

10:01 a.m.

Wednesday, October 10, 1990

[Chairman: Mr. Ady]

MR. CHAIRMAN: I'd like to call the committee to order.

This is the first session of our committee that we have a minister before us. We're pleased to have our Provincial Treasurer, the Hon. Dick Johnston, before the committee this morning. He's accompanied by his deputy, Mr. Allister McPherson. We appreciate both of them being here.

REV. ROBERTS: Mr. Chairman, I have a recommendation I'd like to read into the record for the committee.

MR. CHAIRMAN: Okay. I'll have you do that in just a moment.

REV. ROBERTS: Okay.

MR. CHAIRMAN: Just to re-emphasize that it is the process we established yesterday in our organizational meeting, members can read in the recommendations that they've prepared to be debated before the committee. We'll have the Member for Edmonton-Centre do that now, prior to turning some time over to the Provincial Treasurer, so if you'd like to do that.

REV. ROBERTS: Thank you, Mr. Chairman. I'd like to read into the record the recommendation as follows:

That at a minimum of seven days before the commencement of the annual hearings of the select standing committee on the Heritage Savings Trust Fund, the Provincial Treasurer publicly release the following three documents:

- (1) the annual report of the Heritage Savings Trust Fund,
- (2) the annual audited financial statements of the Alberta Crown corporations with debentures owing to the fund, and
- (3) the report on the breakdown of the investments of the commercial investment division and of the fund's cash and marketable securities, giving the total return of investments net of inflation.

MR. CHAIRMAN: Thank you. Are there any others?
The Member for Clover Bar.

MR. GESELL: Thank you, Mr. Chairman. By way of notice to the Chair I want to give an indication that I may wish to appeal the decision of the Chair yesterday on a point of order under *Beauchesne* 821(1). However, Mr. Chairman, I'm conscious that there is a time frame for raising these matters, and I do wish to review the Blues of the discussion yesterday before actually making the decision on that appeal. So this is notice that I may wish to raise that matter after the Blues have been provided, and I believe that may be at 12 noon today.

MR. CHAIRMAN: The Chair will be prepared to hear your point this afternoon when we reconvene then, if that's acceptable.

MR. GESELL: Thank you.

MR. CHAIRMAN: Okay.
Edmonton-Centre.

REV. ROBERTS: Yes. I'm sorry, Mr. Chairman, but is there also provision within this committee for tabling documents? There are two articles which I think would be very useful for the

committee to have at its disposal for reviewing the fund. I've checked that one is available in the library, but the other is not, and I just thought if I could table it for members' edification.

MR. CHAIRMAN: It's within the mandate of the committee to receive documents for their consideration. What you're proposing to do is to make the document available to all members of the committee?

REV. ROBERTS: I have three copies here, and I could see that . . .

MR. CHAIRMAN: To be tabled?

REV. ROBERTS: Yes.

MR. CHAIRMAN: Yes, we can accept them.

REV. ROBERTS: The first is an article entitled Alberta Heritage Fund: Measuring Value and Achievement, by Glen Mumey and Joseph Ostermann. The other is the two documents called the Trustee Papers from the Alaska Permanent Fund Corporation, one on Oil Rich: Spend or Save? and the other a 10-year review of the Alberta Heritage Savings Trust Fund.

MR. CHAIRMAN: Thank you. It's the understanding of the Chair that all of those documents are public documents.

REV. ROBERTS: That's right.

MR. CHAIRMAN: Thank you.
Member for Lacombe, did you . . .

MR. MOORE: No, I just had my hand up to get into the . . .

MR. CHAIRMAN: Okay. All right.

We'd like to turn the time to the Provincial Treasurer to give an overview, and then we'll move to questions from the committee.

MR. JOHNSTON: Thank you very much, Mr. Chairman and ladies and gentlemen of the committee. It's a pleasure to be in front of you today to discuss the remarkable Alberta Heritage Savings Trust Fund. The period under consideration is April 1, 1989, to March 31, 1990, and those financial statements, including the Auditor's report, have been made available. I notice the Member for Edmonton-Centre objecting to the time frame. If there is a difficulty in the time frame, we'll obviously try to correct it in the future. But you do have a considerable amount of time ahead of you in terms of consideration of the statements, and I'm sure that other ministers will be available to discuss wherever necessary the elements that they're responsible for.

Secondly, I can say in terms of the actual technical putting together of this report that the same people who put this report together were in fact working on the very successful Telus privatization issue. That, of course, reflects not only in their time but also in terms of the other comments I'll make with respect to the heritage fund itself, because in fact the Telus share offering does show up eventually as a postbalance sheet item in the Heritage Savings Trust Fund. I know everyone is very pleased to know how the Telus operation proceeded, and I'm sure at various times over the course of the next few months we'll be very pleased to tell you.

Mr. Chairman, in terms of introductory comments let me say that this annual period to March 31, 1990, was a period in the capital markets which was characterized by some uncertainty which continues in the capital markets to today, a period where you saw substantial price swings in natural resources prices, uncertainty in the capital markets themselves in terms of interest rate changes, and substantial economic fluctuations driven by a variety of world events including the dramatic changes taking place in eastern Europe, and uncertainty about whether or not the major economies were in recession. And of course it is also the period at the end of a fairly substantial bull market which started in July, August 1982 and continued right through to perhaps the first part of this year, the last part of this reporting year for the heritage fund. All of those caused money markets to change somewhat, to be characterized with some uncertainty, and to leave those people who have to manage funds in some difficulty themselves. Nonetheless, I think in a footnote it is appropriate to say that in terms of rate of return for this portfolio it has performed fairly well. Of course, a decision made a couple of years back to move into a more liquid form – in fact, maintaining cash and marketable securities at the end of March 31, 1990, of over \$3 billion – is, I think, confirmed by the market changes, the market attitude, and has allowed the fund to transfer some \$1.2 billion to the General Revenue Fund.

Let me also note in our opening comments, Mr. Chairman, that again the Auditor has pointed out that the financial disclosure of the Heritage Savings Trust Fund, with the disagreement noted with respect to deemed assets, has been accounted for appropriately on a consistent basis with previous years. He has found nothing that would suggest that there's been any difficulty with the accounting process – information has been provided by Treasury, those people who manage the funds – and it is appropriately described and presented based on so-called accounting principles. That is a very important statement. I'm sure you'll talk to the Auditor General eventually.

He does flag the difference of opinion with respect to deemed assets and financial assets. Let me make one statement: that the total assets of the fund, including financial and deemed assets, in fact did not change in a year-over-year basis. It stayed exactly the same at the \$15 billion level. There were, of course, transfers within the financial assets to the capital assets under the government's plan to continue to expand the very important elements of the deemed assets section: such things as irrigation and those kinds of important projects which are part of the diversification and part of the special nature of the way in which this fund has responded to the economic pressures and changes in this province. Let me also note that with respect to the valuations of the assets themselves, the assets in this fund are measured on a cost basis. In fact, our yield calculations are on a cost basis as well, which are very conservative calculations.

Secondly, there have been increases in some of the assets carried on the financial statements, particularly on the balance sheet, which in a very crude calculation probably show an increase in asset value at least equal to \$700 million: such things as the increase in the ownership of Alberta Energy Company, for example, which generates about \$280 million; the increase in the commercial investment division fund, which generates about \$200 million pure profit. Other funds which are on the financial statements at cost in fact have shown increases in value.

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The one I always watch particularly is the Alberta Heritage Savings Trust Fund scholarship fund. That fund has moved up in value because of the market investments that have been made

by the managers despite the drawdown against this fund by scholarships, running about 4,000 scholarships a year. This part of the fund has performed effectively, ensuring, of course, that the scholarship trust fund will continue in the future and that a reasonable amount of money will be available to provide scholarships to high school students with excellence in the academic side, a very remarkable outcome and success story of the Heritage Savings Trust Fund. I won't mention the other funds, including the medical research fund which has a market value far above the cost of the asset.

The point I'm making is that these statements are put on a cost basis. The increase in value has not been taken into any kind of an accounting profit recognition, and therefore I have to suggest to you that the valuations in the fund are far above the \$15 billion total shown there and certainly far above the \$12 billion in financial assets.

The other remarkable feature of the fund that must be noted today is that at the end of March 31, 1990, the cumulated transfers between the Heritage Savings Trust Fund to the General Revenue Fund have totaled over \$12 billion; in other words, the relief against taxation, assistance in achieving special interests in priority spending areas such as health and education have been assisted dramatically by the Heritage Savings Trust Fund. In conceptual terms we have essentially transferred one Heritage Savings Trust Fund financial asset pool to the General Revenue Fund. Twelve billion dollars has been transferred cumulatively from the heritage fund to the General Revenue Fund to save taxes, to reduce tax pressure, to increase the priorities in spending areas, and that's a remarkable story. It is a savings fund, it has generated revenue for the General Revenue Fund, it has allowed us to maintain a competitive position in terms of our tax position, and it certainly has assisted us in terms of our priority areas of spending, such as health and education.

I must, by way of note, Mr. Chairman, also read into my opening comments the fact that yesterday Moody's of New York confirmed the province's double A-1 rating, saying, just to quote specifically, that

Alberta's high grade credit quality is a function of the ample liquidity provided by [the] Heritage Fund . . . a considerable taxing margin relative to other Canadian provinces, and the strategic importance of its sizable but inherently cyclical resource-based economy.

I want to thank Moody's for helping me with my discussion today, of course. The timing is, once in a while, good; I think Allister may have assisted me somewhat. But I want to point specifically to Moody's saying that our rating has been confirmed, not downgraded as one of the other rating companies reflected last quarter. One of the reasons that in fact our rating has been confirmed, which is good news to all Albertans, is that there's an ample liquidity provided by the heritage fund. That's the \$3 billion I'm talking about in terms of the liquid assets in the heritage fund which are used for a variety of purposes including cash available to transfer to the General Revenue Fund, including cash available to finance in some cases some of our General Revenue Fund operations, and of course using cash to finance some of our very special economic objective programs, such as the farm credit stabilization program and the small business assistance program, which allow those people, including farmers and small businessmen, to take advantage of the asset pool here in the province of Alberta – the economic strengths of the province – and to borrow money at 9 percent. That 9 percent borrowing rate for farmers in particular is a real

asset to them, given the interest rate profile we've seen in this province over the past year.

