Alberta's Heritage Fund: Should vs. Can

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Introduction

“*Digging Deep for the Heritage Fund: Why the Right Fund for Alberta Pays Dividends Long After Oil is Gone*”, Ton van den Bremer and Rick van der Ploeg, University of Calgary School of Public Policy. 2014.

Outline:

- Current Heritage Fund
- Norway model
- The Permanent-income Hypothesis (**PIH**) fund
- Policy implications
- Reflections

Current Heritage Fund

- Fair Market Value of fund : $19.1B as of December 31, 2016
  - 5.7% of GDP
- All earned income is a dividend
  - Dividend is transferred into general revenues account
  - Value of dividend was $1.4B for first 9 months of 2016/17 fiscal year
- Contributions are set by the Treasury Board
  - No contributions since 2007/2008
- Alberta Growth Mandate whereby AIMCo invests up to 3% of the fund in Alberta growth

Norway “Bird-in-Hand” Model

- All resource royalties go into a fund
- The annual dividend is 4% of the financial wealth of the fund.
- Not sustainable
  - Over time, total wealth will transfer from belowground to aboveground
  - Dividend will become a larger proportion of total wealth, which may erode total wealth

Time	Total Wealth	Fund	Underground Value	Dividend
1	1	0	1	0
2	1	0.25	0.75	0.01
3	1	0.5	0.5	0.02
4	1	0.75	0.25	0.03
5	1	1	0	0.04

PIH Approach

1. Total resource wealth is constant over time

$$\overline{total\ resource\ wealth} = fund + belowground\ wealth,$$

$$\Delta fund = \Delta belowground\ wealth$$

2. Total resource wealth remains a constant fraction of total GDP

$$\bar{C} = \frac{total\ resource\ wealth}{GDP}$$

PIH Approach – Cont.

3. Constant proportion of total resource wealth

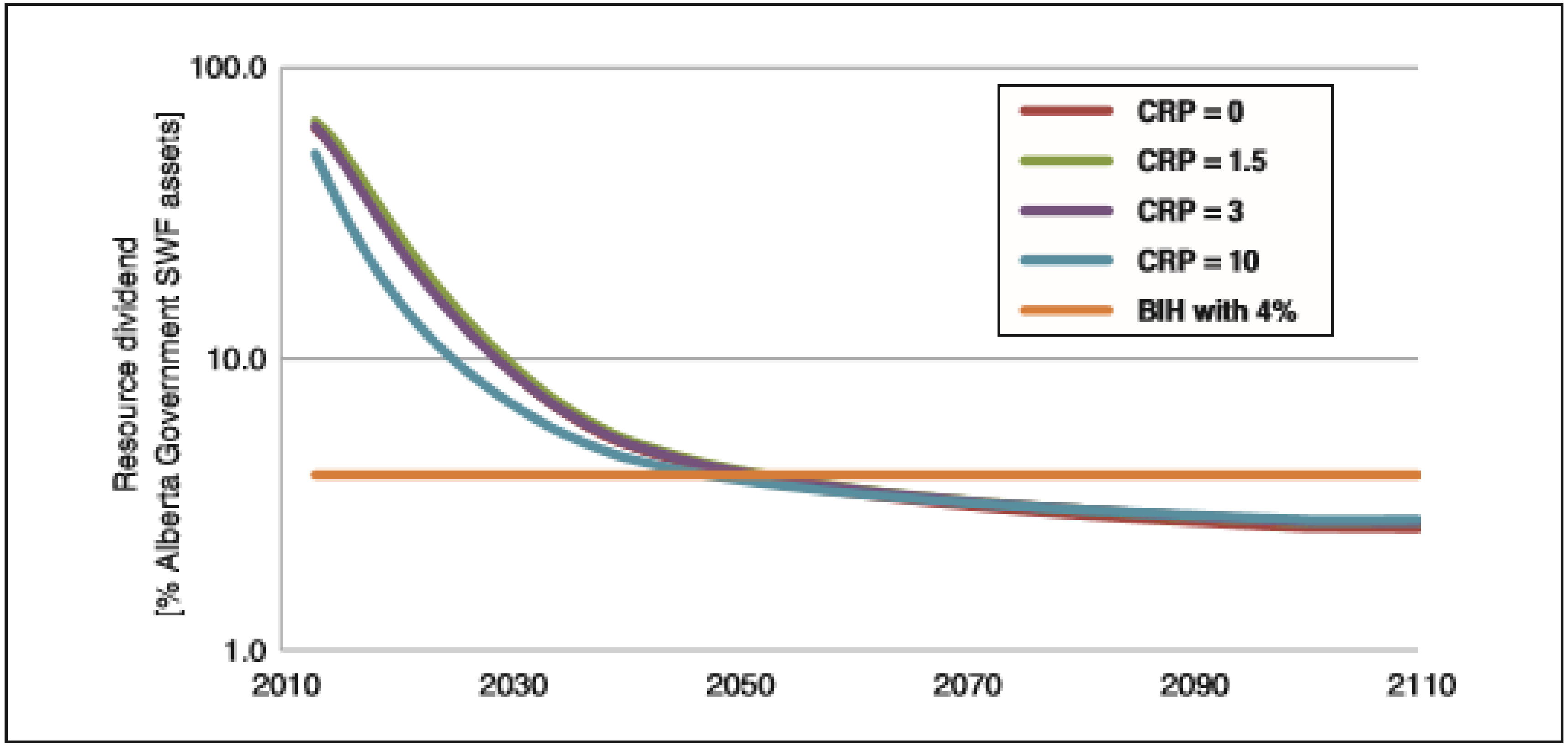
$$\mathrm{D} = \bar{\delta} \cdot total\ resource\ wealth$$

