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# Commentary

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## What Crisis?

### Global Lessons from Norway for Managing Energy-Based Economies

Greg Poelzer

To say the rapid drop in oil prices has sent shock waves across the global economy might be the understatement of 2015. Russia's geopolitical resurgence, fueled by high oil prices, has stalled and the country is reeling from a massively devalued ruble and the loss of foreign currency earnings. Only a few months ago Canada was touting its aspirations and capacity to become an energy superpower; now, the federal government and oil-producing provinces, especially Alberta, are scrambling to deal with unanticipated budget deficits and job losses. The Sirens of energy resources, it would appear, have once again seduced governments with the promise of brimming coffers only to cruelly draw government budgets onto the rocks of falling oil prices. Perhaps, one might think, the strategy of building economies on the cornerstone of energy resources is not so wise after all.

Across the Atlantic, however, Norway tells a different story. The drop in oil prices is a cause for prudent concern, not panic, even though oil accounts for 25 percent of the Norwegian economy, the same as in Alberta (Jafarov and Leigh 2007; Segal 2012). Norway, moreover, has no plans to radically change its forecasted budget and it even has a budgetary buffer of \$8.5 billion should things get worse (Reuters 2015) – which is roughly the same as the \$7 to \$10 billion deficit that Alberta is expected to see the next fiscal year (Bennett 2015).

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The difference between Norway and most other oil-producing jurisdictions is around policy choices determining the role of resource wealth in the economy in general and in government budgets in particular. Twenty-five years ago, Norway established a sovereign wealth fund to capture its oil revenues and remove them from government general revenues (Caner and Grennes 2010; Lücke 2010). Canada has not; neither has Saskatchewan nor Newfoundland (Wilson, Penner, and Demyen 2012; Yew 2013). Premier Peter Lougheed had the vision to create the Alberta Heritage Trust Fund almost four decades ago; yet, scarcely a decade later his successors abandoned the commitment to build the fund (Campbell 2013). Today, Alberta is paying the price. In contrast, Norway shows that governments blessed with petroleum resources can build modern, stable, and prosperous economies on the bedrock of oil and gas, without suffering from the Dutch disease (where an overheated resource sector creates a shrinkage in manufacturing due to rising labour costs and higher export prices) or taking tumultuous rides on the boom and bust cycles of energy commodity markets (Baena, Sevi, and Warrack 2011).

The lesson is simple: the current shock wave is a wake-up call to change policy course. The oil producing provinces and territories can and should build modern economies using natural resources as a critical foundation. But, such efforts will only be successful if they make fundamental policy changes. A necessary, though not sufficient, policy is building a sovereign wealth fund. The paper begins with a stark reminder of the impact of the current fall of oil prices on oil economies within Canada and abroad, and contrasts this with the situation in Norway. Next is an overview of what sovereign wealth funds are and the different policy goals they serve. The paper then outlines the path to the development of the most successful sovereign wealth fund in the world, Norway's Government Pension Fund Global. Finally, it outlines policy directions the resource-producing provinces and territories, as well as Canada, should follow to produce sustainable, prosperous futures based on a cornerstone of natural resource wealth.

## Oil Prices and Petro Economies

The impact of falling oil prices on petroleum-producing states is colossal. The Russian ruble is in free fall; since the end of summer 2014 it has lost nearly 50 percent of its value and this past year was the worst performer among 170 currencies tracked by Bloomberg (Barley 2015; Tanas 2014). No doubt a factor in the ruble's plummet are the "smart sanctions" imposed by the West over President Vladimir Putin's adventures in Ukraine. Much more significant, however, is the drop in oil prices. Oil and gas make up more than 50 percent of the revenues in the Russian federal budget (Hong and Cox 2014) and 70 percent of Russia's export earnings (Johnson 2015). In Nigeria the situation is even worse: oil exports account for 95 percent of export earnings (The Economist 2014). The rapid decline in Nigerian fiscal resources and, concomitantly, the inability to build a more effective state, make the prospects for addressing crises, especially attacks by the militant Islamist group Boko Haram, increasingly bleak.

