

7:05 p.m.

Tuesday, October 5, 2004

**Annual Public Meeting – Redwater**

[Mr. Hutton in the chair]

**Mr. Broda:** Good evening, everyone. Thanks for attending our annual all-party Standing Committee on the Alberta Heritage Savings Trust Fund. I'm very pleased that the town of Redwater was chosen to host the committee's 2004 annual meeting.

I'd like to introduce some of our committee members in attendance. There are several that were not able to make it this evening. However, I'll start on my right, and that is Richard Marz, who is MLA for Olds-Didsbury-Three Hills. Next to him is Bill Bonner. He's the MLA for Edmonton-Glengarry. At the far end is Rob Lougheed, MLA for Clover Bar-Fort Saskatchewan – and I'm sure most of you people from Redwater probably know Rob – and George VanderBurg for Whitecourt-Ste. Anne. George, welcome. Next to me is Drew Hutton, and he's the chair of the committee. Drew is from Edmonton-Glenora.

**Mrs. Prodaniuk:** You were from Redwater for a while on TV.

**The Chair:** Yeah, I know. Yesterday I was.

**Mrs. Prodaniuk:** I said: what's he doing there?

**The Chair:** I got a number of calls about that, being the MLA for Redwater.

**Mrs. Prodaniuk:** I figured they threw Dave out already.

**The Chair:** I'd like to welcome you all this evening. I'd also like to introduce some other individuals that do need some introduction, but before I do that, I want to thank Dave for setting up the opening of the RCMP building today just for us. It was very nice of you to do that, Dave. Thank you. Also, we had a great tour of Agrium and spent a great day seeing Redwater and the region. So thank you very much, Dave, for that.

I would like to introduce members of the government first: the Hon. Greg Melchin, who is the Minister of Revenue and responsible for the heritage trust fund from the government's perspective. In the crowd is a near and dear friend of us all, Minister Mike Cardinal. Mike, good to see you out. With Minister Melchin is Doug Stratton, who is the director of fund management for Alberta Revenue; Peter Orcheson, who is the senior manager of equities from Alberta Revenue. We also have Glenn Shepherd, the minister's executive assistant – where is Glenn? Oh, he's hiding in the back; nice to see you, Glenn – Cathy Housdorff, who is the director of communications for the Department of Revenue; and Tammy Forbes, who is with communications as well.

Then I'd like to introduce the folks that make my life a lot easier as chair of the Alberta heritage savings trust fund: Karen Sawchuk, who is the committee clerk and makes my life a breeze – good to see you, Karen – and Rhonda Sorensen, who is the communications coordinator; Liz Sim, who is the managing editor of *Alberta Hansard*; and Heather McNeill and Janet Schwegel, who are editorial assistants with *Alberta Hansard*.

This meeting is being recorded by *Hansard*, so it will go on public record, and copies of the transcript from the meeting will be available on-line at the Assembly web site or by calling the committee number listed on the brochures that are at the front, up here.

Our presentation this evening will be in two parts. Members from the committee will review the history, mission, structure, and governance of the heritage trust fund. The Minister of Revenue, Greg Melchin, and Doug Stratton and Peter Orcheson will then discuss the operation and performance of the fund. A question and answer session will follow. At this time we're going to put our eyes towards the screen here.

The heritage trust fund has helped put the province in the enviable position it is in today, and Albertans will continue to benefit from the fund's contributions. During the fund's 28-year history approximately \$26 billion in investment income has been used for Albertans' priorities, including debt reduction, health care, education, social programs, infrastructure, and capital expenditures.

Now I'd like to call on my colleague from the region, Dave Broda, to continue.

**Mr. Broda:** Thank you, Mr. Chair. The heritage fund was started in 1976 and has been a unique aspect of Alberta's financial situation. No other province has such a fund, and that's very unique. From 1976 to 1983 the fund grew with 30 per cent of oil and gas revenues going into the fund. From 1982 to the present all income from the fund has been transferred to the general revenue account or fund to meet the financial obligations or priorities of the province. As well, spending on capital projects ended in 1995. The bulk of the fund's investment up to 1996 was in fixed-income instruments such as bonds and money market securities.

Boy, this is really good team work. I'll let Bill Bonner continue.

**Mr. Bonner:** Thank you very much, Dave. Thank you for organizing this meeting in Redwater today, and thank you to the constituents of Redwater for your warm hospitality. We've had an excellent day, and we'd come back in a minute. I think you might have gotten more people out to this meeting than the previous two. Other members of the committee will be commenting on that.

An obvious question that's raised by the chart is why the fund has not grown since 1987. The value of capital projects is not included, and after 1987 nearly every dollar of income generated by the fund was taken out and used within the general revenue fund. Those dollars were used to support programs in various sectors, such as health, education, and infrastructure. The only exceptions were in 1997, 1998, and 2000 when \$176 million, \$25 million, and \$230 million were retained for inflation-proofing.