4. Grows with GDP
   - since total resource wealth also grows with GDP

- Therefore, the savings rate is endogenous
  - Savings of NRRs is not constant over time

Bird-in-Hand vs. PIH

Resource Dividends as a Percentage of the Fund



Van den Bremer and Van der Ploeg, page 13.

Policy Implications

- A focus on consumption, rather than investment approach
  - Alberta Growth Mandate not be optimal
- May be difficult to implement in practice
  - Dividend and savings would have to be determined every fiscal year
  - Not clear what the optimal saving rate is
- Heritage Fund vs. Contingency Fund
  - Dividends channelled to Contingency Fund according to policy-marker’s prudence.

Benchmarks for PIH Approach

- Currently,
  - fund is 5.7% of GDP
  - total resource wealth is $1.24T (2013), 400% of GDP
- Fund benchmarks (middle-of-the-road prudence):

Year	Percent of GDP	Total size
2016	5.70%	$19.1B
2030	39%	$200B
2050	101%	$1T

Heritage Fund Timeline

- **1976**- Established Fund
  - 30% of non-renewable resource revenue from 1976 fiscal year
  - $1.5B of cash and other assets
- **1977-1982** - Lent funds to Manitoba, Quebec, Newfoundland, New Brunswick, Nova Scotia, and PEI.
  - Lent total of $1.9B
  - Average interest rate of 12.5%
- **Late 1980s** – funds withdrawn
- **1987** – transfers to fund stopped
- **1995-1997** - Public consultations
- **2005** – accumulated debt was paid off and transfers resumed
- $33B has been taken from the fund since inception

Reflections

- Are the presented benchmarks realistic?
- What should be the next steps for managing a fund?
- What are realistic and tractable saving/dividend rules?
- What is the purpose of the fund?
  - Is income smoothing a priority?
  - Fund capital spending in the province?
  - Fund consumption: tax cuts, program spending, poverty reduction?

References

- http://www.finance.alberta.ca/publications/budget/budget2013/heritage-fund.pdf
- http://www.qp.alberta.ca/1266.cfm?page=F12.cfm&leg_type=Acts&isbncln=9780779736058&display=html
- http://www.qp.alberta.ca/documents/Acts/f14p7.pdf
- "*Digging Deep for the Heritage Fund: Why the Right Fund for Alberta Pays Dividends Long After Oil is Gone*", Ton van den Bremer and Rick van der Ploeg, University of Calgary School of Public Policy. 2014.