FRONTIER CENTRE FOR PUBLIC POLICY
FCPP POLICY SERIES NO. 50 NOVEMBER 2008

POLICY SERIES

Restoring Peter Lougheed's Original Vision

Heritage Fund

A Comparison of Alberta's Heritage Savings Trust Fund and the Alaska Permanent Fund

ALASKA PERMANENT FUND
Established 1976

By Mark Milke

About the Author

Mark Milke is the Frontier Centre's Director of Research. Mark also lectures in Political Science at the University of Calgary where he received his doctorate. He is the author of three books on Canadian politics, including the 2006 *A Nation of Serfs? How Canada's Political Culture Corrupts Canadian Values* from John Wiley & Sons. He is a former director (first in Alberta and then British Columbia) with the Canadian Taxpayers Federation 1997-2002. Since 2002, among other work, Mark has written policy papers on British Columbia's treaty process, the Canada Pension Plan, Alberta's Heritage Fund, automobile insurance, corporate welfare and the flat tax. He is writing a book on the effects of anti-Americanism on deliberative democracy in Canada and is a Sunday columnist for the *Calgary Herald*. In addition, his columns on politics, hiking, nature and architecture have been published across Canada including in the *National Post, Globe and Mail, Reader's Digest, The Western Standard, Vancouver Sun*, and *Victoria Times Colonist* and the Washington DC magazine on politics, *The Weekly Standard*.

The Frontier Centre for Public Policy is an independent, non-profit organization that under-takes research and education in support of economic growth and social outcomes that will enhance the quality of life in our communities. Through a variety of publications and public forums, the Centre explores policy innovations required to make the eastern prairies region a winner in the open economy. It also provides new insights into solving important issues facing our cities, towns and provinces. These include improving the performance of public expenditures in important areas like local government, education, health and social policy. The author of this study has worked independently and the opinions expressed are therefore his own, and do not necessarily reflect the opinions of the board of the Frontier Centre for Public Policy.

Date of First Issue: November, 2008
Reproduced here with permission of the author.
ISSN 1491-78

MB: 203-2727 Portage Avenue,
Winnipeg, Manitoba Canada R3J 0R2
Tel: 204 957-1567 Fax: 204 957-1570

SK: 2353 McIntyre Street,
Regina, Saskatchewan Canada S4P 2S3
Tel: 306 352-2915 Fax: 306 352-2938

AB: Ste. 2000 – 444 5th Avenue SW
Calgary, Alberta Canada T2P 2T8
Tel: (403) 230-2435

www.fcpp.org

FCPP Policy Series No. 50 • November 2008

Restoring Peter Lougheed's Original Vision

A 2008 Comparison of Alberta's Heritage Savings Trust Fund and the Alaska Permanent Fund

By Mark Milke

Table of Contents

This shower of riches [the Alaska Permanent Fund] sent Alaska into a frenzy of public spending, particularly on capital projects. … By 1976, the state had spent most of the initial lease money, and Alaskans were aghast they had frittered away so much in so short a time. Fears of uncontrolled legislative spending had been confirmed, and Alaskans sought ways to protect their natural resource revenues for future generations.

- Jonathan Anderson. The Alaska Permanent Fund: Politics and Trust. Public Budgeting & Finance / Summer 2002: 68

Oil wealth in many other countries has been used to finance colossal fortunes for the few, or bread and circuses for the many. Norway has avoided both traps. The revenue from the Petroleum Fund could help to maintain Norwegian living standards long after the oil reserves are exhausted. In addition, macroeconomic and structural policies have been used to ensure that the non-oil economy, which accounts for most of the GDP and virtually all employment, remains as viable and prosperous as possible, including in the traded sectors. But pressures to spend more of the capital of the Fund straight away are strong.

- The OECD's economic survey of Norway, 2005

Are we prepared as a province to put aside substantial sums of current revenues from the sale of non-replaceable crude oil production for the sake of our children and for our grandchildren and not make it available for current revenue needs; to use it for that day … when some of the wells may have gone dry?

- Premier Peter Lougheed, in Alberta's legislature, 1976

Executive Summary

An historic opportunity for Alberta

Few jurisdictions around the world have the good fortune to possess natural resource wealth and only a fraction manages windfall revenue with prudence. This study casts a glance at Alberta's spending patterns, present practice and choices for the future. It also compares the Alaska Permanent Fund (APF) with Alberta's Heritage Savings Trust Fund (AHST) to learn from Alaska in order to avoid errors and to ensure that future generations of Albertans also enjoy the Alberta Advantage. The challenge for Alberta is to learn from its Heritage Fund history as well as from the examples of other arguably more successful jurisdictions.

Findings:

Alberta's fiscal context

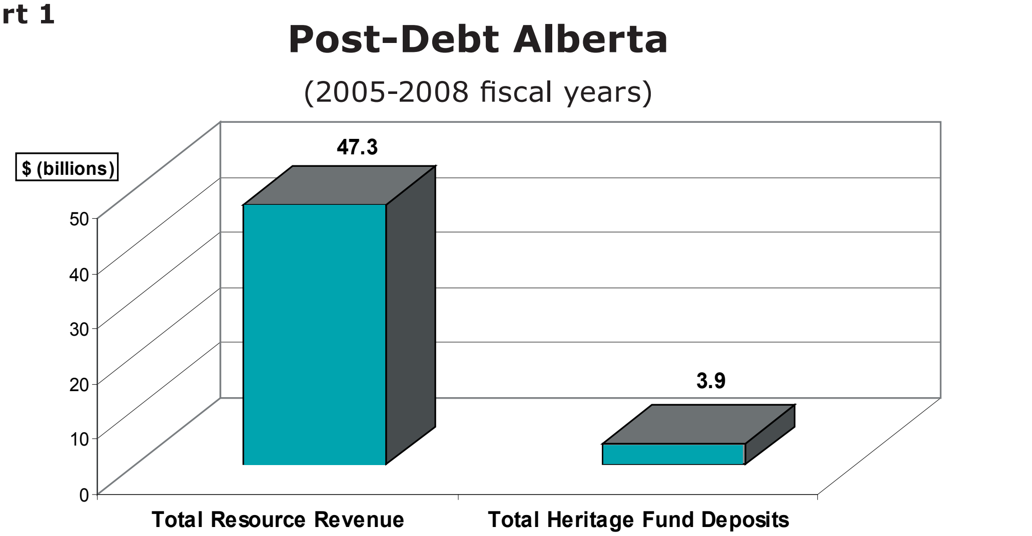
- The provincial government often increased spending beyond inflation and population growth. In inflation-adjusted per capita terms, Alberta's program spending is projected to rise to $10,077 per person in 2009 from $9,396 in 2008. In 1995, per person spending was $6,789.
- There is no automatic restraint upon the growth of government in Alberta. In contrast, Alaska's legislature is restrained, because of the constitutional obligation to place 25 per cent of resource revenue into the Alaska Permanent Fund.
- Over the course of the Heritage Fund's history since its inception in 1976, $30.9-billion in Heritage Fund earnings has been transferred to the province's General Revenue account. Deposits over that period to the end of the current fiscal year will amount to $16-billion, most of it from 1977-1987, leaving a net withdrawal of $14.9-billion.
- Since Alberta became debt-free in 2003-2004, non-renewable resource revenue to the end of the last fiscal year (2007-2008) amounted to $47.3-billion. Since then, only $3.9-billion in new deposits has been allocated to the Alberta Heritage Savings Trust Fund including investments in the advanced education sub-fund.
- Under Alberta's Fiscal Responsibility Act, the province may use up to $5.3-billion annually from non-renewable resource revenue for General Fund expenditures. In practice, the Fiscal Responsibility Act is porous; it cannot effectively limit the province's annual use of resource revenue. Due to expenditures from various funds, significantly more than just $5.3-billion in non-renewable resource revenue is spent annually.
- Alberta is heavily reliant on natural resource revenue. With a review of the last 15 years and with conservative assumptions on interest, spending and other tax receipts beyond resource revenue, Alberta would have faced deficits in seven of the last 15 years had Alberta's government been limited to earning half of the actual resource revenue that accrued. Two of those years would include the previous and current fiscal year with deficits of almost $1.4-billion and $4.3-billion respectively.

Fund comparisons

	Alberta Heritage Savings Trust Fund	Alaska Permanent Fund
Total value (In $ Cdn)	$17.1-billion	$37.3-billion ($36.4-billion US)
Per capita(In $ Cdn)	$4,770	$54,514
Is inflation-proofing required?	Yes, but weak	Yes
Does the fund have constitutional status?	No	Yes
Is there a legislative requirement for annual resource revenue deposits?	Only if authorized by a Special Act.	Yes (25 per cent)
Year created/ First year in which resource revenue deposited	1976/ 1976	1976/ 1977

As of June 30, 2008, for Alberta and July 31, 2008, for Alaska.

Chart 1



Findings:

Fund comparisons between Alaska and Alberta

- Alaska created the Alaska Permanent Fund in 1976 and deposited resource revenue one year later. The state government is constitutionally obligated to deposit 25 per cent of all natural resource revenue into the fund.
- Alaska created its trust fund after much of its previous natural resource wealth was spent on capital projects.
- Alberta – the first jurisdiction to create a trust fund (in 1976) and which immediately deposited revenue into the fund – ceased contributions in 1987 and only resumed deposits in the 2005-2006 fiscal year.
- The principal in the Alaska Permanent Fund is constitutionally protected and cannot be withdrawn by the state legislature or used for purposes other than those noted in the constitutional amendment. Alberta has no such constitutional protection of fund principal.

Recommendations

Recommendation One

- Alberta's annual per capita spending should not exceed population growth and inflation.

Rationale: The province must act prudently now or be forced to rein in future spending in the manner it did in the early to mid-1990s. *Prudent spending is the foundation for future choices:* tax relief, the avoidance of a deficit because of an economic downturn or decline in resource prices or emergency spending on unforeseen catastrophes. The ability to set aside resource revenue in the Heritage Fund is directly linked to restraint on the expenditure side of the ledger. In inflation-adjusted terms, per capita program spending has grown from $6,789 in 1995-1996, and it is forecast to reach $10,077 in the current fiscal year.

Recommendation Two

- Each year, the province should deposit between 30 per cent and 40 per cent of all non-renewable resource revenue into the Heritage Fund.

Rationale: In its original incarnation in 1976-1977, 30 per cent of non-renewable resource revenue was directed into the Heritage Fund. The fund retained all earnings.

Annual set-asides are feasible, as Alberta no longer has to allocate money annually for provincial debt interest payments (funds have already been set aside to pay off debt as it becomes due). Thus, a total set-aside of 30 per cent or 40 per cent of resource revenue is feasible – providing the province reins in spending. It should be noted that even under a 40 per cent plan, *the province could still spend 60 per cent of non-renewable natural resource revenue every year.*

Recommendation Three

- The province should consider transfers of additional resource revenue into the Heritage Fund (beyond the recommended percentages) in imitation of Alaska.

