SASKATCHEWAN HERITAGE FUND:

CAPTURE THE NEXT BOOM AND SOFTEN THE NEXT BUST

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Taxpayer.com

ABOUT THE CANADIAN TAXPAYERS FEDERATION

The Canadian Taxpayers Federation (CTF) is a federally incorporated, not-for-profit citizen's group dedicated to lower taxes, less waste and accountable government. The CTF was founded in Saskatchewan in 1990 when the Association of Saskatchewan Taxpayers and the Resolution One Association of Alberta joined forces to create a national taxpayers organization. Today, the CTF has 117,000 supporters nation-wide.

The CTF maintains a federal office in Ottawa and regional offices in British Columbia, Alberta, Prairie (SK and MB), Ontario, Quebec and Atlantic Canada. Regional offices conduct research and advocacy activities specific to their provinces in addition to acting as regional organizers of Canada-wide initiatives.

CTF offices field hundreds of media interviews each month, hold press conferences and issue regular news releases, commentaries, online postings and publications to advocate on behalf of CTF supporters. CTF representatives speak at functions, make presentations to government, meet with politicians, and organize petition drives, events and campaigns to mobilize citizens to affect public policy change. Each week CTF offices send out Let's Talk Taxes commentaries to more than 800 media outlets and personalities across Canada.

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Stand Up. Be Heard!

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INTRODUCTION

Saskatchewan needs a better long-term plan for our non-renewable resource revenue.

We owe it to our children and grandchildren to make sure they benefit from some of these blessings rather than simply spending the money.

We also owe it to ourselves because booms create temptation for unsustainable spending while busts bring the spectres of deficits and budget cuts.

It's obviously prudent to pay down debt and save during good times to prepare for tough times.

The Canadian Taxpayers Federation is recommending the creation of a Saskatchewan heritage fund based on three principles:

1. A referendum should be held to endorse the creation of a heritage fund and, once created, a referendum must be required to alter the fund in the future;

2. All non-renewable resource revenues in excess of $1.5 billion each year should be used to pay down debt, and, when the debt is paid, the payments should go into a heritage fund; and,

3. The principal in the heritage fund must be protected and only the returns on those investments should be spent.

Here's the good, but frustrating, news: it is possible to create a successful heritage fund. This is not a theoretical abstraction. Alaska, a state with a population of 737,625, has more than $58 billion[1] (CND) in its heritage fund. Norway, with a population of 5.2 million, has $1.15 trillion[2] (CND) in its fund.

The necessity of a heritage fund is clear. The benefits are obvious. Saskatchewan is continually paying the price for failing to create one. Now is the time to create a heritage fund in Saskatchewan.

[1] Alaska Permanent Fund Corporation Annual Report 2015. Pg. 22.
[2] Norges Bank Investment Management website.

RECOMMENDATION ONE: REFERENDUM

Any effort to establish a Saskatchewan heritage fund must start with a referendum.

Saskatchewan has tried to established a heritage fund before. There are a host of scholarly papers contrasting our failed attempts with successful funds in Alaska and Norway.[3] They are frustrating to read as our savings were washed away as quickly as they came, while elsewhere successful funds were built up to lofty heights. Here are the basic points: Alaska and Norway have clear rules requiring regular deposits and prohibiting the spending of the principal in the fund, while Saskatchewan has done neither.[4]

For example, Alaska held a referendum before establishing its heritage fund and then protected it with an amendment to the state constitution.[5]

A referendum is critical because a heritage fund will require sacrifice and commitment from all Saskatchewanians. Dedicating non-renewable resource revenues to debt repayment and a heritage fund may mean slowing infrastructure construction; controlling public sector wages; and, showing patience on tax relief. The decision to create a heritage fund impacts everyone in the province today and in the future.

Even more importantly, it's crucial to send a clear message from the start: The heritage fund belongs to the people of Saskatchewan and only the people can change it. Requiring a referendum to change the fund is the only way to make sure future governments make the required deposits and keep their hands off the principal.

