



**Submission to the
Alberta Government Financial Investment
Planning and Advisory Commission**

October 31, 2007



TABLE OF CONTENTS

I. INTRODUCTION	3
II. DISCUSSION	3
1. A VISION FOR THE PROVINCE AND ITS NATURAL RESOURCE WEALTH.....	3
2. THE FRAMEWORK FOR THE ALBERTA HERITAGE SAVINGS TRUST FUND (HSTF) ...	5
3. THE PROVINCE’S SHORTER-TERM SAVINGS FRAMEWORK, INCLUDING THE SUSTAINABILITY FUND AND CAPITAL ACCOUNT	7
4. VARIOUS ENDOWMENT AND OTHER SPECIAL PURPOSE FUNDS ESTABLISHED BY THE GOVERNMENT	8
III. SUMMARY OF RECOMMENDATIONS	10
IV. WORKS CITED	12
V. APPENDIX A: FINANCIAL INVESTMENT PLANNING ADVISORY COMMISSION TERMS OF REFERENCE	13



I. Introduction

The Calgary Chamber of Commerce represents over 3,200 Calgary based businesses. The Chamber seeks to raise the consciousness and quality of public discourse on key policy issues confronting its members and stakeholders, through informed discussion grounded in fact and reasoned analysis.

The Calgary Chamber puts forth this submission on behalf of its members, the small, medium and large enterprises that are directly impacted by the financial investment decisions of the province. This submission is structured as a response to the Alberta Government Financial Investment Planning and Advisory Commission's *Terms of Reference* contained in the appendix¹

II. Discussion

1. A Vision for the Province and its Natural Resource Wealth

Alberta has benefited significantly from the development of its natural resources. Non-renewable resource revenues have contributed at least 30 per cent of total provincial government revenues since 2001, and were as high as 40 per cent in 2005-06.

On average, however, provincial government expenditures have increased beyond the rate of inflation and population growth since 1982 and, in budget 2007 increased by a further 17 per cent – well above the combined rate of inflation and population growth (8 per cent).

The government's continued reliance on non-renewable resource revenue for current and increasing consumption expenditures creates an unsustainable and unhealthy dependence on volatile revenue sources. In the absence of non-renewable resource revenues, the government would have been confronted with budgetary deficits every year since 1995 (Alberta Chambers of Commerce and Certified General Accountants Association of Alberta (ACC), 2006:22). In the event of a sudden forward decline in energy prices, it will be challenged to maintain current program and service expenditures without increasing corporate and personal taxes, which represent approximately 30 per cent of total provincial government revenues.

The Chamber recognizes the importance of maintaining a competitive tax burden and investment climate. Canada already has the second highest effective tax rate among OECD countries and, in 2005, exhibited a total tax-to-GDP ratio of 41 per cent - well

¹ See the Financial Investment Planning and Advisory Commission (FIPAC) website at: http://www.finance.alberta.ca/fipac/terms_reference.html



above the G7 average of 37 per cent. Consequently, any new taxes will only further threaten the Canadian and Albertan investment climates.²

Of further concern, the Alberta Government's non-renewable resource revenue has recently declined from a high of \$14.3 billion in 2005, to approximately \$10.3 billion for the 2007-08 fiscal year, and is forecast to fall further, to \$7.8 billion, in 2009.

In its 2007 pre-budget submission survey, the Chamber canvassed its membership on the issue of government spending and fiscal management, and found that nearly 60 per cent believe the provincial government is spending unsustainably.

Given the finite and volatile nature of non-renewable resource revenues, combined with the potential for an unhealthy dependence on an unsustainable revenue source, and consistent with the Alberta Chambers of Commerce and Certified General Accountants of Alberta *Vision 20/20* recommendations, the Chamber advocates that government strategically save and invest a long term average of 35 per cent of all non-renewable resource revenues to preserve and enhance the future prosperity for all Albertans in the event resource revenues decline or expire.

The Chamber recognizes that achieving this objective requires commitment and leadership and, therefore, recommends that government first and foremost adopt a fully integrated vision for the future prosperity of the province, which clearly articulates how resource revenues and changes to its fiscal management and investment policies directly contribute to this vision.

The Chamber recommends, therefore, that government adopt a vision that encourages entrepreneurial innovation, and principled strategic investment in leading-edge research, emerging sectors and energy technologies that compliment the province's natural resource base and other endowments that form its comparative advantage. This would help position Alberta as a leader in global competitiveness, and provide a level of insurance against anticipated shifts in energy consumption patterns, market changes, and emerging environmental regulatory trends that threaten our economic base.