Rationale: Oil and natural gas prices have dropped from their recent all-time highs. This reality underscores the necessity to deposit portions of such revenue in to the Heritage Fund in every fiscal year. If the province does not return to regular, mandated deposits as occurred under Peter Lougheed, the heretofore default course will continue: additional spending above (the combined effect of) population growth and inflation. The result will be a missed opportunity. Continual above population-plus-inflation expenditure growth is not sustainable.

Introduction

I Albertans and the provincial government have worked hard to get Alberta to their enviable status

When I first wrote about the Alberta Heritage and Savings Trust Fund for the Alberta Certified General Accountants Association of Alberta and the Alberta Chamber of Commerce over two years ago, the province was in the middle of a boom, which looked—as it always does at the peak—endless. In contrast, in what is an updated version of that report now for the Frontier Centre for Public Policy, the short-term outlook is negative for resource prices. Still, Alberta is debt-free, and the medium- to long-term outlook for Alberta is still favourable, because of the demand for natural resources, especially as Asian economies recover from whatever slowdown in growth that may occur.

Insofar as it concerns long-term savings, the province has largely ignored planning for the current downturn. It has invested in some short-term funds – the Sustainability and Capital funds – but these funds are due to be spent, not saved for future generations. If the province is to avoid repeating the mistake of the past few years, it must choose a prudent course and invest – literally – in the future.

Alberta's prosperity is not merely the result of natural resource luck. Its current prosperity is the result of first, personal and business initiative; second, government policy mostly favourable to the foregoing; third, restraints on government expenditures in the early to mid-1990s; and only fourth, the good fortune to have a wealth of natural resources.

However, the provincial government now risks ignoring one significant factor in any jurisdiction's continued success – prudent limits on government expenditures, the absence of which would create unsustainable paths and limit the options for future generations of Albertans. The province must counterbalance calls to spend now with the need to save for the future and to preserve the Alberta Advantage for future generations.

Every generation must choose how much to levy in taxes, how much to spend via government and how much to save. In Alberta's case, these choices are also made in the context of non-renewable natural resource revenue. This revenue provides the province with additional flexibility but also with additional temptations, most often to overspend, because of the faulty assumptions that such windfall riches are permanent or that additional government spending will produce results.

II Alberta's fiscal context

The end of deficits and debt: 1994 and 2004

The province of Alberta last ran a deficit in the 1994 fiscal year, when expenditures outran revenue by almost $1.4-billion. Alberta's accumulated debt reached $22.7-billion that year and after a decade's worth of surpluses and debt repayment, Alberta has not only been deficit-free but as of 2004, debt-free.[1]

Alberta is still heavily reliant on natural resource revenues

Since Alberta's last deficit, resource revenue income ranged from a low of $2.37-billion in 1999 to a high of $14.3-billion in 2006. The forecast for the current fiscal year (which ends March 31, 2009) is $11.7-billion. The average resource-revenue income each year during the 15-year period (1994-2009 inclusive) is almost $9.3-billion.[2]

Alberta's Fiscal Responsibility Act (FRA) limits the amount of non-renewable resource revenue the province may use every year for

1. Historical Fiscal Summary, Budget 2008, p. 90.
2. Ibid.

day-to-day expenditures paid for out of the General Revenue Fund (the province's main set of books) to $5.3-billion.

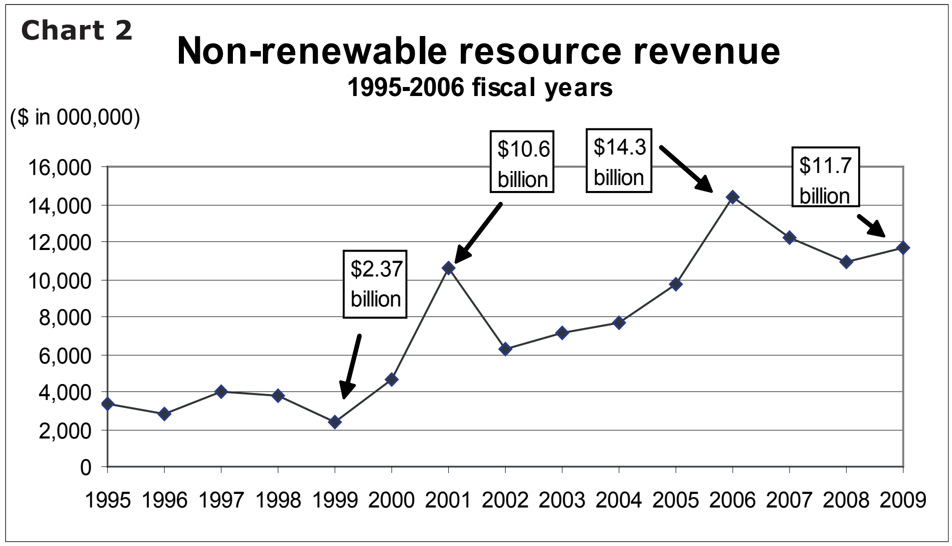
Over 30 per cent of all revenue in the 2008-2009 fiscal year is the result of non-renewable resource revenue ($11.7-billion). As a percentage of all revenue, resource revenue has ranged from a low of 14.1% in 1999 to a high of 41.5 per cent in 2001.

Consider Alberta's budgetary balances without resource revenue or only *half* of resource revenue: seven deficit years since 1995

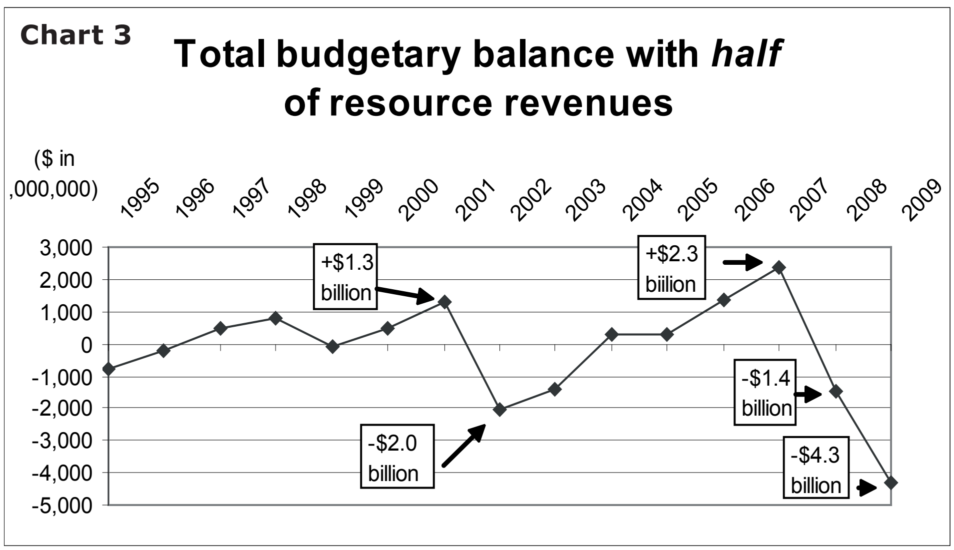
It would be difficult to imagine Alberta's treasury not being the beneficiary of any resource revenue; however, given recent events, it is not implausible to consider what would happen if half of the average resource revenue over the past 15 years were suddenly not available in a given fiscal year.

Thus, consider the annual budgetary balances if resource revenues were at half their actual level in the 1995-2009 fiscal years. (Chart 3) Note that this scenario does not include the effect that an absence of half of the natural resource wealth would have had on other tax collections (i.e., business and personal; nor the effect of compounding interest on accumulated annual deficits). Thus, the numbers are conservative.

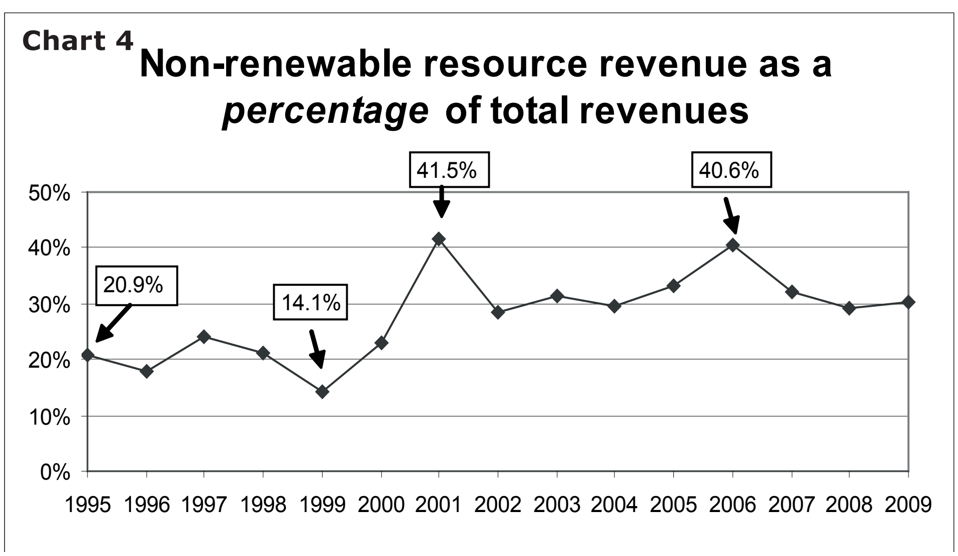
Without such revenue, the provincial government would have incurred deficits in seven out of 15 years, most notably the fiscal years 2008 and 2009.[3]



Sources: Historical Fiscal Summary, Alberta Budget 2008.



Sources: Historical Fiscal Summary, Alberta Budget 2008. Calculations by author.



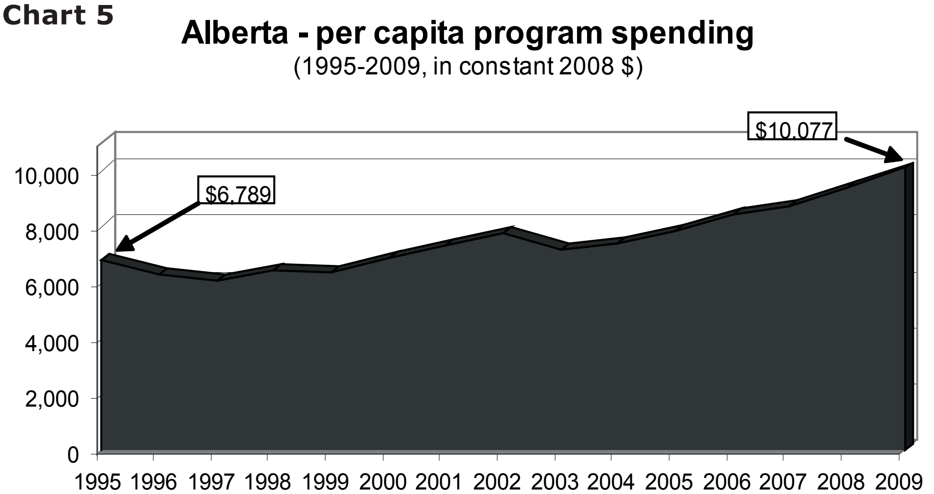
Sources: Historical Fiscal Summary, Alberta Budget 2008. Calculations by author.

