in conjunction with a discussion of a long-term savings fund. The IMF has identified two additional types of reserve funds that can benefit economies including Saskatchewan: funds for socio-economic development, and to cover pension liabilities. [20] Both of these types of funds are geared to future generations, to build up infrastructure, to improve socio-economic conditions, and to reduce the future pension burden on taxpayers.

In Saskatchewan, socio-economic and infrastructure projects are not ignored, but are handled through the general revenue fund and existing budget process. It may not be necessary to establish a dedicated fund of this type if these expenditures are being handled by the general revenue fund, although one of the benefits of such a dedicated fund would be increased transparency, and a better way of recording, promoting, remembering, and assessing the benefits of these ventures – the SHF annual reports provided both annual and cumulative summaries of such spending. It is often overlooked that not all government expenditures are for the short-term, and that there is a distinction between operational costs and investment expenditures. Government capital expenditures have benefits that may last several generations.

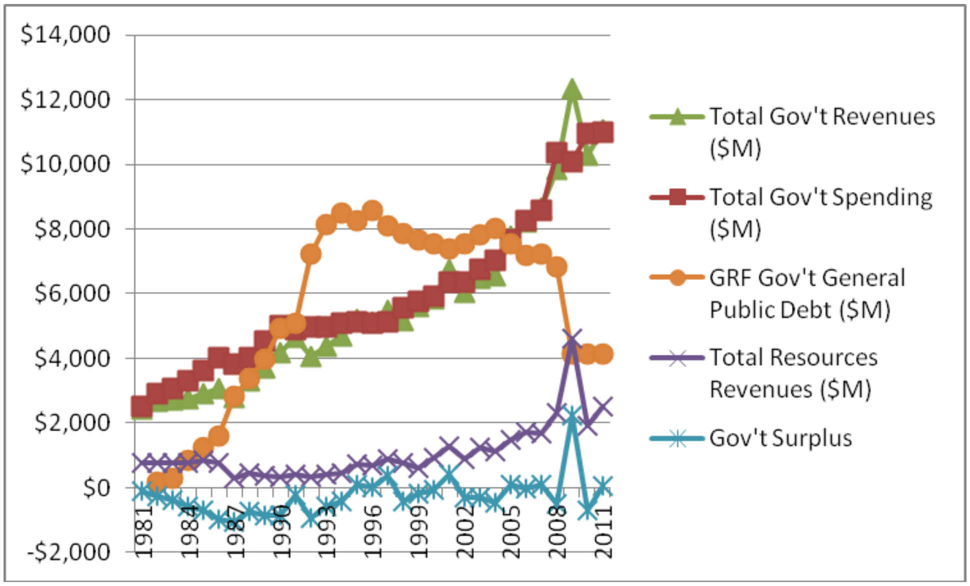
The government would do well to fully establish a fund to cover its pension liabilities. The Saskatchewan Government does have public sector pension liabilities estimated at $6.4 billion by fiscal year-end 2012, and these liabilities are expected to increase another $232 million in the coming year.[21] Such a fund would help cover these liabilities and shield future generations from carrying these costs.

Conclusion

Saskatchewan is currently enjoying a resource boom and economic renaissance. But, as experienced in the recent past in both Saskatchewan and Alberta, resource booms tend to be followed by resource busts. The current Saskatchewan Government has recently paid down part of its debt, and is encouraged to continue doing so. It also needs to avoid the pitfalls of resource booms by not relying too much on resource revenues to fund government spending. Saskatchewan needs to continue to budget its spending prudently and save for the short-term by adding to the Growth and Financial Security Fund. However, since the boom is driven by non-renewable resources, these resources will eventually be depleted and will not be available for future generations. Saskatchewan also needs to prudently save for the long-term by continuing its commitment to debt reduction and by establishing a long-term investment fund to benefit future generations. A fund need not be developed to handle capital investments that meet socio-economic and infrastructure development goals, unless the government wants to better advertise and promote those expenditures on an ongoing basis. In addition, the government needs to adequately fund its pension liabilities so that future generations do not have to carry current obligations and costs.