² See www.fin.gc.ca/frt/2006/frt06_9e.html



2. The Framework for the Alberta Heritage Savings Trust Fund (HSTF)

Purposes and Goals of the HSTF (or Heritage Fund)

According to the *Alberta Heritage Savings Trust Fund Act* (AHSTFA) “the mission of the Heritage Fund 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” (Alberta Legislative Assembly, 2000:preamble).

Section 3 of the *Act* establishes the endowment portfolio of the Heritage Fund, and requires that any investments be made with the “objective of maximizing long-term financial returns.” It also requires that when making investments, the Minister of Finance “adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and obtain a reasonable return that will enable the endowment portfolio and the transition portfolio to meet their respective objectives.” (Alberta Legislative Assembly, 2000:s.2).

The Chamber endorses the current mission and investment requirements of the AHSTFA, as these provide for prudent, long-term and responsible management of the Alberta’s resource wealth.

However, as part of the purposes and goals of the Heritage Fund, the Chamber recommends that government articulate an ultimate objective for the Fund that seeks to maintain Albertans’ standard of living long after the energy reserves are depleted. Government should undertake objective analysis to identify and legislate criteria under which revenues should be withdrawn from the Fund.

Second, the Commission has asked for input on whether a portion of the Heritage Funds should be earmarked for investing in Alberta and/or used to provide venture capital in the province. While the Chamber recognizes and endorses government’s legitimate role in encouraging wealth creation in Alberta, the Chamber does not endorse earmarking a portion of the HSTF for Alberta specific investments and/or venture capital initiatives.

Encouraging wealth creation in Alberta is a separate and distinct policy objective from “maximizing long-term financial returns” on investments, and will introduce a number of complicating and competing factors into the decision-making process for the overall management and stewardship of the HSTF. Consequently, the Chamber recommends that Alberta pursue these separate and distinct wealth creation objectives through other, more appropriate and targeted funding vehicles, such as the endowment funds model.



Principled Approach to Saving

As part of its vision for the province, the Calgary Chamber of Commerce recommends that government adopt a principled approach to saving a portion of non-renewable resource revenues in the HSTF. Under the terms of current AHSTFA, government may transfer an unspecified percentage of non-renewable resource revenue each year from the General Revenue Fund to the Heritage Fund. Net income earned on the HSTF less inflation (if applicable) is automatically transferred directly into the General Revenue Fund, and not earmarked for specific purposes.

The Alberta Chambers of Commerce and Certified General Accountants Association of Alberta, through their Vision 2020 research, estimate Alberta could deposit between 30 and 40 per cent of all non-renewable resource revenue per year into the Heritage Fund without cuts in current program spending. Other studies, such as the research of the Canada West Foundation (Kneebone, 2006:48), suggest that a 50 per cent savings model is feasible provided there is a binding “effort by government to control the gap between long-term expenditures and tax revenues.”

In a recent survey of its membership on the issue of non-renewable resource revenue, the Calgary Chamber of Commerce found that 96 per cent of members believe the provincial government should save at least 25 per cent of all non-renewable resource revenues. The Chamber estimates that the HSTF would be valued at over \$128 billion today had the government deposited 35 per cent of non-renewable resource revenue into the HSTF every year since 1976, at 5 per cent interest compounded annually, with the net revenue reinvested.

Consequently, the Chamber recommends that government structure the HSTF as a true “trust fund”, in which the net income earned on the capital invested is added to the fund rather than automatically transferred into general revenues. The Chamber further recommends that government commit to investing 35 per cent of non-renewable resource revenues in the HSTF and other endowments annually, and that this threshold be legislatively entrenched in the AHSTFA. Any proposed changes to this threshold, the rules governing the withdraw of net income, or investment objectives, should be subject both to consultation of the Board of the Alberta Investment Management Corporation, and elector assent (through binding referendum provisions such as those contained in the *Alberta Taxpayer Protection Act* and/or the *Constitutional Referendum Act*).



3. The Province's Shorter-Term Savings Framework, Including the Sustainability Fund and Capital Account

In 2003, the government created the Sustainability Fund under the *Fiscal Responsibility Act* to help “ensure that government spending doesn’t rise and fall with volatile energy prices.” (Alberta Legislative Assembly, 2003:3). Under the *Act*, \$5.3 billion of all non-renewable resource revenues can be used for general government purposes, but any excess must be transferred to the Sustainability Fund. If actual non-renewable resource revenue is less than \$5.3 billion in any given year, the difference may be allocated from the Alberta Sustainability Fund to the General Revenue Fund.