Alberta's current fiscal position: The facts on Alberta's spending

In after-inflation terms, Alberta's per capita program spending is projected to jump to $10,077 in 2009 from $9,396 in 2008, which compares to just $6,789 per capita in 1995.

Alberta does have more policy room on tax-and-spend choices than other provinces. Its per capita revenue is higher than other provinces, and the absence of debt interest payments (beyond that provided for in the debt repayment account) does give the province additional flexibility. However, Alberta's current expenditure levels are propped up by large transfers from resource revenue, both directly and indirectly though the Sustainability Fund and the Capital Account.[4]

Chart 5



Source: Fiscal Reference Tables, Ministry of Finance (Ottawa) based on Alberta Public Accounts/Historical Fiscal Summary Alberta Budget 2008/Alberta Municipal Affairs/Employment Alberta/Statistics Canada. Population estimates for 2008 and 2009 are from Alberta Employment, Immigration and Industry. 2008 and 2009 are estimates based on sources. Inflation calculations from the Bank of Canada, Inflation Calculator. Fiscal years ending March 31.

Why capital or program spending makes little difference

In terms of options and future budgetary balances, whether money is spent on capital projects or programs is practically irrelevant: The issue is the amount of money spent. The increased use of non-renewable resource revenue for day-to-day program spending or for transfers to the Capital Fund translates into fewer choices for future generations of Albertans. If provincial government spending continues to accelerate beyond inflation and population growth, a repeat of past deficits will occur.

Context: How Alberta spends more than just $5.3-billion annually in non-renewable natural resource revenue

Alberta's Fiscal Responsibility Act limits the amount of non-renewable resource revenue the province may use every year for day-to-day expenditures paid for out of the General Revenue Fund (the province's main set of books) to $5.3-billion. That is an increase from a $3.5-billion cap when the FRA was created in 2003. Resource revenue above $5.3-billion is deposited into the Sustainability Fund and/or the Capital Account.

3. Note that deficits would have added to the interest costs of the provincial treasury. The hypothetical balances in Charts 1 and 2 are conservative estimates, as they are based on actual interest payments since 1995, i.e., how the province's interest costs declined due to annual surpluses and debt repayment, not the extra interest costs that would have occurred if deficits were incurred in later years.

4. Note that the $7.6-billion Sustainability Fund is only useful to reduce one-time shocks provided such shocks are rare. Once the Sustainability Fund is drained, other choices are forced into play.

When revenue is sent back to the General Revenue Fund from the Sustainability Fund (to be spent on a program) or spent out of the Capital Account (on a capital project), more than $5.3-billion annually is spent from non-renewable natural resource revenue precisely because that money originated in non-renewable revenue in the first place. It was merely parked in the Sustainability or Capital accounts until required.

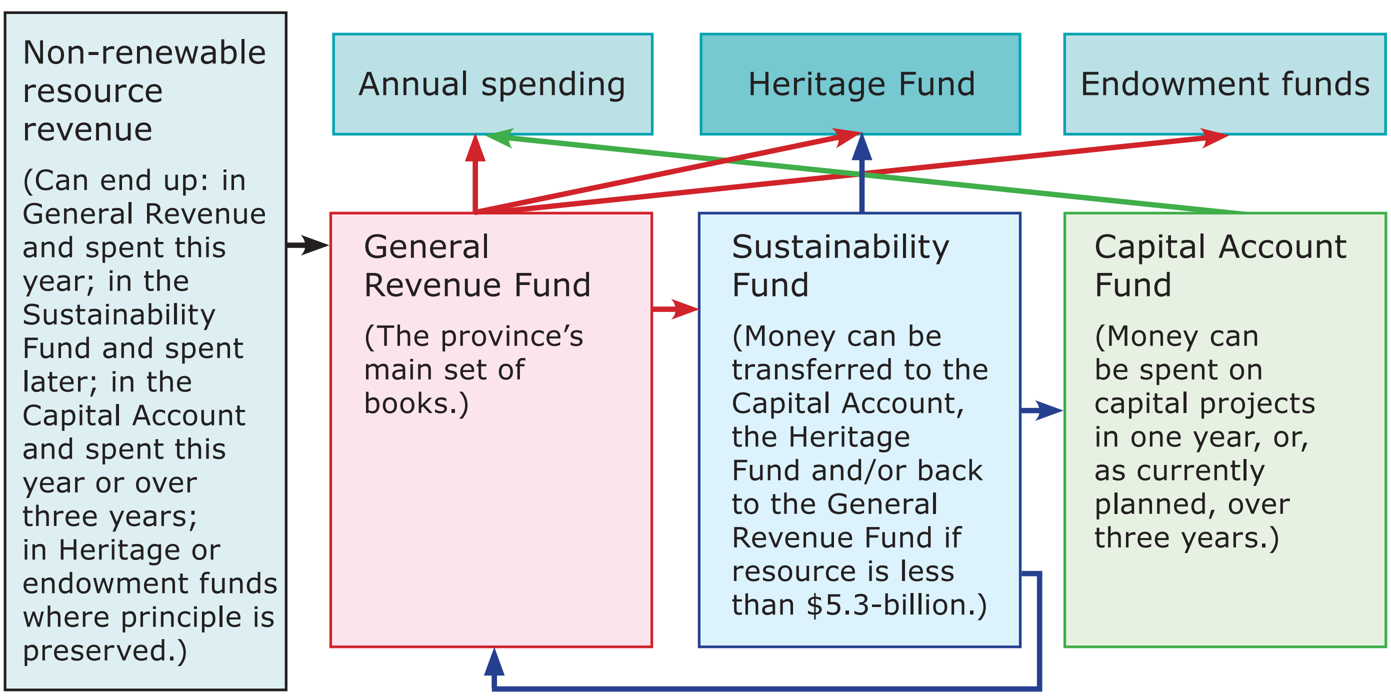
For example, in the current fiscal year, the province will spend $9-billion on capital projects. Of that amount, $6.8-billion (from the Capital Account and Sustainability Fund) will be spent on capital projects in 2008-2009 and only $1.6-billion will be used from General Fund revenue. Thus, money transferred to other funds such as the Sustainability Fund, Capital Fund or "other balance sheet improvements" as the province refers to them as, may end up being spent in the current fiscal year. When that occurs, natural resource revenue above $5.3-billion is expended and the FRA is practically invalid.

Table 1. Planned capital spending

CAPITAL PLAN SUMMARY 2008-2009, 1st Quarter Forecast (millions of dollars)	
To be funded by	
Current-year revenue	1,615
Capital Account	6,805
Alternative Financing including P3s	554
Total Capital Plan	8,974

Source: First Quarter Update, August 2008, p. 6, Alberta Finance

Table 2. How resource funds can be transferred and spent



III Alberta's labyrinth of savings funds

There are currently 10 funds (government or government-created) in addition to the Alberta Heritage Fund that serve as short- or long-term accounts and where the province can direct money if it so chooses. Some are part of or adjunct to the province's General Revenue Fund or within the Alberta Heritage Savings Trust Fund (in addition to its main balance) and others are in neither the General nor the Heritage Funds.

Why the province is not actually saving one-third of resource revenue

In Budget 2008, the province noted that in-year surpluses are divided in the following manner: one-third to savings and two-thirds to capital.[5]

However, that one-third allocation is not the same as either one-third to the Heritage Fund itself or allocating one-third of all resource revenue to savings in general. In addition, even the one-third allocation to savings is a chimera: The money directed to select savings accounts is subsequently spent (money allocated to the Capital Account and the Sustainability Fund for example). In fact, far less than one-third of surpluses is allocated to any permanent savings fund such as the Heritage Fund.

Since Alberta's debt was eliminated in fiscal 2004, the province has collected $47.3-billion in resource revenue and deposited only $3.9-billion into the Heritage Fund. Revenue that is deposited into other funds, such as Capital or Sustainability, will be spent, not saved. Thus, the notion that such accounts should be seen as an investment in long-term saving is unsupportable.

5. Alberta Budget 2008-2009, p. 21.

IV Resource trust funds: Alaska and Alberta

What is a trust fund? Public purpose trust funds and binding future action

As Jonathan Anderson notes, a trust fund is essentially a contract governing future use of specified resources. It can be public or private. A private trust fund may be one where a benefactor sets up a foundation for charitable work including educational, religious or artistic purposes. "Resources are transferred by the owner, or trustor, to an agent, or trustee, who manages them for a specified beneficiary or beneficiaries. ... A trust can be revocable or irrevocable" (64).

Dedicated revenue streams are often established in tandem with public trusts; the source and use of the revenue is stipulated. Usually, future legislators cannot change the allocation decision through the appropriations process, which is more amenable to individual power and political maneuvering (Anderson 65). Anderson notes one problem with public trusts is that "they often combine the role of trustor and trustee because the legislature both establishes the fund and governs its administration. Because public trusts are governed by law, they are revocable" (65). In contrast, in trusts established by state constitutions, "a degree of space is created between trustor and trustee, because citizens, who must approve constitutional changes, share the role of trustor" (66).

Svetlana Tsalik (2003, 19) notes three critical factors in the success of a Natural Resource Fund (NRF):

> If NRFs are to serve effectively as a compact between governments and citizens, they must be able to reduce the discretion of a single branch of government in making expenditure decisions. An NRF that is easily changed or liquidated is unlikely to constrain the government from irresponsible behavior. There are three

particular factors that compel governments to respect their NRFs:

- Checks and balances. One of the principal reasons for creating an NRF is to help government resist the temptation to spend heavily in the short run, at the expense of future generations. A separation of powers creates layers of oversight into an NRF and minimizes opportunities for diversion of resources.
- Transparency. NRFs that operate in secrecy are more likely to be diverted from their original goals. An aggressive disclosure policy minimizes opportunities for abuse.
- Public involvement. The more engaged a citizenry is in the fate of its country's resource revenues, the less likely it is that a government will risk public ire by tampering with an NRF (Tsalik 2003, 19).

The Alaska Permanent Fund was created to remove part of the resource revenue stream from the usual political budget competition; it serves as a tool to restrict government spending. Anderson notes how the trust fund is insulated from political pressure:

- The existence of the APF is constitutional rather than merely statutory;
- Two-thirds of the state legislature and half the state's voters must approve constitutional changes;
- A certain percentage of resource income is designated as principal (i.e., it is transferred to the Alaska Permanent Fund and may not be transferred out of the Fund) and thus is not accessible for spending; only income from the fund may be spent;
- A separate trustee organization manages the fund, not a ministry or department;
- Thus, day-to-day decisions about the fund are governed by the trustees and by concepts of prudent investments rather than budget or political pressures;
- The fund is further protected by political reality: the large number of stakeholders in the form of Alaskans and their dividend. Any move to alter the rules affects every Alaskan (66).

Anderson notes this is in distinct contrast to the initial orientation of the Alberta Heritage Fund "where the initial policy was to invest in provincial development rather than for income, as a 'prudent investor'" (66).

Glen Mumey and Joseph Ostermann (1990) note that

> In contrast to the Alberta Fund, which was created by an act of the Legislature, the Alaska Fund was incorporated by public referendum amending the state Constitution. The Alaska fund is an 'inviolate trust' on which the principal must be invested in perpetuity unless change is sanctioned through public referendum (43).