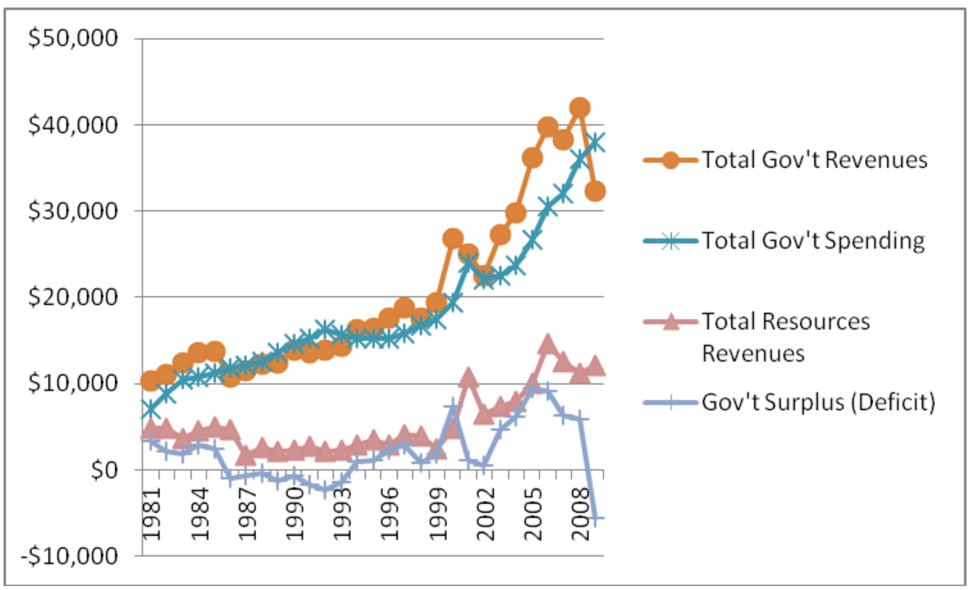
Saskatchewan needs to actively debate the guidelines for these types of funds, defining how they should be used, what target balances are desired, and how these funds will be integrated into the budget process. Ignoring these issues would mean placing higher burdens on future generations, especially in light of the ongoing aging phenomenon, the retirement of the baby boom generation, and expected social security support pressures on government.

Figure 1: Saskatchewan Public Accounts Data, 1981-2011, in millions



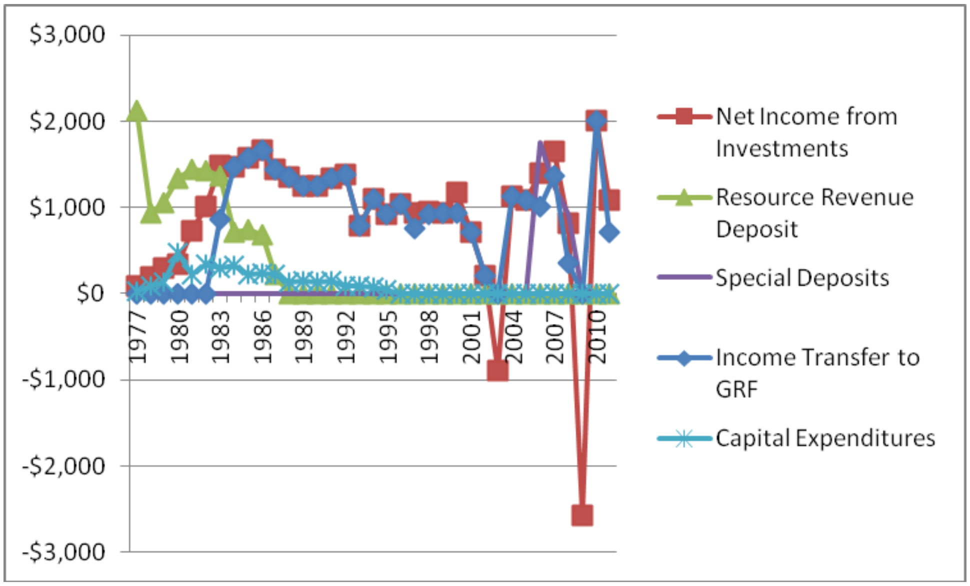
Source: Saskatchewan Public Accounts, 1981-2011, fiscal year-end basis