While not as grave, the situation in Canada is nevertheless stark for the energy-producing provinces and territories; the fall in prices has even affected the federal government. In January, Minister of Finance Joe Oliver announced that the federal government would postpone its budget – a move that is almost without precedent: "Given the current market instability, I will not bring forward our budget earlier than April. We need all the information we can obtain before finalizing our decisions" (Fekete 2015, 1). Many expect the federal government will have great difficulty meeting its deficit targets. Indeed, TD Economics anticipates that the federal deficit in 2015/16 is likely to be more than \$2 billion instead of the nearly \$2 billion surplus outlined in the fall 2014 federal update (Bartlett 2015). If oil prices remain at current rates, the federal government should anticipate a further \$600 million deficit in the subsequent fiscal year (Curry 2015). TD Economics expects that a return to surplus will only be achieved in 2017/18 (Bartlett 2015). However, if oil were to fall to \$40 a barrel and stay at that level, the deficit could soar to \$4.7 billion in 2015/16 and to \$2.4 billion in 2016/17 (Curry 2015). "The conclusion is unambiguous. In the absence of new measures to raise revenue or cut spending, TD is projecting budget deficits in fiscal 2015/16 and 2016/17 as opposed to the surpluses expected at the time of the update," states the report authored by TD senior economist Randall Bartlett (cited in Curry 2015, 1).

The impact on the oil-producing provinces is much more severe. Alberta, the engine room of Canada's emerging energy superpower ambitions, is staring an economic recession in the face and has floated the notion of a provincial sales tax – historically a policy no-go-zone – as a serious policy option to mitigate the revenue hemorrhaging in the provincial budget. Premier Jim Prentice has indicated that the province may reach a deficit of more than \$7 billion and possibly as high as \$10 billion in 2015 (Bennett 2015). To put the size of the deficit into perspective, the provincial budget is roughly \$40 billion. The energy sector in Alberta is cutting billions in spending. Suncor Energy Inc., Canada's largest oil and gas company, has already cut 1000 jobs and will cut \$1 billion from its 2015 budget (Cattaneo 2015). Premier Prentice warns, "The circumstances that we're in are the most serious financial circumstance we have seen in this province in 25 years, if not 50, and certainly they will affect every Albertan" (Bobrovitz and Boushy 2015). Saskatchewan, Canada's second-largest conventional oil producer, but with a more diversified resource portfolio, is nevertheless urgently tightening its belt. It is noteworthy that the two premiers who did not attend the January 2015 Council of the Federation meetings are from Canada's two largest oil-producing provinces.

The situation in Norway could not be more different. The petroleum sector is crucial to the Norwegian economy, accounting for about 25 percent of the GDP and about 1 in 11 workers (England 2014). As in the case of other oil-producing countries and regions, the 50 percent drop in prices is drastically reducing oil revenues and capital expenditures, the latter forecast to be cut by 15 percent in 2015 (Reuters 2015). But, the Norwegian government is not panicking, nor is it facing a crisis. Following a meeting among the prime minister, the finance minister, and the governor of the Norges Bank, on January 16th – ironically, one day after Minister Joe Oliver announced the federal government would delay the budget until at least April – Finance Minister Siv Jensen assured the general public at a press conference that Norway would stay the course and no immediate changes were necessary: "For the moment we think the fiscal budget is well adjusted to the economic situation" (Reuters 2015, 1). She further notes, "Some are quick to use the word crisis. I want to underline that this is not a crisis" (Hovland 2015, 1). In addition, according to Hovland (2015), Ms. Jensen said "monetary policy and the exchange rate had proven to be useful 'shock absorbers' for the economy so far, as had the country's sovereign-wealth fund and solid banking sector" (1). At the same news conference, the governor of the Norges Bank, Øystein Olsen, observed, "Altogether, there's nothing dramatic in what we see now. As earlier forecast, growth in 2015 will be weaker, but we still see growth picking up over the next years" (Reuters 2015, 1). At the same time, other export sectors are benefitting from the lower Norwegian currency, thus balancing declines in activity in the oil sector. By legislation, the Norwegian government may use a maximum of the real return (interest minus inflation) from the fund; by policy, the Norwegian government has used the estimate of a 4 percent real return as a strict benchmark that had broad cross-party and societal support. The 4 percent return was used for non-petroleum national government budget deficits (Reiche 2008), through a complex model of fiscal forecasting of future expected revenues and expenditures. However, the fund is now so large that the 4 percent return already exceeds the fiscal revenue needs of the national government. Recognizing this new reality of its sovereign wealth fund, the government budgeted to draw on only 3 percent, giving the Norwegian government a buffer of \$8.5 billion should it need to increase spending (Reuters 2015). Having the foresight to establish its sovereign wealth fund 25 years ago and demonstrating the fiscally conservative discipline to maintain its course across governments of different political stripes, Norway is now weathering the current stormy seas.