Tsalik (2003) remarks that Alaska's constitutional and referenda process has given the Alaska Permanent Fund institutional protection from the danger that results from control of the fund by just one branch of government.

> In 1970, and again in 1975, the legislature attempted to create a permanent fund. However, since the state constitution prohibited the creation of dedicated funds that bypassed the appropriations process, only a constitutional amendment could authorize the establishment of a permanent fund.
>
> In November 1976, a majority of voters approved an amendment establishing the Alaska Permanent Fund (APF). This amendment required that a minimum of 25 per cent of all mineral-based royalty revenues be placed in the Fund, with the principal used for designated income-producing instruments. The fact that the APF was created by amendment, and not by a legislative act, has provided the APF with institutional protection against change by any single branch of government (21).

6. Recall the context: $900-million US from the first oil leases was quickly spent and primarily on capital projects, the very road Alberta now travels.

A Dissenting View

William Brown and Clive Thomas (1994) assert that Alaska "has the most unbalanced and least diversified economy of any of the fifty states" (39). They argue that diversification of the state's economy is problematic. "[G]iven Alaska's geographic location, climate and high cost of labor, diversification will be unsuccessful unless supported by massive expenditures" (40). However, the Brown-Thomas musing that Alaska (or any economy) could diversify via massive government expenditures – a proposition they give no literature support for – is similar to ventures tried and found wanting by multiple resource-rich jurisdictions around the world including Alberta in the 1970s and 1980s.

The Resource Curse

Jeffrey Sachs and A.M. Warner (2001) note that resources can and often are a curse: "Empirical support for the curse of natural resources is not bulletproof, but it is quite strong" (828).

> Many are surprised by the resource curse finding because it runs against the textbook story in history books or common discussion of growth advantages. One example is an influential work by Habakkuk (1962) who argued, among many other points, that greater natural resource endowments in the United States helped explain why it surpassed England in the 19th century. As a further example, note that the beneficial effects of natural resources are still being stressed for some developing countries. As recently as August 2000, President Clinton's speech in Nigeria stressed that '[w]ith ...vast human and natural resources, a revitalized Nigeria can be the economic and political anchor of West Africa.'
>
> We mention two points on this. First, although the data are scarce, when one measures natural resource intensity using historical data, the ratios as a per cent of GDP are much smaller than the ratios that many countries have achieved in the mid-to-late 20th century. Sweden, Australia and the United States in earlier times never approached the level of natural resource intensity we see today in the Gulf States. Second, Habakkuk's argument could be credible for an earlier period during which cheap power from the proximity of coal was more technologically essential. With the emergence of the petroleum-based economy and revolutions in global transportation, cheap energy can be transported today in a way that was impossible earlier.
>
> What explains the curse? Just as we lack a universally accepted theory of economic growth in general, we lack a universally accepted theory of the curse of natural resources. Most current explanations for the curse have a crowding-out logic. Natural Resources crowd-out activity x. Activity x drives growth. Therefore Natural Resources harm growth (832-833).

Few jurisdictions around the world have the good fortune to possess natural resource wealth, and only a fraction manages windfall revenue prudently. The challenge for Alberta is to learn from its Heritage Fund history and from the examples of other, arguably more successful jurisdictions.

The Alaska Permanent Fund

Impetus for and origin of the Alaska Permanent Fund

The political spur for the creation of the Alaska Permanent Fund began in the 1960s. In 1968, after oil was first pumped from Prudhoe Bay, the state held an auction for oil leases; the result was a $900-million US windfall when the annual state budget was barely more than $100-million. "This shower of riches sent Alaska into a frenzy of public spending, particularly on capital projects" (Anderson 2002, 58).

> By 1976, the state had spent most of the initial lease money, and Alaskans were aghast they had frittered away so much in so short a time. Fears of uncontrolled legislative spending had been confirmed, and Alaskans sought ways to protect their natural resource revenues for future generations (58-59).

Legislation and constitutional status

In 1976, on the urging of then governor Jay Hammond, the Alaska legislature crafted a constitutional amendment that called for the creation of a permanent fund to preserve a portion of oil revenue for future generations. In November 1976, the voters approved the amendment by a two-to-one margin.

> At least twenty-five per cent 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. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law [Effective February 21, 1977]
>
> -Alaska Constitution Article IX, Section 15, Alaska Permanent Fund.

The first transfer of resource revenue into the fund occurred in 1977.

How it works [7]

Alaska's constitution divides the fund into reserved assets (principal) and unreserved assets (realized earnings). The principal can only be used for income-producing investments; the legislature may not spend the principal. The reserved assets are derived from four sources:

- Constitutionally dedicated mineral revenue (primarily from oil), which has added $10.5-billion into reserved assets to date (fiscal 2008);
- Special legislative appropriations from the fund's unreserved assets and the state's General Fund, which jointly have contributed $7-billion into the reserved assets;
- Inflation-proofing – the annual legislative transfer from realized earnings to principal has deposited $11.6-billion into the principal; and
- Unrealized gains or losses that reflect the market volatility on the value of assets (this amount changes daily).

The unreserved assets (realized earnings) remain invested in the fund and the legislature may spend it. The unreserved assets come from

- stock dividends / bond interest / real estate rents;
- gains or losses from the sale of any of these investments.

7. Available at http://www.apfc.org/_amiReportsArchive/2008_8_PROJ.pdf and http://www.apfc.org/_amiReportsArchive/2008_AR.pdf

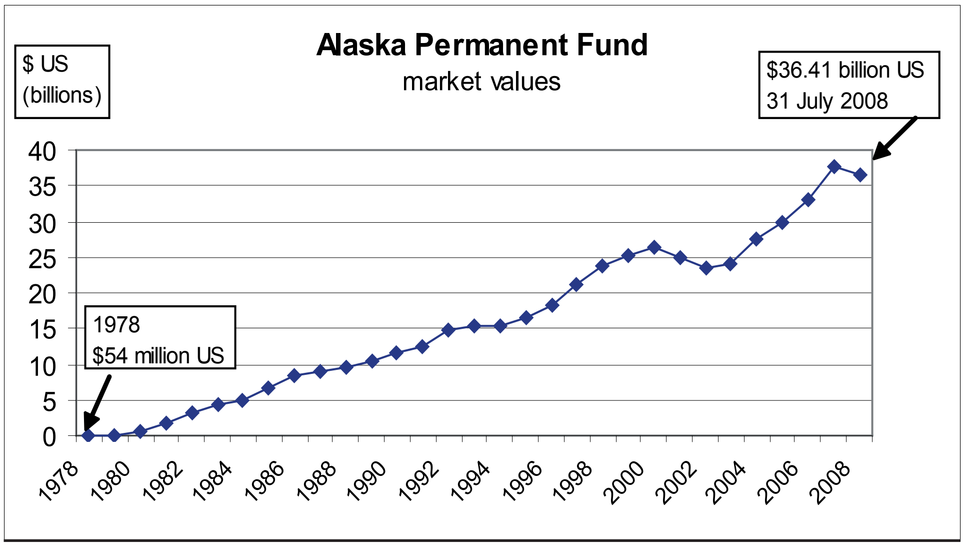
The legislature has used the unreserved assets for

- dividends: $16.7-billion paid out since 1982;
- inflation-proofing the principal: $11.6-billion to date;
- special appropriations to principal: $7.0-billion; and
- fund-related expenses to state agencies and other state government expenses: $20.9-billion.

Present state of the Alaska Permanent Fund

As of July 31, 2008, the Alaska Permanent Fund stood at $36.41-billion US, or $37.34-billion Cdn.

Chart 6



Source: Alaska Permanent Fund Corporation, as of July 31, 2008.

The Alaska Dividend: History

After the 1976 amendment was passed by the legislature and the voters, the House Special Committee on the Permanent Fund held public hearings in late 1977. Based upon input from the public and consultants as well as the committee's own deliberations, the final report made multiple recommendations and observations.

- The money in excess of current needs should be put into the fund.
- This money should not be used for current expenditures.
- The investments should not be in areas where existing private financing is available.
- The income of the Permanent Fund should be used for the benefit of current and future Alaskans.
- The structure of the Permanent Fund should allow public accountability.
- However, political decision-making should take place where necessary.
- Appointed officials of the Permanent Fund should not make these types of decisions.
- Subsidizing industries or commercial enterprises through cheap loans or bonds is not a good idea for the Permanent Fund.
- If the proposed projects are viable, private financing entities will fund them.
- If private banks refuse funding, then perhaps the project is not a good one.
- In that case, why should the state take the risk?

The Alaska Permanent Fund Corporation recounts the debate and notes the wariness about using the fund for loans:

> The most aggressive (and in conventional terms, imprudent) lending policy cannot, however, create an industry where resources, markets, skilled labor and other requisites are missing, and the Fund's managers should never become so soft as to finance enterprises whose promoters are not taking a substantial risk themselves, or which do not have convincing prospects of long-term viability (Kasson, 1983).

Given the remoteness of many Alaskan communities, the consultants did feel that medium and small industries might benefit from the fund. However, in 1978, as various proposals worked their way through the political process, the governor's position was that loans were an unreasonable subsidy. In his 1978 testimony, he argued instead for dividends.

> Take the case of someone who gets a $100,000 state loan of oil wealth at 9½ per cent interest. Yet, all other Alaskans who own just as much of that wealth as he could get about 15½ per cent return if their money were loaned at market rates. Therefore, the loan recipient is receiving a dividend, or subsidy, of $6,000 in the first year alone. That subsidy or dividend would amount to an incredible $94,000 on a 30-year loan.
>
> That dividend or subsidy is being paid from oil wealth owned by all Alaskans. We don't confine payment of such loan dividends to taxpayers only or demand that before we provide Alaskans with low-interest loans, we first eliminate the income tax. Why should a system which provides far more equitable benefits to all Alaskans, such as the Permanent Fund dividend concept, be subordinate to that consideration? It seems high time that any new means of dispersing oil wealth should provide that all Alaskans, even the non-taxpaying, housewife, student, unemployed or retired couple get a share (Kasson, 1983).

Governor Hammond argued for a permanent annual dividend from the fund, because it would establish a citizen interest in the fund. The dividend would make it more difficult for the legislature to spend the money, because any increase in spending would necessitate a corresponding decrease in the dividend. If government wished to increase its share of the energy revenue, it could do so but only through taxation.

Hammond's proposal was simple but not simplistic. The legislature could obtain more natural resource revenue initially designated for the Permanent Fund – if such earnings were first paid out to citizens in the form of dividends and then taxed. That process would serve as a useful check on the expansion of government, a necessary measure given the tendency of citizens and elected representatives to treat resource wealth as a permanent feature of the economy. In addition, the dividend would give Alaskans a direct interest in the fund, which would serve to educate voters about public finances. As Anderson (2002) notes:

> With oil revenues accounting for 85 per cent of state spending (and no state sales or income taxes) voters tend to underestimate the true cost of government spending. The result is that they support too much spending and too many public goods. The dividend thus establishes a link between citizens and expenditures. Higher states expenditures mean less money available for dividends (61).