Recommendation One: A referendum should be held to endorse the creation of a heritage fund and, once created, a referendum must be required to alter the fund in the future.

[3] Stuart J. Wilson, Jason Penner and Amy Demyen. *"Call for a New Saskatchewan Heritage Fund."* University of Regina – Department of Economics, Oct. 2012.

[4] Peter MacKinnon. *"A Futures Fund for Saskatchewan."* Pg. 3.

[5] Alaska Permanent Fund Corporation website.

RECOMMENDATION TWO: LEGISLATED DEPOSITS

A savings account requires deposits. There are different ways to structure deposits. It's worth looking at different plans, but the important point is to pick a plan and follow through.

Norway saves 100% of its oil revenues. If Saskatchewan had deposited all of its non-renewable resource revenue from 2005 to 2015, its heritage fund would contain about $29.5 billion even if all of the investment returns were withdrawn rather than reinvested.[6] However, the Norwegian example is problematic for Saskatchewan. Norway can save all of its oil revenue because it *controls* all of its oil revenues.

The Canadian constitution gives provinces jurisdiction over natural resources.[7] However, this isn't the reality in practice.

The federal government's $18-billion Equalization program[8] is funded by taxes collected from all Canadians, but, because the Equalization distribution formula arbitrarily penalizes provinces with non-renewable resource revenues, the large majority of the benefits are consistently delivered to those that have not developed non-renewable resource industries. Therefore, much of the bill for Equalization is left to provinces that have developed their non-renewable resources because they've developed those resources. In effect, the federal government takes non-renewable resource revenues out of Saskatchewan.

However, Saskatchewan can't use Equalization as an excuse for failing to save. While Ottawa siphons millions out of Saskatchewan, the provincial government still has control over a significant amount of resource revenue.

Alaska provides an instructive example for Saskatchewan. Alaska's constitution requires the state government to save 25% of its oil revenues. Later legislation increased that threshold to 50%.[9] If Saskatchewan had deposited 25% of its non-renewable resource revenue from 2005 to 2015, its heritage fund would contain about $7.4 billion, even if all of the investment returns were withdrawn rather than reinvested.

Obviously, both Alaska and Norway have done very well with their heritage funds, but it makes sense for Saskatchewan to develop its own unique plan.

Premier Brad Wall asked[10] former University of Saskatchewan President Peter MacKinnon to examine other heritage funds and recommend a plan for Saskatchewan in 2013. At that time, non-renewable resource revenue made up about 26% of the Saskatchewan government's revenues. Dr. MacKinnon noted it would be hard for the government to reduce its dependence on non-renewable resource. Therefore, he recommended simply capping reliance on non-renewable resource revenue at 26% of revenues and depositing any additional revenues in a heritage fund.[11]

If Saskatchewan had used the MacKinnon plan from 2005 to 2015, its heritage fund would contain about $901 million. The only deposit would have come in 2009 when non-renewable resource revenues spiked to 32% of total revenues. However, it would have been a valuable start and positioned the province well if resource revenues boom again.

The MacKinnon plan has not been implemented. Dr. MacKinnon noted it would be hard for any government to make the spending cuts necessary to reduce its dependence on non-renewable resource revenues. Saskatchewan, it seems, could not bring itself to start saving because it was blessed with too much money at the time.

[6] References to Saskatchewan non-renewable resource revenues are found in provincial Public Accounts. All such figures are inflation adjusted to 2015 dollars.
[7] Canadian Constitution: http://laws-lois.justice.gc.ca/eng/const/page-4.html#h-19.
[8] Department of Finance: https://www.fin.gc.ca/fedprov/mtp-eng.asp.
[9] Mark Milke and Milagros Palacios. "How Alberta Squandered a Decade of High Energy Prices." February 2015. Pg. 11.
[10] Government of Saskatchewan press release: "Premier Wall Releases 'Saskatchewan Plan for Growth.'" Oct. 16, 2012
[11] Peter MacKinnon. "A Futures Fund for Saskatchewan." Pg. 11.

