Jim Prentice's government should revitalize Peter Lougheed's legacy

Time Albertans rebuilt Heritage Savings Trust Fund

Mike Priaro, a resource engineer with 25 years experience in Alberta's oil patch, outlines how successive provincial governments have failed to live up to the objectives set by the late former premier Peter Lougheed when the Alberta Heritage Savings Trust Fund was established in 1976. Priaro contrasts Alberta's management and use of the fund – now worth close to $18 billion – with that of Norway, whose government has accumulated almost $900 billion in a similar fund.

Mike Priaro

Alberta's Heritage Savings Trust Fund (HSTF) was worth $17.5 billion as of March 31, 2014 according to the Alberta government's 2013-2014 annual report.

Before anyone gets too giddy, this news should be tempered by the fact that in 1987 the value of the fund was $12.7 billion. This means that in the intervening 27 years of Progressive Conservative governments under Getty, Klein, Stelmach, Redford, Hancock, and now Prentice the fund has grown by an average of only 1.4 percent per year. Adjusting for inflation, which averaged 3.1 percent per year over the same period, the fund has actually **shrunk** in real terms by 33 percent since 1987.

The HSTF was established by Peter Lougheed in 1976. Thirty percent of resource revenue received by the Government of Alberta was to accrue to the Heritage Fund. As well, a special initial contribution of $1.5 billion of cash and other financial assets was transferred from Alberta's General Revenue Fund to the Heritage Fund on August 30, 1976.

From 1976 to 1982, the government transferred thirty percent of resource revenue to the Heritage Fund. From 1983 until 1987, under low oil prices that bottomed out at $10/bbl in 1986, the percentage was reduced to fifteen percent. Due to low oil prices, however, the last transfer of resource revenue to the HSTF was made by Premier Getty in 1987. In 2006, two special contributions were made to the HSTF.

The Alberta HSTF investment portfolio earned $2.1 billion in fiscal 2013-2014 but only about $0.2 billion, roughly one percent of the fund's current value, will be retained in the fund to protect the fund against inflation. The remaining $1.9 billion will be transferred to the province's General Revenue Fund as has all resource revenue since 1987.

According to the Fraser Institute, between 1977 and 2011 the Heritage Fund's net income totaled $31.3 billion, of which $29.6 billion (in investment portfolio earnings) was transferred to the General Revenue Fund. This is why the Alberta Heritage Savings Trust Fund is worse than stagnant and will never even begin to grow to the $889 billion accumulated in Norway's fund as of June 30, 2014. Note that at the same 7.5 percent average return on investments achieved by the HSTF during the last ten years, Norway's fund would generate $67.5 billion per year. It doesn't take a financial genius to understand that "It takes money to make money."

According to Barry McKenna, in a recent *Globe and Mail*

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(Table 1)

Selected Sovereign Wealth Funds

COUNTRY • STATE • PROVINCE	FUND VALUE (BILLION USD)
Abu Dhabi	$931
Norway	$893
Saudi Arabia	$757
Kuwait	$548
Qatar	$256
Russia	$182
Kazakhstan	$79
Algeria	$77.2
Dubai	$70
Libya	$66
Iran	$62
Texas	$55
Alaska	$51.7
Brunei	$40
Azerbaijan	$37.3
New Mexico	$19.8
Iraq	$18
Alberta	$17.5
East Timor	$16.6

Source: Sovereign Wealth Fund Institute

article entitled "Norway proves oil-rich nations can be both green and prosperous", Norway has managed to secure its financial future with production of only about 38 billion barrels of oil since 1971, compared to Alberta's 54 billion.

As shown in the table above of selected oil and/or gas Sovereign Wealth Funds, the value of Alberta's HSTF ranks just ahead of East Timor and just behind war-ravaged and looted Iraq.

The Conservative government has said that by 2017-18, all net income earned by the Heritage Fund will remain in the fund. However, even at an optimistic 7.5 percent per year this means the fund will grow by only $1.3 billion per year, less inflation.

Instead of funding all operational and infrastructure expenses from a stable and progressive tax system, where the wealthiest and highest paid workers in this country pay an equitable share of their incomes, the Progressive Conservative Party of Alberta has so far insisted on standing by its regressive flat-tax system, relying on unstable and unpredictable non-renewable resource revenue to fund critical programs like health, education, and infrastructure.

Successive Conservative governments have also failed Albertans by insisting on one of the lowest royalty regimes anywhere. In fiscal 2013, royalties garnered Albertans only about five dollars per barrel of oil equivalent in resource revenue.

The Conservative government of Ralph Klein paid off the accumulated debt of previous Conservative Governments on the backs of those most vulnerable and least able to pay by, for example, maintaining health care premiums instituted by previous Conservative governments, and by instituting a flat-tax income tax regime — both highly regressive fiscal measures — and by demolishing hospitals and cutting back spending on other infrastructure and social services.

Premier Jim Prentice has said it is acceptable to run operational deficits that once again will force Albertans into debt to fund needed infrastructure like schools, hospitals, roads, public transit, and parks. Indeed, with the recent declines in oil prices, Prentice will have no choice but to run deficits as well as cut back on essential services and infrastructure and look for additional sources of revenue.

In a search for ways to increase government revenues, Prentice's Progressive Conservative government has recently floated trial balloons regarding health care premiums and a sales tax. Such measures would be anything but progressive. They would also reveal a lack of both vision and courage. Have we failed to learn from previous mistakes? If the new premier proceeds along this path we are almost certainly doomed to repeat the failures and experience once again the hardships of the past.

Mike Priaro, *B.Eng.Sc., P.Eng., Lifetime Member Association of Professional Engineers and Geoscientists of Alberta, worked in Alberta's oil patch for 25 years. He co-authored 'Advanced Fracturing Fluids Improve Well Economics' in* Schlumberger's Oilfield Review. *He has presented to Canada's House Committee on Natural Resources. His commentaries have also been published by U.S. energy industry website* RBN Energy, *in the July 17, 2014 edition of the* Oil and Gas Journal, and in Petroleum Technology Quarterly, Q3 2014.