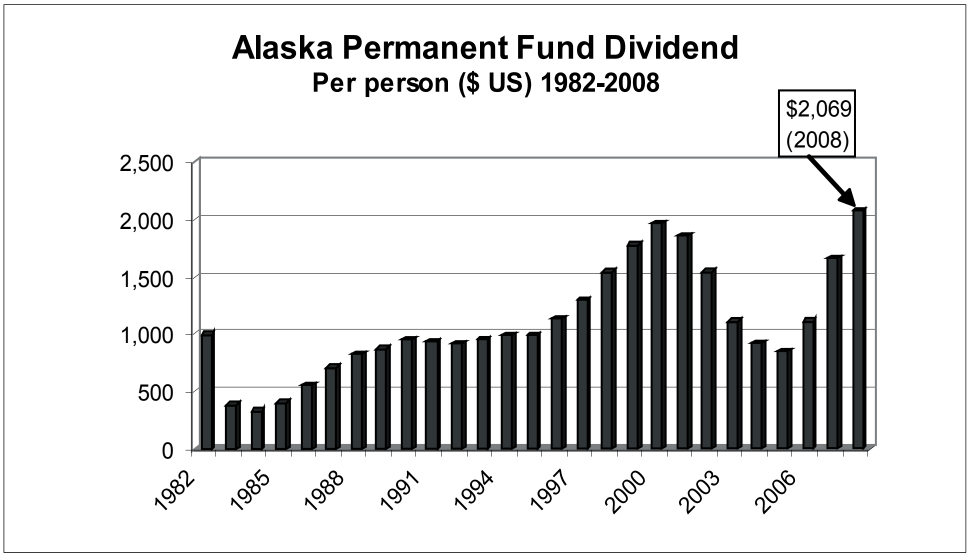
The dividend served as a check on excessive government spending by reminding voters of the fiscal illusion that occurs in a booming natural resource-rich jurisdiction. In 1981, the Alaska legislature eventually adopted the House proposal on dividends and rejected the idea of providing loans out of the APF.

Tsalik (2003) concludes that

> The Alaska Permanent Fund is a bold and innovative approach to managing natural resource wealth. It is based on the principle that citizens are the owners of their mineral wealth and that every citizen is entitled to an equal share of this wealth. It adheres

to the libertarian belief that people will be better off spending their own money rather than allowing the state to spend it on their behalf. By involving citizens in every aspect of the Fund's creation and evolution, the APF has given the public a stake in its preservation, and restrained the government from spending away oil wealth in a more effective way than any formal rules could (24-25).

Chart 7



Source: Alaska Permanent Fund Corporation

The Alberta Heritage Savings Trust Fund

Impetus for and origin of the Alberta Heritage Savings Trust Fund[8]

In 1976, because of an initiative by then premier Peter Lougheed, the Alberta Heritage Savings Trust Fund Act was created, given Royal Assent and initially given three objectives:

- To save for the future;
- To strengthen or diversify the economy; and
- To improve the quality of life for Albertans.

History

Initial deposits in the Alberta Heritage Savings Trust Fund occurred in the 1976-1977 fiscal year and came from two sources:

- Thirty per cent of the non-renewable resource revenue ($620-million) received by the Government of Alberta from April 1, 1976, to March 31, 1977.
- A special contribution of $1.5-billion in cash and other financial assets was transferred from Alberta's General Revenue Fund to the Heritage Fund on August 30, 1976.

As Rognvaldur (2001, 72) notes, 30 per cent of the province's oil and gas revenue was deposited into the AHSTF while statutory deposits into Alaska's Permanent Fund were then allocated at half that percentage or less. Alberta's allocation was gradually scaled back, and deposits ended completely in 1987 after the collapse of the price of oil in 1986.

8. The history of the Alberta Heritage Savings Trust Fund is summarized courtesy of Alberta Finance Heritage Fund Historical Timeline, www.finance.gov.ab.ca/business/ahstf/history.html.

Overview of the four AHSTF divisions

Prior to its restructuring in 1997, AHSTF was organized into four divisions: Commercial Investment Division, Canada Investment Division, Capital Projects Division and Alberta Investment Division.

Commercial:

Invested in shares and bonds and expected to earn a commercial return. Met with results comparable to other investment funds in Canada.

Canada Investment:

Lent money to other provinces at concessionary rates. The loans were reported as fully paid in December 2000.

Capital Projects:

Invested in infrastructure, education and research.

Alberta Investment:

In 1988, this division held over half the AHSTF's assets. In 1996, it was down to 20 per cent. Most of the money was invested in various Crown corporations: Alberta Mortgage and Housing Corporation, Alberta Agricultural Development Corporation, Alberta Government Telephones, Alberta Municipal Financing and the Alberta Opportunity Company.

Rognvaldur writes that these "Crown corporations were for the most part not a financial success. The 'competitive' interest they paid on the loans from the Heritage Fund was in part financed by grants from the provincial government itself, making the income of these funds illusory." (Rognvaldur 2001, 74-75)

Mumey and Ostermann (1990, 40) reported that after correcting for those General Fund transfers, the real rate of return of the Alberta Investment Division was about 2 per cent (1981-1988) compared with 10 per cent in the Commercial Investment Division.

1997 Restructuring

In 1997, the province restructured the Heritage Fund. Economic development and social investment were eliminated as uses for payouts in part because of multi-billion dollar losses due to provincial business loans and loan guarantees in the 1970s and 1980s. In response, a new business plan was created with a focus on long-term investments. A new Legislative Standing Committee operating at arm's-length from the government was also created. The Heritage Fund notes the 1997 changes:

> Following the results from the 1995 survey, the Heritage Fund was restructured. The Fund can no longer be used by government for direct economic development or social investment purposes. A new business plan was implemented, with a plan to increase long-term investments. And a new Legislative Standing Committee operating at arm's-length from the government was put in place to review and approve the business plan and ensure that the objectives and goals of the Fund are met.

Currently, the fund is managed by an arm of the provincial finance department, Alberta Investment Management, which also hires external managers for specific mandates.

Current legislation

Investments in the Heritage Fund are governed by the *Alberta Heritage Savings Trust Fund Act.*[9] The goal is "to provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans." Investments must be made with

- the objective of maximizing long-term financial returns.
- the objective of supporting the *Government's short-term to medium-term income needs as reflected in the Government's consolidated fiscal plan.* (Italics added)

9. Available online at www.qp.gov.ab.ca/Documents/acts/A23.CFM. Relevant sections regarding investment are contained in Chapter A-23, section 3, sub-sections (1) through (4).

How the Heritage Fund works

Under the *Alberta Heritage Savings Trust Fund Act,* there is no predetermined percentage of non-renewable resource revenue to be transferred to the fund on an annual basis. A Special Act must be introduced in the legislature for such a purpose.

Principal

In Alberta, a government could remove all principal with the stroke of a legislative pen. The inability to remove principal in the Heritage Fund is due to a political barrier (i.e., public opinion), not a constitutional one.

Income

- Prior to 1982, the Heritage Fund retained its income.
- Heritage Fund income, minus amounts for inflation-proofing, is transferred to the province's General Revenue Fund as per Section 8 (2) of the Alberta Heritage Savings Trust Fund Act. While inflation proofing is mandated by the Act, there is room to not inflation-proof the fund if its income falls below the inflation-adjusted amount (Section 11). In other words, the province may keep the income from the fund if the total does not allow for a transfer to the General Revenue Fund and inflation proofing. The former takes precedence over the latter.

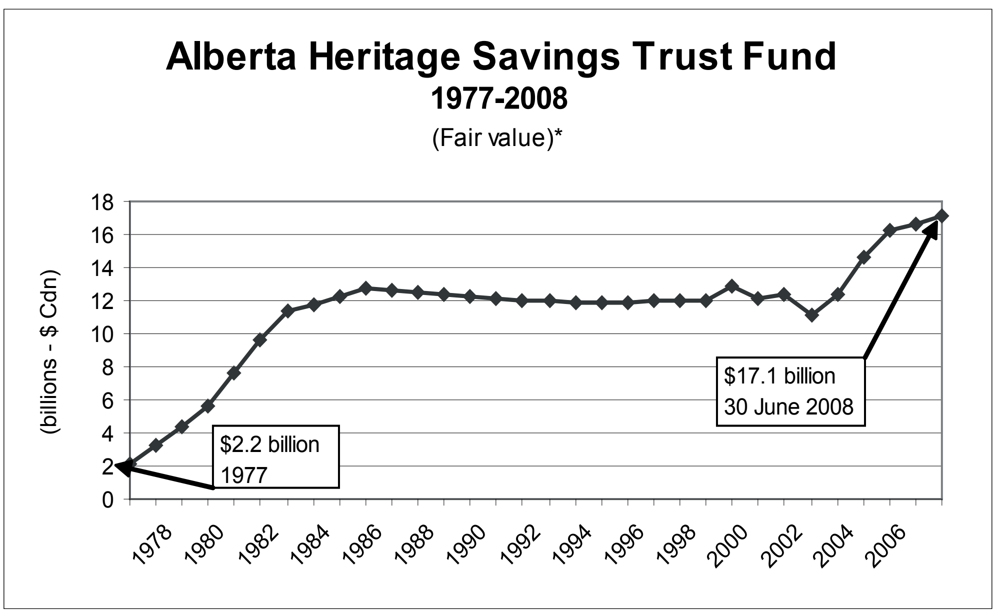
Withdrawals

Since Alberta achieved a surplus position in the General Revenue Fund in fiscal 1994-1995, $12.1-billion has been transferred out of the Heritage Fund. New deposits (including the Advanced Education Endowment sub-fund) total $3.9-billion. Thus, the net withdrawal from the Heritage Fund in 1995-2009 inclusive (estimated to the end of this fiscal year, which ends March 31, 2009) will amount to over $8.2-billion.

Present state of the Alberta Heritage Fund

The fair value of the Heritage Fund was $17.1-billion as of June 30, 2008 (below).

Chart 8



Note: AHSTF historical figures used here are pre-2000 and are fund equity valuations, which is not identical to fair value. The AHSTF was not tracked for fair market value for its entire history though it is tracked in statements that are more recent. As of June 30, 2008.

V A comparison of the Alberta and Alaska funds

Constitutional status

Alaska's Permanent Fund has constitutional status. Due to the 1977 voter-approved amendment to the state constitution, 25 per cent of all natural resource revenue must be placed within the APF. In addition, the principal cannot be transferred out of the fund. Constitutionally dedicated mineral revenue (primarily from oil) has added $8.1-billion into reserved assets to date.

The Alberta fund has no constitutional or referenda protection.

Legislative status/actions regarding natural resource use

Alaska's legislation (in accordance with the Constitution) requires 25 per cent of natural resource revenue be placed in the Permanent Fund.

Alberta's legislation does not specify a predetermined percentage of resource revenue to be deposited into the Heritage Fund.