The Chamber recognizes the importance of protecting the province from the volatility of our natural resource dependence as well as funding capital projects to help manage our growth pressures, and endorses the concept of the Sustainability Fund. However, the Chamber also recognizes and supports the need for a principled approach to the fiscal management of our resource revenues.

It is estimated that the proportion of resource revenue required for government to meet long-term spending obligations between 2001 and 2005 was 55 per cent (Kneebone, 2005:37). If government were to invest 35 per cent of resource revenue into the HSTF and other endowments as recommended above, then 10 per cent of annual resource revenues would be available for allocation to the Sustainability Fund without significantly impacting government program expenditures.³ The Chamber, therefore, recommends that government adopt a 10 per cent proportion (rather than absolute) rule for annual resource revenue allocations to the Sustainability Fund.

The uncertainty surrounding world energy markets creates challenges for governments in anticipating future resource revenues. According to the *Fiscal Responsibility Act*, when resource revenues exceed \$5.3 billion at least \$2.5 billion must be held in the Sustainability Fund in anticipation of emergencies, disasters, rebates, First Nation settlements and budget shortfalls. However, such an arbitrary threshold is not necessarily responsive to market conditions and future revenue shortfalls.

Consequently, rather than establishing a minimum threshold for the Fund, the Chamber recommends that the government adopt a formula-based approach for setting the Sustainability Fund minimum amount, in part, based on economic forecasting techniques. A formula based approach will help ensure sufficient funding exists to cover budget shortfalls in response to volatile energy prices and economic trends that impact Alberta’s resource revenues.

³ It should be noted the proportion of resource revenue required for government to meet long-term spending obligations increased from 44 per cent between 1995 – 2000, to 55 per cent between 2000 and 2005 (Kneebone 2006:42), an indication that a 55 per cent government dependence benchmark is a generous assumption.

The *Fiscal Responsibility Act* has been amended in each of the last three years, with the government spending limit increasing from \$3.5 billion in 2003-04 to \$5.3 billion in 2006-07. In addition to adopting formula based approaches for establishing Fund allocations and thresholds, and in accordance with a principled approach to savings and investment, the Chamber recommends that any subsequent threshold and allocation changes to the Sustainability Fund be subject to consultation with the Board of the Alberta Investment Management Corporation.

4. Various endowment and other special purpose funds established by the government

The Calgary Chamber of Commerce recognizes the value that the endowment funds of the Alberta Heritage Savings and Trust Fund bring to Albertans. The funds now include: *Alberta Heritage Medical Research Endowment Fund* (AHMREF), *Alberta Heritage Science and Engineering Endowment Fund* (AHSEEF, or Ingenuity Fund), *Alberta Heritage Scholarship Fund* (AHSF), and the *Access to the Future Fund* (AFF).

The purposes of AHMREF, AHSEEF and AHSF are sufficiently clear and have produced successful results over their respective lifetimes. However, the Chamber contends that the mandate of the *Access to the Future Fund* is overly broad and in need of refinement. Under the current legislation the criteria for payouts are far too general and will result in the depletion of the fund without more concrete restrictions, such as targeting access to underrepresented segments of the population, or resolving infrastructure issues that force post-secondary institutions to turn away qualified students. The Chamber recommends that the fund be focused on addressing two or three issues that clearly restrict access to post-secondary education, rather than the *carte-blanche* approach that exists under the existing legislation.

The current savings mechanisms of the various funds are also insufficient. The savings mechanisms referred to in the terms of reference are no more than ceilings over which the funds cannot grow. For example, the *Access to the Future Fund* has a limit of \$3 billion and the AHMREF has an annual contribution limit of \$500 million. As it stands, there are no provisions in the legislation for minimum deposits made to these funds from the Alberta government. The Calgary Chamber of Commerce recognizes that these funds are a product of resource wealth and recommends that they be fortified with surplus revenues produced in future budgets, whereby government automatically commit a proportion of future budget surpluses to the various endowment funds – similar to the government's *in year surplus allocation policy* of committing one third to savings and investments (Alberta Finance 2007:8).