## What are Sovereign Wealth Funds?

Sovereign wealth funds (SWF) in general and Norway's Government Pension Fund Global in particular have attracted waxing attention over the past decade. SWFs have also generated increasing debate among policy-makers in the fields of global finance and geopolitical relations. At their core, sovereign wealth funds are government owned and managed investments, typically separate from foreign reserves, and sourced through budget surpluses, resource revenues, taxes, and other instruments. The International Working Group of Sovereign Wealth Funds (2008) defines SWFs as "special purpose funds that are owned by the

general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets” (27).

The term *sovereign wealth fund* is relatively new, coined by Andrew Rozanov in 2005 (Rozanov 2005). However, sovereign wealth funds themselves are not new (Cohen 2008). A number of scholars suggest that state-managed financial instruments that can be classified as sovereign wealth funds can be found as early as the 19th century. France, for example, created a state fund in 1816 called the Caisse des Dépôts et Consignations (CDC). This fund consists of overseas tax-exempt funds collected by French savings banks and post offices. At present, “the CDC invests its deposits in public housing, universities and other sustainable development projects” (Yi-chong and Bahgat 2010). In North America, Texas pioneered a similar effort, creating two public funds to fund public education, the Public School Fund in 1854 and the Public University Fund in 1876, the latter endowed by public lands following the annexation of Texas by the United States in 1845.

Most scholars agree that the first modern SWF was the Kuwait Investment Authority (KIA), established in 1953 and built on the surplus funds from the discovery of oil (International Working Group of Sovereign Wealth Funds 2008; Kern 2007). In 2014, the KIA fund was valued at nearly US\$600 billion, making it the sixth largest SWF (Sovereign Wealth Fund Institute 2015b). The second SWF, the Revenue Equalization Revenue Fund, was created in 1956 by the British in the Gilbert Islands in Micronesia (after independence in 1979 known as Kiribati) (Sovereign Wealth Fund Institute 2015a). This SWF was funded by a different resource, namely phosphate deposits, which were exhausted by the time of independence. The number of SWFs grew slowly with the most notable in Abu Dhabi, Singapore, and Alberta in the 1970s, Brunei and Oman in the 1980s, and Botswana, Hong Kong, Malaysia, and Norway in the early 1990s (Allen 2014; Cohen 2008; Kern 2007). However, by the end of the 1990s, SWF numbers began to accelerate; in fact, more than 30 SWFs have been established since 2005 alone or just under half of the nearly 80 SWFs operating around the world today (Cohen 2008; Kern 2007).

There are five main SWFs – saving funds; stabilization funds; reserve investment funds; pension reserve funds; strategic development funds – and each operates as a policy instrument designed to achieve specific policy goals (Das et al. 2009). Saving funds or future generation funds are created to convert revenues from a one-time natural resource development, typically petroleum or mineral resources, into investment funds whose capital can continue to provide returns in perpetuity. Governments establish these funds so that future generations continue to benefit from the development of a country’s non-renewable resources.

Stabilization funds are created to mitigate the volatility that often accompanies a resource-based economy (Das et al. 2009; Landon and Smith 2013; Segal 2012; Weinthal and Luong 2006). Natural resource development, especially during boom periods, often overheats economies if the newfound wealth is dumped directly into the economy. By taking the resource dollars out of the economy and only indirectly drawing on a portion of the return on the capital, stabilization funds dampen the overheating effect (Tsani 2013). Another important effect of putting resource revenues into a fund rather than directly into government general revenues is that it stabilizes government budgets (Tsani 2013). Most governments put resource revenues into government budgeting processes. This would be fine, as long as commodity prices remain stable and predictable. However, as the markets demonstrate time and time again, oil and gas prices can rise rapidly and descend just as quickly (Wilson et al. 2012). How often have we witnessed governments spending lavishly during boom periods, but slashing spending and cutting programs when commodity prices fall? If governments instead draw on the return of the accumulating capital, the flow of revenue is far more predictable and the volatility in government budgets is greatly reduced (Di John 2011). SWFs can also serve as an effective tool in regard to foreign reserves (Segal 2012). Governments often accumulate trade surpluses, but rather than earning very little interest, a portion of government foreign exchange reserves can be invested to achieve greater rates of return, at least in the short run. In a similar way a SWF can invest pension holdings to achieve greater rates of return.