The third-last bar shows a drop in the book value of the fund in the fiscal year 2002-2003, representing a loss in the year but then a stable value up to June of 2004. We will be discussing recent income in later slides.

The income profile of the fund will now be discussed by Rob Lougheed in the next slide. Rob.

**Mr. Lougheed:** Thanks, Bill. As indicated by this chart, the heritage fund has made a substantial contribution to the province's revenue. From 1977 to 1986 the income grew dramatically. This reflected the growth of the fund and the fact that interest rates were substantially higher during that period. The income of the fund has since declined, reflecting the fact that the fund has not grown and interest rates have declined as well. In fact, interest rates peaked in 1981 and declined by 1991 and then further declined to current rates of about 5.4 per cent for 30-year government of Canada bonds.

Cumulative income transferred to the general revenue fund as of March 31, 2004, was \$23 billion plus about \$3.5 billion for capital projects for a total of \$26.5 billion. The net income of \$1.13 billion in 2003-04 resulted in a cash transfer of that same amount to the general revenue fund that year. It was a large increase relative to the

net loss of the previous year. The previous year's net loss was attributable to the equity investments held in the fund and the decline in equity markets of that year. However, it was the fund's commitment to those equities and the subsequent market turnaround that resulted in the 2003-'04 net gain.

Now I'll turn it over to Richard.

7:15

**Mr. Marz:** Well, thanks, Rob. Good evening, ladies and gentlemen. This is my first trip to Redwater, and I felt most welcome, especially around the supper table tonight.

The income transferred over the years to the general revenue fund does not include the impact of legacy investments, which continue to make social and economic contributions in Alberta. One example is the Alberta Heritage Foundation for Medical Research endowment fund. This fund was started in 1980 with a \$300 million contribution from the heritage fund. Not only does this provide an immediate impact in terms of advances in medical science but has also provided a competitive edge in the biotechnology industry.

By 1996 concerns were being raised about the sustainability of investment income, and many Albertans were wondering whether we should sell off the fund and just pay down the debt of the province. It was decided to keep the fund, based on advice from Albertans.

How should this fund be managed in the future? Well, I'll have George VanderBurg tell us that with the next slide.

**Mr. VanderBurg:** Well, thanks, Richard. Good evening, everyone. An important step in the resolution of those issues was a broad consultative process. In 1995 questionnaires were sent to all Alberta households asking whether Albertans thought the fund should be sold or retained. Further, if the fund was retained, how should it be managed?

As a result of the process, it was decided to retain the fund but to manage it on a new basis. The mission of the fund would be to focus on maximizing the financial return. This would allow current and future generations of Albertans to gain the maximum benefit from the fund.

Finally, the new legislation and business plan for the fund calls for professional investment management. It was decided that policy investments would be sold and that the fund would be managed on the same basis as an institutional endowment fund.

The issue facing the government in 1996 was: how do we get from an income-oriented fund to a fund that would give us an opportunity to maximize the potential financial return on the fund?

Dave, I'll ask you to speak on the governance of the fund, please.

**Mr. Broda:** Thank you, George. One of the keys of the heritage fund is transparency. Every quarter an investment report is provided on the fund both in hard copy and on the heritage fund's web site. Copies are available at the back, and we would be happy to add your name to the mailing list. In addition, an annual report is prepared and published within three months of the end of the province's fiscal year, which is March 31.

Another key is accountability. We have clearly defined benchmarks that we can use to measure the performance of the fund. We have adopted a well-defined standard of care in the management of investments, that of a reasonable and prudent person, which is the basis for the investment management industry. We have instituted public meetings such as this to discuss the fund and its performance.

Finally, the fund performance is reviewed by this all-party committee of the Legislative Assembly and by the Endowment Fund Policy Committee. To hear more about that, Drew, it's your turn.

**The Chair:** Thanks, Dave. The chart broadly sets out the governance structure of the plan. First, the government as elected representatives of Albertans is responsible for the broad fiscal objectives of the fund. It is at this level that the decision to create the fund was made and, more recently, to underscore the principle of an endowment for all Albertans.

The select standing committee is created under section 6 of the heritage fund act and currently includes two of nine members that are not in the governing party. The duties of the committee are to review and approve the business plan, to receive and review quarterly reports, to approve the annual report, to review after each fiscal year-end the performance and report to the Legislature as to whether the mission of the heritage fund is being fulfilled, to hold public meetings with Albertans on the investment activities and results of the Alberta heritage trust fund. Today's meeting fulfills the final requirement.

The act also delegates the day-to-day running of the fund to the Minister of Revenue. The Minister of Revenue in the last fiscal year created the Endowment Fund Policy Committee. The committee has responsibility for advising the minister on investment policies that are designed to achieve the mission of the fund. The committee is comprised of three MLAs, including the minister, plus private-sector investment experts. Implementation of the investment policy is charged to Alberta investment management, a division of Alberta Revenue.