Times have changed. Non-renewable resource revenues have plummeted. The Saskatchewan government is now actively working to control spending in order to adjust to lower non-renewable resource revenues.

There are two silver linings in this dark cloud of low resource prices. First, Saskatchewan is reducing its dependence on non-renewables out of necessity. Second, it's giving Saskatchewan a golden opportunity to prepare for the next boom (if we're blessed enough to have a next boom).

In 2015, non-renewable resource revenues accounted for 12.9% of total provincial revenues. What Dr. MacKinnon speculated would be impossible due to budgeting difficulty is becoming a reality due to the economic situation: Saskatchewan is learning to live with less non-renewable resource revenue. Now Saskatchewan needs to make the most of this difficult opportunity.

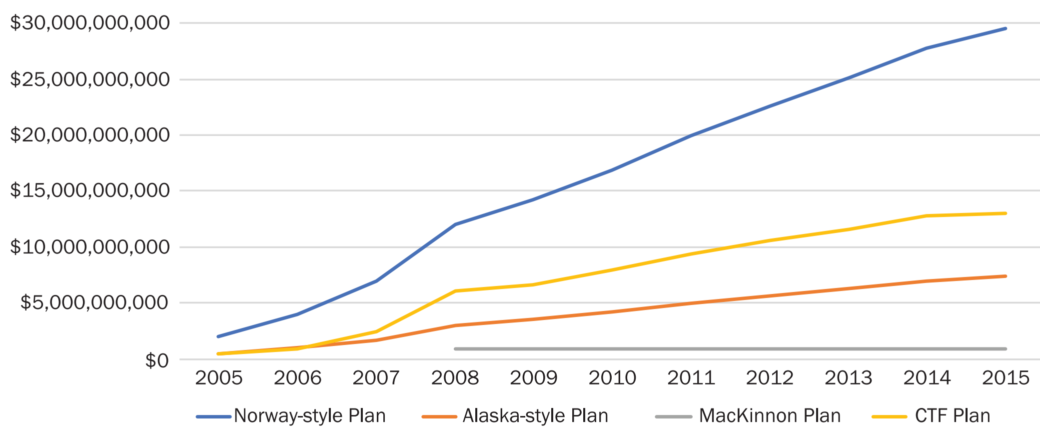
Saskatchewan can build on Dr. MacKinnon's concept of a cap, but strengthen and simplify the structure by limiting government spending of non-renewable resource revenues to a maximum of $1.5 billion per year. If non-renewable resource revenues fall below $1.5 billion, there would be no deposit. However, if prices rise, any non-renewable resource revenues beyond $1.5 billion would go to debt repayment, and, when the debt is paid, subsequent payments would go into the heritage fund.

For the sake of comparison, let's set aside debt repayment for a moment. If Saskatchewan had capped dependence on non-renewable resource revenue at $1.5 billion each year from 2005 to 2015, the heritage fund would now contain about $13 billion. That's much less than a Norway-style fund would have collected, but more than an Alaska-style fund or the original MacKinnon plan would have collected.

Most importantly, a heritage fund accomplishes two fundamental goals. First, it ensures that Saskatchewan never again allows itself to become dependent on non-renewable resource revenues for more than $1.5 billion each year. Second, it puts a solid plan in place to save a significant portion of any future booms. Accomplishing these goals would stabilize and strengthen Saskatchewan's fiscal future.

Recommendation Two: All non-renewable resource revenues in excess of $1.5 billion each year should be used to pay down debt, and, when the debt is paid, the payments should go into the heritage fund.