With respect to the funds, obviously I can say that on a postbalance sheet basis – and I'm sure that we'll get a lot of discussion here about the funds. The postbalance sheet issue that needs to be footnoted and has in fact been disclosed is the fact that part of the Alberta investment division, where we had debentures of the Alberta Government Telephones entity transferred in a privatized form into shares – obviously, that's probably more important for next year, but it is in fact a postbalance sheet issue we need to reflect on.

Secondly, I think the Minister of Municipal Affairs in particular has indicated that he's in the process of rethinking Alberta Mortgage and Housing Corporation. He has already indicated that he will be selling off some of the assets in AMHC to the private sector, taking the cash back, and obviously generating more liquidity for the General Revenue Fund and for the Alberta Heritage Savings Trust Fund.

So let me just end there, Mr. Chairman. I should say that I have circulated to you today, sir, for distribution at your discretion, the reconciliation of the commercial investment division. That commercial investment division has made profits of over \$200 million which have not been realized. But, in fact, on a book to market value basis there's that \$200 million profit that has not been taken into account; there is an analysis of the ownership of shares that we always on a matter of precedent give you every time I appear, and I should say that on a debating point, although it's not my responsibility to note it, I will have some questions about the Member for Edmonton-Centre's position with respect to what sort of disclosure on the commercial investment division is made. I'm sure that at some point I'll have a chance to discuss that.

So that's where we are. In conclusion, I think it's a valuable asset pool. It has served the province perhaps better than we ever anticipated it would serve us. Because of the cash flow and the cyclical nature of the Alberta economy our own General Revenue Fund has been under some pressure, as you well know. We're on course towards a balanced budget in '91-92, and obviously it's been assisted in a significant way by the contributions from the Alberta Heritage Savings Trust Fund. Nonetheless, because of the uncertainty in oil prices in particular, we have not been able to recharge, if you like, in the vernacular, the Heritage Savings Trust Fund to any extent, but over some period of time we would have to look at that as an option, as I have said before. At the present time this is a holding position. We've moved the assets into liquid form, continued to use the capital assets for diversification purposes, enhancing vast parts of our province with special unique funding opportunities, and still using the revenue from the fund to provide assistance in the General Revenue Fund. Again I say that as of right now we have transferred more money from the Heritage Savings Trust Fund to the General Revenue Fund than the financial assets of the fund itself, and that is a remarkable success story and is part of what I've indicated: that we have done better with the fund than we ever anticipated in terms of its assistance.

The fund is still in its liquid position and still has a great deal of benefit to the province over the decade ahead. I hope that at some point, given consideration by this committee, we would be able to rethink ways in which we can recharge the fund, but at this point, given the financial position of province, it is important to use the income stream to assist us in the General Revenue Fund.

Mr. Chairman, those are my opening comments. I look forward to the exchange of ideas; certainly recommendations

from the committee are helpful to us. I'd be glad to answer whatever questions I can, and I may have to, obviously, call on my colleague Allister McPherson to provide some assistance from time to time.

MR. CHAIRMAN: Thank you, Mr. Minister. Just for clarification: it was your intention that the information you provided on the commercial investment division investments be made available to the members of the committee?

MR. JOHNSTON: It's at your discretion, Mr. Chairman.

MR. CHAIRMAN: It would be my intention that they be distributed. I will ask the legislative secretary to do that at this time.

We'll move, then, into the question portion and recognize the Member for Edmonton-Centre, followed by the Member for Lacombe.

REV. ROBERTS: Thank you, Mr. Chairman. It's good to be back in the Chamber and with the Treasurer sitting on that side of the House. I hope when he becomes the Leader of the Official Opposition that, like his friend Robert Nixon, he'll enjoy his time in that regard.

It's kind of hard to know where to begin. I have at least 12 questions for the Treasurer, and I hope I've distilled it down to three which I think might be the most salient.

The first has to do with the annual report, Mr. Chairman: 48 pages, much the same as last year; some new photos and pretty new pictures, some editorial changes, and of course the new figures for '89-90. I do have to wonder why the whole report took so long when, in fact, it was audited by the Auditor General in August. We still have a couple of months before we, as this committee, get it. However, in perusing it closely last night, there were some changes over the report from last year. As I say, not many, but one thing did jump out at me in glaring terms, and I'd like to pose it as the first question to the Treasurer. It has to do with the fund: its stated purpose in terms of strengthening and diversifying the Alberta economy. In the legislation for the fund, that's one of its stated purposes, and the Treasurer keeps talking about that. Yet to my amazement I see in last year's annual report on page 3 that the Treasurer reports "Alberta's economy with real economic activity increasing by 8.7 per cent" in '88-89. Yet in this year's report he says that "the Alberta economy has expanded . . ." and that "real economic growth in 1989 was a moderate 0.5 per cent."

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It certainly begs my first question, given the stated purpose of the fund, to strengthen and diversify the economy, and the rhetoric of the Treasurer that this is indeed happening. But his own figures in the reports show a decline from 8.7 percent in terms of real economic growth in one year to only a moderate .5 percent this past year. So I'd like to know why that is the case.

MR. JOHNSTON: Because that's the measurement.

REV. ROBERTS: All right. Well, that's a very interesting measurement, and no wonder the report took so long in coming, Mr. Chairman, if that's what the Treasurer has for us.

The other change over last year in this year's annual report is the Treasurer focusing, of course, on the Alberta investment division. I'm saying that it's not the '70s or '80s any more but

that we're in the '90s. Let's take a much harder look at what's happening with the Alberta investment division: I think in a sense almost trying to do away with many of the Crown corporations with a preference for a much more liquid portfolio.

I don't want to get into the whole argument - I'm sure Edmonton-Meadowlark will - in terms of the circular funding around that, but what I'd like to get at with the Treasurer is a way of accounting for the real value of the Alberta Crown corporations. As I said in the document I tabled earlier, there is another accounting method for determining the net debenture value of those debentures by the Alberta Crown corporations. I take it that the Treasurer is an accountant, and whether he can determine these calculations for me now or will get them to me in writing later - the figures aren't in this annual report - I would like to know with respect to the Alberta Crown corporations if we take a formula to determine the net debenture value to be equal to the assets of the Crown corporations minus the liabilities of the Crown corporations which they owe to creditors other than the fund. If he could get me those figures as well as the net interest calculated by the annual interest paid by the Crown corporations to the Heritage Savings Trust Fund reduced by the General Revenue Fund's operating grants to the Crown corporations, to get a sense of that way of accounting for the net interest which, in fact, accrues from those debentures. Those two calculations are specific and I think are important if we're going to move in the '90s to re-evaluating these Crown corporations. I'd like those figures from the Treasurer.

MR. CHAIRMAN: So is the Chair to understand that your question to the minister is: can he make that information available to you either now or in written form?

REV. ROBERTS: According to those accounting formulas.

MR. JOHNSTON: There are no such things as accounting formulas, Mr. Chairman. But we can simply indicate, on the broader question of how the Crown corporations are accounted for, that it really doesn't much matter whether there's a flow or not.

What I can say to you is that the debentures of the Crown corporations are guaranteed by the General Revenue Fund; therefore, the value of the debentures of Crown corporations in the Heritage Savings Trust Fund is always equal to its market value or cost; in this case cost, because they're essentially the same thing. The guarantee ensures that these debentures are worth what they're disclosed on the financial statements. I draw your attention again to the Auditor's statement. He has said that the assets have been disclosed on a basis consistent with last year's and had there been any major change in the valuation of those assets held by the heritage fund, he would have had to either footnote and suggest to us that we write down the value of them or do something else. Obviously, he has said in his opinion that the valuation is as stated: at cost at least, or market value in this case. So the value of the debentures in the heritage fund is just as disclosed here. Because of the guarantee they are in fact equal to the cost of the asset.

Now, as I've said many times before, the province is in the process of looking at its investments in Crown corporations. We have already given a clear signal that we're going to privatize entities. We've privatized, very successfully, Alberta Government Telephones, and that will show up in profits in the Heritage Savings Trust Fund in the current year, 1990-91. As the \$12 per share issue is rolled into shares in the heritage fund, about 44 percent of the company will now be owned in the

heritage fund. As we have said before, there are a variety of ways in which you can securitize or put into the marketplace the holdings of assets in the heritage fund. I don't know what the question is and I would have to look at it before I agree to answer the question in detail, but I can say, as I've said before, that the assets of Crown corporations in the heritage fund are probably - at cost is a very good approximation of their value, and in many cases the value is above that. Certainly in the case of AGT we've argued that consistently before, and that's now being shown to be fact as we privatize the company through the period '90-91.

REV. ROBERTS: Mr. Chairman, I'm disappointed in that answer. I did not disagree with the way in which it's accounted; I said there's another way of accounting for the value of these debentures. I will put that in writing to the minister and expect some sort of response, although I'm sure what he's trying to do is abstract the guarantee, but I know the Treasurer doesn't want to get off of that.

I guess the final question, Mr. Chairman, is a broader, more contemporary concern about what's now being called the Persian Gulf crisis and the vastly increasing price per barrel of oil on the world markets. I know many in Calgary and Alberta are called the blue-eyed sheikhs who almost like what's going on in the Persian Gulf, although many of us are very concerned and don't want to benefit at the expense of so many people in the Persian Gulf and the conflict there. However, given that the Treasurer has predicted, I believe, a \$21 a barrel price for this year on average and that it may well be above that, what plans does the Treasurer have for, in a sense, a royalty flowback into the fund of the amount that might be in excess of the \$21 a barrel price over the course of the year? I know it might fluctuate or might be short term, but the Premier, I've heard, has said that it's not going to help bail out operating revenues or deficits. There's always been a thought that the trust fund is the depository of these royalties when they're above the prices predicted, and I just want to know what plans the Treasurer might have in this regard.

MR. JOHNSTON: Mr. Chairman, to some extent I answered that question already in my opening comments, but I'd be glad to restate the thesis. First of all, one would have to ask: is Edmonton-Centre's view that there's suddenly been a windfall profit from the price of oil real or not? He's assuming that there's going to be some continuing upward pressure on the price of oil.

It's taken the NDP opposition some time to realize that the price of oil is moving up. I remember the questions going back to the spring of 1990 were doom and gloom to say the least. I remember Mr. Hawkesworth saying that the forecast was dead in the water, the Leader of the Opposition suggesting that a price of \$10 on oil would be realistic: that kind of attitude, Mr. Chairman. It's refreshing to see these people change their minds. They're just like the wind: they change direction twice a day if you give them a chance.