In practice, most SWFs often serve two or more policy goals. Although the Norwegian Government Pension Fund Global was established as a savings or future generations fund, it has proven to serve a powerful stabilization role in the Norwegian economy. Economists have noted that the GPFG has played a key role in avoiding the Dutch disease by taking oil dollars out of the economy directly.

## Norway's Sovereign Wealth Fund: Origins and Current Functions

Without the discovery of oil in the North Sea in 1969, it is almost certain there would be no GPFG. And, there may not have been the discovery of North Sea oil had there not been the discovery of large gas fields near Groningen in the northern part of the Netherlands in 1959 (Reiche 2008). Prior to that discovery, the general consensus was that Norway had little prospects for oil and gas (EITI 2015). However, the Dutch find prompted petroleum companies to consider exploration off the coast of Norway. As early as 1962, Phillips Petroleum applied to the Norwegian government for exploration (EITI 2015). The Norwegian government rejected the application as state authorities deemed the application a request to secure exclusive rights for a single private company (FACTS 2013). This was a critical juncture in the development of Norwegian policy regarding oil and gas development on the Norwegian Continental Shelf. The first principle to emerge was clear state control over development; the second principle was to develop the resource in a carefully planned manner. In 1963, the Norwegian government asserted sovereignty over the Norwegian Continental Shelf, including exclusive ownership of the subsurface resources (FACTS 2013). It started first with permitting seismic exploration by multiple companies, but not drilling. In the interim, the Norwegian government had to negotiate the boundaries of its sovereign extension in the North Sea with Denmark and Great Britain, and an agreement was reached in 1965 (EITI 2015). The first well was drilled in 1966, but was dry. The first successful well was drilled in 1969 in Ekofisk, Norway's equivalent of Leduc #1 in Alberta, Canada, setting off the Norwegian oil era, with production commencing in 1971 (EITI 2015).

Norway made two key policy decisions at the beginning stages of the development of the petroleum sector. First, in 1972 the Storting (Norwegian parliament) created Statoil, the Norwegian state-owned petroleum company (Rommetvedt 2005; Statoil 2007). Second, parliament enacted the principle of 50 percent participation of the state in oil and gas activities (FACTS 2013). Statoil pays its share of costs of exploration and development and receives its share of returns. The 50 percent principle has subsequently been modified depending on the particular lease. By 1976, Statoil made its own major discovery in Statfjord, which was brought into production by 1979 (Statoil 2007). With increasing engagement in the petroleum sector and increasing cash flow into Statoil, in 1985, the Norwegian state reorganized the management of assets in Statoil with the creation of the State's Direct Financial Interest (SDFI) (FACTS 2013). SDFI is the formal government entity that owns interests in various oil and gas fields, pipelines, and onshore facilities. By 2001, following three decades of experience in the petroleum sector, the Norwegian government made steps toward greater privatization. The first step was to create Petoro, a state-owned management company separate from Statoil and, subsequently, to allow the sale in 2001 of 21.5 percent of SDFI assets (15 percent was sold to Statoil and 6.5 percent to other licensees, including 5 percent to NorskHydro). In the same year, Statoil was publicly listed on the Oslo and New York stock exchanges as a partially privatized company (Statoil 2007). Today, 67 percent of shares are held by the Norwegian government and 33 percent are held by other shareholders, making it a multinational company, albeit majority Norwegian owned (Statoil 2011). Statoil operates as any other company, primarily on the Norwegian Continental Shelf, but also globally in places such as Brazil. The petroleum industry accounts for nearly one-quarter of Norway's gross domestic product.

The Norwegian path to oil development had significant bearing on the development of Norway's sovereign wealth fund. The OPEC shock wave sent oil prices skyrocketing in the 1970s leading to increasing expectations of wealth generation in Norway. However, bringing discovered oil fields into production took more time than

predicted. Norway was not immune to the global economic challenge of the 1970s with high government spending, pressures on employment, and inflation requiring government stimulus spending (Tranoy 2010). By the 1980s, the oil sector was moving in earnest; however, this initial optimism was tempered by the crash in oil prices in 1985 and large government deficits (Shemirani 2011) and significant efforts to put Norway back on track fiscally.