Figure 2: Alberta Government Data, 1981-2009, in millions



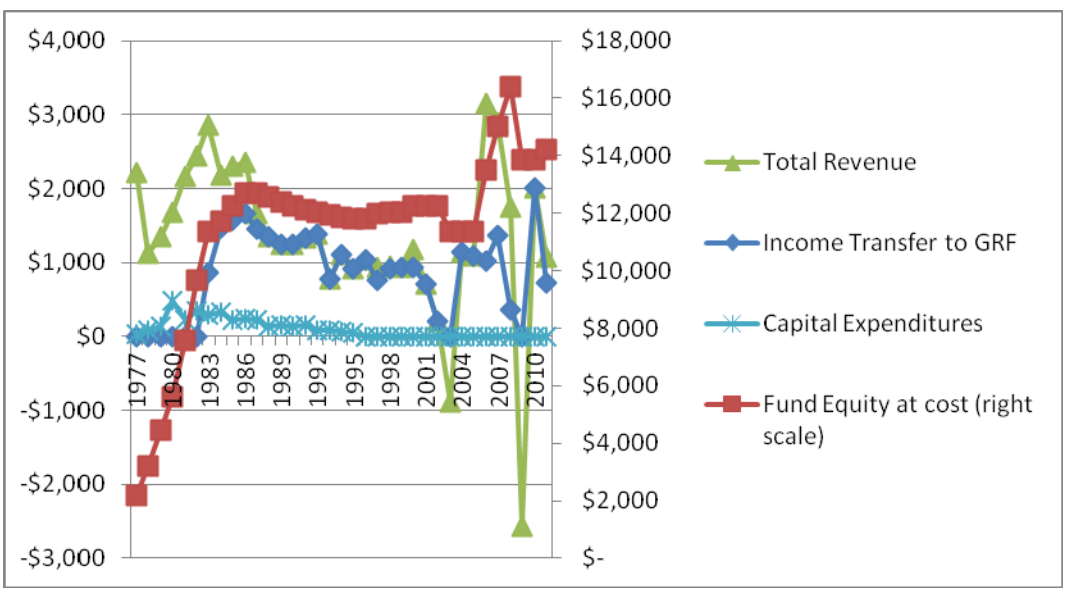
Sources: Statistics Canada, CANSIM Database, Table 384-0004, calendar year data accessed April 2012 (Government revenues and spending); Alberta Department of Resources, Alberta Resource Revenues, Historical and Budget www.energy.alberta.ca/Org/docs/Revenueworkbook.xls, March 31 fiscal year-end data attributed to previous calendar year for comparative purposes, accessed April 2012 (resource revenues).

Figure 3: Alberta Heritage Savings Trust Fund Revenues, 1977-2011, in millions



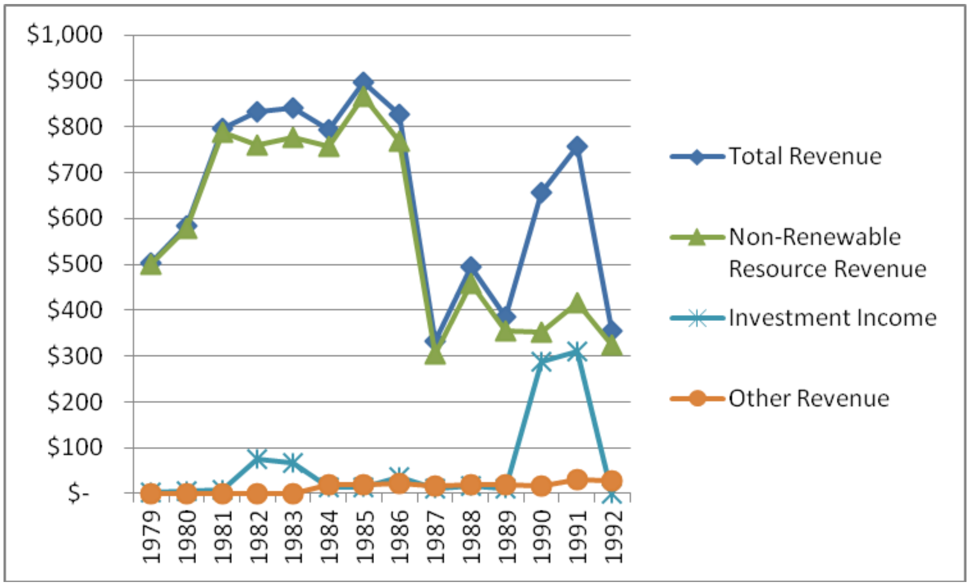
Source: Alberta Heritage Savings Trust Fund Annual Report, 2010-11, fiscal year-end data