Inflation proofing

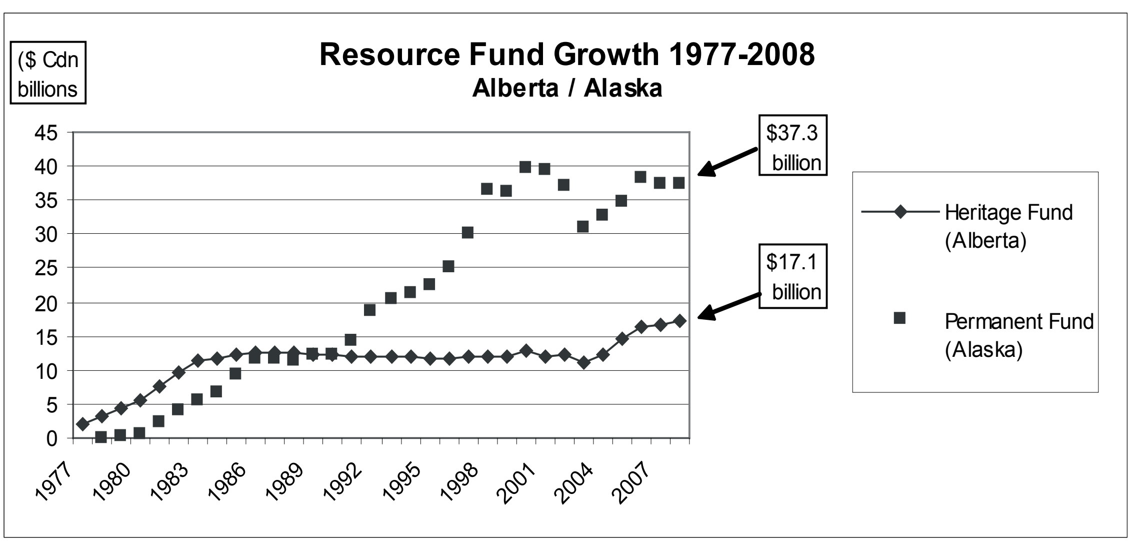
In Alaska, inflation proofing from realized earnings converted to principal resulted in $11.6-billion in additional principal (principal that is then constitutionally protected) since the fund's inception in 1977.

In Alberta, inflation proofing for the Heritage Fund is now mandated by the Alberta Heritage Savings Trust Fund Act, but it is dependent on fund income. Thus, the province may choose not to inflation-proof the fund depending on circumstances. In addition, the weak legislation may be easily changed at any time.

Fund growth

Both jurisdictions deposit resource revenue into their trust funds and both withdraw earnings. There is a significant difference in how much has been re-invested in the funds. The result appears when fund growth is examined. In Canadian dollars, Alberta's Heritage Fund total is $17.1-billion and

Chart 9 Resource Fund Growth Compared



Alaska's Permanent Fund total is $37.3-billion. Hannesson (2001) notes this about the Alberta Heritage Fund:

"Compared to the Alaska Permanent Fund the Alberta Heritage Fund must be regarded as a failure. The process of transforming non-renewable resource revenue into permanent wealth has long since come to an end, and such transformation as did occur was less than fully successful.

Why did things turn out the way they did? Perhaps the fiscal needs of the province were greater than those of Alaska at the critical point of falling oil prices in 1986, perhaps the willingness to prune unsustainable public consumption was less, on behalf of both politicians and the electorate at large. But the institutional structure was also different, and for the Heritage Fund, less conducive towards long-term preservation of wealth." (Hannesson 2001, 78)

Table 3. Fund comparisons

	Alberta Heritage Savings Trust Fund	**Alaska Permanent Fund**
Total value (In $ Cdn)	$17.1-billion	$37.3-billion ($36.4-billion US)
Per capita (In $ Cdn)	$4,770	$54,514
Is inflation proofing required?	Yes, but weak	Yes
Does the fund have constitutional status?	No	Yes
Is there a legislative requirement for annual resource revenue deposits?	Only if authorized by a Special Act.	Yes (25 per cent)
Year created/ First year in which resource revenue deposited	1976/ 1976	1976/ 1977

As of June 30, 2008, for Alberta and July 31, 2008, for Alaska.

"The Alberta government and legislative may, however, be criticized for taking an insufficient interest in preserving the petroleum wealth."
- Hannesson Rognvaldur. (2001)
Investing for Sustainability.

VI Alberta's options

Present Context

- Between Alberta's last deficit year (1994-1995) and the end of the present fiscal year (2008-2009), the province will have collected almost $112-billion in non-renewable natural resource revenue.
- Since Alberta became debt-free in 2003-2004, non-renewable resource revenue to the end of the current fiscal year will total $47.3-billion. Since Alberta became debt-free, $3.9-billion has been deposited into the Alberta Heritage Savings Trust Fund.
- The average annual income from non-renewable resource revenue between April 1, 1994, and March 31, 2009, is $9.3-billion.
- The provincial government has long increased spending beyond inflation and population growth. In constant 2008 dollars, per capita program expenditures amounted to $6,789 in 1994-1995 and they are forecast to be $10,077 in 2008-2009.
- In Alberta, there is no automatic restraint upon current spending. In contrast, Alaska's legislature is constrained, because of the constitutional obligation to place 25 per cent of resource revenue into the Permanent Fund.

Option: Government-directed investment

In the first two decades of the Heritage Fund's existence, the Alberta Investment Division was a costly, clear example of good intentions but flawed results. The choice to intervene directly in the market – to guarantee loans for Alberta companies and/or directly lend capital to such entities – placed the civil service and the legislature in the position of picking economic winners and losers, a task for which neither was suited.

The Alberta government should avoid any new temptation to intervene in the marketplace in an attempt to diversify the economy. The most extensive reviews of these government actions (and of studies that advocate the same) are deeply critical of such flawed endeavours. Buss (1999) reviewed over 100 targeted industry studies[10] in the United States and noted the problematic approaches.

> Targeting as a strategy is buttressed and guided by targeted industry studies. The efficacy of targeting studies, in spite of their wide use, never has been scientifically validated (D. K. Lee, 1992). Practitioners identify industrial targets and publicly intervene, whereas industries or economies grow or decline, develop or devolve. Did targeted interventions contribute to growth and development? Or were other factors responsible for change? What were targeting's positive and negative effects, unintended consequences, and long-term impacts? Did costs of targeting exceed benefits? What public investments were forgone in favor of targeting?
>
> I know of no study that answers these questions.
>
> The dearth of scientific evidence in support of targeting is, in many respects, damning in itself: Having been around so long, why hasn't targeting been evaluated? Validation is likely impossible because targeting violates basic economic reasoning, uses unsound methodologies and faulty data, and encourages inappropriate political

10. Targeted industry help is defined by Buss as that which "employs public interventions - subsidies, incentives, or brokering - to support existing or start-up businesses or to attract outside firms."

> interference, benefiting some at the expense of others. Perhaps this is why targeting studies are not published in professional economic, social science, or policy studies journals but only appear as unpublished consultant reports, details of which are rarely disclosed (1999, 340).

Buss found that where attempts to answer such questions exist and were in favour of subsidies to business, the underlying economic premises in the evaluations were deeply and seriously flawed and the benefits illusory.

> Targeted industry studies and strategies have been widely used in economic development practice since the 1970s, and their use continues to grow. In spite of their longevity, targeting as a method never has been formally or rigorously evaluated. This article looks at dozens of studies and strategies and concludes that targeting is based on poor data, unsound social science methods, and faulty economic reasoning and is largely a political activity (321).

Option: Tax reductions

On tax relief, one option to consider is to enact tax reductions equal to the amount of new earnings in the Heritage Fund every year. If the fund should produce a revenue stream of an additional $100-million for the province's General Revenue Fund, the province could then reduce taxes by a similar amount.

Option: Dividends

The province could pay out "prosperity dividends" to the citizens of Alberta as it did in 2006. However, unlike Alaska's annual dividend cheques, which result from interest and earnings in the Alaska Permanent Fund, the 2006 payouts from the government of Alberta were a result of a spike in natural resource revenue prices.

In 2006, Alberta put the dividend cart before the principal horse. A more prudent course is for the province to invest in the Heritage Fund and pay dividends out of subsequent earnings and interest. In this scenario, fund principal would still be built up, thus preserving future choices: dividends, spending or permanent tax relief.

In terms of what dividend payouts would look like in the current and next two fiscal years based upon provincial government forecasts, each Albertan could receive $833 over three years. A family of four would receive $3,332 over three years.

Option: Multiple new funds

The provincial government has already created a wide array of funds (as detailed in part III of this study). The justification for specialized funds already in existence is that they provide for specific, long-term attention to one priority: debt repayment, scholarships and health care research to list only a few possible priorities.

The negative consequence is that such funds severely restrict flexibility for future generations and their governments. They do so not in a general manner that is more defensible – through the transfer of some natural resource wealth now to future generations that preserves choice – but by a method that dictates future spending priorities for future generations. Designated trust funds for a particular purpose require future generations to expend taxpayer revenue on projects and priorities desired by today's Albertans. Funds dedicated to one purpose set a floor for what must be spent annually on that priority and exclude other options. That is problematic, as demographic shifts and other changes may require future expenditures that are unforeseen and/or unlike today's: more money for healthcare and perhaps less for scholarships or vice versa.

In addition, multiple funds present an accountability problem – it is difficult for the public or the media to track such funds; it also becomes problematic for MLAs, as money is already set aside in advance each year for specific purposes. That undermines their roles as stewards of the pubic trust. As it concerned long-term fiscal planning, the Alberta Chambers of Commerce recommended in 2005 that the province should

- concentrate and invest surpluses that belong to all Albertans in the Heritage Savings Trust Fund and
- retain public control of surplus funds through investment of surpluses in the Heritage Savings Trust Fund, a fund held accountable and controlled by the legislature. This enables redirection of investment returns as future circumstances and priorities dictate versus locked-in endowments beyond public control. This fund will be key in inter-generational equity and sustainable program spending.

Option: Fewer funds but expanded future choices

For the sake of transparency, accountability, simplicity and the preservation of maximum choice for future generations, the province should refrain from creating new funds.

If they wish, Albertans and businesses can contribute to new funds that can be privately managed for public purposes. The province should consider collapsing several funds into the Heritage Fund to preserve maximum flexibility for future generations and their governments.

The optimal scenario is one where the only restriction on present and future governments is the unavailability of substantial portions of annual resource revenue. This scenario would provide some restraint on present spending but would make available general choices to future generations on spending, tax relief or dividends.

The Heritage Fund – from which earnings can still be drawn after investment-proofing and predetermined deposits are protected – is the optimum vehicle for saving current resource revenue precisely because it is a general trust fund and not designated for one type of expenditure.

Discussion:

How much should be invested in the Heritage Fund?

Alaska deposits 25 per cent of its resource revenue and additional monies as circumstances and political will permit. Initially, Alberta added 30 per cent of all resource revenue to the Heritage Fund but gradually scaled back that portion and eliminated deposits in 1987. Between fiscal years 1987 and 2006, Alberta added no resource revenue and withdrew all earnings from the Heritage Fund.

Alberta cannot deposit 100 per cent of annual resource revenue into the Heritage Fund. In most years, without sharp spending reductions, that option would create a deficit in the General Revenue Fund. However, the province should consider several other options.