Mr. Chairman, let me say that I'm not too sure that the price of oil is going to stay at the current level of \$40 a barrel, and I think as a conservative I would not want to factor that kind of a price regime or price deck into my estimations. But I can say that some things are working against us in the overall oil and gas royalty side, one of them being, of course, the exchange rate, which has kept the Canadian dollar relatively higher than we expected against the U.S. cross currency, and therefore that's

costing the General Revenue Fund dollars as the price moves up and down.

I've already indicated before, Mr. Chairman, that in terms of our fiscal profile the one element that troubles the government is that we have been subject to severe fluctuations in the price of oil over the past five years. It has not been on our expenditure side: we have maintained high priority items in education and health and maintained our expenditures on a 1.8 percent expansion on a five-year average basis, the best level of expenditure of any government in Canada. We have had the deficit problems driven by oil and gas prices. You saw it in the earlier part of this year, you saw it in '86, and you saw it in '87 when the price shot up above our expectations.

As I've indicated before, if we could find a place where the paradigm assumptions on oil pricing were such that the minimum levels were going to be \$25 or \$27 or even \$30, if that becomes the price deck assumption, then perhaps we'd have to reconsider recharging the Heritage Savings Trust Fund. I think that's within our view or one of the options we'd look at over the next decade or five years ahead, whatever the assumption is. What I should say in answer to the first question is that in fact the response here is in part because of the sharp changes in our economic situation. Obviously if you have a very depressed recessionary period, as we saw in '86 and the early part of '87, you suddenly get some real economic growth. You get a generation of a real number that's fairly large. As any statistician will tell you, if you have a low base and it suddenly moves up a small amount, you get a fairly sharp percentage change, and if you stay somewhat flat, still having economic growth, the relative percentages don't change as much. That's really what happened in the comparison of '87-88 with '88-89. It's simply a statistical number; nonetheless, our economy rebounded dramatically.

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Many people will tell us that the rebound in our economy was expected because of the diversification which is taking place in our economy; because of the strength of the consumer sector, the investment sector, and the export side; and in part because of the Heritage Savings Trust Fund allowing us to transfer money to the General Revenue Fund and reducing the tax pressure on Albertans, maintaining the lowest personal income tax of any province in Canada, allowing consumption to flow into the system, allowing the economy to rebound, and keeping, for example, the highest retail sales per capita of any province in Canada. These are some of the things in the big circle of economic profile, economic growth, economic diversification that are in fact happening as a result of the heritage fund and the fiscal policy of the government.

Now, let me say that we're on course to the balanced budget. It's too soon to factor in this high price scenario because I don't know if the price of oil is going to stay as high as it has, and to some extent we haven't seen the parity relationships on natural gas moving as rapidly as we expected.

MR. CHAIRMAN: Thank you.

I recognize the Member for Lacombe, followed by Westlock-Sturgeon.

Just a word of caution to the committee. We took almost 15 minutes with that set of questions. I would ask the committee members to be a little briefer with their lead-in, and perhaps the minister could be more succinct so that everybody could get an opportunity to get into the questions. We have a long list of members who would like to put some questions to the minister.

MR. MOORE: Thanks, Mr. Chairman. I indeed enjoyed the reply of the Provincial Treasurer. Hopefully, he'll give me an in-depth answer to my questions too, and others, because I certainly don't like the details that would be missed when you kind of skim over. The Provincial Treasurer does an excellent job of explaining it for the citizens of Alberta. Surely with this few numbers here they'll be able to understand them when it's all over. So, Mr. Provincial Treasurer, I thank you for the explanation.

Before I get into my questions, Mr. Chairman, I am certainly pleased also this morning to see that we're getting back to what this committee is all about, after the media charade yesterday of trying to get headlines in the paper by the opposition and put everybody through it. Even the public thought it was ridiculous. But now we're getting back to what the committee is all about, Mr. Chairman, so let's get on with the question.

I want to go to page 9 on the Alberta Opportunity Company, Mr. Chairman. I note in there that in your venture and seed funding programs, it says they're being financed by repayable advances from the General Revenue Fund. It's my understanding that AOC was funded from heritage trust fund money and not reliant on general revenue funding. Is this a change, or is this a move in that direction to put more of this back under general revenue and release heritage trust fund money for other things?

MR. JOHNSTON: Mr. Chairman, a very good question. There is a dichotomy in the government's approach to funding AOC, as has been properly noted by the Member for Lacombe. First of all, traditionally we have financed the Alberta Opportunity Company on the same basis as other Crown corporations wherever possible: through the dollars or the cash in the Heritage Savings Trust Fund. The Heritage Savings Trust Fund would buy debentures in the AOC, and that would be the long-term financing for the corporation. The model is quite simple. We would hope that the rate of return earned on the loans advanced by AOC would cover both the retirement of the debentures in the heritage fund plus costs of operation. It probably hasn't been all that successful, but we have used the heritage fund to allow the private sector, in particular the small businessman, to have access to capital at reasonable rates. I think the success of AOC is clear on the straight loaning side.

Yet there was a demand from my colleagues in caucus. Many Conservative MLAs, including the Member for Lacombe, suggested to us that we needed to have some way to provide some patient money to small business. During the considerations on the white paper on industrial and science policy 1985-1990, that was also one of the concerns that emerged from a public discussion across Alberta: that despite the size of the corporation - in particular, small corporations are having difficulty finding either patient money or seed money, start-up money. Therefore, the caucus and cabinet agreed that they would provide AOC with a new program, and that new program was venture capital, seed capital funding.

Venture capital funding is not the same kind of traditional approach to funding that you find in straight borrowing or straight loans. Because it takes a long time to recognize an investment return, because the losses are generally larger than in traditional kinds of financing, and because exiting the portfolio is always difficult, we thought that despite the need there we would not want to put the losses or potential losses back in the heritage fund. So we took the advances out of the General Revenue Fund so that if there were losses, we would put those in the General Revenue Fund and realize them on a

day-to-day basis or year-to-year basis and not have the charge against the heritage fund. But because it's seed capital, because it's venture capital, because it's riskier and has a different time frame in terms of realizing your investment – the member is absolutely accurate – we have funded that from the General Revenue Fund as opposed to the heritage fund.

MR. MOORE: Supplementary, Mr. Chairman. Do you see in the future of the AOC with this move that eventually we could recover back into the heritage trust fund all the money we have in there and have this over in general revenue? In that way they would be subject to restraint policies of the government. As we go into areas where there is less income and we have to cut spending, have to put firmer control on it, it would bring in better fiscal management from the day-to-day economics being brought into play.

MR. JOHNSTON: I think if you're referring specifically, Member for Lacombe, to AOC or to other Crown corporations . . .

MR. MOORE: That's right. AOC or any Crown corporation I'd like to get back to the private sector. That's my own philosophy, but AOC I'm referring to right now.

MR. JOHNSTON: AOC, I think, is in pretty good shape. You know, if you were to ask me if we can say that the asset value of AOC is equal to debenture value, I've already made reference to the fact that the debentures are guaranteed by the government. Therefore, there's always no doubt that the valuation in the heritage fund is equal to the face value of the debenture at least. The traditional borrowing practices of AOC have been essentially financed mostly from the Heritage Savings Trust Fund, to some extent from the cash flow within the entity, but from the Heritage Savings Trust Fund. So I think the valuations could be realized as shown on the heritage fund, and as I've said before, there would be a variety of ways that we could privatize our position as we're doing in AGT and as we're doing in Alberta Mortgage and Housing Corporation. So on principle I think the answer is generally yes, for the reasons I've given. As to attitude, I don't know that we have a view right now that we want to privatize our position in AOC, but that's certainly subject to discussion amongst our caucus members, not so much this committee. But it is one of the possibilities.

MR. CHAIRMAN: Final supplementary.

MR. MOORE: Well, Mr. Chairman, instead of taking a final supplementary, I want to come in on another subject. Would you put my name on the bottom of the list? I'll come in on another subject separate from this.

MR. CHAIRMAN: Thank you.

The Member for Westlock-Sturgeon, followed by the Member for Wainwright.

MR. TAYLOR: Thank you very much, Mr. Chairman, and good morning. I also want to compliment the Treasurer on being able to find the good news in the credit rating and why it had gone up. Most of us had assumed it was because the Angus Reid poll had shown there was a good chance the government would be changing in Alberta.

I want to concentrate on the gray sheets at the back of the report a little more. The first question would be: just where is

the Treasurer going to put the proceeds from the Telus shares? In other words, is it in the Alberta investment division or cash and marketable securities? Just how do you plan to use the proceeds from the Telus shares?

10-41

MR. JOHNSTON: Well, as I've mentioned before, Mr. Chairman, the very successful privatization of Alberta Government Telephones has been carried off, the largest equity issue ever done in Canada. Over \$880 million of investors' funds flowed to this very important asset. Within Alberta alone, Mr. Chairman, if my memory is accurate, roughly \$800 million worth of assets from Alberta alone supported the privatization concept, investing in the future of an exciting telecommunications industry, providing cash to the General Revenue Fund, and providing cash and shares – shares essentially – to the Heritage Savings Trust Fund. As I've said before, the mechanism was quite easy. All we essentially did was roll about \$1.278 billion worth of debentures held by the heritage fund into shares of the corporation at \$12, and we kept the heritage fund essentially clean. There were no commissions; we didn't want to have any charges against the heritage fund. So the heritage fund itself will end up being very clean, essentially rolling over at \$12 a share.

Then part of the installment receipts and part of the shares sold will come out of the heritage fund, because obviously the size of this share issue was so large and so successful and, since the ownership was in both places – in the General Revenue Fund, which had the retained earnings and equity, and in the heritage fund – obviously part of the sale had to come out of both pools. But on principle we sold our General Revenue Fund position first and then the heritage fund. The remaining 44 percent of the corporation will stay in the heritage fund and will be part, I guess, of the Alberta investment division and section 10 in part, because there's some cash involved.

As to future dispositions, we haven't got a position on that right now, but I can say that obviously, as I've said before, debentures which had a value of about \$1 billion or so have now taken on a new meaning. We can say to you specifically that the value of AGT, one of the Crown corporations that criticism has been directed towards by the opposition, now has a new value, and that value is market driven, not driven by some other artificial means but market driven, confirming what we have said all along: that the values of the assets in the Heritage Savings Trust Fund are in fact real values and those Crown corporations, including AGT, have real values. Now we have a market performance test to confirm that: that \$12 a share. In fact, installment receipts are trading today at six and seven-eighths, I understand, which shows the confidence in the company, provides more benefits to Albertans on their investment. I think that stock is going to perform very well over the next year as well, as the dividends start to be paid.