Two themes emerged in the discussion of how to proceed with the development of Norway's petroleum resources: first, oil and gas development should proceed slowly, or in a paced way; second, a fund should be established to bank the newfound wealth. The latter idea did not take immediate hold, as policy-makers thought the Norwegian electorate would expect oil dollars to be used first and foremost to address urgent societal needs. While Norway is known today for consistently topping the charts of the United Nations Human Development Index as the best country to live in, it needs to be remembered that in the 1970s Norway was the poorest Scandinavian country, with Denmark and Sweden enjoying significantly more prosperous economies. However, the forecasts by policy-makers in the 1970s did not come to pass and provided important lessons about the unpredictability of the global economic events in general and the petroleum sector in particular. By the 1980s, the idea to build a sovereign wealth fund was back on the table.

The revenue for the GPF comes primarily from taxation on the petroleum sector (Murphy and Clemens 2013), as well as the dividends from the government-owned Statoil (created originally in 1972 and reconfigured several times over the last 40 years). None of the oil revenue goes directly into government budget revenues. As a consequence, the fund now stands in excess of \$US890 billion. There are strict rules (covering such elements as ethical investments, limits on equities, transparency, and so on) governing how the funds are invested. All of the funds are invested outside of the country to lessen inflationary pressures on the economy from resource-driven prosperity. There are also strict rules regarding how the funds are to be used (Segal 2012). Only the real return (interest minus inflation) from the fund, currently estimated at 4 percent, can be used for non-petroleum national government budget deficits.

The GPF plays a critical role in ensuring stability in Norwegian government budgets, reduces the risk of inflation and an overheated economy, and prevents the undesirable effects of the resource curse and Dutch disease, such as factor movement (such as labour to resource sector), spending effects (excessive demand), and spill-over losses (in non-resource sectors). The fund also dampens the ability of governments to make large, politically expedient expenditures that may not be in the long-term interest of the country.

## Canada: Past Practice and Current Initiatives

Canada is resource rich. The country holds enormous reserves of oil sands in Alberta, as well as conventional oil and gas in Alberta, Saskatchewan, the Northwest Territories, and Newfoundland and Labrador. Saskatchewan is the number one producer of potash and number two producer of uranium. Nunavut has rich iron ore deposits, and the territory has significant deposits of uranium, gold, and other minerals. However, as a country, we have been poor fiscal stewards of our natural resource wealth. If Canada is to build stable, powerful, and sustainable economies, and to secure our place as an energy and natural resource power globally, the federal government, the provinces, and territories need to commit to building SWFs.

The idea of establishing SWFs is not new in Canada. But, past failures should provide important lessons for future choices. The Alberta Heritage Trust Fund in Alberta is the most prominent example. Created in 1975 by Premier Lougheed, it began with a one-time infusion of \$1.5 billion from general revenues and with annual contributions of 30 percent of non-renewable resource revenues, amounting to another \$620 million within the first year (Campbell 2013; Milke 2008). However, the amount of contributions from non-renewable resources declined and contributions were stopped altogether by 1987 (Gibbins and Roach 2006). The growth of the fund has stagnated at about \$17 billion. The Fraser Institute found that had the

Alberta government followed the rules of the Alaska Permanent Fund – 25 percent of non-renewables – the contribution to the Alberta Heritage Trust fund between 1982 and 2011 would have been more than \$42 billion; had the Alberta government followed the Norwegian rules – 100 percent of non-renewables – it would have contributed nearly \$170 billion (see table 1) (Murphy and Clemens 2013).

**TABLE 1: Actual Alberta Fund deposits versus hypothetical Alaskan and Norwegian models, fiscal year 1981/82 through 2010/11 (in C\$millions)**