As I stated, this is the last requirement for this year for the heritage trust fund. Whether the Premier calls an election this fall or next spring, this will be the last time that I'll be chairing a meeting with this minister. For the last three and a half years I've had the good fortune of having a minister who is a chartered accountant and an award-winning chartered accountant from his body; he has been recognized by chartered accountants. We're very fortunate to have somebody of this calibre as our Minister of Revenue.

At any time that I asked a question or if you had asked a question of the support staff over the past few years, you know that the response is rather rapid and it is very transparent. So I want to thank you, Minister, and your staff for the great job in the last three and a half years, and hopefully we'll see each other at the caucus table but not in this forum.

At this point I'm going to pass the meeting over to the Minister of Revenue and his support staff. I'll turn it over to you now, Minister.

**Mr. Melchin:** Thank you, Drew. I'm not certain what event you might be referring to in the near future, but certainly that's the great thing about democracy, that we all have the opportunity to partake in.

It's been a real honour for me over these past three and a half years as Minister of Revenue. Clearly, one of the roles is looking over the Alberta heritage savings trust fund. It's your money; it's Albertans' fund.

Really, we've had many opportunities to consult Albertans about what you would like us to do with that fund. We've heard numerous times really, repetitively, that they want it there for the future, and it's in that aspect that we really want to talk a little bit about its investment policies, its benchmarks, its investment philosophy, why we are investing and how we are investing. This is a fund that's intended to be there for the long term, and we do mean the long term. There's no real end in sight. So we can have investment policies that could look towards that end. They don't have to be so short term in duration.

I'd just like to say that this year has been one of the great years to finally report. With our results ended March 31 of 2004 – that's the year-end we're reporting on – this fund increased almost \$2.5 billion in value over the year, the largest increase ever in its history, a

substantial turnaround in the marketplace.

Since I was put in, we've seen a few years where the marketplace, really, and the equities in particular have declined substantially, in fact one of the third largest declines in the equity markets in recorded history in this century. But we've seen a substantial rebound, and it's partially because of that volatility that we're encouraged that we can't look necessarily day by day, but we have to take a long-term horizon and be patient with this. If we had not been patient with our investment strategy and had panicked at the time when the markets were collapsing, we would have lost that 2 and a half billion dollar upside when the markets do rebound. So it's this year-end when we can see the wisdom, in many respects, of picking a long-term thought, staying with it, weathering sometimes the volatility that's very evident in the marketplace.

I'm going to turn some time over to Doug Stratton and Peter Orcheson, two outstanding individuals. We have a group of highly educated professionals in investment management that are part of our Alberta investment management organization. They are certainly the cream of the crop. We are fortunate to have them in our organization and to have investment expertise as qualified as they are. I'm going to have them talk a little bit about our investment philosophy and management of the fund.

Doug.

**Mr. Stratton:** Thank you, Mr. Minister. In terms of Alberta investment management's investment philosophy that we bring to the management of the fund, we would characterize ourselves as being risk aware. We pay close attention to where we have invested the fund relative to the investment policy approved in the business plan. Risk is primarily managed through diversification.

We also consider ourselves to be disciplined investors. We look for strategies that can generate value added on a consistent and repeatable basis. We look for opportunity to add value incrementally where it makes sense. We take a long-term view and do not try to anticipate every bump and blip in the market. We believe that cost does matter. A clear and competitive advantage is that we can invest at a very low cost. Finally, we do not try to do everything in-house. About one-third of assets are managed outside of Alberta Revenue.

7:25

The main point of diversification is to reduce risk. As an example, suppose we take a portfolio comprised of 40 per cent bonds and 60 per cent equities. Based on the performance of bonds and equities over a 69-year period from 1926 to 2003, this diversified portfolio has offered relatively lower volatility with competitive returns relative to its constituent asset classes.

With regard to the heritage fund we look at the fund to make sure that we do not ignore or have an excessive exposure to any particular asset class, equity index, investment style, stock, or industry. This was an important consideration in the decision to have half of our equity exposure in non-Canadian markets. Canada represents only 3 per cent of world equity markets and does not have exposure in many key sectors. By increasing our non-Canadian equity exposure, we increase our overall diversification.

This chart illustrates, generally, the investment structure of the fund. From the perspective of Alberta investment management the investment policy as described in the fund's annual business plan is our starting point. From this we set our implementation plan, which includes the actual asset mix and the method of accessing any particular asset class.

We use traditional managers that try to add value with stock selection. We add managers with different styles of investing,

growth, value, et cetera. We use synthetic structures such as equity swaps, and we use absolute return strategies as well.