So the point is that they're in the Heritage Savings Trust Fund in share form, not in debenture form. Dividends will be paid to the Heritage Savings Trust Fund, 44 percent there, and it's held in the Alberta investment division and in the section 10 cash sections.

MR. TAYLOR: All that noise was to say that 44 percent is going to go into the Alberta investment division. That's really all I wanted to know. Actually, I supported you in selling this thing.

Section 40 – I'd like to go to page 44, if I may, Mr. Treasurer. They're still in the gray sheets here. I'm a little bothered, and

I was just wondering if the concern has come through to this government at all that you have a huge investment – well, at least \$150 million in commercial investments in oil and gas, pipelines, utilities, minerals, paper products. You're supposed to be the referee in this game, yet you're taking your place in the batting order too, deciding which pitchers you're going to swing at. Do you not think there's a conflict of interest for the heritage trust fund to be investing in corporations and shares that are in our pipelines, oil and gas, and primary sectors, when we are out there trying to referee the exploitation and development of resources, environmental problems, and all the rest that comes with it? We have such a huge investment; 30 percent of our total commercial investment is in the very industries that we're supposed to control. Does that bother you at all?

MR. JOHNSTON: Mr. Chairman, that's an interesting point, and I don't think there's too much disagreement between the member and myself. First of all, the commercial investment division, as I've indicated, has so far on cost versus market value at the end of March 31, 1990, generated a profit of over \$200 million investing only in equities in Canada. That \$200 million is not part of the asset disclosure, but there is a \$200 million profit that's shown here on the 1990 amount: \$316 million versus \$519 million. Now, if that amount had been reversed – our costs were \$316 million and the market value was \$216 million – then you'd have to say: "Well, what's going on here? You've lost \$100 million on value." But that isn't the case. We've made \$200 million on value in that fund at the end of March 31, 1990.

Secondly, we do attempt to balance our portfolio based on certain rules, the rules being that we would not own more than – is it 10 percent or 5 percent?

MR. McPHERSON: Five.

MR. JOHNSTON: Investments will not exceed 5 percent of the total issued and outstanding voting shares. We generally don't vote the shares of the entity itself, and generally we don't interfere with policy questions. In fact, I doubt very much if members of my caucus would even know which investments we have on a day-to-day basis, even though some of the decisions we make do in fact impinge on some of the outcomes in certain sectors of the economy. Of course, we tabled those guidelines here in 1980, so they're available for all members as part of the permanent record.

Yes, Allister and I have discussed the ways in which we can change the weighting of this fund. Remember that any fund is based on a view of what sort of weighting should be attached to your investment in certain sectors of the economy. I can say that we're in the process of evaluating again our ratio, but we keep track of our percentage investment relative to the weighting on the Toronto Stock Exchange TSE 300 and see how our weights compare to the TSE 300. Because, of course, one of the basic comparisons will be in any kind of fund: how has this fund performed compared to the TSE over some longer period of time? I can say by way of footnote that we've done fairly well compared to the TSE 300.

Finally, I think there's a recommendation from this committee with which I concur, and that is that we should diversify the equities, not so much in terms of the profile or the vertical nature of the investment in the commercial investment division but as to aggregates and to which markets we invest in. There is a correlation analysis that shows that as goes the New York market, an inverse correlation exists with the Japanese market.

Therefore, you can see that if you want to protect or hedge or ensure your portfolio, you would have your portfolio invested in several markets. We are in the process of doing that. That's a recommendation from this committee with which we agree. We're in the process of doing just that.

However, stock markets right now are quite bearish. I think the New York Stock Exchange is trading around 2,500 points, and the Tokyo market, for example, has gone from 39,000 points down to about 22,000 points. So you can see that the markets are essentially reflecting the judgment that we're in a recessionary period – I guess it was confirmed this morning by some statistician – and therefore that market is moving against us.

MR. TAYLOR: Last supplementary? I get two supplementaries, don't I?

MR. CHAIRMAN: Yes; final supplementary.

MR. TAYLOR: Yes. The answer does concern me, Mr. Chairman, because the Treasurer concentrated on the profit and there's a tendency to start playing with the rules if the profit isn't good enough. This is what bothers me. If the concentration is on the profit – and it should be – and the government is also making the rules, Mr. Chairman, there's got to be a great deal of concern whether they won't bend those rules to increase the profit of the shares they hold.

To go on a step further, also on the gray sheets, though. To the Treasurer: how does he equate this government's announced intention and his own from time to time that HTF is to diversify Alberta's holdings and diversify the economy down the road with the huge capital investments we have in OSLO, Syncrude, Nova, Millar Western, Lloydminster upgrader, and so on? It sounds to me like you're diversifying from crabapple jelly into crabapple wine. Could you just explain how that's going to diversify in the future of Alberta?

MR. JOHNSTON: Mr. Chairman, I just missed the letters that the member quoted. Is it HSTF or HTF?

MR. TAYLOR: The whole heritage trust fund, yeah.

MR. JOHNSTON: Oh. Do you really want to ask that question?

MR. TAYLOR: HSTF.

MR. JOHNSTON: I mean, it's a dangerous question to ask me. I'm giving you some free advice. What the member is asking me is: how has the heritage fund diversified the Alberta economy? I mean, do you want the long speech or the short speech?

10:51

Mr. Chairman, I appreciate the opportunity to talk about the way in which the fund has diversified the Alberta economy.

MR. CHAIRMAN: I can appreciate the member putting that question. However, I hope the member realizes that he jeopardizes the opportunity of the other members to get in.

MR. TAYLOR: I just asked him about OSLO, Syncrude, Nova, Millar Western, and the Lloydminster upgrader, not the plan to diversify Alberta.

MR. CHAIRMAN: Perhaps we could ask the minister to give his short version on that subject.

MR. TAYLOR: I think the minister does not have a short version.

MR. JOHNSTON: You can sense, Mr. Chairman, that I wanted to give the short version. But never missing an opportunity to talk about diversification, the economic strength of this province . . .

MR. TAYLOR: I'm talking about these four investments.

MR. CHAIRMAN: Order.

MR. JOHNSTON: . . . I will simply focus, as my colleague . . .

MR. TAYLOR: Can't you hold him to the investments?

MR. CHAIRMAN: Order.

MR. JOHNSTON: As my friend from Westlock-Sturgeon has indicated, with respect to OSLO, Syncrude, Nova, Millar Western, and perhaps Canadian Western Bank, well, you're absolutely right. In fact, some of these investments, in particular the OSLO, to some extent Millar Western . . . [interjection] No, no. I'm not going to give you the rhetoric. If I've ever given rhetoric in my life, I'll avoid it this time right now, Mr. Westlock-Sturgeon.

The point is well taken that we have to take some initiative in government to ensure that jobs, economic strength, and development of our resources accrue to the province. In a broad way we want to ensure that the most value added takes place here, and essentially the government uses its assets to ensure that where there's a market dislocation or where the market has not been perfect in terms of its response to the opportunities here, it is incumbent on a government to try to make the market more attractive to the opportunities or make the opportunities more attractive to the market - there's a mediation factor there - and fortunately in the case of Alberta we have a tremendous opportunity with the heritage fund to do just that.

I would say, first of all, that many of these investments were initial investments to trigger a new round of investments. In the case of Millar Western, that's the case; we have now triggered a vast round of investments which are market-sensitive investments, which haven't had the direct participation by the government. Millar Western was the first of the major projects to develop a new resource in our province, the forestry resource. As we have said many times, that is continuing to expand in this province.

Secondly, in terms of the upgrading of oil, the investments both in Syncrude, in OSLO, in Lloydminster have added a valuable new resource to our profile of nonrenewable resource production. I should note that right now our traditional oil and gas production is falling off and to some extent it's been replaced by synthetic production. The OSLO is one of the cases where as well we have not got a rate of return built into our calculations. That is to say, we've invested assets in OSLO, in Millar Western, to some extent in Prince Rupert, and in Lloydminster, and these are quite a large pool of assets right now which have not generated an economic return to the fund. Therefore, for any calculation which shows a return, although substantial at this point, we must note that a lot of the assets are not fully invested. They're still in the growing embryonic stage

and will eventually generate returns to the province but have been used now to diversify and to trigger economic investment in this province which is quite significant.

I would say that in the case of Syncrude, obviously the price of oil has allowed the assets to appreciate to some extent, and I would say that the increase in the oil price today has increased the value of Syncrude, shown on the books at about \$500 million. In the case of Lloydminster, that project is proceeding well; the spread, I guess, Allister, has been about seven bucks on oil, and that generates more return for the province. In the case of Syncrude, it's generated cash for us; it's generated cash flow already. In the case of Millar Western, that has not generated a return for us at this point because of the way in which the debentures are shaped. In the case of Prince Rupert, that debenture has not been repaid either at this point but, in fact, over time will generate a return to us.

So I think there has been significant diversification. Forestry: embarking on the Millar Western project with the strength of the heritage fund has allowed that sector to fully expand. We witnessed last week the opening of Daishowa. We have other projects that are on stream, and these are going to expand value added to the province of Alberta. In the case of synthetic or heavy oil production, Syncrude is a good investment. Its value has increased; it's generating cash flow to us. Other investments in OSLO or Syncrude expansion or Lloydminster allow us to exploit a particular kind of resource which is in substantial need right now. We believe OSLO is one of those projects that need to proceed. I can't understand why the feds are backing away from OSLO and investing in Hibernia. We think energy self-sufficiency of the resources found in Alberta must be a Canadian objective, not just an Alberta objective. The Premier and Mr. Orman have obviously made that point considerably.

Investment in Nova, of course, is an important diversification as well; petrochemical upgrading, export of gas into the Canadian markets are significant. In the case of Prince Rupert, it's an agricultural diversification to allow our western grain producers to access eastern markets and not pay the same kind of demurrage or transportation costs because, as everyone knows, Prince Rupert is at least one day closer to eastern markets than the Vancouver port facility.

Now, I could go on and talk about Vencap, I could go on and talk about other forms of diversification, but the member has asked me to limit myself to these important diversification sectors which have in fact generated jobs, triggered new investment to the people of Alberta, added value to our economy, diversified major sectors of our economy that the private sector would not have triggered right now, and essentially have provided value to the heritage fund, economic growth to the province, jobs to the people of Alberta, and, I think, an opportunity to exploit a natural resource which will in the long term add value to our economy.

I appreciate the question, Mr. Chairman. I would like to give a more full answer, but perhaps some other time.