Fiscal year (end)	Alberta natural resource revenue	Actual contribution to Heritage Fund	Alaskan rule – 25% contribution	Norwegian rule – 100% contribution
1982	4,748	1,434	1,187	4,748
1983	4,122	1,370	1,031	4,122
1984	4,779	720	1,195	4,779
1985	5,229	736	1,307	5,229
1986	4,932	685	1,233	4,932
1987	1,892	217	473	1,892
1988	2,626	—	657	2,626
1989	2,085	—	521	2,085
1990	2,240	—	560	2,240
1991	2,688	—	672	2,688
1992	2,022	—	506	2,022
1993	2,183	—	546	2,183
1994	2,817	—	704	2,817
1995	3,378	—	845	3,378
1996	2,786	—	697	2,786
1997	4,034	—	1,009	4,034
1998	3,778	—	945	3,778
1999	2,368	—	592	2,368
2000	4,650	—	1,163	4,650
2001	10,586	—	2,647	10,586
2002	6,227	—	1,557	6,227
2003	7,130	—	1,783	7,130
2004	7,676	—	1,919	7,676
2005	9,744	—	2,436	9,744
2006	14,347	1,750	3,587	14,347
2007	12,260	1,250	3,065	12,260
2008	11,024	918	2,756	11,024
2009	11,915	—	2,979	11,915
2010	6,768	—	1,692	6,768
2011	8,428	—	2,107	8,428
<b>Total Principal</b>		<b>9,080</b>	<b>42,366</b>	<b>169,462</b>

Sources: Murphy and Clemens 2013

To put this in perspective, Alberta could have taken 4 percent of its fund this year – the real rate of return rule of the Norwegian government – and had no deficit. But, Alberta is not the only province to have squandered such an opportunity. The Blakeney government created the Saskatchewan Heritage Fund in 1978 with an initial endowment of \$465 million (Harding 1995; Wilson et al. 2012). All non-renewables were to be deposited to this fund (Harding 1995); however, 80 percent of these funds could be transferred to government general revenues. The fund ended up being no more than a flow through account. Pressures on the fund compounded further during the Devine period when spending expanded rapidly, followed by a period of collapse in commodity prices. By 1992 the province was on the verge of bankruptcy. The newly elected Romanow government terminated the fund as part of a series of austerity measures to return the province to solvency (Wilson et al. 2012). The stories of Alberta and Saskatchewan reveal two important lessons: first, failure to contribute annually means the fund will not grow and one-time earnings from non-renewable resources are lost forever; second, governments should only use the interest and not touch the principal, otherwise governments will overspend, putting programs at even greater risk when resource commodity prices fall, as they always do.

Establishing SWFs for non-renewable resources is gaining renewed interest in Canada. Quebec has two notable SWFs, neither of which is based on non-renewables: Caisse de dépôt et placement du Québec (CDPQ), which is a pension fund, and the much smaller Generations Fund, which is largely based on hydro revenues and used to pay Quebec's debt. Currently, British Columbia is considering a SWF based on the LNG sector (Hunter 2013). Even Alberta recently changed its rule regarding its Heritage Fund, which will enable it to begin growing again and including measures around inflation-proofing. Both the Northwest Territories and Saskatchewan recently undertook publicly released studies that outlined policy options for each respective jurisdiction. Both reports, *Today's Resources, Tomorrow's Legacy: Report on NWT Heritage Fund Public Consultation*, (Northwest Territories Finance 2010) and *A Futures Fund for Saskatchewan: A Report to Premier Brad Wall on the Saskatchewan Heritage Initiative* (MacKinnon 2013) considered the experiences of Alberta, Alaska, and Norway.

The Government of the NWT (GNWT) considered several options for how a SWF could be structured and what it would be used for. Following a public consultation process on the initiative, the GNWT enacted legislation in 2012 to establish its Heritage Fund. A major consideration in the creation of the Fund was achieving a devolution agreement between the NWT and the federal government. The agreement provides for 50 percent sharing with the federal government on resource revenues up to a maximum of \$76 million (before oil prices fell, it was estimated that the NWT would receive about \$60 million under the new formula) (Northwest Territories Finance 2010). Within the territory, the GNWT has agreed to share 25 percent of its amount with Aboriginal governments (Northwest Territories Finance 2010).

The GNWT, however, is facing multiple pressures in addition to ensuring there is long-term sustainability and intergenerational equity. The first is the infrastructure deficit in the territory; the second is the public debt. The legislation allows for discretion on the amount that the GNWT can contribute in any given year, but the maximum that can be withdrawn is 5 percent of the principal. Given the immediate pressures, the minister of finance first announced that 5 percent of non-renewable resource revenues would be deposited in the Heritage Fund (Wohlberg 2014). The announcement received considerable critical reaction (Wohlberg 2013). The GNWT revised its position and will put 25 percent of non-renewable resource revenues into the fund, starting 2015/16 (Wohlberg 2014). It notes that the percentage contributed to the fund could grow over time as infrastructure deficits and the public debt are successfully addressed. Moreover, the GNWT will not make any withdrawals on the fund for 20 years.