This pie chart illustrates the policy asset mix of the fund. This is the asset mix that is detailed in the 2004 annual report of the fund. Ranges are established for each asset class. This ensures that the fund will maintain exposure to each major asset class and limits the discretion of the manager. If market action results in the breach of any of these limits, then a discipline of rebalancing is imposed.

The fund has significant investments in equities, including foreign equities, U.S., and non-North American; is broadly diversified by country, industry sector, and company; and has a significant component that is managed externally. The fund has also an important allocation to real estate, and there are allocations as well to absolute return strategies and private equity.

There are other investment policies that Alberta investment management follows. We have policies with respect to hiring of external managers, types of strategies we will use, limits on the quality of securities, and how much of specific types of securities we will hold. There are policies on how much discretion we allow managers to have in terms of executing transactions.

Finally, our mandates are clearly defined benchmarks on which to monitor and measure performance.

Peter Orcheson will now comment on investment performance.

**Mr. Orcheson:** Thanks very much, Doug. Moving on to investment performance, the year ended March 31, 2004, was a very strong year. The fund earned a positive return from all asset classes and posted an overall rate of return of 22 and a half per cent. Stock markets were particularly strong. Returns in the Canadian market, for example, as measured by the S & P/TSX composite, were up an amazing 37 per cent.

The fund is positioned for long-term growth, and this is reflected in an important equity allocation, as Doug outlined. In 2002-2003 equities declined in value, and this caused a loss in the value of the fund. It was actually the first loss in the 27-year history of the fund. However, it was the fund's commitment to equities that resulted in the large gains that we reaped last year.

One of the goals of the investment policy, which is determined by the Endowment Fund Policy Committee, is to balance the short-term swings in income with the longer term higher growth of some of the more volatile asset classes. The following chart may help illustrate the long-term potential of equity investing.

This chart shows the return of U.S. stocks versus U.S. government bonds from 1926 to 2004. The red line is the S & P 500 index, a broad index of larger companies in the United States, and the blue line represents the U.S. government 30-year-bond index. The obvious point to note here – and it's marked in terms of performance of a hundred dollars invested – is that if you invested that in the stock market in 1926, in 2004 that investment is worth over \$252,000. If you'd invested in bonds, it was only worth \$5,860, but nothing in the stock market happens in a straight line.

Looking closer, we can see some fairly large swings, in particular during the Great Depression of the '20s. We see again a fair amount of volatility in the '70s and then again more recently with the collapse of technology stocks in early 2000.

You know, as we've toured the province, one thing that we have definitely seen is a strong entrepreneurial spirit that exists within Alberta. Perhaps some of you have been in a position where you've started your own company or had to make an investment in a piece of equipment for your farm. In doing so, you've likely dipped into your savings, given up the certainty of returns for the possibility of

greater reward.

From our perspective, in taking money out of fixed income and investing it in the equity market, we've given up that certainty as well. However, as long as Canada, the U.S., Europe, Asia, and the Far East are profitable places for corporations to do business, we will reap the higher returns. It's just not going to happen in a straight line.

The bar chart here outlines the recent performance of the fund. It's taken from the 2003-2004 annual report. Again, note the very strong year that we've had. As we extend the horizon, we see that we've earned a 3.2 per cent annual rate over four years. Our expectation for the fund is something closer to 4 and a half to 5 per cent in real terms. The four-year period is biased a little bit by a weaker equity performance after coming off a very strong performance in the '90s.

Moving on to the future of the fund, it's important to note that investment income and volatility are becoming more apparent in the fund, and we've seen this in the last two years. This has come about with the inclusion of longer term investments.

Future income levels for the fund will be dependent on future capital market returns, and certainly we don't anticipate a 22 per cent return as a sustainable number, but again 4 and a half to 5 per cent appears realistic. Income is also going to depend on the extent to which the fund is allowed to grow.

With that, I'd like to turn the mike back to our chair, Drew Hutton, to lead questions and discussion.

**The Chair:** Thank you very much, Peter, and thank you, Doug and Minister, for the presentation. That was excellent.

Before I turn it over to questions, I'd just like to conclude by thanking some of the people that really made this happen. Dave Broda offered to organize to come to Redwater, and you did a fabulous job, Dave, and I want to thank you. I also want to acknowledge Gail in his constituency office for the fine work that she did. Where is Gail? There she is. Thank you, Gail.

The person that really, really makes my life easy is Karen Sawchuk. She makes sure I'm here and on time and have the right materials in front of me. Karen, you've been a great asset, so thank you very much.

Now, that was really the formal portion of the evening. I will turn it over to you. It is your fund, and we would love to hear your questions or remarks with regard to the Alberta heritage savings trust fund, so feel free. There's a mike right up there for those that would like to stand and just ask any one of us or the minister a question, and state your name, if you would be so kind.

Thank you.