MR. CHAIRMAN: Thank you, Mr. Minister.

The Member for Wainwright, followed by the Member for Edmonton-Meadowlark, followed by Ponoka-Rimbey.

MR. FISCHER: Thank you, Mr. Chairman, and good morning to our Provincial Treasurer and his staff. I always enjoy listening to his knowledge about the heritage fund.

I would like to ask you a question or two. You did mention Syncrude, some of the nice things that Syncrude has done for us here in Alberta, and it has been invaluable, of course, to the

development of our tar sands. We have \$519 million, I believe it is, invested in it now, and we don't ever see much about the real value of that \$519 million. What would be the estimated value of our share in Syncrude? Could you elaborate just a bit?

MR. JOHNSTON: Mr. Chairman, I think when the Premier was here last year and maybe the Minister of Energy, Mr. Orman, and perhaps even myself, we indicated that we were examining a process whereby we could privatize our interest in Syncrude, which at the present time is about 16.74 joint venture interest. Does that include, Allister, our Syncrude equity? Sixteen point seven four is our investment. We're in the process of doing just that. The Minister of Energy and myself, in an ad hoc committee with our two deputy ministers, have been talking to a variety of financial groups around the world to see if there's any interest or how we can best go about it. So in terms of privatization, as I said before, the assets that are shown in the heritage fund can be sold into the marketplace as AGT has been. We're investigating the sale of Syncrude as a possible disposition of an asset which would be better suited and properly suited to the private sector.

Although the asset is shown on the books at \$519 million, perhaps some of the statistics may be helpful to the Member for Wainwright. In '89-90, Syncrude's 11th year of operation, the plant produced 51.3 million barrels of oil. That's down about 3 million barrels on a year-over-year basis. The fund's 16.74 participation produced a profit of \$23.5 million on a book value of \$519 million. The only year we didn't have a profit was in '89-90, when we had a small loss as a result of oil price changes.

Now, the reason I put these numbers on the table, Mr. Chairman, is to say that this asset is a very unique asset in that if you continue to produce the sludge, the heavy oil, that generates about 50 million to 55 million barrels of oil a year. That's a long-term process; unending, if you like. Therefore, if the price-of-oil assumptions move up, then obviously the future cash flow over that long period of time – say, 25 years – moves up in value as well.

I don't think I can tell you right now what the value of Syncrude is. I can tell you that in my view it's above the cost of the asset on the heritage fund. In my view, the price will obviously enhance the assets' value. Consequently, as I indicated again, we're in a process of trying to find some way to dispose of our interest, and we would not dispose of that interest if it wasn't substantially above the book value shown on the fund.

11:01

MR. FISCHER: That is only part of the picture of Syncrude. Of course, there's a lot of other benefits to our province here because of it. I'm thinking of royalties that we otherwise never would have seen had we not been involved in it, and the employment and the spin-off and so on. Could you elaborate just a little bit on the royalties? They never show up. I guess they go to the general revenue part of it. Could you give us some indication of the royalty value that we have seen from Syncrude?

MR. JOHNSTON: Well, Mr. Chairman, I did say that in '89-90 the 16.74 percent ownership produced a profit of \$23.5 million, and that would go into the General Revenue Fund. Those are essentially royalties, Allister, I guess, that would go to the General Revenue Fund. I think we've displayed that in our budget document as well, but on a technical basis I'd have to get that information for you specifically as to the royalty. The reason I pause is that I recall reading the Syncrude agreement,

which has, I think, a fairly complex royalty structure, and that complex royalty structure is triggered by certain plateaus of price, production, and costs. I don't want to get into that explanation right now, because frankly I am not up to speed on it, but I can get you that information, certainly, to allow you to understand the royalty regime, understand the impact on general revenue and on the heritage fund as prices go up, as production expands.

I would note, Mr. Chairman, that the member makes a very important point: that Syncrude has been an important element of economic diversification. Not only has it allowed us to tap this very vast pool of resources – some 1 trillion barrels of oil, one of the largest reserves of oil in the world – but in complement with the work done by the Alberta Oil Sands Technology and Research Authority and the entity itself, we have now probably 100 percent of the oil technology as it affects synthetics and heavy oil, perhaps, here in Alberta. Not only does that allow us to exploit this resource to its maximum potential for Albertans, satisfying both energy self-sufficiency and value added to our province, but at some point it will also be an exportable product for us as well.

The technology here should not be casually dealt with. Some of the work being done by AOSTRA – for example, in underground mining and in underground in situ techniques – are really remarkable examples of how we've invested to exploit this asset and how the cash flow is now coming back. The technology that's here is remarkable. In part it's owned by the company, in part it's owned by the government through AOSTRA and through other contracts, but it is one of the outcomes which will allow us, as the price rises through the \$25 to \$27 level, to exploit more fully, for the benefit of Albertans and Canadians, this vast pool of liquid hydrocarbons which can be developed both on traditional technology and on new technology over the next period. OSLO is a significant aspect of that. The technology is contemporary, and it must proceed.

MR. FISCHER: Another supplementary question. The \$7 million investment in capital again this year: could you elaborate just a bit on that and what it's for?

MR. JOHNSTON: That's an equity adjustment, Mr. Chairman. As the entity, the joint venture itself, generates pluses or minuses, our participation has a different equity value, and that equity then shows up in the adjustment to the cost of the assets shown in the heritage fund. That's why it's not stable every year. We simply do an equity adjustment to our investment – we increased it by some this year; we decreased it last year – depending on how the joint venture participation works.

MR. CHAIRMAN: Thank you.

The Member for Edmonton-Meadowlark, followed by Ponoka-Rimbey.

MR. MITCHELL: Thank you, Mr. Chairman. I would like to pursue the problem of circular accounting as it affects the quality of earnings that the Treasurer claims the heritage trust fund pays his General Revenue Fund. I would like to quote from an article found in the *Canadian Public Policy* journal, March 1990: Alberta Heritage Fund: Measuring Value and Achievement, written by Glen Mumey and Joseph Ostermann of the Faculty of Business at the University of Alberta. I thank the Member for Edmonton-Centre for providing a copy of this.

Obligations of the Provincial government and its Crown Corporations comprise much of the asset position [of the fund], and . . .

Alberta government subsidies and guarantees increase the Fund's reported earnings. These interrelationships confound the reporting of the Fund's size and performance.

Could the Treasurer please tell us how he can claim \$753 million of earnings on debentures to five Alberta Crown corporations which comprise two-thirds of the total earnings of the heritage trust fund, how he can claim that much interest payable from five Crown corporations when three of those Crown corporations last year lost \$276 million and one of those in addition, Alberta Mortgage and Housing, entered the year with a \$606 million unfunded deficit? In essence, he has dragged \$753 million of "earnings" from five Crown corporations, three of which are in a loss position of \$882 million. Could he please tell us how he can conceivably do that?

MR. JOHNSTON: Well, Mr. Chairman, we've explained this I think at least five times since I have been here, since 1986. I'd be glad to go back over it for the member. I notice that the Liberal Party continues to rotate their members through, so I guess we have to go through this time and time again until they make up their mind who is going to look at the heritage fund responsibilities. I explained it last time to Mr. Chumir, I'd be glad to explain it this time to Mr. Mitchell.

First of all, there is a circular flow. There's no question that funds do flow between the heritage fund from the General Revenue Fund, from the Crown corporations. That's exactly what happens. There is no doubt about that at all. That doesn't mean that anything in fact is being not reported or that there's anything that is irregular. In fact, again I draw your attention to the Auditor's report, which indicates quite clearly that this is all quite reasonable in terms of accounting principles, consistent with the previous year's disclosure.

Secondly, as I have said before, if these Crown corporations had to borrow money, they would have to borrow money somewhere. Now, surely it's better for the money to be borrowed from the heritage fund with the income being provided to the heritage fund from the General Revenue Fund than to, say, some Japanese investor or some New York investor or some Saudi investor or some Swiss investor. It makes sense to me to capture as much of the economic rents as possible, and that's why in terms of our position here we've advanced money from the heritage fund to these Crown corporations.

As well the government has guaranteed these investments. Now, despite where the source of money may come from, the government, the General Revenue Fund, would have to guarantee the interest on the Crown corporations. Therefore, there's nothing untoward with respect to this response in that the money was borrowed from the heritage fund, it's a debt that the Crown corporation made to the heritage fund, the Crown corporation is governed by a board of directors, and the government has to guarantee either the losses in the corporation or the debenture repayment. I'd much rather make the debenture repayment to the heritage fund than to some offshore investor. In any event, we have done it in this fashion, and there is, as the member points out, a circular flow. But, you know, these assets have real value because they are guaranteed by the province. [interjection] Well, I'd be glad to explain again how we privatized Telus, how we're in the process of rethinking Alberta Mortgage and Housing Corporation and, in fact, selling off the pool of mortgages in AMHC. I can assure you that in the case of AMFC, one of the other Crown corporations, it has a lot of assets. A lot of assets. He picks on the one corporation which suffered losses, but I can also say that if you blend together all the Crown corporations, you would in all likelihood

have a plus as opposed to a minus. In the case of AMFC, Alberta Municipal Financing Corporation, that entity has substantial surpluses, but still we have done the same thing with those investments.

MR. CHAIRMAN: Supplementary.

MR. MITCHELL: The Treasurer made the point earlier today that the value of the debentures is enhanced, established, guaranteed by the Alberta government. Professors Mumej and Ostermann go on to say . . .

MR. JOHNSTON: Professors who?

11:11 ~

MR. MITCHELL: Mumej and Ostermann. They address this point directly. The Alberta Crown Corporation debentures are protected from formal default by government guarantee.

They accept your point.

But this guarantee is equivalent, from the viewpoint of a government-owned Fund . . .

And this is interesting.

. . . to a fire policy written by an insurance company on its own office building.

Could the Treasurer please explain what the implications of that observation are for the real value of the debenture; for example, in Alberta Mortgage and Housing Corporation?

MR. JOHNSTON: Mr. Chairman, those comments are irrelevant to this argument, to this debate. They absolutely are asymmetrical in terms of comparison.

MR. MITCHELL: That's a good one.

All right . . .

REV. ROBERTS: There are none so blind . . .

MR. CHAIRMAN: Final supplementary.