Figure 1: How much money would be in a Saskatchewan Heritage Fund under different plans



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Norway-style Plan	$2,022,323,861	$3,973,386,589	$6,940,077,685	$12,080,723,241	$14,187,045,994	$16,910,681,213	$19,910,720,053	$22,551,111,338	$25,139,661,504	$27,782,715,980	$29,543,980,980
Alaska-style Plan	$505,580,965	$993,346,647	$1,735,019,421	$3,020,180,810	$3,546,761,498	$4,227,670,303	$4,977,680,013	$5,637,777,834	$6,284,915,376	$6,945,678,995	$7,385,995,245
MacKinnon Plan	-	-	-	$901,066,080	$901,066,080	$901,066,080	$901,066,080	$901,066,080	$901,066,080	$901,066,080	$901,066,080
CTF Plan	$522,323,861	$973,386,589	$2,440,077,685	$6,080,723,241	$6,687,045,994	$7,910,681,213	$9,410,720,053	$10,551,111,338	$11,639,661,504	$12,782,715,980	$13,043,980,980

RECOMMENDATION THREE: PROTECT THE PRINCIPAL

Putting money into a heritage fund is only the first step. Saskatchewan has managed that step before, but ultimately failed. A heritage fund only works if the money stays in the account.

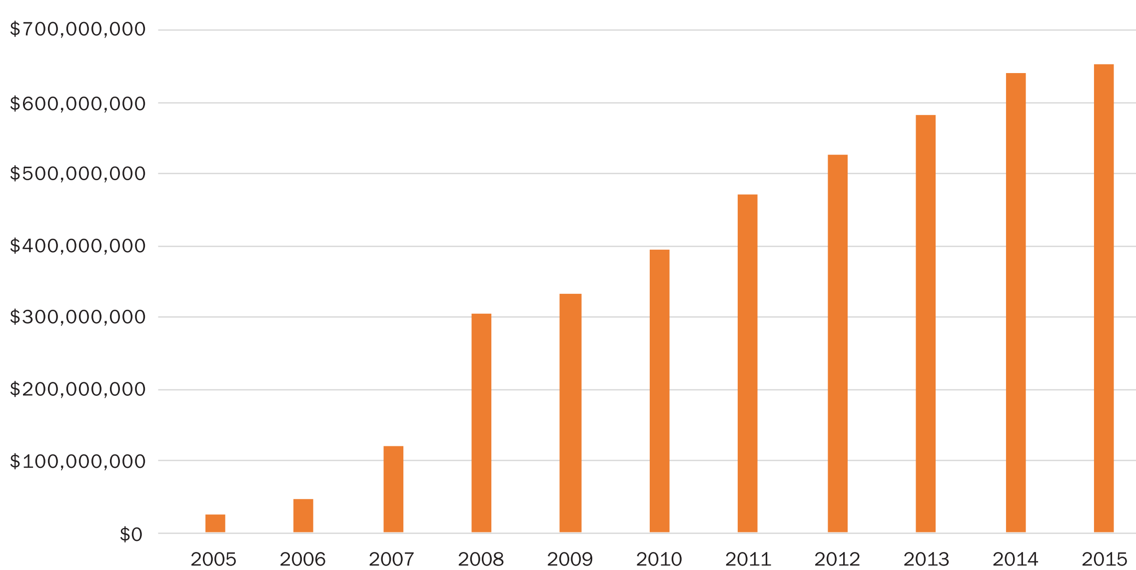
Saskatchewan created a heritage fund in 1978, but the government could transfer up to 80% of the money in the fund out of the savings account and into general government coffers each year. Over time, government withdrawals grew to exceed 80%. Even the remaining money wasn't safe from political interference as governments directed the capital to fund everything from University of Saskatchewan building projects to the Moose Jaw Wild Animal Park. Ultimately, runaway deficits caused the province to liquidate the remains of the fund in 1992.[12]

Politicians in Alaska and Norway are not allowed to spend the principal in their heritage funds. In fact, in addition to protecting the principal, some of the investment returns are re-invested in those funds to keep them from being eroded by inflation. Further, the funds have to be invested intelligently rather than being redirected to whatever new ideas strike the fancy of the government of the day.[13]

The benefits of this kind of discipline are significant.

If Saskatchewan had capped dependence on non-renewable resource revenue at $1.5 billion each year from 2005 to 2015, the heritage fund would contain about $13 billion. If the heritage fund then delivered a return of 5%[14] after expenses and inflation proofing, more than $652 million would be flowing into the provincial treasury in addition to up to $1.5 billion in non-renewable resource revenue every year.