**Mr. Broda:** Don't be shy. It's a public meeting. We're all friends, so don't be shy.

7:35

**The Chair:** I have a question. I've been asked this many times. I'm going to raise a question that has come up at our committee meetings. It's really with regard to inflation-proofing the fund, and if the minister wouldn't mind just making a few remarks with regard to if that's possible, when it's possible, and the like.

**Mr. Melchin:** Thank you. The chair is out of order for asking questions. Actually, it's an excellent question. As you noticed, the fund was created in the '70s, and by the early '80s it reached about \$12 billion. It's still at that amount today, so it hasn't grown in absolute dollars. It certainly fluctuates from year to year as to market values. The income is being used. Presently it goes to

general revenues of the government.

There was, however, when it was restructured, as we talked about, a fairly significant consultation in '95-96. Then in '97 it was changed to more of an endowment structure, and by put-in legislation there is a requirement to inflation-proof the fund once the debt of Alberta is paid off. Therefore, with this year's announcement that we now have sufficient funds to pay off the remaining debt and in conjunction with a survey you should all have had an opportunity to respond to, It's Your Future, where there were a number of questions asked and some of it even about the Alberta heritage savings trust fund, that opportunity, not just opportunity but really commitment, is to see that we retain the real value of the fund; in other words, allow it to grow at least by inflation. So I would be clearly recommending that that be the case.

That will be taken into consideration with the comments that Albertans have given back to us as to what they would like the fund to do in the future. In our next year's business planning, when we put the budget together, it would certainly be my recommendation that that be one of the things that be accommodated in the fund, as it is a legislated requirement. So you'll see that fund over time starting to grow at least by an inflationary amount rather than using all of the revenue for general purposes of the government.

I would say one other thing though. In the past years it has been the priority of the government to pay off debt, and though the fund itself hasn't increased, our balance sheet or value, our net worth of the government, has gone up over these years. We had \$23 billion of debt on the one hand and \$12 billion of savings. We've now eliminated that \$23 billion down to zero, so we now have a savings account unencumbered by any debt. It is full and clear and no encumbrances of debt. Our interest payments on the debt at one stage were about \$1.7 billion annually, so we're saving \$1.7 billion in interest expenses annually going forward. Even though we haven't built up the savings account, we've paid off the mortgage completely. So our value, our savings are now free and clear.

**Mr. VanderBurg:** Well, I was at a meeting in Whitecourt yesterday, and I was telling the folks that I was heading over to Redwater for a heritage trust fund meeting. The very first question that came to me was: "You know those loans that we lent to those eastern fellows? Did we get paid back, and did we get our fair interest?" So I said: well, I'll get the minister on record on the return from those loans to the Maritimes and Quebec and the other provinces.

**Mr. Melchin:** The heritage fund, when it was originally created, actually had multiple purposes. One was to save for the future, but a portion of the heritage fund was allowed to be loaned to other provinces at prevailing interest rates. Those loans were given to the other provinces in the early '80s. At that time interest rates were very high and they had various terms that they were due. Two years ago I believe this December the last of those loans was repaid in full. All of those loans have been paid in full, complete with interest and so forth. So the heritage fund did very well, actually, through that period of time with interest rates that were prevailing quite high in the early '80s.

So they were paid in full. The heritage fund no longer has any such special kinds of loans in it.

**Mr. VanderBurg:** Thank you.

**The Chair:** Dave Broda.

**Mr. Broda:** Thanks, Drew. I just wanted to make a comment on what the minister had said earlier. We've got to recognize that in the

early '80s, when we had interest rates where we were paying roughly \$1.7 billion interest to the banks on money we'd borrowed to run this province, we were fortunate that we had the heritage trust fund there because we were taking about \$800 million out of there that covered a good portion of that. But in the past years, over 28 years, there was \$26 billion that the fund generated so that we were able to pay down some of the interest payments and also put money into not only science and technology but other departments that needed some injections of funds so that we could see this province prosper and grow.

It's very unique that we are the only province in Canada that has this kind of ability to do it. Yes, you can all say that it's oil and gas. We're fortunate, but it was the foresight to see that we needed to have this fund in place for our future generations.

There are questions. Should we blow it and spend it? Yeah, we probably could do that, but there's always a time when things will not be the same as they are today, so you've got to make sure that we have something to fall back on. I oftentimes hear – and I just wanted to clarify it here. When you mention the Alberta heritage savings trust fund, a lot of people say that there's no such thing. I just wanted to clarify it and say: yes, there is, and thanks to our Minister of Revenue – he's been looking after it very well – plus all his staff.

Thank you. Those are my comments.

**The Chair:** Thanks, Dave.

Could you please state your name, sir, and your question. Thank you.

**Rev. Sparks:** Reverend Stephen Sparks, and I'm the current president of the PC Association for the Redwater riding. Hello, Dave. First of all, I want to thank you for coming to Redwater, and I want to thank you for the information that you've shared.