MR. MITCHELL: Yes. The Treasurer mentioned earlier that over the years the heritage trust fund had transferred in total \$12 billion of earnings into the General Revenue Fund. We know, for example, that in the last nine years the government of Alberta has subsidized the Alberta Mortgage and Housing Corporation to the tune of \$3 billion on a \$3 billion debenture. Could the Treasurer please give us a final accounting of the total amount of money that has gone the other way; that is to say, the total amount of money that has been transferred from the General Revenue Fund into those Crown corporations which in turn are forced to transfer "earnings" back into the heritage trust fund so it can pay the General Revenue Fund?

MR. JOHNSTON: What is the question?

MR. MITCHELL: The total amount that has been transferred by way of subsidy from the General Revenue Fund to the Crown corporations which in term transfer the money back to the General Revenue Fund ultimately.

MR. JOHNSTON: That's exactly what happens, Mr. Chairman, and that's what I've explained. These Crown corporations have commitments to the heritage fund. It doesn't matter whether the commitment is to the heritage fund or to some offshore investor; they have to make payment on the interest. Now, some

of the corporations have operated at a loss, and some of the corporations have in fact operated at a profit.

MR. MITCHELL: How much?

MR. JOHNSTON: Well, you can calculate as fast as I can. You can go back and do your own calculations on that flow, but if you are not capable of finding that information, I would consider providing it to you.

MR. CHAIRMAN: Thank you.

The Member for Ponoka-Rimbey, followed by Calgary-Mountain View.

MR. JONSON: Yes, Mr. Chairman. I have sort of a philosophical question for the Treasurer. If the purpose of the Heritage Savings Trust Fund was changed to be that of only dealing with the deficit and the reduction of debt – in other words, one of maximizing the return from investments – what would be the implications for the change in management and investment patterns for the fund? What are the implications of that?

MR. JOHNSTON: That's an important point, Mr. Chairman. I've alluded to that in part already, but let me make it quite specific. First of all, Allister and his group have recommended to us that we should maintain a more liquid form in this fund. I think that's been very prudent advice because, of course, the money market investments have performed much better than other kinds of investments. Given the high interest rate regime we've seen, obviously the more liquidity you have, the more you can play with the current trends and interest rate policy directed by the central government and Mr. Crow. That's shown up on the rate of return on the liquid assets.

Secondly, if you were focusing entirely on rate of return, if that was the only measurement you wanted to use, then probably you would not be investing in any of the capital projects, for example, and you would not be investing in other kinds of diversification instruments that may be found in the Alberta investment division, because as I've said before, these don't generate a rate of return. In fact, assets transferred from the financial side to the deemed asset side: actually you lose investment dollars in those as they go into the capital projects area.

Thirdly, as I've indicated before, some of our investments have a zero rate of return or a zero yield. Such investments would include our participation right now in Husky, perhaps in OSLO, in Millar Western, in Prince Rupert. Although we have a significant amount of money invested in those assets for diversification purposes and other policy reasons, they are not generating a cash flow or real income to us. Therefore, they have a zero yield. So if our decision-making was driven entirely by yield or rate of return calculations, we would not make these kinds of investments.

That's what makes this fund so unique. There's a blend of investment criteria that is used here: rate of return, cash flow, the \$12 billion that goes to the General Revenue Fund, and diversification reasons. A blend of those is important to ensure that this fund meets a variety of tests, not just rate of return tests. That's really what this committee has done over its history: suggest investments to us that are much more than rate of return investments but investments which diversify the economy, provide unique opportunities to expand infrastructure and, as well, provide a cash flow protection to the General Revenue Fund from the income streaming from financial assets.

It's been an amazing success story, and the members of this committee deserve credit for its outcome.

MR. JONSON: Supplementary question then, Mr. Chairman. I'd like to ask the Treasurer if he could provide the committee with a comparison between the rate of return from the fund on its investments and, I guess you'd say, the mean or the overall rate of interest that we're having to currently pay to service our debt.

MR. JOHNSTON: Yes. I think, Mr. Chairman, if the member looked at pages 6 and 7 of the annual report, he would see part of the clue to that answer. In fact, they set out some of our investment criteria or the rules of thumb that may be used to both direct investments and to measure the outcomes.

First of all, let me say that in the case of the province of Alberta our borrowing costs . . . You'd have to forgive me, but I haven't got that statistic in front of me. Let's assume they're normal kinds of market-structured deals. That is to say, if you're borrowing long term – that is, five to 10 years – that market cost, interest cost will be lower than a short-term investment certificate or asset. That has been the case already, and in fact that's been amplified over the past year. When you looked at the rates of return on certain investments of bonds, you had a so-called inverted yield curve just on your asset side, whereby assets which had a duration less than five years were far above the rate of return on assets that had a longer duration. But I think you can say, though, that the cost of borrowing on the long-term basis is below the rate of return earned on short-term liquidity positions, and that spread or that kind of 1 or 2 percent is in our advantage. Actual numbers, of course, would have to be calculated, but I can tell you that right now because we are in a liquid form, you can see that the cash and marketable securities over 1989-90 generated a 12.4 percent yield to the fund, whereas the cost of our borrowing in the long-term position would be probably, say, 10 to 10 and a half percent in most cases. Finally, I can tell you that the generation of income from the heritage fund is in fact greater than the cost of our borrowing. [interjection] And an aggregate basis.

MR. CHAIRMAN: Final supplementary.

MR. JONSON: Could I by way of clarification just ask a question about one of the figures he quoted?

MR. CHAIRMAN: For clarification on your other supplementary?

MR. JONSON: Did you say that there was a figure of 12.4 percent in terms of income to the fund? I'm looking at page 6. I did look at it before.

MR. JOHNSTON: Yes: Rates of Return and Yields on Investments 1989-90. Cash and marketable securities generate 12.4 percent.

MR. JONSON: I see what you're referring to.

All right; final supplementary then, Mr. Chairman. Taking one of our investments, and that is Syncrude, it would appear that there was a certain backing off a few months ago with respect to pursuing the sale of Syncrude shares. I could understand that in terms of the rate at which oil was selling at that time and, I suppose, the projected profits for the company. Now with there being some increase in the price of oil, are we

pursuing the sale of Syncrude shares with vigour, and have we had any takers?

MR. JOHNSTON: Again, Mr. Chairman, I have in part answered this question before. I'll simply summarize. The value of this asset is a function of the price of oil. Putting aside the value of the technology or the fact that the asset is in place or the replacement value of the asset, this is essentially a cash flow asset. If you take the stream of income over a 25-year period, provide a discounted cash flow number to it, it'll get a rough valuation for the value of that entity.

11:21

There are obviously other items which would trigger the value, including strategic ownership. What is happening with the rest of the participants? Are they in fact buying or selling their position? Those have been blended together in some fashion, and we're now in the process of searching for an individual entity that would sell our investment interests or consider selling our investment interests.

There are complex ways in which you can change this as well outside of the simple discounted cash flow approach. Some of those may be on a commodity basis, some sort of complex transactions whereby you swap the position and then there's some other way in which you add value to the long-term position of the asset stream. Those are a little too complex at this point for me to advise you as to whether or not they're moving ahead. But I would imagine that within the next month or so . . . Is that correct, Allister?

MR. McPHERSON: Uh huh.

MR. JOHNSTON: . . . we will select an individual who would be the number one investment adviser to us in terms of our sale of the asset, and then they would be responsible for searching the world environment for other participants who may want to buy our position. If it, as I said, triggered a premium or a profit to the Heritage Savings Trust Fund, then we would consider disposing of that interest. It's essentially a fairly simple matrix made up of cash flow, and the price of oil is driving that cash flow. But nobody's offered us money right yet.

MR. CHAIRMAN: Calgary-Mountain View.

MR. HAWKESWORTH: Thank you, Mr. Chairman. I'd like to welcome the Provincial Treasurer this morning and say that I appreciate, first of all, that he didn't leave his sense of humour at home. I've got quite a bit of enjoyment and chuckles out of some of his responses this morning.

I'd like, first of all, Mr. Chairman, to ask about the integrity of the fund's capital. As the Provincial Treasurer knows, since we hit the high-water mark in March of 1987 in terms of the financial assets of the fund, the fund has lost something close to half a billion actual dollars. The capital of the fund has been depleted by close to half a billion actual dollars. As well, over that three-year period due to inflation the purchasing power of the fund has been further eroded so that, say, with inflation of 5 percent a year and the depletion in actual dollars, the value of the fund could be anywhere between 18 and perhaps 22 percent less than it was three years ago. I'm very interested in comparing that to, for example, the Alaska Permanent Fund. Under their legislation the earnings of that fund first go back into the fund to maintain its purchasing power and to offset the effects of inflation.

So I guess I'd like to ask the Provincial Treasurer, you know, in comparing what has happened in Alberta with that in Alaska, where the integrity of the capital in their fund has been preserved and in fact enhanced over the period that . . .

MR. CHAIRMAN: Hon. member, could you move to the question?

MR. HAWKESWORTH: I want to make sure the Provincial Treasurer understands my question, Mr. Chairman.

I'd like to ask the Provincial Treasurer: why doesn't Alberta pursue such a prudent - indeed, may I dare to say conservative - investment strategy such as that in Alaska in order to maintain for the long term the capital of the heritage trust fund?

MR. JOHNSTON: Again, Mr. Chairman, I've answered this question in part already, but let me just correct the misinformation that the member has left. First of all, in 1980-81, if you take that schedule back far enough, page 28 or 29 of our annual returns, you'll see that the value of the financial assets was \$7.6 billion, and today they're worth \$12.2 billion. So, you know, I think it's safe to say that over the decade the fund has increased by \$5 billion. Over that \$5 billion period we have also taken \$12 billion out of the fund and put it in the General Revenue Fund. So let's make sure the facts are on the table.

The second fact that has been glossed over just a touch, to the convenience of the member, is that the fund hasn't changed in value in nominal dollars at all. The fund is worth 15 billion and some hundred thousand dollars. It was last year, it was the year before, and it is this year. Fifteen billion dollars is what the fund's worth, Mr. Chairman, so the fund hasn't lost money. The assets are still there: \$15 billion. I draw your attention to the footnote of the financial statements, page 38, a very important display here. All members will want to have the facts. Note 3, page 38: the total assets for 1989, \$15,311,572,000; 1990 assets total \$15,311,572,000. The facts are that the fund hasn't changed in value. The facts are that we have taken a variety of policy responses to managing this fund, and I'll be glad to go into that.