Figure 4: Alberta Heritage Savings Trust Fund Expenditures and Equity at Cost, 1977-2011, in millions



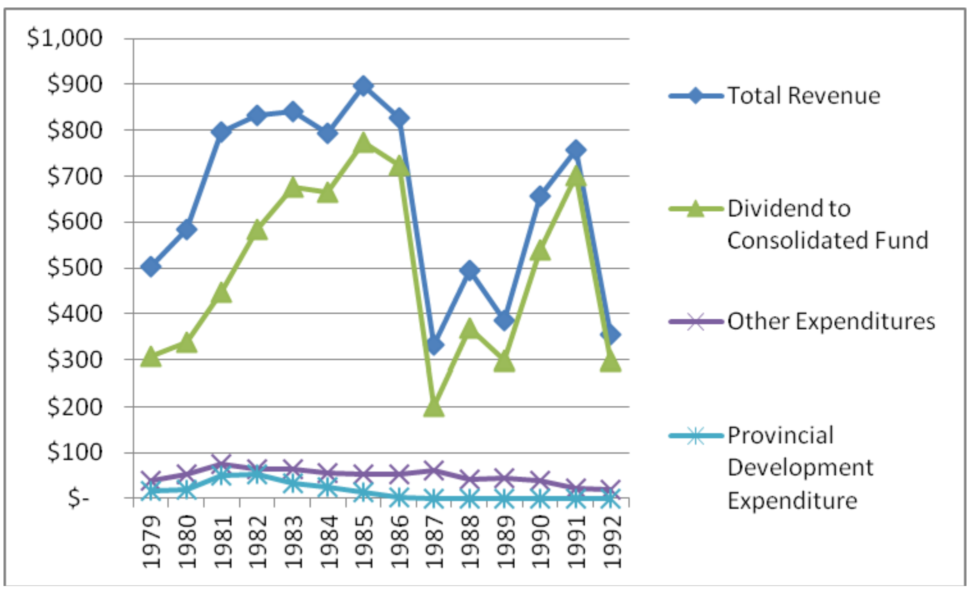
Source: Alberta Heritage Savings Trust Fund Annual Report, 2010-11, fiscal year-end data

Figure 5: Saskatchewan Heritage Fund Revenues, 1979-1992, in millions



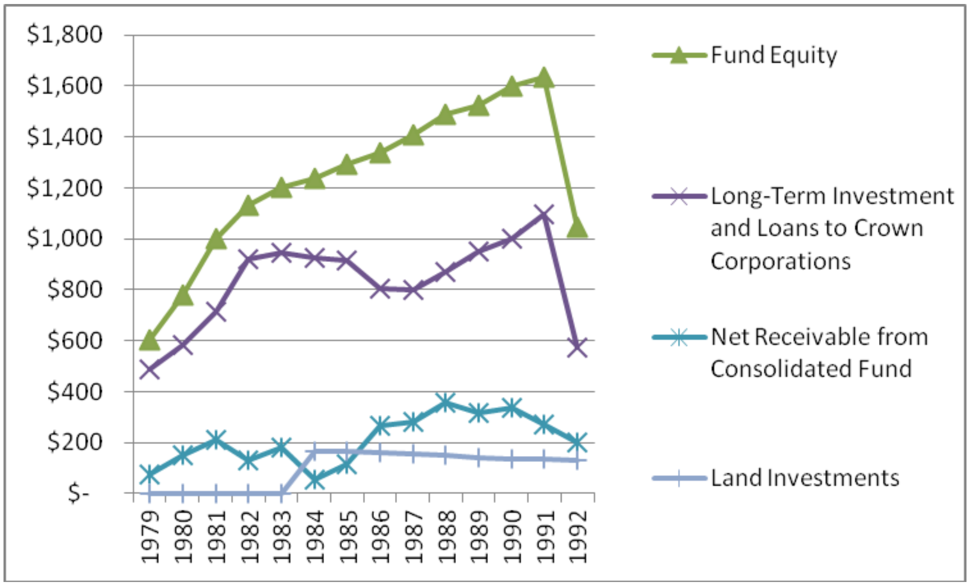
Source: Saskatchewan Heritage Fund Annual Reports, 1978/79-1991/92, fiscal year-end data