The Heritage Fund and its endowments are designed to ensure the long-term prosperity of the Province of Alberta. In addition to its entrepreneurial spirit, Alberta's current prosperity is based on resource wealth and the energy sector. A fund should therefore be



established to attract the best and brightest researchers on energy related issues, including alternative energy sources, to secure Alberta's position as one of the world's leading energy producers for generations to come.

The Alberta Government has already identified energy research as a priority and, under the auspices of the Alberta Science and Research Authority, created the Alberta Energy Research Institute. The institute, which started as the *Alberta Oilsands Technology and Research Authority* (AOSTRA), is charged with managing energy research in the province, and is considered one of the reasons that Alberta's oil sands were developed so successfully (Mansell and Schlenker, 2006:50).

Several research institutes have commented on the need for significant investment in energy research going forward. The Canada West Foundation, for instance, listed among various investment ideas that the government pursue "aggressive research and development on the clean use of fossil fuels," and a "sustainable energy program of research and demonstration projects to ensure that, no matter what the energy future might be, Albertans would be at the front of the pack." (Gibbins and Roach, 2006:17).

While it is unclear whether the province and industry have provided sufficient support for energy research, relative to other Canadian industries, the oil and gas sector stands to gain substantially from increased investment in research and development (R&D) activities. The level of R&D investment by the Canadian oil and gas sector is small given the size of the industry; and it is estimated that the sector spends approximately \$0.78 for every \$100 of GDP generated, which is one sixth the level of R&D invested by Canada's manufacturing sector (\$4.80 for every \$100 of GDP) (FERENCE, Weicker and Co., 2007).

The Institute for Sustainable Energy, Environment, and Economy (ISEEE) noted that research and investment in the energy sector is about one-third of what it was in the early 1980s and that it will be a "significant task" to bring R&D investment back to levels consistent with the magnitude of the energy opportunities and challenges in the province (Mansell and Schlenker, 2006:50-51).

The Chamber, therefore, recommends that government raise the priority of energy research in the Province and create a new endowment called the *Alberta Heritage Energy Research Fund* (AHERF) under a similar framework as the *Alberta Heritage Foundation for Medical Research*, an arms length body with an appointed multi-stakeholder board of directors that manages the strategic direction of the Fund. The energy research currently taking place under the support of the Ingenuity Fund can then be transferred to the Alberta Heritage Energy Fund, freeing up resources for other, non-oil and gas related research avenues, and contributing to the diversification of research programs in the province.

If Alberta were serious about the "significant task" of increasing energy R&D investment in the province, and about securing its future as a global player in the energy sector, then



AHERF would require an endowment similar to those of the other research funds currently sitting at around \$1 billion.

III. Summary of Recommendations

A Vision for the Province and its Natural Resource Wealth

1. The Chamber recommends that government adopt a vision for the province that encourages entrepreneurial innovation, and principled strategic investment in leading-edge research, emerging sectors and energy technologies that compliment the province's natural resource base and other endowments that form its comparative advantage.

The Framework for the Alberta Heritage Savings Trust Fund (HSTF)

2. The Chamber endorses the current mission and investment requirements of the AHSTFA, however, the Chamber recommends that government articulate an ultimate objective for the Fund that seeks to maintain Albertans' standard of living long after the energy reserves are depleted. Government should also undertake objective analysis to identify and legislate criteria under which revenues should be withdrawn from the Fund.
3. The Chamber recommends that Alberta pursue Alberta specific investments and/or venture capital initiatives through other, more appropriate and targeted funding vehicles, such as the endowment funds model.
4. The Chamber recommends that government structure the HSTF as a true "trust fund", in which the net income earned on the capital invested is added to the fund rather than automatically transferred into general revenues. The Chamber further recommends that government commit to investing 35 per cent of non-renewable resource revenues in the HSTF and other endowments annually, and that this threshold be legislatively entrenched in the AHSTFA.

The Province's Shorter-Term Savings Framework, Including the Sustainability Fund and Capital Account

5. The Chamber recommends that government adopt a 10 per cent proportion (rather than absolute) rule for annual resource revenue allocations to the Sustainability Fund.
6. The Chamber recommends that the government adopt a formula-based approach for setting the Sustainability Fund minimum amount, in part, based on economic forecasting techniques.