Figure 2: Annual investment returns a heritage fund would have generated



Year	Amount
2005	$26,116,193
2006	$48,669,329
2007	$122,003,884
2008	$304,036,162
2009	$334,352,300
2010	$395,534,061
2011	$470,536,003
2012	$527,555,567
2013	$581,983,075
2014	$639,135,799
2015	$652,199,049

[12] Stuart J. Wilson, Jason Penner and Amy Demyen. "*Call for a New Saskatchewan Heritage Fund.*" University of Regina – Department of Economics, Oct. 2012.

[13] Robert P. Murphy and Jason Clemens. "*Reforming Alberta's Heritage fund: Lessons from Alaska and Norway.*" Fraser Institute, March, 2013.

[14] A 5% estimated return is conservative. The Alberta Heritage Savings Trust Fund reports annualised returns of 12.2% over the past five years (http://www.finance.alberta.ca/business/ahstf/). The Canadian Pension Plan reports annualised returns of 6.8% over the past 10 years (http://www.cppib.com/en/our-performance).

Receiving a consistent and predictable cash flow is critically important.

The government currently bases important budgeting decisions for healthcare and education on its best guesses regarding resource revenues. Unfortunately, despite using the best industry forecasts, nobody really knows what will happen to prices for a barrel of oil or a tonne of potash even a few months into the future. Actual non-renewable resource revenues have varied from government projections by an average of 34% from 2005 to 2015 – that's an average variation of $700 million every year. In 2009, non-renewable resource revenues were 142% higher than projected and in 2015 they were 28% lower than projected. This isn't necessarily the government's fault – commodity prices are impossible to precisely predict.

This causes considerable instability. When revenues are up, bureaucrats propose new programs. When revenues fall, bureaucrats worry about cuts. It simply isn't prudent to depend on a volatile source of revenues that varies from projections by an average of more than 34% per year. When the government makes plans to deliver services for Saskatchewan, it should be confident that funding will be there for the long-term rather than worrying about oil and potash prices.

A heritage fund will address this dangerous instability in two ways. It ensures that the government is never counting on non-renewable resource revenues for more than $1.5 billion. Second, it replaces volatile resource revenues with more stable investment returns.

There is always the theoretical possibility of some disaster that makes it necessary for a government to use the principal in the heritage fund. The problem is that defining a disaster is subjective. Therefore, if a government feels it's absolutely necessary to draw on the principal of the heritage fund, it would be required to submit the decision to the people through a referendum. The people, and only the people, can be trusted to decide whether unexpected circumstances require a withdrawal of principal from the heritage fund.

A successful heritage fund needs a solid plan to make regular deposits as well as strong protections for the principal it accumulates.

Recommendation Three: The principal in the heritage fund must be protected and only the returns can be spent.

OBJECTIONS: EXCUSES FOR FAILING TO SAVE

Creating a heritage fund is common sense. Politicians from all parties have spoken in favour of the concept. And yet, Saskatchewan doesn't have a heritage fund. It's natural to ask: why not?

"The most lasting legacy we can leave our children and grandchildren is a debt-free province. Once that is achieved, we need to look ahead to ensure that our resource revenues continue to benefit future generations."

– Saskatchewan Premier Brad Wall[15]

"Having a savings plan for the future is pretty important in families and also in government,"

– Former NDP Leader Dwayne Lingenfelter[16]

Here are some possible objections to these recommendations.

What if we can't afford to save this much?

It's absolutely true that making deposits in a heritage fund will mean that money isn't available for other things. Further, it's important to recognize that non-renewable resource revenues spent in the past weren't necessarily wasted – billions have gone to debt repayment and long-term infrastructure investments. Creating a heritage fund is the right thing to do, but that doesn't mean it's an easy thing to do. That's a key reason for making this decision through a referendum.

Perspective is important. If Saskatchewan can't live without non-renewable resource revenues today, how will our children and grandchildren live without those revenues in the future? Saskatchewan is currently spending non-renewable resource revenues as fast as they come in. Even worse, despite that spending, the provincial debt is rising. Future generations face the spectre of paying off our debts without the benefits of non-renewable resource revenues that we're spending. Saskatchewan needs to take future generations into consideration.