I also want to say that it's being well managed, and I think you've done a tremendous job in terms of your capacity to oversee the program. However, a common question that I hear on the street is simply this. It's nice to say that you have \$12.4 billion, but what are you doing with the \$12.4 billion?

Now, I understand in reading the documentation and also listening to you very wise and learned individuals that the money does go into general operating revenues to help support various programs, such as health care and education, but I'm wondering in the long term: is there a defined definition as to the purpose and orientation of this fund other than as money stored away just for a rainy day? I wonder if that could be elaborated on.

**The Chair:** That's a very good question. I'm going to start off with part of the answer and then turn it over to the minister.

**Mr. Broda:** Because you don't have all the answers.

**The Chair:** I have very few of the answers.

In my experience as being chair, well before my time funds had been set up by the heritage trust fund. There's a scholarship fund that exists, and there's a science and research fund. That goes on in perpetuity now. So we're very, very fortunate that elected officials prior to us being here had the foresight for that.

We've asked Albertans – and the minister mentioned it – with the questionnaire we've put out: well, what do you see as the next step with the fund? Again, it is your fund. We're looking at where's the best place.

I'll go on record to say this. I chaired a committee on health and wellness out of the Mazankowski report in 2002. One of the recommendations was to set aside \$250 million for wellness initiatives. You know, an ounce of prevention is worth a pound of

cure. Health care is really about fixing the past. Those are the kinds of things that I would like to see, but I'm one individual. My constituents that have come to meetings in my riding have said: yes, they would like to see things like that.

For somebody a little bit more knowledgeable on it, I'll turn it over to the minister.

**Mr. Melchin:** I'd like to say two things. The heritage fund originally had a mandate that was multipurpose. One was to save some for the future. Two, you could do special loans. Another, you could have economic and social diversification kinds of purposes, and it did do a number of economic diversification loans. Some of those came back where the province lost quite a bit of money on those particular loans, and it was restructured as a result in reaction to a lot of feedback from Albertans in the mid-90s. That was primarily the message. Leave it there for the future, the principal itself.

7:45

We asked Albertans another question about two years ago about the fund itself: why are we saving? To me it's a critical question. We have some direction from Albertans, and I would say that we're going to have to get yet more precision in that direction. It's critical to know why you're saving because then you can define how much. If you know the purpose for which you are saving, then you can figure it out. Some would suggest that we ought to have this huge fund, but before you go do that, we're not just saving to throw the money away under a mattress and never touch it again. You should be clear about: is there an ultimate use for that sometime, somewhere, somehow? It's that purpose, now that our debts are gone, that I think we'll be able to turn greater clarity to.

What has been done recently, though, is to preserve it as an endowment, meaning that the principal will be perpetually retained. So rather than assuring Albertans that it won't be touched and rather than creating a whole separate, different set of priorities about where to spend the income, it was thought better to let that income go to general revenues so that the overall priorities of government in its business planning set the priorities of how to spend money rather than having a separate heritage fund pot of money that people could come to for separate priorities. Let the whole government priorities be measured together, and let the income of the fund service part of those priorities, like health and education, rather than creating a separate stream of priorities. How do you know which one is more important than the other?

Now we'll start inflation-proofing the fund so that the real value will be retained. Then the next question is: if we have future surpluses that are large again, should we be building this fund? I would say that it's the time of the question to Albertans to give them some options about how you build the future. Is it in a savings account or other vehicles or otherwise? I'd say that clarity has to come at a future question. I mean, I have ideas, I have preferences, Drew has expressed some, and you might have some preferences, too, but it is Albertans' fund after all, and it's not any one of our opinions to have to settle on. So Albertans will have a say on that question.

**Rev. Sparks:** Just one further supplementary question, if I may. This is purely speculative, but I've heard some individuals say to me: it would be nice if we received a monthly cheque. Personally, I don't support that view. I think that definitely those monies could be generated to a wide variety of government programs, including renewed infrastructure as just one example. But having said that, I'm just wondering: have you heard that suggestion?

**Mr. Melchin:** The Alaska fund is built on that model actually. They pay a dividend out annually. It works a little easier in the sense that they have a small population and it's also a federal fund. Well, it's not a federal fund, but it's a state that's almost isolated by its own entity. It's a little simpler, maybe, for them to deal with it in that regard. The cheque is a little larger because their population is so small. Our population is quite a bit larger; it wouldn't have the same impact. That said, despite all of that, we have heard that, and many people continue to offer that as a suggestion. But we've heard back overwhelmingly that Albertans want the money there and retained and that fund allowed to grow and keep it more as an endowment for priorities rather than sending a dividend cheque.