Thirty per cent plus inflation proofing

In its First Quarter Update, the province noted that unallocated savings amounted to $2.5-billion. If the province deposited that amount into the Heritage Fund, it would stand at $19.6-billion ($2.5-billion above its June 30, 2008, level). If the province also set aside 30 per cent of non-renewable resource revenue annually, the set-aside would be just under $2.8-billion annually based on the past 15-year average of natural resource revenue collections. The fund would reach $39.3-billion by 2015, $57.5-billion by 2020 and $77.3-billion by 2025.[11]

11. The AHST is forecast to achieve a real rate of return of 4.5 per cent (6.3 per cent nominal) on average over the next five years (AHSTF Annual Report 2007-2008, p.8). I assume the fund would be allowed to keep only the inflation-proofing portion, i.e., 1.8 per cent per annum and, of course, the annual injection of principal. This applies to both the 30 per cent and 40 per cent scenarios.

Results: 30 per cent model

By 2015, the 30 per cent option could generate $1.8-billion annually in earnings, $2.6-billion by 2020 and $3.5-billion by 2025. Those are the amounts the province could withdraw from the fund *while still inflation proofing it at 1.8 per cent per annum.*

In this scenario, the General Revenue Fund would still be able to withdraw $36.1-billion in Heritage Fund earnings from 2009 to 2025 inclusive while building up the fund to $77.3-billion by 2025.

Forty per cent plus inflation proofing

If the province set aside 40 per cent of non-renewable resource revenue annually, the set-aside would be just over $3.7-billion based on the past 15-year average of natural resource revenue collections. The fund would reach $45.2-billion by 2010, $68.7-billion by 2020 and $94.4-billion by 2025.

Results: 40 per cent model

By 2015, the 40 per cent option could generate $2-billion annually in earnings by 2010, $3.1-billion by 2020, and $4.2-billion annually by 2025. These are the amounts the province could withdraw from the fund while still inflation proofing the fund at 2.5 per cent per annum. In this scenario, the General Revenue Fund would still be able to withdraw $42.3-billion in Heritage Fund earnings from 2009 to 2025 inclusive while building up the fund to $85.6-billion by 2025.

Rationale

In its original incarnation in 1976-1977, 30 per cent of non-renewable resource revenue was directed into the Heritage fund, and it retained all earnings. Alberta no longer has debt interest payments beyond those scheduled to be paid with set-aside funds for that purpose. In this scenario, the province would still collect and spend 70 per cent of all non-renewable resource revenue.
A 40 per cent plan (where 25 per cent of resource revenue is set aside in addition to the 15 per cent previously spent on debt interest) is possible and reasonable; the province would still spend 60 per cent of non-renewable natural resource revenue every year.

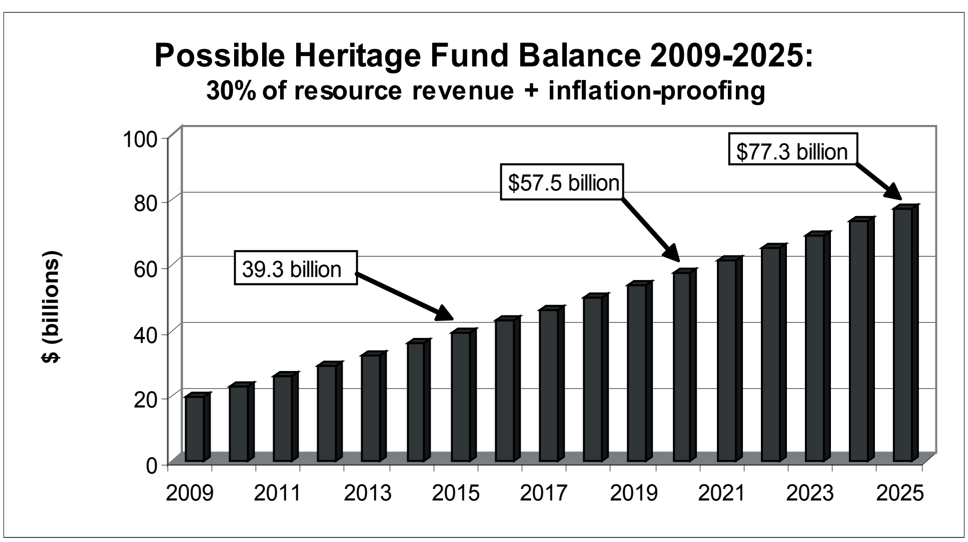


Chart 10

Thirty per cent model and the resulting fund balance

Chart 11

Thirty per cent model and the resulting possible transfers

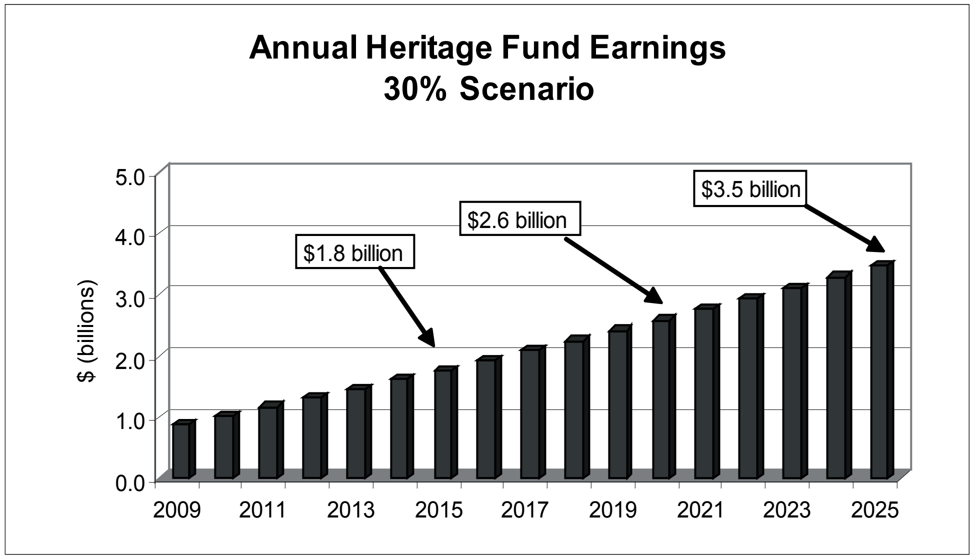


Chart 12

Forty per cent model and resulting fund balance

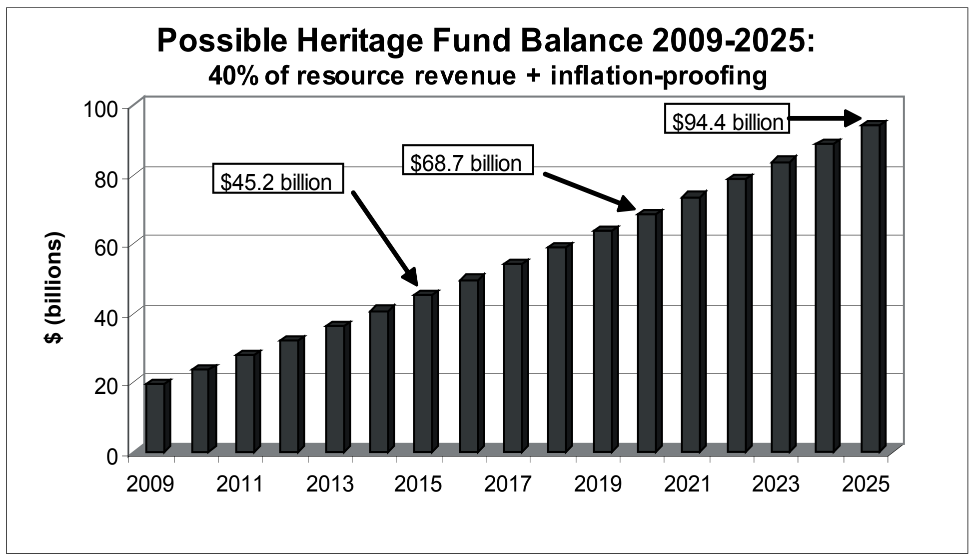
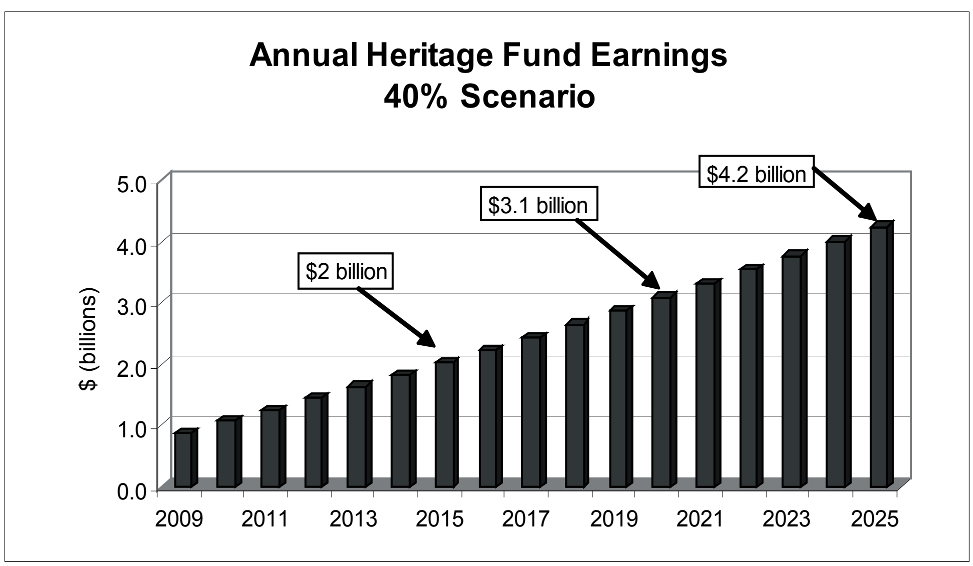


Chart 13

Forty per cent model and the resulting possible transfers



VII Recommendations

Recommendation One

- Alberta's annual per capita spending should not exceed population growth and inflation.

Rationale: The province may act prudently now or be forced to rein in future spending in the manner it did in the early to mid-1990s. Prudent spending is the foundation for future choices: tax relief, the avoidance of a deficit because of an economic downturn, decline in resource prices or emergency spending on unforeseen catastrophes. The ability to set aside resource revenue in the Heritage Fund is directly linked to restraint on the expenditure side of the ledger. In real inflation-adjusted terms, per capita program spending has grown from $6,789 in 1995-1995 to $10,077 in the current fiscal year.

Recommendation Two

- The province should deposit between 30 per cent and 40 per cent of all non-renewable resource revenue into the Heritage Fund annually.

Rationale: In its original incarnation in 1976-1977, 30 per cent of non-renewable resource revenue was directed into the Heritage Fund. The fund also retained all earnings.

Annual set-asides are feasible. Alberta no longer has debt interest payments beyond those scheduled to be repaid with set-aside funds for that purpose. Set-asides of 30 per cent or 40 per cent are thus feasible if the province controls spending. Even under a 40 per cent plan, the province would still spend 60 per cent of non-renewable natural resource revenue every year.