Creating a heritage fund isn't just about the future, it's about the present as well. Volatility is expensive. As revenues rise, spending tends to rise, but when revenues fall, spending often continues to rise and the shortfall is filled with borrowing. That growing debt comes with hundreds of millions of dollars in interest payments every year. A heritage fund creates stability on two fronts. It makes it less likely the government will become dependant on resource revenues in good times and it provides consistent investment returns in tough times.

If Saskatchewan had invested non-renewable resource revenues above the $1.5-billion cap starting in 2005, our heritage fund would have paid out more than $4.1 billion in returns by 2015. The principal in the fund would be $13 billion. Every year, it would be paying out dividends of $652 million even at an interest rate of 5%.

[15] Government of Saskatchewan press release: "Premier Wall Releases 'Saskatchewan Plan for Growth.'" Oct. 16, 2012.
[16] Patrick Book, CJME News. "NDP Announces Bright Futures Fund." Oct. 11, 2011.

Should we be saving more?

If non-renewable resource prices remain low, a $1.5-billion cap may mean the government doesn't make any deposits at all. Wouldn't that make the heritage fund a failure?

The recommendation to set the cap at $1.5 billion is not set in stone. The right number may be higher or lower. It's a topic that merits discussion.

The recommendation to set the cap at $1.5 billion is based on two factors. First, falling non-renewable resource revenues have put a $1.5-billion cap within reach. Second, limiting government reliance on non-renewable resource revenue to $1.5 billion will significantly reduce volatility.

Most importantly, it's a plan. If non-renewable resource revenues go up again, Saskatchewan will be ready. If history is any guide, that readiness will be rewarded.

However, if Saskatchewanians, either present or future, decide to lower the cap and make larger debt payments or deposits into the heritage fund, it would almost certainly be a good decision. Alaska started by depositing 25% of oil resource revenue and later raised that number to 50% and Saskatchewan could eventually follow a similar path.

In the meantime, the priority should be to get a good plan implemented now instead of continually waiting for a perfect time to implement a perfect plan.

Wouldn't heritage fund give future governments control over a horde of cash?

The government already has control over the non-renewable resource revenues it collects, the question is whether that money should be spent immediately or whether it should be invested in a heritage fund that provides a more stable cashflow over time.

Right now, the government makes spur-of-the-moment decisions regarding windfalls – sometimes the money is used to pay down debt or reduce taxes, but it's also used to support increased spending. The government is equally unprepared for revenue shortfalls and often resorts to deficits and tax hikes.

A heritage fund can't guarantee non-renewable resource revenue will be spent well (that's probably an impossible mission), but it can create a steadier cashflow rather than unpredictable booms and busts.

Shouldn't Saskatchewan deal with deficit first?

Yes, Saskatchewan must deal with its deficit.

However, the deficit is partly due to the fact that Saskatchewan doesn't already have a heritage fund. Having a plan in place to put windfalls into debt repayment or heritage fund deposits will reduce the temptation to simply increase spending. It would also ensure there's a relatively stable investment income available to address deficits in tough times.

The provincial government is already adjusting to lower non-renewable resource revenues projected at $1.3 billion for the 2016-17 fiscal year[17], so a cap set at $1.5 billion is clearly possible.

[17] Government of Saskatchewan. "Mid-Year Report." Nov. 22, 2016.

CONCLUSION

Saskatchewan needs a heritage fund. We owe it to Saskatchewanians of today and the future to take the prudent step of saving some of our non-renewable resource revenues. We've seen what others have accomplished with heritage funds and it's time to follow that lead.

There will always be reasons to procrastinate. We may have too much money or too little. These concerns are not insignificant, but neither the time nor the plan will ever be perfect and the price of procrastination is simply too high.

Saskatchewan needs a heritage fund with concrete plans for the deposits; ironclad protections for the principal; and, the commitment to let the people of Saskatchewan, through referendums, establish or change the fund.