I would only note that with the terms of evaluation I must come back to the first point I made earlier on, Mr. Chairman, a point that the opposition doesn't like to hear but I want to make sure is on the record. I can enumerate fairly quickly here about \$750 million in profits that have been realized: \$200 million, commercial investment division; \$280 million to \$300 million, Alberta Energy Company; \$75 million, Heritage Savings Trust Fund scholarship fund; \$200 million, medical research fund; several million more, Telus Corporation. I mean, these total another billion dollars, I imagine, under the Conservative philosophy, the Conservative approach. These assets are there, Mr. Chairman.

I know the opposition doesn't like it, and they take great pains in showing that the financial assets have reduced, but you know the financial assets are reduced for a couple of reasons. One reason is that we said some time ago that we're going to use the income stream from this asset to support the General Revenue Fund. We've already made that point: \$1.24 billion this past year reducing taxes, priority in spending. Secondly, there's been an intratransfer within the fund to ensure that diversification initiatives as characterized by deemed assets, infrastructure investments, food production, technology, rehabilitation of the environment, and other major investments have in fact assisted Alberta to achieve its growth in economic performance, an outstanding position relative to other provinces that has been characterized by the Conference Board and others as the

strongest province in Canada in 1990-91 with the best financial position of any. That's what we've done with those dollars. They've gone within the fund.

As to inflation, I've already spoken to that. There is a reasonable argument to say that if we had left an inflation factor in the fund as opposed to transferring \$12 billion to the General Revenue Fund, you may have protected any asset erosion based on nominal dollars and some assumption about inflation, but inflation hasn't been a big problem in Alberta for the past five years. However, I can say that if there is a decrease as a result of nominal inflation impact, it's been more than compensated for by the change in asset values, which have been on the positive side and not reflected in the statements over the period as well. Moreover, I've enumerated those for you.

The final point in terms of the policy. The member compared this with the Alaska fund. In response to the Member for Ponoka-Rimbey, I did detail in some form a broad way in which we have handled this investment portfolio. It is not one which is driven by one single criterion; that is, what is your rate of return and did you maximize the rate of return. It's probably worthy of some debate as to whether or not that should be the objective, but seeking the advice of this committee, going back to 1976 they have said that won't be the only measurement of performance in this fund. We want a broader based approach with this fund. We want to do a variety of things that we've talked about. We want to diversify the economy, take some additional risk, move in where the market hasn't responded, do those unique and exciting things that no other province can do, and use the fund to stabilize the economic profile of the province.

11:31

MR. TAYLOR: The only exciting thing they've done is re-elect you.

MR. JOHNSTON: Even the Member for Westlock-Sturgeon must understand simple Keynesian economics. I'm not too sure about Calgary-Mountain View, but certainly the Member for Westlock-Sturgeon can understand simple Keynesian economics. I mean, this is classic textbook economics. In a period of surpluses, you park the money; in a period of deficits, you spend the parked money. What more simple economic profile can you have? That's what governments are all about. It's essentially what governments are about, and this fund has in fact performed on that basis. That's the broad thing, to stabilize the ups and downs in our economy, cash flow to the province based on this volatile, changing oil price, this irregular cash flow generated by our resource revenue, until we get the economy diversified, and the economy is now being more fully diversified than ever and more predictability is coming back to the revenue side. We've controlled the expenditures already, but in simple Keynesian terms this fund has performed ideally.

Why is it that other provinces are now copying this? Why is it, Mr. Chairman? For essentially the same economic reasons. In a period of time when you have surpluses, you should save them somewhere. You shouldn't spend them out your ears like the Liberal government - you mentioned Mr. Nixon - in Ontario did. We've had to bear the burden of that inflationary cost, by the way, in terms of higher interest. We've had to share for their fiscal policy. The costs here have been shared by higher interest rates. We have saved the money during those fiscal periods, and when the fiscal situation is such that we have to call on the resources of the heritage fund, we've done that; \$12 billion has been called upon to stabilize the fiscal changes

in our economy. Classic Keynesian economics. Other provinces are now copying it. I think five other provinces have some sort of fund that they use to stabilize the cash flows, and they're simply accepting this model. The advantage is that we were there sooner. We saved \$15 billion from our resource revenue, and we're now reaping the benefits of that wise decision. Despite the whines and the cries and the cynicism, this fund has worked for all Albertans far better than some of the former framers thought and, in fact, has been a very major asset during the downturn in our economy in 1986 and has saved us considerable costs in terms of borrowings, in terms of fluctuations in our economy and, moreover, has allowed us to move toward a further completion of a diversification objective which has, in fact, shown in economic performance as well.

I appreciate the question. I hope more of that order are forthcoming.

MR. CHAIRMAN: Thank you.
Supplementary.

MR. HAWKESWORTH: Well, thank you, Mr. Chairman. One other fact is that the Auditor General reserves his judgment in the annual report regarding the deemed assets for that very reason so that the fund cannot be misrepresented the way the Provincial Treasurer did it in his response.

Mr. Chairman, the accountability of the Alaska fund has also been more prudently handled than the accountability of the heritage fund here in Alberta. Just a couple of examples that might interest you. There was in '86 a thorough external review of the Alaska fund. There are performance evaluations done in addition to audits. A statement of earnings from each investment and a market value appraisal of investments are provided to the public. There is a board of trustees set up to administer the fund, to insulate the fund but not isolate it from short-term partisan political pressures. Their meetings are by law required to be open to the public. Meetings are held all over the state of Alaska, and the public's encouraged to get out and attend and participate and find out how their fund is being administered. Monthly financial statements are provided. Research papers produced by the fund managers are available to members of the public. All these things are done to enhance accountability of the fund's managers to the people they're administering this fund on behalf of.

My question to the Provincial Treasurer, Mr. Chairman, is: why does the Alberta government not adopt some of these measures that have worked so well for Alaska to improve access to information, improve quality of information, and improve the accountability of the fund's trustees to the people for whom the fund supposedly is being set up?

MR. JOHNSTON: Mr. Chairman, to say that we don't do those things is not accurate. The mechanisms for evaluation, however, are much different. This point I attempted to make earlier with respect to the objectives of the Alaska fund versus the objectives of the heritage fund.

First of all, it should be a matter of record that the Auditor has always, except in the first term he was Auditor, indicated that the deemed assets in his view shouldn't be disclosed the way we did disclose them. I think members will remember that we have consistently disclosed the deemed assets as part of the fund. We feel they are an integral part of the fund, and up to, I guess, 1987, was it, Allister? If you'll just forgive my memory lapse here, we had an unqualified statement from the Auditor. Mr. Salmon, who was the Auditor, in his first term as Provincial

Auditor agreed that there was no need to qualify his opinion even though we had disclosed the deemed assets on the financial position. In the second year of his term we accepted some of his advice and in fact showed separately the deemed assets and the financial assets. Despite that, the Provincial Auditor found it necessary to qualify his report with respect to the disclosure of deemed assets only – disclosure, not the accounting, not consistency, not the valuations. No other irregularities had been discovered with respect to the reporting.

So we've had this evaluation take place by the Auditor, an external evaluation by an independent person responsible to this Legislature, and he has only said consistently that with deemed assets there's a disagreement as to how they should be disclosed. Remember that the Act says these deemed assets shall be shown, and that's what we're doing. So on the audit side let's be very clear that this sort of external evaluation has taken place. The Auditor has really expressed the view that the financial statements of the heritage fund are appropriate and disclosure is consistent with other years. He's said, you know, that there's a disagreement between management and himself as to how the deemed assets should be shown.

I've already referred to the difference of opinion with respect to evaluation of the performance. The Alaska fund is a single-performance criterion. It invests in all kinds of high-performing assets, but they're not really directed toward the state themselves. A lot of them are financial assets outside of Alaska, and it's governed by a board, whereas this fund is governed by the members of this committee and members of the investment committee, and there is ultimately an accountability to the people of Alberta by the elected process. It's much different from the Alaska fund, which has an independent board. If you have an independent board, you want to make sure they're satisfying the kinds of tests that can be applied to the management of these funds. Even so, you can find some funds that might generate a return as high as 60 percent if they happen to get lucky on certain assets. At the same time, you can find some funds that generate a negative return if they happen to ride the market the wrong way and have a different view of the market. This fund is generating both an economic return, providing diversification and providing other kinds of assistance to stimulate our economy in a variety of ways that I've described. So you can't compare the two in terms of a single evaluation, although the opposition would like to do that.

MR. CHAIRMAN: Final supplementary, Calgary-Mountain View.

MR. HAWKESWORTH: Thank you, Mr. Chairman. Again on the question about the prudent management of the fund, I draw the members' and the Provincial Treasurer's attention to page 42 regarding the Alberta investment division investments. I'll just give you a moment to find that. In particular, I'm interested in the \$120 million participating debenture to Millar Western Pulp Ltd., and I note at the bottom in a note to the financial statements, in describing this debenture, it says that payments are going to be applied first to repayment of the principal and secondly to the payment of interest and that "no interest is due until the full principal amount has been repaid," which to anybody in the lending business is backwards. Your payments first go to pay off interest and then are applied to your principal amount.

Perhaps the Provincial Treasurer saw *The Journal* broadcast on Monday night last when they were talking about some of the loans that were made by these savings and loan institutions in

the United States, very similar to this one, and one of the reasons why some of them fell into such hard times.

11:41

I guess my question is: given the nature of this debenture and perhaps other debentures as well, I'd like to know whether the fund itself pursues any kind of prudent lending practices, and I'm thinking of standard lending practices of financial institutions. For example, is there any review done of the financial statements of the obligants, are there any negative covenants registered in the debenture agreement, and how can we be sure that any of those prudent policies are being followed? So perhaps the Provincial Treasurer could enlighten us whether there are any standard, prudent lending practices being exercised at all by the fund in terms of this specific debenture and the other ones that are listed.

MR. JOHNSTON: Well, first of all, Mr. Chairman, I'm required to correct the position taken by the member. There is no similarity at all between what's happened to the S and L crisis in the United States and investments by the heritage fund. I make that absolutely clear. If that is the position of the member, the record must show that that's just dead wrong. If there was a similarity between the S and L system, that similarity would be between the problems in the Principal Group and the S and L crisis, not with investments by the heritage fund. So let that record be very clear.

Secondly, in terms of evaluation of our investments. First of all, the reason for the investments has been outlined already. We have indicated that we will use this fund to diversify the economy to provide a change in market response that is not otherwise provided by the private sector to ensure that some of our resources are developed. There are sometimes windows in economic profiles that allow you to do certain things, and this window opened, I guess, in 1985-86. We had been attempting for some time to develop a forestry industry. I don't have to advise you that the forestry industry is now quite a mature industry in Alberta, and we are experiencing a lot of first-round investment activity in that sector. I could recite the number of projects, but I'll simply say that it's triggering a lot of investment and, believe it or not, that triggers certain things for Alberta.