Recommendation Three

- The province should consider transfers of additional resource revenue into the Heritage Fund (beyond the recommended percentages) as per Peter Lougheed's original vision.

Rationale: Since Alberta became debt-free in 2004, the province ignored an opportunity to build up the Alberta Heritage Savings Trust Fund quickly. If the province does begin to deposit significant resource revenue into the Heritage Fund, the likely default course will be additional spending above (the combined effect of) population growth and inflation. Such extra expenditures are not sustainable. The result would be another missed chance.

VIII Assumptions

- The forecast growth in the Alberta Heritage Fund and forecast earnings in the 30 per cent and 40 per cent models are based on assumptions contained in the Alberta Heritage Savings Trust Fund Annual Report (p. 8). The report assumes a real rate of return of 4.5 per cent per annum and an inflation rate of 1.8 per cent. Thus, in my models, I assume inflation proofing of 1.8 per cent and annual set-asides based on 30 per cent and 40 per cent of average annual resource revenue to arrive at estimated fund values. I also assume earnings and transfers to the General Revenue Fund based on a 4.5 per cent return that is not re-invested in the fund. In other words, I assume the fund will be allowed to keep the inflation-proofing portion, i.e., 1.8 per cent per annum and the annual injection of new principal. This applies to both the 30 per cent and 40 per cent scenarios.
- Canadian dollar comparisons assume a December 31 exchange rate in each applicable year or a December 29 or December 30 exchange rate when the market was closed on December 31. The exception is 2008 where dollar comparisons are based on the last reporting date of the fund.
- Hypothetical scenarios of past budgetary balances with only half of actual resource revenue assume interest costs and other revenue have remained constant. In fact, interest costs have risen and other revenue beyond just natural resource revenue has been less. Thus, the hypothetical model is conservative. The budgetary balances would have dipped deeper and more often into the red than estimated here.
- Years not noted as a fiscal year (i.e., 2008-2009) should be assumed to be a fiscal year-end, i.e., 2009 is the 2008-2009 fiscal year.

Table 4 Fund values by year in $ Cdn (billions)

	Alberta Heritage Fund	Alaska Permanent Fund
1977	2.17	
1978	3.21	0.06
1979	4.43	0.16
1980	5.63	0.59
1981	7.57	2.20
1982	9.66	4.07
1983	11.35	5.52
1984	11.74	6.67
1985	12.25	9.46
1986	12.69	11.73
1987	12.68	11.59
1988	12.55	11.33
1989	12.40	12.25
1990	12.26	12.32
1991	12.11	14.39
1992	12.03	18.76
1993	11.95	20.44
1994	11.87	21.34
1995	11.83	22.46
1996	11.83	25.23
1997	12.00	30.15
1998	12.03	36.49
1999	12.03	36.24
2000	12.90	39.63
2001	12.10	39.45
2002	12.40	36.98
2003	11.10	31.06
2004	12.40	32.80
2005	14.60	34.72
2006	16.30	38.35
2007	16.60	37.38
2008	17.10	37.34

As of June 30, 2008, for Alberta and July 31, 2008, for Alaska. *Note that the 2000-2008 figures for Alberta reflect fair market value. Fair market value comparisons dating back to 1977 are not available. Years previous to 2000 reflect fund equity but not necessarily fair market value as it applies to Alberta.

References

Akram, Q. Farooq (2005). "Efficient consumption of revenues from natural resources – An application to Norwegian petroleum revenues, working paper." Oslo: Research Department, Norges Bank. Available at www.norges-bank.no/publikasjoner/arbeidsnotater/pdf/arb-2005-01.pdf

Alaska Permanent Fund Corporation. (2008a). Fund Financial History and Projections. August 31, 2008. http://www.apfc.org/_amiReportsArchive/2008_8_PROJ.pdf

Alaska Permanent Fund Corporation. (2008b). The Strength of Diversification, annual report 2008. http://www.apfc.org/_amiReportsArchive/2008_AR.pdf.

Alaska Permanent Fund Corporation. (2008c). Monthly Financial Report, July 2008. http://www.apfc.org/_amiReportsArchive/2008_7_FIN.pdf.

Anderson, Jonathan (2002). "The Alaska Permanent Fund: Politics and Trust." Public Budgeting and Finance, Summer 2002.

Antolin P. and W. Suyker (2001). "How Should Norway Respond to Ageing?" OECD Economics Department Working Papers, No. 296, OECD Publishing.

Brown, William and Clive Thomas (1994). "Good sense or political expediency?" Challenges, September-October 1994, pp. 38-44.

Buss, Terry F. (1999). "The Case Against Targeted Industry Strategies," Economic Development Quarterly, Vol. 13 (4), 1999, pp. 339-357.

Buss, Terry F. (1999). "To Target or Not to Target, That's the Question: A Response to Weiwel and Finkle." Economic Development Quarterly, Vol. 13 (4), 1999, pp. 365-370.

Buss, Terry F. (2001). "The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature." Economic Development Quarterly, Vol. 15 No. 1, February 2001, pp. 90-105.

Certified General Accountants Association of Alberta (2004). "Alberta depends on good luck as much as good government," March 24, 2004, news release.

Dewar, Margaret E. "Why State and Local Economic Development Programs Cause So Little Economic Development." Economic Development Quarterly, Vol. 9 (2), 1998, pp. 134-146;

Government of Alberta (2008a). Alberta Finance, Budget 2008. http://www.finance.alberta.ca/publications/budget/budget2008/pdf.html.,

Government of Alberta (2008b). Alberta Finance, First Quarter Fiscal Update 2008-09 http://www.finance.alberta.ca/publications/budget/quarterly/2008_1stq/report.pdf.

Government of Alberta (2008c). Alberta Finance, Alberta Heritage Savings Trust Fund – First Quarter Update. http://www.finance.alberta.ca/business/ahstf/2008_1stq/report.pdf.

Hannesson, Rognvaldur (2001). Investing for Sustainability: The Management of Mineral Wealth. Boston/Dordrecht/London: Kluwer Academic Publishers.

Kasson, Joan (1983). Alaska Permanent Fund Corporation, Trustees' papers volume V. The creation of the Permanent Fund: A Short History. Wed edition, www.apfc.org/reportspublications/TP5-2.cfm.

Lougheed, Peter (2006). It's time to save, again. Calgary Herald, p. A14, February 15, 2006.

Mumey, Glen and Joseph Ostermann (1990). "Alberta Heritage Fund: Measuring Value and Achievement. Canadian Public Policy, Vol. XVI, pp 29-50.

References Cont'd

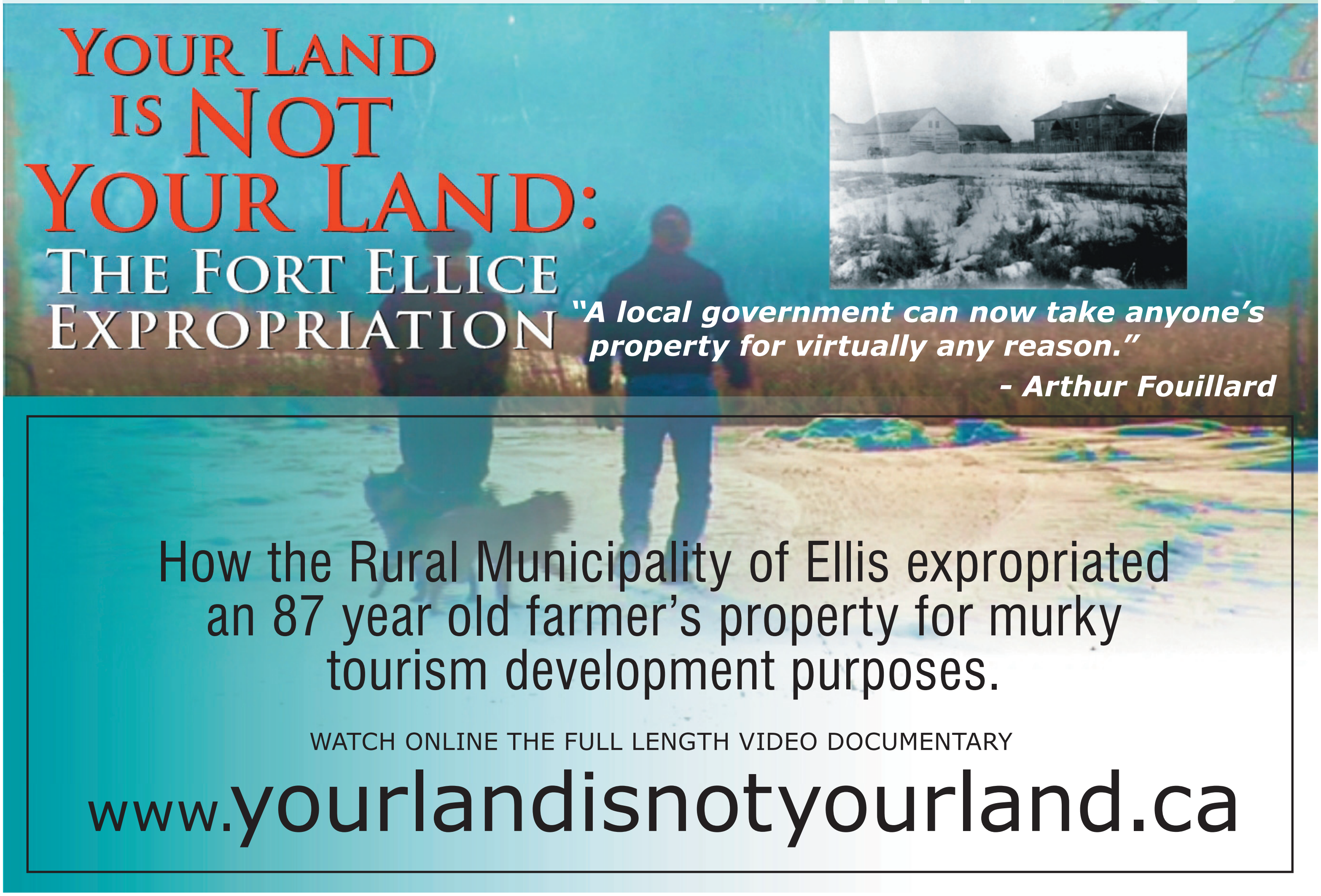
OECD (2002). "OECD Economic survey Norway Policies to boost potential output growth." OECD Economic Surveys. Vol. 2002, no. 15, pp. 184-244.

OECD (2005). OECD Economic Surveys. Norway, August 2005.

Sachs, J. and A. M. Warner (2001). "The curse of natural resources." European Economic Review 45 (2001) 827-838.

Thomas, Kenneth P. (2000). Competing for Capital: Europe and North America in a Global Era, Georgetown University Press, Washington, D.C.

Tsalik, Svetlana (2003). "Caspian Oil Windfall: Who Will Benefit?" Open Society Institute, 2003.



Also from the Frontier Policy Series

The Seven Habits of Highly Successful Governments
A Policy Primer for the New Alberta Government
(Best Practices Volume 1)

For more on government policies visit

www.fcpp.org