We've done focus group tests. We've done a variety of ways of polling. We've done surveys. We've done informal meetings like this. Our own MLAs in our own constituencies are continually getting feedback from our constituents. It isn't the message of Albertans to say to send that cheque back at this stage. That could change in the future, but it's not today's message.

**The Chair:** To add to that a little bit, I spent some time with some Alaskan legislators this summer – I'm a member of the Pacific Northwest Economic Region, and they're members – looking at the fund and saying: what's it doing? Well, we don't have a PST, a provincial sales tax. That's a decision that the Alaskans made as well. That truly is one of the things that we have the ability to do. Also, our tax regime, if you will, our base in Alberta, is the lowest in the nation and will continue to be. So I think you do have the money in your jeans as far as that portion of it.

The Alaskan legislators warned us that you can run into the situation where you are giving away a dividend and we're in a commodity province – we haven't transferred over to a knowledge-based or found other industries to move to – and oil and gas isn't going to last forever, you know. So will you benefit by having that \$4,000 cheque on the short term? Perhaps. But they cautioned me, when we have our deliberations, that they do regret doing that. They would have looked at other methods of investing in the state.

Richard, you wanted to add to that?

**Mr. Marz:** Yeah, just a few comments, because I myself did have one or two constituents raise the issue. So I did a little bit of research on it, and as the minister pointed out, the population is quite a bit smaller there: just under 600,000 compared to our a bit over 3 million.

The other problem is that earlier this year they thought they were going to run into a deficit situation. When it becomes an annual payout, stores have sales, it becomes a big event, and people start thinking after awhile that this is an entitlement. Then when the revenues go down, it becomes a political problem that they can't make the payout. It is a perceived mismanagement, but it's all fluctuating on the markets. I'm not sure we want to go down that road.

The other thing – it's slipped my mind now. I guess I'll have to come back to that. I lost my space.

**Rev. Sparks:** I thank you for answering my questions, and I would agree with the last two statements. I think you are wise to avoid that. Thank you.

**Mr. Wanechko:** My name is Dale Wanechko. What type of trust is the heritage trust fund? Is it like a statutory trust or a structured trust? What kind of category does it fall in as to the matter of trusts?

**The Chair:** The simple answer is that it is an endowment fund.

Could you clarify what you mean?

**Mr. Wanechko:** Well, usually a trust is like property held by someone in benefit for someone else. Usually in a trust there are the trustees and beneficiaries. The trustees hold the property on behalf of the beneficiaries.

**The Chair:** No. The fund is managed by the Department of Revenue, which has fund managers that manage managers. I guess that's the simplest way of saying it.

**Mr. Melchin:** The trust fund is not operating under trust law. There is a whole set of trust law, trustee, and so forth relationships. There's a separate act created for the Alberta heritage savings trust fund. It is set up literally as a fund. It's Albertans' fund. I mean, the government and all of its funds are Albertans'. But it's not set up or operated under the sense that if you wanted to see what laws it was under as to the trust act – it's not under the trust act as it applies. It's not under that same set of laws. It was created as a savings account. It was given a name as a trust fund, but it's a savings account.

**Mr. Wanechko:** So is there someone like a trustee running the heritage trust fund?

**The Chair:** Part of the reason for this committee that I chair was to have I guess the fiduciary responsibility to Albertans that they have a venue to come to us. Then we take it to the Department of Revenue, which is government. So you have access to each one of the MLAs, and it's an all-party committee. Also, you have access through the web, through writing to your MLA. Our responsibility, then, is to pass that on to the Minister of Revenue, but they're managing the funds. Peter or Greg may better answer this, how the fund is being invested right now with equities, bonds, cash, and real estate.

**Mr. Wanechko:** I was just curious as to how the fund was structured. That's why I asked.

**The Chair:** A good question.

**Mr. Wanechko:** Okay. A few short other questions. It's always mentioned: about Alberta's debt. To whom does Alberta owe the debt?

7:55

**Mr. Melchin:** Just as you would buy Canada savings bonds, for example, when the federal government needs to borrow money to provide for whatever programs and services it delivers, the same thing happened in Alberta. Through the years, especially the mid-80s through about '93, '94, there was a decade where the operating expenses of providing for health and education and roads and everything else were costing more than the money we were taking in every year. So to cover the shortfall, the government was borrowing money.

What you do is go and sell bonds in the marketplace. Those bonds were held by people around the world: by Albertans, by Canadians, by Americans. They're traded actively in the marketplace.

This may get a little more complex. We've put aside enough money to pay off the debt, but we haven't paid off the debt because some of that debt doesn't mature until about 2013 and 2014. Those bonds are held by people around the world. There's no way to force

them to sell the bonds back, and if you try and buy them back, all you do is drive the price up. So we will continue to try and buy them at the best rates, but we will set aside money to buy them out when they mature in full over a period of time. It's going to take us, really, the next decade to completely pay it out though we have cash set aside in a bank account to pay them when they come due.