Figure 6: Saskatchewan Heritage Fund Expenditures, 1979-1992, in millions



Source: Saskatchewan Heritage Fund Annual Reports, 1978/79-1991/92, fiscal year-end data

Figure 7: Saskatchewan Heritage Fund Equity, 1979-1992, in millions



Source: Saskatchewan Heritage Fund Annual Reports, 1978/79-1991/92, fiscal year-end data

ENDNOTES

[1] The authors wish to acknowledge members of the Saskatchewan Chamber of Commerce Finance Committee for helpful comments, suggestions and encouragement of this project.

[2] Hutton D, NDP pitches potash savings fund, the StarPhoenix, Thursday September 1 2011.

[3] Mandryk M, Campaining parties compete for best ideas, Leader-Post, Tuesday October 11 2011.

[4] Statistics Canada, CANSIM Tables 379-0025 and 051-0001.

[5] Hoffman MD, The economic impact of the Alberta Heritage Savings Trust Fund on the consumption-savings decision of Albertans, Western Centre of Economic Research, University of Alberta, Information Bulletin Number 36, February 1996.

[6] Alberta Heritage Savings Trust Fund Annual Report, 2010-11.

[7] Emery JCH and Kneebone RD, Alberta's problems of plenty, Policy Options, May 2011: 10-16.

[8] Kneebone RD, The government of Alberta's fiscal future: Possibilities and pitfalls, Institute for Sustainable Energy, Environment and Economy (the University of Calgary), Paper No. 16 of the Alberta Energy Futures Project, November 2006.

[9] Saskatchewan Heritage Fund Annual Budget, 1978-79.

[10] Saskatchewan Heritage Fund 1977-78 and 1978-79 Annual Reports.

[11] Saskatchewan Heritage Fund 1991-92 Annual Report.

[12] Emery JCH and Kneebone RD, Will it be déjà vu all over again? The School of Public Policy SPP Briefing Papers, (the University of Calgary) Volume 2 Issue 1 April 2009.

[13] Klein J, Alberta let rainy day Heritage Fund dwindle as the storm gathered, the National Post, Oct 18, 2011.

[14] Warrack A, Alberta Heritage Fund: Blessing becoming a curse? Western Centre for Economic Research, University of Alberta, Information Bulletin Number 85, November 2005.

[15] Alaska Permanent Fund 2011 Annual Report.

[16] Fasano U, Review of the experience with oil stabilization and savings funds in selected countries, IMF Working Paper 00/112, 2000:12.

[17] Government Pension Fund Global 2007, 2008, 2011 Annual Reports, Norges Bank Investment Management, Oslo Norway.

[18] Saskatchewan Heritage Fund Annual Budget, 1978-79.

[19] Saskatchewan Provincial Budget 12-13 Budget Summary, available at http://www.finance.gov.sk.ca/budget2012-13/2012-13BudgetSummary.pdf.

[20] IMF Global Financial Stability Report 2007, Annex 1.2, http://www.imf.org/external/pubs/ft/gfsr/2007/02/pdf/annex12.pdf, accessed July 19, 2012.

[21] Saskatchewan Provincial Budget 12-13, Budget Summary.