First of all, it allows a renewable resource to be value added for our province. That value added provides economic growth to our economy and provides jobs. We want to generate high paying, meaningful jobs, technically qualified jobs, and that's been our objective all along both in terms of infrastructure investment for education purposes and in triggering new rounds of investment in major resource sectors, diversification in particular. The window of opportunity was presented, and we thought that this Alberta company should have an opportunity to trigger an expansion in the forestry sector. This is state-of-the-art technology. I think it generates 140 jobs, if my numbers are right. It produces about 140 tonnes of premium quality bleached pulp a year. We had to make a decision that if we wanted to ensure that this diversification took place, we would have to provide a debenture to this entity. Because we're not driven by a single criterion – that is, rate of return – we can use this resource to trigger economic diversification, and it's happened. We can use this fund to be a little more patient in terms of some of our investment activities as long as it benefits Albertans and their Alberta economic resource is developed, as this one has done.

Finally, it provides a way in which we can pattern a financing proposal, which is not traditionally done in the private sector,

that has a simple rate of return or simple interest payment, principal repayment, and amortization schedule based on nothing but simple time. This amortization schedule is based on performance, and we participate along with the company on the performance of the entity. That's how we patterned our repayment schedule. There's an upside for the province once the performance starts to flow.

Specifically, we do follow up on all the assets we invest in. In any of our agreements, whether they're direct investments such as this one, debentures, mortgages, or guarantees, we have certain conditions which require that the owners, who will benefit from the advances from, in this case, the heritage fund, have to file financial statements, quarterly statements. We have all kinds of other evaluations that are applied against the entity to ensure that our asset is protected. In this case, with respect to Millar Western, we do just that in terms of financial disclosure, discussions with the entity, the boards, and do some other kinds of technical evaluation of the proposals as they come to us.

So on the final point, Mr. Chairman, let me say there are a variety of reasons for investment. They're not driven by single-criterion, rate of return investments. These are diversification investments. This is a classic example of just that. And because diversification is important in the long-run objectives of this government in terms of new jobs, new economic opportunities, there has to be some up-front patience with respect to our investment. That's what's happened with respect to Millar Western.

MR. CHAIRMAN: The Member for Calgary-Fish Creek, followed by the Member for West Yellowhead.

MR. PAYNE: Thank you, Mr. Chairman. I was interested earlier this morning when the Provincial Treasurer attempted to put into context and to dampen any unrealistic expectations there might be on the part of the members of the heritage fund committee with respect to the now sizable gap between the current crude oil price and his estimate of the crude oil price over the fiscal year. It goes without saying that there is an increasing risk of unrealistic expectations, and I appreciated his effort to put what is happening with respect to the crude oil price into context. However, in his explanation wherein he made reference to exchange rates and other factors, I don't believe the Treasurer made any reference to what's happening to conventional oil production, and I wonder if that was an oversight or whether perhaps it's a very minor consideration compared with the other factors to which he made reference.

MR. JOHNSTON: Mr. Chairman, the Member for Calgary-Fish Creek has an extensive knowledge of the industry, and it should be him answering the question and not me perhaps. But let me say that I think expectations have risen dramatically in the minds of most Albertans that the current price spike on oil is salvation to the province. Our Premier last week indicated not to be fooled by this particular change in oil price, that in fact it's going to be difficult for us to balance the budget by '91-92. Our commitment, however, is just as clear, and we still have to manage our expenditure side very specifically to ensure we get to that balanced budget.

It goes without saying that an increase in the price of oil is, of course, better for the industry and better for the government. It does trigger a new cash flow to the private sector, and that private-sector cash flow I would hope would be reinvested in new exploration and development within Alberta. The economic

benefits both by head office and by the actual first-round economic investment will assist Albertans. But I think there's a certain skepticism on behalf of the industry in that they want to see what's going to happen over 1991 before they commit to new investments, and we're in the same position. We should be clear that the impact on our budget, while it's still positive, is not nearly as dramatic as some people expect.

There are several factors which condition that response. Number one, I mentioned already that the cross-currency, U.S. and Canadian dollars, is working against the province. We did not forecast that the Canadian dollar would be as high against the U.S. currency as it has been. I think it recently traded last Monday at 87.07 cents. I haven't seen it today, but it's in that area of 86 cents to 87 cents. That has an impact on the industry and on the government in terms of its cash flow because all our sales are denominated in U.S. dollars.

Secondly, the production, which the Member for Calgary-Fish Creek identifies properly, is working against the government to some extent. The industry is producing less conventional oil of the traditional kind of quality that we have seen previously, and that production on a daily basis is falling off, which means that we have less oil production in this province. Since I've been in government, we've always forecasted this would happen, but because we've had a reduced price regime and therefore less exploration in the province of Alberta on conventional oil, we find our production is falling off this year.

11:51

Production is being replaced to some extent by other kinds of oil. Heavy oil is replacing in part some of the lost production, but as you know, heavy oil has a lower price than sweet crudes. I'm not telling the member anything he doesn't know, but I'm putting it on the record. Therefore, the substitution of production both down and in kind has worked against the cash flow to the province.

I should also note that the parity relationship between oil and gas has not held as firm as we would like. There has been a rule of thumb that the price of gas should be about one-tenth the price of oil. I can tell you that the price of gas is not \$3.50 to \$4 an mcf right now; it's far below that. In fact, there's a softness in the price of gas right now, which again has not generated as much royalty resource revenue to us as we'd expected. Remember that gas plays an increasing percentage of our total nonrenewable resource revenue than it has historically because gas is becoming a commodity in demand. You well know that we're pumping two point something trillion cubic feet of gas into the U.S. market and once TCPL and Iroquois start to connect, we'll probably expand into that market, but for the time being, the price is low and volumes haven't changed all that much. Therefore, the impact on us is down as well.

Finally, other sorts of benefits that are associated with the industry, including the Alberta royalty tax credit, are costing us more. Although the price is high and the long-run benefit to the industry will be lower as the price is high, at the present time if you have a higher price regime, the ARTC cost, the Alberta royalty tax credit, must be higher as well because royalties paid are behind. Therefore, that's working against our interests.

So the member is quite right. We shouldn't have too high an expectation about the impact of this oil on our budget position. It's still a long way to go to balance the budget, and I think all members have heard me make that speech before. Obviously, the price of oil where it is right now is far better than it was two and a half months ago at \$16 a barrel, but it does point to what I consider to be the world regime, the world supply/demand

situation, which is, I think, fairly narrowly defined right now. As we said early on this year, it is that narrowness between supply and demand, the fact that OPEC was producing close to 80 percent of its producible levels in the early part of 1990, that in fact elicited this sharp price response once the Kuwait/Iraq adjustment took place. Remember, just before the Kuwait/Iraq crisis we found the OPEC discipline bringing the price of oil between \$21 and \$22 once they came back to their senses about production quotas. That simply confirms again that we're in a very thin balance between supply and demand, which means that over the longer term we probably can expect the price of oil not to fluctuate as low as it has historically. Probably it will fluctuate down toward the \$25 level should there be peace in the Gulf area. That means there's been a fairly significant increase in the overall price of that commodity, which obviously in the longer term, if the price of gas goes up and we tend to get a little better exchange rate characteristics, will work to the advantage of the province. But right now it is not a windfall, and right now, looking out over the next year or so, it's not going to be as large an amount of money as some people expect.

MR. PAYNE: Mr. Chairman, I wonder if I could shift gears and refer the Provincial Treasurer to page 4. In the section "Who Makes the Decisions?" reference is made to the "respective staffs" of the elected officials, and try as I might, I couldn't find anywhere else in the report any elaborative information about those respective staffs. At the risk of sounding more cynical than I really am, there is a historical tendency for bureaucracies to grow larger and faster than the programs they administer; hence, I'd like to ask the Provincial Treasurer: how many management and nonmanagement people are involved either on a full-time basis or on a priority assignment basis with the administration of the heritage fund?

MR. JOHNSTON: I'll have to ask Allister to deal with that. I hope he doesn't surprise me.

MR. McPHERSON: I guess the answer, Mr. Chairman, would depend on whether you include all the accounting functions and things like that. But if you restrict it to who is involved in the kind of day-to-day management of the assets of the fund, probably we're dealing with no more than a handful of people that would be involved in that activity.

MR. JOHNSTON: I should say that the policy has been to reduce the costs of administration on the heritage fund, although we do charge annually a fee for that and that's shown here as

well. But the people who essentially, I think, first of all are very capable but are responsible for the day-to-day operations obviously have other jobs. They're not essentially dedicated to the heritage fund. Those people work in Energy to some extent, Allister, and work in Treasury, but they'd also have other kinds of investment responsibilities. The same people who operate our General Revenue Fund investment portfolio, our pension fund portfolios, would also operate the asset portfolios of the heritage fund. The same people who on a day-to-day basis deal with other kinds of administrative responsibilities in Treasury would deal with, as a prime example, the management of our Telus sale. Again, I indicated already that the people who were dealing with the Telus sale are the same people who were preparing this report, and there's only a limited amount of time each of these people has without increasing the size of staff. That's why – and I apologize – this report was late.

MR. PAYNE: Mr. Chairman, I'm encouraged by the deputy's use of the word "handful." That's, of course, an imprecise word, but it sounds at least as if we don't have a whole lot of bodies administering an otherwise very worthwhile program. I think I'll pass on my second sup, Mr. Chairman, given the lateness of the hour.

MR. CHAIRMAN: It's regrettable that all the committee members who wished to put questions to the minister were not able to. Some of the questions were quite lengthy and so were the answers. However, it's difficult for the Chair to rule what's valid and what's rhetoric, so our time is gone. The committee appreciates the minister and his deputy being with us today and the information that was given out to the committee and the exchange. If there's no further business . . .

REV. ROBERTS: Mr. Chairman, just one item. I was wondering about the status of the October 23 meeting with the Treasurer, if that's to be in camera or . . .

MR. CHAIRMAN: The Chair will endeavour to work with the various caucuses and with the minister in an effort to resolve that and will bring that back at a subsequent meeting.

MR. JONSON: I move we adjourn, with due thanks to all.

MR. CHAIRMAN: Thank you. The meeting is adjourned until 2 o'clock this afternoon.

[The committee adjourned at 11:59 a.m.]