**Mr. Wanechko:** So the majority of the debt is owed to bondholders?

**Mr. Melchin:** Yes, but you could be one of the bondholders. I have no idea, but it could be any of your savings accounts. But it is bondholders. Correct.

**Mr. Wanechko:** Can the province of Alberta borrow from the Bank of Canada?

**Mr. Melchin:** We can borrow, yes. We have the highest credit rating allowed by a province, so we have the capacity to institutionally borrow. Especially in the '80s for almost all the governments really – the United States, North American, European – it was a time of inflation and debt. I don't know why we got into that. I mean, that's a history lesson, I guess, that we could go through. But everybody was out competing in the marketplace to borrow money.

So it wasn't a matter of just going to the Bank of Canada. They establish financial powers. They're not the lender of all of the funds though. What you're going to find is that you – large institutional investors, individuals like you and I – go to the marketplace to borrow money.

**Mr. Wanechko:** Under Premier Reid the government of Alberta defaulted on its bonds, but subsequently the Bank of Canada bailed out the provinces of Manitoba, Saskatchewan.

Okay. That's an end to my questions.

**Mr. Stratton:** I don't believe we ever defaulted on our bonds, if you're going back to the '30s. I don't believe we ever did. There might have been some technical issues, but I don't think we ever defaulted, although our rating was certainly very low.

**The Chair:** If there are no further questions.

**Ms Krause:** I'll ask one.

**The Chair:** Oh. Good, good. Your name?

**Ms Krause:** Juanita Krause. Are there any discussions taking place regarding spending some of the trust fund money, not the principal but your interest, on a megaproject such as the bridge by Agrium or the Fort McMurray rail?

**The Chair:** The short answer is indirectly yes, because it becomes an aggregate of what revenues we receive that we then expend. I mean, last year \$23 billion was our expenditure, of which health care was \$8 billion and then education was \$6 billion. So the interest from the heritage trust fund goes into general revenue, and then it's distributed.

Is it earmarked specifically for a bridge? No. But there is money used for infrastructure; therefore, indirectly the expenditures are there.

**Mr. Melchin:** I'd just like to say that our government budget is

probably no different than your household. You might have a savings account, and you also have a salary. When you have your household budget and you figure out how much it's going to cost for the mortgage and for the car and for the utilities and for shopping and food and clothing and all those things, you don't actually typically prepare a budget for your savings account and a budget for your salary. You usually think of what it costs to operate in your own household, and that's the better way to plan a budget, I would say, for us, for the government.

Rather than creating specialty budgets all over, create a budget for the government. Let the government fix its priorities in all things. Is that project a higher priority than another area? That's how it has to fit into it. It really has to balance. Have we got the right balance between some of these infrastructure projects and health, for example? Once we've got the overall government budget, then we try to assess: do we have the revenue to match it? That will come from the heritage fund and from taxes and from royalties and the like.

**The Chair:** Well, those were all good questions. I want to thank all of you for attending this evening.

Before I turn it over to our host to conclude, I also want to thank *Hansard*. They set this all up each time we meet, and I want to thank you for doing that. Also, Brian from Ciné Audio: thank you for coming out. I know that it's a lot of work to have us miked for *Hansard*. So thank you very much.

I want to thank Dave once again for hosting us today, and I'll let him have the last word.

**Mr. Broda:** Thank you, Drew. Certainly, I'm very pleased to have the committee here in Redwater. As everybody probably knows, I won't be running again, so it's my last hurrah. It's good to have you all here, not only my colleagues, MLAs. Mike Cardinal is here as well. He's going to be the next candidate for this constituency of Athabasca/Redwater. I'm sure he's going to be wanting your support, and I hope you will give it to him. Whenever the election will be called, it'll be called, but we certainly have some good people in government, and I'd like to see them all continue.

Also, I'd like to thank the staff. I'd like to thank the Pioneer Club for allowing us to use this facility. They were very generous with, you know, the ability to have access to it. I'd like to thank Rose Lyle, who prepared our supper this evening – it was very good; thanks, Rose; we just recognized you for the meal – and all the staff that have helped for this day.

I think it was a beautiful day, and I think we would have had more people had the weather been a little bit more lousy. Today was nice, and our farming community is busy right now with harvesting, and every day they can squeeze in is a day that they may not get tomorrow.

So with that, I would wish all of you a safe trip home.

I was hoping that there would be a little bit more questions, but I think a good number of questions were asked and were responded to. Certainly, if you do have questions, as indicated, I am your MLA here, and if you want to give me a call, I may not have all the answers, but I know where to get them. [interjection] Yes, there are e-mails and web sites on the backs of these cards. Thanks, Bill.

So if I'm the one to say the last word, yes, thank you very much for being here, staff, members, everyone else. Thank you.

[The committee adjourned at 8:03 p.m.]