Various endowment and other special purpose funds established by the government

7. The Calgary Chamber of Commerce recognizes that the endowment and special purpose funds are a product of resource wealth and recommends that they be fortified with surplus revenues produced in future budgets, whereby government automatically commit a proportion of future budget surpluses to the various endowment funds.
8. The Chamber recommends that government raise the priority of energy research in the Province and create a new endowment called the *Alberta Heritage Energy Research Fund (AHERF)* under a similar framework as the *Alberta Heritage Foundation for Medical Research*. The Chamber further recommends that the AHERF be provided an endowment similar to those of the other research funds currently sitting at around \$1 billion.
9. The Chamber recommends that the *Access to the Future Fund* be focused on addressing two or three issues that clearly restrict access to post-secondary education, rather than the *carte-blanche* approach that exists under the existing legislation.



IV. Works Cited

- Alberta Chambers of Commerce and Certified General Accountants Association of Alberta. (2006). *Vision 2020: Saving for the Future Alberta Advantage*. Edmonton: Mark Milke.
- Alberta Finance. 2007. Budget 2007-10 Fiscal Plan.
- British Columbia Ministry of Energy, Mines and Petroleum Resources. (2007) *Research and Development Strategy for Oil and Gas*. Victoria: Weicker Ference
- Alberta. Legislative Assembly. "Speech from the Throne," Hansard. (Feb.18, 2003)
- Alberta. Legislative Assembly. "Alberta Heritage Savings Trust Fund Act." RSA 2000 Chapter A-23.
- Gibbins, Roger and Roach, Robert. (2006). *The Transformative Potential of Alberta's Natural Resource Wealth*. In Roger Gibbins and Robert Roach (Eds.) *Seizing Today and Tomorrow: An Investment Strategy for Alberta's Future* (pp. 1-24) Calgary: Canada West Foundation.
- Institute for Sustainable Energy, Environment and Economy (ISEEE). (2006). *Energy and the Alberta Economy: Past and Future Impacts and Implications*. Calgary: Robert L. Mansell and Ron Schlenker.
- Kneebone, Ronald D. (2006). *The Feasibility of a 50% Savings Rule for Alberta*. In Roger Gibbins and Robert Roach (Eds.) *Seizing Today and Tomorrow: An Investment Strategy for Alberta's Future* (pp. 37-50) Calgary: Canada West Foundation.



V. Appendix A: Financial Investment Planning Advisory Commission Terms of Reference

The Commission will:

Review and make recommendations regarding the framework for the Alberta Heritage Savings Trust Fund including:

- Are the purposes and goals of the Heritage Fund in need of refinement or change?
- Are the broad investment and spending objectives and policies consistent with the long-term interests of Albertans?
- Are there better uses for new savings?
- Is the governance structure for the Heritage Fund appropriate?
- Are the purpose and functions of the Heritage Fund clear and can they be better communicated to Albertans? If so, how?

In addressing these issues, the Commission may wish to consider any or all of the following questions:

- Should the real value of the Heritage Fund be preserved? Should it grow?
- Should a specified portion of the Heritage Fund be earmarked for investing in Alberta? Should a portion of the Fund be used to provide venture capital in Alberta?
- Should some portion of the income of the Heritage Fund be transferred to the General Revenue Fund to fund current programs and services?
- If so, should the Heritage Fund adopt a spending rule to smooth transfers to the General Revenue Fund?
- Of any portion to be transferred, should any or all of it be directed to support certain specific types of spending, such as community grants?
- Should the Heritage Fund adopt some or all of the characteristics of similar funds held by other jurisdictions, such as Norway or Alaska?

Review and make recommendations regarding the province's shorter-term savings framework, including the Sustainability Fund and Capital Account?

- Are the purposes of these accounts/funds sufficiently clear?
- Are there better uses of these funds or new savings?
- Are the broad investment objectives and policies consistent with the purposes?
- Would alternative savings vehicles better achieve the desired purposes?

Review and make recommendations regarding the various endowment and other special purpose funds established by the government including:



- Are the purposes of the funds still valid or in need of refinement or change?
- Are these purposes best served by continuing the current savings mechanism as defined in the legislation?
- Are there any scenarios or purposes under which new endowments should be created?
- Are the purposes of the funds clear and can they be communicated more effectively to Albertans?

In addressing these issues, the Commission may wish to consider any or all of the following questions:

- Should the real value of the funds be protected?
- Are the broad investment and spending objectives and policies consistent with the long-term interests of Albertans?
- Should endowments with similar objectives be consolidated into one large fund?

Review and make recommendations regarding the transparency and communication of the governance, management and results of Alberta's various long-term investment funds.

The Commission will submit a report to the Finance Minister by November 30.