The Saskatchewan Government has accepted the core recommendations, in principle, from its commissioned report (The Canadian Press 2013). However, it has yet to commit to starting the fund, citing the need to pay down government debt first. The report itself is comprehensive and carefully considered, as you



might expect from the author, the former President of the University of Saskatchewan. Most of the 10 core recommendations fit well with best practices established by successful funds, such as Norway's GPF. These include, among other things, establishing the fund as a permanent fund with the principal untouched and setting up the fund separate from government with a professional board of directors and CEO and with full auditing and public accountability.

Two of the recommendations have generated some debate. The first is the scope of investments, recommending investments should be allowed not only globally (current best Norwegian practice), but also within Saskatchewan (consistent with Alaska, but contrary to Norway), "provided that investments within the province are neither privileged nor preferred in whole or in part for that reason" (MacKinnon 2013, 12). The concerns with this recommendation are 1) how to avoid privilege or preference – real or perceived, and 2) that investments from the fund potentially undercut a number of key economic reasons to set up the fund in the first place, including Dutch disease, inflation, and so on. The second recommendation that generated more reaction was capping the share that resource revenues could contribute to general revenues at 26 percent (which is the level of the five-year average) (MacKinnon 2013). A number of observers have understood this to be a rolling five-year average. The author of the report intended the amount to be a fixed number based on the average of the previous five years. The concern by some with this recommendation is that the fund will be very difficult to build with such a high threshold and the province will never really move away from dependence on non-renewable resource revenues.

## The Policy Options

The current drop in oil prices has generated a fiscal seismic event in Canada for the federal government, and especially for energy-rich provinces and territories: Alberta, Saskatchewan, and the Northwest Territories. Only a few years ago, Saskatchewan faced fiscal challenges when potash prices fell, with the growing energy sector balancing out what could have been an even worse situation. All of this is avoidable. But, it will require Canada, the provinces, and territories to make bold policy choices with strategic vision. One of the most important policy choices Canada must make is to establish a national SWF and for provinces and territories such as Alberta, Saskatchewan, Newfoundland and Labrador, and the Northwest Territories to do the same. Taking the non-renewable resource revenues out of general government revenue – treating non-renewable resources as capital assets (Crowley 2015) – and placing them into a permanent capital fund has vitally important budgetary and economic advantages:

- The removed revenues do not overheat the economy and provide greater macroeconomic stability.
- It removes high volatility and unpredictability in government budgeting, as only a portion of the return on the principal goes into general revenues.
- It mitigates the deleterious effects of Dutch disease.
- It converts one-time resources into a permanent mechanism for wealth generation.
- It provides for intergenerational fairness in use of non-renewable resources.
- It provides a mechanism to invest in innovation, education, and training to generate future growth.

Although the federal government, in contrast to the provinces, does not typically collect royalties (the federal government does collect royalties in the territories and offshore petroleum), it does collect considerable income tax. Table 2 shows the tax that the federal and provincial governments have received from the mining sector (including oil sands).

**TABLE 2: Corporate taxes paid by the mineral sector to federal and provincial governments, 2003–2012 (C\$millions)**

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	Total
Mining and Quarrying											
Federal Tax	268	495	536	806	866	909	321	644	627	<i>143</i>	5615
Provincial Tax	83	209	245	352	478	636	220	497	535	<i>131</i>	3386
Total Tax	351	703	781	1158	1344	1545	541	1142	1163	<i>274</i>	9002
Oil Sands Mining			1,233	4,932	—						
Federal Tax	529	278	280	476	887	550	0	563	575	<i>429</i>	4567
Provincial Tax	195	92	303	671	794	264	0	155	166	<i>121</i>	2761
Total Tax	724	370	583	1147	1681	814	0	718	741	<i>550</i>	7328
Primary Metal Manufacturing											
Federal Tax	213	318	395	822	414	245	121	109	110	<i>63</i>	2810
Provincial Tax	92	153	191	383	187	152	80	73	77	<i>49</i>	1437
Total Tax	305	471	586	1205	601	397	201	182	187	<i>112</i>	4247
Non-Metallic Mineral Manufacturing											
Federal Tax	268	269	291	326	389	285	206	221	206	<i>176</i>	2637
Provincial Tax	124	129	152	169	198	163	135	146	140	<i>132</i>	1488
Total Tax	393	398	443	495	587	449	341	367	346	<i>308</i>	4125
Total for Mineral Sector											
Federal Tax	1278	1360	1502	2430	2556	1989	648	1537	1519	<i>811</i>	15630
Provincial Tax	494	583	891	1575	1657	1215	435	871	918	<i>433</i>	9072
Total Tax	1773	1943	2393	4005	4213	3204	1083	2408	2437	<i>1244</i>	24702

Notes

1. Federal tax includes corporate income taxes and certain other direct taxes such as the large corporation tax in applicable years. The provincial tax data cover only corporate income tax. They do not include provincial capital taxes.

2. Numbers in italics are estimates.

Source: Toms and McIlveen 2013.

Accordingly, the federal government could build a SWF from income tax. The provinces could build SWFs from royalties and also from income tax.

Had Canada, Alberta, and Saskatchewan built SWFs 25 years ago, the federal government would be delivering its budget on time with a steady stream of revenues from a fund based on non-renewables; Alberta would not be facing the greatest fiscal challenge of the last 50 years (and Saskatchewan would not be engaged in budget tightening). Alberta did not do that and it is paying the price.

But, we do have a choice not to repeat past mistakes and instead to build innovative, dynamic national and regional economies, with non-renewable resources as a foundation. What steps should we take? Norway – a northern, resource-based, liberal democratic, globally engaged nation – has provided us a road map. The key elements include but are not limited to:

- 100 percent of non-renewable resource revenues – bitumen, conventional oil, gas, uranium, potash, and other minerals and metals – should be committed to federal and territorial/provincial SWFs.
- SWFs should be managed arms-length from government by a separate financial unit with its own board – they should have independence equivalent to the Bank of Canada's.
- Funds should have mechanisms to cover operating costs and some degree of inflation proofing before any of the returns are transferred to government revenues.
- Provincial and territorial SWFs should not be allowed to make investments within their own jurisdictions – otherwise, it has the potential to contribute to undermining the key economic advantages SWFs have for stabilizing economic growth.
- There must be cross-party and broad social consensus to build SWFs.

The first and the last points are more challenging in Canada. Current federal and provincial budgets depend heavily on resource revenues going directly into government coffers. However, reaching a target of 100 percent transfer of non-renewable resource wealth into SWFs could be achieved in a 20-year period. In Saskatchewan, for instance, non-renewable revenues account for approximately 20 percent of provincial government revenues; hence, over a 20-year period, the provincial government could gradually transition – annually an additional 1/20 of contribution that non-renewable resource revenues make – to a SWF. Such an approach would allow the province to pay down the principal on its debt with any resource revenues above 20 percent, until the debt is retired. At that point, all non-renewable wealth could go into the fund. Achieving cross-party and societal consensus is essential and possible, though more difficult for some jurisdictions than others. All political parties in Canada support universities as a key public institution to advance Canada's economic growth, for instance. No party is advocating their abolition. SWFs have the same importance as an institutional mechanism for the betterment of the whole society. Parties may disagree over where revenue generated by SWFs should be directed, but not the generation of the revenue in the first place.

Canada has an impressive portfolio of energy and mineral resources. The demand for these resources will only grow over time. There are a number of critical policy decisions Canada, the provinces, and territories must make if Canada is to emerge as a true energy and natural resource superpower. Among other things, these include decisions around infrastructure such as pipelines, investments in education, training, and research, and new partnerships with First Nations, Inuit, and Métis peoples. But, as Norway has shown the world, prudent fiscal policy, especially creating SWFs to manage the earnings of non-renewable resources, is a necessary policy choice to ensure much wealthier and more stable, dynamic resource-based economies.

## About the Author



### **GREG POELZER**

Greg Poelzer is the Founding Director and Executive Chair of the University of Saskatchewan International Centre for Northern Governance and Development (ICNGD). He is an Associate Professor of Political Studies and an Associate Member of the schools of Public Policy and Environment and Sustainability at the university. He is widely known as a builder and innovator who has success pulling together Aboriginal organizations, government, and the private sector to develop innovative approaches to education, research, and capacity building.



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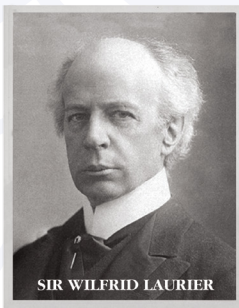
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